

**AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND**



MOZAMBIQUE

2006-09 COUNTRY STRATEGY PAPER

**COUNTRY OPERATIONS DEPARTMENT
(North, East and South Region – ADF)**

April 2006

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CURRENCY EQUIVALENTS

March 2006

Currency Unit	=	Mozambican Metical (MZM)
1 UA	=	35,863.3 MZM
1 UA	=	1.441 US\$
1 US\$	=	24,887.8 MZM

FINANCIAL YEAR

January 01 to December 31

WEIGHTS AND MEASURES

Metric System

ACRONYMS AND ABBREVIATIONS

ACP	African Caribbean and Pacific Countries
ACTIVA	Mozambican Entrepreneurial Women Association
ADB	African Development Bank
ADF	African Development Fund
AGOA	African Growth and Opportunity Act
AM	Aide Mémoire
AMC	Arbitration, Mediation and Conciliation Centre of CTA
ANE	National Roads Authority
APP	Participatory Assessment of Poverty
APPR	Annual Portfolio Performance Review
BCM	Banco Comercial de Moçambique
BIM	Banco Internacional de Moçambique
BoM	Bank of Mozambique
CBO	Community Based Organizations
CEEI/ISRI	Strategic and International Studies of the Higher Institute for International Relations
CEP	Centre for Population Studies
CFMP	Medium Term Fiscal Scenario (Framework)
CGP	Country Governance Profile
CIRESP	Inter-ministerial Commission for Public Sector Reform
CPI	Investment Promotion Centre
CPIA	Country Policy and Institutional Assessment
CSOs	Civil Society Organizations
CSP	Country Strategy Paper
CTA	Confederation of Business Associations of Mozambique
CUT	Single Treasury Account (Conta Única do Tesouro)
DANIDA	Danish International Development Assistance
DNCP	National Directorate of Public Accountancy
DNEAP	National Directorate of Studies and Policy's Analysis
DNI	National Directorate of Taxes
DNPO	National Directorate of Planning and Budgeting
DNT	National Directorate of Treasure
DP	Development Partners
DSA	Debt Sustainability Analysis
ECA	United Nations Economic Commission for Africa
EDM	Mozambique Electricity
FFPI	Small Industries Support Fund
FMI/IMF	International Monetary Fund
FTA	Free Trade Area (SADC)
GoM	Government of Mozambique
HIPC	Heavily Indebted Poor Countries
IAF	Household Survey
IDA	International Development Association
IDH	Human Development Index
IFC	International Finance Corporation (World Bank Group)
INE	National Statistics Institute
INIA	National Agricultural Research Institute
IVA	Value Added Tax
JAS	Joint Assistance Strategies
MADER	Ministry of Agriculture and Rural Development
MAE	Ministry of State Administration

MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
M&E	Monitoring and Evaluation
MF	Ministry of Finance
MFI	Micro Finance Institutions
MIC	Ministry of Industry and Trade
MINEC	Ministry of Education and Culture
MINT	Ministry of Home Affairs
MIREM	Ministry of Mineral Resources
MISAU	Ministry of Health
MITUR	Ministry of Tourism
MJUST	Ministry of Justice
MMAS	Ministry of Women and Social Action
MOPH	Ministry of Public Works and Housing
MoU	Memorandum of Understanding
MPD	Ministry of Planning and Development
MTFF/CFMP	Medium Term Fiscal Scenario Framework
NEPAD	New Partnership for Africa's Development
ODA	Official Development Assistance
OGE	State Budget
OMM	Mozambican Women Organization
ONG	Non-governmental Organization
PAF	Performance Assessment Framework
PAPs	Program Aid Partners
PARPA	Plan of Action for the Reduction of Absolute Poverty
PBA	Performance Based Allocation
PCR	Project Completion Report
PER GROU III	Third Program of Economic Reform and Good Governance for the Reduction of Poverty
PES	Economic and Social Plan
PFR	Public Finance Reform
PIB	Gross Domestic Product
PiU	Project Implementation Unit
PNUD	United Nations Development Program
PPG	Public and Publicly Guaranteed
PROAGRI	National Program for Agricultural Development
PRSP	Poverty Reduction Strategy
PSR	Public Sector Reform
QUIBB	Questionnaire of Welfare Indicators
RMC	Regional Member Country
ROCS	Roads and Coastal Shipping
SADC	Southern African Development Community
SATCC	Southern African Transport and Communications Commission
SIDA	Swedish International Development Agency
SISTAFE	Financial Management Information System
TM	Task Managers
UAC	Anti-Corruption Unit
UEM	Eduardo Mondlane University
USAP	Public Procurement Supervision Unit
UTRAFE	State Financial Administration Reform Technical Unit
UTREL	Technical Unit for Legal Reform
UTRESP	Technical Unit for Public Sector Reform
WB	World Bank
WTO	World Trade Organization

EXECUTIVE SUMMARY

Country Context: During the last three years, Mozambique has continued to enjoy strong economic growth (real GDP growth averaged 7.6% per year), receding inflation, whilst improving its external position and debt sustainability. Economic policy reforms together with political stability and substantial donor support have contributed to macroeconomic stability, socio-economic transformation, and significant poverty reduction. Despite these achievements, the country faces tremendous challenges that require perseverance in reforms as well as substantial donor support. Mozambique still has: (i) an inadequate legal and regulatory framework for economic activity; (ii) considerable costs of doing business and poor access to credit and micro-finance; (iii) weak infrastructure; (iv) low economic diversification with high dependency on the agriculture sector; (v) low level of domestic savings, partly due to low incomes and poor access to financial services in rural areas; (vi) low civil service capacity; (vii) high levels of corruption; and (viii) strong prevalence of HIV/AIDS, low levels of access to education and an inefficient health care service.

National Development Agenda and Medium-term Prospects: Mozambique's medium-term poverty reduction strategy aims to reduce poverty headcount from 54% of population in 2003 to 45% in 2009, and to promote human well being and economic development through rapid, inclusive and broad-based growth, based on three pillars: (i) good governance; (ii) human capital; and (iii) economic development. The GoM recognizes the key role that private sector plays in fostering growth and reducing poverty. During the next four years, the GoM envisages carrying out the second "wave" of institutional reforms and providing the country with suitable economic and social infrastructure in order to address the main bottlenecks to private sector development. Overall, it is expected that the economy could grow at an annual real rate of 5% over the PARPA period (2006-09). If these growth targets are realized and the inequality indexes remain at historical levels, the poverty per capita will decrease to 31% by 2015. Such progress would hopefully allow the MDG for poverty reduction to be met.

Bank Group Country Assistance Strategy: The proposed Bank Group assistance strategy to Mozambique aims to: (i) scale up financial resources through budget support and project financing in support of good governance and increased economic infrastructure; (ii) improve the performance of the current portfolio; (iii) assist in capacity building; (iv) increase policy dialogue, underpinned by economic and sector analytical work; and (v) enhance coordination and harmonization with development partners.

Strategy Rationale: The preparation of the CSP followed discussions with government, development partners and civil society, and incorporated lessons learned from previous CSPs, portfolio reviews, and projects completion reports. The main selection criteria for the intervention pillars included: (i) GoM agenda and PARPA pillars and priorities; (ii) ADB vision in promoting Good Governance, Regional Integration and Private Sector Development; (iii) ADF-X policy guidelines and the results based and increased selectivity approach; (iv) synergies from previous interventions; (v) ADB experience or specific specialization agreed among donors (*e.g.* African Water Facility, Rural Water Supply and Sanitation Initiative and NEPAD); (vi) sectors' implementation track record; (vii) sectors' ability to increase project's average size; and (viii) sectors' ability to reinforce donor harmonization and to comply with Paris Declaration targets. Based on the above criteria **Governance** and **Infrastructure** emerged as the most suitable pillars for Bank intervention.

Improve Portfolio Performance: The Bank Group has, since operations began in Mozambique in 1977, approved fifty three projects, six policy-based programs and eleven studies. Total commitments stand at UA 914 million (April 2006). In terms of the size of the portfolio within the Bank, Mozambique is the fifth most supported country with 4.8% of the Bank's (ADF) total portfolio. According to the recently finalized Country Portfolio Review, in order to improve portfolio's performance, the following key efforts need to be undertaken: (i) strengthen capacity building; (ii) increase the average size of operations in order to reduce transaction costs; (iii) re-think current project designs in terms of quantity of loan conditions, usage of PiUs and counterpart fund requirements and discuss it more extensively with all relevant stakeholders; (iv) increasing cooperation, harmonization and coordination with donors; (v) ensure a minimum task manager turnover rate; (vi) increase the number of Bank staff fluent in Portuguese; and (vii) review more systematically the portfolio.

Donor Harmonization: The CSP also envisages to strengthen donor harmonization and some concrete steps have been taken: (i) the CSP M&E mechanisms are based on the PAF Matrix (refer to chapter 3.2), thus assuring enhanced coordination on donor support and M&E mechanisms; (ii) the current strategy and pillar choices took into consideration sectors ability to comply with the Paris Declaration; (iii) the Bank recently joined the G-18 donor group in Mozambique, and will be able to participate fully in donor coordination efforts, particularly at direct budget support level; (iv) the Bank became a member of a donor group that is in charge of preparing potential JAS for Mozambique; (v) with the opening of the regional office, the Bank will now be able to fully participate in donor coordination efforts on the ground; (vi) it is expected that all projects approved under ADF-X would be co-financed; and (vii) following recent bilateral agreements, the Bank will have two secondees from DfID and Portuguese Cooperation working on Mozambique in 2006.

Country Dialogue: Bank's non-lending activities will concentrate on underperforming areas that emerged in the CPIA, namely: Policies for Social Inclusion (Cluster C) and Public Sector Management (Cluster D). The recently prepared Gender Profile Report and Country Governance Profile will support Bank discussions with relevant stakeholders. Dialogue will also focus on the importance of GoM continuous effort to promote growth and macroeconomic stability, attract larger investment inflows, through efforts to improve fiscal policy and reforms, ongoing monetary discipline and progress in debt sustainability. Additionally, the improvement of the business climate and investment environment indicators, the flexibility and competitiveness of the labor, land, and capital markets and natural resources management, as well as the promotion of high potential sectors such as transport infrastructure, tourism, new mega-projects and agro-business opportunities would also be discussed with the GoM.

Recommendation: The Boards of Directors are requested to consider and approve the proposed strategy of activities and interventions contained in the Mozambique 2006-09 CSP, and the proposed three-year level of assistance as proposed under Mozambique's ADF-X annual allocation of UA 178 million, which is based completely on loans. The remaining two years of the CSP will be funded by the yet to be confirmed ADF-XI allocation.

MOZAMBIQUE 2006-2009 COUNTRY STRATEGY PAPER

1. INTRODUCTION

1.1 The Boards of Directors approved the 2002-04 Mozambique Country Strategy Paper (CSP) in September 2003 (ADB/BD/WP/2003/106, ADF/BD/WP/2003/127). The CSP covering ADF-IX period was based on the Government of Mozambique's poverty reduction strategy articulated in the Action Plan for the Reduction of Absolute Poverty (PARPA) covering 2001-05. The CSP welcomed the significant progress achieved by government in macroeconomic management, structural reforms and rehabilitation of the war-devastated infrastructure. However, it identified weaknesses in governance and institutional and human capacity, in addition to inadequacies in economic and social infrastructure as major constraints to poverty reduction and economic development. In approving the Bank Group's strategy, the Boards noted that the PARPA provided an effective framework for poverty reduction, with targets consistent with the Millennium Development Goals (MDGs) and endorsed the Bank's support for governance reforms, public utilities investments and human capital strengthening. The Boards, in addition, emphasized the need for effective and sustained coordination with other development partners (DP) operating in Mozambique.

1.2 In response to the Boards' directives, the Bank Group opened the Bank's Regional Office in Mozambique and signed a Memorandum of Understanding (MoU) to harmonize programs and policies with DP. The Bank also approved several projects to strengthen capacity, support the financial and civil service sector reforms, develop infrastructure and finance two private sector operations. Furthermore, the Bank Group enhanced its understanding of the country through the preparation of a Country Governance Profile, a Country Gender Profile, a Country Portfolio Review, and the Southern Africa Regional Assistance Strategy.

1.3 The preparation of the Bank Group's new CSP for Mozambique has been delayed in order to align the assistance strategy with the country's second generation poverty reduction strategy (PARPA II for 2006-09), which was finalized in December 2005. Two interim updates of the Bank Group's 2002-04 CSP were prepared to allow presentation of projects in 2005. The overarching objective of PARPA II is to reduce poverty to 45% in 2009 and to promote human well being and economic development through rapid, inclusive and broad-based growth. The proposed Bank Group assistance strategy to Mozambique aims to: (i) scale up financial resources through budget support and project financing in support of good governance and increased economic infrastructure; (ii) improve the performance of the current portfolio; (iii) assist in capacity building; (iv) increase policy dialogue, underpinned by economic and sector analytical work; and (v) enhance coordination and harmonization with donors.

2. COUNTRY CONTEXT

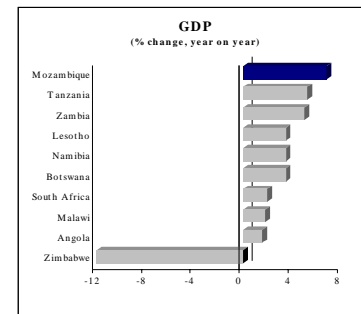
From the late 1990's, after 15 years of a centrally planned economy and two decades of civil war, the country has undergone far reaching political, social and economic transformation, leading to political stability, improved macroeconomic management, enhanced institutional framework and a better enabling environment for private sector investment. In spite of recent remarkable performance, the country faces tremendous challenges that require perseverance in reforms as well as substantial donor support. This Chapter provides a brief update of the most recent trends in the political situation, growth and macroeconomic environment, sector and social development, as well as the country's prospects and strategic choices.

Box 1: Key Features of the Country

Mozambique has a total land area of nearly 802 000 sq. km, and a 2 700 km coastline of vast environmental value and rich in fisheries resources. The country provides a natural and strategic sea-access for the several land-locked countries of southern and central Africa. It has 15 000 sq. km of inland fresh water constituted by 13 major rivers and 36 million ha of cultivable land (45 percent of the land area). The country is divided into 10 provinces. Its population numbers 19 million. Its non-renewable resources consist of large coal, natural gas, and uranium, gold and iron ore deposits. Economic activity is dominated by agriculture, which contributes 25% of GDP and provides employment for 80% of the population.

Poverty levels remain extremely high. GDP per capita is estimated at US\$345 and 54% of the population lives under poverty. The incidence of poverty is higher in rural areas and in northern and southern provinces. The GoM has made commendable progress in instilling stability into the economy and stimulating robust growth and poverty reduction. Comparing with neighbouring countries, Mozambique has achieved impressive growth rates.

Mozambique went through a series of major transformations from 1975 to 2005: (i) Independence and post-colonial adaptation; (ii) transition to a socialist regime and planned economy; (iii) a prolonged civil war; (iv) transition from a state party regime to a multiparty democratic system; (v) transition to a market economy; (vi) several natural disasters; and (vii) strong donor support and foreign direct investment. Mozambique has been heavily dependent on foreign aid (45% of state budget is financed by foreign aid) and the GoM hopes in the long run that this aid dependency could be reduced, considering that foreign direct investment has grown strongly during the past five years and investor confidence is higher. However, to maintain the momentum of private investment, performance of governance indicators would have to improve.



2.1 Political Context

In December 2004, Mr. Armando Guebuza won the presidential election as the candidate of the ruling Frelimo party; Frelimo also won a majority in the legislative elections. Mr. Guebuza took over from the outgoing president (and head of Frelimo), Mr. Joaquim Chissano, who led the country for more than a decade and helped to bring about peace and political stability, transforming its economic and political system¹ and laying the foundations for growth, private sector investment and a solid partnership with the international community. Ms. Luisa Diogo, the former Minister of Finance, was appointed Prime Minister. The new cabinet comprises twenty-two ministers, including six women. Regional and municipal governors were also appointed, including two women. Three electoral acts have occurred so far for the presidency and parliament, indicating that democracy is being consolidated as it is commonly recognized and accepted by the international community. The new Government has made clear its commitment to reforms in promoting good governance and institutional capacity building.

2.2 Macroeconomic and Structural Context

2.2.1 Economic Growth: Government policies and reforms, together with substantial donor support, have contributed to macroeconomic stability, rapid growth, socio-economic transformation and poverty reduction. Real GDP growth averaged 8% over the past decade and it is estimated at 7.7% for 2005. Growth has been driven by: (i) construction sector, which has been supported strongly by donors (one of the highest Aid/GDP ratio in Africa²); (ii) foreign investment mainly related to mega-projects³ (representing on average 7% of GDP) in aluminum smelting, natural gas

¹ Refer to Annex III - Political Situation.

² Mozambique is one of the continent's largest aid recipients garnering \$58 per inhabitant (compared to \$26 for Sub-Saharan Africa) equivalent to 12-19% of GDP (compared to a Sub-Saharan average of 5%).

³ Refer to Annex V – Mozambican Companies.

and mining; and (iii) consistent growth in the agriculture sector despite unfavorable climatic conditions in 2000 and 2005.

2.2.2 Fiscal Stance: Over the past three years, prudent monetary and fiscal policies have stabilized the economy. The reviews under the three-year Poverty Reduction Growth Facility approved by the IMF in July 2004 have been favorable. Reporting and management of expenditure has improved considerably (refer to Chapter 2.2.6) and the tax base has been broadened, increasing fiscal revenues to 13.8% of GDP, in 2005. The fiscal deficit (including grants) for 2005 is estimated at 5.6% of GDP, just under the 6% target. Nevertheless, additional efforts to mobilise tax revenues are necessary in order to reduce dependence on foreign aid. Gross national savings averaged 7% of GDP between 2003 and 2005, while the average annual gross investment rate was 23% of GDP, with the gap being financed by foreign savings including grants.

2.2.3 Monetary Policy: The 2005 Bank of Mozambique targets for growth of broad money stock (14%) and inflation (8%) were not met. Money supply increased by 25% mainly due to the depreciation of the metical on the foreign currency deposits. The metical, after appreciating 25% in real terms in 2004, depreciated 28% against the US\$ and 13% against the South African Rand (SAR) during 2005. The currency also experienced some volatility following the introduction of a foreign exchange auction system in January 2005⁴ but stabilised towards the end of the year as the market and monetary authorities gradually adjusted to the new system. After experiencing in 2004 the lowest inflation rate for three years at 12.6%, the recent oil price increase, led the inflation to rise up to 14% in 2005. However on the assumption of normal weather conditions and continued monetary restraint, inflation is expected to decelerate to one digit figure during the next years.

Graph 1: Macroeconomic Indicators



Source: IMF

⁴ The exchange system in Mozambique is a managed float. Foreign exchange can be bought or sold by the BoM, which sets a daily rate, to customers in a perfectly negotiable basis. Restrictions on payments and transfers for current account transactions have been eliminated.

2.2.4 External Balance: While Mozambique’s external position has improved considerably during the first half of this decade, in 2005, the trade deficit widened to 8.5% of GDP due to the low performance of some traditional exports like prawns, sugar, and tobacco, reflecting mostly temporary adverse factors. Imports also increased due to higher oil prices and higher cereal imports triggered by the drought affecting part of the country. Taking into account higher-than-expected donor and private capital inflows, the net international reserves stood at 4 months of imports. In the upcoming years, the external current account (-5% in 2004) could deteriorate due to strong imports for mega-projects, yet higher international oil prices and dividend payments to mega-projects’ foreign shareholders.

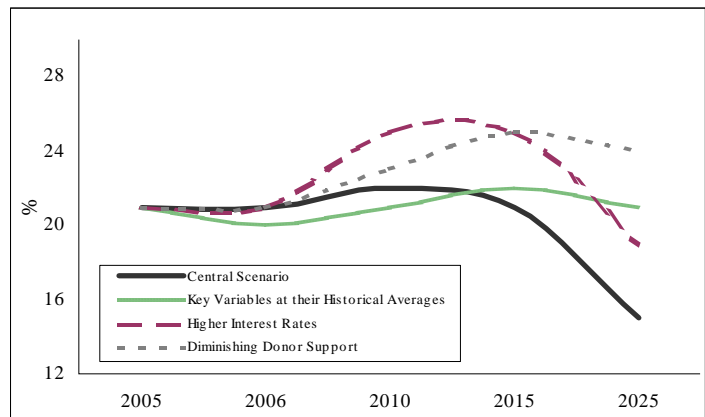
Box 2: Impact of the Oil Prices Increase in the Mozambican Economy

- 20% of Mozambican imports are oil related – oil products (12%) and energy-intensive manufactured goods, such as plastic and other chemical goods (8%).
- From 2003 to 2004, the imports increased USD 16.5 million due to the augmentation in the price of fuel.
- Augmented oil prices affect the balance of payments, the exchange and inflation rates, as well as the domestic price of fuel. According to DNEAP, (i) imports cost should rise by USD 150 million (2.3% of 2006 estimated GDP); (ii) the Metical should suffer a real depreciation of 9-10%; (iii) inflation should increase by 6%; and consequently (iv) domestic price of fuel should fluctuate by 15 to 40%, comparing to the price level in June 2005.
- Negative impact over poverty, especially in urban areas. Poverty incidence is expected to change from 54.1% to 55.5-55.8%.

Source: “Impacto do Aumento do Preço do Petróleo na Economia Moçambicana”, DNEAP, 2005

2.2.5 Debt Sustainability: Continued efforts under the HIPC debt relief initiative are essential to maintain the country’s debt sustainability. Mozambique reached the HIPC Decision Point in April 1998, when it was declared eligible for HIPC debt relief. After reaching HIPC Completion Point in 1999, the country received total debt relief of US\$ 4.3 billion in nominal terms (equivalent to 72% of outstanding debt). Assuming full relief from the Multilateral Debt Relief Initiative (MDRI), the NPV of public external debt will be more than halved to about 10% of GDP. According to the IMF 2004 debt sustainability analysis (DSA), that does not yet take into account the MDRI impact, the NPV of public and publicly guaranteed (PPG) debt would decrease from 21% of GDP, in 2005, to 14%, in 2025, which is well below the 40% sustainability limit defined by the WB Country Policy and Institutional Assessment (CPIA). Consequently, even without MDRI, Mozambique’s external and public debt situations are sustainable and would remain so for the foreseeable future. This conclusion is valid for the central scenario as well as its sensitivity to a number of standardized shocks (refer to Graph 2 and Annex IV for projections’ assumptions).

Graph 2: NPV Debt to GDP



Source: IMF

2.2.6 Institutional and Policy Reforms: Over the last decade, the GoM has implemented significant structural reforms with the close support of the donor community, confirming a high level of commitment and ownership to the reform agenda. Following the 1999 elections, several commissions and implementation units were formed to address several institutional bottlenecks. A technical unit (UTRESP) was set up to prepare the Public Sector Reform (PSR) strategy, covering the 2001 to 2011 period aiming: (i) to redefine and reinforce the role of the state; (ii) to improve the quality of service delivery; (iii) to strengthen the democratic participation of citizens at different

levels of government; (iv) to promote decentralization; (v) to consolidate anti-corruption mechanisms; and (vi) to promote transparency and good governance. Within the PSR efforts, Mozambique also initiated a Public Finance Reform (PFR) strategy designed to: (i) introduce a new public finance management system (e-SISTAFE); (ii) reform the revenue collection system; and (iii) improve the internal audit framework. In 2002, the Inter-Ministerial Commission on Legal Reform (CIREL) was created to prepare a legal reform strategy, to modernize state functions and the administration of justice. The latest joint donor reviews have given an overall positive assessment of the results achieved to date, although recognising GoM limitations on human and institutional capacity to implement these reforms.

2.3 Sector Context

Primary sector

2.3.1. Agriculture: Agriculture⁵, including livestock and forestry, accounts for a quarter of GDP (crops 20.5%; livestock 2.5%; and forestry and wildlife 2.5%). In the last ten years, agriculture production has grown slightly below the overall economy. The area under cultivation has expanded at a rate of 2.4% per year due to: (i) macroeconomic stability; (ii) sector liberalization; and (iii) return of 3.2 million displaced persons to the rural areas. Of the total 36 million ha of land suitable to agriculture, only 5 million was actually used up to 2003. Productivity remains very low but in some areas subsistence farming has shifted partially to production-for-market. Agribusiness and commercial production remains well below the 1970's level and smallholders (that account for 95% of cultivated areas) make little use of improved farming systems or technologies. Around 75% of the cultivated area is taken up with food crops, mainly maize, cassava, rice and beans, with the remaining 25% being used for the production of export crops, such as cotton, cashew, copra, sugar cane and tobacco. These crops together with cattle and poultry have high growth potential if appropriate restructuring measures are put in place. In the fisheries sub-sector, some 1,500 species are believed to be present in the Mozambican seawaters, of which 400 are of direct commercial importance. Industrial and semi-industrial shrimp fishing is highly concentrated as illustrated by the fact that the three largest companies add up to between 35 to 40% of the country's total fish exports. Noteworthy is the high cost of fishing license fees, US\$ 5m/year, as well as the lack of transparency in their allocation process that obviously deters new entrants and smaller players. The main sector constraints are being addressed through the National Program for Agrarian Development (PROAGRI) that has designed programs to: (i) increase the productive capacity and productivity of crops, livestock and forestry in the family sector; (ii) guarantee rights of access to land and reduce the bureaucracy associated with land registration; (iii) promote the marketing of agricultural products; and (iv) reduce the vulnerability of rural households and chronic food shortages.

Secondary sector

2.3.2 Manufacturing Industry represents 13% of GDP. Sector growth has been driven by mega-projects⁶ that have left most of the country's economic base, thousands of micro enterprises employing less than 10 people, relatively untouched. Manufacturing growth depends mainly on resource based extractive industries (metals & minerals) and sub-sectors enjoying trade preference (garments) or natural protection (food & beverages), which made up 74% of the total sector output. Labor-intensive manufacturing firms have been unable to compete internationally. When compared to regional competitors, local firms have insufficient skills and manufacturing techniques and

⁵ Refer to Annex VI for projects summary description and to Annex XVIII - Comparative Socio Economic Indicators II.

⁶ Refer to Annex V - Mozambican Companies.

overall productivity remains low. Manufacturing firms face high operational and transaction costs, mainly due to lack of infrastructure, labor market rigidity and bureaucracy.

Tertiary Sector

2.3.3 Trade reforms⁷ and mega-projects investments have helped open up the economy. The large-scale projects of Mozal (Aluminum) and Sasol (Gas) that account for 73% of exports have boosted exports. Mozambique's traditional exports (mostly prawns, cashew and garments) have been growing more modestly at 2% per year. The trade weighted average tariff is 9%, one of the lowest in Sub-Saharan Africa and further

Table 1: Foreign Trade in Mozambique (2004)

Principal Exports	US\$ M	Principal Imports	US\$ M
Large Scale (Aluminum, Electricity and Gas)	1049	Machinery & equipment	139
Prawns	101	Transport equipment	114
Cashew	82	Fuel	92
Manufacture	24	Textiles	43
		Metal products	39
Main Exports Destinations	%	Main Imports Origins	%
Belgium	30%	South Africa	35%
South Africa	17%	Australia	10%
Italy	12%	Portugal	6%
Spain	11%	US	5%

Source: IMF

reductions in tariffs will follow as the SADC trade protocol is implemented. In spite of the progress on tariff reduction, some challenges remain on other trade barriers such as customs reform. With only 7% of national production (excluding mega-projects) exported, the country still needs to exploit better the opportunities provided by the numerous trade treaties and organizations it belongs to. Mozambique is a member of SADC, the Islamic Conference Organization, the Lusophone Countries' Community, and the Indian Ocean Rim Association for Regional Cooperation. Additionally, Mozambique has access to the EU market under the Cotonou Agreement and to the US market under the Africa Growth and Opportunity Act; belongs to the WTO; and benefits from the New York Convention on the Recognition and Enforcement of Foreign Arbitrage Awards.

2.3.4 Financial System: Financial sector reforms have supported the transformation of the former state-dominated financial sector into a more diversified and competitive system. Two state-owned commercial banks have been privatized and the financial system has currently over 80 banking and non-banking intermediaries. Nevertheless, the financial system remains small and limited, particularly when compared to neighboring countries in terms of financial assets⁸ and country outreach. The commercial banking sector dominates the financial system, accounting for more than 90% of the system's total assets. Except for a recently founded small bank, all commercial banks in Mozambique are majority foreign-owned⁹. The inefficiency and the small size of the banking sector are reflected in the high intermediation spread. Other factors include still limited competition¹⁰, absence of effective judicial procedures to facilitate loan recoveries, and the lack of an effective land titling system that could serve as collateral¹¹. The stock exchange, established in 1999, remains small with only one listed equity, and trades mainly in public and private bonds. The market

⁷ The top tariff rate has been steadily lowered, from rates approaching 100% in the early 1990s, down to 25% in 2005. Refer also to Annex XVIII – Comparative Socio-Economic Indicators II for trade evolution indicators.

⁸ For instance, total bank assets, as a percentage of GDP for Mozambique was 10% in 2003, while it was about 25% in Botswana, 12% in Malawi, and 39% in Zimbabwe.

⁹ Four of the 10 commercial banks, including the two biggest ones, are owned by Portuguese investors, three by South African companies, and the others by Malaysian, Mauritian and Rwandese investors.

¹⁰ *Banco Internacional de Moçambique* (BIM), accounting for 44% of total banking assets and owns 42% of total bank branches. The four largest banks account for over 85% of total banking assets.

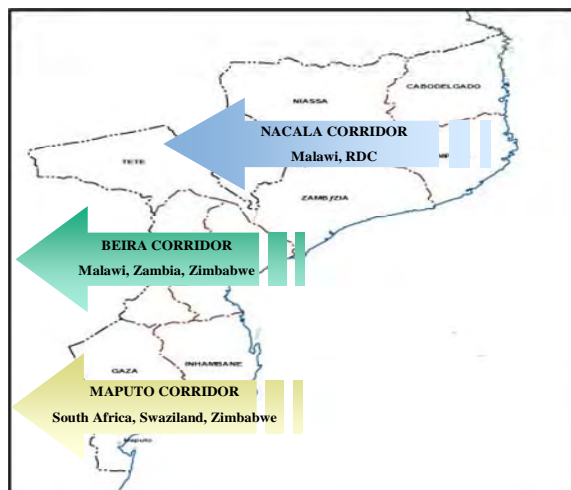
¹¹ Some of the financial sector constraints are addressed in the recently approved Financial Sector Technical Assistance Project. Please refer to Annex VI for project description.

capitalization of the securities market amounts to MZM 1,553 billion and represents only 1.8% of GDP.

2.3.5 **Microfinance:** While the microfinance industry has grown rapidly, it still has a very small outreach. There are currently about 55,000 borrowers, who account for about 1% of total credit offered by the banking system. It remains mostly an urban phenomenon with most borrowers based in the capital, Maputo. The industry itself is highly concentrated, with four MFIs¹² dominating the market, accounting for about 84% of loans and 59% of customers. Microfinance is still characterized by low productivity and operational inefficiency¹³. Areas requiring further development include the set up of a suitable regulatory framework, including simplified reporting requirements and provisioning rules as well as capacity building initiatives to update MFI's personnel skills.

2.3.6 **Transport:** Mozambique has one of the least developed road infrastructure¹⁴ in the Southern African region, with a road density of less than 0.02 km/m² and 0.86 km per capita, against 0.2 km/m² and 36 km of developing countries. The GoM with the support of developing partners has made significant investments in the sector to foster regional integration and give rural population access to basic social services. Mozambique's transport development policy concerning railway and

Map 1: Transport Development Corridors



road network is developed around three Development Corridors which give access to neighboring landlocked countries. The country's ports and railways were mainly developed to serve regional trade while the road system served internal trade and access to the coastal ports. These corridors along with the ports of Maputo, Beira and Nacala serve Zimbabwe, South Africa, Swaziland, Malawi, Zambia and the Democratic Republic of Congo. To improve the operational efficiency of ports and railways, the GoM has granted some concessions for these services to the private sector. The transport and communications sector accounts for 18% of gross receipts of export services.

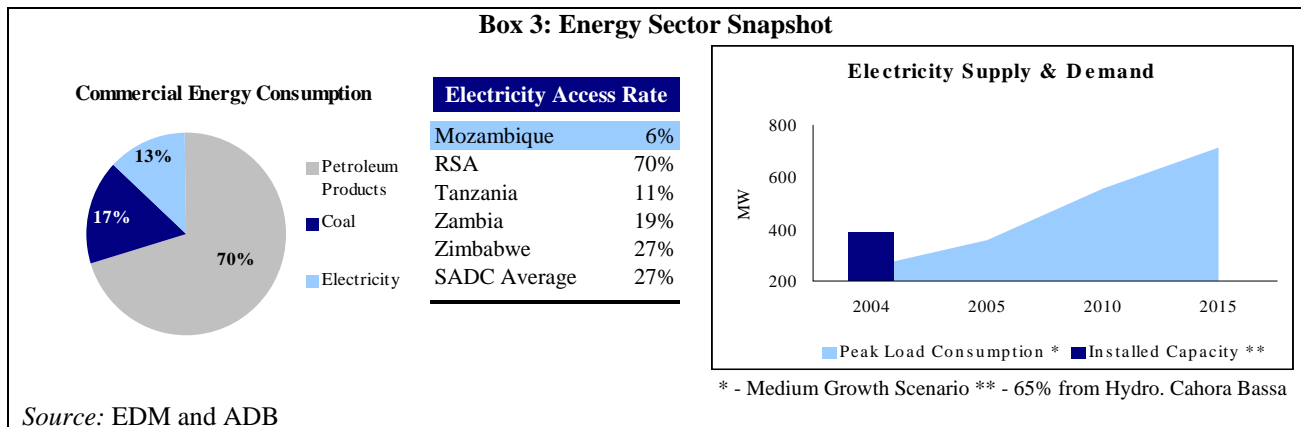
2.3.7 **Energy:** Mozambique benefits from important coal, gas and forestry reserves and hydro power capabilities. Coal deposits are estimated at about 87 million tons and exist extensively throughout the central-western part of the country while a gas field discovered at Pande, about 800 km North-East of Maputo, has proven reserves of 60 billion cubic meters. Moreover, Mozambique has a significant endowment of surface fresh water resources comprising Lake Nyasa (Malawi) and 13 major river basins including the Zambezi, the Limpopo, and Save Rivers. The 12 dams in the country have a total storage capacity of 44,700 million cubic meters giving the country a remarkable hydro power generation capacity. The Cahora Bassa dam, the second biggest dam in Africa, has an installed capacity of 2,075 MW. Mozambique is connected to the Southern Africa Power Pool (SAPP) via the Republic of South Africa and Zimbabwe, and Hydro Cahora Bassa is beginning to participate in the Short-Term Energy Market introduced under SAPP, as net seller of electricity. In spite of current generation capacity, due to lack of distribution networks, electricity

¹² The market leader and most successful example is the Novabanco (www.mixmarket.org/en/demand).

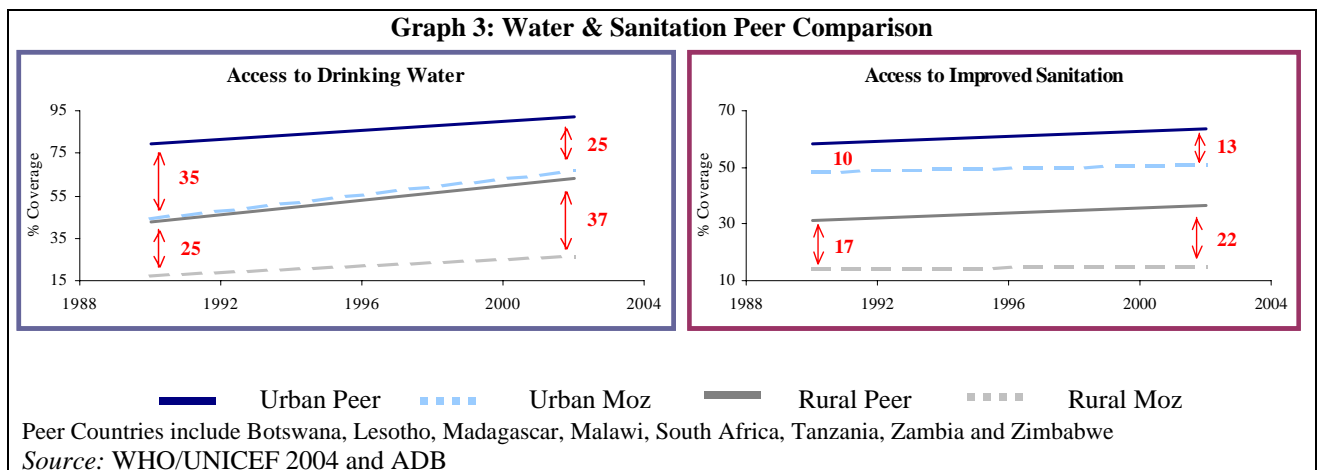
¹³ Some of the microfinance sector constraints are addressed in the Rural Finance Intermediation Project. Please refer to Annex VI for project description.

¹⁴ It has 26,193 km of surfaced roads, of which 20.5% are paved, 26.5% are gravel, and the rest are dirt roads.

does not reach national end users, particularly in rural areas. According to the WB Investment Climate Report, 64% of the sampled companies have identified energy as being a major problem with 17 power cuts registered per month. Electricity access rate is significantly below the SADC average (refer to Box 3), therefore most of the energy derives from fuel-wood and charcoal, which are costly, inefficient and environmentally damaging. Energy consumption is dominated by petroleum products, which account for 70% of commercial consumption (refer to Box 3). Besides the urgency to invest in transmission lines, the country should also increase its installed capacity to meet, not only the expected rise of internal peak load consumption (refer to Box 3), but also to take advantage of its neighbors' energy dependence. Given its natural conditions, Mozambique offers vast opportunities for private sector investments and Public-Private Partnerships (PPP) initiatives in this area.



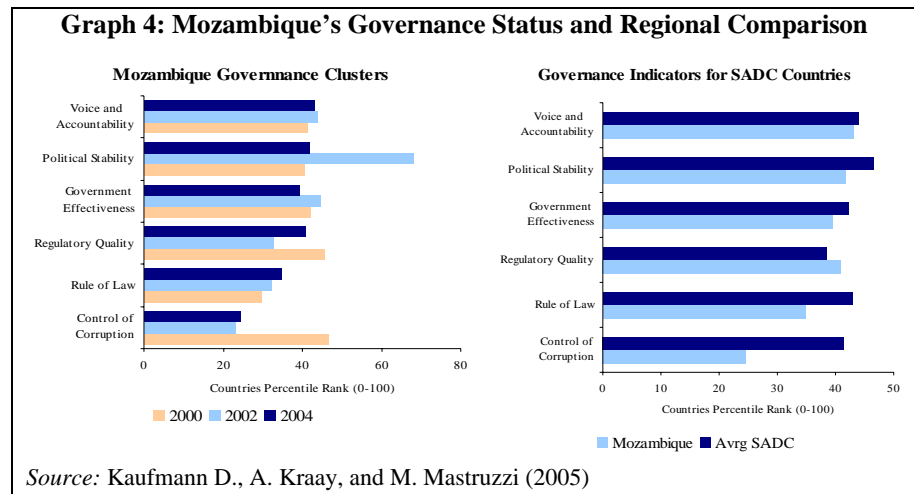
2.3.8 Water & Sanitation: Over the past ten years, access to clean drinking water has increased from 40% to 67% in urban areas and from 17% to 26% in rural areas. However, the MDG of halving the population with no access to water may not be achieved. Additionally, both urban and rural water connections are significantly below the regional average. The gap between Mozambique and comparable countries has decreased, in cities from 35%, in 1990, to 25%, in 2002, but in rural areas it has increased from 25% to 37%, in 1990 and 2002. Investment in urban sanitation has been the major concern, even though rural household connections are also clearly insufficient. Access to sanitation improved marginally during the past ten years, from 48% to 51% in urban areas and from 14% to 15% in rural areas. The gap with comparable countries increased in both areas. The following graphs illustrate the urgency to investment in the water supply and distribution sector, particularly in rural areas.



2.3.9 **Tourism:** The country is well endowed with natural resources and impressive physical attractions that can be harnessed to encourage international and regional tourism. In addition to the extensive coastline with many unspoiled beaches and potential holiday resorts, the country also possesses one of the most diverse collections of wildlife species. The North and the South of the country are recognized centers of biodiversity, with extensive vegetation and unique wetlands that typically support plant and animal species found only in few other countries in the world. The extension of the Kruger National Park in South Africa to the border with Mozambique and the Limpopo National Park has also opened new opportunities for sharing tourists between the two countries. Conservative estimates are that, apart from the high employment-creation potential, tourism could contribute as much as 10% of the current level of exports¹⁵. The main constraint to the sector development is the lack of suitable infrastructure.

2.4 **Cross-Cutting Issues**

2.4.1 **Governance** indicators relating to accountability, transparency, stakeholder participation, legal reform and the fight against corruption have been improving in recent years but are generally worse than the average of SADC countries (refer to Graph 4). Accountability and transparency is insufficient and ineffective, and corruption remains a major constraint, namely to private sector development. According to the most recent Transparency International Corruption Perception Index¹⁶, Mozambique ranked at the 93rd place in a total of 146 countries covered by the survey. Good governance remains a major challenge in Mozambique and efforts towards its improvement are critical to achieve a broad-base sustainable growth. The full diagnosis of the governance status is documented in the CGP prepared in 2005.



2.4.2 **Regional Integration:** When compared to SADC countries, Mozambique is still relatively an inward-oriented economy, although highly dependent on regional trade and investment flows. Regional integration and cooperation is developing, mainly in transport, power and water resource management. Within SADC, Mozambique was, until recently, responsible for the coordination of projects in the Transport and Communications sector, and the Southern African Transport and Communications Commission (SATCC) is based in Maputo. The three regional transport corridors (Beira, Nacala and Maputo) play a strategic role in freight handling to and from the land-locked neighboring countries of Zimbabwe, Zambia and Malawi, as well as South Africa, whose ports are congested. Mozambique will also benefit from electricity and gas exports to its neighbors. The Pande Gas Pipeline that connects the gas fields to Johannesburg (800 km) will enable the country to double its exports earnings. Finally, regional cooperation in water resources management has improved and it is essential to reduce the impact of natural disasters. Mozambique is poised to make

¹⁵ According to the WTO, in 2005, Mozambique was, after Kenya, the second African country with highest growth rate of tourism revenues. Refer to Annex XVIII - Comparative Socio-Economic Indicators II.

¹⁶ Please refer to Annex VII - Corruption Analysis.

a greater contribution, commensurate with its size, resource endowments and strategic location, to the economic integration of the region.

2.4.3 Population: The Mozambican population is very young. About 45% of the population is younger than 15 and the median age is 17.5 years. Population density is lower than Sub-Saharan average and neighbor countries. Most populated provinces are Nampula and Zambezia in the North (refer to Annex XVIII – Comparative Socio-Economic Indicators II). Population growth rates are expected to fall (and align with peer group - refer to Annex XVIII – Comparative Socio-Economic Indicators II) together with fertility rates (from 5.7, in 2000, to 5.1, in 2010) and dependency rates (from 90%, in 2000, to 83%, in 2010). Population is expected to increase from the current 19 million to 27 million in 2020. However, according to sector studies¹⁷, population growth in Mozambique does not constitute a major risk for poverty and inequality. Demographic dynamics have indeed supported the rise in per capita incomes and poverty reduction.

2.4.4 Gender: Although Mozambique’s poor Gender Development Index (GDI) - 133rd position out of 144 countries - some progress has been made. Gender ratios¹⁸ have improved, the GoM signed the Convention for the Elimination of all forms of Discrimination against Women (Beijing Declaration), it recognizes the SADC Gender Policy and passed a breakthrough Family Law strengthening women’s position within the household. The law maintains the concept of monogamy (it also recognizes *de facto* unions - equivalent to common law marriages), reinforces women’s rights within the marriage, and recognizes the right of either spouse to be the head of the family. In the decision making sphere, significant achievements have been made: (i) 36% of the parliamentarians are women (above the SADC target); (ii) Parliament is required to have a female Vice Deputy Speaker; (iii) both a Parliamentary Commission for Social affairs, Gender and Environment and a Parliamentary Women’s Caucus have been put in place to recognize and coordinate specific gender and women’s related issues; and (iv) women account for 20% of provincial governors and directors and 30% of elected presidents of village councils.

2.4.5 Mozambique is an agricultural economy and women account for 55% of the labor force in this sector. As shown in Table 2, 88% of employed women are unskilled agriculture workers.

Women represent only 25% of the skilled labor force¹⁹ and are still clearly a minority within the skilled labor categories, leading to an obvious salary imbalance towards men.

Table 2: Skill and Gender Composition of the Mozambican Labor Force (2003)

	Gender Shares by skill		Skill shares by gender			Wage index
	Fema.	Male	Fema.	Male	Total	
Unskilled Agric. Labor	59,0	41,0	88,2	67,0	78,1	100
Skilled Agric. Labor	25,3	74,7	2,4	7,8	5,0	164
Unskilled Non-Agric. Labor	30,1	69,9	7,1	18,0	12,3	430
Skilled Non-Agric. Labor	25,2	74,8	1,8	5,8	3,7	1474
Highly Skilled Non-Agric. Lab.	25,3	74,7	0,4	1,4	0,9	3509
Average/Total	52,2	47,8	100	100	100	225

Source: “A Gendered Analysis for Mozambique”; FOI Working Paper No. 07/2003; Danish Research Institute of Food Economics, Copenhagen.

¹⁷ Klasen and Woltermann, 2004 in Mozambique Country Economic Memorandum.

¹⁸ EP girls to boys is 0.83, the proportion of seats held by women in national parliament is 35.6% and female/male earned income ratio is 68%.

¹⁹ The Bank approved recently the Women Entrepreneurship Project to enhance the skills of female agriculture workers.

2.4.6 Employment and Labor Market: Formal employment, which covers only 10% of the active labor force, has been growing less than real GDP²⁰. However, the informal (76% of urban labor force) sector has been growing at a rate of 7%-8% per year. Mozambique has one of the least flexible labor markets in the region and is particularly restrictive in terms of cost-cutting. According to the WB Ease of Doing Business Report, Mozambique has the eight least flexible labor markets in a survey of 145 countries. Improving the regulatory framework, making labor markets more flexible, modernizing inspection, hygiene and security at work, and easing the hiring of foreign workers are essential to attract new investments. With regard to core labor standards, Mozambique has ratified all eight ILO Convention core standards and child labor related conventions.

2.4.7 Environment: Mozambique is responsible for yearly carbon dioxide emissions of 0.2 tn³ per capita (less than the Sub-Saharan average of 0.8 tn³), and has signed and ratified all major international environment conventions²¹. The country is endowed with abundant and valuable natural resources. However, a number of key environmental problems exist, mainly due to the internal migration to the relatively war-safe urban and coastal centers. One of the most debilitating environmental effects of these displaced people has been the decimation of the coastal mangrove forests by 70% that has been used for fuel wood and building materials. Additionally, since the mangrove swamps constitute breeding grounds for shrimps and protect the fragile region from coastal erosion, there is an urgent need for their replanting, otherwise one of the most valuable natural resources of Mozambique will be destroyed and, with it, a major source of employment and an important source of foreign exchange earnings.

2.5 Poverty, Social Context and Related Issues

2.5.1 Poverty Profile: Around 54% of Mozambique's population lives in poverty, mostly in rural areas and work in agriculture and other related activities. Poverty incidence is more intensive in the northern (the most populated region - chapter 2.4.3) and southern provinces and among women (Table 2). Although access to services (health, water, sanitation and education) has improved dramatically, the poorest quintile of the population continues to have a very limited level of education and access to health care services (refer to chapters 2.5.4 and 2.5.5). According to the 2005 Human Development Index (HDI) Mozambique is ranked as 168 (172 in 2004) out of 177. The implementation of Mozambique's development strategy has not progressed so far at the required pace to reach the MDGs²². The only MDGs likely to be achieved are income poverty, child mortality and maternal health. According to the GoM, the key factors that determine poverty, (i) the low level of education within households; (ii) high dependency rates; (iii) low returns from agriculture and manufacturing activities; and (iv) limited access to infrastructure will be carefully addressed by the PARPA II (refer to chapter 3.1).

2.5.2 Nevertheless some progress has been made. The strong economic growth led to a rapid and broad based decrease in poverty from 69%, in 1996, to 54%, in 2003²³. One of the pillars of economic growth was the performance of the agriculture sector that together with intensive rural-urban migration explains the greater poverty reduction in rural areas (refer to Box 4). Another reason for successful poverty reduction performance is the low income inequality across the population summarized by the Gini Index. On income distribution, Mozambique performs better

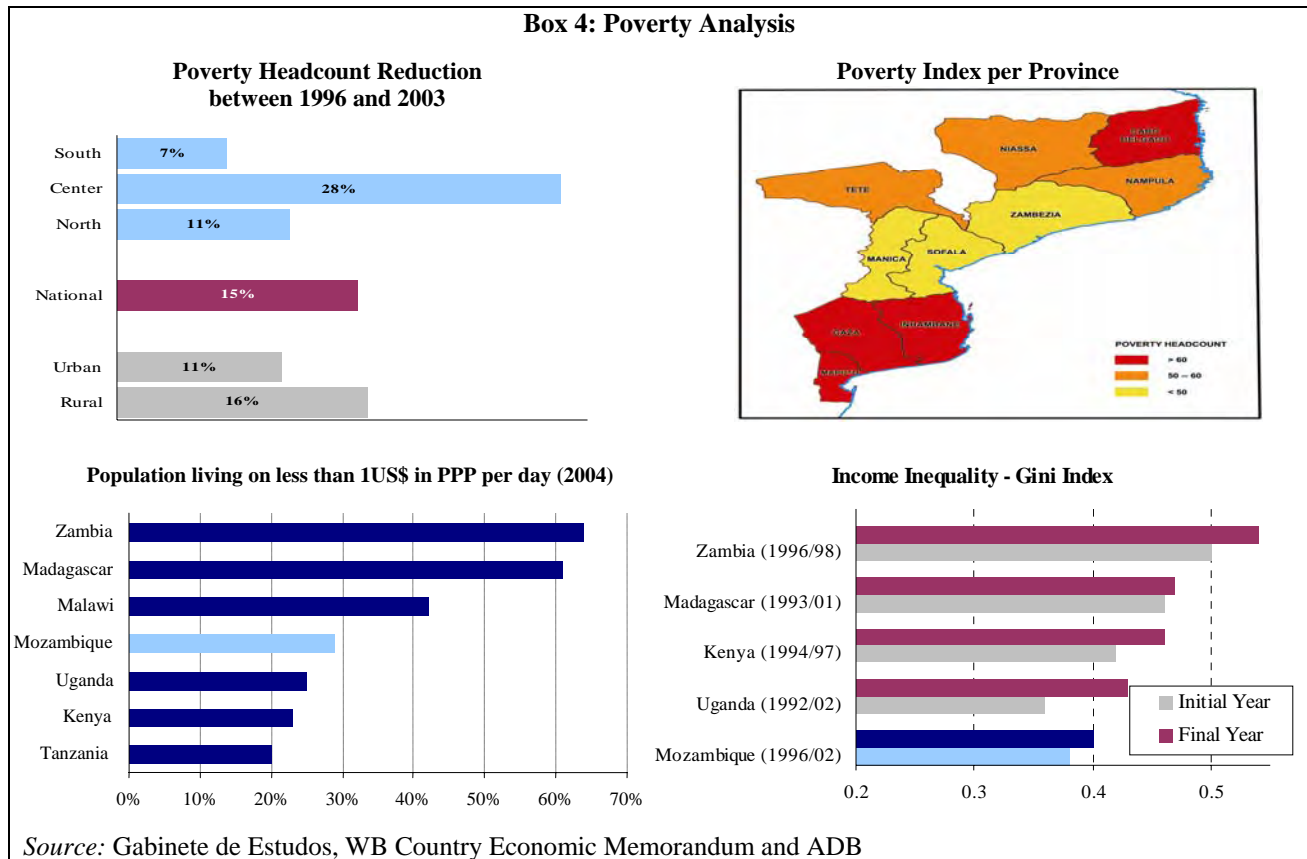
²⁰ Labor elasticity (GDP vs labor market growth) has remained between 0.1 and 0.4, partially due to the civil service sector restructuring.

²¹ Cartagena Protocol, Convention for the Climate Change, Kyoto Protocol and Convention for Biodiversity.

²² Refer to Annex VIII - Mozambique's MDG's.

²³ Under PARPA I, the GoM aimed at reducing poverty to 60% by 2005, which means that this objective was surpassed by 5%.

than its neighbors, some of them recently overtaken in terms of absolute poverty levels (refer to Box 4).

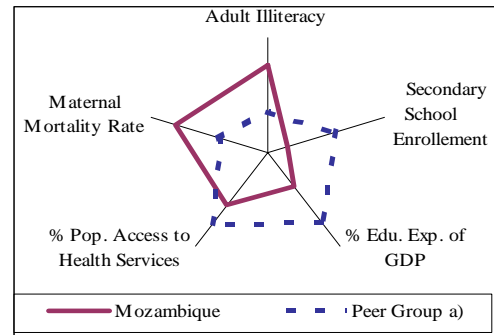


2.5.3 From 1996 to 2003 private consumption increased annually by 4.6% and across all income groups. The poorest quintile's consumption increased on average 3.5% per year, which allowed to double in eight years most of their non-monetary welfare indicators (e.g. access to house durable roofs, radios, bicycles, clocks, percentage of income spent on food, etc). Poverty can also be measured in terms of access to basic services that in turn fosters further poverty reduction. Total youth literacy increased from 49%, in 1990, to 59%, in 2003, net enrolment rates for primary schooling increased from 44% in 1997 to 70% in 2003, infant mortality fell from 149 in 1995 to 95 in 2005, and access to clean water increased from 24% to 42% of the population in the last 8 years.

2.5.4 **Education:** During the past ten years, the number of primary schools increased by more than 65% and the number of secondary schools increased by about 43%. The GoM succeeded in achieving the targets for EPI's enrolment rates both for girls and boys and introduced a new curriculum for primary and secondary schools. However, owing to capacity constraints, the quality of education has not kept pace with the rapid expansion of coverage. Mozambique still performs poorly when compared with regional peers (refer to Graph 5), particularly regarding adult illiteracy (47%), secondary school enrolment (16%), coefficient of efficiency (46%), and education expenditure as percentage of GDP (3%).

2.5.5 Health & HIV/AIDS: In the past ten years, the number of health units has expanded from 946 to 1063. Over this period the number of persons vaccinated has increased by 74% and the number of outpatient visits has increased by 82%. Maternal mortality and infant mortality rates have decreased substantially. However national indicators are still significantly below those presented by Mozambique's peer group, particularly the maternal mortality rate (175 per 100.000), percentage of population with access to health services (30%), contraceptive prevalence (5.6%) and health expenditure as percentage of GDP (4.1%). Out of the health related MDGs only child mortality and maternal health targets might be attained.

Graph 5: Education & Health Snapshot



a) Peer countries include Botswana, Lesotho, Madagascar, Malawi, South Africa, Tanzania, Zambia and Zimbabwe.

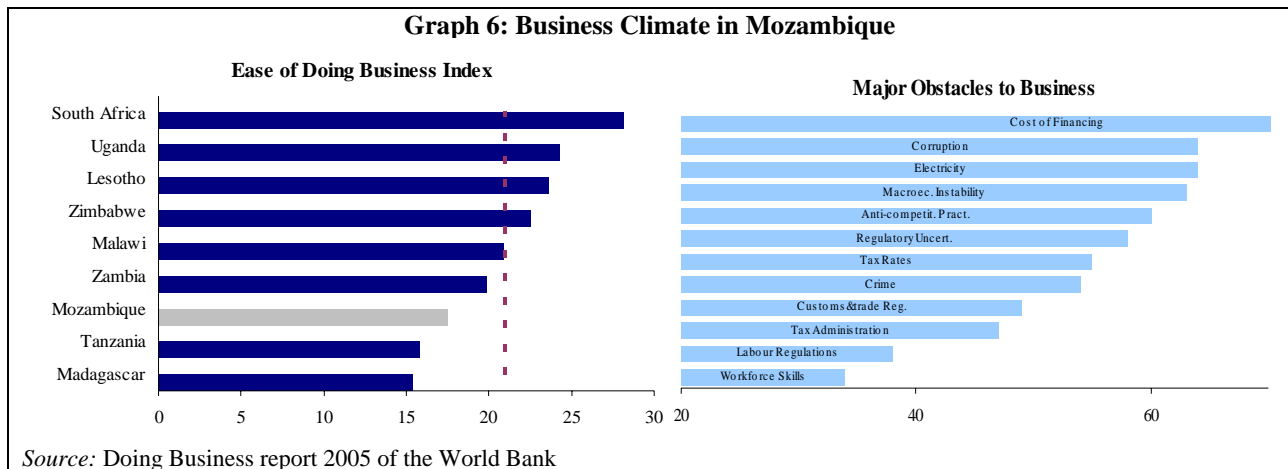
Source: ADB

2.5.6 Mozambique is in the top ten of Sub-Saharan African countries that have been hardest hit by HIV/AIDS, with 1.3 million adults infected. The latest estimates indicate an adult prevalence rate of 12% and 470,000 children orphaned. The demographic, social and economic consequences of AIDS are of major concern. By 2015, the infant mortality rate is forecast at 25% higher than it would have been without HIV/AIDS, and life expectancy will have declined from 42 to 36 years rather than increasing to 50 years as targeted by the GoM. The cost of HIV/AIDS impact to the economy is estimated at approximately 1% of GDP growth per year.

2.6 Private Sector Climate and Related Issues

2.6.1 A friendly business climate is fundamental for attracting investment. According to the ease of doing business index²⁴, Mozambique ranks poorly, in the bottom 10% of SADC countries. It takes between 132 and 153 days to start a company (compared to a regional average of 63) and it costs around 96% of per capita income. Few entrepreneurs are willing to endure such a long and high cost process and many give up or remain unregistered. Contract enforcement is difficult due to the inadequacy of the legal and judicial system. Among five selected countries in Southern Africa, Mozambique is by far the country in which debt recovery through the courts takes longest. Apart from insolvency disputes, it takes approximately 540 days to recover a debt in Mozambique, whereas in Malawi, Tanzania and Zambia, the time ranges between 100 and 200 days.

²⁴ Simple average of country rankings for 7 topics: Starting a Business, Hiring and Firing Workers, Registering Property, Getting Credits, Protecting Investors, Enforcing Contracts and Closing Business. (Doing Business report 2005 of the World Bank).



2.6.2 Additionally, the inadequacy of the financial system and labor regulations, difficulty in accessing property and capital, limited institutional and human resource capacity, lack of good governance, difficult access to energy, weak infrastructure, and lack of competitive practices are also main obstacles to business. On the other hand, state participation in economic activity is declining and the privatization process²⁵ is almost completed. Although several constraints still remain, the investment climate is improving and Mozambique is one of the leading recipients of FDI in the region (excluding RSA). Additionally, Mozambique offers political stability and a successful track record on economic growth and commitment to reforms. Important achievements were also made in promotion of external trade and liberalization of the economy and special investment legislation has been developed to attract new investors. The country has abundant natural resources (land, coal, titanium, natural gas, hydropower), tremendous opportunities in tourism and construction sectors, following the infrastructure construction plan supported by the donor community, strategic geographical location to several landlocked countries and preferential access to important markets (refer to paragraph 2.3.3). Table 3 – Mozambique Strategic Outlook summarizes the country’s main development constraints, comparative advantages and potential growth drivers.

3. NATIONAL DEVELOPMENT AGENDA AND MEDIUM-TERM PROSPECTS

The previous section highlighted that, in spite of recent achievements relating to political stability, ability to attract foreign investments and assistance, economic growth and poverty reduction, there are still several challenges facing the country, namely: (i) continuation of macroeconomic stability and sound public financial management; (ii) development of the private sector and improvements in the business climate; (iii) promotion of good governance; and (iv) regional economic integration. The country has: a) considerable costs of doing business and poor access to credit and micro-finance; b) weak infrastructure; c) low economic diversification with high dependency on the agriculture sector; d) low level of domestic savings, partly due to low incomes and poor access to financial services in rural areas; e) low civil service capacity; f) inadequate legal and regulatory framework for economic activity; g) high levels of corruption, and h) strong prevalence of HIV/AIDS, low levels of access to education and an inefficient health care service. The GoM supported by the donors needs to address these constraints in order to improve the country’s productivity and trigger further exploitation of its comparative advantages, as summarized in Table 3 - Mozambique Strategic Outlook.

²⁵ Since 1995, the GoM has engaged in privatization of state-owned enterprises alienating more than 1,200 companies.

3.1 Key Elements of the Government Development Agenda

3.1.1 Poverty Reduction Strategy: The PARPA aims to reduce poverty headcount from 54% of population, in 2003, to 45%, in 2009, and to promote human well being and economic development through rapid, inclusive and broad-based growth. Alongside these objectives, the strategy seeks to: (i) foster real GDP growth through enhancement of business climate; (ii) increased coordination with the international community and to attract aid support to the country, particularly through budget support; and (iii) guarantee income distribution and equity, especially to the poorest, through effective provision of social and other public services.

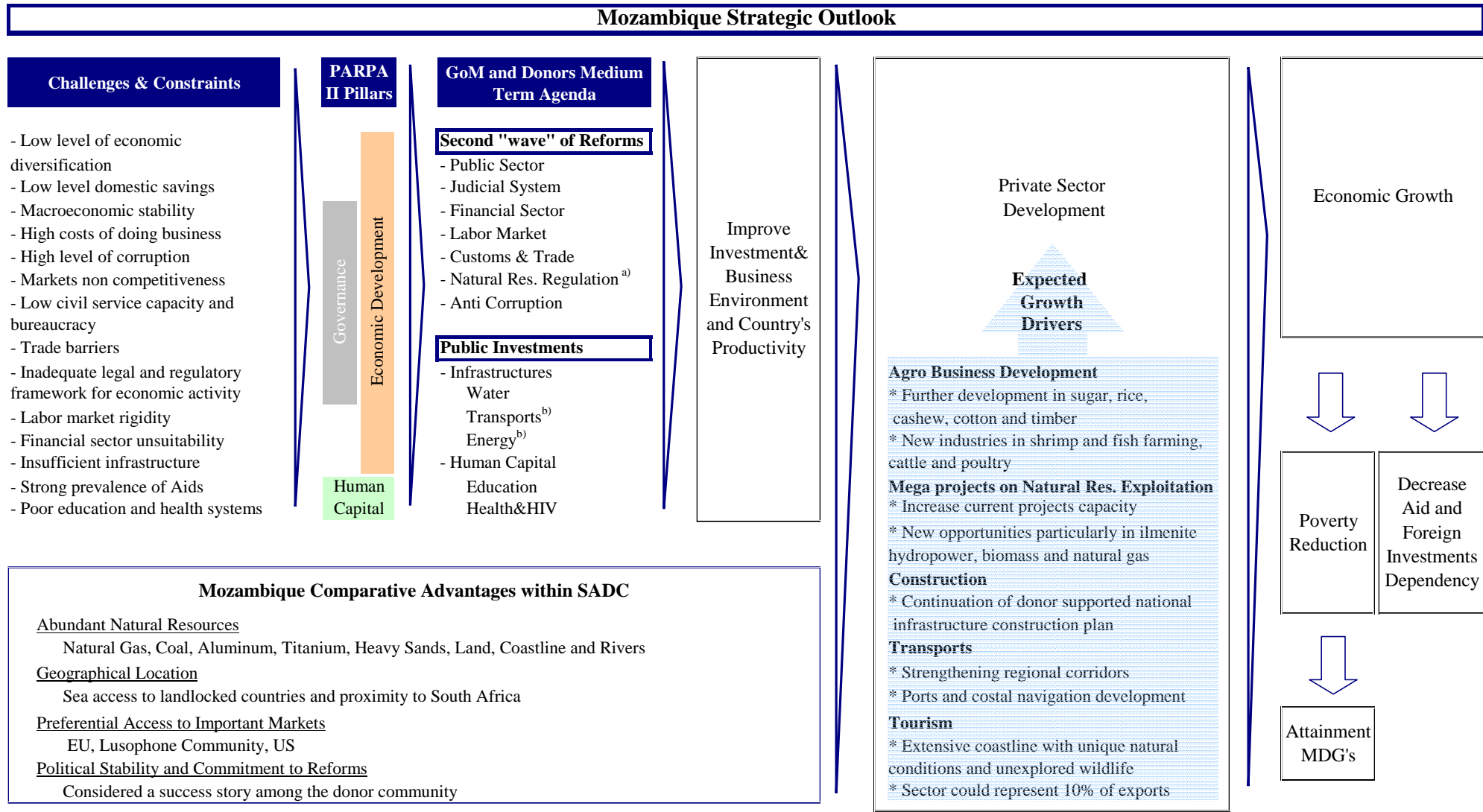
3.1.2 Strategic Pillars: The PARPA²⁶ sets out the GoM's poverty reduction strategy within three pillars: (i) good governance; (ii) human capital; and (iii) economic development. **Pillar 1 – Good Governance** is a key state instrument to stimulate economic development. By ensuring transparency, rendering accountability and active implementation of laws against criminal acts and corruption, as well as minimizing opportunities for deviation and misuse of funds and public resources, the GoM shall create an enabling environment for the private sector development. **Pillar 2 – Human Capital** aims to continue to develop labor, technical and scientific capacities, health and sanitary well being, to increase access to basic resources (particularly food and water) and to reduce disease incidence such as HIV/AIDS, malaria and tuberculosis. **Pillar 3 – Economic Development** is centered on the basic conditions for pursuing productive activity, such as improving infrastructures, reducing bureaucratic blockages and establishing legislation that guarantees property rights, stimulating increased productivity and innovation. Additional priorities are development of the banking and financial system so that it may comply with its tasks of retaining savings and actively financing productive operations, in particular those of small and medium enterprises. Priorities underlying the third PARPA pillar are: (i) to develop structural transformation in agriculture; (ii) improve the road network to foster integration of the national economy and improve connection to ports and SADC market; (iii) increase access to water and sanitation; (iv) achieve energy self-dependency in the long run; (v) macroeconomic stability and improved public finance management; (vi) promote national savings and credit to the economy; (vii) establish an international trade policy; (viii) improve private sector business environment and expand the agro-industrial businesses; (ix) enforce a sustainable and profitable exploitation of mineral and natural resources; and (x) promote tourism and self-sustaining development.

3.1.3 Prospects: Overall, it is expected that the economy will grow at an annual rate of 5%²⁷ in the next few years. It is believed that higher GDP targets of 7% or 8% can be met if in addition to sound macroeconomic and public finance management, crucial restructuring operations, namely the second “wave” of reforms and infrastructure investments are carried out. These are essential in order to improve business environment and therefore promote private sector development that drives economic growth, as summarized in Table 3 - Mozambique Strategic Outlook. If these growth projections are observed and the inequality indexes remain at historical levels, the poverty level will decrease to 31% in 2015. Such progress would hopefully allow the MDG for poverty reduction to be met.

²⁶ Refer to Annex IX for PARPA methodology.

²⁷ Available macroeconomic growth models suggest an annual growth rate of 7%, to which 2% has been subtracted to account for HIV and natural disasters negative impacts (1% each).

Table 3: Mozambique Strategic Outlook



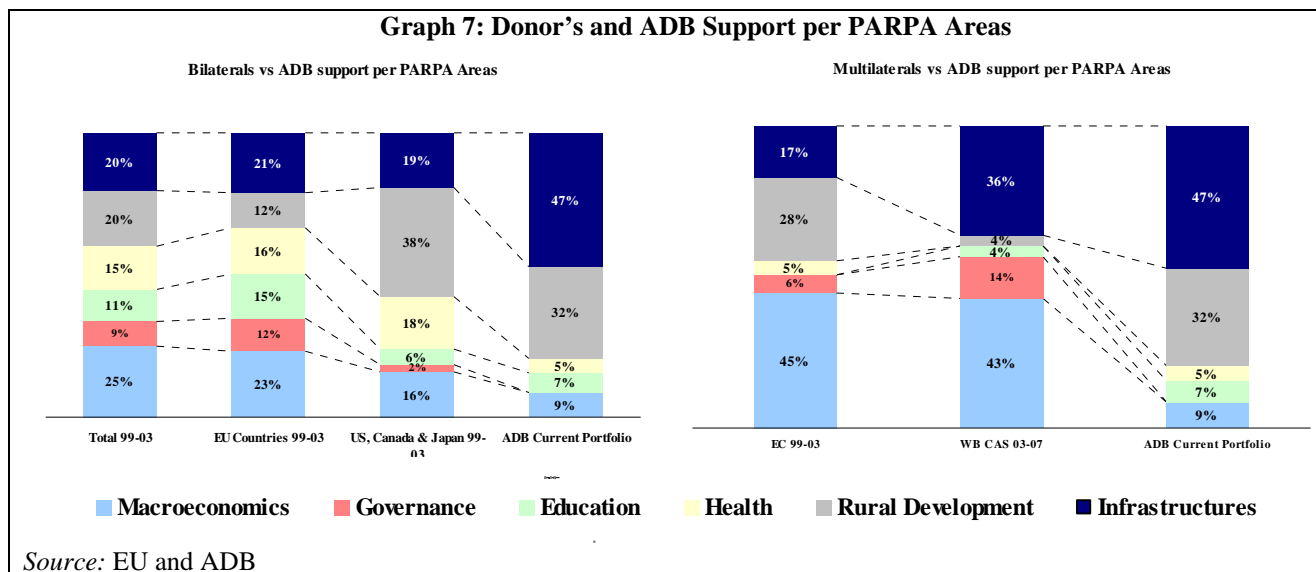
a) Including anti-trust legislation

b) High potential for private sector participation and PPP initiatives

3.2 The Partnership Framework

3.2.1 International development partners have supported actively GoM's poverty reduction strategy²⁸. Mozambique is among the largest recipients of development assistance in Sub-Saharan Africa. In the last five years the country has received US\$ 6.8 billion of Official Development Assistance (ODA), equivalent to 32% of GNI. Bilateral funding accounted to 71% of total ODA. EU countries, mainly UK, France, Portugal, Germany, Italy and Sweden are responsible for 80% of total bilateral funding. The ADB resource flow during the last five years accounted for about 14% of multilateral support and 4% of total support. The ADB is the third largest donor after the World Bank and the European Union.

3.2.2 In terms of support breakdown per sector, between 1999 and 2003, donors have been favoring macroeconomic/multi-sector and governance sectors. The graphs below illustrate donor support breakdown per PARPA I pillars. Compared to the ADB's current portfolio, bilateral donors' portfolios have significantly smaller shares of agriculture and infrastructure projects and larger shares of social, multi-sector and governance projects. Comparing with multilateral institutions, the WB has also a significant share in infrastructure but is progressively pulling out of the agriculture sector. According to the World Bank's most recent Country Assistance Strategy (CAS) 2003-2007²⁹, agriculture accounted only for 4% of total support. Most supported areas were cross-cutting issues, through budget support (40%), transport sector (25%) and governance (14%). The EU allocated 51% to macroeconomic and governance areas, through budget support, and 45% to rural development and infrastructures.



3.2.3 Aid Coordination: Development Partners (DP) have supported GoM's efforts through financial and technical assistance, consultation and policy dialogue. DP have increasingly channelled their assistance through budget support programs following the Paris Declaration (PD)

²⁸ Refer to Annex X – Donor intervention by sector.

²⁹ World Bank's strategy for 2003-2007 aims at i) improving the investment climate; ii) expanding service delivery; iii) building capacity; and iv) providing cross-cutting/budget support.

principles. Some donors (G-18)³⁰ agreed on a joint program for providing budget support and have signed a Memorandum of Understanding (MoU) in the spirit of the PD³¹. The ADB joined the G-18 in February 2006. This budget support program (refer to Box 5) is aligned with PARPA priorities and has increased donor coordination, harmonization and alignment. Mozambique is perceived to have a progressive and harmonized framework of intervention.

Box 5: Donor Harmonization Efforts

The movement to increased donor coordination started in the 1990s and was formalized in 2000 with the establishment of the Joint Donor Program for Macro-Financial Support (JP), underpinned by a MoU known as the Joint Agreement (JA). This agreement provided a common focus and allowed for regular dialogue and an annual review, known as the Joint Donor Review (JDR). While some form of budget support had been delivered before 2001, it was linking budget support to the PARPA that led to increased coordination among donors and initiatives to support harmonization and alignment. The M&E systems were reinforced to ensure that the use of these resources meets the accountability requirements of donors. The new system allowed a greater ability to measure and monitor results and, subsequently, a greater trust/lower risk in relying on government systems to measure and monitor performance. This aid modality thus serves to support donor use of government systems.

In 2002, preparation of a detailed matrix of PARPA activities by sector revealed a need to make information about PARPA priorities more systematic and to monitor a meaningful number of indicators. The GoM led a process to define a performance assessment framework, requesting all PARPA sector ministries and those responsible for cross-cutting reforms to identify priorities for the coming three years. This resulted in a 56-page Matrix (the 'long PAF Performance Assessment Framework'), which was then reduced to a 'short PAF' (two pages of key priorities). The general planning, PES, budget and the PAF matrix provide an integrated and consistent framework of objectives, intermediate outcomes and monitoring indicators. This provided a sound basis for harmonization around results based reporting.

In 2004, a group of 15 donors agreed to use the PAF³², a multi-annual matrix of priority targets and indicators based on the PARPA, updated on an annual basis through the PES process and agreed through cross-government dialogue. Progress in the achievement of all the indicators contained in the PAF is assessed twice a year through the Joint Review in April/May and the Mid-Year Review in September of each year. This included issuance of a Memorandum of Understanding (MoU) signed in April 2004 between the government and the 15 budget support donors. This MoU has a duration of five years and provides declaration that the signatories "are determined to work in the spirit of the principles of" NEPAD, the Monterey Consensus and the Rome Declaration on Harmonization, in a process of open dialogue and mutual accountability". In this context, the GoM and the PAPs declared their commitment "to improve aid effectiveness and country ownership of the development process through increasing donor harmonization, increasing recipients' institutional capacities in planning, implementing, monitoring and evaluating their programs, strengthening domestic accountability..." (Memorandum of Understanding, page 3).

4. BANK GROUP COUNTRY ASSISTANCE STRATEGY

4.1 Portfolio Management and Lessons Learnt

4.1.1 Implementation Performance: According to the Mozambique 2005 Country Portfolio Review (CPR), the overall performance of current operations was satisfactory. The average age of Mozambique's portfolio is 3.9 years, which is below the Bank's average of 4.2 years. This indicator is further reinforced by the 2004 CPIA that placed Mozambique on the first quintile of the Portfolio Performance sub-section. In terms of progress made over time, the portfolio performance has improved. Comparing the 1999 CPR with the 2005 CPR, it can be concluded that, although with

³⁰ Including Belgium, Denmark, Canada, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the European Commission, the World Bank and the African Development Bank. G-18 observing external partners included Japan, the United States, UNDP, and the IMF.

³¹ Refer to Annex XII - ADB Compliance with Paris Declaration.

³² Refer to Annex XV - PAF Matrix and Annex X - Donor Intervention per Sector.

variations across sectors, the overall results in 2005 in terms of disbursement rates, average age and overall project's performance are significantly better than those seen in 1999. The 2004 Annual Portfolio Performance Report (APPR) evaluation also confirmed this trend. It identified only five problematic (PP) or potentially problematic projects (PPP) while the 2002-03 APPR identified ten.

4.1.2 Performance per Sector: The 2005 CPR helped also to identify the best performing sectors. Sectors performance was evaluated according to six criteria: age, disbursement rate, project overall rating (Implementation Progress indicator in the CPR), project development impact rating (Development Objectives indicator in the CPR), donor harmonization efforts (number of co-financed projects per sector) and average project size. According to this evaluation, infrastructure and multi-sector/PBL emerged as the highest performing sectors (refer to Annex XI for detailed results).

4.1.3 Lessons Learnt: Experiences from previous CSPs, portfolio reviews, project completion reports, post-evaluation reports, and consultations with stakeholders and donors, point out the need to put stronger emphasis on: (i) strengthening implementation capacity; (ii) increasing the average size of operations in order to reduce transaction costs; (iii) increasing selectivity and concentrate efforts on sectors with higher implementation track record; (iv) re-thinking current project designs in terms of quantity of loan conditions and usage of PiUs; and (v) increasing cooperation, harmonization and coordination with other donors.

4.2 Country Context and Strategic Selectivity

4.2.1 The Bank Group and the donor community have aligned their support with the PARPA, which is the driving document for donor support strategies. The Boards agreed to reschedule the CSP presentation, initially programmed for 2005, precisely to allow the Bank to align and harmonize its strategy with the country and the donor community. The selection of the proposed Bank Group's interventions took into consideration three main criteria, namely: (a) Alignment with the Country's main development priorities (following chapter 3.1 main conclusions); (b) Improving efficiency of ADB activities (following chapter 4.1 and ADF-X policy guidelines); and (c) Increase donor harmonization and Institutional coherence (following chapter 3.2 analysis and the Paris Declaration principles). Based on the criteria overall assessment, the strategic areas identified by the Bank as CSP pillars for 2006-09 are **Governance** and **Infrastructure**.

4.2.2 (a) Alignment with the Country's main development priorities (point i in Table 4): As highlighted in chapter 3.1, the GoM recognizes the key role that private sector plays in fostering growth and reducing poverty. Hence, during the next four years, the GoM envisages carrying out the second "wave" of institutional reforms and providing the country with suitable economic and social infrastructure in order to address the main bottlenecks to private sector development (refer to Table 3). Since the main goal of the 2006-09 CSP is to support the 2006-09 PARPA II's program, the Bank's strategy was designed to support the institutional reform efforts and part of the public infrastructure national plan. Consequently, the first CSP pillar – Governance links directly to PARPA Pillar 1, while the second CSP pillar – Infrastructure links directly to part of PARPA Pillar 3 - Economic Development³³ (refer to Table 4). Understandably, the selectivity principle that emerged from the results based approach prevents the Bank to be active in all PARPA areas.

³³ It also links indirectly with Pillar 2 – Human Capital given the efforts under the RWSSI to improve water and sanitation network that have significant impacts on health related indicators.

4.2.3 (b) Improve efficiency of ADB activities (points iii to x in Table 4): The proposed Bank Group interventions also took into consideration previous experiences, lessons learned and ADF-X policy guidelines. According to the latter and its results based framework, implementation is a key concern and should be at the core of the Bank's strategy. The Bank should be selective and focus in areas that maximize development impact. As already mentioned, the 2005 CPR identified infrastructure and multi-sector/PBLs as the best performing sectors, not only in terms of implementation indicators, but also in terms of overall project evaluation and development impact. Another criteria is size. Previous experiences highlighted the need to increase project's average size and to reduce the number of interventions in order to improve implementation. Additionally, the Bank assumed a leading role among the donor community in infrastructure related initiatives (eg. African Water Facility, Rural Water Supply and Sanitation Initiative and NEPAD) where it is perceived to have comparative advantages. The efficiency criteria should thus take into account potential synergies from these Bank-wide initiatives. A link to previous strategies is also important to ensure continuation of the development and poverty reduction effort, maximizing and profiting from the impact and progress already attained. Accordingly, the efficiency criteria should also consider synergies from previous Bank interventions in the country. Finally, the CSP strategy considered possible imbalances of ADB regional support. By comparing the Bank's portfolio distribution per region with the poverty headcount per province, it emerges that the Bank should be more active in the Northern provinces.

4.2.4 (c) Increase donor harmonization and Institutional coherence (points ii and xi to xvi in Table 4): The ADB strategy in Mozambique should be consistent with the Bank's vision in promoting good governance, regional integration and private sector development in the Continent. It should also be consistent with the Southern Africa Regional Strategy (ADF/BD/WP/2004/134) and treaties and agreements the Bank has signed, namely the Paris Declaration and the MoU with the G-18. Following Paris Declaration and MoU principles, the Bank should decrease the number of PiUs, increase the percentage of support relying on GoM PFM and procurement systems and the number of co-financed projects. The ADB strategy should also incorporate lessons learned from key stakeholders from one of the most supported countries in Africa. The consensus among the donor community, in Mozambique, is to increasingly concentrate resources on macroeconomic and governance areas³⁴, a strategy also strongly supported by the GoM. In terms of project design donors have been favoring direct budget support to project support, since it helps to: (i) improve aid coordination amongst donors; (ii) reduce aid transaction costs; (iii) strengthen GoM capacity by avoiding new PiU set ups; (iv) enhance country appropriation of poverty reduction strategy; and (v) empower the government to build capacity and increase its planning ability³⁵. Recent studies³⁶ conclude that general budget support policies in Mozambique have been a very successful case of donor/government collaboration, enhancing aid effectiveness and contributing positively to conditions for economic growth.

4.2.5 To summarize, Governance and Infrastructure are the pillars that best fulfill the selection criteria described above. Table 4 highlights the rationale for CSP pillar choices and illustrates their likely impact in terms of (a) alignment, (b) efficiency and (c) Institutional coherence and harmonization.

³⁴ Both multilateral and bilateral donors have spent on average 55% and 34% of their resources in these areas, while the ADB spent 9%.

³⁵ Refer to Annex XVI for GBS framework and advantages on poverty reduction effectiveness.

³⁶ Joint Evaluation of General Budget Support – Mozambique Country Report, International Development Department, University of Birmingham, 2005.

Table 4: Strategy Rationale

Selection Criteria	Benchmark	Current ADB Portfolio	Projects to be Approved under ADF X	Portfolio at the end of ADF X Cycle		
		2005 (I)	2006-09 (II)	2009 (I) + (II) ^{c)}		
Alignment	i Alignment with the Country's main Development Priorities					
	ii % Support relying on GoM PFM and Proc. Systems ^{h)}	40% ^{g)}	9%	40%	24%	
	iii Average Project Size (US\$ M)	50.6 ^{a)}	20.9	67.5	33.5	
	iv Age (years)	2.8 ^{a)}	4.4	3.0 ^{b)}	3.5	
	v Disbursement Rate (%) ^{h)}	65% ^{a)}	34%	42% ^{b)}	40%	
	vi Project's Overall Evaluation (Rating 0-3 scale)	N/A	2.0	2.2 ^{b)}	N/A	
	vii Project's Development Impact (Rating 0-3 scale)	N/A	2.1	2.2 ^{b)}	N/A	
Efficiency Indicators	viii Synergies from Previous Interventions & Selectivity Principle					
	ix Regional Balanced Support	Invest. Priorities ^{a)}				
		North	33%	27%	46%	34%
		Center	27%	26%	27%	26%
		South	40%	47%	27%	40%
	x Alignment with Special Bank Initiatives (AWF, RWSSI, NEPAD)	N/A	+	++	++	
	xi ADB Mandate on promoting Governance, Regional Integration and Private Sector Development	N/A	+	++	++	
	xii ADB Southern Africa Regional Strategy	N/A	++	+++	+++	
	xiii Paris Declaration on Aid Effectiveness	Refer to Annex XII	-	++	++	
xiv Project Design - Number of PIU within portfolio ^{h)}	26% ^{g)}	78%	38%	58%		
xv Number of Co Financed Projects (%) ^{h)}	50% ^{g)}	32%	100%	66%		
Harmonization Indicators	xvi Support per Sector					

a) WB 2004 Portfolio, b) Assuming current average age, disbursement rate and ratings of multisector and infrastructure sectors (CPR 2005)

c) And assuming that in 2009 half of the current projects are completed. The efficiency results might be under estimated since it also assumes that RO and Bank Reform impact on implementation is null. The idea is not to forecast results but to assess exclusively pillar choices impact

d) Inverse correlation with poverty headcount by province (1996-2003 GoM Poverty Survey)

e) Total donor support from 99-03 breakdown per sector. Includes all EU countries, Japan, US, the WB and EC that are responsible for 90% of total

f) Indicative pipeline. Projects not yet approved by the Management, g) According to Paris Declaration, h) Paris Declaration Indicator

4.2.6 The first pillar - Governance is aligned with GoM priorities, enhances donor harmonization, helps the Bank to comply with the PD and MoU targets, and the remaining selection criteria (refer to Table 4). Governance is a major constraint to Africa's and to Mozambique's development and has emerged as one of the key areas for intervention, as recognized by the GoM that singles it out as one its three PARPA pillars. As an African development institution, the ADB should assume a leading role addressing a core constraint in Africa's development and be at the forefront of good governance policies. The CGP, recently finalized, will enable the Bank to prepare its governance interventions in line with the country's priorities and donor community support strategies.

4.2.7 The second pillar – Infrastructure is also aligned with the selected criteria (refer to Table 4). Inadequate infrastructure, particularly in rural and peri-urban areas is a major cause of poverty in the country, and a barrier to sustainable economic growth. Only 26% of the rural population has access to adequate water supply, while only 6% of the population has access to electricity despite the country's huge generation capacity. Given its low accessibility, the costs of modern forms of energy and water and sanitation services have been prohibitive to most Mozambicans. The country's physical infrastructure, which was devastated during the long civil war, requires substantial investment to ensure rehabilitation and expansion. Besides the cross-sector impacts and contribution to the achievement of MDGs, development of Mozambique's infrastructure is essential to enhance business productivity and the country's regional competitiveness.

4.3 CSP Pillars and Results Framework

4.3.1 Pillar 1 – Governance's main objective is to reinforce economic reforms, good governance and institutional capacity. Interventions within this pillar consist of supporting: (a) Macroeconomic reforms, aimed at: (i) enhanced efficiency and effectiveness of public expenditure management, and (ii) appropriate budget allocation to PARPA priority sectors; (b) Public sector reforms, aimed at: (i) rationalization, restructuring and decentralization of Ministries, (ii) pay reform and enhancement of incentives framework, (iii) transparency and efficiency of procurement system, and (iv) implementation responsiveness, participatory, transparent and accountable anti-corruption programs; (c) Legal and Judicial reform, aimed at: (i) supporting increased efficiency in the provision of justice services, through institutional capacity building and up-dating of legal codes, and (ii) improve progress in clearing judicial cases pending and licensing new businesses.

4.3.2 Under Pillar 2 - Infrastructure, the Bank seeks to develop national infrastructure and increase access to basic economic and social services by: (i) improving the national road network; (ii) increasing access to water and sanitation; and (iii) bringing electricity access rate up to regional standards and thus addressing one of the main obstacles to business³⁷.

4.3.3 Focus on Outcomes: The results framework is based on a logical relationship between current challenges, strategic goals and outputs, based on the PARPA's development agenda and the MDGs. The Thematic Results Matrix (Table 5)³⁸ represents this inter-dependency and links the CSP and PARPA pillars to the expected results of the Bank's interventions during 2006-09. Successful implementation of the CSP strategy will be measured in terms of ADB contribution to the achievement of country's targeted goals. The CSP M&E instruments are closely aligned with those of PARPA and PAF Matrix (refer to chapter 5.1).

³⁷ According to the Doing Business Report 2005 of the World Bank (refer to Graph 6).

³⁸ Refer also to Annex XIV for a more detailed matrix.

Table 5: Thematic Results Matrix

Longer Term Strategic Goals	Medium Term CSP Outcomes				Bank Priorities and Performance	
RMC development Goals	Sector-related Issues	CSP Outputs and Outcomes	Indicators	Actions	Bank Intervent.	Measuring Bank Performance
CSP Pillar 1: Governance through Budget Support						
1. Macroeconomic Reforms						
<p>Ensure a rigorous macroeconomic management and competent management of public finance, budget and investment resources.</p> <p>(applicable baseline indicators: - Rev/GDP = 14% - % budget allocated to prior. areas = 64%)</p>	<p>Weak management, execution and monitoring of State resources.</p>	<p>Enhance efficiency and effectiveness of State funds management.</p> <p>Appropriate budget allocation to PARPA priority sectors.</p> <p>Integration and harmonization of planning and evaluation instruments.</p>	<p>Ratio fiscal revenue/GDP increased to 15% as previewed in the PARPA II.</p> <p>e-SISTAFE implemented in all Ministries and roll-out of basic functionalities (treasury, budget execution and accounting) as set in the 2006-08 action plan.</p> <p>65% of total budget allocated for PARPA priorities in 2006 (values for 2007 to 2009 according to targets set in PARPA II).</p>	<p>Support macro-economic and public finance management reforms.</p>	<p>Budget Support - Governance III.</p>	<p>Annual Review of the Economic and Social Plan (PES).</p> <p>Progress Reports on the implementation of e-SISTAFE.</p> <p>Annual Reviews of Economic and Social Plans, Quarterly Budget Execution Reports and OE.</p>
2. Public Sector Reforms						
<p>Improve the quality of public services delivered to the citizens.</p>	<p>Capacity constraint of civil service.</p> <p>Under-skilled staff and inconsistent incentives framework.</p> <p>Weak national procurement system.</p> <p>Significant levels of corruption.</p>	<p>Rationalization and functional restructuring (e.g. decentralization) of Ministries.</p> <p>Salary reform and improvement of incentives framework.</p> <p>Transparency and efficiency of procurement system.</p> <p>Implement responsive, participatory, transparent and accountable anti-</p>	<p>CFMP restructuring plans implemented in the MISAU, MEC, MINAG, MIC, MAE, MPD, MF and new decentralization policy adopted.</p> <p>New salary reform system (SII) implemented at national level, with a decrease of wage bill as % GDP.</p> <p>New procurement regulation implemented to district level by 2007 and connected with e-SISTAFE.</p> <p>Supervision Unit for Public procurement created, budgeted and operating by 2006.</p>	<p>Support public administration procurement reforms and anti corruption programs.</p>	<p>Budget Support - Governance III.</p>	<p>Progress Reports on the Public Sector Reform Program.</p> <p>Progress reports on the Action Plan for Procurement Reform and decrees approving the new regulations.</p> <p>Anti Corruption Survey Report and Decree of the Council of Ministers.</p>

		corruption programs and services.	Recommendations of completed corruption survey implemented through short-medium term anti-corruption strategic plan and disseminated to the public.			Donors Joint Review and Mid-Term Review and PAF matrix.
3. Legal and Judicial Reform						
Consolidate an effective, accessible and transparent legal and justice system and guarantee the protection of property and land use rights. (applicable baseline indicators: - # of judicial verdicts reached:42% - number of days to register a company: 153).	Limited human and institutional capacity. Outdated legal codes that impede business and economic development. Slow progress in clearing judicial cases pending and licensing new businesses.	Increase efficiency in provision of legal and justice services.	50% of judicial verdicts reached. Approval and implementation of revised Civil Procedure Code, Penal Procedure Code, Penal Code and Notary Code, Commercial Code, Civil and Bankruptcies Process Code and Labor Law. Number of days to start a business reduced to 90. 95% of processes regarding the attainment of the rights for land tenure authorized in 90 days.	Support law reforms and sector capacity building.	Budget Support - Governance III.	Progress reports on training activities. Approved Strategic Plan for Legal Sector Reform. Decrees approving the new legal codes. Donors Joint Review and Mid-Term Review and PAF matrix.
CSP Pillar 2: Infrastructures						
1. Infrastructure						
Rehabilitation, upgrading and maintenance of transport, power and water infrastructure in the rural areas. (applicable baseline indicators: - roads in good condition: 70% - pop. with access to safe water 42% - Electricity access rate 6%)	National Road Network in poor condition; High transportation and maintenance costs Limited or no access to safe water and sanitation services, especially in rural areas. Limited access to electricity and low reliability of supply	Improve national road network – to reduce transport costs, time and maintenance costs. Sustainable increase in access to water and sanitation. Increase access to electricity effective supply and lower losses of production.	Increase to 75% of road network in good and reasonable conditions. Increase to 45% of population with access to safe water and to sanitation services. New 30.000 domestic electrical connections.	Support the development of regional transport corridors. Support the rehabilitation, maintenance and development of basic socio-economic infrastructure.	Montpuez Lichinga Road. ADB Water Initiative RWSSI. Rural Electrification – Electricity IV.	Monitoring by PiUs. Donors Joint Review and Mid-Term Review. Poverty Observatories. Project Completion Report. Country Portfolio Review.

4.3.4 In addition to the projects/pillars' specific impact (highlighted in Table 5 - Thematic Results Matrix), the ADB support strategy can also be assessed in terms of contributing to the overall goal of poverty reduction. Hence, for the next four years, it can be estimated that, under the model assumptions described in Annex XVI, between 25,000 and 36,000 Mozambicans will no longer live under poverty due to ADB activity.

4.4 Regional Dimensions of Bank Group Assistance

The Bank Group's strategy also aims to promote economic cooperation and regional integration of RMCs. The indicative pipeline of projects will enhance regional integration activities. The Montepuez-Lichinga Road will reinforce the Nacala corridor, the Electricity IV will strengthen the transmission distribution system in the central provinces and thus facilitate electrical integration with the Malawian electricity network, and the Third Program of Economic Reform and Good Governance for the Reduction of Poverty (PER GROPIII) will address some of the investment climate constraints therefore contributing to attract more foreign investors into the country. Additionally, the Bank Group's NEPAD unit plans to co-finance the Mozambique-Malawi Interconnector project, the construction of an electricity transmission line from Cahora Bassa hydroelectric power station to the Malawi border. Other priority NEPAD regional projects that the Bank, together with GoM, is discussing are the Nacala Port Rehabilitation and the Mebanda Uncua Hydropower projects. Additionally, the Bank recently approved, through its multinational financing window, a shared watercourses support project/study for Buzi and Save (with Zimbabwe), and Rumuva (with Tanzania) River basins, that may foster new regional interventions.

4.5 Bank Group Assistance: Performance-Based Resource Allocation, Performance Criteria, and Lending and Non-Lending Activities

4.5.1 Portfolio Lending Summary: The Bank Group has, since operations began in Mozambique in 1977, approved fifty three projects, six policy-based programs and eleven studies. Total commitments stand at UA 914 million of which UA 783 million were from ADF resources, UA 125 million from ADB resources and UA 7 million from NTF resources. Of the seventy approved operations, twenty four are at present on going with a total commitment of UA 352 million, and a disbursement rate of 42%. Agriculture (36%) and public utilities (25%) are the most active sectors and together are responsible for a total commitment of UA 196 million. Mozambique's current portfolio distribution across sector, apart from Agriculture, which has 12% more than the Bank's average, is broadly in line with the Bank's portfolio. Additionally, through its private sector window, the Bank has approved two projects, namely the MOMA Titanium Minerals Project, in May 2003, for an amount of UA 31 million, and the SASOL Gas Pipeline Project, in October 2003, for an amount of UA 52 million. In terms of the size of the portfolio within the Bank, Mozambique is the fifth most supported country with 4.8% of the Bank's (ADF) total portfolio.

4.5.2 Assistance Scenarios: Bank Group's assistance to Mozambique consists of project investments and policy and institutional based support funded by the ADF-X allocation for 2005-07, which is made on the provision of 100% loans, and as yet to be determined ADF-XI allocation (for 2008-09). The total indicative ADF-X allocation for Mozambique is UA 178 million (a 120% increase from the ADF-IX allocation)³⁹. The existing enhanced Performance-Based Allocation (PBA) system, which derives from the score Mozambique generates in the annual Country Policy and Institutional Assessment (CPIA), constitutes the basis for allocating resources annually. Actual

³⁹ The biggest ADF country allocation increase for countries with allocations above UA 50 million.

allocation will also depend on Mozambique's: (i) overall performance; (ii) performance relative to that of other ADF countries; (iii) the amount of overall resources available to ADF; (iv) changes in the list of active ADF-eligible countries; and (v) the terms of financial assistance provided. The evaluation of the GoM's capacity to attain performance benchmarks envisages to address policy and institutional weaknesses identified in the CPIA (refer to chapter 4.5.3) and CPR (refer to chapter 4.5.5).

4.5.3 **Performance Benchmarks** may act as leverage factors to improve the institutional and policy performance of the country, as well as to increase Mozambique's share of ADF resources, if well managed and addressed. The country's performance has improved since the 2003 CPIA. The 2004

evaluation under CPIA was satisfactory, placing Mozambique at the second quintile among 53 RMCs. The rating placed Mozambique at the first quintile in terms of Portfolio Performance and revealed significant improvements on Economic Management and Structural Policies. However, Policies for Social Inclusion (Cluster C) and

Public Sector Management (Cluster D) should be more thoroughly addressed. In addition to CSP M&E instruments, the Bank will therefore closely monitor and assess Clusters C and D performance using the targets contained in Table 6, which are derived from the PARPA II and the annual donor joint reviews.

Graph 8: CPIA (2004)

First Quintile	First Quintile	First Quintile	First Quintile	First Quintile	First Quintile	First Quintile
Second Quintile	Second Quintile	Second Quintile	Second Quintile	Second Quintile	Second Quintile	Second Quintile
Third Quintile	Third Quintile	Third Quintile	Third Quintile	Third Quintile	Third Quintile	Third Quintile
Fourth Quintile	Fourth Quintile	Fourth Quintile	Fourth Quintile	Fourth Quintile	Fourth Quintile	Fourth Quintile
Fifth Quintile	Fifth Quintile	Fifth Quintile	Fifth Quintile	Fifth Quintile	Fifth Quintile	Fifth Quintile
Cluster A - Economic Managt.	Cluster B - Structural Policies	Cluster C - Policies for Social Inclusion	Cluster D - Public Sector Managt.	Governan. Factor	Country Portfolio Perform.	Overall Rating

Table 6: Reference Framework to Determine Performance

CPIA 2004 Weaknesses	Objectives, Structural Reforms and Actions	Performance Indicators and Benchmarks (2006-2007)	Means of Verification
Policies for Social Protection and Inclusion			
Gender equity	Promotion of equal rights and integration of gender in poverty reduction strategies	Gender Policy and Gender Implementation Strategy approved and initiated by 2006, implemented in PARPA areas by 2007 (all sectors by 2008).	Donor Joint Review (DJR)
Building human resources	Education Strategic Plan for 2005-2009 Expand access to quality basic health services Reduce number of new HIV infections	Net Enrol. Rate EP (1+2)= 85% and 88% by 2006/07 Completion rate (EP2)= 82% and 86% by 2006/07 Utilization rate – prof. consultations/inhabitant/year= 0.94 and 0.95 by 2006/2007 % and number of HIV + pregnant women receiving treatment in the last 12 m = 10% (16 000) by 2006	DJR/PAF
Public Sector Management			
Property rights	Improve legal framework for securing property and contract rights	Law reforms on private property, access to land and civil and commercial codes	DJR/PAF
Efficiency of revenue mobilization	Tax reform – strengthening tax administration and increase taxes collected	Total revenue as % of GDP= 14.8% and 14.9% by 2006/07	DJR/PAF
Quality of public administration	Progress in Public Sector Reform Rationalization and decentralization of state functions Review the wage and incentives system (SII) Public finance decentralization (CFMP)	Restructuring plans implemented in line ministries: according to PARPA targets for 2006/09 New SII implemented at national level: according to PARPA targets for 2006/09 Decentralization policy adopted according to PAF targets for 2006/08	DJR/PAF
Transparency, accountability & corruption in public sector	Improve coverage and function of internal and external auditing Implement Strategy to fight corruption	% of districts and municipalities audited by IGF= 20% and 50% by 2006/07 Number of financial audit reports done by the Court of Auditors= 70 by 2006 Increased number corruption cases concluded by Anti-corruption Unit	DJR/PAF

4.5.4 Non-lending Activities: Most of the Bank's non-lending activities will precisely concentrate on Cluster C and D constraints. The Gender Profile Report (2004) and Country Governance Profile (2005) will be two important instruments for the envisaged dialogue and follow up activities.

4.5.5 Portfolio Performance Improvement Measures: Monitoring the implementation of the Bank Group's portfolio, through the 2005 CPR Action Plan and its updates, will also form a performance benchmark. Overall, in order to improve the portfolio's performance, the following key efforts need to be undertaken: (i) to reinforce the mechanism for reviewing procurement and payment documents; (ii) reduce delays in fulfillment of grant conditions to make grants effective; (iii) enforce timely release of counterpart funds; (iv) enforce timely transmission to the Bank of quarterly reports, financial bid evaluations and audit reports; (v) strengthen PiU's capacity; (vi) improve communications between PiU, MF, BoM and the Bank and make use of the Regional Office facilities to institutionalize a periodic dialogue mechanism with task managers; (vii) set up a system to monitor and follow up all project related observations and recommendations contained in supervision missions *aide mémoire*; and (viii) organize internal portfolio reviews and transmit the review reports to the Bank for information. The Bank should also make an effort to: (ix) streamline loan conditions; (x) improve project design (staffing, costs, timeline, outputs) and discuss it more extensively with all relevant stakeholders (GoM, beneficiaries, if possible the likely PiU); (xi) organize more often training sessions in procurement and financial management; (xii) ensure a minimum task manager turnover rate; (xiii) increase number of Bank staff fluent in Portuguese; and (xiv) increase cooperation, harmonization and coordination with donors; and (xv) review more systematically the portfolio.

4.5.6 Private Sector Operations: The Bank has so far approved the Moma and Sasol projects that together account for 9.3% of Bank's private sector portfolio. With the ongoing reforms and investments (some of them supported by the ADB public sector projects) to promote an enabling environment for private sector development, the Bank is hopeful that further projects would be identified and financed in the future. The GoM is promoting public-private partnerships in infrastructure, eco and cultural tourism⁴⁰, and industrial development that will generate viable private sector projects for ADB financing in support of local private investors. Assistance for the strengthening and diversification of the financial sector could also be considered through lines of credit or equity participation in investment funds.

4.6 Partnership and Harmonization

4.6.1 The current operations that have been co-financed with other development partners include: (i) Mineral Resources Management Project with the World Bank, the Nordic Development Fund (NDF) and the Government of South Africa (RSA), (ii) Financial Sector Technical Assistance Program with the World Bank and the GTZ/KfW, (iii) Energy Reform and Access Project with the World Bank, and

Table 7: ADB Donor Harmonization Track Record

Sectors	Number of Proj. with Cofin.	Co-financiers ...	
		...contribution for Total Proj. Costs	...status within ADB projects
Rural Development	0%	0%	Non existent
Finance & Industry	50%	74%	Project Leaders
Public Utilities	40%	30%	Supporting Role
Transport	50%	14%	Supporting Role
Social Development	20%	13%	Supporting Role
Weighted Average	32%	14%	Residual Role

⁴⁰ The Bank is considering to support a cultural heritage program in the Island of Mozambique.

(iv) Road Rehabilitation and Upgrading Project, the Education IV and Electricity III Project with the OPEC Fund. In addition, there are several other projects in electricity, water and sanitation sectors where bilateral partners are co-financing specific components of projects. On the whole, although co-financiers still have a residual role in ADB projects (14%), the coordination performance is satisfactory and therefore should be leveraged in the future.

4.6.2 Under the CSP period, it is expected that donor harmonization will be enhanced. First, CSP pillars and its M&E mechanisms are based on the PAF Matrix, thus assuring enhanced coordination on donor support and M&E mechanisms. Second, the current strategy and pillar choices took into consideration sectors ability to comply with the Paris Declaration indicators and targets⁴¹. Third, the Bank recently joined the G-18 and will be able to fully participate in donor coordination efforts, particularly at direct budget support level through the PAP framework. The Bank also became a member of a donor group that is in charge of preparing potential JAS for Mozambique. Fourth, with the recent opening of the regional office in February 2006 the Bank will now be able to participate fully in donor coordination efforts on the ground. Fifth, besides the already mentioned joint budget support framework, it is expected that all the remaining projects approved under ADF-X would be co-financed. Under Electricity IV, following the Electricity III arrangement, the Bank will co-finance together with the OPEC Fund. Under Lichinga-Montepuez Road project, the Bank is co-financing with SIDA and is under negotiations with the Japan Bank for International Cooperation for joint financing. The Bank is presently negotiating the co-financement for the RWSSI. Finally, following recent bilateral agreements signed with the donor community, the Bank will have two secondees from DfID and Portuguese Cooperation working in the Bank on Mozambique in 2006.

5. RESULTS-BASED MONITORING AND EVALUATION

5.1 Monitoring of CSP Outcomes and Bank Group Performance

5.1.1 **Government Monitoring and Evaluation:** The PARPA M&E strategy is organized around the following instruments: (i) Economic and Social Plan (PES) and the PES Assessment (BdPES); (ii) Budget Execution Report⁴²; (iii) Annual Report on Impact (RAI) which measures the external performance of public policies; (iv) the PAF Matrix assessed during donor annual reviews; and (v) poverty quantitative and qualitative analysis⁴³. The PARPA II will be monitored both at the central, municipal and district/local level, by the MPD⁴⁴, municipal authorities and district governments.

5.1.2 **Bank Group Monitoring and Evaluation:** Monitoring of CSP outcomes will be undertaken mainly within the PAF framework and donors annual joint reviews. More specific data will rely also on UN progress reports on the MDGs, the IMF's PRGF reviews, and various World Bank analytical reports. Additionally, portfolio and sector reviews, supervision and project completion reports, and particularly compliance with the CPR Matrix Action Plan will also monitor Bank's performance. A mid-term CSP review will be prepared in 2007-08 to determine, based on the performance assessment of 2005-06 period, the progress made towards expected outcomes and whether CSP results and priorities were achieved. This review, in conjunction with the CPIA evaluations, may determine adjustments to ADF-X and ADF-XI resource envelopes for

⁴¹ Refer to Table 4 and Annex XII.

⁴² Its major function is to monitor public expenses used in PARPA implementation. The Public Expenditures Review provides additional information on cost-efficiency analysis.

⁴³ Poverty Observatories and Community Consultation Institutions (IPCC) reports will have significant M&E value.

⁴⁴ Responsible for elaborating the PES/BdPES, the RAI and the municipal BdPES. District governments are responsible for monitoring the service delivery indicators.

Mozambique. The CSP completion report will provide new opportunities to assess lessons learned that feed back into the preparation of the next CSP post-2009.

5.2 Managing Risks

5.2.1 Risks: There are a number of risks that will influence the implementation of the CSP over the forecast period, namely: (i) corruption, lack of sound government regulation, inefficiency in public service delivery and weak institutional and technical capacities; (ii) insufficient resources and poor financial management that might delay and hinder the implementation of the PRS agenda; and (iii) insufficient coordination and harmonization between stakeholders, with a consequent waste of aid resources, duplication of efforts and non-appropriation of the development strategy. In addition there are risks outside GoM's control (exogenous), namely: (i) natural and environmental disasters, (ii) the impact of HIV/AIDS, (iii) external shocks (e.g. rise in oil prices), and (iv) reduction of external funding.

5.2.2 Mitigation: Mitigating measures that can help reduce the impact of **risks under the GoM's control** include improving governance, undertaking sector, economic and structural reforms in order to address institutional bottlenecks. Bank's interventions under Pillar 1 – Governance and the envisaged non-lending activities address some of these issues. Within the PAF framework, Bank's DBS operations should be designed taking into consideration GoM constraints and also progress made in the reform efforts. Endogenous risks could also be mitigated if donors' projects are registered in the national budget⁴⁵ and if more aid is channeled through DBS. The current Bank's efforts in implementing the PD will assist and encourage other donors to do so. Donor commitments to Mozambique are essential for the PARPA and CSP effectiveness and the Bank should play an important role in mobilizing resources and foster donor harmonization. Although harder to forecast and to manage, **exogenous risks** can be mitigated mainly with international development partners' support. Interventions such as providing emergency/disaster relief, support regional integration and access to foreign markets, as well as strengthening budget support could mitigate such risks. Also the continued implementation of the National Strategic Plan on HIV/AIDS will help to mitigate HIV/AIDS impact. Regarding **ADB operations risks**, the Bank shall improve quality-at-entry of new operations and training PiUs staff in Bank Group rules and procedures. Chapter 4.5.5 describes the measures to improve Bank's Group operations in the country.

5.3 Country Dialogue Issues

5.3.1 Macroeconomic and Structural Policies: Dialogue will focus on the importance of GoM continuous effort to promote growth and macroeconomic stability, attract larger investment inflows, through efforts to improve fiscal policy and reforms, ongoing monetary discipline and progress in debt sustainability. The efforts under the HIPC and MDRI initiative also need to be continuously considered, as well as public expenditure and financial sector management (refer to chapter 4.5.4). Dialogue should also focus on improving service delivery and policies for social inclusion, investment in infrastructure rehabilitation, capacity building to respond to external shocks, such as the recent rise in oil prices.

5.3.2 Good Governance: The implementation of the good governance agenda should be assessed and discussed with relevant authorities. Conclusions from the CGP show that the Bank can have a major role in supporting this effort.

⁴⁵ Approximately 30% is still off budget, that is, outside MF control.

5.3.3 Private Sector Development: The improvement of the business climate and investment environment indicators, the flexibility and competitiveness of the labor, land, and capital markets and natural resources management, as well as the promotion of high potential sectors such as transport infrastructure, tourism, new mega-projects and agro-business opportunities should also be discussed with the GoM.

5.3.4 Portfolio Management: As explained in both sections 4.1 and 4.5, efforts to maintain sound portfolio management, procedures, mechanisms and possible solutions for identified weaknesses should be discussed and implemented jointly by the Bank and the relevant GoM institutions.

5.3.5 Donor Coordination: The 2006-09 CSP is closely integrated with the PARPA and the PAPs PAF. Besides harmonizing M&E mechanisms, PAPs should also: (i) make more efforts in expanding the aid effectiveness of PAPs portfolio (predictability of disbursements and technical assistance should be reinforced); (ii) further integration of external funds in GoM budgetary systems; (iii) eliminate inconsistencies between bilateral agreements and the MoU; and (iv) improve overall harmonization and alignment.

6. CONCLUSION AND RECOMMENDATION

6.1 Conclusion

The GoM's PARPA 2006-09 sets out the priority areas that are expected to help increase real GDP growth and reduce poverty by focusing on: (i) good governance; (ii) human capital; and (iii) economic development. While there are several constraints that stand in the way of achieving the PARPA goals, government is committed to tackling them. The Bank Group's 2006-09 CSP is designed to tie-in with the PARPA and help reduce poverty by selectively focusing on key areas. The Bank Group, in consultation with GoM, donors and stakeholders, has chosen to support interventions in governance and infrastructure.

6.2. Recommendation

The Boards of Directors are requested to consider and approve the proposed strategy of activities and interventions contained in the Mozambique 2006-09 CSP, and the proposed three-year level of assistance as proposed under Mozambique's ADF-X annual allocation of UA 178 million, which is based completely on loans. The remaining two years of the CSP will be funded by the yet to be confirmed ADF-XI allocation.