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Report No.: 22480

PERFORMANCE AUDIT REPORT

MOZAMBIQUE

**BEIRA TRANSPORT CORRIDOR PROJECT
(CREDIT 2065-MOZ)**

**MAPUTO CORRIDOR REVITALIZATION (TECHNICAL ASSISTANCE) PROJECT
(CREDIT 2454-MOZ)**

**FIRST ROAD AND COASTAL SHIPPING PROJECT
(CREDIT 2374-MOZ)**

June 27, 2001

Sector and Thematic Evaluation Group
Operations Evaluation Department

Currency Equivalents
Monetary Unit = Metical (MT)

(MT/US$, period average)

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
745	929	1,435	2,517	3,874	6,039	9,024	11,294	11,655	12,180

Weights and Measures
Metric System

Fiscal Year of Borrower
January 1 – December 31

Abbreviations and Acronyms

AfDB	African Development Bank
BCA	Beira Corridor Authority
BTCP	Beira Transport Corridor Program
CAS	Country Assistance Strategy
CFM	Caminhos de Ferro de Moçambique
CFM(C)	Caminhos de Ferro de Moçambique (Centro)
CFM(N)	Caminhos de Ferro de Moçambique (Norte)
CFM(S)	Caminhos de Ferro de Moçambique (Sul)
CIDA	Canadian International Development Agency
DANIDA	Danish International Development Assistance
DGIS	Direktoraat Generaal Internationale Samenwerking
ERP	Economic Rehabilitation Program
ERR	Economic rate of return
FINNIDA	Finnish International Development Agency
GOM	Government of Mozambique
IDA	International Development Association
MIS	Management information system
MT	Metric ton (1000 kg)
NEI	Netherlands Economic Institute
NORAD	Norwegian Agency for Development Cooperation
NRZ	National Railways of Zimbabwe
OECF	Overseas Economic Cooperation Fund
RITES	Rail India Technical and Economic Services
ROCE	Return on capital employed
SADCC	Southern Africa Development Coordination Conference
SADC	Southern Africa Development Community
SAR	Staff Appraisal Report
SIDA	Swedish International Development Authority
TA	Technical assistance
TEU	Transport equivalent unity
ODA	Overseas Development Administration
UNDP	United Nations Development Program
USAID	United States Agency for International Development

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

June 27, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Mozambique
Beira Transport Corridor Project (Credit 2065-MOZ)
Maputo Corridor Revitalization (Technical Assistance) Project (Credit 2454-Moz)
First Road And Coastal Shipping Project (Credit 2374-Moz)

Attached is the Performance Audit Report (PAR) prepared by the Operations Evaluation Department on three transport projects in Mozambique: Beira Transport Corridor Project (Credit 2065-MOZ; approved in FY90, closed in FY97); Maputo Corridor Revitalization (Technical Assistance) Project (Credit 2454-MOZ; approved in FY93, closed in FY99); First Road and Coastal Shipping Project (Credit 2374-M0Z; approved in FY92, closed in FY00). All three projects closed one year behind scheduled. A total of US$110 million equivalent was disbursed, and US$13.3 million was cancelled at closing.

All three projects were designed to help Mozambique regain its status as the main international transit route in Southern Africa and recover from the long civil war and from economic and social stagnation. The projects were identified and prepared under difficult political and economic circumstances. There were significant implementation risks, but a peace agreement in 1992 between the government and the rebel group, RENAMO, ended the 15-year civil war and removed the major project risk.

The Beira Transport Corridor Project was part of a multi-donor, 10-year program to rehabilitate the transport infrastructure in the Beira Corridor. In 1986, a group of 18 bilateral and multilateral donors, including the Bank, formulated the Beira Transport Corridor Program (BTCP) to assist in the rehabilitation and upgrading of the port, rail and road facilities, and to provide technical assistance and training for implementing the program and managing the corridor. The Bank's main role in this multi-donor program was to provide financing for technical assistance and manpower development and training. The BTCP enjoyed extensive donor support and strong government ownership. The Beira Corridor Authority, the implementing agency, took a lead role in facilitating donor coordination during project preparation and implementation.

The Maputo Corridor Revitalization Project was a technical assistance project to assist the government improve the performance of CFM-South (Mozambique Rail and Port Company) through private sector participation in the management and financing of the Maputo port and its connecting railway system. But unlike the Beira project, the Maputo project lacked donor support and government ownership. Many donors were skeptical of the master-lease/concession scheme proposed by the Bank. Similarly, the government and CFM preferred organizational restructuring and improving the system within a public sector framework than the concessioning scheme.

At the end, all parties agreed that the optimal reform option would be determined through a consultant study financed under the project.

The First Roads and Coastal Shipping Project (ROCS1) aimed at improving transport infrastructure and services through selective rehabilitation and maintenance of key roads and small ports, and increasing the capacity of the trucking and coastal shipping industries. However, the 1992 peace agreement changed the original project rationale. The emphasis on coastal shipping was substantially curtailed and more focus was given for emergency assistance to repair war-damaged roads and bridges and to integrate the country after the civil war. In addition, the project, together with the follow-on ROCS2 project, promoted a sustainable institutional framework for managing and financing roads.

The PAR rates the outcome of the three projects *satisfactory,* institutional development *high* for the Maputo Corridor Revitalization project, and *substantial* for the Beira Transport Corridor project and First Roads and Coastal Shipping project, and sustainability as *likely.* These ratings are the same as the ICR ratings, except that the PAR upgrades the institutional development rating for the Maputo Corridor project from substantial to high. The project's significant contribution to the promotion of private sector participation in the port sub-sector warrants the upgrade. The PAR further rates Bank and borrower performance *satisfactory*, the same as the ICR rating.

Experience with this project confirms a number of OED lessons. First, *privatization is a learning process.* It is a complex undertaking and government officials learn how to do it on the job. As the concept is foreign to many officials in developing or formerly socialist countries, exposure to early success stories in the country and outside is crucial.

Second, *the particular private sector participation option is determined by the government's political readiness.* While some reforms are better than others at improving the transport sector more readily and eliciting maximum private investment, the reform option adopted depends on the readiness of the government for the particular reform option and its capacity to carry out the chosen option.

Third, *negotiations between the conceding authority and the preferred bidder can improve the terms of concession when response from competitive tendering is inadequate.* Ex-post negotiations are often considered inappropriate because they could be vulnerable to non-transparent behaviors and unfair to losing bidders, especially if original tender conditions are relaxed during the course of negotiations. However, when the tendering process results in few bidders, as in the case for the Maputo port concession, negotiations can be used to get advantageous concession terms and minimize the monopoly/cartel position of the potential concessionaire.

Attachment

Contents

This report was prepared by Binyam Reja (Task Manager) who audited the report in December 2000 and reviewed by Hernan Levy and Klas Ringskog. William B. Hurlbut edited the report. Romayne Pereira provided administrative support.

Principal Ratings

Beira Transport Corridor Project (Credit 2065-MOZ)

	ICR	OED/ES	OED/PAR
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Uncertain	Likely
Institutional Development	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Maputo Corridor Revitalization (Technical Assistance) Project (Credit 2454-MOZ)

	ICR	OED/ES	OED/PAR
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development	Substantial	Substantial	High
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

First Roads and Coastal Shipping Project (Credit 2374-MOZ)

	ICR	OED/ES	OED/PAR
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Key Staff Responsible

Beira Transport Corridor Project (Credit 2065-MOZ)

	Task Manager	Division Chief	Country Director
Appraisal	D. Graham	Isaac Sam	Sven Sandstrom
Completion	Yash. P. Kedia	Yusupha B. Crookes	Phyllis R. Pomerantz

Maputo Corridor Revitalization (Technical Assistance) Project (Credit 2454-MOZ)

	Task Manager	Division Chief	Country Director
Appraisal	Naa Dei Nakoi	Phyllis R. Pomerantz	Stephen Denning
Completion	Yash. P. Kedia	Yusupha B. Crookes	Phyllis R. Pomerantz

First Roads and Coastal Shipping Project (Credit 2374-MOZ)

	Task Manager	Division Chief	Country Director
Appraisal	Carlos Alvarez	Isaac K. Sam	Stephen Denning
Completion	Abdelmoula M. Ghzala	Yusupha B. Crookes	Michael N. Sarris

Preface

This is a Performance Audit Report (PAR) of three transport projects in Mozambique: Beira Transport Corridor Rehabilitation Project (Credit 2065-MOZ, approved in FY92), Maputo Corridor Revitalization Project (Credit 2454-MOZ, approved in FY93), and the First Roads and Coastal Shipping Project (Credit 2374-MOZ, approved in FY92).

The PAR was prepared by the Operations Evaluation Department (OED). In November 2000, an OED mission traveled to Mozambique to discuss the projects with relevant government officials, representatives from the private sector, labor groups, beneficiaries, professional and trade organizations, and Bank staff in charge of the projects at headquarters and the country office. The kind cooperation and invaluable assistance from all the people consulted are gratefully acknowledged. OED staff also reviewed the President's Reports, Staff Appraisal Reports (SARs), Implementation Completion Reports (ICRs), transcripts of Board proceedings, project correspondence files, Bank documents on other transport projects, and other Bank and non-Bank materials.

The audit largely agrees with the ICR ratings. All three ICRs were of good quality, exercised fair judgment, and identified useful lessons. The PAR adds value to the ICRs by focusing on Mozambique's experience with promoting private sector participation in the transport sector and by drawing lessons of broad applicability from the experience.

Following standard OED procedures, copies of the draft PAR was sent to the relevant government officials and agencies for their review and comments. Comments received are attached as Annex E.

1. Introduction and Background

1.1 The three audited projects, the *Beira Transport Corridor Project, Maputo Corridor Revitalization Project,* and *First Road and Coastal Shipping Project,* were designed to support Mozambique's effort to regain its status as the main international transit route in Southern Africa and to help it recover from the long civil war and a period of economic and social stagnation. The projects comprised physical investments and institutional development support to rehabilitate the transport systems and to promote market-oriented reforms.

1.2 Mozambique's geography determines its economic destiny. The three main transport corridors (Nacala, Beira, Maputo) provide the main source of foreign exchange and generate the largest formal employment in the country. They serve as international transit routes for the landlocked neighbors (Zimbabwe, Zambia, Malawi, Swaziland, and Botswana) and for the northeastern part of South Africa. Before independence in 1975, the transport sector earned US$110 million a year in foreign exchange revenues and financed 90% of the country's trade account deficits on the balance of payments. After independence, however, a combination of internal conflict, regional politics, and a debilitated and poorly managed transport system discouraged the neighboring countries from using Mozambique's ports and surface transport system for their international trade transit. Consequently, transit traffic in Mozambique declined from around 20 million tons of freight in 1973 to 4.7 million tons in 1987. This substantial loss of transit traffic plunged the Mozambican economy into a deep recession and precipitated a downward spiral of the GDP, which, in 1986, stood at two-thirds of the 1974 level.

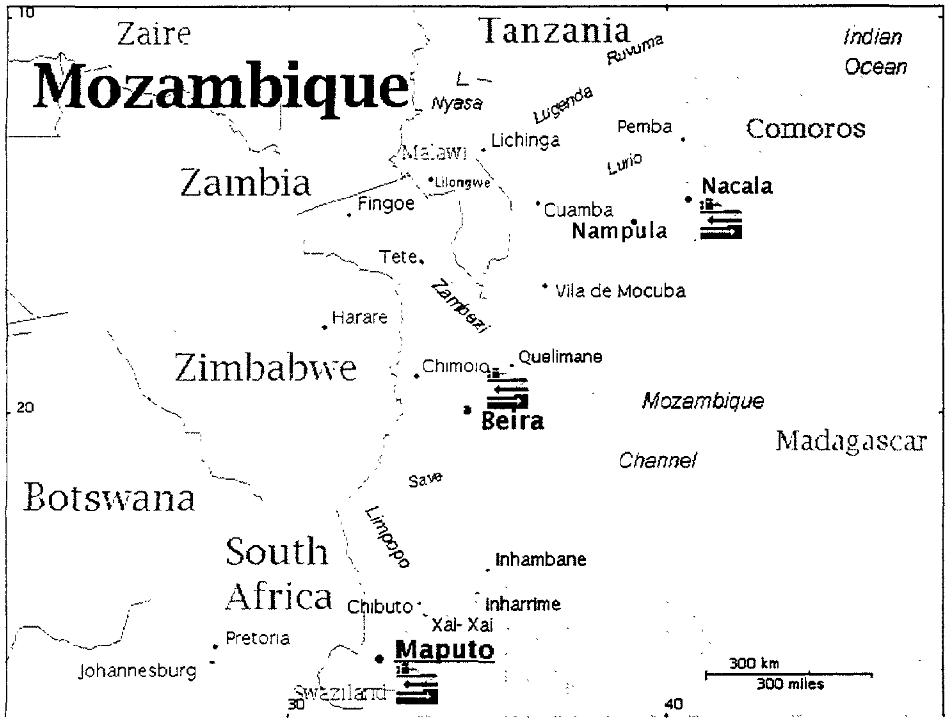
1.3 Mozambique joined the World Bank Group in 1984 and in 1987 launched an Economic Recovery Program (ERP) to reverse the decline in GDP and to rehabilitate the country's economic and social infrastructure. The rehabilitation of the three main transport corridors (Nacala, Beira, and Maputo) was a key component of the ERP.

1.4 Mozambique's GDP grew at an average of 10% per year between 1995 and 1999, assisted by peace and stability prevailing in the country. In 1999, GDP per capita was US$230. Economic reforms begun in the mid-1980s have allowed Mozambique to qualify for $3.7 billion in debt relief. The rapid economic growth reflects recovery in part from extremely depressed levels rather than progress on a firmly established growth path.

The Transport Corridors

1.5 Mozambique's three transport corridors consist of integrated railways and port facilities and serve primarily regional transit traffic. The corridors are distinct geographical segments with no inter-connection. (see graph 1). The corridors are managed and operated by CFM (Mozambique Railways and Ports Company) and its regional companies.

Figure 1: Mozambique Transport Corridors



Maputo Corridor

1.6 The Maputo Corridor commands the greatest traffic potential. The Maputo Corridor system, operated by CFM-Sul, comprises the main Port of Maputo and Port of Matola and three rail connections with the port. The port presently handles about 3 million tons and 35,000 teu's per year. It is the only port in Southern Africa that can handle significant incremental traffic without major capital expansion.

1.7 The three rail connections include the 88-kilometer-long Ressano Garcia Line linking Maputo with RSA, the 68-kilometer-long Goba Line connecting Maputo Port with Swaziland, and the 534-kilometer-long Limpopo Line linking Maputo with Zimbabwe.

Beira Corridor

1.8 The Beira Corridor system, operated by CFM-Centro, comprises the Port of Beira, and two rail connections with the port, and an oil pipeline to Zimbabwe. The Beira Port presently handles 2.2 million tons and 35,000 containers per year. The Port of Beira has an annual capacity of 3 million tons. The two rail connections include the 317-kilometer-long Machipanda Line linking Beira with Zimbabwe and the 331-kilometer-long Sena Line linking Beira with Moatize and Malawi. The Sena Line has not been in operation since 1984 when it sustained heavy damage during the war. The Machipanda Line has a theoretical annual capacity of 2 million tons and presently handles over 0.8 million tons per year. The port has general cargo, container cargo, a coal terminal and a pre-cooling plant. The oil terminal can handle tankers up to size 50,000 DWT (dead weight tons). The pipeline currently pumps about 1 million tons of oil products to Zimbabwe.

Nacala Corridor

1.9 The Nacala Corridor, operated by CFM-Norte, comprises the Port of Nacala and a 615-kilometer-long rail link to Malawi. The Nacala Port presently handles about 675,000 tons and 25,000 teu's per year. The rail line presently carries 350,000 tons per year. The port of Nacala is the best natural deep-water harbor in East Africa.

CFM – Portos e Caminhos e Ferro de Mocambique

1.10 CFM controls both the railway and port system in Mozambique. CFM is the biggest formal employer with more than 18,000 staff. These figures are significant when it is realized that only 95,000 of Mozambique's 7 million adults are formally employed.

1.11 Before 1989, CFM was part of DNPCF, a Directorate in the Ministry of Transport and Communications. CFM became an autonomous state company in January 1989, to make the company financially viable as soon as possible. A major step toward commercialization was taken when CFM was transformed into a public company in January 1995 as a separate legal entity with administrative and financial autonomy operating under the subordination of the Ministry of Transport and Communications.

2. Project Objectives and Relevance

Beira Transport Corridor Project Objectives

2.1 The Beira Transport Corridor Project was part of a multi-donor, 10-year program to rehabilitate the transport infrastructure in the Beira Corridor. In 1985, the government of Mozambique established the Beira Corridor Authority (BCA) to plan and oversee the rehabilitation and upgrading of the corridor through donor funding. In 1986, a group of 18 bilateral and multilateral donors, including the Bank, formulated the Beira Transport Corridor Program (BTCP) to assist in the rehabilitation and upgrading of the port, rail and road facilities, and to provide the technical assistance and training for implementation of the program and management of the corridor.

Relevance of the Project objectives and Coherence of Components

2.2 The BTCP was an important and relevant program for the economic recovery program of the country. It was consistent with the Bank's assistance strategy in Mozambique to provide support for the establishment of a basis for sustainable growth. The BCTP was designed to reduce transport costs and allow Beira to regain its cost-effective trading route for neighboring countries, and generate vital foreign exchange and productive employment for economic recovery.

2.3 The Bank's main role in the multi-donor program was to finance technical assistance and manpower development and training, which the BCA was not able to secure funding from the other participating donors. The support was designed to increase CFM-C's capacity to manage the ports and railways under its purview, and to assist BCA to implement the 10-year rehabilitation and upgrading program for the Beira transport corridor. The manpower development and technical assistance program were crucial in providing the needed skills to carry out the day-to-day management of the ports and railways and the implementation of the BTCP.

Donor Coordination and Government Ownership

2.4 The BTCP enjoyed extensive donor support and strong ownership by the government, especially BCA. Extensive donor coordination and consultation with the government took place before the launching of the program. The BCA took a lead role in facilitating donor coordination.

The Maputo Corridor Revitalization Project Objectives

2.5 Approved in 1992, the Maputo Corridor Revitalization Project was a technical assistance project designed to assist the government to restructure CFM-S to improve its long-term efficiency. The Maputo project's primary focus was on curtailing the government's role in the transport sector and on increasing the participation of the private sector in the management, operation, and financing of the transport system in the Maputo corridor.

2.6 The rationale for this approach was threefold: First, Mozambique's fiscal situation and the competing demands for its scarce resources, especially the post-conflict demands of the social sectors, meant that the government had inadequate resources to improve the transport system, and that the private sector was the best option to secure financing for rehabilitating the debilitated infrastructure. Second, experience elsewhere suggests that public sector–oriented investments and restructuring are ineffective in improving the operational efficiency of ports and railways. Third, regaining the confidence of the shippers in the region and reversing the competitive disadvantage of the Maputo corridor vis-à-vis other transit routes (especially Durban, South Africa) requires aggressive marketing strategies, which could only be attained by introducing private sector incentives and profit motives.

2.7 Within this context, the Bank approved the project to: (i) facilitate the government's divestiture of direct involvement in the port and railway system in the corridor on commercially advantageous terms and establishment of a regulatory regime, (ii) assist government in staff rationalization program and in ensuring that retrenched staff are adequately cushioned against the effects of loss of employment.

2.8 To achieve these objectives, the project comprised investment and financial advisory services; legal advisory services; environmental advisory services; and labor deployment strategy.

Project Relevance

2.9 The objective of improving the performance of the Maputo corridor through private sector participation was relevant in light of the above rationale for the project design. The strategy adopted benefited from strong analytical inputs from the Bank staff involved during project preparation. The Bank's preferred option for private sector participation was in the form of a master lease/concession of the port-railway system.

Donor Coordination and Government Ownership

2.10 Unlike the Beira project, the Maputo project did not enjoy donor support and government ownership. Many donors were skeptical of the master-lease/concession scheme and preferred a different public-private partnership scheme that leaves more residual role for the public sector. Similarly, the government and CFM preferred to undertake organizational restructuring and improving the system within a public sector framework than going to a concessioning scheme. At the end, all parties agreed that the optimal privatization option would be determined through a consultant study financed under the project.

First Roads and Coastal Shipping Project Objectives

2.11 The First Roads and Coastal Shipping Project (ROCS1) aimed at improving transport infrastructure and services through selective rehabilitation and maintenance of key roads and small ports, and increasing the capacity of the trucking and coastal shipping industries. However, shortly after the project became effective in 1992, the peace agreement was signed and changed the original rationale for the project. In particular, the emphasis on coastal shipping was substantially curtailed and more focus was given to providing emergency assistance to repair war-damaged roads and bridges open then for traffic and to integrate the country after the civil war had made some parts of the country inaccessible. In addition, the project, together with the follow-on ROCS2 project, tried to promote a sustainable institutional framework for managing and financing roads.

Relevance of the Project

2.12 The project was prepared when the country was still at war. As such, the original emphasis on coastal shipping was designed to provide an alternative to road transport, which was difficult and unsafe during the war. When the war was over, however, roads were open to traffic and road transport once again became important . The Bank's quick decision to restructure the project in light of the changing country conditions and to provide emergency road assistance was relevant and beneficial for the country.

3. Implementation Experience

Beira Transport Corridor Project

3.1 The project was prepared and approved during a time of internal conflict and difficult political and economic circumstances. There were significant implementation risks and uncertainties whether the goal of restoring Beira traditional transit route would be achieved. Soon after the project was approved, however, a peace agreement was signed between the government and the rebel group, RENAMO, ending the 15-year civil war and removing the major project risk.

3.2 During the 10-year implementation period for the Beira Transport Corridor Program, a number of institutional reforms were undertaken. CFM was transformed from government entity to a public enterprise, comprising the CFM holding company (in Maputo), three regional companies, CFM-North, CFM-Central, CFM-South. The main elements of the institutional reforms were: (i) commercial orientation with a clear emphasis on CFM operating as a commercial company; (ii) encouraging private sector participation and allowing CFM to enter into lease, concession, joint venture, management contract agreements with the private sector; (ii) signing performance contract with the government incorporating, among other things, the mission and objectives of the company, obligations of the government, performance targets for the company, and investment selection criteria; (iv) managerial autonomy in setting of tariffs; and (v) the creation of two management boards – a seven-member management board and a three-member Fiscal Council.

3.3 The project was successfully implemented by the BCA, which provided strong leadership and coordination for implementing the Program in a timely manner. After the completion of the implementation of the program, BCA was dissolved and its responsibilities were transferred to CFM-Central.

3.4 As part of the restructuring of CFM-C, the BCA created "result centers" to delegate authority of operations with accountability for results. Five result centers were created for the port and rail operations. For the port, the result centers were: Multi-purpose and Container Terminal, Oil Terminal, General Cargo Terminal, and Maritime Services. For rail, the Beira Rail was created to operate the Beira-Machiapnda railway line. In addition, a Central Results Center was created to oversee central administrative functions.

3.5 The notion behind the creation of result centers was to increase organizational efficiency by clarifying responsibilities among the different units and delegating operational authority while holding them accountable for results. The creation of the result centers also helped in transforming CFM-C to a commercially oriented public enterprise, and paved the way for introducing private sector participation in port and railway operations.

The Maputo Corridor Revitalization Project

3.6 The implementation of the Maputo Corridor Revitalization project, unlike the Beira project, had a rocky implementation history with many twists and turns. At the outset, the government resisted the Bank's proposal for to concession the Maputo corridor to the private sector. The Bank, based on experience in other countries with the positive results of concessioning and the poor results of public-sector restructuring, believed that a concession would elicit maximum private investment in the Maputo corridor and improve operations more quickly. CFM, however, was not convinced that the master-concessioning strategy was the optimal one. It preferred different reform options, such as experimenting with specific terminal leasing and joint ventures with the private sector and restructuring CFM-S within a public sector context. The Bank, while convinced that its strategy was the better one, agreed with the government to have an international consultant carry out an investigative and analytical study to determine the best reform strategy for CFM-S.

3.7 The divergent approaches between the government and the Bank on the suitable form of private sector participation resulted in poor ownership for the project and delayed project implementation. The government was slow in procuring consultants to carry out the study. And once the consultants were finally on board, there were poor working relationships between the government and the consultants. In fact, as will be shown below, the study turned out to be redundant and served only as an instrument to delay the eventual concessioning of the port-railway system.

Selection of Consultants and Implementation of Studies for Maputo Corridor Revitalization

3.8 Consultants were engaged to assist the government in the tender process for the selection of a firm to conduct the study to determine the optimal reform strategy for the Maputo corridor. The government set up a six-member body called the Inter-Agency Committee (IAC) to oversee the entire process from procuring and managing consultants and planning the implementation of the study recommendations. A representative from the Ministry of Transport and Communications headed the IAC.

3.9 Based on international competitive bidding procedure, six firms were short listed and invited to submit technical and financial proposals. After a lengthy and contentious evaluation process, the government signed a contract with an international consultant that was judged as the lowest-evaluated bidder by the IAC and its external consultant. The Bank gave its no objection to the award.

3.10 As per the terms of reference, the phasing and scope of the consultant services were structured as follows:

> Phase 1 – undertake a detailed analytical study of the market for CFM-South system's services and its competitive position and prospects
> Phase 2 – determination of scope and form of restructuring and commercializing the CFM-South system (and, by corollary, the degree of public sector involvement in the system's management)
> Phase 3 – advisory and support services to GOM and CFM in the implementation of the option chosen by GOM.

Phase1: Analytical Study

3.11 The consultants started the work in 1996, and over a year produced a series of technical reports. But IAC, unsatisfied with the consultants' work, appointed a local consultant to analyze the various reports related to Phase 1 and Phase 2 of the study and make recommendations on how to proceed with the studies. The newly retained consultant, together with a technical team from CFM/IAC, reviewed the documents produced by the consultants and found them to be background reports rather than analyses of the key issues to support the tender process.

Phase 2: Privatization Option Study

3.12 By the time the privatization options study was launched, reform experiences from other parts of the world, especially from Latin America, were coming in and suggesting that the concession model was the preferred option to reform ports and railways. Thus, Phase 2 of the study, which required the determination of the scope and form of privatization on the CFM-South system by presenting various privatization options, seemed redundant. This was clearly a waste of time and the consultants, seeing the developments, made just one recommendation– to concession the rail and port system. One of the important tasks of the consultants was to come up with an appropriate mix and form of public and private participation on the system. But at the end of the day, there were no options to choose from for the government; there was just the concession scheme, which it had to follow.

Phase 3: Implementation of the Chosen Option

3.13 In July 1996, four years after the project was approved, the government decided to go with Phase 3 of the consultant services. Phase 3 was to provide advisory and support services to GOM and CFM in the implementation of the option chosen by GOM. The consultants started the preparation of the transaction documents, which included Information Memorandum, Instructions to Bidders and draft Concession Agreement, for both the rail and port systems.

3.14 At this juncture, the Bank arranged a study tour for a small team from IAC and CFM to visit Argentina, Brazil, and the United Kingdom to have a look at the concessioning schemes implemented in those countries. The experiences of those countries were crucial in developing the concession framework for the Mozambique rail and port system, and helped remove many doubts about the privatization process in general, and about whether concessioning could work in Mozambique.

3.15 The concessioning of the port of Maputo proved to be an extremely complex undertaking The master concession scheme for the Maputo port was proposed in 1992 when the project was first identified. It took the government four years to adopt the concessioning scheme, and another four years to complete the tendering process. The tendering process was long and arduous. It involved the standard competitive bidding and contentious negotiation between the winning bidder and the government. (Annex A and B provide detail analysis of the concessioning process).

First Roads and Coastal Shipping Project (ROCS1)

3.16 The Development Credit Agreement for ROCS1 was amended three times (April 1993, August 1994, and March 1994) to reflect the changing country circumstances and the transport needs of the post-war Mozambique. The end of the civil war made it possible to focus on long-standing policy and institutional issues, as well as long-term investment programs. ROCS1 was mainly focused on improving the institutional capacity of the transport sector through institutional and policy reforms, and through technical assistance to improve the management of the road network. The project included a review of the government's Road Policy and the institutional structures of the various organizations responsible for the management and control of the road network. The follow-on ROCS2 project was designed to provide an investment program for the rehabilitation and maintenance of the road network.

3.17 ROCS1 provided extensive technical assistance to improve the management of the road network and to put in place a long-term institutional rehabilitation program. This apparently was needed because Mozambique had a severe shortage of human resource capacity to begin improving the management of the road system and to plan for a major investment program in the sector.

3.18 Like the Beira and Maputo projects, ROCS1's main output was studies to restructure the institutional framework within which the road network and coastal shipping were managed. Several studies were carried out under the project and resulted in a number of reforms and policy initiatives. The most important of these are the development the government's road policy to commercialize the management of the road network, the establishment of the road fund, and the restructuring of the National Directorate of Roads and Bridges (DNEP)and the Provincial State Enterprise for Construction and Maintenance of Roads and Bridges (ECMEPs).

3.19 The institutional and policy reforms improved the framework within which the transport sector is managed and financed. DNEP was dissolved and, in its place, an autonomous road agency, the National Administration of Roads (ANE), was established to maintain and manage the road network. The ANE, under the direction of Board of Directors, is responsible for the management of the national and regional roads and administration of the road fund. ANE's capacity to manage and maintain Mozambique's road network has substantially increased over the last few years, thanks to the institutional support from ROCS1 and the ability to learn-by-doing through the follow-on ROCS2 project.

3.20 The government-owned and -controlled construction enterprises, ECMEPS, were consolidated from 10 province-based organizations into three regional companies, each having independent management board with a mandate to operate on commercial terms.

3.21 ROCS1 assisted in the development of human resource capacity to improve the management of transport sector. With the establishment of Roads Technical Training Center (CTE) more than 9,600 staff from DNEP, Provincial Department of Roads and Bridges (DEP) and Provincial State Enterprise for Construction and Maintenance of Roads (ECEMPs) were trained.

4. Ratings

Outcome

4.1 OED rates the outcome of the three audited projects *satisfactory*, the same as the ICR ratings. The relevance of the *Beira Transport Corridor Project* to the development objective of the country was high (chapter 2), and the project's efficacy was substantial. It succeeded in rehabilitating and upgrading the port and restoring its transit function. In terms of the its efficiency, ICR estimates an ERR of 8.6% (versus 14.1 % at appraisal). The ex-post ERR was lower than expected due to reduced transit traffic, but the recent takeover of the Beira port terminals by the private sector is expected to increase the traffic flow and raise the ERR.

4.2 The *Maputo Corridor Revitalization Project* was instrumental in introducing private sector participation in the management and operation of the Maputo port. The project's relevance to Mozambique's development objective was high (chapter 2). The efficacy was substantial: Four port terminals were concessioned to the private sector during the first phase of the privatization program (See Annex A) and a master concession for the port of Maputo has been agreed with a private consortium, which is expected to take over operations from CFM by the end of 2001 (Annex B). The railway concessioning, however, is still under negotiations with a possible concessionaire (Annex B). The efficiency of this project, however, was negligible. While no ERR was calculated for this project, the cost of the project, which financed mostly consultant studies, were rather high relative to the usefulness of the consultant studies. In particular, the consultant study to advise CFM on restructuring strategy was redundant, and the subsequent advisory services were also not helpful to CFM in finalizing the tender agreement with the private consortium.

4.3 The *First Roads and Coastal Shipping Project* provided critical emergency road repair assistance and financed technical assistance to increase the capacity of the implementing agencies and to develop a long-term institutional and policy reform strategy. Its relevance was high in supporting Mozambique's recovery effort from the long civil war. The efficacy of the project was substantial and resulted in opening up of many parts of the country isolated during the war. The efficiency was high with an estimated ERR of 47%.

Sustainability

4.4 OED rates the sustainability of the three audited projects *likely*, same as the ICR ratings. The sustainability of the benefit streams from these projects is assured by the extensive involvement of the private sector in managing and operating the transport system. The private sector is likely to continue improving the performance of the system and providing the finances to maintain the transport system. The flow of international transit traffic in the corridors is likely to increase with the aggressive marketing strategy of the private operators to win back customers to use the Mozambique transit corridors.

Institutional Development Impact

4.5 OED rates the institutional development impact *high* (versus substantial) for the *Maputo Corridor Revitalization Project, and substantial for both the Beira Transport Corridor project and First Roads and Coastal Shipping project.* The three audited projects can be considered institutional development projects. But they are not traditional institutional development projects that seek to increase the capacity of existing organizations through training and technical assistance, even though these were major project components. The main focus of these projects was on overhauling the institutional framework and realigning the incentive structure within which the transport sector is organized. They were about changing the "rules of the game" in the transport sector. And they have substantially achieved their institutional development objectives. The *Maputo Corridor Revitalization Project* was instrumental in the leasing of the port terminals and the eventual master concession for the Maputo port and the upcoming railway concessioning. On these account, OED upgrades the institutional impact ratings. The *Beira Transport Corridor Project* changed the institutional set up for CFM-Central. It created several "result centers," which helped in the subsequent concessioning of the port terminals. The *First Roads and Coastal Shipping project* provided assistance in the establishment of a modern, autonomous road agency and a stable financing mechanism in the form of a dedicated road fund.

Bank and Borrower Performance

4.6 OED rates Bank and borrower performance *satisfactory* for the three audited projects, same as the ICR ratings. The Bank and borrower relationship is congenial and productive. The policy dialogue between the Bank and the borrower agencies was the key in getting the government to agree to the concessioning of the ports and railways.

5. Lessons Learned

5.1 The focus of this audit is on assessing Mozambique's experience with private sector participation in the ports and railways sector. The concessioning of the ports and railways experience lends three important lessons with broad applicability:

Lesson one: Privatization is a learning process

5.2 Privatization (or more broadly private sector development) is a complex undertaking and government officials learn how to do it on the job. As the concept is foreign to many officials in developing countries or formerly socialist countries, exposure to success stories in the country and outside helps. If some success stories can be generated in the country itself by taking small reforms before tackling far-reaching reforms, it is even better. CFM was able to gain early experience from leasing its Maputo port terminals and restructuring the Beira port. These reforms allowed CFM and its senior officials to learn how reforms are carried out and advantageous concession terms are negotiated. The early experiences were crucial when CFM began negotiating the master concession for the port of Maputo and its connecting railways. In addition, the exposure of CFM senior officials to reforms in other countries, particularly through the study tour in Latin America, proved valuable.

5.3 The corollary to this lesson is that the use of consultants to design and advise the government on an optimal privatization strategy is ineffective in helping the government the capacity to privatize its assets, to negotiate advantageous terms and to subsequently monitor and regulate the private sector. The consultant service to advise the government on privatization options was clearly redundant as the option was decided, not by the study conducted, but through the evolution of the government's thinking on privatization and its dialogue with the Bank. However, consultant services are useful for facilitating the transaction of the concessioning process, preparing bidding documents, etc. They are also more effective when there is constant interaction between the consultant and the government and the Bank.

Lesson two: The particular private sector participation option is determined by government's readiness.

5.4 Mozambique carried out several types of reforms. In the experimental phase (Annex A), it leased some specific terminals to the private sector, while later, with a push from the Bank, it adopted a master concession scheme for the port of Maputo (Annex B). It is not clear which reform option was better for Mozambique. But, the first phase was more politically palatable for CFM and the government, while the master concession was fraught with political difficulties and problems of implementation. The audit concludes that reform options should be chosen based on the political readiness of the government to adopt a certain type of reform strategy and its capacity to implement such a reform strategy. There is no point to push for a reform strategy the government is not ready to implement. In the case of the Maputo concession, for example, the government was not ready to implement the master concession scheme. Despite the Bank's push, the government took eight years to implement the concession scheme, and used all instruments at its disposal to delay the concessioning and to move at its own pace.

Lessons three: Negotiations between the conceding authority and the preferred bidder can improve the terms of concession when response from competitive tendering is inadequate

5.5 Ex-post negotiations are often considered inappropriate because they could be vulnerable to non-transparent behaviors and unfair to losing bidders, especially if original tender conditions are relaxed during the course of negotiations. However, when the tendering process results in few bidders, as in the case for the Maputo port concession, negotiations can be an important mechanism to get advantageous concession terms and minimize the monopoly/cartel position of the potential concessionaire. In the case of the Maputo port concession, for example, there were only two serious bidders, and only one was technically qualified. But the financial offers by the qualified bidder were substantially lower than expected by the government. It was only during negotiations that the terms of the concession were improved (Annex B).

Annex A: Private Sector Development in the Transport Sector

1. The main focus of the three audited project's was on supporting the government's effort to reform the institutional and policy framework within which the transport sector is organized. This and the following sections assess the Bank's role, including its informal policy dialogue with the government beyond these projects, in promoting and facilitating private sector participation in the transport sector. But first, a brief background on transport reform worldwide in order to put the Mozambique experience in a context.

A World *"Going Private"* in Transport

2. For most of the post-World War II period, transport infrastructure and services in both developing and industrialized countries have been provided by the public sector. This was commonly justified by various "market failure" arguments associated with transport systems. The large capital investments and scale economies in many transport sectors have been used to support the claim that some transportation systems are natural monopolies. The network characteristics of many transport systems have also been used to support the scale economy and natural monopoly argument for state ownership and intervention. Developing nations have also used arguments of equity and the need to foster productive capital to justify public sector provision of transport infrastructure and services. By the 1980s, the transport sector in most nations was characterized by state-led or state-owned provision of transport infrastructure and services.

3. From this position of predominantly public sector provision, a worldwide trend toward deregulation and privatization of transport began approximately two decades ago.[1] The earliest policy innovations included trucking and airline deregulation in the United States, and the privatization of railways and airlines as part of Prime Minister Thatcher's privatization reforms in Great Britain. Since then, the pace of private sector participation in the transport sector has quickened, with many developing countries leading the pack.

4. The trend toward privatization has been bolstered by intellectual arguments in favor of increased private sector involvement. Many economists have long contended that private sector firms are more efficient than state-owned enterprises. That thinking has been reinforced more recently by theories of competition that question the natural monopoly structure of various industries. These include the theory of contestable markets, which was influential in airline deregulation in the United States, ideas of open access that have been key to telecommunications and other utility deregulation and, more specifically in transportation, the realization that various modes compete with each other, such that scale economies and other market failures within modes might not preclude competitive markets as frequently as was previously thought.

The Evolution of the Privatization Process and Thinking in CFM

5. The cornerstone of the government's reform and economic development strategy entails promoting the potential of the private sector and liberalizing trade and opening the economy for international investment and markets. Mozambique has carried out one of the most rapid and successful privatization programs in Sub-Saharan Africa, with the government having divested more than 700 firms, 40 of them large companies. In the rail

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1. See Gomez-Ibanez and Meyer (1993) Going Private for an early survey of transport reforms worldwide.

and port sectors, the government's strategy has been to concession the assets, rather than selling outright. The private-sector companies are expected to invest and operate the rail and port systems, as well as assume most of the commercial risks associated with the operations of rail and port systems.

6. Mozambique's rail and port privatization followed three different approaches:

Experimental Phase – CFM experiments with new ideas such as leasing, joint ventures, and contracting out with the private sector for the operation and management of selected port terminals.
Competitive Tendering Phase – Following Bank recommendations, CFM uses a consultant to study the best privatization option and tendering to encourage competition and transparency. This approach was essentially confined to CFM-South.
Direct Negotiations Phase – CFM negotiates one-to-one concession agreements with consortium of investors. This approach was followed in both CFM-Central and CFM-North.

Experimental Phase: Leasing, Joint Ventures, and Contracting Out

7. In what was then considered a novel approach, CFM launched a reform program in 1991 to involve the private sector in the operation and management of selected terminals. This experimental phase, which lasted until 1995, resulted in the leasing of one road (dry land) terminal and four port terminals: Road Terminal at Gare de Mercadorias; Coal Terminal at the Port of Matola; Sugar Terminal at the Port of Maputo; Citrus Terminal at the Port of Maputo; Container Terminal at the Port of Maputo.

Road Terminal At Gare de Mercadorias (1991)

8. CFM signed its first joint venture lease agreement for a road terminal at Gare de Mercadorias in 1991. The joint venture lease agreement was based on one-to-one discussions with Tertir, a Portuguese company. The resulting negotiations led to the formation of a joint venture company called Sociedade Terminais de Moçambique (STM) in December 1991, with CFM and Tertir each holding 50% of the shares.

9. The object of the lease agreement was simple and involved contracting the management and operation of the storage, reception, and dispatches of goods and vehicles, and the maintenance of the land and buildings. The period of the lease was 10 years, which could be renewed for two 5-year periods, in case the lessee requested an extension and based on new contract clauses to be negotiated.

Coal Terminal at Port Of Matola (1993)

10. In 1994, CFM signed a "Heads of Lease Agreement Matola Coal Terminal" with a South African–based company, CMR Engineers & Project Managers (Pty) Ltd. The formal lease agreement was signed with Terminal de Carvão da Matola Limitada (a company registered in Mozambique as required by the local rules) on December 29, 1996, nearly three years later than the initial agreement.

11. The object of the lease agreement was to have the private sector manage, operate, and develop the coal terminal. But the lessee was ineffectual in improving the performance of the terminal. The throughput at the terminal was much below the minimum projected in the contract. The financial implications were severe and the lessee was not able to pay the

fees stipulated in the contract which was based on a guaranteed throughput of 1.4 to 2 million tons. A long round of negotiations followed resulting in the First Addendum being signed in January 1997. The amendment scaled down the amount of guaranteed throughput at the terminal to 1 million tons in the first 18 month of the contract and gradually increasing the guaranteed throughput to 2.5 million tons. The amendment also changed the fee structure and allowed for more investment in the terminal to increase the terminal's handling capacity.

12. Despite these changes to the original contract, the lessee was still not able to meet its contract obligations. Traffic continued to be persistently lower than projected and the lessee failed to make the anticipated investments. In terms of payments due to CFM, the company was in chronic default and by December 2000, according to CFM records, the company owed CFM about US$2.01 million.

Sugar Terminal at the Port of Maputo

13. The Zimbabwe Sugar Association and the Swaziland Sugar Association are the main clients for the sugar terminal at the port of Maputo. The facilities at the sugar terminal needed to be upgraded and rehabilitated. The private sector was willing to invest in the terminal, if the management and operation was handed over to them. In 1993, a private company approached CFM with a formal lease proposal. A lease agreement was signed in February 1994.

14. The private lessee claims to have made some investment in the terminal. Recently, the lessee presented a strong case for additional investments combined with an extension of the lease agreement. But the negotiations did not take off seriously because the planned concession for the Port of Maputo was underway and it was not clear how the lease arrangement would fit with the planned concession (see next chapter).

15. The sugar terminal lease agreement is generally considered a success. The lessee has brought consistently higher traffic through the terminal, royalty payments to CFM have been reasonably prompt, and overall relations between CFM and the lessee have been cordial.

Citrus Terminal at Port of Maputo

16. The citrus terminal serves as an export outlet for citrus products from the Republic of South Africa and Swaziland. SACCE, the citrus exporter and sole user of the terminal, approached CFM to lease the citrus terminal after word got out that CFM was considering leasing the terminal. (During this time, there were no open tendering or official announcements for lease opportunities.) The citrus exporting company was using both the South African and Mozambican ports for its export outlets, and as the sole user of the sugar terminal in Mozambique, it had a lot of bargaining power. During negotiations with CFM, the company often used threats of diverting its entire traffic to South Africa port in order to get more advantageous terms from CFM. An open tender approach may not have helped in this case, because there was only one main user for the terminal and that user, if not awarded the lease, could divert its traffic to South Africa, which could effectively close down the terminal. After some tough negotiations between the parties, the lease agreement was finally signed in September 1994.

17. The fees for the lease contract were denominated in South African currency and there was always the danger of the devaluation of the South African rand against the U.S.

dollar. The problem with possible devaluation of the rand was recognized and debated during negotiations, but the company was unwilling to denominate its payments in U.S. dollars. As a compromise, a clause was included in the agreement essentially providing for revision of the fees if the rand was devaluated by a substantial margin. Although the rand has depreciated against the U.S. dollar substantially over the years, it has been difficult for CFM to revise its fees under this clause, showing that the leaseholder continues to wield its monopoly power to keep fees below the optimal level.

Container Terminal, Port of Maputo

18. The worldwide trend toward containerization of cargo has resulted in the need for dedicated container terminals and generates the largest potential for private sector participation. In all the four cases we have seen earlier, the lease agreements were reached based on direct negotiations between CFM and a single party. In the case of the container terminal, a quasi-tender system was used to select the private partners. An open tender system requires that the "rules of the game" are made explicitly clear at the beginning of the tender process. The rules would need to specify, ex ante, the detailed bid instructions, contents of the technical and financial proposals, technical evaluation criteria, basis of final selection and draft concession agreement. However, the tender was launched without any of the above documents in place.

19. An outside consultant was engaged to oversee the whole selection process. As the rules of the game were not clear, one could not expect a fair selection process. The consultant sought to bring together two interested parties and make them the selected partners. At the end, the partners identified were P&O and Rennies Group from South Africa. CFM started negotiations with this group in 1995. The final transaction documents was with the Maputo International Port Services (MIPS), which consisted of P&O (30%), Rennies (37%), and CFM (33%).

20. A five-year management contract was agreed with one of the partners, who was paid a management fee of 7% of gross revenues on the first US$5 million and 4% on all revenue over and above US$5 million. The basis on which the fee structure was arrived at was not spelt out and it is unclear whether CFM got a good deal. In addition, unlike the other lease agreements, the container-terminal lease agreement involved paying management fees to one of the partners in the consortium. The leaseholder, MIPS, however, still had to pay royalty fees to CFM in the amount of US$200,000 per annum in fixed fees and variable fees of 15% if gross revenues exceed US$3 million, zero% otherwise.

21. The management contract specifies that the company achieve a target of 100,000 teu by the fifth year, with progressive higher targets in the subsequent years. But the actual figures are much lower than the target traffic, with only 32,000 teu handled by the end of the term in 2000.

22. In sum, the "experimental phase" to lease terminals has been beneficial. The performance of the terminals has improved, albeit in varying degrees and less than expected. The main benefit from the terminal leasing experiment, however has to be the opportunity it provided CFM to learn how to carry out reforms, negotiate lease terms, and work with the private sector. This learning opportunity and the experience that came with it were crucial and proved useful when CFM launched the master concession scheme for the Maputo Port and its connecting railway system. The next section details the evolution of this experience.

Annex B: Port of Maputo Concession: The Open Tender System

1. In parallel with CFM's experimentation with public-private partnerships and leasing out some selected port terminals, the Bank, as part of the *Maputo Corridor Revitalization Project*, was encouraging CFM to adopt a much bolder scheme to concession the entire port of Maputo and its connecting railways to the private sector. As discussed in chapter 3, consultants were engaged to provide CFM with advisory services to determine the optimal privatization option and help it with the implementing the chosen privatization option. After much discussions and delay, CFM chose to privatize the port of Maputo in the form of a long-term concession. This section provides an assessment on the concessioning process.

Elements of the Concession Design

2. CFM/IAC, with help from the consultants, developed the concession design. The main elements of the design were: the status of the existing terminal leases, the fee structure as evaluation criteria, investment strategy, length of concession period, staffing issues, and equity contribution by the CFM. These are discussed below.

Existing Terminal Leases

3. As outlined in the previous chapter, four terminals in the port of Maputo – coal, sugar, citrus, and the container terminal – were leased out to the private sector for periods ranging from 10 to 15 years. When the concessioning of the port of Maputo was seriously considered, the issue of what to do with the existing terminal lease agreements came up. Terminating the leases would have been fraught with legal risks. But what were the alternatives? Should the lease contracts be taken over by potential concessionaire with the consent of all parties to the agreement? What would happen if one of the terminal lessees refused to go along with the new arrangement? After some negotiations with the leaseholders, the lessees agreed to have their lease contracts reassigned to the potential concessionaire. In addition, *it was agreed that the variable fees from the lease contracts would be transferred to the future concessionaire, while the fixed fees would remain with CFM.* (This later changed during negotiations with the preferred bidder, see para. 6.20)

Fee Structure – Evaluation Criteria

4. There are generally three components in the concession fee structure – entry fee, fixed fee, and variable fee, but the question was which would be used as the main selection criteria – the variable fee or the fixed fee? The consultants' initial recommendation for the fee structure was to have a predefined entry fee and a variable fee, expressed as a percentage of turnover. The sole selection criteria would be the variable fee. But the scheme proposed was unsatisfactory, since it implied that the government would take an inordinately bigger share of the consequences of poor performance by the concessionaire. Therefore, most of the commercial risk would be with the government, not with the private sector as intended in the concessioning scheme.

5. The consultants were adamant that their scheme was the best and brooked no second opinion. On this point, the intervention of the World Bank was very crucial to set the thinking of the consultants on the right track. Accordingly, it was decided to adopt a

different approach. The concessionaires would pay an entry fee, fixed fee, and variable fee. The variable fee component was a fixed parameter: 5% of the gross revenues for the rail and 10% for the port. These percentages were determined by running some simple financial models. As regards the fixed fee, the concessionaires could either pay a single lump sum amount in the beginning of the contract or propose appropriate annual installments, linked to an index, such as the U.S. CPI.

6. Although the consultants were not too happy, it was decided to have the fixed fee as the sole selection criterion, after the technical evaluation. On balance, this was the most appropriate and the most advantageous for the government. The cut-off mark for technical evaluation was kept at 70 marks. Only the final offers of those bidders who got 70 or more marks in the technical evaluation were to be opened and evaluated. After the technical evaluation, all the technically qualified offers were on the same level. In such circumstances, the selection criterion was the highest amount of fixed fees offered in present value terms.

Investment Strategy

7. Hitherto, the investment strategy in concessions was to specifically include the investments in terms of amounts as a specific obligation of the concessionaire. But the experience of other countries suggested that that predefined investment programs had failed for various reasons. Investment programs are often poorly predicted and unforeseen circumstances prevent the concessionaire from making the intended investment.

8. Therefore, the emphasis shifted from the investment amounts to a minimum standards of maintenance of the assets concessioned (for example, the channel depth, condition of quay structure, track speed). Accordingly it was decided that the standards would be pre-defined and incorporated in the concession agreement as one of the concessionaire's obligations. Once the standards were adequately defined, the concessionaire would be left free to develop his own investment program and financing plan to achieve the specified standards. It was, however, incumbent on the Conceding Authority to ensure, through frequent technical audits, that the standards were being achieved and maintained. The concession agreement would also provide for penalties in case the agreed standards were not achieved or maintained. As the investment program was not a criterion for evaluation, any investment program offered by the bidder was not to be considered as binding.

Length of Concession Period

9. The consultants had initially suggested a 25-year concession. The rationale for this approach was that the concessionaire had sufficient time to recover all its investment. However, this line of argument ignored one fundamental fact: apart from initial investments required to upgrade and rehabilitate the facilities to an acceptable level, periodic investments are required throughout the concession period. It is difficult therefore to ensure that all assets, financed by a concessionaire, are fully depreciated at the end of the concession period. The focus was then to develop an appropriate formula to compensate the concessionaire for assets not fully depreciated by the end the concession period.

Staffing Issues

10. The staff issue would always remain a thorny one in any privatization scheme. Various studies had shown that CFM, with a total employment of nearly 18,000, was grossly overstaffed, and about 12,000 of them were estimated to be surplus. Concerned about the large numbers of surplus workers involved, the Government of Mozambique and CFM developed a staff rationalization program to minimize the negative effects of restructuring and privatization and make CFM restructuring acceptable to workers and the union. Crucial to the success of privatization, the staff rationalization program consists of two main components: (i) financing of severance payments to staff being retrenched or retired early; and (ii) provision of redeployment support to help workers find alternative jobs or become self-employed. These were going to be possible by the Bank-supported project, *Railways and Ports Restructuring Project,* approved in 1999.

11. The idea of having the Bank finance the retrenchment of surplus was that the concessionaire would not be burdened with any financial commitments for staff rationalization. The question remained – what is the sequence in which the staff should be retrenched. The consultants' initial recommendation was that the entire staff should first be taken over by the concessionaire and retrenched later in stages. But, this approach was impractical and would have discouraged potential bidders from participating. The final idea agreed was that the concessionaire would be given the full freedom to fix the number of staff required to run the system. Within these required numbers, the concessionaire would give the first option to CFM staff.

Equity Contribution of CFM

12. A unique feature of the private sector participation scheme in the rail and port sectors in Mozambique is CFM's participation as a shareholder in the concession companies. The shares amounting to 33% were mostly in kind contribution, except for the Nacala route concession where CFM's 49% contribution was paid in cash to CEAR (the Malawi railway concessionaire).

The Concession Process

13. With all the bid elements in place, the private sector was invited to participate in the tendering process for the port of Maputo, as well as the connecting railway system. Twenty-three offers were received for the Maputo port and the railway system. Of these, two offers were found valid for the port of Maputo:

- *Maputo Port Development Consortium (MPDC)* comprising of Mersey Docks & Harbours Company (UK), Grinroad (Pty) Ltd (RSA), Liscont (Portugal), Mozambique Gestores S.A.R.L, Skanska Bot Projects S.S. (Sweden)

- *Maputo Port Authority Concession (MAPAC)* comprising of Bouygues SA (France), Basil Read International (Pty) Ltd (RSA) and Hessnatie (Belgium).

And, for the rail concession, four offers were found valid:

- *Transnet Consortium* – comprising Spoornet (RSA), Rennies Group Limited and Hutchison Port Limited (UK)

- *RITES Consortium* - RITES (India), Container Corporation of India (India), South Africa Infrastructure Fund (RSA)

- *Consortium Cimentos* - Cimentos de Moçambique S.A.R.L (Mozambique), Delaware Railways and service company (United States), SOPART, CP – Caminhos de Ferro de Portugueses EP (Portugal), Consulgal, PROFABRIL and Somafel

- *Consortium 2000* - Somague SGPS (Portugal), Emefe, Gestra, Visabeira, Alcatel Portugal S.A (Portugal), ETE, Socarmar, Portsines and Efacel.

14. Of the two valid offers received for the port concession, a technical evaluation by IAC and the consultants concluded that the MPDC's offer was the most suitable one and invited the consortium for negotiations. For the rail concession, the offers from Consortium 2000 and Transnet were accepted by IAC. Consortium 200 was invited to negotiate for concession of the the Goba Line, Limpopo Line, workshops and marshalling yards, while the Transnet Consortium (with its South African (Spoornet) partner) was invited to negotiate for the heavily-trafficed Ressano Garcia line concession.

Invitation for Negotiations

15. The concession design for the port was such that the entry fee was fixed at US$5 million, the variable fee component at 10% of the gross revenues. The sole selection criterion for the winning concessionaire was the total amount of the annual fixed fee offered by the bidders. The offer from the preferred bidder, MPDC, for the annual fixed fee was US$0.75 million. But IAC considered this amount inadequate and made the negotiations with MPDC (and its leading partner Mersey Docks) focused on the fees offered.

16. The figures presented by the consortium to reach their decision on fees were reviewed by IAC's technical team, which found serious inconsistencies between the figures used in the technical bid and the financial model used to arrive at the offer. For example, under the technical bid, the consortium considered three traffic scenarios. But in the financial model to arrive at the bid offer, they adopted a traffic scenario much lower than the three scenarios. Similarly, with respect to operational costs, the consortium used a much-inflated operating cost in the financial model than was used in the technical bid document.

17. At the same time, IAC's analysis developed a financial model showing how much the consortium is capable of paying: annual fixed fees of US$5 million up to year 3; US$7 million up to year 5 and US$9 million thereafter. This shows that there was a huge gap between the SUS0.75 million offered by the consortium and the government's expectations on what the concession fixed fees should be.

18. During four months of negotiations both IAC and the consortium made a series of concessions and the following significant changes were made to the tender conditions:

- *Fixed Fees for Leased Terminals* As per the tender condition, the variable fees for the four terminal leases – container, sugar, citrus and coal terminals – were to be collected by the concessionaire, while the fixed fees were to remain with CFM (see para. 6.3). During negotiations, this major condition was relaxed to allow the concessionaire to keep both the variable and fixed fees for the existing concessions.

- *Dredging Operations*. As per tender condition, the concessionaire was responsible for maintenance dredging at his cost, irrespective of the quantity or cost involved. This was relaxed, whereby the concessionaire was responsible for maintenance dredging up to a maximum point, after which CFM will carry out the dredging.

- *Deferment of Fixed Fees* As per tender rules, payment of fees could not be deferred. This condition was relaxed whereby the fixed fees for years two and three could be deferred up to a maximum of $2 million to years seven and eight.

- *Exclusive Stevedoring/handling services*. There was no provision in the tender rules for the concessionaire to have exclusive stevedoring rights. However, IAC agreed to give exclusive rights to the concessionaire to provide stevedoring/handling services within the perimeter of the concession.

19. The consortium, on its part, substantially increased the fees payable to the government (see Table 1). Although the Government preferred to have more of the fixed fee component, it was finally agreed to increase the variable fee portion during the later years of the concession.

Table 1. Changes Made in the Consortium Offer

	Original Offer	*Revised Offer*
Entry Fee	US$5 million	US$5 million
Variable Fee	10% of gross revenues during entire term of concession	Years 1 - 5 – 10% of gross revenues Years 6 – 10 – 12.5% of gross revenues Years 11 – 15 – 15% of gross revenues.
Annual Fixed Fee	US$0.75 million	US$5 million in real terms Note - The Company may elect to defer up to a maximum of 40% (forty percent) of the Fixed Fee otherwise payable in years 2 and 3 until years 7 and 8. Any deferred sum shall be indexed from the date when such amount was payable until the actual date of payment.

20. Accordingly, the decisions taken were formalized in an aide memoire on September 30, 1998, followed by the MOU on October 9, 1998.

21. The above modifications were incorporated in the draft concession agreement originally issued in November 1997. The original draft concession agreement was substantially revised, with both parties agreeing to a final version in January 1999.

The Railway Concession Snag: A New Complication for the Port Concession

22. In the meantime, on another front, the CFM/IAC terminated the negotiations with the Transnet Consortium, the preferred bidder for the concession of the Ressano Garcia

railway line. This was done officially in December 1998 and the main reason given by CFM/IAC was the "extremely low fees offered by the Consortium." The termination of the negotiations had a serious implication on the port concession, as the port consortium believed that without the rail concession and the expected performance improvement, the financial prediction for the port concession might not be realized. As result, in January 1999, the port consortium sent a letter to CFM stating that it would pull out of the concession agreement unless CFM/IAC resumes the negotiations with Transnet and its leading consortium Spoornet of South Africa.

23. The position of CFM/IAC was that the concession of the Ressano Garcia line was never a pre-condition for the port concession. At the time of the launch of the tender process, it was not known whether Spoornet would bid for the rail concession, leave apart the question of it being a preferred bidder. It appeared to CFM/IAC that the consortium was trying to extract some more concessions from them on the concession agreement. With the Spoornet/Transnet issue, the port consortium raised a number of issues including:

- Reduction of fixed fees from US$5 million to US$2.5 million and making it conditional to several factors such as revenue levels, satisfactory contractual performance of rail concessionaires
- Inclusion of the Matola Industrial Port within the perimeter of the present concession
- Change of risk profile of project due to new development of Ponta Dobela
- Freedom to sub-concession individual terminals in the port, while at the same time, gross revenues to include only the fees obtained for the sub-concession, and not the gross revenues, as per tender stipulation. This had an impact on the variable fee, which was computed as a certain percentage of the gross revenues.

24. The sudden change in stance of the consortium led IAC to consider canceling the tender. But things were getting entangled at a higher level and the whole process was being influenced by outside parties – foreign embassies, articles in the foreign press, e-mails from ex-ministers to CFM Board members. At the end, the concession agreement was finally approved by the Council of Ministers in July 2000 and was finally signed on September 22, 2000. The important clauses of the final agreement are summarized in Annex C.

Final Agreement, Waiting Takeover

25. A number of precedent conditions have to be satisfied before the consortium takes over operations from CFM. The most important one requires financial closure, which has seen some snags. By the time of the audit mission in December 2000, the consortium still had not reached financial closure with its lenders. As per the present indications, the takeover is not likely to take place until toward the end of 2001.

26. In sum, the concessioning of the port of Maputo has proved to be a complex undertaking. It was not simply a matter of retaining a consultant, tendering, and awarding bids. Rather it was a long and arduous process. The master concession scheme for the port of Maputo was proposed in 1992 when the Maputo Corridor Revitalization project was first identified. But it took the government four years to agree to adopt the concessioning scheme, and another four years to complete the tendering process. In a country, with perceived high risks, serious international investors often are not willing to put their

money in what could be a profitable operation. In this risk environment, therefore, the businesses that willing to invest are those that are willing to take the high risk in exchange for exceptionally high returns within a short period. This high risk and high return scenario may lead into a sub-optimal outcome for the concessioning process. Expected investments may not be realized, and opportunistic behavior may be abound during the bidding process, and during the implementation of the concession.

Annex C: Port Of Maputo Concession Contract–Summary

Item	Comment
Perimeter	Port Concession Area includes the existing Port facilities in the Port of Maputo and the coal terminal alone in Matola. Specifically, it includes the existing 4 terminal concessions - Container, Sugar, Citrus and Coal Terminal at Matola- (Schedule 3) and excludes the Mozal, Oil and Grain Terminal in Matola (4.2)
Concession Period	15 years from the Date of Operations (3.1).
	The Company may request, no later than 30 days following tenth anniversary of Date of Operations, an extension of term by 10 years (3.2).
Grant of Concession	The Conceding Authority grants to the Company the right to conduct the Port Operations and finance, manage, operate, maintain, develop and optimize, at its own cost and risk, the Port Concession Area and perform the Rehabilitation Works and the Development Works (4.1.1).
	The Company's rights pursuant to this Agreement shall be at the Company's own cost and risk and without recourse to any credits or guarantees of the Conceding Authority or CFM (4.1.2).
Competing Interests	During the term, the Conceding Authority, through all necessary legislative and regulatory process ensure that:
	No discriminatory economic measures are imposed, that might adversely affect fair competition and, consequently, either the Company's rights and obligations arising under the terms of this Agreement or the financial viability of the Project, or both, as the case may be; and
	The rail, road, and port infrastructure systems are developed and regulated in a manner, which encourages fair competition within and among these infrastructure systems (4.3).
First Right of Refusal	The development of new port facilities in the Port Jurisdiction Area would be governed by the following principles:
	The Company is entitled to engage in the development of new port facilities including any specialized cargo terminals within the Port Jurisdiction Area subject to prior approval by GOM of the relevant detailed plan, engineering designs, feasibility studies, EIA.
	In case GOM, based on its own initiative or any third parties initiative, plans to develop certain facilities including any specialized cargo terminals within the Port Jurisdiction Area (outside the Perimeter), the Company shall have the first right of refusal within 60 days of receiving the GOM proposal. Where the Company does not exercise its first right of refusal within the 60 day period, GOM shall be free to award the development of such facilities to interested third parties (4.4)
Employees	The Company shall select the required national personnel from CFM employees, which shall initially number approximately 1,550 personnel in accordance with the tender offer (7.1).
	In the event it is demonstrated that CFM personnel are not suitable, the Company is free to recruit such personnel from other sources (7.1).
Tariff Levels	The tariffs charged by the Company shall at times be sufficient to cover the long-term costs in providing the Port Services, except for promotional offers (8.2.1)
	Subject to above, the Company shall be free to set and revise the tariffs charged for its Port Services (8.2.2).

Annex D. Basic Data Sheet

BEIRA TRANSPORT CORRIDOR PROJECT (LOAN 2065-MOZ)

Key Project Data (amounts in US$ million)

	Appraisal estimate	*Actual or current estimate*
Total project costs	74	64
Loan amount	40	30
Cofinancing	29.5	29.8
Date physical components completed	12/31/1995	12/31/1996
Economic rate of return	14%	8.6%

Cumulative Estimated and Actual Disbursements

	FY90	*FY91*	*FY92*	*FY93*	*FY94*	*FY95*	*FY96*	*FY97*
Appraisal Estimate	4.0	16.0	26.0	32.0	37.0	39.0	40.0	40.0
Actual	0.0	6.0	10.6	17.5	18.4	23.8	30.2	30.1
Actual as % of Estimate	0%	38%	41%	55%	50%	61%	76%	75%

Date of final disbursement: February 2, 1998

Project Timetable

Stage of project cycle	*Date Planned*	*Date Actual*
Identification (Executive Project Summary)	Oct.87	Sep.88
Preparation	Jun.88	
Appraisal	Sep.88	Oct.88
Negotiations	Dec.88	Apr.89
Board Presentation		Sep.14,1989
Signing		Sep.28, 1989
Effectiveness	Jan. 89	Jul. 10, 1990
Midterm Review		
Project Completion	Dec. 31, 1995	Dec. 31, 1996
Loan/Credit Closing	Jun.30, 1996	Jun. 30, 1997

Staff Inputs

Stage of project cycle	*Revised*		*Actual*	
	Weeks	*US$*	*Weeks*	*US$*
Through Appraisal	-	-	39.8	80.8
Appraisal – Board	-	-	35.6	74.5
Board – Effectiveness	-	-	3.4	7.7
Supervision	-	-	88.0	226.7
Completion	7.0	13.9	7.0	13.9
Total	-	-	173.8	403.6

Mission Data

Stage of project cycle	*Month/ year*	*No. of persons*	*Staff days in field*	*Specialized staff skills represented a/*	*Performance rating*		*Types of problems*
					Implementation Status	*Development Objectives*	
Through Appraisal							
Indentification	Oct.87	5	10	FA,TP,EC,CL			
Preparation							
Pre-appraisal	Feb. 88	4	15	FA, CL			
Appraisal through Board approval							
Appraisal	Oct. 88	11	18	FA,TP,EC,CL			
Post Appraisal							
Pre-Board							
Pre-effectiveness							
Supervision							
Supervision 1	Mar.91	1	14	RE	1	1	
Supervision 2	Aug. 91	1	8	RE	2	2	TAP
Supervision 3	May 92	1	13	RE	2	1	TAP
Supervision 4	Mar.93	1	9	RE	2	2	TAP
Supervision 5	Dec. 93	1	8	RE, FA	2	2	TAP
Supervision 6	Nov. 94	1	8	RE	S	2	
Supervision 7	Apr. 95	1	8	RE	S	S	
Supervision 8	Oct. 95	1	11	RE	S	S	
Supervision 9	Apr. 96	1	8	RE	S	S	
Supervision 10	Sep. 96	1	8	RE	S	S	
Supervision 11	Apr. 97	1	8	RE	S	S	
Completion	Oct. 97	1	10	CL			

Key to specialized staff skills
EC=Economist - CL=Consultant- FA=Financial Analyst
RL=Railway Engineer- TP=Transport Planner

Key to performance rating
I=Problem Free-2=Moderate Problems-3=Major Problems-4=Major Problems. Corrective action to be taken.

HS=Highly Satisfactory; S=Satisfactory; U=Unsatisfactory; HU=Highly Unsatisfactory

Key to Problems
AF=Availability of Funds
CLC=Compliance with Legal
FP=Financial Performance
PMP=Project Management Performance
PP=Procurement Progress
SP=Study Progress
TP= Training Progress
TAP=Technical Assistance Progress

MAPUTO FIRST ROADS AND COASTAL SHIPPING PROJECT

Key Project Data (amounts in US$ million)

	Appraisal estimate	*Actual or current estimate*
Total project costs	10.5	5.9
Loan amount	9.3	5.8
Cofinancing	0.7	0.1
Date physical components completed	12/31/1997	12/31/1998
Economic rate of return	NA	NA

Cumulative Estimated and Actual Disbursements

	FY93	*FY94*	*FY95*	*FY96*	*FY97*	*FY98*	*FY99*
Appraisal Estimate	0.5	0.6	0.9	1.2	2.8	9.2	9.3
Actual			0.6	2.5	4.8	5.6	5.8
Actual as % of Estimate	0%	0%	67%	208%	171%	61%	62%

Date of final disbursement March 16, 1999

Project Timetable

Stage of project cycle	*Date Planned*	*Date actual*
Identification (Executive Project Summary)		
Preparation	September 1991	September 1991
Appraisal	March 1992	March 1, 1992
Negotiations	November 9, 1992	November 16, 1993
Board Presentation	October 15, 1992	January 19, 1993
Signing		February 12, 1993
Effectiveness	May 31, 1993	September 27, 1993
Midterm Review		
Project Completion	December 31, 1997	December 31, 1998
Loan/Credit Closing	June 30, 1998	March 16, 1999

Staff Inputs

Stage of project cycle	*Revised*		*Actual*	
	Weeks	*US$*	*Weeks*	*US$*
Through Appraisal			40.1	70.8
Appraisal – Board			9.7	23.1
Board – Effectiveness			19.2	33.0
Supervision			69.3	186.1
Completion	9.5	18.1	9.5	18.1
Total			147.8	331.1

Mission Data

Stage of project cycle	Month/ year	No. of persons	Staff days in field	Specialized staff skills represented a/	Performance rating		Types of problems
					Implementation Status	Development Objectives	
Through Appraisal							
Indentification							
Preparation							
Pre-appraisal							
Appraisal through Board Approval							
Appraisal							
Post-Appraisal							
Pre-Board							
Pre-effectiveness							
Supervision							
Supervision 1	Apr-83	1	10	OO	2	1	
Supervision 2	Feb-94	2	5	00,FA	2	1	
Supervision 3	Apr-95	1	10	RE	S	S	
Supervision 4	Dec-95	2	9	RE,FA	S	S	
Supervision 5	July-96	1	8	RE	S	S	
Supervision 6	Oct-96	2	10	RE,PE	S	S	PP
Supervision 7	Dec-96	1	8	RE	S	S	PP
Supervision 8	May-97	2	10	RE,FS	S	S	PP
Supervision 9	Jul-97	3	8	RE,PE,TE	S	S	
Supervision 10	Oct-97	6	8	RE,PE,TE,FA,PSS	S	S	
Supervision 11	Jan-98	2	9	RE,TE	S	S	
Completed	Nov-98	1	10	CO	S	S	

Key to specialized staff skills
FA=Financial Analyst; OO-Operations Officer; PE=Port Engineer
PSS=Private Sector Specialist; RE=Railway Engineer; TE=Transport Economist

Key to performance rating
1=Problem Free; 2=Moderate Problems; 3=Major Problems; 4=Major Problems. Corrective action to be taken.
HS=Highly Satisfactory S=Satisfactory; U-Unsatisfactory; HU=Highly Unsatisfactory

Key to Problems
AF=Availability of Funds
CLC=Compliance with Legal Covenants
FP=Financial Performance
PMP=Project Management Performance
PP=Procurement Progress
TAP=Technical Assistance Progress
SP=Study Progress
TP=Training Progress

FIRST ROADS AND COASTAL SHIPPING PROJECT (CREDIT 2374-MOZ)

Key Project Data (amounts in US$ million)

	Appraisal estimate	*Actual or current estimate*
Total project costs	144.7	188.5
Loan amount	74.3	74.3
Cofinancing	99.5	88.5
Date physical components completed	6/30/1998	12/31/1999
Economic rate of return	12%-150%	47%
Institutional performance		

Staff Inputs

Stage of project cycle	*Revised No. Staff weeks*	*Actual US$*
Identification/Preparationl	154.8	312.5
Appraisal/Negotiation	123.2	246.0
Supervision	184.4	427.0
Completion	8.0	20.0
Total	470.4	1005.5

Mission Data

Stage of project cycle Month/Year	*Count*	*No. of Persons and Speciality (e.g.2 Economist, 1 FMS etc.*	*Performance rating*	*Types of problems*
Identification				
April 1990	1	Transport Planner		
July 1990	1	Transport Planner		
	1	Highway Engineer		
	1	Port Engineer		
December 1990	1	Highway Engineer		
	1	Traning Specialist		
April/May 1991	1	Highway Engineer		
	1	Training Specialist		
Appraisal/Negotiation				
September/ October 1991	1	Transport Engineer		
	1	Financial Analyst		
	1	Procurement Specialist		
	1	Highway Engineer		
	1	Training Specialist		
	1	Trans. Operations Special.		
	1	Equipment Specialist		
	1	Shipping Oprations Expert		
	1	Environmental Expert		
	1	Port Management Special.		
	1	Legal Officer		
	1	Agricultural Specialist		
February 1992	1	Transport Engineer		

Supervision				
October 1992	1	Transport Engineer	HS	HS
	1	Financial Analyst		
	1	Highway Engineer	S	S
	1	Port Engineer		
	1	Operations Officer		
	1	Civil Engineer		
	1	Procurement Specialist		
	1	Highway Engineer		
	1	Environmental Specialist		
	1	Legal Officer		
September 1993	1	Port Specialist	S	S
	1	Operations Officer		
	1	Civil Engineer		
	1	Procurement Specialist		
	1	Road Policy Reform Specialist		
March 1994	1	Financial Analyst	S	S
	1	Operations Officer		
		Port Engineer		
May/June 1994	1	Financial Analyst	S	S
	1	Operations Officer		
	1	Environmental Specialist		
September/October 1994	1	Financial Analyst	S	S
	1	Operations Officer	S	S
	1	Program Assistant		
	2	Consultants		
September/October 1995	1	Financial Analyst	S	S
	1	Consultant		
March 1996	1	Financial Analyst	S	S
September/October 1996	1	Operations Officer		
July 1997	1	Financial Analyst	S	S
	1	Operations Officer		
October 1997	1	Project Assistant	S	S
	1	Project Assistant		
July 1998	1	Operations Officer	S	S
	1	Project Assistant		
	1	Highway Engineer		
September 1998	1	Operations Officer	S	S
	1	Project Assistant	S	S
	1	Highway Engineer		
July 1999	2	Operations Officer	S	S
	1	Project Assistant		
	2	Highway Engineer		
	1	Transport Economist		
ICR				
December	2	Highway Engineer	S	S
	1	Financial Analyst		
	2	Consultant		

Annex E: Borrower Comments

ANE
ADMINISTRAÇÃO NACIONAL DE ESTRADAS

FAX TRANSMISSION

To: Mr Alain Barbu
World Bank
Sector and Thematic Evaluation Group
Operations Evaluation Department

Fax n°: 00 1 202 522 3123 **Country:** USA **City:** Washington

From: C. FRAGOSO, ANE MAPUTO
Pages (i.t.o.): 1 **Ref:** 52 /PCA /2001 **Date:** June 26, 2001

Dear Mr Barbu

SUBJECT: **Mozambique First Road and Coastal Shipping Project (Credit 2374-Moz) Draft Performance Audit Report**

We apologise for the delay in responding to your request.

Having reviewed the document we are please that you have found the project to have been a success and are satisfied with the content of the report as applicable to the portion in which we participated.

Yours sincerely

Carlos Fragoso
Chairman

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