Document of
The World Bank

Report No.: 48920

PROJECT PERFORMANCE ASSESSMENT REPORT

MOZAMBIQUE

ECONOMIC MANAGEMENT AND PRIVATE SECTOR OPERATION
Credit 3709

FIRST POVERTY REDUCTION SUPPORT CREDIT
Credit 3950

SECOND POVERTY REDUCTION SUPPORT CREDIT
Credit 4111

June 17, 2009

Country Evaluation and Regional Relations
Independent Evaluation Group (World Bank)

Currency Equivalents (annual averages)

Currency Unit = metical (MZM)

2008	US$1.00	25,000 MTM
2009	US$1.00	26,330.MTM

Fiscal Year

Government: January 1 – December 31

Abbreviations and Acronyms

AAA	Analytical and advisory work
BIM	Banco International de Mocambique
BM	Banco de Mocambique
CAS	Country Assistance Strategy
DPL	Development Policy Lending
EMOSE	Empresa Mocambicana de Seguros
EMPSO	Economic Management and Private Sector Operation
EMRO	Economic Management and Reform Operation
ERC	Economic Recovery Credit
FRELIMO	Front for the Liberation of Mozambique (Portuguese acronym)
FYDP	Five-Year Development Program
GBS	General budget support
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
IAS	International Accounting Standards
ICR	Implementation Completion Report
ID	Institutional development
IDA	International Development Association
IEG	Independent Evaluation Group
IMF	International Monetary Fund
INSS	Instituto Nacional de Seguranca Social
LAM	Linhas Aereas de Mocambique
M&E	Monitoring and Evaluation
PAF	Performance Assessment Framework
PARPA	Action Plan for the Reduction of Absolute Poverty (Portuguese acronym)
PFM	Public Financial Management
PPAR	Project Performance Assessment Report
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSD	Private Sector Development
RENAMO	Mozambique National Resistance Party (Portuguese acronym)
SISTAFE	Integrated Financial Management Information System (Portuguese acronym)
SME	Small and medium-sized domestic enterprises
TA	Technical assistance
TDM	Telecommunications Authority of Mozambique (Portuguese acronym)
UTREL	Technical Unit for the Reform of the Legal Sector

All $ amounts are U.S. dollars.

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About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEGWB annually assesses about 25 percent of the Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEGWB staff examine project files and other documents, interview operational staff, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, and interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate.

Each PPAR is subject to internal IEGWB peer review, Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible Bank department. IEGWB incorporates the comments as relevant. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

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Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension generally is not applied to adjustment operations. *Possible ratings for Outcome:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Risk to Development Outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for Risk to Development Outcome:* High Significant, Moderate, Negligible to Low, Not Evaluable.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for Bank Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for Borrower Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Contents

This report was prepared by Fareed Hassan, Task Manager and Adil Kanaan, Consultant, who assessed the project in February 2009. Ms Cecilia B. Tan provided administrative support.

Principal Ratings

	ICR*	ES*	PPAR
Economic Management and Private Sector Operation - P049878			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Institutional Development Impact**	Modest	Modest	———
Risk to Development Outcome	———	———	Moderate
Sustainability***	Likely	Likely	———
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory
First Poverty Reduction Support Credit - P075805			
Outcome	Satisfactory	Satisfactory	Satisfactory
Institutional Development Impact**	Substantial	Substantial	———
Risk to Development Outcome	———	———	Moderate
Sustainability***	Highly Likely	Likely	———
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory
Second Poverty Reduction Support Credit – P056201			
Outcome	Satisfactory	Satisfactory	Satisfactory
Institutional Development Impact**	Substantial	Substantial	———
Risk to Development Outcome	———	———	Moderate
Sustainability***	Likely	Likely	———
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible Bank department. The Evaluation Summary (ES) is an intermediate IEGWB product that seeks to independently verify the findings of the ICR.
**As of July 1, 2006, Institutional Development Impact is assessed as part of the Outcome rating.
***As of July 1, 2006, Sustainability has been replaced by Risk to Development Outcome. As the scales are different, the ratings are not directly comparable.

Key Staff Responsible

Project	*Task Manager/Leader*	*Sector Manager*	*Country Director*
Economic Management and Private Sector Operation - P049878			
Appraisal	Peter Moll/Antonio Franco	Philippe H. Le Houerou	Darius Mans
Completion	Jose Luis Macamo	Emmanuel Akpa	Michael Baxter
First Poverty Reduction Support Credit - P075805			
Appraisal	Antonio Franco/Johannes Zutt	Emmanuel Akpa	Michael Baxter
Completion	Gregor Binkert	Emmanuel Akpa	Darius Mans/Michael Baxter
Second Poverty Reduction Support Credit - PO56201			
Appraisal	Antonio Franco/Johannes Zutt	Emmanuel Akpa	Darius Mans/Michael Baxter
Completion	Gregor Binkert	Emmanuel Akpa	Michael Baxter

Preface

This is a Project Performance Assessment Report (PPAR) on three operations in Mozambique: the Economic Management and Private Sector Operation (EMPSO) approved on August 29, 2002; the First Poverty Reduction Support Credit (PRSC I) approved on July 6, 2004; and the Second Poverty Reduction Support Credit (PRSC II) approved on September 13, 2005.

EMPSO was supported by a development policy credit of $120 million equivalent. Both PRSC I and PRSC II were general budget support operations provided in the spirit of the Paris Declaration. The first consisted of a single tranche of $60 million equivalent grant, and the second consisted of an IDA credit of two tranches for a total of $120 million equivalent.

This report is based on a review of relevant documentation, interviews with World Bank staff members at headquarters in Washington D.C., as well as interviews in Maputo during the first half of February 2009 with members of the Mozambican authorities and civil society, Bank and International Monetary Fund (IMF) staff members, and representatives of some of the main development partners (Annex II).

A summary of the main findings, conclusions and lessons is presented prior to the main body of the report.

Chapter 1 gives a brief presentation of the political and economic backgrounds and an equally brief summary of World Bank support during the 1987-2002 period, essentially from the time soon after Mozambique became a member of the World Bank, up to the year that the EMPSO was approved.

Chapter 2 presents a summary of the main elements of Mozambique's overall socio-economic development strategy, the Bank's assistance strategy, and the fit of the three reviewed operations within these strategies.

Chapters 3, 4, and 5 present assessments of EMPSO, PRSC I, and PRSC II, respectively; including the assignment of standard Independent Evaluation Group (IEG) review ratings for all three projects, with regard to: outcome, risk to development outcome, Bank performance, and Borrower performance.

Finally, Chapter 6 starts with a very brief evaluation of the three operations taken together, and concludes with a listing of the main lessons learned from this assessment, and some of the main lessons mentioned in the ICRs or IEG reviews covering the three projects.

Summary

1. ***Background and Context.*** At the turn of the millennium, Mozambique had suffered heavily through a destructive civil war during its first fifteen years since its independence in 1975. With the signing of the Peace Accord in 1992, the government was able to start directing its efforts at economic stabilization, reconstruction, and growth; while it made the painful but rewarding fundamental changes, from a command to a market economy, and from a colonialist past and severe civil conflict to peace and a multi-party democracy. The efforts paid off. Overall macroeconomic performance during the nineties was impressive, as was the reduction in poverty that was achieved. A significant start and initial progress was made in several important areas of structural reforms; and by the dawn of the new millennium, the country had developed a very favorable track record as an achiever and effective recipient of international aid. It was judged by the community of its development partners as poised for further growth and development, and was ready for a new generation of analytical work and lending operations to help deepen economic reform, and deal with the still very high level of poverty and very low level of social development. Also, by the beginning of the review period covered by this report, the need was felt to direct a much more explicit and forceful effort at aid coordination, a subject that had formed one of the three strategic pillars of the Bank's 1997 Country Assistance Strategy (CAS), covering the 1998-2000 period.

2. ***Mozambique's Development Strategy.*** The government's overarching strategic economic development objective has been the promotion of growth, in order to reduce poverty and improve the general well-being of the Mozambican people. This broad objective guided the design of the medium-term *Five-Year Development Program (FYDP) for 2000-04*, which incorporated the government's interim *Action Plan for the Reduction of Absolute Poverty* (PARPA – its Portuguese acronym) for the identical period.

3. The three main pillars of the FYDP and PARPA consisted of: (i) *increasing economic opportunities* by generating poverty-reducing and employment-creating growth, through the private sector; (ii) *improving governance and empowerment* through a more effective public sector, improving the rule of law, and promoting greater accountability and transparency; and (iii) *improving human capabilities* by strengthening the delivery of social services and safety nets. Implicit in the first pillar was the maintenance of *macroeconomic stability* which is often an essential pre-requisite for sustained growth. Another related objective to growth was to *decrease the dependence on external financial assistance* which had been one of the highest in the world. These strategic pillars were translated into specific policies, measures, and some quantitative targets and triggers designed to meet the stated objectives, and captured in a number of government planning and monitoring documents.

4. ***The World Bank's Assistance Strategy.*** The Bank's assistance strategy over the period encompassing the three operations assessed in this report was very closely aligned with the government's own overall economic development strategy and plans. This

alignment became even closer throughout the period, as implementation matrices and benchmarks were also meshed; and greater coordination among the large group of donors ensured that the alignment included the assistance strategies of all concerned. In terms of content, the two CASs that overlapped with this period essentially shared the same strategic objectives and covered the same policy areas. The overall intent was to assist the government in its efforts to promote growth in order to improve the country's standard of living and to reduce poverty. This was to be achieved primarily through maintaining a stable macroeconomic environment; and promoting private sector initiative, particularly for small and medium-sized domestic enterprises (SMEs), and in agriculture. To that end, public sector performance needed to be improved through capacity building measures, better governance, and administrative decentralization; the financial sector needed to be developed and strengthened; and human resources needed to be developed through the provision of improved education and health services. Very close coordination among the government and its development partners, including the World Bank, would help mobilize the needed levels of financial assistance and increase the chances of their efficient use. The policy and institutional development areas supported by the three operations were prominently featured in the government's and the donors' strategies and programs.

5. ***Economic Management and Private Sector Operation (EMPSO).*** This project aimed at assisting Mozambique in improving public sector management and promoting private sector development. It was essentially a development policy operation (DPL) that addressed a broad range of policy areas. Under the public sector management component, the main areas covered included: (a) expanding the budget's coverage to include the own receipts *(receitas proprias)* of the ministries, and expenditures funded by development partners; (b) disseminating the findings of a recently completed public expenditure review by the Bank; and (c) tax reform measures to decrease the level of effective protection. Under the private sector development (PSD) component, the main areas included: (a) a broad set of financial sector reform measures for both banking and non-banking institutions designed to avoid a financial crisis that had been looming, and lay the foundations for a healthy development of this sector; (b) measures to improve the performance of the telecommunications, air transport and petroleum sectors; and (c) legal and judicial sector reforms.

6. Good, though incomplete, progress was made in the Public Financial Management (PFM) and financial sector areas. Limited progress was made in PSD in general, although the privatizations in the telecommunications and air transport sectors were carried out. As a result, the employment generating effect of any PSD was very limited. Finally, the very limited and slow progress in legal and judicial reform was disappointing. In all, this assessment agrees with the IEG review that the overall outcome of this project merits a rating of *moderately satisfactory*, a notch below the satisfactory rating given to it by the ICR.

7. The risk to development outcome is rated *moderate* for a number of reasons: (i) the government and its development partners, including the Bank, have been and continue to be committed to achieving better progress in the areas of the reform covered by this project; (ii) the political climate in the country has remained stable, and prospects

for continued stability are good; and (iii) a number of new key institutions, frameworks, regulations, and processes have been set up, and are likely to be strengthened over time.

8. The design of this operation was completely consistent with the government's development strategy, and the Bank's assistance strategy. The specific components and measures selected as conditions for the disbursement of the first and second tranches were appropriate. The operation was closely supervised by the Bank with four project status reports. In addition, staff of the Bank's office in Maputo met regularly with counterpart officials to review progress. This assessment, therefore, agrees with the ICR and the IEG review that the Bank's overall performance merits a rating of *satisfactory*. The implementing agencies for this operation, both the government and the Central Bank, assigned competent personnel, though small in number considering the paucity of professionals in the country, who collaborated very closely and openly with the Bank; and their stable tenure in their positions provided continuity and predictability during the project preparation and implementation. All relevant information was made available to the Bank, with few exceptions like the purchase contract for Banco Austral. Training was provided to relevant staff that enabled them to extend their experience to working with the private sector. Still, the preparation of the project took a long time, partly due to the resistance by managers in the financial sector to subject their institutions to full forensic audits, which the Bank had to reluctantly abandon. On balance, this assessment agrees with the ICR and the IEG review that the Borrower's overall performance merits a rating of *satisfactory*.

9. ***First and Second Poverty Reduction Support Credits (PRSC I and PRSC II).*** These two operations shared a common objective, and consisted of identical components; although some of the specific measures under these components might have differed. The three common components were: (i) building public sector capacity and accountability; (ii) improving the investment climate, particularly for the private sector; (iii) expanding service delivery in education, health, water supply, and sanitation. Specific measures included as prior conditions, or second tranche conditions under the second operation essentially reiterated, or built upon, the same or similar conditions under the first operation.

10. Thus, the main measures included in the first and the second operations under the three project components were:

(i) building public sector capacity and accountability through maintaining a sound macroeconomic policy framework; maintaining the share of poverty reducing expenditures at close to 65 percent of total public expenditures; improving the management of public expenditures; increasing revenues to enable fiscal prudence; introducing clear and transparent procurement practices; building the capacities of local authorities for planning, budgeting, financial management, and service delivery; strengthening the regulatory framework for business; and developing the capacity of the government to deal with corruption more aggressively;

(ii) improving the investment climate through more effective supervision of banking and non-banking financial institutions; moving towards more efficient and profitable banks; a complete divestiture of the government of its interests in the banking system; reducing

the level of effective protection to local industries; and allowing for a more efficient and flexible labor law, which would allow businesses to become more competitive; and

(iii) expanding service delivery through reducing the mortality rate for mothers and infants; increasing access to basic health services; increasing access and retention, and reducing gender inequalities in primary education; and increasing access to potable water and sanitation.

11. The overall outcome of the two operations taken together was *satisfactory*. The public sector capacity and accountability component broadly performed well and achieved good results. Again in the context of an ongoing IMF program, macroeconomic stability was maintained and overall macroeconomic performance was good. PFM, which received the lion's share of prior conditions under the entire Poverty Reduction Support Credit (PRSC) series (PRSC I through V), also did well; while the progress made in the governance area was partial and uneven. Under the investment climate component, financial sector development (FSD) fared well except for access to affordable credit by SMEs and farmers, which remained a key constraint to employment generating PSD-led growth. As for the social services delivery component, the target of providing 65 percent of budget expenditures to priority sectors was met (again, throughout the entire five PRSC operations), and Joint Reviews of the Performance Assessment Framework (PAF) by the government and development partners ascertained that specific implementation targets across most of the sectors concerned (education, health, water supply, and sanitation) were broadly met, while those for agriculture and rural development made partial and limited progress.

12. The risk to the development outcome of these two projects is rated *moderate*, and could have its origins in a number of factors including: (i) some potential for macroeconomic instability, (ii) the availability of funds from development partners may become less certain, (iii) limited implementation capacity, and (iv) the potential for deterioration in governance. However, as detailed in the main text, these risks have been mitigated by a number of specific factors and more general considerations related to government commitment, political stability, and some significant institutional and procedural reforms. The Bank's and Borrower's performance are both rated *satisfactory* throughout the preparation and implementation stages of the projects.

13. ***Overall Evaluation and Lessons***. The three operations reviewed in this report fell within a period of transition in the modality of the Bank's support to Mozambique's development agenda at the core structural level; from a DPL mode represented by the Economic Management and Private Sector Operation (EMPSO), to a general budget support (GBS) mode represented by PRSC I and PRSC II, which were followed by three additional PRSCs that were completed by the end of 2008, at the time this report was being drafted. Although the achievements of EMPSO were only partial, they were quite encouraging and sufficient to help set the stage for introducing the GBS mode of support, at a time when the country was keen to have it, and the community of development partners had reached the conclusion to embrace it. As the first two such budget support operations in Mozambique, and taken together, PRSC I and PRSC II achieved broadly satisfactory results; and helped to maintain the momentum of commendable overall

macroeconomic performance, and ongoing though uneven progress across a wide front of other policy areas.

14. As a new approach that had been adopted by the donor community, the GBS/PRSC modality, which had its conceptual origin in the Paris Declaration, argued for tightly coordinated direct budget support by development partners to countries with a proven economic development record. The country itself was expected to assume the leadership in driving its own development program, and to be accountable for its implementation. The partners, in turn, would be accountable for providing predictable and appropriate levels of direct budget support. In the case of some partners, like International Development Association (IDA), disbursement of funds would be linked to prior actions, as opposed to conditions on any future disbursement, as in DPLs, for example. Thus, the emphasis would essentially be on "monitoring" past/ongoing performance, instead of "motivating" anticipated performance through conditionality.

15. As with other countries, the question has arisen in the case of Mozambique as to whether this modality of assistance has worked well, in comparison to alternatives. In fact, as of the drafting of this report, an internal Bank study was conducting a broad, multi-country analysis of the subject, including a case study of the experience in Mozambique. The comprehensive draft report of this case study concluded that the PRSC has served well as an instrument to coordinate the Bank's budget support with that of other general budget support financiers. The GBS is fully integrated with the government's PARPA. However, the current GBS set-up prevents flexibility and does not allow focusing the policy dialogue on core policy reforms and their implementation if they have not been already been supporting the performance assessment framework matrix. According to this case study, this inflexibility has been related to the mismatch in timing between the PAF process and the Bank's own, internal review processes. This Project Performance Assessment Report (PPAR) agrees that the PRSCs have done well as an instrument of predictable budget support, and of coordination among the partners and the government. The government officials interviewed by the PPAR mission certainly felt that this modality of support recognized the ownership and lead role played by the government, a welcome departure from the past. They also felt that the partners' efforts, including those of the Bank, to align their support with the PAF have been broadly successful, and appreciated.

16. As for the inflexibility of the PRSC modality regarding policy dialogue and implementation, opinions of the participants in the process seem to have been divided. Some of the participants interviewed by the PPAR mission have felt that the instrument has been rather inflexible with regard to policy content. Others, while agreeing to the timing problems associated with monitoring past performance instead of motivating future actions, have argued that the process has still allowed for flexibility, at least in policy dialogue, through the reviews of ongoing PAFs, and the possible introduction of policy measures either in new PAFs, through parallel sector, or investment operations. But even those proponents of the GBS/PRSC approach have agreed that efforts should still be considered to make the process more flexible and responsive, particularly as new, unforeseen developments emerge. This PPAR feels that the PRSC instrument has worked well; and that, on balance, its advantages have outweighed its disadvantages, which is a view shared by the IEG case study.

Lessons

17. The main lessons that emerge from the analysis in this PPAR, as supplemented by the analysis conducted in the context of the Country Assistance Evaluation (CAE) which was being carried out simultaneously, are as follows:

- The very good macroeconomic performance sustained by Mozambique over the last two decades suggests that as long as the country is following prudent and effective macroeconomic stabilization and management policies in the context of ongoing IMF programs, it is sufficient for the Bank's assistance program, as has been done in the context of the EMPSO and the PRSC series, to base its evaluation of macroeconomic developments on IMF's assessment, and to provide ancillary support (such as in trade policy, public expenditure allocation, and some specific revenue enhancing measures), without devoting major extra efforts itself across the whole spectrum within this policy area. The important thing is for the Bank to reach its own evaluation that macroeconomic performance is satisfactory, without necessarily having to do all the assessment itself.
- The experience of Mozambique also suggests that the PRSC/GBS modality seems to have yielded broadly satisfactory results, which have been at least as good as alternative modalities, but with the added advantage of having the country itself leading its development agenda and playing a central role in coordinating the assistance from its development partners. The presumption of a proven track record, while not a guarantee for continued success, is an important pre-condition. Close monitoring and evaluation by the country and its partners during implementation is also very important. Meanwhile, this assessment agrees with views expressed by a number of participants in this modality that it would be useful to look for ways to introduce more flexibility in the underlying decision processes, to allow for the incorporation of policy and implementation adjustments in response to changing conditions, as needed.
- The experience of the financial sector and that of the telecommunications and air transport sectors, suggests that accompanying budget support, or DPL operations, with related Technical Assistance (TA) may increase the chances for success. However, for more complicated sectors like PSD, or agricultural and rural development, this may not be sufficient, and there may be a need for additional interventions.
- Stability in the composition of Bank and counterpart project teams, and close involvement of staff of the Bank's Office in Maputo at all stages of project preparation and implementation are important for increasing the chances of success of Bank-supported operations.
- When a project seeks to achieve changes in legislation, regulations, and processes; it is important for it to articulate well-defined and achievable results indicators that allow for effective monitoring of implementation, and adjusting the process as needed. In this context, the Bank should pay particular attention to help in strengthening the Borrower's monitoring & evaluation (M&E) capacity.
- Several efforts by Mozambique and its partners to make credit more accessible to SMEs and micro-borrowers through more orthodox banking practices have not

yielded encouraging results, so far. Granted that this objective is inherently difficult in a very poor country with a predominant informal/rural sector, with a low level of education and training. This suggests that less orthodox and more innovative measures may be needed. In view of the paramount importance of creating employment, particularly in underserved rural areas, political economy considerations may even call for some more risky measures whose social dividends could counterbalance any additional risks.

18. Finally, a lesson cited in the Simplified ICR for PRSC I, which was particular to that operation, was the need to take electoral cycles into consideration and avoid aiming at approvals of key legislation during election periods (e.g., the labor and procurement laws were delayed because of the 2004 elections). It is not clear to this assessment that, in practical terms, it is correct to generalize this "lesson". Most countries go through various election cycles regularly, and often these elections do delay some procedures, including approval of laws. On balance, however, it seems that it would be better on many occasions to just live with this fact and move ahead, trying to approve various measures. Keeping the momentum and the pressure to follow through may be the right thing to do under some conditions, despite ongoing elections.

19. ***Recommendation.*** The three operations reviewed in this report all sought to assist the government's efforts to promote sustainable and more equitable growth through support for PFM, PSD, and FSD. Although progress has been made to this end, due in part to these three operations, but also to subsequent PRSCs; the single most important recommendation of this assessment, in line with the main CAE finding, is for the Bank to give an even higher priority to assist the country in its efforts to modify its growth pattern and make it more inclusive and employment generating. This can be done by building on the achievements so far in the areas of macroeconomic performance, FSD, and PSD. In particular:

- Stronger efforts should be directed at making credit more accessible to SMEs and the agricultural/rural sector. To this end, more attention could be directed at developing financial intermediation in these areas, including through the promotion of non-banking institutions and schemes like the network of traders that had operated before independence.
- Much stronger efforts should also be made to simplify and streamline business procedures and regulations; and, in particular, to deal more imaginatively with the problem of collateral.
- The good experience with the privatization of the telecommunications and air transport sectors, as well as the good overall progress made in the financial sector; argue for the use of TA operations in parallel to budget support, or DPL-type operations. Although not a guarantee of full success, such TA could prove very helpful.

1. Background and Context

Political Background

1.1 Mozambique was colonized by Portugal in 1500. It became independent on June 25, 1975, after ten years of a guerilla campaign, led by the Front for the Liberation of Mozambique (FRELIMO). The new government of Samora Machel supported liberation movements in both South Africa and Zimbabwe (Rhodesia, at the time). In turn, these two countries fostered and financed the Mozambique National Resistance (RENAMO) armed rebel movement, igniting a very costly civil war; about one million people were killed, close to two million took refuge in neighboring states, and several millions were internally displaced. An already poor infrastructure was further weakened, and private enterprises nationalized, when a Marxist economic system was adopted soon after independence. In addition, a mass exodus of Portuguese nationals and Mozambicans of Portuguese heritage took place, depleting the new nation of much needed qualified personnel. The civil war, with its devastating effects on infrastructure and economic production and services in general; the loss of qualified manpower; and according to some, the imposition of an inefficient centrally-planned economic management system led to a near collapse of the economy and society. In 1986, President Machel died in a plane crash.

1.2 The new President, Joaquim Chissano, began peace talks with RENAMO and initiated market-oriented economic reforms in 1987. A new constitution was enacted in 1990. It provided for a multi-party political system based on free elections, and a market-based economic system. A peace accord signed in October 1992 brought the civil war to an end, and with the new economic management regime, signaled the beginning of a new era that laid the foundations for improved economic, political and social conditions; despite severe difficulties that were to prevail to the present day, particularly with regard to poverty and the devastating effects of HIV/AIDS.

1.3 On the political side, the country has moved steadily in a basically stable manner through a number of parliamentary, presidential, and local elections in recent years. FRELIMO has managed to remain ahead of RENAMO in all these elections and has, therefore, maintained its control over the National Assembly, the Presidency, and the Cabinet; with RENAMO accounting for a sizeable opposition party. The December 2004 parliamentary and presidential elections kept up this pattern, and Armando Guebuza, also from FRELIMO, was elected.

Economic Background

1.4 Even before the signing of the Peace Accord in 1992, early efforts at economic reform had started in 1987. With the end of the civil war, and following the elections of 1994, the Guebuza government was in a position to accelerate economic reforms. The country was rewarded by impressive achievements at the overall macroeconomic level. Over the 1994-99 period, real growth averaged more than 8 percent annually, and accelerated to over 10 percent, during 1999-2001; making Mozambique one of the fastest growing economies of the world during that period. Meanwhile, inflation fell from about

60 percent in 1994, to less than 10 percent in 1997, and beyond. The poverty headcount fell from almost 70 percent in 1996-97 to 54 percent in 2002-03. Structural reforms were also started; with the liberalization of prices, the exchange rate, and external trade; and the re-privatization of the previously nationalized entities, including banks. For example, about 800 of 1,250 (64 percent) entities were privatized by 1997, during the first decade of reforms. Very few interventions by the government in the agricultural sector remained by the mid-1990s. The telecommunications sector was liberalized considerably, as was the commercial air transport sub-sector; and throughout the nineties, import tariffs were steadily decreased to an average of 9 percent, among the lowest in Africa. A start was made to liberalize and strengthen the financial sector, and early efforts were directed at improving fiscal performance.

1.5 These rapid and successful early efforts made Mozambique one of the most promising Sub-Saharan countries with regard to growth and development. By 2000, it ranked third among 24 countries on an "optimism index" that reflected the views of international businesses active in Africa, as reported in a World Bank country economic review in 2001. External financial assistance, in addition to increased political stability and the economic reforms, made all of this possible. In addition, a one-time significant development that contributed to this performance was the "bounce-back" effect in agriculture, due to a combination of two factors. First, the cultivated area doubled, with the return of war refugees to their lands; and second, yields also doubled with the abandonment of the rigid command economy in favor of the more flexible market system.

1.6 Despite this impressive record, however, a number of very serious problems remained at the turn of the new millennium. In 2000, per capita income stood at only $220, among the lowest in the world. More than two thirds of the population lived below the poverty line. About 60 percent of the adult population (76 percent of women) could not read, and life-expectancy at birth was only 46 years. All these indicators were even below the Sub-Saharan average. These sobering facts highlighted the need for maintaining high growth, and more importantly, ensuring that its benefits should reach the poorer and less-advantaged segments of the population. The 2001 country economic review argued for aiming at a growth rate above 7 percent; since such a rate, combined with even a moderate population growth rate, would mean that Mozambique would need a full century before it could attain current (at the time) average incomes in countries like Mauritius, or Mexico.

Summary of Prior World Bank Support (1987-2002)

1.7 The Bank started its support for Mozambique in the mid-1980's, before the end of the civil war and the signing of the Peace Accord in 1992. The early emphasis of lending operations was on: general rehabilitation projects (two operations by 1987, followed by a third in 1989); a wide range of infrastructure projects in various sectors (e.g. urban facilities, roads and bridges, energy and power, and railways and ports); a number of operations in social services (mainly basic education and health services); a few projects in agriculture and rural rehabilitation; and a number of free-standing TA and capacity building operations in a range of sectors (e.g. finance and economic management, public

sector and the legal institutions, transport, and natural gas development), in addition to a wide range of TA components in sector, or investment operations, across the board.

1.8 With the end of the civil war in 1992, a series of three Economic Recovery Credits (ERCs) was initiated (the first in 1992, the second in 1994, and the third in 1997), in addition to continuing operations in infrastructure, agriculture, social services and TA for capacity building (including a Mineral Resource Management Capacity Building Project in 2001, in view of the potential importance of this area to the economy). The three ERCs were designed to support the country's reform agenda which focused on macroeconomic stabilization, private sector led growth, and human resource development. In addition, an Economic Management and Reform Operation (EMRO) was approved in 1998. This two-tranche grant provided in the context of the Highly Indebted Poor Countries (HIPC), sought to support the government's efforts to maintain a stable macroeconomic environment and to improve public sector operations. It consisted of a tax and trade reform component, and a budget management component. The first aimed at reducing tax-induced distortions, and improving tax and customs administration. The second aimed at improving the coverage and transparency of the budget, ensuring funding of recurrent expenditures on health, education, and the maintenance of infrastructure, containing civil service salaries, and improving the prioritization and sustainability of public expenditures, within a Medium-Term Expenditure Framework. Finally, a Flood Emergency Recovery operation was approved in 2000 to help ameliorate the significant adverse effects of the flooding that year on agricultural production and the economy at large.

1.9 In all, during this sixteen-year period (1987-2002) preceding the start of the three operations reviewed in this report; a total of 33 operations were approved, averaging about 2.1 operations per annum. The main thrust of all this operational support was on helping Mozambique: (i) rehabilitate and recover from the devastating effects of the civil war, (ii) set up and strengthen institutions and processes required for nation building, and (iii) start the transition from a command to a market economy, in an effort to promote higher growth to alleviate poverty.

1.10 The analytical and advisory work (AAA) completed by the Bank during the 1987-2002 period basically underpinned its operational program and its policy dialogue with the government. During the earlier years, it focused heavily on sector analyses in such areas as: energy/electricity, agriculture and fisheries, manufacturing and SME development, foreign investment, telecommunications, poverty reduction, environmental issues, health, and water resource management. Surprisingly, until the 2001 country economic review, it seems that hardly any overarching formal economic work had been completed. A first of a two-phase public expenditures management review was completed in 2001; and both a financial accountability assessment and an investment climate assessment were completed in 2002.

1.11 In addition to lending operations and AAA, the Bank provided support in two other important areas: external debt consolidation and reduction, and aid coordination. It provided technical support for Mozambique's Paris Club debt-rescheduling agreements (the fifth such agreement was concluded in November 1996), and also approved an HIPC debt-reduction package for which Mozambique reached the completion point in June

1999. The completion point for an enhanced HIPC was reached in September 2001. The total debt relief received exceeded $2 billion in net present value terms. As for aid coordination, the 1997 CAS, covering the fiscal year 1998-2000 period, included "Strengthening Development Partnerships" as one of its three strategic pillars. Mobilizing and coordinating aid was one of the main objectives under this pillar, and remained an important objective for the Bank in subsequent periods, one that was met with considerable success, as demonstrated under the PRSCs.

Concluding Remark on the Overall Context for the Three Operations

1.12 The three operations reviewed in this report (EMPSO, PRSC I, and PRSC II) were approved in August 2002, July 2004, and September 2005, respectively. The PRSC series had been originally envisaged to consist of four annual, single-tranche operations. However, due to timing considerations regarding PARPA II, it was reduced to three, with a second set of three PRSCs to coincide with PARPA II. Then, due to timing considerations regarding some co-financiers and the country's budgetary cycle, the first series was further reduced to two operations, and PRSC II was modified into a two-tranche operation; although it still closed in June 2006, within only nine months of its approval. In effect, therefore, the three operations covered in this review spanned a four-year period, from about mid-2002 to mid-2006; and more significantly for the purposes of this review, they more or less shared the common background and context summarized in the three previous sections of this chapter. In view of this observation, and in the interest of avoiding wasteful repetition, this chapter provides a common overall background and context. In case of any developments which are not reflected in this chapter and that were significant for a specific operation, they are reflected in the respective chapter covering that operation.

1.13 ***To summarize***, at the turn of the millennium, Mozambique had suffered heavily through a destructive civil war during its first fifteen years of independence starting in 1975. With the signing of the Peace Accord in 1992, the government was able to start directing its efforts at economic stabilization, reconstruction, and growth; while it made the painful but rewarding fundamental changes, from a command to a market economy, and from a colonialist past and severe civil conflict to peace and a multi-party democracy. The efforts paid off. Overall macroeconomic performance during the nineties was impressive, as was the reduction in poverty that was achieved. A significant start and initial progress was made in several important areas of structural reforms; and by 2002, the country had developed a very favorable track record as an achiever and effective recipient of international aid. It was judged by the donor community as poised for further growth and development, and was ready for a new generation of operations to help deepen economic reform, and deal with the still very high level of poverty and very low level of social development. For the World Bank, the three operations reviewed in this report were completely consistent with its strategy for assisting the government in attaining this end, as will be discussed in the next chapter.

2. Development and Assistance Strategies

2.1 This chapter presents the strategic context, both from the standpoint of Mozambique and the Bank's assistance to the country; at the time of inception of EMPSO, PRSC I, and PRSC II, roughly from 2002 to 2005. As with the overall political and economic background and context, given the short period over which the three operations were implemented in relation to the time normally needed to change strategic considerations, the three operations essentially shared a common strategic context.

Mozambique's Strategic Orientation and Framework

2.2 The overarching strategic economic development objective of the government at the turn of the millennium was to promote growth in order to reduce poverty and improve the general well-being of the Mozambican people. This broad objective guided the design of the medium-term Five-Year Development Program (FYDP) for 2000-04, which incorporated the government's interim PARPA for the identical period. This action plan was endorsed by the Bank and the IMF in March 2000 and was accepted to serve as the country's interim PRSP. An updated PARPA II (2001-05) was completed in April 2001, and was again endorsed by the Bank and the IMF in August 2001 as Mozambique's first full PRSP, allowing the country to achieve the enhanced HIPC completion point.

2.3 The three main pillars of the FYDP were: (i) increasing economic opportunities by generating poverty-reducing and employment-creating growth, through the private sector; (ii) improving governance and empowerment through a more effective public sector, improving the rule of law, and promoting greater accountability and transparency; and (iii) improving human capabilities by strengthening the delivery of social services and safety nets. Implicit in the first pillar was the maintenance of macroeconomic stability which is often an essential pre-requisite for sustained growth. Another related objective to growth was to decrease the dependence on external financial assistance which had been one of the highest in the world. These strategic pillars were translated into specific policies, measures, and some quantitative targets and triggers designed to meet the stated objectives, and captured in a number of government planning and monitoring documents.

The World Bank's Assistance Strategy

2.4 The Bank's assistance strategy for the period covering the three operations was articulated in two CASs: the June 2000 CAS covering fiscal year 2001-03, and the October 2003 CAS covering fiscal year 2004-07.

2.5 ***The 2000 CAS***, by explicit design and in agreement with the government, adopted the identical three pillars of the FYDP: increasing economic opportunities, improving governance and empowerment, and improving human capabilities. In fact, the drafting of this CAS meshed into it the main substantive content of the FYDP by stating how each of the major program objectives was to be assisted by specific Bank operations, or services. The CAS went further and harmonized its targets and performance indicators with the monitoring plan of the FYDP and the PARPA.

2.6 According to this CAS, the three common pillars were to be achieved by policies and measures in a number of key areas as follows:

2.7 *Pillar I: Increasing economic opportunities* was expected to be achieved by: (i) strengthening the private sector environment and the financial sector; (ii) developing infrastructure; (iii) promoting rural development and agriculture; (iv) ensuring sound environmental management; and (v) promoting innovation, competitiveness and employment.

2.8 *Pillar II: Improving governance and empowerment* was expected to be achieved by: (i) reforming the public sector; and (ii) improving the rule of law.

2.9 *Pillar III: Increasing human capabilities* was expected to be achieved by: (i) containing and reducing the impact of HIV/AIDS; (ii) improving health; (iii) improving education; and (iv) improving social protection.

2.10 The CAS then went on to describe how specific products within the Bank's proposed assistance program for the fiscal year 2001-03 period, in each of the key policy areas, would meet the main objectives of the three common pillars. In particular, the first of the three operations reviewed in this report, *the EMPSO, was introduced in this CAS*, under the first item of its first pillar, dealing with the strengthening of the private and financial sectors.

2.11 ***The 2003 CAS*** was a rather voluminous document, consisting of 45 pages of text and almost 80 pages of annexes. It included a useful evaluation of progress under the 2000 CAS and the PARPA. The main lessons learned from this evaluation, in line with those of the Completion Report for the 2000 CAS, were: (i) the Bank needed to be more strategic and selective in its support; (ii) the design of Bank-supported projects should be simple, in view of the country's limited implementation capacity; (iii) recurring cross-cutting implementation risks needed to be realistically assessed and consistently addressed; (iv) the Bank Group needed to improve monitoring its own results, and its assistance to the government in monitoring its PARPA results; and (v) the development partners needed to make a greater effort to improve the alignment of their support with the PARPA, and to assist the government in improving its implementation capacity.

2.12 In line with the last lesson, this CAS gave a detailed account of the elaborate consultative process that had been involved in its preparation among a wide range of stakeholders: the government, the donors, non-governmental organizations (NGOs), the private sector, and opinion leaders. Several lengthy meetings were also held among the Bank, International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) to coordinate and align their respective and joint assistance. The CAS also briefly highlighted some areas in which it disagreed with the government on how some issues should be handled; such as labor regulations, land use, the divestiture of state-owned enterprises, and the pace of reform in the legal and regulatory area.

2.13 The *PRSC series was introduced in this CAS* as a group of operations that would be ideal for promoting the desired improvement in coordination efforts among the government and the donors (the Group of 11, in 2003; which subsequently grew into the

Group of 19). This coordination took on a very practical shape when it was agreed in September 2003 that the government would develop a Performance Assessment Framework (PAF); a "matrix of policy and institutional reforms, with results-focused monitoring indicators and progress benchmarks, for which the government is prepared to be held to account, and against which donors would agree to provide budget support in more predictable ways" (Box 7, page 22 of the 2003 CAS).

2.14 As with the other CASs for Mozambique, the 2003 CAS also had three strategic pillars. They were: (i) *improving the investment climate*; (ii) *expanding service delivery, both to businesses and to the poor*, and (iii) *building public sector capacity and accountability structures*. These pillars were essentially the same as those of the 2000 CAS, as was natural to a great extent, and freely admitted in this CAS. The main improvements sought, based on the experience with the previous CAS, were to embed this CAS in a much more coordinated framework among the government and the large group of donors, and to put much more emphasis on accountability of all concerned, through the PAF and its process. In terms of substance, the intent was to deepen and broaden the ongoing reforms that had been started under the previous CASs.

The Strategic Fit of the Three Reviewed Operations

2.15 It is worth noting that the overall strategic orientation of the government's economic development program, as supported by the donor community, remained essentially unchanged and appropriate from the nineties to the present. This is evident from a review of the November 1997 CAS, covering the fiscal year 1998-2000 period; as well as the April 2007 Country Partnership Strategy (CPS), covering the FY08-11 period. Both these documents sought to support the government's overarching objective of reducing poverty through: sustained growth led by the private sector, providing improved social services, and improving public sector performance and accountability; although the specific wording of these three fundamental pillars was slightly different.

2.16 *In summary*, the Bank's assistance strategy over the period reviewed in this review (and, in fact prior to that) was very closely aligned with the government's own overall economic development strategy and plans. The alignment became even closer throughout the period, as implementation matrices and benchmarks were also meshed; and greater coordination among the large group of donors ensured that the alignment included the assistance strategies of all concerned. In terms of content, the two CASs essentially shared the same strategic objectives and covered the same policy areas. The overall intent was to assist the government in its efforts to promote growth in order to improve the country's standard of living and to reduce poverty. This was to be achieved primarily through maintaining a stable macroeconomic environment; and promoting private sector initiative, particularly for SME-sized domestic enterprises, and in agriculture. To that end, public sector performance needed to be improved through capacity building measures, better governance, and administrative decentralization; the financial sector needed to be strengthened and developed; and human resources needed to be developed through the provision of education and health services. Very close coordination among the government and its development partners, including the Bank, would help mobilize the needed level of financial assistance and increase the chances of its efficient use. The first operation reviewed in this report had its origin in the 2000

CAS, and the last two (originally expected to be four, but compressed to two for practical, inter-donor timing considerations, as well the desire to align the second set of three PRSCs with the government's PARPA II cycle) had their origin in the 2003 CAS. The first was subsumed under the growth strategic pillar, which called for improving the business environment to promote private sector development. The PRSCs included components corresponding to all three strategic pillars of the CASs.

3. Economic Management and Private Sector Operation (EMPSO)

Background and Context at Appraisal

3.1 Over the six years previous to the preparation of this operation (1996-2001), Mozambique's overall economic performance had been impressive. Gross Domestic Product (GDP) growth had averaged about 9 percent annually, that of per capita gross national product (GNP) about 7 percent, and exports about 20 percent. Inflation had been reduced dramatically from about 57 percent in 1996 to single-digit levels. The flooding in 2000 and 2001 briefly interrupted this trend. Growth dipped temporarily and, due to flood related emergency expenditures and the need to recapitalize the two largest commercial banks over this same period, inflation increased to about 22 percent. At the time this operation was being prepared, the economy was expected to start re-stabilizing and inflation to drop to about 13 percent by end-2003.

3.2 In 2001, the government prepared the PARPA which, among other goals, aimed at reducing absolute poverty from 70 percent in 1997, to 60 percent in 2005, and by 50 percent in 2010. PARPA's development strategy focused on economic growth, public investment in human capital and infrastructure, and on institutional and policy reforms to improve the environment for private investment. Growth was expected to be driven by large-scale, capital-intensive projects financed by private foreign investors; productivity gains in agriculture and manufacturing; and expansion in internal trade, transport, and services. The PARPA highlighted six priority areas for action: health, education, infrastructure, agriculture and rural development, governance, and macroeconomic and financial policies. It also delineated specific policy measures in each priority area, and established targets and milestones in an operational matrix.

Project Objectives and Design

3.3 In accordance with the PARPA strategy and objectives, the EMPSO aimed basically at improving public sector management and the environment for private investment. As mentioned in the previous chapter, these objectives were entirely consistent with both the government's FYDP and the Bank's 2000 CAS, both of which shared identical strategic pillars. The project was essentially a DPL that addressed a relatively wide range of policy areas within these two broad components. The specific details of these policy areas were discussed in the project's President's Report of August 2, 2002, listed in a Policy and Processing Matrix in Annex 1 of that report; and addressed in the government's Letter of Development Policy (LDP). They were predicated on the need to consolidate macroeconomic stability as a pre-requisite for sustained growth. Beyond that and under the public sector management component, the main areas covered included: (a) expanding the budget's coverage to include the own receipts (*receitas proprias)* of the ministries, and expenditures funded by development partners; (b) disseminating the findings of a recently completed public expenditure review by the Bank; and (c) tax reform measures to decrease the level of effective protection. Under the PSD component, the main areas included: (a) a broad set of financial sector reform measures for both banking and

non-banking institutions designed to avoid a financial crisis that had been looming, and lay the foundations for a healthy development of this sector; (b) measures to improve the performance of the telecommunications, air transport and petroleum sectors; and (c) legal and judicial sector reforms.

3.4 The Policy and Processing Matrix gave a detailed listing of the main policies to be addressed by the project. It also listed intermediate benchmarks regarding actions expected to be taken by August 2002, some of which were used as conditions for Board presentation and the release of the first tranche of the credit; as well as intermediate benchmarks regarding actions expected to be taken by end 2002, some of which were used as conditions for the release of the second tranche of the credit. Annex I of this report gives a listing of the first and second tranche conditions. These are also presented briefly in the following paragraphs.

3.5 ***Macroeconomic stability:*** For both the first and second tranches, the main condition required the maintenance of the overall macroeconomic targets defined in the context of the IMF-supported Poverty Reduction Grant Facility (PGRF) operation, ongoing at the time (e.g. inflation to be kept under 7 percent per annum, maintenance of a competitive exchange rate, and keeping the domestic primary budget deficit below 3 percent of GDP). In addition, and as a first tranche condition, the Cabinet was expected to pass a new code of fiscal incentives for investment, rationalizing these incentives and reducing revenue losses.

3.6 ***Public Financial Management:*** (A) First tranche conditions: (i) establishment of an action plan for the reporting of donor funds using data from sectoral ministries; (ii) drafting of a strategic integrated plan for the reform of the judicial sector (by negotiations), and the final plan for the reform of the Ministry of Justice. (B) Second tranche conditions: (i) obtaining data on monthly off-budget revenues *(receitas proprias)* by public institutions, computing estimates for the year, and incorporating all such estimates into the fiscal year 2003 budget plans; and (ii) reporting donor-funded expenditures, using the new financial classification, as statistical annexes in the budget execution reports, starting with the report for the first quarter of fiscal year 2002.

3.7 *Private SectorDevelopment*: (A) First tranche conditions: (i) a number of measures regarding the further recapitalization of Banco International de Mocambique (BIM), listed in Annex I; (ii) issuance of a monitorable bad debt collection action plan for Banco Austral (by negotiations), including the use of *"execuseos fiscals"*, with monitoring through the publication in the quarterly budget execution reports; (iii) issuance of a decree on external auditing of financial institutions; (iv) submission to Parliament of a legal amendment ending TDM's monopoly on international services; (v) enactment by the Cabinet of a new air policy; and (vi) drafting of a strategic integrated plan for the reform of the judicial sector (by negotiations), and the final plan for the reform of the Ministry of Justice. (B) Second tranche conditions: (i) receiving a report by a specialist that would have assessed BIM, and transmittal of such report to the Bank; (ii) transmittal to the Bank of a list of banks that would have received letters from *Banco de Mocambique* (BM – (the central bank), specifying their respective compliance, or non-compliance with prudential regulations for their end-June 2002 accounts, including appropriate corrective action, as needed; (iii) completing an independent audit of the state-owned *Empresa Mocambicana*

de Seguros (EMOSE) insurance company accounts, and appointing consultants to start an independent actuarial analysis of the *Instituto Nacional de Seguranca Social* (INSS), the state pension fund; (iv) submission to the National Assembly of a law, satisfactory to the Bank, covering the telecommunications sector policy; (v) appointment of investment advisors for the privatization of *Linhas Aereas de Mocambique* (LAM, the state-owned airlines); and (vi) approval of the final strategic integrated plan for the reform of the judicial sector, and submitting it to the Bank.

3.8 Although primarily of a procedural, institutional, and administrative nature; these conditions were judged generally appropriate at this relatively early stage, to lay the foundations for further and more substantive progress in improving public financial management and private sector development. In turn, the first tranche conditions were intended to initiate actions that would lead to the implementation of the second tranche conditions.

Implementation Experience and Outcome

3.9 The ICR for this operation concluded that the overall achievement of outputs, and therefore the broad outcome of the project, was *satisfactory*. However, when the ICR proceeded to give a rather candid assessment of actual achievements, on a component by component basis, the results were mixed and partial, at best (pages 7-11 of the ICR). For example, only limited progress had been achieved in incorporating *off-budget items* within the budget, although progress was judged to be continuing in this regard. Similarly, the treatment and reporting of *donor funding* within the budget was judged to be of generally poor quality that did not properly allow for the tracking of the funds to specific expenditures; yet the ICR concurred that the second tranche condition governing this item had been achieved. With regard to the development of the *legal and judicial sector*, the ICR concurred with the judgment of the government and the donors expressed during a joint review of the PAF, that progress had been very slow, and only initial steps had been taken. Many problems and issues remained, including a high level of pending unresolved cases, and lack of progress in matters related to collateral and the enforcement of contracts. Such slow and partial progress was correctly judged by the ICR as having a debilitating effect on private sector development, a major area of focus for this operation.

3.10 In the financial sector, where the operation's objectives included the avoidance of a major financial crisis in view of worrisome developments in the sector, progress was started, but also remained partial and mixed. The *assessment of the BIM Group* was viewed by both the government and the Group itself as an important achievement. For example, it showed that no capital injection was needed for BIM, as had been feared. The assessment report, which fell short of the Bank's initial desire for a forensic audit, did not identify any mismanagement, or wrong-doing. However, it failed to explain what might have led to the financial problems to begin with. In addition, although it was delivered to the Attorney General's Office, it did not lead to any substantive results.

3.11 A waiver had to be given by the Bank regarding the condition requiring *compliance with International Accounting Standards (IAS)* by the banking system, and therefore, the ICR considered this condition only partially achieved. According to the ICR, this requirement had proved unrealistic in retrospect, in view of capacity constraints. The

waiver was granted on the grounds that the ongoing practice of closely monitoring prudential ratios, and taking corrective action when necessary, was a favorable consideration; and that the government was making progress in developing plans for all banks to be in compliance with IAS. In the event, technical assistance was subsequently required for the desired IAS conversion, and for conducting diagnostic reviews of four major banks, including BIM.

3.12 As for the remaining conditions governing the financial sector, a satisfactory independent audit of the *insurance company EMOSE* was completed, but the actuarial analysis of the *INSS state pension fund* was delayed, and ended up requiring the hiring of a consulting company to assist with building and operating the requisite database.

3.13 The progress made in telecommunications sector was good. A *telecommunications law* was passed, which ended the state monopoly Telecommunications Authority of Mozambique (TDM). It allowed for the separation of TDM and MCel (a mobile phone company) as independent firms, and for the entrance of a new mobile phone company. As a result, mobile telephones spread rapidly among different segments of the population, and regions of the country.

3.14 Competition also increased in the *air transport sector*, with the entrance of two private competitors to Linhas Aereas de Mocambique (LAM, the previous state monopoly air carrier). Plans and actions had also been underway to privatize LAM, but have been in abeyance.

3.15 In view of the above remarks, the ICR's conclusion that the achievement of the operation's overall objectives and outputs was satisfactory was too favorable. To begin with, the tranche conditions themselves were, by and large, not very demanding, nor onerous; and although progress was made, it fell considerably short of the relatively modest expectations. As a result, this review agrees with the assessment of an IEG review (in early 2005), and considers that the operation's outcome was only ***moderately satisfactory***.

3.16 According to the ICR, it seems that implementation of the financial sector and PSD components of this operation suffered from a high degree of passive resistance by previous high level politicians who ended up as the new elites of the private sector, heading some of the recently privatized banks. These individuals resisted subjecting their new entities to financial scrutiny, and were in a position to easily deflect efforts of the technical supervisors who had been their subordinates in the civil service. Other factors highlighted by the ICR that also stood in the way of better implementation included the complexity in the design of some of the proposed measures; combined with inadequate capacity, and poor sequencing in some cases.

Institutional Development Impact

3.17 Although institutional development (ID) impact is no longer rated separately in PPARs, this report felt it would be useful to address this area briefly for this project, since at the time that the ICR and the IEG review were completed, it was discussed separately in these documents. This review agrees with both the ICR and the IEG review that the institutional development impact of this operation was *modest*. Although the operation did

not include a stand-alone ID component as such, most of the components of the project contained ID design elements; or during their implementation, had a modest, positive impact on the development of local institutions. Of particular note were: (i) the enhanced role of the Financial Management Information System (SISTAFE) in connection with the implementation of the public management component of the project; (ii) the establishment of the Technical Unit for the Reform of the Legal Sector (UTREL), which could subsequently help unify the fragmented approach to the development of the sector; and (iii) the inclusion of public finance management, governance, and private sector development within the PAF framework and discussions. A number of other developments also contributed modestly to improved institutional performance, such as: the improved reporting of ministerial receipts and of donor funds which improved transparency; and the improved capacity and willingness to undertake supervision of the performance of banks which strengthened the Central Bank's capacity in this important area. All these ID improvements were expected to be further consolidated under the then forthcoming PRSC series.

Risk to Development Outcome (Sustainability)

3.18 This review agrees with both the ICR and the IEG review that the sustainability (which was still being rated separately in ICRs and IEG reviews at the time) of the results achieved under this operation was likely. On the overall strategic and policy levels, previous successive governments had demonstrated their broad commitment to following through with reforms designed to improve the performance of public sector management and private sector development; both in their published strategic and planning documents, as well as in their policy discussions with the Bank and other donors. The political climate had been stable, and prospects for continued political stability were considered fair at the time, with the international community showing continued interest in supporting the consolidation of the democratic process. Despite some resistance by specific interest groups to some policy measures, particularly during the start-up of the reforms; there had hardly been any strong, politicized opposition to the reform program as a whole. The passage of some key legislation and the setting up of new institutions, frameworks, regulations, and processes were not likely to be reversed, as a general trend. These considerations lead this review to rate the risk to the development outcome of the project as *moderate*; particularly since the Bank and other donors were geared to improve their coordination and follow through with considerable additional support for the country's economic reform efforts, through the then forthcoming PRSC series, and other instruments.

Bank Performance

3.19 The ICR and the IEG review rated the Bank's overall performance as *satisfactory*. The ICR argued that the design of the operation was completely consistent with the government's development strategy, and the Bank's assistance strategy. The specific components and measures selected as conditions for the disbursement of the second tranche were also judged to have been in key policy areas, in support of these strategies. It was argued that Bank staff could have been more realistic in their expectations regarding matters like the imposition of IAS on the banking system over a short period, or forensic audits of banks. Instead, the ICR argued, the Bank could have provided technical assistance to help guide the introduction of these measures, rather than give the impression

to the authorities that measures ought to have been immediately implemented. The operation was closely supervised by the Bank with four project status reports. In addition, staff of the Bank's Office in Maputo met regularly with counterpart officials to review progress. This assessment agrees with the ICR and the IEG review that the Bank's overall performance merits a rating of *satisfactory* for the same reasons cited in both documents.

Borrower Performance

3.20 As with the Bank's performance, the ICR and the IEG review both also rated the government's overall performance as *satisfactory*. The ICR argued that the implementing agencies for this operation, both the government and the Central Bank, assigned competent personnel, though small in number considering the paucity of professionals in the country, who collaborated very closely and openly with the Bank; and their stable tenure in their positions provided continuity and predictability during project preparation and implementation. All relevant information was made available to the Bank, with few exceptions like the purchase contract for Banco Austral. Training was provided to relevant staff that enabled them to extend their experience to working with the private sector. Still, the preparation of the project took a long time, partly due to the resistance by managers in the financial sector to subjecting their institutions to full forensic audits, which the Bank had to reluctantly abandon. Again, this assessment agrees with the ICR and the IEG review that the Borrower's overall performance merits a rating of *satisfactory* for the same reasons cited in both documents.

4. First Poverty Reduction Support Credit (PRSC I)

Background and Context at Appraisal

4.1 The overall background and context for this operation has already been presented in the first chapter of this report. In addition to that presentation, there were two developments that modified the overall context of the PRSC series itself. First, the series embodied the introduction of programmatic budget support by the Bank to Mozambique; and second, it did so in the context of a more tightly coordinated support by a growing, relatively large group of international donors, which had reached fifteen members at the time this operation was being prepared. The series could also build on the initial, though partial, progress achieved under EMPSO in the areas of: macroeconomic management, the investment climate for private initiative, and laying the foundations for legal and judicial reform.

4.2 The PRSC series was also designed to be completely coherent with the government's PARPA, and the Bank's 2004 CAS; which in turn, was closely aligned with the PARPA, and consistent with the assistance strategies of most major donors operating in the country. Moreover, the series benefited from very close cooperation with the IMF, including in the area of tracking public expenditures in the context of the HIPC initiative. Finally, the series was based on a burst of analytical work by the Bank completed during the few years prior to its the initiation, including: a country economic review (FY01), two public expenditures management reviews (FY01 and 03), a country financial accountability assessment (FY02), a country procurement assessment review (FY03), an investment climate assessment (FY03), a financial sector assessment (FY03), and a poverty assessment (FY04).

4.3 The series was also seen by the Bank and the government as falling within a continuum of Bank support for the government's economic rehabilitation, recovery, and reform programs that had been initiated in the late 1980s and early 1990s, and expected to be supported by a second PRSC series during the second half of the 2000s.

Project Objectives and Design

4.4 The overall objective of the series as a whole was to deepen the Bank's support for the government's efforts to reduce poverty by promoting growth and employment, and strengthening governance and PFM. More specifically, PRSC I aimed at assisting in: (i) building public sector capacity and accountability, (ii) improving the investment climate, and (iii) expanding service delivery in the education sector.

(i) ***Building public sector capacity and accountability*** was to be achieved through: (a) maintaining a sound macroeconomic framework; (b) strengthening public sector financial management by improving budget formulation, execution and reporting, reducing aid dependency by increasing tax revenues, and improving M & E, particularly regarding the impact of government programs on poverty; and (c) improving governance by strengthening procurement procedures, reforming public sector institutions,

promoting decentralization, reducing corruption, and reforming the legal sector.

(ii) ***Improving the investment climate*** was to be achieved through: (a) strengthening the financial sector, (b) improving the regulatory environment by reducing trade tariffs, surveying the time needed for and cost of business start-ups to assess steps needed for improvements which could then be included in subsequent operations, and establishing a tripartite body (consisting of the government, private sector and labor unions) to propose reforms to improve labor mobility; and (c) improving infrastructure services in telecommunications, electricity, and natural resource use in order to improve the environment.

(iii) ***Expanding service delivery in education*** by improving school construction and expanding capacity.

Implementation Experience

4.5 A Simplified ICR, dated November 29, 2005, basically applauded what it perceived as a broadly successful operation, despite a few lapses and delays in some areas, mainly attributed to presidential and parliamentary elections. It also concluded that, at the time of its drafting, it was too early to evaluate outcomes and achievements in some areas of the project, like developments in the business climate. These matters were subsequently covered in the full, and much more comprehensive, ICR for PRSC II, dated January 17, 2007, and evaluated the achievements of the two operations together.

4.6 As a single tranche operation, the disbursement of the entire credit amount ($60 million equivalent) was conditioned by a list of ***prior actions*** that had to be completed before effectiveness (Annex I). As it turned out, the prior actions were all completed before Board presentation on July 6, 2004. The specific prior actions completed under the respective components of the project, and in line with the government's Letter of Development Policy (LDP), were as follows:

4.7 ***On the macroeconomic front***, the Bank and the IMF considered that overall macroeconomic performance during 2003 and 2004 had been sound. GDP had grown by 12.8 percent in 2003, and 7.2 percent in 2004. Inflation had declined to just over 9 percent by end 2004, despite a relaxation in the fiscal stance due to the elections at the time. The current account deficit on the external account had dropped by about a third, and had reached just below 14 percent of GDP by end 2004. Interest rates had also continued to decline during this period, although they remained high.

4.8 ***On the PFM front***, almost 65 percent of budget expenditures (excluding interest and spending on the elections) was expended on priority, poverty-reducing sectors (education, health, water supply and sanitation), in accordance with the PARPA. SISTAFE regulations were adopted, and its first phase became operational, with the adoption of an electronic system of control over the government's bank accounts. The technical Unit for the Public Financial Management Reform Program (UTRAFE) was established, and the Data Processing Center was strengthened. Measures to increase

revenues were implemented. These included automatic fuel tariff adjustments, and tax withholding for government employees; actions that increased revenues by about 0.7 percent of GDP in 2003. Although revenues in 2004 were expected at the time to decline, they were also expected to rebound by almost double the 2004 drop, in 2005. In the area of public sector reform, the following measures were completed: (i) the time taken to register land was reduced to below 90 days; (ii) a new regulatory framework was adopted to expedite industrial registration; (iii) visas started to be issued at the borders for visiting workers from neighboring countries; (iv) a decentralization law was approved (the Local State Organs Law), which provided for increased autonomy of a district authority as a budget entity; and (v) an anti-corruption law was approved.

4.9 ***On the investment climate front***, top import duties on consumption goods were reduced from 30 to 25 percent.

4.10 Finally, other than the 65 percent budgetary requirement covering priority social sectors, no prior actions covering the ***service delivery*** component of the project were included.

4.11 Details of specific measures and benchmarks covering all project areas were described in the Program Document for this operation (pages 31-64), and listed in a Program Matrix, which is annexed to the Program Document.

4.12 According to the Simplified ICR, four factors affected the implementation of the project; three positively, and one negatively. On the positive side, the cross-sectoral design was cited, but it was not explained why it had a positive contribution. The second factor involved the wide and good coordination among the donors. On balance, this seemed to reduce the overall burden on the government of dealing with individual donors; and more importantly, led to a more unified effort in the assistance they provided, and as such, might have possibly led to a higher level of donor funds. The third positive factor was the fact that the government and the donors used the same documentation that was submitted to the Parliament for its assessment and budget support for the project. This had the effect of applying pressure on the government to improve the quality of the documentation it provided to the Parliament, and more importantly, increasing its accountability toward it. On the negative side, the presidential and parliamentary elections held in December 2004 delayed the approval of the labor and procurement laws and the finalization of the 2005 budget, which was not approved until May of that year. Still, most of the PAF targets were met, and the newly elected government affirmed its commitment to move ahead with the reforms at an accelerated pace.

Outcome

4.13 The Simplified ICR touched briefly only on the outcome of this operation. Instead, the full ICR for PRSC II dealt with this topic more comprehensively, and in a combined manner for the two operations. The IEG review for PRSC I also considered this matter briefly and concluded that the achievements of the first two components (dealing with public sector capacity and accountability, and the investment climate) were substantial, but the achievements of the third component (expanding service delivery) were only modest.

4.14 *Building public sector capacity and accountability:* Real GDP growth averaged more than 7 percent for 2004 and 2005. This growth continued the very good trend of the previous few years, and as a result, a 2004 country economic review estimated that the proportion of the population below the poverty line declined from an average of 69 percent during1996-2002, to 54 percent during 2003-05. Inflation declined sharply from 12.6 percent to 6.3 percent over 2004-05. Nominal interest rates declined moderately from an average of 22 percent to 19.5 percent over the same period, but the sharp decline in inflation implied that real rates increased significantly. According to IMF sources, the domestic primary deficit declined by 2 percent of GDP in 2005, due to an increase of 1.5 percent of GDP in revenues, and a decline of 0.5 percent of GDP in expenditures. The integrated financial management system (SISTAFE) was being implemented, with a roll-out to key ministries expected by mid-2006, and to all other ministries and other levels of government by 2007. M & E started to improve, but at a slow pace. External aid relative to GDP declined steadily from 15.7 percent in 2003, to 14.5 percent in 2004, and 13.5 in 2005. Public spending on priority sectors had been targeted at 65 percent of the total throughout the 2003-05 period; this target was basically met in 2003, but actual expenditures subsequently fell slightly short, and were 63.3 in both 2004 and 2005. More efforts were dedicated to public accounting and auditing, but no evidence of improvements had been noticed yet at the close of this operation. Measures started under PRSC I to improve procurement led to the adoption and implementation, though behind schedule, of a procurement law under PRSC II. The adoption of a commercial code was delayed, but eventually took place under PRSC II. The integrated legal plan for legal reform was completed, and started to be implemented under PRSC II, when a new law on judicial courts was adopted. A new Central Office for the Fight against Corruption replaced a much smaller and less effective Anti-Corruption Unit. However, as of the writing of this PPAR, the actual impact of these measures in the areas of procurement, legal reform and governance remained partial and limited.

4.15 *Improving the investment climate:* A new Financial Law was prepared under PRSC I, and subsequently approved under PRSC II. The autonomy of BM increased. According to the IMF, prudential ratios started to improve, and the proportion of non-performing loans fell to below 5 percent of the total. Still, the impact of these helpful measures on actually improving the business climate was unclear; for example, the Doing Business Report for 2006 had not yet shown any improvement. A new labor law was prepared under PRSC I and subsequently approved under PRSC II. In principle, this law was expected to improve labor market flexibility, but this has remained an elusive target. Finally, measures to restructure the telecommunications and electricity sectors were started.

4.16 *Expanding service delivery:* A direct support program for schools started to be implemented. This seems to have been the only measure completed in this important area.

4.17 Despite the limited attention given to the third component of this operation, and the fact that some key actions had to await PRSC II to come to fruition; the overall progress achieved was commendable and laid the foundations for the more complete progress in the following year under PRSC II. As such, this review agrees with the ICR and the IEG review that the operation's outcome was ***satisfactory***.

Risk to Development Outcome, Bank Performance, and Borrower Performance

4.18 Since the PRSC series ended up consisting of only two operations which were implemented over a relatively short period of less than two years (PRSC I was approved in July 2004, and PRSC II was closed in June 2006), it is more reasonable and productive to discuss the risk to their development outcome, and Bank and Borrower performance for the series as a whole. This is done in the next chapter, which primarily discusses the implementation experience under PRSC II.

5. Second Poverty Reduction Support Credit (PRSC II)

Background and Context at Appraisal

5.1 Economic data available in mid-2005 showed that the good overall macroeconomic performance that had started after the end of the civil war, continued. Real GDP growth registered a solid 7.8 percent in 2003, and was projected at the time to remain over 7 percent in 2004. The trade deficit was reduced by almost a quarter in 2004, as exports from mega-projects increased sharply. Non-performing loans of the banking system fell from 27 to 6 percent of gross loans, thereby reducing the risk to macroeconomic stability from the banking sector. The exchange rate, which had appreciated by about 25 percent in 2004, depreciated to a more competitive level. On the other hand, public revenue performance fell by a percentage point of GDP, below expectations in 2004 (12.3 percent of GDP, compared to the targeted 13.4 percent). The investment to GDP ratio was also lower than expected, mainly due to a slowdown in investing in mega-projects relative to what had been expected. Finally, while the second review in June 2005 by the IMF of its ongoing PRGF operation concluded that overall performance over the October 2004 to March 2005 had been mixed, with some slippages in tax collection; it did confirm that prospects for 2005 remained favorable for growth, inflation, and the external account. However, despite the generally good overall economic performance, Mozambique remained among the poorest countries in the world, with a per capita GNP of $270 in 2004; and the social development indicators remained equally low.

5.2 General elections were held in December 2004. The new President, Armando Guebuza, from the same FRELIMO party as the previous President; was elected with 64 percent of the vote. In March 2005, the new government submitted its new Five-Year Program to Parliament, outlining an ambitious reform program to reduce poverty. This program was subsequently developed into the more operational PARPA II (equivalent to PRSP II), which was approved by the Cabinet in 2006. In turn, the PARPA II was translated into the more operational PAF matrix, that served as the common framework for policy dialogue among the government and the group of donors (the G18 by 2004), and for additional financial support from these donors.

Project Objectives and Design

5.3 Recall that the primary objective of the PRSC series was to support the government's own objective of reducing poverty and making progress toward ultimately achieving the Millennium Development Goals (MDGs), by promoting high, sustainable growth and improving service delivery. To this end, and in line with the main pillars of both the government's and Bank's strategies, the main objectives of the first PRSC series (common to both I and II) were to support: *(i) building public sector capacity and accountability* through strengthening public financial management, decreasing aid dependency, improving M & E, and accelerating public sector reform; *(ii) improving the investment climate* through strengthening the financial sector, easing constraints in the

regulatory environment, and expanding infrastructure services; and *(iii) enhancing service delivery* in health, education, water supply and sanitation.

5.4 More specifically, the measures included in the series in the above main areas were as follows:

(i) ***building public sector capacity and accountability*** through maintaining a sound macroeconomic policy framework; maintaining the share of poverty reducing expenditures at close to 65 percent of total public expenditures; improving the management of public expenditures; increasing revenues to enable fiscal prudence; introducing clear and transparent procurement practices; building the capacities of local authorities for planning, budgeting, financial management, and service delivery; strengthening the regulatory framework for business; and develop the capacity of the government to deal with corruption more aggressively;

(ii) ***improving the investment climate*** through more effective supervision of banking and non-banking financial institutions; moving towards more efficient and profitable banks; a complete divestiture of the government of its interests in the banking system; reducing the level of effective protection to local industries; and allowing for a more efficient and flexible labor law, which would allow businesses to become more competitive;

(iii) ***expanding service delivery*** through reducing the mortality rate for mothers and infants; increasing access to basic health services; increasing access and retention, and reducing gender inequalities in primary education; and increasing access to potable water and sanitation.

5.5 Further details regarding specific measures and benchmarks were described in more detail in the Program Document for this operation (pages 42-47), and listed in the PAF that corresponded to this operation, which was annexed to the Program Document.

Implementation Experience

5.6 Overall, the implementation of this operation proceeded well. Many of the measures that were started under PRSC I, were completed under this project; in addition to the set of measures foreseen under this operation itself. This completed the generation of reforms envisioned for this series, and laid the groundwork for the next phase of reforms that were planned to be supported by the next series of PRSC operations (III through V). A Joint Review of economic policy performance by the government and its development partners within the PAF framework, which was carried out in May 2005; and found this performance satisfactory. The credit's first tranche of $60 million equivalent was disbursed in October 2005, soon after effectiveness; and following the implementation of a set of prior conditions. The second tranche of an equal amount was disbursed in March 2006, following satisfaction of the conditions for the release of this tranche. These prior actions and second tranche conditions are presented in Annex I, along with the prior actions for PRSC I.

5.7 Whereas the program matrix for PRSC I differed somewhat from the respective PAF, PRSC II adopted the up-dated PAF as its own program matrix, thereby achieving total coincidence with the policy programs of the government and the group of development partners. Due to the elections that took place in December 2004, the adoption of new procurement and labor laws, both prior conditions, was delayed; but was subsequently implemented along with other measures related to the release of the second tranche. In addition, however, two other measures were introduced to this operation: one related to the inclusion of some off-budget items into the budget, and the other consisted of submitting bills to Parliament revising the organic law of judicial courts and the notary codes. PRSC II included no specific conditions in the area of service delivery; it simply required that at least 65 percent of public expenditures should be in the agreed social development priority sectors.

5.8 According to the ICR, the implementation of this operation was affected by several factors; four positively, and two negatively. On the positive side: (i) the design appropriately focused on cross-sectoral actions to improve public financial management broadly, before embarking on specific reforms within sectors. These reforms were owned by the government since they were in its own PAF, and were based on extensive analytical work; (ii) coordination among the development partners and with the government was strong. It was formalized and made explicit in a Memorandum of Understanding, signed in April 2004 by a group of 15 donors (G15), which subsequently increased to G19; (iii) modifying PRSC II into two tranches in exchange for dropping the third operation of the series allowed for better coordination with the budget cycles of the government and some of the other partners; and (iv) the PRSC series and the development partners used the same planning and reporting documents that the government provided Parliament. This improved overall government accountability, and the quality of the documentation. On the negative side: (i) the December 2004 elections delayed the passage of the procurement and labor laws, as stated above; and (ii) the implementation period for this PRSC series was shortened from three years with three operations, to less than two years with only two operations to harmonize among budget cycles of donors and the government. This meant that only two, instead of three, Joint Reviews could take place. It is not clear for this report why such a development constituted a negative factor.

5.9 An elaborate process of M&E of the design and implementation of the PRSC series had been set in place by the government and its development partners prior to PRSC I, in the context of the Memorandum of Understanding signed in April 2004. The process was based on the PAF, a framework designed to help monitor and evaluate the implementation of actions agreed among the government and its partners, which involved donor resources channeled through the budget in support of priority sectors within the PARPA. The PAF, in turn, was extracted from a more comprehensive Strategic Matrix which served as the overall monitoring framework of PARPA II by the government and the G19. Reviews of the PAF by all the parties concerned took place periodically, and were used to modify and update the PAF, in accordance with progress achieved. Since the approval of PRSC I, and through the completion of PRSC II; two joint reviews and two mid-year reviews took place. The joint reviews tended to be backward-looking, and evaluated progress achieved, while the mid-year reviews tended to be forward-looking and agreed on performance indicators for the following year. On balance, it seems to

have reduced the burden on the government in comparison to a process that might have involved bilateral agreements between the government and each donor separately. It certainly led to a more coordinated, and efficient use of donor resources, since it imposed prior consistency between the strategic objectives of all concerned. However, although the process led to a number of corrective actions in some sectors, as cited in the ICR; the overall M & E performance remained weak, with key policy areas like the delivery of social services not receiving sufficient attention, particularly under PRSC I, when elections had distracted the government.

Outcome

5.10 The ICR presented a matrix (Table 3, pages 19-21) that compared the measures supported by PRSC I and PRSC II to expected outcomes, and to actual results. The details underlying this matrix were elaborated in the ICR, and provide the basis for the following paragraphs.

5.11 Commendable overall progress was made in implementing the first component of the operation, dealing with ***public sector capacity and accountability,*** although actual achievements in the governance area remain elusive despite the implementation of a number of measures.

5.12 *Macroeconomic Framework.* Robust growth continued. It averaged 7.7 percent annually during 2003-05. Inflation continued to decline, from a peak of 16.8 percent in 2002, to 6.4 percent in 2005. The fiscal deficit, before grants, also continued to decline steadily, from 17.3 percent in 2002 to 8.9 percent in 2005. The deficit on the current balance of payments account dropped in 2003 and 2004, but increased to 17 percent of GDP in 2005, due mainly to higher oil and cereal import prices. Still, it remained at the lowest level since 2000, except for 2004. Interest rates declined, and financial sector performance was positive. The fourth PRGF review of June 2006 concluded that economic performance in 2005 had been strong.

5.13 *Public Financial Management.* The e-SISTAFE integrated financial management system was rolled out to three central economic ministries: Finance, Planning and Commerce; which started to improve their budget execution, according to the latest assessment of the public expenditure and financial accountability by the Bank. Donor-supported programs also started to be included gradually into the e-SISTAFE, and a joint task force between the government and the donors was set up in 2005 to recommend better ways of including all external assistance in the budget. This started to lead to better management of external financial aid.

5.14 *Governance.* Progress was made across a number of areas under this heading: administrative and budgetary decentralization; procurement; and, to a more limited extent, the legal and regulatory framework for business. A Decentralization Law was approved, and together with the previously approved Integrated Financial and Management Information system (IFMIS), has provided a framework for decentralized planning and funding, since it established the district as a budgetary unit for the first time. This allowed the central government to allocate direct transfers to districts, although some confusion was still apparent regarding specific guidelines for the use of such funds.

A new Procurement Code was approved, in accordance with international standards. Procurement audits were carried out in several ministries. Standard bidding documents were approved and published and training of staff in their use started. These measures started to increase the transparency of procurement practices. Progress in dealing with corruption remained elusive. Although the budget of the Central Office for the Fight against Corruption increased ten-fold in 2006, the number of cases prosecuted did not increase. According to the 2006 corruption perception index published by Transparency International, Mozambique ranked 99th out of 163 countries, about the same ranking as in 2005 and 2004, and slightly better than in 2003. Compared to some of its African neighbors, Mozambique ranked roughly in the bottom half of the group.

5.15 A number of measures were carried out that started to improve the overall ***business climate***, under the second component of this operation.

5.16 *Legal and Regulatory Environment.* The Notary Code was revised, and the Commercial Code and the Code for the Registry of Legal Entities were approved. As a result, the number of days to register a business dropped from 153 to 113, according to 2005 data used in the 2007 Doing Business Report. Subsequently, the Cabinet approved the electronic publication of a firm's articles of incorporation, instead of going through the time-consuming process of going through the Official Gazette. This simple measure drastically further reduced the start-up time for new businesses to 30 days only. Computerized registration of firms was being applied in three of the country's ten provinces, with the intention to achieve full coverage. This started to improve the accuracy and speed of the registration process. Together with the speeding up of land and industrial registration, and the issuance of visas at the borders for migrant workers; these measures started to modestly improve the regulatory framework for doing business in the country. The maximum import duties had been reduced previously from 30 to 25 percent. In January 2006, the maximum duty for neighboring Southern Africa Development Cooperation (SADC) countries was reduced to 20 percent.

5.17 *Financial Sector.* The approval of the new Financial Institutions Law improved the capacity of the Bank of Mozambique to supervise all the financial institutions. In accordance with this law, BM drafted prudential regulations in compliance with Basel I Principles, with an accompanying inspection manual. These were expected to be approved soon, as was the start of hands-on training for inspectors. This was, in fact, done.

5.18 The outcome of the third component of the operation, dealing with ***service delivery in priority sectors***, improved under the second PRSC operation, compared to the first. The overarching objective of directing at least 65 percent of budget expenditures to the priority social sectors was broadly met, or exceeded: 63 percent in 2004, 66.3 percent in 2005. The 2006 Joint Review of the PAF by the government with its development partners showed that most of the targets for 2005 in education, health, HIV-AIDS, and infrastructure were met. Out of 15 indicators, 10 were either met or surpassed, 2 were partially met, 2 were not met, and one could not be measured. In addition, out of 8 indicators in the agriculture and rural development sector, 2 were met and 6 were partially met. This sector was included in the Results Framework also used to monitor progress under PRSC II. Details on these achievements were provided in the ICR (pages

17–18). For example, the target for the net enrollment rate for girls was surpassed; that for the number of institutional deliveries was met; the DPT3 vaccination target was not reached; the road rehabilitation target was attained, but the routine maintenance target was not; and significantly, although the funds directed at HIV-AIDS and the community initiatives surpassed their targets, the number of HIV positive pregnant women and neonates receiving preventative treatment fell short of the target, and HIV-AIDS prevalence in the population at large continued to rise.

5.19 On balance, the overall outcome of the measures supported by this operation was commendable; and as such, this review agrees with the ICR and the IEG review that it merits a ranking of ***satisfactory***.

Risk to Development Outcome

5.20 This section applies to both PRSC I and PRSC II. While the ICR cited four risks, this review examines measures taken by the government to mitigate these risks.

5.21 First, there is some *potential for macroeconomic instability*, as a result of exogenous factors, the fragile performance so far of the financial sector, or an unsustainable accumulation of new external debt. While serious exogenous shocks cannot be ruled out, particularly since the recent increase in the global price of foodstuffs, as well as the global financial crisis of 2008/09; the country had been able to weather some of these shocks in previous years, and is likely to remain capable to do so, at least for moderate shocks. As for the financial sector, prudential and other measures implemented under these two operations have already reduced the share of poorly performing loans in bank portfolios, and moderated the risk of accumulating high shares in the future. Regarding external debt, the IMF and the Bank continue to assist the government in conducting annual debt sustainability analyses, designed to forewarn of any adverse developments and take remedial action promptly, as well as provide debt relief. In fact, between 2004 and 2007, Mozambique HIPC and Multilateral Debt Relief Initiative (MDRI) debt relief totaled over $2.4 billion, and all outstanding debt to the IMF, the WB and the African Development Bank (AfDB) was cancelled under the MDRI initiative (Table 1).

Table 1: Mozambique HIPC and MDRI Debt Relief (million USD)

	CY2004	CY2005	CY2006	CY2007	2004-2007
HIPC, total	135.2	135.8	130.9	130.0	532.0
Of which IDA	8.9	9.7	9.8	10.6	39.0
Of which AfDB	2.6	2.5	2.6	2.9	10.6
IMF	-	15.0	34.0	-	49.0
Bilateral and other	123.7	108.7	84.5	116.5	433.4
MDRI			1,916.8		1,916.8
Of which IDA			1,319.0		1,319.0
Of which AfDB			477.8		477.8
IMF			120.0		120.0
Total HIPC and MDRI relief	135.2	135.8	2,047.7	130.0	2,448.8

Source: 2007 CPS for Mozambique

5.22 Second, *disbursements by development partners may become unpredictable*, particularly in view of the global financial crisis. This risk has been mitigated to a great extent, by the strong degree of donor coordination and harmonization, through the Memorandum of Understanding and the regular Joint Reviews and Mid-Year Reviews. The increased ownership role being played by the government since April 2005 has been welcomed by the donors and has consolidated mutual trust in the process.

5.23 Third, *weak capacity to implement reforms* may end up delaying the reform process, or compromising its development impact. To mitigate this risk, the government and the donors agreed to develop an integrated strategy for capacity development in public financial management, and to strengthen the management of reforms.

5.24 Fourth, there is a distinct *potential for deterioration in governance* that could compromise economic reforms, growth and poverty reducing efforts. For example, reforms in the legal and judicial sector have not kept up with their intended pace. Still, the G19 continues to actively support the government in its efforts to improve governance, and to press it to keep up the pace.

5.25 In addition to the arguments provided in the above four paragraphs which outline how the risks noted in the ICR were being mitigated, the more general arguments provided in para. 3.18 regarding the risk to development outcome for EMPSO also apply to PRSC I and PRSC II. Namely, that: (i) the government has demonstrated its commitment to following through with reforms in its policy dialogue with, and to the satisfaction of, its development partners; (ii) the political climate has been stable and is likely to remain so for the foreseeable future; and (iii) a number of key pieces of legislation have been passed, and institutions, processes and frameworks set up which are unlikely to be reversed. For all of these reasons, this assessment agrees with both the ICR and the IEG review that the risk to development outcome of these two operations merits a rating of *moderate*.

Bank Performance

5.26 This section applies to both PRSC I and PRSC II. This review agrees with the ICR and the IEG review that the Bank's overall performance in designing and supervising the two operations was ***satisfactory***. The ICR makes a very tight case for such a rating, and this was confirmed during this review.

5.27 During the design and preparation stages, the Bank ensured that the operations were completely in line with the government's development strategy, as reflected in its PARPA; and with the Bank's CAS, which was explicitly aligned with the PARPA. Discussions with the government and the partners during the periodic Joint and Mid-Year Reviews also provided useful inputs. In addition, the design benefited from a range of analytical work conducted mainly by the Bank and the IMF, and to a lesser extent, by others. More than a dozen relevant reports were listed in the ICR in this regard (pages 23-24). Moreover, the design of the second operation benefited from some experience gained during the implementation of the first, such as the introduction of the e-SISTAFE in the Ministries of Finance and of Planning. PRSC II also adhered more closely to the PAF than its predecessor, and it was better aligned with the budget cycles of the other

partners and the government. Although the M&E arrangements that were put in place in the context of the Joint Reviews and the Mid-Year Reviews of the PAF were adequate to track the implementation of nearly fifty measures, and main outputs; they fell short of allowing the measurement of clear results.

5.28 The Bank's supervision of the two operations was aligned with the supervision of the joint Direct Budget Support program of the group of donors. Within the framework of the joint Reviews, the mid-year reviews, and some other intervening reviews by the G19; broad-based, multi-sectoral teams from the Bank maintained a broad and constant supervision of implementation progress. In addition, technical assistance was provided by the Bank in three concurrent projects: Public Sector Reform Project, Enterprise Development Project, and Financial Sector Technical Assistance Project.

Borrower Performance

5.29 This section also applies to both PRSC I and PRSC II. This review agrees with the ICR and the IEG review that the Borrower's overall performance during the design and implementation of the two operations was ***satisfactory***. The government played a central role in choosing the priority areas of its development strategies (PARPA I and PARPA II), and participated actively in the design of the components of this series, in support of this strategy. It also took the lead, in the context of the PAF design and monitoring process, in implementing the specific measures, and the underlying M&E activities. Of particular importance, was the government's regular reporting to Parliament on progress, which forced it to be accountable, and in return, enabled to have Parliament's endorsement of its programs. Whereas some delays were encountered under the first operation because of the December 2004 elections, the new government promptly showed its commitment to follow through with the reforms, and even made up for these delays during the implementation of the second operation.

6. Overall Evaluation and Lessons

Overall Evaluation

6.1 The three operations reviewed in this report fell within a period of transition in the modality of the Bank's support to Mozambique's development agenda at the core structural level; from a DPL mode represented by the EMPSO, to a GBS mode represented by PRSC I and PRSC II, which were followed by three additional PRSCs that were completed by the end of 2008, at the time this report was being drafted. We have seen in the previous chapter that, overall, EMPSO achieved encouraging but only partial progress across a number of important policy and institutional development areas. Nevertheless, this progress was sufficient to help set the stage for introducing the GBS mode of support, at a time when the country was keen to have it, and the community of development partners had reached the conclusion to embrace it. As the first two such budget support operations in Mozambique, and taken together, PRSC I and PRSC II achieved broadly satisfactory results; and helped to maintain the momentum of commendable overall macroeconomic performance, and ongoing though uneven progress across a wide front of other policy areas.

6.2 *Macroeconomic Performance.* This PPAR was being conducted simultaneously with a CAE that also covered experience under the subsequent PRSCs (notably, PRSC III and PRSC IV). As such, and benefiting from the analysis conducted in the context of the CAE, it is useful here to reproduce a table from that CAE summarizing overall macroeconomic performance over the 2001-07 period (Table 2), with some of its accompanying commentary.

Table 2: Mozambique: Main Macroeconomic Indicators

	2001	2002	2003	2004	2005	2006	2007
GDP Growth (%)	13.1	8.2	7.9	7.5	6.2	8.5	7.0
GNI per capita (US$)	210	210	230	270	310	340	
Population Growth (%)	2.4	2.2	2.1	2.1	1.9	1.9	
GDP per capita growth (%)	10.7	6.0	5.8	5.4	4.3	6.6	
Agriculture VA (%)	9.4	10.8	9.1	8.3	1.7	9.0	
Industry VA (%)	20.9	9.8	10.1	5.1	7.7	9.7	
Services VA (%)	13.6	5.7	4.6	8.8	8.9	7.8	
Inflation (CPI, %)	9.0	16.8	13.4	12.7	7.2	13.2	8.2
Gross Investment (% of GDP)	25.9	29.8	27.4	22.6	18.7	19.0	19.2
(Public)	(15.4)	(12.5)	(12.5)	(9.4)	(8.6)	(12.1)	(12.1)
(Private)	(10.5)	(17.3)	(14.9)	(13.2)	(10.1)	(6.9)	(7.1)
Exports (% of GDP)	27.2	29.0	28.2	31.0	31.7	37.4	
Imports (% of GDP)	45.0	47.8	44.0	39.3	41.5	42.0	
Current account balance (% of GDP)	-17.8	-21.2	-17.0	-10.3	-11.1		
External Debt (% of GNI)	144.1	128.8	103.6	90.6	82.3		
Debt Service (% of GNI)							
Budget Deficit (incl. Grants, %GDP)	-6.1	-7.0	-4.5	-4.4	-2.3	-1.7	-3.9
Budget Deficit (excl. grants, % GDP)	-19.9	-17.3	-14.0	-11.7	-8.9	-12.5	-13.5
Current Revenues (excl. Grants, % GDP)	12.4	12.4	12.9	12.6	13.6	14.0	16.4
Total Expenditures (% of GDP)	32.1	30.0	26.5	24.5	22.0	25.1	29.7
Capital Expenditures (% of GDP)	18.6	16.1	12.2	10.2	8.6	11.9	11.9

Source: World Bank Internal Database.

6.3 In brief, Mozambique's overall growth performance over 2001-07 was very good, given the country's capacity constraints and keeping in mind the dire conditions that had prevailed at independence. Maintaining an annual growth rate that averaged between 7-8 percent was a commendable achievement. In addition, the performance of exports and the external account as a whole was also good, due mainly to exports by the so-called mega-projects.

6.4 Despite the positive performance of overall growth and the external account, however, a number of features of the overall macroeconomic performance that accompanied them continued to be sources of concern. First, although inflation was reduced significantly from the early days of post-independence, it fluctuated during this period, and averaged a two-digit 11.5 percent. Therefore, the threat of macroeconomic instability remains, particularly in view of recent increases in the global prices of food, and the overall uncertainty surrounding global developments in petroleum and primary commodities markets. Second, the disappointing trends in both public, and particularly private, investment do not bode well for future growth prospects. This is related to a fundamental question raised in a 2005 country economic review regarding how much of growth can be expected to come from a "permanent" component that is sustainable, as distinct from that due to one-time events, such as the "bounce-back" effect in agriculture when farmers went back to their abandoned land after the end of the civil war. Third, the high dependence on aid has been a concern for the government and the donor community for the last decade, or so. There have been about forty donors active in Mozambique, and about half of all public expenditures have been financed from external sources, in addition to the significant debt relief that has been provided by some of the major donors. Although it is unlikely that Mozambique will be abandoned by its development partners overnight, the continuation of this high level of dependence, particularly given recent global financial developments, remains a cause of uncertainty and concern. Finally, there is the very important question of the nature and characteristics of growth in Mozambique, and how much of it has been, or is likely to become, employment generating and poverty reducing?

6.5 The most recent country economic review, like its predecessor, addressed this central matter. This country economic review is a very good piece of analytical work that looked to the future and tried to see how Mozambique could reshape its growth pattern, by promoting an open, export-oriented economy through trade and regional integration, so it could create more employment. The first chapter of this review started with analyzing past performance, focusing on what might have been the drivers of growth during the past couple of decades. Among its main conclusions, it affirmed that ever since 1999, growth had been driven mainly by capital accumulation which is consistent with the timing of mega-projects and that the country benefitted from exploiting some of its natural resources although it has not yet resolved the challenge of creating more jobs and making growth inclusive. It also concluded that there had been increases in factor productivity and improvements in the quality of labor.

6.6 The CAE/PPAR mission confirmed that there was general agreement among the policy makers and resident representatives of the community of development partners with these conclusions. Overall growth has been impressive during the review period, and the underlying macroeconomic performance very satisfactory, but the benefits of

growth have not reached the majority of the population, particularly those in rural areas, to the extent desirable. Thus, while the recent country economic review correctly concluded that the continued interest in mega-projects by foreign investors in new areas like coal, and pipelines for natural gas and possibly petroleum is likely to be very beneficial for the economy, particularly if backward linkages to the domestic economy are strengthened as intended; the major challenge remains to create a significant volume of new employment in the "smaller" economy; both in urban locations, but particularly in the rural hinterland.

6.7 *Modality of Bank and Donor Assistance.* Again, the following paragraphs benefit from the analysis done in the context of the CAE. As a new approach that had been adopted by the donor community, the GBS/PRSC modality, which had its conceptual origin in the Paris Declaration, argued for tightly coordinated direct budget support by development partners to countries with a proven economic development record. The country itself was expected to assume the leadership in driving its own (and owned) development program, and to be accountable for its implementation. The partners, in turn, would be accountable for providing predictable and appropriate levels of direct budget support. In the case of some partners, like IDA, disbursement of funds would be linked to prior actions, as opposed to conditions on any future disbursement, as in DPLs, for example. Thus, the emphasis would essentially be on "monitoring" past/ongoing performance, instead of "motivating" anticipated performance through conditionality.

6.8 As with other countries, the question has arisen in the case of Mozambique as to whether this modality of assistance has worked well, in comparison to alternatives. In fact, as of the drafting of this report, IEG was conducting a broad, multi-country analysis of the subject, including a case study of the experience in Mozambique. The comprehensive draft report of this case study, dated November 2008, concludes that the PRSC has been instrumental in coordinating the Bank's budget support with that of other GBS financiers. The GBS is totally integrated with the PARPA. Although the current GBS set-up prevents flexibility and does not allow to focus on the policy dialogue of core policy reforms and their implementation if they have not been already been supporting the PAF matrix. According to this case study, this inflexibility has been related to the mismatch in timing between the PAF process and the Bank's own, internal review processes. This PPAR agrees that the PRSCs have done well as an instrument of predictable budget support, and of coordination among the partners and the government. The government officials interviewed by the PPAR mission certainly felt that this modality of support recognized the ownership and lead role played by the government, a welcome departure from the past. They also felt that the partners' efforts, including those of the Bank, to align their support with the PAF have been broadly successful, and appreciated.

6.9 As for the inflexibility of the PRSC modality regarding policy dialogue and implementation, opinions of the participants in the process seem to have been divided. Some of the participants interviewed by the PPAR mission have felt that the instrument has been rather inflexible with regard to policy content. Others, while agreeing to the timing problems associated with monitoring past performance instead of motivating future actions, have argued that the process has still allowed for flexibility, at least in policy dialogue, through the reviews of ongoing PAFs, and the possible introduction of

policy measures either in new PAFs, or through parallel sector, or investment operations. But even those proponents of the GBS/PRSC approach have agreed that efforts should still be considered to make the process more flexible and responsive, particularly as new, unforeseen developments develop. This PPAR feels that the PRSC instrument has worked well; and that, on balance, its advantages have outweighed its disadvantages, which is a view shared by the IEG case study.

Lessons

6.10 The main lessons that emerge from the analysis in this PPAR, as supplemented by the analysis conducted in the context of the CAE which was being carried out simultaneously, are as follows:

6.11 The very good macroeconomic performance sustained by Mozambique over the last two decades suggests that as long as the country is following prudent and effective macroeconomic stabilization and management policies in the context of ongoing IMF programs, it is sufficient for the Bank's assistance program, as has been done in the context of the EMPSO and the PRSC series, to base its evaluation of macroeconomic developments on the IMF's assessment, and to provide ancillary support (such as in trade policy, public expenditure allocation, and some specific revenue enhancing measures), without devoting major extra efforts itself across the whole spectrum within this policy area. The important thing is for the Bank to reach its own evaluation that macroeconomic performance is satisfactory, without necessarily having to do all the assessment itself.

6.12 The experience of Mozambique also suggests that the PRSC/GBS modality seems to have yielded broadly satisfactory results, which have been at least as good as alternative modalities, but with the added advantage of having the country itself leading its development agenda and playing a central role in coordinating the assistance from its development partners. The presumption of a proven track record, while not a guarantee for continued success, is an important pre-condition. Close monitoring and evaluation by the country and its partners during implementation is also very important. Meanwhile, this assessment agrees with views expressed by a number of participants in this modality that it would be useful to look for ways to introduce more flexibility in the underlying decision processes, to allow for the incorporation of policy and implementation adjustments in response to changing conditions, as needed.

6.13 The experience of the financial sector and that of the telecommunications and air transport sectors, suggests that accompanying budget support, or DPL operations, with related TA may increase the chances for success. However, for more complicated sectors like PSD, or agricultural and rural development, this may not be sufficient, and there may be a need for additional interventions.

6.14 Stability in the composition of Bank and counterpart project teams, and close involvement of staff of the Bank's Office in Maputo at all stages of project preparation and implementation are important for increasing the chances of success of Bank-supported operations.

6.15 When a project seeks to achieve changes in legislation, regulations, and processes; it is important for it to articulate well-defined and achievable results indicators that allow for effective monitoring of implementation, and adjusting the process as needed. In this context, the Bank should pay particular attention to help in strengthening the Borrower's M&E capacity.

6.16 Several efforts by Mozambique and its partners to make credit more accessible to SMEs and micro-borrowers through more orthodox banking practices have not yielded encouraging results, so far. Granted that this objective is inherently difficult in a very poor country with a predominant informal/rural sector, with a low level of education and training. This suggests that less orthodox and more innovative measures may be needed. In view of the paramount importance of creating employment, particularly in underserved rural areas, political economy considerations may even call for some more risky measures whose social dividends could counterbalance any additional risks.

6.17 Finally, a lesson cited in the Simplified ICR for PRSC I, which was particular to that operation, was the need to take electoral cycles into consideration and avoid aiming at approvals of key legislation during election periods (e.g., the labor and procurement laws were delayed because of the 2004 elections). It is not clear to this assessment that, in practical terms, it is correct to generalize this "lesson". Most countries go through various election cycles regularly, and often these elections do delay some procedures, including approval of laws. On balance, however, it seems that it would be better on many occasions to just live with this fact and move ahead, trying to approve various measures. Keeping the momentum and the pressure to follow through may be the right thing to do under some conditions, despite ongoing elections.

6.18 ***Recommendation.*** The three operations reviewed in this report all sought to assist the government's efforts to promote sustainable and more equitable growth through support for PFM, PSD, and FSD. Although progress has been made to this end, due in part to these three operations, but also to subsequent PRSCs; the single most important recommendation of this assessment, in line with the main CAE finding, is for the Bank to give an even higher priority to assist the country in its efforts to modify its growth pattern and make it more inclusive and employment generating. This can be done by building on the achievements so far in the areas of macroeconomic performance, FSD, and PSD. In particular:

- Stronger efforts should be directed at making credit more accessible to SMEs and the agricultural/rural sector. To this end, more attention could be directed at developing financial intermediation in these areas, including through the promotion of non-banking institutions and schemes like the network of traders that had operated before independence.
- Much stronger efforts should also be made to simplify and streamline business procedures and regulations; and, in particular, to deal more imaginatively with the problem of collateral.
- The good experience with the privatization of the telecommunications and air transport sectors, as well as the good overall progress made in the financial sector; argue for the use of TA operations in parallel to budget support, or

DPL-type operations. Although not a guarantee of full success, such TA could prove very helpful.

Annex I: Prior Actions and Tranche Release Conditions (EMPSO, PRSCs I and II)

EMPSO
First Tranche Conditions
Maintain overall macroeconomic targets as defined in the PRGF
Cabinet to pass a new code of fiscal incentives for investment rationalizing the incentives and reducing revenue losses
Establish an action plan for the reporting of donor funds, using data from sectoral ministries
(By negotiations): Draft strategic integrated plan for the reform of the judicial sector, and the final plan for the Ministry of Justice
Concerning the further recapitalization of BIM, (i) issue a circular requiring that accounting information sent monthly by all commercial banks are signed by competent managers previously registered at BM; (ii) prepare a business plan (including a monitorable debt collection plan) showing how the low business viability of the bank will be improved; (iii) Government undertakes not to vote on its shares for executive directors; (iv) appoint a specialist advisory group to assess the reasons why the former BSM made serious financial losses, examining the procedures in credit and other risk management practices
(By negotiations): Issue a monitorable bad debt collection action plan for B Au, including use of "*execucoes fiscals*", with monitoring through publication of the quarterly budget execution reports
Issue a decree on external auditing of financial institutions, requiring that financial statements issued after the date of the decree be audited annually by qualified auditors in compliance with standards of the International Federation of Accountants
Submit to Parliament a legal amendment ending TDM's monopoly on international services
Enactment by Cabinet of the new air policy which opens all non-scheduled traffic to any provider, provides free licensing for scheduled domestic flights, and provides multi-designation of carriers for international scheduled operations
Second Tranche Conditions
Report donor-funded expenditures as statistical annexes in the budget execution reports, starting with the first quarter of calendar 2002
Incorporate estimates of all known ministerial own receipts *("receitas pr6prias")* in the 2003 budget
Adopt officially the finalized *Strategic Integrated Plan for the Legal and Judicial Sector 2002-2006*
Complete an assessment of the deficiencies in the system of checks and balances of BIM, and the causes of the extensive risk management failures, and, in the event wrongdoing is found, report it to the Attorney-General
Enforce full compliance of all banks with all existing prudential rules and regulations, by specifying corrective measures to all non-compliant banks
Complete an independent audit of the 2001 accounts of EMOSE, including an opinion on mathematical reserves, valuation of real estate holdings and other fixed assets, information systems and accounting standards; and initiate an independent actuarial analysis of INSS by the appointment of consultants
Submit to the National Assembly a telecommunications law reflecting the sector policy
Appoint investment advisers for the privatization of LAM
Approval of the final Strategic Integrated Plan for the legal and judicial sector by the Borrower's legal and judicial coordinating board *(Conselho de Coordenacao de Legalidade e Justica)* and submitting it to the Bank

PRSC I
Prior actions
Spending 64.9% of its 2003 budget (excluding interest and election spending) on prior sectors referred to in the PARPA, in accordance with paragraph 9 of the LDP
Adoption of regulations for implementing SISTAFE, establish the Technical Unit for Public Financial Management Reform (UTRAFE); and substantially strengthen its data processing center, and make SISTAFE's first phase operational with the adoption of an electronic system of control over the Government Bank accounts, all in accordance with Paragraph 8 of the LDP
As of 2003, increase domestic revenue mobilization through implementing fuel tariff adjustments which includes an automatic fuel tariff adjustment mechanism for January 2004, and a withholding tax on the income of public sector employees all in accordance with paragraph 10 of the LDP.
Adoption of the following **public sector reform measures** (i) reduce the land registration to a maximum of 90 days; (ii) adopt a new regulatory framework to simplify and expedite the process of industrial registration; and, (iii) start to issue visitor visas at the Borrower's borders, all in accordance with paragraph 11 of the LDP.
Adoption of a law decentralizing certain services to the district level (the Local State Organs Law) which provides for increased autonomy of district authorities and the legal basis for treating a district authority as a budget entity thereby strengthening the territorial dimension of public sector management, in accordance with paragraph 12 of the LDP
Adoption of a law on anti-corruption, in accordance with paragraph 13 of the LDP
Reduction of top import duties on consumption goods from 30 to 25 percent, in accordance with paragraph 20 of the LDP

PRSC II
Prior actions for first tranche
MoF will implement e-SISTAFE in the Ministry and its provincial Directorates
The Council of Ministers will approve a new procurement decree that brings public procurement into line with international practice
The Government will present a new Financial Institutions Law to the National Assembly
Making the hiring of foreign labor more flexible through the adoption of decree 57/03
The Government will present a new Commercial Code to the National Assembly
The Government will formulate its 2005 budget with agreed allocations to PARPA priority areas and execute its 2004 budget consistent with agreed allocations, in particular it will spend 65 percent of its 2004 budget in priority areas
Triggers for second tranche
Adoption of a new procurement code and start of its implementation as evidenced by: (a) the approval of a revised implementation action plan; (b) the carrying out of procurement audits in at least two of its ministries in accordance with the activity plan of the internal audit system; (c) the preparation of a training program for civil servants and suppliers; (d) the preparation of terms of reference for elaboration of standard bidding documents
Revision of the 1888 Commercial Code through the adoption of a new Code
Rolled out e-SISTAFE to the Ministry of Education and Culture
Conclude the study on "off-budget" in the health sector and initiated the implementation of the study's recommendations as evidenced by the inclusions in the 2006 budget proposal of: (a) the revenues and expenditures of the special clinics (clinica special) and special care (atendimento special) and (b) a larger portion of the revenues and expenditures.
Legal reforms: submit bills to its Parliament revising: (a) the organic law of judicial courts including commercial sections; and, (b) the Notary Code
Combat corruption by increasing, in real terms, the resources allocated in its 2006 budgetary proposal for anti-corruption work, when compared to the 2005 budget

Annex II: List of People Interviewed/Met

In Mozambique:

Ministry of Planning and Development

H.E. Victor Bernardo, Deputy Minister
Dr. Adriano Ubisse, Director of Investment and Cooperation
Ms. Ester dos Santos Jose, Deputy Director of Investment and Cooperation

Ministry of Finance

H.E. Paulo Manique, Permanent Undersecretary

Bank of Mozambique (Central Bank)

Mr. Waldemar de Sousa, General Manager
Mr. Leonardo Marcos Simbine, Head of Foreign Department
Ms. Maria Esperanca Majimeja, Economist

Private Sector

Mr. Mario da Graca Machungo, Chairman, Millennium (BIM) Bank; Ex-Prime Minister and Ex-Minister of Finance
Mr. Yann Groeger, Director General, Pro Credit Bank
Mr. Manuel Rodrigues, Partner, METIER Consulting

Embassies

Mr. Niels Richter, Deputy Head of Mission, Danish Embassy
Ms. Lotta Karlsson, Deputy Chief of Mission and Chief of Cooperation, Finnish Embassy
Mr. Bengt Johansson, Chief of Cooperation, Swedish Embassy
Ms. Marit Strand, Counselor-Economist, Norwegian Embassy

IMF

Mr. Felix Fischer, Resident Representative
Ms. Emmy Bosten

UNDP

Mr. Jose Luis Macamo, Governance Programme Manager

IFC

Mr. Tunde Onitiri, Country Manager

World Bank

Mr. Michael Baxter, Director
Ms. Susan Hume, Country Program Manager
Mr. Young-Chul Kim, Senior Economist
Mr. Antonio Lucifora, Senior Economist
Mr. Samuel Maimbo, Senior Financial Sector Specialist

In Washington

World Bank

Mr. Peter Nicholas, Country Coordinator
Mr. Peter Moll, Senior Economist
Mr. Mazen Bouri, PSD Specialist
Ms. Louise Fox, Lead Economist
Mr. Rui Benfica, Economist
Ms. Maria Benitto-Spinetto Research Analyst
Mr. Brendan Horton, Consultant, IEG

IMF

Mr. Jose Sulemane, Advisor to the Executive Director (from Mozambique)

In Bern, Switzerland (by telephone)

Mr. Gregory Binkert, Senior Economist (on leave from the World Bank)

Annex III: Borrower Comments

Todate, no comments have been received from the government.

Annex IV. Basic Data Sheet

ECONOMIC MANAGEMENT AND PRIVATE SECTOR OPERATION – (Credit 3709)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	120	134.17	112
Loan amount	120	134.17	112
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	Original	*Actual*
Initiating memorandum	09/15/2000	12/05/2000
Negotiations		09/11/2002
Board approval		08/29/2002
Signing	09/10/2002	09/11/2002
Effectiveness		10/09/2002
Closing date		07/01/2004

Mission Data

Stage of Project Cycle	*Actual/Latest Estimate*	
	No. Staff Weeks	US$ ('000)
	41.2	204,363
Identification/Preparation	56.4	269,551
Appraisal/Negotiation	60.6	248,717
Supervision	21.4	90,086
ICR	179.6	812,717
Total		

Staff Inputs (staff weeks)

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating	
Month/Year	**Count**	**Specialty**	**Implementation Progress**	**Development Objective**
Identification/Preparation				
July 23-August 13, 2000	1	Country Economist (1); Country Director (1); Resident Representative (1); Economists (2);		
October 3-20, 2000	7	Country Economist (2); Country Director (1); Resident Representative (1); Sector Manager (1); Financial Sector Specialist (1); Operations Officer (1); Operations Officer (1);		
February 22-March 22, 2001	7	Country Economist (2); Economist (1); Financial Sector Specialist (1); Public Sector Specialist (1); Private Sector Development Specialist (1); Financial Officer (1);		
Appraisal/Negotiation				
December 18, 2001	12	Country Economist (2); Economist (1); Operations Officer (1); Consultant (1); Financial Sector Specialist (1); Private Sector Development Specialist (1); Financial Officer (1); Financial Analyst (1); Financial Management Specialist (1); Financial Economist (1); Country Director (1);		
Supervision				
October 28, 2002	7	Country Economist (1); Consultant (1); Economist (1); Sector Manager (1); Financial Officer (1); Private Sector Development Specialist (1); Advisor/Banking, Capital Markets & Fin. Eng. (1)	S	S
December 9-13, 2002	3	Country Economist (2); Advisor/Banking, Capital Markets & Fin. Eng (1)	S	S
December 16-24, 2002	3	Country Economist (2); Economist (1);	S	S
ICR				

FIRST POVERTY REDUCTION SUPPORT CREDIT (Credit 3950)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	Actual or current estimate	Actual as % of appraisal estimate
Total project costs	60	60	100
Loan amount	60	60	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	Original	Actual
Initiating memorandum	02/16/2004	02/18/2004
Negotiations	04/15/2004	04/22/2004
Board approval		
Signing		
Effectiveness	09/16/2004	09/16/2004
Closing date	06/30/2005	06/30/2005

Staff Inputs (staff weeks) No Data Available

	FYxx	FYxx	FYxx	FYxx	FYxx	FYxx	Total
Preappraisal							
Appraisal							
Negotiations							
Supervision							
Other							
Total							

Mission Data No Data Available

SECOND POVERTY REDUCTION SUPPORT CREDIT (Credit 4111)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	120	120	100
Loan amount	120	120	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	Original	*Actual*
Initiating memorandum	05/24/2005	06/14/2005
Negotiations	07/27/2005	07/11/2005
Board approval		
Signing		
Effectiveness	10/13/2005	10/13/2005
Closing date	06/30/2005	06/30/2005

Staff Inputs (staff weeks)

Stage	Staff Time and Cost (Bank Budget Only)	
	No. of Staff Weeks	US$ Thousands (including travel and consultant costs)
Lending		
FY05	59.75	375,591.53
FY06	35.55	183,175.68
TOTAL:	**95.1**	**558,767.21**
Supervision/ICR		
FY05	3.15	140,087.26
FY06	10.23	94,285.08
TOTAL	**13.38**	**234,372.34**

Task Team Members

Name	Title	Unit	Responsibility/ Specialty
Lending (from Task Team in Program Document)			
Gregor Binkert	Lead Specialist	AFTP1	TL
Jeeva A. Perumalpillai-Essex	Lead Operations Officer	AFTS1	TL
Peter G. Moll	Sr. Country Economist	AFTP1	Macro framework
Antonio Franco	Sr. Economist	AFTP1	PARPA
Maria Teresa Benito-Spinetto	Research Analyst	AFTP1	Macro framework
Lurdes Samuel Malate Amaral	Executive Assistant	AFTP1	Administrative support
Peter Nicholas	Country Program Coordinator	AFCMZ	Country Strategy
Gilberto de Barros	Sr. Private Sector Development Specialist	AFTPS	Private Sector Development
Louise Fox	Lead Specialist	AFTPM	Poverty
Daniel De Sousa	Investment Officer	AFTS1	Agriculture Sector
Caroline Forkin		AFTS1	HIV/AIDS
Jacomina de Regt	Lead Specialist	AFTS1	HIV/AIDS
Luisa Matsinhe	Team Assistant	AFTS1	Administrative support
Caroline Guazzo	Language Program Assistant	AFTS1	Administrative support
Noel Kulemeka	Sr. Economist	AFTH1	Education Sector
Alexandria Valerio	Sr. Education Specialist	AFTH1	Education Sector
Humberto Cossa	Sr. Health Specialist	AFTH1	Health Sector
Jean-Jacques de St. Antoine	Lead Operations Officer	AFTH1	Health Sector
Kate Kuper	Sr. Urban Specialist	AFTU1	Decentralization
Lance Morrell	Lead Operations Officer	AFTU1	Decentralization
Kathy Revels	Principal Regional Team Leader	AFTU1	Water Sector
Jose Luis Macamo	Public Sector Management Specialist	AFTPR	Public Sector Reform
Ravi Ruparel	Sr. Financial sector Specialist	AFTFS	Financial Sector