Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 23-Nov-2022 | Report No: PIDC35201

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Mozambique	P178668	Mozambique Second Institutions and Economic Transformation DPF (P178668)	P176762
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EASTERN AND SOUTHERN AFRICA	Jul 06, 2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Economy and Finance	Ministry of Economy and Finance		

Proposed Development Objective(s)

The DPF aims to support reforms strengthening institutions and laying the foundations for sustained growth and economic transformation.

Financing (in US$, Millions)

SUMMARY

Total Financing	200.00

DETAILS

Total World Bank Group Financing	200.00
World Bank Lending	200.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

This proposed Development Policy Financing (DPF) operation supports reforms that aim to strengthen institutions and lay the foundations for sustained growth and economic transformation. The operation, the second in a programmatic series of three DPFs, takes the form of an International Development Association (IDA) grant to the Republic of Mozambique amounting to SDR 156.5 million (US$200 million equivalent). The program development objectives of this DPF are to: (i) strengthen budget institutions and responsibility; (ii) improve the investment climate and financial access;

and (iii) promote low-carbon growth potential. The DPF is fully aligned with the country's Five-Year Program (2020-2025) and the National Development Strategy (2022-2032). The operation is also in line with the World Bank Group's FY17–21 Country Partnership Framework (CPF) and the new CPF under finalization. The series draws on previous and ongoing World Bank Group (WBG) activities, including the Prevention and Resilience Allocation (PRA), which seeks to help Mozambique address the drivers of conflict and fragility across the country.

Mozambique has implemented comprehensive reforms since the 2016 hidden debt crisis and subsequent shocks, strengthening public sector institutions ahead of the expected natural gas boom. In recent years, the Mozambican economy experienced a protracted slowdown owing to a series of shocks, including the debt crisis, climate disasters, the escalation of conflict in the northern province of Cabo Delgado, the Coronavirus Disease (COVID-19) pandemic, and the war in Ukraine. Measures taken to improve economic governance include legislative reforms strengthening state-owned enterprise (SOE) oversight and tightening risk assessments for issuing guarantees, regular publication of debt reports and fiscal risk statements, and new regulations requiring appraisal of public investment projects before including them in the budget. The authorities are preparing public institutions for the efficient and transparent management of substantial revenues from liquified natural gas (LNG) production expected at the end of the decade. LNG resources could help accelerate inclusive growth and reduce poverty.

Recent reforms strengthened the foundations for sustained economic recovery from the multiple shocks and the compounding domestic impacts of the emerging global food, energy, and climate crises. The recovery that started in 2021 has gathered momentum, despite the headwinds from the global economy. Growth is projected at 4 percent in 2022, from 2.3 percent in 2021, driven by services growth as mobility fully resumed. Growth is projected to rise over the medium term, reaching an average of 6.5 percent over 2024-2025, as the first LNG project begins production and services recover further. Despite proactive monetary policy, inflation has surpassed double digits as international fuel and food prices surged due to the war in Ukraine. The medium-term outlook is positive but subject to substantial downside risks, including the Ukraine war, potential for escalation of the insurgency in Northern Mozambique, and natural hazards.

However, the successive shocks have exposed the pitfalls of Mozambique's existing development paradigm, characterized by weak institutions, limited job creation, and low climate resilience. First, given the upcoming LNG revenues, effective medium-term fiscal policies and institutions are vital in promoting faster and sustained growth while maintaining fiscal sustainability. Second, growth has been less inclusive, and job creation remained limited as Mozambique increasingly depends on large natural resource investments with weak local linkages. Most jobs remain in low-productivity activities, primarily in agriculture and informal services. Job creation requires promoting growth in non-extractive sectors, necessitating greater private sector participation. Low productivity partly reflects a significant infrastructure deficit, notably in the public utilities, and weak human capital. Third, as Mozambique is one of the most vulnerable countries globally to climatic disasters, mainstreaming climate change into the country's development agenda is imperative to sustain growth and keep people from falling into poverty.

The long-standing structural challenges and vulnerability to shocks meant that poverty and inequality remain persistently high. Recent estimates show that the US$ 2.15/day poverty rate has increased from 48.4 percent in 2015 to 58.3 percent in 2020, largely due to COVID.[1] At the same time, the disproportionately adverse impact of recent shocks on the better-off has substantially decreased inequality, falling by ten percentage points to 45.4 percent over the same period, albeit from an already high level. The spatial distribution of poverty is skewed, with the poor concentrated in the Northern and Central regions.[2]

[1] World Bank estimates based on the 2019/2020 Household Survey (Mozambique Poverty Assessment, forthcoming).
[2] Poverty rates are higher in Nampula (77.7 percent), Zambezia (67.7 percent), Cabo Delgado and (64.4 percent) than in Maputo Province (24.5 percent) and Maputo City (17.1 percent).

The authorities are taking bold steps to accelerate inclusive growth and economic transformation by fostering private sector growth and laying the basis for more resilient development. In August 2022, the Government of Mozambique (GoM) launched a reform initiative (*Pacote de Aceleração Económica*—PAE) that aims to speed up economic recovery while maintaining fiscal sustainability and enhancing climate resilience. These reforms—expected to be implemented over 2023-2024 and anchored in the country's long-term development strategy—aim to foster private sector development by improving the business environment and aligning fiscal policy with development objectives. At the same time, the GoM is implementing comprehensive revenue and wage bill reforms to enhance fiscal sustainability, supported by the ongoing IMF program. Measures are also being taken to improve tax administration, including avoiding the accumulation of tax arrears, modernizing the taxpayer registry, and increasing tax compliance.

This operation builds on the government program and progress made during the first operation on budgetary institutions, the investment climate, and resilient, low-carbon growth potential. On completion of the DPF series, the reform outcomes will lay the foundations for economic transformation and a more inclusive and resilient development path. The operation is supported by three pillars and eight prior actions. The prior actions in the first pillar will help strengthen fiscal responsibility with medium-term fiscal objectives and rules, enable a more strategic and value-for-money approach to procurement, and address substantial fiscal risks from the public pension system. Pillar two's prior actions will foster investor confidence and accelerate investment flows into the country while protecting the environment, as well as expand financial access, notably for small enterprises and women. The policy and institutional measures under pillar three are expected to unlock the country's forest capital, better leveraging it for more sustainable development. They will also improve financial sustainability and private sector participation in the power and water utilities. Finally, this operation aligns with WBG corporate commitments by delivering climate co-benefits, reducing gender gaps, and maximizing finance for development.

Relationship to CPF

The proposed operation is aligned with the WBG Country Partnership Framework (CPF) for FY17–23. The CPF focuses on: (i) promoting diversified growth and enhanced productivity; (ii) investing in human capital; and (iii) enhancing sustainability and resilience. The reforms supported by this operation are aligned with the CPF objectives. Pillar 1 of this operation supports the objectives of improving economic management and increasing the accountability and transparency of public sector institutions. Pillar 2 addresses the CPF objective of improving the business environment for job creation. Pillar 3 supports the CPF objectives of recovery and resilience, expanding access to reliable electricity and water services.

This DPF leverages ongoing and planned WBG supported projects. All reform actions are anchored in existing technical assistance and sector projects. Fiscal transparency and procurement reforms will be underpinned by the Economic Management for Inclusive Development Project (P176664) and the Managing Public Resources for Service Delivery (P173178). Reforms targeting the investment climate and the financial sector are supported by the IFC program, the Financial Inclusion and Stability Project (P166107), and the upcoming Access to Finance and Economic Opportunities Project (P178658). Finally, reforms promoting Mozambique's low-carbon growth potential are supported by the Conservation Areas for Biodiversity and Development Project (P172777), Northern Mozambique Rural Project (P174635), the Energy for All Project (P165453), Rural and Small Towns Water Security Project (P173518), and Urban Sanitation Project (P161777).

Additional resources under the Prevention and Resilience Allocation (PRA) are used to support the GoM's efforts to de-escalate conflict and violence in Mozambique. The PRA Eligibility Note—discussed by the Board of Executive Directors in

April 2021—establishes Mozambique's eligibility for access to PRA. All operations in the Mozambique portfolio under IDA19 benefit from the PRA top-up to the performance-based allocation (PBA). Mozambique has successfully maintained PRA eligibility into IDA20, enabling it to access a further US$ 700 million of IDA financing over the three-year cycle—contingent on successful annual review.

C. Proposed Development Objective(s)

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Key Results

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D. Concept Description

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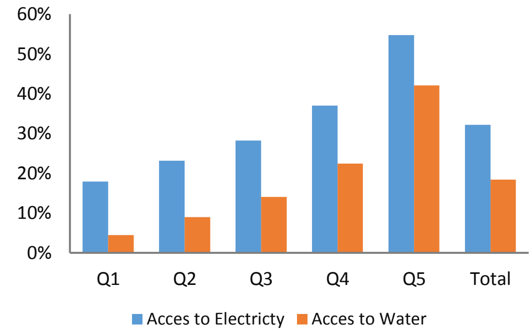
E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

Overall, the reforms supported under the proposed DPF are expected to have poverty-reducing effects in the medium term. Favorable impacts would come from greater financial inclusion (PA#5), and cheaper electricity and water services for the poorest (PA#7 and PA#8). Strengthening transparency in public procurement (PA#2) and pension system sustainability (PA#3) are expected to improve service delivery by enhancing responsibility in managing public resources. Enabling a private sector-led development (PA#3) would benefit the poor through job creation. Further, the reforms addressing climate and environmental governance (PA#6) would reduce poverty in the long run, as the poor are more vulnerable to climatic shocks.

Financial access and inclusion are crucial enablers of poverty reduction. PA#5 will support poverty reduction through enhancing households' economic resilience and facilitating the expansion of social transfer programs. Transaction accounts serve as a gateway to other financial services, such as credit.

Figure 3: Access to electricity and water across income quintiles



Source: Household Survey 2019/2020.

The new electricity tariff structure (PA#7) is expected to alleviate poverty by providing reliable and affordable electricity services. Adopting cost-reflective rates are anticipated to enhance EDM's financial sustainability and improve electricity service delivery. The potential adverse effects on low-income people will be mitigated by the social tariffs for low-volume consumers. The average household tariff is high, at US$¢14 per kilowatt hour (kWh), but many families currently benefit from the generous social tariff scheme.

Prior Action 8 supports the GoM's efforts to achieve universal access to WSS by 2030 and poverty reduction efforts. Greater private sector involvement in providing WSS services is expected to improve service performance and expand service coverage to the poor. Better WSS access and quality will benefit the poor because of their much lower access to safe water and sanitation (Figure 3).

Prior Action 4 on the revised Investment Law is expected to positively impact job creation and poverty reduction. Addressing legal obstacles to private sector growth is expected to contribute to structural transformation, job creation, and poverty reduction. Greater private sector participation is also expected to generate additional fiscal revenues that could help improve public service delivery.

Several reform actions included in this operation will benefit women especially. Given the lower rate of women's access to banking services, PA#5 will help narrow the financial inclusion gender gap by creating more opportunities for women. PA#7 and PA#8 will also support electricity and water access to female-headed households, mainly in rural areas where women suffer from lower incomes and literacy rates.

Environmental, Forests, and Other Natural Resource Aspects

Several reforms under this operation are expected to have considerable positive impacts for the environment, forests, and other natural resources; the remaining reforms will likely have no significant positive or negative impact (Annex 2). PA#1 supports the use of resource revenues for investments in climate resilience. PA#6 includes reforms strengthening forest governance and will directly support climate change mitigation by helping to reduce emissions. Addressing the drivers of deforestation will not only help Mozambique uphold its low-carbon trajectory, but also enhance its climate resilience and maintain goods and ecosystem services, including water storage, slope stabilization and flood management.

Greater financial sustainability of the power sector (PA#7) is also expected to lead to service expansion and the progressive decrease of kerosene-based lighting, reducing adverse environmental impacts. Tariff reforms are expected to help reduce the climate vulnerabilities of Mozambique's energy sector and support a low-carbon and resilient power sector. By enhancing cost recovery and increasing revenues, the utility will be able to maintain its assets and help ensure that new infrastructures are climate-resilient. In the water sector, a more financially sustainable utility is expected to implement a comprehensive climate-smart investment plan that contributes to (i) demand control with optimized water use and savings by consumers; (ii) flood-proofing of water treatment, transport, and distribution infrastructure; and (iii) developing and implementing system-specific drought management plans. The fiscal and governance-related reforms under Pillar One will help generate additional fiscal space, freeing up resources to support climate change adaptation. Under the new investment law (Prior Action 4), prospective investors would be expected to promote social and environmental responsibility through their investment projects, providing additional safeguards.

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APPROVAL

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