IDA AT WORK

Mozambique: From Post-Conflict Recovery to High Growth

Mozambique has emerged from decades of war to become one of Africa's best-performing economies. One of the poorest countries in the world at independence, the country has enjoyed remarkable recovery, achieving an average annual rate of economic growth of 8 percent between 1996 and 2008, the highest growth rate among African oil-importers. This resulted in more than three million people being lifted out of poverty. Inequality has remained relatively low by regional standards. From the human development perspective, this has meant a 40 percent decrease in infant and under-five mortality, and a 76 percent increase in net primary school enrollment. Progress has been made toward the key Millennium Development Goals of reducing infant mortality and increasing primary enrollment.

Country Indicators	1990/92	2005/06	2008
GDP per capita (US$)	150	310	370
Average inflation (%)	39	9.7	10.3
External debt (% of GDP)	286	81	36.8*
Poverty incidence (%)	69 (1997)	54 (2003)	54 (2003)
Net primary school enrollment (%)	43	71	89
Under-five child mortality (per 1,000)	235	152	68
Population (millions)	16.5	20.1	21.3

Source: Instituto Nacional de Estatisticas (INE); Government of Mozambique; Banco de Moçambique and IMF; National Household Surveys; Ministry of Education; Demographic and Health Surveys.

*Nominal debt to GDP ratio

Mozambique is one of the largest recipients of resources both from the International Development Association (IDA), the World Bank's fund for the world's poorest countries, and from other donors active in Africa. Along with financial support, IDA's technical expertise, global experience and ability to draw on its wide spectrum of development work have all contributed to Mozambique's successes.

COUNTRY ACHIEVEMENTS

After emerging from three decades of armed conflict, Mozambique has achieved economic and social progress.

Thirteen years of anti-colonial warfare were followed by independence in 1975 and a 16-year civil war which killed an estimated one million Mozambicans, and forced millions more to flee their homes. Since peace was restored with the Rome Accords in 1992, a new constitution has guaranteed a multi-party political system, a market-based economy, and free elections.

Growth and poverty reduction.

Growth has averaged over 8 percent a year between 1996 and 2008, mostly driven by exports, good performance in the transport, communication and construction sectors, and recovery in agriculture. Consistent implementation of fundamental reforms has led to large increases in foreign direct investment in aluminum, natural gas, coal, and titanium.

Poverty fell by about 15 percent between 1997 and 2003, bringing almost 3.5 million people out of extreme poverty in six years. Poverty decreased more in rural areas (from 71 to 55 percent) than in urban areas (62 to 52 percent)—Mozambique is the second country in the world after Vietnam to have achieved this.

These successes are due to overall macroeconomic stability, policy reform, government expenditures that benefit the poor and strong donor support, producing robust growth across most sectors of the economy.

Key achievements have included:

- **Improvements in education**: In primary education (grades 1–7), the number of children attending school more than tripled from approximately 1.3 million in 1992 to 4.2 million in 2008. Net enrolment rate at primary doubled from 45 percent in 1998 to 98 percent in 2008.
- **External debt management:** The net present value of public external debt has been halved, from 25 percent of GDP in 2003-2004 to 10.3 percent in 2008.
- **Financial sector reform:** There has been an overall improvement in financial stability and soundness, particularly capital adequacy and asset quality. In addition, the reforms in the sector led to dramatic reductions in non-performing loans from 14.4 in 2003 to 2.9 in 2008.
- **Improvements in water availability**: access to safe water increased from 31 percent in 1990 to 51 Percent in 2009. Sanitation services coverage improved from 16 percent to 45 percent over the same period.

- **Rising health standards**: both infant mortality and under-five child mortality have fallen by 40 percentage points between 1996 to 2008.
- **Trade liberalization**: Between 1994 and 2006, Mozambique introduced 18 new products to its export basket, a significant boost to its export performance.
- **Rebound in agriculture:** output growth has averaged 5.6 percent since 1992, with half of the growth due to area expansion, and the remainder due to labor force growth and yield improvements. The percentage of rural farm households who have adopted techniques recommended by agricultural extension agents increased from 2.4 percent in 2000 to 13 percent in 2004.

A well-managed response to crisis

Mozambique skillfully managed the recent global food and fuel crises by promoting agricultural production and staying away from generalized subsidies or measures that create trade distortions. The impact of higher oil and food prices on inflation and the exchange rate was successfully mitigated by tightening monetary policy and allowing limited adjustments to foreign reserves. The government's fiscal plans were also revised in June 2008 to introduce measures to mitigate the social impact of the higher prices, including a temporary scaling up of social protection measures, and measures to support the productive sectors of the economy most vulnerable to the increase in energy prices.

Notably, the government opted for a sustainable response that builds on the agricultural potential of Mozambique, a fertile country with abundant land, to help increase agriculture production in the short and medium term. In this context, in June 2008 the government approved the Action Plan to Increase Food Production which articulates an aggressive push to increase agricultural production over the 3-year period 2008-2011, and is intended to reduce Mozambique's future vulnerability to increases in food prices. The plan translates into significant increases in the budget expenditure for the agricultural sector from 0.5 percent of GDP in 2008 to 2 percent in 2009 and 2010.

The government faced a difficult tradeoff to finance these measures. The additional fiscal cost in 2008 of the response measures approved by the government is estimated to have amounted to approximately 1.3 percent of GDP (or US$120 million). In order to finance the measures in 2008, the government realized expenditure savings, increased domestic borrowing, and also sought additional financing from development partners, notably IDA. The World Bank contributed US$10 million in additional budget support from the GFRP Trust Fund to the government's Food Production Action Plan in 2008, and also increased the level of budget support in 2009 by a further US$10 million from the IDA allocation.

Mozambique's overall achievements have rested on three pillars which IDA has helped consolidate: strong government ownership of the reform program; coherent and well-grounded reforms; and large volumes of increasingly well-coordinated donor assistance.

IDA CONTRIBUTIONS

Since the end of the civil war, IDA has committed more than US$3.6 billion in support of over 60 projects and completed more than 40 formal in-depth analytical reports on Mozambique. Mozambique became a major element of the Africa portfolios of other World Bank Group institutions—the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency—including financing and guarantees for the Mozal aluminum smelter.

IDA's contribution to Mozambique's recovery began even before a formal peace treaty was signed in October 1992. IDA supported the government in working with the International Monetary Fund (IMF) and a wide range of donors to create an innovative financing package that matched the needs of an economy able to absorb quickly unusually large flows of aid. This financing allowed Mozambique to launch structural reforms and move gradually away from receiving humanitarian aid to development assistance.

A first IDA economic recovery credit in 1992 supported a broad post-war strategy, including redeploying government expenditures towards key social sectors and small-holder agriculture, liberalization and privatization in industry and agriculture, and financial sector reform.

Supporting a government-led program.

The government has had a clear set of policy priorities which have reflected the direction in which it wanted to take Mozambique. To reinforce its ownership of the development agenda and reduce transactions costs, the government has stressed the benefits of improved harmonization, and has worked to bring donor assistance into the budget and in line with the government's budget cycle.

A group of 19 donors[1] providing direct budget support to Mozambique base their programs on a single performance assessment framework built entirely on the government's poverty reduction strategy (known by its Portuguese acronym PARPA). A focal donor is appointed for each sector to ensure coherent and unified dialogue with the government on sector priorities. IDA's wide-ranging analytical work was instrumental in building the structure of this framework by helping to prioritize actions and indicators across sectors.

IDA has increasingly moved from project assistance to sector- and program-based approaches. Since 2004, it has worked with other donors to form a coherent group supporting a single government program, rather than a fragmented and potentially incoherent set of separate donor projects

Providing technical expertise and worldwide experience.

Mozambique's post-war success was built on a number of reforms that worked because they were coherent, based on sound knowledge and analysis and because they benefitted from other countries' experiences. IDA's technical expertise, worldwide experience, and ability to integrate knowledge from across the whole spectrum of development work played an important role.

For example: the successful liberalization of the telecommunications sector emerged from IDA's knowledge of other countries' experience with licensing private mobile operators. IDA was able to produce a synthesis of good practice models in Africa and beyond, and highlight their dramatic impact on connectivity. This helped spur the government to quickly liberalize the mobile market, and

1. In addition to IDA, the following are members of the "Group of 19": the African Development Bank, Belgium, Canada, Denmark, the European Commission, Finland, France, Germany, Austria, the Netherlands, Ireland, Italy, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

The Cellphone Revolution

The cost of mobile telecommunications dropped drastically after competition was introduced and a second operator entered the market in 2003. Total teledensity went from 4 subscribers per 100 inhabitants in 2004 to 8 percent of the population the following year and 20 percent today.

IDA helped introduce competition, and draw a new telecommunications law in 2004, paving the way for full liberalization of the sector by December 2007.

cell-phone users grew from 51,000 in 2001 to 4.4 million in 2008/2009.

Through its analytic work, IDA has supported the Government in shaping Mozambique's poverty reduction strategy. This included poverty assessments, along with agriculture, health and education sectoral analyses.

Other country analyses (i.e., a Country Economic Memorandum as well as studies on rural development and tourism) provided recommendations for the optimal use of Mozambique's natural resources—land, forestry, fisheries, mining and water—and for integrating their management into the country's overall growth strategy.

Reviews and assessments of public expenditure (especially in the social sectors), financial accountability, procurement, the financial sector, the investment climate, and the legal and judicial sectors all formed the basis for reforms.

Providing and leveraging aid and private finance.

Increased aid and private sector flows have helped finance Mozambique's investment programs. IDA has supported these programs by integrating analytical work, institution-building and multi-donor assistance.

The World Bank Group has played a key role in leveraging private sector inflows by supporting the creation of an investor-friendly business climate and providing guarantees to a number of very large investments.

IDA has also helped to boost private sector investment through advisory services, training and projects linked to mega-projects. Through poverty reduction credits, it has supported efforts to reform the commercial code, tourism law, investment regulation, and business registration.

IDA's institutional support, policy advice and investments have helped Mozambique improve its roads, financial sector, water and education.

Roads. IDA provided the primary support of the roads network over the last 15 years, both through financing (US$400 million for two programs) and advisory services.

Based on analytical work conducted while the war was still underway, IDA supported the government in developing and obtaining financing for a high priority, long term roads sector program, which integrated rehabilitation and maintenance, civil works and institution-building. Initial rehabilitation priorities were based both on agricultural priorities (using knowledge gained from IDA's involvement in that sector), and on the need to provide access to returning refugees.

IDA helped to mobilize significant financing from donors and assisted the government in managing the trade-offs that this implied for other sectors. This was one of the first examples of a sector-wide approach.

Classified roads in good or fair condition have increased seven-fold to 70 percent, and impassable roads have fallen ten-fold to only 5 percent. The road building program was complemented by an institutional capacity-building program including the creation of an independent road fund to pay for government's share of maintenance, by pooling fuel user charges. IDA also supported the creation of an innovative scholarship program to retain staff after training and for the development of private sector trucking and contracting enterprises.

Financial Sector. At a critical time in Mozambique's transition to a free-market economy, IDA quickly supported the creation of a separate Central Bank and an independent private commercial banking sector. Subsequently, IDA and a team of development partners (including the African Development Bank, the United Kingdom, and Germany) supported dialogue with the government on the development of a competitive and efficient banking sector.

With that support, Mozambique is implementing a major financial sector reform program. Notable financial sector reforms include a new banking law that enhanced supervisory powers (2004); three Commercial Courts in Maputo, Beira, and Nampula (2005); a comprehensive review of the major banks (2005); introduction of a new bank insolvency law (2007); establishment of a new Financial Information Center of Mozambique law (2007); and strengthening of supervision with a focus on risk-based assessments, enhanced transparency and increasing use of market instruments. It also improved monetary and exchange rate policy implementation leading to a decline of real interest rates.

There has been overall improvement in financial stability in Mozambique. As a result, the banking sector's soundness, in particular, asset quality, improved substantially reflected, in part, by dramatic reductions in non-performing loans from 14.4 in 2003 to 2.9 in 2008.

Water. Institutional reforms in the water sector started in 1995 with the formulation of an IDA-supported national water policy. The urban water sector has since made considerable progress in the introduction of a policy of delegated management framework - whereby assets are owned by the government and operations are managed by independent operators including the private sector.

Support to Mega-Projects

MIGA provided guarantees in the Mozal aluminum smelter and SASOL, worth US$2 billion and US$1.2 billion respectively. In addition, the IFC invested US$145 million in the Mozal aluminum plan, and IDA established a project to help small and medium enterprises benefit from contracts with Mozal.

IDA worked with the IMF and MIGA to advise government on how to optimize the terms of a US$950 million loan for the transfer of the Cahora Bassa hydropower plant from majority Portuguese to majority Mozambican ownership – a project which could open new opportunities for hydropower in Mozambique's Zambezi Basin.

IDA is also working to ensure maximum development benefits from future mega-projects, such as the planned US$ 1.5 billion foreign investment in the Moatize coal project.

IDA supported the creation in 1998 of an asset holding company and a regulatory board that laid the groundwork for improving service levels and attracting investment. Mozambique's delegated private sector management approach has attracted about US$350 million of investments for urban water over the last six years. The level of service in cities served by the holding company has improved steadily over the past three years, with hours of supply increasing from 9 to 24 hours daily in the cities of Beira, Quelimane, Nampula, and Pemba. Access to safe water has more than doubled to 27 percent in rural areas between 1996/7 and 2002/3, and the Millennium Development Goal of 70 percent sustainable coverage in urban areas will likely be met.

Education. IDA-supported reforms in the education sector have resulted in a new curriculum for primary education, launched nationwide in 2004, which is expected to have a direct impact on the quality of education. Other IDA-backed achievements include an expanded national program of direct support for schools introduced in 2004, the first providing direct financing to primary schools aiming at quality improvement and decentralization. Since 2006, this program received a boost with financial contribution from other partners and was expanded in 2008 to secondary schools.

CHALLENGES AHEAD

The government faces three major challenges: to ensure more jobs are created; to sustain the growth of rural incomes; and to achieve greater success in reducing the incidence of HIV/AIDS.

Access to a higher level of external financing in the next few years, if coupled with continued vigorous implementation of reforms, could accelerate real annual growth and help the country accelerate progress toward the Millennium Development Goals.

Creating jobs will require a greater focus on improving the business environment. Considerable progress has been made in reducing licensing times and other administrative bottlenecks. Mozambique has reformed and simplified the licensing processes for a number of sectors, especially for small and medium enterprises and simple economic activities. The government has reformed the commercial code, introduced good investor protection, simplified tax payments for SMEs, and eliminated the minimum capital requirement for business start-ups. However Mozambique needs to accelerate and broaden the ongoing reform effort since other comparable economies are reforming at a much faster pace.

Sustaining growth in rural incomes. Growth in agriculture has started to plateau after the post-conflict "bounce back", and there is a need to focus more on enhancing productivity. This will call for: improved research that is relevant to farmers; broader dissemination of drought-resistant crop varieties; encouragement of out grower arrangements; exploration of new models for access to financial markets by smallholders; facilitating investment in medium- and large-scale farms; and upgrading rural infrastructure, including irrigation and roads.

Investing in irrigation will be worthwhile. About one-tenth of the country's 36 million hectares of cultivable land is suitable for irrigation, but less than 1 percent of this is irrigated, the lowest in the region. The benefits of small-scale irrigation are high: an investment of US$20 million per year over 15 years would increase total agricultural value added by about US$250 million in 2020. Lack of water storage is one key constraint to expanding irrigation. The useful capacity of the country's dams represents only 5 percent of the mean annual river runoff, excluding the Zambezi, and there would be major benefits from increased water storage.

Improving health. Mozambique faces significant health challenges, including rates of infant and child mortality that are still high by world standards. Mozambique is the only country in Sub-Saharan Africa where HIV infections are on the rise. HIV prevalence—at about twice the regional average—is a major concern: HIV/AIDS affects 16 percent of the 21.3 million Mozambicans.

It is estimated that life expectancy at birth, which was 41 in 2008, may drop to 36 years by 2010, rather than increasing to 50 years as it would have been in the absence of HIV/AIDS. Despite increased political commitment and funding, the prevention of HIV/AIDS is lagging behind particularly in the south region where the prevalence rate has increased in the last 4 years.

In recognition of the lack of progress in prevention, the government approved a strategy to accelerate prevention of HIV transmission in November 2008. The strategy will focus more on key determinants of the epidemic. Considerable progress has been made in rolling out antiretroviral treatment (ART) during the last 4 years despite major health system weaknesses including low numbers of health professionals and underdeveloped infrastructures and laboratory technology.

Monitoring also needs to be improved, and efforts are under way to develop a comprehensive financial tracking system for HIV/AIDS allocations and expenditures.

Malaria and tuberculosis remain significant problems as well: malaria is the primary cause of death among children, with some 25,000 to 50,000 children dying each year.

Significant reductions in mortality and morbidity would accrue from increased expenditure on outreach mechanisms for preventive services, scaling up community-based interventions, improving facility-based care and an outreach strategy for primary curative care.

Scaling up investments would be feasible and desirable in a number of other areas:

Energy. Despite recent investment in expanding electricity provision, the country still lags in terms of access to energy. UNDP estimated the electrification rate at a mere 6 percent in 2007.

Roads and bridges. The rehabilitation of the road network was an important factor in the strong economic growth over the last 10 years. Despite this, continued rapid rehabilitation and new construction will be needed if growth is to be sustained. Additional resources would allow significant extension of the rural and feeder road network, especially in areas with high growth potential, and would allow improvements in the condition of rural secondary and tertiary roads.

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http://www.worldbank.org/ida