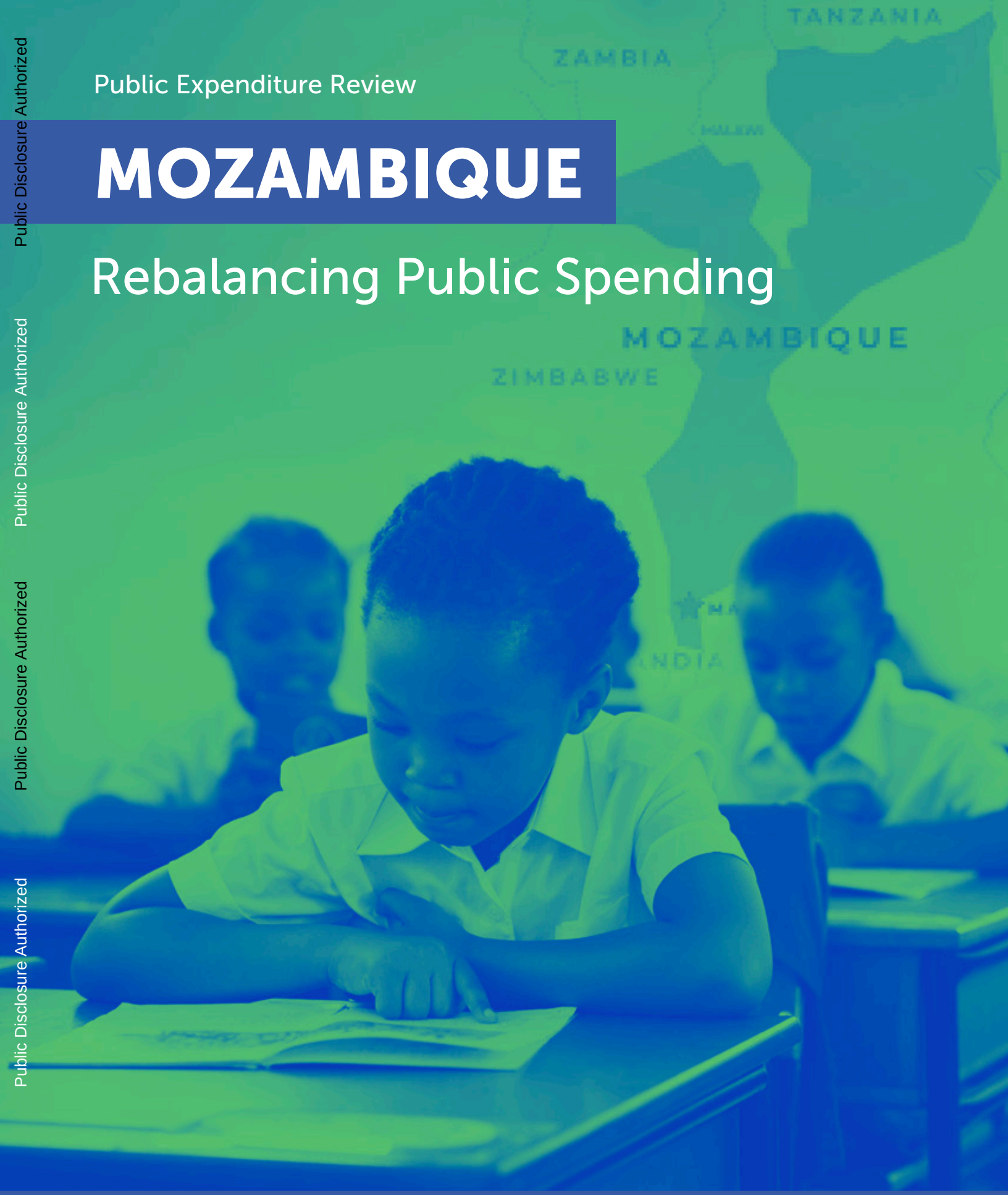
Public Expenditure Review

MOZAMBIQUE

Rebalancing Public Spending

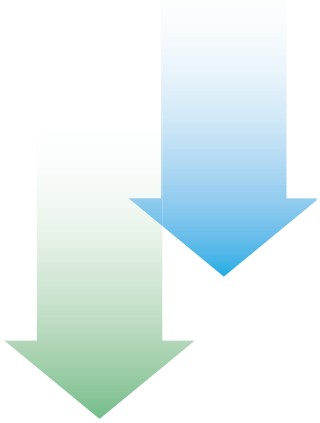


WORLD BANK GROUP

UKaid
from the British people

Acknowledgments

This report was prepared by a team led by Fiseha Haile (Senior Economist and TTL), Albert Pijuan Sala (Senior Economist and co-TTL), and Ana Cristina Hirata Barros (Senior Governance Specialist and co-TTL). The team included Fernanda Ailina Pedro Massarongo Chivulele (Research Analyst, EAEM2), Andre Loureiro (Senior Economist), Ana Ruth Menezes (Senior Education Specialist), Lucia Jose Nhampossa (Education Specialist), Guilherme Kono (Consultant), Ariel Melamud (Consultant), Mariam Bibi Umarji (Consultant), Andrew Lawson (Consultant), Tomas Selemane (Consultant), Jeffery Marshall (Consultant), Andrea Lepine (Consultant, UNICEF), Helder Machango (UNICEF), Arianna Ranuschio (Consultant, UNICEF), and Matheus Bueno (Young Professional, EAEM2). Fiona Hinchcliffe provided excellent editorial support. The report was prepared under the overall guidance of Idah Pswarayi-Riddihough (Country Director, AECS2), Mathew A. Verghis (Practice Manager, EA1M2), and Paulo Guilherme Correa (Program Leader and Lead Economist, EACS2). Adelina Mucavele (Assistente de Programa, AECS2) provided excellent assistance. The report has benefited from the generous financial support from the Foreign Commonwealth and Development Office (FCDO). The team is also grateful for the good collaboration with the Government of Mozambique.



Executive Summary

Mozambique is a country in Southern Africa with a population of nearly 33 million. It is endowed with abundant natural, energy, and agricultural resources, potential to develop as a regional trade hub, and a young population. The discovery of huge gas reserves is expected to provide Mozambique with a transformative opportunity for sustained and inclusive growth. Multi-billion liquefied natural gas (LNG) projects promise growth and substantial fiscal revenues; if managed well, these resources will create fiscal space to invest in human capital and climate-resilient infrastructure, reduce poverty, and pay down debt.

Mozambique's fiscal position is weak, owing to a series of governance, climatic, and health shocks. The revelation of "hidden debts" in 2016[1] led to a crisis of economic governance, causing a suspension of donor budget support and a protracted economic slowdown. The fiscal situation deteriorated in 2019 after two cyclones caused massive damage to infrastructure and livelihoods. The escalation of insurgency in Northern Mozambique further drove up security and humanitarian spending. While public investment and social spending remain subdued, the public sector wage bill and short-term financing needs of underperforming state-owned enterprises (SOEs) have been rising. Supporting the incipient recovery from COVID-19 will require resuming fiscal consolidation and rebalancing public expenditures.

In 2014, the World Bank prepared a comprehensive Public Expenditure Review (PER) that identified options for creating fiscal space and enhancing the pro-poor orientation of public spending. It covered revenue mobilization, wage bill, debt and fiscal risks, public investment management, and spending in priority sectors, among others.[2] Recent years have seen several sector expenditure reviews in priority areas, including education (2016), health (2017, 2021), agriculture (2019), transport, and water (both in 2021).

The present PER discusses challenges and opportunities for rebalancing public expenditures, enhancing fiscal revenue, and improving the efficiency and equity of limited public resources. It updates the 2014 PER drawing on the latest World Bank's Boost dataset, jointly developed with the Ministry of Economy and Finance. It zooms in on two selected sectors: state-owned enterprises, which have never been analyzed before, and the education sector, which needed updated analysis. The sectors for the study were selected based on a combination of factors, including the country's development program and reform priorities, spending trends, budget size, potential fiscal risks, and World Bank engagement. Throughout the PER, Mozambique is consistently benchmarked against a set of regional, structural, and aspirational peers.[3]

Rapid growth has helped reduce poverty, but unevenly

In recent decades, Mozambique has been one of the fastest-growing economies in sub-Saharan Africa (SSA). Growth in

1 In 2013 and 2014, a clique of government officials created three state-owned enterprises that took on US$1.3 billion (equivalent to 10 percent of Gross Domestic Product) of debt. Allegedly, the funds were to build shipyards, develop tuna fishing, and police the coast—with financing arranged by Credit Suisse, VTB, and BNP Paribas, three major banks. These loans—commonly known as "hidden debts"—were undisclosed until the international media reported on them in 2016. They breached the International Monetary Fund (IMF), program at the time, and the IDA's non-concessional borrowing policy. The authorities have undertaken extensive reforms since then, supported by the World Bank, the IMF and other development partners.

2 Priority sectors included education, health, water, agriculture, transport and energy infrastructure, and social protection.

3 Structural peers are countries with similar structural characteristics. These include Côte d'Ivoire, Ghana, Tanzania, and Uganda. Aspirational peers are those that set a good development precedent. These include Botswana, South Africa, Malaysia, and Mauritius.

real gross domestic product (GDP) accelerated remarkably following the end of the protracted civil war in 1992, averaging 7.9 percent between 1993-2015, compared to 0.5 percent in 1980-1990. However, growth decelerated sharply in recent years due to consecutive shocks. Progress has been made on social outcomes, but inequality has been on the rise. Life expectancy increased from about 46 in 1993 to 61 in 2020, and gross school enrollment rates roughly doubled in primary education over the same period. The poverty rate fell from 79.8 percent in 2002/03 to an estimated 63.5 percent in 2021. However, people in the bottom 40 percent of the income distribution have been mainly left behind. Rapid growth has disproportionately benefited urban and higher-income households. Access to basic infrastructure is concentrated in urban areas, while rural regions lag in the central and northern provinces.

With fiscal pressures persisting, Mozambique needs to resume fiscal adjustment and rebalance spending

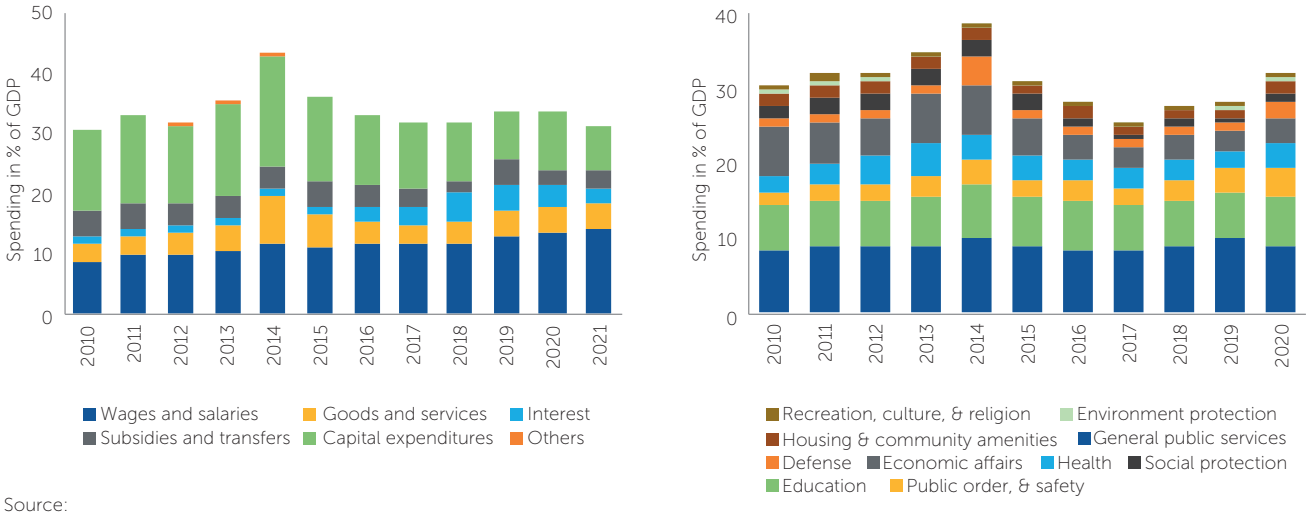
The consecutive shocks, combined with the lack of donor budget support in recent years, caused significant spending pressures, and the pandemic interrupted fiscal consolidation. Rising non-discretionary expenditures dominate the recurrent budget, driven up by the high public sector wage bill, debt service payments, and pensions. The wage bill and debt service absorb 90 percent of all tax revenues. In 2020, Mozambique spent 13.3 percent of GDP (or 40.3 percent of total spending) on public wages and compensation, compared to an average of 7 percent of GDP in peer countries.

Compared with its peers, Mozambique stands out for its significant level of public spending (in percent of GDP), but development outcomes remain weak. Public spending is dominated by general public services, the social sectors (education and health), and national defense. Despite having one of the highest social spending rates in Africa, human capital formation is suboptimal and has been severely affected by COVID-19. Salaries in education, health, and national defense absorb over half of total public spending. In contrast, subsidies and transfers have been shrinking and are much lower in Mozambique than comparable countries, reflecting a limited social safety net and fiscal adjustment efforts. Access to infrastructure is also much lower than for regional peers, despite the higher level of capital spending. However, together with subsidies and transfers, investment spending saw significant cuts owing to the fiscal pressures caused by repeated shocks.

Underperforming SOEs have added to the domestic debt pressures, accruing large liabilities and posing significant fiscal risks. About 80 percent of the increase in public debt in the past four years is explained by SOE-related financing needs; their debt stock amounts to 17 percent of GDP. Given tight fiscal constraints and high spending needs, it is crucial to resume fiscal adjustment.

High public spending, combined with weak outcomes, raises concerns over fiscal sustainability of such spending, underscoring the need to streamline public finances. A sizable part of the fiscal adjustment will need to come from discretionary spending and improving the efficiency of public spending. A new law to restructure employee compensation and the civil service career structure, approved in 2021–and reforms supported by the upcoming IMF program–expect to rein in employee compensation over the medium term, delivering cumulative wage bill savings worth 1.7 percentage points of GDP by 2024.

Wages and salaries in the big spending social sectors (education and health) absorb the bulk of total spending



Source:

Mozambique needs to enhance spending efficiency in education and health, improving outcomes and possibly freeing up resources to expand social protection. It also needs to rebalance the composition of spending from cross-cutting general public services to more productive activities in critical enabling sectors, particularly public investments with high returns, including resilient road, electricity and water infrastructure.

The authorities have taken steps to strengthen public financial management but challenges remain

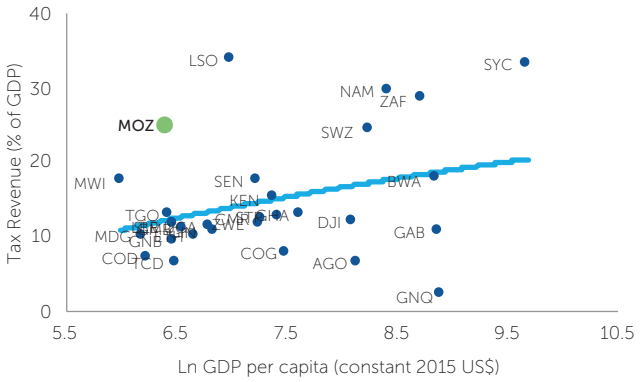
The Government has implemented several measures to address the governance and public financial management (PFM) weaknesses that led to the 2016 hidden debt crisis. These included reforms requiring tighter risk assessments for debt and guarantees issuance, including by SOEs. There has also been substantial progress on fiscal transparency, with regular publication of fiscal risk and debt reports. These reforms culminated in the approval of a new PFM law in 2020, integrating the SOE sector and subnational governments into the budget system. The revised law determines the scope for planning and budgeting and establishes clear roles and responsibilities for internal audits. Further, the law includes key procurement provisions previously in separate and dispersed legislation and the management of public assets.

Despite this progress, several PFM processes and practices need to be strengthgened. Budget credibility is low, with tenuous links between budget priorities and allocations. There are weaknesses in treasury operations and cash management. The authorities often accumulate payment arrears, resulting from the lack of budget credibility, enforcement of controls during budget execution, and weak cash management. Moreover, budget execution rates need to improve, particularly investment spending. Ensuring more spending is executed within the integrated financial management system will enhance control, avoid over-commitment at the spending entity level, improve predictability and oversight, and reduce the scope for extra-budgetary arrears.

Mozambique fares better than its peers in terms of tax performance but more needs to be done to broaden the tax base to enhance the sustainability of revenue collection

Mozambique's tax revenues have performed well, and its fiscal revenues are higher than those of its peers and the SSA average. Tax revenue averaged 21 percent of GDP over 2017-2021, on the back of administrative and tax policy reforms. However, a substantial portion of tax revenue comes from the extractive industry and FDI-related activities, which raises questions about the sustainabiltity of domestic revenue collection. Therefore, it is crucial to broaden the tax base and promote revenue mobilization in non-extractive industries. A

Mozambique has higher tax revenue for its income level



Source: IMF.

sizable revenue expansion is expected when all LNG projects come online, but not until the late 2020s. LNG revenues could be transformational and support a more inclusive growth path, but public finances need to be balanced before significant gas revenues start flowing.

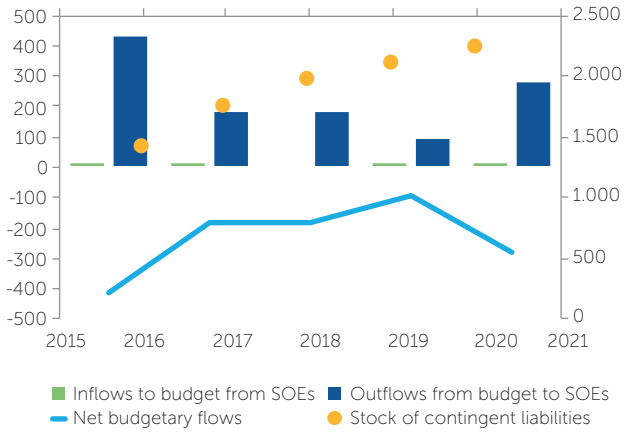
Mozambique has increasingly relied on direct taxes—corporate income tax (CIT) and personal income tax (PIT)—rather than indirect taxes. However, indirect taxes (VAT and excise taxes) account for a significant share of total taxes. Non-tax revenue is also considerable, averaging 3.2 percent of GDP over 2013-21, though markedly lower than for peers. Mozambique also relies on external (project) grants, which are substantially higher than the SSA and SADC averages. Grants picked up significantly in 2020 and 2021, reflecting donor support to the country's efforts to deal with the disasters and the pandemic.

Increasing tax revenues further would require broadening the tax base, given the concentration of direct taxes on a few large firms and individual taxpayers. The country is undertaking several reforms to make its taxation system more efficient and simplify tax filing by taxpayers. However, excessive tax exemptions and incentives are a problem, mostly benefiting the most profitable economic sectors and activities and resulting in considerable revenue losses and low corporate income tax productivity. Inefficiencies in the tax administration system remain an obstacle to broadening the tax base.

The SOE sector is generally underperforming and poses significant fiscal risks

State-owned enterprises (SOEs) play a crucial role in the Mozambican economy and their financial performance has significant fiscal implications. The SOE portfolio currently comprises 74 directly owned SOEs, a decline from 122 in 2017. Available data indicate that the state holds additional stakes in at least 48 companies through indirect

SOEs generally pose a significant fiscal drain



Source:

shareholding or subsidiary arrangements. SOEs and their subsidiaries operate in 30 sectors, from natural monopolies and network sectors to activities that could be provided by private investments without the need for market regulation. SOEs held assets totaling US$ 8.2 billion (or 62 percent of GDP) in 2020. The sector as a whole suffers from a chronic lack of profitability of the SOE and is highly indebted. The equity to asset ratio stands at 30 percent in 2020, meaning the State as shareholder owns, on average, about a third of SOE assets, with the rest being leveraged.

The market distortions created by the dominance of SOEs propped up by state aid crowd out the private sector in some areas and compromise much-needed social spending. In-depth analysis of five focus SOEs—*Aeroportos de Moçambique* (ADM), Electricidade de Moçambique (EDM), Empresa Nacional de Hidrocarbonetos (ENH), Linhas Aéreas de Moçambique (LAM), and Petróleos de Moçambique (PETROMOC)—reveals that several rely significantly on transfers or other support from the state. The annual fiscal drain of the five focus SOEs has averaged approximately US$ 227m over the past five years, and their combined stock of direct and contingent liabilities to the State and other SOEs is estimated at US$ 2.2b in 2020. Their adjusted debt stands at 19.5 percent of GDP. This represents a de facto subsidy given to the SOE sector each year on a rather ad hoc basis. However, this subsidy is not necessarily well targeted, since subsidies for airlines, airports, fuel and LNG may be quite regressive and not benefit the poor. To put this into perspective, USD$ 227 million yearly outflows would be enough to cover the education spending of approximately 1.25 million secondary students in Mozambique for a year.

SOEs' public sector obligations are at the root of many of the fiscal risks they pose

SOEs' public service obligations can contribute to tensions between SOEs' commercial and non-commercial mandates, particularly if these are imposed on SOEs without adequate funding to support service delivery. For example, an otherwise relatively well-governed SOE may still incur losses or fail to deliver adequate services if the state requires it to provide services below market rates without sufficient compensation or to operate commercially unviable projects. LAM serves routes with low demands and low yields, leading to a weak load factor and generating strong losses for the company. Conversely, where SOEs provide public services essential to achieving development outcomes, governance reforms should consider the broader societal impact and factor these into proposals (e.g., the impact on the public of rises in electricity, water, or transport costs).

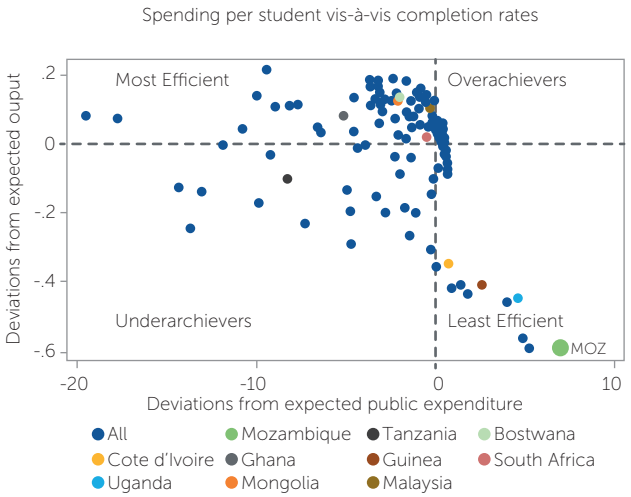
Mozambique needs to invest in quality education to reap the demographic dividends

Weak human capital is undermining the prospects for inclusive growth in Mozambique. Although the country has one of the highest social spending rates in SSA, spending per student is low and human capital formation remains weak. Compared to its peers, the country also has one of the lowest levels of learning, which is a critical obstacle to faster and more inclusive growth. Many Mozambicans—especially those in rural areas and in the central and northern regions—lack access to the quality education that is essential for productive adult lives.

Mozambique's rapidly growing population poses both challenges and opportunities for long-term development. The country has one of the highest fertility rates in the world; over 40 percent of the population are likely to be under the age of 15 by 2030. This highlights the critical importance of improving efficiency in the use of limited public resources to ensure opportunity of quality education for all. In a context of limited fiscal space, and substantial learning losses caused by COVID-19, improving education quality will require rethinking policies and introducing innovative approaches to service delivery, while simultaneously improving efficiency and equity in the provision of public services. This means more effective allocation of the education budget to priority areas across and within levels of education, and making better use of existing resources.

The share of education in total government expenditure has generally been higher than most peers over the past 20 years. However, overall education spending has remained relatively constant while student populations have continued to expand, given the persistently high fertility rates, and as a result, per-pupil spending levels are generally declining. Recurrent expenditures (mainly teacher salaries) make up 85 percent of total spending and are rising, while almost all investment spending is externally funded. These increases in recurrent spending have led to decreases in spending on areas that directly impact the quality of the sector, such as teachers' professional development, better geographical distribution of resources, and improved infrastructure of school buildings.

The efficiency of education spending is low



Source:

Mozambique performs below its peers for the efficiency and equity of its education sector

The extremely high pupil-teacher ratios observed in some areas of Mozambique (especially the northern provinces) are ineffective; outcomes could be improved for the same spending by allocating teachers more evenly across the country, including through better professional development and compensation. In Mozambique, education spending is also highly inequitable, with large differences in per-student education spending across provinces. Teacher training institutes (IFPs) are not equally distributed across the country. The most populous northern provinces cannot train enough teachers to supply even the existing primary schools, quite apart from the expanding needs generated by high population growth in these regions. A critical binding constraint for a more efficient use of existing resources in the education sector is the low level of management capacity at the central, provincial, district, and school levels. A higher level of efficiency of education spending requires better systems and processes, as well as better prepared staff.

Recommendations

Resuming fiscal consolidation and promoting revenue mobilization

- *Resume fiscal adjustment.* Given that the country's LNG revenue windfall may only come at the end of the decade, Mozambique needs to resume fiscal consolidation in the short and medium term. A sizable part of the fiscal adjustment will need to come from discretionary spending and improving the efficiency of public revenue and expenditure in critical sectors. Fiscal sustainability analysis shows that Mozambique needs a combination of high growth rates and structural wage bill and VAT reforms to rebalance its public finances and bring down debt levels. These reforms will be partly supported by the IMF program.
- *In the short term, maximize concessional sources of financing and reduce domestic borrowing costs* through active debt management, including upgrading IT systems for debt recording and reporting. This would allow directing public resources to development priorities and spending them more efficiently.
- *In the medium term, establishing fiscal objectives and rules is essential.* There is a need to strengthen the medium-term fiscal framework (MTFF) and gradually transition towards a fiscal policy based on fiscal objectives and rules.
- *Reform budget execution and financial controls,* strengthening the expenditure chain and preventing the accumulation of arrears. Budget execution rates must improve, particularly investment spending. Ensuring more spending is executed within the integrated financial management system (IFMIS) will improve control, avoid over-commitment at the spending entity level, improve predictability and oversight, reducing the scope for extra-budgetary arrears. Finally, the authorities should also move from cash rationing to proactively managing cash flows and balances.
- *Review the advantages and disadvantages of tax incentives.* Carry out an analysis of the impact of incentives on investment, and maintain only the most essential incentives, phasing them out from the extractives sector. Following this, statutory tax rates can be gradually reduced.
- *Rationalize the portfolio of VAT tax exemptions to broaden the tax base and ensure fairer burden-sharing.* Address tax expenditures with a negative carbon impact, such as VAT, and trade tax exemptions on pesticides for agriculture.
- *Establish a tax policy framework, and review the use of fees and charges in non-tax revenue areas,* which currently generate only 12-15 percent of non-tax revenues. Fees and charges could be expanded, increasing their environmental role (e.g.' water fees', toll road systems).

Clarifying the policy for SOE ownership

- *The rationale for state ownership should be evaluated—and reevaluated periodically—, taking into consideration the costs and benefits of ownership in light of resource constraints, as well as any adverse market effects due to SOE participation. SOEs that fail to meet the criteria for continued state ownership could be privatized, restructured or wound down over time as appropriate.*
- *Set forth a dividend policy for SOEs: an inclusive and transparent due process (including Treasury and other important stakeholders) should be established for setting dividends.*

Managing fiscal risks and costs of the SOE sector

- *Improve monitoring and disclosure of equity stakes held by the State:* a comprehensive inventory should be taken of the State's shareholdings.
- *Strengthen monitoring and reporting on SOE arrears and cross-debts:* a stock-taking of SOE arrears should be undertaken (e.g., arrears to the State in the form of tax, pensions or customs duties and cross-debts between SOEs), and these should be monitored regularly.
- Consolidate the fiscal risk monitoring and reporting functions for SOEs to avoid duplication of efforts or gaps in coverage: in an environment of constrained capacity.
- Decision-making in the SOE sector with potential for significant fiscal impact should follow a transparent due process and involve all interested parties to decide upon matters such as public service obligations and significant investments.

Focus on select SOEs in which there is momentum for reform

- *A sustainable solution, involving the State as shareholder, is necessary to improve the financial situation of the selected SOEs: as a first step this would include a debt restructuring strategy, and clearance of cross-debts and arrears.*
- *SOE indebtedness—including short term debt—could be limited in accordance with certain financial ratios: this could take the form of a cap on permitted leverage ratios.*

Increasing efficiency and equity in education spending

- *Improve teacher effectiveness and deployment.* Better professional development and compensation frameworks are critical for increasing teacher quality and reducing absenteeism. Reforming the national teacher career framework (Sistema de Carreiras e Remuneração) will help achieve these. A more equitable process of teacher deployment and an increase in the effective number of hours of teaching, with a focus on the northern provinces, is also needed.
- *Increase the equity of allocation of funds to subnational levels through a new education financing framework* to increase regional equity in spending per student at all education levels, with priority for disadvantaged groups.
- *Improve the predictability of budgets.* This is key to enhancing efficiency and effectiveness of spending, allowing textbooks and other essential items to be procured on a timely basis, better planning of investments, and more efficient disbursement of available external resources.

Increasing efficiency and equity in education spending

- *Reform teachers' career framework to improve teacher quality.* In line with the proposed National Teacher Policy, better professional development and merit-based compensation frameworks are critical for increasing teacher quality and reducing absenteeism. Reforming the national teacher career framework (Sistema de Carreiras e Remuneração) to introduce merit-based progression and focusing the teacher professional development on contents and classroom management skills.
- *Improve the process of teacher deployment and increase the effective number of teaching hours.* Define clearer rules for the deployment of new teachers, with focus on the areas with the pupil-teacher are the highest create incentives for existing teachers to move to remote areas with a focus on the northern provinces, as well as increase the number of weekly hours in the existing teachers' contracts.
- *Digital learning. Expand and improve the quality of distance learning to support teacher development and as an alternative for reducing pupil teacher ratios and increasing coverage in secondary education.*
- *Increase the equity of allocation of funds to subnational levels through a new education financing framework* to increase regional equity in spending per student at all education levels, with priority for disadvantaged groups.
- *Improve the predictability of budgets* for higher efficiency and effectiveness of education spending. Reform the budgeting and planning frameworks and processes for more predictable and timely budget execution and disbursement of available resources.

CHAPTER 1

Expenditure

Summary: While public spending in Mozambique has been high, the country lags behind its peers on several outcome indicators, indicating the low efficiency of spending. This chapter analyzes the evolution and composition of public spending, identifying the main challenges and opportunities for improving expenditure efficiency and generating fiscal savings. The analysis sets the scene for the three chapters which follow. It also sheds some light on public financial management systems and practices at the central level. In addition, the analysis addresses the effects of the COVID-19 pandemic. It highlights some vulnerabilities in the government's spending model, exacerbated by several shocks in recent years. With the revenue windfall from the country's liquefied natural gas (LNG) only likely to appear at the end of the decade, there is a need to resume fiscal consolidation and reblance spending in the short and medium term.

The chapter is organized as follows: Section 1.1 outlines Mozambique's recent economic history, describing how its growth model and the impacts of recent shocks have led to fiscal vulnerability. Section 1.2 presents the country's overall trends in public spending, before conducting an in-depth analysis of the sustainability of government expenditure, while also benchmarking Mozambique against regional and structural peers. Progress and challenges in Mozambique's public financial management are reviewed in Section 1.3, especially its moves towards decentralization. Finally, Section 1.4 uses fiscal sustainability analysis to present fiscal and debt projections for 2022–2026 under four scenarios.

1.1 Recent Macro-fiscal Developments

After the civil war, Mozambique saw sustained high economic growth for more than two decades. Real gross domestic product (GDP) growth accelerated remarkably following the end of the protracted civil war in 1992, averaging 7.9 percent between 1993-2015, compared to 0.5 percent in 1980-1990. In recent decades, Mozambique has been one of the fastest-growing economies in sub-Saharan Africa (SSA) (Figure 1.1). The rapid growth in the 1990s primarily reflected aid-financed post-war reconstruction and the return to political stability, which provided a foundation for sound macroeconomic policies. Improved economic management, in turn, helped attract foreign direct investment (FDI) and extensive donor support, which financed infrastructure investment and expansion in public services.

Although some improvements in social indicators accompanied this rapid economic expansion, the existing growth model has exacerbated inequality. Life expectancy increased from about 46 in 1993 to 61 in 2020, and gross school enrollment rates roughly doubled in primary education and quintupled in secondary education over the same period. The poverty rate fell from 60.3 percent in 2002/03 to 48.4 percent in 2014/15. Although rapid growth helped reduce poverty, it did so unevenly. People in the bottom 40 percent

of the income distribution have been mainly left behind—their share in private consumption declined over the same period (World Bank, 2020). Rapid growth disproportionately benefited urban and higher-income households. Access to basic physical and social infrastructure has been similarly concentrated in urban areas, while rural regions in the central and northern provinces are lagging behind. Mozambique increasingly relies on capital-intensive mega projects with limited linkages with the rest of the economy, explaining how the rapid growth was accompanied by rising inequality.[4]

Economic growth had lost momentum in recent years due to successive domestic and external shocks. In 2016, the revelation of previously undeclared loans plunged Mozambique into an economic crisis and macroeconomic instability, derailing its track record of high growth. Growth halved from 7.7 percent over 2000-2016 to 3.3 percent over 2016–2019. The country's economic prospects deteriorated further with the insurgency in northern Mozambique, escalating since 2017; the tropical cyclones in 2019; and the COVID-19 pandemic. The pandemic pushed the economy into its first recession in almost three decades, with GDP contracting by 1 percent in 2020. The pandemic worsened the external environment, dampening global demand, commodity prices, and capital flows. At home, strict measures to contain the spread of the virus weakened domestic consumption and investment.

The recurrent shocks strained the fiscal accounts and pushed Mozambique into debt distress, interrupting fiscal consolidation. Public debt, which was already on an upward trajectory, surged to 127 percent of GDP in 2016 after the hidden debts were revealed. Donor budget support was suspended, and financing costs increased. The government responded by implementing a successful fiscal consolidation program up until 2019. As a result, the primary deficit was reduced from 6 percent of GDP in 2015 to 2.1 percent in 2018; the debt-to-GDP ratio had decreased to 108 percent by 2019. However, the above-mentioned shocks undermined domestic revenue collection and increased spending pressures.

Rising spending needs and the absence of budget support have led to a steep rise in costly short-term domestic debt. Total domestic debt ramped up from 13 percent of GDP in 2016 to 22 percent in 2021, given the suspension of direct budget support since 2016.[5] Spending pressures in recent years stemmed from the need to address: (i) the security and humanitarian crisis in the north of the country; (ii) the loss and damage caused by cyclones Idai and Kenneth in 2019; (iii) COVID-19 financing needs between 2020 and 2022; (iv) the increasing debt service; and (v) SOEs' arrears and financing needs.

Underperforming SOEs have added to the domestic debt pressures, accruing significant liabilities. About 80 percent of the increase in public debt in the past four years is explained by SOE-related financing needs. SOEs' debt stock amounts to 17 percent of GDP, of which 14 percent is external, and 3 percent is domestic debt. Further, the weak financial position of several SOEs poses a significant fiscal risk through contingent liabilities. The International Monetary Fund estimates SOEs' net worth at –6.9 percent of GDP.[6] Recent improvements in the SOE legal and regulatory framework are a step forward in addressing these vulnerabilities (see Chapter 3). However, thorough restructuring of the portfolio is still needed.

Fiscal pressures will likely persist in the coming years, owing to rigid expenditures, insurgency in the north, and climatic and other shocks. A new salary structure for civil servants in 2022 promises greater control in the medium term, but at a near-term cost. Increased capital spending in the past few years reflects the externally financed vaccination program and expenditure needs to address northern Mozambique's security and humanitarian situation. The country faces an array of natural hazards, including flooding, droughts, and cyclones, which regularly destroy public infrastructure and increase social assistance needs. More recently, the Ukraine-Russia conflict has further exacerbated fiscal pressures.[7]

The revenue windfall from the country's liquefied natural gas (LNG) may only come at the end of the decade, so Mozambique needs to resume fiscal consolidation and rebalance spending. Fiscal revenues (in percent of GDP) remain significantly higher than the average for sub-Saharan African economies (Figure 1.1 and Figure 1.3). Tax revenue averaged 21 percent of GDP over 2017-2021, on the back of administrative and tax policy reforms. A sizable revenue expansion is expected when all LNG projects come online, but not until the late 2020s. LNG revenues could be transformational and support a more inclusive growth path, but public finances need to be balanced before significant gas revenues start flowing.

Higher spending has not translated into significant improvement in outcomes (Figure 1.4 and Figure 1.5). Although Mozambique has one of the highest social spending rates in Africa, human capital formation is weak and has been severely affected by COVID-19. Further, access

4 The Gini coefficient rose from 0.47 to 0.56 between 2008 and 2014, putting Mozambique among the most unequal countries in SSA.
5 In addition to its increased levels, domestic debt presents considerable costs and maturity concentration. The effective interest rate on domestic debt issuances (excluding Central Bank loans) is above 10 percent. The short and medium-term maturity requires debt rollover, contributing to the rapid increase in the stock.
6 IMF (2021): Fiscal Transparency Evaluation. Technical Report.
7 The authorities are planning to introduce some fiscal measures to mitigate the adverse socio-economic effects of the oil and cereal prices shock resulting from the Ukraine conflict, which may further increase financing needs

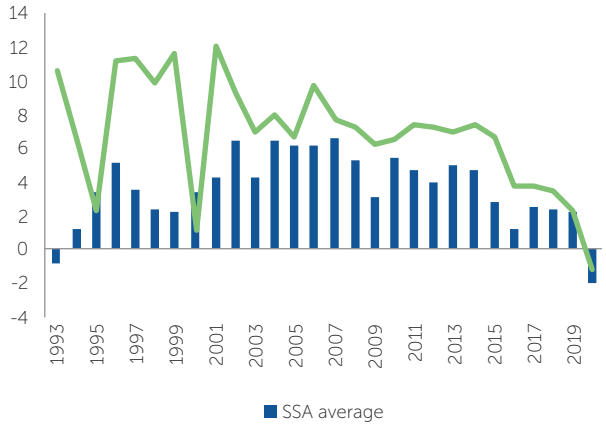
to infrastructure is also much lower than in regional peers (Figure 1.5), despite the high levels of capital spending.[8] On the other hand, current spending are still driven up by the wage bill, pensions, and interest payments (Figure 1.4). Debt service and the public sector wage bill absorb 90 percent of total tax revenues. Considering the limited fiscal space, it is critical to direct public resources to development priorities and spend them more efficiently.

1.2 Public Expenditure: Trends and Drivers

Overall trends in public spending

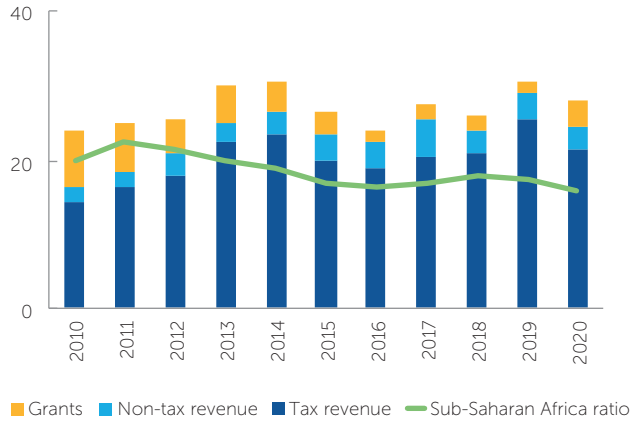
Public spending in Mozambique has been consistently procyclical during the last decade, mainly mimicking the country's growth trajectory, with some fiscal consolidation before the pandemic. During 2010-2015, which coincided with the end of the second wave of megaprojects (Figure 1.1) and was characterized by higher growth, expenditures boomed, peaking above 40 percent of GDP in 2014. Public spending was driven mainly by increases in compensation for employees and public investment largesse. However, GDP growth decelerated in 2016-2021 following the disclosure of the hidden liabilities. In 2016, the hidden debt scandal negatively affected investment prospects and access to external financing and grants which had traditionally financed a significant part of public spending. A successful fiscal consolidation program ensued between 2015 and 2019, including eliminating transportation and food subsidies, streamlining public investment, and improving fiscal transparency and debt management. As a result, public spending contracted, hovering around 30 percent of GDP between 2015 and 2020.

Figure 1.1: Real GDP % growth rates, Mozambique and peers, 1991-2019



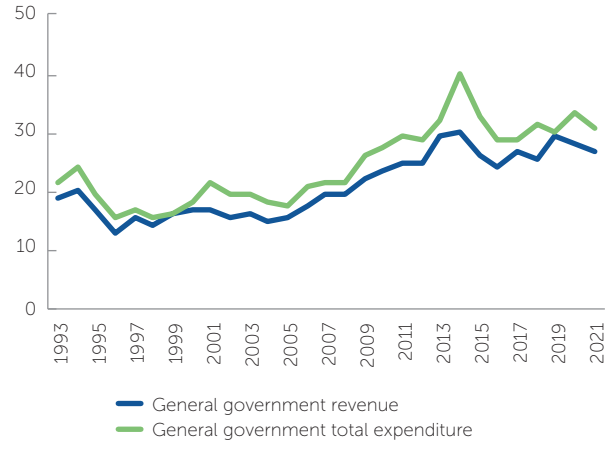
Source: World Bank and MEF

Figure 1.2: General government revenues as a percent of GDP, 2010-2020



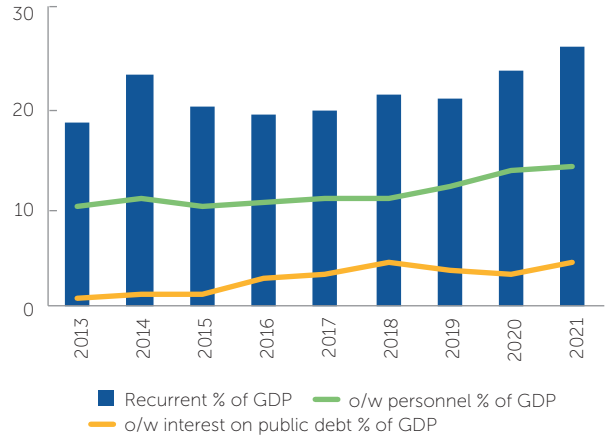
Source: MEF and IMF. Note that SSA is a weighted average

Figure 1.3: Revenue increase and expenditure growth as percent of GDP, 1993-2021



Source: IMF.

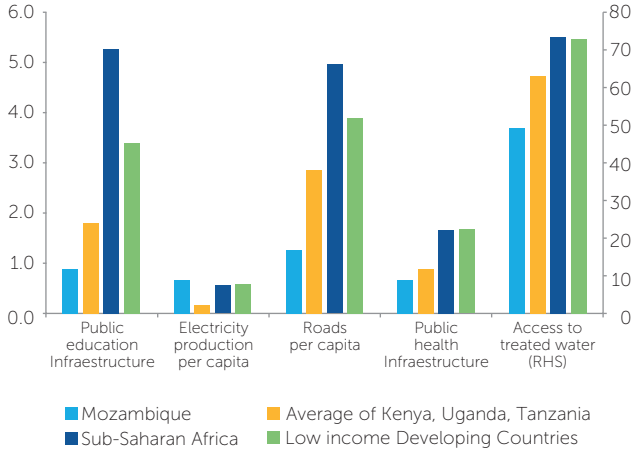
Figure 1.4: Current expenditures as percent of GDP, 2013-2021



Source: World Development Indicators (2015).

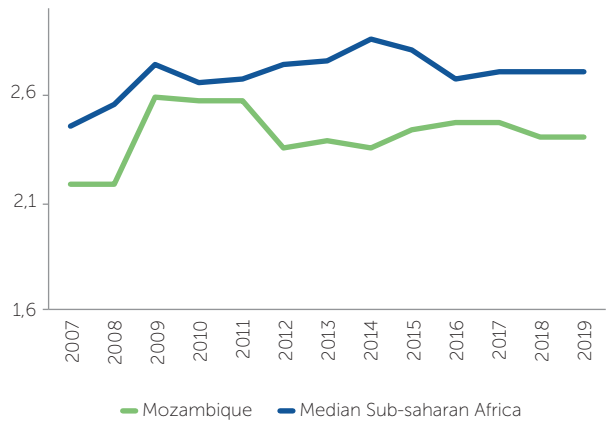
8 World Bank (2019).

Figure 1.5: Access to infrastructure, Mozambique and peers



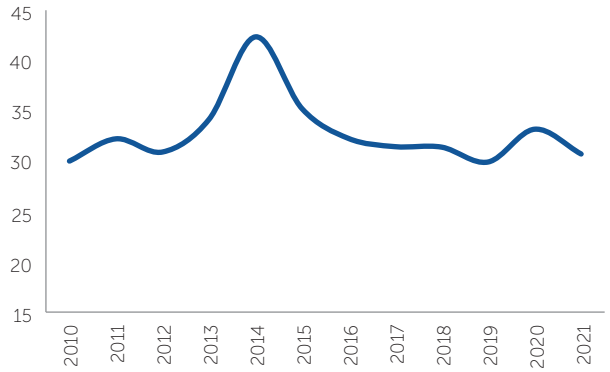
Source: World Development Indicators.

Figure 1.6: Quality of Infrastructure Index, 2007-2019



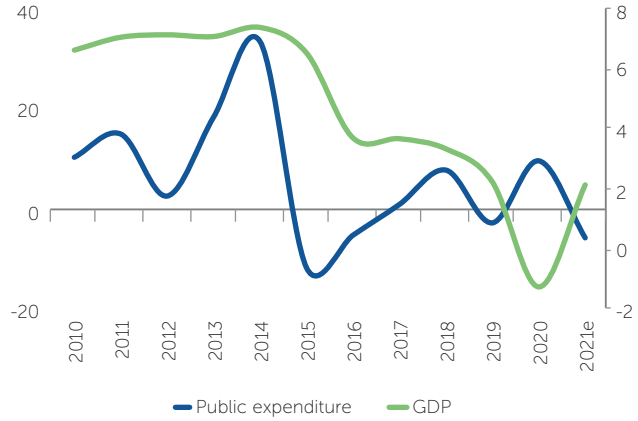
Source: World Economic Forum Global Competitiveness Index

Figure 1.7: Evolution of total government expenditures, 2010-2021e, % of GDP



Source: IMF.

Figure 1.8: Real GDP (RHS) and real public expenditure (LHS) annual growth rates, %

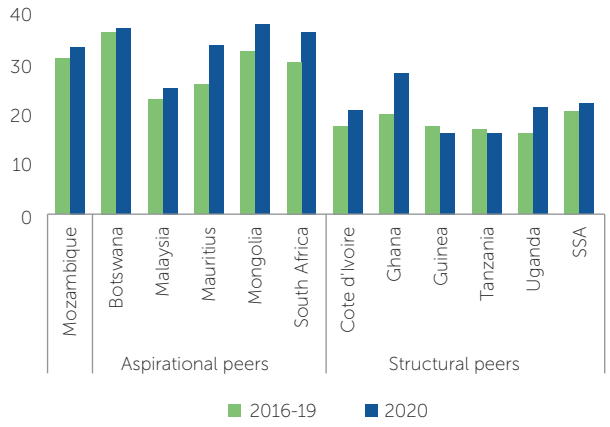


Source: IMF.

However, with the outbreak of COVID-19 and the escalation of conflict in the north and the cyclones, budgetary policy has recently become slightly countercyclical. The global pandemic dented the outlook further, while amplifying spending needs and interrupting fiscal consolidation. Development partners made external financing commitments totaling USD 808 million (6 percent of GDP) to support the COVID-19 policy response in 2020. Following a budget revision, the authorities developed a package of COVID-response measures that increased total government spending from 30.5 percent of GDP to 33.1 percent. The support to businesses included deferring income and corporate tax advance payments for small firms, reduced electricity tariffs, and credit facilities on favorable terms. To protect families, the authorities expanded beneficiaries of social protection programs by over one million, simplified ID requirements for mobile money transfers to these beneficiaries, and suspended VAT on some staple goods.

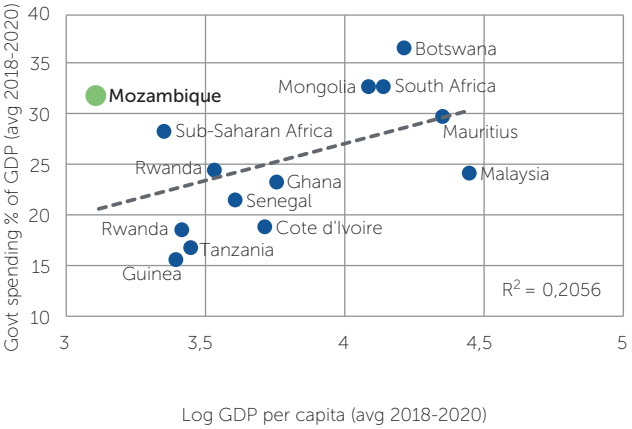
Compared with aspirational and structural peers, Mozambique stands out for its relatively high level of public spending in relation to its income per capita. After years of conflict, public expenditures grew significantly in the 1990s because Mozambique had been left with low physical capital stock and limited access to basic infrastructure and services. As the country started rebuilding its economy, infrastructure, and institutions, its recurrent and capital spending surged, reflecting these development needs. When growth sharply decelerated from 2016, public investment budgets were cut, reflecting lower revenues and limited access to foreign financing. Still, at an average of 31.2 percent of GDP over 2016-2019, Mozambique's level of spending is much higher than its structural peers, averaging 17.4 percent over the same period (Figure 1.9). Considering its GDP per capita, Mozambique also shows a high level of spending (Figure 1.10), raising concerns over the fiscal sustainability of such spending levels and their effectiveness.

Figure 1.9: General government total expenditure, Mozambique and peers, 2016-19 and 2020, % of GDP



Source: Based on data from MEF

Figure 1.10: Government expenditure and GDP per capita, Mozambique and peers



Source: World Economic Outlook database, Oct. 2021

1.3 Composition of Government Expenditure

Expenditure by economic classification

Rising non-discretionary expenditures, notably wages and interest payments, dominate the recurrent budget. Current spending (in percent of GDP) grew substantially between 2010 and 2014. However, it remained relatively stable during the second half of the decade, with some changes in its composition, driven mainly by increases in public wages and interest payments (Figure 1.13). Within current spending, Mozambique shows increasing and relatively high spending levels on public wages, and low levels of subsidies and transfers. In 2020, Mozambique spent 13.3 percent of GDP (or 40.3 percent of total spending) on public wages and compensation, compared to an average of 7 percent of GDP in peer countries (Figure 1.11 and Figure 1.12). However, this should be interpreted with caution as differences in expenditure classification partly explain the significant gap in wage levels between Mozambique and its peers. A new law to restructure employee compensation and civil service career structure, approved in 2021—and reforms supported by the upcoming IMF program—expect to deliver cumulative wage bill savings worth 1.7 percentage points of GDP by 2024.[9] Besides containing wage increases, current reform discussions also feature early retirement schemes, hiring constraints, and a functional review of the employment structure. The low level of transfers and subsidies is explained by the low coverage of the social protection system and the small size of the decentralized intergovernmental fiscal transfer system (2 percent of total revenues).

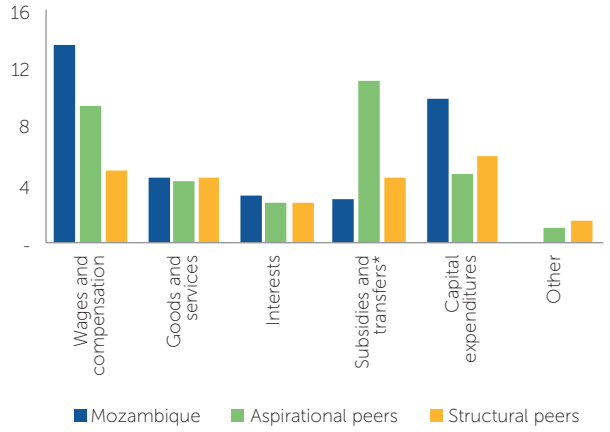
Ad-hoc increases in salaries and other compensations, and to a lesser extent employment, have been the main drivers of wage and salary growth. Public wages and salaries grew from 8.4 percent of GDP in 2010 to 13.8 percent in 2021. As a percentage of total spending and total fiscal revenue, public wages and salaries were 28 and 44 percent in 2010 and reached 45 and 55 percent in 2021. Mozambique's central government employment-to-population ratio is around the median for its peers. This suggests that high wage-spending levels in Mozambique most likely reflect higher compensation levels (IMF, 2018). About 92 percent of total salaries are allocated to civil servants and the remaining 8 percent to military personnel.

Salaries in education, health, and national defense absorb over half of total public spending. Wages and salaries in the education sector absorb around 40 percent of spending (Figure 1.14), mainly at the primary and secondary levels (47 and 27 percent of the total). General public services are usually second in importance, closely followed (and sometimes surpassed) by public order and safety. Health absorbs around 10 percent of public wage and salary spending. A further breakdown of the wage bill spending suggests that, while compensation has also been the main driver, employment dynamics have played a more prominent role in the education sector.

Goods and services are the second most important spending item among current expenditures, averaging 20 percent of total spending (or 6.2 percent of GDP), on a par with those of peers (Figure 1.13). About 54 percent of the total is allocated to goods and the rest to services. Among goods,

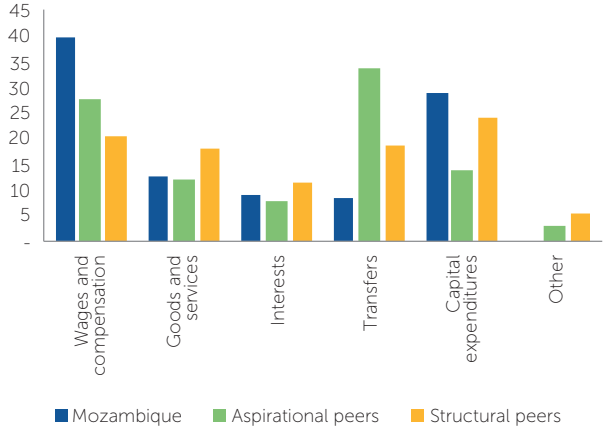
9 The government often over-executes wage spending, showing a lack of control over the administrative instruments that regulate public servants' remunerations, and making public wages relatively high and unpredictable. Mozambique's ongoing public wage bill reforms seek to simplify different pay scales, supplementary pay components and bonuses, as well as indexing mechanisms used across the public sector.

Figure 1.11: International spending comparison, by economic classification, 2020 (% of GDP)



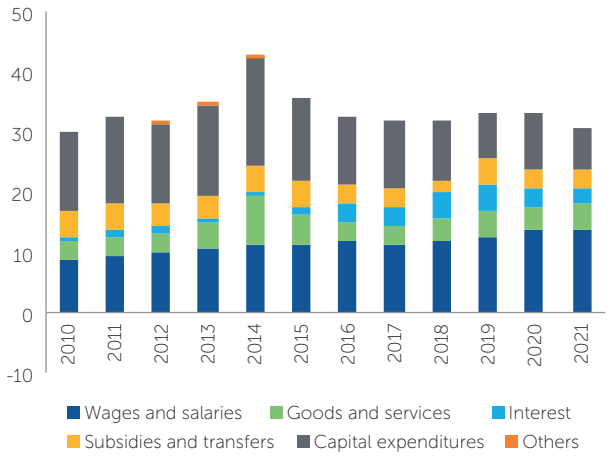
Source: IMF staff reports for selected countries

Figure 1.12: International spending comparison, by economic classification, 2020 (% of total spending)



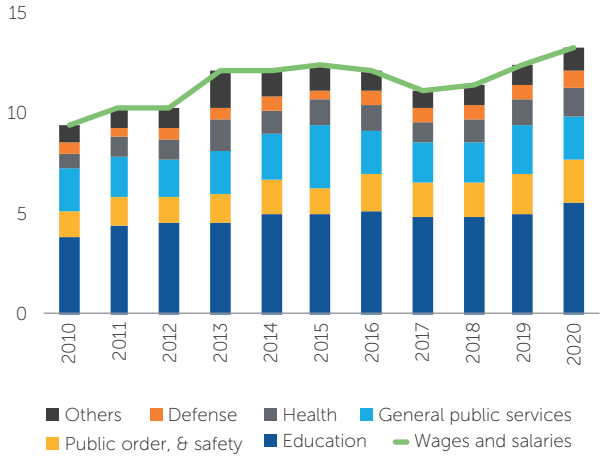
Source: IMF staff reports for selected countries

Figure 1.13: Public spending by economic classification, 2010-2021e (% of GDP)



Source: Extended Economic Outlook, IMF (2019); IMF (2022).

Figure 1.14: Public wages and salaries by sector (% of GDP)



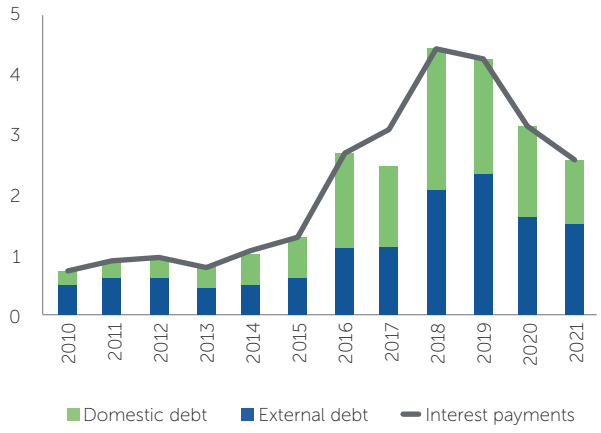
Source: Boost database.

the acquisition of medicines, food, and fuel dominates. Within services, most of the spending is accounted for by consultancy services, general communication, electricity, and transport. A significant share of goods and services (22 percent on average for the decade) was financed by external donations.

In the face of limited access to concessional financing and rising debt, interest payments have been the second most crucial driver of public expenditure growth. They rose from an average 1 percent of GDP in 2010-2015 to 3.7 percent of GDP in 2016-2021 (Figure 1.15). Both domestic and external debt interest payments soared after the hidden debt scandal. Given lower access to concessional financing, the government resorted to domestic markets, at much higher rates. Further, the increase in the portion of non-concessional external debt stock from 2012 contributed to the ramp up in the external debt service. The Debt Service Suspension Initiative (DSSI) helped reduce interest payments by a total of 1.4 percent of GDP in 2020 and 2021. Mozambique stands out for having higher interest payments as a percentage of GDP than comparable countries, at 3.1 percent of GDP in 2020, versus 2.7 percent in structural peers.

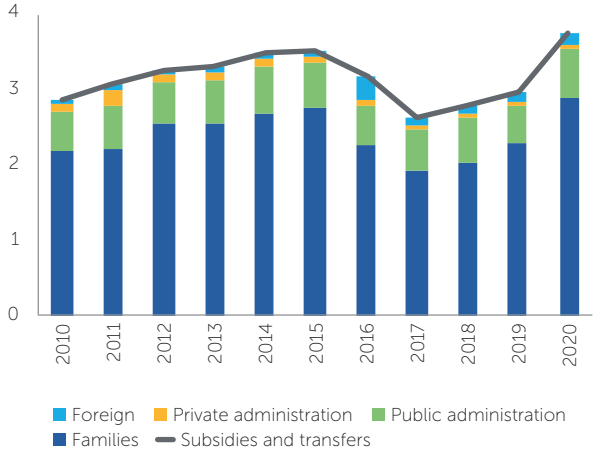
Subsidies and transfers are much lower in Mozambique than comparable countries, reflecting a limited social safety net and fiscal adjustment efforts. In 2020, Mozambique spent 2.8 percent of GDP (or 8.6 percent of total spending) on current transfers and subsidies (Figure 1.16), compared to an average of 7.7 percent for peer countries. This is partly explained by spending cuts, particularly in 2016 and 2017, including the removal of some fuel and wheat subsidies, accompanied by an automatic fuel price adjustment mechanism and increases in electricity and public transportation tariffs in 2017-2018.

Figure 1.15: Interest payments (% of GDP)



Source: Extended Economic Outlook, IMF (2019); IMF (2022).

Figure 1.16: Subsidies and transfers (% of GDP)



Source: Boost database.
Note: Transfers to foreign includes international organizations.

Further, the social safety net coverage has been low in the last decade (reaching 608,724 vulnerable households by 2020, about 1.6 percent of total spending or 0.5 percent of GDP). In the last decade, 76 percent of current grants went to families and 18 percent to the public administration (mainly embassies and other levels of government as they receive 2 percent of total revenue by mandate).[10] In the early 2010s, transfers to families were mostly channeled to social protection. However, since 2016, the largest share of current transfers to families was accounted for by pensions, mainly for retired military personnel.

Together with subsidies and transfers, investment spending saw significant cuts owing to the fiscal pressures caused by repeated shocks. Capital expenditures have decreased and been more volatile in the last decade. Investment spending fell from 14.5 percent of GDP to 7 percent between 2014 and 2021. Discretionary investment spending is much less rigid and took the brunt of fiscal consolidation efforts, compromising future economic growth and further denting infrastructure efficiency.

Dwindling external financing and low execution rates have also dampened capital spending. While capital expenditures averaged 35.5 percent of total spending in the last decade, this share has steadily gone down, falling below 30 percent in the last three years, and reaching a record low of 23.9 percent in 2021 (Figure 1.17), largely reflecting fiscal adjustment in response to shocks. Both externally and domestically financed capital expenditures have diminished by 3.4 and 2.9 percentage points of GDP between 2015 and 2021 (Figure 1.18) given limited access to external finance since 2016. Limited revenue growth due to the cyclones and the pandemic also contributed to the decline in capital spending.[11]

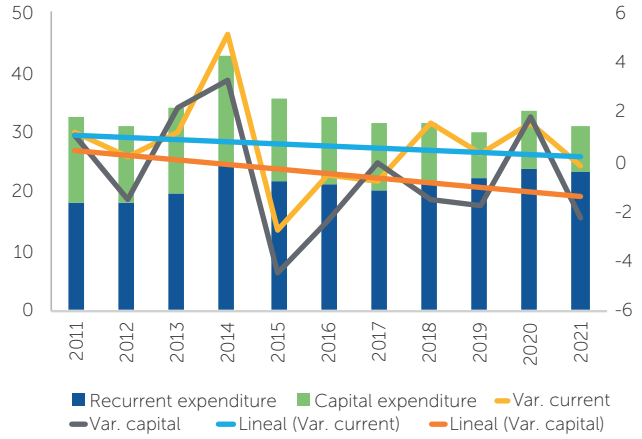
Despite its downward trend, capital spending in Mozambique is higher than in peer countries, while investment outcomes remain suboptimal. At 9.6 percent of GDP in 2020 (Figure 1.17), Mozambique has a higher level of capital spending than benchmark countries. However, it ranks below regional peers in access and quality of infrastructure (Figure 1.5). Past investment decisions on poorly appraised projects were associated with low economic and social returns. Resources are not allocated to areas lagging in access to basic infrastructure but instead have been concentrated in urban areas. Between 2009 and 2015, only 40 percent of the investment budget effectively contributed to gross capital formation related to improvements in infrastructure for service delivery (World Bank, 2019). Weak multi-year budgeting reduces financing predictability and constrains financial planning for public investment projects. Therefore, improving investment management, including better appraisal and selection, and increased transparency, are critical to improve the efficiency of investment spending. In 2019, the government launched a PIM system, which includes methodologies for investment appraisal and an information system to store public investment information. The authorities have also recently adopted a climate-smart public investment management framework to strengthen climate-resilient planning and budgeting.

All expenditure items positively correlate with GDP growth, confirming Mozambique's procyclical fiscal policy. Capital expenditure (capex) variation shows the highest correlation

10 The ENSSB (National Basic Social Security Strategy) 2016-24 and the government's five-year plan (Plano Quinquenal, 2019-24) set ambitious goals to expand basic non-contributory social protection coverage to more than two million direct beneficiaries, covering 28 percent of households living below the poverty line by 2024 (up from 22 percent in 2020). The ENSSB recommended that the budget for these social protection programs, implemented through the National Institute for Social Action (Instituto Nacional de Acção Social, INAS), be increased to 2.2 percent of GDP by 2024.

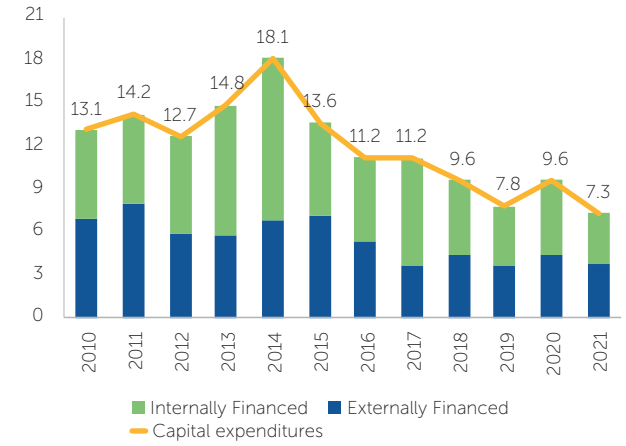
11 However, sizeable grants received in 2020 related to COVID and cyclone reconstruction support created space to increase public investment.

Figure 1.17: Current and capital expenditures, 2010-2021e % of GDP (LHS) and annual variation (RHS)



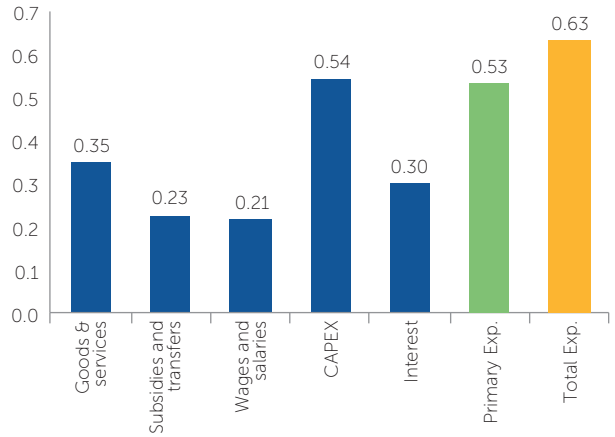
Source: Extended Economic Outlook, IMF (2019); IMF (2022).

Figure 1.18: Capital expenditure by source of financing, 2010-2021, % of GDP



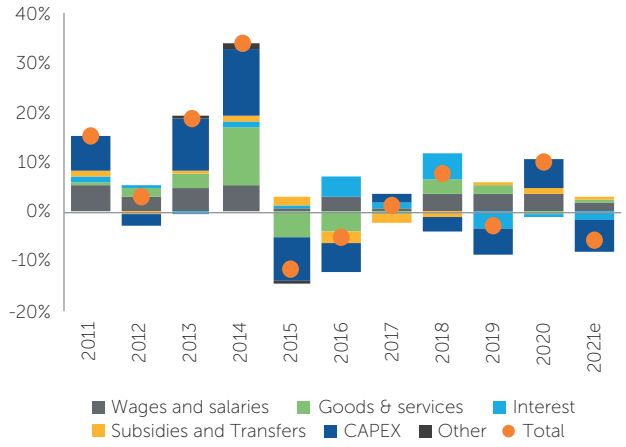
Source: IMF World Economic Outlook, October 2021, and Staff Reports.

Figure 1.19: Correlation coefficient between cyclical component of expenditure and GDP*, 2004-2021e



Source: Extended Economic Outlook, IMF (2019); IMF (2022).
*Note: Cyclical components of GDP and public expenditure are estimated by detrending the series with a Hodrick-Prescott Filter. A positive (negative) correlation indicates procyclical (countercyclical) fiscal policy behavior.

Figure 1.20: Contribution to real expenditure growth, 2011-2021e



Source: Extended Economic Outlook, IMF (2019); IMF (2022).

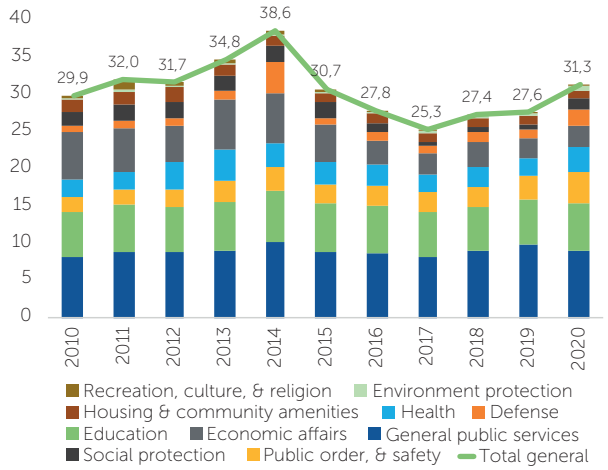
with GDP growth (0.54), signaling that this spending item is the adjustment variable along the business cycle (Figure 1.20). The higher correlation between capital expenditure and GDP than current expenditures and GDP may indicate a higher fiscal multiplier effect of capital expenditure. Though positively correlated, public wages and salaries show the lowest correlation coefficient (0.21), pointing to their rigidity.

Expenditure by functional classification

Public spending is dominated by general public services, the social sectors (education and health), and national defense. General public services accounted for the largest share of public spending, averaging 29.6 percent of total spending (or 9 percent of GDP) over 2010-2020 (Figure 1.21)[12], lower than those of peers (Figure 1.22). General public services spending has remained relatively stable, at 9 percent of GDP in the last decade, though with some changes in its composition. The increase in interest paid after the hidden debt scandal outweighed the reductions in other spending items within this function (Figure 1.23).[13] Education was the second largest expenditure, at an average of 15 percent of total spending (or 6.3 percent of GDP), somewhat lower than those of peers. Mozambique allocates more spending to health than comparators (10.5 versus 8 percent of the total, respectively).

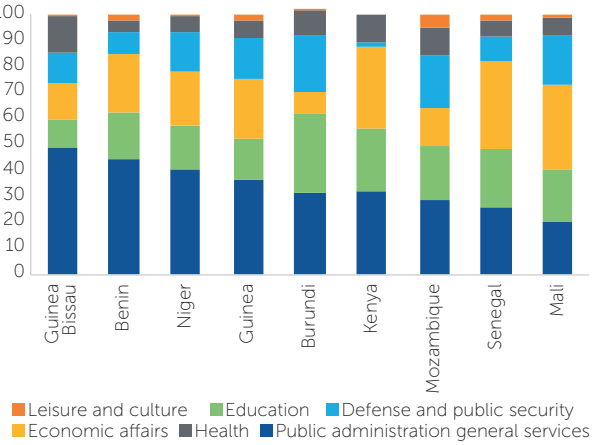
12 General public services reached a record high of 35.8% of total spending in 2019.
13 While there are valuable data on subfunctions for 2017-2020, data are not disaggregated by subfunction for the previous years.

Figure 1.21: Expenditure composition by function 2010-2020, % of GDP



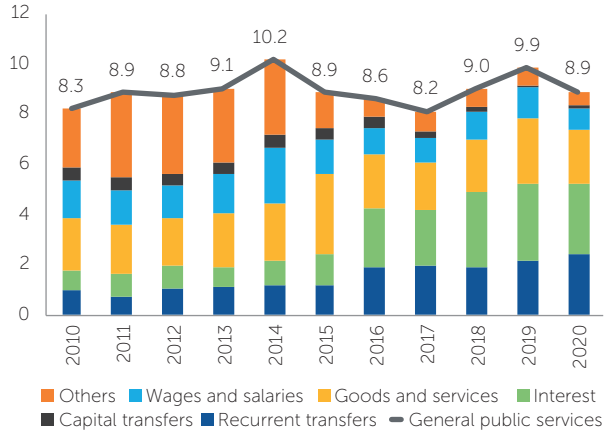
Source: Boost Database, World Bank.

Figure 1.22: Benchmarking: Expenditure by function, latest available data, % of total spending



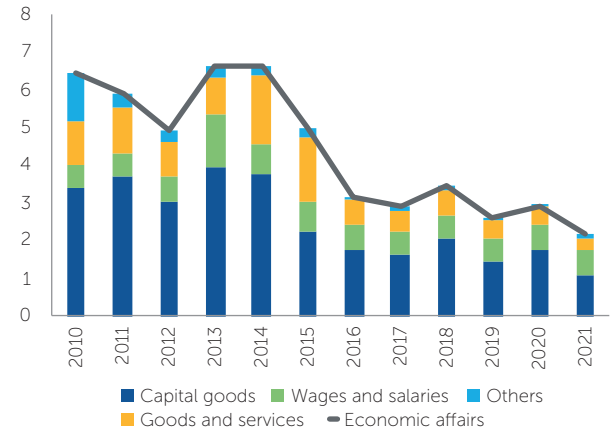
Source: Boost Databases, World Bank.

Figure 1.23: General public services by economic classification, 2010-2020, % of GDP



Source: Boost Database, World Bank.

Figure 1.24: Economic affairs by economic classification, 2010-2021, % of GDP



Source: Boost Databases, World Bank.

Spending in education has been stable, averaging 6.3 percent of GDP and 20.7 percent of total expenditure (Figure 1.31), in line with peer countries; however, outcomes remain weak. Chapter 4 in this PER is dedicated to education. It underscores Mozambique's relatively low levels of spending efficiency in the sector; countries with similar levels of spending attained better outcomes (in terms of enrolment rates, completion levels and test results) by prioritizing pre-primary, primary, and secondary education over higher education. Technical education, university, graduate, and postgraduate education added up to 15.5 percent of total spending on education in 2020 (Figure 1.32), which is a significant amount considering the low numbers of beneficiaries, particularly compared to primary and secondary education. An incidence analysis concluded that Mozambique's primary and secondary education spending is progressive, while higher education spending is regressive.[14]

Health spending is a government priority, although it had been declining until the COVID-19 pandemic hit. Health spending soared between 2010 and 2013 as a share of GDP, supported by external financing (Figure 1.28). However, it decreased thereafter, driven by lower external funds. In 2020, health spending expanded by almost 1 percentage point of GDP, mainly reflecting increased expenditure needs to combat the pandemic. Among the identified health subfunction, 24.5 percent was allocated to medical products and equipment, 20.9 percent to public health services, and 13

14 Baez et al. (forthcoming).

to general hospital services. At 10.5 percent of total spending in 2020, Mozambique stands slightly above the average of 8.3 percent for peer countries. However, on average, from 2010-2020, about 41 percent of health spending was taken by public wages and salaries, reflecting that the sector channels a large spending share to public wages.

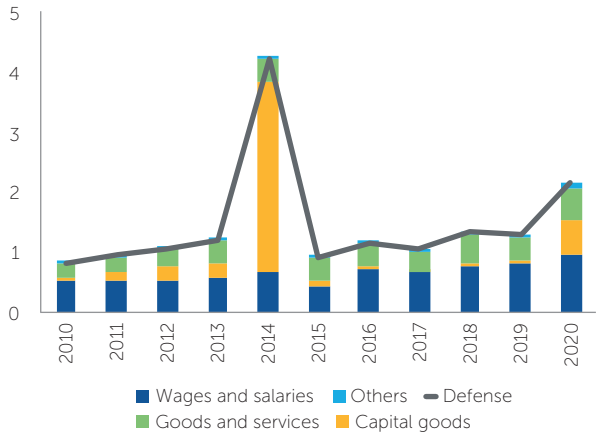
Despite a small recovery in 2020, largely owing to temporary transfers in response to COVID-19, social protection spending remains small. Social protection accounted for 5 percent of total spending (or 1.6 percent of GDP) between 2010 and 2020 (Figure 1.21). The Social Protection Response Plan to COVID-19 (June 2020) aimed to guarantee social support and reinforce the resilience of poor and vulnerable households exposed to the COVID-19 pandemic. The plan temporarily increased population coverage and benefits. The social protection budget almost doubled to 0.9 percent of GDP in 2021, with funding primarily from development partners, and the number of beneficiaries reached 1.1 million. Spending on water supply and sanitation has shown a volatile trend, with most of it allocated to urban areas where there is higher access to safe drinking water.

Public order and safety more than doubled as a share of GDP, from 2 percent in 2010 to 4.2 percent in 2020. Public wages and salaries represent more than 50 percent of spending in this function, while goods and services are second in importance (Figure 1.25). In terms of subfunction, public order and safety represent more than three-quarters of this function, while law courts and prisons take up almost a quarter (Figure 1.28). The increased in this spending category partly reflects the preferential wage increase and significant recruitment for the police force during the period.

Figure 1.25: Public order and safety by economic classification, 2010-2020 % of GDP

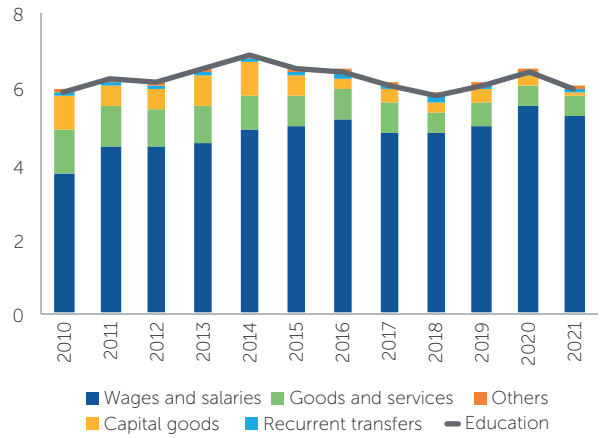
Source: Boost Database, World Bank.

Figure 1.26: Defense by economic classification, 2010-2020 % of GDP



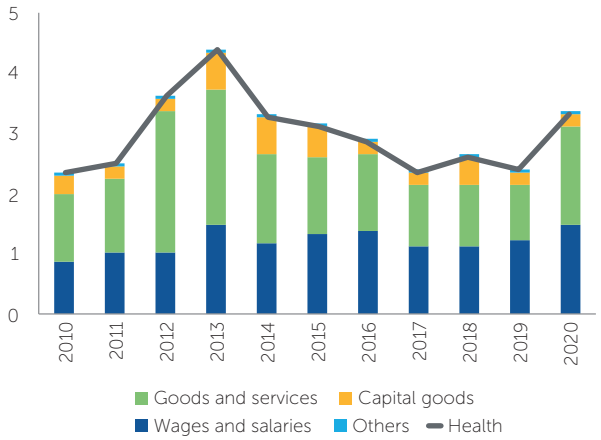
Source: Boost Databases, World Bank.

Figure 1.27: Education by economic classification, 2010-2021 % of GDP



Source: Boost Database, World Bank.

Figure 1.28: Health by economic classification, 2010-2020, % of GDP



Source: Boost Databases, World Bank.

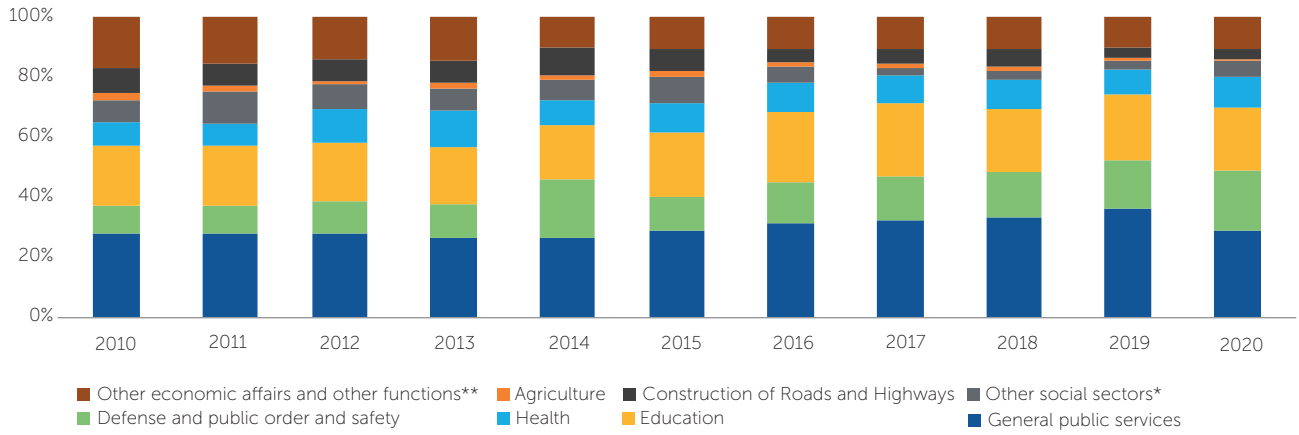
Defense spending also rose significantly over the decade, following escalating conflicts in the north and center of the country. The resurgence of low-intensity armed conflicts between RENAMO and FRELIMO over 2013–2016 contributed to the increase in defense spending. Further, since 2017, the authorities have been fighting a rising insurgency in the north of the country, increasing military spending needs and adding substantial pressures to the state budget. The government mainly resorted to security interventions in 2020 and 2021.[15] Military spending alone increased almost 1 percent of GDP in 2020. During most years, wages and salaries represented more than half the spending in this function (Figure 1.29). Goods and services represent a stable share of defense (but a growing share of security spending; Figure 1.30).

Together, security and defense accounted for 20.2 percent of Mozambique's budget in 2020, above the average for benchmark countries, at 13.7 percent of spending. Security and defense spending grew from 0.8 and 2 percent of GDP in 2010 to 2.2 and 4.2 percent in 2020, respectively. This share is double the proportion accounted for by health and four times the expenditure on social protection. If Mozambique succeeds in containing conflicts, it could reduce spending in these functions and free up fiscal space for priority social spending.

Expenditure by administrative classification

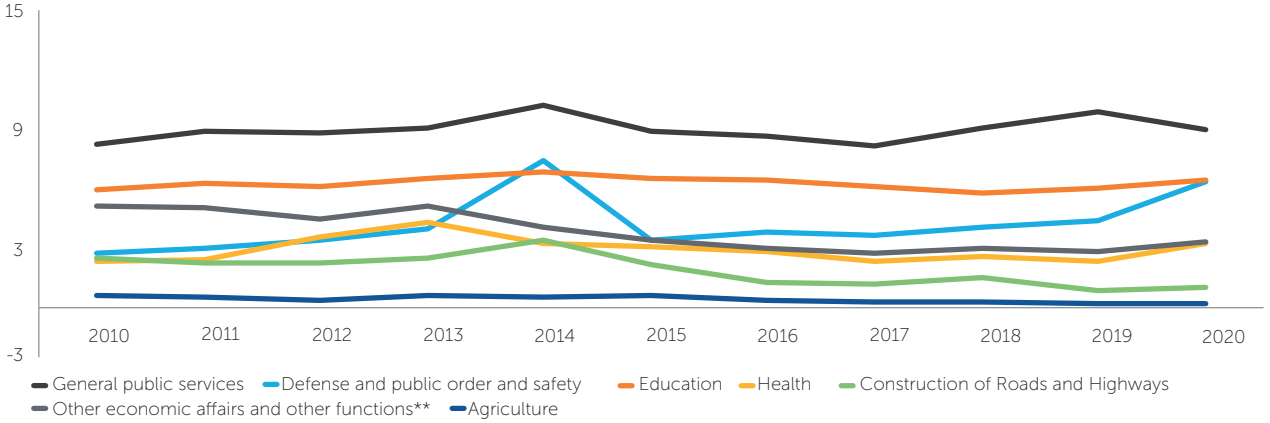
Spending on the Presidency stands out when classifying spending by administrative unit. It more than doubled in

Figure 1.29: Sectors prioritized in the five-year development plan and other sectors, 2010-2020, % of total spending



Source: Boost database, World Bank. *Social protection, recreation, culture, and religion **Water supply, environment, housing & community amenities.

Figure 1.30: Sectors prioritized in the five-year development plan and other sectors, 2010-2020, % of GDP



Source: Boost database, World Bank. *Social protection, recreation, culture, and religion. **Water supply, environmental protection, housing & community amenities.

15 World Bank (2021).

the past decade, rising from 8.8 percent of total spending to 22.4 percent in 2020 (Figure 1.31). This is owing to a new administration format featuring so-called "open presidencies", significantly increasing travel and logistics to the districts and localities, and establishing credit lines to the districts. The Ministry of Finance also augmented its share, starting at 4.5 percent of spending in 2010 and ending at 8.7 percent in 2020. This increase is likely related to the concentration of sectoral project administration in the ministry. Further, the Ministry of Interior also increased its share of spending, in line with the growing public order and safety spending. In contrast, three administrative units diminished their share of total expenditure: State General Orders (*Encargos Gerais do Estado*), the Ministry of Public Works and Housing (consistent with the reduction of capital expenditures), and the Ministry of Education, reflecting more deconcentration.

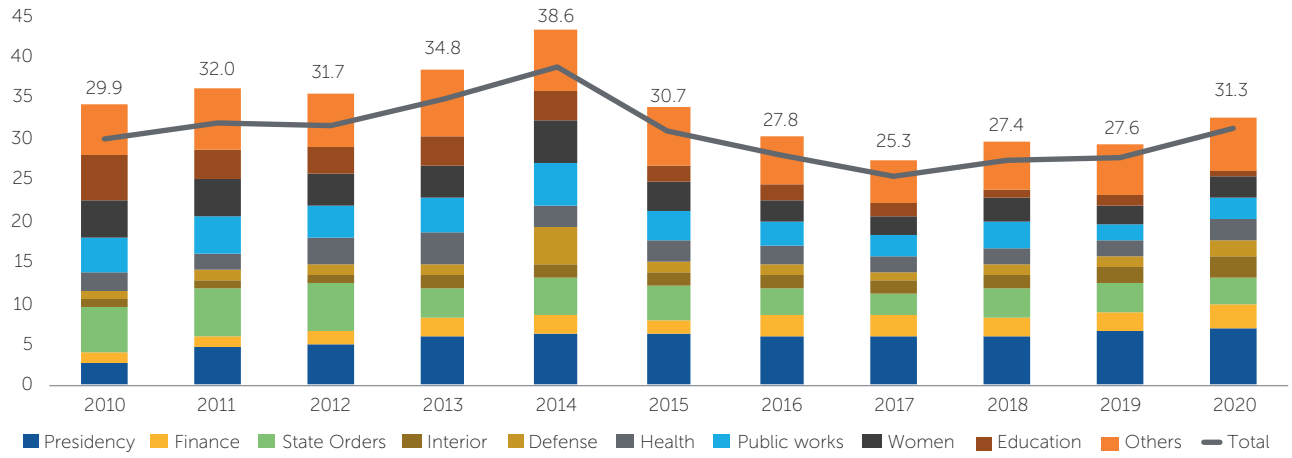
Expenditure by level of government

There are three levels of government in Mozambique, with the central government administering around 60 percent of aggregate spending in the 2010s (Figure 1.39). The constitution, approved towards the end of the civil war, defined Mozambique as a unitary state and established three levels of territorial governance: (i) central government; (ii) provincial government; (iii) district government and municipalities.[16] Since the 1990s, there has been a gradual process of deconcentration and decentralization of services and an increase in the number of subnational units. The legal framework for subnational governance has been evolving but has tilted towards deconcentration (Section 1.4)

The 2010s has seen more deconcentration to districts. Between 2010 and 2020, district spending increased by 16.3 percentage points, with provinces losing 13.5 percentage points. On average, central government has administered 62.6 percent of aggregate spending in the past decade, while provinces have been responsible for 19.1 percent, districts for 16.8 percent, and municipalities for 1.5 percent.[17] The central government diminished the share of spending it managed until 2015 but partially recovered it in the following years, having lost 3.4 percentage in spending share between 2010 and 2020. Several challenges remain in Mozambique, including establishing a clear division of functions between institutional units across government, maximizing each level's own sources of revenue, and ensuring equity and transparency in intergovernmental fiscal transfer (IGFT). A robust, predictable, and transparent IGFT formula does not yet exist, limiting planning and budgeting for public services across government.

The most deconcentrated function is education, falling mainly under the districts' responsibility. The central government only administered 16.2 percent of spending on education, while provinces spent 16.9 percent and districts the remaining 66.9 percent on average for the period 2016-2020 (Figure 1.41). Health is also a relatively deconcentrated public service, with about half of spending under the responsibility of the central government, while a quarter is in the provinces and a quarter in the districts. Social protection, which represents less than 1 percent of GDP, is also decentralized at the provincial level. Except for defense, which is naturally under the responsibility of the

Figure 1.31: Public spending by administrative unit, 2010-2020, % of GDP



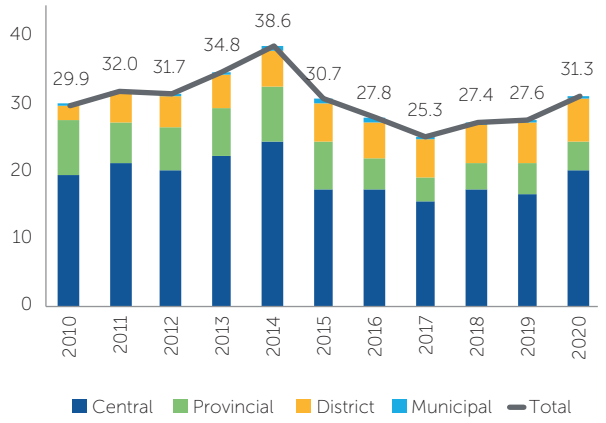
Source: Boost database, World Bank.

16 Mozambique has 11 administrative provinces, one of which consists of the capital city Maputo. The provinces are further divided into 154 districts and 407 administrative divisions, encompassing smaller localities and aggregated villages (povoações).

17 The current spending registration system only takes into consideration transfers to municipalities and does not include their own revenues. Notwithstanding, all subnational levels of government, including municipalities, have very low levels of resource mobilization.

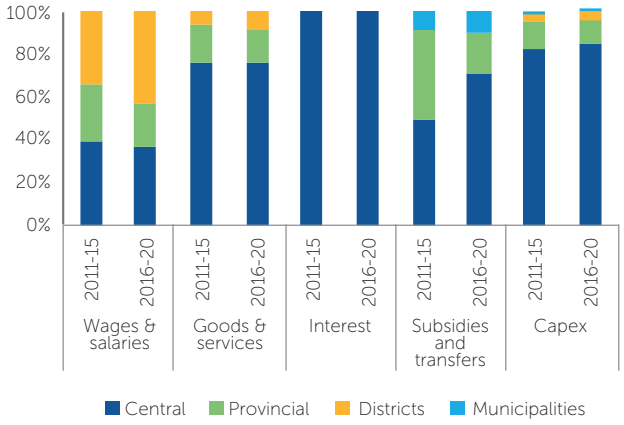
central government, the remaining functions are shared between government levels, with the central government having most of the participation. Provincial governments were decentralized in 2019, but it is unclear what functions are expected from provincial governors and decentralized assemblies vis-a-vis provincial secretaries of state (central government). When analyzing spending by economic classification (Figure 1.40), both provinces and districts spent a higher percentage of their budgets on public wages and salaries (55.8 and 90.3 percent respectively for 2020) than the central government (25.1 percent). Seen from the economic classification angle, the central government spends 40 percent of wages and salaries, 14 percent by the provincial level, and 40 percent at the district level, according to the Boost dataset. Central government entities executed around 80 percent of goods and service spending, 11 percent was spent by provincial agencies, and the remaining 9 percent was spent at the district level.

Figure 1.32: Spending by level of government, 2010-2020 % of GDP



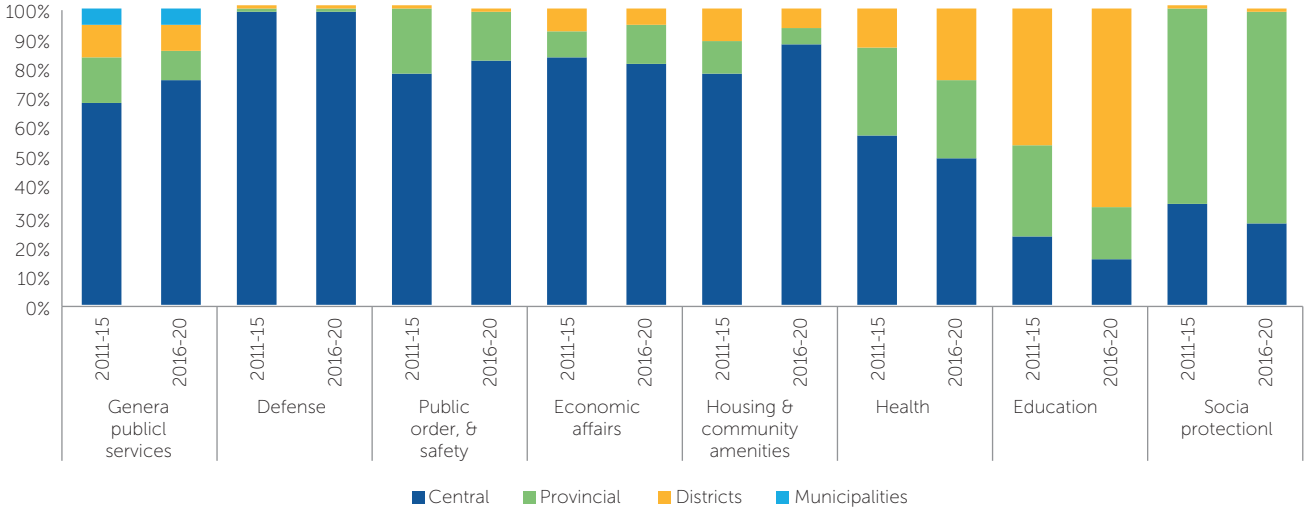
Source: Boost Database, World Bank.

Figure 1.33: Spending by level of government by economic classification, % of total spending



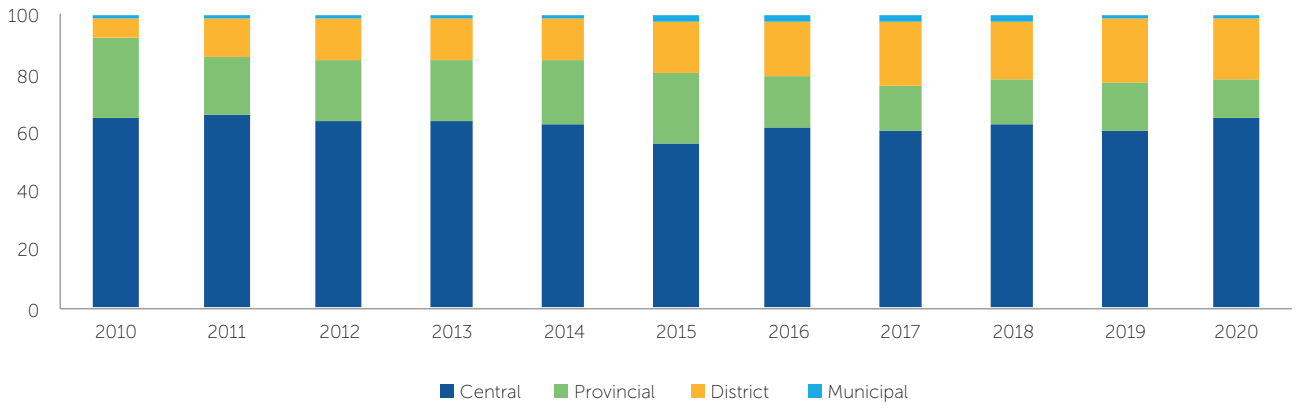
Source: Boost Databases, World Bank.

Figure 1.34: Share of each level of government by function, 2011-2015 and 2016-2020, % of total spending



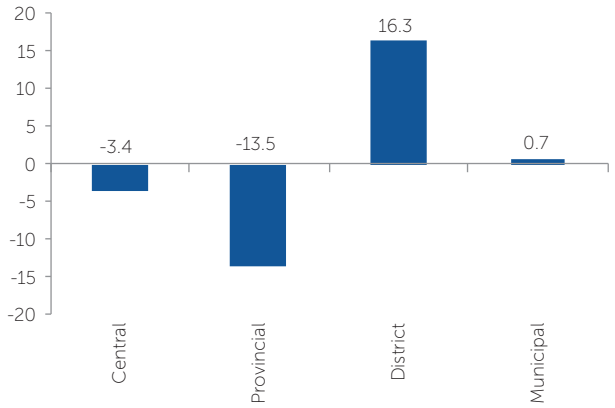
Source: Boost Database, World Bank.

Figure 1.35: Public spending by level of government in percentage



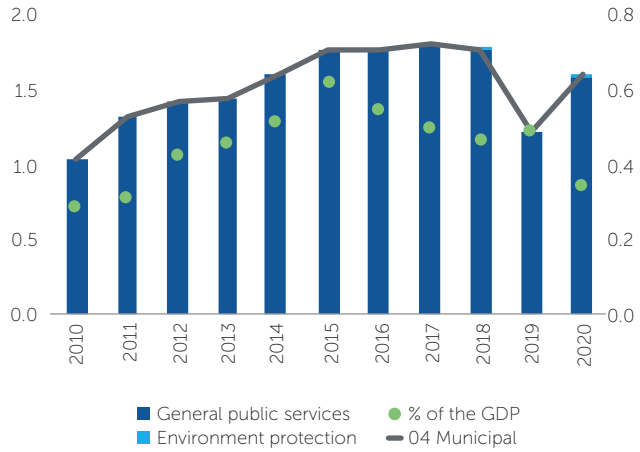
Source: Boost database.

Figure 1.36: Variation in expenditure composition by level of government (2010-2020)



Source: Boost database.

Figure 1.37: IGFTs to municipalities as a percentage of public spending (LHS) and GDP (RHS)



Source: Boost database.

Budget execution

The authorities have consistently under-executed their budgets over the past decade, on average spending 92.6 percent of the initial budget. The exceptions were 2013 and 2020, with the latter pushed up by COVID-related additional spending. When analyzing the economic classification, wages and salaries, and subsidies, stand out for their over-execution, with the former being much more significant in size. Again, this points to the rigidity and hysteresis of this spending category. More importantly, a complex salary structure, comprised of multiple complementary remunerations underpinned by multiple administrative acts, makes it hard to ensure predictability. In contrast, capital goods have been under-executed by a significant 30 percent on average, signaling problems in the planning of investments and using this spending line as the adjustment variable when revenues decline. When analyzing by function (Annex A Table 0.2), budgets related to intensive public goods in human resources (with a higher composition of wages and salaries) have been over-executed throughout the decade, including defense, public order and safety, health, and education. On the other hand, general functions, or interest payments and capital goods, had some degree of under execution, including general public services, economic affairs, housing, and community amenities. A similar effect can be seen when analyzing by level of government (Annex A Table 0.3): central government had a 15 percent under-execution on average over the decade. In contrast, at the subnational level there was over-execution in all three tiers, with the highest rate of over execution (12 percent) occurring at the district level.

Box 1.1: Public Financial Management Progress and Challenges

The authorities have taken comprehensive measures to address the PFM weaknesses that led to the 2016 hidden debt crisis. Debt regulations approved in 2017 expanded debt oversight from the Minister of Finance to the Council of Ministers, as well as required tighter risk assessments for issuing debt and guarantees. In addition, the Government of Mozambique (GoM) strengthened the governance of SOEs through a new law. There has also been substantial progress on fiscal transparency, with the regular publication of comprehensive debt reports and fiscal risk statements since 2019. n 2020, the authorities approved a decree stipulating a regulatory framework for public investment management. It requires that public investments be appraised for social and economic impacts before financing through the state budget. Further, to enhance fiscal sustainability, the decree requires that the design of infrastructure projects considers disaster resilience. Additionally, progress has been made in strengthening public accountability in the aftermath of the hidden debt scandal, including prosecution of senior officials and public figures allegedly involved in the scandal.

These reforms culminated in the approval of a new overarching public financial management (PFM) law in 2020, integrating the SOE sector and subnational governments into the budget system.[a] The previous 2002 SISTAFE law had established the basis for PFM, but the 2020 revised law tackles critical transparency and accountability bottlenecks. It brings SOEs and subnational governments under the budget system legislation. It strengthens the focus on debt and fiscal risk management by consolidating and expanding previous decrees in one core piece of legislation. The law strengthened budget planning, public investment and debt management, procurement, monitoring, and enforcement. Public procurement stages have been added to the electronic financial administration system (e-SISTAFE). Suppliers are now required to show valid commitment notes before delivering goods and services, supporting ex-ante approval processes by the supreme audit institution (Tribunal Administrativo).

The authorities have also improved public procurement statistics. The Central Unit on Public Procurement (UFSA) has registered statistics on contracts procured through open competitive tenders for 2019 (http://www.ufsa.gov.mz) and disseminated the manual of procedures to 290 states institutions, of which 24 at the central government level and 266 at the provincial level, covering 202 and 502 civil servants, respectively. The Central Unit on Public Procurement (UFSA) has registered statistics on contracts procured through open competitive tenders for 2019 (http://www.ufsa.gov.mz) and disseminated the manual of procedures to 290 state institutions, of which 24 at the central government level and 266 at the provincial level, covering 202 and 502 civil servants, respectively.

Despite these advances, some challenges remain. The government should still regulate municipal SOEs' borrowing through secondary legislation approved by the Council of Ministers. In coordination with the Fiscal Risks Directorate, the Debt Directorate at MEF should strengthen the oversight of national and municipal SOEs' borrowing, on-lending agreements, PPPs, and public guarantees. This data should be published in annual debt and fiscal risk reports, including SOEs' borrowing thresholds for the year ahead. The authorities recently established a disaster fund, initiated public investment reforms to consider resilience, and established robust infrastructure practices in some sectors. The revised SISTAFE legislation introduced climate consideration in public investments but without concrete measures on how to do it. Climate change resilience is neither a 'must-have' criterion nor a binding legal requirement for the approval of infrastructure investment projects. Specific methodologies, standards, and processes are yet to be established.

The government needs to reform budget execution and financial controls to strengthen the expenditure chain and prevent the accumulation of arrears. All stages of the expenditure chain must be incorporated within e-SISTAFE, to enhance budget execution control, budget discipline, and budget transparency. All public procurement stages shall be included into the system (Modulo de Património do Estado). Ex-ante quarterly commitment limits for all expenditure units must be established. These limits will allow all expenditure units to record expenditure transactions in real-time and issue commitment notes in e-SISTAFE. The Treasury must set the quarterly treasury budget to determine limits on quarterly commitments to be operationalized and eliminate ex-ante weekly commitment limits in the budget law and the corresponding budget execution decree (*Decreto de Delegação de Competências*).

The authorities should move from cash rationing to proactively managing cash flows and balances. The government must set up an interdepartmental cash management committee for financial program decision-making and a cash management unit within the Treasury to forecast and manage cash flows. The MOF will enhance the coverage and functioning of the treasury single account (Conta Única do Tesouro—CUT), beginning with a complete mapping of all public sector bank accounts. The MEF must finalize the new financial programming tools that it is developing in e-SISTAFE (Modulo de Programação Financeira) consisting of the annual Orçamento de Tesouraria for budgetary planning, and the quarterly Plano de Tesouraria for financial programming in all spending units.

a. SISTAFE law, December 2020, and asscіated regulations (2021).

Budget rigidities: trends and benchmarking

In Mozambique, a large share of public expenditure can be classified as non-discretionary spending, representing about 70 percent of total expenditure. This includes spending on wages (45%), interest payments (6.5%), capital expenditure financed through foreign loans and grants (6.2%), pensions (5.7%), and transfers to public entities (embassies and municipalities: 1.8%) (Table 1.1).[18] About 13% of total spending can be considered partially rigid; this includes services spending, current transfers to families as social protection, subsidies, and transfers to foreign agencies and the private sector.

Budget rigidity has increased in the past decade, shrinking the space for resource reallocation. The weight of high rigidity spending in the total has increased by 14.5 percentage points in the past 10 years. Low rigidity spending declined 8 percentage points and medium rigidity spending fell by 7 percentage points. The decline in the more discretionary spending was mainly driven by the reduction in subsidies – reflecting the elimination of fuel and bread subsidies since 2018—and the reduction in domestically financed capital expenditure, reflecting cuts in capital expenditure because of the fiscal consolidation initiated in 2015. The increasingly smaller share of low rigidity spending implies little margin to reallocate resources among categories; thus, improving efficiency within each component is paramount.

The current budget rigidities limit the distributional role of fiscal policy, which is crucial for addressing growing inequality and poverty. The bulk of public expenditure is allocated based on historical spending trends. The budget allocation process is incremental and focuses on ensuring that the previous year's spending – principally salaries, goods, and services – is covered to assure the continued functioning of the public administration. Any remaining resources are then distributed, following two steps: (i) the government splits the remaining share between central government and provinces based on historical trends; (ii) once the total share of the provincial budget is determined, allocation follows a formula that assigns a weight of 70% to

Table 1.1. Budget rigidities, 2011-2020, % of total expenditure

	2011-2014	2015-2018	2019-2020	2010-20	Standard deviation
High Rigidity	**55.5**	**61.6**	**68.4**	**14.5**	**6.2**
Wages and compensation	33.7	40.1	43.2	12.4	5.1
Interest	2.8	6.1	11.2	8.5	3.6
Capital expenditure - financed by external grants and loans	12.0	8.0	6.6	-7.1	3.1
Transfers to public administration*	1.8	1.9	2.0	0	0.2
Pensions	5.3	5.5	5.4	0.5	0.5
Medium Rigidity	19.0	15.8	13.0	-6.7	3
Social aids and other transfers to families	2.4	2.5	2.5	0.2	0.2
Transfers to foreign entities	0.2	0.5	0.5	0.3	0.3
Transfers to private administration	0.5	0.3	0.2	-0.1	0.1
Subsidies	3.9	1.2	0.4	-4.8	1.8
Services	12.1	11.3	9.5	-2.2	1.7
Non-rigid (flexible)	**25.5**	**22.6**	**18.7**	**-7.8**	**4.1**
Goods	10.4	9.8	10.1	-0.8	0.8
Capital transfers	2.5	1.9	0.9	-1.9	0.7
Capital expenditure - financed by domestic sources	12.7	11.0	7.7	-5.1	3.6
TOTAL	100.0	100.0	100.0	100.0	

Source: IMF, World Economic Outlook database, October 2021; Boost database, World Bank.
* Includes subnational governments and embassies

18 The higher standard deviation of wages and salaries and interest is not explained because of their volatility as they are highly rigid, but because of their weight in total expenditure and their increasing trend in comparison to other expenditure items. The growth of public wages considers (i) the rate of inflation; (ii) half the rate of real GDP growth (as a proxy for productivity); and (iii) a factor "delta", that presumably reflects negotiations between the government and professional employee associations. The latter reduces the capacity of the public sector to address inefficiencies by automatically granting wage increases to a wide range of workers, regardless of any determination of whether their salaries are at an appropriate level.

the subnational population and 30% to the multidimension poverty index. Following advances in the decentralization process, the government now allocates one third of the budget to subnational governments and deconcentrated units (Section 1.4). A study by UNICEF shows that the proportion of resources subjected to the distributional formula averaged between 0.4 to 0.8% of the total annual spending and between and 3 to 4% of the annual domestic investment envelope between 2012 and 2014.[19] This shows the limited potential for the budget to address distributional issues, which include disparities in access to infrastructures and public services. This reinforces the need to improve efficiency.[20]

Comparing the degree of budget rigidity across countries is not a straightforward exercise; however, the flexibility for resource reallocation in the budget is much lower in Mozambique than in other countries of the SSA region. There is no commonly accepted methodology, and the sources of rigidity or what constitutes rigidity are heterogeneously defined in the literature. Mozambique cannot be benchmarked on rigidity as no such analysis has been conducted for other countries in the region. However, budget rigidity is much lower in Guinea, Mali, Senegal, and The Gambia and like Guinea Bissau considering the assessments done in recent years in their respective PERs. In the former countries, non-rigid (flexible) expenditure items reach 38%, 33%, 27%, and 20%, respectively, while it reaches 12% in Guinea Bissau. Additionally, analysis for select middle-income Latin American countries suggests that budget rigidity is lower in those economies than in Mozambique, partly explained by a high degree of fiscal decentralization.[21]

1.3 Mozambique's Evolving Intergovernmental Fiscal Architecture

Decentralization is a fundamental mechanism for power-sharing and greater political inclusion, but progress in Mozambique has been mixed (World Bank, 2020).[22] It was introduced after the Rome peace agreement under a philosophy of gradualism. Mozambique has seen a gradual and staggered political devolution process, establishing administratively and fiscally autonomous local governments (autarquias) with elected leaders and multiparty assemblies, both in urban areas (municipalities) and in rural districts (povoações). The number of municipalities increased from 33 to 53 and a formula-based intergovernmental fiscal transfer system was set up (Weimer and Illal, 2018). However, the establishment of devolved district and subdistrict governments has not yet taken place, and neither has the transfer of functions and resources from central state-controlled districts to municipalities.[23]

Recent budgetary data show slow progress towards fiscal decentralization and a preference for deconcentration.[24] The central government has been administering almost two-thirds of public spending, with the remaining third managed by provinces and districts. Districts have seen their share of deconcentrated spending increase, to the detriment of provinces, which only became decentralized entities in 2019. Spending on education, mainly wages and salaries, has driven this trend (Figures 1.38 to Figure 1.41). Municipalities, the only government level effectively autonomous until 2019, were responsible for managing a meager 1.5 percent of public spending (or 0.4 percent of GDP) on average in the decade to 2020, excluding their own sources of revenue (Figures 1.1-1.2). Throughout 2010-2020, two-thirds of these were recurrent grants, and the remaining were capital grants. IGFTs through the municipal compensation fund (FCA) amount to 1.5 percent of government revenues annually and are the primary revenue source. Several other minor transfers, including the Fundo de Desenvolvimento Distrital (FDD) and the Programa Eratégico de Redução a Pobreza Urbana (PERPU), were discontinued in the 2020 budget.[25] Municipalities have untapped revenue mobilization potential, but lack incentives and capacity and face regulatory bottlenecks.

Recent changes in the legal framework foresee a push for further fiscal decentralization of provinces and districts, but progress has been slow. In 2018 the constitution was amended following the political dialogue for peace between Frelimo and Renamo.[26] The revised constitution introduced a new article, defining decentralized entities as Órgãos de Governação Descentralizada (OGDs - provinces and districts), in addition to municipalities/autarquias. According to the amended constitution, all decentralized entities should have administrative, financial and patrimonial autonomy but be subject to administrative guardianship by the state, under the subsidiarity principle. The constitutional amendment envisages democratically elected OGDs, but also introduced the figure of the centrally appointed secretary of state in the provinces, which reinforces central control at the subnational level. In 2019, a subsequent package of laws was passed covering the governance and administrative frameworks

19 UNICEF (2017).
20 World Bank (2019).
21 World Bank (2016).
22 World Bank (2020), Mozambique Risk and Resilience Assessment, October 2020 (Forthcoming – confidential).
23 Weimer and Carrilho (2017)
24 Deconcentration refers to how responsibilities and staffing are managed within central government ministry structures. It is a transfer of responsibilities, powers and resources within the national government, from headquarters to district and provincial field offices.
25 There is no readily available data on the Fundo de Investimento Distrital (FID) and the Fundo de Investimento de Iniciativa Autárquica (FIIA), which are minimal and also appear to have been discontinued in 2020.
26 Law 1/2018.

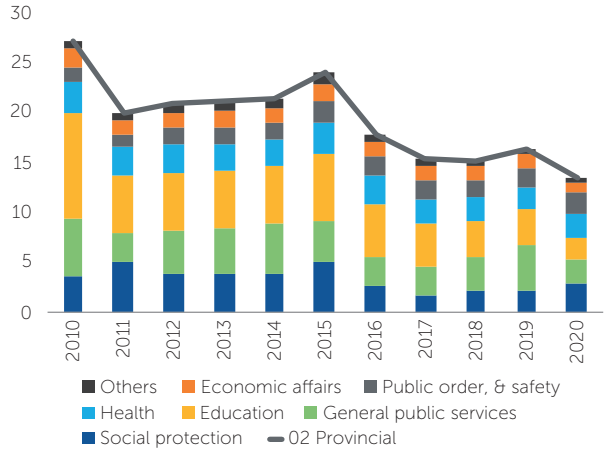
in the provinces.[27] A similar suite of laws is expected at the district level, as districts will be democratically elected from 2024.

Effective fiscal decentralization requires a clear assignment of service delivery mandates and responsibilities between levels of government and the transfer of sufficient financial resources. Fiscal decentralization has four pillars: expenditure assignments, revenue assignments, transfers, and borrowing. The revenue sources available to subnational governments in devolved or decentralized systems typically includes local sources of revenue, IGFTs and borrowing. Once expenditure and revenue assignments are established, IGFTs help to equalize vertical and horizontal fiscal imbalances between central and subnational levels of government. IGFTs are often paid from a transfer pool (or several transfer pools with different sources and distribution criteria) according to an agreed formula. The way the pool is distributed among subnational governments is important for equity (UNICEF, 2019).

Despite the emerging subnational governance and administrative legal frameworks, an overarching framework that regulates the intergovernmental fiscal architecture does not exist in Mozambique. There are three dimensions of decentralization: political/governance, administrative and fiscal. Each dimension needs a legal framework. Mozambique has specified its governance and administrative legal frameworks for municipalities and provinces, but a regulatory intergovernmental fiscal framework is not yet in place. The recent revision of the public finance law (SISTAFE) does not specify this framework. There is no government agency currently setting the intergovernmental fiscal arrangements or with overall knowledge of them (World Bank, 2018). Beyond the FCA, other minor grants to the subnational government are not formula-based and were developed independently without a standard policy. This has resulted in an inconsistent approach to fiscal relations with the subnational government. The objectives of the different funding sources are not always well-specified, and the recipients are sometimes confused over what funding they can or cannot spend (World Bank, 2018). The financing regime for the newly elected provinces recently passed envisages that the revenue sharing system between central government and provinces will be established by law.[28] However, this law has not been developed, and, in its absence, the system is set annually through the budget.[29]

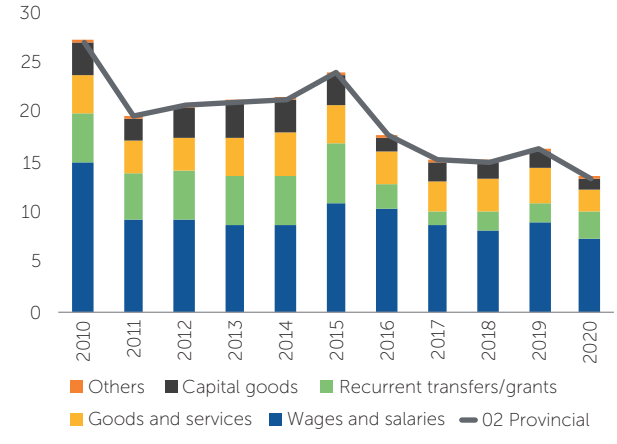
The fiscal arrangements between the levels of government cannot be determined until the service delivery mandates (expenditure assignments) of the different levels of government are clearly defined. The importance of intergovernmental grants to local governments in Mozambique varies greatly. To the smaller districts and municipalities they are essential and major elements of local government revenue. To Maputo and the other large municipalities, they are less critical, but still a significant source of funds. However, one cannot decide what level of financial assistance a municipality or a province needs from the central government until its expenditure assignments are known and what revenue sources are available (revenue assignments). Clarifying the detailed service delivery mandates and revenue-raising capacities for municipalities and provinces is essential to advancing the decentralization agenda.

Figure 1.38: Spending at provincial level as a share of total spending by functional classification



Source: Boost database.

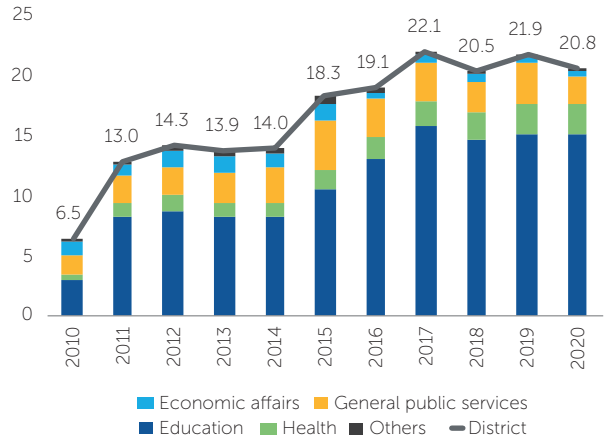
Figure 1.39: Spending at provincial level as a share of total spending by economic classification



Source: Boost database.

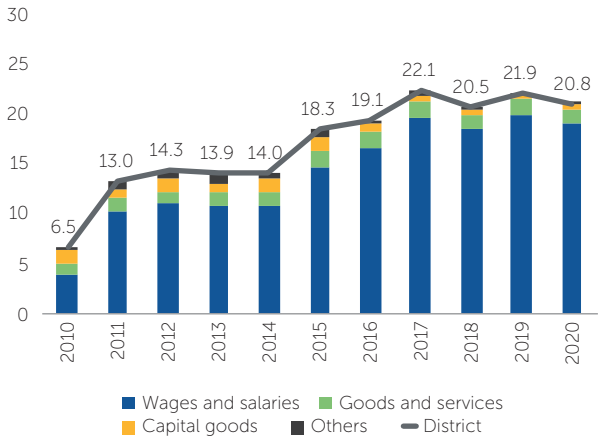
27 Laws 3/2019, 4/2019, 5/2019, 6/2019, and 7/2019.
28 Law 16/2019.
29 Until the formula is defined, the authorities have been transferring funds to provinces based on population (60%), geographical area (15%), and poverty levels (25%).

Figure 1.40: Spending at district level as a share of total spending by functional classification



Source: Boost database.

Figure 1.41: Spending at district level as a share of total spending by economic classification



Source: Boost database.

Table 1.2. Scenario assumptions

Scenarios	Assumptions
Baseline	• WB-IMF DSA (April 2022) macro-fiscal framework • LNG projects resume • Elimination of VAT exemptions and a reduction in the tax rates (cumulative fiscal savings worth 2.4 percent of GDP over 2022-24) • Reform in public wages and salaries • Concessional loans mainly cover net financing needs while domestic borrowing repays maturing domestic debt
S1: Low growth and slower reforms	• VAT and public wage reforms advance at half their anticipated speed • Real GDP growth slows as downside risks materialize (delays in LNG investments, new COVID-19 waves, and protracted war in Ukraine) • Primary expenditure constant in nominal terms (rigid in the short-term)
S2: Contingent liability shock	• Contingent public, publicly guaranteed, and non-guaranteed liabilities shock on SOEs worth 10% of GDP • 3.2% GDP shock arising from PPP liabilities • Debt and financing needs increase by 2.6% of GDP per year
S3: Expenditure efficiency gains	• Efficiency gains of 20% in education and health expenditure (2% of GDP per year) • Efficiency measures include: (i) digitizing learning to enable serving a fast-growing population, (ii) enhancing PFM through planning and budgeting, allocation, implementation, and monitoring of public resources (reducing government need to borrow domestically for cash flow management), improving public procurement and compliances that results in better value for money; and (iv) expanding staff capacity by re-deploying and hiring competent staff, which would save time and resources.
S4: Increased financing needs in an inflationary context	• Climatic shock causes higher expenditure of 3% of GDP in 2023 and 2024 • Higher commodity prices induce domestic inflation and upward adjustments in the monetary policy rate / interest costs of domestic debt; annual nominal domestic interest rate set at 15%. • Higher financing needs in 2023 and 2024 to support the poor and most vulnerable (3% of GDP per year)

There is scope to review and improve existing transfers and allocations. For instance, the government of Mozambique may consider distributing Municipal Compensation Fund (FCA) funds based on the relative effort of the municipalities to raise own-source revenue once relevant data become available (World Bank, 2018). However, this review should be done within this broader analysis of functional (expenditure) and revenue assignments.

It will be essential to establish legislation that identifies the various types of intergovernmental financing flows to subnational governments, including for instance, (i)

revenue sharing; (ii) fiscal equalization grants; (iii) conditional grants; (iv) matching grants; and (v) special grants. In other countries, these laws/regulations typically take the form of an intergovernmental fiscal management act or equivalent. This law/regulation should make the government's overall objective to equalize vertical and horizontal fiscal imbalances explicit in support of territorial equity. The government could consider including a separate section in the budget documentation showing all aspects of the government's fiscal relationships with subnational governments (World Bank, 2018). In the longer term, the government may consider what administrative arrangements will maximize confidence in the fiscal relations system and establish those arrangements (World Bank, 2018).

1.4 Fiscal Sustainability Analysis

Mozambique's fiscal position is fragile, following concurrent shocks that have put pressure on spending and elevated debt levels. The "undisclosed debts" scandal, peaking in 2016, led to the suspension of development partner budget support, a sharp slowdown in growth, and surging financing costs. The socio-economic cost of increasingly frequent natural disasters linked to climate change exceeded 3% of GDP in 2013 and 2016, reaching a devastating 11.3% of GDP in 2019. Commodity price increases are fueling imported inflation, hitting the poor and most vulnerable and increasing social spending needs. Insurgent attacks in the north of the country have caused thousands of deaths and sown fear, destroying towns and villages, and driving up defense and security spending. Mozambique is at high risk of debt distress, with public sector debt above 100 percent of GDP in 2021 and rising expensive domestic debt.[30] Managing the shocks and supporting the incipient recovery is a significant challenge with a heavy debt burden and tight financing constraints.

This section uses fiscal sustainability analysis to present fiscal and debt projections for 2022–2026 under various scenarios. The analysis draws on the World Bank's fiscal sustainability tool and complements the latest Fund-Bank LIC DSA. It uses scenario analysis to explore some of the risks mentioned above and policy proposals selected from the menu of policy options available to the Mozambican authorities (Table 1.3).[31] The baseline analysis includes the wage bill and VAT reforms featured in the IMF program. It assumes that the TotalEnergies-led LNG in Area 1 and Exxon-Mobil-led one in Area 4 LNG projects will be delayed by two years, with the Area 1 project starting production in 2026 and Area 2 one in 2028. A first downside scenario (S1) considers delays in implementing the fiscal consolidation program and lower growth due to delays in the LNG projects and other external shocks, significantly affecting fiscal sustainability. A severe contingent liability shock (S2) on the SOE portfolio worth 10 percent of GDP and a 3.2 percent GDP shock arising from PPP liabilities in 2022-2026, increasing debt and financing needs by 2.6% of GDP per year.[32], Scenario 3 (S3) simulates substantial expenditure efficiency gains in the health and education sectors that could support social protection and capital spending, which have suffered recently. A final scenario includes a climatic shock and mounting inflation, which could see interest rate rises and higher domestic financing costs.[33]

The baseline scenario sees positive fiscal balances by 2026 (Table 1.3). Driven by LNG investments and exports, real GDP gathers pace after 2022, averaging 8.1% between 2022 and 2026. The wage bill and VAT reforms deliver cumulative net savings worth 2.4 percentage points of GDP by 2024. Under this scenario, the overall and primary fiscal balance improves annually, reaching a surplus by 2024 and 2026. Interest payments would decrease from 3.4% of GDP in 2022 to 2.6% in 2026.

Scenario 1 significantly affects fiscal sustainability. Cumulative net savings from wage will and VAT reforms would add to 0.85 and 0.35% of GDP by 2024. Lower GDP would adversely impact tax and non-tax revenues, but non-interest and non-wages and salaries expenditure would remain as in the baseline scenario in nominal terms. As a result, fiscal deficits would persist over the forecast period, and debt levels would stay elevated, above the 100% of GDP benchmark, negatively impacting fiscal sustainability.

The contingent liability shock threatens budget balances, delaying consolidation and constraining fiscal space. As discussed in Chapter 3, the state heavily supports ailing SOEs and could face severe fiscal risks if contingent liabilities from the sector materialized. Like Scenario 2, debt levels remain elevated, falling below 100 percent in GDP terms only by 2026 when growth reaches 13.8 percent. Gross financing needs exceed baseline levels by around 3 percentage points of GDP each year on average. As in the low growth-slow reforms scenario (Scenario 1), these circumstances would severely constrain fiscal sustainability and limit the fiscal space needed to support much-needed social and productive spending.

30 April 2022 IMF-World Bank debt sustainability analysis (DSA). However, the DSA concludes that Mozambique is assessed to be sustainable in a forward-looking sense because a significant share of projected borrowing reflects the state's participation in sizable LNG projects, which will be repaid directly from future gas revenues.

31 The scenarios do not consider an exchange rate shock, although it is recognized as one of the most sensitive shocks in Mozambique's DSA. The analysis assumes that the exchange rate will likely remain stable in the short- to medium-term as some capital controls remain and the central bank continues to intervene in the interbank forex market effectively. Further, expected foreign currency inflows from LNG, the IMF program, and budget support from the World Bank and potentially other donors can support the domestic currency.

32 It assumes that the shock is distributed equally during the forecast period. This combined contingent liability shock mimics a similar downside scenario used in the recent Bank-Fund DSA.

33 The analysis considers that Mozambique accesses significant multilateral and bilateral concessional financing in the next three years as in the baseline. However, the additional financing needs would be covered by domestic debt issuances market at higher interest rates.

Scenario 3 creates the fiscal space needed to support transfers to families under targeted social programs and finance growth-inducing infrastructure investments, for example. As discussed in Chapters 1 and 4, despite Mozambique's relatively high expenditure on health, and similar education spending to comparator countries, it achieves weaker outcomes, indicating inefficiencies. Several efficiency measures combined would generate fiscal space worth 2 percent of GDP annually between 2022 and 2026, and debt would enter a downward path sooner, reaching 74.7% by 2026. The primary balance would see a surplus from 2022, and the overall fiscal balance would turn positive by 2026. This efficiency savings would generate fiscal space to expand social protection and public investment spending, which have seen large cuts in recent years.

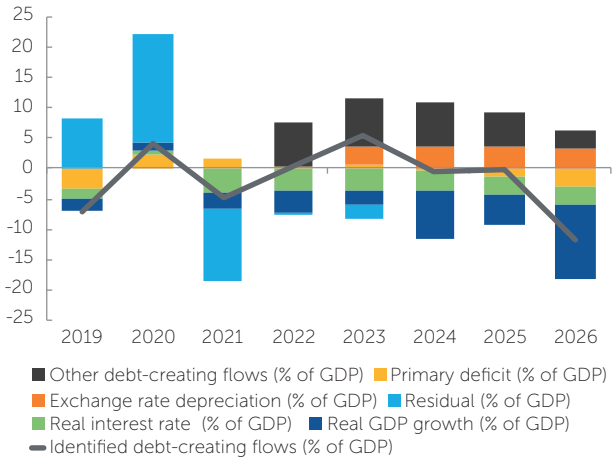
Scenario 4 could see interest rate rises and higher domestic financing costs. The fiscal situation is like Scenarios 2 and 3, underscoring the effects that extreme climate events can have on Mozambique's public finances. On average, the fiscal deficit for the forecast period averages 4.4% of GDP and the debt-to-GDP ratio would be 101.4% over 2022-2026, falling below the 100% mark in 2026. Gross financing needs in 2023 and 2024 would heighten refinancing risks as they reach 24 and 26% of GDP, while interest payments surpass 17% of domestic revenues for those two years.

Table 1.3: Macro-fiscal projections

		Baseline		Scenario 1		Scenario 2		Scenario 3		Scenario 4	
In percent of GPD (unless otherwise stated)	2021	2022	2026	2022	2026	2022	2026	2022	2026	2022	2026
Primary balance	-1.8	-0.2	2.9	-1.8	-0.1	-0.2	2.9	1.8	4.9	-0.2	2.9
Fiscal balance	-4.4	-3.6	0.4	-5.3	-3.0	-3.6	0.0	-1.6	2.6	-3.6	-1
Debt stock	104.2	101.4	83.2	104.8	103.7	104.1	94.6	99.4	74.6	101.4	91.1
External	81.1	80.7	76.1	83.3	93.8	82.7	85.4	0.0	69.0	76.6	78.5
Domestic	23.1	20.7	7.2	21.5	9.8	21.4	9.2	0.0	5.6	24.8	12.6
Gross borrowing requirements	10.8	16.4	4.6	18.3	12.6	19.1	11.1	14.4	5.1	16.4	16
Interest as % of domestic revenues (net of grants)	10.3	13.5	10.3	13.5	12.1	13.5	11.6	13.5	9.4	13.5	15.8
Domestic revenues	25.3	25.1	24.8	25.1	25.8	25.1	24.8	25.1	24.8	25.1	24.8
Real gross domestic product (percentage change)	2.2	3.8	13.8	1.9	4.5	3.8	13.8	3.8	13.8	3.8	13.8

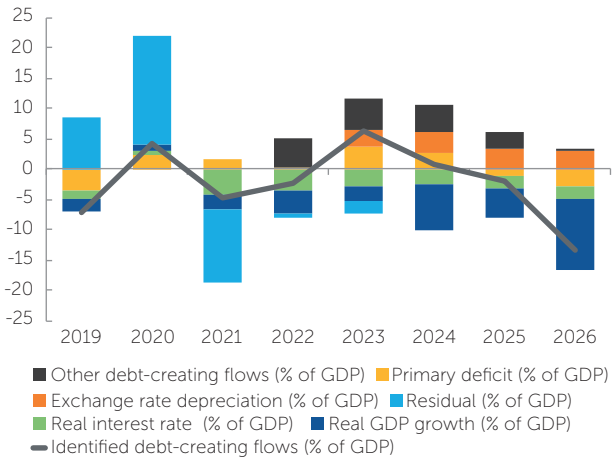
Source: MOF (2020); World Bank projections (2022-2026).

Figure 1.42: Drivers of debt dynamics as % of GDP (2019-2026) – Scenario 2



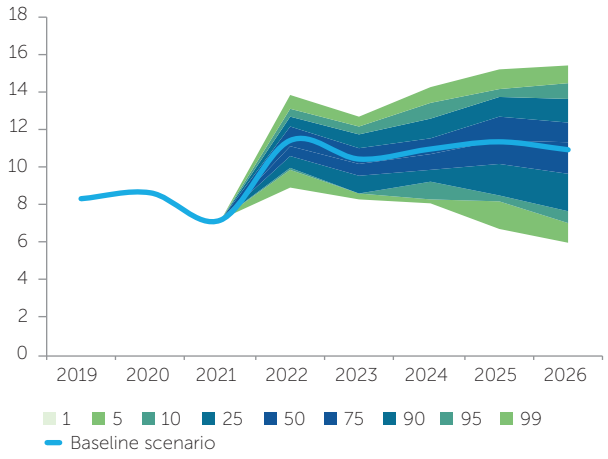
Source: MOF and IMF (2020). World Bank projections (2022-2026)

Figure 1.43: Drivers of debt dynamics as % of GDP (2019-2026) – Scenario 3



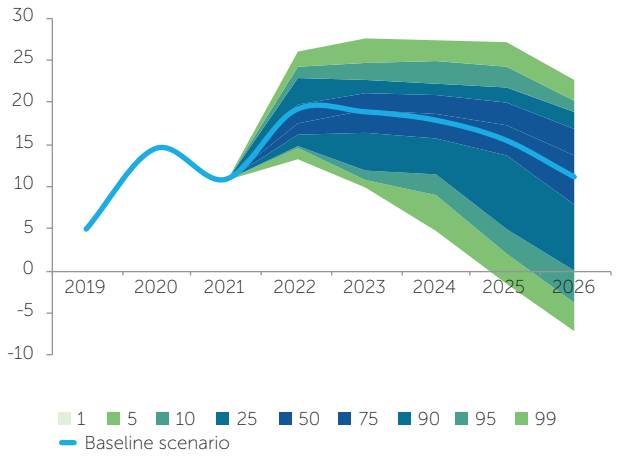
Source: MOF and IMF (2020). World Bank projections (2022-2026)

Figure 1.44: Debt service fan chart as % of GDP (2019-2026) – Scenario 2



Source: MOF and IMF (2020). World Bank projections (2022-2026)

Figure 1.45: Gross borrowing fan chart as % of GDP (2019-2026) – Scenario 2



Source: MOF and IMF (2020). World Bank projections (2022-2026)

In summary, Mozambique needs a combination of high growth rates and structural wage bill and VAT structural reforms, as well as substantial concessional financing, to rebalance its public finances and bring down debt levels. Contingent liabilities, climate shocks, and slowing growth rates pose fiscal sustainability threats in the medium term, compounded by Mozambique's high risk of debt distress. The figures below present fiscal and debt balances under the baseline and the scenarios discussed, including drivers of debt dynamics for the four alternative scenarios and probabilistic fan charts for the contingent liabilities scenario.

1.5 Recommendations

- *Resume fiscal adjustment.* Given that the country's LNG revenue windfall may only come at the end of the decade, Mozambique needs to resume fiscal consolidation in the short and medium term. A sizable part of the fiscal adjustment will need to come from discretionary spending and improving the efficiency of public revenue and expenditure in critical sectors. Fiscal sustainability analysis shows that Mozambique needs a combination of high growth rates and structural wage bill and VAT reforms to rebalance its public finances and bring down debt levels. These reforms will be partly supported by the IMF program.
- *Rebalance spending towards priority areas.* The need to allocate greater resources to infrastructure and social spending brings to the fore the fiscal implications of continuing to spend 40 percent of total public spending (13 percent of GDP) on the wage bill. Spending on the Presidency more than doubled in the past decade, rising from 8.8 percent of total spending to 22.4 percent in 2020. This is owing to a new administration format featuring so-called "open presidencies", significantly increasing travel and logistics to the districts and localities, and establishing credit lines to the districts.
- *In the short term, maximize concessional sources of financing and reduce domestic borrowing costs* through active debt management, including upgrading IT systems for debt recording and reporting. This would allow directing public resources to development priorities and spending them more efficiently.
- *In the medium term, establishing fiscal objectives and rules is essential.* Mozambique needs to strengthen its medium-term fiscal framework (MTFF) and gradually transition towards a fiscal policy based on fiscal objectives and fiscal rules. The planned Sovereign Wealth Fund (SWF) law needs to include clear rules governing deposits and withdrawals, embedded in a sound MTFF and fiscal rules. No institutional structure can guarantee successful SWF management unless there is a broader commitment to fiscal discipline and fiscal rules that can help manage spending volatilities. These rules should account for spending pressures from recurrent climatic shocks. Further, it is crucial to ensure the participation of independent, non-state actors in the oversight of the Fund. Additionally, the government needs to capitalize on its recent public investment management reforms to introduce climate-smart standards for more resilient public infrastructure and lower future fiscal pressures.
- *Reform budget execution and financial controls,* strengthening the expenditure chain and preventing the accumulation of arrears. Budget execution rates must improve, particularly investment spending. Ensuring more spending is executed within the integrated financial management system (IFMIS) will improve control, avoid over-commitment at the spending entity level, improve predictability and oversight, reducing the scope for extra-budgetary arrears. Finally, the authorities should also move from cash rationing to proactively managing cash flows and balances.

References

Baez, J. et al. (forthcoming), "How Do Taxes and Transfers Affect Poverty and Inequality in Mozambique?". World Bank: Washington DC.

IMF. 2018. "Mozambique: 2017 Article IV Consultation—Selected Issues. Wages Bill Dynamics and Reform Options". By Chadi Abdallah. Country Report No. 18/66, March 2018. Washington, DC: IMF.

IMF. 2019. "Mozambique: 2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for the Republic of Mozambique". Country Report No. 19/166, June 2019. Washington, DC: IMF.

IMF. 2021.

IMF. 2022. "Mozambique: Staff Report for the 2022 Article IV Consultation and Request for an Arrangement under the Extended Credit Facility". April 15, 2022. Washington, DC: IMF.

Peixoto and Forquilha. 2021. "Mozambique Recovery and Peacebuilding Assessment – RPBA".

UNICEF. 2017.

World Bank. 2014. "Mozambique: Public Expenditure Review. Addressing the Challenges of Today, Seizing the Opportunities of Tomorrow". September 2014. Washington, DC: World Bank.

World Bank. 2019. "Mind the Rural Investment Gap. Disparities in Access to Basic Infrastructure and Directions for Mozambique's Public investment Program". December, 2019. Washington, DC: World Bank.

World Bank. 2020. "Mozambique Economic Update. Setting the Stage for Recovery". February, 2021. Washington, DC: World Bank.

World Bank. 2021. "Mozambique Country Economic Memorandum. Reigniting Growth for All". October, 2021. Washington, DC: World Bank.

Bahl, R. (2000), *Intergovernmental Transfers in Developing and Transition Countries: Principles and Practice,* Washington, D.C.: World Bank Group.

Faria, F. & Chichava, A. (1999), *Descentralização e cooperação descentralizada em Moçambique. n.p.* (Maputo). Retrieved from: http://www.ilo.int/public/portugue/region/eurpro/lisbon/pdf/descentra_mocambique.pdf

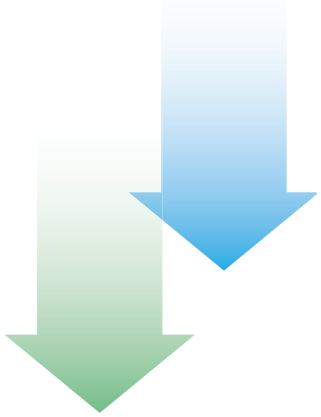
UNICEF (2019), *Public Finance for Children (PF4C) Global Learning Programme, Fiscal Decentralisation and Financing at the Sub-National Level, Module 7,* UNICEF and Oxford Policy Management.

Weimer, B. and Carrilho, J. (2017), *Political Economy of Decentralisation in Mozambique Dynamics, Outcomes, Challenges,* Maputo, Mozambique.: Institute for Social and Economic Studies (IESE).

World Bank (2020), *Mozambique Risk and Resilience Assessment,* October 2020 (Forthcoming –confidential).

Weimer, B. and Illal, A. (2018), *Urbanização, serviços públicos e recursos fiscais –Os desafios principais para as autarquias moçambicanas. Uma análise com enfoque às transferências fiscais intergovernamentais)*, in Desafios 2018: 67-107 Maputo. Instituto de Estudos Sociais e Económicos (IESE)World Bank (2018), Mozambique Horizontal Funds Distribution to Sub-national Government in Mozambique Funding the Districts and Municipalities, Policy Note, Washington, D.C.: World Bank Group.

CHAPTER 2



Revenue Mobilization

Summary: Despite the recent economic contraction caused by natural disasters and the COVID-19 pandemic, Mozambique's tax revenues have performed well, and its tax performance is above SADC and SSA averages. The country is undertaking several reforms to make its taxation system more efficient and to simplify tax filing by taxpayers. However, the tax base is concentrated on a few large taxpayers, notably in the extractive industry and FDI-related activities, which raises questions about the sustainability of revenue collection. In addition, unproductive tax exemptions and incentives are a problem, mostly benefiting the most profitable economic sectors and activities and resulting in considerable revenue losses and low corporate income tax productivity. Inefficiencies in the tax administration system are also an obstacle to broadening the tax base. This chapter reviews these challenges and makes several key recommendations for reducing inefficiencies and expanding the tax base. These include reviewing tax incentives and exemptions and adopting a broader excise tax base.

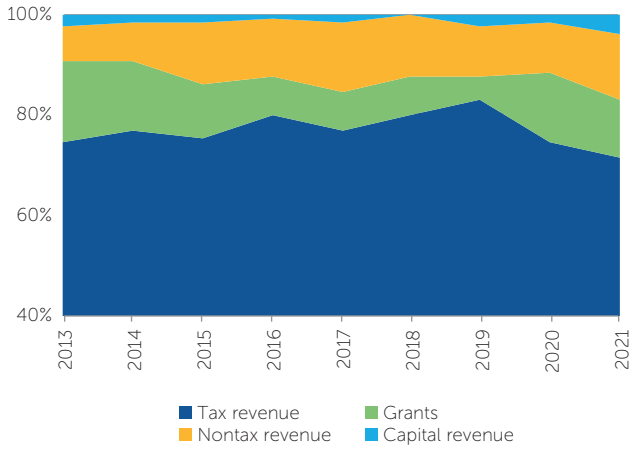
The chapter is organized as follows: It begins with an overview of the trends in Mozambique's revenue performance (Section 2.1), including tax and non-tax revenue and grants, benchmarking performance against comparable countries in the region. Section 2.2 assesses Mozambique's tax policy, reviewing its statutory rates for the major taxes and comparing them with peers. It also reviews the progressivity of its tax policy and the use of exemptions and incentives. Section 2.3 turns its attention to how Mozambique administers its tax system, unpacking some challenges to its efficient operation. Section 2.4 concludes with several recommendations for removing inefficiencies and expanding the tax base, while contributing to public good outcomes such as health and the environment.

2.1 Trends in Revenue Performance

Revenues have held up well in recent years, driven by strong tax revenue performance, but remain concentrated in a few large tax payers. Total government revenue is made up of current revenue (tax and non-tax revenues) and capital revenue (revenue generated from the sale of government assets or stocks). Of this, tax and non-tax revenue accounted for 19.2 and 3.1 percent of GDP on average over 2013-2021, respectively, while capital revenues represented 0.8 percent of GDP (Figure 2.1, Table 2.1). Tax revenue is the main source of fiscal revenue and comprises direct taxes (income taxes), indirect taxes (goods and services taxes, and customs duties) and other taxes.[34] Total fiscal revenue increased from 23.1

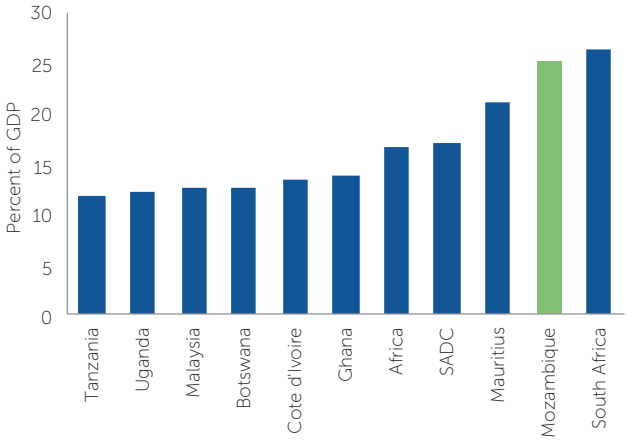
34 Other taxes comprise tax on fuels, taxes on mining activity, taxes on oil activity, additional liquefied natural gas (LNG) taxes and other national taxes (inter alia stamp duties, vehicle taxes, inheritance taxes, reconstruction taxes).

Figure 2.1: Revenue structure by source, 2013-2021



Source: Mozambique Tax Authority.

Figure 2.2: Regional benchmarking of Mozambique's tax revenues, 2019



Source: OECD Tax Revenue Statistics database for comparator countries; WIDER GRD for Tanzania.

percent in 2019 to 25.1 percent in 2021. Mozambique's revenue-to-GDP is higher than its peers (Table 2.2).

Tax revenue

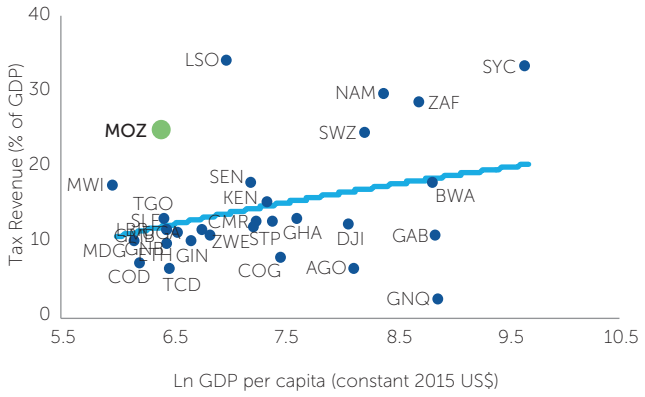
Mozambique's tax-to-GDP ratio is high and stable (Table 2.1). Tax revenue averaged 20.4 percent of GDP over 2013-2021. It has declined slightly in recent years, however, owing to a series of shocks: the hidden debt crisis in 2016, the cyclones in 2019, and the pandemic since 2020. Increased collections of capital gains tax (CGT) from the transaction of assets in the extractives sector in 2017 and 2019 have contributed to the strong revenue performance in recent years.[35] Tax revenue collection has also been underpinned by improvements in tax policy and tax administration. The key tax policy changes include increased withholding taxes on payments to non-resident service and finance providers in the extractives industry; elimination of some corporate income tax (CIT) tax incentives; lifting of tax exemptions and expansions in the value-added tax (VAT) base; and introduction of a new excise tax code in 2018. In recent years, major tax administration reforms include digitalizing customs declarations and introducing e-taxation. The rollout of e-taxation is ongoing, but some components have already been introduced, such as tax payment via banks, a digital taxpayers' registry, and the development of a digital interface to allow taxpayers to file and pay their taxes electronically.

Despite the economic contraction caused by natural disasters in 2020 and the pandemic since 2020, tax revenues have performed well. The tropical cyclones in 2019 had a limited impact on tax revenues,[36] despite their devastating socio-economic effects in the affected areas. To alleviate the negative impacts of the disasters, the government took several tax measures.[37] Excluding CGT, tax revenues remained stable at about 20 percent of GDP in 2020 and 2021. In 2020, the authorities approved some further tax measures to mitigate adverse socio-economic impacts of COVID-19, including extending VAT exemptions; postponing income and corporate tax advance payments for small firms (turnover of less than MZN 2.5 million); and postponing advanced CIT payment for companies with total revenue up to US$ 40,000.[38]

Mozambique fares better than its peers in terms of tax revenue performance (Figure 2.3), but its tax base remains narrow. In 2019. It performed better than the SADC and SSA averages (17 and 16.6 percent of GDP, respectively) and those of its structural peers. This may be partly explained by good performance in collecting taxes from large tax payers, including in the extractive and other FDI driven sectors and a possible underestimation of GDP (denominator effect). In other words, some economic activities that contribute to tax revenue collection may not be well captured in the data sources used for national accounts compilation.

35 CGT amounted to 2.5 percent of GDP in 2017 and 5.6 percent of GDP in 2019.
36 The resilience of taxes can be explained by greater control of tax bases and increased tax administrative efficiency. Faced with an economic contraction, the authorities have improved their ability to expand the tax base by simplifying administrative procedures, improving administrative capacity and better use of withholding at source (AT, 2020). In addition, simplifying tax procedures (notably use of banks for processing tax payments and increased used of cross-checked third-party information – especially for VAT – have helped improve tax administration capacity.
37 These included tax exemptions for importing companies, especially those located in areas affected by the cyclones; creation of facilities for importing companies to expedite imports of food and reconstruction materials; a five-month postponement of 2018 CIT and PIT due in 2019; and exemption of 2019 CIT advanced payments.
38 The cost of the CIT postponement measure was estimated at MTN 3 billion, amounting to 0.3 percent of GDP.

Figure 2.3: Tax mobilization and level of development in Sub-Saharan Africa, 2019



Source: WIDER GRD, World Bank and World Bank staff calculations.
Note: GDP per capita (constant 2015 US$) in 2019 is used for all countries.

Mozambique outperforms its peers on income taxation as a share of the economy (Table 2.2). Over 2013–2021, Mozambique has increasingly relied on direct taxes—corporate income tax (CIT) and personal income tax (PIT)—rather than indirect taxes (Table 2.1). The share of direct taxes in total taxes averaged 45.6 percent between 2013–2021 (Figure 2.4). The increase in the share of direct taxes is driven by CIT, although mainly one-off significant increases in CIT rather than structural improvements in CIT collection. CIT collection has remained robust in recent years, despite some fluctuations. CIT revenue averaged 5.8 percent of GDP (27.4 percent of total tax revenue) over 2017-2021 while PIT averaged 3.8 percent of GDP (18 percent of total tax revenue) (Figure 2.5). PIT collection has risen in recent years, reflecting improved tax administration for controlling withholding taxes under PIT for non-residents.

Indirect tax accounts for a large share of total taxes, which is perhaps symptomatic of a less equitable tax system. Indirect taxes consist of domestic goods and service taxes (VAT and excise taxes) and international trade taxes. Indirect tax revenue averaged 9.3 percent of GDP (about 45 percent of total tax revenue) over 2013-2021, the bulk of which was driven by taxes on domestic goods and services (Figure 2.4). However, indirect tax revenue has fallen, from 47.7 percent of total tax revenue in 2013-2016 to 42.1 percent in 2017-2021, reflecting lower VAT, trade, and excise tax collection. On the latter, Mozambique lags behind most of its peers (Table 2.2). Indirect tax revenues are generally higher in low-income countries since enhancing collection of direct taxes is more challenging, while indirect taxpayers are easier to identify. A relatively high share of indirect taxes may have equity implications given that they are essentially levied equally on taxpayers, regardless of their income.[39] The composition of revenues should shift from personal income taxes to consumption with rising economic development.

VAT receipts dominate taxes on goods and services. VAT collection averaged 6.5 percent of GDP over 2013-2021 (Figure 2.5), but has stagnated in recent years, partly owing to design and implementation issues. Swistak et al. (2017, 2019) discuss two key factors which point to the gradual deterioration of VAT over time in Mozambique. First, VAT collection is on a gross rather than net basis (due to low levels of VAT refunds paid—this increases firms' requests for tax exemptions to compensate them for the lack of VAT refunds. Second, as pervasive tax exemptions on business inputs have been awarded, the result is tax cascading and artificial expansion of the VAT base.[40] For instance, in 2016 the authorities provided VAT relief (exemptions and zero-ratings) for LNG investments, public transport, agricultural inputs, and water supply. This zero-rating of passenger transport and piped water amounted to a 0.3 percent of GDP loss.[41] The revenue lost from the VAT relief measures outweighed the expansion of the VAT base in 2017, when services related to drilling, research and infrastructure for extractive activities were made subject to VAT.

Other indirect tax revenues—specifically excise and trade taxes—are small compared to VAT. Excise revenues, levied on domestic and imported goods, consist of excise taxes on specific domestic consumption items and a separate tax on oil products.[42] Excise revenues averaged 1 percent of GDP over 2017-2021 (Figure 2.5). A new tax code on excise duties introduced in 2018, expanding the base and increasing some rates, explains the marginal increase in excise revenues in recent years. Nonetheless, there is a scope to increase excise revenues further, as also suggested by Mozambique's weak performance compared to peers. Weak performance in excises reflects high tax evasion, fostered by weak border controls and the prevalence of informal trade. International trade tax amounted to 1.6 percent of GDP over 2017-2021, lower than the average for the pre-hidden debt period. Mozambique's customs duties are higher than the SSA and SADC averages (both 1.4) and all peers, except Côte d'Ivoire and Uganda (Table 2.2).

39 In the context of a developing country like Mozambique, VAT is likely a regressive tax, with more vulnerable households carrying a higher tax burden since they spend a higher proportion of their income on consumption. Given the equity-efficiency trade-off, better designed VAT should be complemented with a progressive income tax system and/or pro-poor expenditures aimed at the most vulnerable. However, VAT may not be entirely regressive as a huge proportion of the poorest households get their products from informal sector traders, who do not pay VAT, and are not eligible for VAT refunds.

40 A cascade tax or cascading tax refers to a system that imposes sales taxes on products at each successive stage in the supply chain from raw material to consumer purchase. Each buyer in the supply chain pays a price based on its cost, including the previous tax or taxes that have been charged.

41 Swistak et al. (2019).

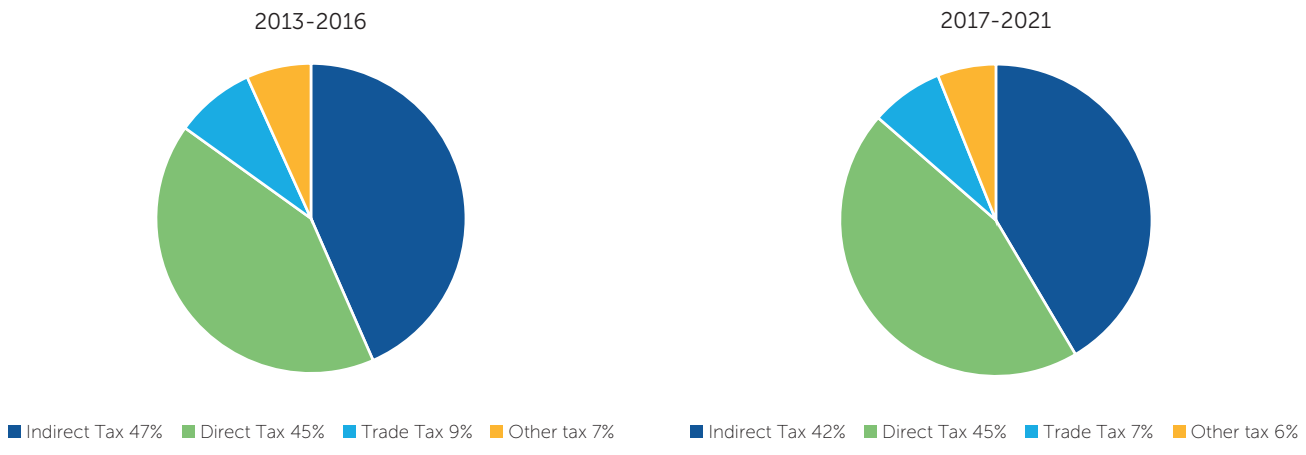
42 The excise code allows for primary excisable products – alcoholic beverages, tobacco products and vehicles – as well as other goods. The TSC base comprises motor and aviation gasoline, diesel oil, jet fuel, fuel oil and LPG. Excise taxes are implemented at ad valorem (based on the assessed value of a property, product, or service) or specific rates, with specific rates applicable per taxation unit. For goods to which both ad valorem and specific rates apply, the rate resulting in a higher tax value applies.

Table 2.1: Trends in revenue, 2013-21, % of GDP

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Current revenue	**24.1**	**25.8**	**22.7**	**21.8**	**24.9**	**23.8**	**28.0**	**23.6**	**23.9**
Current revenue (no CGT)	24.1	25.8	22.7	21.8	22.4	23.8	22.3	23.6	23.9
Tax revenue	**22.0**	**23.4**	**19.5**	**19.1**	**21.0**	**20.5**	**24.9**	**20.8**	**20.3**
Tax revenue (no CGT)	22.0	23.4	19.5	19.1	18.5	20.5	19.2	20.8	20.3
Direct taxes	10.9	11.0	8.0	8.5	11.5	10.1	15.0	10.2	9.9
CIT	6.7	8.0	5.7	4.9	5.5	6.4	5.4	6.0	5.9
Capital gains tax					2.5		5.6		
PIT	2.9	3.3	3.3	3.6	3.5	3.7	3.9	4.2	3.9
Indirect taxes	9.5	10.8	10.5	9.1	7.8	8.8	9.2	9.0	9.5
VAT	6.4	7.4	7.3	6.4	5.4	6.2	6.7	6.4	6.5
Domestic VAT	5.5	3.8	3.4	3.8	3.1	3.2		3.5	
VAT on imports	0.9	3.6	4.7	3.9	3.4	4.0		4.0	
VAT reimbursements			0.8	-1.3	1.1	-1.0	-1.2	-1.0	
Excise tax	1.2	1.3	1.2	1.0	1.0	0.9	0.9	1.0	1.1
Domestic goods	0.6	0.6	0.6	0.6	0.6	0.4	0.5	0.5	0.5
Imported goods	0.5	0.7	0.6	0.4	0.4	0.5	0.5	0.5	0.6
Trade taxes	2.0	2.1	2.0	1.7	1.4	1.7	1.6	1.6	1.9
Other taxes	1.5	1.6	1.5	1.5	1.6	1.7	0.7	1.7	0.8
Non-tax revenue	**2.1**	**2.4**	**3.2**	**2.7**	**3.9**	**3.2**	**3.1**	**2.7**	**3.6**
Grants	**4.9**	**4.1**	**2.8**	**2.0**	**2.1**	**2.0**	**1.2**	**3.9**	**3.2**
Investment projects	2.0	2.4	0.9	0.4	1.2	1.4	0.5	2.1	3.2
Common funds	1.6	0.2	0.9	1.4	0.9	0.6	0.6	1.8	
Budget support	1.3	1.5	1.2	0.1					
Capital revenue	**0.7**	**0.5**	**0.5**	**0.3**	**0.5**	**0.0**	**0.8**	**0.6**	**1.2**
Total revenue	**29.6**	**30.5**	**26.0**	**23.9**	**27.4**	**25.8**	**29.9**	**28.1**	**28.3**

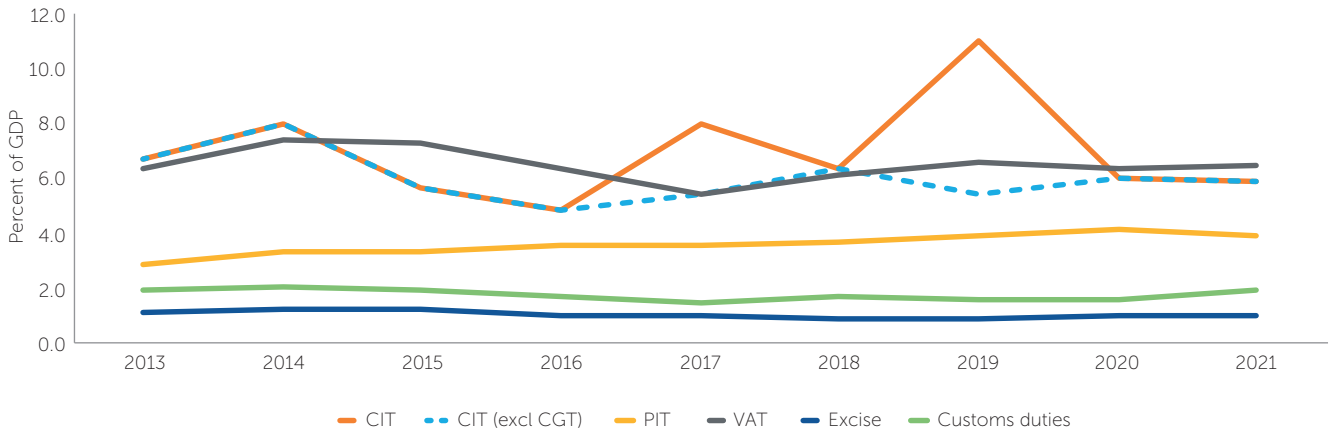
Source: Mozambique Tax Authority.
Note: CGT=capital gains tax; CIT=corporate income tax; PIT=personal income tax; VAT=value-added tax

Figure 2.4: Composition of tax revenues, 2013-2021



Source: Mozambique Tax Authority.

Figure 2.5: Revenue collection by tax type, 2013-2021



Source: Mozambique Tax Authority.

Table 2.2: Benchmarking of government revenues, 2019, % of GDP

	Government revenue	Tax revenue	Direct taxes	Indirect taxes	PIT	CIT	VAT	Excises	Customs duties
Mozambique	23.1	19.2	9.4	9.2	3.9	5.4	6.7	0.9	1.6
Africa	21.6	16.6	6.3	8.6	3.2	2.9	4.9	1.5	1.4
LAC	-	22.9	6.2	11.4	2.2	3.6	6.0	1.5	1.3
SADC	24.6	17.0	8.6	9.3	5.2	3.4	6.1	2.7	1.4
Structural peers									
Cote d'Ivoire	14.0	13.2	1.6	8.0	0.0	1.5	2.8	1.1	1.8
Ghana	16.3	13.5	5.7	7.1	2.2	3.4	3.6	1.7	1.5
Tanzania	13.9	11.7	4.2	7.5	1.9	1.4	3.4	2.9	1.0
Uganda	12.5	12.1	4.3	7.9	3.0	0.9	3.7	0.9	2.8
Aspirational peers									
Botswana	28.0	12.6	7.9	4.6			4.1	0.3	0.0
Mauritius	23.4	21.1	5.7	13.4	2.1	3.2	7.1	4.3	0.3
South Africa	26.7	26.2	13.4	10.5	9.3	3.8	5.9	3.3	1.0

Source: AT for Mozambique; OECD Tax Revenue Statistics database for comparator countries; WIDER GRD for Tanzania.
Note: CGT=capital gains tax; CIT=corporate income tax; LAC=Latin America and the Caribbean; PIT=personal income tax; SADC=Southern African Development Community; VAT=value-added tax.

The responsiveness of revenue mobilization to national income (i.e., tax buoyancy) is low for indirect taxes but higher for income taxation. Tax elasticity or buoyancy measures the responsiveness of tax mobilization to underlying tax bases, proxied by GDP or national income.[43][11] (A tax would be considered buoyant if the increase in revenues is proportionally more than a rise in national income or output.) In Mozambique, a 1 percent increase in GDP is associated with a 0.97 percent increase in tax revenues (0.85 percent when CGT is excluded) (Table 2.3), indicating low tax buoyancy. Tax buoyancy is higher for direct taxes than indirect taxes. For PIT, rapid economic growth might have led to substantial increases in hiring and ad hoc wage and salary adjustments, resulting in a significant increase in PIT. For CIT, on the other hand, it is probably driven by large one-off capital gains and withholding taxes on extractives. VAT is much less buoyant. Domestic VAT is considerably less buoyant than import VAT, perhaps reflecting increased dependence on imported consumption goods, accumulation of VAT refunds and pervasive tax exemptions.

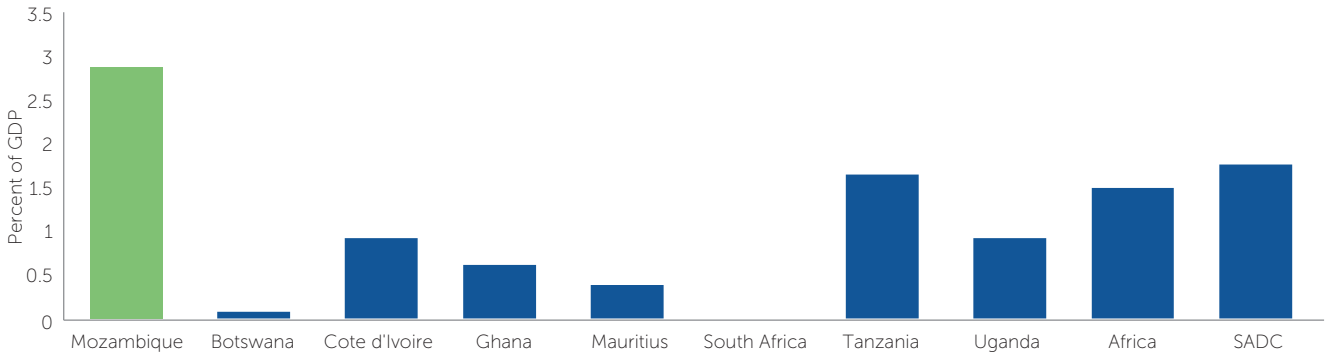
43 Tax elasticity (buoyancy) is estimated using a log-log regression specification of tax revenue on GDP. GDP is used as a proxy for the general tax base.

Table 2.3: Elasticity of tax bases against GDP

Tax type	Elasticity
Tax revenue	0.967***
Tax revenue (no CGT)	0.847***
Direct taxes	1.149***
Direct taxes (no CGT)	0.927***
PIT	1.391***
CIT	1.049***
CIT (no CGT)	0.713***
Indirect taxes	0.842***
VAT	0.857***
Domestic VAT	0.426
VAT on imports	2.362*
Excises	0.618***
Trade taxes	0.698***

Source: AT and World Bank staff calculations.
Note: Italics represent estimates excluding CGT.

Figure 2.8: Benchmarking grants, average for 2013-2019 or latest available year



Source: OECD Tax Revenue Statistics database for comparator countries; WIDER GRD.

Non-tax revenue

Non-tax revenue receipts are considerable, averaging 3.2 percent of GDP over 2013-21, though markedly lower than those of peers (Figure 2.6 and Figure 2.7). Non-tax revenues come from various sources, such as economic activities (flat rates for free zones and diverse fees), social contributions, rents and royalties from the extractives sector, and exploration fees. Due to its often one-off nature, non-tax revenue fluctuates significantly (Figure 2.6). Non-tax revenues contributed a greater share following the hidden debt crisis in 2016 as economic activity decelerated sharply, leading to lower tax collection. However, the pandemic had a dampening effect on non-tax revenue, falling from 3.1 percent of GDP in 2019 to 2.7 percent in 2020, because of the strict lockdown measures.[44] It picked up again in 2021, driven mostly by a resumption of sales of goods and services.[45] On average, non-tax revenue in Mozambique is substantially lower than the African (5.5 percent of GDP) and SADC averages (6.3 percent), and some structural peers.[46]

Grants and other external financing

Grants have also played an important role in Mozambique (Figure 2.8 and Figure 2.9). Grants comprise investment projects, sector common funds, and budget support. They

44 Aslam et al. (2022).
45 AT (2021).
46 The African average includes all 30 countries in the Revenue Statistics for Africa Database (OECD/AUC/ATAF, 2021).

averaged 2.5 percent in 2017-2021, down from 3.4 percent of GDP in 2013-2016. Grants dropped sharply, from a peak of 4.9 percent in 2013 to 2 percent in 2016, following the suspension of budget support after the discovery of the undisclosed loans. Budget support alone had averaged 1.3 percent of GDP over 2013-2015, but fell to a meagre 0.1 percent of GDP in 2016. However, grants picked up considerably in 2020 and 2021, reflecting support to the country's efforts to deal with the tropical cyclones and the pandemic. Grants to Mozambique are substantially higher than the SSA and SADC averages, and its structural peers (Figure 2.10).

2.2 Tax Policy

Statutory tax rates in Mozambique are generally higher than those of peers (Table 2.4), although tax expenditures narrow the tax bases. While Mozambique has a higher VAT rate, it has several more VAT-exempt or zero-rated items than its regional peers.[47] The statutory VAT rate (17 percent) is higher than the average for its aspirational peers (13 percent), as well as the SADC average (15.7 percent), but lower than for most structural peers. The statutory CIT rate is 32 percent while the effective tax rate (ETR) is 30.8 percent.[48],[49] There have been no recent changes in the statutory tax rate in Mozambique, with the last change occurring in 2002: a reduction from 35 percent to 32 percent. The statutory (and effective tax rates) in Mozambique are higher than the average for structural peers.

Mozambique's statutory CIT rate is higher than its peers, but its efficiency ratio (CIT productivity) is low, driven by excessive tax exemptions (Figure 2.11). CIT productivity is low due to numerous general and sector-specific tax incentives granted through the Code of Fiscal Benefits (CFB), which places a low tax burden on large companies. The tax incentives mostly benefit the most profitable economic sectors and activities, resulting in considerable revenue losses and low CIT productivity. This is a problem, as CIT in Mozambique is mostly paid by the most profitable companies, most of which benefit from generous tax reductions and concessions. In addition, high statutory rates potentially increase incentives for shifting profits out of Mozambique to other jurisdictions.

The simplified tax regime (ISPC) was introduced in 2009 to simplify tax payments for small taxpayers (for whom it replaces the CIT, PIT, and VAT) and reduce administrative and compliance costs, thereby widening the tax base. It is a simplified tax on MSME's gross business turnover, using a flat-rate tax system imposable on an annual business turnover below MTN 2.5 million. The tax payable under the ISPC regime is either MTN 75,000 or 3 percent of annual turnover. Micro enterprises have a yearly turnover below MTN 750,000; small enterprises have an annual turnover of between MTN 750,000 and MTN 2.5 million; while medium-sized enterprises have an annual turnover of over MTN 2.5 million. The ISPC regime is aligned with the VAT registration threshold, with businesses below the VAT threshold

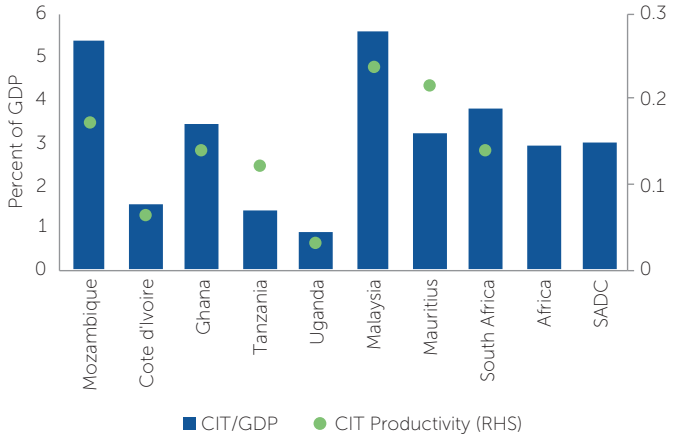
Table 2.4: Tax rates for Mozambique and its peers

Rates for four major taxes (%)				
	CIT	ETR	PIT	VAT
Mozambique	32	30.8	32	17
SADC	28.5	20	31.3	15.7
Structural peers				
Côte d'Ivoire	25	8.8	36	18
Ghana	25	17.7	30	15
Tanzania	30	20.8	30	18
Uganda	30	22.3	40	18
Aspirational peers				
Botswana	22	21.5	25	12
Malaysia	24	21.8	30	10
Mauritius	15	10.3	15	15
South Africa	28	21.8	45	15

Source: AT for Mozambique; Tax Foundation for CIT rates; ODI Tax Employment Dataset for PIT top rates; Crowe (2018) for VAT rates.

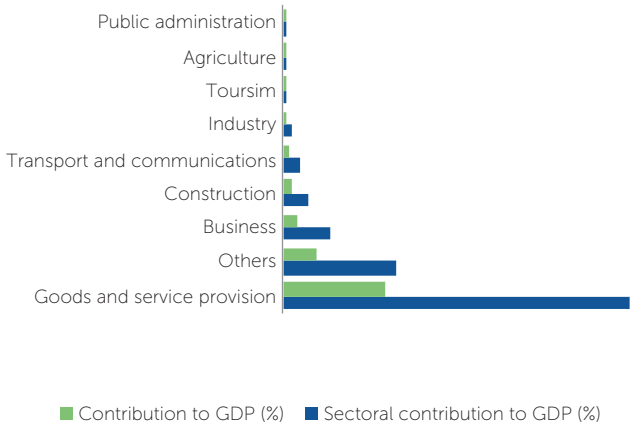
47 IMF (2022).
48 The effective tax rate is the rate companies pay, after deductions, exemptions and other tax-deductible allowances granted by legislation. As a result, effective tax rates are typically lower than statutory tax rates. Effective tax rates are often proxied by "profit tax (% of profit)".
49 The statutory tax rate is the prevailing tax rate which applies to the corporate sector, as stipulated in the tax code.

Figure 2.9: CIT performance and productivity, 2019



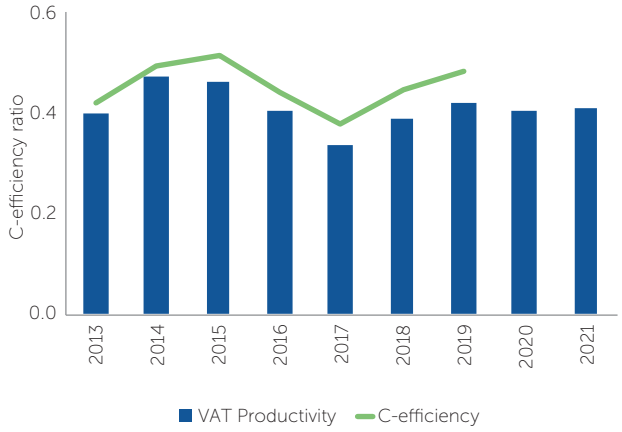
Source: Mozambique Tax Authority.

Figure 2.10: Revenue contribution by sector, 2019



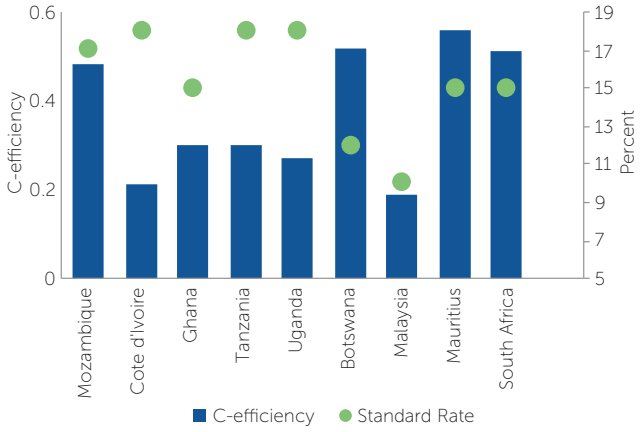
Source: Tax Stats Report (2019).

Figure 2.11: VAT productivity and C-efficiency, 2013-2021



Source: Mozambique Tax Authority (MAT).

Figure 2.12: Benchmarking Mozambique's C-efficiency and standard VAT rates, 2019



Source: MAT; OECD Tax Revenue Statistics database for comparator countries; Crowe (2018) for statutory VAT rates.

qualifying for the presumptive regime and those above subject to the standard tax regime (VAT, CIT, PIT and other taxes). However, the effectiveness of the ISPC regime may be compromised by other regimes like the lump sum PIT, placing a high tax burden on small taxpayers and rendering the tax administration costly, with an eventual negative benefit-cost ratio as a result.

The PIT (*Imposto sobre o rendimento das pessoas singulares*) was introduced in 2002 in Mozambique. Individuals' income is taxed under five separate categories.[50] The taxable income under the PIT is the sum of the income earned in each of the five categories in each year, allowing for deductions and allowances, specifically personal and dependent allowances. The PIT is progressive, containing five income bands. Its receipts also contribute significantly to revenue mobilization, averaging 3.6 percent of GDP over 2013-21 and peaking at 4.2 percent of GDP in 2020 (Table 2.1). As employment income constitutes the bulk of PIT revenue, this performance is driven almost entirely by an expansion in the public sector wage bill. As of 2017, employment income accounted for 86.4 percent of total

50 Employment income and pensions; business and self-employment income; capital income and capital gains; property income; and income from gambling, lotteries and the sum corresponding to an increase in wealth not accounted for by income classified in other categories.

PIT, business and self-employment income accounted for 5.9 percent, capital income for 2.3 percent, rental income for 4.1 percent and other/unspecified income accounted for 1.4 percent.[51] The PIT reform in 2013 introduced a final withholding tax of 20 percent on employment, which also contributed to the initial revenue increase, but undermined equity and productivity. The ratio dropped slightly in 2021, perhaps reflecting the economic slowdown that followed the containment measures taken to contain the pandemic.

As regards PIT rates, the bottom marginal rate is 10 percent, while the top marginal rate is 32 percent. The rates schedule does not allow for a total exemption for the lowest PIT earners. This absence of a lower exempt threshold for PIT income makes Mozambique somewhat different from many peers, whose lowest-income populations are exempt or subject to a specific lump sum tax scheme. However, a lump sum regime is in place for the lowest income levels of micro, small and medium-sized enterprises (MSMEs), exempting them from the PIT (see below). These exemptions leave only a PIT on wages for people with low salaries, at a 10 percent rate. As most of the PIT base consists of employment income from the public sector, the 10 percent rate collects low amounts of revenue because low-income wages are most likely in the informal sector.[52] The revenue impact of this PIT design can go both ways since the large tax base paying PIT at 10 percent on taxable income needs to be seen against the administrative costs of bringing low-income taxpayers into the tax net. The 32 percent PIT top rate is higher than the SSA average (31 percent) and the average of all aspirational peers (29 percent), but lower than the average of structural peers (34 percent) (Table 2.4).

Mozambique's statutory CIT rate is higher than its peers, but its efficiency ratio (CIT productivity) is low, driven by excessive tax exemptions (Figure 2.11).[53] CIT productivity is low due to numerous general and sector-specific tax incentives granted through the Code of Fiscal Benefits (CFB), which places a low tax burden on large companies.[54] The tax incentives mostly benefit the most profitable economic sectors and activities, resulting in considerable revenue losses and low CIT productivity.[55] This is a problem, as CIT in Mozambique is mostly paid by the most profitable companies, most of which benefit from generous tax reductions and concessions.[56] In addition, high statutory rates potentially increase incentives for shifting profits out of Mozambique to other jurisdictions.

The simplified tax regime (ISPC) was introduced in 2009 to simplify tax payments for small taxpayers (for whom it replaces the CIT, PIT, and VAT) and reduce administrative and compliance costs, thereby widening the tax base.[57] It is a simplified tax on MSME's gross business turnover, using a flat-rate tax system imposable on an annual business turnover below MTN 2.5 million. The tax payable under the ISPC regime is either MTN 75,000 or 3 percent of annual turnover. Micro enterprises have a yearly turnover below MTN 750,000; small enterprises have an annual turnover of between MTN 750,000 and MTN 2.5 million; while medium-sized enterprises have an annual turnover of over MTN 2.5 million. The ISPC regime is aligned with the VAT registration threshold, with businesses below the VAT threshold qualifying for the presumptive regime and those above subject to the standard tax regime (VAT, CIT, PIT and other taxes). However, the effectiveness of the ISPC regime may be compromised by other regimes like the lump sum PIT, placing a high tax burden on small taxpayers and rendering the tax administration costly, with an eventual negative benefit-cost ratio as a result.

Mozambique's VAT system is characterised by tax policy and compliance issues. The C-efficiency (i.e., the ratio of actual VAT collections to potential tax base) is often used to evaluate the revenue performance and overall efficiency of the VAT system. The decline in the C-efficiency ratio in recent years (Figure 2.13) largely reflects VAT relief (exemptions and zero-ratings, especially on LNG and public transportation) and growing non-compliance with domestic VAT. Mozambique's performance is lagging behind many of its peers (Figure 2.14). As many of these countries have lower statutory VAT rates, their better performance points to tax policy and compliance issues in Mozambique's VAT system.

Recent analysis shows that most fiscal interventions in Mozambique are progressive. Using a commitment to equity (CEQ) methodology, Baez et al., (2020) carried out a fiscal incidence analysis on the main components of Mozambique's public revenue and social expenditure system. They found that most fiscal interventions were progressive. VAT was found to be progressive, because of higher consumption informality among poor households. Further, zero-rating and exemptions add to the regressivity of the VAT. Subsidies, customs duties, and tobacco excises were found to be regressive. Fuel subsidies were found to be progressive, driven entirely by external factors. The fall in oil prices from mid-2014 essentially converted the fuel taxes into an implicit tax that mainly affected richer households (most of whom own cars).

51 IMF (2022).
52 Swistak et al. (2017).
53 CIT productivity is defined as the ratio of CIT to GDP and the statutory CIT rate.
54 The general tax incentives include full expensing, accelerated depreciation and investment tax credits. Sector-specific tax incentives include a reduction in the statutory rate for investment in agriculture, hotels and tourism, and special economic zones.
55 Swistak et al. (2017).
56 The top 1 percent of companies (those with positive tax liability) contribute close to 70 percent of the CIT (Swistak et al., (2017).
57 Prior to 2009, all firms with a turnover of less than MTN 2.5 million were subject to the standard taxes like CIT, VAT and PIT.

Removing all consumption-related tax exemptions would provide an estimated revenue increase of 1.3 percent of GDP.[58] Using the latest household survey data, the IMF assessed consumption patterns by income decile and the overall distributional impact of a VAT reform scenario that would remove all VAT exemptions except on inferior goods.[59] In that scenario, the expected overall increase in VAT revenues amounts to 1.3 percent of GDP, with the tenth decile contributing the most (approximately 40 percent of the overall increase in VAT revenues). The analysis shows that VAT collection is concentrated, with roughly 40 percent of total revenues collected from the tenth income decile, while the first five deciles contribute approximately 20 percent.

The authorities are set to implement the above reform scenario to broaden the VAT base and promote revenue mobilization. They have identified a list of items for which VAT exemptions and zero-ratings will be removed from 2023, which would include up to 50 intermediate goods and services. To minimize the impact of the reform on the most vulnerable and poorest households, items classified in the "basic basket" of goods and services—which are of most importance to low-income households and individuals—will remain exempt from VAT. This reform is expected to deliver additional revenue worth 0.7 percent of GDP between 2022 and 2024. In addition, to ensure political support for the proposed reform and better align the VAT rate with neighboring countries, the government would reduce the VAT rate from 17 to 16.5 percent in 2023 and down further to 16 percent in 2024.

2.3 Tax Administration

The *Autoridade Tributária* (AT) is responsible for executing tax and customs policy under the authority of the Ministry of Economy and Finance. In 2014, the Government of Mozambique introduced the e-Tax project to make it easier to submit annual tax declarations by doing so electronically. However, limited progress in the development and implementation of the e-Tax project has been posing significant challenges. In the meantime, taxes are still being collected using the Interim Revenue Collection System, with limited automation.

The absence of harmonized procedures in the tax administration remains an issue, with no approved manuals on tax collection procedures. This is exacerbated by decentralized tax units preparing their own taxpayer compilations, resulting in a loss of integrity. This practice compromises the quality of the taxpayer register, resulting in reduced registrations. It also impinges on the AT's ability to perform in-depth tax gap analysis to monitor the extent of inaccurate reporting in returns. The most recent Tax Administration Diagnostic Assessment Tool (TADAT) assessment, in 2015, sheds light on these weaknesses. It found many deficiencies, including inaccuracies in taxpayer information and identification, the absence of risk mitigation through a compliance program, delays in responding to information requests and filing tax returns, substantial inaccuracies in reporting (orsby inadequate tax audits), and delays in taxpayer payments and in handling dispute resolutions.

There are other challenges to Mozambique's tax administration. First, complexities in filing tax returns for the major taxes are particularly challenging as they promote poor compliance management. Compounding that is the lack of digitization, meaning returns are filed in hard copy only, significantly increasing compliance and administrative costs. Second, only a basic risk analysis is carried out and is not broken down by the specific tax or type of taxpayer. Most audits focus on the largest taxpayers, with limited capacity for auditing SMEs. Third, there is almost no cross-checking of third-party information against information reported by taxpayers. Fourth, efficiency in revenue collection and reporting systems is tenuous, with only sporadic use of withholding at source. This is further exacerbated by the complexities of payment, with those who choose simplified regimes (such as the ISPC) filing and paying taxes more frequently than those in the real regime. Finally, electronic payments are non-existent.

The authorities are undertaking reforms to resolve these tax administration challenges. First, the AT continues its efforts to expand the e-tax system, which is now being used in some offices (particularly in large taxpayer offices). A digital interface (Portal do Contribuinte) is being developed to allow all taxpayers to file and pay taxes electronically, facilitating tax compliance. The interface is currently only operational for the VAT and ISPC. Second, the authorities are increasing efforts to gather and cross-check third-party information to improve taxpayer compliance and enforce arrears collection for major taxes. A risk management committee has been created to strengthen compliance and design procedures for taxes and customs in all value chains, focusing on mining and gas taxation.

2.4 Policy Recommendations

Review the advantages and disadvantages of tax incentives. While Mozambique's headline CIT rate is generally higher than its peers, any rate reduction without a corresponding tax base expansion could have undesired adverse effects, bringing in less revenue. The availability of multiple tax incentives is undermining the high tax rates; any reduction in statutory rates without a corresponding increase of the CIT

58 IMF (2021).
59 Goods whose demand drops when people's incomes rise.

base (by eliminating tax incentives) would create an unfair tax burden and reduce corporate tax revenue.[60] This is particularly crucial in the extractives sector, where megaprojects benefit from many tax incentives. Tax incentives in the extractives sector are inefficient (they help the companies that would have invested in the sector anyway) and ineffective (the extractives sector is location-specific, making incentives moot) and should be phased out. The CIT reform could be pursued following the same strategy as VAT reform. An analysis of the impact of incentives on investment could be carried out, and only the most important incentives maintained, after which statutory tax rates can be gradually reduced. In effect, the prior elimination of unnecessary tax incentives may compensate for the revenue lost from an eventual reduction in the statutory CIT rate.

Broaden the excise tax base to include more items consumed by specific taxpayer types and embody a particular economic behavior. For example, including excises on private transportation could help address health and climate externalities. Including luxury goods and services in the excise base would also help achieve equity and a fair tax burden. Where possible, an increase in excise rates (especially on relatively inelastic goods like tobacco and cigarettes) would increase excise tax revenue. However, any increase in excise rates without corresponding improvements in administrative capacity to control borders would not be productive. The country has porous borders which enable cross-border shopping, smuggling, and illegal and informal trade. If controlling the borders proves challenging, then excise tax rates must ensure that prices of excisable goods (especially alcoholic beverages and tobacco) are comparable to neighboring countries (especially SADC countries). In addition, border exemptions should be abolished –especially import excises for political parties and Mozambiquan miners returning from South Africa.

Rationalize the portfolio of VAT tax exemptions to broaden the tax base and ensure fairer burden-sharing. There is scope for addressing tax expenditures with a negative carbon impact, such as VAT on goods and services and trade tax exemptions on pesticides for agriculture. The suggested government and IMF reforms would contribute significantly to this domain. In addition, reforming the VAT refund system is crucial and could involve three key facets: (i) increase the budget allocation for VAT refunds, so that the AT can pay legitimate refunds; (ii) invest in building capacity to uncover tax evasion (illegitimate refund requests) in the refund system; (iii) introduce sunset clauses which would limit VAT credits/refunds to within a specific period. Given the importance of the LNG sector for Mozambique's outlook, exemptions and zero-ratings across all value chains should be carefully calibrated. For example, given LNG's heavy reliance on imports of goods and services, exemptions on some of its most important inputs would be warranted. Services linked to the sector, however, should be taxed.

Establish a tax policy framework, including costing parameters on fees and charges in non-tax revenue areas. Currently, fees and charges generate only 12-15 percent of non-tax revenues, which is below potential. A systematic review of the current application of fees and charges could assess the potential for expansion to create behavioral incentives, such as curbing activities with a negative impact on carbon emissions. Mozambique's Nationally Determined Contribution to the UNFCCC provides an overview of specific areas, such as water fees and toll road systems, among others.

60 This is exacerbated by onerous fiscal stabilization clauses with poorly designed fiscal terms.

References

AT (Autoridade Tributaria) 2018. "Mozambique Tax Authority Balance Sheet Report: Activities Developed by AT from January to December 2018 and Perspectives of Actions for 2019". Maputo, Mozambique.

AT 2019. "Mozambique Tax Authority Balance Sheet Report: Activities Developed by AT from January to December 2019 and Perspectives of Actions for 2020". Maputo, Mozambique.

AT 2020. "Mozambique Tax Authority Balance Sheet Report: Activities Developed by AT from January to December 2020 and Perspectives of Actions for 2021". Maputo, Mozambique.

AT 2021. "Mozambique Tax Authority Balance Sheet Report: Activities Developed by AT from January to December 2021 and Perspectives of Actions for 2022". Maputo, Mozambique.

BER (Budget Execution Report) 2013. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

BER 2015. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

BER 2017. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

BER 2018. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

BER 2019. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

De Mooij, R., Fenochietto, R., Hebous, S., Leduc, S., & Osorio-Buitron, C. 2020. Tax policy for inclusive growth after the pandemic. *IMF COVID-19 Special Notes, International Monetary Fund, Washington DC December*.

BER 2020. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

BER 2021. "Republic of Mozambique: Government Report on the Results of Budget Execution, Volume I". Maputo, Mozambique.

Crowe. 2018. Gateway to Africa: Africa VAT/GST Guide 2018-19. Crowe Global.

IMF (International Monetary Fund) 2018a. "Republic of Mozambique: 2017 Article IV Consultation – Press Release; Staff Report; And Statement by the Executive Director for the Republic of Mozambique". IMF Country Report No. 18/65. Washington DC: IMF.

IMF 2018b. "Republic of Mozambique: Selected Issues". IMF Country Report No. 18/66. Washington DC: IMF.

IMF 2019. "Republic of Mozambique: 2019 Article IV Consultation – Press Release; Staff Report; And Statement by the Executive Director for the Republic of Mozambique". IMF Country Report No. 19/166. Washington DC: IMF.

IMF 2021. "Republic of Mozambique: Policy Note for ECF Program Discussions and the 2021 Article IV Consultation". IMF Country Report No. 21/xxx. Washington, DC: IMF.

IMF 2022. "Republic of Mozambique: Staff Report for the 2022 Article IV Consultation and Request for a Three-Year Arrangement under the Extended Credit Facility". IMF Country Report No. 22/xxx. Washington, DC: IMF.

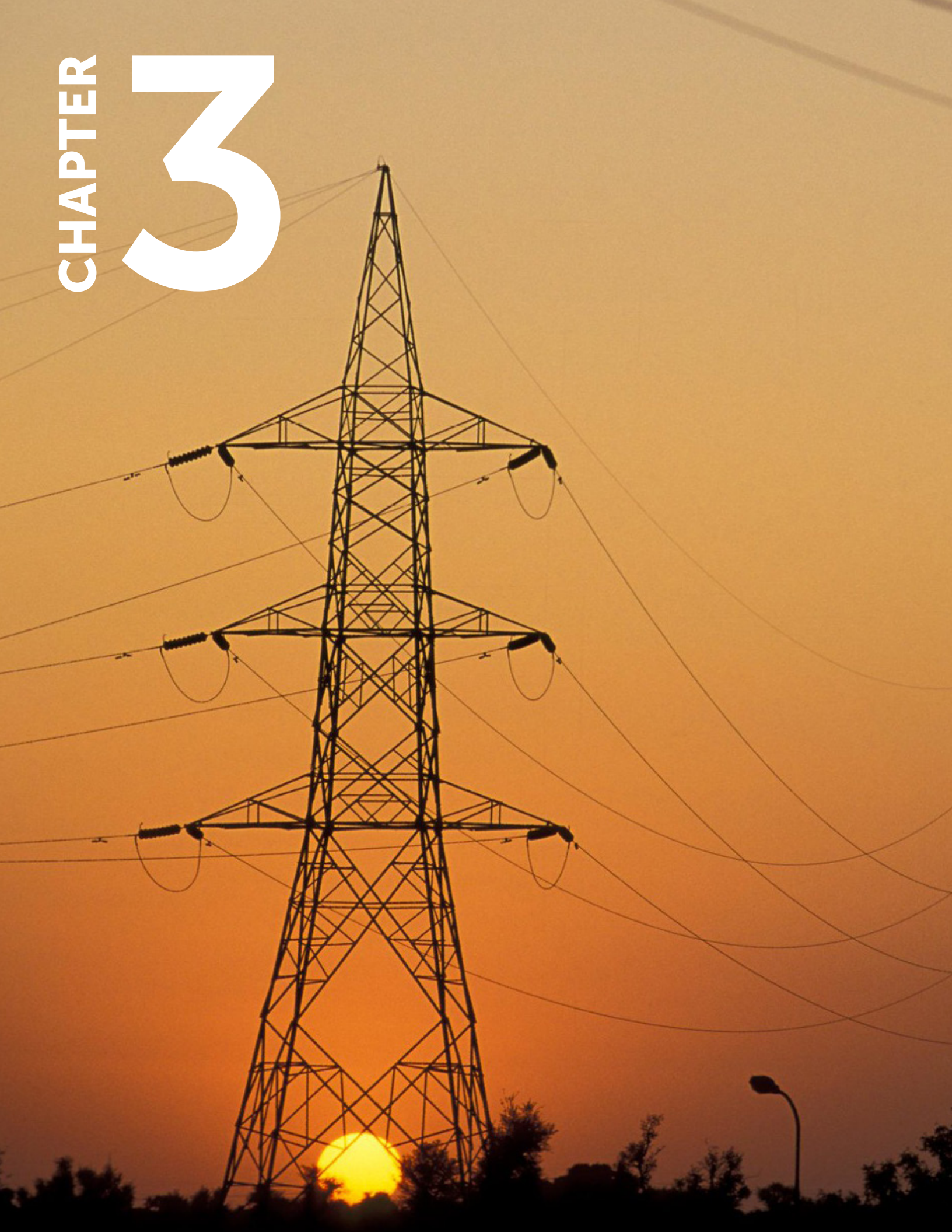
OECD/AUC/ATAF 2021. *Revenue Statistics in Africa 2021,* OECD Publishing, Paris, https://doi.org/10.1787/c511aa1e-en-fr.

Swistak, A., Liu, L., and Varsano, R. 2017. "Mozambique: Towards More Efficient Non-Resource Taxation: A Strategy for Reform". Technical Assistance Report, IMF, March 2017.

Swistak, A., Modi, A., and de la Feria, R. 2019. "Mozambique: Strategy for a VAT Reform". Technical Assistance Report, IMF, October 2019

World Bank 2021. "Mozambique Economic Update: Setting the Stage for Recovery". World Bank: Washington DC.

CHAPTER 3



State-owned Enterprises: Performance and Governance

Summary. State-owned enterprises (SOEs) play a crucial role in Mozambique's economy and their performance has significant fiscal implications. This chapter provides an overview of the SOE landscape in Mozambique, examining the key governance challenges and the fiscal drains and risks they represent. The chapter seeks to provide a more nuanced understanding of the SOE sector, updating and complementing previous studies, and assessing the sector's governance and accountability. It provides recommendations for strengthening oversight, improving performance, and mitigating the risks arising from the sector, based on a deep-dive focus on five of Mozambique's largest SOEs. The chapter aims to inform the policy dialogue with government, as well as contribute to planned reforms in the SOE sector, and their implementation.

The chapter is organized as follows: Following a brief introduction, Section 3.2 provides an overview of the SOE landscape in Mozambique. Section 3.3 analyzes the fiscal costs and risks posed by the SOE sector, focusing in depth on five key SOEs—Aeroportos de Moçambique (ADM), Electricidade de Moçambique (EDM), Empresa Nacional de Hidrocarbonetos (ENH), Linhas Aéreas de Moçambique (LAM), and Petróleos de Moçambique (PETROMOC). Section 3.4 looks at SOEs' corporate governance and accountability mechanisms. Finally, Section 3.5 provides broad reform options for the sector, as well as tailored recommendations for the five focus SOEs.

3.1 Introduction

State-owned enterprises (SOEs) play a key role in Mozambique's economy and pose substantial fiscal risks and drains. Mozambique's SOE portfolio comprises 74 directly owned SOEs, down from 122 in 2017.[61] Available data indicate that the state holds additional stakes in at least 48 companies through indirect shareholding or subsidiary arrangements. SOEs operate in 30 sectors, from natural monopolies and network sectors to activities that private investments could provide without market regulation.[62] In 2020, SOEs held assets totaling US$ 8.2 billion, or 62 percent of GDP. Their operations have significant fiscal implications, with adjusted net losses amounting to 1.9 percent of GDP in 2020. Further, their quasi-fiscal activities (such as carrying out commercially unviable investments and providing goods and services below costs) are a source of fiscal risk, as SOEs have been required to take out debts (some backed by sovereign guarantees) to finance them. Adjusted debt in the SOE sector stands at 21.4 percent of GDP, and the debt/equity ratio is 360 percent, indicating that the sector is highly

61 Made up of 12 public enterprises (PE), 20 majority-owned companies, and 42 companies in which the state holds a minority stake.

62 Mozambican SOEs have (a) a legal monopoly on import of liquefied petroleum gas (LPG), automobile gasoline, aviation oil, lighting oil, and diesel; (b) a de facto monopoly on electricity imports, transmission and distribution, telecom backbone infrastructure and fixed lines, airports, and maritime ports; and (c) significant market participation in electricity generation, fuel retail and wholesale, and air transport services (IFC, 2021).

leveraged. Such high indebtedness and poor operational results mean the sector risks needing state intervention in the near term to maintain ongoing operations.

Following the hidden debt crisis, the Government of Mozambique (GoM) has been carrying out a number of reforms in the SOE sector, but challenges remain. Several new reforms are a positive step in the right direction, but their recentness makes it difficult to assess their impact. The GoM has succeeded in reducing the number of SOEs and their financial debt, and consolidating the role of the state as a shareholder. However, greater control over and transparency surrounding SOEs' public service obligations is needed, as is better reporting of arrears among SOEs and the state. Finally, there is a need to clarify and rationalize how the sector is monitored – a process which is currently fragmented, raising risks of gaps in oversight and diminished accountability.

Box 3.1: Scope and Methodology

This study uses the generally accepted definition of SOEs as entities owned or controlled by the state that provide goods or services on a commercial basis. An entity is considered an SOE if: (i) it is controlled by the state, whether legally, through the ownership of shares, or other means; (ii) it is legally and financially autonomous from the state such that it has legal personality, specific rules of operation defined under a legal regime, and its own revenues and sources of funding; and (iii) it operates in a market for goods or services that could, in theory, be provided by a private company. The definition is adapted from the Organisation for Economic Co-operation and Development's *Guidelines on Corporate Governance of State-Owned Enterprises*[a] and the World Bank's Integrated State-Owned Enterprises Framework (iSOEF).

The analysis focuses on non-financial, commercial SOEs with full or majority ownership by the central government. SOEs owned by subnational governments are not included and neither are public institutes that operate autonomously, but are not meant to have a commercial objective. Likewise, autonomous funds—such as the Road Fund or the Water Assets and Investment Fund (FIPAG)—form part of line ministries and are beyond the scope of this review.[b] The legal and institutional framework for the financial sector (banks, insurance) is also not covered, given that these sectors are regulated by a separate set of international principles. Likewise, the financial analysis does not always include financial institutions, as several financial indicators used to analyze them are distinct (e.g., capitalization, asset quality, exposure), or interpreted very differently from the real sector (e.g., profitability, liquidity). The report notes when state-owned financial institutions are or are not included as part of the financial analysis.

In Mozambique, commercial SOEs encompass *empresas públicas* (unincorporated entities with a social or commercial objective that are fully-owned by the state) as well as *empresas participadas* (shareholding corporations with a profit-making objective) which the state owns fully or else holds a stake, majority or minority. Such entities are described here under the umbrella term "SOEs". Due to data limitations, the study does not cover minority owned SOEs. The GoM does not collect information on these, nor does it monitor them.

The analysis uses data from the SOEs' audited annual financial statements. As such, the period of analysis—unless otherwise noted—ends in 2020, the latest year for which such statements were available.

The study draws on the diagnostic toolkit from the World Bank's Integrated State-Owned Enterprise Framework (iSOEF) for assessing the performance of SOEs. It assesses their rationale, economic implications, the factors enabling their operational efficiency, and options for reforming the sector. It also considers international examples of good practice in order to assess governance and fiscal risks. In particular, this chapter focuses on two modules of the iSOEF: *Fiscal Impact* (Module 2), which offers an assessment of main fiscal costs and risks from SOEs in Mozambique; and *Corporate Governance and Accountability Mechanisms* (Module 4), which examines the impact of governance practices on SOE performance. Both de jure (legal requirements) and *de facto* (actual practice) perspectives are considered. Actual practice was assessed through a questionnaire adapted from the iSOEF, analysis of the financial and economic data, and interviews with counterparts and the management teams of select SOEs.

a. (The World Bank, 2019).
b. Fundo de Investimento e Património de Abastecimento de Água.

This chapter provides an overview of the SOE landscape in Mozambique and makes recommendations for reforming the sector. Box 3.1 outlines the scope and methodology underpinning the analysis. In addition to assessing the overall SOE sector, the chapter also includes deep-dive analyses of the financial performance and fiscal impact of five key SOEs, selected for their significant actual or potential drains and risks to the state budget (Box 3.2 describes how these SOEs were chosen).

3.2 Overview of the SOE Landscape in Mozambique

The dominance of SOEs in the Mozambican economy is rooted in the economic model following independence. After gaining independence from Portugal in 1975, the government at the time embarked on a governance model that involved centralized economic planning and the nationalization of most large-scale industries. The state channeled public resources to companies under its control, and private sector participation in the economy was limited.[63]

During the 1980s, the state began to move away from central planning towards a market-based economic model, privatizing many SOEs. This was provoked by a sharp economic downturn in 1982 due to several factors, including the civil war and a severe drought. The government embarked on a structural adjustment program with the support of the international donor community and pivoted to a market-oriented economic model. Legislation to privatize a number of SOEs was first enacted in 1989, and technical units were established in 1991 to manage the process via public tender. By the end of 1997, 840 of the 1,248 SOEs had been privatized – over 90 percent of them small and medium-sized enterprises.[64, 65]

Today, SOEs and their subsidiaries are active in more than 30 sectors of the economy. According to the 2020 Country Private Sector Diagnostic (CPSD), *Caminhos de Ferro de Moçambique* (CFM), the national rail company, is a leading player in the private network of maritime ports and rail transport companies, as well as other highly regulated sectors. CFM also has shareholdings in cement, tourism, and financial services companies. The state hydrocarbons company—*Empresa Nacional de Hidrocarbonetos* (ENH)—also has several subsidiary companies, which is part of its strategy for expansion. Other public enterprises, such as Electricidade de Moçambique (EDM), Petróleos de Moçambique (PETROMOC), Mozambique Telecom (Tmcel), and Mozambique Airlines (LAM), have shareholdings in many other companies, reported as financial investments. Moreover, these entities often represent the state in large consortium projects, which require substantial capital commitment. Table 3.1 lists the companies in which central level SOEs are known to have an ownership stake.

The state is a smaller shareholder, both directly and indirectly, in numerous other companies; however, the rationale for state presence in these is questionable. The state holds additional stakes in at least 80 companies through direct minority ownership, and indirect shareholding or subsidiary arrangements. These are often commercial companies with no strategic mandate, with the cost (including opportunity cost) of maintaining them likely outweighing the benefits. Although some minority-owned companies pay dividends, the return of such investments tends to be low, much below the average cost of capital. Further, when the controlling shareholder of these companies requires a cash injection into those companies, the state (in its minority position) is often unable to meet the equity increase (due to liquidity constraints). Its shareholdings thus tend to become diluted in an adverse way by the controlling shareholders. Lastly, given IGEPE's (the shareholding entity) limited human resources and capacity, the state might wish to rethink its presence in some enterprises, notably its portfolio of minority shareholdings.

In some cases, public enterprises also exercise a regulatory function, presenting a conflict of interest. In the absence of a specific body dedicated to regulatory activities, public enterprises operating in a monopoly, such as CFM, also undertake regulatory responsibilities. A regulatory agency has been set up in the electricity and energy sector (ARENE), a positive step forward. However, it is not fully independent regulator, as it is under the administrative aegis of the Ministry of Mineral Resources and Energy (MIREME). Some of its decisions—including fuel pricing—are subject to approval by the Council of Ministers.

IGEPE's portfolio only includes companies in which the central government has a total full or majority stake and are classified into three groups:[66] (i) the *strategic structural portfolio* comprises profitable companies with high social impact, operating in a priority sector, such as natural resources, energy, infrastructure, transport, telecommunications, and finance; (ii) the *strategic social portfolio*, i.e., companies with high social impact but low profitability that are not in a priority sector; and (iii) the *economic and financial interest portfolio* i.e., companies with the potential for high economic impact and profitability, but lower social impact (IGEPE, 2019). Annex B lists SOEs in which the state has a full or majority stake, by portfolio and sector according to IGEPE's classification.

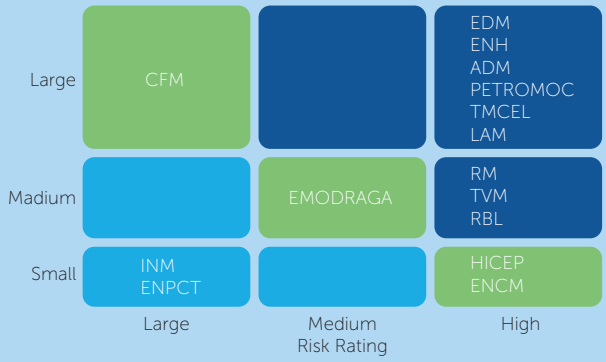
63 By 1981, the National Planning Commission had disbursed an estimated USD $800 million to public investment projects in several sectors including agriculture, transport, communication and construction (International Monetary Fund, 2001).
64 The technical unit established to manage the privatization of large and medium sized enterprises, the UTRE, was the precursor to IGEPE. Source: (AfDB/OECD, 2003)
65 According to a joint study by the African Development Bank (AfDB) and the OECD (AfDB/OECD, 2003).
66 This classification is set out in IGEPE's strategy for the state business sector for 2020-2030.

Box 3.2: Criteria Used to Select SOEs for Deep Dive Analysis

This chapter also includes deep dives, or snapshots, of the financial performance and fiscal impact of five SOEs selected for their significant actual or potential drains and risks to the state budget. These companies were chosen based on some key criteria. As a first filter, the size of the companies, as measured by their total assets, was considered. The top eight companies were passed through a second filter, looking at their total liabilities as a proxy for the actual and potential fiscal drain and risk they could pose. To further ensure that the companies selected were significant from a fiscal drain and risk perspective, additional analyses were conducted on their debt-to-equity ratio and adjusted debt. The figure below illustrates the selection exercise and the companies which passed each filter. These criteria align with the current risk rating methodology developed by the Fiscal Risk Department of the Ministry of Finance. According to this methodology, TMCEL ranks above LAM as its liabilities exceed LAM by approximately US$ 70 m. However, given LAM's liquidity issues and the contagion factor to other SOEs, it presents a much higher budgetary risk than TMCEL.

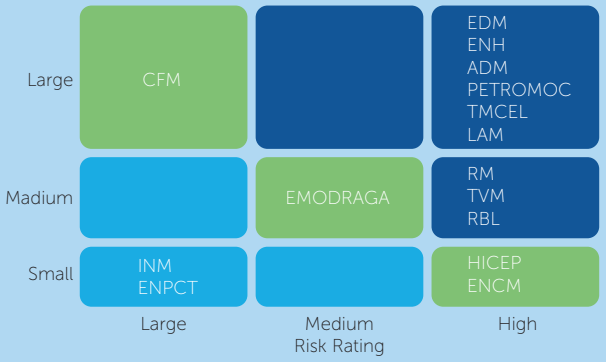
The team selected five companies because, given available time and budget, this was the maximum that could be analyzed in depth. For these companies, the PER presents reform scenarios and options to minimize fiscal risks.

Figure 3.1: Risk rating heat map



Source: Ministry of Economy and Finance.

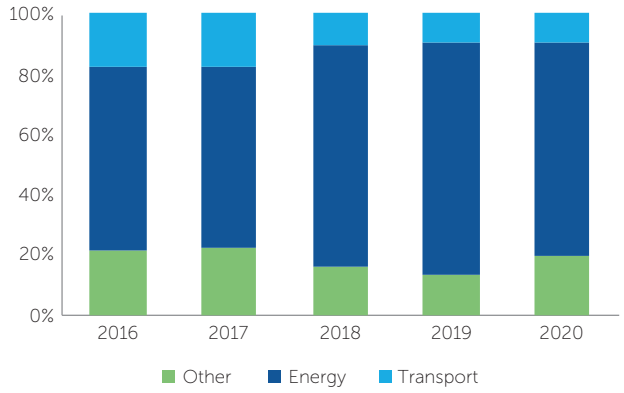
Figure 3.1: Risk rating heat map



Source: Ministry of Economy and Finance.

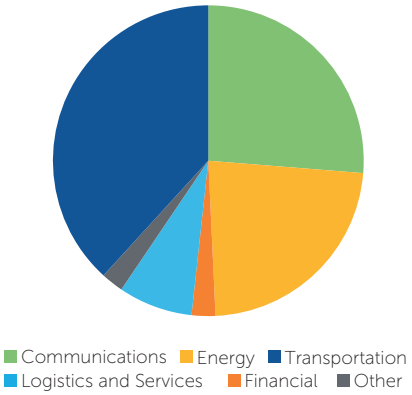
Source: Ministry of Economy and Finance.

Figure 3.2: SOE total assets by sector, 2016-2020



Source:

Figure 3.3: SOE employment by sector, 2021



Source:

Figure 3.4: SOEs reporting profits/losses and those with no data, 2016-2020

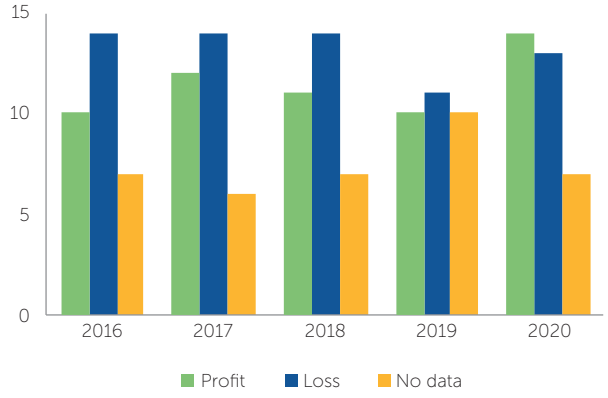
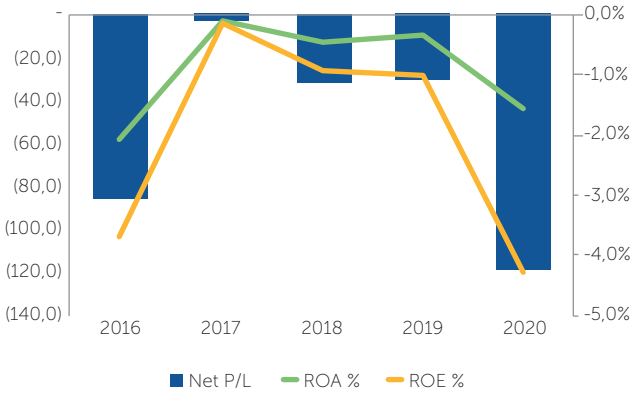


Figure 3.5: Profitability of the SOE sector in USD mil, 2016-2020 (majority and fully owned)



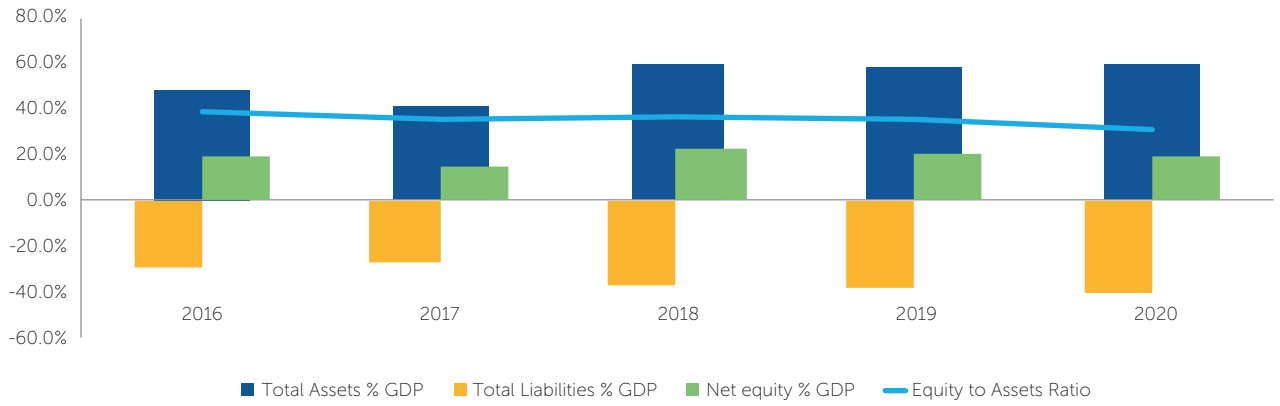
Source: World Bank calculations based on IGEPE and MEF data.
* Return on assets excludes the financial sector.
** Return on equity includes the financial sector, but no financial sector data were reported for 2019.

In terms of assets, the energy and mining sector dominates the SOE portfolio (Figure 3.2). The sector comprises some of the largest SOEs, among them EDM (electricity), ENH (gas), PETROMOC (fuel), and HCB (hydroelectric power plant), as well as somewhat smaller ones, such as EMEM (mining). The sector accounted for the vast majority of SOE assets, equivalent to nearly US$7 billion (or 46 percent of GDP) in 2020. Two of the more profitable companies are also in this sector (HCB and ENH), with the overall sector posting MZN 983.4 million (US$ 15.4 million) in net profit in 2020, equivalent to 73.6 percent of the entire SOE portfolio profit that year. In terms of total assets, transportation is the second largest sector, with just over MZN 6 billion (US$ 96 mn), or 10 percent of total assets. SOEs in this sector include CFM (railways and ports) and LAM (airlines). ADM, the airports and air traffic management company, is included in the logistics and services sector.

In 2021, SOEs employed approximately 17,000 workers, representing 1.5 percent of Mozambique's 1.1 million workers in the formal sector. While data are not complete (there are no employment data for seven of the 32 SOEs), the issue of bloated SOE payrolls does not seem to be a problem in Mozambique, unlike in many other countries. The largest share of SOE employment is in transport companies (6,639 employees), followed by communications (4,564) and energy (3,994). SOEs in other sectors employ fewer workers, as illustrated in Figure 3.3.

IGEPE has issued an investment strategy for the SOE sector for 2020-2030, a positive step towards clarifying the role of SOEs in the economy. Nonetheless, the rationale for state ownership could be enhanced, considering the potential adverse effects of SOEs on the market. As reflected in the World Bank's iSOEF and the OECD Guidelines on the

Figure 3.6: Net equity, assets, and liabilities of non-financial SOEs 2016-2020, as % of GDP



Source:

Corporate Governance of State Enterprises (2015), good international practice stresses the importance of the state carefully evaluating and disclosing the objectives that justify state ownership and subjecting these to regular review. It further recommends developing an ownership policy, setting out the rationale for state ownership, and clearly defining the public policy objectives that individual public corporations or groups of public corporations are required to achieve. While the strategy clarifies the rationale for state ownership (reflected in the categorization of the three portfolios described above), it does not seem to consider the potential and actual adverse effects of SOEs on market functioning and private sector participation. Considering whether SOEs are responding to a market failure, or whether the private sector could adequately provide goods and services, could be important as part of the investment strategy for the SOE sector going forward.

The market distortions created by the dominance of SOEs propped up by state aid have crowded out the private sector in some sectors. As discussed further in the individual SOE snapshots in Section 3.3, several of the largest SOEs rely significantly on transfers or other support from the state to operate. This creates an anti-competitive environment for other companies operating in or seeking to enter these markets, for example, the electricity sector, which EDM dominates. The recent CPSD also found that companies in the private sector faced significant constraints due to restrictive regulations, anti-competitive practices by SOEs and overlaps in the ownership, regulation, and management of SOEs. While promoting synergies among SOEs can be desirable in some cases, the state's approach to investment, as outlined in IGEPE's 2020–2030 strategy, could result in market distortions by compelling SOEs to contract with other SOEs rather than seek the best options in the marketplace.

Monitoring SOE financial information is currently limited to SOEs in IGEPE's portfolio, where the central government directly owns a majority stake or greater. IGEPE has made considerable efforts to improve data collection for SOEs in its portfolio during recent years. While IGEPE's coverage has been improving over the years for fully and majority-owned SOEs, they do not collect financial data for minority-owned SOEs, or the "second-generation" SOEs, i.e., those in which an SOE is the parent company. Further, some companies have not been reporting consistently or at all. For 2020, seven SOEs did not send financial data to IGEPE. In 2019, 10 companies did not report, including state-owned financial institutions. Figure 3.4 shows the number of companies that reported profits and losses over the previous five-year period, as well as those that did not report at all.

The SOE sector has been in a weak financial position and generating losses for the past several years. From 2016 to 2020, the SOE sector averaged losses of USD 54 million per year. In 2020, the overall portfolio suffered significant losses, which may be attributed in part to the COVID-19 crisis, as well as currency depreciation. As several SOEs have accumulated debt denominated in USD (and revenues in local currency), depreciation of the metical had a detrimental impact on their revenues. In 2020, the largest loss-makers were EDM (electricity), LAM (airways), TMCEL (telecom), ADM (airports) and PETROMOC (fuel distribution). On the positive side, HCB (hydroelectric power plant), CFM (ports and railways), and ENH (gas) were the largest profit-makers. Financial SOEs, namely *Banco Nacional de Investimentos*, BNI (bank), and EMOSE (insurance) made approximately US$25m in profits during 2016-2020.

The SOE sector's chronic lack of profitability is also reflected in its relatively low capitalization levels. The equity-to-asset ratio declined from 37 percent in 2016 to 30 percent in 2020, as shown in Figure 3.6. This means that as a shareholder, the state owns, on average, about a third of SOE assets, with the rest being leveraged. This illustrates the high indebtedness of the SOE sector – given their lack of profitability, they have had to rely almost entirely on borrowing to fund their capital investment.

3.3 Assessment of SOEs' Fiscal Costs and Risks

This section provides a snapshot of the fiscal costs and risks posed by the five SOEs selected for a deep-dive analysis ("focus SOEs"), and suggests reforms to reduce the costs and mitigate the risks. It begins by assessing the nature of fiscal costs and risks posed by the five focus SOEs, and provides a quantitative analysis of the most significant risks. The five SOEs were selected using the criteria described in Box 3.2. Some deliver core public services vital to social development outcomes for citizens (e.g., the national electricity provider), while others manage vital infrastructure (e.g., airports and air navigation). Sub-sections then present detailed assessments of each of the five focus SOEs in turn. Section 3.5 outlines tailored suggestions for financial and economic reforms to reduce the fiscal cost and risk they pose.

The total fiscal cost of the SOE sector and the risks it poses are not fully identified or quantified. There are three main issues. First, the scope of companies being monitored—i.e., wholly and majority owned SOEs, with direct state ownership—does not comprise all those which may pose a high fiscal cost or risk. Second, the information collected is not comprehensive enough to cover the range of fiscal costs and risks SOEs may pose. Third, there are sometimes discrepancies in data. For example, the data contained in the audited financial statements of SOEs do not always align with data contained in spreadsheets and reports issued by IGEPE, or different directorates within MEF, or budget documents.

IGEPE and MEF do track some types of support, such as on-lending, guaranteed debt, and direct subsidies. Other kinds of support, however, are not being followed. For example, some guaranteed debt is being serviced directly by the state to the bank. A more transparent channel would be for the state to pay the SOE, who in turn pays the bank (as the debt sits on the SOE balance sheet, not on the state's). Equity injections are also not always transparent, as sometimes this is done directly by the state, and other times, via IGEPE. Furthermore, there is no monitoring of arrears between SOEs and the state, or among SOEs (e.g., tax, customs duty and social contribution arrears, and non-payment of goods and services delivered by SOEs as electricity, fuel, airport taxes, etc.). Other types of contingent liabilities, such as lawsuits, are not identified or monitored. Further, in the absence of a dividend policy, it is difficult to plan and budget for expected revenues.

The five focus SOEs held assets equivalent to over 40 percent of GDP in 2020. They are a mix of *empresas públicas* and joint-stock companies, and the state has at least a majority stake in all of them. All five companies are characterized by weak operating results and cash flow constraints. The debt-to-equity ratio for the past five years has been troublesome. ADM, LAM and PETROMOC had negative ratios in 2020, meaning their liabilities exceed their assets. If they were not state-owned, they would have likely gone into bankruptcy. EDM and ENH have high ratios. The implication for EDM was a large debt conversion into equity in 2021. On the other hand, due to the structure of ENH and the design for the company to participate in the gas projects, it may never generate any positive cash flow, as the dividends from those projects will be entirely used to service its debt.[67] Strategic SOEs such as LAM (airline), ADM (airports) and PETROMOC reported negative equity in 2020 i.e., the value of the companies liabilities exceeded that of their assets.

Table 3.1: Overview of SOEs in Mozambique, 2020, in USD millions

	A	B	C (A-B)	D	E	F	G	H	D/C
Company	Total assets	Total liabilities	Net worth (shareholder's equity)	Adjusted net profit[1]	Adjusted debt[2]	Direct subsidies	Dividends	Employ-ment	Debt/ equity ratio
ADM (Airports)	471.1	484.2	(13.1)	(46.0)	278.3	10.4	0.0	758	-3702%
EDM (Electricity)	3,391.3	2,434.8	956.5	(123.3)	995.8	0.0	0.0	3,271	255%
ENH (gas)	1,215.8	1,018.4	197.5	20.8	898.7	0.0	4.5	201	516%
LAM (Airlines)	53.3	282.5	(229.2)	(80.8)	100.1	4.1	0.0	819	-123%
PETROMOC (Fuel)	336.5	355.2	(18.7)	(21.2)	271.8	0.0	0.0	491	-1902%
Total	5,468.1	4,575.1	893.0	(250.5)	2,545	14.5	1.3	5,540	
% of GDP	41.9%	35.0%	6.8%	-1.9%	19.5%	0.1%	0.01%		
% of SOE sector	67.1%	82.4%	34.3%	225.4%				32.7%	

Source: IGEPE and WB staff calculations. All data for 2020, except employment (2021).
1/ Net income adjusted for non-cash and non-recurring items.
2/ Debt adjusted for arrears with other entities.

67 The State issued a guarantee of USD 2.25 billion allowing the national hydrocarbons company (ENH) to participate in a consortium that will explore natural gas in the north of the country. While the full extent of the guarantee has not been committed, the impact on the national budget if the potential fiscal risks from ENH are realized would be severe.

The annual fiscal drain of the five focus SOEs has averaged approximately US$ 227m over the past five years, and their combined stock of direct and contingent liabilities to the state and other SOEs is estimated at US$ 2.2b in 2020. This represents a *de facto* subsidy given to the SOE sector each year on a rather *ad hoc* basis. However, this subsidy is not necessarily well targeted since subsidies for airlines, airports, fuel, and LNG may be quite regressive and do not benefit the poor. To put this into perspective, USD$ 227 million in yearly outflows would be enough to cover the education spending of approximately 1.25 million secondary students in Mozambique for a year.[68]

While SOE debt is broadly trending down, cross-debts among SOEs and arrears to the state or other SOEs are a significant concern. After the debt crisis, liquidity to SOEs dried up since commercial banks were no longer willing to lend to them. Therefore, some SOEs have been delaying payments to the state or to other SOEs to manage these liquidity constraints. The study found evidence of significant cross-debts among SOEs. For example, the failure of the national airline carrier (LAM) to settle its bills is causing financial distress for other SOEs that supply it with vital services, such as the airport infrastructure management company (ADM) and the main fuel distributor (PETROMOC). LAM owes an estimated USD 110m in total to ADM and PETROMOC, representing 45 percent of LAM's current liabilities and 34 percent of its total liabilities. EDM, another relevant example, owes an estimated USD 190 million in total to HCB, which represents 19 percent of EDM's current liabilities and 7 percent of total liabilities. Other SOEs are in arrears to the state for tax, customs duties and social security contributions. Combined with the existing financial debt, these arrears contribute to the high fiscal risks posed by the sector as a whole.

Table 3.2: Fiscal costs and risks of five focus SOEs 2016-2020, in USD million

	2016	2017	2018	2019	2020
A. Inflows to budget from SOEs	15.5	2.8	0.0	4.9	4.5
Tax Payments	15.5	2.8	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	4.9	4.5
Outstanding items / arrears	0.0	0.0	0.0	0.0	0.0
B. Outflows from budget to SOEs	426.7	186.0	180.7	88.8	278.4
Tax arrears	2.3	42.6	53.7	23.9	48.8
Equity / capital injection	0.0	0.0	0.0	0.0	0.0
Guaranteed Debt	79.9	7.4	10.7	15.3	24.9
On-lending	217.3	11.0	21.0	17.2	67.0
Arrear with other SOEs	114.8	125.0	83.4	26.5	133.5
Subsidies	12.3	0.0	11.9	18.5	14.5
C. Net budgetary flows (A - B)	-411.2	-183.2	-180.7	-96.5	-284.3
D. Stock of contingent liabilities	1,400	1,734	1,963	2,089	2,232
Guaranteed debt	551	600	610	558	506
On-lending	465	658	714	870	996
Tax arrears	11	48	137	151	168
Arrears with other SOEs	374	427	501	511	562

Source: Staff calculations, based on the audited financial statement data from the five largest SOEs, 2016-2020.

Table 3.3: Fiscal costs and risks of five focus SOEs 2016-2020, percent of GDP

	2016	2017	2018	2019	2020
A. Inflows to budget from SOEs	0.13%	0.02	0.00%	0.03%	0.03%
B. Outflows from budget to SOEs	3.55%	1.41%	1.22%	0.66%	2.06%
C. Net budgetary flows (A - B)	3.42%	1.39%	1.22%	0.63%	2.03%
D. Stock of Contingent Liabilities	11.64%	13.12%	13.22%	13.67%	15.92%

Source: Staff calculations, based on the audited financial statement data from the five largest SOEs, 2016-2020.

68 Secondary education spending in Mozambique was approximately USD 181 per student in 2020 (see Chapter 4)..

If the current performance trajectory of the large, loss-making SOEs is maintained, transfers from the national budget are forecast to balloon in the coming years, absorbing valuable scarce funds that may have otherwise been directed towards more productive uses. For example, the price of fuel is regulated and has been subsidized by the state at certain moments. The state-owned fuel distributor, PETROMOC, does not generate sufficient revenue to pay for fuel imports to meet demand and relies on transfers from the state. PETROMOC is projected to require annual budgetary support of USD 124m to finance fuel imports, assuming current international oil prices of US$106 per barrel and no adjustments in pump prices.

Public sector obligations (PSOs), or quasi-fiscal activity, are at the root of many of the fiscal risks posed by the SOE sector. The SOE Law stipulates that the costs of PSOs should be covered by the state (Article 17 of the SOE Regulation). However, these provisions do not require SOE reporting of performance against social objectives as distinct from profit-making objectives. The law also calls for correlating subsidies and transfers from the state to SOEs to the national budget and specific goals.[69] However, in practice, the state does not necessarily fund PSOs, nor does it estimate service delivery costs by the enterprise. The SOE Law requires that enterprises with PSOs sign a performance contract with the government, which should delineate the rights and responsibilities of both parties; however, since the first of these have just been issued, it is premature to evaluate their effectiveness.

Despite significant improvement in fiscal risk reporting in recent years, there is still a lack of timely and reliable information to inform fiscal risk decision-making. The Ministry of Economy and Finance (MEF) now issues annual fiscal risk, credit risk, and debt reports, including on the SOE sector. These represent a significant positive step toward greater transparency and accountability. Nonetheless, some actions could be taken to strengthen the process. For one, the data on fiscal risks are somewhat dispersed across several different spreadsheets, which are sometimes not consistent. Some inconsistencies could be identified when analyzing data presented by IGEPE, MEF, and the SOEs themselves (in their audited, annual financial statements). Furthermore, there is a lack of transparency, as not all reports are publicly disclosed.

The following sections provide a more in-depth analysis of the five focus SOEs

Aeroportos de Moçambique (ADM)

ADM is a fully-owned SOE with a mandate to manage airport infrastructure and the air traffic navigation system. ADM's operations can be divided into two main business lines: aeronautical services, which include managing the flows of passengers/cargo and navigation control of Mozambican aerospace; and non-aeronautical services where ADM explores the commercial areas of the nine airports and 11 airfields across the country. Around 85 percent of ADM's revenues come from aeronautical fees, with passengers and navigation fees the main contributors. The remaining revenues classified as non-aeronautical derives from leasing agreements, vehicles parking fees, and publicity fees, among others.

Current net debt/equity ratio is around 17x, and the company is in technical default (negative equity). Over 55 percent of ADM's debt burden stems from the construction of the Nacala airport, which has been loss-making since its opening in 2016 (Figure 3.7). Although ADM was not a highly profitable company, given the nature of the airport industry (capital intensive, high margins), prior to the Nacala airport project, most of its fiscal risks were mitigated. The company held legacy assets and was only lightly leveraged. However, to finance construction of Nacala airport, ADM took out a loan of USD 300 million, largely from the Brazilian Development Bank, BNDES. As a result, over 80 percent of ADM's debt is denominated in US dollars and there is a lack of viable options on the market to hedge against such exposure; thus, the company is vulnerable to foreign exchange fluctuations between the dollar and the metical. Moreover, given its weak operating results, financing options other than transfers from the national budget are unlikely.

Operating results are strongly affected by the inability to collect payments adequately from its primary customer, LAM. PSOs also contribute to weak results. The national airline (LAM) has been accumulating arrears with ADM for years, totaling nearly US$70mn in 2020. LAM, the only airline that serves the domestic market, has consistently failed to settle its bills, and has not passed along the passenger fees it collects on ADM's behalf. Despite efforts to improve payment collection from LAM, ADM seems to be impaired by non-executive decisions.

On a much smaller scale, ADM's obligation to keep unprofitable airfields open and operational puts additional pressure on the company's results. ADM has already identified airfields that post negative results and will likely remain that way in the short/medium-term, mainly due to lack of demand. Closing these airports could reduce some pressure on the company's cash flow, but given the nature of the airport business—which is capital-intensive and light on operational expenses—this would only make a small contribution.

ADM is expected to rely on the budget to cover its negative operating cash flow and amortize loans. Assuming no major changes in operational performance, ADM is expected to

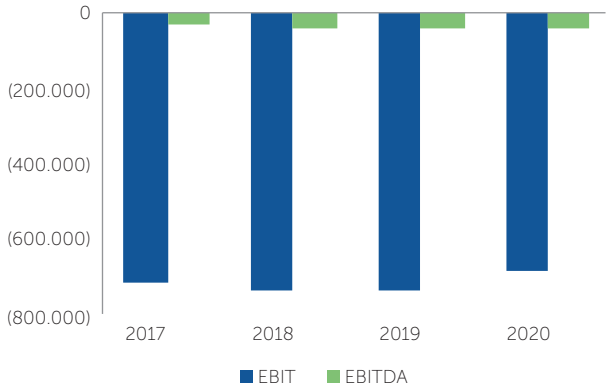
69 Article 21 of Law No. 3/2018 discusses performance contracts between the SOE and the state.

Table 3.4: ADM's key financial indicators (USD m)

Indicator (US$ m)	2019	2020
Shareholder's equity	178.7	-14.2
Shareholder's equity w/o asset re-evaluation	-77.7	-102.5
Net debt/EBITDA	8.0x	16.9x
Net debt/Adj. EBITDA (LAM late payments)	9.2x	22.8x

Source:

Figure 3.7: Operating results for Nacala airport



Source:

generate an average annual cash gap of US$4mn between 2021-2025. The estimates indicate that the cash generated by operating income will be entirely used to pay financial expenses and to finance LAM's balance sheet. Considering that a minimum maintenance capital expenditure will be disbursed to avoid disruption to operations, the company may need to find a source to finance this cash gap. The current debt amortization schedule points to an annual average cash consumption of US$ 55mn between 2021 and 2025. As the cash position and the operating cash generation will not be enough to fulfill these obligations, ADM also needs to find resources to address this cash issue. ADM needs an average annual cash inflow of nearly US$ 60mn for the next five years, mostly to pay down loans with sovereign guarantees. The highly leveraged balance sheet and operation distress ADM has been facing in recent years suggest that the shareholder may be the only viable option to avoid ADM's bankruptcy and the cash inflow may have to come from the government budget.

The GoM should consider embarking on a de-leveraging exercise for ADM to make the company viable again. This would require converting ADM's debt into equity as ADM's operating cash flow will not be able to sustain the debt service. In addition, the GoM is better positioned to negotiate more favorable rates and maturities with lenders, reducing its financial cost and extending maturities.

To improve the operational performance of ADM, arrears from LAM needs to be addressed. Despite the need to improve other sources of inefficiencies, it is essential that ADM receives passenger fees collected by LAM and is paid for the airport services provided in a timely manner.

Concession arrangements for its profitable airports with an experienced private operator could be considered as an alternative. An experienced private operator could unlock value from real estate opportunities, improve results from commercial areas of the airport and avoid build-up of arrears from clients, which jeopardize the company's financial results. Additionally, the expected concession fees received by ADM alongside revenues from the air navigation services which must remain under state control for national security purposes, could cross subsidized unprofitable airports if these are maintained.

Four different scenarios have been considered (Figure 3.25).[70] The status quo (S1) assumes that no significant measures are taken. S2 assumes that the guaranteed debt and on-lent loans are converted into equity. S3 assumes that LAM normalizes the payments to ADM. S4 features a combination of S2 and S3.

Electricidade de Moçambique (EDM)

EDM is the fully state-owned SOE responsible for transmission, distribution and commercialization of electricity in Mozambique. The company also generates electricity, but it relies on IPPs (Independent Power Producers) for most of the supply in Mozambique. The IPPs and EDM have contracts defining volumes and prices. As prices are denominated in USD the cost structure of EDM is strongly affected by foreign exchange fluctuations.

Lack of timely and systematic application of tariff increases has been a major challenge to the company's financial sustainability. The GoM has enacted several tariff adjustments, with average domestic tariffs increasing by more than 150 percent between 2015 and 2020. However, since electricity tariffs are set by the Council of Ministers, without pre-defined methodology and schedule, there is little clarity or predictability over tariff reviews and adjustments. When costs rise due to uncontrollable factors and tariffs are not adjusted accordingly in a timely manner, EDM bears the financial losses (referred to as regulatory losses). One positive step has been the creation of a regulatory agency (ARENE),

70 The analysis does not consider a scenario with a concession arrangement.

Figure 3.8: Four scenarios for improving ADM's financial sustainability

Source:

which was given the mandate to establish and implement a new methodology for setting and adjusting tariffs to domestic consumers. This new methodology is expected to be approved by mid-2022 and ARENE would become the sole entity to systematically apply it and set tariffs.

EDM has accumulated arrears given its highly leveraged balance sheet and weak operational performance. Current net debt/recurrent EBITDA[71] is above six times, and if net debt is adjusted for arrears with suppliers the ratio reaches over 24x (Table 3.5). As EDM has not been generate enough cash to fulfill its liabilities and the weak balance sheet restrains access to credit lines, it has been accumulating arrears with its main suppliers. The estimated amount owed to suppliers by the end of 2021 was above USD 500m.

EDM's posted stronger financial and operational performance in 2021. This was largely due to a conversion of over USD 700m of on-lent loans to EDM which were converted into equity by the GoM. In addition, the State taking over EDM pension liabilities. These were also supported by improvements in financial management practices and electricity volumes growth driven by electrification. In 2021, despite the contribution to deleverage EDM's balance sheet, the cash impact on EDM's accounts is limited. The company continues to be highly leveraged, and liquidity is still a major challenge. Notwithstanding, it was a relevant step towards improving EDMs balance sheet.

EDM, as the sole electricity distributor in Mozambique, is expected to deploy investments to increase the population's access to electricity. The clear need to expand access to electricity has been prioritized by GoM through the approval by Council of Ministers of a National Electrification Strategy (NES). NES allocates GoM the responsibility to drive the electrification agenda, prioritizing investments and providing the financial resources needed to implement them, but whenever financial resources are not provided by the GoM, EDM needs to use its own balance sheet to fulfill the required investments.

71 EBITDA, or earnings before interest, taxes, depreciation, and amortization, is used as a measure of a company's financial performance.

Table 3.5: EDM's key financial indicators (US$ million)

	2020	2021 (E)
Shareholder's equity	1,036	1,805
Net debt	992	202
Net debt/recurring EBITDA (x)	57.4x	6.5x
Net debt (including arrears) /recurring EBITDA (x)	86.5x	23.8x
ROE (%)	-12.9%	-3.0%
ROA (%)	-3.6%	-1.4%

Note: ROA=Return on assets; ROE=Return on equity.

Figure 3.9: Effective domestic tariff increase

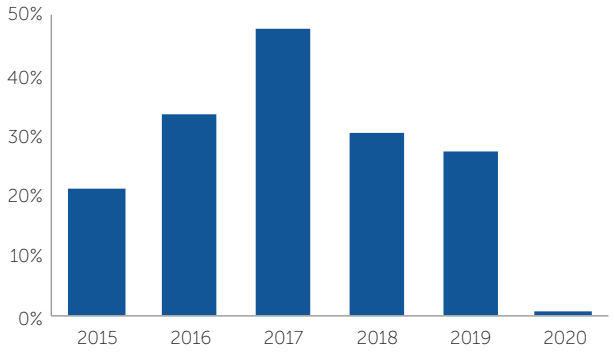
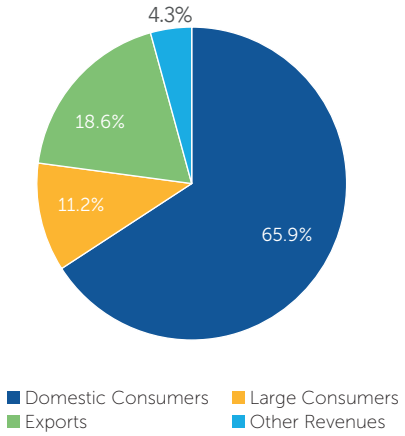
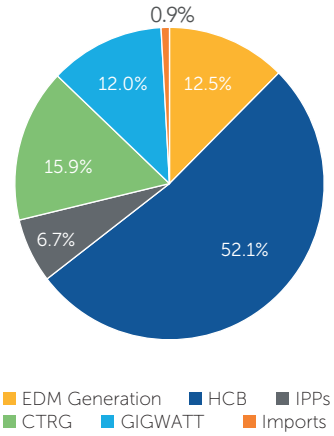


Figure 3.10: EDM's revenue breakdown 2020



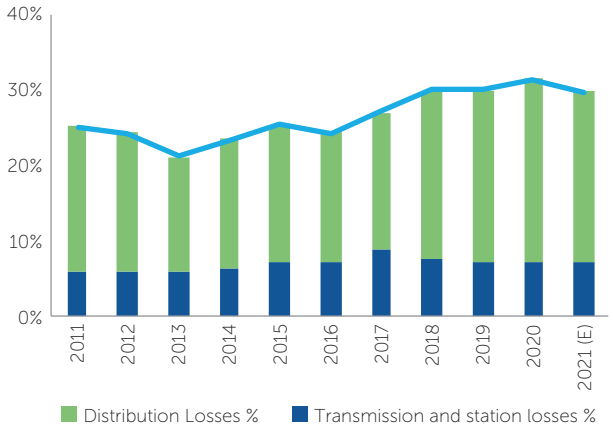
Source:

Figure 3.11: EDM's supply breakdown 2020



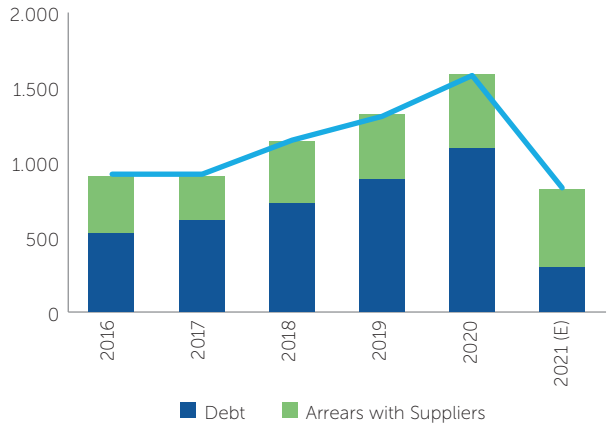
Source:

Figure 3.12: Operating losses as % of gross electricity



Source:

Figure 3.13: Adjusted debt to arrears, in USD m



Source:

EDM is required to nearly double its purchases of electricity from IPPs. If operational losses and the tariff model are not addressed, this would further exacerbate the company's financial situation and pose fiscal risks to the state. If the additional capacity that EDM is obliged to purchase from IPPs in the future suffers from similar levels of operational losses (30 percent), and if the tariff model is not calibrated, EDM's net losses may reach over US$160m per year. EDM's total purchased/produced electricity is expected to nearly double by 2025 due to new IPPs, which may exacerbate its financial troubles. Increasing exports would be one way to reduce these losses (as exports incur much lower operational losses than electricity for domestic consumption and are not subject to tariff restrictions). However, this perhaps runs contrary to the objective of expanding access to electricity in the domestic market.

Defining and implementing a new tariff methodology based on cost recovery is essential to achieve and sustain in time the financial viability of EDM. Establishing ARENE as a regulator and advancing on defining the new methodology are relevant steps, but still not enough to guarantee that domestic tariffs will reflect an efficient cost structure for EDM. As seen in the fuel distribution market where ARENE is also the regulator, the methodology that decides prices to consumers can be overruled at the discretion of ARENE's board of directors through not technical decisions.. Such discretion should be avoided, as it opens up space for possible government interference and may result in tariff adjustment delays, or adjustments that do not fully recover unmanageable costs.

PSOs need to be adequately quantified and fully covered by the GoM. Such investments should be funded by the Government rather than via EDM's balance sheet, so as not to compromise EDM's financial sustainability and to bring transparency and accountability of company's commercial performance.

Three different scenarios are considered (Figure 3.26). The status quo (S1) assumes that no significant measures are taken. S2 assumes a forex shock of 20 percent to indicate the risk of not having a cost recovery methodology to adjust tariffs, and S3 where tariffs are adjusted within the new methodology and EDM's guidance of operational improvements is achieved in five years.

Figure 3.14: Three scenarios for improving EDM's financial sustainability

Source:

Linhas Aéreas de Moçambique (LAM)

LAM is the flagship airline of Mozambique. The state has a stake of 96 percent, with the remaining 4 percent held by employees. Although the GoM opened the domestic market to other players, in 2017, LAM is currently the sole airline serving the domestic routes. FastJet and Ethiopian Airlines were the key competitors just after the end of the monopoly in 2017, but both ceased their operations in 2019 and 2021, respectively, indicating the low attractiveness of the sector in Mozambique. LAM also operates regional flights in the African continent and holds commercial partnerships with international airlines.

Nearly 85 percent of LAM's revenues come from ticket sales to passengers, with domestic routes contributing 73 percent and regional routes 12 percent. Cargo transportation, mail services, and loyalty program revenues comprise the remaining 15 percent of LAM's total revenues.

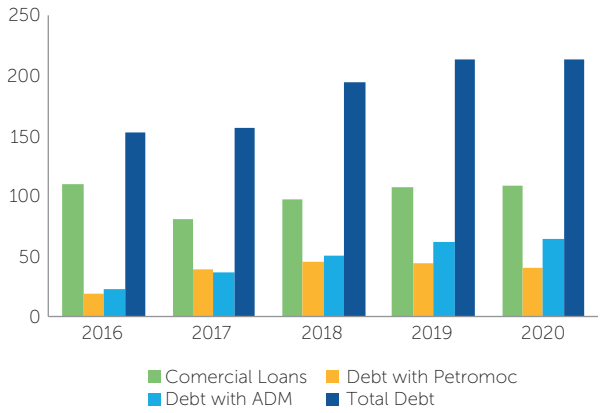
LAM's balance sheet is highly leveraged, and the lack of credit access has led LAM to fund its operations through arrears to SOEs and the government. LAM has been in technical default (negative shareholders' equity) since 2015; its operating results have also been negative since 2014, rendering most financial ratios meaningless. As of December 2020, LAM posted a debt position of nearly US$117mn, of which over US$61mn carry a sovereign guarantee issued by the GoM. Additionally, LAM's cost of debt is above 20 percent leading to high financial expenses on its income statement.

In addition to commercial debts, LAM has increasing arrears with other SOEs. For years, PETROMOC supplied jet fuel to LAM without receiving payment. In addition, LAM suspended airport fees payments to ADM and stopped passing along the boarding fees collected from passengers on behalf of ADM. In 2018, PETROMOC sold its jet fuel unit to a private player (Puma), aiming to stop being forced to supply fuel to LAM, but the arrears to ADM are still building up. Currently, LAM owes over US$43mn to PETROMOC and near US$69mn to ADM.

Table 3.6: LAM's key financial indicators (US$ million)

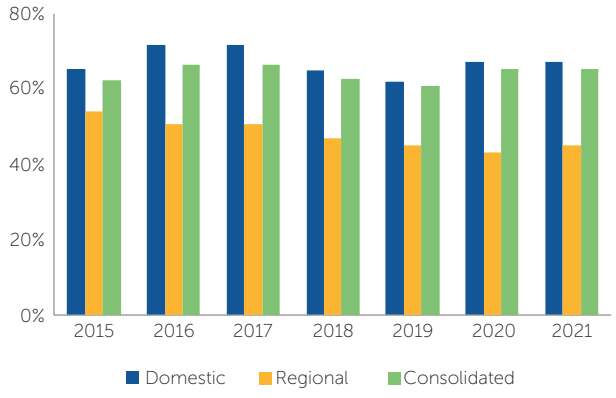
	2019	2020
Shareholder's Equity	-189.0	-248.4
Net Debt	105.7	106.3
Net Debt/EBITDA	-4.4x	-1.7x
Adj. Net Debt	212.1	210.7
Adj. Net Debt/EBITDA	-8.9x	-3.4x
Debt with PETROMOC	44.8	40.4
Debt with ADM	61.6	64.0

Figure 3.15: Debt breakdown (US$ million)



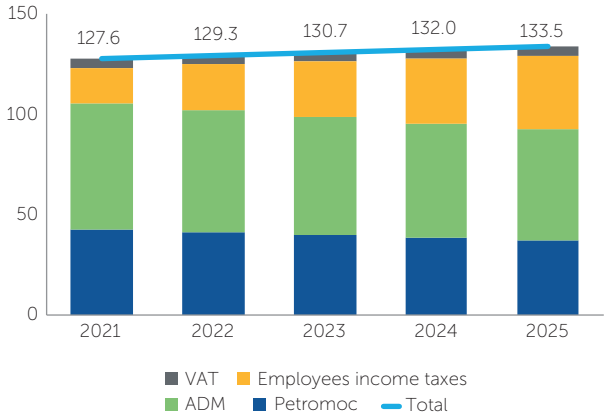
Source: IMF.

Figure 3.16: Load factor



Source: IMF.

Figure 3.17: Stock of arrears, in US$ million

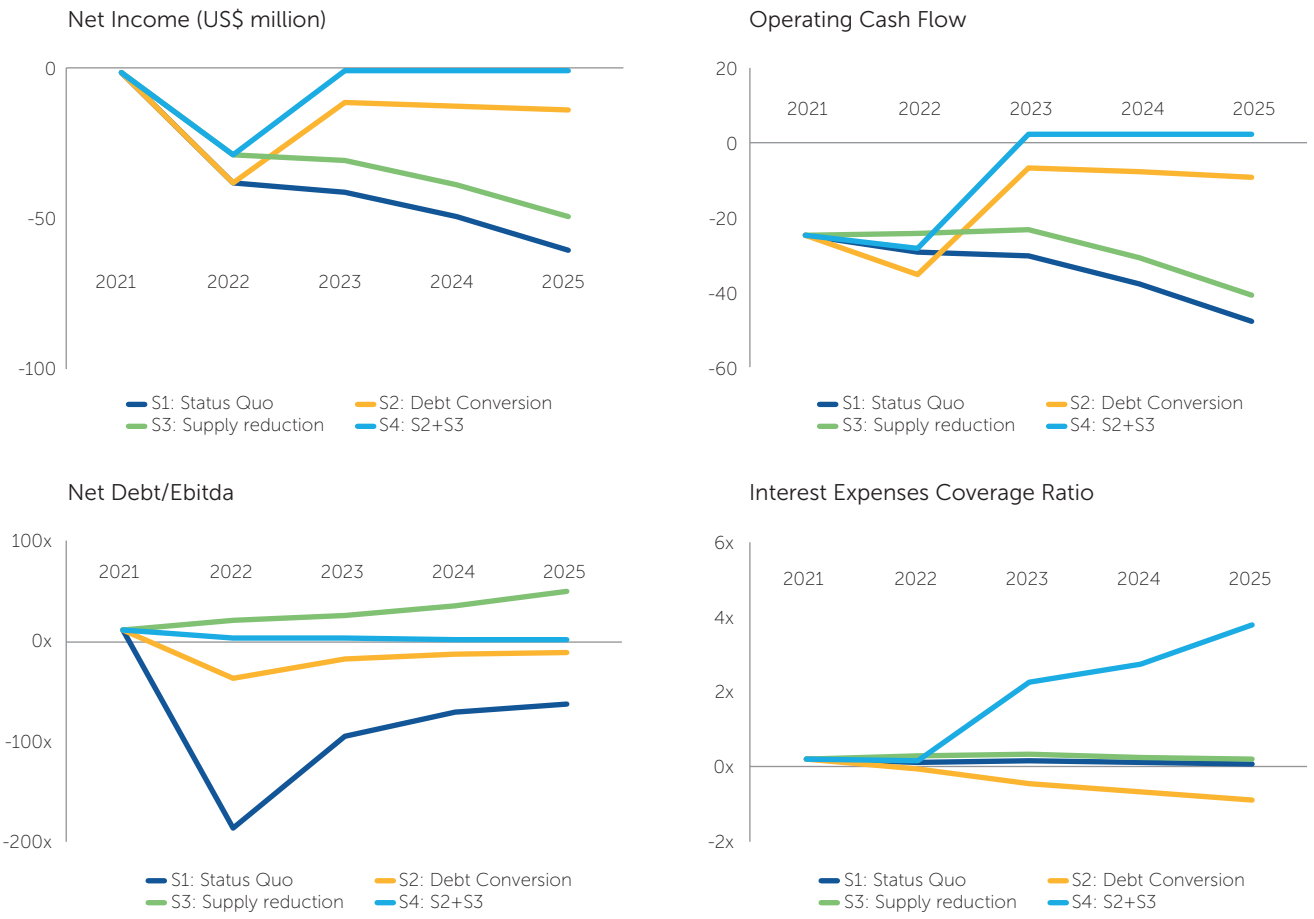


Furthermore, LAM has built up tax arrears (VAT) and has not been transferring employees' payroll taxes it has withheld from employees onto the state. In 2021 the amount owed in VAT taxes and payroll taxes withheld are estimated to have reached US$5mn and US$17.5mn, respectively. Such arrears started to increase significantly when PETROMOC stopped supplying fuel for LAM, hence LAM had to start paying for fuel and find another source of funding. This demonstrates that until a sustainable solution is found to address LAM's financial position, the state will continue to provide support on an ad-hoc basis, through costly and opaque channels.

Operating results have been below break-even since 2014, and a strong turnaround seems unlikely. LAM's weak financial performance is partly due to public service obligations (being required to fly certain domestic routes at a loss) and inefficiencies and mismanagement. Some routes are served with low demand at low yields, leading to a weak load factor and generating strong losses for the company. But operating results cannot be exclusively explained by PSOs, as LAM has also been serving regional destinations with very weak results, where average load factors are historically below 50%. EBIT and EBITDA margins have been deeply negative since 2015. The effects of Covid-19 deteriorated further the company's operational performance but are not the main explanation for the weak results.

Assuming LAM will continue to operate as is, state support, in the form of subsidies, taxes forgone, and a possible equity injection is expected to rise. Alternatively, LAM may continue increasing arrears with ADM. LAM has signed a performance contract with the GoM ("*Contrato Programa*") to receive direct subsidies to partially cover unprofitable routes the company is forced to fly. Over four years (2021–2024) a total amount of US$13mn is expected to be paid to LAM by MEF. In addition, LAM is expected to continue to accumulate payroll liabilities to finance its operations. World Bank calculations estimate annual average payroll contributions forgone of US$7mn, which would keep the same pace of previous years.

Figure 3.18: Four scenarios for improving LAM's financial sustainability



Source:

Subsidies and arrears are not enough to close the cash gap in LAM's operations; additional support from the GoM is likely to be required. Assuming that subsidies will continue to be paid according to the performance contract with the GoM and taxes forgone will remain the same as in previous years, World Bank calculations estimate that between 2020 and 2025 an additional US$28 mn will be required annually, on average, for LAM to fulfill its debt service and continue its operations. As it seems unlikely that LAM will have access to corporate credit, the only options that can now be foreseen to close this cash gap are either some sovereign guaranteed loan or an equity injection by the GoM.

The state should consider embarking on a de-leveraging exercise for LAM to improve the financial situation of the company and reduce fiscal risks. This approach suggests LAM's high-cost guaranteed debt is assumed by the GoM and converted into equity. The main rationale is that the GoM is better positioned to negotiate with lenders. Given that, since 2021, LAM's financial expenses have already been paid directly from the state budget, renegotiating the terms of the loans as a sovereign state rather than as an insolvent SOE should translate into lower financial expenses and longer maturities. Additionally, the state could also consider assuming LAM's debt to ADM and PETROMOC, thereby absorbing the spillover effects to the wider SOE portfolio and cleaning up the balance sheets of affected SOEs.

To improve operating results, LAM could prioritize profitable routes and reduce the capacity on unprofitable ones. Regional routes which are historically unprofitable, and domestic routes, could be trimmed down, resulting in higher load factors and profitability. LAM could still explore regional and international routes through commercial partnerships with other airlines, leading to some revenue generation, no operating costs and as a feeder to its domestic routes. Routes the GoM consider as PSOs, and therefore cannot be eliminated, should be reduced to minimum levels and the losses generated by these routes be adequately quantified, disclosed, and fully subsided by the GoM.

Figure 3.27 explores the impact of four different scenarios on LAM's possible financial sustainability: Status quo (S1) assumes that nothing material is changed. S2 assumes that high-cost debt is converted into equity. S3 assumes reduction of regional and domestic routes. S4 combines S2 and S3.

Petróleos de Moçambique (PETROMOC)

PETROMOC is the largest fuel distributor in Mozambique. The state controls the company with 80 percent equity share, with the remaining 20 percent held by employees. The core business of PETROMOC consists of importing, storing and distributing fuel and lubricants to retailers (pump stations) across the country and large customers. PETROMOC also has a small footprint (5 percent of revenues) in fuel exports to neighboring countries. Domestic fuel distribution represents over 80 percent of PETROMOC total sales, a market in which it competes with private sector companies (including several international oil companies such as Total and Galp). While it has been the market leader for many years, its market share has nearly halved, from 44 percent in 2015 to 23 percent in 2021.

Fuel price regulation has a significant impact on PETROMOC's finances. It results in a de facto subsidy to end-users, which is weakly targeted, regressive, and costly to the state budget. Fuel prices are highly regulated. They are set by ARENE (regulatory agency) on a monthly basis and released on the third week of each month. Fuel distribution companies recognize revenues according to the current formula price (i.e., income statement revenues), but the actual revenues (i.e., cash flows) are based on the pump price, which is not always aligned with the formula price. The price gap between the formula and pump prices is called a regulatory deficit when pump prices are below the formula price, and constitutes a de facto subsidy to fuel consumers. This generates a liability of the GoM, and fuel companies are put in a precarious situation in which they are not sure when the state will reimburse them for this gap in prices. As a result, the financial statements of PETROMOC may be difficult to interpret, as its revenues will show a much higher level than the actual cash collection, and this gap between revenues and cash collection will be carried on PETROMOC's balance sheet as assets against the GoM, being hard to predict when they will turn into cash.

PETROMOC's balance sheet is highly leveraged and operating cash flow is not sufficient to service its debt, which is guaranteed by the GoM. PETROMOC's current net debt/EBITDA ratio is over 4x, and the company is in technical default (negative shareholder's equity). To enable PETROMOC to service its high-cost commercial debt (interest rate of 18 percent), the GoM allowed PETROMOC to stop paying customs taxes on fuel for the past few years. As a result, an estimated US$50mn of tax receipts is foregone by the state each year, and the accumulated amount on PETROMOC's balance sheet was near US$170mn by the end of 2020. Adjusting PETROMOC debt to these liabilities results in a current net debt/EBITDA ratio of nearly 10x.

PETROMOC's distressed financial position is caused by weak operating results and strong government interference in the sector. PETROMOC's high-cost structure, low asset utilization, and a weak strategy for operating in regions far from the coast are key factors that hinder profitability. Despite being the largest fuel distributor in the country, which should lead to some gains of scale, PETROMOC posts costs per liter up to 2x higher than its major competitors. Part of this inefficiency

is historically explained by a low asset turnover and by weak management decisions on how to operate in the countryside of Mozambique. Additionally, PETROMOC was also used in the past to supply SOEs and other entities of the GoM without collecting payments for the goods sold. As the fuel distribution business has a low operating margin, such unpaid receivables add considerable cash constraints for the company. Such interference is currently not observed, but the legacy of these weak policies persists on PETROMOC's balance sheet and partially explains PETROMOC's current financial position.

PETROMOC is expected to continue dragging resources from the government budget through taxes forgone to keep servicing its debt. Taxes forgone to enable PETROMOC to pay down its high-cost debt with commercial banks are estimated at an annual average of US$35mn for 2022 and 2023. By the end of 2023 PETROMOC may be free of interest-bearing debt, but it will have accumulated a total amount over US$280mn of delayed tax payments with GoM. These calculations assume a hypothetical scenario where no subsidies are given to final consumers using fuel distributors' balance sheet.

In a scenario where the GoM decides to continue subsidizing fuel prices, the impact on PETROMOC's balance sheet and, consequently, the state budget can be significant. Assuming PETROMOC's 2020 volumes, every 1 Metical/liter of subsidy on fuel prices generates an annual cash burn of US$6.4mn for PETROMOC, which has been exacerbated by the Ukraine war, causing a surge in international oil prices. The calculation also estimates that if WTI remains at US$106/barrel and fuel prices unchanged, this de facto subsidy costs PETROMOC US$124.7 mn annually. Box 4 shows the potential impact of the Ukraine war to public finances, as a result of the fuel subsidy.

Box 3.4: Impact of Ukraine war on PETROMOC and state budget

The fuel subsidy can have a large impact on PETROMOC's balance sheet and on the state budget; the war in Ukraine (and subsequent oil price spike) can exacerbate this to a worrisome level if pump prices are not adjusted. In a scenario where the government decides to continue to subsidize fuel prices, the impact can be devastating for PETROMOC's balance sheet and the state budget. Table 2, below, estimates the annual fiscal drain caused by the fuel distribution sector if pump prices are not adjusted, assuming international oil prices of US$80 (pre-war); US$106 (current oil prices); and US$120 (if the war continues and WTI prices continue to rise).[a] It also considers the tax and customs revenues the state is foregoing from PETROMOC). Assuming current international oil prices, the total fiscal drain caused by the fuel sector is estimated at nearly a USD 630 million per year.[b]

Table 3.7: Estimated yearly fiscal drain to the state budget caused by the fuel sector, US$ million

	WTI US$ 80	WTI US$ 106	WTI US$ 120
A. Total de facto subsidy*	**(56.9)**	**(542.1)**	**(803.3)**
Of which, PETROMOC	(13.1)	(124.7)	(321.3)**
B. Tax expenditures, PETROMOC at 23% market share	**(63.9)**	**(87.4)**	
Assuming 40% market share PETROMOC	...	...	(166.6)
(Regulatory deficit/liter in MTN)	-2.98	-20.87	-30.50
Estimated yearly fiscal drain (A+B)	(120.8)	(629.4)	(969.9)

* Total de facto subsidy is based on the average volume of total annual fuel imports, and assumes a split of approximately 75% diesel, 25% petrol, at current pump prices.
** Assumes 40% market share of PETROMOC.

Source: World Bank staff calculations.
a. These values assume that the USD/MTN exchange rate remains stable, and the diesel pump price remains at 71.00 MTN/liter. Table 2 considers the additional detrimental effect to PETROMOC if its market share increases in response to private companies slowing down operations (a likely scenario), in the case of WTI rising to US$ 120 a barrel.
b. At MTN 64: USD 1 exchange rate.

In a scenario where PETROMOC increased its market share from 23 to 40 percent, the annual cash burn (assuming the current subsidy level of 20.87 MT/liter) is estimated to reach US$219mn. In 2017, there was near a disruption in fuel supply. The government decided to increase returns of distributors and vowed to readjust the fuel price every month according to a defined methodology that would recover costs. While price adjustments never occurred monthly, international oil prices came down while the Metical appreciated against the USD, leading price pumps to be higher than the price defined by the methodology. At this point the GoM allowed the distributors to keep the excess amount to compensate the subsidies they accumulated on their balance sheets in previous years. This new scenario with attractive margins and cash flows led the private sector to increase investments hitting PETROMOC's market share (from 2015 to 2021, market share reduced from near 45 to 23 percent). If the GoM persists in using fuel distribution companies to finance the subsidy on fuel price to final consumers, private players may decide to restrain their participation to a similar market share level of 2015, and as a result PETROMOC may be pushed to absorb this market share to avoid disruptions to fuel supply.

Empresa Nacional de Hidrocarbonetos (ENH)

ENH is the fully-owned SOE designated by the Hydrocarbons Law 21/2014 as the exclusive representative of the state to participate in oil and gas projects. ENH invests in these projects via special purpose vehicles (SPVs), which typically involve a joint venture with leading multinationals operating in the sector. Through ENH, Mozambique has maintained a 10-15 percent share as an investor in the consortia involved in the large-scale exploration and development of liquefied natural gas (LNG) in the Rovuma basin. ENH holds a 15 percent stake in Mozambique LNG Project, which is in the Development Phase. The total capex deployment is estimated to reach US$27.5bn. ENH operates as a holding company, and its stakes in Rovuma basin projects represent over 80 percent of the company's total assets. ENH has also stakes in CMH (*Companhia Moçambicana de Hidrocarbonetos*, 70 percent stake), CMG (*Companhia Moçambicana de Gasoduto*, 80 percent), Matola Gas Company (MGC, 25 percent), among others.

The expected equity/debt structure at the beginning of the production phase is 45/55 percent, requiring ENH to invest nearly US$1.9bn in the SPV led by TotalEnergies. As ENH lacks the financial capacity to fulfill its equity share, it has essentially borrowed this amount from private consortium participants.[72] ENH reports this loan ("Carry") in its balance sheet and the cost of debt increases significantly as the project matures. Capex related to the Exploration Phase (dedicated to studying the commercial viability of the project), the interest rate is of LIBOR+1 percent, while for the Capex related to the Development Phase (after signing the Development Plan with government), the interest rate increases to 8.7 percent until 2025, and 13 percent after that.

GoM has provided a sovereign guarantee to this project, which will be in place until *Mozambique LNG* generates revenues. The sovereign guarantee issued by GoM will reach a maximum amount of US$ 2.25bn when the full capex is deployed, just before the SPV starts to generate revenues and the sovereign guarantee lapses.[73] Currently only USD 40 million of the loans have been drawn down, and given the capex financed by SPV own equity was almost fully deployed, the risk of fiscal contamination by the GoM being called on this guarantee is well mitigated now and going forward.

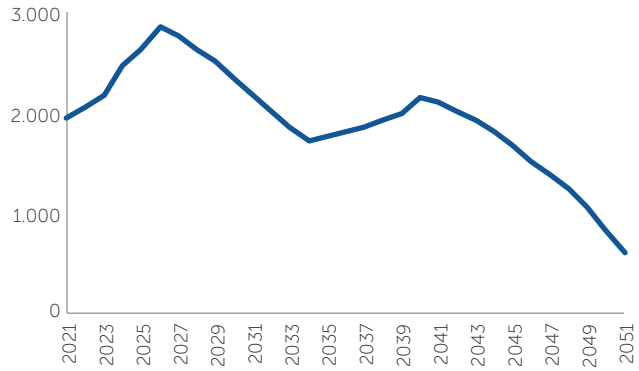
ENH holds a 10 percent stake in Coral-South (FLNG) Project, which is expected to start production in the second half of 2022. The total capex deployment is estimated to reach US$10.5bn. The Coral-South Project is set up similarly to the *Mozambique LNG* project, with a major difference being that the GoM did not issue any sovereign guarantees. Additional differences are the following. Firstly, the expected equity/debt structure at the beginning of the production phase is 56/44 percent, requiring ENH to invest nearly US$ 585 million in the SPV led by ENI. Further, the Development Capex Phase has an interest rate of 8.7 percent, which remains the same throughout. Finally, the private participants of the consortium presented the necessary guarantees, charging ENH a 7 percent fee related to ENH stake (10 percent of total debt contracted), which was added into the Development Carry amount.

ENH holds stakes ranging between 10-20 percent in several SPVs still in the exploration phase. Rovuma LNG Project seems to be more advanced in commercial viability studies, but still has not signed the Development Plan. The fiscal risk these projects will present to the state is not yet well defined, but is likely to be minimal. Contracts define that the capex of SPVs that are still in the Exploration Phase must be deployed by the private participants of the consortia and such capex only become a loan ("Carry") to ENH if the projects advance to the Development Phase. This structure protects ENH from increasing leverage with projects that may be dismissed in the initial phase. However, if the projects move to the Development Phase ENH has no option but to follow the decision of the consortia. In that event, all investments up to that date are then considered to calculate the amount of carry ENH is responsible for.

72 The shareholder agreement defined that private participant of the consortia, following its equity stake of the SPV, would lend the necessary resources to ENH and would be paid back by ENH's future dividend share of the project.

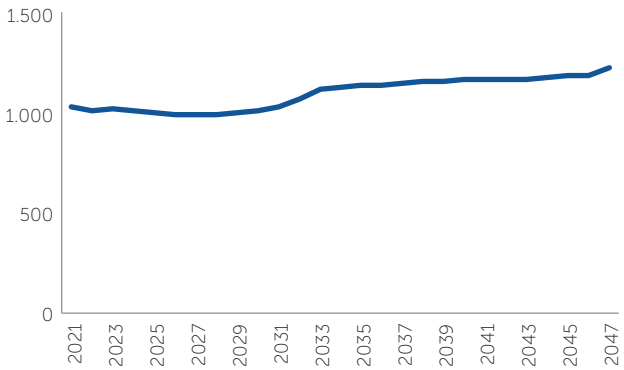
73 The debt share of the Mozambique LNG Project is contracted under project financing arrangements, with the SPV being the borrower. However, such arrangements only become effective after the completion of the full capex plan and when the SPV starts to generate revenues. Until then, the SPV is required to present different forms of guarantees, including insurances and balance sheet collaterals from the SPV shareholders. As ENH's balance sheet does not offer options to provide such guarantees, the GoM has issued a sovereign guarantee to cover the construction period.

Figure 3.19: Mozambique LNG Carry trajectory (US$ million)



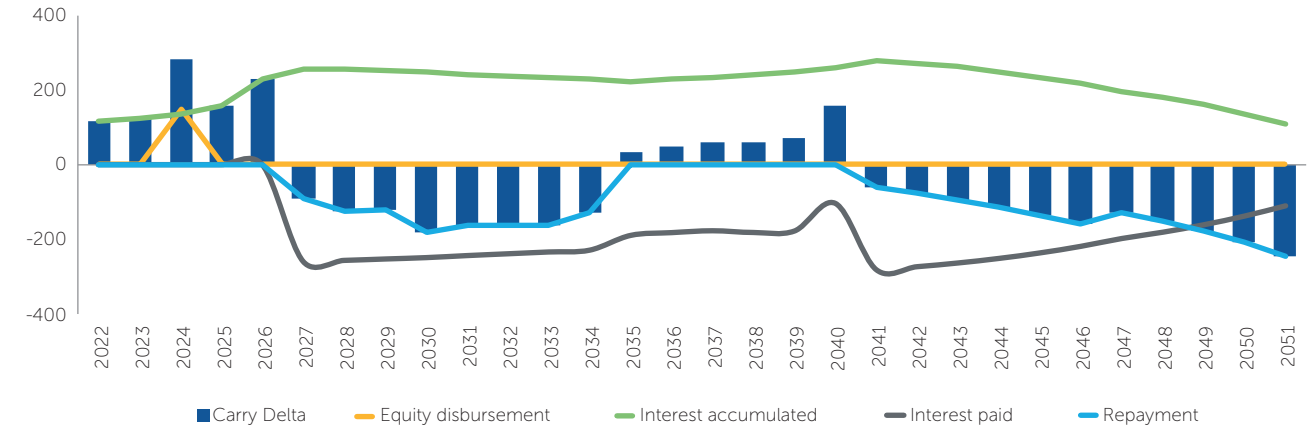
Source:

Figure 3.20: Coral-South Carry trajectory (US$ million)



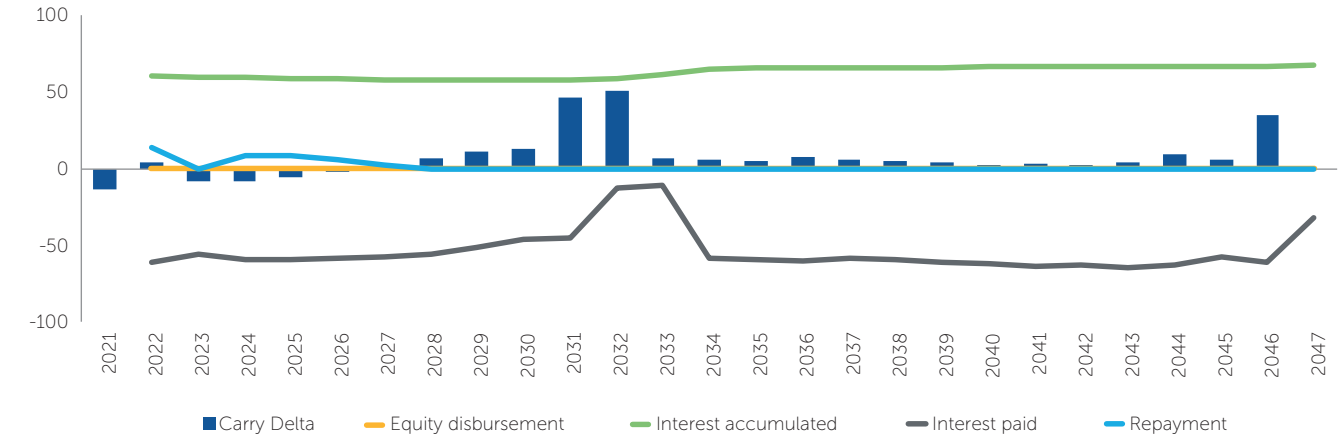
Source:

Figure 3.21: Mozambique LNG Carry breakdown (US$ million)



Source:

Figure 3.22: Coral-South Carry breakdown (US$ million)



Source:

ENH is not expected to be a fiscal drain or risk, but the model also indicates that ENH will likely not generate dividends to the state for the foreseeable future. The structure defined for ENH's participation in the LNG projects has the benefit of no cash requirements during the heavy investment phase. This structure allowed ENH and the state to be involved in these projects despite a weak balance sheet position and no access to credit lines, and without pressuring fiscal accounts. But the cash came at a high cost and ENH future dividends may go on debt service to private partners in the SPVs. Estimates indicate that, by the end of 2021, the carry related to Mozambique LNG and Coral-South (FLNG) projects were running at US$1.9bn and US$1bn, respectively. Assuming Mozambique LNG Project will start operations in 2026, by the time the SPV begins to distribute dividends, ENH's carry will total nearly US$2.8bn and it may take up to 25 years to pay back all its debt. For Coral-South (FNLG) Project the estimates are even worse, and it is unlikely that the carry will be fully repaid during the life spam of the project.

3.4 Corporate Governance and Accountability

This section assesses the governance practices of the SOE sector focusing on the legal framework; key features of state ownership and oversight, including performance monitoring; the structure and function of the board of directors; financial accountability and transparency; and procurement practices.

A key element to consider is the political economy aspect of SOE governance reforms, which can stall without the buy-in of actors with the authority and political will to drive them. SOEs often manage significant revenue streams and are sometimes used by the state or political groups to exert political influence over economic outcomes and resource allocation. They may also encounter political interference in operational matters to benefit vested interests who may seek to misappropriate funds. A recent report evaluating the effectiveness of SOE reforms supported by the World Bank observed the importance of mitigating the risks from political economy factors in achieving successful reforms.[74] Efforts to reform the governance of SOEs, which may include restructuring, can face resistance from those who gain from maintaining the *status quo*. As a result, reforms may stall without the support of key local actors, as well as strong enough leadership and capacity to withstand resistance from vested interests.[75]

SOEs' unique mix of commercial and political mandates also poses significant challenges to introducing and sustaining governance reforms. Public service obligations can contribute to tensions between SOEs' commercial and non-commercial mandates, particularly if these are imposed on SOEs without adequate funding to support service delivery. For example, an otherwise relatively well-governed SOE may still incur losses or fail to deliver adequate services if the state requires it to provide services below market rates without sufficient compensation or to operate commercially unviable projects. Conversely, where SOEs provide public services essential to achieving development outcomes, governance reforms should also consider the wider societal impact and factor these into proposals (e.g., impact on the public of rises in electricity, water or transport costs).

While the practices of individual countries vary, there is broad international consensus on the components of good SOE governance. Drawing on the World Bank's iSOEF and the OECD Guidelines for SOEs, the key components of governance used in the assessment are summarized in Box 3.4.

Legal and institutional framework

In Mozambique, there are two main legal forms of SOEs: (i) empresas públicas (EP), uncorporatized public enterprises, which are fully owned by the government and can have both social and commercial objectives; and (ii) *empresas participadas*, corporatized shareholding companies, with the primary objective to generate returns to the national budget from commercial activities. *Empresas participadas* may be either Sociedades Anónimas (the equivalent of joint-stock companies) or Sociedades limitadas (similar to a limited liability company).

Following the hidden debt crisis, which exposed significant weaknesses in the previous statutory requirements, the state has overhauled the legal framework governing SOEs and tightened controls over sovereign guarantees. The state revamped the legal framework by issuing Law No. 3/2018 and Decree No. 10/2019 (the "SOE Law" and "SOE Regulation" respectively). The public financial management law, SISTAFE,[76] was also refreshed, bringing the SOE sector under wider public sector provisions to enhance transparency and accountability. As a result, guarantee limits are now included in the annual Budget Law, which is approved by the National Assembly. Furthermore, SISTAFE requires, among other things, that all SOEs are listed in the Annual Economic and Social Plan, as well as the State Budget; that the Council of Ministers (CM) approve the opening of SOE bank accounts; and that the CM has powers to subject SOEs to the state's internal audit system. A debt management decree was also adopted in December 2017 which tightens risk assessment of guarantee proposals and requires their approval by the Council of Ministers (The World Bank Group, 2020). No new guarantees have been issued to SOEs in the past two years.[77]

74 State your Business! An Evaluation of World Bank Group Support to the Reform of State-Owned Enterprises FY08-18 (The World Bank, 2020).
75 The iSOEF provides guidance on mitigating political economy factors in Thematic Guidance Note 2: Political Economy Analysis of SOE Reform
76 Law no. 14/2020 of 23 December 2020.
77 Art. 74 of Decree no. 26/2021,"SISTAFE Regulation."

Box 3.5: Overview of Assessment Criteria for Governance of SOEs in Mozambique

Legal Framework. A clear and coherent legal framework for SOEs is essential for effective corporate governance. Such a framework establishes clear obligations that do not contradict each other, covers all significant requirements, and facilitates compliance and enforcement.

State Ownership Arrangements. The state has a distinct responsibility to act as an active and responsible shareholder and should be accountable for the discharge of its ownership role. Ownership functions should be assigned to an entity with appropriate powers and resources to effectively manage the SOE portfolio.

Performance Management and Monitoring. To be an informed, effective owner, the state needs to monitor SOE performance and hold their management teams and boards accountable for results. The state needs to establish appropriate monitoring systems based on clearly defined mandates, strategies and performance objectives.

Structure and Functioning of the Boards of Directors. Boards of directors are often considered the "cornerstone" in an enterprise. They provide critical strategic advice to management and exercise oversight over sensitive areas such as strategic planning, risk management, executive remuneration, conflicts of interest, external reporting, and auditing. Effective boards typically have clearly defined responsibilities, a merit-based and diverse membership, a limited number of specialized committees (e.g., on audit), an adequate remuneration framework, and a process in place to evaluate their effectiveness at regular intervals.

Financial Accountability, Controls and Transparency. Transparency, disclosure and effective internal controls are vital to holding SOEs accountable for their performance. This involves relevant, timely and accurate reporting on financial performance and other activities, a strong internal control environment, and independent, competent external audits. In addition, the publication of portfolio-level information (commonly referred to as "aggregate reporting") enables policymakers and stakeholders to be informed about the performance and situation of the SOEs; it also helps ensure the government is accountable for fulfilling the state ownership role effectively.

Procurement in SOEs. A key issue regarding procurement in SOEs is the extent to which they are subject to the same rules as government bodies, whether the requirements on procurement applicable to SOEs are appropriately flexible to reflect their commercial nature. Irrespective of the system in place, it should ensure that SOEs observe sound, universally accepted principles of procurement – e.g., transparency, efficiency and economy.

Source: iSOEF (The World Bank, 2019).

Requirements have been strengthened for creating new SOEs; however there are no restrictions for establishing subsidiaries of SOEs. Approval by the Council of Ministers is required to establish new SOEs, based on the results of a series of economic, financial and operational feasibility studies of the proposal.[78] Since the issuance of these regulations, no new SOEs have been created. However, there are no restrictions on SOEs taking on equity holdings in other companies. This could result in an expansion of the SOE sector without proper oversight.

The SOE Law stipulates that SOEs should adhere to general rules governing competition. However, other provisions in the wider legal framework allow SOEs privileges not available to private companies. Article 23 of the SOE Law ostensibly invokes competitive neutrality for SOEs, stating that SOEs should operate on the same terms as other commercial enterprises. However, SOEs benefit from special legal provisions that are not available to peers in the private sector. For example, the law establishes special procedures for bankruptcy of SOEs that depend on a decision of the Council of Ministers rather than the procedures set out by the bankruptcy rules in the Commercial Code (IFC, 2021).

The law does not set forth a due process for setting dividend policies, which can make it difficult for the State to plan and budget for expected receipts. The lack of a dividend policy can hinder planning and budgeting for the SOE sector. The SOE law asserts that a core function of SOE activity is to contribute revenue to the Treasury (Article 9). However, there is no overarching dividend policy for the sector, and it is the responsibility of the General Assembly

78 Source: Article 3 of SOE Regulation

of each SOE to decide on its dividend policy (Article 12). In practice, IGEPE defines a dividend policy with SOEs on an individual basis each year but there is no legally stipulated due process for doing so. Other important stakeholders such as the Treasury are not necessarily part of the process. In practice, dividends tend not to be significant.

The SOE Law does not define specific enforcement actions for SOEs that fail to comply with its requirements. Article 35 of the SOE Law states that the civil suits brought against SOEs can be adjudicated in the courts. However, the legal framework for SOEs does not specify any actions- administrative, civil or penal - that can be taken for failure to comply with its provisions. In practice, there was limited data available on enforcement actions taken against SOEs.

Employees of SOEs are subject to the Labor Law applicable to the wider corporate sector. Article 31 of the SOE Law does not prescribe differentiated requirements for the employees of SOEs who are expected to comply with the provisions of the Mozambican Labor Law (Law 23/2007). However, the legal framework allows civil servants to be seconded to roles within SOEs. Article 32 of the SOE Law stipulates that secondees to SOEs from the public sector are to retain the rights under their original employment contract.

IGEPE has a clear statutory role to set the strategic direction for the SEE. The 2020-2030 strategy for the SEE is a solid step in articulating the State's approach to ownership of SOEs, its investment objectives and priorities. According to the SOE Law, IGEPE's duties include ensuring implementation of the state business strategy[79]. In 2019, IGEPE published a wide-ranging ten-year strategy for the SEE. IGEPE's strategy sets out the investment policy, general investment principles and opportunities by sector as well as for individual SOEs. The strategy is consistent with some aspects of good practice such as the OECD principles, which recommends publishing a high-level policy that provides a clear understanding of the overall goals and priorities for state ownership as well as governance principles for the SOE sector. In order to strengthen accountability and transparency, the strategy should be made publicly available on the IGEPE website.

IGEPE articulates priority sectors for investment in the state business strategy and enumerates possible investment opportunities for the sectors as well as for select individual SOEs. The 2020-2030 strategy identifies priority sectors for investment as: natural resources (namely, ENH), energy (EDM), infrastructure and transport (ADM), telecommunications (TMCEL), and finance (BNI). The strategy also defines criteria for project evaluation aligned to the investment approach and sets forth broad public policy goals for priority sectors as well as for select strategic SOEs. IGEPE identifies priority sectors for investment according to defined criteria that take into consideration factors such as competitiveness of the industry, potential rate of return and the ability to generate sustainable profits.

The strategy does not include an assessment of whether SOE activities may be better performed by private sector actors; it could thus be strengthened by including a rationale for State ownership that considers potential or actual adverse effects of SOEs on the market. Good international practice, as reflected in the World Bank's iSOEF and the OECD Guidelines on the Corporate Governance of State Enterprises (2015), stress the importance of the state carefully evaluating and disclosing the objectives that justify state ownership and subjecting these to regular review. It further recommends that an ownership policy be developed, which sets out the rationale for state ownership and clearly defines public policy objectives that individual public corporations or groups of public corporations are required to achieve. Considering whether SOEs are responding to a market failure, or whether goods and services could be adequately provided by the private sector could be an important factor to consider as part of the investment strategy for the SOE sector going forward.

The new SOE law the mandate for oversight of many strategic SOEs from line ministries to IGEPE which is a positive step towards reducing fragmentation and increasing financial accountability. The SOE Law centralized responsibility for managing the ownership of SOEs under IGEPE and articulates its duties, which are subject to approval by the Council of Ministers. A recent study of SOEs in Latin America reported that a strong oversight and control agency yields better governance results than a fragmented approach with responsibilities shared between multiple agencies and ministries. The study found that in countries where centralized monitoring agencies are used, SOEs tend to have better financial performance and fewer liabilities relative to gross domestic product (Musacchio, et al., 2019).

According to the SOE Law, IGEPE is responsible for monitoring and supervising the economic and financial performance of all companies in the SEE. Articles 7 and 8 of the SOE Law establishes performance monitoring as one of the duties that IGEPE should exercise on the State's behalf. In practice, given limited resources, IGEPE is responsible for monitoring SOEs in which the State owns at least a majority stake (for details of the monitoring actually conducted by IGEPE, refer to the section on Performance Monitoring below). Line ministries monitor operational performance but are not mandated to produce reports.

While social and environmental factors were identified as considerations in the investment criteria for continued state ownership, these areas do not form part of regular performance monitoring. The 2020-2030 strategy identified sustainability and social development in the decision-

79 Article 8 of the SOE Law.

making criterial for investment by the state. These criteria were particularly relevant for classifying companies in the strategic-structural portfolio or strategic-social portfolios. However, existing monitoring activity does not cover these areas.

Managing the portfolio

IGEPE is charged with managing the SOE portfolio and is authorized to acquire and sell equity stakes on behalf of the State, subject to approval by the Council of Ministers. However, IGEPE does not currently maintain a comprehensive list of the state's equity shareholdings, including the stakes SOEs hold in other companies. Article 7 of the SOE Law grants IGEPE authority to manage the equity shareholdings of the State. Due to capacity constraints, IGEPE's portfolio is currently limited to the largest SOEs. While understandable that the largest SOEs are prioritized, IGEPE should at least maintain a comprehensive list of all equity stakes the State holds and the stakes held by SOEs in "second-generation companies". For example, ENH holds equity in a number of subsidiary companies as part of its strategy for expansion. Other SOEs, such as EDM, report their shareholdings as financial investments.

IGEPE has the mandate to conduct studies to consider restructuring opportunities within the SOE portfolio. IGEPE should consider fiscal risks as part of these studies and report on any actions recommended as a result. Article 8 of the SOE Law gives IGEPE the authority to develop restructuring strategies for the SOE portfolio. As explored in further detail in section F, many SOEs are experiencing severe financial or operational difficulties. Tackling the root causes of weak SOE financial performance entails developing and implementing a broad-based restructuring plan that addresses operational, organizational and financial weaknesses that hinder service delivery and profitability. In IGEPE's analysis in the SEE strategy, opportunities to restructure debt or liabilities are mentioned as possibilities for some struggling SOEs. IGEPE should build on these initial analyses, drawing on the assessment of the fiscal risks posed and include these results in its reporting.

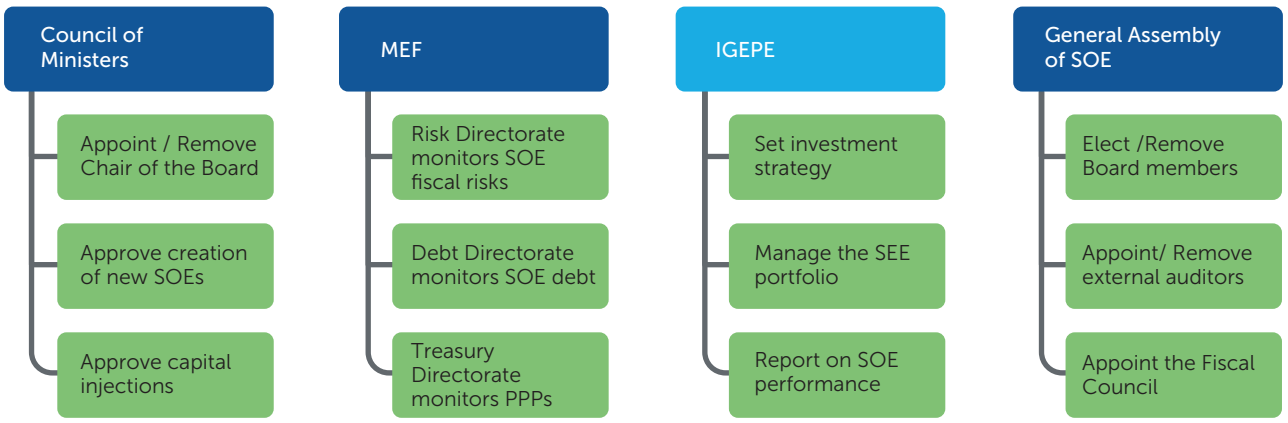
Overall, responsibility for many of the core ownership functions has been allocated to IGEPE. Figure 3.23 illustrates the principal bodies that play a leading role in managing state ownership and summarizes the key functions that they discharge.

The main gaps in terms of ownership functions relate to the management of the portfolio: monitoring the equity stakes of the portfolio and identifying opportunities for restructuring. To address these gaps, IGEPE should develop and maintain a list of the equity stakes held by the State. It can prioritize monitoring based on assessed risks, however, at a minimum, basic financial data on these shareholdings should be collected. This list of shareholdings should include basic financial information such as assets, liabilities, debt and revenue. As a longer-term goal, IGEPE should also develop restructuring strategies for SOEs in financial distress. Priority steps for addressing these gaps are summarized in Table 5 below.

General Assembly

The General Assembly of shareholders is one of the statutory bodies for SOEs mandated by the legal framework. Within the internal corporate structure of individual SOEs, the General Assembly is the main body responsible for oversight of the SOE. As described further in the Performance Monitoring section below, other statutory bodies typically report to the General Assembly for approval on strategic matters such as annual financial reporting, multi-year planning or key appointments. Where the State

Figure 3.23: Exercise of principal state ownership functions in Mozambique



Source: World Bank based on SOE Law and SOE Regulations.

holds less than 100 percent of equity, IGEPE serves at its representative in the General Assembly. The line ministry may also be represented in the General Assembly. According to the SOE Regulation, the General Assembly should meet at least twice a year (Article 8).

Structure and Function of the Board of Directors

SOEs are required by law to have a board of directors. The board is essentially the management body of the SOE. Appointments to the board consist of four-year renewable terms subject to approval by the Council of Ministers. The duties of the Chair and of the board as a whole are stipulated in the SOE Law[80]. For example, the board is responsible for developing the strategic plans of the company, approving internal policies and procedures and management of human resources. In practice, the largest SOEs comply with these requirements.

Board appointments tend to be informal and are not necessarily based on the professional qualifications of the candidate. The State should conduct open, transparent, merit-based appointments. In practice, appointments to the board are made informally and consist of well-connected, often politically-exposed persons or high-ranking civil servants. This point was raised in a previous country study on the SEE (World Bank, 2016). Appointments should be made according to an open, transparent process based on merit (as recommended in Table 9). Such a process could involve advertising vacancies, specifying selection criteria, maintaining a list of suitable candidates, and assessment of each candidate's professional qualifications.

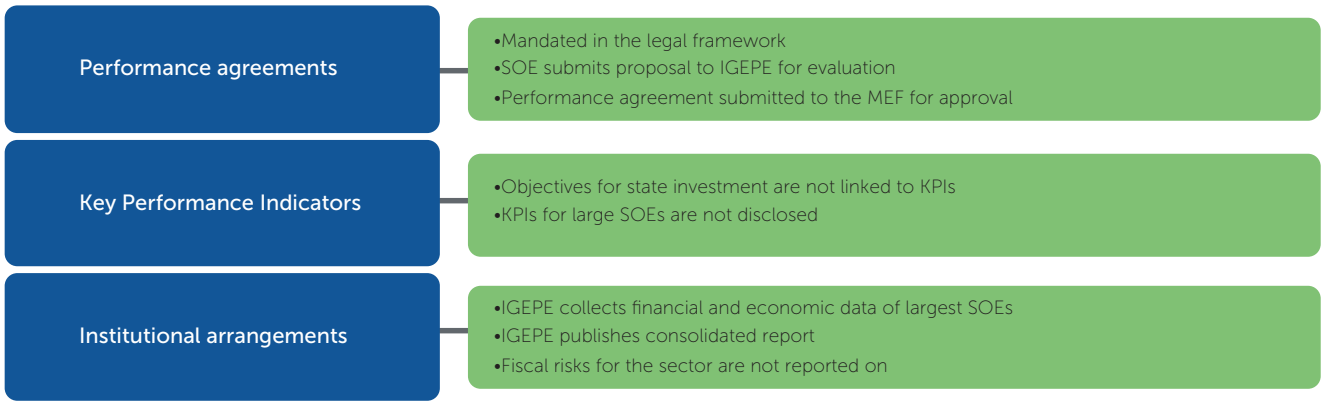
SOE Performance Management

IGEPE is responsible for oversight of the financial and economic performance of SOEs. According to good practice[81], performance management involves performance agreements between the State and the SOE; the use of key performance indicators (KPIs) to measure performance and adequate institutional arrangements to support monitoring. Institutional arrangements encompass monitoring of individual SOEs as well as for the entire sector. Each function is examined below. Figure 7 summarizes current practice in Mozambique.

Performance Agreements

Performance agreements between SOEs and the state are mandated by the legal framework[82]. However, the rationale for public service obligations that individual SOES are required to achieve, the associated costs and delivery objectives are not disclosed. As IGEPE's strategy for the SEE recognizes, SOEs provide many essential services to the public that are vital to social development outcomes, such as improving access to electricity, water, transport or telecommunications. However, in certain cases services are provided at below-cost tariffs without appropriate funding from the State. Some SOEs are in financial distress as a result of PSOs. Identifying PSOs of SOEs and quantifying associated outputs and unit costs in a performance contract are critical to assessing SOE financial performance and operational efficiency, particularly when the SOE receives state subsidies. Without first defining and formalizing PSOs and measuring their cost, it will be difficult for SOEs to achieve financial sustainability and reduce the associated burden on public finances. Good

Figure 24: SOE Performance Management in Mozambique



Source: World Bank based on SOE Law and observed practice where available.

80 Articles 13, 14, and 15 of the SOE Law.
81 World Bank iSOEF (The World Bank, 2019)
82 Article 21 of the SOE Law and Article 17 of the SOE Regulation

practice (World Bank iSOEF, OECD Principles) calls for the identification and disclosure of services that are expected to be delivered below market cost. At the individual SOE level, performance agreements are a relatively new initiative in Mozambique. As such, there were no examples available to observe in practice.

Key Performance Indicators

The strategy for the SEE articulates high-level objectives and priorities for state investment, however, these are not linked to measurable, financial targets. KPIs for large SOEs are not disclosed. IGEPE's strategy for the sector identifies high-level objectives such as improving sustainability and profitability of the SEE as a whole or strengthening corporate governance. While priorities and intermediate steps for achieving these objectives are defined, the strategy does not articulate measurable, financial targets (Annex II provides examples of commonly used KPIs for consideration). Similarly, for the select large SOEs analyzed in the SEE strategy, IGEPE uses KPIs to monitor performance, however, these were not disclosed.

Institutional arrangements

IGEPE currently monitors the performance of the largest SOEs in the portfolio leveraging data from SOE financial statements. To effectively monitor and report on performance of the SEE, IGEPE should automate its reporting systems to the extent possible. Due to capacity constraints, IGEPE has adopted a risk-based approach which focuses on monitoring performance of the largest SOEs. The process involves manual data entry of financial and economic data from the financial statements of individual companies into spreadsheets. The data is not always reliable given the opportunities for errors in following a manual process. Data input should be automated to the extent possible. This would allow staff more time for analysis.

IGEPE is required to prepare a consolidated report on the SEE. Its most recent report described the composition of the SEE but was limited in its analysis of financial performance and did not disclose the results of any monitoring activity performed. Article 7 of the SOE Law stipulates that IGEPE prepares consolidated reports of the state business sector. IGEPE's consolidated report published in November 2019 described the legal framework; IGEPE's role and governance structure; listed SOEs in its portfolio and provided one-page summaries of each individual company in the portfolio (sector, main operational activities but no financial analysis or data). Any monitoring activity performed by IGEPE or other oversight bodies was not disclosed in the report, nor was there any financial analysis of the sector as a whole. No other reports have been published since 2019. The frequency of reporting is not set in the legal framework. Consistent with good practice, IGEPE ought to publish its aggregate report on its website.

The level of performance monitoring of SOEs is limited. Increasing capacity and resources for IGEPE is key to addressing the gaps identified in the monitoring framework such as incorporating costed KPIs in performance agreements for SOEs providing public service obligations, using automated tools and dashboards in monitoring activity, or enhancing the analytical elements of current reporting. Recommendations to improve performance monitoring over the short and medium term along with suggested priority steps for consideration are summarized in Table 8.

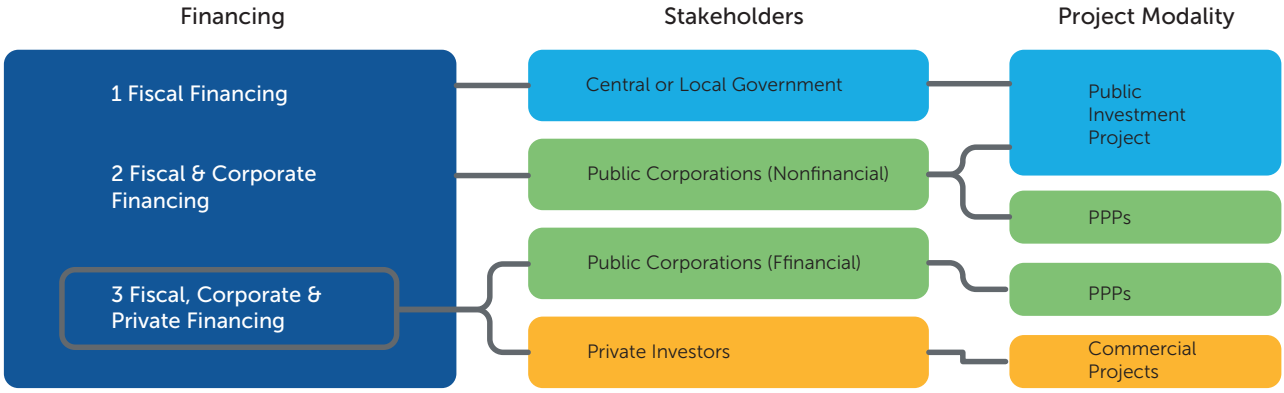
Oversight of the fiscal risks posed by the SOE sector is currently spread across three directorates within the Ministry of Economy and Finance, which can result in fragmentation and gaps in oversight. The Debt, Fiscal Risk and Treasury Directorates within the MEF have parallel or overlapping roles in monitoring and overseeing fiscal risks for the state enterprise sector. This state of play has arisen due to the MEF restructuring of the directorates managing the treasury functions. Fragmentation can undermine accountability as responsibilities among the three directorates are not always clear. In an environment of constrained capacity, it would be a beneficial use of limited resources to have a single, dedicated unit responsible for identifying, analyzing and reporting on fiscal risks.

While SOEs are required by law to have a board of directors, the board is essentially the management body of the SOE. Most SOE boards comprise only executive members. Board appointments tend to be informal and are not necessarily based on the professional qualifications of the candidate. In practice, appointments to the board are made informally and consist of well-connected, often politically exposed persons or high-ranking civil servants. In addition, IGEPE serves as the state's representative in the General Assembly of SOEs. The line ministry may also be represented in the General Assembly. According to the SOE Regulation, the General Assembly should meet at least twice a year (Article 8).

Public Investment Management

The GoM has embarked on several public investment management reforms to improve the efficiency of its expenditures. In 2021, the Government advanced the institutional framework for PIM by merging the national planning and budgeting systems. The expenditure planning process was also further enhanced by the Electronic National Public Investment Subsystem (E-SNIP). E-SNIP established a comprehensive and digitalized pre-investment process, including four distinct phases: profile, pre-feasibility, feasibility, and proposal. E-SNIP resulted in a transparent and publicly available public investment portfolio of projects endorsed for implementation. However, very few projects originated by SOEs follow the pre-investment process established by the E-SNIP and effectively bypass the Treasury screening process. The reasons are twofold, as explained below and illustrated in Figure 3.24.

Figure 3.25: Sources of funds and investment modality



Source: IMF.

First, projects initiated and funded by SOEs are not captured by E-SNIP and bypass the newly established PIM processes. Mozambique, like most other countries in the region, is yet to establish an integrated public investment management framework where all projects, irrespective of the financing modality (funding by the budget or SOEs financing) or procurement modality (traditionally procured projects or public-private partnerships) comply with the same set of procedural and legal requirements.

Second, there is a significant loophole in the PIM system, as all projects receiving private sector investment are considered confidential and thus outside the system, even if involving majority-SOEs. To illustrate, we could consider an Independent Power Project (IPP) initiated by EDM. EDM intends to offtake power from the IPP using proceeds generated from the sale of electricity to the end consumers. IGEPE considers such a project a commercial agreement between EDM and private sector partners. The project will not be subjected to the standard PIM processes unless the investor requires a direct government subsidy. However, suppose EDM's electricity tariff to the final consumers gets below the cost recovery level over time, accelerated by the high power purchase agreement tariffs. In that case, the budgetary transfers will be required to finance the EDM deficit.

Continued PIM reforms are needed to bring SOEs projects under the same umbrella. Under the existing PIM framework, EDM would have to prepare a feasibility study for the proposed power purchased agreement (PPA). The feasibility study will highlight if the proposed PPA is above the generation component of the end-user tariff, shedding light on the size of the fiscal liability created if the project is approved. However, suppose the economic feasibility of the power plant is still justified. In that case, it will help EDM demonstrate that the political and social pressure to keep tariffs low contributes to the financial unsustainability of the utility operations. It will also help Treasury to improve the budgeting function by realizing contingent liabilities created by parastatals. Further, the transparency introduced by E-SNIP helps Treasury to monitor compliance of the stakeholders with procedural requirements, as it raises the question mark when the power plant is being commissioned. Yet, it was never registered in the Treasury database.

Financial accountability, controls, and transparency

The revamped legal framework sets forth the financial reporting, internal control and external audit requirements for SOEs. The SOE Law stipulates the composition of the financial statements of SOEs, mandates the establishment of the Fiscal Council (a financial control body) and requires internal audit function as well as independent external audit. Each element is examined below.

Financial reporting

The statutory financial reporting requirements for SOEs are broadly in line with international practice. SOEs are required to prepare a full set of financial statements comprising consolidated balance sheet, income statement, cash flow, statement of changes in equity and explanatory notes. Financial statement require review by the Fiscal Council, a report from the independent external auditors and approval by the General Assembly of shareholders before filing. Financial statements are sent to IGEPE, the relevant line ministry and to the MEF. The statutory requirements for financial reporting of SOEs largely align with international practice, with the exception of the filing deadline for financial statements which is set at three months after fiscal year end. Typically, the deadline is six months following year-end.

The financial statements of the larger SOEs in the SEE appear to be of relatively good quality, however there is

scope to further improve transparency and disclosure of SOE financial reporting with regards to consolidation of subsidiaries, disclosure of equity stakes in other companies and reporting on financial risks. While only the financial statements of larger SOEs were observed, these provided the reader with useful information to assess performance. However, the financial statements provided limited information on SOE's self-assessment of financial and other risks. The statements also did not consolidate the results of subsidiary companies or significant associated companies, although this is a requirement of the SOE Law (Article 30). Currently, SOEs reported in their financial statements holding more than 10 percent equity stakes in approximately 80 companies. Some data are available on the number of shareholdings and the percentage equity stake SOEs hold in other companies, but none were provided on the value of equity, or the associated assets and liabilities. There was limited transparency in the financial situation of these companies.

Gaining access to the financial statements may present a challenge for the general public. Many SOEs only publish financial statements in newspapers (as permitted by law). However, in a digital age, it should be a requirement that SOEs make their financial statements publicly available on their company website, on IGEPE's website or at a centralized online registry at no or low cost.

Internal controls

Primary responsibility for overseeing internal controls of individual SOEs rests with the Fiscal Council. The Fiscal Council is appointed by the General Assembly for a term of three years. It comprises three members, at least one of whom must be a certified accountant or auditor. All members of the Fiscal Council must have knowledge or experience in accounting, auditing, business management or law. The legal framework permits a professional accountancy firm (other than the external auditor) to discharge the duties of the Fiscal Council. These include examining the accounting and budgeting activity of the SOE, issuing an opinion on the financial statements, reporting on the fulfilment of performance agreements by the SOE and commenting on internal audit reports. The Fiscal Council is required to meet at least quarterly and to prepare an annual report on the discharge of its duties.

While the SOE Law requires an internal audit function, its duties are not defined. There is a need to clarify internal audit requirements applicable to SOEs to minimize potential overlap or duplication with the Fiscal Council or other internal control activities. Currently, the SOE law calls for the establishment of the Fiscal Council and an internal audit function. The duties of the Fiscal Council are defined in the law; however, some duties appear to cover those that would typically fall under the purview of internal audit. For example, the Fiscal Council is charged with giving an opinion on the SOE's compliance with any performance contracts with the State as well as checking compliance with applicable laws and regulations. Moreover, the responsibilities of internal audit are not described[83] .

External audits

The financial statements of SOEs are required to be audited by an independent audit firm which is consistent with good practice. The SOE Law mandates an external audit of financial statements where the auditors provide an independent opinion on the material accuracy of the financial statements. The General Assembly of the SOE is responsible for appointing the external auditor. Many of the larger SOEs select external auditors from the international network professional accounting firms.

The external auditor for SOEs is required to be selected by public tender. Mandatory rotation period of four years for audit firms is shorter than commonly seen in international practice. Requiring public tender in selection of external audit firms is good practice. However, limited information was provided on the requirements for conducting the tendering process or contract award. The SOE Regulation mandates rotating audit firms every four years. While mandator rotation is generally considered good practice to avoid excessive familiarity between the auditor and management of the company that can impair professional skepticism, the rotation period of four years is shorter than the requirements in other countries. For example, in the European Union, even the largest publicly listed joint-stock companies are only required to change statutory auditors at least once every ten years[84].

While not a statutory requirement under the legal framework for SOEs, the Administrative Court (*Tribunal Administrativo*) also conducts audits of SOE activity. As mentioned, the only external review mandated by the SOE Law is independent external audit. However, in practice, the Administrative Court, an external body which reviews public sector agencies, also reviews SOEs. The scope, objectives and results of these audits could not be assessed as the reports were not available.

Procurement

The legal framework allows each SOE to develop its own procedures and criteria for procurement of goods and services, which are then approved by IGEPE. This

83 The role of the Conselho Fiscal is described in Articles 16 and 17 of Law No. 3/2018. Paragraph 1 of Article 28 only requires that SOEs have an internal audit function without any further directives. There is potential inconsistency with Article 25 of the SOE regulation and the "internal control" duties described.

84 Source: Website of the EU Commission on the Reform of the EU Statutory Audit Market

approach leads to inconsistent practices, unfair advantages over private sector peers, and a lack of transparency. The procurement legislation of 2016 and the SOE law of 2018 established that SOEs should apply general principles such as giving preference to bids and promoting transparency, publicity, and impartiality. SOEs are allowed to develop their own procurement practices subject to review by IGEPE. As the recent Country Private Sector Diagnostic determined, there are risks associated with this approach. On one hand, it is positive to provide SOEs with greater flexibility when buying goods and services, particularly for those that perform commercial activities and compete against the private sector. On the other hand, it places a significant burden on IGEPE to effectively approve and monitor the procurement rules of each SOE. IGEPE's monitoring role is particularly relevant as the current legislation may allow companies delivering public services, receiving state support, to operate outside of the general procurement standards (IFC, 2021). Procurement activity of SOEs – such as tenders, contract awards, beneficial owners of contracts – should be conducted via the State Procurement Portal and disclosed.

SOEs operate according to individualized procurement rules defined in the company by-laws, not the general public procurement regime. This can lead to unfair advantages over private sector peers. The Country Private Sector Diagnostic identified the Transport sector as an area where procurement practices by SOEs were distorting the market. The study cited instances of conflicts of interest or a lack of transparency in the public procurement of transport services. Poor implementation of regulations, for example, on overloading and corrupt practices such as informal road fees were also raised as examples of anti-competitive behavior.

Concessions are often awarded without following a tendering process or the inclusion of KPIs to monitor service delivery to agreed objectives. Under the legal framework, SOEs should apply general principles promoting transparency, publicity, and impartiality in the procurement process. Although the 2016 legislation established bidding as a rule, and special and exceptional procedures as the exception, around 50 percent of procurement is single source in practice. Only a third of both central and provincial procurement was awarded through open tendering procedures (IFC, 2021).

According to the Country Private Sector Diagnostic, public procurement accounts for a significant share of the economy: 31 percent of public expenditures and about 10 percent of the GDP in 2018. SOEs benefit from a preferential approach that allows them to obtain goods and services based on bespoke procurement rules. The current legal framework does not mandate participation by SOEs in the general public sector procurement regime, which can result in market distortions, for example, procurement practices by SOEs not available to private players contribute to an anti-competitive environment in the transport and logistics sector (IFC, 2021).

3.5 Reform Options

The recommendations are grouped into three main areas: (i) clarifying the policy for SOE ownership, (ii) managing fiscal risks and costs of the SOE sector, and (iii) specific recommendations for select SOEs in which there is momentum for reform. The recommendations focus on concrete, actionable reforms that can be implemented in the short to short/medium term, and low-hanging fruit. Actions that would result in only marginal improvements, that have little impact, or can only be taken in the longer term are not included.

Clarifying the policy for SOE ownership

Evaluate the rationale for state ownership—and reevaluate it periodically—considering the costs and benefits of ownership given resource constraints and any adverse market effects due to SOE participation. In developing the investment strategy for the SOE sector, the state should carefully evaluate and disclose the objectives that justify state ownership. Given the demands on limited public resources, the state should analyze the costs and benefits of maintaining equity stakes in companies, particularly in SOEs that do not deliver a public service mandate or meet a strategic objective. An important factor to consider is whether SOEs respond to a market failure or if the private sector could adequately provide goods and services. SOEs that fail to meet the criteria for continued state ownership could be privatized, restructured, or wound down over time as appropriate.

Establish a dividend policy for SOEs, including an inclusive and transparent due process (including Treasury and other important stakeholders) should be established for setting dividends.s. The SOE law asserts that a core function of SOE activity is to contribute revenue to the Treasury. However, there is no due process for setting dividend policies, which makes it difficult for the state to plan and budget for expected receipts. IGEPE defines the dividend policy on an individual basis for each SOE. Other important stakeholders, such as the Treasury, are not necessarily part of the process.

Managing fiscal risks and costs of the SOE sector

- **Improve monitoring and disclosure of equity stakes held by the state.** A comprehensive inventory should be taken of the state's direct shareholdings, as well as the equity stakes held by SOEs in other companies. SOEs have reported in their financial statements holding equity stakes of 10 percent or more in approximately 80 companies. The state needs collect and analyze

basic information on the financial situation of these companies, such as assets, liabilities, revenue and operating results.

- **Strengthen monitoring and reporting on SOE arrears, which pose a significant fiscal risk and function as a *de facto* subsidy to the sector, to the detriment of private enterprises.** As a first step, IGEPE should consider conducting a stock-taking of SOE arrears by type – for example, arrears to the state in the form of tax, pensions, or customs duties; and arrears between SOEs for goods or services delivered, but where payment is still outstanding. Arrears should be monitored and disclosed.
- **Consolidate SOEs' fiscal risk monitoring and reporting functions within the MEF to avoid duplication of effort or gaps in coverage.** These functions are currently dispersed across different units within the MEF, leading to potential overlapping duties. The state should clarify and, where appropriate, consolidate responsibilities, considering each unit's staff expertise and available resources. In an environment of constrained capacity, it could be a beneficial use of limited resources to have a single, dedicated unit responsible for identifying, analyzing and reporting on the overall fiscal risks arising from the SOE sector.
- **Ensure that decision making in the SOE sector with a significant fiscal impact follows a transparent due process and involves all interested parties.** For example, due process should be established to define SOEs' public service obligations and should involve consultations with the line ministry, the MEF, the sector regulator, and other relevant parties. Similarly, decisions about significant investments by SOEs should also follow a defined process, subject to appropriate approvals, oversight and transparency. The impact and longer-term sustainability of public sector obligations (PSOs) or investment projects ought to be considered more systematically, as they may contribute to fiscal risk exposure.

Focus on select SOEs in which there is momentum for reform

- **A debt restructuring strategy targeting the SOEs facing the most serious challenges should be developed as a first step.** Furthermore, cross-debts and arrears among SOEs and the state ought to be identified, and a suitable plan for clearing these developed and implemented. Looking forward, options should be considered to address operational, organizational and financial weaknesses that hinder service delivery and profitability and contribute to fiscal risks. Specific options should be presented for each company and include support from the shareholder to restructure and renegotiate financial debt with lenders; splitting SOEs into smaller entities with coherent operating objectives; and reducing public participation and/or bringing in private participation.
- **Limit the indebtedness of SOEs—including short-term debt—in accordance with certain financial ratios.** This could take the form of a cap on permitted leverage ratios. The cap would replace the current policy, which allows SOEs to increase short-term debt without approval by IGEPE. For example, the cap could be set at a leverage ratio of 1.5 (i.e., 1.5 x net debt/EBITDA).

Recommendations and scenarios for individual SOEs

Aeroportos de Moçambique (ADM)

The GoM should consider embarking on a de-leveraging exercise for ADM to make the company viable again. The Government is better positioned to negotiate more favorable rates and maturities with lenders, reducing its financial cost and extending maturities.

To improve the operational performance of ADM, arrears from LAM needs to be addressed. Despite the need to improve other sources of inefficiencies, it is essential that ADM receives passenger fees collected by LAM and is paid for the airport services provided in a timely manner.
Concession arrangements for its profitable airports with an experienced private operator could be considered as an alternative. An experienced private operator could improve results from commercial areas of the airport and avoid build-up of arrears from clients, which jeopardize the company's financial performance. Additionally, the expected concession fees received by ADM alongside revenues from the air navigation services which must remain under state control for national security purposes, could cross subsidized unprofitable airports if these are maintained.

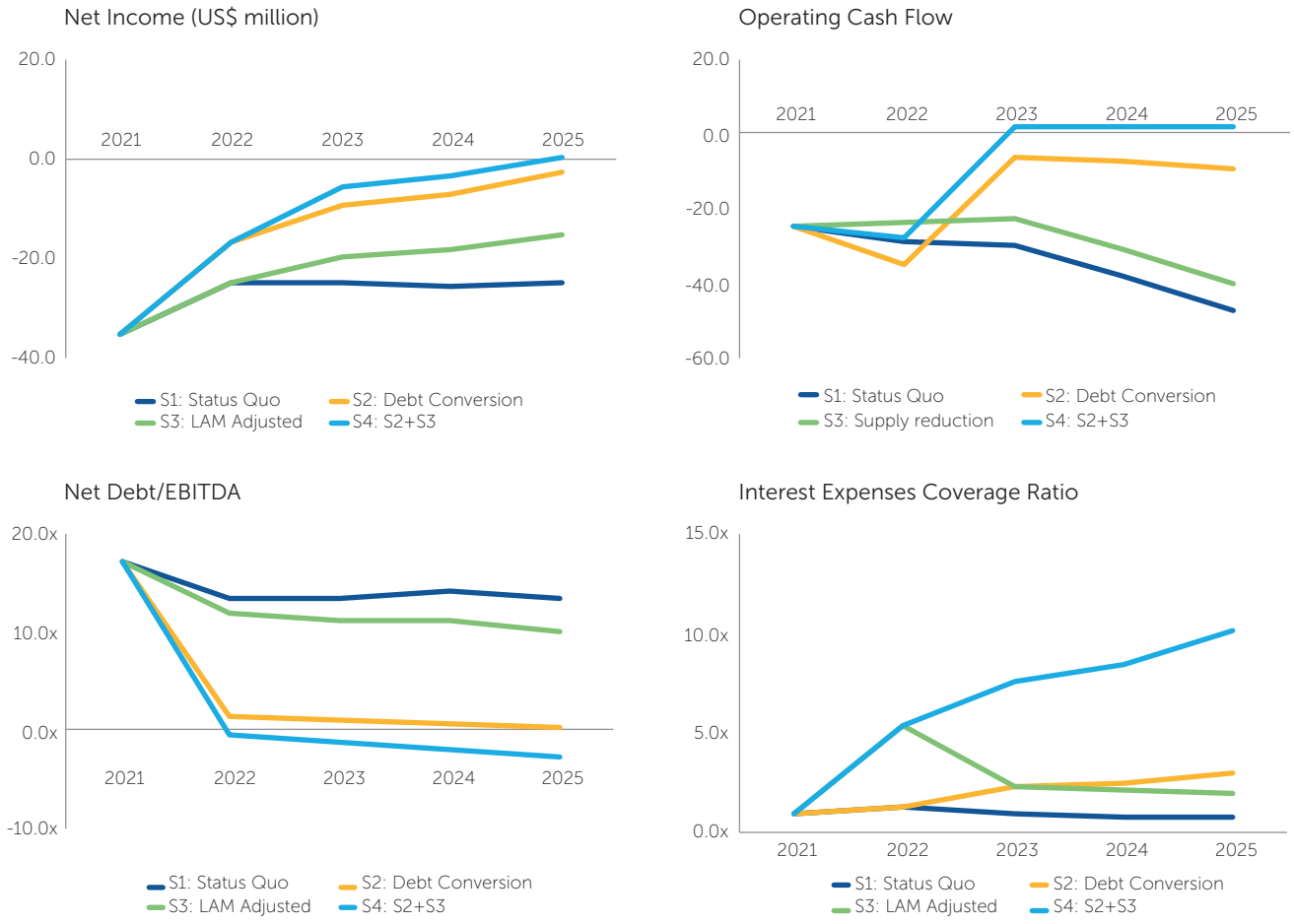
Four different scenarios have been considered (Figure 3.25).[85] The status quo (S1) assumes that no significant measures are taken. S2 assumes that the guaranteed debt and on-lent loans are converted into equity. S3 assumes that LAM normalizes the payments to ADM. S4 features a combination of S2 and S3.

Electricidade de Moçambique (EDM)

Defining and implementing a new tariff methodology based on cost recovery is essential to achieve and sustain the financial viability of EDM. Establishing ARENE as a regulator and advancing on defining the new methodology are relevant steps, but still not enough to guarantee that domestic tariffs will reflect an efficient cost structure for EDM. As seen in the fuel distribution market where ARENE is also the regulator, the methodology that decides prices to consumers can be overruled at the discretion of ARENE's

85 The analysis does not consider a scenario with a concession arrangement.

Figure 3.26: Four scenarios for improving ADM's financial sustainability



Source:

board of directors through not technical decisions. Such discretion should be avoided, as it opens up space for possible government interference and may result in tariff adjustment delays, or adjustments that do not fully recover unmanageable costs.

The GoM should consider favoring investments and efforts to improve the transmission and distribution network now that significant investment is already in place for generation. EDM has been suffering operating losses, since about 28 percent of electricity is lost and thus not generating revenues. Increasing the volume of electricity purchased/generated before solving the distributional loss issue would likely bring additional pressure to EDM's financial position, possibly worsening its performance further.

PSOs should be adequately quantified and fully covered by the GoM. Such investments should be funded by the Government rather than via EDM's balance sheet, so as not to compromise EDM's financial sustainability and to bring transparency and accountability of company's commercial performance.

Three different scenarios are considered (Figure 3.26). The status quo (S1) assumes that no significant measures are taken. S2 assumes a forex shock of 20 percent to indicate the risk of not having a cost recovery methodology to adjust tariffs, and S3 where tariffs are adjusted within the new methodology and EDM's guidance of operational improvements is achieved in five years.

Linhas Aéreas de Moçambique (LAM)

The state should consider embarking on a de-leveraging exercise for LAM to improve the financial situation of the company and reduce fiscal risks. This approach suggests LAM's high-cost guaranteed debt is assumed by the GoM and converted into equity. The main rationale is that the GoM is better positioned to negotiate with lenders. Given that, since 2021, LAM's financial expenses have already been paid directly from the state budget, renegotiating the terms of the loans as a sovereign state rather than as an insolvent SOE should translate into lower financial expenses and longer maturities. Additionally, the state could also consider assuming LAM's debt to ADM and PETROMOC, thereby

Figure 3.27: Three scenarios for improving EDM's financial sustainability

Source:

absorbing the spillover effects to the wider SOE portfolio and cleaning up the balance sheets of affected SOEs.

To improve operating results, LAM could prioritize profitable routes and reduce the capacity on unprofitable ones. Regional routes which are historically unprofitable, and domestic routes, could be trimmed down, resulting in higher load factors and profitability. LAM could still explore regional and international routes through commercial partnerships with other airlines, leading to some revenue generation, no operating costs and as a feeder to its domestic routes. Routes the GoM consider as PSOs, and therefore cannot be eliminated, should be reduced to minimum levels and the losses generated by these routes be adequately quantified, disclosed, and fully subsided by the GoM.

Figure 3.27 explores the impact of four different scenarios on LAM's possible financial sustainability: Status quo (S1) assumes that nothing material is changed. S2 assumes that high-cost debt is converted into equity. S3 assumes reduction of regional and domestic routes. S4 combines S2 and S3.

Petróleos de Moçambique (PETROMOC)

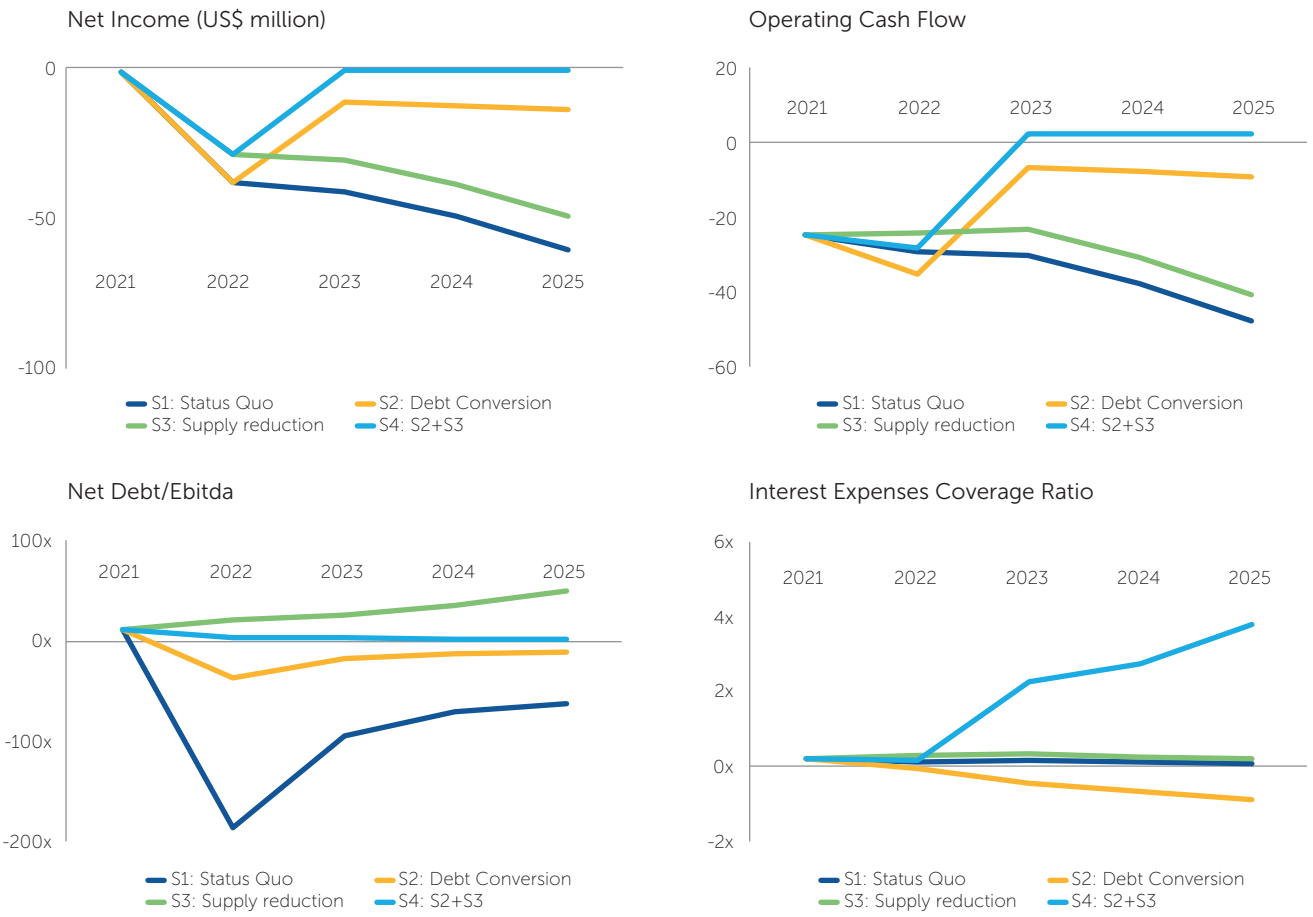
The state should reconsider the amount of fuel subsidy provided to final consumers and/or treat such subsidies directly, and not through the fuel distribution companies' balance sheets. PETROMOC has been struggling over the past several years and has required strong support from the government. The Ukraine war has intensified a situation that was already critical, and even higher levels of tax arrears will be necessary to cover the current regulatory deficit, and subsequent likely market share gain by PETROMOC, given the sector is highly unattractive to private players at present.

Divesting from the highly competitive fuel retail market and instead focusing on large consumers and the storage business may increase PETROMOC's profitability. The company may focus on serving large consumers where the market is less competitive. PETROMOC should also consider turning the storage into its core business, taking advantage of its current assets and the high margin profile of this business line. Additionally, PETROMOC could potentially generate cash via the sale of the retail fuel business line (a similar

approach to the one taken with the jet fuel business line) or keep a minority stake in a joint venture for the retail business, either expanding on the existing joint arrangement with SASOL or creating a new one with a new partner. Under any of the suggestions, PETROMOC would remain strategically poised to take over any fuel distribution market in an eventual scenario where private players resign their operations, avoiding any disruption of fuel supply across the country.

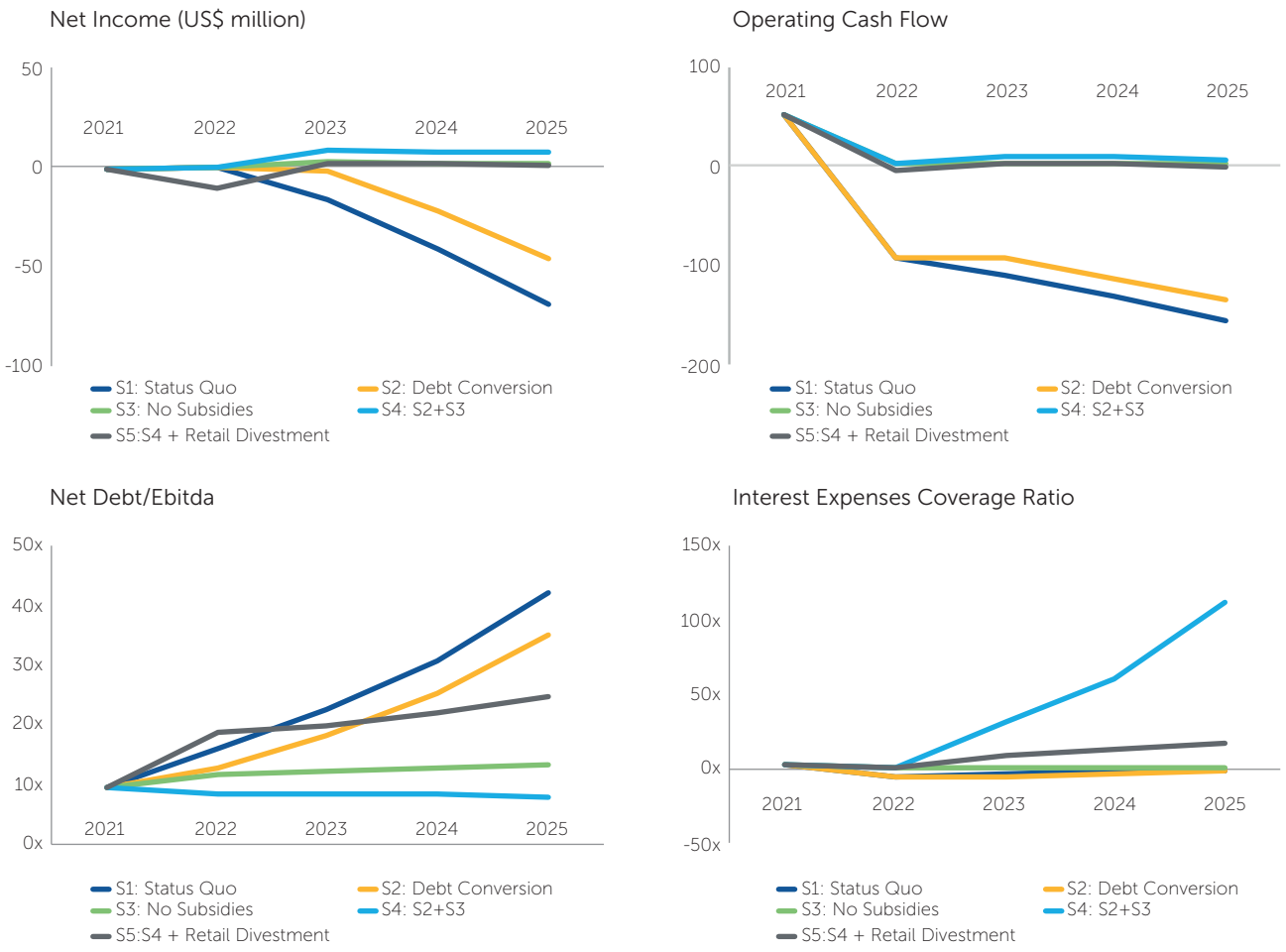
Four scenarios are considered. The status quo (S1) assumes that no significant measures are taken. S2 assumes that the expensive guaranteed debt is converted into equity. S3 assumes that subsidies are no longer financed through PETROMOC's balance sheet. S4 combines S2 and S3. Finally, S5 combines S4 with a potential divestment from the retail business (excluding the amount paid for this business line).

Figure 3.28: Four scenarios for improving LAM's financial sustainability



Source:

Figure 3.29: Four scenarios for improving LAM's financial sustainability



Source:

References

AfDB/OECD. (2003). *African Economic Outlook: Mozambique.* African Development Bank/ Organisation for Economic Co-operation and Development.

Allen, R., & Alves, M. (2016). *Fiscal Policy, How to improve the financial oversight of public corporations.* Fiscal Affairs Department. International Monetary Fund.

IFC. (2021). *Country Private Sector Diagnostic: Creating Markets in Mozambique.* International Finance Corporation.

IGEPE. (2019). *Estratégia de Investimento do Sector Empresarial do Estado 2020 - 2030.* Instituto de Gestão das Participações do Estado.

IGEPE. (2019). *Sector Empresarial Do Estado.* Instituto de Gestão das Participações do Estado.

International Monetary Fund. (2001). *Republic of Mozambique: Selected Issues and Statistical Appendix.* International Monetary Fund.

Musacchio, A., Pineda, E., Huber, J., Jara, M., Kim, H., Ter-Minassian, T., & Wagner, R. (2019). *Fixing State-Owned Enterprises; New Policy Solutions to Old Problems.* Inter-American Development Bank.

OECD. (2015). *Guidelines on Corporate Governance of State-Owned Enterprises.* Organisation for Economic Co-operation and Development.

República de Moçambique. (2019). *Decreto No. 10/2019 de 26 de Fevereiro de 2019.* Boletim da República - Publicação Oficial Da República de Moçambique.

República de Moçambique. (2021). *Decreto No. 26/2021 de 3 de Maio de 2021.* Boletim da República - Publicação Oficial Da República de Moçambique.

República de Moçambique. (2018). *Lei no. 3/2018 de 19 de Junho de 2018.* Boletim da República - Publicação Oficial Da República de Moçambique.

The World Bank. (2016). *Republic of Mozambique: Assessing Fiscal Risks from the Public Corporation Sector.*

The World Bank. (2019). *Integrated State-Owned Enterprises Framework iSOEF.* The World Bank.

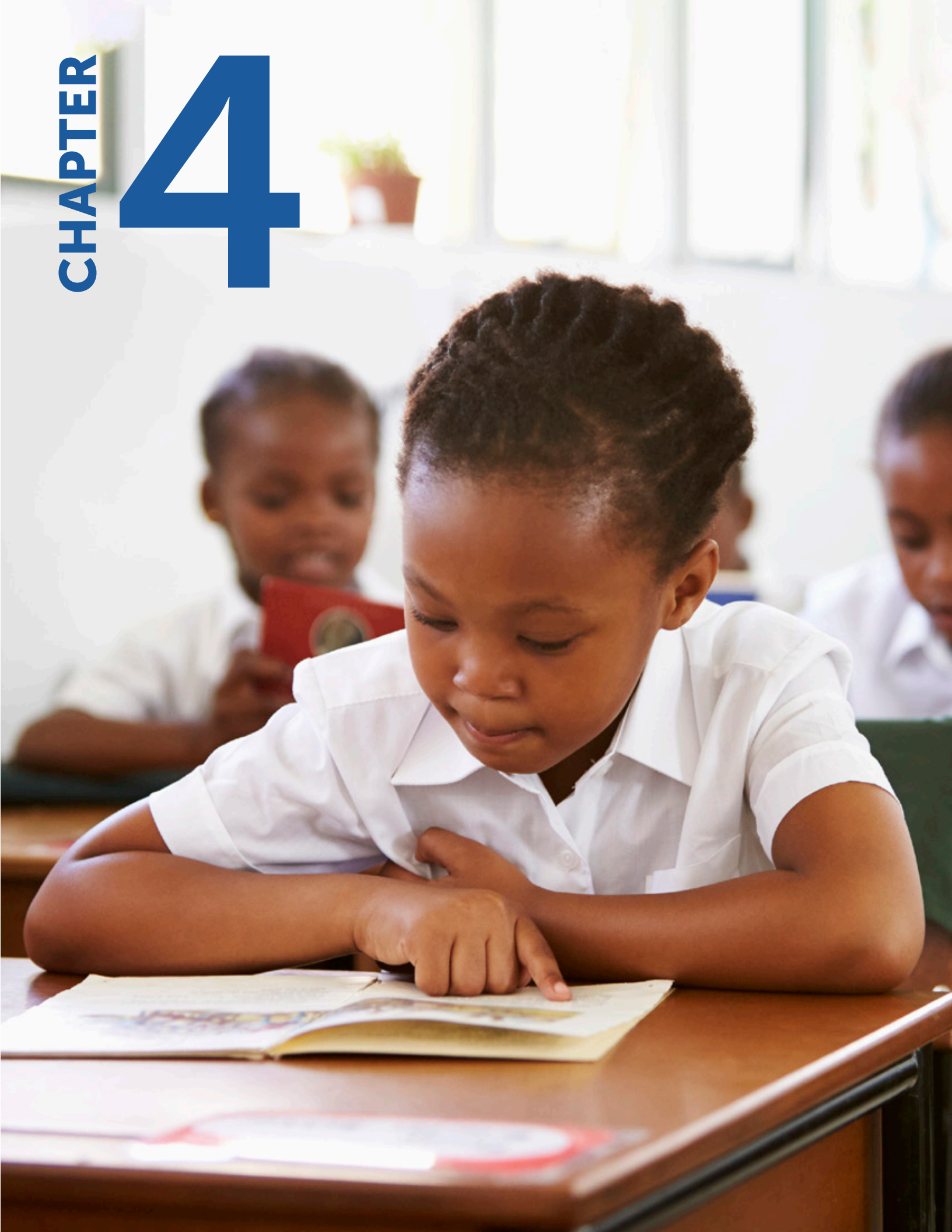
The World Bank. (2020). *State your Business! An Evaluation of World Bank Group Support to the Reform of State-Owned Enterprises FY08-18.* Independent Evaluation Group. World Bank.

The World Bank. (2021). *Kyrgyz Republic Integrated State-Owned Enterprises Framework (iSOEF) Assessment.* The World Bank.

The World Bank. (2021). *Mozambique Country Economic Memorandum: Reigniting Growth for All.* The World Bank.

The World Bank Group. (2020). *Performance and Learning Review of the Country Partnership Strategy For the Republic of Mozambique for the Period FY17 to FY21.* The World Bank Group.

CHAPTER 4



Education[86]

Summary. Mozambique needs to improve the quality of its education system to take full advantage of its demographic dividend. Doing so will be essential to ensure that jobs in more productive sectors can be created and filled, and to contribute to inclusive growth. This chapter reviews the recent trends in Mozambique's education sector—looking at how it performs on a range of indicators and in comparison to the country's regional and aspirational peers. An in-depth assessment of the efficiency and equity of the sector reveals the need to ensure that the system can keep up with the booming school-age population, and also adopt a more focused approach to quality education provision in the remote regions. Policy recommendations center on actions to improve efficiency and equity, while reducing pupil-teacher ratios (particularly in the north and central regions) and improving learning and completion rates, including: Reforming teachers' career framework to improve teacher quality; improving the process of teacher deployment and increasing the effective number of teaching hours; expanding distance learning for reducing pupil-teacher ratios and increasing coverage in secondary education; increasing the equity of allocation of funds to subnational levels; strengthening sector implementation capacity and service delivery; and increasing the predictability of budgets of the sector.

The chapter is organized as follows: Section 4.1 sets the scene, laying out the main challenges facing the education sector. Section 4.2 describes its organization and governance, as well as progress towards greater decentralization. A performance review of the sector is the topic of Section 4.3, which also benchmarks Mozambique against peer countries, and sub-Saharan Africa as a whole, for education performance and spending indicators. Section 4.4 provides a thorough assessment of the efficiency and equity of the sector, asking how resource allocations are translated into results, and whether education inputs are equitable geographically, by gender and according to socio-economic status. Section 4.5 looks into budgeting for the sector and at what is holding back investment. Policy recommendations in Section 4.6 suggest reforms in five key areas.

4.1 Introduction

Weak human capital is undermining the prospects for inclusive growth in Mozambique. Although the country has one of the highest social spending rates in Sub-Saharan Africa (SSA), human capital formation remains weak. Compared to its peers, the country also has one of the lowest levels of learning, which is a critical obstacle to faster and more inclusive growth. Many Mozambicans—especially those in rural areas and in the central and northern regions—lack access to the

86 This chapter was prepared in collaboration with UNICEF.

quality education that is essential for productive adult lives. Households in these provinces may be unable to benefit from growth due to lack of productive assets (including human capital), which limits their access to economic opportunities. High-quality education is a critical element for building human capital, improving labor productivity, and inclusive job creation. Enabling Mozambicans, particularly the poor and vulnerable, to contribute to and benefit from economic progress requires investing in quality education. The development of skills (including digital skills) is essential for the future of Mozambique, boosting labor productivity in an era of rapid technological change.

Mozambique has a rapidly growing population, posing both challenges and opportunities for long-term development. The country has one of the highest fertility rates in the world, at 4.7 children per adult woman, compared to the SSA average of 4.6. According to United Nations projections, more than 40 percent of the population in Mozambique will be under the age of 15 by 2030. The country's demographic transition represents a potential source of dynamism and economic growth, challenging the country to invest in quality education, among others, to reap the benefits. This highlights the critical importance of improving efficiency in the use of limited public resources to ensure opportunity of quality education for all.

Significant progress has been made in expanding access to education in Mozambique, but important challenges related to quality remain. Despite steady progress in the coverage of primary and secondary education in recent decades, Mozambique has one of the lowest levels of human capital in the world, being below most of its peers in SSA in the the World Bank's 2020 Human Capital Index.[87] A child born in Mozambique before the COVID-19 pandemic can expect to be 36 percent as productive when she grows up as she could have been if she had enjoyed complete education and full health. The main drivers of improvements in the HCI are changes in education quality as measured by learning, especially in the early grades. The level of foundational learning is alarmingly low in Mozambique: the 2016 National Learning Assessment found that only 5 percent of Grade 3 students could read and understand a simple text.[88] In addition, less than half of all students complete primary education. The key challenges driving these low education outcomes include: (i) an insufficient number of qualified teachers; (ii) low-quality management at school and district levels; (iii) insufficient infrastructure; (iv) insufficient provision of learning materials; (v) and low access to preschool and late entry into primary education. The COVID-19 pandemic has deepened the challenges facing the education sector in Mozambique, with the reduction in school engagement and learning time contributing to learning losses (Box 4.2).

Although Mozambique has achieved a remarkable expansion in access to technical and vocational education and training (TVET) and higher education, coupled with improvements in regional and gender equity, participation rates are still among the lowest in the region. The universalization of access to primary education and steady expansion of secondary education in recent decades were followed by rapid growth in access to TVET and higher education. Enrollment in TVET programs has more than doubled in recent years and has increased exponentially in higher education, from just over 10,000 students in 2000 to roughly 230,000 in 2021. This impressive growth is explained in part by the growing number of private institutions, from just 5 in 2000 to 32 in 2020. Equity in access to TVET and higher education has also improved in recent decades. The number of female students in post-basic education has been growing steadily, although with a concentration in humanities and social sciences. Despite the substantial increase in enrollment in TVET and higher education, enrollment rates in these levels remain among the lowest of peer countries given the rapid demographic growth.

As Mozambique is facing significant fiscal constraints, increasing spending efficiency is critical for meeting expenditure needs and providing high-quality public services, including education. In a context of limited fiscal space, improving education quality will require rethinking policies and introducing innovative approaches to service delivery, while simultaneously improving efficiency in the provision of public services. This means more effective allocation of the education budget to priority areas across and within levels of education, and making better use of existing resources to enable further expansion in services provision. This chapter therefore analyzes public expenditure in the education sector in Mozambique, with a view to identifying reform options to improve the efficiency and equity of the system. A critical first step towards improving access to quality education is to identify the main bottlenecks facing the education sector and highlight measures that can help to deliver more and better results. Based on the diagnostic of the education sector, a range of policy options to improve the efficiency and equity of the education sector in Mozambique are discussed.

4.2 The Education Sector: Organization and governance

The education system is under the responsibility of three ministries and one state secretariat, and is highly centralized at the national level. Preschools, primary and secondary schools, technical training institutions, higher education institutions, and other service delivery units report to four entities at central level and corresponding

87 World Bank (2020a)
88 MINEDH (2017).

entities at subnational level. There is limited delegation to local administration. The majority of these implementing institutions have limited financial and operational autonomy, and instead act as deconcentrated "beneficiary units", receiving transfers of funds to execute a certain number of pre-approved expenditures. The decentralized governance model adopted in the 2018 constitutional review has yet to be fully implemented, and ambiguities and overlapping functions remain. There are also overlapping functions and responsibilities between institutions at the provincial level, undermining sector plan and budget preparation and implementation (discussed further below).

The education system involves four main subsystems, according to the revised National Education System Law (Law 18/2018 of December 28):[89]

- **Pre-primary education.** Children from zero to five years of age can be enrolled in pre-primary centers, regulated by the Ministry of Gender, Children and Social Action (MGCAS), in collaboration with the Ministry of Education and Human Development (MINEDH) and the Ministry of Health (MoH). Mozambique developed its first strategy for the pre-primary sector in 2012, although most pre-primary schools are not public, but private or community run. There are four types of pre-primary school: nurseries for children of two months to two years old; daycare centers (*Centros Infantis*) for children from two months to five years old; kindergartens (*Jardins Infantis*), for children between three and five years old; and preschools (*Escolinhas*), also for children between three to five years old, often in rural areas and under community responsibility.

- **General education, including both primary and secondary education.** This is the main pillar of the national education system and provides students with qualifications to access the other subsystems. Primary education has been free since 2004. It comprises six grades organized into two cycles of three grades each: first cycle (grades 1-3 and second cycle (grades 4-6). Before the new Education Law, primary schools were divided in two categories, EP1 (grades 1-5) and EP2 (grades 6-7). Students completing primary education are entitled to continue to secondary education, which in turn has two cycles. ESG1, or lower secondary (grades 7 to 9), has been free since 2019 (reform approved in 2018); and ESG2 or upper secondary (grades 10-12), which collects fees from students. Completion of this level allows for access to higher education and TVET institutions. To meet the high demand for secondary education, evening classes are also offered, focusing on older students (over 15). A secondary education distance-learning program has also been created to help expand post-primary education, but its coverage is still very limited.

- **Technical and professional education.** This subsystem covers several types of institution providing access to professional certification. Vocational education institutions are classified according to the type of vocational education provided and degree level: (i) vocational schools, which award basic level certificates and for which the minimum entrance requirement is completion of grade 7; (ii) medium institutes, which confer certificates and medium-level degrees; entrance requirements are either completion of grade 10 (in general secondary education) or of the third year of the basic level of TVET, or a "Vocational Certificate 2" from a TVET institution; and (iii) vocational training centers, which grant partial qualifications, at elementary, basic, medium or higher levels. The government recently approved the system of Recognition of Prior Learning (RPL), allowing people who have not undergone conventional training to apply for certification for acquired professional competencies. Currently most students are enrolled in the basic or medium technical levels. The reform of technical education is introducing a competency-based training methodology in medium-level institutes, allowing for the accumulation of credits in courses approved by the government. This level of education is not free and is managed by the State Secretariat of Technical and Professional Education, with professional centers that offer professional education under the management of the State Secretariat for Youth and Employment.

- **Higher education.** Higher education covers public and private universities, schools, higher education institutes, as well as academies. To enter a higher education institute, students are required to have completed grade 12 of general secondary education or the TVET equivalent, and to have passed an entrance exam. This subsystem is managed by the Ministry of Science, Technology and Higher Education (MCTES).

The governance and management of the system is complex and highly centralized. Preschools, primary and secondary schools, institutes, higher education institutions and other service delivery units are distributed across the 11 provinces and report to the institutional structures described in Box 4.1. Except for higher education institutions, most training

89 The law also established two other systems, also managed by the Ministry of Education and Human Development. The Teacher Training Education subsystem is responsible for training teachers for all subsystems from pre-primary to higher education. The Ministry of Education is responsible for this subsystem and regulates the opening and functioning of teacher training colleges and institutes. Adult Education is an additional subsystem, offering literacy programs and education for youth and adults, providing them with general scientific knowledge to pursue further studies in TVET or higher education institutions. This subsystem includes two levels: primary, accepting students 15 years old and above; and secondary, accepting students 18 years old and above.

institutions have limited financial and operational autonomy, largely because they are not designated as planning and budget units in the public financial management (PFM) system. Instead, they are designated as deconcentrated "beneficiary units", receiving transfers of funds for a certain number of pre-approved expenditures. This status also severely limits their ability to collect and use their own revenues. The organizational architecture of the sector and the related degrees of financial autonomy at each stage are presented in Figure 4.1.

The decentralization process is incomplete, as practical steps are still needed to put in practice what has already been established in the law. The decentralized governance model adopted in the 2018 constitutional review is generally accepted as being necessary and beneficial to the country.

Box 4.1: The institutional and management framework of the education sector in Mozambique

As shown in Figure 4.1, at the central level there are four institutions:

- Ministry of Education and Human Development (MINEDH: *Ministério de Educação e Desenvolvimento Humano*), responsible for primary and secondary education.
- Ministry of Science, Technology and Higher Education (MCTES: *Ministério de Ciência, Tecnologia e Ensino Superior*), responsible for higher education (universities and institutes).
- State Secretariat of Technical and Professional Education (SEETP: *Secretaria do Estado de Educação Técnica e Profissional*), responsible for technical and professional education.
- Ministry of Gender, Children and Social Action (MGCAS: *Ministério do Género*, Criança e Acção Social), responsible for pre-primary education (jointly with MINEDH).

At the provincial level, two institutions represent the sector:

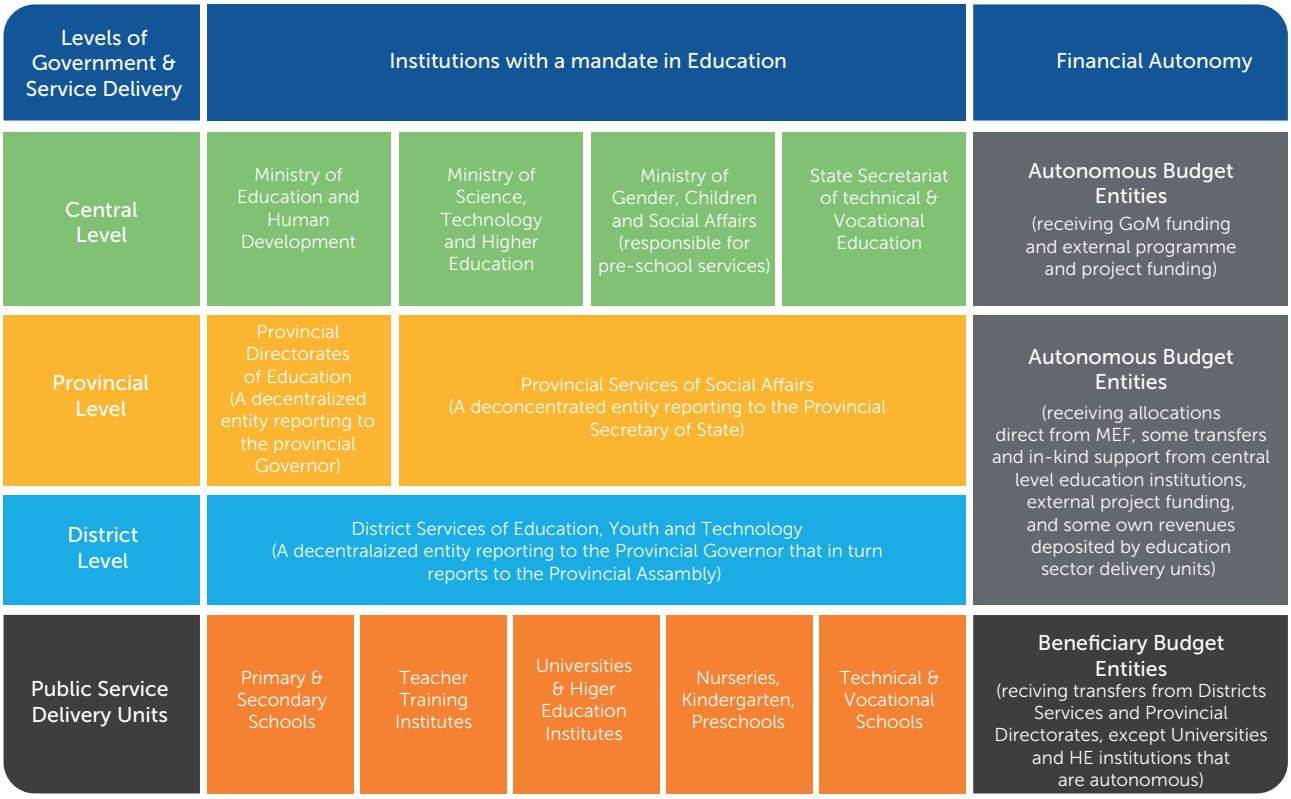
- Provincial Directorate of Education (DPE: *Direcção Provincial de Educação*), responsible for primary and secondary education as well as the recruitment and allocation of teachers in the province.
- Provincial Services for Social Affairs (SPAS: *Serviços Provinciais de Assuntos Sociais*), responsible for technical schools, teacher training institutes and pre-schools.

At the district level, there are two institutions representing the sector:

- District Services for Education, Youth and Technology (SDEJT: *Serviços Distritais de Educação, Juventude e Tecnologia*).
- District Service for Women, Health and Social Action (SDSMAS: *Serviços Distritais da Saúde, Mulher e Acção Social*), only covering pre-primary education.

The central level entities are system regulators and responsible for developing standards to ensure the efficient and effective allocation of financial and human resources. They monitor the implementation of strategies and assess their impact in improving performance. The central government also makes decisions on staffing to ensure regional equity. In the case of basic education, MINEDH is responsible for allocating the School Grants (Direct Support to Schools—ADE in Portuguese), based on inputs received from the provincial and district authorities. The central government, represented by the Ministry of Economy and Finance, communicates expenditure limits to provinces as part of the process of drawing up the Medium-Term Fiscal Framework. The DPEDs and SPAS are responsible for allocating the budget to different sectors and to districts within the province. These decisions should be informed both by the District Socioeconomic Plan (Plano Económico e Social do Distrito) and by broad guidance from central level. The DPEs and SPAS harmonize and monitor the district and provincial annual plans and budgets, striving to minimize disparities and inequities among the districts and education institutions. Districts are responsible for allocating resources to schools and ensuring the local operation of the education system. The district then allocates the budget to the schools. They are charged with planning and budgeting the districts' education activities. Districts are instrumental in managing human resources in all district schools. At the start of the fiscal year, districts collect statistics which are used to inform spending needs (e.g., the number of students) and formulate the District Socioeconomic Plan. SDEJTs are also expected to play a key role in monitoring teaching-learning processes within education institutions, with particular attention to primary and secondary education and to adult literacy and education programs.

Figure 4.1: Mozambique's education architecture and levels of financial autonomy



Source: Legislation of the Mozambique Government.

However, ambiguities and overlaps in the execution of functions persist. Practical guidance on how to implement the selected decentralization model is lacking, and hence allocation and management decisions are not consistent and are frequently adjusted as the reforms actually take place. Autonomy, especially at service delivery level, which was intended to increase with fiscal decentralization, is being hampered by this deep uncertainty, and remains very limited as a result (Chapter 2).[90]

Functions overlap between institutions at the provincial level, undermining how the sector plan and budget is prepared and implemented. For example, both the DPEs and SPAS have responsibilities for ensuring quality education services, promoting inclusive education, applying organizational and operational norms for adult education, constructing schools, and ensuring pupils' health, hygiene, and nutrition (Figure 4.1). What each entity should be deciding, planning, and implementing within these shared responsibilities is not clear. At the provincial level, education managers strongly express the need for further revision of the existing decentralization laws and regulations to clarify functions and competencies more precisely, and assign the necessary financial and human resources for an effective service delivery.

Procurement of "big ticket items"—in particular, textbooks and school constructions and refurbishments—remains centralized. Moreover, there are important challenges related to the distribution of these services between levels. The purchase and distribution of textbooks is financed centrally and deployed only to the capital of each district. No additional funding is provided directly at that level to deliver textbooks to each school. As a result, the distribution of textbooks depends on the "good will and ingenuity" of each school director, who must ensure their transportation from the district capital to the primary school. The process results in persistent delays in delivering textbooks to students.

Operational autonomy is further restricted by the limited financial autonomy of the service delivery units. Only a small number of education institutions are designated

90 However, spending responsibilities are increasingly delegated to the subnational level, both in absolute and relative terms. For instance, districts managed 80 percent of education expenditures in 2021, up from 57 percent in 2014 (MINEDH, BERs). The major increase in the share of expenditure by districts is for personnel costs due to the shift in responsibility (since 2011) from provinces to districts for paying salaries and other personnel costs. Spending on goods and services has also seen decentralization, with provincial and district responsibility rising in recent years. Capital expenditure remains the responsibility of provinces and central level, although the share of provincial responsibility has been increasing relative to the central level.

as autonomous budget management entities (UGBs), even though the e-SISTAFE system and the related digital infrastructure could easily accommodate more institutions. Furthermore, only entities designated as UGBs are allowed to collect and manage their own revenues (discussed further in Section 4.5). This situation is of particular importance for teacher training institutes and TVET institutions, which are under the responsibility of SPAS at provincial level. However, since all of them are in districts, in practice they end up being under the responsibility of SDEJT. These training institutes are too big and important as education institutions to be managed by a SDEJT. Although they train and graduate the teachers who feed into the school system, they have less operational autonomy than the district-level structures. In addition, the consequent constraints to their own revenue generation and use mean that while they do collect revenues, they are not sufficient to sustain their own needs, nor to adequately complement the budget transfers they receive.

4.3 Mozambique's Key Education Indicators

Trends in key education indicators

Mozambique has experienced sustained growth in enrollment across all levels of education over the last two decades, reflecting the efforts of the government to increase access. In primary education (EP1-EP2), the total number of students has nearly tripled since 2000, with the school system expanding to accommodate the growing demand in part associated with the free primary education for all policy adopted in 2004. The education system is heavily weighted towards primary, which accounts for nearly 85 percent of the combined primary and secondary enrollment; the initial primary level (EP1) accounts for 72 percent of all primary-secondary enrollment. Secondary and tertiary enrollments have grown at a faster pace than primary enrollment in recent years, but they still make up relatively smaller shares of the overall total (Figure 4.2). In 2021 there was a slight reduction in enrollment in primary education, despite the continuous population growth, revealing an impact of COVID-19 on school engagement.

Mozambique's population is heavily weighted towards younger cohorts and is growing rapidly, generating substantial pressure on the education system. Almost half of the Mozambique population is under the age of 18 and approximately 30 percent of the population is younger than 10. If Mozambique keeps the current fertility rate, younger population cohorts are projected to continue growing steadily in the next decades, with the 6-17 year-old cohort expected to increase from 9.8 million in 2020 to 13.6 million by 2035 (Figure 4.3). These demographic trends will exert substantial pressure on the education system in the coming years, with more learning spaces and teachers required to accommodate the growing number of children.

The rapid population growth in Mozambique stems from extremely high fertility rates, despite reductions in recent years. Total fertility, measured as the average number of children per woman, declined substantially in Mozambique, from 5.8 children in the 2000-2005 period to 4.9 in 2015-2020. Similarly, the crude birth rate (number of births per 1,000 population) declined from 44.3 to 37.7 between 2000-2005 and 2015-2020. But the Mozambique figures are still higher than the Sub-Saharan Africa averages, as well as those of most structural peers, and substantially higher than aspirational peers (Figure A1, Annex C).

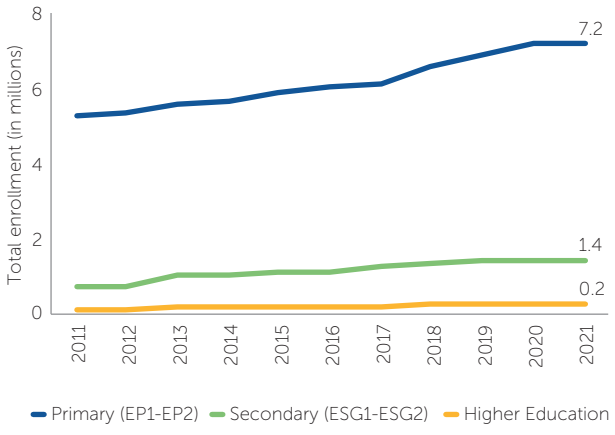
Enrollment growth in basic education is higher in the more populous northern and central regions, with the south having a higher increase in upper secondary. The vast majority of Mozambican children that are enrolled in basic education (primary and lower secondary) are in the provinces located in the north and center of the country (85.5 percent), which have also experienced the largest growth in enrollment in the last 5 years (Figure 4.4). The less deprived southern provinces have experienced a higher increase in upper secondary education, the only level of general education that continue to officially charge fees from students. This positive relationship between enrollment size and growth in the early grades can also be observed for students between 6 and 12 years old, with growth rates for enrollment being substantially higher in the northern and central provinces (Figure 4.5).

A low proportion of young Mozambicans have access to secondary education. The recent eradication of school fees for lower secondary education in Mozambique (effective since 2019) is increasing the demand for secondary education, but challenges for effective access remain. Mozambique has more than 4.6 million people between 12 and 17 years old (official age range for secondary education in Mozambique), but less than 1.5 million of students are enrolled in secondary education, with more than 1/3 of these students being older than 17.[91] Enrollment is concentrated in primary education, with less than 1 in 5 general education students enrolled in secondary (Figure A3). The low proportion of students in secondary education is a result of low supply of secondary schools and qualified teachers, as well as slow student's transition from primary to secondary education (Figure A2).

After an extended period of rapid increase, the teacher labor force growth rate is slowing, and it is highly concentrated in primary education, with a relatively low weekly workload. Despite the continuous increase in the number of students enrolled, the total teacher labor force in public general education was nearly 148,000 in 2021, compared with approximately 139,000 in 2019, 131,000

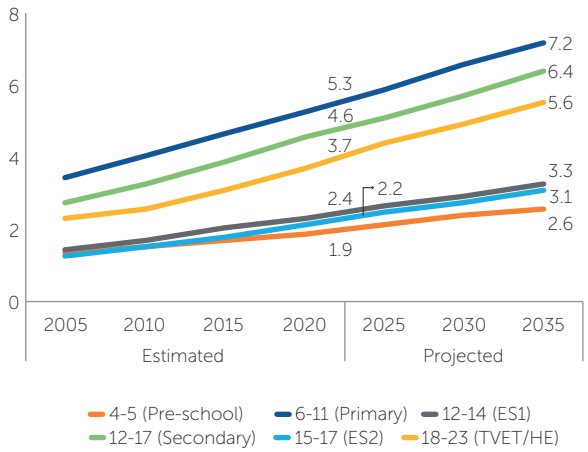
91 MINEDH and IOF, 2020.

Figure 4.2: Total enrollment in primary, secondary and tertiary levels, 2011-2021



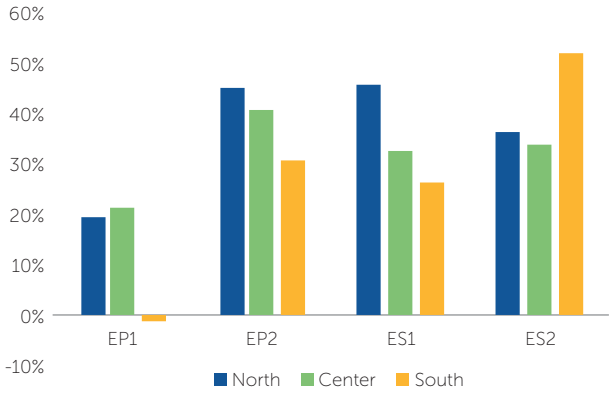
Source: UNESCO Institute for Statistics (UIS) and MINEDH.

Figure 4.3: Mozambique's population by age group, 2005-2035



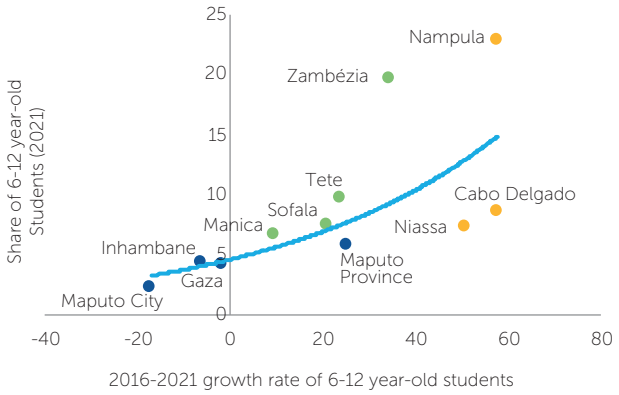
Source: UN Department of Economic and Social Affairs.

Figure 4.4: Enrollment growth rate 2016-2021 by education level and region 2016-2021



Source: MINEDH.

Figure 4.5: Growth rate of 6-12 year-old students (2016-2021), versus share of 6-12 year-old students (2021)



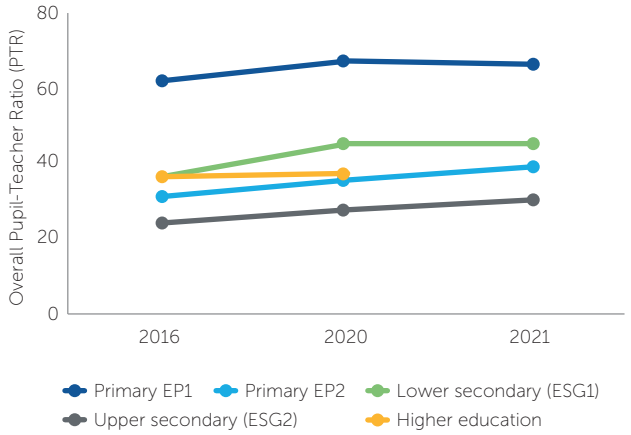
Source: MINEDH.
Note: Northern provinces in yellow, central provinces in green and southern provinces in blue. Dotted line represents exponential fitting between the two variables.

in 2016 and just 68,000 in 2004. The majority of general education teachers are teaching in EP1 (61 percent), with 21 percent teaching in EP2 and less than 18 percent of teachers at secondary level. Teachers have contracts of 20 to 24 hours per week in primary and secondary schools, with a significant fraction of these teachers working extra hours, or, in situations of sudden increased demand, the number of hours may double temporarily (with a maximum temporary increase of 60 percent in their usual salaries).

The total number of schools has increased substantially, especially at secondary level, but the ratio of students per school has not declined, as the growth of the school-aged population outpaced the system capacity to supply at the required levels. To meet the demand of the growing school-aged population in Mozambique, the number of schools increased between 2016 and 2021 by 6.3 percent in EP1, 29.1 percent in EP2, 21.1 percent in ESG1 and 52.1 percent in ESG2. Most newly built schools in recent years were in the provinces in the north and central regions (Figure A4). Cabo Delgado was the only province with a reduction in the number of schools between 2016 and 2021, reflecting the conflict that the province has experienced in recent years. But the overall average school size (in terms of enrollment) in all levels increased over this same period, albeit with large variation by province.

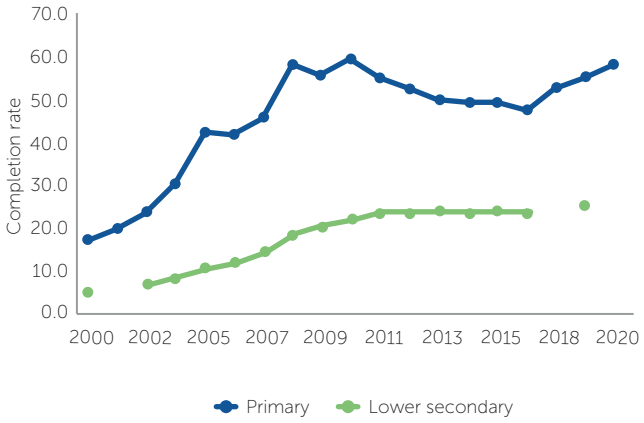
As result of the increase of enrollment outpacing the expansion of the teacher labor force, pupil-teacher ratios have increased in all levels in recent years. Pupil-

Figure 4.6: Pupil-teacher ratio by education level, 2016-2021



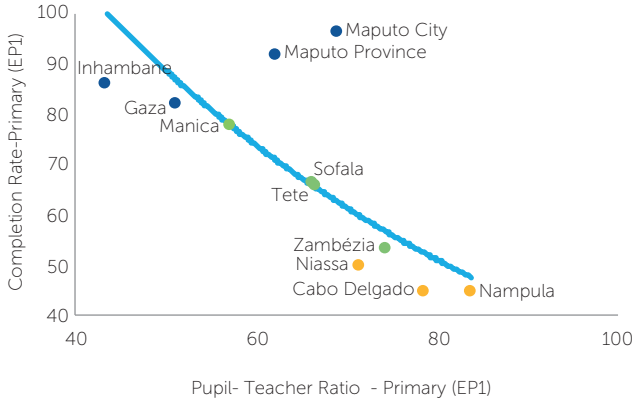
Source: MINEDH and MCTES.

Figure 4.7: Completion rates by education level, 2000-2020



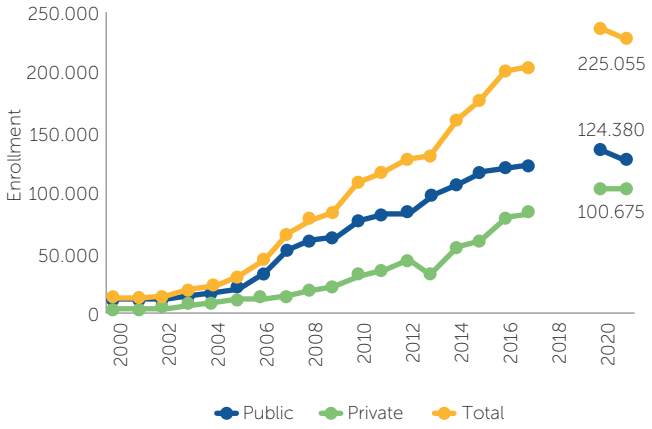
Source: World Bank Indicators. 2000-2020.
Note: Info not available for some years for lower secondary.

Figure 4.8: Pupil-teacher ratio vs Completion rate, Primary Education (EP1), by province, 2019-2020



Source: MINEDH and IOF. Note: Northern provinces in yellow, central provinces in green and southern provinces in blue. Line represents exponential fitting between the two variables..

Figure 4.9: Enrollment in higher education by sector and year, 2000-2020



Source: MCTES.

teacher ratios in Mozambique are increasing in primary and secondary, but the averages differ across the provinces[92] and for each education levels, with more than 60 students for each teacher in primary education (Figure 4.6).[93] In addition, the range between the lowest and highest students per teacher ratio increased substantially in the period between 2018 and 2020 (Inhambane 43.5 and Nampula 82.8 in 2020). In 2021 the national average pupil-teacher ratio was 65.9 in EP1, 39.4 in EP2, 44.9 in ESG1 and just 30.2 in ESG2[94]. In secondary education the pupil-teacher ratios are generally higher in the southern region than in the northern provinces.

After significant improvements between 2000 and 2009, completion rates have stalled in low levels in recent years, most notably in lower secondary education. Completion rates are calculated as the percentage of older age cohorts

92 Cabo Delgado and Nampula had throughout the period the highest level of student teacher ratio

93 Pupil-teacher ratios (PTR) are calculated by taking the total number of students and dividing by the number of teachers for that level. A similar measure is the pupil-class ratio, which is calculated by dividing total enrollment by the number of reported classes ("turmas"). These ratios do not directly measure the number of students who are studying with individual teachers ("class size"), but they are often used as proxies for class size. The MINEDH 2021 annual statistics summary shows that pupil-teacher ratios (overall average 59) are consistently higher than pupil-class ratios (overall average 50), but provincial averages for these two indicators are highly correlated (0.89).

94 In EP1 one teacher covers all subjects and the PTR reflects the average number of students per teacher while from EP2 onward, teachers cover one or two subjects and teach many classes.

who have completed the level (e.g., 15-18 year olds who have completed primary). Completion rates in Mozambique have remained low in recent years, with less than two-thirds of students completing primary education and less than one-third completing lower secondary education (Figure 4.7). And a substantial share of the students who complete the education levels are overage (Figure A2 and Figure A5).

Low completion rates are associated with challenging learning environments, particularly the high numbers of students each teacher is responsible for. Completion rates are particularly low for the provinces in the north region, where average pupil teacher ratios are as high as 80 (Figure 4.8). On the other hand, completion rates are around 90 percent in the southern provinces, with lower pupil-teacher ratios than most central and northern provinces, which also mirrors the differences in the ratio of population growth across provinces.

There has been a massive expansion in higher education enrollment, which has increased from just over 10,000 students in 2000 to roughly 230,000 in 2021. The substantial growth in higher education enrollment is the result of the rapid expansion of the system which also open the space for the introduction of private institutions. Both public and private institutions pace of growth increased, from 5 in 2000 to 22 in 2020 (public) and 5 to 32 (private). Although most private institutions are small, private institution enrollment has been slowly catching up with public institution enrollment, and as of 2021 public enrollment accounted for just over 57 percent of the total (Figure 4.9).

Equity in access to TVET and higher education has improved in recent decades, both regionally and by gender, with enrollment of female students in post-basic education growing steadily, but remaining mostly concentrated in social science areas. Female enrolment in higher education currently represents 45 percent of total enrolment, up from 32 percent in 2003. Gender equity in higher education has increased as completion rates in secondary education have become more gender balanced. Regional equity is being addressed with the establishment of new tertiary education institutions in the provinces and expansion outside Maputo of campuses for two of the major public institutions. Prior to this expansion, the government attempted to address geographic imbalances through quotas (by region of student origin) for major public institutions in the enrollment of students. In 2012, for example, 40 percent of the students enrolled in higher education were not from Maputo.[95] Survey data (from the 2000s) also show increased access of students from households in the first, second and third lowest socio-economic status (SES) quintiles which, although still low, increased from 2.9, 6.3, and 6.0 percent in 2002/03 to 10.8, 13.2 and 18.4 percent in 2008/2009, respectively.

Pre-pandemic levels were critically low, and learning losses associated with COVID-19 are likely to add to existing inequities, making the challenge more complex. The level of student learning assessed in by the most recent national learning assessment, in 2016 only 5 percent of Grade 3 students in Mozambique were able to read at the expected level.[96] Regional assessments (e.g., Service Delivery Indicators, SDI and SEACMEQ) have shown some improvement.[97] But the assessment results consistently show very low levels of achievement (discussed further below), and with the school closures during COVID-19, learning loss is likely at all levels of education (Box 4.2).[98]

95 World Bank (2014).
96 MINEDH (2017).
97 Southern and Eastern Africa Consortium for Monitoring Educational Quality.
98 New rounds of both the National Learning Assessment in Mozambique and SEACMEQ are planned to be executed in 2022.

Box 4.2: Impacts of COVID-19 on Mozambique's education sector

In Mozambique, as in most countries, the pandemic represents a real threat to children's education. The most visible direct impact was the closure of schools across all education levels, which affected a total of 8.5 million Mozambican children and students during 2020 and 2021, and the impact is still visible in 2022. From September 2021 the restrictions have been reduced and schools have returned to face-to-face learning; but given the need to maintain social distancing the actual instruction time for students, especially in primary education, has been further reduced compared to before the pandemic. In addition, some students can only attend school 2 or 3 times a week as there is a restriction that students groups have to be smaller than 45 students, and for schools with large pupil teacher ratios the students come to school on alternating days. This is particularly the case in the northern region where teacher-pupil ratios are very high, which is expected to have a substantial effect on learning results.

Challenges for remote learning. Despite the government's effort to provide teaching opportunities via distance learning, access to mass media is limited for the majority of the population in both urban and rural areas – only 39.5% and 50.7% of urban households have access to a radio and television respectively, while those figures go down to 32.8% and 7.8% for rural households. Access to the internet is only 5.5% for urban households and 0.6% for rural households. In the case of technical education, the 2021 academic year was modified as distance education resources were not sufficiently developed for teaching practical subjects. Therefore, students who entered medium-level technical institutes in 2021 completed their studies in May 2022. In higher education, the sector noted that over 30% of the students were not able to effectively access learning through distance education; as a result, the academic year was also rescheduled, with implications for overall system efficiency. In practice, these disruptions lead directly to forgone earnings for those who dropout because they cannot afford digital devices. For those who do complete their education, the rescheduled academic year means considerable delays. These impacts are in addition to the inefficiencies that plagued the system prior to the pandemic. Together, they are likely to harm the poorest families and represent a potential source of instability given the growing number of young people who lack adequate skills to successfully enter and thrive in the labor market. These risks are especially notable for families in the northern region, which represent over 33% of the country's population and where the poverty gap is the highest.

The likelihood of early dropout from the education system increased during the COVID-19 pandemic. The pandemic increased the likelihood of girls dropping out, driven by the reduced time for instruction and higher opportunity costs for poor families. Due to the school closures the school year was compressed to about seven months in 2020. During this period teaching and learning was mostly carried out in a distance model which was not effective for most students for the low technology penetration. Teachers were instructed to prepare exercise handouts for students in primary and secondary education who could not access other modus of distance learning (MINEDH 2020). It is estimated that 63 percent of children were engaged in some learning but mostly aided by caregivers which means that a great majority of children whose caregivers could not read in Portuguese in practice were left with no support to engage, consolidate and develop new learning. A rapid assessment conducted by UNICEF indicated that 37% of children did not have any learning activity, 16% got hand-outs directly by their teachers and of those 80 percent did not communicate with the teacher during 2020. The automatic promotion of children opened the space for new entrants in 2021 but did not address the catch-up on learning losses. Although MINEDH issued a Ministerial Diploma in May 2021 to cover for curriculum revision most students that were enrolled in the system in 2020 had to catch-up on their learning. The survey also found differentiation on the level of learning engagement across regions and noted that the children from most deprived provinces which also had performed lower in the national learning assessments suffered the major impact of the pandemic. The survey also found that 31 percent of rural households were affected by a disruption to their income-generating activities and that about 35 percent of rural households had been affected by the illness, injury, or death of an income-earning member due to COVID-19 i, against just over 20 per cent in urban areas. These impacts in income generation associated with the school closures led to many families involving their children in income generation activities with greater incidence to students in the north and center regions of the country which have a greater number of students' households when compared with the south region. The reduction in income which continued throughout 2021 for most poor families is estimated to have contributed for dropout of children. In addition, a longitudinal evaluation of dropouts in Mozambique conducted by UNICEF in 2021 indicated that children who dropout up from school scored about half of what the children who stayed in school scored on the letter and word identification tests. Evidence from previous school shutdowns shows that school children, and especially girls, who are out of school for extended periods are much less likely to return when classrooms reopen. Furthermore, financial pressures faced by households that lost their livelihoods caused by the overall slowdown of the economy may also have reduced private investment in education, with corresponding increases in unemployment and under-employment.[a]

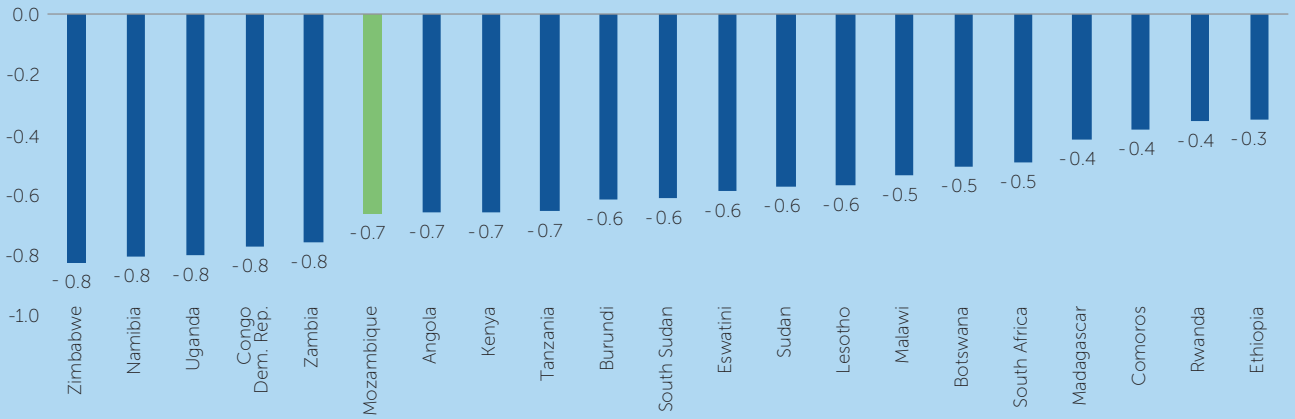
Mozambique has implemented policies seeking to mitigate the impacts of COVID-19, but challenges remain. The measures implemented included temporary school closures combined with mobilization to provide remote learning to students (mainly one-way communication strategies, such as radio, TV and printed materials), efforts to improve sanitation conditions in schools and remediation measures to catch up with a loss of learning, not only at the onset of the pandemic but also at the peaks of the infection waves. However, some of these interventions were limited in terms of coverage and effectiveness. A household survey revealed that by November 2020, only 70 percent of students in Mozambique had a minimal level of school engagement during the school closures.[b]

Simulations indicate that students in Mozambique experienced substantial learning losses, making the improvement in learning more challenging and requiring more efforts. Currently there are no data available to fully document the learning losses due to Covid-19 in Mozambique, but simulations provide an indication of the likely impacts of school closures. The projected impacts of COVID-19 on learning-adjusted years of schooling (LAYS, the average years of schooling when the effective learning is taken into account) are nearly -0.4 (reaching 4 LAYS) in a intermediate scenario and -0.7 (reaching 3.7 LAYS) in a pessimistic scenario. These numbers represent an average reduction in the lifetime earnings of a single individual (present value) of nearly USD 1800 and 2820 (respectively, intermediate and pessimistic scenarios).[c]

The full impact of the pandemic in the sector still needs to be fully documented, but it is clear that specific strategies are urgently needed to mitigate the long-term impact. Therefore, the following strategies—some of which are already being implemented by the sector—deserve attention:

- Strengthen the measures for bringing students back, including re-enrollment campaigns, incentives (cash or in kind, such as school meals), and comprehensive services to support children's education, health, psycho-social wellbeing and other needs.
- Provide nutrition packages for children up to nine years old whenever possible (working with the Ministry of Health and Agriculture).
- Consolidate the curriculum to focus on foundational learning.
- Implement large-scale remedial learning at different levels of education (teaching at the right level based on students assessments).
- Build teachers' capacity in pedagogies for remedial learning and digital teaching approaches, so that all teachers are prepared and supported to address learning loss among their students.
- Launch an open-access, adaptable learning assessment tool that measures learning losses and identifies learners' needs.

Projected Impacts of COVID-19 on Learning-Adjusted Years of Schooling (Pessimistic Scenario), selected countries



Source: World Bank´s Learning Losses Tool (2021).

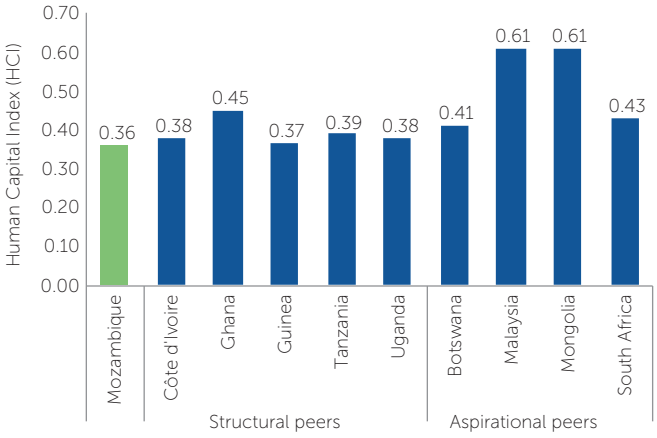
a Al-Samarrai, (2020).
b Impacts of COVID-19 on households in Mozambique, World Bank, 2021.
c World Bank´s Learning Losses Tool (2021).

International benchmarking of Mozambique's education system

Mozambique has one of the lowest levels of human capital in the world, and among its peers. The country has one of the lowest Human Capital Index (HCI) in Sub-Saharan Africa and below most peer countries (Figure 4.10). A low HCI is closely related to the low levels of learning (a key factor in the index). The low level of human capital is a binding constraint to sustained economic growth, with low levels of income being associated with a low ranking on the HCI (Figure 4.10).

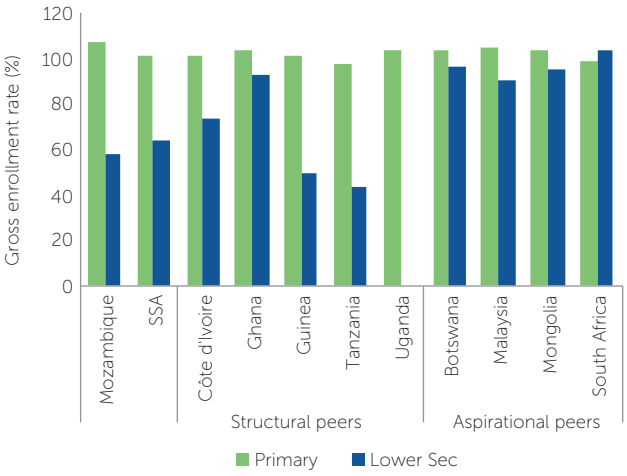
Significant gains have been realized in enrolling children in school, but persistently high gross enrollment rates is a symptom of inefficiency. Since GERs take into account all students enrolled, regardless of age, figures above 100 percent indicate a high number of overage students and a low level of student progression, which in turn is associated with low internal efficiency. After reaching nearly 120 percent, the gross enrolment rate (GER) in primary has declined in recent years, but is still higher than peers (Figure 4.11). The high GER reflects the massive expansion of the primary system in recent decades as a result of introduction of reforms that allowed more school access of children from poor households and specially girls due to the reduction of costs for families, provision of free textbooks and had positive spillover effects in attendances rates in secondary education. Enrollment in lower secondary has increased, but is still far below the SSA average. Mozambique's GER for lower secondary is 38 percent, compared to 51 percent in SSA, indicating considerable room for improvement.

Figure 4.10: Human Capital Index, 2020



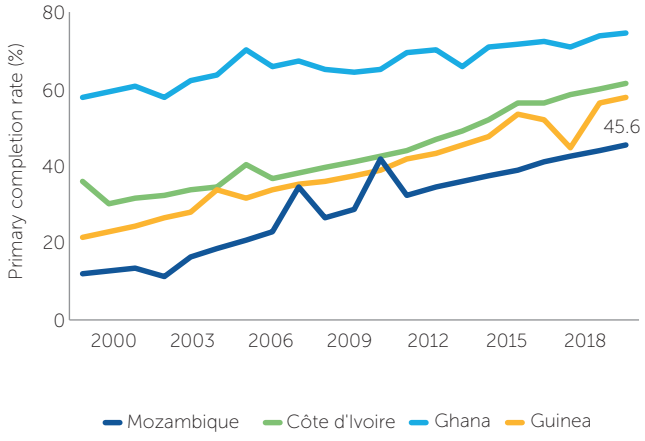
Source: UNESCO Institute for Statistics (UIS) and MINEDH.

Figure 4.11: Gross enrollment rate in primary and lower secondary, Mozambique and peers



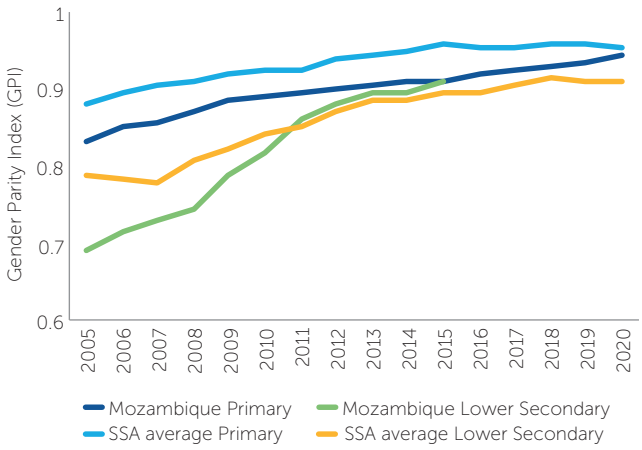
Source: UN Department of Economic and Social Affairs.

Figure 4.12: Primary completion rate trends, Mozambique, and peers, 2000-2020



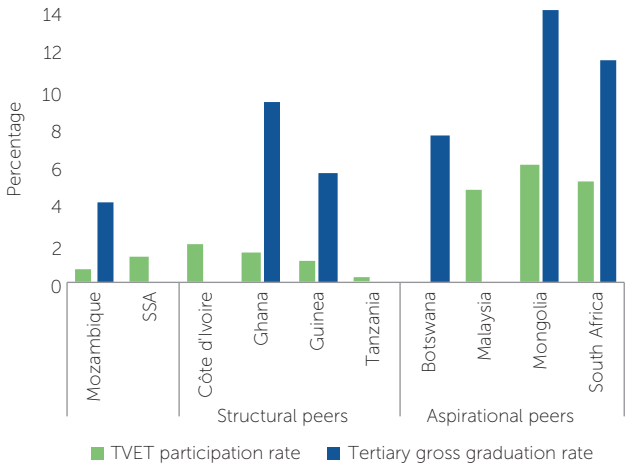
Source: UIS statistics. Latest year of data by country for TVET/Tertiary: Mozambique (2015/2018), SSA (2020/NA), Cote d'Ivoire (2020/NA), Ghana (2020/2020), Guinea (2019/2017), Tanzania (2017/NA), Botswana (NA/2014), Malaysia (2019/NA), Mongolia (2019/2019) and South Africa (2019/2019).

Figure 4.13: Gender Parity Index trends in primary and lower secondary, 2000-2020



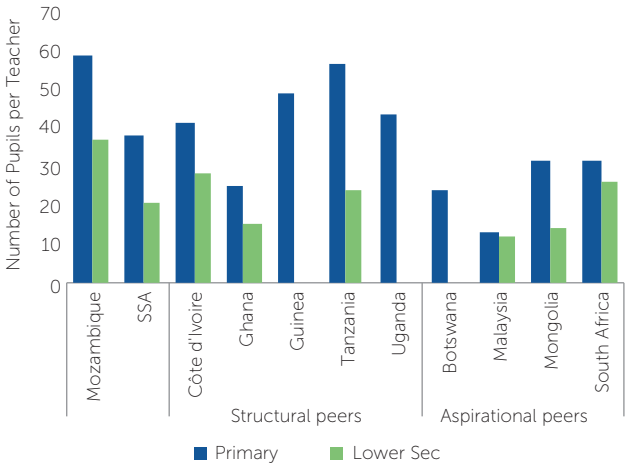
Source: UIS statistics.

Figure 4.14: TVET participation rate (15-24 year olds) and tertiary gross graduation rate



Source: UIS statistics (2018).

Figure 4.15: Pupil-teacher ratio (PTR) by level and country



Source: UIS statistics. Latest year of data by country: Mozambique (2019), SSA (2020), Cote d'Ivoire (2020), Ghana (2020), Guinea (2020), Tanzania (2020), Uganda (2017), Botswana (2015), Malaysia (2019), Mongolia (2019) and South Africa (2015).

Despite important improvement in completion rates in recent years, less than half of students complete primary education. The existence of the seven-year primary cycle in Mozambique until recent years (longer than most countries) hinders comparisons with peers with fewer primary grades, but despite steady improvement over time, Mozambique still lags substantially behind other countries for this outcome. In 2020 the primary completion rate was just under 50 percent (Figure 4.12) —although up from 30 percent in 2010—while lower secondary completion rates were extremely low (15.5 percent). Also, the gross intake ratio for the last year of primary education was 58 percent in 2020, compared to 71 percent for Sub-Saharan Africa.

Mozambique has made considerable progress in reducing gender imbalances in basic education and has steadily caught up with the Sub-Saharan Africa average in both primary and lower secondary. In 2000 the ratio of girls to boys enrolled in primary education in Mozambique was 0.75, and in lower secondary education there were 0.63 girls for each enrolled boy (Figure 4.13). By 2020 these ratios were closer to 0.95, which in lower secondary is higher than the SSA average. However, parity between genders is still not achieved, as girls' enrollment rates lag behind boys' at all schooling levels.

Despite the impressive growth in enrolment in recent years, Mozambique has very low levels of higher education and TVET participation in comparison with its peers. Less than one percent of Mozambican youth (aged 15-24) were enrolled in a TVET program in 2015, compared with an average of 1.3 percent in SSA and roughly 5.0 percent in aspirational peer countries (Figure 4.14). For tertiary education the gross graduation ratio in 2018 was 4.0 percent, which is lower than peers such as Ghana, Guinea, Botswana and South Africa (Figure 4.13). The ratio of students enrolled in sciences, technology, engineering, and mathematics rose from 18 percent in 2007 to 26% in 2017, but this ratio is still below the SSA region average of 30 percent.

A major binding constraint to education quality is the student group size; Mozambique has one of the highest pupil-teacher ratios in primary and secondary education among peers. Using UNESCO Institute for Statistics (UIS) data, the pupil-teacher ratios (PTRs) are nearly 58 students per teacher in primary, and 36.5 in secondary (Figure 4.15). Both averages are substantially higher than the SSA averages for these levels, and are also higher than structural and aspirational peers.

The numerous challenges that affect the provision of quality education in Mozambique are evident in the very low levels of learning in comparison with peer countries. Measures of student learning, including test scores from national and regional assessments, are one of the main output indicators for education quality. Although results from the Service Delivery Indicator (SDI 2014, 2018) and the Southern and Eastern Africa Consortium for Monitoring Education Quality (SEACMEQ 2007, 2013) show some evidence of improvement over time, test scores in language and mathematics are lower than almost all other participating countries.[99] For example, on the SDI Mozambique's students scores in language and math increased from 19 (out of 100) and 25 (out of 100) in 2014 to 31 in both subjects in 2018,

99 World Bank (2015, 2019).

which is higher than Niger in 2015 (23 out of 100 in language and 12 in math), but still far below what students in Tanzania scored in 2014 in both language (48 out of 100) and math (58 out of 100). It was also below Madagascar in 2016 (57 out of 100 in math and 44 out of 100 in language). Challenges related to quality have been exacerbated by the COVID-19 pandemic school closures, also affecting student learning levels (Box 4.2).

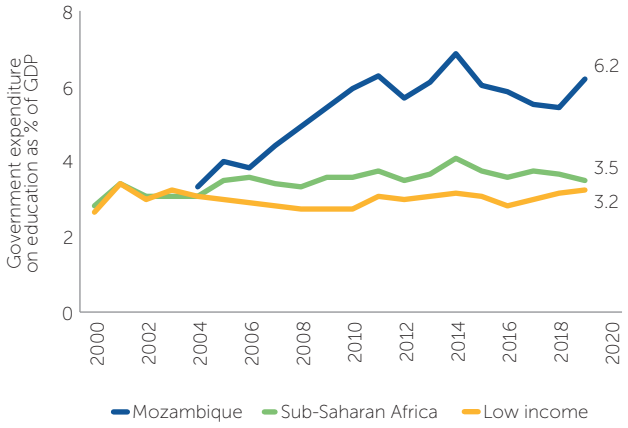
4.4 Education Spending

Government expenditure on education as a percentage of GDP and total expenditure are significantly higher in Mozambique than structural peers and the SSA average. The education spending as a share of GDP in Mozambique has been trending upwards since the mid-2000s and is now on a par with aspirational peers such as Botswana and South Africa (Figure 4.16). The share of education in total government expenditure has generally been higher than most peers over the past 20 years, revealing the priority of the education sector for the Mozambique Government (Figure 4.16). However, the overall education sector spending in Mozambique has been relatively constant in recent years. Nominal education spending steadily increased between 2009 and 2021, and real spending also increased between 2009 and 2014. But since 2014, education spending in real terms has been relatively stable. There was a significant decline in 2021, however, reflecting the impacts of COVID-19 on the government financing of the education sector.

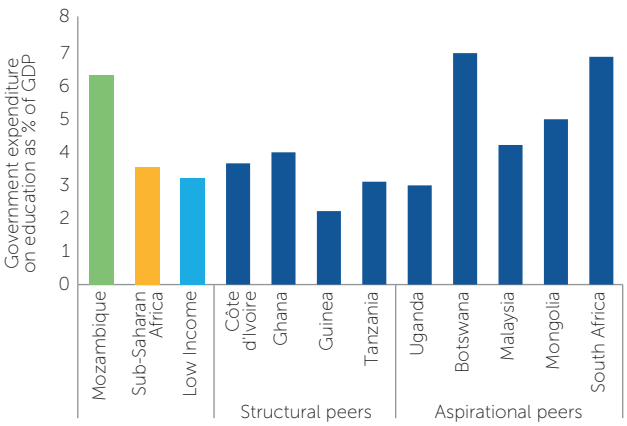
Primary and secondary education (upper and lower secondary combined) account for the largest shares of education spending. The share of spending on primary education in Mozambique has been nearly double that

Figure 4.16: Government expenditure on education as a percentage of GDP and of total expenditure

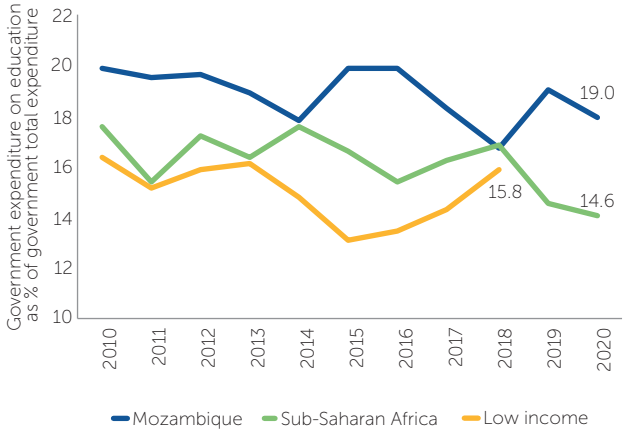
a. % of GDP, 2000-2020 trends



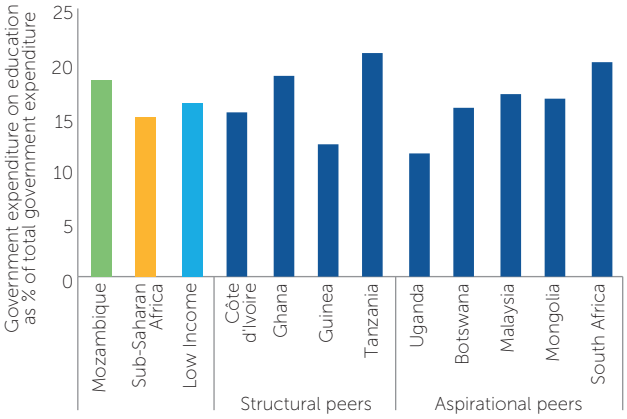
b. % of GDP, most recent year (2020)



c. % of government total expenditure, peer comparison, 2010-2020



d. % of government total expenditure, peer comparison, 2020

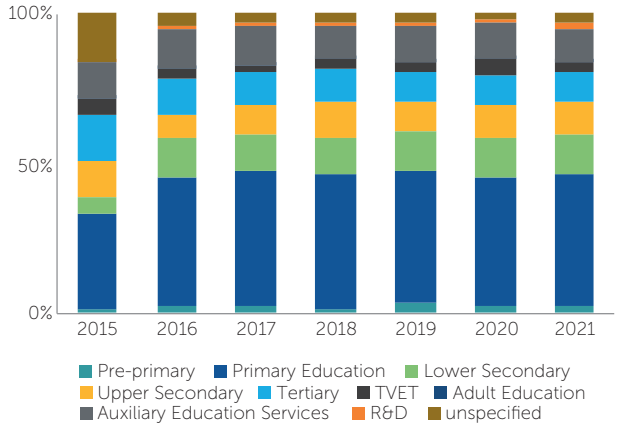


Source: UIS statistics. Latest year of data by country: Mozambique (2020), SSA (2020), low-income countries (2020), Cote d'Ivoire (2020), Ghana (2018), Tanzania (2018), Uganda (2018), Botswana (2019), Malaysia (2020), Mongolia (2020), and South Africa (2020).
Note: SSA averages consider all countries in the region, except high-income countries.

of secondary education for several years (Figure 4.17).[100] In 2021, primary education spending accounted for 44 percent of total spending and secondary education spending accounted for nearly 25 percent. Pre-primary education accounts for, on average, just 2 percent of total education spending. Primary and secondary spending shares are on par with regional averages and several structural peers, although aspirational peers tend to assign larger shares of spending to secondary and tertiary (Figure 4.18).

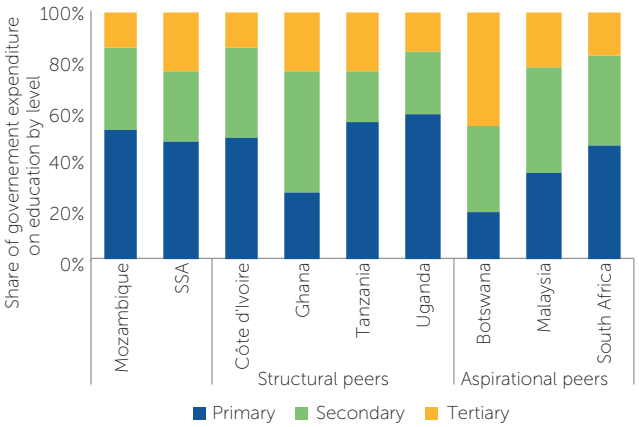
Despite significant government efforts to allocate funds to education, spending per student in Mozambique—the relevant metric for improving education quality—is low compared with peers. High levels of total spending on education as a share of GDP and total government expenditure do not automatically lead to high levels of per-student spending, especially when education spending growth is not keeping pace with growth in the student population. Mozambique's average per-pupil spending is lower than most structural peers, is less than half the Sub-Saharan average in 2015, and is far below aspirational peers (Figure 4.19). Per-pupil spending in secondary is higher (roughly $275 USD/student in 2013), but still substantially lower than aspirational peers and based on a much smaller share of enrollment.

Figure 4.17: Education spending share by level, 2015-2021



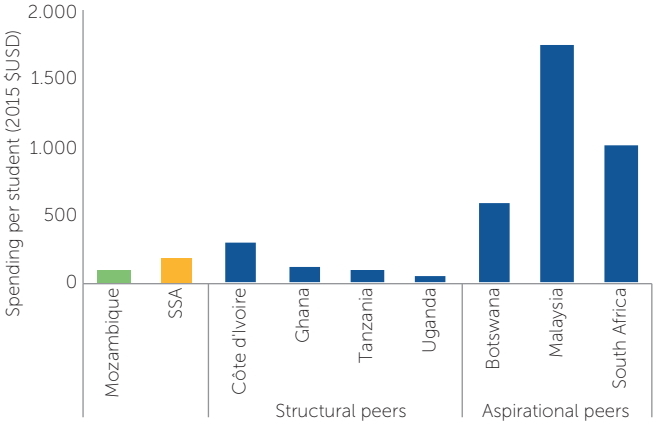
Source: CGE 2015-2021.

Figure 4.18: Share of overall government expenditure on education by level, Mozambique and selected countries



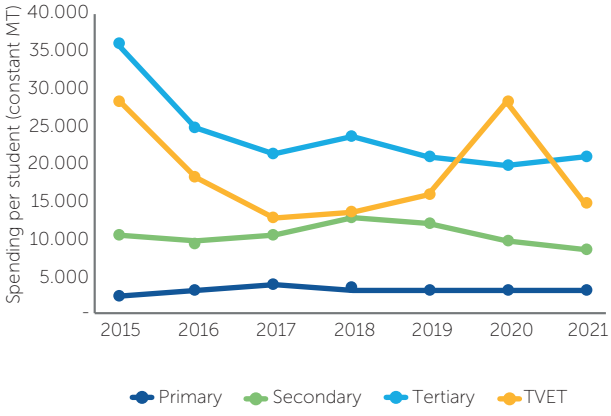
Source: UIS statistics. Latest year of data by country: Mozambique (2013), Cote d'Ivoire (2018), Ghana (2014), Tanzania (2014), Uganda (2014), Botswana (2009), Malaysia (2018) and South Africa (2018).

Figure 4.19: Per-pupil spending in primary education, Mozambique, and selected countries (USD 2015)



Data source: UNESCO Institute for Statistics (UIS) and MINEDH

Figure 4.20: Per-student education spending by level, 2015-2021, constant MT



Data source: UN Department of Economic and Social Affairs

100 It is also worth noting that a substantial share of education spending was categorized as "unspecified" until the early years of the previous decade and there is a strong indication that these expenditures have been gradually reassigned (or recategorized) to primary education.

Overall education spending has remained fairly constant while student populations have continued to expand and, as a result, per-pupil spending levels are generally declining. Primary spending was as high as MT 3,600 (in 2015 MT) per pupil in 2018, but has declined to just under MT 2,800 in 2021. n secondary education the decline between 2018 and 2021 has been even more pronounced and amounts to a 33 percent decrease in real per-pupil spending. Large declines are also notable in tertiary and TVET. The common theme in these trends is that enrollments are increasing rapidly while overall spending—and spending shares across levels—have remained fairly stable. For example, the total number of students in the system was 6.7 million in 2015, and 8.9 million in 2021.

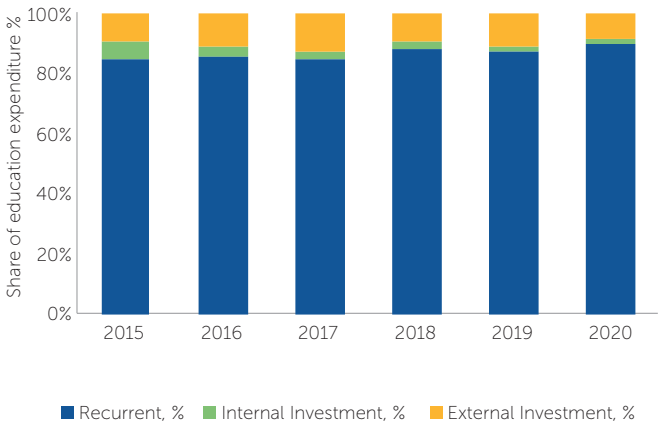
Average per-student spending has generally been converging across the different levels in recent years, but remains highest for tertiary and TVET. TVET and tertiary per-pupil spending levels have declined considerably from earlier high points due to a combination of enrollment growth and fluctuation in shares devoted to these levels, especially compared to 2015, when tertiary and TVET spending were especially high (Figure 4.20). Nevertheless, despite the general trend towards equality, large gaps remain: secondary spending per pupil is more than twice as high as primary (in 2021), and tertiary spending is 7.5 times higher per student than primary.

Most of the education budget is used for recurrent expenditures (mainly teacher salaries), and almost all investment spending is funded externally. The share of recurrent spending has steadily increased in recent years, and makes up 85 percent of total spending (Figure 4.21). In 2015 recurrent spending accounted for 84 percent of total spending, with six percent devoted to internally-sourced investment and 10 percent coming from externally-sourced investment. In 2020, the recurrent share had increased to 90 percent, while the internal investment share had declined to just two percent and the external investment share had remained steady at nearly 9 percent. External investments have increased from 61 percent of total education investments in 2015 to 89 percent in 2020. In addition, the education sector in Mozambique is mostly funded internally by the state budget, as donor on-budget contributions to education spending held steady at around 10 percent between 2015 and 2020.

Increases in the share of resources devoted to recurrent spending have led to decreases in spending on areas that directly impact the quality of the sector. Important investments to improve the quality of the sector have decreased due to the number of new teachers being hired. The expansion of these recurrent spending components has coincided with a decrease in investment components, such as teachers' professional development, and better geographical distribution and improved infrastructure of school buildings, among others. (Figure 4.22).

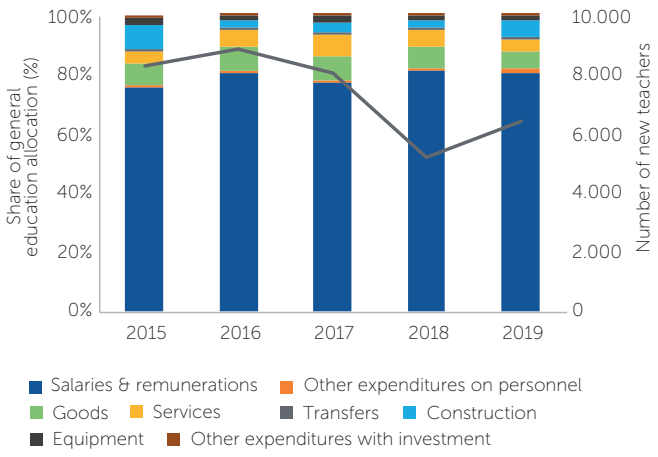
The portion of education funding executed by subnational administrations has increased in recent years, but investment is still concentrated at the central and provincial levels. The deconcentration process of the education sector is reflected in the increase of spending executed by the district levels, which have seen their share of spending increase to the detriment of provinces. Wages and salary spending has driven this trend (Chapter 2). However, it is important to note that there is no investment spending at the district level, and the entire district-level education spending is made up of salaries, which generates a high level of dependence of districts on the province and the central level. About 20 percent of the provincial-level education spending and 14 percent of central-level sector spending is investment.

Figure 4.21: Recurrent vs. investment shares in overall education spending, 2015-2020



Source: Boost 2015-2020.

Figure 4.22. Summary of spending shares by component, 2015-2019



Source: MINEDH.

4.5 Efficiency and Equity of Mozambique's Education Sector

How are resource allocations translated into results?

Spending-outcome efficiency

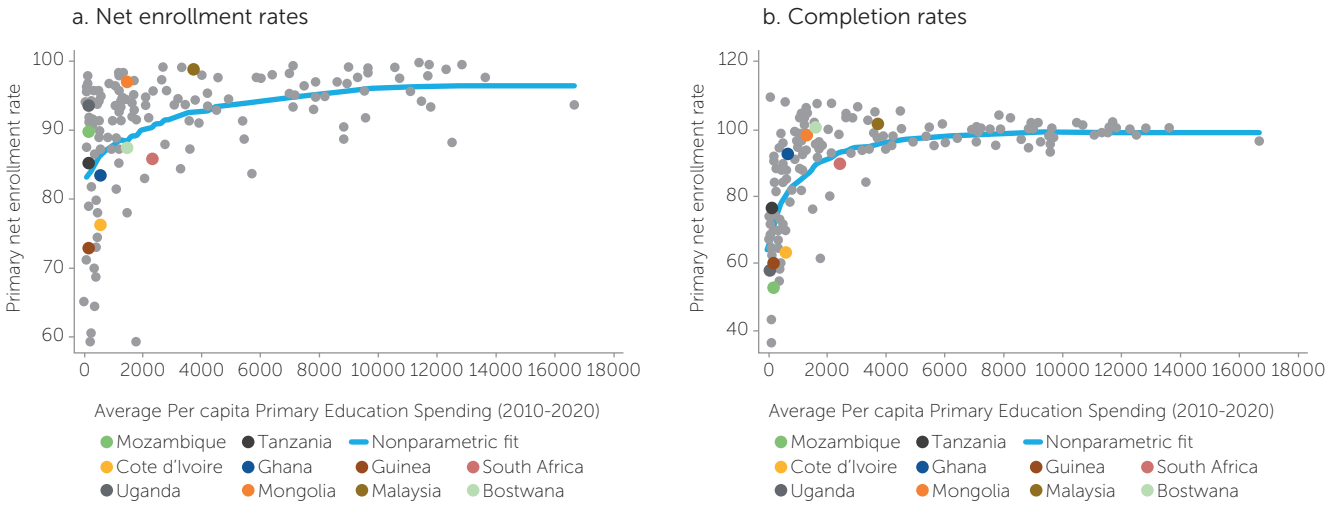
Mozambique performs below its peers for the efficiency of its education sector. Figure 4.23a and b show the relationship between spending in primary education and key education outcomes (completion and net enrollment rates). Based on the net enrollment rate in primary education, Mozambique seems to outperform most of its peers in spending-outcome efficiency (Figure 4.23a). But when the efficiency comparison is based on primary completion rates, the relative efficiency per spending result is markedly lower (Figure 4.23b). This raises questions as to whether primary education spending is targeted at enrolling more students rather than addressing obstacles to school retention and completion (e.g., teacher capacity, absenteeism, and barriers to accessing education, notably for the most vulnerable and girls etc.). Similar conclusions are reached when the relative efficiency analysis is considered. When country-level efficiency is assessed by measuring how much countries deviate from predicted values (i.e., how much a country would spend per student and what it would achieve in terms of education outcomes if it behaved like other countries with similar characteristics) similar conclusions about efficiency emerge. Mozambique is relatively efficient when net enrollment rates are considered, but highly inefficient when completion rates are analyzed, meaning that students are enrolled at the right age, but do not progress or dropout, and less than 50 percent complete primary education (Figure 4.24a and b). A summary of the methodology is presented in Box 4.3.[101]

The level of efficiency at primary level varies significantly across districts with high enrollment rates—particularly in the northern provinces—limiting education outcomes. The efficiency level of primary education is estimated for Mozambique districts with a panel dataset of education spending per student and retention rate up to grade 3 between 2019 and 2021 using a Data Envelopment Analysis (DEA). The level of efficiency of the districts is plotted against the size of the district school network (Figure 4.25), revealing a positive correlation though this varies widely across regions. There is a high level of inefficiency, particularly in smaller districts in the southern provinces, as well as northern districts with larger school networks. However, relatively small districts in the northern provinces have a high efficiency score for primary education. The low retention rates up to Grade 3 observed in most of the northern districts is associated with the high pupil-teacher ratios in these areas (Figure 4.28). A key element driving the high level of heterogeneity of outcomes for a given level of spending per student is the management capacity at the local level.

Allocative efficiency

The measure of pupil-teacher ratio is key aspect for efficiency in the education sector, but education outcomes are hampered when class sizes are extremely high, as observed in Mozambique. The pupil-teacher ratio is a key indicator of the efficiency of the education sector as it captures the link between the main input of the education production function (teachers) and the main output (students

Figure 4.23: Primary per-student expenditure vis-à-vis education outcomes



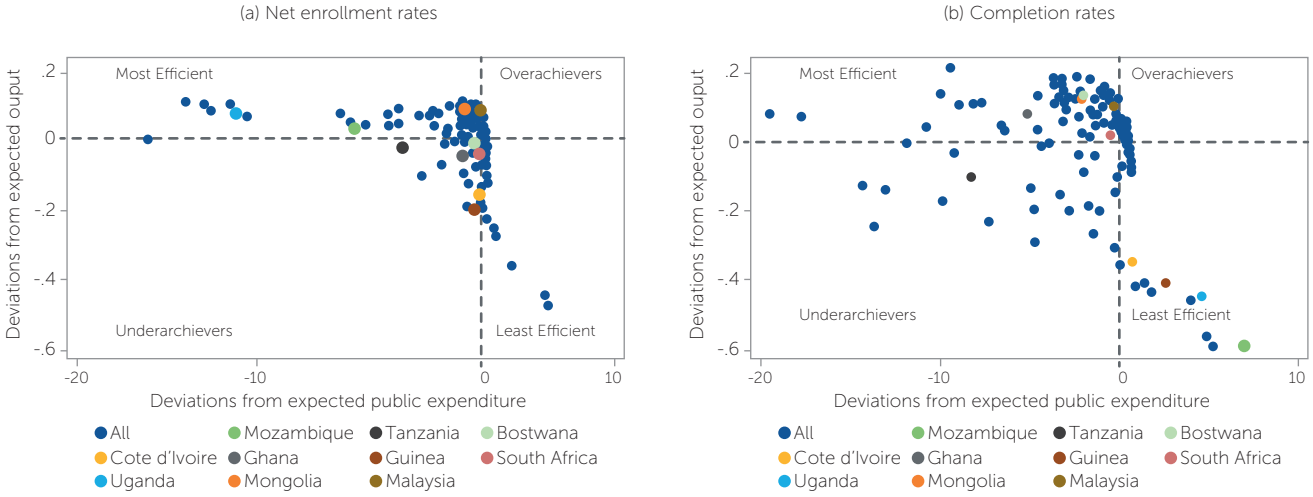
Note: Net enrollment rates and completion rates are the averages of data from 2010 to 2020 for most countries. Spending data in USD: latest year of data by country: Mozambique* (2013), SSA (2012), Cote d'Ivoire (2018), Ghana (2014), Tanzania (2014), Uganda (2014), Botswana (2009), and South Africa (2018).
Source: WDI.

101 An efficiency analysis is also performed with Data Envelopment Analysis (DEA, a linear programming method for assessing the efficiency and productivity of units called Decision Making Units - DMUs), reaching similar conclusions.

enrolled). As discussed in Section 4.3, pupil-teacher ratios in Mozambique are well above most of its peers and higher than the levels considered adequate for an effective learning environment. High pupil-teacher ratios reflect the on-going challenges of increasing the numbers of teachers and schools/classrooms to keep pace with the rapid growth of the school-aged population. Moderately high pupil-teacher ratios can increase the efficiency of the system, as more results (at least outputs, but not necessarily outcomes) are achieved for a given level of inputs, but very high levels become counterproductive.

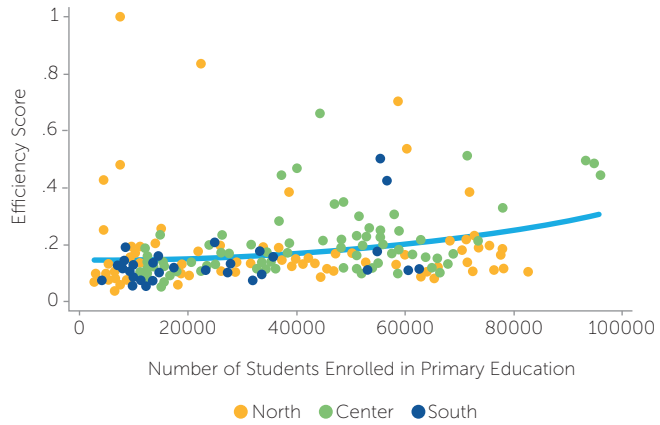
The extremely high pupil-teacher ratios observed in some areas of Mozambique (especially the northern provinces) reveal a high level of allocative inefficiency. The distribution of the pupil-teacher ratio in primary education across Mozambique's provinces and districts reveals the high variance of the indicator across the country, with some districts below 25, while in others the ratio between students and teachers is above 100. Pupil-teacher ratios have not changed significantly in Mozambique's districts since the beginning of the COVID-19 pandemic but are substantially different across regions (Figure 4.27 and Figure

Figure 4.24. Relative efficiency: spending per student vis-à-vis education outcomes



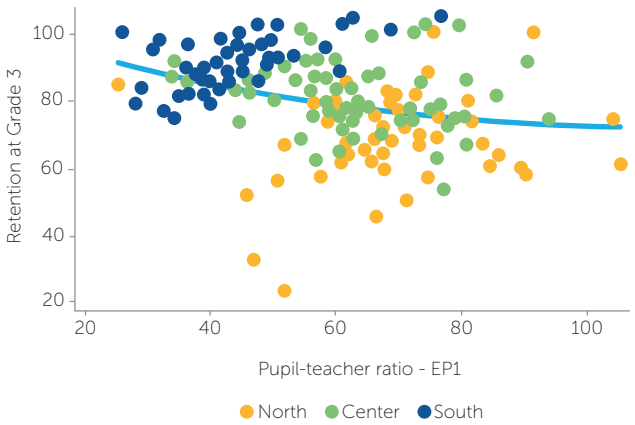
To interpret the graphs, please see Box 4.3. NER and completion rates the averages of data from 2010 to 2020 for most countries. Spending data: latest year of data by country: Mozambique* (2013), SSA (2012), Cote d'Ivoire (2018), Ghana (2014), Tanzania (2014), Uganda (2014), Botswana (2009), Malaysia (2017) and South Africa (2018). Spending data for Mozambique figures between 2014 and 2020 are based on a projection considering actual trends in Boost data and GDP per capita.
Source: WDI.

Figure 4.25: Efficiency of spending in primary education (2019-2021) vs Size of primary education school network (2021), Mozambique districts



Source: MINEDH and Boost, 2019-2021.

Figure 4.26: Retention at Grade 3 vs pupil-teacher ratio (Grades 1-3), Mozambique districts, 2019-2021



Source: MINEDH and Boost, 2019-2021.

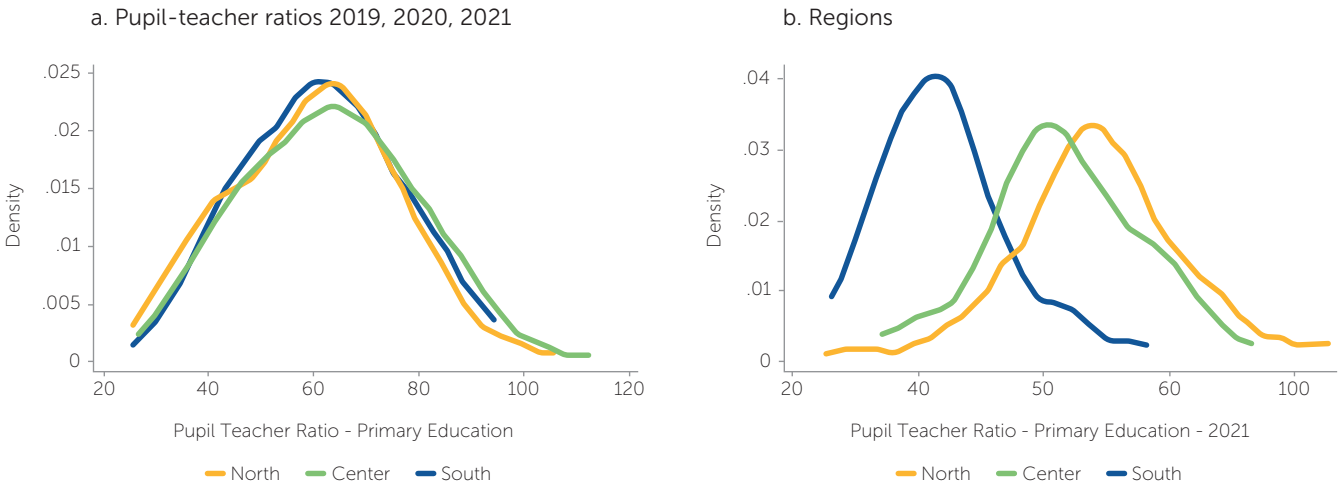
A7) and particularly high in the provinces of the north and central regions. This high heterogeneity in pupil-teacher ratios across regions indicates a high level of allocative inefficiency as outputs could be increased for the same level of education spending simply by allocating teachers more evenly across the country.

School surveys also document serious problems with teacher absenteeism in Mozambique—one of the highest in the region—which reduces the actual teaching time. The Service Delivery Indicator (SDI) surveys found a reduction in teacher absenteeism based on unannounced visits between the 2014 and 2018 surveys,[102] but the rates were still quite high and very unequal by region: 45 percent of teachers were absent during the 2014 visits, which declined to 30 percent in 2018 (World Bank, 2019). In 2018 the northern region average was nearly 41 percent, compared with 28-29 percent in the central and southern regions. These high rates of teacher absences translate into limited effective teaching time, which averaged just over 2.5 hours per day in 2018 (up from 1 hour and 41 minutes in 2014).

Internal efficiency

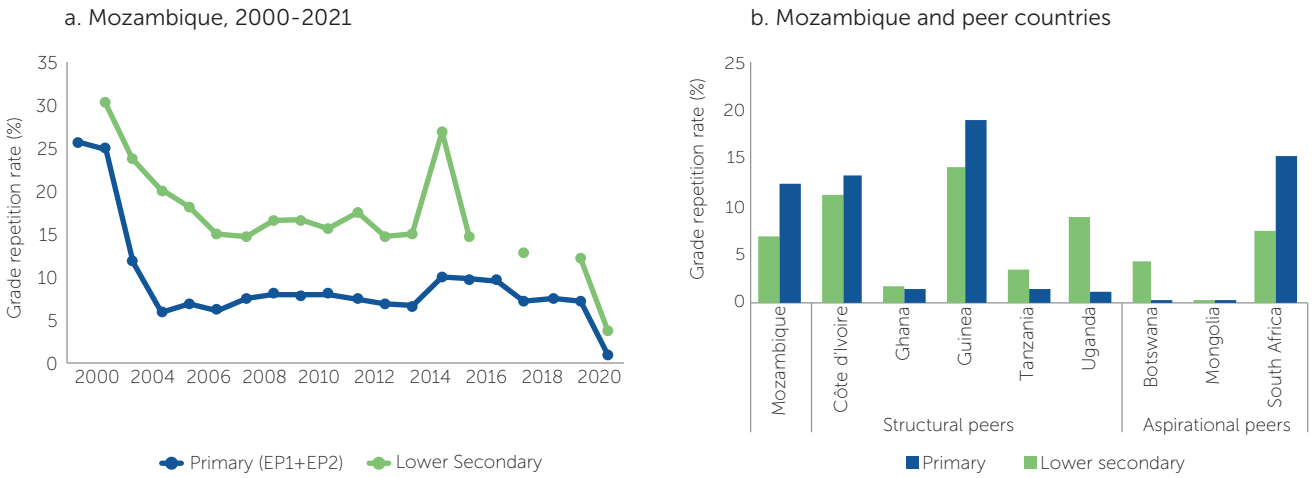
The internal efficiency of primary and secondary education has stabilized at relatively high levels in recent years, and there are some temporary improvements due to COVID-19 pandemic measures that reduce grade repetition. An important aspect of an education sector is its level of internal efficiency, measured by the flow of students across grades. A

Figure 4.27: Distributions of pupil-teacher ratios – primary education, by districts



Source: MINEDH. Note: Distribution density plotted using kernel density estimation.

Figure 4.28. Grade repetition rates by education level



Source: MINEDH and UIS statistics. Latest year of data by country: Mozambique (2019), Cote d'Ivoire (2016), Ghana (2017), Guinea (2013), Tanzania (2019), Uganda (2017), Botswana (2012), Mongolia (2018) and South Africa (2018).

102 World Bank (2015,2019).

key indicator of internal efficiency is the grade repetition rate, because the school cost incurred by a student in a given year is doubled if that student needs to repeat the same grade in the following school year. Repetition rates have dropped dramatically in Mozambique since 2001, especially in primary education, but remained relatively high in both primary and secondary education until 2020 (Figure 4.28a). This is reflected in the fairly constant completion rates over the same period (Figure 4.10). To mitigate the COVID-19 pandemic shocks on the education sector, and to create space for new cohorts, MINEDH has implemented policies to facilitate the transition of students between grades, significantly reducing repetition rates in 2021. However, if policies to recover learning loss are not put in place, automatic promotion of students in a year can generate spikes of repetition rates in the medium-term, and will also be reflected in dropout and completion rates. Despite the downward trend, repetition rates are still higher than most peer countries and contribute to systemic inefficiency (Figure 4.28b).

Is the allocation of education inputs and achievement of outcomes equitable?

Education spending

Education spending is highly inequitable in Mozambique, with large differences in per-student education spending across provinces. Although primary education expenditures in Zambezia and Nampula provinces are the highest in absolute terms, equal to MZN 8.1 billion (or 17 percent) and MZN 7 billion (or 15 percent), respectively, these are not sufficient to ensure the same per-student spending levels as in the rest of the country. In fact, annual per-student spending levels in primary education in Zambezia and Nampula are among the lowest, equal to about MZN 5,200 and MZN 5,600, respectively (Figure 4.29). This is more than 30 percent less than the average per-capita spending on education in Mozambique, and less than half the per-capita spending in Maputo City.

Secondary education spending is also unequal across provinces and districts, but with a different pattern to primary education due to very different rates of transition from primary to secondary. In primary education there is a clear concentration of low per-pupil spending in the northern provinces and districts (see concentration of northern districts below MT 5,000 per pupil in Figure 4.30), which sharply contrast with spending levels in southern provinces and districts. However, in secondary education there are individual northern provinces (Niassa, Cabo Delgado) with relatively high per-pupil spending, and a sizeable number of districts with above average per-pupil spending (Figure 4.30). As a result, the regional variation in per-pupil spending at the secondary level is not as pronounced as at primary level. However, this apparent regional (or north-south) equity should take into account that the northern provinces

Box 4.3: Two-dimensional analysis of public expenditure efficiency in education

Relative efficiency can be assessed visually in two dimensions: results (approximated by standard indicators of education output/outcome) and financial means (public expenditure on education). Instead of one summary efficiency score (as would be obtained with other methods), the analysis returns two numbers for each country. The first number measures the difference between actual and expected results, while the second measures the difference between actual and expected public spending. Expected results and expected public spending are statistically predicted values obtained independently of each other using data from a large sample of countries; they are estimated conditional on income levels and other selected structural country characteristics (i.e., the observed deviation cannot be explained by these characteristics).

Results of the analysis are expressed in such a way that countries can be compared with each other on the "efficiency map," a four-quadrant graph where (0,0) is the point at which education outputs and expenditures are at levels predicted by the model. In the cross-sectional analysis, percentage deviations from expected education outcomes/outputs are represented vertically (along the y axis) and percentage deviations from expected expenditure horizontally (the x axis). In the structural analysis, results are presented the same way, but in standard deviations of the outcome or expenditure variable.

For all education indicators used here, a higher value is better, so a position in the northwest quadrant is the most efficient and a position in the southeast quadrant is the least efficient. The southwest quadrant has countries with poor education outcomes and low expenditures—"underachievers." Those in the northeast quadrant are "overachievers." When looking at changes over time, movements to the northeast are efficiency improving and movements to the southwest indicate efficiency losses. Movements in the other directions reveal important trade-offs between expenditure and output performance.

Source: World Bank (2017)

have significantly lower rates of intake into secondary education. Southern provinces account for 16 percent of the secondary age population, but nearly 40 percent of total secondary enrollment, while for the northern provinces this ratio is reversed: they make up about 40 percent of the total population, but only about 20 percent of secondary enrollments.

Enrollment and teacher deployment

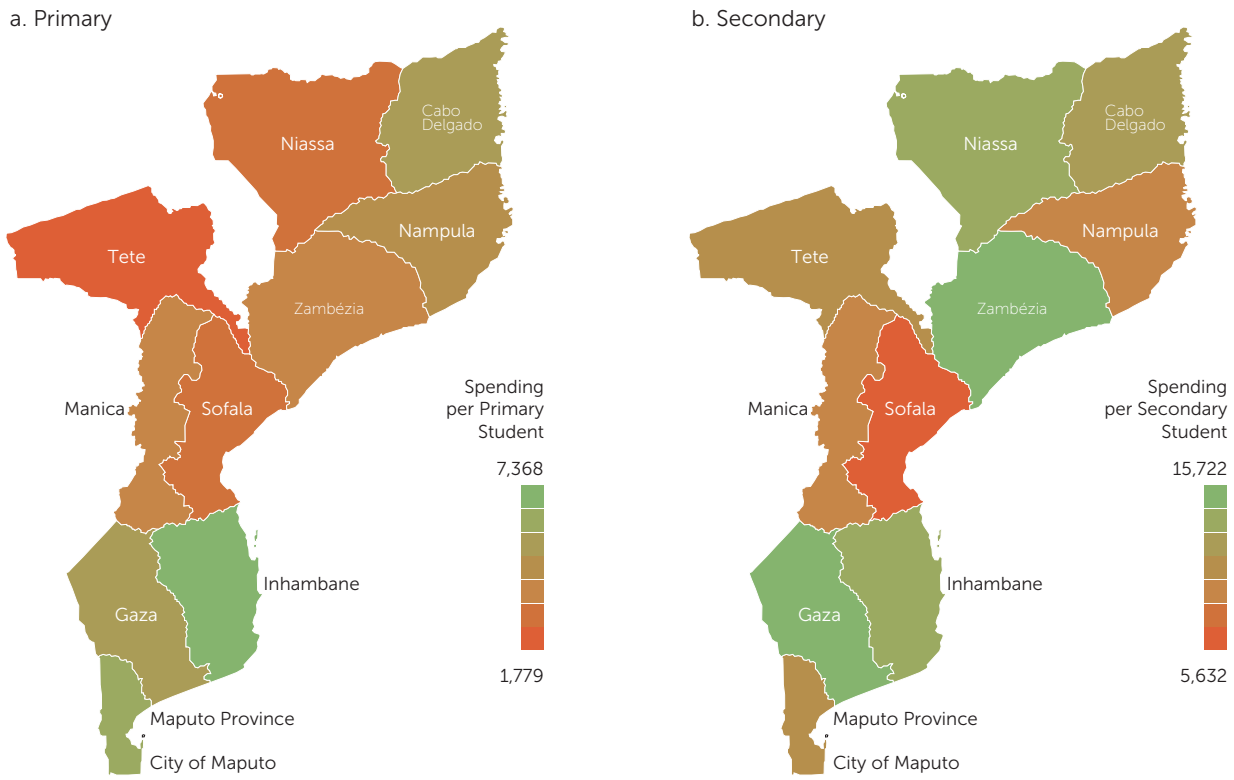
Primary education enrollment is concentrated in the northern and central regions that have larger access gaps and fertility rates than the rest of the country. The northern region provinces (Niassa, Cabo Delgado, and Nampula) accounted for about 32 percent of the total EP1 enrollment in 2021, compared with 56 percent for the central region (Zambezia, Tete, Manica and Sofala) and 11 percent for the southern region (Inhambane, Gaza, Maputo province and Maputo City). For higher levels of education, the shares are very different: southern provinces make up 31 percent of secondary education enrollment, while only accounting for about 16 percent of the population. In primary education the northern provinces and Zambezia have the highest pupil-teacher ratios and have experienced the most growth in recent years, while in secondary the pattern is reversed, as the ratios are generally higher in the southern region.

New hirings of teachers have been concentrated in northern and central provinces, where enrollment is growing faster, but there is clearly room for improving the targeting of new resources. New schools and teacher hires are generally concentrated in the provinces that are expanding the most in terms of enrollment in both primary and secondary education, which is consistent with demand-driven resource allocation (Figure 4.31). However, the persistently high pupil-teacher ratios in EP1 in the northern and central provinces (Figure A7), and the fact they are increasing at a higher rate than in the south, while their populations are also growing faster, requires that the deployment of teachers in these regions is intensified.

Teacher training and school inputs

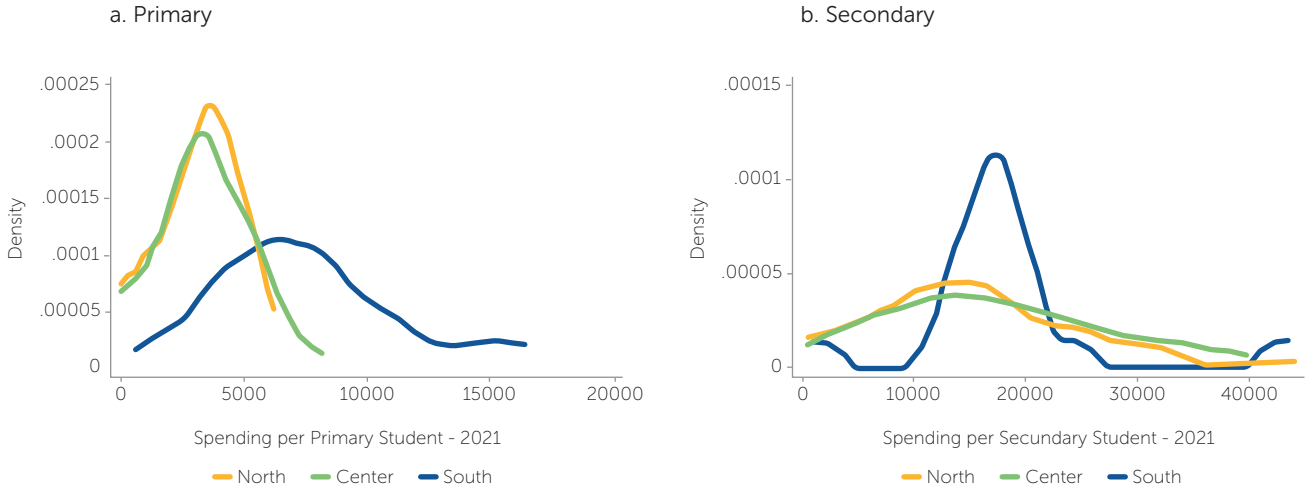
Teacher training has improved significantly in Mozambique in recent years, but the levels vary substantially across provinces, especially in primary education. The biggest changes are in the shares of teachers with higher education degrees (Licenciatura), which are significantly higher in 2021 than in 2016 (Figure A9). For example, 9.1 percent of EP2 teachers had a higher education degree in 2016, compared with nearly 23 percent in 2021. Also, the percentage of untrained teachers has declined from 3-6 percent (by level) in 2016 to under one percent in 2021. This progress in

Figure 4.29: Spatial distribution of education spending per student by province, MT, 2021



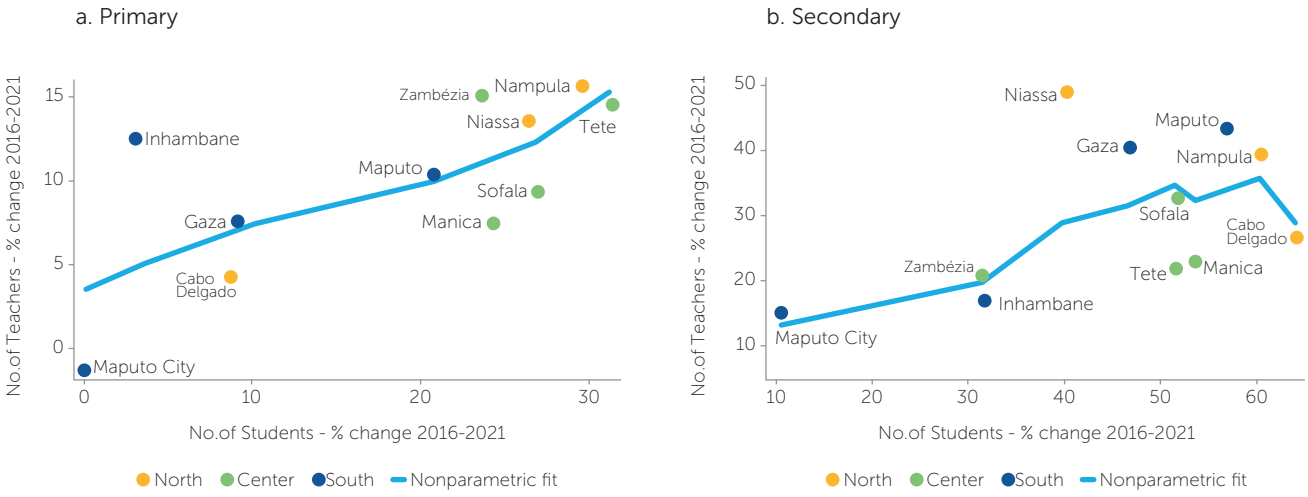
Source: WBG Boost 2021.

Figure 4.30: Distribution of education spending per student by district, 2021



Source: WBG Boost.
Note: Distribution density plotted using kernel density estimation.

Figure 4.31: Teacher versus student % growth rates by province - Primary, 2016-2021



Source: MINEDH.

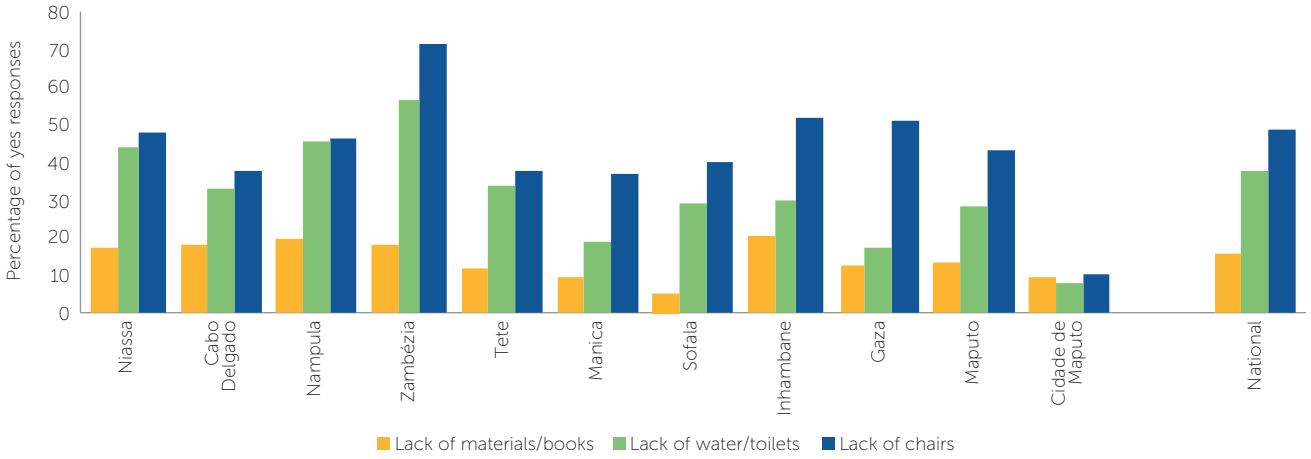
Source: MINEDH.

teacher preparation is especially notable given the steady growth in the number of teachers. However, the level of teacher training varies substantially across provinces, especially in primary education. In the northern provinces, the share of EP1 teachers with higher education training is 5-7 percent, compared with over 10 percent in southern provinces (and 33.3 percent in Maputo province) (Figure A10). These differences are not as notable in higher levels of education, especially in ESG2, where nearly 90 percent of teachers have a higher education degree. A key factor for a more equitable regional distribution of qualified teachers is improving the distribution of training institutes across provinces (Box 4.4).

Teacher content knowledge is insufficient, and is another source of inequality in education provision across regions. As is the case with teacher absences, the results from the Service Delivery Indicator surveys in 2014 and 2018 show significant improvement in teacher knowledge levels. Between 2014 and 2018, correct answers given by teachers to math questions increased from 30.4 percent to 43.1 percent in 2018, and 32.3 to 40.9 percent for Portuguese.[103] Despite the improvement, these scores are still very low compared to other countries. And there are also very large gaps by region, especially in math, with southern region teachers averaging 50.4 percent, compared to 33.3 percent in the northern provinces.

103 World Bank (2019).

Figure 4.32: Problems reported by public school students by province, IOF 2019-20



Source: IOF 2019-20.

Box 4.4: Tackling the unequal regional distribution of teacher training institutes

Teacher training institutes are not equally distributed across the country. Equality in access to education across regions starts with equality in the training of teachers, particularly in the primary sub-sector. To meet this objective, the MINEDH has established teacher training institutes (IFPs – *Instituto de Formação de Professores*) in all provinces. However, IFPs are not equally distributed across the provinces. The two biggest provinces by population size, Nampula and Zambézia, only have five IFPs each – the same number as the relatively small province of Maputo. As a consequence, these provinces have insufficient capacity to train enough teachers to supply even the existing primary schools, without considering the expanding needs generated by the high population growth in these regions.

In 2021, Nampula province required 2,500 new teachers, but only 270 teachers graduated from its IFPs. The balance should come from other provinces, but this is not always possible as the selection of teachers is done at district level and there are no deployment benefits for those coming from far away. Though efforts were made to attract teachers from the neighbouring provinces of Zambézia, Tete and Niassa, these did not prove successful due to the remoteness of the province's rural areas, the difficult living conditions, as well as the complications arising from different local languages and customs. These proved to be a large disincentive to the teachers graduating in neighbouring provinces.

An incentive to attract and retain teachers in hard-to-post areas could help offset the limited number of teachers in the most populated provinces while more public or private teacher training colleges are introduced. Incentives should be designed to consider sustainability and avoid more burden to the state budget. They could therefore involve measures such as (i) limiting the length of postings in remote areas (3-5 years), after which the teacher can opt for another posting of their choice; (ii) allowing the number of years working in remote years to count more for the career progression than years worked in more amenable places; (iii) providing housing and opportunities for further studies through distance learning; and (iv) ensuring merit-based recognition of teachers working in difficult conditions who manage to get good results.

Deficiencies in basic learning materials and infrastructure are widespread and are especially notable in northern provinces. A national survey conducted in 2016 showed that 23 percent of grade 3 students were studying outdoors under trees.[104] A recent national household survey found that 15 percent of public school students cited problems with a lack of materials or textbooks, 38 percent cited a lack of water or toilets, and nearly half referenced a lack of chairs (Figure 4.32). Water and toilet access concerns were mentioned more frequently in northern provinces.

104 Bassi, M., O. Medina, and L. Nhampossa. 2018

Education outcomes

There is a high level of heterogeneity of education outcomes at primary level between provinces and districts. Southern provinces with relatively high levels of per-pupil spending have substantially higher net enrollment rates (NERs) in primary compared with their central and (especially) southern counterparts. Nampula, Cabo Delgado and Niassa have the lowest per-pupil spending in primary, and their NERs are much lower than other provinces. A similar pattern is found at the district level for retention at Grade 3, which shows a concentration of northern districts with low levels of per-pupil spending and low levels of Grade 3 retention (Figure 4.33). By contrast, southern districts are consistently in the higher ranges of spending and retention.

Access to Early childhood education (ECE) is low, with participation concentrated in urban areas. Based on household survey data (IOF 2019-20), less than two percent of children aged 3-5 are in some level of preschool, with the reported ages for preschool attendees fairly equally distributed across the 3-5 year age range (Figure 4.34). Children from urban and higher SES households are much more likely to be enrolled in preschool, but even among quintile 5 children (the highest SES category), fewer than 9 percent are enrolled. Finally, there are large differences across provinces and regions, with higher rates in Maputo City and very low rates in the northern provinces of Niassa and Zambezia.

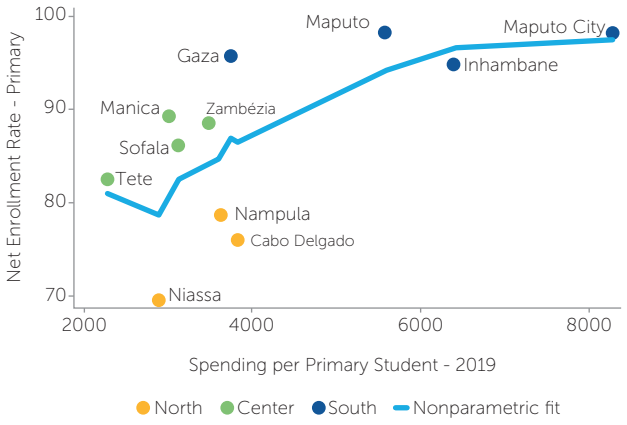
Inequality in education attendance across income groups in Mozambique is substantial. There are three components to overall differences in grade attainment between high and low socio-economic status (SES) children. First, significant percentages of low SES children are not entering school or are entering late. According to the 2019-20 IOF survey, 11.4 percent of SES quintile 1 (Q1; the lowest SES category) children aged 13-15 had never been to school, compared with less than one percent of quintile 5 (the highest SES category) children (Figure 4.35). Second, lower SES children are more likely to leave school early than higher SES children: 56 percent of Q1 children aged 16-17 had already left school in 2019-20, compared with just 20.4 percent of Q5 children. And finally higher SES children are progressing through grades more efficiently by starting school on time and not repeating. In 2019-20, 67.2 percent of quintile 5 children aged 13-15 were enrolled in lower secondary (the correct level for the age group), compared with just 8.9 percent of quintile 1 children. Almost all quintile 1 children aged 13-15 who were in school in 2019-20 were still enrolled in the primary level.

Rural-urban gaps in education participation have declined, but rural children are still significantly less likely to be in school than their urban counterparts in all age groups. Younger rural children (especially ages 6-8) are much less likely to be in school than urban children of the same age. The gap then narrows for ages 10-12, before widening again. By the age of 15, urban children are over 20 percent more likely to be in school than rural children (Figure A8).

North-south gaps in educational participation are particularly visible in higher age ranges, and are a product of the cumulative effects of late entry, early dropout and grade repetition. The most recent MINEDH data show that only about half of 6 year olds in northern provinces are in primary school, compared with nearly all 6 year olds in southern provinces (Figure 4.36). Nearly half of 13-17 year olds in northern provinces have never entered school or had dropped out at the time of the 2019-20 IOF household survey, compared with much smaller proportions in southern provinces. And the 13-17 year olds who are still in school in the north are mainly in primary, with relatively small

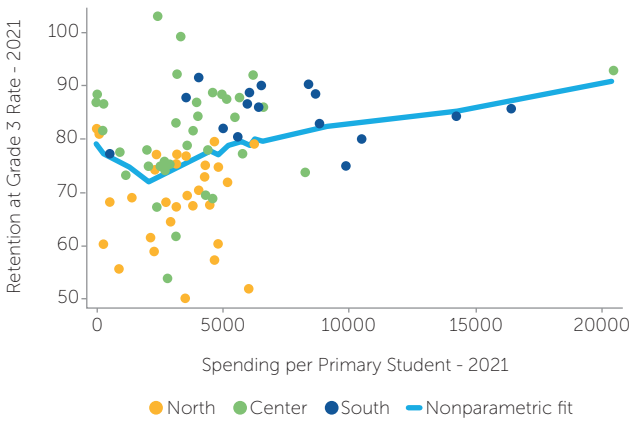
Figure 4.33: Education spending per student vs education outcomes

a. Net enrollment rates – primary (provinces)



Source: IOF 2019-20.

b. Retention at Grade 3 (districts)



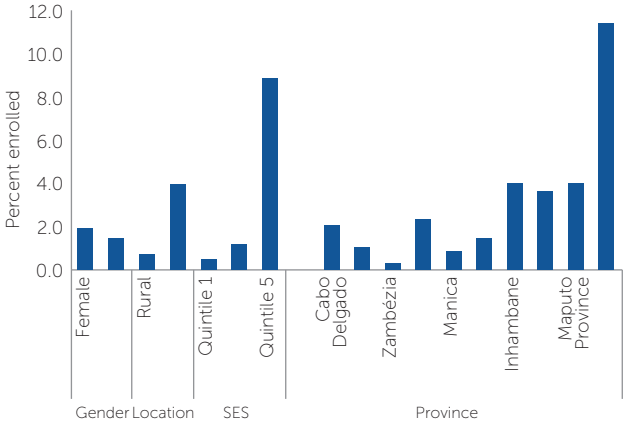
Source: IOF 2019-20.

shares having reached secondary education. The cumulative effects are especially notable in completion rates, as only about half of 16-20 year olds have completed EP1 in the northern provinces, compared with nearly 90 percent in the southern provinces (Figure 4.37). Similar patterns by province are shown for EP2 and ESG1.

Learning levels are low, particularly in the northern provinces, and the results from student assessments consistently demonstrate large learning gaps by gender and region. The 2018 SDI test of student knowledge in Portuguese and math showed significant differences by gender (favoring boys), location (favoring urban) and region (Figure 4.38). The regional achievement gap is especially large in Portuguese: northern region students averaged 19.9 percent correct, compared with 54.8 percent in the south.

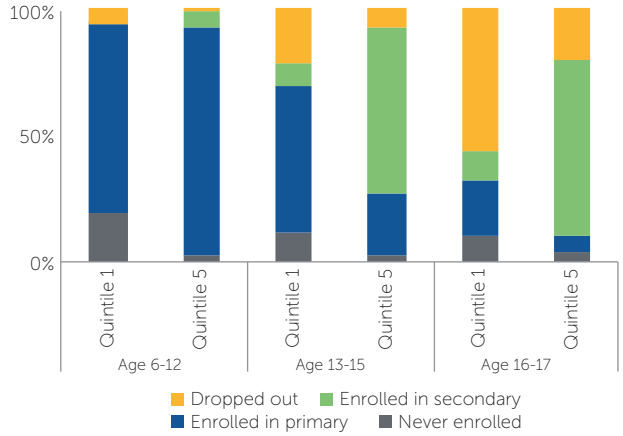
Despite the substantial growth in overall enrollments, especially for female students, tertiary education access is still very limited and unequal across provinces, with low percentages of graduates. The 2019-20 IOF survey reported that 15 percent of people aged 18-25 were enrolled in tertiary education (Figure 4.39). Female students are more likely to be enrolled in tertiary education institutions, but more male students have completed that level of education. Tertiary access is restricted primarily to urban residents, with very large differences between SES quintiles: 35.5 percent of persons from quintile 5 households are enrolled in tertiary, compared with just 1.7 percent of persons from quintile 1 households. Provincial differences are also very large, with relatively low access rates in the north and central regions compared with the southern provinces. These are a natural consequence of regional differences in rates of completion at lower levels of schooling.

Figure 4.34: Preschool enrollment rates for ages 3-5 by main strata, 2019-20 IOF



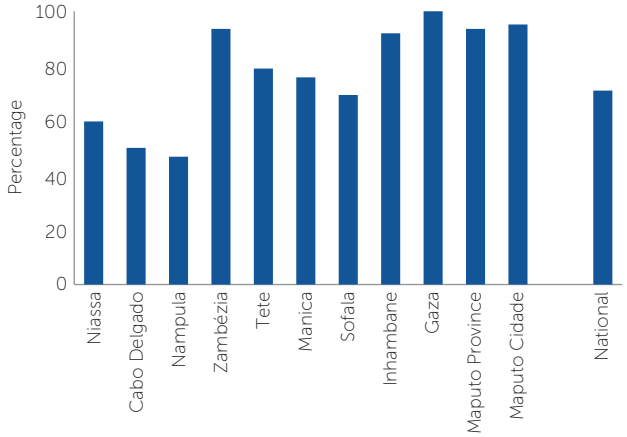
Source: IOF 2019-20.

Figure 4.35: School attendance status by age group and SES quintile, 2019-20



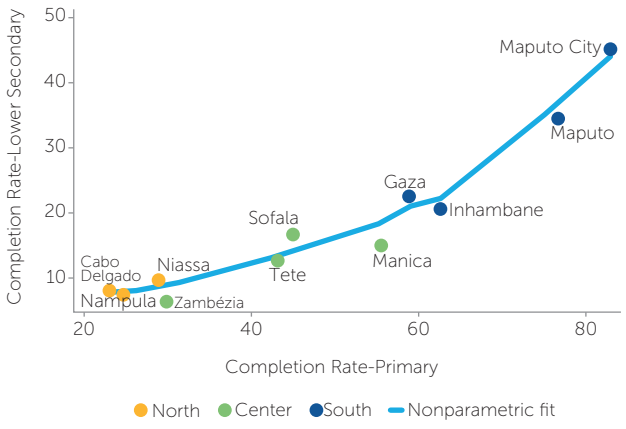
Source: IOF 2019-20.

Figure 4.36: Percentage of 6 years old enrolled in primary school by province, 2019-20



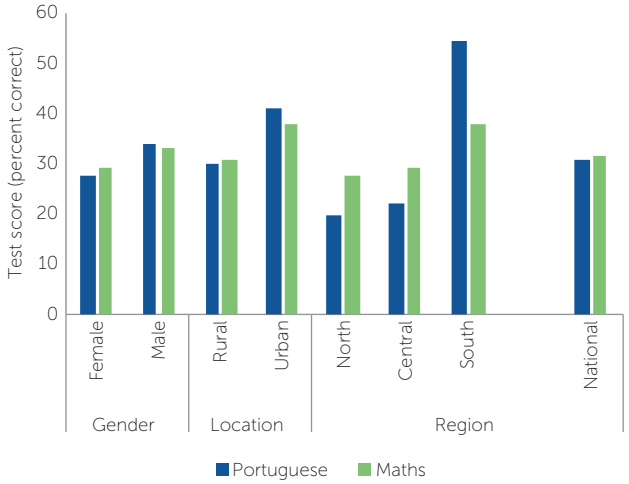
Source: IOF 2019-20.

Figure 4.37: Percentage of people aged 16-20 that have completed basic education, 2019-20



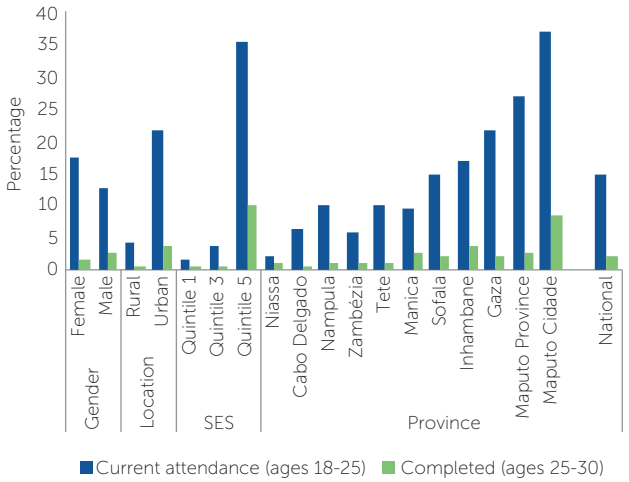
Source: IOF 2019-20.

Figure 4.38: Test scores by sub-population and subject, SDI 2018



Source: World Bank (2019).

Figure 4.39: Tertiary enrollment and completion rates by age group



Source: IOF 2019-20.

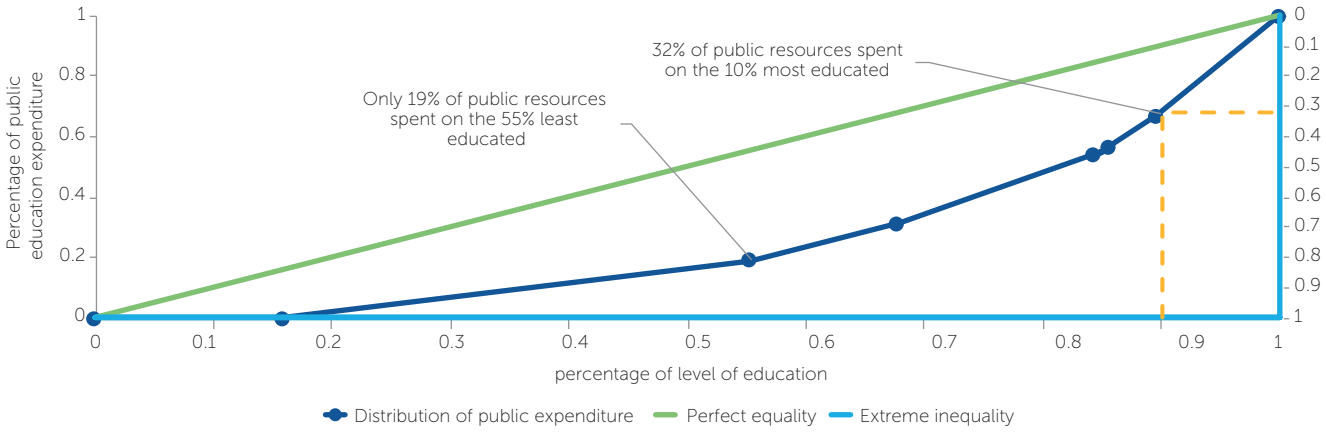
Benefit incidence of education spending

As children of higher social economic status families have better progression across the levels of education, they benefit more from education expenditures in higher levels of education. Approximately 32 percent of public education resources are spent on the 10 percent most educated, while only 19 percent of public resources are dedicated to the 55 percent least educated (Figure 4.40). Also, the wealthiest 20 percent of students receive 29 percent of education spending while the poorest 20 percent receive just 11 percent of spending. In terms of concentration of resources among high and low SES households the widespread access to primary schooling means that public expenditures are equally distributed in this level across households, but in lower and especially upper secondary education the public spending disproportionately benefit families in the right hand side of the income distribution (Figure A11).

The large discrepancies in benefit incidence across households are attributable to differences in unit costs and the time that is spent in the system. IOF 2019-20 survey data show that 68 percent of children from the highest SES quintile enter lower secondary education and 34 percent continue into upper secondary, compared with just 12 and 3 percent respectively for the lowest SES quintile children. This survey shows that 21-25 year olds in the richest quintile have completed nearly 10.4 years of education on average, compared with just 4.1 years for the lowest quintile.

Promoting a better level of quality in the provision of education across all income groups in Mozambique requires a focus on improving education outcomes at the lower levels of education. This will increase the transition of children with less resources to the next levels of education. Children with more resources in all provinces, but especially in the southern region, benefit from better-resourced

Figure.40: Distribution of public education spending on the level of education, 2020



Source: IOF, MEF and MINEDH.

primary schools. These in turn help them reach secondary levels (and beyond), where they obtain the critical skills needed for labor market success. Reversing this dynamic—which means equalizing the lifetime benefit incidence of education spending across regions and families—requires a combination of school quality improvements in primary and greater access to secondary and post-secondary schooling options, especially in the northern regions.

4.6 Public Financial Management Systems and Processes

Recent public financial management (PFM) legislation offers scope for strengthening links between plans and budgets in the education sector. Since 2021, Mozambique has introduced a new planning and budgeting methodology (PESOE) for all sectors, which merges the plan and the budget into a single document, resulting in more clarity, transparency, and consistency. The approach also promotes results-based management using institutional performance targets and a program classification system to organize spending. The 2022 budget proposal submitted to Parliament in November 2021 and approved in December 2021 was prepared using this new methodology. A potential difficulty is created by the fact that central, provincial and district levels must prepare their plans and budgets at the same time, exacerbating the challenges of having a national sector plan and budget which is aligned across all levels of government as well as all the subsystems of the education sector. However, MINEDH and the Ministry of Higher Education still have full authority over expenditure in education. The development of a more robust medium-term expenditure framework for the sector would help address this gap, as all budget actors would know in advance their potential share of the budget to achieve agreed results. The funding of the sector can also be increased by improving procedures to directly collect revenues (Box 4.5).

A new Education Sector Strategic Plan 2020–2029 (ESSP) for primary and secondary education was finalized in 2019 and is being implemented. Its overall objective is to improve learning outcomes by strengthening the quality of education, including through improving school management, developing pre- and in-service teacher training, expanding bilingual education, supporting teacher motivation, and allocating sufficient resources and materials for primary education. The ESSP covers general education and has a sound analytical base. It is a logical successor to the 2012-2016/2019 strategy, and has incorporated significant learning about what works well and what works less well. It also takes account of potential disruptive forces – particularly natural disasters – which significantly affected the implementation of the previous plan. The plan includes well-modelled scenarios for financing the strategy. The level of detail is mirrored in the draft three-year rolling Operational Plan (2020-2022). The ESSP focuses on the first few years of primary, including pre-primary, as they are key to developing better results at all education levels. Higher education and technical/vocational education have similar long-term strategies.

Box 4.5: Existing procedures for collecting own revenues hampers the funding of the education sector

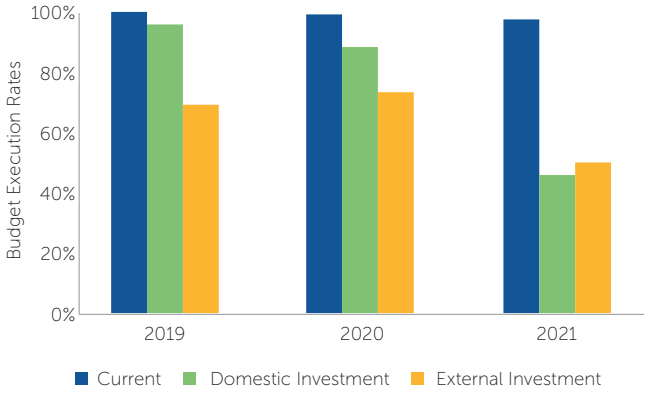
The education sector collects a range of revenues itself. These include administrative fees resulting from the issuance of certificates and other academic documents, rental of premises (halls, conference rooms and sports facilities), as well as registration fees (*taxas de matrículas*), and school fees (*propinas escolares*). Each of these revenues must be deposited with the autonomous budget entities (UGBs) to which institutions report, and also declared to the relevant revenue management authority. Only at this point are the entities who collect the revenues entitled to receive back the revenue. As long as they have budgeted for its use, they can then use it. However, many entities under-budget for the use of their own revenues – in part because they believe that budgeting in full might undermine access to other budgetary transfers. Moreover, because in the past the collecting institutions have either never received them back or only received them with delays, they choose not to declare the revenues collected. This is a violation of the SISTAFE law, but the practice continues to be commonplace because of how the procedures for collection and use of own revenues are structured. However, within this framework facility managers wishing to respect SISTAFE regulations have limited incentives to collect their own revenues.

Entities which are not autonomous budget entities (UGBs) have limited rights to use locally collected revenues. Another problem is the requirement that the major share of locally collected revenues should be remitted to the central level. For example, while the registration fee for examinations at teacher training institutes (IFPs) is MZN 650, MZN 400 has to be sent to Maputo, leaving only MZN 250 for spending by the teacher training institutes. The justification is the fact that IFPs are not UGBs. Promoting IFPs to UGBs would therefore change the incentives and allow them to dedicate more resources to teacher training.

A predictable pattern of resource allocation might assist in addressing these challenges, but the underlying context is not conducive to this. In comparison with peer countries, the education sector has consistently suffered from a low level of resources in per-pupil terms, especially since the suspension of budget support in 2016. Even though the sector has historically received a relatively high share of the annual government budget (18–22%), in the context of a constrained overall budget and a fast-growing school age population, this degree of 'protection' for the sector is insufficient. The problem of scarce resources is exacerbated by the uncertainty over funds and cash availability, both within each budget year and over the medium term. Faced with an uncertain debt-servicing scenario, as well as the effects of unexpected shocks from floods, the COVID-19 pandemic and regional and international conflict, in the years since 2016 the Ministry of Economy & Finance (MEF) has been unable to establish a consistent budget framework which would allow for predictable and reliable resource allocations.

The resulting unpredictable allocation process is not conducive to effective spending. The approved budget is frequently released late due to uncertainties and liquidity constraints in MEF. Budgets are regularly revised upwards during execution, but often not until the second or third quarter (Q2 or Q3). Many educational institutions therefore make commitments to suppliers in Q1 and Q2 without real knowledge of planned funding flows, leading to late payments and accumulated debts. Although actual execution compares well with the approved budget, this outcome is obtained only as the result of within-year revisions, meaning that expenditures are concentrated in the latter half of the year (thus creating inefficiencies, particularly in the supervision of schools and the procurement of materials that are useful in the first half of the year). It also means that the structure of spending is substantially different to that originally approved, with higher recurrent expenditures and lower investment.

Figure 4.41: Education sector budget execution rates as % of the revised budget, 2019–2021



Source: State budget and annual accounts.

Externally financed expenditures also face challenges in their timely execution, including implementation capacity. Overall, the rate at which externally financed projects are implemented on time is low, due both to late notification of the full budget available and a shortage of qualified technical staff to plan and manage procurements strategically and to meet donor conditions. The pattern of spending of the external investment budget is particularly striking: the major budget revisions occurring late in the year to complete the execution process result in a high level of under-expenditure. The year-by-year rates of execution of the revised budget for recurrent and investment expenditures are shown in Figure 4.42. Although the results in 2020 and especially in 2021 are likely to have been influenced by the effects of COVID-19, it nevertheless suggests that the pattern of under-expenditure of investment budgets has been worsening.

4.7 Policy Recommendations

Reforming Mozambique's education sector is critical for achieving better education outcomes with the resources that are available (efficiency), while increasing access by disadvantaged groups and regions to higher levels of education (equity). The proposed reforms for improving the efficiency and equity of the education sector of Mozambique - while reducing pupil-teacher ratios (particularly in the north and central regions) and improving learning and completion rates - are presented below, and are organized into six areas: (i) Reform teachers' career paths to improve teacher quality; (ii) Improve the process of teacher deployment and increase the effective number of teaching hours, with a focus on the northern provinces; (iii) Expand and improve distance learning as an alternative for reducing pupil teacher ratios and increasing coverage in secondary education; (iv) Reform the education financing framework to be mainly based on spending per student to increase regional equity, giving priority to disadvantaged groups; (v) Strengthen the planning, management, implementation and monitoring capacity of the education sector at ministry and local levels; (vi) Increase education sector budgets predictability to improve the efficiency and effectiveness of spending.

Reform teachers' career paths to improve teacher quality. Improving the frameworks for professional development and compensation are critical steps to increase teacher quality and reduce absenteeism, with direct impacts on the efficiency of the education system. A key action in this area is:

- Reform the national teacher career framework (Sistema de Carreiras e Remuneração), as planned by the government, to include performance assessment as a condition for the progression of teachers up the career ladder, linking the level of salaries to the complexity of the task (e.g. bonus for teachers focused on literacy), strengthening the merit-based selection of teachers and focusing the teacher professional development on contents and classroom management skills.

Improve the process of teacher deployment and increase the effective number of teaching hours, with a focus on the northern provinces. Given the rapidly growing population of school-age children, more teachers will need to be hired and trained, especially in the northern provinces. However, the number of teaching hours can be expanded in the short run through the following actions:

- Review and reform the processes related to the deployment of teachers.
- Improve the system to monitor teacher absenteeism and create incentives for districts to monitor teacher attendance and take action when needed.
- Increase the number of weekly hours in the existing teachers' contracts.

Expand and improve distance learning as an alternative to reducing pupil teacher ratios and increasing coverage in secondary education. Access to secondary education is still very limited and the demand is rising rapidly. Given the current fiscal constraints, alternative forms of delivering secondary education are needed, including the expansion of relevant and quality distance learning programs, as planned by the government, incorporating technology into the learning spaces and teacher training in curriculum content and ensuring digital skills are integrated also in capacity development of teachers.

Reform the education financing framework to be mainly based on spending per student to increase regional equity, giving priority to disadvantaged groups. Improving equity in the results of the education sector, both from a regional and socioeconomic perspective, depends critically on increasing equity in spending and improving the conditions for disadvantaged groups to progress to higher levels of education. Specific measures to consider include:

- Approve legislation that reforms the national education financing framework to improve regional equity in primary, secondary and early childhood education, associating the allocation of funds for schools based on enrollment levels by province and district, and applying higher weights for disadvantaged students/regions;
- Accelerate the implementation of the decentralization process accompanied by results-based accountability (with a focus on education outcomes) and capacity building for the subnational level entities;
- Ensure adequate budget allocation to technical and professional education and consider financing mechanisms with private sector collaboration;
- Consolidate and establish new financing mechanisms in tertiary education, such as the institutionalization of competitive financing mechanisms and the use of performance-based contracts to shift the funding gradually from input financing towards performance- or project-based financing;
- Create financial incentives for provinces and districts aimed at improving education outcomes, coupled with technical support to achieve these outcomes.

Strengthen the planning, management, implementation and monitoring capacity of the education sector at ministry and local levels. A key binding constraint for a more efficient use of existing resources in Mozambique's education sector is the low level of management capacity at central, provincial, district and school levels. A higher level of efficiency of education spending requires better systems, business standards and processes, as well as better prepared and motivated staff at all levels to perform tasks related to planning, management, monitoring and evaluation, statistics, procurement, financial management, and social and environmental safeguards aspects. Key actions in this area include:

- Implement an external assessment of skills and needs of the sector to map the sector existing competencies (central and local levels) to draw up a strategy for customized professional development opportunities (conventional and on-the-job training) for staff in key areas, as well as identifying hiring needs or redeploying existing staff through competitive and transparent mechanisms.
- Review and reform the processes of planning, budgeting, implementation and monitoring of education programs and activities, with a focus on results-based accountability.
- Strengthen the national education management information system to produce timely and accurate statistics to guide education planning and policies.

Increase education sector budgets predictability to improve the efficiency and effectiveness of spending. More predictable and timely budgets would allow textbooks and other essential items to be procured when needed, while also facilitating better planning of investments and thus more efficient disbursement of available resources. Key actions in this area include:

- Improve the accuracy of the three-year Fiscal Framework (CFMP) and the overall budget framework through timely sharing of the projected sector financial envelops;
- Develop a multi-year system for planning and implementation of education activities and programs;
- Develop a reliable framework for budget formulation that simplifies budget execution and increases the predictability of the monthly credit limits and cash releases.

References

Al-Samarrai, S. 2020. The Impact of the COVID-19 Pandemic on Education Financing, World Bank Group, Washington, DC.

Bandiera et al. 2018. The Economic Lives of Young Women in the time of Ebola: Lessons from an empowerment programme, J-PAL.

Bassi, M., O. Medina, and L. Nhampossa. 2018. Education *Service Delivery in Mozambique: A Second Round of the Service Delivery Indicators Survey*. World Bank: Washington, DC. https://documents1.worldbank.org/curated/en/811891562864504006/pdf/Education-Service-Delivery-in-Mozambique-A-Second-Round-of-the-Service-Delivery-Indicators-Survey.pdf.

IOF 2019-20. Inquerito sobre Orçamento Familiar (Household Budget Survey), Mozambique.

MINEDH (Ministry of Education and Human Development). 2017. Relatório de Avaliação Nacional 2016, Maputo: MINEDH.

———. 2019. *Análise do Sector de Educação (ESA): Relatório Preliminar*. Maputo: MINEDH.

Montenegro, C.E., and H.A. Patrinos. 2014. "Comparable Estimates of Returns to Schooling around the World." Policy Research Working Paper 7020, World Bank Group, Washington, DC. https://openknowledge.worldbank.org/handle/10986/20340.

OCHA 2020. Global Humanitarian Response Plan COVID-19. Available at: https://www.humanitarianresponse.info/sites/www.humanitarianresponse.info/files/documents/files/global_humanitarian_response_plan_covid-19_.pdf

Plan International 2015. Ebola: Beyond the health emergency.

Pontuschka, R. 2021. "Longitudinal Assessment of School Dropout." UNICEF, June 21. https://www.unicef.org/mozambique/en/stories/longitudinal-assessment-school-dropout.

Psacharopoulos, G., and H.A. Patrinos. 2018. "Returns to Investment in Education: A Decennial Review of the Global Literature." Policy Research Working Paper 8402, World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/29672.

UNESCO 2019. Mozambique Education Sector Analysis.

UNICEF (United Nations Children's Fund). 2019. Budget *Brief: Education—Mozambique 2019*. New York: UNICEF. https://www.unicef.org/mozambique/media/2751/file/Budget_Brief_2019_-_Education.pdf.

———. 2021. Education Expenditures 2015–2019: An Equity Analysis. New York: UNICEF.

Walter, T.F., and C. Zipfel. 2019. "Teacher Gender and the Gender Gap in Education: The Case of Mozambique Primary Schools." Policy Brief 36422, International Growth Centre, London. https://www.theigc.org/wp-content/uploads/2020/01/Walter-and-Zipfel-policy-brief-2019-36422.pdf.

World Bank 2014. Mozambique's Sustained Efforts on Higher Education, Science and Technology. Washington, DC: World Bank

———. 2015. Mozambique: Service Delivery Indicators. Washington, DC: World Bank.

———. 2017. Mozambique Public Expenditure Review: Education. Washington, DC: World Bank.

———. 2019. "Mozambique: Service Delivery Indicators." Washington, DC: World Bank.

———. 2020a. *The Human Capital Index 2020 Update: Human Capital in the Time of COVID-19*. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/34432.

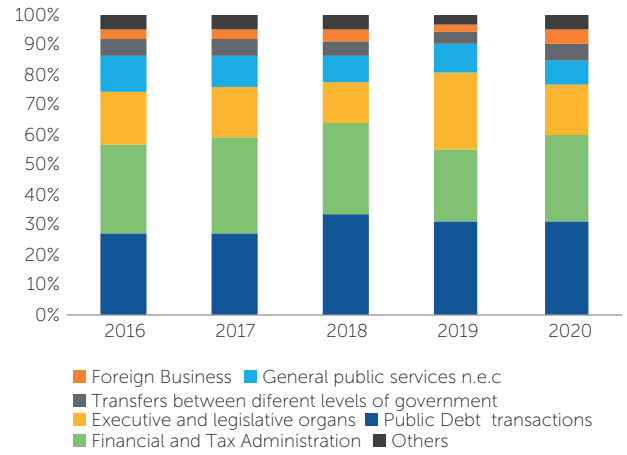
———. 2020b. *Monitoring COVID-19 Impacts on Urban Households in Mozambique*. Washington, DC: World Bank.

———. 2020c. *Expansion of Secondary Education in Mozambique*. Washington, DC: World Bank.

Annexes

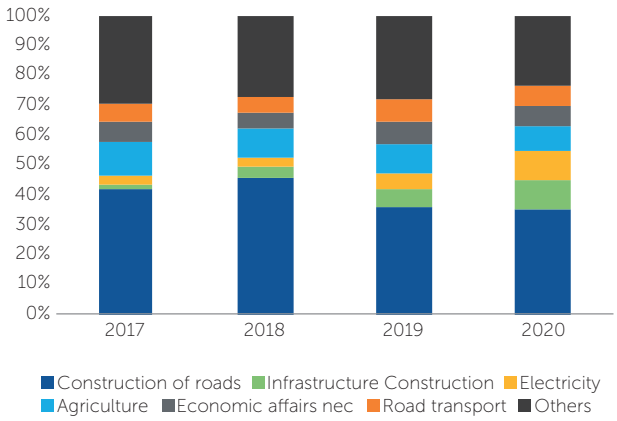
Annex A: Additional Expenditure Data

Figure A1: General public services by subfunction, 2016-2020, % of total spending



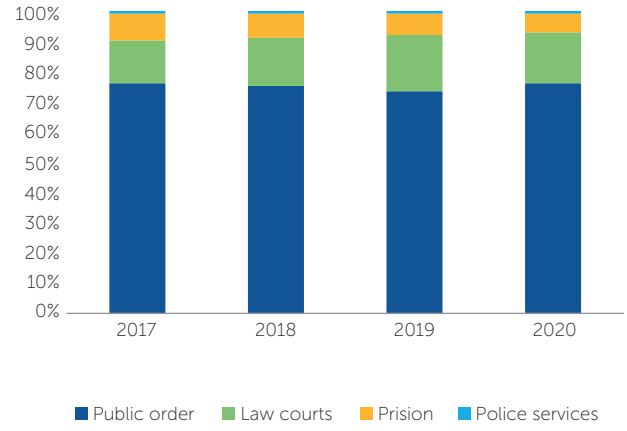
Source: Boost database, World Bank.

Figure A2: Economic affairs by subfunction, 2017-2020, % of total spending



Source: Boost database, World Bank.
Note: n.e.c. includes non-specified codes.

Figure A3: Public order and safety by subfunction, 2017-2020, % of total spending

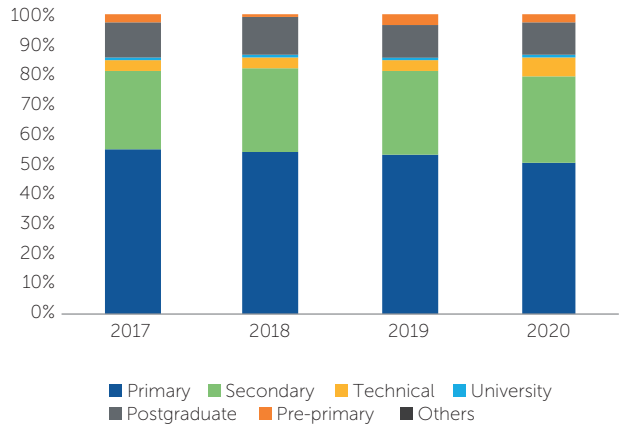


Source: Boost database, World Bank.

Figure A4: Public order and safety by economic classification, 2010-2020, % of GDP

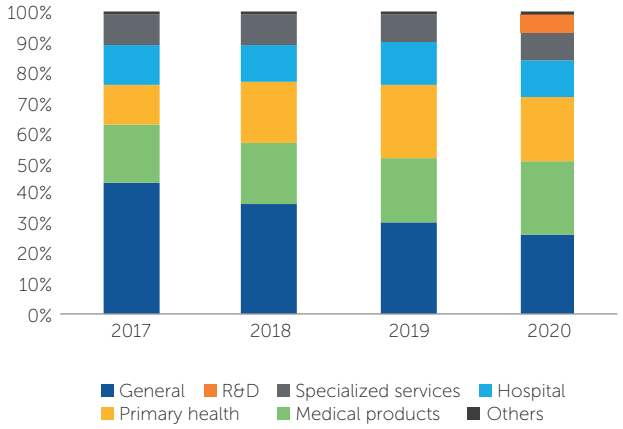
Source: Boost database, World Bank.

Figure A5: Education by subfunction, 2017-2020, % of total spending



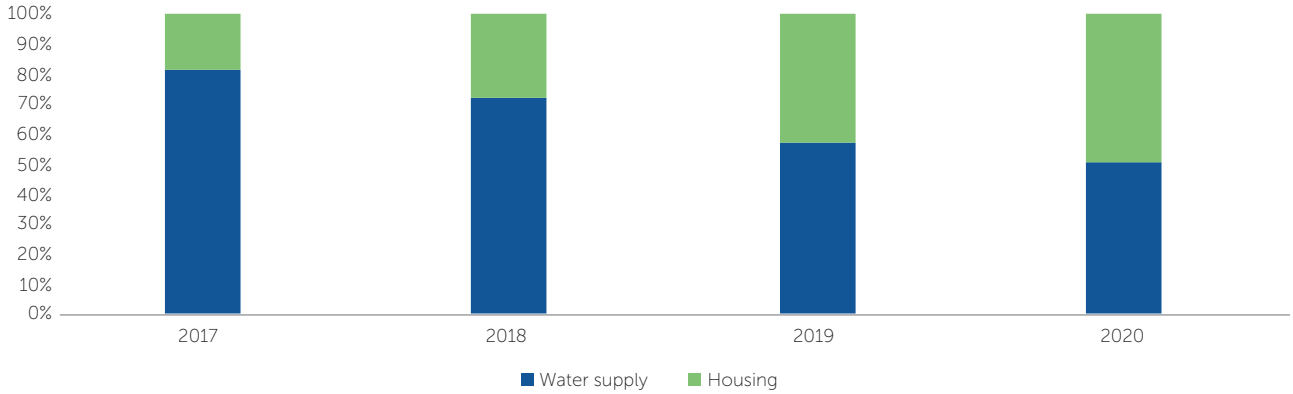
Source: Boost database, World Bank.

Figure A6: Health by subfunction, 2017-2020, % of total spending



Source: Boost database, World Bank.
Note: n.e.c. includes non-specified codes.

Figure A7: Water supply, housing, and community amenities by subfunction, 2017-2020, % of total spending



Source: Boost database, World Bank.

Table A1 Budget execution by economic classification

Final expenditure/initially appropriated budget, in %

	2010-13	2014-17	2018-20
Wages and salaries	104.1	105.6	104.0
Goods and services	104.7	96.1	102.8
Interest	102.2	97.3	79.9
Recurrent transfers/grants	95.8	102.1	107.5
Subsidies	165.2	85.2	117.5
Capital goods	75.6	60.5	77.4
Capital transfers/grants	103.5	83.4	87.1
Total	**94.4**	**89.2**	**94.6**

Source: Boost database, World Bank.

Table A2 Budget execution by function

Final expenditure/initially appropriated budget, in %

	2010-13	2014-17	2018-20
General public services	101.4	95.6	91.7
Defense	107.4	112.9	173.6
Public order & safety	98.7	104.7	131.1
Economic affairs	74.2	62.5	64.0
Environment protection	87.5	82.2	68.0
Housing & community amenities	70.6	72.8	97.1
Health	125.0	90.6	99.3
Recreation, culture & religion	127.9	95.3	101.6
Education	103.5	98.9	101.2
Social protection	93.9	102.6	110.7
Total	**94.4**	**89.2**	**94.6**

Source: Boost database, World Bank.

Table A3 Budget execution by administrative unit

(Final expenditure/initially appropriated budget, in %)

	2010-13	2014-17	2018-20
Republic Presidency	114.3	114.1	115.8
Ministry of Finance	124.5	123.9	100.7
State General Order	89.9	77.0	59.3
Ministry of the Interior	97.4	104.2	129.5
Ministry of Defense	111.1	121.5	173.4
Ministry of Health	134.6	88.1	96.3
Ministry of Public Works and Housing	85.0	70.2	77.5
Ministry of Women and Social Action	100.3	80.0	116.2

Source: Boost database, World Bank. * This table includes the ministries with highest budget.

Table A4 Budget execution by level of government

Final expenditure/initially appropriated budget, in %

	2010-13	2014-17	2018-20
01 Central	88.08	80.73	87.77
02 Provincial	109.71	101.73	106.88
03 District	110.62	113.07	112.73
04 Municipal	105.10	100.99	102.06
Total	**94.43**	**89.22**	**94.62**

Source: Boost database, World Bank.

Annex B: List of SOEs in Mozambique

Matriz	No. Employees 2021	Sector	State Ownership	Legal Form	Porfolio	Company	SOE Ownership
1. SEMOC	-	Agriculture	100%	S.A.	Not Strategic	-	-
2. CAIC - COMPLEXO AGRO-INDUSTRIAL DE CHOCKWE	-	Agriculture	70%	S.A.	Not Strategic	-	-
3. CORREIOS DE MOÇAMBIQUE	-	Communications	100%	EP	Not Strategic	CORRE-Correios Expresso de Moçambique	50%
4. IMPRENSA NACIONAL DE MOÇAMBIQUE	138	Communications	100%	EP	Strategic	-	-
5. RM - RÁDIO MOÇAMBIQUE	1.052	Communications	100%	EP	Strategic	-	-
6. TVM - TELEVISÃO DE MOÇAMBIQUE	551	Communications	100%	EP	Strategic	-	-
7. SOCIEDADE NOTÍCIAS	382	Communications	100%	S.A.	Not Strategic	-	-
8. TMCEL	1.826	Communications	90%	S.A.	Strategic Stuctural	Teledata Lda	95%
						Carteria Movel S.A	70%
						Tv Cabo	50%
						Televisa	50%
						Listas Telefonicas	50%
9. EDM - ELECTRICIDADE DE MOÇAMBIQUE	3.506	Energy and Mining	100%	EP	Strategic Stuctural	EDM Telefriba	100%
						CEZA-Companhia Electrica do Zambeze	100%
						CEZAII	100%
						CTRG - Central Térmica de Ressano Garcia	51%
						Sociedade Nacional Transporte Energia.SA	100%
10. ENH - EMPRESA NACIONAL DE HIDROCARBONETOS	202	Energy and Mining	100%	EP	Strategic Stuctural	Companhia Moçambicana de Hidrocarbonetos, S.A	70%
						ENH Logistics, S.A	100%
						CMG - Companhia Moçambicana de Gasoduto, S.A	80%
						CMG - Companhia Moçambicana de Gasoduto, S.A	80%
						Portos Cabo Delgado, S.A	50%
						Pensão Taj Mahal	100%

Matriz	No. Employees 2021	Sector	State Ownership	Legal Form	Porfolio	Company	SOE Ownership
11. COMPANHIA PIPELINE MOÇ./ZIMBA.	-	Energy and Mining	50%	Ltda	-	-	-
12. EMEM – EMPRESA MOÇAMBICANA DE EXPLORAÇÃO MINEIRA	31	Energy and Mining	85%	S.A.	Not Strategic	Emgemas, SA	51%
13. HCB - HIDROELÉCTRICA DE CAHORA BASSA	-	Energy and Mining	85%	S.A.	Strategic Stuctural	-	-
14. PETROMOC	487	Energy and Mining	80%	S.A.	Strategic Stuctural	Somotor	100%
						Petroauto	80%
						Ecomoz	65%
						PETROMOC&Sasol	51%
						Petrogas	60%
						PetroStarEnergy	50%
						Petrobeira	51%
						MIAFS	51%
						Olimax	100%
15. BANCO NACIONAL DE INVESTIMENTOS - BNI	65	Financial	100%	S.A.	Strategic Stuctural	-	-
16. EMOSE - EMPRESA MOÇAMBICANA DE SEGUROS	362	Financial	70%	S.A.	Not Strategic	Mocambique Previdente	80%
						SMI	80%
						EMOSE Imobiliaria	100%
17. EMATUM - EMPRESA MOCAMBICANA DE ATUM	-	Fisheries	100%	S.A.	-	-	-
18. FUNDAÇÃO MALONDA	-	Foundation	100%	Foundation	-	Sociedade Malonda	57%
19. FARMAC - SOCIEDADE DE FARMÁCIAS DE MOÇAMBIQUE	195	Phamaceuticals	100%	S.A.	Not Strategic	-	-
20. SMM - SOCIEDADE MOÇAMBICANA DE MEDICAMENTOS	67	Phamaceuticals	100%	S.A.	Strategic	INFARMA,SA	55%
21. MEDIMOC	-	Phamaceuticals	65%	S.A.	Not Strategic	-	-

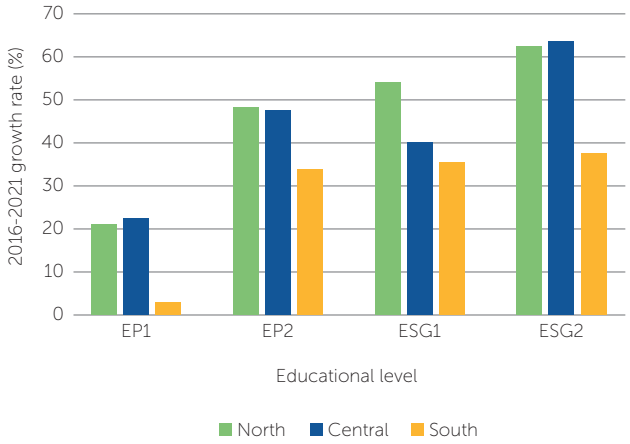
Matriz	No. Employees 2021	Sector	State Ownership	Legal Form	Porfolio	Company	SOE Ownership
22. DOMUS - SOCIEDADE DE GESTÃO IMOBILIÁRIA	71	Real Estate	94%	S.A.	Not Strategic	-	-
23. PARQUE DE CIÊNCIA E TECNOLOGIA EM MALUANA	70	Science and Technology	100%	EP	Strategic	-	-
24. ADM - AEROPORTOS DE MOÇAMBIQUE	758	Services and Logistics	100%	EP	Strategic Stuctural	-	-
25. EMODRAGA - EMPRESA MOÇAMBICANA DE DRAGAGENS	209	Services and Logistics	100%	EP	Strategic	-	-
26. HICEP - HIDRÁULICA DE CHÒkWE	151	Services and Logistics	100%	EP	Strategic	-	-
27. REGADIO DE BAIXO LIMPOPO - RBL	154	Services and Logistics	100%	EP	Strategic	-	-
28. MONTE BINGA	7	Services and Logistics	100%	S.A.	Not Strategic	MB Construções	100%
						Monte Binga Segurança,Lda	70%
29. STEMA - SILOS E TERMINAL GRANELEIRO DA MATOLA	74	Services and Logistics	100%	S.A.	Not Strategic	-	-
30. C.F.M - CAMINHOS DE FERRO DE MOÇAMBIQUE	5.810	Transportation	100%	EP	Strategic Stuctural	Sociedade de Turismo do Indico	100%
						CFM-Transporte e Trabalhos Aéreos	100%
						CFM-Sociedade Turistica	100%
						Companhia dos Caminhos de Ferro da Beira	100%
						Sociedade Terminais de Mocambique	50%
						Portos de Cabo Delgado	50%
31. TRANSMARÍTIMA	112	Transportation	100%	S.A.	Not Strategic	-	-
32. LAM - LINHAS AÉREAS DE MOÇAMBIQUE	790	Transportation	96%	S.A.	Strategic Stuctural	Moçambique Expresso, SA	100%
						Limpeza Expresso,Lda	85%
						Agência de Viagem Mextur, Lda	65%
						Mozambique Airport Handling Services, Lda	51%
						Galileo Mozambique, Lda	51%
						Lam Aircraft Appearence PTY	51%
						SMS - Sociedade Moç. de Serviços, SA	50%

Matriz	No. Employees 2021	Sector	State Ownership	Legal Form	Porfolio	Company	SOE Ownership
33. AÇUCAREIRA DE MOÇAMBIQUE, S.A	-	-	15%	S.A.	-	-	-
34. AÇUCAREIRA DE XINAVANE, S.A	-	-	12%	S.A.	-	-	-
35. AUTO - GÁS, S.A	-	-	22%	S.A.	-	-	-
36. CARTEIRA MÓVEL, S.A	-	-	30%	S.A.	-	-	-
37. CEGRAF - SOCIEDADE GRÁFICA, S.A	-	-	8%	S.A.	-	-	-
38. CERVEJAS DE MOÇAMBIQUE (EX-MAC-MAHON), S.A	-	-	1%	S.A.	-	-	-
39. CIM - COMPANHIA INDUSTRIAL DA MATOLA, S.A	-	-	1%	S.A.	-	-	-
40. CIMENTOS DE MOÇAMBIQUE, S.A	-	-	5%	S.A.	-	-	-
41. COCA - COLA SABCO (MOÇAMBIQUE), S.A	-	-	5%	S.A.	-	-	-
42. COMPANHIA DE SENA, S.A	-	-	5%	S.A.	-	-	-
43. COMPANHIA MOÇAMBICANA DE GASODUTO-CMG, S.A	-	-	20%	S.A.	-	-	-
44. COMPANHIA MOÇAMBICANA DE HIDROCARBONETOS-CMH, S.A	-	-	20%	S.A.	-	-	-
45. DIÁRIO DE MOÇAMBIQUE, S.A	-	-	40%	S.A.	-	-	-
46. GAPI - SOC. PARA APOIO A PEQUENOS PROJ.DE INVESTIMENTO, S.A	-	-	9%	S.A.	-	-	-
47. GEOMOC, S.A	-	-	20%	S.A.	-	-	-
48. GRUPO MADAL, S.A	-	-	5%	S.A.	-	-	-
49. HIDROMOC - BEIRA, S.A (EX-HIDROMOC,E.E.DELG. R. CENTRO)	-	-	20%	S.A.	-	-	-
50. HOTEL CARDOSO, S.A	-	-	26%	S.A.	-	-	-
51. IBC - INDÚSTRIA DE BORRACHA E CALÇADO, S.A	-	-	20%	S.A.	-	-	-
52. IFLOMA - INDÚSTRIAS FLORESTAIS DE MANICA, S.A	-	-	20%	S.A.	-	-	-
53. MILLENNIUM BIM , S.A	-	-	17%	S.A.	-	-	-
54. MOZAÍCO DO ÍNDICO, S.A	-	-	49%	S.A.	-	-	-
55. MOZAL, S.A.	-	-	4%	S.A.	-	-	-

Matriz	No. Employees 2021	Sector	State Ownership	Legal Form	Porfolio	Company	SOE Ownership
56. EMERITUS RESSEGUROS, S.A (EX. MOZRE, S.A)	-	-	20%	S.A.	-	-	-
57. NORSAD , SA	-	-	3%	S.A.	-	-	-
58. SOCIEDADE MALONDA, S.A (EX. SOC. DE DESENVOLVIMENTO MOSÁGRIUS)	-	-	3%	S.A.	-	-	-
59. SOMEC - SOC. MINEIRA DE CUAMBA, S.A	-	-	20%	S.A.	-	-	-
60. STEIA 2000 - SOC.TÉCNICA DE EQUIP. IND.E AGRÍCOLA, S.A	-	-	20%	S.A.	-	-	-
61. TEXTÁFRICA, S.A	-	-	23%	S.A.	-	-	-
62. CHÁ NAMAE, LDA.	-	-	20%	Ltda	-	-	-
63. GRAPHIC - COMÉRCIO E INDÚSTRIA, LDA.	-	-	7%	Ltda	-	-	-
64. TECNAUTO - EMPRESA DE ASSISTÊNCIA TÉCNICA AUTO, LDA	-	-	48%	Ltda	-	-	-
65. TECNOMECÂNICA, LDA	-	-	20%	Ltda	-	-	-
66. TELEDATA, LDA	-	-	5%	Ltda	-	-	-
ADM	-	-	10%	-	-	Sociedade de Desenvolvimento do Corredor de Maputo - SDCM	69,50%
CFM	-	-	27%				
EDM	-	-	10%				
PETROMOC	-	-	13%				
EMOSE	-	-	10%				

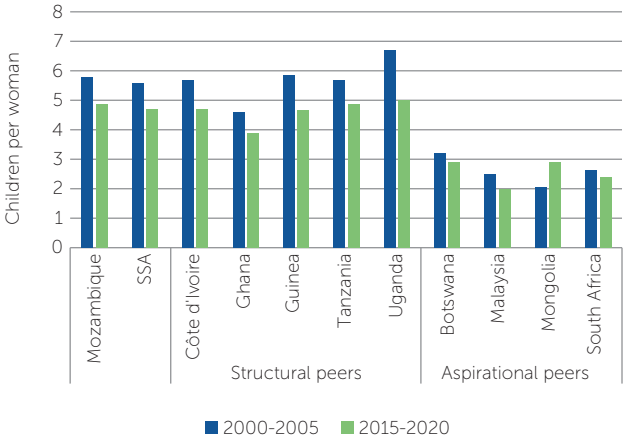
Annex C: Additional Education Data

Figure A8. Enrollment growth rate 2016-2021 by education level and region 2016-2021



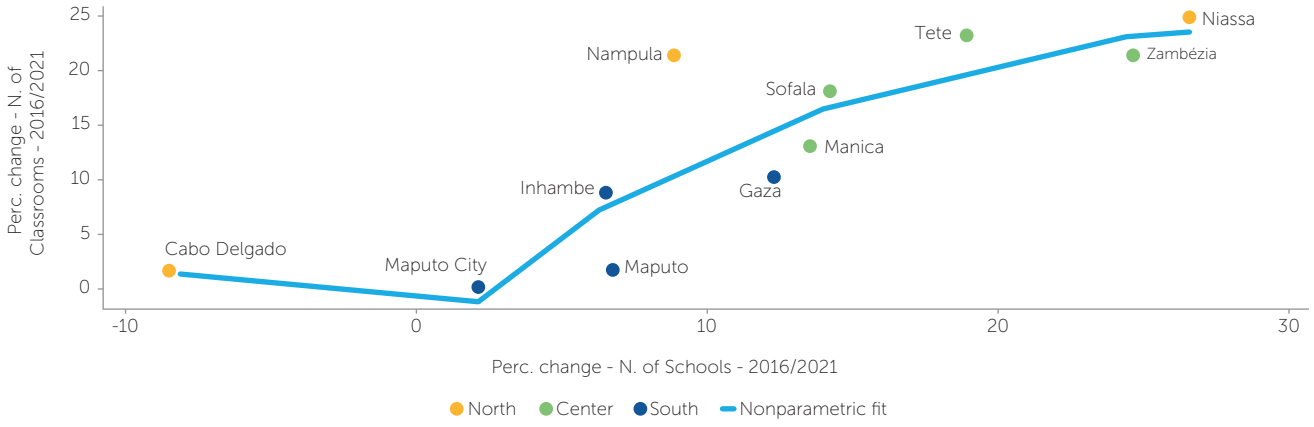
Source: MINEDH.

Figure A9. Total fertility (children per woman) 2000-2005 and 2015-2020



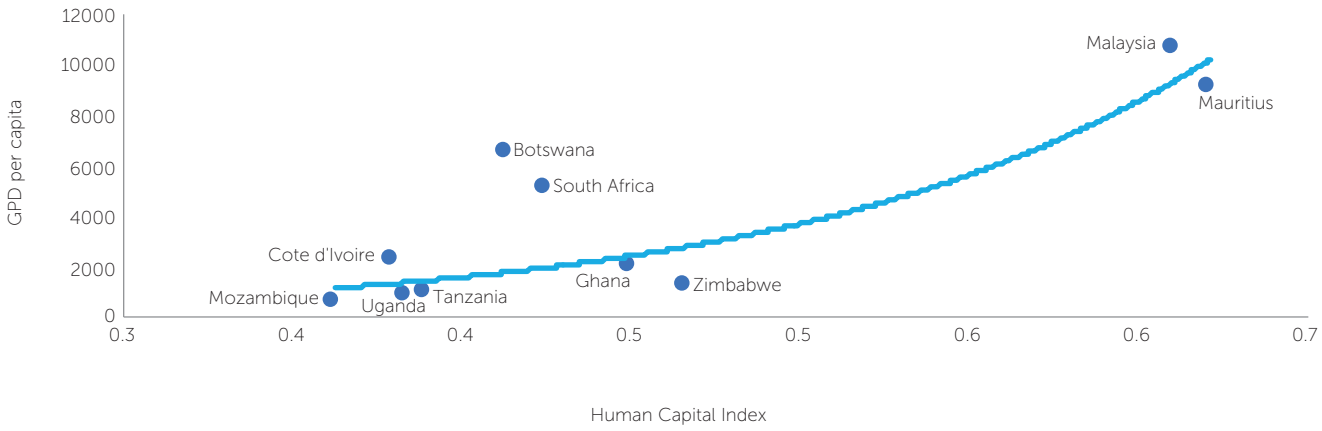
Source: United Nations Department of Economic and Social Affairs (data retrieved April 26 2022 from https://population.un.org/wpp/DataQuery/).

Figure A10. Percentage Change in the number of schools and classrooms, provinces, 2016-2021



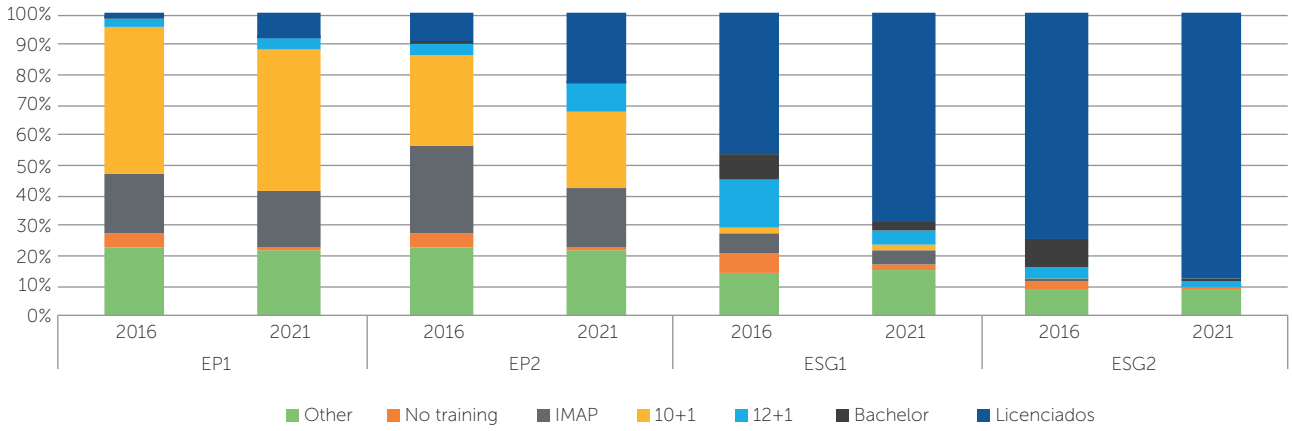
Source: MINEDH.

Figure A11. Human Capital Index (2020) versus GPD per capita (2020), Mozambique and Peer Countries



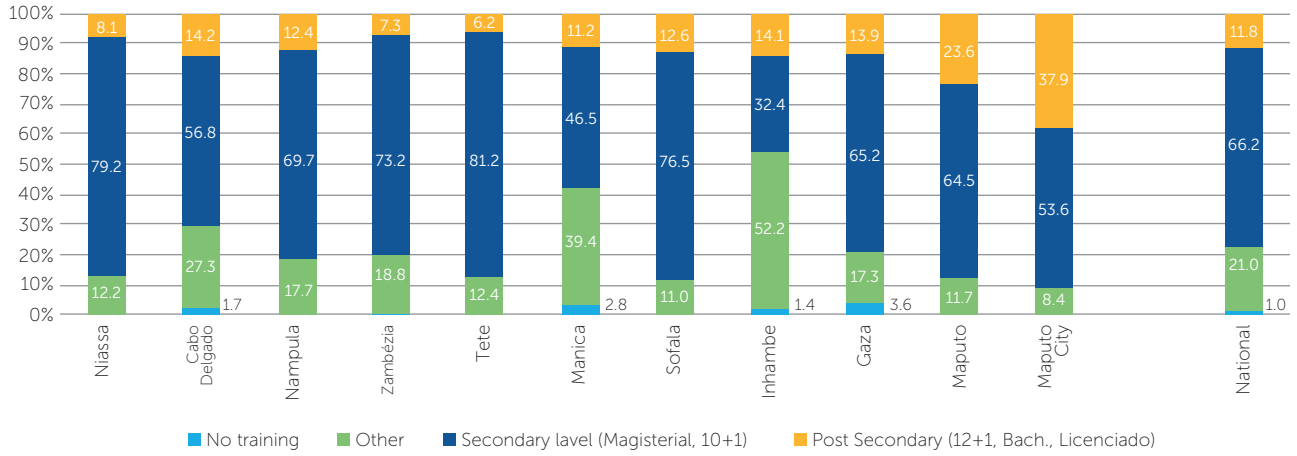
Source: World Bank.

Figure A12. Teacher training summary by education level. 2016-2021



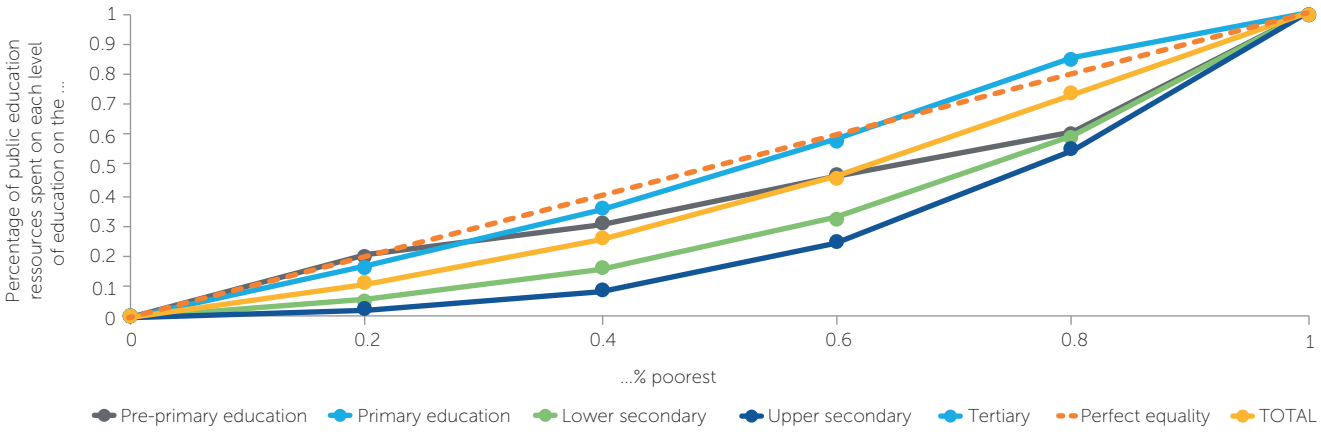
Source: MINEDH.

Figure A12. Teacher training levels in EP1 by province, MINEDH, 2021



Source: MINEDH.

Figure A13. Concentration of public education resources by level of education, 2018



Source: IOF, MEF and MINEDH.


WORLD BANK GROUP