Republic of Mozambique: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

October 29, 2008

The following item is a Letter of Intent of the government of Republic of Mozambique, which describes the policies that Republic of Mozambique intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Republic of Mozambique, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
Republic of Mozambique: Letter of Intent

October 29, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Government of Mozambique is implementing a financial and economic program consistent with its medium-term Plano de Acção para a Redução da Pobreza Absoluta II (PARPA II), and with support from the IMF through the Policy Support Instrument (PSI). We have concluded discussions with IMF staff for the third review under the PSI-supported program and our policies under the program for 2009 are summarized in the attached Memorandum of Economic and Financial Policies (MEFP). The technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. Implementation of the PSI-supported program has been satisfactory. All quantitative and structural assessment criteria (AC) and benchmarks through end-September 2008 were met. The program is broadly on track and we expect to meet the ACs and benchmarks for end-December 2008, except for the AC on reserve money and the end-December benchmark to undertake a study that would serve as a basis for drafting a Public Enterprises Law. As a consequence of the increase in international import prices during 2008, the end-December AC for reserve money has been modified, as set out in Table 1. The benchmark on the study of Public Enterprises is expected to be met by March 2009. On this basis, we request completion of the third review under the PSI-supported program.

3. The policies set out in the MEFP aim at consolidating macroeconomic stability and sustaining strong broad-based growth through a second wave of reforms towards the achievement of the Millennium Development Goals. Under the program, we have agreed with IMF staff on ACs and benchmarks for 2009. We anticipate that the fourth review on the basis of program performance to end-December 2008 will be conducted by end-June 2009 and that the fifth review on the basis of program performance to end-June 2009 will be conducted by end-December 2009.
4. The Government of Mozambique will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies and achieving the objectives of the program.

5. The Government of Mozambique believes that the policies set forth in the MEFP are adequate to achieve the objectives of our PSI program; it will take additional measures to that end if deemed necessary. During the implementation of the program, the Government of Mozambique will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the PSI, at the initiative of the Government or whenever the Managing Director requests such a consultation.

Sincerely yours,

/ s /   
Manuel Chang  
Minister of Finance

/ s /   
Ernesto Gouveia Gove  
Governor  
Bank of Mozambique

Attachments: Memorandum of Economic and Financial Policies  
Technical Memorandum of Understanding
ATTACHMENT I

Republic of Mozambique: Memorandum of Economic and Financial Policies of the Government of Mozambique for the Third Review of the PSI Supported-Program

October 29, 2008

1. The Government of Mozambique is committed to further consolidating macroeconomic stability to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and a second wave of structural reforms. This MEFP reviews the performance under the PSI-supported program with the IMF through September 2008 and describes the policies and targets for 2009.

I. Program Implementation in 2008

A. Background

2. Mozambique’s macroeconomic performance in 2008 has remained strong, although it has been adversely affected by the increase in international food and fuel prices in mid-year. In the 12 months to September, domestic gasoline and food prices rose 30 and 16 percent respectively and headline inflation at the end of 2008 is now expected to be higher than initially projected. Performance was also adversely affected by disruptions to the transmission of electricity via South Africa with consequences for manufacturing and aluminum exports. As a result, projected real economic growth in 2008 has been revised down from 7.0 to 6.5 percent. The current account balance was also adversely affected and, including grants, is expected to deteriorate to 7.9 percent of GDP. This deterioration was mitigated by a decline in the volume of oil imports and more than offset by higher capital inflows, so that the real effective exchange rate appreciated through most of the year and international reserve accumulation by end-2008 is projected to be larger than envisaged.

B. Fiscal Sector

3. The fiscal strategy during 2008 remained in line with the Government’s medium-term strategy to constrain domestic financing to make room for private sector credit. Budget implementation during the year encountered major challenges arising from the sharp increase in fuel and food prices and from difficulties in executing capital expenditures, due to procurement procedures.

4. During the first half of the year, net credit to the Government was better than envisaged under the program, despite a substantial delay of program aid to the second semester. Domestic revenues during the first half of 2008 were stronger than projected, but capital spending fell well short of projections mainly because of procurement constraints.
5. The Government’s fiscal plans were revised in July, in consultation with IMF staff, to reflect measures to mitigate the social impact of higher fuel and food prices. The Government had already introduced an urban transportation subsidy in February which was incorporated into the fiscal program. In June, the Government deferred fuel-related taxes until end-2008, and launched the Food Production Action Plan (FPAP), together costing 1.3 percent of GDP. These additional measures have been largely financed by reductions in non-priority spending and additional World Bank budget support. As a result, the Government’s target for net credit to the Government in 2008 has been revised from about 0.5 percent of GDP under the program to about 0.3 percent of GDP (excluding a substantial World Bank disbursement in support of the 2009 budget expected in late 2008).

6. The Revenue Authority (Autoridade Tributária-AT) took steps to improve its operational capacity. With the help of donors, a revised 2009–10 strategy was approved in October. The AT has established indicators of overall performance and a framework for assessing staff performance. Its audit capacity was strengthened through additional hiring, so that the increase in tax audits and coverage was broadly in line with 2008 targets. The AT will develop a strategy on managing and controlling revenues from mega-projects. The implementation of the PDTI—an information technology master plan—will be initiated in early 2009.

7. The study on the stock of VAT arrears due to contractors of large infrastructure projects and covering 80 percent of claims was completed in July. The audit identified MT 1.285 million in arrears, of which MT 200 million is budgeted for clearance in 2009.

8. Several tax policy measures are being introduced to reduce the cost of doing business while increasing the tax base. A bill to simplify taxes for small taxpayers was submitted to Parliament. The law proposes a direct tax on petty trading and small-scale agricultural and industrial activities and aims to reduce tax collection costs and facilitate tax compliance. In October, the adjusted tax benefit code was approved by the Council of Ministers and submitted to Parliament.

9. Public Financial Management (PFM) reforms are progressing well. Most importantly, the second phase of the e-Sistafe reform is being successfully concluded. The sectional classification was completed in May 2008 and the first pilot of the UTRAFE budget initiated. The decree on the multi-currency single treasury account (CUT) was approved in April 2008. On the basis of the civil servants census, the list of e-Sistafe operators will be updated by early 2009. The system for program budgeting was used to prepare the 2009 budgets of 5 ministries, linking their programs to the PARPA sub-programs. Salary payments through e-Sistafe was initiated in April 2008 in the office of the Inspector General of Finance (IGF-Inspecção Geral das Finanças), and rolled out to twenty institutions at the national level. The e-Sistafe system was rolled out to a total of twenty State organs at the central level. The census of civil service pensioners was finalized in October 2008. Due to external financing
constraints, the study of public enterprises will be delayed to 2009 (end-December 2008 structural benchmark).

10. In September 2008, the Council of Ministers approved the medium-term civil service pay policy, which will be implemented as from 2009 in a fiscally sustainable manner. In October 2008 the Government published for the first time the statistical yearbook on civil servants based on the census of civil servants.

11. The MF has continued to restructure the debt management department. The MF has developed strategies aimed at strengthening automated record keeping and analysis. The MF has completed a work plan to implement and strengthen the new departmental structure. It has also reviewed the legislation relating to debt management as the basis for revising the legislation. For 2008, the MF will publish the annual debt management report recently designed by the debt management department.

C. Monetary Sector

12. Monetary policy in 2008 has been geared towards price stability. Reserve money expansion to end-June was in line with the program, in an environment of reduced liquidity reserve requirements since April 2008. Implementation of monetary policy in the second quarter was complicated by an unusually large seasonal surge in currency demand. Moreover, as import prices increased beyond program projections, the Bank of Mozambique (BM) has sought to accommodate the pass-through to domestic prices while averting a second-round impact on inflation. As a result, reserve money is now projected to rise 10 percent during the year to end-December 2008. Moreover, headline inflation is expected to be higher than initially programmed at end-2008, inflation excluding food and energy related items will likely remain below 4 percent.

13. The impact of higher import prices on the balance of payments was offset by higher capital inflows so that, until August, the nominal exchange rate versus the US dollar depreciated by around 2 percent and the real effective exchange rate appreciated by 7 percent. Moreover, despite some program aid delays in mid-year, the BM met its external reserve target at both end-June and end-September.

14. The BM has continued to strengthen its monetary and exchange rate policy and operations. To strengthen policy formulation, the BM has stepped up its monitoring, analyzing and forecasting of macroeconomic and monetary indicators. To strengthen operations, the BM introduced repos in July 2008 and will implement measures during the remainder of 2008 to expand their use in place of treasury bills. In June 2008, the Meticalnet was adapted to allow for outright operations for the secondary market (structural benchmark for June 2008). To strengthen liquidity management, the Ministry of Finance (MF) is now providing cash flow projections to the BM on weekly basis. In its foreign exchange operations, the BM has made a sharper delineation between the use of direct bilateral transactions for regular sales of aid inflows and the use of auctions for controlling liquidity.
15. The BM has implemented measures to strengthen its internal audit. The BM has conducted an external quality assurance review of its internal audit function in accordance with international standards. An internal audit charter has been adopted and the BM has initiated periodic reporting to the BM’s Executive Board on the implementation of audit recommendations (end-July structural benchmark). Pending the approval of the new central bank law, the Audit Board has assumed the role of an audit committee. New terms of reference for the audit board were approved, to make it more focused on matters related to accountability, transparency, and internal control and provide oversight over financial reporting, external and internal audits, and systems of internal control (end-June structural AC). The tightening of control over reserve management has experienced some delays: (i) The installation of physical access controls in SWIFT operations is still ongoing and is expected to be completed by end-December 2008; and (ii) the procurement for devices allowing the recording of dealer communications on trading activities, which is expected to be completed by end-December 2008.

D. Other Structural Policies

16. To strengthen the management and transparency of mineral resources, in June 2007 the laws no. 11/2007 and no. 12/2007 for specific taxation in the mining and petroleum sectors were approved, respectively. Also in June 2007, the law no. 13/2007, which defines the incentives and benefits applicable on the mining and petroleum sector, was approved. The complementary regulations for both laws (11/2007 and 12/2007) were approved by decrees nº4 and 5/2008. All new agreements in mining and petroleum and gas concession are following the new fiscal legislation and relevant new framework agreements. The MF has started to compile and consolidate data on mega-projects, which is the basis to prepare an annex to the budget execution report. As noted below, the Government intends to accede to the EITI.

17. Mozambique continues its trade liberalization efforts. The SADC free trade area came into effect in January 2008, but problems related rules-of-origin have limited duty-free treatment within SADC. In November 2007, Mozambique, together with other SADC members, reached an interim Economic Partnership Agreement (EPA) with the EU. Members of the SADC EPA will retain quota- and duty-free access to the EU and, on a reciprocal basis, will reduce their customs tariffs on EU imports. Mozambique will implement this agreement from January 2009, subject to the approval by the Parliament. Negotiations with the EU on a final EPA are continuing.

18. The Government has stepped up its efforts to reduce the costs of doing business. The Government approved a decree to consolidate business inspections in selected sectors. A revised draft corporate insolvency law to simplify the business closing process and increase the recovery rate will be re-submitted to the Council of Ministers by end November. The Decree for Simplified Licensing came into force in October, 2008. A proposal to revoke the bank-deposit and eliminate the minimum capital requirements to start up a business was
submitted to Parliament. A proposal was submitted to the Council of Ministers to introduce the electronic one-stop window, aimed at facilitating cross-border trading. The Council of Ministers approved the creation of an SME Institute. Following the adoption of a competition policy in 2007, a draft competition law and competition authority's statute will be submitted to the Council of Ministers.

19. Progress in judicial reform remains a priority. The Integrated Strategic Plan for the Justice sector was approved by the Council of Ministers in October. The Integrated Strategic Plan will be used as an instrument for strengthening the management and monitoring the capacity of the justice institutions aimed at increasing the provision of legal services to the public. The organic law of the Institute of Judicial Assistance (Instituto de Patrocínio e Assistência Jurídica) was formulated and discussed with national and international partners in October, 2008.

20. The Government is reinvigorating its anti-corruption efforts. After the abolition of the Anti-Corruption Forum in January 2008, the implementation of the Anti-Corruption Strategy has been monitored as part of the public sector reform program by the Public Sector Inter-Ministerial Committee (CIRESP), chaired by the Prime Minister. In the first semester of 2008, 31 cases were sentenced by the courts for corruption. Furthermore, the Council of Ministers approved in August, 2008 the Report on the implementation of the Anti-Corruption Strategy formulated for the year 2007.

21. Significant progress has been made with respect to improving capacity on producing and disseminating macroeconomic statistics, especially at the INE and the MF. INE has prepared a Statistical Strategic Plan (2008–12), which is integrated with the poverty reduction strategy paper—PARPA II (2006–09) and the MF is increasingly using e-SISTAFE to generate public finance statistics not yet in compliance with the 2001 GFS manual.

II. Outlook and Policies for 2009

A. Overview

22. Mozambique’s prospects for 2009 and the medium term remain robust. However, there are considerable risks arising from the volatility and uncertainties concerning the impact of the current global financial crisis. Large variations in international prices and the recent substantial price declines for commodities including oil, gas and aluminium have a substantial impact on Mozambique’s external trade balance and a deeper slowdown in global demand would also affect export volumes. Moreover, the global financial crisis may adversely affect private capital inflows and the turbulence could spread to the Mozambican financial system. In addition, the economy will remain heavily dependent on inflows from the international donor community for many years to come. Mindful of these risks, the Government will monitor international and domestic developments in these areas closely and stands ready to take actions as needed, in close consultation with the IMF.
23. On the basis of the current global outlook and notwithstanding the above risks, economic prospects for 2009 remain strong. However, the outlook for real GDP growth has been reduced from 7.0 to 6.7 to accommodate the impact of the exogenous shocks (oil and food prices). The analysis made on the impact of the international financial crisis points to a growth of 6.2 percent of GDP. Lower commodity prices will help headline inflation decline to around 7 percent by the end of 2009. Lower import prices will also help mitigate the impact of lower exports on the current account deficit. However, the weaker global environment could also deter capital investment inflows so that external reserves are expected to decline during the year.

B. Fiscal Sector

24. In line with the Government’s medium-term fiscal strategy, the 2009 budget aims to support economic growth and poverty reduction while limiting domestic financing to provide room for private sector credit growth. The fiscal framework under the program, which is broadly in line with the budget presented to Parliament, envisages a modest net domestic debt repayment of 0.1 percent of GDP (including a substantial World Bank disbursement in support of the 2009 budget expected in late 2008). The Government recognizes there are risks to revenue collection and foreign assistance in the current global economic environment. Should any revenue or financing shortfalls arise, the Government will implement measures to cut nonpriority spending to maintain positive domestic debt repayments.

25. Under the program, domestic revenue is expected to rise from 15.8 percent of GDP in 2008 to 16.9 percent of GDP in 2009. As intended, this incorporates a reversal of the deferral in fuel-related taxes implemented in mid-2008 (0.6 percent of GDP). The Government remains committed to raising the domestic tax efforts by 0.5 percent of GDP. This is expected to come mainly from higher excise taxes on tobacco and alcoholic beverages (0.1 percent GDP) implementation of simplified taxes for small taxpayers, implementation of new code of benefits and improvements in revenue administration (0.4 percent of GDP). The latter includes more personnel and equipment, including scanner at international entry ports, the collection of tax arrears, and raising the number of taxpayers. Donors have made commitments to provide support around 18 percent of GDP that is similar to 2008 (including the advanced WB disbursement). In addition, the Government expects receipts of about 0.4 percent of GDP from privatization of parastatals.

26. Expenditures are in line with the revised Medium-Term Fiscal Framework (Cenário Fiscal de Médio Prazo-CFMP) and based on donors’ aid commitments provided by the donors. Expenditures take into account continued measures to mitigate the impact of high food prices as part of the FPAP (1.2 percent of GDP). The wage bill will rise 0.4 percentage points to reach 8.4 percent of GDP and includes additional hiring of 12,000 teachers and 1,500 health workers. Under the Medium-Term Pay Policy approved in September 2008, the Government is committed to reduce the wage bill back to 8 percent of GDP and below.
Spending on priority sectors will remain above 65 percent and will be closely monitored. The fiscal framework incorporates election-related costs and of the deferral of the fuel-related taxes introduced in June 2008. Capital expenditures, largely financed by foreign aid, are envisaged to reach 16.3 percent of GDP, 1.4 percentage points higher than in 2008. These scaled-up expenditures would help address infrastructure deficiencies, particularly in the energy sector.

27. The Government will continue to improve the efficiency of the tax system. The AT will implement a revenue payment system through banks. Based on the approved Strategic and Tactical Plans—the Authority will prepare operational plans with specific performance indicators for every department. Furthermore, the AT will improve and simplify the reimbursement system for VAT as well as the payments of personal and corporate income taxes. The authority will elaborate a strategy and action plan to strengthen the audit capacity of the mega-projects unit by end December 2009. The Government is committed to clearing all VAT arrears by 2011, including those already identified in the external audit and will formulate a repayment schedule to this effect.

28. In preparation of the third phase of the e-Sistafe reform, the Government is drafting a PFM vision paper and an action plan for 2009–11, taking into account the PEFA, Fiscal-ROSC and other diagnostic assessments. This will be approved by the MF by end-March 2009 (structural benchmark). The e-Sistafe will be rolled out to additional jurisdictions, bringing the total of districts using e-Sistafe to 42 districts. Salary payments through the e-Sistafe will be expanded to all central Government ministries, by June 2009. The corporate income tax prototype project in e-Tributação will be implemented by end-September (structural benchmark) with adequate donor funding, and will be expanded to all other taxes during 2011. The MF will publish public domestic and external debt data by end-December 2009. The Multi Currency Treasury Account (CUT) will be available by early 2009 and the Government will encourage donors to transfer project aid through this account.

29. The MF in coordination with the Ministry of Civil Service will prepare an estimate of the new pay policy for the fiscal years 2010 to 2012 by end-August 2009 (structural benchmark).

30. The MF’s debt management will be further improved under the FSTAP program by strengthening the institutional capacity of the debt management department, strengthening its procedures and controls, finalizing the consolidation and reconciliation of the debt database for all public debt, and improving the Treasury cash management policies and procedures with assistance of the World Bank. By December, 2009 the MF will start publishing its regular debt sustainability analysis reports.

31. To strengthen monitoring of net lending to public enterprises a draft public enterprises law will be submitted to the Council of Ministers by end-September 2009.
(structural benchmark). It will include the requirement for monthly financial reporting to the MF and the ring–fencing of commercial activities.

C. Monetary Sector

32. The BM is committed to pursuing a prudent monetary policy within the context of a flexible exchange rate regime. Monetary policy will remain geared towards price stability with the objective of reducing inflation to about 7 percent by end-2009. Consistent with this objective, the BM aims to increase reserve money, its operational target, by 11 percent during 2009, which will allow broad money to rise by about 16 percent. Following the large increase in external reserves anticipated in 2008, partly because of the accelerated World Bank disbursements, the BM will target a modest fall in reserves during 2009 to about 4.6 months of imports. In implementing monetary policy, the BM will also continue to rely more heavily on sales of foreign exchange reserves rather than Government securities to sterilize liquidity to make room for credit to the private sector to rise by about 28 percent.

33. The BM will continue refining its monetary policy framework and instruments for implementing policy. To buttress monetary policy formulation and support the decisions of the Monetary Policy Committee, the BM will allocate more resources to monitoring, analyzing and forecasting macroeconomic and monetary indicators. The BM with technical assistance support of the Fund will design a plan to strengthen the monetary policy framework comprising all intermediate steps, including agreement on a core inflation indicator by end-December 2009 (structural benchmark). The BM will also follow up on plans to strengthen policy implementation. In this regard, the BM will continue to focus on strengthening liquidity management, paying particular attention to improving coordination with the MF on its cash flow projections and with banks on their liquidity requirements. To help strengthen the interbank market and liquidity management, the BM will broaden its use of repos to build a flexible and more realistic corridor that better reflects market conditions. To further strengthen the interbank market, the BM will also stimulate the market’s use of repos by improving confidence between the market players as result of the increase of volume and frequency of transactions.

34. The BM will implement measures to further buttress its internal audit. In accordance with the audit charter, the internal audit office will report periodically to the BM’s Board on the implementation of audit recommendations and on financial developments at the BM. The Government will draft a new central bank law for Mozambique once the SADC central bank model law has been approved (expected in 2010). It will also publish its audited financial statements for 2008 in compliance with IFRS by end-June 2009.

35. Under the strategic plan (2008–10), the BM will continue to strengthen its banking supervision framework by adopting a risk-based approach to supervise financial institutions. The Risk-Based Supervision (RBS) Framework is expected to be finalized by end-2009. A consultant has been appointed under FSTAP to assist BM on the designing of the road map
for the implementation of Basel II in Mozambique. The consultant will assess the impact of Basel II on financial sector and prepare a transition strategy, procedure manuals, and circulars on procedures.

36. A new foreign exchange law which fully liberalizes current account transactions is currently with Parliament. Following its approval, the Government intends to accept the obligations under Article VIII sections 2, 3, and 4 of the Fund’s Articles of Agreement. The recent regulation (Aviso 2/06) pertaining to the current import and export transactions remains suspended.

D. Other Structural Policies

37. Following the recent adoption of a new law on social protection, the Government intends to strengthen the social security and supplementary pension system. As part of the restructuring of the social security system, the National Social Security Institute (INSS), the Government has drafted a report on an actuarial study and on a new investment management strategy, that will provide the basis for a plan to reform the INSS into a financially sustainable institution. The Government is finalizing a census of pensioners covered by the civil service pension system managed by the MF and has requested an actuarial study with the World Bank’s support. Efforts are also underway to strengthen the regulatory and supervisory framework of the insurance sector and to strengthen the institutional capacity of the Inspecção Geral de Seguros (IGS).

38. To manage the budgetary and macroeconomic implications of megaprojects the Government intends to expand the prerogative of the Institute for National Statistics to collect data on megaprojects so as to develop a comprehensive data system that also satisfies the needs of MF and BM. The Government will strengthen the analytical and forecasting capabilities at the MF in close coordination with other ministries and the BM. The Government will strictly implement the mining and petroleum fiscal regime and related regulations and model contracts to all new projects and continue to adopt nonrecourse financing clauses in future megaprojects.

39. To ensure a transparent management of mineral resources, the Government organized a seminar with representatives of the Parliament, Government, development partners, private sector, and civil society. By June 2009 the Government will formally submit a request to start the process to become a member of the EITI (structural benchmark). The Government, the private sector and civil society will be required to undertake a sequence of actions required for the validation of Mozambique’s adherence to the EITI. This process is expected to take at least three years.

40. Based on the strategy approved in February 2008, the Government is accelerating reforms to reduce the costs of doing business. The Government will implement the new corporate insolvency law once approved by the Parliament; implement the one-stop window
to facilitate trade across borders by December 2009; submit the draft competition law to Parliament; simplify and facilitate electronic tax filing (covered in e-Tributação); amend legislation to accelerate property registration; consolidate progress in streamlining licenses, and establish the SME Institute. Moreover, by end-March 2009, the Ministry of Industry and Trade will issue a decree streamlining the business inspection process (structural benchmark).

41. The Government places particular emphasis on implementing the second phase of the public sector reform program (2006–11), which consists of four pillars: improving service delivery to the citizen and the private sector; strengthening the capacity of local governments, with special emphasis on the Districts (including the decentralization strategy); creating a more professional public sector (including payroll systems, performance evaluation and wage policy); and strengthening good governance systems and the fight against corruption. By end 2009, the Government will draft a Public-Private Partnership Law aimed primarily to avoid, prevent and manage fiscal and para-fiscal risks, which could also be applicable to megaprojects.

42. The Government will prepare a decentralization strategy with the help of the World Bank and other partners. The strategy will propose, among other things, a clear legal, regulatory, and institutional framework for revenue raising and spending responsibilities and functions of sub-national units (provinces, districts, and municipalities), as well as monitoring of their fiscal operations. The strategy will pay due regard to the administrative capacity of sub-national units and need to maintain fiscal control as well as fiscal sustainability in planning, finance, execution and control. A draft decree will be adopted by the Government outlining the general principles of the repayment framework of the OIIL district revolving funds, as well as their management structure.

III. Program Monitoring

43. The revised quantitative assessment criteria for end-December 2008 and the new assessment criteria and indicative targets for 2009 are shown in Table 1, with further definitions and explanations contained in the Technical Memorandum of Understanding. Table 3 lists the structural benchmarks for 2009.
Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets, 2007–09

(Millions of MT, unless otherwise specified)

<table>
<thead>
<tr>
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<th>2008</th>
<th>2009</th>
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<tbody>
<tr>
<td></td>
<td>Assessment</td>
<td>Indicative</td>
</tr>
<tr>
<td></td>
<td>Criteria</td>
<td>Criteria</td>
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<tr>
<td>Net credit to the government (cumulative ceiling)</td>
<td>-3,210</td>
<td>-2,003</td>
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<tr>
<td>Stock of reserve money (ceiling)</td>
<td>17,044</td>
<td>17,044</td>
</tr>
<tr>
<td>Stock of net international reserves of the BM (floor, in millions of U.S. dollars)</td>
<td>1,704</td>
<td>1,604</td>
</tr>
<tr>
<td>New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling)</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Stock of short-term external public debt outstanding (ceiling)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>External payments arrears (ceiling)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Indicative targets</td>
<td>Balance of the government’s savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars)</td>
<td>0</td>
</tr>
<tr>
<td>Government revenue (floor)</td>
<td>17,287</td>
<td>17,762</td>
</tr>
</tbody>
</table>

1 For definition and adjustors see the attached Program Monitoring Section of Memorandum of Economic and Financial Policies and the Technical Memorandum of Understanding.
### Table 2. Mozambique: Structural Assessment Criteria and Benchmarks Under the Policy Supported Instrument (March–December 2008)

<table>
<thead>
<tr>
<th>Actions</th>
<th>Expected Date of Implementation</th>
<th>Comments</th>
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<tbody>
<tr>
<td><strong>Structural assessment criteria</strong></td>
<td></td>
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<tr>
<td>Finalization of a new terms of reference for the Audit Board of the Bank of Mozambique.</td>
<td>June 2008</td>
<td>Met</td>
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<td><strong>Structural benchmarks</strong></td>
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<td>An integrated and e-SISTAFE compatible payroll database will start to be used by the Ministry of Finance to carry out salary payments via e-SISTAFE.</td>
<td>April 2008</td>
<td>Met</td>
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<tr>
<td>A list of additional district and municipalities for the rollout of e-SISTAFE will be defined.</td>
<td>End-June 2008</td>
<td>Met</td>
</tr>
<tr>
<td>The Meticalnet will be adapted to allow for outright operations of treasury bills for the secondary market.</td>
<td>End-June 2008</td>
<td>Met</td>
</tr>
<tr>
<td>The BM adopts an internal audit charter and commences periodic reporting to the Executive Board on the implementation of audit recommendations.</td>
<td>July 2008</td>
<td>Met</td>
</tr>
<tr>
<td>A study, with appropriate technical assistance, will be undertaken that will serve as a basis for drafting the public enterprises law.</td>
<td>December 2008</td>
<td>Delayed until March 2009</td>
</tr>
<tr>
<td>Actions</td>
<td>Expected Date of Implementation</td>
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<tr>
<td>The Ministry of Finance will approve a PFM vision paper, as the basis for the Sistafe Action Plan and Budget for 2009-2011.</td>
<td>end-March 2009</td>
<td></td>
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<tr>
<td>The Ministry of Industry and Trade will issue a decree streamlining the business inspection process.</td>
<td>end-March 2009</td>
<td></td>
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<tr>
<td>The Government will formally submit a request to start the process to become a member of EITI.</td>
<td>end-June 2009</td>
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<tr>
<td>The Ministry of Finance in coordination with the Ministry of Public Service will prepare an estimate of the new pay policy for the fiscal years 2010-2012.</td>
<td>end-August 2009</td>
<td></td>
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<tr>
<td>A draft public enterprises law will be submitted to the Council of Ministers.</td>
<td>end-September 2009</td>
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<tr>
<td>The central revenue authority and UTRAFE, will implement the pilot project on corporate income tax for the revenue collection module (e-Tributação) of the e-Sistafe.</td>
<td>end-September 2009</td>
<td></td>
</tr>
<tr>
<td>The BM with technical assistance support of the Fund will design a plan to strengthen the Monetary Policy framework comprising all intermediate steps, including agreement on a core inflation indicator.</td>
<td>end-December 2009</td>
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</table>
1. The purpose of this technical memorandum of understanding (TMU) is to describe the concepts and definitions that will be used in monitoring the Policy Support Instrument (PSI) program, including the following:

- net credit to the central government by the banking system;
- government revenue;
- net international reserves, and reserve money of the Bank of Mozambique (BM);
- new nonconcessional external debt contracted or guaranteed by the central government or the BM with a maturity of more than one year;
- short-term external public debt outstanding;
- external payments arrears; and
- foreign program assistance and external debt service.

This memorandum also describes the adjusters that will be applied to certain quantitative assessment criteria of the program.

I. Definitions

Net credit to the central government

2. Net credit to the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts with the banking system, recapitalization bonds issued to the BM, and proceeds from the signing fee for coal exploration. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in net credit to the central government by the banking system will be cumulative from end-December of the previous year.

3. The government encompasses all institutions whose revenue and expenditure are included in the state budget (Orçamento do Estado): central government ministries, agencies,
and the administration of 11 provinces. Although local governments (33 municipalities or autarquias) are not included because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

**Government revenue and financing**

4. Revenue is defined to include all receipts of General Directorate of Tax (Direcção Geral dos Impostos or DGI), the General Directorate of Customs (Direcção Geral das Alfândegas, DGA), and nontax revenue, including certain own-generated revenues of districts and some line ministries as defined in the budget. Net receipts from privatization received by the National Directorate of State Assets (Direcção Nacional do Património do Estado) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

5. For the purpose of program monitoring, revenue is considered as collected at the time when it is received by the DGI from private agents or other government collecting agencies, in cash or checks, or through transfers into a DGI bank account.

**Reserve money**

6. Reserve money is defined as the sum of currency issued by BM and the commercial banks’ deposits in the BM. The commercial bank deposits include the statutory required reserves and excess reserves held at the BM. The reserve money stock will be monitored by the monetary authority and provided to the IMF by the BM.

**Net international reserves**

7. Net international reserves of the BM are defined as reserve assets minus reserve liabilities. The BM’s reserve assets include (a) monetary gold; (b) holdings of SDRs; (c) reserve position at the IMF; (d) holdings of foreign exchange; and (e) claims on nonresidents, such as deposits abroad (excluding the government’s savings account related to the Moatize coal mine concession). Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guarantee for a third-party external liability (assets not readily available.) The BM’s reserve liabilities include (a) all short-term foreign exchange liabilities to nonresidents with original maturity of up to and including one year; and (b) all liabilities to the IMF.

8. For the purposes of program monitoring and in order to exclude valuation changes, net international reserves will be measured at the official exchange rates prevailing at end-2007 and used by the BM.

9. The BM will publish the exchange rates quoted by commercial banks on average as the market rates.
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of more than one year

10. The term ‘debt’ will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Government debt is outstanding debt owed or guaranteed by the central government or the BM (but does not include debt of any political subdivision or government-owned entity with a separate legal personality that is not otherwise owed or guaranteed by the central government).

11. The central government will limit contracting or guaranteeing external debt up to US$5 million each year with original maturity of one year or more with a grant element of less than 35 percent, calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the annual Budget Law. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. This assessment criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

12. The central government will not contract or guarantee external debt with original maturity of less than one year. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this assessment criterion are short-term, import-related trade credits. This assessment criterion will be assessed on a continuous basis.

External payments arrears

13. The government undertakes not to incur payments arrears on external debt owed or guaranteed by the central government, with the exception of external payments arrears arising from government debt that is being renegotiated with creditors, including Paris Club creditors. This assessment criterion will be assessed on a continuous basis.

Foreign program assistance

14. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through BM accounts excluding those related to projects (Table 1).

Actual external debt-service payments

15. Actual external debt-service payments are defined as cash payments on external debt-service obligations of the government and central bank, including obligations to Paris Club
and other bilateral creditors rescheduled under enhanced HIPC Initiative completion point terms, multilateral creditors, and private creditors, but excluding obligations to the IMF (Table 1).

II. Adjusters

Net international reserves

16. The quantitative targets (floors) for the central bank’s net international reserves will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted downward by 100 percent of any shortfall in external program aid (up to a maximum of US$100 million) and any excess in external debt service payments, compared to the program baseline (Table 1).

17. The quantitative targets (floors) for the central bank’s net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year.

18. They will also be adjusted upward for the full amount of any external privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government’s savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

19. The quantitative targets (floors) for the central bank’s net international reserves will be adjusted downward up to a maximum of US$50 million per annum by the amount that the actual fuel import bill is higher due to a rise in the average fuel import price. This adjustment will be equal to the difference between the realized and the programmed average fuel import price, multiplied by the volume of total fuel imports programmed for each quarter (Table 1).

20. The quantitative target (floor) on net international reserves will be adjusted downward to accommodate the possible need for higher external outlays to deal with natural disasters, up to a total limit of US$20 million.

Net credit to government

21. The quantitative targets (ceilings) for net credit on the central government (NCG) will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted upward by 100 percent of any shortfall in external program aid (up to a maximum of US$100 million) and any excess in external debt service payments, compared to the program baseline (Table 1).
22. These targets will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government’s savings account abroad.

23. The quantitative targets (ceilings) for NCG will be adjusted downward (upward) for any increase (decrease) in domestic financing from the non-financial private sector. The government expenditures contingent on higher disbursements of foreign program assistance (and lower external debt service) will be used to finance greater “priority” spending identified in the budget.

24. The quantitative target (ceiling) for net credit to the central government (NCG) will be adjusted upward to accommodate the possible need for higher locally financed government outlays to deal with natural disasters, up to a total limit of MT 500 million.

Reserve money

25. The reserve money ceiling will be adjusted equivalently upward up to a maximum of MT 500 million to the extent that the outstanding stock of currency issued by the BM exceeds those projected in Table 1. The maximum at end-December will be further adjusted by an additional MT 500 million because of the seasonal increase in the demand for currency during the festive season in the fourth quarter of the year.

III. Data Reporting

26. In addition to providing the monthly and quarterly data needed to monitor program implementation in relation to the programs’ quantitative targets and broader economic developments, the authorities will provide weekly updates of the daily data set out in Table 1 as well as the weekly data set out in Table 4 of the TMU dated May 26, 2005. Monthly updates will also be provided of the foreign exchange cash flow of the BM.

27. The government will continue to provide Fund staff with the data corresponding to monthly government revenues (in detail according to the fiscal table), with a lag not exceeding one month. In addition, the government will continue to publish and provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.

28. In addition, the government will provide monthly information on the balance of its savings account abroad and will start developing and providing information on domestic arrears on a quarterly basis.

29. From December 2005 onwards, the monetary survey made available by the BM will clearly identify donor-financed project deposits (with a breakdown between foreign and domestic currency) included in net credit to the government in both the central bank’s and commercial banks’ balance sheets.
## Mozambique: Technical Memorandum of Understanding, 2007-09

<table>
<thead>
<tr>
<th>Country Report 08/220</th>
<th>2008</th>
<th>2009</th>
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<td>Net foreign program assistance (US$ mn)</td>
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<td>Gross foreign program assistance</td>
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<tr>
<td>External debt service</td>
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<td>Average fuel import price, US$/barrel (10 barrels per mt)</td>
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<td>Total fuel import bill (US$m)</td>
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<td>127</td>
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Source: Mozambican authorities and IMF staff estimates