



# Norwegian budget support to Mozambique

Desk Appraisal

Economics and Public Administration Department

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## Norad Technical Note

This note is part of the Department's ongoing work. The views and opinions expressed in this note do not necessarily correspond with those of the management of Norad.

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## Foreword and acknowledgments

Norway has contributed with general budget support to Mozambique since 1996, and considers supporting a new phase of the program. Norad has been requested by the Norwegian Embassy in Maputo to assist in preparing an appraisal as a basis for the decision of allocating funds for the new phase of the program.

This Norad document is a desk appraisal and assesses the relevance of the general budget support program, the experiences with previous support, and the design of the new phase and makes an overall assessment of the balance of risks and expected results with a recommendation to continue general budget support.

This report has been prepared by Senior Adviser Rasmus Bakke from Economic and Public Administration Department in Norad. We would like to thank the Norwegian Embassy in Maputo for good collaboration during the appraisal process.

Oslo, June 2009

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# Table of contents

<b>Foreword and acknowledgments.....</b>	<b>iii</b>
<b>Table of contents.....</b>	<b>iv</b>
<b>Abbreviations.....</b>	<b>v</b>
<b>Executive summary.....</b>	<b>vi</b>
<b>1 Background.....</b>	<b>1</b>
<b>2 Purpose.....</b>	<b>2</b>
<b>3 Assessment of Programme.....</b>	<b>3</b>
3.1 Assessment of Government multi-year operational plan.....	3
3.2 Assessment of GBS design .....	6
3.3 Experiences with previous support .....	8
<b>4 Assessment of performance and risks .....</b>	<b>13</b>
4.1 Macroeconomics and poverty .....	13
4.2 Public financial management.....	14
4.3 Governance.....	17
4.4 Corruption.....	18
4.5 Human capital.....	19
4.6 Economic development .....	21
4.7 Cross cutting issues.....	21
4.8 Donor performance .....	23
<b>5 Summary assessment of underlying principles.....</b>	<b>24</b>
5.1 Democracy and human rights.....	24
5.2 Prioritizing poverty .....	24
5.3 Macro economy and PFM.....	24
<b>6 Summary risk assessment .....</b>	<b>25</b>
<b>7 Overall assessment and recommendation .....</b>	<b>27</b>
<b>Annex 1: Reference List .....</b>	<b>29</b>
<b>Annex 2: Terms of reference for appraisal of General Budget Support 2009-2012.....</b>	<b>30</b>

## Abbreviations

AR	-	Annual Review
CCIs	-	Cross Cutting Issues
CGE	-	Annual State Accounts
DAC	-	Development Assistance Committee
DP	-	Development Partner
EIU	-	Economist Intelligence Unit
e-SISTAFE	-	Computerized Accounting System
GBS	-	General Budget Support
GDP	-	Gross Domestic Product
GoM	-	Government of Mozambique
GOP	-	Government's Multi- Year Operational Plan
HOAP	-	Harmonization of Overseas Audit Practices
IGF	-	General Inspectorate of Finance
IMF	-	International Monetary Fund
JR	-	Joint Review
MDGs	-	Millennium Development Goals
MDP	-	Ministry of Planning and Development
MTFF	-	Medium Term Fiscal Framework
MoU	-	Memorandum of Understanding
MYR	-	Mid Year Review
NOK	-	Norwegian Kroner
ODs	-	Development Observatories
OE	-	Annual State Budget
PAF	-	Performance Assessment Framework
PAPs	-	Programme Aid Partners
PARPA II	-	Government's second Action plan for Reduction of Absolute Poverty for 2006-2009
PEFA	-	Public Expenditure and Financial Accountability
PES	-	Government's Annual Economic and Social Plan
PETS	-	Public Expenditure Tracking Survey
PGBS	-	Partnership General Budget Support
PFM	-	Public Financial Management
PQG	-	Government's Five Years Programme
PSI	-	Policy Support Instrument
PSR	-	Public Sector Reform
SBS	-	Sector Budget Support
TA	-	Administrative Court
UNDP	-	United Nations Development Program

## Executive summary

- The general budget support programme in Mozambique is of high relevance to Mozambican and Norwegian priorities.
- Assessments of goals and objectives in the Government Multi Annual Plan and the financial framework supporting it, give a good basis for concluding that the expected development results of continuing supporting this plan are reasonably high
- The new Memorandum of Understanding fulfilled the needs for reporting, reviews and mechanisms for transfer of funds satisfactorily. In addition, the General Budget Support programme has developed further in the positive direction of harmonization, alignment, mutual accountability, predictability and managing for results during the period.
- The Joint Review earlier this year concludes that Mozambique has shown good progress in a number of areas giving a reliable basis for donors to decide on continued budget support.
- The overall trend within public financial management has been positive the last five years, and continued progress is anticipated. However, there are still weaknesses in the public financial management system, in particular within comprehensiveness and transparency of the budget, predictability and control in budget execution and external scrutiny and audit, but mitigating actions are in place through ongoing and planned reforms.
- There are also high risks related to lack of capacity in governance and service delivery regarding implementing the Government's second Action plan for Reduction of Absolute Poverty for 2006-2009. Reforms and capacity building in public administration is high on the agenda in the government's Multi annual plans
- The low capacity in the legal and judicial areas is a major constraint to development. Government's second Action plan for Reduction of Absolute Poverty for 2006-2009 includes a broad agenda of reforms and strengthening of the justice sector.
- The impact of the financial crisis remains to be seen, but will most likely reduce rates of economic growth and the rate of poverty reduction, thereby probably having a significant negative impact both in the short and medium term.
- Government of Mozambique demonstrates, through the Performance Assessment Framework and the planned implementation of reforms, a clear commitment to mitigating actions related to the most serious risks.
- Given the positive track record in implementing reforms, the expected development results of budget support for the following period, and commitments taken by the government for risk mitigating actions, we find that the expected development results of budget support outweigh the identified risks.

## Recommendations

- Norway should continue providing general budget support to Mozambique for a new three year period.
- An increased volume of budget support for the period 2009-12, compared with the earlier period, is reasonable given the documented results and positive experiences achieved with the support

# 1 Background

Norway has provided general macro-economic support to Mozambique since signing the Balance of Payments support agreement in 1996. Norway continued with macroeconomic support that gradually developed into a more coordinated budget support mechanism. Under the present bilateral agreement, signed in November 2006, Norway has disbursed 500 million NOK, and since 1996 Norway has contributed well over 1 billion Norwegian kroner. Before 1996 Norway also contributed with import-support to Mozambique.

19 donors (the G19) participate in the General Budget Support (GBS) mechanism, contributing almost 20 % of the state budget, or more than 485 million USD (2009), directly through the GBS. More than 50% of Mozambique's state budget is funded through development aid. Norway is among the 5 largest bilateral donors.

The GBS is based upon the Government's poverty reduction plan, the Government's second Action plan for Reduction of Absolute Poverty for 2006-2009 (PARPA II), which has been extended to 2010. The main purpose of the PARPA II is to promote poverty reduction and attaining the Millennium Development Goals (MDGs).

A Memorandum of Understanding signed in March this year between the G 19 and the Government of Mozambique (GoM), sets out the procedures for managing the GBS. Larger donors that are not full members of the G19 such as USAID, also have the option of entering into an associate membership and to participate in most meetings and processes. The GBS mechanism is the main overall development aid coordination process in Mozambique at present. A more general Code of Conduct is under development.

The Norwegian Strategic Plan for Development Cooperation for 2010- 12 highlights that the development cooperation will be concentrated on energy, fishery and general budget support. A Platform for Dialog document for a new phase of budget support was approved by Ministry of Foreign Affairs in April this year.

## 2 Purpose

The purpose of the appraisal is to carry out a quality control that assesses the relevance, feasibility and potential risks and sustainability prior to the decision of new funding of Norwegian budget support to Mozambique. The appraisal will make an overall assessment of the balance of risks and clear recommendation of whether Norway should provide budget support to Mozambique.

The appraisal is carried out as a desk appraisal, and based on analyses done in the Joint Annual Review and other joint analyses carried out.



## 3 Assessment of programme

### 3.1 Assessment of Government multi-year operational plan

#### PARPA II

The PARPA II was finalised in 2006 and decided prolonged to 2010. The document is a successor of the PARPA I from 2001 and shares the same main priorities in the areas of human capital development through education and health, improved governance, development of basic infrastructures and agriculture, rural development, and better macroeconomic and financial management.

PARPA II differs from its predecessor in its enhanced emphasis on integration of the national economy and need for increase in productivity. In particular it focus more strongly on district-based development, creation of an environment favourable to growth of the nation's productive sector, improvement of the financial system, measures to help small and medium-size companies to flourish in the formal sector, and the development of both the internal revenue collection system and the system of allocating budget funds.

The Government's general objectives as given in the Five Year Plan for 2005- 09 and in PARPA II are twofold:

- Reduction in the levels of absolute poverty
- Promotion of rapid, yet sustainable and comprehensive, economic growth

The strategy for promoting growth and reducing poverty is organised around three pillars: governance, human capital and economic development, and additionally integration of cross cutting issues<sup>1</sup>.

Main objectives in Governance are:

- Consolidation of national unity, peace, justice and democracy
- Confrontation of corruption, excessive bureaucracy, and crime
- Strengthening sovereignty and international cooperation
- The harmonious development of the country

Main objectives in the Human Capital pillar are:

- Expand and improve the levels of education
- Improve and expand access to health care
- Improve and expand access to potable water and adequate sanitation
- Promote and consolidate self-esteem in the minds of the citizens
- Increase awareness of the importance of a culture that values work, enthusiasm, honesty, and accountability
- Help young Mozambicans to realize their potential and creative and entrepreneurial abilities, and express their voluntarist spirit

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<sup>1</sup> PARPA II identifies eight cross-cutting topics: Gender, HIV/AIDS, Environment, Food and nutritional security, Science and technology, Rural development, Natural disasters, De-mining

Some of the priorities here are to curb the incidence of HIV/AIDS; reduce death from malaria and tuberculosis and develop and consolidate social networks of support for the least favoured citizens.

Regarding the Economic Development Pillar there are three objectives. These are:

- Rural development
- Foster the development of the national business community
- Create an environment favourable to investment

One priority here is to promote the expansion of the agro-industrial system, the labour-intensive manufacturing, and export oriented local industries, particularly small and medium-scale units and those that make a high relative contribution to national income and job creation.

The administrative barriers to the pursuit of economic activities are identified in PARPA as the most serious constraint on private sector development. The Government will proceed with a review of the legal and institutional framework that will make it possible to simplify and accelerate the licences of commercial and industrial activities and tourism.

The development partners' assessment is that there was a substantial increase in participation in the PARPA II process as compared to PARPA I, that PARPA II is better integrated into domestic processes and that the quality of poverty diagnosis has improved substantially.

The Development Partner (DPs) assessed PARPA II in 2006 and concluded to provide support for implementation of the PARPA.

The DP assessment also finds that the PARPA II:

- is in line with international conventions regarding gender equity and women's rights
- includes the country's obligations under human rights convention, by clearly prioritising the poorest and most vulnerable
- is found to be a credible strategy for accelerating the national response to the AIDS pandemic within the National Strategic Plan to fight HIV/AIDS

There is at this point of time little available information regarding how a the next PARPA (PARPA III) and the next governmental five year plan expected to cover the period from 2011 and forwards, would look like, but, there is little reason to expect that the coming plans and strategies will be of such a character that the main conclusion of continued support will be reversed. However there is always some uncertainty connected to a new plan and the next PARPA has to be properly assessed before deciding on continued support to the new plan.

### **PARPA Strategic Matrix**

A strategic matrix for monitoring the PARPA II has been developed by GoM covering crucial reform areas within the central pillars of PARPA II. The Performance Assessment Framework (PAF)- matrix for monitoring of results is based fully on PARPA and other governmental plans and with a baseline of data from 2005 provides indicators and targets for the period 2006- 09. Despite that data is a quality concern; this framework is a useful result monitoring tool for GoM and DPs.

## Medium Term Fiscal Framework

The 2009-11 Medium Term Fiscal Framework (MTFF), was analyzed during the Mid Year Review (MYR), in September 2008<sup>2</sup>. The new MTFF has a new approach to planning and budgeting. The new methodology for drawing up the fiscal framework represents an advance, providing greater visibility in prioritizing expenditure, particularly through the definition of key priority programmes. The Government has defined 12 “key priority” investment programmes based on the Government’s five years Programme (PQG) and on PARPA II, covering actions in the pillars of human capital, economic development and governance.

The adjustments made in the internal component of the MTFF were clearly influenced by the Food Production Action Plan and by funding the salary reform in the public administration, which includes an increase in wage expenditure of 5.5% in real terms. Thus to finance Food Production Action Plan which is estimated to be 10% of the total, the sectors of agriculture, fisheries, industry and trade are those that show noteworthy increases in their budget allocation, while the social sectors remain constant, with lesser capacity to prioritize at this level.

For the three year period 2009- 11 it is estimated that nominal growth in expenditure will be about 19% compared with 2008, falling as a percentage of GDP from 35.4% in 2009 to 33.3% in 2011. The total external resources for 2009 are estimated at about 50% of the total, falling to 44% in 2011<sup>3</sup>. Internal resources was according to MTFF expected to continue to grow annually by 0.5% of GDP.

However, these projections were done before the effects of the global financial crises were emerging. According to May 2009 International Monetary Fund (IMF) estimates the economic growth could fall to about 4.3% in 2009, down from 6.8% in 2008, with only a gradual recovery beginning in 2010<sup>4</sup>. Further the IMF estimates shows that the revenues for 2009 is expected to fall by 1.3% of GDP relative to the budget approved by Parliament. This underlines a need for possible additional financial support to help mitigate the exogenous shock stemming from the global economic downturn.

The process of driving up the 2009- 11 MTFF shows improvements in comparison with previous exercises, with the gradual introduction of programme budgeting and with the definition of key priority investment programmes which has allowed a tighter link between the objectives of the PQG and PARPA II, and the choices made on sector funding in response to the new challenges. However the MTFF still does not include many of the details about the prioritization done within these programmes, including their territorial content and scale.

The Annual Budget and the Annual Economic and Social Plan for 2009 is based on the MTFF framework and assessed by the Budget Support Donor Group in Maputo.

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<sup>2</sup> Main conclusion is taken from “Mid-Year Review 2008, Aide Memoire, September 2008”

<sup>3</sup> General Budget Support committed by Norway and other Donors are incorporated in this amount

<sup>4</sup> For more information refer to “IMF Press Release No. 09/165, May 13 2009”.

*A review of the assessments done of the goals and objectives in the Government Multi Annual Plan and the financial framework supporting it, gives a good basis for concluding that the expected development results of continuing supporting this plan are high.*

### **3.2 Assessment of GBS design**

A new Joint Memorandum of Understanding (MoU) was signed by the Mozambican Government (GoM) and 19 Programme Aid Partners (PAPs) in March this year. This MoU sets out the principles and terms for the partnership between GoM and PAPs. The MoU covers the common procedures related to consultation and decision making, disbursement, monitoring and reporting, review and evaluation, audit financial management and the exchange of information and cooperation agreed upon between the Signatories.

The joint overall objective of the Budget Support to Mozambique is to contribute to poverty reduction in all its dimensions. The Budget Support should according to the MoU, help attain the mutual objectives of poverty reduction and the (MDGs) in Mozambique by providing budget financing to the public sector for poverty reduction, aligned with Mozambican systems and clearly and transparently linked to performance.

The budget support should according to the MoU be linked to performance in a way which:

- supports the evolution, implementation and monitoring of the GOP
- improves aid effectiveness and country ownership of the development process
- reduces transaction costs
- allows allocative efficiency, increased transparency and accountability of public spending and predictability of aid flows
- increases the effectiveness of the state and public administration
- improves monitoring and evaluation
- strengthens accountability between the Signatories
- improves accountability of GoM to Parliament and Mozambican people

A basis for the cooperation is the following underlying principles:

- safeguarding peace and promoting free credible and democratic political processes, independence of the judiciary, rule of law, respect for human rights, good governance and probity in public life, including the fight against corruption
- prioritizing fighting poverty through its policies and plans in its patterns of public expenditure
- pursuing sound macro-economic policies and public financial management systems

The violation of an underlying principle is understood as being above and beyond concerns raised about under-performance against indicators and targets expressed in the GoM PAF.

The focus of attention of GoM performance is particularly on the GoM PAF which is a multi-annual matrix of priority indicators, selected from among the indicators in the strategic matrix of the Government's multi-year operational plan (GOP). The focus on attention on the PAP's performance is the PAP's commitment to complying with a PAF which sets annual targets for the way in which they provide their Budget Support and other development assistance, corresponding to their undertakings in the MoU, as well in the Paris Declaration and the Accra Agenda for Action.

Monitoring and dialogue processes follow an Annual Review (AR) process aligned with the GoM's planning, budgeting and monitoring cycle. An AR of performance will be held following the production of the Government's AR of the Economic and Social Plan. The purpose of the AR is to obtain an overall view of GoM and PAP's performance in year n-1 based on dialogue and assessments by both parties. This will serve the PAPs as the basis for making their assessments and future commitments. The assessment of performance may include divergent opinions between the two Parties. There will also be a PAF annual planning meeting prior to the submission of the Government's Economic and Social Plan and State Budget to the Parliament. The purpose of the meeting is to set and agree both the final indicators and targets for the year n+1, and the indicative PAF targets for the succeeding years n+2 and n+3. Dialogue will be held between the GoM represented at ministerial level, and the PAPs represented at Head of Mission level, in political level dialogue meetings held four times a year.

Compared with the previous MoU signed in 2004 there are some minor adjustments in the new MoU:

- The new MoU includes only GBS. This means a limitation compared with the 2004 MoU which also included Sector Budget Support (SBS). Only donors providing GBS qualify for full membership. It is also included in the new MoU that the PAP group is committed to provide SBS and programme aid in accordance with the Paris and Accra agenda.
- The new MoU refers in addition to the Mozambican action plan for the reduction of absolute poverty (PARPA II) to a possible future similar plan. This opens up for the new MoU also to be in force into a new five year period supporting the possible following governmental plan, as PARPA II is expected to be valid only up to 2010.
- A specific reference is taken in the underlying principles regarding sound public financial management systems.
- The previous Mid Year Review (MYR) is changed into a PAF Annual Planning Meeting, meaning that there now is only one backward looking review monitoring progress and results.
- The formalization of four political dialogue meetings is also new with this MoU. However, this has been a procedure in the budget support follow up the last years.

- The new MoU opens more clearly up for divergent opinions between GoM and the PAPs in the assessment of performance than the previous. The previous MoU emphasized that the assessments done should be joint. It is stated in the new MoU that it is the PAPs that will assess the GoM performance and intend to reach a joint view with GoM on performance by the end of the Annual Review. Likewise it is GoM that will assess the PAPs performance to which the PAPs respond.
- There is some more emphasis on civil society in the new MoU. It is mentioned that the GoM and PAPs are committed to include representatives from civil society in the annual review processes.

In general, the adjustments made in the new MoU are relative modest, and the consequences for Norway's participation in the BS- program are small. A step in the right direction regarding efficiency and reducing the burden on GoM in the follow-up process is the limiting of the backward looking assessment more clearly to one review. The inclusion in the new MoU of the political dialogue meetings underlines the important role the GBS forum plays in political dialogue in Mozambique<sup>5</sup>. The opening up for divergent opinions between GoM and PAPs will also open up for better technical reviews of results, as Governments everywhere might be hesitating in formalizing goals and indicators not achieved.

The previous MoU has been assessed in connection with earlier Norwegian decisions for budget support<sup>6</sup>. Some main findings were that:

- The programme had good harmonized reporting requirements.
- the programme was well aligned with PARPA and governmental budget and planning processes
- important steps to increase predictability had been taken
- mechanism for stronger mutual accountability is in place

*The conclusion was that the previous MoU fulfilled the needs for reporting, reviews and mechanisms for transfer of funds satisfactorily. The adjustments made in the new MoU do not give any reason for a change this conclusion. In addition, the BS programme in general has developed further in the positive direction of harmonization, alignment, mutual accountability, predictability and managing for results during the period of the previous MoU period, which this new MoU is a visible sign of.*

### **3.3 Experiences with previous support**

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<sup>5</sup> The dialogue between G19 and the Government is actually held at a much higher level than in most African countries. It has tended to be held in a formal setting and not very dynamic and interactive. Nonetheless, the issues that are raised at that level are taken very seriously by the Government and often end up being moved on fairly rapidly. Refer to "Institutional features of Budget Support Mechanism, Learning experiences from Mozambique to Uganda, Norad November 2008, Task team Torun Reite".

<sup>6</sup> Norwegian Budget Support to Mozambique, Appraisal Report Norad May 2004

## Joint DAC Evaluation of General Budget Support

In the Joint Development Assistance Committee (DAC) Evaluation of General Budget Support carried out for the period 1994- 2004, Mozambique was one of the 7 countries chosen for the study<sup>7</sup>. This evaluation provides the first major evidence- based study across several countries of the use of budget support. It is still the most relevant reference document in assessing experiences from previous budget support in Mozambique<sup>8</sup>.

The overall conclusion for Mozambique and four of the other countries was clearly positive. The overall assessment of Partnership General Budget Support (PGBS)<sup>9</sup> in Mozambique was that this has been a very successful case of donor- government collaboration, and that PGBS has contributed positively to conditions for economic growth and poverty reduction.

Some of the main findings from the Mozambican country evaluation case are:

- The original design of PGBS is relevant to the national context and has led to the creation of a framework that has allowed it to broaden its policy and poverty focus and to increase government's participation. This sort of partnership could not have emerged through project aid and did not develop under structural adjustment programmes.
- PGBS has developed mechanisms for harmonisation and alignment that have been very effective in practice. The mechanisms of dialogue and shared conditions have been important. It is very unlikely that this level of harmonisation and alignment could have occurred through any other aid instrument.
- PGBS has had an important role in developing common instruments of planning and prioritisation both within the operating government and between government and donors, and by working through the government's own systems of cash management, procurement and audit. It has thus strengthened governmental systems and leadership.
- PGBS has had positive effects in increasing the proportion of public expenditure subject to the national budget. Through policy dialogue and conditionality PGBS has supported the prioritisation of "pro-poor" sectors, and allocations to priority sectors have grown roughly in proportion to the State Budget as a whole.
- PGBS has had positive effects in strengthening planning and budgeting systems, policy processes and macroeconomic performance, and in increasing the efficiency of public expenditure.

The evaluation concludes that PGBS has had an impact on Cross Cutting Issues (CCIs)<sup>10</sup> in Mozambique mainly in three ways:

- coordinating and giving collective impetus where previously donors were working separately with government: e.g. on conditionality, decentralisation, and potentially on capacity building;

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<sup>7</sup> The six other countries were Burkina Faso, Malawi, Nicaragua, Rwanda, Uganda and Vietnam

<sup>8</sup> For more information on the methodology and main conclusions see: "Evaluation of General Budget Support: Synthesis Report IDD and Associates, May 2006".

<sup>9</sup> The evaluation is using the concept Partnership General Budget Support (PGBS). For more details on definitions see the IDD Evaluation Report.

<sup>10</sup> The evaluation distinguishes between policy (or "outcome") CCIs and governance (or "process") issues. The first set of CCIs came fully on the PGBS agenda in 2003 when the agreement with the government was revised to include: gender, environment, HIV/AIDS and human rights. The second set of issues that concerned PGBS were there from the outset – the public-private relationship, decentralization and capacity building, ownership and conditionality, transaction costs, corruption, and accountability. It was to address some of these issues that PGBS according to the evaluation, came into being.

- making links where themes are shared across sectors but had previously been encapsulated sectorally: e.g. the public-private relationship, HIV/AIDS, gender and corruption;
- pressing for implementation where formal policies, rights and legislation are in place but the implementation of reform is weak: e.g. human rights, gender, decentralisation and potentially the environment

In addition to the identified positive effects there were also weaknesses. The main weaknesses in performance against the criteria adopted by the evaluation were in:

- Technical assistance and capacity building;
- Predictability of PGBS funding<sup>11</sup>;
- Domestic accountability<sup>12</sup>;
- Policies addressing market failure and private sector development;
- Administration of justice and respect for human rights

These identified weaknesses are all given attention in PARPA II and in the monitoring dialogue between GoM and PAPs<sup>13</sup>.

The evaluation report for Mozambique is listing a number of recommendations within areas such as: aid strategy between government and donors; donor performance; government performance; civil society's engagement; and the private sector and growth. Some of the most important recommendations are:

- Develop an aid strategy that specifies the government's objectives with regard to different aid modalities
- Maintain Joint Review pressure for measures against corruption
- Maintain pressure to focus and implement reform of the justice sector and audit systems
- Strengthen international partner dialogue within private sector and growth

These recommendations are on the agenda in the dialogue between GoM and PAPs<sup>14</sup>.

The evaluation concludes that corruption is a serious problem in all study countries, but the study teams found no clear evidence that budget support funds were more affected by corruption than other forms of aid. Systematic strengthening of public finance management, which PGBS supports, is an important part of a broad anti- corruption strategy.

## HOAP Report

A group of representatives from National Auditor General Offices named HOAP (Harmonisation of Overseas Audit Practices) finalized a joint audit of General Budget

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<sup>11</sup> PGBS disbursements have tended to be unpredictable and hence to have short- run destabilising impacts, contributing to inflationary financing. Over the period PGBS funds have become more predictable as the disbursement problem has been acted upon with a commitment to multi- annual donor agreements and growing alignment with the government's budget.

<sup>12</sup> While instruments of domestic accountability remain weak, a finding in the evaluation is that they become stronger with the support of PGBS.

<sup>13</sup> For more elaboration please refer to chapter 4 and 6 in the document

<sup>14</sup> For more elaboration on these issues, please refer to chapter 4 and 6 in this document.



Support to Mozambique in 2009<sup>15</sup> The overall objective of the audit was to assess donor's management of GBS to Mozambique and how the funds have been accounted for.

One of the three sub objectives were to assess donors' compliance with the MoU and related documents as to increase the predictability of the flow of funds, and Mozambique's accounting for receipt of grants transferred to the treasury. The report concludes that the donors have honoured their pledges, that BoM have prepared accounts showing that transfers from donors have been converted to local currency at a correct rate of exchange and made available to the Treasury on a timely basis, and that the appointed auditors have fulfilled their mandate.

The second sub objective was to assess donor's monitoring and control of the use of the grants as part of Mozambique's budget implementation, and the evidence that the approved budget profile was adhered to. The report concludes that donors and GoM have established and use a comprehensive monitoring mechanism, that donors assess and approve the budget profile and that donors assess the budget execution adequately, but the donors do not fully use the information available from The General Inspectorate of Finance (IGF) and the Administrative Court (TA). The report urges the donors to increase the effort on improving the communication with those two auditing institutions. The HOAP report also raises the issue if the large number of 29 working groups is in line with the Paris Declaration on reducing the transaction costs. However, the HOAP group took note that the working groups in practice not only manage budget support but a significant proportion of all aid to government in Mozambique, and that the Government has underlined that the set-up of the working groups is related to PARPA II and as such should remain in place.

A third and final sub- objective was to assess the donor's monitoring of financial systems and control mechanisms related to funds disbursed to the end users. The audit underlines that there has been a positive development in the Mozambican economy and in its Public Administration Systems. The report concludes that the basis for the fight against corruption has been established in Mozambique, but that the results have not yet materialised. The report concludes also that the financial reporting is improved, but due to that only part of the Mozambican State Budget is executed through the computerised accounting system e-SISTAFE the reporting does not give donors full assurance on the correctness of the accounts. The report also finds it unclear if the follow-up information in the Aide Memoire that builds on administrative data is regarded as sufficiently valid and reliable, and urges the donors and counterparts to take adequate measures to ensure that the quality of follow up information is assured. The overall HOAP conclusion was that the two audit institutions in Mozambique appear to function satisfactorily, but they should coordinate their audit work more closely. The HOAP also highlighted that the TA has not expressed an opinion on the correctness of the national accounts for 2006 which according to HOAP is in line with generally recommended auditing practices. The report recommends the donors to influence their counterparts so that TA in the future will get the support and encouragement from the Parliament to express an overall opinion in the General State Accounts. This issue will be closer followed up by the donors, although the findings in the TA annual report have already been presented to the Parliament and published, which also provides an important basis for the control needs.

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<sup>15</sup> Please refer to "HOAP 2008 Review of General Budget Support to Mozambique in 2007", carried out by the SAIs of Denmark, Sweden and Norway" In addition the report " Dokument nr. 3: (2008-09) Riksrevisjonens undersøkelse av generell budsjettstøtte til Mosambik" was presented to the Norwegian Parliament in May 2009.

Generally speaking, we assess the HOAP report to be quite positive. Although the HOAP report underlines the critical need to continue the ongoing work on reforms in public financial management, statistics and combat of corruption, the report documents important progress and positive findings on donors management of the GBS and on how funds are accounted for.

Main follow up issues are:

- Increasing the amount of funds channelled through the electronic accounting system e- SISTAFE, This will contribute to better control of funds
- Donor should be more active in using available information from Auditor General.
- More focus on securing data quality

The issues raised by HOAP are high on the agenda in the dialogue and monitoring work related to the follow up of budget support. The Embassy is also directly involved through support to SISTAFE and support to the Mozambican National Institute of Statistics in two of the main areas for follow up.

### **Previous Annual Reviews**

A conclusion from the Annual Reviews in 2009 was that the Government performance was satisfactory in the various areas of the programme covered by the PAF indicators, but also that there are areas with poor performance, to which it was agreed to pay more attention. The Joint Review considered that there is a satisfactory basis for the PAPs to continue giving budget support. This conclusion is in line also with the conclusion from the Annual Reviews carried out in 2008 and 2007 and previous years.

Experiences confirm that GBS creates an important arena for political dialogue on critical issues. Norway was heading the PAP Troika during the AR in 2008. From the Norwegian side, it was a focus on putting corruption, better use of natural resource incomes and more efficient poverty reduction on the political agenda. The Embassy's experiences were that this to a high degree was successful.

The implementation of the MoU was reviewed as a part of the Annual Review 2009. In general requirements for the presentation of reports were adhered to by the government in accordance with the MoU. The monitoring and dialogue processes between the reviews were successful. The financial audit of the flow of program support funds in 2008 was carried out but the final report was not concluded by the end of the joint review. Based on the information available from the Annual Review there is reason to conclude that the MoU is implemented by the GoM and the PAPs satisfactorily.

*Experiences from previous support through evaluations and reviews confirms that budget support to Mozambique has been a very successful case of donor- government collaboration, and that the support has contributed positively for conditions for economic growth and poverty reduction.*

## 4 Assessment of performance and risks

### 4.1 Macroeconomics and poverty

The IMF published the results of the Third Review under the Policy Support Instrument (PSI) in February 2009. IMF concluded that Mozambique is meeting the macroeconomic objectives of its medium- term development strategy and program performance to the end of June 2008 has continued to be satisfactory<sup>16</sup>. IMF concluded further that the government remains committed to prudent fiscal and monetary policy and that the fiscal program for 2009 is providing space for a significant expansion of private sector credit within an appropriate monetary policy. The government is according to IMF also maintaining the momentum of structural reform by focusing on strengthening policy operations and giving special attention to the tax systems and public financial management. IMF concludes also that the government is focusing on reforms to support private sector development, management of country's natural resource and public sector governance.

The Mozambican economy showed a satisfactorily growth in 2008, in spite of the unfavourable external environment characterized by the international crises of high food and fuel prices and the global financial crises. The real growth rate of GDP was 6.8%, slightly below the programmed level of 7%, with a particularly good performance in the sectors of Agriculture (10.2%), Construction (13%), Transport and Communication (18.3%) and Financial Services (12.9%).

The international instability in prices contributed to an annual inflation of 10.3%, which is above the target. The Metical was in 2008 stable against the American dollar partly benefitting from policy measures, through the sale of foreign currency on the Interbank Foreign Exchange Market.

The change in the cost of living due to the increase of the international food and fuel prices affected the whole population and revealed the serious social vulnerability in the poor strata, which may to a large extent reduce the speed of poverty reduction.

In general, fiscal policy was characterized by an increase of revenue collection and a growth of expenditure for the PARPA priority sectors. The realization of income as part of GDP increased with 0.3 % in 2008 to 16.3%. Expenditure in the PARPA priority sectors absorbed 64.2%, with the Education and Health sectors together having spent 54.5% of priority expenditure.

According the last National Household Survey carried out in 2004, there was a spectacular fall in the poverty rate in Mozambique, from 69% in 1996/97 to 54% in 2002/03. There has been a lively technical discussions regarding methodology used in the survey and also the results in Maputo, but not any substantial updating of the main results and conclusions. Next

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<sup>16</sup> For further elaboration: "Republic of Mozambique: Third Review under the Policy Support Instrument- Staff Report" IMF Country Report No 09/49, February 2009.

stock taking point on poverty data is the new National Household Survey expected finalized by end this year.

The Development Observatories (ODs) are identified as a crucial forum in including representatives from civil society institutions in discussions and monitoring of implementation of the PARPA. The performance of the ODs is monitored as a part of the Joint Review (JR). The number of provinces where ODs were held increased from 3 to 11 from 2007 to 2008, and a new guide to the provincial ODs was also developed and approved.

The financial crisis' main impact will be felt in the real economy. The reduction of global demand, driven by the recession effect will pressure world commodity prices to fall. In Mozambique, the most direct impact on macro- economic variables will be seen in the external accounts<sup>17</sup>. Commodity prices fall in the form of reduced prices for natural resources, which will reduce the export volume of Mozambique. Since 30% of Mozambican imports are oil related and the country remains a net food importer, the fall in the oil and food prices may on the other hand improve the trade balance, thus reducing the effect of imported inflation. However the negative effect of the decline of prices and reduced demand for the main export commodity, aluminium, is expected to offset the positive impact, resulting in a deeper current account deficit in 2009. The severe impact of the crises on South Africa, Mozambique's main trading partner, is likely to aggravate the negative effect in the trade balance.

Growth is expected to slow down in 2009, either through the negative effect of the crisis on the export-led mega projects, or by impacting on the new drivers of growth. The crises will deepen the budget financial gap and increase reliance on donor and external financing, if further domestic revenue generation is not mobilized.

Mitigation of the effects of the global financial crises was assessed during the JR and the agreed actions to be developed by The Government are to: i) accelerate the implementation of concrete measures to stimulate the productive sector, with particular attention to employment creation; ii) accelerate the adoption of special measures in the area of social protection. This choice of actions seems to be high relevance for mitigating the effects on the crises on the poverty situation. Agreed action to be developed by the PAPs is to make due efforts to support the country's development plans. The Government has requested the donors to maintain the level of aid and in particular budget support. This is reasonable since the budget support instrument is a very flexible instrument which gives the government space for deciding on effective actions in mitigating the effects of the financial crises.

## **4.2 Public financial management**

The latest assessment of the Public Financial Management (PFM) systems and processes of Mozambique based on the Public Expenditure and financial Accountability (PEFA) methodology was finalised in April 2008<sup>18</sup>. The report presents the results of the external assessment of Public Finance Management in Mozambique in the period up to the end of the

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<sup>17</sup> Main conclusions regarding impact of financial crises is based upon analyses carried out by African Development Bank.

<sup>18</sup> For further elaboration please refer to: "Assessment of Public Finance Management in Mozambique 2006, Based on the PEFA Methodology - Public Expenditure and Financial Accountability", SAL Consultaria e Investimentos (SAL) and FICUS Public Finance Consultants, April 2008.

2006 budget cycle, taking account of the accounting and audit information on past years produced during 2007.

The PEFA assessment concludes that significant improvements in the quality of PFM systems and processes have been achieved between 2004 and 2006, as measured by the PEFA-methodology.

The most significant improvements have come in the following areas: i) Payroll, procurement and internal controls; ii) Cash management; iii) External scrutiny & Audit, iv) Revenue collection and management and v) Donor practices.

The 2004 PEFA drew particular attention to the weaknesses identified in internal control systems, especially in control over the payroll, over expenditure commitments and over procurement processes. Significant improvements have been made in each of these areas. They remain to be consolidated and completed but the degree of control is now considerably stronger. A higher proportion of public acquisitions are now made by competitive tender; there is now a validated independent personnel data base against which the payroll can be reconciled and it is now virtually impossible to make a commitment without a prior budget allocation or a payment without a commitment. With these controls in place, efficiency and value for money in service delivery are now more likely to be achieved.

There have been improvements in the coverage of external audit and in the quality of follow up of audit recommendations, but capacity remains an issue. The building up of the external audit capacity of the Tribunal Administrativo requires highly skilled human resources and is necessarily a slow process in Mozambique. The quality of follow- up to international and external audit reports has improved only modestly. There is scope for achieving much greater impact from audit work if more attention could be given to follow up of actual expenditures and revenue.

Taken as a whole, the indicators covering accounting, recording and reporting appear to have deteriorated slightly. There have been improvements in the timeliness and regularity of accounts reconciliation and in the quality and timeliness of in-year budget reports but these have been offset by the fact that with no Public Expenditure Tracking Survey (PETS) completed in the last three years, the score on information available from service delivery units has declined. A PETS in education is now ongoing.

The improvements identified in the PEFA analyses have in some cases, come simply as the result of small managerial and administrative improvement but most have been driven by the ongoing programmes of reform to public finance management systems. Especially important have been the reforms to revenue collection and management, to procurement and to public financial management deriving from the ongoing implementation of e-SISTAFE. There have also been ad- hoc actions taken in other areas- notably the census of public servants – which have impacted positively. Some of these resulted directly from the results of the 2004 PEFA and the corrective actions agreed at the time by government. Most reforms were already under implementation or at advanced stages of design in 2004, which underlines the fact that the improvements observed in 2006 are for the most part the fruit of investments undertaken much earlier.

The main areas where the desired improvements have not been registered is in relation to the credibility of the budget, as measured by the degree of consistency of actual expenditures and

revenue collections as compared with originally approved budgets and projections. According to the PEFA report the problem derive from the fact that planned activities are not properly costed during budget preparation and sector ministers are responding to budget ceilings not by cutting activities, but unsuccessfully to trim costs. Performance under this area has shown substantial progress the last years.

The PEFA assessment concludes that the necessary control and reporting system to achieve the goal of maintenance of aggregate fiscal discipline are now reasonably well established in Mozambique, and underlines that Mozambique has a good record of macro- economic management. Debt and treasury management systems are strong and the improvement in financial control which e-SISTAFE has permitted makes major fiscal slippages less likely. However, an area of vulnerability is the quality of oversight of fiscal risks from public sector entities, in particular in relation to the expanding scope of public entities in the natural resource sector.

According to the PEFA assessment, it seems to be the mechanisms for strategic allocation of resources which are most lagging behind. One part of the reason is the absence of a programmatic classifier. The decision taken to introduce programme classification system from 2008 is regarded as an important step which assists in addressing these weaknesses and, over time and able the Mozambican system to allocate public resources to agreed strategic priorities.

Performance under PFM was assessed as positive under AR 2009. Of eight PFM performance indicators, five of the targets were “met” and three “not met with progress”. The proportion of total expenditure directly executed through e-SISTAFE increased from 11.5% in 2007 to 23.6% in 2008. In the tax reform area there was progress in the rationalization of tax incentives. In the procurement area there was substantial improvements in 2008 in the issue of public tenders by State organs and institutions. The TA made 350 audits covering 33.3% of the State Budget, which is above the target defined as 30%.

In 2008 the TA Report and Opinion on the Annual State Accounts (CGE) was prepared and sent to the AR within the legal time limit. It was also for the first time published in the Boletim da Republica thus facilitating public access to the contents. The TA strengthened its intervention in the inspection of public works. The TA further strengthened the monitoring of its decisions and imposed financial sanctions on 280 managers.

The government has decided to prepare a Strategic Public Finance Management Vision to be concluded during 2009. Some of the main concerns identified in the AR to be taken into consideration in this vision are:

- How to increase the proportion of the Annual State Budget (OE) executed by e-SISTAFE through the combination of roll out and the incorporation of external funds
- Systematic and consistent follow up of the internal and external audit activities and of the TA and AR recommendations on the State Accounts. Improvement of effective public access to information on the work of the TA.

This main concerns also pointed out by the HOAP Report are of high relevance and should continued to be given high attention.

### 4.3 Governance

Mozambique was for many years a one-party state, but in 1994 the first multi-party elections were held. The democratic institutions are quite stable. Mozambique has a judiciary that is formally independent, and an Administrative Court that among other functions is the country's supreme audit institution. Municipal elections in the largest urban areas are held. The political system in Mozambique is developing. The National Assembly is taking a stronger role in debating policies and the use of public finances. The municipal elections are broadening the political landscape. The overall democratic frame conditions are to a large extent satisfactory.

The country furthermore has a fairly vigorous press in terms of number of publications and views. The coverage is however limited to the major cities, but there is reason to conclude that there is a clear freedom of expression in Mozambique

The human rights situation must be seen in connection with the high level of poverty and its consequence through the non- fulfilment of basic needs. Human right violations are a problem in Mozambique, but the level of human right violation is not high compared to countries at similar level of socio- economic development. There are commitments to uphold human rights and ensure increased access to justice services in PARPA II, but the document is not clear on how implementation will be assured.

The Frelimo Party retains an overwhelming political position in the country in terms of organization, resources, and control of the state, including the loyalty of senior civil servants. The structural power between political and economic actors is heavily in favour of the state and the party that controls it. In Mozambique there is almost a complete absence of a "domestic demand function" outside the government for improvement in the budget. This is a manifestation of deep- rooted structural features of the Mozambican situation that will change only gradually as the country achieves higher levels of economic and social development<sup>19</sup>. A crucial development will also be the emergence of a more effective parliament, with resources for proper scrutiny of the executive. The PARPA II has limited emphasis on strengthening key accountability mechanisms such as parliament. Although there is a clear objective for the separation of executive, legislative and judicial powers, there is little indication in the PARPA II on how this will be delivered. The need for strengthening of the parliament should be given high attention by Norway and other development partners in the dialogue with GoM.

A main problem is the low quality of service delivery in the public administration. The level of skills is very low, the motivation is also weak given the low salaries, and the problems of corruption are high. This undermines the popular legitimacy of the state. Mozambique is now in the process of implementing a Public Sector Reform (PSR)- program covering among other areas deconcentration and decentralization of public administration and civil service restructuring. The overall progress in the reform process has however up to now been quite slow, but clearly moving in the right direction. A broad and ambitious agenda of institutional reform including PSR is set in PARPA II.

The low capacity in the legal and judicial areas is a major constraint to development. The limited capacity means that there is a huge back- log of pending cases. The capacity of the sector in pursuing corruption cases is poor and convictions are few, but there are signs of a more positive development in 2008 regarding follow up of corruption cases. The number of corruption cases under investigation is reported to be 231 in 2008. There is also slow

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<sup>19</sup> Reference "Political Economy of the Budget in Mozambique", Hodges and Tibana, December 2004

progress in implementing policy decisions. The overly complex legislation in the area of civil procedure and commercial law affects the investment climate and the growth of the private sector. PARPA II sets out an ambitious agenda of reforms in judicial sector.

The main conclusions here are mainly in line with an internationally “Democracy Index”<sup>20</sup> developed by the Economist Intelligence Unit. This 2008 democracy index which includes measures of electoral process, government functioning, political participation, political culture and civil liberties ranks Mozambique 92<sup>nd</sup> out of 197 countries, placing it in the middle of 36 countries considered hybrid regimes<sup>21</sup>. Mozambique’s highest scores, for the electoral process and political culture reflect the regular holding of democratic elections since the end of the civil war in 1994 and the existence of a multiparty democracy and a generally free press. Elections held in Mozambique have generally been rated free and fair by independent electoral observers, although the increasing dominance of Mozambique’s ruling party Frelimo, according to Economist Intelligence Unit (EIU) is threatening to undermine the country’s democratic credentials and could cause its scores in these categories to fall in the coming years. The country’s lowest score is in the civil liberties category. According to EIU this reflects the dominance of the media by the state, worsening press freedom and sporadic incidences of police brutality. The country’s relative poor score for government functioning reflects the weakness of its public administration, both in terms of human resources and funding, although this is gradually improving thanks to sustained donor investments. As a result this category is likely to continue to improve in future indices.

*Our conclusion in general is in line with conclusions from earlier assessments done. This means that the track record and commitments of GoM regarding implementation of governance reforms confirms that the context in Mozambique is open and possible to develop further in a positive direction*<sup>22</sup>.

#### **4.4 Corruption**

The battle against corruption is one of the major objectives in the PARPA II. According to the document, the battle must be launched in all possible sectors and at all levels of government and actions must seek to identify both those who are corrupted and those who corrupt, followed by prosecution of those involved.

The assessment of the development partners is that the PARPA II sets out a broad and ambitious agenda of Anti- corruption measures. The GoM Anti-Corruption Strategy covers three fundamental moments: prevention, administrative action and sanctions<sup>23</sup>. These moments are closely linked with ongoing and planned reforms within the overall public reform sector strategy, including reforms and capacity building within public finance management and judicial systems.

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<sup>20</sup> Reference to “Country Report Mozambique, April 2009, Economist Intelligence Unit”

<sup>21</sup> This designation includes the neighboring states of Tanzania, Zambia and Malawi, whereas the country’s other neighbors, Zimbabwe and Swaziland, are classified as authoritarian regimes and South Africa as a flawed democracy.

<sup>22</sup> Reference to Appraisal Norad May 2004

<sup>23</sup> For more details please refer to “Republic of Mozambique Anti-Corruption Strategy 2006-10”. This document was approved by the Council of Ministers in April 2006.



There is also recognition within Government that combating corruption requires a holistic approach embracing: prevention; encouragement of compliance; enforcement; administrative discipline; and application of the rule of law including criminal investigation and punishment. The Government's anti-corruption strategy is focusing on reducing the potential for corrupt practices by putting in place better systems, strengthening transparency and accountability. This strategy makes up one of the key dimensions of the country's Public Sector Reform process, and anti-corruption work is thus an explicit item in the Government's reform program.

According to donor analyses, there is a need for improving the monitoring and evaluation system of the Anti- Corruption Strategy. It is urgent that an independent mechanism be redefined for the supervision and monitoring of the Anti- Corruption Strategy, in order not to lose the dynamics with which this office had inspired the fight against corruption. Moreover, it continues to be necessary to adjust the national law to the ratified International Conventions, and to clarify how the courts may implement them.

A central part of the GoM's Anti-Corruption Strategy is the formulation and implementation of action plan in five key sectors: Finance, Health, Education, Justice and Interior. Previous reviews in 2007 and 2008 identified existing plans as ineffective and not integrated in the normal planning and budget instruments. GoM committed in the 2008 Annual Meeting to review the five sector plans. A Governance Platform assessing these plans did not find evidence of a revision in four of the five sectors, health being the exception. Ownership continues according to the Platform to be low in all sectors. The conclusion was confirmed by an independent monitoring report of a civil society coalition published in April this year. In the 2009, AR one of the main agreed actions to be developed by the government was acceleration of the implementation of the anti-corruption strategy at sector level.

Furthermore, the 2009 JR concluded that regarding the implementation of the Anti-Corruption Strategy, more visible action was observed in the justice sector, and in the public administration, but the difficulties of measuring the impact of these interventions persist. Regarding the anti- corruption action plans, several activities were carried out on the relevant sector level. The corruption performance indicator of the Government in the PAF of publishing statistics on number of corruption cases was met<sup>24</sup>.

*Despite of slow progress in implementing corruption plans on sector level, it is reason to conclude that the Government has taken important steps, through implementation of relevant reforms for en enabling framework for combat of corruption the last years.*

#### **4.5 Human capital**

The main picture in the social sectors is that there are as a whole considerable progress in service livery during the last three years, but quality of services remains a main issue.

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<sup>24</sup> Please refer to "Joint Aide Memoire 2009, April 2009, Annex 1" Number of corruption cases: i) 619 reported; ii) 231 under investigation; iii) 151 accused, iv) 53 abstained, v) 124 detained and vi) 59 tried, preliminary data

According to the MDG Mozambique should achieve universal primary education by 2015. This means that 100 % of children of primary school age should be attending school at this level. This goal is unlikely to be achieved. However, according to survey results in 2007, the net enrolment rate in 1st Grade education has achieved a national average of 95.5% showing a significant increase compared to the 2003 average of 69.4%<sup>25</sup>.

The choice of two out of three indicators on the education sector on girls' education in the budget support monitoring framework means that the budget support has a focus on results in girl's education. In the education sector, the level of 6- years old schoolgirls increased from a baseline of 56% in 2005 to 73% in 2008, slightly under the PAF- monitoring framework target of 74%. Graduation rate for girls in secondary education has also increased but at a more moderate level, from 28% in 2005 to 34% in 2008 during the period. The big discrepancy between the rate of girls starting primary and completing secondary school illustrates that there are considerable challenges in keeping girls in school the whole way through secondary level.

One MDG goal is to reduce the under- five child mortality rate by two thirds. This goal has according to the United Nations Development Program (UNDP) a potential to be achieved. Child mortality rates dropped from 147 to 124 per 1000 live births between 1997 and 2003, whilst the mortality rate of children under 5 years decreased from 219 to 178 per 1000 live births over the same period. The MDG goal of reducing the maternal mortality ratio by three quarters by 2015 has also a potential to be achieved. Routine survey details show that maternal mortality per 100 000 live births has decreased from 234 in 1993 to 163 in 2007.

In the health sector the annual budget support review in 2009 concluded that the performance in 2008 has been mixed, with progress showed in strengthening the capacity for national service delivery, elimination of leprosy and a reduction of the number of malaria sufferers registered. Despite this progress, the sector still confronts challenges in increasing the volume of quality primary services regarding infant mortality and mother mortality and other crucial areas. The number of people receiving ART treatment in a HIV/AIDS programme is increased from a baseline 15 900 in 2005 to 118 937 in 2008, which is lower than the target of 132 280 set in the PAF.

In the water sector there are registered 1 377 newly constructed isolated water sources which is well above PAF target and the 2005 baseline of 1090<sup>26</sup>.

Number of children, old people, handicapped people, women as heads of households who benefit from social protection increased from 143 305 in 2007 to 181 304 in 2008. This is worth taking note of given that direct transfers as instrument in poverty reduction has gained increased attention last years.

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<sup>25</sup> Numbers and assessments related to MDGs in this chapter are based on: "Report on the Millennium Development Goals Mozambique 2008, UNDP and Government of Mozambique"

<sup>26</sup> One could for the water sector question whether the number of people with safe access to water sources would be a better indicator.

## 4.6 Economic development

In general there has been a positive development in economic infrastructure such as roads, ports, railways, transmission lines and telephone and internet access in Mozambique the last three years. One example is the energy sector where there has been an expansion of the national network. From a baseline of 302 218 people connected to the network in 2005, the number has increased to 614 510 in 2008, which is above the targets set in the PARPA II Strategic Matrix. There are also signs of financial services slowly being moved out and more accessible.

A concern is the business climate. During 2008, Mozambique worsened its position in the Doing Business Index from number 159 to 161 of a total of 181 countries. This underlines the importance of accelerate the speed of reforms in the area lack of flexibility in labour force, preoccupation in relation to bureaucracy and corruption, additional costs imposed by Government on business environment, basically on international trade and the inefficiency of the judiciary system, in particular for the resolution of labour conflicts are main problems regarded by investors. Some reforms have been carried out. The New Commercial Code from 2007 allows for a reduced time to register a company and consolidates the protection of investors. In 2008, a regularity framework aiming at reducing barriers for development of the private sector was sent to supplement an approved strategy to strengthen the business environment.

Support for promoting job creating activities and employment in rural areas are a core elements in income generating and poverty reduction. The numbers of farmers supported by public extension services has increased substantially from a baseline of 177 000 in 2005 to 354 070 in 2008, of which 150 315 are women. However, there remains a main challenge related to effectiveness and efficiency in supporting frame conditions for agriculture including reaching the farmers in rural areas with extension services.

## 4.7 Cross cutting issues

### Climate and environment

Mozambique is regularly affected by tropical cyclones. Furthermore, the many rivers flowing into the Indian Ocean are regularly affected by floods and droughts, resulting in severe economic impacts and halting of development<sup>27</sup>. A decreasing trend in rainfall has been observed in the East Africa as a whole over the last four decades while the occurrence of droughts has been steadily increasing. High variability of rainfall and tropical cyclones is resulting in extreme floods and droughts from time to time.

The impacts of climate change are particularly serious for Mozambique. Consequences expected are: increase in the mean air temperature, reduction of rainfall, increase in the solar radiation and increase of the evaporation. The main sectors that are likely to be or are being

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<sup>27</sup> Assessments in this section are mainly based upon analyses in the report: "Review of the Embassy's Development Assistance Portfolio: Environment and Climate Change, Greening and Climate Proofing of the Portfolio, The Royal Norwegian Embassy, Maputo, Mozambique" Norad Report 20/2008 Discussion,

impacted by climate change are: agriculture; forests and pastures; livestock, water resource; coastal areas and resources; infrastructure, health and fishing. The impacts of climate change are likely to be greatest where they co-occur with a range of other stresses as unequal access to resources, inadequate access to water and sanitation, food insecurity and poor health systems. These stresses and climate change will increase the vulnerability of many people in Mozambique. Declining agricultural yields are likely due to drought and land degradation, especially in marginal areas. Current water stress in Mozambique is likely to increase.

MICOA has prepared a National Adaptation Programme of Action (NAPA) which was approved by the Council of Ministers in 2007. In the NAPA, the most vulnerable areas are identified. GoM is dealing with the natural disasters in a serious manner and is normally managing the follow up of annual floods and droughts without additional humanitarian assistance.

## **Gender**

Mozambique has a long political tradition of emphasizing gender equality and the empowerment of women, dating back to the post- independence Frelimo era<sup>28</sup>. The equal rights of men and women are firmly established in the constitution. Mozambique is a signatory to all relevant international agreements on gender and equality, and the empowerment of women are is an integral part of the country's poverty reduction strategy. However, there are major discrepancies between men's and women's access to land and agricultural production, employment and income, education, health and access to the justice system and to attending legal rights. One very serious condition is the widespread practice of domestic violence and abuse of women.

One important step taken by GoM is the preparation and approval of the National Plan for the Prevention and Fight against Violence against Women passed by the Council of Ministers in December 2008. Another area of good performance in 2008 is the strengthening and expansion of the Offices for Assistance to Victims of Violence with the creation and inauguration of Model Offices. Furthermore, the Ministry of Planning and Development has included a requirement to integrate gender aspects in the MPD guidelines for the preparation of the Government's Annual Economic and Social Plan (PES) and OE 2009. There is also now an obligation to include a clause in the contracts stipulating that the civil construction companies must employ at least 25% of female workers.

A weak area of GoM performance is the poor integration of gender issues in the fight against HIV, taking into account the feminization of HIV and the lack of progress regarding the preparation of a strategy for the protection of girls against abuse at school. Another area is the persistence of not presenting data disaggregated by gender, even in the sectors where these data exists. The JR concluded that these issues should be object of special attention in 2009 and also in the scope of the assessment of PARPA and subsequent processes.

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<sup>28</sup> Assessments in this section are mainly based upon analyses in the report: "Gender Policies and Feminization in Mozambique", CMI Report R 2008:13

## HIV/AIDS

The JR 2009 noted that Mozambique has registered progress towards the attainment of the Millennium Development Goals (MDGs). However, the attainment of these objectives may be threatened by the development of the AIDS pandemic at national level. The 2007 epidemiological data suggest that the HIV/AIDS prevalence rates are very high, particularly among young girls, affecting 16% of the population, of which 58% are women. Although the average prevalence may have remained stable at 16% since 2005, some provinces have reached very high levels.

An important action taken by GoM is the preparation of a new Strategy for the Acceleration of HIV/AIDS Infection Prevention, passed by the Council of Ministers in 2008. The strategy has a multi-sectoral character. Also the Law on the Defence of Human Rights and Fight against the Stigmatization and Discrimination of people living with HIV/AIDS was passed by Parliament in 2008 is representing a big step towards the political context for the prevention of HIV in the country.

A main concern is the slow progress with universal access, which remains a big challenge. Other continuing challenges are the data management system and the limited access to data about the epidemic.

### 4.8 Donor performance

A review of PAP's performance has been carried out by external consultants. This was based on the PAP's 2008 PAF-matrix, which includes: the portfolio composition; the utilization of the Government's public financial management systems; and the short term predictability of the general budget support. The review showed a mix performance of the group. Norway was the only PAP deterring between the groups, falling from the group of best performers to the second best group of donors classified as PAPs with medium high performance. This is mainly due to the strategic choice of supporting the energy sector, which is a more difficult sector in achieving goals regarding coordinated technical assistance and avoiding separate missions.

In the AR it was agreed that actions to be developed by the PAPs was to; increase the predictability of funds, make due efforts to support the country's development plans in spite of the financial crises, advance toward a more coordinated technical assistance and make joint efforts to reduce the number of missions.

## 5 Summary assessment of underlying principles

According to the MoU, the underlying principles are listed in three main groups. We will here review each of these groups, based on the assessments from the previous chapter.

### 5.1 Democracy and human rights

The text in the MoU is:

“Safeguarding peace and promoting free credible and democratic political processes, independence of the judiciary, rule of law, respect for human rights, good governance and probity in public life, including the fight against corruption”

Based on the assessment that the overall democratic frame conditions in Mozambique to a large extent is satisfactory, that the human rights situation must be seen in connection with the high level of poverty, and the Government’s commitments to uphold human rights, combat corruption and ensure increased access to justice services, we find the overall situation to be satisfactorily in line with the underlying principles.

### 5.2 Prioritizing poverty

The text in the MoU is:

“Prioritizing fighting poverty through its policies and plans in its patterns of public expenditure”

Based on the commitments in the Governments multiannual plans, the MTFP, the annual budgets and the track record analyzed by Budget support working groups we find that the underlying principles under these areas are satisfactory.

### 5.3 Macro economy and PFM

The text in the MoU is:

“Pursuing sound macro-economic policies and public financial management systems”

Based on the analyses of satisfactory macro- economic performance carried out by IMF and the Government’s commitment to PFM reforms and their track record shown i.e. in the PEFA analyses we find that the underlying principles under these areas are satisfactory.

## 6 Summary risk assessment

An overview of risk factors connected to budget support in Mozambique is outlined in the table below. In line with the draft Norwegian guidelines for budget support, attempts have been made to classify the potential impact of the various risk factors as small, medium or large; and to classify the probability of the occurrence of various risk factors as low, medium and high. Any such grading will be relatively subjective, so care should be taken in drawing strong conclusions based on the grading in this table. It should also be kept in mind that many of these risk factors will affect all forms of aid, not only budget support. One should also take in mind that it is not necessarily to expect that many of the main risks identified will change substantially during a medium term period of three to five years.

### Overview of risk factors related to budget support to Mozambique

Risk factors	Identification	Potential Impact	Probability	Mitigating Action Ongoing
<b>1. Fiduciary risks</b> Comprehensiveness and Transparency of the Budget  Predictability and control in Budget execution  External scrutiny and audit	<ul style="list-style-type: none"> <li>Mechanisms for strategic allocation of resources behind</li> <li>Weakness in procurement, revenue management and public financial management</li> <li>Limited coverage and follow up of external audit</li> </ul>	Medium  Medium  Medium	Medium  Medium  Medium	Introduction of new MTFF and programmatic classifiers in budget, capacity building  Continue implementation of e-SISTAFE, capacity building Program to strengthen payroll controls under implementation  Development of audit capacity within the Tribunal Administrativo ongoing. Increased focus on follow up of public audits.
<b>2. Implementation of PARPA</b> Human resources  Economic development	<ul style="list-style-type: none"> <li>Weak capacity in public sector</li> <li>HIV/Aids affecting capacity</li> <li>Lack of proper data information on impact</li> <li>Weak environment for private investments</li> </ul>	Large  Medium  Medium  Large	High  High  Medium  Medium	Public sector reforms and capacity building in decentralization, justice sector, and Anti-Corruption strategy being implemented.  Stronger political leadership has led to development of HIV/AIDS strategic plans in all sectors and provinces  Capacity building within statistics and monitoring  Speed up government reform in making a more friendlier climate for small and medium sized businesses
<b>3. Political and economic Governance</b> Political stability	<ul style="list-style-type: none"> <li>Uncertainty whether progress in reforms will continue in new development plan</li> </ul>	Large	Low	Political dialogue and monitoring

Democratic accountability	<ul style="list-style-type: none"> <li>• Weak accountability mechanisms and Civil Society</li> <li>• Weak capacity in legal institutions in combat of corruption</li> </ul>	Small	High	Strengthening of Parliament and watchdog institutions in Civil Society
Economic accountability		Medium	High	Actions related to simplification and faster processing of judicial cases and capacity building.
<b>4. Exogenous shocks</b>				
Natural disasters	<ul style="list-style-type: none"> <li>• Increased risk for flood and drought in fact of climate crises</li> <li>• Volatility in prices of key commodities</li> <li>• Impact on economy and poverty from global financial crises</li> </ul>	Small	High	Good national disaster and prevention management
External economy		Medium	Medium	Maintain international reserves and increased external support
		Medium	High	Stimulate broad based growth and job creation

As the table indicates, there are still considerable fiduciary risks related to budget support in Mozambique. Main risk factors are within the areas of comprehensiveness and transparency in the budget, predictability and control in budget execution and external scrutiny and audit. In general, there is reason to conclude that there is a strong commitment to managing the critical risk factors through the ongoing reforms of public financial management.

The public finance management sector is generally highly committed to addressing fiduciary risk, but has limited resources and in particular has relatively few senior technically skilled staff to attend to the vast reform agenda. The lack of capacity in public sector is also a high risk factor, though some progress is achieved in recent years, and the government is committed to implement reforms.

A main risk factor critical area is the legal and judicial sector. This is closely linked to the corruption problem and a major constraint to development in Mozambique. Some, but not much progress has been achieved the recent years. This area was highly on the agenda on the JRs and strong commitments to follow up regarding justice sector reform and combat of corruption is reflected in the Governmental Multi Annual Plans.



## 7 Overall assessment and recommendation

The main argument for Norway to continue budget support to Mozambique is that:

- Given the high commitment by GoM to implement an ambitious reform programme within the core areas for poverty reduction through the Governmental Multi annual Plans, the expected development results of implementing this programme are high. Although progress can be monitored as slow in specific areas in the short term, the medium and long term picture is that the development is moving in a right direction. Given earlier track record, the probability of an overall satisfactory performance is also regarded as high.

Other important arguments are:

- There is a joint conclusion among the 19 donors providing budget support, including The World Bank in April this year, that good progress has been achieved in a number of areas in the implementation of PARPA, giving a reliable basis for PAPs to continue budget support.
- Evaluations and reviews of budget support to Mozambique concludes that the budget support to Mozambique has been a very successful case of donor – government collaboration and that budget support has contributed positively to conditions for economic growth and poverty reduction.
- The dialogue related to general budget support has a strong focus on the need for reforms in public financial management and is actively supporting promotion of reforms within this area. The overall trend for all of the main categories within public financial management has been positive the last five years.
- Budget support is highly prioritised by the Mozambican Government.
- The political system in Mozambique is clearly developing. The context is open for further development in a positive direction. The dialogue with Government in a donor-harmonised programme for budget support is of strong importance. It gives a possibility for dialogue, to focus on critical issues and actively support pro- reform forces in Mozambique on these issues. Without participating in this group, Norway will have a substantially reduced possibility to influence.

The main risks related to budget support are:

- There are still quite high fiduciary risks within core areas of public financial management. There is also need for major improvements in external audit.
- While service delivery, particularly in the education but also in health, has improved, there is still a need to improve the quality of the services. The level of skills among government employees is low and problems related to corruption are high. This undermines the legitimacy of the state and reduces GoM's capacity to implement its policies and programme. The low quality in public sector is a problem also related to HIV/AIDS prevention.
- The low capacity in the legal and judicial areas is a major constraint to development. This is considered to reduce private sector investments.
- The impact the financial crises remains to be seen, but will most likely reduce rates of economic growth and the rate of poverty reduction, thereby probably having a significant negative impact both in the short and medium term.

In general, these risks are addressed and managed in governmental planning and actions through Government's Multiannual Plans and the strategic monitoring framework.

Given the positive track record of budget support, the expected development result of budget support for the following period stated in the Government's Multi annual plans, the risk mitigation actions taken, and the other relevant arguments listed above, we find that the expected development results outweigh the identified risks. We would therefore recommend that Norway continues providing general budget support to Mozambique for a new three year period.

GBS must be seen in a strategic country context where complementarities between different aid instruments seeks to be optimised. It has a number of potential advantages over project aid in Mozambique. GBS offers an exceptionally powerful instrument for focusing both government and international partners' attention on the development and implementation of the poverty reduction strategy.

## Annex 1: Reference List

- Government of Mozambique, Second Action Plan for Reduction of Absolute Poverty for 2006- 09 (PARPA II)
- Government of Mozambique, Medium Term Fiscal Framework
- Mid Year Review 2008, Aide Memoire, September 2008
- Institutional features of Budget Support Mechanism, Learning experiences from Mozambique to Uganda, Norad November 2008, Task Team Torun Reite.
- Norwegian Budget Support to Mozambique, Appraisal Report Norad, May 2004
- Evaluation of General Budget Support, Synthesis Report IDD and associates May 2006
- HOAP 2008 Review of General Budget Support to Mozambique in 2007, SAIs of Denmark, Sweden and Norway
- Republic of Mozambique, Third Review under the Policy Support Instrument, Staff Report, IMF Country Report 09/49, February 2009
- Assessment of Public Finance Management in Mozambique 2006, Based on the PEFA Methodology, SALConsultora e Investimentos (SAL) and FICUS Public Finance Consultants, April 2008.
- Country Report Mozambique, April 2009, EIU
- Joint Aide Memoire 2009, April 2009
- Report on the Millennium Development Goals Mozambique 2008, UNDP and GoM
- Memorandum of Understanding for General Budget Support between GoM and PAPs signed in March 2009.

## Annex 2 Terms of reference for appraisal of General Budget Support 2009 – 2012

### *1 Background*

Norway has provided general macro-economic support to Mozambique since signing the Balance of Payments support in 1996. Norway continued with macroeconomic support that gradually developed into a more coordinated budget support mechanism. Under the present bilateral agreement, signed in November 2006, Norway has disbursed 500 million NOK, and since 1996 Norway has contributed well over 1 billion Norwegian kroner. Before 1996 Norway also contributed import support to Mozambique.

19 donors (the G19) participate in the General Budget Support (GBS) mechanism, contributing almost 20 % of the state budget, or more than 485 million USD (2009), directly through the GBS. More than 50% of Mozambique's state budget is funded through development aid. Norway is among the 5 largest bilateral donors.

The GBS is based upon the Government's poverty reduction plan, the PARPA II, that has been extended to 2010. The main purpose of the PARPA II is to promote poverty reduction and attaining the MDGs.

A Memorandum of Understanding (signed March 18 2009) between the G 19 and the Government of Mozambique (GoM) sets out the procedures for managing the GBS. Note that larger donors that are not full members of the G19 also have the option of entering into an associate membership and to participate in most meetings and processes. So far USAID and UN have joined as associate members. The GBS mechanism is the main overall development aid coordination process in Mozambique at present. A more general Code of Conduct is under preparation.

### *2 Purpose*

The appraisal will be used as an important input for the Appropriation Document for the next phase of GBS to Mozambique. The appraisal will make the overall assessment of the balance of risks and expected results and make a clear recommendation of whether budget support should be continued or not. If there is a negative a conclusion, concrete risk reduction steps shall be suggested.

### *3 Scope of work/priority issues*

#### *3.1 Assessment of the Partners' planning process*

- Brief review of the assessments of the PARPA II from the previous appraisal including stakeholder participation and relevance of the strategy.
- The use of lessons learned from earlier experience with the GBS and PARPA implementation based upon the results from the JR and other reviews, including civil society participation in the JRs.

#### *3.2 Assessment of the programme design*

- Brief review of the assessments of the quality of the design elements from the previous appraisal, including baseline and other issues.
- Discussion of how the Performance Assessment Framework (PAF) and the follow-up process of the indicators have performed and impact on implementation and follow-up.
- Are relevant risk factors identified, analysed and are mitigating actions integrated in the program design?
- Assessment of the MoU as a tool for GBS management and donor coordination incl:
  - Sufficiency of management procedures and documentation requirements of the MoU
  - Roles and responsibilities as described in the MoU for donors, GoM and civil society
  - Alignment with Partner's systems and procedures including discussion of multi-currency CUT and getting more aid on-CUT
  - Efficiency of framework for cooperation

### *3.3 Assessment of results, sustainability and risks*

- Progress on keeping macro-economic stability
- Corruption risks and anti-corruption efforts with reference to the HOAP-report.
- Public financial management reform including strengthening implementation capacity
- Socio-cultural and gender aspects (incl. HIV/AIDS) incl reference to the gender review of the Embassy's portfolio in May 2009.
- Economic and financial aspects including long-term financial sustainability and increasing public revenues.
- Institutional and organisational aspects
- Possible impact of environmental challenges, in particular climate change and natural disasters
- Discussion of impact of the financial crisis including volatile international markets, and also the measures taken to increase food security.
- Brief update on developments within the underlying principles in the MoU.

The Embassy will make a separate assessment of whether the overall governance situation has improved sufficiently to allow an increase in the budget support or not – with reference to the Embassy's decision in May 2008 to not increase the GBS in 2009 due to governance and corruption concerns.

### *4 Implementation of the appraisal*

- The Joint Aide Memoires of recent years will be the main source for results and lessons learned. Other documentation will be made available by the Embassy. In line with the ambition of limiting the number of separate missions, existing documentation will be used for the appraisal work. Some meetings with other donors and civil society will be included.
- Rasmus Bakke from Norad will perform the appraisal with most of the work being done at the Embassy during a 1 week field stay at the Embassy. The Embassy will give necessary assistance and input, country economist Marit Strand will be the main contact point. José Capote will participate in the audit and budget execution discussions. Anne-Beate Tvinnereim will participate in the governance discussions and Mette Masst will contribute overall

experiences from implementation of the PARPA including discussion of targets and indicators.

- The Embassy will make available most of the documentation prior to the mission from mid-April. A draft outline of the appraisal will be prepared by Norad including the most important questions for clarifications before the mission begins (1-2 pages). The mission will take place from May 4<sup>th</sup> until May 7<sup>th</sup>, overlapping with the gender review of Embassy's portfolio. A first draft appraisal report will be available by May 15 and the Embassy will give its comments within May 20<sup>th</sup>. The Report will be finalised by June 5. A brief field visit may be included in the program with the Embassy and Norad financing their respective staff.
- Norad will cover the participation costs for Mr Bakke.

### *5 Reporting*

The appraisal report will include an introductory summary with main conclusions and recommendations. The reporting language is English and Norad will send the Embassy an electronic version of the report. The appraisal will be published by Norad.

Mette Masst, Chargè d'Affaires a.i. 04.05.09

