

DFID

MOZAMBIQUE

COUNTRY ASSISTANCE PLAN

2004 – 2007

CONSULTATION DRAFT



SUMMARY

i. Mozambique is one of the poorest countries in the world. Achieving and sustaining a real reduction in absolute poverty will not be easy: the legacy of colonialism and war is one of low skills, weak institutions and poor coverage of essential basic services. External aid, which funds half of government expenditure, will continue to be needed over the medium to long term. HIV/AIDS and growing crime and corruption compound the development challenge.

ii. Yet there are many reasons to be optimistic about Mozambique's future. That it has just celebrated eleven years of peace after a bitter civil war which killed over 100,000 people, dislocated some five million, and left most of the country's infrastructure in ruins, is a remarkable achievement, and one of which Mozambicans are justly proud. Despite some setbacks, the democratic system continues to develop, and preparations are underway for the country's third multi-party general elections in 2004. Striking also has been Mozambique's success in maintaining macroeconomic stability, and in attracting new foreign investment, which has resulted in high growth in recent years.

iii. Ensuring that this growth is sustained and broadened is the key to poverty reduction. The potential is there: Mozambique is well endowed with natural resources, including rich agricultural land and some yet unexploited mineral deposits; its ports are the natural gateways to Africa's landlocked centre. Action in a relatively small number of areas – particularly related to the business environment, governance, and the role of donors - will help to determine whether or not this potential can continue to be unlocked over the next decade.

iv. This Country Assistance Plan (CAP) sets out a DFID view on the role which we can play in this process. We do not pull any punches in our analysis: the road to greater prosperity will not be short or smooth, and we must be clear that the risks are high. But the payoff is high also, and our judgement is that, with careful management and monitoring, the risks are worth taking.

v. The CAP analyses the poverty situation in Mozambique, and assesses the Government's strategy for reducing poverty, the PARPA. Challenges and risks to poverty reduction are examined in detail, along with the role of donors and aid in reducing these risks and in contributing to sustained growth and development. The CAP concludes that the PARPA provides a sound basis for the creation of a partnership between donors and the Government of Mozambique (GoM), and between GoM and Mozambican citizens, to address the causes of poverty. The PARPA also provides the strategic framework necessary to increase aid effectiveness through greater coherence, harmonisation and alignment with national systems. The CAP argues that support for the evolution, implementation and monitoring of the PARPA should be at the heart of the DFID country programme.

vi. The CAP evaluates DFID's experience in Mozambique, and draws on this and experience elsewhere to appraise DFID's future role in Mozambique. On the basis of

analysis of DFID's comparative advantage and value added, the CAP recommends an integrated programme consisting of direct budget support (DBS) complemented by a substantial programme of coordinated technical assistance, concentrated on improving the efficiency, effectiveness and accountability of government; and underpinned by action to promote demand from civil society for pro-poor policies, improved governance and greater access to economic opportunity.

PART I

POVERTY AND THE PARPA

Poverty incidence, trends and inequality

1. Mozambique faces a significant challenge in addressing poverty: consumption based poverty indices from the most recent published household survey in 1997, show 69.4% of the population of 18 million living in poverty; more holistic measures such as the Human Poverty Index give an aggregate figure of 56.8%, but this masks significant regional disparities¹.

2. Economic growth in Mozambique has been significant in recent years (apart from 2000 when it was badly affected by the widespread floods). Limited evidence suggests that there has been some associated reduction in poverty (e.g. growth in production of staple crops and off-farm incomes), but data so far available are inadequate to permit us draw firm conclusions. Such data is currently being collected and analysed (e.g. through a second IAF (Household Survey), and the QUIBB²) and it is expected that by early 2004 a clearer picture of the impact of this growth, at least in aggregate terms, will emerge.

3. There are noticeable geographical differences in the distribution of poverty, with, in general, higher levels of poverty associated with greater distance from Maputo. The PARPA identifies the economic and social inequality between Maputo province and the rest of the country as a key challenge, but does not identify specific actions to be taken to address this.

4. These differences are reflected not only in the markedly different economic structure outside Maputo, but also in the political and ethnic geography of the country. Frelimo, the current ruling party, draws its support largely from the south, Renamo, the main opposition party, from the centre and north. Preserving stability and democracy will require greater economic integration of the country, accompanied by a gradual decentralisation to province and district levels of some financial and decision making responsibilities. Low capacity at these levels is a constraint.

Poverty reduction

5. The Government of Mozambique has set out its plan to tackle poverty in the Plano de Acção de Redução da Pobreza Absoluta (PARPA) 2001-2005, which constitutes the country's PRSP. The PARPA has as its central objective reducing the incidence of absolute poverty from its 1999 level of 70% to less than 60% by 2005 and less than 50% by 2010.

¹ UNDP, 2001 Mozambique Human Development Report 2001.

² Questionário dos Indicadores Básicos de Bem-Estar or Core Welfare Indicators Survey

6. We share the PARPA's conclusion that the key determinants of poverty are economic growth, levels of education of the economically active population, especially women, dependency rates, agricultural productivity, employment opportunities, and basic infrastructure in rural areas. Participatory poverty assessments (PPAs) show that perceived poverty depends mainly on personal assets; adequacy of infrastructure; agricultural productivity; and adequacy of welfare organisations. The priorities of the poorest are increased agricultural returns, opportunities for participating in markets for agricultural products, and improved access to health care and water.

7. Although the central objective of the PARPA is set in terms of a reduction of absolute poverty measured by consumption, the Plan's concept of poverty is multi-dimensional, embracing not only income but also access to health, education and other services. The PARPA is underpinned by the objective of sustaining rapid and broad based economic growth in the medium and long term. Growth is to be influenced by policies to ensure that it is inclusive of the poor. In the short to medium term, the emphasis is on getting the economic fundamentals right, accompanied by investment in human development and in improving productive capacity, with the aim of creating a 'virtuous cycle' of accelerated and sustainable progress in addressing poverty. Thus, the six "fundamental areas of action" in the PARPA are education, health, agriculture and rural development, basic infrastructure, good governance, and macro-economic and financial management.³

8. Overall, our view, and that of most donors, is that the PARPA provides a good preliminary framework for tackling poverty and a sound basis for improving the effectiveness of development assistance.

³ Within these priority areas the main objectives are: universal primary education with an expanding secondary and tertiary sector; expansion of primary health care, combating endemic diseases and addressing HIV/AIDS; increased income generating opportunities in the family farm sector, particularly through improved access to markets which will be stimulated through better rural infrastructure; a governance agenda which includes decentralisation, public sector reform and the reduction and containment of corruption; and a series of measures designed to maintain macro-economic stability and improve public financial management.

CHALLENGES AND RISKS

9. This section analyses the challenges and risks to the achievement of the PARPA's objectives.

Evolution of PARPA process

10. It is essential that the PARPA becomes a dynamic, broadly-owned process, embedded in national planning, budgeting and monitoring processes. Broadening ownership of the PARPA within government is an immediate priority. Provincial government institutions, in particular, have limited knowledge of the process and have received little guidance to date on the implications of the PARPA for their planning and budgeting processes.

11. This is also an issue which affects central government - although a PARPA document has been produced, integrating the PARPA process into the Government's existing planning and budgetary processes is a critical challenge and is expected to be a lengthy process. The annual Economic and Social Plan (PES) and budget have not been used in any structured way in the past as a means of operationalising the PARPA. Supporting the government in implementation of reforms in this area will be important. Plans to link the PARPA to a Medium Term Fiscal Framework in Mozambique (the CFMP) have not yet been realised. This is partly due to concerns about the robustness of CFMP resource projections, especially in the light of a continuing high level of off-budget expenditures, which exacerbates a generally weak political and administrative recognition of the Ministry of Planning and Finance (MPF) as the unquestioned guardian of public finances. It is not clearly established that all public spending proposals should be subject to the scrutiny of MPF and should be challenged if inconsistent with national objectives in the PARPA or with basic principles of value for money. More active political support for the central role of MPF will be needed to achieve this, accompanied by significant change in the organisational culture and effectiveness of MPF as a whole.

12. There is a need to develop a comprehensive system for monitoring the impact of spending on the poor, and for the impact more broadly of government policies on PARPA poverty reduction objectives to be understood and fed back into policy making. The Government has developed a good PARPA monitoring and evaluation strategy, but the status of the strategy is unclear since it has not been formally approved or endorsed. Government capacity is low and there is no clear operational plan for implementing and institutionalising the strategic framework. In addition, capacity of both civil society and Parliament is very low, limiting the effectiveness of scrutiny. These challenges have been identified in recent PARPA Implementation Reports and there is a willingness in government to improve monitoring systems and among donors to provide coherent support to this process.

13. As part of the M&E strategy, government has established a Poverty Observatory, as a mechanism by which a broad range of actors, including civil society and donors, can keep an overview of progress, drawing on a range of sources. Whilst

this represents an important effort to be more publicly accountable for setting and delivery of PARPA objectives, the process needs considerable strengthening. The PARPA is based on the Government Programme 2000-2004 and, to a large degree, the sectoral plans of Ministries. The sectoral planning process included consultation with partners – civil society, the private sector and donors - but the process was criticised for focusing on dissemination rather than debate. Some sections of civil society feel that this stemmed more from a lack of consultation skills within government, than an unwillingness on their part to consult. In any case, greater involvement of the private sector, civil society, and the Assembleia da República (Parliament) is required in future development of the PARPA, and there is at least spoken agreement to this on the part of Government. Government's increased willingness to engage with civil society needs to be matched by building the capacity of Mozambique's currently weak civil society to seize this opportunity. An effective civil society that demands and facilitates public accountability and broader participation, citizens' rights and access to economic opportunities is very important to ensure that Mozambique achieves PARPA objectives. The development of the role of the Assembleia da República is critical here also. At the moment, the AR does not really perform an effective accountability function.

PARPA Implementation

14. Partly as a result of the weaknesses in the process of development of the PARPA, it does not quite succeed in making the link between the reform processes to which the Government has committed itself, and its poverty reduction targets. Whilst the essential elements are implicit in the analysis, and prioritised as commitments in the Performance Assessment Framework (discussed below), fully identifying cross cutting reform areas in the PARPA and taking action on these will be an important challenge for Mozambique in the coming years. A clearer prioritisation is needed within and across sectors, as well as a policy agenda which links growth, the business environment, governance and participation.

15. To take this analysis one step further, it is helpful to identify two broad groups of cross-cutting issues on which progress is crucial to achieving PARPA objectives. These relate to (i) the development of a capable, responsive and transparent government ie one that works with civil society and private sector partners to build an effective framework for sustainable pro-poor policies and service delivery; and (ii) the creation of an enabling environment for broad-based, sustainable private sector-led growth.

Capable government

16. Weak systems and poor capacity are key problems right across the government system, most visibly in the service provision sectors such as health and education. For example, the country currently produces approximately 2000 secondary school graduates annually, significantly fewer than the numbers required to achieve PARPA targets on expansion of service delivery, never mind catering for the growing needs of the private sector. Existing sector plans do not realistically address

these sort of constraints, nor their likely worsening in the short and medium term through the impact of the HIV/AIDS pandemic. It is significant that sector plans generally do not analyse in any depth the role of improved management of human and financial resources in delivering improved policy making and programme implementation, nor do they tend to draw any explicit linkages to the central public service and public financial management reform processes underway to address these particular constraints in a comprehensive and coherent way. As the PARPA evolves it will be important to ensure that it facilitates the embedding of these key central processes into the arms of government responsible for policy and programme implementation.

17. The PARPA was the first public document in Mozambique to mention corruption explicitly. Although it recognises the need to tackle corruption by, inter alia, strengthening the judicial system and enhancing accountability through decentralisation and deconcentration, the links between all of this and poverty reduction are not clearly drawn. Corruption will inevitably reduce growth levels over time, while weakening the impact of that growth on poverty and undermining democracy. At the same time, survey evidence points to the enormous direct impact which petty corruption has on poor people's daily lives – charges for services which should be free, bribes demanded for processing official papers and so on. The blurred lines between the public and private interests of some officials and politicians has exacerbated doubts about commitment to tackle corruption, including by reforming state institutions. Rooting out this corruption will require action on a number of fronts, including improved pay and conditions for public servants and greater access for the public to information on fees and services. This will work only if it is reinforced by clear evidence that corruption is being tackled at all levels, and by a strong and consistent signal to civil society that complaining is a right.

18. The PARPA also has a strong focus on government, which is not really complemented by a recognition of the role of civil society and the private sector in key areas. Work is currently underway, in the context of the public service reform process, to examine the role of government in Mozambique, and this should assist in defining those areas where GoM should provide an enabling, rather than direct service provision role.

Enabling environment for growth

19. Mozambique has achieved annual average growth in recent years at or above the ambitious PARPA objective of growth of 8%. However, while 2002 and 2003 saw reasonable growth in the agriculture sector, upon which most people depend for their livelihoods, most of the increase in GDP was driven by a small number of “mega-projects” (including Mozal), and by construction, both concentrated in the Maputo corridor. This reinforces a pattern of increasing regional disparities between the north and south of the country. There is general consensus that mega-projects, while very welcome, are not enough. While they help Mozambique's image as an investment

destination, broader expected impacts in terms of technology and knowledge transfer will not be realised without improvements to the general business climate.

20. Despite the strong focus on growth as the key to poverty reduction, the PARPA does not as yet articulate a clear strategy for achieving and sustaining that growth. That said, many in the domestic private sector argue convincingly that immediate priority should be given to implementing already agreed reforms to improve the climate for investment and growth, rather than to abstract strategising. All would agree, however, that there is also a need for policy-focused, forward-looking analysis of the potential sources of growth, and of how this growth can maximise the impact on poverty reduction.

21. Most analysis of Mozambique's growth prospects highlight a number of key challenges that need to be addressed urgently. These include HIV/AIDS; red-tape, bureaucracy and corruption; a weak financial services sector; poor infrastructure; and the low skills base.

22. Although the national rate of HIV infection is around 12%, this masks significantly higher rates in central and southern areas bordering Zimbabwe and South Africa. The concentration of the pandemic amongst the economically active young has prompted suggestions that HIV/AIDS could reduce annual growth rates by one to two percentage points in future years. Rapid progress on the implementation of a national strategy to arrest the spread of the pandemic is essential, as well as integration of the National Strategic Plan on HIV/AIDS (PEN) within the PARPA and concerted efforts across government, civil society and the private sector. Other less high-profile diseases, particularly malaria, also have a devastating effect on productivity and the availability of labour in rural areas.

23. The links between governance issues and the creation of an enabling environment for growth are not clearly drawn in the PARPA. The development of a dynamic domestic private sector is severely constrained by the very high cost of doing business in Mozambique. Despite some recent reforms, licensing and regulation requirements remain onerous, and provide opportunities for bribe-seeking by corrupt officials. Recent large foreign investments have been facilitated by the waiving of many bureaucratic hurdles rather than by removing them. Smaller local firms still suffer, and there is a danger that success in attracting large investments could make Government complacent about these real obstacles. The PARPA acknowledges that the justice system is not working – resolving commercial disputes is an excessively time-consuming process, and even then decisions are not enforced. Investment and growth will be threatened so long as property rights are not secure and contracts cannot be enforced, and these issues must have high priority in the dialogue between GoM and donors.

24. Many are hopeful that recent new entrants to the financial services sector will facilitate change, but the banking system remains relatively underdeveloped and uncompetitive. Corruption and mismanagement on a grand scale within two privatised banks has been exposed over the past three years. The upheaval in the sector,

combined with higher Government financing via Treasury Bills in 2001 and 2002 (much of this to fund the costs of the banking crisis), has pushed up real interest rates. That growth has remained high despite this indicates the lack of dependence of investors on the domestic market. Again, small to medium size Mozambican firms without access to cheaper foreign sources of funds suffer, and face a serious credit squeeze. Meanwhile, agricultural growth is hindered by the fact that farmers have practically no access whatever to credit institutions. Improved banking supervision, increased competition and reduced demand for domestic borrowing by Government are essential if the financial system is to develop in a way which facilitates growth.

25. Significant development of transport infrastructure has taken place in the south, much of it driven by private investment. Poor transport infrastructure in the rest of the country, particularly in rural areas, impedes access to markets and raises costs, and remains a serious obstacle to increasing economic activity. The parastatal sector is not large, but it is concentrated in the key utility and infrastructure areas. Poor management, inefficiency and corruption contribute to the low coverage of electricity and telecommunications networks, and the degradation suffered by the main ports.

26. The foreign private sector in Mozambique has been able to address its skills shortage problems to some extent by bringing in managers and workers with key skills, but at considerable cost and not without some opposition. Over time, improved education and skills transfer will make a difference, but in the meantime, growth will be inhibited unless Government is willing to permit skilled foreigners to work in Mozambique, in the private and indeed the public sectors. Donors must exercise caution in pushing for more rapid progress towards universal primary education than Mozambique can afford, for example through the externally driven fast-tracking initiative. With only 8,000 young people entering secondary school (2% of total), it is arguable that to sustain growth, Mozambique needs to be allowed to find an appropriate balance between investments in the various levels of education.

27. Within its growth strategy, Government may also need to look at the extent to which revenue policy could inhibit growth. This applies not only to the modern sector, but also to agricultural development. Economic activity and trade in rural areas is discouraged by a plethora of local taxes, including on bicycles and draught animals, and by relatively high Customs duties on commercial vehicles. The discretion provided by the existence of these taxes yields extensive opportunities for bribe-seeking.

Donor behaviour

28. Mozambique receives in excess of half a billion dollars each year in development assistance, but there is little evidence on which to base a judgement on the effectiveness of much of this aid. Mozambique is highly aid dependent, and, given its narrow revenue base, will continue to need to receive significant concessional external flows for many years if poverty reduction targets are to be met. This will require that Government retains the goodwill of donors by demonstrating commitment through action, and that donors recognise the need for a long-term approach to the challenges facing Mozambique.

29. The key challenge is for donors to live up to good practice commitments entered into most recently at Monterrey and Rome. Donors in Mozambique, particularly those providing budget support (currently called the G14), have made important progress in aligning behind the PARPA and government systems and working better together. This can particularly be seen in the Performance Assessment Framework (PAF) process. In the last year government has been through a rigorous process of internal dialogue to develop the PAF as a prioritised list of annual commitments for delivery of PARPA objectives. GoM is committed to this approach and to using it to develop and improve its existing annual planning, budgeting and monitoring process, focused on the PES and the OE. This is essential to avoid the creation of parallel systems which would undermine the drive to enhance domestic accountability. The G14 and the World Bank are committed to using the PAF/PES as the single conditionality framework for budget support and using government monitoring information as the basis for their assessment of performance. A new Memorandum of Understanding (to replace the current Joint Agreement) governing the G14 budget support joint programme is currently being developed, which will set out the nature of the partnership, commitments on both sides, aspects of alignment and how donors will respond to performance against the PAF.

30. A number of major donors, however, continue to spend significant amounts of money outside government systems, which tends to create parallel structures, undermines sustainability, and hinders the development of accountability within Government, and of Government to its citizens. Other donors can use peer pressure to encourage change, but Government needs to put pressure on donors by holding them to account for their international promises. In addition, Government needs to demonstrate to sceptical partners that it is committed to using resources well. This evidence is also needed by those donors who have moved towards budgetary aid, to avoid domestic public pressure to revert to less effective but superficially more controllable modalities. There is also significant opposition from within those parts of Government which benefit from direct funding – principally line ministries – to changes in funding mechanisms. Some of this is driven by genuine concern that the central system will not be able to deliver resources to identified priorities, with consequent impact on the level and quality of services. Some also reflects reluctance to see long-standing power bases undermined.

31. As in other developing countries, tied technical assistance remains a problem, as even quite progressive donors feel pressure to ensure a continuing market for their nationals. TA is not being used to maximum effect, and may, in some cases, be undermining capacity. There is a need for greater donor coherence to reduce duplication and overlap, including in the provision of overseas training. Making TA more effective will require willingness on the part of donors to pool funds and allow Government greater flexibility to buy what it needs, possibly including long-term expatriates.

32. Even with continued growth, making a significant dent in poverty will be a long-term process and will require long term commitment from donors. Maintaining the

interest of results-driven donors through the long but necessary process of building institutions will be a challenge. We need to be ambitious but realistic about the pace at which progress can be made given political realities and capacity constraints, and agree on indicators which reflect this. Equally, as more aid is channelled through the central budgetary system, predictability becomes more important, and it is essential that we deliver on this by making the common performance assessment framework approach work. Donors will have to ensure that they are true to the principles underlying this approach and that they allow it to evolve in keeping with the needs of the Government.

33. Finally, donors need to continue to avoid seeking to overcome weaknesses in the PARPA process and government systems by imposing their own parallel objectives and monitoring systems. This would undermine the principles of government ownership of the PARPA and the need to build on and enhance democratic systems of government accountability to citizens.

Other risks

34. There are a number of clear political risks, chiefly related to presidential and general elections scheduled for late 2004.

35. In the run up to the elections, the relatively narrow and shallow ownership of the PARPA means that there is already apprehensiveness about the commitment to its objectives of those within Government responsible for actually implementing policy and expenditure decisions. DFID's view is that commitment is sufficient in critical parts of Government, but we need to be conscious that a Government facing an election in a year has less incentive to take difficult decisions or tackle vested interests. Maintaining even the already slow rate of progress on key "second-generation" reforms, including of the public service, will require active dialogue. In other areas, such as the introduction of an integrated system of public financial management, Government is keen to make very rapid progress, partly driven by a genuine desire to avoid financial instability in the run-up to the 2004 election.

36. President Chissano's decision to stand down for the presidential/general elections in 2004 has rightly won widespread praise. However, it means that there will definitely be a change of regime, which adds to the uncertainty facing Mozambique over the medium term. Frelimo has publicly committed itself, however, to continuing to take forward the PARPA, and there are indications that a new Frelimo government would place a strong emphasis on growth, and on the development of the domestic private sector in particular. More concerted action against crime and corruption is also promised.

37. If Renamo is successful in the 2004 elections, a peaceful change of government would be a good sign for the strength of Mozambican democracy, but Renamo would face significant difficulties in forming an effective administration. Their party structure is weak, and support is focused in the centre and north. How the Frelimo-dominated civil service would react to a Renamo win is uncertain. Some senior professionals

might be willing to stay on, but a major shakeout is possible, inevitably reducing the capacity of an already weak administrative system. The failure so far to embed the PARPA in the parliamentary process has meant that the opposition has had little chance to buy-into the strategy, so it is not clear what would become of the PARPA in the event of a Renamo victory. The Renamo leadership has said, however, that it is committed to the principles underpinning the PARPA, and it has also been closely involved in the Vision 2025 process, a collaboration between the political parties and civil society which aims to provide a longer-term perspective on Mozambique's development challenge.

38. If the results are as close as in 1999, either party might be reluctant to accept that the other has won. While there is little appetite for a return to war, the November 2000 Montepuez incident showed that violence has not yet been exorcised from the body politic. To avoid conflict and preserve hard-won democracy, it will be essential that the international community ensures widespread coverage by impartial foreign monitors, that they and local monitors have free access, including to the count, and that monitoring continues until the results are published.

39. There are also a number of at least partly exogenous risks, involving factors over which Mozambique has limited direct control, including climatic events and regional or global instability.

40. The serious impact which adverse weather can have on Mozambique was demonstrated by the experience of 2000, when extensive flooding reduced economic growth to almost zero. It is important, however, that these risks are not treated as exogenous in the future by Government. Poor rains, for example, are a regular occurrence in this region, and this will need to be factored more explicitly into the growth scenario underpinning the PARPA targets.

41. Mozambique's growth will be sub-optimal unless it is able to gain greater access to markets, particularly those of the EU. Good yields per hectare in sugar, for example, make Mozambique a competitive supplier, but the development of this potentially high-employment industry is undermined by low access to European markets, even with the concessions provided by Everything but Arms. DFID has a key role to play in ensuring that the UK Government's position on this and other trade issues remains pro-development.

42. Zimbabwe's problems have already had a negative impact on the centre of Mozambique which has a long tradition of trade and seasonal labour migration. Economic collapse in Zimbabwe would carry immediate threats to Mozambique's stability, if this resulted in an influx of migrants or refugees. In the longer term, Mozambique may lose investment if the Zimbabwe situation influences investors' attitudes to the region as a whole. South Africa will remain the engine of growth for the sub-region, and the economic health of this powerful neighbour will continue to be a major determinant of Mozambique's future prosperity. It is also clear that failure to address the spread of HIV/AIDS in South Africa will undermine any efforts to control the pandemic in Mozambique.

43. As with other aid dependent countries in Africa, achievement of poverty reduction goals could be threatened if aid resources were to be diverted, for example, as a result of the situation in the Middle-East. Increases in oil prices would have a negative impact on Mozambique's terms of trade, and could also retard growth.

Risk assessment

44. Overall, we judge the risks to the delivery of poverty reduction in Mozambique to be **medium to high**. We are convinced that the potential rewards are high also: the greatest risk is that poverty reduction will not be achieved if we are not willing to engage. The challenges and risks set out above do not exist in a vacuum – they are inherent in the systems and structures which we are seeking to transform through our engagement. Much of the responsibility for mitigating risks lies with Government itself – particularly meeting its commitments to ensure the rule of law and tackle corruption, to implement key reforms related to the management of financial and human resources, to improve the business environment, and to broaden participation. Donors must contribute to the reduction of risk by working together more effectively to take forward a shared agenda. DFID's role in this process is set out in Part II.

PART II

WHAT HAVE WE LEARNED?

45. DFID has been working in Mozambique since the 1980s. Our programme has increased significantly in the past five years, from £19 million in 1997/98 to £35 million in 2003/04, and is scheduled to increase further to at least £48 million in 2005/06. Despite rapid expansion, the programme has remained tightly focused. In 2002/03, there were thirty projects and programmes, four of which (including direct budgetary support) accounted for 75% of expenditure.

46. The last Country Strategy Paper (CSP), approved in 1998, defined four “impact areas” within the programme: improving economic and financial management; public service reform; promoting sustainable livelihoods; and improving health and education. These areas of focus were well chosen, in a country with a fragile macroeconomic environment, weak public institutions, social indicators that are low even by Sub-Saharan African standards, and a population that largely depends on agriculture.

47. The strategy suffered, however, from what is sometimes termed the “missing middle” problem. Many of the interventions funded by DFID have been judged by internal and external reviewers to have been well designed and implemented, and they have clearly had positive impacts on direct beneficiaries. It is more difficult, however, to draw from this any rigorous conclusions about their sustained structural impact on poverty reduction.

48. Our analysis and experience in Mozambique and elsewhere has led us to recognise that many of the obstacles to the achievement of sector outcomes are unrelated to the sector itself, as demonstrated by the challenges identified above. Action to tackle poor management, low incentives and corruption at sector level, needs to be integrated with broader efforts across the public service. Even the impact of successful “sector-based” reform, such as we have supported in Customs, will eventually be threatened unless the wider governance environment improves.

49. A further implication of this is that donors can contribute as much or more to improving eg health and education status by supporting, for example, the reform of public expenditure management, as by a focus on sector policy per se. Such joined-up thinking has been evident to some extent within the DFID programme, but it was not facilitated by the impact areas of the last CSP, which tended to reinforce stratification, and there are significant opportunities for improved coherence.

50. Another key lesson concerns the importance of harmonisation and the embracing by donors of recognised good practice, which is even more critical in a country with over two dozen active donors. The potential for duplication, inconsistency and incoherence, and the sheer burden on Government of dealing with so many interlocutors, make it imperative that we work together to a shared agenda. The high proportion of the government budget being provided by donors also makes donor

predictability and transparency extremely important. Mozambique has a good record on donor coordination and harmonisation, and the PARPA provides a framework for further streamlining. DFID has pursued a strong collaboration and harmonisation agenda in Mozambique for some time, chairing or participating actively in many key donor groups. We have learned that this approach has enormous implications for team member's work programmes, with a substantial amount of a typical working week spent in multi-donor engagement with Government. We have also realised that being one of so many donors makes it difficult for each to identify and demonstrate their value added, and that donors need regular, rigorous and honest monitoring of their activities to ensure that they remain relevant and effective.

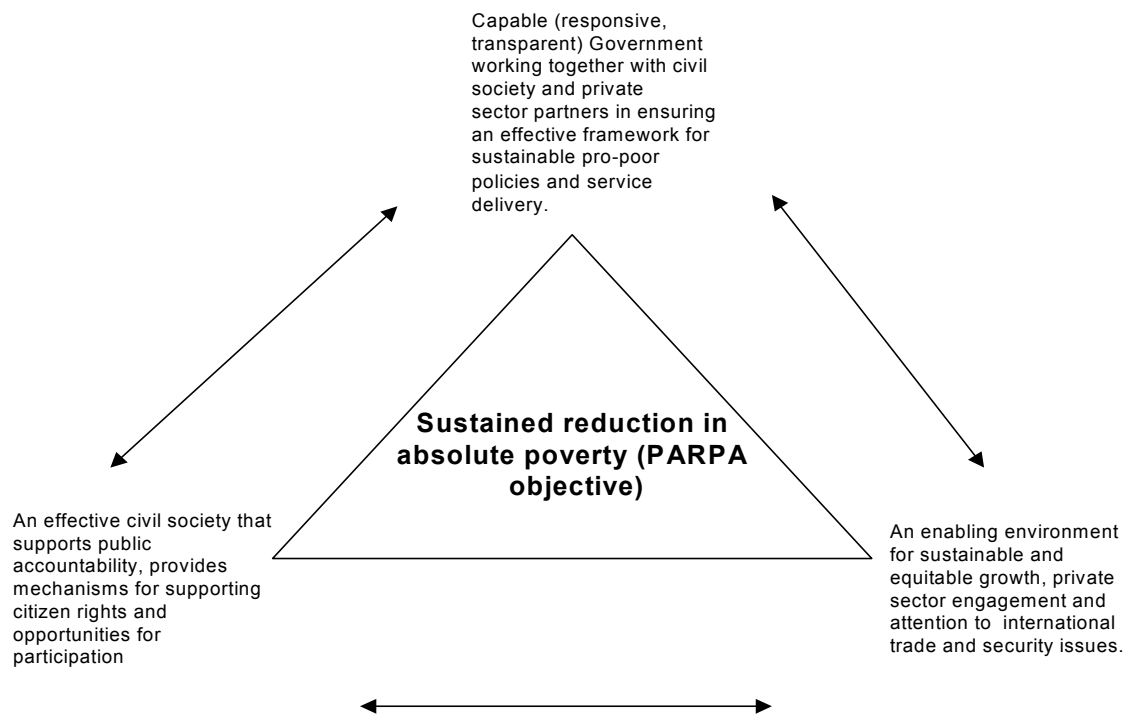
51. Some commentators argue that donors have contributed to the growth of corruption in Mozambique by focusing their accounting and auditing concerns on their own separately managed funds, and not on the health of the government system. Over half of aid to Mozambique is off-budget, including traditional projects and funds channelled directly to sector ministries both at the centre and in the provinces. This undermines government systems by by-passing them, it reinforces a pattern of accountability to donors rather than to the centre of government and to the public, and it allows donors to dictate the composition, distribution and pace of expansion of government services.

52. Our analysis of SWAPs, which developed out of efforts to address some of the generally accepted weaknesses with the project model, shows that they have had some obvious benefits. It is probable that they have prepared sectors for a transition to budget support, and have facilitated improvements in line ministries' capacity to demand better information and services from central departments. SWAPs have also played a role in improving donor coordination and sector planning. On the other hand, we have found that SWAPs can reinforce a pattern of concentration of donor coordination around sector issues, and around the processes of direct funding of these sectors by donors. Thus, much dialogue with government takes place at a level which cannot deliver the fundamental reforms and structural change essential to sustained improved outcomes. Sector-based dialogue is still needed, but it must be more closely linked to the broader process of government reform, and must facilitate prioritised resource allocation across government and a more accountable relationship between sectors and the centre.

53. DFID's view is that the key to maximising aid effectiveness is for government-to-government aid to be channelled increasingly through the central system in the form of untied direct budgetary support. The PARPA process provides a framework within which priorities can be agreed, and resources re-oriented accordingly. We recognise the weaknesses which exist in planning and budgeting, in expenditure management, and in the responsiveness of government to civil society, but these weaknesses can only begin to be addressed if donors work within the system.

DFID'S FUTURE PROGRAMME

54. DFID's aim in Mozambique is to make a significant contribution to the sustained reduction of poverty by supporting the evolution, implementation and monitoring of the PARPA. Drawing on our analysis of challenges and risks, DFID Mozambique has developed the following 'poverty reduction triangle' as a way of organising our thinking about strategic areas for engagement in the Mozambican context.



55. This triangle identifies as critical elements support to the key cross cutting areas of reform outlined in the challenges section (building a capable government and an enabling environment for growth) and building the demand side. Each of the three elements is inevitably shorthand for a complex array of policies, organisations and institutions (including the "rules of the game"), but the triangle provides a way of organising thinking about strategic areas for engagement in the Mozambican context. In particular, it provides a basis for a "logic model" to guide the definition of the future DFID programme, and its monitoring and evaluation.

56. For each point of the triangle, DFID Mozambique (supported by external inputs) asked what were the key areas where progress is needed, what were the processes that would drive this progress and what donors could do to facilitate these processes. To arrive at a shortlist for DFID support, the options were then sifted by the team using an agreed decision making framework, including elements such as maximising strategic impact and comparative advantage.

57. We noted earlier that defining comparative advantage in a multi-donor context is difficult, but our analysis confirmed the hypothesis that thinking and working across sector and disciplinary boundaries, and integrating our engagement in central level reforms with sector level processes could yield a significant multiplier effect. This points us towards a different approach to prioritisation, one which is focused not on simply limiting the number of sectors in which we engage, but rather on dynamic and opportunistic influencing of a small number of the key change processes which will drive progress on poverty. With a strong concentration on these processes in the programme, we can contribute to improved outcomes across the priorities identified in the PARPA, and add maximum value to the efforts of other donors.

What will we do?

58. The future DFID programme will operate at a number of levels. Our analysis concluded that the policy dialogue process must be supported by, and learn from, specific engagement (including dialogue and technical assistance) aimed at addressing the weak capacity at all levels of Government which, even with strong commitment, will continue to inhibit the formulation and implementation of pro-poor policies and programmes. We also need to support the development of an active and challenging civil society that can hold government to account.

Policy Dialogue and budget support

59. DFID Mozambique will seek to maximise aid effectiveness by channelling aid increasingly through the central system in the form of untied direct budgetary support, in support of the PARPA. There are concerns that, given GoM's weak public financial management capacity, a rapid shift from current direct sector funding to budgetary support may carry risks for service provision. A summary of the fiduciary risk analysis is shown in Box 1 below. The conclusions of this analysis argue for some gradualism in folding existing commitments (eg the essential medicines pool) into the central budget. However, we will be very cautious in using this to justify the generation of new off-budget arrangements.

60. We will continue to work with the G14, World Bank and the government to ensure that GoM and donor commitments agreed in the PAF (and reflected in the PES) and in a revised GoM/G14/World Bank memorandum of understanding, which will govern our overall relationship. Predictable levels of budget support will underpin the development of a mature, long-term partnership between donors and GoM, with clear commitments on both sides, focused around the PARPA process and building up GoM's own systems and accountability to Mozambican citizens. Through the PAF we will explicitly link the provision of budget support to the government's commitment to poverty reduction, as evidenced by the implementation of reforms critical to pro-poor growth and sustainable service delivery. We will use budget support to facilitate a focus in our policy dialogue on the cross-cutting issues identified in the PAF, including governance and the growth strategy, at a level in government which has the power to deliver and which can be held to account through democratic processes.

BOX 1: Fiduciary Risk

Our assessment of fiduciary risk in Mozambique draws on the Mozambique Report on the Observance of Standards and Codes (ROSC), Country Financial Accountability Assessment (CFAA) and draft Public Expenditure Review (PER, Part 1). The assessment follows DFID and DAC guidance, and is based on a desk review commissioned by DFID in consultation with donors and PEFA.

We have summarised provisional ratings against key areas of risk set out in the guidance as follows: A (complies with good practice), B (some significant weaknesses exist which need to be addressed); and C (major weaknesses exist requiring substantial upgrading). In addition to current the levels of attainment, the assessment below considers the pace and direction of change of reforms, and commitment to action plans that address key problems in the budget process.

Background - Financial management reforms gained significant momentum with the launching of the Expenditure Management Reform Strategy (EMRS) and approval of the Budget Framework Law in 1997. These steps led to some improvement in transparency and accountability (e.g. through establishment of broad functional classifiers) and to the introduction of a medium term framework (MTFF). External and internal audit functions were established [Inspeção Geral de Finanças (IGF) and Tribunal Administrativo (TA)] leading, for example, to closure of the State Accounts (1998) for the first time since independence.

Situation now - Although the EMRS emphasised the need for a comprehensive coverage of the budget and creation of unified systems, off-budgetary spending and revenues remain very considerable. Over half of overall public spending is still financed off budget, with about 80 per cent of the investment budget financed off-budget by donors, and a considerable proportion of internal revenues being collected off-budget. The capacity of the IGF and TA are far below the desired capacity needed to fulfil their functions effectively. The MTEF has been updated and now provides a regular basis for the annual State budget, but still has no formal status and has yet to be developed into a fully effective planning instrument.

Future commitments - In recognition of major systemic weaknesses and with growing concerns expressed by IFIs and donors, a new integrated public financial management system (SISTAFE) was approved in late 2001. SISTAFE embraces all key areas of public expenditure management (Treasury, Accounting and Budget) and promises to address existing weaknesses in comprehensive manner. The reform is ambitious but carries strong commitment by Government, donors and IFIs, as reflected in a joint MoU due to be signed in November 2002.

Risk ratings - Our overall judgement is that until recently the risks inherent in the overall system were very great and now fall between categories B and C (i.e. a combination of significant and major weaknesses) with strong momentum for further improvement. Most of these will be tackled through SISTAFE, but even with SISTAFE beginning to be implemented fiduciary risk is high because budget planning, costing and prioritisation is weak; the risks of funds not reaching their intended use is great; unknown but probably low levels of efficiency and effectiveness are inherent in public delivery systems; and there is significant risk of misappropriation reflected for instance by lack of a coherent set of procurement principles.

Protection - Protection against these risks should, complementary to SISTAFE, focus on: institutionalising the medium term budgetary framework; strengthening external and internal audit capacity; and improving procurement principles and practices. Clearer conditionality might be built into arrangements for future budget support to provide a measure of protection. Implementation of SISTAFE is to become reflected in future PRGF benchmarks.

61. The PAF should facilitate robust and honest dialogue on key issues, particularly macroeconomic stability, addressing HIV/AIDS, economic and political governance, allocation and management of public expenditure, structural reform and the business environment. Assessing whether or not progress is adequate will not be

as easy as adding up scores against agreed milestones. It will require us to make judgements about whether the direction of change is sufficiently positive. Donors will need to operate with greater political sophistication than has often been the case. For example, one key judgement will be whether the fact that progress is slower than promised is because GoM can't or won't move more quickly. The new MoU will provide space for GoM and its donor partners to address potential problems or disagreements in a way which avoids the interruption of financing within the financial year. The consequences of failure to deliver on promised actions – probably involving a structured tapering off of funds over a certain period – will be clearly spelt out in the MoU, along with the fact that donors must ultimately retain the right to suspend disbursements at any time if they feel that there has been a fundamental breach in the trust between them and GoM.

62. To deliver on the objective of shifting accountability away from donors and towards national stakeholders, greater opportunities will need to be developed for civil society engagement in planning and monitoring, combined with increased capacity of Parliament and civil society to undertake this role. This includes making the Poverty Observatory process a more effective, year-round forum for accountability, institutionalising civil society participation and improving the accountability of civil society to citizens.

63. To be effective, the MoU must be based on mutual accountability, with obligations not just on Government but also on donors. We will seek to ensure that the G14 commits as far as possible to provide an increasing proportion of our funding in the form of direct budgetary support (recognising that this will be difficult even for some G14 members), to ensure that the size and timing of promised disbursements are predictable and in line with Mozambique's financing needs and to maximise harmonisation. We will seek to ensure that the government and other actors can effectively hold donors to account for these commitments.

64. On DFID's part, subject to satisfactory progress in the context of the PAF, we will increase the share of the Mozambique programme provided as direct budgetary support over the coming three years. We will closely monitor fiduciary risks, as far as possible through government systems, and support action to mitigate them. We will seek to reduce risks by tackling them directly through engagement in reform processes. We do not propose to earmark our budgetary aid in any strict sense, but in the context of the PAF, we will seek to ensure that Government meets its expenditure commitments in the priority areas identified in the PARPA. In this way, we will contribute significantly to the funding of these priority expenditures. We will also ensure that assessment of progress in the sectors is integrated into the overall review and dialogue around the PAF. Existing funding commitments at sector level will be folded into our DBS as early as possible. Transition processes will need to be designed and agreed. We and other donors will want to ensure, for example, that shifting currently earmarked drugs funding fully on budget does not result in a sudden sharp reduction in the availability of essential medicines, which could endanger lives

unnecessarily and undermine the equitable central allocation mechanisms which have been developed.

Reform of Government

65. Appropriate instruments will be used to meet different needs. In addition to direct budget support, we will provide technical assistance for capacity building within and outside government, working as far as possible through untied pooling arrangements with other donors. We will also deploy a limited amount of project funding where this can add value, for example, in promoting innovation and supporting lesson learning.

66. Drawing on DFID's broad-based expertise, we will take a strategic and integrated approach to improving policy-making, management and delivery in the four sectors (health, education, agriculture and infrastructure) identified as priorities in the PARPA. Our analysis points to the need for a comprehensive and coherent approach. In particular, it highlighted the strategic links between the poverty reduction outcomes identified in the PARPA, whether in terms of broad-based growth or improved social indicators, and the mechanisms by which better policies are made and implemented, resources are more effectively managed, and real participation is stimulated. We need to look beyond individual sectors (and sector-related outcome targets) to the underlying problems inhibiting progress across a range of objectives. We will argue, for example, that we may contribute more to the PARPA/PSA education targets through a focus on improved financial and human resource management than through direct interventions in education per se.

67. DFID will examine on an ongoing basis the value of its contribution to each area of engagement, and seek opportunities for working with other donors to maximise impact and to reduce the number of interlocutors with whom GoM has to interact. In particular, DFID will seek to add value to other's work at sector-level by focusing on the integration of ministry-level reform with the central reform processes in which we are active, drawing on what we believe is a strong comparative advantage derived from our relative success in promoting joined-up working within the team. We will actively seek opportunities to work through other donors to reduce both our transactions costs and those of GoM interlocutors.

68. We will seek to mainstream HIV/AIDS concerns into all of our work, including our policy dialogue. In addition we will work directly with the newly-established National AIDS Council to support its mandate to tackle HIV/AIDS on a broad front. The NAC has a key role to play in moving the focus away from health, and in harnessing the energy of Government, civil society and the private sector in mainstreaming the fight against HIV/AIDS.

69. At the central level, we will continue to support the development and implementation of the Government's comprehensive and interlinked programmes for public service reform and for improved public financial management, including through pooled technical assistance. Drawing on our experience in Customs reform, we will

support the rolling out of reforms across the tax system, and will assist Government to define and establish an appropriate model for the future management of the revenue function.

Strengthening Civil Society Effectiveness

70. A stronger civil society and greater opportunities for holding the government to account are critical for providing an effective challenge function to government. We will work closely with other donors to take forward the recommendations of analysis, funded by DFID, on how to improve the participation of broadly-defined civil society in the PARPA process. We will also work with CSOs to improve poor people's knowledge of their rights, including access to land and other natural resources, and their capacity to hold government to account in fulfilling them. Linked to this, our dialogue with Government will include the need to enhance their responsiveness to the needs and views of poor people in policy processes and to create an enabling environment for CSOs. We will seek to ensure that donor engagement with government builds on and reinforces rather than undermines this. We will provide limited support to NGOs involved in public service delivery which can influence policy, promote wider lesson learning and act as a platform for advocacy, but which can also help to ensure that some benefits are perceived by poor people in the shorter term. We will evaluate and build on our experience of working with NGOs involved in the social marketing of certain private goods, as part of a process of building demand and addressing market failure. These programmes can also have an immediate direct impact - in the case of treated bednets, for example, reducing the exposure of children to malaria dramatically.

71. We are conscious that civil society is relatively weak in Mozambique, and that we need to be very careful that our support does not result in a donor-driven pattern of development for national CSOs. We will identify ways of managing such risks in our civil society strategy.

Support to the private sector

72. Our current direct involvement in private sector development consists of a small number of projects in micro-credit and business development with no clear strategic purpose. We will streamline our involvement, and strive for greater strategic impact, particularly by using our engagement in the multi-donor PODE programme to develop our knowledge of the constraints faced by business, and by feeding this knowledge into our policy dialogue. There are clear opportunities here to work more closely and synergistically with the British High Commission.

Partners

73. We will work in close cooperation with other donors, particularly members of the budget support donor group (currently 13 bilateral donors and the European Commission plus the World Bank), seeking to increasingly harmonise our assistance. We will also cooperate with and seek to influence less like-minded donors through our

participation in the Development Partners Group, which includes all donors active in Mozambique.

74. We will continue to work very closely with the British High Commission, which plays a key role in the process of influencing, particularly at the top levels of Government. We will work together to improve our understanding of the political realities of Mozambique, and ensure that this analysis informs our policies and our programme. Specifically, we will work together to design a programme of support for the effective monitoring of the general elections in 2004, which are crucial to Mozambique's future stability and prosperity.

75. Our analysis concluded that our long relationship with the province of Zambézia did not in itself justify building a focus on this province into our future programme. It is clear, however, that we have learned a lot from this provincial engagement, and that it has allowed us to feed lessons into our policy dialogue. Where there is a legitimate demand for us to work at Province level and below, for example to embed central reform processes and reinforce capacity, or to undertake strategic piloting work, we will build on the advantage derived from our relationships and concentrate on Zambézia.

How will we monitor progress?

76. We will base our monitoring of short and long term change on Mozambique's national monitoring systems. We will pay particular attention to reporting against the PAF, as this will give information on progress in the areas considered most important for poverty reduction.

77. We will supplement this with internal DFID monitoring, in order to assess the effectiveness of DFID interventions in helping achieve change in Mozambique. Progress in interventions in each of the corners of the triangle will be reported on every quarter. An overall assessment will be made annually, at the end of the first quarter, to coincide with the national monitoring process.

78. PSA/SDA monitoring will also draw from national monitoring systems. Facilitating broad-based growth is the PARPA's central objective and therefore will be monitored through national systems. There is a clear read-across from the PARPA to other PSA/SDA targets. DFID will contribute to the PSA target on the reduction of the proportion of the population living in absolute poverty, and the related SDA targets on support for the development of PRSPs, for improved economic and political governance and for an improved climate for investment and growth; the PSA/SDA targets on education and health; the PSA target on conflict; and the additional target on donor harmonisation.

PART III

79. The change impact monitoring table will provide the basis for annual planning. It shows both DFID interventions and, where possible, the Government identified

objectives and actions to which they link. In order to make it a useful business planning tool, it has been set out around the three change process areas described earlier:

- i. An enabling environment for sustainable and equitable growth, private sector engagement and attention to international trade and security issues;
- ii. An effective civil society that supports public accountability, provides mechanisms for supporting citizen's rights and opportunities for participation;
- iii. Capable (responsive, transparent) government working together with civil society and private sector partners in ensuring an effective framework for sustainable pro-poor policies and service delivery.

80. To take forward this complex agenda, the Mozambique office will be reorganised into three cross-cutting teams, focused on these change process areas. Each of the teams will be led by one or two advisers. Other staff who work least directly in a particular corner of the triangle will lead on challenging function the teams. This approach will ensure that obstacles to progress on poverty reduction are addressed in an appropriate and holistic way, and will also facilitate an active challenge function within the office.