

**14 March 2006**

**Poverty Reduction Budget Support to Mozambique  
2007 - 2011**

**PROGRAMME DOCUMENT**

**DFID MOZAMBIQUE**

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## LIST OF ACRONYMS

AfDB	Africa Development Bank
BHC	British High Commission
CAB	Crown Agents Bank
CAP	Country Assistance Plan
CS	Civil Society
EC	European Commission
GDP	Gross Domestic Product
GoM	Government of Mozambique
G18	Group of 18 PRBS Donors
G20	Group of 20 Civil Society Organisations
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MoU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
MYR	Mid Year Review
ODA	Overseas Development Assistance
OE	State Budget
PAF	Performance Assessment Framework
PARPA	Plano de Acção para a Redução da Pobreza Absoluta
PEFA	Public Expenditure and Financial Accountability
PES	Economic and Social Plan (Annual)
PFM	Public Financial Management
PFMA	Public Financial Management Assessment
PRBS	Poverty Reduction Budget Support
PRGF	Poverty Reduction Growth Facility
PRS	Public Sector Reform
PRSP	Poverty Reduction Strategy Paper
PSA	Public Service Agreement
RAR	Resource Allocation Round
TA	Technical Assistance
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WB	World bank

## **1. SUMMARY**

1.1 This programme document describes a five-year rolling instrument for Poverty Reduction Budget Support in Mozambique. Approval is requested for up to £236m. This would be sufficient for five years through to 2010/11 under a high aid framework scenario. Each year new funding will be requested to maintain five year predictability.

1.2 The continuing case for budget support rests on evidence of the past impact of budget support and an assessment of a continuing favourable environment. The fiduciary risks are assessed as medium to high but improving and the overall risk as medium.

1.3 Other risks include weak institutional capacity to deliver service improvements to poor people (medium), risks of policy reversal (low in the short-medium term), risks from external shocks (high) and slow progress by other donors in implementing the PARIS commitments. To underpin this programme the UK is now leading new work to elaborate a political development trajectory for Mozambique, this will help forecast possible political risks, sharpen strategies for mitigating political risks and help us locate any corruption or human rights events against a continuum of expected reform.

1.4 The programme will provide finance for Mozambique's new PRSP (*PARPA 2*) The PARPA sets out a fairly ambitious programme of service delivery and continued policy and public sector reform. Reinforcing the delivery targets are credible assumptions by government of significant increases in own revenue, with GDP forecast to grow at 7% a year. The key delivery targets which the programme will contribute to, include a 24% fall in child mortality, a 14% fall in maternal mortality, an increase in access to HIV treatment to 39% of eligible adults and expanded coverage of 57% with water supply and 45% with sanitation services .

1.5 The programme will continue to be governed by the current Memorandum of Understanding between 18 donors and the GoM. The Memorandum requires decisions on commitment of budget support to be made following an annual review of performance against a Performance Assessment Framework (PAF). The PAF is government's own instrument, approved by Parliament and contains a mixture of output and input targets.

1.6 Once a year there is a Joint Review of performance against this PAF. The Joint Review looks at performance during the previous full budget year. Following the Review a decision is made on progress and commitments are made for the next budget year. These commitments can be halted only if there is a fundamental breach of the underlying principles which are defined as the Government's commitment to peace to promoting free, credible and democratic political processes, independence of the judiciary, rule of law, human rights, good governance and probity in public life, including the fight against corruption, commitment to fight poverty and to sound macro-economic

management. Decisions to halt or reduce aid in the event of a breach will, ideally, be made by the joint group of 18 donors.

1.7 The programme will consist of a core and indicative amount. Each year the Secretary of State will be asked to approve a forward balance between the core and indicative amounts as the programme rolls forwards. For each “roll” there will be no indicative amount in the first year, a very small amount in the next year and a larger amount in each of the remaining three years of the roll. We will advise the Secretary of State on the appropriate balance between core and indicative based on a range of factors including the overall size of our aid framework, evidence of continued satisfactory impact from budget support and the fiduciary environment. Our objective is to ensure that core plus indicative funding adds to at least 75% of the programme by 2010. Key complementary interventions will continue with sector support, support to policy reforms and capacity development, and work on strengthening domestic accountability through support to civil society.

## **2. PROGRAMME DETAILS**

### **2.1. PROGRAMME DESCRIPTION**

2.1.1 The programme **goal** is poverty reduction, its **purpose** is to increase GoM’s financial, policy and institutional capacity to implement its poverty reduction programmes and reach its poverty reduction and growth goals.

2.1.2 The programme will provide a growing share of DFID Mozambique’s aid framework as budget support. With the aim, subject to satisfactory progress, of reaching 75% of the programme as budget support by 2010.

2.1.3 The programme will be provided as rolling support over a five year period. Each year a decision will be taken by the Secretary of State on a new outer year and the “shape” of the roll, including the balance between the core and indicative components. The first year of the programme will always be 100% core. We recommend that the second year has a very small indicative component and the outer three years have more flexibility to deal with uncertainty.

2.1.4 Total funds requested are £236m (option 2 in table below). Because there is current uncertainty about the aid framework this amount is an upper bound and may exceed the total possible commitment if the aid framework is less ambitious than we have assumed. The proposed core commitment for all five years is for an annual disbursement of £40 million from 07/08 onwards (in real terms). The core plus indicative amounts will add to £60m by 2010/11 under option 2.

**PRBS (core + indicative) steadily grows to 75% of Programme by 2010/11**

£ million	2006/07	2007/08	2008/09	2009/10	2010/11	Total Programme Envelope
<b>Option 1</b> Aid Framework constant (real)	Core 36	Core 40 Indicative 1	Core 41 Indicative 2	Core 42 Indicative 4	Core 44 Indicative 5	
<b>Total</b>	<b>36</b>	<b>41</b>	<b>43</b>	<b>46</b>	<b>49</b>	<b>215</b>
<b>Option 2</b> Aid Framework increasing in line with Mozambican GDP growth	Core 36	Core 40 Indicative 1	Core 41 Indicative 5	Core 43 Indicative 10	Core 44 Indicative 16	
<b>Total</b>	<b>36</b>	<b>41</b>	<b>46</b>	<b>53</b>	<b>60</b>	<b>236</b>

2.1.5 Each year we will request funding approval for a new outer year 5. We will support such requests with a summary of the Joint Review outcome, complemented by the following analytical updates:

- Population and Housing Census (2008)
- Full Public Financial Management Assessments (end 2007 and 2010, complemented with yearly updates)
- Household Budget Survey (2008)
- Demographic and Health Survey (2009)
- National and Presidential elections (2009)
- PARPA II completion and PARPA II successor programme (2009-10)
- Value for money audits (1 sector per year starting with the Justice sector in 2006)
- Sector tracker studies (timetable to be agreed)

### **Expected Outputs**

2.1.6 The finance will support the expenditure priorities set out in the Government's PARPA (Mozambique's second PRSP). The PARPA policy framework will last until 2009. Beyond 2009 we expect Government to revert to its own policy and planning tools, including a five year plan and rolling Medium Term Expenditure Priorities.

2.1.7 A near full draft of the PARPA is available which sets out probable outcome targets. But these are still tentative, the GoM is still finalising detailed expenditure plans, costings and related outcomes for the next 4 years. There remain several uncertainties, eg over ambition in HIV treatment. Based on the current (near final) draft we expect the key outcome deliverables to be:-

### **Key expected PARPA II outcomes**

Indicator (Outcome)	PARPA II Target for 2009 (compared with 2003)	PARPA II target as projection to MDG <sup>1</sup>	Govt / UN agreed likelihood of meeting MDG <sup>2</sup>
Poverty	54% to 45%, resulting in 2m fewer living in poverty by 2009		
GDP	7% per annum	N/A	N/A
NO TARGET FOR REVERSING SPREAD – targets include: % of HIV positive pregnant women that receive prophylaxis treatment for the prevention of vertical transmission of HIV	3% (2005) to 22%		
Reduction in child (under 5) mortality rate, deaths per 1000 live births	178 to 135, resulting in 30,000 fewer deaths per year by 2009		
Reduction in maternal mortality rates, per 100,000 births	408 to 350, resulting in 500 fewer deaths per year by 2009		
Births attended by skilled birth attendant	48% to 56%, resulting in 80,000 more births attended by 2009		
Primary net enrolment	83% to 93%, resulting in 400,000 more children enrolled by 2009.		
Sanitation coverage rate	33% (2004) to 40% (rural) 33% (2004) to 55% (urban) Result is 2.5m more people with access to improved sanitation by 2009		
Access to safe drinking water	41% to 57% (rural) 36% to 60% (urban) Result is 3.5m more people with access to improved water supply by 2009		

2.1.8 The first coloured column in this table shows the expected PARPA outcome. It shows that most are on a straight line track towards the 2015 MDG Targets. The risks of missing these targets are discussed in the rest of this document. Some key service delivery targets for 2005 (eg HIV and water) have already been missed and the Joint Review in April 2006 will discuss this in more detail. The final column of this table gives a joint GoM and UN *traffic light* assessment of the final likelihood of reaching the MDG in Mozambique in 2015. There is still pessimism about whether the final 2015 targets will be met. This reflects uncertainty over aid volumes and the real difficulty in making progress over the final period during 2009 – 2015, when it will be necessary to expand service coverage to the most remote and most disadvantaged populations.

2.1.9 We will appraise the final GoM expenditure policies after the Mid Year Review (September/October). At this time we will also confirm the more

<sup>1</sup> Based on a straight-line projection to the MDG target

<sup>2</sup> Assessment of likelihood of meeting the MDG target agreed by GoM and UNDP as published in UN Mozambique MDG Report 2005. Red indicates unlikely; amber, potentially; and green, probably.

detailed trajectory of output/service deliverables that will form the core of the results based performance framework for this budget support programme. Our appraisal will also include a more detailed assessment of the balance between ambition and realism in the PARPA in the light of more detailed information on costs and success or failure in reaching key 2005 performance targets.

## **Policy Dialogue**

2.1.10 In addition to providing financial resources, the PRBS programme also entails policy dialogue around the GoM's poverty reduction programme. DFID's and other donors' expertise, in-house or contracted, is available to advise the Government on policies, provide challenge and invest in continued assessment of policy impact. Policy dialogue is structured through sector working groups, chaired by a GoM representative from the relevant Ministry and with donor and civil society representation.

2.1.11 The programme will continue to be provided under the existing joint Memorandum of Understanding between 18 donors and the Government. The MoU provides for two key yearly events for structured policy dialogue. The first is the Joint Review which is primarily backwards looking and reviews progress in the previous year, whereas the Mid-Year Review is forward looking and used to agree policy priorities for the next 3 years (on a rolling basis).

## **2.2 PROGRAMME APPRAISAL**

Annexes 4 and 5 provide full economic, social, institutional, political and corruption appraisals. The key appraisal issues are those affecting the risk of delivery.

### **2.2.1 Background**

2.2.1.1 Total PRBS from all donors in Mozambique has grown from only 29.5m US dollars in 2000 (3.5% of ODA) to 239.4m dollars in 2004 (24% of ODA) while overall ODA has remained relatively stable at around 1bn dollars. This significant increase in the use of the budget support instrument has enabled the overall GoM budget to grow by 36% between 2000 and 2004, with PRBS representing 16.8% of the total budget in 2004.

2.2.1.2 The volume of budgetary funding for the PARPA priority sectors<sup>3</sup> has grown at least in the same proportion. The draft report of the Joint Evaluation of general budget support says that, "PRBS in Mozambique has played a significant role in supporting the continued rapid expansion of

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<sup>3</sup> Education, Health, Agriculture, Infrastructure, Governance, and Other (social action, labour, and mineral resources)

expenditures for pro-poor service delivery since 2000 and has, in particular, made it easier for GoM to finance the recurrent cost of public services”.

2.2.1.3 This shift in modalities against a background of constant aid (and hence declining aid per capita) has underpinned a significant improvement in service delivery and outcomes. Health service units and health personnel have grown annually by 3.7% and 7% respectively between 2001 and 2004, although the health service still covers less than 50% of the population. Child mortality was reduced from 219 (per 1000 live births) to 178 between 1997 and 2003. Over the same period maternal mortality rates are estimated to have halved, though they remain very high at 408 per 100,000 live births. The education system has expanded dramatically. The number of children in school increased by 50% between 2000 and 2004, from 2.3 m in 2000 to 3.7 m and since 1999, an average of 3,300 new classrooms have been built each year.

2.2.1.4 Mozambique currently receives about 15% of GDP from aid. There are 49 bilateral and multilateral donors in Mozambique, financing about one half of public expenditure. Because of the plethora of projects off budget only one half of public expenditure is on-budget. GoM capacity is extremely limited. The number of donors and the amount of aid off budget creates greater co-ordination and management problems than in other DFID PSA countries. The case for harmonisation and alignment around one national planning, budgeting and monitoring system is therefore particularly strong in Mozambique

2.2.1.5 The coming together of 18 budget support donors (the Group of 18) has led to a step change in the relationship between government and donors. The 18 donors are working within one performance framework, are having one co-ordinated policy dialogue with government and have delivered a significant improvement in the predictability of financing within each budget year.

2.2.1.6 Related to this change in behaviour and the changed approach to policy dialogue and conditionality the Joint Evaluation report also noted PRBSs strong effect in establishing and maintaining a comprehensive reform policy increasingly owned by Government. And the increased predictability of aid is improving government’s fiscal processes. Budgeting and planning are beginning to be driven by government (instead of donors) and the proportion of public expenditure that is subject to parliamentary scrutiny has increased. This, in turn, is delivering improvements in accountability.

2.2.1.7 The Government will finalise the new PARPA in March 2006 but the latest draft was published in November 2005 (see Annex 6 for a summary of the draft). In many aspects the draft is strong, including a clear sense of government ownership, a balanced, results-based vision around the three pillars of governance, human capital and economic development, and a clear intention to locate the PARPA within the formal policy, parliamentary and budgetary processes of government.

2.2.1.8 The PARPA sets out a fairly ambitious programme of delivery (see Annex 3 on developmental outcomes). There is still some concern that the programme is overly ambitious and targets may not be met. This is a difficult judgement to make in the context of continuing uncertainty about total aid flows, but expanding service delivery in a sparsely populated country and through a public service with high rates of HIV, remains tough. Some key service delivery targets for 2005, eg in HIV and roads, have been missed.

2.2.1.9 If the PARPA targets are met Mozambique would by 2009 be on-track for the majority of the MDGs, including those for poverty reduction, health and water and sanitation. By 2009, the GoM aims to reduce poverty to 45% - the MDG target is 44% by 2015; increase the primary completion rate from 39% to 59% - an ambitious target though still off-track; reduce child mortality rate from 178 per 1000 live births to 135 and maternal mortality from 408 per 100,000 live births to 350 – both on-track to meet the MDGs; and, increase water and sanitation coverage significantly to get this on-track. The target to increase water coverage from 36% to 57% by 2009 would mean that 3.5 million more people would have access to safe water. HIV targets are to reduce new infections and substantially increase those with access to treatment. These are, however, likely to be insufficient to stem the rise in HIV prevalence in the short to medium-term.

2.2.1.10 The PARPA has not yet been finalised, nor costed or complemented with a new MTEF. The costings are due in March 2006 and the MTEF in April 2006. Under this current government we expect expenditure policies to remain pro-poor. Under the last PARPA the Government committed to allocating at least 65% of public expenditure to the PARPA priority sectors (agriculture, health, water, roads and infrastructure) and adhered to this commitment. In contrast little money is spent on security and defence. A recent PEFA based public financial management assessment (see annex 2 on fiduciary risk) notes improved links between outcomes, policies and resource allocation and we expect the new MTEF to maintain or deepen the focus on pro-poor expenditure.

2.2.1.11 We are less clear about the expected pattern of unit costs in Mozambique and hence about the exact costs of delivering the targets in the PARPA. Some of the “easy-wins” (eg expanding access to ARTs in Maputo City) will not be so easily available in PARPA 2 and we expect to see unit costs of reaching ambitious coverage in service delivery and maintaining quality (eg in education) increase rather than decrease. We may not get as fast a pace of change or of impact during this period of budget support as from the last. Broadly, we are still encouraging Government to stay ambitious and we are working carefully at sector level to tackle these issues and flesh out better costings and support GoM to make the right policy choices. In some sectors, eg Education, the Government has taken careful decisions to maintain the pace of delivery. For example reducing the length of teacher training to one year, decentralising school building. But the process will be iterative and we will report regularly on the key tension between ambition versus realism.

2.2.1.12 The Government of Mozambique has made clear that budget support is its preferred aid modality to finance the PARPA and the Prime Minister has called for donors to move towards 65% budget support (on average) and has specifically asked the UK to move above that figure recognising the leading role the UK has taken in budget support.

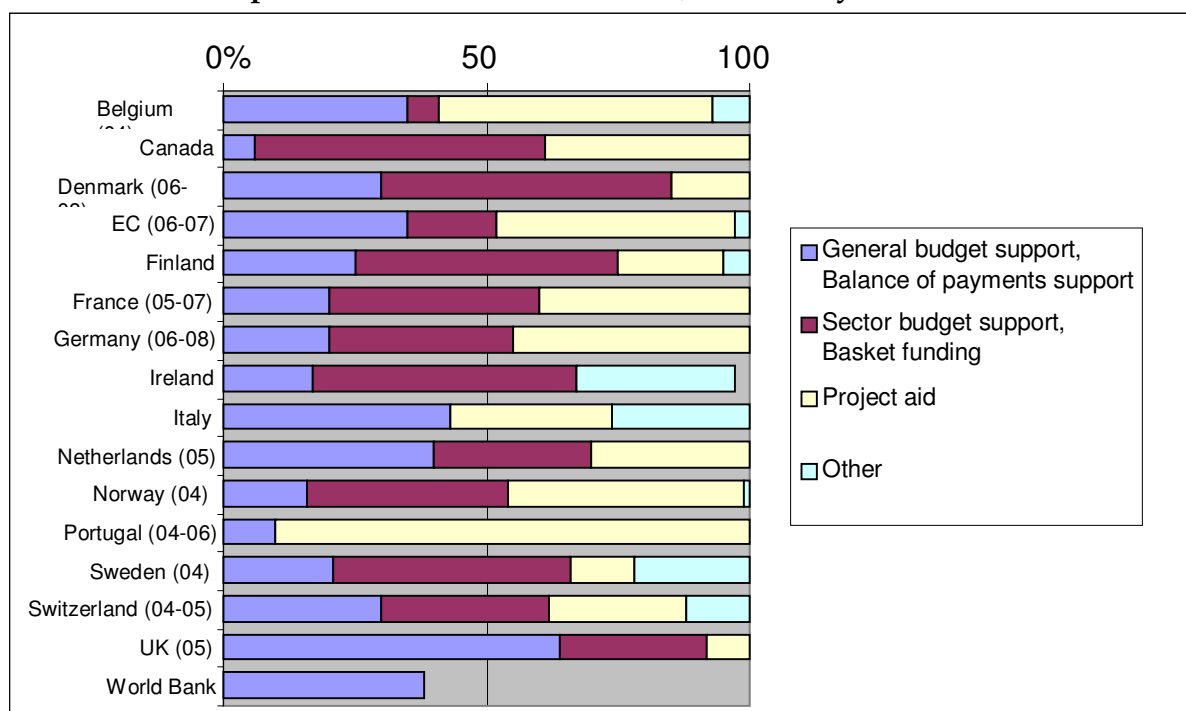
### **Compliance with DFID Policies and the Country Assistance Plan for Mozambique**

2.2.1.13 The approach set out in this project memorandum is consistent with DFID Policies on Budget Support and with the Country Assistance Plan for Mozambique. DFID's whole programme approach has resulted in an integrated country programme consisting of PRBS, complemented by a substantial programme of coordinated technical assistance targeted at raising the efficiency, effectiveness, and accountability of government, and action to promote demand from civil society for pro-poor policies. In addition, DFID remains engaged at the sector level in order to help shape the sector-level aid programmes towards better aid practices that are more fully aligned and integrated in Government systems, and in order to deepen the focus on results and improved service delivery in key sectors. How quickly we will graduate out of sector level budget support and increase the share of general budget support up to and beyond 75% will depend on the extent to which progress is made on this sector agenda and continuing clear evidence of results from budget support. A new CAP building from this PRBS programme will be developed during 2006.

### **Other Donors Providing PRBS**

2.2.1.14 Eighteen donors now provide PRBS in Mozambique through the common MoU. However, few donors provide a large share of their programme as PRBS (see Graph One). DFID accounts for only 10% of aid but in 2006, the DFID PRBS disbursement will represent 22% of total PRBS in Mozambique. Looking forwards it is unclear whether the PARIS agenda will push other countries to move increasingly towards budget support or whether the percentage of aid as budget support is at a plateau. A critical mass of PRBS is needed for PRBS to make serious inroads in improving aid effectiveness. It is clear, therefore, that there is a key role for DFID to continue to drive this agenda and to stay in the vanguard. It is likely that in the short to medium term DFID will remain the largest budget support donor in Mozambique.

**Graph 1: Shares of aid modalities, different years**



## **2.2.2. Approach**

2.2.2.1 The two key design issues for this programme are extending the predictability of budget support and alignment with DFID's policy on conditionality.

**Our basic proposal is a 5 year rolling programme with a 100% core component for the first year, a very small indicative amount for the next year, followed by a core element which ensures Mozambique the same (real) total amount of budget support in the outer three years. Any decrease from the core components could only occur as a result of joint G18 decisions in the context of a perceived breach of the underlying principles, which could – inter alia – result from unsatisfactory PAF performance.**

### **Predictability**

2.2.2.2 Considerable progress has been made in improving the predictability of aid within the budget year. But the medium to long term predictability of budget support remains weak. None of the G18 donors having a rolling programming framework and only few provide firm commitments beyond year 1. As long as predictability is not improved, GoM will remain wary about scaling up public expenditure. The G18 is starting to realise this and our rolling 5-year framework with a core component that remains stable in real

terms raises the standard. We will raise the issue of improving medium-term predictability with GoM and the G18 to encourage other donors to follow suit.

2.2.2.3 A predictable and rolling five-year programme will ensure that the government always has a clear view of UK PRBS resources for the next five years. This compares with the current situation where the government has no idea at all about UK budget support from 2007.

2.2.2.4 The programme would be rolled every year. There are arguments for rolling less frequently and having higher profile “rolls” (eg akin to UK Spending Round processes). However, the GoM will be rolling the Performance Framework each year and we want to keep up with that, so we can always have a firm commitment underpinning the agreed Framework.

2.2.2.5 Section 5.2 sets out in more detail the decision-making process. We propose two points each year when we will seek a decision from the Secretary of State, one at the commitment stage and one at the disbursement stage.

### **Conditionality**

2.2.2.6 Whereas any decrease from the core components could only occur as a result of joint G18 decisions in the context of a perceived breach of the underlying principles, increases could be made unilaterally and would come in the following 2 ways:

- From aid allocation decisions through UK RAR processes;
- Increasing the share of PRBS in the overall Mozambique programme based on positive trends in service delivery outcomes, a reduction in fiduciary risk, positive PAF performance, and marked improvements in harmonisation and alignment of external assistance at sector level.

2.2.2.7 The new PARPA sets the policy framework for the next 4 years. As in the past, that policy framework will be operationalised in yearly ‘Social and Economic Plans’. Each yearly plan is accompanied by a three-year Performance Assessment Framework (PAF), which is rolled over every year (cf. annex 7 for the latest PAF).

2.2.2.8 The PAF also serves as the framework that the G18 uses to track progress and make decisions on budget support commitments. Donors still have considerable weight in the design and content of the PAF but it is formally a government instrument and forms part of the government’s own monitoring and planning instruments and is approved by Parliament.

2.2.2.9 The PAF is reviewed each year during a Joint Review by a “tripartite” group of Government, donors, and civil society. The Joint Review looks at performance during the previous full budget year. Following the Review a decision is made on progress, and commitments are made for the next budget year. These commitments can only be halted if a series of underlying fundamental principles are breached by government. So, for example, funding into the 2007 budget is based on performance in 2005. The

current PAF includes a mix of policy activity and outcome indicators. There are no privatisation or economic policy conditions and the way the PAF is used is in line with DFID's conditionality policy. There are no specific triggers but rather a broad assessment of progress against the framework (although some donors do select specific PAF indicators in their conditionality framework).

2.2.2.10 The PAF does not include performance on political or human rights issues. These issues are included in the underlying principles. These principles are defined in the multi-donor MoU as the Government's commitment to peace and to promoting free, credible and democratic political processes, independence of the judiciary, rule of law, human rights, good governance and probity in public life, including the fight against corruption, commitment to fight poverty, and to sound macro-economic policies. This definition is broadly similar to the circumstances identified in our policy on conditionality under which aid can be reduced, interrupted or suspended.

2.2.2.11 The political and human rights issues are not benchmarked and currently there is no clear donor consensus about the details of a reasonable political development path for Mozambique, nor about appropriate responses to deviations from this path. Working closely with the High Commission we have now kick-started a process with others to determine how we can effectively monitor these issues, get early warning of potential problems, and then respond appropriately.

2.2.2.12 Although there is no specific and automatic link between unsatisfactory PAF performance and a breach of the MoU underlying principles, it is most likely that, de facto, an unsatisfactory PAF outcome would be interpreted as a lack of commitment to poverty reduction and therefore a breach of underlying principles, or likewise a breach of the Partnership Commitment as defined in the conditionality guidelines. We therefore propose to use the PAF in two ways, first to assess whether Mozambique is not veering away significantly from its poverty reduction objectives (Partnership Commitment), and second, to inform the size of new core and indicative commitments as part of the aid allocation and aid instrument decision process.

### **2.2.3 Economic Appraisal**

2.2.3.1 It is important that budget support is used to underpin a strong macro-economic position. One of the advantages of budget support is that it allows a lower inflation rate and lower domestic debt for a given level of expenditure. However it is also important that the fiscal position is not overly tight; ie with a risk of damaging growth and expenditure prospects in order to achieve tight inflation targets.

2.2.3.2 The Government's medium term fiscal scenario will be finalised with the PARPA and the MTEF. Indications from the draft PARPA and the PRGF are that a prudent fiscal position will be maintained with net domestic

financing moving into negative from 2006 onwards, allowing for a reduction in interest payments on domestic public debt from 0.7% of GDP in 2004 to 0.5% of GDP by 2008. It is unclear whether this will feed through into lower final interest rates to business or what the impact on the volume of private sector credit will be - given the severe constraints on private sector borrowing in the real economy, particularly around the lack of contract enforcement.

### ***Fiscal indicators - PRGF projections (December 2005)***

<i>%GDP unless specified otherwise</i>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Real GDP growth	7.7	7.9	7.0	7.0
CPI (annual average)	6.3	7.5	6.5	5.7
Government domestic revenues	13.8	14.5	15.3	15.5
Government expenditure and net lending	27.1	27.5	27.8	26.8
Total grants	7.7	9.1	8.5	8.0
Overall Balance after grants	-5.6	-3.9	-3.9	-3.3
External financing (incl. debt relief)	5.4	5.1	5.2	4.6
Net domestic financing	0.2	-1.3	-1.3	-1.3
Gross international reserves (months of imports)	4.6	4.4	4.2	4.3
NPV public external debt	21.0	20.9	21.3	21.6
Domestic public debt (incl. securities for central bank recapitalisation)	2.2	4.7	4.1	3.6

2.2.3.3 There are some concerns that the fiscal position in the draft PARPA is too tight with an improving primary domestic deficit which is forecast to move into surplus in 2006. We are continuing to discuss this with GoM and the IMF. There are clearly benefits from reducing the stock of domestic debt but in the medium to longer term Mozambique may be able to sustain a slightly higher deficit. We expect that the GoM and IMF would only be prepared to move away from the current conservative position if there is considerably more certainty about medium to long-term aid flows.

2.2.3.4 During PARPA I, the agreement was that 65% of expenditure (excl. bank restructuring costs, net lending, and interest payments)<sup>4</sup> would go to the PARPA priority sectors. This was achieved although the lumpiness of infrastructure expenditure led to some small variations around the 65%.

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<sup>4</sup> Note that budgetary figures do not represent the full picture of public expenditure in Mozambique as a considerable amount of donor-financed public expenditure remains off-budget. A Government-donor task force was set up in 2005 to address this issue.

### **Priority Sectors' Share of Total Expenditure**

	1999	2000	2001	2002	2003	2004 est.	2005 proj.	2006 proj.
Education	16.1	19.8	23.3	18.0	17.8	20.9	19.9	20.1
Health	13.4	12.9	9.9	12.6	14.9	10.5	12.7	14.7
HIV/AIDS	0	0	0.5	0.8	0.3	0.4	0.7	1.5
Infrastructure	13.3	15.7	17.4	16.5	11.8	13.2	18.7	16.0
Agriculture and rural development	5.2	6.3	3.4	5.5	6.9	4.4	3.9	3.3
Governance and judicial system	8.9	7.8	7.7	7.7	8.9	9.7	8.9	12.6
Other priority (social action, labour and employment, mineral resources and energy)	5	5.6	3.6	4.5	5.1	3.9	2.2	1.5
<b>Total</b>	<b>61.9</b>	<b>68.1</b>	<b>65.8</b>	<b>65.6</b>	<b>65.7</b>	<b>63</b>	<b>66.3</b>	<b>69.5</b>

Source: IMF

#### **2.2.4 Social Appraisal**

2.2.4.1 There are two critical appraisal issues. First whether aid is being provided into an environment where underlying trends and actions are tending to promote social cohesion and second, but related, whether all groups in society will be able to access the benefits of growth and improved service delivery.

2.2.4.2 PARPA II considers the consolidation of social stability and progress on social justice as basic conditions for the achievement of its growth and poverty reduction targets. On the specific issue of gender equality, PARPA II fares well. It places gender inequality as one of the key issues to be addressed over coming years. The yawning gap in literacy rates between men and women<sup>5</sup> and the disproportionately high rates of HIV infection among women are indicative of the unequal power relations between men and women and the marginalisation of women in Mozambican society. The Mozambican constitution guarantees equal rights and opportunities between men and women – PARPA II re-states this commitment. Moreover, it spells out a series of prioritised actions to promote gender equality and the empowerment of women.

2.2.4.3 But there is little analysis in the Plan of the forces and factors at play which could undermine social stability and threaten progress made to date on social justice. For example, a profile of the (differential) access of various racial, ethno-linguistic groups to economic and social rights and opportunities is not available. The inadequacy of the analysis reflects a broader lack of relevant data and information.

<sup>5</sup> Over two thirds of women of illiterate compared to just over a third of men

2.2.4.4 Access to economic and social services and opportunities is also related to where one lives. Overall, the southern part of the country is better served than the central and northern regions. Qualitative data also shows that people living in more remote communities believe that those living near the administrative centres benefit more from government support as they have better access to services. There is a strong feeling of abandonment among those living in remote rural areas. Such feelings of abandonment can either grow and foment social unrest or else contribute to an increasing 'disconnection' from the formal system. PARPA II does not tackle issues of regional inequalities. It does acknowledge that increased income inequality is sometimes associated with rapidly growing economies like Mozambique, recognises the potential destabilising effects and calls for close monitoring of these trends.

2.2.4.5 In conclusion there are social threats and risks to unequal access to services in Mozambique. The GoM is alive to some of these issues and PARPA II sets out a relatively ambitious social agenda for the next four years. We will continue to work with GoM on broader issues around social inclusion, working with others to invest in new information and analysis and will carefully monitor inequality and the risks of destabilisation and disconnect.

## **2.2.5 Institutional Appraisal**

2.2.5.1 Improving the capacity of Mozambican institutions, including parliament, will be critical to ensuring that the PARPA and this PRBS programme delivers the results we want. The PARPA recognises this and also the enormity of the challenge.

2.2.5.2 Mozambique emerged from civil war with few institutions intact. The country has been rebuilt over the past decade at an impressive rate and continues on a positive trajectory. However, even today, levels of educational attainment are relatively low and few professionally qualified individuals are choosing the public sector for their careers. The public sector in Mozambique is not overly bloated and in many cases there are simply too few qualified personnel to do the work. Outside Maputo and one or two other cities public sector capacity is extremely low, is being eroded by HIV and public services are rudimentary.

2.2.5.3 The generic problems facing the public sector in Mozambique have a clear negative impact on the GoM's capacity to deliver basic services to all. Both the health and education sectors are plagued by a critical shortage of suitably qualified 'front-line' personnel. Institutional weaknesses – in financial and human resource management, communications, planning and supervision – cause a whole series of bottlenecks that currently prevent additional financial resources from translating smoothly into better service delivery outputs.

2.2.5.4 On the 'demand side' of service delivery, barriers to access include among other factors the continued presence of formal and informal

fees for basic services. In health, there is evidence of a shift in the government's position towards making primary health care free at the point of service. DFID will work with the Ministry of Health and other partners to support the implementation of free basic health care. In education, user fees at primary level were abolished in 2004. Informal fee charging needs to be tackled as part of GoM's overall anti-corruption strategy.

## **2.2.6 Political and Corruption Appraisal**

2.2.6.1 Although President Guebuza's government has been in power for more than a year, the international community remains unsure about the direction in which Mozambique is now moving. Guebuza is perceived as one of the Frelimo "Old Guard" who is expected to tighten the Party's grip on the machinery of the State. The deep political division between Frelimo and Renamo shows little sign of diminishing with very limited constructive political engagement on issues in Parliament or elsewhere.

2.2.6.2 Neither Parliament, nor the legal and judicial sectors currently provide an effective check on the Executive. This is a result of both limited capacity and weak political will. This has led to a climate of political impunity in which the conduct of government is not effectively challenged and high-level corruption is rarely investigated or punished. The political and economic interests of the elite are intimately entwined and there is no public disclosure of assets by public servants. Sections of the media have been prepared to speak out against the many conflicts of interest at senior levels of government but there are few signs as yet that this is having a positive impact either on the behaviour of politicians or on the demands voiced by civil society.

2.2.6.3 Guebuza has spoken out strongly against corruption and waste in the public sector. However, his rhetoric has yet to be translated into concrete results. An Anti-corruption Strategy and Action Plan, which have been consulted upon, will be published this year. It remains to be seen how much political commitment will accompany them.

2.2.6.4 The weak accountability of Government and the desultory application of the law (and their consequent effects on levels of corruption) are the major governance issues facing Mozambique. Donor support in these areas has been fragmented and, to date, largely ineffective. Analysis of both the underlying problems and the opportunities for reform - will be key to developing DFID's and other donors' country assistance plans in 2006.

2.2.6.5 The lack of clarity about Guebuza's vision for Mozambique's political governance, coupled with recent events in Ethiopia and Uganda, has also prompted donors (led by DFID and the BHC) to start developing a more thorough analysis of the trajectory of political development and democratisation in Mozambique. The aim will be to identify where the vulnerabilities and risks might lie and to enable donors to think more systematically about what sort of early-warning and problem-resolution

processes might be appropriate. A dialogue around this analysis will also give GoM a more transparent picture of donor concerns and expectations.

## **2.2.7. Environmental Appraisal**

2.2.7.1 The poor in Mozambique are heavily dependent on the environment both for income generation and consumption. The PARPA highlights the important role of natural resources and environment to combat poverty. It identifies environment as one of the cross-cutting issues within the PARPA. The capacity of the Ministry of Environment remains limited. The plans are to mainstream environmental management in the implementation of the PARPA II.

2.2.7.2 The Government has committed itself to the preparation of environmental indicators based on the draft compendium of Environmental Statistics. From the donors' side the Dutch are leading this process. However, DFID will support a dialogue through the G18 for the appropriate analysis and development of PRBS indicators which encourage sustainable natural resource management.

2.2.7.3 Water and sanitation are identified as priority areas in the PARPA II however implementation capacity is a concern. The PARPA II sets 2009 targets as 57% water supply and 45% sanitation coverage. DFID is engaging in policy dialogue at a sectoral level on water supply and sanitation issues. We will continue our policy dialogue with Government and other donors in the water and sanitation sectors; and we will continue our engagement and support to access to land and associated natural resources through the DFID led multi-donor 'Community Land Fund Project'.

## **2.3. LESSONS LEARNT & EVALUATION**

2.3.1 The Joint Evaluation of General Budget Support 1994-2004 – Mozambique country report (draft January 2006) notes that PRBS “has been a very successful case of donor-government collaboration, and that general budget support has contributed positively to conditions for economic growth and poverty reduction.” Causality effects were found to be particularly strong in PRBS's contribution to harmonisation and alignment, the proportion of public expenditure that goes through a growing state budget, the strengthening of planning and budgeting systems, policy processes, and macro-economic performance. The main weaknesses were found in TA and capacity building, predictability of PRBS (though improved since 2003), and domestic accountability.

2.3.2 The report also identifies some key lessons learned, which include the need for a more conscious strategy for the management of change and with regard to the role of different aid modalities, the need for further improvements in predictability. A summary of the report is provided in annex 8.

2.3.3 Action is being taken to address the identified weaknesses. DFID is leading a subgroup to improve the effectiveness of TA and capacity building, and we are developing a vision paper on the aid architecture in Mozambique that will seek to set out a process of managed rather than incremental change. Accountability will be a central theme in our new CAP and we will seek to influence other donors to improve the medium-term predictability of PRBS.

### **3. IMPLEMENTATION**

#### **3.1. Management Arrangements**

3.1.1 This PRBS programme forms part of a multi-donor PRBS programme in Mozambique, governed by a multi-donor MoU, which the Secretary of State approved in December 2003 and is attached in annex 1. Commitment and disbursement decisions remain the responsibility of each partner in discussion with GoM, but all partners use a common process to assess progress, and reach a common conclusion on the level of progress achieved.

3.1.2 The overall group of donors is managed by a Troika+ (three bilateral donors, the World Bank and the EC). One bilateral donor is the chair and acts to co-ordinate the group of donors, including securing consensus on key policy issues and acting as the main interface with government. DFID had the chair in 2003/04 and we may put ourselves forward for the chair again in 2008. The next chair will be the Dutch (2006) and after that we expect Norway or the EC to be voted in. Working through this streamlined structure provides clear benefits for government. For the UK it means that we have to be prepared to subordinate our direct bilateral relationship with government to the wider process and managing our relationship with the wider donor group is key.

3.1.3 The Project Officer will be the Economic Advisor, currently Simon Vanden Broeke. The Senior Governance Advisor, currently Jane Rintoul, is responsible for the assessment of Fiduciary Risk. In addition, all advisors are closely engaged in policy dialogue through the different working groups with support from the programme staff.

#### **3.2. Timing**

3.2.1 In the first instance the length of the programme (5 years) would respond to one year of performance from the last year of performance from the old PARPA performance framework (ie 2005) and cover the length of the policy framework in the new PARPA.

<i>Funds disbursed in Mozambique Budget Year :</i>	<i>Based on a review of performance in:</i>	<i>With the review carried out in April:</i>	<i>Showing in UK Financial Year:</i>
2007	2005	2006	2006/07
2008	2006 (first year of new PARPA)	2007	2007/08
2009	2007	2008	2008/09 (new UK RAR)
2010	2008	2009	2009/10
2011	2009 (last year of PARPA and election year)	2010	2010/11

### **Decision Points:**

3.2.2 In line with current practice in Mozambique there will be a single annual tranche. This will offer **two points** each year when we will seek a decision from the Secretary of State, one at the commitment stage and one at the disbursement stage:

#### Decision point 1: Commitment for core and indicative components

3.2.3 The MoU specifies that within four weeks of the Joint Review of PAF performance in the previous year, donors must make their PRBS commitments for the next GOM budget year. This permits integration of firm commitments at the start of the budget preparation cycle and is in line with the UK conditionality guidelines.

3.2.4 In practice, this means DFID will need to confirm the core commitment for the coming budget year in April this year based on a satisfactory review of the prior year's performance. From next year onwards, DFID will need to decide on turning the indicative component of year 2 into a core component for year 1.

3.2.5 At the same time, in the context of a rolling programme, DFID would need to decide whether or not to increase the size of the core components for years 2 to 5, whether or not to revise the size of indicative components and decide on new core and indicative components for the new year 5.

#### Decision point 2: Disbursement decision year 1

3.2.6 Given the Government's typical cash flow profile, we propose to continue disbursing in the 1<sup>st</sup> quarter of the Government's fiscal year, which

coincides with DFID's 4<sup>th</sup> fiscal year quarter. We propose to submit in December each year and disburse the yearly tranche in January.

3.2.7 In line with the UK's conditionality guidelines and the multidonor MoU, we would recommend full disbursement of the committed amount, unless there is a breach of underlying principles. In those circumstances, we would recommend a response based on an assessment of the underlying issue at cause and following consultation with Government and other PRBS donors.

3.2.8 Decision points could also occur at other times but only in case of a potential breach of underlying principles, in which case we will seek the Secretary of State's view on the appropriate response.

### **3.3. Funding**

3.3.1 Total funds requested are £236m. Because there is current uncertainty about the aid framework this amount is an upper bound and may exceed the total possible commitment if the aid framework is less ambitious than we have assumed.

3.3.2 The DFID grant forms part of a multi-donor PRBS programme of support to GoM. There are now 18 donors providing PRBS under the common MoU. The following table sets out the committed disbursements for 2006.

#### ***Committed disbursements for 2006***

	<i>(Millions of USD)</i>
DFID	61.8
World Bank	60
EC	54.5
Sweden	25.2
Netherlands	21.4
Germany	11.9
Norway	11.1
Denmark	9.6
Ireland	7.2
Sweden	6.6
Finland	6
Italy	3.9
Spain	3.6
France	3.6
Belgium	3.6
Canada	2.2
Portugal	1.5
<b>Total:</b>	<b>283.5</b>

3.3.3 There is no complete picture of PRBS funding beyond 2006 but the expected scenario is a gradual increase in real terms with either new donors

signing up to the MoU (the AfDB became a signatory to the MoU in February 2006) or existing MoU donors increasing their ODA to Mozambique or the share of PRBS.

### **3.4. Contracting and Procurement**

3.4.1 All procurement from the grant will be done by GoM in accordance with its own procurement regulation and procedures. A new procurement regulation, which substantially follows international standards (98% according to the WB specialist), was approved in December 2005 after extensive consultations and with close World Bank involvement. The assessment of GoM's procurement systems takes place within the context of overall fiduciary risk assessments and in the context of the yearly Joint Reviews.

### **3.5. Accounting / Audit**

3.5.1 The accounting and auditing arrangements are set out in the MoU annexes 6,7, and 8 (See Annex 1). There will be annual audits 1) of the financial records of Programme Aid by a qualified auditing company, contracted and financed by GoM; 2) of budget execution by Mozambique's Auditor General, and 3) of expenditure performance in relation to results (value for money) by the Ministry of Finance Internal Audit Department jointly with selected consultants for one sector each year (starting with the Justice Sector). There will also be new tracker studies at sector level.

3.5.2 Upon the Secretary of State's approval to disburse, CAB (Crown Agents Bank) will make the transfer into the dedicated PRBS account.

### **3.6. Monitoring and Reporting**

3.6.1 The reporting and monitoring arrangements are set out in more detail in section 6, and annexes 3 and 4 of the MoU. The monitoring framework is one of mutual accountability.

3.6.2 Monitoring and dialogue processes will follow an annual review process aligned with GoM's planning, budgeting and monitoring cycle. Monitoring and dialogue processes will use reports outlined in the MoU, focusing on the documents submitted by GoM to Parliament. All formal performance assessments will be undertaken jointly by GoM and programme aid partners and not bilaterally. There will be two joint GoM-PAP reviews annually on Programme Aid: the annual review (following the production of the Balanço de PES) and a mid-year review (prior to submission of the PES and OE to Parliament). Budget Working Group meetings will take place four times a year, discussing budget execution up to the end of the previous quarter, based on budget execution reports. PAPs and GoM will agree on the detailed disbursement schedule at the December meeting. GoM will monitor donor performance annually against an agreed set of behaviour targets.

3.6.3 DFID engagement in the monitoring processes will come through our membership of the G18 structure and inputs from the DFID advisory team into the government/donor working groups that support the G18.

#### **4. RISKS**

4.1 The following table summarises the risk assessment, and a fiduciary risk assessment is included below. Although fiduciary risk is assessed as medium to high (and reducing), **the overall risk level is judged to be medium**. The main reasons are a track record of improving service delivery outcomes through government systems, a credible government programme for the next 4 years, and the likelihood of continued political commitment to poverty reduction. The risk of external shocks and limited institutional capacity undermining further progress are real and will need to be managed. Risk mitigation measures are included in the table.

##### ***Risk Assessment and Risk Mitigation Measures***

<b>Risk</b>	<b>Probability</b>	<b>Impact</b>	<b>Assessment / Mitigation Measures</b>
Fiduciary risks seriously undermine progress with service delivery outcomes	Medium	High	<p>Fiduciary risk, though medium to high, is decreasing and GoM has a track record of increasing service delivery in the context of a significant shift in modalities over the last 5 years towards modalities that use government systems such as PRBS.</p> <p>Regular PFMA assessments will be undertaken with yearly updates and close attention to fiduciary risk issues in the PAF dialogue processes.</p>
External shocks (aid volatility, adverse weather patterns, terms of trade,) cannot be effectively managed	Medium	High	<p>Mozambique's reserve levels are robust and Mozambique's economy has shown itself relatively resilient in the face of the recent deterioration in the terms of trade due to the oil price shock. However, adverse weather conditions can lead to localised food crises and Mozambique's high aid dependence means that its fiscal situation is highly dependent on continued donor support.</p> <p>The GoM/G18 established consultation mechanisms should help avoiding substantial ad hoc interruptions in PRBS but rather provide for a coordinated response. Donors have started a political development benchmarking exercise to strengthen the analytical foundations for donor responses to adverse political events if they were to arise. Our high core component and the proviso that we will not reduce PRBS unilaterally should also contribute to a measured response to any adverse developments. The food security situation is regularly monitored and mechanisms for</p>

			disaster-related relief are in place.
Institutional capacity constrains effective planning, prioritisation and delivery of pro-poor public policies	Medium	High	<p>Mozambique still has characteristics of a post-conflict country in that institutional capacity is very limited. The ongoing public sector reforms are tackling capacity issues with varying degrees of success. Part of the problem is that capacity development and technical assistance is still poorly coordinated and far from being government-led.</p> <p>A G18 subgroup was set up with the purpose of reviewing and strengthening the framework for capacity development support.</p>
Reduced political commitment to reforms; policy priorities are not maintained beyond the PARPA and into the next electoral cycle,	Low	High	<p>Indications are that the recently-elected government will maintain a commitment to reforms as it wants to achieve its poverty reduction and economic growth objectives. As long as the current reform agenda continues to deliver results, it is unlikely that even post-election, a significant policy shift would occur. The more so, given that Mozambique is highly aid-dependent, including for its core budget, and could ill afford to veer away substantially from its poverty reduction programmes.</p>