Sida Evaluation 99/32

Programme Assistance to Mozambique

A joint donor review

Grayson Clarke
Jens Claussen
Rolf Kappel
Jytte Laursen
Stefan Sjölander

Department for Africa

Programme Assistance to Mozambique

A joint donor review

Grayson Clarke
Jens Claussen
Rolf Kappel
Jytte Laursen
Stefan Sjölander

Sida Evaluation 99/32

Department for Africa

Evaluation Reports may be ordered from:

Infocenter, Sida
S-105 25 Stockholm
Telephone: (+46) (0)8 795 23 44
Telefax: (+46) (0)8 760 58 95
E-mail: info@sida.se, Homepage http://www.sida.se

Authors: Grayson Clarke, Jens Claussen, Rolf Kappel, Jytte Laursen, Stefan Sjölander.

Sida Evaluation 99/32
Commissioned by Sida, Department for Africa

Registration No.:
Date of Final Report: February 1999
Printed in Stockholm, Sweden 1999
ISBN 91 586 7849 2
ISSN 1401–0402

SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
Address: S-105 25 Stockholm, Sweden. Office: Sveavägen 20, Stockholm
Telephone: +46 (0)8-698 50 00. Telefax: +46 (0)8-20 88 64
Telegram: sida stockholm. Postgiro: 1 56 34–9
E-mail: info@sida.se. Homepage: http://www.sida.se

Table of Contents

Executive summary

Main objectives of the mission

The second Joint Donor Review (JDR) mission (8 to 19 February 1999) was carried out on behalf of five like-minded donors: Denmark, Norway, Sweden, Switzerland and the United Kingdom. It concentrates on a review of what, in the Terms of References (TOR) of the JDR-team, was originally called "macro-financial support".

During the mission, the team-members felt that this term was not well chosen. "Macro-financial assistance" was more seen as a synonym for general balance of payments support and general budget support. The prefix "Macro" certainly does not fully reflect that substantial parts of the financial assistance provided by the five donors come as support tied to specific imports and/or specific sectors. Moreover, parts of the funds can be, and actually are, used to finance technical assistance, i.e. a very special sort of imports. Therefore, to better circumscribe the various forms of financial assistance the five donors provide, the term "programme assistance" has been chosen for the final version of the mission report. This choice follows the traditional definition that programme assistance makes available certain amounts of financial capital or commodities, which are usually tied to negotiated conditions of sectoral and/or overall programmes of policy and institutional reforms.

The JDR-mission in 1999 is in some sense a follow-up of a first mission that took place in May 1998 (at that time without the UK). The aspect of a follow-up already indicates that the five like-minded donors share a common objective, which they intend to follow and strengthen in the future. It is the objective to make their programme assistance more effective and efficient through a better co-ordination of their efforts. Measures may include the pooling of resources and the simplification and unification of procedures and conditions. In addition it may concentrate on better co-ordinated support for institutional, organisational and technical improvements to increase the effectiveness, efficiency, accountability and quality of public action of the Government of Mozambique (GOM). In the period 1998–99 the total of these funds of the five donors adds up to more than 60 Million US-Dollars per year (not including project support).

The main objective of the review was to consider the justification for continuing programme support. The justification has four particular aspects:

1. Whether the Government of Mozambique still needs continuing programme assistance, both to provide forex for essential imports and to maintain and improve essential public services
2. Whether the Government of Mozambique deserves continuing support by pursuing economic policies consistent with objectives agreed with the donors, notably promoting private sector development and poverty alleviation
3. Whether existing mechanisms for providing programme assistance are efficient in terms of meeting agreed objectives, and if not to propose improvements and/or alternative ways of procedures
4. Whether the Government of Mozambique is using all the resources at its disposal in an efficient, effective and transparent way.

The mission in 1999 gave the highest priority to the fourth aspect, i.e. identifying recommendations that may help GOM to improve the transparency, accountability and quality of financial management of all public resources, domestic revenues as well as external funds.

The report is structured as follows. After the executive summary, chapter 2 contains a brief overview of economic performance and major steps of policy reforms in 1998. Chapter 3 reviews current practices of foreign exchange allocation. Chapter 4 discusses the current state of the financial management system in the public sector and ongoing reforms. Chapter 5 reviews briefly the public service and civil service reform. Chapter 6 analyses objectives and practices of various donors in providing programme assistance, and tries to sketch opportunities for better co-ordination. Apart from discussing important issues in the respective areas, each chapter contains conclusions and specially marked and enumerated recommendations.

Economic performance and policy reforms

The overall good economic performance in 1998 was supported by a satisfying macro-economic management. Economic growth was probably close to 10% p.a. Tight control of public expenditure was maintained. The exchange rate policy was made more flexibly to allow a gentle devaluation of the Metical against the US-Dollar to help the competitive position of the key export sectors. It is very likely that the benchmarks and performance criteria of the 1998/99 policy matrix in the current ESAF-arrangement can be met. This implies that donors should reflect very positively on the continuation of programme assistance linked to general policy conditions and performance criteria in the PFP.

However, as the country actually faced a deflation from the beginning to the end of the year, the JDR-team recommends that very the tight base money control in 1998 be reviewed, particularly with regard to its impact on cash supplies to the informal sector in urban areas and to the rural areas in general. If possible this analysis should include a closer look at the functioning of payments and credit systems for these segments of the economy, and possible improvements. Moreover, the JDR-team recommends taking a closer look at possible measures to strengthen revenue generation from personal income taxes and corporate profit taxes, and to review the option to include forex cash reserves of the banking system into statutory reserves. Very urgently the JDR-team recommends that follow-up work on the poverty assessment and poverty strategy reports, that had been finalised by the end of 1998 but were not yet released at the time of the mission, be made a prominent issue of the next PFP.

Current practices of foreign exchange allocation

As discussed at length during the first Joint Donor Review mission in May 1998, substantial disadvantages of the existing model for forex allocations from external financial assistance remain. The crucial change needed is to abolish regulations on imports in the allocation of forex provided by donors, which produce substantial transactions costs without offering any significant operational advantages. As the country disposes of substantial amounts of “free” foreign currency funds from export earnings, and as funds are fungible, import regulations attached to donor funds are virtually useless to control for undesired imports. This problem can better be solved by making available reliable general customs statistics and strengthening procurement rules in the public sector in general.

The JDR-team recommends strongly that the follow-up work on the recommendations of last year's mission be accomplished. Above all, this implies that the negative list and procurement regulations for private importers be removed from the current BOM forex allocation model. Procurement regulations for entities of the public sector must be maintained but should not be linked to the forex allocation process. Both steps will reduce considerably the transaction costs in the financial sector and BOM. Moreover, BOM and MPF should agree as soon as possible on adequate accounting and reporting procedures that provide donors with full and timely information on the inflow and outflow (to the banking system and importers) of donor forex funds, on the generation of counter-value funds, and on their flow into the treasury system.

Financial management: Current situation and ongoing reforms

The integration of different financial management systems makes it important to prioritise those that will have the strongest impact on the whole structure. In the current situation in Mozambique this is without doubt the treasury system. Without efforts to establish reconciliation mechanisms between bank accounts in the State payment system, and without proper reporting on cash flow from these accounts, donors will be reluctant to use other parts of the system such as the State Accounts and Government budget and planning procedures. Our recommendations to improve accounting, reporting and audit systems in this field should be considered as most urgent. We would like to stress that it is equally important that all available information is made official and that transparency should increase. Also in the case of the operation of counter-value fund accounts valuable information already produced on donor flows should be made available to donors and the public as soon as possible.

New planning instruments in Mozambique – the MTEF – should make it possible in the medium term for donors to integrate their assistance into national procedures, and to present a more complete picture of donor contributions to public expenditure. Donors need to continue to support and monitor this process in more than one way. Integration of different planning instruments is still weak and dependent on the continuation of donor support to develop information from simulations with the present macro model into a medium term framework. Donor co-ordination through SWAPS will involve the major part of the donor community. Relating to the decisions on total resources available to implement sector programmes, it should be remembered that a large part of the domestic resource contribution is also funded by donors through counter-value. This gives donors an opportunity to discuss with the Government the assumptions behind MTEF-projections, and to help build coherent linkages with macroeconomic forecasts and the annual budget.

The public service/civil service reform

Improvements in financial management systems are unlikely to be sustainable without motivated and trained civil servants capable of operating them. Therefore during this year's mission the JDR-team put some emphasis on reviewing the public service/civil service reform than last year. The JDR-team recognised the advances made in implementing the National Human Resources Management System, the decompression of civil servants' salaries and the new career and remuneration system. Decentralisation has made a decisive step forward with the municipal elections in 1998, although a comprehensive strategy of how decentralisation will continue still has to be developed. Progress is less advanced in the area of training and education and the legal and ethical framework for the civil service. Nonetheless, first steps of implementation in these areas are clearly underway. The JDR-team wants to suggest that more emphasis in the ongoing efforts of public service reform should be given to increasing community participation, and to the development of a performance management system to measure the outcomes of the reform, i.e. the improvements in the quality of public services and the impact on the working and living conditions of the people. Moreover, the JDR-team proposes that the JDR-mission in the next year take a closer look at the advances and impediments of the public service /civil service reform.

Rationale for macro financial support: towards a co-ordinated approach

A review of donor practices to provide programme assistance revealed a large variety of individual procedures of disbursement, accounting, reporting and auditing, as well as conditions attached to the provision of funds (although conditions are usually within the PFP-framework). There is a large potential to pool funds and to simplify and unify procedures and conditions, and thus to increase transparency and consistency of assistance, and to reduce transaction costs. The JDR-team strongly suggests to both donors and GOM to develop and implement a concept of a single facility for general budget support, with a common set of conditions (within or at least compatible with the PFP-framework), and common disbursement, accounting, reporting and auditing procedures. Similar efforts should be undertaken in cases of sector support and sector-specific import support. Wherever possible, accounting and auditing procedures should be linked with established procedures and efforts of improvement of GOM. Donors should follow a multi-year approach with tranche releases geared to benchmarks, both closely linked to the PFP-cycle and content.

Given the deficient accounting and audit systems, the JDR-team had long and controversial discussions of the question whether donors should provide under these circumstances general budget support or not. Basically, the possible and unknown diversion of funds invisible under a deficient accounting and audit system is part of or a special kind of the general problem of aid fungibility. The alternative to general budget support could be to switch to sector support, which allows for a full control of the use of donor funds. At first sight that looks like an improvement of the overall situation regarding the control of publicly used funds. But in the end it was found that this depends critically on one hypothesis. The total proportion of controlled public funds will increase only if the impact of the switch from general budget support to fully controlled sector support is not compensated by other opportunities to divert public funds. Unfortunately, that hypothesis can practically not be tested, and it is probably as likely as not that the switch would indeed improve the situation.

However, a more detailed analysis of the strengths and weaknesses of general budget support and sector support reveals that the two instruments should more be seen as complements and not as mutually exclusive. The JDR-team therefore recommends that the five like-minded donors co-ordinate their efforts to find a sort of “optimal” mix of these instruments with sufficient flexibility for individual preferences.

1. Economic performance and policy reforms

At the time of the mission, the National Accounts for 1998 were not yet published, and some of the preliminary data to be discussed in this chapter were only available to the second or third quarter of the year. Despite this limited availability of macroeconomic indicators it may be concluded that 1998 was another year of good overall economic performance. Preliminary estimates put growth of GDP at about 10%, private investment soared with a number of large foreign direct investment projects, and export revenues grew again after they had declined in 1997. The most dynamic sectors were apparently construction, transportation, communication and agriculture.

This favourable growth record was accompanied by sound fiscal policy – at least to the third quarter of the year, on which preliminary data were available. On the revenue side, a considerable restructuring of taxes took place in 1998. Personal income taxes and tax bands were restructured, and the top rate was lowered from 30% to 20%. Corporate profit tax rates, which had varied between 35% and 45%, were unified at 35%. For agriculture a tax rate of 10% was implemented for the next 10 years. A simple extrapolation of revenue data up to the third quarter of 1998 indicates that the programmed values for the end of the year may have been achieved. However, interviews within the treasury revealed that in several cases expenditure funds were not available as a direct result of poor revenue collection not answering to projected figures.

Throughout 1998 the preparations to introduce a value-added tax (VAT) went ahead. The tax rate was set at 17%, the VAT code was submitted to the Council of Ministers, the VAT unit was reorganised and strengthened, the computer system and the software were purchased (but, at the time of the mission, had not yet been fully implemented and tested), the VAT taxpayer register was being built up, staff was being trained in the public and the private sector, and a publicity campaign was launched. The planned date of implementation is 1 April 1999. It seems that some preparations for the introduction of VAT were initiated rather late and/or required more time than originally planned. At the time of the mission it appeared that the time schedule for things still to be done was very tight.

On the expenditure side equally significant changes took place in 1998. The first step of the salary decompression for civil servants was implemented in April 1998: the ratio of the highest to the lowest salary was increased from 9.6:1 to 13.2:1 in April 1998. A second decompression to 17:1 is planned for April 1999. This is the major driving force of an expected increase of public expenditures of 1.5 percentage points relative to GDP from 1997 to 1999. Apart from these changes, preliminary data to the third quarter of 1998 indicate that public expenditures were pretty much in line with the programmed targets. All in all it may be concluded that the slight decrease of the fiscal deficit before grants, as it is included in the IMF's programme for 1998, may have been achieved by the end of the year.

In 1998 BOM followed a very tight monetary policy. Although M2 increased by 19%, base money decreased by –3.8%. The growth of banknotes and coins in circulation (cash) was 5%. Annual inflation (5. 8% in 1997) did not only decline again, but turned into deflation: the CPI decreased by – 1.3%. At the time of the mission there was some debate on the question whether monetary policy was overly tight and should be loosened. The growth of emissions of central bank bills, from 130 Billion Meticais in 1997 to 490 Billion Meticais in 1998, reflect BOM's advances in applying indirect monetary policy instruments. (In 1998 there were only two emissions of treasury bills.)

In the financial sector lending rates continued to fall in 1998 while deposit rates were more or less stable, with slight increases in the recent past. Nonetheless, as of February 1999, nominal and real interest rates and spreads were still high – the former around 20%, the latter around 10%. It appears that the high level of lending rates and spreads result mainly from high transaction costs, high set-up costs for new banks, high risk premium and limited competition in the financial sector. Reserve requirements for banks were reduced from 12% to 9% of liabilities in 1998. However, foreign exchange cash reserves held by the banks are still not accounted as part of the statutory reserves – a request that has been put forward by banks time and again.

During 1998 the Metical depreciated against the US-Dollar by 6.2%. This was mainly a result of increased net foreign exchange purchases of BOM. From 1996 to June 1998 BOM's net purchases were mainly geared to the net foreign assets held by the banking system, and it appears that the central bank – at least since mid-1996 – virtually had pegged the nominal exchange rate to the US-Dollar. Since the second half of 1998 the net purchases are directed towards achieving the central bank's international reserve targets set in the IMF's financial programme, and it seems that BOM considers more the development of the real effective exchange rate. As a consequence of the new policy the appreciation of the real effective exchange rate, which had occurred since October 1995, has been stopped and dampened.

Regarding international trade, another step towards additional trade liberalisation has been taken by signing the Free Trade Protocol of the Southern African Development Community (SADC). GOM intends to accept the relevant obligations of Article VIII of the Fund's Articles of Agreement in July 1999. Moreover, it is planned to reduce the maximum import tariff from 35 to 30% in 1999. Plans for the step-wise reductions of tariffs vis-à-vis SADC-countries are being prepared and negotiated. As another step to reduce transaction costs for international trade, GOM introduced in 1998 the so-called "documento unico", a single document for importers and exporters that facilitates import and export procedures considerably.

The overall good economic performance, the macroeconomic policy in general, and the advances in policy reforms in 1998 are good reasons for the five like-minded donors to reflect very positively on their continuation of programme assistance linked to benchmarks and performance criteria in the PFP. Among other things, the JDR-team welcomes the changes in BOM's exchange rate policy, GOM's strong dedication to implement the VAT on 1 April 1999, and the intentions to attend to the Article VIII of the Fund's Articles of Agreement in 1999. These issues have been part of the concerns and recommendations regarding macro-policy in last year's aide mémoire.

A somewhat critical policy issue in 1998 might have been the tight monetary policy. It may be worth to conduct some further investigation of the question whether the low increase of cash supply relative to GDP growth has indeed – as some anecdotal evidence indicates – contributed to cash shortages that may have hampered economic development. This is a concern above all with regard to small and micro-enterprises (self-employed persons) in the formal and informal sector of urban areas, and a concern with regard to people living and working in the rural areas. It goes without saying that the issue of "sufficient" or "insufficient" cash supply for transaction and investment purposes is closely linked with the question whether adequate credit and payment systems are in place to satisfy the demands of these segments of the economy. But it is conceivable that the tight monetary policy in 1998 could have exacerbated deficient credit and payment systems.

Recommendation 1
The JDR-team would like to recommend that an in-depth study of the impact of the tight monetary policy particularly in rural areas and on the informal economy in general be commissioned and – if need be – monetary policy be revised accordingly.

Regarding revenue generation, there is still a lot of work to be done and GOM should strengthen efforts to improve tax collection. The restructuring of customs has been hampered by the slow progress in retrenching existing staff and programming the refurbishment of customs posts. A concern raised already during last year's JDR-mission is the tax exemptions granted for new investment projects, particularly large foreign direct investment projects. It is not a concern of principle that GOM allows for tax deductions on domestic and foreign direct investment, it is more a concern with regard to the total amount of reductions allowed for, the use of discretionary leeway, and the control of misuse of duty-free imports supposedly for construction purposes in the free trade zone.

Recommendation 2
GOM should inform donors as early as possible about the plans and details of tax concessions to be granted to large investment projects, the estimated costs of revenues foregone and the estimated benefits of the projects.

Recommendation 3
An issue to be taken up for the next PFP discussion round is the repeated request of banks that BOM should accept the forex cash reserves held by the banking system as part of the constituent reserves – at least a certain proportion of the forex cash. There is no fundamental argument against BOM considering such a move, which would free resources and increase flexibility.

Recommendation 4
In the current PFP it was agreed that GOM have a poverty assessment and a poverty action plan prepared by the end of 1998. Unfortunately, at the time of the mission, these documents were not yet available, and it was not possible to reflect on specific conclusions and recommendations.

Nonetheless, the JDR-team would like to strongly recommend to GOM and the five like-minded donors that follow-up work on the poverty assessment and poverty strategy document is given high priority in the next PFP and within the sector programmes in which the donors are engaged. Apart from promoting and strengthening the implementation of a poverty strategy, a continuous monitoring of poverty development should be established as part of the overall efforts to improve the statistical information system on economic and social development. There can be no doubt that the development of a comprehensive and reliable statistical information system regarding poverty (income poverty and related social indicators) lags far behind the development of the information system on economic aggregates. Given the declared importance of "broad-based, poverty reducing economic development", this imbalance in the information system should be reduced as much and as soon as possible.

2. Current practices of foreign exchange allocation and reforms

Forex Allocation Model

As discussed at length during the first Joint Donor Review mission in May 1998, substantial disadvantages of the existing model for forex allocations remain. Since the May 1998 mission, the BOM has made a draft proposal for a new model (dated 14 August 1998), which has been discussed in the import support working group. The G-4 donors have made a reply to the BOM on the proposed model (dated 4 November 1998), but has not received further comments from the BOM. Thus, the model currently in use is the same as during the May 1998 review.

The crucial change needed is to abolish regulations on imports in the allocation of forex. At present, donor funds can only be sold to commercial banks in the forex inter-bank market, subject to information on the end use of funds. In practice, this means that an importer needs to present documentation on adherence to standard World Bank procurement guidelines to the commercial bank, which then presents this documentation to the BOM when purchasing specific forex provided by donors. This involves considerable transaction costs. The scheme's auditors calculated that in 1997, approximately 60% of the forex transactions by value were not initially properly vouched (usually because of missing documentation)

As long as forex provided by donors are tied to the end use in any manner, the BOM will need to trace the use of forex to the specific imports by any importer, including private importers. As such, the forex provided by donors cannot be treated in a manner similar to that of the 'free funds' (forex obtained through export receipts). As discussed in the May 1998 Aide Memoire, this poses a significant constraint on the development of a viable forex inter-bank market. As was also noted then, such conditions on the sale of forex provided by donors does not provide any useful information – as long as 'free funds' exist, an importer can switch to these for imports of items not condoned by the donors.

Recommendation 5

Due to these observations, the JDR-team strongly recommended removing procurement regulations from the sale of forex in the inter-bank market. A further implication of this – although perhaps not described in sufficient detail then – would be that all requirements regarding the end use of funds be removed. Otherwise, not much is gained in terms of developing the inter-bank market. This means that any requirements concerning eligible imports should be removed from the forex allocations – and hence, no requirements should be made concerning either positive lists or negative lists, in whatever form. The concerns donors and the Government may have regarding military equipment, hazardous items, etc. should be imposed through import documentation – in fact the GOM imposes certain restrictions in this manner.

The team strongly recommends that donors use a similar approach – which implies that donors may consider the overall composition of imports into the country, obtained through import statistics. To the extent that donors do not wish to (directly or indirectly) be supporting specific items, total imports of these items can be compared to total forex *not* provided by donors – as long as the amount of imports is below amounts of forex from non-donor sources, donors can be satisfied that their funds have not directly supported the importation of these items.

All in all, it is strongly recommended that the new model be fully agreed to by BOM and the donors as soon as possible. On the donor side, this implies removing the considerations regarding a negative list. On the BOM side, this implies finalising the draft proposal presented to donors in August.

Debt alleviation fund

The debt alleviation fund, FDAF, is an account managed by the BOM on behalf of the Government, with the aim of financing a certain share of the scheduled debt service payments to its multilateral creditors. In principle, the system works in the following manner:

- donors make contributions to the FDAF, which is a special account held for debt service payments to multilateral creditors;
- forex from the fund is used according the schedule of eligible debt service payments;
- countervalue funds are generated to be used for 'additional' expenditures in health, education, and water. This is done by crediting special accounts in Treasury for special expenditures within the eligible sectors.

A number of issues may be raised in this context:

1. What is really meant by 'additional' expenditures? As long as the Government is aware of the implied savings to the budget of the FDAF funds for debt servicing, the GOM will and should plan increased expenditures in the eligible sectors. The concept of additional expenditures may therefore not be particularly meaningful
2. Some contributors to the FDAF have removed the constraint on sectors eligible for 'special expenditures', due to concerns (as raised in the May 1998 Aide Memoire) over the capacity for these sectors to absorb large volumes of extra resources in an effective and efficient manner. This has clearly enhanced economic management of the additional resources.
3. It appears that no interest is reported to the donors – and the Team was informed that in fact, the BOM does not earn interest on its accounts held abroad. This is hard to understand, since substantial interest earnings should be obtained in these accounts – and accrue to the Government. As is perfectly normal, the BOM charges a certain percentage for handling of these funds for the Government – however, it appears that this information is not directly provided in the quarterly reports to the donors.

Recommendation 6

In order to provide full information to the donors, it is recommended that bank statements of al transactions (inflow of funds, debt service payments, interest earned, handling charges subtracted, etc.) are provided in the quarterly reports to the donors. In addition, the annual schedule of debt service payments should be provided, which would enable donors to follow the evolution of debt service more closely.

4. In practice, only a relatively small percentage of the countervalue funds generated by contributions to the FDAF are in fact released to the Treasury. The remaining funds are sterilised in a blocked account. Funds from the World Bank Third Economic Recovery Loan are sterilised in a similar manner. The rationale for this is that the there is limited absorptive capacity in the domestic economy of the very large inflows of forex – which are required to finance the large debt service burden. While questions may be raised on this, it is clear that the absorptive capacity of the economy is limited – the decision concerning the degree of monetisation of these amounts is carried out within the overall macroeconomic framework.

Recommendation 7
It is recommended that the volume of countervalue funds released to Treasury be reported in the quarterly reports. In addition, the annual plan for total releases should be provided.

Import support

Some of the donors included in this review provide import support in the form of medicine imports. As was noted in the May 1998 Aide Memoire, such support should be seen in the context of sector support to the health sector and, as such, should not be dealt with under the aspects of macroeconomic performance and policies. A few comments on the current scheme and a recommendation are provided below:

1. It was already recommended in the 1998 JDR-report that donors should establish a common pool of funds for the purchases of medicines. This would enable the Ministry of Health (MOH) to rationalise the procurement and purchase of medicines (which takes about 12 months from initiation of the process until goods arrive in Mozambique) and ensure that the MOH can secure the medicine items according to its list of priorities. This is currently underway by a group of donors, including some of the G-5.
2. There appears to be considerable concern regarding the availability of medicines in public health centres, although the JDR-team only has anecdotal evidence of this. Such issues must be dealt with in the context of the health sector programme, as it relates directly to issues of efficiency within this sector. This argument further supports the recommendation to deal with medicine imports in the context of support to the health sector.
3. Two donors (Denmark and Canada) continue to provide some support for medicines, which are tied to purchases in their respective countries. This limits the freedom of the MOH to rationalise its medicine purchases and may carry substantial costs in terms of flexibility, planning of procurement, additional administrative burdens, and price paid for the products.

Recommendation 8
It is recommended that donors pool their funds for medicine imports and that the scheme of tied aid practised by Canada and Denmark is reviewed to assess the costs involved.

3. Public financial management: Current situation and reforms

Introduction

Public financial management issues (in a broad definition, also including audit) have been introduced in the Terms of Reference (TOR) as a result of a donor's wish "to get accountability from the Government's own systems." Further, "Mozambique's budget process, budgeting and accounting procedures are becoming more important" in relation also to the disbursement of different kinds of PA.

This chapter will present our view on the present status and development of public financial management systems in Mozambique. As the presentation is limited to be system oriented, the implications of findings and conclusion might also be found in other parts of the report, especially chapter 6.

Budget and planning

The inclusion of budget and planning issues in our report has its rationale in the fact that a substantial amount of the state budget is funded through counter-value funds that could be derived from the disbursements of PA. This holds the question of efficient use of these resources. Further, the presentation of resources on- or off- budget is highly related to the possibilities of utilising the Government's payment system. This system is also used to transfer external funds to treasury funds, thereby financing budget expenditures. This displays that different parts of the financial management system are mutually dependent on each other. There is little likelihood that resources presently off-budget will be presented on-budget until the Ministry of Planning and Finance (MPF) and BOM can present a reliable payment system for State Budget funds. As will again be discussed in chapter 6, this also raises the question of control of external funds transferred through the State payment system.

A report on the issue of off-/on-budget resources has been presented to the MPF as a draft. This is internal material and was not made available to us during the mission. The final report will be presented in March. So far it could be stated that the identification of these resources do not only bring solutions but also problems. Among other issues, there is an uncertainty if all of these resources can be incorporated in the budget for legal reasons stated in agreements with donors. At the same time, all attempts to introduce common funding of sector programs will be severely hampered by the fact that maybe half of the resources available to the sector are off-budget, i. e. unknown or not accounted for on the budget.

The Medium Term Expenditure Framework (MTEF) was introduced in Mozambique to guide the decision-making process of the State Budget for 1999. This would indicate that not only systems but also routines and processes are new. MTEF-projections are integrated with projections that formulate the Three Year Investment Plan (PTIP) and are also connected to the introduction of Sector Wide Approaches (SWAPS), which all are linked to and dependent on funding arrangements through Sector Programme Support (SPS).

The MTEF is produced based on e.g. macroeconomic input from the Gabinete do Estudo at MPF/Plano e Orcamento. The macro-model is under development but was used already for the first year of the MTEF to support calculations of the total resource envelope. The MPF has also produced and presented analyses on the differences between these multiyear projections and the annual budget, answering to the first year of the MTEF.

The MPF has also presented guidelines to the formulation and implementation process of SPS. The MTEF of 1998 (the budget of 1999) has concentrated on and underlined the integration between SPS sectors and MTEF projections.

Conclusions

Our impression is that the MTEF process has taken off well considering actual available human resources, especially at Line Ministries. The dialogue between the SWAP-sectors and the MPF holds substance, which is reflected in the analyses of differences between projections made for the annual budget and the MTEF. The fact that there is a macroeconomic input in this work also indicates the awareness of the need to derive budget allocations (and eventually sector allocations) from a sound macro-economic framework. Though procedures and input still are fragile, there are good reasons to support the continuation and stabilisation of the on-going process.

One way of doing this is to ensure that donors (on a compulsory basis) report on all (new) inflow of resources to public expenditure to the MPF/Plano e Orcamento. The MTEF provides donors with new opportunities in this area. Many donors hesitate to report on new inflows since they interpret this as putting their resources on-budget. MTEF is however a much broader concept than the State Budget, including all known resources in a planning procedure aiming at most efficient utilisation of total resources available. (MTEF is supposed to produce financial ceilings for each ministry's/ sector's budget. It must therefore consider only those funds that can finance sector budget expenditure whether or not tied to specific budget lines. The MTEF may be a suitable vehicle to record total expenditures, including projects on a memorandum basis but not reflected in the financial ceilings.) This difference gives donors the opportunity to report on new resources, without committing themselves to the inclusion of resources in the budget. Donors already prepared to report on their inflow, complain however that there is no request from the MPF concerning this kind of information. Consequently no reporting routines have been presented.

Some worries linked to the new planning concept are visible. There seems to be a gap between annual budget projections and the MTEF. This is shown in the fact that different macro models/forecasting procedures are being used for these projections on different terms. Also, political guidance to lead the MTEF process is limited. Political focus is on the annual budget (as in most countries!). The implications are that nobody actually co-ordinates and relates total expenditure – funded from internal and external sources – to what is feasible from a macro-perspective. This issue is emphasised through the introduction of SPS. The absence of political guidance also creates a vacuum in the final allocations of funds between sectors. There is a risk that sector allocations in the annual budget still are the result of marginal budgeting (based on last years figures irrespective of their relevance) and not on projections derived from an overall economic policy. (This risk is at the same time reduced by the introduction of sector strategies). Further, the reliability of budget figures could still be questioned. Line Ministries have in many cases only access to poor information of actual expenditure in relation to budget. The origin of this problem is the accounting system to be discussed later in this chapter.

The integration between MTEF and SWAPS has changed focus from the PTIP towards the SPS, where the five involved sectors (Education, Health, Agriculture, Water, and Roads) represent 80% of budget expenditure. This shift – from a more investment oriented planning model to a model that integrates all resources and different macro and micro perspectives – has created a divergence between the MPF, which moves forward in fast pace in introducing improved instruments and procedures, and the Line Ministries, which still hold on to old planning models and instruments. Simultaneously, this new model has contributed to carry into effect the formal integration of the previously separated departments of Planning and Budget at MPF.

Through the dominating position of SWAP-sectors in the budget the processes and planning procedures related to sector strategies and SPS will formulate the basis of the continued MTEF. In the SPS guidelines presented by the MPF it is stated:

> *"Under ideal conditions, all funding to a PSI (Integrated Sectoral Programme) should be channelled through a single account managed in accordance with national procedures. Such a system could only operate transparently and efficiently if rigorous routines in the areas of financial management, accounting and auditing are in place. Moreover, such a system will also require changes in the procedures of donors. Although it is only possible to attain these objectives in the medium and long term, intermediate steps will aim at simplifying the disbursement of the external funds.*
>
> *Identifying these intermediate steps will constitute an important task in the formulation of the PSI. In general efforts in this area will seek to:*
>
> - *harmonise the disbursement and procurement routines of the different donors; and*
> - *establish standardised routines for reporting, whether from the donors to the government concerning disbursements, or from the government to the donors on the receipt and use of funds".*

This quotation not only reveals a high level of awareness of the present status of public financial management systems in Mozambique, but also points to the necessity of donors' adherence to common planning, accounting, disbursement and authorisation routines of external support to SWAPS. In addition these routines should to the extent possible be integrated with national systems.

There is an obvious risk that limitations from previous project support and co-operation procedures are inherited into SWAPS if donors do not co-ordinate and integrate with national routines in the funding procedures of sector programmes. To avoid the absorption of scarce competence at co-operating institutions, and equally to avoid that human resources will be unable to participate in the development of more sophisticated national and general systems, donors must co-ordinate in these routines and also refrain to ask of too much sophisticated accounting information in the intermediate period. The continued progress of the MTEF is closely linked to the establishment of these common routines between MPF, sectors and donors.

In Mozambique on-going SWAP-processes and discussions on co-ordinated funding of sector programs have reached a point that will make it possible to develop a planning and disbursement model that partly integrates with national financial management systems.

Through the PROAGRI-process at the Ministry of Agriculture a proposal on financial management structures in this sector programme has been presented. Though not yet decided and with technical features still to be discussed, this proposal is built on far-reaching integration with national systems. The point of departure for this proposal is that all donors involved are to agree on the structure of the financial management integration.

Present capacities and system structures at the MPF presuppose that financial management procedures within different SWAP-agreements are co-ordinated and follow common routines. The final formulation of the PROAGRI programme will and should therefore affect all following programmes. This increases the importance of the decided structure and the features of the financial management system of this programme.

Common reporting and disbursement routines between different sector programmes will however not be sufficient. The lack of political presence in the MTEF process and its linkages to SWAP-programmes, and the limited resources at the MPF to manage this process, indicate that external support and general donor engagement will be necessary. Current DFID support to the technical establishment of a Sector Programme Unit at the Ministry should be extended to also include policy issues in the MTEF-process.

Apart from the introduction of SWAPS there are also other good reasons for donors to participate more actively in the elaboration of the MTEF and its planning procedures. Domestic contribution to SWAP-funding is to a large extent financed through counter-value funds, originally disbursed as macro-financial support. This would indicate that the fulfilment of a sector programme is dependent on donor assessments of the reasons for continued macro-support – motives that could differ substantially from those guiding the engagement in a sector support. The present weaknesses in internal overall guidance to this process further emphasise the need for active donor participation in the MTEF-process. Without this increased donor presence and involvement there will be limited scope for the MPF to integrate and internalise current external economic and financial analyses and projections presented by the IMF and the World Bank to support the budget process.

Continued and possibly also extended support to the elaboration of macroeconomic models linked to MTEF-projections is also recommended. The on-going development of present macro models, based on expatriate participation, should – despite weaknesses – continue and not be substituted through the introduction of existing external models. Further, current macro revenue projections have to be supplemented with projections of actual revenue collection. The possibilities of domestic resource mobilisation relating to sector program funding are crucial. Simultaneously, it is evident that there is a divergence between the revenue projection that is formulated through macro models and actual revenue collected. The latter is dependent on the standards of tax authorities and control mechanisms in this system. Improvement of and sustainability in the tax revenue system are dependent on a number of factors not being analysed in this report.

Recommendation 9
Donors should report on a compulsory basis to the MPF- MTEF process on all new financial inflows that could be defined as an activity that normally should be funded through the State Budget. At the same time MPF should present reporting procedures to the donors that makes this possible and a routine.

Recommendation 10
MTEF and budget projections should be based on Government priorities between sectors. Present donor support to the introduction of SWAP-programmes and sector programme fundin, should be extended to include the MTEF-process and policy issues linked to this process. DFID should be the leading donor agency in the formulation of this extended support.

Recommendation 11
Donors, MPF and concerned sector ministries should agree on common disbursement and reporting routines related to SWAP-funding. All efforts to integrate with national systems should be made, matching SWAP-funding with support to capacity building at concerned institutions. This calls for integration of information flows between sectors concerning on-going formulation work related to sector programmes.

Recommendation 12
The MTEF-team, as part of its co-ordination role in SWAPS, must develop a common format/basis for sector strategy plans and a performance measurement system.

Recommendation 13
Revenue projections should be supplemented with statistics of actual revenue collection introduced in discussions on the possibilities of domestic resource mobilisation as part of an agreement concerning a SWAP-programme.

Recommendation 14
The Economic and Social Plan that is linked to the annual budget should be presented as a document covering a multiyear period, thereby making it possible to link this kind of planning to the MTEF and at the same time visualising trends measured through the economic and social indicators presented in the plan.

The Government Accounting and Treasury System

Development partners have known for some time that the accounting and budget systems used by the Government of Mozambique do meet acceptable standards, set by international bodies such as IFAC and INTOSAI. The 1999JDR-mission had as a key objective to determine the progress the Government has made in improving standards. For reasons both of time and significance, the mission has concentrated on :

- Accounting for off-budget revenues and in particular counter-value funds, generated through various forms of financial support
- Accounting for the State Budget Expenditures (Budget Execution)
- Accounting for development partner funds, particularly those given at sector level.

A. Accounting for counter-value funds

Counter-value funds are funds generated in local currency (Metical) by a number of different financial support packages paid in foreign currency. The most significant of these are:

1. Money-market transactions, where foreign currency is auctioned off through the commercial banking system to importers, who pay the counter-value. Importers can use the forex, subject only to the restrictions of the negative list and procurement procedures.
(As discussed before, this model is currently being revised and should be streamlined.)
2. Traditional import support, where foreign exchange is only paid on specific actual invoices.
3. Food aid, where donated food replaces the forex, but the domestic purchaser pays contervalue funds for the food.
4. Retrocessional agreements, which allow state companies access to forex for capital goods, and allows them to pay back the counter-value over 2–5 years
5. Drugs and medicines support, where forex is allocated to Medimoc, the state company responsible for drugs and medicines purchases. It does not pay counter-value although the value of the transaction in Meticais is recorded through a “Titro” (journal) in the counter-value account.

There are a few counter-value accounts but by far the largest and most significant is the MB 10. A Department of Counter-value Funds was established in the Treasury in the MPF in April 1997, and with the assistance of an EU-funded project, has established a detailed tracking system to record counter-value payments. Funds are traced from the signing of the original agreement through to the recording of the counter-value in the MB 10 and other accounts, and subsequent on-ward transmission to the Central Treasury account.

Although the Department of Counter-value Funds has made a lot of progress, the system still has the following significant loopholes:

1. The Department is not allowed access to the bank statements for the forex account and is therefore unable to undertake a reconciliation between that and the MB10/other counter-value accounts. This means that agreements that have not been notified to the department, as well as interest receipts on forex funds, cannot be accounted for.
2. Although the Department can do a bank reconciliation of the MB10 and other counter-value funds, its remit does not extend to examining the flows of counter-value funds into the Central Treasury account(s) and its subsequent applications (in financing the state budget or otherwise).
3. The Department does not make its report public allowing development partners to track the general level of counter-value funds generated.

These loopholes mean that there can be no assurance that financial support made available as budget support is being wholly used to support government budgetary expenditures in the way intended.

There are two other points that should be mentioned. First the current EU project at the Department of Counter-value Funds is ending at the end of February 1999. Although it is intended to commence a second phase of support, there is likely to be a lengthy interval between the two phases. At the present time, no transitional arrangements are in place and therefore there is a danger (despite the training of counterpart staff) that the present system may become less efficient in this period.

Second, the counter-value funds are treated within the Government System as a source of finance, not a source of revenue. As such they are not subject to the same checks and controls (however inadequate) to revenues that are collected through the tax system.

Recommendation 15
Transitional Arrangements for continued technical assistance to the Department of Counter-value funds must be agreed with GOM and put in place before the end of March 1999. This is an immediate priority.

Recommendation 16
The GOM should be asked to provide to development partners a detailed reconciliation of its counter-value assumptions contained in the State budget with known or expected financial/budget support agreements by the start of each new budget year.

Recommendation 17
A study should be commissioned to examine further assistance (in addition to the new EU-project) necessary for the development of a sound and comprehensive payments system. This recommendation is considered as one of the top-priorities of recommendations presented in this report.

B. The Budget Execution System

(Annex 1 provides more information on the Government Accounting System)

Budget Execution

Over the past four years a major attempt has been made, with the help of a Swedish project, to develop an auditable accounting system. The key starting point for this system was to:

- provide a simple but flexible classification system for income and expenditure (otherwise known as a Chart of Accounts),
- develop the budget for 1998 and 1999 on that classification, and
- design simple computerised accounting systems to consolidate the expenditure reports

Information on expenditure should be available from two sources – the MPF and the individual sector ministries. The MPF is responsible for producing the statutory accounts, whereas the sector ministries produce expenditure reports on a memorandum basis for use by internal management. This information should, in theory, agree with that available to the MPF, but may in practice differ due to missing returns, calculation errors, improperly vouched expenditure etc. Provinces are also presenting information to both MFP and sector ministries.

We believe that line ministries are producing expenditure reports. We were informed by the team leader of the Swedish accounting project that consolidated quarterly returns, at least up to September 1998, have been produced by the Department of Budget and submitted to the National Assembly.

Unfortunately the MPF has produced no consolidated financial information government wide for any period during 1998. It appears that this was because returns were missing for a few provinces. Even if this only a small problem, it needs to be tackled before backlogs grow too large to easily catch up. This may involve additional targeted training and firm management action.

Furthermore, even the absence of such returns should not delay the consolidation of returns as far as possible. Regular deadlines need to be set for monthly consolidation, as part of the development of accounting disciplines within the MPF. We were dismayed to be informed that the likely consequence of missing returns would be that the State General Account would not be closed. We were advised that officials would rather prefer to miss the legal deadline for not closing the accounts, than actually making errors in the accounts themselves.

Because the government accounts are prepared on a single-entry cash basis, there is no scope for making prior-year adjustments that are possible under other accounting models. There is however, be scope to deduct in subsequent budget years, amounts in respect of non-vouched or improper expenditure from cash releases as a discipline to spending agencies

Cash flows

As indicated above, an initial cash advance of 2/12 should be payable within the first two months of the year. Our investigations in one provincial department suggested that the advance was not paid until the end of March, and then was not cleared for another week because of delays in the banking system.

As a result the department lived on a “hand-to-mouth” existence for three months borrowing from other sources, notably receipts, to pay essential bills. We are unclear as to how widespread this problem is, although it is likely to be more common in the provinces.

Reimbursement of the advance was then limited to 1/12 of the budget per month, with the final reimbursement claim submitted at the end of December. This effectively made it impossible to claim reimbursement of 2/12 (the original advance). We are not sure if this failure to permit reimbursement of this sum was due to a lack of cash, or a lack of understanding on behalf of either the provisional line ministry or the DPPF.

Investment cash flows were provided on an irregular basis during the year. However, in October 1998, approval was withdrawn from a number of provincial projects, in order to fund central projects. Thus any expenditure made against these projects would technically become illegal, and subject to repayment.

New Accounting Model
The existing accounting model is based on an out-dated single-entry system. Its replacement has been proposed for several years, and terms of reference have been drafted for a consultant (funded by the Swedish project) to produce a feasibility study and a project plan for a new system. A consultant from the Ministry of Finance in Portugal has been identified, and a report on next steps should be available by the end of June. It is vital that this study involves key sector ministries fully in drafting the user requirements for this system.

Clearly, in the longer term, it would be desirable to replace the present ad hoc systems with a modern comprehensive accounting system, that would not only produce comprehensive accruals accounts but also timely and flexible management information. We would counsel however that this is no easy task and should not be rushed. Large organisations with a pool of experienced computer-literate financial and IT specialists take a minimum of 2 years to replace an existing computerised system. In the case of large organisations developing computerised systems in Sub-Saharan Africa, a development period of less than 3.5 years is not realistic (e. g. the Tanesco accounting project financed by the World Bank, 1994-97).

GOM does not even have the experience of personnel operating degraded double-entry systems (manual or computerised). As well as the requirement to develop project management and IT skills, it is also essential that accounting skills and disciplines are built up in advance of any new system. We believe that the Swedish accounting project has an important role to play in building familiarity with accounting routines, and considerable benefit would result from consolidation of the present rudimentary system

Recommendation 18
Development partners should make the **closure of the State General Account** in accordance with the law a key condition in the disbursement of external assistance through the Government accounting system. Closure of the accounts (and their subsequent verification by external audit) in accordance with legal deadlines is a key measure in promoting financial discipline.

Recommendation 19
Development partners should request monthly information on cash releases and revenues to the Government budget. We consider that counter-value funds, which are generally more plentiful at the beginning and end of the year, have an important role in cushioning the impact of low tax collections at the beginning of each fiscal year.

Recommendation 20
Development partners should consider what additional scope they may have to assist the government in its cash flow management, by relaxing the rules on the use of specific project accounts. The Government should also consider whether it might relax its own policies on the sterilisation of funds (particularly those accruing from the Debt Alleviation Fund)

Recommendation 21
Development partners should be given quarterly reports on budget execution, submitted to the National Assembly by the Director of Budget

Recommendation 22
Development partners should refrain from establishing separate accounting models in sector Ministries but should support (with funding if necessary) the development of the new central accounting system. This will generate the necessary flexibility in reporting, especially at sector level, that agencies require The Swedish project team should be the lead body for co-ordinating technical assistance in this area.

C. Accounting for Development Partner Funds

A large amount of external support is currently "off-budget" and not accounted for through the Government system. This support consists of three kinds – financial assistance as budget support (discussed above), project aid and sector financial support. The latter is usually tied to supporting specific activities. No figures are available, but discussions with the Ministry of Health suggest that approximately 50% of expenditure is off-budget for that sector. Government-wide, and taking account of debt service and repayments, the off-budget share may be as high as 70%

Incorporating project funds in the Government budget may not at this stage be a realistic or particularly beneficial exercise, since the budget is supposed to reflect items within government responsibility. Bringing these items "on-budget" would be a theoretical exercise only. The MTEF planning process may serve as a mechanism for capturing these flows on medium term.

However, financial support for the budget, whether tied or not to particular expenditures, should in principal and on medium term be brought "on-budget". The precise mechanisms for doing this need to be developed, but three broad principles need to be agreed:

1. The budget should for each sector ministry and its departments and agencies be prepared on an all-inclusive basis. Any external funds, however disbursed, should only be spent on items and to the amounts authorised by the state budget.
2. Expenditure reporting should be against the state budget, and therefore also inclusive of all funds used.
3. Disbursement and accountability procedures should be standardised, as far as possible, within and across sectors

To support the establishment of these three principles, one lead donor could take responsibility for the disbursement and stewardship for all external funds given to a sector. This would require one set of disbursement accounts for external funds in each sector.

The PROAGRI Aide-Memoire has suggested that such external funds should be registered as on-budget by passing them through a central treasury account in Maputo. For audit and accountability purposes, this account would hold both external funds and those provided by the Government. Funds would then be released to budget execution accounts in the Ministry of Agriculture at central and provincial level. It is not clear if these accounts would be parallel to or be consolidated with existing MAP-accounts, but the accounting for funds would be done in the normal way.

We feel that this is a good model, although the detailed modalities need to be worked out (e. g. accounting for payments direct from the external forex account). It should also be possible to transfer funds directly to provincial or even district level, without passing them through the central line ministry.

Development partners need to give careful consideration to linking the flow of external funds to the Government's own cash releases. This issue needs to be handled sensitively with regard to the Government's general financial position and conditional agreements concluded at the macro level (e. g. on the level of government borrowing). However, it is important to ensure that domestic resources are used, as far as possible, in line with budget and sector commitments made to development partners.

In the absence of detailed activity-based expenditure, it will be important to develop performance agreements as a mechanism for focusing attention on the delivery of tangible and measurable service improvements for money provided. Performance targets should be related to the agency's, institution's or province's role in meeting the overall strategic objectives of the sector, as defined in the sector's rolling strategic plan.

Recommendation 23

Development partners should negotiate with each other and GOM the creation of a single set of disbursement accounts for each ministry or agency, and a common set of disbursement and accountability rules, and produce a report, summarising the position at the time of the next JDR-mission.

Accountancy pay, training and status in the government service

Accountants are in very short supply in Mozambique generally and as such can command high pay. In the private sector, we were informed by one of the major accountancy firms that a newly qualified bookkeeper can earn $500 per month. This can rapidly rise to $1,500 per month after 2–3 years experience. In contrast government bookkeepers currently earn around $130 for middle ranking technicians and $250 for graduates (who will be economists or business administrators).

Clearly the Government's proposed public service pay reform may help remove some of the differentials. However, it is important that the government recognises the central role of the accountancy profession, not merely in compiling financial records, but also in the design, planning and execution of government expenditure and revenue collection programmes. This will necessitate an upgrading of the status of accountants

Although very significant training was provided in the introduction of the new budget classification system, more substantive institutional arrangements need to be made. We understand from a recent pre-project planning seminar at the Tribunal Administrativo that the Ministry of Education and the university are examining the development of such programmes. This has also been recognised as an important step by the PROAGRI mission team, although their suggestion for the establishment of a professional accountancy body may be premature.

We feel that as a first step, this could involve developing an accounting and finance degree course at the university, in co-operation with an interested private sector. Such a programme would involve compulsory courses on government accounting and public finance, and should aim to provide a small number of high quality public financial managers.

On the technician level, consideration should be given to providing a government accounting certificate qualification to existing and new staff. PROAGRI have suggested setting up an accounting and auditing training unit in the MPF, and this could be a responsibility of such a unit. It may be appropriate to develop such a programme in conjunction with the Public Administration Institute, as part of the overall public service reform programme to upgrade its capacity.

Recommendation 24
A study should be commissioned to make recommendations for the future development of the accountancy profession in Mozambique from both a public and private sector perspective. This should examine current supply and demand and the options for improving the overall supply.

Audit

In Mozambique there are at least three different state institutions dealing with financial audit, apart from tax audit, which does not have the same inspection function as the others.

These three are:

- One section of the Tribunal Administrativo. The Tribunal is a part of the High Court in Mozambique and submits in its audit function only to the Parliament;
- Inspeccao Geral de Financas at the MPF, reporting to the Minister of Finance;
- Inspeccoes Sectorias, representing internal audit at line ministries.

In addition there also exist other audit institutions, the most important ones being:

- Inspeccao do Estado, linked to the President's Office;
- Inspeccao Geral Administracao do Estado, linked to MAE, the Ministry of Public Administration.

These two institutions also deal with issues that could link to the activities of the three previous ones, though not producing financial audits.

Tribunal Administrativo has a right to audit ministries and agencies throughout the civil service. Inspeccao Geral de Financas can audit all entities submitting to the Government. Internal audits at line ministries obviously have the mandate to audit their own structures.

Actual audits are performed by all these three bodies apart from the Tribunal Administrativo. Inspeccao Geral de Financas, for example, carried out a little less than 50 audits at central and provincial level during 1998, concerning the execution of the budget of 1997. Tribunal Administrativo can display a comprehensive legislative framework for operations, but can show no auditing activities.

Audits provided by these organisations are classified as internal material, with the exception of audits that have been carried out on the request of donors. This would indicate that transparency is low and that no actual discussion with donor parties, concerning the result of national audits, normally take place. There is little external knowledge of what happens with audits performed, and if any sanctions or other measures are imposed as a result. We were informed that there are currently 20 outstanding reports awaiting final approval by the MPF.

Furthermore, there is little knowledge of the quality of these reports, even though assistance to some of the audit organisations would indicate that a lot still is missing. The absence of actual performance in some cases, in combination with little access to existing reports, irrespective if these reports are dealing with concerned donor interests or not, creates an atmosphere of mistrust among donors against the findings, the capacity of the organisations and the (political) will to take action.

Further, there is little knowledge on how state audit institutions inter-link and co-operate, between each other and in relation to external audit capacity. Technical assistance is established at Inspeccao Geral de Financas and is under formulation at Tribunal Administrativo. Establishing these projects will however not result in capacity to present reliable audits from these organisations for at least several years.

Recommendation 25

All donors are recommended to take into consideration the absence of actual capacity within state audit structures in Mozambique for at least the medium term, indicating that all transfer of, e.g., programme support will need to be followed-up repeatedly through external audits. In the case of support through sector programs, this need should be calculated as a substantial cost as part of donor funding of the program.

However, this "individual" audit policy will never provide donors with a clear picture of how audit structures in Mozambique work and how the audit of one individual donor's money is linked to other cash flow (from domestic resources or other donors). External auditors hired by donors are not allowed to audit expenditures defined as funded by domestic revenue. In reality, however, this difference between domestic and external resources does not exist, since financial external support eventually is being used to fund domestic budget expenditures. This calls for an operational audit structure with sufficient competence that could perform audits that include budget resources from all sources.

In relation to the construction and funding principles of sector programme support, this could almost be defined as a pre-requisite. This kind of support will in most cases eventually be not only budgeted through the same structures as domestic funding contribution to the programme, but also external and national cash flow will be merged through common accounts. In practice there will be no possibility to audit these funds separately, using internal audit structures for domestic resources and external audit for donor resource input, since this division between different kinds of money no longer will exist. Eventually this new structure of co-operation will make it necessary to perform audits that include all financial resources allocated, irrespective of their source. This could in the medium term only be achieved through a co-operation between donors and domestic audit institutions, aiming at two objectives:

- To clarify the interrelation between Mozambican state audit bodies and how the system of audit performance and actual sanction works, both in relation to internal resources and in relation to donor funds. Sweden could take the main responsibility to initiate such a study, given the engagement at both Inspeccao Geral de Financas and Tribunal Administrativo. It should be possible to present TOR for the study during 1999 and also start investigations.
- Based on that, offers should be made to the Mozambican audit organisations to participate in every audit performed by external auditors, and to co-ordinate these activities with on-going capacity building projects at some of the institutions. At the same time donors should ask to be allowed to co-operate with these organisations in internal audits that could be defined as more important also to donors. In audits related to sector programme support co-operation, this collaboration should be compulsory agreed as part of the agreement on the program.

4. The public service/civil service reform

In 1987 GOM created the Ministry of State Administrative Affairs (MAE) to improve – in close co-operation with the other ministries of the state apparatus – the capacity and quality of the public service. This is a formidable task, as there are about 95'000 civil servants in the public sector, of which the large majority is poorly educated, receives low salaries (both in absolute terms and relative to the private sector) and is inadequately motivated. A few numbers may give a crude picture of the situation. 80% of the civil servants have no more than basic 6th grade education, only 3% have had university education, and more than 50% earn less than the equivalent of 40 US-Dollars a month. 48% of the civil servants work in the education sector, 18% in the health sector.

MAE is the lead-ministry to develop and co-ordinate the implementation of the reform process. An Interministerial Group for Co-ordination of Reform of the Public Service (GICRAP) has been established, which will be supported by a Technical Group for Reform of the Public Service (GTRAP), responsible for the overall management of the reform. At the time of the mission, the head of this technical working group had just been nominated.

MAE's reform strategy can be divided into five major "vectors": (1) Rationalisation of Human Resources, (2) Institutional Reforms, (3) Rationalisation of Administrative Processes, (4) Decentralisation and De-concentration, and (5) Reform of the Budgetary Process. It goes without saying that the vectors overlap, that particularly the vectors (2) and (3) must strongly rely on concepts developed with and within individual ministries, and that vector (5) is heavily determined by the MPF. Over the last years, MAE has put major emphasis on vector (1). Therefore the following discussion will mainly focus on activities relating to human resources.

MAE has created a National Human Resource Management System (SRH), which contains standard personnel files of over 85% of public employees. The implementation of that system went along with a reclassification of job and salary categories. The former was reduced from 9'000 to 908, the latter to 98. MAE is introducing a computerised personnel database (SIP) for planning purposes, and is establishing standard procedures for personnel administration in all sectors and provinces. The employees not yet recorded in the SRH system should be included by 1 April 1999.

As already mentioned in chapter 2, a first decompression of salaries took place in 1998, and a second will follow in June 1999. The decompression, which also goes along with a rise of the low- to mid-level incomes (of personnel such as teachers and nurses), aims at keeping employees in the public sector that are most threatened by workforce flight. In addition, MAE is in the last stages of developing a new civil service career system (SCR), which is designed to create greater transparency and consistency in compensation, and a long-term incentive system to stay in the public service. 2'000 occupations are classified into 12 career groups with 13 levels of progression. Procedures to progress in a career group and between career groups include tests and evaluations, and take into consideration additional training and special work experience. All in all, the system is much more "delivery"-oriented and flexible than before. MAE expects that all public employees will be classified in the new system by mid 1999.

An important measure within the new human resources system is to strengthen training and education of public employees. A Public Administration Training System (SIFAP) has been approved, but only very recently the first steps towards implementation have been taken. At the time of the mission, a tender had been launched on pre-qualification of agencies capable to develop a preparatory programme of training of civil servants. The preparatory programme is to be implemented at the Institute for Public Management (IMAP). It aims at both formal training, i.e. a 3 year training programme at IMAP, and an informal training programme, i.e. a modular set of short courses. Funding and technical assistance for the preparatory programme is provided through UNDP. In the end, a full programme should be implemented with a significant impact on the qualification of personnel in the public sector. The formal programme is supposed to cover (in the medium term) a target group of some 1'000 to 2'000 public employees, and the informal modular programme envisages a target group of 6'000 to 10'000 civil servants.

In addition to these measures, a number of activities have taken place or have been initiated in the area of government ethics and civil servants' duties and responsibilities. Norms of conduct and disciplinary procedures have been put in place, the National Assembly has passed a Government Ethics Bill in March 1998, and a new State Administrative Inspectorate (IAE) within MAE has been founded. GOM's proposition of establishing a High Authority Against Corruption was however rejected by the National Assembly, mainly on the grounds that already existing bodies in the legal system, notably the Administrative Tribunal, could and should take care of these issues.

Conclusions

It is obvious from this brief summary that work on the human resource management system, the salary reform and the new career classification is most advanced, while progress in the area of training and ethics/codes of conducts and related procedures are considerably less advanced. Likewise, the progress in institutional, organisational and procedural reforms within various ministries varies widely. In comparison, as mentioned in previous chapters, the new budgeting process, an important element of public service reforms, has made significant progress. Regarding decentralisation, the most important step is reflected in the municipal elections carried out in 33 cities and towns in 1998. Anecdotal evidence indicates that this attempt to delegate more decision power, fiscal resources and accountability to elected local authorities is very promising. However, a comprehensive strategic concept of how to continue the decentralisation process has not yet been worked out.

Instead of giving recommendations on the public service reform, the JDR-team would rather like to raise two issues that so far appear to have been rather neglected – at least according to our information – and suggest to reserve more time for this area in next year's JDR-mission.

The first issue we want to raise is clients' participation to strengthen the reform process. It is widely agreed that the speed and quality of numerous public services could be improved without having fully implemented complex and expensive reform measures. One measure to strengthen the reform process in various areas could be the implementation of a well-targeted client participation in the sense that clients would be allowed to raise their voice regarding the quality of the services they get. Instruments could go from discussion rounds, as they have already been held e.g. with the business community, to beneficiary assessments, as they have been initiated in at least one donor-funded sector programme. It can be expected that in many cases only modest investments would be required to design and implement procedures to collect and analyse the information, and to put conclusions and decisions into action. Of course, the latter is absolutely decisive. But it is for sure that the whole public service reform process would win additional credibility and support from the public if such "quick steps" would be taken wherever possible.

The second issue refers to the impression of the JDR-team that the many measures envisaged in the public service reform are mostly "input-oriented" and show a relative lack of "output" and "impact" orientation. To be sure: the reforms on the input side are necessary preconditions for success, but in the end they will only add up to sufficient conditions if the output and the impact are monitored and evaluated. This raises questions like: Which indicators of the quality of public services that are to be increased by the reform are actually envisaged, i.e. how are the results and the impact of the reform to be measured? How and by whom will they be monitored, how will they be evaluated, and how will evaluation results be put in action?

The JDR-team would like to suggest to both GOM and the donors engaged in supporting the public service reform to take up these two issues for further discussion and possible follow-up work.

5. Rationale for programme assistance: Towards a co-ordinated approach

More donor co-ordination required for programme assistance

As mentioned in chapter 1 the original terms of reference (TOR) of the JDR-mission called for a review of the various donors' objectives of different forms of "macro-financial support". The concept of macro-financial support, as indicated by the TOR, covers a wide range of donor assistance from "overall budget support to sector budget support, from general balance of payments support to debt relief and import support". The JDR-team came to the conclusion that this broad range of instruments should not be summarised under the catchword "macro-financial support".

Donors provide different forms of aid, or "instruments", to promote change at different levels and with different approaches. At the micro level donors provide project tied aid, at the sector level sector support and at the macro level they provide general balance of payments/budget support to promote the implementation of general or specific policies. It is the latter which can be associated with the term "macro-financial support", as budget support is generally linked to performance indicators and benchmarks of macroeconomic development, macroeconomic policies and institutional reforms on the macro-level. As indicated in chapter 1, all forms of non-project assistance – including general budget support – can best be summarised under the tern "programme assistance". Whether it is import support, sector support or general budget support, in all cases financial and technical assistance is made available in the context of policy programmes. From these policy programmes, agreed upon between donors and recipients, the conditions are derived that must be achieved and fulfilled for the programme to be "on track", which then ascertains continued support. (The term condition is used here as a catchall term that includes benchmarks and performance criteria.)

If overall public sector management were considered adequate to monitor the actual implementation of agreed policies (reflected by reliable records of actual public expenditures and monitorable indicators in terms of quality, quantity and impact of public services), there would be no reason to disburse funds under project or sector programme agreements. Instead, all aid could be provided as general budget support – a sort of "optimal solution". Since this does not appear to be the case in Mozambique, in fact, at the time being, in no developing country at all, donors continue to disburse directly to projects and sectors. Among other things, this implies the assumption that general budget support will not necessarily filter down to the sector and micro level exactly the way it is intended. Nonetheless, even under these circumstances general budget support is a reasonable and legitimate instrument. It can be provided to give incentives for implementing agreed policies that will improve overall economic and public sector management. It is also frequently considered as the best instrument to support the development of domestic capacities to generate and implement policy and institutional reforms independent of donor-driven concepts.

General budget support does not target disbursements to recurrent or investment expenditures in any specific sector, but is a general contribution to finance total public expenditures. It is concerned with total resources available and its use. Accordingly, conditions of general budget support should focus on total resource mobilisation and total resource use. However, assuming that an ESAF-arrangement is in place, these conditions should be compatible with the policy matrix of the Policy Framework Paper (PFP). This matrix includes among others things the key-parameters of macroeconomic policies and institutional reforms. Any additional conditions outside the range of the policy matrix, as well as a too large and detailed set of conditions in general, may overburden the Government, may create disincentives to generate and implement reform policies independent of donors, or even create non-solvable policy conflicts. It goes without saying that achieving compatibility may require the active involvement of bilateral donors in the PFP-process.

Some donors provide support tied to specific imports and/or conditions regarding the country of origin, with or without generating counter-value funds (cash or in-kind contribution). Moreover, donors also provide sector support where – if not the forex – at least the generated counter-value funds are tied to specific sectors. All these forms of ties contribute to increase the transaction cost for the Government in allocating resources efficiently. The resulting problem is an exacerbation of the problem of possibly too many and too detailed conditions outlined above for the case of general budget support. The Government of Mozambique receives aid in all forms and shapes from more than 50 official donors and IFI's with conditions attached that refer to the micro, sector and macro level. It is a tremendous task to sort out these conditions, which always bear the risk of conflicting requests, and to include them in a coherent policy package. Therefore the argument to ascertain compatibility and a manageable burden of conditions, as mentioned above for the case of general budget support, holds for assistance tied to sectors and specific imports as well.

With assistance tied to specific imports and sectors the question arises whether conditions attached to these forms of aid should only refer to the respective sectors or may also refer to more overarching general (macro-) policies. It is obvious that tying sector support and specific import support to general policy conditions is in fact double tying. First, the form and sector-specific conditions of aid limit the opportunity to allocate funds freely. Second, the Government must also adhere to general policy conditions. However, the allocation restriction is of course loosened by the fact that aid is fungible. Funds allocated by donors to a specific sector or purpose may free domestic funds that can be re-allocated to other sectors or purposes. Moreover, as mentioned before, empirical studies indicate that the effectiveness of all forms of aid depends upon the quality of policies and institutions in recipient countries. This means that donors seeking effectiveness will, either in explicit terms or with some more or less obvious implicit understanding, make their assistance conditional on the overall quality of policies and institutions, independent of their form or composition of assistance.. Therefore it may very well make sense to attach general policy conditions to assistance tied to sectors. If the non-fulfilment of certain macro-conditions has a clearly negative impact on the effectiveness of the sector support this cross-level double tying is reasonable.

Recommendation 26

There is a need for all donors to co-ordinate the conditions they attach to their various forms of programme assistance in order to reduce transaction costs for the Government as much as possible. The five like-minded donors could take a leading role in this effort. Among other things, this co-ordination must include the establishment of a limited and compatible set of conditions that can be managed by the Government within the PFP-process. In addition it requires rational decisions on whether and how support tied to specific sectors should not only be linked to sector-specific conditions but also to general policy conditions as outlined above.

Control of budget execution and outcomes

In Mozambique, poverty alleviation has been translated into, among others, public sector expenditure for social sectors. Emphasis has been put on measuring to what extent social sector expenditure, both in terms of financial targets (share and volume of expenditure) and output indicators (like teachers per pupil, etc.) have increased. In the former case actual verifications are difficult to obtain due to low capacity in public sector financial management. In the latter case it seems difficult with the current information available to find a strong link between volume of expenditure and output/impact. There is a need to have more information on the impact of the policies pursued on poverty alleviation in Mozambique if such conditions or performance criteria are to be meaningful.

A new budget framework has been introduced. However, the volume of "off-budget" expenditure is still not known, nor is it known how it will have an impact on total allocation of resources between sectors. In terms of actual budget execution, the "on-budget" expenditure cannot be verified since actual expenditure data have not been published, and even only a part of what is "on-budget" is actually captured by the present system of public accounting. To verify how various types of resources have actually been distributed is even more difficult. It appears that sources and uses of funds are not reconciled at the treasury, and expenditures are not verified by auditing of accounts.

Thus there is a limited basis for using profiles of budget execution as a condition or performance criteria for programme assistance. There is already a process ongoing to capture "off-budget" expenditures in the budget. With a new budget taking these resources into consideration it will be possible to present a budget that shows the intended profile of total public expenditures. However, the Government will still have a long way to go before actual expenditures can be presented and reconciled with the cash-flow, and even longer time to actually verify the use of total resources by auditing.

This situation of limited transparency and accountability of public financial management raises a fundamental question: should donors provide general budget support under a financial management system that does not allow for a fully satisfying control of the actual use of all public funds, i.e. domestic and donor funds lumped together? To put it differently: should donors under these circumstances not prefer to provide sector support, which allows them to fully control the use of their funds? Control means in this context financial control, i.e. the check whether there are any differences between planned expenditures and actual expenditures. Aspects of implementation capacity and quality of services are not included in the following discussion. Both can, in all sectors of public activities, be improved through technical assistance and/or the contracting of qualified implementing agencies. This is a different aspect referring to other instruments, although it is to be admitted that the financial control of planned public expenditures and the monitoring of the amount and quality of services generated with it follow one goal.

The (financial) control problem is a special case or part of the fungibility problem. Usually, aid fungibility is seen as a phenomenon on the level of budget planning. If a donor starts to provide assistance for a certain purpose, the government may react by re-allocating planned expenditures in the respective area for other purposes. As a consequence donor assistance would not be fully additional. The effect can be measured by analysing expenditure patterns and sectoral patterns of assistance. Under a deficient financial management system fungibility may exist without detectable re-allocations in the budget. The government may divert resources from one purpose to another, without adjusting the budget, and without the diversion being visible in the incomplete and unverified information about expenditure execution.

Under these circumstances the proportion of controlled public funds can most probably not be solved by switching from general budget support to sector support. This is best illustrated by a fictitious numerical example. Let us assume that the budget is 100, financed by domestic revenues of 80 and general budget support of 20. In addition it is assumed that the Government, for whatever the reason, diverts 10 from planned expenditures for other purposes. Moreover, it is assumed that 2 of the 20 general budget support are not used as planned. Now let us assume that donors decide to fully substitute the budget support by sector support, which they fully control. Will the sum of diverted funds then be reduced from 10 to 8? That would only be the case under the assumption that there are no other opportunities for fund diversion in the rest of the budget. This hypothesis is probably heroic, and in any case hard to prove. It is at least as likely that the diversion of funds will remain at 10. We just don't know.

As mentioned above, the financial control problem is a special case or part of the fungibility problem. The fungibility of aid requires that donors, independent of the form of assistance they provide, must check whether the overall budget allocation sufficiently reflects their ideas of an "adequate" volume and pattern of public expenditures. Under a deficient accounting and audit system, the financial control problem implies that donors, of course again independent of the form of assistance they provide, must take into consideration that public funds may be diverted without that being visible. Under these circumstances, donors cannot ascertain with sector assistance (or project assistance) that the respective sectors actually receive the funds as planned.

Recommendation 27

Under these circumstances donors may consider the following options regarding the provision of general budget support:

- Donors may decide not to provide general budget support, based on the argument that the current public financial management system is too weak to provide an overview of total resource flows and their use. Instead they can target disbursement to specific sectors or projects, making sure that at least donor funds are verifiably executed as intended. However, donors must admit that they cannot be sure whether this actually improves aid effectiveness. What counts is the net effect of aid. Only if the unknown diversion of donor funds, hidden by an incomplete and unverified accounting and audit system, were not substituted by other opportunities of diversion, the overall situation would improve through the increased control of funds. However, that is an assumption virtually impossible to prove.

- Donors may provide general budget support, but should not expect to receive reliable and verified indicators on the profile of total budget execution in the short term. In that case donors fully acknowledge the possibility that an increased proportion of fully donor-controlled funds will not necessarily improve the overall situation, i.e. that only an improvement of the overall financial management system will provide a remedy. Therefore donors should strongly support the ongoing efforts to improve overall financial management, which in the future will allow for more reliable indicators of actual budget execution. Advances in this area should be high priority conditions, backed by technical assistance to secure as much progress as possible. It goes without saying that also the first option can be combined with this concern and support.

The two options are obviously based on two different answers on the hypothesis regarding the overall impact of an increased proportion of totally donor-controlled funds. Unfortunately, the hypothesis is practically impossible to test. But there are arguments that actually both routes can and should be followed with good reasons.

There is wide agreement that if sector support is provided, the procedures applied should not be stand-alone donor operations parallel to public sector procedures, but that they should be integrated and made compatible with the government budgeting and accounting framework. In other words, donor resources, although fully controlled by donors, should be captured in budget execution for at least two reasons. First, this will contribute to minimise the transaction costs for the Government in utilising the resources. Second, it can be expected that such a co-operative approach will have positive synergies. Not only the donors but also the government benefits from the improved control of resources, and it is likely that sound procedures of accounting, budget execution and auditing will have spill-over effects into the existing procedures of the respective sectors.

On the other hand the provision of general budget support has the advantage that it provides more flexibility and less costly opportunities for the government to decide about sectoral budget allocation and actual expenditures. The agreement between the government and donors about an appropriate expenditure pattern is then clearly more a case of policy dialogue than financial and operational donor intervention. As mentioned before, the combination of general budget support and policy dialogue, if not overburdened with too many detailed conditions from the donor side, is interpreted as an incentive to strengthen endogenous reform forces.

Common to both approaches is the concern to improve of the public financial management system through technical assistance. In the first option that will partly be accomplished very closely with the sector support, in the second option it will also be accomplished with technical assistance, backed by conditions attached to general budget support. All in all it seems that there are good reasons to follow both routes and to take advantage of the strengths of both instruments. General budget support and sector assistance are more complementary to each other than mutually exclusive. Therefore it seems highly recommendable that the five like-minded donors co-ordinate their efforts and try to work out an optimal mix of these instruments.

A common system for programme assistance

The five donors all provide some form of programme assistance but through a large variety of approaches and conditions. Import support is provided to generate counter-value as general budget support. The following examples may serve as illustrations:

1. Import support/budget support – Tied to general PFP performance and emphasis on new organisational structure, selection of computerisation scheme and initiation of public campaign for VAT. In addition issues like increased central Gov. revenues to GDP, reduced share for public expenditure for defence and security, implementation of a new career stream compensation structure for civil service and satisfactory revision of the commercial code are stated as criteria.

2. Import support/budget support – Tied to general PFP performance. Co-financed with the World Bank, however private sector do not have to comply with the stated procurement regulations.

3. Import support/budget support – Tied to general PFP performance, with specific focus on improved customs effectiveness, monetary control, fiscal management and increased social sector spending.

4. Import support/budget support – Tied to general PFP conditions, but with special emphasis on progress on reform related to Government budget, accounts and audits

5. Debt relief/ budget support – Tied to general PFP performance, and Government design and implementation of retrenchment scheme for civil servants. Disbursed on a reimbursement basis to cover debt service payments to the World Bank, ADF and IMF with savings from debt service tied to costs of retrenchment of civil servants.
6. Foreign Debt Alleviation Fund – Tied to general PFP conditions. In addition savings from reduced debt service payments to be allocated to social sector expenditure and poverty alleviation programs[1].
7. Foreign Debt Alleviation Fund – FDAF conditions, i.e. additional expenditure for social sector and poverty alleviation programs[2].

Judging from the above, its is reasonable to say that the donors jointly consider progress under the PFP-framework as conditions for their support, but with differences in focus on certain benchmarks/performance criteria in the PFP and different procedures for disbursement.

A co-ordinated approach would include the following elements:

- a common set of issues to focus on (performance criteria).
- a common procedure in jointly reviewing performance as basis for release of funds
- a common procedure for disbursement of the funds
- a common approach in monitoring the utilisation of the funds

Recommendation 28

Common issues or performance criteria
If the donors are to apply a common approach they should decide on a common set of issues that either are included in the PFP or at least compatible with the PFP. This set of performance criteria/benchmarks should be monitored and adjusted, as other policy issues become important within the PFP-framework. In Annex 2 we suggest some broad areas within the financial management area where targets could be set within or compatible with the PFP-framework. Since it is to fall within the scope of the PFP, the criteria to be established should follow a review after the annual IMF-review mission unless the donors have the ambition to influence the PFP-process at this level.

The criteria should be clear, simple and achievable. Clarity and simplicity are important so it does not involve lengthy ex-post discussions on what was to be achieved by the GOM. Achievable means agreed performance criteria should be within the GOM level of capacity.

To give some illustrations:

- If donors demand information on actual expenditures in social sectors as an indicator of GOM implementing poverty alleviation policies, they need to agree on what kind of information this is to be presented. If donors demand data on total public expenditures this is not achievable since a major share of resources are not budgeted and even less accounted for within the current public accounting system.

[1] Apparently the FDAF conditions on allocations to social sectors have been waived.
[2] Same waiver as above.

- If donors put a lot on emphasis on progress by GOM in developing a framework for overall planning, budgeting, accounting and auditing they should focus on establishing an agreed timetable with the GOM and define the improvements to be made and actions to be taken. This is related to the ever-returning issue of "off-budget" expenditures. The coming study by itself is by the PFP considered a benchmark, however the main issue is how all resources provided outside the budget can be incorporated in the state financial system on a sector by sector basis. Both can be used as performance criteria, however it is the latter that will make some impact.
- On the disbursement side, the Government is asked to reconcile balance of payments support inflows with revenues generated for the budget in the form of counter-value funds. They have done so in terms of forex sold to the private banks, but never been asked to consolidate these flows through to the treasury. Secondly they have not been asked to reconcile these flows with all other flows to treasury to see the budget support in relation to total resources and their use.

All the above are samples of issues which could be a basis for defining some common criteria by the five like-minded donors.

General budget support by donors is not meaningful to trace on a donor by donor basis. It is the total flow of resources and their utilisation, which are the key issues. Since information concerning total public expenditures can not be produced with the current status of the system, a number of second best criteria associated with the budget support may be applied. They are associated with the ongoing process to improve the situation.

One set of issues which seems highly relevant following the findings from this mission (other than general assessment of progress under the framework of PFP) would be issues related to financial management like:

- Agreement on a timetable (e.g. on a quarterly basis) for the GOM to produce estimated actual expenditures as per accounts and total disbursement from treasury for budget execution, even though such estimates will only capture a certain proportion of total resource flows. These figures should be presented in relation to the budget, despite the fact that the budget captures more than the accounts. The purpose is not to focus on the numbers themselves but rather to institute a process of public presentation of information related to budget execution.
- Agreement on a timetable to map out resources flowing to and from the treasury accounting system. This may include additional technical assistance extending the EU-funded project on the MB10 and broaden the scope to include all revenue accounts and the treasury account at central level. Based on the mapping of the revenue flows through central treasury, agreement should be found on a procedure for quarterly reporting on actual resources made available through those treasury accounts.
- Agreement on a timetable for the Government to map out "off budget" expenditure and a plan for how to incorporate them in the Medium Term Expenditure Framework, Annual Budget and subsequently the public accounting system. The issue will have linkages to the process of designing Sector Wide Programs (SWAPS).

In the short run, the attempt to also include output indicators or indicators of impact seems less relevant, simply because very little is actually known of the linkages between public expenditures and quality/quantity of e.g. social services. However, this is undoubtedly an important problem to be tackled in the medium and long run. If such output indicators are to be applied in the future, additional resources to produce this information is required. Such efforts should be considered as components under sector programmes, as studies to be implemented as part of an assessment of the actual impact on poverty and/or as support to the current work of formulating a poverty alleviation strategy and develop related information systems.

Recommendation 29

Common procedure for monitoring performance
The donors should agree on common procedures for monitoring progress, working as far as possible within already established joint working groups (e.g. budget working group). The procedures must include the format of reports, the frequency of monitoring and dealing with non-performance (including such issues as the possible suspension of MFS). Criteria need to be distinguished as critical and important.

In addition to the already established procedure for joint annual reviews, it should include:

- Whatever performance criteria are used, the information required to review progress should be made available by reporting in an agreed format at regular intervals (quarterly).
- The review of the reporting can be the task of the already established joint GOM/donor working groups (like the Budget Working Group).
- Joint decision on how to respond if important performance criteria are not met or seem to lag far behind an agreed schedule (call for a joint review meeting, etc.).
- The Joint Donor Review missions could continue as the instrument for providing input to the monitoring by donors with a timetable for the JDR agreed upon between the GOM and donors.

Recommendation 30

Common procedure for disbursement
As an attempt to establish a funding facility to disburse according to progress, to relieve the Government of the burden of reporting and accounting on a donor by donor basis and track funding from various accounts the following should be considered:

- If possible, consider pooling all resources into a "trust fund"/forex account or other facility (similar to DFAD) for all general budget support. Disbursements to generate counter-value should be guided by the above performance criteria (tranches).
- For donors disbursing on a reimbursable basis, the replenishment of this fund could be based on progress related to specific criteria however should preferably be based on the above common set of criteria.
- Another option is to consider co-financing with one donor taking the lead, with the pool of funds being disbursed according to the above criteria.
- Release of funds from the "trust fund" (sales of forex to the Inter-bank marked) should be based on the joint quarterly monitoring of progress with the usual condition that counter-value funds are immediately disbursed to treasury.
- The release of funds can be made in tranches every quarter or six months. The share of the forex to be released in each tranche should be agreed upon.

- In addition to performance criteria release of funds should be linked to the requirements in terms of reporting (accounting for utilisation and annual auditing).
- Accounting and auditing should include a reconciliation of funds from sources (the forex account or fund) through the transformation into counter-value in the inter-bank to the treasury (not the limited reconciliation done today).

The above means:

- Pooling the funds into one account under the management of BOM.
- Funds to be released in tranches based performance in relation to specific criteria and reporting on utilisation.
- Accounting and auditing covering flows from the forex account to the internal treasury account providing cash to the various expenditure accounts for, among others, budget execution

Rather than annual or one-time allocations donors should consider a medium term approach of two to three years linked to the PFP-cycle and the MTEF-process.

Recommendation 31

Shared monitoring of the utilisation of donor funds
The core issue is the utilisation of the counter-value funds for budget execution. The focus of attention should accordingly be on the total flow of funds from the trust fund (common forex account) through to the treasury account used for budget execution. As discussed in more detail before, this requires accounting and auditing performed for the total flow of funds including the reconciliation between all the following steps:

- The flow of funds from donors to the "trust fund account".
- Forex sold from the "trust fund" to the market at the market exchange rate.
- Counter-value generated for the GOM by selling the forex (deposited into the MB10 account or a new transitory account if MB10 cannot be reconciled with previous flows).
- The transfer of counter-value to the treasury account for budget execution.

Annex 1

Terms of Reference for a joint donor review of macro-financial support to Mozambique

1. Background

Mozambique has been the recipient of substantial amounts of macro-financial support for a relatively long period of time, both before and after the initiation of structural reform programmes in 1987. The five donors included in this Review are Denmark, Norway, Sweden, Switzerland and the United Kingdom. These five countries have been and continue to be among the largest bilateral donors of macro-financial support of different forms. In the following, the term macro-financial support will be used to describe import support, balance of payments support, provision of foreign exchange, general budget support, sector-specific budget support, and debt relief. The modalities of this support have shifted over time in response to the changing economic environment in Mozambique.

The development objective of the macro-financial support provided by the five donors is to support the efforts of the Government's structural adjustment policies that aim at enhancing economic growth and efficiency as well as transparency in resource allocation and provision of government services; the ultimate goal being to improve the living conditions of the population.

When macro-financial support is disbursed, it is mainly accounted for against imports. Increasingly, the five countries involved in this review have felt that the rationality for using import statistics to verify the accountability is becoming out-of-date with developments in Mozambique. Efficiency of Mozambique's budget process, budgeting and accounting procedures is becoming more important. Accountability for the countervalue funds is moving from import statistics to budget execution and accounting numbers. Donors' moving from projects to sector wide approaches also require accountability in the terms of the recipient's budget systems and the review should be aware of the work being undertaken on this at the sector level (notably in PROAGRI).

The five countries therefore wish to increase their knowledge of the host country's budget system: both in terms of how the Government of Mozambique proposes to change its budgetary allocations over the medium term; and in terms of the payments, accounting and auditing systems used to maintain and check compliance with these budgeted allocations. The Joint Review Team shall also follow-up on its proposed changes and recommendations from last year's assignment (May 1998).

Annex 2 provides a brief description of the current types of macro-financial support provided by the five donors.

2. Objectives

The overall aim of the Joint Review is to improve the efficiency with which our macro-financial support helps Mozambique meet its overall goals, in particular of poverty reduction.

The specific objectives of the Joint Review are to:

i. draw lessons and conclusions from past and current macro-financial support;

ii. follow-up on the proposed changes and recommendations from the Joint Review in May 1998.

iii. assess the overall need for macro-financial support in Mozambique;

iv. review trends and plans for budgetary allocations and assess the strategy and efficiency of the Government's revenue generation at central and local levels;

v. assess the quality of accounting and auditing of the state budget, planned reforms and the expected time schedule;

vi. propose a common system and benchmarks for macro-financial support;

vii. identify issues for deeper discussion within the Policy Framework Paper process;

3. Scope of Work

The scope of work shall include but not necessarily be limited to:

The Justification for Macro-Financial Support.
The team will develop a general justification for providing macro-financial support over the next 5 years which covers the following areas:

- The overall need for macro-financial support and loans in Mozambique today and in the period up to end 2003, drawing on data for 1994-98. This could involve analyses of: Government's strategy on the real exchange rate and international reserves, given the magnitude of likely shocks facing the economy; Government's efforts to mobilise resources to the state budget, reviewing the assumptions on this underlying the MTEF; the Government's projections of financial assistance underlying its MTEF and (largely qualitative) assessments of the government's capacity to absorb a greater volume of financial assistance.
- The effectiveness with which the Government of Mozambique uses donor macro-financial assistance for pursuing its key policy objectives, notably poverty reduction. Review Government's plans set out in the MTEF, highlighting the trend changes in expenditure priorities since 1994. Make recommendations on the process by which Government and donors should jointly review expenditure priorities.

The team should draft terms of reference for studies into those issues it judges a more in-depth analysis is required.

Rationale behind Macro-Financial Support & Conceptual Issues.
The team will assess the various donors' objectives of different forms of macro-financial support (overall and sector budget support, import support, multilateral debt alleviation fund, debt relief and balance of payments support). The team is also to elaborate how the different forms of macro-financial support relate to each other conceptually and in practice in order to help start to define common systems.

The Efficacy of Existing Mechanisms.
The team will review the efficiency of existing mechanisms used for disbursing macro-financial assistance in order to recommend improvements, subject to ensuring adequate donor accountability. The team should highlight any easily avoidable structural rigidities inadvertently introduced which either impose unnecessary transaction costs on the Government of Mozambique in accessing these funds or otherwise make the flow of funds to Government unpredictable:

- The forex model: assess whether the changes proposed in the last review to the "Banco de Moçambique model" have taken place and, if so, whether they have led to a better functioning inter-bank market. The team may recommend further developments in the foreign exchange system, with special emphasis on the smooth functioning of the forex market and accountability requirements of donors;
- The Foreign Debt Alleviation Fund: review with a view to assessing efficiency and accountability;
- Budgetary support: review the institutional requirements for the different forms of macro-financial support, especially accounting, payments systems and auditing. The quality of fiscal management at the central and regional levels should be assessed. The team will review the improvements and reforms in the pipeline and recommend how soon these reforms will allow us to get accountability from the Government's own systems. The team will also assess the existing audit and accounting mechanisms related to transfers from the Transitory Account of the Bank of Mozambique and the Treasury Account. The team may also recommend accounting, payments system and auditing reforms that would be accepted by the five donors. The team will initiate work with Government on an action plan for common arrangements and procedures for macro-financial support.

Policy Implications.
Drawing on the results of the above tasks and a review of the present Policy Framework Paper's matrix, identify issues for feeding into debate and discussions on present and future work with the Policy Framework Paper. The focus should be on adding value to the Government's negotiations with the IFIs.

4. Method of Work

The review shall to a large extent be based on information already available and discussions with relevant parties. In relation to the first, second and third specific objectives, the review team shall make its conclusions and assessments mainly on the basis of existing documentation and penetrating interviews with relevant Mozambican and foreign parties. The different forms of macro-financial support shall be reviewed to determine how much funding was disbursed during 1996-98, and how much is planned to be disbursed during 1999-2000. The review should pay special attention to support from Norway, Switzerland, Denmark, Sweden and the United Kingdom, but also include all other donors' macro-financial support.

The review of trends and plans for budgetary allocations (point 4) should be based on statistics on the Government's budget execution as well as discussions with officials from the Ministry of Planning and Finance. Conclusions on revenue generation should be based on statistics from central and local tax departments as well as discussions with relevant parties from tax and customs offices. Interviews with officials from the CPI and foreign investors may complement the overall picture of resource mobilisation.

The assessment of accounting and auditing (point 5) should be based on in-dept discussions with relevant parties at the MPF. The assessment should benefit from interviews with Government officials and central bankers, as well as representatives from the private sector and donor community.

The JRT could also consider the use of workshops for obtaining information and discussing ideas, specially regarding specific objectives 6 and 7.

5. Output

A first draft Aide-Memoire including only a summary of the mission's findings and recommendations shall be prepared during the mission and discussed with the Government and representatives from the five donor embassies in Maputo prior to the mission's departure from Mozambique. A second draft Aide-Memoire shall be forwarded to the Government and the five donors for their written comments not later than 4 weeks after the mission's departure from Mozambique. The final Aide-Memoire shall be mailed to the Government and the donors within 4 weeks after receiving comments or not later than 10 weeks after the mission's departure from Mozambique. To the extent it is deemed relevant and necessary, more detailed analyses and descriptions should be provided in technical annexes to the Aide-Memoire.

All documents prepared under the services shall be prepared in the English language.

6. Composition of Review Team and Timing

The mid-term review is intended as a joint effort between representatives of the Mozambican Government and the involved donors.

The Government of Mozambique (GOM) representatives will be:

– Ministry of Planning and Finance: Mr Matos, Director Nacional de Contabilidade Publica,
– Mr Mambo, Director Nacional Adjunto do Tesouro para a Area da Divida Publica
– Mr Lambo, Director Nacional Adjunto do Plano e Orcamento
– Banco de Moçambique: Mr Umaia Mahomed, Dep. de Operacoes Cambiais
– Ms Elsa Maria Chambal, Dep. de Relacoes Internacionais

The donor representatives will be:

– Denmark: Esther Lønstrup, Danish Embassy and Jytte Laursen, Technical Advisory Service (TSA)
– Norway: Rasmus Bakke, Norwegian Embassy and Jens Claussen, external consultant
– Sweden: Maude Svensson, Swedish Embassy and Stefan Sjölander, external consultant
– Switzerland: Urs Zanitti and Telma Loforte, SDC/Swiss Embassy and Rolf Kappel, external consultant
– United Kingdom: Malcom Smart, DFID-Harare, Anna Bewes, British High Commission and Grayson Clarke, external consultant

Mr. Jehan Arulpragasam, the World Bank, shall participate as a resource person, especially for the specific objective No 5.

The donor representatives shall basically cover the following professional areas:

- Macro-economist(s) with good knowledge of structural adjustment and public sector economics.
- Economist(s) with a good knowledge of fiscal policies, budgetary and payments systems, accounting and auditing.
- Forex operations specialist(s) in the areas of central bank operations as well as commercial bank operations.

- Accounting and auditing specialist(s).

Donor representatives as well as GOM representatives should cover all professional areas.

The external consultant from Switzerland will act as team leader during the mission. The representative from the Swedish embassy will act as co-ordinator for the review.

The mission will take place in Mozambique 8-19 February 1999.

List of Documents and Background Material

1. Annual Sector Review Agreement: Annual Joint MISAU/Health Sector Review, ???? 1999.
2. Annual Sector Review Agreement: Annual Joint MINED/Education Sector Review, ???? 1999.
3. Banco de Moçambique: The Banco de Moçambique Model for Forex Allocations,
4. Banco de Moçambique: Proposal for Alteration of the Model for Assigning of Foreign Exchange From the Bank of Mozambique, August 1998.
5. Banco de Moçambique: Untied Import Support/Credit Line to Mozambique, Co-financing World Bank, 1993/96, Project Completion Report, December 1996.
6. Banco de Moçambique: Annual Report, 1997.
7. Banco de Moçambique: Recent Macroeconomic Indicators.
8. Banco de Moçambique: Exchange Control Regulation.
9. Banco de Moçambique: Boletins Estatísticos.
10. Banco de Moçambique: Relatório da Balança de Pagamentos de Moçambique de 1997.
11. Cassels, Andrew: A guide to sector-wide approaches for health development; Concepts, issues and working arrangements, 1997.
12. Commission of the European Communities: Supply Oriented Sequencing of Adjustment Policies, April 1993.
13. Danida: Evaluation of Danida Balance of Payment Support, Case Study of Mozambique, prepared by Luís Macamo and Jens Erik Torp, April 1994.
14. Danida: Review and Appraisal of Danish Balance of Payments Support to Mozambique, January 1996.
15. Danida: Programme Document, Danish Balance of Payments Support 1996-99, August 1996.
16. DFID: Mozambique: Assistance With the Introduction of an MTEF, June 1997.
17. DFID: Mozambique Programme Aid PEC Submission 98(39), 1998.
18. DFID: Design of IMF Programmes in Aid Dependent Countries, March 1998.
19. DFID: Partnerships for Development in Africa: A Framework for Flexible Funding, November 1997.
20. Economist Intelligence Unit: Country Report, Mozambique 4th Quarter 1998
21. European Union: Financing Proposal. Structural Adjustment Support, 8th EDF, November 1997.
22. Forrester, Paul and McLoughlin, Bernard: Sector Wide Approaches & Financial Accountability, December 1998.
23. Government of Mozambique: A View Into the Future, September 1998.
24. Government of Mozambique: Debt Strategy for Mozambique, Note to Consultative Group Meeting, May 1997.

25. Government of Mozambique: Expenditure Management Reform Strategy, May 1997.
26. Government of Mozambique: Expenditure Management Reform Strategy, Status Report, September 1998.
27. Government of Mozambique: Orçamento do Estado para 1999, Fundamentação, Setembro 1998, incl. Anexos.
28. Government of Mozambique: Policy Framework Paper for 1998-2000.
29. Government of Mozambique: Plano Económico and Social para 1999, Setembro de 1998.
30. Government of Mozambique: Public Administration Reform, Perspectives and Strategies, May 1997.
31. Government of Mozambique: Reform of the Mozambican Public Sector, Strategy and Actions, August 1998.
32. IDHEAP: Monitoring Swiss Balance of Payments Assistance and Budget Support in Mozambique. Report of the 3rd Mission: Tripartite Review, July/October (revised), 1998.
33. IMF: Demand for Money in Mozambique: Was there a structural Break?, November 1998.
34. IMF: Republic of Mozambique: Selected Issues, March 1998.
35. IMF: Republic of Mozambique – Request for the Third Annual Arrangement Under the Enhanced Structural Adjustment Facility, August 1998.
36. Joint Review of Balance of Payments Support, May 1998.
37. Ministério do Plano e Finanças: Relatório: Fundo de Alívio da Dívida, Maio and Setembro 1998.
38. Ministério do Plano e Finanças: Execucão do Orcamanto do Estado em 1998.
39. Ministério do Plano e Finanças: Integrated Sectoral Programmes, December 1998.
40. Ministério do Plano e Finanças: Projecto de Gestão de Financas Públicas, O Sistema de Contabilidade Pública, Novembro de 1998.
41. NORAD: Assessment of Norwegian Budget Support to Mozambique, prepared by econ, January 1998.
42. NORAD: Financial Management, Risk Analysis and Risk Control in Development Cooperation with Mozambique, prepared by ECON, July 1996.
43. NORAD: Norwegian Balance of Payment Budget Support to Mozambique. Appraisal Report, prepared by ECON, July 1996.
44. ODA: Financing Structural Adjustment via the Budget – ODA Experiences", December 1996.
45. Sida: Aid and Macroeconomics: An Evaluation of Swedish Import Support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam.
46. Sida: Government of Mozambique, Sida and the World Bank "Mozambique: Capital Markets Study", December 1997.
47. Sjölander, Stefan: Ministry of Planning and Finance in Mozambique, October 1997.
48. SPA: Guidance on Strengthening Public Financial Management in Sub-Saharan Africa.

49. Tribunal de Contas da Suecia: Relatório Final do Estudo de Avaliacão sobre a viabilidade de um Projecto de Desenvolvimento da Capacidade Institucional no Tribunal Administrativo de Mocambique, Dezembro de 1998

50. World Bank: Assessing Aid, November 1998.

51. World Bank: Mozambique: Economic and Financial Management Technical Assistance Project, Implementation Completion Report, June 1998.

52. World Bank: Mozambique: Economique Mangement Reform Operation: President's Report, November 1998.

53. World Bank: Mozambique: HIPC Debt Initiative: President's Report and Final HIPC Document, April 1998.

54. Memorandum of Understanding between the Ministry of Health, Ministry of Planning and Finance, Royal Norwegian Embassy and the Swiss Development Cooperation on the Implementation of a Pooling Arrangement for Recurrent Costs, Drugs and Medical Supplies. Draft version, 1998.

55. Fiscal Management Review: Study on Fiscal Governance, October 1996.

56. Notes on Budget Process, Prepared by Michael Åsén, October 1998.

57. Acordo entre o Governo da Confederacao Suica e o Governo da Republica de Mocambique sobre o Apoio ao Sector Farmaceuticp do Ministerio da Saude, Octobre 1997

58. Agreement between the Government of the Kingdom of Norway and the Government of the Republic of Mozambique regarding Balance of Payments and Budget Support, November 1998.

59. Agreement between the Government of Sweden and the Government of Mozambique on Balance of Payments and Budget Support 1998, October 1998

60. Agreement between the Government of Sweden and the Government of Mozambique on Balance of Payments and Budget Support 1998, Directed to the Foreign Debt Alleviation Fund, November 1998.

61. Agreement between the Government of the Swiss Confederation and the Government of the Republic of Mozambique on the Support to the Pharmaceutical Sector of the Ministry of Health, October, 1998.

62. Agreement between the Government of the Swiss Confederation and the Government of the Republic of Mozambique concerning Balance of Payments Assistance and Budget Support, June 1998.

63. Co-financement Agreement between the Pool of Donors and the Swiss Development Cooperation (SDC) regarding provision of financial support to the pharmaceutical programme of the Mozambican Ministry of Health. Draft version, 1998.

64. Agreement between the Norwegian Agency for Development Cooperation (NORAD) and the SDC regarding provision of budget support to the Mozambican Ministry of Health. Draft version, 1998.

65. Joint Agreement between the Pool of Donors and the Niassa Provincial Government regarding the provision of Budget Support to the provincial Health Directorate. December, 1998.

66. Annex 2

The British Macro-financial support

Britain has been providing macro-financial support to Mozambique since 1984. Traditionally, this was disbursed and accounted for against imports, though through increasingly liberalised systems, such as the inter-bank market. With the move towards a market determined exchange rate, Britain believes that the rationale for, and so accountability from, imports is weakened. What matters now is how the Government budgets and accounts for the counterpart funds the Bank of Mozambique credits to the Government's account. For this reason, the 1997/98 grant moved away from balance of payments support and was disbursed explicitly as budgetary support, as reimbursement of IFI debt servicing.

In 1998 the UK government has doubled the size of its macro-financial support grant, to £20 million for the UK financial year to end March 1999. It is envisaged that the grant will remain at this level for the next few years.

A recent change in British Treasury rules allows DFID to start making multi-year commitments of macro-financial support. It is proposed that the next UK grant will be a three year commitment, covering the period of the next ESAF. Although it is likely that some of this will be disbursed against IFI debt servicing in the early part of the period, it is hoped that systems will be developed to get accountability against other recurrent expenditures, so allowing a more effective dialogue with GoM over budgeting, accounting and auditing practices."

The Danish Support to Macro-Economic Restructuring

The Danish macro-financial support to Mozambique in the form of commodity aid tied to procurement in Denmark started in 1987 and total assistance committed for this kind of support covering the period 198–1993 was approximately USD 20 million. The next "generation" of Danish macro-financial assistance was a mixture of tied import support and contributions to credits by the World Bank. In total, four financing packages was provided by Danida, equally totally around USD 20 million.

The last agreement on macro-financial support was entered into in 1996, covering the four-year period 1996–99 and with a total budget of DKK 172.5 million, of which DKK 90 million was untied BOP support and DKK 80 million tied to procurement of medicine. The remaining sum of DKK 2.5 million was for the financing of a statistical adviser to Banco de Moçambique, as well as for audit and monitoring of the grant.

The last Danish macro-financial assistance package addressed the budgetary problem in the adjustment financing in a situation where the liberalised foreign exchange market provided mechanisms for forex resource allocation and the concessionality therefore accrues to the Government. Consequently, the Danish macro-financial support focused on public finance issues by setting conditions for disbursements related to the execution of the state budget (OGE) and the overall macro-economic management. This view was translated into broad adherence to the policy conditions laid out by the IMF as well as adherence to the PFP-matrix 1996–98. The following core issues were emphasised: i) improved effectiveness of customs, ii) improved monetary control and health of the financial sector, and iii) improved fiscal management.

A new agreement for macro-financial support is to be prepared in conjunction with the present joint review, thus taking into account the findings and recommendations of the review. The next agreement is planned to cover a five year period, 1999–2003, with an estimated budget frame of approximately DKK 230 million. In addition to the core issues focused on during the last financing package, it is expected that a closer link will be established between disbursement of the tranches and adequate control mechanisms, i.e. improvements in the Government's budget, accounting and auditing system with a view to arriving at a transparent and accountable system for this aid form.

Norwegian macro-financial support

Norway signed the first Agreement of Balance of Payment and Budget Support of NOK 100 mill in December 1996. Norway disbursed NOK 25 mill in 1996 and NOK 75 mill in 1997. The objective as laid in the Agreement is to contribute to poverty reduction through supporting the stabilisation and reform of the Mozambican economy. This is linked to the Policy Framework package of reforms adapted for the period 1996–98. The support is based on the structure and procedures laid out in the "BM Forex Model".

Norway signed a second Agreement in November 1998 of NOK 200 mill, with tentatively allocations of NOK 60 mill in 1998, NOK 80 mill in 1999 and NOK 60 mill in 2000. The performance criteria for this Agreement is also linked to the PFP. A special focus on the reform process related to budgeting, accounting and auditing.

Norway signed an Agreement for NOK 150 mill for support to the Mozambican Multilateral Debt Alleviation Fund in October 1997, with annual disbursements of NOK 75 mill in 1997 and 1998. This support is based upon the structure and procedures laid out in the Mozambican Multilateral Debt Alleviation Fund. However, Norway has opened up for a more flexible use of the "countervalue funds" in relation to the procedures laid down in Fund.

Norway is planning to give general budget support to the central level and to the provinces for the health sector for 1999 and the following years.

The Swedish macro-financial support

Sweden has provided Mozambique with import support, balance of payments support and debt relief since independence in 1975. As the situation in the country change, the support is flexible. After 1987, Balance of Payments Support as well as remaining Import Support to Mozambique have been untied and aimed at assisting in the efforts to transform the economy to a well functioning market economy. This is linked to the World Bank and International Monetary Fund's package of economic reforms as specified in the Policy Framework Paper. The ultimate goal is to reduce poverty both through the countervalue that is generated and through a stabile macro economic framework.

During 1997, Sweden had three Agreements regarding Balance of Payments Support amounting to 177 MSEK. There were two "traditional" Agreements on Balance of Payments Support and one directed to the Foreign Debt Alleviation Fund. The contributions to this fund are used for servicing multilateral debt and the budgetary savings are allocated to socially important sectors like health, education and programmes for poverty alleviation. During 1998, two Agreements on Balance of Payments Support amounting to 150 MSEK was signed. However, it seems like disbursement procedures, reporting requirements and follow-up of the support need to be analysed in order to better suit and also improve recent developments in Mozambique.

The trend for the future may be to complement the Balance of Payments support with sector specific budget support, and also to move towards general budget support. Discussions on a sector wide approach for the Swedish educational support are on an advanced stage, as are the discussions on budget support to Niassa province. Sweden also supports the efforts within the agricultural sector to co-ordinate aid (PROAGRI). In these efforts, it has become clearer that donors' knowledge of the Mozambican budget and payments systems ought to be improved.

The Swiss macro-financial support

A description of the Swiss macro-financial support will be sent out separately.

Annex 2 – The Current Accounting System

Key Objectives of an Accounting System

There are three principal objectives of any accounting system. It should be comprehensive, in that it brings into account all expenditures and revenues controlled by the government. It should be informative, in that it can provide information in a timely and relevant manner to a large number of users within and outside the government structure. It should have integrity, in that the information so provided gives an accurate picture of transactions undertaken, and that the system itself promotes the development of proper financial controls.

The present system should be evaluated in the light of these criteria.

Background
(a) – Goods and Services
The Government Accounting System is based on legislation from 1888 and 1901 and is both old-fashioned and degraded. No national accounts have been closed since 1984, and information on budget execution has been scant and unreliable

The current system (shown in the diagram below) operates on an imprest basis, in which advances ("paga") are made to individual Ministry expenditure accounts at central and provincial level, and then subsequently retired ("liquidata"). These advances are paid directly from Central Treasury account(s) to line Ministries in Maputo but at the provincial level are channelled through Provincial Departments of Planning and Finance (DPPF)

Advances are retired through the presentation of an expenditure report. The documentation used is slightly different for central Ministries as opposed to provinces. The Central Ministries have to submit a "Balancete" which records committed and actually paid expenditure for the month and year to date, and provides a balance against available budget. They also provide a "Mapa Demonstrativo de Execucao Orcamental". This is essentially a summary bank reconciliation statement, which records bank balances and provides details of unpresented cheques and uncredited receipts.

At the provincial level, the line Ministries provide an expenditure return, "Orcamental Centrale", showing expenditure incurred against each main budget vote. Original documentation supporting the imprest retirement is attached and sent to the DPPF, together with a bank statement. A copy of the claim and photocopies of supporting documentation are kept in the Department of Administration and Finance. A copy of such claims should also be sent to the line Ministry. This enables it to prepare a memorandum expenditure account statement for the line Ministry as a whole.

DPPFs are responsible for reconciling transfers received from Central Treasury accounts (in Maputo and at provincial level) with consolidated expenditure returns although it is unclear if this is performed.

The MPF is responsible for producing consolidated accounts. It should do this by reconciling transfers to each bank account, against the consolidated totals of acquitted expenditure (recorded on the Orcamental Centrale) and balances on each bank account (adjusted for unpresented cheques, bank errors etc). In practice there are always likely to be amounts of unacquitted expenditure in the system due to loss of supporting documentation, unofficial loans etc.

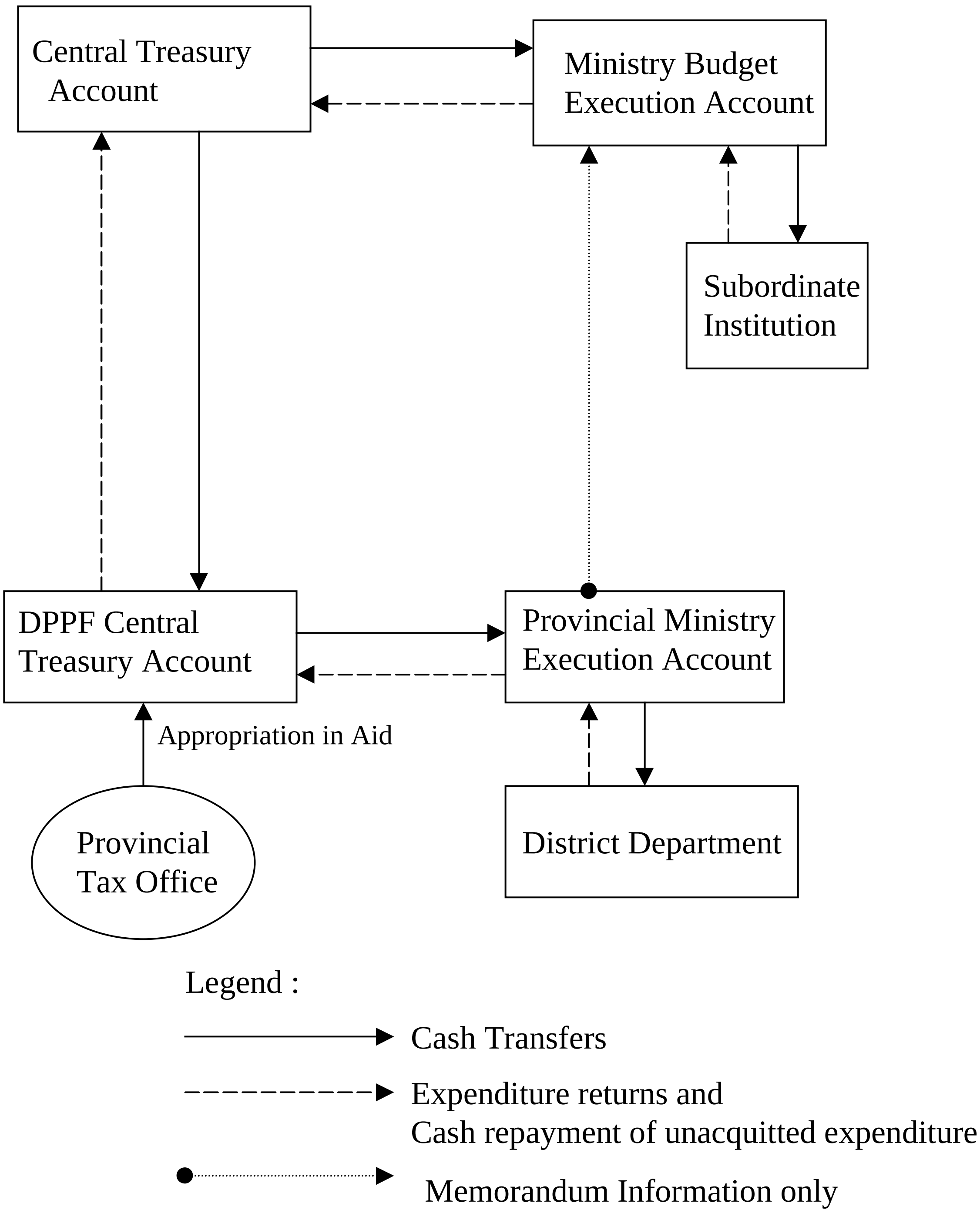
A particular problem lies with the failure of some subordinate institutions (such as hospitals etc) to submit returns for inclusion within their parent ministries.

The documentation submitted for retirement, if accurately compiled, will trigger a reimbursement of the claim. For expenditure accounts for goods and services, an initial advance of 2/12 of the available budget is made on a standing imprest basis, and has to be repaid in full at the year end. Reimbursement should then be made on a monthly basis. Reimbursement is usually limited to 1/12 of the budget, possibly for cash flow reasons. As a result, it would appear at least in the Provinces that ministries have difficulty spending their budgets, because reimbursement claims cannot be submitted before March.

At the end of the year there is a pool of unacquitted expenditure, which provincial line Ministries must acquit within 2 months and central Ministries within 3. Bank accounts are cleared through the repayment of any unspent balances and the initial advance although presumably they are allowed to remain dormant for use in the following year.

The only difference for investment expenditures is that the initial cash advance and subsequent reimbursements are not as rigidly tied to fixed proportions of the budget. Nevertheless cash flows for investment projects are usually more irregular, as they are used to cushion the impact of under-collections of revenue against budget.

Flow Diagram of the Accounting System



(b) – Payroll
Payrolls are prepared on a monthly basis by individual line Ministries and their provincial counterparts. They are sent to the MPF's own computer unit, which processes the payroll and sends cheques for the total amount of each payroll to each DPPF. Each payee has a unique identification number, which is the same as his or her national registration number.

Salaries are paid in cash and acquitted by the employee at the point of collection. This involves signing a pay slip, a copy of which is retained by the employee and a second copy by the issuing unit. Payment sheets are also used on occasion. Inspectors from the IGF are supposed to visit on a periodic basis for the purposes of payroll verification, although it may be presumed given the number and quality of IGF staff, this does not happen often.

Employees on leave or training may arrange to have their salaries collected by a relative.

No advances or loans to employees are allowed by the system. Nevertheless, it is likely that unofficial loans and advances are paid, using among other sources, uncollected salaries.

There appears to be tight control over the recruitment of permanent employees, as all appointments have to be approved by the Public Service Commission. However Ministries and Agencies appear to be able to take on contract staff, if there is sufficient budget available. Obtaining additional budgetary provision may however, take considerable time. For example, the Minister of Agriculture gave his approval for the appointment of three graduates in the Provincial Ministry in Zambezia in 1994, but budgetary provision was only secured in the 1998 estimates.

Nevertheless over time, with budgets being prepared on an incremental basis, it is possible that there has been an upward drift in the total number of civil service employees and the consequent wage bill. This does not however, in itself, signify the presence of a large number of ghost workers.

There are a large number of pensioners, many of them young soldiers and as a result the budget for pensions is growing (in 1999 about 8% of recurrent expenditure). The retirement process can take up to 4 years from the first application to retirement. Applications for pensions are made through each line Ministry, (where retirement has to be personally approved by the Minister or Vice-Minister) to the MPF. The Tribunal Administrativo has to check and authorize the grant of every pension. Only when the notice of the intention to retire is published in the Bulletin of the Republic, can the worker apply for his "Marching Order" and his salary freed to employ a new worker.

The long-windedness of this process means there is a large backlog of workers who are waiting to retire. A further complication is that workers have to submit a number of documents notably a statement of work record issued by the DPPF every five years. Many would-be retirees have not applied for these statements and as a result face a long delay in filing their initial application for retirement. The difficulties of both retiring and recruiting permanent staff, makes human resource planning impossible.

(c) – Receipts
Receipts for line Ministries mainly consist of fees and charges. Their significance varies from Ministry to Ministry, but their overall contribution to the government budget is very small. (In 1999 non-fiscal receipts were budgeted to contribute only 471 bn meticais (7.7%) out of total government receipts of 6.1 trillion meticais) Nevertheless receipts may become more important, particularly in providing for maintenance of facilities developed with donor support.

Large receipts such as licences for land development or forestry appear to be adequately accounted for. However leakage of small cash receipts is likely to be very high. Generally there are few incentives either individually or organisationally to bring receipts into account. For example officers can only receive additional remuneration if they are handling 100 million meticais per month, and then the remuneration is only 5,000 meticais

Organisationally many receipts are not treated as an appropriation-in-aid. They are paid either into a central Treasury account or a Central fund in the line Ministry (such as the Agricultural Promotion Fund). As a result, cash income is likely to be unofficially retained at district level or in subordinate institutions to provide some minimum funds. Given that districts have access to virtually no central funds (both because of budget inadequacies and the lack of banking facilities), it would seem obvious to regularise this situation.

Annex 3: Achievable Progress in financial Management in the next 12 months

Area	Achievable Objectives
1. MTEF	MTEF team to produce standard format for common disbursement and reporting routines in SWAP sectors. Development of Government Agenda to make it possible to present projections based on priorities between sectors Routines developed on donor and Government discussions of MTEF projections and funding of SWAPS Increased support to MTEF policy formulation processes Elaboration of multiyear projections in the Economic and Social Plan
2. State Budget	Inclusion of 1998 actual data by budget classification (on "expected actual data"-basis if necessary) for comparison purposes. Detailed statement of anticipated counter-value funds, as far as possible
3. State Accounting System & Budget Execution	Closure of State General Account by legal deadline, if necessary with caveats regarding information not available Distribution to development partners of quarterly expenditure reports
4. Payment system	Agreement on the development of the State payment system between concerned donors, MPF and BOM.
5. Audit	Development of Action Plan to audit State General Account 1998
6. Development Partners	Agreement at least among G-5 and GOM on standard disbursement, audit and accountability procedures on: * SWAP programmes * Debt Alleviation * Import support for medicines

Summary on the present status of the financial management system

Annual budget and planning procedures answering to on-budget resources include – at least partly – a dialogue between MPF and Line Ministries and with provinces. A process of decentralisation is ongoing, transferring influence over planning and utilisation of resources from MPF to Line Ministries and also to provinces.

The budget only holds approx. half of all public resources utilised in different sectors and probably not more than 30% of all cash flow through the State payment system. This constitutes a major problem in sector programming. Even though off-budget resources have been analysed, it is still unclear to what extent these could be incorporated.

The medium term planning process, eventually defining also annual resource allocations, is displayed through the MTEF-process. This tool was introduced in planning procedures only last year. Though fragile and weak, there is every reason for donors to support this process: Not only is there a continued need for support to further develop existing macro projection models. Through the introduction of SWAPS, the MTEF relies heavily on information made available through sector program agreements. This calls for compulsory submission from all sector programs to common reporting (and disbursement) routines to the MPF.

Donors, co-ordinated by DFID, are advised to increase support to the MTEF-process, develop and submit to common reporting procedures and strengthen also the policy position of this process.

For the first time since 1975 there will be a possibility to present State Accounts answering to the disbursement of budgeted sector allocations in the 1998 State Budget, during the following year (1999). Although this information may prove reliable in terms of actual spending and commitments of resources, it will still reflect only a limited part of all resources spent within each sector, and even less of all resources that should be a part of annual State Accounts (normally answering to all cash flow through the payment system).

Further, the closure of these accounts is still very much in doubt, even though a major part of the information is available. Information is also withheld concerning budget execution, cash releases and revenue collection.

Donors, co-ordinated by the Swedes/Sida at MPF, are advised to link the conditions of any new support that should be accounted for in the accounting system, to the closure of annual State Accounts and the presentation of actual budget execution during the year.

The State payment system is not reconciled in flows between all central bank accounts, i.e. the major forex account, the major counter-value account and the Treasury account at the MPF. This makes the final utilisation of e.g. MFS uncertain, a fact that is further underlined by the MPF policy not to publish existing information on counter-value funds generated at the so called MB 10 bank account.

Donors are advised to take this situation of actually not being able to guarantee the flows of MFS into consideration when they decide on the structure of continued support to Mozambique and when they discuss cash flow mechanisms in relation to SWAPS. Donors are also advised to request technical improvements as to make it possible to transfer all external support through the State payment system with full transparency of all cash flow. This recommendation is considered top-priority by the team.

Possibilities to perform reliable audits by the Mozambican domestic public audit organisations, are so far very limited. The introduction of SWAPS will however make it necessary to structure possibilities to audit all funding of sector programs at the same time. This calls for organised co-operation between State audit organisations and external auditors. We understand that the Tribunal Administrativo is not prevented under legislation from hiring private audit firms to carry out its activities.

Donors are advised, under the lead of the Swedes/Sida, to introduce a study on the collaboration of domestic audit structures in Mozambique. Donors are further advised to agree on common audit procedures in connection to sector program agreements and to budget for extensive external audit expenditures as part of these programs.

Recent Sida Evaluations

99/18 Atmospheric Environment Issues in Developing Countries. Gun Lövblad, Per Inge Iverfeldt, Åke Iverfeldt, Stefan Uppenberg, Lars Zetterberg
Department for Infrastructure and Economic Cooperation

99/19 Technical Assistance to Central and Eastern Europe. A cooperation between Chambers of Commerce in Sweden and in Central and Eastern Europe. Claes Lindahl, Monica Brodén, Peter Westermark
Department for Central and Eastern Europe

99/20 Sida Support to the Energy Sector in Egypt. Rolf Eriksson, Edward Hoyt
Department for Infrastructure and Economic Cooperation

99/21 Sida Support to the Energy Sector in Jordan. Rolf Eriksson, Edward Hoyt
Department for Infrastructure and Economic Cooperation

99/22 Environmental Aspects in Credit Financed Projects. Gunhild Granath, Stefan Andersson, Karin Seleborg, Göran Stegrin, Hans Norrström
Department for Evaluation and Internal Audit

99/23 Sida SAREC Marin Science Programs in East Africa. Stephen B. Olsen, James Tobey, Per Brinck
Department for Research Cooperation, SAREC

99/24 Sweden's Assistance to Bosnia Herzegovina. A study of aid management and related policy issues. Claes Sandgren
Department for Central and Eastern Europe

99/25 Psychiatry Reform in Eastern Europe. Nils Öström
Department for Central and Eastern Europe

99/26 Sida Projects in the Forestry Sector in Poland. Kristina Flodman Becker, Roland Öquist
Department for Central and Eastern Europe

99/27 FARMESA. Farm-level applied research methods in Eastern and Southern Africa. Clive Ligthfoot, William W Wapakala, Bo Tengnäs
Department for Natural Resources and the Environment

99/28 The African Association of Universities (AAU) Study Programme on Higher Education Managmenent in Africa. Ad Boeren, Jairam Reddy
Department for Research Cooperation, SAREC

99/29 Apoyo al Programa Nacional Indigena en Bolivia. Lars Eriksson, Maria Cristina Mejia, Maria del Pilar Sanchez
Department for Latin America

99/30 Support to the Micro-finance Sector in Bolivia. Lars-Olof Hellgren, Leonel Roland
Department for Infrastructure and Economic Cooperation

99/31 Proyecto VNU Promotores del la Paz en Guatemala. Kristina Boman, Eberto de León
Department for Latin America

Sida Evaluations may be ordered from:

Infocenter, Sida
S-105 25 Stockholm
Phone: (+46) 8 795 23 44
Fax: (+46) 8 760 58 95
info@sida.se

A complete backlist of earlier evaluation reports may be ordered from:

Sida, UTV, S-105 25 Stockholm
Phone: (+46) 8 698 5099
Fax: (+46) 8 698 5610
Homepage:http://www.sida.se

SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
S-105 25 Stockholm, Sweden
Tel: +46 (0)8-698 50 00. Fax: +46 (0)8-20 88 64
Telegram: sida stockholm. Postgiro: 1 56 34–9
E-mail: info@sida.se. Homepage: http://www.sida.se