

THE INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

REPUBLIC OF MOZAMBIQUE

**Poverty Reduction Strategy Paper—Progress Report
Joint Staff Advisory Note**

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June 10, 2005

I. INTRODUCTION

1. **The government has been implementing its Action Plan for Reducing Absolute Poverty (Portuguese acronym PARPA; the Mozambican Poverty Reduction Strategy Paper) for 2001-05 for four years.** In the last Joint Staff Assessment (JSA), the staffs of the World Bank and the IMF concluded that the implementation of the PARPA continued to be sound because it appeared to have borne fruit in the form of a sharply reduced poverty rate. The staffs also pointed out that, among other things, (i) the reform effort should be intensified in areas that are crucial for private sector development, including the cost of doing business, basic infrastructure, and the judicial system; (ii) there was a need to strengthen further the financial sector and improve the lending environment, including by facilitating the use of land as bank collateral and establishing an appropriate framework for microfinance activities; (iii) the data reporting system should be strengthened; and (iv) improvements were needed to strengthen the PARPA process and the preparation of subsequent planning and progress reports.

2. **This Joint Staff Advisory Note (JSAN) provides advice on the PARPA implementation in 2004 and its main goals for 2005.** It draws mainly on the government's Annual Progress Report (APR, or BdPES in Portuguese) on PARPA implementation for 2004, and the 2005 Economic and Social Plan (PES, the country's annual program).¹ The Mozambique planning and monitoring system consists of the PARPA (outlining the five-year

¹ Other background documents include the following government documents submitted to the national assembly: the budget execution report for 2004, the medium-term fiscal scenario (CFMP), and the state budget (OE). The government and the direct budget support donors annually review the past year's implementation in April/May and agree on new commitments in September. These reviews lead to an aide-mémoire that complement the APR and the PES. The most recent aide-mémoire (May 2005) was used as background for this JSAN.

poverty reduction strategy), the PES (detailing the action program to implement the PARPA in a particular year), and the APR (assessing implementation of the PES and the PARPA in that year). The 2004 APR evaluates Mozambique's performance relative to benchmarks set by the 2004 PES, while the 2005 PES defines the country's program for 2005. Both reports are submitted to the national assembly. The 2004 APR is an improvement over the 2003 APR in that it better reflects the PARPA and PES implementation and responds to issues raised in previous JSAs. It could benefit, however, from more analysis (especially of the weak performance in some areas) and a closer linking to the central, sector, and provincial monitoring systems. The APR in Mozambique does not provide an overview of the coming year's policy intentions, which is set by the PES.

3. **The government is preparing a new PARPA for 2006–10.** It is expected to be finalized during the first half of 2006 and will examine the relationship between annual management instruments and the APR and suggest changes in the development of the monitoring and evaluation systems. With the first PARPA expiring at the end of 2005, the staffs have recommended that the government prepare a full implementation report. The government indicated that it would include this assessment in the framework for the next PARPA.

4. **The staffs agree with the APR view that a number of the Millennium Development Goals (MDGs) are within Mozambique's reach but that, to achieve others, Mozambique will require the help of the international community** to make further progress and attract more investment. In particular, Mozambique is likely to reach the poverty MDG (namely, to halve poverty by 2015) and the infant mortality goal (to halve the under-5 infant mortality rate by 2015). However, it is unlikely to meet the goal of universal primary school completion by 2015 or the goal of gender equality in education (completion rates, rather than enrollment rates). Overall, much policy reform, effort, and additional donor support—aimed partly at relieving capacity limitations in the country—will be required for Mozambique to meet the majority of the MDGs. The PARPA for 2006–10 will assess the MDGs.

II. GROWTH AND POVERTY

A. Macroeconomic Performance in 2004 and Medium-Term Framework

5. **The staffs note that although the economy continued to perform well in 2004, the envisaged fiscal consolidation was not achieved and there were some delays in the implementation of structural reforms.** The APR shows that, based on the new official nominal GDP series for 2000–03,² growth decelerated to an estimated 7.2 percent of GDP in 2004, reflecting the completion of a number of private sector megaprojects. Year-end inflation

² The new GDP series for 2000–03 were revised upward by 10 percent on average. The revision affects all ratios to GDP not only during that period but also for the medium-term projections.

fell from almost 14 percent in 2003 to 9.1 in 2004. A decrease in the share of nonperforming loans enabled the banking system to reduce its vulnerability. Strong growth in traditional exports, the completion of megaprojects, and improved terms of trade narrowed the external deficit. The smaller deficit, together with greater-than-anticipated external aid and private capital inflows, helped to boost net international reserves. As a result, the metical appreciated in real effective terms. In contrast, fiscal performance was below expectations because of a shortfall in revenues.

6. **The revised medium-term scenario (in the PES) envisages strong growth in 2005–08 (in the range of 6–8 percent) together with a gradual decline in inflation to 6 percent by 2008.** The medium-term economic policies are intended to spur export-led private sector growth while enhancing fiscal and external viability through a buttressing of tax administration coupled with more efficient expenditures.

7. **The staffs think, by making a concerted effort and implementing the proposed actions on tax administration, the country will be able to achieve its medium-term fiscal objectives.** The medium-term fiscal projections envisage a decline in the government's domestic primary deficit from 3.7 percent of GDP in 2004 to 1.5 percent in 2008 through a further strengthening of government revenue, improvements in public expenditure management, and better control over the wage bill. In line with the PARPA, government revenue is expected to increase from 12.3 percent of GDP in 2004 to 15.1 percent in 2008.

8. **The APR does not include a detailed discussion of debt-management issues, a weakness that needs to be addressed.** However, Mozambique's public debt is expected to remain sustainable over the medium term. Based on the revised macroeconomic framework, the net present value of external debt to GDP will continue to decline gradually to about 20 percent by 2008.

9. **The staffs believe that the prioritization of expenditures for the PARPA priority sectors should continue at the core of the new PARPA.** APR estimates for 2004 indicate that spending on priority sectors reached 63.3 percent of total expenditure excluding interest payments, or 92 percent of the budget target. This represents a slight decrease compared with 2003 (63.4 percent).³ Spending execution rates on education, health, infrastructure, and governance was high (above 90 percent), except for spending on HIV/AIDS (59 percent) which was low as a result of persistent problems with financial mechanisms, untrained staff, and weak national coordination. Spending execution was also low on agriculture (62 percent), as a result of delays in disbursements from donors.

³ When the costs of elections and interest payments are excluded from total expenditure, the spending on priority sectors is 64.4 percent. This performance is acceptable considering the costs of elections, the shortfall in revenues, and the good performance of domestically financed spending.

10. **The staffs believe that budget comprehensiveness, through a single treasury account, is critical to enhancing public financial management and it is not addressed in the APR.** The staffs encourage the government to include it in the forthcoming new PARPA. Many own revenues and donor flows remained either completely off the budget or were not executed through the treasury in 2004. This tended to undermine the budget process because a large proportion of the line ministries' resources is off-budget. It also led to an under-reporting of the execution of externally financed investment expenditures and to inconsistency between budget execution reports and information provided separately by line ministries.

III. POVERTY

11. As mentioned in the previous JSA, **the government prepared a new poverty analysis during 2004 based on recent information. The findings, which corroborated the earlier analysis, indicated that Mozambique had significantly reduced poverty.** For example, the estimated proportion of the population living below the poverty line fell to 54 percent in 2002/03 (thereby already achieving the PARPA target for 2005). In addition, the new analysis showed that all groups in society, including the poorest, had benefited from economic growth and that inequality in real consumption between provinces and regions had diminished. The preparation of the new PARPA, currently under way, is taking the 2004 analysis into account to design policy reform.

12. **Preliminary information shows strong links between the rapid growth experienced by the country in recent years and poverty reduction.** The composition of growth in 2004 continues to be broadly based and, according to the government's 2004 analysis, has contributed to a further reduction in the poverty level; this conjecture, however, can be confirmed only by a new household survey. The APR does not produce this analysis but includes the sectoral composition of total output. Sustaining high, broad-based growth in the future will depend on a new generation of reforms that the country needs to develop and implement; the PARPA revision should produce a strategy and a framework for such reforms.

IV. PUBLIC FINANCIAL MANAGEMENT

13. **The staffs agree with the APR that the government's performance in managing its public finances was mixed.** After the rollout of the new public financial management system (SISTAFE) was initiated in the Ministry of Finance (MF), it made critical progress, but the subsequent rollout process then suffered significant delays. Steps were taken to establish the central revenue authority although Mozambique's revenue performance was poor in 2004. Procurement reform has been delayed, although recent developments are promising.

14. **The rollout of the SISTAFE began on November 1, 2004 allowing the government budget to be executed electronically through e-SISTAFE.** The budget execution of the Ministry of Finance and the Ministry of Education and Culture through e-SISTAFE were to have been initiated in 2004 but are now scheduled for end-2005. The delay, not explained in the APR, was due to institutional weaknesses during the transition period leading to the

installation of the new government. The staffs see the SISTAFE as crucial for enhancing budget execution, transparency, and comprehensiveness (with the inclusion of off-budget expenditures), and the country should focus on its implementation.

15. **The tax reform progressed as envisaged.** A draft general tax law creating the Central Revenue Authority was submitted to the national assembly in early August 2004, and the internal regulations for the Domestic Tax General Directorate were approved in December 2004. Revenue collection, however, was lower than programmed partly as a result of delays in implementing the computer system for the new income taxes, the effects of the appreciation of the metical on customs revenues, and continuing administrative weakness. The government should make special efforts to improve revenue administration, raise revenue collection, and broaden the tax base.

16. **Although a new procurement regulation has not yet been approved as had been anticipated, some progress has been made and a final draft is expected to be approved by the government in 2005.** The delays were partly the result of complications related to consultations with the different stakeholders. The staffs believe that the government's next critical steps should be to implement the new regulation in the context of the SISTAFE reform and to build capacity.

V. PRIVATE AND FINANCIAL SECTORS

17. **Mozambique's performance in implementing reform in the private and financial sectors was mixed,** as determined by the APR, and the staffs agree. The authorities made reasonable progress in implementing structural reforms in the financial sector but little progress in deeper reforms that would improve the functioning of the banking system, such as legal and judicial reform (discussed in Section V), and the tradability of land-use titles. They made modest progress in improving the business environment but are urged to step up their efforts to improve the environment for private sector development; the PARPA revision should address this issue.

18. **The reform of the financial sector was good, although the APR did not provide much information in this domain.** In particular, the government approved a strategy for adopting International Financial Reporting Standards by 2007, prepared regulations related to the banking institutions law, and began to develop the strategy for its withdrawal from the Banco Internacional de Moçambique BIM. It made little progress in submitting a bankruptcy law to the national assembly or in preparing a strategy to regulate the participation of state-owned enterprises in the financial sector. Moreover, although the anti-money-laundering law was approved, the financial investigations unit was not established. The government, however, has committed itself to developing an action plan and corresponding timetable by end-May 2005 so as to have the unit operational by December 2006.

19. **No progress was made in 2004 in modernizing the titling system for urban or rural land—an important condition for facilitating the channeling of resources through the financial sector to the private sector.** Although the government discussed a proposal for

urban title reform, it did not present the proposal for consideration by the Council of Ministers. With donor support, the government is committed to do a poverty and social impact analysis of land titles. The staffs are of the opinion that little progress was made in moving forward with the project.

20. **Progress in improving the business environment was mixed.** The revision of the labor law was delayed to end-2005 by the PES—the staffs think that this reform may well slip into 2006 to ensure that revisions are properly designed and consultations are done; that of the commercial code was also delayed but expected by end-June 2005; and new, simplified regulations for licensing commercial and industrial activities were put in place, as were the regulations for inspections of commercial and industrial activities. It is important that the revision of the labor law introduce more flexibility, particularly with respect to short-term hiring and recruitment of foreign labor.

VI. GOVERNANCE

21. **The APR described overall progress in the area of governance (public, legal, and judiciary reforms and decentralization) as slow, and the staffs share that view.** The targets for the public sector reform in 2004 were partially met but had a limited impact on service delivery. Some progress was made on the anticorruption agenda: the anticorruption law was approved, and the National Survey on Governance and Corruption was completed. Little progress was registered in the justice sector, including the administration of justice. The country made notable progress on decentralization (see paragraph 25).

22. **The APR reported modest progress in public sector reform.** Only two of the six functional analyses (of the Ministries of Agriculture and Industry and Commerce) were formally approved, presentation of the remaining four has been rescheduled for 2005. Preparatory work began on the civil service pay reform, but the staffs urge the government to do more to ensure that the reform will be consistent with overall fiscal targets. The staffs also think the reform of the public sector (including development of capacity building) is a crucial part of the requisite second generation of reforms.

23. **Although the APR does not provide much information, some progress was made in combating corruption.** The national survey on corruption was completed in the last quarter of 2004, with dissemination rescheduled for the second quarter of 2005, and an anticorruption law was passed, although the regulations for this law have not yet been elaborated. In addition, an anticorruption unit, while not yet formalized, is operating. The staffs are of the view that although the APR does not draw this conclusion, many alleged corruption cases have been reported to the unit but that the number of investigations and convictions completed so far is extremely low. The government needs to develop an anticorruption action plan as part of the judicial reform based on lessons from the survey.

24. **The APR has a long section on justice, but the staffs are of the opinion that Mozambique made little progress in reforming the justice sector.** The legislative reform and training programs are being implemented. An integrity study of the judiciary was

completed, and funding to the sector was increased. However, the long-term vision document, an essential part of the reform program, was not completed as planned and is not expected soon. The backlog and the total volume of judicial cases continue to increase. The government's ongoing challenges are to enforce human rights, provide access to justice combating corruption and economic crime, and contribute to a favorable business climate. The revision of the PARPA should include a stronger action plan for the reform of the justice administration.

25. **The APR identified progress in decentralization—an assessment shared by the staffs.** For example, the introduction of participative district planning moved forward more than expected, but a number of challenges remain. The APR does not emphasize as strongly as the staffs do that budget allocation, execution, and accountability mechanisms at subnational levels need to be strengthened and that off-budget expenditure and revenue should be systematically recorded.

VII. SERVICE DELIVERY

26. **Overall, service delivery in 2004 improved,** as reported in the APR. The staffs find that the APR describes adequately service delivery; it also includes a good amount of statistical information and shows functioning monitoring systems. However, these systems need to be better coordinated with the central system.

27. **Mozambique made good progress in the education sector, particularly in primary education.** For example, compulsory fees for primary schools were abolished, making education available to a larger number of students. The new curriculums for basic education, literacy, and nonformal education were implemented. At the secondary level, the curriculum was revised at the post-secondary level, and important improvements were also achieved. Nevertheless, challenges remain: (i) finalizing the second four-year strategic plan for the education sector, (ii) improving financial management, and (iii) strengthening teacher training. The APR does not identify teacher recruitment as an issue, but the staffs are of the view that the sector needs to improve the link between teacher training and budget ceilings; this issue should be address during the PARPA revision.

28. **Progress was made in the health sector in 2004, with an expansion of basic and essential obstetric services leading to an improvement of the MDGs indicators—**namely, the reduction of the infant and under-5 mortality rates. Problems arose in the management of the vaccination program, particularly in logistics and the poor performance of the outreach teams. The APR does not, but should, stress the need to prioritize actions in the health sector to improve efficiency.

29. **Progress in combating HIV/AIDS was mixed in 2004.** On the one hand, mother-to-child transmission declined, antiretroviral treatment increased more than had been expected, and a single national strategic plan with one coordinating mechanism and one national monitoring and evaluation system was established. On the other hand, access to care and treatment needs to be scaled up. Political leadership at all levels and across all sectors was not

strong and few sectors have mainstreamed HIV/AIDS in their sector strategies, with still fewer dedicating resources to the problem. Finally, civil society engagement at all stages of strategy development and implementation has not been adequate, and government coordination of HIV/AIDS programs needs to be improved for its programs to become more effective as infection rates increase.

VIII. MONITORING, EVALUATION, AND DISSEMINATION OF THE PARPA

30. **Monitoring of the PARPA has improved along the lines suggested in the previous JSA, but there is still room for significant progress.** On the positive side, (i) the 2004 PES and the annual budget (OE in Portuguese) are better integrated in the PARPA implementation process than in previous years; (ii) the macro-fiscal scenario for the medium term (CFMP in Portuguese) was sent to the national assembly for the first time in 2004, and (iii) the government has made progress in formulating its 2005 budget in the context of the CFMP. However, the government still needs to (i) integrate more tightly the PES, the OE, and the CFMP into a single process; (ii) link more closely the discussion in the APR with the PES so that the APR reports specifically on outturns relative to benchmarks established in the PES and provides more information on the main policy developments and issues; (iii) harmonize more fully the sectoral and provincial monitoring systems with the APR preparation; (iv) include all off-budget operations in the budget, which will allow, among other things, for the presentation of more disaggregated expenditure data and more complete information on donor-financed spending in budget execution reports; (v) ensure that the APR that is sent to the national assembly is the final version of the document rather than one in a series of revised drafts; and (vi) ensure that the separation of the planning and finance functions into two separate ministries will not create problems for the implementation and monitoring of the PARPA and the relationship between the PES and the OE.

31. **Significant efforts have been made to broaden the consultation process and the dissemination of information about PARPA implementation to development partners and the public in general,** as emphasized in the last JSA. The APR does not go into this but lists many steps that were taken: (i) the Second Poverty Observatory was held in April 2004 and included representatives from the private sector, civil society, and a broad spectrum of public entities; (ii) representatives from civil society participated in the sectoral meetings to assess the implementation of the PARPA in 2004 in the context of the joint review process; (iii) representatives of civil society will also participate in the preparation of PARPA II; (iv) the government has consulted with the private sector about procurement reform; and (v) the government has consulted with the private sector and unions on the revision of the labor law.

IX. SUMMARY AND RECOMMENDATIONS

32. **The APR broadly reflects Mozambique's progress in implementing the PARPA in 2004 and lays out the government's agenda for improving performance and monitoring progress.** The staffs believe that the government's poverty reduction strategy is still appropriate; it has been effective in reducing absolute poverty, and the improvements appear to

have been well distributed across regions and segments of society. Significant improvements have been made in how the government's consults with stakeholders and in integrating the PARPA into the government's annual planning and monitoring instruments. Moreover, high, broad-based economic growth and macroeconomic stability have been maintained, although fiscal efforts fell short of expectations. Good progress is being made in achieving the PARPA targets; the improvements have been particularly noteworthy in the provision of services (education and health care).

33. **The staffs' concern, however, is that progress has been limited in the implementation of many of the fundamental reforms that will lay the groundwork for a continued and sustained reduction in poverty and high growth rates.** Moreover, the reform effort will need to be intensified in areas that are crucial for private sector and rural development to allow for increased productivity and to improve the conditions for export-led growth. Many key areas where the pace of reform needs to accelerate are the same ones that were highlighted in the last JSA, indicating that the deeper and more wide-ranging reforms are yet to be tackled in an intensive manner. They include reducing further the cost of doing business, making the labor market more flexible, improving basic infrastructure, implementing public sector reform, and modernizing the judicial system. The revision of the PARPA that will take place in 2005 is a good opportunity to address all these issues comprehensively. In addition, the PARPA should also include the recommendations of the 2004 Diagnostic Trade Integration Study (DTIS)

34. **In addition to improving the transparency of budget execution, the implementation of the SISTAFE, together with the inclusion of off-budget operations, will help to improve the data-reporting system,** as highlighted in the last JSA. In particular, budget execution reports still need to be strengthened so that they provide a more detailed functional classification of expenditures and fully reflect donor-funded expenditures so as to facilitate monitoring of priority expenditures.

35. **While decentralization has moved forward, much more still needs to be done to strengthen administrative and financial capacity at the local level,** as described by the last JSA.

36. **The government needs to move quickly to clarify, codify, and implement the organizational changes announced in January 2005.** In particular, there needs to be clarity on all levels about the division of labor between the new Ministries of Finance, Planning, and Agriculture. A prolonged lack of clarity about the operational responsibilities of these ministries could slow down planning and execution in the relevant areas of the PARPA.

37. **Finally, it is important that an overall assessment of the implementation of the PARPA be prepared in the context of the next PARPA.** The staffs think that it should be the government's decision whether this is a separate document or a section of the new PARPA.