

JOINT REVIEW – 2006

Aide-Mémoire

April 13, 2006

I. INTRODUCTION & CONTEXT

1. On April 13, the Government of Mozambique (GoM) and the Programme Aid Partners (PAPs)¹ concluded the annual Joint Review of the Government's implementation of the poverty reduction strategy (PARPA) and of the performance of PAPs. The review assessed GoM and PAPs performance over 2005 based on the performance assessment frameworks agreed, and drew key lessons learned with bearing on performance in 2006 and the planning and budget process 2007. The review was based on Government plans and reports, as reflected in the PARPA, the Economic and Social Plan (PES) 2005, including the Performance Assessment Framework (PAF) 2005, the Budget (*Orçamento do Estado*), the 2005 Government reports on the execution of the budget and the PES, as well as an independent report on the performance of the PAPs.
2. Twenty four working groups, distributed over four thematic pillars plus cross-cutting issues, consisting of the Government, PAPs, other donors and civil society representatives, completed detailed reviews in assigned areas; their reports are included as annexes to this Aide Mémoire (AM).² The overall assessment of the performance of GoM and PAPs is presented in Section II. The detailed assessment of the Government performance in 2005 and the key lessons learned are presented in Section III. The assessment and recommendations relating to PAPs performance are described in Section IV. Section V outlines issues related to the implementation of the joint Memorandum of Understanding (MoU).
3. The *Aide Mémoire* includes the following annexes: (i) the 2005 PAF matrix with an assessment of performance in relation to the defined targets (Annex 1); (ii) the PAP Performance Assessment Matrix 2005 and the PAPs PAF matrix for 2006 (Annex 2); (iii) the working group reports (Annex 3), (iv) the revised 2006 PAF matrix (Annex 4); (v) the list of pillars and working groups (Annex 5) and; (vi) the Terms of Reference of the Joint Review (Annex 6).
4. The selection of PAF indicators for 2007-9 originally planned for this review will be carried out following approval of PARPA II.
5. In 2005 the main part of the PARPA II formulation process took place. Formal GoM approval is expected in April 2006 with an assessment by development partners shortly thereafter. The PARPA process was consultative and participatory taking place at all levels throughout the country. This exercise provided a basis for better alignment of sectoral policies with the national development agenda.
6. Also in 2005, due to the changes in legislature and the formation of a new government, the regular work of the Assembleia da República including the adoption of the Budget was delayed.

¹ Participating external partners included African Development Bank, Belgium, Denmark, Canada, the European Commission, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the World Bank. These PAPs support a joint programme for providing budget support and have signed a Memorandum of Understanding with the Government. Observing external partners included: Japan, the United States, UNDP and the International Monetary Fund.

² A list of all working groups and pillars is attached to this AM.

II. OVERALL ASSESSMENT OF PERFORMANCE IN 2005

7. The Mozambican economy continues to show solid growth, having achieved a real GDP growth rate of about 8% (preliminary), which was driven by the good performance in the transport, communication and construction sectors. Low growth was experienced in agricultural production on which a major part of the population is dependent; this indicates that the overall economic growth may not have been as broad-based as in the past. Due to external shocks and partially due to internal policy decisions, there was a significant fluctuation in the exchange rate and inflation reached a level above that which was forecast, reaching 14% (on the old basis and 11.2% with the new CPI base of December 2004) at the end of the year. In 2005 there was growth in credit both by the banking sector and micro-finance sector. The economic impact of the HIV/AIDS pandemic remains a threat to future economic growth.

8. A participatory PFM assessment was carried out according to the PEFA methodology during the last quarter of 2005 with the final report submitted and approved in April 2006.

9. Overall, the Government Performance Assessment Framework (PAF³) performance in 2005 was satisfactory, although there were significant variations across the range of PAF areas. 35 of the 49 PAF targets were fully or partially met (including one with delay) and 13 were not met.⁴ As was the case at the 2005 Joint Review, performance was good in terms of the expansion of service delivery (although the data is preliminary); however, there is growing concern about the quality aspects. Performance relating to the implementation of critical cross-cutting issues and reforms (notably Governance) continues to lag and is a central concern. Government and PAPs recognize the continuous need to improve the prioritisation of the reform agenda by demonstrating a high level of commitment and leadership. The pace of these reforms must be accelerated and progress made visible in order to assure that service delivery expansion and poverty reduction will be sustainable. In general PAP performance in 2005 was considered to be satisfactory. Improvements are required in medium-term predictability, reductions in the administrative burden and progress in meeting Paris Declaration targets (in particular those related to portfolio composition).

10. In relation to Government performance, on the **positive side**, the expenditures in the priority sectors achieved 67% of total expenditure, of which 55% went to the education and health sectors (preliminary data). Important progress was realised in the procurement area, with the approval of the new public procurement code based on internationally recognised principles for the acquisition of public goods. Total revenues showed encouraging real growth, achieving 14% of GDP, above the PAF target, which represents an important recovery following the observed reduction in 2004 (although this was only 97.3% of the budgeted value) with the strongest real growth realized in income taxes. Progress was also realized in the tax reform process, with a strengthening of the administration and preparation for the establishment of the ATM⁵. In the human capital pillar, emphasis is given to the performance regarding the indicators for access and for primary education completion rate indicators, with results above the targets and in the general access to health services (despite underachievement of the vaccination target). Regarding HIV and AIDS, stronger political leadership led to the development of HIV/AIDS Strategic Plans in all sectors and provinces to operationalise the PEN II. A costed multi-sectoral plan to address the situation of orphaned and vulnerable children in the context of AIDS was also developed and the number of grants provided by the CNCS largely to Civil Society Organisations trebled in 2005 compared to 2004. The poverty analysis and monitoring systems area registered important progress which made a

³ The PAF is a matrix of indicators taken from the PES, and is annexed to the PES.

⁴ Information on one target is still not available.

⁵ Autoridade Tributária Moçambique

significant contribution to the formulation of PARPA II, which was developed in the context of a broad consultative process.

11. There were various areas which showed a **mixed performance**. In all areas of the economic development pillar there was substantial progress. However, some areas continued to be vulnerable to external shocks, especially agriculture. Institutional reforms continued to be slow in general. In the case of e-SISTAFE, important steps were taken to use it for budget execution and accounting as well as for the production of the budget report. However, there were substantial delays and partial implementation in comparison to the original plan. In spite of improved financial programming, budget execution was lower, mainly due to the late approval of the OE. The study on off-budgets in the health sector was concluded and its results were used in the 2006 budget cycle, resulting in the incorporation of a significant part of revenues and financing in the state budget 2006. However, other off budget resources still remain to be included in the budget and it is necessary to have a strategy on how to deal with the consequences for the sectors and provinces when off-budget funds enter into the budget. The lack of detailed information on functionally classified expenditures due to the delay in integrating a budget elaboration module and the clarification of its use in the context of e-SISTAFE should be highlighted. In terms of decentralisation and deconcentration, the targets for 3 indicators were not achieved. However, the following was done (i) the positive steps in the allocation of funds for each district; (ii) the approval of the LOLE regulations, and; (iii) the formulation of important inputs that could support the elaboration of a decentralisation policy and strategy. In the roads sector, the targets for rehabilitation and periodic maintenance of the national network were met while the target on routine maintenance was not. In the private sector, despite the progress realized in the improvement of the business environment such as the reduction of the time it takes to open a company, the targets were not achieved and Mozambique still finds itself in the lower echelons of the “Doing Business” report 2006. For the financial sector, the actuarial study of the social security system was postponed; however the forensic audit of Banco Austral was completed. Regarding HIV/AIDS, in spite of significant progress in 2005, only 8% of the total population and 3% of children have access to anti-retroviral treatment. There is a need to reinforce the emergency nature of the national response to the pandemic and scale-up interventions.

12. However, there are important areas where progress relative to PAF targets was **not satisfactory**. These include principally governance targets of which 8 out of 13 were not met. In public sector reform, two important targets that were not met were the approval of the salary policy and the restructuring of selected ministries. The anti-corruption strategy was neither approved nor implemented, but the study was published and the Central Anti-Corruption Agency (GCCC) was strengthened. In the Justice sector, there are signs of progress although the sector recognizes that there are big challenges to substantially improve the quality of service delivery and access to justice for citizens. For the human capital pillar in spite of the expansion of service delivery, the quality of services has not improved. For example, in education the student-teacher ratio worsened from 68:1 to 74:1. A key gender indicator in health was not met which can also be considered as an indication of insufficient quality. Finally, performance in the water sector was far below the target set and the sector faces challenges related to debts and delays in payment of VAT.

13. Based on this assessment, the review recommends that **special attention** should be given in 2006 to the following issues:

- As in 2004, performance in the governance area has not been satisfactory and will continue to require special attention in 2006 and beyond. Tangible results in the fight against corruption are expected following the approval of the anti-corruption strategy as well as progress in public sector reform and the justice sector.

- Implementation of reforms in the PFM area must be a key priority in 2006 in order to consolidate the generally positive developments in 2005. In particular, the effective implementation of the new procurement system; roll-out of e-SISTAFE; strengthening of internal and external audit capacity; and the integration of additional funds in the State Budget/Treasury. The “PEFA” assessment led to the definition of a PFM action plan which should, through well coordinated implementation, further address critical areas such as payroll control.
- In HIV/AIDS, given the emergency nature of the pandemic, there is an urgent need for more ambitious targets, accompanied by sustained financial and human resources.
- Equally, the proposed reduction in water sector targets in PARPA II is in contrast with the expansion in other service areas. Water has an important role not only for poverty reduction but also for economic development. Major innovations are needed, especially in urban water supply and in the development of the country’s water resources.
- 2006 provides an opportunity to strengthen links between PARPA costings and sectoral allocations in the OE, thus strengthening the GoM Medium Term Fiscal Framework (MTFF) and providing guidance for PAPs to improve medium term predictability of commitments and disbursements. The MTFF and sectoral ceilings of 2007 budget should be approved in a collective form at a high political level.
- A comprehensive policy and management of domestic revenue mobilization is needed, including the revenues resulting from the exploitation of natural resources (mines, forests etc) and higher transparency in its accounting.
- Continued expansion in the service delivery areas is once again occurring faster than the underlying policy and institutional reforms. One of the PAF targets with a clear gender dimension was not achieved (the number of pregnant women receiving PVT prophylaxis). Adequate allocation of resources to the entities responsible for coordinating cross cutting issues is one of the essential elements for ensuring that these issues are mainstreamed effectively. These issues remain fundamental for poverty reduction and sustainable growth in Mozambique. Together these factors raise concerns about the sustainability, quality and equity of the services being delivered.
- The budget allocations to health and education needs to be analysed in the context of (i) the implications of bringing more external funds on budget, and (ii) the continuing need for significant additional frontline workers in both sectors. With regards to the latter it is essential that 2007 budget negotiations for recurrent costs allocations to each of these ministries are based on a thorough analysis of the needs, including payroll reform issues, absorptive capacity; and the risks of continued underinvestment in human resources.
- The issue of VAT payments and counterpart funds for externally financed large infrastructure projects (in particular in the energy, road and water sectors), as well as the accumulation of public sector debts associated with these counterpart funds, was again identified as a matter requiring attention. In 2006, the GoM and partners will commit to discussing, and contributing to a solution to this problem.

- Drought and flooding in 2005 demonstrated that Mozambique remains vulnerable to natural disasters. More priority needs to be given to addressing the needs of those communities chronically vulnerable to drought.
- Continuing efforts are needed to improve the conditions for private sector development, to promote labour-intensive sectors, and to allow traditional sectors (e.g. agriculture and fisheries) to make a bigger contribution to the economic growth.

14. **The Joint Review found that satisfactory progress has been made, giving a reliable basis for PAPs to continue general budget support.** Commitments for the 2007 general budget support will be made within 4 weeks of the Joint Review.

15. Overall, in 2005, **PAPs performance** was satisfactory. While performance improved relative to 2004 there is still a need for further progress. Success was noted in short term predictability but medium to long term predictability needs significant improvement. General Budget Support (GBS) as a proportion of total aid to GoM remained small (31%) with project aid actually increasing faster than GBS. A key opportunity in 2006 is the development of new country strategies by 12 PAPs. These need to show a change in modalities by demonstrating a strong commitment to increasing programmatic and budget support. A clearer aid policy statement from the Government of Mozambique indicating preferences for receiving aid and a more robust MITFF are needed. There was a clear message from the Government of Mozambique that transaction costs were still high and need to be reduced.

III. ASSESSMENT OF GOVERNMENT PERFORMANCE IN PARPA IMPLEMENTATION IN 2005 AND KEY LESSONS LEARNED FOR 2006

A. Poverty and Macroeconomic Management

16. The overall economic performance was reasonably good in 2005 with continued growth reaching about 8 % of real GDP. The positive assessment was constrained by instability of exchange rates and double digit inflation. The growth rates were driven by good performance in transport and communications and construction sectors. Poor performance in traditional sectors of the economy, such as agriculture, may have had negative implications on the welfare of the population, despite the efforts to mitigate the impacts of the drought. A number of quantitative and qualitative poverty analyses were published, adding to the body of government-led poverty research, and much of this work was used in the formulation of the PARPA II. The participatory process of the elaboration of the PARPA II was notable for its involvement of stakeholders at all levels of society. General performance within Public Financial Management was satisfactory although there were several constraints resulting in poor performance in key public service delivery areas. Overall, there was a significant increase in revenue collection with 14 % of GDP in 2005; notwithstanding this, the level of revenue remains low.

17. During the mid-year review in September 2005, prospects for continued rapid growth and single digit inflation looked promising. Unfortunately end of year inflation went up to 14% (using base of 1998 and 11.2% using new base Growth in 2005 was driven by good performance in the transport, communications and construction sectors. These sectors are less labour intensive and their output more cyclical. Partly because of exogenous shocks and partly because of internal policy decisions, there was significant volatility in the exchange rate during the year that might have been counterproductive to building investor confidence in the Mozambican economy and contributed to the inflation.

18. The **macroeconomic performance** was satisfactory especially when taking into account the adverse exogenous shocks (increased in oil price, drought and floods). However, more attention should be given to improving conditions for an increased contribution of the traditional sectors (i.e. agriculture and fisheries) of the economy, and to the promotion of labour-intensive and export oriented growth. It is still necessary to improve the business environment, increase investments in rural infrastructure, and in human capital. Access to credit is an important condition for developing the productive sector. Progress was made in 2005 although the level remains low and improvements in the financial sector should be given attention. Challenges related to the negative socio-economic impact of HIV/AIDS should be taken into account in the macroeconomic policies and also be reflected in the strategies to enhance economic growth.

19. In the area of **Poverty Analysis and Monitoring System**, overall performance in 2005 was satisfactory, with positive performance against the two PAF targets. The development of the PARPA II was a notably consultative process and the target was fully met, though with some delays. The target for initiating the single process for the formulation of MTFE, PES and OE was met, though real progress remains limited. There were, however, positive steps taken such as the inclusion of off-budget funds in the budget and the estimation of costs and fiscal projections in the PARPA II. In the broader area of M&E, there were some positive developments, particularly in strengthening the participatory poverty monitoring process, through national and provincial poverty observatories. There has been a steady improvement in the quality of quantitative analysis. However, Government capacity to undertake both quantitative and particularly qualitative analysis and use it in planning, budgeting and policymaking processes needs to be further strengthened. It will also be necessary to use the opportunities created through the processes of developing PARPA II to strengthen the overall PARPA II M&E framework.

20. The overall assessment of GoM performance in the area of **Public Finance Management** is positive, although there remain some important areas of concern. The recently performed PFM Assessment shows that there are still important weaknesses in the PFM framework and addressing these will require continued efforts in the coming years. Co-ordination of the reforms in the PFM area is important, especially of reforms involving many institutions, such as the reform of the payroll and the implementation of the new procurement regulation. Over the last ten years there have been major improvements in PFM systems, as part of the first generation of reforms, which have served to establish the essential legal and institutional structure for PFM. During the last years, second generation reforms were designed but which have not yet had substantial impact either because they are in the design or early stages of implementation. The challenge now is to enhance compliance and improve the actual practices within Public Financial Management. Key areas include, inter alia: development of a coherent Medium Term Fiscal Framework; implementing e-SISTAFE; strengthening coherence between OE, BER, PES; getting funds on-budget/treasury; integrating the salary databases and improving human resource management. Another challenge is the re-introduction in the budget of the functional expenditure classifier in order to strengthen the use of the budget as a policy instrument. The implementation of the classifier in the context of e-SISTAFE should be adopted quickly. A management workshop has been organized in February 2006 with the different relevant GoM stakeholders to discuss the findings and to prioritize a number of short- and medium-term actions and more long term structural reforms. An action plan has been presented, but still has to be approved.

21. The key indicators in the area of **Budget Execution** have been met. In 2005, total government spending in priority sectors reached 67%, of total expenditures (excluding interest and financial operations) of which 55% were in Health and Education (preliminary figures). These preliminary numbers for 2005 were better than 2004 (respectively 63% and 50%). A study on off-budget resources in the Health sector was completed. Results of this study were used in the 2006 budget cycle and to follow-up on the work, a task force on off-budgets resources was created. Due to the late approval of

the budget and delays in execution caused by the mid-year introduction of e-Sistafe the percentage of execution was relatively lower than in 2004, with 90.2% for recurrent and 66.3% for the investment budget (part of low execution was caused by underreporting on external financing). In spite of this lower execution rate the financial programming improved, with most sectors reporting that the flow of funds was more regular and predictable than in the past.

22. The main weak point in 2005 and main challenge for 2006 and subsequent years remained the external component of the investment budget, characterised by low rates of execution, the absence of reporting and many problems in reconciling numbers between different actors. Moreover, the level of off-budgets remained high and there is a need to have a strategy to address the consequences for sectors and provinces of channelling additional resources on budget and on treasury.

23. The performance in 2005 in the area of **tax reform** was positive. In the context of strengthening tax administration and preparing for the establishment of the Central Revenue Authority (ATM) in 2006, performance was satisfactory. Effective total revenue reached 14 % of the GDP in 2005. The lowest growth levels in the taxes on goods and services were observed in the VAT on internal operations and in the excises on tobacco. Aiming at improving the efficiency in revenue collection, the following areas improved: the identification and collection of tax arrears; audits on large tax payers; customs inspections and smuggling control; simplification of customs clearance procedures; better information to the tax payers and, training for tax administration staff. Progress was also observed in the process of VAT reimbursements, with reduction of the processing time from 90 to 30 days, also a result of better performance by the taxpayers. In spite of these improvements, there remain delays in the payment of the VAT counterpart funds by the government in investments with external financing.

24. The publication of 2004 General State Account and the opinion of the Administrative Court on this account, raised questions and recommendations for the improvement and greater transparency in the revenues records and performance of the administration services. This had in part been corrected during 2005, but still deserves follow up attention and improvement. Stronger efforts must be made to increasing efficiency and reducing tax evasion. A more rigorous management of the tax benefits is also necessary, as well as a further rationalization of tax concessions. It is also necessary to enhance the management of the domestic revenues, including the revenues resulting from exploitation of natural resources (mines, fauna, forests, etc) and higher transparency. An indicator and target were agreed for PAF 2006 on tax reform (this had been pending since MYR 2005). The target is the elaboration and approval of the Information Technology Development Plan (PDTI), in the context of the establishment of the ATM.

25. A new **procurement** code now allows Mozambique to establish a procurement system in line with international recognised principles. It was agreed that the practical application of two specific areas: the preference of national suppliers for goods and the appeal mechanism shall be thoroughly monitored with regard to the efficiency and the costs and benefits of its application. If the results of this monitoring so required, corrective measures will be implemented. The dissemination of the new regulation, training of procurement officials and implementation of the new system are now of utmost importance as the new regulation enters into force in June 2006. The “quick win” measures agreed during the JR 2004 and reiterated in 2005 to ensure that the implementation of a transparent and efficient procurement system is not further delayed were completed and follow-up activities have been initiated. In general, progress in the procurement reform area in 2005 was good.

26. 2005 saw the initiation of the use of e-**SISTAFE** for budget execution and budget accounting and reporting. There have been significant delays compared to the agreed planning. The delays have been both in the area of development and in the rollout of the system. An intermediate version with limited

functionality including execution of payments of recurrent goods and services was developed and rolled out to MEC, MF and MPD. The 2006 PAF target was agreed during the Joint Review, and relates to the full development of 'direct budget execution' and its rollout to the three pilot ministries and three additional ministries (Health, Public Works, and Agriculture) by July 2006. The further development and rollout of the basic functionality (budget, execution, accounting, and treasury) should be the main focus for 2006. The delays and concerns over the cost and cost sustainability of the reform caused a delay in the approval of a new MoU and Action Plan for the reform. Their adoption is planned for June 2006.

27. Although progress can be noted in terms of **internal audit** performance and of new ongoing initiatives, IGF as well as the Subsystem of Internal Audit (SCI) experienced delays and poor performance in some priority activities. The underlying reasons, include; the change of Government which limited the possibility to carry out audits effectively during the first quarter 2005; not planned requests by superiors; joint audits which involved the on-job training of sectoral inspectors; and the weak capacities of IGF civil servants at intermediate level. Progress was made in the area of developing human capacities through training of new staff. In general, performance of the internal audit area in 2005 can be considered mixed with a positive perspective of improvement for 2006.

28. In 2005, the **external audit** institution carried out 68 financial audits. Although this shows a clear improvement in relation to previous years, it still represents a very low coverage in terms of proportion of public entities and public spending. In addition, completion of the judgements in order to guarantee the adequate follow up of the findings should improve. In the context of the new Strategic Plan of the TA for 2006-2010, currently under preparation, particular attention should be paid to the medium term challenges, including the increase of coverage and territorial expansion; follow-up of the conclusions and recommendations at different levels; dissemination of the results of the realised audits; legislative reform in favour of the full development of TA competencies as external audit institution and capacity to work in new working environments created by ongoing reforms (SISTAFE, procurement and decentralization).

B. Governance

29. Overall performance in the governance area is reflected in the following degree of achievement of the planned indicators for 2005: 4 out of 13 targets were met, 1 indicator was partially met and 8 were not met. However, some positive developments are not reflected by the indicators and some progress is acknowledged on indicators where targets were not attained. In the area of decentralisation, the Government approved the legislation that confers a central role to districts in the planning process and in local development, including the introduction of an investment budget. Also pointed out is the intention to expand the number of municipalities. The approval of a Strategic Plan for the State Administration Sector is also a positive factor as the Plan outlines general orientations for the Ministry of State Administration as well as local and municipal administrations. In the area of legal reform there are signs of progress, however the sector recognises that the challenges of substantially increasing the quality of service delivery and access of citizens to justice are big. The need to strengthen integrated planning mechanisms (PEI and POPEI) and internal control continues to affect service delivery. Yet this is expected to reduce with the conclusion of the Vision and the establishment of an Integrated Monitoring and Evaluation System currently under discussion.

30. Strategic direction and orientation of the reforms towards concrete results will be crucial in sustaining growth and reducing poverty and to meet the PARPA and MDG targets. This will require strong leadership by the Government, demonstrated by a clear indication of priorities within the broad reform agenda and the identification of the roles and involvement of all relevant actors in the implementation of reforms.

31. Overall, there is a need to bring a clear sense of direction for ongoing and planned governance reforms. Therefore, high expectations are placed on the formulation of a broad and realistic vision for the legal sector that can boost confidence of development actors in the establishment of the rule of law. Equally necessary is approval of a document which details and provides clarification on the longer term decentralisation process (the division of roles and responsibilities between local governments and municipalities as well as the intersectoral coordination with integrated plans and budgets at territorial or municipal level, the devolution of sector competencies, the role of the private sector, etc.) with a view to increasing government effectiveness and transparency in delivering services. The decentralisation policy should also consider the impact of HIV/AIDS on the capacity of institutions and the participation of citizens.

32. There is a strong need for governance reforms to deliver development results as they tend to become an end in themselves. The adoption of an action oriented anti-corruption strategy, a second phase of public sector reform that is clearly oriented to improving services and effective fiscal decentralisation (in particular to municipalities) would be strong signposts of the right direction.

33. The 2005 PAF targets for **Public Sector Reform** – the approval of a salary policy, and restructuring of selected ministries – were not met. The Strategic Review of Phase I of the Public Sector Reform Programme provided some useful recommendations on moving the reform agenda forward. A reference group was constituted to prepare Phase II of Public Sector Reform, working in coordination with UTRESP. The progress in the areas of Quick Wins and Change Management was also encouraging. Another important development was the analysis of the inter-ministerial commissions which was carried out with the aim of rationalising the commissions and taking the first steps towards improving the functioning of the Council of Ministers. Slow progress was recorded in the Functional Analysis and Restructuring processes in various ministries, the development of a salary policy, general human resource planning and management, and in the search for adequate solutions for cross cutting issues such as gender and HIV/AIDS in the public sector.

34. For public sector reform there is a continued need for improved prioritisation of the reform agenda, and high level commitment to and leadership of the process is vital. The quality of leadership can in part be facilitated through the clearer definition of roles and responsibilities between the main institutions overseeing the reform process: CIRES, MAE and UTRESP. Stronger links between UTRESP and line ministries and other public sector bodies is also important. There is an immediate need to reflect the funding of Public Sector Reform on-budget.

35. In the area of **decentralisation and deconcentration** the new Government has emphasized that the district will be the development pole for combating poverty through expanding decentralised planning and the allocation of a local investment budget (OIL) for each district in 2006. The Government opted not to base the 2006 budget allocations for districts on pre-established criteria as was foreseen in the PAF. Although the allocation of the OIL is considered a positive step, there remains a big challenge as to the capacity of the districts to deal with increased pressure to deliver development. A model for integrated district government structures was also approved. The approval of the LOLE regulation signifies a step forward in the evolution towards territorial governance. A decentralisation policy was not formulated in 2005, but Terms of Reference were prepared and the work started by the time of review. In the meantime, important instruments that could feed such a strategy were formulated, such as the National Decentralized Planning and Financing Strategy (still to be approved) and the National Strategy and Policy for Municipal Development (approval imminent). FCA and FIL were transferred to each municipality, but not evenly and not at promised levels (1% instead of the legally established 3%). No noticeable progress was made in terms of fiscal decentralisation during 2005.

36. The commitment to district based development poses a challenge to create the necessary instruments and capacity to allow districts to effectively deliver services and account for the execution of district budgets. Further, in order to ensure a balanced development integrating rural and urban development and harmony between districts and municipalities, it is important that fiscal transfers to the municipalities are increased. In 2006, the National PPF strategy and the Municipal Development Strategy and Policy should be approved by Government as the basis for a more harmonised support to provinces, districts and municipalities. Further priorities are: the development of institutional and human capacity at provincial, district and municipal levels; supporting districts and municipalities in planning, budgeting and implementing of their plans, with particular attention for procurement and supervision of infrastructure; improving participation and accountability mechanisms. It is also expected that district allocations for 2007 should be based on specific criteria, and the FCA and FIL transfers to the municipalities should represent a step towards complying with the legal provisions.

37. The assessment of targets and results for the **justice sector** shows some advances, while at the same time the challenges of substantially improving service delivery and access to justice for citizens are increasing. Progress was noted in relation to the processing of cases at the level of the courts. The Public Prosecution also increased productivity. However, the official data cannot be interpreted as signifying a concrete improvement of service delivery for the majority of the population or increased access to justice. Also notable is a reduction in the number of prisoners awaiting trial. Despite all this, the sector in general continues to be confronted with an annual increase in the number of cases, overcrowding of certain prisons and a shortage of resources for juridical assistance. There were some achievements in legal reform, including the approval of a new Commercial Code and Civil Process Code. However, the target in relation to the Penal Code was not met, and the Prison Legislation was finalised but not approved in due time. Some positive developments are not adequately reflected by the indicators. The indicators related to the Vision process of the sector, the revision of integrated planning instruments and the creation of a harmonized monitoring and evaluation system were not met. From a financial management point of view the completion of an internal audit in the Ministry of Interior was positive. Notwithstanding some positive results, it is recognised that society still has a negative perception of the sector taking into account the eagerness of the population to see many cases resolved that were submitted to the institutions of the administration of justice.

38. Given the complexity of integrated strategic planning, associated with changing political factors, such as the revision of the Constitution, the formulation of a Vision document for the justice sector was not completed as foreseen. However, there is a notable development with the revision of the preliminary version conclusion of which is foreseen by the end of July of the current year. The establishment of the Integrated Monitoring and Evaluation System was also not concluded, as its preparation runs concurrently with the Vision process, reason why its first phase is subject to the same calendar. A better integration of the justice sector must be guaranteed during the formulation of the second phase of the public sector reform, as well as, an improvement in the financial and administrative management, including the implementation of SISTAFE.

39. Targets in the fight against **corruption** have been partially met. Main achievements included the publication of the survey on good governance and corruption and the strengthening of the Central Office for the Fight against Corruption (GCCC). Nonetheless, the anti-corruption strategy has not yet been approved and this is delaying its implementation⁶. It is essential that the anti-corruption strategy is accompanied by specific action oriented plans of the various sectors. These plans will include enhanced inspections and audits, the development of monitoring systems and the continued roll out of e-SISTAFE. Furthermore, it is essential to strengthen democratic control mechanisms to supervise the

⁶ The Council of Ministers approved the Strategy on 11 April 2006.

operation of state institutions. It is expected that the implementation of the anti-corruption strategy will yield more visible results.

C. Economic Development

40. All sectors in the Economic Development pillar experienced substantial progress, yet some remain highly vulnerable to exogenous shocks, particularly agriculture. Institutional reform across the board remains slow. An enhanced business environment, as illustrated by a 40-day fall in the number of days necessary to start a business was experienced in 2005. There was intense growth in cash crops and gas production & exports suggesting a gradual strengthening of the productive capacity of the economy. However, scant strategic planning capacities to insulate the productive sectors from these recurring shocks may hamper the medium and long term robustness of these improvements.

41. In addition, a steady expansion of nominal credit coupled with a three-point reduction on the average interest spread (from 13.8 % to 10.8%) and considerable increases in the outreach of microfinance institutions, indicate that the financial sector is both consolidating as a result of the advances of the real economy and also fostering further private initiatives. Finally, additional reductions in transaction costs may be accomplished via public investment on maintenance and extension of the road network, the expansion of the national electric grid (especially to rural areas), sound macroeconomic planning and management of energetic resources (including the anticipation of potential booms) and the simplification of the legal structure of land.

42. In the area of **private sector**, Mozambique made significant improvements to the business environment in 2005, perhaps best illustrated by the reduction in the time it takes to start a business, which fell from 153 to 111 days reflecting the government's commitment to progress. Nonetheless, this commitment has not yet translated into progress in several other critical areas. The "Doing Business 2006" report places Mozambique towards the bottom of the ranking. Neither of the two 2005 targets under the PAF was met in 2005. Nonetheless, the new Commercial Code was approved at the end of 2005 and the Labour Law negotiations were nearly complete as of March 2006. Beyond the PAF indicators, the Government pursued in 2005 other measures aimed at improving the business environment, notably the opening of one-stop shops in all provinces, the introduction of simplified procedures for industrial licensing, and a further reduction in import duties and on-time implementation of steps towards a SADC FTA. Visa requirements were eliminated for several SADC countries, including South Africa. A new Code for Registration of legal entities was approved in 2005, and progress was made on computerization of the registry, in anticipation of a pilot launch in Maputo in August 2006.

43. There was scant progress in the other areas; (i) there was no review of government equity positions in privatized companies (ii) there were no significant developments on either privatization of (or introduction of competition in) state monopolies with the exception of the long-delayed handover of the Nacala Corridor; and (iii) the perverse incentives inherent in the system of inspections and fines was not corrected in any ministry other than the Ministry of Industry and Commerce.

44. In 2005, new lessons learnt included (i) specific legislative proposals from outside government (e.g. private sector's draft labour law) are acceptable to the GoM and can help define the issues and accelerate reform; (ii) early warning and careful analysis is needed to support proposals for change.

45. Growth in **agricultural** production in 2005 was around 1.8%, partly due to climatic problems, affecting the central and southern regions of the country on a large scale. This indicates a slow down in comparison to 2004 when the rate of growth was 9%. There were improvements in the processing time of land titles. The impact of the droughts and floods in combination with outbreak of plague and disease

combined with other factors resulted in the loss of 7% of the area sown nationally. Around 265,000 families were affected, out of a total of around 3.5 million. The 1.8% growth was due to the recorded increase in cash crops, especially cashew nut (142.7%), tobacco (33.9%) and sugar cane (19%). A drop in production of around 2.1% was recorded in food crops. Within the framework of the PAF, the following targets were met: (i) concessions with approved management plans (135%) and (ii) marketed production of grain, specifically maize, sorghum and rice (97%). The other targets were not met

46. 2005 was the transition year for PROAGRI II start-up, characterised by the development and implementation of MINAG's new planning, management and monitoring instruments. The definition of the agricultural sector's priorities was initiated, and this will allow the formulation of the sector's Medium-Term Expenditure Framework (2007-2009). Within the framework of the Institutional Reform, the new Organic Structure of MINAG and the new internal regulations were approved in January 2006. The staffing structure is being finalised and a new department for Management Information Systems was created. Various action plans for cross-cutting issues were approved, specifically for gender, the fight against HIV/AIDS, and PROAGRI II Strategic Environmental Assessment.

47. MINAG and its partners share a concern for obtaining greater results at local level. This objective has to be ensured through larger transfers to the Provinces and Districts, either through increased general budget allocation or increased financial contributions of PROAGRI II partners, so as to fund MINAG core functions at local level and to implement new local agricultural development initiatives. The need remains for harmonisation of the methodologies for calculation of the sector's growth rates and for presentation of the budget execution report (BER) with the MPD and MF.

48. The **energy sector** made progress in the majority of indicators set in the sector policy and strategy. The expansion of the national electricity grid is making good progress with the construction of new transmission lines, substations to electrify new areas as well as growth in the number of new connections that surpassed 2004 by 25%. The number of EDM customers rose to 336,000.

49. The production and exports of natural gas grew significantly, by 68% and 64.4% respectively. The total production of gas was 88.028.511 GJ of which 0.8% was used for domestic consumption in Southern Mozambique. Fees resulting from *royalties* on the natural gas and condensate operation showed a growth of 71.4% in 2005.

50. Initiatives have been undertaken to introduce bio fuels in Mozambique. In addition, an agreement has been signed on the transfer of Hidroeléctrica de Cahora Bassa from Portugal to the Government of Mozambique.

51. The development of rural electrification projects, namely the construction of isolated networks and the renewable energy projects, (e.g. solar panels) was unsatisfactory. There was no progress in the implementation of the mechanisms for obtaining funds for FUNAE. As to the development of new energy-generating sources, particularly hydro-electric projects, there are still constraints.

52. The new programme contract between the Government and EDM was not signed; and the CNELEC is not operational yet. The difficulties the EDM faces are of concern, i.e. the current and future debt with the GoM resulting from the conditions of the social projects of country-wide electrification which are co-funded by donors. It is proposed that the matter be approached jointly by the ministries of Energy/Finance/Planning & Development/Foreign Affairs and Cooperation / EDM and Donors seeking to revise the loans' terms and conditions.

53. Amongst the key lessons learnt, it stands the necessity of strengthening the institutional capacity of the new ministry of energy and the necessity of analyzing the barriers impeding the development of new hydro-electric projects. Given that the country is a potential oil producer there is a need to capacitate, create and reinforce the inter- institutional relations ensuring a transparent management of large revenue volumes coming from oil exploitation.

54. The **road sector** presents a mixed performance in 2005: (i) The targets for rehabilitation and periodic maintenance of the national network were met while the target on routine maintenance was not, (ii) The expenditures of 2005 road budget was 83% due to delays of N1 projects and cancelling of four rural projects and Vanduzi-Changara road project, that were mainly externally funded, (iii) The general conditions of the roads deteriorated but road accessibility has improved, (iv) There was good progress in increasing revenues to the road fund (exceeded the budget by 8%) and an increase in the investment funds from the Ministry of Finance channelled through the road fund.

55. Institutional reforms within the Road Sector are on-going aiming at restructuring the functional organization at both provincial and central levels of ANE. The donors are moving towards sector budget support and sector project support.

56. The 2005 IGF Value for Money Audit includes the following findings: (a) The Fundo de Estradas (FE) is on track and can be expected to continue to perform effectively. However, technical assistance and further training of local technical staff is recommended. (b) Whilst road private contractors improved their execution capability at provincial level much more needs to be done.

57. Delays in VAT reimbursement are still constraining the sector. There is a perception in the sector that these delays are inflating the unit prices implying considerable efficiency losses in road sector investment. The issue of VAT payments and counterpart funds for externally financed large infrastructure projects (in particular in the roads and water sectors), as well as the accumulation of public sector debts associated with these counterpart funds, was again identified as a matter requiring attention, The GoM and partners will commit to discussing, and contributing to a solution to this problem.

58. Three key lessons were learned: 1) The sector needs the establishment of good governance with clear entities roles and functions - MPWH, FE, ANE, the Municipalities, Instituto Nacional de Viação (INAV) and the management of the non-classified road network, and a revised road policy and strategy, 2) Better management of senior staff is necessary, in coordination with the respective Boards, and 3) FE, the liaison entity, should further improve the dialogue and exchange of information with the donor WG for planning of meetings, take the lead on monitoring for the sector as a whole, and effective delivery of documentation (ToRs, quarterly technical and financial progress reports, audit reports and performance indicators).

59. Overall performance in the **financial sector** was mixed with limited progress against the 2005 PAF targets but there were positive developments in the sector and there are good prospects for 2006.

60. With regard to the PAF targets, the forensic audit of the Banco Austral was completed but the Bankruptcy Law and Social Security Law have not yet been submitted to Parliament. The BIM strategy had to be revised, and the actuarial study of the INSS delayed to accompany information needs. However, all 2006 PAF targets are expected to be reached except the actuarial study, which will not be completed within 2006.

61. The banking sector shows positive developments with 48% nominal credit growth relative to 2004, and a reduction in average interest rate spreads from 13.8% to 10.8%. The share of non-

performing loans improved from 6.5% to 3.8% in 2005. The microfinance sector saw 27% growth in client numbers and 37.5% nominal credit growth. 54 percent of microfinance clients are women. The number of banking branches increased from 204 to 219, of which 45% are in Maputo City and province. The microfinance sector has a new licensed operator and is opening up more branches, particularly in the Central and Northern provinces. INSS Social Security coverage increased from 9.2% to 10.3% of the economically active population, but there was a decrease in the number of beneficiaries and active contributors.

D. Human Capital

62. Human capital sectors (education, water, health, HIV/AIDS) made reasonable progress in 2005, in that eight of the twelve PAF targets were met. Some of the basic indicators demonstrating system expansion and greater coverage (namely EP1 net enrolment in education and consultations per inhabitant per year in health) exceeded expectations, On the other hand. There is a major challenge in the delivery of services of adequate quality, not just in service expansion. In contrast, the equivalent indicators for potable water coverage and greater immunisation coverage were not met.

63. As a significant proportion of external funding to some sectors has either been moved ‘on-budget’ in 2006 and will be part of the planning process in 2007, it will be important to monitor what is actually happening to total resource flows in the human capital pillar as a result of this trend.

64. Overall numbers of ‘frontline’ workers in health and education, in spite of some additional recruitment in 2005, appear to be totally inadequate in terms of meeting the minimum requirements for service delivery expansion. It is essential that 2007 budget negotiations for recurrent cost to each of these ministries are based on a thorough analysis of the needs but also of the risks of continued underinvestment in human resources. At the same time, the issues of absorptive capacity and reform of human resources management, including payroll reform require special attention.

65. In **education**, the rapid expansion of access to basic education constitutes important progress towards the universalization of education. In 2005, the net enrolment rate for EP1 reached 83.4% (81.2% for girls), against 79% (77% for girls) that had been planned. The completion rate for 2004⁷, for EP1 was 48% (39% for girls). All targets were exceeded.

66. Regarding adult literacy and education, more than 70% of those attending were women. Measures were also introduced to enhance access, quality and relevance of Literacy and Adult Education (AEA), such as literacy through the radio, non-formal literacy and a new curriculum for AEA. In the area of Technical Education, the PIREP⁸ was developed and funding was secured for the pilot phase from 2006 and 2010. Other notable achievements include the successful roll-out of e-SISTAFE and the adoption of new teacher training policies designed to meet the needs of a rapidly expanding system.

67. However, some of the negative impacts of this rapid expansion are becoming clear. Without an adequate allocation of resources, without training and recruitment of sufficient teachers (4715 were budgeted for in 2005 against 11500 requested by MEC when the budget was being negotiated) and without the modernization of the pedagogic supervision and monitoring systems, the quality of education is being affected, resulting in imbalances in the whole education system. In 2005, the pupil

⁷ The annual data for completion rate are available only in May after the Join Review. For that reason the assessment is based on 2004 data.

⁸ Integrated Reform for Professional Education Programme

teacher ratio rose to 74/1; the number of children who completed primary education exceeded the existing vacancies in secondary education by 70 000.

68. MEC continued to implement specific strategies to improve the quality of teaching and learning: the ongoing teacher training programme (CRESCER), was expanded and now covers 44 districts; Direct Support to Schools (ADE) has been consolidated and incorporated into FASE; the programme to build 600 classrooms per year with the community support; and, the programme of free distribution of text books

69. Allocation of sufficient resources and the implementation of these strategies at a national scale will enable more teachers to be hired, thereby reducing the pupil-teacher ratio; the elimination of three shifts in primary school; increase the time pupils spend at school; and reduce the number of classes taking place in inappropriate settings. MEC also requires an institutional development programme in order to build capacity in the areas of human resources, financial management, planning and monitoring at all levels.

70. Delays in the finalization and approval of the Education Sector Strategic Plan (ESSP II) may have hindered the adoption of the necessary measures by various stakeholders (Government, partners and other relevant institutions) and prevented long-term financial commitments from being made. The approval of a properly costed plan (which is foreseen by the end of May this year), is therefore essential.

71. In the area of **water and sanitation**, average potable water coverage is 40.4%, having increased by 0.6% in 2005 above the 40.2% forecasted during the MYR, but well below the original PAF 2005 target of 44.2%. A downward adjustment of the targets for the coming years has therefore been agreed. Sanitation coverage figures for rural and urban areas are based on national surveys, the latest of which was carried out by INE in 2003. Consequently no updated information on sanitation is available for 2005. The performance of the sector in 2005 has significantly improved in water resources management and in the execution rates of internal and external investment.

72. The following conclusions are mainly based on sector information, as the BER 2005 does not permit an overall picture of the sector. Budget execution in the water sector has improved substantially. Internal investment spending in the sector has increased to about 65%, approximately 10% more than in 2004, but considerably less than the 146.2% mentioned in the BER that does not include the figures of DNA. The execution of the sector's external component of the investment budget has been exceptionally high. This is due to the accelerated implementation of major investment works by FIPAG and ARA-Sul. Although the BER indicates an execution rate of 54.9% for the sector, this rate may be well over 100%.

73. DNA's debt burden is increasing, in spite of the fact that the debts originating from the reconstruction after the 2000 and 2001 floods have been reduced to one third of the original amount. The main reasons for the increase are arrears on VAT payments and other counterpart contributions for externally funded projects as well as the low disbursement rate of the internal component of the investment budget.

74. In the area of **health**, the PAF indicators continue to show positive progress, in particular in relation to the average up-take of services measured by consultations per inhabitant, which surpassed the target defined in 2005; and, the coverage of institutional deliveries, which met the PAF target. However, two of the four indicators did not reach the target established: those for immunisation and the prevention of vertical HIV transmission (PVT).

75. Improvements were also seen in the expansion of obstetric care and in the quality of the child health programme, as shown through the survey on health centres carried out in 2005, as well as in the decreasing trend of malaria-related intra-hospital infant mortality. The HIV/AIDS programme was expanded, in particular, to the more needy provinces and, notwithstanding the need for greater integration; the programme's targets were achieved with the exception of that for PVT. There were improvements in planning, both with regards to the inclusion of vertical funds in the state budget, and in the alignment of external funds with the state budget planning cycle.

76. Budget execution in 2005 was 80.5%. There are still difficulties in the execution of investment funds and new approaches to managing this issue will be required. Little progress was recorded in improving the health information system, which is still characterised by data that is unreliable and not sex-disaggregated.

77. While the sector's human resources have increased, they are still not sufficient to cover the needs, particularly for the continued expansion of the health network. Despite improvements recorded in the planning process, there is still a need to continue with efforts to integrate and align the planning instruments and cycles.

78. In the area of **HIV/AIDS**, two of the targets in the PAF 2005 matrix were met (% of CNCS funds channeled to sub-projects and % of CNCS funds channeled to OVC initiatives) and the third was partially met (prevention of vertical transmission).

79. There were a number of achievements during 2005 in the implementation of PEN II. Strong political leadership resulted in the development of operational plans by all sectors/provinces (not widely available); the M&E framework was finalized; progress was made in collecting baseline data for most indicators; and the new National Communications Strategy was finalized.

80. Grant management improved: the number of CNCS sub-grants increased from 2 in 2003, to 595 in 2004, and 1,724 in 2005; and progress was made in the development of new a MOU and operational framework to harmonize/simplify the Grant Management System. Progress on harmonization led to the agreement of new TORs, a Code of Conduct and a Partners Performance Matrix for HIV/AIDS Partners Forum.

81. In terms of the national HIV/AIDS response, anti-retroviral treatment (ART) trebled to 19,726 (34 sites) and pediatric treatment increased from 500 to 1,600 (5 to 21 sites).

82. In spite of these achievements there are concerns about the progress made in 2005 which include: a need to re-affirm an emergency response, set ambitious targets; and, ensure sustained human/financial resources. In PARPA II indicators and targets for the OVC Action Plan were removed, targets for PVT were lowered, targets for pediatric treatment were also reduced; and social action targets are very conservative. Only 8% of estimated population in need of ART had access and only 5% of the estimated HIV positive pregnant women received prophylaxis for prevention of vertical transmission (PVT). Significant geographic and generational inequities exist (about 60% of people on ART are concentrated in Maputo and only 3% of children have access to treatment).

83. There are serious resourcing issues. Domestic financing for HIV/AIDS across all sectors still insufficient and the state budget contribution to CNCS decreased by 15% in 2005. CNCS-Secretariat's budget execution rate is low (56%); increased OE resources would signal Government commitment and ensure longer term sustainability. Sectors need to secure their own financial and human resources and not only rely on limited CNCS funding.

84. Within CNCS, capacity development is required to shift the focus from management of sub-grants to coordination. Improved GMS efficiency could be achieved by increasing the number of grants to large Category A NGOs and “Facilitating Agencies”. In terms of external support, significant work remains to coordinate, harmonize and reduce transaction costs and demands on government counterparts.

85. In 2005, 22% of women aged 20-24 (7% men) were living with HIV/AIDS – development of appropriate, targeted programming is essential. The operationalization of the Communications Strategy needs to focus on: ‘the window of hope’; counseling and testing; PVT; gender inequalities and involvement of PLWHAs. Lastly, few organizations (public or private) have operational HIV/AIDS Workplace Policies in place – this need to be redressed.

86. Outside of government, the protection law submitted by PLWHAs and NGOs has yet to be discussed by the National Assembly.

E. Cross Cutting Issues

87. While not all cross cutting issues were part of the PAF matrix for 2005, they were integrated into PARPA II given their importance to poverty reduction and as such a brief analysis is included here. Reports from the working groups on cross cutting issues are included in Annex 3.

88. Very good progress was made in 2005 in achieving greater conceptual and methodological clarity in the identification of cross-cutting issues that should be mainstreamed and integrated across all Government sectors, as illustrated by the inclusion in the draft of PARPA II and the 2006 PES, of a dedicated section on cross-cutting issues, including Gender, HIV/AIDS, Food Security and Nutrition, Natural Disasters, and Environment. There remains however considerable challenges for fully mainstreaming these issues and ensuring that they are prioritised properly resourced and addressed in a co-ordinated manner. For example, the critical need to fight HIV/AIDS, address gender equality, combat malnutrition and provide emergency response to the chronic vulnerability situation created by the Triple Threat through a *genuine* multi-sectoral approach are not appropriately reflected throughout the PARPA II and PES. The list of planned activities should be reflected in a more visible set of priority actions across all government sectors and acknowledged as instrumental for enhancing economic growth and reducing poverty.

89. Instruments and tools need to be defined to ensure operationalisation of cross-cutting issues. The mandate of bodies responsible for these cross-cutting issues needs to be strengthened through strong political leadership and increased human and financial resources, i.e. CNCS as the one body responsible for co-ordinating the implementation of the national response to the AIDS pandemic, SETSAN as the responsible body for co-ordinating the implementation of the national Food Security and Nutrition Strategy, INGC as the co-ordinating body for prevention and mitigation of natural disasters, and MMAS as the lead ministry for co-ordinating the implementation of the new Gender Policy and the multi-sectoral response to the OVC crisis. In 2005, for example, the overall share of the State Budget allocation to MMAS was only 0.6%.

90. Moreover, there is no clear delineation of overall government expenditure on cross-cutting thematic areas in the State Budget. A more accurate picture of multi-sectoral expenditure on HIV/AIDS, Gender, and Food Security and Nutrition is essential for coordination and planning, as well as for ensuring that these issues are prioritised by the Government in general and by the Ministries of Planning and Development and Finance in particular. Instruments should be developed to ensure desegregation of sectoral allocations and expenditures in each of these cross-cutting issues.

91. Significant progress was made in 2005 to integrate **HIV/AIDS** issues across all sectors and in the implementation of the 2005-2009 National HIV/AIDS Strategy (PEN II). First, as a result of increased political leadership both at national and provincial levels, 25 sectors and all the provinces prepared their operational plans for the 2006/2007 period around the 7 strategic areas of the PEN II, with a cost estimated at US\$40 million. The planning capacity of the HIV/AIDS focal points within Ministries at both national and local levels was strengthened during this exercise. Second, a costed multi-sectoral action plan was developed to address the situation of orphans and vulnerable children within the context of the AIDS pandemic. The plan foresees the provision of a set of minimum services by various sectors (Health, Education, Justice, State Administration and Women and Social Action) for the more vulnerable children for the period 2005 to 2010. In 2006 alone, 1.2 million OVC are targeted by the plan, with a cost of US\$71 million. Finally, the M&E multi-sectoral framework for the PEN II was finalised, including 27 key national indicators to monitor the national response to the AIDS pandemic.

92. Many challenges however remain for implementing a multi-sectoral response in a co-ordinated manner (see the section of HIV/AIDS in the human capital pillar): (i) the role of civil society as a fundamental partner in the national response need to be re-affirmed and additional efforts are required to support the capacity development of CSOs to be able to genuinely engage as a full partner in policy, strategy and planning dialogue; (ii) Government financing for HIV/AIDS across the various sectors remains negligible. The allocation of adequate state resources for CNCS Secretariat at national and provincial levels is needed to signal political commitment to the national response and ensure sustainability; (iii) The current State Budget and classifications do not provide an adequately comprehensive picture of government and other sources of funding for the fight against HIV/AIDS (other than resources allocated to the CNCS Secretariat). In order to ensure a coordinated and adequately resourced response, it is essential to institutionalise a sustainable government-wide system for tracking on- and off budget of HIV/AIDS-related financial allocations and expenditures across sectors; (iv) there is limited recognition by many sectors, at both the national and provincial levels, of the role of CNCS as the “one” coordinating authority for HIV/AIDS. The role of the CNCS needs to be reaffirmed and strengthened at all levels; (v) the capacity of all sectors to monitor the implementation and impact of the national response, under the overall coordination of the CNCS-Secretariat and its Provincial Nucleos, needs to be urgently reinforced; and (vi) despite increasing coordination and harmonisation between Government and partners, transaction costs for Government are still high. There are still too many projects/programmes with different reporting requirements. Some agencies are still operating outside the common funding mechanisms and not working within nationally set priorities and frameworks.

93. The Government’s commitment to the elimination of **gender inequalities** remains strong as illustrated by the progress made in the following areas: dissemination of the Family Law, integration of gender issues in the PARPA II, approval of the Protocol to the African Charter on Women’s Rights, increase in the number of women in leadership positions at different levels, significant increase in the number of units for Victims of Domestic Violence in police stations (Gabinetes de Atendimento a Vitimas de Violência Doméstica) (an increase of 12 units in 2005, bringing the total to 96). Also worth highlighting is the continuation of the preparation process of the Gender Policy and Implementation Strategy, the updating of the National Plan for the Advancement of Women for 2002-2006 and the Revision of Legal Instruments that discriminate against women (Commercial Code and Records and Notary Code). However, as demonstrated by the Gender Development Index (GDI) where Mozambique is placed 140 out of 144 countries, there is a need to improve the level of implementation in the following areas in particular: i) gradually explore types of gender budgeting, ii) strengthen the sex-disaggregation of data in PARPA II and the PAF, iii) allocation of adequate resources-human and financial-to the National Directorate of Women and the National Council for the Advancement of Women; and iv) institutionalisation, capacity development and financing of Gender Units and Focal Points in different Ministries.

94. **Food Security and Nutrition** (FSN) monitoring continues to indicate a persistently fragile situation for many communities in the drought-affected districts. In October 2005 it was estimated that more than 800,000 people in the vulnerable districts needed immediate food aid. The production of staple food per capita is decreasing, the price of food is rising and malnutrition among children (acute: 4.7% and chronic: 35.7%⁹) is still high. While the FSN was not appropriately reflected in PARPA I, the preparation of PARPA II was an opportunity to highlight the critical importance of FSN in reducing poverty and achieving the MDGs. Malnutrition continues to be the leading underlying cause of mortality in children in the country. An assessment carried out in 2005 on the implementation of the FSN strategy, indicates the need for a multi-sectoral response and for the allocation of funds from the State Budget. FSN should be paid greater importance in the allocation of human and financial resources, particularly in the area of nutrition. The PAF should include a food security and nutrition monitoring indicator (i.e., low weight for age, low weight for height, low height for age and low birth weight). These indicators should be disaggregated by geographical area, by socio-economic groups and sex.

95. In order to guarantee natural disaster preparedness, the Government readjusted its Contingency Plan (CP) in 2005, which was budgeted at US\$ 24 million to address the threats of drought, floods and cyclones. In function of the evolution of the scenarios, the Plan was readjusted to cover approximately 800,000 people affected by the drought up to the end of 2005. In order to mitigate the effects of the drought, the Government disbursed 72 billion Meticaís, of which 80% was spent on the procurement of different food products, holding agricultural fairs, construction of gutters, cisterns (reservoirs) and on the acquisition of water tanks. The donor community and national solidarity contributed with the acquisition of 70 thousand tons of various food products that covered approximately 70% of the food needs up to March 2006. The follow-up in the implementation of the different mitigation and prevention plans, which permitted the readjustment of the 2004/5 Contingency Plan focusing on the Agricultural, Water, Health and Public Works sectors was carried out by multi-sectoral groups in the drought affected areas in the southern and central regions of the country. A major constraint in this area is due to the weakness of the information management system, which needs clear definition of hierarchy and decision centres. Finally, while addressing the chronic vulnerability situation in drought affected areas requires long term solutions and massive financial investment, particularly in the area of water and sanitation, it is essential that financial resources are mobilised in a timely manner in order to ensure rapid response to the immediate humanitarian needs created by the recurrent drought in affected districts.

96. In 2005, the **environment** sector prioritised the integration of the environmental agenda in PARPA II, based on the Environmental Strategy for Sustainable Development in Mozambique. The report on the situation of the integration of the environmental agenda in the Ministries, Local and Municipal Governments, civil society, and the Environmental Statistics Compendium was concluded. The following negative aspects, however, should be highlighted: the targets for the environment sector in 2005 were not totally met; the Law on Territorial Distribution and Planning has not yet been approved by Parliament; the Policy on Territorial Distribution and Planning has not yet been approved; and the Environmental Strategy for Sustainable Development has also not been approved. The integration of the spatial component in the district plans should imply better coordination in the interventions by the different State bodies and among partners. The integration of environmental aspects in the sectors through the institutionalisation of Environment Units is recommended.

⁹ MISAU Nutrition Survey conducted in 54 drought affected districts, October 2005

IV. ASSESSMENT OF PAPs PERFORMANCE 2005

97. As well as evaluating GoM's performance in 2005 through a focus on the PAF framework, the Joint Review of the Budget Support programme involved an independent review of the performance of the PAPs as measured against the indicators in the PAPs PAF matrix. Annex 2 details donor performance against the PAP's PAF targets (2005) as well as provides a list of indicators for 2006.

98. Overall, in 2005 PAPs performance was satisfactory. While performance improved relative to 2004 there is still a need for further progress. Success was noted in short-term predictability but medium to long term predictability needs significant improvement. General Budget Support (GBS)¹⁰ as a proportion of total aid to GoM remained small (31%) with project aid actually increasing faster than GBS. A key opportunity in 2006 is the development of new country strategies by 12 PAPs. These need to show a change in modalities by demonstrating a strong commitment to increasing programmatic and budget support. A clearer aid policy statement from the Government of Mozambique indicating preferences for receiving aid and a more robust MTF is needed. There was a clear message from the Government of Mozambique that transaction costs were still high and need to be reduced.

99. The PAPs performed well in 9 of the ten core indicators based on the MoU. The group expanded to 17 PAPs, and accounts for more than 80% of all aid inflows to Mozambique. Aid flows continue to increase steadily. With respect to most of the other indicators based on the Paris Declaration (indicators shown as shaded in Annex 1), a more qualitative assessment has been made as there were no pre determined targets (it is worth noting that the new PAF matrix 2006 now includes quantifiable targets for these indicators).

100. The key trends and challenges are outlined below:

Portfolio Composition

101. There has been no significant progress towards a higher share of GBS and programme aid. In fact a declining trend was noted for the period 2004 – 2006. The share of GBS in Total Aid fell by 8.5% between 2004 and 2006 and in Aid to GoM by 10%. Project aid meanwhile remained the largest aid modality and is expected to increase in the period 2004-06 by 15% as a proportion of Aid to the GoM, and by 17% of Total Aid. A trend is also noted whereby a number of PAPs have chosen to increase sector aid faster than general budget support.

102. Whilst it is recognised that these trends may in part be explained by the legacy of bilateral funding commitments which were approved prior to the signing of the MOU and the Paris declaration, nonetheless this should not divert attention from the fact that a significant increase in non-earmarked aid to the GoM (a key objective of the Paris Declaration) is not yet being implemented at the required scale and speed.

¹⁰ General Budget Support (GBS) is aid provided to the government budget that is fully programmable by the government (thus, it cannot be earmarked by the donors). Programme aid typically includes GBS and balance of payment support and earmarked pooled funds (sector/province budget support and basket funds). Project Aid is aid provided to specific projects, which can be aligned and or not with government priorities. However these definitions have not been applied uniformly resulting in some misclassification of data.

103. There is an urgent need for a more assertive and clearer aid statement from the GoM, indicating preferred aid modalities, as well as the scale and speed of transition. The GoM is working on developing an “External Aid and Cooperation Policy” to be finalized during 2006 and it is essential that this includes clear targets for GBS and other aid modalities. This is especially pertinent as 12 PAP members are this year preparing country strategies which provides a real opportunity to press ahead with improvements in portfolio composition and quality in favour of GBS and other programme aid.

Predictability

104. There have been significant improvements in “in year” or short term predictability in 2005. All PAPs that had clearly defined disbursement schedules¹¹, disbursed as agreed. There is however a need for improvement in medium to long term predictability. This can only be achieved through longer term, multi-year programmes with clear commitments. These would preferably be of a rolling nature. None of the current multiyear programmes are rolling, and it is recognised that there are legal obstacles to this for many donors. When this is the case, it will be important to find other ways of improving medium and long term predictability.

105. A key lesson is that increasing predictability requires clearer and more rigorous records of commitments, effective peer pressure to ensure compliance with the rules, and a strong and proactive GoM stance through improvement in the MTFE and continuing analysis of predictability in aid disbursements.

Information

106. Information sharing is poorly co-ordinated both on the part of the donors and GoM. There needs to be a clear official agreement to replace the earlier DCI reporting format with the EU database, and a clear strategy for increasing GoM ownership of the EU database whilst both meeting GoM information needs and removing double reporting requirements for donors.

Administrative burden and transaction costs

107. The trend in the overall number of missions was mixed. GBS related missions outside the mandatory ones (JR and MYR) increased from 3 to 7 (the number of individual missions increased from 3 to 4, and other 3 in 2005 were joint). The number of individual non-GBS related missions fell significantly between 2004 and 2005, from 195 to 164 (-16%).

108. This indicator has served to reduce the number of international missions, but there is also recognition that this remains a weak indicator owing to the absence of an agreed definition of the term “mission”. Moreover missions only represent one part of transaction costs. There is a need to 'remain committed to continue to revisit ways of working to reduce transaction costs, e.g. by streamlining the MYR process and significantly reduce un-necessary administrative burden and transaction costs. It is necessary for partners to follow established lines of communication with the GoM such as sectoral working groups.

V. MOU IMPLEMENTATION

Reporting requirements

109. In general, the MoU reporting requirements were followed and reports delivered by GoM as per paragraph 15 of the MoU to allow a continuous dialogue during 2005 and also to feed into the Joint

¹¹ Three of the 17 PAPs were not part of the group when disbursement schedules were defined.

Review 2006 (PES, PES implementation report, budget execution report, CGE, Administrative Tribunal report and opinion). Nevertheless, the PAPs were not able to assess the Budget 2006 during the MYR and it was agreed to postpone this assessment to the Joint Review 2006. The Budget was discussed in the budget working group meeting. The report of this meeting is in Annex 3.

110. The PARPA II has been developed through a broad consultative process during 2005, to be completed during 2006, after the Joint Review. The MTFE will be part of the PARPA II. As for the annual report on PFM assessment, comments have been made in the earlier sections of this Aide Memoire that deal with Public Financial Management issues.

111. The PAPs complied with their commitments as per paragraph 16 of the MoU on information requirements. However, the report on the review of PAPs performance was delayed making it difficult to integrate its results in the working groups work.

112. GoM and PAPs feel that it would be appropriate to give a flexible interpretation to the MoU stipulation that a Fiduciary Risk Assessment should be performed annually. The PFM Assessment using the PEFA Methodology focuses on the structural framework for PFM, and the structural reform processes do not necessarily lead to significant year-on-year changes. In addition, the PFM Assessment in its current approach (emphasizing dialogue and knowledge transfer) is a time-intensive process. Therefore, it is felt that it is more appropriate to perform a full and comprehensive PFM Assessment every two or three years. The proposal for future PFM Assessments is that the next full PFM Assessment using the PEFA Methodology should be performed in the last quarter of 2007, to assess the PFM performance of 2005 and 2006. This assessment will feed into the Joint Review in 2008. For the Joint Review of 2007 the assessment of PFM will be based on the regular follow-up of the related PAF/strategic matrix indicators and on other available analytical inputs (such as a possible Poverty Expenditure Tracking Survey).

Reviews and dialogue

113. The monitoring and dialogue processes were successfully followed between the two reviews and aligned with GoM's planning and budgeting cycle. The structure of the working groups with joint Government and PAPs participation was improved. Joint lessons were learnt from the 2005 JR and MYR on how to improve the process further (this document can be found on the PAP-website). The Governance pillar considers it necessary to improve indicators so as to better reflect the realities in all areas.

Revision of MoU Annexes

114. Although the MoU was approved in 2004, there were some annexes which needed updating (Annex 1: List of Signatories; Annex 6: Disbursements; Annex 7: Auditing; Annex 8: ToRs for Audit of the Financial Record of Programme Aid and Annex 10: Exceptions to the MoU). Annex 9 on GoM and PAP responsibilities and structures for dialogue was missing.

115. This process was completed before the Joint Review and the updated version of all annexes are available. In line with the requirements of the MoU the number of exceptions in Annex 10 was reduced (for details see Report on Review of PAPs Performance in 2005).

Bilateral Agreements

116. As recommended in last year's Aide Memoire, the consistency of bilateral agreements with the MoU was verified. The conclusion of this exercise is that there are quite a number of inconsistencies and grey areas. PAPs decided to engage in a peer review mechanism (see Troika ToRs in Annex 9 of the MoU) when renewing their bilateral agreements in order to bring them more in line with the MoU.

Audits

117. The MoU foresees the delivery of 3 annual Audits:

(i) Value for Money Audit (VfM)

118. The MoU foresees annual value for money audits on a sample of activities relevant for poverty reduction. Those audits should be delivered by IGF with the support of qualified and independent experts. Sectors or areas as well as ToRs and financing should be agreed upon between PAPS and GoM. The second VfM audit undertaken in the framework of the MoU was related to road sector. Presentation and discussion of the results (draft presented in the 2005 Joint Review) occurred in the 1st semester of 2005. The work was concluded in 2005 and approved by the Minister of Finance in March 2006. It is essential that the follow up of the implementation of the recommendations are part of IGF and road sector 2006 activity plans. It is recommended that the conclusion and formal approval of the annual reports are done in a shorter period. The third VfM audit is being undertaken in the water sector. Due to delays from the initial calendar, only the draft has been released at the time of this Joint Review. This draft will be assessed by PAPS and GoM but a concern was raised on the definition and objectives of this type of audits in Mozambique. Based on this experience, it is recommended for future exercises, the work of IGF and of the independent consultants be more coordinated from the planning phase, the choice of the consultants well thought in view of IGF capacity needs to perform such type of audits, and that terms of reference be discussed widely to agree on objectives and expectations. This is very important to ensure that those VfM audits look comprehensively at performance, results and costs of delivery and go further than a financial audit.

119. A new VfM audit will be carried out during 2006. The preparatory work should start immediately after the Joint Review to avoid recurrent delays and in order to have a final product to be part of the analysis of the 2007 Joint Review. As agreed in the 2005 Mid Year Review, the justice sector will be chosen for this exercise (and agriculture in 2007). The financing support from a PAP should be identified as soon as possible. As specified in the MoU, one VfM audit will take place yearly until the capacity of IGF has made it possible to undertake this type of audits form the regular activity plan of the competent Mozambican audit authorities. In this regard, IGF has informed the PAPS that based on the already existing experience it foresees during 2006 the creation of a new specific unit within its organic structure that will be charged with the realization of VfM audits.

(ii) Audit of the financial records of the Programme aid

120. The draft of the 2005 financial audit of the flow of budget support funds into the Treasury Account in 2005 was released, commented and therefore a final version should be circulated soon. The current version of the report shows that 2005 PAPS funds were transferred from the forex accounts to the transitory account up to the central treasury account. However, additional clarifications on specific issues raised by PAPS as well as inclusion of government's replies to the auditors' observations and recommendation are still awaited.

(iii) Audit of the General State Accounts

121. The Administrative Court audits annually the State Accounts. PAPS received in December 2005 the report and opinion of the TA on the 2004 State Accounts. These two documents provide an essential basis to feed into the dialogue between the PAPS and the Government on public finance management issues, in particular budget allocations, execution and transparency of state accounts for the previous year. In general the TA is positive about improvements, both in the CGE and in the dialogue with GoM.

The CGE contains more information and the consistency within the document has improved. Also the additional information from GoM, as requested by the TA, was more exact and complete than in previous years. Two examples are the inclusion for the first time of the Financial Operations as part of the overall balance and more detailed information on the external component of investments. Having said that, the TA report offers a list of irregularities in budget allocation and execution according to the TA. Some of these issues are new; whilst most others have been mentioned in previous reports as well. The most important are the following: changes in allocations, comprehensiveness of the budget, *acordos de retrocessão* and state credits, classification issues, and the execution of the investment budget. Following the experience initiated in the 2005 Joint Review and the respective recommendation, a dialogue has been opened between PAPs and the Ministry of Finance on the follow up given to the TA report. It is planned to deepen this dialogue after the Joint Review with the presence of the TA, to discuss its recommendations.