

JOINT REVIEW – 2005

Aide-Mémoire

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I. INTRODUCTION

1. On May 12, the Government of Mozambique and the Programme Aid Partners (PAPs)¹ concluded the annual Joint Review of the Government's implementation of its development programme and of the performance of PAPs. The review process involved the participation of civil society in the working groups. The review consisted of a backward looking exercise at performance over 2004, and a forward looking part that articulated some key issues and recommendations for 2005 and 2006. The review was based on Government plans and reports, as reflected in the Action Plan for the Reduction of Absolute Poverty (PARPA), the Economic and Social Plan (PES) 2004, including the Performance Assessment Framework (PAF) 2004 and the Budget or *Orçamento do Estado* (OE), the 2004 Government reports on Budget Execution and the PES, as well as an independent report on the performance of PAPs.

2. Twenty three working groups, distributed over six thematic areas, consisting of Government, PAPs 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 is presented in Section II. The detailed assessment of Government performance in 2004 and the recommendations for 2005 and 2006 are presented in Section III. The assessment and recommendations relating to PAPs performance are described in Section IV. The 2004 PAF matrix with the assessment of the defined targets of performance is given in Annex 1. Annex 2 presents the PAP Performance Assessment Matrix. Annex 3 includes the sector working group reports.

3. The review took place a few months after the third General Elections which were marked by a peaceful transition to the new Government. PAPs welcome with satisfaction the statements and actions taken by the new leadership to inject a new spirit of dynamism and accountability into the public sector.

II. OVERALL ASSESSMENT OF PERFORMANCE IN 2004

¹ Participating external partners included Belgium, Denmark, Canada, the European Commission, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Sweden, Switzerland, the United Kingdom and the World Bank. These 16 PAPs (G16) support a joint programme for providing budget support and have signed a Memorandum of Understanding with the Government. Observing external partners included: Japan, Spain, the United States, UNDP, the International Monetary Fund and the African Development Bank. Details of participating civil society organizations are included in the list of working groups.

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

4. Overall, Government PES/PAF performance in 2004 was satisfactory, albeit with significant variation across the range of PAF targets. Performance relating to the implementation of critical cross-cutting and structural reforms (notably in Public Finance Management and Governance) is a cause for concern. All partners agree that the incoming Government now has a unique opportunity to drive forward progress on these second-generation reforms and to use the revision of the PARPA to further embed these processes in Government policy across the board. The PARPA process will also provide an opportunity for the Government to develop a clear policy on external assistance. PAF performance remains mixed with regard to aid effectiveness. Progress has been made, particularly in terms of alignment and harmonization. Weaknesses were more pronounced in the area of transparency and less progress was noted in improving predictability and in reducing the Government's aid-related administrative burden.

5. The Mozambican economy continues to grow strongly and fairly stably with a real growth rate of 7.2% and inflation below forecast, at 9.1%. Encouragingly, the growth structure remains broad, with the agriculture sector seeing a real growth rate of a little over 9%, and the household survey shows that growth has contributed positively to poverty reduction. The monitoring of the PARPA has improved and there was some progress against the key PES/PAF indicators of ensuring integration of the PES, OE and CFMP and strengthening the BdPES. Spending in priority sectors was below target of 65% but considered acceptable at 63.3% of total expenditure (preliminary data), of which 50.4% was in education and health (thereby attaining the 50% PES/PAF indicator). Performance in public service delivery can be considered positive overall. In education, performance was broadly on-track. In health, positive progress was made both in PES/PAF and Millennium Development Goal (MDG) indicators. Although the 2004 PES/PAF targets were met, HIV/AIDS remains one of the greatest threats to Mozambique's development and a stronger and better coordinated gender sensitive multi-sectoral response is needed. Water sector coverage targets were achieved to a large degree. In terms of the environment for private sector development, progress in PES/PAF indicators was varied, with progress in the areas of financial sector reform and infrastructure services. Critical steps have been taken in areas of cross-cutting reform: SISTAFE, with the initiation of implementation in the Ministry of Finance; tax, with institutional development and steps to create the Central Revenue Authority (CRA); internal audit, with the revision of its functions; and decentralization.

6. There are, however, important areas where progress against the targets in the PES/PAF has not been satisfactory. These include key governance-related targets, particularly: (i) the absence of clarification regarding how to deal with external audit indicators; (ii) procurement reform, where considerable delays were noted (iii) legal and judicial reform, where stronger Government commitment is essential to accelerate progress; and (iv) corruption, with specific concerns raised about the ongoing delay in the release of the report of the corruption survey and the low ratio between concluded investigations and reported cases. A further central concern for Government and PAPs was the failure to produce the 2004 Public Financial Management Assessment in time for the Joint Review. Performance in revenue mobilization was disappointing, with the PES/PAF target for revenue relative to GDP missed by 1 percentage point. Disbursement constraints, of both internal and external funds, continue to hamper sector performance, although the flow of funds improved in 2004 in comparison with previous years; in the PARPA priority sectors, the budgeted investment expenditures were substantially underspent. In public sector reform, preparatory work has been done but there is as yet

limited discernible impact on service delivery. Performance relating to the environment for private sector development remains mixed, with poor performance against two PES/PAF indicators for the financial sector, namely the submission of the bankruptcy law to Parliament and the regulation for participation of public companies in the financial sector, and some progress, albeit delayed, in the Amendment of the Labour Law, the Commercial Code, and on regulations for licensing commercial and industrial activities.

7. Real progress needs to be made in the areas of public financial management and governance if Mozambique is to sustain growth and poverty reduction and meet the PARPA and MDG targets. For the same reason, greater attention must also be given to addressing the cross cutting issues of gender, HIV/AIDS and the environment. The government is aware of these challenges and expectations are positive, but action now needs to be taken. The Joint Review identified the following main priorities for ensuring achievement of the 2005 PES/PAF targets: (i) Government needs to continue efforts to identify indicators for the monitoring of external audit; (ii) approve new regulation on public procurement based on internationally recognized principles, begin implementation of the required institutional changes and strengthen capacity; (iii) accelerate progress in the effective implementation of legal and judicial reform and strengthening the rule of law; (iv) successfully roll-out SISTAFE, including external funds currently off-budget; (v) strengthen the dialogue between the MF and the sectors to ensure improvements in budget execution with regard to delays in disbursements and their prevention; (vi) consolidate tax reforms and implementation of measures (strengthening administration) to recover revenue and broaden the tax base, and; (vii) publish the results of the corruption survey.

8. **PAPs** made progress in improving the effectiveness of programme aid, particularly against core MoU commitments in the areas of alignment and harmonisation. Weaknesses were more pronounced in the area of transparency and less progress was noted in making PAP aid more effective in the broader sense, particularly in improving predictability and reducing the Government's aid-related administrative burden. Government and PAPs have therefore agreed to make improving the effectiveness of the PAPs' overall portfolio a priority. Sector processes and capacity strengthening programmes must be better aligned with the Government's cycle; aid reporting must be improved and aid better integrated in the Government's budget, and; faster progress is needed in reducing the Government's aid-related transaction costs, including through reducing aid fragmentation. The number of MoU PAPs has now risen to seventeen. All PAPs are urged to improve the overall aid effectiveness in the spirit of the MoU and the recent Paris Declaration. Government intends to include an aid policy statement in the elaboration of the PARPA II.

9. The Joint Review found that satisfactory progress has been made, giving a reliable basis for PAPs to continue programme aid and direct budget support.

III. ASSESSMENT OF GOVERNMENT PERFORMANCE IN PARPA IMPLEMENTATION IN 2004 AND KEY RECOMMENDATIONS FOR 2005

A. Poverty and Macroeconomic Management

Performance in 2004

10. **Overall progress is satisfactory.** The Mozambican economy continues to grow strongly with the rate of inflation coming down to a single digit. Improvements are registered in integrating the PES, OE and CFMP and in strengthening the *Balanço do PES* (BdPES) to monitor the PARPA. Significant improvements have been made in quantitative poverty analysis and dissemination. Steps to improve the monitoring system are also noted.

11. **Growth and poverty** performance are quite robust. Real GDP growth was 7.8% in 2003 and is estimated at 7.2% in 2004, reflecting a slow down in construction related to the completion of a number of private sector mega projects as well as a decline in fishing production. Growth in most of the sectors continued to be buoyant, including agriculture (8.9%), transport (16.4%), government services (9.4%) and mega-projects (15.4%). The end of period inflation rate declined to 9.1% (from 13.8% at end-December 2003), despite a sharp rise in petroleum prices. The banking system has reduced its vulnerability as the share of non-performing loans has decreased. Mega project-led exports have contributed to a significant decrease in the trade deficit, which coupled with higher-than-projected donor support and private capital inflows, boosted reserve accumulation to 4.8 months of imports (including imports for megaprojects). This contributed to a strong real appreciation of the Metical, reversing the depreciation trend of the past four years. This appreciation is in line with the changes in economic fundamentals characterised by a sharp increase in exports and capital inflows. Fiscal performance was below expectations with the collection of revenues lower than programmed by about 1 percentage point of GDP (even lower than the GDP percentage in 2003), which contributed to the domestic primary deficit target being missed by 0.7% of GDP; the deficit outturn was 3.8%. The composition of growth indicates that its base continues to be broad and should have contributed to a further reduction in the poverty level; this can only be confirmed when a new household survey is undertaken.

12. **Monitoring of PARPA** has improved. There was some progress against the PES/PAF indicators relating to the integration of PES, OE and CFMP using the single process methodology (*processo único*) and strengthening the BdPES. The 2004 PES and OE are a good representation of improved linkages between core actions, outputs and outcomes to be achieved towards the implementation of the PARPA. The CMFP defines the base framework for 2004 and gives a perspective for the period 2005-2008 but its dissemination to the main Government ministries is still weak. The Government has included the CFMP in the 2005 budget. The separation of Planning and Finance raises concerns and could have implications for the *processo único* methodology. The BdPES is a better reflection of the PES implementation but still needs to provide more information on main policy developments and issues. In addition, the sector and provincial monitoring systems are not yet fully harmonized with the BdPES preparation. Although the relationship between the PES and OE has improved, it is still weak and needs to be strengthened. This mainly covers the identification of unit costs, improved budget comprehensiveness, with inclusion of off-budget items, and the beginning of budget programming.

13. **On poverty analysis** good progress has been made with high quality reports produced in 2004 on various aspects of poverty, for example poverty determinants and profiles, inequality, and comparisons between the two most recent household surveys.

These surveys provide reliable information on poverty analysis but ways need to be found to allow for shorter-term analysis and improved linkages between the PES and the PARPA. For this reason the forthcoming QUIBB survey results are eagerly anticipated. According to the poverty analysis, all groups in society, including the poorest, should have benefited from economic growth. In addition, inequality in real consumption between provinces and regions has diminished. However, the gains recorded hide the complexity and diversity of the way in which poverty affects different groups in society, and gender, geographical and other disparities persist. For example, some key groups, including female-headed households, orphans and vulnerable children, have not benefited fully from the gains in poverty reduction. The levels of chronic malnutrition (stunting) are also very high, with 41% recorded in 2003 among children 6 to 59 months old. To improve the understanding of these issues, and to promote the mainstreaming of food security and nutrition across the sectors in the context of the PARPA II preparation, further work, including qualitative analysis, still needs to be done.

14. **Gender** inequality is costly for development. Women's limited economic opportunities, participation and roles are among the key determinants of poverty. The relatively high prevalence of **HIV/AIDS** also has a critical impact on poverty. The treatment of these issues has been variable in the PARPA, BdPES and OE. There is little mention of gender inequality in the PARPA and this issue has not been analysed in the BdPES or reflected in the OE. Several critical actions have, however, been taken towards the setting up of an institutional framework to promote gender equality, including the design of a national action plan and the preparation of a National Gender Policy, though this is yet to be approved by the Council of Ministers. Though HIV/AIDS was addressed fairly comprehensively in the BdPES, it has had little visibility in the PARPA and the OE allocation to HIV/AIDS is still low and in fact has fallen in real terms.

15. The targets for **environment** set out in the 2004 AM have not been fully achieved. The expected report assessing the status for integration of environment into selected sector ministries has not been prepared. A territorial Law has been drafted, but not yet approved by Parliament. Discussions are ongoing between MICOA and MPD on how to integrate the territorial planning with the district development planning, concrete pilot projects will be initiated in 2005 and the necessary regulatory measures initiated. It is of concern that unsustainable exploitation of natural resources may be undermining sustained economic growth. In urban centres, problems regarding sanitation and solid waste are growing. There is insufficient information to provide a full overview on the state of the environment and its relation to economic and social development.

Recommendations for 2005 and 2006

16. Growth and poverty reduction:

- Economic growth in Mozambique needs to continue to be broad-based to impact upon poverty reduction. As the majority of Mozambicans depend on the rural economy, it is particularly important that the country has, and implements, a comprehensive and coherent rural development strategy that focuses on the development of agricultural and all other sectoral activities, including improved access to rural finances. This strategy is being prepared and will be integrated into PARPA II.
- High rates of broad-based economic growth are fundamental for continued reduction in poverty. To maintain such high rates of growth, private sector development will be

critical. In this regard, it will be important to continue to reduce the cost of doing business in Mozambique, reduce corruption, improve the rule of law, address rigidities in the labour market, improve basic infrastructure, enhance access to credit, and modernise procurement regulations.

- Fiscal policy and its different elements should be improved. The efficiency and efficacy of expenditures need to be improved to maintain their impact on growth and poverty reduction.
- The human and economic impact of HIV/AIDS will be addressed in the PARPA II.
- Gender analysis and gender responsive interventions need to be integrated in PARPA II, highlighting the correlation of increased gender equality with increased poverty reduction and economic growth.
- Improved natural resource management (fisheries, forestry, mining, land, water) is needed to sustain growth and to contribute to budget resources mobilization. The National Strategy for Sustainable Development will be integrated into PARPA II and include environmental indicators.

17. Monitoring and Analysis:

- The Government will maintain its commitment to the integration of PES, OE and CFMP and of these with the Government's five year programme and the PARPA in the single process (*processo único*) methodology. A key PES/PAF indicator will be developed to monitor food security and nutrition in 2006.
- The revision of the PARPA will be used to develop an integrated comprehensive and gender-sensitive system with a study on the planning, budgeting and monitoring cycle to ensure that information from all levels is included in the BdPES. The monitoring system needs to engage the other stakeholders: civil society, faith based groups, private sector, and donors. The relationship between the PARPA and the MDGs, including monitoring and evaluation, will be strengthened.
- Development partners will strengthen and accelerate their efforts to align with Government planning and monitoring systems and harmonize their support.
- Establishing a system for monitoring the sustainable use of natural resources and environment is a priority. Environment mainstreaming will be implemented and monitored through the PES and PAF. Indicators will be prepared for consideration at the MYR 2005.

B. Governance

Performance 2004

18. In the area of governance (Public Sector Reform, Decentralization/Deconcentration, and Legal Sector Reform and Reform of the Judiciary), **overall progress** was slow, although the Government has met some targets. It has also been agreed that substantial advances in the ongoing reforms are indispensable for meeting the PARPA objectives and the MDGs. Without those reforms aiming at more effective delivery of public services, enhancement of the rule of law and significant improvements in accountability to citizens, the targets of poverty reduction may be hard to meet.

19. In the area of **public sector reform** the three targets agreed for 2004 have been partially met, with limited impact on service delivery. The PES/PAF target for completion

and approval of Functional Analyses (FAs) was only partially met; out of the six FAs only two have been formally approved by CIRES (MADER and MIC), and presentation of the remaining four has been rescheduled for 2005. Preparatory work was undertaken for the Medium Term Pay Policy. The unification and verification of databases for public servants is still outstanding. Concerns relate to the need for government to strengthen leadership in the reform process, and to better identify priority areas of intervention which will have an early impact and provide quick wins.

20. Some progress was noted in **anti-corruption** work: the national study on good governance, corruption and service provision was partially completed in the last quarter of 2004, with dissemination rescheduled for June 2005. The Anti-Corruption Law was approved in 2004, but the regulations are not yet elaborated and the High Authority for the Combating of Corruption (Gabinete Central de Combate à Corrupção) has not yet been created formally. Many alleged corruption cases were reported to the Unidade Anti Corrupção (Anti-Corruption Unit) in the Attorney General's Office, but the rate of concluded investigations and convictions have been extremely low so far. The Government signed, but has not yet ratified the UN convention or the SADC protocol on corruption. An institutionally comprehensive anti-corruption strategy needs to be prepared, with strong political backing and clout.

21. In the area of **decentralization/deconcentration** there is notable progress against the PES/PAF targets. Concerning the introduction of participative district planning, the target has been exceeded. The other target, the approval of the regulation of the Law nº 8/2003 on Local Government was not met, it was approved in April 2005. A number of challenges remain. Budget allocation, execution and accountability mechanisms at sub-national levels are a concern, with stagnating percentage shares of the budget going to provinces and districts. Off-budget expenditure and revenue are not systematically accounted for. There is a further concern that the Government has focused more on consolidation of the municipalities than on their quantitative and qualitative expansion. Also, resources are not allocated where poverty indices are highest.

22. Little progress was noted in the area of the **justice sector reform programme and in the administration of justice**. The legislative reform and training programmes are being implemented. An integrity study of the judiciary was completed and there was an increase of funding to the sector. However, the long term vision document, an essential part of the reform programme, was not completed as planned and is not expected shortly. With regard to the **judiciary**, a review of the 2004 targets shows little progress. Despite an increase in the productivity of case disposition meeting the 2004 PES/PAF target, the backlog and the total volume of judicial cases continues to increase. Slow case processing in civil cases and high judicial costs constitute barriers to contract enforcement. The target regarding decreasing the number of detainees awaiting accusation and trial was not met. The ratio between investigated and sentenced cases of reported incidents in the area of corruption and economic crime continues to be low, and communication with the public on the resolution of certain high profile cases is still outstanding. The slow progress in the justice reform programme and in service delivery may undermine the confidence of citizens in the democratic institutions of the state and its capacity to combat crime, corruption and to ensure predictability. If the constraints are not overcome, they will continue to affect the appropriate functioning of the administration of justice services and the sector's capacity to contribute to poverty reduction. Henceforth, the challenges continue to be: enforcement of human rights,

particularly in prisons; access to justice, including both formal and informal justice delivery; combating corruption and economic crime; contributing to the promotion of social justice, and; a favourable business and investment climate. Stronger Government commitment is essential to accelerate progress in this area.

Recommendations for 2005 and 2006

23. Public Sector Reform

- There is a need for a Government endorsed review of the approach, and progress of the reform process, in order to inform the “implementation phase” (2006-2011). This should be done before the Mid Year Review 2005, in order to provide the basis for rethinking the PES/PAF targets so they better measure the impact of the reform.
- The Government should identify priority action areas and give due focus to these.
- The donor community should make an additional effort to streamline its coordination and simplify the management of UTRESP funds.
- The Government should accelerate the unification and auditing of civil servants' records.

24. Anti-Corruption

- The elaboration of the national anti-corruption strategy through a consultative process which involves, among others, the Government, the future *Gabinete Central de Combate à Corrupção*, civil society, and should take into account the findings of the recent survey.
- Increasing the ratio between reported cases of corruption and economic crime and concluded investigations and sentences, and improving communication with the public regarding high profile cases.
- Use the existing administrative sanctioning measures in the fight against corruption.

25. Decentralization

- Consolidation of policy elements through an operational Decentralization and Deconcentration Strategy (2005 PES/PAF indicator), arrived at through a consultative process with local governments and municipalities within the PARPA II scheme. It is important that this is based on the subsidiarity³ principle.
- Creation of a vertical planning and budgeting system which is reconciled with the logic of territorial and administrative planning, basing itself on a common legal framework. The innovative work that is being carried out in Nampula could be a model for such a system. MICOA and MPD will in 2005 define how the Territorial planning, and the Districts' Development Planning can be integrated. Guidelines, manuals and regulations will be prepared/revised. 10 pilot projects will be initiated in 2005.
- The improvement of accountability mechanisms through the strengthening and capacity building of the Institutions of Participatory Community Consultation (IPCCs).

³ Decisions taken at the lowest possible level of public administration

- Elaboration of a manual for district finances which clarifies the district's function as a budgetary unit, its incorporation into SISTAFE as well as their capacity to retain revenue.
- A survey of internal and external recurrent and investment resources (on- and off-budget) available to the provinces and covered by the decentralized planning and finance programme, in which the responsibility of each is clearly defined. This would provide the basis for increased discretionary funding for provincial, district and municipal governments and would facilitate a more transparent monitoring of global expenditure.
- Better integration into the planning process at the local level of HIV/AIDS, gender and management of natural and environmental resources is needed.

26. Justice

- The completion of the sector's vision document is being proposed, with the corresponding review of the sector's strategic documents, aiming at a better integration of the justice sector and police, particularly the Criminal Investigation Police (PIC). In this process, the Coordination Council for Legality and Justice (CCLJ) should play an important role, as well as in the articulation and coordination of the sector with its international partners.
- Justice sector delivery needs to be more focused at the poorest strata of the population and the promotion of development, by creating a favourable environment for private business and investment.
- The sector needs to consider a better integration of the reforms of the legal and the public sector, as well as the need for a functional analysis (of the justice sector), which takes into account its particularities, as well as a greater openness towards and dialogue with the civil society (Bar Association-OAM), Human Rights NGOs, IPAJ, and others) in the execution of the sector's operational plans.
- The sector needs to create better harmonized monitoring and evaluation systems, and to identify gender sensitive indicators geared towards service delivery and access to justice, as well with regard to the monitoring of PARPA.
- A gender perspective needs to be applied with regard to all legislative reform work.
- In facing the progressively increasing number of newly opened and pending judicial cases, as well as detained people, the sector should take measures that go beyond increasing the productivity of each magistrate. In order to resolve the current situation, measures to be taken should include the involvement of auxiliary legal institutions (law lecturers, internship students, CFJJ, OAM, advisors in the prisons, etc.) and the use of arbitration to accelerate dispute resolution.
- With regard to the fight against corruption, the authorities need to increase the ratio between investigated and sentenced cases and the total of reported cases.
- The inspection (internal audit) of the courts and the prosecution needs to gain impetus, notably with regard to using the results as criteria for the performance assessment of judiciary personnel.
- The reform of the Penal Code and the Penal Procedural Code, should include domestic violence in an adequate and effective manner to guarantee full legal protection against such crime.

C. Public Financial Management

Performance in 2004

27. **Performance in this area is at best mixed.** Based on preliminary figures, spending in priority sectors remained below target at 63.3% of total expenditure, of which 50.4% was in education and health (thereby attaining the 50% PES/PAF indicator). Critical progress on SISTAFE was made with the initiation of its rollout in the Ministry of Finance. Improvement was also made in the review of internal audit functions, and steps were taken towards the establishment of the central revenue authority. Less positively, procurement reform has been delayed - although recent developments are promising - and revenue performance is worrying. A key concern for PAPs is that dialogue on the performance of external audit remains absent. A further central concern for Government and PAPs was the failure to produce the 2004 Public Financial Management Assessment in time for the Joint Review, hampering a comprehensive PFM assessment.

28. In the area of **budget execution**, spending on priority sectors continues to be the main focus of fiscal policy. Government spent 63.3% of total expenditures, less interest payments, on PARPA priority sectors. This represents a slight decrease compared to 2003 (CGE: 63.9%). This performance is acceptable considering the costs of elections and the good performance of domestically financed spending. However, the final figures for expenditure in priority sectors will only be available when the State Accounts are published. Progress in improving the comprehensiveness of the budget is slow, with many own revenues and donor flows remaining outside the budget. Reported execution of the external grants financed investment expenditures remains low at just 52%, probably reflecting weak reporting more than weak execution.

29. The flow of funds from the MF improved significantly compared to 2003, as demonstrated by the budget execution figures for recurrent costs (94.8% in 2003 and 98.2% in 2004) and by the internal component of the investment budget (80.1% in 2003 and 98.7% in 2004) compared to initial budget allocations.⁴ From the perspective of the sectors the flow of funds remains irregular and unpredictable, both for internal and external funds. The alterations in the originally approved budget allocations are not reflected in the execution reports, making the analysis more difficult. The reports from the sectors (e.g. water, education and agriculture) show that the consistency of information between sectors, the MF and partners remains unsatisfactory.

30. **SISTAFE** began roll-out in the MF on the 1st November 2004 allowing financial execution of the State budget through e-SISTAFE. According to the PES/PAF indicator it had been expected that general budget execution of the 2004 State Budget, as well as direct budget execution in the Ministries of Finance and Education through e-SISTAFE, would have been initiated in 2004. For a number of understandable reasons this was not accomplished. Consequently the 2004 PES/PAF indicator has partially been met.

31. Progress has been made in the review of the **internal audit** functions. The MF presented the diagnostic study on the situation of the internal control institutions at national level, a 2005-2009 strategic plan, and a 2005 activity plan and budget for the

⁴ Figures including advances.

internal control subsystem. A value for money audit in the road sector due to be conducted in 2004 was carried out at the beginning of 2005 and a draft report has been released. The quality of this audit is considered satisfactory. Important findings and recommendations will be followed up by the MF and the roads sector.

32. Concerning **external audit**, neither the assessment of progress towards the 2004 PES/PAF target nor the discussion on the indicators and targets for 2005-2007 could take place. Nevertheless, it was recognised that improvement was experienced during 2004 on the external audit by the TA of the General State Accounts, in terms of the timeliness, scope, and in some respects quality of the audit reports for 2002 and 2003, which were debated in the National Assembly in April 2005. The PAPs and the Government welcome the start in early 2005 of a dialogue to follow up on the main content issues raised in the TA audit report.

33. In **Procurement**, the 2004 PES/PAF indicator to approve a new procurement regulation was not met. This was partly due to delays in scheduled consultations with the different stakeholders. On the basis of conclusions made at a workshop discussing the fourth draft regulations, a more advanced draft will now be elaborated by Government for discussion with the stakeholders, thus creating the conditions for preparation of the decree. It was agreed in the 2004 Joint Review that a number of "quick wins" should be targeted in 2004. In general, progress towards achieving these was unsatisfactory.

34. **Tax reform** showed mixed performance. The PES/PAF target to submit the draft legislation on the creation of a revenue authority to parliament was achieved. The draft law creating the CRA was submitted to Parliament in August 2004. The revenue collection target of 14.7%⁵ of GDP was missed by about 1 percentage point. Weak performance was observed across all taxes. On the international taxes (VAT on imports and tariffs), the reduction was mainly due to the appreciation of the Metical. On income taxes, the delay in computer processing of income declarations, delayed submission of declarations by taxpayers, as well as reduced collection of retained tax in public service, were amongst the main reasons mentioned for the shortfall. Improvements were observed on the main private sector concerns on tax administration: processing time for VAT refunds was reduced from 60 to 30 days; about 82% of the refund claims were processed, compared to 67% in previous year, e; improved customs clearance procedures.

Recommendations for 2005 and 2006:

35. Public Financial Management

- The 2004 PFM Assessment report will be ready for the MYR 2005. The 2005 report will be ready in time for the 2006 Joint Review.
- The mixed performance in the area of public financial management is influenced by the relatively weak management capacity in the different reform areas. Given the importance of these reforms for the sustainable implementation of PARPA, this needs to be addressed.

⁵ Quantitative target based on old GDP series. Under new series, reviewed in 2005 (with higher GDP figures in nominal terms), the revenue ratio to GDP is 12.3% in 2004.

- PAPs and Government will work on a joint strategy for capacity development in Public Finance Management. Further it was agreed to strengthen reform coordination and management.

36. Budget Execution

- Government and PAPs will revise the indicators for measuring budget performance (including allocation and execution) for poverty reduction prior to the MYR.
- It was agreed to improve the quality of financial programming and allocation for priority sectors for both internal and external funds, in order to secure a more regular and predictable flow of funds.
- Additional improvements are also required to strengthen the dialogue between the MF and the sectors regarding the causes of delays in disbursements and their prevention.
- It was agreed that future execution reports will not only compare expenditures to the final budget, but also to the original allocation. Also the reports will give more information on budget and execution of externally financed funds and projects.
- An improved picture on multi-sectoral expenditure on HIV/AIDS is essential for coordination and planning, as well as for demonstrating government commitment.
- It was agreed that the treasury quarterly cash flow plan should be sent to PAPs by December in order to improve disbursement planning and to avoid liquidity gaps. PAPs have not yet received the information for 2005.
- Review the possibility to track budget allocations to measure investments in gender equality.
- A stronger effort is needed to improve consistency of information between the MF and the sectors in order to turn the budget execution report into a more useful tool. Donors will contribute by improving the information they provide.
- Budget coverage and comprehensiveness must be increased in steps to include all own-generated revenues of budget units and donor funds and to include these funds in e-SISTAFE budget execution.

37. SISTAFE

- Adequate project management capacity, including transparent and efficient procurement arrangements, should be put in place. The IT-security audit to provide assurance about the security and integrity of data is to be undertaken as a matter of urgency.
- UTRAFE should develop a clear change management strategy in order to respond more proactively to the changes associated with the reform within MF as well as within line ministries.
- It is also recommended that UTRAFE elaborate an updated and user-friendly overview of the Public Financial Management reform and its principal elements. This would include a full roll-out plan and a realistic timetable for the e-SISTAFE roll-out to be refined based on the experience of Ministry of Education and Culture (MEC).
- It is important to start updating in the context of e-SISTAFE the current budget management practices and systems to improve transparency and efficiency and strengthen budgetary control.

- The IMF, which has been providing technical assistance to SISTAFE reform, has signalled that it will evaluate its role by the end of 2005. There is thus an urgent need to agree on the approach and scope of continuous technical assistance to SISTAFE reform.
- The following PES/PAF indicators left open for 2005 were agreed: (i) Preparation of a semi-annual budget execution report on the basis of the e-SISTAFE using new budget classifiers (due 15 August, 2005); and, (ii) Roll-out of e-SISTAFE to the MEC will be completed by December 2005.

38. Audit

- Government needs to mobilize resources to implement the 2005-2009 strategic plan on the sub-system of internal audit.
- Government will continue efforts to identify indicators for the monitoring of external audit.
- A PAF indicator for 2005 has not yet been agreed. Government will propose an indicator before the end of May when donors commit funds for 2006. The PES 2006 should have adequate coverage of the audit area and the PES/PAF 2006 needs to draw adequate indicators from this for performance of external and internal audit.
- The water sector Value for Money (VfM) audit will be completed before the 2005 Mid-Year Review. Future VfM audits will be delivered in time for inclusion in the Joint Review.

39. Procurement

- The 2005 PES/PAF indicator is the approval of a decree revising procurement regulations for public works and concessions, goods and services based on international standards in 2005. It is expected that the decree be submitted to the Council of Ministers by the end of June 2005.
- Measures should be undertaken during 2005 to ensure that the implementation of a transparent and efficient procurement system is not further delayed. These measures include: a revised action plan; procurement audits in a sample of ministries in accordance with the IGF activity plan for 2005; elaboration of ToRs for a consultant to elaborate standard bidding documents; elaboration of a training programme for civil servants and suppliers, as well as elaboration of ToRs for a Code of Conduct for procurement.
- The integration of the procurement reform into the e-SISTAFE system is important.

40. Tax Reform

- The consolidation of VAT and income taxes introduced in 2003 is of critical importance. Measures will be taken to recover revenue and broaden the tax base, including strengthening of tax administration, intensifying inspections and audits on taxpayers and expansion in attribution of NUIT's (tax identification number).
- The development of actions towards the creation of the central revenue authority should continue during 2005, addressing the critical issues of customs and tax administrations integration, change management, strengthening information management and capacity building.

- Based on GDP figures revised by INE (National Institute of Statistics) in 2005, it was agreed that the PES/PAF target of total revenue relative to GDP for 2005 is defined at X% (to be confirmed on May11).

D. Private Sector and Financial Institutions

Performance 2004

41. Overall performance in this thematic area is mixed. The sub-area assessments are: (i) financial sector: fairly good; (ii) private sector: mixed/improving; (iii) agriculture: quantitative is satisfactory but institutional development is not satisfactory; (iv) roads: construction is satisfactory but financing is not satisfactory; and (v) energy: mixed. Whilst overall growth of the private sector has been positive, observers believe that the reform process slowed, a trend which could damage future private sector growth. Key areas for improvement in 2004 that carry over into 2005 include legal and judicial reform, banking efficiency, tradability of land-use titles, labour law reform, improved public finances management, and energy availability and efficiency for private sector growth.

42. Financial Sector Reform: Performance against the PES/PAF indicators was assessed as fairly good. Good progress was made against four targets. A strategy for International Financial Reporting Standards (IFRS) has been presented, regulations related to the Banking Institutions law (LICSF) were prepared, the withdrawal of Government participation in Banco Austral was completed, and a chart of accounts for the insurance sector was published. Progress against two targets was rated as fair. The forensic audit of Banco Austral hasn't started but the contracting of the audit company has been completed, and the strategy for Government withdrawal of BIM has not yet been defined but is under development. For those two targets rated as poor – the submission of the bankruptcy law (LFL) to Parliament and the development of a strategy to regulate the participation of public companies in the financial sector – there has been little activity to date. The establishment of a Financial Investigations Unit by December 2004 was not achieved. However, the Government has committed to develop an action plan and timetable by the end of May 2005, in order to have the unit operational by December 2006 at the latest.

43. Progress against the PES/PAF indicators for the **business environment** is mixed, with optimism for future improvement. Of the 4 PES/PAF 2004 targets under the *Ad Hoc* Legal Reforms section: the Amendment of the Labor Law is in progress; the Commercial Code is delayed but progressing; and regulations for licensing commercial and industrial activities, and the regulations for inspections of commercial and industrial activities, are already in place. Much remains to be done at the level of the PES/PAF Strategic Objective for 2004: "Creation of favorable environment for private sector action". Since a third of 2005 has already passed, immediate attention is now required.

44. **In the area of agriculture**, overall progress on the PES/PAF quantitative indicators for 2004 was satisfactory, but less progress was made on the institutional reforms of MINAG. Growth in the agricultural sector in 2004 remained strong at about 8.9%; this was mainly achieved through expansion in land use and productivity gains in the north of the country. Indicators for vaccinations were below the target by 50%. Some advances were recorded in

the institutional reform of MINAG, namely the revision and approval of its status and functions, and in the newly created or restructured subordinated institutions; however, less than expected progress was made in drafting the plan for staff resource development and deployment. The Ministry finalized the preparation of its strategy document for PROAGRI II. Disbursement constraints continued to hamper normal implementation of the sector's activities; out of the total amount foreseen for 2004, only 62% of budgeted investment was disbursed. Specific budget execution concerns include: (i) the lack of a uniform mechanism for the flow of information on execution for projects outside of PROAGRI system; (ii) information regarding execution external investment budget at provincial level not being sent to central level by the DPPF; and, (iii) the lack of information on MINAG's procurement account.

45. The **energy sector** shows progress in the majority of the indicators set in the sector policy and strategy. Most significantly, EdM implemented the goals for connecting new consumers, the Master Plan (2005-20) for grid extension has been completed and distribution networks for low-cost technologies and intermediate energy types are being established. The first large scale gas project has been implemented and future areas for exploration and investors have been identified. New sources of funding for FUNAE (National Energy Fund) have been identified, but not approved. Significant progress has been achieved in drafting new regulations for natural gas distribution and electricity. Less positively, no study of outages has yet been carried out; the Mozambique-Malawi inter-connector has not advanced; and, the efficiency goals for EdM were not achieved.

46. The overall trend of the **road sector** is positive. The PES/PAF indicators were largely achieved: the routine maintenance target was accomplished (103%); the rehabilitation indicator was significantly overcome (184%); but the periodic maintenance indicator remains weak with funds used for maintenance reaching only about 80% of the planned amount. The Road Fund (RF) has been obliged to shift funding from periodic maintenance to rehabilitation against the RF policy due to the fact that, the fuel levy decree was approved after the 2004 budget was approved by the Parliament. Thus, the MF had to match the investment and fuel levy funds considering the limits imposed by the Law.

47. The limited capacity of *Administração Nacional de Estradas* (ANE) for the implementation of projects and supervision services, lack of maintenance funds, and the decentralization process are matters of major concern. Another area of major concern is the bureaucratic and lengthy process of contractor and consultant payments. This has resulted in significant RF debts related to late payment, interest and claims (approximately \$10 million in 2004) and has a detrimental impact on private sector development, especially smaller companies.

Recommendations for 2005 and 2006

48. Financial Sector

- The forensic audit of Banco Austral should be completed by December.
- Progress is needed in selling Government's interest in BIM and the submission of LFL legislation should be accelerated.
- The drafting of the social security law should be finalised.

- During the Mid Year Review new actions and targets will be defined focussing in particular on the PES/PAF objective of improving financial intermediation especially for micro, small and medium enterprises. Furthermore, a strong case was made for conducting an analytic inventory of existing public instruments for financing of private enterprises.
- Emphasis should be placed on commencing the actuarial study of INSS.

49. Business Environment

- Complete a broad consultation process on the labour law and formulate a plan of action.
- Approval of the new commercial code and full entrance into force.
- Business registration: adoption of reforms including the computerisation of Notary registries and registered lawyers to function as alternative notary agents.
- Fines and inspections: immediate abolition of current system for fines distribution among the inspector, the institution in charge, and the Treasury. Complete implementation of a transparent and accountable system whereby fines are deposited in a bank account of the Treasury.
- Special attention must also be paid to: payment scheduling (including VAT refunds); one-stop-shops; simplification of licensing and registration of the economic ministries; telecommunications regulations, and; HIV/AIDS.
- MICOA will prepare a yearly report on the progress in the integration of the environment into the private and service delivery sectors.

50. Agriculture

- In 2005, MINAG should achieve improved results in the areas of institutional development, including: human resources; management information systems (MIS); procurement and assets management; and comprehensiveness of the information system on budget execution.
- MINAG should ensure implementation of the Gender Strategy and the recommendations of the Strategic Environmental Assessment and the HIV/AIDS diagnostic study.
- The implementation strategy for the restructuring of MINAG (to be completed in 2007) as approved by CIRESA needs to be prepared and initiated.
- Implementation mechanisms for PROAGRI 2 should be finalized in 2005, in consultation with other stakeholders (MF, MPD, MAE, MIC, MOPH and provincial governments) to allow a gradual implementation in 2006 and 2007.
- Develop a medium term fiscal framework for agriculture consistent with international recommendations, namely NEPAD, and with the Government's Medium Term Fiscal Framework.

51. Energy

- Establish a monitoring and evaluation system in the energy sector for coherence between existing planning and monitoring instruments and enhancing fulfilment of sector indicators.

- Establish a result oriented human resource plan for the staff of the new Ministry of Energy, to ensure that the needed competence is in place to carry out its mandated role.
- Ensure that funds for FUNAE's administrative budget are available by the end of 2005 and a flow of income for the investment budget is available by the end of 2006.

52. Roads

- Donors and Government should produce an action plan to move towards a common, un-earmarked fund to the Road Sector through RF to reduce transaction costs on RF and government road institutions.
- The performance monitoring system at central and provincial levels must be improved, as must the reporting system against PARPA objectives including main institutions, provincial directorates and donors. For the 2006 PES/PAF matrix, it is proposed to add an indicator reflecting *capacity analysis*, as the percentage of planned funding versus actual financing. In addition, it is recommended that the coordination and monitoring between RF and ANE be improved.
- The recommendations from the recent MF (Inspeção-Geral de Finanças) institutional capacity assessment of the Road Sector should be actioned to increase overall management.
- The RF should be given full financial and administrative autonomy.
- A systemised mechanism for increasing participation of local road sector contractors and consultants should be developed and implemented.
- There is a need to align with the PARPA performance indicators by adding a performance indicator for the percentage of impassable roads.

E. SERVICE DELIVERY

Performance in 2004

53. Service delivery in 2004 showed **fairly good overall progress**. In education performance seems to be on track, although data on the completion rate indicator will not be available until May. Despite promising progress in girls' enrolment, regional and gender inequalities continue. In health there was positive overall progress, both in MDG indicators measured by the demographic and health survey of 2003 and in the PES/PAF indicators, although DPT coverage rates stagnated in 2004. In HIV/AIDS the targets for 2004 were satisfactorily met, but implementation of an equitable multi-sectoral HIV response remains a major challenge. In the water sector, the water coverage target was partially achieved. The Government is still facing challenges in the improvement of sanitation services.

54. There were **common concerns and issues** in the four sectors, including late disbursement of budget funds. This, combined with problems in execution capacity across the sectors, resulted in low budget execution rates. Several sectors noted discrepancies in financial data (allocation and execution) between the MF and the sectors. Also large volumes of funds remain off-budget in the priority service sectors and there is little information on their execution. The slow roll-out of SISTAFE continued to raise concerns. The impact of the HIV/AIDS epidemic is significant across the service delivery sectors, and although there has been some progress in the health and education sectors, the development and implementation of sectoral HIV strategies has been

negligible. In addition, the national HIV response has suffered from a lack of strong political leadership at all levels and across all sectors. None of the sectors has progressed much in institutionalising and mainstreaming gender. Gender inequalities are evident in primary education indicators; the health sector information systems cannot provide data to measure gender disparities; and gender inequality is one of the driving forces behind the HIV/AIDS epidemic. Investments in sexual and reproductive health are important pro-poor measures and determinants for greater gender equality.

55. Overall performance against the three **HIV/AIDS** PAF/PES indicators in 2004 was satisfactory. The target for the prevention of mother-to-child transmission (PMTCT) was 81% met. Although this target was not fully achieved, overall progress is positive as 2004 was the first year of implementation of PEN Saúde, and there were significant challenges in scaling-up access to care and treatment. The target for antiretroviral (ARV) treatment was exceeded; and the target for prevalence was met. There was significant progress in the application of the “*Three Ones*” – namely the establishment of one national strategic plan; one coordinating mechanism; and one national monitoring and evaluation system. Political leadership at all levels and across all sectors is crucial to an effective national response - yet the CNCS Board (which should spearhead this effort) did not meet in 2004, compounding the fact that political leadership has been sub-optimal. HIV/AIDS is inextricably linked to gender inequality and poverty, and must be tackled through a coordinated multi-sectoral response, yet few sectors have mainstreamed HIV/AIDS in their sector strategies and still fewer have dedicated resources for implementation. The upsurge in the number of orphans and vulnerable children has stretched coping mechanisms beyond their limits. Civil society engagement at all stages of strategy development and implementation is key to the achievement of PAF/PES, PEN II and PEN Saúde targets, but has yet to be adequately recognized. Significant delays in the development of a workable Grant Management System have detracted CNCS from focusing on its core business of coordinating, leading and monitoring the national response. Although HIV/AIDS was addressed fairly comprehensively in the PES 2005 impact analysis, it was not mainstreamed in the following sector strategies. There is a need to revisit the HIV/AIDS PAF/PES indicators for 2006.

56. In the **education** sector, the net enrollment indicator from the PES/PAF matrix was achieved, but data on the completion rate indicator will not be available until May. Significant regional and gender disparities continue to exist. Significant progress was registered in Primary Education. The Government abolished the payment of compulsory fees that were being made in primary schools. The implementation of the New Curriculum for Basic Education and literacy and non-formal education, as well as the HIV/AIDS Strategy constituted areas of progress. Important changes were seen at the post-secondary education level. The revision of the Secondary School curriculum is in process with a view to transforming the curriculum in order to address concerns with improvement in quality and relevance of this sub-sector, as well as the changes in Primary Education. A reform of Technical-Professional Education is also in progress with the participation of the private sector and both national and international partners.

57. Nevertheless, MEC still faces serious challenges. The ESSP II has not been finalized as foreseen in the PES/PAF, as a result of some weaknesses in the planning capacity at MEC. The difficulties observed in the area of financial management led to low budget execution, hindered the disbursements of FASE funds and caused delays in salary payments for teachers and subsidies for literacy trainers, thereby compromising

MEC's programmes. Teacher training, including in-service training, and distribution of text books still do not respond to needs in the sector. Similarly, the area of gender registered weak progress and continues to be a concern. HIV/AIDS continues to be a great challenge.

58. The **Health** sector performed positively in 2004, as in addition to the 2.1% increase in the global volume of activities, two out of three targets set in the PES/PAF were achieved. Only the coverage of DPTHeB (3rd dose) remained unchanged compared to 2003 which can be attributed to problems related to the management of the vaccination programme (PAV), particularly in logistics (vaccine supply and the regular operation of the cold chain in the health units) and the poor performance of the outreach teams. Expansion of basic and essential obstetric services and interventions within the network also contributed to the overall positive performance, as evidenced by the improvement of the MDG indicators, namely the reduction of the infant and under-five mortality rates from 147 to 124 and from 219 to 178 per 1,000 live births respectively, according to 5-year averages calculated from the Demographic and Health Surveys of 1997 and 2003.

59. Provision of **HIV/AIDS** prevention and treatment services experienced growth with the entry into operation of 113 voluntary counseling and testing sites and 25 Day-Hospitals. Access to ARV Treatment remains limited. The gender perspective is still being institutionalized in the sector. The share of total budget allocated to the health sector has shown a reduction, from 14% in 2002 to 11% in 2004, although its execution has shown some improvements. As for the sector SWAp, the Ministry of Health (MoH) manages three common funds, in collaboration with the MF. Sector reform is still in the diagnostic analysis phase. There are still delays in the disbursement of funds, as well as in the absorption and deployment of human resources in the periphery.

60. In **water and sanitation**, the PES/PAF indicator for access to safe water is for 41% coverage and the sector achieved 39.8% in 2004, implying an overall satisfactory performance. Sanitation coverage figures for rural and urban areas are based on various surveys but these do not allow for the monitoring of the indicator on a yearly basis. The government is still facing challenges in the improvement of sanitation services. First steps in improving the monitoring system (for which DNA is responsible) were made, with some provinces and cities having updated sector databases. Budget execution figures are still not finalized as the budget execution report does not coincide with either DNA or DPOPH financial figures and final figures will be available in the 'Conta Geral do Estado'. Internal investment spending at central level has improved to 55.5% (approximately \$7 million out of \$12 million), but still low as a result of Treasury difficulties. Execution of the sector's external component of the investment budget, however, is alarmingly low at 22.8% due to slow disbursement of the funds. 70% of the provinces (Tete, Sofala, Maputo, Gaza, Nampula, Inhambane and Niassa) have reported investment execution rates of at least 70% and some report on-time disbursements from the MF, while others report execution rates below 60% due to later disbursement from the MF. Progress on the debt load reduction has been made and one third of the total amount has been reduced. Progress has been registered in international river management, in the elaboration of National Water Resources Strategy and in revision of the National Water Policy and Water Act.

Recommendations for 2005 and 2006

61. Common recommendations across service delivery thematic area

- The need to improve relations between the MF and sectors in order to make it possible to have correct, timely data available and decrease discrepancies of financial data.
- Budget execution of investment funds needs improvement across sectors, especially for the external component.
- Serious and systematic work is needed to identify "off-budget" amounts available to sectors at different levels of implementation.
- The implementation of a coordinated national response for HIV/AIDS taking into account the gender dimension of the epidemic and its impact in all sectors needs the strong involvement of all sectors.
- Serious effort is needed to mainstream gender into sector activities.
- The numerous partners of the service delivery sectors need to further coordinate, harmonise and simplify actions and support in order to reduce transaction costs for government counterparts.

62. HIV/AIDS

- Build on political leadership at all levels (national, provincial, district and community) and across all sectors. Although some progress has been made, the national response is still not commensurate with the scale of the epidemic. It is critical that this gap is closed and that a coordinated, costed, financed, multi-sectoral response across the entire public sector is mounted based on PEN II and PARPA II. In addition, the CNCS Board must fulfill its mandate and meet on a quarterly basis.
- CNCS must concentrate on its 'core business'. CNCS must focus its attention on coordinating, leading, monitoring and analyzing the national response. In order to do so, it must develop a credible plan and time-line for establishing an effective, simplified grant management system. It must also continue to build its own capacity, as well as that of the public sector and of civil society interlocutors.
- Civil society must be involved. Civil society must be given the space to engage at all stages of determining and implementing policies and strategies in order to achieve the PEN II and PEN Saude targets.
- Gender dimensions must be addressed. It is critical that appropriate, targeted, multi-faceted programming be developed and resourced to address the inextricable link between gender inequality and HIV/AIDS. All sector strategies must mainstream HIV/AIDS and address gender inequalities.
- Analysis of HIV/AIDS expenditure. As: (i) a significant amount of funding is "imbedded" in sectors; (ii) many civil society organizations are funded directly, and; (iii) many public sector initiatives are off-budget, a public expenditure review should be undertaken to map and assess how and where HIV/AIDS funding is being channeled, and to what effect. It will also be important to understand how "earmarked" HIV/AIDS resources are impacting the resource envelope and altering government spending patterns.
- Review of Indicators. In the context of the implementation plan for PEN II, the current HIV/AIDS indicators will be revisited at the time of the Mid-Year review, taking into account revised targets and confirmation (or otherwise) of readily available, reliable data.

63. Education

- Finalization of the ESSP II and elaboration of the implementation plan including the financial plan and the implementation manual.

- Creation of conditions for the effective implementation of **SISTAFE**.
- Reinforcement of internal financing within the Education Sector.
- Implementation of the policies for Teacher Training, Technical and Professional Education and School Construction.
- Implementation of actions to accelerate progress in the area of gender, including: concerted efforts to increase the number of female teachers and ensure girls' protection in school; prioritizing those districts with the greatest disparities or gender gap; and; improvement in the performance of cooperating partners with regard to their commitments and ways of working.

64. Health

- Within the on going health information system reform, PES/PAF indicators and targets should be revised taking into account (i) the institutionalization of data collection systems disaggregated by sex, (ii) the need to include indicators to track implementation of government policies (e.g. malaria program, ARV treatment) that lead to improved outcomes, and (iii) possible changes of EPI indicators coverage rate.
- Improve the absorption levels of health professionals trained within and outside the MoH's training institutions, emphasizing their deployment in the areas most in need.
- Maintain/increase OE funding for health as a priority sector.
- Register more external funds on-budget, continue the process of harmonising the management of off-budget pooled funds with OE.
- Continued and strengthened investments in sexual and reproductive health are necessary for the achievement of poverty reduction goals and improved gender equality.

65. Water

- The monitoring system must be strengthened and improved to have reliable data on the PES/PAF indicators (coverage). A consultancy underway for sector MDGs planning could be used to help implement an improved, unified, and transparent system which should be managed from within DNA. This consultancy, or a separate one, might be used to prepare the formats and implement the procedures for collecting and analyzing the information to be used in the joint and MYRs.
- The areas of Planning and Finance in DNA and the provinces must be strengthened. This will require support from the cooperating partners. Improved relations between the MF and DNA should make it possible to have correct, timely data available.
- Budget execution of investment funds must improve, especially for the external component. An intensive effort to identify the key constraints to increasing expenditures (linked to improved sustainability of works) should be undertaken. Serious and systematic work is needed to have a better idea of the "on-budget" and "off-budget" amounts available to the sector.
- Agreements (MoU) with those partners working off budget should be facilitated in order to receive regular information. Donor harmonization needs to advance in the water sector. More regular follow-up meetings of the core group of donors must take place during 2005, at least every 3 months, to follow the Joint Review recommendations. In order to improve this mechanism DNA, with support of donors, has contracted a consultant to elaborate a National Strategy for achieving the MDGs. The scope of this consultancy will be widened to cover both the

monitoring of the off-budget funding and the establishment of a database for a performance monitoring process.

IV. MOU IMPLEMENTATION AND AID EFFECTIVENESS

Performance in 2004

66. The PAPs, in consultation with Government, commissioned three consultants to undertake an independent review of PAPs' performance in 2004⁶ against the commitments and indicators set out in the PAP Performance Assessment matrix and compared with the 2003 baseline study⁷. The main findings of the report are presented here and the annex shows in more detail how PAPs have performed against the PAP matrix.

67. **Overall**, substantial efforts were made in increasing aid effectiveness in 2004 although there is still considerable room for improvement. Performance against core MoU commitments was better than performance against broader aid effectiveness commitments. The improvements are particularly accentuated in the areas of alignment and harmonisation, although PAPs are urged to improve in-year predictability of disbursements. Weaknesses are most pronounced in the area of transparency. About one third of PAPs are not meeting the requirements on quarterly reporting on aid flows to DCI. Furthermore, efforts to improve predictability and relieve the administrative burden of the Government did not gain momentum with delegated cooperation remaining a rarity and project modalities continuing to dominate. Government pointed to the co-existence of GBS with other modalities of aid and the high initial costs of establishing operational GBS systems as reasons for high transaction costs. Aid fragmentation continues. Large numbers of donors remain engaged in many sectors with limited concentration and labour partitioning efforts (e.g. 26 donors continue to be active in the education sector).

68. Consultations with Government and civil society showed clear and strong support for increasing the share of aid to be delivered as general budget support in accordance with the current MoU principles. The reasons given related to the strengthening of accountability, predictability, intra-governmental co-ordination, Government planning and budgeting, policy development, aid co-ordination, and potentially lower transaction costs. Concerns were expressed, however, regarding the risk of greater donor coordination leading to a worsening of the already unequal bargaining power between Government and donors. Line ministries in particular indicated the risk that higher shares of general budget support could exacerbate Government management weaknesses with limited options for negotiating with donors at sector level as an alternative. Hence, a gradual move to increased budget support was advocated in line with strengthened government systems (e.g. SISTAFE). The PES/PAF indicators were said to reflect both

⁶ 'Perfect Partners? – The Performance of Programme Aid Partners in Mozambique, 2004' – May 2005 – A report to the G16 Programme Aid Partners and Government of Mozambique by Tony Killick (team leader), Carlos N. Castel-Branco, and Richard Gerster. Will be made available on the PAP website: <http://www.scm.uem.mz/pap>

⁷ Baseline Study on PAP Performance in 2003 – Sept. 2004 – Report to the G15 Programme Aid Partners and Government of Mozambique by Richard Gerster and Alan Harding.

government and donor priorities, albeit in an uneven negotiation playing field. Further PES/PAF streamlining and simplification was advocated.

69. Issues around MoU Implementation

- There is the possibility that new or existing members could introduce new 'annex 10' exceptions or add to the existing exceptions, thereby negatively impacting on the overall MoU signatories' commitment to reduce the number of exceptions in the spirit of increased harmonisation, alignment and predictability.
- The heterogeneity of the G16 is a potential problem that could undermine the effectiveness of the group in moving the harmonisation and aid effectiveness agenda forward.
- MoU reporting was satisfactory regarding the financial audit of 2004 programme aid flows. The audit annex discusses the other audit reports required by the MoU. A significant delay in finalising the 2000-2002 MB10 financial audit, however, led to great concerns among the PAPs. The MoU does not specify a response mechanism for dealing with reporting problems.
- At the Mid-Year Review it emerged that there is a lack of clarity around what is meant by budget 'headlines information'.
- Multiple visits by PAP national audit institutions led to significant transaction costs, which could probably have been reduced by better co-ordination and information sharing.

Recommendations for 2005 and 2006

70. PAP Performance Assessment Framework

- Government and donors will agree on an updated PAPP matrix that sets out PAP commitments in the area of aid effectiveness by the MYR. Targets rather than monitoring indicators will be identified and further progress will be made in extending the outreach of the matrix to the overall G16 portfolio. As per government request, disaggregated individual donor commitments will also be identified.
- Following the Government's suggestion that PAPP exercises should result in a performance rating for each PAP, a criteria and weighting framework to assess individual PAP performance will be developed by the MYR at the latest.

71. Aid Effectiveness

- The Government has indicated its intention to include a statement on aid policy in the elaboration of the PARPA II. A first draft will be prepared by September.
- An initiative to align the sector planning and reviewing cycles with the Government cycle is already underway and will continue.
- Given that a significant and increasing share of non-GBS aid takes the form of capacity strengthening programmes, a priority will be to commission an issues paper around a joint strategy for capacity strengthening, as agreed during the Mid-Year Review. The main objective will be to identify ways in which the framework for allocating and managing such programmes can be made more strategic and government-led, and to introduce guidelines for capacity strengthening programmes to reflect best practice. Specific terms of reference will

be agreed by June, with an aim to discuss the finalised paper by October at the latest.

- The criticism of the PAPP report on sector-level aid warrants further discussion among PAPs and with Government.
- The PAPs should increase efforts to disburse on committed dates. When there are reasons for not disbursing on given dates, PAPs should inform the Government to enable the mitigation of negative impacts.

72. Reporting On External Aid

- Most external support to the MF and MEC will be included into SISTAFE by the end of 2005 as a first step to more comprehensive budget information and management. Revised planning and reporting standards for external support shall be developed in order to facilitate this process.
- PAPs commit to improve programme aid and overall aid reporting.

73. Reducing Transaction Costs

- The Ministries of Finance and Development and Planning have already indicated a preference for a quiet period running from June to August, which is a crucial period for the budget preparation process. Further discussion is needed on what this will mean in practice and whether further measures could be taken. Sector working groups are also encouraged to agree quiet periods with line ministries.
- The G16 will seek to make further progress in limiting the number of missions, reducing aid fragmentation, and agreeing a better division of labour.
- PAPs will recommend to their respective audit institutions to co-ordinate visits and share information to the extent possible.

74. Programme Aid MoU Implementation

- Government and donors have agreed (i) to consider any proposed MoU change in terms of its impact on existing commitments for increased harmonisation, alignment and predictability, (ii) that principles should apply indiscriminately to existing signatories and new entrants, (iii) that a critical criterion for membership should be a commitment not to expand the type and number of exceptions.
- The Mid-Year Review budget 'headlines information' will consist of the macroeconomic and fiscal framework, including expenditure information for the priority sectors. Further discussion is needed on the implications for the existing 31st August deadline for this information.
- Government and PAPs will discuss and agree on a response mechanism for dealing with MoU reporting problems.
- The consistency of all PAP programme aid bilateral agreements with the MOU will be verified.