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IMF Programs and Health Spending: Case Study of Mozambique

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Abstract

This case study examines the interaction between IMF program design, health policies, and spending in Mozambique. The authors investigate a number of potential criticisms of IMF-supported programs including that the macroeconomic frameworks underlying the programs take a too conservative view of what is needed for macroeconomic stability, thereby constraining a desirable scaling-up of health spending, and that some of the specific aspects of program design, notably the use of wage bill ceilings, have adverse consequences for the health sector. The focus of the study is on programs negotiated under the Poverty Reduction and Growth Facility (PRGF) with a primary focus on the most recent set of programs, from 2004-2006. The authors conclude with lessons for the IMF, the Government of Mozambique, and donors.

This paper informed the deliberations of the Center for Global Development's Working Group on IMF Programs and Health Expenditures.

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This case study examines the interaction between IMF program design, health policies, and spending in Mozambique. The aim is to investigate a number of potential criticisms of IMF-supported programs, including charges that the macroeconomic frameworks underlying programs take too conservative a view of what is needed for macroeconomic stability (thereby constraining a desirable scaling-up of health spending) and that specific aspects of program design, notably the use of wage bill ceilings, have adverse consequences for the health sector. The focus of the study is on programs negotiated under the Poverty Reduction and Growth Facility (PRGF).[1] We focus primarily on the most recent set of programs, from 2004-2006, in order to examine how well the IMF is adapting to a situation in which the main macroeconomic policy challenge is to make good choices on how to utilize the potential for greater fiscal space (not to address short-term macroeconomic instability) and how these macro choices have interacted with a scaling-up of health spending. However, we will also examine how the IMF responded to prospects for higher aid in the 1999-2003 programs.

I. Overview of Key Economic Developments and Health Outcomes

Mozambique is one of the major recipients of aid in Africa with total aid inflows amounting to 12-15 percent of GDP in recent years and accounting for about half of government spending. Significant progress has been made in reducing poverty and improving many health indicators, boosted by strong economic growth (averaging 8 percent) since the ending of the civil conflict in 1992. A considerable measure of macroeconomic stability had already been achieved before the 2004-2006 PRGF arrangement: inflation had been reduced from over 50 percent in 1995 to 14 percent in 2003; gross external reserves had risen to 7 months of imports;[2] and debt and debt service levels were manageable following HIPC debt relief (see Table 1). However, Mozambique remains poor with large unmet health needs, education needs, and inadequate infrastructure. The poor in Mozambique also suffer from high vulnerability to economic shocks and natural disasters (most recently devastating floods in 2000).

Table 1. Mozambique Key Macroeconomics Indicators, 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006 est.
Inflation (percent)	6.0	11.7	21.1	9.1	13.8	9.1	11.2	9.4
Real GDP growth (percent)	7.5	1.9	13.1	8.2	7.8	7.5	7.7	7.9
Fiscal (in percent of GDP)								
Grants	11.7	7.8	13.7	10.3	9.5	7.5	6.5	10.7
Revenues	12.0	12.9	12.4	12.4	12.9	12.6	14.0	14.4
Total expenditures	24.7	26.7	32.1	27.9	26.5	24.4	22.6	27.1
Overall balance, before grants	-13.2	-13.7	-19.9	-17.3	-14.0	-12.0	-8.8	-12.7
Overall balance, after grants	-1.5	-5.8	-6.1	-7.0	-4.5	-4.5	-2.3	-2.0
External								
Total net aid flows (US$ million)	345	450	286	598	682	791	618	984
External current account balance, before grants (% of GDP)	-17.5	-26.8	-26.1	-23.0	-19.9	-14.1	-16.3	-16.2
Gross external reserves (in months of imports of goods and services)	5.5	6.1	5.2	5.0	5.4	5.8	4.6	4.0
Source: Appendix Table 1.								

The Government's medium-term economic strategy is set out in the Five-Year Government Plan (*Plano Quinquenal do Governo*) and has been reflected in the first PARPA (*Plano de Acção para a Redução da Pobreza Absoluta)* -- Mozambique's version of the PRSP approved by the Government in 2000. PARPA I was based on maintaining macroeconomic stability, encouraging the private sector, promoting

investment, rehabilitating infrastructure, and developing human capital. Six priority areas were identified for public expenditure: education, health, agriculture, rural development, infrastructure and good governance. The goal was to reduce the proportion of the population below the national poverty line from 69 percent in 1997 to 60 percent in 2005 and 50 percent in 2010. The macroeconomic framework incorporated into the PARPA largely followed that already agreed with the IMF under the program supported by the 1999-2003 PRGF arrangement. It aimed for a greater mobilization of domestic resources and less dependence on external financing (although, as we will discuss later, exactly what was meant by the latter objective was not always clear).[3]

A second PARPA, covering the period 2006-2009 was finalized in 2006 and incorporated additional planned expenditures financed by resources released by the Multilateral Debt Relief Initiative (MDRI) and increased aid flows. PARPA II shared many of the same priorities as PARPA I - including education, health, agriculture and governance - while placing greater emphasis on private sector growth, productivity, and decentralization. The 'baseline' macroeconomic framework used in PARPA II also targeted a gradual increase in domestic revenues (by about ½ percentage point of GDP a year to 16.2 percent by 2009) and declining reliance on foreign aid. Foreign aid was, again, projected to remain broadly flat from 2006-2009, albeit at a significantly higher level than earlier (in the range of $900-950 million). However, PARPA II made clear that this framework would be modified if additional resources (from further debt relief or additional aid) became available. It included brief discussions of several more optimistic scenarios, but these scenarios were not linked to specific plans for expanded expenditure programs. (See Section II for further discussion).

Income poverty has declined significantly in recent years, reflecting Mozambique's strong economic growth and broadly unchanged levels of inequality.[4] Measured by the share of the population living on less than US$1 per day in PPP terms, poverty fell from 38 percent in 1995 to 29 percent in 2002/03. The share of the population under a consumption-based national poverty line also fell, from 69 percent in 1996/7 to 54 percent in 2002/03 (see Table 2). Access to health services has improved with immunization rates and births attended by skilled staff having risen. The proportion of the population with access to water and sanitation facilities has also improved but, at 30-40 percent, still remains low.

The picture for health outcomes shows mixed improvements and huge remaining challenges. Mortality rates for infants and under-5's have declined significantly, but malnutrition of children remains widespread and the prevalence of HIV/AIDS has increased. So, while Mozambique is on track to meet the MDGs on income poverty as well as on infant and maternal mortality, achieving these targets in other areas—such as halting and reversing the spread of HIV/AIDS and malaria—is much less likely.[5]

Table 2. Mozambique—Progress on Health MDGs

	1990	1995	2000	2001	2002	2003	2004	2005
Goal 1: Eradicate extreme poverty and hunger								
Poverty headcount ratio at national poverty line (% of population)		69**			54**			
Prevalence of undernourishment (% of population)					45			
Goal 4: Reduce child mortality								
Immunization, measles (% of children ages 12-23 months)	59	71	71	74	77	77	77	
Mortality rate, infant (per 1,000 live births)	158	145	122				104	
Mortality rate, under-5 (per 1,000)	235	212	178				152	
Goal 5: Improve maternal health								
Births attended by skilled health staff (% of total)						48		
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1500	980	1000					
Goal 6: Combat HIV/AIDS, malaria, and other diseases								
Children orphaned by HIV/AIDS(thousands)				330		330		510
Contraceptive prevalence (% of women ages 15-49)						16.5		
Incidence of tuberculosis (per 100,000 people)	275		573	601	616	624	635	
Prevalence of HIV, total (% of population ages 15-49)				12.1		16		16.1
Tuberculosis cases detected under DOTS (%)		53.8	44.5	43.9	45	45.5	45.9	
Other								
Life expectancy at birth, total (years)	43	44	43		42	42	42	

*Source: UN Statistics MDGs Indicators and World Bank Millennium Development Goals.
**1996/97
***2002/2003.

II. The IMF-Supported Programs [6]

Since the focus of this case study is on the most recent set of programs, it is worth recalling the "key features" that were meant to distinguish programs under the PRGF, introduced in 1999, from the earlier Enhanced Structural Adjustment Facility (ESAF): (i) broad participation and greater country ownership; (ii) embedding the program in a broader strategy for growth and poverty reduction; (iii) government budgets that are more pro-poor and pro-growth; (iv) appropriate flexibility in fiscal targets; (v) more selective structural conditionality; (vi) emphasis on measures to improve public resource management and accountability; and (vii) social impact analysis of major macroeconomic adjustment and structural reforms.

In 2004, the Independent Evaluation Office (IEO) of the IMF assessed how well the programs in Mozambique under the 1999-2003 PRGF arrangements had fared vis-à-vis these key features as part of a broader evaluation of the PRSP and PRGF. The main conclusions for Mozambique are worth repeating: [7]

- The macroeconomic framework of the pre-existing PRGF-supported program had influenced that of the PARPA. Over time, however, the PRGF objectives had become broadly aligned to PARPA goals including the links to poverty reduction.[8]
- The fiscal stance in programs had, in practice, become more flexible in dealing with aid flows but analysis of the issue was cast in terms of mechanical adherence to an "objective" of reducing aid dependence.
- Not much had changed in terms of room for considering alternative macroeconomic frameworks and the tradeoffs between them. Moreover, the IMF internal policy formulation process had not fully adapted to the PRSP/PRGF approach.
- There had been little public discussion of macroeconomic policy issues. The IMF could contribute to a broader discussion of macroeconomic policies in the country by facilitating wider dissemination and discussion of the analytical work that forms the basis for its policy recommendations.
- There had been a significant streamlining of structural conditionality under the PRGF, but this largely reflected a sharper division of labor with the World Bank rather than a reduction in aggregate conditionality by the two institutions.

Of course, ownership is hard to define and measure. So it is important to recognize that the content of programs is the outcome of a negotiation process in which different domestic stakeholders—even within the Government—are likely to have different views on priorities and the appropriate balancing of risks (e.g., between macroeconomic stability and other objectives). So even if some stakeholders are dissatisfied with the choices that are made, this does not mean necessarily that the IMF has acted inappropriately. ***Therefore, the approach taken in this paper is to examine whether the IMF unduly narrowed the policy space available to the authorities by not considering some feasible policy options.***

a. Macroeconomic framework, external resource envelope and fiscal path in 2004-2006 programs

The new PRGF agreed in June 2004 was intended primarily as a means of "signaling" to donors and others that macroeconomic and related policies were judged appropriate by the IMF. The financing attached to the program was minimal (only $17 million over the 3-year period of the arrangement). Indeed, the staff report on the original program stated explicitly that the IMF arrangement was expected to play a catalytic role in securing financing from donors. In light of this expectation, it is surprising how little the original program documents discussed alternative financing scenarios or the rationale for the central assumption about aid levels (see below).

Macroeconomic strategy. What was the macroeconomic strategy underlying the programs; how was the strategy derived; and were alternative policy options considered? To address these questions, we reviewed all IMF program documents, beginning with an ex-post assessment of long-term program IMF involvement (completed in March 2004) and through the papers for the original PRGF-supported program (June 2004) and four subsequent reviews.[9] Table 3 indicates key program targets and outcomes and Table 4 summarizes the rationale and analytical basis (as discussed in IMF documents) for some of the major components of the programs.

Table 3. Mozambique: Key Macroeconomic Targets and Outcomes Under IMF Programs, 2004-2006

	Original Program Targets [10]	Actual[11]	Significant Modification at program reviews?
Inflation (in percent)	From 13.8% in 2003 to 7 % in 2006	7% in 2006	No
Real GDP growth (average; in percent)	Average of 7.2% over period	Average of 7.6% in 2004-2005	No
Total net aid flows	Total of $2.1 billion over 3-year period 2004-2006	Latest estimate is $2.4 billion	Yes: significant upward revision
Change in overall fiscal balance, before grants (in percent of GDP)[12]	Deficit to be reduced by 4.8 percentage points over 3-year period	Deficit reduced by 1 percentage point	Yes: Reviews targeted significantly less fiscal adjustment
Net domestic financing of the deficit (in percent of GDP)	From slightly positive (0.1 percent of GDP in 2003) to negative financing of 0.5 percent in 2005-2006	Negative financing of 1.5 percent of GDP in 2005 and 2.2 percent in 2006	Precise targets varied but objective of negative financing remained unchanged
Change in total government expenditures (in percent of GDP)	Reduced by 4 percentage points	No change. (Declined in 2004-2005 but increased back to original level of 27 percent of GDP in 2006.)	Yes—toward higher expenditures. (Part may reflect more aid-financed spending being brought on-budget.)

Source: Appendix Table 1.

The ex-post assessment (EPA) of the IMF's long-term program engagement in Mozambique reiterated that a major goal of programs had been fiscal adjustment aimed at (i) avoiding pressure on domestic interest rates arising from domestic financing of the government deficit and (ii) reducing the country's medium-term dependence on foreign aid. However, it did not undertake any analysis of the quantitative importance of these links or of the implications of alternative paths for the fiscal deficit. These objectives were carried over into the strategy for the 2004 program.

Table 4. Rationale and Economic Analysis Underlying program Content and IMF Policy Advice on Selected Issues, 2003-2006

Policy issue	Key program content/policy advice	Analytical basis provided in IMF documents[13]	Other analytical inputs drawn upon by program
Projected aid flows	Original program assumed aid flat in dollar terms. Subsequent reviews projected a short-term increase in aid but flat thereafter. The recently completed fifth review (December 2006) projects a sharp further increase in net aid (to $1.3 billion a year over 2007-2009).	No discussion/analysis of alternative scenarios in the original program or early reviews. No discussion in program documents of what the assumption implied in terms of Mozambique's share of aid flows to Africa or globally. However, the fifth review acknowledges explicitly that a major scaling-up of aid will be the key macroeconomic challenge, with the consequences depending critically on how the additional resources are used. A more comprehensive analysis of a scaling-up scenario is to be presented in the 2007 Article IV consultation.	The World Bank undertook a number of simulations of the effects on growth etc of different aid levels on the assumption that the additional resources were channeled to health and infrastructure. (See the 2005 CEM). However, the simulations were not based on specific cost estimates and expenditure plans for Mozambique and do not seem to have had any influence on the IMF programs. (but see below)
Path of fiscal deficit/ net domestic financing	Original program targeted a significant decline in deficit (before and after grants) and negative domestic financing. Subsequent reviews targeted a gradually smaller reduction in fiscal deficit, but domestic financing still programmed to be negative.	Debt sustainability analysis showed that (after debt relief) larger fiscal deficits would have been sustainable (see Box-). Rationale for programmed fiscal path (and negative domestic financing) was to channel credit resources to the private sector ("crowding in") and to reduce pressure on domestic interest rates. But there was no analysis to justify the assumed importance of this link (see main text).	A World Bank analysis (reported in the 2005 CEM) concluded that real interest rates on loans in Mozambique were higher than in countries of similar level of development, although the level of credit relative to GDP (at 18 percent in 2004) was not out of line. High bank spreads caused by heavy loan-loss provisions and large overhead costs were important causal factors.
Revenue levels	Original program targeted a moderate (about 1 percentage point of GDP) increase over the 3-year period, largely to be achieved by strengthened tax administration. Subsequent reviews largely maintained this objective, with targeted revenue effort eventually increased to ½ percentage point of GDP a year, in line with PARPA II.	IMF assessment of Mozambique's tax system in the 2005 consultation concluded that the structure of the tax system was broadly in line with international best practices, but that its tax ratio was low compared with other SSA countries because of a too narrow tax base because of generous tax exemptions, especially for megaprojects, and ineffective tax enforcement.	
Expenditure levels and composition	Original program targeted a substantial decline in expenditure/GDP. This was gradually modified in subsequent reviews until later ones were targeting expenditure/GDP to be flat or increasing slightly over medium-term.	There was no analysis in IMF documents of the potential macroeconomic implications of alternative paths for the level (or composition) of expenditures. PARPA II contains some analysis of alternative, more optimistic scenarios for aid and discusses how expenditures would respond. (see main text.)	Analysis of sector-level expenditure issues are underway in the World Bank, as an input to discussion on policy trade-offs in scaling-up, but the results are not available yet.
Wage bill ceilings	Original program targeted a decline in wage bill as share of GDP by 0.5 percentage points over 3-year period. First and second reviews shifted to targeting a generally flat wage bill. Third and fourth reviews targeted a rising wage bill (see Table 6).	Discussion in program documents suggests the motivation for the ceiling was concerns about long-term fiscal consequences of expanding activities with high recurrent costs, but there was no analysis of these potential costs or any explicit link to the specific ceilings chosen. In practice, the programs showed flexibility in modifying the ceilings, but without explanation.	
Exchange rate/Dutch disease issues	Ex-post assessment took the view that there was little evidence of Dutch disease, a position reaffirmed in subsequent programs.	The assessment was based on the strength of export growth and movements in various measures of the real effective exchange rate.	The World Bank simulations mentioned above also concluded that Dutch disease appeared not to be an important factor.

The original (June 2004) program targeted a further fiscal adjustment: the fiscal deficit excluding grants was targeted to fall from an estimated 4.9 percent of GDP in 2003 to 3.2 percent in 2006.[14] After taking account of projected concessional external financing, net domestic financing—which was already zero by 2003—was targeted to be a negative 0.5 percent of GDP by 2006. The rationale underlying the fiscal path was to "crowd in" credit to the private sector—the June 2004 staff paper referred again to the need to "reduce pressure on domestic interest rates"—but there was no analysis of how the proposed fiscal path would achieve this or what the implications of alternative paths might be. The Medium-Term Fiscal Framework documents for 2004 and 2005 produced by the government simply state that maintaining negative net domestic financing was linked to the overall objective of macroeconomic stability, and to the primary fiscal deficits targets agreed with international partners. In fact, broader empirical evidence for low-income countries suggests that the strength of such "crowding in" factors can vary substantially and cannot just be assumed.[15] Government domestic debt levels were already very low (5 percent of GDP in 2003). While domestic debt markets in Mozambique were indeed thin, which limited the likely scope of domestic financing of the deficit, the causes of high domestic loan rates were complex. Structural problems in the banking system and the costs of enforcing contracts that resulted in very high interest rate spreads were important factors that were unlikely to be affected directly by fiscal consolidation (see Table 4).[16]

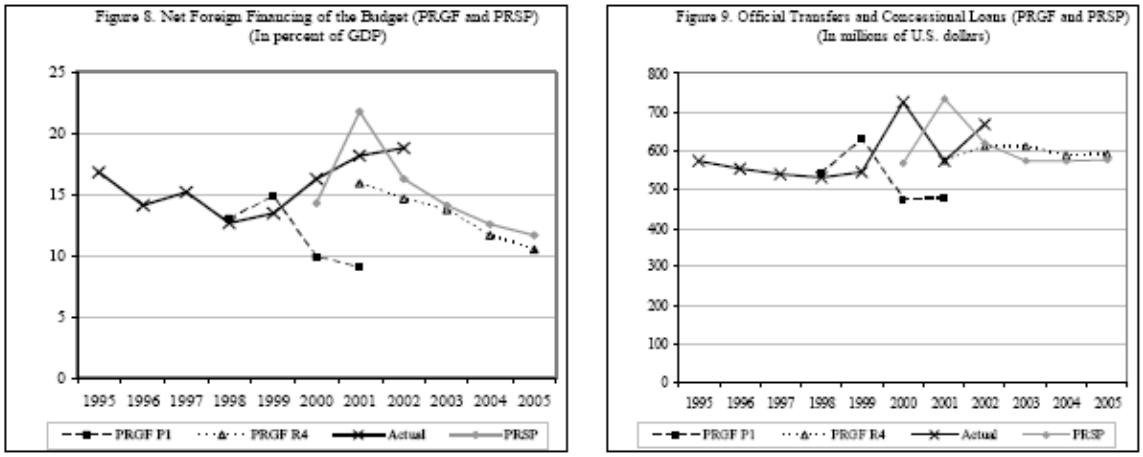
Neither the ex-post assessment nor the original program documents discussed the rationale or appropriateness of the objective of reducing aid dependence over the medium term. In fact, this emphasis on reducing aid dependency went back to earlier programs but was not supported by any strong macroeconomic justifications (see Box 1). As already noted, an earlier IEO assessment of these earlier arrangements had reached a similar conclusion. The lack of a more in-depth discussion is surprising since the ex-post assessment also concluded that there was little evidence of aid-related Dutch disease (export growth was strong and the measured real effective exchange rate had been stable or declining). The only argument mentioned in subsequent program documents is that the high share of total government spending that is foreign-financed (over 50 percent) leaves pro-poor spending increasingly vulnerable to aid volatility.

In this context, the ex-post assessment (EPA) introduced what would be a key assumption underlying the design of the subsequent program—that aid flows would remain unchanged at the current dollar level (about $750 million a year). However, there was no discussion in the EPA or the subsequent program of the rationale for this assumption or of donor views on aid prospects. In interviews, IMF staff said that the original aid projections – and subsequent upward revisions at the time of the various reviews – had been based on discussions with all significant donors, following which the staff would prepare donor-by-donor projections, broken down into program and project aid. The authorities had been closely involved in the process and, in later years, were the main source of the aggregate estimates. The relative "conservatism" of the initial medium-term projections reflected the staff's experience that donors tended to consistently overestimate the level of aid that would actually be disbursed, although there was no formal mechanism for "discounting" the forecasts of each donor. However, it was not only the IMF that made statements about the desirability of reducing aid dependence. Such a goal was mentioned in political statements within Mozambique (and, as noted, was in the PARPA). And not just in Mozambique: such a goal is a frequent staple of statements by groups of African leaders (e.g., the African Union). But it is hard to interpret them as implying a concrete political choice not to seek, and to turn down if offered, higher aid. Certainly that was not what actually happened when additional aid was forthcoming in Mozambique. Rather, they appear to reflect a concern about the longer term political consequences of heavy reliance on aid combined with a recognition of the importance of ensuring that any new activities started with donor support can be sustained over the long term.

The EPA acknowledged that reaching the MDGs, including the health-related ones would require substantial additional resources (although no estimates were provided) and said flexibility in future program design would be needed to accommodate additional spending in priority sectors in case aid turned out to be higher than envisaged (In practice, the original program design limited such flexibility, at least *ex ante*: see Section IIb). But there was no analysis in the EPA or in subsequent program papers of alternative expenditure paths and their possible consequences for the macro-economy.

Box 1. What did Earlier IMF-Supported Programs Assume About Aid?

A review of program documents from the period of the 1999-2003 PRGF indicates that the emphasis on reducing aid dependency began earlier than the arrangements that are the main focus of this case study. The two figures below indicate that the programs projected aid flows to decline substantially from 2000 onwards. Compared to actual results, these projections proved to be too pessimistic: overall aid flows and those channeled through the budget both increased. Programs eventually adapted to the higher-than-expected aid, although longer-term projections still assumed that aid would be flat in US dollar terms.[1]



Source: IEO (2004b)

However, the more fundamental question is not just whether the IMF made a forecast that proved too pessimistic. This is bound to happen sometimes, especially since the IMF is rightly concerned that its programs not be underfinanced. Rather, the key question is whether the IMF was sending a signal about what aid *should* be (i.e. that it should not increase, in the interests of reducing aid dependency). Our review of the program documents and other material suggests that, while the IMF never said explicitly that more aid was not warranted, the strong emphasis given to the potential downside risks and to the desirability of reduced aid dependence amounted to a negative signal. For example, a report by a consultant commissioned by the UK's Department of International Development concluded that:

" if additional external support could be made available on acceptable terms, Mozambique could in principle make good use of it, either to accelerate expenditure growth if absorptive capacity permits, or to increase reserves or reduce taxation if it does not." (Foster (2002). The report went on to call for a "high case" aid scenario on the grounds that *"Donors will react to bids which the Government develops for their support. The PARPA sends the message that donors are neither expected nor invited to even maintain existing levels of support in real terms, yet alone increase them. In these circumstances, donors can be expected to commit their resources elsewhere."*

The IMF appears to have argued against this position, on the grounds that it would increase the risks to the sustainability of the macroeconomic position in the face of an eventual decline in aid flows.[17] In practice, of course, aid did increase, so it is hard to know how important any negative signals from the IMF were. But at the very least it presented only a partial picture of the potential macro consequences of higher aid by not considering more systematically the potential supply-side consequences.

[1] The sharp projected decline in external financing of the budget as a share of GDP largely reflects strong GDP growth; in dollar terms, the projection was also flat.

Subsequent program reviews (at least until the recent fifth review in late 2006) did not revisit the underlying rationale of the program design or consider in any depth the tradeoffs between different objectives—although, as will be discussed shortly, the programs did in practice show considerable flexibility in adapting to changing circumstances. For example, the staff report for the 2005 Article IV consultation (and second review) acknowledged that the "*government's major challenge is to balance its commitment to macroeconomic stability and strong and broad-based growth with stepped-up efforts to achieve the MDGs"*. But there was no exploration of what this challenge might mean in terms of balancing alternative objectives and policy options for the deficit as well as the level and composition of expenditures. The 2005 staff paper concluded that external and public debt appeared sustainable and asserted, without further analysis, that additional fiscal consolidation was needed to limit government recourse to monetary financing and preventing the crowding out of private credit. But there was no discussion of the potential consequences of alternative fiscal paths (and hence different compositions of public and private expenditures) for the macro-economy, even though the debt sustainability assessments made clear that fiscal paths involving larger deficits would have been at least sustainable (see Box 2).

This lack of sufficient exploration of alternative fiscal strategies is a reflection of one of the main issues that characterize the role of the IMF in Mozambique, which was highlighted by a number of actors interviewed during the field visit. The government, in particular the Ministry of Finance, has limited capacity to carry out substantive analysis on policy options regarding alternative fiscal scenarios, for two main reasons. First, its limited internal resources and weak information basis, both on macroeconomic variables and on sectoral data, prevent it from making projections and exploring alternative options based on reliable estimates for the costing and likely effectiveness of expenditures. Second, the government knows and understands the IMF position, and normally tends to only include in budget documents figures that it knows the IMF will be willing to accept. In other countries, the World Bank has often stepped in providing analysis on the potential impact of alternative expenditure paths, but in Mozambique the role of the Bank has shifted given the heavy focus on donor coordination within the group of donors providing general budget support (the G-18). Therefore, while the Bank has taken more of a back seat, the G-18 as a whole has not managed to step in and provide the kind of analytical inputs that could have promoted a different kind of dialogue that explored the possibilities for a greater scaling-up of expenditures. This situation may be changing with the strong indication in the recent fifth review that the composition and effectiveness of expenditures are critical to any macroeconomic assessment of scaling-up. IMF staff told us during interviews that additional analytical work was underway to explore these issues, with World Bank inputs, but the results are not yet available.

Degree of fiscal flexibility. In practice, the IMF showed considerable flexibility in modifying key parts of the program as circumstances changed, although it typically did not discuss these adjustments in the program documents in a manner that allowed for a transparent reconsideration of the underlying rationale of the program design. For example, the fiscal program was changed significantly at the time of the first review (January 2005)—allowing substantially higher deficits before grants (Chart 1 and Appendix Table 1). This reflected an expectation of higher capital spending financed in part by higher concessional loans (Chart 2).[18] Aid flow projections (loans plus grants) for 2005-2006 increased to the $920-950 million range from the earlier projection of $750 million (See Chart 3).

Chart 1. Programmed and Actual Fiscal Adjustments

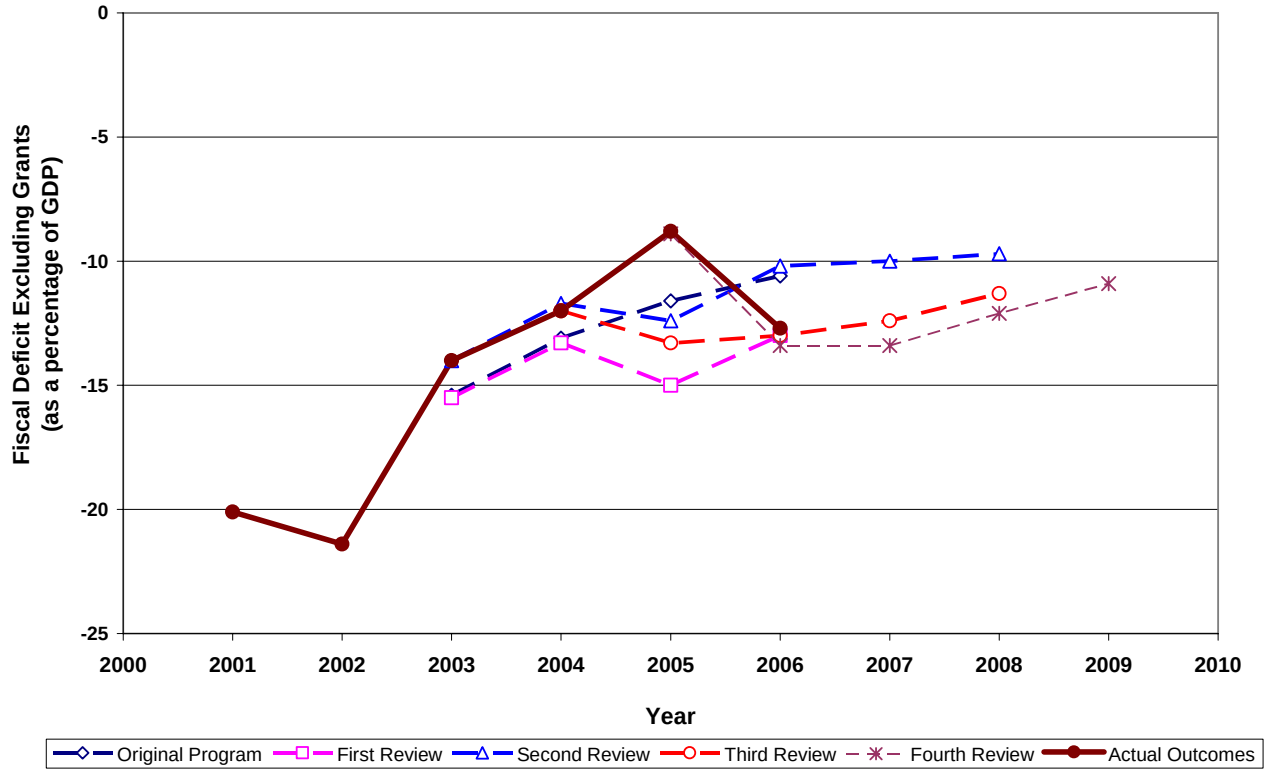
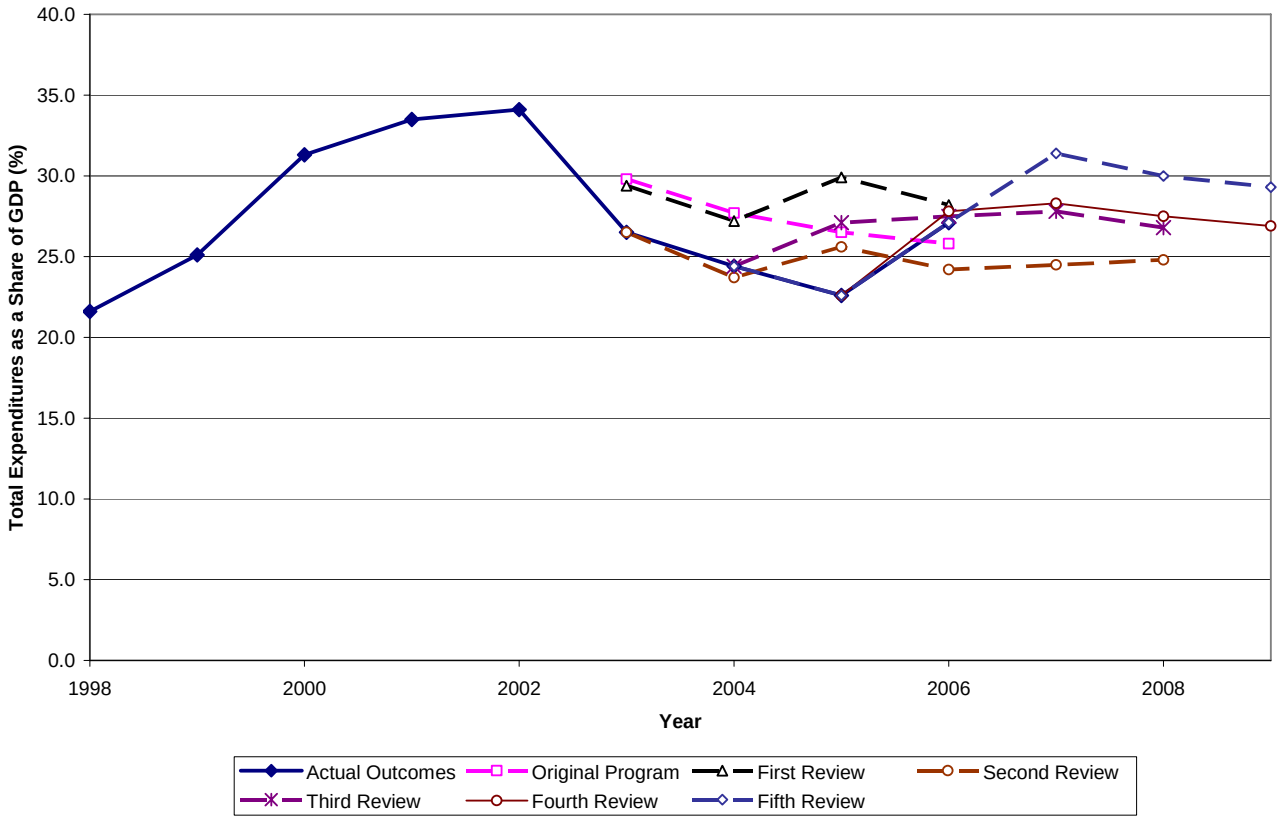


Chart 2. Programmed and Actual Government Expenditures



Box 2. IMF Debt Sustainability Analysis for Mozambique[19]

IMF staff undertook three detailed debt sustainability assessments (DSA) for Mozambique in recent years: at the time of the 2003 Article IV consultations, the 2005 Article IV consultations (and second program review) and the fourth program review (in June 2006). While some details of the methodology and conclusions varied, all of the assessments had the following key features:

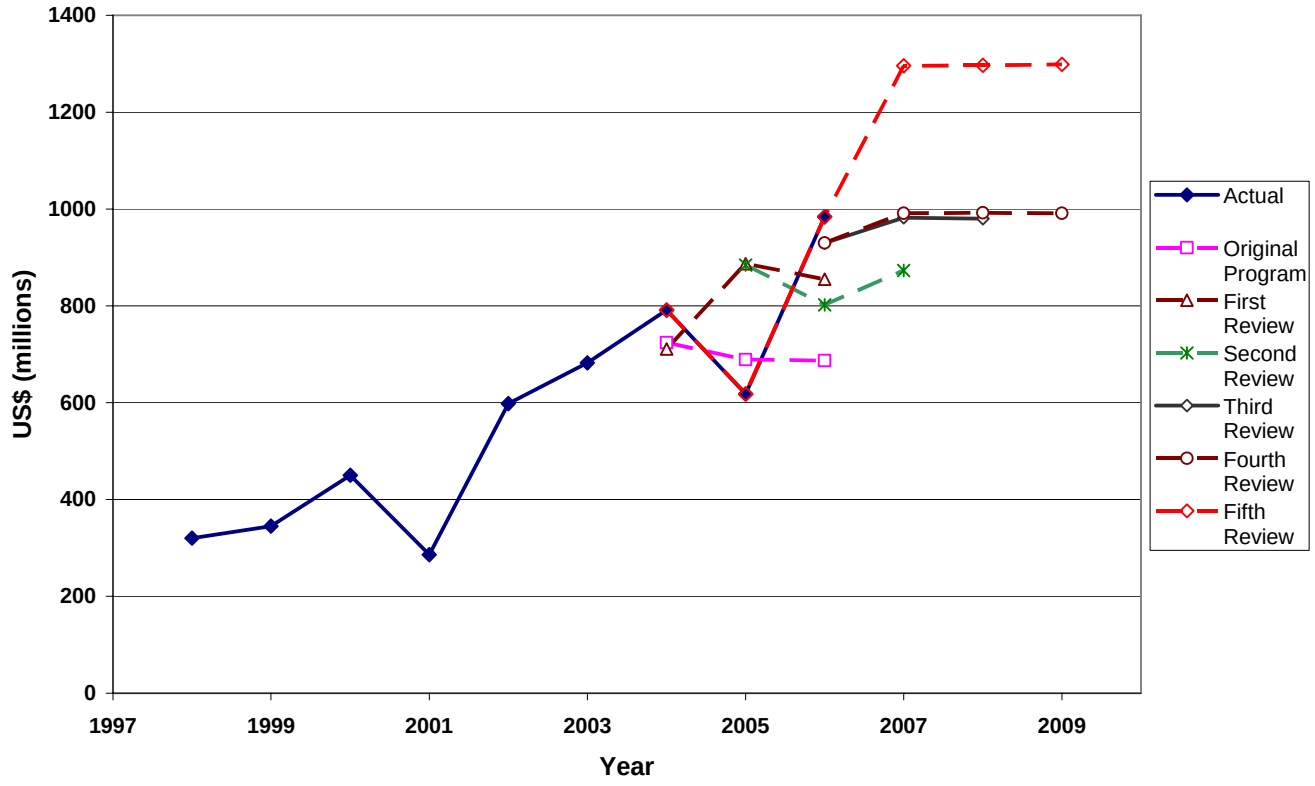
- After HIPC debt relief, Mozambique faced a low risk of debt distress. All of the assessments concluded that its external and public sector debt would be sustainable under all likely scenarios.[20]
- There was limited discussion of alternative aid scenarios. For example, the share of grants (in relation to GDP) was assumed to decline gradually over time as the economy becomes "less aid dependent," but there was no systematic discussion of the rationale underlying the particular baseline path (e.g., what it might mean in terms of Mozambique's share of global aid flows). Moreover, the sensitivity analysis that was undertaken did not link aid paths to alternative choices for fiscal deficits and public expenditure scenarios.
- Fiscal policy was assumed to remain "prudent," but there was little explanation of the criteria underlying the particular fiscal path chosen for the baseline scenario. For example, the DSA undertaken in 2005 assumed additional fiscal adjustment of about 2-1/2 percentage points of GDP over the long term (i.e., the domestic primary deficit reduced to 1 percent of GDP and the overall deficit (after grants) to 2 percent of GDP.) But the "fiscal anchor" that generated this assumed path was not discussed. It was certainly not driven by sustainability considerations since an alternative scenario, assuming an unchanged primary fiscal balance, resulted in broadly constant debt indicators well below the thresholds indicating potential debt distress. For example, in this latter scenario, the debt-to-GDP ratio (in net present value terms) was projected to remain around 24 percent, even before the granting of further debt relief under the MDRI, well below the indicative threshold of 40 percent that was judged under the DSA to be associated with risks of debt distress.
- Therefore, the rationale underlying the baseline fiscal path relied on considerations of an "optimal" (as opposed to simply sustainable) fiscal strategy based on a rationale of not crowding out desirable private sector activities. However, there was no discussion of public expenditure choices and their likely effects, or of alternative policy options within the feasible (i.e., sustainable) fiscal space.

A significant issue that has remained unexplored in these sustainability assessments is the longer term fiscal implications of donor-financed activities outside the government sector (e.g., HIV/AIDS treatment) that might create potential contingent fiscal liabilities if such expenditures eventually became a responsibility of the government. As explained in the main text, these contingencies are potentially large, as a substantial proportion on donor funding is still 'off-budget', and it often includes recurrent spending, including personnel items.[21]

Similarly, the program for 2006 was modified at the time of the third review (December 2005). The targeted overall deficit excluding grants was increased (from 10.2 % to 13% of GDP, in terms of the new GDP series) because of a scaling-up of projected aid flows and expected MDRI debt relief. However, the recorded figures overstate the magnitude of the actual scaling-up, since part of the increase was due to more donor projects being brought "on-budget." Previously, information about these projects had been very sketchy. The additional expenditures were to be spent only after consultation with staff at the time of the next (fourth) review—i.e. they were made contingent on higher revenues and achievement of debt relief under the MDRI. The main reason for the caution in allowing additional expenditure was that IMF staff were not fully convinced about the capacity of the authorities, especially in some of the key sectors, including health, to properly plan and effectively implement additional programs, including an assessment of their macroeconomic consequences. However, by the time of the fourth and (especially) fifth reviews, the IMF program was more accommodating of fully spending any additional aid received (Charts 2 and 3).

Degree of optimism of the aid projections. We compared the original and subsequent program projections for aid to a series of benchmarks in order to test how optimistic they were. The results suggest that the original program projections were too pessimistic *vis-à-vis* all of the benchmarks, but that the projections made at the time of subsequent reviews were reasonably optimistic, at least compared to the available benchmarks. (See Box 3.) But perhaps more striking than the degree of optimism of a particular scenario was the fact that there was virtually no discussion for most of the period reviewed of the potential macroeconomic consequences of alternative aid paths. (As noted, such an analysis is now expected in 2007.)

Chart 3. Projected Net Aid Flows Under the 2004-2006 PRGF*



** Net aid flows are measured as grants plus concessional loans (including IMF lending) minus amortization actually paid.*

Box 3. How Optimistic Were the Projections of Aid Underlying the 2004-2006 Programs?

To test the degree of optimism or pessimism of the aid assumptions, we compared the original program projections for aid flows (grants plus net loans) as well as those of all subsequent reviews to a series of benchmarks: (i) previous trend growth in aid flows to Mozambique; (ii) expected trends in global aid flows at the time each program was finalized (according to the OECD DAC)[22]; and (iii) actual outcomes (to the extent the data is available). The results indicate the following:

- Measured against all three benchmarks, the original program projections proved to be pessimistic. The program assumed a small trend decline over the three-year period (2004-2006) compared with expected global aid trend growth of over 9% over the same period (Table 5). The actual trend growth in aid flows to Mozambique over the prior five-year period (1999-2003) had been even higher (24.5%), although this had been influenced by a surge in aid in response to the floods. Even after taking account of the large shortfall in actual aid flows in 2005 (which reflected a shortfall in on-budget project expenditures), aggregate aid flows over the period still appear to have been higher than the program projections (See Table 6).[23]
- Subsequent reviews substantially revised upwards the short-term projections of aid (i.e., for 2005), with the growth of aid assumed to taper off thereafter (Chart 2). In the first review, these projections proved too optimistic with respect to actual aid flows in large part due to the shortfall in 2005 on-budget project expenditures (Table 6).
- Measured against the benchmark of expected global aid flows, the most recent projections, especially that for the fifth review, imply that Mozambique would receive an increasing share of total aid to Africa.[24]

Table 5. Comparison of Program Projections for Growth in Aid to Past Trends and Global Commitments (in percent; based on US$ values)[a]

	Original Program (2004-2006)	First Review (2004-2006)	Second Review (2005-2007)	Third Review (2006-2008)	Fourth Review (2006-2008)	Fifth Review (2006-2008)
Projected Average Annual Aid Growth	**-1.2%**	**2.8%**	**5.8%**	**5.8%**	**19.6%**	**36.6%**
Trend growth in aid over 5 years preceding program/review[b]	**24.5%**	**22.6%**	**23.1%**	**17.1%**	**7.8%**	**7.5%**
Expected growth in global aid[c]	**9.5%**	**11.6%**	**9.1%**	**7.0%**	**11.4%[d]**	**11.4%[d]**

Source: Authors' calculations based on data in IMF documents and OECD-DAC.
a. Aid flows (in nominal values) are defined as official transfers plus net concessional lending.
b. Average annual trend growth over the period t_{-6} to t_{-1} using the estimated actual aid flows at the time of the program negotiation or review.
c. Based upon most recent OECD DAC global aid projections at the time of program negotiation or review.
d. Based on OECD DAC Secretariat projections of Gleneagles commitments. Authors' calculations use 2004 as the base year and interpolate yearly aid flows assuming linear increases.

Table 6. Program Projections vs. Actual Outcomes, 2004-2006 (in US$ millions)

	Program Projections				**Actual Outcomes**			
	2004	2005	2006	Total 2004-2006	2004	2005	2006	Total 2004-2006
Original Program	724	689	687	2100	791	618	984	2393
First Review	711	887	855	2453	791	618	984	2393

The PARPA II did discuss an alternative, more optimistic scenario for higher aid inflows and associated expenditures. Compared to its baseline scenario (which was very similar to that of the revised IMF programs), the more optimistic scenario assumes a continued increase in aid inflows (to inflows of $1.15 billion by 2009, compared with $950 million in the baseline). The PARPA II does not discuss in detail how the additional aid would be allocated, except to indicate that it would support additional investment (not recurrent) expenditures. Reflecting concerns over the sustainability of additional aid, priority is to be given to (i) investments that needed significant startup funding but can be sustained by lower funding during the implementation phase; and (ii) interventions that stimulate the productive sector of the economy. This would rule out using higher-than-expected aid flows to the budget to support a faster expansion of health interventions with high recurrent costs. These guidelines resulted from government's intention to focus PARPA II on growth and growth-generating investment, partially shifting the previous emphasis on basic social service provision.

b. Short-term program design–response to aid shocks and expenditure smoothing

The key fiscal conditionality in the 2004-2006 programs was a ceiling on the domestic primary deficit (defined as revenue minus non-interest current expenditure minus locally-financed capital expenditure and net lending). Foreign-financed project lending and related expenditures were not subject to the ceiling, so the program automatically allowed for fluctuations in aid-financed project spending. However, spending financed by program aid (general budgetary support or sector-level support such as that provided to the health sector) **was** subject to the ceiling. The initial 2004 program allowed for upward adjustment of the fiscal deficit in the event of higher program aid inflows, but only up to a cap of 0.5 percent of GDP. This cap was justified by the "high volatility of grants". The precise nature of the program adjustments to aid shocks varied from review to review but generally involved an asymmetric adjustment to positive and negative shocks (see Table 7). High volatility alone is not a good reason for such asymmetry, which reflects an implicit judgment that at some point the potential "costs" of using external reserves to smooth such shocks outweighs the benefits of smoother expenditure planning and implementation. The importance of such program adjustments depends on the predictability of aid flows. An analysis by Lawson et al. (2006) of direct budget support during 2002-2004 shows that there were substantial within-year delays in the delivery of such aid compared with a foreseen disbursement schedule on the basis of signed bilateral agreements, although the aid was eventually delivered. Interviews with IMF staff indicate that this lack of within-year predictability did cause significant problems for fiscal, monetary, and reserve management. As will be discussed further in Section III, it also seems to have been an important factor in constraining expenditure implementation.

Given Mozambique's substantial external reserves and the fact that the degree of permanence of any such shock could always be reconsidered at the time of the six-monthly program reviews, a program design that leaned more in the direction of expenditure smoothing would have been justified. Indeed, there was a major change in this aspect of program design – toward much greater fiscal flexibility -- at the time of the fourth review (June 2006): essentially, the program now cushions expenditures against any temporary aid shortfalls (up to a limit) and allows full "spending" of higher-than-projected aid.

Although until recently the *ex ante* program design generally limited the authorities' ability to expand expenditures in the event of higher-than-anticipated aid, in practice there was considerable *ex post* fiscal flexibility, in the sense that program targets were modified at the time of reviews in light of changing circumstances. For example, as already discussed, the original fiscal targets for 2005 and 2006 were substantially modified at the time of subsequent reviews. Another important factor to take into account is that, as we will see in more detail later, the health sector relies on the government budget only a

fraction of its funding. This means that some of the macro constraint identified above in practice meant little in terms of limiting overall sector funding, except for the important fact that most wage expenditure is still paid from the government budget component.

Table 7. How Programs Adjusted to Aid Shocks

	Nature of adjustment*	Implications
Original program	Ceiling on domestic primary deficit adjusted for higher-than-envisaged budgetary grants, but adjustment capped at equivalent of about 0.5% of GDP, linked to higher capital spending. NDA ceiling adjusted by 100% of any shortfall or excess in foreign program aid, but adjustment for higher program aid subject to the same cap.	Asymmetric adjustment. Program capped the extent to which higher program aid could be spent at 0.5% of GDP, and only if on capital expenditures.
First review	Same as above.	Same as above.
Second review	No adjustments to domestic primary deficit for aid deviations. 100% adjustment to NDA ceilings.	Full adjustment to both positive and negative shocks
Third review	Ceiling on Central bank NDA adjusted upward by 100% of any shortfall in external program grants and loans; ceiling adjusted downward by 50% of any excess in program aid.	Asymmetric adjustment: program allowed domestic financing to cushion against shock of any temporary aid shortfall, but required half of any 'excess' aid to be saved.
Fourth review	Shift in fiscal ceiling to net claims of banking system on Government. No adjustment for any excess in disbursements of foreign program assistance. Ceiling adjusted upward for any shortfall in such assistance, up to a maximum of $50 million.	A major shift in technical program design reflecting a change in implicit judgment on balance of risks. Program now allows full 'spending' of higher-than-envisaged aid while allowing domestic financing (and external reserves) to offset any shortfall up to a $50 million limit .
Fifth review	Same as above.	Same as above.

* The focus here is on the program adjustments to the targets for fiscal variables and net domestic assets (NDA) of the banking system; typically, there was a corresponding adjustment to the target for net international reserves.

c. Treatment of priority spending, including health, under the programs

Overall expenditure priorities. Mozambique's government has sought to give a pro-poor orientation to its budget since the 1990s by increasing allocations to education and health as well as basic infrastructure. This pattern continued under the PARPA. The key monitoring indicator under the PRGF-supported programs was the share in total spending of a broadly-defined range priority spending categories established under the PARPA. This reflected the Government's commitment to donors to spend at least 65 percent of its total budget resources (excluding debt service) on these priority sectors, which included health, education, infrastructure development, agriculture and rural development, governance and the judicial system.

PARPA priority spending did rise substantially—to over 14 percent of (revised) GDP in 2005. But such a target is an unsatisfactory way of setting and monitoring priorities for several reasons (see de Renzio and Sulemane, 2006, Box 5 for a further discussion): (i) it takes a very wide view of 'priorities', monitoring only broad sectoral and sub-sectoral allocations (in the health sector, two items called 'national health system' and 'HIV/AIDS' are covered); (ii) the coverage of donor flows in the budget is very incomplete and therefore potentially misleading (in the health sector, a 2005 study revealed that more than 60 percent of donor funding was off-budget, which means that its allocation does not figure in the PARPA monitoring figures); (iii) given their numerical nature, there are strong incentives for government officials to adjust the figures to meet targets; (iv) the focus on inputs and broad sectoral

allocations distracts attention from identifying more specific actions that are most likely to yield better outcomes, such as specific programs in the health sector that may have an impact on particular poverty indicators or on the MDGs; and (v) it does not consider issues linked to the quality of public spending. We were told that a re-evaluation of these priority categories is now underway, with a view to sharpening their focus on critical areas.

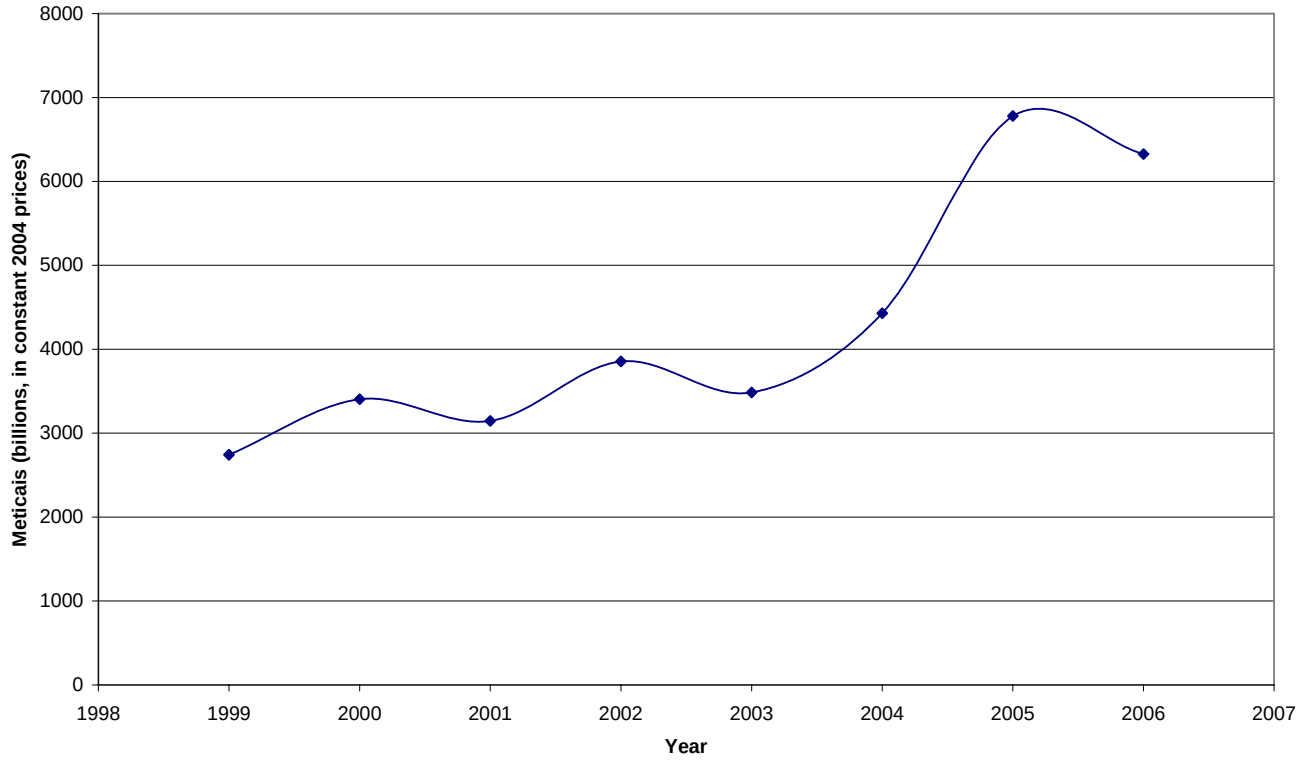
Health sector spending. Within these overall priorities, total government expenditures on health, using the PARPA classification, were in the range of 2 ½ to 2 ¾ percent of GDP during 2003-2005—somewhat below target (Table 8). A substantial increase was targeted for 2006, and initial estimates suggest that this was largely achieved, although part of the increase appears to reflect the efforts to bring "on-budget" existing aid to the health sector. Health spending has risen gradually as a share of total government spending, and appears to have reached the Abuja target in 2006. Recorded real government spending on health has risen sharply in the last two years, although an unknown but probably significant part of this increase reflects the capturing of additional activities that were previously off-budget (Chart 4).[25] These recent efforts at bringing more of the existing aid to the health sector "on-budget" have clarified the overall resource envelope that the health sector can count on. However, the fact that about 40 percent of resources for the health sector are still in the form of "off-budget" project funding, mostly earmarked for HIV/AIDS and other specific areas of intervention, means that prioritization within the sector suffers from a lack of control of the overall budget. At the moment, only centrally allocated resources and two of the three existing common funds are directly under the Ministry of Health's control.

Table 8. Projected and Actual PARPA Expenditures on Health (Including HIV/AIDS)

	1999	2000	2001	2002	2003 Est.	2004 Prog	2004 Est.	2005 Prog	2005 Est.	2006 Prog	2006 Est	2007 Prog
(In percent of GDP)												
Original Program		3.6	3.1	3.7	3.9	3.1						
Second and Later Reviews					2.7	2.9	2.5	3.1*	2.9	4.2*	4.1	3.4*
				(In percent of total government expenditures)								
Original Program	11.6	14	9.5	12.5	13.2	10.9						
Second and later reviews						11.7*	10.9	12.9*	13.4	15.6*	16.2	12.8*

Source: IMF documents.
GDP series was revised about the time of the second review.
**2004, 2005, 2006, and 2007 targets are those set at the second, third, fourth, and fifth reviews, respectively.*

Chart 4. Trends in Real Government Health Spending (1999-2006)
(in constant 2004 prices*)



* PARPA spending on health and HIV/AIDS, deflated using the overall GDP deflator.

d. Wage bill ceilings

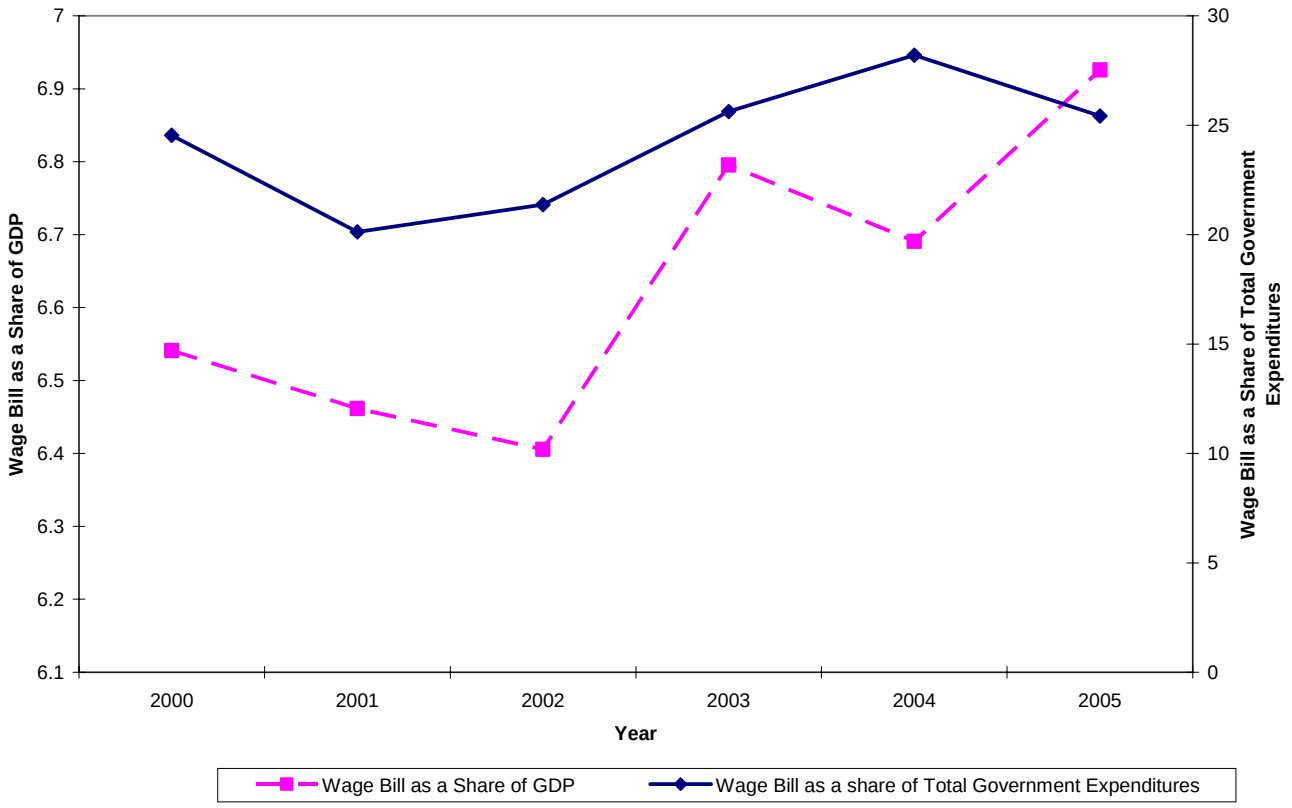
Explicit ceilings on the wage bill are relatively recent features in IMF arrangements with Mozambique. They were not used in the 1999-2003 programs, although wage policies were the subject of discussions at this time. They were introduced in the original PRGF arrangement for 2004-2006 approved in June 2004 and were continued in subsequent program reviews until the fourth review (in June 2006), when they were discontinued as a form of conditionality. Among the low-income countries where such conditionality has been introduced in recent years, Mozambique is the first country where it has subsequently been discontinued.[26] In Mozambique, the ceiling took the form of a quarterly indicative target or benchmark expressed as a maximum cumulative annual expenditure (in local currency) on wages.[27]

The government wage bill increased markedly in years before the recent program (see Chart 5). The 2003 ex-post assessment (EPA) of IMF program involvement said this was only partly justified by hiring of more personnel in priority areas and largely reflected excessive wage increases and loss of payroll controls and concluded that "strong discipline" was needed to reverse these trends. The EPA noted that previous efforts at civil service reform had achieved little, and that existing payroll systems were not reliable. For example, there are at least three separate, non-matching personnel databases. The lack of appropriate controls means that there are no clear figures on overall government employment (see Lawson et al 2006). In interviews, Mozambican budget officials said that they also had become increasingly concerned about the lack of good information about the number and distribution of public servants. In fact, 2003 was a particularly difficult year, as long-lasting negotiations with the trade

unions led to a final wage bill that was much higher than originally forecast. There was no discussion in IMF documents of the rationale for a wage bill ceiling as an instrument for reversing these trends or addressing these systemic shortcomings, but IMF staff indicated that part of the reason for introducing the ceiling was to "call attention to the issue." Our interviews also suggest that senior officials in the Ministry of Finance were keen to see an IMF ceiling included in the program as a way to prevent further domestic political pressures to increase wages.

The original program targeted a slight decline in the overall wage bill, as a share of GDP in 2004-2005 (Table 9). The projected increase was revised upward at the time of the third review. Given the strong GDP growth, this implied a significant real increase. This increase was justified mostly on the basis of foreseen additional recruitments in priority sectors (mostly health and education), which the new president elected in late 2004 was keen to see included in the budget. The wage bill ceilings for 2004-2005 incorporated an increase of 7,200 in the number of permanent positions in priority sectors (5,443 teachers and 1,767 health care workers) out of a total increase for priority and non-priority sectors of 10,000.[28] The 2004 ceiling also assumed a reversal in the previous year's big increase in contractual employment, often funded by donors through sector programs to circumvent recruitment freezes. The ceiling for 2006 was further increased (by ½ percent of GDP) at the time of the third review, with the increase linked—although without much explanation—to additional hiring in priority sectors.[29] Given the rapid underlying growth in real GDP, this latest increase implied real growth in the overall wage bill ceiling of about 23 percent in 2006; the actual outcome was well under the ceiling.

Chart 5. Wage Bill as a Share of GDP and Total Government Expenditures



Source: IMF (2006)

Table 9. Wage Bill Targets and Outcomes*
(in percent of GDP)

	2003 Actual	2004 Program	2004 Actual	2005 Program	2005 Actual	2006 Program	2006 Est.	2007 Projected	2008 Projected
Original program	7.5	7.3		7.1		7			
Second review	6.8		6.7	6.9		6.9		6.9	7.0
Third and fourth reviews**			6.9		7	7.4	7.1	7.5	7.5
Fifth Review**			6.9		7		7.1	7.5	7.5

***** GDP series was revised substantially around the time of the second review so shares of GDP are not comparable between the original program and the reviews.
**Targets are mentioned in the fourth and fifth review documents, but they are not subject to any conditionality.

Thus, in effect, the IMF program does not seem to have imposed a major squeeze on the wage bill in these later periods. The reasons for the upward revision at the time of the third review are not well explained, but the program documents (third and fourth review) refer to the hiring of about 10,000 teachers and 2,000 additional health workers in 2006, justifying the revised projection of the wage bill rising from 7 to 7½ percent of GDP. However, the program documents are silent on what actually happened to hiring in priority areas and there is no discussion of how such numbers might fit into a medium-term strategy or whether they are judged as adequate.

As a matter of fact, it is not easy to get a clear picture of health sector employment and recruitment, mostly for lack of reliable data and due to the decentralization of the human resources function to the provincial level. While clearly there have been some improvements over recent years in addressing the shortfall of qualified personnel in the health sector (see Table 10), the capacity of the health sector to train, recruit and deploy additional staff is still limited. This is due not only to the limited capacity in the country's training facilities, but also to the lack of a clear human resources strategy for the sector as a whole. In 2006 the Ministry did formulate a more articulated training plan which tries to respond to the need for scaling up health services and which provided inputs for the PARPA II. However, funding for such an accelerated plan is still not secured, and is likely to come from a combination of government and donor sources.

Table 10. Health Sector Personnel Data

	2000	**2006**
Public health sector staff	17,890	24,664
Doctor/Inhabitant ratio	43,584	37,002
New health staff trained	640	1015*

Source: World Bank (2003) and Ministry of Health. *2005 data.

The wage bill ceiling was dropped at the time of the fourth review. No reason was given in program documents, but IMF staff and Mozambican officials indicated that (i) the IMF was more confident that the government was committed to containing wage bill spending regardless of an IMF-imposed ceiling, and (ii) given the shortcomings of the payroll system and the extent of donor-funded personnel expenditure, it made more sense to focus on improving the systems rather than focus on a numerical target. As a consequence, it was agreed that a comprehensive civil service census would be carried out

using biometric data, in order to establish a clearer picture of the size of the civil service, its composition and cost. This action is now included in the Performance Assessment Framework matrix (agreed between the government and the G-18) for 2007.

The wage bill ceiling has also had some adverse side effects by pushing some personnel expenditures into the investment projects components, with the workers involved recruited outside the regular civil service cadre.[30] This was part of a more general perverse incentive, discussed above, to keep some donor-financed expenditures off-budget that was exacerbated by the way in which fiscal performance criteria were formulated. In the case of the health sector, this led to some distortions, as sector donors have tried to respond to the need for additional recruitment by circumventing normal procedures, partly due to existing IMF-related ceilings, but also due to cumbersome and lengthy recruitment procedures. A study carried out on behalf of the health sector donors in 2006 revealed that wage-related 'incentives' paid from the donor-supported Health Common Fund (PROSAUDE) saw a total of more than 1,200 health sector employees receive payments totaling more than $10 million. This number only includes central-level staff, and does not include other possible payments included in specific investment projects. Some IMF staff interviewed said they were aware that wage and other recurrent spending was being classified as aid-financed investment spending to avoid the fiscal ceilings and that they regarded this as a useful "safety valve" to avoid squeezing high-priority activities.

The existing contradiction between the clear need to recruit additional personnel in key sectors and the lack of adequate planning and control is well summarized in the *Aide Memoire* of April 2006 on the review between the Government and its Programme Aid partners, which states that:

> *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.* (p14)

Table 11. Mozambique: Chronology of Key Events Related to the Wage Bill Ceilings

May 2001	PARPA I approved.
2003	Overall government wage bill rises by__ in nominal terms during year.
April 2004	IMF mission agrees with Government on new program incorporating, for the first time, an indicative ceiling on the wage bill ceiling (approved by IMF Board in June 2004. Agreement covers quarterly ceilings on wages for remainder of 2004.
Nov. 2004	IMF mission agrees with Government on wage bill ceilings for 2005 as part of first program review. Targeted ceiling allows for recruitment of 1,767 health workers. The Annual Operational Plan for the Ministry of Health foresees 1,486 new recruitments, of which only 1,207 actually happen.
Dec. 2005	IMF mission agrees on program for 2006 as part of third review. Ceiling incorporates hiring of 2,000 health workers. The government's Social and Economic Plan foresees 826 new recruitments. By June 2006, recruitment figures include the hiring of 553 new trainees and 37 foreign doctors, and the regularization of 786 contracted workers.
April 2006	IMF mission agreed with Government on revised program (fourth review) that drops the wage bill ceiling. A national civil service census using biometric data is agreed for 2007, along with further work to improve payroll systems.
May 2006	PARPA II approved by the Government, with an indication that until 2010 the total number of public sector health staff should reach 27,189 (an increase of about 10 percent over the estimated 2006 level).

e. Process of IMF program negotiations

In general terms, program negotiation in Mozambique is well integrated with other policy dialogue mechanisms which have been put in place around direct budget support, such as the bi-annual joint reviews that bring together donors, government and other stakeholders. The IMF does not feature prominently in these forums, but the timing of its missions is organized to feed into the process. Negotiations around the IMF program, however, are traditionally limited to a small number of senior officials in the ministry of finance and the central bank, with some interaction with other donor agencies, but hardly any involvement of actors such as sector ministries and civil society.

In recent years, program negotiations have been characterized by a lack of fundamental disagreements between the government (especially finance officials) and IMF staff. Interviews with senior government officials confirmed that the need for fiscal discipline and tight macroeconomic management is seen as a priority by the government. For example, despite the elimination of the wage bill ceiling by the IMF, the government is still using a figure of 7.5 percent of GDP as an internal benchmark.[31] However, recent studies (Killick et al. 2005; Trocaire and Christian Aid 2005) point to the lack of serious dialogue on possible alternative frameworks, reflecting insufficient analytical work that could underpin the exploration of feasible alternative options.

While finance officials do prepare the macroeconomic framework internally before scheduled IMF missions arrive, the ministry does not seem to produce any serious analysis on alternative

macroeconomic scenarios. Consequently, discussions tend to coalesce quite quickly around a path that the Government knows the IMF will accept. Nor does the IMF provide very substantive justifications for its position on what the macroeconomic fundamentals should be, especially with regard to the suggested fiscal path and alternative policy scenarios. Moreover, within the country there are few other voices with the capacity and the authority to engage in such a dialogue. G-18 donors have so far not been forthcoming with analysis that could challenge IMF wisdom, despite their engagement with the IMF on some more specific issues (such as the debates around the wage bill). A case can certainly be made for the need to open up the policy debate to other sources of information and analysis, and to incorporate and improve the dialogue with sector ministries and other possible stakeholders. This issue was also raised in the independent evaluation of the PRSP in Mozambique carried out by the IEO of the IMF and the OED of the World Bank. The forthcoming analysis of the scaling-up scenario, which plans to integrate sector-level inputs from the World Bank and others on the cost and likely effectiveness of expenditure plans, would be one opportunity to broaden the circle of debate.

However, at a more fundamental level, there are limits to how much the IMF alone can be expected to open up the policy debate, especially since it is playing several distinct roles that involve some tensions. First, it is acting as a negotiator of short-term conditionality, with the Government as its counterpart. Acknowledging and exploring alternative feasible options and recognizing that policy choices are being made with limited information (and hence involve considerable gray areas) will complicate the short-term negotiations. Second, it is a "confidential advisor" to the authorities, so the choice on how transparent to be ultimately rests with the Government. Third, it is a signaler to other providers of external resources about the feasibility of the macroeconomic framework. And finally, it is (or should be) a "knowledge institution," bringing its particular expertise to help inform a broader internal policy debate. Clearly, these issues go well beyond the case of Mozambique, but in our view the best way to proceed if the IMF is to play as productive a role as possible in these low-income countries where the main challenge is how to manage the longer term macroeconomic consequences of scaling-up would be to downplay the role of negotiator of short-term conditionality and emphasize the role as a knowledge institution, including by using the budget and planning cycles to help countries like Mozambique produce better policy documents to improve decision-making by its own political institutions (Cabinet, parliament, etc.). This would inevitably involve exploring a range of policy options. But the IMF should not be expected to be the exclusive source of such advice. The domestic debate would be more effective if the capacity to undertake analytical work not just within the Government but also by outside groups were strengthened.[32]

III Budgetary Processes and Links to Medium-Term Priority-Setting[33]

a. Planning and budgeting

The existing framework for planning and budget formulation and implementation in Mozambique is a result of a series of recent reform efforts which culminated in the enactment and implementation of two key pieces of legislation: the Budget Framework Law of 1997 and the SISTAFE Law of 2003. The objectives of such efforts were to: (a) improve the coverage and transparency of the management process of public finances; (b) gradually assure effectiveness and efficiency of public spending according to policy objectives; and (c) enhance and assure long-term sustainability of the fiscal policy and processes.

The Budget Framework Law established the budget structure using modern and universal classifiers, and introduced a medium-term fiscal framework (*Cenário Fiscal de Médio Prazo*, CFMP) as a key instrument of fiscal policy. The SISTAFE Law had broader objectives, from the establishment of an an

Integrated Financial Management Information System (IFMIS, or in its Mozambican incarnation, *Sistema da Administração Financeira do Estado*, SISTAFE) and of a single Treasury account, to the introduction of program classifiers as means of linking policies/plans and expenditures. These reforms have underpinned some key improvements in the planning and budgeting process, which is now much more transparent, predictable and reliable than just a few years ago.[34]

Despite recent and ongoing improvements, there are several problems with the current system that complicate an effective integration of macroeconomic policy-making with the planning and implementation of expenditures for individual sectors, including health:

1. Weak integration of planning and budgeting processes. In practice, the CFMP has not been able to link the medium-term objectives of the five-year Plan and PARPA to medium-term inter-sector expenditure allocations within forecasts of overall resource envelope. Reasons for this are: (i) no effective mechanisms ("challenge functions") for making hard choices between alternative trade-offs on long list of objectives. (As discussed below, donors exacerbate this problem by fostering fragmentation of the budget); (ii) technical information on which the medium term fiscal framework is based is insufficient for such trade-offs to be assessed (in terms of costing, details on expenditure options, and identification of how budgetary choices linked to various policy choices.). As discussed earlier, the "priority" areas established under the PARPA are too broad to be an effective guide to making such tradeoffs. The result has been that the CFMP is largely an internal technical exercise within the Ministry of Finance and does not guide strategic resource allocation decisions (although it was discussed by Cabinet for the first time in 2006).[35] In practice, annual budgets are largely derived on an incremental basis, with allocations for individual sectors established to fit overall resource constraints set by the macroeconomic framework.

2. While annual budget implementation has generally delivered quite good control of overall aggregate expenditures, there have been substantial variations between budgetary allocations and actual outturns for some expenditure categories and sectors. Budgetary allocations for personnel are consistently overspent whereas non-wage recurrent spending and capital spending fall short of the budget allocations. Moreover, the health sector has suffered from systematic, large shortfalls in spending of the resources channeled through the central budget (see Table 12). Information for the first semester of 2006 suggests only a slight improvement.[36] The shift in the composition of expenditures during budget implementation must, at some level, reflect *de facto* political choices on priorities. Lawson et al. (2006) report that significant in-year budget adjustments were decided without the knowledge or involvement of the ministries and agencies concerned. But weaknesses in the budgetary process played an important role: (i) the old system of budget disbursements (*sistema duo-decimal*), in which instructions to budget entities on the ceilings for expenditure commitments are provided only two months in advance (based on estimates of resource availability), caused delays in fund transfers and inflexibility that prevented ministries from managing effectively their budgetary allocations;[37] (ii) large "off-budget" expenditures—mainly reflecting donor activities —reduced incentives for effective formulation and execution of the central budget . The precise extent of such off-budget activity is hard to measure. One estimate by the Ministry of Planning and Finance for 2003 indicated that 31 % of overall public spending was off-budget.[38] For the health sector, a recent study estimated that 29% of the total resources of the health sector remained off-budget at the programming stage and 60% at the execution stage, meaning that there is no systematic way of collecting data on their allocation across functional and economic classification (Cabral and others, 2005).[39]

With such a budget disbursement system, any short-term disruptions to the flow of funds (e.g. because of temporary shortfalls in aid flows) can significantly disrupt expenditures; and since some types of expenditures are in practice protected from such liquidity shocks, the burden on other expenditures is magnified. In these circumstances, whether or not the design of the macroeconomic program allows for domestic financing of the deficit to offset the impact of any temporary aid shortfalls, thereby cushioning expenditures, can have significant implications for budget implementation in the sectors that are most likely to be affected in practice by such shocks. This is why these aspects of program design, discussed in Section Iib, are important for the health sector.

3. There is little integration between budget and performance outcome information, which makes it difficult to analyze how public expenditure is meant to contribute to specific objectives. Moreover, the medium-term fiscal framework (CFMP) is essentially an internal technical exercise within the Ministry of Finance to ensure that sectoral ceilings are compatible with the projected overall resource envelope. It does not reflect a process where medium-term expenditure choices, generated by the need to reach agreed policy objectives, drive resource allocation decisions.

4. The current state budget and its expenditure classifications still do not provide adequately comprehensive financial tracking of what is being spent on various health initiatives. This is especially the case for HIV/AIDS where large-scale expenditures, such as PEPFAR, are not only off-budget but are also "off-plan", in the sense of not being integrated into the overall planning and priority-setting framework for the health system. An additional problem relates to the quality of expenditure reporting at various levels of government. In a survey carried out in 2002, Lindelow et al. find that "provincial directorates could provide complete district-level data for only 40 percent of their districts. The lack of this information makes it difficult to assess whether the resources allocated to the districts reach their intended destination". (Lindelow et al. 2004:1). A recent audit of the PROSAUDE Common Fund also reported a general lack of transparency and of adequate financial management systems.

In recent years, the government has made various efforts to address some of these issues. Since 2006, for example, the CFMP is submitted to Cabinet for approval, which should facilitate a deeper political discussion on policy priorities. Efforts at strengthening medium-term planning and budgeting capacity are under way both at central and at sector level, especially in sectors that receive large sector-specific funding such as health. A reconciliation of planning and budgeting cycles is taking place, to ensure that sector instruments feed into central processes, rather than function in parallel.[40] Finally, the gradual roll-out of the IFMIS (e-SISTAFE) should ensure more flexible and speedier disbursements of sector funding from the government budget, substituting for the old *sistema duo-decimal*, and more effective and transparent financial reporting.

b. The framework for external aid

The use of national procedures in managing donor-financed activities remains relatively low, and information on many program and especially project activities are not well-integrated with the budget.[41] This reflects in part donors' concerns about weaknesses in national public finance management systems but also tends to prolong those weaknesses by encouraging continued fragmentation of monitoring and priority-setting systems. General budgetary support (GBS) has been growing in importance as a form of aid (rising from $100 million in 2002 to almost $300 million in 2006, but most donors also favor continued sector and project support.[42] Government officials do complain about lack of predictability,

but rather than apply discount factors on aid commitments, they tend to encourage the donor community to comply with some of the commitments they have made in international arenas, such as the Paris Declaration on Aid Effectiveness. The evidence in Lawson et al (2006) indicates that the predictability of disbursements of general budget support has been improving.[43] Under the Memorandum of Understanding with donors (see below) donors' commitments of direct budget support are now expected to be confirmed no later than end-August of the preceding year, in order to facilitate budgetary planning, although the deadline is missed by a few donors.[44]

Table 12. Budgetary Shortfalls or Overshooting, 2002-2004*

(In billions of *meticais*)

	2002			2003			2004		
	Budget	**Actual**	**Outturn**	**Budget**	**Actual**	**Outturn**	**Budget**	**Actual**	**Outturn**
Recurrent Expenditure	13,523	14,077	104.1%	16,858	15,916	94.4%	19,578	19,082	97.5%
Personnel Expenditure	6,198	6,470	104.4%	7,365	7,617	108.4%	9,148	9,410	102.9%
Goods and Services	3,213	3,208	99.8%	4,407	3,364	76.3%	4,578	4,129	90.2%
Transfers	2,699	2,702	100.1%	3,135	2,952	94.2%	3,613	3,497	96.8%
Debt Service Charges	1,088	1,262	116%	1,176	1,355	115.2%	1,228	1,228	100%
Capital Expenditure	2,530	2,702	106.8%	3,490	2,534	72%	3,414	3,106	91%
Total Expenditure	14,965	15,517	108.7%	19,172	17,095	89.2%	21,764	20,960	96.3%
of which: Ministry of Health	1,456	1,220	-16.2%	1,812	1,019	-43.8%	1,942	1,561	-19.7%

* On-budget central and provisional expenditure, recurrent plus domestic investment.
Source: Lawson and de Renzio (2006).

The coordinating framework for budget support (both GBS and sector-level program support like PROSAUDE) was strengthened in 2004 through a Memorandum of Understanding that clarified mutual obligations and, at the Government's request, provided for greater predictability and transparency of budget support. A common Performance Assessment Framework (PAF) provides common indicators of performance assessment and provides the basis for donors' support commitments for the following year.[45] The set of about 40 indicators include some for the health sector (Appendix Table 2). Eighteen donors (the G-18), including the World Bank, now participate in this coordinating framework.[46] (The IMF is an observer.) The participating donors themselves are also assessed periodically against a specific set of performance indicators. Key messages emerging from the 2004 assessment included the following (see Killick et al (2005)):

- Donor performance is improving vis-à-vis the benchmarks set out in the assessment framework for donors, although the benchmarks are relatively unambitious. More aid is gradually coming on budget.
- The PAF captures the Government's priorities, as set out in the PARPA, reasonably well, and there seemed to be little tendency to try to enforce conditionality over and above that in the PAF. However, the PAF is still too elaborate and unfocussed. Moreover, conditions linked to the PRGF are not fully aligned with the PAF.

- There has been too little progress in reducing administrative burdens on the Government (e.g., too many missions and not enough coordination between them)
- Of the sectors reviewed, the health sector offered the "greatest sense of forward progress", but there were still large numbers of off-program donor projects where the connection to the annual operational plan for the health sector was often tenuous.
- Since program aid still only accounts for one third of total aid, the key challenge to improve aid harmonization would require a more proactive approach by the Government in working out an overall Assistance Strategy with its development partners, including a clear statement of the purposes for which aid is sought and priorities among those purposes and a willingness to say "no" to aid for low priority schemes. A stronger agreement on overall principles and a stronger accountability framework for donors is needed.

The role played by the IMF in this framework deserves further attention. As indicated above, the IMF has observer status in the G-18, and through the office of the country representative it attends most relevant meetings. The timing of the missions are synchronized with the budget cycle and with the reviews carried out around the same time as assessments of performance under the GBS framework. However, negotiations around IMF programs tend to be pretty closed, and the nature of the dialogue does not usually encompass considerations about policy options and alternative scenarios.

While the IMF has been instrumental in pushing donors to bring more aid on budget and increase their transparency and predictability, the lack of a broader dialogue, coupled with existing fragmentations within government, mostly means that sectors, including health, are seldom aware of the nature and scope of macroeconomic constraints to health spending. At the same time, the lack of credible strategies and information from the health sector means that both the IMF and central agencies within government do not trust the ministry of health in delivering on often overambitious plans. Such lack of reciprocal dialogue and understanding is reinforced by existing arrangements within most donor agencies, where the macroeconomist in charge of overseeing the GBS program, interacting mostly with the ministry of finance and the IMF missions, has little knowledge of the issues related to the financing of sector programs and other sector-specific activities, which are in turn under the responsibility of a sector specialist who talks mostly to the sector ministry and other sector donors.

Another issue that the current aid environment has not managed to address is the nature and source of analysis to inform macro-policy options, given the fact that at the moment the government does not have the capacity to produce such analysis. The G-18, logically placed to provide support in this sense, so far has been focusing mostly on the day-to-day monitoring of actions included in the PAF policy matrix, without stepping back and asking more fundamental questions on broader economic policy issues. The consensual nature of the body also means that agreeing on a common research and analysis agenda may take longer than needed, unless the government takes a clear leading role.

This analysis suggests that there is a bigger potential role for the IMF in this area than is currently the case. Certainly the IMF is well placed to provide useful analytical inputs for the government to consider different macroeconomic policy options and scenarios. However, as noted earlier, this would entail some changes in the IMF's way of doing business, with greater emphasis on providing inputs into a broader policy dialogue around macroeconomic policy and less emphasis on the negotiation of a specific short-term program. It could also be more proactive in identifying the key information gaps (e.g., about sector-specific expenditure plans and their longer term fiscal consequences) that are inhibiting such assessments.

IV. The Health Sector Strategy and Links to the Macroeconomic Program and Budgetary Process

Mozambique inherited a weak and fragmented health system at independence. The health network was further damaged by years of civil war, leaving it heavily biased toward urban and curative services and with limited coverage in many rural areas. Increased donor financing in the 1990s originally operated almost entirely through projects, with donors often taking responsibility for specific regions. Health delivery systems in rural areas were gradually rebuilt, but the approach further undermined the already weak planning and management abilities of the Ministry of Health. Beginning in the late 1990s, a number of donors supported a shift toward a sector-wide approach (SWAP), which culminated in the preparation of the Government's *Strategic Plan for the Health Sector* (referred to as PESS 2001-2005-2010). Since 2003, a number of donors channel funds through an on-budget common fund (known as PROSAUDE) to support the health sector strategy.[47] A code of conduct (known as the Kaya Kwanga agreement) was established to set the framework for cooperation between the government and its development partners, but some donors active in the health sector have not signed the code and do not abide by the decisions taken at the SWAP forum of donors.[48]

The PESS was formulated about the same time as the first PARPA and is broadly consistent with it, but the PESS was limited to establishing a broad agenda for the health sector. It did not establish a clear set of prioritized interventions based on an analysis of costs and linked to possible levels of resource availability. The health sector suffers from the same weak links between long-term strategies, medium-term expenditure policies, and the annual budgetary process discussed above. Moreover, the integration between the central and sector-level planning and budgeting processes tends to be weak in the health sector because the high level of donor financing exerts a strong incentive on the Ministry of Health to view the PESS-SWAP sector arrangements as the most important channel for setting policies and priorities, rather than the national budget framework.[49] The main instrument for operationalizing the PESS is an Annual Operational Plan, which details the activities to be undertaken and the available financing sources (from the annual national budget, PROSAUDE, project financing etc.)

Health financing

Resources available for public health spending have increased substantially in recent years, in large part because of the rapid growth in donor support through the common funds and a more modest increase in the government's own resources devoted to the health sector (see Table 13). But the share of vertical funding has increased in recent years, largely because of the surge in funding for HIV/AIDS, such as the US PEPFAR.[50]

Table 13. Health Financing by Source, 2001-2005
(In US$ million)

	2001	2002	2003	2004	2005
Total expenditure	165	178	209	252	356
Government budget	70	82	96	105	112
Common funds	17	20	37	63	113
Vertical funding	75	75	75	85	130

Source: Martinez (2006).

As can be seen from Table 13, about two thirds of funding for the health sector comes from external sources, either in the form of common funds that donors contribute to and which are managed by the ministry, or through vertical funds and projects directly or indirectly implemented by donors using parallel systems. This does not include of course the share of the government budget which is funded through general budget support, bringing external financing to higher levels yet.

As highlighted above, the high dependence on different sources of external funding renders the planning and budgeting process much more problematic, especially given the dearth of planning capacity and of effective monitoring and reporting systems. This creates two overlapping sets of tensions. First, while donors are more willing than ever to provide additional support to a key MDG sector such as health, sector-level absorptive capacity issues, partly brought about by the nature of the additional funding made available, undermine the capacity of the sector to quickly scale up service delivery. Second, as noted earlier, the lack of reciprocal understanding and dialogue between macroeconomic and sector actors bring about a series of misunderstandings on existing macro-level absorptive capacity constraints on health spending and on the strategies and information that could at least partly relax them.

V. Lessons

The case study suggests a number of conclusions and lessons for the IMF, the Government of Mozambique and donors.

a) The IMF

1. *The IMF should explore in more depth the macroeconomic consequences of alternative scenarios for aid and public expenditures.* The medium-term projections for aid underlying the original program were too pessimistic and there was insufficient exploration of alternative scenarios. Subsequent programs did adapt quite well to changing circumstances, both in terms of the degree of optimism about expected aid flows and the flexibility with which the fiscal programs used the additional aid. Even in this latter period, however, the IMF was largely just reacting to decisions taken by the donor community. This was partly because the necessary information to undertake such analysis (e.g., prioritized sector-specific plans for scaling-up expenditures) was not available. But the consequence was that the IMF was not in a position to signal to donors whether or not other paths for aid and expenditures would have been feasible from a macroeconomic perspective

2. *Greater clarity is needed about the "signal" the IMF is sending about any particular level of aid.* Most of the key factors influencing Mozambique's ability to absorb additional resources, including in the health sector, involve sector-level constraints and the effectiveness of policies to overcome them. There is not much the IMF on its own can say about such issues without better information, which implies the need for considerable humility in making macroeconomic assessments unless they are based on a more in-depth analysis that explores the key micro-macro links. This has important implications for the nature of the signal the IMF should be sending donors: in the absence of such analysis, it can say relatively little about whether any future path for aid is macroeconomically justified. For example, the language used in the earlier program documents (including those for the 1999-2003 arrangement) concerning the need to reduce dependence on aid was not based on any solid macroeconomic justification and probably sent the wrong signal to donors.

3. *A wider range of feasible fiscal paths should be analyzed and the IMF should be more explicit about the rationale and analysis underlying the path it recommends.* The fiscal targets under the program, including the negative domestic financing of the deficit, were derived as part of a strategy of releasing additional resources to the private sector. While the broad objectives of such a strategy were reasonable (and in line with the authorities' own announced objectives), the programmed path for the fiscal deficits assumed, rather than analyzed, that a specific deficit reduction was needed to "crowd in" the private sector and lower domestic interest rates. In fact, cross-country experience suggests that the response of private sector activity and investment in such circumstances can be very difficult to predict. These considerations were important because, following debt relief, a wide variety of fiscal deficit paths would have been sustainable. Once again, a key consideration is the likely effectiveness with which any additional resources would be used, which requires better sector-level inputs (including for the health sector) than have been available so far. The IMF should be proactive in identifying what information is needed to explore alternative fiscal options, in the context of a broader dialogue with government and donors.

4. *The longer term fiscal implications of key choices involving scaled-up recurrent spending for health (and other social sectors) have not been sufficiently investigated.* Such an investigation would have to include an exploration of the potential consequences for the budget if donor financing were to be disrupted, including the funding of various health interventions that are currently off-budget. Of course, the IMF has neither the mandate nor the expertise to analyze in depth sector-specific issues, so others, including the World Bank, will have to do more to provide the necessary information for such macroeconomic assessments (see below).

5. *IMF conditionality on the wage bill in Mozambique does not seem to have imposed a major squeeze on the overall wage bill in recent years, but the rationale for such a ceiling was unclear and it fostered various distortions. So the IMF was right to drop it. The* IMF's reasons for adopting and then dropping the wage bill ceiling were not clear, however. Shielding senior finance officials from political pressures to allow additional wage spending might have played a part, along with the need to signal that weaknesses in payroll management were of concern. The IMF did make substantial efforts to ensure priority sector hiring was protected under the ceiling, but given the weaknesses in payroll systems, there was no way of systematically monitoring and enforcing such protection.

6. *The IMF should seek to broaden the debate on macroeconomic policies, including by explaining more fully the analysis underlying its policy advice.* The discussion on the macro framework should be broadened to other actors, integrating macro debates in broader negotiations (i.e., a stronger linkage between PRGF and PAF), and creating better linkages between macro and sector debates and strategies. There are inevitable tensions between the different roles the IMF is expected to play. In our view. The best approach to easing these tensions would be to downplay its role as a negotiator of short-term macroeconomic conditionality (at least in countries like Mozambique that have made considerable progress toward macro stability) and emphasize its contributions as a knowledge institution, helping Mozambique design better national policy documents, setting out the consequences of different policy options for the domestic political process.

b) Government of Mozambique

1. *The Government should take further steps to sharpen national priority-setting processes.* Some of the difficulties in assessing alternative fiscal paths reflect the lack of reliable data and mechanisms that allow for a clear definition of strategies that integrate sectoral plans with macro frameworks. Such an integration is needed to identify clear priorities and action plans. While this issue has been the focus of much attention in recent years, and quite a lot has already been done or is underway, there is still a long way to go. Recent efforts at strengthening the CFMP process, and the linkages between central and sector agencies that make the CFMP meaningful, will be of central importance. Ensuring good coordination between the recently separated Ministries of Finance and Planning and Development is also critical.

2. *The Government's own policy analysis capacity needs to be strengthened, with assistance from donors.* Policy space depends on policy analysis capacity. At the moment, the Government has too little capacity, although this is slowly improving. The lack of sufficient evidence on a number of issues (crowding out, support to private sector, regional comparisons, etc.) is not being adequately addressed. A first step would be for the Government to take the lead—in the context of the existing framework for Government-donor coordination—in establishing a prioritized research agenda, with agreement on who does what and by when.

3. *The capacity of the Ministry of Health to undertake budgetary planning should be strengthened, with the focus on producing concrete operational plans that will make a good case for additional budgetary priorities* One of the major problems in the health sector is the lack of a well-costed plan that is based on a clear strategy and is linked to and compatible with macro constraints identified by the Ministry of Finance. The Health Sector Strategic Plan is currently being reformulated, with a heavy focus on costing. The goal of this reformulation should be to have clearly prioritized plans that make clear what additional health interventions will be achieved with larger resources.

4. *A more comprehensive and operational human resource strategy for the health sector is needed.* There is no clear human resource development plan that provides a comprehensive picture of human resource needs and options for a medium- to long-term increase in the quantity and quality of health sector personnel.

c) Donors

1. *Predictability of aid and long-term commitments of aid are critical for effective planning of a scaling-up of health spending.* There have been some improvements in the predictability of aid recently, especially for direct budget support as donors signal their commitments early in the annual budgetary process. However, much longer term assurances of levels of support are needed if the Government of Mozambique is to embark on a major expansion of health (or other social) initiatives that have substantial recurrent cost implications and would be difficult to reverse. The shorter the timeframe of any aid commitments, the greater the fiscal risk for Mozambique, which will inevitably affect the incentives to undertake such an expansion. This is also true for rapidly growing "vertical" funds, even though the bulk of their operations are off-budget. Once started, donors have to be in for the long haul on such initiatives because it will be beyond the fiscal capacity of Mozambique's government to take them over for a very long time.

2. *The role that donors (including the World Bank) play in the dialogue on macro policy should be enlarged in ways that strengthen the Government's own capacity to undertake policy analysis and that encourage an opening up of the debate on macroeconomic policy*. The World Bank should do more to ensure timely availability of analysis of public expenditure options. G18 members have provided useful inputs into the dialogue on macro issues involving the government and the IMF, after assisting the government to bring a broader perspective that takes account of sector-specific realities to particular policy issues. This function could be carried out in a more systematic way, supported by adequate research and analysis. Stronger internal coordination between macro and sector-level support would also improve donor capacity to engage in this policy dialogue, since the fragmentation that exists between central and sector agencies within the government is often also reflected in donor agencies.

Appendix 1

Mozambique: Actual Outcomes	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation	t_{-6}	t_{-5}	t_{-4}	t_{-3}	t_{-2}	t_{-1}	t_0	t_1	t_2	t_3	t_4	t_5		t_0-t_2	t_3-t_4
Real GDP growth (percent)	12.6	7.5	1.5	13.0	7.4	7.8	7.5	7.7	7.9						
Inflation (percent; end-period)	-1.3	6.2	11.4	21.9	9.1	13.8	9.1	11.2	7.0						
External Targets															
Unrequited Official Transfers (US$ mn)	313	434	564	504	400	514	527	461	2466					3454	
Public foreign borrowing (US$ mn)	218	112	222	115	259	236	315	228	357					900	
Amortization (US$ mn)	-211	-201	-336	-333	-61	-68	-51	-71	-1839					-1961	
Total net aid flows (US$ mn)	320	345	450	286	598	682	791	618	984					2393	
Current account balance before grants (%of GDP)	-19.1	-29.2	-25.2	-28.0	-26.1	-19.9	-14.1	-16.3	-16.2						
Current account balance after grants (%of GDP)	-11.0	-17.5	-13.2	-14.5	-14.3	-9.2	-5.2	-9.4	-17.6						
Fiscal targets (% of GDP)															
Unrequited Official Transfers	8.1	11.7	12.0	13.5	11.8	9.5	7.5	6.5	10.7						
Revenues	11.4	12.0	13.2	13.3	14.2	12.9	12.6	14.0	14.4						
Total expenditures	21.6	25.1	31.3	33.5	34.1	26.5	24.4	22.6	27.1						
of which: wage bill	4.5	5.8	6.7	7.0	7.3	6.8	6.9	7.0	7.1						
Overall balance, before grants	-10.5	-13.2	-18.0	-20.1	-21.4	-14.0	-12.0	-8.8	-12.7						
Overall balance, after grants	-2.3	-1.5	-6.0	-6.6	-7.9	-4.5	-4.5	-2.3	-2.0						
External financing, incl. debt relief	4.6	1.8	4.3	4.7	7.0	4.2	2.8	3.5	4.2						
Domestic primary balance	-0.6	-3.4	-10.8	-7.3	-5.9	-3.3	-3.6	-1.9	-2.5						
Mozambique: Original program (June 2004)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)						7.1	8.4	6.8	6.5						
Inflation (percent; end-period)						13.8	11.0	8.5	7.0						
External Targets															
Unrequited Official Transfers (US$ mn)					420	536	551	502	502					1555	
Public foreign borrowing (US$ mn)					248	224	233	251	252					736	
Amortization (US$ mn)					-39	-47	-60	-64	-67					-191	
Total net aid flows (US$ mn)					629	713	724	689	687					2100	
Current account balance before grants (%of GDP)						-18.6	-12.4	-15.5	-15.2						
Current account balance after grants (%of GDP)						-6.2	-1.8	-6.7	-7.1						
Fiscal targets (% of GDP)															
Unrequited Official Transfers						10.6	9.4	8.0	7.4						
Revenues						14.3	14.6	15.0	15.2						
Total expenditures						29.8	27.7	26.5	25.8						
of which: wage bill						7.5	7.3	7.1	7.0						
Overall balance, before grants						-15.4	-13.1	-11.6	-10.6						
Overall balance, after grants						-4.9	-3.8	-3.5	-3.2						
External financing, incl. debt relief						4.8	4.1	4.0	3.7						
Domestic primary balance						-4.0	-3.3	-3.1	-3.0						

Mozambique: First Review (Jan 2005)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)						7.1	7.8	7.3	6.5						
Inflation (percent; end-period)						13.8	9.1	8.5	7.0						
External Targets															
Unrequited Official Transfers (US$ mn)					400	514	483	556	557					1596	
Public foreign borrowing (US$ mn)					259	236	294	405	369					1068	
Amortization (US$ mn)					-61	-68	-66	-74	-71					-211	
Total net aid flows (US$ mn)					598	682	711	887	855					2453	
Current account balance before grants (%of GDP)						-21.2	-15.6	-19.0	-17.0						
Current account balance after grants (%of GDP)						-9.3	-6.8	-10.6	-9.2						
Fiscal targets (% of GDP)															
Unrequited Official Transfers						10.6	8.3	7.9	7.5						
Revenues						14.3	14.0	14.9	15.3						
Total expenditures						29.4	27.2	29.9	28.2						
of which: wage bill															
Overall balance, before grants						-15.5	-13.3	-15.0	-13.0						
Overall balance, after grants						-4.9	-4.9	-7.0	-5.5						
External financing, incl. debt relief						4.8	3.1	6.0	5.3						
Domestic primary balance						-3.6	-3.6	-3.3	-3.1						
Mozambique: Second Review (June 2005)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)						7.8	7.2	7.7	7.4	6.4	6.4				
Inflation (percent; end-period)						13.8	9.1	8.0	7.0	6.0	5.8				
External Targets															
Unrequited Official Transfers (US$ mn)						514	491	557	558	585	614			1606	1199
Public foreign borrowing (US$ mn)						168	315	405	323	369	395			1043	764
Amortization (US$ mn)						-68	-63	-78	-79	-81	-79			-220	-160
Total net aid flows (US$ mn)						614	743	884	802	873	930			2429	1803
Current account balance before grants (%of GDP)						-19.9	-13.8	-13.9	-12.9	-15.0	-13.1				
Current account balance after grants (%of GDP)						-9.2	-5.8	-7.1	-6.8	-9.2	-7.5				
Fiscal targets (% of GDP)															
Unrequited Official Transfers						9.5	7.3	6.4	5.8	5.6	5.5				
Revenues						12.9	12.3	13.2	14.0	14.6	15.1				
Total expenditures						26.5	23.7	25.6	24.2	24.5	24.8				
of which: wage bill						6.8	6.7	6.9	6.9	6.9	7.0				
Overall balance, before grants						-14.0	-11.7	-12.4	-10.2	-10.0	-9.7				
Overall balance, after grants						-4.5	-4.4	-6.0	-4.4	-4.4	-4.2				
External financing, incl. debt relief						4.2	2.8	4.7	4.2	4.2	4.1				
Domestic primary balance						-3.7	-3.7	-2.8	-1.6	-1.7	-1.5				

Mozambique: Third Review (Dec 2005)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)							7.5	7.7	7.9	7.0	7.0				
Inflation (percent; end-period)							9.1	8.0	7.0	6.0	5.5				
External Targets															
Unrequited Official Transfers (US$ mn)							539	550	654	670	682			1743	1352
Public foreign borrowing (US$ mn)							315	356	357	391	376			1028	767
Amortization (US$ mn)							-63	-71	-81	-79	-78			-215	-157
Total net aid flows (US$ mn)							791	835	930	982	980			2556	1962
Current account balance before grants (%of GDP)							-14.1	-17.0	-17.4	-19.8	-17.7				
Current account balance after grants (%of GDP)							-5.0	-8.8	-7.9	-11.0	-9.4				
Fiscal targets (% of GDP)															
Unrequited Official Transfers							7.5	7.7	9.1	8.5	8.0				
Revenues							12.6	13.8	14.5	15.3	15.5				
Total expenditures							24.4	27.1	27.5	27.8	26.8				
of which: wage bill							6.9	7.0	7.4	7.5	7.5				
Overall balance, before grants							-12.0	-13.3	-13.0	-12.4	-11.3				
Overall balance, after grants							-4.5	-5.6	-3.9	-3.9	-3.3				
External financing, incl. debt relief							3.2	5.2	4.8	5.0	4.5				
Domestic primary balance							-3.6	-2.9	-2.1	-1.9	-1.7				
Mozambique: Fourth Review (July 2006)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)							7.5	7.7	7.9	7.0	7.0	7.0			
Inflation (percent; end-period)							9.1	11.2	7.0	6.0	5.5	5.4			
External Targets															
Unrequited Official Transfers (US$ mn)							527	468	793	661	680	688		1788	1341
Public foreign borrowing (US$ mn)							315	228	357	375	359	351		900	734
Amortization (US$ mn)							-51	-71	-199	-45	-47	-48		-321	-92
Total net aid flows (US$ mn)							791	625	951	991	992	991		2367	1983
Current account balance before grants (%of GDP)								-15.9	-17.1	-17.8	-16.4	-14.4			
Current account balance after grants (%of GDP)								-8.9	-5.7	-8.8	-7.9	-6.6			
Fiscal targets (% of GDP)															
Unrequited Official Transfers								6.5	11.1	8.8	8.2	7.6			
Revenues								14.0	14.4	14.9	15.4	16.0			
Total expenditures								22.6	27.8	28.3	27.5	26.9			
of which: wage bill								6.9	7.0	7.4	7.5	7.5			
Overall balance, before grants								-8.9	-13.4	-13.4	-12.1	-10.9			
Overall balance, after grants								-2.3	-2.4	-4.6	-3.9	-3.3			
External financing, incl. debt relief								3.3	4.8	5.0	4.4	3.7			
Domestic primary balance								-1.7	-2.6	-2.4	-2.2	-2.2			

Mozambique: Fifth Review (Dec 2006)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		*04-06*	*07-08*
Growth and inflation															
Real GDP growth (percent)							7.5	7.7	7.9	7.0	7.0	7.0			
Inflation (percent; end-period)							9.1	11.2	7.0	6.0	5.5	5.3			
External Targets															
Unrequited Official Transfers (US$ mn)							527.0	461.0	2466.0	947.0	963.0	974.0		3454	1910
Public foreign borrowing (US$ mn)							315.0	228.0	357.0	375.0	359.0	351.0		900	734
Amortization (US$ mn)							-51.0	-71.0	-1839.0	-26.0	-25.0	-26.0		-1961	-51
Total net aid flows (US$ mn)							791.0	618.0	984.0	1296.0	1297.0	1299.0		2393	2593
Current account balance before grants (%of GDP)							-14.1	-16.3	-16.2	-21.0	-20.1	-18.3			
Current account balance after grants (%of GDP)							-5.2	-9.4	-17.6	-8.9	-8.5	-7.4			
Fiscal targets (% of GDP)															
Unrequited Official Transfers							7.5	6.5	10.7	11.9	11.3	10.6			
Revenues							12.6	14.0	14.4	14.9	15.4	16.0			
Total expenditures							24.4	22.6	27.1	31.4	30.0	29.3			
of which: wage bill							6.9	7.0	7.1	7.5	7.5	7.5			
Overall balance, before grants							-12.0	-8.8	-12.7	-16.5	-14.7	-13.4			
Overall balance, after grants							-4.5	-2.3	-2.0	-4.6	-3.4	-2.7			
External financing, incl. debt relief							3.2	3.5	4.2	5.2	4.3	3.8			
Domestic primary balance							-3.9	-1.9	-2.5	-2.9	-2.7	-2.5			

Appendix 2
Table 3. Health-Related Indicators in the 2005 Performance Assessment Framework

Areas	Objectives	Actions	Indicators	PAF 2005 Targets		
				2005	2006	2007
Health	Maternal mortality reduce	Increase offer of obstetric care	Proportion of institutional deliveries among expected births	49%	51%	51%
	Infant mortality reduced	Increase coverage of the Extended Vaccination Program	T coverage <1 year DPT3eHB	95%	95%	95%
	Increase access to basic health services	Spread access to quality treatment of transmitted and non-transmitted diseases	Utilisation rate – consultations per inhabitant per year	0.93	0.94	0.95
HIV/AIDS	Prevention and mitigation of the impact on people infected and affected by HIV/AIDS	Reduction of vertical transmission	# HIV+ pregnant women and neonates receiving PMTCT Prophylaxis	15,000	25,000	35,000
		Strengthen capacity and partnerships and spread institutional support to the programs	Percentage of funds channeled by CNCS-SE to civil society organizations, public and private (by type of organization)	55%	65%	70%
		Care and community and home-based support (orphans and vulnerable children)	Percentage of community initiatives or CBOs supported by CNCS-SE to support orphans and vulnerable children in the country (% of total applications of CSOs and institutions from public and private sector)	20%	23%	25%

Source: Batley *et al* (2006), Annex 7.

I. Documents reviewed

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Ex-Post Assessment of Mozambique's Performance under Fund-Supported Programs, November 21, 2003.

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Third Review under the PRGF, December 5, 2005.

Fourth Review under the PRGF, June 1, 2006.

Fourth Review under the PRGF and Financing Assurances Review, December 1, 2006.

IMF and World Bank: Joint Staff Advisory Note on Mozambique's Poverty Reduction Strategy Paper, November 14, 2006.

Mozambique Government documents

Action Plan for the Reduction of Absolute Poverty, 2001-2005 (PARPA), May 2001.

Action Plan for the Reduction of Absolute Poverty, 2006-2009 (PARPA II), May 2006.

Agenda 2025, November 2003.

Aide-Memoire on the Mid-year Review between the Government of Mozambique and its Programme Aid Partners, April 2006.

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Norton, Roger (2004). Long-Term Visions and Development Strategies and Their Links to Poverty Alleviation: The Case of Mozambique. Global Development Initiative, The Carter Center, April 2004.

Martinez, Javier (2006). Implementing a Sector-Wide Approach in Health: The Case of Mozambique. HLSP Institute technical approach paper, June 2006.

Trocaire and Christian Aid (2005). Donor Coordination and Aid Effectiveness in Mozambique. Discussion document.

University of Birmingham (2006). Joint Evaluation of General Budgetary Support—Mozambique Country Report, International Development Department, May 2006.

II . Persons interviewed

- Jonas Chambule, Health Sector Specialist, Irish Aid Mozambique
- Jean Clement, African Department, IMF
- John Coughlin, Trocaire, Mozambique
- Elias Mangujo Cuambe, Deputy Director Planning, Ministry of Health, Mozambique
- Paulo Cuinica, G-20 Civil Society Secretariat, Maputo
- Juan Carlos Di Tata, IMF
- Felix Fisher, IMF Resident Representative, Mozambique
- Douglas Hamilton, Health Sector Specialist, European Commission, Mozambique
- Geoff Handley, Economist, Ministry of Planning and Development, Mozambique
- Joseph Hanlon, Open University, UK
- Sam Jones, Economist, Ministry of Planning and Development, Mozambique
- Domingos Lambo, Budget Director, Ministry of Finance, Mozambique
- Helder Martins, Adviser to the Minister of Health, Mozambique
- Jolke Oppewal, Macroeconomist, Netherlands Embassy, Maputo
- Dieter Orlowski, Adviser, Ministry of Planning and Development, Mozambique
- Perry Perone, Former Resident Representative in Mozambique, IMF
- Mark Plant, Senior Advisor, Policy Development and Review Department, IMF
- José Sulemane, Former Director of Plan and Budget, Mozambique; currently Senior Advisor to IMF Executive Director
- Siddarth Tiwari, Deputy Director, African Department, IMF
- Rachel Turner, Head of Office, DfID Mozambique
- Paul Wafer, Social Development Advisor, DfID Mozambique

Endnotes

[1] Mozambique has been involved in IMF-supported programs for most of the last two decades. During this period, it has had five multi-year arrangements with the IMF: a Structural Adjustment Facility (SAF) arrangement (1987-1990), two arrangements under the Enhanced Structural Adjustment Facility (ESAF) (1990-95 and 1996-99) and two arrangements under the PRGF (1999-2003 and 2004-2006).

[2] Excluding imports related to mega projects.

[3] Domestic revenues were targeted to rise to 15 percent of (unrevised) GDP in 2005 and 17 percent by 2010. Net external financing (grants and concessional loans) to the budget was assumed to be flat at about $540 million a year.

[4] This paragraph draws on the discussion of poverty trends in the World Bank's Country Economic Memorandum of September 2005 and the UN's Millennium Development Goals (MDG) database. The data on poverty is largely based on two national household surveys, conducted in 1996/7 and 2002/3.

[5] To date, only 10 percent of people in need of ART receive treatment and less than 5 percent of pregnant women living with HIV or AIDS receive the full course of prophylaxis for the prevention of mother-to-child transmission.

[6] See Appendix 3 for a list of documents reviewed and persons interviewed. There was a significant revision to the national accounts series in early 2005, which affected the GDP estimates for 2000-2003 (and consequently affected comparisons of targets and outcomes). The new GDP series was incorporated into program targets at the time of the second program review (in June 2005).

[7] See section on "Findings and Lessons for the IMF" in the joint case study of Mozambique conducted by the IEO and the World Bank's Operations Evaluation Department as part of the evaluation of the PRSP and PRGF (July 2004).

[8] The evaluation concluded that the whole PRSP process had been initially resented by the authorities as an additional externally driven procedural requirement, but that the process had eventually become more country-driven with strong government ownership.

[9] Appendix 3 lists the documents reviewed. Papers for a recently completed fifth review have not been made public yet.

[10] Original program targets were often revised at the time of program reviews; see Appendix Table 1 for details.

[11] Estimated for 2006, based on IMF staff report for fifth program review.

[12] Change (in percentage points of GDP) between t_{-1} and t_{+2}, where t_0 is the year in which the original program was approved.

[13] Including analysis in the 2003 Ex-Post Assessment of the IMF long-term program involvement in Mozambique and various Article IV consultation papers.

[14] These targets are in terms of the old GDP series, which was subsequently revised.

[15] As discussed in the background paper on *The Nature of the Debate Between the IMF and its Critics*, the strength of "crowding out" effects as higher deficits displace private investment through higher interest rates can vary substantially depending on country circumstances. IMF programs tend to overestimate the speed at which a reverse "crowding in" will take place as deficits are reduced. In particular, it can take private demand for domestic credit considerable time to recover in "post-stabilization" phases, which has important consequences for the conduct of fiscal policy:

> *"realistically there is likely to be a recovery phase in which the private sector occupies less 'economic space' than it would in a more equilibrium configuration. The balance between government expenditures and any associated deficit financing may be struck differently during such a phase than they will subsequently" (Adam and Bevan, 2001).*

[16] In interviews, IMF staff indicated that, drawing on World Bank analysis, they had also been concerned that a potential failure of a state-owned bank would entail significant quasi-fiscal costs requiring additional domestic debt to be issued. But there was no discussion of such considerations in the IMF reports.

[17] A set of comments on the Foster paper were circulated by the IMF resident representative in Mozambique.

[18] The review paper said the additional spending would be for infrastructure (water projects and bridges). Part of the additional external financing also reflected the repatriation of the proceeds of coal exploration fees that had initially been invested abroad in liquid assets.

[19] Like any framework that has to rely on long-term projections and probabilistic assessments, the Debt Sustainability Assessment framework used by the IMF and World Bank has a number of limitations. See the background paper on *The Nature of the Debate Between the IMF and its Critics* for a discussion of these problems (2006).

[20] For example, the DSA undertaken at the time of the fourth program review followed the recently introduced IMF-World Bank DSA framework. That framework, discussed in more detail in the background note on ***The Nature of the Debate Between the IMF and its Critics*** sets indicative, country-specific debt burden thresholds that depend on the quality of a country's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), according to which Mozambique ranks as a "medium performer." The indicative thresholds of potential debt distress for countries in this category are a net present value (NPV) of debt-to-exports ratio of 150 percent, an NPV of debt-to reserve ratio of 250 percent, an NPV of debt-to-GDP ratio of 40 percent, and debt-service-to-exports and revenue ratios of 20 and 30 percent, respectively. Mozambique's debt indicators remained well below these levels both under the baseline scenario and under various stress tests.

[21] In the health sector alone, donors fund personnel "incentives" to the tune of $8-10 million per year.

[22] Although commitments data has generally proved to be a relatively poor guide to actual dollar disbursements, the comparison here is in terms of trend rates of growth.
[23] Estimated actual for 2006 is based on partial-year data.
[24] The projected growth in aid made at the time of the fourth and fifth reviews look expecially high because they are calculated relative to the 2005 shortfall.
[25] The sharp recorded decline in the share of health spending in total government expenditures in 2001 reflects the increase in other, drought-related spending in that year. The data recorded in Table 8 differ somewhat from those recorded in the WHO National Health Accounts database, even though data for 1999-2004 in the latter are recorded as being drawn from IMF country reports.
[26] Seventeen out of the 42 countries with PRGF-supported programs during 2003-2005 included some form of ceiling on the wage bill; all were in Africa or the Central America/Caribbean region. Such ceilings were especially common in Africa (13 out of 24 cases during the period). See the background paper ***The Nature of the Debate Between the IMF and its Critics*** for further details.
[27] Unlike formal performance criteria (PC), which if breached imply an automatic interruption of access to IMF financing unless the Executive Board grants an explicit waiver, indicative benchmarks have no such explicit link to IMF financing. Rather, they are taken into account at the time of reviews to judge whether the overall program is on track.
[28] According to the annual report on PARPA implementation (*Balanço do PES*) for 2005, in the health sector more than 1,200 new recruitments did take place, even though most of them were regularizations of contracted personnel being paid from donor funds.
[29] The reasons for the upward revision at the time of the third review are not well explained, but the program documents (third and fourth reviews) refer to the hiring of about 10,000 teachers and 2,000 additional health workers in 2006, justifying the revised projection of the wage bill rising from 7 to 7 1/2 percent of GDP.
[30] See, for example, the discussion in Box 4.2—*IMF targets,"fictitious" projects and off-budgets* of Hodges and Tibana (2004).
[31] This is included as the projected figure in the MTEF 2007-2009 for all three years.
[32] Work is underway to create an economic research institution in Mozambique.
[33] This section draws largely on De Renzio and Sulemane (2006) and the Assessment of Public Finance Management in Mozambique, by Lawson, de Renzio, and Umarji (2006).
[34] For more detail, see de Renzio and Sulemane (2006). Many of the improvements are also linked to the shifts in Mozambique's aid environment and the signing of the MoU with donors providing general budget support.
[35] Lawson , De Renzio, and Umarji (2006) conclude that the CFMP is not regarded*…"as a policy instrument for constructive dialogue with other agencies and with the political level. Indeed, the involvement of sector ministries in the preparation of expenditure projections is very limited and the consequent link to sector strategies is tenuous.*" (p. 27)
[36] *[Aide-memoire, P. 10.]*
[37] Such short-term disbursement systems are often used in situations where liquidity constraints require expenditures to closely track available domestic revenues and aid flows, but they make efficient expenditure planning more difficult and can cause some types of expenditures to be favored over others, for reasons that have little to do with announced priorities. The aide-memoire on the 2006 mid-year review by the PAP donors talks of a "number of common factors that appear to be inhibiting higher levels of budget execution in the health sector, notably delays in the release of funds and procedures for reallocation."
[38] Quoted in Batlet et al.(2006), Annex 4b.
[39] The main difference between the two stages is that some donor spending may be included in budget documents for programming purposes, even though it does not flow through government financial management systems during the execution phase.
[40] While the central Social and Economic Plan, until 2006, was prepared by the sector and submitted to the Ministry of Finance by the end of July, the sector annual plan was finalized only in November of each year. And while the *Balanço do PES*, the central annual reporting instrument, has to be ready by mid-February each year, the evaluation of the sector plan was only done towards the end of March.
[41] The PEFA-based ratings given by Lawson et al (2006) are D+ for financial information provided by donors and D for the proportion of aid managed by national procedures (i.e. under 50 %). To improve the tracking of information on aid and related expenditures, an aid database was piloted by the EU Member States in 2005, covering project data. It has now been extended to most other donors and to program aid.
[42] See Batley et al (2006), section A3.
[43] See Lawson et al. (2006), Annex Four. While in-year predictability has caused some problems, overall levels have often surpassed initial pledges, bringing about different kinds of problems linked to expenditure, planning and implementation. See also the annual reports on donor performance, agreed under the Memorandum of Understanding for general budget support (www.pap.org.mz).

[44] According to the *Aide-Memoire* for the mid-year review with the Programme Aid Partners, donors have committed to $370 million of direct budget support to the 2007 Budget (not including sector funds like PROSAUDE).
[45] Most donors make their commitments on the basis of the overall collective assessment of performance against the PAF indicators but 3 donors commit part of their financing based on assessment of specific indicators within the PAF.
[46] The principal bilateral donors that do not participate directly in the framework are Japan and the United States.
[47] Since 2004, the Global Fund to Fight Aids, TB and Malaria (GFATM) has channeled all its support through the PROSAUDE.
[48] The code of conduct, as modified in 2003, calls for the development of a common vision and strategy, supported by multi-year funding commitments and efforts to use and strengthen existing national systems, and a flexible and gradual approach to reforms. The most important bilateral donor active in the health sector that has not participated in these harmonization efforts is the United States (including USAID and PEPFAR).
[49] The discussion here is based on Box 1 of De Renzio and Sulemane (2006).
[50] Funds allocated to Mozambique under PEPFAR have risen from $37.5 million in FY2004 to $60 million in FY2005 and $94 million in FY2006.