The Loan Contraction Process in Africa

The Case of Mozambique

AFRODAD

African Forum and Network on Debt and Development

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About AFRODAD

AFRODAD Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

AFRODAD Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

AFRODAD Objectives include the following:

1 To enhance efficient and effective management and use of resources by African governments;

2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of the people in the world.

3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being a political, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of Seven programme and five support staff.

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Preface

The 2002 Monterrey Financing for Development Conference established a consensus among the international development community that 'sustainable foreign borrowing' will remain an important source of capital to finance private and public investment in developing and least developed countries for the foreseeable future.

Research findings show that governments and international financial institutions often negotiate and sign loan agreements in a non-transparent and non-accountable way. In some cases the government may overrule their parliament's objections to a loan, and often parliaments end up rubberstamping new lending agreements without being properly involved in the decision-making process. On the other hand, civil society organizations have played a very limited role at any stage of lending agreements. There is no formal legislation to involve them in the loan cycle, and they lack the resources and skills to research, advocate on and monitor government loans.

Citizens' groups need to be allowed to scrutinize the process by which aid-recipient countries agree to take on the terms and conditions of a loan. This should help to avoid lending and borrowing mistakes, which in the past have led to the build-up of unsustainable debt that now has to be paid off at the cost of financing the MDGs. Citizens' organizations and the bodies that represent the interests of different groups of poor people in the formal democratic process need to be informed about the purpose of every project and programme financed by new loans, including the associated risks of the loan in the light of a country's existing unpaid loans and economic indicators. Public debate should inform the final decision of governments and creditors on the content of development projects and programmes, as well as the most appropriate form of finance. The MDG targets, which may differ from country to country, provide a useful political tool that allows citizens to hold their governments and creditor institutions to account.

The present document aims to provide the Mozambican experience on loan contraction process from the identification of the need to contract a loan to its management and repayment. It starts by setting the context in which the Mozambican debt unfolded overtime, providing information about debt stock by source in recent years and the impact of debt relief initiatives. Legal framework is then presented, emphasizing on the existing statutory laws and highlighting the role and responsibilities of the various stakeholders involved in the loan contraction process. For a better understanding of the subject, a case study is presented on Energy Reform Access Project loan contraction process. The document also presents information on the impact of Multilateral Debt Relief Initiative on poverty reduction efforts. Some considerations are made regarding the efforts that the country is pursuing towards the achievement of Millennium Development Goals and the extent to which they can actually be achieved. Finally, the document makes some recommendations to the Government, Parliament and Civil Society with the view of improving the present status of loan contraction process.

Charles Mutasa

Executive Director

AFRODAD

Table of Contents

List of Tables, Diagrames And Figures

List of Abbreviations

AFRODAD	African Forum on Debt and Development
CAS	Country Assistance Strategy
EDM	Electricidade de Moçambique
ERAP	Energy reform Access Project
ESAF	Enhanced Structural Adjustment Facility
HIPC	Highly Indebted Poor Countries
IFIs	International Financial Institutions
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
MoU	Memorandum of Understanding
MPF	Ministry of Planning and Finance
NGOs	Non Governmental Organisations
OECD	Organisation for Economic and Cooperation Development
OPEC	Organisation of Petrol Exporting Countries
PARPA	Plano de Acção para a Redução da Pobreza Absoluta
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Programme
SADC	Southern Africa Community development
SISTAFE	System for Financial Administration
WB	World Bank

1.0 Introduction and Background

The emergence of external debt in many developing countries was originated by the need to finance development projects for the improvement of the well-being of their populations. However, a diversity of factors such as the lack of experience of new governments that emerged after the colonial independences, natural disasters, unstable world markets, and low productivity of their economies resulted not only in the incapacity of repaying debts but also in a need to contract new loans to respond to the increasing needs of the people. This was compounded by the conditionalities imposed by the International Financial Institutions (IFIs) that further worsened the situation of poor countries and these further plumbed into debt.

Research studies show that despite the implementation of debt relief initiatives such as rescheduling processes, HIPC initiative and the Multilateral Debt Relief Initiative (MDRI), developing countries will still rely on loans to finance their development needs in the near future. This calls for the implementation of debt management policies and strategies to minimize the rate of failed projects and programmes and the occurrence of mismanagement of resources and new debt crisis. Mozambique is one of the countries whose external debt reached unsustainable levels in the mid eighties. Despite several rescheduling and debt cancellations under various schemes, the country is relying on external funding to finance part of its development needs. Presently, 50 percent of funding needs are supported by credits and grants.

Despite the country's dependence on external funding, it does not yet have a formal strategy to contract and manage its debt. Overtime, debt contraction has been carried out according to issued guidelines to standardise procedures. These guidelines include: i) the guarantee that the resources are used to finance priorities defined within Government plans; ii) contraction of loans with an element of concessionality equal or greater to 35 percent; iii) long maturity periods. In 2004 the country embarked on an exercise to produce its debt management strategy with the support of debt and financial related institutions. This strategy still awaits for the approval of appropriate institutions.

The Mozambican Parliament empowers the Government, through the Ministry of Finance, to lead loan negotiations, sign loan agreements, manage public resources and repay the debt from the pool of budget resources. Sectoral ministries and the Bank of Mozambique are involved in this process. The World Bank and the International Monetary Fund play a critical role as advisors in budgeting process to make sure that the macroeconomic targets are respected. They also are an important source of funding as loans provided by them meet the criteria/guidelines mentioned above. However, the conditionalities attached to their credits produce negative effects to the poor, thus, reducing the impact of their contribution. There is a need to establish a permanent and inclusive dialogue with the Government and civil society around their policies to reduce the negative effects of their policies and share responsibilities in development outcomes.

Civil society organizations are not involved in both budgeting and loan contraction processes. This can be seen as a shortfall of the process as they play an important role in development processes and would bring critical inputs to the processes.

The Multilateral Debt Relief Initiative and other relief initiatives have contributed to increased investment in priority sectors. Available data show that more resources have been channelled to education, infrastructures, health and governance and judicial sectors.

Overall, the Government is making a deliberate effort towards the achievements of the Millennium Development Goals (MDGs). However, the challenges are enormous that if additional efforts are not made, some targets will not be met by 2015. Given the above situation, the Government should increase the resource base of the economy by increasing investment in productive sectors, expanding and improving tax collection systems and improving the management of public resources. The Parliament should not only empower the Government to contract and manage the loans but also demand transparency and accountability in the use of public resources.

In light of the above, AFRODAD commissioned a study to examine the loan contraction and management process in Mozambique and make recommendations to the government of Mozambique and the IMF and World Bank on improving transparency, accountability and participation in the debt management process.

1.2 Purpose of Study

The study is premised on the understanding that the procurement, utilization and management of public loans and debts are a national and global issue and, therefore, should be seen to be transparent, accountable, participatory and inclusive. The processes of loan procurement and debt management require legitimacy and systematic planning to be sustainable. By making loans sustainable, governments will have extra revenue to support their social services and goods for development and enhance their people's welfare and reduce poverty. This study constructs a framework for rationalisation of the loan contraction and debt management process in these terms.

1.3 Overall Objective

The purpose of the study was to critically examine the loan contraction and debt management process in Mozambique and make recommendations on improving transparency, accountability and participation of the processes.

Specific Objectives

The objectives of the study are to:

- Give a summary of the existing external loan agreements still being serviced by the government or recently contracted by the government.
- Outline the legal framework which regulates the government's lending practices.
- Examine the role of the IMF and World Bank and other major creditors/lenders' permanent representatives and missions in the Loan contraction process.
- Examine the role of civil society in the loan contraction and monitoring process.
- Give an example of a specific loan process.
- Critically evaluate the progress made by the country as a potential MDRI beneficiary.
- Give an assessment of the performance of government (i.e. a current status) in its responsibilities as a duty bearer to its citizens with particular regard to the attainment of the Millennium Development Goals in the country.

1.4 Methodology

Both primary and secondary sources of information were collected for the write up of this report. Primary data was gathered through interviews. Relevant government officials in the Ministry of Finance and the central bank of Mozambique were interviewed. Interviews were also had with the officials of donor institutions such as the World Bank, as well as officials of Non-governmental organizations and Civil Society Organizations. As for secondary data, information on Mozambican debt was obtained from the Ministry of Finance. Relevant documents published by the government, donor institutions, and civil society organizations were studied and reviewed.

1.5 Socio-economic background

Mozambique is one of the developing countries whose indebtedness reached unsustainable levels in the mid eighties. This situation is associated to internal and external factors.

Internal factors included natural disasters such as floods and drought and internal conflict that resulted in a reduction in economic activity, destruction of social and economic infrastructures and an increase in the levels of poverty. The lack of appropriate capacity to manage state owned companies and the implementation of economic policies that increased government expenditure without the necessary recovery of the costs further plummeted the country into debt.

External factors were characterized by the destruction in the use of infrastructures such as roads, ports and railways by South Africa and Rhodesia resulting in the reduction of country's revenues; reduction in the remittances from the miners as a consequence of their dismissal from the South African mines; the oil crises of the mid 70s that required increased amounts of foreign currency to finance import expenses; a generalized increase on interest rates in the international market and the deterioration of the terms of trade.

The factors mentioned above forced Mozambique to further contract loans to finance its needs at the same time that its internal capacity to service them was drastically reducing, resulting in a vicious cycle of indebtedness. Following the country's announcement of its incapacity of keeping up with its debt service commitments, the Government entered into negotiations with several creditors with the view of rescheduling and/or seeking debt cancellation within the existing debt relief initiatives. Table 1 below presents the loan and debt evolution in recent years showing some light of the important changes under the international debt alleviation initiatives:

Table 1 - Mozambican External Debt Aggregates (millions USD)

	1998	1999	2000	2001	2002	2003	2004
Debt Forgiveness	0.0	31.7	79.0	99.8	947.4	13.3	315.1
Annual New Loans	479.2	453.2	545.0	157.8	595.1	224.0	313.1
Grants for Investments	133.9	180.3	226.8	256.7	221.5	259.5	197.8
Interest on Governmental Debt	150.3	84.0	147.1	139.2	190.2	46.3	68.7
Interest on Private Debt	13.0	60.5	71.5	89.9	99.3	119.8	128.1
External Assistance	179.3	253.7	337.7	212.5	628.4	232.4	333.4
Foreign Direct Investment	234.9	381.7	139.3	255.4	347.6	336.7	121.9
External Assistance + Grants	313.2	434.0	564.5	469.2	849.9	491.9	531.2
Domestic Debt	0.0	6.0	14.0	327.9	952.0	1,002.0	921.0

Table 1 shows the substantial growth of the debt stock over an extended period of time.

Additionally, the table shows that debt forgiveness under the HIPC initiative continued to be complemented by high levels of grant financing. The grant financing and the external assistance remained strong and stable over the years and then rose sharply in 2002 due to the HIPC initiative debt alleviation. Mozambique enjoys strong external assistance compared to other African countries.

The stock of internal debt also rose considerably over the period under consideration. Although the numbers have not reached unsustainable levels, cautionary measures have to be taken as to avoid crisis situations. Moreover, the cost of internal debt is higher compared to that of external debt. Hence, the recourse to internal borrowing should be done as long as all the other funding alternatives have been exhausted and/or when it represents the implementation of a monetary or financial policy.

Table 2 shows that Mozambique's external debt remains large such that in the medium and long run, dependency on aid can be reduced only gradually. After the introduction of the Economic and Social Rehabilitation Program in 1987 under the support of the International Monetary Fund and World Bank Group, multilateral institutions became the main lenders. As a result, currently, multilateral debt represents more that 50 percent of total debt. Mozambique's external debt to the Organisation for Economic Cooperation and Development (OECD) stands at 15 percent.

Table 2 - Mozambican External Debt Stock By Source (million USD)

	1998	1999	2000	2001	2002	2003	2004
Multilateral	2,133.5	2,141.9	1,348.2	1,331.8	1,706.4	1,953.3	2,321.2
Bilateral	3,922.5	3,569.8	3,654.5	3,608.7	1,899.5	1,985.5	2,105.6
OECD	1,981.1	1,804.6	1,854.4	1,842.4	571.1	563.5	646.7
OPEC	657.1	570.1	615.8	613.3	632.4	623.3	788.8
East European countries	197.9	142.7	212.0	187.5	197.1	189.6	298.6
Others	1,086.4	1,052.4	972.3	965.5	498.9	609.1	371.5
TOTAL	**6,056.0**	**5,711.7**	**5,002.7**	**4,940.5**	**3,605.9**	**3,938.8**	**4,426.8**
Annual flows	0.0	-344.3	-709.0	-62.2	-1,334.6	332.9	488.0
OPEC+East Europe+Others	1,941.4	1,765.2	1,800.1	1,766.3	1,328.4	1,422.0	1,448.0

Source: Bank of Mozambique Statistics and Mozambican Debt Group

Mozambique has experienced rapid growth since the peace agreement in 1992, largely due to policy changes such as resettlement and transformation of a centrally-planned state-owned economy into a market-oriented one. In that context, investment flourished and Mozambique's external partners granted large amounts of aid. During this time, the country achieved high levels of growth, built capacity and transformed aid modalities to sector-wide approaches and to budget support against agreed country performance indicators.

Generally, Mozambique's development programme had, until now, delivered mixed results. As already seen, income improved since 1992, but the majority of the population still lives in poverty. Growth has been high, but has tended to involve the exploitation of natural resource capital in an unsustainable way. Exports, excluding large-scale projects, are flat. Many firms are struggling for their economic and financial survival. Labour and capital productivity are below regional averages and some portfolios with international institutions are distressed.

In this regard, the country needs rapid and sustainable growth mainly sourced in agriculture and labour-intensive manufacturing and services in order to reduce poverty. To that end, Mozambique will require yield-improving inputs and technologies and essential rural infrastructure and increased efficiency of public spending towards poverty-reducing sectors. All these need additional financing, meaning contracting new loans, seeking more aid and increasing its internal revenues through an improvement in tax collection basis, using a fair, coherent and inclusive system.

2.0 Loan Contraction: Legal and Institutional Framework

This chapter assesses previous and current practice in Mozambique's external public debt management and the country's legal and regulatory framework. This chapter assesses previous and current practice in Mozambique's external public debt management and the country's legal and regulatory framework

2.1 Legal Framework Regulating Government's Borrowing Practices

Mozambique does not yet have a formal strategy for the contraction and management of external and internal debt. With technical assistance from the Debt Relief International Development and the Macroeconomic Financial Management Institute in 2004, the Government embarked in an exercise with the view of producing its Loan Management Strategy in which its is hoped to see clearly defined: i) conditions that will ensure the sustainability of public debt in terms of amounts involved, modalities and contraction conditions; ii) interveners, responsibilities and functional structure; iii) legal and institutional frameworks, processes and procedures for public indebtedness and iv) options that the country has and the efforts needed to alleviate debt burden. This strategy has not been yet approved.

Over time, the Government has been operating according to guidelines defined to standardise loan contraction procedures. In 1996, the Government announced that from January that year, all the loans would be contracted with an element of concessionality equal or greater to 35 percent, long maturity period and, whenever possible, the Government would substitute loans by grants.

The only clear constitutional declaration in regards to loan contraction is Chapter 11, Article 179, of the 2005 National Constitution which deals with the competence of the National Assembly. The Government is granted legal rights under general conditions, to contract loans, operate other credit agendas, for a period of one economic year and establish maximum level of state loans to be contracted. In fact, when the Government presents the budget to the approval of the Parliament, it shows the amount secured by internal sources, grants and the deficit to be financed by loans. Once the budget is approved, the Government is given the responsibility of contracting loans to fill in the financial gap.

The Presidential Decree nº 22/2005 states that the Ministry of Finance is the central organ of the State that, according to principles, objectives and tasks defined by the Government, oversees the management of public finances. Therefore, it is responsible for ensuring the celebration of agreements with financial institutions and control of their implementation.

It should be noted that other important aspect of the economy such as the Mozambican, the budget is prepared by the Government under the assistance of the IMF and the World Bank Group who make sure that macroeconomic objectives, namely, inflation target, reserve accumulation objective and growth rate as well as budgetary deficit financing are taken into consideration. Civil society is not involved nor consulted in this process.

2.2 Role of Different Stakeholders in Loan Contraction Process

Stakeholders play different roles within the loan contraction process in Mozambique. Table 3 lists their respective contributions.

Parliament	Empowers the Government to contract and manage loans, according to set guidelines
Ministry of Finance	Contracts and manages loans
Central Bank	Loan recipient and channels funds to the beneficiary
Attorney General Office	Gives legal opinion about the loan contraction act
Auditors General Office	Audits the execution of state budget including funds from loans
Bank and Fund	Advisors on budget formulation and creditors
Civil society	Not involved
Donors and UN Agencies	Not involved, unless playing the role of creditor

Table 3 shows that there is a clear allocation of responsibilities within loan contraction processes. What can be considered a shortfall is the mechanism of monitoring and evaluating public funds, including resources from loans. During the implementation phase of a given project there should be a transparent and permanent way of monitoring the use of resources, not only by the line ministry but also by an appropriate designated institution. The audits undertaken by the Auditors General Office should be complemented by this monitoring process to avoid/minimize administrative and financial malpractices.

The Ministry of Finance has the responsibility of signing contracts with financial institutions and control their implementation, on behalf of the State. This requires putting in place instruments and mechanisms to effectively control the use of public funds. There are still many weaknesses in the system, judging by cases of failed projects. Although some steps are being taken to improve the situation, namely the creation of SISTAFE (System for Financial Administration) and Anti-Corruption Unit, the question remaining is how effective will they be.

The media has been playing an important role in bringing to public knowledge some of the issues related to public funds mismanagement. However, there has not been an official response to those concerns in terms of their veracity and measures taken to avoid future situations.

The Parliament should also reinforce its role not only in delegating responsibility to the Government to contract and manage public funds but also that of demanding accountability by the service provided and use of public resources.

Civil society, as an important actor in development processes should be involved in budget formulation and also debt contraction processes. The Mozambican Debt Group, a coalition of NGOs, religious groups, trade unions, researchers and individuals, already working in debt and development issues, could be the entry point to the establishment of this dialogue.

2.3 The Government's Borrowing Practices

In Mozambique, the annual state budget is the most important national financial short term plan complemented by a social and economic plan that justifies the economic and social actions to be carried out by the Government during each economic year.

The construction of the budget focuses on the identification of priority activities to be carried out and the calculation of the expenditures for that specific year. It estimates the funding provision of the receipts to finance the expenditures and identifies financial gap. It is during the budgetary process that financing needs are identified as well as financing sources or pledges. Today, Mozambique domestic receipts finance only 50 percent of all annual priority expenditures, meaning that the remaining must be supplemented by grants and/or credits.

When the government prepares the budget proposal through the Ministry of Finance with the support of the IMF and the World Bank Group, it is presented to the Parliament for approval. The Parliament exercises its role as the people's representative body and has power to amend the budget and its source of financing. By approving the budget, the Parliament gives power to the Government to realize the expenditure, including the contraction of loans to fund the financial deficit.

Loan contraction is usually initiated and carried out by the Ministry of Finances to fill in the overall financial gap of the State Budget. However, sometimes individual ministries identify funding partners for a specific project and negotiate loans in accordance with the Government guidelines, with the involvement of the Ministry of Planning and Development and the Ministry of Finance. After the signature of the credit agreement, the project is then recorded in the State budget and follows the normal procedures.

Diagram 1 shows the steps taken during the loan contraction process. It indicates the different institutions involved and their respective roles.

Diagram 1: Loan Contraction Process

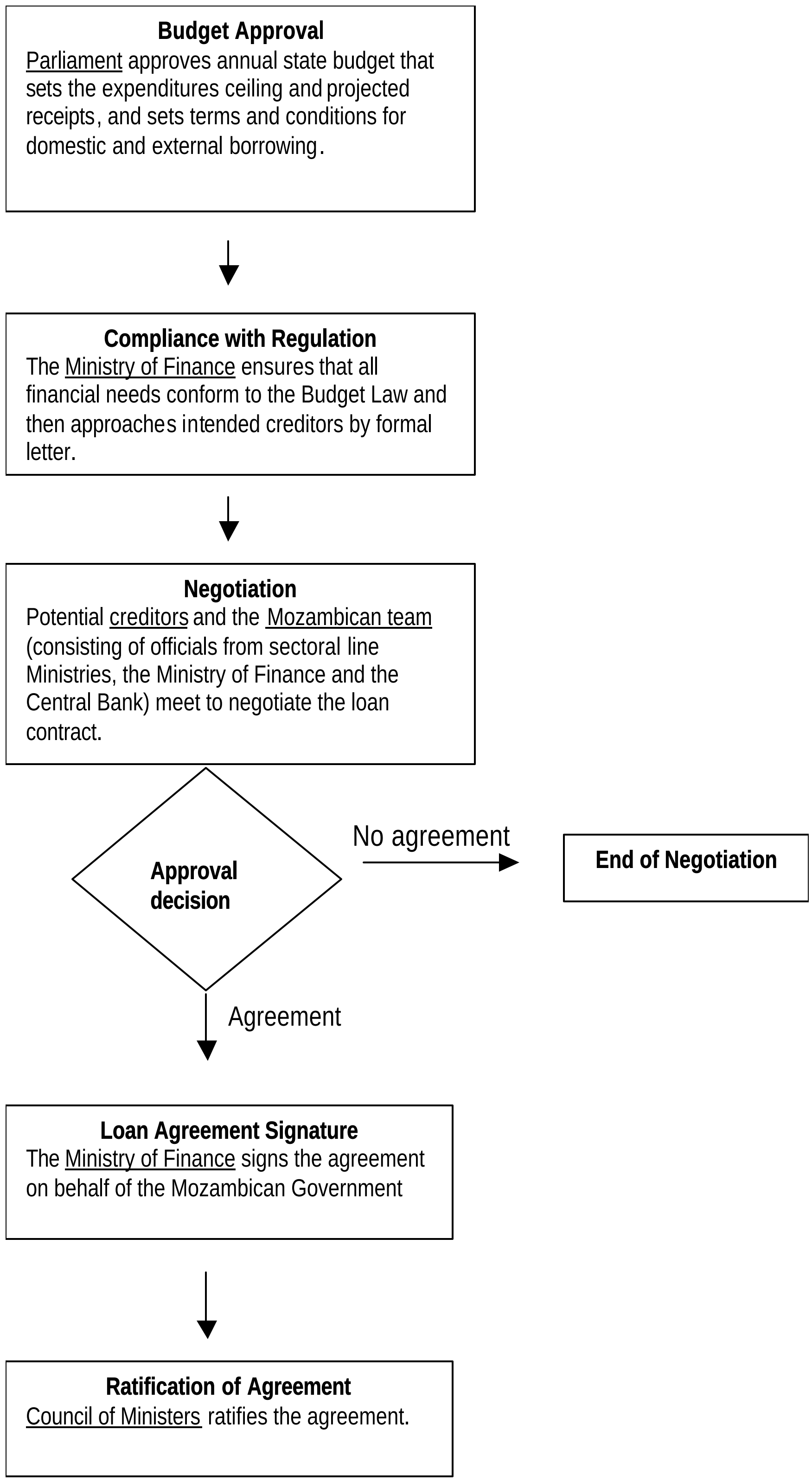
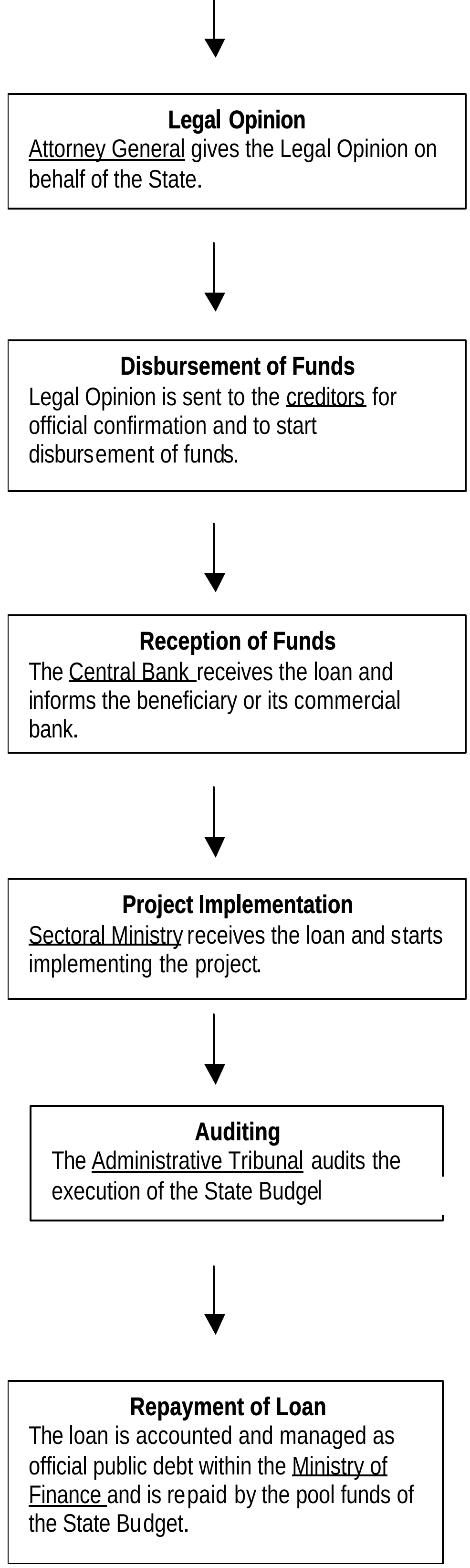


Diagram 1: Loan Contraction Process



This diagram presents a consolidated procedure for either when a line ministry decides to request the inclusion of a new project in the budget and identifies a potential creditor or when the Ministry of Finance initiates negotiations for the financing of a programme included in the state budget. In both cases, the Government is sure about the speed of the course of negotiations and the creditor's readiness to disburse the money within the same fiscal year when the negotiations start. Otherwise the project cycle is somehow time consuming, especially the identification and appraisal phases and its presentation to the creditor's board. In this case, only the line sectoral Ministry request the project integration in the annual budget when the negotiations are already successfully concluded and awaiting implementation.

The Ministry of Finance is the Government institution that contracts the public and official loans from abroad and takes care of their management. This Ministry is also responsible for the contraction of internal debt. It is also responsible by repaying the debt with the pool of public funds.

The Central Bank is the state bank and the Government's financial agent. As the exchange authority, the central bank authorizes and registers the private sector activities in contracting and extending loans externally as Mozambique has capital account controls.

During the budget execution, all loan contractions must be stamped by the Attorney General as confirmation that the Government is acting on behalf of the Mozambican State.

Another important player in the budget process in Mozambique is bilateral donors who are budget support partners. They aim to contribute to poverty reduction in all its dimensions by supporting the evolution, implementation and monitoring of the Plan of Action for Poverty Reduction operationalised through annual state budgets.

Clearly, the budget support group maintains a keen commitment to the country only if the authorities pursue sound macro-economic policies, with reference to the IMF "on track" status. Individual donor's evaluation is taken into account to pursue additional budget support to the country.

The disbursement schedule is agreed upon between the Mozambican Government and budget support partners before the beginning of each fiscal year. It takes into account the needs of the budget, as identified in the central Treasury planning. The instalments are requested by the Mozambican Ministry of Finance in written form from budget support partners in question with copy to the Central Bank. As the instalment is deposited in the account indicated by the Government, the Central Bank, as recipient, converts the equivalent amount in foreign currency into national currency and credits the specific treasury account.

The principle that donor support should be aligned around, and follow country-owned poverty reduction strategies is now widely accepted. The Memorandum of Understanding (MoU) signed between budget support partners and the Government of Mozambique sets that the Mozambican Government takes a material lead in donor coordination, indicating that priorities are being driven by the articulated national policy agenda related to poverty reduction. This means that in Mozambique there is a strong effort between donors and the government to construct a more open and transparent dialogue on goals-setting, resource allocation and outcomes monitoring.

These constructive mechanisms are evolving into institutionalized processes and are increasing Government ownership, as well as enabling a more coherent delivery of development assistance.

The MoU represents a very important step, not only in Government ownership of the economic programme, but in building capacity to have greater control of the inflow of funds and reducing off-budgets. Additionally, the Mozambican authorities, from the implementation of this MoU started to have more control upon variables affecting the entire economy as well as enabling them to program more accurately the macroeconomic indicators.

The present Mozambican law gives the authorities a strong degree of manoeuvre concerning loan contraction. In this context, the annual budget is approved by the Parliament and there is no much difference between written laws and normal practice of borrowing and loan management. In 2004 the Government empowered the Administrative Tribunal to oversee the use of public funds. This is an autonomous institution responsible for external auditing, ensuring accountability and transparency of the Government and providing advice on best practices and procedures for future years, as well as acting on behalf of Mozambican State.

One of the shortcomings of Administrative Tribunal, according to the interviewees, is the fact that its President is appointed by the Head of State. They suggest that should be appointed by the Parliament on the basis of three proposals presented by the Mozambican President to give him/her a more informed degree of independence in judging government procedures.

2.4 How powerful is Mozambique's Ministry of Finance

A relatively powerful Ministry of Finance is critical in ensuring an efficient level of spending and allocation of public funds. In the early years of the country's post-independence period, institutional reforms carried out undermined the Ministry of Finance's authority by dispersing responsibility for resource allocation within the public sector as follows:

i. By decentralizing responsibility for financial management to line Ministries in 1975;

ii. By subordinating financial management functions to the central planning machinery introduced in 1981, and

iii. By passing responsibility for aid management to a separate Ministry of Cooperation.

As a result of all these changes in 1992 there were three institutions responsible for core resource management functions, namely, the Ministry of Finance, the National Planning Commission and the Ministry of Cooperation.

Post-war reforms 1992 consolidated planning and financial management functions in a unified Ministry of Planning and Finance (MPF) and placed the aid management function of the disappeared Ministry of Cooperation in the Ministry of Foreign Affairs. These reforms strengthened the MPF relative to other ministries. Fozzard (2002), when comparing the Mozambican MPF to others of Commonwealth countries saw lack of authority of that ministry.

However the new Government from the 2004 multi-party elections divided again both functions by creating two new Ministries of Finance and of Planning and Development. Notwithstanding the developments, recent reforms in centralizing inflow of resources under the control of the Ministry of Finance reduced "back-door" financing, thereby strengthening the power of the Ministry over macroeconomic variables which is important to fight against poverty. In addition, the Ministry of Finance today can exert control over line ministries by contesting agencies' budget proposals and regulating the monthly replenishment of accounts against statements of expenditure. The line ministries' authority over resource application decisions in their areas of competence is generally respected.

3.0 The Role of Other Stakeholders

3.1 The Role of IMF and World Bank

The International Monetary Fund and the World Bank Group play a crucial role in loan contraction not only as facilitators but also as loan providers and the main government advisers. The IMF and World Bank Group's opinion about the Mozambican economic performance is more important than the lending itself, as their favourable opinion opens additional doors to the country for debt lending and grants. However it is important to note the nature and content of IMF/ WB policy conditionalities, and their impact on the economy. An assessment of the impact of trade liberalisation on the cashew nut sector, reviewed that this adversely affected exports and hence increased the financial gap that may require further external assistance. Such policies lock the country into a vicious cycle of dependence and may create conditions for further borrowing and hence indebtedness

In Mozambique, the fact that all contracted loans must be in concessional terms apart from being imposed by the IMF, the World Bank Group and its branch the International Development Agency, makes these institutions the main providers of that kind of loans under PRSP. This justifies the role that the IMF and the World Bank Group play in budgeting and loan contraction processes, as budgeting is one of the four components of annual financial programming envisaging macroeconomic stabilization as a key factor for poverty reduction programme.

3.2 Mozambique and the IMF

The key role of the IMF is to ensure that macroeconomic stability and their assessment on the performance of each economy is crucial for other poverty reduction stakeholders. The IMF has set up a resident representative that allows closer discussions on the matter of common interest. The IMF resident representative has recently set up in the country but has little to do concerning missions from the headquarters, playing a rather supportive role. The role of the IMF representative is still marginal in loan contraction in Mozambique as all decision taking processes are still centralised in Washington.

a. Mozambique shares at the IMF until August 2005 were SDR 113,6 million representing 0.05% of the total IMF shares;

b. The first Mozambican financial agreement with the IMF was SAF (Structural Adjustment Facility) on June 8th, amounting to SDR 42.7 million for three years maturity (until 1990).

c. The second financial agreement was ESAF (Enhanced Structural Adjustment Facility) that was initiated in June 1st 1990 until 1993, of SDR 130.05 million with the same maturity;

d. The third agreement was ESAF and approved on June 21st 1996 for an amount of SDR 75.6 millions until 1999.

e. The fourth financial agreement was ESAF which was later changed to PRGF that was executed from June 28th 1999 until June 28 2003 amounting SDR 87.2 million.

f. And the fifth agreement was approved in July 6th 2004 until July 5th 2007 by amount of SDR 11.36 millions under PRGF.

The IMF lending procedures are still classical ones; no important practical policy changes have been made even under Poverty Reduction Growth Facility. Mozambique still has a three year programme; disbursements under the requirement of good performance related to tight macroeconomic targets; single digit inflation and tight monetary policy which are a pre-requisite for poverty reduction. The amount provided is related to the county quota at the IMF.

3.3 The World Bank Group

a. The World Bank Group assistance to Mozambique is mainly focused on economic rehabilitation projects with the aim of enhancing a shift towards a market economy and promoting social sectors in order to reduce poverty in the country.

b. According to the World Bank Resident Mission, Mozambique has already benefited until now (2006) from eight adjustment credits and fifty eight investment credits amounting around 3.0 billions USD distributed as follows in Table 4.

Table 4 - World Bank Credit Distribution by Sectors in Mozambique

Sectors	Amount in %
Transport	38
Education	16
Water and sanitation	14
Agriculture	04
Others	28

c. Mozambique under the HIPC initiative benefited to the tune of 2.023 millions USD of which 875 million USD was from the World Bank Group. Today, the World Bank Group is Mozambique's major multilateral creditor.

The World Bank Group has more experience in this regard and they were pioneers in set-up a resident mission in Mozambique to provide oversight over Malawi and Angola, apart from Mozambique.

The World Bank Group maintains the central approach of PRSP related to the principle that countries should own their strategies. In Mozambique the resident mission helps more with national involvement in the design of national strategies. With the World Bank Group, many negotiations are being conducted by their resident representatives or via video conferences that reduce time consuming processes as well as other financial resource related to the negotiations.

The World Bank Group assists the country under the Country Assistance Strategy (CAS) plans, which support the Mozambican government's poverty reduction plan. CAS is the main pillar of the World Bank Group through which interventions are identified in consultation with the local authorities with respect to projects for financial assistance.

In the case of Mozambique, there is no way that the loan contraction initiative should come from parliament or government unilateral initiative to present to the parliament before discussion with the IMF and World Bank Group, because according to our interviewees this procedure is considered time wasting. The IMF and WB are insisting that negotiations be undertaken as a basis for sustainable cooperation in Loan contraction. National ownership as provided for by the IMF through its PRGF framework and the World Bank's PRSP process implies the attainment of national consensus through the participation of all national stakeholders (government, Parliament, the private sector civil society). The research found out that the theory differs from mission negotiations practices.

The IMF and World Bank Group need to change on loans contraction on the following:

1. To hear more from the countries' authorities that are mandated by their people and best know the country reality;
2. To reduce conditionalities related to loans of which most are not inter-related;
3. To give more power to resident representatives to negotiate because they know the reality of the country and know what is being spoken about in practical terms;
4. Local countries government's need to hear their people and involve them and to be inspired by them in each loan contraction;
5. To reform the existing trade-off between restrictive monetary policy with one digit inflation target vis-à-vis additional funding to the budget support to spur growth to reduce poverty.

4.0 Energy Reform Access Project (ERAP) Loan Contraction: A Case Study

ERAP is a Government of Mozambique project that includes, among others, the following objectives:

- Use electricity for economic growth and social services improving the quality of life in un-served and under-served areas in both peri-urban and rural areas
- Strengthen the country's capacity to increase access to modern energy;
- The power sector reform component consists of separation of the EDM (Electridade de Moçambique) into several business units; and
- Participation of the private sector in EDM's distribution and supply business.

Total cost of the ERAP was 81.52 millions USD. As a huge project, it was cofinanced by the World Bank, African Development Bank and NORAD Funds.

The first step for this loan contraction process was the presentation of Government interest in developing rural electrification to attract additional investment to boost inclusive economic activities in the countryside as the majority of the Mozambican population is living in this area in order to reduce peri-urban and rural poverty. Clearly, it is a poverty reduction project with strong potential to change the quality of life of the population to benefit from its implementation.

The second step was project identification which for ERAP was done by the World Bank and by a team from Electricidade de Moçambique (EDM), a Mozambican electricity state-owned company, whose results were shared by all other creditors. During the identification phase, the World Bank offered the local team analysis where requested. During the same step the technical, institutional, economic, environmental, financial issues were studied and addressed.

The third step comprised of the appraisal mission. During this phase, review work was done of the outcomes of the previous step. The appraisal team produced a report which was presented to the local authorities for comments. After including Mozambican Government comments, the appraisal mission report was submitted to each board to get the green light. For this specific case the boards of the World Bank, African Development Bank and NORAD were involved.

When the boards approved the appraisal report, this was followed by the fourth step involving the loan negotiation process. The local authority team was constituted by the Ministry of Planning and Development, the Ministry of Finance, the Central Bank as government financial agent and the relevant sectors sector's officials (EDM) on one hand, and on the other hand, the team from each creditor.

- During the negotiations, the operational issues of the future agreement were discussed as follows:
- Disbursement conditions;
- Checks and balances related to the local laws that contradict what is already proposed in the approved appraisal report;
- Constraints to be faced in the operational stage of the project;
- Definition of the project financial implementing agent where the money will be disbursed from donor's account.

In addition the following documents were analyzed:

- The final version of the appraisal report;
- And other agreement documents (Conditions for local and international bids, bids evaluation, bid results, hiring process and models and contents of the contracts, etc).

The fifth step of the ERAP loan contraction process was the submission of the final agreement text for its signature between the Government of Mozambique and each creditor.

This agreement was sent to the Council of Ministers of the Government of Mozambique for ratification. The loan agreement ratification was sent to the General Attorney to issue the Legal Opinion that was distributed to each creditor.

Having the legal opinion the final step in the ERAP loan contraction process was related to the disbursement process by creditors to kick-off implementation of the project by EDM and supervision by each creditor who was interested to see if the terms of the contract were respected. For instance, the issues of concern were the bids for procurement guidelines of goods and services, and the need for audit of financial accounts of the loan execution. This loan is accounted as Mozambique's debt and the repayment will be done by public resources from the state budget and not as a project itself.

5.0 Multilateral Debt Relief Initiative (MDRI) Beneficiary

When all traditional debt-relief mechanisms for poor countries like Mozambique were originally conceived by Paris Club, there was a consensus that the debt relief involved would lead to the availability of greater budgetary resources to be channelled to the poor countries. In recent years, the international community has significantly committed itself and expanded its goals for debt relief for poor and aid-dependent countries, putting together debt-relief and aid allocation decisions.

Multilateral Debt Relief Initiative aims to help low income countries to achieve Millennium Development Goals by 2015. This relief consists in the cancellation of all existing IMF debt stock until December 2004 and all debt stock with African Development Fund until December 2003.

Within this context, in January 2006 the IMF cancelled USD 154.7 million, of USD 124.2 million within MDRI and the remaining USD 30.5 million within HIPC initiative. The World Bank (WB) and African Development Fund (ADF) cancelled, in July 2006, USD 1,306 million and USD 239 million, respectively. The Mozambican debt stock with the IMF, World Bank and African Development Bank is USD 3.5 million, USD 269.7 million and USD 303.6 million, respectively.

Table 5 shows the stock of Mozambican public debt in 2005, before and after MDRI

Table 5 - Stock of External Debt before and after MDRI

Description	Multilateral	IMF	WB	ADF	Others	ilateral	Total
Stock in December 2005	2,534.9	157.5	1,575.9	542.6	258.9	2,113.9	4,648.8
MDRI cancellation	1,699.0	154.0	1,306.0	239.0	0.0	0.0	1,699.0
Stock after MDRI	835.9	3.5	269.9	303.6	258.9	2,113.9	2,949.8

Source: Mozambican Debt Group

Table 4 shows the reduction in debt stock from USD 4,648.8 million to USD 2,949.9 million as a result of the implementation of MDRI. This reduction will result in the re-allocation of funds previously intended to service debt to investment in poverty reduction objectives.

The impact of MDRI is reflected not only in the reduction of debt stock, as shown in table 4 but also in improvement of sustainability indicators and the availability of resources for development activities. Over the last years, we have witnessed a considerable increase in investment in priority areas as a result of HIPC initiative and MDRI. Thus, overall, the education sector has received more resources, followed by infrastructures, health and governance, security and judicial sector. Although agriculture and rural development are critical in poverty reduction, the financial allocation to these sectors is very low. Similarly, resources allocated to HIV/AIDS are also insignificant if we consider the magnitude of the problem. Efforts should be made to increase the budget to these sectors, if poverty reduction is to become a reality to every Mozambican.

Notwithstanding these positive developments Mozambique is still a poor country and aid-dependent in order to function properly and to invest in the public goods in order to create a suitable climate for domestic and foreign investment. This means that the country needs additional foreign assistance and grants for its growth and to impact on the social side of its people. The Mozambican civil society opinion is that the results from MDRI although good, do not compensate the sacrifice of living under conditionality imposed by the IMF and the World Bank Group.

It is true that MDRI was designed with indicators of debt sustainability rather than poverty reduction even given that that was the objective of donor community in that regard when they decided to enhance the HIPC initiative. As already seen in Table 1, the country still needs additional flows of funds to finance public investment, essential to attract private investment and for sustainable growth. Apart from the provision made by the IMF and the World Bank Group that the country should look for loans on concessional terms, and to support budget execution and monitoring, there is no structural change to be mentioned.

It is significant to mention that institutional provisions have been made between the budget support group and the Mozambican government to channel each and every support through the budget in order to reduce the volume of the off-budgets and to increase the government ability to control all the state operations and variables that affect the economy as whole. This effort can be seen also as a way to have better absorption of foreign aid and avoid any additional borrowing with negative impact on the future debt sustainability. Fiscal reforms are underway that improve revenues collection and reduce gradually its dependence on foreign assistance.

Mozambique still has many structural problems as follows:

- Undeveloped agricultural practices yet the majority of Mozambicans are strongly dependent on it;
- Lack of infrastructure (roads, water management, energy, transport, market information).

These features demand additional institutional reforms to be made; meaning that external financing is crucial for changes as well as debt relief is still needed to spur additional investment, for growth that generates employment and further poverty reduction.

It is important to remember that MDRI was brought to the international agenda through civil society pressure in the developed countries. These international organizations play a very important role in Mozambique in an effort to build a strong Mozambican civil society through different means (financial support, workshops to deliver experiences, etc). Today in Mozambique there are many fora that gather the government, donors, private sector and the Mozambican civil society to discuss issues of common interest, like Observatorio da Pobreza i.e., Poverty Observatory, where results, policy performance and instruments pursued do reduce poverty in the country are discussed.

It is important to note that good performance implies good allocation of resources, and avoiding mismanagement of public good for self interest. The government created under umbrella of the General Attorney the Anti-Corruption Cabinet to deal with all related cases. We expect to see some actions in terms of preventing corruption cases as well as applying corrective measures to those who violate ethic principles. Additionally, the civil society created its own organization (Ética) to promote accountability, and transparency on public good management.

6.0 Human Rights Obligations And Mdg Status

The MDGs are seen as the reaffirmation by the world's leaders of their collective responsibility to uphold the principles of human rights, equality and equity as universal. There are eight main goals to be achieved over 25 years (1990-2015). After 1992, the year the peace agreement was signed, Mozambique is seen as one of the successful stories of post-war reconstruction and economic recovery. Table 6 shows the assessment of the performance of government in its responsibilities as a duty bearer to its citizens with regard to the attainment of the Millennium Development Goals in the country.

Table 6 - Mozambique's Progress Towards MDGs

Goal	Will the goal be met?	Supportive environment
1. Eradicate extreme poverty and hunger	Potentially	Strong
2. Achieve universal primary education	Unlikely	Fair
3. Promote gender equality and empower women	Unlikely	Weak but improving
4. Reduce child mortality	Potentially	Fair
5. Improve maternal health	Potentially	Fair
6. Combat HIV/AIDS, malaria and other diseases	Unlikely	Fair
7. Ensure environment sustainability	Unlikely	Weak but improving
8. Develop a global partnership for development	Potentially	Fair

The country has recorded high economic growth in recent years, averaging about 9 percent from 1997 to 2005, and way above the average for the rest of the African continent and has made significant progress related to key indicators of human and social development, with substantial decline in child and maternal mortality rates and an increase in net enrolment rates.

Table 7 reports the current status of Mozambique with respect to achieving the MDGs using selected indicators.

Table 7 - Mozambican available key development indicators

MDG target indicator	1997	2003
1. Population living below the national poverty line (%)	69.4	54.1
2. Primary completion rate (%)	22.0	38.7
3. Under-five mortality rate (per 1.000 live births)	219	178
4. Maternal mortality rate (per 10.000 live births)	1.000	408
5. HIV/AIDS prevalence among adults (15-49 yrs in %)	8.2	16.2
6. Population with access to an improved water source (%)	37.1	52.0
7. Births attended by skilled health personnel	44.2	47.7

Source: PES-GoM

Despite these improvements, the country faces great challenges. The country remains one of the poorest in the world, ranking 168 out of 177 in UNDP's Human Development Index, the lowest in the SADC region. Additionally, the country ranks 133 out of 140 countries in the Gender Development Index.

HIV/AIDS remains the greatest threat to development in Mozambique and its prevalence among adults is increasing. To attain the MDGs, the country needs to reverse the incidence of HIV-AIDS, improve the efficiency of service delivered to the poor, focusing on employment creation, increase the state revenue and reduce foreign aid dependency and create a capacity for effective preparedness for periodic and devastating natural disasters.

If the idea of 100 percent cancellation of multilateral debt with similar initiatives in the context of Paris-Club to achieve the forgiveness of bilateral debt gathers the consensus is possible to speak about additional visible changes in the government of Mozambique human rights obligations.

7.0 Conclusion & Recommendations

Mozambique is a poor country and aid-dependent. In the medium run, the country will need additional loans to enhance growth that generates employment to improve the living standard of Mozambicans.

Additionally, the country faces the following main challenges:

1. Sustainability and pattern of growth. Despite the good economic growth and subsequent reduction in the poverty levels, there is much to be done. The current challenge is to strengthen loan contraction that generates growth and poverty reduction;
2. Improve the effectiveness of foreign assistance. The country is highly dependent on foreign aid which now represents 50 percent of the state budget, but its weight in terms of GDP has been gradually decreased;
3. Rapid growth of urban population. By 2015, they will be as many people living in urban areas as in rural ones. This pressure is challenging and needs to be addressed, and external assistance for additional urban infrastructure will be demanded.
4. HIV-AIDS pandemic. Increasing prevalence of this pandemic is shocking that affects mainly the poor households. As a result, workers become less productive, vulnerability increases with greater demand for healthcare. The country is not prepared to face alone this challenge demanding additional foreign assistance.
5. Vulnerability to external shocks (including natural disasters). Many Mozambican remain highly vulnerable to factors such as food insecurity, floods, droughts and diseases. Again Mozambique is unable to tackle this challenge without foreign assistance.

In order to improve the impact of loans contraction, Mozambique should pay more attention not only on loan contraction processes but also on project/programme implementation. The shocking examples of 23 percent and 25 percent of loan utilization from the World Bank Group and African Development Bank are a clear example of neglecting the implementation side.

The country is strictly complying with the IMF and World Bank Group focus on loan contraction in concessional terms that increases loans from multilateral institutions related to bilateral.

After consultation to the government, bilateral and multilateral organizations documents as well as conducted interviews, the study is in the position to present the following direct recommendations:

Government:

- Additional openness is required to build strong partnership between the government and the civil society in order to increase the access to primary information related to public good management;
- During the discussion of the budget, the government should present detailed information on the internal and external sources of financing to allow other stakeholders to have informed opinions;
- A formal mechanism of civil society participation is required in the budgeting processes as the annual state budget reflects the PARPA (poverty reduction medium term program);
- The government should consider the proposal of including civil society organizations in all training events carried out on the budgeting process and public goods management issues and all related aspects. These initiatives contribute to have a well informed civil society which is technically prepared to give to the government reasonable insights in all related issues.
- Accelerate efforts to register all externally financed activities in the state budget to enable improved coordination and planning.
- Increase support to productive sectors of the economy to alleviate supply-side constraints that hinder trade competitiveness;

- Improve effectiveness, transparency and predictability of aid in the spirit of Paris declaration, by further aligning donors' assistance with government priorities and harmonising planning and budgeting cycles.
- Ensure transparency and accountability in the management of all public funds.

Civil society:

- The Mozambican civil society should be more pro-active in designing a framework of its own intervention in the budgetary process rather than waiting for government initiatives. It should also advocate for its inclusion in loan contraction and public funds management processes.
- Civil society should continue to look for partners for training in areas where they think it is essential to develop knowledge because this is the best way to create space for dialogue with the government;
- Parliament:
- The Parliament should create formal or informal fora to exchange views with civil society organizations to have informed opinion during the plenary;
- During the discussion of fiscal accounts, Parliament should consult civil society on government performance;
- All evidences points to a strong linkage between the parliament and civil society as contributing to a more accountable and transparent government.

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