The PRGF and Fiscal Space in Mozambique

A Research Commissioned by AFRODAD

AFRODAD

African Forum and Network on Debt and Development

THE PRGF and Fiscal Spacein Mozambique

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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.

Preface

The impact of fiscal space on growth and achievement of the internationally agreed development goals has featured prominently on the research agenda of government development agencies, international financial institutions, and civil society organizations. The Poverty Reduction Growth Facility (PRGF) has remained topical in the discussions around the quest by countries in the South to regain control of their own fiscal space from the International financial institutions. The controversy over IMF polices especially the PRGF boils down to a difference of opinion over how and when governments should be allowed to invest in both infrastructure and basic services. The IFIs, CSOs and the UN Development Programme (UNDP) have contrasting views on how to increase fiscal space, that is, on how to enable governments to spend and invest more. In their definition of fiscal space, the UNDP stresses the quality of public expenditure since productive expenditures will foster growth and human development, a larger 'budget pie', and more fiscal space in the long-term. On the other hand, Scholars, policy-makers and activists have focused on how to mobilize resources, or create the 'space' in national budgets, to invest in achieving the internationally agreed development goals, including the MDGs.

In efforts to recover from economic crises, most countries in sub-Saharan Africa began implementing IMF- and World Bank-led structural adjustment programmes during the 1980s. Those programmes promoted policies to expand the role of the market and reduce that of the state in economic affairs. They curtailed public spending for education and health care, privatized state-owned enterprises and liberalized trade. African governments had to cede control over their economic decision-making in order to qualify for World Bank and IMF loans. The PRGF and the succeeding Policy Support Instrument (PSI, introduced in 2005) have been nothing less than a continuation of such policies but under the guise of a new framework. The policies contained in both PRGF and PSI remains consistent with the standard IMF austerity programmes that have proved deeply controversial over the last 25 years. The only difference is that the IMF through such instruments is seeking to polish up its appalling image of being a tough lender and disciplinarian in Sub-Saharan Africa. This study constitutes one of the several PRGF researches that AFRODAD commissioned as part of its contribution to the civic call for the IMF to free policy space and enable African governments to pursue economic resuscitation of their battered economies after many years of the ill-conceived structural adjustment programs.

This study discusses the PRGF and the question of fiscal space as perceived by the citizens who are affected by IMF policy instruments. Conditions are one of the most controversial aspects of IMF and World Bank lending. Critics often claim that the institutions do not pay adequate attention to how the conditions affect people's lives or the contradictory ways in which multiple conditions interact with each other. Many governments also say that the conditions prevent them from making decisions which should rightly be made by elected leaders and that they also fail to address the basic problems that hinder economic development. The study concludes by giving recommendations to both the Fund and the government(s) on how to deal with the question of fiscal space.

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Executive Director
AFRODAD

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List of Abbreviations and Acronyms

ESAF	Enhanced Structural Adjustment Facility
HIPC	Highly Indebted Poor Countries
IFRS	International Financial Reporting System
IMF	International Monetary Fund
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MEFP	Memorandum of Economic and Financial Policies
MTEF	Medium Term Expenditure Framework
NPV	Net Present Value
ODA	Overseas Development Assistance
PARPA	Plan of Action for the Reduction of Absolute Poverty
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Programme
PSI	Policy Support Instrument
SAF	Structural Adjustment Facility
VAT	Value Added Tax

EXECUTIVE SUMMARY

Despite tremendous efforts from governments across the world geared towards poverty reduction, billions of people still go to bed hungry, lack access to basic services and opportunities. World leaders have committed themselves to the attainment of Millennium Development Goals (MDGs) by 2015. This commitment will only be achieved if substantial debt relief is provided to low income countries to enable them to increase their investment in priority areas.

The IMF in Mozambique

Mozambique is a low income country that was highly indebted and joined the IMF in 1984 to seek support for the implementation of activities aimed at re-invigorating the economy and promoting growth, after many years of armed conflict that destroyed economic and social infrastructure. The IMF provided support under Structural Adjustment Facility (SAF), Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction Facility Growth (PRGF) all aimed at promoting economic growth through macroeconomic and monetary stabilisation and implementation of structural reforms tied to structural benchmarks and quantitative conditions. The PRGF in particular seeks to establish a link between growth and poverty reduction, through the formulation and implementation of Poverty Reduction Strategies Programs (PRSP) and the allocation of resources to priority areas. Thus, Mozambique formulated its PRSP/PARPA (Plan of Action for the Reduction of Absolute Poverty) I and II for the period 2001/2005 and 2005/2009, respectively.

Given that Mozambique was successfully implementing PRGF, it became eligible to debt relief under HIPC (Highly Indebted Poor Countries) initiative and Multilateral Debt Relief Initiative (MDRI) and benefited from a significant debt reduction, allowing the country to contract new loans to finance its development programme.

The implementation of PRGF has been subjected to many criticisms due to its structural conditions and benchmarks that are hard and sometimes with hurtful effects to the poor that the program is supposed to help. However, an evaluation to PRGF shows that it has contributed to debt relief, economic growth and poverty reduction. Through the compliance with the macroeconomic, financial and fiscal targets and structural reforms, the economic indicators have improved significantly and the level of poverty has decreased. From a total of 70% of the population who lived below poverty line in 1997, this number reduced to 54% in 2003.

The PRGF and Fiscal Space

Overall it can be said that fiscal space has increased in Mozambique due to debt relief, economic growth and donor contributions. The implementation of policies and strategies that allowed the country to benefit from debt relief and increase national revenues has led to government ability to increase investment in critical areas without prejudice to the sustainability of financial position. The government was able to increase public expenditures over time while maintaining fiscal and monetary targets and the sustainability of expenditure. However, it is important to note that fiscal space increased within the framework of a restrictive development model.

However, this increase occurred in the context of a restrictive development model in which compliance with macroeconomic targets and structural benchmarks set by the Fund is prior to the definition of government's priorities for resource allocation. In education, for example, in 2007 the government was restricted in the recruitment of teachers to meet its needs consistent with the attainment of MDGs.

The PRGF has contributed to economic growth, which enables the government to allocate more resources to priority areas. Through IMF positive signalling, PRGF has also contributed to donors' willingness to provide more resources to Mozambique, which led to an increase in fiscal space. However, the increase in assistance from development partners has come up against the IMF's need to preserve the country's macroeconomic indicators, highlighting the weaknesses of the PRGF has a development strategy. For example, the government was unable to hire additional teachers and nurses due to constraints on its wage bill.

Agriculture is defined as a priority area for poverty reduction due to its potential and the fact that the majority of rural population depend on it for subsistence. However, the allocation of resources has been meager over the years and the country has not taken advantage of its potential. Moreover, PRGF, through its conditions, had a negative impact to the agriculture sector in areas with emphasis to the followings: the abolition of subsidies to ICM (Mozambique Institute of Cereals) and liberalization of the cashew industry. As a result, many factories closed and many families lost their income. Development partners also are reluctant to invest in agriculture due to its perceived low rate of return.

Many challenges remain though, which highlight the weakness of the PRGF as a development strategy. More than 50% of the population still live below poverty line and there are regional disparities. PRGF also affected the national income distribution because some companies created new jobs that allowed people to have some income. However, the pattern of growth based in mega-projects and capital intensive reduced the extent of job creation and hence, income distribution. In addition, the fact that companies can easily export their profit reduces their potential of creating further work posts.

Fiscal space also increased through borrowing from external and internal sources. As mentioned in the previous section, from 2004 to 2007 Mozambique borrowed about USD 1.1 billion to support its development programme. Recourse to debt external for countries who have just come out of unsustainable debts and have fragile economic base should be done with care and need reliable debt management systems. Otherwise, the gains obtained from debt relief can be lost in the presence of inability to sustain new debt obligations. Internal debt, on the other had has been used to increase fiscal space but it is expensive and can affect negatively the development of the private sector because the government would be competing for the same resources.

More has to be done to increase the level of fiscal space mainly from government revenues to reduce the level of dependency. Political space within PRGF process though, is still very tight. Apart from fiscal space, the country needs a political space in which the government and national institutions should decide on their development priorities and objectives and institute appropriate mechanisms of accountability. The PRGF document is not open to debate by civil society and other stake holders. As a result, there is lack of understanding about IMF programmes in different countries and weak interaction with non state stakeholders. In Mozambique there have been some consultations with IMF country representatives but the interaction needs improvement. Civil society would like to establish a communication channel with the Fund and be able to participate in the PRGF/PSI processes.

1.0 INTRODUCTION

We live in a world of absolute poverty in which millions of people lack income, access to basic services and information that would enable them to make choices regarding their lives. World leaders have committed themselves to the attainment of Millennium Development Goals (MDGs) by 2015 to be materialised by an increase in resources to poverty reduction priority areas. This was to be facilitated by debt relief through the Highly Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) as well as the promotion of economic growth through the adoption of the structural programme in the Poverty Reduction and Growth Facility (PRGF).

1.1 HIPC Initiative

Despite considerable economic growth in some low income countries, poverty eradication is still a mirage. The MDGs can surely not be met without a substantial debt relief, particularly in low income countries. The HIPC initiative is the major international scheme for debt relief and cancellation set up in 1996 by the World Bank and IMF to reduce poor countries' debt, giving them an "exit from unsustainable debt". Under this scheme the international community aimed to reduce the stock of debt to sustainable levels namely the ratios debt stock to exports of up to 250%, debt stock to government revenues of up to 150%, debt service to exports of up to 20%, debt service to government revenues of not more than 11%. At the same time, countries were required to strengthen the links between debt relief and poverty reduction efforts through the formulation and implementation of Poverty Reduction Strategies Programmes (PRSP) as well as promoting long term debt sustainability. By the end of 2006, 41 countries had qualified for debt relief under HIPC initiative, whose total cost in Net Present Value (NPV) terms was USD 67.7 billion. Mozambique was one of the first groups of countries to become eligible to benefit from HIPC initiative[1] .

One of the HIPC's requirements was the implementation of Poverty Reduction Growth Facility programme, which aimed to improve the fiscal position of the borrower governments. It was intended that PRGF supported programmes will in time be based on country owned poverty reduction programmes adopted in a participatory manner and articulated in a Poverty Reduction Strategy Paper (PRSP) to ensure that they are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty.

All countries embarking on PRGF programme are required to stabilise their exchange rates, implement tariff reforms, trade liberalisation and financial sector reform, eliminate price controls, undertake privatisations, pursue good governance and allocate resources to social sectors consistent with macroeconomic framework. They also have to adhere to the development model defined by the Fund. It was expected that with the implementation of the actions stated above borrower countries will be able to revitalize their economies through the achievement of higher rates of economic growth, stable monetary and fiscal indicators, well functioning public and private sectors and an increase in expenditure in priority areas for poverty reduction. Therefore, the combination of HIPC initiative and PRGF programme is expected to create and increase fiscal space in borrower countries.

Fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position. The incentive for creating fiscal space is strengthened where resulting fiscal outlays would boost medium-term growth and perhaps even pay for itself in terms of future fiscal revenue. Thus, any consideration of fiscal space requires judgement that higher expenditure in the short term, and any associated future expenditure, can be financed by current and future revenues and this can be articulated within the context of medium-term expenditure framework (Peter Heller, Understanding Fiscal Space).

Mozambique was a highly indebted poor country that benefited from debt relief initiatives that led the country to a sustainable debt. As a result, Mozambique has been financing its development programmes with resources that were previously devoted to debt service, thus contributing to the increase of fiscal space.

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[1] World Bank Group, Economic Policy and Debt – HIPC, The Enhanced Heavily Indebted Poor Countries, 2000

1.2 Background on Mozambique

Mozambique is a Sub-Saharan African country that gained its independence in 1975, after 500 years of Portuguese colonisation. The new government inherited an economy that was, under-developed and poor, with 90% of its population illiterate. To reverse this situation, the government embarked on ambitious development programmes with the view to reducing poverty and developing the economy. This effort was hampered by the massive exodus of Portuguese expatriates and lack of internal capacity to manage and sustain the development processes underway.

The situation was further aggravated by the outbreak of internal conflict that impeded the continuation of the development programme and destroyed the efforts made so far. The war resulted in thousands being killed and additional thousands being displaced. Social and economic infrastructures such as schools, hospitals, shops, power stations, railways, roads and bridges were destroyed. At this point, Mozambique was characterized by an unsustainable external debt, an uncompetitive economy, inefficient public sector and a centrally planned economy, to name a few.

The Mozambican government approached the International Monetary Fund to seek support for the implementation of programmes that would improve the performance of the economy, rehabilitate the social infrastructure and reduce poverty. Joining IMF meant accessing resources for development not only from the Fund but from other development partners, accessing opportunities for debt relief but also embarking on an endless implementation of structural reforms and conditionalities. Today, after 17 years of implementing International Monetary Fund supported programmes, Mozambique is still complying with IMF conditionalities within HIPC, PRGF and PSI (Policy Support Instrument) frameworks.

Mozambique was one of the countries whose level of indebtedness hampered development efforts and the wellbeing of its population due to debt service obligations. The external debt grew overtime, reaching unsustainable levels in the eighties and its pick in 1998. This situation was a result of internal factors mentioned above as well as external factors such as high interest rates in the international markets, unfavourable terms of trade, economic sabotage from the apartheid and natural disasters. Table 1.1 below shows the evolution of external debt over twenty years and the impact of debt reduction mechanisms namely HIPC and MDRI.

Table 1.1 Stock of External Debt in Million USD (1985 - 2006)

Year	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Debt Stock	2,794	3,157	3,898	4,210	4,391	4,960	4,995	5,041	5,011	5,277	5,472
Year	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Debt Stock	5,692	5,480	6,056	5,712	5,002	4,941	3,606	3,939	4,427	4,649	3,226

Source: Mozambican Debt Group, Seminar on Debt Management, 2007

The stock of external debt in 1985 was considered unsustainable given the country's incapacity to generate enough resources to service debt while responding to development needs. Moreover, the then prevailing poor economic performance, the impact of debt rescheduling mechanisms that led to further increase in debt and the need to contract new loans to respond to national pressing needs led to higher levels of external debt, reaching its maximum high of over USD$6.0 billion in 1998.

Within this context, Mozambique together with other low income countries benefited from HIPC initiative. In April 1998 and 2000 the country reached the decision points for HIPC I and II respectively. In June 1999 and September 2001 Mozambique reached the completion points, with an expected debt relief of USD$4.3 billion.

Following the decision made by the G8 in 2005 to further reduce debt of low income countries that had successfully implemented macroeconomic policies, PRSP and good management policies, Mozambique was eligible to benefit from MDRI. Thus, in 2006 the country received a cancellation of USD$153 million from the IMF and USD$1.2 billion from the World Bank, of which $34 million and $945 million respectively related to HIPC II. The African Development Fund agreed to cancel USD$526 million of Mozambican debt.

These debt reduction mechanisms have helped the country to reach and maintain a sustainable debt so far, increase the confidence of private investors and create fiscal space by enabling the government to borrow more resources for its development programme. It is important to note that the IMF has been advising the government in the process of loan negotiation, while encouraging other creditors to provide debt relief.

The impacts of debt relief in Mozambique are many. The external debt stock and its related service payments. The level of international reserves has subsequently improved. There has been more public investments in the priority areas for poverty reduction.

As part of the HIPC programme, Mozambique embarked on the implementation of PRGF programmes and also benefited from HIPC initiatives, the requirements for which included an adoption and implementation of a Poverty Reduction Strategy. The country is implementing its second Poverty Reduction Strategy Programme that ends in 2009, whose priority areas are consistent with Millennium Development Goals. In fact, the government has created a matrix that encapsulates the commitments within PRSP, MDGs and NEPAD frameworks in order to facilitate monitoring the achievement of the targets.

1.3 Statement of the Problem

The main objective of this study is to strengthen the links between debt relief and poverty reduction policies and to demonstrate their usefulness in understanding the fiscal and macroeconomic issues that will arise from an increase in aid flows to Mozambique. In this context, the research aims to make an assessment as to whether the fiscal space created by the PRGF has indeed improved and contributed to the country's development strategy.

Specifically, the study seeks to:

- Present the challenges and failures from the implementation of the PRGF.
- Establish how the PRGF has been underpinned within the national macro - economic framework and establish how the programs have shaped the public expenditure framework.
- Establish the linkage between the program with various national instruments including National development plans/visions/strategies, Medium term expenditure framework, National Budget, and Sector allocations.

To this end, the study starts by giving a background on Mozambique prior to PRGF. Then it presents the different contractual arrangements between the Fund and the Government of Mozambique and discusses the conditions and benchmarks associated with the implementation of PRGF as well as its outcome. Given the importance of debt relief on fiscal space, the situation of debt in Mozambique is presented, with emphasis given to the impact of PRGF on external and domestic debt and the impact of debt relief on fiscal space. Then the study presents the linkages between PRGF and poverty reduction. Finally, discussion is made on the impact of PRGF on resource allocation and income distribution, followed by some conclusions.

2.0 Mozambique and the IMF

Mozambique joined the IMF in 1984 to seek support for the implementation of activities aimed at re-invigorating the economy and promoting growth, after many years of armed conflict that destroyed economic and social infrastructure. IMF provided support under SAF, ESAF and PRGF all aimed at achieving economic growth through macroeconomic stability and implementation of structural reforms tied to structural benchmarks and quantitative conditions. An evaluation to PRGF showed that, despite several criticisms to its conditionalities, it contributed to debt relief, economic growth and poverty reduction.

2.1 A Historical Account

Mozambique joined the IMF in 1984, following the President's announcement that the country was no longer able to pay for its external debt. The International Monetary Fund supported programme was launched in 1987 and involved shifting from a centrally planned economy to market based economic policies and structural reforms. This programme consisted of the implementation of major reforms that included the unification and stabilisation of the exchange rate, significant tariff reforms and trade liberalisation, the elimination of most price controls, privatisation of public enterprises and extensive financial sector reform.

For the implementation of this programme the Government formulated Medium Term Macroeconomic Frameworks consistent with IMF requirements and signed several financial arrangements through SAF (Structural Adjustment Facility) and ESAF, that was later transformed into PRGF. Presented below is the information on lending instruments' approval and expiration dates as well as the amounts approved and drawn:

Table 2.1 Contractual Arrangements between IMF and Mozambican Government

Type	Approval Date	Expiration Date	Amount Appr. USD million	Amount Drawn USD million
PRGF	7/20/2004	7/5/2007	15.16	
ESAF/PRGF	6/28/1999	6/28/2003	116.36	60.31
ESAF	6/21/1996	6/27/1999	100.88	100.88
ESAF	6/1/1990	12/31/1995	173.55	153.87
SAF	1990		56.98	

Source: IMF Country Report nº 01/17, January, 2001; Moz. Government Letter of Intent, June, 2004 and Loan Contraction Process, Pimpão and Marta Cumbi, 2007

ESAF is a concessional IMF facility for assisting eligible members that are undertaking reform programmes to strengthen their balance of payments and improve their growth prospects. The overall ESAF objective in Mozambique for 1996-98 was to raise domestic savings and improve the allocation of resources to create the conditions for growth and poverty reduction. Basic macroeconomic objectives were geared towards achieving average annual growth of 5%, reducing the rate of annual inflation to 10% by 98 and increasing international reserves to 4 months of imports. For structural reforms the program aimed to accelerate privatisation and financial sector reform, export promotion, strengthen the revenue base and implement public administration reforms namely decentralisation and civil service reform, promotion of greater transparency and accountability in the public finance and in the regulatory systems as well as strengthening of the judicial system. Emphasis was also given to the social sector whose activities consisted in the development of the agriculture sector, the revision of safety nets, completion of Poverty Assessment Action Plan, expansion of the primary and secondary education and improvement of primary health care, responding to mother and child needs as well as training of the mid-level health professionals.

An evaluation made to the ESAF supported programme showed that macroeconomic performance improved markedly under which Mozambique consolidated its recovery from the war and raised depressed per capita income.

The economic growth rose from an average of 6.7% a year during 1987-95 to 10% in 1996-98. The inflation rate declined from 50% in 1995 to less than 1% in 1998 and gross international reserves were 4 months of imports in 1998. Expenditures in social sector also improved: education expenditure rose from 16% in 1996 to 18% in 1998 and health expenditure rose from 7% to 9% in the same period[2]. This strong performance was fostered by prudent fiscal and monetary policies, political stability and favourable external developments. Increased confidence in the economy was reflected in higher levels of foreign aid, long-term capital inflows and a stable exchange rate[3].

The IMF Directors recognised the challenges facing the country to reduce high incidence of poverty that affected 70% of the population. They stressed the need to increase government revenue, strengthen tax administration and reduce exemptions and tax distortions. They also encouraged the Government of Mozambique to preserve the reform path highlighting the emphasis given to civil service reform, the improvement of legal and judicial system, the development of the financial system and the encouragement of private sector to participate in the provision of public services. With the recognition that entrenched poverty and severe inequality in economic opportunities and asset endowments can themselves be an impediment to growth, there was the formulation of a Poverty Reduction Strategy (PRSP) by the government with the active involvement of civil society, NGOs, private sector, donors and international institutions.

In 1999 the Mozambican government designed a programme termed Plan of Action for the Reduction of Absolute Poverty (PARPA) meant to implement activities with the view to reduce the number of people living in absolute poverty. A family survey undertaken in 1996/7 had shown that 70% of the population lived in extreme poverty mainly in rural areas. It also revealed that 60% of the population, especially women, was illiterate, only 12% of the population had access to clean water and maternal mortality and infant mortality were 175/100,000 and 147/100,000, respectively. To comply with the new conditionality imposed by the IMF, Mozambique transformed its PARPA into PRSP by incorporating the macroeconomic framework and observing the core principles mentioned above. Thus, the first PRSP/PARPA I covering the period 2001 to 2005 was approved by the Council of Ministers in April 2001.

PARPA I was a medium term plan which contained the strategic vision for poverty reduction, including the main objectives and key actions. Its specific objective was to reduce the incidence of poverty from 70% to 60% in 2005. PARPA I focused its activities in seven fundamental areas namely: education, health, infrastructures, agriculture and rural development, governance, law and justice and macroeconomic and financial policies.

2.2 PRGF Arrangement

The Poverty Reduction and Growth Facility (PRGF) is the IMF concessional facility for low-income countries that aims to promote sustainable development and growth while tackling poverty. The IMF approved the first PRGF for Mozambique in 1999. The 1999/2002 government programmes supported by PRGF aimed to consolidate economic growth achieved under ESAF (10% in 1999 and 7% in 2000-1), maintain low rates of inflation (5% in 1999 and onward) and increase gross international reserves to about five months of imports of goods and nonfactor services (1999-2001).

To achieve these objectives the government set itself to continue emphasizing financial discipline, outward-looking policies, and the creation of an environment conducive to private investment. The authorities were also committed to pursuing structural reforms. Overall, the government programme sought to promote fiscal sustainability, improve the efficiency and transparency of the budgetary process, ensure the sustainability of public expenditure programmes, reduce further the extent of state participation in the economy, develop an efficient and accountable public administration, improve monetary management, create competitive and sound banking system and increase the openness of the economy.

Mozambique continued to make progress in the implementation of its programme under this new financial arrangement. However, some setbacks were experienced due to the occurrence of floods that affected the central and southern part of the country in 2000.

[2] IMF, Public Information Note nº 99/61, July14, 1999

[3] IMF, Press Release 99/25, June 28, 1999

Nonetheless, economic growth rose from 1.6% in 2000 to over 13% in 2001, inflation rose to 22%, revenues were ½% of GDP higher than programmed, current account deficit after grants narrowed to 11% of GDP and net international reserves increased.

On the structural reform front, by 2001 over 1,300 public enterprises had been privatised, granted for concession or liquidated and career streams and new compensation system were implemented.

In addition, the government has been making some progress towards the achievement of the Millennium Development Goals. Some improvements were registered in some areas between 1997 and 2003 period, namely: the number of people living in absolute poverty reduced from 70% to 54%, enrolment in primary education rose by 25%, gender disparity (ratio girls to boys) in primary education improved from 0.71 to 0.83, under five mortality rates reduced by 19%, infant mortality reduced by 16%, maternal mortality decreased from 1,000/100,000 to 408/100,000[4] .

Despite the implementation of IMF-supported programmes over 13 years and impressive economic growth, social indicators remained below the averages of other Sub-Saharan countries and the HIV and AIDS indicators worsened, with its incidence widening from 8.2% in 1997 to 16.2% in 2004. Moreover, there were still macroeconomic concerns namely low government revenues, low domestic savings, high external dependency, weak legal and regulatory environment for the private sector and lack of qualified public servants for public administration. This situation can be attributed to the fact that Mozambique does not have an integrated development strategy that responds to the root causes of poverty. There are isolated sector strategies that do not complement each other, there are external influences to national agendas and there is lack of adequate resources and capacity to deal with development challenges. In addition, income distribution is still very weak; i.e., the increase in GDP is not necessarily reflected in income distribution in an equitable way.

The last PRGF arrangement for 15.16 million USD was approved in July 2004 to support the implementation of the Government Macroeconomic programme for 2004-2007. The programme aimed at consolidating macroeconomic stability and addressing the remaining structural adjustment challenges to sustain and broaden growth, promote employment and further reduce poverty. The policies envisaged in the PRGF-supported programme were consistent with PRSP/PARPA priorities and also with the Social and Economic Programme regarding budgetary allocations and policy interventions.

The medium term macroeconomic framework for 2004-2006 envisaged to achieve the following:

1) Real GDP growth of over 8% in 2004 due to MOZAL and Sasol income tax and a slower growth of 6 ½ - 7% per year in 2005/6; and 2) End of year inflation of 11%, 8 ½% and 7% in 2004, 2005 and 2006, respectively, in response to maintenance of prudent fiscal stance and tighter monetary conditions. Aid flows were expected to increase to US$735 million in 2004 and down to USD$700 million in 2005/6. Within the fiscal programme the Government sought to continue with progress in fiscal consolidation to provide adequate room for credit to private sector while allowing for higher expenditure in priority areas.

Within the fiscal programme the Government sought to continue with progress in fiscal consolidation to provide adequate room for credit to private sector while allowing for private expenditure in priority areas. Thus, the primary deficit was projected to 3.3% of GDP in 2004 and 3% in 2005/6. The revenue was expected to strengthen due to better tax administration and higher receipts in royalties from megaprojects and the reduction in wage bill as a result of a prudent wage policy. This would offset the shortfall of inflows in external funding and allow for an increase in locally financed capital expenditure in priority sectors.

The current account deficit after grants was projected to decline to 2% in 2004, with exports increasing more that 40% of GDP owing to Mozal II and Sasol and imports reclining due to the completion of construction phase in megaprojects. However, in 2005/6 the deficit was expected to widen to 7% as a result of the initiation of other large scale projects, including the titanium ore project. Gross revenues were expected to be 5 ½ months of imports by the end of 2006.

[4] Government of Mozambique, Report to the Millennium Summit, 2005

According to the Sixth Review under the PRGF arrangement economic performance was strong in 2006 with the economic growth reaching 8.5%. The rate of inflation also reduced from 14% in 2005 to 9.4% in 2006. Fiscal position was better than programmed in 2006 due to the effect of corporate and personal taxes.

For the whole PRGF period GDP growth remained strong and inflation rates were high but under control, due to cyclical occurrence of emergency situations that have been affecting the country almost at a yearly basis. Presented below are main economic indicators from 2001 to 2006.

Table 2.2 Economic Indicators from 2001 to 2006

Year	2001	2002	2003	2004	2005	2006
GDP growth (%)	13.1	8.2	7.8	7.5	6.2	8.5
Inflation Rate (%)	21.9	9.1	13.8	9.1	14.0	9.4
Current Account Deficit (% GDP)	2.1	3.0	2.6	1.7	2.0	
International Reserves (% GDP)	6.1	5.2	5.0	5.7	5.8	4.0

Source: GMD, Debt Management Seminar, 2007; Aid Delivery and Country's progress, 2008

This improved economic performance and support from development partners had a positive effect in the increase of expenditure to priority areas such as education, health, infrastructure, agriculture and rural development and governance and judicial reform. This expenditure accounted for 65.7% of the total in 2006, above the PARPA II target of 65%.

2.2.1 Structural Benchmarks and Quantitative Conditions

Structural benchmarks and quantitative conditions are an integral part of the Memorandum of Economic and Financial Policies of the Government of Mozambique with the IMF. All the reviews undertaken under the PRGF arrangement evaluate the extent to which the structural benchmarks and the quantitative conditions have been met. These are many and will not be listed here. However, for a better understanding of the impact of quantitative conditions and structural benchmarks covering the period 2000 to 2006, a summary highlighting the main areas of reform and their perceived contribution to the fiscal space is presented. It is important to note that the reforms of later PRGF are a continuation of actions from the previous ones. Therefore, all of them were expected to contribute to economic growth and poverty reduction through the improvement of macroeconomic targets and increase in resources allocated to poverty reduction priority areas:

Legislation

Formulate, revise and submit to the approval of the Parliament laws and regulations of the following: tax and customs reform (update number and reinforce capacity of customs personnel, widen the tax base, and improve tax collection and administration); governance, transparency and legal environment (review of transparency of fiscal management in relation to the Code of Good Practices in Fiscal Transparency and formulate new commercial code for companies and contract law); trade policy (undertake reviews of sector policies).

Monetary Policies

Adopt flexible exchange rates; exercise monetary control; develop timetable to gradually move to IFRS in the commercial banking system and to comply with loan classification and provisioning based on best international practices; recapitalisation of the Banco Austral and Banco Commercial of Mozambique.

Financial Management

Roll out e-SISTAFE in all ministries, provincial departments and in selected districts; establish tax tribunals in Maputo, Beira and Nampula, prepare the budget execution report on the basis of accounting generated by e-SISTAFE, abolishing the advancement of funds; complete audits of compliance with taxes of large taxpayers

Public Sector Reform

Continue the privatisation process and seek decision regarding the future of public enterprises and companies with majority state ownership; complete feasibility study on the divestment of the Government's participation in BIM (International Bank of Mozambique); produce social sector indicators, update civil service employment data and related benefits, review Labour Law

Governance

Creation of institutions and systems to fight corruption; publication of survey on Corruption and Governance; In the social area, continue to improve health and education by improving the allocation of resources to priority areas, strengthen the decentralization process as well as strengthening the overall performance of public institutions.

2.2.2 Outcome of PRGF Reviews

The implementation of PRGF in Mozambique expired in July 5, 2007. Several reviews highlight the commitment of the Mozambican government in continuing to consolidate macroeconomic stability that has led to sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and second wave of structural reforms. The stabilisation of the exchange rate, the control of the inflation, the improvement of the fiscal position and increase in investment in social sectors were among the achievements of this programme. Some structural benchmarks and quantitative conditions were instrumental to the achievement of this result

These are presented below:

1) The improvement of fiscal position was a result of the implementation of tax reform that consisted in reforming revenue administration, widening the tax base, better tax collection and administration, reform of the public service (update of the public servants database and revision of public service policy). This has contributed to reduction of fiscal deficit and an increase in investment to priority areas. The approval and implementation of a diversity of legislation to better business environment, introduction of VAT (value added tax) and the implementation of e-SISTAFE, contributed to the increase in internal revenues.

2) Monetary policy has remained prudent due to flexible interest rates in government securities, following the removal of interest caps in 2006. Flexible exchange rates also contributed to the control of the money circulation within the economy. These policies were instrumental in the control of inflation over the years.

3) Reforms made in public sector such as census of the civil servants to determine the exact number of workers has eliminated ghost workers. The revision and implementation of income tax for all public and private workers, the establishment of tax tribunals in different cities have also had an impact in the increase of government revenues.

4) Some privatisations also had a positive impact in the sense that the government was freed from supporting operational expenses, new companies boosted production and generated income that was captured through taxation.

It is important to note that compliance with these conditions was a challenge. Some conditions had an immediate negative impact to the population but the government had to meet them to ensure to remain on track and receive further funding. In fact, the more a country complies with conditions the more it has access to resources. Another challenge for the implementation of PRGF was the lack of flexibility of the macroeconomic model and the one size fits all principle. Finally, the structural benchmarks and quantitative conditions are imposed and restrict the growth of money base, primary deficit and government expenditure.

The outcome of the PRGF should be analysed within the overall development context. . While the IMF provided resources for strengthening international reserves, other donors were funding other programmes such as privatisations, governance, macroeconomic stabilisation, civil service reform, education, health, HIV, infrastructures, all with benchmarks and quantitative conditions within PRGF framework.

Therefore, PRGF impact can not be singled out but seen as an integral part of development efforts. The signing of peace agreement and prevalence of peace were also major contributors to the outcomes. The overall evaluation of PRGF is positive because it contributed to the transformation of a country that was highly indebted, poor and unfeasible to what is termed now as a "success story" on economic recovery and poverty reduction.

The reviews undertaken by IMF and Mozambican government teams emphasized the commitment of the authorities in continuing to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction. The IMF welcomed the Mozambican government by pursuing prudent macroeconomic policies over the years and by implementing first and second waves of structural reforms. The results of these efforts are self explanatory: Mozambique has been experiencing high economic growth rates, rates of inflation under control, comfortable international reserves and poverty reduction.

As per the final PRGF review, economic growth accelerated to 8.5% in 2006. The inflation rate was down from 17.7% in April to 9.4% in December 2006 and further to 5.4% in February 2007 but rose sharply to 12.10% in December of the same year due to the rise in oil and food prices[5]. The net international reserves were over 4 months of imports[6]. Fiscal position was strengthened due to better tax collection and reduction in expenditure, resulting in the consolidation of the domestic primary deficit. Aid flows were higher than expected and share of priority spending is in line with 65% PARPA target. Progress was also made in increasing access to finance to rural areas and on the implementation of structural reforms particularly in the areas of public sector, cost of doing business and governance.

According to the World Bank, "the pro-poor growth was a result of the response of farmers' families and family businesses to government economic policies pro- development. Many farmers increased the diversification of their production, improving food security and nutrition. Others were involved in commercial farming in small scale, increasing their income through the sale of the surplus or diversifying to export goods such as tobacco and cotton. Another factor that contributed to poverty reduction mentioned above was the growth of the private sector of extended base and intensive labour that had an income distribution element. At the same time, the investment in social and economic infrastructure expanded the access to public services, reduced inequalities in social benefits and supported the living standards of the average Mozambican. Capitalizing on donors' willingness to support good projects in disadvantaged regions and government's commitment to use them for poverty reduction, major achievements were made in the construction of roads and education, where the investment was around 20% of the overall government's expenditure, which produced higher improvements to poor families and from rural areas"[7]). Government policies were critical in this process. However, it is also important to note that economic growth started from very low levels because of the effect of war. Productive capacity was underutilised and farmers could not work the land. Following the peace agreement in 1992, factors of productions were put to work and farmers who had been displaced returned to their homelands and re-started their lives, working the land, even with little or no support from the government.

Despite this impressive positive outcome, PRGF conditions brought some negative effects to the populations, especially the poor. Some of the most controversial and highly publicized conditions imposed to Mozambique are related to (i) the liberalization of the cashew nut sector, (ii) the privatization of the state owned enterprises, (iii) adjustment of the prices of water, transport, electricity, petrol and communications to reflect the market price; (iv) abolition of the subsidies to the National Institute of Cereals and v) curtailing of expenditure in public sector. These conditions led to severe negative social impact in the households, as with liberalisation and privatization, some enterprises closed, the unemployment rate increased and with adjustment in prices of essential services many citizens could not afford to pay to benefit from such services. According to the Trade Unions estimates, over 120,000 people lost their jobs as a result of the privatizations. Although the privatisation of certain companies can be deemed necessary, lack of mechanism to follow up on privatised companies and absence of social security schemes to worker who lost their jobs, constituted major obstacles to this process.

[5] IMF, Six Review under PRGF arrangement, March 28, 2007

[6] Government of Mozambique, Memorandum of Economic and Financial Policies of the Government of Mozambique for Sixth Review under PRGF and for PSI – June 2007 – June 2010, of March 2007

[7] World Bank, Reaching the Improbable – Sustain the Inclusion in Growing Economy in Mozambique, 2007

Curtailing of the government expenditure led to shortage of teachers and nurses and/or their lack of motivation. This has contributed to overcrowded classrooms, provision of bad services and low quality of education and health service.

The recent turmoil that caught Mozambique by surprise due to the rise in transport costs can also be a reflection of how some people live on the edge between poverty and decent living. It is worth noting that the turmoil took place in capital cities in which workers and students took part claiming that their income can not support the rising cost of transport and the overall raise in the cost of living. This situation is more dramatic to rural people with no regular income and appropriate social support systems. Thus, the possibility of relapsing poverty should be analysed and handled with appropriate actions.

2.3 PRGF and Indebtedness

2.3.1 Public External Debt

The implementation of PRGF supported programmes had an impact on the level of indebtedness of the country in two ways. On one hand, the implementation of PRGF allowed Mozambique to access resources from the multilateral and bilateral sources, be it in terms of grants or credits. On the other hand, the fact that Mozambique was on track with the implementation of PRGF led to access to debt relief under HIPC and MDRI. The government has always been cautious about the observance of macroeconomic targets set by the IMF when evaluating the options to contract a loan. Moreover, the IMF gives assistance/advice to the government in the process of loan negotiation, which could also imply some guidance on the level of debt consistent with macroeconomic targets. In order to minimise the impact of debt burden, the government has decided to comply with some basic loan management principles namely a loan with a concession element of at least 35%, maturity period of not less than 21 years with 6 years grace period and interest rate of less that 3%.

PRGF, through HIPC initiative and MDRI, has contributed to the reduction of debt stock and its related debt service. The overall debt relief under HIPC and MDRI is expected to reach USD 5.28 billion of which USD 4.3 billion from HIPC and USD 980 million from MDRI. In 2006 the level of indebtedness after HIPC and MDRI was USD$3,226.4 million, representing 41% of GDP, 130% of exports and 3 times the state revenues. According the IMF estimates, the external debt after MDRI for 2008 is USD 2,187. Debt service has also reduced as a result of debt cancellation. For 2004, 2005 and 2006 Mozambique paid 4.2%, 3.7% and 2.9% of GDP, respectively. This level is considered sustainable according to debt sustainability analysis´ indicators. However, civil society organisations in Mozambique think that this sustainability is regarding the ability of the country to repay its debt obligations and not necessarily its capacity to respond to increasing development needs.

External borrowing is one of the venues for the increase in resources to finance development programmes, provided that its level is within sustainable levels. The present debt situation in Mozambique gives room to the government to contract further loans to support its development programmes. In fact new loans have been contracted to finance priority areas of the development programme. For example, between 2004 and 2006 the government contracted about USD 1.0 billion against debt relief of USD 1.9 billion in 2006 alone. The new loans are a result of the fiscal space created by debt relief and have the potential to create revenues to further increase fiscal space in the future depending on the areas in which the resources are invested and government's commitment to improve the management of public resources. Table below shows total loans from 2000 to 2006.

Table 2.3 Total Loans to Mozambique in Million USD (2000 - 2006)

Year	2000	2001	2002	2003	2004	2005	2006
Loan	163	104	248	214	313	398	398

Source: GMD, Aid Delivery and Country's progress, 2008

Despite the prevailing debt sustainability situation, precautionary actions should be taken to avoid the re-occurrence of future unsustainable debts, namely to ensure that investment is also made in sectors that generate income and that the overall debt package is adequately managed.

It is important to note that even with the recourse to extremely concessional loans, this could lead to unsustainable debt if the economy can not respond to debt service and development needs. The government is in a process of formulating a debt management strategy that will re-define roles, responsibilities and conditions for loan contraction. It is hoped that the Parliament and Civil Society will have an active role in the process.

2.3.2 Public Domestic Debt

Another source of financing of the government's development programmes is public domestic debt. Although the public domestic debt is regarded as sustainable so far, it has been increasing rapidly in recent years, creating room for some concerns. The main reason why the government has sought to borrow domestically is that there have been delays in funds disbursement by donors and creditors originated by either bureaucratic procedures or lack of compliance with conditionalities. From a total stock of 51,900 million MT , in 1999, it had reached 3,366.900 million MT by the end of 2005, representing 0.1%, 4.3% and 2.2% of the GDP in 1999, 2003 and 2005 respectively.

Table 2.4 Public Domestic Debt of Mozambique: Trend and Sustainability Indicators, 1999-2005

Years	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Public Domestic Debt (10^9 MT)/a	51.9	817.0	1,684.0	3,681.6	4,932.0	2,536.7	3,366.9
Public Domestic Debt/ GDP (%)	0.1	1.4	2.2	3.8	4.3	1.9	2.2
Public Domestic Debt/Government Revenues (%)	0.8	10.8	17.8	30.5	33.5	15.1	15.8
Interest rate/Government revenues (%)	0.1	0.2	3.5	7.9	6.8	5.4	3.7

a/ Including Government bills issued to strengthen payment balances of the Central Bank.

Source: IMF Country Report No. 06/46, 2006; IMF 2005 Country Report No. 05/168; IMF 2004 Country Report No. 04/342

1 USD = 25.00

It is expected that by 2008 the public domestic debt will reach 8,500,000 millions MT.

Although figures suggest that this debt is still sustainable, the fact that the interest rates are fixed and serviced at market prices is worrisome by deviating considerable amount of resources to debt service. At the present, the public domestic debt service constitutes a bigger burden than the public external debt service. While in 2004, the public external debt was serviced at 411,000 millions MT, the public domestic debt was serviced at 910,000 millions MT, representing 1.3% and 2.9% of the total Government Expenditures of the same year, respectively Moreover, the recourse to public domestic debt can limit private investment as both the government and private sector are competing for limited internal funding. Therefore, although recourse to domestic borrowing can increase fiscal space in the short run, the same can be reduced in the long run due to the crowding-out effect and heavy debt service.

3.0 PRGF & Mozambique's Development Strategy

The Government Five Year Plan is the main development instrument which sets the countries priorities for five years and is implemented through the annual Economic and Social Plan. This document is inspired by the Agenda 2025 that defined development vision between 2000 and 2005. On the other hand, the government designed PARPA aimed to tackle the unacceptable levels of poverty. The implementation of PARPA actions is also done through the Economic and Social Plan. Given that PRGF aims to promote economic growth and poverty reduction, the study seeks to establish the link between PRGF and PARPA.

According to the IMF Policy Development and Review Department document on Key Features of IMF Poverty Reduction and Growth Facility (PRGF) Supported Programmes,

The IMF arrangements under the PRGF must support and be consistent with the overall poverty reduction strategy. The link with the PRSP will need to be assessed by the staff at the time PRGF arrangements are recommended for Board approval and reassessed at the time of program review". On the other hand, the different letters of intent from the Government of Mozambique to the IMF state that "the Memorandum of Economic and Financial Policies that the Government intends to implement as well as the underlying macroeconomic policy framework are consistent with PRSP/PARPA.

Looking at the content of both PARPA and PRGF supported programmes we can conclude that there is consistency in terms of objectives and policies. PARPA II states that for the achievement of sustainable economic development and poverty reduction, it is necessary to have a stable macroeconomic situation, an institutional framework and a favourable environment to investment, a developed and comprehensive financial system, infrastructures and increased technical and technological capacity of companies and Mozambican workers.

This strategic document is organised in three pillars: governance, human capital and economic development. In each pillar, the following priority areas were defined:

- Governance - public sector reform, reform of justice, legality and public order. Other areas include peace, political and social stability, social justice, legality and security and information and communication;
- Human Capital - education and culture, health, water and sanitation, HIV/AIDS, youth and sports, women and social action, housing, food security and nutrition and science and technology.
- Economic Development - envisages to continue to guarantee macroeconomic stability through a solid and stable management of monetary and fiscal variables; continue to improve the state financial management, including management of public expenditure, revenue collection and financial relations with development partners; promote the consolidation and integration of national markets through the improvement of basic infrastructures and transport systems, as well as the improvement of the regulation of commercial trade within the national market; improve business and work environment; reinforce regulation and supervision of the financial system; modernise and expand financial systems; contribute to the creation of a strong, dynamic, competitive and innovative private sector; promote enlargement of entrepreneurial base, the development of priority sectors and activities, strengthen family sector economy; continue to improve the insertion of Mozambique in regional and international economies and contribute to a comprehensive and sustainable economic and social development that contributes to the well being of the citizens. These objectives are similar to the ones presented in section two regarding PRGF. Therefore, the PRGF structural conditions and quantitative benchmarks coincide with the implementation of the main objectives of PARPA II.

What may not seem clear is whether the PRGF supported programs are underpinned in PARPA objectives or PARPA is underpinned in the PRGF macroeconomic framework. This grey area is supported by the following facts. First, Mozambique has been implementing IMF supported programmes for seventeen years and its macroeconomic framework has been, in great deal, shaped by international policies. The implementation of these policies has been reinforced by the need to comply with conditionalities, which in turn dictated the access to external funding. Second, other government documents like the Five-Year plan and annual plans and their respective budgets are in line with PRGF macroeconomic targets. Third, the timing of approval of both PRGF and PARPA (PRSP) do not show a coherent precedence: PRGF approved in July 1999 for a period of three years and PARPA I approved in April 2001; final PRGF approved in July 2004 for 3 years and PARPA II approved in May 2006. Fourth, in the various letters of intent formulated by the government and presented to the IMF, the government stated that,

The Government of Mozambique believes that the policies and measures set forth in the attached Memorandum of Economic and Financial Policies are adequate to achieve the objectives of the programme to be supported by the new PRGF arrangement, but will take any further measures that may become necessary for this purpose. Moreover, the Government will continue to consult with the Fund on its economic and financial policies, in accordance with Fund's policies on such consultations and provide the Fund with such information as the Fund needs to assess the Government's progress in implementing the economic and financial policies described in the MEFP.

There is a sense of government "subordination" to the IMF in the paragraph above. Lastly, civil society organisations have been participating in the formulation of the PRSP where they discuss all issues related to poverty reduction programmes except the macroeconomic framework because this has been already defined to comply with the IMF model. From the statements above, it is evident that the PARPA macroeconomic and structural frameworks and other government documents such as the Five years Plan, sector plans and their related budgets are underpinned in the PRGF supported programmes which respond to the IMF development model.

3.1 Financing the PARPA

The formulation of PRSP/PARPA was accompanied by the construction of different budgetary scenarios aimed to project the availability of resources to finance this development programme. The scenarios represented perceptions about different possibilities of mobilising resources in the medium term to be allocated to different priority areas for poverty reduction. The Medium Term Expenditure Framework (MTEF) helps to foresee the availability of resources and their respective allocation. In this document the basic scenario is presented, showing total internal and external resources expected to fund the development programme as well as the corresponding expenditure. State revenues consist of fiscal income, non fiscal income, capital income and designated income. External resources include grants and credit.

Table 3.1 Resources Envelope for PARPA (2005-2009) in Million MT*

Year	2005	2006	2007	2008	2009
State Revenue	24,503	27,017	29,510	32,633	35,842
External Resources	17,446	25,864	27,132	26,433	25,793
Total (1)	41,503	52,881	56,641	59,066	61,635
Expenditure (2)	40,979	51,548	55,839	58,006	60,586
Net Internal Credit (2,1)	-524	-1,332	-802	-1,061	-1,049

Source: Government of Mozambique, PARPA II

*** 1 USD = 25.00 MT**

Table 3.1 shows that the government expected an increase in the state revenues as a result of a prudent fiscal policy brought about by better tax collection and resources management. On the other hand, an increase in external resources through grants and credit was also expected, with a declining trend in 2008 and 2009.

Looking at economic indicators we can conclude that the government succeeded in collecting increasing amount of internal resources through taxation to finance the development programme. The introduction of VAT, the expansion of tax base and the management of expenditure through e-SISTAFE, all representing PRGF structural benchmarks and quantitative conditions, have contributed to this outcome. Table below shows government revenues from 2003 to 2005 and ODA disbursements regarding grant and loans for the same period. It also provides information of real total expenditure from 2003 to 2005.

Table 3.2 Government Revenues and ODA Disbursements in Million USD (2003 - 2005)

Year	2003	2004	2005
Revenues	616.8	876.3	842.9
Grants	840.0	1050.0	999.0
Loans	250.0	256.0	360.0
Real Expenditure	1,276.10	1,731.70	1,480.70

Source: GMD, Aid Effectiveness 2008

Table 3.2 shows that total aid to Mozambique, to support government development programmes geared to the attainment of MDGs had an increasing trend. The biggest proportion of aid consists of grants, which is consistent with government efforts to seek more grants than loans. The government is shifting from bilateral creditors to multilateral because the latter offer longer maturity periods, low interest rates and long grace periods. One can conclude that expenditure in priority areas has increased as a result of increased resources from internal and external resources. It is important to note that this information refers to funds channelled through General Budget Support and Sector Basket Funds. The resources provided via project support (off budget) and that are not under the control of the Ministry of Finance are not included. Of equal importance is the fact that donors have come together as G19 (Group of 19 Donors) to support government development efforts and are taking steps towards the implementation of some aspects of the Paris Declaration. Overall PARPA was financed by internal resources (state revenues and internal debt) and by external sources (grants and loans). The major development partners for Mozambique are United States, United Kingdom, France, Germany, Denmark, Sweden, Netherlands, IDA, European Community, African Development Bank, IMF, to name a few.

4.0 PRGF and FISCAL SPACE

As mentioned in the definition provided by Heller in the previous chapter, fiscal space occurs when the government has room to provide resources for a desired purpose without affecting negatively the sustainability of its financial position. According to the IMF, fiscal space for public expenditures can be financed by higher taxes, borrowings and/or grants. Each of these sources should be analysed carefully due to their effect in the economy. For example, higher taxes can constrain private sector development; external borrowing is subject to availability and debt sustainability constraints. Recourse to domestic debt can impinge in private sector given limited domestic resources. Grants are subject to availability and tend to be less predictable. The different alternatives should be evaluated in accordance with country specificities. Moreover, the aforementioned document suggest that better allocation of existing resources and taxation resulting from a transparent, equitable and efficient processes are the most dependable, and sustainable source of additional public resources to finance poverty-reducing expenditures[8] .

According to government officials interviewed in the context of this study, low income countries considered fiscal space as the possibility of accessing and using freely additional external resources to finance priority expenditures consistent with the achievement of MDGs. This concept was challenged, as the IMF defended that fiscal space should primarily be backed by internal resources through sustainable growth, domestic savings, taxation and better allocation and use of resources. This position is reflected in the overall PRGF framework that foresees macroeconomic and social policies with associated conditionalities that led to the reduction of external debt, economic growth, reduction of non priority expenditures, improvement in tax administration and better management of resources and public institution.

In Mozambique, the implementation of several activities within the PRGF programmes has contributed to the increase in fiscal space by allowing the government to allocate additional resources to PARPA priority areas without prejudice to the country's financial position. Evidence is given by data on national budget and MTEF that have been showing increasing trend overtime. The allocation of resources to PARPA priority sectors also prove that the government has been able to make additional investment without prejudice to the country's fiscal position. In fact, for the period 2005, 2006 and 2007 covered by the last PRGF total expenditure was 35,646.00 43,429.00, 52,969.00 million MT of which expenditure in priority areas amounted 24,082.00, 27,114.00 and 32,337.00 million MT respectively. Within the same period the country continued to observe the macroeconomic and fiscal targets set within the PRGF framework, as shown by the IMF reviews presented in the previous sections. In addition, according to Table 3.1 above, the government has made an effort to raise internal resources to finance its budget with state revenues amounting 24,503.00 27,017.00 and 29,510.00 million MT for 2005, 2006 and 2007 respectively. For the same period external funding was 17,446.00, 25,864.00 and 27,132.00 million meticais, respectively. However, apart from fiscal space, the country needs a political space in which the government and institutions should decide on their development priorities and objectives and institute appropriate mechanisms of accountability.

4.1 Impact of PRGF on the National Budget and MTEF

Medium Term Expenditure Framework is a tool that supports the government in the prevision of resources for a three year horizon. Its main objectives are to indicate the amount of financial resources needed to implement activities during a medium-term to respond to the policies defined within the government five-year plan and PRSP and ensure budgetary discipline with the view to maintaining budget equilibrium and make budget deficit sustainable. MTEF shows the extent to which the government set itself to mobilise resources to fight poverty and achieve the MDGs. It is based in the present situation and projects the future. The scenario presented in PARPA II regarding the forecast of resources for 2005 to 2009 shows that the inspirations of the government in terms of increasing resources to priorities areas of poverty reduction have been translated into numbers. Government projections for 2008 to 2010 MTEF show an increase in both revenues and aid to finance increasing needs consistent with PARPA objectives.

[8] IMF, Review of PRGF Programme design, August 2005

However, some challenges can be considered in this process: 1) government capacity to accurately forecast future income and expenditure; 2) donors' willingness to provided information on their pledges; 3) donors compliance with their commitments in terms of disbursements; 4) government capacity to raise the targeted internal revenues and 5) government ability to splits the expenditure between recurrent and capital costs to comply with the level of wage bill set by the IMF.

The PRGF has contributed to economic growth, which enables the government to allocate more resources to priority areas. Through IMF positive signalling, PRGF has also contributed to donors' willingness to provide more resources to Mozambique, which led to an increase in fiscal space.

However, the increase in development assistance has come up against the IMF's need to preserve the country's macroeconomic indicators, highlighting the weaknesses of the PRGF has a development strategy. For example, over the years, the government has been expressing the need to hire more teachers and nurses. Although the Ministry of Finance has raised the wage bill from 6.5 to 7.5% of GDP with the consent of IMF, it continues to constrain teachers' recruitment. In 2007, the government asked for 12,000 extra teachers to reduce the pupil-teacher ratio but was only allowed to hire 9,000 teachers and 1,000 administrative staff.

It seems that some change has been occurring though. For 2008 the wage bill is expected to reach 7.7% of GDP, mainly on the account of the hiring of 12,000 teachers, 5,000 health workers and reinforcement of security forces. This is a positive move because it can mean openness from the IMF to accommodate some government needs and/or increased capacity that the economy has in increasing expenditure without provoking macroeconomic imbalances. Government's ability to increase its revenues is a solid foundation to increase fiscal space and it is line with IMF advice. Indeed, the Government of Mozambique has been increasing the revenues and financing higher levels of development expenditure.

4.2 Impact of PRGF on Sector Allocations

The impact of PRGF on sector allocation can be presented in two ways: the one related to restrictions in the increase of the wage bill, affecting all sectors, and the other related to the overall effect of the implementation of PRGF that leads to the rise in national income and resulting increase in resource allocation. Although the bill cap is usually associated to teachers and nurses, in reality it affects all government employees who earn very low salaries and struggle to sustain their families. The result is that they either leave their jobs in search for better conditions or do other jobs while working for the government. The consequence of this is a generalized lack of motivation and low performance.

The economic growth brought about by PRGF implementation has enabled the government to increase resources in priority areas for poverty reduction. In addition, IMF resources also contributed to the improvement in international reserves that were used to finance government and private sector external obligations. Therefore, as GDP grew and external debt reduced, the Mozambican government allocated more resources to priority areas. Table below presents PARPA priority expenditure from 1999 to 2007.

Table 4.1 PARPA Priority Expenditure for 1999 to 2007

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Debt Service (% GDP)	2.5	0.8	2.1	5.2	4.9	4.2	3.7	2.9	3.5
Total Expenditure (%)	52.8	73.9	59.9	62	60.3	60.3	63.9	63.2	65.7
Education (%)	14	21.5	21.2	17.1	19.2	20	19.2	19.5	19.7
Health (%)	11.7	13.9	9.0	11.9	10.1	10.1	12.2	14.2	12.6
HIV/AIDS (%)	0.0	0.0	0.5	0.8	0.3	0.4	0.6	1.4	1.3
Infrastructure (%)	11.6	17.0	15.8	15.6	13.2	12.6	18.0	15.9	18.0
Agric. Rural Development (%)	4.5	6.8	3.1	5.0	4.7	4.2	3.8	3.3	5.9
Gov. Security & Jud. Syst (%)	7.7	8.5	7.0	7.7	8.9	9.3	8.6	12.1	6.3
Other Priority Exp. (%)	4.3	6.0	3.2	3.9	3.9	3.7	2.1	1.1	1.5

Source: Mozambican Debt Group, Seminar on Debt Management, 2007

As shown in the table above, investment in priority areas grew over time and was directed to three main areas namely education, infrastructure (roads and sanitation) and health. As a result of the reduction of debt service and the increase in domestic revenues, the government was able to invest more in priority sectors, in line with the 65% PARPA target. In addition, as the country became economically viable, donors were willing to put more money to support government's development program, as shown in previous sections and foreign direct investment also rose resulting in increased tax collected to government coffers.

While acknowledging the achievement in enrolment rates in education and increased coverage in the health sector to meet development agendas such as Education for All and Health Pacts, this was not necessarily matched by improved quality. This situation can be attributed to different factors: the observed increase in resources does not correspond to the real needs of the sectors; poor allocation of resources within the sector and priorities set by donors that sometimes prefer constructions to other critical areas like teachers and health personnel training and proper school and health equipment. A study undertaken by the Mozambican Education Networks on Financing for Education shows that more resources were allocated at central level and to construction of infrastructures and little was directed to quality issues such as teachers training and recruitment, teaching equipments, etc.

Agriculture is defined as a priority area for poverty reduction due to its potential and the fact that the majority of rural population depend on it for subsistence. However, the allocation of resources has been meager over the years and the country has not taken advantage of its potential. Moreover, PRGF through its conditions brought a negative impact to the agriculture sector in areas with emphasis to the followings: the abolition of subsidies to ICM (Mozambique Institute of Cereals) and liberalization of the cashew industry. As a result, many factories closed and many families lost their income. Development partners also are reluctant to invest in agriculture due to its perceived low rate of return. Again, the existence of off-budget expenditures makes it difficult to evaluate the real extent of PRGF impact on sector allocation and country's investment in different sectors. More has to be done to increase resource allocation between sectors and within sectors.

Moreover, it is important to note that this increase in the allocation of resources to priority areas was done within the context of IMF model characterized by restriction, with the main concern being the reduction of inflation and primary deficit. For example, in the last PRGF/PSI the expansion of base money was restricted and recourse to financing from domestic financial system is not advised. The government has turned to internal borrowing mostly when disbursements from donors are not timely delivered compromising the implementation of government programme.

4.3 Impact of Structural Benchmarks and Quantitative Conditionalities on Fiscal Space

Structural benchmarks and quantitative conditions have had an impact on fiscal space. The primary objective of structural benchmarks and quantitative conditions was to promote growth through the stabilisation of the economy, improved fiscal position and better collection of taxes and improved management of public resources.

The PRGF/PSI set specific targets in the macroeconomic indicators that influenced fiscal space directly.

1) The rate of inflation for 2004 to 2006 was expected to be 11%, 8 1/2% and 7% respectively. This would contribute to an economic growth of 5%, 6 1/2% and 7% respectively and a current account deficit of 2%, 7% and 7% respectively. As far as inflation is concerned, the targets were tighter over the period implying restrictions in the expansion of base money. For the current account deficit, however, there was a tolerance allowing an increasing trend due to the effect of imports from new mega projects. But overall GDP was 7.5%, 6.2% and 8.5% respectively.

2) In fiscal position the target was to increase government revenues through improvement of tax collection, approval of specific taxes and fiscal incentives in mineral resources and mineral sectors, public financial management through implementation of e-SISTAFE and alignment of MTEF with PARPA II objectives. For 2005 to 2007, for example, there was an increase in government revenues of over 4,000 million MT, which contributed to financing government expenditures.

3) Although wage bill was raised from 6.5% to 7.5% of GDP in 2007, it recruitment of public servants was constrained. For example, in 2007 the Government wanted to hire 12,000 extra teachers to reduce the pupil/teacher ratio but it was only allowed to hire 9,000 and 1,000 administrative staff. Therefore, although expenditure in education rose in this year, it was not enough to meet government needs but rather to comply with the IMF development model.

It is important to note that despite the restrictions, inflation rates have been higher than programmed in the last years due to the raise in food and oil prices. The government has been guaranteed waivers for no observance of base money targets.

4.4 Debt relief and Fiscal Space

Debt relief has certainly led to increased fiscal space. When the country was highly indebted it could not meet its development objectives because a considerable amount of resources was devoted to repaying debt obligations. The HIPC initiative and the Multilateral Debt Relief Initiative have been fundamental in reducing the external debt to what can be considered sustainable levels. In 2006 alone, Mozambique benefited from close to USD 2.0 billion in debt relief under HIPC and MDRI against the contraction of news loans of about USD 2.13 billion between 2004 and 2006, resulting in a net saving of USD 870 million over the same period.

However, this number should be analysed with caution as it did not necessarily translate into money to the government. Some debts were not being paid due to lack of capacity. Hence, debt relief did not result in saved money but in writing off the amount from both creditor and debtor books. With debt relief, the resources saved from debt services are redirected to social and economic activities. Indeed debt service was 4.2%, 3.7% and 2.9% of GDP for 2004, 2005 and 2006 respectively. In addition, some creditors and donors attach their debt relief to investment in social sectors consistent with PARPA priorities. Debt relief also provided a good sign to investors and donors that felt that investing in Mozambique and/or providing support to the government would bring positive results. As a result, additional resources are poured into the country to support government program and to invest in a variety of activities.

4.5 Fiscal Space: Has it Increased or Decreased?

Overall the fiscal space has increased in Mozambique due to debt relief, economic growth and donor contributions. The implementation of policies and strategies that allowed the country to benefit from debt relief and increase national revenues has led to government ability to increase investment in critical areas without prejudice to the sustainability of financial position. The government was able to increase public expenditures over time while maintaining fiscal and monetary targets and the sustainability of expenditure. However, it is important to note that fiscal space increased within the framework of a restrictive development model. It increased in the extent of compliance with macroeconomic targets and not necessarily to the full extent of government needs. For example, ceiling for wage bill was lifted from 6.5% to 7.5% of GDP in 2007. However, this was not enough to allow for the contraction of 12,000 teachers required but only 9,000 teachers and 1,000 administrative staff. This is a reflection of the limits imposed in the rates of inflation and primary deficit.

Fiscal space also increased through borrowing from external and internal sources. As mentioned in the previous section, from 2004 to 2007 Mozambique borrowed about USD 1.1 billion to support its development programme. Recourse to debt external for countries who have just come out of unsustainable debts and have fragile economic base should be done with care and need reliable debt management systems. Otherwise, the gains obtained from debt relief can be lost in the presence of inability to sustain new debt obligations. Internal debt, on the other had has been used to increase fiscal space but it is expensive and can affect negatively the development of the private sector because the government would be competing for the same resources.

More has to be done to increase the level of fiscal space mainly from government revenues to reduce the level of dependency. One of the strategies could be investment in productive sectors and support to small and medium enterprises.

Political space within PRGF process though, is still very tight. The PRGF document is not open to debate by civil society and other stake holders. As a result, there is lack of understanding about IMF programmes in different countries and weak interaction with non state stakeholders. In Mozambique there have been some consultations with IMF country representatives but the interaction needs improvement. Civil society would like to establish a communication channel with the Fund and be able to participate in the PRGF/PSI processes.

5.0 PRGF and POVERTY REDUCTION

During the implementation of PRGF poverty reduced from 70% in 1996 to 54% in 2003 as a result of the implementation of the government Plan of Action for the Reduction of Absolute Poverty. PRGF also contributed to income distribution through job creation and allocation of resources to priority areas. However, the pattern of growth was not always compatible with poverty reduction namely mega-projects with related capital intensive approach, lack of appropriate support systems to people who lost their jobs through privatizations, lack/weak support to small and media companies, etc.

5.1 Impacts on Income Distribution

The impact of PRGF on income distribution was both positive and negative. It's positive because it contributed to economic growth that in turn allowed for some job creation and allocation of resources to poverty reduction objectives, in line with PARPA targets. However, some fundamental issues, although not entirely dependent on PRGF, are worth mentioning:

1) The economic growth was based primarily on foreign mega-projects with capital intensive approach as opposed to labor intensive. These projects also have the privilege of employing expatriates, even if there is capacity within nationals. In addition, the wealth created in these companies as profit is exported to other countries, reducing the impact to economic growth.
2) Privatizations were associated with massive lay-offs with no corresponding provision of social security to cope with lost jobs.
3) There is no consistency and transparency in the support of national small and media enterprises. The conditions for accessing resources are hard to meet.
4) During the implementation of PRGF supported program, the incidence of poverty reduced from 70% in 1997 to 54% in 2003. However, recent estimates show that from 2003 to 2005 some of the people who were better off in previous years are now worse off due to loss of income or their source of subsistence.
5) The difference between rich and poor has been widening, as rich are becoming richer and poor are getting poorer.
6) The rise in prices of food and oil is hitting hard on poor as they have little alternatives of survival
7) Poor people have little capacity of using the market to their advantage.
8) Regional disparities in the allocation of resources.
9) An overview to the overall government budget shows that, despite government efforts to implement the decentralization process, about67% of the resources are still allocated at central level, 30% to provincial and only 3% to district levels

5.2 Recent PRGF Arrangement: Poverty Support Instrument

After successful implementation of PRGF some countries feel that do not want or need financial assistance from the IMF. Indeed, some low income countries made significant progress in economic stability and no longer need IMF funding but need ongoing advice, monitoring and endorsement of their economic policies. Thus, in October 2006 the IMF introduced the Policy Support Instrument (PSI) that enables the Fund to support countries in this situation. The PSI helps countries design effective economic programmes that, once approved by the IMF executive Board, signals to donors, multilateral development banks and market Funds endorsement of a country's policies. PSI aims to promote a close dialogue between the IMF and member country, provide more frequent assessment of economic and financial policies and deliver clear signals on the strength of these policies. Countries that have achieved a reasonable growth performance, low underlying inflation, adequate level of official international reserves and have begun to establish external and net domestic debt sustainability are eligible to PSI.

Given the positive performance of the economy over the last years, Mozambique adhered to PSI in July 2007 to ensure a satisfactory continuation of the implementation of macroeconomic, financial and fiscal policies as well as the restructuring of the public sector. Several reviews undertaken by IMF show that Mozambique has been growing at satisfactory levels and complying with IMF requirements. Despite this impressive growth, the Fund recognises that there are still some challenges that have to be dealt with namely poverty levels still high, inequalities and dependence from external resources.

The IMF approved a three year Policy Support Instrument for Mozambique in June 18, 2007, covering the period 2007 - 2010. The main objective of the programme is to sustain high rate of growth and further reduce poverty in line with PARPA II. This will be achieved by continuing to implement sound monetary and fiscal policies as well as prudent debt management and public finance reforms. Thus, inflation rates are expected to be maintained at single digit, preservation of comfortable levels of foreign reserves, flexible exchange rate and no recourse to financing from the domestic financial system.

PSI supported programme also envisages to persevere with timely implementation of second wave of reforms to continue to improve public service delivery and create an enabling environment for private sector activity. The main areas of emphasis are: human resources management, including payroll system, performance evaluation and wage policy, decentralisation policy, good governance and better business environment[9].

Overall, the PSI is the continuation of the implementation of PRGF reforms. It is a step further from the PRGF supported programmes policies but with no Fund's money involved. Structural performance criterion and structural benchmarks continue to be a requirement and their assessment is at a semi-annual basis. These focus on the approval of legislation for the mining industry, budget management through e-SISTAFE, management of civil service, to name a few. There is no evidence of new conditionalities but rather a step further of those already underway.

The IMF and the Mozambican Government have already undertaken the first review under PSI. According to their review, "In 2007 economic performance remained strong with continued robust growth. Fiscal position was better than programmed and inflation expected to decline to single digit, despite high food and oil prices. Net international revenue is expected to remain comfortable. All quantitative and structural targets for end June and September 2007 were met except for the base money. Progress was made in strengthening public expenditure management through the implementation of e-SISTAFE. Tax administration also improved". Recommendations were made regarding the need to further improve governance and cost of doing business, plan to implement new mining and petroleum fiscal regimes and ensure concessions are extended in a transparent manner[10].

Further to this review, IMF visit to Mozambique held in February 2008 reinforced the comments made above. The IMF team congratulated the Mozambican government by its strong commitment to sound economic track record over last years. Prudent fiscal and monetary policies during 2007 kept inflation under control, although higher than programmed and real GDP averaged 8%. The country still faces some challenges though: poverty still remain high, with 54% of people living below poverty line. Hence, there is a need to develop policies towards employment creation and improvement of income distribution within the different regions of the country. In addition, it is necessary to develop policies to reduce the cost of doing business and support development of small and medium enterprises as well as diversify the structure of productive sector in Mozambique, extend financial services and access to rural areas and remove infrastructure bottlenecks. This will lead to higher economic growth and significant reduction in poverty[11].

These reviews show that the Mozambican government is committed in continuing to promote growth and poverty reduction. It will also continue to comply with structural benchmarks and quantitative conditions under the PSI supported programme, which will ensure a positing signalling by the IMF. As with the PRGF, the PSI will contribute to the creation of fiscal space by ensuring high economic growth and the allocation of resources to priority areas.

[9] IMF Press Release: IMF Executive Board Completes Final of the Review of the PRGF Arrangement for Mozambique, March 28, 2007

[10] IMF, Press Release nº 07/268 – Press Statement at the Conclusion of First Review under PSI, November 2007

[11] IMF Press Release nº 08/28, February, 2008

Internal revenues resulting from better tax administration, better civil service management and reduction of spending in non-priority, sustainable debt and aid will continue to be an important source for the improvement of fiscal space.

However, the negative impact of some policies should not be ignored. Benchmarks and quantitative conditions are still part of this support package and consist of the continuation of the PRGF targets. Although some of them are critical in ensuring an improvement in macroeconomic indicators, others have produced negative effects to the poor, such as privatisations, curtailing of government expenditure, rise of prices in certain areas, to name a few.

Within this context, the government should seek to improve its dialogue with the IMF to reduce the level and kind of conditionalities. In fact, under the ownership principle of the Paris Declaration, Mozambique should be allowed to define its development priorities and strategies and set up appropriate mechanisms for monitoring and accountability to Mozambican institutions such as the Parliament and to the citizens. PSI should allow for an increase in Mozambican political space.

6.0 CONCLUSION

PRGF as a lending facility has helped low income countries strengthen their international position through the provision of foreign exchange to finance external commitments of the government and the private sector. Taking into consideration the challenges faced by low income countries to generate foreign exchange to meet import needs, the provision of resources by the IMF helps to minimize this problem.

Given that one of the requirements to benefit from debt relief was the implementation of PRGF, adherence to this program enabled the country to benefit from debt relief under HIPC and MDRI, thus, contributing to the creation of fiscal space by devoting the resources that were previously directed to debt service to finance priority areas for poverty reduction. Today, the Mozambican debt both external and internal are considered sustainable, in accordance with IMF debt sustainability indicators but it is necessary to put in place a debt management policy to avoid the re-occurrence of a new debt crisis.

The benchmarks and conditions set within the PRGF supported programmes have resulted in observed growth and poverty reduction. Economic growth has been strong in the last years, averaging 8% in the period 1996 to 2006. In 2007 economic growth was 7.3% against a planned target of 7% and internal revenues have been increasing. Inflation rates though, have been fluctuating, with a single digit at the beginning of the year and two digits at the end of the year. In 2007 the main contributors to inflation were food and non alcoholic drinks. This resulted in the deterioration of purchasing power leading to social unrest that culminated with the turmoil that occurred in February 5, 2008. The graduation of Mozambique from PRGF to PSI did not result in the relaxation of conditionalities. These continue to be a requirement for the country to benefit from IMF advice and signaling role.

Poverty reduction has also experienced some improvements. From a level of poverty of 70% in 1997, a survey undertaken by the government on family households showed that the incidence of poverty had decreased to 54% in 2003. This number was 5% higher than the one foreseen in PARPA.

Another gain resulting from PRGF is that Mozambique is considered a feasible country for foreign and domestic investment. The cost of doing business has reduced, the performance of public institutions is improving due to the implementation of several reforms, management of public resources is also improving with the implementation of e-SISTAFE in government institutions at central, provincial and some district levels. There is also an indication of efforts to improve governance. However, a lot more has to be done to consolidate these gains such as the integration of the several policies already under implementation, better coordination of public institutions and improvement of statistical data and service delivery.

The implementation of PRGF has contributed to the increase in fiscal space through the improvement tax collection, a positive signaling from the IMF that led to donors and foreign companies trust with resulting channeling of resources in terms of grants, credit and foreign investment. This enabling environment is reflected in the Medium Term expenditure Framework and translated in the allocation of resources to priority areas of poverty reduction, in line with PARPA. However, this increased fiscal space occurred within the context of a restrictive development model which requires compliance primarily with the macroeconomic targets and not to the full extent of government needs.

As far as income distribution is concerned, the PRGF has contributed to the creation of jobs and investment in priority sectors, including those that promoted income generation. However, the pattern of growth based in mega-projects reduced the extent to which job creation happened because it is based in labor intensive as opposed to labor intensive and the profits can easily be exported rather than re-invested to create further jobs.

Despite this impressive growth and increased fiscal space, more than half of the population still lives below poverty line. Income distribution measures have not been properly implemented because the gap between poor and rich has been widening. Although there is a recognition that economic growth provided for new job opportunities, it is also true that the implementation of some reforms led to massive unemployment. It is estimated that over 120,000 Mozambicans lost their jobs due to privatizations and entire families were subjected to poverty.

The policy of cutting or reducing public expenditure to control inflation has also produced some negative effects. For example, the limitation of government budget for the recruitment, training and payment of social workers such as teachers and nurses has led to lack of motivation and bad performance which in turn resulted in bad quality of services provided. This has also generated some corruption practices within these sectors.

The implementation of the PRGF was a challenge due to several conditionalities associated to it. The performance based mechanism for the disbursement of the funds was also another challenge. If the government wanted to continue receiving resources from the IMF and other development partners, it had to comply with all the conditions and benchmarks imposed. Sometimes it was not easy to fulfill all the conditions but the government had to do all on its power to remain on track and receive the support it needed, even if it hurt its people. The case of the cashew industry in Mozambique is a clear example of this situation.

The imposition of conditionalities and compliance with foreign agendas makes our government weak and not accountable to the people. This is a serious handicap to modern democracies in which governments are supposed to give voice to their people and can not be accountable to them but to those who provide resources to development programs.

With the promotion of Mozambique from PRGF to PSI we expect that some of the challenges mentioned above will be overcome through the establishment of a true partnership between the Fund and the Government of Mozambique, in which policies are discussed and shared and not imposed. Thus, apart from increased fiscal space, we expect the creation of Mozambican political space in which the Mozambicans, lead by their government, are allowed to define a development agenda that is inclusive and beneficial to all citizens and set up appropriate mechanisms for government accountability to the Parliament and to people.

PRGF policies and objectives are not open to public debate. According to the IMF Independent Evaluation, the IMF has lithe interaction with civil society which leads to lack of understanding of its role and activities. In Mozambique, civil society organizations have had some meeting with IMF representatives in which they asked for their participation in the formulation of PRGF. We hope that within the PSI framework the Fund will respond positively to this request.

Despite these improvements, more has to be done to ensure that by 2015 all the MDGs are met. To this end, a combined effort by the government, civil society and donors as foreseen in MDGS under the principle of partnership for development has to be put into practice to ensure a well being to the citizens of Mozambique. The government has to continue to pursue policies and strategies that ensure stable economic growth, good governance and better income distribution.

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