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Mozambique: Better Budget Machinery – First Focus of Reforms

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Mozambique is undergoing a number of major reforms in the public sector including reform of the public finance management system. This article describes the environment before the budget reforms, highlighting the weaknesses in budget planning and preparation, budget implementation and the governance framework including the weak oversight role of Parliament. A legal framework was put in place as a first step. Underlying systemic problems were addressed to allow clearer linkages between budgets and service delivery. Then budget planning reforms were introduced. The article discusses the nature of the major technical reforms, considers the governance framework and provides an assessment of the effectiveness of the reforms.

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1. Introduction

Mozambique is currently undertaking major reforms within the public sector in general, including modernising the public finance management (PFM) system. The public sector reform is intended to be a comprehensive overhaul of the public sector. It covers issues such as deconcentration and decentralisation of public administration; civil service restructuring, including pay and compensation reforms; legal and judicial reforms, with an anti-corruption component; and procurement reform, which is considered critical to curb corrupt practices within public procurement. PFM reform is a component of the public sector reform, but contains specific aspects that make it a separate process. The key dimensions of the PFM reforms are:

- the introduction of a new PFM system;
- revenue reform; and
- internal audit reform.

The sections that follow summarise the reform process within PFM in Mozambique since the 1990s, when the reforms began.

Before proceeding, the structure of the state should be considered briefly. The structure consists of two levels, central and territorial. At the central level there are ministries and related or subordinated institutions. At the territorial level there are two sub-levels, each following specific legislation. The first, according to the Constitution, is divided into 11 provinces. The provinces are divided into districts (a total of 128), which are divided into administrative posts, and these into localities. On average, there are three administrative posts per district, and four localities per administrative post. These parts of the territorial units follow the Law of Local Government Organs of 2003. In the second sub-level, there are 33 municipalities, which follow separate legislation approved in 1996/97.

1.1. The scenario prior to budget reforms (and some current issues)

Significant progress has been made in tackling some of the main budget outcome problems, especially since the end of the war in 1992:

- Overall fiscal stability had improved markedly by the mid/late 1990s.
- There was also a substantial expansion in expenditure, in real terms, on the priority sectors for poverty reduction, partly due to high levels of donor

assistance, but also on account of the peace dividend. This has been buoyed by the gradual increase in internal revenue (rising from 11.3% of GDP in 1997 to 14.3% in 2003).

- Still, serious deficiencies in the effectiveness, efficiency and (territorial) equity of spending exist. These issues were revealed in the public expenditure review exercises (and related sector expenditure reviews) conducted in the 1990s and more recently during 2001-03.

Prior to budget reform, the main concerns were about weaknesses in the budget process. These are outlined below.

Budget planning and preparation:

- Lack of linkage/consistency between long-term plans – the Government Programme, the Plan of Action for the Reduction of Absolute Poverty (PARPA)/ Poverty Reduction Strategy Paper (PRSP) and sector strategic plans – and annual Economic and Social Plans and the annual budget.
- The fragmentation inherent in the incremental nature of input-based budgeting, in the absence of frameworks, criteria or procedures for objectives-driven resource allocation.
- The overly detailed nature of the budget, with thousands of input-based allocations to government bodies and thousands of micro projects.
- Large off-budget resource/expenditure flows, which make coherent, prioritised planning and budget formulation extremely difficult.
- Direct donor funding of line ministries, in a context where donors account for more than 50% of total resources and only about one-third of donor funds are for general budget support; in other words, direct budget support represents approximately 18% of total expenditure (recurrent and capital).
- Internal revenues from user charges, and so on, being retained by government bodies and not fully reported to the Ministry of Planning and Finance (MPF).
- Confusion over vertical and horizontal channels for planning and budget formulation (through vertical ministry hierarchies and/or through district or provincial governments), due to the “matrix” system of public administration inherent in double subordination, in which there is no clear attribution of competencies to different levels of government (reflecting, in turn, a failure to develop coherent policy for decentralisation and deconcentration).

Implementation:

- Lack of a double-entry accounting system.
- Lack of planning mechanisms for budget execution, under a simple “duodecimal” system, resulting in liquidity problems, especially in the early part of the year.

- Liquidity problems exacerbated by the existence of thousands of government accounts (and the lack of a single Treasury account).
- Serious delays in releasing funds to budget units and in reporting, replenishing and closing accounts, prejudicing service delivery.

Governance framework:

- Weak auditing, both internal (by the General Finance Inspectorate) and external (by the Administrative Court), due to capacity constraints, resulting in long delays in the delivery of audited State Accounts, which take up to two years before reaching Parliament. Prior to budget reform there were no State Accounts; only in 2000, for the first time after Mozambique's independence, were State Accounts for the 1998 fiscal year produced and submitted to the Administrative Court and Parliament.
- Weak involvement of the Council of Ministers in making trade-offs in resource use, due to the input-based nature of the annual budget and fact that a Medium-term Fiscal Framework (MTFF) is not used as a strategic resource allocation instrument.
- Weak oversight by Parliament, which includes:
  - ❖ not receiving, debating or approving key long-term plans, such as the PRSP, sector strategic plans or an MTFF;
  - ❖ deputies having difficulty in analysing a very detailed, input-based budget and relating it to policy objectives and the Economic and Social Plan;
  - ❖ off-budget problems, which remove large chunks of government resources/expenditure from parliamentary oversight;
  - ❖ poor parliamentary capacity (political polarisation, low level of education of most deputies, no research assistants);
  - ❖ a high degree of flexibility for the Ministry of Planning and Finance to make budget adjustments (hundreds annually) without the need for parliamentary approval;
  - ❖ the setting of tax rates by executive decree, outside the annual budget; and
  - ❖ long delays in submitting audited State Accounts to Parliament.

This brief analysis of the situation prior to budget reforms, and some current concerns on this matter, point to the following objectives in attacking the weaknesses of the system:

- improve the coverage and transparency of the management process of public finances (revenues and expenditures);
- gradually assure effectiveness and efficiency of public spending according to policy objectives; and

- enhance and assure long-term sustainability of the fiscal policy and processes.

This article sets out the various steps that have been taken to address these concerns and achieve the objectives. It does so in three main sections. First, the major technical reforms are discussed, from changes to the legal framework through to particular interventions, such as the development of a budget planning and control tool. Second, budget governance is considered, particularly whether sufficient reform has taken place to facilitate improved transparency and public accountability. Third, an assessment is offered of reform effectiveness, and the remaining challenges to the reform process are identified.

2. Main stages of the reform

Given the major objectives of the PFM reforms, and also considering the human resources and financial constraints, certain steps were deemed critical to pursue these reforms. There was the need to improve the legal framework and procedures to facilitate resource allocation (internal and external) in accordance with priorities defined in policy documents and statements, and to contribute to greater transparency of the decisions undertaken. Actions and mechanisms had to be established to allow decision-making instances to deliberate in accordance with defined policies and priorities.

2.1. The Budget Framework Law and the Law on the State Financial Administration System

In order to advance with these activities, two milestones in recent years were the Budget Framework Law (BFL) of 1997 and the Law on the State Financial Administration System (LSFAS).

The objectives of the BFL were to increase coverage and transparency of the budget, achieve effectiveness and efficiency in the use of government resources and ensure fiscal sustainability. This legal framework established the budget structure using modern and universal classifiers adjusted to Mozambican conditions, and imposed specific requirements in terms of organic structure, norms and procedures for programming, management and budget execution.

The objectives of the LSFAS were very broad: to establish and harmonise rules and procedures for programming (revenues and expenditures), managing, executing, controlling and evaluating the use of public resources. The main intended reforms include:

- the establishment of an Integrated Financial Management Information System (IFMIS);
- a new double-entry accounting framework;

- the establishment of a single Treasury account;
- the introduction of cash-flow planning for budget execution, through quarterly and monthly plans; and
- the introduction of programme classifiers as a means of linking policies/plans and expenditures.

The focus of the reforms has mainly been on improvements in process (rather than product), chiefly the technical as opposed to institutional aspects of process.

2.1.1. Budget Framework Law measures

The main measures undertaken in terms of the Budget Framework Law are outlined below.

- **Introduction of the Medium-term Fiscal Framework (MTFF) in 1998/99:** In practice, the MTFF is focused more on forecasting the resource envelope and much less on making priority-based resource allocations. The first phase of the development of the MTFF emphasised the analysis of the expenditure side of the budget and forecasts, aiming at bringing together a more comprehensive approach to public expenditure, taking into account domestic and external resources. In the second phase, during 1999 and 2000, the focus was on establishing the links between policies and the process of resource allocation, in particular analysing the coherence of public spending and imposing its rationalisation. The third phase, from 2001, has focused on the objective of promoting the equilibrium and stability of the public finances, in particular the control of spending as a means for more effective use of resources. In this regard, the MTFF has become an exercise for projecting public spending (based on the resource envelope from a macroeconomic framework) on a predetermined indebtedness situation, in particular related to the Heavily Indebted Poor Countries (HIPC) initiative. This has become a mere financial exercise, and there is a need to reinforce the analytical content of the different programmes and their links to policies and strategies, as it is being used as a framework for decision making at the Cabinet level.
- **Introduction of a new budget classification system:** The new classification system (functional, organic, economic and territorial) has improved budget planning and execution. However, the functional classification is not fully applied and, in essence, remains an aggregation of administrative classification.
- **Integration of investment and recurrent budgets:** The investment and recurrent budgets have been integrated in the framework as a financial exercise, but could still be made more effective in supporting better allocative decisions. Currently, the two budgets are still predominantly

planned separately, a large amount of recurrent expenditure is wrongly classified as investment expenditure (partly to circumvent IMF targets for the primary deficit) and there is no real attempt to analyse the implications of investments for future recurrent outlays.

- **Improvement in budget preparation and reporting:** Based on the two previous activities, and in order to improve budget preparation and management, an IT application (SISORÇ) was developed in 1998 within the National Directorate for Planning and Budget. SISORÇ is basically software for budget preparation, using detailed classifiers and items on expenditure; it is also a budget management tool for budget alterations during the year, taking into account the budget ceilings approved by Parliament. The software provides a permanent and exact record of the situation of the state budget at a central level. This system was extended to provincial level in 1999, which has contributed to the reduction of time required for budget preparation at the moment of globalisation of the annual budget. Regulations for budget execution and alterations have been implemented, as has a handout of procedures and routines for budget management and elaboration.
- **Improvements in budget coverage (the off-budget problem):** Interventions in this regard improved the recording of resource and expenditure flows on the approved budget, but brought far less progress in making execution procedures and the reporting of state accounts more comprehensive. The first study of off-budgets was conducted in 1999 and covered the health, education, agriculture, public works and social action sectors.
- **Improvements in accounts:** Accounts recording is performed by the National Directorate for Public Accounts. Since 1901 a manual system for recording expenditures was used. In 1997/98 this system was computerised. The computerised system facilitated the elaboration of the consolidated State Accounts produced annually. Since the State Accounts for the 1998 fiscal year were released in 2000, these accounts have been sent annually to the Administrative Court and Parliament. Based on this system, quarterly budget execution reports have been produced and have been released 45 days after the end of each quarter, since the first quarter of 2000.
- **Improvements in debt management:** The restructuring of public debt has been quite successful, with most public debt reduced according to the HIPC initiative and guidelines. Mozambique still needs to establish a post-HIPC debt management strategy, which is required to analyse the country's vulnerability to future debt problems. There is an ongoing exercise with Debt Relief International in designing this strategy. An immediate concern is internal debt and its related management. In the past few years, there has been large and costly internal debt, coupled with high interest rate spreads;

this can reduce government flexibility to manage the economy through short-term treasury bills, in particular in a situation where external resource disbursements are not predictable.

2.1.2. LSFAS activities

Under the Law on the State Financial Administration System, the main activities in practice are related to implementation of the reforms, focusing overwhelmingly on computerisation, for example on the establishment of the IFMIS and the related single Treasury account. Other components, such as the introduction of programme classifiers and cash-flow planning (to replace the duodecimal system), have been delayed. Very little, if any, attention has been paid to other aspects of planning and budget formulation, for example strengthening of the MTFF (in particular, to overcome the limitations signalled above).

3. Efforts to improve budget governance

Budget governance, in the sense of institutional arrangements and political involvement in budget and financial management, has been much less of a focus in practice, compared with reforms related to the technical aspects of the accounting/payments systems and computerisation. This section provides an overview of problems and interventions in various systems that support transparency and public accountability.

PFM reforms have been concentrated at the level of the Ministry of Planning and Finance, moving towards the line ministries and provinces and districts due to the ongoing decentralisation process, but other stakeholders must increase their role in budget governance. One of these stakeholders is Parliament. The main measures that would improve parliamentary oversight can be grouped as follows:

- improved budget comprehensiveness (reducing off-budget problems), but this activity is proving slow and difficult in practice, because it affects both internal and external partners, each one with specific interests;
- the speeding up of production and auditing of consolidated State Accounts (to be reduced to nine months after the end of the fiscal year), to permit more timely parliamentary oversight; and
- a medium-term vision of the fiscal accounts provided by the MTFF/budget.

Efforts to improve budget governance have to start with revenue reforms: very little revenue is raised locally, producing poor incentives for local accountability. Revenue reforms cover both revenue collection and institutional aspects. Reforms in this area started in 1987 with the first programme with the IMF. In the period 1987-96, most of the reforms concentrated on indirect taxation (excise tax and customs). From 1997 onwards, a period of consolidation of reforms followed, in terms of collection and institutional arrangements. In 1997, customs reforms took place, with regard to both institutional capacity building and simplification of the tariff system. In 1999, these were followed by more reforms in indirect taxation, in particular the introduction of the value-added tax. In 2002/03, most of the reforms concentrated on direct taxation. From 2004 onwards most reforms will be related to the creation of the Central Revenue Authority and the effects of regional integration or trade blocks. These reforms have contributed to the increase in the domestic revenues as a percentage of GDP since 1997.

Another area for budget governance is related to auditing practices. Recently, there have been some related investments in strengthening procedures and capacity for auditing (internally and externally). The Administrative Court is the entity that deals with the external auditing of the State Accounts. This institution has received technical assistance for some time, which has permitted it to audit the State Accounts from the 1998 fiscal year onwards. Besides this oversight activity of the State Accounts, the Administrative Court is a Civil Service Commission (providing clearance on major personnel decisions like hiring and promotions) and a National Contracts Committee/Tender Board (providing clearance of public contracts), and it provides for clearance of financial agreements (for example, grants and loans) with foreign institutions. This imposes an insurmountable burden on the Administrative Court and, consequently, limits its capacity to perform; it also includes conflicting functional roles as the Administrative Court passes *ex ante* judgments on contract/tender procedures and hiring decisions, which later it has to audit. Although the Administrative Court has an independent status under the Constitution, it follows normal civil service hiring conditions (depending on the state budget for normal functioning), so it faces normal recruitment problems for qualified staff. In the last two years, budget allocations have improved to allow for the strengthening of the institution, but it has continued to face structural problems given its conflicting responsibilities.

The General Finance Inspectorate (GFI), within the Ministry of Planning and Finance, is the entity responsible for internal auditing, the internal inspectorate for public finances. It has undergone some improvements over the last few years, even being treated as a semi-autonomous institution for budgetary purposes, in order to exercise more control over resources and their internal allocation. It has been recruiting skilled staff and has designed a long-term development plan, which is being implemented systematically. The GFI has received some technical assistance, and has been able to perform more in-depth audits, including performance audits (value-for-money audits). It is now in the process of strengthening the regional offices in the central and northern parts of the country.

Attempts are ongoing to involve external partners linked to the budget support schemes and civil society, in general, in the planning/budget process. Two lines of action can be presented here.

- **External partners:** A highly structured process has been developed for dialogue between the government and the G-15 partners (13 bilateral donors and the European Commission and the World Bank) providing general budget support to Mozambique. This involves a Memorandum of Understanding that establishes two joint reviews annually, focused on a performance assessment framework (PAF) indicating key outputs and actions over a three-year period. Donors constitute both a strength and a challenge for Mozambican authorities. Donor staff are proactive and engage in very detailed monitoring activities, providing proposals, undertaking studies and engaging in policy and technical discussions. This can overwhelm local staff and result in them feeling more accountable to donors, through this and other (sectoral) processes, than to Parliament. Discussion with donors focuses on strategic policy issues, the quality of work and data, thus raising the appropriate issues for debate and decision making. One important aspect of this harmonisation exercise, however, is the use of existing planning and budgeting instruments/documents to incorporate the discussed indicators/issues within the Economic and Social Plan (ESP) and the annual budget, and also the use of the existing monitoring and evaluation mechanisms (ESP Reports, Quarterly Budget Reports and State Accounts).
- **Civil society:** The framework for dialogue with other (internal) stakeholders is much weaker, although an annual "Poverty Observatory" provides a consultative forum for dialogue with civil society organisations on progress in the struggle against poverty. Various documents produced either by the government or by civil society are analysed at this forum. However, the budgetary dimensions of this have not been prominent in the dialogue.

Finally, continuing weaknesses of the MTFF are a subject of concern. The MTFF has not yet developed into an instrument for strategic, medium-term resource allocation; it remains essentially a technical forecasting tool, used internally within the National Directorate for Planning and Budget for projecting resource envelopes and setting limits for budget formulation using an incremental approach. Given its limited technical role, the MTFF still does not go to the Council of Ministers for discussion and approval, and therefore is also not submitted to Parliament.

The National Directorate for Planning and Budget has drawn on these lessons, and has developed a methodology for submissions to the senior management of the Ministry of Planning and Finance, which addresses these institutional weaknesses. Since the beginning of 2004, a major overhaul of the methodology has been proposed, in the sense of looking at the MTFF, the Economic and Social Plan and the annual budget as parts of a single process. The first stage is at a strategic and policy level, while the second stage deals with the detailed elaboration of the documents, which are submitted to Parliament. With this single process, policy documents become more integrated. The new process may be implemented in the 2006 budget cycle.

4. Assessment of the budget process reforms

Assessing the effects of reforms is a very complex matter, particularly in a changing environment. Reforms are moving in a relatively structured and comprehensive manner. The trend in PFM has been positive, but further improvements are needed in medium-term planning and budgeting to increase transparency and coverage, while budget execution is still weak, as are external auditing and accountability in general. Budget formulation has improved slightly in terms of coverage, classification, identification of resource envelopes and discipline regarding fiscal aggregates.

A look at the budget out-turn in the last several years shows that the overall balance after grants, which had been very high in the early 1990s, was reduced to 1.5% of GDP by 1999, though it widened in the early 2000s, peaking at 8.2% in 2002, falling in 2003 to 4.6% and in 2004 falling again to around 4.1%.

In what is a concern regarding coverage and transparency, significant off-budget flows remain, making budget management inherently difficult. Due to the size of these resources in some sectors, the government and external partners have decided to start a health sector study to analyse these off-budget resources and to propose measures for their incorporation in the state budget and its mechanisms.

Budget formulation has changed very little, if at all, in terms of effectiveness, equity and efficiency, because there are no mechanisms in place (through the MTFF or the budget itself) for linking resource allocation to policy priorities, addressing territorial equity issues, and so on. The only allocative targets explicitly being followed are on fiscal aggregates (agreed with the IMF) and the share of PRSP priority sectors (65% of overall recurrent and capital expenditures), but some slippage has occurred (63% in 2003 according to the audited State Accounts). There are no explicit targets for intra-sectoral or territorial allocation. For the 2005 budget, some basic criteria based on population size and the poverty index level have been used to start to determine resource allocation for provinces, in particular.

Some large line ministries are beginning to plan and budget better, but they are doing so with their own systems, parallel to the macro-level annual budget system. These line ministry systems are related to the sector strategic plans and common funds schemes developed as a result of sector-wide approaches, and include off-budget flows.

An overall assessment of the reforms can be classified as a positive change, but they are still at an early stage. The trends are clearly positive; however, limited resources (in particular, senior technical skills) to attend to the vast demands of the reform agenda impose some risks on the actual implementation of the reforms.

4.1. Successful aspects and challenges

It is fair to say that the following have aided the successful aspects of the reforms:

- Political commitment exists, for the public sector reform in general, and for public finance management reforms within the Ministry of Planning and Finance in particular. The MPF is in the driving seat of the PFM reforms, so senior management provides appropriate support for the reform process.
- There is strong donor pressure (to reduce fiduciary risk), given the high level of dependence on donor resources. The move towards budget support and the implementation of the Memorandum of Understanding puts quite a lot of pressure on government and its institutions to show positive outcomes through the indicators of the PAF (performance assessment framework) and the policy discussions during the joint reviews.
- Technical assistance, as indicated above, has had a positive effect in helping to implement reform tasks in different areas, due to the shortage of skilled staff.

Mozambique's reform route differs to some degree from that of other countries. Whereas many other countries introduce more sophisticated strategic budgeting systems, such as Medium-term Expenditure Frameworks, while the annual budget process and budgeting machinery are still in disarray, Mozambique's first efforts were aimed at addressing underlying systemic problems, such as an inadequate classification system and poor financial management information systems, and to improve the coverage of the budget. The MTFF was only introduced later and is being used with some success as a technical financial forecasting tool. Mozambique's budget management system now faces issues regarding the alignment of policy and budgeting, and co-ordination of spending plans towards improved overall budget policy performance. There are major challenges for further development of budgeting systems in this regard. This may require a shift in approach to budget reforms, from emphasising the technical to including consideration of institutional factors. Specific challenges in this regard are outlined below.

- There is a strong incentive for line ministries and donors to maintain direct donor assistance to line ministries, bypassing fully or partially the state budget system. This hinders budget coverage and transparency by maintaining off-budget flows. It also makes policy co-ordination at the central level more difficult.

- There are weak incentives for the political leadership (Council of Ministers) to assume control of the resource allocation process, to avoid having to make hard decisions about trade-offs between competing priorities, while individual ministries (or even directorates within them) have direct access to donor funds to meet their own priorities. The MTFF is still largely a technical exercise, with little involvement by the Council of Ministers.
- There are huge capacity constraints, both within the Ministry of Planning and Finance and within line ministries, provinces and districts. This aspect will determine the pace of the reforms, because reforms require changes in the mindset of public servants.
- Internal demand (from Parliament and civil society) for improved budget management is still very weak; all the pressure is coming from donors and international financial institutions.