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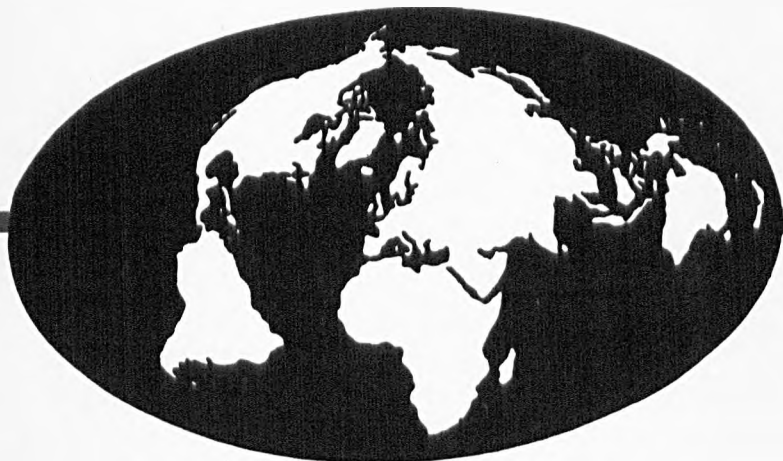
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Foreign Aid, Structural Adjustment,
and Public Management
the Mozambican Experience¹

by

Marc Wuyts²
DPP Working Paper No 36

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1996



Development Policy and Practice Research Group
Faculty of Technology
The Open University

March 1996

Foreign Aid, Structural Adjustment,
and Public Management
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Marc Wuyts²
DPP Working Paper No 36

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- 1 Special thanks to SIDA who gave me the opportunity and assistance to return to Mozambique to gather data for this study. I am indebted to Haroon Akram-Lodhi, Maureen Mackintosh and Bridget O'Laughlin for valuable comments on earlier drafts of this paper.
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Contents	Page
Abstract	
Introduction	1
1 The Weight of Foreign Aid in Domestic Expenditures: 1980 - 1993	2
2 Conceptualising Public Sector Reforms in Mozambique	11
3 Aid, Central Control and Devolved Financial Management	16
Conclusion	30
Appendix	33
Bibliography	35
Endnotes	38
Figure 1: Sectoral Gross Output (1980 Prices: Billions of MT)	3
Figure 2: GDP Exports and Imports (1980 prices; billions of MT)	4
Figure 3: Exports and Imports as % of GDP (in current prices)	5
Figure 4: Foreign Grants, Net Capital Inflows and Debt Relief (in \$ millions)	7
Figure 5: Foreign Grants, Net Capital Inflows and Debt Relief (as % of GDP)	8
Figure 6: Government Recurrent Expenditures, Revenues and Investment (% of GDP)	9
Figure 7: The Budget Deficit and its Financing (% of GDP)	10
Chart 1: Foreign Aid and Fiscal Management	17
Table 1: Counterpart Funds in the Budget (as % of Total Government Expenditures)	19
Table 2: Distribution of Recurrent Expenditures (Selected Categories; % of total Recurrent Expenditures)	20
Table 3: Cash Limits on Public Investments 1990-93	21
Table 4: Cash Limits, Programmed and Executed Public Investment, 1990-1993 (billions of meticaís; constant 1992 prices)	22
Table 5: Cash Limited and Programmed Expenditures for PTIB 1993/5 (% shares)	23
Table 6: Programmed Investment Expenditures 1990/93 (% distribution)	24
Table 7: Total Programmed Recurrent Expenditures by Budgetary Source: State Budget and Investment Budget (PTIP) 1993 (in billions of Meticaís)	26

ABSTRACT

This article argues that the particular combination of fiscal restraint imposed through financial programming along with the proliferation of decentralised project-based management, jointly proved to be a potent mixture which failed to reconstruct a coherent pattern of state action in Mozambique under structural adjustment. The problem lies in the increasing dominance of foreign aid and in the uneasy interplay between programme aid, on the one hand, and project aid, on the other, as projects compete resources away from regular state programmes without there being much prospects of such projects becoming self-sustainable in the absence of the continued infusion of foreign aid.

INTRODUCTION

In the last decade, Mozambique witnessed considerable turmoil as a result of three interactive processes of change. First, the 1980s saw the intensification of a brutal war waged by the South Africa - backed resistance army, *Renamo*, against the socialist government led by *Frelimo*, the ruling party since independence in 1975. The devastation caused by the war and the stalemate to which it gave rise as neither of both parties was able to win decisively, finally, in 1992, gave rise to a peace settlement, followed by UN-supervised multiparty elections and the formation of a new government, led by *Frelimo*, in the context of a newly formed parliamentary democracy. Second, during the same period, the country also underwent a transition from a centrally-planned socialist economy to market-led development favouring private enterprise rather than the state as the key agent for economic growth and development. These reforms, initiated internally in 1983, gained momentum with the adoption, in 1987, of the Economic Recovery Programme (ERP) under the aegis of the IMF and the World Bank (Wuyts, 1991). Finally, a third feature of this period was the rapid increase in aid dependency, both *quantitatively* as measured by the contribution of foreign aid toward financing the deficits of external trade and the government budget, and *qualitatively* as evidenced by the increased fragmentation of the control over public money as between government institutions and donor agencies. These three broad processes of change fundamentally restructured the nature of economic and social development in Mozambique, and redefined the role of the state therein.

In the light of these broader processes of change, this paper seeks to understand what is happening in the process of budgetary reforms in Mozambique during structural adjustment. More specifically, the paper argues that in a context where foreign aid increasingly dominates the scene, both quantitatively and qualitatively (in terms of control over public money), the unintended outcomes of these budgetary reforms come to diverge more sharply from intended policies. The first section of the paper develops an argument as to the quantitative dimension of the increasing dominance of foreign aid in matters of public finances during structural adjustment. I argue that what matters in assessing the dominance of foreign aid is not just the increase in the volume of aid during structural adjustment, but also the increased weight of foreign aid in domestic expenditures as a result of the dramatic changes in relative prices due to the depreciation of the real exchange rate. In section two, the paper briefly outlines the basic ideas behind the public expenditure reforms initiated since 1987 with the assistance of the World Bank. This section argues that the reforms aimed to develop a coherent framework for

budget management rooted in financial programming at the macro level combined with a clear definition of sectoral priorities and decentralised sector level expenditure planning and management. Section three then looks at the actual practice of budgetary management as it evolved over recent years. Far from resulting in a process of greater coherence and ownership of budget management, the paper argues that the actual process of budget management can only be understood once we take account of the uneasy interplay between programme aid, on the one hand, and project aid, on the other, in a situation where foreign aid finances the lion's share of public expenditures. In this context, the process of reforms set in motion a vicious circle which rendered state action progressively less coherent and effective as projects compete resources away from regular state programmes without much real prospect of such projects becoming self-sustainable in the absence of the continued infusion of aid.

1 The Weight of Foreign Aid in Domestic Expenditures: 1980 - 1993¹

Introduction

This section shows how foreign aid became increasingly more dominant in the national economy at large, and in public finances in particular. I argue that to assess the quantitative importance of foreign aid, it is not sufficient to look only at its growth in dollar terms, but that it is important also to assess its changing weight in domestic expenditures as a result of relative price changes. Indeed, an important facet of the reforms propelled by structural adjustment was the dramatic change in relative prices in the economy, provoked by sustained currency devaluations coupled with stabilisation policies. Rapidly changing relative prices in an economy considerably complicate our interpretation of trends in macro aggregates. Unfortunately, this is often overlooked. More specifically, if our interest lies in assessing the evolution of the volume of goods and services available in the economy, it is preferable to measure the relevant macro aggregates in real terms (i.e. at constant prices). However, if we are interested in assessing the relative importance (i.e. the weight) of a macroeconomic aggregate in the economy's expenditures or income patterns, it is preferable to measure it as a share of GDP (Gross Domestic Product), in current prices, so as to capture the effects of relative price changes. This section shows that the latter point is specifically important if we try to assess the extent to which the economy, its external trade, and its public finances were aid dependent. Before turning to this issue, however, let me first quickly sketch some basic macroeconomic trends in the economy against which such changes took place. Let me make clear from the

outset that it is not my intention in this section to dwell at any length on Mozambique's economic history. I have done this elsewhere (Wuyts, 1989a, 1991)².

Trends in the Volumes of Output, Exports and Imports

Figure 1 gives a rough sketch of the evolution of the gross sectoral outputs of, respectively, agriculture, industry and services.^{3 4} As can be seen from these graphs, the three sectors evolved differently over time. In agriculture, production fell markedly in the first half of the 1980s, witnessed a mild recovery in the late 1980s, declined once more in the early 1990s, to revive again in 1993 when hostilities had ended.

Caution should be taken, however, in the interpretation of the agricultural data since the trend they reveal is based on very scanty information. The war situation - which mainly effected rural areas - made it impossible to collect much reliable data on agricultural output. It is not unlikely, therefore, that agricultural production suffered greater declines than is revealed in these data.

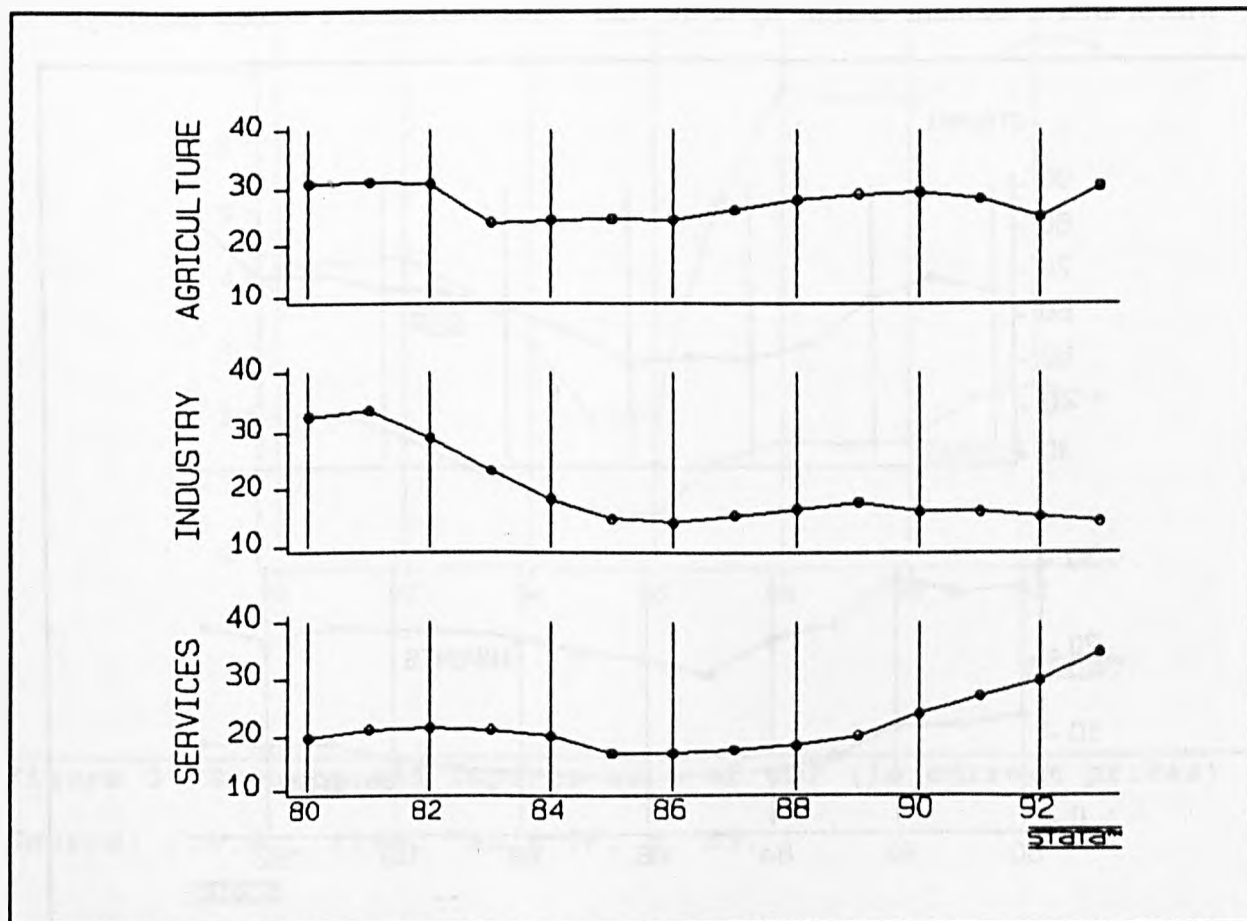


Figure 1 : Sectoral Gross Output (1980 Prices: Billions of MT)

Source: C.N.P, 1994: Tables 31 and 32, p. 33.

Throughout the period as a whole, industrial output experienced a secular decline, with the exception of a minor revival during 1987-89, the first three years of structural adjustment. Its steep fall in the early 1980s was probably due to the lack of export earnings to pay for imported intermediate goods, spare parts, and maintenance investment goods. In the second half of the 1980s, the increase in aid funds along with the switch by donors towards commodity import support accounted for a mild revival in industrial production. In the 1990s, however, industrial output continued its decline.

In contrast, services (i.e., the social sectors, commerce, hotels and restaurants, domestic services, etc.), after an initial decline, witnessed a period of sustained growth. A significant component of its growth during the 1990s was accounted for by the growth of commerce and of restaurants and hotels.

Turning now to Figure 2, its upper panel depicts the evolution of real GDP. As can be seen, output fell significantly during the first half of the 1980s, and subsequently witnessed a notable revival under structural adjustment. The lower panel in figure 2 shows that import volume underwent a similar trend, but its recovery under structural adjustment was less pronounced. The same is true for export volume which, after a dramatic decline up to the mid-1980s, witnessed a modest recovery.

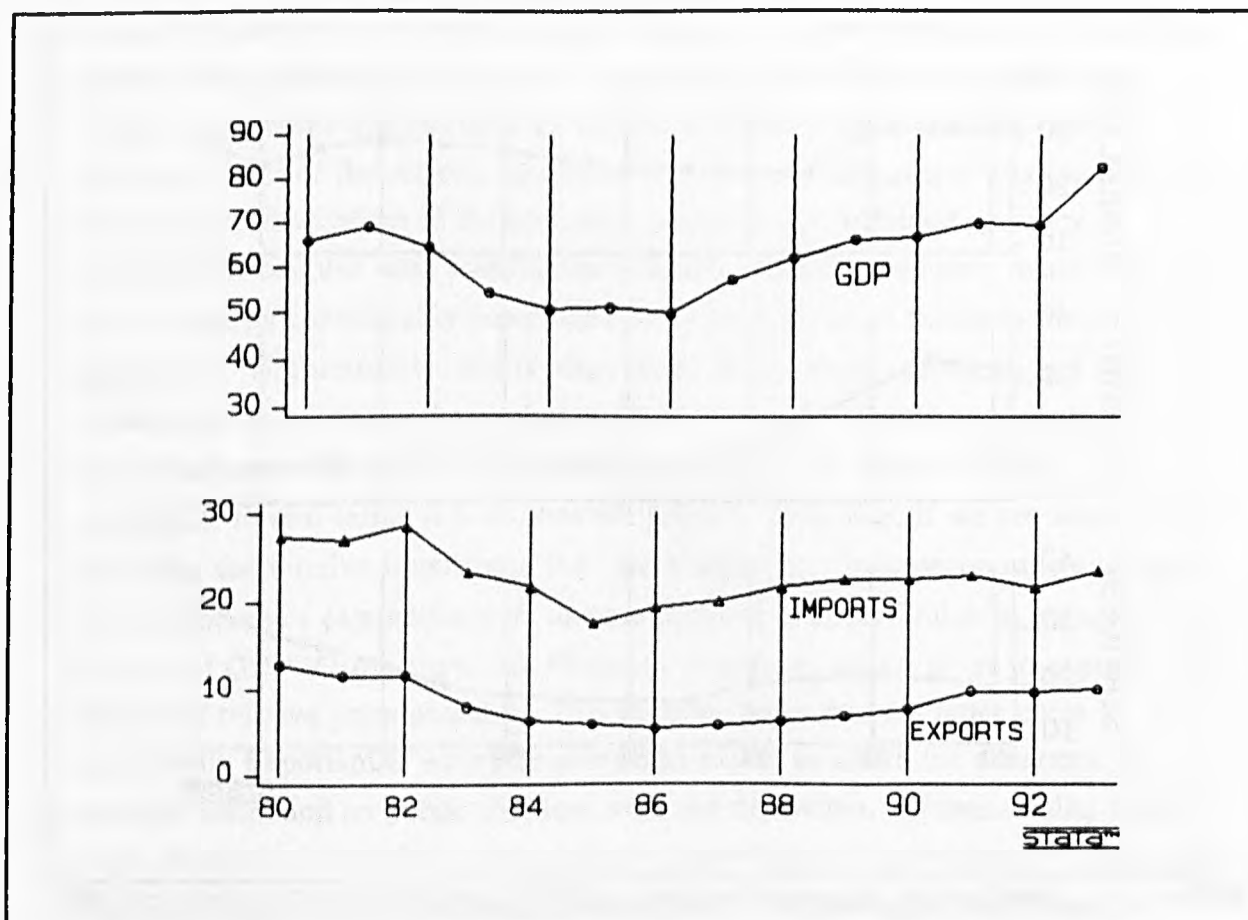


Figure 2 GDP, Exports and Imports (1980 prices; billions of MT)

Changing Relative Prices and the Shares of Imports and Exports in GDP

In a context where relative prices - particularly, the relative prices of tradables versus non-tradables - change dramatically, trends in foreign trade look quite different when expressed as shares of GDP in current prices. Figure 3 shows this by depicting exports and imports of goods and services as shares of GDP in current prices.

The remarkable feature about Figure 3 is the sharp increase in the shares of imports and, less visibly, of exports since 1987, the year the Economic Recovery Programme was initiated. Obviously, as is evident from Figure 2, these increases are not principally due to the respective increases in the volumes of imports or exports (relatively to the growth in real GDP), but resulted mainly from changing relative prices between *tradables* and *non-tradables* in the domestic economy.

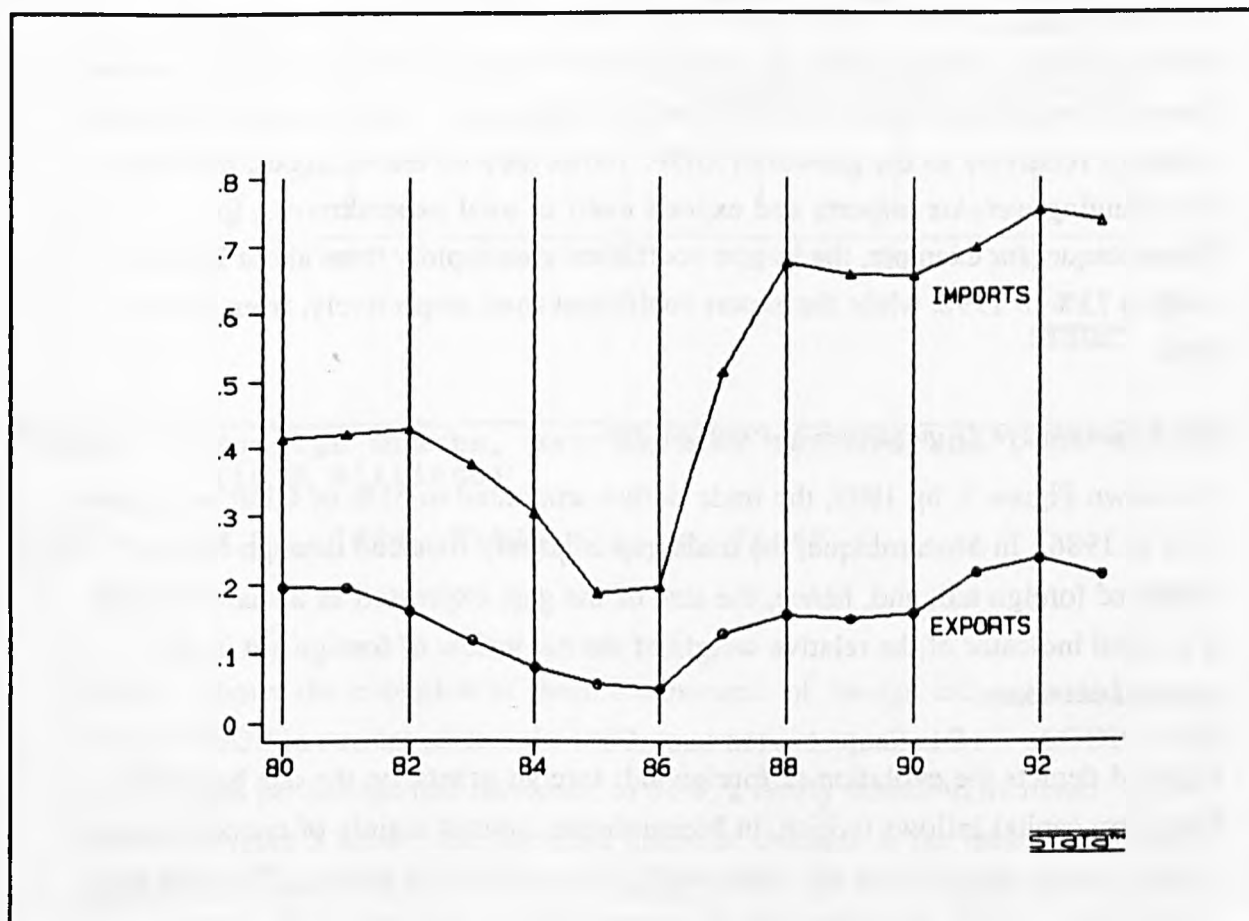


Figure 3 Exports and Imports as % of GDP (in current prices)

Source: C.N.P., 1994, Table 76, p. 69.

The reason, as shown in the appendix, is that the share of imports in GDP depends not only on volume changes in imports and GDP, but also on two sets of relative prices - the external terms of trade, on the one hand, and the real exchange rate, on the other. The real exchange rate measures the relative price of tradables (in this case, importables) to non-tradables. A similar argument applies to the share of exports in GDP which can equally be shown (see appendix) to depend on volume changes of exports and GDP, on the one hand, and on two sets of relative prices - the real exchange rate of exportables and, as before, the external terms of trade.

Other things being equal, therefore, the shares of imports and exports in GDP will rise with a depreciation of the real exchange rate. In a period of dramatic changes in the real exchange rate as a result of deliberate policy reforms, as was the case in Mozambique after the implementation of the economic recovery programme, this relative price effect, as clearly shown in Figure 3, can come to exert an overwhelming influence on the behaviour of imports and exports measured as shares of GDP. Consequently, in such a period of rapidly changing relative prices, shares of exports and imports in GDP tell us little about volume changes in these variables relatively to the growth of GDP. What they do tell us about, however, is the changing *weights* imports and exports exert in total expenditures. In Mozambique, for example, the import coefficient rose rapidly from about 20 % in 1986 to 75% in 1992, while the export coefficient rose, respectively, from 5% to 24%.

The Quantitative Dimensions of Foreign Aid

As shown Figure 3, by 1992, the trade deficit amounted to 51% of GDP, as against 15% in 1986. In Mozambique, the trade gap is largely financed through the net inflow of foreign aid, and, hence, the size of the gap, expressed as a share of GDP, is a good indicator of the relative weight of the net inflow of foreign aid in the national economy.

Figure 4 depicts the evolution of foreign aid: foreign grants, on the one hand, and long term capital inflows (which, in Mozambique, consist mainly of concessionary loans)⁵ minus amortization plus debt relief, all in millions of dollars. For lack of a better term, I labelled the sum of both components as total net aid (i.e. not counting debt relief which pays for the amortization of previous loans). Figure 4 shows that foreign grants increased steadily, while, in contrast, net capital inflows minus debt relief witnessed a secular decline. As to the latter, external borrowing decreased over time, while amortization and debt relief both increased, resulting in

a pattern of secular decline in the balance between them. Total net aid (i.e. foreign grants plus net external capital flows and debt relief) increased, from 1982 to 1992, by 67 % in dollar terms.

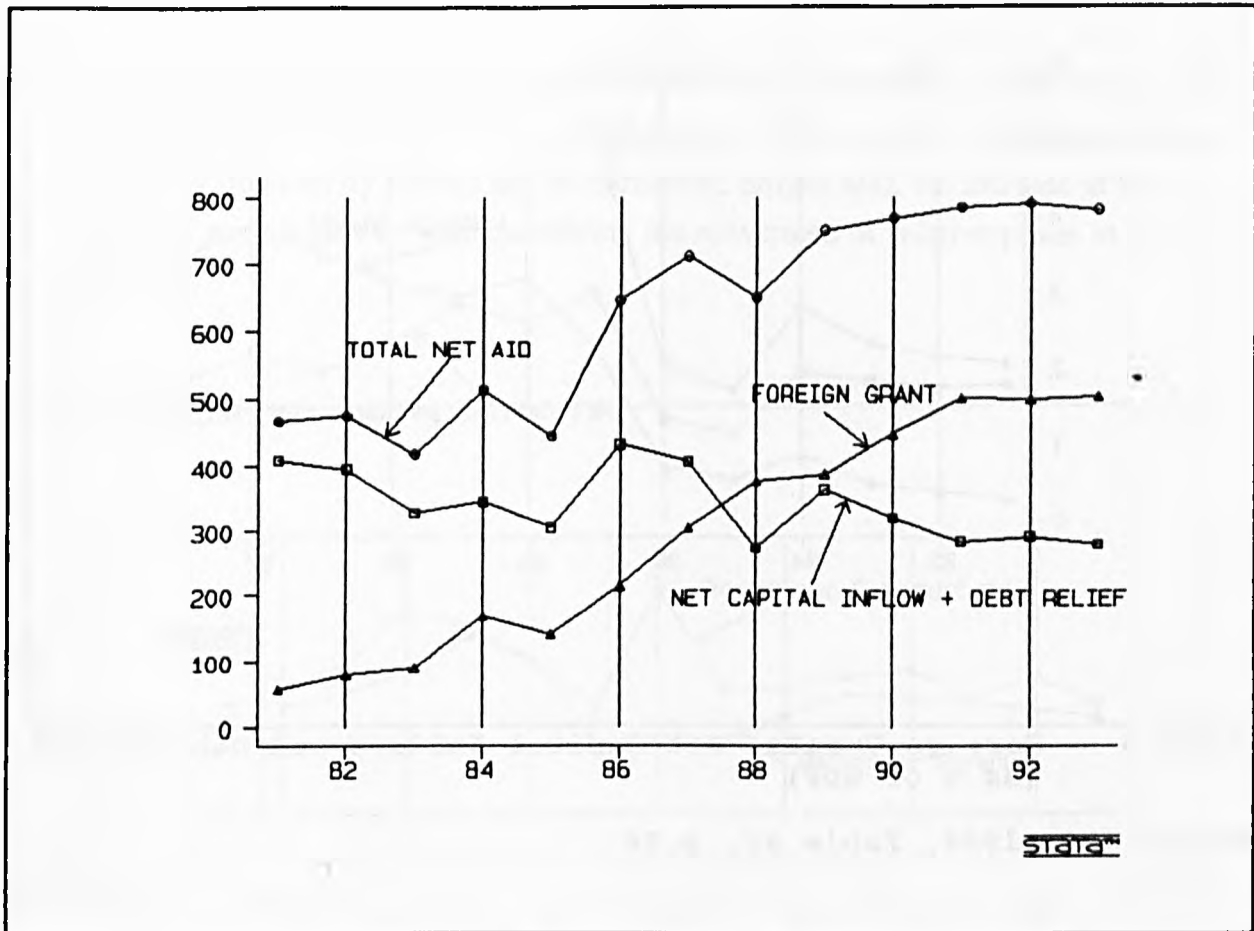


Figure 4 Foreign Grants, Net Capital Inflows and Debt Relief (in \$ millions)

Source: C.N.P., 1994, Table 61, pp. 56-57

Figure 5 shows the evolution of these components of foreign aid expressed as shares of GDP in current prices. In 1982, total net aid equalled 21% of GDP, while in 1992, this percentage had increased to 61%, a nearly threefold increase! As in Figure 3, Figure 5 shows that the most dramatic changes in the relative prices of tradables and non-tradables took place during 1987 and 1988, the initial years of the economic recovery programme. As with imports, the share of the net inflow of aid in GDP does not only depend on volume changes in aid and GDP, but also, as shown in the appendix, on the real exchange rate (of importables) and on the external terms of trade.

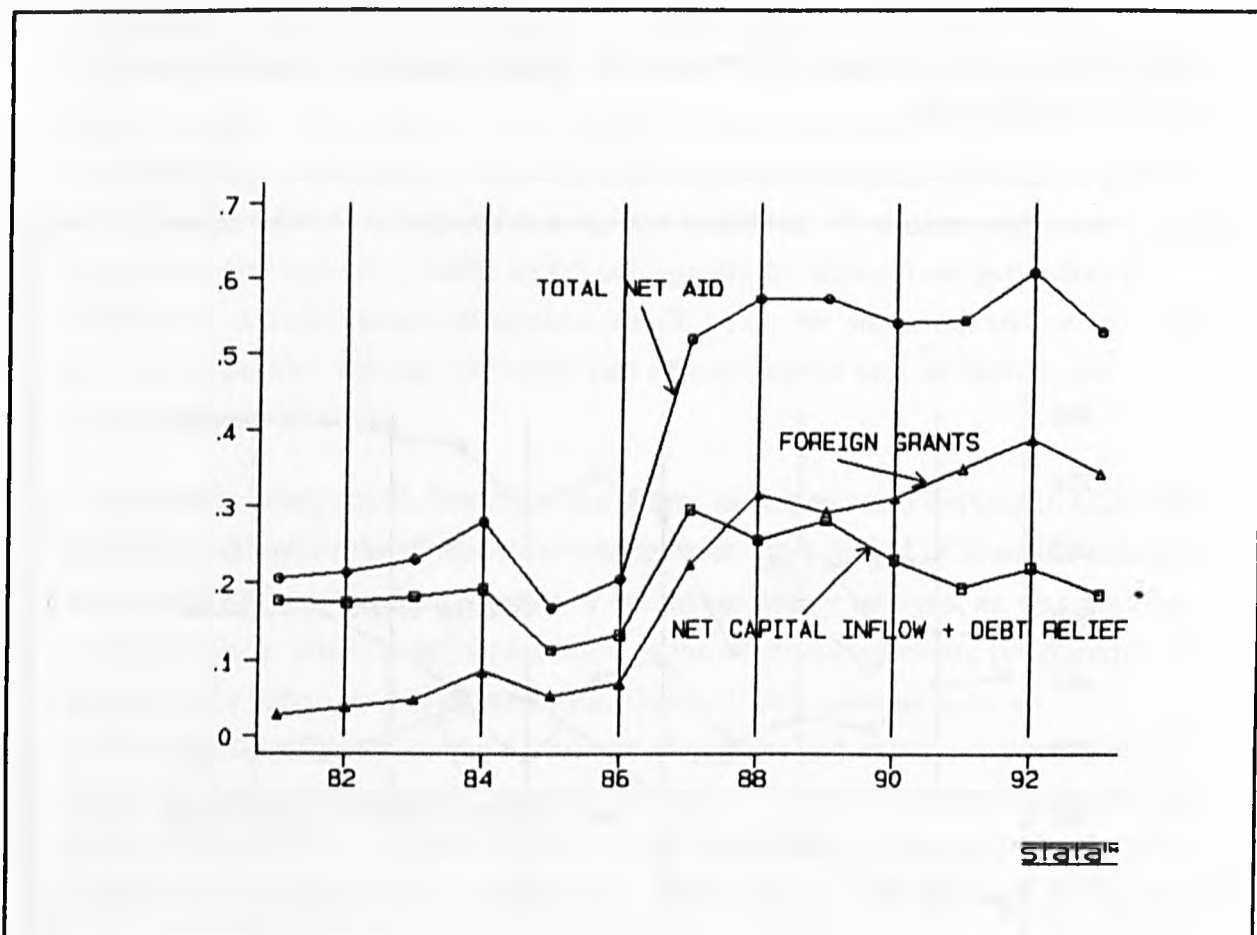


Figure 5 Foreign Grants, Net Capital Inflows and Debt Relief (as % of GDP)

Source: CNP, 1994, Table 62, p.58

This digression on the relation between shares in GDP and the movement of relative prices leads us to an important conclusion relevant to the subsequent argument in this paper. The dramatic depreciation of the real exchange rate in Mozambique - particularly, during 1987 and 1988, the initial years of structural adjustment - greatly amplified the weight of foreign aid in the expenditure and income patterns in the economy. This matters since foreign aid, directly or indirectly (as a result of counterpart funds), channels finance to the government budget. In the Mozambican context, by 1988, this contribution of foreign aid to the budget became very prominent.

The Evolution and Structure of Public Finances

Figure 6 depicts the evolution of, respectively, recurrent expenditures and revenues, on the one hand, and of government investment, on the other, all expressed as a share of GDP (in current prices). Its top panel shows that recurrent revenues failed to keep pace with recurrent expenditures. In the early

1980s, the share of recurrent revenues in GDP fell dramatically and only recovered slightly in the second half of the 1980s. From 1985 onwards, recurrent expenditures consistently exceeded recurrent revenues, but the gap narrowed in later years, mainly because of the slower growth in public expenditures (relatively to GDP growth).

The bottom panel shows that investment as a share of GDP fell significantly in the mid-1980s, and subsequently rose steeply from 1987 onwards. Since investment is largely financed by foreign aid (in particular, project aid), the increase in the share of government investment reflects the movement of relative prices in the economy.

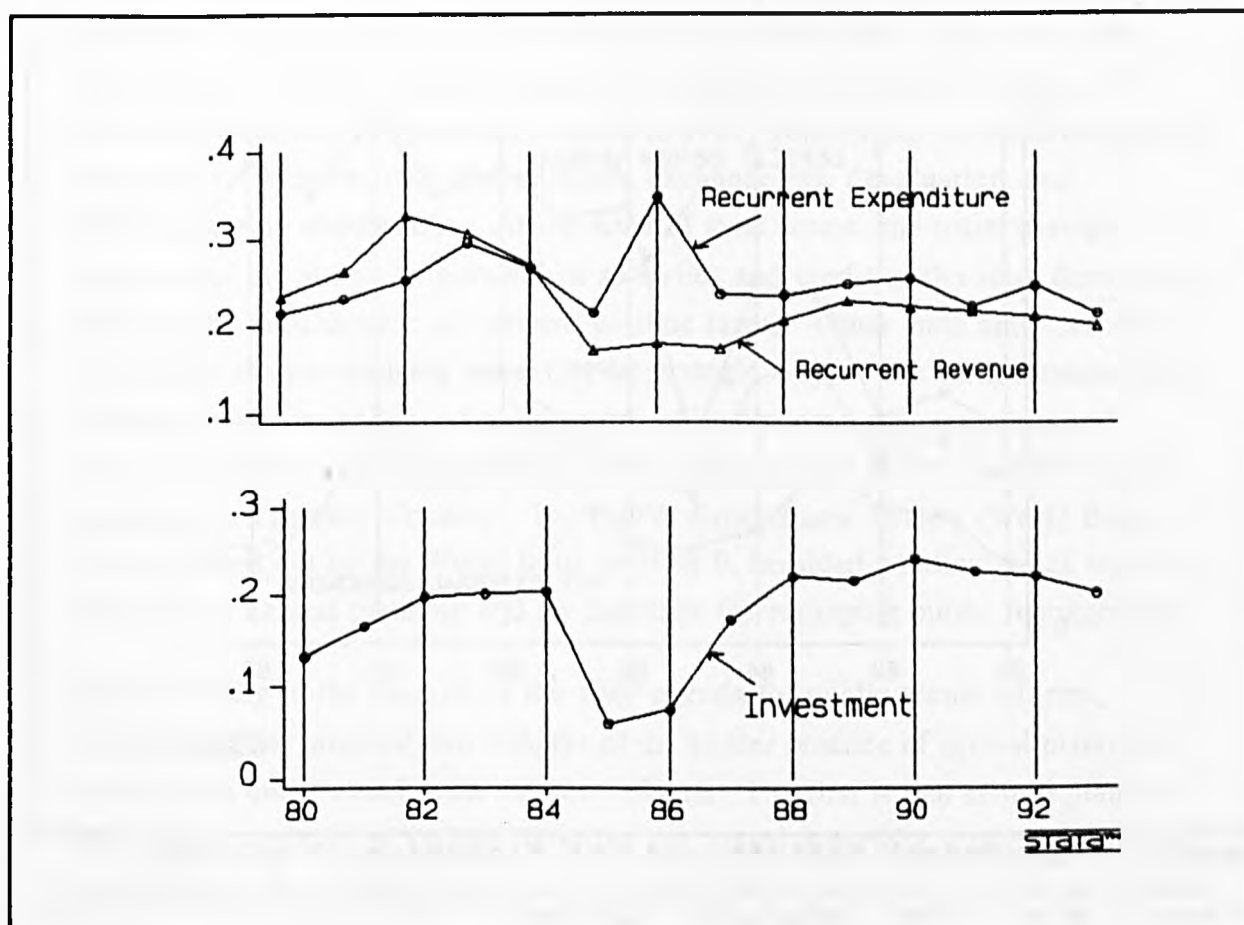


Figure 6 Government Recurrent Expenditures, Revenues and Investment (% of GDP)

Source: C.N.P, 1994, Table 41, pp. 38-9

Figure 7 then takes a closer look at the government's budget deficit and the way it is financed. The budget deficit before including foreign grants equals total government expenditures (both recurrent and investment) minus government revenues. The deficit after including foreign grants equals total government expenditures minus the sum of government revenues and foreign grants. The share of the deficit before grants in GDP rose significantly over the period as a whole, while the share of the deficit after grants in GDP fell. Foreign grants, therefore, financed an increasingly more prominent share of the government's budget deficit.

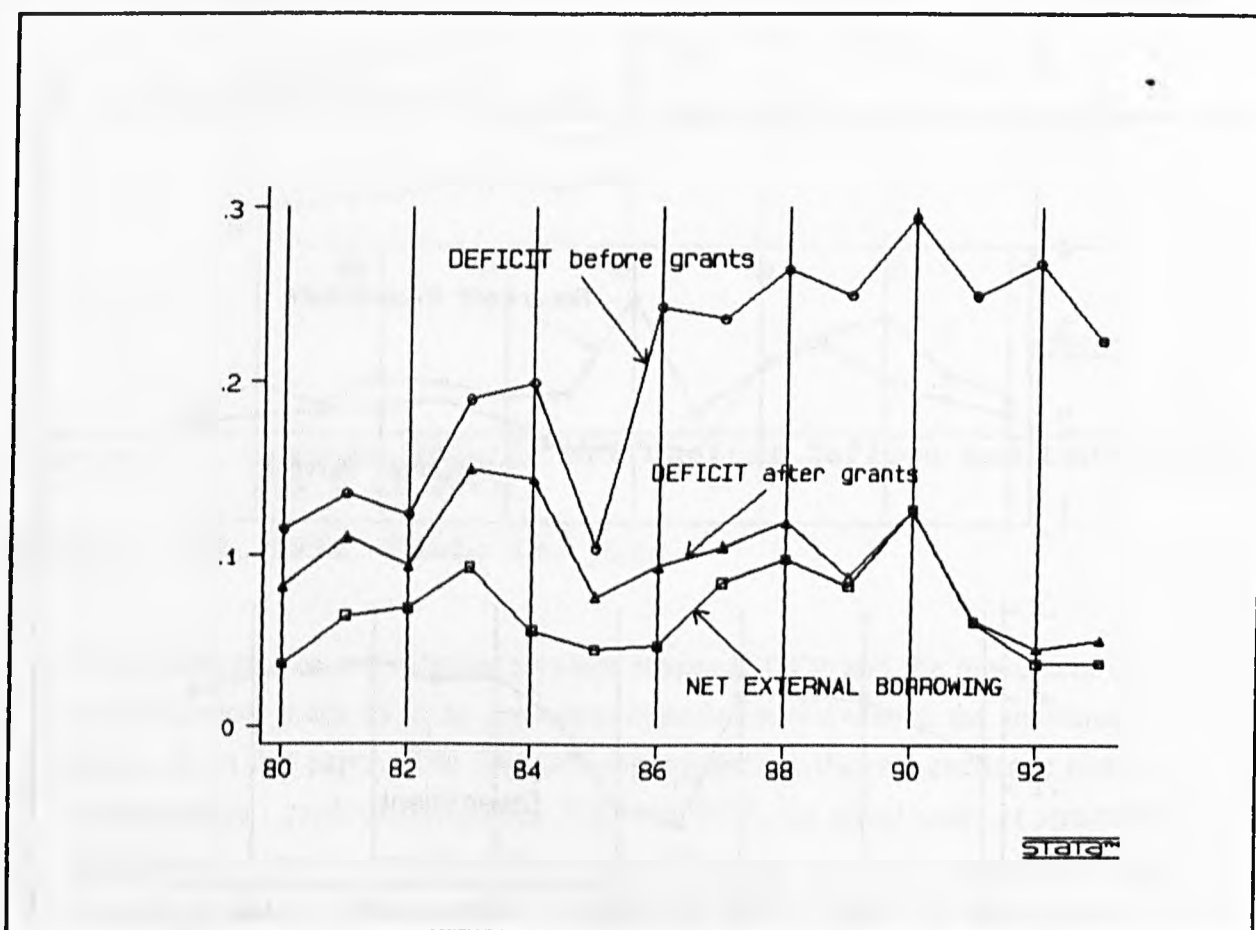


Figure 7 The Budget Deficit and its Financing (% of GDP)

Source: C.N.P., 1994, Table 41, pp.38-9

In the Mozambican context, the deficit after grants can be financed either by money creation or, externally, through net foreign borrowing. Figure 7 reveals that, after 1987, the gap between the deficit after grants and net foreign borrowing narrowed considerably, implying that little or no recourse was taken to money creation to finance government deficits. In short, after structural adjustment, the budget deficit, which increased as a share of GDP, was predominantly financed through foreign grants and loans. In the early 1990s, this deficit amounted to between 25 to 30% of GDP (that is, slightly more than 55% of total government expenditures).

2 Conceptualising Public Sector Reforms in Mozambique

From Central Planning to Market-led Development

It was not until 1989 that a coherent approach to public sector management under structural adjustment in Mozambique came to be formulated. Up to that point, public sector reforms had been largely incremental and reactive in nature. The Economic Recovery Programme, adopted in 1987, initially put the main emphasis of economic reforms on trade liberalisation, exchange rate devaluation, and macroeconomic stabilisation. At the level of state action, the main strategic change was the state's withdrawal of subsidies and credit to the state farm sector followed by considerable divestment of state farms. Other state practices also changed in the process, but not as yet in strategic ways. The earlier mechanisms of central planning continued to linger on, while domestic policy makers and advisors searched for new ways of public management in the context of a rapid transition to a market economy. The *Public Expenditure Review* (World Bank, 1989), carried out by the World Bank in 1988-9, heralded a radical break with the remnants of central planning and set the stage for reshaping public management.

Before turning to the analysis of the 1989 agenda for public sector reforms, however, let me pinpoint two features of the earlier practice of central planning which came under attack with the new reforms. The first is that central planning essentially consisted of *volume planning* (or, stated otherwise, material planning); the second is that the key objective of state action was *to invest in the accelerated expansion of the state sector* (Wuyts, 1989, 1991). Both these elements stood in sharp contrast with what was to become the new agenda for public management: the move to *cash planning* as distinct from volume planning, on the one hand, and the redefinition of the role of the state as at most a *residual supplier with the key objective of promoting alternatives to its own activity*, on the other.

In theory, the allocation of resources under central planning was to be smooth and orderly, leaving sufficient room for resources to be channelled to support private

production and the transformation of peasant agriculture. In practice, however, central planning turned out to be a messy affair in which the state's investment hunger, ambitious targets and overoptimistic input norms effectively crowded out alternative uses of resources. In fact, Mozambique's planning experience largely boiled down to investment planning aimed at mobilising resources behind the expansion of the state sector. The unintended outcome of it all, further aggravated by the escalating war, was that the peasantry was largely left to fend for itself in an ever-growing parallel economy where private initiative in short-run speculative ventures reigned supreme. A new culture of private enterprise, rooted in speculation and biased towards commerce, thus developed in the margins of state-centred development and gradually encroached upon it. That is, the state sector itself increasingly came to depend on this parallel economy to procure food, buy cash crops, feed its army, etc. Not surprisingly, therefore, the first steps in trade liberalisation of the domestic economy initiated by the 1983 economic reforms were largely prompted by the growing strength of the parallel economy and the state's increased dependence on it (Wuyts, 1989, 1991.).

In fact, in the mid-1980s, when the World Bank became prominent in policy debates in Mozambique, it was this inability of the state to foster the development of peasant agriculture in particular, and the private sector in general, which was singled out as a major reason behind the need for reforms;

Little attention has been paid to the development of institutions and infrastructure to deliver essential agricultural services such as research, extension, marketing and credit to family and private producers (World Bank, 1988, in Gibbon et. al., 1993: 51).

Clearly, in this quote, and others like it, the World Bank called upon the state to shift its focus towards playing an enabling role in the economy at large, rather than crowding out the private and household production sectors. It was the public expenditure review of 1989 which set the scene for reforming public management to achieve this aim. This review further outlined a new approach to public sector management which heralded a radical break with the previous tradition of central planning. Interestingly, however, the authors of the report were clearly aware that potentially contradictory elements - which they identified as *institutional constraints* - might well crop up in the reform process itself. It is this notion of the interplay and potential tension between a blueprint for reforms, on the one hand, and the possible institutional constraints acting upon it, on the other, which is relevant to the argument of this paper.

The main thrust of these reforms can be summarised in four major points. *First*, they involved a shift from volume to cash planning so as to ensure that macroeconomic balances are maintained by imposing *cash limits* on total and sectoral public expenditures. *Second*, resources should be concentrated on *priority sectors* (in particular agriculture, transport, health and education), and the management of public expenditure programmes was to be *decentralised* towards sectoral ministries within the overall confines of centrally controlled cash limits on sectoral public expenditures. *Third*, within each sector, priority should go to *quick-yielding investments* with rapid turnover and to *revitalising current expenditures on operation, maintenance and rehabilitation*, both aimed at supporting the private and family sectors instead of merely expanding state activities. *Finally*, foreign aid was to be relied upon to continue to support government expenditures by means of two separate mechanisms: (1) using *counterpart funds as general budget support* instead of such funds being earmarked by donors for special uses, and (2) mobilising *sector-based aid-financed projects* to enhance sectoral public expenditure programmes.

Financial Programming and Fiscal Restraint

The shift towards cash planning was initiated from 1987 onwards in the context of IMF/World Bank inspired stabilisation policies. The basic framework for stabilisation is the IMF's *financial programming model* (Tarp, 1993: 56-78). In essence, this model draws on a few identities of national income and monetary accounts and combines these with two key behaviour relations to arrive at policy prescriptions which are deemed to be generally valid. More specifically, domestic credit creation in general, and government borrowing from the banking system in particular, is identified as the major source of macroeconomic imbalances in the economy.

As to its accounting identities, the model makes use of the fact that the difference between national income, Y_N , and domestic absorption (= total domestic expenditures on goods and services), A , equals the balance on current account, CA , of the country's balance of payment, as follows,

$$Y_N - A = CA \quad (1)$$

Note that the difference between national income and absorption also equals the difference between *national savings*⁶ and investment.

The current account, in turn, must be balanced by changes in international reserves, ΔR , held by the country's banking system and by net capital inflows, ΔF

(where F are net foreign assets held by the non-banking sectors of the economy), as follows,

$$CA = \Delta F + \Delta R \quad (2)$$

This is where the money supply enters the picture, since the change in the money supply of the banking system, ΔMS , must be balanced by the change in international reserves, ΔR , and the change in domestic credit, ΔDC , as follows,

$$\Delta MS = \Delta R + \Delta DC \quad (3)$$

These three accounting identities, by themselves, say nothing about the structure of causation among macroeconomic variables, and hence, do not provide a basis for policy prescription. To get there, two key behaviour relations are necessary: namely, '*that there are strong functional connections between money or credit creation and nominal income, and between income [meaning nominal income] and imports*' (Eshag, 1983:244)⁷. This completes the model in its simplest form which, however, contains the essence of the argument.

The key variable in this model, as well as its main culprit, is domestic credit. Indeed, an expansion of domestic credit (for example, as a result of deficit financing by government) will first increase the money supply and subsequently, as borrowers spend the money, nominal income. Part of the additional expenditures will be directed to domestic goods and services, while the remainder will spill over into a demand for imports, which, in turn, leads to a deterioration of the balance of payments (Tarp, 1993:62-3). Not surprisingly, given this diagnosis of the problem, the remedy is sought in the control of domestic credit creation. And this is precisely what financial programming is all about (Killick, 1995: 129-155; Tarp, 1993: 73-78).

In Mozambique, two main instruments are used to control domestic credit creation. First, there is the imposition of *credit ceilings* on bank lending. Second, the country's public finances are subjected to financial discipline to avoid the government taking the lion's share of domestically available credit. Indeed, in a country like Mozambique where capital markets are undeveloped, the financing of government budget deficits is largely done through money creation. *Cash limits* on public expenditures are used, therefore, to avoid this happening. But, clearly, cash limits on government expenditures do not go well together with a system of public management geared towards volume planning. The 1989 reforms, therefore, sought to restructure public management by integrating the use of *cash limits* in a wider context of *cash planning*.

Hence, the reforms envisaged that macro-management should set the limits to public expenditures, given the level of revenues and receipts of counterpart funds, and regulate its distribution between recurrent and investment expenditures as well as across sectors. Within these macro settings, each sector was to formulate its expenditure plans and programmes, dependent, in part, upon the availability of project aid. *Triennial Rolling Investment Plans*, to be implemented from 1990 onwards, were seen as a way to control investment expenditures within a medium term perspective and to achieve a proper balance between investment and recurrent expenditures. Indeed, since investment expenditure brings in its wake a future stream of recurrent expenditures, it was felt that investment should not run ahead of the state's capacity to support its recurrent implications. Furthermore, investment planning was to ensure that government expenditures were allocated in line with sectoral priorities.

Projects: Agency versus Expenditure Category

It was the concern with the need to balance investment and recurrent expenditures which led the authors of the World Bank's 1989 Public Expenditure Review in Mozambique to take a closer look at the investment budget which, not surprisingly, was largely financed by *project aid*. The review pointed out, however, that most projects contained a significant proportion of recurrent expenditures. There was, as the review put it, a strong tendency to *projectize recurrent expenditures*, and, hence, the *investment budget* which mainly consists of projects included a significant recurrent component. Hence, the distinctive feature of the investment budget was that it grouped all projects together in one budget, rather than grouping all investment expenditures together. As such, the authors argued, the so-called investment budget was in essence an *aid* budget which featured all projects independently of whether these projects engaged in investment or recurrent activities.

This, in itself, was not seen to be a bad thing, although the review recognised the danger of making recurrent expenditures excessively dependent on aid. The report's main concern, however, was that this tendency to projectize recurrent expenditures blurred the distinction between recurrent and investment expenditures, and, consequently, imposed institutional constraints on the state's ability to strike a proper balance between both components of public expenditures. A key recommendation of the report was that steps should be taken, with the help of donors, to identify the recurrent component of existing or planned projects.

Inherent in this argument, however, is an interesting confusion as to the nature of a project. One way to look at a project is to see it as *donor-funded investment* support. In this perspective, aid-funded project expenditures can best be aggregated into the investment budget. By and large, this more traditional way of looking at projects corresponded quite well to the earlier practices of project aid during the 1960s and 1970s. But in the 1980s public action came to be recognised as being wider than state action proper, and the devolution of the control over public expenditures towards semi-autonomous financial management centres came to be seen as a desirable aim. In Mozambique, this process of change was largely steered by foreign donors. The 1980s, therefore, witnessed a proliferation of donor projects, governmental and non-governmental alike, which effectively took a large share of the control over public expenditures away from the central state (Hanlon, 1991). The distinctive feature of many of these projects is not that they concern investment activities as such, but rather that they are managed in semi-autonomous units which recruit their own staff, disburse aid funds, generate incomes, etc. Hence, another way to look at projects is to see them from the perspective of *projects as agency*, a point which the 1989 Public Expenditure Review touched upon, without tracing its implications.

Looking at projects as a question of agency rather than of expenditure category, however, brings into the open the potential tension which can arise within the public management reforms between emphasis on central control over expenditures totals, on the one hand, and the *de facto* devolution of public management to donor-controlled semi-autonomous cost centres, on the other. My argument is that unless we address this tension, we cannot come to grips with the likely outcomes, often unintended, of the public management reforms. In the next section I shall show that this potential tension became very real in the Mozambican context.

3 Aid, Central Control and Devolved Financial Management

Introduction

This section looks at Mozambique's experience with public management reforms under structural adjustment and attempts to show how they diverged from intended policy outcomes. As Chart 1 illustrates, my aim is to analyse the tensions between central financial management, on the one hand, and devolved project-based financial management, on the other, in a context where foreign aid finances the greater share of public expenditures. In fact, foreign aid clearly played an increasingly prominent role in financing the government budget under structural

adjustment. A quick glance back at figure 7 confirms this point. Compare, for example, the situation in 1984 with that in 1990. First, the overall deficit (expressed as a share of GDP) is lower in 1984 than in 1990. Second, in 1990, no recourse was taken to domestic borrowing to finance the deficit, notwithstanding its large relative share. In contrast, in 1984, a considerable proportion of the deficit (given by the difference between the deficit after grants and net external borrowing) was financed through money creation.

As shown in Chart 1, there are essentially two broad mechanisms through which aid supports the government budget: project aid, on the one hand, and counterpart funds obtained from programme aid, on the other. Programme aid forms part and parcel of the package of structural adjustment policies and consists of debt relief, commodity import support and donations of foreign exchange to be sold to obtain local currency for budget support (White, 1995). Project aid, in contrast, is earmarked for special purposes and involves setting up semi-autonomous cost centres, managed by donors, to undertake specific activities in the public sector.

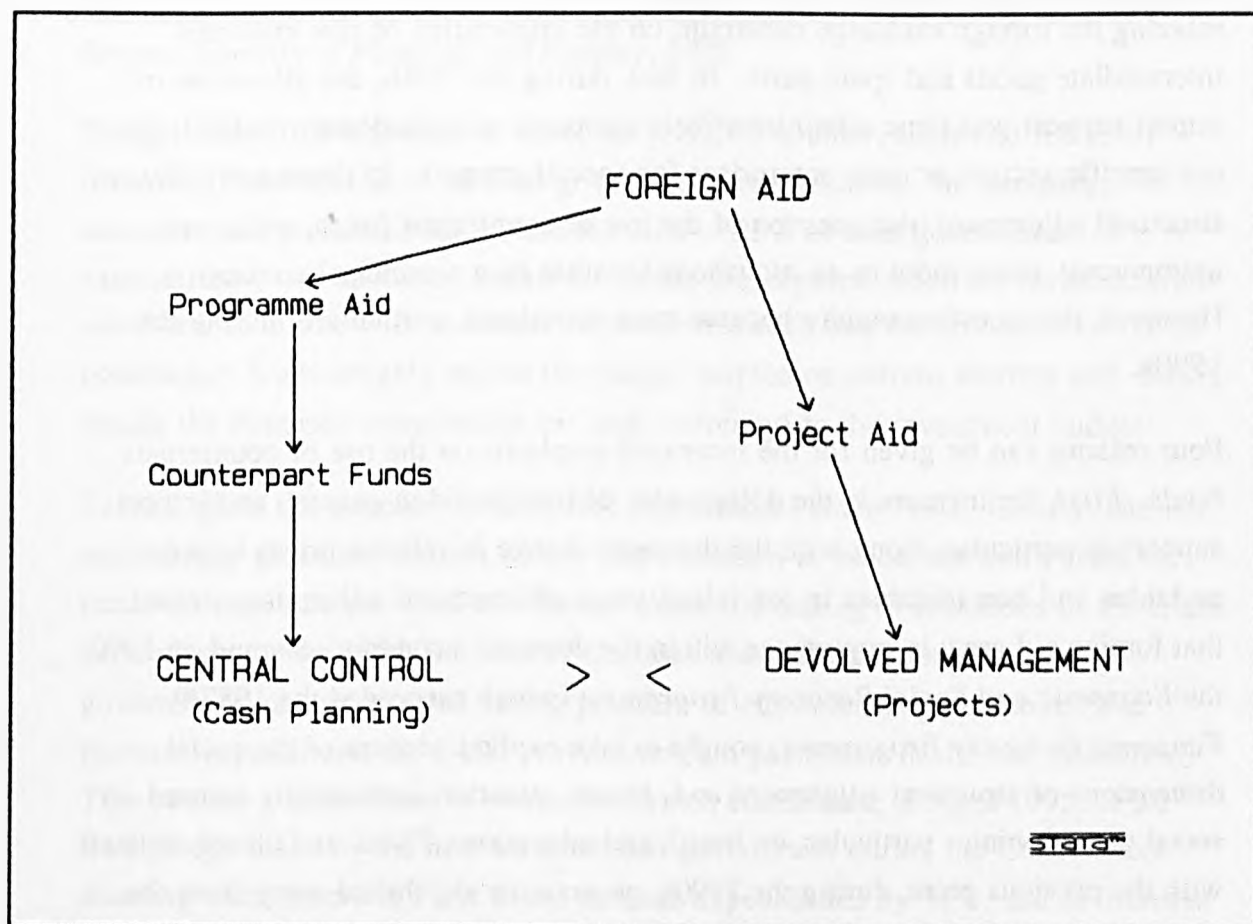


Chart 1 Foreign Aid and Fiscal Management

Through both routes, programme and project aid, donors can (and do) exert considerable influence on the allocation of public expenditures and on setting the agenda for policy reforms. I shall argue, however, that donors exert this influence differently, depending on whether it concerns project or programme aid. As stated, programme aid is closely tied up with the country's acceptance of IMF/World Bank conditionalities linked to structural adjustment policies. Here general policy concerns prevail. Project aid implies that donors have a major stake in the specific activities in which they are involved. Policy action in this context is more concrete, sector-based, and focused. Similarly, at the level of the government, different state entities confront donors in different capacities. At the central level, the concern is with the macro management of structural adjustment policies; sectoral ministries and regions, however, are constantly engaged in bargaining for resources from the central state and pulling in project aid.

Programme Aid, Counterpart Funds and Budget Support

Under structural adjustment, programme aid which, initially consisted mainly of debt relief and import support, became a prominent feature of foreign aid. Apart from relief aid, the main purpose of import support was to revitalise production by relaxing the foreign exchange constraint on the importation of raw materials, intermediate goods and spare parts. In fact, during the 1980s, the allocation of import support was done *administratively* inasmuch as each donor would single out specific sectors or even enterprises for special support. In those early days of structural adjustment, the question of the use of counterpart funds, while not unimportant, arose more as an *afterthought* rather than a principal concern. However, this question rapidly became more prominent, particularly during the 1990s.

Four reasons can be given for the increased emphasis on the use of counterpart funds. *First*, the increase in the dollar value of foreign aid in general, and import support in particular, along with the dramatic change in relative prices between tradables and non-tradables in the initial years of structural adjustment, meant that foreign aid grew in importance within the domestic economy. *Second*, in 1990, the *Economic and Social Recovery Programme* (which succeeded the 1987/9 *Economic Recovery Programme*) sought to take explicit account of the social dimensions of structural adjustment and, hence, attention increasingly centred on social provisioning - particular, on health and education. *Third*, and closely related with the previous point, during the 1990s, programme aid shifted away from the direct material allocation of commodity support to sectors or enterprises, and towards the donation of foreign exchange to be sold freely to raise local currency to

support the government budget. Consequently, attention focused on the use of counterpart funds as budget support, while the import use of donations of foreign exchange was increasingly left to market-based allocation mechanisms. *Finally*, the collection of countervalues proved to be very problematic and, hence, the treasury was effectively providing credit to users of import support. This became an issue of mounting tension between the government and donors. The latter demanded greater transparency on the collection of funds and insisted that any implicit credit (or even grant) arrangements should be abolished (Wuyts, 1995).

Table 1 Counterpart funds in the Budget (as % of Total Government Expenditures)

	1989	1990	1991	1992	1993
Grants	13.7	14.9	15.8	18.6	15.3
Loans	12.4	10.4	3.7	1.5	3.6
Total	26.1	25.3	19.5	20.1	18.9
Recurrent Revenues	49.2	44.5	48.4	45.7	48.3

Source: Ministry of Planning and Finance, 1995

Table 1 shows the importance, in recent years, of countervalues and recurrent revenues, expressed as % of total government expenditures. In summary, countervalues accounted for in between 20% to 25% of total government expenditures. As shown in Figure 6, during these years, recurrent revenues were more or less in line with recurrent expenditures, such that the amount received in counterpart funds roughly equals the budget surplus on current account and, hence, equals the domestic contribution (in local currency) to the investment budget.

Table 2 gives the structure of recurrent expenditures since 1990. Clearly, and not surprisingly given the context of war and transition to peace, the lion's share of recurrent expenditures went to defense. After the ending of hostilities in 1992, and particularly during 1994, the year of elections and the formation of a new government, donors exerted strong pressure to cut defense expenditures and increase expenditures on social provisioning (in particular, health and education). This became a major issue of contention which culminated, in April 1995, in the firm pledge made by the new Mozambican government during the Consultative Meeting with donors in Paris to cut defense expenditures by 37%, and to increase social expenditures 44%, both in real terms, in 1995 (Ministry of Finance and Planning, 1995; Wuyts, 1995).

One aspect of Table 2 which hardly featured in this debate, however, is the very low share of agriculture in recurrent expenditures. This is peculiar since, in the mid-1980s, the major critique launched by the World Bank and other donors against *Frelimo's* policies was, as shown above, its persistent neglect of peasant agriculture. Yet, by 1994, this issue failed to feature as a major concern in allocating public expenditures in the aftermath of the war. In other words, by 1994, under pressure of the donor community, the policy agenda had shifted quite dramatically away from its earlier concerns with production towards the social sectors (Wuyts, 1995). Obviously, issues change because they evolve and, hence, new problems come to the fore, but issues can also change because the focus of attention shifts elsewhere and old concerns are abandoned or relegated to a secondary position without necessarily being resolved. In the latter case, they become *blind spots*: they exist, but remain out of focus.

Table 2 Distribution of Recurrent Expenditures (Selected Categories; % of total Recurrent Expenditures)

Category of Expenditures	1990	1991	1992	1993
Interest Payments	13.1%	10.1%	15.7%	16.9%
Defense/Security	39.7%	38.9%	33.9%	35.6%
Demobilisation/ Elections	--	--	--	--
Subtotal	52.8%	49%	49.6%	52.5%
General Administration	4.8%	5.7%	7.5%	9.5 %
Social Sectors	18.2%	21.5%	21.5%	22.0%
Health	(10.9%)	(11.7%)	(10.3%)	(10.4%)
Education	(4.9%)	(6.5%)	(6.5%)	(7.1%)
Agriculture	0.8%	0.8%	0.9%	1%
Construction	0.4%	0.4%	0.4%	0.4%

Source: Public Expenditure Review of the Social Sector, 1994.

Cash Limits and the Investment Budget

The surplus of recurrent revenues plus countervalues over recurrent expenditures is used to fund investment expenditures. In Mozambique, in recent years, about

20% of the investment budget is financed by the surplus on current account of the government budget (Wuyts, 1995:26). These funds are mainly used to *lever-in* aid-financed investment support (mainly, project aid), rather than to finance separate investment activities. The reason is that most donors require that the Mozambican government contributes local funds to finance projects.

Consequently, there is a link between the availability of local budget funds for investment purposes and the amount of foreign aid which can be leveraged in by such funds.

This explains why two sets of cash limits on investment expenditures are in use since the adoption of *Triennial Rolling Investment Plans* (or *PTIP*, using the portuguese acronym) from 1990 onwards. First, the *internal cash limits* on local funds (= the surplus of recurrent revenues plus countervalues over recurrent expenditures) are, at least in theory, strictly *binding*. The reason is that these cash limits aim to eliminate unwarranted domestic credit creation. *External cash limits* seek to limit the amount of donor-financed direct investment support (project aid) and tend to be more *indicative* in practice. By setting overall cash limits (external plus internal), the planning ministry seeks to regulate the level of public investment and its division across sectors. Table 3 shows the evolution of cash limits, in constant 1992 prices and in dollars, for the period 1990 to 1993.

Table 3 Cash Limits on Public Investments 1990-93

	In 1992 prices: billions of meticaís			In millions of dollars		
	Internal	External	Total	Internal	External	Total
1990	279.4	841.0	1120.0	107.0	322.1	429.0
1991	189.7	530.0	719.0	80.8	225.8	306.0
1992	190.1	645.2	835.0	81.2	275.7	356.0
1993	127.8	570.6	598.0	46.5	171.2	217.0

Source: PTIB 1993/5:8

As can be seen from Table 3, cash limits on public investments tightened in real terms over the period concerned, with cash limits on internal funding decreasing more rapidly than those on external funding. Hence, cash limits aimed to cut programmed investment by about half its 1990 value in 1993, in real terms.

Table 4 compares the total cash limits with, respectively, programmed (the sum total of planned expenditures as reported by new and ongoing projects) and executed (= actual) public investment.

Table 4 Cash limits, Programmed and Executed Public Investment, 1990-1993 (billions of meticaais; constant 1992 prices)

	Cash limits (1)	Programme Expenditures (2)	Executed Expenditures (3)
1990	1120.3	1081.4	505.3
1991	719.7	788.0	414.6
1992	835.2	896.8	617.2
1993	598.4	840.9	657.7*

* Estimated

Source: PTIB 1993/5: 11

As is obvious from the table, executed investment behaved quite differently from either programmed investment or cash limits. The reason is that executed investment depends on the rates of execution of different project activities. As can be seen, over time, executed investment increased, while programmed investment declined, implying that the rate of execution of projects improved, particularly from 1992 onwards. This is not surprising given that, in 1992, hostilities ended as the peace process bore fruit.

In a context where investment is aid-driven and distributed over a large number of semi-autonomous donor-controlled projects, central authorities cannot exert much effective control over the volume of planned investment and its distribution over sectors. Yet the central state is nevertheless subject to considerable pressure to keep public expenditures in check in accordance with IMF conditionalities. This tension between macro conditionality and dispersed micro activities is formally resolved through cash planning in accordance with the principles laid down in the World Bank's 1989 Public Expenditure Review. In reality, however, fiscal restraint is achieved through a process of *ad hoc* adjustments based on the *principle of least resistance*. In other words, the actual process is more akin to *muddling through* by cutting programmed investment whenever the opportunity arises because resistance is weak or can be ignored.

The Triennial Rolling Investment Plans play an important role in affecting this process of *ad hoc* adjustments. The reason is that these so-called *plans* are no more than a listing of donor commitments of programmed investment over a three years horizon. An interesting feature of these plans is that invariably programmed investment totals for the first year tend to be higher than that for the second year, with the third year recording the lowest value. The reason is that donors, on average, do not commit funds over several years at once, but tend to roll over

existing projects by extending them for another year or so. This tendency for programmed investment expenditures to decrease over the plan horizon, however, is not equally strong in all sectors. In other words, some sectors do better in attracting firm commitments from donors in the medium run.

Table 5 Cash Limits and Programmed Expenditures for PTIB 1993/5 (% shares)

Sector	1993		1993-1995	
	cash limits	programmed expenditures	cash limits	programmed expenditures
Agriculture	20.2	19.2	20	14.1
Fishing	3.1	3.4	2.9	2.9
Mining	2.6	1.4	2.2	0.9
Manufacturing	0.5	1.9	0.4	1.4
Electricity	3.9	2.5	3.6	1.6
Water supplies	15	13.9	15.3	13.3
Public works	20.1	21.3	20.1	28.2
Commerce	0.9	0.9	1	0.5
Transport	5	9.7	5.3	7.3
Communications	0.8	0.4	0.8	0.3
Education	14.1	10.4	14.4	13.1
Health	10.3	7.4	10.5	8.3
Culture	0.5	2.4	0.5	1.6
Public Admin.	3	5.2	3	6.6

Source: PTIB 1993/5:25.

Table 5, for example, lists the percentage distributions of programmed investment (reflecting donor commitments) and cash limits, for, respectively, the first year of the triennial plan of 1993/5 and for the three-year period as a whole. Note that, for some sectors, the distribution of programmed investment differs markedly as between its share in the first year and in the period as a whole. Public works, in particular, but also, to a lesser extent, health and education did relatively better in attracting medium term commitments from donors, while, in contrast, agriculture performed poorly.

Table 5 also lists the cash limits as set out in the 1993/5 PTIP. With minor changes, the distribution of cash limits over the period as a whole reflect its distribution in the first year. But only the cash limits for the first year are *de facto* binding, while the limits for the two subsequent years are merely projections which may be adjusted in the next triennial plan. Indeed, the basic idea behind a rolling

plan is that it should be medium-term oriented, yet *adaptive*. It is quite plausible, therefore, that, following the principle of least resistance, cash limits in the subsequent year are adapted in accordance with the *revealed* strength of medium-term donor commitments in the previous triennial plan. In other words, agriculture would be a loser, while transport, health and education would gain in terms of their relative share in total cash limits⁸.

In fact, over the 1990-3 period, the sectoral composition of the investment budget changed significantly as shown in Table 6. In part, these changes reflect deliberate policy choices in line with stated priorities, but some of the changes may well reflect *sectoral drift* - a process in which some sectors are crowded out as a result of creeping *ad hoc* adjustments made to implement fiscal restraint. The social sectors gained in relative terms, while industry and energy were the main losers. Within the tertiary sector, construction (particularly, the road construction programme) gained at the expense of the other sub-sectors. The primary sector witnessed some loss in terms of its relative share, but priority was given to agriculture.

In sum, to deal with the inherent tension between the need for central control over public expenditures, on the one hand, and investment activities propelled by largely uncoordinated donor preferences expressed through project aid, on the other, the imposition of cash limits follows the path of least resistance. When donor interests in a particular sector as revealed by their medium-term commitments are lukewarm, cash limits are adjusted downwards, thereby tightening the belt on the sector's investment plans.

Table 6 Programmed Investment Expenditures 1990/93
(% distribution)

Sector	1990	1991	1992	1993
Agriculture, fishing and mining	26.6	27	23.4	24
Industry and energy	12.0	9	4.3	4.2
Construction, transport, commerce & communication	31.1	28.3	32.6	32
Social sectors: education, health and water supplies	27.4	32.1	36.4	34.6
Administration	2.9	3.6	3.3	5.2

Source: PTIB 1993/5:29.

Semi-Autonomous Projects and Sectoral Needs

During the heyday of socialist planning in Mozambique, a project was essentially an investment activity - usually, but not always, located within the state sector. The state sector itself acted (in theory, at least) as a monolithic whole in accordance with the directives of the Planning Commission. Obviously, in practice, coordination was a messy affair which required adaptive action, often within parallel circuits, by state entities. But, by and large, the room for manoeuvre for autonomous public action on the part of different public entities was severely restricted (Wuyts, 1989).

In the 1980s, the notion of public action underwent dramatic changes in Mozambique. First, public action came to be defined more broadly than state action. From the mid-1980s onwards, the proliferation of NGOs (Non-Governmental Organisations) involved in emergency aid, famine relief or poverty alleviation became one of the fastest growing sectors in the economy and society (Hanlon, 1991). Second, state action itself witnessed rapid transformations. One aspect of this change was privatisation which, initially, mainly concerned selling off the state farms to the private sector. But another aspect which concerns us here, was the donor-driven process of *splitting up the state* (Mackintosh, 1992) and devolving part of its activities to semi-autonomous cost centres. In health care, for example, the concept of a national health service came under serious attack with the proliferation of *selective provisioning*. Health provisioning was split up into different programmes (essential drugs, mother and child care, anti-diarrhoea programme, etc.), each managed independently with its own financial resources (Cliff *et. al.*, 1986; Wuyts, 1991). Over time, this practice became more widespread and many of these semi-autonomous cost centers also came to be involved in income generating activities. For example, in agriculture, import support linked to projects generates incomes from the sale of agricultural implements and inputs which are then channeled to special funds earmarked for financing agricultural investment. Nor did these activities remain confined to needs provisioning only. For example, at present, activities concerned with institutional support (particularly, the provision of planning or management expertise) are constituted as separate activities with their own finance and management structures.

These changes in the management of public expenditures profoundly altered the nature of projects. The distinctive feature of projects today is that they are donor-run semi-autonomous cost centres which manage public expenditure (in- or

outside the realm of the state). Whether such projects manage recurrent or investment activities, or do both, is not the main point. The World Bank's 1989 Public Expenditure Review touched upon this issue, but only traced its implications insofar as they concerned the balance between recurrent and investment expenditures. My argument is that the key issue is not just whether expenditure categories are correctly measured, but what the implications are of aid-based decentralised financial management on the effectiveness and coherence of state action. To tackle the latter issue, we need to get an idea of the size of the problem. On this count, the measurement of the recurrent component of the investment budget provides useful insights.

Table 7 Total Programmed Recurrent Expenditures by Budgetary
Source: State Budget and Investment Budget (PTIP) 1993
(in Billions of Meticaís)

SECTOR	Recurrent Budget	PTIP Investment Budget			Total Recurrent Expenditure	Of which % share of State Budget
	Recurrent Exp (1)	Recurrent Exp (2)	Investment Exp (3)	Recurrent as % of Total (4)	(1) + (2) (5)	(1)/(5) (6)
Administration	92.95	36.19	7.3	83.2%	129.14	72.0%
Agriculture	7.79	63.75	97.6	39.5%	71.53	10.9%
Commerce	2.65	2.99	4.5	39.9%	5.64	47.0%
Constr/Water	2.50	29.46	264.8	10.0%	31.96	7.8%
Mining	1.83	1.78	9.5	15.8%	3.6	50.8%
Ind & Electr	1.26	27.69	7.4	78.9%	28.95	4.4%
Fisheries	1.12	24.07	4.9	83.1%	25.22	4.4%
Education	29.28	42.99	44.3	49.2%	72.27	40.5%
Health	26.94	36.70	25.9	58.6%	63.63	42.3%
Culture	12.64	3.92	20.6	16.0%	16.57	76.3%
Transp/Comun	4.5	16.57	68.1	19.6%	21.07	21.4%
TOTAL	183.46	286.11	554.0	34.1%	469.11	39.1%

Source: PTIB 1993/5:63-4.

Table 7 depicts the sectoral breakdown of the estimated programmed recurrent and investment expenditures of the 1993 PTIP, and compares these totals with the programmed recurrent expenditures of the state (recurrent) budget. Column 4, in particular, lists the sectoral shares of recurrent expenditures in total PTIP expenditures. It shows that an estimated 34% of all expenditures in the investment budget are in fact recurrent expenditures. This average, however,

hides considerable sectoral variations. Looking at the priority sectors only, the shares of recurrent expenditures in total sectoral PTIP expenditures are, approximately, 40% for agriculture, 10% for construction, 50% in education, 59% in health, and 20% in the transport sector. Hence, the data confirm that many projects are involved in recurrent activities.

Column 6 throws a different light on this issue. It shows the extent to which different sectors depend on projects to cover their recurrent expenditures. On average, 61% of programmed recurrent expenditures derive from projects. This average hides a great deal of sectoral variation. With respect to priority sectors, we get the following picture: 60% in the social sectors, 79% in transport and communications, 89% in agriculture and 92% in construction.

It seems reasonable to hypothesize, that, in a given sector, the higher its recurrent component in project aid and its dependence on projects to finance running costs, the lower the average rate of turnover of projects is likely to be. In other words, donors may find it hard to phase out projects since they do not really have a definite time horizon (as would be expected from investment projects). This would explain the change witnessed over time in the reported estimated average duration of projects: from 3.7 years in PTIP 1990-2, to 6 years in PTIP 1993-5. Consequently, tighter cash limits on investment and low turnover of existing projects limit the scope for new investment initiatives (PTIP 1993-5:37).

It is in the interest of each sectoral ministry to attract project aid to finance investment and running costs. Project aid mediates a sector's bargaining power with central authorities. A sector which succeeds in rallying strong medium-term donor commitments can better withstand pressure to cut its cash limits. Sectors collude with donors, therefore, to protect their specific sectoral programmes. But this does not mean that no tensions arise within sectors as between projects and programmes, and among projects. To illustrate this point, let me consider two different examples.

First, a sector like the ministry of health has to cope with a bewildering number of 405 donor-funded projects which come in all shapes and sizes. These projects have high administrative costs (30% to 40% of project funds), operate on the basis of tied aid as to the acquisition of drugs or other materials, and often fail to coordinate their actions among each other, or with those of the ministry. This puts a heavy burden on the sector's managerial ability to run coherent programmes of action in the midst of fragmented project activities. In some cases, sectors manage to persuade major donors to pool resources into sub-programmes

managed by one donor. In health, drug acquisition and technical assistance, and in construction, the road construction programme, are run this way. These sub-programmes (which are larger-scale collaborative projects) prove to be quite successful at leveraging-in more foreign aid backed by stronger medium-term commitments. (Wuyts, 1995: 34)

Second, tighter cash limits increase pressure on sectors to scale down existing projects or postpone certain of their planned activities. This does not always proceed smoothly since strong donor interests are involved at project level. Agriculture provides an interesting example. In this sector, a few big World Bank loan-based projects which require local counterpart funding take the lion's share of all funds available within the cash limits allocated to the ministry. To avoid crowding out other projects, some of which are grant-based, planners in the ministry sought to scale down the World Bank projects so as to reduce their overall demands on internal funds. The World Bank responded, however, by threatening to transfer its projects to the control of ministry of finance and planning, while its local investment costs would continue to be charged to the internal cash limits of the ministry of agriculture. (Wuyts, 1995:33)

This case reveals how donors find themselves operating on both sides of the tension between central control and decentralised financial management. As policy advisor/maker, the World Bank insisted on fiscal discipline and aimed to strengthen sectoral capabilities to formulate coherent investment programmes and to evaluate and monitor projects. Yet as project manager, the World Bank was less receptive to scrutiny aimed to reduce the size of its projects. It was therefore quite prepared to use its weight and collude with central authorities so as to escape the evaluation and monitoring procedures at sectoral level.

Projects and Markets

While projects often behave as little islands, they do not operate in isolation. A glance back at Figure 6 reveals that government investment which mainly consists of projects accounted for 20% to 25% of GDP. Not surprisingly, therefore, projects exert considerable influence on domestic markets. This is true for both labour and commodity markets.

First, projects create markets within the state, in particular with respect to the demand for skilled labour. Fiscal restraint, on the one hand, meant that wages and salaries in the civil services fell in real terms under structural adjustment. Projects, on the other hand, are largely insulated from the squeeze on domestic borrowing since they are largely financed by foreign aid. There is, in fact, a thriving

market for the employment of Mozambican skilled personnel as project staff, experts or consultants (Wuyts, 1995: 38-40). As projects pay higher salaries and wages than the regular civil service, they have no difficulty attracting local skilled personnel away from government employment. Consequently, there is a real brain drain out of state employment towards projects. This practice has now become so widespread that, in response, most government entities seek to obtain donor funding to be able to re-employ their skilled staff as consultants on projects engaged in technical assistance and capacity building. This type of collusion, however, is not just a one-sided. Skilled staff, previously employed in the civil service, who move to projects get higher salaries or wages and improved working conditions and, hence, benefit directly from project aid. There are, therefore, strong incentives to substitute technical assistance (involving local consultants besides foreign experts) for regular employment. In fact, an estimated 25% of the investment budget finance projects concerned with institutional support (Wuyts, 1995).

This system only works as long as such projects continue in operation, a problem now confronting the agricultural sector. The agricultural ministry employs a total of 4680 civil servants of which 1077 are working at the level of the central government. Projects financed by the investment budget in this sector, however, employ a total of 4717 persons, of which 1132 are technical staff and 1097 are extension workers. As a number of major projects are presently being phased out, investment planners now find that the recurrent budget of the ministry has no capacity to absorb project personnel back into its ranks, although many of them are necessary for the operation of the essential services. The only way out from this impasse is for the ministry to find new projects which can absorb the recurrent component left lingering by projects which finally came to an end.

Second, project expenditures shape the structure of domestic markets. They can do so either by stimulating domestic production, or they can by-pass it by relying on imports instead. In Mozambique, projects are strongly biased towards favouring import demand. Castel-Branco (1994) gives several examples. An agricultural project imported vast quantities of agricultural implements for distribution in rural areas. As a result, local industry was left to accumulate large stocks of farm implements which could not be sold. Similarly, emergency aid projects imported clothing to distribute to the rural population without consideration for the local industry's capabilities to supply at least part of these goods. According to Castel-Branco, about 60% of clothing and 90% of agricultural implements and inputs supplied on the domestic market, at times free of charge,

were obtained from grants in kind. Food aid can have a similar effect on the demand for domestically marketed food (Ministry of Finance and Planning, 1995; Wuyts, 1995).

Part of the problem is that projects often include a considerable component of import support which forms part of their income generating activities. In agriculture, for example, the counterpart funds obtained from the sale of imported agricultural implements and inputs financed by import support linked to specific projects, are earmarked to complement the ministry's investment resources, although, in practice, the ministry has difficulty in obtaining these funds from the treasury (Wuyts, 1995). These income generating activities, therefore, encourage reliance on imports and discourage domestic production.

This bias in favour of imports may well be endorsed by the sectoral authorities in which these projects are located. Relying on imports may be seen as an easy way out to get quick results. Indeed, the rehabilitation and restructuring of local production might be cumbersome and, besides, it may concern a different sector. Consequently, in the absence of deliberate policies which favour domestic production, imports may well become the preferred option to supply projects with their material needs.

Conclusion

As shown in this paper, in Mozambique, under structural adjustment, two processes appear to have been at work: *squeezing* the state went hand in hand with *splitting* the state (Mackintosh, 1992). Squeezing the state was done through financial programming within the overall framework of stabilisation policies. Splitting the state resulted from the increased fragmentation of control over public money as between state institutions and a multitude of donor initiatives. In the process, foreign aid came to exert a dominant influence in budget management. Programme aid, along with the counterpart funds to which it gives rise, appeared as a new player on the scene, while project aid, both in and outside the state, increasingly split away from regular state activities into a multitude of semi-autonomous cost centres.

In many ways, these developments reflected the new orthodoxy which came of age during the 1980s and led to reshaping the role of the state in economic development (Mackintosh, 1992). This changing view on the role of the state was, of course, not just peculiar to the Mozambican experience, but instead was a reflection of a broader world-wide trend which started initially, in the early 1980s,

in the industrialised market economies (particularly, but not exclusively, in the UK and the USA), and, subsequently, rapidly gained momentum when the Soviet experience with central planning collapsed dramatically. As to its content, this emerging new orthodoxy on public sector management warns against *government failure* as distinct from *market failure* (World Bank, 1983), and seeks to remedy the former *by calling upon the state to become at most a residual supplier of public goods, with the key objective of promoting alternatives to its own activity*. Pluralism in the delivery of public goods, therefore, thus became a guiding principle of public sector reforms. The underlying argument is that, not only should the state do *fewer* things, but what it does, it should do in *competition* with alternative suppliers (within and outside the public sector). Hence, by supporting the development of alternative suppliers (private enterprises, voluntary agencies, or competing state agencies), and by promoting competition among them, the state should aim to improve the quality and responsiveness of the delivery of public goods, reduce costs, and supplement tax income (and government borrowing) with other sources of funds (private capital, voluntary contributions, income generating activities, cost recovery etc.).

This new concept of public management implies two related, but not wholly compatible sets of policies for public expenditure reforms. On the one hand, there is the objective of *fiscal restraint* which emphasizes central control over expenditure totals through the use of *cash limits* on public sector deficits (World Bank, 1988). But, on the other hand, the state is also called upon to act in a more *business-like* fashion by devolving the production and delivery of public goods to (sometimes competing) semi-autonomous agencies. While both these sets of policies - central control and devolved initiative - share a common concern for controlling deficit spending, their coexistence in public sector reforms is, however, not without tensions since they imply quite different approaches to financial management. Central financial management is about control and closure of accounts. In contrast, agency-based decentralised financial management centres on the financial viability of the devolved unit, and, hence, also includes concerns about income generation, costs fund raising and cash flow (Mackintosh, 1995)⁹.

My argument in this paper has been that, in Mozambique, this tension between central control and devolved initiative is acutely present within the public expenditure reforms in Mozambique, but that it is mediated by the role of foreign aid in the economy and its public finances. I disagree with Hanlon (1991), however, that this tension merely boils down to a conflict between a weak government desperately trying to assert, or regain, central control over public

expenditures (including foreign aid), on the one hand, and a multitude of donor agencies each running their own autonomous projects, on the other. In fact, as shown in this paper, the problem is far more complex and *systemic* in nature, with, at its core, the uneasy interplay between *programme* aid, on the one hand, and *project* aid, on the other. This is where we encounter the tension between central control and devolved initiative in a context where foreign aid dominates the scene. My argument is not that government and donor agencies are located at the opposite poles of this tension, but instead that *both* are to be found on *both* sides of the fence.

Furthermore, I have argued that, while public sector reforms in Mozambique aimed to render the state more effective, responsive and adaptive, the way this dichotomy between programmes and projects works out in practice means that public action becomes increasingly more sluggish, inflexible, and aid dependent. Put differently, I shall argue that the process of reforms threatens to set in motion a *vicious circle* which renders state action progressively less coherent and effective as projects compete resources away from regular state programmes without much real prospects of such projects becoming self-sustainable in the absence of the continued infusion of aid. The crux of the matter is that aid dependence has become a new way of life which, increasingly, as this paper has shown, is built into the very mechanisms through which the state operates.¹⁰

APPENDIX

RELATIVE PRICES AND SHARES IN GDP

The Share of Imports in GDP

Let M_s be the share of imports, M , in GDP, Y , both measured at current prices.

Hence,

$$M_s = M / Y$$

Now, if we decompose GDP with respect to the value added of non-tradables and of tradables, and within the latter, of exportables and importables, we obtain,

$$Y = Y_m + Y_x + Y_n$$

where the subscripts - m , x , and n - refer, respectively, to importables, exportables and non-tradables.

Furthermore, separating changes in volumes from those in prices, yields,

$$Y = Y^*_m P_m + Y^*_x P_x + Y^*_n P_n$$

where the asterisk (*) superscript refers to macro aggregates measured in volume terms, and P_m , P_x , and P_n are price indices (in domestic currency) of, respectively, importables, exportables, and non-tradables.

Similarly,

$$M = M^* P_m$$

where M^* is the volume of imports, and P_m its price deflator ¹¹. Consequently, we get,

$$M^s = \frac{M^*}{Y^*_x \frac{P_x}{P_m} + Y^*_m + Y^*_n \frac{P_n}{P_m}}$$

which shows that the share of imports in GDP does not only depend on the volumes of its component macro aggregates, but also on two sets of relative prices: the external terms of trade, TOT, measured as P_x/P_m , and the real exchange rate, RER_m , the relative price of tradables (in this case, importables) to non-tradables, measured as P_m/P_n .

The Share of Exports in GDP

Similarly, X_s , the share of exports, X , in GDP, Y , can equally be expressed as depending on two sets of relative prices, the real exchange rate of exportables, RER_x , measured by P_x/P_n , and the external terms of trade, TOT , defined above. The resulting equation for X_s thus becomes,

$$X_s = \frac{X^*}{Y_x^* + Y_m^* \frac{P_m}{P_x} + Y_n^* \frac{P_n}{P_x}}$$

The Share of Aid in GDP

Finally, analogous to the case of imports, the share of the net inflow of aid, A , in GDP, Y , depends on the real exchange rate and on the external terms of trade, as follows,

$$\frac{A}{GDP} = \frac{A^*}{Y_x^* TOT + Y_m^* + Y_n^* / RER_m}$$

since the import price index, P_m , is the appropriate deflator of the net inflow of foreign aid.

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Endnotes

- 1 All the data used to draw the graphs in this section are taken from the same source (Comissão Nacional do Plano, 1994). This document contains the estimates and methodology of the national account for the period 1980-93.
- 2 After gaining independence in 1975, the Mozambican economy went through a brief but intense production crisis provoked by the massive exodus of its Portuguese settler community which, in colonial days, monopolised most skilled jobs. By 1977, however, the fall in production stabilised, and, subsequently, economic activity witnessed a significant but only partial recovery during the period 1977-81. This period signalled the heyday of Mozambique's socialist experience with central planning in a context of state-centred accumulation which reached its peak in 1980, with the adoption of an ambitious and overtly over-optimistic 10-years development plan which envisaged the accelerated expansion of the state sector in the following decade. From 1981, onwards, however, this investment strategy, which largely neglected the peasantry and provoked the rampant development of speculative private capital accumulation within a rapidly evolving parallel economy, was undercut by the widespread devastation, destruction and hardship of the war. A process of economic reforms took place from 1983 onwards: modest, at first, but gaining momentum with the adoption of the economic recovery programme in 1987 (Wuyts, 1989, 1991).
- 3 Note that the gross value of the sectoral output is not the same as the value added of the sectors concerned. That is, intermediate inputs are not netted out when measuring gross output.
- 4 There is a further problem with Mozambican statistics which aim to depict volume changes. Normally, this done by expressing macro aggregate data in constant prices of a particular base year. In Mozambique, however, the statistical practice is to express the real growth of a variable in a given year with reference to the prices prevailing in the year before. The only way to obtain a time series, therefore, is to extrapolate the value of a macro aggregate from its base year by using these year to year growth rates. This is not a very satisfactory procedure, but the best that can be done, given the data available.
- 5 This item also includes direct foreign investment. Since the latter component was, however, fairly insignificant over the period as a whole, its inclusion hardly affects the inferences made from the patterns in the data.
- 6 National savings differ from domestic savings inasmuch as the former include net foreign transfers into the country. Note that Figure 7 depicts domestic savings along with the trade gap.
- 7 These two central propositions date back to the Polak model which laid the basis for what has become known as the monetary approach to the balance of payments which underscores the practice of financial programming. An excellent and comprehensive discussion of this original model, its later developments, and its use in practical applications can be found in Tarp (1993:56-78).
- 8 This tendency to crowd out certain sectors was confirmed in interviews I held in April 1995 with the World Bank's resident chief economist and with staff of the planning department of the ministry of agriculture.
- 9 The hypothesis that the new model of public management contains a potential tension between two distinct systems of financial management constitutes the basic premise of a broader joint research project initiated by Maureen Mackintosh and myself. This concluding theme, therefore, is a prelude to further research which, we hope, will enable us to develop this hypothesis in greater detail (see also, Mackintosh, 1995).

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- 10 In principle, donors and the government alike acknowledge that aid is a temporary device until such time that economic growth resumes as structural adjustment policies bear fruit; in practice, nobody believes it. Short-termism thus becomes the order of the day. Yet this poses the question whether a state which operates on a short horizon can in fact support a shift to a private sector culture of longer term investment. This question is beyond the scope of this paper. In this sense, this paper is merely a prelude to clear the way for further research.
- 11 Strictly speaking, the price index of imports is not exactly the same as the price deflator of the value added of importables. Similarly, the price index of exports is not identical to the price deflator of exportables. For convenience, to avoid complicating the formulae, I have used the same price index for both imports and importables (and, similarly, for exports and exportables). Making the formulae more complex does not, I believe, invalidate the main argument made here.

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