



Mozambique Advisory Services in
Support of the Agricultural Sector

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Refocusing the Fundo do Fomento

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Executive Summary

This report is the result of a process of consultation and participation, driven by the Commission appointed to refocus the *Fundo*. This work is in reaction to the review of MADER in terms of the role that the *Fundos* de Fomento should play in context of the overall development of the rural financial sector. It used the earlier reviews commissioned as point of departure. MADER acknowledged the problems experienced by the *Fundos*, but is still committed to improve the functioning of the *Fundos*. The realisation has been emphasised that the *Fundos* on their own cannot solve all the rural finance problems of Mozambique, and thus must be seen as part of the overall system. The brief is to identify the key focus areas of the *Fundo*, to provide an approach towards administrative efficiency and operationalisation of the *Fundo* and to inform how the *Fundo* should be part of the overall system of rural finance.

The report starts by providing an overview of the relevant policies, emphasising the role of PROAGRI and the prominent focus on poverty reduction. It also considers the policies of other relevant Ministries, thus making sure that all the relevant policy directives are considered. The study further analysed the current role and status of the *Fundos*, noting that the *Fundos*'s activities in terms of development interventions is a function of the level and efficiency of collections, and the administrative cost structure of the *Fundos*. The *Fundo*'s strategic direction takes its cue from the Policy Declaration by MADER.

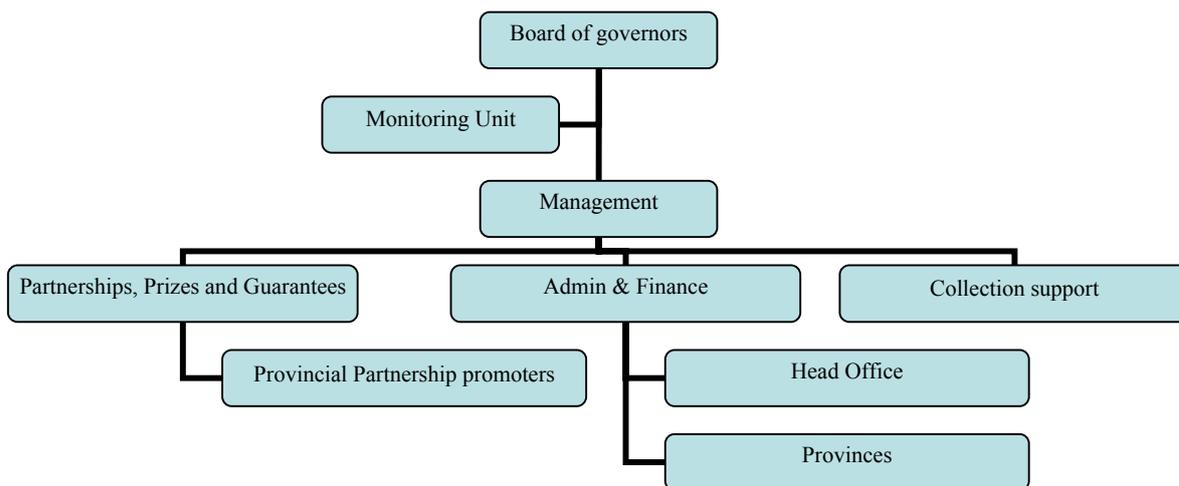
The context within which the *Fundo* must operate and must be refocused is also important. The study indicated the current situation of the agricultural and rural sectors, and the reality of the situation in terms of the immense task to build the rural economy. The challenges are noted, and the great improvements over the last ten years are also noted. The context section describes the situation of all the role players, divided into public sector and private sector organisations. The context section is summarised by outlining the main issues influencing the performance of the sector. These include issues related to agriculture (limited marketing channels and networks, low levels of production, limited extension system, land availability problems and the influence of a variable climate), institutions (lack of farmer associations, need for decentralisation in MADER, difficulties with loan recovery due to the judicial system), finance (farmers lack assets, lack of a credit culture, limited rural savings, lack of access to credit, difficult to use land as an asset) and cross cutting issues (poor infrastructure, gender, lack of basic services, HIV/Aids, natural resource management).

To ensure that the report covers all aspects, a section was included on international experience with specialised agricultural finance institutions. The economic arguments for intervention is stated (monopolistic behaviour, externalities, imperfect information, contract enforcement problems) and the dismal history of specialised farm finance institutions are summarised, as well as the new approaches to the restructuring of these institutions). The focus should be on all financial services, not only credit. Transaction costs and sustainability of institutions are important, as are, information flows and the recognition of the functioning of markets.

Once the background, context, policy imperatives and international experience were discussed the report emphasised the focus areas, or the selection of focus areas of the *Fundo*. Two main areas were highlighted, being, access to financial services and the creation and strengthening of the market. A set of criteria was devised with which to decide on focus areas. The *Fundo* should focus on specific activities (for example activities consistent with

the stated policies, that are conducive for partnerships and more)and geographical areas (where there is growth and growth potential and where non-financial support is largely in place. Once these aspects were covered the report addresses the different focus areas in more detail, with examples. The report also identified instruments to use in this process. After studying most options it was decided that a partnership approach will be the most conducive for the objectives of the *Fundo*.

The last part of the report highlights the strategy and operationalisation of the *Fundo*. It highlights a governance structure, as well as an innovative new structure within which to operate. This structure is depicted in the next diagramme.



The structure uses the focus areas, the type of instruments favoured and the context within which the *Fundo* will operate as departure points. It brings in the concept of a monitoring and evaluation unit that will report to the board. The board will also have external (to MADER) board members. The operational structure is more decentralised as was the original structure, and raises the concept of promoters that will work at community level.

The last phase in the refocusing of the Fundo is to compile an operational plan and budget for the implementation of the Fundo. This is the responsibility of the Commission and MADER. The report provides several suggestions on issues that should be considered during this phase.

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1. Introduction

1.1 Background and Terms of reference

The Ministry of Agricultural and Rural Development (MADER) has been reviewing the role that its *Fundo do Fomento* (Funds for Jumpstarting Activities) should play in the context of overall development of the rural financial sector. To date, the sector is characterized by extremely weak or non-existent financial services provided to rural households, which has led to considerable pressure on the public sector to provide services, such as credit, that should normally fall within the domain of the private sector.

MADER commissioned a thorough review of its two operational funds, *Fundo do Fomento Agrário*, (Funds for Jumpstarting the Agrarian Sector or FFA) and the *Fundo do Desenvolvimento do Hidráulica Agrícola* (Fund for Development of Agricultural Hydrology). The consultancy, conducted by the companies Rural Consult and Seed, provided a detailed assessment of the operational status of these funds during the last three years. It was clear from this work that the financial and operational management of the Funds needs to be substantially improved. Neither Fund was able to begin to reach the vast number of stipulated objectives. The consultancy recommended different models for redesigning the organizational structure of the Funds, particularly at the provincial level, and maintain most of the original objectives of the Funds.

An internal review by the Department of Policy Analysis (DAP) of the Directorate of Economics (DEC) of the consultant's work and proposed structure concluded that it was necessary to clearly define what the role of the Funds should be and design a structure to fit that role. There is a clear need to reduce the number of activities permitted to be undertaken by the Funds and concentrate on a few activities done well. Selected activities should be in accordance with overall policies adopted by the Ministry and should clearly fall within the domain of the public sector. For this reason, activities such as direct credit provision should be eliminated. Moreover, the proposed structures, in their attempt to be more representative, are non-sustainable in that they involve too many actors who would in all likelihood require some stipend for their participation.

In spite of all their problems, MADER is committed to maintaining the Funds because of the widely acknowledged failure of the private sector to provide needed services, particularly within the areas of credit and input provision, and the high cost of obtaining key assets for adding value to agricultural. A Working Group, led by DAP and including representatives of MADER directorates, the Funds, and donors, was appointed by the Minister to develop a Declaration concerning MADER's policy concerning the Funds. Central to that declaration was the recognition that the Funds need to be re-designed and must meet the basic requirements of good financial and organization management, with annual work plans approved by a larger body. There was also recognition that the Funds in and of themselves will not solve the tremendous problem of lack of rural financial service provision in Mozambique. Rural finance will instead be addressed by other initiatives being proposed or currently underway.

Consequently, there is a need to address three key issues:

- ❑ What should be the key, limited number of activities undertaken by the Funds that will maximize the use of available funds and are appropriate for public sector?
- ❑ How should these funds be organized and administered at the central and provincial level so as to be capable of sustainably implementing these activities at a reasonable administrative cost?
- ❑ How should these Funds fit into an overall system of rural financial services?

Subsequent to the issuing of these terms of reference MADER appointed a Commission to study the previous report on the *Fundos* and decide on a strategic direction. The Commission decided to combine the two *Fundos* and therefore this report departs from the notion of a combined *Fundo do Fomento Agrário* and *Fundo do Desenvolvimento do Hidraulica Agricola*. At the beginning of the study, a joint meeting was held with the Commission and the Working Group. At this meeting the TOR was confirmed.

1.2 Outline of the report

The report follows a basic outline of describing context, current situation, objectives and identifies strategies to fulfil these objectives in the reality of the context of Mozambique and the point of departure of the current situation.

2. Agricultural & rural development policy in Mozambique

2.1 Rural and agricultural development policy

Agricultural development policy in Mozambique is governed by PROAGRI, which started in 1998 and is run through the Ministry of Agriculture and Rural Development (MADER). PROAGRI's main goal is to have an impact on poverty reduction, through the implementation of overarching principles:

- ❑ Poverty reduction
- ❑ Decentralization and Empowerment
- ❑ Good governance
- ❑ Environmental and Social Sustainability
- ❑ Market Oriented Policies.

The eight components of the program are:

- ❑ Institutional Development, including increasing MADER's capacity to implement core functions, institutional modernization, and human resource development;
- ❑ Research
- ❑ Extension
- ❑ Forestry and Wildlife
- ❑ Land
- ❑ Irrigation
- ❑ Crop Production
- ❑ Livestock production

PROAGRI has, to date, focussed on restructuring MADER to create a Ministry more capable of responding to the demand for services from the rural sector. Current priorities include developing institutional structures and procedures that interface directly with clients, particularly at the provincial and district levels.¹ Key policy issues under consideration are the *Fundo* de Fomento, the establishment of a rural development programme, and the activity's second phase.

Independent institutes for cotton and cashew are charged with promotion of these crops, in coordination with MADER.

2.2 Policies of other Ministries in support

MADER coordinates rural development activities in Mozambique that includes the activities of other Ministries in rural areas. The Minister of Agriculture chairs the board task with this coordination.

The Ministry of Industry and Commerce (MIC) is responsible for policies related to agricultural marketing and industrial processing. MIC's objectives are to promote private economic activity through acting as a facilitator, and creating an enabling environment favourable to the private sector. MIC is also the principal implementer of the government's Agricultural Marketing Policy, adopted in 2001 by the Council of Ministers. The key objective of this policy is to create, in the medium term, that the promotion of initiatives from all the actors in the market, as well as the creation of a level playing field within the context of a transition to a market economy.

The main orienting principles of this policy focus on the role of the state and of the private sector. The government is charged with:

- ❑ Creating a favourable environment for domestic and foreign investment in agricultural trade;
- ❑ Facilitating investments that generate positive externalities, especially:
 - Rehabilitation, expansion and modernization of infrastructure to support the development of agricultural trade, with priority given to rural areas;
 - Acquiring, systemizing and diffusing information on world markets, with the aim of promoting exports, especially of non-tradition products and in new markets;
- ❑ Promoting and supporting greater involvement of smallholder farmers in the market, thus increasing the value of their production.

The private sector, including both informal and formal businesses, is to take leadership roles in:

- ❑ Investing in trade, aiming at the rehabilitation, expansion and modernization of the commercial network and job creation;
- ❑ Purchase of agricultural surpluses for processing or further sale in international or domestic markets
- ❑ Diversifying exports and market studies
- ❑ Selling goods, above all basic consumption items to the population and agricultural tools and inputs.

¹ PROAGRI Aide Memoire, 21 November 2001

The five focus areas under this policy include initiatives to:

- ❑ Create policies to develop (foment) agricultural marketing
- ❑ Establish a favourable legal and administrative environment
- ❑ Establish adequate market infrastructure
- ❑ Provide information on agricultural marketing
- ❑ Facilitate agricultural marketing.

This policy includes input from other Ministries, notably MADER, in simplifying the legislation concerning the registration of economic associations, choosing pilot areas for rural market development programs, improving statistics, market information, market studies, development of input trade, and developing a domestic processing industry.

Other specific policy areas of MIC include:

- ❑ Development of programs to promote the expansion of rural market sites
- ❑ Restructuring of the Mozambique Cereals Institute (ICM)
- ❑ Providing a line of credit of €2 million, along with capacity building, to two non-bank financial institutions for lending in support of agricultural marketing and processing
- ❑ Reform of the Marketing Fund (their fomento fund), which ran out of money due to low repayments and high administrative costs

The Ministry of Public Works is responsible for rural infrastructure, thus specifically the expansion and maintenance of rural roads. They are working on developing more sustainable programs to support maintenance of feeder roads, particularly through the National Roads Administration (ANE). The Ministry of Transport and Communication is working through the public telecom company, TDM, to expand access to telephones in rural areas, especially in Zambezia Province. Another policy issue is the high cost of domestic ocean freight shipments, and high port charges in Mozambique. These limit domestic transportation of agricultural produce, and make local exports more expensive.

The Bank of Mozambique is the central bank and regulates the financial sector. Its policies, especially in areas such as registering financial institutions, interest rate policy, and bank supervision can have an effect on the rural sector. Currently, the central bank's policies place few limits on lending. Savings mobilization is much more strictly regulated. The legal framework does not promote the development of small-scale credit cooperatives, common in most other African countries, through high minimum capital requirements and lengthy bureaucratic requirements. Minimum capital is \$8,000 and registration, if attempted by an organization outside of Maputo, can take more than two years.

Other government institutions with a tangential impact on rural development include:

- ❑ The Ministry of Health
- ❑ The National Council for Combating AIDS, at the national and provincial levels
- ❑ The Ministry of Education

As we can see, while MADER has prime responsibility for agricultural development policy, other government bodies play a key role in dealing with key issues, such as marketing (MIC), infrastructure (MTC) and regulation of financial institutions (BM).

2.4 The current role of the Fundos

2.4.1 Introduction

The *Fundos* currently focus on acting as a catalyst to promote further development in the agriculture and livestock sectors. They have focussed on the financial side because they have identified the lack of financial resources going to agriculture as a key policy issue. However, the *Fundos* have not defined specific areas of intervention (crops, geographic areas, and types of projects). Financial support has not always been in terms of credit. For instance, in 1999, 90% of funds used for Fomento went to cover costs related to paying for customs duties, fees, storage and transports of fertilizers and pesticides donated to Mozambique under the KR II program.

Currently, the *Fundos* provide assistance to a wide variety of activities in agriculture, mainly in support of other public entities. When programs are denominated as a “loan,” repayment rates are extremely low. The annual reports for both FFA and FDHA do not assess the impact of the *Fundos*’ activities.

2.4.2 FFA

According to the FFA Annual reports in 1999 and 2000, activities supported by the fund included:

Table 1: Activities supported by the FFA in 1999 and 2000	
Activity	Funds (meticaais)
Financing customs fees, warehouses and transportation of inputs donated under the KR II program, 1999 and 2000	3,372,882,592
Purchase of liquid nitrogen for the Animal Production Institute to store bull semen, 1999 and 2000	238,550,975
Co financing of 50% of a tractor for farmers in Mocimboa da Praia, 1999	223,369,940
Seminar on border control, 1999	34,064,000
Cabo Delgado Forestry Inventory, 1999	25,000,000
Support for annual meeting of Forestry and Wildlife Directorate, 1999	75,000,000
Rehabilitation of Forestry and Wildlife Department in Sofala, 1999	60,000,000
Financing rehabilitation of irrigation canals for smallholders in Manica, 2000	25,153,000
Purchase of a motor pump for rice farmers in Gaza, 2000	40,829,000
Purchase coconut seeds for farmers in Matutuine, Maputo, 2000	20,000,000
Funds to import improved food for the Animal Production Institute, 2000	100,800,000
Unspecified support to a credit cooperative in Angónia, Tete Province, 2000	109,757,000
Rehabilitation of the offices of the National Veterinary Research Institute, 2000	150,000,000
Purchase 4 X 4 for the Maputo Province Control Department, 2000	74,511,000
Fuel and per diems for agricultural control in Cabo Delgado, 2000	23,000,000
Training, fuel and per diem for agricultural control in Tete, 2000	100,000,000
Repair of three cars in Sofala, 2000	
Office supplies in Sofala, Tete, Manica and Zambezia, 2000	60,000,000
Maintenance of Hero’s Square, the responsibility of MADER, 2000	230,380,860

The table illustrates the unfocused nature of the *Fundo*. Credit activities included lending 107,250,000 meticaais to 106 farmers, on 80.5 hectares of rice on Gaza in 1999. Repayments were 12,0001,961 of principal, plus 8,120,706 interest, for a repayment rate of 11.2%. Also, 200,000,0000 meticaais worth of inputs were sold in credit under the KR II program, but is not clear what amounts were reimbursed? In 2000, 43,025,000 meticaais were disbursed for rice

production in Matutuine District of Maputo Province, but only one third of this was issued, due to floods.

The Fund spent most of its resources on salaries, though in 2001, amounts spent on Fomento were slightly higher than salaries. Of spending, Fomento was 26.9% of the total, up from 13% in 2000 and 23,11% in 1999. The vast majority of *Fundo* resources go to internal administration. Receipts for the FFA increased from 10.4 billion meticaais in 1999 to 12.3 billion in 2000 to 25.8 billion in 2001.

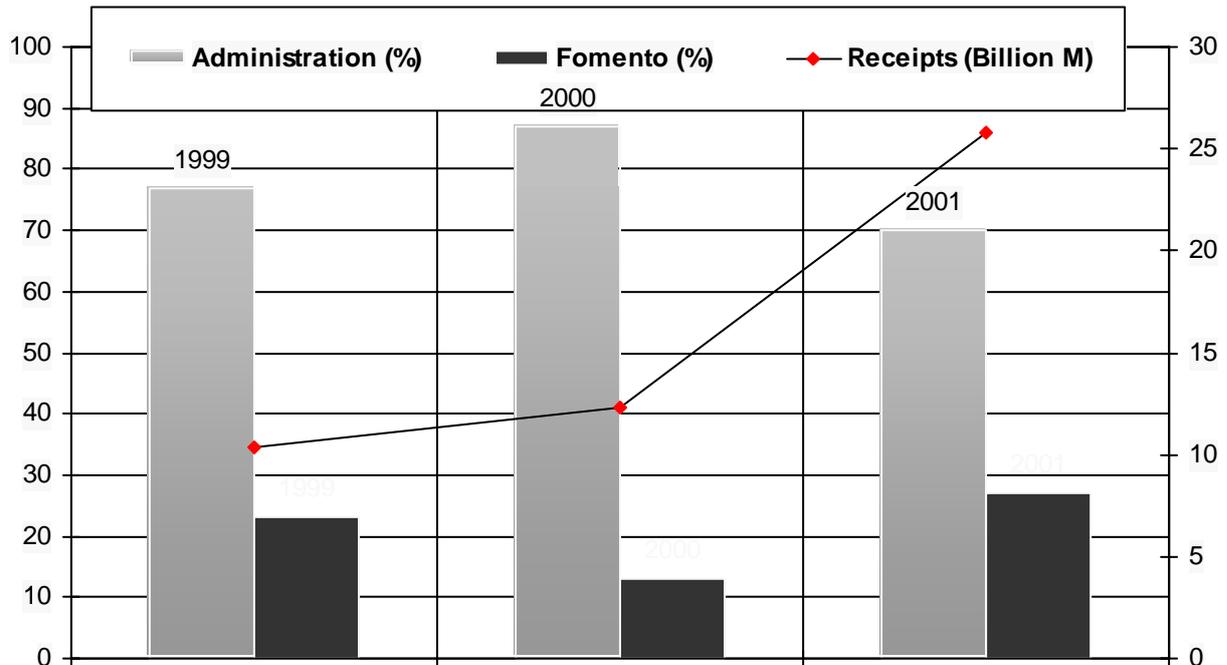


Figure 1: Receipt and allocation of FFA funds, 1999 to 2001

Note that the amount received per year has a specific influence in the allocations. As the fund has virtually fixed administration costs, *Fomento* spending can only start after the administrative cost is covered. In 1999 and 2000 the lower receipts translated into low percentages spent on *Fomento* activities, while the higher receipts in 2001 seemingly translated in a sizable increase towards spending on *Fomento* activities. This implies that two areas can be improved to ensure higher spending on *Fomento* activities. First, a decrease in administration costs that could be achieved through more efficient streamlined structures and systems, secondly, increased receipts, which can be achieved through more efficient collection of funds. The latter aspect has been proved in the case of Maputo province where receipts are quite high, notwithstanding the fact that the income potential for the fund is not that high.

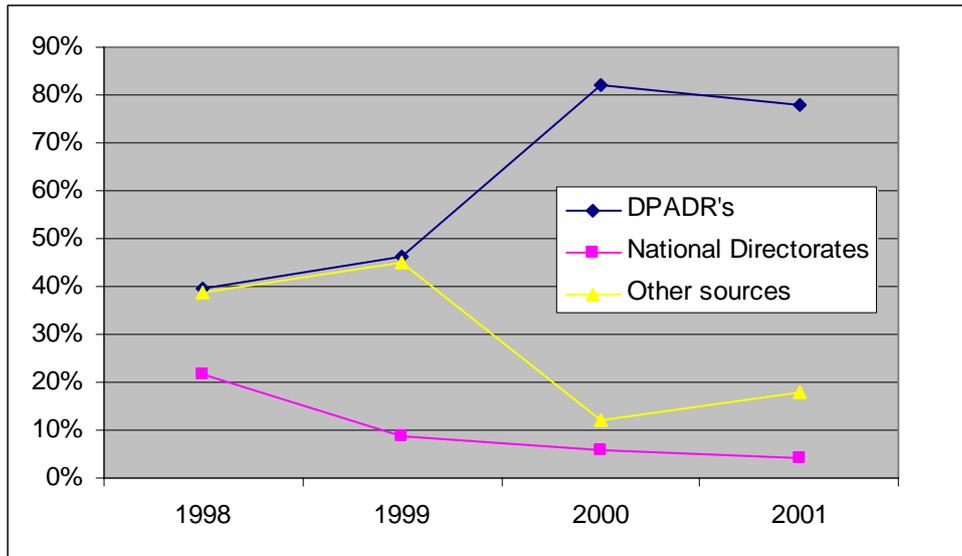


Figure 2: Sources of FFA funds, 1998 to 2001

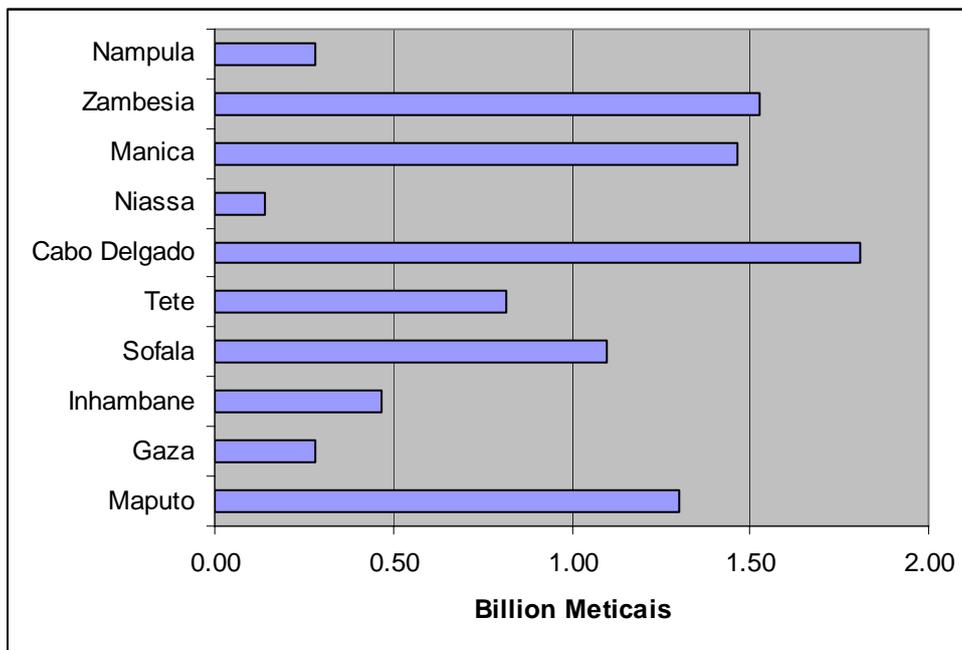


Figure 3: DPADR contributions by province, annual average, 1998 to 2001

It is clear from the above tables that the bulk of FFA funds are mobilised from the provinces. Zambesia, Manica, Cabo Delgado, Sofala and Maputo are those with the highest contributions, in most cases due to the high proceeds from timber. In the case of Maputo it reflects an efficient funds mobilisation effort. This implies that improved collection could also increase the contributions from the other provinces where improved collections are closely linked to the presence of the FFA in a province (for example, Maputo).

Closer scrutiny of the allocation of funds (see next figure) indicate that credit extension increased in 2001 due to the renewed round of credit applications and allocations after the flood period. Current indications show that repayment is active. A more detailed breakdown of allocations, including fund administration is provided in figure 5.

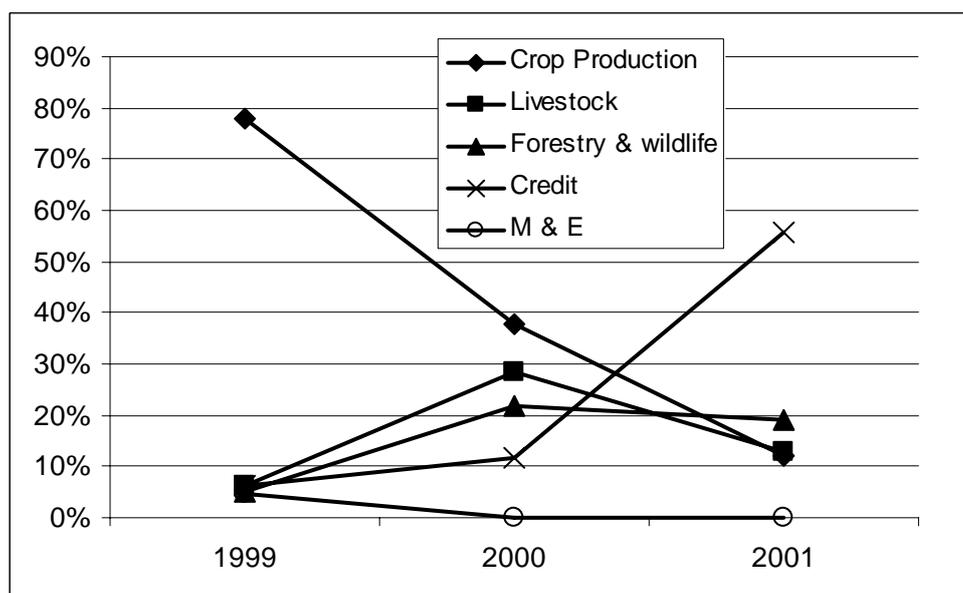


Figure 4: Allocation of FFA Funds from 1999 to 2001

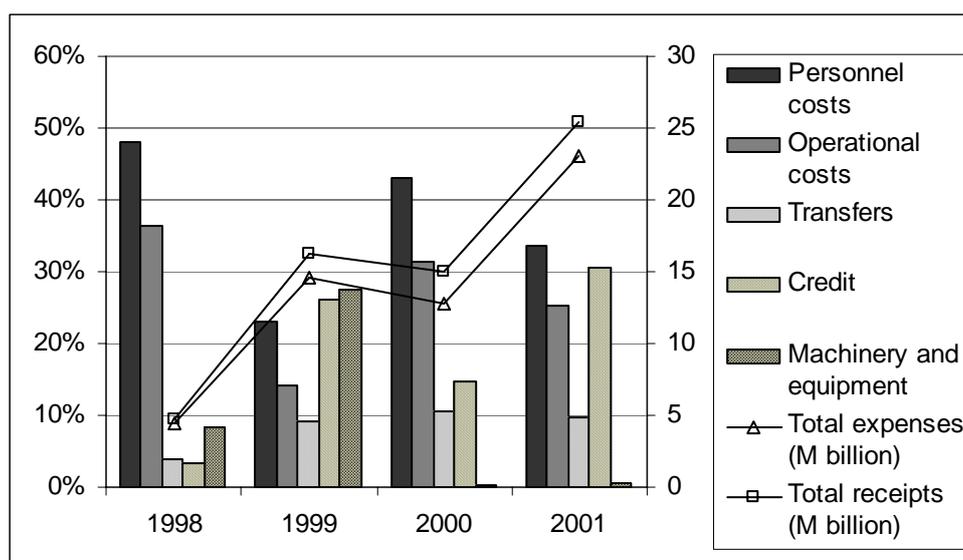


Figure 5: Detailed breakdown of FFA allocations, compared to receipts and total expenditure (1998 to 2001)

The information in figure 5 confirm the earlier observation that higher overall collections take the FFA past the critical mark where all operational costs (defined as personnel and operational costs in the figure) is covered and this allows higher allocations to *Fermento* activities. The nature of *Fermento* activities became quite credit orientated in 2001.

2.4.3 FDHA²

The FDHA is mainly a manager of four irrigation schemes in Maputo Province, Massaca and Mfuiane, Sabié-Incomati, Moamba II and Maguiguane. These are not profitable, and are

² Detailed information from the FDHA will be combined with the FFA analysis as soon as it is made available.

underused due to floods in 2000, and the tendency of farmers not to use irrigated areas for farming during the rainy season. The funds main sources of income are rents on property it owns.

The FDHA has provided credit, mainly in kind in terms of inputs and mechanization services, to selected farmers. In Sabié-Incomati farmers received interest free loans, through funds supplied by donors, since 1996. In 1999, the outstanding amount, 1,546,420,000 was considered irrecoverable. Also, in 1999, “nearly three billion meticaís” were given out, but only 1,092,133,588 meticaís repaid. Without knowing the exact amount lent, and the loan terms, it is impossible to assess the performance of this component.

In 2001 in Massaca, 1,006,000,000 were lent to farmers to promote banana production. The FDHA report provided no information on repayments, but given total revenue from the banana scheme was only 411,762,708, this level must have been low.

The above activities of the FDHA (and in a limited way the activities of the FDA) illustrate vividly the inefficiency and failure of retail credit activities by the funds. This is similar to experience in other countries where direct provision of retail credit by governments are practised.

The Policy Declaration

The need to articulate the government’s formal and official position concerning the Agriculture and Irrigation Development Funds comes out of the necessity to clarify the role of these funds in the context of agricultural sector reform under PROAGRI. The premises of this declaration are contained in the results of the study on the Funds commissioned by the Ministry of Agriculture and Rural Development (MADER), comments by the Policy Analysis Department of the Economics Directorate, opinions from the Consultative Forum held in October, and the consensus that arose out of discussions during the Fomento Funds Working Group, which was created by the Minister of Agriculture and Rural Development.

In the current context of the Mozambican economy, very little credit and development resources are directed to rural areas, with an agricultural development perspective. In the same way, there are no guaranteed sources of resources for financing agricultural infrastructure, which can support short, medium and long-term growth. The emergence of a framework of financial institutions providing rural financial services is a long-term ideal, but not a realistic expectation over the short term. In sum, there is an almost total lack of resources, both direct and indirect, aimed at jump-starting activities in the sector. As the intention of the Government is not to provide retail financial services, this leaves the question how financial services can be promoted in rural areas, thus how Fomento funds can be applied to improve access to financial services in a coordinated fashion with endeavours like PAEI, PROAGRI, PAAO and PES. A further requirement is the efficient administration of the funds to ensure that the funds are not merely applied to keep an administration structure afloat, with minimum resources channelled to the real needs to be addressed by the *Fundo*.

In the short term the funds should continue to focus on mobilising resources through the current structures and assist the rest of MADER and institutions active in rural areas, but not through the provision of retail credit services. The funds must emphasise administrative efficiency and the provision of support and resources to institutions that can act as rural retailers. Eligibility criteria must incorporate innovation and best practice approaches.

In the medium and long term the emphasis must be on the development of a market where the private sector will take on the role of the provision of financial services. The funds should also play a role in decreasing regional imbalances and the decentralisation process. MADER should ensure that the benefits of a wide range of ongoing studies are internalised by the *Fundo*, and should appoint appropriate expertise to attend to these issues. In addition, MADER should ensure that a discussion forum is created where stakeholders can discuss issues of importance regarding rural and agricultural finance. These stakeholders should also participate in the Ministry's annual consultative meeting in May, along with development partners.

2.5 Summary of objectives and goals

The main goal of rural development policy in Mozambique is to reduce poverty within the framework of a market economy. This requires strong collaboration between the public and private sectors, each of whom have well-defined roles. The public sector is focussed on changing the role of the government and its institutions, including MADER but also other public support bodies, so they become facilitators of expanded private activities. In other words, the government plays a role in creating an enabling environment for economic growth, which will reduce poverty.

The specific activities the government is undertaking to improve the environment include:

- ❑ Constantly refining government laws, regulations and policies, to improve the enabling environment for growth;
- ❑ Promoting markets, including collecting and disseminating information on prices and conditions at the national, regional and international levels;
- ❑ Improving infrastructure, including roads, telecommunications, and the physical settings for rural markets and fairs;
- ❑ Defining a limited set of priority areas for government intervention;
- ❑ Working to improve social conditions throughout the country, particularly access to basic services such as health, education, water and sanitation; and
- ❑ Reforming administrative structures to better focus working within a more liberal framework.

The private sector, broadly defined as all economic entities not under the control of the government, is taking the lead role in directly implementing the activities required to generate wealth and economic growth. These include:

- ❑ Market operations, such as buying, selling, and transporting agricultural produce and other goods, both for domestic and international consumption;
- ❑ Investing in storage and processing facilities;
- ❑ Providing financial services on a commercial basis to rural businesses;
- ❑ Undertaking market studies and diversifying markets; and
- ❑ Providing public services through contracting (outsourcing) with the government.

3. Context

3.1 The state of agriculture in Mozambique

Agriculture is the most important sector to Mozambique's population. 70% of the population live in rural areas. In the 1997 census, 66% of men, and 95% of women, cited agriculture as their primary activity. This sector also provides some limited resources to the poor in Mozambique, of whom 91% work in the rural sector. Rural areas face high levels of absolute poverty; a recent study in Nampula Province in 2000 found average per capita incomes to be \$64 per year, or 18 cents a day. 96% of the population had gross incomes below the World Bank standard of US\$ 1.00 per day.³ Therefore, economic development in Mozambique depends, in large measure, on increasing incomes in agriculture and reducing rural poverty.

Agricultural production in Mozambique has been hampered by distortions caused by colonial rule, three decades of civil conflict, misguided economic policies, and natural disasters, especially drought and flood. Currently, the vast majority of agricultural production takes place on small farms, often isolated from local, regional and world markets, with limited use of improved technologies or inputs. Average yields for Mozambique's principal crops are low, especially compared to most of her neighbours.

According to the agricultural census, conducted in 2001, there are an estimated 3 million agricultural production units throughout the country. The average cultivated area per agricultural holding is 1.24 hectares. 6% of units use animal traction, and 1.16% use tractors. Of small and medium sized producers, meaning those farming less than 10 ha, only 2.2% use natural or chemical fertilizers.

In spite of this dismal picture, the past ten years have seen great improvements in Mozambican agriculture, due to the end of civil conflict, greater access to markets, and an improved policy environment. Production of food crops has increased, and in most years domestic production can meet the needs of the population. For cash crops, poor world market prices for cotton and cashews have not promoted their production, though other crops, such as tobacco, and niche crops such as paprika and tea, have increased over the past few years. Tobacco production increased from 700 tons in 1998/99 to 20,000 in 2001/02.

3.3 Institutional support for agricultural and rural development

3.3.1 The public sector

The main public institution supporting agriculture in Mozambique is MADER. It operates throughout the country, through a network of offices at the district, provincial and national level. Under PROAGRI, the ministry focuses on five areas:

- ❑ Poverty reduction
- ❑ Decentralization and Empowerment
- ❑ Good governance
- ❑ Environmental and Social Sustainability
- ❑ Market Oriented Policies.

³ Negrão, José, "Como Induzir o Desenvolvimento em África: O Caso de Moçambique," 2001.

The main sections or departments of MADER that have direct contact with the rural sector are agriculture, livestock, extension, research, geography and cadastre, forest and wildlife.

MIC support to the agriculture sector is governed by the government's 2000-2004 Agricultural marketing policy, adopted by the Council of Ministers in 2001. Its main objective is to create, in the medium term, that the promotion of initiatives from all the actors in the market, as well as the creation of a level playing field within the context of a transition to a market economy.

MTC has an indirect role to play in supporting the agricultural sector, through the provision of roads and telecommunication infrastructure. On the roads side, MTC coordinates the construction of new roads, though these are mainly paid for by donor funds. This ministry is also responsible to designing policies to promote more sustainable maintenance of roads, especially in rural areas.

The Ministry of Health plays an important yet indirect role in promoting agricultural development through providing health services, both on the treatment and prevention sides. However, public structures have limited abilities to reach out to rural areas, so the population depends more on traditional healers (*curandeiros*) and, to a lesser extent, services of NGOs.

The National Council to Combat AIDS (CNCS) is an inter-ministerial body coordinating activities, mainly between government, NGOs, civil society and donors, attempting to mitigate the HIV/AIDS crisis. It has also set up 'Nuclei' in all provinces to perform this coordination role at the provincial level.

The Ministry of Education provides schooling throughout the country. Education in rural areas is comprised mainly of first-degree primary schools, which offer five years of schooling, with fewer second – level schools. Secondary institutions are found mainly in urban areas, and reach few people. In Zambezia Province in 2001, enrolment rates in secondary and technical institutions were only 3.5% of the eligible population.

The Ministry of Public Works and Housing (MOPH) has a role to play in the design and construction of market infrastructure.

3.3.2 The private sector

This section takes a wide definition of the private sector, encompassing any economic entity that is not owned or controlled by the government, including joint venture companies, any farmer selling any amount of their own production, associations engaged in economic activities, micro-entrepreneurs, traders not licensed by the government, and registered businesses. It is also difficult to talk about an "organized" private sector in Mozambique, as few private businesses or farmers belong to effective institutions. However, groups that are not formally or effectively integrated into an institutional structure, such as small farmers, are an important part of the factors promoting the growth of the agricultural sector.

The main private institutions in Mozambican agriculture are large agro-industrial concerns, processors, traders of varying sizes, large-scale farmers, and smallholders. Associations, especially of smallholder farmers, and some larger firms, are playing a growing role in the rural sector.

Agro-industry

This comprises of relatively large companies, focussed on specific sub-sectors, mainly cotton, cashew or tobacco. In the cotton sector, these companies provide inputs on credit and extension advice to smallholders, purchase farmers' production, process the cotton, and then sell it on domestic or international markets. The situation in tobacco is similar, except that the processing is done in neighbouring countries. The cashew industry in Mozambique focussed more on purchasing and processing the nuts, with less involvement in ancillary services such as credit and extension. Note that these processing companies work on the concept of concessions that gives them monopsonistic powers in the areas where they operate.

This sector's performance depends on the type of crop used. Companies involved in cotton are losing money, due to low world prices, low domestic production, and what they claim to be inappropriate government policies. LOMACO is getting out of the cotton business entirely. In cashew, the end of an export tax on raw nuts made many large scale factories unable to compete with processors in other countries, so they have been closing. The decline in productivity and quality of Mozambican cashews, a result of under-investment in production, also limits the ability of these firms to make a profit. Tobacco is the fastest growing cash crop in Mozambique, with production reaching 20,000 tons in 2002, up from less than 10,000 tons in 1999. Tobacco companies, like their cotton counterparts, have concessions to buy all the production in a certain area. This allows them to receive repayments of loans made for input supply. Tobacco in Mozambique is exported to Zimbabwe or Malawi for processing and eventually sold on the world market. Some tobacco companies in Mozambique are subsidiaries of Malawian or Zimbabwean firms.

Processors

Compared to neighbouring countries, there is limited agro-processing in Mozambique. This sector includes small business people, operating diesel maize hammer mills or manual oil presses, up to large industrial wheat and maize millers. As a general rule, the smaller units are profitable if they are near production or consumption centres. Larger firms have focussed on processing imported food, such as wheat or raw vegetable oil, and can serve Maputo. There is some small new investment in medium scale processing facilities, especially in the oilseed sector. Processors' main role in agriculture is as a purchaser of raw materials from farmers.

Traders

While it is customary to divide this part of the private sector into the formal (meaning fully registered and licensed through the government) and informal sectors, this distinction is not particularly informative in analysing agricultural marketing. "Informal" traders are subject to a wide range of government regulations, particularly at the district and municipal levels, such as fees for licenses and market space. Some "formal" merchants are leaving this sector, or expanding into the "informal" sector by avoiding regulations and taxes. Therefore, in order to look at a current situation, a rough distinction will be made between smaller and larger merchants.

Small traders, the vast majority who are from the "informal" sector perform most agricultural marketing in Mozambique, particularly in cereals. These are not organized into companies,

are not fully registered under Mozambican law, though they do pay local taxes and market fees. Cereal buyers also provide rural dwellers with basic goods from outside, such as salt, oil, soap and candles. Such traders are a recent development in Mozambique, having appeared only in the past ten to fifteen years. They have been instrumental in creating vibrant, relatively efficient marketing chains, especially for supplying Maputo with maize from the centre of the country. These traders are not organized into effective associations or other institutions.

Larger traders, who tend to be more likely to be in the “formal” sector,⁴ are successful if they have been able to adjust to the more liberalized policies of the Mozambican government. Previous systems gave rural shop owners sole buying rights over predetermined areas, and with margins set by the government, these traders were profitable. Some of these business people have not been able to deal with competition, and are burdened by what they claim are excessive government regulations and a lack of support (subsidies) given to them. In northern Mozambique, two grain traders, with foreign ownership, have successfully bought cereals for the past several years. One advantage they have is access to offshore financing.

Commercial Farmers

This sector in Mozambique is limited, with only 60,000 of 3.2 million farms considered “commercial.”⁵ However, most of these plots are underused, as this sector’s impact on production is limited in most crops. Many “commercial” farms are not operating near their capacity, due to dependence on climate, marketing problems, and difficulties in accessing credit. In the past year, 56 farmers from Zimbabwe have received permission to operate large farms in Manica Province.

Smallholders

As show above, the vast majority of producers in Mozambique are smallholders, farming less than 2 hectares of land. They face significant obstacles to increasing their production, and find themselves in a low-input, low-output trap. Yields are low, often less than one ton per hectare for maize, so a family’s production and revenues are limited. These resources are not sufficient to buy extra inputs, such as labour and fertilizers, so production remains low. In many parts of rural Mozambique, limited market linkages means that farmers have no incentives to increase production, as they either can not sell their surplus, or producer prices are too low to justify extra investments.

Associations

Some smallholder farmers are organized into associations, although even basic estimates of total membership are unknown. Many of these associations are not formalised and therefore have no specific legal personae. Much of the formation of associations has been promoted by donors and international NGOs, as a means of organizing farmers to benefit from higher sales prices, cheaper inputs, obtaining community land title, for advocacy purposes, or a combination of these ends. There is also a National Union of Farmer Associations, UNAC, which has active unions in four provinces (Maputo, Manica, Nampula and Sofala). Provincial unions in turn are made up of district unions, which in turn consist of member

⁴ This distinction is far from absolute. In Barué in April 2002, one formal trader complained, “There are barefoot informal traders making more money than I can!”

⁵ Notícias, 10 May 2002

associations. However, linkages between UNAC and the individual associations are limited, and UNAC has not been able to provide any services on a consistent basis to much of its membership. Most associations are not linked into the UNAC structure.

In general, farmer associations are constrained by limited management capacity, little experience in rural Mozambique of such institutions operating in a transparent manner, dependence on donors or NGOs and not on commercial transactions, and an inadequate legal framework. This inadequate legal framework also results in most of the institutions having no legal personae. Those who formalise do it in different formats, some as non-profit institutions to ensure that they do not pay taxes

The government has undertaken very limited efforts to promote the development of private, voluntary farmer associations. State efforts in the 1970s and 1980s to oblige rural people to work in “cooperativas” were not popular, particularly where benefits from production did not accrue to the members, and most of these institutions have collapsed. Registration of farmers associations is quite onerous. In theory it should take between 60 to 90 days to register an association. A minimum of 10 members and 10 million Meticais is required for registration as well as some additional requirements. The big problem here is to organise the farmers into voluntary associations and explain the benefit of registration and joined effort. Many NGOs support this process.

Associations of larger producers and businesses are lobbying the government to promote their interests. Examples of such associations are CTA, the Cotton Association, and the Cashew Association.

Well functioning associations could be a good interaction point for financial service providers. This notion is based on the fact that collective action is also partly a collateral substitute and could serve to secure intermediation until enough is known of the individual members to move to providing services on an individual basis rather than a group basis. This as an objective should be considered as a focus area for the *Fundo*.

3.3.3 Other non-financial support institutions

NGOs have played a significant, albeit decreasing role, in agricultural development in Mozambique. Most international NGOs entered the country during the emergency period in the late 1980s and late 1990s, when they provided food aid and other donations to destitute populations. Such NGOs have, with varying degrees of success, transformed their activities from an emergency to a development outlook. Over the past five years, their activities have focussed on extension, market development, and association building. Particularly on the extension side, their activities are becoming more integrated into MADER structures through PROAGRI.

Local NGOs are playing a larger role in agricultural development in Mozambique. These maybe indigenous organizations, or spin-offs from international NGOs or projects. Such organizations tend to play a stronger role in advocacy than their international counterparts, for example ORAM works with local communities to assert their rights under the 1997 Land Law.

3.4 Financial support institutions

The provision of financial services in rural Mozambique is limited. Such support is delivered through five main types of institutions: commercial banks, non-bank financial institutions, microfinance institutions, informal arrangements, and the government.

Commercial banks provide little, if any service to rural areas. Bank lending to agriculture is constrained by high risks to the sector, past difficulties in obtaining loan repayments, lack of specialized knowledge required to make effective loans to agriculture, and, perhaps most important, the existence of profitable, risk free operations through trade finance and the purchase of government bonds, which pay 34% per annum. Bank lending rates in Mozambique start at 37% per year, in local currency. The banking sector has reduced its presence in rural areas, as branches have been closed due to low volumes of loans and deposit collections. This trend is not unique to Mozambique, and is experienced in all neighbouring countries.

Non-bank financial institutions come in three forms: companies providing inputs on credit, traders providing supplier credit, and specialized lending institutions. Companies, mainly in the agro-industry sector in cotton and tobacco, provide farmers with inputs. The cost of these inputs is deducted from the sales proceeds. Such a system is profitable to the company if farmers sell to the company, the inputs are used in a way that justifies their cost, and world market prices remain high enough to cover their costs. Agro-industry credit to tobacco farmers was estimated to be \$2 million in the 2001/02 season.

Supplier credit for marketing, particularly for cereals, is used between people who have a long-standing business relationship. Interest rates involved can be competitive if the main supplier has access to offshore finance. Volumes of this type of credit are unrecorded.

There are two key specialized lending institutions operating in rural areas: AMODER and GAPI. AMODER, has been providing marketing credit to traders in five provinces of Mozambique since 1997. Loan volumes range from \$3,000 to \$100,000. While AMODER has identified solid clients, mainly medium-sized traders, at least 10% of their portfolio is non-performing, and its on time repayment rate is 55%. Both figures would send a commercial operation into bankruptcy. AMODER can provide this service through support from donors, and profits from other activities (e.g. the sale of used clothing).

GAPI is a registered company, and the result of a German project that was in effect a challenge fund. GAPI follows a partnership approach with the government and has an investment portfolio of \$15.5 million that emphasises SMMEs. GAPI is well organised with 44 staff serving the organisation. They are operationally self-sufficient. They feel that they are autonomous, accountable and not influenced by politics.

AMODER and GAPI receive funds for loans and to pay for technical assistance, from MIC, through support from the European Union.

Microfinance institutions in Mozambique serve more than 29,000 clients, with an outstanding portfolio of \$3 million as of the end of 2001.⁶ However, most of these are in urban areas. Few MFIs operate in rural areas, due to the high operational costs of a heavily

⁶ Based on self reported data from the eleven largest institutions in Mozambique

dispersed clientele, the lack of “bankable” activities, and high risks. One MFI, Karela, in Zambezia reached nearly a 1000 clients in rural areas, though none of their loans were for agricultural production.

Informal sources of financial services include storing crops, raising livestock, use of family and social networks to obtain emergency loans or donations, and *xitiques* for savings, especially in Southern Mozambique.

CARE International is developing a pilot project, based on a *xitique* model, for mobilizing savings and making loans, in rural areas in Inhambane and Nampula provinces. Under this model, rural residents create groups of 20 to 30 people. Each member contributes a set amount each week, and loan out their capital to members based on group decisions. The institution is the local group; CARE acts as an outside facilitator.

Government financial support to agriculture is provided through the FFA, and the Economic Rehabilitation Support Fund (FARE), which supports the rehabilitation of rural shops. The Marketing Fund, that provided credit to traders, though MIC, has run out of funds and is inactive, though a restructured fund may be coming. In general, these schemes have not been able to fully meet their objectives of providing financial resources to the agricultural sector. For instance, the FFA lending to agriculture in 1999 was only \$48,000 in 1999. Loans by the FDHA in 2001 were \$50,000, all in one province.

Sources outside on MADER know little about the FFA, other than it exists. One civil servant said he had no idea what the fund did. During two farmers meetings in Manica Province, one group said they had never heard of the FFA. In the second group, one member said he had heard the name on the radio but did not know anything else about it.⁷

Another important observation is that there is a complete lack of formal deposit facilities in rural areas. Some studies also indicate a lack of savings, however not enough evidence exist to make this a general statement. The lack of savings facilities is however an important gap in the financial services offered in rural areas.

3.6 Main Issues

Based on interviews with key stakeholders, from the public sector (MADER and MIC), the private sector, including associations and financial service experts, and a representative of farmer associations, as well as studies of recent documents the state of rural development in Mozambique, several key issues have been identified that influence the sector. These issues are related to three main categories: agriculture, institutions, and finance, as well as cross cutting issues from other arts of the Mozambican economy and society that play a role.

3.6.1 Agriculture

A. Limited marketing channels and networks

Marketing channels are new, due to restrictions imposed in colonial times and after independence. Linkages are poorly formed. Producers lack information about markets, such as prices, needed quality. Old trading systems (cantinas) were mostly destroyed by war and

⁷ A report, in Portuguese, on meetings held with farmers in Manica on 22 May can be found in Annex 7.

economic upheaval. There is also a lack of transport capacity, even in rural areas with reasonable roads. However, an informal, market based system is emerging but is less than ten years old.

B. Low levels of production

Yields for almost all crops in Mozambique are low compared to world and Southern African standards. Maize yields are below 1000 kg/ha. Most smallholders produce a surplus, but this is small. For instance, average annual crop per household in Nampula and Zambezia provinces were \$22 in 2001.⁸ A key factor behind these productivity levels is the limited use of improved technologies, including improved seed varieties, fertilizers, animal traction and mechanization. For farmer groups in Manica District, lack of access to inputs was a concern. It was the highest priority for one group, and the second of four for another. “The priority here is our field, because that is the source of everything, including money,” one man said. Lack of access to funds meant they could not afford inputs, particularly fertilizers.

C. Limited extension system

Agricultural extension, in the public sector, is provided in 16% of the country’s districts. Even in districts covered by the system, extension agents often lack the resources to reach out to farmers, particularly those living far from district capitals. Extension services are also provided by the private sector, mainly in higher-value cash crops such as cotton, tobacco, and in some cases cashew. MADER has recently begun a program, with EU support, of using public funds to outsource the provision of extension services to private companies and organizations.

Extension systems and messages are not delivered according to the expressed needs of local farmers, who have little input in planning. However, this situation is improving under PROAGRI. Also, research and extension agendas not well linked, with research driven more by scientific interest than by the priorities from the field level.

Farmers in neighbouring communities in the District of Manica had different opinions of the public extension service. One community recognized the assistance received from an extension agent who taught them how to better plant vegetables. In another area, 5 km from the first, farmers said they received no support from the government, which “does nothing except demand taxes.” However, one farmer who received 5 grams of onion seed shared his experience, “later, they came with a truck with 25 people to see my small plot of onions. Then the extension agent kept asking me to pull up the plants so he could take them as samples to show his boss. By the time the onions were ready, there were none left; they had all be taken to the boss.”

E. Land availability

Although Mozambique has 36 million hectares of arable land, one community visited in Manica District stated that land pressure was their biggest problem in agriculture. Their community is near a forestry concession and another mining area, leaving little land available for farming. The farmers added that the local Land Forum, a grouping of NGOs, and the

⁸ World Vision Mozambique, Agricultural and Natural Resources Management Project, Final Survey, November 2001.

Government Geography and Land Survey Service were working with them to clarify land issues in the area.

These issues can be very localized; farmers in a neighbouring community did not mention land availability as a problem.

F. Climate

Mozambique's climate includes irregular rainfall, making the country susceptible to droughts and floods, limiting agricultural production.

3.6.2 Institutions

A. Lack of Farmer Associations

With a dispersed population of smallholders, it is difficult to reach them on an individual basis, whether we talk about lending to them, providing them with extension, or purchasing their produce. Associations can act as financial wholesalers between an institution and its members, can disseminate extension advice, can assemble large quantities of produce for marketing. But associations in Mozambique generally lack management capacity, have difficulty getting registered, and depend on outside support. This lack of farmer organizations also impedes smallholder participation in agricultural services and planning.

B. Legal System Constraints

The legal system does not encourage the establishment and registration of economic associations. In rural areas, registering a new farmer association can take up to 9 months and costs \$200.

C. Need for Decentralization in MADER

Previously, priorities for Mozambican agriculture were determined at the central level. This approach did not fully take into account the varying agro-climatic and economic conditions in various parts of the country. The decentralisation of the Ministry, going on under PROAGRI, allows for agricultural activities to be defined, planned and implemented in accordance with local needs.

D. Loan Recovery Difficult under Judicial System

Obtaining loan repayments through formal legal mechanism can be a long and expensive process, especially for seizing collateral offered by a borrower. Loan recovery is therefore problematic.

Land as an asset is not held privately and therefore the use of land as collateral for loans can be problematic.

3.6.3 Finance

A. Farmers lack Financial Resources and Lack of Credit to Agriculture

Particularly among smallholders, most rural residents are poor and thus cannot access financial resources required for them to respond to market signals and to increase their incomes.

Few resources go the agricultural sector, including production, trading and processing. Loan products available have high interest rates, high collateral requirements, and short terms, which are not suited to many agricultural businesses. Interviews in two communities of Manica District did not find any evidence of any credit, formal or informal, to agriculture.

B. Limited Rural Savings

Savings in rural areas are mainly in-kind, often stored crops or livestock. These cannot easily be invested in other parts of the rural economy. In general, a complete lack of formal deposit facilities exists in rural areas.

C. Lack of a Credit Culture

People in Mozambique are not used to honouring commitments to pay back loans. In particular, loans from the government are seen as gifts that do not need to be repaid.

D. Difficult to use Land as an Asset

If land could be used as an asset, it could be a store of wealth, a source of savings, or, particularly for larger farmers, a form of collateral.

3.6.4 Cross cutting issues

These issues are not directly related to agriculture per se, but have a strong impact on the sector.

A. Poor Infrastructure

Poor roads, especially in rural areas, mean some potential high-production areas cannot send their products to market. Poor infrastructure also contributes to high transportation costs. Lack of telecommunications in rural areas inhibits the flow and dissemination of market information.

B. Gender

Women do most farm work but they are not included in many rural programs.

C. Lack of basic services, such as education, health, water.

D. HIV/AIDS

F. Natural Resource Management

4. Specialised agricultural lenders, experience⁹

4.1 Introduction

Two issues of importance need to be raised before the focus areas and the functioning of the *Fundo* are addressed. The first has to do with the concept of the *Fundo*, and answering the question, should the government be involved at all in intervening in the market? We provide a discussion of this question in this section. The second area of importance has to do with the lessons learned from international experience, and how should this guide our thinking, without losing focus on the importance of different contexts. These lessons are reflected in Annex 3. Although the terms of reference started with the existence of the *Fundo* it is important to raise these two questions.

The policies of development finance and thus the development of financial markets are in a continuous search for the answer to the question whether there should be intervention in the market by government and if yes, in what format should this intervention be. Over time the question of whether there should be intervention faded in the background in favour of the discussion on the format of intervention. If we only concentrate on the Post WWII period we see an emphasis on the specialised agricultural credit institution as intervention instrument up to the late 1970s. Thereafter the NGO bravely entered the arena while the agricultural credit institution (also referred to as agricultural development banks) was pushed to the background.

Recently, in the late 1980s, as the NGO push started to subside, other formats of intervention were rediscovered. Commercial banks started to enter the fray and some development banks reformed into entities resembling commercial organisations with a development profile. Several NGOs shrugged of structural constraints and turned themselves into banks, once again with a commercial approach and a development profile. In many countries this range of players expanding the microfinance market broadened to include retailers, organised microlenders, agricultural processors, mining houses, self organised groups (in many guises, e.g. ROSCAs¹⁰, Village Banks, Credit Unions) etc. Today the institutional profile of development finance at the retail level is wide and varied and far different from the mono-institutional culture of the 1950s to 1980s.

The result in terms of clients obtaining access to financial markets is staggering. Since the 1970s it is also an urban story. Access to financial services in rural areas of developing countries continue to be a vexing problem and the debate still rages of what would be the best institutional format for improving access. During this debate the “should there be intervention” lobby also made them heard from time to time. The aim of this section is to highlight issues and reflect on international experience.

⁹ This section draws largely from Coetzee and Graham, 2002 (in Coetzee, Gerhard, 2002, Agricultural development banks in Africa: The way forward, published by AFRACA: Rural finance series no 2). We insert this section to keep the basic question of intervention in focus.

¹⁰ Rotating Savings and Credit Institutions

4.2 Beyond the market and the state¹¹

Government intervention is typically defended to provide public goods (health, nutrition, mass vaccinations, education, etc.) since without this intervention supply would be less than optimal. This is due to the inability of private agents or suppliers of these services to internalise the positive externalities to society at large generated by the supply of these goods and services. These services have been characteristically supplied directly by government through traditional channels of Public Finance (i.e. government expenditures). However, more recently in some developed countries a voucher movement has emerged challenging the governments continued supply of these services.

Development finance, on the other hand, is not generally involved in supplying public goods. On the contrary, as the name implies development finance institutions (DFIs) supply loans or equity finance to, inter alia, private businesses and individuals. The contrast to public finance is clear. DFIs are not engaged in generating expenditures. They expect to be repaid. The question arises why can't private lenders make these loans? What justification is there for the government to intervene in private markets to either provide these services or subsidise their supply by others?

Four arguments are frequently made to justify the intervention of government in financial markets (where, in essence, the markets are not functioning properly): (i) monopoly; (ii) externalities; (iii) imperfect information; and (iv) contract enforcement problems. Monopolies are frequently associated with markets segmented by geography. Introducing more competition into these markets increases the supply of loans beyond the profit maximising level determined by the monopolist. Hence government intervention to correct for the under-supply of finance does not necessarily have to imply direct supply by a government lender. The same effect could be achieved indirectly by breaking down barriers to entry and encouraging additional competitors through temporary tax credits or subsidy schemes or increasing access to the segmented area through the expansion of public goods like roads that in turn generate other positive externalities. When the monopolist enjoys increasing returns to scale, governments typically intervene with marginal cost pricing formulas to regulate the monopolist's output behaviour and returns.

Externalities are the classic form of market failure. In the realm of financial markets externalities can emerge on the side of borrowers or lenders. On the borrowers' side, defaulted borrowers increase interest costs to good borrowers as lenders pass on the higher costs of their bad lending experience to the rest of their clientele. Externalities exist on the lender's side when borrowers have access to more than one source of credit (i.e. obtaining partial funding for a project from more than one lender). This multiple lender scenario creates a potential free rider problem in monitoring since the lenders benefit each other via their monitoring. Another scenario is where a borrower borrows for several projects from different sources of credit. The effort on each project is not separable. The terms and conditions of one lenders contract can affect the effort and payoff for the other lender (Besley, 1992).

Multiple indebtedness, a feature common to rural financial markets where both formal and informal finance intermingles can generate more loans than is socially optimal (i.e. excessive indebtedness). While government interventions to deal with this feature of multiple

¹¹ This section draws on a report by Graham, Coetzee and Brandes (1999).

indebtedness would be desirable, it is not clear what form this intervention could take. Private lenders could undertake denying or reducing the size of loans to those who are already in debt to another source. However, one would need to generate an all-embracing credit bureau that shared (or charged for) this universal information base for this to become effective. It is not clear what form government intervention could take to directly address this issue of excessive indebtedness through multiple lending unless it undertook to carry out or subsidise this credit bureau clearinghouse role.

Asymmetric or imperfect information is the third and most discussed perspective on market failure. This refers to the uneven, one-sided distribution of information favouring borrowers at the expense of lenders. Adverse selection highlights how interest rates do not clear the market between supply and demand since rising risk premiums only induce risk averse borrowers to leave the loan market while encouraging relatively more risk-prone borrowers with riskier projects to stay in the market. The end result is a rise in loan losses for the lender, hence lenders choose not to raise interest rates (beyond some reasonable risk adjusted level) but rather ration the quantity of credit in the market. This is considered socially inefficient since even a constrained Pareto optimum has not been reached with under-investment governing the supply of credit (i.e. some credit-worthy borrowers are denied credit since the lender cannot tell the difference between some good and bad borrowers). This is the classic market failure example used to argue for government intervention in credit markets.

Moral hazard underscores the possibility that individuals with loans will exert less effort to restrain risky behaviour the higher the interest rate. This adverse incentive effort on borrowers behaviour also increases the likelihood of a worsening portfolio for the lender who in turn faces this challenge by rationing credit at lower interest rates. The quantity of loans lent to an individual is restricted for incentive reasons.

Adverse selection and moral hazard jointly generate a socially inefficient supply of finance, i.e. a smaller supply than that which would obtain in a world without asymmetric information problems where truly creditworthy clients would not be rationed out of lender portfolios. This creates an argument for government intervention to deal with the problem of imperfect information. Creating the argument is one thing. Carrying it out is another thing altogether. This brings us to the fourth and most important dimension behind market failure, namely, the lack of an effective contract enforcement framework. Practically all the writers in the asymmetric information school assume away this problem. Perhaps this is due to the fact that they all live largely in the United States where contract enforcement is reasonably robust. However once one moves to the developing world, especially the world of the disenfranchised within the developing world, one has to face this issue. The lack of clearly specified property rights and cost effective and equitable contract enforcement machinery are severe problems for financial markets in these societies. The role of the government here is obvious. Strengthening property rights and streamlining more rigorous contract enforcement procedures and mechanisms are likely the most significant action governments can undertake in developing societies to improve the alleged market failure of financial market.

Most researchers of market failure invariably end their statements for government intervention by recommending once again, the tried and tested policies of government failure in the past, i.e. government credit programs, targeted credit, and subsidised interest rates. This is done despite the fact that the financial landscape of developing countries is littered with the carcasses of dead and half-dead government, targeted lending programs with

subsidised interest rates. None of these traditional recommendations get to the “core” of the problem, i.e. the causes of information deficiencies and/or contract enforcement problems. They only address the issue of increasing the supply of loans through government auspices regardless of the costs.

Indeed the transfer of more lending into government hands carries the risk of increased moral hazard. Everyone in developing countries knows that the sector in which contract enforcement is weakest is the government sector. Borrowers from government targeted credit programs know they likely will not suffer any consequences for defaulting on their loans, hence the large element of rent seeking behaviour in these programs.¹² Yet analysts of market failure frequently overlook this fact, no doubt, because they assume in their modelling exercises no problem with contract enforcement.

It is instructive to note that the major breakthrough, substantially reversing financial market failure in the past decade, owes nothing to the traditional recommendations outlined above. This is the breakthrough in lending technologies for the "best practice" microenterprise organisations. These organisations directly addressed the core problem of substantially reducing the imperfect information problem, enhancing monitoring, and devising innovative ways around the contract enforcement problem. Direct government intervention in financial market variables played no role in this unique effort except to fund a select number of donors who in turn supported, in an ad hoc manner, consultant and non-profit organisations carrying out these innovations in financial technology.

A further aspect is that over time one would expect the private sector to play an increasingly important role in rural areas following the market based approach and the development of the aspects relevant to the existence of a market over time. Thus, based on the efficiency of the market based approach and the inefficiency of government based approaches, private sector institutions will provide services in preference to government based institutions. This line of thought is questioned where the private sector decrease services in rural areas based on the inability of rural private sector bank branches to adhere to increased profit targets.

4.3 Specialised farm credit institutions¹³

“Why are specialised farm credit institutions founded in low-income countries, and why do they frequently flounder?” were questions posed by Von Pischke (1978). Added to these inherent difficulties associated with specialised farm credit, institutions have often been used by states as conduits for carrying out agricultural and social policies, such as compensating the farm sector for excessive taxation of agriculture and urban bias. This has led to a lack of autonomy. It is this lack of autonomy that has crippled these institutions rather than state ownership *per se*. In effect, financial markets were used to allocate subsidies, rather than fulfil their role of efficient allocators of finance (Adams, 1992). Because government has pursued social and agricultural policy objectives *via* rural financial institutions, these institutions have been particularly vulnerable to collusion by their politically organised clients. Using specialised financial institutions to compensate farm sectors or pursue social objectives has mostly been futile. Quite often all the participants in the agricultural sector suffer from bad policies, bad prices and/or bad weather, however only a minority of better off

¹² “People in Mozambique think funds from the State are a donation, and even if we tell them it is a loan, they will not repay,” according to a high ranking civil servant interviewed for this report.

¹³ Or agricultural banks.

clients have access to credit and therefore received “compensation”. In the specific case of Mozambique, a rural finance expert said “No one ever goes anywhere with fomento in a country like this. The needs are so great, and the available resources too small.

The realisation of this state of affairs necessitated a re-look at the way rural financial markets are approached. This started with the publication of the USAID sponsored Spring Review of Agricultural Credit Programmes (Donald, 1976). In the period following the mid seventies the donor agencies tended to ignore the specialised farm credit institutions that they had created as part of their earlier effort to throw money at development problems. The market was rediscovered and these institutions, being supply-led in nature, obviously did not meet the requirements of the new approach to rural finance. In the new approach a few basic rules changed:

- ❑ Savings were seen as important: It was realised that most poor people did not make use of credit and saved in some liquid form to serve as a reserve to be applied for consumption smoothing due to income shocks.
- ❑ Transaction costs were given more attention and the realisation dawned that the frictionless market of the neo-classical school is somewhat removed from reality.
- ❑ Information flows and risks inherent in asymmetric information situations were highlighted.
- ❑ Institutions mattered as sustainable services to poor clients were impossible without sustainable institutions. This unlocked research on all aspects of institutional sustainability.
- ❑ Financial markets were treated as markets and not as conduits anymore.

Unfortunately, in the mad rush towards the market the specialised credit institutions were sidelined. Recently, the realisation dawned that in countries with a weak private sector these were the only institutions providing services in rural areas, albeit within a skewed policy framework. Even where the private sector has a more prominent presence, it still is not willing to initiate the provision of services on a broad basis in rural areas. The attention is now shifting back to these institutions as one institutional form of a range of retail institutional options to increase outreach. However it is not yet clear whether this refocus is noticed in the large multilateral development finance institutions. Further, development banks in their conventional guise would obviously hold no answers. Emphasis is placed on the restructuring of these institutions with the objective of emulating commercial operations with a development face, thus taking up the challenge of being self-sustainable and having a development impact and vast outreach at the same time. Indeed a formidable challenge and to date, with a limited success record.

Although we refer to development banks here, these lessons apply to all government interventions in rural financial markets. In the case of the *Fundo*, these base arguments apply as well.

5. Determining the main focus areas

This section is the result of a great deal of interaction with stakeholders and interested parties, and this process of interaction is not yet complete. We therefore see this document as work in progress, and it should not be taken as representing definitive conclusions or views.

5.1 Identification and discussion

The TOR for this study, and experience with government supported financial institutions indicate that a focused approach is essential to the success of these institutions. In earlier sections the objectives of agricultural and rural development efforts in Mozambique, as reflected in PROAGRI were outlined. This is however still vague and not focused on practical issues that should be addressed. In the interviews with stakeholders and interaction with the commission and its members several issues were raised and a wide range of focus areas was mooted. In this section we reflect a process and suggestions to indeed focus on a few leverage areas. We do not argue that these should be the long-term focus and that this cannot change. However, it is important to start with specific focus areas that reflect the objectives stated and the reality that prevails in Mozambique.

5.2 Two main areas of concern

5.2.1 Creation and strengthening of the market

The reality in Mozambique necessitates addressing two core focus areas. Our discussion thus far vividly illustrates the weak market and in effect, the absence of a rural financial market if judged in terms of volumes of transactions and the cost of transactions. It follows that the role of the state in this regard should be focused on the creation and strengthening of the market. This would therefore cover all facets of market development, inter alia, the improvement of information flows, of legal structures and contract enforcement, the provision of appropriate infrastructure and capacity building and the strengthening and expansion of institutions (like organised farming).

5.2.2 Access to financial services

At the same time, we realise that the building and strengthening of a market is a long-term process, and that in the interim rural producers lack access to financial services. We also acknowledge and support the notion that government as a direct retailer in rural areas have a severely blemished track record, and that experience have indicated that governments should rather not be involved in the direct provision of financial services. In the case of Mozambique and the earlier role of the *Fundo*, this aspect has been highlighted. Thus, this leads to a need to get other institutions to provide financial services to rural producers and communities. Thus the second focus area should be to facilitate the provision of financial services in rural areas, and to harmonise this with the market development responsibility.

5.3 How to decide on focus areas

During the interviews with stakeholders, several suggestions were made on how to decide to focus. We used these suggestions, international experience, the objectives and the reality of the agricultural sector and suggest criteria that should be considered when focus areas are being selected. In a way, this list will be the sieve that will test funding requests' adherence to the objectives of rural and agricultural development as discussed in earlier sections.¹⁴

□ **Focus on activities that:**

- Is consistent with the basic principles and objectives of MADER and PROAGRI

¹⁴ The weight that each consideration carries in selecting a focus project should also be discussed.

- Reflect an integrated approach by different directorates in MADER and also different government departments.
 - Is conducive for partnerships and co-ordinated approaches, even better that involve a community - public sector - private sector partnership (CPPP).
 - Will have concrete impacts over the short term
 - Avoid duplication and parallel structures
- **Focus on geographical areas where:**
- There is growth and growth potential for agricultural activities
 - Farmers are organised or have potential for joint efforts through farmers organisations
 - Non-financial support is largely in place (thus where farmers have a reasonable chance of success), good or better infrastructure; marketing arrangements in place; note that we cannot solve non-financial problems with financial services.
 - The majority of funds have been collected to ensure a relationship between contributions and benefit from the application of the funds.

Another consideration could be the different farmer groups that should receive focused attention. One could focus on commercial (or emerging commercial) farmers as that could bring good results in terms of increased agricultural production and multiplier effects in the rural economy. Another focus could be subsistence and small farmers, as this would relate to MADER's objectives on poverty reduction. In reality, MADER cannot focus exclusively on any group, as this will reflect a policy contradiction. It is suggested that MADER follows the suggested considerations, notwithstanding the farmer group being focused on. MADER should also clearly decide what instrument to use, and the proportion of the *Fundo*' Fomento activities that would be focused on each farmer group. As a guideline MADER should focus more on leveraging private sector funds and endeavours with the commercial group. With the subsistence and small farmer group the focus should be on projects that focus on organisational issues and where the small farmers can contribute in kind.

5.3 The focus areas

This emphasis on focus areas is important to ensure that all facets of the *Fundo* work in harmonised fashion and that the *Fundo* do not attempt to cover so many areas that little progress is possible, even with the most efficient operation of the funds. The limited funds in the *Fundo* also impose the reality that crucial areas of intervention must be identified, and that the involvement of the *Fundo* should be focused on leveraging resources, rather than to try and cover all facets of interaction and support. It further provides focus areas that should be adhered to both in the market development and the provision of access to financial services imperatives as proposed. Circumstances do change and the focus areas proposed are seen as initial focus areas, which must be revisited, periodically to ensure that the *Fundo* always address the relevant issues.

5.3.1 Activities to improve and strengthen the functioning of the market¹⁵

In this section we focus on areas where groups of farmers or districts/provinces benefit rather than individual farmers. These are also efforts that will be expected to have results over longer periods.

Policy and Institutions

- Areas of focus to ensure food security. This links with “access to financial services” measures in the next section, but also incorporates the facilitation of livelihood opportunities for rural people (thus emphasising both the ability to obtain food and the ability to produce food).
- Support in ensuring that the fees, fines and levies applied are efficiently collected to ensure a continuous stream of income for the *Fundo*, and that the rules of government are enforced.
- Ensure that the legal system encourages loan recovery and enforcement of loan contracts.
- Develop means so that land can be better used as an asset in agriculture.
- Emphasis on and simplification of natural resource management practices
- Integration of HIV/AIDS awareness strategies in all policies and activities
- Ensure an appropriate emphasis on supporting women, as they provide most of the country’s agricultural production.

Promote the organisation of farmers

- Promote farmer associations at the grassroots level, focussed on bringing benefits to their members. This should include the development of long lasting institutional and management structures.
- Promote associations as businesses, acting as sellers, purchasers, and guarantors of loan repayments on behalf of their member.
- Provide resources for the initiation and legalization of associations
- Assist with different support in organisation for different farmer types (subsistence, emerging and commercial groups)
- Promote local, community level solutions to problems. A source contacted for this report said he recently went to Inhambane Province and got a rural community to list their problems. When asked who would solve the problems, the community’s answer was either “the government” or “a project,” never themselves.

Promote investment in soft and hard infrastructure

Work towards the efficient establishment of non-financial areas of farmer and rural entrepreneurial support (extension, input supply, mechanisation, research, access to resources like land for production, support infrastructure):

- to promote livestock farming (including genetic improvement)
- to promote greater use of irrigation in farming
- to improve wildlife “farming”
- to improve communication in rural areas
- to improve transport facilities (access roads)
- to promote trade and commercialisation in agriculture
- to improve facilities at physical markets and fairs

¹⁵ Note that this relates to macro level issues and refer to issues that have more to do with things that must be in place to ensure that the Fundo invest in areas where there are coordinated efforts, rather than being a focus area of the Fundo. Thus investment in making the market work.

Invest in marketing and the commercialisation of agriculture

- Promoting the spread of information on market prices and conditions
- Scales and cleaning equipment to assist with standardisation, focused on providing these to farmer associations
- Forestry products marketing

5.3.2 Activities to ensure access to financial services

In this section we concentrate on activities that will result in direct interaction with individual farmers and thus benefits accruing to individual farmers (thus on farm activities). These activities should have positive effects over the short, medium and long term and should be integrated and institutionalised within the long-term objectives.

Facilitate access to financial services through retail intermediaries

- Financial assistance to farmers to invest in livestock (purchases)
- Access to funds for crop production
- Access to a range of services including savings (and recognising that some people save in livestock), attempt to monetise savings and move away from hoarding to the provision of deposit facilities (note the legal constraints in this regard)
- Promotion of member owned financial institutions, addressing issues such as, lack of social cohesion, focus on formation of groups, building on pre-existing social structures, links to farming associations, etc.
- Access to financial services to support marketing endeavours
- For mechanisation and animal draft power
- With respect to wildlife stocking

Focus on non-financial measures that will benefit financial measures

- Improving on-farm production practises and support
- Improving forestry management and reforestation
- Improving on farm storage facilities and techniques

6. Instruments and arguments

6.1 Introduction

In this section certain instruments applicable in the circumstances and to address the focus areas will be discussed. This will only include those deemed as realistic options. The final choice of instruments will be a combination of the objectives the *Fundo* want to achieve and the reality and context of the areas and circumstances it operates in.

6.2 Instruments

- i. **Matching Grants** to get a range of institutions into the rural areas (capacity building of retail institutions, use of existing institutions, how to get commercial entities into the fray, leveraging of retail services, emphasis on savings). The *Fundo* could reach out to a wide variety of financial institutions, including commercial banks, agro-industry, non-bank institutions, farmer associations, and NGOs. If the *Fundo* provide funds for on-lending through these institutions, they should verify that they have the management and technical capacity to use them in a sustainable manner. Funds for capacity building

can be included in the *Fundo*'s support. Under this system, the *Fundo* can provide a grant to an eligible institution, provided they have already made a significant contribution to their initiative. Use of matching funds ensures the beneficiaries have some ownership of the project, and are committed to working for its success. As a rule, the *Fundo* contribution should not be more than 50% of the project's value. Such funds have been tried in neighbouring countries, but have not yet been tried, on a large scale, in Mozambique. Use of matching funds will require strong monitoring of impact. Note that contributions from communities can also be considered in an in-kind format (e.g. contribution of labour).

- ii. **Guarantee funds.** These would be applied to commercial entities that lacked access to credit. As a rule, these funds should share risks with other parties, and should be gradually withdrawn over time. Note that too high guarantees lead to moral hazard and a disincentive to make proper decisions by financial institutions. Look at the document on a Guarantee Fund for Agro-Industrial activity as an example structured in a way to decrease the negative aspects of guarantee funds.
- iii. **Challenge funds,** applications from the areas representing the eight components of the Ministry according to known criteria and decisions by board according to known criteria. This should be to expand the internal resources and to promote activities of external institutions.
- iv. **Community, public, private sector partnerships:** The *Fundo* would work as a catalyst to promote partnerships among the public sector, private sector, and communities. This work would be carried out through providing information linkages, or providing small amounts of finance or other instruments for a partnership. These could include the building of infrastructure, creating common grades and standards, technical assistance to outgrower schemes, or the promotion of livestock marketing, as is common in Honduras. (The *Fundo* Ganadero de Honduras involves a partnership between the government, private cattle raisers, and the industrial sector. It focuses on credit in kind. A key innovation is that the Government used its resources funds to start the fund, but "sold" its shares to the private sector through a process of subsidized credit. This means the state has a minority position on the Board of Directors. The schemes activities include running cattle ranches, mainly for the benefit of the other users of the project; a cattle rental scheme, structured as an equity partnership, with the FGH receiving 55% of profits. This includes technical assistance and monitoring to ensure the farmers maintain high levels of productivity required to remain in the program. There is also an in-kind credit program, based on reimbursement by using calves. Beneficiaries cover costs of technical assistance by sending young cows to the slaughterhouse. Key aspects are rigorous selection criteria, monitoring and technical assistance to beneficiaries, diversification of activities, and prioritizing activities in areas with the greatest profitability).
- v. **Joint venture arrangements,** whereby funds are provided to an initiative undertaken by a private organization for a short period of time, less than one year. At the end of the contract, profits and losses are shared according to each party's contribution. If both contribute \$10,000, and profits are \$4,000, each gets \$2,000. Malonga, a program supported by the Swedish Government, operates in Niassa Province and supported six marketing joint ventures in the past year. All were profitable in real terms. Malonga maintains strict control over bank accounts and assets, and provides intensive

management support, during the joint venture period. This approach creates a partnership, and provides finance but not through a loan system with attendant repayment issues. In Mozambique, any joint venture funds should be combined with management assistance, from specialized sources with a proven track record in a sector, to strengthen the business.

- vi. The *Fundo* could provide **funds for prizes**, to be awarded at district, provincial and national levels for farmers and associations operating in various categories, such as farmers with the best quality cotton, associations with the highest sales, etc. These categories could change from year to year, depending on agricultural priorities. The prize giving ceremonies would be an important opportunity for Ministry staff to build links with local farmers, and show how agriculture is improving in a given area. Cash disbursements would also provide greater incentives for farmers to increase their production, over and beyond increasing their incomes, to earn recognition and extra cash.

Table 2: Instruments under consideration				
Instrument	Objectives	Advantages	Disadvantages	Admin load
Matching grants	<ul style="list-style-type: none"> <input type="checkbox"/> Entice own contributions which can also be in kind <input type="checkbox"/> Get private sector involved 	<ul style="list-style-type: none"> <input type="checkbox"/> Can use sliding scale approach to incentivise higher own contributions <input type="checkbox"/> Different from guarantee funds in that it is more clear for budgeting purposes and it acknowledges the <i>Fundo</i> contribution up front 	<ul style="list-style-type: none"> <input type="checkbox"/> Without conducive market may not get great uptake. 	<ul style="list-style-type: none"> <input type="checkbox"/> Low to medium
Guarantee funds	<ul style="list-style-type: none"> <input type="checkbox"/> To get private sector involved in financing rural activities 	<ul style="list-style-type: none"> <input type="checkbox"/> Get private money in rural areas <input type="checkbox"/> Makes risk more palatable for private sector institutions 	<ul style="list-style-type: none"> <input type="checkbox"/> Inadequate structuring can lead to moral hazard and adverse selection <input type="checkbox"/> Need very good administration. <input type="checkbox"/> International not good track record. <input type="checkbox"/> Without conducive market may not get great uptake 	<ul style="list-style-type: none"> <input type="checkbox"/> High and speedy action needed.
Challenge funds	<ul style="list-style-type: none"> <input type="checkbox"/> Promote innovative approaches as fund is an incentive for innovation 	<ul style="list-style-type: none"> <input type="checkbox"/> Opportunity to allocate funds to best use in terms of innovative approaches 	<ul style="list-style-type: none"> <input type="checkbox"/> Difficult to get objective judgment of different proposals. <input type="checkbox"/> Not necessarily shared risk, thus better incentive to perform, unless structured in such a way 	<ul style="list-style-type: none"> <input type="checkbox"/> Admin spurts during challenge fund deadlines, thereafter monitoring
CPP Partnerships	<ul style="list-style-type: none"> <input type="checkbox"/> Get interactive approach to market development, use resources from different parties 	<ul style="list-style-type: none"> <input type="checkbox"/> Good blend of resource uses. <input type="checkbox"/> Provide positive incentives for conducive behaviour, share risk 	<ul style="list-style-type: none"> <input type="checkbox"/> Difficult to work out right blend and weights of contributions <input type="checkbox"/> Without conducive market may not get great uptake 	<ul style="list-style-type: none"> <input type="checkbox"/> Low to medium
Joint ventures	<ul style="list-style-type: none"> <input type="checkbox"/> Get private sector involvement and share risk 	<ul style="list-style-type: none"> <input type="checkbox"/> Good blend of resource use. <input type="checkbox"/> Share risk 	<ul style="list-style-type: none"> <input type="checkbox"/> Without conducive market may not get great uptake 	<ul style="list-style-type: none"> <input type="checkbox"/> Low to medium as admin can be devolved down to partners.
Prizes	<ul style="list-style-type: none"> <input type="checkbox"/> Positive incentive to incentivise specific behaviour conducive to promotion of agriculture and rural development 	<ul style="list-style-type: none"> <input type="checkbox"/> Easy to administer <input type="checkbox"/> Provide opportunity for visible support, small wins 	<ul style="list-style-type: none"> <input type="checkbox"/> Could be misused for political gains 	<ul style="list-style-type: none"> <input type="checkbox"/> If decentralised low.

Note that the Matching Grants, CPP partnerships and Joint Ventures overlap in many ways and could be combined to as one instrument, while retaining the advantageous characteristics of each. The same applies for Challenge Funds if part of the structure incorporates own contributions. Therefore the instruments can be grouped into three main categories:

- ❑ **Joint efforts** in different guises like matching grants, partnerships, joint ventures and challenge funds (if structured with an own contribution requested). The advantage of these options is that it creates shared ownership and risk. Quite often it is argued that poor people cannot contribute, but this is an important incentive (the contribution) and it can be in-kind. The importance is in the effect partnerships have on poor and marginalized communities. The ideal would be to start with a matching grant where a community or group contribute in kind, and follow it up where they contribute financial resources once they are in the position to do it.
- ❑ **Guarantee instruments** generally have a chequered history and rarely operates well in a weak market, as the guarantee does not really address the elements that weakens the market (information and infrastructure problems). Limited use is possible where the guarantee percentage is so low that it leaves a measure of risk to the financial institution just big enough to ensure good loan and other decisions. Also, where the administrative issues with payments where guarantees are invoked have been solved.
- ❑ **Prizes**, small but visible effect and allows an instrument for small wins. Good combination with the joint efforts.

Instrument	Objectives	Advantages	Disadvantages
Joint ventures Partnerships Challenge funds	Entice own contributions, get private sector involved, dilute risk for partners	Can leverage higher own contributions, clear for budgeting, good allocation of funds, risk share, incentives to perform	Without conducive market, limited investment opportunities, thus no great uptake, low to medium administration load
Guarantees	Entice private sector to finance development	Get private money in development areas, get private sector used to development risks	Moral hazard problems if the guarantee percentage is too high, high demand on administrative resources
Prizes or incentives	Try to incentivise conducive behaviour	Easy to administer, opportunity to show visible support	Could be misused for political gains

7. Strategy of the Fundo and operationalisation

7.1 Introduction

The approach used in this section seeks to build on existing conditions and structures to promote rural development in Mozambique. The *Fundo* has limited resources and therefore each investment must leverage more funds or activities to promote agricultural development. Further, it must be run in a transparent and acceptable manner that would improve access, decrease administration costs and pull potential investors and donors. The idea is that the bulk of the *Fundo* funds must be utilised to reach its stated objectives and not on excessive administrative systems. The idea is also that transparency and an inclusive rather than an exclusive approach should entice private sector and other stakeholders to enter into

partnerships with the *Fundo*. In this section the guidelines regarding governance and operational structure will be addressed. When deliberating on the governance and operational structure we consider the objectives with the *Fundo* and the indication by MADER and the minister that an important change in vision and operation is required. We further emphasise the concept of leverage through partnership approaches.

7.2 Governance structure

7.2.1 Introduction

It is important to note that formation of the governance structure provides the opportunity to ensure broader participation than government officials, and also provide the opportunity for the facilitation and promotion of partnerships. The international trend in the formation of governance structures is to ensure that there is a link between ownership and governance, and that there is a clear division between governance and management.¹⁶ The role of the governance structure should be to provide strategic direction to the *Fundo*, and to ensure that management is implementing the strategies of the *Fundo*, and thus measuring the performance of management.

7.2.2 Structure proposed

It is proposed that the *Fundo* governance structure should represent the source of the funds for the *Fundo*, the institution owning the *Fundo*, and the private sector stakeholders and potential partners. The Governance structure should meet twice a year, and ensure that the strategic issues of the *Fundo* are attended to.

7.3 Operational structure

7.3.1 Introduction

The objective is to ensure that the *Fundo* has an efficient operational approach and system. Further, the cost of this system should not be at a level where all possible investment funds are redirected to administration of the fund. Further, the fund in its new guise and within its focus areas would not need the same administrative capacity as before. In essence, the exclusion of retail credit activities leads to a lower demand for administrative capacity. The instruments identified in Section 6 do not need a heavy administrative system. However, at the moment the *Fundo* do suffer from a lack of presence in many of the provinces, and this aspect should also receive attention.

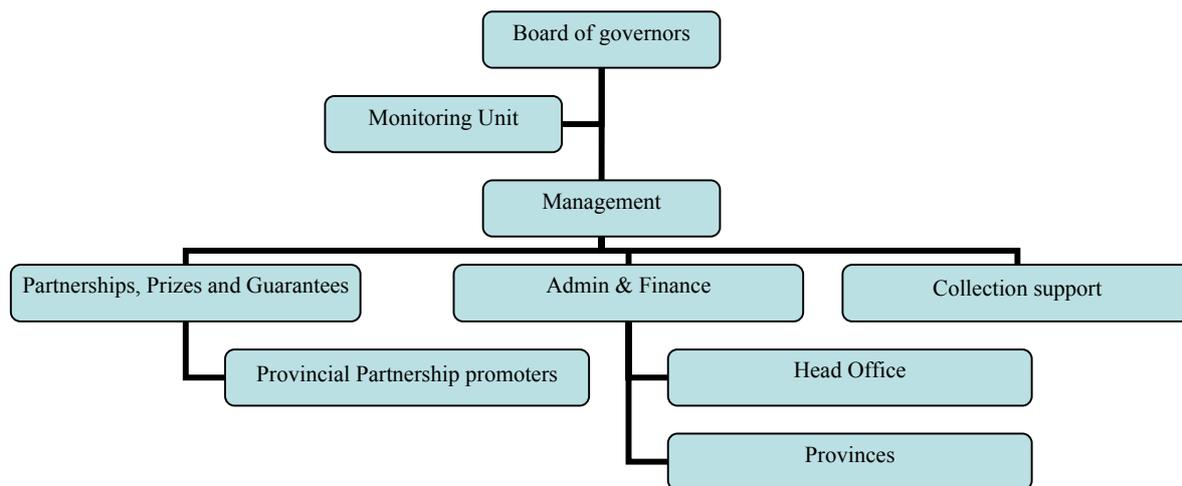
7.3.2 Proposed structure and operation

In the current structure of the *Fundo* the agricultural sub-sector areas of MADER is emphasised, for example, livestock and forestry and wildlife. In essence the current structure compartmentalise thinking on how the *Fundo* should operate. In the proposal espoused here we turn away from this structure, to a structure that rather focus on a functional instrument (formation of partnerships), in this way emphasising the objective to form partnerships.

¹⁶ Note the problems without this division as vividly illustrated by the collapse of multinational institutions like EMRON and more.

These partnerships can be inside MADER, between MADER and other departments, and can also include private sector institutions (inclusive of farmer groups and organisations).

It is proposed that two options be considered for structuring the operational and administrative system of the *Fundo*. These two options are considered in terms of creating administrative capacity internal or external to the *Fundo*. It is further based on a proposed structure for the *Fundo*. This structure takes into consideration the type of instruments, the focus areas and the criteria of lower administrative loads and concomitants costs and administrative efficiency, as well as better access to the *Fundo*.



This structure includes staff members who are specifically focused on the promotion of partnerships, as the prominent instrument to be used by the *Fundo*. This is specialised work and the right promoters and experienced people in working with communities, groups and the private sector need to be obtained. At this stage the Guarantees need more investigation before it can be considered and here an expert should do the necessary studies before this specific instrument is expanded. The emphasis is therefore on partnerships and leverage of *Fundo* funds.

Many initiatives are possible to decrease the administrative burden of the *Fundo*. In the current structure the bulk of the positions are focused on administration. A more structured application process that is timed for two or three times per year could contribute to a leaner administrative system. On the other hand, getting a presence in the provinces and appointing promoters would increase staff.

7.4 Monitoring and evaluation

It would be to the benefit of MADER to ensure that a well resourced monitoring unit takes up the responsibility for ensuring that all projects funded is structured to accommodate the monitoring of the execution and the impact of the project. Monitoring is extremely important as it reflects to MADER the progress with projects and possible impact and it provides information to existing and potential investors. This unit is responsible for generating information to assist the governance level to assess progress and impact of the work of the management level. It therefore has to report to the governance level and should also have a profile of independence.

8. Considerations for Implementation

8.1 Introduction

The objective is to compile an operational structure that is small and effective. One change from the previous structure would be to increase provincial representation and take a proactive stance in terms of finding and nurturing partnership opportunities. For example, it may mean the identification of a farmer group that can interact with a processor company, or a community group that may contribute to value adding activities, and more. The challenge is to keep the administration small and agile; however, it begs the question what will happen to the current staff. This will be an important part of the discussion on the *Fundo* and need to be addressed in the operational plan of the *Fundo* which forms the next phase of the overall study. Staff with the right skills and experience will most definitely be considered for transfer to the *Fundo*.

8.2 Governance

It is proposed that the *Fundo* governance structure should represent the source of the funds for the *Fundo*, the institution owning the *Fundo*, and the private sector stakeholders and potential partners. In this regard it is suggested that the Minister of Agriculture and Rural Development request publicly that people propose candidates. This public announcement should reflect the requirements and the number of positions. The Minister should then appoint those that answer to the requirements. It is the prerogative of the Minister representing the main shareholder to make the appointments. Appointments should be for no more than three years at a time. Half of the first appointments should only be for two years to ensure continuity on the Board. No person that is elected to a position should serve on the board. The board should consist of:

- ☐ Representatives from Government, preferably not more than four members with at least two from MADER,
- ☐ One person from the farming community
- ☐ One person from the financial sector
- ☐ One person from the donor community (selected by the donor fraternity) and part of the Board as an observer and not a full Board member
- ☐ One development finance specialist
- ☐ A chairman selected from the appointed members, proposed by the Board and appointed by the Minister.

The Board is therefore balanced with the same number of government and outside members. The Board should meet twice a year, and ensure that the strategic issues of the *Fundo* are attended to.

8.2.1 Monitoring Unit Reporting to the Board

The Board should also appoint the manager of the monitoring unit, in consultation with the Managing Director. The Monitoring Unit should consist of a manager, who should also be a technical expert in monitoring and evaluation, two specialists and an administrative person. The unit should start with only one specialist (who can be the manager), more specialists should only be appointed once adequate demand (workload) justifies the appointment.

8.3 Management

The Board should appoint a Chief Executive Officer. This person should be knowledgeable in the areas covered by the *Fundo*, and must have extensive management expertise. The CEO would also have observer status on the Board.

A manager should also be appointed for each functional area. This will include the partnerships promotion function, administration and finance unit¹⁷ and collection support. This team will then select and appoint the rest of the staff, drawing first from the existing staff compliment.

Position	Function	Requirements
Chief Executive Officer	Managing the <i>Fundo</i> , responsible for business planning and budgeting, responsible for all controls, research and implementation, final responsibility for meeting the targets set by the Board on an annual basis	Experienced manager understanding the context within which the <i>Fundo</i> will operate, at least 5 to 8 years of management expertise, preferable qualified in a financial area and knowledgeable and experienced in rural and agricultural development, at least appropriate degree, preferably a post graduate qualification.
Manager partnerships, prizes and guarantees	Manage the unit to identify and nurture partnership opportunities, manage and motivate the staff, responsible for unit budget and implementation, investigate the other instruments and propose operational rules	Five years experience in management and rural and agricultural development, keen to involve the private sector in development, keen to mobilise small farmers and community groups.
Manager collections	Innovatively devise strategies to increase collections, identify inefficiencies in systems, design or refine systems and implement, work in support and coordinate with MADER and/or the administration unit	Financial background, good understanding of agriculture and rural development, innovative problem solver
Manager admin and finance	Financial administration and management of the fund. Close liaison with provincial offices.	Financial training and background.

8.4 Staffing

The following table represents the maximum staff required for the *Fundo*. Additional appointments should only be made after a solid motivation to management and the Board that the workload justifies the positions. The following table provides the initial staff compliment.

Note that the table reflects a purely indicative situation as the operational model that will be chosen will impact on the staff numbers and composition.

¹⁷ Note that where the Commission and MADER decides that the administration responsibilities could be handled by the current administration structure in MADER the suggestions here in terms of the administration unit would not be relevant.

Staff numbers should be minimised to ensure that staff costs are minimised, that the maximum proportion of funds are therefore available to allocate towards Femento activities, rather than towards administration.

Table 4: Proposed staff numbers and requirements for the functional areas			
Unit	Position	Function	Requirements
Partnerships	Assistant to manager	Administration and logistics of the unit	Experienced administrator, knowledge of the functional area
Partnerships	Four provincial promoters	Promotion of partnership approach, identification of possible partnerships, working with the partners to bring projects to fruition	Good knowledge of agricultural and rural development, willing to work away from the office, diploma or similar technical qualification, good financial skills, experienced in working with small farmers, rural people and rural support institutions
Collections	Assistant to manager	Administration and logistics of the unit	Experienced administrator, knowledge of the functional area
Collections	Two collection officials	In field improvement of collections, work with manager to devise innovative methods of improving collections	Financial and co-ordination skills, willing to work outside head office in provinces
Admin & Finance	Assistant to manager	Administration and logistics of the unit	Experienced administrator, knowledge of the functional area
Admin and Finance	Two Administrators	Responsible for all financial administration at head office	Experienced financial administrators and controllers
Admin and Finance	Provincial officers	To be decided on	Note that this can be a function of MADER's existing provincial administrative functions.

8.5 Organisations that can play a role

To get any of the proposed instruments to operate the system would need organisations to take part. These may range from farmers organisations and NGOs to a range of private sector institutions. In the remainder of this section we take a view on the numbers and types of organisations that may make use of the instruments highlighted.

MADER investigated the number of institutions already active in all the provinces of Mozambique and found that at the NGO level approximately 605 institutions are known, with 108 of them indicating that they work in agricultural development, and 38 indicating that they also are involved in financial services. The distribution of these institutions favours Maputo with 45% of the NGOs indicating that they are active in the Maputo Province. This skew distribution of activity has also been indicated in the Agri-Business Guarantee Fund Proposal. It is expected that these types of organisations would be the primary institutions to interact with small farmer groups.

Private sector institutions would find it easier to interact with small farmer groups once they are more organised and interactions carry lower costs per interaction.

There are existing institutions that already interact with small farmers and these institutions would indeed be the kind of partners that the *Fundo* will seek. These would include institutions like GAPI, AMODER and processing firms.

9. Operational Plan and Budget

9.1 Introduction

The Commission decided that the detail of the operational plan and the budget will be the responsibility of the Commission. This is therefore a new phase in the whole effort towards refocusing the *Fundo*.

The rest of the issues raised in this section are to remind the Commission about points that were discussed at the Commission meeting and that would inform the execution of the next phase.

In this section strategies and assumptions should be stated on the administrative costs, collection plans and expected request for finance during the first two years. In terms of collections the *Fundo* should focus on those provinces with the most potential to improve contributions and collections.

9.2 Salient aspects for consideration

9.2.1 Initial focus of the Fundo

The Commission should decide what the initial focus of the Fundo should be for the first period of operations. This is to ensure that a focused approach is followed until the new management and board comes to grips with their responsibilities.

9.2.2 Confirmation of current status

An assessment should be executed of the current staff, equipment and resources in the two *Fundos* as a basis for the planning phase. This should include current and new commitments. This will ensure that adequate information exists in terms of planning for the transfer of relevant resources to the refocused single *Fundo*.

9.2.3 Legal status of the new Fundo

The Commission should deliberate on the legal status of the refocused *Fundo* and the relationship with MADER. It is important to have a joint understanding of this aspect as it will influence all the other considerations around the operationalisation of the *Fundo*.

9.2.4 Appointing the governing body of the new Fundo

In the previous section a process is proposed. This should start with an advertisement by the Minister to invite proposals from the general public. This advertisement must be specific about the expertise needed on the Board. The Commission and MADER should then study the proposed candidates and make a submission to the Minister in terms of who should be the preferred candidates. The selected candidates should then be vetted and invited to serve on the Board formally by the Minister.

9.2.5 Initial operational targets

The Commission should deliberate on the initial operational targets of the Fundo. This can be changed by management later, but at first it will serve to focus the activities of the Fundo, and to provide a basis on which to calculate the budget requirements.

This emphasis should also be extended to the current activities of the two existing Fundos to ensure that already now the current activities are aligned to ensure a smooth integration into one Fundo.

9.2.6 Management and staff appointments

It is important the CEO is appointed as soon as possible by the Board. However, for the first appointment MADER could request the commission to make suggestions to the Minister.

Staff appointments will first draw from qualified existing staff where after open advertisements should be placed. It is expected that staff would be drawn from existing Fundos staff and MADER staff.

It is also necessary to decide on whether certain functions will be performed internal to the Fundo, or by the relevant department in MADER. The Commission should provide clear guidance on the approach with respect to structuring a more independent Fundo, or structuring a more integrated Fundo.

The Commission expressed the opinion that the monitoring and promotion activities should most definitely be part of the Fundo structure, while the administration functions should be the subject of a discussion.

9.2.7 Budget

The Commission was clear on the fact that a detailed budget must follow the operational plan of the Fundo. This will assist clear thinking and understanding about the structure and scope of the Fundo.

The Commission also noted that the MADER budget must reflect the Fundo budget. This is important as without this the Fundo would be in an awkward position, having functions and staff but no budget to execute its functions.

9.2.8 Implementation schedule (draft)

This is a proposed implementation schedule to be finalised and confirmed in the operational plan phase. Aligning the implementation schedule with the schedule of MADER, for example the PROAGRI review in May, should be considered.

Activity	Responsible	When
Operational plan and budget	Commission	March and April 2003
Discussion and report back to ProAgri	MADER and Commission	May 2003
Invitations to potential board members	MADER	June 2003
Appointment of board members and selection of Chair	Minister and MADER	July 2003
Appointment of MD	Board	August 2003
Appointment of management team	MD	August 2003
Appointment of staff	MD and management team	August 2003
Formal launch of <i>Fundo</i>	All staff and MADER	August 2003
Finalisation and implementation of systems, procedures	Management and staff	September 2003
Open applications for partnership support	Management and staff	September 2003