Country case study

# External finance for rural development

## Country case study: Mozambique

Maria Ana Jalles d'Orey

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**Key messages**

- Agriculture and rural development are priorities for the Government of Mozambique, as reflected in its strategies and plans. Despite the enormous challenges in the sector, agriculture plays a leading role in driving the country's economic growth and employs a large percentage of Mozambique's working-age population.
- Government spending on agriculture as a percentage of total expenditure might achieve the 10% Malabo target for the first time in the near future.
- Demand for external development assistance for agriculture and rural development is expected to continue over the next five to 10 years.
- Mozambique is highly indebted and aims to maximise grant-financing and highly concessional loans, showing little appetite for non-concessional borrowing, at least in the medium term.
- Alignment to national priorities is key for the government, together with predictability and project sustainability. The catastrophe deferred drawdown option is appealing, given Mozambique's vulnerability to natural disasters.

# Introduction

## Background

Rural development worldwide relies heavily on private funding. Yet the public sector has a key role to play in providing both investment and policy support to tackle persistent market failures. These include the under-provision of public goods (such as infrastructure, and research and development), negative externalities (such as the need to adapt to and mitigate the effects of climate change), informational asymmetries (e.g. the development of rural financial services) and the lack of protection for vulnerable people through, for example, social protection.

Far more finance is needed to achieve food security and promote sustainable agriculture in line with Sustainable Development Goal (SDG) 2. The United Nations (n.d.) estimates that an additional $267 billion per year is needed to achieve every SDG 2 target: almost twice as much as total official development assistance (ODA) each year from all donors combined. Official development finance (ODF)[1] to agriculture and rural development rose slightly from $10.2 billion in 2015 to $10.9 billion in 2018. This is only a fraction of the total ODF disbursements of $254 billion in 2018. Public expenditure on agriculture development also remains low: since 2001, governments have spent, on average, less than 2% of their central budgets on agriculture (FAO, 2019).

## Objectives, definitions and methodology of this country case study

This country case study summarises key findings from a country analysis of financing for rural development in Mozambique. It is one of 20 analyses that is synthesised for comparison in Prizzon et al. (2020).

The case study has two main objectives:

- to map demand from the Government of Mozambique (GoM) over the next five to 10 years for external development assistance to support public investment in inclusive and sustainable rural development
- to analyse the financial and non-financial terms and conditions of such demand, its main preferences and the type of instruments that the government wishes to access or scale up to support public investment in rural development.

**Definitions**

**What we mean by public investment in inclusive and sustainable rural development** (see Prizzon et al., 2020, for more details): Our research has focused on six areas that contribute to such investment: access to agricultural technologies (research and development) and production services; agricultural value chain development (e.g. crops, livestock, fisheries); climate-resilient agricultural practices; rural basic infrastructure (e.g. water and irrigation systems, local roads, local energy generation and storage facilities); rural financial services; and rural investment environment (e.g. policy, legal and regulatory frameworks).

**What we mean by external assistance for inclusive and sustainable rural development:** We look beyond ODA to include government-to-government funds from bilateral and multilateral donors that do not meet concessionality criteria[2] (usually defined as other official flows, or OOFs). We call this official development finance (ODF). As a proxy for financing rural development, we examine data on external assistance to the agriculture sector and rural development (cross-cutting) based on an Organisation for Economic Co-operation and Development (OECD) definition. This is not a perfect measure, but given the lack of a sectoral definition or

1 The sum of ODA and OOFs: the latter flow from bilateral and multilateral donors that do not meet the concessionality criterion for ODA eligibility.

2 The definition of concessionality is based on the share of the grant element. With the 2014 OECD reform, the grant element varies according to the income per capita of the ODA eligible country to be counted as ODA: at least 45% for low-income countries (LICs), 15% for lower-middle-income countries (LMICs) and 10% for upper-middle-income countries (UMICs). The International Monetary Fund (IMF) discount rate (5%) is also adjusted by income per capita group: 1% for UMICs, 2% for LMICs and 4% for LICs, including least-developed countries (LDCs).

attribution to rural development as such, it is the closest we can get to a consistent, cross-country mapping of external assistance from development partners. As a second-best option, we rely largely on quantitative and qualitative data on agricultural development. While the agriculture sector is a major component of rural development, data on agriculture alone cannot capture important non-farm activities.

**Research questions**

This country case study reflects our four main research areas:

- the government's priorities for public investment in inclusive and sustainable rural development
- financing for public investment in inclusive and sustainable rural development
- borrowing (external development assistance) for this public investment
- the government's preferences in relation to external development assistance for public investment, including its demand for specific types of instruments.

As this project took place during the early stages of the Covid-19 pandemic, we also reflect the short- and medium-term implications of the crisis for government priorities and preferences for public investment, as well as the amount and type of external assistance demanded.

**Methodology**

We used a qualitative case study approach, with the analysis of individual countries informed by a political economy framework, as developed by Greenhill et al. (2013) for aid negotiations (see Prizzon et al., 2020).

Our approach comprised a critical review of relevant policy literature[3] and data analysis,[4] which also helped us to identify country stakeholders. This was followed by interviews with key informants, informed by an electronic questionnaire submitted before each interview. For Mozambique, we held seven interviews in June 2020, and received 10 questionnaires (see Annex 1 for a list of those interviewees who agreed to their names being shared).

## Mozambique: country context

Mozambique is a low-income country (LIC) eligible for finance as a member of the International Development Association (IDA) and from the African Development Fund (ADF).

Mozambique is classified as a fragile country by the World Bank. In 2015, it was ranked by the global Climate Risk Index as being the country most affected by climatic events (IFAD, 2018). In 2019, Cyclone Idai, one of the worst cyclones in modern history, claimed the lives of more than 1,000 people in Mozambique and neighbouring countries, devastating farms and transport and severely hampering the prospects for economic growth (IMF, 2019).

A combination of natural disasters, insurgent attacks, and a disputed election saw Mozambique and Libya in joint second place in terms of increased fragility on the 2020 Fragile States Index (FSI, 2020). Mozambique's human development index score for 2018 was 0.446, which puts the country in the low human development category and ranks it at 180 out of 189 countries (UNDP, 2019). Mozambique is a resource-rich country – particularly in gas and bauxite – but the potential of the extractive sector to support the country's growth and government revenues remains largely unexploited (IMF, 2019).

Mozambique is heavily indebted and is classified as having a high risk of debt distress by the World Bank and the International Monetary Fund (IMF, 2019). Gross domestic product (GDP) growth had been stable until 2015, at an average of around 7% from 2010 to 2015, when it began to slow down, falling by almost half, to 3.4% in

3 Government strategies including the Government's Five Year Plan 2020–2024 (GoM, 2020), Estratégia Nacional de Desenvolvimento Económico 2015–2025 (GoM, 2014), debt-management documents (MEF, 2020) and sector-specific plans, such as the Strategic Plan for Development of the Agricultural Sector (PEDSA) 2011–2020 (MoA, 2011). We also reviewed other documents from the Ministry of Agriculture, Article IV from the IMF and World Bank diagnostic tools.

4 Spanning IMF, OECD and World Bank sources.

2018 (World Bank, 2020a), as a result of faltering growth in the country's mining sector (IMF, 2019).

In 2016, Mozambique acknowledged that it had $1.2 billion of previously undisclosed lending, which was intended to fund a tuna fishing fleet. As a result, the IMF and foreign donors cut off their support, which triggered a default on the country's sovereign debt and a currency collapse – the currency has now lost more than 60% of its value over the past decade (IMF, 2019).

More than half of the population – 63% – live below the poverty line of $2 per person per day, according to data from 2014 (World Bank 2020b), and 66% of them are found in rural areas. Poverty is concentrated in the northern provinces, which also have the highest populations (IFAD, 2018). Undernutrition is a major concern, with 43% of children suffering from stunting (IFAD, 2018).

Agriculture plays a leading role in economic growth, together with the mining sector and other services (IMF, 2019). Agriculture's contribution to real GDP has been stable since 2014, averaging 23.9% of real GDP and the sector employs around 72% of Mozambique's working-age population (latest data from 2017, World Bank (2020b)). Nearly 95% of Mozambique's agricultural production is rain-fed and led by smallholder farmers (IMF, 2019). Smallholder farmers account for 94% of agricultural production, and 95% of this production takes place on less than 1.5 hectares of land (IFAD, 2018).

## Government priorities for rural development

Agriculture and rural development are key priorities for Mozambique for the next five years. When launching the Government's Five Year Plan 2020–2024 (PQG), Prime Minister Carlos Agostinho said that

> now is the time to join forces and capitalise on our comparative advantages in order to raise the levels of production and productivity, particularly in agriculture, to increase the availability of food and gradually reduce imports.

The prime minister sees the boosting of agriculture, coupled with greater industrialisation linked to energy, infrastructure, tourism and hydrocarbon projects, as the way to reach the goals of job creation set out in the PQG (GoM, 2020).

The PQG is part of the government's long-term development strategy – Estratégia Nacional de Desenvolvimento Económico, which aims to improve livelihoods through the structural transformation of the economy, and the expansion and diversification of national production. Transforming and modernising the agriculture sector is, therefore, a key priority for the government. This is particularly so in the areas of production and market development, which require both private-sector involvement and the integration of the traditional farming sector into national and international markets (GoM, 2014; 2020).

When it comes to agriculture sector-specific strategies, the Agriculture Plan 2020/2024 (which is still a provisional name for the plan) is being drafted and will replace the Strategic Plan for Development of the Agricultural Sector (PEDSA, 2011–2020) and its investment instrument, the National Agriculture Investment Plan 2014–2018. The main goal of the PEDSA 2011–2020 was to contribute to the food security and incomes of agricultural producers, through a competitive and sustainable approach that ensures social and gender equity. This goal was based on four pillars: agricultural productivity, market access, natural resources and institutions (MoA, 2011).

While agriculture is prioritised in national plans, Mozambique's fragility presents enormous challenges to the sector. Several of the challenges inherent to a fragile context were mentioned consistently by our interviewees and mirror the constraints identified in national and sectoral strategies. These are: persistent hunger and malnutrition (particularly in rural areas); the country's vulnerability to climate shocks; its limited institutional capacity; the need for more consistent policies; the lack of access to finance for rural poor people; weak productivity and production; limited infrastructure and services to help farmers access markets; and the inappropriate use of natural resources (MoA, 2011; IFAD, 2018).

Support to smallholder farmers is the main priority for the government. Even though the Agriculture Plan 2020/2024 has not yet been approved or made public, all of our interviewees mentioned a strong focus on smallholder farmer and traditional farming as a key priority for the government. This is confirmed by the PQG, which has set key goals for rural development that target smallholder farmers specifically (GoM, 2020). Our interviewees also mentioned that there is some geographical targeting in this sector, with a focus on the north of the country where there are higher levels of poverty and larger populations.

Increased access by farmers to rural financial services is a priority for the government and for partners working in rural development in Mozambique. Development of rural basic infrastructure (including water and irrigation systems, local roads, local energy generation and storage facilities) has also been mentioned as a priority, given the fragility of the country. Furthermore, value chain development (particularly improved seeds), access to agriculture technology and investment in research and agriculture extension services were key priority areas that emerged from discussions with our interviewees and are also mentioned in the PQG.

The Covid-19 pandemic has reinforced the need for the government and its development partners to prioritise smallholder farmers. Our interviewees reported that the government was particularly worried about the impact of the crisis on smallholder farmers – who cultivate less than 2 hectares of land each and account for around 99% of farming households in Mozambique – and continues to prioritise this group.

## Financing rural development

### Public finance

The government's medium-term fiscal strategy aims to improve revenue collection and enhance public expenditure efficiency to intensify fiscal consolidation (IMF, 2019). Government revenues and expenditures fell from 32% and 36% of GDP in 2015 to 26% and 31% of GDP in 2018, respectively. In 2019, however, revenues and expenditures rose to 30.5% and 37%, respectively.

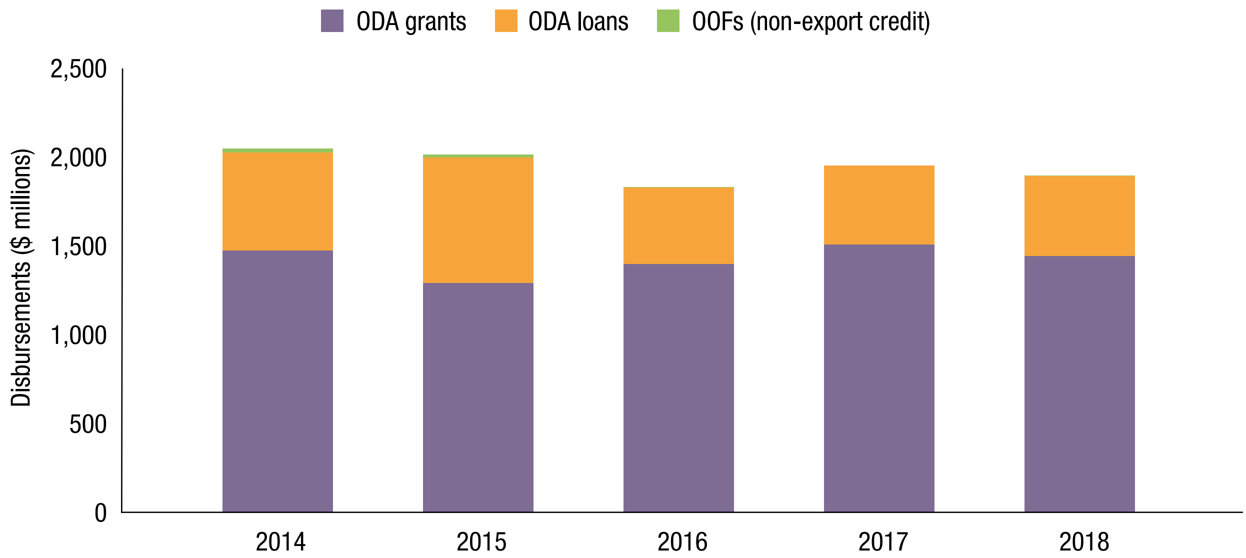
While Mozambique's fiscal deficit fell from 10% in 2014 to nearly 0% of GDP in 2017, it then increased to 2.5% of GDP in 2019 (World Bank, 2020b). This rise has been attributed to expensive domestic borrowing given Mozambique's tight monetary policy and the limited availability of external financing (IMF, 2019).

The government's spending on agriculture as a percentage of its total expenditure might achieve the 10% Malabo target for the first time in the near future. Until now, agriculture spending has been far below the 10% target, peaking at 7.6% of total expenditure in 2005. Back in 2017, Mozambique scored 4.1 out of 10 in terms of the commitments set out in the Comprehensive Africa Agriculture Development Programme. The country was identified as being 'on track' in implementing the Malabo declaration on agriculture transformation in Africa (NEPAD, 2017), a sign of its growing support.

Our interviewees reported that the agriculture minister who has been in post since January 2020 has ambitious plans for the sector, having announced a hike in the agriculture budget to reach the 10% Malabo target. This was also announced by President Filipe Nyusi in January 2020 during his acceptance speech for his second term in office.

Although the Covid-19 pandemic may have an impact on budget allocations in the short term and concerns were raised about whether the Malabo target would actually be achieved in 2020, interviewees were certain that agriculture will remain a priority sector for the country and its development partners – perhaps even more so as a result of the crisis. At the time the interviews took place in June 2020, interviewees revealed that a Covid-19 emergency plan was in the making and that an extra pot of $312 million would be dedicated to agriculture.

**Figure 1 Official development finance to Mozambique, across sectors**




Note: constant 2018 prices. ODA, official development assistance; OOF, other official flow.
Source: OECD (2020)

## External development assistance

Mozambique is an aid-dependent country, despite the decrease in external finance following the hidden debt crisis in 2016, with an ODA to gross national income ratio of 14.5% in 2017. Likewise, ODA as a percentage of government expenses has increased from 68.4% in 2016 to 76.2% in 2017 (World Bank, 2020b).

To date, the GoM has largely received concessional finance: essentially grants and concessional loans from sovereign donors and multilateral development banks. Grants are the largest flow by far, averaging 73% of total ODF between 2014 and 2018, at a fairly stable value since 2014 (Figure 1).

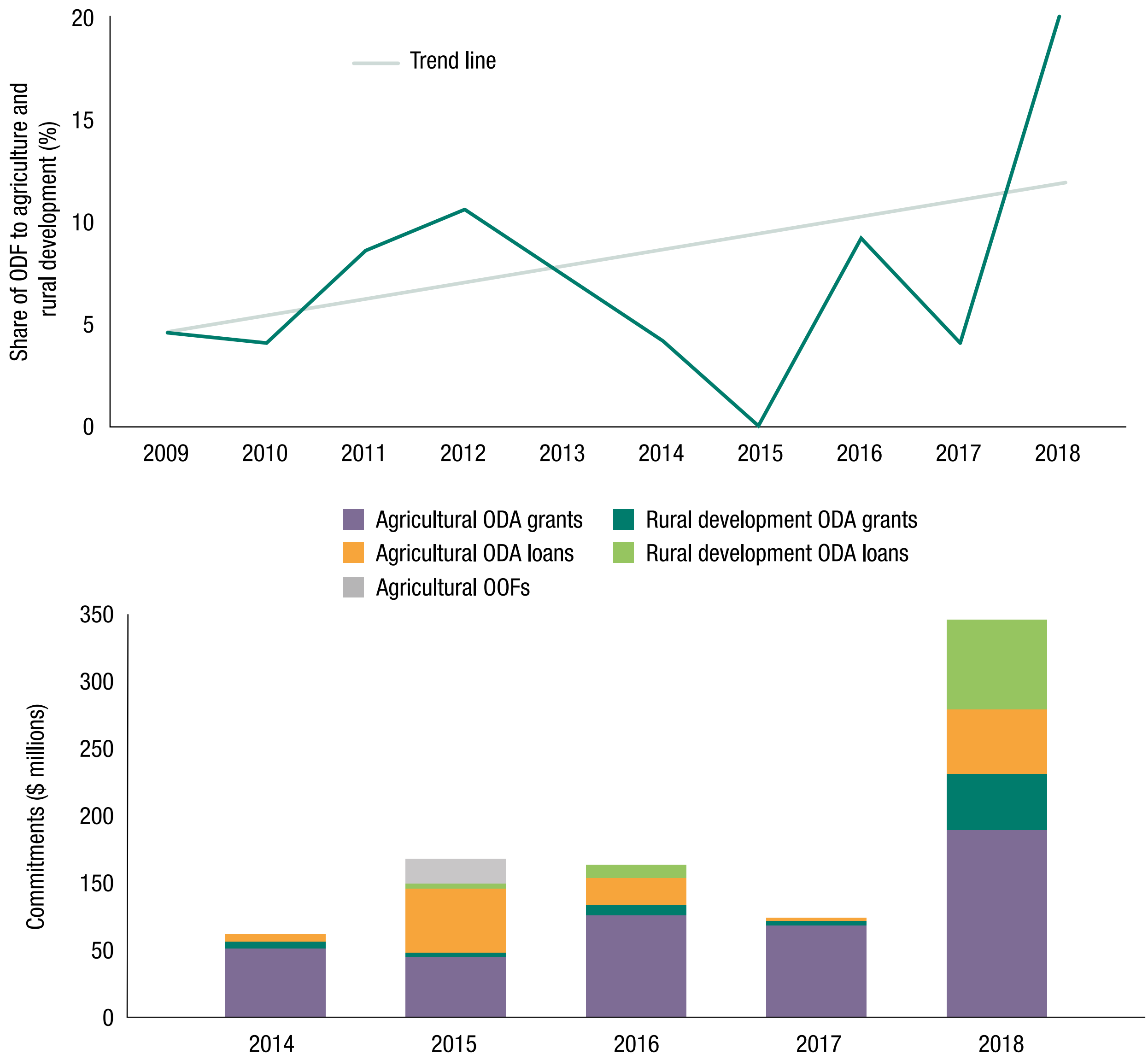
The vast majority of ODF is for project-type interventions, and there have been no changes in its composition since 2014. The United States is the dominant donor, funding approximately 26% of total gross ODA (on average in 2017–2018), followed by the IDA (13%), Japan, the Global Fund, the United Kingdom, European Union (EU) institutions, Sweden, Germany, African Development Fund and Portugal.

ODF plays a key role in the agriculture and rural development sector. Despite irregular contributions from development partners since 2009, the share of aid for agriculture and rural development aid (as a percentage of total aid) has increased on average, rising from 5% in 2009 to 20% in 2018 (Figure 2). This reflects the prioritisation of the sector by the government and, in particular, growing commitments to rural development in 2018 from the World Bank through concessional loans amounting to $78 million, followed by EU institutions ($45.3 million in grants in 2018).

ODA grants to agriculture have been the predominant flow since 2009 (except in 2015, when the percentage of ODA loans was larger). The spike in 2018 flows was the result of increased ODA grant commitments from multilateral organisations (from the African Development Bank, EU institutions and the International Fund for Agricultural Development (IFAD)) and ODA loans from IDA, mostly for smallholder farmers' projects. According to our interviewees, this spike was the result of the greater interest in the sector over the past decade, which became clear in 2018 as a result of the programming cycle.

Before the predominance of project-type interventions in the sector, two phases of the National Programme for Agricultural Development, known as PROAGRI I (1998–2004) and PROAGRI II (2006–2010), included a common fund for agriculture. Interviewees felt that development partners lost confidence in working through such government systems

**Figure 2** Share and composition of official development finance to agriculture and rural development




Note: ODA, official development assistance; ODF, official development finance; OOF, other official flow.
Source: OECD (2020)

as a result of weaknesses in public financial management and the hidden debt crisis. That confidence is, however, slowly returning.

There are expectations that government demand for external development assistance grants and highly concessional loans will increase over the next five to 10 years. In light of the Covid-19 pandemic, the partners who are active in the agriculture sector have formed a group to discuss their investment plans, with our interviewees revealing that agriculture and rural development will remain a priority for both the government and its partners.

Access to additional financial resources at below-market rates is seen as the most advantageous aspect of external development assistance. Our survey results found that every respondent saw this aspect as important or extremely important for the government. This is not surprising, considering the prioritisation given to the sector by both the government and its development partners, a future investment plan that aims to reach the 10% Malabo target, and the country's continued aid dependency.

This attribute is followed by project management and policy advice, with 80% and 70% of respondents (respectively) citing these as aspects that are valued by the government. Some interviewees noted that the government values, in particular, the contributions of development partners to the improvement of project management practices, and appreciates the engagement and advice of development partners in national policy processes.

## Borrowing for rural development

### Debt trends and composition

Mozambique is in debt distress. The country's debt-to-GDP ratio reached about 113% at the end of 2018, up from a ratio of less than 54% in 2013. The stock of arrears on public and publicly guaranteed external debt stood at $1.2 billion at the end of 2018 (World Bank, 2020a). According to projections by S&P Global Ratings, the debt-to-GDP ratio might only fall to 107% by 2022, because revenues from Mozambique's big gas projects will not come on stream until 2023 (IMF, 2019).

The country's debt composition is dominated by concessional borrowing, which accounts for around 61% of total debt to official creditors, with 72% of concessional flows coming from multilateral organisations. In all, 96% of non-concessional lending (which forms about 39% of total official creditors' debt) comes from bilateral lenders (2018 data from World Bank, 2020a). This is to be expected, given that Mozambique is an IDA-only country and therefore has a very low share of multilateral non-concessional lending. However, the government does borrow commercially and has issued bonds since 2013, with an increase in private creditors' debt from 3% of total public and guaranteed debt in 2010 to 16% in 2018.

### Policies and preferences for borrowing and debt management

The government is pursuing a strategy to bring public debt down to a moderate risk of distress in the medium term (IMF, 2019). To achieve this, it is committed to prudent debt-management measures. These include complying with four thresholds: 30% debt-to-GDP ratio; 140% debt-to-exports ratio; 10% debt-service-to-exports ratio; and a 14% debt-service-to-revenue ratio (MEF, 2020). The government's strategy also aims to strengthen debt-management capacities and effective oversight over the entire range of state-owned enterprises (IMF, 2019). Since the height of the Covid-19 crisis, Mozambique has been given debt relief by the World Bank and debt payments were suspended for one year.

The government is expected to rely on grant financing and highly concessional loans as much as possible. As of 2019, fiscal policy measures include the reallocation of lower priority spending to emergency assistance and reconstruction, and a reliance on grants and highly concessional loans for budget financing.

At the same time, the government is pursuing significant debt relief from private creditors and gradual medium-term fiscal consolidation (IMF, 2019). The issuance of government debt and guarantees is expected to follow the new approval procedures established in a December 2017 decree. As the country is in debt distress, it is not likely to be able to access international financial markets in the medium term.

There is little or no appetite or demand, at least in the medium term, for non-concessional borrowing. This applies not only to agriculture or rural development, but also to every other sector. This lack of appetite stems from the combination of a vulnerable debt position, limitations to non-concessional borrowing and prudent debt management, together with the fact that the country is not graduating away from the soft windows of multilateral development banks.

## Preferences and instruments for rural development

During our interviews, stakeholders highlighted the alignment of external development assistance to national priorities as a key qualitative attribute. The responses to our survey corroborate this view, with 100% of respondents seeing alignment as an 'extremely desirable' or 'desirable' feature of such assistance.

Predictability also matters to the government, according to our interviewees and survey results.

Project sustainability was also mentioned as 'extremely desirable' by 80% of interviewees, which is understandable, given that project-type interventions are the main form of aid to the agriculture and rural development sector.

Flexibility, long-term financing and speed of delivery were also high on the list, with 60% of respondents considering them as 'extremely desirable' aspects of development assistance. In particular, interviewees highlighted the quick availability of resources to fill in budget gaps and the rapid demonstration of impact.

When it comes to demand for other types of instruments, in the round of interviews and survey results, it emerged that the catastrophe deferred drawdown (CAT-DDO) option was particularly appealing for the government as a way to manage risk in a country that is so exposed to natural disasters. In all, 80% of respondents suggested that there was strong demand for this instrument, particularly after the damage caused by Cyclone Idai.

Interviewees were also interested in initiatives beyond CAT-DDO, such as shock-responsive social protection and sovereign disaster-risk insurance – both of which are being considered by some development partners at present. Multi-phase lending was also highlighted by respondents as a way to ensure project durability, which is highly valued by the government, together with project preparation facilities to support local capacity-building.

## Conclusions

Our analysis of the experience and perspective of Mozambique on financing public investment for inclusive and sustainable rural development, and particularly its demand for external assistance, is summarised as follows.

- Agriculture and rural development are key priorities for the Government of Mozambique, and are reflected in national and sectoral strategies and plans. Despite the country's fragility and the enormous challenges facing the sector, agriculture is one of the sectors that drives economic growth in the country and employs a large percentage of the working-age population.
- The government's spending on agriculture as a percentage of total expenditure might achieve the 10% Malabo target for the first time in the near future. In addition to government funding, there are expectations that demand for external development assistance will continue to fund agriculture and rural development over the next five to 10 years.
- Mozambique is heavily indebted and aims to maximise grant-financing and highly concessional loans to fund the sector. There is little appetite or demand, at least in the medium term, for non-concessional borrowing for agriculture and rural development, or for any other sector.
- The alignment of external development assistance to national priorities is key for the government, together with predictability and project sustainability. The CAT-DDO is particularly appealing, given the country's high vulnerability to natural disasters.

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# Annex 1 List of interviewees

| Name | Institution |
|---|---|
| Daniel Gonzalez | European Union |
| Margarida Mosca | Rural Observatory |
| Custodio Mucavel | International Fund for Agricultural Development (IFAD) |
| Robson Mutandi | IFAD |

# Acknowledgements

This country case study on Mozambique is part of a project that aims to map future demand from recipient country governments for external development assistance from official donors to support public investment in inclusive and sustainable rural development over the next five to 10 years. It also aims to explore the financial and non-financial terms and conditions of this assistance. Its analysis is also included in the synthesis report for this project (Prizzon et al., 2020), which reviews the experiences of 20 low- and middle-income countries.

We are grateful to the interviewees who gave up their time to take part in this project, share their insights and provide feedback to this country case study, particularly during the challenging times of spring 2020. Their contributions were vital to corroborate and challenge our initial analysis.

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We have taken care to validate the information included in this case study and any omissions, errors or misreporting are unintentional and the author's own. The views expressed in this study do not represent those of ODI or IFAD.

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