

PD-ABH-026

15484280

PRIVATE SECTOR SUPPORT

PROGRAM

MOZAMBIQUE

(656-0208)

AMENDMENT # 3

PAAD

MAY 1991

CLASSIFICATION:

AID 1120-1

PRM

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.	656-0208 Amendment No. 3
2. COUNTRY	Mozambique
3. CATEGORY	Private Sector Support Program
4. DATE	
5. OYS CHANGE NO.	
6. OYS INCREASE	
7C BE TAKEN FROM:	
9. APPROVAL REQUESTED FOR COMMITMENT OF:	
10. APPROPRIATION - ALLOTMENT	
11. TYPE FUNDING	<input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT
12. LOCAL CURRENCY ARRANGEMENT	<input type="checkbox"/> INFORMAL <input checked="" type="checkbox"/> FORMAL <input type="checkbox"/> NONE
13. ESTIMATED DELIVERY PERIOD	
14. TRANSACTION ELIGIBILITY DATE	
15. COMMODITIES FINANCED	

8. TO: John M. Miller
Acting Director
USAID/Mozambique

FROM: Carlos Pascual
Program Officer

11. TYPE FUNDING: LOAN GRANT

12. LOCAL CURRENCY ARRANGEMENT: INFORMAL FORMAL NONE

15. COMMODITIES FINANCED: Seeds; fertilizers; tractors, tractor spare parts, implements, and harvest equipment; trucks and truck spare parts; irrigation equipment, pipe and spare parts; petroleum products.

16. PERMITTED SOURCE

U.S. only: _____

Limited F.W.: _____

Free World: _____

Cash: _____

17. ESTIMATED SOURCE

U.S.: _____

Local: _____

18. SUMMARY DESCRIPTION

Pursuant to the Foreign Assistance Act of 1961, Delegation of Authority No. 551, and 91 State 88494, I hereby authorize the addition of petroleum products to the list of commodities eligible for financing under this Program, as indicated in item 15 above. The attached PAAD Supplement provides further detail regarding the financing, distribution, and use of the petroleum products. Except as specifically amended herein the terms and conditions of the original PAAD approved August 24, 1989, as previously amended, remain in full force and effect.

19. CLEARANCES	DATE
CMO (A): T. Born	May 7, 1991
CON: M. Rocha	May 8, 1991
RLA: D. Keene (via fax)	May 7, 1991

20. ACTION

APPROVED DISAPPROVED


AUTHORIZED SIGNATURE

5/15/91
DATE

Acting Director, USAID/Mozambique
TITLE

ACTION MEMORANDUM FOR THE ACTING DIRECTOR, USAID/MOZAMBIQUE

FROM: Carlos Pascual  Program Officer

SUBJECT: Amendment to the Private Sector Support Program
(656-0208)

I. Problem

You are requested to approve an amendment to the Private Sector Support Program (PSSP) to (1) add petroleum products to the list of commodities eligible for financing under this program, and (2) incorporate pricing and marketing reforms for selected petroleum products into the PSSP's policy objectives.

II. Discussion

The purpose of the PSSP is to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. The PSSP as previously amended addresses five fundamental constraints to private agricultural production -- prices, land access, availability of inputs, availability of foreign exchange, and market access -- through policy reform. Funds have been provided to increase the availability of foreign exchange (planned LOP total \$54.05 million) and to provide technical and related assistance in support of the policy reform agenda (planned LOP total \$3 million under 656-0218).

In direct support of private sector agriculture, PSSP funds have been disbursed through a Commodity Import Program (CIP) to finance critical inputs: trucks, farm equipment, irrigation equipment, spare parts for these, and fertilizers and seeds. Petroleum products, which had been eligible under predecessor CIPs, were not included in the PSSP because other sources for these commodities were available to Mozambique.

The reforms in the foreign exchange regime in the past year have affected demand for PSSP CIP financing. In particular, the creation in October 1990 of the secondary exchange market (MSC) effectively priced our import support at about twice the official rate. Since other donor import support funds were still available at the official rate, importers did not draw on the CIP for several months, and disbursements have not proceeded as quickly as expected. The next amendment to the PSSP PAAD, to be completed in June 1991 to permit obligation of FY 1991 funds, will focus on foreign exchange regime issues and their implications for the PSSP.

In the meantime, recent dramatic fluctuations in international prices and the closing off of Mozambique's traditional concessional sources of petroleum products have resulted in the GRM's urgent request for donor assistance to finance petroleum imports. As discussed in the attached PAAD amendment, the cost of petroleum imports for 1991 is likely to be at least 30 percent above the 1990 cost for the same quantities. This situation has huge implications for economic recovery if import quantities were to be reduced dramatically. In particular, stable supplies of gasoline and diesel are of crucial importance to the rehabilitation of agricultural production and marketing.

Inclusion of petroleum products in the PSSP CIP will be based on additional policy reform measures contributing to Mozambique's transition to a market-based foreign exchange regime. These are presented in the Revised Summary of Policy Objectives and Workplan below and described in detail in the PAAD amendment.

The following special considerations are relevant to your review and approval of this memorandum.

AID/W Concurrence: State 88494 provided AID/W concurrence with reprogramming all or a portion of the funds already obligated under the PSSP to finance petroleum imports contingent upon GRM concurrence in additional policy reforms on pricing of specific products. This cable is included as Annex A of the PAAD amendment.

Letter of Intent: The draft of the GRM statement of petroleum pricing and related policy reforms appears as Annex D of the PAAD amendment. Amendment of the PSSP grant agreement to permit disbursements for petroleum is conditioned upon receipt by USAID of the letter of intent.

Initial Environmental Examination: The Regional Environmental Officer has helped USAID to prepare an IEE of the potential effects of petroleum imports under the PSSP. A negative determination was recommended and has been approved by the Africa Bureau Environmental Officer. The IEE appears as Annex E of the PAAD Amendment.

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
1. Agricultural Pricing Policy	OBJECTIVE: To maximize the liberalization of the agricultural pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural prices on world parity.			Price changes and announcements.	Production increases on family and commercial farms.	Production statistics by crop, province, farm type.
a. Maize, beans, rice	Establish parity producer prices; plan for floor price system. (Note: beans actually moved to floor price in 1989)	Move white maize to parity-based producer floor price system; continue parity-based producer floor price for beans; adjust parity-based producer price of rice; assess impact and make recommendations re: rice.	Adjust producer floor prices to maintain parity base.		Farm income increases on family and commercial farms. More consistent supply in markets throughout year.	Estimated farm income calculated from production functions. Selected market surveys.
b. Cash crops	Establish parity based floor price system.	Adjust floor prices to maintain parity base.	Adjust floor prices to maintain parity base.			
c. Consumer prices		Deregulate consumer price for white maize; assess impact; make recommendations re: beans and rice.	Implement recommendations.			
Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	OBJECTIVE: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling, and registration) to redistribute state farms to commercial and family farmers.			Declared policies on land redistribution including divestiture and titling procedures.	Farms privatized. Production increased on divested farms.	Statistics on actual and planned divestitures. Production statistics by crop in divestiture areas.
a. Planning and implementation	Continue case by case divestitures of state farms. Identify issues and policies to be addressed in divestiture program. Complete terms of reference for additional tenure analyses and design of divestiture program.	Implement analysis program on tenure issues. Enact general divestiture program design. Enact design of USAID specific program for pilot divestitures.	Implement USAID-specific pilot divestiture. Continue divestitures in accordance with general program. Refine divestiture policies, as needed, based on pilot divestiture.	Development and promotion of divestiture program.	Farm income increased.	Estimates of farm income calculated from production functions and verified by sampling.
3. Private Ag. Sales and Services	OBJECTIVE: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			Percentage of private companies/traders participating in program.	Wider and better access to agricultural inputs. Expansion of privatization.	Statistics on numbers of private importers and dealers by input type and province. Sampling of farmer attitudes toward supply networks. Sampling of dealers to assess constraints to expansion.
a. For importers/distributors	Continue private importation and distribution of all A.I.D. commodities; exempt for lubricants and limited spares.	A.I.D. commodity imports fully private (except for petroleum); plan to privatize ag-related public enterprises.	Begin privatization plan.	Finalization of "randomized system" for end users.		
b. For end users	Replace GDM administrative allocation system with direct private sales.	Maintain.	Maintain.			

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
a. Access to foreign exchange	OBJECTIVE: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			Implementation of FI allocation options agreed upon with donors.	Increased access to foreign exchange at market-determined price.	Survey of DGL users to determine private sector access.
a. Allocation mechanism	Establish limited trial of DGL system.	Evaluate effectiveness of FI trial with IMF and USAID follow-up.	Plan to extend DGL framework to larger portion of FI or test other allocation options.	Range of eligible DGL sectors and volumes of FI increased.		Trends in official and parallel exchange rates.
b. Private Marketing Channels	OBJECTIVE: To reduce restrictions on competitive private sector trade and transportation serving agricultural producers in the Sofala, Manhiça, and Zambezia provinces.			Announcement and promotion of deregulations.	Increased number of active traders and transporters.	Sampling of traders/transporters/farmers.
a. Movement of commodities		Review regulatory restrictions on inter-district and inter-provincial movement of agricultural commodities.	Assess impact.		More consistent supply of commodities in markets throughout the year.	Market surveys.
b. Wholesaling		Open district wholesaling opportunities to any licensed trader desiring to compete.	Assess impact.		Increased producer access to consumer goods and other "incentive" commodities.	Sampling of farmers.
c. Licensing		Analyze licensing requirements for private marketing agents at all levels to assess disincentive effects.	Simplify licensing requirements based on analysis and encourage new competitors.		Improved food balances between deficit and surplus production areas.	
a. Petroleum Importation and Marketing	OBJECTIVE: To promote increased and more reliable access to selected petroleum products at import parity prices based on the secondary market exchange rate.			Announcement and promotion of price changes and deregulations.	More consistent supply of and access to petroleum products nationwide.	Sampling of farmers, transporters, traders, and industries.
a. Pricing			- Realign consumer price for gasoline at or above import parity at the MSE rate and continue to adjust consumer price of diesel to reflect exchange rate and international price changes.			Sampling of importers/distributors.
b. Deregulation			- Complete analysis and implement recommendations for deregulating import, distribution, and pricing of avgas.		Private sector importation and distribution of avgas.	Trends in prices of diesel and gasoline.
			- Analyze import and distribution of petroleum products to identify further measures to support a more efficient market for these.			

III. Authority

DOA 551 Section 4 authorizes you to amend project (including non-project assistance) authorizations provided that the amendment will not result in total Life of Project funding of more than \$30 million, present significant policy issues or deviate from the original project purpose, or require issuance of waivers that may not be approved by you. None of these restrictions applies here.

IV. Recommendation

That you authorize the addition of petroleum products to the list of commodities eligible for financing under the Private Sector Support Program CIP.

APPROVED:



DISAPPROVED:

DATE:

5/15/91

Clearances:(A)CMO:T.Born (draft 5/9/91)
CON:M.Rocha (draft 5/8/91)
RLA:D.Keene (telecon 5/13/91)
Drafted:PRM:J. Born:05/03/1991

Mozambique Private Sector Support Program (656-0208)
Amendment to the Program Assistance Approval Document
for Petroleum Financing

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Mozambique Private Sector Support Program (656-0208)
Supplement to the Program Assistance Approval Document
for Petroleum Financing

I. Mozambique's External Sector

This section analyses the current balance of payments situation in Mozambique and confirms the need for continuing and increasing levels of fast-disbursing balance of payments assistance. In the context of the overall balance of payments situation, this section also considers the specific case of petroleum imports. Although Mozambique, through its strong economic reform efforts, has successfully attracted extraordinarily high donor commitments to meet its external financing gap in 1991, most donor assistance remains tied to specific purposes or sectors and, in some cases, to specific procurement and source/origin requirements. This has created a particular crisis for petroleum imports as a result of the Soviet Union's inability to continue to supply concessional aid and the disruption of the international petroleum market in late 1990 and early 1991, which caused a significant amount of untied aid to be used for high-cost petroleum imports. The availability of petroleum products, as discussed in Section I.B., is of particular relevance to the agricultural marketing objectives of the Private Sector Support Program, since the marketing of most agricultural products depends on motorized transport.

A. Sources and Uses of Foreign Exchange

Demand for and supply of foreign exchange in Mozambique can be examined either from a traditional balance of payments perspective, or from a functional perspective focused on the sources and uses of foreign exchange. For the purpose of understanding what pressures lie beneath the existing foreign exchange allocation system, the latter approach is more revealing. The discussion in this section follows the presentation in Table 1 below.

Table 1. Mozambique: Sources and Uses of Foreign Exchange, 1980-2000
(millions of current U.S. dollars)

	1980	1986	1987	1988	1989	1990	1991	1995	2000	AVG TRLY CHANGE, 1991- 2000
	----	----	----	----	----	----	----	----	----	----
FOREIGN EXCHANGE SOURCES										

Export Earnings (FOB)	281	79	97	103	105	117	139	263	621	18.2
Service Earnings	171	119	137	157	167	170	160	221	406	9.1
Private Transfers				78	85	90	92	100	110	2.0
Official Transfers	56	213	304	377	388	427	539	596	690	4.9
Foreign Borrowing	503	284	301	227	244	304	304	317	358	1.6
TOTAL SOURCES	1011	695	839	942	989	1108	1234	1497	2165	7.0
	----	----	----	----	----	----	----	----	----	----
FOREIGN EXCHANGE USES										

Import Expenditures (CIF)	800	543	625	736	808	870	958	1213	1678	6.6
Non-Interest Service Expenditures	69	123	137	143	142	152	156	174	201	2.6
Debt Service Payments	145	490	533	495	484	503	501	418	691	3.2
Interest Payments	8	155	148	117	169	165	189	192	200	1.9
Scheduled	8	112	125	103	139	131	114	53	13	-20.6
On New and Refinanced Debt	0	43	23	14	30	35	75	139	167	18.1
Amortization Payments	139	336	384	378	315	338	312	226	491	3.6
TOTAL USES	1014	1156	1294	1374	1434	1525	1615	1805	2570	5.4
	----	----	----	----	----	----	----	----	----	----
Errors and Omissions	-30	-27.2	29.3	59	25.1	10.2				
OVERALL BALANCES										

Merchandise Trade Balance	-519	-464	-528	-633	-703	-753	-819	-950	-1057	
Current Account (excluding grants)	-423	-622	-676	-658	-762	-810	-912	-995	-942	
Current Account (including grants)	-367	-409	-372	-281	-374	-383	-373	-399	-252	
Overall Balance for Financing	-32	-488	-425	-373	-420	-407	-381	-308	-385	

Continued ...

The table presents export earnings, service earnings, unrequited transfers (private and official), and foreign borrowing as the non-financial sources of foreign exchange available to Mozambique. Non-financial foreign exchange uses, on the other hand, include import expenditures, non-interest service expenditures, and debt service commitments (interest and amortization). After the fact, the balance of payments must balance, and the financing segment of Table 1 indicates how this is done. Either Mozambique resorts to a drawdown in its net foreign asset position (including net use of IMF resources), or it successfully seeks cancellation or rescheduling of its foreign debt, or it accumulates arrears on these debt commitments. On an *ex ante* basis, however, a financing gap indicates that something must change in either the non-financial sources and/or uses, or something (such as arrears accumulation) must change in the financing of the balance of payments.

1. Sources of Foreign Exchange, 1986-90

Mozambique's export earnings in 1986 were a scant \$79 million, the nadir of a steady decline in exports since 1980. 1986 exports were barely 28 percent of their 1980 level and covered less than 15 percent of the import bill, compared with a comparable 1980 figure of 35 percent. The major reason for this decline was not export prices, which remained relatively steady throughout the period, but export volumes. The main source of the drop in export earnings was the sharp fall-off in exports of cashew, sugar, and tea. Indeed, in 1986, the only export product that showed an increase was shrimp. The direct causes of this fall-off were two: the insecurity situation, and the economic policy framework pursued by the GRM. Given that peak production and marketing levels in Mozambique were observed in 1980, and given the fact that the insecurity situation, at least at its current degree of intensity, began in the early 1980s, it is tempting to ascribe to insecurity rather than economic mismanagement the lion's share of the blame. In any case, by 1986 an economy that in 1980 already could not afford to pay its import bill from its export earnings was in an even worse position.

Since 1986, there has been some recovery in exports, with earnings growing at an annual average of just over 10 percent. Export prices in general dropped slightly between 1986 and 1990, and the majority of the improvement has come through increased export volumes. However, to attain the 1980 level of exports, average annual growth of nearly 40 percent would have been required over the past four years, and would have required, *inter alia*, cashew exports to increase at an average annual rate of about 40 percent.

Service earnings also dropped off between 1980 and 1986, with a reduction in transport earnings the primary cause. This reflects the effects of the insecurity situation on the economy. Primarily to blame for the drop in service receipts are the decline in rail transport of neighboring country imports and exports and the consequent loss of foreign exchange earnings at Mozambique's ports. Since 1986, there has been some increase in service receipts, but none of the improvements have been due to increased transport earnings.

The most dramatic increase in foreign exchange inflows in the past few years has been in foreign grants and loans. Although the sum of these two components in 1986 did not differ significantly from their sum in 1980, it is interesting to note that the structure of the sum has changed sharply. In 1980, foreign loans were about 90 percent of these external inflows, contributing in a major manner to the current debt situation facing Mozambique. By 1986, the grants exceeded foreign borrowing as a source of balance of payments financing, a welcome trend. Additionally, the term and interest structure of Mozambique's external borrowing has changed in Mozambique's favor. Since 1986, foreign borrowing has remained at approximately the same level as it was in 1986, but external grants have increased at about 20 percent per year, in nominal terms, a strong indication of donor interest in and sympathy for not only Mozambique's development problems, but also Mozambique's current economic policy reform stance.

During the 1986-90 period, external inflows in the form of grants and loans represent approximately 70 percent of total sources of foreign exchange, compared with just over 50 percent in 1980. Compared with debt service, on a commitment basis, grants and loans were almost 100 percent of debt service in 1986, but were beginning to outstrip debt service by 1990. Over the past five years, foreign borrowing has been exceeded by amortization payments, not to speak of the interest payments to service the debt, indicating that, at least on a commitment basis and excluding grants, Mozambique is a net creditor to the rest of the world.

2. Uses of Foreign Exchange, 1986-90

Imports are Mozambique's single largest use of foreign exchange, averaging around 50 percent of total uses during 1986-90. Between 1980 and 1986, imports dropped by about one-third, reflecting primarily a reduction in imports of intermediate inputs and capital goods, each of which declined by around 50 percent in nominal terms. The only growing import over the same period was food, which increased by about 40 percent. In real terms, however, imports did not decline as much as the nominal data suggest, inasmuch as prices of Mozambique's imports were down by about 20 percent, comparing 1986 with 1980. Still, real imports dropped by about 15 percent, causing Mozambique's manufacturing sector to slow to a standstill.

The relative size of imports is perhaps best understood by comparing it to GDP. In the mid-1980s, such comparisons are of dubious validity, because of the extreme overvaluation of the exchange rate, which must be used to relate imports to GDP. However, a better measure may be seen in 1989, when imports were two-thirds the size of GDP. Were one to take into account the remaining overvaluation of the exchange rate, this ratio would rise to close to 100 percent. Taking this together with the fact that Mozambique's exports are so small, one can see that domestic production does not even cover Mozambique's consumption needs, let alone covering investment spending.

Non-interest service expenditures, which have represented about 10 percent of overall foreign exchange uses in the past several years, are a relatively steady and not particularly interesting portion of foreign exchange uses. In the past few years, these service payments have grown as a result of the GRM permitting foreign investors to repatriate some of their profits.

The remaining 40 percent of Mozambique's foreign exchange is used for debt service. Of debt service commitments, which have averaged half a billion dollars per year in 1986-90, about 40 percent in the past two years have been for interest, with the balance covering amortization. Mozambique, as of the end of 1988, had accumulated debt of about \$4.2 billion with the rest of the world. The bulk of that debt, about \$3.5 billion, was bilateral official debt, approximately equally divided between OECD countries and countries with centrally planned economies (when one removes the 20 percent owed to OPEC countries and Brazil). Debt service commitments are large enough that, were these commitments to be removed from the balance of payments calculus, preferably through cancellation, Mozambique's balance of payments would indeed show ex ante balance.

3. Financing the Gap, 1986-90

With total uses exceeding total sources, Mozambique has had an overall deficit in the balance of payments during this period on the order of \$400-plus million. This deficit has averaged 30 percent of Mozambique's total uses of foreign exchange from 1986-90. To cover this financing-gap, Mozambique has gone significantly into arrears on external debt payments. End-1988 arrears stood at about \$1.5 billion, more than a third the level of total debt outstanding at that time. The bulk of these arrears are on bilateral debt and therefore presumably restructurable, at least within the confines of the Toronto terms discussed below. To date, the majority of debt restructuring has been in the form of rescheduling, rather than cancellation, thereby pushing the problem into the future. In years during which Mozambique has been unable to come to terms with creditors on restructuring, the country has simply not made debt payments, thereby closing the ex ante balance of payments gap. This will present a serious crisis in the late 1990s when debt that was rescheduled under Toronto terms, which is virtually all of the OECD debt, can no longer be rescheduled. The GRM, World Bank, and IMF have put forward Mozambique as an example of the need to change the terms of debt relief to include significant cancellation and not just rescheduling of debt, possibly on the proposed Trinidad terms now being considered by the Paris Club. The Trinidad terms would cancel two-thirds of the Paris Club debt, rescheduling the remaining one-third over 25 years with a five-year grace period.

4. Balance of Payments Prospects, 1991-2000

The following discussion of balance of payments prospects for this decade is based on IMF projections available as of April 1991. These data are arrayed in Table 1, using estimated outturns for 1989 and 1990, and projections for 1991, 1995, and 2000. Although in nominal terms the data indicate that total sources of foreign exchange will grow (at seven percent) more rapidly than total uses (at five percent), the overall balance for financing remains significant. About a year ago, IMF projections were considerably more bullish on the growth of sources of foreign exchange than they are now. Exports are expected to grow in nominal terms by over 18 percent, an admittedly large rate, but the low export base in 1990 (equivalent to only about one-seventh of the imports) hardens the balance of payments projections. However, the most telling revision in the estimates is that concessional loans and grants are expected to grow much more slowly than anticipated a year ago, although still at very high rates of about five percent for grants and 1.6 percent for loans. Throughout the decade,

the overall deficit in the balance of payments exceeds the volume of possible debt relief, emphasizing again that cancellation of a significant portion of Mozambique's official debt will be critical to achieve external financial viability.

In the near term (1991-92), IMF projections suggest that the gap is close to being closed. For 1991, the December 1990 Paris Consultative Group meeting was able to obtain sufficient pledges to close the gap, assuming debt relief on the order of about \$700 million and a clearing of \$300-plus million of arrears to London Club banks through a debt buy-back program co-financed by the World Bank and several bilateral donors. The World Bank has awarded a contract to Merrill Lynch to coordinate the purchase of commercial debt, estimated to be worth less than 10 U.S. cents to the dollar. The commercial buy-backs should be completed in mid-1991.

Another critical consideration in the 1991 balance of payments is the flexibility with which donor aid is provided. Mozambique has made significant progress in raising the level of untied aid (in regards to source and origin) to about \$300 million annually. This allows for more effective utilization of scarce resources as a greater share of imports can now be purchased where they are least expensive, rather than in the country of the donor providing the assistance.

Progress has not been as extensive, however, in the untying of foreign exchange for specific purposes. Donors still continue, understandably, to prioritize certain sectors and to limit imports to commodities in these sectors. The Nordic countries, for example, strongly support social services. A.I.D., through the PSSP, has given priority to agriculture. Such targeting of balance of payments support can be argued to have had certain beneficial development impacts, particularly when the exchange rate was exorbitantly overvalued. It also creates specific problems, however, linked with the importation of critical commodities when one or more of the principal donors in a sector cut their assistance. As is discussed in the following section, such a situation has occurred with petroleum products, given: (1) the Soviet Union's lack of capacity to continue to provide concessional assistance, and (2) the shortage of untied donor funds to finance petroleum import requirements. This situation is one of the underlying factors leading to this amendment to expand the eligible list of commodities under the PSSP to include petroleum products.

Projections for 1992 suggest yet a more critical situation. Even after debt relief of \$320 million, a financing gap of \$35 million remains. Debt service ratios, even after debt relief, will be on the order of 40 percent. Mozambique's only course of action for the foreseeable future, regardless of the degree of workable stabilization policies, will be to solicit an increase in grants and concessional lending, and to seek greater flexibility in the utilization of official aid flows, both in terms of source and origin and in relation to specific import purposes. Cancellation of a portion of the official debt, which is essential for a viable balance of payments in the late 1990s, depends wholly on Paris Club negotiations, which are outside of Mozambique's control.

B. Petroleum Import Requirements

Extreme volatility in petroleum prices, together with the termination of a concessional trade agreement with the Soviet Union for petroleum products, have exacerbated Mozambique's balance of payments crisis in 1990-91. This will directly affect both the agriculture and transport/marketing sectors which consume over half of Mozambique's petroleum imports.

Since the early 1980s, Mozambique has depended on concessional trade agreements with the Soviet Union to finance, in recent years, approximately \$50 million out of a total petroleum import bill averaging about \$75 million. With the vast political and economic upheaval and increasing scarcity of hard currency in the Soviet Union, the U.S.S.R. cannot continue to subsidize Mozambican petroleum imports. Moreover, the sudden termination of the U.S.S.R.'s concessional support came during a period of rising international petroleum prices due to the 1990-91 Gulf crisis, placing yet more strain on the balance of payments.

Table 2 below presents several scenarios for petroleum import requirements in 1991 and compares them to the cost of petroleum imports in 1990. Under relatively conservative price assumptions, the petroleum import bill will rise to \$107 million in 1991 from \$73.8 million in 1990. At November 1990 prices, the 1991 import bill will rise to over \$140 million. Such sharp fluctuations in international petroleum prices as were associated with the Gulf crisis make it difficult to project the evolution of petroleum prices over the next 12 months. Moreover, because Mozambique does not have the capacity to refine crude oil and therefore imports only refined

TABLE 2
ESTIMATED 1991 PETROLEUM IMPORT REQUIREMENTS
FOUR SCENARIOS

PETROLEUM PRODUCTS	IMPORTS 1991	1		2		3		4		Total Cost 1990
		Average unit price \$	Aug/Oct 90 Total \$	Average unit price \$	Nov 90 Total \$	Average unit price \$	Feb 91 Total \$	Proposed Scenario unit price \$	Total \$	
LPG	mt 9,000	481	4,329,000	481	4,329,000	500 (a)	4,500,000	475	4,275,000	3,150,000
AV GAS	mt 4,680	486	2,272,140	380	1,778,400	264	1,237,158	275	1,287,000	1,497,600
GASOLINE	mt 40,200	394	15,833,976	370	14,874,000	233	9,366,600	285	11,457,000	8,201,200
JET FUEL	mt 45,600	388	17,710,584	422	19,243,200	311	14,181,600	325	14,820,000	9,120,000
KEROSENE	mt 13,700	388	5,320,943	422	5,781,400	311	4,260,700	325	4,452,500	2,603,000
DIESEL OIL	mt 234,000	309	72,191,340	348	81,432,000	258	60,372,000	250	50,500,000	39,780,000
FORK OIL	mt 37,600	165	6,208,136	183	6,880,800	112	211,200	140	5,204,000	3,741,200
ASPHALTS	mt 10,000	293	2,930,000	305	3,050,000	300 (a)	3,000,000	300	3,000,000	1,900,000
LOB OILS	mt 8,400	453	3,805,200	450	3,780,000	425 (a)	3,570,000	425	3,570,000	3,360,000
SOLVENTS AND WHITE SPIRITS	mt 1,000	400	400,000	435	435,000	450 (a)	450,000	400	400,000	350,000
TOTAL			131,001,319		141,583,800		105,149,258		107,825,500	73,783,000

(a) Estimated

products, the added volatility in the prices for these products further complicates any medium-term analysis of import requirements. Although there is clearly a long-term correlation between prices for crude oil and refined petroleum products, trends in the past four months suggest that prices for refined products will increase more rapidly than the price of crude oil and may not decrease as rapidly when crude oil prices fall.

The increased cost of oil imports from 1990 to 1991 represents 24 percent of Mozambique's total projected export earnings for 1991. The loss of both workers' remittances from East Germany and financial assistance from the Soviet Union and other Eastern bloc countries represents an additional external shock equal to seven percent of GDP and about 30 percent of export earnings. As shown in the balance of payments analysis above, Mozambique does not have the resources to absorb these shocks within its own foreign exchange earnings or to assume additional commercial debt. Additional donor financing is required to ensure a reasonably consistent flow of petroleum imports.

Since September 1990 when the petroleum price impacts of the Gulf crisis began to manifest themselves, the GRM has pursued additional donor balance of payments support for petroleum imports. Few donors had previously made provisions in their assistance programs to finance petroleum products since the Soviet Union had traditionally supplied the majority of Mozambique's needs, and diesel fuel could be imported under World Bank rehabilitation credits. Several countries, notably France, Germany, and the Netherlands, responded quickly to the GRM's requests to make available about \$24 million in late 1990 and early 1991 from existing import support programs. The World Bank, Sweden, England, Italy, and Japan have also contributed about \$31 million. However, without the continuation of the Soviet Union's concessional trade agreement, this still leaves unfunded approximately 50 percent of the petroleum import bill for 1991.

A major shortfall in petroleum financing would have its most significant impact on the agricultural and transport sectors, particularly during the high season of the agricultural marketing year, between May and September. In 1989, the last year for which estimates are available, the agricultural sector consumed 10 percent of all oil products. The transport sector, and by implication marketing, accounted for 40-50 percent of consumption. Significant shortages in petroleum could thus be expected to result in: (1) reduced capacity to move agricultural products from producers to consumers, possibly

even depressing producer prices and creating a disincentive to production in subsequent years; (2) higher costs associated with agricultural marketing; (3) higher consumer prices for food due to both higher marketing costs and the inability to evacuate crops efficiently from production areas; and (4) a reduction in agricultural exports, particularly cotton and cashews which rely almost exclusively on motorized vehicles to transport crops to processing factories and then on to ports.

Negative impact on both producers and consumers of food would be highly probable given that wholesale and retail markets are just re-emerging after a decade of suppression compounded by disruption due to the security situation. With just a few key intermediaries in any given province still controlling a significant share of all trade, and with a highly inelastic demand for basic food commodities, increased marketing costs have generally been passed on to consumers and producers. It would not be unreasonable to extend the impact of a 50 percent shortfall in petroleum to a need for increased food aid for urban areas, particularly at a time when some parts of the country are experiencing a severe drought, and higher costs for delivering such food aid. There is, of course, a high degree of speculation involved in any such analysis. Yet it serves to demonstrate that petroleum is an essential input in the agricultural production and marketing process, and that a sharp drop in the availability of petroleum, particularly during the marketing season, would negatively affect farmers, consumers, and export competitiveness.

II. Program Description

A. Objectives

This PAAD amendment will (1) revise the eligible commodity list under the PSSP to include petroleum products, and (2) incorporate pricing and marketing reforms for selected petroleum products into the PSSP's policy objectives. AID/W's concurrence with expanding the commodity list to include petroleum products is provided in Annex A. As discussed in Section I, financing of petroleum products is based upon the importance of petroleum to the agricultural production and marketing objectives of the PSSP, Mozambique's continuing need for extensive balance of payments support, and the limited provisions for donor financing of petroleum imports under most import support programs.

The proposed amendment is fully consistent with the PSSP's purpose to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. USAID's financial support for petroleum imports provides an opportunity to pursue policy reforms with the Government that will help institutionalize incentives for efficient use of petroleum imports and take a first step toward laying the foundations for private participation in the importation and distribution of petroleum products. Such measures will contribute significantly to promoting consistent availability of petroleum products within the country and will help avoid the types of production and marketing bottlenecks discussed in Section I that would result from significant petroleum shortages. Including the petroleum pricing and marketing reforms which are discussed in Section II.D. below, the expected policy impacts under the PSSP are expanded as follows:

- (1) Increased agricultural productivity and strengthened competitive markets by utilizing floor prices that guarantee producers a fair return in cases where there may be only one buyer and by replacing floor prices with a liberalized market when conditions permit;
- (2) Clearly defined policies and an action plan leading to divestiture of selected state farms to private family and commercial farmers;
- (3) Demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers;
- (4) Tested policy and procedural options to both increase the access of private enterprises in the agricultural sector to foreign exchange and institutionalize market principles as a basis for foreign exchange allocations;
- (5) Reduced restrictions on competitive private sector trade and transportation serving agricultural producers in Mozambique; and
- (6) Increased and more reliable access to selected petroleum products at import parity prices based on the secondary market exchange rate.

B. Progress to Date

Annex B contains a detailed report on progress under the PSSP over the past year. On the whole, the GRM continued to implement the economic reform measures agreed upon with the international community.

The GRM fully met agreed upon targets for pricing policy reforms. Fixed producer prices have been abolished in favor of minimum prices intended to protect producers as markets re-emerge but suffer from lack of competition. Consumer prices for maize, beans, and rice have been readjusted to overcome marketing disincentives created by previously inadequate margins between producer and consumer prices. Some delays -- to some extent bureaucratic -- have been encountered in enactment of PSSP marketing reforms. This issue has been raised at senior levels of government and a process has been initiated under the Prime Minister's review to remove restrictions on inter-provincial and inter-district trade and to allow open competition among district-level wholesalers. Commodity imports under the PSSP continue to support the private sector. Indeed, we have noted increased Government emphasis on private sector access to foreign exchange across its import support programs.

Implementation of foreign exchange reforms and state farm divestiture has proved more complex than the other PSSP pricing and marketing policies. Conflicting emphases from the World Bank and IMF, analyzed in detail in Maputo 896 and Maputo 998, have complicated the process of developing a clear strategy leading to market-based allocation and pricing of foreign exchange. The GRM has, in fact, met the specific targets agreed upon for 1990-91 with the expansion of its Open General License experiment and the creation of a secondary foreign exchange market. We are nonetheless concerned that more intensive oversight from the World Bank and IMF are needed to make these initiatives work. Based on April 1991 consultations with World Bank and IMF staff in both Washington and Maputo, we believe that both of the multilaterals are now seized with meeting this need.

State farm divestitures, as predicted in November 1990 correspondence on the economic development implications of constitutional reform, have assumed a heightened sense of political sensitivity with the anticipated advent of electoral politics and the demobilization of military forces. Although actual divestitures continue, attempts to formulate a clear set of guidelines for the divestiture process have been ensnared in the political process. The Government, nevertheless, continues to comply with credit and subsidy restrictions on parastatals, and this is squeezing many state farms out of existence. The GRM has also requested continued U.S. support to analyze and rationalize divestiture policies.

C. Considerations in Petroleum Financing

In analyzing which petroleum products to finance under the PSSP, USAID took into consideration the following factors: (1) critical petroleum products for agriculture and marketing and in relation to overall economic stability; (2) foreign exchange cash flow, particularly the availability of donor financing and specific procurement constraints, relative to demand; (3) broad concerns over petroleum pricing and distribution policy; and (4) long-term interests in shifting petroleum imports to a newly created secondary foreign exchange market in which the exchange rate is determined through supply and demand. Based on the analysis summarized below, USAID proposes to finance diesel and gasoline imports under the PSSP.

1. Critical Petroleum Products

Diesel is the principal fuel used in agricultural production equipment and vehicles for agricultural marketing. Gasoline, while not of such direct importance to agricultural and marketing activities, is essential to the overall transport requirements of the country. If the GRM does not receive donor financing for gasoline imports it will be required to tap other foreign exchange sources, possibly at the expense of other critical production inputs, to ensure minimal gasoline supplies in key areas throughout the country. Failure to maintain adequate supplies of gasoline would add to existing urban social tensions that could threaten the continued implementation of the agricultural pricing and market liberalization reforms under the PSSP, particularly until a supply side response to improved agricultural production incentives can mitigate short-term food price increases.

2. Supply and Demand Factors

As shown earlier in Table 2, the principal fuel import requirements for 1991 are for diesel (about \$58.5 million), jet fuel (about \$15 million), and gasoline (about \$11.5 million).

Diesel, as discussed above, is a high national priority which is central to agricultural production and marketing. The GRM made provisions to finance diesel imports early in 1991 through other donor support programs, particularly the World Bank's Third Rehabilitation Credit. USAID also financed a small diesel purchase with balances remaining under the 1988 Private Sector Rehabilitation Program. Donor assistance for diesel imports will prove most critical later in 1991.

Donor financing is scarcer for gasoline imports. The World Bank added gasoline to its eligible list of commodities and financed some small gasoline purchases early in the year. On several occasions when gasoline supplies have been completely exhausted in Maputo, the GRM has used its limited foreign exchange receipts to import gasoline. The need to assist with gasoline imports is both large and immediate.

The principal users of jet fuel generally receive payments in hard currency and thus have the potential to import jet fuel directly utilizing foreign exchange receipts. This is also the case for LAM, the national airline, which utilizes a portion of its foreign exchange earnings to finance petroleum needs as part of its export retention agreement with the Government.

3. Broader Policy Considerations

Prior to the start of Mozambique's Economic Rehabilitation Program in 1987, commodity shortages were endemic throughout the country. The GRM generally dealt with such shortages through rationing and price controls, in many cases further eroding incentives for production or for efficient use of scarce resources, and fomenting the growth of parallel markets. The World Bank and the IMF have worked with the GRM to phase out rationing programs and to manage demand, to the extent it continues to be necessary to do so, by adjusting prices. To help the GRM implement this strategy, donors have provided extraordinarily high levels of financing, as discussed in Section I, in order to shore up commodity supplies.

A major interruption in the supply of petroleum products could drive the GRM to again resort to rationing petroleum products, particularly diesel and gasoline which would be in shortest supply. USAID assistance for gasoline and diesel imports would help to meet the commitment that donors have assumed to finance critical imports in order to allow the GRM to continue to pursue the liberalization of pricing and distribution policies.

4. The Secondary Foreign Exchange Market

A broader objective of the PSSP has been to reinforce GRM, World Bank, and IMF efforts to create a functioning foreign exchange market in Mozambique. In October 1990 the GRM took an important step toward liberalization of the foreign exchange regime through the creation of a secondary foreign exchange market (called the MSC) in which supply and demand determine the exchange rate. The secondary market still remains thin, averaging about \$1 million in sales per month. In part this is due to a lack of clarity on eligible foreign exchange sources to supply the market. Non-traditional exports are intended to be but still have not been moved to the secondary market. Mechanisms have not been established to channel donor funds through the central bank to be sold into the MSC. Hence, the principal sources of supply have been foreign exchange sales from embassies and NGOs, and ad hoc arrangements with enterprises with export retention schemes. Due to general knowledge of the minimal availability of foreign exchange within the MSC, moreover, demand has been limited principally to relatively small transactions for travel and other services.

The IMF, World Bank, and USAID are presently working with the Government to shift an increasing share of imports and exports to the MSC exchange rate in order to stimulate exports and encourage efficient use of scarce foreign exchange for imports. In the long term, a viable foreign exchange market in a country such as Mozambique, which depends on donors for 80 percent of its foreign exchange, will require extensive strengthening of the central bank. As a transitional measure, the GRM and donors will seek to channel receipts from non-traditional exports through the MSC, and to use the MSC exchange rate as a proxy for an equilibrium rate under various import support programs such as the SNAAD (a limited Open General License program) and USAID's CIP.

Based on USAID's analysis of domestic prices for petroleum products (see Annex C and the discussion in Section II.D. below), gasoline is currently slightly above and diesel slightly under import parity at the MSC exchange rate, and have been close to import parity since the major consumer price increases announced soon after international prices escalated in late 1990. In conjunction with the financing of gasoline and diesel imports under the PSSP, USAID and the GRM will formalize the current de facto shift of the importation of these products from the official to the secondary foreign exchange market. This shift will ensure consistent monthly demand within the MSC, which creates a basis for increasing the flow of foreign exchange into the secondary market without artificially depressing the exchange rate.

D. Revised Policy Framework

This amendment revises the policy agenda for the Private Sector Support Program by adding a sixth policy objective and several specific policy benchmarks for 1991-92 related to the importation and pricing of petroleum products. The revised policy agenda is presented in the updated "Summary of Policy Objectives and Workplan" matrix which follows (Table 3).

As in the past, policy reforms under this amendment will be agreed upon with the Government through a "Letter of Intent" from the GRM to USAID. This Letter of Intent describes specific reform measures to promote increased and more reliable access to selected petroleum products at import parity prices based upon the secondary market exchange rate. The Government has submitted the Letter of Intent prior to USAID's amending the PSSP grant agreement to authorize the procurement of petroleum products. Once USAID has determined that it addresses the policy issues discussed below, the letter will be incorporated into the grant agreement by reference through an amendment to modify the list of eligible commodities. The Letter of Intent is provided in Annex D.

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
1. Agricultural Pricing Policy	OBJECTIVE: To maximize the liberalization of the agricultural pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural prices on world parity.			Price changes and announcements.	Production increases on family and commercial farms.	Production statistics by crop, province, farm type.
a. Maize, beans, rice	Establish parity producer prices; plan for floor price system. (Note: beans actually moved to floor price in 1989.)	Move white maize to parity-based producer floor price system; continue parity-based producer floor price for beans; adjust parity-based producer price of rice; assess impact and make recommendations re: rice.	Adjust producer floor prices to maintain parity base.		Farm income increases on family and commercial farms. More consistent supply in markets throughout year.	Estimated farm income calculated from production functions. Selected market surveys.
b. Cash crops	Establish parity-based floor-price system.	Adjust floor prices to maintain parity base.	Adjust floor prices to maintain parity base.			
c. Consumer prices		Deregulate consumer price for white maize; assess impact; make recommendations re: beans and rice.	Implement recommendations.			
Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	OBJECTIVE: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling, and registration) to redistribute state farms to commercial and family farmers.			Declared policies on land redistribution including divestiture and titling procedures. Development and promotion of divestiture program.	Farms privatized. Production increased on divested farms. Farm income increased.	Statistics on actual and planned divestitures. Production statistics by crop in divestiture areas. Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and implementation	Continue case-by-case divestitures of state farms. Identify issues and policies to be addressed in divestiture program. Complete terms of reference for additional tenure analyses and design of divestiture program.	Implement analysis program on tenure issues. Complete general divestiture program design. Complete design of USAID-specific program for pilot divestitures.	Implement USAID-specific pilot divestiture. Continue divestitures in accordance with general program. Refine divestiture policies, as needed, based on pilot divestiture.			
3. Private Ag. Sales and Service	OBJECTIVE: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			Percentage of private companies/traders participating in program. Elimination of "credential system" for end users.	Wider and better access to agricultural inputs. Expansion of privatization.	Statistics on numbers of private importers and dealers by input type and province. Sampling of farmer attitudes toward supply networks. Sampling of dealers to assess constraints to expansion.
a. For importers/distributors	Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	A.I.D. commodity imports fully private (except for petroleum); plan to privatize ag-related public enterprises.	Begin privatization plan.			
b. For end users	Replace GOM administrative allocation system with direct private sales.	Maintain.	Maintain.			

POLICY AREAS	1989/90	1991/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
14. Access to Foreign Exchange	:OBJECTIVE: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			Implementation of FX allocation options agreed upon with donors.	Increased access to foreign exchange at market-determined price.	Survey of OGL users to determine private sector access.
14a. Allocation mechanism	Establish limited trial of OGL system.	Evaluate effectiveness of OGL trial (with IDRO with USAID follow up). If trial is generally successful, modify and expand eligible sectors under OGL; otherwise formulate new options.	Plan to extend OGL framework to larger portion of FX or test other allocation options.	Range of eligible OGL sectors and volumes of FX increased.		Trends in official and parallel exchange rates.
15. Private Marketing Channels	:OBJECTIVE: To reduce restrictions on competitive private sector trade and transportation serving agricultural producers in Cabo Delgado, Manhiça, and Zambezia provinces.			Announcement and promotion of deregulations.	Increased number of active traders and transporters. More consistent supply of commodities in markets throughout the year.	Sampling of traders/transporters/farmers. Market surveys.
15a. Movement of commodities		Rescind regulatory restrictions on inter-district and inter-provincial movement of agricultural commodities.	Assess impact.			
15b. Wholesaling		Open district wholesaling opportunities to any licensed trader desiring to compete.	Assess impact.		Increased producer access to consumer goods and other "incentive" commodities.	Sampling of farmers.
15c. Licensing		Analyze licensing requirements for private marketing agents at all levels to assess disincentive effects.	Simplify licensing requirements based on analysis and encourage new competitors.		Improved food balances between deficit and surplus production areas.	
16. Petroleum Importation and Marketing	:OBJECTIVE: To promote increased and more reliable access to selected petroleum products at import parity prices based on the secondary market exchange rate.			Announcement and promotion of price changes and deregulations.	More consistent supply of and access to petroleum products nationwide.	Sampling of farmers, transporters, traders, and industries.
16a. Pricing			Maintain consumer price for gasoline at or above import parity at the PSC rate and continue to adjust consumer price of diesel to reflect exchange rate and international price changes.			Sampling of importers/distributors. Trends in prices of diesel and gasoline.
16b. Deregulation			Complete analysis and implement recommendations for deregulating import, distribution, and pricing of kerosene. Analyze import and distribution of petroleum products to identify further measures to support a more efficient market for these.		Private sector importation and distribution of kerosene.	

1. Gasoline and Diesel Prices

The GRM will maintain the consumer price for gasoline at or above import parity at the secondary market exchange rate and will continue to adjust the consumer price for diesel to reflect changes in the exchange rate and international prices. As illustrated in the pricing model provided in Annex C, both diesel and gasoline prices were very close to import parity at the MSC exchange rate as of mid-April 1991, with gasoline slightly above. The pricing model was developed with World Bank technical assistance and reflects the tax and cost structures agreed upon with the IMF and World Bank. At a minimum, the Government will review gasoline and diesel prices quarterly and adjust them as necessary to reflect changes in international prices, insurance and freight costs, domestic handling costs, taxes, and the secondary market exchange rate. Any petroleum products financed by the PSSP CIP will be priced at import parity at the secondary market exchange rate utilizing this model (or a modified version agreed upon by USAID and the GRM).

As discussed above, the official shift of gasoline and diesel to the secondary foreign exchange market will: (1) promote more efficient utilization of these imports since their prices will no longer reflect a highly overvalued official exchange rate, and (2) create the consistent foreign exchange demand in the secondary market needed to allow donors to channel funds through the MSC or, as in the case of USAID's CIP, through import support programs that utilize the MSC exchange rate.

2. Avgas Imports, Distribution, and Pricing

The Government will complete an analysis and implement recommendations for deregulating the market for avgas by allowing users to make their own arrangements for supplies, either by importing directly or purchasing at a market-determined price from intermediaries (e.g. Petromoc, BP, Mobil, Total, etc.) who will be free to import directly. Currently, the parastatal enterprise Petromoc has a monopoly on the importation of all petroleum products. The principal users of avgas are charter air companies and non-profit organizations, many of which are linked with the provision of emergency assistance and other donor programs.

Problems at times arise with the supply of avgas because the use of air charters is strongly linked to the security situation. At times when key roads become inaccessible, the demand for air charters, and thus avgas, can increase sharply. Conversely, Petromoc does not wish to overstock avgas in response to emergency conditions since an unpredictable improvement in the security situation could lead to an oversupply of this fuel which, if stored for six months, deteriorates in quality and needs to be sold at a lower price as gasoline. The deregulation of avgas imports should eliminate periodic shortages which can drastically disrupt emergency programs.

Virtually all users of avgas receive payment for their services in foreign exchange and therefore could either import directly or make arrangements with other users to pool funds to purchase through an intermediary. It is probable that Petromoc will still continue to import the largest quantities of avgas and, through bulk purchases, offer the best prices. Avgas users, however, will no longer be dependent on Petromoc as the exclusive importer. The alternative of importing directly or through intermediaries will also reduce their vulnerability to GRM foreign exchange cash flow problems that affect Petromoc's capacity to import.

The analysis will take into consideration relevant technical, operational, financial, and economic issues and will make specific recommendations on policy, regulatory, and legislative changes. It will be completed by July 1991.

3. Analysis of Other Import and Distribution Options

In addition to the above liberalization measures, USAID will reinforce World Bank and GRM efforts to analyze import and distribution systems for petroleum products in general in order to create a more efficient domestic petroleum market. In mid-1991, Arthur D. Little will complete a World Bank-financed study for the GRM which examines the relative advantages of rehabilitating Mozambique's refinery to allow the importation of crude oil versus continuing to import refined products. The results of this analysis will be incorporated into a second study, also financed by the World Bank, on importation, distribution, and storage systems. The Government will review the results of these studies with USAID and discuss follow-up measures to continue to increase the efficiency of the importation and marketing of petroleum products.

E. Foreign Exchange and Local Currency Management

Disbursements for petroleum imports will be made through a Commodity Import Program, as is the case for all other commodities financed under the PSSP. As discussed in the Procurement Plan below, Petromoc will be the importing agent for diesel and gasoline. Operational procedures for the CIP will be the same as those utilized for all other commodities financed under the PSSP. Priorities, procedures, and controls for the use of local currency generated by petroleum imports authorized under this amendment will be as described in the original Private Sector Support Program PAAD.

F. Procurement Plan

This procurement plan focuses on the purchase of approximately 40,000 metric tons of Super 93 gasoline to be financed using funds obligated under the Private Sector Support Program in FY 1989 and FY 1990. It is anticipated that other petroleum products may be purchased at a subsequent time. Plans and procedures for such procurement(s) may be agreed upon with the GRM through a Project Implementation Letter or incorporated into subsequent amendments to the PSSP.

1. Responsible Entities

Petromoc, a parastatal responsible for the import of all petroleum products to Mozambique, will be the entity responsible for the purchase of the diesel and gasoline financed under the PSSP. As discussed above, USAID, with AID/W concurrence, agreed to allow a state-owned company access to program funds because: (1) fuel is critical to agriculture, the program's target sector; and (2) use of the funds for fuel at the secondary market exchange rate will encourage the institutionalization of a market-based system of foreign exchange allocation.

The Regional Commodity Management Officer has conducted an examination of the capability of Petromoc to undertake the purchase of gasoline and other petroleum products. Based on a review of Petromoc's standard procurement procedures and its good record on previous USAID-funded procurements, he recommended the use of host country procedures, under careful USAID guidance.

USAID will review each step in the procurement process, including the draft Invitation for Bids, the selection, and the final award and contract. The final award will be subject to the formal approval of the Mission Director after consultation with the RCMO and RLA.

2. Procurement Procedures

Because of the limited availability of counterpart funds and the short shelf life of gasoline, Petromoc has requested four shipments of approximately 10,000 metric tons each, three months apart. Given the volatility of the petroleum market and the likelihood that prices will vary by 20 percent or more over the period, two Invitations for Bids (IFBs) will be issued, one by April 1, 1991* and the second six months later. Both IFBs will be for two shipments, the first 30 days after award and the second three months later. The basis for award will be the lowest price relative to the Platt's Oilgram** price on the date of the bill of lading. The availability of both IFBs was advertised at the same time in the Commerce Business Daily and the A.I.D. Procurement Information Bulletin. All suppliers requesting the first IFB will receive a copy of the second when it is issued.

3. Source and Origin

Since the U.S. is a net importer of petroleum products, since the authorized source/origin for the PSSP-obligated funds is A.I.D. Geographic Code 935, and since Mozambique's usual suppliers are based in Kenya, South Africa, and the Gulf, the source and origin of the gasoline will almost certainly be a Gulf State included in Code 935, Nigeria, or Kenya.

4. Shipping

If no U.S. ship is available, the program will finance the shipment of the non-U.S. source petroleum on 935 vessels. In order to meet the terms of the Cargo Compliance Act, suppliers will be required to advertise the availability of the cargo in the Transportation News Ticker 30 days before the expected loading date. If no U.S. flag vessel responds to the advertisement, MS/OP/TRANS will issue a Determination of Non-Availability.

* The IFB, issued on April 1, stated clearly that the resulting contract is subject to the availability of funds. Petromoc will not award the contract until after this PAAD amendment is authorized.

** Platt's Oilgram is a daily compilation of prices for petroleum products. It is the benchmark for the industry.

5. Procurement Schedule

CBD notice covering both IFBs published	March 15, 1991
First IFB, covering first two shipments, issued to suppliers	April 1, 1991
Bids for first two shipments received	May 17, 1991
Award made for first two shipments	May 24, 1991
Letter of Commitment (L/Com) issued for first shipment	May 31, 1991
First shipment of 10,000 tons arrives Maputo	July 20, 1991
L/Com for second shipment issued	August 14, 1991
Second IFB, covering third and fourth shipments, issued	September 1, 1991
Bids for third and fourth shipments received	September 27, 1991
Award made for third and fourth shipments	October 11, 1991
Second shipment of 10,000 tons arrives Maputo	October 15, 1991
L/Com issued for third shipment	October 15, 1991
Third shipment of 10,000 tons arrives Maputo	December 15, 1991
L/Com issued for fourth shipment	January 15, 1992
Fourth shipment of 10,000 tons arrives Maputo	March 31, 1992

Annex A

AID/W Concurrence Cable

ACTION: AID-3 INFO: AMB DCM

VZCZCT00908
RR RUEHTO
DE RUEHC #8494/01 0722226
ZNR UUUUU ZZH
R 192225Z MAR 91
FM SECSTATE WASHDC
TO RUEHTO/AMEMBASSY MAPUTO 5245
INFC RUEHMB/AMEMBASSY MBABANE 1362
RUEHNR/AMEMBASSY NAIROBI 0332
BT
UNCLAS SECTION 01 OF 04 STATE 028494

LQC: 115 511
20 MAR 91 2235
CN: 12402
CHRG: AID
DIST: AID

1991 3.20.

Proc

AIDAC MBABANE FOR RLA; NAIROBI FOR REDSO

E.O. 12356: N/A

TAGS:

SUBJECT: MOZAMBIQUE PRIVATE SECTOR SUPPORT PROJECT
(656-0208): PAAL AMENDMENT NO. 3 -- EVOLVING STRATEGIES
ON FOREIGN EXCHANGE MANAGEMENT

(GORDON AND PHILLIPS)

REFS: (A) PASCUAL/BROWN TELECON, 1/31/91; (B)
PASCUAL/ROZILL TELECONS, 2/1/91, 1/29/91; (C) USAID/
MOZAMBIQUE BRIEFING PAPERS FOR CG, 11/90; (D) AN
EXAMINATION OF THE FX ALLOCATION SYSTEM IN MOZAMBIQUE,
11/90; (E) CONSULTATIVE GROUP PLEDGING STATEMENT, 12/90;
(F) 90 MAPUTO 4318

CPA SUBJECT

Noted

*656-0208
FY 91 Correspond*

SUMMARY:

1. THIS CABLE RESPONDS TO THE OPTIONS AND ANALYSES
PRESENTED IN REFS A-D CONCERNING THE PROGRAMMING OF
USAID/MOZAMBIQUE'S ASSISTANCE UNDER THE PRIVATE SECTOR
SUPPORT PROGRAM (656-0208). AID/W CONCURS WITH
REPROGRAMMING ALL OR A PORTION OF THE FUNDS ALREADY
OBLIGATED UNDER THE PSSP TO FINANCE PETROLEUM IMPORTS
NOTING THAT THE MISSION WILL OBTAIN GRM CONCURRENCE ON

ADDITIONAL POLICY REFORMS ON PRICING OF SPECIFIC
PETROLEUM PRODUCT(S). FOR THE PLANNED FY 1991
AUTORIZATION/OBLIGATION OF LOLS 12.590 MILLION, AID/W
ENCOURAGES THE MISSION TO FOCUS ESPECIALLY ON OBJECTIVE
NO. 4 UNDER THE PSSP AS APPROVED ESTABLISHMENT OF A
PROCESS OF TESTING FX ALLOCATION OPTION THAT WILL
INCREASE THE ACCESS OF PRIVATE ENTREPRENEURS IN THE
AGRICULTURAL SECTOR TO FX, AND INSTITUTIONALIZATION OF
MARKET SIGNALS AS AN ALLOCATION MECHANISM. THE GUIDANCE
HEREIN ASSUMES THAT USAID WILL CONTINUE TO PURSUE
PROGRESS ON THE AGRICULTURAL AND MARKETING REFORM
MEASURES OUTLINED IN AMENDMENT NUMBER 2 TO THE PRIVATE
SECTOR SUPPORT PROGRAM. OUR COMMENTS FOCUS ON EXCHANGE
RATE MANAGEMENT QUESTIONS GIVEN THE ISSUES RAISED BY
RECENT POSITIVE MEASURES TO CREATE A SECONDARY FOREIGN
EXCHANGE MARKET IN WHICH THE EXCHANGE RATE IS DETERMINED
BY SUPPLY AND DEMAND WITHIN THAT MARKET.

GENERAL STRATEGY ON CREATING A FX MARKET:

2. UNDER THE PRIVATE SECTOR SUPPORT PROGRAM, USAID UNDERTOOK TO QUOTE TEST POLICY AND PROCEDURAL OPTIONS TO BOTH INCREASE THE ACCESS OF PRIVATE ENTREPRENEURS IN THE AGRICULTURAL SECTOR TO FOREIGN EXCHANGE AND INSTITUTIONALIZE MARKET PRINCIPLES AS A BASIS FOR FOREIGN EXCHANGE ALLOCATIONS. UNQUOTE. THE MISSION INITIALLY PROPOSED TO SUPPORT THE GPM/WORLD BANK EXPERIMENT WITH AN OPEN GENERAL LICENSE SYSTEM CALLED THE SNAAD. AID/W HAS NOTED THE LIMITATIONS OF THE SNAAD OUTLINED IN REFS C AND D. WE ALSO AGREE THAT, WITH THE INTRODUCTION OF THE NEW SECONDARY MARKET, IT MAKES SENSE NEITHER TO SUPPORT THE SNAAD AS A POLICY MEASURE NOR TO CONSIDER CHANNELING A.I.D. FUNDS THROUGH THE SNAAD WHICH CONTINUES TO FUNCTION AT AN OVERVALUED OFFICIAL EXCHANGE RATE.

3. AS DISCUSSED IN REFS A AND B, THE RECENT CHANGES IN EXCHANGE RATE POLICY OFFER AN OPPORTUNITY TO EXPEDITE THE TRANSITION TOWARD A FUNCTIONING FOREIGN EXCHANGE MARKET IF THE GOVERNMENT AND DONORS CONCUR ON A SOUND STRATEGIC FRAMEWORK TO ACHIEVE MARKET PRICING AND ALLOCATION OF FOREIGN EXCHANGE WITHIN A REASONABLE TIMEFRAME. AID/W'S UNDERSTANDING IS THAT THERE ARE THREE COMPONENTS TO THIS STRATEGY.

A. UNIFICATION OF THE EXCHANGE RATES. THE GRM HAS

AGREED WITH THE IMF ON A PROGRAM TO PROGRESSIVELY DEVALUE THE OFFICIAL EXCHANGE RATE IN ORDER TO UNIFY THE OFFICIAL AND SECONDARY MARKETS AT AN EQUILIBRIUM EXCHANGE RATE BY DECEMBER 1992. THE IMF IS THE LEAD DONOR FOR MONITORING AND ENSURING COMPLIANCE. WE UNDERSTAND FROM REF F THAT COMPLIANCE WITH THE OBJECTIVES OF THE EXPANDED STRUCTURAL ADJUSTMENT FACILITY (ESAF) WAS CONSIDERED SATISFACTORY DURING THE LAST ARTICLE IV CONSULTATIONS IN OCTOBER 1990. THE NEXT CRITICAL REVIEW WILL BE IN MAY 1991 AFTER COMPLETION OF THE FIRST FULL YEAR OF THE 1990-1992 ESAF PROGRAM.

B. CONSOLIDATION OF FX MARKETS. THERE IS A NEED FOR A PHASED MOVEMENT OF SECTORS FROM THE OFFICIAL TO THE SECONDARY MARKET (FOR BOTH IMPORTS AND EXPORTS). TO IMPLEMENT THIS COMPONENT OF THE STRATEGY, THE GRM AND DONORS MUST COORDINATE FOREIGN EXCHANGE DISBURSEMENTS TO ENSURE THAT, FOR ANY GIVEN COMMODITY, ONLY ONE SINGLE RATE APPLIES TO IMPORT AND EXPORT TRANSACTIONS. AID/W

CONCURS WITH USAID'S PROPOSED INVOLVEMENT IN THIS COMPONENT OF THE STRATEGY, PARTICULARLY TO FACILITATE QUICK MOVEMENT ON CONVERTING A GREATER SHARE OF EXPORTS AT THE SECONDARY RATE TO MAKE IT EASIER FOR THESE INDUSTRIES TO GROW AND RESTORE THEIR PROFITABILITY.

C. INSTITUTIONALIZATION OF THE OPEN (SECONDARY) MARKET. THERE IS, FINALLY, A NEED TO INSTITUTIONALIZE PROCEDURES FOR THE SECONDARY MARKET TO OPERATE. GIVEN THAT DONORS PROVIDE 80 PERCENT OF MOZAMBIQUE'S FX, THESE PROCEDURAL MATTERS ARE CRITICAL TO THE MEANINGFUL UNIFICATION OF THE OFFICIAL AND SECONDARY MARKETS AT A RATE CLOSE ENOUGH TO THE PARALLEL MARKET RATE SO THAT THE DIFFERENTIAL IS LIMITED TO A REASONABLE PREMIUM ON CAPITAL FLIGHT. OF CRITICAL CONCERN IS THAT THE CENTRAL BANK HAS THE TECHNICAL CAPACITY TO MANAGE FLOWS OF FOREIGN EXCHANGE SO THAT THE EXCHANGE RATE INDUCES A CREDIBLY RAPID RATE OF GROWTH IN EXPORT EARNINGS AND EFFECTIVELY FORESTALLS THE EMERGENCE OF A HIGHER PARALLEL MARKET EXCHANGE RATE. THE WORLD BANK, WE UNDERSTAND, IS PROVIDING EXTENSIVE TECHNICAL ASSISTANCE TO THE BANK OF MOZAMBIQUE (BOM), BUT THAT IT WILL NEVERTHELESS TAKE SOME TIME BEFORE THE BOM MASTERS MANY BASIC FUNCTIONS OF A CENTRAL BANK. TO THE EXTENT THAT WE LACK CONFIDENCE IN THE BOM'S ABILITIES WE MAY NEED TO CONTINUE TO DISBURSE FUNDS THROUGH A CIP MECHANISM RATHER THAN A CASH TRANSFER.

D. THE PAAD AMENDMENT ANALYSIS NEEDS TO EXPLAIN THE NEXUS OF THE FX REFORMS THAT THE AMENDMENT IS SUPPORTING IN THE PRIVATE AGRICULTURAL SECTOR. AID/W UNDERSTANDS THAT FOR THE FX FOCUS ON TRANSPORT MOST OF THE TRANSPORT MAY WELL BE IN THE PRIVATE AGRICULTURAL AREA, AND THAT THE EXPORTS THAT THE AMENDMENT'S REFORM WILL FOCUS ON MAY WELL BE AGRICULTURAL EXPORTS.

UNDISBURSED PSSP OBLIGATIONS:

4. IN LIGHT OF THE ABOVE STRATEGIC FRAMEWORK, AID/W CONCURS WITH USAID/MOZAMBIQUE'S PROPOSAL TO UTILIZE ALL OR A PORTION OF THE UNDISBURSED OBLIGATIONS UNDER THE PSSP TO FINANCE PETROLEUM IMPORTS. REF C IS CLEAR IN DESCRIBING THE REASONS WHY IT IS NOT PRESENTLY FEASIBLE TO FINANCE IMPORTS ON THE ORIGINAL COMMODITY LIST GIVEN THAT USAID MUST PROVIDE ASSISTANCE AT THE SECONDARY MARKET RATE WHILE IMPORTERS CAN STILL OBTAIN FINANCING UNDER OTHER DONOR PROGRAMS AT THE OFFICIAL EXCHANGE RATE. AS DISCUSSED IN PARA 3 (B) ABOVE, THIS MATTER MUST BE RESOLVED THROUGH DONOR COORDINATION. YET WE ALSO RECOGNIZE THAT IT IS A TEMPORARY IMPLEMENTATION SETBACK TO WHAT IS AN OTHERWISE POSITIVE DEVELOPMENT IN THE CREATION OF A SECOND, MARKET-DRIVEN FOREIGN EXCHANGE WINDOW.

5. THE NEED FOR CONTINUING ASSISTANCE IS FULLY DOCUMENTED IN REFS C, D, AND F. THE RATIONALE FOR FINANCING TRANSPORT RELATED IMPORTS IS SET FORTH IN AMENDMENT NUMBER 2 TO THE PSSP AS PART OF A STRATEGY TO

PROMOTE AGRICULTURAL MARKETING REFORMS. WE RECOGNIZE THAT PETROLEUM IS AN ESSENTIAL COMPONENT OF THE TRANSPORT AND MARKETING EQUATION AND EXPRESSED OUR GENERAL CONCURRENCE WITH THE CONCEPT OF FINANCING PETROLEUM IN THE U.S. PLEDGE AT THE DECEMBER CONSULTATIVE GROUP MEETING (REF E). REF C ALREADY SETS FORTH A BASIC CASE FOR PETROLEUM FINANCING, AND WE EXPECT THAT USAID WILL EXPAND ON THIS ARGUMENT IN A PAAD AMENDMENT AS DISCUSSED BELOW IN PARA 10.

6. AS USAID IS AWARE, ALL FUNDS PRESENTLY OBLIGATED UNDER THE PSSP ARE AUTHORIZED ONLY FOR CIP DISBURSEMENT. ANY IMPORTS OF PETROLEUM PRODUCTS MUST THEREFORE BE DONE THROUGH A CIP MECHANISM. MOREOVER, THESE TRANSACTIONS MUST OCCUR AT THE SECONDARY MARKET EXCHANGE RATE SINCE IT IS THE HIGHEST LEGAL RATE OF

EXCHANGE THAT IS NOT UNLAWFUL IN MOZAMBIQUE. IT IS AID/W'S UNDERSTANDING THAT USAID WILL NEGOTIATE SPECIFIC PETROLEUM PRICING REFORMS THAT WILL RESULT IN IMPORTED PRODUCTS BEING SOLD TO THE PUBLIC AT IMPORT PARITY USING THE SECONDARY MARKET RATE.

6A. AID/W UNDERSTANDS THAT PETROLEUM IMPORTS MAY WELL BE CRUDE PETROLEUM, WHICH WILL NOT RAISE AN ISSUE OF INELIGIBLE COMPONENTRY THAT MIGHT BE PRESENT IN THE CASE OF FINANCING REFINED PRODUCTS. UNDER A.I.D. SOURCE/ORIGIN RULES, ANY COMPONENT (I.E., CRUDE OIL GOING INTO THE PRODUCTION OF A REFINED PRODUCT) FROM A NON-935 COUNTRY (E.G., LIBYA, IRAN, SYRIA) MAKES THE END COMMODITY INELIGIBLE FOR A.I.D. FINANCING. WHILE IRAQ AND KUWAIT ARE INCLUDED IN CODE 935, AND THUS ELIGIBLE UNDER A.I.D.'S SOURCE/ORIGIN/NATIONALITY/COMPONENTRY

RULES AND THE PAAD, THE MISSION SHOULD ENSURE THAT THE PROCUREMENT COMPLIES WITH THE IRAQ SANCTIONS ACT OF 1990 AND THE IRAQ/KUWAIT EMBARGO EXECUTIVE ORDERS AS IN EFFECT AT THE RELEVANT TIME. PROCUREMENT SHOULD ALSO NOT PERMIT IRAQ/KUWAIT COMMODITY SIMPLY BECAUSE THE SANCTIONS ACT/EXECUTIVE ORDERS PROHIBITIONS IN EFFECT AT THE RELEVANT TIME MAY NOT REACH COMMODITY.

6E. AN IEE REQUESTING A NEGATIVE DETERMINATION FOR PETROLEUM WILL BE REQUIRED. A CATEGORICAL EXCLUSION UNDER REG. 16 SECTION 216.2(C) (2)(IX) IS NOT APPROPRIATE SINCE A.I.D. HAS KNOWLEDGE OF THE SPECIFIC COMMODITY TO BE FINANCED.

7. CONCERNING PSSP COMMODITY IMPORTS, AID/W RECOGNIZES THAT WE MIGHT AGAIN BE ABLE TO COMPETITIVELY FINANCE SOME OF THE ITEMS ON THE ORIGINAL COMMODITY LIST DEPENDING ON: (A) THE MISSION'S SUCCESS IN WORKING WITH THE GRM AND DONORS TO PHASE SECTOR(S) FROM THE OFFICIAL TO THE SECONDARY MARKET; AND/OR (B) THE SPEED AT WHICH THE GRM DEVALUES THE OFFICIAL EXCHANGE RATE. HENCE, SOME FLEXIBILITY IN OUR FINANCING DECISIONS IS DESIRABLE, AND IT MAY MAKE SENSE TO AGREE TO PETROLEUM IMPORTS IN TRANCHES IN ORDER TO AVOID FORECLOSING OTHER FINANCING OPTIONS AS THEY DEVELOP.

FY 1991 PSSP OBLIGATIONS:

8. ASSUMING THAT THE SPECIFIC AGRICULTURAL/MARKETING REFORMS CONTAINED IN THE PSSP POLICY REFORM FRAMEWORK

CONTINUE ON TRACK, IT IS AID/W'S UNDERSTANDING THAT THE KEY REFORM TO BE PURSUED PRIOR TO OBLIGATION OF THE FY 1991 TRANCHE OF LOLS 12.590 MILLION IS THE PHASING OF SPECIFIC SECTOR(S) FROM THE OFFICIAL TO THE SECONDARY FOREIGN EXCHANGE MARKET. USAID HAS INITIALLY INDICATED ITS INTENT TO HIGHLIGHT TRANSPORT, PENDING FURTHER DISCUSSIONS WITH THE WORLD BANK AND OTHER DONORS FINANCING TRANSPORT IMPORTS. WE ALSO ENCOURAGE THE MISSION TO INCORPORATE INTO THE REFORM PACKAGE GREATER FLEXIBILITY IN CONVERTING APPROPRIATE EXPORTS AT THE SECONDARY MARKET RATE IN ORDER TO ENHANCE THE COMPETITIVENESS OF MOZAMBIKAN EXPORTS SINCE THIS IS AN APPROVED AREA FOR POLICY REFORM.

9. AS THE FY 1991 PSSP TRANCHE HAS NOT YET BEEN AUTHORIZED, USAID MAY CONSIDER THE POSSIBILITY OF DISBURSING VIA CASH TRANSFER IF THIS WOULD CONTRIBUTE TO A FUNCTIONING FOREIGN EXCHANGE MARKET AND IF THE CENTRAL BANK CAN COMPLY WITH A.I.D. SEPARATE ACCOUNT AND DOLLAR TRACKING REQUIREMENTS. OTHERWISE WE WOULD EXPECT USAID TO CONTINUE WITH A CIP.

DOCUMENTATION REQUIREMENTS:

10. OBLIGATED FUNDS. FOR FUNDS THAT HAVE ALREADY BEEN OBLIGATED UNDER THE PSSP BUT NOT DISBURSED, USAID SHOULD PREPARE AND APPROVE A PAAD AMENDMENT IN THE FIELD,

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TOWARD RESOLVING THESE PROBLEMS, AND ENCOURAGE YOU TO
CONTINUE TO WORK CLOSELY WITH OTHER DONORS TO CHART A
CLEAR COURSE TOWARD MARKET ALLOCATION AND PRICING OF
FOREIGN EXCHANGE AS AFFECTING THE PRIVATE AGRICULTURAL
SECTOR. BAKER

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Annex B

**Private Sector Support Program
1991 Progress Report on Policy Reform Agenda**

UNCLASSIFIED

MAPUTO 1282

VZCZCTOI *

PP RUEHC RUEHR

DE RUEHTO #1282/01 095 **

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FM AMEMBASSY MAPUTO

TO RUEHC / SECSTATE WASHDC PRIORITY 3132

INFO RUEHR / AMEMBASSY NAIROBI 5539

BT

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CLASS: UNCLASSIFIED
CHRG: AID 04/04/91
APPRV: AMB:TFRIEDMAN
DRPTD: PRM:JBORN/CPA
CLEAR: L.DCM:MMETELI;
2.ADIR:JMILLE;
DISTR: AID4 AMB DCM

AIDAC

AID/W FOR AFR/PD/SA AND AFR/SA
NAIROBI FOR REDSO/ESA

Peog

E.O. 12356: N/A

SUBJECT: MOZAMBIQUE PRIVATE SECTOR SUPPORT PROGRAM
(656-0208/18): 1991 PROGRESS REPORT ON POLICY REFORM

AGENDA

REF: (A) 90 MAPUTO 1336, (B) 90 STATE 235374, (C) MAPUTO
131, (D) STATE 8494; (E) MAPUTO 896; (F) MAPUTO 998

1. THIS CABLE SUMMARIZES PROGRESS IN ACHIEVING THE
1990/91 POLICY REFORM BENCHMARKS UNDER THE MOZAMBIQUE
PRIVATE SECTOR SUPPORT PROGRAM (PSSP). USAID EXPECTS TO
DISCUSS IMPLICATIONS OF THIS PROGRESS AND RELATED
CIRCUMSTANCES WITH AFR DURING CURRENT AID/W VISIT OF
USAID DIRECTOR.

SUMMARY

2. THE GRM CONTINUED IN 1990 TO PROGRESS WITH ECONOMIC
REFORM MEASURES, IN PARTICULAR ALLOWING THE MARKET TO
PLAY A MORE FUNDAMENTAL ROLE IN DETERMINING THE PRICES OF
BASIC COMMODITIES SUCH AS MAIZE. HOWEVER, 1990 MIGHT BE
MOST ACCURATELY CHARACTERIZED AS A YEAR OF POLITICAL
OPENING AND TRANSITION. THE GOVERNMENT AND RENAMO HAVE
ENTERED INTO DIRECT NEGOTIATIONS, ALTHOUGH NOT WITHOUT
FITS AND STARTS. IN DECEMBER 1990 THE GOVERNMENT ENACTED
A NEW CONSTITUTION AFTER AN EXTENSIVE AND OPEN PUBLIC
DEBATE. THE CONSTITUTION PROVIDES FOR MULTIPARTY
ELECTIONS AND FREEDOM OF THE PRESS, ENCOURAGES
DECENTRALIZATION OF GOVERNMENT, AND DROPS THE PREVIOUS
CONSTITUTION'S MARXIST RHETORIC. THESE POLITICAL
DEVELOPMENTS ARE CRITICAL CONTEXTUAL FACTORS BOUND TO
INFLUENCE THE CONTINUING SHIFT FROM A CENTRALLY PLANNED
TO A MARKET-BASED ECONOMY.

3. IN RELATION TO THE PRIVATE SECTOR SUPPORT PROGRAM,
THE GRM FULLY MET AGREED UPON TARGETS FOR PRICING POLICY
REFORMS. FIXED PRODUCER PRICES HAVE BEEN ABOLISHED IN
FAVOR OF MINIMUM PRICES INTENDED TO PROTECT PRODUCERS AS
MARKETS RE-EMERGE BUT SUFFER FROM LACK OF COMPETITION.
CONSUMER PRICES FOR MAIZE, BEANS AND RICE HAVE BEEN

READJUSTED TO OVERCOME MARKETING DISINCENTIVES CREATED BY PREVIOUSLY INADEQUATE MARGINS BETWEEN PRODUCER AND CONSUMER PRICES. SOME DELAYS -- TO SOME EXTENT BUREAUCRATIC -- HAVE BEEN ENCOUNTERED IN ENACTMENT OF PSSP MARKETING REFORMS. THIS ISSUE HAS BEEN RAISED AT SENIOR LEVELS OF GOVERNMENT AND A PROCESS HAS BEEN INITIATED UNDER THE PRIME MINISTER'S REVIEW TO REMOVE RESTRICTIONS ON INTER-PROVINCIAL AND INTER-DISTRICT TRADE AND TO ALLOW OPEN COMPETITION AMONG DISTRICT-LEVEL WHOLESALERS. COMMODITY IMPORTS UNDER THE PSSP CONTINUE TO SUPPORT THE PRIVATE SECTOR. INDEED, WE HAVE NOTED INCREASED GOVERNMENT EMPHASIS ON PRIVATE SECTOR ACCESS TO FOREIGN EXCHANGE ACROSS ITS IMPORT SUPPORT PROGRAMS.

4. IMPLEMENTATION OF FOREIGN EXCHANGE REGIME REFORMS AND STATE FARM DIVESTITURES HAS PROVED MORE COMPLEX THAN THE OTHER PSSP PRICING AND MARKETING POLICIES. CONFLICTING EMPHASES FROM THE WORLD BANK AND IMF, ANALYZED IN DETAIL IN REFS E AND F, HAVE COMPLICATED THE PROCESS OF DEVELOPING A CLEAR STRATEGY LEADING TO MARKET-BASED ALLOCATION AND PRICING OF FOREIGN EXCHANGE. THE GRM HAS, IN FACT, MET THE SPECIFIC TARGETS AGREED UPON FOR 1990/91 WITH THE EXPANSION OF ITS OPEN GENERAL LICENSE EXPERIMENT AND THE CREATION OF A SECONDARY FOREIGN EXCHANGE MARKET. WE ARE NONETHELESS CONCERNED THAT MORE INTENSIVE OVERSIGHT FROM THE WORLD BANK AND IMF ARE NEEDED TO MAKE THESE INITIATIVES WORK (AGAIN, SEE REFS E AND F). STATE FARM DIVESTITURES, AS PREDICTED IN NOVEMBER 1990 CORRESPONDENCE ON THE ECONOMIC DEVELOPMENT IMPLICATIONS OF CONSTITUTIONAL REFORM, HAVE ASSUMED A HEIGHTENED SENSE OF POLITICAL SENSITIVITY WITH THE ANTICIPATED ADVENT OF ELECTORAL POLITICS AND THE DEMOBILIZATION OF MILITARY FORCES. ALTHOUGH ACTUAL DIVESTITURES INDEED CONTINUE, ATTEMPTS TO FORMULATE A CLEAR SET OF GUIDELINES FOR THE DIVESTITURE PROCESS HAVE BEEN ENSNARED IN THE POLITICAL PROCESS. THE GOVERNMENT, NEVERTHELESS, CONTINUES TO COMPLY WITH CREDIT AND SUBSIDY RESTRICTIONS ON PARASTATALS WHICH ARE SQUEEZING MANY STATE FARMS OUT OF EXISTENCE. THEY HAVE ALSO REQUESTED CONTINUED U.S. SUPPORT TO ANALYZE AND RATIONALIZE DIVESTITURE POLICIES.

5. ON THE WHOLE WE BELIEVE THAT GRM PERFORMANCE IN 1990

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UNDER THE PSSP MERITS CONTINUED U.S. SUPPORT. THE KEY ISSUE REQUIRING RESOLUTION IS THE Delineation OF A COGENT FOREIGN EXCHANGE REGIME REFORM STRATEGY. THIS WILL DEPEND MOST CRITICALLY ON IMPROVED COORDINATION BETWEEN THE WORLD BANK AND IMF. SPECIFIC SUGGESTIONS FOR A COORDINATED STRATEGY ARE SET FORTH IN REF B. ASSUMING THAT THE MULTILATERAL AGENCIES CAN DEVELOP A WORKABLE STRATEGY LEADING TO AN EXCHANGE SYSTEM THAT REFLECTS MARKET FORCES, USAID BELIEVES CONDITIONS WILL HAVE BEEN MET TO ALLOW US TO CONTINUE OUR SECTORAL ASSISTANCE PROGRAM. WE BELIEVE THAT THE WORLD BANK AND IMF ARE NOW SEIZED WITH MEETING THIS NEED.

BACKGROUND

6. IN APRIL 1990, REF A REPORTED ON POLICY REFORM PROGRESS DURING THE FIRST YEAR OF PSSP IMPLEMENTATION, AND SET OUT THE 1990/91 BENCHMARKS USAID EXPECTED THE GRM TO PROPOSE AS THE BASIS FOR OBLIGATING THE 1990 PSSP FUNDING INCREMENT. ON JULY 3, 1990, USAID RECEIVED THE GRM'S UPDATED "LETTER OF INTENT" DETAILING STEPS THE GOVERNMENT INTENDED TO TAKE IN 1990/91 IN EACH OF THE POLICY AREAS TARGETED BY THE PSSP. BASED ON THE UPDATED LETTER OF INTENT, THE FY 1990 INCREMENT WAS OBLIGATED FOR DISBURSEMENT THROUGH THE USAID CIP.

7. CONCURRENTLY DURING APRIL-JUNE 1990, USAID PREPARED A PAAD AMENDMENT ADDRESSING MARKETING POLICIES AND INCENTIVES, AND PROPOSED THAT AN ADDITIONAL DOLS 10 MILLION IN AERPR FUNDING BE PROVIDED THROUGH THE PSSP/CIP FOR TRUCKS AND SPARE PARTS IN SUPPORT OF EXPANDED PRIVATE SECTOR MARKETING ACTIVITIES IN THE THREE NORTHERN PROVINCES OF MOZAMBIQUE. SPECIFIC POLICY REFORM MEASURES INCORPORATED INTO THE ABOVE MENTIONED LETTER OF INTENT FOCUSED ON THE LIBERALIZATION OF AGRICULTURAL MARKETING, PARTICULARLY THE LIFTING OF REGULATORY RESTRICTIONS HAMPERING COMPETITION. WITH AID/W'S GUIDANCE (REF B) USAID OBLIGATED THESE AERPR FUNDS ON JULY 20, 1990, BRINGING PSSP WPA OBLIGATIONS TO DATE TO DOLS 36.05 MILLION AND THE EXPECTED LOP TOTAL TO DOLS 54.05 MILLION. (IN ADDITION TO THE NON-PROJECT ASSISTANCE, THE PSSP PROVIDES PROJECTIZED TECHNICAL AND RELATED ASSISTANCE IN SUPPORT OF THE POLICY REFORMS THROUGH 656-0218, PRIVATE SECTOR SUPPORT TECHNICAL ASSISTANCE PROJECT; PLANNED LOP FOR PROJECT ACTIVITIES IS DOLS THREE MILLION.)

8. THE PSSP'S PURPOSE IS TO IMPROVE INCENTIVES FOR PRIVATE SECTOR AGRICULTURAL PRODUCTION IN ORDER TO ENHANCE THE PRIVATE AGRICULTURAL SECTOR'S PRODUCTION AND INCOME. SPECIFIC POLICY OBJECTIVES OF THE PROGRAM, AS STATED IN THE PAAD'S "SUMMARY OF POLICY OBJECTIVES AND WORKPLAN" MATRIX (JULY 1990 REVISION) ARE:

A. TO MAXIMIZE THE LIBERALIZATION OF THE AGRICULTURAL PRICING SYSTEM AND, FOR CROPS WHERE FULL DEREGULATION MAY

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NOT BE PRESENTLY FEASIBLE, INSTITUTIONALIZE PROCEDURES FOR BASING AGRICULTURAL PRICES ON WORLD PARITY.

- B. TO DEVELOP AND INITIATE THE IMPLEMENTATION OF A DIVESTITURE PROGRAM (INCLUDING SUPPORTING POLICIES FOR RATIONAL LAND REDISTRIBUTION, TITLING, AND REGISTRATION) TO REDISTRIBUTE STATE FARMS TO COMMERCIAL FARMERS.
- C. TO DEMONSTRATE THE EFFECTIVENESS AND VIABILITY OF PRIVATE SALES AND SERVICE NETWORKS FOR PROVIDING AGRICULTURAL INPUTS TO COMMERCIAL AND FAMILY FARMERS THROUGHOUT THE COUNTRY.
- D. TO ESTABLISH A PROCESS OF TESTING FOREIGN EXCHANGE ALLOCATION OPTIONS THAT WILL INCREASE THE ACCESS OF PRIVATE ENTREPRENEURS IN THE AGRICULTURAL SECTOR TO FOREIGN EXCHANGE AND INSTITUTIONALIZE MARKET SIGNALS AS AN ALLOCATION MECHANISM.
- E. TO REDUCE RESTRICTIONS ON COMPETITIVE PRIVATE SECTOR TRADE AND TRANSPORTATION SERVING AGRICULTURAL PRODUCERS IN CABO DELGADO, NAMPULA, AND ZAMBEZIA PROVINCES.

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9. FOR REPORTING PURPOSES, THIS CABLE STATES, UNDER EACH OF THE FIVE POLICY AREAS, THE BENCHMARKS OUTLINED IN THE PAAD AND GOVERNMENT'S POLICY AS DESCRIBED IN THE UPDATED LETTER OF INTENT (FULL TEXT OF THIS LETTER OF INTENT IS CONTAINED IN ANNEX F OF JULY 1990 PAAD AMENDMENT NUMBER TWO). A DISCUSSION THEN FOLLOWS ON ACTUAL POLICY PERFORMANCE. SPECIFIC MEASURES ARE THEN PROPOSED FOR THE 1991/92 PROGRAM.

POLICY DIALOGUE

10. USAID-GRM POLICY DIALOGUE HAS GROWN MORE TIME-CONSUMING AND COMPLEX OVER THE PAST YEAR. AS DISCUSSED IN REF A, A USAID-GRM (INTERMINISTERIAL) WORKING GROUP ON FOOD SECURITY AND AGRICULTURE POLICY WAS SET UP BY THE MINISTER OF FINANCE IN CONNECTION WITH THE PSSP, AND PROVED CRITICAL TO THE EARLY STAGES OF PSSP POLICY REFORM. OTHER DONORS SOUGHT TO ESTABLISH SIMILAR WORKING GROUPS TO ADDRESS POLICY AND IMPLEMENTATION ISSUES ON THEIR PROGRAMS. BOTH GOVERNMENT AND DONORS HAVE NOW HAD TO FACE UP TO THE AGGREGATE NEGATIVE EFFECTS OF THE DOZENS OF SUCH SPECIAL TASK FORCES AND WORKING GROUPS SET UP IN RECENT YEARS. BY DRAWING ON THE SAME FEW KEY GOVERNMENT ANALYSTS OVER AND OVER AGAIN FOR SUCH SPECIAL ACTIVITIES, THE WORKING GROUP APPROACH WAS SEEN TO RISK COMPROMISING PROGRESS TOWARD THE GOVERNMENT'S OVERARCHING OBJECTIVE OF TRANSPARENT AND EFFICIENT USE OF RESOURCES FOR REAL PRIORITIES.

11. IN THE PSSP'S SECOND YEAR, DIRECT DIALOGUE WITH KEY MINISTRIES HAS GROWN IN IMPORTANCE. THE KEY ACTORS IN THIS DIALOGUE HAVE BEEN THE VICE MINISTERS OF AGRICULTURE (FOR PRODUCTION POLICY AND STATE FARM DIVESTITURE ISSUES) AND COMMERCE (FOR MARKETING AND CONSUMER PRICING POLICIES). THESE INDIVIDUALS HAVE SUFFICIENT STATURE IN GOVERNMENT THAT THEY CAN DRAW IN THE APPROPRIATE TECHNICAL EXPERTISE TO ADDRESS SPECIFIC TECHNICAL ISSUES. WE HAVE ALSO FOUND THAT WE HAVE HAD CONSISTENT ACCESS TO THEM AND THEIR STAFFS. DISCUSSIONS ON FOREIGN EXCHANGE REGIME REFORMS HAVE NECESSARILY BEEN ELEVATED TO THE LEVEL OF THE PRIME MINISTER, WITH THE AMBASSADOR AND THE USAID DIRECTOR REPRESENTING THE USG. THE PRIME MINISTER HAS NAMED A TASK FORCE CONSISTING OF THE MINISTER OF COMMERCE, THE GOVERNOR OF THE BANK OF MOZAMBIQUE AND A REPRESENTATIVE OF THE MINISTRY OF FINANCE TO ENSURE THAT WE CAN JOINTLY DEVELOP AN ASSISTANCE STRATEGY THAT ADDRESSES BOTH USG AND GRM CONCERNS, AND IS CONSISTENT WITH THE BROADER POLICY FRAMEWORK BEING DEVELOPED WITH THE WORLD BANK AND IMP.

12. DONOR COORDINATION HAS ALSO BECOME AN INCREASINGLY IMPORTANT PART OF THE POLICY DIALOGUE. ON FOREIGN EXCHANGE REGIME REFORMS, THE LEAD DONORS ARE THE IMP AND WORLD BANK. THE USG HAS ALSO PLAYED AN IMPORTANT ROLE BECAUSE: (1) WE HAVE A MORE EXTENSIVE IN-COUNTRY

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MONITORING CAPACITY THAN THE BANK OR THE IMF; (2) FOREIGN EXCHANGE ALLOCATION ISSUES HAVE EVOLVED QUICKLY, PARTICULARLY IN THE FOUR MONTHS SINCE THE LAST IMF CONSULTATIONS; AND (3) WE HAVE OBSERVED DIFFERENCES IN EMPHASIS IN THE POLICY ADVICE OFFERED BY THE BANK AND THE IMF WHICH COULD HAMPER THE EFFECTIVENESS OF THE CURRENT FOREIGN EXCHANGE REGIME REFORM STRATEGY. REFS E AND F REQUESTED AID/W AND STATE TO RAISE SPECIFIC POLICY CONCERNS WITH THE OFFICES OF THE U.S. EXECUTIVE DIRECTORS OF THE WORLD BANK AND IMF. WE HAVE ALSO ADVISED THE GRM DIRECTLY OF OUR CONCERNS AND OF OUR INTEREST IN ENSURING THAT THERE IS A SOUND POLICY FRAMEWORK IN PLACE THAT WILL CONTINUE TO RECEIVE THE SUPPORT OF IMF MANAGEMENT. A VIABLE LONG-TERM RELATIONSHIP WITH THE IMF IS CRITICAL TO THE SUCCESS OF MOZAMBIQUE'S MACROECONOMIC REFORM EFFORTS, IN TERMS OF BOTH CREATING AN OBJECTIVE FRAMEWORK FOR REFORMS THAT WILL GUIDE POLICYMAKERS THROUGH AN UPCOMING PROCESS OF POLITICAL TRANSITION AND COMPETITION, AND PROVIDING A FOUNDATION FOR THE MASSIVE LEVELS OF DONOR ASSISTANCE (INCLUDING DEBT RELIEF) REQUIRED TO ACHIEVE LONG-TERM VIABILITY IN THE BALANCE OF PAYMENTS.

13. SPECIFICALLY ON FOOD AND AGRICULTURE SECTORAL ISSUES, WE MAINTAIN A CONSISTENT DIALOGUE WITH THE WORLD

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BANK, FAO, WORLD FOOD PROGRAM, THE EEC AND SIDA (THE SWEDISH INTERNATIONAL DEVELOPMENT AGENCY). WITH WORLD BANK STAFF DEVELOPING THE POLICY FRAMEWORK PAPERS WITH THE GOVERNMENT, WE HAVE EXCHANGED INFORMATION TO ENSURE THAT WE MOVE IN A CONSISTENT DIRECTION ON PRICING AND MARKETING POLICY REFORMS. COORDINATION WITH FAO AND WFP HAS FOCUSED ON THE SHARING OF PRODUCTION AND MARKET LEVEL DATA AND ON THE DESIGN OF SYSTEMS FOR DATA COLLECTION. THIS HAS HELPED AVOID DUPLICATION OF DONOR EFFORTS AND GIVEN US ACCESS TO THE WIDEST RANGE OF STATISTICS AVAILABLE IN AN EXTREMELY DATA POOR COUNTRY. WITH EEC AND SIDA WE HAVE WORKED TO COORDINATE INVESTMENTS TO PROMOTE AGRICULTURAL MARKETING. AS A RESULT OF THIS DIALOGUE, AS WELL AS THEIR OWN EXPERIENCES WITH PUBLIC SECTOR MARKETING ACTIVITIES, BOTH AGENCIES ARE ADOPTING MORE OF A PRIVATE SECTOR ORIENTATION IN THEIR ASSISTANCE PROGRAMS.

AGRICULTURAL PRODUCER PRICES

14. PAAD BENCHMARKS FOR 1990/91: (A) MOVE WHITE MAIZE AND RICE TO PARITY-BASED PRODUCER FLOOR PRICE SYSTEM; (B) CONTINUE PARITY-BASED PRODUCER FLOOR PRICE FOR BEANS; (C) ASSESS IMPACT AND MAKE RECOMMENDATIONS.

15. THE GRM LETTER OF INTENT STATES: "IN 1990/91 THE GOVERNMENT INTENDS TO PROCEED WITH PHASED PRICE DEREGULATIONS. DOMESTICALLY PRODUCED MAIZE WAS MOVED IN JUNE 1990 FROM A FIXED PRODUCER PRICE TO A PRODUCER FLOOR PRICE. IN SEPTEMBER 1990 THE GOVERNMENT WILL ALSO INTRODUCE A MINIMUM PRODUCER PRICE FOR RICE. ALL OTHER PRODUCER FLOOR PRICES WILL BE READJUSTED BASED ON IMPORT/EXPORT PARITY. THE NEW AGRICULTURAL PRICE REGIME WILL BE ANNOUNCED IN SEPTEMBER 1990..." THE LETTER CONTINUES: "A KEY MEASURE ANNOUNCED IN JUNE 1990 IS THE LIBERALIZATION OF THE CONSUMER PRICE OF DOMESTICALLY PRODUCED MAIZE. ...THE GOVERNMENT, WITH USAID SUPPORT, WILL EVALUATE BY JUNE 1991 THE IMPACT OF DEREGULATED DOMESTIC MAIZE PRICES... SHOULD THE RESULTS PROVE POSITIVE, THE GRM PLANS TO EXTEND ITS EXPERIENCE WITH MAIZE LIBERALIZATION TO BEANS AND EVENTUALLY RICE."

16. DISCUSSION OF PERFORMANCE: PRICE POLICY REFORM BENCHMARKS A AND B ABOVE HAVE BEEN MET. AS NOTED IN THE LETTER OF INTENT, MAIZE WAS MOVED TO THE PRODUCER FLOOR PRICE SYSTEM IN MAY 1990. IN NOVEMBER 1990 RICE, THE LAST AGRICULTURAL PRODUCT STILL SUBJECT TO A FIXED PRODUCER PRICE, ALSO WAS MOVED TO THE FLOOR PRICE SYSTEM. AT THE SAME TIME, SORGHUM AND SOME TYPES OF BEANS, WHICH PREVIOUSLY WERE UNDER THE MINIMUM PRODUCER PRICE REGIME, WERE MOVED TO THE LIST OF PRODUCTS WITH MARKET-DETERMINED PRICES. (TWO TYPES OF BEANS ARE STILL SUBJECT TO A MINIMUM PRODUCER PRICE.) LATE 1990 ADJUSTMENTS IN THE MINIMUM PRODUCER PRICES BRING MAIZE AND RICE TO APPROXIMATELY 90 AND 92 PERCENT, RESPECTIVELY, OF INDICATIVE CIF MAPUTO PRICES FOR IMPORTS OF THESE COMMODITIES, CALCULATED AT THE OFFICIAL EXCHANGE

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RATE.

17. AS FURTHER NOTED IN THE LETTER OF INTENT, USAID IS ASSISTING THE GRM TO EVALUATE THE IMPACT OF THE 1990 DEREGULATION OF PRICES FOR DOMESTICALLY PRODUCED MAIZE. WITH FUNDING FROM THE PSSP TECHNICAL ASSISTANCE PROJECT (656-0218), MICHIGAN STATE UNIVERSITY AND THE MINISTRY OF AGRICULTURE HAVE ESTABLISHED A TRIAL MARKET INFORMATION AND ANALYSIS SYSTEM WHICH WILL REGULARLY PROVIDE - PRODUCTION, PRICE, AND OTHER MARKET INFORMATION FROM KEY PRODUCING DISTRICTS OF NAMPULA PROVINCE AS WELL AS FROM A FEW WHOLESALE AND CONSUMER MARKETS IN MAPUTO, ZAMBEZIA, CABO DELGADO, AND NAMPULA PROVINCES. THIS INFORMATION, UP TILL NOW OBTAINED ONLY THROUGH SPECIAL STUDIES, WILL BE ROUTINELY OBTAINED, ANALYZED, AND REPORTED ON BEGINNING IN APRIL 1991. ANALYSIS BASED ON THIS REGULAR INFORMATION, ON RAPID RURAL APPRAISALS, AND ON IN-DEPTH FARMER AND TRADER SURVEYS PLANNED BY MSU AND THE MINISTRY OF AGRICULTURE FOR JUNE-JULY 1991 WILL PERMIT THE GOVERNMENT TO EVALUATE THE MAIZE PRICE LIBERALIZATION AS INTENDED.

18. 1991/92 PROGRAM MEASURES: USAID PROPOSES TO PROCEED WITH AND IMPLEMENT THE PRICING REFORM MEASURES AS

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OUTLINED IN THE UPDATED POLICY MATRIX CONTAINED IN AMENDMENT NUMBER 2 TO THE PSSP. SPECIFICALLY, MINIMUM PRODUCER PRICES WILL BE ADJUSTED TO REFLECT CHANGES IN INTERNATIONAL PRICES. THE MARKET WILL CONTINUE TO DETERMINE THE CONSUMER PRICES FOR MAIZE AND BEANS. WE HAVE NOT YET COMPLETED OUR ASSESSMENT OF HOW TO PROCEED WITH THE CONSUMER PRICE FOR RICE. OF CONCERN IS THAT A FEW MILLS CONTROL THE MAJOR SHARE OF DOMESTICALLY PRODUCED RICE ENTERING URBAN MARKETS, PARTICULARLY MAPUTO. WE ARE BALANCING THIS AGAINST GROWING RETAIL LEVEL COMPETITION OFFERED BY DONOR FOOD AID AND APPARENT PARALLEL MARKET IMPORTS. IN ADDITION, THE GRM WISHES TO ENCOURAGE PRIVATE COMMERCIAL RICE IMPORTS FINANCED THROUGH THE NEW SECONDARY FOREIGN EXCHANGE MARKET. OUR PRELIMINARY IMPRESSION IS THAT THERE MAY BE ADEQUATE WHOLESALE AND RETAIL LEVEL COMPETITION TO JUSTIFY LIBERALIZATION OF THE CONSUMER PRICE. WE EXPECT TO CONCLUDE OUR ANALYSIS OF THIS ISSUE IN MAY.

STATE FARM DIVESTITURES

19. PAAD BENCHMARKS FOR 1990/91: (A) IMPLEMENT ANALYSIS PROGRAM ON TENURE ISSUES; (B) COMPLETE GENERAL DIVESTITURE PROGRAM DESIGN; (C) COMPLETE DESIGN OF USAID-SPECIFIC PROGRAM FOR PILOT DIVESTITURES.

20. THE LETTER OF INTENT STATES: "IN 1990/91, THE GOVERNMENT, WITH USAID ASSISTANCE, WILL DEEPEN THE ANALYSIS OF DIVESTITURE ISSUES THROUGH FURTHER STUDY OF LAND TENURE SECURITY IN GENERAL, AND THROUGH THE DETAILED PLANNING AND IMPLEMENTATION OF AT LEAST ONE PILOT DIVESTITURE OF STATE FARM LAND TO FAMILY FARMERS. ...FIELD WORK IS EXPECTED TO BEGIN IN OCTOBER 1990. ALSO IN 1990/91, THE GOVERNMENT INTENDS TO COMPLETE A STATEMENT OF POLICIES AND GUIDELINES FOR ENCOURAGING LAND USE IN SUPPORT OF INCREASED AGRICULTURAL PRODUCTIVITY, AS GUIDANCE FOR THE VARIOUS AUTHORITIES INVOLVED IN LAND ALLOCATIONS AND PARTICULARLY DIVESTITURES."

21. DISCUSSION OF PERFORMANCE: REP C PROVIDED AID/W A DETAILED STATUS REPORT ON DIVESTITURE AND RELATED LAND POLICY ISSUES. DUE TO THE COMPLEXITY OF THE POLITICAL, SOCIAL, LEGAL, AND TECHNICAL ISSUES INVOLVED IN LAND ALLOCATIONS AND ESPECIALLY DIVESTITURES, WHICH IS OF COURSE COMPOUNDED BY INSECURITY-INDUCED POPULATION MOVEMENTS AFFECTING ACCESS TO LAND AND USE RIGHTS, THIS POLICY AREA CONTINUES TO BE THE MOST DIFFICULT TO DISCUSS IN SPECIFIC TERMS. AS REPORTED PREVIOUSLY, DIVESTITURE AUTHORITIES ARE DECENTRALIZED, AND THE AD HOC DIVESTITURES (WHICH UNDENIABLY HAVE INVOLVED A LARGE PART OF THE FORMER STATE FARM HOLDINGS) ARE OCCURRING WITH LITTLE ATTENTION TO LONGER-TERM ECONOMIC CONSEQUENCES FOR AGRICULTURE OF DIFFERENT STYLES AND SCALES OF DIVESTITURE.

22. BASED ON OUR CONSISTENT INTERACTION WITH MINISTRY OF AGRICULTURE COUNTERPARTS AND OBSERVATIONS OF EXPERTS FROM THE LAND TENURE CENTER (LTC), USAID JUDGES THAT THE FIRST

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BENCHMARK ABOVE HAS BEEN MET. PUBLIC ANALYSIS OF TENURE ISSUES DURING THE PAST YEAR HAS BEEN LED BY THE CENTER FOR AGRICULTURAL TRAINING OF THE MINISTRY OF AGRICULTURE IN COLLABORATION WITH TECHNICAL SECTIONS OF THE MINISTRY. PROVINCIAL AUTHORITIES HAVE ALSO BEEN CONSULTED AND INVOLVED IN SOME OF THIS WORK. ACTIVITIES INCLUDED PUBLICATIONS AND PUBLIC SEMINARS AS WELL AS INTERNAL PLANNING ACTIVITIES.

23. IN MARCH 1990 THE GRM REQUESTED USAID TO PROVIDE LTC ASSISTANCE TO IMPROVE THE ANALYSIS OF THESE ISSUES AND ORIENT THIS ANALYSIS SO IT CAN HELP POLICYMAKERS WITH DECISIONS THEY FACE NOW. AT THAT TIME, THE BEST APPROACH TO THIS REQUEST WAS THOUGHT TO BE A PILOT DIVESTITURE ACTIVITY UNDER LTC GUIDANCE. GIVEN THE RANGE OF DIVESTITURE APPROACHES UNDERWAY, HOWEVER, AND FOR OTHER REASONS DETAILED IN REF C, BY NOVEMBER 1990 IT WAS CLEAR THAT A SERIES OF POLICY-ORIENTED ANALYSES OF EXISTING DIVESTITURES WOULD BE A MORE PRODUCTIVE APPROACH THAN A SINGLE PILOT DEMONSTRATION. DESIGN OF THIS ASSISTANCE PROGRAM HAS BEEN COMPLETED AND A PROPOSAL SUBMITTED BY LTC FOR USAID AND GOVERNMENT REVIEW; THE LTC-ASSISTED PROGRAM IS EXPECTED TO BEGIN IN JUNE 1991.

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24. THE INTENDED GOVERNMENT STATEMENT OF POLICIES AND GUIDELINES FOR DIVESTITURE AND OTHER ALLOCATION DECISIONS HAS NOT YET BEEN COMPLETED. IN JULY 1990 A ROUNDTABLE ON THE FUTURE OF THE STATE AGRICULTURAL ENTERPRISES WAS HELD. LATER, PROVINCIAL-LEVEL COMMISSIONS WERE ESTABLISHED FOR EVALUATING AND HANDLING THE SALE OR OTHER ALIENATION OF STATE PROPERTIES. THESE ARE PROCEEDING, AND NEWSPAPERS IN MAPUTO AND IN BEIRA CARRY ANNOUNCEMENTS AND INVITATIONS FOR BIDS ON THESE TRANSACTIONS.

25. FISCAL AND MONETARY REFORMS WHICH HAVE CUT CREDIT AND SUBSIDIES TO STATE FARMS MAY, IN FACT, BE THE MOST SIGNIFICANT PRESSURES DRIVING THE DIVESTITURE PROCESS. ANECDOTES ABOUND CONCERNING THE CLOSURE OF STATE FARMS AS A RESULT OF INCREASED FISCAL PRESSURES. WE ARE IN THE PROCESS OF COLLECTING AND ANALYZING STORIES ON THE EVOLVING STATUS OF THE STATE FARM SECTOR, BOTH TO UNDERSTAND CURRENT DYNAMICS, AND TO HELP THE GOVERNMENT INCORPORATE RELEVANT LESSONS INTO ITS DIVESTITURE POLICIES. AS DISCUSSED ABOVE, ONGOING ANALYSIS OF DIVESTITURE EXPERIENCE WILL ALSO BE CENTRAL TO THE LTC ROLE IN MOZAMBIQUE. THROUGH LTC, WE SEEK TO INSTITUTIONALIZE IN THE MINISTRY OF AGRICULTURE THE PROCESS OF ANALYZING ONGOING EXPERIENCES WITH THE DIVESTITURE OF STATE FARMS.

26. 1991/92 PROGRAM MEASURES: EXOGENOUS FACTORS AFFECTING THE STATE FARM DIVESTITURE PROCESS ARE LIKELY TO INCREASE IN THE COMING YEAR. PROSPECTS FOR PEACE, DEMOBILIZATION OF FIGHTING FORCES, AND MOZAMBIQUE'S FIRST-EVER ELECTIONS CALL INTO QUESTION WHETHER THE GRM CAN AND SHOULD DEVELOP AND IMPLEMENT A GENERAL DIVESTITURE PLAN. IN THE CURRENT ENVIRONMENT WE BELIEVE A REALISTIC FORMULATION OF OBJECTIVES FOR 1991/92 IS TO: (A) MAINTAIN CURRENT FISCAL AND MONETARY PRESSURES (AS DEFINED BY CREDIT AND SUBSIDY CEILINGS AGREED UPON WITH THE WORLD BANK AND IMF) THAT ARE SPURRING THE DIVESTITURE PROCESS; (B) CONTINUE THE ANALYTIC PROGRAM FORMULATED WITH LTC AS A MEANS TO FACILITATE THE APPLICATION OF A MORE EFFECTIVE SET OF POLICIES FOR INDIVIDUAL DIVESTITURES; AND (C) DEVELOP, ANNOUNCE, AND IMPLEMENT STANDARDIZED NOTIFICATION AND REVIEW PROCEDURES FOR CARRYING OUT STATE FARM DIVESTITURES THAT WILL INCREASE THE TRANSPARENCY OF THE DIVESTITURE PROCESS.

PRIVATE NETWORKS FOR AGRICULTURAL INPUTS

27. PAAD BENCHMARKS FOR 1990/91: (A) A.I.D. COMMODITY IMPORTS FULLY PRIVATE; (B) PLAN TO PRIVATIZE AGRICULTURE-RELATED PUBLIC ENTERPRISES.

28. THE LETTER OF INTENT STATES: "IN 1990/91, THE GOVERNMENT INTENDS THAT PRIVATE IMPORT AND DISTRIBUTION CHANNELS WILL HANDLE ALL USAID-FINANCED COMMODITY IMPORTS, AGAIN RETAINING THE ANNUAL LIMIT (OF ONE TRACTOR AND TRUCK) PER CLIENT. AS A STEP IN FURTHER ENCOURAGING

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THE DEVELOPMENT OF EFFECTIVE AGRICULTURAL SUPPORT SERVICES, THE GOVERNMENT ALSO INTENDS IN 1990/91 TO IDENTIFY AND ANALYZE A NUMBER OF AGRICULTURE-RELATED PARASTATAL ENTERPRISES FOR POSSIBLE DIVESTITURE TO PRIVATE OPERATORS. DEPENDING ON THE TECHNICAL REQUIREMENTS FOR THE ANALYSIS, THE GOVERNMENT MAY REQUEST USAID SUPPORT FOR TECHNICAL ASSISTANCE."

29.—DISCUSSION OF PERFORMANCE: ALL COMMODITIES FINANCED OVER THE PAST YEAR UNDER THE PSSP WERE IMPORTED AND DISTRIBUTED BY THE PRIVATE SECTOR. POSSIBLY OF GREATER IMPORTANCE IS THE GRM'S GENERAL INCREASE IN ATTENTION TO ENSURING THAT THE PRIVATE SECTOR HAS ACCESS TO FOREIGN EXCHANGE UNDER OTHER DONOR-FINANCED IMPORT SUPPORT PROGRAMS. UNDER THE MODIFIED OPEN GENERAL LICENSE (OGL) SYSTEM INITIATED WITH THE WORLD BANK, FOR EXAMPLE, OVER 90 PERCENT OF THE FOREIGN EXCHANGE HAS GONE TO THE PRIVATE SECTOR. ALTHOUGH THE OGL EXPERIMENT HAS HAD SIGNIFICANT OTHER PROBLEMS (DISCUSSED BELOW), THE GRM HAS NOT ATTEMPTED TO RESTRICT ACCESS TO LIMITED SUPPLIES OF UNTIED FOREIGN EXCHANGE TO THE PUBLIC SECTOR. AS PROGRESS CONTINUES WITH INCREASING THE TRANSPARENCY OF THE PUBLIC SECTOR BUDGETING PROCESS, IT WILL BECOME

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EASIER FOR BOTH THE GRM AND DONORS TO VERIFY THAT PARASTATALS DO NOT RECEIVE SUBSIDIES THAT WOULD GIVE THEM ADVANTAGES OVER PRIVATE COMPETITORS IN OBTAINING ACCESS TO FOREIGN EXCHANGE UNDER A NON-ADMINISTRATIVE FX ALLOCATION SYSTEM.

30. PER REF D, A.I.D. AND THE GRM HAVE AGREED TO USE A PORTION OF PSSP FUNDS LATER IN FY 1991 TO FINANCE SELECTED PETROLEUM IMPORTS DEEMED CRITICAL FOR AGRICULTURAL MARKETING PURPOSES. AT PRESENT, THE ONLY ENTITY IN MOZAMBIQUE WITH THE CAPACITY TO HANDLE THE VOLUME OF IMPORTS INVOLVED IN THE PROPOSED TIMEFRAME IS THE PARASTATAL, PETROMOC. THE GOVERNMENT HAS, HOWEVER, AGREED TO PRICE PETROLEUM PRODUCT(S) IMPORTED UNDER THE PSSP AT IMPORT PARITY USING THE SECONDARY MARKET EXCHANGE RATE. THIS IS AN IMPORTANT STEP IN IMPLEMENTING THE STRATEGY DISCUSSED BELOW TO SHIFT THE IMPORTATION OF SPECIFIC COMMODITY GROUPS FROM THE OFFICIAL EXCHANGE RATE TO THE MORE REALISTIC SECONDARY MARKET RATE.

31. THE GRM HAS ALSO PROCEEDED WITH NEGOTIATIONS TO PRIVATIZE AGRICULTURE-RELATED PARASTATAL ENTERPRISES. THE MINISTRY OF AGRICULTURE IS NOW COMPILING FOR USAID A STATUS REPORT ON ENTERPRISES WHICH IT IS PRESENTLY NEGOTIATING TO DIVEST AND OTHERS WHICH IT WOULD LIKE TO DIVEST DEPENDING ON THE INTEREST OF POTENTIAL INVESTORS. PRIOR TO OBLIGATING FUNDS IN FY 1991, USAID WILL REVIEW THIS REPORT WITH THE MINISTRY OF AGRICULTURE AND CONFIRM THAT SATISFACTORY PROGRESS HAS BEEN MADE.

32. 1991/92 PROGRAM MEASURES: WITH THE EXCEPTION OF PETROLEUM, ALL FUNDS DISBURSED THROUGH A COMMODITY IMPORT PROGRAM WILL CONTINUE TO BE CHANNLED THROUGH PRIVATE IMPORTERS FOR PRIVATE SECTOR END USERS. AS DISCUSSED BELOW UNDER THE FOREIGN EXCHANGE ALLOCATION OPTIONS, USAID BELIEVES IT WILL BE APPROPRIATE TO CONTINUE TO PROVIDE BALANCE OF PAYMENTS SUPPORT THROUGH A CIP. TO THE EXTENT THAT MOZAMBIQUE CAN MOVE TO A MARKET-BASED FX ALLOCATION SYSTEM IN THE FUTURE, HOWEVER, FARMARKING FOR THE PRIVATE SECTOR WOULD NOT BE APPROPRIATE.

33. ON THE PRIVATIZATION OF AGRICULTURE-RELATED ENTERPRISES, USAID PROPOSES TO CONTINUE TO LIMIT ITS INVOLVEMENT TO A MONITORING ROLE FOCUSED ON CONFIRMING CONTINUED PROGRESS IN REDUCING THE ROLE OF STATE ENTERPRISES IN THE AGRICULTURAL SECTOR. GIVEN THE WEAK STATUS OF MOST OF THESE ENTERPRISES AND A LIMITED EXTENT OF PRIVATE SECTOR INTEREST IN ASSUMING THEIR LIABILITIES, THERE WOULD BE LIMITED UTILITY TO DEVELOPING A MORE AGGRESSIVE DIVESTITURE SCHEDULE. AS WITH THE DIVESTITURE OF STATE FARMS, THE ELIMINATION OF SUBSIDIES AND PREFERENTIAL ACCESS TO CREDIT HAS BEEN THE DRIVING FORCE BEHIND PRIVATIZATION OR CLOSURE OF AGRICULTURE-RELATED PARASTATALS. SPECIFICALLY, USAID WILL MONITOR THE GRM'S COMPLIANCE WITH CEILINGS AGREED UPON WITH THE WORLD BANK AND IMF ON SUBSIDIES AND CREDIT TO PARASTATALS. WE WILL ALSO REVIEW WITH THE MINISTRY OF AGRICULTURE SPECIFIC MEASURES TAKEN IN 1991/92 TO DIVEST, PHASE OUT OR SCALE

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DOWN THE ROLE OF PARASTATALS IN THE AGRICULTURE SECTOR.

ACCESS TO FOREIGN EXCHANGE

34. PAAD BENCHMARKS FOR 1990/91: (A) GRM TO EVALUATE WITH THE WORLD BANK THE EFFECTIVENESS OF OGL TRIAL (WITH USAID FOLLOW-UP); (B) IF TRIAL IS GENERALLY SUCCESSFUL, MODIFY AND EXPAND ELIGIBLE SECTORS UNDER OGL; OTHERWISE FORMULATE NEW OPTIONS.

35. THE LETTER OF INTENT STATES: "THE GOVERNMENT IS SEEKING ADDITIONAL DONOR RESOURCES TO PERMIT THE PLANNED EXPANSION OF THIS SYSTEM (FOR NON-ADMINISTRATIVE ALLOCATION OF FOREIGN EXCHANGE, SNAAD) TO ADDITIONAL PRODUCTIVE SECTORS. IN MAY 1990, THE GOVERNMENT ANNOUNCED THE EXPANSION OF THE SNAAD TO INCLUDE AGRICULTURAL INPUTS SUCH AS...SPARE PARTS... FURTHER EXPANSION TO INCLUDE OTHER AGRICULTURE INPUTS AND OTHER SECTORS WILL DEPEND ON THE LEVEL OF DONOR RESOURCES MOBILIZED FOR THE SNAAD AND ON A RIGOROUS EVALUATION OF THE SNAAD'S PERFORMANCE TO BE CONDUCTED IN JUNE-AUGUST 1990.

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36. DISCUSSION OF PERFORMANCE: STRICTLY SPEAKING, THE GRM HAS COMPLIED WITH THE BENCHMARKS FOR 1990/91. AN EVALUATION OF THE SNAAD WAS CARRIED OUT, AND AT LEAST ONE OTHER OPTION (THE SECONDARY EXCHANGE MARKET, OR MSC) WAS NOT ONLY FORMULATED BUT ACTUALLY PUT INTO OPERATION. HOWEVER, MANY POLICY AND OPERATIONAL ISSUES REMAIN AND MAKE IT CLEAR THAT MOZAMBIQUE HAS NOT YET INSTITUTED A VIABLE MARKET-BASED ALLOCATION SYSTEM FOR FOREIGN EXCHANGE. AS DISCUSSED IN-DETAIL IN REFS E AND F, WE BELIEVE THAT A MAJOR CONSTRAINT IN DEVELOPING A COGENT STRATEGY LEADING TO A MARKET-BASED FOREIGN EXCHANGE ALLOCATION SYSTEM HAS BEEN A DIFFERENCE IN POLICY EMPHASIS BETWEEN THE WORLD BANK AND THE IMF, WHO ARE THE LEAD DONORS ON THIS TOPIC.

37. THE WORLD BANK AND THE GRM COLLABORATED ON AN ASSESSMENT OF THE SNAAD IN LATE 1990; HOWEVER, THE PUBLISHED RESULTS OF THAT ASSESSMENT, PRESENTED AT THE DECEMBER 1990 CONSULTATIVE GROUP MEETING, WERE INCONCLUSIVE. A USAID ASSESSMENT CONDUCTED IN NOVEMBER 1990 CONCLUDED THAT, AS A MECHANISM FOR NON-ADMINISTRATIVE ALLOCATION OF FOREIGN EXCHANGE, THE SNAAD WAS CONSIDERABLY FLAWED. ALTHOUGH FOREIGN EXCHANGE FOR ELIGIBLE IMPORTS WAS INDEED APPARENTLY FREELY AVAILABLE TO ELIGIBLE APPLICANTS, THE ADMINISTRATIVE PROCEDURES UNDER THE SNAAD PROVED EQUALLY AS CUMBERSOME AS THOSE UNDER ADMINISTRATIVE ALLOCATION SYSTEMS. AS OF FEBRUARY 1991, ALL FUNDS UNDER THE SNAAD WERE FULLY DISBURSED. WITH NO SIGNIFICANT INJECTION OF DONOR FUNDS IN THE PIPELINE, ANY IMPORTER CONFIDENCE IN THE SNAAD'S ADVANTAGES OVER ADMINISTRATIVE MECHANISMS IS LIKELY TO BE UNDERMINED. FURTHERMORE, THE SNAAD HAS NOT BEEN USED IN A MANNER THAT PUTS PRESSURE ON THE EXCHANGE RATE; IN FACT, WITH THE SNAAD OUT OF FUNDS, THE GRM MANAGERS OF THE SNAAD ARE IN EFFECT ADMINISTRATIVELY CONTROLLING DEMAND FOR FOREIGN EXCHANGE RATHER THAN ALLOWING THE PRICE TO COMPENSATE FOR EXCESS DEMAND, AS INTENDED.

38. THE SECOND BENCHMARK FOR 1990/91 CALLED FOR THE GRM TO FORMULATE NEW OPTIONS, IF THE SNAAD EXPERIMENT WAS FOUND NOT TO HAVE BEEN GENERALLY SUCCESSFUL. THE INSTITUTION OF THE MSC IN OCTOBER 1990 WAS AN EXPLICIT IMF RESPONSE TO THE PERCEIVED FAILURE OF THE SNAAD. ESTABLISHMENT OF THE MSC WAS MADE AN ESAY PERFORMANCE CRITERION. THE MSC WAS TO OPERATE AT A MORE DEPRECIATED EXCHANGE RATE THAN THE OFFICIAL RATE AND WOULD INITIALLY FOCUS ON INDIVIDUAL INVISIBLE TRANSACTIONS, BUT WITH THE INTENTION TO EXPAND ITS COVERAGE. (SEE 90 MAPUTO 4109, 90 MAPUTO 3807, AND 90 MAPUTO 3662 FOR DETAILS ON THE CREATION AND EARLY DAYS OF THE MSC.) AT THE END OF ITS FIRST FOUR MONTHS, THE MSC DOES NOT HAVE THE CHARACTERISTICS OF A FOREIGN EXCHANGE MARKET (SEE REFS E AND F); ALTHOUGH IT AT LEAST EMPLOYS THE CONCEPT OF UTILIZING A MORE REALISTIC EXCHANGE RATE IN THE ECONOMY.

39. THIS HAS TWO CRITICAL IMPLICATIONS FOR THE PSSP. FIRST, THE COMMODITY IMPORT PROGRAM IS ON HOLD, BECAUSE POTENTIAL APPLICANTS ARE UNWILLING TO PURCHASE OUR CIP

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FUNDS AT THE LEGAL SECONDARY MARKET RATE THAT A.I.D. REGULATIONS REQUIRE, WHEN THEY (OR THEIR COMPETITORS) MIGHT BE ABLE TO PURCHASE FOREIGN EXCHANGE FOR THE SAME COMMODITIES AT THE OFFICIAL RATE THROUGH OTHER DONOR PROGRAMS. SECOND, EVEN IF USAID WERE SATISFIED WITH SNAAD PERFORMANCE AND WISHED TO PROGRAM ASSISTANCE THROUGH THIS SYSTEM, WE WOULD BE UNABLE TO DO SO, BECAUSE THE SNAAD OPERATES AT THE OFFICIAL RATE.

40. THE AMBASSADOR AND USAID HAVE RAISED THESE ISSUES WITH SENIOR GRM OFFICIALS. THE PRIME MINISTER HAS APPOINTED THE MINISTER OF COMMERCE AND THE GOVERNOR OF THE BANK OF MOZAMBIQUE TO COORDINATE A TASK FORCE TO WORK WITH USAID TO FORMULATE SOLUTIONS THAT WILL: (A) CONTRIBUTE TO THE LONG-TERM OBJECTIVE OF A MARKET-BASED FOREIGN EXCHANGE REGIME, AND (B) ALLOW FOR THE EFFECTIVE DISBURSEMENT OF A.I.D. FUNDS. THE MISSION HAS ALSO REQUESTED AID/W AND STATE TO RAISE THESE ISSUES WITH THE OFFICES OF THE U.S. EXECUTIVE DIRECTORS AT THE WORLD BANK AND IMP. DIALOGUE WITH THE GRM AND THE MULTILATERAL AGENCIES IS ONGOING.

41. 1991/92 PROGRAM MEASURES: WE ARE SEEKING TO

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NEGOTIATE AGREEMENT WITH THE GRM TO MOVE THE IMPORTATION OF SPECIFIC COMMODITY GROUPS FROM THE OFFICIAL TO THE SECONDARY MARKET EXCHANGE RATE. THIS WOULD TEST THE RESPONSE OF DEMAND TO A MORE REALISTIC EXCHANGE RATE, AND IT WOULD ALLOW USAID TO FINANCE SOME OF THESE COMMODITIES THROUGH A CIP. THE GRM HAS INDICATED THAT IT AGREES WITH THIS PRINCIPLE, AND HAS PROPOSED TO PHASE IMPORTS FROM THE OFFICIAL TO THE SECONDARY MARKET BY CREATING A NEGATIVE LIST FOR THE OFFICIAL EXCHANGE RATE THAT WOULD BE EXPANDED OVER TIME. THE GRM HAS, FURTHERMORE, REQUESTED USAID TO CHANNEL FUNDS THROUGH THE MSC, RATHER THAN USE A CIP MECHANISM, IN ORDER TO HELP INSTITUTIONALIZE ITS FX MARKET ALLOCATION AND PRICING EXPERIMENT.

42. WE HAVE INDICATED THAT WE SUPPORT THIS CONCEPT IN PRINCIPLE, BUT THAT A SIGNIFICANT NUMBER OF POLICY AND MANAGEMENT QUESTIONS MUST BE ADDRESSED BEFORE WE CAN MAKE A CASH GRANT TO SUPPORT THE MSC (SEE REF F). AS A TRANSITIONAL MEASURE, WE HAVE PROPOSED TO USE A CIP TO FINANCE ITEMS ON THE NEGATIVE LIST (IN PARTICULAR, TRANSPORT EQUIPMENT CONSISTENT WITH THE PSSP'S MARKETING OBJECTIVES), AND TO COLLABORATE WITH THE GRM, WORLD BANK, AND IMF TO RESOLVE POLICY AND MANAGEMENT CONCERNS. THIS, WE BELIEVE, COULD LEAD TO A SOUND FRAMEWORK TO UNIFY THE OFFICIAL AND SECONDARY FOREIGN EXCHANGE MARKETS BY DECEMBER 1992, AND TO MANAGE THE FOREIGN EXCHANGE REGIME AFTER UNIFICATION ACCORDING TO MARKET PRINCIPLES.

PRIVATE MARKETING CHANNELS

43. PAAD BENCHMARKS FOR 1990/91: (A) RESCIND REGULATORY RESTRICTIONS ON INTER-DISTRICT AND INTER-PROVINCIAL MOVEMENT OF AGRICULTURAL COMMODITIES; (B) OPEN DISTRICT WHOLESALING OPPORTUNITIES TO ANY LICENSED TRADER DESIRING TO COMPETE; (C) ANALYZE LICENSING REQUIREMENTS FOR PRIVATE MARKETING AGENTS AT ALL LEVELS TO ASSESS DISINCENTIVE EFFECTS.

44. THE LETTER OF INTENT STATES: "THE GOVERNMENT WILL, BY SEPTEMBER 1990, ELIMINATE ADMINISTRATIVE REGULATIONS HINDERING FREE INTER-DISTRICT AND INTER-PROVINCIAL MOVEMENT OF AGRICULTURAL COMMODITIES, AND WILL OPEN DISTRICT-LEVEL WHOLESALING OPPORTUNITIES TO ANY LICENSED TRADER DESIRING TO COMPETE. ...IN ADDITION, THE GOVERNMENT WILL ANALYZE LICENSING REQUIREMENTS FOR PRIVATE MARKETING AGENTS (TRANSPORTERS, WHOLESALERS AND RETAILERS) TO ASSESS POTENTIAL BARRIERS TO ENTRY. THE GOVERNMENT WILL REVIEW THIS ANALYSIS WITH USAID BY FEBRUARY 1991, ALLOWING AGREED UPON RECOMMENDATIONS TO SIMPLIFY LICENSING REQUIREMENTS TO BE IMPLEMENTED RATHER THAT YEAR.

45. DISCUSSION OF PERFORMANCE: THERE HAVE BEEN DELAYS IN MEETING THESE BENCHMARKS AND WE ARE WORKING WITH THE GOVERNMENT TO ENSURE THAT THE ABOVE REGULATORY

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RESTRICTIONS ARE LIFTED BY MAY 1991. IN LATE 1990 THE MINISTRY OF FINANCE ISSUED A CIRCULAR TO THE PROVINCIAL GOVERNMENTS INDICATING THAT THEY SHOULD NO LONGER CONTROL INTER-PROVINCIAL AND INTER-DISTRICT TRADE. FIELD VISITS IN FEBRUARY 1991 INDICATED THAT LOCAL OFFICIALS WERE STILL, HOWEVER, CONTROLLING COMMODITY FLOWS. THE AMBASSADOR AND USAID RAISED THESE ISSUES IN THE ABOVE-MENTIONED DISCUSSIONS WITH THE PRIME MINISTER, WHO REFERRED THEM TO THE TASK FORCE COORDINATED BY THE MINISTER OF COMMERCE AND THE GOVERNOR OF THE BANK OF MOZAMBIQUE. AFTER SEVERAL TECHNICAL MEETINGS, THE VICE-MINISTER OF COMMERCE HAS PROVIDED USAID WITH A DRAFT ANNOUNCEMENT TO RESCIND RESTRICTIONS ON INTER-PROVINCIAL AND INTER-DISTRICT TRADE, AND TO OPEN COMPETITION AMONG DISTRICT-LEVEL WHOLESALERS. USAID HAS SUGGESTED SOME MODIFICATIONS TO THE ANNOUNCEMENT, WHICH SHOULD BE PUBLISHED IN MAY.

46. AS FOR THE ANALYSIS OF LICENSING REQUIREMENTS, INFORMATION HAS BEEN GATHERED THROUGH RAPID APPRAISALS BY THE MICHIGAN STATE UNIVERSITY - MINISTRY OF AGRICULTURE RESEARCH TEAM FINANCED UNDER THE PSSP TECHNICAL ASSISTANCE COMPONENT. AN IN-DEPTH TRADER SURVEY TO BE

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IMPLEMENTED BY THIS TEAM IN SELECTED DISTRICTS OF NAMPULA PROVINCE IN JULY 1991 WILL PERMIT THE INTENDED ANALYSIS AND THE DEVELOPMENT OF RECOMMENDATIONS FOR CHANGES.

47. 1991/92 PROGRAM MEASURES: AS PROPOSED IN THE LAST UPDATE OF THE PSSP POLICY MATRIX, USAID AND THE GRM WILL: (A) ASSESS THE IMPACT OF REMOVING THE ABOVE CONSTRAINTS TO COMPETITIVE MARKETING, AND (B) IMPLEMENT ANY NECESSARY MEASURES TO SIMPLIFY LICENSING OF TRADERS. MSU WILL WORK CLOSELY WITH THE MINISTRY OF AGRICULTURE AND USAID IN COMPLETING THE MARKETING ASSESSMENTS.

48. SEPTTEL WILL FOLLOW REQUESTING ISSUANCE OF BUDGET ALLOWANCE. WE WOULD APPRECIATE AID/W COMMENTS ON THE ABOVE, PARTICULARLY ON WASHINGTON DEVELOPMENTS IN DISCUSSIONS WITH THE WORLD BANK AND IMF ON FOREIGN EXCHANGE REGIME REFORM ISSUES. FRIEDMAN

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Annex C

Model for Gasoline and Diesel Prices

The following model on the structure of gasoline and diesel prices in Mozambique compares the consumer prices for both gasoline and diesel with import parity costs as of April 1991. The basic structure of the model was developed by the GRM with World Bank technical assistance and reflects margins and taxes agreed to with the World Bank and the IMF.

The model starts from FOB Mediterranean prices based on Platt's Oilgram and adds insurance and freight costs based on early 1991 experience to derive CIF Maputo prices. For both gasoline and diesel two scenarios are shown, using official and secondary exchange rates in effect in April 1991. This model takes into account taxes, handling and transportation costs, losses, and the margins of the importer, wholesaler, and retailer, to arrive at a per-liter price to the consumer which covers all costs. Finally, these derived consumer prices are compared with the fixed consumer sale prices now in effect. The analysis concludes that the present consumer sale prices for gasoline is about 102 percent of the actual import parity cost at the secondary exchange rate, while the current diesel price is about 92 percent of its cost.

This model can be adjusted as exchange rates and cost elements change, thereby permitting easy monitoring to ensure that consumer price adjustments continue to keep gasoline at or above import parity and diesel near import parity at the secondary exchange rate.

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**PETROBRAS PRICING MODEL
GASOLINE AND DIESEL**

PRICE STRUCTURE	notes: (1)	GASOLINE EXCHANGE RATES			DIESEL EXCHANGE RATES		
		1,965.00	1,900.00	1,650.00	1,965.00	1,900.00	1,650.00
FOB PRICE		237.00	237.00	237.00	167.00	167.00	167.00
INSURANCE AND FREIGHT		40.00	40.00	40.00	40.00	40.00	40.00
CIP PRICE - USD/MT	(2)	277.00	277.00	277.00	207.00	207.00	207.00
CONVERSION FACTOR TO M3	0.72				0.83		
PARITY BORDER PRICE - USD/M3		199.44	199.44	199.44	171.81	171.81	171.81
PARITY BORDER PRICE - MET/LT		391.90	378.94	329.08	337.61	326.44	283.49
CUSTOMS TAX	7.50%	29.39	28.42	24.68	7.50%	25.32	24.48
HANDLING, TRANSPORT, ETC.	0.36%	1.41	1.36	1.18	0.53%	1.79	1.73
OPERATIONAL COSTS	(3) 3.65%	14.30	13.83	12.01	4.24%	14.31	13.84
SPECIAL FIXED TAX ON GASOLINE		300.00	300.00	300.00		0.00	0.00
ESTIMATED OPERATIONAL LOSSES	2.50%	9.80	9.47	8.23	1.00%	3.38	3.26
		746.80	732.02	675.18	382.41	369.76	321.22
PETROMOC MARGIN (IMPORTER)	37.80%	282.29	276.71	255.22	5.00%	19.12	18.49
CIRCULATION TAX	10.00%	102.91	100.87	93.04	10.00%	40.15	38.82
		1,132.01	1,109.60	1,023.44	441.68	427.07	370.29
SELLING PRICE AT REFINERY DOOR							
DISTRIBUTION COSTS	(4)	15.00	15.00	15.00	15.00	15.00	15.00
PETROMOC WHOLESALE MARGIN	6.61%	75.82	74.34	68.64	4.02%	18.36	17.77
CIRCULATION TAX	1.00%	12.23	11.99	11.07	1.00%	4.75	4.51
		1,235.05	1,210.93	1,118.15	479.79	464.44	405.43
WHOLESALE SELLING PRICE							
RETAILER GROSS MARGIN	4.06%	50.14	49.16	45.40	4.00%	19.19	18.58
TRANSPORT DIFFERENTIAL		1.93	1.93	1.93		2.00	2.00
CIRCULATION TAX	1.00%	12.87	12.62	11.65	1.00%	5.01	4.85
		1,300.00	1,274.64	1,177.13	505.99	489.87	427.23
RETAIL SELLING PRICE	(5)						
MAY 1991 RETAIL SELLING PRICE		1,300.00	1,300.00	1,300.00	450.00	450.00	450.00
DIFFERENCE FROM IMPORT PARITY		0.00	25.36	122.87	(55.99)	(39.87)	22.23

- (1) Various exchange rate scenarios for 1991.
- (2) Based on actual costs in early 1991.
- (3) Represents ?
- (4) Represents ?
- (5) At Maputo and Beira gas stations.

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Annex D
Letter of Intent



REPÚBLICA DE MOÇAMBIQUE

MINISTÉRIO DA COOPERAÇÃO

Mr Julius Schlotthauer
Director
USAID Mozambique
Maputo

Maputo, May 15, 1991

Dear Mr. Schlotthauer:

The Government of the Republic of Mozambique wishes to thank the United States for its continued support for the development of Mozambique's food and agricultural sector. We are particularly appreciative of your timely and positive response to our request that the Private Sector Support Program finance the imports petroleum products. Without your assistance, agricultural marketing would be seriously disrupted this year. The purpose of this letter is to state our intention to apply the Government's policies and objectives to the supply and distribution of these products.

The Government's Economic and Social Rehabilitation Program (ESRP), as described in the Policy Framework Paper for 1990-92, sets forth the Government's development strategy for the next two years. Under the ESRP the Government is working to create an economic environment that favors and increased role for the private sector, imposes financial discipline on public enterprises, and gives the exchange rate, prices, and interest rates the central role in resource allocation.

This letter focuses on two specific actions in the area of petroleum pricing and importation within the overall ESRP framework. These actions are: establishing and maintaining the price of gasoline at or above import parity at secondary market exchange rate, and continuing to adjust the domestic price of diesel and completing an analysis leading to specific recommendations on deregulating the importation and pricing of avgas.

Government Policy on the pricing of petroleum products has evolved rapidly over the last year. Gasoline is now priced well above import parity and diesel has moved closer to parity at the window exchange rate. In 1991 and 1992, the Government will continue to adjust, at least on a quarterly basis, the consumer price for gasoline to maintain import parity utilizing the secondary market exchange rate, and will continue to make adjustments on the price of diesel.

A.V.

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It is, futhermore, understood that any petroleum products financed by USAID will be priced at import parity at the secondary market exchange rate utilizing a model to be agreed upon by USAID and the Government.

The Government will also complete an analysis in coodination with USAID leading to the deregulation of avgas imports, distribution and pricing.

The analysis will take into consideration relevant technical, operational, financial and economic issues and will make specific recommendations on policy, regulatory and legislative changes. The analysis will specifically consider appropriate measures to allow avgas users to make their own arrangements for supplies, either by importing directly or purchasing from intermediaries who would be face to import directly and sell at market - determined prices.

The analysis will be completed, and the Government will consider it for appropriate action, by July 1991.

During 1991/1992, the Government also intends to study other measures in support of -more efficient market for petroleum products. A study, financed by the World Bank, is currently underway to analyse the relative advantage of rehabilitating Mozambique's refinery to allow the importation of crude oil versus continuing to import refined products. The results of this analysis will be incorporated into a sencond study, also finance by the World Bank, on importation, distribution and storage systems. The Government will review the results of these studies with USAID and discuss follow-up measure to promote more reliable access to petroleum products, and to continue to improve the efficiency of their importation and marketing.

In conclusion, the Government confirms its intention to pursue the objectives set forth the PFP as they apply to the petroleum sector. We intend to take significant steps in 1991/1992 toward achievement of these objectives. These actions will in part depend on USAID's continuing support, both financial and thecnical, in this sector. We look forward to continuing our close and productive collaboration.

Sincerely,

Jacinto Veloso

Jacinto Soares Veloso
Minister of Cooperation

Annex E

**Initial Environmental Examination
for Petroleum Imports**

PAADAM3

Signed
orig of
Annex E

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

From: Carlos Pascual, Program Officer

Subject: Initial Environment Examination and Negative Threshold Decision Recommendation, Amendments to Private Sector Support Program (PSSP), 656-0208

This memorandum is an Initial Environmental Examination for the purchase of fuel under the two planned FY 1991 amendments to the Private Sector Support Project. The first amendment, planned for May, adds petroleum products to the positive list. The second, planned for June, will provide additional funds under the authorized LOP level.

Project Country:	Mozambique
Project Title:	Private Sector Support
Project Number:	656-0208
Funding:	DFA
LOP:	Dols 54,050
IEE prepared by:	USAID/Mozambique
Environmental action recommended:	Financing of gasoline and diesel fuel, negative determination.

This IEE covers gasoline and diesel to be financed under FY 1991 amendments to the Private Sector Support Program (PSSP) in Mozambique. The amendments authorize the financing of gasoline and diesel imports for use in motor vehicles. Petroleum products are critical for agriculture marketing purposes and virtually all marketing is dependent on motorized transport.

Most of the gasoline will be used in cars in urban areas whereas most of the diesel will be used in trucks and utility vehicles in rural areas. In the first year (beginning June, 1991) approximately 50,000 tons (metric) of gasoline and 25,000 tons of diesel will be imported under the amended PSSP. Similar or smaller amounts may be financed in subsequent years.

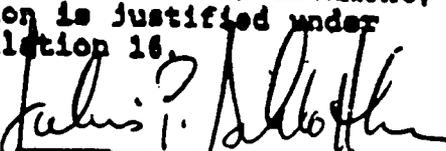
The overall effect on the environment of the use of approximately 75,000 mt of petroleum spread over three provinces in Mozambique is not expected to be significant. The incremental effect of USAID's financing of the fuel will be nil.

The gasoline will be imported into the port of Maputo. Petromoc, presently the only entity authorized to import petroleum products to Mozambique, has a storage capacity dedicated to gasoline of over 50,000 tons, and can accommodate the CIP-financed imports without any difficulty at all. The Petromoc facilities were built in the 1960's and early 1970's when Maputo was a major depot for imports to RSA and Swaziland as well as a refining center with a 1,000,000 ton per year capacity. The diesel will be imported into the two ports of Maputo and Beira, which also has significant excess storage capacity.

The risk of an oil spill in the well-sheltered Maputo harbor is minimal, and none has occurred for at least 17 years. Ships enter and exit only during daylight hours and no international carrier has ever sunk within the harbor. The unloading facilities are adequate and the storage facilities, situated about 300 yards from the water, are surrounded by stone dikes, so that spilled fuel can be salvaged and reused. The fire-fighting facilities, built for the refinery, which closed in 1984, have been maintained and are operational. These are certainly adequate for any fire within the storage areas. The channel into the harbor limits tankers to under 30,000 tons of fuel, and the largest shipment during the last year was about 20,000 tons. As a result, the potential for adverse environmental impact on coastal and freshwater quality appear to be minimal.

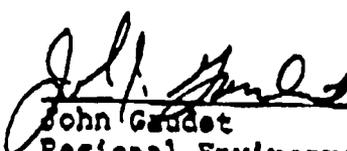
Based on the above, A.I.D. financing of 75,000 mt of petroleum is not expected to have any significant effect on the environment, and consequently a negative determination is justified under section 216.3(A)(2)(iii) of A.I.D. Regulation 16.

Approved:


Julius Schlotthauer
Director

Date: 13 May 1991

Concurrence:


John Gaudet
Regional Environmental Officer

Approved

Disapproved

Date: 4/29/91

Cleared by: RLA Donald Keens (fax attached)
REDSO REA Andre DeGeorges (91 Nairobi 9605 attached)

Clearance:

APR/GC: MA Klenz Date: 5/10/91

FACSIMILE FORM

TO:

Sent by:

NAME: TIM ECFN

NAME: DONALD KEENE

COMPANY: USAID/MAPUTO

FAX: office hours, 217-212
After hours, 217-217

FAX Number: _____

Official X
Personal _____

No. of Pages _____
(Including this sheet)

EXO Approval if more than 10
Pages 1

MESSAGE:

I have reviewed and concur in the text of proposed IEE set forth in your fax to me dated April 19, 1991.

61

ACTION: AID-3 INFO: AMB DCM.

YPRKVNZCDSV7CZCT00662

PP BUFRTO

DE REFREP =9626 1251311

ZNR UUUUU ZH

P 151311Z APR 91

FM AMEMBASSY NAIROBI

TO AMEMBASSY MAPUTO PRIORITY 4611

BT

UNCLAS NAIROBI 26626

LOC: 150/151 490
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CN: 10654
CERG: AID
LIST: AID

ADM AID

FOR TIN BORN

P.O. 12356; N/A

SUBJECT: MOZAMBIQUE - IFB FOR PETROLEUM

1. SUBJECT TO INCLUSION OF COMMENTARY REGARDING VISIT TO PETROCOO FACILITY IN MATOLA, REDSO/REA DIGEORGES AND SUPERVISOR R. BOSE CLEAR LEE HAND-CARRIED BY ROMO DURING EXERCISE TO MAPUTO. COMMENTARY WOULD REFER TO MOZAMBIQUE'S RECORD REGARDING OIL SPILLS AND ITS FACILITIES (EG, DIKES AROUND EACH STORAGE TANK) AT MATOLA.

2. BELIEVE COMPLETED LEE WITH REDSO/REA CLEARANCE INDICATED, SHOULD GO TO AID/W BUREAU ENVIRONMENTAL OFFICER (JOHN GATZET) AND PLA REIDLER FOR FINAL CLEARANCE PRIOR TO MISSION DIRECTOR APPROVAL.

3. REDSO/OM DISTRIBUTED ADDITIONAL COPIES OF SUBJECT IFR TO:

- - COLUMBIA EXPORT GROUP
- - INTERMARTINING GROUP INC.
- - PAKO CONSTRUCTION
- - PEBERO ENERGY INC.

4. WP ALSO RECEIVED COPY OF FAX REQUEST ADDRESSED TO PETROCOO FROM CLIFTON C. COLLINS, SR., FAX NO. 213-644-2977, TEL NO. 213-412-1795. DID PETROCOO RECEIVE THIS REQUEST? WE ARE NOT SENDING FAX COPIES OF IFR AND THEREFORE HAVE TAKEN NO ACTION WITH THIS REQUEST. BEMPSTONE

BT
#26626

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ACTION	
DATE DUE:	16 APR 91
ACTION OFFICER:	RR
INFO	_____
DIR	_____
DO	_____
FROM	_____
CONF	_____
EXC	_____
FFP	_____
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NAIROBI 26626

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