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PRIVATE SECTOR STRATEGY

STUDY

Prepared for

U.S. Agency for International Development
USAID/Mozambique
Contract No AFR-0438-C-00-5037-00
Task No. 25

Prepared by

International Science and Technology Institute, Inc.
1129 Twentieth Street, N.W.
Washington, D.C. 20036

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PRIVATE SECTOR STRATEGY STUDY

EXECUTIVE SUMMARY

OBJECTIVES OF WORK

A.I.D. Mozambique and the Private Sector Office of A.I.D.'s Africa Bureau (AFR/PRE) contracted a three-person consulting team to execute a private sector study which would enable it to develop a small number of strategies which A.I.D. Mozambique will be likely to be able to execute within its financial and manpower limits, and which will promote private sector growth in Mozambique. Emphasis was to be on the process of private sector analysis, diagnosis and strategy setting. The next step, project development, is beyond the scope of this assignment.

RECOMMENDED STRATEGIES

The strategies described below include the support of management, technical assistance and coordination among donors, rather than providing massive finance. The strategies are listed in recommended order of priority. The team recommends that A.I.D. Mozambique carry out all four strategies over the next three to five years, but that it stay within its manpower and financial constraints by executing only one or two small projects under each.

I. Enhance development of private sector institutions and participation in the economy.

Selected approaches to executing this strategy are to promote the formation of a business association and other organizations, support the export promotion function in existing firms, support on-the-job labor training initiatives (perhaps as an extension of the mission's present participation in the regional Human Resources Development Project), and assist the formation of a loan guarantee fund (based on local currency generations) to facilitate purchases of state-held firms.

II. Stimulate transformation of international donations into self-sustaining key private sector activities.

On the assumption that the war continues indefinitely, a key necessity is to influence the conversion of massive donor resource injections into a large number of small, flexible private sector activities, at least some of which can be successful in rural areas. Examples are rural-shop-based grain milling, equipment repair, mini-irrigation systems and artisanal fishing. Such small units are perhaps less subject to attack and, with improved linkages to cities (see Strategy III), might provide for at least the survival of the rural population over the long run. Other examples of approaches are establishment of a lease-purchase firm for donor trucks, repair facilities for donated equipment, and support of domestic and international debt/equity swaps.

III. Increase private sector urban-rural linkages.

Under the assumption stated in Strategy II, a major Mozambique resource would be a string of interconnected secure urban areas, containing about 30% of the population. Because of low wage rates and good access to ports, heavy exports of labor-intensive goods should be possible. Examples of development steps to secure this asset are to expand coastal and river shipping and civil air transport, reactivate the rural retail network, support integrated agribusiness joint ventures and encourage upcountry grain milling.

IV: Rehabilitate and convert existing underutilized plant and equipment capacity.

Many local managers appear to lack the skills necessary to use effectively already-available plant and equipment. Such use gets recovery going more quickly, saves foreign exchange, avoids future maintenance problems from over-sophisticated equipment and promotes substitution of low-cost labor for capital. Some appropriate A.I.D. Mozambique technical assistance projects might be to provide for technical assistance appropriate to in-place plant and equipment (using retired IESC or VITA volunteers or similar third-country contractors who are familiar with "outdated" equipment), expand the present Commodity Import Program's scope slightly to allow for the import of used machinery, support efficient circulation of existing equipment by providing technical assistance to existing firms, and stimulate domestic and international barter transactions.

OTHER RECOMMENDATIONS

To help develop projects under the above strategies, the local consultant group and existing material are sufficient in most areas. However, special studies of feasible and eventually self-sustaining interventions in the informal sector (including family farming and artisanal fishing) and in the commercial distribution system are recommended.

In addition, A.I.D. Mozambique may want to seek technical assistance in areas which will help it to execute more projects than its limited resources would normally allow. Examples are help in orienting and developing local contractors and help to the mission to work with GPRM to carry out some sample state-enterprise and intervened-company valuations or market appraisals so as to test the feasibility of the several possible projects involving privatization.

PRIVATE SECTOR PROFILE

The private sector is simply defined as the universe of economic entities controlled by non-government parties. However, Mozambique is unusual in that many private firms are intervened, i.e. GPRM assumed ownership when expatriates fled. Although most intervened firms are privately managed with minimal state interference, such firms are not considered in this study to be in the private sector.

The material below is a brief summary of findings in the report of a local consultant group which A.I.D. Mozambique contracted to help with the study, as well as the team's own findings. The years for statistical comparison are 1980 and 1985. Small scale enterprises (SSE's) include the small, formal sector enterprises with up to 50 employees and micro-scale, informal sector enterprises with under five employees. In 1985, of total GDP, the formal sector contributed 10%, with the informal sector registering 67%. The public sector contributed the remaining 23%.

Informal sector participation is concentrated in agriculture (family farms) which account for 47% of the informal sector contribution to GDP. Beyond its quantitative contribution, the informal sector is important in several ways to the qualitative development of the private sector. Informal sector firms provide much of the commuter and farm-to-market transport, appearing to be less prone to terrorist attacks than larger enterprises. They are also able to work with and recycle much of the scrap and machinery which larger enterprises consider obsolete. Family farms enable a large portion of the population to avoid rural-to-urban flight, which would otherwise put the cities under intolerable pressure. Finally, some informal enterprises are leading the way in de-facto privatization of intervened firms. For example, mechanics in an intervened garage do a large part of their work "moonlighting" through informal-sector repair facilities.

In the commerce and service area, formal-sector employment fell 14%. Major constraints are government policies (e.g. state run distributors and price controls) and transport restrictions which the war causes. In the transport sector, the war and other causes have reduced the truck fleet by 84% since 1973.

Industry's 1985 GDP contribution is 11%, vs. 12.8% in 1980, with figures at current prices. The GPRM has recently begun to favor privatization of intervened firms. For example, the former owners of a optician and lens-grinding firm successfully negotiated witn the government for the company's repurchase. Major industrial constraints are the unavailability of imported materials and parts, intervention by state distribution firms, and the loss of about half the local market because of the war.

The GDP contribution of agriculture and fishing is 53%, so the reduction of its production to half of 1981 levels, resulting in the need to import 90% of grain requirements, is disastrous. However, there has been some stabilization in cashews and increases in cotton and seafood recently. Major constraints are deterioration of the physical distribution system (resulting in too few consumer goods to stimulate family-farm production of surpluses), droughts and floods and lack of imported inputs for commercial farms.

The financial market is very undeveloped, comprising only two government and one private bank. 75% of all credit goes to 20 large firms, mostly state-owned.

The Bank of Mozambique (BM) has the central banking functions of issuing money, managing currency reserves, monetary system control and fixing the rediscount rate.

The commercial banking division of BM holds 53% of all deposits in the country and extends 79% of all loans. The People's Development Bank is a parastatal founded soon after independence to help develop the economy. It lends at medium and long term to finance investment projects and at short term to agriculture. It has 38% of all deposits and extends 18% of all loans in the country. The majority of loans (70%) are made to agriculture, followed by loans to industry, housing and for consumer goods. The Standard & Totta Bank is the only private bank in the country. In 1976 it lost its foreign exchange license. The bank's present activities are mostly lending up to 18 months, financed through overdrafts or receivables financing. Reportedly, many of its loans are uncollectible. The bank has 9% of deposits and 3% of the loans in the country.

In 1985 the agricultural sector received 50% of total credit, industry 20%, commerce 12%, transport 10% and construction 7%, with insignificant changes through 1987. Demand for credit is extremely limited due to the weakening economy, with the possible exception of some formal-sector farms, which recently have required local-currency credit to buy newly-available equipment. The one private sector bank does not try to develop business because, as shown above, its scope of operations is limited and it is highly over-liquid. Although on first look it seems as if credit is freely available, in reality government banks mostly handle agriculture and state enterprises.

Present policy is not positive in stimulating private financial activity. But government policy toward the financial sector is moving in the right direction. For example, the removal of the 20% retention tax on exports is a positive step. The Central Bank's commercial banking activities have a competitive advantage, offering a greater number of services, including international trade financing than can the one private bank. But, if Standard & Totta does indeed receive a new foreign exchange licence, competition will increase soon.

In summary, almost all enterprises face serious, multiple constraints (listed in the Diagnosis section below), all of which must be addressed for business success.

INVESTMENT CLIMATE ANALYSIS

Figure 2 summarizes the conclusions. The war is unlikely to result in the government's overthrow, and it appears that the GPRM is moving rapidly from socialist central planning to mixed-economy control of only key economic variables. However, many bureaucratic rigidities remain. The falling real wage (it is now about $20 per month) causes social hardships. Low wages are a necessary but not sufficient condition for effective international competition in the production of labor intensive goods. Particular opportunities are in garments, processed seafood, cashews, timber and cotton. Some links with Portuguese companies (in shoe production, for example) are providing the other necessary conditions of market knowledge and access, imported components and production methods. In general, however, local firms do not have access to these assets.

OTHER DONOR CURRENT ACTIVITIES AND PLANS

Some 22 bilateral and a dozen multilateral donors are active in Mozambique but with very little private sector development efforts. In a general meeting on support to the private sector most expressed a strong desire for A.I.D. Mozambique to get into selected private sector assistance projects which would leverage other donors' mostly infrastructure and food relief. A truck leasing and maintenance program is an example.

DIAGNOSIS

Based on the findings outlined in the previous chapters, this section briefly presents key constraints and opportunities to private sector growth, organized by type of resource needed for <u>any</u> firm's expansion - management, money, markets, manpower and materials. The principal factors missing in the Mozambique private sector economy, inhibiting its rehabilitation and expansion, include:

- Absence of private sector organizations to facilitate access to government and for inter-company communication, resulting in little mutually supportive activity;

- Over-dependence on donor aid and government-supplied foreign exchange, resulting in ineffectual functioning of the credit system;

- An enclave mentality in the private sector, with major populations and resources in rural areas cut off from the urban productive centers;

- A notable deficiency in administrative and technical management, as well as a severe shortage of spare parts, leading to very low utilization of plant and equipment.

A.I.D. Mozambique private sector assistance strategies should concentrate on addressing these deficiencies, in ways consistent with A.I.D. Mozambique's objectives and feasible within its resources and constraints.

A.I.D. MOZAMBIQUE OBJECTIVES AND RESOURCES

The team recommends that A.I.D. Mozambique pursue the following objectives in its support of the private sector. In other words, it should expect eventual projects to produce measurable results in these areas

- Increased self reliance and reduced dependence on donor support
- Employment generation
- Income growth
- Improved income distribution
- Rapid growth of exports
- Private sector institution development, leading to development of a market-type economic system.

To achieve the above objectives A.I.D. Mozambique has limited resources, naturally affecting its choice of strategies. Use of any significant portion of its local currency counterpart generations (about $57 million) outside of the framework of IMF sanctioned monetary policy is out of the question because of the inflationary effect. Attributing it to previously-approved ministry budgets might be technically acceptable, but it is questionable if it would directly strengthen the private sector. Current non-disaster A.I.D. program annual spending is about $10 million (mostly CIP) and is expected to rise to at least $15 million. The present program design has correctly taken into account the lack of mission professional personnel. As future manpower will be almost as limited, and as the security situation is likely to continue limiting foreign personnel's movement even more than that of locals', any new activities are likely to need additional local intermediaries or contractors to implement successfully.

One of A.I.D. Mozambique's major resources is being able to tap A.I.D.'s experience and human resources which many successful private sector projects in other countries have created. A.I.D. Mozambique should be able to use Agency and Bureau (Africa and PRE) facilities, such as management training (extending present participation in the Human Resources Development Project) and SSE-support projects, without committing much local management time. Particularly compared to other donors operating in Mozambique, these resources give A.I.D. Mozambique a real advantage in assisting the private sector.

ACRONYMS

BM	Bank of Mozambique
CIP	Commodity Import Program (A.I.D. Mozambique).
ERP	Economic Recovery Program
FRELIMO	Front for the Liberation of Mozambique (national governing party
GDP	Gross domestic product
GPRM	Government of the Peoples Republic of Mozambique
IBRD	International Bank for Reconstruction and Development
IESC	International Executive Service Corps
IMF	International Monetary Fund
MONAP	Mozambique Nordic Agricultural Program
MT	Metical (plural meticais, official exchange rate MT450/US$, parallel rate MT1000/US$)
PRE	Bureau For Private Enterprise, A.I.D.
PVO	Private/voluntary organization
RSA	Republic of South Africa
SADCC	Southern Africa Development Coordinating Council
SIDA	Swedish International Development Agency
SSE	Small-scale enterprise
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VITA	Volunteers in Technical Assistance

I.

INTRODUCTION

A. OBJECTIVES OF WORK

Briefly stated, A.I.D. Mozambique and the Private Sector Office of A.I.D.'s Africa Bureau (AFR/PRE) wanted the consulting team to recommend a small number of strategies which A.I.D. Mozambique will be likely to be able to execute within its financial and manpower limits, and which will promote private sector growth in Mozambique. Emphasis was to be on the process of private sector analysis, diagnosis and strategy setting. The next step of project development is beyond the scope of this assignment.

The scope of work calls for the team to:

- Assist A.I.D. Mozambique to initiate work towards a private sector development strategy and to identify program actions which will both promote and utilize private business so as to further A.I.D. country development goals;
- Assist A.I.D. Mozambique to identify policy and regulatory constraints to business growth and suggest ways to eliminate or neutralize such constraints; and to
- Identify follow-up actions required and the consultant support needed to implement the private sector strategy.

B. BACKGROUND

A.I.D. Mozambique appears to have achieved positive results since it started work in Mozambique in 1984. Its activities have included emergency food assistance, agriculture-oriented commodity-import support (Commodity Import Program - CIP) and a limited number of training activities under the regional Human Resources Development Project. CIP evaluations have included no measurement of production increases. However, qualitative indications of success - such as Maputo Central Market's recently-returned abundance of fruits and vegetables, as well as CIP farmers' minor loss of vehicles to terrorism (four out of 300 over the last three years) - give some confidence that A.I.D. Mozambique will be able to build on its experience to prepare a few sound projects which will successfully execute the recommended strategies.

This initial success has occurred under very negative economic conditions, which only over the last six months give even qualitative indications of improving (Annex C of this study gives a brief macro-economic background). Section E (Conclusions) of Chapter II discusses conditions, as they affect the private sector, briefly. The local consultant group's report, on file at A.I.D. Mozambique, goes into the matter more deeply.

As this report will reveal, there is strong evidence that over the last six months the Government of Mozambique (GPRM) has significantly increased its interest in relaxing private sector restrictions. The GPRM has begun to take concrete measures to formalize its change of direction from the socialist norm of pervasive state controls. For example, it freed the prices of fruits and vegetables, which, probably in conjunction with benefits of CIP, rapidly led to filling the urban market, previously almost bare. Massive devaluations of the currency (metical, plural metecais - MT), from about 40 to 450 to the dollar, has begun to stimulate exports. Licensing private sector import/export and local distribution firms is beginning to allow other companies to avoid the costly intervention of government corporations.

Conversations with the Ministers of Finance and Cooperation, officials of the Bank of Mozambique (BM) and the National Director of Planning reveal a very positive attitude toward development of the private sector. Measures to be undertaken this year include a meeting with the United Nations regarding privatizing the transportation and distribution systems, further development of commerce through the private sector and further moves away from government-corporation control of imports and exports. The GPRM appears to be convinced that private firms can best increase exports substantially, one of the government's top priorities. The GPRM supports the use of locally generated MT trust funds and special deposits by means of guarantee funds to encourage banks to finance the private sector. Finally, the Minister of Cooperation stated that terrorist activities in the countryside would not be an impediment to the GPRM's plans to expand commercial activity in the interior, as the army would begin new security efforts in these areas, and civilians would be allowed to arm themselves for self defence.

These developments have led to new, but not very clear, indications of opportunities for A.I.D. Mozambique to act as a private sector support specialist among the donors present in Mozambique and to agreement with AFR/PRE that this is an excellent moment for A.I.D. Mozambique to develop an overall approach or strategy for its private sector support activities.

The objective of this, the team's initial visit, was only to break the ground, resulting in an action-oriented strategy outline. The study's activities were as follows. AFR/PRE arranged a pre-trip briefing in Washington. Before the team's arrival in Mozambique, A.I.D. Mozambique selected a local consultant group: an economist specializing in agricultural inputs, one specializing in agricultural-input distribution, an information-science specialist, an economist knowledgeable on weather and other ambient conditions, and a group leader with experience in industry and transport. The local group provided excellent support to the international team and is likely to be a valuable resource to A.I.D. Mozambique when it enters the project-development stage. The group's report, Economic Profile of the Private Sector in Mozambique, is about 150 pages long and presents economic material, especially newly-developed measures of the formal and informal sectors in the total economy, broken down by major economic activity.

The team had some 50 interviews with private sector entrepreneurs from companies of all sizes, as well as government officials. Annex B lists these contacts, and Figure 3 analyzes the characteristics (especially problems) of the enterprises visited.

Other sources of this report's information are conversations with U.S. Embassy officers, two visiting World Bank missions (including pre-trip discussions at the Bank), meetings with the major international donor agencies and a study of relevant documents, some supplied by AFR/PRE (see Annex A). Experience in advising A.I.D. Mozambique's in other countries on similar issues and the reactions of the local group, A.I.D. Mozambique and A.I.D./State personnel to the study's draft conclusions were also useful.

A.I.D.'s design for this study would be appropriate for other countries in which the mission was small, conditions were quickly changing, and the mission desired to develop permanent, local, private sector sources of expertise and information, not just ministry contacts. It turned out that important international team qualities were long experience with management in the private sector, strategic planning, and some exposure to A.I.D. procedures.

II.

PRIVATE SECTOR PROFILE

A. DEFINITION

The private sector is simply defined as the universe of economic entities controlled by non-government parties. However, Mozambique is unusual in that many private firms are intervened, i.e. the GPRM assumed ownership when expatriates fled. Although most intervened firms are privately managed with minimal state interference, such firms are not considered to be in the private sector.

Small scale enterprises (SSE's) include the small, formal sector enterprises with up to 50 employees and micro-scale, informal sector enterprises with under five employees. In Mozambique, informal enterprise is defined as "unregistered and unorganized" business, "usually with less than five employees."

B. INFORMAL SECTOR

1. Quantitative contribution

Comments on the contribution of the informal sector to various specific types of business activities are in section C. The following section comments on the sector as a whole. The informal sector accounts for the bulk of total employment and contribution to Gross Domestic Product (GDP). In 1985, of total GDP, the formal sector contributed 10%, with the informal sector registering 67%. The public sector contributed the remaining 23%. Informal sector participation is concentrated in agriculture (family farms) which account for 47% of the informal sector contribution to GDP. The largest sector outside agriculture is commerce, with a contribution to GDP of 8%, followed by transport (trucks and taxis) with 4%.

Informal-sector activities make a significant contribution to urban family income. According to a 1982 study of families in the three major cities (Maputo, Beira and Nampula), 35% of the surveyed families' money income came from sales and other activities. More recently,in 1986 a small survey in Maputo revealed that 42% of the polled families' income was from sources outside of salaries. The figure fell to 32% in 1987, perhaps an indication that the Economic Recovery Program's (ERP) incentives had begun to cut illicit "speculation".

However, informal sector agricultural employment has fallen significantly. See section C3b for details. Outside agriculture, 1985 employment figures demonstrate that informal sector industry, followed by commerce, employ the greatest percentage of the total workforce. Of total 1985 industry employment, 26% was in the informal sector; in commerce the figure is 25%.

From experience elsewhere, it is probably safe to say that, if complete surveys were possible, urban SSE employment would probably comprise 40-60% of the total. For example, 1970 figures show informal sector manufacturing in Ghana at just over 78%, and nearly 60% of all industrial employment was found among SSE's in a sample of six other African countries (Page and Steel).

2. Qualitative Contribution

Beyond its quantitative contribution, the informal sector is important in several ways to the qualitative development of the private sector. Informal sector firms provide much of the commuter and farm-to-market transport, appearing to be less prone to terrorist attacks than larger enterprises. They are also able to work with and recycle much of the scrap and machinery which larger enterprises consider obsolete. Family farms enable a large portion of the population to avoid rural-to-urban flight, which would otherwise put the cities under intolerable pressure. Finally, some informal enterprises are leading the way in de-facto privatization of intervened firms. For example, mechanics in an intervened garage do a large part of their work "moonlighting" through informal-sector repair facilities.

C. FOR-PROFIT

The material below is a brief summary of findings in the local consultant group report and those of the team's study.

1. Commerce and Services

a. Commerce

Of total 1985 GDP contribution the formal sector accounted for 2.9% and the informal sector for 8.4%. Nearly 75% of commerce is in the private sector. Formal-sector employment fell 14%, from 42,000 in 1980 to 36,000 in 1985.

Urban informal-sector shops handle products unavailable in the formal market because of price controls or import restrictions, for example basic grains, textiles and consumer electronics. This trade comprises about 10% of total retail volume. The sources of goods for this trade are local commercial and industrial firms' shifting a part of their volume away from the official quota system and smuggling from neighboring countries.

Besides the general lack of goods to sell and the accelerating fall in consumer purchasing power, in part a result of devaluation and the GPRM's allowing real wages to fall in 1986-87, special constraints which this sector faces are:

- The GPRM policy, still in effect despite the relaxations mentioned above, of favoring public-sector wholesalers (35% of total volume);
- The closing of 20% (about 1000) of rural retailers between 1982 and the present, mostly because of war. Because of this and the approximate doubling of the rural population from 1966 to 1987, the population per rural retail store has risen from 1033 to 3860.

b. Transport

The 1985 GDP contribution of the formal sector was 6.2%, that of the informal sector 4.0%. Employment registered in the formal sector fell from 73,000 in 1980 to 58,000 in 1985 (21%). However, the reduction of GPRM regulations have recently allowed informal sector urban transport to grow. This is an especially important factor in supporting the recent increase in the availability of vegetables grown in the outskirts of major cities. There is also qualitative evidence of growth in informal (unlicensed) river transport (partly in response to insecurity of road and rail transport), as well as a continuing informal use of state-owned vehicles.

Special constraints which the sector faces are:

- Continuing government control and dominance of state-owned firms;

- Lack of spare parts because of foreign exchange shortages;
- Security, particularly in rural areas;
- Reduction by war, flight and lack of maintenance of the truck fleet (from 12,000 in 1973 to 1900 in 1985, an 84% drop);
- Lack of sufficient internal civil aviation services;
- Lack of shipping service to secondary coastal and river ports.

c. Tourism

This sector comprises restaurants, pensions and hotels. There are about 1000 establishments, 52% in Maputo and Beira. 1985 GDP contribution was 2.0%. Most establishments are in private hands. Employment in the formal sector was 18,000 in 1980 and the same in 1985, with the private sector accounting for 14,000.

Special constraints are, as expected, security, international tourism (mostly from South Africa -RSA) down, the cost of amenities' rising because of devaluation and the flight of skilled proprietors.

d. Construction services

Little information is available on this sector, but A.I.D. Mozambique is currently conducting a special study on it. A high proportion of demand and supply is in the public sector, with state firms' dominated by a few large entities. The sector is heavily dependent on donor inputs because the major constraints are lack of foreign exchange for inputs and the deterioration of local sources of supply (for example, even cement clinker must be imported now from RSA).

e. Machinery repair services

About half (53%) of establishments are private. Further, there is evidence of "moonlighting" by public-sector technicians.

Special constraints are customers' businesses being limited by security problems and difficulty of getting correct inputs through government importers.

2. Industry

a. GDP contribution (1985): Industry's formal sector contribution was 8%, while that of the informal sector 3%.

b. Employment: The formal sector employed 150,000 and the informal sector 50,000. Informal sector employment is concentrated on the edges of major cities.

c. Trends: In accordance with resolutions of the Fourth FRELIMO Congress, the state has been de-emphasizing its role in production and commerce by transferring some 1200 small businesses from intervened status to private ownership, forming new joint ventures with private capital when it is in the public interest, licensing private companies to import directly (if they have foreign exchange) without using the government companies and allowing firms to export directly on a case-by-case basis, permitting on the average 50% "retention" (permission to buy dollars at the rate of exchange existing at the time of the purchase, not at the time the firm generated the foreign exchange). These moves are already beginning to improve industry performance, although few statistics are available yet.

d. Constraints

Lack of skilled management;

- Shortage of qualified supervisors;
- Untrained and illiterate labor, with poor urban transport and poor health conditions' leading to low productivity;
- Many companies are dependent on imports, with foreign exchange in short supply;
- Companies supplying agriculture and transport have lost much of their markets because of war and the diminished number of vehicles;
- Intervention by state distribution firms, increasing costs and often resulting in improper inputs' being available;
- Small scale industries have no access to bank credit, larger businesses or public/private enterprise support systems;
- Fixed selling prices, sometimes below production cost;
- For agro-processing firms, lack of agricultural inputs and lack of foreign exchange for imported components (e.g. packaging materials).

3. Agriculture and fishing

a. 1985 GDP contribution: In this field the formal sector contributed 52% (59% of such farms are in two of the 10 provinces - Maputo and Gaza) and the informal sector 48%, the largest single GDP component. Production in 1986 was 50% of the 1981 level, 90% of grain requirements' now having to be imported. Seafood is a healthier sector. It comprised 43% of Mozambique's 1985 exports, with total production (formal and artisanal sectors) of 50,000 tons, only 12% of estimated sustainable potential. Further, there was some stabilization in 1986 of cashew production and increases in cotton.

b. Employment: The agricultural formal sector employed 218,000 in 1980; and 130,00 in 1985, a fall of 40%. Family farms provide employment for 80% of population and sell 20% of their production. In the 1980-85 period the total number of farms fell by 10%. Rural population rose 16% during this period, to 11.8 million. The average population per farm in 1980 was 5.1 persons. Assuming that the latter figure remained constant, then the combined effect of the above population increase and the decrease in the number of farms was the displacement of 2.7 million (26% of the 1980 rural population) from the land. Artisanal fishing grew over the period, but it employed only 42,300 in 1985.

c. Income: During 1980-85, rural commerce suffered from a lack of goods to sell and a decline in number of outlets. These effects caused rural dwellers' cash holdings to increase. In many areas it was preferable to barter rather than purchase goods. This situation, along with deteriorating security and a lack of balance between prices paid to producers vs. those of goods for sale, resulted in 1985 median rural family income falling to MT2000, an almost complete break between these families and the market economy. ERP might improve the terms of trade between the rural and urban economies and stimulate the use of money again.

d. Constraints

- Deterioration of the physical distribution system, principally the number of trucks and road conditions;

- War, with many effects such as forcing family farmers to flee to the cities and forcing large farms to hire security forces, adding about 10% to their total costs, all in all affecting about 40% of the rural population;
- Insufficient supply of consumer goods and agricultural inputs (e.g. seeds, pesticides, breeding stock and veterinary medicines) to stimulate production of surpluses;
- Natural disasters, such as ten years of drought (especially decreasing cattle production), followed by scattered floods;
- Lack of foreign market connections for exporting non-traditional products;
- Lack of supporting processing industries (for example there is no chicken feed industry);
- Unreasonably low government-set prices (government has, however, decontrolled prices of some commodities, e.g. fruits and vegetables).

D. NON-PROFIT

1. Cooperatives

a. Definition: Consumer cooperatives are defined by law and are organized to distribute consumer goods to their members. Production cooperatives are either in the agriculture or handicraft areas. They are organized to improve productivity and income, with earned surplus, if any, distributed among members.

b. Contribution to GDP: Agriculture co-ops contribute only 0.3% of agriculture production but are more important in the growing peri-urban fruit and vegetable "green zones". Consumer co-ops comprise 9-10% of total commerce.

c. Members: There are 14,000 agriculture co-ops in Gaza and Maputo, with a high percentage of women members. There are 1500 consumer coops, with an average size much smaller than that of the total 6000 shops in rural areas;

d. Constraints

- Extremely weak organization and management capabilities;
- The need for increasing the effectiveness of a private sector umbrella organization to provide support for co-op organization and management;
- A distribution structure which is extremely weak;
- The poor security situation.

2. <u>Business organizations</u>

Presently existing ones are the Hotel Association of Maputo, Shoemakers Association, Hairdressers and Barbers Association, Maputo Green Zone Producers Association, Provincial Producers Association and the Maputo Transport Association. The main objective of such organizations is to get supplies of materials from government distributors, but they have been generally unsuccessful so far. They are not strong enough to effectively represent themselves and appear to have little potential on their own to do so.

3. Foundations

Some foundations exist, but there is no information on their economic activity.

4. Private education and training institutions

The number of informal-sector ones appears to have been growing in recent years, but there is no further information on them.

E. FINANCIAL MARKET ANALYSIS

1. Components of financial market

a. Bank of Mozambique

The BM was founded as the central bank after independence, to take over the functions of the Banco Nacional Ultramarino, a private Portuguese bank, which had previously acted in this capacity.

BM has the central banking functions of issuing money, managing currency reserves, monetary system control and fixing the rediscount rate. It divides other central banking functions with the Ministry of Finance.

The commercial banking division of BM holds (the following deposit and loan figures are all for June 30, 1987) 53% of all deposits in the country and extends 79% of all loans. Steps are now being taken to separate the commercial banking function from central bank activities.

b. People's Development Bank

This is a government development bank founded soon after independence to help develop the economy. It lends at medium and long (up to 25 years) term to finance investment projects and at short term to agriculture. It can also issue bank guarantees, take shares in firms and purchase company paper. It is supposed to assist the launching of new companies by such means as feasibility studies and financial promotion. In fact, however, it does not exercise these non-banking functions.

It has 10 branches in the provincial capitals and 153 agencies throughout the country. The bank has 38% of all deposits and extends 18% of all loans in the country. The majority of loans (70%) are made to agriculture, followed by loans to industry, housing and for consumer goods. The bank receives funds from the Organization of Petroleum Exporting Countries, Kuwait and the United Nations International Agricultural Development Fund. It also manages loans from the African Development Bank.

The bank has nearly 550,000 accounts, which it manually processes. Not surprisingly, it has problems with the accurate and timely calculation of interest due or payable, a disincentive to save via this bank.

c. Standard & Totta Bank

This is the only private bank in the country. It was founded in 1890 and is majority owned (the GPRM holds the remaining 20% interest) by Standard Bank of RSA, Banco Totta e Acores and Banco Fonseca e Burnays. The latter two are Portuguese banks which were nationalized after Portugal's revolution in 1974. Standard & Totta was important in Mozambique prior to independence, at which time it had 44 branches. In 1976 it lost its foreign exchange license.

The bank's present activities are mostly lending up to 18 months, financed through overdrafts or receivables financing. Reportedly, many of its loans are uncollectible. The bank has accepted some long term deposits but is presently over-liquid and so now accepts few.

BM indicates that the bank's foreign exchange license will be restored step by step, depending on how actively the bank engages in foreign business. The foreign exchange license initially will enable the bank to sell travellers checks and effect foreign transfers of funds. Shareholders receive no dividends from the bank, which only generates expenses for them. The bank has 9% of deposits and 3% of the loans in the country.

d. Agricultural Credit Bank

The GPRM has recently announced this bank's creation. Its objective is to provide medium and long-term credit for agriculture, at low interest rates.

e. Agrarian Development Fund and Development Fund for Agricultural Water Resources

These funds are for rural development, including infrastructure and irrigation systems for agriculture. They are in the process of being created. Plans are to lend at concessional rates and terms. The GPRM also expects that these facilities will permit agricultural extension work. An administrative council, representing the Ministry of Agriculture and the Secretary of State for Agricultural Water Resources, will direct this activity.

f. Mozambique Insurance Company

Created in 1977, this parastatal offers life, workmen's compensation, personal accident, maritime, air and rail, fire, and vehicle insurance. It has a monopoly on insurance of local risks but works with foreign companies for offshore and foreign-currency risks.

It may have some untapped potential to be a capital-market player. The company does not cover war risks.

2. Market for financial services

The shares of the three banks in total 1985-86 credit are as follows:

	1985 %	1986 %
Bank of Mozambique	79.4	79.0
Peoples Development Bank	18.1	18.0
Standard & Totta Bank	2.5	3.0

In 1985 the agricultural sector received 50% of this credit, industry 20%, commerce 12%, transport 10% and construction 7%, with insignificant changes through 1987.

Demand for credit is extremely limited due to the weakening economy, with the possible exception of some formal-sector farms, which recently have required local-currency credit to buy newly-available equipment. The one private sector bank does not try to develop business because, as shown above, its scope of operations is limited and it is highly over-liquid. Although on first look it seems as if credit is freely available, in reality government banks mostly handle agriculture and state enterprises. In fact, 20 state companies absorb 75% of total bank credit. Private clients would borrow local currency in order to purchase foreign exchange if they could.

While demand for MT credit exists, many companies are not borrowing due to raw material and spare parts limitations, the result of foreign exchange shortages, among other things. If permitted, foreign investment and merchant banks could introduce debt/equity swaps, stock option plans, privatization and leasing companies.

The current new issue of treasury bonds, if successful, could be the beginning of a capital market. These bonds carry the incentives of interest payment in convertible local currency and, for those holders chosen by lottery, repayment of principle in convertible (at the parallel rate) currency. However, a secondary market for bonds is needed to provide liquidity, otherwise future issues will be hindered. The recent debt/equity swap agreement by the Portuguese government could open the door to other swaps.

Although inflation was 166% last year, and is projected at 70% in 1988, there is no financial investment for the public or businesses which pays real or almost real interest rates other than the above bonds. Although a recent law requires banks to pay 3% on sight deposits and 12-20% on deposits from 30 days to two years, banks are not interested in paying for new deposits because of limited ability to invest the funds.

3. Savings

As explained above, because of over-liquidity, banks do not seek new deposits. As a result, term deposits in 1986 formed only 3.7% of bank liabilities. This, as well as the need to deal in the informal economy rather that in the formal economy where many goods are not available, have led to the prevalence of a "mattress economy" (that is, savings outside of the banking system), particularly in rural areas, for both MT and hard currency.

It will be difficult to mobilize savings with a high inflation rate and an overvalued currency (presently MT450 per dollar, vs. the parallel rate of MT1000). The inclination is to move to a dollar economy. Senior administrative and technical personnel are paid partly in dollars in some firms, and official hard-currency stores are important in urban commerce.

4. Foreign exchange

Legal access to foreign exchange is through the following banking mechanisms:

- The Exchange Fund, which BM uses on a case by case basis to fund companies' mostly raw material import needs;
- Consigned Funds Accounts, which are foreign currency accounts to which the holders (mostly the larger exporting companies) have automatic access only to the MT equivalents but usually better access to foreign currency for export financing than do non holders.

The informal exchange market has an annual volume of several millions of dollars. Sources of foreign exchange are emigrants to neighboring countries and foreign residents in Mozambique. The major uses of funds are transfers to finance foreign travel and local purchases of consumer goods in hard-currency stores.

One way to reduce the outflow of dollars is to allow dollar deposit accounts in banks. Success would depend on the public's confidence that such deposits would not be nationalized in the future. The National Bank of Hungary (the central bank), for example, accepts numbered accounts in dollars at rates very competitive with the Eurodollar market.

5. Policy and regulatory environment

Present policy is not positive in stimulating private financial activity. But government policy toward the financial sector is moving in the right direction. For example, the removal of the 20% retention tax on exports is a positive step. The Central Bank's commercial banking activities have a competitive advantage, offering a greater number of services, including international trade financing than can the one private bank. But, as explained above, competition will increase soon.

F. CONCLUSIONS

The local consulting group's conclusions as to the major private sector constraints are:

- War, which raises the risks of doing business, particularly in rural areas;
- Lack of management experience outside the commercial sector, affecting industry and agribusiness;
- A shortage of inputs and raw materials, the result of a lack of foreign exchange and rural/urban separation;
- Lack of transport and the high war-risk of using that which remains;
- Poor equipment maintenance from lack of spare parts and old machinery;
- Lack of rural and commercial credit.

Nevertheless, many firms are in the process of being rehabilitated. While available numbers show the economy "going off the cliff" (e.g. per capita GDP $270 to $124 1980-1985), there are some qualitative indications of increased interest in the private sector and isolated indications of recovery. Devaluation, regular updating of some controlled prices to let them reflect production costs, allowing employee incentives for increased productivity, freedom for rural stores to set their own margins, and allowing some foreign-exchange retention are examples of recent policy changes. The rebound in the urban supply of fruits and vegetables, artisanal fishing's catch rising 50% in five years, interest in small-scale costal and river transport, increased government interest in selling intervened companies, the growth of informal-sector urban transport, scattered reports of rural shops' having been able to restock and the beginning of an export garment industry - are all first signs of revival. The latter development appears to be especially promising. Experience elsewhere indicates that the major deficiency of local exporters is strong links to developed-country finished goods importers and raw materials exporters. Many Mozambique firms still have links to Portuguese ones, which in turn have access to the European Community market.

SSE's play an important role in the local economy in terms of both contribution to employment and to GDP. Nevertheless, with the displacement of employment due to war, famine and generally poor economic performance, the number of people involved in SSE's has been decreasing over the past ten years. Among other concerns, a shrinking SSE sector removes one of the most important on-the-job and entrepreneurial training grounds afforded a poorly-educated population.

SSE's face the following key constraints:

- The GPRM policy and regulations discourage SSE productivity, potential for expansion and new start-ups;

- Access to local and imported materials and spare parts which, if relieved, would be replaced by lack of access to MT credit;
- Low level of education and training among owners and operators, and there are no public or private institutions to provide assistance.

Nevertheless, the team found some potential among SSE's for increased import substitution and even some export development if they were to receive appropriate technical and managerial assistance. Also, there are indications of higher plant and equipment utilization among SSE's than among the large enterprises. See Figure 3 for details.

Conclusions on the financial system are that several reforms will have to be made before it can operate satisfactorily and be responsive to the needs of the economy. Interest rates must be real, i.e. in excess of inflation and should be floating rather than fixed. The metical should be devalued to closer to its real value, which will stimulate exports and help restrict imports except for necessities. A realistic exchange rate would tend to lessen the flight of capital and even cause repatriation if investment opportunities exist in the country. It is also important to allow additional private banks and finance companies in the country to provide competition and introduce financial services not known yet due to insularity of the financial system.

In summary, almost all enterprises face serious, multiple constraints, all of which must be addressed for business success. Any firm must have sufficient supplies of money (fixed and working capital), management, materials, access to and knowledge of markets for its products and manpower in order to operate. In many countries, a large number of firms lack a sufficient amount of only one of the above factors (e.g. micro-enterprises in Brazil often lack only access to commercial working-capital credit). However, in Mozambique the majority of firms appear to lack appropriate management ability, access to raw materials and direct contact with their markets (because of government marketing intermediaries and security problems). Therefore effective efforts to stimulate business recovery must assist firms in almost all of the above areas, not just one or two.

III.

INVESTMENT CLIMATE ANALYSIS

A. POLICY AND REGULATORY ENVIRONMENT

1. Political stability and risk

Despite the insurgency (which the team feels will continue in a low-level way indefinitely), there appears to be little danger that the FRELIMO government will fall. Renamo does not seem to be offering an attractive, alternative program. The GPRM seems genuinely committed to continuing its private sector liberalizing program, but this will require continuing support from the World Bank and IMF, as well as other donors, and continued serious consideration of their policy suggestions. RSA's future actions are very unpredictable, but the latest indications are that it is willing to support the rehabilitation of the Cahora Bassa power line and cooperate on rail and port matters. Clearly, even a small change in RSA's support for Mozambique in general and its private sector in particular would have large positive or negative effects.

2. National development policies and plans

The announced policy shift from micro-economic to macro-economic planning and from only yearly to yearly and longer-term planning - going from socialist-style central planning to mixed-economy control of only key variables such as interest rates - could have a very significant positive effect if the GPRM can induce its own bureaucracy to follow the policy. This is because, as discussed in the last chapter, state interference in the day-to-day running of private firms (e.g. the forced use of state distribution companies) is one of their major constraints.

The present medium-term plan (Economic Rehabilitation Program) reached almost all targets last year. Government thinks that it will reach year 2 targets (e.g. the official exchange rate closer to parallel one, internal commodity prices closer to international ones, the budget deficit down, and inflation down to 60-70%).

Agricultural policy is a question mark in Mozambique's future. It is certainly important for a country which is 80% rural and has a great potential to stimulate economic growth quickly: "In general, the evidence supports the view that the quickest way to lift African agriculture from its current stagnation is to support reforms in the producer's incentive structure. In contrast few programs to develop and transfer technology or provide credit can hope to reach all farmers in a decade, much less in a single year." (A.I.D., Policy Reform in Africa, 1986, p. iii). While there is heartening evidence of liberalization in such areas as the rural distribution system and in prices for fruits and vegetables, other commodity prices are still at artificially low levels, and the GPRM appears to feel that urban dwellers' real purchasing power has already declined to a dangerously low level. Further, ample evidence from other countries indicates that the recently-established specialized agriculture and irrigation funds will become part of the problem rather than part of the solution.

3. Business formation and investment incentives

There are major bureaucratic barriers to establishing a new company, as might be expected in a country which is only in the process of leaving central planning. Usually a problem but it can enhance the purchase value of intervened companies. For example an intervened optical company's main value to its buyer was its position as the only authorized lens producer and the expectation that competition would be unable to secure a similar authorization. The rules for privatization of small and medium-sized companies are fairly clear, but it is unlikely that an unsophisticated entrepreneur can satisfy them without help. This is because the government negotiates each purchase on a case-by-case basis, reportedly taking very inconsistent positions on the purchase price. Over the past year some 1200 shops have been privatized smoothly, but few industrial firms (2-3 per year) have been.

4. <u>International remittances</u>

As explained above, an exporter is given a permit to buy about half of the foreign exchange that he generates when he needs such funds to import more inputs. However, under this arrangement, as explained, he also bears the risk that the MT will devalue between the time when he generates the foreign exchange and when he buys some of it back. Therefore, under-invoicing and illicit foreign accounts still make sense.

Profit remittance agreements can be negotiated successfully, but it is unlikely that a small foreign firm or returning expatriate would be able to do so unaided.

5. <u>International trade restrictions</u>

There are no restrictions on trading partners, not even with RSA. However, lack of foreign contacts, after so many years of isolation, are likely to severely hamper potential exporters. Donor financing is usually tied to home country input purchases.

6. International Agreements

There are preferential trade agreements with Tanzania, Zimbabwe, and other neighboring countries. Southern Africa Development Coordinating Council (SADCC) block transactions (as opposed to trade with individual members) have not been a factor up to now, but conversations at SADCC headquarters in Botswana indicate growing interest in brokering deals in which countries such as Mozambique would provide raw materials, while countries such as Botswana would contribute hard currency.

A present reality is countertrade with the Eastblock, for example an agreement with the Soviet Union to exchange shrimp for cement for petroleum.

7. Taxes

Incentives to export, for example a tax holiday for an exporting firm, can be negotiated. On the negative side, high corporate income tax rates and a value-added tax which does not allow for netting out the tax paid at preceding levels (e.g., the European system allows a retailer to compute the tax on only the difference between his buying cost and selling price) are strong disincentives to honest reporting.

8. Labor laws

The private sector now pays more (occasionally including a portion in dollars) than the government does for skilled people. This will probably lead to private sector management strengthening over time. Real wages falling, especially at lower levels. Last year's inflation was 166%, but wage increases only averaged 60%. The average wage is now worth about one pack of cigarettes per day, but this severe downward trend is unlikely to continue because lower-level wages are now reaching survival level and are becoming a strong disincentive to productivity. Specifically, rural labor is now difficult to attract because of the historical preference of subsistence farmers to work on their own plots but also because the rate of 35-40 U.S. cents per day is too low to overcome the above preference. Tragically, there appears to be seldom the possibility of rural wage employment in areas of starvation.

It is now possible to fire poorly performing employees and to pay more for improved productivity.

9. Government controls and interference

Controls and interference are rapidly decreasing. For example, state presence in firms through the party cell structure is becoming less of a factor, as managers report that they have gained the cooperation of such units. However, as reported above, there is still major interference in input purchasing (especially importing) and selling through wholesalers. What is worse, many donors reinforce this interference by insisting that the government be the intermediary in distributing such donations.

10. Availability of government advisory and promotional services

A government-run foreign investment promotion service (Gabinete de Promocao do Investimento Estrangeiro) is not effective yet; from experience in other countries, it is unlikely to become so. The government-managed Institute for Legal Affairs suffers from trying to replace the individual practice of commercial law and from the fact that there are less than 10 registered "commercial services" attorneys in country. Promotion of large-scale government-to-government fishing joint ventures suffers from lack of equipment and maintenance.

B. ECONOMIC AND RESOURCE FACTORS

This section presents a comparison of 1980 and 1985 economic figures.

1. Economic and market stability and growth prospects

The informal sector, of which 71% is family farms, contributes 68% of GDP, the formal business sector (including state-owned firms) 24% and the public sector 8%. The total private sector contributes 77% of GDP. This underlines the economic importance of the informal sector, in particular family farms, and the private sector in general.

Formal business sector employment is down 31% to 463,000 (34% of which is private sector employment). In real MT terms formal business sector industry contribution is down 56%, commerce down 69%, and agriculture down 40%. However, as mentioned before, there is evidence of recovery in vegetable, fruit and fish production, the former probably because of freing market prices and A.I.D. Mozambique interventions (CIP). The government projects exports up 8% p.a., which is not nearly sufficient to treat the country's disastrous balance of trade.

2. Population

Mozambique is not overpopulated in the sense that there is still sufficient untilled arable land available. However, in the sense that it cannot feed and educate its citizens, it does have a population problem. 75% of population is rural, mostly family farms.

There is an alarming urban drift - cities are growing at 7% p.a. - caused by security and economic problems.

3. <u>Business base</u>

International transportation receipts are 60% of 1981 levels, 30% of those of mid '70s. As this income traditionally balanced a chronic trade deficit, the decline is a major problem. While there is some hope for providing security in the Beira Corridor, and therefore greatly increasing traffic, the Maputo-RSA link and the northern one with Malawi are still far from secure.

Industry operates at 20-40% of capacity, and 1985 exports are 14% of imports. It now appears that these measures of the country's economic disaster bottomed out in 1986.

4. <u>Market potential</u>

The low wage rate ($20 per month average, up to $300 for skilled managers) is among the lowest in the world. For example, Haiti's is $60 per month, China's $21. This favors unskilled-labor-intensive export industries, especially if the production process allows for individual productivity incentives.

There is an excellent hydroelectric sales potential to RSA if the power pylons can be guarded, reportedly only possible with direct RSA cooperation. There is also high potential for exports of products based on seafood, cashews, timber, tea and cotton if security problems in the producing areas and transport channels are resolved. Similarly, there are opportunities for high value to weight mineral exports (e.g. tantalite) if mines and transport are allowed to use privatized security forces and such forces are available for hire at reasonable prices.

5. Basic materials and parts

Almost all must be imported, even cement clinker.

6. Infrastructure

Despite high agricultural, hydroelectric and mineral potential, historically the major infrastructure has been devoted to serving transport needs of neighboring countries. Because of this and security problems with land links, Mozambique needs coastal, river and lake shipping. There is also likely to be a private sector civil aviation opportunity.

7. Local capital and credit

Larger firms formerly used cheap, plentiful local currency bank financing, but now they mostly self-finance working capital needs because of IMF-inspired restrictions on bank lending. Small scale enterprises use family funds and supplier credit, with no access to banks.

Capital investment is limited by lack of confidence as to future economic prospects and future foreign exchange availability. Transformation industries cannot get sufficient agricultural supplies from the interior to justify new capital investment. However, there is some evidence that managers of big industries prefer capital investment to more imaginative use of available labor and materials. This is a common problem in developing countries, particularly ex-colonies, and is one of the many reasons for increasing management training.

8. Business services, entrepreneurial and management resources

The Chamber of Commerce, with its strong government connection, favors large enterprises and is currently not very active.

Entrepreneurs are in very short supply except in retail trade and a few simple services. Expatriate nationals who have gained skills abroad and repatriated Portuguese hold moderately high potential if they can be encouraged to return.

9. Skilled labor

This is in very short supply and must be generally be trained within each firm.

IV.

OTHER DONOR CURRENT ACTIVITIES AND PLANS

Figure 4 provides details about each donor's projects. The following is a summary of each one's major activities.

A. AUSTRIA

Beira Corridor and heavy industry (e.g. CIFEL, abattoir), also SOS small villages for orphans and assorted agriculture projects.

B. PORTUGAL

Cabora Bassa Dam finance, two lines of credit to two Portuguese companies in Bengela and Beira, IMA (steel company), Lusalit (building materials), irrigation projects, pipes and fiber cement for building schools and houses.

C. FAO

Major agency for UNDP technical assistance program (institution building and production-oriented research for improvement of agricultural products).

D. ITALY

Pledged to spend $400 million in the next three years, all in public sector areas such as ports and vehicles. They have signed a new protocol to provide $26 million in food and an additional $80 million for other inputs.

E. UNDP

Training for university-level managers, management of the emergency (mainly food) distribution system (they and other donors will import 1500 trucks in 1988-9 to distribute 700 thousand tons of grain).

F. UNICEF

Help to abandoned and crippled children, relief and rehabilitation.

G. U.S. EMBASSY COMMERCIAL SECTION

Export promotion program

H. UNITED KINGDOM

Will provide 15 million pounds for import support.

I. MONAP

Nordic joint agricultural program budgeted at $12.5 million in 1988,provides support to the Ministry of Agriculture to aid the private sector and support women's program. MONAP is also working with small enterprises.

J. WORLD BANK

The Bank is preparing projects which will promote rehabilitation finance for export-oriented large industries. It will also provide finance, technical assistance and management support to private and public firms, particularly those supplying infrastructure such as housing.

K. EQUATOR BANK

The Equator Fund gives grants to small farmers ($40,000 this year).

L. FRENCH EMBASSY

Lending $20 million for Texlon textile factory revitalization.

M. SIDA

While its aim is to create financially viable projects, SIDA is expected to withdraw its support after "some time". The Swedes are discontented at being drawn further and further into projects breeding long-term dependency on foreign exchange and technical assistance inputs. 1985-88 spending is $29.2 million.

N. SUMMARY

There is little donor participation in private sector support. Only the Portuguese, FAO, MONAP, World Bank, A.I.D. Mozambique and Equator have any such programs. A.I.D. Mozambique is the only donor with a significant proportion of its total support in the private sector. However, there is strong interest among donors in A.I.D. Mozambique's designing relatively limited activities to bring private sector strengths to their programs (e.g. truck maintenance).

V.

DIAGNOSIS

Based on the findings outlined in the previous chapters, this section briefly presents key constraints and opportunities to private sector growth, organized by type of resource needed for any firm's expansion.

A. MANAGEMENT

- Weak at the top and supervisory levels, with no access to outside training;
- There is some potential for a few Portuguese and skilled expatriate citizens to return.

B. MONEY

- While local currency seems abundant in bank balance sheets, the IMF-supported credit restrictions effectively severely limit credit availability;
- Foreign exchange is generally limited to state importers and retentions by already-exporting firms, resulting in severe constraints to production. It appears that management does not use the parallel market as much as is done in other countries with similar problems;
- Portuguese debt-equity swaps up to a total of $45 million are now possible, but it is too early to say whether they will be a significant source of capital.

C. MARKETS

- The requirement to buy and sell through state distributors raises costs and prices, lowers productivity and reduces market penetration;
- The insurgency results in the only safe zones being the major cities (containing about 25% of the population) and reduces the market for mass consumer goods by 50% or more;
- The distribution system is severely disrupted;
- Years of isolation, poor country image and flight of Portuguese has resulted in lack of foreign market contacts.

D. MANPOWER

- Plentiful in cities (farmers are tied to the subsistence economy), cheap, untrained, and of low productivity.

E. MATERIALS

- Scarce and high-cost, with a need to import almost all of them.

F. CONCLUSIONS

The principal factors missing in the Mozambique private sector economy, inhibiting its rehabilitation and expansion, include:

- Absence of private sector organizations to facilitate access to government and for inter-company communication, resulting in little mutually supportive activity;

- Dangerous dependence on donor aid and government-supplied foreign exchange, resulting in ineffectual functioning of the credit system;

- An enclave mentality in the private sector, with major populations and resources in rural areas cut off from the urban productive centers;

- A notable deficiency in administrative and technical management, as well as a severe shortage of spare parts, leading to very low utilization of plant and equipment.

VI.

A.I.D. Mozambique OBJECTIVES AND RESOURCES

"The American people understand that the goal of foreign assistance is not simply to keep people alive for the next 12 months. Rather, it is to give people the tools to be self-sufficient economically and to pursue more advanced levels of economic growth in an atmosphere of political stability." Peter McPherson, New York Times (no date or page).

A. RECOMMENDED OBJECTIVES

The team recommends that A.I.D. Mozambique pursue the following objectives in its support of the private sector. In other words, it should expect eventual projects to produce measurable results in these areas.

- Increased self reliance and reduced dependence on donor support
- Employment generation
- Income growth
- Rapid growth of exports
- Improved income distribution
- Private sector institution development, leading to development of a market-type economic system.

B. RESOURCES - HUMAN AND FINANCIAL

To achieve the above objectives A.I.D. Mozambique expects to work with limited resources, naturally affecting its choice of strategies. Local currency counterpart generations now total approximately $57 million at the current exchange rate. However, monetizing any significant portion of it is out of the question because of the inflationary effect. Attributing it to previously-approved ministry budgets might be technically acceptable, but it is questionable if it would directly strengthen the private sector.

Current program annual spending is about $10 million (mostly CIP) and is expected to rise to at least $15 million. The present program design has correctly taken into account the lack of mission professional personnel. As future manpower will be almost as limited, any new activities are likely to need additional local intermediaries or contractors to implement successfully.

One of A.I.D. Mozambique's major resources is being able to tap A.I.D.'s experience and human resources which many successful private sector projects in other countries have created. Not only A.I.D. officers but also consultants and other outsiders are available to design and help execute such projects. A.I.D. Mozambique might be able to use Agency and Bureau level facilities, such as management-training (it has begun to use the regional Human Resources Development facilities) and SSE-support projects, without committing much local management time. Particularly compared to other donors operating in Mozambique, these resources give A.I.D. Mozambique a real advantage in assisting the private sector

VII.

RECOMMENDED MISSION STRATEGIES TO STIMULATE PRIVATE SECTOR

A. INTRODUCTION

1. Definition of a strategy

A strategy is the mobilization of resources towards the achievement of an objective. Strategy setting is discussed next.

2. Steps to strategy formulation

Broadly speaking, strategy setting is an analytical endeavor that selects practical actions to solve identified problems and achieve agreed-upon objectives. The development of a strategy relies on:

- Defining the problems;
- Defining desired objectives;
- Formulating a rationale for an implementing vehicle, in this case, "why support the private sector?";
- Narrowing the focus and determining priorities by identifying availability of resources - human and material;
- Formulating specific initiatives or approaches to assist in answering, "What do we do?", moving towards defining potential project interventions.

3. Rationale for considering strategies rather than specific projects

This process is likely to result in a few selected projects which:

- Try to make limited A.I.D. Mozambique human and financial resources have their greatest impact on private sector growth;
- Assure coherence among the few projects which are eventually selected;
- Facilitate coordination between A.I.D. Mozambique and other US Mission activities supporting the private sector;
- Give a long term basis to A.I.D. Mozambique resource planning.

4. <u>How the recommended strategies are described</u>

The discussion of each strategy contains the following sections:

- Selected approaches: These are not necessarily recommended projects, rather illustrations to better describe the strategy.
- Policy dialog: This is an important area because, "While there are numerous reasons for Africa's economic predicament, one reason stands out: misguided economic policies. For many African governments, reforming bad policies is the most promising economic growth and development strategy for the years ahead." A.I.D., "Policy Reform Programs in Africa: a Preliminary Assessment of Impacts, Executive Summary", p. i.

However, A.I.D. Mozambique should not put itself in the position of the doctor, with the GPRM the patient. Sections below simply list selected policy questions which are likely to come up during strategy implementation.

Policy dialog, as well as the remaining points below, include only actions necessary for implementation of the strategy in question.

- Collaboration with other donors and other US agencies: This section discusses strategy elements to which other donors are likely to add resources or areas where A.I.D. Mozambique resources are particularly needed to leverage private sector benefits of other donor or mission programs.
- Independent private sector actions: These are areas where unsupported private sector activities are necessary to execute a strategic element.
- Finance: It is beyond this study's scope to give more than general comments on sources and level of funding.
- Organization/management: This section points out which entities might be involved in executing the strategy.
- Immediate steps: Work which should be started now to develop the strategy.
- Longer term actions: These are actions involved in executing the strategy itself.
- Results measurement: These are key, measurable items which will change if A.I.D. Mozambique implements its strategy successfully.

5. Common thread of strategies

The strategies described below include the support of management, technical assistance and coordination among donors, rather than providing massive finance. This is consistent with A.I.D. Mozambique's resources and recommended private sector objectives, as described in the last chapter.

6. Scope of recommendations

The recommended strategies do not cover A.I.D. Mozambique's involvement in support of large foreign investment projects, disaster assistance or direct support to the GPRM. Such activities fall outside the scope of the team's study.

7. Recommended approach to implementation of strategies

The strategies are listed in recommended order of priority. The team recommends that A.I.D. Mozambique carry out all four strategies over the next three to five years, but that A.I.D. Mozambique stay within its manpower and financial constraints by executing only one or two small projects under each.

B. STRATEGY I: Enhance development of private sector institutions and participation in the economy.

1. Selected approaches

- Promote the formation of a business association and other organizations - such as cooperative unions and provincial small-farmer associations (which have been organized to get inputs, equipment and technical assistance) and possibly the nascent small input producers' associations - to support management skill development and promote private sector views;

- Support the export promotion function in existing firms (involve the U.S. Trade Development Program beyond the financing-study phase, especially in the shrimp, minerals and building materials areas);
- Support on-the-job labor training initiatives;
- Assist the formation of a loan guarantee fund (based on local currency generations) to facilitate purchases of state-held firms, specifically helping a private sector firm to gain the ability to run such an operation.

2. Policy dialog, collaboration with other donors and other US agencies

As part of carrying out this strategy, A.I.D. Mozambique should encourage business associations and other non-government organizations to present issues for discussion which represent the views of broad sectors of the private sector. Major areas which A.I.D. Mozambique should discuss with the GPRM are permitting the private sector to carry out its purchases and sales without the intermediation of government and under generally-promulgated rules rather than case-by-case negotiations. When it enters the area of counterpart funds use, A.I.D. Mozambique should negotiate uses of local currency generations which support a broad base of enterprises rather than a few specially-selected firms.

Because of its special resources, congressional mandate and the wishes of other donors, A.I.D. Mozambique can and should assume a leadership role in coordination of donor private sector activities. For example, with no more human resources than A.I.D. Mozambique has, USAID/Botswana is playing an effective role in the donor community of recommending activities which support the private sector and placing experts in key institutions such as the national chamber of commerce.

With the possible exception of guarantee funds, new A.I.D. Mozambique activities should provide management assistance through such means as planning support and training, while other donors furnish the capital to, for example, privatize the transportation and distribution network. The Africa Bureau and PRE have several facilities (e.g. banker-client training) which have been economical and effective elsewhere. Through discussions within other U.S. Mission elements, A.I.D. Mozambique should develop a common strategy for promoting relations with and support of both national and provincial chambers of commerce as a single system in the private sector. Elsewhere, for example in Botswana, Guatemala and Ecuador, government interference in these organizations has diminished when the organizations began to offer real benefits to their members, and thus to draw their support.

3. Independent private sector actions

A very small amount of A.I.D. Mozambique technical assistance will help private sector organizations to develop their own objectives and plans. The team detected a weakness among many managers of large organizations, in which they insist on uneconomic levels of new investment rather than make better use of the assets which remain in the country. As SSE's are traditionally very good at the latter, there is an opportunity for a business organization to provide a forum which will allow large and small organizations to help each other, in a purely businesslike, profit-seeking way. Further, on the assumption that in the long term secure areas remain isolated urban islands, there is a need for regional business organizations to develop regular consultations which will bind these centers together.

4. Finance and organization/management

A.I.D. Mozambique should plan its spending on the principle that most private-sector projects should become self-financing by the end of the project period. To plan otherwise is to assume that there are external economies, not available to those private sector elements which are to pay for the goods or services financed. In Mozambique's unusual and difficult-to-measure environment, such an assumption may be hard to support at the planning or evaluation stages. As the examples in the first section of this discussion show, A.I.D. Mozambique can utilize local currency generations as a guarantee fund and additional Development Assistance supplements to provide technical assistance, not massive capital finance. Support of a new business association, through presently-available technical assistance and training funds, should start immediately (and did, in fact, start during the team's visit). Other strategy elements should await overall agreement on the mission strategic plan.

Technical assistance and training projects require little A.I.D. Mozambique management time if intermediaries such as business associations make well-reasoned individual assistance recommendations, following A.I.D. Mozambique-developed guidelines. Operations risking large quantities of local currency generations, e.g. through a guarantee fund, run the danger of being more mission-management intensive unless an existing private sector organization carries most of the management burden for a fee.

Post-trip consultations in Washington reveal PRE/I interest in helping to develop such a delivery system. The idea would be to support the establishment of a new, small, semi-autonomous unit of Standard & Totta Bank. It would broker leveraged buyouts of intervened companies, supported by the guarantee fund mentioned above and also perhaps have access to PRE's dollar revolving fund to finance inputs for exporting companies. If this unit were to go after smaller, more promising businesses, the World Bank would be likely particularly to support it.

5. Immediate steps, longer term actions and results measurement

A.I.D. Mozambique has already begun to support the formation of a business organization. Through consultation with its members, chambers of commerce, the GPRM, and A.I.D./W - A.I.D. Mozambique should quickly begin to develop one or two specific follow-on projects under this strategy.

As a longer term action, the mission might execute one or two of these follow-on projects. Chosing these should grow out of a day-to-day relationship with the organizations, in which both A.I.D. Mozambique and the organizations begin to appreciate the organizations' key needs and select from these one or two which A.I.D. Mozambique has both the financial resources and special expertise to help address. For example, but at the risk of anticipating the results of this process, there are Africa Bureau or PRE resources readily available for banker-client training in the exporting process.

Projects under this strategy should be set up in a way to facilitate measurement of changes which relate to A.I.D. Mozambique's objectives. Examples are:

- Percentage of total firms joining business associations and extent of national coverage;
- Number and extent of GPRM rule changes giving more flexibility to import-export trade;
- Number and specific results of technical assistance and training interventions.

C. STRATEGY II: <u>Stimulate transformation of international donations into self-sustaining key private sector activities.</u>

1. <u>Selected approaches</u>

On the assumption that the war continues indefinitely, a key necessity is to influence the conversion of massive donor resource injections (food, capital equipment, money) into a large number of small, flexible private sector activities, at least some of which can be successful in rural areas. Examples are rural-shop-based grain milling, equipment repair, mini-irrigation systems and artisanal fishing. Such small units are perhaps less subject to attack and, with improved linkages to cities (see Strategy III), might provide for at least the survival o. the rural population cver the long run.

Other examples are:

- Establishment of a lease-purchase firm for donor trucks;
- Repair facilities for donated equipment;
- Support of domestic and international debt/equity swaps;
- Locally managed private security firm.

2. Policy dialog, collaboration with other donors and other US agencies

A.I.D. Mozambique should take the lead with other donors in defining appropriate private sector dialog issues with the GPRM, particularly in the area of better private sector use of donated capital. An example is recommend necessary legal changes to enable private sector lease-purchase of assets which will be donated to the government.

A.I.D. Mozambique should continue hosting donor meetings on private sector topics, as the first one was not time-consuming and was successful at focusing donor attention on the private sector.

3. Independent private sector actions

A.I.D. Mozambique training activities should encourage entrepreneurs to commercialize their activities on a for-profit basis, e.g. leasing of trucks instead of working for a donor as a driver.

4. Finance and organization/management

A.I.D. Mozambique should use local currency generations to support a guarantee fund (useful, for example, in the above lease-purchase possibility) and Development Assistance funds, particularly to support the planning and training parts of the above possibilities.

Donor relations will be top-management-intensive for A.I.D. Mozambique, so other activities should be handled by outside contractors.

5. Immediate steps, longer term actions and results measurement

As mentioned above, A.I.D. Mozambique should keep up the present momentum of hosting donor meetings. Through such consultations it should develop a donor consensus on one or two specific projects which are within the mission's financial constraints and for which expertise from A.I.D./W or identified contractors is readily available. A.I.D. Mozambique could then carry out one or two such projects.

Besides the measurements mentioned in Strategy I, projects under this strategy should document A.I.D.'s leveraging effect on other donors' projects and should therefore measure the number of other donor projects which were once executed through the public sector but now have private sector elements. It should also measure the number and size of other donor projects now with self-sustaining elements.

D. STRATEGY III: Increase private sector urban-rural linkages.

1. Selected approaches

Under the assumption that the insurgency will continue indefinitely and that the countryside will remain insecure, a major Mozambique resource would be a string of interconnected secure urban areas, containing about 30% of the population (about five million). Because of low wage rates and good access to ports, heavy exports of labor-intensive goods should be possible. Examples of development steps to secure this asset are:

- Expand coastal and river shipping, civil air transport;
- Reactivate the rural retail network;
- Support integrated agribusiness joint ventures, both domestic and foreign, maximizing foreign input, technical

and marketing assistance but minimizing ownership of hard-to-defend local assets;

- Encourage upcountry grain milling.

2. Policy dialog, collaboration with other donors and other US agencies

A.I.D. Mozambique should encourage GPRM authorization to organize private security forces with the right to bear arms but under properly-supervised licensed conditions. On the assumption that Renamo will especially target growing, effective businesses, GPRM forces are probably insufficient to protect such scattered assets, but such businesses should be able to pay for and manage at least a part of their own protection. A.I.D. Mozambique should also encourage the reduction of state companies in rural shipping and distribution. A good use of technical assistance is to provide a clearer picture to private sector promoters of GPRM-acceptable deal characteristics for potential agribusiness joint ventures.

A.I.D. Mozambique should encourage other donors to utilize private sector repair facilities and train local repair technicians. It should participate in dialog with chambers of commerce, especially outside of Maputo.

3. Independent private sector actions

As explained above, A.I.D. Mozambique should promote subcontracting between large and small enterprises.

4. Finance and organization/management

The fund collateralized by local counterpart generations, described in Strategies I and II, is likely to consider credit guarantees to small scale enterprises in the activities favored under this strategy - e.g. truck leasing, rural milling, costal and river shipping - if A.I.D. Mozambique technical assistance to entrepreneurs in these fields includes help in designing bankable projects.

The heavy use of the guarantee-fund in executing this strategy requires developing a private sector intermediary to avoid A.I.D. Mozambique's being forced to make case-by-case decisions. Such a possible intermediary has already been described.

5. Immediate steps, longer term actions and results measurement

After, perhaps, some technical assistance to better define a position and its benefits to the economy, A.I.D. Mozambique should start the above policy dialog steps. At the same time, it should develop one or two specific projects - but probably not immediately tackling the use of a guarantee fund - under this strategy.

As a second step, A.I.D. Mozambique should study and negotiate the use of local currency generations as a guarantee fund. As part of this step, it needs to identify and develop a private sector intermediary, then execute one or two projects using the fund. If necessary to satisfy the GPRM, A.I.D. Mozambique could develop a policy statement on the use of the currency generations so that it will not be railroaded into such unwise moves as bailing out heavily-indebted state enterprises.

A.I.D. Mozambique should encourage a donor such as the World Bank to develop baseline statistics on rural-urban interchange of goods by volume, value and means of transport. Thus, when A.I.D. Mozambique designs projects under this strategy, it will be able to set up goals for the projects' impact on such levels.

E. STRATEGY IV: Rehabilitate and convert existing underutilized plant and equipment capacity.

1. Selected approaches

As stated above, many local managers appear to lack the skills necessary to use effectively already-available plant and equipment. Such use gets recovery going more quickly, saves foreign exchange, avoids future maintenance problems from over-sophisticated equipment and promotes substitution of low-cost labor for capital. Some appropriate A.I.D. Mozambique technical assistance projects might be:

- Provide for technical assistance appropriate to in-place plant and equipment, using retired IESC or VITA volunteers (or professionals from countries which successfully use such equipment, e.g. Brazil) who are familiar with "outdated" equipment;
- Expand CIP's scope slightly to allow for the import of used machinery, once its appropriateness had been certified by an organization such as VITA. Many developing-country firms use such economical and easily-repaired machinery, and knowledgeable brokers are available in North America and Europe;
- Support efficient use of existing equipment by providing technical assistance to existing firms and supporting the private sector's importing of used parts and machinery, for example, through giving technical assistance to the establishment of a spare-parts "finder" firm (a successful one exists in Kenya);

- Support of domestic and international barter transactions.

2. Policy dialog, collaboration with other donors and other US agencies

A.I.D. Mozambique could provide the GPRM with model regulations which have worked elsewhere, covering private companies' importing used machinery and replacement parts. It should also help to clarify GPRM rules (import/export regulations and tax) on international barter transactions.

A.I.D. Mozambique should convince donors to sell or lease equipment used in their programs to independent entrepreneurs.

3. Independent private sector actions

As mentioned above, A.I.D. Mozambique can use a PVO to work with private firms to renovate plant and equipment with assistance of retired professionals and used machinery.

4. Finance and organization/management

CIP funding may have to be expanded slightly to cover its possible increased scope. Development Assistance funds would be used for technical assistance.

As PVO's currently exist which are experienced in executing major elements of this strategy, execution would not be A.I.D. Mozambique-management intensive.

5. Immediate steps, longer term actions and results measurement

A.I.D. Mozambique has already started talking to VITA, but it should contact other such PVO's through A.I.D./W to ask for proposals. It should then develop one or two projects with such PVO's.

One appropriate measurement of the results of this strategy is the number of plants rehabilitated with A.I.D. Mozambique assistance. Before CIP is expanded, clear performance standards must be set, as no good ones exist now.

F. OTHER RECOMMENDATIONS

1. Studies to develop strategies

In general, many studies necessary to develop projects under the above strategies already exist. Other donor agencies appear to have a wealth of them. Further, the local consulting group developed for this study would be a very appropriate source of much other information. However, there are a few areas which probably require new work before beginning the process of project development.

- Informal sector research: The above selected approaches pay less attention to SSE's than the Analysis and Diagnosis would lead one to expect because so little is known about the sector in Mozambique. It appears clear that "standard models", in which small loans at above-commercial rates and no explicit technical assistance can result in project self-sufficiency, are unlikely to work in Mozambique because of the sector's multiple problems. The issue is whether a new, appropriate approach (i.e. which addresses problems which many SSE's have but with a good chance for eventual self-sufficiency) is feasible.
- Family farming and artisanal fishing study: What inputs and processing/marketing assistance would result in enough foreign exchange generation to cover foreign

exchange costs of assistance? What works now in Mozambique, especially under difficult security conditions, and could be expanded (e.g. production of jute for bags, technical help for small cotton producers)?

- Identification and study of needed commercial (including distribution-system) improvements for the few subsectors which now have overcome all other barriers (perhaps small commercial fisheries).

2. <u>Technical assistance to A.I.D. Mozambique</u>

A.I.D. Mozambique will probably require some technical assistance, beyond the above studies, to start project development. Examples are:

- Further definition of A.I.D. Mozambique project-management needs and the impact of resulting planned capabilities on project selection;
- Define alternative organization approaches for A.I.D. Mozambique to implement chosen strategies (e.g. use of a contractor to carry out project tasks which a local mission would normally handle, and continued use of Bureau-wide facilities, such as the regional Human Resources Development Project).
- Help to the mission to work with the GPRM to carry out some sample state-enterprise and intervened-company valuations or market appraisals so as to test the feasibility of the several possible projects involving privatization.

ANNEXES

FIGURE 1

INTERACTION OF THE PRIVATE SECTOR WITH

THE DONOR COMMUNITY AND THE GOVERNMENT OF MOZAMBIQUE

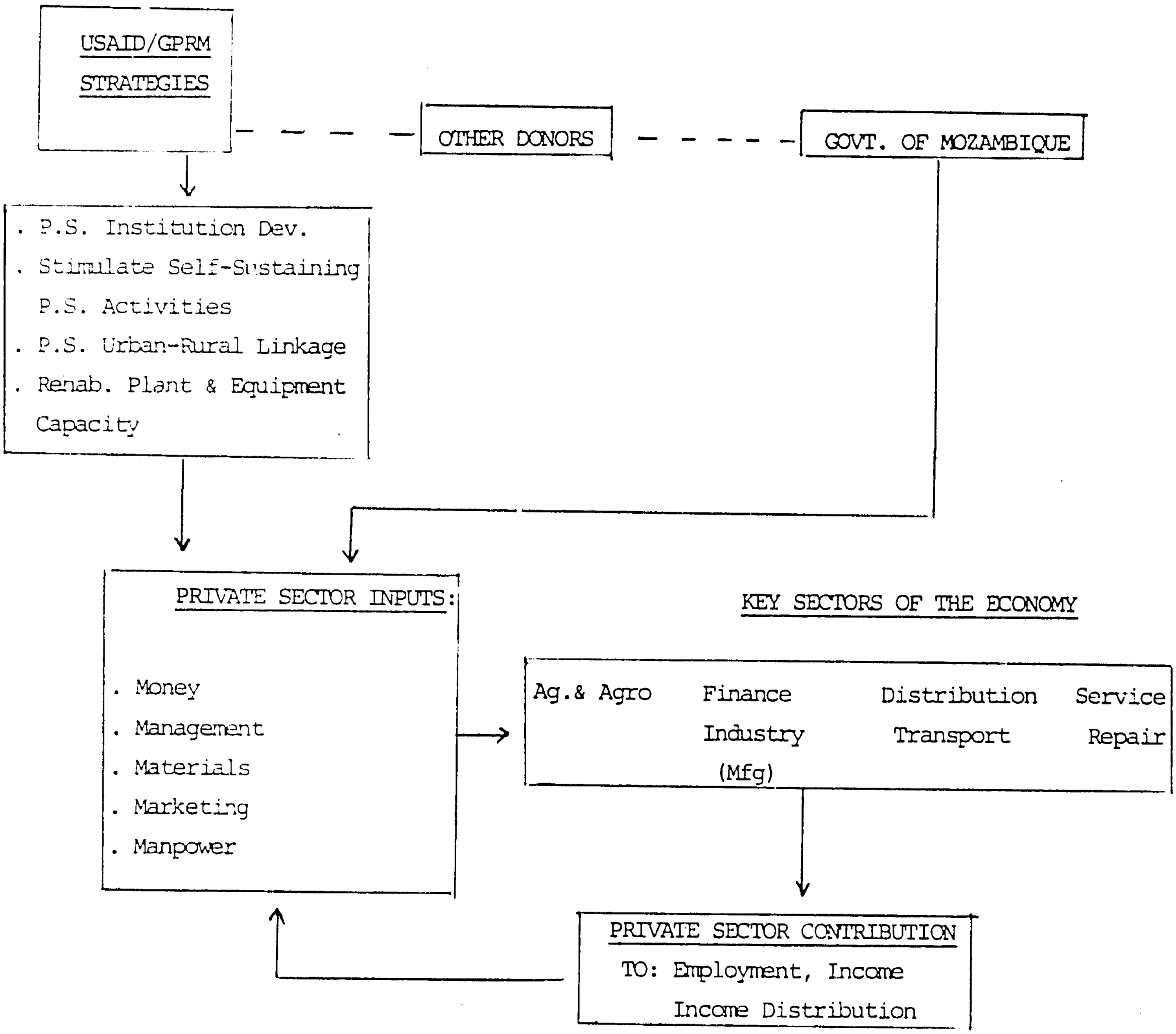

Figure 2

RELATIVE IMPORTANCE GIVEN BY BUSINESS EXECUTIVES TO ECONOMIC AND MARKET FACTORS IN ENCOURAGING PRIVATE SECTOR DEVELOPMENT IN MOZAMBIQUE

FACTOR	CONSIDERED FAVORABLE			CONSIDERED UNFAVORABLE		
	MAJOR	MODE.	MINOR	MAJOR	MODE.	MINOR
Political stability & risk			X			
National development plans		X				
Business formation and investment incentives					X	
International remittances					X	
International trade restrictions	X					
International agreements		X				
Taxes			X			
Labor laws			X			
Government controls and interferences				X		
Availability of advisory services					X	
Economic and market stability			X			
Population					X	
Business base				X		
Market potential			X			
Basic material and parts				X		
Infrastructure				X		
Local credit and capital			X			
Business and human resources					X	
Skilled labor				X		

Figure 3

Selected Characteristics Of Enterprises Visited In Maputo and Xinavane

Sector/Activity	Fixed Assets ($U.S.) Replacement Value	Current Employment	Current Capacity	Ownership/ Mngt. Control	Importance in Economy	Major Growth Constraints
Agro-Industry/ Food Processing	5 million	400	< 17%	Family Corp./ Private	Only rice producer	Raw materials-Spare parts Security/Distribution Labor Product vity
Agriculture/ Tobacco	10 million	130	100%	Family/Private	80% of local market	Raw materials--98% of blend is imported tobacco
Agro-Industry/ Sugar Cane	100 million	3,500	9,000 tons '88 80,000 '72	2/3 GPRM-1/3 Portugal Govt. Portuguese Mngt.	Only producer, Country now imports	Foreign Exchange Machinery-Spare Parts Security, No World Mkt.
Agro-Industry/ Condensed Milk	10 million	150	25%	1/3 GPRM-1/3 Std. Tota Bank Private	Only producer	Materials--all imported, can't get tin cans (sugar & powder milk require foreign exchange)
Agro-Industry/ Tea	50 thousand	25	10%	Family Corp./ Private	Import substi-tution	Security Government control purchasing
Industry/ Rubber tubes	8 million	75-100	> 40%	Private/Private	Major Mfg.	Raw materials ($1.2 million a year)--Government controls
Industry/ Tires	65 million	400	-0-	Private & GPRM/ Private	Only producer	Foreign exchange Labor (training)-Market infor.
Industry/ Textile	100 million	1000	85%	Foreign + GPRM/ Private	Export Indus.	Security--lack of cotton Spare parts Gov. controls purchase & sales
Industry/ Steel	5 million	25	10%	GPRM & Private/ Private	Major Producer	Foreign exchange Dependent on donors
Industry/ Metal mechanic	0.5 million	25	85%	Sole proprietor/ Private	Repair-rural link	Raw materials Spare Parts
Industry/ Metal mechanic	100 thousand	60	85%	Sole proprietor/ Private	New & repair-rural link	Limited market--security (Donor success & Woman mngt.)
Artisan Indus./ Ceramic	50 thousand	108	80%	Sole proprietor/ Private	Major rural employer	Plant equip. very old but appropriate, only one truck.
Industry/Emboss	150 thousand	15	80%	Sole proprietor/ Private	Only producer	Lack of materials No local technical assistance

Sector/Activity	Fixed Assets ($ U.S.) Replacement Value	Current Employment	Current Capacity	Ownership/ Mngt. Control	Importance in Economy	Major Growth Constraints
Industry/Shoes	10 thousand	100	75%	Sole proprietor/ Private	Potential export	Cost of leather locally more than import Govt. control of purchasing Foreign exchange retention difficult
Transport/Ships	150 million	1,600	100%	Private Holding Co./ Private	Only major private Co.	Government regulations, control
Commerce/Store	5-10 thousand	3	10%	Family/Private	Consumer goods	Government control-No mkt.
Commerce/Optical	20 thousand	3-5	90%	Family/Private	Consumer goods	Foreign exchange--lenses Government control--stones
Commerce/Lenses	50 thousand	23	90%	Private/GPRM	Service Import Subs.	Govt. purchasing of lenses Lack of knowledge--export mkt.
Commerce/Store	500	2	15%	Sole proprietor/ Private	Consumer goods	Govt purchasing control Govt regulations on profit
Service/Repair	200	2	60%	Sole proprietor/ Private	Low-income fam. shoe repair	Lack of raw materials Lack of working capital
Central Markets	100	1	low	Sole proprietor/ Private	Food products	Govt. control of purchasing Govt. control of prices except vegetables/fruit No money, no working capital

FIGURE 4
IDENTIFICATION OF OTHER DONOR PROJECT SUPPORT
FOR THE PRIVATE SECTOR
(US$)

Project Activity (Title and Number)	Donor	Assistance 1986	Committed for Total Project	Duration Total Project Begin-End Date	Nature of Assistance and Location
CEFONA	France	569,782	6,386,292	1984-89	Creation of a training center and maintenance of agricultural machinery, Chokwe
Agricultural Input Supply Project/Manica Province	FRGermany	N/A	2,160,000	1986-89	Providing local farmers with seed, fertilizer and farming tools
MOZ/81/022/K/01/37 Steel Industry	UNDP	155,423	418,000	1984-87	Assistance to the establishment of steel industry in Mozambique. 1 expert, short term consultants, Maputo
MOZ/82/011/M/01/37	UNDP	2,000	429,000	1983-85	Assistance to the establishment of an aluminum industry. In 1986 only some equipment. Maputo
Investment Promotion	Friedrich Ebert Foundation	9,130	9,130	1986	Foundation of "Gabinete de Promoção dos Investimentos Estrangeiros" (G.P.I.E.)
M067 Trucks	UNICEF/USA FOR AFRICA	97,600	97,600	1986	Donation of USA for Africa through UNICEF to Support NGO logistic capacity in a number of provinces
Private Sector Rehabilitation	USAID	720,000	3,000,000	1984-89	Studies of the construction and building materials industries, and the ammonia and oil industry; private sector agricultural machinery repair and training.

DONOR CAPITAL ASSISTANCE

Title or Project/Activity	External Source(s) of Investment and Date	Capital Committed (US$ Equiv.) Loans/ Credits	Grant	Amount Disbursed in 1986	Coments (grace period, interest rate, location of project, etc.)
Cassava Production	Canada 1986		21,739	21,739	Purchase of two tractors for the Cooperative General Union. Ploughing and planting of around 420 ha.
"Julius Nyerere" Cooperative	Canada 1986		18,116	N/A	Support hand tools purchase for a carpentry cooperative in Chimoio, Manica Province
Rehabilitation of Texlom in Maputo	France 1984	7,788,160		198,000	Training program and rehabilitation. Maturity 15 years; grace period 5 years; interest 5%; 30% grant. Matola
Cotton Production Units (1 and 2)	France 1984	2,414,330		180,374	Maturity 15 years; grace period 5 years; interest 4,5%. Nampula-Cabo Delgado. 32% grant component
Revolving Fund	FEF 1985	365,300			Various Projects (rehabilitation of carpentry workshops, pottery materials, vegetable oil, etc.); provinces of Niassa, Maputo, Zambezia, Cabo Delgado and Sofala.
Private Sector Rehabilitation Commodity Imports	United States		9,570,000	9,570,000	To finance agricultural inputs (equipment, fuel, tools, seeds, etc) for private, family, commercial and cooperative farmers, in Maputo and Gaza Provinces.
Rehabilitation Credit	World Bank (June 1985)	45,000,000		23,700,000	General development credit for spare parts, raw materials, and technical assistance, for the industrial, transport and agricultural sectors; to be used within 2 years; grace period: 10 years; amortization: 40 years.
Commodity imports; Balance of Payments support	Holland		3,500,000		Services and maintenance contracts; commodity imports and balance of payments support.

ANNEX A

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ANNEX B

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ANNEX C

MACRO-ECONOMIC DEVELOPMENTS IN MOZAMBIQUE

Source: A.I.D. Mozambique, March 1987

1. Background

Economic activity in Mozambique contracted sharply from 1980 through 1986. Even though the downward trend of income was halted in 1986 and positive growth has been reported for 1987, the various available measures indicate that aggregate real income in 1986 was less than 68% of its 1980 level. In addition, per capita income has declined by over 50% from 1980 through 1986 and is believed to remain constant or decline slightly in 1987.

Mozambique's external accounts are in disastrous imbalance. Ex-ante overall balance of payments deficits have risen from $32 million in 1980 to $542 million in 1986. The financing of these deficits has led to the reduction of the country's foreign reserves from $268 million in 1980 to $72 million at the end of 1986. In addition, over $1.1 billion in debt arrears were accumulated over this period. The overall deficits arise from the following developments:

- Contraction in exports of goods and services of over 45%;

- Increase of over 300% in scheduled debt service (excluding arrears) which has resulted in debt service to export ratios of 100% or more since 1982; and

- Increase in non-interest service expenditures of more than 78%.

Through 1986 Mozambique's currency was highly overvalued relative to foreign currencies. The rate at which the metical was pegged was not adjusted either in response to domestic inflation or the general shortage of foreign exchange in the country.

Mozambique's internal financial situation has been equally mismanaged. Due to large budget deficits and parastatal losses, the broadly defined money supply has risen at an annual rate of roughly 20%. Money held by the public has grown from 43% of income in 1980 to over 70% of income in 1986. This monetary expansion, largely driven by the fiscal deficit, has placed extreme pressures on domestic prices which officially have increased at an annual rate of 20-25%. Given the extreme rigidity and lack of adjustment in official prices, the full scope of these lax policies have been reflected through shortages in official markets and significantly higher prices in parallel markets.

2. Economic Rehabilitation Program

The current economic rehabilitation program (ERP) for 1987-89 being implemented by the Government of the People's Republic of Mozambique (GPPM) in collaboration with the International Monetary Fund (IMF) and the World Bank (IBRD) is directed at:

- Reversing the decline in production and restoring a minimum level of income and consumption, particularly in rural areas;

- Curtailing domestic financial imbalances and strengthening the external payments position;

- Establishing conditions for sustainable economic growth once security conditions and other exogenous factors permit.

3. Exchange Rate

A principal target has been the exchange rate. At the outset of the program, foreign exchange was selling at up to 40 times the official rate on the parallel market. The exchange rate has undergone a series of adjustments with nearly all resulting price changes passed along in domestic consumer prices. By January 1988, the metical had been devalued from 39 meticais per US dollar to 450 meticais per dollar, a nominal depreciation of approximately 92%. At the same time, the price of foreign exchange on the parallel market has also declined from a reported high of 1800 to approximately 900 meticais per dollar at the end of 1987. As a result, the GPRM met its target for moving the official exchange rate to at least 50% of the parallel rate as of the beginning of 1988. The GPRM is expected to adjust the metical to about 70% of the parallel rate in 1988 and reach a market-clearing rate by the end of the program in 1989.

4. Agricultural Reforms

Since 1983 and, more systematically, since the adoption of the IMF/IBRD economic rehabilitation program in 1987, the GPRM has departed substantially from the concept of central economic planning. Private farmers are now recognized as the basis for agricultural policy. Price controls on fruits and vegetables were abolished in 1985. The remaining ceiling prices on foods (other than basic staples) - e.g. meat - are well above present market clearing prices. It is anticipated that the completion of the reforms proposed in the ERP will take several years with the initial program covering a three year period. Many changes have occurred since the start of the ERP in January of 1987. In agriculture, pricing and marketing reform is being directed at stimulating production and improving the incomes of rural producers. Price changes occurring since January 1987 for selected commodities follow:

AGRICULTURAL PRODUCER PRICES
(Meticais per kilo)

	1986	1987	Percentage Increase
Maize	13	65	400
Rice	16	75	369
Sorghum	12	65	442
Beans	23.5	150	538
Groundnuts	20	150	650
Sunflower	15	75	400
Copra	9.7	100	930
Cashews	20	105	425
Cotton	12.5	104	732

In accordance with its overall pricing policies, the GPRM intends, over the life of the ERP, to reduce further the number of agricultural products subject to fixed pricing. However, for those commodities for which prices continue to be fixed (e.g. basic grains), producer prices will be set based on international prices, appropriately adjusted to ensure adequate producer incentives and processing and internal distribution costs.

5. Other Reforms

The GPRM allowed wage increases in 1987 which provided higher raises and bonuses to more valuable employees. Similarly, provisions were made for releasing employees for economic reasons. As a result, Maputo civil service rolls were reduced by approximately 10% due to redundancies, while the state farms and parastatal sectors realized smaller losses. Fiscal policies were also reformed, with subventions to the parastatal sector being brought on-budget and faced with nominal ceilings slightly below their prior year's levels. A cap was placed on consumer price subsidies payable on some staple items. Furthermore, the number of items subject to fixed prices was reduced. Finally, the tax code was substantially revised in 1987, streamlining personal income taxes while expanding the tax net, increasing turnover and consumption taxes, and accelerating business tax payments.

6. Future Prospects

Although these represent a wide range of reform activities, they have been undertaken so recently that their impact cannot yet be fully assessed. Early indicators show, however, that capacity utilization and production are up, and a modest rate of growth has been reported for 1987. Growth projections for 1988 are substantially higher. The actual outcome for the rehabilitation program is of course also dependent on the exogenous factors of weather and insurgency. Thus, in spite of the adoption of a wide array of progressive economic reforms, the growth expected as a response to these reforms is susceptible to drought and insurgency activities. It is difficult, if not impossible, at this time to begin to disaggregate the effects of each on the economy.