PD-AAZ-846

Mozambique Private Sector Support Program

(656-0208)

August 1989

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: Timothy J. Bork, AFR/PD

SUBJECT: Mozambique Private Sector Support Program (656-0208)

I. Problem: You are requested to (a) approve a multi-year Private Sector Support Program totalling $45.55 million for Mozambique; (b) authorize $13.55 million for obligation in FY 1989 and disbursement through a CIP mechanism; (c) authorize $1.5 million for technical assistance over the life of the program; (d) redelegate authority to the USAID/Mozambique Mission Director to authorize incremental obligations, with conditions on that authority described herein; and (e) reconfirm a waiver of Agency policy to allow placement of local currency generations under the program in a non-interest bearing account.

II. Discussion: USAID/Maputo proposes to provide $45.55 million over three years to support the liberalization of prices and marketing for agricultural products. $13.55 million of DFA is anticipated to be obligated in FY 1989. Of the $45.55 million program total, $44.05 will be provided for non-project assistance under a Commodity Import Program (CIP) and $1.5 million will be provided for technical assistance to support implementation of policy reforms and for monitoring, evaluation and audit purposes. In FY 1990 and FY 1991 some non-project assistance funds could be authorized for disbursement through an Open General License (OGL) system described further below. Such authorization shall be subject to AID/W concurrence. This program follows a five-year rehabilitation program from 1984-1988 which provided $54.905 million in agricultural commodities.

A. Purpose

The purpose of the program is to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. Specific policy impacts expected through the program are:

(1) increased liberalization of agricultural producer prices and, for food crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices on world parity;

(2) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers;

(3) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and

(4) tested policy and procedural options to both increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market principles as a basis for foreign exchange allocations.

B. Macroeconomic Background

In 1987 the Government of Mozambique (GOM) launched a comprehensive Economic Rehabilitation Program (ERP) with the World Bank and the IMF. This has led to major reforms in pricing, distribution channels, exchange rate policy, and control over public expenditures. The program has received widespread donor support and has facilitated major Paris Club and London Club reschedulings of the country's debt. The ERP's impact has been reflected in a reversal of negative growth rates since 1980 to positive gains in GDP of 4 percent in 1987 and 1988. Agricultural producer prices are now approaching import/export parity and the exchange rate has moved significantly toward equilibrium.

C. Private Agricultural Sector

Because agriculture is the most productive sector of the economy, the GOM's strategy under the ERP focuses on stimulating agricultural production on family and commercial terms. A.I.D.'s assistance has been both a precursor of and support to the ERP. The policy reform measures outlined in the Private Sector Support Program focus on private agriculture. They build upon the general reform measures which the GOM developed with the World Bank and the IMF in the context of the February, 1989, Policy Framework Paper. The Mission believes that continued support for private agriculture is appropriate as it (1) addresses food security requirements in an emergency situation; (2) helps reduce emergency import and logistical needs; (3) represents the most viable area for private sector led growth without major infrastructural investment; (4) decentralizes investment decisions to private producers who can best judge viable investments in the current environment; and (5) contributes significantly to an improved macroeconomic position.

D. Program Description

1. Policy Reform Agenda

An approved analytical framework for the program, including the planned policy implementation schedule, is presented in Table 1. The GOM and USAID/Mozambique will finalize the policy agenda in a

Table 1

SUMMARY OF POLICY OBJECTIVES AND WORKPLAN

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS
1. Agricultural Producer Prices	Objective: To maximize the liberalization of the producer pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural policies on world parity.			- Price changes and announcements.	- Production increases on family & commercial farms. - Farm income increases (family & commerical farms).	- Production statistics by crop, province and production unit. - Estimate farm income calculated from production functions. - Farm level sampling to verify macro analyses.
a. Maize, Beans, Rice	Establish parity producer prices; plan for floor price system.	Establish parity-based floor price system.	Adjust floor price system to reflect changing market conditions.			
b. Cash Crops	Establish parity-based floor price system; plan for deregulation.	Deregulate all producer prices.	Maintain deregulation.			
c. Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	Objective: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of National Plan.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and Implementation	Complete national plan and USAID-specific implementation schedule.	Implement Phase I	Implement Phase II			
b. Assessment		Impact evaluation.	Impact evaluation.			
3. Private Ag. Sales and Service	Objective: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/traders participating in program.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For Importers, Distributors	Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	New A.I.D. items and spares fully private. Plan to privatize or phase out lubricants. Plan to privatize ag-related public enterprises.	Implement Phase I of privatization plan for lubricants.			
b. For End Users	Replace GOM administrative allocation system of ag inputs with direct sales via private companies.	Maintain direct sales.	Maintain direct sales.			
4. Access to Foreign Exchange	Objective: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			- Implementation of FI allocation options agreed upon with donors. - Range of eligible OGL sectors and volumes of FI increased.	- Increased access to foreign exchange at market-determined price.	- Survey of OGL users to determine private access. - Trends in official and parallel exchange rates.
a. Allocation Mechanism	Establish limited trial of OGL system.	If trial is generally successful, modify and expand eligible sectors under OGL; otherwise, formulate new options.	Plan to extend OGL framework to larger portion of FI allocations or test other allocation options.			
b. Assessment		Impact Assessment				

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letter of intent which the GOM will submit before the initial obligation of funds. The letter of intent will be based upon the framework as outlined and discussed in the Mozambique Private Sector Support PAAD. It will specify precise policy measures to be implemented during 1989/90 with more general targets for 1990/91 and 1991/92. USAID and a GOM working group on food and agriculture policy will meet quarterly to review progress on policy matters and will update the policy agenda annually. Through this approach, the GOM will adopt the agreed upon policy agenda as its own program, in effect institutionalizing a policy process in which USAID will actively participate.

2. Disbursement Mechanisms

FY 1989 resources will continue to be provided through a Commodity Import Program (CIP) for production inputs and capital goods focussed on the private agricultural sector. For FY 1990 and FY 1991, consideration will be given to disbursing funds through the Open General License System the GOM is implementing with World Bank and IMF backing. In its trial phase the OGL will introduce a system for nonadministrative (i.e. market based) foreign exchange allocations for a limited range of industrial inputs. If successful, the OGL will make hard currency allocations for eligible sectors more dependent on market principles and give productive enterprises more direct control over import decisions. Several policy and evaluation requirements would have to be met before funding the OGL with A.I.D. assistance. Prior to authorizing program funds for disbursement through an OGL, the Mission would seek AID/W concurrence.

3. Technical Assistance

A small amount of program funds ($1.5 million) is to be authorized separately for short term technical assistance (TA) on policy matters related to the food and agriculture sector, implementation and monitoring of program activities, and an external audit and evaluation. USAID/Mozambique proposes to use short term TA to provide frequent "snapshots" of the impact of various policy measures and to analyze their logical evolution. Eight short term technical assistance teams are envisaged over the life of the program. Funds will also support ongoing monitoring of program impact. Technical assistance funds will be first obligated in FY 1990. Until then, USAID/Mozambique will utilize funds remaining under the earlier Private Sector Rehabilitation Program to meet TA needs.

4. Local Currency

Local currency will be used in accordance with the Africa Bureau's guidance of July 1988 and Agency guidance contained in STATE 327494 dated October 1987. Funds will be programmed "in support of the proposed sector of the reform program", specifically, the food and agriculture sector. This sector is also defined to include commodity marketing. To ensure compliance with Africa Bureau guidance, USAID and the Ministry of Finance have developed a set of programming principles for local currencies which is included in the Program Assistance Approcal Document (PAAD).

E. CIP Implementation

Private firms will distribute and import the bulk of program commodities. Their participation has grown progressively from 12 percent distribution and 31 percent importation in 1984 to an estimated 93 percent and 95 percent, respectively in 1989. By the end of the program, all USAID-financed commodities will be privately imported. The GOM, with A.I.D. assistance, will also develop a plan to privatize state enterprises and mixed companies in the agricultural input, implement, tractor and related commodities business.

F. Feasibility

1. Institutional Commitment

USAID and the U.S. Embassy, Maputo have carefully reviewed the evolution of GOM policy and have concluded that the political and economic measures which the GOM has instituted since 1986 constitute a fundamental change in direction and focus from the years immediately following independence and that this change has been successfully integrated into the country's political consciousness. The process of economic liberalization is expected to continue in the future.

2. Social

Program benefits are transmitted primarily through policy reforms which are reinforced by increased farmer access to agricultural inputs. The principal direct beneficiaries are commercial farmers, family farmers and agricultural importers and distributors. Secondary benefits accrue from increasing the amount of domestically produced food available for purchase or emergency distribution. Improved agricultural prospects have a particularly direct impact on women who are the principal family farmers.

3. Economic

A cost/benefit analysis of the economic impact of policy reform in Mozambique, using plausible assumptions on supply elasticities, demonstrates that improved price signals could stimulate an increase in production conservatively valued at $8 million per year. This annual increment in output continued for the next twenty years would have a net present value of about $70 million. Factoring in the costs and benefits of program commodities, the benefits (about $120 million) would exceed the value of discounted costs (less than $40 million) by about three to one.

G. Financial Plan

This PAAD requests approval of the full life of program funding estimated at $45.55 million, with authority redelegated to the USAID/Mozambique Mission Director to authorize subsequent tranches. $13.55 million will be authorized initially by the AA/AFR (Acting) and obligated in FY 1989. These will be disbursed as a private agricultural sector CIP. For 1990 and 1991, $16 million will be made available annually for commodity imports, technical assistance and, tentatively, support for the OGL system. USAID financing for the OGL will be contingent upon successful completion of an evaluation and AID/W concurrence with the Mission's recommendations. Commodity import and OGL funds will be obligated to the GOM and will either generate local currency or require a complementary local currency deposit. Funds for technical assistance will be obligated through direct contracts between USAID and the respective implementing agents. An illustrative budget is provided in Table 2.

TABLE 2

SUMMARY FINANCIAL PLAN
($ 000s)

	FY 1989	FY 1990	FY 1991	TOTAL
Commodity Import Assistance	13,550	12,400	10,100	36,050
OGL Financing (Subject to concurrence)	0	3,000	5,000	8,000
Subtotal Producing L/C	13,550	15,400	15,100	44,050
Technical Assistance	0	600	900	1,500
a. Short-Term	0	400	300	700
b. Implementation & Monitoring	0	200	200	400
c. Evaluation & Audit	0	0	400	400
T O T A L	13,550	16,000	16,000	45,550

H. ECPR Conclusions

The ECPR for the Mozambique Private Sector Support PAAD met on July 14, 1989. The ECPR concluded that the PAAD was one of the most complete sector assistance presentations the Bureau has reviewed and represented significant progress in moving U.S. assistance in Mozambique from emergency aid to policy-based development assistance. The ECPR recommended that the policy framework presented in the PAAD be modified to sharpen the linkages between annual benchmarks and program objectives. The ECPR also recommended that additional mechanisms be incorporated to measure the program's farm-level impact. These changes have been made to the committee's satisfaction.

III. Prior Actions

A. Letter of Intent. Prior to the initial obligation of funds to be disbursed pursuant to the Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., a written comprehensive statement of policy governing the development of the liberalization of prices and marketing for agricultural products (the "Letter of Intent"). The Letter of Intent shall embody a liberal approach for the improvement of incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. It shall specifically address the following objectives, to be realized by the end of a three-year period under this program: (a) increased liberalization of agricultural producer prices and, for food crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices on world parity; (b) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers; (c) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and (d) tested policy options to increase both the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as a foreign exchange allocation mechanism.

B. Terms of All Disbursements. Prior to any disbursement, or the issuance of any commitment documents pursuant to which disbursement will be made, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., a statement of the names and titles of persons who will be official and additional representatives of the Cooperating Country under the Program Agreement, together with a specimen signature of each person specified in such statement.

C. Terms of Disbursement in Excess of $13,550,000. Prior to (i) disbursements of any non-project assistance funds which are in excess of $13,550,000, but which, when added to such $13,550,000 amount, total less than $29,000,000, or (ii) the issuance of any commitment documents pursuant to which such disbursements will be made, A.I.D. shall be satisfied that significant progress has been made toward achieving the policy objectives set out in the Letter of Intent and that the work plan for the first year program as described in the Letter of Intent has been completed.

D. Terms of Disbursement in Excess of $29,000,000. Prior to disbursements of any non-project assistance funds in excess of $29,000,000, or the issuance of any commitment documents pursuant to which such disbursements will be made, A.I.D. shall be satisfied that significant progress has been made toward the achievement of the goals for the second fiscal year of the program as described in the Letter of Intent, as such goals may be subsequently modified by A.I.D. and the GOM consistent with the program purpose and conceptual framework now included in the PAAD.

IV. Special Concerns

A. Waiver of Interest-Bearing Account Requirement. The requirements for the establishment of an interest-bearing special account for local currency generations and deposits under the program shall be waived. Agency guidance (as contained in State 327494, dated October 21, 1987) states interest-bearing accounts should be used " . . . so long as such accounts . . . . do not undermine internationally supported stabilization agreements and sound monetary policy." In the case of Mozambique, the Government is implementing a structural adjustment program with the World Bank and IMF. Banks cannot presently pay interest due to excess liquidity. To insist on an interest-bearing account would, therefore, undermine the viability of the Government's structural adjustment efforts with the World Bank and the IMF. It is therefore considered appropriate to waive the requirement for the interest-bearing account and instead establish a non-interest bearing special account. (Refer to Annex H of the PAAD for a more complete justification.)

B. IEE. After consultation with the Regional Legal Office serving Mozambique and the Regional Environmental Officer (REDSO/ESA) during preparation of the PAAD, a categorical exclusion was recommended and approved by the Africa Bureau Environmental Officer and GC/AFR. The IEE is attached as Annex G to the PAAD.

C. Implementation Agencies. The Program Agreement will be signed by the GOM Minister of Cooperation. A GOM working group on food and agriculture policy which includes representatives from the the Ministries of Finance, Agriculture and Commerce will have principle responsibility for ensuring the implementation of policy reforms. This working group will meet quarterly with USAID/Maputo.

D. Responsible Officers. In the field, Judi Shane is the Commodity Management Officer responsible for the CIP component and Carlos Pascual is the Program Officer responsible for the technical assistance and policy component. Sidney Bliss, AFR/PD/SA, is the officer responsible for backstopping the program in AID/W.

E. Statutory Checklists are attached to the PAAD.

F. Gray Amendment. The PAAD recommends full and open competition in the choice of contractors for the technical assistance component. CBD notices and instructions to offerors will contain language encouraging "participation to the maximum extent possible of small business concerns, small disadvantaged business concerns and woman-owned small business concerns ... as prime contractors or subcontractors."

G. Source and Origin of Commodities, Nationality of Services. The nationality of services, including ocean transportation services, and the source and origin of commodities financed under the project shall be as set forth in the Africa Bureau instructions on Implementing Special Procurement Policy Rules Governing the Development Fund for Africa (DFA), dated April 4, 1988, as may be from time to time amended.

H. Local Costs. Dollar disbursements for local costs are not expected and will not be made unless such disbursements are made in accordance with the requirements of Handbook 1B, Chapter 18.

I. Notification to Congress. The Planned Program Summary Sheet was included in the FY 1989 Congressional Presentation.

V. Recommendation

That you: (i) approve a multi-year Private Sector Support Program with total anticipated A.I.D. funding of $45.55 million; (ii) authorize $13.55 million for obligation in FY89. These funds will be obligated and disbursed as a CIP; (iii) authorize $1.5 million in project assistance to be obligated in FYs 1990-1991; (iv) redelegate authority to the USAID/Mozambique Mission Director to authorize funding increments, with AID/W concurrence to be sought before authorizing funds for OGL disbursement; and (v) waive the requirement that local currencies generated or deposited under the program be placed in an interest-bearing account.

APPROVED [signature]

DISAPPROVED ____________

DATE 8-24-89

Clearances:
AFR/PD, KKelly (draft)
AFR/SA, DMelville (draft)
AFR/DP, LRosenberg (draft)
AFR/TR/ARD, TO'Hare (draft)
PPC/PB, RMaushammer (draft)
GC/AFR, MFittipaldi
DAA/AFR, ELSaiers

AFR/PD/SAP:CKozell/CPascual:eld:7/20/89:5112L

ECPR ISSUES PAPER

Friday, July 14, 1989
2:00 p.m.
Room 6941 NS

Country	:	Mozambique
Program	:	Private Sector Support (656-0208)
Estimated LOP Funding	:	$ 45.55 Million
FY 1989 Authorization	:	$ 13.55 Million
Obligation	:	$ 13.55 Million
Authorization Venue		
First Tranche	:	AID/W
Subsequent Tranches	:	USAID/Mozambique

I. Description.

The proposed Private Sector Support Program (656-0208) is a multi-year, policy-based assistance program for Mozambique aimed at reform of the agricultural sector. It forms part of a multi-donor support package which assists the GOM through the difficult process of implementing its Economic Reform Program (the "ERP"). The GOM's strategy under the ERP focuses on stimulating agricultural production in the family and commercial sectors, and the policy measures described under the proposed program focus on private agriculture. They also build upon the more general reform measures which the GOM develcped with the World Bank and the IMF in the context of the recently approved Policy Framework Paper (the "PFP"). The Mission believes that continued support for private agriculture is appropriate as it: (a) addresses food security requirements in an emergency situation; (b) helps reduce emergency import and logistical needs; (c) represents the most viable area for private sector rehabilitation without major infrastructural investment; (d) decentralizes investment decisions to private producers who can best judge viable investments in the current environment; and (e) contributes significantly to an improved macroeconomic position.

The overall goal to which the proposed program contributes is to "increase agricultural production and exports and promote domestic food security." The specific purpose of the program is to "improve incentives for private agricultural production in order to enhance the private agricultural sector's production and income." To achieve this purpose, the Mission proposes to support implementation of several GOM policy reforms aimed at the following objectives:

A. The complete liberalization of the producer pricing system for Mozambican agricultural commodities;

B. The redistribution of state farms to commercial and family farmers;

C. The development of private sales and service networks for agricultural inputs; and,

D. The institutionalization of a foreign exchange allocation mechanism (an Open General Licensing [OGL]) to increase the private sector's access to foreign exchange and to allow the market to play a greater role in determining the uses of scarce foreign exchange.

To accomplish these objectives, the GOM will implement early workplans. Authorization and obligation of subsequent tranches of this three year program will be contingent upon a review of the completion of the prior year's workplan.

The Mission has requested approval of a three-year, $45.55 million program. The FY 1989 authorization and obligation will total $13.55 million and will be disbursed as a CIP. During the second year, the Mission requests authority to authorize and obligate a total of $16 million, of which $12.4 million will be disbursed as a CIP; $3 million may be disbursed as a cash grant to the GOM to finance the OGL; and $600,000 will finance technical assistance associated with the program. For FY 1991, $10.1 million will be disbursed as a CIP; $5 million for the OGL; and $900,000 for technical assistance.

An issues meeting was held on July 12, 1989. At that meeting issues identified by the Bureau and REDSO/ESA (Nairobi 20274, attached) were discussed. The conditionality concerns raised by REDSO were clarified at the meeting. The issue related to REDSO's environmental concerns was discussed and the Mission representative will work with AFR/TR/ANR to submit and process approval for a revised IEE. Other concerns and issues raised will be referred to the ECPR for review and decision.

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II. Issues and Concerns

A. Issue No. 1: Are the overall program objectives of policy reforms in the areas of agricultural price liberalization and the privatization of agricultural inputs achievable over the course of the program? Are they the appropriate objectives?

Discussion: The Mission has clearly stated the policy objectives of reforms in all four of the proposed areas. It is also relatively clear what the first year conditionality (i.e., target) is in each policy area and how that relates to the overall objective. In the outyears, the Mission is proposing a process for continued reform, and with respect to agricultural pricing and input privatization, it is clear that at the end of the program the GOM will be somewhere on the road to achieving the stated objective. At the ECPR, the Bureau agreed that out year conditionality need not be specified at this time. However, the Mission was instructed to develop achievable program targets and indicate what the anticipated out-year targets might look like for achieving each objective. Unless the Bureau is prepared to approve targets which will not meet the stated objectives, either the objectives of the program or the policy targets may need to be revised.

The ECPR should discuss with the Mission representative the overall framework for the program. Because the Bureau has indicated a willingness to approve less than a stringent conditionality strategy in this case, a full exposition of the development objective/policy reform matrix should be included in the PAAD itself.

Recommendation: That the overall framework be revised to include objectives achievable within the life of the program. Once completed, the workplans and specific targets to be reached should be revised so as to clearly achieve the stated objectives.

B. Issue No. 2: Are the objectives in the state farm objectives area appropriate at this time?

Discussion: One of the overall objectives of the program is to divest the GOM of the state farms. During the life of the program, approximately 10,000 hectares will be divested. As A.I.D. experience shows, divestiture is not only a question of policy change. It involves a plethora of specific actions on the part of the government and host country institutions capable of carrying out those function. In the area of land reform/land redistribution, the process is particularly fraught with socio-cultural concerns. Does the GOM have the capacity to divide, measure, title and transfer secure title to new owners and register the land? What does it do with occupants

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who cannot buy the land or a parcel? Is there a land transfer and title system that functions? Is the Mission intending to include any technical assistance to help effect the divestiture process?

Recommendation: That the objective in this area be scaled back to allow sufficient time and analytical effort to (1) develop a rational and complete GOM land divestiture policy; and, (2) determine what additional skills or institutional capacities are required to implement a land divestiture program.

C. Issue No. 3: Is approval of A.I.D. financial support for the Open General Licensing System warranted at this time?

Discussion: The PAAD proposes to move to a cash disbursement mode after 1989 if the GOM is ready to implement an Open General Licensing System. The PAAD, in fact, states that A.I.D. dollars would be used to finance such a system. Under the OGL, the Central Bank would essentially allocate foreign exchange for uses that it, the Central Bank, approves. Does the setting up of such a system really represent a positive step toward introducing market forces into the foreign exchange allocation system? The application for, review of, and granting of import licenses can be a very cumbersome process susceptible at every step to the influence of non-economic considerations. Generally, when governments seek to introduce market considerations into the foreign exchange allocation process, it is systems such as the OGL that are dismantled or undermined. What other alternatives (foreign exchaqnge auctions, limited recognition of the illegal, but operational, parallel market, crawling peg devaluations, etc.) has the GOM considered to introduce market forces into the foreign exchange regimen? Alternatively, is the objective of the GOM simply to develop a system for it to better control access to foreign exchange for more clients?

At the same time that the Mission is proposing to initiate dollar disbursements for the OGL, it is also proposing to continue with the CIP. Why is the Mission proposing to maintain two foreign exchange allocation mechanisms side-by-side? It would seem that such a practice could undermine the effectiveness of the OGL by maintaining a special procedure for certain imports.

How important is specific A.I.D. assistance to the OGL since at this time Bureau policy is to disburse dollars under a cash grant for specific policy reforms, not to finance specific activities? The Bureau's position is that such funds will be disbursed to the host country for general foreign exchange use (with the specific exception of military financing) and not for specific uses. Therefore, at best and under current guidance we would probably only want to approve a cash grant as a disbursement to the foreign exchange holdings of the GOM. What implications would such lack of specificity have on the OGL? on the ability of the GOM to effectively manage and use A.I.D. resources?

The PAAD forms the basis for approval of a three year program, which includes the period under which the OGL would initiate operations. Yet, the PAAD is uncertain that A.I.D. support will be provided or is warranted for the OGL. Can the Bureau feel comfortable approving this as an option to be exercised without further AID/W review prior to initiation of cash disbursements? Alternatively, the Mission has proposed submitting the specifics of the OGL for AID/W review in conjunction with subsequent authorization amendments. In this case, authority to delgate future year tranches should not be delegated to the Mission at this time.

Recommendation: That the inclusion of specific support for the development and implementation of the OGL (either as an acceptable policy measure or as worthy of A.I.D. financing) be postponed to at least the second year of the program. In the meantime, and as the intentions of the GOM and the World Bank and the design of the program become more clear, the Mission should submit an separate request for including the OGL in the program.

D. Issue No. 4: Is the relationship between the illustrative use of local currency and the overall program strategy sufficiently clear? What are the parameters which will dictate local currency use?

Discussion: The PAAD contains a detailed discussion of the types of constraints Mozambique faces in determining the proper use of local currency. The Mission should be commended for its recognition and analysis of the relationship of between LC use and the macroeconomic situation. The PAAD, however, contains a list of potential uses of local currency. There is no indication of priority or magnitudes of resources that might be directed at any of the proposed uses (with the exception of the A.I.D. Trust Fund). Some of these uses are off the budget uses. Some of them require A.I.D. management. It is unclear under others that are to be disbursed through the budget whether they are additional or new line items (i.e., represent expenditure increases). At the same time, some of the uses appear very directed and may not quite fit into the category of "generalized budget support" as defined in the Oct. 1987 guidance. This would have certain management implications for the Mission.

Recommendation: That a more complete presentation be included in the local currency use plan. This should include an illustrative budget (with room for flexibility), and an assessment of the management implications of each type of activity contemplated.

E. Issue No. 5: Is the monitoring and evaluation plan adequate in form and content?

Discussion: The Mission has placed some importance on acquiring sufficient data to monitor the program. The PAAD states that feedback and experience will be important in order to adjust the policy environment. "Feedback and experience" appears to refer to the 8 snapshots (2 economists spending 6 weeks in-country on 8 occasions over three years) to be taken, as well as a survey of three model farms on a quarterly basis. While such an approach may be adequate to monitor some aspects of what's happening at the farm level, there is some question as to whether the snapshots and surveys will provide the data required to adequately assess the impact of the policies over time. How will the Mission look at questions of farm production impact? How will it assess whether the peasant farmer, the family farmer and the commercial farmer are economically better off after prices have been liberalized and inputs are privatized and state land is divested? Such impact indicators do not appear to have been incorporated into the evaluation plan.

The Project Committee also questioned the adequacy of the proposed methodolgy for collecting adequate evaluation data. Will the snapshots and surveys provide the data required to adequately assess the impact of reforms (price changes, land divestiture, input privatization) unless some system for regular data collection is established. Since there are at least three types of farms, the usefulness for evaluation purposes of surveying only three model farms to provide qualitative information seems limited.

Recommendation: That the Mission incorporate a more systematic and more impact focussed evaluation effort into the program and devote adequate resources to it.

F. Issue No. 6: Are the timing and content of technical assistance resources both adequate and sufficient to ensure both implementation and tracking of the program objectives?

Discussion: The human resource constraint to development in Mozambique is well knowm and documented. The Mission in discussing the policy dialog process in Mozambique has often bemoaned the shortage of expertise in the GOM. At the same time, implementation of several of the policy reforms will require a high level of expertise. State farm divestiture, as stated above, requires much more than policy change. Implementation of any new foreign exchange allocation system is tricky for even the best of economists and Central Bank managers. Yet, there is no technical assistance aimed at helping the GOM to implement any of the policies. Why?

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The policy dialogue process as outlined in the PAAD also seems limited. Should the Mission encourage the GOM to broaden that process? Broadening it would probably require additional expertise. Finally, what is the Mission's capacity to carry on an on-going policy dialogue with the GOM and (hopefully) other elements of Mozambican society? No Mission economist has been identified, and REDSO has indicated that it cannot provide the same level of economist assistance during implementation that it did during design. If the Mission is to undertake an active policy dialogue, it will probably require more assistance, not less.

Recommendation: That the Mission be encouraged to incorporate a greater level of technical expertise in the program to help with implementation and that such expertise be financed earlier than the second year of implementation.

G. Issue No. 7: Is the authorization/obligation/ disbursement strategy outlined in the PAAD acceptable?

Discussion: AID/W is being asked to authorize the program without A.I.D. having received the GOM's Letter of Intent. Once the Letter is received the Mission will obligate and disburse the program. At that point there is still three years of program targets or conditions to meet and only two tranches of resources left. It appears that the Mission considers finalization of this program's targets to be a condition for a follow-on program. The Mission's proposal is consistent with an approach to program implementation that is ex post facto, but it may be inconsistent with our desire to "get ahead of the curve". Under the disbursement plan proposed, all resources would be disbursed well in advance of initiating work on third year targets. Is this reasonable?

Should the Program be authorized or obligated prior to receipt of an acceptable Letter of Intent? Should the Program be disbursed prior to meeting targets?

Recommendations:

(1) That an acceptable Letter of Intent be received prior to obligation of funds.

(2) That the ECPR discuss the feasibility of moving program targets forward or, alternatively, holding a third tranche of A.I.D. resources for disbursement closer to the end of the Program. This may be made more feasible by holding whatever cash disbursement may be contemplated for the final year.

H. Concerns.

1. Separation of authorization and approval for project and non-project components of the program. Documentation will need to be revised to include appropriate authorizations for both project and non-project assistance.

2. Interest on Local Currency Accounts. Pending GC review, the PAAD may need to include a waiver of A.I.D. policy on interest to be earned on Special Accounts.

draft: AFR/PD/SA:CRozell:5086L:7/14/89

CLASSIFICATION: UNCLASSIFIED

AID 1120-1 (8-86)

PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: 656-0208 PAAD NO. 656-T-604

2. COUNTRY: MOZAMBIQUE

3. CATEGORY: PRIVATE SECTOR SUPPORT PROGRAM

4. DATE: June 30, 1989

5. TO: Walter Bollinger, A/AA/AFR

6. OYB CHANGE NO.:

7. FROM: Timothy J. Bork, AFR/PD

8. OYB INCREASE:

TO BE TAKEN FROM:

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 13,550,000

10. APPROPRIATION - ALLOTMENT: GSSA 89-31656-KG39 (914 61 656 00.53-91) 72-1191014

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☐ INFORMAL ☒ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD: 7/89 - 6/93

14. TRANSACTION ELIGIBILITY DATE: Date of obligation

15. COMMODITIES FINANCED

Seeds; fertilizers; tractors, tractor spare parts, harvest equipment and implements; trucks and truck spare parts;irrigation equipment, pipe and spare parts; lubricants.

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $1,588,710
Limited F.W.:	Special Free World: (935) $8,234,540
Free World: $13,550,000	Local:
Cash:	Selected Free World: (941) $3,726,750

18. SUMMARY DESCRIPTION

The attached Program Assistance Approval Document (PAAD) contains justification for a multi-year $45,550,000 non-project assistance grant to liberalize prices and marketing for agricultural products in Mozambique. A summary of the policy objectives appears in Table 1 attached hereto. Direct assistance will be provided for agricultural inputs and other commodities that address production and marketing constraints in the agricultural sector. This facesheet authorizes a $13,550,000 non-project assistance grant for this purpose for FY 1989 as the initial tranche of non-project assistance to be provided under the program. In each subsequent fiscal year of the program, the PAAD facesheet may be amended by the USAID/Maputo Director to increase the authorized level of funding by the amount to be obligated for disbursement to the Open General License (OGL) system in Mozambique; concurrence from AID/W shall be sought before such obligation and pursuant to Africa Bureau guidance on subsequent authorizations of non-project assistance.

The authorization reconfirms a waiver of A.I.D. policy with respect to the placement of local currency generations or deposits into an interest bearing account for LOP funding.

19. CLEARANCES		DATE
AFR/SA, FFischer	[signature]	8/8/89
AFR/DP, JWestley	[signature]	8/2
AFR/PD, TBork	[signature]	8/6/89
GC/AFR, ESpriggs	[signature]	8/7/89
SER/OP/COMS, JFrame	[signature]	8/3/89
PFM/FM/PAFD, EOwens	[signature]	8/2/89
PPC/PB, RMaushammer	[signature]	8/3/89
DAA/AFR, LSaiers	[signature]	8/24

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Walter J. Bollinger — 8/24/8

AUTHORIZED SIGNATURE DATE

TITLE

CLASSIFICATION:

Pursuant to the Foreign Assistance Act of 1961, and the Foreign Operations, Export Financing and Related Programs Appropriations Act of 1989, I hereby approve the three year non-project assistance component described herein. I hereby delegate authority to the Director, USAID/Maputo, to authorize these incremental non-project assistance funds except that, if any non-project assistance funds are to be used to support OGL, concurrence from A.I.D./W shall be sought before the obligation of any such funds. Conditionality in these PAAD amendments must be consistent with the program purpose and conceptual framework described in the Letter of Intent (as defined below).

Prior to the obligation of funds to be disbursed pursuant to the Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., a written comprehensive statement of policy governing the development of the liberalization of prices and marketing for agricultural products (the "Letter of Intent"). The Letter of Intent shall embody a liberal approach for the improvement of incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. It shall specifically address the following objectives, to be realized by the end of a three-year period, for the financial sector under this program: (a) increased liberalization of agricultural producer prices and, for food crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices on world parity; (b) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers; (c) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and (d) tested policy options both to increase the access of private entrepreneurs in the agricultural sector to foreign exchange and to institutionalize market signals as a foreign exchange allocation mechanism.

The Letter of Intent shall also include a workplan for the implementation of such policy objectives over the life of the program. The policy objectives and workplan to be included in the Letter of Intent shall be substantially as outlined in Table 1 attached hereto.

The Grant Agreement shall contain, in substance, the following essential terms and conditions for obligations:

a. Terms of First Disbursement. Prior to any disbursement, or the issuance of any commitment documents pursuant to which disbursement will be made, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., a statement of the names and titles of persons who will be official and additional representatives of the Cooperating Country under the Grant Agreement, together with a specimen signature of each person specified in such statement.

b. Terms of Disbursement in Excess of $13,550,000. Prior to (i) disbursements of any non-project assistance funds which are in excess of $13,550,000, but which, when added to such $13,550,000 amount, total less than $29,000,000, or (ii) the issuance of any commitment documents pursuant to which such disbursements will be made, A.I.D. shall be satisfied that significant progress has been made toward achieving the policy objectives set out in the Letter of Intent and that the work plan for the first year program as described in the Letter of Intent has been completed.

c. Terms of Disbursement in Excess of $29,000,000. Prior to disbursements of any non-project assistance funds in excess of $29,000,000, or the issuance of any commitment documents pursuant to which such disbursements will be made, A.I.D. shall be satisfied that significant progress has been made toward the achievement of the goals for the second fiscal year of the program as described in the Letter of Intent.

Waiver of Interest-Bearing Account Requirement. The requirements for the establishment of an interest-bearing special account for local currency generations under the program shall be waived. A non-interest bearing special account shall be established for the program. Local currency counterpart funds shall be programmed under normal Mission counterpart fund programming and budgeting policies and procedures and shall support the food and agricultural sector in effecting the policy reforms to liberalize prices and agricultural marketing in accordance with Africa Bureau guidance. Projected uses of local currency generations are set forth in the body of the PAAD.

Attachment: Table 1

Clearances: As shown on Facesheet

5169L

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: ____ — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Mozambique

3. PROJECT NUMBER: 656-0218

4. BUREAU/OFFICE: Africa — 06

5. PROJECT TITLE (maximum 40 characters): Private Sector Support Program T.A.

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 06 DD 30 YY 93

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 90 — B. Quarter 1 — C. Final FY 91

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE		FIRST FY 90 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total		600		600	1,500		1,500
(Grant)		(600)	( )	(600)	(1,500)	( )	(1,500)
(Loan)		( )	( )	( )	( )	( )	( )
Other U.S.	1.						
	2.						
Host Country							
Other Donor(s)							
TOTALS		600		600	1,500		1,500

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) SS	144	070				1,500		1,500	
(2)									
(3)									
(4)									
TOTALS						1,500		1,500	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 011 | 019 | 070

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BR	BL	BF
B. Amount	500	500	500

13. PROJECT PURPOSE (maximum 480 characters)

To improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income.

14. SCHEDULED EVALUATIONS: Interim MM YY MM YY — Final MM 03 YY 91

15. SOURCE/ORIGIN OF GOODS AND SERVICES: ☐ 000 ☒ 941 ☐ Local ☒ Other (Specify) 935

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY
Signature: Walter G. Bollinger
Title: Walter G. Bollinger, A/AA/AFR
Date Signed: MM 08 DD 24 YY 89

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM 07 DD 06 YY 89

AID 1330-4 (8-79)

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PROJECT AUTHORIZATION

Name of Country:	People's Republic of Mozambique
Name of Project:	Private Sector Support Program Technical Assistance
Number of Project:	656-0218

1. Pursuant to the Foreign Assistance Act of 1961, as amended, and the provisions of the appropriations heading "Sub-Saharan Africa, Development Assistance", contained in the Foreign Operations, Export Financing, and Related Programs Appropriations Act of 1989, I hereby authorize the project component of the Private Sector Support Program for the People's Republic of Mozambique (the "Cooperating Country") involving planned obligations of not to exceed $1,500,000 in grant funds over a two-year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to finance short-term technical assistance for the project. The planned life of the project is three years from the date of initial obligation.

2. The project component will finance short-term technical assistance on policy matters related to the food and agriculture sector, implementation and monitoring of program activities and an external audit and evaluation to achieve the objectives under the Private Sector Support Program (the "PSSP"). The PSSP consists of financial and technical assistance to support the liberalization of prices and marketing for agricultural products in Mozambique.

3. Prior to the obligation of funds to be disbursed pursuant to the project component, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., a written comprehensive statement of policy governing the development of the liberalization of prices and marketing for agricultural products (the "Letter of Intent"). The Letter of Intent shall embody a liberal approach for the improvement of incentives for

private sector agricultural production in order to enhance the private agricultural sector's production and income. It shall include specifically the following objectives for the financial sector under this program: (a) increased liberalization of agricultural producer prices and, for food crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices on world parity; (b) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers; (c) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and (d) tested policy options to increase both the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as a foreign exchange allocation mechanism.

The Letter of Intent shall also include a workplan for the implementation of such policy objectives over the life of the program. The policy objectives and workplan to be included in the Letter of Intent shall be substantially as outlined in Table 1 attached hereto.

4. Any agreements for technical assistance under the project component which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Source and Origin of Commodities, Nationality of Services. The nationality for suppliers of services, including ocean transportation services, and the source of origin of commodities financed under the project component shall be as set forth in the Africa Bureau Instructions on Implementing Special Procurement Policy Rules Governing the Development Fund for Africa, dated April 4, 1988, as may be amended from time to time.

Walter Bollinger
Walter Bollinger
Assistant Administrator
Bureau for Africa

Date: 8/24/89

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Table 1

SUMMARY OF POLICY OBJECTIVES AND WORKPLAN

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS
1. Agricultural Producer Prices	Objective: To maximize the liberalization of the producer pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural policies on world parity.			- Price changes and announcements.	- Production increases on family & commercial farms. - Farm income increases (family & commerical farms).	- Production statistics by crop, province and production unit. - Estimate farm income calculated from production functions. - Farm level sampling to verify macro analyses.
a. Maize, Beans, Rice	Establish parity producer prices; plan for floor price system.	Establish parity-based floor price system.	Adjust floor price system to reflect changing market conditions.			
b. Cash Crops	Establish parity-based floor price system; plan for deregulation.	Deregulate all producer prices.	Maintain deregulation.			
c. Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	Objective: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of National Plan.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and Implementation	Complete national plan and USAID-specific implementation schedule.	Implement Phase I	Implement Phase II			
b. Assessment		Impact evaluation.	Impact evaluation.			
3. Private Ag. Sales and Service	Objective: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/traders participating in program.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For Importers, Distributors	Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	New A.I.D. items and spares fully private. Plan to privatize or phase out lubricants. Plan to privatize ag-related public enterprises.	Implement Phase I of privatization plan for lubricants.			
b. For End Users	Replace GOM administrative allocation system of ag inputs with direct sales via private companies.	Maintain direct sales.	Maintain direct sales.			
4. Access to Foreign Exchange	Objective: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			- Implementation of FX allocation options agreed upon with donors. - Range of eligible OGL sectors and volumes of FX increased.	- Increased access to foreign-exchange at market-determined price.	- Survey of OGL users to determine private access. - Trends in official and parallel exchange rates.
a. Allocation Mechanism	Establish limited trial of OGL system.	If trial is generally successful, modify and expand eligible sectors under OGL; otherwise, formulate new options.	Plan to extend OGL framework to larger portion of FX allocations or test other allocation options.			
b. Assessment		Impact Assessment				

Clearances:

AFR/PD/SA, CRozell ____CRozell____
AFR/PD, KKelly ________________
AFR/SA, DMelville ________________
AFR/DP, JGovan ________________
AFR/DP/PAR, LRosenberg ________________
GC/AFR, MFittipaldi ________________

M/SER/OP/OS/AFR, JHacken ________________
PPC/PB, RMaushammer ________________
DAA/AFR, ELSaiers ________________

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(656-0208)

PROGRAM ASSISTANCE APPROVAL DOCUMENT

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Economic Analysis

Market Analysis

5123L

E X E C U T I V E   S U M M A R Y

I. Purpose and Funding Level

The Private Sector Support Program is a non-project assistance activity to support the liberalization of prices and marketing for agricultural products. The purpose of the program is to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. Specific policy impacts expected through the program are:

(a) increased liberalization of agricultural producer prices and, for food crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices on world parity, with prices announced in time to affect production decisions;

(b) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers;

(c) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and

(d) tested policy options to increase both the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as a foreign exchange allocation mechanism.

Direct assistance will be provided for agricultural inputs and other commodities that address production and marketing constraints in the agricultural sector. In FY 1990 and FY 1991 some program funds may be disbursed through an Open General License (OGL) system described further below. Minimal technical assistance ($1.5 million) will also be financed to support implementation of policy reforms and for monitoring, evaluation and audit purposes. Total DFA funding over three years will be $45.55 million, with $13.550 million to be obligated in FY 1989. This program follows a five-year rehabilitation program from 1984-1988 which provided $54.905 million in agricultural commodities.

II. Macroeconomic Background

Foreign assistance in Mozambique must be seen in the context of post-independence insurgency, drought, and inappropriate economic policies. In 1983, the Government of Mozambique (GOM) officially acknowledged the need for reform and began to encourage private sector development. In 1987, it launched a comprehensive Economic Rehabilitation Program (ERP) with the World Bank and the IMF. This has led to major reforms in pricing, distribution channels, exchange rate policy, and control over public expenditures. The program has received widespread donor support and has facilitated major Paris Club and London Club reschedulings of debt.

The ERP's impact has been reflected in a reversal of negative growth rates since 1980 to positive gains in GDP of 4 percent in 1987 and 1988. Agricultural producer prices are now approaching import/export parity and the exchange rate has moved significantly toward equilibrium. Nevertheless, it will be years before Mozambique can shift completely from an emergency outlook to reconstruction and, eventually, to new investment. From that point, self-sustaining growth is likely to be a generation into the horizon, with the current account balance of payments gap widening in the interim. High and rising levels of donor assistance will be required well into the next century.

III. Private Agricultural Sector

The GOM's strategy under the ERP focuses on stimulating agricultural production in the family and commercial sectors. A.I.D.'s assistance was both a precursor of and support to the ERP. The policy reform measures outlined in the Private Sector Support Program focus on private agriculture. They build upon the general reform measures which the GOM developed with the World Bank and the IMF in the context of its February, 1989, Policy Framework Paper. The Mission believes that continued support for private agriculture is appropriate as it (1) addresses food security requirements in an emergency situation; (2) helps reduce emergency import and logistical needs; (3) represents the most viable area for private sector rehabilitation without major infrastructural investment; (4) decentralizes investment decisions to private producers who can best judge viable investments in the current environment; and (5) contributes significantly to an improved macroeconomic position.

IV. Program Description

A. Policy Reforms Agenda

An illustrative policy implementation schedule is presented in Table 1 and is amplified in Part Two, Section III of the text. The policy program is still under negotiation with the GOM, but basic agreement has been reached on all key objectives. The GOM and USAID/Mozambique will finalize the policy agenda in a letter of intent which the GOM will submit before the obligation of funds. The letter of intent will be based upon the policy work plan outlined in this document and will specify precise measures for 1989/90 with more general targets for 1990/91 and 1991/92. USAID and a GOM working group on food and agriculture policy will meet quarterly to review progress on policy matters and will update the policy agenda annually.

This approach offers the advantage that the GOM adopts the agreed upon policy agenda as its own program, in effect institutionalizing a policy process in which USAID will actively participate. Following are the constraints to be addressed through the policy program:

1. Producer Prices: The agricultural pricing system is central to the incentive structure for agriculture. Although most producer prices now approach import/export parity, the pricing system needs to be institutionalized and the scope for administrative discretion reduced.

2. State Farm Divestitures: Although there is no scarcity of fertile land in Mozambique, more efficient use of productive land in secure areas with access to transport routes could have a quick production impact. The evolution of land ownership patterns after independence left many of the most desirable farms in state hands. These could be more productively exploited through divestiture to commercial and family farmers.

3. Private Sales and Service Networks: The inability of parastatals to establish extensive and reliable input supply networks constrains the capacity of farmers to respond fully to improving price incentives. USAID's original Private Sector Rehabilitation Program helped establish private sales and service networks in three provinces. The key now is to create incentives to expand such networks to other provinces.

4. Access to Foreign Exchange. Until production inputs are produced locally or foreign exchange earnings radically increase, limited access to foreign exchange will be a constraint to production. Mechanisms need to be explored in order to institutionalize private sector access to the official foreign exchange market.

SUMMARY OF POLICY OBJECTIVES AND WORKPLAN

Table 1

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS
1. Agricultural Producer Prices	Objective: To maximize the liberalization of the producer pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural policies on world parity.			- Price changes and announcements.	- Production increases on family & commercial farms. - Farm income increases (family & commerical farms).	- Production statistics by crop, province and production unit. - Estimate farm income calculated from production functions. - Farm level sampling to verify macro analyses.
a. Maize, Beans, Rice	Establish parity producer prices; plan for floor price system.	Establish parity-based floor price system.	Adjust floor price system to reflect changing market conditions.			
b. Cash Crops	Establish parity-based floor price system; plan for deregulation.	Deregulate all producer prices.	Maintain deregulation.			
c. Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	Objective: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of National Plan.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and Implementation	Complete national plan and USAID-specific implementation schedule.	Implement Phase I	Implement Phase II			
b. Assessment		Impact evaluation.	Impact evaluation.			
3. Private Ag. Sales and Service	Objective: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/ traders participating in program.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For Importers, Distributors	Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	New A.I.D. items and spares fully private. Plan to privatize or phase out lubricants. Plan to privatize ag-related public enterprises.	Implement Phase I of privatization plan for lubricants.			
b. For End Users	Replace GOM administrative allocation system of ag inputs with direct sales via private companies.	Maintain direct sales.	Maintain direct sales.			
4. Access to Foreign Exchange	Objective: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			- Implementation of FX allocation options agreed upon with donors. - Range of eligible OGL sectors and volumes of FX increased.	- Increased access to foreign-exchange at market-determined price.	- Survey of OGL users to determine private access. - Trends in official and parallel exchange rates.
a. Allocation Mechanism	Establish limited trial of OGL system.	If trial is generally successful, modify and expand eligible sectors under OGL; otherwise, formulate new options.	Plan to extend OGL framework to larger portion of FX allocations or test other allocation options.			
b. Assessment		Impact Assessment				

B. Disbursement Mechanisms

In FY 1989 all A.I.D. resources will continue to be provided through a Commodity Import Program (CIP) for production inputs and capital goods focussed on the private agricultural sector. As in the original Private Sector Rehabilitation Program, this program will finance production inputs for areas in Maputo, Gaza and Manica provinces. In addition, Sofala, Zambezia, Nampula and Cabo Delgado will receive support. These areas have great potential, and demand for equipment and other production inputs is very high compared to supply.

In FY 1990 and FY 1991, consideration will be given to disbursing funds through the Open General License System the GOM is implementing with World Bank and IMF backing. In its trial phase the OGL will introduce a system for nonadministrative (i.e. market based) foreign exchange allocations for a limited range of industrial inputs. If successful, the OGL will make hard currency allocations for eligible sectors more dependent on market signals and give productive enterprises direct control over import decisions. Several policy and evaluation requirements would have to be met before funding the OGL with A.I.D. assistance.

C. Technical Assistance

A small amount of program funds will be authorized separately for short term technical assistance on policy matters related to the food and agriculture sector, implementation and monitoring of program activities, and an external audit and evaluation. Available information in Mozambique is inadequate to make cohesive policy decisions, particularly after implementing basic pricing reforms that address serious imbalances. To overcome this problem, USAID/Mozambique proposes to use short term technical assistance to provide frequent "snapshots" of the impact of various policy measures and to analyze their logical evolution. Eight short term technical assistance teams are envisaged over the life of the program. Funds will also support ongoing monitoring of program impact. Technical assistance funds will be first obligated in FY 1990. Until then, USAID/Mozambique will utilize funds remaining under the earlier private sector rehabilitation project to meet TA needs.

D. Local Currency

Local currency will be used in accordance with the Africa Bureau's guidance of July 1988. Funds will be programmed "in support of the proposed sector of the reform program", specifically, the food and agriculture sector. This sector is also defined to include commodity marketing. To ensure compliance with Africa Bureau guidance, USAID and the Ministry of Finance have developed a set of programming principles for local currencies. These are presented in Part Two, Section IX.

V. Implementation

Private firms will distribute and import the bulk of program commodities. Their participation has grown progressively from 12 percent and 31 percent, respectively, in 1984 to an estimated 93 percent and 95 percent in 1989. By the end of the program, all USAID-financed commodities will be privately imported. The GOM and USAID will also develop a plan to privatize state enterprises and mixed companies in the agricultural input, implement, tractor and related commodities business.

VI. Feasibility

A. Institutional Commitment

USAID and the U.S. Embassy, Maputo have carefully reviewed the evolution of GOM policy and have concluded that the political and economic measures which the GOM has instituted since 1986 constitute a fundamental change in direction and focus from the years immediately following independence and that this change has been successfully integrated into the country's political consciousness. This assessment is based in part on the ways in which President Chissano has attempted to encourage open expression, revise the constitution, and encourage political and economic development of areas traditionally neglected in favor of the southern provinces. By so doing, President Chissano has created a sociopolitical climate which will make reversal of liberalization trends difficult.

B. Social

Mozambique's social problems are grave and will become more so unless attempts are made to allow people to establish some sense of normalcy which will provide a base for social reconstruction in the future. Agricultural development is key to this process, not only because agriculture is the largest sector of the economy, but also because it is the population's first survival strategy. Program benefits are transmitted primarily through policy reforms which are reinforced by increased farmer access to agricultural inputs. The principal direct beneficiaries are commercial farmers, family farmers and agricultural importers and distributors. Secondary benefits accrue from increasing the amount of domestically produced food available for purchase or emergency distribution. Improved agricultural prospects have a particularly direct impact on women who are the principal family farmers. The social impacts of increasing women's access to earned income have been extensively documented.

C. Economic

A cost/benefit analysis of the economic impact of policy reform in Mozambique, using plausible assumptions on supply elasticities, demonstrates that improved price signals could stimulate an increase in production conservatively valued at $8 million per year. This annual increment in output continued for the next twenty years would have a net present value of about $70 million. Factoring in the costs and benefits of program commodities, the benefits (about $120 million) would exceed the value of discounted costs (less than $40 million) by about three to one.

D. Security

Lack of security will be a constraint on production as long as the armed conflict continues. The insurgency, however, is of a hit and run nature. Neither side can fully control the administration of rural areas. Nor is there a consistent pattern to what areas might be considered safe. This, consequently, argues for flexibility in defining program areas and not limiting the program to the initial three provinces. Rather than increase security risks through expansion, diversification should have the opposite effect.

E. Environmental

The Bureau Environmental Officer has approved an Initial Environmental Examination included as Annex G.

VII. Program Monitoring and Evaluation

Funds have been budgeted to assess the following issues during the course of implementation: impact on farmer income and economic status, farmer awareness of and responsiveness to changing policy incentives, farmer investment decisions and use of program commodities, technology transfer from commercial to family farmers, changes in rural employment and land tenure patterns, impact on women as farmers and traders, and rural transport and marketing developments. Ongoing internal assessments will be verified through an external mid-term evaluation in February/March 1991.

VIII. Financial Plan

This Program Assistance Approval Document (PAAD) requests approval of the full life of program funding estimated at $45.55 million, with authority redelegated to the USAID/Mozambique Mission Director to authorize the FY 1990 and FY 1991 tranches. $13.55 million will be authorized and obligated in FY 1989 and disbursed as a private agricultural sector CIP. In FY 1990 and FY 1991, funds will be obligated for commodity imports, technical assistance and, tentatively, support for the OGL system. USAID financing for the OGL will be contingent upon successful completion of an evaluation and AID/w concurrence with the Mission's recommendations. Commodity import and OGL funds will be obligated to the GOM and will generate local currency. Funds for technical assistance will be obligated through direct contracts between USAID and the respective implementing agents. A summary budget is provided in Table 2.

TABLE 2

SUMMARY FINANCIAL PLAN
($ 000s)

	FY 1989	FY 1990	FY 1991	TOTAL
Commodity Import Assistance	13,550	12,400	10,100	36,050
OGL Financing	0	3,000	5,000	8,000
Subtotal Generating L/C	13,550	15,400	15,100	44,050
Technical Assistance	0	600	900	1,500
a. Short-Term	0	400	300	700
b. Implementation & Monitoring	0	200	200	400
c. Evaluation & Audit	0	0	400	400
T O T A L	13,550	16,000	16,000	45,550

IX. Document Outline

The following document is divided into three parts. Part One, the Program Analysis, discusses how the macroeconomic and sectoral environment and other donor programs have influenced USAID/Mozambique s programming decisions and justify the proposed policy-based assistance. Part Two is a detailed program description. Part Three contains the feasibility studies that confirm the program's viability.

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X. Recommendation

USAID/Mozambique recommends: (a) approval of a three-year policy-based program for $45.55 million; (b) authorization of FY 1989 funds in the amount of $13.55 million for obligation to the GOM and disbursement through a CIP mechanism; (c) authorization of $1.5 million in technical assistance over the life of the program; and (d) redelegation of authority to the USAID/Mozambique Mission Director to authorize the FY 1990 and FY 1991 incremental obligations, with AID/W concurrence to be sought before obligating funds for OGL disbursement.

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PART I

PROGRAM ANALYSIS

I. Macroeconomic Framework

A. Introduction

Mozambique inherited at independence a shrinking economy with serious imbalances and inequities. Attempts to rectify these problems and stimulate growth through centralized administrative controls exacerbated matters. For the past decade, Mozambique has been afflicted by intermittent drought and a rural insurgency that has made over a third of the population dependent on external assistance for its basic food needs. In 1987, Mozambique began to implement with the World Bank and the IMF an ambitious Economic Rehabilitation Program (ERP) to reverse its economic decline and stabilize its financial situation.

Mozambique has faithfully adhered to its agenda for structural adjustment. The exchange rate has been devalued by over 95 percent since 1987 and there is a schedule for continued devaluation to bring the real exchange rate close to equilibrium. The government's recourse to bank credit fell substantially in 1987 and 1988 and, by the end of 1989, the ratio of bank financing to GDP will have declined to 1.7 percent, from over 12 percent in the year prior to the ERP. The number of controlled commodity prices has been whittled down to 20 products from 46 in 1987. The government has also cut the number of products subject to administrative allocation from 43 at the start of the ERP to 15 as of January 1989. Agricultural farmgate prices have been increased to a level approaching import/export parity. The impact of these measures has been reflected in a reversal of negative growth rates to increases in GDP of 4 percent in 1987 and 1988, with a projected growth rate of 5 percent in 1989.

The insurgency precludes, however, a full transition from emergency relief and crisis management to sustainable development. Only a fraction of the country's agricultural potential can be tapped. Little can be done to exploit a rich natural resource base. Throughout the country's 10 provinces more than 5.5 million people, out of a population of 15 million, have been displaced, placed at risk or driven into refugee status in adjacent countries. Bridges, schools and health posts are destroyed faster than they can be rehabilitated. The capacity of the human and managerial infrastructure to cope with the emergency is increasingly taxed. Even after a peaceful resolution of the insurgency, it will be years before Mozambique can shift from reconstruction to strictly new investment. From that point, self-sustaining growth is likely to be at least a decade or a generation into the horizon. The current account balance of payments gap, as discussed further below, will widen in the interim.

In the present crisis environment, development objectives must be necessarily cautious: first, maximizing what can be squeezed from a beleaguered economy and, second, laying a sound policy foundation for the future. These limited goals have required bold and decisive policy actions that the government has unhesitatingly taken and continues to commit itself to through its ERP. The intent of this analysis is to describe the evolution and impact of economic policy in Mozambique, and to assess current and planned policies in light of prevailing constraints, including those inherited at independence. From this context, the analysis examines both the parameters for growth and the limitations of structural adjustment and economic investment.

B. Post Independence: 1975 - 1986

1. Colonial Legacy

In the five years before independence, Mozambique's GNP fell by 17 percent. The service sector, geared largely to the needs of South Africa, Malawi and Rhodesia, accounted for 55 percent of GNP in 1975 and had been as high as 60 percent in 1970. Transit services and workers remittances from South Africa were the principal sources of foreign exchange and usually offset trade deficits. Remittances were a particularly important source of foreign currency since, under agreement with the pre-independence Portuguese Government, South Africa withheld 60 percent of workers salaries and credited this amount directly to Portugal. With these funds, South Africa allowed Portugal to purchase gold at a fixed rate far below the market price. Portugal then paid the miners the balance of their salaries in local currency (Colony escudos) at the official exchange rate. The difference between South Africa's subsidized price of gold and its international trading price was a pure profit for metropolitan Portugal.

Agriculture (including fishing) and industry accounted for, respectively, 25 percent and 20 percent of GNP in 1975. Only 13 percent of 36 million arable hectares was under cultivation. This was divided virtually in half between 4,500 European commercial farms averaging over 500 hectares and 1.7 million traditional African farms averaging 1.4 hectares. Forced or *de facto* forced labor to run the commercial farms precluded further expansion of traditional agriculture.[1] The industrial sector had been stunted by a history of neo-mercantilist colonial domination. Only 215 firms of more than 100 employees had been created, and most of these were high-cost operations dependent on imported raw materials and cheap credit.

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[1] Even after forced labor policy was abolished, a tax system was established which required farm families to pay taxes in currency. As most indigenous farmers were outside the cash economy, the only jobs made available to earn hard currency were as minimally paid farm laborers. In the south, individuals also had the more lucrative option of migrant labor in the South African mines.

Within months of independence most Portuguese business persons, traders, farmers and professionals fled the country, despite FRELIMO's strong commitment to nonracialism, with no provision for orderly transition. By 1977 the Portuguese community had shrunk to approximately 20,000 from 240,000. The critical service sector lost more than 7,000 skilled and semiskilled port and railroad workers. In agriculture, the rural marketing system withered with the departure of Portuguese and Indian merchants.

Perhaps most importantly, the colonial administration had made few investments in the indigenous African population. Illiteracy was estimated at over 90 percent. The African education system, dependent largely on Portuguese Catholic Church schools, was organized in three stages that effectively precluded most Africans from completing more than a three-year rudimentary program and, in rare cases, five years of primary school. Only about 1 percent of the student population reached high school. An estimated 80 percent of employment in the "modern" sectors of the economy was held by non-Africans. In 1970, only 15 percent of the indigenous population was integrated into the cash economy.

2. The Domestic Economy

Mozambique responded to the immediate crisis at independence by centralizing economic management under the government. In agriculture, attempts were made to establish substitute market channels through parastatals. The state took over almost 2,000 abandoned estates and created large state farms, such as the Limpopo Agro-Industrial Complex (CAIL).[2] Strongly influenced by FRELIMO's experience in Tanzania prior to independence, small scale family agriculture was collectivized.

Simply reactivating some abandoned farms resulted in initial production increases from 1977-1980, particularly in copra and tea. Over time, however, management constraints and policy disincentives prevailed: consumer prices were subsidized as diminishing supplies drove prices up; parastatals were subsidized as consumer prices did not cover marketing costs; intervened farms were not sufficiently productive to recoup capital investments; collectivized farms did not mesh with traditional practices or provide incentives for individual producers; and state marketing channels could not effectively link producers with consumers further eroding production incentives and exacerbating urban shortages. In 1986, for example, grain available to be marketed reached barely 10 percent of the total required by market consumers. Severe flooding in 1977-78,

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[2] CAIL is particularly symbolic because it was the GOM's first effort in the late 1980s to redistribute state farm land to commercial and family farmers, with significant production impacts. USAID's CIP supported recipient farmers and ensured the availability of necessary inputs.

followed by prolonged drought and cyclones from 1982-85, devastated large areas in the central and southern regions and made matters worse.

Similar patterns developed in the industrial sector. The government "intervened" a number of enterprises destined for bankruptcy which had been abandoned by the departing Portuguese. In 1977, enterprises in sectors considered vital to national sovereignty were nationalized, including the country's only coal mine, the petroleum processing industry, banks and insurance companies. As in agriculture, the initial reactivation of abandoned industries and heightened worker morale from newly created production councils caused an upsurge in production of 20 percent, 10 percent, and 7 percent, respectively, from 1979 - 1981. However, these levels were well below the increases needed to justify capital investments and even further below the projected increase of 34 percent in 1981. By 1983, the industrial output level had declined to 50 percent of its level ten years before.

With a process of economic deterioration already under way, the jolt given by an intensifying armed conflict was crushing. In the initial years after Rhodesia established RENAMO as a countermeasure to Mozambican support for Zimbabwean liberation movements, fighting was relatively limited. The scope of the war broadened in 1980 when, after Zimbabwe achieved majority rule, South Africa took up RENAMO's financing. The insurgency spread throughout the country with RENAMO employing hit and run tactics, attacking and ravaging areas but never retaining administrative control or promoting local development. The U.S. State Department-financed Gersony report concluded in May, 1988, that the scale and viciousness of atrocities perpetrated by RENAMO paralleled those of the Khmer Rouge.

The insurgency both added new socioeconomic problems and precluded effective resolution of many of those that had accumulated over the previous decade. By 1985, defense spending accounted for 40 percent of government expenditures. Security concerns reduced savings and investment incentives. Many areas of the country could not and still cannot be consistently reached by land, which inhibits production and the exploitation of natural resources (e.g. Tete coal). Markets were further disrupted due to irregular transport and, in many areas, inability to maintain regular purchasing and distribution points. This, in turn, also dampened production incentives.

Inevitably, government focus and energy turned increasingly to basic human survival. Although the Fourth FRELIMO Congress resolved in 1983 to consolidate and restructure the state sector and encourage private family and commercial agriculture, preliminary reforms could not reverse the economic decay. By 1986, the domestic economy had all but collapsed and political uncertainty due to the insurgency continued to discourage private investment. Table I.1 below summarizes the overall retrenchment of the domestic economy through 1986.

3. External Economy

Regional political developments as well as internal economic policy profoundly affected the external economy. In 1976, the GOM decided to enforce the United Nations sanctions against Rhodesia, at the time one of its three most important trading partners, and lost between $105 million and $165 million annually in port fees, freight charges and remittances from migrant workers. Foreign currency problems intensified when South Africa reduced the number of Mozambican miners in 1976 and, in 1978, unilaterally cut off the subsidized gold remittance scheme that had existed for 50 years. To compound the situation, $300 million worth of property and equipment was destroyed during Rhodesian attacks.

Table I.1

Evolution of GDP by Sectors, 1973-86

(percentages based on constant 1980 prices)

	Average Annual Growth (a)						
Sector	1973-83	1973-76	1976-80	1980-83	1984	1985	1986
Agriculture	-1.5	-1.3	1.1	-9.5	n.a.	n.a.	n.a.
Industry(b)	-3.4	-17.8	3.2	-7.8	n.a.	n.a.	n.a.
Other(c)	-1.6	-17.3	4.7	-0.7	n.a.	n.a.	n.a.
GDP	-1.9	-9.8	2.5	-6.3	-2.2	-10.4	-2.0

(a) Trend rates based on least squares estimates.

(b) Includes manufacturing, mining, construction, electricity, gas, and water.

(c) Includes transport, storage and communications, wholesale and retail trade, banking, insurance, and real estate, ownership of dwellings, public administration and defense, and other services.

The government continued to try to maintain import levels, despite the collapse in invisible's earnings, in order to operationalize its agricultural and industrial development plans and to meet basic consumption requirements due to food shortages. From 1975 to 1980, imports increased by 60 percent in value, while the real value of exports rose just 40 percent. By 1981, efforts to supply imported commodities virtually eliminated the country's foreign exchange reserves and further entrenched exchange controls. While there appears to be no precise data on the parallel foreign exchange market in the five years after independence, the official rate remained almost constant (around Mt32/$1.00) through 1980 and had depreciated only to about Mt40/$1.00 in 1986 despite the near economic collapse and a parallel rate of over Mt1,800/$1.00. By 1984 the depletion of reserves allowed few imports for investment other than those financed by foreign donors, and in agriculture most donated investment goods went principally to state farms and realized little productive impact.

In 1981 the first five year's pattern of increased exports reversed and exports declined by an annual average of 15.7 percent from 1978-84. As exports declined and with industry generating little import substitution (industry operated at 20-40 percent of capacity), the differential between official and parallel exchange rates widened. The private sector became increasingly excluded from of the economy as it had little or no access to the official foreign exchange market and the parallel market became unaffordable in light of the investment risks, the deteriorating business climate, and the extreme differential in the rates. Even after the Fourth Congress total private investment was negligible. Foreign investment was also nonexistent for similar factors, including restrictions on the retention and repatriation of foreign exchange.

This inability to generate foreign exchange led to growing debt to finance imports. Through 1982 Government relied on commercial short term credits at virtually any rate it could obtain (generally LIBOR plus up to 2 percent) in order to finance monthly foreign exchange gaps. When short term interest rates became unaffordable the government incurred additional long and medium term debt. It gained some relief on debt service in 1984 through the first Paris Club rescheduling but is now considered uncreditworthy and can realize virtually no net new finance. As the basic indicators in Table I.2 demonstrate, by 1986 the external economy had turned as bleak as the domestic.

C. The Economic Rehabilitation Program

1. Overview of the ERP

The GOM joined the World Bank and IMF in September 1984. In January 1987 the GOM launched a comprehensive Economic Rehabilitation Program to:

> (a) reverse the decline in production and restore a minimum level of consumption and income for all the population, particularly in the rural areas; (b) reduce substantially the domestic financial imbalances and strengthen the external accounts and reserves; (c) enhance efficiency and establish the conditions for a return to higher levels of economic growth once the security situation and other exogenous constraints have eased; (d) reintegrate official and parallel markets; and (e) restore orderly financial relationships with trading partners and creditors.

Table I.2
Balance of Payments Indicators, 1980-86
(US$ Million)

	1980	1981	1982	1983	1984	1985	1986
Trade Balance	-384.9	-389.7	-467.1	-396.6	-351.0	-347.2	-463.6
Exports	280.8	280.8	229.2	131.6	95.0	76.6	79.1
Imports	-665.7	-670.5	-696.3	-528.2	-446.0	-423.8	-542.7
Services (net)	-37.6	-76.4	-109.8	-108.7	-125.0	-78.8	-158.7
Current Account Balance	-422.5	-466.1	-576.9	-505.3	-476.0	-426.0	-622.3
Capital Account & Official Transfers	390.1	397.1	431.8	140.9	192.3	63.7	134.3
Overall Balance	-32.4	-69.0	-145.1	-364.4	-283.7	-362.3	-488.0
Memorandum Items							
Current Account Deficit (Percent of GDP)	17.2	20.1	25.4	26.3	23.7	21.7	35.3
Net Reserves as Months of Imports	3.6	2.6	0.5	0.0	0.0	1.5	1.5
Debt Service/XGS (Before Rescheduling)	32.4	76.3	99.3	142.7	244.9	207.8	247.4

This program became the basis for an IMF Structural Adjustment Facility ($15.4 million) in 1987 and World Bank Rehabilitation Credit ($90 million) in 1988. Successful implementation of the 1987 program led to continuing programs in 1988 and 1989 (see Part One, Section III for financial details).

Under the ERP, the GOM has implemented major reforms in all key areas of the economy. The underlying strategy of the ERP is to improve price incentives and increase reliance on market signals relative to centralized administrative controls. The government has also adopted restrictive domestic financial policies. The following parts of this section describe the three basic areas of the government's macroeconomic reform program -- exchange rate devaluation, liberalized pricing and distribution policy, and demand management through fiscal and monetary reforms -- as well as the ERP's impact on the economy to date.

2. Exchange Rate Policy

Since February 1987 the GOM has carried out a series of devaluations of the metical from Mt39/$1.00 to Mt400/$1.00 at the end of 1987, Mt620/$1.00 at the end of 1988, and Mt728/$1.00 as of June 1989. These devaluations have reduced the real effective exchange rate to approximately one-half its 1983 value and approximately one-third of its peak value of early 1987. Figure I.1 displays an estimate of the real effective exchange rate using a geometric average of the trade-weighted real exchange rate of Mozambique and its 19 principal trading partners which account for approximately 70 percent of Mozambique's reported trade. In nominal terms, the exchange rate has been devalued by over 95 percent since the start of the ERP.

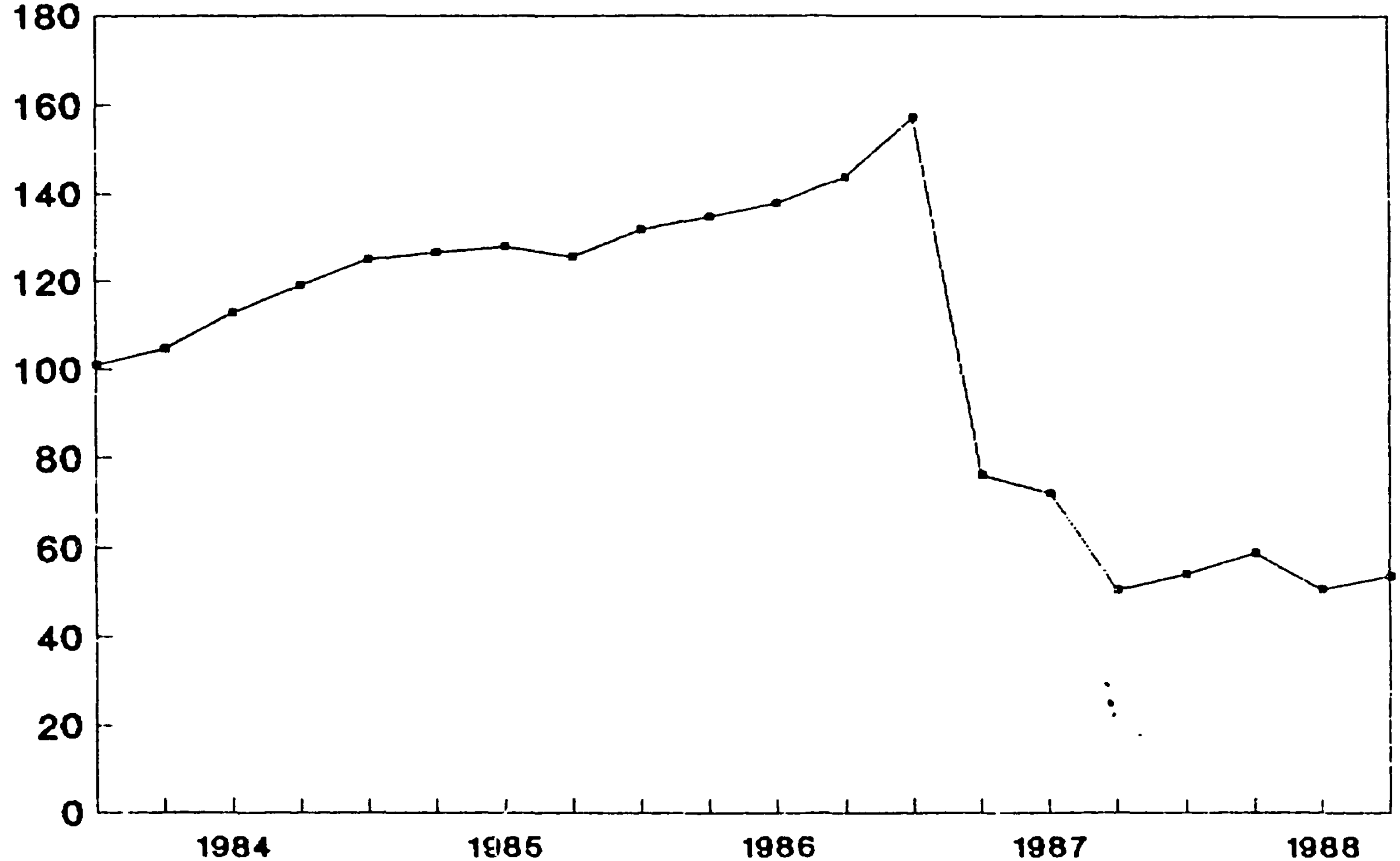
While the GOM has made considerable progress in exchange rate adjustment, there remains the question of whether the existing official rate is, in any sense, an "equilibrium" one. At present, the external accounts of Mozambique are subject to a number of contradictory forces. On the one hand, the insurgency reduces foreign exchange earnings while imposing additional substantial requirements for food, to repair damaged infrastructure, and for arms and supplies. At the same time, Mozambique receives an extraordinarily high level of donor assistance. As both the insurgency and the requirement for donor assistance are likely to continue in the foreseeable future, the only reasonable assumption is to assume that both are semipermanent features of the economy and attempt to equilibrate the external accounts taking them as given.

One common fallacy is to assume that the parallel market represents the "real" value of foreign exchange which would prevail in the absence of controls. The existence of an overvalued official exchange rate increases the demand for those restricted categories of transactions with access to the official market. This reduces the supply of foreign exchange for those categories for which the parallel market must be utilized. That is, the official rate is too low and the parallel rate is too high. In these circumstances, the market clearing rate will lie somewhere between the two prevailing rates.

The estimation of the equilibrium rate which would result if the two markets were unified depends highly on the elasticities of supply and demand in the two markets. Under a broad range of plausible assumptions about the elasticities in the two markets, the equilibrium rate is essentially the weighted average of the two exchange rates, the weights being the volumes of transactions in the two markets. The official market volume of foreign exchange is well defined. The volume of transactions in the parallel market, about $40 million annually, is estimated by aggregating the principal known components of supply: miners remittances, workers for foreign and private domestic entities paid wholly or partly in foreign exchange, and leakage from export retention schemes.[3]

[3] Individual firms may work out arrangements with the GOM to retain a portion of their foreign exchange earnings, generally about 25 percent.

MOZAMBIQE REAL EFFECTIVE EXCHANGE RATE
(1983 = 100)



Working through the above methodology yields an estimated weighted average of between 700 and 836 Mt per dollar as of February 1989. Based on these estimates, the metical was 79-95 percent of its "equilibrium" value at that time. That is, devaluations under the ERP are pushing the metical toward a realistic market value.

One recent additional factor which has compounded this situation is the apparent presence of South African flight capital in the Mozambican parallel foreign exchange market. Since April 1989, the cross rates between the dollar and the rand in Maputo have been over 20 percent above those which prevail for trade transactions in South Africa. The extent of these transactions is unknown. Their effect of the pattern of trade is probably more or less neutral as South African goods and services are made relatively cheaper, while those from the rest of the world become slightly more expensive. The important thing to be kept in mind, however, is that the parallel rate between the metical and dollar is artificially depreciated somewhat due to these externally motivated transactions. As a result, the parallel rate is presently an exaggerated indicator of trends in the value of the metical.

3. Fiscal and Monetary Policy

Fiscal reforms under the ERP have focussed on containing recurrent government expenditure, including streamlining and divestiture of public enterprises, and strengthening the revenue base through tax reforms and improved tax administration. To curb expenditures, the government, in conjunction with the IMF, established ceilings for consumer subsidies, wage increases and budget transfers to meet the operating losses of public enterprises. The latter is increasingly forcing public enterprises to increase efficiency or to phase down operations, in some cases leading to divestiture or closure. On the revenue side, the GOM substantially revised the domestic tax code by widening the tax base, rationalizing income tax regulations and simplifying collections.

Money and credit policies for 1987 and 1988 significantly reduced excess liquidity in the economy and improved the efficiency of credit utilization. The government's recourse to bank credit fell substantially in 1987 and 1988. Interest rates were raised sharply effective January 1987, from a range of 0-6 percent for deposits and 3-10 percent for loans, to 3-20 percent for deposits and 12-35 percent for loans. The interest rate on bank loans to the government was increased to 8 percent in 1988, and the government became current on interest owed to the banking system. A major simplification of the structure of bank lending rates was introduced in January 1989. With the rapid deceleration of inflation already achieved with the financial program for 1989, interest rates on loans may become positive in real terms in 1990. The government has also agreed with the IMF to pay all domestic interest when due. Commercial banks, however, still find it financially impossible to offer interest bearing deposit accounts despite the policy changes, as they have large excess liquidity positions. A government issue of treasury obligations in 1988 did exhibit a high nominal interest rate structure.

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4. Pricing and Distribution Policies

The objective of pricing and distribution reforms has been to establish a market structure that responds to supply and demand pressures and thereby provides incentives to producers and traders. The ERP's strategy has been to decontrol prices and distribution channels, recognizing the constraints imposed by the market deficiencies created by the security situation.

The number of products subject to fixed consumer prices was reduced first from 46 to 37 in 1987 and to 20 as of June 1989. Table I.3 identifies the remaining 20 commodities and specifies the GOM's rationale for continuing control. There is an ongoing dialogue with the World Bank and IMF on further decontrol. USAID is, through its P.L. 480 Section 206 program, promoting effective liberalization of, first, white maize and maize flour prices and, subsequently, domestic bean and rice prices. In addition to general liberalization, fixed prices of goods and services have been raised significantly. For commodities subject to price markup regulations, enterprises have been allowed to change prices without prior government approval.

Agricultural producer prices also increased significantly as a means to promote production incentives. Prices announced in October 1988 for the 1988/89 agricultural season represented 50-90 percent increases over the previous year, depending on the crop. Most of these prices, (see Part One, Section II on the agricultural sector) are now approaching import/export parity. Preliminary steps were also taken to liberalize price setting mechanisms. A floor price rather than a fixed price was announced for cashews. For selected other cash crops, fixed factory gate prices were announced, with producer prices determined on a competitive basis within the margins allowed by the respective factory gate prices.

As part of its policy to increase the flexibility of producers and traders, the GOM significantly liberalized domestic and international trade and encouraged increased competition among trading corporations. Enterprises have been permitted to trade directly with other enterprises in domestic and international markets. In particular, private enterprises can now participate in most trading activities previously reserved for parastatals. While the state continues to be a buyer of last resort for some agricultural commodities, private traders compete alongside public corporations.

TABLE I.3

MOZAMBIQUE

PRODUCT GROUPS SUBJECT TO FIXED PRICING

	RATIONALE FOR CONTROL					
	A	B	C	D	E	F
FIXED PRICES AS OF JANUARY 1989	TAX REVENUES	FOOD AID	RATION SYSTEM	STATE MONOPOLIES	RAW MATS.	OTHER
TOBACCO	X					
BEER	X					
MAIZE		X	(X)			
RICE		X	(X)			
MAIZE FLOUR		X				
WHEAT FLOUR		X				
MILK		X				
BREAD		X				
BEANS			X			
SUGAR			X			
COOKING OIL			X			
SOAP			X			
ELECTRICITY				X		
HYDROCARBON AND DERIVATIVES				X		
DIESEL OIL				X		
GASOLINE				X		
RENTS				X		
SOYA					X	
SORGHUM						X
MEAT						X
TOTAL NUMBER OF PRODUCT GROUPS REMAINING SUBJECT TO FIXED PRICE REGULATION : 20	2	6	4	5	1	2

NOTE:

1. FROM JANUARY 1989, A MINIMUM PRICE SYSTEM IS OPERATING FOR THE FOLLOWING PRODUCTS : CASHEW, COPRA, MAFURRA, SUNFLOWER AND GROUNDNUTS.
2. SOYA IS USED AS INPUT FOR THE PRODUCTION OF COOKING OIL.
3. OF THE MEAT PRODUCTS, ONLY BEEF AND PORK REMAIN SUBJECT TO FIXED PRICE CONTROLS.
4. ALL OTHER INDUSTRIAL PRODUCTS ARE SUBJECT TO THE CONDITIONED PRICE LEGISLATION, AND ALL OTHER AGRICULTURAL PRODUCTS ARE FREE OF CONTROLS.

5. Impact of the ERP

The combined measures to improve the macroeconomic framework and promote structural adjustment have reversed the consistent decline in GDP since 1980. GDP grew at 4 percent in 1987 and 4.1 percent in 1988. Indicators of macroeconomic development under the ERP are summarized in Table I.4 below.

Pricing and distribution policies, in particular, stimulated family and commercial farm production. Marketed output of food crops grew by 15 percent, while aggregate agricultural marketed production grew by more than 5 percent. Growth in the agricultural sector, and especially among family farmers has a broad distributional impact as agriculture employs over 80 percent of the labor force and generates 80 percent of export earnings. Moreover, pricing changes have also helped to shift urban/rural terms of trade in favor of agriculture. New distribution and trade policies, in turn, have strengthened agricultural support services.

Table I.4

Macroeconomic Developments
(percentage changes)

	Average 1985-86	1987	Est. 1988	For. 1989
Growth				
GDP (per annum)	-6.2	4.0	4.1	5.0
Consumption (per capita)	-14.5	0.3	5.9	3.8
Balance of Payments				
Current deficit/GDP	13.9	45.5	67.3	86.9
Debt Service ratio after debt relief	179.0	20.9	31.5	50.5
Grants/Grants + MLT	41.0	50.0	59.0	54.0
Fiscal				
Current deficit/GDP	10.7	5.2	5.7	4.7
Bank finance to budget/GDP	10.7	3.9	3.3	1.8
Overall deficit after Grants/GDP	13.2	11.8	14.2	10.2
Money Supply Growth	n.a.	50.0	43.0	30.0
Memo Items				
Imports (volume, goods)	12.0	7.1	6.4	8.5
Export (volume, goods)	-10.0	15.0	1.9 1/	16.8
Inflation (CPI)	34.0	163.0	50.0	30.0

1/ Export growth in 1988 was below target levels as a result of climatic and security factors, especially affecting cashew production. The 1988/89 production levels are forecast to return to normal levels.

The industrial sector has recovered less quickly than agriculture. Lack of spare parts and productive inputs curtailed growth early in 1988, but light industrial activity revived later in the year allowing for modest overall growth. Performance in the service sector has been mixed, with reduced rail and port traffic from South Africa partially offset by increases from Zimbabwe, Malawi and Zambia.

Fiscal measures have reduced the current budget deficit from over 10 percent of GDP in 1985/86 to about 6 percent in 1988. Investment has been financed externally, allowing domestic bank financing of the budget to fall from over 10 percent of GDP to 3 percent during the same period. The combined fiscal restraint and shift to external financing has permitted a greater share of domestic credit to support productive sectors while controlling money supply growth. The overall fiscal deficit, however, remains high due to external financing for critical and heretofore neglected public investments. These investments are also reflected in a substantial increase in the current deficit of the balance of payments, from about 14 percent of GDP in 1985/86 to about 67 percent in 1988. Inflation has been significantly controlled after the initial impacts of devaluations and price adjustments and is down from 163 percent in 1987 to 50 percent in 1988 and a projected 30 percent for 1989.

D. The 1989 Reform Program and Future Prospects

The GOM firmly committed itself to continuing the process of policy reform in its February 1989 Policy Framework Paper developed with the World Bank and the IMF. The key dimensions of the 1989 program are summarized below.

1. Exchange Rate Devaluation. The Government has agreed to implement monthly devaluations with a view to achieve moderate real depreciation by the end of 1989. All devaluations through June 1989 have been made as scheduled.

2. Foreign Exchange Allocation. In mid to late 1989 the Government will implement, with World Bank financing, an Open General License (OGL) system for specified sectors that will phase out administrative foreign exchange allocations and give private enterprises direct access to foreign exchange. The importance of this measure and its relation to the Private Sector Support Program are described in detail in Part Two, Section V.

3. Debt Ceilings. The Government and the Bank of Mozambique will not contract or guarantee external loans on non-concessional terms of 1-12 years maturity in excess of $50 million during 1989-91, of which no more than $20 million will be contracted in 1989. The Government will also refrain from accumulating new external payment arrears.

4. Fiscal Policy. New revenue measures designed to yield Mt17 billion in 1989 have already been introduced. Expenditures will be constrained through ceilings on subsidies to unprofitable state enterprises (Mt12 billion) and consumer subsidies (Mt3.5 Billion). Civil service wage increases will be limited to inflation plus a minor fixed increase per worker of Mt2,000 to compensate for the elimination of certain subsidies.

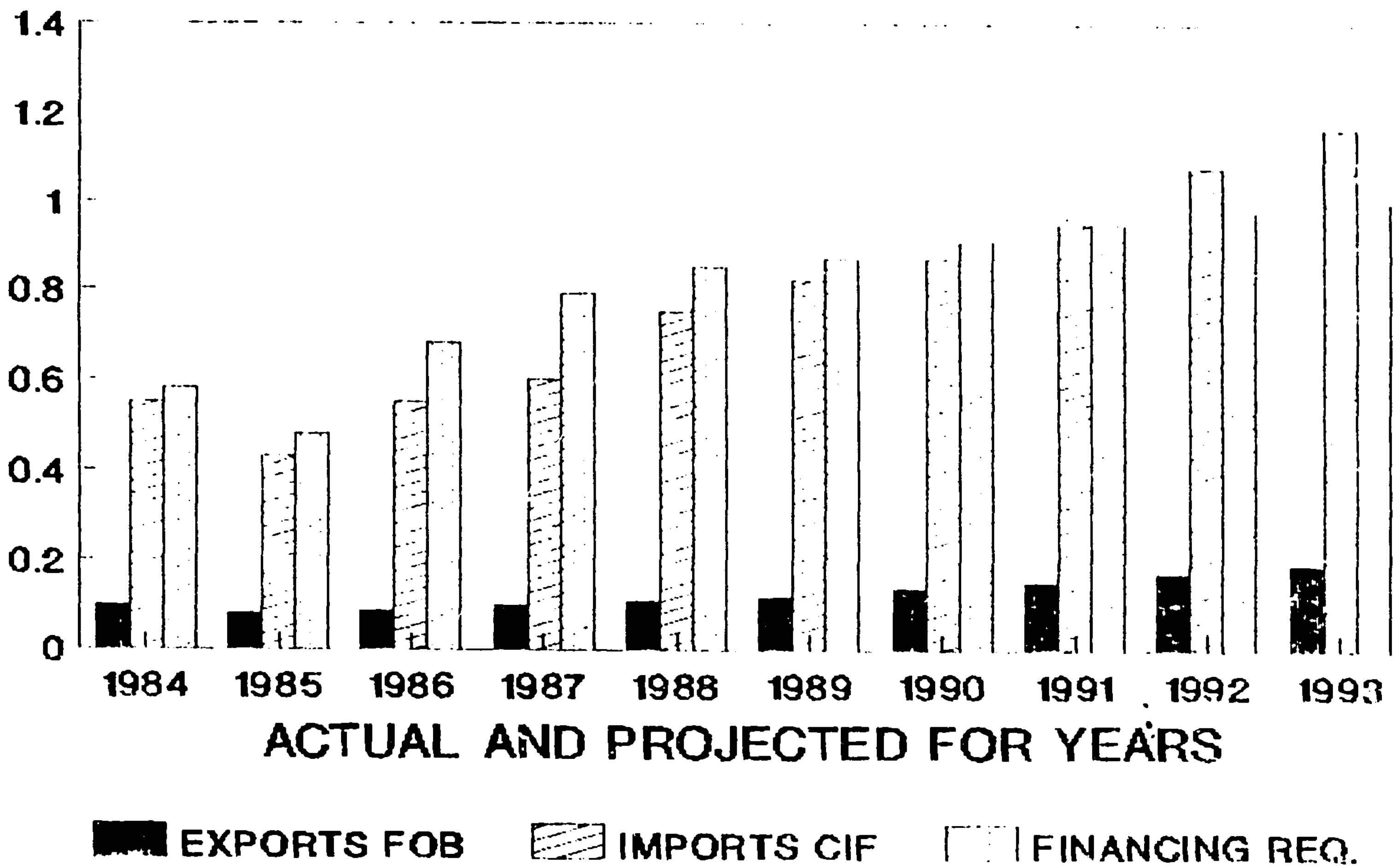
5. Monetary and Credit Policy. Money growth will be limited to conform to inflation and balance of payments targets. Expansion of net domestic credit in 1989 will be limited to Mt68 billion (29 percent of the money stock at the beginning of the period), with a ceiling of Mt15 billion of net financing for the government.

Based on the GOM's policy commitments, the IMF has estimated annual growth from 1989-91 at between 4.5 and 5 percent. Agricultural growth is projected at about 6 percent per annum. Smaller growth rates are projected for the industrial and service sectors, particularly since increased transit trade from neighboring countries depends on improved security. In balance of payments projections through 1993, the value of exports is estimated to grow at an average annual rate of 13.5 percent (volume growth is estimated at 9 percent). The value of imports is expected to grow at 8 percent per annum. However, the deficit in the trade balance will increase annually over this period because of the vast difference in the 1988 base of exports ($98.3 million) and imports ($763.6 million). After considering debt rescheduling, the gross external financing requirements from 1989-93 are expected to average about $1.35 billion annually (see Figure I.2). As discussed in greater detail in Part One, Section III on donor assistance, a significant financing gap is projected in each year even after factoring in assumptions on increased donor assistance.

In short, this analysis establishes that the GOM's ambitious policy reform program has had a significant impact on stabilizing the economy and promoting economic growth. However, the analysis also confirms that Mozambique is by no means in a position to curb its dependence on external assistance. In part, this is due to the minimal base against which progress is measured. The continuing insurgency and the problems it creates in addressing historical constraints are also major factors. With the number of displaced people growing and urban unemployment increasing, the Government will need to continue to play a major role in helping people meet basic subsistence requirements.

Specifically in terms of the Private Sector Support Program, this analysis confirms the need for fast disbursing balance of payments assistance. Commodity assistance provides the financing required to boost short-term agricultural production, in turn mitigating the need for commercial credit and helping the GOM comply with its policy agenda. It is also critical in order to continue implementing the Economic Rehabilitation Program without inducing major domestic shortages and uncontrolled price increases. The policy measures to be implemented in conjunction with the Private Sector Support Program (see Part Two, Section III) reinforce the directions established with the World Bank and IMF. Through continued policy reform and financial assistance it is expected that Mozambique will be able to meet the basic objectives outlined at the outset of this section of maximizing the productive capacity of its economy and establishing a policy base for future growth as the security situation improves.

EXPORTS, IMPORTS AND DONOR FINANCING
(BILLION U.S. DOLLARS)



II. The Private Agricultural Sector

A. Rationale

The private agricultural sector is composed of commercial farms that range from 2 to 200 hectares, cooperative farms (largely in the south, averaging 45 hectares), and family farms averaging 1.1 hectares - down from 1.4 hectares in Colonial times. (See Table II.1) As discussed below in greater detail, the private sector accounts for 96 percent of Mozambique's food grain production.

Table II.1

Cultivated Area
by Category of Farm Unit, Quantity of Farms 2/ and Size 1/

	1970		1976		1983		1989	
Category	No.	Area	No.	Area	No.	Area	No.	Area
State	0	0	75	2,250	80	120	77	100
Private	4,500	2,250	n.a.		1,100	50	3,000	105
Cooperative	n.a.		n.a.		320	5	320	14
Family 2/	1,700	2,380	1,970	2,760	2,200	3,300	1,300	1,430
Total		4,630		5,010		3,475		1,649

1/ Area in thousands of hectares.
2/ Number of family farms in thousands.

Source: IBRD, Mozambique Agricultural Sector Survey, May 12, 1988; Ministry of Agriculture, Government of Mozambique; USAID estimates.

Also critical to private agriculture is the network of market outlets scattered throughout the country. Although the departure of Portuguese and Indian merchants seriously curtailed this network as discussed earlier (Part One, Section I.B), a significant number of retail outlets, principally private, have recently resurfaced. Government statistics, which likely understate the importance of private networks, show that private traders provide 69 percent of Mozambique's retail outlets, with the balance made up principally by AGRICOM [4] (6 percent) and cooperatives (22 percent) (See Table II.2). In volume terms, private entities accounted for 63 percent of agricultural trade in the 1987/88 crop year.

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Table II.2

Number of Retail Sales Locations
by Province and Type, 1989

Province	Private	AGRICOM	Cooperatives	Others	Total
Cabo Delgado	168	0	96	0	264
Niassa	30	24	3	41	98
Nampula	450	31	247	27	755
Zambezia	101	10	12	0	123
Tete	17	17	0	2	36
Manica	82	39	12	5	138
Sofala	62	3	8	0	73
Inhambane	414	17	118	0	549
Gaza	152	8	5	0	165
Maputo	342	0	78	0	420
Total	1,818	149	579	75	2,621
Percentage	69	6	22	3	100

Source: AGRICOM

USAID has focused assistance under this program to private farmers and their related marketing requirements due to the following factors:

- First, increased domestic food production is essential in the current emergency environment in Mozambique. Food production is not just a statistic affecting import requirements or export earnings -- it has an immediate bearing on survival.

- Second, increased local food production reduces the logistical demands and foreign exchange drain associated with food distribution. In areas where security limits food distribution, distributing a $25 ag-pack (seeds and hand tools) to a dislocated family will offset the necessity to import/distribute approximately $80 of cereal equivalent to meet the needs of the dislocated family. Land availability, security and time considerations are the key limiting factors to a strict focus on production assistance.

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4 AGRICOM is a parastatal marketing organization.

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- Third, private production can be revitalized most quickly in the agricultural sector. Although poor transport infrastructure is a constraint, major infrastructural investments are not immediately critical to boost production as is the case in industry.

- Fourth, the current security situation requires decentralization of investment decisions to the maximum extent possible so that those most familiar with local circumstances, including security, can judge whether they can make a return on their investment. This is most practically done through private producers.

- Fifth, private sector agriculture is the cornerstone of the GOM/Bank/IMF strategy for economic rehabilitation. Our investments have short term macroeconomic impacts while also contributing to a sound base for future economic growth.

B. Sector Description

1. Defining the Private Sector

The distinction between public and private in the Mozambican economy is imprecise. For example, Mozambique had many private firms which became "intervened", i.e. managed by the GOM but not owned by the GOM, after the management and ownership fled. Such firms are considered by USAID to be parastatals. The private sector is further disaggregated into the formal sector - registered businesses with an established organization and 5 or more employees, and the informal sector - unregistered and unorganized businesses with fewer than 5 employees. Private firms may be at times subject to considerable Government influence and direction that ranges from jawboning to allocation of market share and quotas as well as access to foreign exchange and bank credit.

Prior to independence almost all manufacturing, commerce and agricultural enterprises were in private hands. The situation changed radically after independence and the private sector not only lost importance in quantitative terms (Table II.3) but that which remained was subjected to regulation under Decree-Law No. 18/77 (28 April 1977) which provided the state the means to exercise discipline over the private sector in order to assure effective management of the economy in accordance with the national interest. A form of defacto deregulation occurred after the Fourth FRELIMO Congress allowing for greater private sector participation in the economy. In practical terms, the Fourth Congress policy decision and subsequent structural adjustment under the ERP have had their greatest impact on private agriculture.

Agriculture is the most important sector of the economy - accounting for approximately 40-50 percent of GDP and employing over 80 percent of the population. Part One, Section I discusses the process by which, immediately after independence, the Government moved to restore production on the farms abandoned by approximately 2,000 Portuguese by combining them into large state farms. Simultaneously, peasants were urged, even forced, to form communal villages with collective farm plots. The short term goal of this restructuring was to alleviate growing food shortages and increase employment.

TABLE II.3

Structure of Manufacturing, Minerals, Fishing and Energy Industries by Type of Enterprise

Type of Enterprise	Enterprises Existing in 1984 No.	Enterprises Existing in 1984 Percent	Percent Contribution to National Output 1977	Percent Contribution to National Output 1982
Private	294	51.1	71	27
State	114	19.8	15	25
Cooperative	21	3.6	-	-
Intervened	140	24.3	5	37
Mixed	6	1.2	9	11
Total	575	100.0	100	100

Source: NSO and MIE

The structure of the agriculture sector continues to change as both the number of state farms and the cultivated area of state farms decline and more emphasis is placed on private commercial and family farmers. Part of this decline is attributable to a change in GOM policy which now provides for the restructuring or divestment of unprofitable state enterprises as well as provincial level de facto redistribution of unused and/or abandoned land. One of the largest divestitures occurred in Chokwe, 250 Km from Maputo, of the CAIL scheme which, as indicated earlier, had been one of the Government's showcase state ventures. The formation of the GOM/Lonrho joint venture (Lomaco) [5] and the abandonment of state farms due to civil strife are also factors in the state farm decline. The total cultivated area has not decreased substantially, however, since most of the divested and some of the abandoned land was redistributed to family and private commercial farmers. In general, arable land is not a constraint in Mozambique. Only some 4 million hectares of a total estimated area of 36 million hectares of arable land are in cultivation. Of course, infrastructure investments to open up new land would be high.

[5] Lonrho's (London-Rhodesia Company) interests in Mozambique are widespread and include mining as well as agriculture. Agricultural holdings include citrus, livestock, cotton, and tomato production and processing capacity.

TABLE II.4

Production and Marketing of Selected Agricultural Commodities
Mozambique 1980 - 1988
(Metric Tons)

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
Maize									
State	46,386	50,887	66,983	41,012	69,450	32,991	11,702	18,163	4,364
Private	19,677	16,135	10,140	7,553	10,086	15,461	4,437	5,394	19,005
Cooperative	4,786	4,292	3,673	1,977	2,423	3,244	957	693	965
Family	781,250	1,151,406	1,139,188	780,750	991,938	926,594	364,688	407,875	858,675
Total Production	852,099	1,222,720	1,219,984	831,292	1,073,897	978,290	381,784	427,125	883,009
Rice									
State	56,314	43,676	64,295	25,635	25,821	21,469	21,689	34,333	33,823
Private	12,195	4,189	1,201	841	2,701	6,707	1,683	13,091	46,488
Cooperative	4,577	4,954	3,447	1,923	1,173	1,162	507	1,014	546
Family	65,471	10,511	24,117	14,009	28,520	34,825	52,807	64,986	29,683
Total Production	138,557	63,330	93,060	42,408	58,215	64,163	76,686	113,424	110,540
Sunflower									
State	1,863	3,824	1,086	701	439	406	105	120	182
Private	5,667	5,153	880	1,317	1,283	1,023	253	140	360
Cooperative	775	658	317	196	161	61	22	19	25
Family	12,261	10,460	14,524	9,498	6,411	7,740	1,290	1,260	1,032
Total Production	20,566	20,095	16,807	11,712	8,294	9,230	1,670	1,539	1,599
Cotton									
State	15,146	33,932	25,323	14,872	8,488	3,381	2,418	4,815	4,189
Private	6,550	6,038	6,844	1,984	2,325	556	2,768	3,043	5,981
Cooperative	576	420	275	476	282	14	106	218	116
Family	43,117	33,704	29,453	7,490	8,732	1,032	5,545	20,417	22,267
Total Production	65,389	74,092	61,095	24,822	19,827	5,703	10,829	28,493	32,533
Copra									
State	15,000	15,000	10,038	9,796	11,000	9,503	9,178	5,586	3,822
Private	14,018	14,952	12,128	12,381	12,128	9,196	8,862	8,991	6,427
Cooperative	0	0	0	0	0	0	0	4	0
Family	52,432	68,797	58,009	52,032	46,058	49,665	54,932	55,302	56,915
Total Production	81,450	98,749	80,967	75,009	69,186	68,354	72,972	69,083	67,164
Cashew									
State	0	0	0	0	0	0	0	0	0
Private	0	0	0	0	0	0	0	0	0
Cooperative	0	0	0	0	0	0	0	0	0
Family	116,000	120,133	76,000	24,133	33,752	40,473	53,433	50,047	58,180
Total Production	116,600	120,133	76,000	24,133	33,752	40,473	53,433	50,047	58,188

Source: Statistical Information 1987, National Directorate of Statistics, GPRM; IBRD, Mozambique Agricultural Sector Survey, May 12, 1988; USAID/Mozambique Estimates

The importance of the family farms contribution to agricultural production, shown in Table II.4, was emphasized in the World Bank's recent Mozambique Agricultural Sector Survey (1988). At present, USAID estimates that about 90 percent of the cultivated land is worked as family farms with the remaining 10 percent divided between private commercial farmers, cooperatives and state farms. Each farm unit is described in greater detail below.

2. Agricultural Production Units

a. Commercial Farms. Mission estimates indicate that there are approximately 3,000 private commercial farms, averaging 35 hectares in size, in Mozambique. These farms are the innovators in the agricultural sector, responding rapidly to changing production and market conditions. Purchased inputs and equipment are used efficiently and projected returns from production are the basis for investment decisions.

The recent evaluation of the Private Sector Rehabilitation program (656-0201) indicated that in the Gaza Province, each tractor distributed through the program brought an additional 20 to 150 hectares of land into production. This amount does not include land brought into production through custom work. This is a substantial figure in terms of productive resources, both land and labor, required for such an expansion. Most of this new land is coming from the reallocation of state farm lands with the balance new land which is outside existing irrigation schemes or land that was not under production due to lack of equipment. Labor is also an important factor in the production equation even with the introduction of tractors. On average, each additional 20 hectare unit will employ 15 full time laborers.

The level of technology on the commercial farms does not differ significantly from that of the family farms, i.e. they remain very labor intensive even after the introduction of equipment. The primary difference is that commercial farms employ nonfamily paid labor and, relative to the size of farm unit, a higher proportion of purchased inputs and mechanization. This level of technology is easily managed by the commercial farmers, and those family farmers producing commercially, without the need for technical assistance or extension inputs. Data gathered from farmer interviews have consistently demonstrated an untapped wealth of knowledge regarding fertilizer use, appropriate seed varieties, pesticide requirements and irrigation practices. The private commercial farms by virtue of their demonstration, their hiring and teaching of labor, be it male or female, their provision of custom plowing and other farm services to their neighbors, and their function as an output marketer and input supplier for their neighbors help to pull up the level of farm entrepreneurship in their vicinity.

Two farmers whose experiences typify the expansion in production and the transmission of benefits to other farmers through improved technologies and increased employment are Zefanias Mucavel (a farmer in the Xai-Xai district of Gaza province) and Fernando Santos (a farmer in the Chokwe district of Gaza province). Mr. Mucavel has had his 32 hectare farm for 5 years, although he previously farmed elsewhere in Mozambique for some 16 years. Until March 1988, when he purchased a CIP-financed tractor, only 12 of his 32 hectares of the land were under production. Hired labor was used for most of the land preparation (unless custom tractor services could be obtained), planting, weeding, harvest and transport activities.

During the 1988/89 production season, all 32 hectares were utilized, 16 hectares in rice and 16 hectares in maize followed by 2 hectares of vegetables. He continues to use the same amount of hired labor, although concentrated in different activities and feels that he could expand the vegetable production by adding several more laborers. However, a transport constraint also limits the expansion of his vegetable production. Since Mr. Mucavel uses the tractor as a means of transporting his crops, he has been able to do only 40 hectares of custom plowing for his neighbors. Mr. Santos has a 16 hectare farm that has been producing rice and vegetables for several years. He purchased his first tractor (state farm surplus property) several years ago and in March 1988 purchased a CIP-financed tractor. For the 1988/89 production season, Mr. Santos shifted his production program to maximize the benefits from both the land and the new tractor. He now produces 10 hectares of rice and uses the remaining area for maize and vegetable production. With this combination of crops he hires 12 laborers throughout the year. To fully utilize the tractor, he performs custom plowing services for neighbors on 116 hectares of abandoned state farm land, producing rice and maize.

b. Cooperatives. Ministry data indicate that there are 320 production cooperatives averaging 45 hectares in size in Mozambique. Production technology varies in cooperatives with the majority using traditional family farm methods, although some are using technology similar to that of private commercial farms when purchased inputs and equipment are available. The number and cultivated area of cooperatives has declined since independence as a result of civil strife and the lack of commitment by the members to shared production. The preference of most cooperative members is to farm their own family plots to guarantee their subsistence. Many of the peri-urban green zones have cooperatives consisting entirely of female members.

c. Family Farms. There are approximately 1.3 million family farm units averaging 1.1 hectares in size in Mozambique. The production system found on the family farms involves heavy dependence on manual labor using hand tools, some animal traction, and when available custom tractor services. Purchased inputs, such as fertilizers, chemical and improved seed varieties, are sparingly used. Producing sufficient food for subsistence is the primary objective of the family farm, although the potential for substantial marketable surplus production exists with favorable price and good weather, especially rainfall. Family farms in the green zones around most urban centers market on the average about 85 percent of their production, particularly vegetables and fruits, in the urban markets; this is often the primary supply to the urban centers. Approximately 86 percent of total food crops, 51 percent of marketed food crops and almost 20 percent of export crops are produced on family farms. Although each is small in cultivated area, the sheer size of combined production makes the family farm sector important.

d. State Farms. There are approximately 77 state farms, averaging 1300 hectares in size, functioning in Mozambique. The state farms are typically on the best lands, with good access to transportation routes, irrigation schemes, or planted with coconuts, sugar, sisal, citrus, etc. Most are highly mechanized and have received, over the years, a preponderant share of the imported inputs as well as favored treatment in the distribution of investment resources. Still, production and yields are low, equipment utilization rates decay rapidly because of poor maintenance and shortages of spare parts, and the financial drain on the treasury to cover operating losses alone was staggering. The accumulated debt for the 109 state enterprises is estimated to be 65 billion meticais (about $100 million at the official exchange rate as of January 1989 but about $1.5 billion at the official rates when the debt was incurred). To overcome this financial drain, the Ministry of Finance will cut subsidies to these enterprises in 1989 to 50 percent of the 1988 subsidy. State farms will not receive a new bank loan in 1989.

C. Analysis of Key Production Factors and Constraints

This section seeks to identify the key factors that influence and are a constraint to private agricultural production in Mozambique. Constraints to be addressed within the Private Sector Support program are discussed in Part Two, Program Description.

1. Security

Security considerations will continue to affect investment decisions and the functioning of markets as long as the armed conflict persists. The insurgency, however, is of a shifting, hit-and-run nature. RENAMO, if challenged, does not try to hold an area permanently but instead employs tactics that will leave a village or small town devastated. The prime targets are typically Government installations, stocks of food and medical supplies and major concentrations of equipment located at either government installations and farms or on the larger private farms. Although crops are usually not primary targets, they are often destroyed. Over the long run, substantial damage has occurred to agricultural infrastructure. A general trend is that provincial capitals have safe access and there is less security the further away from the capital one gets. Overall security across provinces, however, does not differ significantly. Many districts, let alone villages, are not accessible by road and in other districts nothing moves without

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military escort. The geographic strategy proposed for the distribution of commodities from the CIP (see Part Two, Section IV) is oriented around these considerations. The proposed policy reforms will have an impact to the extent that areas are under government control. The likely response to improved price incentives will be lessened to the extent that security conditions, rather than prices and profits, dominate producer's decisions.

2. Land Ownership

An important factor related to security is land ownership. Most state farms, as indicated above, are on the best lands with good access to transportation routes and water for irrigation. Given the disarray of many of the state farms, dividing many of them up, where security permits, and reallocating the land to commercial and family farmers would allow the land to be exploited more productively. This reallocation of state farm land would not resolve the debt problems of the state enterprises. Although the productivity that could be gained in the short run through the reallocation of state farm land is important, land in itself is not a binding constraint on agricultural production.

3. Agricultural Technology and Access to Production Inputs

Modern mechanical technology was introduced on the state farms during their inception and in the long run has not been as successful as anticipated. An essential component for modern technology to be successful which continues to be deficient in the state farm system, and Mozambique in general, is skilled management. In addition, there are few trained technical people to adequately staff a public extension service which could provide technical assistance to the state farms.

Private farmers, on the other hand, are using a level of technology consistent with the 1970s which requires basic entrepreneurial skills, high rates of labor use, minimal use of purchased inputs (other than improved seed and fertilizer) and mechanization. Key to the success of this level of technology is each farmer's entrepreneurial skill and ability to transfer this skill to employed laborers, themselves principally family farmers. Little additional assistance is required when new technology is introduced into this system, since the innovators, usually the medium to large size commercial farmers, are the first in line for the new technology and are better able to adapt the technology to the conditions of the area. At the same time this adaptation process is going on, other farmers learn about the technology through observation and/or word of mouth or hands-on experience as part of the labor force.

Farmers interviewed since the PSR program began in 1984 register their preferences for specific varieties of open pollinated and hybrid seed which are best suited for the geographic area. At present the Ministry of Agriculture conducts few, if any, variety trials for different crops in Mozambique. Since many farmers have worked as laborers in South Africa, either in the mines or agriculture, they have learned about different seeds outside the country. Most of these same Mozambicans bring various commodities, including seed, back when they return. Thus, these farmers through either observation of ongoing production in South Africa or their own trials using seed obtained from outside Mozambique are aware of state-of-the-art seed technology.

The same is true for tractors and other equipment. During the first two distributions of commodities in the PSR program, special attention was given to experienced farmers with obsolete equipment. However, later distributions of tractors and trucks went increasingly to purchasers who had never owned equipment before. Even in the resettlement schemes established by the Portuguese, the most common type of equipment purchased before independence was the oxen plough. These purchases were made 20 or more years ago. After independence equipment wasn t available for use by the private farmers and many farmers unable to work their lands went to work on the newly created state farms. USAID interviews with farmers have found the three most common sources of experience with farm machinery to be: (1) experienced small farmers that were either a part of or worked with the private sector before independence; (2) tractor drivers or machine operators from state farms during the period 1977-1985; and (3) returnees from the mines or farms in the Republic of South Africa especially in the two southern provinces of Maputo and Gaza. Farmers with these types of experience that have received equipment through the PSR program use it to full capacity while maintaining it in good working condition. Even the smaller farmers get the most out of their equipment by using the excess capacity to provide custom services to their neighbors.

4. <u>Input Distribution Systems</u>

From Independence to the inception of the PSR Program, only parastatal importers were authorized to import commodities. During the same period there were few, if any, private distributors (retailers) of agricultural inputs to commercial and family farms. Therefore, USAID/Mozambique initially had to work with the designated public sector importers and distributors. With the implementation of each successive program, more extensive involvement of the private sector has occurred in the program for both the importation and distribution of the CIP-financed commodities/inputs. The increasing use of private sector firms for the importation and distribution of commodities in the program should, over the long term, have the positive effect of reestablishing the commercial relationship between farmers and the dealers of agricultural equipment and inputs. Since public sector entities have traditionally been at best slow to respond to the felt needs of farmers, the reestablishment of the ties between the private sector agribusiness community and the farmers should have a positive developmental impact on agriculture in Mozambique.

Because of the relatively limited number of firms in the provinces, both public and private sector, with the capabilities to operate and manage effective distribution (retail) and service centers, the full benefits to farmers under the PSR program has been limited. It will be important for the future of Mozambique for private importers and distributors not only expand their volume of business but also to reestablish their sales and repair services in the rural area.

5. Access to Foreign Exchange

Few agricultural inputs are produced locally, resulting in a dependency on imports requiring, for the private sector, access to foreign exchange. Earlier in the 1980s most scarce hard currency was allocated, by policy, to the public sector. This policy has changed, but lack of foreign exchange has meant that, in practical terms, the private sector has become dependent on donor allocations. Even though private sector agricultural producers account for more than 50 percent of exports, foreign exchange retention schemes generally do not apply, since the producers do not export directly. In 1989, the GOM will introduce a system for the "nonallocative administration of foreign exchange" (i.e. an Open General License System), for a limited number of products (not those relevant to agriculture at present), that will give the private sector access to foreign exchange through the official market.[6] If successful, the system will be expanded to other sectors. It will be watched closely, and supported by A.I.D., if it provides a reliable and efficient mechanism for the private sector to gain access to foreign exchange.

6. Financing

Most farmers (estimates range over 90 percent) depend on credit of some sort to finance the local currency counterpart for their CIP purchases. The principal source of credit is the Banco Popular de Desenvolvimento (BPD), the government development bank (and about all there is outside Maputo) which has branches or agents in each of Mozambique's 10 provinces. BPD requires that farmers provide 20 percent equity. The present interest rate is 22 percent for agricultural loans, which is negative in real terms but will be approaching a real positive rate as inflation declines in 1989. In addition, the Government introduced in 1988 a medium term subsidized credit window at BPD for agricultural producers called Caixa de Credito Agricola e Desenvolvimento Rural (CCADR). CCADR requires just 1 percent equity and offers loans at 6 percent interest, with a ceiling of Mt 35 million (about $50,000) on each loan. Given limited funds, however, farmers have not received CCADR well, with complaints such as the facility is available only in certain

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[6] The GOM announced the establishment of an Open General License System in April, 1989, but it will not be functional until IBRD disbursement of funds later in the year.

provinces and extreme partiality in the allocation of loans. In general, local currency financing has not been a constraint in the agricultural sector, although under the credit restriction of the new PFP it could become so. USAID has met with BPD to discuss this issue, and they have factored credit requirements for counterpart financing under the CIP into their 1989/90 credit allocation. Annex C provides BPD's confirmation of the availability of local currency financing and a list of their branches and agents throughout the country.

TABLE II.5

ESTIMATED IMPORT/EXPORT PARITY
(Mt PER KG)

	1985	1986	1987	1988	1989
Maize	13	14	25	43	73
Rice	23	24	42	76	110
Sorghum	12	13	23	38	67
Beans #1	79	81	140	271	373
Groundnut	69	71	123	236	330
Sunflower	44	45	79	150	209
Copra	29	30	52	97	145
Cashews	132	136	237	403	580
Cotton	59	61	106	194	227

MOZAMBIQUE CONTROLLED PRICE
(Mt PER KG)

	1985	1986	1987	1988	1989
Maize	13	13	40	65	110
Rice	16	16	48	75	145
Sorghum	12	12	35	50	95
Beans #1	23.5	23.5	100	150	230
Groundnut	20	20	100	150	255
Sunflower	15	15	50	75	138
Copra	5.5	5.5	18	60	100
Cashews	10	10	60	105	125
Cotton	16	6	65	104	175

CONTROLLED PRICE AS PERCENT OF PARITY

	1985	1986	1987	1988	1989
Maize	97%	94%	161%	152%	151%
Rice	70%	68%	115%	99%	132%
Sorghum	98%	95%	154%	130%	142%
Beans #1	30%	29%	71%	55%	62%
Groundnut	29%	28%	81%	64%	77%
Sunflower	34%	33%	63%	50%	66%
Copra	19%	18%	34%	62%	69%
Cashews	8%	7%	25%	26%	22%
Cotton	27%	10%	61%	53%	77%

Source: IBRD, Mozambique Agricultural Sector Survey, May 12, 1988, Table 4.1 and Annex II, Table 1, adjusted by USAID estimates.

7. Pricing

The GOM continues to review and revise agricultural producer prices. For the 1988/89 production year, floor prices announced for the principal food crops -- maize, beans and rice -- approach or exceed import parity, Table II.5. A floor price was established for cashews at the farmgate and a set of fixed prices at the processing factory gate were announced based on import/export parity for groundnuts, castor beans, sunflower, copra and cotton. Public and private sector traders are free to compete in purchasing these products from producers. Cashews sell well above the established floor price in most locations. These changes should be beneficial to the producer. However, market constraints mitigate the productive impact since there are few processing plants in either the public or private sector for these commodities. A buyers market thus exists and the floor price becomes the ceiling price for the producer. Where the ceiling price is set at the factory, then the farmgate price will be lower reflecting the margins and transport costs from the farm to the factory.

These caveats notwithstanding, the current prices on offer represent significant movement toward parity and provide greater incentives to producers than found ever before in Mozambique. Table II.5 illustrates the evolution of Mozambican agricultural prices and their relation to export/import parity since 1985.

In addition to the above price developments, the February 1989 PFP calls for the Directorate of Agricultural Economics (DAE) to develop simple models to analyze estimates of farmgate prices based on world prices. These models would be used in the analysis of producer prices in future crop seasons. However, until the DAE has a more effective data collection system the usefulness of the models may be limited. At present, it is important to assess the impact from the current price changes and to establish an appropriate data collection mechanism that would provide sufficient information for the impact analysis.

8. Markets

Rural markets should play the dual function of clearing surplus food and cash crop production and providing consumer goods and agricultural inputs to producers. As indicated earlier, the functioning of markets was severely disrupted after the departure of Portuguese traders, leading the government to assume this function.

For the 1988/89 crop year, the government opened the marketing of certain agricultural commodities (specified in 6 above) to private competition. The Ministry of Commerce, through AGRICOM and other parastatals, still purchases and distributes cereals in the official marketing system, due to extreme food shortages. However, only small quantities eventually reach consumers through official channels due to the fact that the margin between producer and consumer prices will not cover handling and transport costs. As a result, parallel markets exist for most of the controlled products. Both the GOM and the IMF have concluded that due to the present security problems and extreme income disparities markets for these commodities cannot function properly and open competition would lead to major shortages in poorer areas and drive up prices exorbitantly. However, these conditions should be consistently reevaluated in order to determine if some private participation is viable, with AGRICOM filling in the gaps rather than vice versa.

9. Transportation

Roads are the primary network link between rural areas and agricultural inputs, urban markets and commercial food supplies. The road transportation system, once very efficient, has suffered from a shortage of foreign exchange needed to buy new vehicles, spare parts and fuel. Mounting security problems have reduced the demand for transportation services and increased the risk of operating in rural areas. Sabotage has damaged many bridges, and lack of maintenance has resulted in deterioration of the roads.

The private sector's participation in trucking in Mozambique has declined from an 80 percent share at independence to a 25 percent share today. Large parastatal transport organizations have picked up part of this difference. At the present time, the total Mozambican truck fleet is estimated to number 4,000 (3 tons or greater) of which approximately 25 percent are in the private sector. Of those private sector trucks, approximately two-thirds haul for their own account and only about one-third are for hire. The average age of the private sector fleet is estimated to be more than 20 years old.

Both the private and public transporters are severely affected by the insurgency with the risk of vehicle and cargo losses extremely high. Present freight rates do not account for this high level of risk nor do they fully account for increases in operating costs and replacement costs. Official freight rates are estimated to be Mt 77 per ton-Km (approximately $0.106 per ton-Km). A more realistic rate would be in the range of Mt 200 per ton-Km.

III. Donor Assistance in Mozambique

A. General Trends

This section briefly describes the donor resources being applied to macroeconomic structural adjustment and, specifically, the agricultural sector. The intent is to provide additional context for the Private Sector Support Program proposed in this PAAD rather than to analyze the breadth and viability of donor assistance to Mozambique. Most of the statistics presented in this section are drawn from UNDP reports and IMF projections of future donor assistance. Unfortunately, data on donor aid in Mozambique are not fully consistent, but they are adequate to demonstrate that major financing gaps exist and that only minimal donor assistance has been dedicated to private agriculture.

Between 1980 and 1988 Mozambique received approximately $1.4 billion in grants (disbursed) and $3.2 billion in loans (disbursed). As shown in Table III.1 below, grant assistance increased consistently during this period. Total concessional assistance is expected to increase further in 1989 to approximately $818 million. The grant component of this amount, $440 million, represents more than a doubling of grant assistance since 1986, the year before the Economic Rehabilitation Program was launched in 1987.

Table III.1

Financial Gaps & Donor Assistance
(millions of dollars)

	1983	1984	1985	1986	1987	1988	1989	1990	1991
A. Current Account & Amortization	-801	-814	-719	-958	-1060	-1209	-1273	-1351	-1397
B. Loans and Grants	429	433	378	497	605	722	817	912	1005
- Disbursements:									
Grants	90	168	139	213	304	372	443	511	576
Loans	339	265	239	284	301	350	374	401	429
C. Debt Relief, Arrears, Other	297	394	369	464	464	421	358	355	240
D. Financing Gap	75	-13	-28	-3	-9	66	98	84	152

The IMF estimates that, based on current commitment levels and normal growth, foreign assistance will average $930 million annually through 1993. Even with these increases, Mozambique will have an annual financing gap of $420 million. While debt rescheduling will affect part of this gap, current projections show that Mozambique will require, on average, additional external support of around $110 million per year from 1989-1993 to meet its financial requirements under the Economic Rehabilitation Program.

Mozambique has a wide range of donors providing economic assistance, the five largest being Italy, Sweden, the U.N. system (including the IMF and World Bank), the United States and the EEC. Depending on the year, between 15-20 percent of donor assistance has been provided in the form of technical assistance. The balance has been capital assistance, including humanitarian aid and emergency relief. Most donor aid is tied to specific procurement and disbursement procedures which require extensive GOM administrative oversight and reduce flexibility to allocate funds on market principles to the most efficient producers. This trend could change as Mozambique is the pilot country for the IBRD's special program of assistance to the debt distressed which calls for donors to untie their assistance. This issue is discussed in greater detail in Part Two, Section V.

B. Macroeconomic and Agricultural Assistance

The principal donors active in macroeconomic structural adjustment are the IMF and World Bank. The policy dimensions of their programs are described in Part One, Section I. The IMF has provided assistance through a three-year structural adjustment facility for SDR 38.74 million ($51.9 million), equivalent to 63.5 percent of Mozambique's quota. The 1987 and 1988 loans were, respectively, SDR 12.2 million ($15.4 million) and SDR 18.3 million ($25.1 million). The third loan, equivalent to SDR 8.235 million ($11.4 million), was recently approved for disbursement.

World Bank (through the IDA window) assistance consists of concessional balance of payments support under three rehabilitation credits and four sectoral programs. The 1985 and 1988 rehabilitation credits were respectively valued at SDR 45.5 million ($55 million) and SDR 69 million ($90 million).[7] The third rehabilitation credit for 1989 was recently approved for $90 million. The total value of the Bank's sectoral programs is estimated at $122.8 million covering the following sectors: education ($15,8 million); energy ($20.0 million); urban renewal ($60.0 million); and health ($27 million). Additional projects are planned to come on line over the next two years for industrial development, transport, urban household energy, technical assistance and agriculture. Based on current performance under the ERP and anticipating approval of new sectoral programs, the World Bank has projected its average annual disbursements from 1989-1993 at $123.6 million.

Bilateral macroeconomic assistance has been channelled principally as co-financing for the World Bank's rehabilitation credits. The principal contributors under each of the credits have been: Norway and Italy for the first; Norway, Switzerland, Denmark and Holland for the second; and Switzerland, West Germany, Great Britain and Finland for the third. In addition, Sweden, Finland, France and West Germany have converted Mozambique's official debt to grants and others have reduced interest rates to concessional levels, thereby providing indirect macroeconomic support. Most bilateral donors have not engaged in direct policy dialogue with the government on macroeconomic issues.

Donor assistance data for the agricultural sector are less reliable than data on macroeconomic assistance which are verified annually by the World Bank and the IMF. According to UNDP, which depends on individual donor submissions for their information, 64 agricultural

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[7] Dollar values are based on the SDR/dollar rates in 1988.

projects are presently being implemented with grant and loan financing. Total commitments in the agricultural sector for 1983-1987 were $122 million in grants and $185 million in loans. In 1987, the total grants and loans committed were $104.4 million. The principal grant donors are Italy, the Nordic countries, and England. The African Development Bank and France have been the principal financers of soft loans for agriculture.

Projects in the agricultural sector are linked to import support for seeds, hand tools and equipment (63 percent of 1987 assistance) and technical assistance for institutional support (37 percent of 1987 assistance). From UNDP's list of principal ongoing projects, most projects focus on sugar, cotton and irrigation. The World Bank's public expenditure review in 1988 concurred with this general breakdown of agricultural investment (dollar amounts were not provided): irrigation 44 percent, cotton 10 percent, sugar 7 percent and others 39 percent. Even assuming that all projects in the "other" category focussed on private agriculture, total commodity financing in 1987 would have been $25.6 million.[8] Of this amount, $9.835 million was financed by A.I.D. under the Private Sector Rehabilitation program for assistance in Maputo and Gaza provinces. From discussions with other donors, much of the remaining $15.765 million was also invested in these two provinces, leaving virtually no support for other parts of the country.

C. Conclusions

This analysis allows several conclusions. First, the increasing level of assistance for Mozambique indicates a general donor consensus that the GOM has energetically implemented its Economic Rehabilitation Program. The IMF's projections of increased assistance in the future also suggest donor faith in the government's commitment to policy reform.

Second, financing gaps will persist for years despite increased donor assistance. The economic analysis in Part One, Section I describes in detail why the GOM's economic reform process will not, at least in the medium term, lead to financial self-sufficiency. The analysis in this section indicates that projections of increased donor assistance cannot fill the gap. This reinforces the rationale, presented in Section I, for fast disbursing balance of payments support.

Third, private agriculture is not adequately financed. Part One, Section II provides a detailed rationale for a private agriculture focus. Presently, the private agricultural sector's demand for commodity assistance far exceeds supply (see the demand analysis, Part Two, Section IV). This gap spreads further when one considers agricultural marketing requirements. Based on current trends of donor assistance in agriculture, the need for continued commodity support for private commercial and family farmers will persist.

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[8] Based on the assumptions that $ 104.4 million was provided for agriculture, 63 percent of this went for capital assistance, and 39 percent of capital assistance went to the private sector.

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PART II

PROGRAM DESCRIPTION

I. A.I.D. Objectives and Strategy in Mozambique

A. U.S. Foreign Policy Objectives

Mozambique plays a pivotal role in the processes of peaceful change and economic development in Southern Africa. The country occupies a strategic location along the southeastern coast of the Indian Ocean. Its port facilities and rail and road network provide its landlocked neighbors (principally Zimbabwe, Malawi, and Zambia) with an alternative to the only other economic source for these services, the Republic of South Africa (RSA). The development of transport linkages is a key element in the Southern African Development Coordination Conference (SADCC) strategy to reduce economic dependence on South Africa and, thus, to provide alternatives to the member countries. Success in developing these resources requires that Mozambique attain political and social stability conducive to long term economic growth.

Mozambique's domestic and international policies have evolved rapidly since independence, from "scientific socialism" to a pragmatic approach to regional politics and economic development. The Nkomati Accord, signed with South Africa in 1984, signalled Mozambique's understanding of the need to practice shrewd diplomacy in spite of an abhorrence of apartheid. Although Nkomati did not yield the promised results, the GOM has consistently attempted to negotiate with South Africa rather than risk further rupture of relationships. While committed to the goals of SADCC, the GOM has thus had to maintain a delicate balance in its relations with both South Africa and other SADCC countries due to its economic dependence on South Africa as a source of employment for its miners and migrant agricultural workers and its fears of increased South African involvement in its internal affairs.

Mozambique's domestic and international policies have evolved in tandem with its constructive approach to regional politics and economic development. In 1983, the Fourth FRELIMO Party Congress urged new relationships with western governments, international financial institutions, and private foreign investors. It pragmatically acknowledged policy errors, and criticized the inefficiency of state farms, the lack of support for private agriculture, and the inappropriateness of large investments in heavy industry. The Fourth Congress also strongly endorsed a growing role for the family farm sector. As demonstrated in Part One of this paper, the GOM has acted faithfully on these resolutions through its Economic Rehabilitation Program. Continued movement in these directions is expected from the Fifth Party Congress, to be held in late July, 1989.

Despite these measures, Mozambique remains one of the world's poorest countries. Armed conflict, in particular, threatens the progress made in domestic, regional and international policies. Fertile land, installed hydroelectric capacity, and mineral and natural gas deposits cannot be systematically exploited. With 1.7 million people dislocated by war, more than 2.8 million at risk, and about 1 million people in refugee status in neighboring countries, basic survival has become a foremost consideration for more than a third of the population. In such circumstances, political stability and democracy can be fragile.

The U.S. Government supports the new directions of the GOM and feels that it can play a constructive role in the political and economic affairs of the region. To assure that progress is maintained, the U.S. encourages Mozambique's process of economic and political liberalization and seeks to contribute constructively to establishing a lasting peace. The United States strongly endorses Mozambique's use of creative diplomacy to reduce regional tension and strengthen the region's economic base for long term growth. Through direct economic aid, participation in international fora and support for multilateral assistance programs, the United States has also encouraged Mozambique's efforts to strengthen the ties and relationships it has forged with western countries and financial institutions.

B. A.I.D. Objectives in Mozambique

A.I.D.'s program in Mozambique is an essential element in achieving regional and bilateral U.S. foreign policy objectives. Fundamental economic changes are now underway and substantial financial and material resources are required to assure the success of these efforts. Moreover, meaningful change cannot be institutionalized when more than a third of the population is directly suffering the effects of a vicious rural insurgency. A "normal" economic environment will not be achieved without peace, but sheer humanitarian needs -- for food, water and improved health -- demand attention in the interim.

Economic need also factors into regional and international policies. As discussed in Part One, Mozambique, with its massive current account deficits and persisting financing gaps, cannot shift, as a nation, from foreign aid dependency to financial self-sufficiency in the short term. Its capacity to broaden relationships with the West are thus contingent on the willingness of western countries to reciprocate diplomatically and help economically. Mozambique's regional role depends on its ability to rehabilitate the rail and port infrastructure and on its capacity to keep the rail lines open. Mozambique's economic viability, in turn, will affect the overall region's leverage to promote constructive political change in South Africa.

A.I.D.'s economic objectives in Mozambique thus have a direct bearing on broader political dynamics. The Mission's specific goals are fourfold:

1. to address growing humanitarian and emergency needs stemming from civil strife and natural disasters;

2. to support liberalization of economic policies so as to alleviate short term economic crises, boost domestic production and provide a basis for future growth;

3. to facilitate and strengthen new relationships with international financial institutions such as the World Bank and the IMF; and

4. to enhance the viability and mutual benefits of linkages to SADCC and its regional objectives.

C. USAID/Mozambique Strategy

Mozambique's politically difficult and rapidly changing environment, as well as severe infrastructural and human resource constraints, demand both simplicity and flexibility in an assistance strategy. By necessity, initial A.I.D. efforts concentrated on achieving the fastest possible delivery of assistance to end beneficiaries. Immediate impact was critical. Over time, the Mission has refined the mechanisms used to reach target groups so that the process of providing assistance itself becomes developmental and helps lay a base for growth. Long term investments, as it becomes possible to shift the current short and (in agriculture) medium term focus, will seek to reestablish lost capabilities and the capacity to maintain these investments before attempting to expand services and production. Emergency relief and balance of payments support (for both consumption and produc'ion) are the two operational components of the short and medium term strategy. Each of these has important policy dimensions. Long term investments by A.I.D. have been made solely in railway rehabilitation.

Consistent with this strategy, emergency relief programs initially accepted pre-established government structures as the fastest means to maximize assistance for war-affected people. USAID has since worked closely with NGOs and the GOM to improve the efficiency of implementing agencies. The next step is to modify policies and organizational responsibilities in ways that will facilitate transition to a stable, post-emergency economy. This calls for the government to increasingly contract out specific relief functions, particularly food transport from ports to provincial capitals, to spark private initiative and investment. To the extent that end recipients are relatively stable population groups, the Mission will work with NGOs to facilitate simple community networks conducive to self-help and preventative health activities.

USAID/Mozambique's bilateral development program consists of balance of payments support linked with a continuing policy dialogue to promote the viability of the GOM's macroeconomic reforms. Donor financing of critical imports to boost production and to meet basic food needs both complements and facilitates real exchange rate devaluation, price liberalization and other policy changes that would be inoperative without increased resources.

On the production side, the original Private Sector Rehabilitation Program and the Private Sector Support Program proposed in this document couple policy measures to improve incentives for private agriculture with financing for imported inputs that reinforce producer responsiveness to policy incentives. Moreover, by channelling resources through private importers and distributors, USAID's assistance helps strengthen private marketing channels that are critical to long term growth. The GOM's concurrence with private import mechanisms under the PSR program was, in itself, an important initial policy development. The next stage of policy development, as discussed in detail throughout the rest of this program description, is to institutionalize a sound system of price incentives for agricultural production.

Food aid, distributed through commercial channels, is the consumption component of balance of payments support. Due to internal income disparities and supply disruptions, government involvement in distribution and pricing could not be phased out as quickly as with the supply of producer inputs. In this case, first order market solutions had to give way to second-best alternatives. Accordingly, the Mission is now seeking to link price liberalization and distribution decontrol with strategically targeted subsidies for commodities with a low income group market. For most goods this will facilitate a gradual equilibrium between producer and consumer prices at a level that provides a production incentive. It also addresses income and employment disparities, particularly in urban areas where an average eight-member household would have to spend 120 percent of total reported income on food and fuel to meet dietary requirements.

For 1990, USAID/Mozambique has proposed in its Annual Budget Submission a third policy related program to create adequate incentives and opportunities for the growth of private marketing channels and trade networks in Mozambique. The marketing focus would complement efforts under the Private Sector Support Program to create a sound policy structure for agricultural production and under commercialized food aid programs to limit subsidies to vulnerable population groups. Specifically, the Program would seek to phase out centralized administrative controls on transport and marketing issues in order to allow market incentives and local entrepreneurial initiative to play a more dynamic role in domestic trade. It would also support reforms to decentralize decision-making on transport and marketing issues (e.g. transporting emergency food) where a government role is essential. If the program is approved and funds can be disbursed through a CIP mechanism, the initiative could be implemented through an amendment to the Private Sector Support Program.

II. Purpose and Rationale

A. Purpose

As indicated above, the Private Sector Support Program is USAID's principal mechanism to promote private agricultural production in Mozambique. The program purpose is <u>to improve incentives for private agricultural production in order to enhance the private agricultural sector's production and income</u>. Specific policy impacts expected through the program are:

- (a) increased liberalization of producer prices in agriculture and, for crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices at world parity, with prices being announced in a timely fashion to have an impact on production decisions;

- (b) clearly defined policies and an action plan leading to divestiture of state farms to private family and commercial farmers;

- (c) demonstration of the viability and effectiveness of strengthening private sales and service networks for agricultural inputs in order to promote widespread outreach to commercial and family farmers; and

- (d) tested policy options to increase both the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as a foreign exchange allocation mechanism.

Improved price signals will increase production of Mozambique's nine major crops by $8 million per year using conservative supply elasticity assumptions. The present value over a 20 year period of increased production due exclusively to policy reforms would be approximately $70 million. Production inputs would further stimulate production, the net present value of which is estimated at $50 million.

B. Rationale

To achieve this purpose the Private Sector Support Program must address basic constraints to private agricultural production. Part One, Section II describes the rationale for focussing on private agriculture. It also identifies and describes the key constraints affecting private agriculture. The purpose of the following section is to highlight those issues and constraints which are addressed through the Private Sector Support Program and explain why others are not. The specific policy reform agenda for this program is described in Part Two, Section III.

1. Constraints Addressed

a. Producer Prices: The agricultural pricing system is central to the incentive structure for agriculture. Although most producer prices approach import/export parity, the pricing mechanism needs to be institutionalized and the scope for administrative discretion reduced.

b. State Farms: Although there is no scarcity of fertile land in Mozambique, security considerations place a premium on high quality land with access to transport routes. The evolution of land ownership patterns after independence left many of the most

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desirable farms in state hands. These farms could be much more productively exploited through divestiture to commercial and family farms.

c. Private Sales and Service Networks: The inability of parastatals to establish extensive and reliable input supply networks throughout the country constrains the capacity of farmers to respond fully to improving price incentives. Until USAID began to channel assistance through private importers and distributors in 1984, prevailing government policies effectively precluded expansion of private sales and service networks, particularly for high-value agricultural inputs such as tractors, trucks and related implements. The key now is to create incentives to expand such networks to other provinces and, as discussed item d below, to institutionalize mechanisms for private importers to gain access to foreign exchange.

d. Access to Foreign Exchange: Until production inputs are produced locally or foreign exchange earnings radically increase, limited access to foreign exchange will be a constraint to production. It is critical that donor supplied import support (a) be directed to its highest value uses, and (b) be provided in such a way that the strongest possible incentives are provided to producers to earn foreign exchange. This will be handled through policy measures that support a broader World Bank/IMF initiative (see Part Two, Section V).

2. Indirect and Limited Impacts

a. Technology and Extension: The program depends on information spreading about new technologies through private investors. It is clear that Mozambique's research and extension capacity needs to be boosted, but other donors are already active in this field (Italians, Netherlands, FAO, UNDP/WFP). Given current insurgency conditions in most rural areas, further foreign exchange investment would likely exceed short to medium term absorptive capacity.

b. Local Cost Financing: The principal source of credit for agriculture is the Banco Popular de Desenvolvimento (BPD), which has branches or agents in each of Mozambique's 10 provinces. In addition to BPD's normal credit facility, the Government in 1988 introduced a subsidized credit program for agriculture called Caixa de Credito Agricola e Desenvolvimento Rural (CCADR). However, under the credit restriction of the new PFP only limited funds have been available in the CCADR. In anticipation of counterpart financing under the CIP, BPD has factored credit requirements into their 1989/90 credit allocation.

3. Unresolved Issues

Aside from improving transport capacity by financing trucks, the program does not directly address marketing constraints. Given the complexities created by security considerations, the Mission currently does not have sufficient information to address marketing problems effectively and be sure that proposed "solutions" do not themselves entail more problems. In particular, it is not clear what kinds of incentives are needed to reestablish the market networks abandoned by the Portuguese, or if such networks are viable in the midst of armed conflict.

In its FY 1991 Annual Budget Submission, USAID/Mozambique has proposed to use Program Development and Support Funds to conduct an in-depth analysis of marketing systems and constraints in Mozambique. This analysis would lead to a proposal for funding under the Africa Economic Policy Reform Program (AEPRP) to support the development of private markets and trade networks.

The current lack of attention to the issue, however, does not threaten the Private Sector Support Program's viability. As experience demonstrated during the first four years of the CIP's implementation, the areas affected by the program have access to relatively large marketing centers. While transport costs, to the extent they are too low, affect marketing channels, commodities can and do move, suggesting that traders develop informal, yet profitable arrangements.

III. Policy Reform Program

A. Overview of the Policy Process

This section outlines the policy measures which the GOM will implement in support of the program objective to improve incentives for private agricultural production. The GOM's policy measures directly address the four constraints identified above in Section II: producer price incentives, divestiture of state farms, strengthening private agricultural sales and service networks, and increasing private sector access to foreign exchange. Each of these policy areas builds on general reform measures which the GOM developed with the World Bank and the IMF in context of the February 1989 Policy Framework Paper. The policy reform program identified in this document defines a more precise process and schedule for policy implementation.

In addition to these reform measures, the GOM will also be implementing complementary policies under the P.L. 480 Section 206 program in order to liberalize consumer prices for key food crops (white maize, beans and rice) while maintaining a safety net for the poor by subsidizing less-preferred yellow maize. The combined impact of producer and consumer price reforms is expected to be an improved policy environment in the food and agriculture sector in which market forces increasingly define both production patterns and consumer behavior. These policy measures, moreover, would be reinforced by USAID's proposed private market development program for FY 1990 which is intended to improve the policy environment for domestic trade.

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Policy reforms under each of the four key policy areas are phased over the three-year life of the Private Sector Support Program. For each policy area, an overall objective is specified which will be achieved through implementation of annual work plans. The Ministry of Finance will designate a working group consisting of representatives of the Ministries of Finance, Agriculture, and Commerce as well as AGRICOM to meet with USAID on a quarterly basis to discuss progress on both consumer and producer pricing and distribution polices in the food and agriculture sector. Matters will be referred to the Ministerial level as appropriate. The policy agenda may be adjusted each year to add greater specificity on the basis of improved information and to reflect lessons learned during earlier phases. The reform program as presently anticipated is summarized in Table III.1. (See Part Three, Section X for details on policy negotiations.)

The policy agenda finalized in any given fiscal year of the program will have its impact in the agricultural season immediately following (e.g. policy measures agreed upon in FY 1989 will affect the 1989/90 agricultural season beginning in October/November). As Mozambique has two agricultural seasons, there is also scope for mid-term adjustment of policies (say December) in order to influence production and marketing incentives during the second season (generally beginning in January). This will be achieved through the policy group working meetings described above.

FY 1989 funds will be obligated and disbursed on the basis of the general policy principles and specific reforms to which the GOM has committed itself in its February 1989 PFP as well as the measures described in this document which will be formally incorporated into a GOM policy program through a letter of intent to be submitted to USAID before the obligation of funds. USAID will authorize, obligate and disburse subsequent tranches in FY 1990 and FY 1991 after confirming satisfactory progress on the previous year's policy work plans. Details on policy progress and a preliminary assessment of the impact on producers and consumers would be reported to AID/W on a regular basis.

B. Policy Objectives and Schedule

1. Agricultural Producer Prices

Objective: Maximize the liberalization of the producer pricing system for Mozambican agricultural commodities in order to institutionalize fair producer incentives, reinforce trends of increased production, and encourage competitive marketing of commodities that supply national needs and earn the foreign exchange needed for input purchases. The strategy for achieving this objective is, first, to replace fixed producer prices with floor prices that guarantee producers a fair return in cases where there may be only one buyer. In cases where a competitive market exists, floor prices can then be replaced by a completely liberalized market. To continue to protect producers where security and market

Table III.1

SUMMARY OF POLICY OBJECTIVES AND WORKPLAN

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS
1. Agricultural Producer Prices	Objective: To maximize the liberalization of the producer pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural policies on world parity.			- Price changes and announcements.	- Production increases on family & commercial farms. - Farm income increases (family & commerical farms).	- Production statistics by crop, province and production unit. - Estimate farm income calculated from production functions. - Farm level sampling to verify macro analyses.
a. Maize, Beans, Rice	Establish parity producer prices; plan for floor price system.	Establish parity-based floor price system.	Adjust floor price system to reflect changing market conditions.			
b. Cash Crops	Establish parity-based floor price system; plan for deregulation.	Deregulate all producer prices.	Maintain deregulation.			
c. Timing	Before planting decisions.	Before planting decisions.	Before planting decisions.			
2. Divestiture of State Farms	Objective: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of National Plan.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and Implementation	Complete national plan and USAID-specific implementation schedule.	Implement Phase I	Implement Phase II			
b. Assessment		Impact evaluation.	Impact evaluation.			
3. Private Ag. Sales and Service	Objective: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/traders participating in program.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For Importers, Distributors	Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	New A.I.D. items and spares fully private. Plan to privatize or phase out lubricants. Plan to privatize ag-related public enterprises.	Implement Phase I of privatization plan for lubricants.			
b. For End Users	Replace GOM administrative allocation system of ag inputs with direct sales via private companies.	Maintain direct sales.	Maintain direct sales.			
4. Access to Foreign Exchange	Objective: To establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and institutionalize market signals as an allocation mechanism.			- Implementation of FX allocation options agreed upon with donors. - Range of eligible OGL sectors and volumes of FX increased.	- Increased access to foreign-exchange at market-determined price.	- Survey of OGL users to determine private access. - Trends in official and parallel exchange rates.
a. Allocation Mechanism	Establish limited trial of OGL system.	If trial is generally successful, modify and expand eligible sectors under OGL; otherwise, formulate new options.	Plan to extend OGL framework to larger portion of FX allocations or test other allocation options.			
b. Assessment		Impact Assessment				

conditions foreclose competition among buyers, AGRICOM would offer a producer floor price, but the producer would be free to sell at any price should other marketing options become available.

Current Situation: The government announces a fixed factory gate price based on import/export parity for cotton, copra, castor beans, sunflower and groundnuts. Cashews have a floor price. Fixed prices are announced for maize, beans, rice, and sorghum. Maize is the principal food crop and accounts for 80 percent of cereal consumption.

1989/90 Work Plan

--Establish floor prices based on world parity prices for the following cash crops: cashews, cotton, copra, sunflower, castor beans and groundnuts.

--Establish import parity producer prices for maize, beans and rice.

--Announce 1989/90 agricultural prices in adequate time to affect planting decisions. (September 30)

--Analyze the impact of price changes and develop a plan to fully deregulate pricing for cash crops and to move maize, beans and rice to a floor price system in which AGRICOM guarantees a minimum price, but producers are free to obtain the best price from any buyer.

1990/91 Work Plan

--Implement the plan to deregulate producer prices for cash crops and move maize, beans and rice to the floor price system.

--Announce 1990/91 pricing policy in adequate time to affect planting decisions. (September 30)

--Complete an analysis of the impact of price policy changes.

1991/92 Work Plan

--Adjust the floor price system based upon experience in 1990/91 and to reflect inflation, exchange rate movements, changes in world prices, etc.

--Announce 1991/92 pricing policy in adequate time to affect planting decisions. (September 30)

--Complete an analysis of the impact of price changes.

2. Divestiture of State Farms

Objective: Develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling and registration) to redistribute state farms to commercial and family farmers and thereby redeploy resources to the most efficient producers in accordance with the GOM's agricultural development strategy and the ERP. The GOM specified in the February 1989 PFP that it "will prepare an action plan for each (state farm) enterprise, spelling out further changes or reforms necessary (beyond the divestitures completed in 1988) for financial viability or the steps that will be taken to redistribute the land to more efficient producers." The focus of the following measures is to ensure that appropriate policies are established in conjunction with this action plan for divestiture, selection of beneficiaries, and titling. Based on the successful development and adoption of such policies, the policy work plan provides for the divestiture of specific state farms to be agreed upon with USAID. It is recognized that beneficiary selection and titling policies can be very complex to develop and implement and that this, in turn, may delay the process of divestiture.

1989/90 Work Plan

--Complete a comprehensive national plan and schedule, as specified in the February 1989 PFP, to redistribute state farms to commercial and family farmers. The national plan will consider critical policy issues such as titling, beneficiary selection and divestiture procedures.

--Develop with USAID a phased schedule to implement specific components of the redistribution plan over 1990/91 and 1991/92, including details on the numbers and types of farmers and their production needs, in order to ensure the effective linkage of commodity import support with policy implementation.

1990/91 Work Plan

--Implement Phase I of the plan agreed upon with USAID assuming all divestiture policy issues have been satisfactorily addressed.

--Assess the effectiveness, timing and impact of program implementation and develop recommendations for Phase II.

1991/92 Work Plan

--Implement Phase II of the plan agreed upon with USAID.

--Assess the effectiveness, timing and impact of overall program implementation.

3. Private Agricultural Sales and Service Networks

Objective: Demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country. The strategy to achieve this objective is to continue to use the importation and distribution of USAID-financed commodities as a means to strengthen private networks, with sales to end users determined by normal market factors, i.e. the capacity of farmers to pay for the local currency price of the desired input.

1989/90 Work Plan

--Continue focusing USAID financing on private importers and distributors for program commodities and avoid backsliding on progress made under the earlier Private Sector Rehabilitation Program. Only two categories of products will be exempted in 1989: lubricants and spare parts for items financed in the initial years of the CIP which are handled solely by public enterprises.[9] This measure would increase private importation and distribution of commodities to about 97 percent of the total value of the CIP.

--Phase out the administrative allocation system for CIP commodities. Importers/distributors within each province will sell agricultural inputs imported under the program to those farmers with an established farming history who have the capacity to earn and pay the local currency cost of the inputs, with a limit of one purchase per customer of each major commodity (i.e. a maximum of one tractor and truck per customer) so as to ensure wide distribution of benefits. This measure phases out the administrative allocation to end users of high value commodities such as tractors and trucks, and replaces it with a market-based allocation system.

1990/91 Work Plan

--Develop with USAID a plan to privatize the importation and distribution of lubricants or to phase lubricants out of the Private Sector Support Program eligible commodity list.

--Develop a plan to privatize state enterprises and mixed companies that are in the agricultural input, implement, tractor and related commodities business including a schedule for phased implementation.

1991/92 Work Plan

--Implement Phase I of the above privatization plan.

[9] During the initial years of the CIP there was only one official importer, Intermecano, for trucks and tractors. Although USAID has phased Intermecano out of the program for new imports, a dilemma remains about spare parts for commodities previously imported. To stop importing spare parts would principally penalize those farmers who purchased the commodities when they had little alternative. USAID proposes to continue financing for spares under the FY 1989 obligation. Intermecano and other public enterprises would then have a year's lead time to make alternative arrangements.

4. Access to Foreign Exchange

Objective: Establish a process of testing foreign exchange allocation options that will increase the access of private entrepreneurs in the agricultural sector to foreign exchange and allow the market to play a greater role in determining the uses of scarce foreign exchange. The general liberalization of foreign exchange allocation will, in effect, give private entrepreneurs greater access to foreign exchange and thereby facilitate the expansion of private agricultural sales and service networks beyond the Private Sector Support Program as provided for in policy reform area number 3. The World Bank has taken the lead role in pursuing this objective. Under the Bank's Third Rehabilitation Credit, the GOM will initiate a trial Open General License (OGL) System allowing all enterprises in specified sectors to have automatic access to foreign exchange at the official rate, using local currency counterpart and tariff adjustments to regulate demand. USAID financing for the OGL would be contingent upon compliance with the work plans below and other evaluation factors. (See Part One, Section V for details on the OGL and USAID participation.) Should the OGL trial not prove successful, the policy work plan will focus on testing other alternatives.

Current Status: Private enterprises presently do not have direct access to foreign exchange outside of a foreign exchange retention scheme which each enterprise must negotiate with the GOM for foreign exchange earnings. To be considered for "official" foreign exchange, an enterprise must be included in the annual national plan of the government ministry overseeing its sector (e.g. agricultural enterprises must be in the Ministry of Agriculture national plan). It can then be evaluated for an allocation of donor assistance or, in rare cases, an allocation of monthly cash balances after requisite payments are made.

1989/90 Work Plan

--Implement a trial OGL system, using World Bank funds, for enterprises importing raw materials and equipment for textile and shoe production, and limited spare parts for transport.

--Review with USAID the GOM/World Bank evaluation of the trial phase of the OGL, including the effectiveness of demand management, the profile of the clients, its impact on the exchange rate, financial control measures and plans for expansion to new sectors.

1990/91 Work Plan

--Expand eligibility for participation in the OGL system based upon the recommendations of the GOM/World Bank evaluation and as presented to USAID in the 1989/90 review of the OGL. If the OGL trial does not prove successful, develop a plan to test other options that will allow the market to play a greater role in foreign exchange allocation.

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--Review with USAID progress under the OGL system including issues discussed under the 1989/90 program.

1991/92 Work Plan

--Develop a plan, based upon experience under the OGL, to draw a larger portion of the GOM's foreign exchange allocations into the OGL framework or test other allocation options.

IV. CIP Implementation

As explained elsewhere, the GOM is in the process of introducing a system of nonadministratively allocated foreign exchange for a limited range of industrial inputs. The OGL mechanism, if it can be broadened should significantly reduce the risks and uncertainty associated with access to inputs. At the present time, the system does not include agricultural inputs. Moreover, given the massive shortfall in Mozambique's external accounts and the degree to which this shortfall is filled by donor assistance (generally tied), it is not clear how effective a system for nonadministrative allocation will be. For the first year, all A.I.D. resources will continue to be provided through the provision of production inputs and capital goods to the private agricultural sector. Depending on progress in implementing the OGL system, USAID would provide a portion of FY 1990 and FY 1991 funds for OGL disbursement. Section V provides further details on the OGL system. This section focuses on the traditional commodity import mechanism to be employed in FY 1989 and for most future year funding.

A. Geographic Area

The program will again provide production inputs to areas in Maputo, Gaza and Manica provinces assisted by the previous program. In addition, Sofala, Zambezia, Nampula and Cabo Delgado will receive support in this program. These are areas of great potential, and demand for equipment and other production inputs is very high compared to the supply. Demographics and land for each of the geographic areas are shown in Table IV.1. Assistance will not be provided to state farms or irrigation schemes, or to government entities in these areas. A brief description of each province and commodities to be financed is provided below, including FY 1989 funding levels. Future year requirements will be determined before obligation of subsequent tranches.

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Table IV.1

Demographic and Land Characteristics of the Geographic Areas

Province and Sector	Number	Percent of Total	Average Farm Hectares	Total Hectares	Percent of Total
Maputo Province					
Commercial Farmers	850	0.81	25	21,250	14
Family Farmers	92,400	87.7	0.8	73,920	51
Coop Members	12,100	11.48	30	6,000	4
State Farms	15	0.01	3,000	45,000	31
Gaza Province					
Commercial Farmers	1,173	0.95	20	23,460	15
Family Farmers	120,000	97.02	1	120,000	75
Coop Members	2,500	2.02	60	2,500	2
State Farms	13	0.01	1,000	13,000	8
Manica Province					
Commercial Farmers	250	0.27	60	15,000	8
Family Farmers	90,000	98.08	1.5	135,000	77
Coop Members	1,500	1.63	120	1,500	1
State Farms	12	0.01	2,000	24,000	14
Sofala Province					
Commercial Farmers	120	0.17	100	12,000	15
Family Farmers	70,000	98.97	0.8	56,000	72
Coop Members	600	0.85	50	600	1
State Farms	6	0.01	1,500	9,000	12
Zambezia Province					
Commercial Farmers	160	0.13	180	12,800	8
Family Farmers	120,000	99.53	1	120,000	71
Coop Members	400	0.33	50	400	0
State Farms	12	0.01	3,000	36,000	21
Nampula Province					
Commercial Farmers	120	0.05	80	9,600	2
Family Farmers	250,000	99.63	1.5	375,000	97
Coop Members	800	0.32	75	800	0
State Farms	6	0.00	400	2,400	1
Cabo Delgado Province					
Commercial Farmers	60	0.07	100	6,000	8
Family Farmers	80,000	97.48	0.8	64,000	86
Coop Members	2,000	2.44	40	2,000	3
State Farms	5	0.01	400	2,000	3

Source: Ministry of Agriculture, Government of Mozambique; USAID/Mozambique Estimates

1. Maputo Province - $608,450

A.I.D.-financed commodities distributed in the previous sector assistance program enabled the private farmers in this area to increase their supply of vegetables and other agricultural commodities to the Maputo market. Future investments in tractors, transport and other equipment require further development of secondary markets to absorb the additional production output. However, Maputo province, which includes Maputo city and the peri-urban green zones, will continue to receive assistance to finance seeds, fertilizer, lubricants and spare parts.

2. Gaza Province - $1,353,125

The major agricultural production areas in Gaza province lie adjacent to the Limpopo river. An impressive irrigated area with over 30,000 hectares in flood and furrow irrigation is located at Chokwe. Vegetables, rice, maize, cotton and livestock are produced on a large scale in this area. Output is marketed locally as well as in Maputo.

After a disastrous flood in 1977 ravaged the valley, the government took over most of the abandoned irrigated land in the province and developed large state farms. Production on these state farms was below expectations, frequently returning less than the costs of inputs and in some cases land was left fallow (abandoned) due to the lack of operable equipment. Consequently, the government has been redistributing land, and in some cases equipment, from the less profitable state farms to the private farmers in the area. A.I.D. commodity assistance has helped and will continue to assist the private farmers to rehabilitate the newly obtained land and to increase their level of production on old lands. CIP-financing will be provided in this program for seeds, fertilizer, lubricants, tractors, transport and other equipment for this area.

3. Manica Province - $1,792,750

The private farmers in this area have larger land holdings than in other target provinces. These farmers also use a combination of dryland and irrigation production techniques. The main agricultural crops produced in this province are vegetables, maize, sorghum, sunflower, cotton and citrus. Livestock and poultry production are also important. Output is marketed locally as well as in Beira and Maputo.

A.I.D. commodity assistance in previous programs has helped rehabilitate the infrastructure of the private farmers in the area and enabled the level of production to increase. However, the demand for tractors, transport, irrigation and other equipment as well as other production inputs remains very high. CIP-financing will be provided for tractors, transport equipment, irrigation equipment, harvest equipment, seeds, fertilizer, lubricants and spare parts.

4. Sofala Province - $2,117,375

The main agricultural crops produced in this province are vegetables, maize, sorghum, rice, cotton and sugar cane. Most crops are irrigated with the exception of sorghum which is produced using dryland techniques. Output is marketed locally as well as in Beira. CIP-financing will be provided for tractors, transport equipment, irrigation equipment, harvest equipment, seeds, fertilizer, lubricants and spare parts.

5. Zambezia Province - $2,132,375

The main agricultural crops produced in this province are copra, vegetables, cashews, sunflowers, beans, rice and maize. Farmers use a combination of dryland and irrigation production techniques. Output is marketed locally as well as in Quelimane. CIP-financing will be provided for tractors, transport equipment, irrigation equipment, harvest equipment, seeds, fertilizer, lubricants and spare parts.

6. Nampula Province - $2,182,250

The main agricultural crops produced in this province are maize, rice,. sorghum, beans, groundnuts, sunflower, cashews, cotton and vegetables. Private farmers tend to have large land holdings and use a combination of dryland and irrigation production techniques. Output is marketed locally as well as in Nampula and Nacala. CIP-financing will be provided for tractors, transport equipment, irrigation equipment, harvest equipment, seeds, fertilizer, lubricants and spare parts.

7. Cabo Delgado - $1,778,875

The main agricultural crops produced in this province are maize, rice, sorghum, beans, groundnuts, sunflowers, cotton and vegetables. Although there is a large irrigation scheme located at Nguri, most areas use dryland production techniques. Output is marketed locally as well as in Pemba and other larger cities along the coast. CIP-financing will be provided for tractors, transport equipment, irrigation equipment, harvest equipment, seeds, fertilizer, lubricants and spare parts.

B. Commodities to be Financed

1. Commodity Demand

The commodities proposed below for financing are based on the judgements of private importers and distributors assuming current levels of demand and prevailing exchange rates. Importers and distributors interested in participating in the program have been asked to present to USAID an indication of the demand in each new province for potential commodity imports. In effect, this process shifts the demand analysis from USAID onto the very entrepreneurs who have a stake in ensuring that the analysis is correct so that they do not find themselves with excess stock. The analyses submitted to date indicate that demand far exceeds the levels of donor financing. Details of this analysis are provided in Part Three, Section VI.

2. Proposed Commodities

Table IV.2 provides the proposed breakdown for imports in 1990 (i.e. the 1989 obligation). Although subject to later revision, the commodity list was developed through considerable research into the felt needs of private farmers in the field, discussions in each area with distributors of commodities being considered, and discussions with various Ministry of Agriculture officials.

TABLE IV.2

1990 Commodity Import List

Commodity	Estimated Cost CIF	Probable Source/Origin
Farm Equipment:		
Tractors	$2,183,750	A.I.D. Code 941
Tractor Spare Parts	$ 700,000	A.I.D. Code 941/935
Implements	$ 573,000	A.I.D. Code 941
Harvest Equipment	$ 570,000	A.I.D. Code 941
Transport Equipment:		
Trucks	$3,697,750	A.I.D. Code 935
Truck Spare Parts	$ 190,000	A.I.D. Code 935
Irrigation Equipment:	$1,381,000	A.I.D. Code 000/935
Pumps and Spare Parts		
Irrigation Pipe		
Fertilizer:	$1,540,450	A.I.D. Code 000/935
NPK		
Urea		
Ammonium Sulfate		
Potassium Sulfate		
Seeds:	$1,819,250	A.I.D. Code 935
Potatoes		
Garlic		
Groundnuts		
Butter Beans		
Maize		
Sunflower		
Vegetable Seeds:	$ 700,000	A.I.D. Code 000/935
Petroleum Products:		
Lubricants	$ 200,000	A.I.D. Code 935

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3. Future Year Requirements

As part of the ongoing monitoring process, Mission staff will survey recipients, as well as potential recipients, of CIP-financed commodities in each of the geographic areas to assess the appropriateness of the commodities being imported and to estimate the impact derived from the commodities. Additionally, the importers/distributors, in conjunction with provincial Ministry of Agriculture officials, will complete a demand analysis for the commodities being considered. These assessments will then form the basis for the future year obligations.

4. DFA Procurement Plan

The following procurement plan for this program is submitted as required by the Special Procurement Policy Rules Governing the Development Fund for Africa, dated April 1, 1988 (the "Rules"). In accordance with Administrative Recommendation No. 3 of the Rules, the authorized geographic code for the program is code 935. However, Administrative Recommendation No. 2 requires that the procurement plan assure procurement in the United States to the maximum extent practicable. The source/origin and nationality for procurement will be the United States, except as indicated below.

TABLE IV.3

DFA Procurement Plan

	Commodity	Code	Value
1.	Tractors, Implements, Harvest Equipment and Spare Parts	941	$3,726,750
2.	Tractor Spare Parts	935	$ 300,000
3.	Trucks and Spare Parts	935	$3,887,750
4.	Irrigation Equipment	935	$1,031,000
5.	Fertilizer	935	$ 896,540
6.	Seeds	935	$1,819,250
7.	Vegetable Seeds	935	$ 100,000
8.	Lubricants	935	$ 200,000
Total Value of Non-U.S. Procurement			$11,961,290

Past experience under the PSR Program has indicated the U.S. availability of the U.S.-designated commodities. This experience, as supported by the facts presented in Annex E (Amplification of DFA Procurement Plan), demonstrates the need to procure the designated items from code 935.

As stated in Operational Recommendation No. 1 of the Rules, A.I.D.'s normal cargo preference requirements and procedures apply to this program as a matter of law. However, provided that cargo preference

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requirements are complied with, that Recommendation authorizes A.I.D. financing of delivery services on code 935 - flag ocean vessels.

In accordance with Operational Recommendation No. 2, air travel and transportation to and from the United States will be on U.S. certified carriers unless exceptions are made by the USAID Mission Director. Little or no use of air travel and transportation is foreseen.

C. Allocation, Procurement and Distribution

1. Allocation

A transformation has occurred in commercial practices since the inception of USAID's sector assistance program in Mozambique, which began in 1984. At that time, only parastatal enterprises were allowed by the GOM to act as importers. Due, primarily, to USAID's encouragement for the GOM to change its policies, private sector dealers of equipment who had import licenses prior to independence were again allowed to import A.I.D.-financed commodities. More recently, as the program evolved, this policy was expanded to all private sector distributors of commodities being financed under the sector assistance program, including factories with raw material allocations and seed distributors. The bottom line is that for the FY 1988 CIP (656-Q-601D) there was approximately 95 percent participation by the private sector in importation and distribution of A.I.D.-financed commodities. The small balance still imported by the State sector covers lubricants, which are the sole domain of Petromoc; and some spare parts allocations to continue to support some equipment that had been imported with A.I.D. financing in previous years by parastatal dealers. (See Part Two, Section III.B.)

2. Procurement

a. Equipment: Under the terms of A.I.D. Regulation 1, "Rules and Procedures Applicable to Commodity Transactions", (A.I.D. Handbook 15, Appendix A), Section 201.23 (e), procurement under special supplier-importer relationships apply to A.I.D. financed transactions. Solicitation of offers from more than one supplier is not required if the importer is the supplier's authorized dealer. Based on this, and in an effort to strengthen the private sector dealers, and to encourage market competition and allow the end-user to express brand preference for a specific type of equipment, it was determined to allocate the tractor needs between the only two brands handled by private dealers in Mozambique, Ford and Massey Ferguson. This allows for the two dealers to prepare long range plans for mechanics training and other support functions, knowing that each year additional equipment will be coming in. This policy also applies to tractor implements, trucks, harvest equipment and irrigation pumps.

When feasible, and when similar equipment, such as a 65 horse power tractor is represented by more than one private sector dealer, allocations are made on estimated numbers of units, between at least

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two brands, by province, when adequate after-sales service is available for each brand in the geographic area. Trucks, for example, for the FY 1988 CIP, were divided among three importers. For the FY 1989 sector assistance program, which will be implemented in seven provinces, it is envisioned that at least five different truck dealers will be participating, given the geographic spread, payload capacity requirements, and distribution of the number of units.

b. Spare Parts: Spare parts allocations will continue to be made to dealers of trucks, tractors, pumps and other mechanical equipment who have imported A.I.D.-financed equipment under previous CIPs, in order for the dealers to continue providing after-sales maintenance and repair support for that equipment.

c. Fertilizers and Seeds: A private sector importer began to be involved in the importation of seeds during the FY 1987 CIP, and expanded its activities during the FY 1988 program to include fertilizers. The importer contracts with various distributors throughout the target areas to make the distribution of these inputs. For seeds, depending on the variety, requests for quotations are issued to seed producers in Southern Africa and the United States. Depending on the types and quantities of fertilizer, requests for quotations will be issued to producers in Southern Africa and the United States.

d. Lubricants: The only commodity on the procurement list that is limited to a parastatal will be imported by Petromoc, which, as customary, will issue a request for quotations.

3. Distribution

When the Private Sector Rehabilitation program was instituted, beneficiary farmers were largely chosen by District Ministry of Agriculture officials. This system of direct government involvement in the allocation of the inputs was seen as justifiable on the grounds that the demand for the scarce resources far exceeded the supply made available under the program. It was evidently felt that misallocation of these resources would result if market forces were relied upon to determine recipients, particularly given the severe overvaluation of the exchange rate and the resultant subsidy to local currency buyers. This pattern of administratively allocating equipment to recipients was also partly influenced by a history of central planning and bureaucratic control over the resource commodity market.

With the exchange rate reforms and revised tariff structure implemented under the ERP, however, the local currency prices of imported commodities have approached a more realistic market value. Farmers must carefully analyze their investment decisions, and the impetus to ensure full utilization of capital equipment has grown much stronger. Already in 1988 some farmers who were "awarded" commodities later gave up their allocations and the items were sold to others with more profitable enterprises. These are signals that market forces have again become relevant, and should be allowed to determine resource allocations. Accordingly, administrative allocations have been phased out in FY 1989. Importers/distributors will be free to sell commodity imports on an ordinary commercial basis to farmers with an established farming history in the target provinces.

D. Implementation Schedule

USAID/Mozambique expects to negotiate a Grant Agreement with the GOM in August, 1989. In the meantime, the Commodity Management Office will be working with the designated importers and distributors to finalize the specifications and quantities of equipment and inputs for all of the provinces. For the four new provinces to the program, some new distributors will have to be identified, especially for seeds and fertilizers. A tentative implementation schedule follows:

- 1. The first requests for quotations should be issued by September. In addition, those importers with allocations for the equipment should have pro formas finalized during September.

- 2. Direct Letters of Commitment will be issued by the Controller's office, USAID/Swaziland, beginning in October.

- 3. Depending on the commodity and source, some imports will arrive at the port of entry beginning December, 1989.

- 4. Due to planting schedules, some of the seeds and the fertilizers are needed in country between September and December, 1989. Therefore, the requests for quotations will be issued in September, 1989.

In summary, procurement activities, to coincide with input needs of the agricultural cycles, span the following time periods:

- Specification/quantity finalization	Sept.-October 1989
- Pro formas submitted/RFQs issued	Sept. 1989--May 1990
- Direct L/Coms issued	October 1989--June 1990
- Arrivals at Ports of Entry	Dec. 1989--Dec. 1990

This sequence will be repeated in FY 1990 and FY 1991, but to the extent possible timing will be accelerated to allow for a second quarter obligation. Revised demand assessments will be completed by January of each year. Assuming satisfactory progress on policy work plans, funds could be obligated late in the second quarter. This would allow the implementation schedule to be decompressed slightly.

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V. Open General License System

A. Rationale

In conjunction with the World Bank, the GOM plans to implement in mid-1989 a limited trial of an Open General License System (OGL) for foreign exchange allocation.[10] Based on the results of the initial phase, USAID proposes to allocate a portion of the FY 1990 and FY 1991 tranches of the Private Sector Support Program to co-finance the OGL system with the World Bank. The advantages of the OGL system and conditions for USAID participation are discussed below.

The purpose of the OGL is to institutionalize within the economy a mechanism that gives productive enterprises direct access to foreign exchange. Presently, private enterprises depend principally on donor assistance for direct access to the official foreign exchange market, although limited, indirect access is made available through Mozambique's national planning process and exporters can retain a portion of their hard currency receipts (see Part Two, Section III.B for further details). A.I.D.'s commodity import assistance has demonstrated the productive impact of targeting import support to private agriculture, yet A.I.D. and other donor programs for the private sector require the funding agencies to involve themselves directly in program administration to make them function. No other mechanisms exist to give private entrepreneurs direct control over critical imports, suggesting that the private sector would find itself in a foreign exchange crunch similar to that of 1984 should donors curtail import financing.

For both the GOM and its donors, such prospects emphasize the need to phase out administrative allocation of donor commodity financing and to introduce more permanent, market-based allocation mechanisms. Realistically, the OGL system will be just as dependent on donor financing in the medium term as on current commodity import programs, given Mozambique's large and growing current account deficit in the balance of payments (see Part One, Section II). It will, however, make hard currency allocations for eligible sectors more dependent on market signals. In the distant future when the current account moves closer to balance and Mozambique can again assume commercial debt, the OGL system could be financed through normal foreign exchange receipts. In the interim it will at least establish a framework that gives productive enterprises direct control over import decisions.

The proposed OGL will allow all enterprises, public and private, automatic access to foreign exchange at the official rate. Initially, the program will be limited to raw materials and

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[10] The GOM announced the establishment of an OGL system in April 1989, but in practical terms it will not become operational until funds are disbursed under the World Bank's Third Rehabilitation Credit.

equipment for textiles and shoe production and spare parts for transport. The Ministry of Commerce will honor requests for import licenses in these sectors from importers and incorporated enterprises that can demonstrate that they have the local currency counterpart. The license then entitles the recipients to open letters of credit at the Bank of Mozambique.

Demand for foreign exchange will be self-regulating through the effective prices faced by importers, that is, the local currency counterpart plus import duties. Based on the current tariff structure and the GOM's schedule for continued devaluations through the rest of the calendar year, total costs to importers should parallel if not exceed import parity. Before the GOM had instituted its Economic Rehabilitation Program in 1987, the serious overvaluation of the exchange rate eliminated any scope for relaxed administrative control over foreign exchange. Only recently has the rate devalued sufficiently to avoid acute excess demand without massive tariffs or surcharges to regulate the market.

The OGL benefit derives from the fact that the basic foreign exchange allocation criterion then becomes the capacity of a legitimate enterprise to generate revenue to meet local currency counterpart costs. Combined with the World Bank/GOM program to control public expenditures and IMF credit restrictions to public enterprises, parastatals will be forced to become efficient, divest or close as Government curtails its subsidies to inefficient enterprises. By contrast, real production costs for private entities could actually decrease to the extent that they had previously resorted to the parallel market to finance imports.

The limited amounts of foreign exchange available for allocation to the OCL system will, at least initially, constrain the program's impact. Of a total foreign exchange budget of about $900 million, existing contracts (tied import support and project aid, export retention scheme obligations, debt service obligations, and other service payments) pre-commit 74 percent. Essential imports (medical supplies, baby foods and security-related items) account for 9 percent. This leaves 15 percent (about $140 million) available for "free" allocation. Of this amount, the World Bank and GOM should allocate about $15-20 million to initiate the OGL, with the amount increasing based on experience.

The OGL system will have to be monitored carefully to ensure that "over-invoicing" does not become a vehicle for capital flight. Initial inefficiencies should be expected. In particular, the end impact of specific imports will be impossible to trace. This could result in less productive impact, due to leakages or deviations, than traditional commodity import programs. However, if the OGL mechanism proves viable and donors increasingly channel balance of payments assistance through it, the shift from administrative to productivity-based allocations should have a beneficial overall impact that will be easier to measure than the effects of individual bilateral efforts.

B. USAID Support for the OGL

In line with above analysis, USAID will carefully monitor the first year of the OGL's implementation to determine if portions of the FY 1990 and FY 1991 tranches of the Private Sector Support Program should be administered through it. As indicated below, a GOM/World Bank evaluation and specific USAID analyses would be completed before the FY 1990 obligation. The results of these analyses and USAID's assessment of the GOM's compliance with the OGL-specific policy measures outlined in Part Two, Section III would be transmitted to AID/W with a recommendation on whether to finance the OGL and, if so, the appropriate amount. With AID/W approval, the FY 1990 program authorization would be drafted to incorporate a cash grant for OGL disbursement. A similar evaluation process would occur in 1991 in order to determine whether to continue or increase the portion of OGL financing.

Ongoing analysis of the overall efficiency and viability of the Open General License System will be completed by the World Bank and the GOM. The first phase of the OGL will be implemented as part of the first tranche of the World Bank's Third Rehabilitation Credit, currently under negotiation. The second tranche of the Bank's credit is conditioned upon successful implementation of the OGL and its expansion to new products. During the first phase the GOM and the Bank will monitor the range of eligible products, the likely level of pent up or anticipated future demand, the need to apply ceilings to regulate demand, the automatic eligibility of all enterprises, tariff structures and the implications for parity pricing, and the OGL's operation mechanisms. As indicated in Part Two, Section III, the GOM would review the results of the evaluation with USAID.

The second component of USAID's assessment of the OGL will be its impact on the parallel exchange rate. If the OGL shifts some import financing from the parallel to the official market, depreciation of the parallel exchange rate should decelerate. The Mission has already established mechanisms to track monthly changes in the parallel and official rates for rands and dollars. This, however, may not be a fully reliable indicator due to signs that South Africans may be circumventing their domestic currency regulations by trading rands for dollars in the Maputo parallel market. Given the inelastic supply of dollars, this could drive up the metical/dollar rate even if Mozambican trade in the parallel market decreases. (See Part One, Section I C for further details.)

To compensate for exchange rate distortions, a third assessment mechanism will be a series of structured interviews with entrepreneurs in sectors eligible for the OGL. The objectives of the interviews will be to determine whether entrepreneurs are aware of and have utilized the OGL, and to gain a qualitative sense of its effectiveness. Interviews will be conducted approximately 7 months after the OGL has been started, most likely in April 1990. The process would then be repeated a year later.

Preliminary estimates of how much funding would be attributed to the OGL are necessarily tenuous. For planning purposes the financial plan (Part Two, Section VIII) estimates $3 million in FY 1990 and $5 million in FY 1991 but, as indicated above, these amounts will be reconfirmed through annual OGL assessments.

VI. Technical Assistance

The Private Sector Support Program seeks to create a policy environment more conducive to private agricultural production. In FY 1989, USAID will use a CIP mechanism to disburse program funds; in FY 1990 and FY 1991, some disbursements may also be made through an Open General License system as indicated above. In addition to these two disbursement mechanisms, a small amount of program funds, $1.5 million, have been reserved for short term technical assistance on policy matters related to the food and agriculture sector, implementation and monitoring of program activities, and an external audit and evaluation. These requirements are discussed further below.

A. Short Term Technical Assistance

Short term technical assistance to be financed under the Private Sector Support Program is designed to address issues arising from the program's policy agenda. Clearly, available information is not adequate to make cohesive policy decisions, particularly after implementing basic pricing reforms that address salient imbalances. The second stage of analysis always proves more difficult than the first and requires a subtler understanding of producer and consumer behavior. To overcome this problem, USAID/Mozambique will use short term technical assistance to provide frequent "snapshots" of the impact of various policy measures and to analyze their logical evolution. As shown in the program budget (Part Two, Section VIII), eight technical assistance teams are envisaged over the life of the program. Each team is estimated at two persons for two months, including two weeks in the United States to complete final reports. Technical assistance under the program is scheduled to begin in FY 1990. In the interim, USAID will draw upon unexpended technical assistance funds from the earlier Private Sector Rehabilitation Program.

The following is an illustrative list of topics to be considered for further analysis. Topics will be added or deleted as policy needs arise during the course of the program. By the end of the program, the GOM and USAID will have a better understanding of both the impact of agriculture and food sector policy reforms and how best to proceed with the process of economic liberalization.

1. Agricultural Producer Prices: assess the impact of newly established floor prices, examine prospects for further deregulation, address potential constraints due to monopsonistic markets, and suggest measures to provide appropriate incentives to producers.

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2. White and Yellow Maize: assess the cross price elasticities between white and yellow maize, examine the implications for consumer pricing policy, review the impact of major quantities of donated yellow maize, and recommend appropriate donor import and GOM pricing policies.

3. Ration System: develop simpler and more effective methods of delivering basic foods through the food ration system to low-income consumers such as allowing consumers to vary the size and mix of purchases, reducing the types of rationed foods by introducing low-cost, self-targeting commodities, and introducing small corn grinding mills for the private sector.

4. Privatization of Agricultural Businesses: assist the GOM in developing a plan to privatize state enterprises and mixed companies in the agricultural input, implement, tractor and related commodities business.

5. Open General License System: assess the attitudes of entrepreneurs to the OGL, its impact on increasing private sector access to the official foreign exchange market, the OGL's implications for the official and parallel foreign exchange markets, and the advantages and disadvantages of A.I.D. funding for the OGL.

6. State Farm Divestiture: assist the GOM in developing a general program for state farm divestitures and in formulating a specific program to be implemented in coordination with USAID that ensures economic division of land holdings and proper timing of policy measures with input arrivals. Follow-up consultancies are envisaged to help assess the impact of land redistribution to commercial and family farmers.

7. Local Currency Management: reinforce GOM efforts to improve accounting in and the efficiency of government entities involved in the generation, collection, accounting and programming of local currencies.

8. Rural Markets: assess progress in the development of rural markets which efficiently clear marketed commodities and provide producers with access to consumer goods as a means to maintain incentives for surplus production. (Such studies would be folded into a private market development program as proposed earlier.)

B. Implementation and Monitoring

In order to comply with program implementation and monitoring requirements, funds are budgeted for three contracts to assist the Mission Commodity Management Officer with the importation, clearance and distribution of imports, communication with importers regarding arrival and distribution of commodities, and assessment of commodity requirements and mix. Two of these contracts, for a CIP monitor and an end use field monitor, will be local hires. A third contract will be executed with an agricultural economist who will also participate in the Mission's internal working group on food policy. (See Part Three, Section I for details on job responsibilities.)

C. Evaluation and Audit

Funds are budgeted for an external evaluation and audit. Both would take place in 1991. Evaluation plans and requirements are discussed in detail in Section VII. Further information on audit plans is provided in Section VIII.

VII. Monitoring and Assessment

The monitoring and evaluation plan consists of both ongoing assessment of policy progress, commodity use and production impact and a formal external evaluation to provide a more comprehensive and neutral overview of program activities and policy measures. This section outlines the general nature of the ongoing assessments and topics for an FY 1991 evaluation that would lead into the design of a PAAD for an FY 1992 - FY 1994 program.

A. Ongoing Assessment

1. Policy Issues

Responsibility for monitoring developments on food and agriculture policy issues rests with the Mission's internal food policy working group (see Institutional Analysis, Part Three, Section I). This group will meet, at a minimum, on a monthly basis and more frequently as required. Members of the working group, the USAID Mission Director and the Deputy Director will meet quarterly with the GOM working group consisting of representatives of the Ministries of Finance, Agriculture, and Commerce, as well as AGRICOM.

Policy monitoring will focus on progress toward implementing policy measures as outlined in Part Two, Section III and as will be further defined in a letter of intent from the GOM that will be reviewed with USAID before the obligation of funds and submitted officially with the signing of the grant agreement (see Section X, Negotiation Status). In addition USAID will monitor the evolution of producer prices as they move from a fixed to a floor price system, the impact of state farm divestitures, and the effects of instituting an Open General License system. Logistical difficulties and limitations in the Government's statistical capabilities will hinder the regular collection of price data. However, USAID will attempt to work out contracts with private entrepreneurs or farmers to submit monthly data from major markets throughout the country. USAID would then conduct spot checks. Assessments of state farm divestitures and the OGL will require external short term assistance which has been included in the program budget.

Conclusions from the Mission's policy monitoring will be summarized annually and transmitted to AID/W. These annual summaries will form the basis for obligation of subsequent tranches.

2. Commodity Uses and Demand

USAID's end use field monitor will have principal responsibility for monitoring and documenting appropriate end use of program commodities. The Mission Commodity Management Officer and a PSC agricultural economist will also participate in end use monitoring. (See Part Three, Section I for further details on their responsibilities.) The field monitor will develop a schedule for spot checks in all seven of the provinces to receive commodity assistance. Travel to each province will be by air. Within the provinces, travel will be limited to secure areas after obtaining the concurrence of the local Ministry of Agriculture officials. Contracts will be executed with local traders and transporters in each province (other than Maputo) to facilitate travel at the provincial level and to ensure the assistance of individuals familiar with the local environment.

The Commodity Management Officer and the field monitor will also maintain on ongoing dialogue with importers and distributors in each region in order to assess after sales capability and changes in commodity demand. As discussed elsewhere, principal responsibility for demand assessments has been devolved to importers and distributors as they have a profit incentive in ensuring responsiveness to their customers. The results of the Mission's ongoing monitoring of commodity demand will be used to update the program commodity mix annually.

3. Impact Assessments

Neither the GOM nor USAID has the staff capacity to monitor the farm-level impacts of policy changes and program commodities. Consequently, the Mission will select at least three model farms in each of the provinces reached by the program to track program impact and to develop a better understanding of overall farming and marketing systems in each area. The Mission will also contract with a local research institution, if possble, to assess the impact of policy reforms and the provision of commodities on a limited sample of family farmers. If a local entity cannot be found to undertake the family farm sector analyses, the Mission will seek external assistance, preferably from a regionally based contractor or research institution.

The focus of the monitoring program will be qualitative assessment rather than statistically significant quantitative analysis. Issues that will be monitored over three years on the model farms include:

--changes in farmer income, production, expenditure patterns and economic status;

--farmer awareness of and responsiveness to changing policy incentives;

--uses of program commodities, considerations in investment decisions, and technical constraints to production;

--the process and extent of technology transfer from commercial farmers to family farmers;

--changes in rural employment and land tenure patterns;

--program impact on women, both in the agricultural system and as traders;

--developments in rural transport and marketing networks; and

--long-term effects on soil fertility, soil erosion and deforestation.

For the 21 model farms, USAID will seek to select units which represent various techniques of commercial farming. The PSC agricultural economist and the field monitor will conduct quarterly visits to each model farm. The Mission commodity management, evaluation and the women in development officers will also participate in selected visits.

B. Mid-Term Evaluation

An evaluation will be conducted in February/March 1991 after the bulk of the second tranche of program commodities has arrived and been distributed. The objectives of the evaluation will be to: (a) verify the accuracy of ongoing monitoring; (b) assess whether modifications are necessary in the policy agenda or implementation procedures; (c) determine whether additional funds should be invested in the nonadministrative foreign exchange allocation system (the OGL); and (d) provide guidelines for a follow-on policy based program.

Topics for evaluation include a review of the issues identified above for ongoing assessment, the performance of the implementing agents, and more general issues such as overall progress under the Economic Rehabilitation Program, the Private Sector Support Program's relevance to and impact on the ERP, changes in the nature and extent of private sector activity in rural areas, and requirements to stimulate further development of rural markets. The overall impact of policy reform in Mozambique on people's socioeconomic status is also of direct relevance to the program. The evaluation should take note of such developments, relying on secondary sources for data.

The core of the evaluation team will consist of an agricultural economist, a macro economist, and an agricultural marketing and trade specialist. These individuals will be obtained through an IQC for evaluation. The total length of the contract is anticipated to be two months, including six weeks in Mozambique and two weeks in the United States to finalize the evaluation report. The Mission will also request REDSO/ESA to make available a Commodity Management Officer for three weeks to assess progress in the privatization and efficiency of commodity imports and distribution. In addition, USAID's commodity management, evaluation and women in development officers and the end use field monitor will contribute to the final evaluation report.

VIII. Financial Planning and Management

A. Financial Plan

The PSS Program is a Non-project Assistance program of $45.55 million over three years to support the liberalization of prices and markets for agricultural products. This PAAD requests approval of the full life-of-program funding, authorization of the first tranche, and delegation of authority to the USAID Director to make subsequent authorizations. Of this amount, $13.55 million will be authorized in FY 1989 and obligated to the GOM. Funds will be disbursed as an agricultural sector CIP to finance the procurement of a preestablished list of eligible agricultural or agriculturally related commodities for private sector farmers in Mozambique. In FY 1990 and FY 1991, funds will be obligated for commodity imports, technical assistance and, tentatively, support for the Open General License system. Commodity import and OGL funds will be obligated to the GOM. Each tranche of commodity assistance will be disbursed as rapidly as practicable within a two year window. OGL funds would be disbursed immediately after obligation through a cash grant. Funds for technical assistance will be obligated through direct contracts between USAID and the respective implementing agents. Each contract would specify the disbursement period. The program budget for the three-year period FY 1989 - FY 1991 is provided in Table VIII.1. Only the commodity import assistance and the OGL financing would generate local currency.

Table VIII.1
Program Budget
($ 000s)

	FY 1989	FY 1990	FY 1991	TOTAL
Commodity Import Assistance	13,550	12,400	10,100	36,050
OGL Financing	0	3,000	5,000	8,000
Subtotal Generating L/C	13,550	15,400	15,100	44,050
Technical Assistance	0	600	900	1,500
a. Short term a/	0	400	300	700
b. Implementation & Monitoring b/	0	200	200	400
c. Evaluation & Audit c/	0	0	400	400
T O T A L	13,550	16,000	16,000	45,550

NOTES

a/ Eight short term technical assistance teams are budgeted over the life of the program. Each team is assumed to consist of two people spending 40 days in the field and 10 days in the U.S. The cost of each team is estimated at $81,520 broken down as follows: Salary (2 people x $270/day x 50 days = $27,000); Overhead ($35,000); Per Diem Mozambique (2 people x $101/day x 50 days = $10,100); Per Diem Other (2 people x $121/day x 10 days = $2,420); Travel (2 people x $3,500 = $7,000). The eight TA teams planned over the life of the program would cost $652,160. Additional funds are allowed for contingency to bring the total to $700,000.

b/ Implementation and monitoring funds cover two local hire staff for CIP monitoring and end use monitoring, a regionally based agricultural economists, and contracts to be executed with provincially based firms, traders or transporters to assist in end use monitoring.

c/ $200,000 is budgeted for an external evaluation. An additional $200,000 is budgeted for an audit should RIG/Nairobi not be able to complete it. If audit funds are not required, they would be folded into either the commodity import assistance line item or the short term technical assistance line item, depending on the Mission's assessment at the time of obligation.

B. CIP Disbursement Procedures

All importations under the program will be financed by A.I.D. direct letters of commitment issued by the Controller USAID/Swaziland. Once a contract is approved by A.I.D. and the appropriate GOM Ministries, USAID/Mozambique prepares a "Concurrence of Award" letter for the Bank of Mozambique. The importer submits to the Bank of Mozambique an import license, approval of freight rate from MOCARGO, the GOM's freight agent, and a letter advising the Bank of the local currency account to be blocked for the local currency equivalent of the transaction. The Bank then indicates the Bank transaction number on A.I.D.'s letter of concurrence, and returns a copy to USAID/Mozambique. USAID/Mozambique then requests the Controller, USAID/Swaziland to issue the direct letter of commitment. Should funding be provided in FY 1990 or FY 1991 for an Open General License system, a statement on disbursement procedures would be incorporated into the documentation modifications.

C. TA Disbursement Procedures

All TA will be by direct A.I.D. procurement action. The preferred method of disbursement for the Technical Assistance contracts is direct reimbursement, but disbursement procedures (LOC or direct reimbursement) are dependent upon the kind of organization or institution which will be contracted.

D. Audit and Evaluation Plan

Section VII above provides detailed plans for ongoing project evaluation and monitoring. A formal project evaluation will be conducted in the second quarter of FY 1991 to validate the input from the ongoing evaluation and monitoring program and to provide guidance for future project development. Also, RIG/A/Nairobi will be requested to perform an audit in the third quarter of FY 1991. If they are unable, then a nonfederal audit will be requested.

IX. Local Currency Programming and Management

A. Procedures and Controls

In March 1988 USAID/Mozambique hired, under a PSC, a retired A.I.D. Controller to assist on a periodic consulting basis the Ministry of Finance and Bank of Mozambique in establishing internal controls and procedures for controlling local currency deposits and disbursements. The retired controller has been assisted by a highly knowledgeable Mozambican financial analyst.

As a consequence of their efforts, management and control of the local currencies have improved significantly. Past problems included timely deposits of CIP-generated meticais into the special account and Trust Fund account. This was resolved by USAID/Mozambique sending a letter (debit advice) to the MOF requesting deposit into the accounts whenever a commodity importation occurred. The amounts to be deposited represented the prevailing metical equivalent of the CIF value indicated on the shipping documents and deposits will be no later than 120 days after receipt of the original shipping documents. The MOF makes deposits directly into the special account maintained at the Banco Popular de Desenvolvimento, and advises USAID when the deposits are made. Separate accounts are maintained for deposits generated from each year's CIP. Bank statement are forwarded on a monthly basis to USAID/Mozambique for reconciliation. On a semiannual basis, the MOF reports on a cumulative basis total generations (deposits) and utilizations (disbursements).

The current trust fund agreement states that seven (7) percent of local currency generations can be used for covering the metical costs of operating the A.I.D. office. Trust funds are deposited at the Banco Standard Totta de Mozambique in the name of the U.S. Disbursing Officer by the USAID accountant. The accountant passes the deposit slip to the American Embassy cashier who prepares a general receipt for USDO/Paris and USAID/Swaziland. The latter is responsible for reconciling the deposits with USDO/Paris.

These procedures, which have been in effect for approximately one year, have provided adequate control of the deposits into the special account and Trust Fund account.

B. Local Currency Projections

Local currency will be generated by commodity import assistance and OGL financing and, as indicated above, will be deposited in a special account at the Banco Popular de Desenvolvimento. Table IX indicates that approximately Mt45 billion will be deposited in the special account. An additional 7 percent, Mt3 billion, will be deposited in the USAID trust fund.

Table IX.1

Local Currency Projections

	Program ($000)	Special Account (Mt000)*	Trust Fund (Mt000)*
Commodities:			
FY 1989	13,550	10,520,687	807,113
FY 1990	15,400	15,160,905	1,163,095
FY 1991	15,100	18,862,436	1,447,064
TA, Monitoring and Evaluation:			
FY 1989 - FY 1991	1,500		
TOTAL	45,550	44,544,028	3,417,272

* Mt = Meticais
Note. Estimates based on exchange rate of Mt836/$ for FY 1989, Mt1,060/$ for FY 1990 and Mt1,345/$ for FY 1991.

C. Programming of Local Currency

During FY 1988 USAID/Mozambique, in collaboration with the GOM, began programming local currency generations of the CIP. Programmable funds are those funds deposited in the special account at the Banco Popular de Desenvolvimento. Due to the extreme overvaluation of the metical in the past, the possibilities of using counterpart funds were extremely limited. As a result, most counterpart funds generated under earlier programs, including PL 480 programs, were programmed only in CY 1988. USAID and the Ministry of Finance programmed the local currencies for recurrent budget expenditures, as outlined in the FY 1990 ABS, for the Ministries of Agriculture, Health and Education, and for the Department for the Prevention and Control of Natural Calamities. Some funds were also allocated for PVO activities.

The programming and utilization of local currency generations is influenced and constrained by two major factors: the current and expected IMF programs and their budgetary and monetary targets; and the requirements for the accountability of local currency funds.

Given the fact that the GOM is now implementing a major economic reform program with the support and assistance of both the IMF and IBRD (described above), it is imperative that USAID's use of counterpart funds be supportive, rather than destructive, of this program. The key factor under the IMF structural adjustment facility which will influence the use of counterpart funds is the limit on the expansion of net domestic credit to the government. Since USAID counterpart funds are owned by the GOM, any expenditure of these funds will affect this key monetary target. Thus, close coordination between USAID/Mozambique and the Ministry of Finance will be required for the programming and use of funds. This need for coordination becomes even more important and apparent due to the fact that the annual rate of generating counterpart funds corresponds to more than 14 percent of GOM budgetary revenues and more than 10 percent of current budgetary expenditures in 1989.

The principal implication of this constraint is that the programming of the bulk of the counterpart funds will best be accomplished through the GOM budget as a mechanism for financing the budgetary deficit. Since financing of this deficit is already accounted for in the monetary program, following this path will ensure that the use of our counterpart funds support the GOM's stabilization effort. Support for the GOM budget will take the form of attribution to areas of the budget consistent with our program objectives and agreements. Presently, the overall areas of priority agreed upon for the CIP and P.L. 480 programs are agriculture, health, education and emergency assistance, including food purchases in surplus production areas for transfer to deficit areas. In addition, the Ministry of Finance and USAID have agreed to provide local currency support for emergency rehabilitation and developmental activities of U.S. and other PVOs and NGOs.

To supplement these general programming guidelines and to ensure that local currencies generated by the Private Sector Support program are indeed programmed in compliance with the Africa Bureau's guidance of July 1988 (headquarters Management Notice No. 88-44), USAID/Mozambique has developed additional programming principles with the Ministry of Finance. These principles ensure that funds are used "in support of the proposed sector reform program", i.e. the food and agriculture sector. This sector is also defined to include commodity marketing. Thus, to the extent possible, the GOM will utilize local currencies in support of the items specified below which are included in the national budget. The areas of budget support are listed in order of priority. Amounts actually programmed for individual areas will depend on the GOM's actual budget, developed in November/December of one year for the following year, and factors such as actual harvests in a given year which will affect the levels of grain that can be purchased locally. Estimates of the GOM's overall budget in each of these areas are provided to indicate that USAID assistance will contribute to much larger overall budgets.

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- Finance Ministry of Commerce contracts with private transporters to ensure efficient marketing of domestic food production. (Overall budget approximately Mt. 3.5 billion)

- Purchase domestically produced cereals and beans (using private merchants and traders) in surplus areas for DPCCN [11] and NGO distribution in deficit areas. (Overall budget approximately Mt. 5 billion)

- Finance the DPCCN budget, particularly to contract with private transporters for port to province transshipment of donated imports. (Overall budget Mt. 2 billion)

- Finance road reconstruction and rehabilitation in order to reduce marketing constraints. (Overall budget Mt. 10 billion)

- Support the Ministry of Agriculture's efforts to collect statistics, particularly price and production data. (Overall budget 0.5 billion)

The only off-budget item will be limited support (estimated at Mt. 1.0 billion annually) for registered U.S. PVOs to reduce the dependency of displaced and affected people (e.g. agpaks), assess food needs and distribute emergency assistance. Only registered U.S. PVOs will be funded in order to avoid an additional management and tracking burden on the Mission. Actual funding levels will be carefully coordinated with the Minsitry of Finance to avoid conflicts with the GOM's fiscal and monetary policies being implemented in coordination with the IMF.

In FY 1989, USAID's part-time PSC controller and a local accountant conducted financial reviews of the Ministries of Finance, Agriculture, Health and Education. It was determined that all four ministries have adequate management controls and accounting systems in place to account for the receipt and expenditure of local currency. USAID will continue to monitor the accounting and management systems of ministries receiving recurrent budget support under this program. The Mission will also monitor IMF and IBRD efforts to improve and strengthen the GOM budgetary system.

X. Negotiation Status

USAID/Mozambique has met with GOM officials in the Ministries of Finance, Agriculture and Commerce, the Bank of Mozambique and the Banco Popular de Desenvolvimento to discuss the policy agenda

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[11] DPCCN is the Department for the Prevention and Control of Natural Calamities and is the GOM entity responsible for emergency relief efforts.

outlined in Part Two, Section III. Throughout these discussions USAID/Mozambique has stressed that the full Private Sector Support Program requires AID/W approval and therefore cannot be considered final. The Representatives of the GOM have also indicated that, with the Fifth Party Congress approaching in July, it would be impractical to make major decisions on pricing policy beforehand.

The first round of policy negotiations was completed on June 23, 1989 with a meeting between USAID and the Minister of Finance along with representatives of Agriculture and Commerce. At this meeting and a previous meeting with the Minister of Finance, the GOM concurred with all of the policy objectives outlined in the policy agenda in Section III. In particular, it was agreed that:[12]

- a pricing system must be institutionalized that guarantees incentives for agricultural production and that a floor price mechanism should be explored as a means to realize this objective;

- inefficient state farms would be restructured and land redistributed to support commercial and family farm agriculture;

- the use of private importers and distributors for commodity imports and sales should be continued; and

- the GOM and USAID should continue to work closely in designing a program that leads to eventual deregulation of pricing policies in the food and agriculture sector.

The GOM has requested additional time to review the specific policy work plans proposed by USAID. In particular, the Minister of Finance has stressed that the GOM does not have the institutional capacity to implement a comprehensive bilateral policy reform package in addition to the multilateral program developed with the World Bank and the IMF. The Mission indicated that A.I.D. does not wish to impose additional bilateral requirements, but that it is necessary to have a clear statement of how the GOM intends to implement the general policy objectives outlined in the Policy Framework Paper which relate to the principal area of U.S. assistance -- food and agriculture.

The GOM has proposed to submit to USAID a letter based on the proposed policy agenda that will outline its food and agriculture reform program over the next three years. The letter will provide specific measures for the first year and general targets for the second and third years. During each year of the program, the reform agenda will be updated to add specificity.

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[12] An Open General License System was not discussed as the GOM has already announced publicly that it has established an OGL. It has not yet been put into operation due to delays in executing the World Bank Third Rehabilitation Credit.

USAID/Mozambique recommends that the GOM's submission of a letter acceptable to A.I.D. be allowed to substitute for conditionality measures normally found in a grant agreement. Acceptance of a GOM letter has the advantage that the policy reform program is internalized as a GOM process and helps institutionalize commitment to the reforms. A.I.D. will base future tranches of assistance on acceptable policy progress.

After AID/W approval of the Private Sector Support Program and the conclusion of the Fifth Party Congress, USAID and the GOM working group will meet to review the GOM's draft policy letter. The text of this letter will be transmitted to AID/W. The letter will then be finalized and officially submitted to USAID before the signing of the grant agreement.

PART III

FEASIBILITY STUDIES

I. Institutional Analysis

A. Overview of Actors

This section considers the capacity of the institutions related to the Private Sector Support Program to perform functions which affect the program's viability. On the policy side, the critical institutional questions are the GOM's continuing commitment to policy reform and the responsiveness of private agriculturalists to changing policy incentives. Principal responsibility for implementing the commodity import component rests with private importers and distributors, although various government entities and USAID/Mozambique also have important functions.

The private sector's role is discussed extensively in other parts of this document. The analysis of the private agricultural sector (Part One, Section II) and the social analysis (Part Three, Section III) demonstrate that private producers have responded positively to improved price incentives. The section on commodity import implementation (Part Two, Section IV) describes the role of private importers and distributors in ensuring that commodities are ordered in a timely fashion and made available to private agriculturalists. The social analysis points out that, since importers and distributors must recoup costs through sales to private farmers, they have a direct profit incentive in ensuring that inputs arrive before the agricultural season and comply with end-user demand.

Because of the attention already given to the private sector, this section focuses on the institutional questions related to the GOM's commitment to policy reform and to the implementation capacity of both GOM entities and USAID. The key GOM entities for implementation are the Ministry of Agriculture, Bank of Mozambique and the Ministry of Commerce. While each organization has a wide range of responsibilities in the Mozambican government, the discussion is limited to outlining their responsibilities under the Private Sector Support Program and assuring their respective capacities to implement them.

B. GOM Commitment to Reform

The macroeconomic framework presented in Part One, Section I traces the process of policy deliberation which brought the GOM to its present Economic Rehabilitation Program. Increasing trends of donor assistance (Part One, Section III) indicate general donor confidence in Mozambique's commitment to economic liberalization. To augment these analyses, USAID/Mozambique requested the U.S. Embassy, Maputo to assess the current political situation and, based upon its ongoing political analysis, discussions with key government contacts and observations of events leading to the Fifth FRELIMO Congress, to project the prospects for continued commitment to economic reform. A summary of the Embassy's analysis follows.

It is the opinion of the Embassy that the GOM's commitment to a nonaligned stance, economic liberalization and support of the private sector evidenced during Chissano's term of office will be ratified during the Fifth Congress and will continue. The Embassy considers that the political and economic measures adopted by the GOM, particularly since 1986, constitute a fundamental change in direction and focus from the years immediately following independence, and that this change has been successfully integrated into the political thinking of the country. This assessment is based in part on observations of the way that President Chissano has attempted to encourage more open expression, revise the constitution and encourage political and economic development of areas traditionally neglected in favor of the southern provinces. By so doing, Chissano has created a sociopolitical climate which will make a reversal of liberalization trends difficult in the short term. Once the beneficial results of policy measures begin to have a wider impact, the trend toward economic liberalization will be institutionalized more securely, even if there is a change of ideological perspective within the government.

The Embassy does not anticipate a change in perspective away from the nonaligned stance and political and economic pragmatism employed by the Chissano government in the foreseeable future. It appears that the power balance within the government lies firmly with the group which favors such policies, and the influence of those who favor a return to more traditionally Marxist ideology has been gradually eroded. The fact that the GOM has radically reduced the number of Eastern bloc military advisors, and entered into relatively long term assistance and cooperation agreements with a variety of western countries would suggest the continuation of a nonaligned position. Similarly, the creation of an office to promote foreign investment, the selling of state enterprises to the private sector, and an emphasis on training and technical assistance in privatization for government institutions and personnel are indicators of a long term commitment and institutionalization of political and economic reforms.

In line with the integration of such policy reforms into government structures, the government has attempted to seek popular support for its policy measures by building on President Chissano's personal popularity and adopting the successful FRELIMO tactic of holding mass meetings with people and encouraging them to express their views in order to create a sense of Mozambican national identity.

The GOM's long term commitment to sociopolitical and economic reform is also indicated by its attempts to encourage trade within the Southern Africa region, improve relations with the Church, engage South Africa in constructive dialogue in order to reduce the threat of destabilization, and achieve an end to the insurgency. President Chissano and the GOM understand that an end to the insurgency is essential if economic recovery and support for their policies is to be achieved, and it is reported that they are seeking some sort of resolution as an alternative to continued engagement in military conflict which places a considerable burden on the economy and prevents the government from asserting its control in large areas of the countryside.

The analysis of the Embassy thus points to a continued commitment to policy reform, and the program's viability is not therefore likely to be threatened by a change in emphasis.

C. Assessment of GOM Entities

1. Ministry of Agriculture

The Ministry of Agriculture is divided into three State Secretariats (Cotton, Cashews and Hydraulics) and five National Departments (Agriculture, Veterinary, Forestry and Wildlife, Research, and Agricultural Economics). It is represented in the provinces by Provincial Departments of Agriculture, which are then represented in the districts by smaller units. Each year, the Ministry holds a consultative meeting with the Provincial Departments, and at the end of each agricultural season data regarding production are sent from the districts to the Provincial Departments, and then to the Department of Agricultural Economics.

The Department of Agricultural Economics (DAE) is the unit within the Ministry of Agriculture which is responsible for implementing the Private Sector Support Program. USAID/Mozambique submits to DAE lists of proposed commodities, funding levels and implementation mechanisms for distribution in each province. These lists are based on private distributors demand analyses. Following DAE's review, the commodity distribution lists are approved by the Minister or Vice Minister of Agriculture. The DAE then informs the Provincial Departments in the provinces where the program is functioning of the quantity and type of inputs which are being allocated to the region. It is also responsible for informing the banking system in order that credit allocated to each province for agriculture can be adjusted accordingly,[13] and for reviewing distribution, delivery, costs and schedules with the importers or their agents.

The DAE has hitherto been able to perform its tasks adequately, but there have been problems at the district and provincial levels, where lack of qualified staff to undertake planning, monitoring and analysis has been a constraint. Data regarding production costs and agricultural prices are largely unavailable due to the lack of effective collection mechanisms, and USAID has had to incorporate collection of basic statistics into its monitoring program. Similarly, DAE plays an important role in developing pricing models and in preparing the national divestiture plan for state farms, but

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13 USAID also liaises directly with banks providing agricultural credit.

analytic constraints have made the unit highly dependent on technical assistance to complete more than routine functions. It is anticipated that DAE will require short term technical assistance to implement and monitor several of the policy measures outlined in Part Two, Section III. This has been provided for in the program budget.

2. Ministry of Commerce

The Ministry of Commerce has Internal and External Trade Divisions. The Import Department of the External Trade Division is responsible for granting import licenses to private importers for commodities purchased under the program. Thus far, there have been no constraints on the issuance of import licenses from the Import Department, and it is expected that it will be able to continue to perform this function adequately in the future. The Import department will also be responsible for issuing import licenses to enterprises applying to import goods under the Open General License (OGL) system (see Part Two, Section V). To the extent that the OGL allows private enterprises to shift trade transactions from the parallel to the official market, the demand for imports may increase and, in turn, augment the Import Department's workload. However, the volume of foreign exchange available under the OGL will be limited in its initial years, minimizing the likelihood of demand exceeding the Import Department's implementation capacity. Adequate checks and balances are built into the implementation of the OGL to assess the department's workload capacity. Overall, the OGL will reduce demands on Government by phasing down administrative allocations of foreign exchange in favor of increased reliance on market signals.

3. The Bank of Mozambique

The Bank of Mozambique functions both as the central bank and a commercial bank and is the only banking institution in Mozambique which deals with international trade and transactions. In the Private Sector Support Program the Bank of Mozambique controls disbursements, concurs with imports and deposits counterpart funds.

The Bank's involvement in the program begins once USAID approves a contract between an importer and a supplier. USAID sends letters of concurrence with the awards for review and clearance. At the same time, importers present the Bank with necessary documentation relating to import licences, approval of freight rates, and authorization to debit the local currency equivalent of the cost of the goods plus duties and taxes. If contracts are approved, the Bank countersigns the letters of concurrence and returns copies to USAID/Mozambique, which then requests the issuance of letters of credit.

After commodities are shipped, the Bank of Mozambique transfers counterpart funds to the Ministry of Finance/USAID special account in the Banco Popular de Desenvolvimento. Deposits are made within 120 days of receipt of original shipping documents.

The two departments which deal specifically with the program are the International Relations Department, which is responsible for ensuring that financed commodities comply with authorized commodity lists and program objectives, and the Directorate for Imports which interfaces directly with importers, receives shipping documents, collects local currency deposits and ensures that counterpart funds are deposited.

The Bank of Mozambique has been able to perform these functions adequately in the past, and it is not anticipated that it will experience problems in continuing to undertake these responsibilities for an expanded program. A computerized management information system is currently being installed under a World Bank project and is expected to increase the efficiency of operations and ensure that transactions are conducted in a timely fashion.

D. USAID Implementation Capacity

In order to ensure proper and diversified analysis of food and agricultural policy issues, USAID/Mozambique has established an internal food policy working group. The working group consists of the Program Officer, two Food for Peace Officers, a PSC agricultural economist and, particularly for marketing and distribution questions, a Commodity Management Officer. In October 1989 the working group will be supplemented by a food sector specialist to be based in the Ministry of Commerce.[14] Throughout the year the working group meets on at least a monthly basis to review food and agriculture policy issues. During periods of particularly active policy dialogue, for example, during negotiations on P.L. 480 and non-project assistance activities, the working group or subcomponents of it may meet several times a week. The working group reports to the USAID/Mozambique Mission Director and Deputy Director. It also draws upon the counsel of the Mission women in development officer, the REDSO/ESA economist and a local hire economist. Representatives of the Mission's internal working group on food policy liaise with the GOM's policy working group consisting of representatives of the Ministries of Finance, Agriculture and Commerce, as well as AGRICOM.

USAID's Commodity Management Officer manages the implementation of the CIP component of the Private Sector Support Program. The CMO works closely with counterparts in the Bank of Mozambique and the Ministries of Commerce, Agriculture, and Finance. The CMO is assisted by a CIP monitor, a CIP end use field monitor and a secretary.

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[14] The contract with the food sector specialist is funded under the technical assistance component of the original Private Sector Rehabilitation Program.

The CIP monitor oversees the importation, clearance and distribution of the imports and is in constant communication with importers regarding the expected arrival of shipments and the arrangements for clearance and distribution of the commodities. In addition, the CIP Monitor makes periodic field visits to verify if adequate distribution has taken place, and that the commodities are being utilized by the intended target population. The CIP Monitor also keeps a computerized record of all commodity actions and generates monthly activity reports.

Due to the GOM's staffing constraints, the CIP Monitor tracks and reports compliance with cargo preference requirements, normally a host country function. This information is reported by USAID/Mozambique on a monthly basis in a computer report entitled "Shipping Schedule". Also, to comply with cargo preference requirements, under terms of the direct letters of commitment issued to suppliers, each supplier is required to submit a copy of the bill of lading to A.I.D./W Office of Procurement, Transportation Division, which, in turn, submits periodic reports to Congress on worldwide Agency compliance.

The CIP end use field monitor assesses the impact of CIP-financed agricultural inputs on crop production levels in the target areas. The field monitor travels extensively to determine on a first hand basis the extent to which A.I.D.-financed commodities are visible and properly utilized. The field monitor also liaises with private importers and distributors to monitor whether program commodities address farmer demand. Based on this information, recommendations of possible changes in the commodity mix to improve production are then made. The field monitor also tracks trends in availability and the price of produce in the market.

II. Social Analysis

A. Sociopolitical Context

Mozambique currently suffers from the compounded effects of years of underdevelopment, lack of human and financial resources in the years following independence, drought, and the prolonged disruption of insurgency which has devastated whole areas and made normal life impossible for the majority of Mozambicans. Recovery from the trauma of armed conflict and social dislocation will be a long process, even if economic rehabilitation is achieved. At present, Mozambique depends on donor assistance to meet over one third of its food needs, and the biggest public health problems remain malnutrition and malnutrition-related diseases. Infant mortality is estimated at 170 per 1000 live births, under five mortality is estimated at 300 per 1000, (UNICEF, 1988), and stunting and wasting are extremely common. The potential long term mental damage as a result of severe malnutrition is not possible to gauge.

Life expectancy estimates have become largely meaningless given the almost randomly destructive nature of the insurgency and the numbers of people either living in or vulnerable to absolute poverty. Massive numbers of people have been displaced or affected by the insurgency, as they have fled from their homes to escape attack and sought refuge either in neighboring countries or in relatively secure areas around urban centers or along the Beira corridor. The GOM and UNDP presently estimate 1 million refugees in neighboring countries, and 1.7 million people displaced within Mozambique, but these numbers may well only be a fraction of those actually so affected. Most of those displaced in one form or another have absolutely nothing, having fled without belongings or lost them after moving so many times over the years to escape attack. Even those still able to live in rural areas frequently cannot farm because of the security situation.

The years of disruption, the destruction of family structures and established behavior patterns, and the trauma of continued insecurity have had serious sociocultural consequences, the full extent of which will not become evident until some semblance of peace and social order is restored. The number of female headed households has increased dramatically as a result of the insurgency, and such households are most vulnerable to absolute poverty in both rural and urban areas. Social problems may be most severe for those migrating to urban areas who have fewer means to meet subsistence requirements and must find means to earn income to purchase food. Major influxes of people and lack of new jobs have increased overcrowding and unemployment as most people lack education and marketable skills and place an unsustainable burden on urban resources. To some extent, the green zones surrounding urban centers act as a buffer against food vulnerability, but even they are becoming overcrowded and cultivated areas often cannot be expanded further due to security constraints. In Beira and Maputo, the Government has established a subsidized ration system to increase access to scarce commodities and food at affordable prices, but the ration system subsidizes high income groups to some extent. Frequently also, the most vulnerable group, the newly arrived peri-urban migrants, are not considered part of the urban base and therefore not enrolled. Moreover, there is no free food distribution in urban centers except on a small scale under the aegis of missionary groups.

The social impact, particularly on the urban poor, of social adjustment has also caused concern. A World Bank food security assessment in February 1989 concluded that the average household in Maputo must spend 120 percent of earned income on food and fuel to achieve a nutritional diet. To some extent, price control and devaluation have contributed to this situation. Yet the extent of deteriorating real income must be balanced against the economic implications of continuing earlier policies that stifled economic growth, exacerbated domestic shortages and entrenched Mozambique's dependence on foreign assistance. As indicated below, economic liberalization has definitely benefited agricultural producers, as agriculture employs 80 percent of the labor force and contributes the largest share of GDP. It may also in time benefit those migrating to urban centers by allowing them to participate more freely in the informal sector and avoid the added costs often associated with semi-legal participation in parallel markets.

B. Implications for Development

The social problems which Mozambique will face are grave, and will become more so unless an attempt is made now to allow people to establish some sense of normalcy which will provide a base for social reconstruction in the future. Agricultural development is key to this process. Currently, the real population growth rate is estimated at 3 percent per annum, and should the insurgency cease and maternal and infant mortality levels decrease, Mozambique will face an increasingly difficult problem of feeding its people unless production of food increases. Although subsistence farming was traditionally practiced in Mozambique and accounted for over 50 percent of land under cultivation, at independence the GOM established a policy of large state farms while ignoring the private and family sector. Years of disruption due to the insurgency, an inability to recover from the drought and lack of inputs drastically reduced the amount of food produced by the private sector, but it remains both more cost-efficient and productive than the state farms.

With the failure of state farms and a decade of input shortages for private commercial farmers, (see Part One, Section II) the family sector now accounts for 90 percent of land under cultivation and over 85 percent of total food crops. This amount should increase provided sufficient incentives, inputs and consumer goods are accessible. Preliminary crop estimates for the 1988/89 agricultural season indicate that marketed surpluses of maize, the principal food crop, could more than double. The GOM's implementation of policy measures to divest state farms (see Part Two, Section III) will reinforce the impact of policy incentives by redistributing land to more productive private farmers.

Incentives and availability of inputs for agriculture will both decrease the impulse to migrate to urban areas as a survival mechanism and allow those who do not face direct security threats to cope more effectively. In the urban green zones, production incentives have already increased quantities marketed, which will eventually drive prices down for many key food commodities. This in turn would benefit even those consumers within the ration system, as commodities supplied under the system are currently estimated to meet only two thirds of monthly needs. On the production side, improved agricultural prospects in urban green zones have a direct impact on women, and thus increase their access to the cash economy. The social effects of increasing women's access to earned income have been extensively documented, and are referred to in subsection G, following.

C. Beneficiaries and Impact

Program benefits are transmitted primarily through policy reforms. The principal direct beneficiary groups are commercial farmers, family farmers and agricultural importers and distributors who have a policy environment more conducive to development and enterprise. The principal secondary beneficiaries are those who benefit from increased food production, either because it increases the amount of food available for purchase, or because they benefit from free food distribution. Other indirect beneficiaries are those people who in some way benefit from the revitalization of a marketing network which virtually ceased to function at independence.

In terms of numbers, the family farm sector has benefited principally from agricultural policy reforms as production units are small and producers can respond quickly to a changing incentive structure. Those close to urban centers tend to market commodities themselves, thereby drawing the full benefit of liberalized or increased prices. Farmers further removed from urban centers generally sell their produce to private traders or AGRICOM, depending on the extent to which private trading networks operate in their particular part of the country. In these circumstances, family farmers have benefited from pricing policies based on import/export parity which were adopted for the 1988/89 agricultural season.

The principal production inputs benefiting the family sector are seeds and fertilizer. Both commodities are sold freely through market channels. To date, most of those benefited have been farmers oriented largely to urban markets as the original Private Sector Rehabilitation Program (PSR) (656-0201) focussed initially on Maputo and Gaza provinces, which cater principally to Maputo city's consumption requirements. The proposed program expansion into seven provinces will significantly extend outreach to the family farm sector. The productive impact should be considerable as there has been virtually no inflow of agricultural inputs into these areas other than "agpaks" distributed free to displaced persons by a large variety of NGO's. Other donors have also provided free seed for displaced and affected persons, but recipients have shown a willingness to purchase higher quality seed.

Commercial farmers who employ labor and generally have larger farms will continue to be the principal recipients of higher value commodities such as tractors, trucks, mechanization implements and irrigation pumps. As discussed in Part Two, Section II, commercial farmers are the principal innovators in the agricultural sector and have greater financial leeway to take investment risks. For the commercial sector, producer price increases are essential to making their investments viable as devaluation and tariff restructuring have significantly increased the costs of input purchases.

Evidence suggests that the added stimulus to the commercial farm sector is to a certain extent passed on to family farmers, both directly through increased employment of labor and provision of mechanized services, and indirectly through demonstration of improved technology. In particular, the Mission's end use monitoring of commodities under the original PSR program has highlighted a number of cases in which commercial farmers have plowed the land of surrounding family farmers, thereby helping to expand acreage planted (see Part One, Section II). The fees charged for this service cover variable costs and contribute to equipment amortization. In practice, this expansion in acreage cultivated by the family farmer is a first step in promoting a transition to commercial farming. Groups of family farmers have also adopted the concept of expansion and have purchased equipment collectively. However, no accurate data are available on the incidence of such trends, nor is it clear whether farming practices and traditions in the new areas the program proposes to reach will be suited to such practices. The constraints to accelerating the evolution from family to larger commercial farming are discussed further below.

Equally as important as the direct impacts on producers is the stimulation of private marketing networks to supply agricultural inputs and after-sales service which the original PSR afforded. Government attempts to provide such services through parastatals failed either to reach targets or to promote private production significantly. In addition, foreign exchange allocation policies have essentially excluded the private sector from the official foreign exchange market. Since USAID's financing of private agriculture in 1984, the use of private importers and distributors for USAID-financed commodities has increased from 24 percent to over 95 percent. This enhanced capacity has helped ensure that major investments are serviced and kept functioning. For the family sector, the wider availability of quality seed is expected to have the most significant production impact, especially as the border parity price structure for farm crops gives families greater scope for earning a good return on their investment.

D. Beneficiary Participation in Program Design

The program was designed with extensive participation of the intended beneficiaries. Private importers and distributors were responsible for conducting surveys to determine the demand for commodities in their areas. Since these importers and distributors have to put up the local currency counterpart for program commodities, they have a direct financial incentive to ensure that their surveys realistically reflect producer preferences and their ability to purchase the commodities. USAID has also interviewed recipients in the Private Sector Rehabilitation program to gain information on their experience. The program has thus been designed to meet articulated wants and needs, and funds will be allocated to specific areas based on substantiated demand for inputs. In short, the program's market orientation ensures that it is demand driven.

A potential constraint to the program's success is that inevitable market inefficiencies in Mozambique somehow distort actual producer preferences for input purchases. To avoid this, there must continue to be ongoing analysis of the program in terms of specific inputs and geographic focus, and continued discussion with end users to determine the extent to which the program is fulfilling their needs. The Monitoring and Evaluation Plan (Part Two, Section VII) is designed to address this concern.

E. Sociocultural Appropriateness

It is appropriate to focus attention on agriculture, not only because it is traditional and the largest sector of the economy, but also, and perhaps most importantly, because it is the first survival strategy employed by people themselves. It is also appropriate to include the green zones around cities, and the secure areas around marketing outlets because they are the areas to which people are moving, and in which they are attempting to practice some form of agriculture. To the extent that people have access to sufficient land and necessary inputs and there is a positive policy environment, they can better meet their basic needs, and also have access to the cash economy by selling surplus produce. This not only increases the potential for economic recovery but also contributes to the availability of food and thus has a direct effect on the lives of persons who are currently under or malnourished. In broader societal terms, support for the family sector will help people once again take decisions which affect their well being and begin to reestablish family and social structures, thus allowing social reconstruction to begin.

The program's focus on private farmers is particularly appropriate in a sociopolitical environment characterized by population movements and uncertain and variable security. This changing environment emphasizes the need to decentralize investment decisions to the maximum extent possible. The most effective and far-reaching form of decentralization is the individual producer. In the end, the decision to purchase inputs, whether they be seeds or tractors or trucks, lies with each producer, and will be based on need and the knowledge of the prevailing security situation as well as return on investment. Once investments are made, moreover, there is an incentive to ensure that they pay off. Commercial farmers have employed strategies to ensure that heavy equipment is secure at night, with the result that fewer than 10 out of 672 USAID-financed trucks and tractors were lost to sabotage from 1984-1989.

F. Social Viability

The viability of the proposed policy reforms and production assistance depends on the extent to which it will be accepted by its intended beneficiaries, responds to a demonstrated need, can be implemented, builds on the strategies adopted by its intended beneficiaries and, due to the critical importance of policy reforms, receives government support. It is reasonable to assume that the program will be accepted, as it is largely designed in response to demand, and builds on past experiences which have enjoyed a high degree of acceptability and responsiveness in the earlier narrow geographic focus of southern Mozambique. The program is monitored on an ongoing basis to ensure that it continues to respond to the needs of its clientele, and continues to provide appropriate inputs. The program design enhances its viability, in that inputs are channelled to the end users through a variety of private outlets, each of which has a profit incentive in ensuring that it remains responsive to demand.

Over time, two important determinants of the program's viability to be examined are, (1) the ability of displaced rural people to return permanently to their original lands and make the transition back to family agriculture and (2) the capacity of family farmers to expand production. While policy reforms and enhanced production capacity will give program participants increased access to the cash economy, the transition from dependency on free food is a major step, and people must be persuaded that it is in their interests to take it. For dislocated people, the initial move from being totally dependent on free food to partial self-sufficiency using agpaks is relatively easy because people appear to desire that measure of self-sufficiency and the sense of security it brings. However, they must not be allowed to rely on free distribution of seeds and tools as this perpetuates an unsustainable dependency with the inherent risks of inappropriate or mis-timed inputs, and precludes reestablishment of a market economy. There is also the challenge of moving "affected" farmers who have adequate land back into normal production. Evidence suggests that people manage to have access to small amounts of cash for limited purchases of essential items, but obviously agricultural inputs must compete with other needed goods, and there is a reluctance to buy inputs if people think there might be a chance of getting them free. The demonstration effect of seeing other family farmers produce and sell surplus cannot be overestimated, but the process that they follow must be fully understood before it will be adopted.

A similar problem exists as far as persuading and helping people to move from farming small units to larger units. Mozambique has sufficient land for them to do so. Family farmers might find an incentive in the example of commercial farmers, but will not attempt to make the transition unless there are sufficient incentives and they think their goals are attainable. Initially, expansion would take place through the employment of labor. The next step is generally hiring custom services, again with additional labor. Access to cash and credit can be a significant constraint, however, to equipment purchases as, by and large, people do not have sufficient money to invest in large equipment and in a high-risk environment will be reluctant to use funds acquired as a result of selling surplus crops over a period of time as long as they can get by without doing so. Already commercial farmers have been found to provide custom services to family farmers and, in some cases, family farmers have joined together to purchase inputs. However, the demonstration effect will only reach a limited number of people, and there is need for informal networks to be used to allow people to see the benefits.

Obviously the extent to which consumer goods are available is beyond the control of the program, but current liberalization of economic policies has resulted in more goods being available, and there is no indication that this trend will be reversed. It is also reasonable to assume that the program will receive government support as it is in line with and complementary to current government policies (see Institutional Analysis, Part Three, Section I). In addition, the program should increase the amount of food which can be made available either for sale through commercial channels or for free distribution, and thus will reduce dependence on donor imports and might also go some way toward mitigating privation caused as a result of necessary fiscal measures. Marketed surpluses would be readily absorbed in commercial channels or could be purchased for use in emergency relief programs.[15]

G. Other Socioeconomic Considerations

1. General Societal Effects

The program will have an effect on patterns of behavior, and the way people perceive their role in society. Increased income earned from increased production not only allows people to choose what to spend that money on, but also facilitates choice in more subtle ways. Particularly as women are beneficiaries of the program, patterns of behavior which define the role and status of women in society are changed, and because of their role as change agents women have an impact on social mores, often not in relation to themselves, but in terms of the aspirations of their children. There are also often secondary impacts of increasing women's access to income in that they tend to use income which they earn to provide for better conditions for their families, and to obtain benefits of a social welfare nature, by initiating their own self-help efforts such as providing schools, training programs and health facilities.

2. Land Tenure

Mozambique has more than enough arable land for its farmers, but due to the armed conflict and lack of access to marketing channels people will continue to congregate in urban green zones and secure rural pockets near markets. New migrants will be forced onto more marginal land, or overcrowding will occur, with both agrarian and societal consequences. Redistribution of state farm land will help and should prove an important mechanism to promote the transition from family to commercial farming. The GOM is also attempting to

[15] Domestic surpluses of white maize, for example, could be purchased with local currency generations from monetized food aid programs for yellow maize. Donated yellow maize imports would be sold in urban centers as a "safety net" for the poor. White maize purchased internally with local currency could then be used for emergency distribution, saving significant internal transport costs.

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deal with this issue by targeting the family sector in rural areas which are safe or which can be protected, and by adopting policy reforms to reconstruct marketing channels. To assist in this revitalization of rural areas, inputs from the program should be channelled to them as far as possible and viable. The issue of land tenure also raises the question of whether or not people will return to their original lands should a more peaceful environment obtain. To a certain extent, time is a significant factor, in that the likelihood of people returning to areas of origin decreases the longer the insurgency lasts and the more established they become wherever they have settled. It decreases even further as younger people become more accustomed to an urban life-style, or become socially assimilated into the place of relocation, as they have fewer emotional ties with their original home. At present, most people who have been displaced appear to want to return should it be possible. Lack of services and employment opportunities in urban areas are both important factors. There is also a strong tradition of migrant labor within Mozambique, either to the South African mines or to the large pre-independence plantations, and there has been a relatively consistent pattern of return. However, this should not be overestimated. In the past only men moved to work, leaving families behind, whereas in the current situation families have been displaced, and their original homes frequently destroyed. The impulse to return, however, is strong, especially when people feel that they have been forced to leave against their will.

3. Ongoing Program Development

The program should also attempt not to remain static, but to be dynamic and build on past gains if it is to support fully the policy measures being implemented. After the initial stages, providing the same inputs will not produce the same degree of impact either in terms of production or societal benefits. Given that the program is expanding into new areas, heretofore relatively unassisted, saturation points should be far into the future. Nevertheless, it is essential that analysis is undertaken on an ongoing basis to determine an appropriate input mix while keeping the total input list manageable. Consideration should be given to commodities for processing agricultural products, stimulating small-scale enterprises, and maximizing the amount of time spent on productive agricultural activities. These considerations have been factored into the monitoring and evaluation plan.

III. Economic Analysis

A. Benefits of Agricultural Price Liberalization

One of the most significant reforms undertaken under the GOM's Economic Rehabilitation Program is the progressive liberalization of farm gate prices. From a situation in 1985 and early 1986 in which farmers receipts were fixed well below import parity at any realistic exchange rate, the government has adopted the principle that farmers should receive the equivalent of their productions international price and, as of October 1988, announced a set of prices which approximate parity at an estimated equilibrium exchange rate. (See Part One, Section II for an analysis of prices relative to parity.) Not only have official prices been increased, but private marketing for many export crops has been liberalized, most importantly for cashews, cotton, citrus, and processed tomatoes so that the government price, in effect, has been transformed into a floor price.

To date, there has been little overt opposition to these pricing reforms on the part of those who have been disadvantaged by them, chiefly urban consumers. In fact, urban consumers realize that having products available at market clearing prices is overall advantageous to them compared with not having any products available at artificially low fixed prices. That is, market priced farm products either replaced very expensive black market goods or these farm products were completely unavailable. In effect, market prices have come down with the ERP. Prices within the ration shops have increased somewhat, but foreign donated commodities allow the government to maintain subsidies, designed to protect vulnerable population groups, on certain staples.

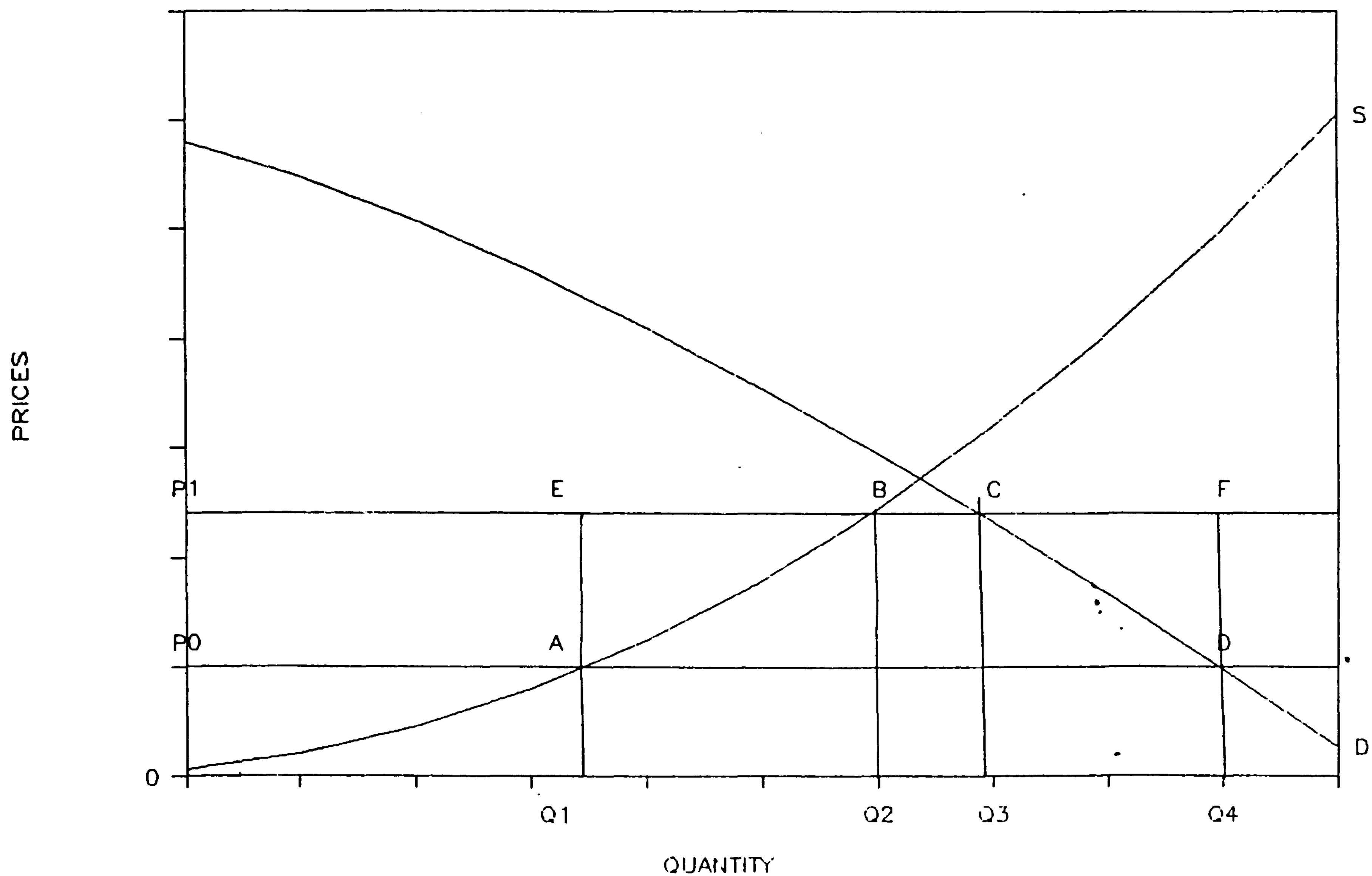
B. Conceptual Framework for Analysis

Estimating the expected benefits from agricultural price liberalization requires various informed and plausible assumptions to compensate for a lack of firm data. Available data on agricultural production represents essentially extrapolation from produce marketed through official channels. Moreover, the disturbed state of much of the countryside makes it extremely difficult to observe such crucial variables as the availability of transport, purchased inputs, improved seed, etc. These factors will be crucial to the ultimate farmer response to improved price incentives. These data problems do not mean that plausible estimates of the effect of the pricing reform are not possible but they do mean that such estimates are subject to a large margin of error.

In estimating the benefits of price liberalization, by necessity, a partial equilibrium framework is used. However, the additional error introduced by ignoring feedback effects of changed output prices on input and factor prices is likely to be small in relation to the uncertainties associated with the basic agricultural data.

The basic analytical framework is illustrated in Figure III.1. The curve S represents an aggregated composite supply curve for agricultural production. Curve D represents income-compensated domestic demand for those same products. P0 represents the formerly controlled price and P1 the free market or import/export parity price. Q1 and Q2 represent amounts offered for sale at P0 and P1 respectively and Q4 and Q3 the corresponding amounts demanded. Note that there is no assumption that the market would clear without imports at prices set by market forces. As drawn, Mozambique would continue to be a food importing country even at parity prices, as it typically did in the years prior to independence.

BENEFITS OF PRICE POLICY REFORM



One possible objection to the conceptual framework represented by Figure III.1 is that it implicitly assumes that imported food is purchased at the prevailing world price. Since virtually all of Mozambique's food imports are donated, the figure overstates the gains from eliminating imports. To the extent that this is true, P1 should be represented as a rising "stair-step" function. At the margin, however, the effect would be the same as shown on Figure III.1. The value of the increased output Q1 Q2 is its parity price times the increased quantity--the rectangle Q1EBQ2. The cost of producing it is the area under the supply curve between Q1 and Q2. Thus the net gain in the value of output is the area of the three-sided figure AEB.

In principle there is a corresponding area of welfare gain CFD which represents the difference between the cost of imported food Q3CFQ4 and its value to consumers Q3CDQ4. However, since the demand curve is income compensated, demand elasticities measured along it reflect only substitution effects and not income effects. It can be assumed that pure substitution effects in response to price changes for agricultural products in general will be very small. Thus the area CFD will be approximately zero.

One final preliminary comment deals with the area of the rectangle P1EAP0. This area represents the difference between the amount that consumers paid for the quantity Q1 of agricultural products before and after the reform. There has been a great deal of discussion of the "social and political costs of reform." In essence these effects are not costs at all in the economic sense but represent the effects of transfer payments. Among economists there has been a tendency to ignore these effects since their net effect on total income is zero--in this case, producers are better off and consumers worse off by the same amount. The problem, of course is that to the individuals involved (and their political representatives) these effects are quite important. Moreover, in many cases governments have great difficulty in reversing or compensating for these transfers without undoing the reform itself. The central rationale for policy-based assistance is that it gives governments the wherewithal to compensate for the effects of such income transfers while realizing the net income gains which result from the reforms.

C. Estimating the Benefits

In order to estimate the benefits of the reforms, it has first been necessary to estimate the evolution of parity prices over the past five years and to compare them with the GOM's controlled prices. This requires the estimation of the "equilibrium" exchange rate, which is done in Part One, Section I, and the estimation of various domestic transportation, packaging, and processing costs necessary to convert import/export parity to farm gate prices. Based on these estimates and an estimated equilibrium exchange rate of 750 Mt per dollar in early 1989, parity prices were calculated for Mozambique's nine principal crops for 1989. The pricing analysis was presented in Part One, Section II.

Two trends can be seen in producer prices. First, there has been a strong tendency to price food grains at a higher percentage of import parity than export crops. This trend continues as domestically produced maize, rice, and sorghum are well above the prices of their imported counterparts, presumably for food security reasons. Another, factor may be that the GOM needs to reduce the budget subsidy to state farms in order to meet IMF fiscal targets, and sets grain prices high enough to reduce state farm losses. The second trend apparent in producer prices is that export crops are now much closer to world prices than they were in 1985-86. The analysis actually understates the degree of the improvement because there is now private marketing of cotton, cashews, and groundnuts. In effect, private marketing converts the official prices into floor prices. These floor prices are set at about 75 percent of the equivalent world price.

Table III.1 below attempts to estimate the net income gain resulting from the improvement in agricultural prices from their low point in 1986 to their level of 1989, for the same nine crops previously considered. This estimate is based on the assumption that a reversal of the present pricing policy would mean a return to prices of approximately 1986 levels. Also given in the first column of Table III.1 is the World Bank's estimate of the total volume of agricultural production for each of the nine crops in 1986. This estimate is an improvement over official figures which are based only on product marketed through official channels.

Two alternative estimates are provided in Table III.1. The first (Price Assumption A) using GOM floor prices for 1989, the second (Price Assumption B) using estimated 1989 export parity on the assumption that private marketing will raise actual farm gate prices to these levels. The actual outcome will presumably lie somewhere between.

The percentage shortfall of the 1986 official price levels are shown either from 1989 official prices (column two) or from parity (column three), whichever is lower. The fourth column takes the production figures from column 1 and multiplies them by estimated 1989 international prices to provide a base value of agricultural production for the nine crops.

The last four columns of price assumptions (A) and (B) calculate the gains, for each crop, to be received from policy reform based on four alternative estimates of the value of the supply elasticity. Referring back to Figure III.1, these estimates correspond to the area of AEB which is roughly a triangle. The basic value of production OP1BQ2 is taken and multiplied by the percentage change in prices and the percentage supply response (i.e., the supply elasticity multiplied by the percentage changes in prices). This result is divided by two to estimate the area of (the approximate) triangle AEB.

TABLE III.1

Estimated Net Income Gain

	ESTIMATED 1986 TOTAL PRODUCTION (000 TONS)	1986 PRICE SHORTFALL (PERCENT) (A)	1986 PRICE SHORTFALL (PERCENT) (B)	VALUE OF 1986 PRODUCTION (1989 PARITY PRICES) (000 METICAL)
Maize	460	6%	6%	33,553
Rice	93	32%	32%	10,169
Sorghum	267	5%	5%	17,823
Beans #1	97	32%	70%	36,199
Groundnut	102	49%	72%	33,528
Sunflower	1	33%	67%	211
Copra	29	51%	82%	4,138
Cashews	40	14%	93%	23,228
Cotton	11	67%	90%	2,445

TABLE III.1 - Continued

Price Assumption (A)
Value of Producer Surplus at Various Supply Elasticities (Million Meticais)

	1.0	0.5	0.2	0.1
Maize	64.7	32.3	12.9	6.5
Rice	531.4	265.7	106.3	53.1
Sorghum	20.4	10.2	4.1	2.0
Beans #1	1,909.4	954.7	381.9	190.9
Groundnuts	4,026.7	2,013.4	805.4	402.7
Sunflower	11.5	5.7	2.3	1.2
Copra	531.6	265.8	106.3	53.2
Cashews	233.9	116.9	46.8	23.4
Cotton	551.1	275.6	110.2	55.1
Annual Value of Reform For 9 Crops				
In Million Meticais	7,880.7	3,940.3	1,576.2	788.1
In Million Dollars	$10.5	$5.3	$2.1	$1.1
Net Present Value of 20 Years Benefits (10 Percent Discount Rate)	$89.5	$44.7	$17.9	$9.0

Price Assumption (B)
Value of Producer Surplus at Various
Supply Elasticities
(Million Meticais)

	1.0	0.5	0.2	0.1
Maize	64.7	32.4	12.9	6.5
Rice	531.4	265.7	106.3	53.1
Sorghum	20.4	10.2	4.1	2.0
Beans #1	9,098.4	4,549.2	1,819.7	909.8
Groundnuts	8,608.7	4,304.3	1,721.7	860.9
Sunflower	47.1	23.6	9.4	4.7
Copra	1,374.9	687.5	275.0	137.5
Cashews	9,962.9	4,981.5	1,992.6	996.3
Cotton	993.2	496.6	198.6	99.3
Annual Value of Reform For 9 Crops				
In Million Meticais	30,701.7	15,351.0	6,140.3	3,070.1
In Million Dollars	$40.9	$20.5	$8.2	$4.1
Net Present Value of 20 Years Benefits (10 Percent Discount Rate)	$348.5	$174.3	$69.7	$34.9

These multiple alternative estimates of supply elasticity reflect a general lack of knowledge of producer behavior. Underlying the supply curve of Figure III.1 are a large number of technical and market factors which are, at this stage, impossible to estimate. The four columns provide values of the gains for each crop based on supply elasticities of 1.0, 0.5, 0.2, and 0.1. The last two lines of both price assumptions (A) and (B) convert the values from 1989 meticais to dollars at the estimated equilibrium exchange rate and estimate the present value of an income stream of 20 years of such benefits, discounted at 10 percent. This measure of the gains from policy reform is completely comparable to the measure of gains used for project type investments.

What a realistic estimate would be for the elasticity of supply of agricultural production is obviously critical. If the elasticity value is close to 1.0 and market liberalization raises the actual farm price to midway between the official floor price and border parity, the price reform has a present value of over $200 million. On the other hand, if the elasticity is as low as 0.1, the reform would have a value of less than $2 million. Our estimate, which will be refined during program evaluations, is that it is reasonable to suppose that the elasticity is closer to the lower number. Given the transportation difficulties and the general insecurity throughout the country which impede both marketing and input supply, it seems likely that the supply elasticity would be rather low. On the other hand, since the largest price adjustments have been for crops which are produced by commercial farmers, the minimum elasticity estimate of 0.1 may be two low. If the security situation were to improve, one would expect a rather high supply elasticity to obtain as underutilized capacity is brought back on stream. Overall, a net present value of about $70 million, corresponding to an assumed elasticity of 0.2, seems a good first approximation.

The above benefits are calculated using a quite conservative estimate of the probable supply response to price liberalization and some observers feel that the response will be much greater. Nonetheless, given the importance of price compression to the agricultural sector, there is an obvious question why the predicted increase in agricultural production is not greater. The estimated annual impact of price liberalization at a supply elasticity of 0.2 is less than two-tenths of one percent of GDP annually. Reviewing the process by which the estimated impact was calculated, and what is known about the current state of the Mozambican economy, suggests a number of reasons for this outcome. First, much of the price liberalization which has taken place thus far has been concentrated in a relatively small number of crops. The principal food grains - maize, sorghum, and, to a lesser extent, rice - have been compensated at fairly close to parity since the inauguration of the ERP. Indeed, an argument could be made that the efficiency cost of raising the price above parity should be subtracted from the estimated benefits of price adjustment. This has not been done on the basis that food security obviously also has a benefit to the GOM which presumably offsets that cost.

The third factor which accounts for the limited response shown on Table III.1 is producer response to the insurgency. Interviews with commercial producers outside the "green zones" of Maputo and Beira have repeatedly shown that these producers plant a mix of crops which includes a larger portion of root crops than would be expected from the market prices for these crops. The apparent explanation for this pattern is that root crops in general, and cassava in particular, would have a local market even if the security situation deteriorated and transportation were to be disrupted, and that cassava can be stored in the ground and is less likely to be carried off by insurgents than are other crops. Improvement in the security situation would probably produce a less "defensive" and more price responsive pattern of cropping and producer behavior.

In addition to the gains from policy reform, there are, of course, direct benefits of the commodities themselves. In a sense, the net present value of the total program is the value of the policy reform plus the value of the commodities, less the cost of the commodities. In a very real sense this analytical separation of the gains from improved price signals from the gains from purchased inputs is artificial. The way in which the gains from improved price signals are realized is by signaling producers to increase use of purchased inputs and factors or to change the technologies they employ.

At the same time, given the artificial scarcity of foreign exchange to private producers imposed by the GOM's system of administratively allocating foreign exchange, it is quite possible that the commodities themselves have had a value to producers higher than, (possibly considerably higher than) the price that purchasers actually pay for them. This artificially created producers surplus is extremely difficult to measure since it will be different for each buyer. With the movement of the exchange rate toward equilibrium (of a certain sort), and the proposed introduction of a nonadministratively allocated foreign exchange system by the GOM for certain spare parts and raw materials, a modification to the CIP procedure to use the open general license system should be considered to increase allocative efficiency.

Therefore, it is possible to conclude that this program provides commodities to purchasers which have a value to them of approximately $50 million, in addition to which, improved price signals provide an overall increase in the value of output of (conservatively estimated) $8 million per year. This annual increment in output continued for the next twenty years would have a net present value of at least $70 million. Therefore the overall program provides benefits equal to at least $120 million at a present value cost of about $40 million.

IV. Environmental Analysis

REDSO/ESA has prepared an Initial Environmental Examination which has been approved by the Bureau Environmental Officer. The IEE is included as Annex G.

V. Market Analysis

Due to the shifting security situation, total demand for agricultural equipment and other commodities is not easily obtained. However, recent surveys of farmer needs for a selected set of commodities in the provinces by Entreposto, the Massey Ferguson/Mercedes dealer, and Tecnica Industrial, the Ford/Mitsubishi dealer, have provided sufficient information, Table V.1, to indicate that the demand for equipment in Mozambique exceeds available program funding.

Table V.1

Demand for Agricultural Equipment

Province

Commodity	Maputo	Gaza	Sofala	Manica	Zambezia	Nampula	Cabo Delgado
Trucks 8-ton	16	35	34	N/A	16	13	N/A
Trucks 3-ton	54	91	24	N/A	48	45	
Trailers	9	7	47	N/A	26	49	
Tractors	190	293	76	64	65	78	
Ploughs	183	290	65	63	37	75	
Disc Harrows	180	277	63	61	37	71	
Seeders/Planters	4	1	43	43	17	17	
Furrowers	8	2	31	33	11	11	
Irrigation Pumps	33	60	24	1	41	55	
Combines							
Self propelled					1	1	
Pulled					1	1	
Threshers			2		6	17	
Grain Mills			3		20	25	

Both Tecnica Industrial and Entreposto are in the process of collecting the data for Cabo Delgado plus data on equipment not included in the earlier surveys in several provinces. In addition, Mission staff has interviewed farmers, Ministry of Agricultural officials, and other provincial officials regarding the needs of the private sector farmers in each of the provinces. These interviews indicate a greater demand for some of the items, such as combines, and threshers, than is indicated in the surveys from the equipment dealers. However, since the equipment dealers will be importing the commodities and will assume the risk for their sale, their demand projections are given greater weight.

The demand for equipment in Maputo, Gaza and Manica provinces is far greater than current program needs when equipment provided in earlier programs is accounted for. Although transport continues to be a major constraint in all provinces, demand has been dampened by the security situation. Demand for tractors and equipment remains high and will remain virtually unchanged after the first phase of the program.

ANNEXES

ANNEX A

PAAD Design Team

Program Officer	Carlos Pascual
Project Development Officer	John Wall
Agricultural Economists	David Martella Fernando Paixao
Economists	Bob Burke Luisa Capelao
Social Analyst	Aileen Marshall
Political Analyst	Mike Ranneberger, DCM
Commodity Management Officers	Judi Shane Ana David
Controller	Richard Solloway

LOGICAL FRAMEWORK

NARATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
A) GOAL Increase agricultural production and exports, and promote domestic food security.	-Statistics on agricultural production disaggregated by food and cash crops, production subsectors and province. -Statistics on food requirements by province. -Agricultural export statistics. -Trends in donor food imports.	-National production statistics. -World Bank and IMF surveys. -UNDP/DPCCN food appeals. -UNDP donor reports.	
B) PURPOSE Improve incentives for private agricultural production in order to enhance the private agricultural sector's production and income.	END-OF-PROJECT STATUS -Increased liberalization of agricultural producer prices. -For crops where full deregulation may not be presently feasible, institutionalized procedures for basing agricultural prices at world parity. -Divestiture of state farm land covering approximately 10,000 hectares to family and commercial farmers. -Strengthened private sales and service networks for agricultural inputs. -A functioning non-administrative allocation system for foreign exchange.	-USAID price surveys. -Annual anouncements of GPRM producer price policy. -USAID/GPRM assessment of state farm divestiture. -Ongoing dialogue with private importers, distributors and farmers. -External World Bank, GPRM and USAID assessment of Open General License System.	-No further deteriation in security situation. -Normal weather conditions.

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LOGICAL FRAMEWORK - Continued

NARATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
C) OUTPUTS			
-Ongoing policy dialogue between USAID and GPRM entities in food and agricultural sector.	-Quarterly meetings between USAID and GPRM policy working group.	-Minutes of meetings.	-Continued donor support of GPRM economic rehabilitation program.
-Program-funded commodities privately imported and distributed.	-100 percent private importation and distribution.	-USAID import statistics and end use monitoring reports.	
-Increased access of private farmers in seven provinces to imported inputs.	-Increased production on model farms.	-End use monitoring reports and longitudinal study of model farms.	
-Funds disbursed through market-based Open General License mechanism.	-$3 million FY 1990 OGL disbursement; $5 million FY 1991 OGL disbursement.	-USAID disbursement records.	
-Policy impact analysis and future pricing policy projections.	-Up to eight consultant studies.	-Completed reports.	
D) INPUTS			
-Balance of payments support.	-$13.55 million in FY 1989; $15.40 million in FY 1990; $15.10 million in FY 1991.	-USAID disbursement records, MACS reports.	-Security situation does not preclude input distribution and monitoring.
-Short term technical assistance.	-32 person months of short term technical assistance.	-USAID contracts.	
-Long term implementation and monitoring assistance.	-Approximately 60 person months of long term technical assistance.	-USAID contracts.	

Confirmation of Credit Availability

and

Listing of BPD Branches

Banco Popular de Desenvolvimento

Of. nº51/DCE/89
Maputo, 23/06/89

A
USAID
Rua Faria de Sousa, 107
Caixa Postal 783
MAPUTO

Acusamos a recepção da vossa carta com a refª 89/345 de 16 de Junho p.p. que mereceu a nossa maior e especial atenção.

Informamos que o B.P.D., através das suas Filiais prontifica-se a prestar apoio ao referido programa.

Contudo, a concessão individual do financiamento está condicionada a que os beneficiários reúnam as condições exigidas para o efeito.

Apresento os melhores cumprimentos.

UNIDADE, TRABALHO, VIGILÂNCIA
DIRECÇÃO DE CRÉDITO E ECONOMIA
O Director-Adjunto

Diogo Amaral

DA/ILFM

DISTRIBUTION OF CREDIT BRANCHES

BANCO POPULAR DE DESENVOLVIMENTO

NIASSA PROVINCE
1. Lichinga Affiliate
2. Cuamba Agency
3. Marrupa Agency

CABO-DELGADO PROVINCE
1. Pemba Affiliate
2. Montepuez Agency
3. Mocimboa da Praia

NAMPULA PROVINCE
1. Nampula Affiliate
2. Namapa Agency
3. Angoche Agency
4. Ilha of Mozambique Agency

ZAMBEZIA PROVINCE
1. Quelimane Affiliate
2. Gurue Agency

TETE PROVINCE
1. Tete Affiliate
2. Ulongue Agency
3. Songo Agency

SOFALA PROVINCE
1. Beira Affiliate
2. Dondo Agency

INHAMBANE PROVINCE
1. Inhambane Affiliate

GAZA PROVINCE
1. Xai-Xai Affiliate
2. Chokwe Agency
4. Xilembene Agency
4. Chibuto Agency

MAPUTO PROVINCE
1. Maputo Affiliate
2. Green Zones Agency

MANICA PROVINCE
1. Chimoio Affiliate

ANALYSIS OF MAIZE MARKETING

Introduction

This paper considers the advantages and disadvantages of adjusting Mozambique's maize marketing policy by phasing out consumer rations and subsidies on white maize and retaining a subsidy for less preferred yellow maize. Consumers would be free to purchase whatever quantities of yellow maize they wish. The analysis is limited to expected trends under the current and the proposed new marketing policies. Due to lack of data on price elasticities of demand, parallel market prices, and quantities marketed through parallel channels, a more extensive research effort would be required before a more precise quantitative analysis could be undertaken. A more elaborate study is not essential before implementing the proposed marketing alternative as policies can be adjusted from time to time on the basis of feedback and experience.

With these constraints in mind, the analysis suggests that the proposed marketing alternative could increase the amount of domestically produced white maize which is commercially marketed, ensure a safety net for the poor, and reduce the government's administrative burden in adressing the nutritional requirements of vulnerable urban groups. While such a policy change entails a number of unknown variables in terms of consumer response, comparison of the suggested alternative with specific elements of current maize marketing policy suggests that the impacts will either be positive or, at worst, neutral.

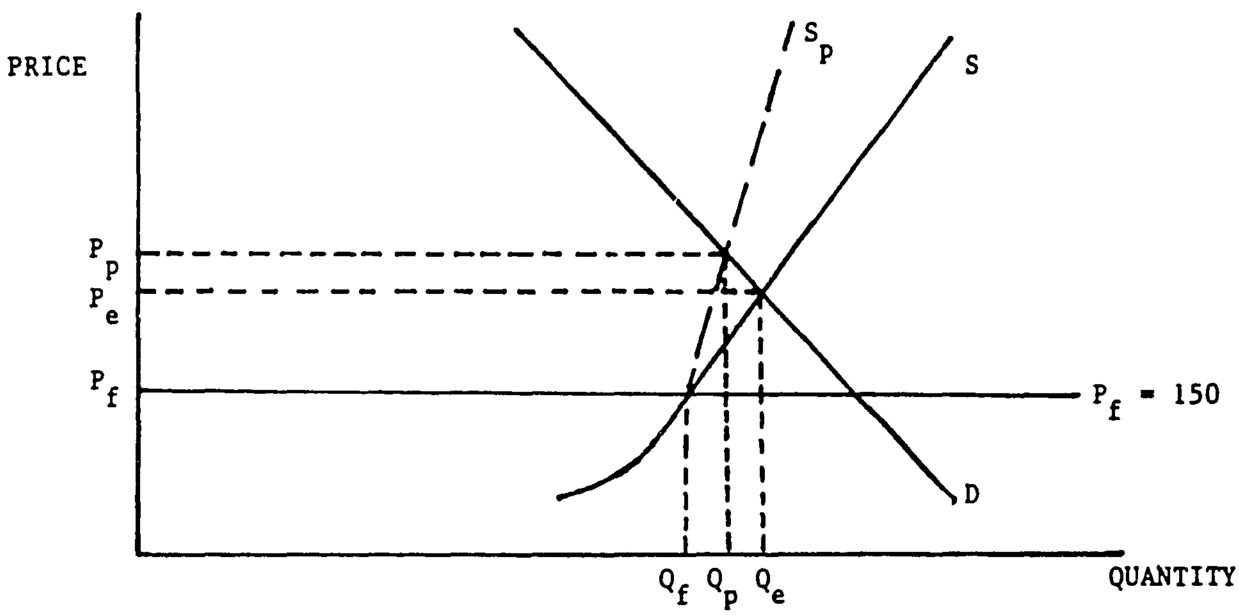
Current Consumer Market

Presently, the consumer price for yellow and white maize grain in Mozambique is fixed at MT 150/kg. The farmgate price is fixed at a level of MT 110/kg. The cost of transporting, handling and marketing maize must be met by the margin allowed between the consumer and the farmgate prices. The fixed consumer price also applies to imported maize grain. There is no price differential between white and yellow maize even though consumers are apparently willing to pay significantly more for white maize. Each registered family in Maputo and Beira reveives a monthly ration of yellow or white maize, with the amount of the ration fluctuating from month to month depending on stocks. Virtually all yellow maize in Mozambique is made available through donated food imports.

The farmgate price for maize, based on USAID's analyses, provides an adequate incentive for production. However, the active trading of white maize on parallel markets suggests that the fixed consumer price does not cover the costs and risks borne by traders and transporters in the marketing process. If this is the case, maintaining a fixed consumer price for white maize could negatively affect total marketed surplus as is illustrated in the following charts. Figure 1 looks exclusively at the supply of domestically produced white maize. Figure 2 examines the import market. Figure 3 combines the domestic and import markets and allows some hypotheses to be drawn about the overall consumer maize market in Mozambique.

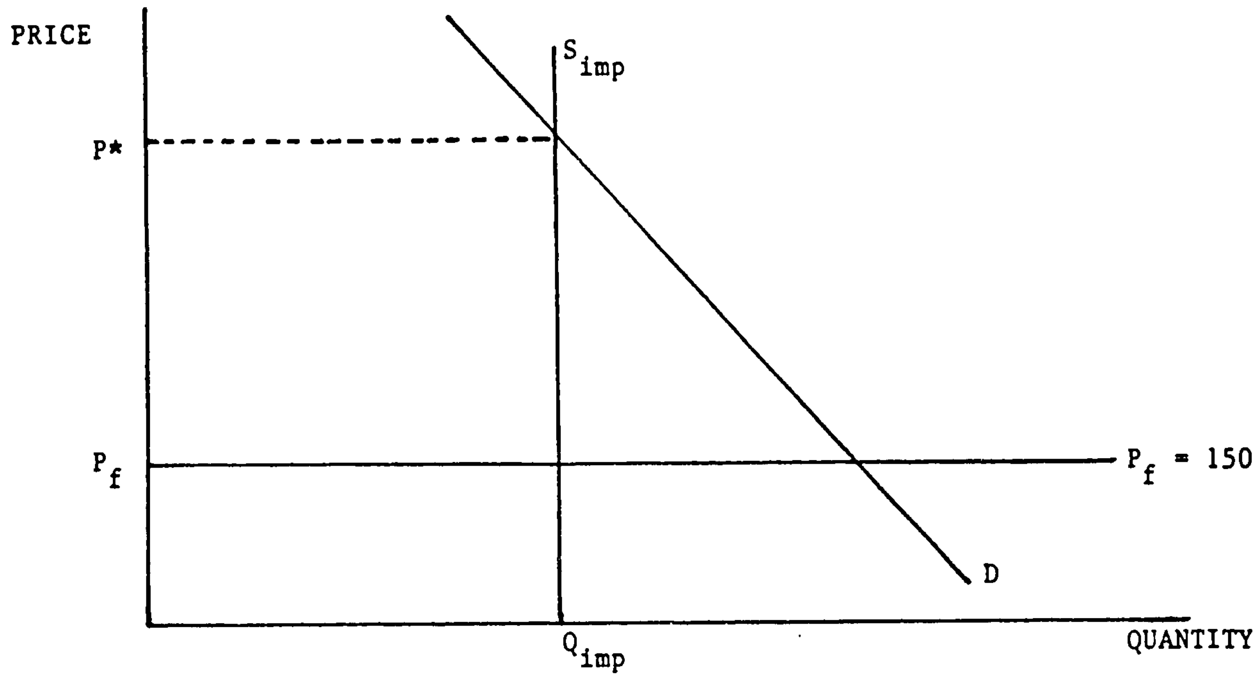
For analytic purposes, the demand for maize is assumed to be fairly inelastic as it represents the principal cereal crop in Mozambique and cannot be readily substituted. The supply of domestically produced maize is not completely inelastic since farmers, traders and transporters can decide how much to market out of total production. In normal circumstances, the market price and quantity sold would be determined by the interaction of supply and demand, i.e. Pe and Qe in Figure 1 below. In this case price is fixed at MT 150/kg, or Pf. The quantity supplied at this price is Qf, beyond which it is not economical to supply at the official price. However, some traders and producers may choose to market additional maize on the parallel market, which entails costs and risks that cause the supply curve to shift upwards. The expected equilibrium price on the parallel market would be Pp. The quantity supplied would be Qp-Qf, that is, the difference between the parallel market equilibrium and that already supplied under the fixed price.

FIGURE 1



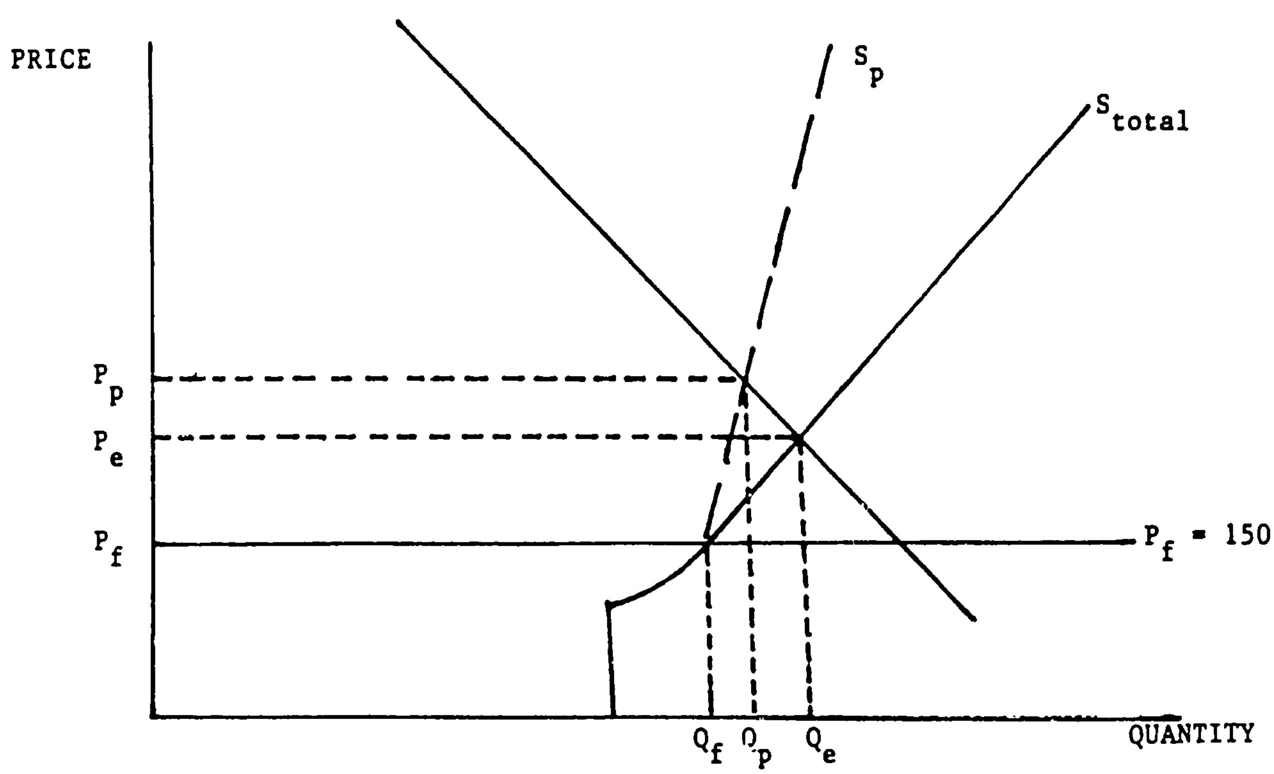
The same demand curve assumed for domestically produced maize applies to the import market. The supply for imports, however, is completely inelastic since it depends wholly on donor grants because Mozambique does not import maize through commercial channels. In this case, as Figure 2 indicates, the fixed price does not affect quantities supplied if adequate administrative controls are assumed. However, individuals could obtain a significantly higher price (P*) by diverting commodities to the parallel market or reselling their allocations.

FIGURE 2



The combined domestic and import market is obtained by the sum of the two supply curves in Figures 1 and 2. Supply is assumed to be fixed and inelastic until the import supply curve intersects the marginal cost curve for domestic production as shown below in Figure 3:

FIGURE 3



Figures 1-3 demonstrate several points. First, if the market were completely liberalized, more domestic maize (i.e. Qe) would be available than is currently available between the combined official (Qf) and parallel (Qp-Qf) markets. Second, the equilibrium price, while higher than the fixed price, would be less than the price on the parallel market. Those who must purchase on the parallel market, most likely medium to low income groups who are the principal consumers of maize, must pay a price penalty (Pp-Pf) in comparison to those who manage to purchase at the fixed price. Third, many of the people who benefit from the fixed price of white maize would be willing and able to pay higher prices. As suggested above in the discussion of the import market, this creates an incentive to divert or resell food.

Finally, a fourth issue should be considered which is not reflected in the above figures but relates directly to the income and purchasing patterns of the poor. Many poor households have seasonal or fluctuating monthly incomes and no practical means to save their earnings in order to regularize expenditures over the year. The result is that major food purchases are made when money is available and these stocks are consumed until the next tranche of seasonal income. In practical terms, this means that a household can purchase only its allocated monthly ration at the fixed, subsidized price. The rest of its food purchases must be made on the parallel market. While there is no information on how many people or households have irregular income flows (this was not part of the Tete and Maputo household surveys), increasing dependence on the informal sector for employment would suggest that the incidence is increasing rather than decreasing. For these households, the structure of the ration system does not let them take advantage of subsidized prices, possibly for a large portion of their purchases.

Marketing Alternatives

A revised marketing mechanism could help to achieve the following objectives:

1. Maximize the quantity of food available for consumption. This would entail maximizing the amount of domestic white maize which is commercially marketed. It would also require maintaining, but possibly restructuring, donated food imports.

2. Maximize the number of people who can afford to meet basic food needs. This would require subsidizing those who cannot pay the full cost of food. To make this affordable to the Government, those who can pay should not be subsidized.

3. Minimize the administrative burden on and cost to the government of implementing such a program. This suggests the need to rely on market forces to the extent possible rather than trying to administer a costly program of means tests to determine eligibility for food subsidies.

The proposed alternative marketing strategy builds on three characteristics of the maize market: (1) consumers prefer white maize to yellow and are willing to pay more for it; (2) only white maize is produced domestically; and (3) the U.S donates 70% of commercialized maize imports, all of which is yellow maize. This suggests that the market for white maize could be fully liberalized to maximize the amount of domestically produced white maize which is sold commercially. Imported yellow maize could still be sold at the current subsidized price but consumers would be free to purchase whatever quantities they wish on the assumption that this is a "second-best" commodity which need not be rationed. And efforts could be made to increase the level of yellow maize imports to the point (or at least close to it) where supply and demand intersect, thereby reducing the incentives for diversions. The following charts outline how such a strategy might work and its potential benefits.

Most white maize would be produced domestically, with some donated imports making up the balance of supply. This is shown in Figure 4 as a inelastic supply curve for the import component which then links into the marginal cost curve for domestic production. The demand curve would be even more inelastic than shown in Figures 1-3 as consumers now consist of somewhat higher income individuals who are likely to buy white maize almost irrespective of the price. This meets one objective of eliminating subsidies for those who can afford to pay. Based on the previous analysis, price and quantity are now freely determined, resulting in the maximum amount of domestic production reaching consumers (i.e. Qe). A parallel market would no longer exist. The parallel supply curve is shown below solely to illustrate the increased quantity marketed.

FIGURE 4

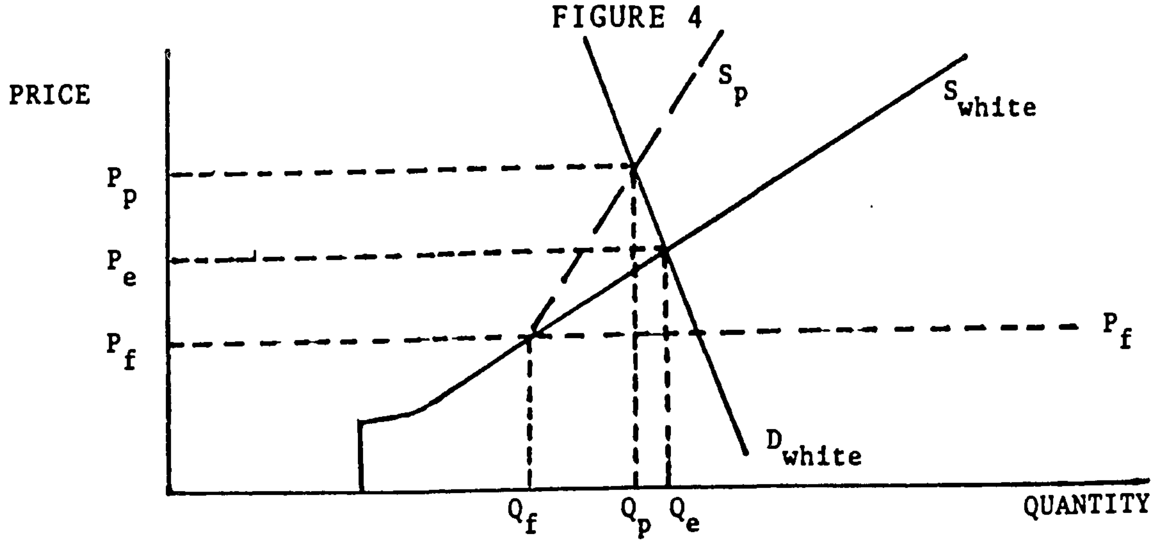
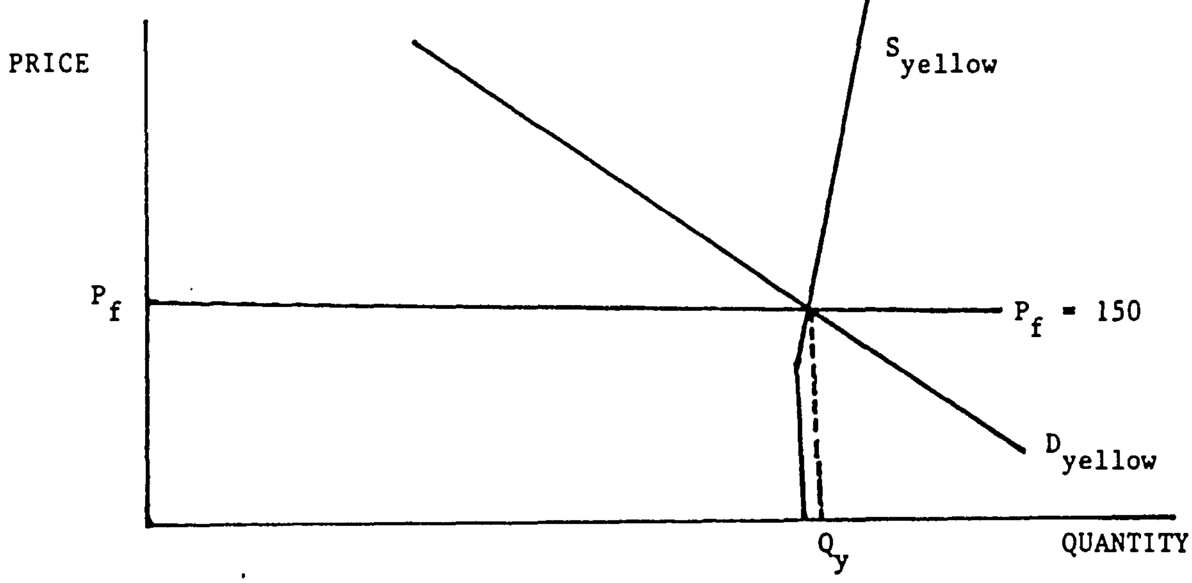


Figure 5 below represents the market for yellow maize. It is assumed that the supply of yellow maize would continue to consist principally of imports and would be virtually inelastic, except for small quantities of domestic production. Given a higher consumer price for white maize as shown above in Figure 4, it is expected that producers would not switch to yellow maize as they now stand a better chance of ensuring that all white maize surpluses are sold. The elasticity of demand is difficult to predict. On the one hand, yellow corn will be a cereal staple for the poorest groups which suggests almost complete inelasticity. On the other hand, some consumers may interchange between the yellow and white maize markets. Some yellow maize is also bound to be used for animal feed. These factors suggest some degree of elesticity. On this basis, a slightly more elastic demand curve than used in Figure 3 is shown below. Figure 5 illustrates an ideal (but initially unrealistic) situation where imports are accurately calibrated to allow supply and demand to intersect at the fixed, subsidized price (Pf). The fixed price in this case is also an equilibrium price.

FIGURE 5



Overall, the proposed marketing alternative addresses all of the objectives set forth above. It would, first, maximize available quantities as imports would not be affected but marketed domestic surplus would increase. Subsidies for upper income groups would be eliminated to the extent such groups consume principally white maize. The subsidy on yellow maize would be a safety net for the poor. If donated yellow maize can be increased to ensure that the equilibrium price is also the fixed price, incentives for diversions would decrease. The administrative burden on the government would diminish as the current ration system for maize would be eliminated and replaced by a more efficient market-based allocation system.

Issues and Caveats

1. Consumer Response and Production Implications. The cross price elasticity of demand between yellow and white maize is not known. Presumably, some consumers would switch preference from white to yellow maize if the price of the latter is too low, in turn diminishing the market for domestic production. This would not, however, be a serious issue in the initial stages, should an alternative mechanism similar to that suggested in this paper be adopted.

Presently the subsidy on white corn results in demand being overstated with no impact on marketing and production since traders receive no additional compensation. If the price of yellow maize remains fixed while the price of white maize increases, the marketing incentive for white maize initially improves. The issue then becomes to monitor the yellow maize/white maize price relationship to ensure that any necessary adjustments to the price of yellow maize are made.

2. Yellow Maize Import Requirements. No one knows how much imported yellow maize is required to ensure that the equilibrium price and the fixed price become one as indicated in Figure 5. Spot checks on the parallel market would have to be made to determine if significant amounts are being traded and at what price. Based on these findings, adjustments may need to be made either to the supply of donated imports or to the fixed price.

3. Animal Feed. There is clearly a demand for yellow maize as animal feed, but the level of demand is not known. Those who presently purchase yellow maize in the official market for animal feed already receive a subsidy, so the alternative system does not present a comparative disadvantage. A more serious concern is whether the removal of the yellow maize ration would result in shortages if individuals can buy unrestricted quantities for feed. Current evidence suggests this would not be the case since yellow maize rations are not fully purchased when there is not sufficient white maize to meet demand. If there were significant unmet demand for yellow maize as animal feed, one would expect that yellow maize rations would be fully purchased and resold at some differential.

4. Nutritional Impact. The negative nutritional impact of a higher white maize price would be mitigated by the continued subsidy for yellow maize. It could be argued that, in fact, the poor are better off in real terms as the subsidy price will be maintained, at least for several months, despite inflation. They will also be able to purchase whatever quantities they wish when they have disposable income which, as indicated earlier, may correspond more accurately to actual income and expenditure patterns and allow the poor to benefit from food subsidies on a larger portion of their basic needs purchases. Upper income groups will not suffer nutritionally and, to the

extent that they purchase significant amounts of maize on the parallel market, will be better off financially at the new equilibrium price (Pe in Figure 4) than at the old parallel price (Pp).

5. Political Impact. Finally, the political impact of any commodity price rise must be carefully considered. In the case of the suggested marketing alternative, the benefits are probably sufficiently significant to counter any adverse reaction to increased prices. The liberalized white maize price will not be as high as the current parallel market price, which hovers between MT 300 and MT 350/kg. The expected level should be closer to a midway point (around MT 250/kg) between the current fixed price of MT 150/kg and the parallel price. This higher price should also be balanced with the prospect of increased availability and freer choice, for both white and yellow maize consumers, on when and how much to purchase.

AMPLIFICATION OF DFA PROCUREMENT PLAN

This annex contains additional information as to why various commodities financed under the program will not be procured from the United States. In the previous CIP's for Mozambique, source/origin waivers were included in the PAAD and approved upon PAAD authorization.

1. <u>Tractors, Implements, Harvest Equipment and Tractor Spare Parts</u>
   Probable Source and Origin - A.I.D. Geographic Code 941

   <u>Tractor Spare Parts</u>
   Probable Source and Origin - A.I.D. Geographic Code 935

Farm tractors, tractor implements, harvest equipment and the spare parts for the tractors are a critical part of the integrated package of inputs designed to support the private commercial and family farms in the program's target areas. There are only two private sector manufacturer's representatives for farm tractors and related equipment of an appropriate size (65 HP and 90 HP) in Mozambique. These two dealerships, Entreposto representing Massey Ferguson and Tecnica Industrial representing Ford, have adequate facilities for maintenance and disbursing of spare parts. There is no representative, either public or private, for any other U.S. tractor producing company.

In 1987 the last U.S. assembly plant for farm tractors (which was operated by Ford) of under 120 horsepower for which representation existed in Mozambique closed down. Thus farm tractors of 65 HP and 90 HP which can be serviced and maintained in Mozambique are not available from the United States. Parts and implements for tractors of these sizes are also not currently produced in the U.S. However, the required tractors, and all except $350,000 of the required parts, implements and harvest equipment are available from Code 941. The remaining parts, implements and harvest equipment are available from Code 935.

2. <u>Trucks and Spare Parts</u>
   Probable Source and Origin - A I.D. Geographic Code 935

One of the crucial elements in this program is the provision of trucks to farmers and private trucking firms to enable them to transport produce to market. Previous PSR Programs have financed the importation of 3-ton and 8-ton trucks. PSS is programmed to finance approximately 190 each 3-ton trucks with spare parts and 32 each 8-ton trucks with spare parts. In Mozambique traffic moves on the left. At present, no U.S. manufactured vehicles are marketed in Mozambique, as no U.S. firm produces trucks with steering wheels on the right side of the cabin. Spare parts and maintenance facilities for U.S. vehicles of any size/type are nonexistent in country. Thus, it is not appropriate to finance U.S. manufactured trucks under this program as they could not be adequately maintained in Mozambique.

3. Irrigation Equipment
Probable Source and Origin - A.I.D. Geographic Code 935

Irrigation by pump is part of the integrated package of inputs designed to support the private commercial and family farms in the target areas. Currently there are three private sector manufacturer's representatives for irrigation equipment in Mozambique. Intraco representing Caterpillar, Entreposto representing Massey Ferguson and Tecnica Industrial representing Ford have adequate facilities for maintenance of irrigation equipment.

Intraco is the only private sector firm that has received an allocation for irrigation equipment under previous CIPs. However, this dealer is only able to supply one size (4 cylinders engine) of pump unit of U.S. manufacture which meets the requirements of the program. The remaining irrigation equipment for which maintenance facilities exist in Mozambique is available from Code 935.

4. Fertilizer
Probable Source and Origin - A.I.D. Geographic Code 935

A key element necessary to support the private farmers is to be able to provide, in a timely manner, good fertilizer. Different agricultural regions use different types of fertilizer due to soil conditions, crops, and farmers past experience with certain types of fertilizer. When quantities justify Procurement will be made in the U.S. provided the quantities and availability of the specific type justify with U.S. origin.

Only until recently have the private distributors started to become involved with fertilizer marketing in Mozambique. It is still difficult for them to conduct real analyses in the different provinces in time to be able to start the procurement for the current agricultural season. The importer will consolidate the different provincial demands at least six months before the beginning of each agricultural season giving the quantities and types of fertilizer for possible procurement from U.S. origin

5. Seeds
Vegetable Seeds
Probable Source and Origin - A.I.D. Geographic Code 935

On of the most crucial elements in this program is the provision of seeds to private commercial and family farms located in the target areas. Experience gained during the implementation of previous CIPs indicates that certain varieties of these required seeds were not available from the U.S. due to different climatic and soil conditions and the nonadaptability of some varieties to the Mozambique environment.

Special attention has been given to seed procurements for Mozambique by the donor community during the past few years in order to establish and obtain the best possible varieties with acceptable germination rates, suitable to local geographic and climatic conditions. Based on prior experience in previous CIPs, appropriate seed varieties not available from Code 000 sources are available from Code 935 sources.

5. Lubricants
Probable Source and Origin - A.I.D. Geographic Code 935

One AID-financed commodity critical to the achievement of program objectives has been engine lubricants which support agricultural production and the transportation of produce from farm to market. With Mozambique's critical foreign exchange shortage, lubricants are frequently not available on the local economy. The provision of lubricants under the PSS Program will help to assure the continued operation of the capital equipment provided under previous and present CIPs and of other equipment owned by private farmers within the program's target areas.

Approximately 40-50 percent of the raw materials to manufacture petroleum lubricants used in the U.S. are currently imported. As the United States is a major importer of lubricants it makes no sense to procure this item from the U.S. rather than through normal commercial channels.

ANNEX F

S T A T U T O R Y   C H E C K L I S T

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FY 1989 Appropriations Act Sec. 578(b). Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents ~~or~~ from entering the United States unlawfully? NO

2. FAA Sec. 481(h); FY 1989 Appropriations Act Sec. 578; 1988 Drug Act Secs. 4405-07. (These provisions apply to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are N/A

laundered with the knowledge or complicity of the government): (a) Does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement? and (b) Has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (1) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (2) the vital national interests of the United States require the provision of such assistance? N/A

3. <u>1986 Drug Act Sec. 2013; 1988 Drug Act Sec. 4404</u>. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress listing such country as one (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the N/A

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government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

4. FAA Sec. 620(c). If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity? NO

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? NO

6. FAA Secs. 620(a), 620(f), 620D; FY 1989 Appropriations Act Secs. 512, 550, 592. Is recipient country a Communist country? If so, has the President determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism? Will assistance be provided NO

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either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?	NO NO
7. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property?	NO
8. FAA Sec. 620(l). Has the country failed to enter into an investment guaranty agreement with OPIC?	No. An OPIC agreement was signed on July 28, 1984.
9. FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made?	NO
10. FAA Sec. 620(q); FY 1989 Appropriations Act Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1989 Appropriations Act appropriates funds?	(a) NO (b) NO
11. FAA Sec. 620(s). If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of	N/A because contemplated assistance is not a development loan or from ESF.

Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?	NO
13. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.)	Any arrearages have been taken into account by the Administrator at the time of approval of the Agency FY 1989 OYB. See FY 1989 "Taking into Consideration" memo.
14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism?	NO
15. FY 1989 Appropriations Act Sec. 568. Has the country been placed on the list provided for in Section 6(j) of the Export Administration Act of 1979 (currently Libya, Iran, South Yemen, Syria, Cuba, or North Korea)?	NO
16. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?	O

17. FAA Sec. 666(b). Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

NO

18. FAA Secs. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

NO

NO

19. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device?

NO

20. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.)

Yes. This factor has been taken into consideration by the Administrator in approving the FY 1989 OYB for Mozambique. See also page 6 of the GC "Taking into Consideration" Memo dated November 9, 1984.

21. FY 1989 Appropriations Act Sec. 527. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States?

NO

22. FY 1989 Appropriations Act Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance? NO

23. FY 1989 Appropriations Act Sec. 540. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin? YES

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy? NO

FY 1989 Appropriations Act Sec. 536. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? NO

2. Economic Support Fund Country Criteria

FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest? N/A

FY 1989 Appropriations Act Sec. 578(d). Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking? N/A

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. <u>GENERAL CRITERIA FOR NONPROJECT ASSISTANCE</u>

1. <u>FY 1989 Appropriations Act Sec. 523; FAA Sec. 634A</u>. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

   The Congress was advised of this activity in A.I.D's "Advice to the Congress on Revised Active and Proposed Projects for FY 1989".

2. <u>FAA Sec. 611(a)(2)</u>. If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action is required within the recipient country.

3. <u>FAA Sec. 209</u>. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

   No.

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This program, while targette at the private agricultural sector, is consistent with the GPRM's program of policy reform.

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

The program will support policy measures which will foster private initiative and increase the flow of international trade. The technical efficiency of agriculture and commerce will be enhanced as a result of the program. The program will not be specifically concerned with (c), (d) or (f).

5. FAA Sec. 601(b). Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

The program will support policy reform measures designed to strengthen the economy. A revitalized economy and liberalized policies will be conducive to greater investment in Mozambique and provide an expanded market for U.S. goods and related services.

6. FAA Secs. 612(b), 636(h); FY 1989 Appropriations Act Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

6. It is not anticipated that any foreign currencies owned by the U.S. will be utilized. However, certain local costs will be borne by the GPRM and the Mozambique private sector. Also provisions in the program grant agreement will require that the GPRM attribute counterpart local currencies generated by the program to the development of the agricultural sector. In addition, a negotiated % of such local currency funds will be made available as A.I.D. administered trust funds for the administrative use of USAID/Mozambique.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? No.

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? Yes.

9. FAA Sec. 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds? N/A

10. FY 1989 Appropriations Act. Will assistance be designed so that the percentage of women participants will be demonstrably increased? Yes.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

N/A. This is not an ESF-funded program.

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?

No.

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

N/A - ESF funds will not be utilized. Local currency generations from previous years' ESF-funded programs will be used consistently with 103-106 objectives.

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A. This is not an ESF-funded program.

e. FY 1989 Appropriations Act. If assistance is in the form of a cash transfer: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currences that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. governnent as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA

N/A

would themselves be available)? (c) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

2. <u>Nonproject Criteria for Development Assistance</u>

a. <u>FAA Secs. 102(a), 111, 113, 281(a)</u>. Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

a) Small scale farmers will be involved in the program by virtue of their access to agricultural implements and inputs financed under the program. b) Many farmers participating in the program also belong to farmer cooperatives and informal associations, which can benefit from use of equipment and inputs. c) Insofar as this program is geared towards private individuals, it can be said to support the self-help efforts of the target groups. d) By permitting women to increase production and thus have greater access to the cash economy, the program both promotes their participation in the national economy and enhances their role and status. e) N/A.

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

Yes.
a) Assistance is targetted at the private agricultural sector, whicl includes small scale farmers.

b) The program directly supports food production, particularly maize and rice, which are the principal food crops in Mozambique.

c) By increasing production the program contributes to increased food security.
The program also supports wider policy measures intended to encourage domestic production, build national food reserves, and address the needs the poor.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outrearch. N/A

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities. N/A

(4) [106] for energy, private voluntary organizations, and selected development problems; if so, extent activity is: N/A

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment; N/A N/A

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations; N/A

(iii) research into, and evaluation of, economic development processes and techniques; N/A

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness; N/A

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance; N/A

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development. N/A

(5) [120-21] for the Sahelian region: if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan which calls for equitable burden-sharing with other donors; N/A (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)? N/A

c. FY 1989 Appropriations Act. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U. S. Government?

Yes.

d. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Yes.

e. FAA Sec. 281(b). Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

By supporting the private agricultural sector the program recognizes the needs, desires and capacities of beneficiary farmers.
The program develops local capacity and supports policy measures of de-centralizing decision making and developing local capacity to engage in the economic process.

f. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes. Although self-sustaining growth remains in the distant future for Mozambique, policy developments since 1987 and production assistance for agriculture have helped reverse declining growth rates to positive GDP growth in 1987 and 1988.

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INITIAL ENVIRONMENTAL EXAMINATION

1. PROJECT TITLE: Private Sector Support Program
   PROJECT NUMBER: 656-0208
   PREPARED BY: Carlos Pascual

2. Environmental Determination

The Bureau Environmental Advisor, based on available project documentation (PAAD) as well as Committee discussion, has determined that the Private Sector Support Program falls within those classes of projects excluded from further environmental review (Reg 16, Section 216.1 (C) (1) (II)). However, to satisfy the concerns regarding possible long-term environmental effects to the natural resource base (Nairobi 20274), long-term impacts on soil fertility, erosion and deforestation will be considered under the impact assessments carried out on the model farms to be set up under this program.

3. Project Objective

The stated objectives of this program are to:

- a. Improve incentives for private agricultural production in order to enhance the private agricultural sector's production and income, and

- b. Progress toward the goal which is to increase agricultural production and exports and promote food security.

4. Environmental Considerations and Recommendations

Pursuant to 22 CFR Part 216, categorical exclusions are allowed for two broad classes of actions for which an initial environmental examination is not required. Section 216.2 (C) (1) (I) provides that categorical exclusions may be given if there is no adverse impact on the environment. This is the first broad class. The second class is 216.2 (C) (1) (II) which provides that actions can have an effect on the environment but, in its part of the activity, A.I.D. has neither knowledge nor control of specifics related to the environmental effect.

The subject Commodity Import Program makes foreign exchange available to private sector companies for importing a range of commodities categorized as farm equipment, transport equipment, irrigation equipment, fertilizer and seed. Procurement will be conducted under the provisions of A.I.D. Regulations and will be financed by A.I.D. Direct Letters of Commitment. Although the general categories of equipment are known, the implementation of this program precludes A.I.D. knowing or controlling the specific commodities imported other than within the broadly described categories, the timing of utilization of said commodities, the location of utilization of said commodities or any of the other factors which would make an environmental assessment useful and realistic. Accordingly, the applicable basis for a categorical exclusion is 216.2 (C) (1) (II).

In the interest of addressing environmental concerns however, especially the long-term effects to the natural resource base which have been expressed earlier (Nairobi 20274), long-term impacts on soil fertility, erosion and deforestation will be considered under the impact assessments carried out on the model farms to be set up under this program. A brief description of this Impact Assessment is given below (Attachment 1). It is recommended that the results of these Impact Assessments be reviewed by the Regional Environmental Officer and that he/she observe any on-going model farm activities bearing on this topic.

In addition, it is recommended that an end of program evaluation be conducted to ascertain environmental impacts from the utilization of the equipment (if possible) and recommended governmental actions to address identified environmental concerns.

Approved ✓

Disapproved______

Date 7/14/89

AFR/TR/ANR, John J. Gaudet
AFR Bureau Environmental Officer

<u>Clearance:</u>

GC/AFR:Mark Fittipaldi mff Date 7/24/89

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Attachment 1

Impact Assessments

Neither the GOM nor USAID has the staff capacity to monitor the farm-level impacts of policy changes and program commodities. Consequently, the Mission will select at least three model farms in each of the provinces reached by the program to track program impact and to develop a better understanding of overall farming and marketing systems in each area. The Mission will also contract with a local research institution, if possble, to assess the impact of policy reforms and the provision of commodities on a limited sample of family farmers. If a local entity cannot be found to undertake the family farm sector analyses, the Mission will seek external assistance, preferably from a regionally based contractor or research institution.

The focus of the monitoring program will be qualitative assessment rather than statistically significant quantitative analysis. Issues that will be monitored over three years on the model farms include:

--changes in farmer income, production, expenditure patterns and economic status;

--farmer awareness of and responsiveness to changing policy incentives;

--uses of program commodities, considerations in investment decisions, and technical constraints to production;

--the process and extent of technology transfer from commercial farmers to family farmers;

--changes in rural employment and land tenure patterns;

--program impact on women, both in the agricultural system and as traders;

--developments in rural transport and marketing networks; and

--long-term effects on soil fertility, soil erosion and deforestation.

For the 21 model farms, USAID will seek to select units which represent various techniques of commercial farming. The PSC agricultural economist and the field monitor will conduct quarterly visits to each model farm. The Mission commodity management, evaluation and the women in development officers will also participate in selected visits.

Waiver of Requirements to Establish an Interest-Bearing Special Account

Issue: The PAAD proposes to waive the Agency policy that local currency generations under non-project assistance activities be placed in interest-bearing accounts.

Discussion: In August, 1989, the Governments of the United States of America and Mozambique will enter into a policy reform program, entitled the Mozambique Private Sector Support Program. The program is designed to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. This program reinforces a broader structural adjustment initiative, called the Economic Rehabilitation Program (ERP), which the Government of Mozambique has been implementing with the World Bank, IMF and bilateral donor assistance. One of the critical dimensions of the ERP has been to control government expenditures, particularly, government recourse to bank credit.

Given that the GOM has committed itself to a significant and far-reaching economic reform program, it is imperative that USAID's use of counterpart funds be supportive, rather than destructive, of this program. Two key reform areas under the ERP which affect the ability of banks to pay interest on deposit accounts are measures to reduce excess liquidity in the economy and improve the efficiency of credit utilization. Initiatives being taken to put the extension of credit on a sound commercial basis include the prompt payment of interest charges on new bank loans and separating the commercial from the central banking functions of the Bank of Mozambique. A review of nonperforming bank loans from the past has been undertaken and will continue. Banks will be encouraged to develop procedures for loan classification based on the period of delinquency, and to establish reserve amounts to take into account the nonperforming loans.

Notwithstanding these positive developments, the current excess liquidity position of Mozambique's banks prevents them from offering interest on deposit accounts. USAID investigated the possibility of establishing interest-bearing accounts for the various local currency deposits that concern A.I.D. -- CIP, food aid and trust funds -- and was advised as follows:

1. Neither of the two government banks (Bank of Mozambique and the Banco Popular de Desenvolvimento) nor the one private bank pay interest on deposits.

2. The private bank (Standard Totta) managing director said that he could not afford to accept any deposits which required the payment of interest, as his deposits greatly exceeded the bank's loans, and the earnings on loans were so low that the payments of interest on deposits would sink his bank. Furthermore, he said that if he were forced to pay interests on deposits, he would have to close accounts and not open any new accounts.

A.I.D. policy (as contained in State 327494, dated October 21, 1987) states that interest-bearing accounts should be used ". . . so long as such accounts . . . . do not undermine internationally-supported stabilization agreements and sound monetary policy." It is clear that to insist on the payment of interest on counterpart generation deposits in the current situation would seriously impair the banking sector and threaten the monetary and credit reform program being implemented with the IMF and the World Bank.

It is further stated in this policy guidance that: "A determination not to follow A.I.D.'s preference for interest-bearing accounts may be made by the highest A.I.D. official at post." Such a determination was made by USAID/Mozambique by cable (1989 Maputo 2063) for all of the Mission's local currency-generating programs. This waiver would be reconfirmed for the Mozambique Private Sector Support Program through the Acting Assistant Administrator's approval of the overall Mozambique Private Sector Support PAAD.

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