PD-ABJ-060
89398

MOZAMBIQUE

PRIVATE SECTOR SUPPORT PROGRAM

(656-0208/18)

Amendment No. 4

June 28, 1991

Working File Copy

ACTION MEMORANDUM FOR THE DIRECTOR, USAID/MOZAMBIQUE

FROM: Carlos Pascual, Program Officer

SUBJECT: Amendment to the Private Sector Support Program (656-0208/18)

I. Problem

You are requested to: (a) approve an amendment to the Private Sector Support Program (PSSP) to expand the list of eligible commodities and geographical coverage of the program, and (b) authorize $17,390,000 for obligation to this program in FY 1991.

II. Background

The purpose of the PSSP is to improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. To achieve this purpose, the PSSP addresses five fundamental constraints to private agricultural production and marketing -- prices, land access, availability of inputs (including petroleum products), availability of foreign exchange, and market access -- through policy reform. Funds have been provided to increase the availability of foreign exchange (planned LOP total $53,440,000) and to provide technical and related assistance in support of the policy reform agenda (planned LOP total $3 million under 656-0218).[1]

III. Discussion

A. Progress to Date

With respect to the disbursement of PSSP funds, the condition precedent to disbursement under Section 2.7 of the Program Grant Agreement as amended has been satisfied. The Government of Mozambique has made significant progress toward achieving the policy objectives of the program and has met the agreed-to policy reform benchmarks. The work plan for the second year of the program, as described in the Updated Letters of Intent attached as Annex C to previous amendments to the Program Grant Agreement, has been followed. Policy progress was reported in 91 Maputo 1282 and is further discussed in Section III.B. of this PAAD amendment.

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[1]The non-project assistance component of the PSSP was originally approved at $44,050,000 and then increased to $54,050,000 in FY 1990 to support an additional set of policy reforms. The approved total was a program estimate based upon potential OYB levels. Actual obligations will be $610,000 less than the approved total as a result of actual OYB allocations.

B. FY 1991-92 Program

The revised policy objectives and workplan for 1991-92 are described in Section III.C. of the PAAD amendment and summarized in the attached policy reform matrix. Benchmarks for this year are:

Agricultural Prices

- Adjust producer floor prices to maintain parity base; and
- Deregulate consumer price of rice by January 31, 1992.

State Farm Divestiture

- Maintain credit and subsidy ceilings for state agricultural enterprises;
- Continue divestitures;
- Continue analysis of divestiture experience and development of divestiture policies and guidelines; and
- Develop, announce, and implement procedures to increase transparency of divestiture process.

Private Agricultural Sales and Services

- Maintain private importation and distribution of A.I.D.-financed commodities (except petroleum);
- Continue privatization of agriculture-related state enterprises; and
- Continue direct private sales of commodities to end-users.

Access to Foreign Exchange

- Establish a "negative list" for imports at the official exchange rate and move non-traditional exports to the secondary exchange market;
- Unify the official and secondary exchange rates by March 1992; and
- Develop plans for market-based allocation and pricing of FX following unification of official and secondary rates.

Private Marketing Channels

- Assess impact of marketing deregulations announced in June 1991; and
- Complete analysis and take steps to simplify licensing requirements for private marketing agents at all levels to encourage new competitors.

Petroleum Importation and Marketing

- Maintain consumer price for gasoline at or above import parity at the MSC rate and continue to adjust consumer price of diesel to reflect exchange rate and international price changes;
- Complete analysis and implement recommendations for deregulating import, distribution, and pricing of avgas; and
- Analyze import and distribution of petroleum products to identify further measures to support a more efficient market for these.

Mozambique Private Sector Support Program (656-0208)
Summary of Policy Objectives and Workplan
June 1991 Revision

Table 7

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
1. Agricultural Pricing Policy	OBJECTIVE: To maximize the liberalization of the agricultural pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural prices on world parity.			- Price changes and announcements.	- Production increases on family and commercial farms. - Farm income increases on family and commercial farms. - More consistent supply in markets throughout year.	- Production statistics by crop, province, farm type. - Estimated farm income calculated from production functions. - Selected market surveys.
a. Maize, beans, rice	- Establish parity producer prices; plan for floor price system. (Note: beans actually moved to floor price in 1989.)	- Move white maize to parity-based producer floor price system; continue parity-based producer floor price for beans; adjust parity-based producer price of rice; assess impact and make recommendations re: rice.	- Adjust producer floor prices to maintain parity base.			
b. Cash crops	- Establish parity-based floor price system.	- Adjust floor prices to maintain parity base.	- Adjust floor prices to maintain parity base.			
c. Consumer prices		- Deregulate consumer price for white maize; assess impact; make recommendations re: beans and rice.	- Deregulate consumer price for rice by January 31, 1992.			
2. Divestiture of State Farms	OBJECTIVE: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling, and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of divestiture program.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and implementation	- Continue case-by-case divestitures of state farms. - Identify issues and policies to be addressed in divestiture program. - Complete terms of reference for additional tenure analyses and design of divestiture program.	- Implement analysis program on tenure issues. - Complete general divestiture program design. - Complete design of USAID-financed program for divestiture policy research and analysis.	- Maintain credit and subsidy ceilings for state agricultural enterprises. - Continue divestitures. - Continue analysis of divestiture experience and development of policies and guidelines. - Develop, announce, implement procedures to increase transparency of divestiture process.			
3. Private Ag. Sales and Service	OBJECTIVE: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/traders participating in program. - Elimination of "credential system" for end users.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For importers/distributors	- Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	- A.I.D. commodity imports fully private (except for petroleum); plan to privatize ag-related public enterprises.	- Maintain private import/distribution of AID-financed commodities (ex. petroleum). - Continue privatization of ag-related state enterprises.			
b. For end users	- Replace GOM administrative allocation system with direct private sales.	- Maintain.	- Continue direct private sales to end users.			

Mozambique Private Sector Support Program (656-0208)
Summary of Policy Objectives and Workplan
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Table 7

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
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.	- Increased access to foreign exchange at market-determined price.	- Survey of OGL users to determine private sector access.
a. Allocation mechanism	- Establish limited trial of OGL system.	- Evaluate effectiveness of OGL trial (with IBRD with USAID follow-up). - If trial is generally successful, modify and expand eligible sectors under OGL; otherwise formulate new options.	- Establish "negative list" for imports at official exchange rate; move non-traditional exports to MSC. - Unify official and MSC exchange rates by March 1992. - Develop plans for market-based allocation/pricing of FX following unification.	- Range of eligible OGL sectors and volumes of FX increased.		- Trends in official and parallel exchange rates.
5. Private Marketing Channels	OBJECTIVE: To reduce restrictions on competitive private sector trade and transportation serving agricultural producers in Cabo Delgado, Nampula, and Zambezia provinces.			- Announcement and promotion of deregulations.	- Increased number of active traders and transporters.	- Sampling of traders/transporters/farmers.
a. Movement of commodities		- Rescind regulatory restrictions on inter-district and inter-provincial movement of agricultural commodities.	- Assess impact.		- More consistent supply of commodities in markets throughout the year.	- Market surveys.
b. Wholesaling		- Open district wholesaling opportunities to any licensed trader desiring to compete.	- Assess impact.		- Increased producer access to consumer goods and other "incentive" commodities. - Improved food balances between deficit and surplus production areas.	- Sampling of farmers.
c. Licensing		- Analyse licensing requirements for private marketing agents at all levels to assess disincentive effects.	- Complete analysis and take steps to simplify licensing requirements to encourage new competitors.			
6. Petroleum Importation and Marketing	OBJECTIVE: To promote increased and more reliable access to selected petroleum products at import parity prices based on the secondary market exchange rate.			- Announcement and promotion of price changes and deregulations.	- More consistent supply of and access to petroleum products nationwide.	- Sampling of farmers, transporters, traders, and industries. - Sampling of importers/-distributors. - Trends in prices of diesel and gasoline.
a. Pricing			- Maintain consumer price for gasoline at or above import parity at the MSC rate and continue to adjust consumer price of diesel to reflect exchange rate and international price changes.			
b. Deregulation			- Complete analysis and implement recommendations for deregulating import, distribution, and pricing of avgas. - Analyse import and distribution of petroleum products to identify further measures to support a more efficient market for these.		- Private sector importation and distribution of avgas.	

C. Commodity Import Program

In direct support of private sector agriculture, PSSP funds have been disbursed through a Commodity Import Program (CIP) to finance critical inputs for agricultural production and marketing, including selected petroleum products. Building on predecessor CIPs, the PSSP CIP expanded coverage from three to seven of Mozambique's ten provinces but retained a limited range of eligible commodities. As detailed in Section III.D., this amendment relaxes the remaining geographical restrictions to permit distribution of PSSP CIP-financed commodities in all ten provinces, and expands the list of eligible commodities to include all commodities on A.I.D.'s Commodity Eligibility List related to agricultural (including fisheries and livestock) production, processing, or marketing. These changes are made in accordance with and support of the Government's evolving policy to increase the volume and range of goods imported at the market-determined secondary market exchange rate and to phase out administrative controls on imports. Another factor contributing to these changes in the program is the significant improvement in the private sector network providing sales and services for agriculture-related inputs and for marketing of agricultural products.

D. Local Currency

The evolution in Mozambique's foreign exchange allocation mechanisms has resulted in two changes in the way the local currency counterpart funds are generated under the PSSP CIP. These changes are described in more detail in Section III.E.:

- The exchange rate used for calculating local currency deposit requirements will be fixed on the date USAID issues the Letter of Commitment covering an import transaction; to determine the highest legal rate on a given date, USAID will use a procedure which takes into account the fact that large volume buyers in the secondary market usually get a preferential rather than the posted MSC rate; and

- In an effort to more closely approximate standard commercial practices, importers will deposit or cause to be deposited in the Bank of Mozambique 20 percent of the estimated local currency equivalent of the dollar financing before a Letter of Commitment is issued, and will deposit the balance of the local currency equivalent before receiving the shipping and related import documents.

E. Additional Considerations

The source and origin of commodities financed under this amendment shall continue to 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 from time to time amended.

A Congressional Notification expired without objection on June 6, 1991, as indicated in State 205923.

IV. Authority

The PAAD approved on August 24, 1989 redelegated authority to you to authorize subsequent incremental obligations, and the only condition attached to this redelegation was that AID/W concurrence is required before authorizing funds for OGL disbursement. Because FY 1991 funds you are now being requested to authorize will not be disbursed through an OGL system, AID/W concurrence is not required. However, AID/W guidance provided in 91 State 88494 has been taken into account in developing this amendment, and the information requested in paragraph 11 of that cable (updated policy matrix and letter of intent) has been provided to AID/W.

Furthermore, DOA 551 Section 4 authorizes you to amend project (including non-project assistance) authorizations provided that the amendment will not result in total Life of Project funding of more than $30 million, present significant policy issues or deviate from the original project purpose, or require issuance of waivers that may not be approved by you. None of these restrictions applies here. (In 90 State 235374 you were previously authorized to exceed the $30 million LOP funding limit.)

V. Recommendation

That you (a) authorize $17,390,000 for obligation in FY 1991 to the Mozambique Private Sector Support Program, for disbursement through a CIP, and (b) approve other changes in the program as described above and detailed in the attached PAAD Amendment.

Approved: Julius P. Schlotthauer

Disapproved: ______

Date: 28 June 91

Clearances:
A/CMC:T.Born (draft 6/24/91)
CONT:M.Rocha (draft 6/26/91)
DD:J.Miller (draft 6/24/91)
RLA:T.Riedler (draft 6/13/91)

Drafted:PRM:J.Born:6/13/91

CLASSIFICATION: UNCLASSIFIED

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

Amendment No. 4

1. PAAD NO.: 656-0208 — Grant Nos. 656-T-604B, 656-T-604C

2. COUNTRY: Mozambique

3. CATEGORY: Private Sector Support Program

4. DATE: June 28, 1991

5. TO: Julius Schlotthauer, Director, USAID Mozambique

6. OYB CHANGE NO.:

7. FROM: Carlos Pascual, Program Officer

8. OYB INCREASE:

TO BE TAKEN FROM:

9. APPROVAL REQUESTED FOR COMMITMENT OF:
$ 656-T-604B:$15,390,000: 72-111/21014: BPC GSS1-91-31656-KG32: 181-61-656-00-59-11
656-T-604C:$ 2,000,000: 72-110/11014: BPC GSSO-91-31656-KG32: 081-61-656-00-59-11

10. APPROPRIATION - ALLOTMENT

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

All commodities on A.I.D.'s Commodity Eligibility List related to agricultural (including fisheries and livestock) production, processing or marketing. These include but are not limited to tractors, implements, trucks, spare parts, engines for farm or transport equipment, seeds, fertilizers, petroleum, small mills, etc.

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	To Be Determined
U.S. only:		U.S.:	
Limited F.W.:			Special Free World (935)
Free World:	$17,390,000	Local:	
Cash:			Selected Free World (941)

18. SUMMARY DESCRIPTION

See Attached.

19. CLEARANCES

	DATE
A/CMO: T. Born (draft)	6/24/91
CON: M. Rocha (draft)	6/26/91
RLA: T. Riedler (draft)	6/14/91
DD: J. Miller (draft)	6/24/91
PRM: J. Born	6/28/91

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Julius P. Schlotthauer

AUTHORIZED SIGNATURE

28 June 91

Director, USAID Mozambique

TITLE

CLASSIFICATION

Pursuant to the Foreign Assistance Act of 1961, the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1991, and the delegations of authority contained in Delegation of Authority 551 and the Program Assistance Approval Document ("PAAD") approved by the A/AA/AFR on August 24, 1989 for the Private Sector Support Program ("Program"), I hereby authorize an additional increment of $17,390,000 of non-project assistance funding for the Program for FY 1991, and otherwise amend the original PAAD, as previously amended, as follows. This additional funding is the final increment to be authorized and obligated under the Program and brings the total authorized Program funding to $53,440,000. This total is $610,000 less than the total funding previously contemplated for the Program.

The Program is also amended to permit distribution of Program-financed commodities in all ten provinces in Mozambique, and the list of commodities eligible under the Program is expanded to include all commodities on A.I.D.'s Commodity Eligibility List related to agricultural (including fisheries and livestock) production, processing, or marketing. The policy framework under the Program, as described in the Annex C, Updated Letter of Intent, attached to the amended Program Grant Agreement, is revised to reflect policy progress to date and the evolving policy environment. All funds authorized hereunder will be disbursed through a CIP.

Except as specifically amended herein, the terms and conditions of the original PAAD approved August 24, 1989, as previously amended, remain in full force and effect.

Mozambique Private Sector Support Program (656-0208)

Amendment Number Four to the
Program Assistance Approval Document

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Mozambique Private Sector Support Program (656-0208)

Amendment Number Four to the
Program Assistance Approval Document

I. Program Factors

The Private Sector Support Program (PSSP) will provide in 1991 its third year of assistance for Mozambique's economic stabilization and adjustment effort. The PSSP concentrates its efforts on the agriculture sector, and in particular on production and marketing activities, but is decidedly linked to the larger task of transforming the Mozambique economy as a whole. In that regard, it is useful to provide a snapshot of the economic setting in which the PSSP operates.

A. Macroeconomic Update, 1987-90

The original PSSP PAAD, dated August 1989, provided a brief sketch of developments in Mozambique's macroeconomy through 1986, with indications of the policy framework objectives for 1987-89. The PAAD Amendment prepared in July 1990 updated that discussion, particularly with respect to the policy framework. It is appropriate now to examine the post-1986 period to see how the stabilization and adjustment program has fared.

1. Policy Framework Developments

A revised PFP (policy framework paper), embodying joint understandings among the GRM (Government of the Republic of Mozambique), the IBRD, and the IMF, is currently (in June 1991) under preparation and not available for our review. The May 1990 version of the PFP, however, provides a useful perspective on the policy framework. The May 1990 PFP collects the policy reform intentions of the GRM in ten categories.

- Exchange and trade reform is a key policy reform area under the program. The GRM in 1987 reversed what had been a steady real effective appreciation of the exchange rate, and has managed to carry out further depreciations, in real effective terms, during the three subsequent years. The foreign exchange allocation system has undergone two reforms, the first to establish an OGL-like experiment and the second to create a secondary foreign exchange market (called the MSC) which partially liberalized transactions (largely invisible) at an exchange rate in excess of the official rate. Although the official exchange rate is still significantly off equilibrium, the GRM extensively devalued the official rate in April 1991 and is finalizing a program with the IMF intended to unify the official and the new secondary markets by March 1992 at an equilibrium rate.

- Pricing and distribution policies have received much attention by the GRM, to the extent possible given the insecurity situation in the country and Mozambicans' concomitant poverty. Generally, the number of controlled prices throughout Mozambique has declined dramatically, in an attempt to have domestic prices reflect border parity. The majority of consumer prices have been completely decontrolled, and producer prices in the agriculture sector are market-determined with floor prices guaranteed to protect producers. Industrial prices are generally "conditioned," permitting producers to adjust prices according to prearranged formulae to reflect costs. Finally, administered prices (on products such as petroleum products, air travel, telephone use, housing, and electricity use) have been regularly increased to take account of underlying cost considerations.

- **Public sector finances** have also been a key reform area, with the GRM attempting to reduce the public deficit to within manageable limits. The objective by 1992 is to generate sufficient public savings (including foreign financing) that the GRM can begin net repayments to the domestic banking system. Although revenues as a share of GDP have probably peaked sufficiently, there have been efforts to further rationalize the tax system. On the expenditure side, wage payments must continue to be contained and subsidies increasingly reduced. On the investment side, the GRM drew up a three-year rolling public sector investment program.

- **Enterprise reform**, another area of policy reform, has focused on establishing management contracts with overseas enterprises, encouraging direct foreign investment, promoting joint ventures, and divesting some state enterprises. Such reforms enable the GRM to extricate itself from activities that are, by its own admission, better left to the private sector. However, given the paramount control that Government maintained over the economy for an extended period, much needs to be done in this regard.

- **Financial sector policy reforms** are important to the success of the overall adjustment program, and the financial sector is likely to become an increasingly binding constraint on development. This is equally attributable to the very shallow state of financial development in Mozambique, and to the fact that any financial development is relatively slow in coming. A key element of the financial reforms is to divorce the Bank of Mozambique's commercial banking functions from its central banking functions. This effort began during 1990 and continues, but is still far from complete. Interest rate policy has changed: although still controlled, interest rates by the end of 1990 were in some cases positive in real terms, for the first time in a decade.

- The primary focus of **agriculture policy** over the past year and more has been a continuation of the relaxation of price controls. Currently, as noted earlier, the bulk of producer prices are administered only as floor prices. Consumer prices have been largely freed, with the exception of the yellow maize price, which remains subsidized as an urban food security measure, and rice.

- In industry, energy, and transport policy, the GRM has continued, as with agriculture, to work on deregulating prices, a task not yet completed but already far along. As of the second quarter of 1990, partly in connection with Gulf War events, gasoline prices were raised to a level covering procurement, taxes, and domestic handling costs at the secondary market exchange rate. In industry, the GRM during 1990 privatized some 40 small enterprises and signed management contracts for another five larger state enterprises. These represent initial steps in what is likely to be a long process.

- Finally, social policy is critical, given the severe conditions of poverty in Mozambique, with some 60 percent of Mozambicans living in absolute poverty. One element of social policy in which USAID has been centrally involved is the attempt to improve the targeting of food subsidies by focusing them on yellow maize, an inferior consumption good. As to health and education, preliminary efforts are being made with donor support, but it is clear that progress will not come rapidly.

2. Macroeconomic Performance

Mozambique has reversed its economic decline and achieved significant growth since 1987 (when it began its Economic Rehabilitation Program). These improvements have come during a period when the civil war continues, a situation under which reform measures are having less than a country-wide effect. Especially during the period through 1989, performance was very good, largely a tribute to the policy measures undertaken. During 1990, however, there was a perceptible fall-off, especially in terms of growth indicators, but also in terms of inflation containment. Thus, despite the more than adequate performance to date, it is important not only that complacency not set in, but that the country redouble its efforts.

a. Production and Use of Resources

Gross domestic product grew at an average annual rate of over five percent between 1986 and 1989, well in excess of the 2.6 percent population growth rate (see Table 1). Agriculture and industry, which account for approximately 50 percent of value added, spearheaded this growth, with agriculture growing at over six percent per year (on average) and industry growing at over 7.5 percent. These growth rates are, of course, partly due to a recovery from significant negative growth in the two sectors throughout the first half of the decade. At the same time, the growth is attributable to improvements in the policy framework. Agriculture has benefited not only from more rational, liberalized producer prices, but also from exchange rate-related export price incentives. Industry has also responded to output pricing changes, but has probably been given a greater boost by the reform-engendered increases in external support, support which has enabled the country to increase its imports of industry-required products.

The increase in external support, coupled with the growth of GDP, has had a positive impact on consumption and investment in Mozambique. Investment, as a share of GDP, increased from a very low 10 percent (probably insufficient to cover depreciation) in 1986 to about 35 percent in 1989. In part, this increased share is due to large price increases for capital goods reflecting exchange rate adjustments. However, investment has also grown in real terms, at an average annual rate of over 12 percent between 1986 and 1989. Given the debilitation of the country's capital stock over the past decade, strong investment growth is necessary even given that much of the economy is operating below capacity. Consumption has grown over the period, even given the strong investment growth, such that per-capita private consumption has grown slightly. Although this says nothing about the distribution of this growth, it is a favorable development that is at least partly due to an inflow of donor food support.

Performance in 1990 was disappointing.[1] The most recent published data suggest that the GDP growth rate dropped to three percent and, with a reduction in the real growth of imports, both consumption and investment growth suffered. On a per-capita basis, private consumption regressed to approximately its 1986 level, assuming zero growth of private consumption in 1990. The real growth rate of investment is estimated at two percent during 1990, also a significant regression. More recent indications are that GDP growth was probably only half the estimated three percent level, implying even grimmer statistics for consumption in 1990. (Generally, investment data are relatively better, and consumption is calculated as a residual in the national accounts.)

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[1] To some extent, the performance data for 1990 must be analyzed with caution. Particularly in agriculture, the GRM has relied heavily on its parastatal marketing agency to report production. As pricing and distribution policy reforms have increasingly encouraged private production and trade, parastatals have had a poor understanding of overall production levels, in most cases understating the level of production. For example, the GRM reported a 50 percent shortfall in maize supplies for 1990, yet nutrition data improved in every province of the country. This suggests that production was indeed significantly higher than registered in official statistics.

Table 1. Production and Use of Resources, 1986-90

Table 1. Production and Use of Resources, 1986-90

	1986	1987	1988	1989	1990
			(billion current meticais)		
Gross Domestic Product	167	423	657	966	1378
Net Imports of Goods and Nonfactor Services	18	151	328	503	682
Imports	24	202	427	652	885
Exports	6	51	99	149	203
Gross Domestic Expenditure	185	575	985	1469	2059
Consumption	169	473	765	1126	1576
Private	142	405	650	931	1309
Public	27	68	115	195	268
Gross Investment	16	102	220	343	483
Private Investment	7	34	61	112	178
Public Investment	9	68	159	231	305
Gross Savings	16	102	220	343	482
Public Savings	-15	41	151	205	271
Private Savings	15	-52	-80	-142	-149
Foreign Savings	17	113	149	280	360
			(percent of GDP)		
Gross Domestic Product	100	100	100	100	100
Net Imports of Goods and Nonfactor Services	11	36	50	52	49
Imports	14	48	65	67	64
Exports	4	12	15	15	15
Gross Domestic Expenditure	111	136	150	152	149
Consumption	101	112	116	117	114
Private	85	96	99	96	95
Public	16	16	18	20	19
Gross Investment	10	24	33	35	35
Private Investment	4	8	9	12	13
Public Investment	6	16	24	24	22
Gross Savings	10	24	33	36	35
Public Savings	-9	10	23	21	20
Private Savings	9	-12	-12	-15	-11
Foreign Savings	10	27	23	29	26

Table 1. Production and Use of Resources, 1986-90 (cont'd)

Table 1. Production and Use of Resources, 1986-90 (cont'd)

	1986	1987	1988	1989	1990
			(percent real growth)		
Gross Domestic Product	1.8	5.8	5.6	4.9	3.0
Imports		4.4	8.2	4.4	1.8
Exports		10.0	11.1	9.2	9.0
Gross Domestic Expenditure	2.5	4.4	5.9	4.5	0.6
Private Consumption	-1.1	3.5	3.5	2.3	negl
Public Consumption	1.0	2.2	4.5	12.0	1.0
Gross Investment	51.4	16.0	16.5	7.3	2.0
			(percent price change)		
Gross Domestic Product	12.8	142.4	47.2	39.5	38.4
Imports		709.0	95.2	46.3	37.2
Exports		673.0	75.7	37.5	25.0
Gross Domestic Expenditure	11.9	197.7	61.8	42.7	39.3
Private Consumption	12.2	175.8	55.0	40.0	40.5
Public Consumption	13.9	147.8	63.2	51.2	36.0
Gross Investment	6.0	441.5	85.1	45.5	38.0
			(percent of GDP)		
Total Economy					
Gross Investment	9.7	24.1	33.4	35.5	35.0
Gross National Savings	0.3	-2.5	10.8	6.5	8.9
Gross Domestic Savings	-1.1	-11.7	-16.5	-16.5	-14.5
Net Factor Income and Transfers	0.8	9.2	27.3	23.0	23.4
Public Sector					
Gross Investment	5.6	16.1	24.2	23.9	22.1
Gross National Savings	-9.2	9.8	22.9	21.2	19.7
Gross Domestic Savings	-12.2	-5.2	-2.8	-2.0	-3.5
Net Factor Income and Transfers	3.0	15.0	25.7	23.2	23.2
Private Sector					
Gross Investment	4.1	8.0	9.2	11.6	12.9
Gross National Savings	8.9	-12.3	-12.1	-14.7	-10.8
Gross Domestic Savings	11.1	-6.5	-13.7	-14.5	-11.0
Net Factor Income and Transfers	-2.2	-5.8	1.6	-0.2	0.2

b. External Sector Developments

Despite a 60 percent increase in the volume of exports between 1986 and 1990, Mozambique's merchandise trade balance worsened significantly over the period (see Table 2). In part, this was due to a sharp worsening in the terms of trade, which declined by over 30 percent as import prices increased over 30 percent and export prices declined by about eight percent. In greater part, the decline in the trade balance was caused by the structure of Mozambique's trade: merchandise exports are very small relative to imports, covering only about 15 percent of the import bill. Thus, it would have taken an impossibly high growth in exports to yield a reduction in the trade deficit. The deficit grew from about $450 million to about $750 million over the period.

Fortunately, largely as a result of the growing, reform program-stimulated inflow of foreign grants and concessional loans, the trade deficit was covered. The other major factor in the balance of payments is the debt service account. Mozambique is in a distinctly undesirable situation, with debt service commitments amounting to nearly twice the volume of export earnings on goods and nonfactor services. As with the gross inflows of donor funds, here again Mozambique has reaped gains from its adherence to a structural reform program. Over the past four years, debt restructuring has been approximately equal to debt service commitments. Relatively little of this debt has been canceled, however, and debt service commitments will increase steadily between now and the end of the decade. Mozambique's London Club creditors are expected in the near future to effectively wipe out the country's commercial bank debt through buy-backs. Clearly, for the foreseeable future, Mozambique will continue to be very dependent on a combination of external financing and debt restructuring. It is inconceivable that export growth can occur at a pace that will any more than marginally reduce this dependence.

Over the course of the past four years, the GRM has steadily worked to improve the country's external competitiveness by depreciating the heavily overvalued metical. Following a severe devaluation during 1987, at the outset of the stabilization and adjustment program, the GRM has depreciated the metical against the dollar at an average rate of over 25 percent per year. However, the relatively high rate of inflation in Mozambique has eroded the nominal gains over the past three years. Indeed, prior to a significant devaluation in the latter part of 1990, it appeared that all the ground gained since 1987 had been lost, in real effective terms. As of the end of 1990, as it turned out, the IMF estimated the real effective depreciation as being on the order of 11 percent compared with yearend 1989. Unfortunately,

Table 2. Sources and Uses of Foreign Exchange, 1986-2000

	1986	1987	1988	1989	1990	1991	1995	2000	AVG YRLY CHANGE, 1991-2000
FOREIGN EXCHANGE SOURCES					(millions of U.S. dollars)				
Export Earnings (FOB)	79	97	103	105	117	139	263	621	18.2
Service Earnings	119	137	157	167	170	160	221	406	9.1
Private Transfers			78	85	90	92	100	110	2.0
Official Transfers	213	304	377	388	427	539	596	690	4.9
Foreign Borrowing (incl Direct Investment)	284	301	227	244	304	284	317	358	1.6
TOTAL SOURCES	695	839	942	989	1108	1214	1497	2185	7.0
FOREIGN EXCHANGE USES									
Imports (CIF)	543	625	736	808	870	958	1213	1678	6.8
Non-Interest Service Expenditures	123	137	143	142	152	156	174	201	2.8
Debt Service Payments	491	532	495	484	503	501	418	691	3.2
Interest Payments	155	148	117	169	165	189	192	200	1.9
Amortization Payments	336	384	378	315	338	312	226	491	3.8
TOTAL USES	1157	1294	1374	1434	1525	1615	1805	2570	5.4
Errors and Omissions	-27	29	59	25	10				
OVERALL BALANCES									
Merchandise Trade Balance	-464	-528	-633	-703	-753	-819	-950	-1057	
Current Account (before grants)	-623	-676	-658	-762	-810	-912	-995	-942	
Current Account (including grants)	-410	-372	-281	-374	-383	-373	-399	-252	
Overall Balance for Financing	-489	-426	-373	-420	-407	-401	-508	-385	

MEMORANDUM ITEMS	1986	1987	1988	1989	1990	AVG YRLY CHANGE
			(percent)			
Terms of Trade Index	100.0	97.0	85.5	81.6	70.5	-8.4
Export Prices	100.0	107.4	103.9	101.3	92.4	-2.0
Import Prices	100.0	110.7	121.5	124.1	131.0	7.0
Trade Volume						
Export Volume	100.0	114.5	125.4	130.9	160.2	12.5
Import Volume	100.0	106.9	111.7	120.1	122.5	5.2

Table 2. Sources and Uses of Foreign Exchange, 1986-2000 (cont'd)

	1986	1987	1988	1989	1990	1991	1995	2000
					(millions of U.S. dollars)			
FINANCING	489	426	373	420	407	401	308	385
Net Foreign Assets (- is increase)	6	-58	-25	-2	9	0	-50	-51
IMF Transactions	0	15	25	16	12	40	-12	-21
Other Assets	6	-73	-50	-18	-3	-40	-38	-30
Debt Restructuring	0	1092	398	21	796	712	29	4
Cancelled			17	21	17	19	29	4
Rescheduled		1092	381		779	693		
Change in Arrears (+ is increase)	482	-608		398	-398	-311		
FINANCING GAP							329	432
	====	====	====	====	====	====	====	====
MEMORANDUM ITEMS					(expressed in percent)			
Debt Service/Exports (GNFS)	247.5	227.6	190.6	177.9	175.3	167.6	86.4	67.3
Debt Service/Total Uses	42.4	41.1	36.0	33.8	33.0	31.0	23.2	26.9
Interest/Debt Service	31.6	27.9	23.6	34.9	32.8	37.7	45.9	28.9
Exports/Imports (Merchandise	14.6	15.5	14.0	13.0	13.4	14.5	21.7	37.0
Overall Balance/Total Uses	42.2	32.9	27.2	29.3	26.7	23.6	17.1	15.0
External Financing/Total Sources	71.5	72.1	64.1	63.9	66.0	68.3	61.0	48.0
Debt Service/External Financing	98.6	88.0	81.9	76.6	68.8	59.4	45.8	65.9
Financing Gap/Debt Service							78.8	62.5
			(NOTE: "-" indicates depreciation)					
Exchange Rate Movements (end of period)								
Dollar/Metical Rate	6.4	-90.4	-35.5	-23.6	-21.0			
Nominal Effective Exchange Rate	-7.2	-91.4	-27.8	-20.6	n.a.			
Real Effective Exchange Rate	22.2	-77.3	1.8	-6.1	-11.0			

subsequent inflation estimates revised the earlier 30 percent rate upward to 47 percent, thereby implying that the real effective exchange rate for year-end 1990 had actually appreciated by several percentage points. To compensate, the GRM devalued the official exchange rate by 18 percent in nominal terms in April 1991 and has continued since then to implement gradual monthly devaluations. Exchange rate management clearly remains a difficult issue for Mozambique.

c. Public Finances

The Government's performance in public finances in the years since 1986 has been impressive. Recurrent revenues, which had reached an extremely low level of 13 percent of GDP in 1986, have been bolstered, and amounted to a respectable -- and probably adequate -- level of 24 percent of GDP in 1989 (see Table 3). The GRM's objective of containing recurrent expenditures has also been met, thereby reducing the recurrent deficit (before grants) from an unacceptably high level of 12 percent of GDP in 1986 to a relatively tame level of two percent of GDP in 1989. The increase in public investment as a share of GDP (from six percent in 1986 to 22 percent in 1989) was entirely covered by an increase in external grants. The result of these fiscal policy measures has been to reduce the overall fiscal deficit to the point that it is basically covered by net external borrowing. Consequently, borrowing from the domestic banking system has been reduced from 12 percent of GDP in 1986 to the point that there was a small repayment by Government to the banking system during 1989.

At first blush, it appears that some retrogression occurred during 1990. The recurrent revenue-GDP ratio declined by about two percentage points, an undesirable situation given recurrent expenditures stayed even. The combination of the resulting increase in the recurrent deficit, a small drop-off in external grants, and a three percentage point increase in public investment, increased the overall balance for financing by four percentage points (from eight percent in 1989 to 12 percent in 1990). Fortunately, an increase in project-related loans enabled the GRM to face only a very minor increase in domestic banking system financing of the public sector, an increase within the GRM's program objectives. At the same time, given the fact that the relatively low level of the public sector balances are based on calculating interest payments on a cash basis, rather than an accrual basis, fiscal management must remain tight.

Table 3. Public Finances, 1986-91

	(billion meticais, cash basis)					
						BUDGET
	1986	1987	1988	1989	1990	1991
	----	----	----	----	----	----
REVENUES	26.0	108.2	222.5	386.3	518.2	751.3
Tax Revenue	15.6	58.1	110.1	199.8	260.4	347.4
Nontax Revenue	6.5	10.5	20.6	26.7	34.5	47.6
External Grants	3.9	39.6	91.8	159.8	223.3	356.3
Project Related	2.1	30.3	48.4	96.7	126.7	204.7
Non-Project	1.8	9.3	43.4	63.1	96.6	151.6
EXPENDITURES	51.7	158.6	288.1	460.5	688.4	861.8
Recurrent Expenditure	42.4	90.6	148.4	246.2	342.8	443.3
Salary and Wages	8.0	15.0	24.8	43.0	63.0	87.5
Interest	0.8	8.3	15.4	30.9	44.0	55.0
Other	33.6	67.3	108.2	172.3	235.8	300.8
Investment	9.3	68.0	139.7	214.3	345.6	418.5
CURRENT BALANCE						
Before Grants	-20.3	-22.0	-17.7	-19.7	-47.9	-48.3
Including Grants	-16.4	17.6	74.1	140.1	175.4	308.0
OVERALL BALANCE	-25.7	-50.4	-65.6	-74.2	-170.2	-110.5
FINANCING	25.7	50.4	65.6	74.2	170.2	110.5
External Borrowing	5.9	33.5	52.9	68.8	166.8	115.7
Drawings	6.1	36.0	58.0	83.0	192.8	156.7
Project-Related	5.2	20.2	34.0	38.6	148.8	125.7
Non-Project	0.9	15.8	24.0	44.4	44.0	31.0
Amortization	0.2	2.5	5.1	14.2	26.0	41.0
Domestic Borrowing	19.7	16.7	13.1	5.4	3.4	-5.2
Banking System	20.1	17.7	9.6	-10.8	3.0	-5.2
Non-Banks	-0.4	-1.0	3.5	16.2	0.4	0.0
NOTE: GDP at Current Prices	166.9	428.1	659.9	968.0	1377.5	1719.1

Table 3. Public Finances, 1986-91 (cont'd)

(percent of GDP, cash basis)

	1986	1987	1988	1989	1990	1991
REVENUES	16	25	34	40	38	44
Tax Revenue	9	14	17	21	19	20
Nontax Revenue	4	2	3	3	3	3
External Grants	2	9	14	17	16	21
Project Related	1	7	7	10	9	12
Non-Project	1	2	7	7	7	9
EXPENDITURES	31	37	44	48	50	50
Recurrent Expenditure	25	21	22	25	25	26
Salary and Wages	5	4	4	4	5	5
Interest	0	2	2	3	3	3
Other	20	16	16	18	17	17
Investment	6	16	21	22	25	24
CURRENT BALANCE						
Before Grants	-12	-5	-3	-2	-3	-3
Including Grants	-10	4	11	14	13	18
OVERALL BALANCE	-15	-12	-10	-8	-12	-6
FINANCING	15	12	10	8	12	6
External Borrowing	4	8	8	7	12	7
Drawings	4	8	9	9	14	9
Project-Related	3	5	5	4	11	7
Non-Project	1	4	4	5	3	2
Amortization	0	1	1	1	2	2
Domestic Borrowing	12	4	2	1	0	0
Banking System	12	4	1	-1	0	0
Non-Banks	0	0	1	2	0	0
MEMORANDUM ITEMS: (percent)						
Financing:						
External (net)	23	66	81	93	98	105
Domestic (net)	77	33	20	7	2	-5
External Funding/Total Outlays	32	54	54	53	62	60
External Proj. Funding/Investment	78	74	59	63	80	79

d. Money and Prices

Inflation-reduction objectives of the GRM's program have been significantly missed in each of the past two years, especially during 1990. Despite a year-end inflation target of 18 percent for 1990, and a preliminary estimate of 30 percent, actual inflation is now estimated at 47 percent. Apparently, the GRM believes that the root causes of inflation in Mozambique are less demand-induced than they are supply-driven. At the same time, however, if monetary expansion is accommodating, the effect of supply constraints on inflation will undoubtedly be realized. What has happened is that broad money, in each of the last two years, has grown by 10 to 15 percentage points higher than it was targeted to grow, despite the fact that the net domestic credit and net domestic credit to government targets have been adhered to (see Table 4). According to the IMF, the major reason for this inflation-fueling, excessive increase in broad money (or banking system liabilities) has been unanticipated increases in net unclassified assets ("Other Items" in Table 4) and in worker remittances. Given this situation, which in a direct sense is beyond the GRM's control, domestic credit expansion must be further reined in.

In terms of the GRM's agreements with the multilaterals on specific monetary sector growth restrictions, the program has operated well. Ceilings on net domestic credit and net domestic credit to the government were not breached. At the same time, a combination of poor (and tardily available) monetary statistics and unanticipated external inflows has resulted in an undercutting of program objectives. This is a particularly unfortunate situation given the poor state of price statistics that could warn of slippage. And it is unfortunate that a situation exists wherein program targets have apparently been scrupulously met, but overall program objectives (on inflation, in particular) have not been attained.

B. Outlook for 1991

Following on the heels of reportedly poor performance during 1990, in terms of growth, the external terms of trade, and inflation, it is useful to look forward to 1991 to see whether these unfavorable aspects of the economic scene can be reversed. This discussion is based on an IMF paper conveying the results of late 1990 Article IV consultations.

Mozambique's GDP growth targets for 1991 will be revised downward, from six percent to four percent, given experience during 1990. If four percent growth is indeed realized, both consumption and investment will likely benefit, with per-capita consumption growth presumably again positive. It is important to remember, however, that both elements of domestic expenditure are also dependent upon performance in the external sector.

Table 4. Monetary Survey, 1986-90

(billion meticais)	OLD SERIES--------------->				NEW SERIES------------>		
	DEC 1986	DEC 1987	DEC 1988	DEC 1989	DEC 1989	SEPT 1989	SEPT 1990
-----STOCKS-----	----	----	----	----	----	----	----
NET FOREIGN ASSETS	0.4	16.0	41.0	52.2	65.8	79.9	76.0
Foreign Assets	3.5	61.1	126.2	182.7	182.7	190.9	233.8
Foreign Liabilities	-3.1	-45.1	-85.2	-130.5	-116.9	-111.0	-157.8
NET DOMESTIC ASSETS	111.0	150.0	213.9	306.6	306.0	256.3	403.0
Net Domestic Credit	168.9	213.1	295.0	407.7	396.6	374.0	493.6
Credit to Government	32.9	42.9	52.5	41.6	30.5	32.1	31.5
Credit to Non-Government	136.0	170.2	242.5	366.1	366.1	341.9	462.1
Foreign Borrowing	-36.8	-413.7	-659.0	-872.2	-872.2	-855.5	-998.4
External Debt of BoM	-36.8	-388.8	-610.8	-759.2	-759.2	-749.7	-853.9
External Debt of GRM		-24.9	-48.2	-113.0	-113.0	-105.8	-144.5
Valuation Adjustment		351.5	559.4	722.7	720.6	709.9	843.7
Other Items	-21.1	-0.9	18.5	48.4	61.0	27.9	64.1
MONEY AND QUASI-MONEY	111.3	166.0	255.0	358.9	371.7	336.3	479.0
Currency in Circulation	32.2	36.6	61.4	83.7	83.7	81.2	107.4
Demand and Savings Deposits	75.1	119.6	183.0	258.6	271.4	238.0	349.6
Time Deposits	4.0	9.8	10.6	16.6	16.6	17.1	22.0
-----FLOWS-----	(valuation adjustments removed)						
NET FOREIGN ASSETS		11.7	13.4	-6.7			-10.9
Foreign Assets		17.4	26.1	10.0			11.3
Foreign Liabilities (- is increase)		-5.7	-12.7	-16.7			-22.2
NET DOMESTIC ASSETS		36.0	69.9	104.8			148.5
Net Domestic Credit		44.2	81.9	112.7			121.5
Credit to Government		10.0	9.6	-10.9			1.3
Credit to Non-Government		34.2	72.3	123.6			120.2
Foreign Borrowing (- is increase)		-28.4	-31.4	-37.8			-9.2
External Debt of BoM		-7.4	-15.4	22.7			22.9
External Debt of GRM		-21.0	-16.0	-60.5			-32.1
Valuation Adjustment							
Other Items (+ is assets increase)		20.2	19.4	29.9			36.2
MONEY AND QUASI-MONEY		47.8	83.4	99.4			137.6
Currency in Circulation		4.4	24.8	22.3			26.2
Demand and Savings Deposits		37.6	57.8	71.1			106.5
Time Deposits		5.8	0.8	6.0			4.9

Table 4. Monetary Survey, 1986-90 (cont'd)

(percent change)	OLD SERIES---------------->				NEW SERIES------------->		
	DEC 1986	DEC 1987	DEC 1988	DEC 1989	DEC 1989	SEPT 1989	SEPT 1990
	----	----	----	----	----	----	----
(w.r.t. beginning-period stock)	(valuation adjustments removed)						
NET FOREIGN ASSETS		2925.0	83.7	-16.3			-13.6
Foreign Assets		497.1	42.7	7.9			5.9
Foreign Liabilities		183.9	28.2	19.6			20.0
NET DOMESTIC ASSETS		32.4	46.6	49.0			57.9
Net Domestic Credit		26.2	38.4	38.2			32.5
Credit to Government		30.4	22.4	-20.8			4.0
Credit to Non-Government		25.1	42.5	51.0			35.2
Foreign Borrowing		77.2	7.6	5.7			1.1
External Debt of BoM		20.1	4.0	-3.7			-3.1
External Debt of GRM			64.3	125.5			30.3
Valuation Adjustment							
Other Items		-95.7	-2155.6	161.6			129.7
MONEY AND QUASI-MONEY		42.9	50.2	39.0			40.9
Currency in Circulation		13.7	67.8	36.3			32.3
Demand and Savings Deposits		50.1	48.3	38.9			44.7
Time Deposits		145.0	8.2	56.6			28.7
(w.r.t. beginning-period broad money stock)	(valuation adjustments removed)						
NET FOREIGN ASSETS		10.5	8.1	-2.6			-3.2
Foreign Assets		15.6	15.7	3.9			3.4
Foreign Liabilities		-5.1	-7.7	-6.5			-6.6
NET DOMESTIC ASSETS		32.3	42.1	41.1			44.2
Net Domestic Credit		39.7	49.3	44.2			36.1
Credit to Government		9.0	5.8	-4.3			0.4
Credit to Non-Government		30.7	43.6	48.5			35.7
Foreign Borrowing		-25.5	-18.9	-14.8			-2.7
External Debt of BoM		-6.6	-9.3	8.9			6.8
External Debt of GRM		-18.9	-9.6	-23.7			-9.5
Valuation Adjustment		0.0	0.0	0.0			0.0
Other Items		18.1	11.7	11.7			10.8
MONEY AND QUASI-MONEY		42.9	50.2	39.0			40.9
Currency in Circulation		4.0	14.9	8.7			7.8
Demand and Savings Deposits		33.8	34.8	27.9			31.7
Time Deposits		5.2	0.5	2.4			1.5

In the balance of payments, current expectations are for a reversal in the declining terms of trade facing Mozambique for the past four years. Unfortunately, for the past two years, _ex ante_ estimates of the terms of trade have proved far off the mark. Indications for external financing (grants and loans) are relatively optimistic for the year as a whole, with the main problem being one of timing of Mozambique's receipt of funds. The latter issue has implications for broader balance of payments objectives, especially those relating to import liberalization.

As to the public finances, the GRM budget calls for a slight increase in the revenue-GDP ratio and a continued containment of recurrent spending, such that the recurrent deficit (before grants) would decline slightly. With a small diminution in public investment and a rather larger increase in grant inflows, the overall deficit for financing is budgeted to be cut in half, from 12 percent of GDP in 1990 to six percent in 1991. Assuming that budgeted loan inflows occur, and that debt restructuring goes as planned, it should be possible for domestic banking system financing of the deficit to be marginally negative.

It is planned that monetary growth will fall during 1991, to 20 percent from the 35 percent growth rate estimated for 1990. Key to attaining this will be an approximately 10 percentage point reduction in all domestic credit growth rates, compared with 1990. In light of the unanticipated monetary developments in 1989 and 1990, the GRM is likely to be asked to adhere to a ceiling on net domestic asset growth (and net domestic credit to government) during 1991, rather than to a more usual net domestic credit ceiling. The objective is to bring the rate of growth of consumer prices down to 20 percent by year's end, compared with the estimated 30-percent rate (i.e., monetary policy is purposefully tighter than required to achieve the 30 percent inflation target).

Although these objectives are distinctly optimistic, they are important to attempt to attain. If either potential investors or external donors perceive a second year of inertia in the economy of Mozambique, progress during 1992 will be even more difficult.

C. Exchange Regime Liberalization: A Key Ingredient

As discussed extensively below, a major question mark in the progress of the PSSP, as originally designed, is the liberalization of Mozambique's foreign exchange regime. An important element in the success of the program is the extent to which relative prices facing potential exporters in the agriculture sector are such that they encourage production for export. At the same time, it is important that the agriculture sector have competitive access to efficiently priced imported inputs to production processes. These two points were key to introducing foreign exchange liberalization -- which would normally be considered a macroeconomic rather than a sectoral question -- into the policy dialogue agenda of the PSSP framework.

Mozambique has undertaken two experiments in exchange system liberalization over the past few years. In response to program conditionality introduced by the World Bank, Mozambique in 1989 introduced the System for Non-Administrative Allocation of Foreign Exchange (SNAAD), an OGL (open general license) experiment. Donors were encouraged to channel through the SNAAD balance of payments support that could be provided to importers of commodities on a prescribed eligibility list. The gameplan was to have both the list of eligible commodities and the sources of funding expand over time, such that access to SNAAD resources would be relatively free. More recently, in October 1990 the GRM initiated a secondary exchange market (the MSC), which responded to IMF conditionality and which was intended to draw illegal parallel market foreign exchange transactions into a legal market wherein the exchange rate would be market-determined.

Under the PSSP, A.I.D. agreed with the GRM to track progress in the SNAAD, with the objective of supporting its expansion with PSSP resources. In its July 1990 Letter of Intent outlining PSSP-related undertakings, the GRM referred to a forthcoming Government review of the SNAAD, a review which would provide a basis for meaningful expansion of the experiment. Detailed results of that review were not made available to the public, although preliminary observations were. These observations were inconclusive and, in November 1990, A.I.D. carried out its own assessment of the exchange allocation system.

In late 1990 A.I.D. determined that the SNAAD's functioning was sufficiently questionable to delay A.I.D. support to the SNAAD (see following section for details). At that time the secondary market alternative also appeared questionable, at least as a means of seriously liberalizing the exchange allocation system. From the standpoint of the PSSP's policy aims on exchange liberalization, the GRM indeed has experimented with an OGL-type system. Unfortunately, at this stage the experimentation has not been sufficiently successful to justify A.I.D.'s provision of cash grant assistance. As discussed in the following section in the context of a more detailed review of the foreign exchange allocation system, the GRM will over the next year take a series of steps that are designed to further liberalize the exchange system. A.I.D. will continue to review and assess these additional liberalization measures to determine whether they warrant A.I.D. assistance through programs other than this PSSP.

II. Foreign Exchange Allocation and Pricing

The purposes of this section are three. First, we describe the existing foreign exchange regime, from the standpoint of allocation and pricing. Second, we attempt to piece together the GRM's plans for liberalizing that regime over the next year. Finally, we comment on these plans and suggest a role for A.I.D. in this liberalization process.

A. Essential Elements of the Existing System

The existing foreign exchange regime contains two elements, both of which are managed by the GRM. The first is the institutional structure for administratively allocating Mozambique's foreign exchange. The second, which in a market allocation system would probably still be subject to some control from the GRM, is the pricing of foreign exchange. The two are clearly closely linked.

1. The Institutional Structure

In 1990 there coexisted at least ten mechanisms for allocating the $1.1 billion in foreign exchange that Mozambique earned through exports or received in the form of grants and loans, as recorded in the official balance of payments data (Table 1). (In addition, a portion of foreign exchange is generated through illegal parallel market transactions, but this is not recorded in the data.) By contrast, in 1986 official foreign exchange was largely allocated by a relatively straightforward administrative system that involved the development of an annual foreign exchange plan and regular meetings throughout the year to fine-tune the allocations, through the ministry system, to end users. As of this writing, the GRM is giving serious consideration to simplifying the system by reducing the number of mechanisms. The variety of mechanisms came about for a range of reasons, and at a time that the GRM was devaluing the official exchange rate in steps to bring it into closer alignment with an equilibrium rate. Now, however, as the GRM moves further away from administrative allocation toward market allocation, the utility of such a complex system is disappearing. It is useful to group these various mechanisms into three general categories, in descending order of GRM direct control: foreign exchange available to the GRM for its own allocative purposes; donor-provided foreign exchange, primarily for imports; and discretionary foreign exchange in the hands of individuals or enterprises. Table 5 summarizes the mechanisms in existence prior to the impending simplification, and accompanies the following more detailed discussion.

a. The Fundo Cambial

The first broad category of foreign exchange sources is the Fundo Cambial (literally, the exchange fund), in the exclusive control of the GRM. The Fundo Cambial is the allocation mechanism used by the GRM to manage the bulk of legal foreign exchange uses, outside donor-funded instruments. With official foreign exchange sources (through the exports of goods and services) for 1990 projected to be roughly $280 million, the Fundo Cambial is expected to handle about $509 million in foreign exchange in 1990, or 46 percent of Mozambique's sources of foreign exchange. The funds allocated by the Fundo are spent on debt payments, defense spending, invisibles, and commodity imports for both public and private sector enterprises. The allocation of global sums for each of these uses is made by a committee comprising representatives of the central bank, the Ministry of Finance, and the Ministry of

TABLE 5. FOREIGN EXCHANGE ALLOCATION SYSTEM, 1990

MECHANISM	ADMINISTRATOR	FUND SOURCE	ELIGIBLE USES	ELIGIBLE USERS		ESTIMATED AMOUNTS, 1990 (US dollars)	ESTIMATED SHARES, 1990 (percent)
CATEGORY 1: MOST CONTROLLED					Subtotal	500	45.5
1. Fundo Cambial	MOC Department of Import	Surrendered forex earnings, loans, grants	Any product, debt payments, invisibles	GOM, enterprises		500	45.5
CATEGORY 2: LESS CONTROLLED					Subtotal	450	40.3
1. SNAAD	GCPI	TRC	Limited product range	Enterprises		20	1.8
2. Market Fund	MOC Department of Import	TRC	Any product	Anyone		10	0.9
3. Other TRC Funds	GCPI	TRC	Any product	Enterprises		89	8.0
4. Non-TRC GCPI Funds	GCPI	Bilateral Donors	Various, and limited	Enterprises		311	27.8
5. Non-GCPI Donor CIPs	Donor Agencies	Bilateral Donors	Various, and limited	Enterprises		30	2.7
CATEGORY 3: LEAST CONTROLLED					Subtotal	160	14.2
1. Export Retentions	Enterprises, Ministries	Export earnings	Any product	Enterprises		84	7.5
2. SOCIEF	SOCIEF, Ministry of Finance	Individuals, Enterprises	For own funds imports, capital flight	Anyone		20	1.8
3. MOF Secondary Market	Ministry of Finance	Unclear	Individual invisible transactions	Individuals		1	0.1
4. Mercado Secundario de Cambio	Banking System	Primarily Individuals, But Also Enterprises	Individual invisible transactions, non-essential imports	Anyone		0	0.0
5. Parallel Market	Individuals	Primarily Individuals, But Also Enterprises	For own funds imports, capital flight	Anyone		54	4.8

Commerce. The funds thereby made available for commodity imports are then allocated by the Department of Imports in the Ministry of Commerce based on specific requests from enterprises and the priorities defined by the Ministry. Thus, the types of products available for import using the Fundo are established by the Ministry of Commerce.

Decisions on how to allocate Fundo Cambial resources among the major categories named above are less than transparent, given that defense-related imports and debt payments are normally fairly opaque decisions in any country. An enterprise must apply for access to the Fundo Cambial through the ministry that supervises its activities (e.g. an agricultural enterprise would generally apply to the Ministry of Agriculture). The controlling ministry may then incorporate the enterprise's funding request in its application to the Ministry of Commerce. Enterprises that are granted access to the Fundo Cambial receive notice from the Department of Imports that they have been allocated a specific amount of foreign exchange for a specific period for specific imports. When the enterprise chooses to use the foreign exchange, an import license is readily and rapidly obtained, and arrangements are made with a supplier on a "cash against documents" basis or through an L/C. The process is painless and quick, but most enterprises do not have access to the Fundo. The Fundo Cambial is the quintessential administrative allocation mechanism providing foreign exchange at the official exchange rate, and was in earlier years the only means of allocating foreign exchange.

b. Donor-Sourced Foreign Exchange

In addition to a portion of donor-provided foreign exchange that is at the disposal of the Fundo Cambial, the remainder (approximately $450 million, or 40 percent of total sources in 1990) is administratively allocated through a variety of mechanisms over which the donor countries have some control. Most of these mechanisms are administered by the GCPI (the Ministry of Commerce department handling coordination of donor import support), but a few (such as A.I.D. funds) are directly administered by the relevant donor. The SNAAD is one of the GCPI-administered mechanisms. This is discussed in somewhat more detail than the other mechanisms because the SNAAD was designed as Mozambique's initial attempt to move away from administrative foreign exchange allocation.

(1) The SNAAD

The SNAAD (System for Non-Administrative Allocation of Foreign Exchange) was designed to be a modified "open general license" (OGL) system, to be supported by the World Bank's Third Rehabiliation Credit. The objective of the SNAAD's formation was to begin to experiment with an OGL that removed quantitative restrictions on a portion of imports, with a view to significantly increasing the efficiency of the import process. Ultimately, the system was to be expanded to encompass the majority of Mozambique's imports. Initially, access to the SNAAD was subject to individual enterprise import ceilings, but these were dropped after about six months. The intent was to make the SNAAD an evolutionary system, one that would shift Mozambique away from administrative exchange allocation to primarily market-based allocation.

To gain access to funds under the SNAAD involves basically three steps, each of which involves various procedures. First, an enterprise must file an application for enterprise eligibility to make individual applications. Second, the enterprise must go through a process culminating in the issuance (or denial) of an import license. Third, the enterprise must go through another procedure to obtain a letter of credit. We discuss each of these in turn.

The enterprise eligibility application procedure involves submitting an application form, with appropriate backup documentation, to the Ministry of Commerce (MOC). To date, in the one-plus year of operation of the SNAAD, such applications are made on an annual basis, and the application form requests information on the registration of the firm, the financial status of the firm, its tax liability situation, and its estimate of the amount and uses of funds for the ensuing year. (The last-named information is to assist the GRM to gauge demand for SNAAD funds.) At the time of initial application, the backup documentation was to include financial statements corroborating the information on the form. On second (renewal) application for enterprise eligibility, apparently all that is required is the application form itself. In response to the application, the enterprise receives a letter from the Ministry of Commerce indicating whether or not the firm is eligible. During 1989, SNAAD applicants were assigned specific (and presumably maximum) amounts for their use under the SNAAD, but during the second calendar year of operation, SNAAD applicants have not been told the amount for which they are eligible during the year.

Once an enterprise is notified of its eligibility, the second stage of the process can begin. When an enterprise wishes to place an order abroad, it must take GCPI a draft of a bid request letter. GCPI issues a "bid number," which must appear on the enterprise's bid request letter as well as on the formal supplier bid documents. The enterprise then puts the letter into final form and sends it to suppliers. Generally, at least three suppliers must bid on each transaction, and IFBs are all that is required for transactions of less than $100,000. For transactions between $100,000 and $500,000, limited public tender is required, while for transactions above $500,000 public tender is required. These requirements are standard World Bank procedures, and govern the SNAAD because the World Bank is funding the SNAAD.

When the enterprise receives its bids, which must stipulate both the FOB and CIF bids on the transaction, the enterprise submits tenders to MOCARGO (the parastatal shipping agent) and to EMOSE (the parastatal insurance agent), informing these two of the FOB value of the transaction, as well as its volume, its weight, and the port from which it will be shipped. Each of these firms may respond to the importing enterprise with a formal bid to provide services. The importing enterprise then fills out a "tender evaluation form," which compares the bids from each supplier, from MOCARGO, and from EMOSE, on both FOB and CIF bases, makes its selection, and submits the form to GCPI for approval of the chosen supplier. When GCPI approves, the importing firm fills out an import license application which GCPI, submits, on behalf of the importer, to the Department of Imports in the Ministry of Commerce (MOC). Once the import license is granted, GCPI returns it to the importer, along with a bill for one percent of the CIF value of the transaction (to cover GCPI's services) and an additional five percent of that one percent (as a circulation tax), both payable in meticais.

The third stage in the process is an application to the Bank of Mozambique (BOM; the central bank, which also serves commercial banking functions and is the only bank in Mozambique currently handling letters of credit) for an L/C (letter of credit) to be opened in support of the transaction. When the L/C is opened, the importer can signal the supplier to begin shipment. An L/C fee is charged to the importer, and is payable in meticais at 0.1 percent of the CIF value of the transaction. Prior to mid-1990, the local currency countervalue was paid by the importer according to a schedule worked out with the BOM. In August 1990 this policy changed, and the importer must deposit with BOM a specified percentage of the countervalue (depending upon the type of commodity) with BOM prior to opening the L/C. The remainder of the countervalue is due when the first shipment of goods under the transaction arrives.

Various elements of the SNAAD mechanism lead us to conclude that, at this point, it has not been sufficiently tested as an OGL to warrant A.I.D.'s support. In addition, procedures under the SNAAD are sufficiently cumbersome that a good deal of change should be considered prior to A.I.D.'s indicating willingness to provide support to the SNAAD, even after further testing of demand and supply under the SNAAD. Specifically:

- **The exchange rate in the SNAAD is determined by administrative fiat, rather than by supply and demand.** When the SNAAD was initially conceived, it was intended that demand pressures within the SNAAD would be used to help guide the process of devaluing the official exchange rate to bring it to equilibrium. The level of foreign exchange flows through the SNAAD have been too low and through too few sectors to serve this purpose. Initially the bureaucratic encumbrances around the SNAAD resulted in a very slow drawdown of funds. Once importers mastered the system of applications and approvals, funds moved very quickly and as of January 1991 were fully depleted, yet no action was taken to adjust the exchange rate applicable to SNAAD transactions.

- **The regulations governing use of SNAAD funds are cumbersome, making the SNAAD as inefficient as other official foreign exchange allocation mechanisms.** The GRM position on this is that the IBRD's procurement regulations are to blame for the procedures. The IBRD responds by saying that the GRM is misinterpreting IBRD requirements. In any event, the procedures are duplicative and time-consuming, and could easily, we believe, be modified to reduce the bureaucratic steps in the process.

- **The amount of time required between initial application and arrival of imports is inefficiently lengthy, largely as a result of these cumbersome procedures.** It not infrequently takes up to one year before an importer's initial application to the SNAAD results in the arrival of imports to Mozambique. Shipment time of on average three months, which is unavoidable, aside, the process to open an L/C has taken 3-4 months and L/C confirmation has taken an additional 2-5 months. The latter confirmation interval should be reduced to less than a week. Management changes made in the Bank of Mozambique in late 1990 appear to have reduced the time required to open a letter of credit to within two weeks once all other approvals have been obtained.

- **There appears little reason for the SNAAD to reside in the trade bureaucracy, rather than in the banking system.** The primary argument in favor of MOC administration of the process is that only they have the capability of checking on the validity of import prices, so as to reduce capital flight. A more desirable alternative would be for the banking system to handle the entire process, based on accepted commodity eligibility rules, and to carry out ex post monitoring (perhaps by the MOC) that would result in cutting off importers who tried to manipulate the system.

- **Finally, the requirement that the parastatal shipping and insurance agents be a mandatory part of the bidding process should be stopped.** MOCARGO and EMOSE should be required to compete with other sources of these services without GRM support. If they are in fact competitive, presumably importers will use their services.

(2) The Market Fund

The Market Fund was established in 1988 with the purpose of enabling importers to secure financing for a wide range of primarily consumer goods. During 1990, between $15-23 million were made available through the IBRD's Third Rehabilitation Credit, at the official exchange rate, under the Market Fund, which is administered by the Department of Imports in the MOC. Although the first half of the 1990 funding was apparently only available to more established importers, subsequent releases were made widely available. Parenthetically, the Market Fund is the only portion of the TRC that is not administered by the GCPI.

(3) Other TRC Funds

The IBRD's Third Rehabilitation Credit, the first tranche of which was released in September 1989, provided a total of $90 million in IDA funds and an additional $29 million in co-financing from bilateral donors. Funds from this combined pot that are not devoted to the SNAAD (IDA funds only so far) and the Market Fund we classify as "other TRC funds." The apparent differences between these funds and the SNAAD are that the commodity coverage of the two is not congruent, that SNAAD funds are limited to productive enterprises whereas the other TRC funds could be used for the social sectors, and that the other TRC funds are more administratively allocated. As far as access procedures and timeliness of the process, the SNAAD and the other TRC funds are identical (with the exception of the initial application for SNAAD eligibility). The funds are administered by GCPI and are converted at the official exchange rate.

(4) Other Non-TRC GCPI Funds

In addition to managing the TRC, GCPI also administers commodity import programs on behalf of a number of donors. Each donor CIP has its own guidelines on uses and on sources of commodities, and all use the official exchange rate. Enterprises potentially eligible are informed by the Ministry of Commerce or their own controlling ministries of the availability of these funds and can then proceed with requests according to the normal GCPI procedures.

(5) Non-GCPI Donor CIPs

In addition to the GCPI-administered mechanisms, some donors (such as A.I.D.) may administer their own commodity import programs. Only A.I.D. applies the secondary market exchange rate to its import support programs. Otherwise, the exchange rate applicable to such CIPs is the official exchange rate (at least as of this writing), and the administrative allocation mechanism is completely in the hands of the donor in question.

c. Discretionary Foreign Exchange Mechanisms

The third category of foreign exchange mechanisms involves foreign exchange from a variety of official and unofficial sources, the allocation of which is generally (but by no means completely) outside GRM hands. The total amount of discretionary foreign exchange in 1990 can only be roughly estimated, and may be on the order of $160 million, or about 14 percent of Mozambique's foreign exchange sources. Allocation of resources under these mechanisms (as a group) is obviously more market-determined than under either of the other groups.

(1) Export Retention Scheme

The GRM introduced the foreign exchange retention scheme in 1983 to permit exporters to retain a portion of their foreign exchange earnings for use in purchasing approved imports needed in their production for export. Although retention rates differ by importer, a rough estimate would put retentions at about 80 percent of merchandise export earnings in 1986. The rate has declined over the past few years and, in 1990, averages perhaps 70 percent of exports, or $84 million, according to GCPI staff.

Mozambique's retention scheme works somewhat differently from that of other countries. The "retention," which is conveyed at the time of export of commodities, is defined as a right that the exporting enterprise has of repurchasing from the GRM a fixed portion of the foreign exchange earnings from the export transaction. Thus, rather than having the retained earnings denominated in foreign exchange, for use by the exporting enterprise whenever it wishes to import approved commodities under an import license, the enterprise must buy the foreign exchange at the official exchange rate at the time of purchase. In the present circumstances of frequent and significant devaluations, the export "retentions" in fact are always losing real value.

Although retentions were initially solely for approved imports, other permitted uses have crept into the regulations more recently. When SOCIEF (see below) was formed in 1989, retention rights could be sold through SOCIEF at what were effectively parallel market rates. (These parallel rates were between the official and the true "black" market rates.) According to the regulations governing the new secondary market (the MSC, discussed below), a portion of the retention rights can be sold on that market.

(2) SOCIEF

The Ministry of Finance in 1989 established SOCIEF, a society of financial and consultancy institutions. In addition to the latter function, the primary purpose of SOCIEF was to offer enterprises a parallel metical rate for their foreign exchange earnings. Enterprises associated with SOCIEF could purchase meticais with either their foreign exchange retentions or their GRM allocations of foreign exchange. This supply of foreign exchange would then be converted by the central bank into dollar-denominated bonds that would be sold by SOCIEF for meticais. Bond purchasers had the options of (a) holding them for three years and realizing not only the interest on maturity but also the exchange rate difference upon redemption in meticais, (b) selling them at an auction held every three months, or (c) cashing them in to the central bank in exchange for an L/C to pay for imports, with a 50-percent reduction in import duties.

SOCIEF was closed for several months during 1990 following a scandal involving the alleged embezzlement of a significant amount of the foreign exchange in the system and the departure from the country of the key individual involved. SOCIEF established itself as a licensed operator in the MSC in early 1991. It has the capacity to buy and sell foreign exchange (principally for invisibles transactions). To the extent that SOCIEF finances imports over $500, it must arrange for letters of credit to be opened through the Bank of Mozambique.

(3) Ministry of Finance Secondary Market

In early October 1990, the GRM announced that it had established, in the Ministry of Finance, a foreign exchange window at which individuals could purchase foreign exchange to travel abroad. A semi-annual ceiling on amounts available per individual at this window was set at $2,000. To obtain allocations, an individual had to apply with both a passport containing a visa and a return ticket abroad in hand. The price of foreign exchange was the official exchange rate, but a stamp tax of Mt 800 per dollar was assessed as well, putting the effective exchange rate at over Mt1,700, halfway between the official and parallel rates at that time. We understand that as of end-October 1990, there were about 300 applications, surely not for less than $2,000 each.

We presume that this window was opened in an attempt to satisfy IMF ESAF conditionality, which required the GRM to establish a secondary market in the banking system by end-October 1990, with the metical price of foreign exchange determined by supply and demand conditions in that market. IMF guidelines suggested that, initially at least, eligible uses of such foreign exchange could be individuals' invisible transactions. Clearly, this second window went only partly toward meeting IMF conditionality. An IMF team arrived in Maputo for consultations within a few days after the creation of this window and expressed surprise at its establishment. Staff at the central bank stated that the similarity between this mechanism and the IMF conditionality was purely coincidental. In any event, the window was soon superseded by a second secondary window experiment in alternative foreign exchange mechanisms, described immediately below, and has been closed.

(4) The Mercado Secundario de Cambio

The MSC (Mercado Secundario de Cambio, or secondary exchange market) was opened on October 31, 1990, thereby meeting IMF conditionality regarding the establishment by that date of a secondary market in foreign exchange, located in the banking system, operating at an exchange rate to be determined by demand and supply conditions in that market. The MSC is in fact an initial experiment into a free market in foreign exchange, although certain regulatory provisions are currently in force that somewhat constrain the system. We expect to see a certain amount of evolution in the system over time, however.

The MSC, according to current regulations, will operate in a manner not unlike that of the parallel foreign exchange market in Mozambique, with the distinct difference that there are certain GRM rules. Banks, registered hotels, registered tourist agencies, financial societies, and registered foreign exchange vendors will operate the system, under central bank scrutiny. To become a foreign exchange vendor, one must apply to the central bank for a license. Applications must be accompanied by details on the firm in question, such as its financial position, the banking institution through which it operates, and details of experience and qualifications to operate a foreign exchange house. The licensing criteria remain unclear. Successful applicants (the BOM promised to respond to applicants within 30 days of application but has not done so) will pay a deposit fee of $1,000 equivalent in meticais or in one of the approved trading currencies. Thereupon, the BOM will inspect the premises of the exchange site and, after the licensed vendor has submitted his police and tax records to the BOM, and after the licensee has all the necessary exchange forms in hand, operations may begin. As of June 1991, only a handful of vendors (including one private enterprise in Beira) and all three of Mozambique's commercial banks had been authorized to open secondary market windows.

Although both banks and non-banks are permitted to apply for licenses, their functions in the market, with respect to the sale of foreign exchange, are not identical. Non-banks have a narrower mandate to handle primarily invisible transactions, and may (a) buy foreign exchange, (b) buy travelers checks to discount through the banking system, (c) buy export retention funds, (d) handle travelers checks and other payment forms sanctioned by the BOM, and (e) sell foreign exchange to individuals to meet needs related to external activities, such as tourism, health care, foreign study, and business travel. Banks are permitted to do all that non-banks can do, and in addition to (a) sell travelers checks and (b) make external payments to suppliers of imports.

Procedures differ for each of those uses. In the case of banking system sales for imports, only transactions in excess of $500 require an import license, but that license must be explicitly approved by the Ministry of Commerce for use of MSC funds. Moreover, sales for imports will not involve turning foreign exchange over to the importer, but making payments directly to a supplier.

In the case of sales of foreign exchange for tourism, an annual limit of $2,000 was established, with buyers required to provide proof of a valid foreign visa and the registration number of a return airline ticket (or automobile registration number, if so traveling). In the case of resident foreigners, proof of residency must be provided as well. If travel is to a neighboring country, the annual ceiling drops to $1,000. The regulations provide for increases in these ceilings by indicating that if the ceilings are raised, applicants must show proof that the travel for which they obtained their earlier applications actually occurred. In the case of sales to pay for medical treatment abroad, this appears to fall within the ceilings on tourism, and payment is not in cash to the buyer, but in external payment form to the medical institution, upon buyer's presentation of a bill. In the case of Mozambicans studying abroad, the ceiling is higher, at $300 per month, and payment may be made in cash to the buyer. The rules for this latter use appear more liberal than in the other cases. The vendor must fill in all the requisite information (such as passport number and the other proof documents) on a receipt form, and maintain a copy in his records. Furthermore, he must stamp the details of the purchase in the individual's passport (which thus serves as a currency exchange form).

The BOM stipulated a list of seven foreign currencies that may be bought and sold through the MSC, but is prepared to approve others on a case-by-case basis. The exchange rate in the market was to be unconstrained by regulation, with each vendor permitted to establish his own rate. The BOM, on the basis of required daily reporting from the vendors, each day was to announce the average rates prevailing in the MSC on the preceding day.

There is no mention in the regulations of any procedures involved in the sale of foreign exchange to MSC vendors. Individuals have been able to sell foreign exchange without questions asked. USAID has tested out the proposition with respect to individuals; it is rapid and requires no justification regarding the source of foreign exchange, at least in nominal amounts. Most embassies, NGOs, and other international organizations use the secondary market to convert foreign exchange for basic operating costs and are the principal source of foreign exchange supply. As of May 1991, the GRM still had not authorized export retentions or earnings from non-traditional exports to be converted in the MSC. This has been a serious point of concern since it has precluded the secondary market from providing a needed boost to exports, and it has limited foreign exchange flows into the market, thereby reducing its utility as an alternative channel to finance imports. Some import transactions in excess of the nominal $500 limit have occurred, but these are the exception.

(5) The Parallel Market

The parallel market in foreign exchange, although illegal, currently operates relatively openly and freely in Mozambique. In this market, supply and demand determine price. The market is operated primarily by Asians, who by all reports are very well organized in terms of their communications on market transactions and prices. The extent of this market is difficult to gauge, but it is estimated that approximately $4.5 million may be the current monthly level of transactions. The reason for metical purchases from the parallel market is clearly the premium obtainable over the official and secondary markets. The reason for the demand for foreign exchange in the parallel market is presumably a combination of (a) the demand for imports not otherwise available,

(b) the demand for invisible services for which there is no alternative source for foreign exchange, and (c) the demand for foreign exchange for capital flight. The thinness of the market was demonstrated in October 1990, when the parallel rate dropped from Mt 2,500 per dollar to slightly less than Mt 2,000 per dollar in a matter of less than three weeks. The appreciation was possibly in reaction to (a) the introduction of the Ministry of Finance secondary window, (b) a recent influx of financing into the Market Fund, and (c) anticipation of the MSC, which was to be formally announced at that time.

2. Exchange Rate Management, 1980-90

During the 1980-86 period, mirroring other examples of economic mismanagement in the economy, the GRM maintained the nominal exchange rate at a relatively constant level with respect to the U.S. dollar (see Table 6). Over the period, appreciation of the dollar, with respect to the currencies of Mozambique's other trading partners, resulted by 1985 in a currency that had appreciated by over 50 percent, in nominal effective terms, with respect to its 1980 level. This clearly made it that much more difficult for Mozambique to compete in external markets. To compound this problem, domestic inflation in Mozambique was sufficiently higher than inflation rates experienced by its trading partners that the real effective exchange rate had appreciated by over 200 percent by 1986, compared with 1980. The combined effects of relative exchange rates and relative inflation rates had left Mozambican exporters only one-third as competitive in 1986 as they were in 1980.

Another indicator of the extent of overvaluation of an exchange rate is the relationship between the official rate and the rate obtainable on the parallel foreign exchange market in the country. This measure is of dubious utility in measuring discrete improvement or worsening over shorter time periods, due to the general thinness of such markets, but the direction of change and broad trends are revealing. Clearly, with the parallel/official rate ratio at about forty in 1986, the exchange rate was heavily overvalued, as indicated by the real effective index.

Table 6. Exchange Rate Trends, 1980-90

(Average annual data, in percent, unless otherwise specified)

	1980	1985	1986	1987	1988	1989	1990	YR-END 1990
Average Nominal Exchange Rate (Mt/$)	32.4	43.2	40.4	292.1	528.7	744.9	929.1	1007.2
Index, Foreign Currency Terms	100.0	75.0	80.2	11.1	6.1	4.3	3.5	
Percentage Change in Index		-5.6	6.9	-86.2	-44.8	-29.0	-19.8	
Nominal Effective Exchange Rate Inde	100.0	152.5	144.6	28.6	10.3	7.9	6.0	
Percentage Change in Index		8.8	-5.2	-80.2	-64.2	-22.9	-24.1	
Real Effective Exchange Rate Index	100.0	246.2	331.0	120.5	75.9	75.1		
Percentage Change in Index		19.7	34.4	-63.6	-37.0	-1.1		-11.0
Parallel Market Rate (Mt/$)		1500	1800	1098	1178	1736	2177.1	2050.0
Ratio of Parallel to Nominal		34.72	44.55	3.76	2.23	2.33	2.34	2.04

Notes:

--Sources:

IMF and IBRD documents

--Major Develuations: (Mt/dollar)

January 1987:	from 39 to 200
June 1987:	from 200 to 400
October 1988:	from 400 to 620
September 1989:	from 620 to 800

* N.B. Real Effective datum for 1990 is end-of-period.

In the ensuing period, between 1987 and 1989, the GRM took several strong management steps in an attempt to raise the price of tradables, so as to price imports at a more realistic, less subsidized level and to improve the competitiveness of exports. Five devaluations occurred in 1987 and 1988, and resulted in a depreciation, in real effective terms, of 60-plus percent in 1987 and of a further 35-plus in 1988. As a result of these policy actions, the real effective exchange rate not only showed a depreciation of over 75 percent in 1988 compared with 1986, but even showed devaluation of some 24 percent compared with 1980. In 1989, the GRM began a policy of relatively small but frequent moves in the exchange rate, in order to maintain real gains and at the same time gradually improve competitiveness. Thus, on an average annual basis, and in real effective terms, the metical showed neither depreciation nor appreciation against trading partner currencies.

For 1989 as a whole, according to IMF statistics, the GRM devalued the exchange rate in nominal terms sufficiently (by 29 percent in foreign currency terms) to meet the program target on the nominal rate. However, the target of real effective depreciation of nine percent was not met (real effective depreciation was only about six percent), largely because the inflation target of 30 percent was exceeded by about five percentage points.

At the end of 1989, the GRM linked its exchange rate to a currency basket including its ten primary trading partners' currencies. Effectively, thus, from that point on there was a measure of certainty that the nominal effective rate would not appreciate. Over the course of 1990, unfortunately, monetary developments resulted in an inflation rate that was about double the programmed target. The GRM carried out a large discrete devaluation in December 1990 to meet the program target of 11 percent, and then carried out an 18 percent devaluation in April 1991 when the 1990 inflation figure was again adjusted upward and a further devaluation was required to meet the program target.

B. Toward a Market-Oriented Exchange System

1. The Current Situation

As of June 1991, the most accurate description of the foreign exchange allocation system in Mozambique is that it is primarily administratively allocated, with minor (and largely nascent) market elements.

The SNAAD meets few of the criteria of the OGL-type system it was originally intended to be. Application procedures are cumbersome, although the original intention was to provide for a system less complex than the official administered system. Supply of foreign exchange to the system is uneven, complicating the approval process. The extent to which rejections are "valid" is unclear. Finally, there was never designed into the system a proviso for allowing pressure on the exchange rate to appear.

The MSC, though on the face of it operating on market principles, is also quite controlled. In part this stems from the lack of competition within the MSC, given apparent GRM reluctance to approve pending applications by smaller operators. (We have been unable to satisfactorily understand what lies behind this reluctance, but suspect that it is the Government's worry that the situation will get out of hand if true market pressures are brought to bear.) On the face of it, one would have expected MSC exchange rate depreciation in excess of the less than one percent experienced over the course of 1991 to date, given the likelihood that prices have increased by well over 10 percent over that period. With details on the functioning of the MSC unavailable, it is not clear whether the lack of movement is primarily a result of continued external supply of foreign exchange to the MSC (say, by the GRM) or whether demand is restrained given the regulations. It is important to note, however, that parallel market rates have also moved only slightly over the same period, leaving the premium in the parallel market (compared with the MSC) essentially unchanged. Thus, although the MSC may not be operating on market principles, the market-based parallel rate has not altered, suggesting that the level of the MSC rate may truly not be under pressure.

Management of the official exchange rate has also been active over the past several months. In keeping with understandings with the IMF, the GRM has depreciated the official rate by nearly 45 percent in nominal terms over the January-June 1991 period. As discussed above, the metical was devalued by 18 percent in April 1991 to compensate for revised inflation estimates. As of mid-June, the official rate stands at about 81 percent of the MSC rate, a major improvement compared with the 46 percent ratio of December 1990.

2. Liberalization Plans for 1991-92

As of mid-May 1991, the GRM and the multilaterals had completed a round of discussions that will culminate in a new Policy Framework Paper and in understandings regarding a second tranche of IMF funds under the current ESAF arrangement. A key element of those discussions was the exchange rate and the exchange system, and how to map out a course of action over the coming year and more. Although details are scanty, the outline of these mutual understandings is taking shape. Essentially, the GRM has apparently agreed to (i) unify the official and secondary market exchange rates by March of 1992, and (ii) take unspecified steps to liberalize the exchange allocation system. The following are our observations on these interrelated areas of reform.

a. Exchange Rate Rationalization

The most recent understandings between the GRM and the IMF, cemented in preparation of a July 1991 review of the second-year program under the ESAF arrangement, call for specific exchange rate targets that are apparently not couched in real effective terms. By the July IMF Board review, the GRM will have brought the official rate to within at least 80 percent of the secondary market rate, and this differential will have been reduced to 90 percent by year-end 1991. Finally, by March 1992 the official and secondary rates will have been merged, erasing the temporary multiple exchange practice and putting all legal exchange transactions in Mozambique on equal footing. Currently, the official rate stands at 81 percent of the secondary market rate, so that the July 1991 target will be met so long as the official rate keeps pace with any appreciation of the secondary market rate.

A key issue in this planned rate unification concerns movements in the secondary market rate. If the latter moves only slowly (as a result of market imperfections, planned or otherwise), then in real effective terms the metical may begin to appreciate. For such appreciation to be officially sanctioned would be inconsistent with the broader objective of moving the exchange rate to a level more consistent with equilibrium considerations.

b. Exchange System Liberalization

Although there is currently little information on the exchange allocation system reform plan, one can begin to guess at its likely course. The liberalization stages can probably be divided into two: that prior to the unification of the official and secondary market rates, and that following the unification.

During the first of these two stages the GRM has indicated that it will move an increasing number of commodities toward the secondary market rate by stipulating that foreign exchange for their importation is no longer available at the official rate. Whether there will be a clear separation is not apparent at this time. The same goods could conceivably be sold at different foreign exchange prices, depending on the importer or the source of the foreign exchange funds. We hope, however, that this situation will not be permitted to occur, because there would be excess rents accruing to those who could import such commodities at the lower official rate. Of course, to the extent that the GRM continues to move quickly toward the unification of the official and secondary markets, the importance of distinguishing between items eligible for the official and secondary rate diminishes.

The GRM's plans during the second, post-unification stage are less clear, partly because of a lack of consensus on the part of the IMF and World Bank on how to move most effectively toward market-based allocation of foreign exchange in an economy where donors control 80 percent of the foreign exchange supply and it comes in an uneven flow, often with extensive restrictions. It is important to appreciate that the act of unification of rates does not simultaneously (necessarily) imply a unification of allocation systems. If the unified exchange rate remains below a market-clearing level, administrative allocation must continue in some guise. The task facing both the GRM and the donors is to ensure that foreign exchange provided through external assistance does not flow back out of the country as capital flight.

Complicating the problem of external assistance is that many donors restrict the use of their balance of payments assistance. This is understandable; the need to do so arises in part from donor appropriation considerations and in part from worries about "non-productive" use of the foreign exchange provided. The more restrictive the basis on which the balance of payments support is provided, the more difficult it is for the GRM to depart from an administrative allocation system. At the same time, however, without liberalizing the allocation system, donor concerns will not be allayed and restrictions will continue. Given the fact that a significant portion of the supply of foreign exchange is already basically "untied," it would behoove the GRM to move as rapidly as possible on the liberalization, with an eye to using improvements to convince Mozambique's external benefactors that unrestricted assistance will be well-spent. Annex C describes two possible options for managing the allocation and pricing of foreign exchange once the official and secondary foreign exchange markets are unified: an open general license (OGL) system, and an auction.

In sum, the shape of things to come is still unclear. Various alternatives are under consideration. External assistance restrictions imply that some extent of administrative allocation will be inevitable. Furthermore, we understand the potential for capital flight. The GRM, with the IMF and World Bank, must come to terms with an exchange allocation system that prices foreign exchange reasonably and that permits the utmost transparency in the process for obtaining foreign exchange. Clearly the objective of liberalization will not be easily or quickly won. It must, however, be pursued actively.

III. Program Description

A. Objectives

This amendment to the PSSP adds the final increment of non-project assistance planned under this multi-year program, amends the policy reform agenda to reflect policy progress to date and the evolving policy environment described above, and modifies some aspects of CIP disbursement of program funds. The program purpose remains unchanged: To improve incentives for private sector agricultural production in order to enhance the private agricultural sector's production and income. Policy reforms addressed in the PSSP are summarized below in Table 7, Revised Summary of Policy Objectives and Workplan (June 1991 Revision), and described in more detail in the following sections.

Mozambique Private Sector Support Program (656-0208)
Summary of Policy Objectives and Workplan
June 1991 Revision

POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
1. Agricultural Pricing Policy	OBJECTIVE: To maximize the liberalization of the agricultural pricing system and, for crops where full deregulation may not be presently feasible, institutionalize procedures for basing agricultural prices on world parity.			- Price changes and announcements.	- Production increases on family and commercial farms.	- Production statistics by crop, province, farm type.
a. Maize, beans, rice	- Establish parity producer prices; plan for floor price system. (Note: beans actually moved to floor price in 1989.)	- Move white maize to parity-based producer floor price system; continue parity-based producer floor price for beans; adjust parity-based producer price of rice; assess impact and make recommendations re: rice.	- Adjust producer floor prices to maintain parity base.		- Farm income increases on family and commercial farms. - More consistent supply in markets throughout year.	- Estimated farm income calculated from production functions. - Selected market surveys.
b. Cash crops	- Establish parity-based floor price system.	- Adjust floor prices to maintain parity base.	- Adjust floor prices to maintain parity base.			
c. Consumer prices		- Deregulate consumer price for white maize; assess impact; make recommendations re: beans and rice.	- Deregulate consumer price for rice by January 31, 1992.			
2. Divestiture of State Farms	OBJECTIVE: To develop and initiate the implementation of an action plan (including supporting policies for rational land redistribution, titling, and registration) to redistribute state farms to commercial and family farmers.			- Declared policies on land redistribution including divestiture and titling procedures. - Development and promotion of divestiture program.	- Farms privatized. - Production increased on divested farms. - Farm income increased.	- Statistics on actual and planned divestitures. - Production statistics by crop in divestiture areas. - Estimates of farm income calculated from production functions and verified by sampling.
a. Planning and implementation	- Continue case-by-case divestitures of state farms. - Identify issues and policies to be addressed in divestiture program. - Complete terms of reference for additional tenure analyses and design of divestiture program.	- Implement analysis program on tenure issues. - Complete general divestiture program design. - Complete design of USAID-financed program for divestiture policy research and analysis.	- Maintain credit and subsidy ceilings for state agricultural enterprises. - Continue divestitures. - Continue analysis of divestiture experience and development of policies and guidelines. - Develop, announce, implement procedures to increase transparency of divestiture process.			
3. Private Ag. Sales and Service	OBJECTIVE: To demonstrate the effectiveness and viability of private sales and service networks for providing agricultural inputs to commercial and family farmers throughout the country.			- Percentage of private companies/traders participating in program. - Elimination of "credential system" for end users.	- Wider and better access to agricultural inputs. - Expansion of privatization.	- Statistics on numbers of private importers and dealers by input type and province. - Sampling of farmer attitudes toward supply networks. - Sampling of dealers to assess constraints to expansion.
a. For importers/distributors	- Continue private importation and distribution of all A.I.D. commodities; exemption for lubricants and limited spares.	- A.I.D. commodity imports fully private (except for petroleum); plan to privatize ag-related public enterprises.	- Maintain private import/distribution of AID-financed commodities (ex. petroleum). - Continue privatization of ag-related state enterprises.			
b. For end users	- Replace GOM administrative allocation system with direct private sales.	- Maintain.	- Continue direct private sales to end users.			

Mozambique Private Sector Support Program (656-0208)
Summary of Policy Objectives and Workplan
June 1991 Revision

Table 7

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POLICY AREAS	1989/90	1990/91	1991/92	POLICY INDICATORS	IMPACT INDICATORS	MEANS OF VERIFICATION
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 institutionalise market signals as an allocation mechanism.			- Implementation of FX allocation options agreed upon with donors.	- Increased access to foreign exchange at market-determined price.	- Survey of OGL users to determine private sector access.
a. Allocation mechanism	- Establish limited trial of OGL system.	- Evaluate effectiveness of OGL trial (with IBRD with USAID follow-up). - If trial is generally successful, modify and expand eligible sectors under OGL; otherwise formulate new options.	- Establish "negative list" for imports at official exchange rate; move non-traditional exports to MSC. - Unify official and MSC exchange rates by March 1992. - Develop plans for market-based allocation/pricing of FX following unification.	- Range of eligible OGL sectors and volumes of FX increased.		- Trends in official and parallel exchange rates.
5. Private Marketing Channels	OBJECTIVE: To reduce restrictions on competitive private sector trade and transportation serving agricultural producers in Cabo Delgado, Nampula, and Zambezia provinces.			- Announcement and promotion of deregulations.	- Increased number of active traders and transporters.	- Sampling of traders/transporters/farmers.
a. Movement of commodities		- Rescind regulatory restrictions on inter-district and inter-provincial movement of agricultural commodities.	- Assess impact.		- More consistent supply of commodities in markets throughout the year.	- Market surveys.
b. Wholesaling		- Open district wholesaling opportunities to any licensed trader desiring to compete.	- Assess impact.		- Increased producer access to consumer goods and other "incentive" commodities. - Improved food balances between deficit and surplus production areas.	- Sampling of farmers.
c. Licensing		- Analyze licensing requirements for private marketing agents at all levels to assess disincentive effects.	- Complete analysis and take steps to simplify licensing requirements to encourage new competitors.			
6. Petroleum Importation and Marketing	OBJECTIVE: To promote increased and more reliable access to selected petroleum products at import parity prices based on the secondary market exchange rate.			- Announcement and promotion of price changes and deregulations.	- More consistent supply of and access to petroleum products nationwide.	- Sampling of farmers, transporters, traders, and industries. - Sampling of importers/distributors. - Trends in prices of diesel and gasoline.
a. Pricing			- Maintain consumer price for gasoline at or above import parity at the MSC rate and continue to adjust consumer price of diesel to reflect exchange rate and international price changes.			
b. Deregulation			- Complete analysis and implement recommendations for deregulating import, distribution, and pricing of avgas. - Analyze import and distribution of petroleum products to identify further measures to support a more efficient market for these.		- Private sector importation and distribution of avgas.	

B. Progress to Date

Policy reform progress under the PSSP has been satisfactory. The April 1991 progress report to A.I.D./Washington appears as Annex B and is updated below.

1. Agricultural Pricing Policy

The GRM has fully met agreed-upon targets for pricing policy reforms. Except for a few commodities whose prices have been fully liberalized (sorghum, some types of beans), all agricultural commodities are now explicitly on a system of minimum producer prices intended to protect producers as markets re-emerge but suffer from lack of competition. Consumer prices for domestically produced maize, for peanuts, and for beans have been fully liberalized. The consumer price of rice remains fixed but has been adjusted to overcome marketing disincentives created by previously inadequate margins between producer and consumer prices. The extent to which these policy changes are being implemented, and their impact, are being monitored by the Mission and by a Michigan State University-Ministry of Agriculture market information system developed as part of the PSS/TA-financed applied food security research in support of PSSP policy reforms.

2. Divestiture of State Farms

Although state farm divestitures continue, the climate of heightened political sensitivity in Mozambique due to the anticipated advent of electoral politics and demobilization of military forces has negatively affected progress on formulating a clear set of guidelines for the divestiture process. Nonetheless, the Government continues to comply with credit and subsidy restrictions on state and parastatal enterprises, and the state farms which have not yet been the object of restructuring (through joint ventures or management contracts) or divestiture (through a variety of approaches) are effectively closed -- work force without salaries, production paralyzed. In some cases, factors such as security risks and the lack of bank credit available for potential private investors remain major impediments to divestiture. Latest updates from the Ministry of Agriculture still do not give an overview of divestiture progress. However, available information indicates that, of the 109 state farms and related enterprises on the Ministry's list in September 1988, only 90 remained in October 1990; as of June 1991, 37 of these 90 have been "divested," either wholly or in parts, through joint (private-GRM) ventures or through sale or lease to or <u>de facto</u> occupation by small to medium private operators or family farmers. It is probable that other divestitures have occurred which are not yet documented by the Ministry, and there are also a number of transactions still in negotiation.

The GRM has requested continued U.S. assistance to analyze and rationalize divestiture transactions. With funding from the PSS/TA (656-0218) project, the Land Tenure Center (University of

Wisconsin - Madison) and the Ministry of Agriculture will undertake a series of policy-oriented analyses of divested state farms to better understand the current dynamics of divestiture and to help incorporate relevant lessons into evolving divestiture and land use policies.

3. Private Agricultural Sales and Services

All PSSP CIP disbursements to date have been for private sector importation and distribution directly to private end users. However, a portion of PSSP funding will be utilized in 1991 for importation by the state enterprise Petromoc of selected petroleum products. As documented in the previous amendment to the PSSP, this was agreed to as part of a package of additional policy reform measures contributing to Mozambique's transition to a market-based foreign exchange regime, including a first step, through avgas, toward permitting direct private sector importation of petroleum products.

The GRM, with support from the World Bank, has begun the process of privatizing the six principal agriculture-related parastatal enterprises which formerly had monopolies on the importation and distribution of certain types of agricultural equipment and supplies. There are several methods of privatization being tried. For MECANAGRO, which handles importation, distribution, and services for agricultural equipment, complete privatization is planned and two expressions of interest from foreign companies are being pursued. INTERQUIMICA (importation of agrochemicals), INTERMECANO (importation of trucks and tractors), and ENACOMO (once the monopoly exporting company for agricultural commodities and now involved primarily in sugar import/export) are to be transformed into corporations with publicly available shares issued, some shares destined for the workers now employed by the enterprises and others available for private investors, including foreign capital. BOROR had the monopoly for distribution of agrochemicals and seeds, and later imported seeds as well as exported copra; the GRM has an expression of interest from the pre-Independence operators of this enterprise to revitalize a private sector BOROR. Already one former state enterprise with broad importation/distribution monopolies for major brand-name equipment from many countries, STEIA, has been dismantled by selling off its manufacturer-authorized representationships (including Caterpillar) to a number of private operators. Finally, the GRM has publicly announced its interest in attracting private (including foreign) investors into the tea sector.

4. Access to Foreign Exchange

As discussed in the preceding sections of this amendment, implementation of foreign exchange reforms has grown increasingly complex. The GRM has met the specific PSSP benchmarks with the expansion of its Open General License experiment (SNAAD) and the creation of a market-based secondary foreign exchange market (MSC). However, still unresolved conflicts between the emphases of the World Bank and the IMF have complicated the process of developing a clear strategy leading to market-based allocation and pricing of foreign exchange. The next steps in foreign exchange regime reforms are the focus of this amenament, and are discussed in detail in Section III.C.4. below.

5. Private Marketing Channels

The announcement of the deregulation of agricultural marketing was published by the Government on June 6, 1991. The announced reforms remove restrictions on inter-provincial and inter-district trade of agricultural commodities and open district wholesaling opportunities to any licensed trader desiring to compete.

In fact, field visits during April confirmed that ad hoc lifting of the restrictions had already occurred in some areas, in contrast to February 1991 field visits which indicated restrictions on commodity movements were still being enforced. In April, the MSU-MOA research team found that provincial and some district level wholesalers already have responded aggressively to the liberalized environment. Some provincial wholesalers have entered for the first time into agricultural commodity trading and are engaging in inter-provincial trade while expanding rural assembly activities. In districts of Zambezia province close to the border with Nampula, wholesalers are routinely sending beans through private channels to Nampula, although other district level wholesalers are responding much more slowly. Field visits have also confirmed that wholesalers who previously had monopoly/monopsony rights in assigned districts remain resistant to these changes.

Analysis of licensing requirements to identify disincentives to agricultural marketing also has begun under the MSU-MOA research program. Initial findings are that the administrative process for approving trader licenses is cumbersome, and that in fact barriers to entering commercial activity at the district level may have increased in Nampula when the capital requirement for a license to operate at district level recently went from 10 million meticais to 50 million meticais (over $26,000 at the current secondary exchange rate). An important change is the emergence of a large number of informal, generally small-scale marketing agents, which are active at the consumer level but not yet visible in the rural assembly points. More detailed study of licensing requirements and other constraints on trader activities will occur in July-August 1991. In the meantime, changes in numbers and activities of traders at various market levels have begun to be monitored in Nampula province.

6. Petroleum Importation and Marketing

The GRM's May 15, 1991 Letter of Intent described the Government's policy on liberalization of petroleum importation and distribution. As stated therein and discussed in the previous PAAD amendment to the PSSP, consumer prices of gasoline and diesel will be monitored quarterly, and gasoline prices will be adjusted as necessary to ensure that they continue to reflect import parity at the secondary exchange rate. Furthermore, the GRM has agreed to undertake an analysis and act upon its recommendations leading to the liberalization of avgas imports, distribution, and pricing. This is the first GRM step in permitting direct private sector importation of petroleum products.

C. Revised Policy Framework

1. Agricultural Pricing Policy

One of the policy reform benchmarks for 1990-91 was to analyze the effects of the liberalization of domestically produced (white) maize, in order to develop recommendations on moving toward liberalized consumer prices for beans and rice; these recommendations were then to be implemented in 1991-92. In fact, the consumer price of beans was also freed in 1990, leaving rice the only domestically produced staple whose consumer price remains fixed.

Preliminary assessment[2] shows that the impact of maize price liberalization on Maputo consumers has not been dramatic. Overall supplies have remained steady thanks to commercialized food aid programs and an excellent harvest in key production areas in 1990. Growth-faltering rates among children under five years of age are reported to have declined in every province of the country in 1990. Price increases have occurred, but these have been far less than the overall inflation rate: Maputo parallel market prices for yellow maize flour (a product which, in the "official" distribution system, is still subject to official price control) rose about 28 percent from April 1990 to April 1991, while those of white maize flour (no longer controlled) rose by about 15 percent. In recent weeks, in fact, white maize flour cost slightly less than yellow maize flour and both were widely available.

However, the extent to which experience with maize liberalization can be considered an example for a policy change on rice has been a question. The GRM's hesitancy to free rice has been attributed in part to the fact that rice supplies and flows to the market have historically been controlled by a small number of rice mills which in theory operate in accordance with a Government-devised distribution plan intended to ensure rice supplies for the Maputo ration system and for selected schools, factories, hospitals, and other institutions. In this situation, it has been argued, price liberalization would give the existing mills unchecked control

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[2]More detailed assessment of the impact of price liberalization in rural and urban markets outside of Maputo is underway as part of the MSU-MOA applied food security research program.

over the market for this staple, with deleterious effects on consumer prices and on market competition.

In fact, however, the fixed consumer rice price applies only to rice obtained in the Maputo ration system. Everywhere else in the country, and for all Maputo rice purchases outside the ration system, a market price prevails. There is evidence from principal rice producing areas that domestic production is moving increasingly through unofficial marketing channels, even bypassing the established mills. In addition, commercial imports are increasing; although they are still mostly informal and small-scale, a large commercial import was recently made possible through a secondary window transaction, and this rice is selling at market-determined prices. The Government is in fact encouraging such private commercial imports. Furthermore, for much of the past year no rice at the fixed price has been available even in the Maputo ration system, as it now receives rice supplies virtually only when donor aid arrives.

The 1990 official consumer price for high-quality rice was 756 meticais/kg. A May 1, 1991 announcement by the Ministry of Commerce to rice millers and traders set the consumer price at 1,250 meticais/kg. At the time this price was announced, the parallel market price for high-quality rice was 1,500 meticais/kg both in Maputo and in Chokwe (the main rice-growing area which supplies the Maputo market). By mid-June, with the 1991 harvest reaching the mills and markets, and considerable commercial imports available, the Maputo consumer price had dropped to 1,250 meticais/kg, bringing the parallel market price in line with the official price. (In consumer markets monitored in other provinces by the MSU-MOA market information system, market prices ranged from 1,000 to nearly 3,000 meticais/kg.)

What the new prices mean to producers is not clear. The producer floor price for rice is 256.5 meticais/kg, but field trips in various rice-growing areas during the recent marketing season confirm that most producers bring the rice they want to commercialize to the mill door, and that millers in different locations offer different prices. For example, millers in Chokwe were provisionally paying rice producers 350 meticais/kg, intending to "adjust" this price as necessary once the new prices were announced; in Xai-Xai, producers were receiving 400-425 meticais/kg. The May 1 Ministry of Commerce announcement officially set the mill door price at 350 meticais/kg (no price differentiation for quality), but the June 6 announcement (referred to in Section III.B.5. above) made this price explicitly "negotiable."

Given the evidence of relative price stability for liberalized commodities, the evidence that current parallel market prices for rice in fact reflect real commercial margins and import parity, and the evidence that domestic production is increasingly flowing through these markets and decreasingly through the official channels at official prices, there is no argument for maintaining a fixed consumer price for rice. The consumer price will be deregulated by January 31, 1992, which is well before the 1991-92 marketing season for rice and other cereals.

The revised benchmarks for agricultural pricing policy for 1991-92 are:

- Adjust producer floor prices to maintain parity base; and
- Deregulate consumer price for rice by January 31, 1992.

2. Divestiture of State Farms

For the reasons described above in Section III.B.2. and in the Annex B discussion of state farm divestitures, the 1991-92 benchmarks for this policy area are:

- Maintain credit and subsidy ceilings agreed upon with the World Bank and IMF for state agricultural enterprises;
- Continue divestitures;
- Continue analysis of divestiture experience and development of divestiture policies and guidelines; and
- Develop, announce, and implement standardized notification and review procedures for divestitures that will increase the transparency of the divestiture process.

3. Private Agricultural Sales and Services

The 1991-92 benchmarks for this policy area focused on development and implementation of a privatization plan for agriculture-related public enterprises. Because GRM progress in this area, discussed in Section III.B.3. above, has been good, and because the World Bank, through its Agricultural Rehabilitation Project, has taken the lead in assisting with the privatization of specific enterprises, the PSSP will continue to monitor progress in this area rather than require additional action. Thus, the revised benchmarks are:

- Maintain private importation and direct private distribution of A.I.D.-financed commodities (except petroleum);
- Continue direct private sales to end users; and
- Continue privatization of agriculture-related state and parastatal enterprises.

4. Access to Foreign Exchange

a. Policy Objectives

The exchange system-related policy objective of the PSSP has not changed:

> "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."

However, the means of meeting the objective has shifted somewhat. According to the PSSP policy workplan, the GRM was to establish an OGL-type mechanism and evaluate that mechanism during the second year of the PSSP. As described above, the SNAAD was indeed established under World Bank auspices in 1989 and an evaluation was carried out in late 1990. The evaluation revealed flaws that brought A.I.D. to the conclusion that the experiment could not be considered a success. As noted in the workplan, if the OGL experiment was not judged to be successful, the GRM would formulate new options. More recently, and as a result of considerations regarding the effectiveness of the SNAAD, the GRM introduced a secondary exchange market (the MSC).

The MSC exchange rate has provided a useful benchmark for an equilibrium exchange rate for the economy and serves as a reference point in the devaluation of the official exchange rate. The institutional limitations of the MSC and its current fragility have precluded channeling donor assistance directly through this market, but A.I.D. has indirectly supported the MSC by applying the secondary market exchange rate to our Commodity Import Program. As discussed below, such indirect support will become increasingly important as the differential narrows between the official and secondary exchange rates, and will help test market demand for a limited range of commodities at a more realistic exchange rate for the economy.

In the immediate future we expect that the GRM will announce that certain imports are no longer available at the official exchange rate. For March 1992, there is a planned merging of the official and secondary market exchange rates. The GRM, World Bank, and IMF have unequivocally committed themselves to implementing a market-based mechanism for the allocation and pricing of foreign exchange to come into effect once the official and secondary rates are merged. We suspect that the post-unification exchange allocation system will continue to require the existence of some OGL-like mechanism (or perhaps an auction). The details of this post-unification system will be the subject of deliberations between the GRM and the multilaterals over the next nine months prior to unification.

A.I.D.'s interest in this process is to determine how we can most effectively support and influence the debate between the GRM and the multilaterals to implement a market-based foreign exchange allocation regime. As previously discussed, Mozambique's extreme dependence on donor assistance, which is often tied and comes in irregular flows, has created considerable uncertainty about an appropriate allocation mechanism which is also within the Government's capacity to implement. To function effectively, a new allocation mechanism will need to be supported by extensive amounts of untied cash immediately when it comes into effect. The dilemma facing the Government and the donors is that the institutional arrangements will require some time to work out, and this will preclude donors from making advance commitments to supporting a liberalized allocation scheme that would help ensure the new mechanism's viability.

A.I.D. will continue to monitor closely the liberalization of the foreign exchange regime so that it can respond quickly and appropriately to positive developments. In line with this, and in support of the measures currently under final negotiation with the IMF, the following are the exchange reform policy benchmarks for 1991-92:

- Establish a negative list for imports at the official exchange rate that will effectively shift these commodities to the MSC, and move non-traditional exports to the MSC;

- Unify the official and secondary foreign exchange rates by March 1992 as agreed with the IMF; and

- Develop specific plans for a market-based foreign exchange allocation and pricing mechanism to come into effect upon the unification of the official and secondary foreign exchange markets, and keep A.I.D. informed on a regular basis regarding developments.

The Government's compliance with these benchmarks will establish a basis for A.I.D. to consider channeling assistance through a sector cash grant beginning in FY 1992 under a successor program to the PSSP.

b. Role of PSSP CIP in Exchange Regime Reform

The role of the PSSP CIP has been to provide the private sector with access to imported inputs to agricultural production and marketing activities, access which was unavailable in sufficient quantities through other channels in the allocation system. This overall role has not changed. In one specific manner, however, the role of the CIP has changed.

With the October 1990 legalization of a secondary exchange market operating at a legal exchange rate higher than the official rate, A.I.D. was required (by A.I.D.'s exchange rate policy) to provide imports under our program at the more depreciated MSC exchange rate. For several months following the inception of the MSC, there was no demand for PSSP CIP commodities inasmuch as the same products were available at the official exchange rate. The situation was not so much one of lack of demand at the higher price as it was one of potential importers seeking to exhaust cheaper alternative sources of supply. In fact, as the official rate draws closer to the MSC rate (the ratio of the latter to the former moved from 1.79::1 in October 1990 to 1.16::1 by mid-June 1991), there is a renewed interest in the PSSP CIP by importers.

A.I.D. understands that, within a few weeks, the GRM will publish a negative list of products for which foreign exchange will not be supplied at the official exchange rate. Although this list will primarily contain consumer durables and other consumer goods, it will also include products which can be supplied through the PSSP CIP. As the only donor placing the requirement on the GRM that the highest legal rate obtain for merchandise imports acquired under a balance of payments program, A.I.D. can rightfully take part of the credit for encouraging the use of a more realistic exchange rate for a growing list of import transactions.

It would perhaps have been possible for A.I.D. to encourage this move by conditioning A.I.D. support on it and thereupon supplying the support through a sector cash grant, but this alternative would have been distinctly less desirable. First, A.I.D. does not have a primary mandate to engage in program-supported dialogue on macroeconomic issues, inasmuch as these issues are the province of the multilateral agencies. Second, there was insufficient justification for A.I.D. to provide resources through a sector cash grant in any event. The approach of using the continued availability of the CIP, in conjunction with less direct, behind-the-scenes dialogue, accomplished A.I.D.'s immediate objectives.

The PSSP CIP is first a means of continuing to provide vital balance of payments support in connection with GRM progress in all the PSSP policy reform areas, and second a means of providing transitional support for foreign exchange regime reforms in particular, until circumstances in Mozambique permit use of a sector cash grant under a more market-based exchange allocation mechanism.

c. Coordination with Multilateral Agencies

USAID Mozambique enjoys a collegial relationship with both resident and visiting staff of the multilateral agencies. A major reason for the success of that relationship has been our direct and active involvement on foreign exchange issues. The Mission has devoted extensive staff resources to researching and understanding these issues; because of our field presence, this has allowed us to contribute constructively to the policy debate. When appropriate, the Mission has also channeled comments through A.I.D./Washington to the U.S. Executive Directors at the World Bank and IMF. In the same way that our close examination of Mozambique's progress in liberalizing the foreign exchange regime will continue, so will the Mission's engagement in dialogue with the multilateral agencies (and other interested members of the donor community here in Maputo). However, as has been clear from experience, our dialogue with the multilaterals here has certain limitations and the Mission will therefore also continue to keep interested Washington parties apprised of developments.

5. Private Marketing Channels

1991-92 benchmarks for this policy area remain unchanged:

- Assess impact of the marketing deregulations announced in June 1991; and

- Complete analysis and take steps to simplify licensing requirements for private marketing agents at all levels and encourage new competitors.

6. Petroleum Importation and Marketing

Benchmarks for this area remain as stated in PAAD Amendment Three:

- Maintain consumer price for gasoline at or above parity at the MSC rate, and continue to adjust consumer price of diesel to reflect exchange rate and international price changes;
- Complete analysis and implement recommendations for deregulating import, distribution, and pricing of avgas; and
- Analyze import and distribution of petroleum products to identify further measures to support a more efficient market for these.

D. CIP Disbursement

While the sectoral focus of the CIP -- agriculture and the marketing of agricultural products -- remains, this amendment relaxes the restrictions on geographical distribution and expands the list of eligible commodities. The major reason for these changes is to support the Goverment's evolving policy to increase the volume and range of goods imported at the market-determined secondary window rate and phase out administrative controls on imports. In addition, private sector activity in all regions has increased considerably during the last few years, and availability of spares and service facilities is now market driven. Thus, the program's requirement that service facilities be installed in the provinces before a commodity was approved for import financing is no longer critical. Finally, the elimination of the exchange rate subsidy on CIP imports limits considerably the additional costs that can be imposed on importers. Specific changes enacted through this amendment are as follows:

1. The CIP originally restricted the distribution of imports to Maputo and Gaza. This was expanded to Manica in 1938, and to Sofala, Nampula, Cabo Delgado, and Zambezia in 1989. This amendment adds the remaining provinces of Tete, Niassa, and Inhambane.

2. The present commodity list -- seeds, fertilizers, tractors, tractor spare parts, implements and harvest equipment, trucks and truck spares, irrigation equipment, petroleum -- is expanded to include all commodities on A.I.D.'s Commodity Eligibility List related to agricultural (including fisheries and livestock) production, processing, and marketing. The expanded list will include, but is not limited to, processing equipment such as small mills, bagging material such as jute or polyethylene, weigh scales, refrigeration equipment, etc.

3. The lifting of geographical restrictions on CIP financing and the broadening of the commodity eligibility list described above also apply to the $10 million AEPRP obligation provided to the PSSP in FY 1990 on the basis of additional policy reforms to liberalize agriculture-related marketing. At the time of obligation, availability of these funds was limited to trucks and related transport equipment in Cabo Delgado, Nampula, and Zambezia provinces. These limitations were set for several reasons: extremely high demand for transport equipment nationally, particularly in outlying areas that had not previously had access to our private-sector CIP (or indeed to any other source of transport equipment for more than a decade); the then still highly overvalued exchange rate applying to CIP imports; the fact that these provinces were already demonstrating a significant production response to price policy changes and improved rural security and that the insufficiency of transport had already emerged as a constraint to further marketing improvements; and the desire to provide the necessary and sufficient conditions to achieve a measurable impact from the AEPRP support. Since then, the marketing policy reforms intended for these three northern provinces were in fact implemented nationally; at the same time, with the changes in exchange rate policy affecting the CIP, demand for transport-related commodities has shifted. We expect that at least $10 million of PSSP CIP-financed commodities will undoubtedly be provided to these provinces, but continuing to administratively set limits on which commodities can go where would run counter to our objective of making this assistance more market-responsive.

4. Aviation gas also will be eligible for CIP financing in order to support the deregulation of avgas imports, distribution, and pricing. Initial analyses of this sector suggested that potential importers could raise sufficient foreign exchange through sales or arrangements with avgas users. Further analysis indicates that the cash flow situation of most users is too tight to allow for extensive forward contracts, which could result in high prices for imports that could threaten the viability of introducing private competition into the parastatal-controlled petroleum sector.

5. CIP implementation procedures will be revised in accordance with the expanded commodity eligibility list and geographical distribution. In particular, previous requirements that end-users be farmers registered with the provincial agricultural authorities will be dropped. Given the extensive reduction in the implicit exchange rate subsidy and USAID's overall efforts to reduce administrative controls in favor of market allocation, such administrative designation of program beneficiaries would be contradictory to broader program objectives. With the exception of petroleum, importers and distributors will continue to be required to maintain lists of end-use purchasers of CIP-financed commodities, and USAID will conduct end-use spot checks to monitor utilization of the commodities and the economic impact of the import support.

6. In order to facilitate the working of the secondary market window for foreign exchange, USAID will coordinate closely with GPCI and major establishments with secondary market windows. At a minimum, USAID will explain the program to the Bank of Mozambique, Banco Standard Totta, and SOCIEF so that they can refer eligible importers to USAID.

7. Allocations for petroleum are not expected to exceed $5,000,000 of the $17,390,000 provided under this FY 1991 amendment, and will be conditional on the policy reform measures discussed in the May 15, 1991 PAAD amendment. All CIP allocations, to the maximum extent possible, will be determined by the effective demand from private sector importers for the eligible commodities. To the extent that demand exceeds the funds available, allocations will be made according to the following criteria: (i) impact on agricultural (including fisheries and livestock) production; (ii) distributor's capacity to provide spares and after-sales service; (iii) contribution to increased competition in sales, marketing, or production; (iv) potential impact on the welfare of the poorest Mozambicans.

E. Local Currency

The evolution in Mozambique's foreign exchange allocation mechanisms has resulted in two changes in the way the PSSP CIP local currency counterpart funds are generated.

1. The Exchange Rate for CIP Transactions

It is a requirement that A.I.D.-financed assistance programs that involve local currency deposits based on A.I.D. dollar financing must utilize the highest legal rate of exchange prevailing in a country. In Mozambique, as discussed above, it is U.S. policy to encourage the Government to apply the highest legal rate of exchange throughout the economy in order to promote efficient use of imports and export competitiveness. Thus, since the creation of the secondary exchange market (MSC), USAID has been obliged to utilize this higher rate.

The exchange rate used for calculating local currency deposit requirements with respect to PSSP importations will be fixed on the date USAID issues the Letter of Commitment covering the import transaction, since this is the point at which all parties in the transaction agree on financial terms. The procedure for determining the "highest legal rate" is as follows:

- USAID obtains daily buying and selling rates on the MSC from three major MSC operators: the Bank of Mozambique, the Standard Totta Bank, and SOCIEF;
- USAID calculates the average between the buying and selling rate for each operator; and
- USAID takes the highest average of the three as that day's "highest legal rate."

This procedure is based on USAID discussions with the IMF, and is intended to incorporate into the calculation the fact that large volume buyers in the MSC usually don't pay the selling rate announced by the operator, but get a more preferential rate.

2. Deposit Requirements

In implementing ththis exchange rate procedure, USAID seeks to approximate, to the extent practical, standard commercial practices. Effective January 11, 1991, with the signature of Amendment Three to the PSSP grant agreement, these are the deposit requirements for PSSP CIP transactions:

- Importers deposit in the Bank of Mozambique, or cause to be deposited through such financial instrument as proves acceptable to the Bank of Mozambique, an estimated 20 percent of the local currency equivalent of the A.I.D. dollar financing under the Letter of Commitment covering an import transaction <u>before</u> USAID issues such Letter of Commitment;

- Importers deposit, or cause to be deposited, the balance of the local currency equivalent for each importation in order to receive the original shipping and related documents for the importation; and

- The Government of Mozambique deposits in the Special Account the full local currency equivalent of A.I.D.'s dollar financing for each importation within 120 days after the Bank of Mozambique receives the original shipping and related documents for that importation.

Local currency generated under the PSSP will continue to be monitored and programmed as described in the original PAAD.

Annex A

Draft Updated Letter of Intent

=====DRAFT=====

June .., 1991

Mr. Julius Schlotthauer
Director
USAID Mozambique
Maputo

Dear Mr. Schlotthauer:

The Government of the Republic of Mozambique appreciates the continuing significant assistance of the United States, and particularly your support for the development of Mozambique's food and agriculture sector. The purpose of this letter is to keep you informed of the Government's policies and objectives in this sector, in order to ensure the continuing timely and effective integration of USAID's economic assistance with the Government's Economic and Social Rehabilitation Program.

This letter builds upon its forerunners, dated August 31, 1989, July 3, 1990, and May 15, 1991, and upon the agreements reached between USAID and the Government on the P.L. 480 Programs for 1989, 1990, and 1991. All measures of those agreements remain in full force and, together with this letter, constitute the full range of policy issues agreed upon by USAID and the Government in the food and agriculture sector.

The Economic and Social Rehabilitation Program (ESRP) was described in the Policy Framework Paper for 1990-92; modifications in the ESRP targets since then will be detailed in a new PFP to be published shortly, and the substance of these modifications has been incorporated into the measures described below. The overall ESRP strategy remains unchanged. The focus continues to be on the recovery of the agricultural sector, through continued improvement of price incentives to producers, improved agricultural support services and markets for agricultural products, and efficient marketing of consumer goods in rural areas. To achieve these objectives, the Government continues to take steps to revitalize the commercial distribution system, particularly private trade networks, and to rehabilitate transport infrastructure. In sum, the Government is working to create an economic environment that favors an increased role for the private sector, imposes financial discipline on public enterprises, and gives the exchange rate, prices, and interest rates the central role in resource allocation.

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This letter focuses on the selected policy areas that support the overall ESRP framework and which were agreed upon as the basis for USAID cooperation with the GRM in the Government's letters of August 31, 1989, July 3, 1990, and May 15, 1991. These areas are: agricultural marketing and pricing policy, restructuring of state farms and agriculture-related enterprises, private sector networks for agricultural inputs sales and services, petroleum pricing and distribution policy, and foreign exchange allocation mechanisms. Following is a summary of progress made in these areas in the past year, and of intended policy measures for 1991 and 1992.

In the area of agricultural marketing and pricing policy, our objectives remain to increase agricultural productivity and strengthen competitive markets. Policy changes in 1990-91 continued to increase the role of the market. Except for a few commodities whose prices have been fully liberalized (sorghum, some types of beans), all agricultural commodities are now explicitly on a system of minimum producer prices intended to protect producers as markets re-emerge but suffer from lack of competition. These floor prices are based on import-export parity and revised at least annually to reflect changes in the market.

Consumer prices for domestically produced maize and for beans also were fully liberalized in 1990-91, leaving rice the only domestically produced commodity whose prices are still set by the Government. Rice prices, although still fixed, have been adjusted to import parity to overcome marketing disincentives created by previously inadequate margins between producer and consumer prices. Recent information indicates that real market rice prices are in fact very close to the adjusted official prices.

Marketing reforms have also been announced and implemented in 1990-91 to maximize the production incentive effects of these price policy changes. The Government has removed restrictions on inter-provincial and inter-district trade of agricultural commodities, to enable marketing agents at all levels to respond flexibly to supply and demand conditions. Furthermore, the Government has explicitly opened district wholesaling of formerly controlled basic consumer goods so that any licensed trader can compete; this will promote the emergence of competitive markets in rural areas, an important element in encouraging increased production and laying the groundwork for the transition from semi-subsistence to market production. With assistance financed by USAID and provided by Michigan State University, the Ministry of Agriculture is monitoring price and supply changes in selected markets around the country and completing analyses of constraints to increased agricultural production and marketing.

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In 1991-92, the Government intends to complete the phased price liberalization process by deregulating the consumer price for rice by January 31, 1992 and by again making adjustments in the producer floor prices by September 30, 1991 to maintain the import-export parity base. Also during 1991-92, the Government intends to complete an analysis already underway by the Ministry of Agriculture with the assistance of Michigan State University, which is examining licensing requirements for private marketing agents at all levels, and to take steps to simplify these requirements and make related changes to further encourage market competition. The Government expects that by July 31, 1992, prices and distribution of all food commodities will have been fully liberalized.

Government policies on land distribution and tenure security continue to evolve, and the assistance in this area provided in 1990-91 to the Ministry of Agriculture by the Land Tenure Center with USAID financing has been appreciated. The objective is to increase the economic use and productivity of agricultural lands by developing land use policies and related reforms which will enhance land tenure security overall and encourage investment in agriculture.

An important factor in achieving this objective is the Government's continuing commitment to and significant progress in restructuring state farms and, wherever possible, divesting these to family and private or joint-venture commercial operators. In some cases divestiture remains problematic due to insecure situations in the areas of some state farms or to the limited availability of bank credit for investment by potential buyers. At present, virtually all state farms which have not yet been restructured or divested are inactive; in some cases, although no formal divestiture has occurred, family farmers, workers on the former state farms, or small commercial operators have occupied areas of inactive state farms and brought these lands back into production on their own account.

In 1991-92, the Government intends to continue to restrict credits and subsidies for state agricultural enterprises, including state farms, in accordance with global ceilings agreed upon with the IMF, and to continue divesting these enterprises as appropriate. In addition, the Government intends to continue, with the assistance of the Land Tenure Center, the analysis of divestiture experience to date and the development of divestiture policies and guidelines. Finally, during 1991-92 the Government intends to develop, announce, and implement, with the continuing assistance of the Land Tenure Center, procedures to increase the transparency of the divestiture process through public announcements and opportunities for competitive offers to be made wherever possible.

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Another objective of the Government's agricultural development strategy is to enhance the reach, competitiveness, and viability of networks providing agricultural inputs and services to farmers nationwide. Implementation of the USAID Commodity Import Program through private importers and distributors has effectively supported progress toward this objective for several years. More recent changes in policies governing commodity imports financed by other donors have also contributed. More commodities, and more choices and competition among them, are available to producers in virtually all provinces, although access to these is not consistent due to insecurity in some areas and lack of bank credit for major purchases.

The Government, with support from the World Bank, has also begun to privatize former state enterprises involved in importation, distribution, or services for agricultural equipment and inputs, to make these enterprises more competitive and efficient. Several methods of privatization are being tried: for MECANAGRO, complete privatization is planned and expressions of interest from two companies are being pursued; INTERQUIMICA, INTERMECANO, and ENACOMO are to be transformed into corporations with publicly available shares issued, some shares destined for the workers now employed by the enterprises and others available for private investors; the Government has received an expression of interest from a private enterprise to revitalize BOROR; and STEIA already has been dismantled by selling off its manufacturer-authorized representationships to a number of private operators.

In 1991-92, the Government intends to maintain private importation and distribution of A.I.D.-financed commodities and direct private sales of such commodities to end users. As of 1991, the previous annual limitation of one USAID-financed tractor and truck per end-use client will be discontinued as a further step toward making these networks more market responsive. Also during 1991-92 the Government intends to continue the process of privatization of agriculture-related state enterprises which is described above.

In its May 15, 1991 Letter of Intent, the Government specified additional policy reforms for 1991-92 in the area of petroleum importation and marketing, recognizing the importance of these factors in increased agricultural production and marketing. Specifically, the Government intends to maintain the consumer price for gasoline at or above import parity at the secondary market exchange rate, and to continue to adjust the consumer price of diesel to reflect exchange rate and international price changes. Also during 1991-92, the Government intends to analyze

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the importation and distribution of various petroleum products to identify policy and procedural measures to support a more efficient market in these products. As a first step, by July 31, 1991 the Government will complete an analysis and take action to deregulate the importation, distribution, and pricing of avgas.

The last policy area concerns the allocation and pricing of foreign exchange, which has critical implications for both imports and exports related to agricultural production. The Government's objective in this policy area is to develop a system that is transparent and based on market principles, enabling those who require foreign exchange to obtain it and at the same time ensuring that exporters obtain a fair remuneration for their products. Important changes in this policy area have occurred in 1990-91 in the context of the overall ESRP. In particular, the creation in October 1990 of a secondary exchange market (MSC) whose exchange rate is based on foreign exchange supply and demand, and subsequent devaluations which have moved the official exchange rate closer to the MSC market-based rate, have laid the groundwork for the transition to a market-based foreign exchange regime. Evaluation of the performance of the system established in 1989 for non-administrative allocation of foreign exchange (SNAAD) and the performance of the MSC since its creation, and discussions between the Government, the IMF, and the World Bank, will result in further reforms in this policy area in 1991-92.

First, the Government intends to establish by July 1991 a "negative list" of commodities for which foreign exchange will no longer be made available at the official exchange rate. Establishment of this list, and its phased expansion, will move more and more commodity imports into the secondary exchange market, where supply and demand control the price, thereby ensuring over time the most productive use of available foreign exchange through buyer competition. Second, the Government intends at the same time to move non-traditional exports to the secondary exchange market, providing an expanded source of foreign exchange at market prices. Third, the Government intends, through continuing devaluations and other adjustments, to unify the official and secondary market foreign exchange rates by March 31, 1992. Between now and March, the Government will develop plans for market-based allocation and pricing of foreign exchange once this unification is complete. The Government has in the past appreciated USAID's opinions on progress in this policy area, and will continue to keep USAID fully informed as developments in this area progress throughout 1991 and 1992.

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In conclusion, the Government reaffirms its intention to pursue the food and agriculture sector policy objectives identified in the PFP and in the specific USAID agreements and previous Letters of Intent cited above. We intend to take significant steps in 1991-92 toward achievement of these objectives. These actions will in large part depend on USAID's continuing support, both financial and technical, in this sector. We look forward to continuing our close and productive collaboration.

Sincerely,

Jacinto Soares Veloso
Minister of Cooperation

Annex B

1991 Progress Report on Policy Reform Agenda

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CLASS: UNCLASSIFIED
CERGE: AID 04/04/91
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CLEAR: L.DCM:MMETELI
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AID/W FOR AFR/PD/SA AND AFR/SA
NAIROBI FOR REDSO/ESA

E.O. 12356: N/A
SUBJECT: MOZAMBIQUE PRIVATE SECTOR SUPPORT PROGRAM (656-0208/18): 1991 PROGRESS REPORT ON POLICY REFORM AGENDA

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

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

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

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

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

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

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

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

BACKGROUND

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

7. CONCURRENTLY DURING APRIL-JUNE 1990, USAID PREPARED A PAAD AMENDMENT ADDRESSING MARKETING POLICIES AND INCENTIVES, AND PROPOSED THAT AN ADDITIONAL DOLS 10 MILLION IN AEPRP FUNDING BE PROVIDED THROUGH THE PSSP/CIP FOR TRUCKS AND SPARE PARTS IN SUPPORT OF EXPANDED PRIVATE SECTOR MARKETING ACTIVITIES IN THE THREE NORTHERN PROVINCES OF MOZAMBIQUE. SPECIFIC POLICY REFORM MEASURES INCORPORATED INTO THE ABOVE MENTIONED LETTER OF INTENT FOCUSED ON THE LIBERALIZATION OF AGRICULTURAL MARKETING, PARTICULARLY THE LIFTING OF REGULATORY RESTRICTIONS HAMPERING COMPETITION. WITH AID/W'S GUIDANCE (REF B) USAID OBLIGATED THESE AEPRP FUNDS ON JULY 20, 1990, BRINGING PSSP NPA OBLIGATIONS TO DATE TO DOLS 36.25 MILLION AND THE EXPECTED LOP TOTAL TO DOLS 54.05 MILLION. (IN ADDITION TO THE NON-PROJECT ASSISTANCE, THE PSSP PROVIDES PROJECTIZED TECHNICAL AND RELATED ASSISTANCE IN SUPPORT OF THE POLICY REFORMS THROUGH 656-0218, PRIVATE SECTOR SUPPORT TECHNICAL ASSISTANCE PROJECT; PLANNED LOP FOR PROJECT ACTIVITIES IS DOLS THREE MILLION.)

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

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

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

- B. TO DEVELOP AND INITIATE THE IMPLEMENTATION OF A DIVESTITURE PROGRAM (INCLUDING SUPPORTING POLICIES FOR RATIONAL LAND REDISTRIBUTION, TITLING, AND REGISTRATION) TO REDISTRIBUTE STATE FARMS TO COMMERCIAL FARMERS.

- C. TO DEMONSTRATE THE EFFECTIVENESS AND VIABILITY OF PRIVATE SALES AND SERVICE NETWORKS FOR PROVIDING AGRICULTURAL INPUTS TO COMMERCIAL AND FAMILY FARMERS THROUGHOUT THE COUNTRY.

- D. TO ESTABLISH A PROCESS OF TESTING FOREIGN EXCHANGE ALLOCATION OPTIONS THAT WILL INCREASE THE ACCESS OF PRIVATE ENTREPRENEURS IN THE AGRICULTURAL SECTOR TO FOREIGN EXCHANGE AND INSTITUTIONALIZE MARKET SIGNALS AS AN ALLOCATION MECHANISM.

- E. TO REDUCE RESTRICTIONS ON COMPETITIVE PRIVATE SECTOR TRADE AND TRANSPORTATION SERVING AGRICULTURAL PRODUCERS IN CABO DELGADO, NAMPULA, AND ZAMBEZIA PROVINCES.

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

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

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

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

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

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

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

AGRICULTURAL PRODUCER PRICES

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

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

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

RATE.

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

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

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

STATE FARM DIVESTITURES

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

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

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

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

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

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

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

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

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

PRIVATE NETWORKS FOR AGRICULTURAL INPUTS

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

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

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

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

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

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

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

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

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

DOWN THE ROLE OF PARASTATALS IN THE AGRICULTURE SECTOR.

ACCESS TO FOREIGN EXCHANGE

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

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

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

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

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

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

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

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

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

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

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

PRIVATE MARKETING CHANNELS

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

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

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

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

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

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

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

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

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Annex C

Options for Foreign Exchange Managment

This annex briefly describes two possible options for allocation and pricing of foreign exchange once the official and secondary foreign exchange markets are unified: an open general license (OGL) system, and an auction.

Open General License System

In this approach, the GRM would in effect merge the SNAAD and the MSC as a step toward the target of one unified foreign exchange market operating an an equilibrium rate by December 1992. In this approach, goods in the OGL would be available (relatively) freely upon demand. A necessary feature of such a system would be to move a growing range of commodities into the OGL, permitting gradual upward pressure on the exchange rate. Resources permitting, by a target date the bulk of goods would be made available through the OGL, such that the exchange rate operating in Mozambique would essentially be at a market-clearing level. To be successful, such a system would require that conditions in the OGL element of the system guide exchange rate management decisions. With the supply of foreign exchange largely donor-driven and thus in a very real sense "fixed," demand conditions would be the sole influence on an equilibrating exchange rate. (To the extent that the GRM decides that containing the exchange rate at a level below that market-clearing level is necessary, foreign exchange allocation must inevitably continue.)

The OGL would initially apply to a limited portion of the foreign exchange market, most probably to untied foreign exchange provided by donors. Key elements of such an OGL might be as follows:

1. The OGL would operate, at least at the outset, at the MSC rate or the rate that emerges at the unification of the secondary and official markets. That rate would depreciate over time, in relation to: (a) real effective considerations (such as cross-exchange rates and relative prices); (b) movements in the parallel-official ratios; and (c) demand and supply pressures in the OGL.

2. The OGL would start out with a positive list of (import) commodities, with all imports of commodities on this list occurring at the new OGL exchange rate. The list would expand such that by a target date (say, end of March 1992) virtually all imports would flow through the OGL. Exports, by the same token, would flow through this exchange window, again perhaps with a gradually expanding "eligibility" list.

3. Individual invisible transactions (with appropriate limits for probably the foreseeable future) would also occur at the OGL exchange rate. This would take some pressure off the parallel market rate, and would price these purchases and sales of foreign exchange at a more realistic rate than the official rate.

4. Although this OGL would not be a market in the true sense of the word, the central banking authorities would manage it according to market principles to the extent possible. For example, if demand for foreign exchange to purchase OGL-eligible commodities began to put pressure on OGL-designated supplies of foreign exchange, the authorities would manage this situation through a combination of exchange rate adjustment and supply-side injections of foreign exchange.

Concurrent with implementing any set of strategic exchange regime reforms, the banking system would need to undergo a set of institutional reforms to make the financial system fully capable of carrying out external transactions. Given the weaknesses of the Central Bank, institutional reforms will need to be phased in and accompanied with extensive technical assistance and training. Eventually, management of the OGL (and the exchange system in general) should be moved from the Ministry of Commerce, where the SNAAD is currently located, to the central banking authorities. By the same token, the role of the Ministry of Commerce in administratively allocating foreign exchange would shrink considerably.

Auction System

An alternative to the OGL approach would be for the GRM to institute a foreign exchange auction. The most basic question would be who would run the auction, and who would be the eligible buyers. One option would be for the central bank to auction foreign exchange to commercial banks and other authorized foreign exchange dealers, who would then sell foreign exchange to importers and individuals requiring foreign exchange for invisibles transactions. Such a system would require a strong central bank capable of managing foreign exchange flows in a manner that would have a desirable impact (say, vis-a-vis exports and the parallel exchange rate) on the official exchange rate. Another alternative would be to auction foreign exchange directly to end users, yet this raises another series of issues related to the role of the central and commercial banks, as well as a number of technical questions on implementing an auction. By all accounts, the Mozambican banking system does not presently have the managerial and technical capacity to use auctions for allocation and pricing of foreign exchange.

Generally, auctions would be held on a regular (probably weekly) basis, and would involve presentation of sealed bids. A specific, pre-announced volume of foreign exchange would be made available for each auction, and the previous auction's results would be published immediately after the auction. Successful bidders would be those whose bids, ranked in descending order of metical price offered, sum to the amount to the amount of foreign exchange made available during each auction. Some issues in the conduct of such an auction are:

1. A decision would have to be made on the nature of the foreign exchange auction and the capacity of the implementing institutions. An auction by the central bank to licensed foreign exchange operators is conceptually appealing since it would keep the central bank out of commercial transactions. Auctions by the central bank to end users of foreign exchange could relegate the commercial banking system to the administrative function of opening letters of credit. Both options would be hampered by an irregular flow of foreign exchange.

2. In an auction to end users, a question arises concerning the types of imports for which foreign exchange would be auctioned. Thus, would the GRM opt to from the outset include all importable commodities as eligible for import under the auction? An alternative would be for the GRM to introduce the auction gradually, by including only certain commodities in the auction and allowing the number of commodities to expand over time, according to a specific plan. Such an approach might be less disruptive, allowing the experiment's procedures to work themselves out.

3. A closely related question is that of whether, if the auction is to be introduced gradually by product group, the official exchange rate is to be set at the auction price level or whether the official rate will be separately managed. For example, an official rate covering goods not yet included "within" the auction could be managed in any one of a number of ways. However, such a differential approach would require the IMF's sanction of Mozambique's return to a multiple currency practice.

4. A fourth question arises with regard to the price paid for foreign exchange under the auction. One approach would be for the marginal bid to determine the metical price paid by all successful bidders. A drawback of this approach is that there would be some bidders who bid at excessive levels knowing that they will only have to pay the marginal price. To deal with this phenomenon, a "Dutch auction" could be substituted, wherein the successful bids are determined as before but each bidder pays the price he bids. The auction

exchange rate would still, however, be the price paid by the marginal bidder.

5. A fifth consideration is whether per-enterprise or per-bid ceilings (or floors) should be part of the auction. Such controls might be considered necessary at the outset of the auction's development.

6. A sixth consideration is the extent of information to be published on each auction. At a minimum, the marginally successful bid price should be announced. The amount auctioned would presumably be known anyway, and could also be announced. Should a list of all successful bidders be published? Should full details of their bids, including price bid, amount of foreign exchange received, and type of imports be published? Should the same information on unsuccessful bids be announced?

The foregoing is not meant to be a technical treatment of the options under an auction system for foreign exchange, but is intended to give a flavor for some of the considerations that the GRM will have to weigh if an auction is a serious possibility.