FOR AGENDA

EBS/87/101
Correction 1

CONFIDENTIAL

June 4, 1987

To: Members of the Executive Board

From: The Secretary

Subject: People's Republic of Mozambique - Request for Arrangements Under the Structural Adjustment Facility

The following correction has been made in EBS/87/101 (5/12/87):

Page 1, lines 1 and 2: for "May 8, 1987" read "April 30, 1987"

A corrected page is attached. Other references to the date of the letter of intent on pages 21, 23, 25, and 51, should also read "April 30, 1987" and will be corrected in the appropriate supplement to be issued after the Board discussion scheduled for Monday, June 8, 1987.

Att: (1)

I. Introduction

In the attached letter to the Managing Director, dated April 30, 1987, the Minister of Finance of Mozambique requests a three-year structural adjustment arrangement under the Structural Adjustment Facility (SAF) and the first annual arrangement thereunder in support of an economic program covering calendar years 1987-89, in amounts that will be available to Mozambique under the SAF (presently estimated at SDR 28.67 million, or 47 percent of quota). Of this amount, SDR 12.20 million (20 percent of quota) will be available in one disbursement to Mozambique upon the Executive Board's approval of the requested arrangement for the first year. One half of the remaining amount, including any augmentation, will be available for each of the following two annual arrangements.

The Economic Policy Framework paper (PFP), which was prepared by the Government in collaboration with the staffs of the Fund and the World Bank and is annexed to the Minister's letter, describes the major challenges facing Mozambique, the objectives of the three-year medium-term program, the priorities and broad thrust of macroeconomic and structural adjustment policies, and the need for and availability of external financing. Table 1 attached to the PFP summarizes the measures contained in the program. A Memorandum of Economic Policies, also annexed to the Minister's letter, provides a more detailed description of the first year of the program. The PFP, the three-year, and the annual program were negotiated with the authorities in March 1987, 1/ and, as noted in the PFP and the Memorandum, many of the program's measures were put into effect in early 1987.

The Executive Board concluded the 1986 Article IV consultation with Mozambique on November 20, 1986; the staff report (SM/86/259, October 21, 1986), and the report on recent economic developments (SM/86/268, November 4, 1986) provide a comprehensive background to Mozambique's request for an arrangement under the SAF. Since the consultation discussions in July 1986, there have been technical missions to Mozambique in October 1986 by the Fund staff, and in December 1986 by the World Bank staff (with Fund participation); the economic program described in the attached Memorandum and PFP were negotiated in light of the earlier discussions.

Mozambique became a member of the Fund on September 24, 1984, with a quota of SDR 61 million. It avails itself of the transitional arrangements under Article XIV, Section 2, of the Fund's Articles of

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1/ The staff team, which visited Maputo during March 9-27, consisted of Messrs. R. Stillson (head-AFR), M.C. Niebling (AFR), E. Heredia (STA), and E. Kumah (EP-ETR), and Mrs. I. Almeida (secretary-BLS). Mr. G.E. Gondwe (AFR) joined the mission during the first week, and Mr. A. Abdallah, Executive Director for Mozambique, attended meetings during the last week.

Agreement. Mozambique has not previously drawn on Fund resources; details of the country's relations with the Fund are given in Appendix II. In 1985 the World Bank accorded Mozambique an IDA rehabilitation credit, of SDR 45.5 million and has appraised a second IDA rehabilitation credit which is scheduled to be considered by the Bank's Executive Board in July 1987; details of the country's relations with the Bank are given in Appendix III.

II. Background and Recent Developments

1. Overview

Despite a favorable resource endowment and some large-scale investments, the Mozambican economy has experienced marked declines in production and increasingly severe financial imbalances over the past several years (Appendix IV, Table 1). These were due to a combination of adverse exogenous developments, problems of internal security, and economic policies that proved inappropriate to existing circumstances. In the late 1970s, the exodus of most skilled manpower following independence (1975) and sharp cutbacks in miners' remittances and transit trade from South Africa undercut much of the basis of the colonial economy. Also, large-scale investments were made, financed by heavy external borrowing, which, in many cases, had small returns. In the early 1980s, prolonged drought was experienced in much of the country, followed by cyclones and floods. Moreover, an externally supported armed resistance (referred to by the authorities as "armed bandits"), increasingly disrupted production and marketing in the countryside, targeting transport facilities and export crops.

The result has been a prolonged drop in production, which probably fell by over 40 percent from the post-independence peak of 1980-81 to 1985, and which barely increased in 1986. 1/ External transactions have nearly collapsed, with exports falling by nearly three fourths since 1980-81, imports being compressed sharply, and debt service obligations and external arrears mounting. Internally, because of large fiscal deficits and essentially open-ended bank financing of public enterprise losses, the money stock more than tripled from end-1980 to end-1986, despite the shrinkage of the market economy. Shortages worsened, and barter and parallel markets became widespread.

2. Prices

Under the centralized physical planning undertaken in the early 1980s, little attention was given to the roles of the exchange rate and

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1/ Official GDP estimates are available only for the expenditure accounts and in current prices, and are not yet considered sufficiently accurate to be used for analysis or comparison. The trends in overall production alluded to here are based on indicative World Bank estimates.