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October 21, 1988

To: Members of the Executive Board

From: The Secretary

Subject: People's Republic of Mozambique - Staff Report for the 1988 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with the People's Republic of Mozambique, which is tentatively scheduled for discussion on Wednesday, November 23, 1988. A draft decision appears on pages 30 and 31.

Ms. Carkovic (ext. 8320) or Mr. Abdi (ext. 8517) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF MOZAMBIQUE

Staff Report for the 1988 Article IV Consultation

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by G.E. Gondwe and H.B. Junz

October 20, 1988

I. Introduction

Article IV consultation discussions with Mozambique were held in Maputo during the period August 13-24, 1988. The mission 1/ met with the Minister of Finance, Mr. Abdul Magid Osman, the Minister of Commerce, Mr. Manuel Aranda da Silva, the Governor of the Bank of Mozambique, Mr. Eneas da Conceição Comiche, the National Director for Treasury, Mr. João Coutinho, and other senior officials. Discussions on a few topics were continued and concluded in Berlin (West) at the time of the Annual Meetings.

Mozambique avails itself of the transitional arrangements under Article XIV. Since becoming a member of the Fund on September 24, 1984, Mozambique has not made use of the Fund's ordinary resources. Disbursements for the equivalent of SDR 12.2 million (20 percent of quota) and SDR 18.3 million (30 percent) were made under the first and second annual SAF arrangements in support of programs for 1987 and 1988, respectively. Mozambique has also benefited from technical assistance in the areas of statistics, banking, and Institute training. The World Bank approved an SDR 45.5 million IDA rehabilitation credit for Mozambique in June 1985. A second IDA rehabilitation credit was approved in August 1987, and together with resources obtained under the African facility, provided an additional SDR 69 million. Besides operations that have already been approved in the energy, education and urban sectors, there are lending projects being prepared in the health, industrial, household energy, agricultural, and technical assistance fields. A third rehabilitation credit, focusing on further liberalization of goods and financial markets and on improvements in public expenditure, is being appraised. Summaries of Mozambique's relations

1/ Comprising Messrs. Williams (head), Kimaro, Kakoza, Hadjimichael (all AFR), Ms. Carkovic (ETR), and Ms. Sucharov (secretary-AFR).

with the Fund and the World Bank, and of statistical issues, and performance relating to benchmarks under the 1988 SAF program are provided in Appendices I-IV, respectively.

The last consultation discussions with Mozambique were held during August 8-22, 1987, and the staff report for the 1987 Article IV consultation (SM/87/245) was discussed by the Executive Board on November 18, 1987. On that occasion, Executive Directors commended the authorities' determination to implement a comprehensive program of economic rehabilitation and structural adjustment under particularly difficult circumstances. Noting that program implementation was largely on track and was accompanied by early signs of recovery of production, they urged that the momentum in policy execution be maintained. Directors welcomed the substantial adjustments in the exchange rate, domestic prices and the prudent stance of demand management and incomes policies, and encouraged the authorities to continue these policies to improve resource allocation further and to strengthen the external accounts. Directors also underscored the need for "safety net" measures, close monitoring of budgetary performance, review of public expenditure, adoption of an action program for the public enterprises, and improvements in the data base. They recognized that Mozambique's need for substantial external financing in support of ongoing economic adjustment would continue for many years.

II. Background Developments

1. Developments through 1987

A variety of noneconomic factors (post-independence exodus of entrepreneurs and skilled labor, droughts, floods, regional tensions, and insurgent activity) and policy weaknesses (expansionary financial policies, pervasive price controls, inefficient administrative allocation of resources, and misalignment of the exchange rate) resulted in a sharp contraction of output and severe financial imbalances during 1982-86. Over the five-year period, real GDP fell by nearly one third, with marketed production of most crops and activity in the industrial and other economic sectors declining even more sharply (Table 1). Meanwhile, parallel markets emerged and widened, and by 1986 goods and foreign exchange were, respectively, selling for up to 10 times and 40 times their official equivalents. In the external accounts, the value of exports and imports shrunk by nearly two thirds and one third, respectively. 1/ Moreover, capital inflows declined while debt service payments escalated, resulting in a massive accumulation of arrears. At end-1986, the outstanding disbursed public debt, inclusive of arrears, was US$3.2 billion.

1/ The official exchange rate for the national currency, the metical (plural is meticais), remained largely unchanged around Mt. 40 = US$1 during the 1982-86 period.

Table 1. Mozambique: Summary Trends in Production, Consumption, and Investment Indicators, 1982-87

(Changes in percent)

	1982	1983	1984	1985	1986	1987	The level of 1987 as percent of the average for 1980-81
National accounts							
Global social product at 1980 prices	-6.3	-18.3	-9.6	-7.4	1.6	3.6	71.0
GDP at constant 1980 prices 1/	-3.5	-12.8	1.6	-9.4	0.6	4.0	81.0
GDP at current market prices 1/	15.0	-0.9	17.2	36.1	13.9	158.6	--
Gross fixed investment at 1980 prices	-4.5	-50.3	17.8	-16.3	51.4	16.0	100.0
Total consumption	-0.5	-5.4	-0.3	-10.9	-1.1	2.9	88.6
Marketed agricultural production							
Cashew nuts	-36.7	-68.2	39.8	20.2	31.9	-6.5	42.2
Seed cotton	-17.6	-59.3	-20.6	-71.1	89.5	152.8	39.4
Tea	10.6	-53.4	-17.0	-58.2	-79.4	-71.9	2.0
Sugar	-29.1	-41.4	-46.7	-36.6	-32.4	...	...
Rice	43.6	-58.3	10.5	-5.8	6.1	65.8	86.9
Maize	13.6	-37.4	47.8	-29.0	-63.3	27.0	38.1
Industrial production 2/							
Heavy industry and energy	-3.7	-20.4	-41.7	-33.6	-4.2	...	...
Light industry and food	-13.3	-3.7	4.8	-19.0	2.6	...	...
Total (including others)	-13.8	-20.0	-21.4	-18.4	-0.9	6.4	47.4
Energy							
Domestic supply	-2.2	-16.0	-24.0	12.2	-2.6	...	...
Electricity-generated	-15.3	103.9	-91.0	28.0	-35.0	12.5	6.0
Coal production	-31.2	-73.9	-6.4	12.0	5.0	67.5	39.0
Petroleum products 3/	7.9	-39.5	-60.9	-100.0	--	--	--
Transportation							
Rail freight (ton-km)	-20.4	-39.2	-30.1	-46.1	4.8	1.9	24.3
Port handling (shipping tons)	--	-26.7	-21.2	-13.5	-6.7	7.4	46.0

Source: National Directorate of Statistics.

1/ GDP data are based on expenditure accounts. There are no official data on sectoral value added.
2/ At constant 1980 prices.
3/ Since the closing of the refinery in 1985, the production of petroleum products has been nil.

The remedial measures taken during 1984-86 had proved insufficient to reverse the severe economic decline. Accordingly, in January 1987, the Government introduced a far-reaching and comprehensive Economic Rehabilitation Program (ERP) intended to strengthen growth prospects and to reduce financial imbalances in the economy. This program for 1987, which was set forth in a Policy Framework Paper (1987-89) and supported by the first annual SAF arrangement, included major steps toward restoring price incentives and strengthening overall allocative efficiency. The program was implemented largely as planned. The metical was devalued from Mt. 39 per U.S. dollar to Mt. 200 per U.S. dollar in January, and to Mt. 400 per U.S. dollar in June 1987. Fixed prices of commodities and services were raised manyfold, the number of products subject to such pricing was reduced by 20 percent in the first year, and increases of prices regulated through mark-ups were permitted without prior approval. In the fiscal field, the revenue base was strengthened through tax reform, recurrent expenditure was contained, with a cap on consumer subsidies and on the financing of losses of public enterprises. The rate of monetary expansion was kept significantly below that of nominal GDP, while interest rates were raised (from a maxima of 6 percent for deposits and 10 percent for loans to 20 percent and 35 percent, respectively). Steps were taken to separate the central and commercial banking operations and accounts of the Bank of Mozambique and to greatly strengthen banks' procedures for evaluating loan requests. On the basis of these policies, the Government successfully approached donors and creditors for significant additional financial support in the form of concessional aid and debt relief.

Most of the unfavorable economic trends of the preceding years seem to have been reversed in 1987. Real GDP is estimated to have risen by 4 percent, reflecting, among other things, enhanced producer price incentives and increased supplies of imported industrial inputs and spare parts. Further, the enhanced supply of commodities and restrained demand management policies resulted in a substantial narrowing of the spreads between parallel market and official prices and exchange rates. In Maputo, for example, the parallel market exchange rate appreciated from the Mt. 1,500-1,800 per U.S. dollar range in late 1986 (about fortyfold the official rate) to Mt. 900 per U.S. dollar (roughly twofold) by mid-1987. Consumer prices, as expected, increased sharply (perhaps by as much as 160 percent) reflecting major adjustments in administered prices as well as the pass through of the devaluation. With average wages increasing by about 90 percent, and reductions in the work force in the public enterprise sector and in the civil service (by 10 percent), real incomes of urban dwellers declined, accentuating the need for "safety net" measures.

Improvements in the budgetary and monetary fields and in the external accounts were also achieved. Total budgetary revenue and expenditure increased by more than threefold, with capital outlays 1/--matched by inflows of foreign grants and loans--rising sevenfold. In relation to GDP, the current budget deficit (excluding grants) was more than halved to 5.1 percent, while the overall deficit, including grants, declined by about 3 1/2 percentage points to about 12 percent (excluding grants, it increased by 3 percentage points to 21 percent). 2/ Government recourse to bank credit also fell substantially, and the growth of money supply was limited to about one third the rate of expansion of nominal GDP.

In the balance of payments, exports recovered by nearly one fourth from the very low level of the preceding years, and imports rose by about 13 percent, financed mainly by increased inflows of foreign grants and some increase in loan disbursements. The Government secured aid commitments through a UNDP-sponsored food donor conference and a Consultative Group meeting and debt relief through reschedulings under the London Club and the Paris Club. Meanwhile, gross official international reserves (including the proceeds of aid loans awaiting utilization) increased by more than twofold, reaching US$148 million, or about 2 1/2 months' imports by year-end.

2. Developments in 1988

The economic recovery in Mozambique seems to have continued in 1988. The program for 1988 (supported by the second annual arrangement under the SAF) was aimed at accelerating real GDP growth to almost 6 percent, lowering consumer price increases by one half to about 70 percent, and improving the external position through, inter alia, the strengthening of export prospects and the maintenance of regular relations with creditors. In the event, while GDP growth may be somewhat lower than planned, inflation seems to have decelerated even faster than targeted and, compared to a target of no change, gross international reserves are now projected to increase moderately. The program objectives were to be achieved principally through:

1/ Capital outlays have tended to include, in addition to government investment spending, rehabilitation and related recurrent expenditure financed from abroad, thus weakening the reliability of the current budget balance as an indicator of the Government's savings position.

2/ Changes over time in the ratio of budgetary aggregates to nominal GDP need to be interpreted with caution in the context of large and rapid changes in relative prices and a weak statistical base. Mozambique's ratios of budgetary aggregates to GDP tend to underestimate the degree of deterioration in government finances during 1980-86 and to underestimate the underlying improvement during 1987-88. For more details, see Chapter IV of the Recent Economic Developments paper.

(1) Further strengthening of market-related price signals through sharp increases in prices of staples; full pass through of the effects of exchange rate adjustments; continued reduction of the number of products subject to centrally fixed prices; further increases in agricultural producer prices; and adjustments in rents for nationalized housing;

(2) Continued flexibility in the management of the exchange rate, with a view to substantially reducing the gap between the official and the parallel market exchange rate by mid-1988 and, thereafter, to preventing the gap from widening through monthly exchange rate adjustments. This was to pave the way for introduction, in 1989, of new criteria and modalities for flexible exchange rate management;

(3) Additional steps toward relaxation of exchange and trade controls, including the introduction, by end-July 1988, of routine and automatic licensing procedures for a limited list of imports and some rationalization of existing guidelines for foreign exchange allocation.

(4) Limiting wage adjustments in early 1988 to amounts necessary to partially compensate for the major increase in the cost of staples in March, with a midyear adjustment to keep wage earnings broadly in line with expected additional increases in living costs;

(5) Continued strengthening of public finances with the government recourse to the banking system declining further through a variety of revenue measures and restraint on most categories of current expenditure. Additional revenue measures were to be identified by June 1988 for introduction, at the latest, with the 1989 budget. The program also provided for a variety of fiscal measures of a structural nature, including a process of external tariff reform, commencing with rate simplification in late 1988; restructuring of public investment expenditure to emphasize rehabilitation and maintenance; a comprehensive review of public expenditure; and the establishment of a technical support unit in the Ministry of Finance to help prepare an action program for addressing the problem of the parastatal sector.

(6) Pursuit of a nonaccommodative monetary policy, supported by: an increase (from 3 to 8 percent) in the interest rate charged on the major part of outstanding bank loans to Government; enforcement of interest payments (on bank borrowing) by both the Government and the enterprise sector; simplification, by mid-1988, of the structure of bank lending rates; regularization of some of the nonperforming loans held by the banking system; implementation of a new plan of accounts for the banking system and extended application of commercial criteria in assessing bank credit applications;

(7) Establishment of specialized funds for agricultural credit;

(8) Mobilization of additional resources to finance a sizable increase in the level of imports commensurate with rehabilitation needs and an accelerated pace of economic recovery.

At the time of the discussions in August, significant progress had been made in implementing the program for 1988, and, despite some departures and delays in meeting benchmarks and in initiating certain measures, there was a strong indication that the broad objectives for the year as a whole could be attained. Information on output was still tentative, pending a further assessment of the impact of the security situation on agricultural performance in certain areas, but provisionally, the authorities expected real GDP growth in 1988 to approximate 5 percent (Table 2). With adequate weather conditions and a favorable response, especially by the smallholder sector, to improved producer price incentives and enhanced availability of consumption goods in the rural sector, agricultural output was estimated to rise by some 9 percent in 1988. Apart from the commercial sector, the gross production of which could increase in real terms by as much as 14 percent, performance in most of the other sectors has been mixed. Construction has been virtually flat, owing to the completion or tapering off of major investment projects. Activity in the transportation sector declined during the first half of 1988 because of security problems, but some recovery is expected during the latter part of the year. Moreover, industrial production, which during the first quarter was adversely affected by lack of imported inputs and spare parts as well as the security situation, started to recover in the second quarter and was expected to register further gains in the remainder of 1988.

As in 1987, prices, wages, and financial conditions have been significantly influenced by continued adjustment in the exchange rate. Thus far in 1988, the exchange rate for the metical has been devalued in three steps from Mt. 400 per U.S. dollar (buying rate) to Mt. 450 per U.S. dollar in January, to Mt. 580 per U.S. dollar at the beginning of July, and to Mt. 620 per U.S. dollar on October 15, bringing the cumulative depreciation in U.S dollar terms to almost 36 percent since end-1987, and 94 percent since December 1986. Meanwhile, the exchange rate in the parallel market, which had been relatively stable for several months, depreciated from around Mt. 900 per U.S. dollar in early 1988 to approximately Mt. 1,350 per U.S. dollar by midyear. Subsequently, the rate appreciated to around Mt. 1,200 per U.S. dollar by mid-August, and has fluctuated around that level.

Domestic prices have been adjusted largely as planned. Substantial increases in producer prices for the 1987/88 season were announced in the fall of 1987 and effected in early 1988. The 1988/89 producer prices for agricultural products, ranging from 52 percent for beans and 93 percent for rice, were announced in the latter part of October

Table 2. Mozambique: Selected Economic and Financial Indicators, 1984-88

Economic and financial indicators	1984	1985	1986	1987 Prog. 1/	1987 Actual	1988 Prog.	1988 Rev. proj.
	(Annual percentage changes, unless otherwise specified)						
Production and prices							
GDP at 1980 prices 2/	2.2	-10.4	2.0	1.2	4.0	5.9	5.0
GDP deflator 2/	22.0	51.0	15.6	...	140.7	63.1	39.6
Consumer prices	30.3	29.2	38.7	...	163.3	70.0	55.0
External trade (based on US$ values)							
Exports, f.o.b.	-27.3	-19.9	3.2	8.9	22.6	22.2	8.5
Imports, c.i.f.	-15.2	-21.5	28.1	18.8	12.6	17.1	23.1
Terms of trade	15.2	5.0	14.2	-2.1	-0.8	-0.7	-6.6
Exchange rate							
Annual average (US$/Mt.)	-5.3	-1.7	6.8	-83.8	-86.1	-34.0	...
Nominal effective 3/	17.8	7.3	-9.3	-90.8	-90.9	...	...
Government budget (cash basis)							
Revenue	-2.4	-14.2	15.5	263.7	210.1	74.9	74.9
Tax revenue	1.5	-17.4	17.4	372.5	271.6	84.7	83.9
Total expenditure	8.7	-11.6	30.5	256.7	207.3 4/	103.0	81.8
Current expenditure	7.4	17.3	28.7	149.4	113.9 4/	71.1	69.8
Money and credit							
Domestic credit	20.7	16.1	17.1	23.7 5/	17.2	34.0	34.0 6/
Government (net)	64.1	21.4	21.7	76.0 7/	43.8 7/	42.3	42.3 6/
Economy	14.1	14.9	16.1	11.0 5/	14.8 5/ 7/	31.7	31.7
Money and quasi-money	15.4	15.4	15.5	44.6	47.3	43.0	43.0
	(In units stated)						
Overall balance of payments deficit (US$ millions)	355.7	353.4	488.0	458.7	459.4	494.1	450.0
Gross foreign reserves (months of imports, c.i.f.)	1.7	1.2	1.5	1.6	2.6	2.5	2.6
External debt (US$ millions)	2,388	2,794	3,157	3,560	4,006	3,563	4,453
Of which: arrears	(454)	(589)	(711)	(--)	(--)	(--)	(--)
Debt service ratio 8/							
Before debt relief	195.9	215.4	247.4	237.7	231.6	239.7	239.5
After debt relief	96.2	110.4	247.4	45.3	21.4	57.5	55.5

Sources: Data provided by the Mozambican authorities; the World Bank; and staff estimates.

1/ Percent changes from data used for program, i.e., revisions to 1986 data not reflected.
2/ Provisional staff estimates.
3/ December averages compared.
4/ Reflects inclusion of enterprise subsidies in expenditure data (estimated bank credit for 1984-86).
5/ Does not include foreign borrowing on-lent through domestic credit.
6/ Indications are that the rate of expansion could be lower. However, the benchmarks have not been revised downwards.
7/ Reflects shift of financing of enterprise losses from banks to budget in 1987.
8/ External debt service as percent of exports of goods and services (including workers' remittances).

1988. Administered prices of rationed staple goods 1/ were increased by up to 410 percent in late March; among these, the price of sugar was increased again in October. Moreover, with a few exceptions, fixed and margin-regulated prices have been increased to allow a full pass through of the exchange rate changes. Rents for public housing have also been raised substantially, although they remain low. Available information, mostly for Maputo, indicates that consumer prices in 1988 could rise at a somewhat slower pace (55-60 percent) than was assumed in the program (70 percent). The adjustment in prices of rationed goods was accompanied by sectoral across-the-board wage increases for salaried workers of Mt 5,200-6,000 per month (the industrial sector's minimum monthly wage rose from Mt. 6,800 to Mt. 12,800; the agricultural sector from Mt. 3,800 to Mt. 9,800; and the government sector from Mt. 7,300 to Mt. 12,500). These uniform increases, bringing a sharply tapererd percentage salary increase for higher paid workers, compare with an average increase of about Mt. 4,000 that had been envisaged under the program. However, the impact on the average wage bill was more than offset by the delay in granting a follow-up wage adjustment of 15 percent announced in mid-October instead of end-June 1988.

During the first half of 1988, budgetary performance was consistent with achievement of the program targets, given the normal seasonality factors and likely trends in prices. Total budgetary revenue over the six-month period was close to 50 percent of projected annual receipts, with better-than-expected yield of taxes on income and profits offsetting a shortfall for most of the other taxes. Over the same period, current expenditure amounted to slightly less than one half of the projected total for the year. In particular, outlays on wages and salaries and on virtually all the other categories of expenditure were less than half the annual totals. Also, budgetary capital outlays amounted to less than 40 percent of the programmed level for 1988, reflecting seasonal influences and a shortfall in the disbursement of foreign loans. As a result, the budgetary deficit evolved as programmed, and government recourse to bank credit, which had somewhat exceeded the benchmark for end-March, was contained well below the program targets for end-June 1988. 2/

Monetary and credit aggregates remained well within the programmed ranges for the first half of 1988. Broad money during the period increased by only about 9 percent, with demand and savings deposits growing at a sluggish pace and term deposits declining somewhat. Credit to the Government (allowing for unpaid interest to the Bank of Mozambique) rose by Mt. 8.5 billion, compared to a ceiling of Mt. 15 billion

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1/ Six staple goods are rationed in Maputo and Beira. These are maize, flour, rice, sugar, edible oil, and soap.

2/ In relation to the stock of broad money at the beginning of 1988, the deviation in March was equivalent to 1 1/2 percent; at end-June 1988, credit to Government was below the benchmark by the equivalent of 4 percent of the money stock.

under the program. Credit to the economy rose by about Mt. 21 billion (an annual rate of expansion of about 25 percent) but excluding the loans financed by the proceeds of medium- and long-term concessional external credits for onlending, which are outside the benchmarks, the expansion was well below the programmed amount.

Balance of payments developments in the first half of 1988 appeared to be broadly in line with the program targets: the limited information available indicated that the trade account, most of the items in the service accounts and unrequited foreign transfers were evolving as programmed; that workers' remittances were higher than projected; and that loan disbursements were lower than forecast. Gross official international reserves, targeted to be unchanged for the year, had increased by US$27 million to about US$175 million, or about 2 1/2 months of imports by end-June, but were expected to decline by up to US$17 million in the second half of the year. At the time of the staff visit, discussions on the London Club rescheduling agreement were still continuing, and bilateral rescheduling agreements with a number of Paris Club members had not been concluded. Some agreements with important official creditors that did not participate in the Paris Club agreement had been finalized, providing for debt rescheduling on highly concessional terms, while discussions with the remaining official creditors had been initiated in most cases. The Government was also engaged in intensive discussions with the World Bank concerning practical procedures for introducing a further liberalization of imports. Mozambique continues to maintain comprehensive restrictions on the making of payments and transfers for current international transactions. Agreements with a few neighboring Fund member countries have restrictive payments features, although in most cases the outstanding balances are small.

III. Report on the Policy Discussions

The discussions concentrated on the execution of the 1988 economic program and on near-term economic prospects. The mission considered that policy implementation has been generally on track, and it was agreed that the comprehensive economic adjustment programs in 1987 and 1988 were largely achieving the aims of economic rehabilitation and recovery and of reducing underlying financial imbalances. There were, however, some departures from the programs in the exchange rate field and delays in adopting certain structural measures. Because of the importance of maintaining the pace of adjustment, these elements were given considerable attention in the discussions. It was clear from the discussions that the implementation of wide-ranging reforms was proving extremely demanding on Mozambique's limited skilled manpower resources. Largely because of this, the authorities had not been able to focus as yet on policies for next year. Accordingly, discussions on macroeconomic policies for 1989 were confined to a few selected areas. A comprehensive review of near- and medium-term policies, including the economic program for 1989, will be discussed by a mission later this year which, together with World Bank staff, will assist the authorities in updating the Policy Framework Paper.

1. Production, pricing, and wage policies

The Mozambican representatives were encouraged by the overall pace of economic recovery and attributed the improvement in agricultural performance to the strengthening of price and other production incentives since 1987 and to recent favorable weather conditions. Consistent with the recommendation of a World Bank agricultural study, adjustments in producer prices have continued to take into account trends in export and import parity prices and in producer prices of neighboring countries. The authorities noted that producer prices for cashew nuts were being raised further by about 57 percent for the 1988/89 crop season, and that the prices of other crops would also be significantly increased again. 1/ Performance in some agricultural regions and in other sectors had been mixed, partly because of the security situation. During the early part of this year, light manufacturing and transport activities had been particularly slow because of shortages of imported inputs and spare parts but started to recover in the second quarter. The availability of these imports would, however, increase in the second half of the year, owing to the expected accelerated disbursement of foreign funds. This, coupled with the ongoing restructuring and the rationalization of marketing and other operational aspects of public enterprises, was likely to result in a more balanced economic expansion.

According to the authorities, prices had been adjusted largely in keeping with the program. Margin-regulated prices have been revised on the basis of developments in costs and stipulated profit margins. Also, with the exception of the few cases noted below, which were dealt with in October, fixed prices, including those of rationed products, were increased to ensure a more realistic alignment with costs and the pass-through effect of exchange rate adjustment. As a result, budgetary subsidies for consumer goods are expected to decline significantly in 1988 and to be confined only to maize, cooking oil, and fish; 2/ subsidies on fish account for about 80 percent of total consumer subsidies at present. Following the exchange rate adjustment on July 1, 1988, prices of rationed products were not increased. However, in mid-October, the authorities announced another round of price increases for a range of items, including electricity (24-35 percent), fish (70 percent), sugar (17 percent), telecommunications, and transport services

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1/ In mid-October, increases of producer prices for the 1988/89 season, including 93 percent for rice, 70 percent for groundnuts, 68 percent for cotton, 37 percent for cashew nuts, and 53 percent for beans, were announced.

2/ Only fish sold by large enterprises is subject to price controls and domestic consumption subsidies.

(ranging from 25-167 percent). Thus far, the prices of those agricultural products whose prices were freed (e.g., fruits and vegetables) have been generally stable, and those of goods freely traded in the parallel markets have increased at a markedly slower pace than administered prices.

Incomes policy in 1988, by focussing on uniform wage increases fixed in absolute terms, aimed at alleviating the impact of economic adjustment on the standard of living of lower paid, mainly urban, workers who are relatively highly dependent on rations of essential commodities at official prices. However, wage policy is also aimed at continuing, to the extent possible, the policy initiated in 1987 of granting productivity bonuses to upper level and other skilled workers so as to help attract and retain qualified people in the civil service and public enterprises. In the event, the wage supplement awarded in April 1988 reflected a more realistic assessment of the incidence of the price increases of rationed staple goods on the cost of living of a family of four (instead of three, as originally assumed under the program). Nonetheless, as most families comprise more than four persons, the wage increments did not fully compensate for the increase in the cost of living arising from the March price adjustments for rationed staple goods. This, coupled with the rise in unemployment (described below), have entailed hardships for a sizable segment of the urban population, particularly large families and non-salaried persons. In these circumstances, and as indicated to the mission, the authorities announced, in mid-October, an additional wage increase of 15 percent in conjunction with the further adjustments in administered prices and in the exchange rate.

In this connection, the authorities noted that the various "safety net" initiatives to be explored under the program had been delayed by difficulties in targeting and by limited institutional capacity to effectively implement these initiatives. However, they were planning to take a number of measures shortly with a view to ensuring a more affordable access, by the vulnerable groups, to transportation services, medical care, schooling opportunities, and energy as well as essential food items. The Fund representatives shared the concern of the authorities in this area and urged that they continue to work closely with the World Bank and other donors in order to develop measures that would be both effective and as efficiently targeted as possible.

The Mozambican representatives noted that the rate of unemployment in the urban areas had tended to increase because of a retrenchment in the public sector, repatriation of migrant workers from South Africa, and rationalization of operations of public enterprises. Because of the large number of workers wholly dependent on certain operations in the sugar sector, and the difficulty in reabsorbing these workers in present circumstancs, the authorities have not taken action to close the loss-making sugar enterprise whose operations were severely affected by the security situation. Such sugar operations, in fact, continue to account for the bulk of budgetary subsidies now being channeled to the enterprise sector. The authorities agreed with the mission that while this approach could be justified in the short term, longer term solutions, including decisions regarding the continued existence of certain of these entities, would be needed.

2. Public finances

The authorities and the staff representatives shared the view that, taking into account the favorable fiscal developments during the first half of 1988, the likely trends in output and prices, and the prospective increase in wages, the budgetary targets for 1988 would be attained (Table 3). Commenting more specifically on revenue developments, the authorities explained that receipts from indirect taxes had been lower than expected during the first six months of 1988. Consumption taxes were particularly affected by the slow expansion in retail sales of beverages and tobacco, while the yield from customs duties continued to be adversely influenced by problems in tax administration. The shortfall in indirect taxes had, however, been offset by increased yields from direct taxes, reflecting mainly the introduction of a system of advance payment of business profits tax on the basis of estimated current year profits, and in part the buoyant expansion in nominal incomes and improvements in tax administration. For the remainder of 1988, the authorities were expecting receipts from indirect taxes to pick up in line with anticipated recovery in output. Moreover, import duty collections were expected to increase somewhat, reflecting recent initiatives to strengthen customs administration, now within the Ministry of Finance. The authorities have requested long-term technical assistance from the Fund to help strengthen customs administration.

The identification of the package of additional revenue measures--to have been finalized by midyear--was delayed essentially because of manpower constraints. The authorities emphasized that the revenue package would be identified in time for the 1989 budget. In this regard, they stated that they would consider the recommendations in the latest Fiscal Affairs tax report 1/ and also explore additional measures with the help of technical assistance from abroad. The authorities also reaffirmed that the process of tariff reform would be continued over the coming months, with the simplification of the tariff rates during the second half of 1988 paving the way for a more systematic rationalization of tariffs in 1989. 2/

1/ The main recommendations of the FAD tax report entailed the extension of the turnover tax to imports and a revision of the rate structure of the turnover tax.

2/ The existing import tariff structure is fairly complex, with often meaningless differentiation, which is in many cases regressive and a disincentive to production. The revenue yield from import taxes in Mozambique has been relatively low in comparison with other developing countries, reflecting mainly exemptions of some 70 percent of imports from import taxes.

Table 3. Mozambique: Government Finances, 1984–88

	1984	1985	1986	1987 Prog.	1987 First half	1987 Second half	1987 Total est.	1988 1/ Prog.	1988 1/ First half Prov.	1988 1/ Second half Rev. proj.	1988 1/ Total rev. proj.
	(In billions of meticais)										
Total revenue	22.3	19.1	22.1	80.5	22.5	46.1	68.6	120.0	56.6	63.4	120.0
Tax revenue	16.2	13.3	15.6	73.9	18.2	39.9	58.1	107.3	48.2	58.7	106.9
Taxes on income and profits	4.4	4.3	4.4	9.7	5.1	10.0	15.1	17.7	12.3	18.7	31.0
Taxes on goods and services	9.3	6.7	9.0	47.4	9.7	20.0	29.7	63.3	25.2	27.0	52.2
Taxes on international trade	1.8	1.5	1.5	13.2	2.5	7.4	9.9	21.5	8.3	10.9	19.2
Other taxes	0.8	0.8	0.7	3.6	0.9	2.4	3.4	4.8	2.5	2.0	4.5
Nontax revenue	6.1	5.8	6.5	6.6	4.2	6.3	10.5	12.7	8.4	4.7	13.2
Current expenditure	28.0	32.9	42.4	105.6	35.7	54.9	90.6	155.0	71.5	82.4	153.9
Of which: budget year											
Defense and security	10.3	11.0	12.4	42.4	15.9	25.9	41.7	62.7	30.5	32.2	62.7
Salaries and wages	7.2	7.6	8.0	17.6	5.1	9.9	15.0	25.8	9.8	13.6	23.4
Goods and services	4.0	4.3	5.0	14.4	4.8	7.9	12.7	21.5	9.2	12.3	21.5
Interest on public debt	0.1	0.1	0.8	7.4	2.7	5.6	8.3	24.9	5.8	22.0	27.7
Subsidies (price and enterprise) 2/	6.4	9.5	14.7	20.8	3.8	11.1	14.8	15.5	6.1	9.4	15.5
Other current expenditure	0.9	0.9	1.3	5.5	0.6	1.4	2.0	8.1	3.4	4.2	7.6
Current deficit (surplus -)	5.7	13.8	20.2	25.1	13.2	8.8	22.0	35.0	14.9	19.0	33.9
Memo: Excluding interest	5.7	13.7	19.4	17.7	10.6	3.2	13.7	10.1	9.1	-3.0	6.1
Capital expenditure	16.7	6.7	9.3	78.5	28.3	39.7	68.0	167.0	64.5	69.9	134.5
Total expenditure	44.8	39.6	51.6	184.1	64.0	94.6	158.6	322.0	136.0	152.3	288.3
Net lending (financial arrangement with railways corporation) 3/	—	—	—	—	—	—	—	—	—	10.0	10.0
Overall deficit before grants	22.5	20.4	29.5	103.6	41.5	48.5	90.0	202.0	79.5	98.9	178.3
Grants received	2.9	3.0	3.9	63.6	18.3	21.3	39.6	108.5	46.5	57.0	103.4
Overall deficit after grants	19.6	17.4	25.6	40.0	23.2	27.2	50.4	93.5	33.0	41.9	74.9
External borrowing (net)	4.7	5.1	5.9	15.3	12.9	20.6	33.5	73.5	20.0	24.9	44.9
Drawings	4.8	5.2	6.1	24.4	13.5	22.5	36.0	86.5	22.0	28.0	50.0
Amortization (paid)	-0.1	-0.1	-0.2	-9.1	-0.6	-1.9	-2.5	-13.0	-1.0	-3.1	-5.1
Domestic financing (net)	14.8	12.3	19.7	24.7	10.3	6.6	16.9	20.0	13.0	17.0	30.0
Domestic bank financing (net) 2/	14.7	13.8	20.1	25.0	7.3	9.4	16.7	20.0	8.5	11.5	20.0
Treasury bonds (nonbank sector) 3/	--	—	—	—	—	—	—	—	5.0	5.0	10.0
Other financing and discrepancy	0.1	-1.5	-0.4	-0.3	3.0	-2.8	0.2	—	-0.5	0.5	—
	(In percent)										
Ratios to GDP:											
Total revenue	20.7	13.1	13.3	19.9	...	...	15.9	16.1	...	...	17.7
Total expenditure	41.6	27.0	30.9	45.5	...	...	36.8	43.2	...	...	45.6
Current deficit	5.3	9.4	12.1	6.2	...	...	5.1	4.7	...	...	5.4
Overall deficit before grants	20.8	13.9	17.7	25.6	...	...	20.9	27.1	...	...	26.2
Overall deficit after grants	18.2	11.9	15.3	9.9	...	...	11.7	12.5	...	...	11.8
Domestic bank financing	13.6	9.4	12.0	6.2	...	...	3.9	2.7	...	...	2.9
Ratios to total expenditure:											
Total revenue	49.8	48.4	42.9	43.7	35.1	48.7	43.3	37.3	41.6	41.6	41.6
Current expenditure	62.6	83.2	82.1	57.4	55.8	58.0	57.1	48.1	52.6	54.1	53.4
Overall deficit before grants	50.2	51.6	57.1	56.3	64.9	51.3	56.7	62.7	58.4	64.9	61.9
Grants received	6.5	7.6	7.6	34.6	28.6	22.5	25.0	33.7	34.2	37.4	35.9
Overall deficit after grants	43.7	44.0	49.6	21.7	36.3	28.8	31.8	29.0	24.3	27.5	26.0
Domestic bank financing	32.8	34.8	39.0	13.6	11.4	9.9	10.5	6.2	6.2	7.6	6.9
Grants and net foreign financing/investment	45.6	122.0	105.7	100.5	110.2	105.5	107.5	109.0	103.0	117.1	110.3

Sources: Data provided by the authorities; and staff estimates.

1/ Preliminary official estimates for the first half of 1988 and provisional official projections for the year as a whole.
2/ Includes estimates of enterprise losses subsidized by banks before 1987, when subsidization shifted to budget.
3/ Sales of treasury bonds with the proceeds used by the railways corporation to repay Mt. 10 billion of outstanding bank debts. The railways corporation assumed the responsibility of servicing (interest and amortization) the treasury bonds.

The Mozambican representatives noted the constraint imposed on budgetary management by the commitment of a substantial proportion (40 percent) of current expenditure to defense and security, but nevertheless, underscored their commitment to expenditure restraint. In particular, they noted that civil service employment had remained largely unchanged in 1988 owing to a general freeze on new hirings, following a sizable reduction in 1987. Moreover, because of the delayed award of a second salary adjustment in 1988, the increase in the wage bill for the year as a whole would be limited to about 56 percent, compared to some 70 percent envisaged under the program. The revised price and wage projections were consistent with approximate maintenance of the wage bill in real terms in 1988, as envisaged in the program.

The authorities were optimistic that outlays on subsidies would decline in the period ahead because of continued adjustment in officially controlled prices and ongoing efforts to strengthen the financial performance of public enterprises. In this regard, they noted that the public enterprise unit will start operating in September 1988. The unit, reinforced with the services of a foreign consulting firm, is currently reviewing the financial performance of 40 enterprises with emphasis on ten strategic and large loss-making entities in maritime and surface transport, distribution of electricity and petroleum products, and sugar and cotton industries. The intention is to develop an action program for the latter group, including steps for financial restructuring, within a year. Parallel efforts, including enhanced involvement of the private sector, will continue to be made, in order to strengthen further the organizational and managerial structures of other enterprises.

The Mozambican representatives noted that, in the broad context of strengthening the financial position of the public enterprises vis-à-vis the banking system, the Government has decided to assume responsibility for Mt. 35 billion of the nonperforming loans owed by certain public entities. Of this amount, Mt. 25 billion is being retired in 1988 out of counterpart funds. 1/ The remainder (Mt. 10 billion) represents bank debts of the railways corporation that are to be retired from the proceeds of a government loan funded by a special issue of treasury bonds to the nonbank sector. This arrangement was intended, in part, to support the ongoing restructuring efforts that have enabled the corporation to start realizing profits since mid-1987.

The mission elicited the authorities' reaction to the preliminary findings of the public expenditure review (PER) which was conducted during the first half of 1988. The review highlighted the need to strengthen the Government's capacity to identify, prepare, and evaluate

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1/ These counterpart funds are not related to the foreign commodity aid channeled through the budget, while in the monetary accounts they are not treated as government deposits and do not thus affect developments in net bank credit to the Government.

investment projects, and to integrate the preparation of the current and investment budgets in a medium-term framework. To this end, the PER enumerated a variety of steps which should be implemented starting in 1989. While the authorities were in general agreement with these recommendations, they considered the timetable for implementing some of them as overly ambitious, given the existing shortages of skilled personnel. Given the large amount of resources being absorbed by the public sector, and the importance of deploying them efficiently, the mission urged the authorities to explore, with assistance from the World Bank and elsewhere, the practical steps, including manpower training, for ensuring effective and timely implementation of the major recommendations.

3. Monetary and credit policy

On recent developments, discussions focused on the reasons for the sluggish growth of monetary and credit aggregates during the first half of 1988 and attendant policy implications for the year as a whole. The authorities partly attributed the slow expansion of broad money in the first half of 1988 (Table 4) to the competitiveness of the above-noted treasury bond issue, which limited the expansion in quasi-money deposits. With interest payments and partial amortization denominated in U.S. dollars, the issue carries an estimated effective rate of about 25 percent, compared with 20 percent for 5-year bank deposits. A further factor in the relatively sluggish growth of broad money was the slower-than-programmed expansion in domestic credit to Government and the rest of the economy. The authorities attributed the lower rate of growth for credit to the non-government sector to delays in the processing of loan requests for which the source of funding was to be disbursement of foreign funds, and to the extension of some trade credit, outside the banking system, to importers using certain external lines of credit.

The staff agreed with the authorities that the demand for nominal cash balances was likely to pick up in the second half of 1988, but the staff also considered that for the year as a whole it was bound to be much lower than was originally programmed, particularly with slower growth in money income. Because of this, the staff representatives pointed out that accommodating credit demand in the second half of the year in amounts much greater than originally programmed for that period could put pressure on domestic prices, and on international reserves, as well as on the exchange rate in the parallel market. Accordingly, the mission proposed that credit expansion under the benchmark for 1988 as a whole be limited to a level below that originally programmed, and that the authorities consider additional measures, including some upward adjustment in interest rates, to strengthen financial savings, reinforce confidence in the metical, and help protect the balance of payments.

While broadly accepting the need for caution in near-term credit policy, the Mozambican representatives pointed out that the growth of credit to the economy during the second half of 1988, when the disburse-

Table 4. Mozambique: Monetary and Credit Developments, 1984-88

	1984	1985	1986	1987	1988 March	1988 June	1988 Dec. (Prog.) 1/
Balances, end of period				(In billions of meticais)			
Net foreign assets	1.0	0.6	0.4	23.0	20.4	41.5	37.4
Assets	4.0	2.9	3.5	61.1	59.1	80.4	...
Liabilities	-3.0	-2.3	-3.1	-38.1	38.7	38.9	...
Domestic credit	124.2	144.2	168.9	217.5	240.0	242.7	291.5
Credit to Government (net)	22.3	27.0	32.9	47.3	58.8	52.3	67.3
Credit to the economy	102.0	117.2	136.0	170.2	181.2	190.4	224.2 2/
Foreign funds on-lent 3/	(27.2)	(34.2)	(36.8)	(56.3)	(57.5)	(64.6)	(56.3) 2/
Domestic-source credit	(74.8)	(82.9)	(99.2)	(113.9)	(123.7)	(125.8)	(167.9)
Money and quasi-money	83.6	96.5	111.4	170.4	186.7	185.3	244.4
Currency in circulation	27.0	29.8	32.2	36.6	36.4	41.9	...
Demand and savings deposits	53.8	62.8	75.1	124.0	140.4	134.7	...
Time deposits	2.8	3.9	4.1	9.8	9.9	8.7	...
Foreign borrowing	27.2	34.2	36.8	420.0	472.8	499.9	657.8
For domestic on-lending 3/	27.2	34.2	36.8	413.7	...	...	...
SAF 4/ and other	--	--	--	6.3	...	...	...
Valuation adjustments	--	--	--	-382.4	-432.1	-432.1	-605.8
Other items (net)	14.4	14.0	21.1	32.5	33.0	31.1	32.5
Capital accounts	11.6	12.7	14.4	28.6	28.6	28.6	...
Other assets and liabilities	2.8	1.3	6.7	3.9	4.4	2.5	...
Flows during year 5/							
Net foreign assets	2.6	-0.4	-0.2	41.3	-5.4	15.7	--
Domestic credit	21.3	19.9	24.7	48.6	22.5	25.2	74.0
Credit to Government (net)	8.7	4.8	5.9	14.3	11.5	5.1	20.0
Credit to the economy	12.6	15.2	18.8	34.2	11.0	20.7	54.0 2/
Foreign funds on-lent 3/	(1.5)	(7.0)	(2.6)	(19.6)	(--)	(8.8)	(...) 2/
Domestic-source credit	(11.1)	(8.2)	(16.3)	(14.7)	(11.0)	(11.9)	(54.0)
Money and quasi-money	11.1	12.9	15.0	52.6	15.4	14.1	74.0
Foreign borrowing	1.5	7.0	2.6	25.8	--	28.3	...
For domestic on-lending	1.5	7.0	2.0	19.5	...	...	...
SAF 4/ and other	--	--	--	6.3	...	...	...
Other items (net)	11.3	-0.4	7.0	11.5	0.5	-1.4	--
Rates of change 5/				(In percent)			
Domestic credit	20.7	16.1	17.1	28.8	11.3	11.6	34.0
Credit to Government (net)	64.1	21.4	21.7	43.8	24.3	10.5	42.3
Credit to the economy	14.1	14.9	16.1	25.3	6.5	11.9	31.7 2/
Domestic-source credit 6/	12.4	8.0	13.9	8.7	5.8	7.0	31.7
Money and quasi-money	15.4	15.4	15.5	47.3	9.6	8.7	43.0

Sources: Bank of Mozambique; and staff estimates.

1/ Based on program flows and revised end-1986 stocks.
2/ Plus foreign funds borrowed and on-lent during year.
3/ Amounts borrowed abroad by Bank of Mozambique on-lent domestically; excluded from program credit benchmarks.
4/ Reclassified from other items (net) in 1987 program presentation.
5/ Flows and resulting percent changes exclude valuation changes resulting from metical devaluations, mainly on external accounts but including foreign currency deposits.
6/ Change in relation to total credit to the economy.

ment of foreign funds was also expected to pick up, would exceed that experienced in the first half. Moreover, they explained that to forestall any adverse consequences from this development while continuing to strengthen the efficiency of the financial markets, they were considering, for introduction in the course of 1988, a variety of initiatives aimed at improving the conduct of monetary policy and the banking system, and strengthening the incentives for financial savings. These would include: (a) the adoption of a system of compulsory reserve requirements for commercial banks, to help reinforce the Bank of Mozambique's control on the evolution of credit; (b) more active use of rediscount facilities as a tool for influencing the credit operations of the commercial banks; (c) minimum capital requirements for the banking system; (d) revision of foreign exchange control regulations with a view to simplifying and codifying them; (e) simplification of interest rates, with deposit and lending rates being realigned to reflect, among other things, the creditworthiness of clients; (f) more frequent payment of interest on term deposits; at present, interest is paid only once a year; (g) the introduction of selective use by banks, for a selected group of customers with good credit rating, of "warranty" or guaranteed checks to facilitate a settlement of transactions across the country; and (h) acceptance of foreign currency deposits. As far as the level of interest rates was concerned, the authorities indicated that they simply had not focused on this area as yet.

The staff representatives welcomed most of these initiatives. They noted, however, that while real interest rates are, as expected, rising because of the significant progress in reducing domestic inflation, they are still negative. They thus urged the authorities to review both the level and the structure of interest rates, including existing ceilings on deposit and loan rates. Attention should be given to the adequacy of incentives for savings with the banking system, also in comparison with those of competitive instruments, such as the treasury bond issue. The staff representatives noted that the faster than anticipated slowdown in inflation would make it easier to implement a more flexible interest rate policy to stimulate financial savings. They also expressed concern that the provision of part of the yield on treasury bonds in foreign currency and the introduction of foreign currency deposits could undermine confidence in the metical. Without rebutting the staff's views on interest rates, the authorities stated that for now, specific action in this area would, as envisaged in the program, be limited to the simplification of the schedule of interest rates. While the simplification envisaged had been somewhat delayed as the other parallel initiatives were being formulated, progress was being made in implementing practically all the other monetary measures in the program. Specifically, since January 1988, the Government has been paying an interest of 8 percent on borrowing from the banking system as well as on the nonperforming loans of public enterprises taken over by the Government. Moreover, one of the commercial banks had fully switched to the new system of accounts, while the remaining banks (including the Bank of Mozambique) were expected to adopt the new system following the computerization of their accounts with assistance under a World Bank project.

4. External sector policies

Policy discussions for the external sector centered on balance of payments developments, exchange rate policy, trade liberalization, and debt issues. Judging from the available limited information on developments during the first half of 1988, the staff and the Mozambican representatives were broadly in agreement that the balance of payments targets for the year as a whole appeared likely to be attained (Table 5). In particular, receipts from merchandise exports and transportation services are likely to increase moderately, while inward remittances of migrant workers are expected to be adversely affected by policies of neighboring countries. Import payments are however estimated to rise by over one fifth, reflecting the impact of increased international support. The 1988 balance of payments deficit is still estimated at US$450 million and can be fully financed through debt rescheduling together with the disbursement of modest Fund resources. As noted earlier, gross international reserves rose further during the first half of 1988, but much of the increase was viewed as temporary, pending utilization of some external financing already disbursed. Reserves were expected to decline somewhat during the remainder of the year, with an increase of about US$10 million on a year-to-year basis.

Regarding exchange rate policy, the staff representatives pointed out that the July adjustment in the official exchange rate to only Mt. 580 per U.S. dollar (less than 50 percent of the parallel market rate at the time), and the subsequent maintenance of that rate had not sufficiently narrowed the gap with the parallel market rate and thus was a departure from the benchmarks under the program. In response, the authorities noted that a number of considerations had prompted them to reorient the operational focus of exchange rate management. First, the narrowing scope of the parallel market, owing to the increased availability, through official channels, of import financing and the substantial adjustment in official prices and the official exchange rate had tended to make the exchange rate in the parallel market more volatile and increasingly susceptible to destabilizing speculative activity. Second, the authorities believed that there was a large illegality premium in the parallel market--including tax evasion considerations--and that, in the future, as during the first half of 1988, the parallel market rate would tend to depreciate in line with the official rate; closing the gap through large official devaluations was not feasible.

In view of these considerations, the authorities had decided to change the focus of their exchange rate policy away from the parallel market exchange rate to an index of the real (official) exchange rate. In particular, the adjustment of the official exchange rate on July 1, 1988 was intended to bring the index to approximately the same level as

Table 5. Mozambique: Balance of Payments, 1984-93

(In millions of U.S. dollars)

	1984	1985	1986	Prog. 1987	Est. 1987	Projected 1988	1989	1990	1991	1992	1993
Trade balance	-444.0	-347.1	-463.6	-564.0	-514.3	-647	-709	-744	-825	-920	-994
Exports (f.o.b.)	95.7	76.6	79.1	86.0	97.0	105	123	142	160	175	192
Imports (c.i.f.)	-539.7	-423.8	-542.7	-650.0	-611.3	-752	-832	-886	-984	-1,095	-1,186
Services (net)	-32.1	-92.9	-158.7	-142.0 1/	-157.5	-232	-265	-240	-242	-230	-227
Receipts	118.1	107.1	119.0	126.0	137.0	131	139	148	158	170	182
Transportation	34.5	39.4	45.0	58.0	35.1	42	48	55	64	73	81
Workers' remittances	57.0	40.8	50.0	43.0	58.0	48	48	48	48	48	50
Other service receipts	26.6	26.9	24.0	26.0	43.9	41	43	45	46	49	51
Expenditures	-150.2	-200.0	-277.7	-268.0 1/	-294.5	-362	-404	-388	-400	-400	-408
Interest 2/	-80.9	-117.3	-154.7	-175.0	-157.9	-203	-240	-225	-232	-230	-234
Other transportation	-24.5	-38.7	-34.0	-44.0	-33.9	-41	-43	-44	-46	-48	-50
Workers' remittances	-25.7	-25.0	-23.0	-25.0	-25.0	-28	-29	-30	-31	-33	-34
Investment services	...	...	-50.0	... 1/	-54.7	-54	-55	-50	-50	-47	-47
Other service expenditure	-19.1	-19.0	-16.0	-24.0	-23.0	-36	-37	-39	-41	-42	-43
Current account	-476.1	-440.1	-622.3	-706.0 1/	-671.8	-879	-974	-984	-1,067	-1,150	-1,221
Unrequited official transfers	167.8	139.0	213.0	321.0	304.2	372	399	426	456	488	522
Capital account	-73.0	-39.7	-51.5	-19.0	-82.9	-13	98	88	153	185	200
Foreign borrowing	264.8	238.8	284.0	310.0	301.1	350	375	401	429	458	491
Amortization	-337.8	-278.5	-335.5	-329.0	-384.0	-363	-277	-313	-276	-273	-291
Grants and credits anticipated from new initiatives 3/	—	—	—	—	—	70	45	85	120	150	158
Errors and omissions (net)	25.6	-12.7	-27.2	—	-9.0	—	—	—	—	—	—
Overall balance	-355.7	-353.4	-488.0	-404.0 1/	-459.4	-450	-432	-385	-338	-327	-341
Financing	355.7	353.4	488.0	404.0	459.4	450	432	385	338	327	341
Net foreign assets	-63.0	7.7	5.8	-19.0	-47.6	-10	-25	-25	-25	-20	-15
Assets (increase -)	-32.0	22.3	-19.0	-19.0	-62.2	-10	-25	-25	-25	-20	-15
Reserve assets	-23.0	20.5	-23.5	-19.0	-76.2	-10	-25	-25	-25	-20	-15
Bilateral payments	-1.4	2.3	4.9	...	7.9	—	—	—	—	—	—
Other	-7.7	-0.4	-0.4	...	6.1	—	—	—	—	—	—
Liabilities	-31.0	-14.6	24.8	—	14.6	—	—	—	—	—	—
Use of IMF credit (net)	—	—	—	15.0	15.4	25	11	—	—	—	-3
Net change in arrears	205.6	152.7	482.2	...	-876.0	-8	—	—	—	—	—
Exceptional financing	213.1	193.0	—	408.0	1,367.7	443	446	410	363	347	359
Debt relief 4/	213.1	193.0	—	408.0	1,367.7	443	—	—	—	—	—
Residual gap	—	—	—	—	—	—	446	410	363	347	359
Memorandum items:											
Gross international reserves	69.0	48.5	72.0	91.0	148.2	158	183	208	233	253	268
(in months of imports)	1.7	1.2	1.5	1.7	2.6	2.4	2.6	2.7	2.7	2.7	2.6
Actual debt service payments	—	50.1	8.0	...	50.2	131	...	...	...	...	...
Debt service ratio 5/											
Before debt relief	195.9	215.4	247.4	237.7	231.6	240	197	186	160	146	141
After debt relief	96.2	110.4	247.4	45.3	21.4	56	...	...	...	...	...
Current earnings/payments ratio 6/	35.1	36.4	29.8	28.5	31.3	26	26	28	28	27	27

Sources: Bank of Mozambique; and staff estimates.

1/ Does not reflect subsequent revision to include "investment services" payments (fees, profits, etc. financed from project loans).
2/ Includes imputed interest on arrears and interest on exceptional financing; for details, see Table 6.
3/ World Bank's special initiatives for low-income debt distressed sub-Saharan African countries.
4/ Reflects Paris Club and similar agreements in principle, not ultimate bilateral agreements. Reflects (1) October 1984 Paris Club agreement on approximately US$60 million in end-1983 arrears, US$153.1 million in 1984 maturities, and US$70.4 million in first half 1985 maturities; (2) OPEC member agreements in 1985 on US$96 million in arrears and US$26.6 million in 1985 maturities; (3) May 1987 London Club agreement on US$268 million (mainly arrears); (4) June 1987 Paris Club agreement on US$386 million for 1987 and US$159 million for 1988; and (5) other agreements on US$713 million for 1987 and US$275 million for 1988.
5/ As percentage of exports of goods and total service receipts.
6/ Ratio of current earnings from goods and services to current payments other than interest.

in 1980, when Mozambique's external position was much stronger. 1/ For the period after July, the authorities intended to adjust the exchange rate periodically, particularly in light of inflation differentials between Mozambique and its trading partners. The first such adjustment, from Mt. 580 to Mt. 620, was effected on October 15, 1988. The Mozambican authorities were confident that their revised exchange rate policy, supported by the above-noted reforms in the banking system, would ensure the attainment of the program objectives.

The staff representatives acknowledged that an exchange rate policy based solely on movements in the parallel market exchange rate could entail operational difficulties; for that reason, such a policy had been envisaged as a transitional phase in the program. The mission also agreed that an effective exchange rate policy would need to be accompanied by supportive measures in the monetary policy area. More importantly, in seeking to attain an appropriate level for the exchange rate, the extent of the differential--presently very large--between the official and the parallel market clearly was evidence to be taken into account. In this connection, the "illegality premium" seemed unlikely to be as large as 50 percent and the staff believed it important that the official exchange rate be brought to a level that was much closer to the parallel market rate to help forestall self-validating speculative activity and also to underpin the country's adjustment efforts, including the import liberalization process (described below). The mission thus encouraged the authorities to consider adjusting the exchange rate soon, preferably in the context of the price and wage adjustments that were expected to be announced in the last quarter of 1988. The authorities took note of the mission's observations and indicated that they would keep adjustment policies under review and would take whatever action they deemed necessary and appropriate to achieve the program objectives.

The Mozambican representatives explained that the adoption of routine and automatic licensing procedures for a specified list of products--that was to have been implemented by end-July 1988--had been delayed, pending the conclusion of discussions with the World Bank staff on the precise modalities for the facility. To-date, the list of eligible goods has been narrowed down to five product types: spare parts for transportation, agriculture, and construction equipment, and inputs for garment and shoe production. However, the detailed list of eligible goods, the amount of foreign exchange to be made available, and the indirect instruments for controlling demand for the selected products remain to be reviewed. The import liberalization, which is a key element in the program to be supported by the Bank's Third Rehabili-

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1/ The mission was not able to review the authorities' calculation of the index; however, using the very rough information available on consumer prices in Mozambique, it would seem that the real effective exchange rate was somewhat more depreciated than the 1980 level, following the mid-1988 adjustment (Chart).

tation credit, should be ready for implementation by the outset of 1989. The staff representatives stressed that the most important instrument for curtailing demand for liberalized imports should be a realistic and flexibly managed exchange rate. Accordingly, this important first initiative on import liberalization needed to be accompanied by further action on the exchange rate.

Concerning external debt, the authorities explained that substantial progress had been made toward the rescheduling of the foreign debt under the Paris Club and the London Club. Agreement had been reached on about one half of the bilateral agreements under the Paris Club, and the discussions were expected to be finalized shortly on the remaining agreements. They said that the bilateral rescheduling agreements concluded thus far have provided for some debt write-off, concessional moratorium rates of interest, and, in at least one case, the possibility of debt-equity conversion for some of the reschedulable debt. The authorities had requested that the deadline for concluding the bilateral rescheduling with all Paris Club members, initially set for June 1988, be extended to December 1988. They also noted that the discussions with the London Club members were still continuing and that a final agreement was likely to be reached before year-end.

The Mozambican authorities reiterated their concern about the high level of foreign debt (currently estimated at US$4 billion, including US$300 million of commercial bank debt). Moreover, they pointed out that even after the debt rescheduling, debt service payments in relation to exports of goods and services were expected to remain around 60 percent over the medium term. To them, this underscored the importance of more far-reaching solutions for coping with the foreign debt problem, including steps that would effectively reduce Mozambique's foreign debt obligations. With respect to debt to commercial banks, it was pointed out that despite the relatively low share of commercial debt on total debt--8 percent as of end-1987--debt service payments on this debt represented a large share in the total projected debt service payments after debt relief--around 24 percent of debt service after debt relief in 1988-93, or about US$43 million per year. This was explained by the market-related interest charges on this debt and relatively short grace and maturity periods, as compared with concessional interest rates and long repayments periods obtained by Mozambique from official and multilateral creditors.

IV. Medium-Term Prospects

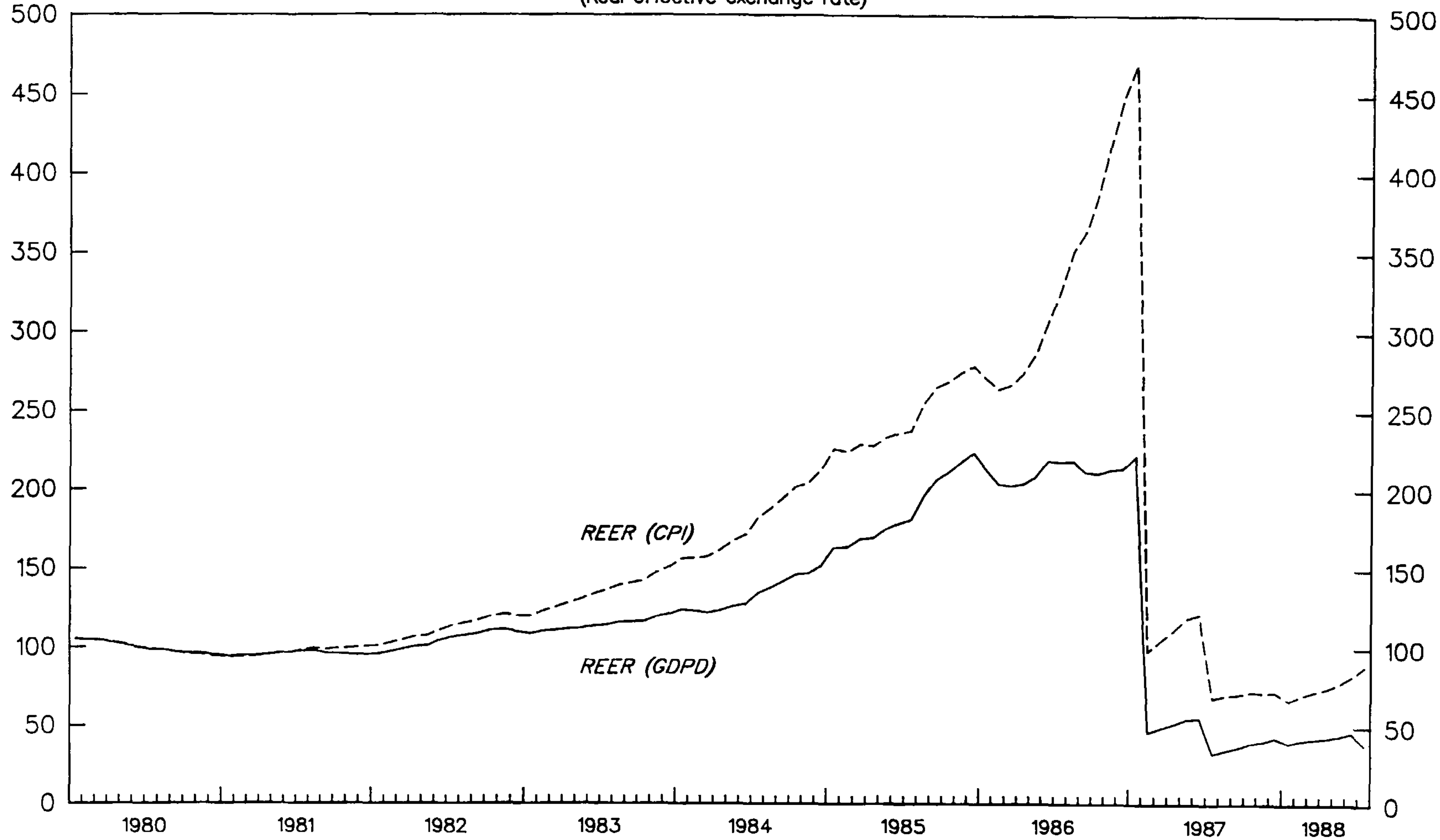
Medium-term financial and economic prospects remain largely in line with those described in the revised PFP (1988-90). The staff's projections (Table 5) are premised on a world economic environment similar to the baseline WEO scenario, Mozambique's continued pursuit of its economic rehabilitation and adjustment efforts, sustained large-scale support by the international community; and no change in the present

CHART 1

MOZAMBIQUE

REAL EFFECTIVE EXCHANGE RATE INDICES, 1980–88

(Real effective exchange rate)



Source: Staff estimates.
REER (CPI) = Real effective exchange rate index using the official nominal exchange rate, the CPI as the domestic price index, and partner countries' exchange rates and prices.
REER (GDPD) = Real effective exchange rate index using the official nominal exchange rate, the GDP deflator as the domestic price index, and partner countries' exchange rates and prices.

difficult internal security situation. The last assumption would, in the best of circumstances, suggest that Mozambique's economic position would remain extremely difficult during the medium term.

During 1989-93, the volume of exports is assumed by the staff to grow at a rate of about 8 1/2 percent, reflecting a strong recovery in the production of cashew nuts, cotton, and sugar, and continued moderate expansion in prawn exports. The volume of imports of consumer goods is likely to grow at a modest pace (less than 3 percent a year), while those of primary materials, capital equipment, and spare parts are assumed to continue to expand at a faster pace (5-8 percent). Even with exports growing relatively much more rapidly than imports, the trade deficit would widen from US$650 million in 1988 to nearly US$1 billion in 1993 because of the large initial trade imbalance.

The deficit on the services account is forecast to be approximately unchanged between 1988 and 1993. Earnings would increase due to recovery in receipts from transport services, while, on the basis of present policies and circumstances in neighboring countries, workers' remittances would remain at their present level. However, the modest improvement in service receipts would be approximately offset by an increase in interest payments. This assumes that the terms of rescheduling of official debt were, on average, concessional 1/ (Table 6). The external current account deficit, excluding unrequited transfers, would thus rise from US$880 million in 1988 to US$1.2 billion in 1993, essentially reflecting the increase in the trade deficit.

Grants and loans are conservatively assumed to increase by 7 percent a year over the whole medium term, a much slower rate than that experienced in 1986-88 from a much lower base. Because of the difficult circumstances, Mozambique would need to continue to reschedule its official debt through 1997 when eligible amounts (i.e., under a Paris Club formula) would decline to practically nil. On that basis, and taking into account the impact of the 1987 rescheduling under the London Club and continued availability on highly concessional terms of the new borrowing, the debt service ratio, before rescheduling, is projected at almost 170 percent (over 60 percent, even after rescheduling) of exports of goods and services during the 1989-93 period.

The overall balance of payments deficit is estimated to decline from about US$450 million in 1988 to approximately US$340 million in 1993; with a continuation of projected trends, it would continue to decline steadily. These deficits could largely be covered by debt relief from official bilateral creditors. The average interest rate on future reschedulings with official creditors is assumed to be around 3 percent per year, based on the average implicit interest rate of recently finalized rescheduling agreements with Eastern European and

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1/ Maturities of 20 years, including 10 years' grace, at an average interest rate of 3 percent.

Table 6. Mozambique: Debt Service Projections on External Debt, 1985–93

(In millions of U.S. dollars)

	1985	1986	Est. 1987	Projections 1988	1989	1990	1991	1992	1993
Original debt service	352.8	447.6	509.0	490.3	418.0	416.8	365.8	319.6	300.3
Principal	278.5	335.5	384.0	363.1	276.7	312.8	275.4	251.1	245.4
Multilateral	(3.3)	(3.5)	(6.2)	(9.5)	(8.6)	(11.1)	(10.9)	(8.0)	(8.0)
Bilateral	(275.2)	(332.0)	(377.8)	(353.6)	(268.1)	(301.7)	(264.5)	(243.1)	(237.4)
Of which:									
Paris Club	(...)	(...)	(81.7)	(95.5)	(81.6)	(120.9)	(124.1)	(121.6)	(110.0)
Other official	(...)	(...)	(283.7)	(235.3)	(178.5)	(178.2)	(137.8)	(119.0)	(124.9)
Banks	(...)	(...)	(12.4)	(22.8)	(8.0)	(2.6)	(2.6)	(2.5)	(2.5)
Interest	74.3	112.1	125.0	127.2	141.3	104.0	90.4	68.5	54.9
Multilateral	(3.6)	(2.8)	(4.3)	(7.3)	(7.1)	(6.6)	(5.8)	(5.4)	(5.2)
Bilateral	(70.7)	(109.3)	(120.7)	(119.9)	(134.2)	(97.4)	(84.6)	(63.1)	(49.7)
Of which:									
Paris Club	(...)	(...)	(74.2)	(75.0)	(68.6)	(64.5)	(54.1)	(41.0)	(34.3)
Other official	(...)	(...)	(45.6)	(43.1)	(64.2)	(32.1)	(30.0)	(21.9)	(15.2)
Banks	(...)	)...)	(0.9)	(1.8)	(1.4)	(0.8)	(0.5)	(0.2)	(0.2)
New debt service	43.1	42.6	32.9	75.8	98.3	120.8	141.8	183.7	227.1
Principal	—	—	—	—	—	—	—	22.2	48.2
On refinancing	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(22.2)	(45.1)
Of which: banks	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(22.2)	(45.1)
On new borrowing	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)
IMF repurchases	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(3.1)
Interest	43.1	42.6	32.9	75.8	98.3	120.8	141.8	161.5	178.9
On refinancing 1/	(40.2)	(39.0)	(29.0)	(71.3)	(83.8)	(95.1)	(104.8)	(112.1)	(115.7)
Of which: banks	(—)	(—)	(8.2)	(26.6)	(26.6)	(26.6)	(26.6)	(25.5)	(21.1)
On new borrowing	(2.9)	(3.6)	(3.8)	(4.4)	(14.3)	(25.4)	(36.7)	(49.1)	(63.0)
IMF charges	(—)	(—)	(0.1)	(0.1)	(0.2)	(0.3)	(0.3)	(0.3)	(0.2)
Total debt service	395.9	490.2	541.9	566.1	516.4	537.6	507.6	503.3	527.4
Principal	278.5	335.5	384.0	363.1	276.7	312.8	275.4	271.3	293.6
Interest	117.4	154.7	157.9	203.0	239.7	224.7	232.1	230.0	233.8

Sources: Bank of Mozambique; and staff estimates.

1/ Includes imputed interest on arrears as well as interest on exceptional financing (consolidated arrears, rescheduled current debt service maturities, and other).

some OECD contries. Assuming a continued modest build-up in gross international reserves to an average of about 2.7 months of imports during the projection period, the resulting financing gaps (after debt relief) for the 1989-93 period would average slightly over US$60 million per year. Given the magnitude of the foreign debt problem and the heavy dependence on inflows of foreign resources, the medium-term projections are highly sensitive to changes in the availability of external grants and loans and to the terms of debt rescheduling and of new borrowing.

V. Staff Appraisal

The Government of Mozambique continues to make good progress in implementing the comprehensive economic recovery and adjustment program initiated in 1987. This program focuses on the development, within a framework of restrained demand management and wage policies, of greatly improved incentives for production, investment, and savings. The economy is responding positively, with agricultural output continuing to recover and production rebounding in other areas as well. Nevertheless, the pace of improvement varies considerably among sectors, reflecting the adverse effects of the security situation and of periodic shortages of imported items. The framework for sustained economic expansion will require development of supporting services in transport, marketing, and other fields and also a stable financial environment conducive to orderly planning and maintenance of stable and efficient price signals. Initiatives on this front should be reinforced with further liberalization of administrative controls in the goods and financial markets; decisive action to strengthen the operational efficiency of public enterprises; and strong producer price incentives. In this regard, the announced increase in producer prices for the 1988/89 crop year is welcome, and continuation of strong structural and financial policies should be expected to play a crucial role in the period ahead.

The authorities are correct in their assessment that the provision of the requisite services will strain Mozambique's limited resources, including skilled manpower, and create a need for continued strong international support. To the extent that there have been delays in the formulation or implementation of certain structural measures, these have largely reflected the existing strains on available skilled manpower in the public service. In retrospect, the timetable for implementing some of the structural reforms in the Policy Framework probably was on the ambitious side. Adequate time should now be given to consolidating the gains already made and to continuing structural efforts in areas already identified, such as import liberalization, strengthening of the financial system, public enterprise reform, broadening the revenue base, and reform of the system of prices.

Domestic prices have generally been adjusted flexibly to reflect cost trends and the pass-through effect of exchange rate adjustment and, as a result, the financial position of public enterprises has strengthened and the scale and scope of consumer subsidies have declined considerably. The authorities have, nonetheless, maintained the policy of wage restraint called for in the program. In the spring of 1988 there was a wage award intended to compensate for the changes in the prices of rationed goods, and in October a 15 percent wage increase was announced in conjunction with further adjustments in administered prices and in the exchange rate. Taken together, these two awards led to wage increases that are somewhat lower than envisaged under the program, but would broadly yield a maintenance of real wages, given the lower increase in consumer prices now estimated. The authorities pointed out that, even with the focusing of the April 1988 wage award on lower-income workers, the adjustment policies have entailed hardships for a significant segment of the urban population, including large families and non-salaried persons. Accordingly, they are considering a variety of "safety net" measures, most of which had been envisaged under the program. Although there are many practical constraints, the authorities should endeavor to ensure that these measures are effectively targeted.

The budgetary objectives for 1988 are likely to be attained. Total budgetary revenue has increased as planned, with the yield from direct taxes exceeding original expectations mainly because of the underlying expansion in the tax base and improvements in tax administration. Moreover, after a sluggish start, receipts from indirect taxes are likely to pick up, owing in part to the enhanced effectiveness of the customs administration, which is now under the direct supervision of the Ministry of Finance. In this regard, the authorities have requested technical assistance from the Fund in the area of customs administration. Following an initial delay in identifying the elements in the package of additional revenue measures, the authorities have indicated that the package will be prepared in time for the 1989 budget, as required under the program. They have also reaffirmed their intention to continue with the process of tariff reform. In the staff's view, sustained efforts to broaden the revenue base and to improve tax administration are fundamental to the strengthening of government finances over the medium term.

The budget continues to be burdened by the heavy requirements for defense outlays. Nevertheless, the authorities' resolve to contain budgetary expenditure is evident: new hirings have been frozen, wage awards have been restrained, and budgetary subsidies have been sharply reduced. The authorities agree with the thrust of the World Bank public expenditure mission's recommendations, the primary objective of which is to foster efficient use of the substantial resources now being absorbed by the public sector. The staff would encourage the Mozambican authorities to explore steps for ensuring timely implementation of the recommendations.

The public enterprise unit started operating in September 1988. The efforts of the unit, including mainly the development of an action program for selected strategic entities, is to be paralleled by sector-wide initiatives to strengthen the organization and management of the enterprises. The Government is also taking steps toward assuming responsibility for the nonperforming loans which the public enterprises owe to the banking system. The staff would welcome the action in this area and would encourage that the taking over of these loans in each case be viewed as part of a comprehensive strategy for dealing with the problem of the individual public enterprise, as was the case with the railways corporation.

Monetary and credit growth during the first half of 1988 was slower than programmed, owing to various factors, including some that are likely to be reversed in the course of the year. The estimated demand for cash balances in 1988 as a whole could also fall significantly below the program projection. In view of this, the staff would recommend that the authorities monitor developments in this area particularly closely in the latter part of the year and be prepared to scale down the expansion of credit below the amounts permitted under the program's benchmarks. The wide-ranging measures in the monetary and banking areas which are being reviewed for adoption in the course of 1988, coupled with the implementation of the various institutional measures in the program, should help promote orderly financial conditions. The staff believes that over the coming months, and especially in the context of the forthcoming program, the authorities should also embark on a comprehensive review of interest rate policy, in order to ensure that interest rates are adequate for efficient mobilization and deployment of financial savings in the economy. The positive response to the higher yielding special treasury bond issue this year illustrates that financial savings flows are responsive to strengthened interest rates. In this regard, the staff would discourage the authorities from further bond issues for which part of the yield is paid in foreign currency on the grounds that this could undermine the confidence in the metical and the strengthening of domestic financial institutions.

Even with a continued strong increase in foreign exchange earnings, Mozambique will for the forseeable future remain heavily dependent on external support for the financing of an adequate level of imports and for the maintenance of normal relations with creditors. This, in part, underscores the need for sustained adjustment efforts, including exchange rate, pricing, and other measures that would help strengthen growth prospects and restore financial stability. The staff welcomes the latest adjustment in the official exchange rate to Mt. 620 per U.S. dollar, but notes that the present official rate is still much more appreciated vis-à-vis the parallel market than assumed in the program's benchmarks. A policy of flexible rate management and attainment of a more realistic rate is necessary to maintain the momentum of adjustment. The staff notes the concerns of the authorities about guiding exchange rate policy exclusively by the parallel market exchange rate. However, in view of the fundamental deterioration in Mozambique's economy and external position during the early 1980s, and the continuing large differential between the official and parallel market rates, the staff would urge the authorities to continue to include among the indicators of flexible rate management the need to reduce the spread between the two rates. The staff believes that depreciation of the official rate in the context of continued restrained demand management would reduce the gap and that this would strengthen the adjustment effort and the prospects for import liberalization.

The adoption of automatic and routine import licensing procedures for a limited list of goods was delayed, but discussions with the World Bank have resulted in a general agreement on the range of goods which could qualify for this purpose. It is to be hoped that other related issues, including the determination of a detailed list of eligible goods, the amount of foreign exchange to be made available, and indirect instruments for managing the demand for the selected products, including the appropriate level of the exchange rate, will be agreed soon in order to permit early adoption of the procedures.

About one half of the bilateral agreements under the 1987 Paris Club rescheduling have been concluded, and the authorities have requested that the deadline for finalizing them be extended to December 1988. They are also hopeful that agreement on the London Club rescheduling will be reached by year-end. Nevertheless, they remain concerned about the heavy debt service burden which, even with continued rescheduling, would likely represent more than 60 percent of exports of goods and services over the medium term. If Mozambique's external accounts are to be manageable in a growth-oriented context, its economic recovery program will require continued strong international support in terms of new financing and of debt relief on terms compatible with its repayment capacity. Given the present heavy weight of debt in the structurally weak external accounts, Mozambique should also explore alternative approaches to alleviating the debt burden. In this regard, the recent initiatives of major official creditors in the framework of the Paris Club as they may relate to Mozambique are to be welcomed. It would be hoped that progress might also be made in reducing the burden of Mozambique's debt to commercial banks through some of the schemes now being utilized for reduction of such debt.

The restrictions evidenced by the external payments arrears, the restrictions remaining pending the execution of the rescheduling agreement with each individual creditor and the restrictive features of bilateral payments agreements between Mozambique and some Fund members are subject to Fund approval under Article VIII. As noted, the authorities have requested that the deadline for finalizing all the bilateral agreements under the 1987 Paris Club rescheduling be extended and have reported continued progress towards agreement on the London Club rescheduling. Under these circumstances, the staff recommends that the Fund approve the retention by Mozambique of the restrictions evidenced by external payments arrears and the exchange restrictions remaining pending the execution of the bilateral rescheduling agreement with each individual creditor until December 31, 1989, or the conclusion of the next Article IV consultation with Mozambique, whichever is earlier. With respect to the restrictive features of the bilateral payments agreements maintained by Mozambique with some Fund members, no approval is recommended considering the discriminatory nature of these restrictions and that no steps are being taken to renegotiate these agreements with a view to eliminate their restrictive features.

It is recommended that the next Article IV consultation with Mozambique be held on the standard 12-month basis.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to the exchange measures of the People's Republic of Mozambique subject to Article VIII, Section 2(a), and in concluding the 1988 Article XIV consultation with the People's Republic of Mozambique in the light of the 1988 Article IV consultation with the People's Republic of Mozambique conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in SM/88/---, the People's Republic of Mozambique continues to maintain restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by external payments arrears, the restrictions remaining pending the execution of the rescheduling agreement with each individual creditor and the restrictive features of bilateral payments agreements between Mozambique and other Fund members are subject to approval under Article VIII, Section 2(a). The Fund notes the intention of Mozambique to eliminate the exchange restrictions evidenced by external payments arrears and urges the authorities to eliminate the restrictive features of the bilateral payments agreements that the People's Republic of Mozambique maintains with Fund members. In the meantime, the Fund grants approval for the retention by Mozambique of the exchange restrictions evidenced by external payments arrears and those remaining pending the execution of

the rescheduling agreements with each individual creditor until December 31, 1989, or until the conclusion of the next Article IV consultation with Mozambique, whichever is earlier.

MOZAMBIQUE - Relations with the Fund
(As of September 30, 1988)

I. Membership Status

(a) Date of membership:	September 24, 1984
(b) Status:	Article XIV

A. Financial Relations

II. General Department

(a) Quota:	SDR 61.0 million
(b) Total Fund holdings of meticais:	SDR 61.0 million (100.0 percent of quota)
(c) Fund credit (SAF):	SDR 30.5 million (50.0 percent of quota)
(d) Reserve tranche position:	-- 1/

III. Current Arrangements and Special Facilities

Arrangements under structural adjustment facility (1987-89)
- Approved on June 8, 1987 for a total of SDR 28.67 million (47 percent of quota)
- First-year loan disbursed on June 11, 1987, of SDR 12.20 million (20 percent of quota)
- Total raised per first review of facility to SDR 38.735 million (63.5 percent of quota)
- Second-year loan disbursement on April 5, 1988 of SDR 18.3 million (30 percent of quota)

IV. SDR Department

(a) Net cumulative allocation:	None
(b) Holdings:	SDR 20,374

V. Administered Accounts: None

VI. Overdue Obligations to the Fund: None

B. Nonfinancial Relations

VII. Exchange Rate Arrangement: Since January 31, 1987, Mozambique's currency, the metical (plural: meticais) has been pegged to the U.S. dollar, the former peg to a weighted basket of six currencies having been suspended on that date. On July 1, 1988, the exchange rate for the metical was devalued to Mt. 580 per U.S. dollar. Rates based on market quotations for 20 other currencies are published daily.

1/ SDR 7,182.

MOZAMBIQUE - Relations with the Fund (continued)

VIII. Consultation with the Fund: The third Article IV consultation discussions were held in Maputo during August 8-22, 1987.

Executive Board discussion of the staff reports (SM/87/245 and SM/87/256) took place on November 18, 1987, and the following decision was adopted:

1. The Fund takes this decision relating to the exchange measures of the People's Republic of Mozambique subject to Article VIII, Sections 2 and 3, and in concluding the 1987 Article XIV consultation with the People's Republic of Mozambique, in the light of the 1987 Article IV consultation with the People's Republic of Mozambique conducted under Decision No. 5392-(77/63), adopted April 29, 1977 as amended (Surveillance over Exchange Rate Policies).

2. As described in SM/87/245, the People's Republic of Mozambique continues to maintain restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2. In addition, exchange restrictions evidenced by external payments arrears are subject to approval under Article VIII, Section 2(a). The Fund welcomes the authorities' efforts under their present adjustment program toward the elimination of these restrictions, and at the same time urges the authorities to eliminate the restrictive features of the bilateral payments agreements that the People's Republic of Mozambique maintains with Fund members.

It was expected that consultations with Mozambique would take place on the standard 12-month cycle.

IX. SAF Arrangements: The Executive Board took the following decision on March 30, 1988:

1. The Government of Mozambique has requested the second annual arrangement under the Structural Adjustment Facility.

2. The Fund has appraised the progress of Mozambique in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/88/68).

2. The Fund approves the arrangements set forth in EBS/88/40.

MOZAMBIQUE - Relations with the Fund (concluded)

X. Technical Assistance

1. Statistics. An initial Bureau of Statistics mission in August 1985 assessed Mozambique's needs for technical assistance in statistics. Technical assistance on compiling monetary statistics and developing more suitable accounts was provided to the Bank of Mozambique in early November 1985; a joint Bureau of Statistics and Bureau of Computing Services mission in April-May 1986 followed up on these matters. Work on preparation of an IFS country page took place during the August 1987 consultation mission. A technical assistance mission on the balance of payments also took place in August 1987.

2. CBD Advisors. Following a Central Banking Department staff visit in August 1985 to assess needs for banking advisors, a Macroeconomic Advisor from the panel of experts was provided to the Bank of Mozambique in February 1986; his initial term has been renewed for a second and a third year. Since May 1986 an Accounting Advisor has been assigned to help revise the banking system's accounts; his initial term has also been extended for a second year. An Advisor in Organization and Methods has been provided to the Bank of Mozambique for an initial one-year term beginning in November 1987.

3. Fiscal Affairs. A Fiscal Affairs Department technical assistance mission visited Maputo for three weeks in October-November 1987 to review the country's customs and domestic tax systems and their administration. Since June 1988, an advisor under the Fiscal Panel of Experts has been assigned to Maputo to assist with the implementation of recommendations of the technical assistance mission.

4. IMF Institute. A two-week seminar on techniques of economic analysis was conducted in Maputo for senior Mozambican officials from June 23 to July 4, 1986 under the direction of the IMF Institute, with participation by the Bureau of Statistics and the African Department.

MOZAMBIQUE - Relations with the World Bank

The first World Bank economic mission to Mozambique took place in November 1984, and an Introductory Economic Survey was issued on June 6, 1985. IDA approved a first Rehabilitation Credit of SDR 45.5 million equivalent on June 18, 1985, to help meet Mozambique's priority needs in the industrial, transport, and agricultural sectors. The Norwegian and Italian Governments have committed an additional US$22 million in cofinancing with the credit. On May 29, 1986, IFC provided about US$2.5 million in financing for the LOMACO company, a major commercial agricultural producer, and on July 28, 1987, IFC took an equity position of up to US$7.75 million in an oil exploration program offshore from Xai-xai with British Petroleum. On May 26, 1987, the Executive Board approved an IDA credit of SDR 15.6 million for a project in the energy sector (based on the conclusions of a recently issued Energy Assessment Report for Mozambique) which incorporates reforms in energy pricing, investment planning, and financial management for the electricity and petroleum subsectors. A second IDA Rehabilitation Credit of SDR 54.5 million, together with SDR 14.5 million from the Special Fund for Africa, was approved by the Bank's Executive Board on August 4, 1987; and a Swiss Special Joint Financing grant (Bank-administered) of Sw F 16.9 million and a Swiss cofinancing grant of Sw F 10.0 million were associated with these credits.

Bank assistance to Mozambique is being focused primarily on rehabilitation of the economy, in the context of the Government's comprehensive program of economic reforms. An IDA third rehabilitation credit to support the introduction of a limited Open General License scheme is currently under discussion with the authorities. An IDA credit for about SDR 10 million is also being appraised to provide complementary technical assistance in economic and financial management to assist the Government in identifying and carrying out future policy adjustments. At the sector level, an education project focusing on primary schooling is under appraisal, with a view to an IDA credit of about SDR 10 million. Future lending operations are also expected for the education, transport, health, industry, and urban sectors.

The agenda for economic and sector work is designed primarily to support the efforts of the Government to adopt more appropriate economic policies. A Review of Enterprises (financed by the Special Project Preparation Facility--SPPF), covering 25 industrial and 15 agricultural enterprises, resulted in initial recommendations in October 1987. A review of four key agricultural subsectors (cashews, irrigation, forestry, and cotton), also financed with SPPF funds, was completed in September 1987 and is providing a basis for operations in the agricultural sector. The Bank initiated a Public Expenditure Review in April 1988, to assess the efficiency pattern of recurrent expenditures and investments. Technical assistance has also been extended in external debt management and reporting.

MOZAMBIQUE--Statistical Issues

Despite recent improvements, Mozambique continues to have a rather weak statistical data base. There is not yet a system in place for the regular reporting of statistical data to the Fund's Bureau of Statistics, and there is not yet a country page for Mozambique in IFS, the GFS Yearbook, or Balance of Payments Statistics.

1. General economic data

In national accounts, estimates of gross domestic product are available only in terms of expenditure; value-added estimates are not yet prepared. The current price estimates of private consumption in large part reflect parallel market prices for purchased items and official producer prices for autoconsumption (on-farm consumption, etc.); hence, ratios of variables valued at official prices (budget, balance of payments) to GDP tend to be distorted and misleading. As appropriate deflators are not available for some components, the constant price (1980-based) GDP estimates should be considered provisional. The prototype of a consumer price index, providing annnual observations on the basis of family expenditure surveys and reflecting purchases at parallel market as well as official prices, is published, and monthly sampling of some items has begun, but a conventional, monthly CPI is not yet available. While a reliable indicator of export prices is available from volume and value data, compilation of an import price index based on customs data is still under way.

2. Government finance

Government finance statistics are judged to be relatively reliable, particularly those relating to the current state budget, but data on investment outlays and on external grants and loans and debt service are less so. Financial accounts of most public enterprises are weak or not available, and no consolidated accounts of the public sector exist.

3. Monetary accounts

Available monetary data are based on outdated and ambiguous systems of accounts. A draft new plan of accounts for the banking system and a simplified balance sheet for the financial institutions, produced and discussed during technical assistance missions in late 1985-early 1986, have been further reviewed and refined with the CBD accounting expert, and approved for implementation on a trial basis in the latter half of 1987 and in full from 1988. At present, the available money and banking data consist of year-end accounts for 1980-83, somewhat more refined quarterly accounts for 1984-86, monthly data through mid-1988; a lag of several months remains for complete accounts. The Bank of Mozambique is about to introduce a new system of accounts for the financial system that has been developed by a CBD accounting expert with the collaboration of Bureau staff.

4. Balance of payments

Although a serviceable balance of payments statement has been assembled from exchange control and trade data, substantial problems of timing and coverage remain. The latest period for which the Bureau has received data is 1986. A report on a technical assistance mission which took place in August 1987 was sent to the authorities in February 1988. To date, no comments have been received.

5. External debt

A commercially developed external debt reporting and management system was provided to the Bank of Mozambique under bilateral assistance in 1985-86, but the information within it remains subject to frequent revision and additions and is not linked with related financial accounts. Data are available by creditor, but debtor institutions are not identified. Mozambique does not yet provide data under the World Bank's debtor reporting system, and the aforementioned data do not meet Bank requirements. The IBRD has initiated technical assistance in this area.

Table I. Mozambique: Financial Benchmarks, Projections, and Performance, 1987-88

(Cumulative changes)

	1987				1988			
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.
	(In billions of meticais)							
Domestic credit 1/								
Program	13.0	26.0	36.0	40.0	29.0	50.0	65.0	74.0
Actual	3.2	9.6	26.2	29.1	22.3	20.2	...	...
Net credit to Government 2/								
Program	10.0	18.0	24.0	25.0	10.0	15.0	19.0	20.0
Actual	1.1	4.2	13.2	14.4	12.5	8.3	...	...
Credit to the rest of the economy 1/								
Program	...	...	...	...	...	...	...	...
Actual	2.1	5.4	13.0	14.7	9.8	11.9	...	...
Money and quasi-money								
Program				49.7				73.8
Actual				52.6 3/				...
	(In millions of U.S. dollars)							
Increase in gross international reserves								
Program	...	...	...	19.0	...	...	...	--
Actual	...	...	...	35.0	...	...	...	...
Nonconcessional external borrowing								
Program	...	...	...	20.0	...	...	...	25.0
Actual	...	...	...	14.0	...	...	...	...

Source: Bank of Mozambique.

1/ Excludes credit arising from foreign loans on-lent through the Bank of Mozambique.
2/ Net credit to Government is defined to include domestic interest due but not paid by Government.
3/ Net of valuation increases in foreign currency deposits (Mt. 6.0 billion).
4/ Contracting or guaranteeing by Government or Bank of Mozambique of nonconcessional external loans of 1-12 years' maturity.

Table II. Mozambique: Benchmarks for the Implementation of Structural Policy Measures for the 1988 Program Under the SAF

Policy measures	Time frame for measures	Implementation
Budgetary revenue measures		
1. Implementation of the first stage of customs tariff reform	By end-1988	Under discussion
2. Formulation of a package of additional revenue measures	By mid-1988	Delayed; will be ready for 1989 budget
Interest rates		
3. Simplification of the structure of bank lending rates	By June 1988	Delayed
4. Increase in the rate of interest on domestic bank loans to Government	By January 1988	Largely implemented
External policies		
5. Substantial reduction in the gap between the official and the parallel market exchange rates	By June 1988	Partially implemented
6. Flexible exchange rate management with adjustment as necessary to avoid widening of gap between official and parallel market exchange rates	After June 1988	Delayed
7. Preparation and implementation of a list of imports subject only to routine and automatic licensing procedures.	By end-July 1988	Delayed; active discussion with World Bank
Pricing and distribution		
8. Substantial increase in administered prices of rationed goods	By end-March 1988	Implemented
9. Reductions in number of products subject to price fixing	January, end-June, and end-year 1988	Implemented so far
10. Full price pass-through of exchange rate effect on goods and services subject to fixed pricing and conditioned pricing	Timing to match changes in official rate	Largely implemented
Public enterprises		
11. Limitation of government subsidies to cover operating losses to no more than Mt. 12.0 billion	1988	Broadly on target