DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/87/101

CONFIDENTIAL

May 12, 1987

To: Members of the Executive Board

From: The Secretary

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

Attached for consideration by the Executive Directors is a paper on the People's Republic of Mozambique's request for arrangements under the structural adjustment facility, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 20.

Mr. Stillson (ext. 8158) or Mr. Niebling (ext. 6943) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF MOZAMBIQUE

Request for Arrangements Under the Structural Adjustment Facility

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 S. Kanesa-Thasan

May 11, 1987

Contents

Contents

I. Introduction

In the attached letter to the Managing Director, dated May 8, 1987, the Minister of Finance of Mozambique requests a three-year structural adjustment arrangement under the Structural Adjustment Facility (SAF) and the first annual arrangement thereunder in support of an economic program covering calendar years 1987-89, in amounts that will be available to Mozambique under the SAF (presently estimated at SDR 28.67 million, or 47 percent of quota). Of this amount, SDR 12.20 million (20 percent of quota) will be available in one disbursement to Mozambique upon the Executive Board's approval of the requested arrangement for the first year. One half of the remaining amount, including any augmentation, will be available for each of the following two annual arrangements.

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

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

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

---

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

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

II. Background and Recent Developments

1. Overview

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

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

2. Prices

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

---

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

domestic prices in resource allocation. Although most prices were in principle only "conditioned" rather than fixed (i.e., subject only to controls on percentage markups over cost), administrative intervention expanded, and the price structure tended to become immobilized. Major anomalies came to exist among official prices, as well as between them and those in parallel markets. Official producer prices became skewed in favor of domestic staples, and, even at the official exchange rate, prices for export crops were typically less than half of the world price. In the pervasive parallel markets, the prices of goods reportedly reached 3-10 times the official equivalents by 1986, and foreign currency exchanged at 25-40 times the official rate of approximately Mt. 40 = US$1, with the higher ends of these ranges being in Maputo. A prototype price index, based on family expenditure surveys that include parallel market purchases, indicates that consumer prices more than tripled nationally from 1981 to 1986 (much more in Maputo), and that by 1985-86 they were rising at some 30 percent annually.

3. Public finance

The government budgetary situation (Appendix IV, Table 2) has deteriorated sharply since the early 1980s, owing to the erosion of the tax base because of production declines and the growth of illicit markets, the pressure of defense spending, and the attempt to maintain social and investment outlays. Revenues declined in nominal terms between 1983 and 1985, and by 1986, the overall deficit (not counting public enterprise losses) exceeded 45 percent of total expenditures; almost half of this deficit was financed by domestic bank credit. In 1985-86, defense and security outlays accounted for about one third of total expenditures, up from one fifth in the early 1980s. The wage bill represented about one fifth of expenditures throughout the period, as a decade-long pay freeze was offset by additional hiring; the freeze and a compressed salary scale also led to a steady loss of the more able workers. The composition of the investment budget, as well as its financing, has in large part reflected the availability of donor support, as well as national priorities; its level dropped sharply in 1985, but, even though emphasis was to be placed mainly on rehabilitation rather than new projects, it recovered considerably in 1986 owing to heavy outlays for infrastructure projects.

The operating losses of public and private enterprises, resulting from low capacity utilization, physical disruptions, and pricing constraints, are estimated to have reached Mt. 14 billion in 1986, somewhat more than defense spending. These losses were financed directly by the banking system rather than through budgetary subsidies, but beginning with 1987 they are to be covered--and limited--by the budget alone.

4. Money and credit

Over the period 1981-86 as a whole, monetary and credit developments in Mozambique were characterized by a more than tripling of domestic credit outstanding, by a comparable increase in domestic liquidity, and by the virtual elimination of a positive net foreign asset position (Appendix IV, Table 3). Of the total increase in domestic credit over the six years ended 1986, 28 percent resulted from the emergence of the Government as a major borrower from the banking system, and at least 55 percent reflected the financing of enterprise losses. Sectoral distribution data show that slightly over one half of outstanding nongovernment credit at end-1986 represents claims on agriculture and about 20 percent on industry. Of total claims on the nongovernment sectors at the end of 1986, 87 percent had been classified as past due; a preliminary review of these claims by the Bank of Mozambique shows that many may have to be rescheduled and some written off.

5. International transactions

From 1980, when a small overall deficit was recorded, the balance of payments outturn worsened in each year, to reach by 1985 a current account deficit before transfers of US$426 million, and an overall deficit of US$366 million (Appendix IV, Table 4). Underlying the sharp deterioration in the external position over this period was a decline in earnings from exports and services by 60 percent, which led to a retrenchment in imports by almost 50 percent. In October 1984 arrears and current maturities totaling US$283 million were rescheduled by the Paris Club, and, in 1985, OPEC countries also rescheduled arrears and current maturities equaling US$123 million. By end-1985, nevertheless, international reserves were almost exhausted, the debt service ratio surpassed 100 percent (200 percent before debt relief), and debt service arrears reached US$838 million (4.6 times earnings from exports and services); 87 percent of imports were financed by inflows of grants and loans.

In 1986, there were some changes from past trends: export receipts rose by 3 percent, service earnings rose by 11 percent, and imports increased by about 30 percent. The upturn in imports resulted in large part from a 35 percent increase in grant and loan inflows, which financed 90 percent of imports in that year. Because of the low level of exports and a sharp increase in scheduled debt service payments (the debt service ratio reached 275 percent in 1986), the current account deficit increased to US$600 million, and the overall deficit approached US$550 million. 1/ In fact, almost no debt service payments were made, and outstanding arrears reached US$1.2 billion by end-1986.

At the end of 1986, the outstanding stock of debt rose to US$3.2 billion; almost 43 percent of this debt is owed to OECD members (about one half of which to commercial banks), 32 percent is owed to centrally planned economy (CPE) countries, and the remainder distributed between OPEC members, other countries, and multilateral agencies (Appendix IV,

---

1/ There was a substantial increase in errors and omissions in 1986 (which totaled US$73 million), probably reflecting an underestimation of arrears accumulation, and of foreign disbursements.

Table 6). Over 50 percent of the outstanding arrears at end-1986 were owed to members of the OECD (mainly to commercial banks), and about one fourth to CPE countries.

Mozambique maintains a comprehensive system of restrictions on trade and payments for current international transactions, including bilateral payments agreements with other Fund members and external payments arrears. All imports and exports are subject to licensing, and foreign exchange is allocated administratively. A foreign exchange retention scheme was introduced in 1984, under which designated exporters obtain automatic rights to purchase certain imported inputs from their export earnings. Import licenses are granted for imports up to US$500 (or more if imports are for own use, i.e., not for trading), when drawing on the country's foreign exchange is not involved.

6. Policy responses, 1983-early 1987

As the economic and financial situation worsened during the early 1980s, there was a growing but gradual recognition of the need for a realignment of economic policies. A number of measures followed during 1984-86, including introduction of the export retention scheme, membership in the Fund and the Bank, the debt rescheduling exercises, price increases for many staples and the freeing of farm produce prices, enactment of a labor law permitting layoffs, and increases in consumption taxes and utility tariffs. However, these measures, which did not address the exchange rate or stabilization problems, proved insufficient to reverse the economic decline. By the time of the July 1986 consultation mission, the authorities appeared to have forged a consensus that much stronger and more comprehensive economic measures were required, and this consensus was maintained after the untimely death of the head of state in October 1986. Indeed, even prior to reaching understandings with Fund and Bank staff, the authorities implemented a substantial range of initial measures in early 1987, broadly along the lines already discussed. These included (1) a devaluation of 80 percent in foreign currency terms; (2) major changes in official prices; (3) substantial tax and expenditure measures; and (4) establishment of an import program and negotiation of sufficient external assistance to finance fully the balance of payments in 1987. The following section describes these initial measures in the program, further steps anticipated during 1987, and the outline of policy measures and objectives for the following two years.

III. The Economic Rehabilitation Program and SAF Arrangements

1. Principal objectives and features

The program for 1987-89 seeks to achieve a sustainable rate of economic growth and consumption through policy measures which will increase economic efficiency and strengthen the country's fiscal, monetary, and balance of payments positions. If these overall objectives are achieved, by end-1989 there should be a significant decline in prices and in the volume of economic activity conducted in parallel markets, with a concomitant increase in the availability of goods in official markets; there should be a substantial reduction in the scope of administrative mechanisms used in resource allocation; and there should be a restoration of orderly financial relationships with trading partners and creditors. Because many of the reforms will take a considerable time to implement and have an effect, and because of uncertainties caused by the present security problems, economic recovery will take several years, and reliance on some administrative controls will have to continue in the interim period.

Economic reforms are being focused on several central macroeconomic policy issues--including pricing and the exchange rate, allocation, the budget, and credit; and on administrative and institutional reforms in the key sectors of banking, agriculture, industry, and transport. Specifically, the exchange rate and official prices of goods will continue to be adjusted periodically with the aim of narrowing substantially the differentials between official and parallel market rates by mid-1988, and eliminating these differences by 1990. Fiscal measures are designed to reduce the overall budget deficit and domestic bank financing through measures that bolster revenues and expenditures. A major tightening of the public enterprise financial operations will be implemented in 1987 and beyond. Monetary and credit policies will complement pricing policies to narrow differences between parallel market and official prices by providing for a growth in liquidity less than that necessary to accommodate the initially large corrections in official prices. Pricing policies will also aim at realigning relative prices to favor production and exports. Price controls are to be reduced and simplified so as to increase the flexibility and market responsiveness of price formation. In line with these pricing policies, the Government is reforming the exchange, trade, and distribution systems to introduce greater flexibility and transparency into the system. Additional sectoral policies in agriculture, industry, and transportation will be implemented with the objective of improving efficiency of resource use and encouraging greater private sector participation.

A modest growth in output can be expected in the first years of the program, accelerating in 1988 and 1989. Current projections show that the balance of payments is fully financed in 1987 and future gaps appear manageable on reasonable assumptions. However, the external financial position of Mozambique will remain heavily dependent on concessional foreign assistance to finance the imports needed for the rehabilitation program, and on debt relief to regularize financial relations with creditors.

2. Exchange rate, wage, and price measures

A comprehensive set of exchange rate, wage, and price measures was initiated in January 1987. An exchange rate adjustment, announced on

January 30, 1987, and made effective the following day, raised the metical price of foreign exchange from Mt. 38.279 per U.S. dollar to Mt. 200.00, or by more than 400 percent in local currency terms, representing a devaluation of more than 80 percent in foreign currency terms. At the same time, the authorities suspended the currency's peg to a weighted basket of six currencies in favor of a fixed peg to the U.S. dollar. 1/

The Government intends to follow a flexible exchange rate policy with the objective of attaining an exchange rate level no less than one half of the parallel market rate in metical terms by the end of 1987 and at least 70 percent of the parallel rate by mid-1988. In this regard, the parallel rate in Maputo (which is reported to be substantially higher than elsewhere) is understood to have declined from upwards of Mt. 1,500 per U.S. dollar before the January devaluation to some Mt. 900-1,100 by the end of the first quarter.

An across-the-board pay increase for all wage earners was also announced on January 30, with effect from the beginning of the year. A new salary system, likewise introduced with retroactive effect, permitted enterprise managers to award productivity bonuses and pay raises that could further increase wages for superior workers; on the other hand, enterprises have been given expanded autonomy to reassign and lay off redundant workers, and the authorities have indicated that substantial reductions in force were to be expected. Wages to be paid in loss-making enterprises, moreover, were limited to 70 percent of the new wage levels for each category of worker, in effect limiting the general wage increase to only 5 percent for workers in these firms. The overall objective of the January wage measures was to offset the effect of official price increases on most workers' earnings, and most likely raised the economy's wage bill by around 50 percent. Depending on further price and exchange rate measures, there may be a further wage increase for profitable firms in mid-1987.

Over the several weeks following the end-January measures (which also included major fiscal actions, as described below), substantial increases in official prices, both fixed and "conditioned," were put into effect. Producer prices for cereals were typically tripled, and those for oilseeds were quintupled or more, although action on some other crops prices (including most exports) was deferred until the end of the ongoing marketing season. Centrally fixed consumer prices for many products were also raised by multiples; however, those for six staple items were held to no more than twice their former level, and for three of these goods, prices in the two major cities continued to be held below those elsewhere. The budget will absorb the difference between these prices and the cost of production through subsidies to wholesalers or processors (see below). Enterprises, whose price-setting authority had in practice been tightly constrained as a rule, were given

---

1/ EBS/87/60, March 12, 1987.

a largely free hand to adjust their prices to reflect new wage and material costs and to improve their financial position. The staff and the authorities have estimated (for working purposes) that official prices by the second quarter of 1987 had risen by some 200 percent from the 1986 level. Given the extent of parallel markets, however, where prices apparently were stable or declined slightly, the impact on the actual cost of living is believed to have been much smaller. 1/

The authorities intend to continue adjusting centrally fixed prices in step with further exchange rate and cost developments, and to reduce the scope and weight of official intervention. The number of items whose prices are centrally fixed is to be reduced from 44 as of early 1987 to 35 by midyear and 30 by 1988, with further reductions to follow. Meanwhile, a new methodology for enterprise price formulation has been proposed for introduction toward mid-1987, based on formulas designed to cover costs while containing profit margins; except for a few key products, the resulting prices are to be subject only to ex-post review by the responsible sectoral ministries.

3. Fiscal policies

Another major element of the Mozambican authorities' program is a thoroughgoing realignment of public sector finances. The program projections are based on the budget as promulgated in late January 1987, with adjustments for price and other policy measures that are to be implemented after the first quarter. The coverage of the 1987 budget has been broadened to include transfers to cover the operating losses of state enterprises and to recognize scheduled debt service obligations in full; previously, enterprise losses were financed directly by bank credit, and the local currency counterpart of external debt service payments were only made to the central bank when it was able to make payments abroad. In 1987 and future years, external payments are to be made as scheduled to a blocked account of the central bank, which will assume responsibility for external payment and/or rescheduling. Also, for the first time in 1987, interest is to be paid on government domestic debt. To improve the comparability of the 1987 projections with the data for prior years, adjusted data for expenditures and deficits that include the estimated enterprise operating losses financed by bank credit are shown for 1985 and 1986 as memorandum items in the fiscal summary (Appendix IV, Table 2). 2/

1/ Reasonable assumptions are that parallel markets accounted in 1986 for about one fourth of transactions volume and had prices 5-10 times the official equivalents; thus, a 200 percent rise in official prices with no change in parallel market prices would result in roughly a 60 percent average effective price increase.

2/ A similar adjustment to include full external debt service obligations for previous years was not possible.

The immediate fiscal objective for 1987 is to begin reducing the overall deficit in relation to total expenditures, from 61 percent in 1986 (on the adjusted basis mentioned above) to 56 percent in 1987, despite a 7 1/2-fold increase in the nominal value of capital outlays (which are largely external); current expenditures are projected to increase by 150 percent. The current deficit is to be held to about the same nominal value as in 1986 (Mt. 25 billion, up from Mt. 22 billion) and will be reduced in proportion to current expenditures from over 50 percent to under 25 percent. External financing will increase over 8 times in metical terms, allowing domestic bank financing to remain essentially unchanged in nominal terms, at some Mt. 25 billion, and to decline in relation to total expenditure, from 43 percent in 1986 to 14 percent in 1987.

A substantial revision of most of the domestic tax code was enacted in January 1987, together with increases in some key tax rates. This reform is designed to capture for the budget an increased proportion of the higher nominal value of transactions resulting from the exchange rate and pricing changes, by widening the tax base, simplifying collections, and accelerating payments. Overall, the combined effects of the tax reform and price increases in 1987 are a near quintupling of tax revenues and a quadrupling of total revenues, to Mt. 81 billion. Major changes include (1) increases of 100 percent and more in the principal specific consumption taxes (on tobacco, beer, and other beverages); (2) a quintupling of certain other specific taxes, fees, and import duties (to equal, in the latter case, the effect of ad valorem rates); (3) increases in the percentage rates of the turnover tax to 5 percent at the producer and wholesale levels and 10 percent at retail, about 2 1/2 times their former effective level on average; (4) an acceleration of business profits tax collections, formerly collected late in the year on the basis of the previous year's results, to a current basis through the introduction of estimated tax payments; (5) the taxation of windfall valuation gains on stocks of exportables (and, if abnormally high, stocks of other goods) at a rate of 50 percent; (6) the subjecting of state enterprises to the business profits tax, while permitting them to retain after-tax profits; (7) the introduction of license fees on artisans, small tradesmen, and the like; (8) the streamlining of individual income tax schedules and the widening of their effective coverage; and (9) the recasting of the poll tax, broadening its incidence and raising it sharply, making it the minimum fiscal contribution of most citizens.

Further revenue measures are envisaged later in the year and beyond. Consumption taxes are to be raised again during 1987 along with prices and wages, and are to be converted to an ad valorem basis by the time of the next budget presentation. Advance payments of business profits taxes in 1987 are to be based on export earnings or, for the larger firms with formal accounts, on projected earnings; beginning in 1988, all profits taxes will be based on projected earnings. Poll taxes, set for 1987 at Mt. 1,000-1,500 (depending on the province), can be adjusted annually, and provincial governments are also empowered to double the minimum schedule of fees payable by artisans and tradesmen.

Although ad valorem customs duties were not modified in the January 1987 legislation, the Council of Ministers was authorized to revise and update the tariff. Finally, the revenue system as a whole remains under review, and the Fund is expected to provide technical assistance in the course of 1987. Further measures deemed necessary will be introduced in 1988 and 1989 to increase buoyancy and efficiency further.

Current expenditures are projected for 1987 at Mt. 106 billion, 2 1/2 times the comparable 1986 level (i.e., as adjusted to include enterprise losses and on a cash basis). The rise is attributable chiefly to defense spending, which the authorities place at a level 3 1/2 times that of 1986, as well as to the budgeting for originally scheduled interest obligations and the substantial expansion of commodity subsidies. The subsidized commodities are maize, maize flour, rice, sugar, edible oil, and soap, and the amount of subsidy is to be kept to less than Mt. 6.8 billion, in part by using donated foodstuffs and in part by limiting the quantities distributed. On the other hand, transfers to cover enterprises' operating losses are to be held to Mt. 14 billion, the same figure as the corresponding bank credit for this purpose in 1986. Wage policy for the civil service is slightly more generous than for the economy as a whole, in the effort to stem the attrition of more able public servants. In addition to the 50 percent across-the-board wage increases in January 1987, a further 25 percent of the wage bill has been appropriated to provide differential raises to higher ranking and more productive workers, alleviating the compression of the salary scale imposed in the past, and a further substantial pay increase is anticipated at midyear to maintain real wages. Reductions in force on the order of 10-20 percent are under way, but as they will affect mainly lower-paid workers, and as the savings will be applied in part to productivity bonuses, the effect on the wage bill will be less than proportional. Thus, the civilian wage bill is projected to more than double, although its share in current expenditure will fall slightly, from 19 percent to 16 1/2 percent. Expenditures on nondefense goods and services, meanwhile, are set to more than triple in 1987, owing to cost increases; real spending in this area is being cut by some 20 percent. Additional savings on current expenditures are envisaged in the future, based on the findings of a review of public expenditure being undertaken in 1987-88 with technical assistance from bilateral donors and the World Bank.

Although the operating losses of enterprises (including private) accounted for the bulk of past credit expansion, these losses will be sharply reduced in real terms in 1987 and are to be largely eliminated over the next 2-3 years. The most immediate measures are the increase in centrally fixed prices and the relatively free hand which was given to enterprises in early 1987 to adjust their sales prices upward in response to cost developments. There were also substantial tariff increases, ranging from 100 to over 200 percent, for price-controlled utilities and transport services in early 1987. The largest losses have been concentrated in a few enterprises particularly affected by security conditions or other special factors. For these enterprises--cement, coal, and tea, for instance--specific measures are being taken to begin rehabilitation, increase inputs, and improve transportation. These and similar case-by-case measures will be reinforced by layoffs, temporary or permanent, and a virtual injunction against general pay increases in loss-making enterprises. By 1988, further measures to improve enterprise autonomy and efficiency are to be introduced, on the basis of a World Bank-sponsored study of 40 industrial and agricultural enterprises now getting under way.

Although capital outlays are projected to increase by 7 1/2 times (on a cash basis), 1/ this level is estimated to represent only a very limited real increase over 1986. Outlays in 1987 are, in principle, focused on rehabilitation-related undertakings, including the regionally strategic and externally funded Beira corridor, and the completion of ongoing projects. For the balance of the program period, when outlays will have been examined by the aforementioned public expenditure review, priority will be given in both government and enterprise investment to rehabilitation of existing capital stock and projects in which high rates of economic return and quick yields or savings of foreign exchange can be established. With a view to encouraging both foreign and domestic private investment in new or existing enterprises, a foreign direct investment law was enacted in late 1984 and a domestic private investment law, together with regulations implementing both laws, were promulgated in late 1986. These codes provided new safeguards and incentives for investment in priority sectors (agriculture, light industries, and transport) with tax holidays offered on investment inflows and exporters given customs exemptions and the right to partial retention of foreign exchange earnings.

4. Monetary and credit policies

To support the exchange rate, pricing, wage, and fiscal policies, the authorities intend to undertake stringent measures to contain overall monetary and credit expansion, in order to absorb excess liquidity and to improve the efficiency of credit use. The target for monetary expansion in 1987 has been set at about Mt. 50 billion or an increase of less than 45 percent (Appendix IV, Table 3). The staff has estimated that the increase in the demand for cash balances due solely to the increases in official prices and the change in the exchange rate is about Mt. 50-75 billion--depending on the model, on assumptions concerning the proportion of the value of transactions made on official and

---

1/ Preparation of the investment budget tends to lag well behind that of the current budget, and execution generally covers the 15 months beginning in April, including a complementary period. The 1987 data in Table 2 are based on provisional budget proposals, adjusted to a calendar-year basis.

parallel markets, and on changes in the velocity of money. 1/ Thus, achievement of the targeted monetary increase should slightly underfinance the increase in the value of official transactions and reduce liquidity for parallel market transactions. To achieve this monetary target, given the small reserve increase in the balance of payments projections, overall credit expansion, other than amounts on-lent from foreign borrowing, will have to be severely constrained, to about Mt. 40 billion. Domestic credit expansion to the Government, of Mt. 25 billion, is consistent with the budget estimates; nongovernment credit expansion will be constrained to Mt. 15 billion, plus amounts on-lent from foreign borrowing of the Bank of Mozambique. 2/ Credit in 1987 is estimated to have a sectoral distribution similar to that in 1986, in which agriculture and industry account for more than two thirds of the total.

A crucial aspect of the credit policy under the program is a closer scrutiny of credit requests of enterprises, with banks now applying commercial criteria in assessing those requests rather than accepting applications on the basis of need. Enterprise credit from the banking system will be used only to finance working capital and productive investment and not operating losses. This implies a significant change from past practices; new guidelines have been written and a seminar for branch managers has been held on the application of the new policy. Meanwhile, a modernized plan of accounts has been prepared with the help of Fund technical assistance, and should be introduced in mid-1987. Interest rates on loans and deposits were raised substantially in December 1986, and the authorities intend to review them periodically. Also, for credit based on foreign loans channelled through the banking system and granted after January 30, 1987, the exchange risk is to be assumed by the enterprises. These new credit policies are going to be very demanding on enterprises; in order for these policies to work, there will be a restructuring of some enterprises' internal debt, mainly the large amount of nonperforming loans. In this respect, the enterprise review conducted with the World Bank will help in deciding whether, when, and how to restructure enterprises' internal debt service. Some loans will have to be written off, others rescheduled, and for some, the Government may have to assume the obligation. Very tentative estimates have been made on the effect of these operations on the capital account of the Bank of Mozambique in 1987 and they have been

---

1/ Judgments about parallel market prices and volumes were made separately for currency and demand deposit transactions from informal inquiries; estimates of changes in velocity took into account the experiences of Ghana in 1983 (when velocity increased almost 60 percent following large changes in the exchange rate and official prices) and Tanzania in 1986.

2/ This foreign borrowing could amount to as much as Mt. 30 billion, but the local counterpart on-lent to enterprises would not have an effect on the money supply.

built into the monetary projections; however, any government assumption of enterprise credit would not take place until 1988, and these estimates have therefore not been built into the 1987 fiscal estimates.

5. Exchange and trade system

An important aspect of the program is the establishment of the basis for the progressive reduction of the comprehensive restrictions on trade and on payments and transfers for current international transactions, and for increasing reliance on the exchange rate and flexible prices for economy-wide resource allocation. The use of flexible exchange rate policy to narrow substantially the spread between the official and parallel market rates and the policy of passing through official exchange rate movements to domestic prices are important ingredients of the program. The establishment of an exchange rate close to the parallel market rate by mid-1988 should provide the opportunity to liberalize the import and exchange system, such that, by the end of the program period, the Government will be able to rely largely on stabilization policies, rather than administrative mechanisms, to manage the balance of payments. A program will be prepared by June 1988 to reduce the scope of administrative allocations in the exchange and trade system, including increasing the number of imported products for which no administrative allocations will be made. For these products, the Government will allow purchases of foreign exchange through the banking system subject only to routine licensing procedures. Already, the number of products for which a trading corporation has a monopoly has been substantially reduced, and the Government is reviewing the possibility of further reductions.

As progress is made toward a realistic exchange rate, the authorities are adopting a number of interim measures for improving foreign exchange allocation. The export retention scheme introduced in 1984 is being broadened by allowing almost all exporters access to the scheme and by narrowing the range of retention rates. Purchases and sales of rights to import using foreign exchange retained under the scheme are now permitted through the banking system at the official exchange rate among participants of the scheme. Additional import liberalization measures will be discussed in the context of the second year arrangement of the program.

The Government will refrain from accumulating new external payments arrears, excluding debt service payments subject to rescheduling, and will not conclude any new bilateral payments agreements with Fund members, which are inconsistent with Article VIII. To improve the debt service profile, the Government and the Bank of Mozambique will limit the contracting or guaranteeing of external loans on nonconcessional terms to US$50 million over the three-year program period, and to no more than US$20 million in the first year.

6. Summary of measures for the first annual program

The Mozambican authorities have taken many measures in recent months that are expected to help achieve the objectives of the program (see Table 1 attached to the PFP in Appendix I for an outline of the specific measures and their phasing throughout the program period). Actions already taken include the initial devaluation, major price increases, wage and labor measures, the 1987 budget measures, initial interest rate increases, and changes in credit policy. Moreover, the authorities intend to take additional actions during 1987, and have established certain benchmarks to monitor progress under the program. Additional measures include reviews to be completed on tax and expenditure policy, the enterprise study, and a study on reducing the scope of administrative allocations in the external trade and exchange system. Also, the Bank of Mozambique will implement its new plan of accounts, there will be a reduction in the number of items for which prices are fixed centrally, changes are to be made in resource allocations to favor the rural areas, further pricing and exchange rate measures will be taken, and various measures will be implemented in the agricultural, transport, and industrial sectors. Quantitative benchmarks are described in paragraph 15 of the memorandum of economic policies; they have been set quarterly on total credit expansion to the domestic economy, net of on-lent foreign borrowing, quarterly on net credit to the Government, and annually on the contracting or guaranteeing of external debt on nonconcessional terms. In addition, the Government will not establish new restrictions on imports and external current payments for balance of payments reasons, bilateral payments agreements, and multiple currency practices.

IV. Medium-Term Balance of Payments Projections

On the basis of the economic policy measures in the program, medium-term balance of payments projections have been prepared by the Fund and Bank staffs in cooperation with the Mozambican authorities (Appendix IV, Table 6). The balance of payments outturn in Mozambique will be strongly influenced by changes in the security situation, as well as the other exogenous factors which affect such projections. The staff projections assume no changes in the security situation over the projection period, not as a prediction about the future course of the disruptions but only to analyze the effects of the policy program on the balance of payments. If the security situation improves, the projected outturn will be considerably more favorable, particularly with respect to export growth.

The projections indicate a partial recovery of exports, the minimum increase in imports deemed necessary for rehabilitation, fairly significant increases in foreign financing but also a rise in debt service obligations, and a gradual decline in the overall deficit during the program period. Mozambique has a well-diversified export structure, and although security problems are assumed unchanged in these projections, some recovery in exports is expected in 1987 (by about 9 percent in U.S. dollar terms), owing to improved incentives and increased availability of consumer goods in the rural areas. Export growth is expected to accelerate in 1988 and beyond, to about 16 percent per year in U.S. dollar terms. Specifically, cashew nut exports are projected to double in value in 1987, while only moderate increases are expected for cotton, tea, sugar, citrus, and wood. The substantial producer price adjustments now under way, and the increase in imported inputs expected under the program, should have a direct positive production effect on many of these crops in 1988-91. Prawn and copra exports are expected to remain relatively stable during the program period, because of physical constraints.

Imports during the program period will be substantially tied to the availability of foreign financing; thus, the composition of imports will depend, in part, on the type of foreign resources available, such as funds for specific projects, food aid, or import support. Staff projections of imports, however, are based only on the composition needed to fulfill the immediate needs of rehabilitation and the recovery program, and not on a projection of foreign aid by type. On this basis, the staff projects that food and other consumer goods imports will decline by about 4 percent in 1987 in U.S. dollar terms, primary materials (particularly for industry and agriculture) will increase by close to 50 percent, and spare parts and equipment by 10 and 26 percent, respectively. Total imports are projected to rise in U.S. dollar terms by 19 percent in 1987 (following the 29 percent rise in 1986), and thereafter by an annual average rate of 6 percent. In fact, given the food emergency that has recently attracted international attention, food aid and food imports are likely to be higher than staff projections in 1987. 1/ In subsequent years during the projection period, actual food imports should decline to near the staff estimates, as agricultural production increases in Mozambique.

Service receipts have suffered in recent years because of the decline in transit trade activity and are likely to be affected by an announced reduction in the number of Mozambican miners in South Africa. While transportation receipts are expected to pick up in 1987, mainly as a result of increased transportation of cargo on the Beira corridor, remittances from the miners are projected not to increase in nominal terms. Consequently, total service receipts are projected to rise by an annual average rate of 5 percent during the program period. Service expenditures are projected to rise sharply in 1987 because of specific identified expenditures, but then are expected to remain stable in real terms in 1988 and 1989. Based on assumed terms of the debt relief expected in mid-1987, interest obligations will reach US$175 million in 1987 and are expected to rise to US$188 million by 1989.

1/ An international conference concerning Mozambique's food emergency was held in Geneva on March 31, 1987; however, the staff has not obtained a confirmed list of new commitments, and thus has not revised its import projections.

Donors' current commitments and likely disbursements in 1987 were discussed with the authorities, the World Bank, and the major donors. Based on these discussions, Mozambique can expect a considerable increase in concessional external assistance in 1987, to about US$630 million (compared with about US$500 million in 1986 and an average of US$410 million in the preceding three years), reflecting mostly an increase in grants. Of the estimated 1987 loan disbursements, the World Bank is expected to contribute about 23 percent and the CPE countries about 32 percent, with the remainder coming from other bilateral donors; for grants, most of the increase comes from OECD donors. Additional grants for food aid amounting to about US$79 million are also assumed. From 1988 to 1989 grants and loan inflows are projected to remain stable in real terms.

The current account deficit (before transfers) is projected at about US$700 million in 1987 and increases slowly during the rest of the program mainly because of rising interest obligations. Grants are expected to rise by 5 percent per year (constant in real U.S. dollar terms). The capital account is projected to show significant improvement during this period because of a decline in scheduled amortization which occurs from 1987 to 1989. On this basis, the overall balance of payments deficit is projected to decline by about one fourth in 1987, to about US$400 million, and to fall just below one half of the 1986 level by the end of the program period.

To regularize relations with creditors and ease the immediate debt service burden, Mozambique will seek from official and private creditors a consolidation of arrears outstanding at end-1986 and a rescheduling of current maturities on terms at least as favorable as those agreed upon in 1984-85; as a result, while moratorium interest payments would rise appreciably, virtually all amortization and scheduled bilateral interest obligations would be deferred. In order for international reserves to be progressively rebuilt to a level equivalent to two months of imports by 1991, there would be annual reserve accumulations averaging about US$15 million over the 1987-91 period. These projections show no financing gap in 1987. In spite of a small projected reduction in the overall deficit in 1988, a financing gap of US$48 million would arise in that year. The projected financing gaps (assuming rescheduling in each year on terms similar to those of 1984-85) are expected to reach US$66 million in 1989, peak in 1990 at about US$77 million, and then begin to decline.

V. Staff Appraisal

Mozambique is a large, relatively well endowed country with a potential for substantial economic growth with a sustainable balance of payments. Upon independence in 1975, however, the basis of the colonial economy was undercut by the exodus of most of the skilled, technical, and managerial manpower, and, in the five years following independence, Mozambique suffered additional economic losses from regional political problems. From 1981 to 1985, the economic situation deteriorated sharply. By 1986, production, exports, and service receipts had fallen sharply below their 1980-81 levels, arrears on debt service payments had increased to many times the annual foreign exchange earnings, and barter and parallel markets had become widespread with goods priced several times the official levels and the exchange rate 25-40 times the official level.

The economic deterioration of the early 1980s was caused by both exogenous and policy factors. In addition to a severe drought followed by cyclones and floods, there have been increasingly severe economic disruptions, owing to attacks by armed bands, which have displaced large numbers of people and damaged production and transportation facilities in some areas. These disruptions have been an important determinant of economic developments in the past few years. Economic policies also contributed to the deterioration, as the prices of goods and the exchange rate were controlled at levels which bore little relation to the scarcity value of goods and foreign exchange, substantial fiscal deficits and enterprise losses were financed by internal credit expansion and resulted in large increases of the money stock despite the shrinkage of the official market economy, central physical allocation of goods frequently led to inefficiency, big investment projects financed by foreign borrowing turned out to have low rates of return, and insufficient attention was given to maintenance and rehabilitation.

As early as 1983, there was a recognition that policy corrections were needed, and steps were gradually taken to begin a process of policy reform. The current program is the result of a comprehensive policy reappraisal in which the authorities are undertaking a major restructuring of the economy. The most important immediate measures include a very large initial devaluation, substantial increases in official prices of goods and changes in the administration of price controls, a wide-ranging tax reform and expenditure constraints that greatly reduce the budget's reliance on domestic bank financing, a tight credit program with bank credit being given only to enterprises able to repay, and sectoral measures designed to increase efficiency and lead to higher growth. Also, the authorities have agreed to undertake several studies which should lead in the later years of the program to increasing enterprise, government, and financial efficiency, and to liberalization measures.

A major objective of the program is to restore the predominance of the official markets for goods and foreign exchange by increasing the availability of goods in these markets, and by decreasing or eliminating the differences between official and parallel market prices. This process will make it easier for the authorities to reduce reliance on centralized physical allocations of goods, with a resulting improvement in allocative efficiency and a saving of administrative resources. The flexible exchange rate policy and pricing measures in the program will increase official prices to nearer the current parallel market levels, while the tight monetary policy will deprive the parallel markets of liquidity and should result in decreasing their prices. During the first quarter of 1987, there has been evidence of a substantial decline in the parallel market exchange rate, and the beginning of a decline in parallel market prices of goods. In accordance with the aim of reducing the spread between parallel market and official prices, exchange rate policy will be aimed at achieving an official exchange rate no less than 50 percent of the parallel market rate by December 1987, and no less than 70 percent of the parallel market level by June 1988. Given the very tight balance of payments and the uncertainties resulting from the security situation, the process of import liberalization will be slow in the early phase of the program. However, liberalization of domestic production and distribution will be more rapid, particularly in the agricultural, industrial, and transport sectors.

The fiscal program for 1987 includes a major tax reform which the staff believes will capture for the budget a reasonable share of the 1987 increase in the value of transactions at official prices and will also increase the buoyancy of the tax system. However, the staff feels that these measures will need to be re-examined during the course of 1987 as their effect becomes apparent. Therefore, as part of the program, the authorities will review various aspects of the tax system, with Fund technical assistance, to devise further measures, if necessary, to be implemented in 1988 and 1989.

The Government's expenditure program attempts to contain the increase in expenditures necessitated by the official price changes, without substantially impairing the effectivenesss of government operations. Large increases nevertheless arise because of the need to reduce the attrition of the better civil servants, the exigencies of defense, the provision of a safety net for the urban population, and the fact that investment expenditure is predominately for imports. The staff feels, and the authorities agree, that, as in the case of revenues, there is an ongoing need for review, particularly as prices, wages, and the exchange rate are changing by large margins; therefore, the authorities are also undertaking in 1987 a review of expenditure policy with the help of technical assistance, including from the World Bank; this review will pay particular attention to the investment program.

Although the increase of the overall deficit is large because the price and exchange rate measures greatly increase capital outlays, there is a corresponding increase in the metical value of external finance. The net result is that domestic bank financing of the deficit is reduced enormously in relative terms, from about 43 percent of total expenditure in 1986 to 14 percent in 1987. The staff feels that this adjustment is consistent with the overall objectives of the program.

Financing enterprise losses has been transferred to the budget and the authorities intend to maintain a strict control on these losses. The staff feels that policies designed to reduce the losses (in the short-term pricing policies, and in the medium-term reorganization and

People's Republic of Mozambique --
Structural Adjustment Facility--
Three-Year and First Annual Arrangements

Attached hereto is a letter, with an annexed Economic Policy Framework paper and an annexed Memorandum of Economic Policies, dated May 8 , 1987, from the Minister of Finance of Mozambique, requesting from the Fund a three-year structural adjustment arrangement and the first annual arrangement thereunder, and setting forth

(i) the objectives and policies of the program to be supported by the three-year arrangement,
and
(ii) the objectives and policies of the program to be supported by the first annual arrangement.

To support these objectives and policies, the International Monetary Fund grants the requested arrangements in accordance with the following provisions and subject to the Regulations for the administration of the Structural Adjustment Facility:

1. For a period of three years from __________, 1987, Mozambique will have the right to obtain three successive loans from the Fund under the Structural Adjustment Facility in a total amount equivalent to SDR 28.67 million.

2. The first loan, in an amount equivalent to SDR 12.20 million, is available for disbursement at the request of Mozambique.

3. The second and third loans will be available upon approval by the Fund of the corresponding annual arrangements and will be disbursed at the request of Mozambique. The amount of the second loan will be equivalent to SDR 8.235 million, and the amount of the third loan will be equivalent to SDR 8.235 million.

4. Before approving the second annual arrangement, the Fund will appraise the progress of Mozambique in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, taking into account primarily:

(a) the measures pertaining to 1987 specified in Table 1 of the annexed Economic Policy Framework paper and the benchmarks specified in paragraph 15 and the intentions concerning external debt specified in paragraph IV of the annexed Memorandum of Economic Policies;

(b) (i) the imposition or intensification of restrictions on payments and transfers for current international transactions,

(ii) the introduction or modification of multiple currency practices, People's Republic of Mozambique - Letter of Transmittal, Request for Three-Year Arrangement and the First Annual Arrangement Thereunder

Maputo, Mozambique
May 8 , 1987

Mr. Michel Camdessus
Managing Director
International Monetary Fund
700 - 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Camdessus:

1. The annexed Policy Framework Paper has been prepared in collaboration with the staff of the Fund and the World Bank. It describes the major economic problems and challenges facing Mozambique, the objectives of a three-year medium-term program, the priorities and the broad thrust of macroeconomic and structural adjustment policies, the likely external financing requirements, and the available sources of such financing.

The Government of Mozambique will remain in close contact with the staff of the Fund and the World Bank on developments and progress in implementing these policies, and the Policy Framework Paper will be updated annually as the program is implemented.

2. The annexed Memorandum of Economic Policies pursuant to the policy framework described above sets out the objectives and policies that the Government of Mozambique intends to pursue for the period 1987-89, and the objectives and policies for the first year of this period, for which balance of payments assistance is needed. In support of these objectives and policies, Mozambique hereby requests a structural adjustment arrangement from the Fund for a period of three years in the amount that will be available to Mozambique under the Fund's Structural Adjustment Facility, and the first annual arrangement thereunder.

3. The Government of Mozambique will provide the Fund with such appropriate information as the Fund requests in connection with the progress of Mozambique in implementing the policies and achieving the objectives of the program.

4. The Government of Mozambique believes that the policies set forth in the annexed Memorandum are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. Mozambique will consult with the Managing

May 8 , 1987

PEOPLE'S REPUBLIC OF MOZAMBIQUE

Economic Policy Framework, 1987-89

1. Over the past decade and particularly in the past five years Mozambique has experienced a dramatic deterioration in its economy. After growing at over 2 percent per annum between 1977 and 1981, GDP declined at about 8 percent per annum between 1981 and 1986; agricultural production is now at about 75 percent of 1981 levels, necessitating food imports equivalent to 90 percent of marketed grain requirements; industry operates at 20-40 percent of capacity; international transportation service receipts are about 60 percent of 1981 levels and 30 percent of mid-1970s levels; export (estimated at about US$80 million in 1986) are 28 percent of their value in 1981 and account for around 14 percent of total imports. This economic decline has resulted from a set of exogenous and endogenous factors, including the worsening security situation, and the imposition of sanctions against Rhodesia's UDI. In order to reverse the decline, and pave the way for a more rapid recovery when the security situation improves, the Government is now embarking on a major recovery program which includes a comprehensive set of policy reforms aimed at stabilization, more efficient resource allocation, and growth. The reforms should reduce the financial imbalances built up over the past several years, substantially improve resource allocation by decentralizing economic decision-making to economic agents, and increase reliance on prices and other indirect levers to guide the economy. While recognizing that the continuing instability and disruption brought by destabilizing forces in various parts of the country will affect the pace of implementation and the effects of the program, the Mozambican authorities are determined to proceed with the program, including the specific measures outlined below.

I. BACKGROUND

2. Mozambique is a large, diverse, and rather sparsely populated country, well endowed with agricultural, hydroelectric, and mineral potential. During the colonial period, the country was developed largely as a service economy for its neighbors, with most of the local population largely excluded from modern education, training or employment. Upon the country's independence from Portugal in 1975, the Government inherited an economy in crisis, severely disrupted by the prolonged struggle for independence and the exodus of about 90 percent of the Portuguese settlers. In the period since independence, the country has suffered a series of exogenous shocks including the effects of drought, renewed oil price increases and the international recession at the beginning of the 1980s. It has also been seriously affected by the instability and turmoil

5. These measures were important first steps in the effort to reform economic management but, on their own, have been insufficient to stimulate any significant economic turnaround. Agricultural production, which accounts for 80 percent of employment and over 70 percent of exports, has continued to suffer; when combined with a worsening security situation this has meant that production and marketing of Mozambique's main exports--cashew nuts, tea, cotton, and copra-- have continued to decline, and are now only about 36 percent of 1981 levels by value. In industry, firms have not been able to adjust their labor force or prices to actual operating capacity and the foreign exchange allocations have been insufficient to allow them to operate at more than 20-40 percent of capacity. The result has been mounting losses and increased dependence on easy bank credit. Overall scarcity of resources, combined with prevailing licensing and tariff policies, have inhibited the development of transport services. Transport services have also been seriously affected by damage to facilities, with some rail and truck routes rendered inoperable and others kept open only at great cost.

6. Financially, the Government budgetary position has seen an erosion of the tax base due to declines in production and a shift towards parallel markets and continuing increases of expenditures, especially for defense. As a result, the current state budget deficit, has shifted from a modest surplus to a considerable deficit since the early 1980s, even without accounting for losses of public enterprises; with these losses included (as they will be from 1987), it amounted to some Mt. 21 billion in 1986 (just over 50 percent of current expenditures). The overall fiscal deficit in 1986, on a cash basis and including losses of public enterprises, amounted to Mt. 31.2 billion, or 61 percent of total expenditure. Domestic bank financing of the Government deficit (including credit to state enterprises) has risen with the overall deficit, to about 20 percent of the opening broad money stock in 1986. Credit policy has also been affected by the fact that commercial and central banking functions are both carried out by the Bank of Mozambique, without adequate separation of these functions. Despite some recent slowing of credit expansion in the past 2-3 years, nonperforming loans make up the bulk of the banking system's portfolio. The broad money stock outstanding remains larger than the estimated value of non-subsistence GDP; the measured value of velocity has dropped by 50 percent since 1980, in large part reflecting a "monetary overhang" caused by the holding of currency for transactions made in parallel markets and not recorded in the official statistics.

7. During 1981-86, foreign exchange earnings averaged only about 40 percent of expenditure on imports of goods and services other than interest, resulting in a build up of external debt and greater dependency on foreign aid. In 1986, export receipts rose by 3 percent, service earnings rose by 11 percent and total imports increased by about 30 percent. Because of the low level of exports and the heavy debt service burden, the current account deficit before transfers reached US$600 million in 1986 and the overall deficit approached US$550 million. In October, 1984, arrears and current maturities totalling US$283 million were rescheduled by the Paris Club, and in 1985 OPEC countries also rescheduled arrears and current maturities equalling US$123 million. The debt service

11. In the first year of the program efforts will be made to improve the efficiency of administrative controls, and substantial measures aimed at achieving the medium-term goals will be taken. These include the exchange rate, pricing, marketing, and budgetary policies already announced and policies in the agricultural, industrial and transport sectors to improve efficiency and cut financial losses. Studies will be undertaken during 1987, with the assistance of the Fund and the World Bank, whenever necessary, to help improve planning and policy making, and to lay the basis for further measures to be taken during the rest of the program period.

12. The Government has already begun the process of reforming economic management in Mozambique, but the impact of economic reforms on growth and the balance of payments will depend in part on developments in the security situation, especially in rural areas. Assuming that the situation does not deteriorate further, that additional inflows of concessional assistance are available for Mozambique, and that economic reform proceeds as planned, the Government expects that: (1) the decline in overall economic activity could be arrested and reversed, with modest GDP growth in the first years of the program, and accelerating in 1989; (2) after major price corrections in 1987 and 1988, parallel markets could be substantially reduced and the annual rate of inflation could fall to less than 15 percent by 1989; and (3) the balance of payments could improve with aid-financed imports rising sharply in 1987 to provide inputs for higher levels of output; after the first year of the program, foreign exchange earnings will increasingly finance the higher import levels.

Economic and Financial Management

13. The Government recognizes that economic recovery in Mozambique will depend in part on reforms and improvements in the system of economic and financial management, and the program therefore includes a set of studies and technical assistance which will be done in conjunction with the World Bank, the Fund, and other donors, and which will help lay the basis for future reforms. A review of public expenditures will be completed by June 1988. This review will cover recurrent and investment expenditures, taking into account the country's priority needs, the objectives of the ERP, and the need to reduce the budget deficit. In line with the objectives of the ERP, and consistent with the objective of improving the performances of the industrial and agricultural sectors, an Enterprise Review is under way, covering about 25 industrial and 15 agricultural enterprises, including some state farms. The review would assess individual enterprises, including some of the largest in Mozambique and those which account for a large volume of domestic credit outstanding, and make specific recommendations as to restructuring (rehabilitation, divestiture or closure) of the enterprises. The review is expected to be completed by October 1987. In the financial sector, technical assistance will be provided by both the World Bank and the IMF to improve the operations of the banking system, and help lay the basis for a separation of the Bank of Mozambique's commercial and central banking operations. In addition, management of external debt, a heavy component in the balance of payments financing, will be strengthened through technical assistance to the Bank of Mozambique. Taken as a whole, these activities should

and the administrative procedures for allocation of foreign exchange in support of that program to ensure that it meets the country's priority needs and contributes to overall efficiency improvements.

17. In light of Mozambique's acute external debt situation, the Government and the Bank of Mozambique do not intend to contract or guarantee external loans on non-concessional terms of 1-12 years' maturity in excess of US$50 million during the period of the program, no more than US$20 million of which will be contracted in 1987. The Government will need to approach external creditors for comprehensive debt relief over the duration of the SAF arrangement and beyond.

Pricing and Distribution Policies

18. Pricing policies are being directed at reducing direct price controls and allowing market forces to guide price formation, and at restoring appropriate cost-price relationships for those products still subject to controls. Accordingly, the Government has adjusted almost all fixed prices to pass on fully the impact of the exchange rate changes already taken. Decontrol of pricing will be initiated by transferring some goods from the fixed to the regulated price list and allowing the prices of some of the goods on the fixed price list to be market-determined. As a result, the number of items with fixed prices will be reduced from about 44 at present to 35 by mid-1987 and to 30 at the beginning of 1988; further reductions will be made during the program period. Some of the goods remaining on the fixed price list will continue to have prices fixed at all levels of production, while others will be fixed only at the consumer level. The system of regulated prices will be made more flexible by allowing managers to make pricing changes without prior approval, and subject only to ex-post review by the relevant sectoral Ministry instead of the Ministry of Finance. As supply conditions improve, and competition increases, the system of regulated prices will gradually be phased out. Pricing policies for the agricultural, industrial, and transportation sectors are discussed in more detail below.

19. In parallel with the changes in pricing and stabilization policies, the Government will continue to open domestic trade, allowing increasing competition among trading corporations at all stages of the marketing system. Private and other enterprises are being permitted to buy an increasing number of products directly from state and other enterprises rather than through state wholesalers. The Government also intends to reduce progressively the number of domestic goods directly allocated. However, in view of the current insecurity in the countryside, as an interim measure, the Government will need to retain some direct administrative control over certain key products to ensure that minimum levels reach all regions and sectors of the economy. But it will endeavor to improve the distribution of such goods and in particular to ensure that an increasing share reach rural areas. Of particular importance will be the administrative mechanisms for allocating food to the 2-4 million people in rural areas that are currently unable to feed themselves. The Government will also be maintaining a rationing system in Maputo and extending it to other urban areas as an important means of ensuring that

of quickly yielding or saving foreign exchange and showing a high rate of economic return.

22. The rate of credit expansion will be moderated in order to reduce substantially the overhang of excess domestic liquidity, by containing the growth of domestic liquidity to amounts less than necessary to accommodate the increase in official market transactions at the new set of prices and exchange rates. In 1987, it is estimated that this should allow an increase in total money of about 45 percent. To support these objectives and encourage domestic savings, the Government will also pursue a flexible interest rate policy. There was a substantial upward adjustment at the beginning of 1987, which will be followed by further adjustments as needed, aimed at achieving positive real interest rates by the end of the program period. Measures will be taken in 1987 to improve the quality and timeliness of the accounts of the banking system as well as work towards a separation of the commercial and central banking functions within the Bank of Mozambique.

Agricultural Policy

23. In agriculture, pricing and marketing reform will be directed at stimulating production and improving the incomes of rural producers. As part of this effort, the Government has decontrolled the prices of fruits and vegetables and some minor animal products. In addition, the prices of some products are now fixed at the provincial, rather than at the national level, permitting greater flexibility in price setting. In January 1987, producer prices of most agricultural products were raised by between 200 and 400 percent. In accordance with its overall pricing policies (set out in paragraph 18), the Government intends to reduce further the number of agricultural products subject to fixed pricing. For those products for which the prices continue to be fixed, producer prices will be set based on international prices, appropriately adjusted to ensure adequate producer incentives and taking account of internal distribution and processing costs. As supply and competitive conditions improve, the Government also intends to reform the system for fixing prices in the agricultural sector, allowing greater price competition and flexibility while ensuring that farmers are guaranteed a minimum or floor price.

24. For some time, the Government has considered that the increased participation of private traders in agricultural marketing, at all levels, should be encouraged. The private sector is already active at the primary and wholesale level, and the policy of allowing direct importation and exportation is likely to increase their participation. To the extent the Government still administratively allocates certain goods, it also intends to increase the allocation of such goods, including consumer goods, to private traders and consumer cooperatives. The Government will also review the bottlenecks in the marketing system for specific commodities, beginning with fruit and vegetables. These various measures are likely to generate greater competition in marketing. State agents such as AGRICOM would both compete in the market and act as residual buyers.

enterprises. Vehicle licensing and registration fees will also be increased. The Government is also encouraging private sector participation in road transport by removing licensing restriction on cargo transport and by expanding maintenance and repair facilities through private agents. The Government will also increase the supply of vehicles and spare parts by the auctioning of little used or inoperative state-owned vehicles. Rehabilitation efforts will focus particularly on the major rail corridors, in order to generate additional foreign exchange earnings from transit services and improve domestic trade.

III. Growth and Social Impact

29. The attainment of the principal objectives of the Rehabilitation Program rests critically on the resumption of growth, particularly in the agricultural sector. Increased production of both domestic food crops and the traditional export crops is essential to the restoration of living standards and to the increase in export revenues. But the magnitude of the supply response to the changing policy environment is difficult to estimate, and is further complicated by the security situation. The program outlined here and in Section IV (and set out in further detail in the attached Tables) assumes that the exogenous regional conditions are unchanged. If the security problems are resolved swiftly, a significantly more rapid response to the policy measures would take place.

30. With the new policy reforms taking time to implement, and with an inevitable lag in the response to these changes, little growth can be expected in 1987 in the agricultural sector, although production should stabilize. In 1988 and 1989, the growth of production in those areas where the security problems are of minor importance should be significant. A substantial response to the pricing and marketing reforms and to the increased supply of incentive goods is anticipated from the family sector, and this should be reflected by 1988 in increases in the output of domestic food crops and of the traditional export crops of cashew, copra and cotton. Consequently, modest GDP growth will occur in the first two years of the program and accelerating in 1989. The growth of export volumes should exceed 8 percent per annum in 1988-89. To achieve these growth rates a substantial increase in real imports should occur over the first two years of the program, to provide consumer goods to stimulate agricultural production, to meet the emergency food requirements, and to facilitate the rehabilitation of the economy. These imports will permit consumption per capita to grow in the first two years of the program.

31. The principal effect of the program's policies will be the reactivation of the rural economy, which will induce a progressive increase throughout the program period in both rural employment and incomes. Thus, the program's initial benefits will accrue principally to the agricultural and export sectors. The quarter of the population living in the urban areas will be affected adversely by increases in unemployment subsequent to the rationalization of the public sector. For those remaining in employment, average wages are expected to roughly keep pace with the actual

cost of living. In the medium term, urban growth will be contingent on the introduction of more efficient and streamlined enterprises that can respond to increased rural and external demand, and the increased flow of imports financed by the growing agricultural surplus.

32. To cushion those sectors of society most affected by the more acute problems, the Government has already introduced a safety net for staples and other essential goods. Under the program, assistance will continue to be provided to the most vulnerable groups, through a targeted and subsidized rationing system. Until economic growth can be sustained, and the Government financial position improved, all sectors of society are likely to suffer from curtailments of social services.

IV. External Finance Requirements

33. Despite the growth in both agricultural and industrial production anticipated in the second half of the program period, the expected growth in exports and service receipts will not be adequate to generate a sustainable balance of payments by the end of 1989. Indeed, even by 1991 the external financial position of Mozambique will remain difficult, and highly dependent on substantial inflows of concessionary foreign assistance, in the form of either grants or highly concessional and flexible credits. This will need to be complemented by comprehensive consolidation of arrears and restructuring of debt service obligations on generous terms. In order to finance the rehabilitation program described in this paper, gross external financial inflow requirements, including grants and anticipated debt relief, are anticipated to remain at around US$1 billion per annum throughout the 1987-91 period.

34. Indicative balance of payments projections embody a partial recovery of exports, and the minimum increase in imports deemed necessary for economic rehabilitation. Through 1991 exports are estimated to rise in dollar terms by an annual average rate of 16 percent, and imports in dollar terms by an annual average rate of 8 percent. The higher import level is directly linked to the availability of grants. Interest obligations are projected to rise significantly from US$177 million in 1986 to US$227 million in 1991. On this basis, the current account deficit after official transfers is expected to rise from US$385 million in 1986 to US$435 million in 1991.

35. Based on donor's current commitments and plans, Mozambique can expect a considerable increase in concessional external assistance in 1987, to US$631 million (compared with US$497 million in 1986), reflecting mainly increases in grants. Existing aid commitments are largely financing project investments. By 1989, amortization before debt relief will decline by almost one half of the 1986 level, allowing net capital inflows to increase from US$83 million in 1986 to a projected US$178 million in 1991. On this basis, the overall balance of payments deficit is projected to decline by about one half over the program period.

36. To regulate relations with creditors and ease the immediate debt service burden, Mozambique will seek from official and private creditors a consolidation of arrears oustanding at end-1986 (which amounted to US$1.2 billion) and a rescheduling of current maturities on terms at least as favorable as those agreed upon in 1984-85; as a result, while moratorium interest payments would rise appreciably, all amortization and scheduled bilateral interest obligations for 1987 would be deferred. With international reserves being progressively rebuilt to a level equivalent to two months of imports by 1991, there would be annual reserve accumulations averaging around US$15 million over the 1987-91 period. These projections indicate that there is no financing gap in 1987. In spite of a small projected reduction in the overall deficit in 1988, a financing gap of US$47 million would arise in that year due to the decline in debt service eligible for rescheduling. The projected financing gap (assuming annual rescheduling on the same terms as in 1984-85) is expected to reach US$66 million in 1989, peak in 1990 at about US$78 million, and then begin to decline.

37. A more rapid rehabilitation and recovery than projected above would be feasible and desirable. It would require substantial additional inflows of external assistance in conjunction with the program outlined above. These additional inflows of grant and concessional loans should be provided in the form of quick-disbursing import support. The Government intends to seek such additional assistance though various fora including requesting regular consultative group meetings. In view of the country's special circumstances, the Government will also be seeking the conversion of credits into grants, as has already been done by some official creditors in 1986, and some shift in the composition of donors assistance from project aid to general import support.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
II. External Policies			
A. Exchange Rate	Establish a realistic rate that will allow a reduction in the scope of administrative allocations in the exchange and trade systems.	a. Initial devaluation of 80 percent in foreign currency terms to Mt. 200 = US$1.	First adjustment implemented in January 1987.
		b. Flexible exchange rate policy that is aimed at establishing a market clearing rate.	Further adjustments to be assessed in the context of the annual programs and consultations with the IMF.
B. Trade and Foreign Exchange Management	Reduce scope of administrative allocations in the external trade and exchange system.	a. Continue the process of opening marketing channels by allowing enterprises to import and export directly as well as through trading companies.	Complete ongoing review by end-1987. Implementation of recommendations thereafter.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
		b. Establish a program to increase progressively the number of imported products for which no administrative allocations are made.	Action program June 1988 for implementation thereafter.
		c. Review of the export retention scheme and other interim measures to improve the flexibility of trade.	Review to be completed in 1987; implement recommendations in 1987/88.
		d. Review import program and procedures for allocation of foreign exchange.	Annual, during program period until exchange rate policy objective achieved.
		e. No new bilateral payments agreements involving exchange restrictions with Fund members.	Program period.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
C. External Borrowing	Reduce debt service burden and improve profile of external public debt.	a. Seek from creditors rescheduling of current maturities on concessional terms.	June 1987 and program period.
		b. Limits on external borrowing at nonconcessional terms in the 1-12 year maturity range.	Maximum of US$50 million during program period, no more than US$20 million of which in 1987.
III. <u>Pricing and Distribution Policies</u>			
A. Pricing measures	Allow prices to adjust to reflect real resource costs with progressively less administrative control so that they come to serve as the primary guide to resource allocation. (Further objectives, policies and measures under sectoral headings).	a. Regular adjustments of fixed prices to reflect exchange rate and other cost changes.	Major adjustment in January 1987. Further adjustments as needed.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
		b. Further reduce the number of products for which producer, intermediate and/or consumer prices are fixed at the interministerial or provincial level.	Reduce number of items so fixed from 44 to 35 by mid-1987 and to 30 by beginning of 1988. Further reductions thereafter.
		c. For goods on regulated price list, allow price changes by managers without prior approval.	Beginning January 1987.
B. Distribution Measures	1. Reduce administrative allocation and increase efficiency of domestic trade.	Establish a program to increase progressively the number of domestic products for which no administrative allocations are made.	Action program by June 1988 for implementation thereafter.
	2. For goods which are not market allocated, increase allocation to rural areas.	Increase share of goods allocated to rural areas as compared with urban areas.	Starting 1987, with annual review of allocations.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
	3. Provide a "safety net" for staples and other essential goods to the most nutritionally vulnerable section of the population.	Improvement in the effectiveness of the rationing system to meet the needs of the poorest section of the population. Subsidy to be financed through the budget.	Safety net introduced in 1985. Improvements, including targeting, to be introduced beginning 1988.
IV. Fiscal Policy			
A. Overall	Restore fiscal discipline and reduce budgetary imbalances.	Limit the 1987 overall budget deficit on a cash basis (including all operating losses of public enterprises) to Mt. 104 billion; thereafter, limit the overall deficit and observe government credit targets as agreed with the IMF.	1987 budget approved. Annual review 1988-89.
B. Revenue Measures	1. Increase budgetary revenue in the short-run, make the revenue system more buoyant, and provide adequate incentives to production.	Implement major tax reform designed to achieve substantial revenue gains given the exchange rate and domestic pricing measures.	1987 measures introduced. Annual review with IMF 1988-89.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
	2. Improve tax administration.	Undertake a review of the tax system taking into account the incentive effects on production.	Review to be completed in 1987 for implementation in 1988.
C. Expenditure Measures	Contain expenditures within agreed limits.	a. Introduce expenditure measures on wages, subsidies, nondefense goods and services, and capital.	1987 measures introduced. Annual review with IMF and World Bank, 1988-89.
		b. Limit net transfers to state enterprises to Mt. 14 billion in 1987 and define future targets based on enterprise review.	Program period.
V. <u>Monetary Policy</u>			
A. Credit Policies	Reduce current excess liquidity.	Maintain credit expansion within limits agreed with the Fund.	1987 credit limits introduced.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
B. Interest Rates	Encourage domestic financial savings and efficient allocation of resources.	Adjustments to interest rates with the aim of achieving positive real interest rates.	Initial adjustment implemented January 1987; subsequent adjustment based on reviews with IMF.
VI. <u>Agricultural Policy</u>			
A. Pricing Policy	Increase incentives for production.	a. Reduce number of agricultural products subject to fixed prices.	Program period.
		b. Regular adjustment of fixed producer prices based on international prices (adjusted for internal distribution and processing costs) converted at prevailing exchange rate.	Major adjustment announced January 1987. Further adjustment thereafter.
		c. As supply and competitive conditions improve, the Government also intends to reform the system for fixing prices in the agricultural sector, allowing greater price competition and flexibility while ensuring that farmers are guaranteed a minimum or floor price.	Program period.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
B. Marketing	Promote competition in marketing and input supply at wholesale and retail and export/import stages.	a. Agricultural producers to import and export directly or through trading enterprises.	Program period.
		b. State agents to both compete with private traders and act as residual buyers.	By the end of program period.
		c. Review of bottlenecks in marketing of specific agricultural products.	Review of fruits and vegetable marketing during 1987. Additional reviews thereafter.
		d. Until more market-determined criteria for resource allocation are established, the Government will increase the allocation of consumer and other goods to private traders and consumer cooperatives.	Program period.
		e. Develop and implement an action program for agricultural marketing enterprises based on enterprise review.	Review in 1987. Implementation during 1988.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
C. Agricultural Enterprises	Better allocation of agricultural resources.	Develop and implement an action program for restructuring state farms based on enterprise review.	Implementation during 1988.
VII. Industrial Policies			
A. Pricing policy	1. Reduce short-term financial imbalances.	Reflect exchange rate adjustment in fixed and regulated prices.	Implemented January 1987. Thereafter, following further exchange rate adjustments.
	2. Increase market influence in formation of industrial product prices.	a. Reduce number of products subject to fixed prices.	Throughout program period.
		b. For a limited number of industrial products, establish an ex-factory ceiling price at the level of the border price of a similar import, adjusted for local capacity utilization.	Establish a program by October 1987 for implementation during program period.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
B. Resource allocation	Increase efficiency of resource use in industry, particularly of foreign exchange.	Pending reduction in scope of administrative allocations in the exchange and trade systems, allocate foreign exchange according to efficiency criteria.	Beginning 1987.
C. Restructuring	Restructure the sector in line with the country's comparative advantage.	Develop and implement an action program for industrial enterprises, based on enterprise review.	Review end-1987. Implementation during 1988.
VIII. Transport Policy			
A. Pricing	Ensure that prices reflect economic costs of transport.	a. Adjust transport tariffs in line with changes in exchange rate and other costs.	Major adjustment January 1987. Further adjustments as needed.
		b. Raise vehicle licensing and registration fees.	By October 1987.
		c. Review of structure of transport tariffs including potential for reduction of administrative controls.	Review completed by June 1988.

Table 1. Mozambique: Summary and Timeframe for Implementation of Macroeconomic Structural Adjustment Policies, 1987-89 (concluded)

Issues	Objectives and Policies	Strategies and Measures	Phasing and implementation
B. Role of private sector.	Enhance private sector role in transportation.	a. Remove licencing restrictions on cargo transport.	During 1987.
		b. Increase competition in provision of maintenance services.	Program period.
		c. Auction of unutilized or inoperative public sector fleet.	First auction by October 1987; periodically thereafter.
C. Rehabilitation	Improve transportation efficiency.	Priority rehabilitation investment in rail and port facilities, especially Beira Corridor.	Program period.

May 8, 1987

Mozambique - Memorandum of Economic Policies

1. The Policy Framework Paper (PFP), which the Government of Mozambique prepared in collaboration with the staffs of the IMF and the World Bank, describes the major economic problems and challenges facing the country, the objectives and priorities of the program for the period 1987-90 (calendar years), and the broad thrust of macroeconomic and structural adjustment policies. This memorandum is intended to complement the description of the policies contained in the PFP, by providing more detail on certain policies, particularly during the first year of the program.

2. As noted in the PFP, a severe economic deterioration in Mozambique occurred during the early- to mid-1980s; output fell substantially and severe shortages developed. The result was the development of parallel markets with prices several multiples higher than official prices, and a deterioration in the balance of payments to the point that substantial arrears were incurred in foreign payments. In 1983, in the face of a worsening economic and security situation, the fourth Party Congress of Frelimo began a reassessment of economic strategies and policies, and in 1984 an Economic Action Program was adopted to implement new policy initiatives. These policies, the most important of which are listed in paragraph 4 of the PFP, were crucial first steps in the effort to reform economic management, but on their own have been insufficient to stimulate a significant economic turnaround. In part this has been due to exogenous events, in particular increased disruptions by the armed bandits affecting millions of people and resulting in large numbers of displaced people no longer able to contribute to national production and requiring emergency assistance.

3. Therefore the Government has decided to seek increased support of the international community for further measures of reform of economic policies. The medium-term objectives of these measures are elaborated in paragraphs 9 and 10 of the PFP, and were described to the People's Assembly by the Prime Minister on January 14, 1987 in his presentation of the Economic Rehabilitation Program. The purpose of this program is to achieve a sustainable rate of economic growth and consumption by increasing economic efficiency and strengthening the country's fiscal, monetary, and balance of payments positions. The Government expects that during the program period modest economic growth will be resumed in the first year of the program and would accelerate in 1989, that there will be a decline in the prices and volumes transacted in parallel markets, and that the balance of payments will be fully financed in 1987 with the establishment of normal financial relationships with trading partners and creditors. The economic reforms are being focused on several central macroeconomic policy issues--including pricing and the exchange rate, allocation, the budget, and credit; and on administrative and institutional reforms in the key sectors of agriculture, industry, and transport. Substantial initial measures were taken in late January 1987 with the announcement of the 1987 budget and plan: these included a devaluation of 80 percent in foreign currency terms and substantial

tax and expenditure measures; in addition most official prices have been raised by several multiples and pricing procedures have been made more flexible. Achieving the objectives depends greatly on the support of the IMF and World Bank, as well as the rest of the international community; without such support, all available resources would have to be directed to the most immediate needs, with the result that economic recovery would be substantially delayed.

Pricing and allocation policies

4. A major step in the direction of allowing prices to serve increasingly as a guide to resource allocation was taken in January 1987 with the devaluation and increases in the official prices of all goods and public services for which prices are administratively set. One important goal of the January 1987 pricing measures, combined with the monetary and fiscal policies described below, was to reduce the divergence between official and parallel market prices. Exchange rate policy will be kept under review with the objective of achieving, by the end of 1987, an exchange rate of no less than half the parallel market rate, and by June 1988 of no less than 70 percent of the parallel market rate; official prices of goods will also be changed as necessary in line with exchange rate changes and other developments in the economy.

5. In addition to adjusting officially fixed prices, more flexibility in price-setting procedures is being introduced by allowing enterprises producing goods whose prices are not officially determined by the central authorities to make pricing changes subject only to certain conditions such as maximum profits and trading margins and an ex-post review. Also, the number of items with centrally set prices will be reduced from 44 at present to 35 by mid-1987 and to 30 at the beginning of 1988, and further reductions will be made during the program period.

6. In line with the changes in pricing policies, the Government will also be reforming the trading and distribution systems for both internal and external trade. These policy changes are described in the PFP, in general in paragraph 19 and more specifically for the agricultural, industrial and transportation sectors in paragraphs 23 through 28. In the first stage, the thrust of these policy reforms is to direct the allocation of imports and domestic goods more to the rural areas and in particular to the family farming sector. Also, the export retention scheme is being broadened by allowing almost all exporters access to the scheme and by narrowing the range of retention rates. Subsequently, as prices better reflect market scarcities and pricing procedures are made more flexible, allocation procedures will be made increasingly flexible by allowing greater scope for enterprise managers to negotiate directly with various competing sources including private traders (who already form an important part of the distribution chain), state trading companies, and foreign suppliers and buyers.

7. In line with changes in the exchange rate and other pricing and allocation policies, the Government will progressively reduce the scope

of administrative allocations in the exchange and trade systems. A program will be established by June 1988 to increase the number of imported products for which no administrative allocation will be made, and the Government will allow purchases of foreign exchange through the banking system for these products subject only to routine licensing.

Public finance

8. A central feature of the economic recovery program is a major fiscal adjustment aimed at improving the overall fiscal position and reducing the Government's recourse to the domestic banking system. To this end, the Mozambican authorities intend that the deficit of the current state budget (including transfers to cover enterprise losses) will be reduced from more than 50 percent of current expenditures in 1986 to about 25 percent in 1987, and will amount to no more than Mt. 28 billion in 1987. In 1987 the overall fiscal deficit on a cash basis and before grants will amount to no more than 56 percent of total expenditure compared with an equivalent deficit of 61 percent in 1986. Budgetary investment will continue to be more than fully covered by external grant and loan receipts net of loan repayment obligations. Domestic bank financing of the deficit in 1987 will be no more than Mt. 25 billion and is expected to be substantially reduced by 1990.

9. To achieve the deficit target for 1987, a substantial tax reform was implemented in January 1987 with a view to facilitating collections and capturing for the budget an increased proportion of the higher nominal value of transactions due to the exchange rate and price measures taken. Thus, major changes include: (1) the major specific consumption taxes have been raised by 100-200 percent, much more than wages, will be raised as official prices are increased during 1987, and will be changed to their ad valorem equivalents by the end of the year; (2) various other specific duties and fees have been quintupled, in line with the January devaluation; (3) the rates of turnover tax have been simplified and raised to some 2 1/2 times their former effective level; (4) business profits taxes, formerly collected on the previous year's profits, have been made subject to estimated payments on a current basis, based in 1987 on export proceeds and forecast revenue, so that the budget benefits immediately from the exchange rate and price changes; (5) windfall gains on the valuation of exportable inventories are being taxed at a rate of 50 percent; (6) state enterprises have been made subject to the business tax, while permitted to retain their after-tax profits; (7) artisans and tradesmen have been subject to a proxy business profits tax in the form of annual fees; (8) personal income taxes have been streamlined and increased in effective coverage; and (9) the per capita tax, the minimum contribution of each taxpayer, has been nearly sextupled. The total of these measures, combined with the increases in official prices, including the exchange rate, are expected to result in a 300 percent increase in revenues in 1987, to Mt. 80.5 billion.

10. Although the measures taken in 1987 amount to a substantial revision of much of the tax code, it will be necessary to keep the tax system under active review with the aim of continuing to improve its buoyancy and maximizing the benefits from the reintegration of official and parallel markets without substantially reducing incentives to producers. The Government's review in 1987 is expected to include technical assistance from the IMF to benefit from international experience, and will lead to additional measures, if necessary, in the 1988 and 1989 budgets.

11. Wage and employment measures are aimed at increasing the civil service wage bill by much less than the increase in official prices, while achieving an efficiency gain in the civil service by better rewarding the more productive members and releasing redundant and less productive employees. With parallel-market prices stable or falling due to tight financial policies and improved supplies, average wages are estimated to keep pace at least with the actual cost of living for the majority of civil servants and the best will benefit from a long overdue real increase. A general civil service wage increase of 50 percent was instituted in January 1987, a further 25 percent increase in the wage bill is to be allocated among the upper levels, and bonuses will be provided for productivity. A further general wage increase of 50 percent will be allowed in mid-1987, which is estimated to be less than further increases in official prices. The authorities aim at a 10-20 percent reduction in the civil service work force over the year, with economic motivation supplementing administrative action in encouraging many lower-paid employees to shift to more productive activities.

12. Expenditures on nondefense goods and services will be reduced by 20 percent in real terms as part of the authorities' austerity program. Two expenditure items which will increase substantially are defense and price subsidies. The first is necessitated by the security situation, which, if it were to deteriorate, would endanger the entire economic rehabilitation program. The second is to provide a safety net for the urban population, which will be adversely affected by the economic measures; under this program, limited amounts of six essential commodities, primarily foods, will be distributed in the two major cities at prices under their cost of production, with the difference made up through budgetary subsidies. The cost of these subsidies will not exceed Mt. 6.8 billion, or 6 percent of current expenditures in 1987, and will be reduced in subsequent years. Total current expenditures in 1987 are programmed for Mt. 108.1 billion, compared with Mt. 41.6 billion in 1986, representing an increase of 160 percent, compared with the increases of official prices estimated at about 260 percent. In addition to these measures, the Government will undertake in 1987, with technical assistance from donors and the World Bank, a review of public expenditure, as described in paragraph 13 of the PFP.

13. In 1986, the Government decided that enterprise productive investment, previously funded largely through the budget, should be financed increasingly from retained earnings and through the banking system, with

banks undertaking investigations of the commercial viability of enterprise projects. The capital budget would then focus on major infrastructural projects, including large projects of regional significance which are wholly financed from abroad. In 1987, the capital expenditures are targeted to rise severalfold, and are estimated to reach Mt. 78.5 bilion on a cash basis; they will consist mainly of rehabilitation-related undertakings, the completion of ongoing projects and the Beira corridor rehabilitation. Foreign financing of the budget (i.e., grants and loans net of repayment obligations) is expected to reach Mt. 78.9 billion.

14. A major tightening of the financial operations of enterprises will be made both in 1987 and in subsequent program years. Their operating losses, previously covered by bank credit, will be financed only through direct subsidies in the budget. These will be limited to Mt. 14 billion in 1987, and substantially reduced during each year of the program period. These losses will be contained in the short run by allowing sufficient price increases for most enterprises to cover fully their costs. Another factor important to reducing enterprise losses will be an increase in capacity utilization, which should result from an increase in, and more efficient use of, imported inputs. Indeed, enterprises not capable of profitably increasing production will have to reduce or stop operations in order to cut losses. Programs have been initiated in the first quarter of 1987 with several major enterprises to reduce their labor and import costs until physical and transportation bottlenecks can be overcome, and production can be increased. Moreover, substantial improvements in efficiency are expected to result from a thorough review of 40 major enterprises during 1987 with assistance from the World Bank. This review will help in decisions on improving organization, management, finances, and efficiency, and in decisions regarding rationalization and financial restructuring.

Credit policy and the financial sector

15. The short-term objectives for monetary and credit policies are to contain the growth of domestic liquidity to amounts less than necessary to accommodate the initially large corrections in official prices, in order to absorb some of the money stock which has been financing transactions on parallel markets. In this way monetary policy will complement pricing policies to achieve a narrowing of the differences between parallel market and official prices. A target for monetary expansion has been set at about 45 percent in 1987; this will require overall credit expansion, apart from that on-lent from foreign borrowing, to be constrained to Mt. 40.0 billion for 1987. Mt. 25 billion of this credit expansion will go to finance the central government budget, including transfers to enterprises to cover their operating losses. Additional credit expansion will result from foreign borrowing by the Bank of Mozambique on-lent to the domestic economy; these amounts, estimated to be about US$150 million, will not affect the money supply. For monitoring purposes, quarterly benchmarks will be established on credit expansion net of foreign borrowing on-lent to the domestic economy as fol-

lows: for the quarter ending March 31, 1987, the cumulative total of such credit expansion will be constrained to Mt. 13.0 billion and Mt. 10.0 billion for total credit and for net credit to the Government, respectively; for the quarter ending June 30, 1987, these constraints will be Mt. 26.0 billion for total credit and Mt. 18.0 billion to the Government; for the quarter ending September 30, 1987, they will be Mt. 36.0 billion for total credit and Mt. 24.0 billion to the Government.

16. Another important aspect of credit policy is to better apply commercial banking criteria in assessing credit applications. The Bank of Mozambique (BM) is undertaking, with assistance from the both the IMF and the World Bank, a program to improve accounting and administration of its central, external, and domestic commercial banking functions. As a first step, interest rates on loans and deposits were raised substantially in January 1987. These interest rates will be reviewed periodically in the light of changing domestic and external circumstances. Also, the exchange risk on credits based on foreign loans channeled through the BM to domestic enterprises and granted after January 30, 1987 is being assumed by the enterprises. However, the BM will have to recognize substantial valuation losses due to past external credits onlent to domestic enterprises for which it accepted the exchange risk. In addition, substantial arrears on domestic debt service have accumulated from some enterprises; the BM may have to capitalize some of these arrears, write off the underlying debt of some enterprises, or have this debt assumed by the Government. Decisions on whether and how to restructure the debt of enterprises which are unable to pay their internal debt service will depend on the results of the enterprise study mentioned above. Should such restructuring be necessary, the resulting changes in domestic credit, which would not change the money supply, would be separately identified and would not be included in the benchmarks of domestic credit.

The external sector

17. In order to achieve a sustainable real growth rate, Mozambique must regularize its external financial relations and improve its balance of payments. The overall objectives of external policies over the program period are to resume normal debtor-creditor relationships with external partners, increase the proportion of imports which are financed by foreign exchange earnings, begin to reduce the direct allocation of both imports and foreign exchange, and accumulate a modest level of foreign exchange reserves of about the equivalent of two months' imports. To make progress toward these goals, Mozambique must first increase its ability to export goods and services; this will require initially an increase in imports allocated to the most efficient users, consistent with the rehabilitation program, and a substantial amount of external assistance. Financing needs and expected availabilities are quantified and explained in Section IV of the PFP.

18. It is estimated that Mozambique's total foreign debt outstanding at end-1986 amounted to about US$3.2 billion, and the external debt service ratio has risen to about 275 percent of 1986 exports of goods and services. Also, external arrears on current payments have accumulated and are estimated at about US$1.2 billion. The Government will seek from official and private creditors a consolidation of external arrears outstanding and a rescheduling of current maturities. Also, the Government and the Bank of Mozambique will not contract or guarantee external loans on nonconcessional terms of 1-12 years' maturity in excess of US$50 million during the program period, no more than US$20 million of which will be contracted in 1987.

19. During the program period the Government does not intend to: (1) modify existing or introduce multiple currency practices; (2) impose new or intensify existing restrictions on payments and transfers for current international transactions, or, for balance of payments reasons, introduce any new or intensify any existing restrictions on imports; (3) conclude any new bilateral payments agreements with member countries of the Fund. The Government will refrain from accumulating new external arrears, excluding debt service payments subject to rescheduling.

20. In order to keep the Fund informed of progress under the program, the Government will send to the Fund financial and balance of payments data on a regular basis. Specifically, estimated credit and monetary data based on preliminary financial returns from the major urban branches of the Bank of Mozambique will be cabled for each month by the end of the following month, along with summary data on the monthly budget outturn. Balance of payments summaries will be cabled quarterly as soon as they are available. Complete credit, budget, and balance of payments data will be airmailed as soon as they are available. The Government will also provide other appropriate information the Fund may request to monitor the progress under the program.

MOZAMBIQUE - Relations with the Fund
(As of April 30, 1987)

I. Membership Status

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

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota:	SDR 61.0 million
(b) Total Fund holdings:	100.0 percent of quota
(c) Fund credit:	None
(d) Reserve tranche position:	None

III. Current Extended Arrangement and Special Facilities: None

IV. SDR Department

(a) Net cumulative allocation:	None
(b) Holdings:	None
(c) Current designation plan:	None

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. Fixed buying and selling rates for telegraphic transfers, in effect since then, have been Mt. 200 and Mt. 204, respectively, per U.S. dollar. Rates based on market quotations for 20 other currencies are published daily.

VIII. Consultation with the Fund: The second Article IV consultation discussions were held in Maputo during July 5-28, 1986. Executive Board discussions of the staff reports (SM/86/259 and SM/86/268) took place on November 17, 1986, 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 1986 Article XIV consultation with the

MOZAMBIQUE - Relations with the Fund (concluded)

People's Republic of Mozambique, in the light of the 1986 Article IV consultation with the People's Republic of Mozambique conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. 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 urges the authorities to adopt adjustment policies that will permit the elimination of these restrictions, and to terminate the bilateral payments agreement that is maintained with a Fund member.

It is expected that consultations with Mozambique will take place on the standard twelve-month cycle. A consultation mission is tentatively scheduled for August 1987.

IX. Technical Assistance

1. Statistics. An initial Bureau of Statistics mission in August 1985 assessed Mozambique's needs for technical assistance in statistics and provided an initial report on balance of payments methodology in December 1985. Technical assistance on compiling monetary statistics and developing a more suitable basic plan of accounts was provided to the Bank of Mozambique in early November 1985, and a report thereon was issued in February 1986. A subsequent joint Bureau of Statistics and Bureau of Computing Services mission in April-May 1986 followed up on these matters, provided training in the use of microcomputers to speed data compilation, and assessed the banking system's needs and plans for further computerization.

2. CBD Advisors. Following 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 year. Since May 1986 an Accounting Advisor has been assigned, to help revise the banking system's plans of accounts; his initial term has recently been extended for a second year.

3. 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 on June 18, 1985, to help meet Mozambique's priority needs in the industrial, transport, and agricultural sectors. Bank staff report that performance under the credit has been satisfactory, with about US$24.6 million disbursed by end-1986. The Norwegian and Italian Governments have recently provided an additional US$22 million in co-financing with the credit. On May 29, 1986, IFC provided about US$2.5 million in financing for the LOMACO company, which is a major commercial agricultural producer.

Bank assistance to Mozambique is now being focused primarily on rehabilitation of the economy, in the context of the Government's efforts to improve the overall policy environment. The Bank's dialogue with the Government over the last two years has moved consistently toward agreement on a comprehensive program for economic reforms. On this basis, the Bank would consider further IDA support for rehabilitation, and a Second Rehabilitation Credit has been included in the lending program and appraised. Complementary technical assistance in economic and financial management would also be provided, to assist the Government in identifying and carrying out future policy adjustments. In addition, the Bank has appraised a project for the energy sector (based on the conclusions of the recently issued Energy Assessment Report for Mozambique) which incorporates reforms in the areas of energy pricing, investment planning, and financial management for the electricity and petroleum subsectors. Future lending operations are expected for the agricultural, education, and transport 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 using the Special Project Preparation Facility--SPPF), covering 25 industrial and 15 agricultural enterprises is now under way, and is expected to result in specific recommendations as to the future role of these enterprises in the economy. A review of four key agricultural subsectors (cashew, irrigation, forestry, and cotton), also financed with SPPF funds, is under way and should provide a basis for future operations in the agricultural sector. Bank participation in a Public Expenditure Review is planned for FY88, to generate a more efficient pattern of expenditures and investments.

Table 1. Mozambique: Selected Economic and Financial Indicators, 1981-87

	1981	1982	1983	1984	1985	1986 Prov.	1987 Prog.
	(Annual percentage changes, unless otherwise specified)						
Production 1/							
Agriculture	1.0	-1.0	-22.1	1.7	0.8	...	...
Industry	3.1	-13.7	-20.0	-22.4	-20.6	...	...
External trade (based on US$ values)							
Exports, f.o.b.	--	-18.4	-42.6	-27.3	-19.9	3.1	8.9
Imports, c.i.f.	0.1	4.3	-23.9	-15.2	-21.5	29.1	18.8
Export volume	-2.7	2.6	-45.5	-35.5	-18.5	4.1	3.7
Import volume	-9.9	-5.2	-28.9	-21.1	-19.9	28.5	10.8
Terms of trade	4.9	-16.3	9.3	16.6	-0.2	-1.5	-2.1
Exchange rate							
Average (US$/Mt.)	-8.3	-6.2	-6.2	-5.3	-1.7	6.8	-83.8
Nominal effective 2/	3.9	7.7	3.2	11.7	15.0	-5.0	-90.8
State budget (cash basis)							
Revenues	23.1	36.1	-11.2	-2.3	-15.2	7.0	297.6
Total expenditure	24.9	23.9	5.1	4.2	-21.2	21.9	258.2 3/
Current expenditure	17.7	19.0	11.3	-0.3	8.4	16.8	150.8 3/
Money and credit							
Domestic credit	25.6	17.1	41.0	20.7	16.1	16.8	23.8
Government (net)	278.2	-39.1	251.8	64.1	21.4	29.3	71.6 3/
Economy	16.8	23.5	29.2	14.1	14.9	13.9	11.2 4/
Money and quasi-money	29.3	30.3	21.9	15.4	15.4	17.8	43.7
	(In units stated)						
Overall balance of payments deficit (US$ millions)	66.5	142.9	328.6	362.3	365.6	542.0	404.0
Gross foreign reserves (months of imports, c.i.f.)	3.1	0.9	0.9	1.5	1.4	1.2	1.3
Debt service ratio 5/	76.4	98.8	131.9	98.0	102.7	274.8	237.0

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

1/ Gross value of output at 1980 prices.
2/ December averages compared.
3/ Reflects inclusion of enterprise losses in both 1986 and 1987 data.
4/ Does not include foreign borrowing on-lent through domestic credit.
5/ Scheduled external debt service as percent of exports of goods and services (including workers' remittances), after reschedulings of 1984-85.

Table 2. Mozambique: Summary of Government Finance, 1984-87

	1984	1985	1986 Prov.	1987 Prog.
	(In billions of meticais)			
Revenue	22.3	18.9	20.2	80.5
Tax revenue	16.2	13.7	15.1	73.9
Income and profits	(4.4)	(4.4)	(4.1)	(9.6)
Goods and services	(9.3)	(6.7)	(8.6)	(47.4)
International trade	(1.8)	(1.5)	(1.4)	(13.2)
Other taxes	(0.8)	(1.0)	(1.0)	(3.6)
Nontax revenues	6.1	5.3	5.1	6.6
Enterprise surpluses received	(3.0)	(1.7)	(2.2)	(--)
Other nontax revenue	(3.1)	(3.6)	(2.9)	(6.6)
Current expenditure	22.0	23.9	27.9	105.6
Total, budget year 1/	22.9	24.4	27.4	108.1
Defense and security	(10.3)	(11.0)	(12.2)	(42.4)
Other wages and salaries	(7.2)	(7.6)	(8.1)	(17.6)
Other goods and services	(4.0)	(4.3)	(4.5)	(14.4)
Interest 2/	(0.1)	(0.1)	(0.8)	(7.4)
Price subsidies	(0.4)	(0.5)	(0.5)	(6.8)
Enterprise losses subsidized 3/	(--)	(--)	(--)	(14.0)
Pensions and social welfare	(0.1)	(0.1)	(0.2)	(1.5)
Other current expenditure	(0.8)	(0.9)	(1.1)	(4.0)
Complementary periods (net) 4/	-0.9	-0.5	0.5	-2.5
Current deficit (surplus -)	-0.3	5.0	7.7	25.1
Capital expenditure	16.7	6.7	9.3	78.5
Total, budget year 1/	10.6	8.1	12.0	119.8 5/
Complementary periods (net) 4/	6.1	-1.5	-2.7	-41.3
Total expenditure	38.8	30.5	37.2	184.1
Overall deficit (before grants)	16.5	11.6	17.0	103.6
Grants received	2.9	3.0	3.6	63.6
External borrowing (net)	4.7	5.1	5.5	15.3
Disbursements	4.8	5.1	5.7	38.0
Repayments	-0.1	-0.1	-0.2	-22.6
Domestic bank financing (net)	8.7	4.8	7.9	25.0
Other financing and discrepancy	0.1	-1.2	-0.1	-0.3
Memorandum items:				
Grants + net foreign borrowing	7.6	8.1	9.1	78.9
Enterprise losses (est.) 6/	...	9.0	14.2	14.0
Items including enterprise losses:				
Current expenditure	...	32.9	42.1	105.6
Current deficit	...	14.0	21.9	25.1
Total expenditure	...	39.6	51.4	184.1
Overall deficit (before grants)	...	20.6	31.2	103.6
Domestic bank financing	...	13.8	22.1	25.0
	(In percent)			
Ratios (items including enterprise losses):				
Current deficit to current expenditure	...	42.5	52.0	23.8
Current expenditure to total expenditure	...	83.2	81.9	57.4
Overall deficit to total expenditure	...	52.2	60.6	56.3
Current deficit to total expenditure	...	35.4	42.5	13.6
Domestic bank financing to total expenditure	...	34.8	42.9	13.6

Sources. Ministry of Finance; and staff estimates.

1/ Not adjusted for timing, i.e., includes complementary period spending after calendar year indicated.
2/ Debt service data cover only actual payments through 1986, but all scheduled amounts in 1987; scheduled amounts for government separately not available for prior years. Interest payments are all external prior to 1987, in which Mt. 2.3 billion are internal. Most government external debt is on highly concessional terms.
3/ Enterprise operating losses have been financed directly by bank credit until 1987.
4/ Timing adjustments to offset net effects of complementary period spending.
5/ Provisional budget proposal; spending to begin in April. Includes government net lending to, and equity participation in, public enterprises from proceeds of external grants (for otherwise off-budget investment).
6/ For 1985 and 1986, authorities' estimates of enterprise losses financed from bank credit; for 1987, policy target for budgetary transfers to cover such losses, with no bank credit for this purpose.

Table 3. Mozambique: Monetary and Credit Developments, 1984-87

	1984	1985	1986	1987 Proj.
Balance, end of year	(In billions of meticais)			
Net foreign assets	1.0	0.6	0.4	9.6
Assets	4.0	2.9	3.4	39.9
Liabilities (short-term)	-3.0	-2.3	-3.0	-30.2
Domestic credit	124.2	144.2	168.4	208.4
Claims on Government, net	22.3	27.0	34.9	59.9
Claims on the economy	102.0	117.2	133.5	148.5 1/
Money and quasi-money	83.6	96.5	113.7	163.4
Currency outside banks	27.0	29.8	33.5	42.0
Demand and savings deposits	53.8	62.8	76.1	117.3
Time deposits	2.8	3.9	4.1	4.1
Foreign borrowing 2/	27.2	34.2	38.6	388.8 1/
Valuation adjustments	--	--	--	-346.2
Other items, net	14.4	14.0	16.5	12.1
Changes during year	(In billions of meticais)			
Net foreign assets	2.6	-0.4	-0.3	5.3
Domestic credit	21.3	19.9	24.2	40.0
Claims on Government, net	8.7	4.8	7.9	25.0
Claims on the economy	12.6	15.2	16.3	15.0 1/
Money and quasi-money	11.1	12.9	17.2	49.7
Foreign borrowing 2/	1.5	7.0	4.4	-- 1/
Other items, net	11.3	-0.4	2.4	-4.4
Rates of change	(In percent)			
Domestic credit	20.7	16.1	16.8	23.8
Claims on Government, net	64.1	21.4	29.3	71.6
Claims on the economy	14.1	14.9	13.9	11.2 1/
Money and quasi-money	15.4	15.4	17.8	43.7

Sources: Bank of Mozambique; and staff estimates.

1/ Plus amounts borrowed externally and on-lent domestically.
2/ Medium- and long-term foreign liabilities.

Table 4. Mozambique: Balance of Payments, 1980-86

(In millions of U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986
Trade balance	-519.3	-520.3	-606.7	-504.8	-444.0	-347.2	-468.0
Exports (f.o.b.)	280.8	280.8	229.2	131.6	95.7	76.6	79.0
Imports (c.i.f.)	-800.1	-801.1	-835.9	-636.4	-539.7	-423.8	-547.0
Services (net)	96.8	54.1	29.8	-0.5	-36.2	-78.8	-131.0
Receipts	167.0	171.1	165.2	160.0	114.0	107.1	119.0
Transportation	(92.6)	(82.0)	(83.4)	(66.4)	(34.5)	(39.4)	(45.0)
Workers' remittances	(53.4)	(64.5)	(61.7)	(71.9)	(53.0)	(40.8)	(50.0)
Other service receipts	(21.0)	(24.6)	(20.1)	(21.7)	(26.5)	(26.9)	(24.0)
Interest	-6.1	-35.9	-60.3	-88.2	-80.9	-103.2	-177.0
Other expenditures	-64.1	-81.1	-75.1	-72.3	-69.3	-82.7	-73.0
Other transport	(-25.6)	(-27.4)	(-28.3)	(-32.8)	(-24.5)	(-38.7)	(-34.0)
Workers' remittances	(-25.3)	(-29.4)	(-23.5)	(-19.9)	(-25.7)	(-25.0)	(-23.0)
Other service expenditure 1/	(-13.2)	(-24.3)	(-23.3)	(-19.6)	(-19.1)	(-19.0)	(-16.0)
Current account	-422.5	-466.2	-576.9	-505.3	-480.2	-426.0	-599.0
Unrequited official transfers	56.0	57.5	79.5	89.6	167.7	139.0	213.0
Capital account	364.2	409.0	395.3	42.8	-73.0	-39.7	-83.2
Foreign borrowing	503.1	718.2	724.6	339.3	264.8	228.8	284.0
Scheduled amortization	-138.9	-309.2	-329.3	-296.5	-337.8	-278.5	-367.2
Short-term capital (net)	...	...	...	...	...	10.0	...
Errors and omissions (net)	-30.1	-66.8	-40.8	44.3	23.2	-38.9	-73.0
Overall balance	-32.4	-66.5	-142.9	-328.6	-362.3	-365.6	-542.2
Financing	32.4	66.5	142.9	328.6	362.3	365.6	542.2
Net international reserves (increase -)	32.4	68.7	148.5	46.8	-54.2	16.9	6.0
Bilateral payments agreements	--	-2.2	-5.6	-3.4	-2.2	3.0	...
Debt relief 2/	--	--	--	--	213.1	193.0	--
Net change in arrears (increase +) 3/	--	--	--	285.2	205.6	152.7	536.2
Memorandum items:							
Stock of debt in arrears 4/	--	--	--	--	750.7	838.2	1,216.2
Debt service payments (actual)	...	...	...	...	...	36.0	...
Debt service ratios 5/							
Before debt relief	32.4	76.4	98.8	131.9	199.7	207.8	274.8
After debt relief	32.4	76.4	98.8	131.9	98.0	102.7	274.8

Sources: Bank of Mozambique; and staff estimates.

1/ In some cases, the counterpart of loan receipts to technical assistance projects may not have been recorded. Therefore, the deficits may be underestimated.

2/ In 1984, the Paris Club rescheduled debt service arrears and current maturities of US$213.1 million and 1985 debt service of US$70.4 million. Debt relief shown for 1984 includes end-1983 arrears of approximately US$60 million. In 1985, members of OPEC also rescheduled arrears of US$96 million and 1985 debt service of US$26.6 million.

3/ Taking account of debt reschedulings in 1984-85.

4/ The stock of arrears shown at the end of 1984 is before debt rescheduling of 1984. In the absence of adequate information on debt service payments and valuation adjustments, data on stock of debt in arrears may not be fully consistent with net change in arrears.

5/ Calculated as a percentage of exports of goods and total service receipts.

Table 5. Mozambique: Balance of Payments Projections, 1986-91

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990	1991
Trade balance	-468	-564	-602	-625	-632	-642
Exports (f.o.b.) 1/	79	86	98	115	138	168
Imports (c.i.f.) 2/	-547	-650	-700	-740	-770	-810
Services (net)	-131	-142	-130	-145	-160	-183
Receipts	119	126	130	136	143	147
Transportation	(45)	(58)	(61)	(65)	(71)	(74)
Workers' remittances	(50)	(43)	(43)	(43)	(43)	(43)
Other	(24)	(26)	(27)	(28)	(29)	(30)
Interest 3/	-177	-175	-171	-188	-205	-227
Scheduled	(-116)	(-88)	(-55)	(-43)	(-34)	(-34)
On refinancing	(-57)	(-74)	(-94)	(-112)	(-128)	(-139)
On new borrowing	(-4)	(-13)	(-22)	(-33)	(-43)	(-54)
Other expenditures	-73	-93	-89	-93	-98	-103
Transportation	(-34)	(-44)	(-37)	(-39)	(-41)	(-43)
Workers' remittances	(-23)	(-25)	(-27)	(-28)	(-29)	(-31)
Other 4/	(-16)	(-24)	(-25)	(-26)	(-27)	(-29)
Current account	-599	-706	-733	-770	-792	-825
Unrequited official transfers	213	321	337	354	372	390
Capital account	-83	-19	32	147	161	178
Foreign borrowing	284	310	326	342	359	377
Amortization	-367	-329	-294	-195	-198	-199
Scheduled	(-367)	(-329)	(-278)	(-175)	(-173)	(-173)
On refinancing	(--)	(--)	(-16)	(-20)	(-25)	(-26)
Errors and omissions (net)	-73	--	--	--	--	--
Overall balance	-542	-404	-363	-268	-259	-256
Financing	542	404	363	268	259	256
Net international reserves (increase -)	6	-19	-15	-15	-16	-16
Bilateral payments agreements	...	...	...	...	...	...
Net change in arrears (increase +)	536	--	--	--	--	--
Fund purchases	--	15	10	10	...	...
Exceptional financing	--	408	369	274	275	272
Possible debt relief	(--)	(408)	(321)	(208)	(198)	(198)
Residual gap	(--)	(--)	(48)	(66)	(77)	(74)
Memorandum items:						
Gross foreign reserves	54	73	88	103	119	135
Stock of debt in arrears	1,216	--	--	--	--	--
Debt service ratio 5/	275	237	204	152	143	135
Reliance on self-financing 6/	0.32	0.29	0.29	0.30	0.32	0.35

Sources: Bank of Mozambique; and staff projections.

1/ On the basis of a detailed commodity breakdown.
2/ On the basis of available foreign financing and end-uses.
3/ Includes scheduled interest, imputed interest on arrears, interest on exceptional financing, and assumed interest on new borrowing.
4/ The counterpart of loan receipts to technical assistance projects may not have been fully taken into account in the projections (see footnote 1 of Table 4).
5/ Total interest and amortization as a percentage of total exports and service receipts.
6/ Ratio of total exports and service receipts to imports and service expenditures, excluding interest.

Table 6. Mozambique: External Debt by Lender and Maturity, end-1986

(In millions of U.S. dollars)

Lender	Disbursed Debt Outstanding 1/	Total Arrears		
		Prin.	Int.	Total
Multilateral 2/	124.9	1.4	1.2	2.6
OECD countries	1,358.0	485.7	175.4	661.1
Medium- and long-term	1,290.6	423.7	174.2	597.9
Governments	(399.1)	(5.3)	(20.4)	(25.7)
Insured banks	(505.9)	(263.3)	(63.5)	(326.8)
Insured suppliers	(230.9)	(76.4)	(36.3)	(112.7)
Noninsured banks	(151.9)	(77.5)	(53.9)	(131.4)
Noninsured suppliers	(2.9)	(1.2)	(0.1)	(1.3)
Short-term	67.4	62.0	1.2	63.2
Noninsured banks	(41.7)	(36.3)	(1.2)	(37.5)
Overdrafts	(25.7)	(25.7)	(--)	(25.7)
OPEC countries 2/ 3/	387.0	67.2	8.4	75.6
Centrally planned economies	1,023.8	235.2	54.8	290.0
Medium- and long-term 3/	1,020.0	231.4	54.8	286.2
Short-term	3.8	3.8	--	3.8
Banks	(2.9)	(2.9)	(--)	(2.9)
Overdrafts	(0.9)	(0.9)	(--)	(0.9)
Other countries	264.6	144.1	42.4	186.5
Medium- and long-term	245.8	131.2	42.0	173.2
Governments	(6.1)	(1.6)	(0.8)	(2.4)
Insured banks	(235.9)	(128.6)	(39.9)	(168.5)
Noninsured banks	(3.6)	(0.7)	(1.3)	(2.0)
Noninsured suppliers	(0.2)	(0.2)	(--)	(0.2)
Short-term	18.8	12.9	0.4	13.3
Insured banks	(4.4)	(4.2)	(0.2)	(4.4)
Noninsured banks	(14.0)	(8.3)	(0.2)	(8.5)
Noninsured suppliers	(--)	(--)	(--)	(--)
Overdrafts	(0.4)	(0.4)	(--)	(0.4)
Total	3,158.3	933.6	282.2	1,215.8
Medium- and long-term	3,068.3	854.9	280.6	1,135.5
Multilateral	(124.9)	(1.4)	(1.2)	(2.6)
Bilateral	(2,943.4)	(853.5)	(279.4)	(1,132.9)
Short-term (bilateral)	90.0	78.7	1.6	80.3

Sources: Bank of Mozambique; and staff estimates.

1/ Including arrears of both principal and interest.
2/ All medium- and long-term.
3/ All governmental.