STABILIZATION AND STRUCTURAL ADJUSTMENT IN MOZAMBIQUE: AN APPRAISAL

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Abstract

This paper outlines the complex historical legacy and structural adjustment efforts in Mozambique in addition to reviewing recent economic developments. An in-depth analysis of new and more reliable national accounts data show that macroeconomic stabilisation has occurred through recovery from a suppressed outset. Yet, easy import substitution has now been used up, and structural transformation on the export side remains to be addressed. Moreover, a coherent development strategy geared towards poverty reduction is still to be implemented. The government budget also remains problematic, and aid dependency continues. Accordingly, fundamental development challenges lie ahead.

Keywords: Structural adjustment, Mozambique, historical analysis.

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1. Introduction

Economic and social policy in Mozambique has undergone a sequence of truly remarkable changes during the past 25 years. Emerging out of colonialism in 1974, the newly independent country initially opted for a command-type economic system inspired by Marxism. It was soon recognised that this approach would not be successful. However, attempts at economic reform could not withstand the vicious war and destruction fuelled by a racist South Africa. Economic collapse became inevitable in 1986, and a set of market-oriented policies was formulated under the auspices of the IMF and the World Bank. Only limited progress was realised before peace was agreed on in 1992. Peace was accompanied in October of 1994 by free and democratic elections, in which the leader of the former Frelimo liberation movement, Joaquim Chissano, was elected President. Frelimo also retained government control, while the former rebel movement, Renamo, became the main opposition party. A new political scene was set, and attempts at reinvigorating economic reforms within the framework of the liberalistic inspired Economic and Social Rehabilitation Programme (ESRP) were initiated.

The transition to democracy in Mozambique was precipitated by fundamental changes in the international political environment. The collapse of the Eastern European and South-African political systems removed many of the external economic and political forces that kept looming behind the devastating internal strife of Mozambique during the 1980s. Nonetheless, the development challenges in the early 1990s and the structural deformation of the economy remained overwhelming, rooted as they are in (i) Portuguese colonial domination from the late 19th century, (ii) a decade long military struggle leading up to independence in 1975, (iii) inept economic policies pursued by Frelimo in the immediate post-independence years, and (iv) the vicious guerilla war staged by Renamo with South African backing from 1980 until cease fire in 1992. Mozambique has now been trying to come to grips with these challenges for more than a decade. Thus, it is most pertinent to try to distill the policy lessons learned from the post-1992 period where peace and relative political stability have been characteristic. Have the reforms implemented so far led to desired results in terms of stabilising and adjusting one of the poorest countries in the world, and has a sound foundation for future growth and stability been established? Answering questions such as these is by no means easy due to a whole gamut of reasons. Nevertheless, peace and the availability of new data have certainly made the task more manageable and meaningful than in the past.

The analysis of the Mozambican reform process in this article will draw on a new set of national accounts, put together by the National Institute of Statistics (NIS). The NIS data set covers the period 1991-96, and preliminary aggregate figures are available for 1997. The new data have been compiled in accordance with the UN standards for national accounting, and they are widely believed to be of higher quality than the official set of national accounts, published by the National Directorate of Planning (NDP). Since the implications of the two sets of national accounts diverge, the current analysis will provide new insights into the adjustment process in Mozambique. Given the importance of the historical heritage in understanding present challenges, Section 2 provides an outline of the path to economic collapse as well as basic political, economic and social background. This is followed in Section 3 by a detailed review of the reform efforts from 1987 onwards, whereas the macroeconomic trends, which emerge from available data sources, are studied in Section 4. Section 5 contains an overall analysis of the stabilization and structural adjustment experience and Section 6 concludes.

2. Historical setting

The early colonial economic system in Mozambique was, besides trade in gold with present-day Zimbabwe, based on the so-called *prazo* system under which Portuguese settlers were granted land as well as absolute power and authority over local people. Many *prazos* were abandoned before 1700 as indigenous resistance towards the Portuguese pushed the colonialists out of rural areas. Yet, the rise in slave trade followed soon after, and a variety of policies to ensure an ample supply of cheap labour were put in place once slavery was officially abolished around 1850. Forced labour and taxes, which could only be settled in cash, were institutionalised, and this left rural populations with little alternative, but to try to increase their production of marketed crops such as cashew and cotton or work as wage labour on plantations or in major investment programmes in Mozambique or the mines in South Africa.

Portuguese colonisation intensified at the end of the 19th century, but Portugal did not have sufficient capital and power to enforce the occupation. This became possible instead through the investment of foreign capital by a variety of British, Rhodesian and South African companies. These companies were given extensive concessions and administrative rights. Thus, by 1917 - when the occupation was complete - Mozambique was to a large extent run by foreign capital. In parallel with the more dominating role of foreign capital, the physical infrastructure became highly skewed towards the needs of neighbouring countries. Due to Mozambique's unique geographical location, roads and railways were geared towards the provision of transit services, from which large rents were generated. Little attention was given to intra-country logistical needs. The result was a significant lack of interconnections between the regions of Mozambique at the end of the colonial period. Basic communications were at the time either lacking or - as in the case of the main rail lines - running east-west, from ports on the coastline to South Africa, Rhodesia and Malawi.

Even by the standards of colonial administration in Africa, there was little investment in social infrastructure in Mozambique, and even jobs requiring only minimal skills were restricted for European settlers. In other words, the economy catered to the needs of the Portuguese, who assumed responsibility for a broad range of functions. Local human capital accumulation was extremely limited with the result that black Mozambican literacy remained under 10 percent (Green, 1991). Though secondary and technical education grew after 1960, and a new university with room for 1,500 students was established, these institutions almost exclusively served the settler community. Accordingly, at the time of independence the number of Mozambicans with university training amounted to only approximately 40 (FAO, 1982).

The last 15 years of colonial rule were characterised by (i) the struggle for independence from 1962, (ii) a gradual removal of racially discriminating legislation such as the labour laws, (iii) a continued inflow of Portuguese settlers, and (iv) an increase in foreign investments. In particular, Portugal was for the first time making available substantial financial resources. This benefited especially industries such as food processing, textiles and machinery and equipment, oriented towards the domestic settler community. In parallel with this colonial investment strategy, the focus in the composition of imports shifted from consumption to capital goods. Thus, this period was characterised by capital accumulation and growth. Nevertheless, the basic contours of the colonial economic system remained in place. The dependence on imports for investment and consumption purposes continued unabated, and agricultural exports, migrant worker remittances, and transit and tourist services were critical for foreign exchange earnings. Moreover, the Portuguese colonial rule left a legacy of widespread administrative controls, combined with the phenomenal reliance on Portuguese human capital.

During the 1974-75 transition and the first year of independence, some 90 percent of the Portuguese settlers or an estimated 200,000 people left Mozambique. This left the country with a deserted and damaged capital stock and a nation with a seriously depleted human capacity in terms of skilled and semi-skilled workers as well as experienced professionals and administrators. It is illustrative that the agricultural marketing network literally collapsed within a matter of months after the Portuguese exodus. The rural population suddenly found themselves without access to even rudimentary networks for the distribution of goods and marketing of output. At the same time, external service and tourist receipts began dropping dramatically, and South Africa took steps to cut back the number of migrant labourers, and divert transit cargo elsewhere. Further potential revenue from transit services was lost due to the application of the United Nations Resolution on Sanctions against Southern Rhodesia and Support to the Patriotic Front.

Government intervention in agricultural pricing and marketing was well established before Mozambique obtained independence. The colonial Portuguese government set producer and consumer prices as well as marketing margins for an exhaustive list of agricultural products. In the 1960s, a marketing board for cereals was created. The focus on centralized decision making, which underpinned the agricultural pricing and marketing system of pre-independence Mozambique, was clearly in line with the ideological preferences of the new government. The continuing centralized marketing system was, subsequently, put under control of the state marketing enterprise, Agricom. Following independence, the rationale of the new government for state intervention was, nevertheless, different, as policy actions were in general conceived within the framework of a centrally planned economy. Hence, all land, banks, schools and medical services were nationalized, and administrators were appointed by the state to run the more than 2,000 abandoned commercial farms and industrial companies.

The desire for strong centralization of decision making was reaffirmed by the Third Congress of Frelimo in 1977. On the same occasion, focus was put squarely on the role of the state in savings, investment, production and trade. The annual central state plan, which contained detailed investment and output targets, acquired the status of law. Meeting targets, set by the central planning authorities, became obligatory with little reference to costs and profits, and state control started permeating almost all commercial activities in the economy. Private companies remained in existence, but as small scale entities, and they were subjected to strict regulation. Great hopes were attached to the new centralised political system, and the Ten Year Perspective Plan launched in December of 1981 envisaged GDP growth rates of no less than 17 percent per year over a ten year period (Government of Mozambique, 1981). Yet, Mozambique lacked the necessary human and capital resources to achieve growth rates of such magnitudes, and since investments did not yield expected economic returns, a critical foreign debt burden started accumulating. Moreover, the failure on the part of the government to provide adequate support on a continuous basis for peasant development gradually affected confidence of the population in Frelimo.

The negative economic trends and the lack of support to the rural smallholder sector, was recognized already in 1983 by the Fourth Congress of the Frelimo party. The one-eyed focus on state farms, excessive centralization of decision making and the management system's rigidity and inability to adjust quickly to changing needs were identified as main problems to be resolved. It was also recognised that planning as so far practised, based on a set of material balances, had left the economic system extremely vulnerable to exogenous shocks. Consequently, Frelimo committed itself to initiate a set of reforms, including greater economic flexibility and decentralisation and reliance on market forces. Renewed emphasis was put on the importance of the peasant sector, private initiative was to be promoted in all sectors of the economy, and reforms were instituted in labour legislation and in the regulation of foreign investment. It was highlighted that Agricom, which purchased around 40 percent of the total amount of crops marketed, should act as a buyer of last resort and not as a monopsonist in the procurement of crops from peasant farmers. Moreover, nominal consumer and agricultural producer prices were raised significantly, and producer incentives came more into focus as an issue and overall objective.

However, due to the escalation of hostilities in rural areas, the measures adopted to decentralize decision-making and strengthen the reliance on market forces were not effective. In the late 1970s Mozambique had become a vocal member of the group of frontline states, in opposition to the Rhodesian and South African governments. Consequently, Renamo was created with the support of the white regime in Rhodesia, and after Zimbabwe gained independence in 1980, it was maintained with support from South Africa. A political move by the Frelimo leader Samora Moises Machel to stop the war by signing the Nkomati Accord in 1984, was to no avail. The unrest disrupted road communications throughout the country. In addition, the agricultural marketing system, which had started to regain momentum after the initial exodus of the Portuguese, was seriously affected. On top of the disruptive internal strife, a series of natural disasters, including in particular the droughts of 1982-83 and 1983-84, occurred with devastating consequences for the economy. The final result was a complete economic collapse in 1986.

All sectors of the economy were affected. The industrial sector had been unable to cope with the large investment projects initiated under the auspices of the Ten Year Perspective Plan due to issues such as centralized control of prices and distribution, lack of foreign exchange, shortage of inputs, and irregular power supplies. The world recession in the early 1980s impacted as well. Thus, industry operated at only 20-30 percent of capacity, and by 1986 industrial output had been reduced to less than half its 1981 level. A similar downward trend could be observed for the agricultural sector, where the disruptive effects of war and the series of natural disasters were the major causes behind the fall of more than 50 percent in officially marketed production. In sum, GDP fell at 6 percent per year in real terms from 1981-86, and the accumulated per capita drop amounted to about 45 percent (Tarp, 1990 and World Bank, 1996). Internal and external economic balances were close to impossible to manage, while repressed inflation mounted due to a loss of monetary control. Generalized shortages were endemic, parallel markets grew rapidly, the exchange rate became grossly overvalued and dependence on donors for financial assistance and food aid reached excessive proportions. Hence, it was clear that drastic economic reform measures were required, but even more pressing was the need for peace, as repeatedly stressed by Samora Machel, until his death in a plane crash in South Africa in 1986.

The severity of the Mozambican civil war is clear from UN estimates. More than one million people died during the 1980s, while close to five million were displaced from rural areas, out of a total population of less than 15 million (UNICEF, 1989). Furthermore, a large part of the social and economic infrastructure was destroyed, including some 1,000 clinics and health posts as well as 3,000 schools. No less than 400 teachers were killed. In addition, livestock populations were literally decimated, and the Livestock Directorate of the Ministry of Agriculture estimates that it will take decades before cattle herds re-attain levels existing in 1983 (Songane, 1996).

Despite ongoing civil war, a liberal constitution was adopted following discussions at the Fifth Congress of Frelimo in 1990. With this step, Mozambique moved decisively towards political pluralism and democracy. The constitution of 1990 provides for separation of the executive, legislative and judiciary powers and manadates regular elections. Following the signing of the peace accord, the UN installed its third largest peace keeping operation ever. General elections were held in October 1994, and Mozambique is currently nurturing a multi-party democracy, in which basic human rights are protected by law.

3. Economic reform efforts

To counteract the economic collapse, the Government of Mozambique introduced in 1987 a comprehensive Economic Rehabilitation Programme (ERP). Subsequently, the reform effort was renamed Economic and Social Rehabilitation Programme (ESRP) in 1989 to put focus on the social dimension of the effort.[1] The stated intention of the programme was to lay the foundation for economic growth through a shift to a more market based economy. The ESRP, as originally conceived, was fairly standard in design. The diagnosis was of an economy which failed to maintain monetary control, consumed beyond its means, focussed production excessively on non-traded goods, and relied on inefficient and inflexible microeconomic structures. The ESRP included a series of standard stabilisation measures such as fiscal adjustment, monetary restraint, and devaluation of the exchange rate. In order to enhance microeconomic efficiency and the capacity of the economy to withstand external shocks, substantial price and trade liberalisation was pursued. Similarly, institutional reforms of the financial sector and a privatisation programme for state enterprises were included as key components of the programme.

Considerable efforts at price liberalisation occurred in the three years following the initiation of the reforms. While products with fixed prices accounted for about 70 percent of GDP in 1986, this proportion had, by 1989, fallen to about 30 percent. Four years later, in July 1993, the government took the substantial step of liberalising prices for major food products such as maize meal, cooking oil, and rice. Price liberalisation continued such that administered consumer prices were, in early 1996, limited to wheat flour, bread, rents, fuels, utilities, and certain transportation fares. By the end of 1996, these few remaining controls had either been removed or a system of regular updating had been put into place usually with reference to world prices (World Bank and Republic of Mozambique, 1996).

However, minimum producer prices for nine agricultural products, including white maize, beans, groundnuts, sunflower, raw cashew nut, cotton, mafurra, paddy, and tobacco persisted into 1996 (World

[1] To keep the number of acronyms to a minimum, adjustment programmes ongoing since 1987 will be referred to as the ESRP.

Bank, 1996). Particular concern was attached to the impacts of minimum prices on maize markets, even though the minimum prices were not generally enforced. Thus, there were reports of selective sanctions against traders purchasing at prices below minimum price levels (Moll, 1996). Since risk of sanction mitigates against the development of private trading activities, the World Bank and other donors continued to push for abolition of de jure minimum prices. Consequently, the government transformed food crop minimum prices to indicative prices in 1997. In sum, domestic price liberalisation has been carried very close to meeting the intentions in the ESRP.

Trade liberalisation, including a move from a system of managed trade towards a liberal trade regime with imports subject to ad-valorem tariffs, has been more gradual. Since 1987, quantitative restrictions on imports and exports have been scrapped, the number and average level of tariff rates substantially reduced, and licensing procedures simplified or rendered automatic. Accordingly, the import tariff structure, implemented in November 1996, contained only three rates: 2.5, 7.5, and 35 percent (Ministry of Planning and Finance, 1996). Despite the simplified tariff rate structure, it still implies significant effective protection for some agricultural processing industries. For example, the rate applied to wheat is 2.5 percent while the rate applied to wheat flour is 35 percent. This implies that the effective protection afforded to wheat milling activities is quite high. Also an export restrictions (taxes and quotas) have been in place for raw cashew nuts in order to protect the domestic cashew processing industry.

The area of trade policy, which caused the gravest concerns was, however, customs administration. In 1995, the Maputo port authority reported that between 300 and 400 import containers had been sitting at the port for more than 180 days, and the average dwell time in port was 114 days (Castro, 1995). Available evidence, moreover, suggests that illicit means existed for traders to speed up the importing process, not to mention avoiding import duties. The unsustainable situation in Maputo port, has given momentum to the ongoing efforts to reform the customs administration. Thus, administrative responsibilities have now formally been contracted to a private UK-firm, Crown Agents, which began operations in mid-1997.

As one of the key components of the ESRP, a comprehensive privatisation programme was initiated in 1989, and by September 1994, about 370 small and medium size enterprises had been privatised (USAID, undated). Nevertheless, very slow progress in privatising large firms meant that around two thirds of total industrial output was still accounted for by state owned firms.[2] Starting in 1994, the privatisation of large enterprises accelerated. By 1996, 32 large enterprises amouting to a large part of the existing stock had been privatised, while another 27 large enterprises were scheduled to be sold in 1997. Moreover, the performance of firms, once privatised, has been positive. A joint World Bank/Government of Mozambique study found that, on average, large enterprises increased output by a multiple of nearly four in the three year period following privatisation (World Bank and Republic of Mozambique, 1997). Regarding the Mozambican railways (CFM), earlier assistance programmes have ensured that rehabilitation of the three port railway systems, all ravaged by war, has been completed. Nevertheless, a decision has been made to delay privatisation in favour of a restructuring and revitalisation programme.

[2] A state owned firm is defined as a company with majority state ownership either through direct state ownership or indirectly through majority ownership by other state owned enterprises.

Another key component of the ESRP was the privatisation of the commercial financial sector. In 1989, the banking system effectively consisted of two state owned banks, *Banco de Moçambique* (BM) and *Banco Popular de Desenvolvimento* (BPD). Efforts to gain control over money creation meant that the commercial banking functions of BM were separated out in 1992, by the creation of *Banco Commercial de Moçambique* (BCM). Privatisation of BCM was contemplated shortly after, but audits of BCM accounts for 1992-93 revealed "substantial losses", mainly due to soft loans to parastatals. Continued poor performance of both BCM and BPD impaired the ability of BM to maintain monetary control, and faced with the consequences of slow and partial banking reform, the government made a decision in March 1995 to proceed as quickly as possible with the privatisation of both financial institutions (World Bank, 1995). Subsequently, BCM was privatised in the summer of 1996, while privatisation of BPD occurred in late 1997.

The agricultural marketing system is now to a large extent in private hands, and major markets for agricultural output, particularly in the central region, appear to be active. Thus, circuits for treating marketed agricultural production have been developing, while state involvement in purchase, storage, and transport of marketed surplus has been declining, particularly in the southern and central parts of the country. In 1994, the state marketing enterprise, Agricom entrusted with a broad mandate for purchasing, storing, and transporting a wide array of agricultural products, was restructured and renamed *Instituto de Cereais de Moçambique* (ICM). The reconstructed institution was, subsequently, given a mandate to act as a buyer of last resort, manage strategic stocks to ensure food security, and contribute to the stabilisation of producer and consumer prices. Despite, the official status, ICM has effectively operated like a private organisation, since no budgetary allocations, working capital, or donor support has been received (Coulter, 1996). Moreover, ICM is still an important player in the procurement of agricultural output, with a storage capacity of approximately 235,000 tons. Reports indicate, among other things, that ICM has been successful in procuring some maize for export out of the northern provinces (Miller, 1996). No future strategies regarding ICM have so far been outlined by the government.

Since the cessation of hostilities in 1992, the use of agricultural production inputs has remained rudimentary. It is difficult to determine whether the negligible use of purchased inputs is due to lack of effective demand or limited supply. An examination of Semoc, the major seed company of Mozambique, provides some insight into the current state of input markets. As a former state enterprise, Semoc was privatised as part of the privatisation programme. Since 1994, the company had made substantial efforts to develop a retail network, but the retracting of donor support for resettlement of displaced people, meant that weak sales failed to cover costs. The company survived by downsizing, generating revenue through trading activities, and converting land previously allocated to seed production activities to straight agricultural production. Semoc projects the market for seed to grow slowly, and it envisages that it will need to rely on other income sources for several years before it can focus exclusively on its core business of producing seed (Bay, 1996).

Inadequate transport infrastructure has been one of the major constraints to the development of trade, particularly in the agriculture sector. While substantial infrastructure investments have resulted in a distinctly improved primary and secondary road system, serious problems remain in transporting agricultural surplus from the farm gate to the roads. This difficulty is compounded by a war-induced shortage of animal traction. After approximately one billion USD in investment, the fertile northern parts of the country remain poorly integrated with the rest of the country, while distinct improvements have been made in the southern regions. The extent of the road network improvements in the south can be measured in part by a detailed study of maize market integration between Maputo and Chimoio (a major market on the Beira corridor). It suggests that significant price linkages exist between these two markets (Donovan, 1996).

The marketing system for cashew has been the focus of intense policy debate in recent years. After having raised a ban on exports in 1991, the government has, since 1993, set and abided by a schedule for eliminating the export tax on raw cashew by the year 2000. Previous lack of competition in export markets and extraordinary inefficiency in domestic cashew processing permitted the domestic price for the raw cashew nut to fall to 16 percent of the export price or about one third the level received by farmers in neighbouring Tanzania (Castro, 1995). Recently, privatised cashew processors seem to have realised efficiency gains. Accordingly, increased competition between processors and exporters, has allowed producer prices to increase to 40 percent of the export price in 1996.

Macro-economic reform efforts in Mozambique have over the past decade been at the core of the ESRP programme. Nevertheless, despite stated intentions from the outset, fiscal adjustment has only recently begun on any significant scale. Effects of the ESRP are visible on the expenditure side. Initiatives to raise government revenue collection include the recent privatisation of the customs administration and the planned introduction of a value added tax (VAT). Overall, the key recommendation of the World Bank's first public expenditure review in 1989, to increase government revenues, has not so far been achieved. The persistent inflows of substantial amounts of aid have therefore been essential in financing public expenditure. Efforts towards retrenchment of the government work force have not been successful, but the so-called peace dividend did materialise. In combination with strict limits on wages and salaries of civil servants, spending on public administration and defence has been reduced significantly.

On the monetary side, the ESRP was very specific in recommending monetary restraint. However, the entanglement of the central and commercial banking functions of the *Banco de Moçambique* (BM), was a stumbling block. Thus, while BM performed central bank functions, it also held more than two thirds of all commercial loans, with the majority of its portfolio directed towards parastatals. While direct subsidies to these companies, amounting to 12 percent of GDP in 1987, had been substantially reduced by 1992, indirect subsidies via soft loans from BM proved difficult to control. A survey of industrial companies in 1993 found that most state owned companies had non-performing loans with the banking system (Castro, 1995). Privatisation of BCM coincided with the regaining of monetary control in 1996. The inflation rate dropped to one-digit levels, after having hovered around 50 percent during most of the previous period. Although adjustment to the new low-inflationary environment has been slow, nominal interest rates have recently started to provide market-oriented signals. Accordingly, real interest rates have turned positive after remaining negative up until 1995.

Overvaluation of the exchange rate in 1987 was of major concern, and devaluation of the exchange rate was one of the essential building blocks in the structural adjustment programme. Between 1987 and 1995, the exchange rate continuously lost value relative to major currencies in nominal terms. Parallel markets existed throughout this period; however, parallel and official rates have converged. In 1987, parallel markets traded the Metical at fifty times the official rate. By 1995, this differential had narrowed to approximately 10%. With the establishment of monetary control in 1996, the exchange rate came into line with the rate on parallel markets. Subsequently, these parallel markets have all but vanished.

Reform efforts have also been directed towards the social sector, in particular the health and education networks. Educational rehabilitation has in particular concerned primary education, where almost all of the school network has been rebuilt. Rehabilitation of health care has also seen some progress, in relation to the recent initiation of a six-year health programme. In line with the general liberalisation efforts, private education was reintroduced in 1990, while private health care has been allowed since 1992. A variety of safety net initiatives has also been pursued, but the need for increasing attention to social issues is widely recognised.

4. Economic and social developments

Given the momentous economic and political changes over the past decade, the scope for recuperation and improvement in economic performance has, particularly since 1992, been enormous. However, assessing such change is critically dependent on the availability of reliable data. The National Institute of Statistics (NIS) has produced coherent sets of national accounts in accordance with the UN System of National Accounts (NIS, 1997).[3] The NIS figures differ from the current official national accounts published by the National Directorate of Planning (NDP). These differences reflect that the NDP data are based on problematic estimation and cross-checking procedures (Johnson, 1995). More specifically, the NDP national accounts rely heavily on data from technical ministries and public enterprises, and they do not capture a variety of activities in the services sector. In contrast, the NIS data are based on a variety of surveys,[4] and adjustment is made for items which go unnoticed in the NDP approach. Accordingly, the more reliable NIS data will be the main data source in what follows. Yet, since balance of payments data are compiled in accordance with NDP national accounts only, both sets of data must be relied on in putting together a coherent assessment.

The evolution of real GDP according to NIS as well as the official NDP figures is set out in Table 1 below. Concentrating on the NIS data, it appears that overall growth of real GDP has been respectable in the period 1991-96. A dramatic drought-induced fall in real GDP in 1992, was reversed the following year, marking the beginning of a period with continuous growth. More specifically, the reasonably high real GDP growth rate in 1994 was supported by the presence of significant external funding of elections, disarmament and mine removal, amounting to nearly 5 percent of GDP. Despite the disappearance of these special programmes, real per capita growth remained positive in 1995 and even accelerated slightly in 1996. Preliminary GDP figures for 1997 indicate very rapid overall growth of more than 12 percent on an annual basis.

Looking at the differences in growth rates between the NIS and NDP estimates, they paint as expected different pictures of the evolution of GDP. Thus, NIS data imply a significant drop and consequent rebound in 1992-93, and reasonably high and stable growth rates during 1994-96. The official NDP figures imply, on the other hand, that the drought did not affect real GDP significantly, while an unprecedented 19 percent growth rate followed in 1993. After this jump, the NDP recorded more modest growth rates in 1994-95, while the 1996 estimated performance matches that of NIS. In sum, there are some similarities among the two sets of data, including low growth in the drought stricken year

[3] Formally speaking the NIS was only established in 1998, taking over the duties of the former National Directorate of Statistics (NDS). In what follows, the acronym NIS will be used.

[4] These include demographic, expenditure and production surveys.

of 1992, followed by high growth rate in 1993, a levelling off through 1995 and a resumption of high growth in 1996. Nevertheless, the NIS data tell a story of an economy, which has maintained stability and continuity in the adjustment process, while the NDP figures indicate more erratic movements. The former are judged to be a more adequate picture of the post-1992 period.

Table 1. Real GDP (100 bn. Mt. in 1991 prices)

	1991	1992	1993	1994	1995	1996
Real GDP (NIS)	29.0	26.6	28.9	31.1	32.5	34.8
Growth rate (NIS)		-8.1	8.4	7.8	4.3	7.1
Growth rate (NDP)		-0.8	19.3	4.4	1.4	6.4

Source: Anuário Estatístico, Statistical Bulletin, and National Institute of Statistics (1997).

Movements in the component shares of real value added are presented in Table 2. These figures indicate that the share of the agricultural sector has increased from 1994. The sector contributed with almost a third of real GDP at factor prices in 1996. Increasing real GDP shares have also been recorded in the investment related construction sector and the export oriented transport and communication sector. The relative importance of the commerce, service and manufacturing sectors (excluding food processing) have declined.

Table 2. Sectoral shares of real value added (%)

	1991	1992	1993	1994	1995	1996
Agriculture	30.7	26.8	30.4	28.1	31.5	32.6
Fisheries	3.5	3.3	3.3	2.9	2.8	2.8
Agricultural Processing	6.5	6.6	5.6	5.5	5.7	7.1
Mining	0.4	0.3	0.3	0.3	0.4	0.3
Manufactures	2.8	2.7	2.5	1.6	1.7	0.8
Construction	6.5	7.1	6.7	8.1	9.0	9.6
Transport and Communication	7.0	9.3	10.3	10.1	10.9	11.3
Commerce	23.3	23.2	19.9	21.4	19.9	18.2
Other Services	19.3	20.8	21.1	21.9	18.1	17.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Institute of Statistics (1997).

Note: The base year for real value added is 1991.

The changing structure of nominal value added as set out in Table 3 stands in sharp contrast to the structure of real value added. In nominal terms, the share of agriculture declined to only 25 percent by 1996, whereas the commerce sector increased to a similar proportion. Considering the movements in the real GDP shares, these trends demonstrate that there have been significant differences in the movements of the relative price of value added across sectors. Accordingly, the price of labour intensive agricultural value added has decreased relative to other sectors. This is most likely due to downward pressures on agricultural producer prices following increases in production. Thus, under the circumstances faced by Mozambique, the repeated depreciations of the exchange rate have not been able to countervail the general downward pressures on agricultural prices. The decline in the relative agricultural value added price appears especially steep when compared to the price in the capital intensive commerce sector. Rising relative prices can also be observed in the equally capital intensive construction and manufacturing (other than food processing). Thus, the share of construction in nominal value added has almost doubled to 12.8 percent, while the share of manufacturing has stabilised around 1.3 percent.

Table 3. Sectoral shares of nominal value added (%)

	1991	1992	1993	1994	1995	1996
Agriculture	30.7	25.7	28.0	24.2	23.3	25.3
Fisheries	3.5	4.0	3.5	3.0	3.9	3.1
Agricultural Processing	6.5	5.7	4.8	5.6	5.7	5.9
Mining	0.4	0.3	0.4	0.4	0.5	0.4
Manufactures	2.8	2.7	2.1	1.1	1.3	1.3
Construction	6.5	8.3	7.7	11.4	12.5	12.8
Transport and Communication	7.0	7.5	8.1	7.5	6.9	6.0
Commerce	23.3	21.9	17.5	22.3	23.9	25.3
Other Services	19.3	23.9	27.9	24.4	22.0	19.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Institute of Statistics (1997).

The evolution over time of the expenditure components of real GDP is depicted in Table 4. These figures show that the share of private marketed consumption declined significantly from almost 75 percent to less than 60 percent of GDP in the period 1991 to 1996. Moreover, the value of marketed consumption underlying the shares in Table 4 includes the value of NGO expenditures, which expanded significantly during 1995-96. Excluding NGO expenditures from marketed consumption brings the 1996 marketed consumption to GDP ratio down to 56 percent. The GDP share of real home consumed production has remained stable at around 23 percent, implying *inter alia* that the growth rate of real home consumed production has matched that of real GDP. In contrast, government consumption has declined as a share of real GDP. These developments imply that the overall contribution of consumption towards GDP has decreased significantly.

The mirror image of the large drop in the GDP share of real consumption is a significantly reduced negative trade balance to GDP ratio. Thus, the export share increased during 1995-96 to almost 20 percent, while the import share decreased to 36 percent. This reflects a drop in the imports of consumer goods, which is consistent with the fact that the GDP share of the import-heavy real investment component has increased in more recent years. It is uncertain whether the increasing GDP share of real investment can be characterised as robust. Nevertheless, preliminary data indicate that the share remained at 25 percent in 1997.

Table 4. Expenditure components of real GDP (%)

	1991	1992	1993	1994	1995	1996
Home Consumption	23	20	23	22	23	23
Marketed Consumption	73	70	64	61	62	59
Government Consumption	12	12	14	19	10	9
Gross Investment	23	23	22	25	28	25
Exports	12	15	13	14	17	19
Imports	-42	-40	-36	-41	-40	-34
Total	100	100	100	100	100	100

Source: National Institute of Statistics (1997).

Note: The increase in the GDP share of Government Consumption in 1994 is due to special programmes.

The nominal GDP shares in Table 5 are only slightly different from the real GDP shares in Table 4, reflecting that changes in relative prices among the different expenditure components of GDP were minor. Consistent with price movements in the agriculture and commerce sectors, the price of home consumed production has fallen relative to marketed consumption. From the real GDP shares it is clear that this shift in relative prices has been accompanied by a shift in the consumption pattern away from marketed consumption towards home consumed production. It is also clear that the relative price of investment goods has risen significantly. This accords well with a similar increase in the relative price of imports. Nonetheless, real investment expenditures have increased over time, indicating that the increased relative prices on imports have primarily had a negative effect on imports of consumer goods.

The lack of a discernible trend in the trade balance deficit until 1995, was the cause of much concern. An already large trade deficit in 1987 increased to an even higher deficit in 1990 due to rapidly growing imports and subdued exports. Some small headway towards reducing the trade deficit was made in the early nineties, but Table 5 demonstrates that imports remained at very high levels until 1995. A significant improvement of the trade balance deficit, due mainly to import compression, was, however, recorded in 1996, and preliminary data suggest that the trade balance as a share of GDP has fallen to a new low in 1997. Accordingly, the trade balance to GDP ratio, which was only slightly above 20 percent in 1996, seems to have fallen below 16 percent in 1997. The main driver behind the improvement in 1996, was a significant decline in the imports of primary agriculture and agricultural processing, while a smaller contribution came from a fall in non-agriculturally related imports. In absolute terms, the decrease in agriculturally related imports was twice as big as the decrease in non-agriculturally related imports. The significant decrease in imports of agriculturally related goods is in particular related to the bumper crop which resulted from the generous weather conditions in 1996. Thus, imports of maize, i.e. food aid, which had already been reduced significantly in 1995, all but vanished in 1996. The decrease in non-agriculturally related imports can be also traced to decreases in imports of consumption related items, while imports of e.g. construction materials and industrial machinery increased. On the export side, the leap in share of exports in GDP in 1995 is primarily due to an increase in exports of services.

Table 5. Expenditure components of nominal GDP (%)

	1991	1992	1993	1994	1995	1996
Home Consumption	23	19	22	19	19	19
Marketed Consumption	73	73	65	63	65	62
Government Consumption	12	14	16	21	10	9
Gross Investment	23	27	27	32	36	30
Exports	12	15	13	13	19	19
Imports	-42	-49	-43	-48	-49	-39
Total	100	100	100	100	100	100

Source: National Institute of Statistics (1997).

Developments in public finances are summarised in Table 6, from which it appears that the total deficit has fallen significantly in real terms during 1995-96. Moreover, the current fiscal deficit has been turned into a surplus from 1995. This is in accordance with the fact that emphasis has been put on expenditure retrenchment throughout the whole adjustment process. Since real government investment has also been reduced in 1995-96, the deficit on the total balance has been on the decrease. Nevertheless, falling grants imply that the deficit after grants remains high.

Concerning recurrent expenditures, defence spending made up an overwhelming 34 percent of the recurrent budget in 1992, increasing even further to a staggering 38 percent in 1994. This year was characterised by large externally funded mine removal and disarmament programmes, counteracting the ongoing process of down-sizing the military capacity. In accordance, defence expenditures as a proportion of recurrent expenditures was at 23-24 percent in 1995-96. The retrenchment of defence spending, i.e. the peace dividend, has therefore proven to be a major precondition for the appearance of a recurrent budget surplus and the accompanying reduction in the overall government budget deficit.

A significant drop in the real value of grants meant that the 1996 real investment expenditure fell back to its 1992 level. In this context, account must be taken of the fact that the investment budget is likely to contain recurrent expenditure items. For example, all aid funded spending, including spending on technical assistance, is considered to be investment. As such, this extreme accounting convention is likely to have inflated in particular the 1994 investment figure. Accordingly, the balance between recurrent spending and investment expenditures should be interpreted with caution.

Turning to the revenue side of the government budget, total tax receipts in real terms have remained essentially constant throughout 1992-96, indicating that tax receipts have declined to a very low 12 percent of GDP in 1996. The poor revenue performance is consistent with relatively strong growth in sectors of the economy, which do not comprise part of the tax base. Thus, the tax performance is in accordance both with the observation that real growth in Mozambique has been relatively strong in the informal agricultural sector and the fact that major tax reforms are yet to be implemented.

Table 6: Public Finances (bn. Mt. in 1992 Maputo CPI prices)

	1992	1993	1994	1995	1996
Tax Receipts	661	768	660	675	669
Current Expenditures	765	820	855	612	592
Current Balance	-104	-52	-196	62	77
Investment Expenditures	694	771	916	801	711
Total Balance	-798	-823	-1111	-738	-633
Grants	690	655	803	584	441
Balance After Grants	-108	-168	-309	-154	-193

Source: Anuário Estatístico.

Inflation and money stock growth rates for the period 1991-96 are set out in Table 7. Greater monetary stability emerged in 1996 after a period where monetary development was clearly out of control. Due to currency devaluation and the deregulation of prices, inflation surged at the onset of the adjustment period in 1987, hitting rates around 200 percent per year. However, annual inflation, as measured by the GDP deflator, had already by the end of 1988 been reduced to around 50 percent, and Table 7 shows that inflation, as measured by the December-on-December change in the Maputo consumer price index (CPI), remained at approximately this level until 1996, where inflation dropped considerably. However, the numbers in Table 7 do not provide a clear picture of the actual speed with which price-inflation was brought down. Thus, almost complete price stability was registered between April 1996 and April 1997, with an inflation rate of no more than 4.6 percent.

The monetary authorities did not manage to control the money stock immediately after the initiation of the ESRP. This was primarily due to the dual role of the *Banco de Moçambique* (BM) as a central bank with the authority to issue money and as a commercial bank with the responsibility of supporting state owned enterprises. Despite the separation of commercial and central banking functions in 1992, BM continued to make overdraft lending available to the two state-owned commercial banks *Banco Comercial de Moçambique* (BCM) and *Banco Popular de Desenvolvimento* (BPD). Since BM had no other option than printing money in order to finance these loans, the money stock soared in the period leading up to 1995. The correlation between M1 and CPI was close in this period, but it became even closer during 1996. Thus, the December-on-December growth rates of M1 and CPI for 1996 was very similar in size, and both growth rates were significantly down from the year before. The correspondence between M1 and CPI growth rates suggests that inflation was in this period to a large extent a monetary problem, although this is a debated issue. In any case, neither general wage-pressures, private sector credit expansion or government expenditure growth appear as plausible causes for the observed inflation rates (EIU, 1997).

The exchange rate between the Metical and the US$ was devalued in several steps after the inception of the ESRP in 1987, and following a very large initial jump it has moved more or less in line with the domestic inflation rate. Despite the initial depreciation of around 700 percent, the overvaluation at that time is likely to have been much greater. This implies that the depreciation of the Metical has continuously lagged behind the rate of domestic inflation, and, consequently, that Mozambique has experienced an overvalued exchange rate during much of the structural adjustment period. This may well have contributed towards the impressive return to price stability in 1996 and 1997. Though the Metical is still likely to be overvalued, it has stabilised along with prices. Accordingly, during a six month stretch in 1996, the Metical depreciated by only 3.6 percent against the US dollar, implying a further real appreciation.[5]

Table 7. Growth rates for the money stock and the Maputo CPI (%)

	1991	1992	1993	1994	1995	1996
M1	35.7	59.3	78.8	57.6	56.2	19.9
CPI	35.2	54.5	43.6	70.1	55.0	16.2
E	54.4	69.6	53.1	58.9	50.2	25.3

Source: Anuário Estatístico and Statistical Bulletin.

Note: Growth rates for M1 and CPI refer to December-on-December changes.

The development of the different components of the current account according to official figures is presented in Table 8.[6] It appears that official data also show an improvement in the real trade balance. Moreover, the service balance has improved in recent years, due to a stabilisation of interest payments combined with increasing service account income. Despite these improvements, the current account balance has remained essentially unchanged, due to the developments of capital transfers. The real value of foreign capital transfers has decreased by two-thirds since 1993, and since the major part of these transfers has been of an unrequited nature, this drop represents a major decrease in grant aid allocations. A large part of this decrease can be related to the completion of aid financed special programmes, as well as the inflow of food aid related to the drought of 1992. Since these externally financed projects are likely to have been very import-intensive, a large share of the concurrent decrease in imports has probably been caused by the disappearance of these projects. Nevertheless, the picture of a significant decrease in direct grant aid transfers still remains. Unrequited transfers, which decreased from 565 mio. US$ in 1995 to 339 mio. US$ in 1996, fell even further to 283 mio. US$ in 1997, according to preliminary data.

[5] It is likely that part of the currency overvaluation problem is related to “Dutch disease” effects stemming from the substantial inflows of foreign aid.

[6] The trade balance data, included in the balance of payments, is the official data compiled by the NDP. Accordingly, the current account resembles closely the NDP estimate of the trade balance deficit. The difference between the trade balance and current account amounts to the recurrent service balance deficit.

Table 8. The current account balance (bn. Mt. in 1992 prices)						
	1991	1992	1993	1994	1995	1996
Exports	337	339	345	383	433	484
Imports	-1868	-2080	-2498	-2606	-1807	-1717
Trade balance	-1531	-1741	-2154	-2224	-1374	-1233
Service balance	-228	-323	-332	-411	-316	-191
Capital transfers	1267	1482	1644	1797	843	606
Current account balance	-492	-582	-841	-838	-847	-818
Source: Anuário Estatístico and Statistical Bulletin.						
Note: The current account numbers (in US$) have been inflated by the official yearly Metical/US$ exchange rate, and deflated by the yearly average of the monthly Maputo consumer price index.						

The capital account of the balance of payments is presented in Table 9. The capital account balance has improved significantly in real terms. Accordingly, the capital account has turned from a large deficit in 1993 to a large surplus in 1996. Mozambique has been able to attract external loans on an increasing scale since 1993, reaching a level in 1996 which surpassed the level of capital transfers. Accordingly, in combination with a 50 percent decrease in amortization payments, this makes up the lions share of the big improvement in the capital account balance. Amortization payments have been decreasing, stemming from a combination of debt-rescheduling and debt reductions. The direct investment component has recently shown significant progress, reaching a peak in 1996 when it climbed to more than 20 percent of the value of new external loans.

Table 9. The capital account balance (bn. Mt. in 1992 prices)						
	1991	1992	1993	1994	1995	1996
External Loans	300	413	485	666	702	744
Amortization	-736	-852	-849	-812	-670	-419
Direct Investment	47	62	84	90	112	155
Capital Account	-390	-377	-280	-57	143	481
Source: Anuário Estatístico and Statistical Bulletin.						
Note: The capital account numbers (in US$) have been inflated by the official yearly Metical/US$ exchange rate, and deflated by the yearly average of the monthly Maputo consumer price index.						

The financing of the balance of payments deficit during 1991-96 is set out in Table 10. It follows that the real value of the financing requirement has decreased drastically through 1996 due to an unchanged current account and the significantly improved capital account. Despite the fall in the financing requirement, debt relief has remained at a high level, making it possible to increase foreign exchange reserves in each of the years 1994-96. Furthermore, changes in arrears have been an important source of finance in several years.

Table 10. Financing of the balance of payments deficit (bn. Mt. in 1992 prices)						
	1991	1992	1993	1994	1995	1996
Change in Reserves	-26	-97	121	-136	-148	-339
Debt Relief	800	1626	555	595	310	663
Change in Arrears	178	-540	465	429	475	-131
Financing	952	989	1142	887	637	193
Source: Anuário Estatístico and Statistical Bulletin.						
Note: The financing numbers (in US$) have been inflated by the official yearly Metical/US$ exchange rate, and deflated by the yearly average of the monthly Maputo consumer price index.						

Indicators for social sector rehabilitation during the adjustment period, including in particular the health care and educational systems, are given in Table 11 below. From the observations regarding immunization against DPT and measles, it is clear that extension of health care has been improving. The general revitalisation of the health system is also visible from the infant mortality rate, which has been declining since the cease-fire in 1992. Nevertheless, absolute levels are still among the worst in the world. The reconstruction of the educational system has only made slow progress, as witnessed by the gross school enrollment figures. Thus, the enrollment rate of the priority sector of primary education has only increased modestly, while enrollment rates in secondary and tertiary education have remained essentially unchanged. The increasing number of primary school teachers and the concurrent increase in the pupil-teacher ratio shows, however, that gross enrollment in primary education has been increasing significantly. Thus, the slow progress in the gross enrollment rate can mainly be attributed to a significant increase in the number of school age children.

Table 11. Social Indicators						
	1991	1992	1993	1994	1995	1996
Immunization, DPT (% of children under 12 months)	46	50	49	55	57	NA
Immunization, measles (% of children under 12 months)	55	56	62	65	71	NA
Mortality rate, infant (per 1,000 live births)	NA	134	NA	NA	126	123
School enrollment, primary (% gross)	67	NA	NA	57	58	60
School enrollment, secondary (% gross)	8	NA	NA	7	7	7
School enrollment, tertiary (% gross)	NA	NA	NA	0.4	0.4	0.5
Primary education, teachers	22236	22474	22396	NA	24575	NA
Pupil-teacher ratio, primary	54.7	53.4	54.8	NA	57.6	NA
Source: World Development Indicators (1997)						
Note: NA indicates that data are not available.						

5. Economic stabilization and structural adjustment in perspective

Major macroeconomic reform issues, singled out by the Bretton Woods institutions at the beginning of the adjustment process, included as already noted in Section 3 that Mozambique consumed beyond its means, production was focussed excessively on non-tradeables, and monetary and credit control was lacking. In addition, the economy was characterised as inefficient and inflexible due to government failures in terms of interventionist measures and outdated legislation. It is clear that action has been taken in each of these problem areas. Thus, most of the available policy measures, which were perceived as preconditions for achieving economic stability and growth, have been deployed. This section will put the actual achievements into perspective, based on the policy measures implemented as well as other developments outside of government control.

Turning first to the performance of GDP, respectable rates of growth have occurred in Mozambique in recent years as shown in Section 4. It is moreover clear that established targets of 4-5 percent growth on an annual basis (Arneberg, 1996 and World Bank, Policy Framework Paper, 1997) have in general been surpassed. Nevertheless, the positive economic performance, which has marked a turnaround, need to be assessed in the light of factors, which have favoured a quick recovery. The 1992-97 period saw the return of millions of displaced people to productive activity in parallel with the reestablishment of political stability. In addition, weather conditions have been excellent, and aid inflows have remained high. Considering as well the very low initial level of GDP, following the collapse in 1986, the virtual stand still of the economy in 1987-91 and the drought in 1992, the growth actually recorded appears less impressive.

Real investment expenditures, which grew quickly between 1992 and 1996, seem to have stabilised at a reasonable 25 percent of GDP. In the past, concern was expressed over the effectiveness of the investment expenditures, since growth rates in real GDP per capita remained at or below 5 percent. One explanation offered for this apparently low impact of investment was that investment figures were too high due to the common practise of including foreign funded items of a recurrent nature in the investment budget. This practice has previously given an upward bias to official investment figures.[7] Nonetheless, the NIS investment numbers, which represent combined public and private investment, have nothing to do with the amount declared as investment spending in the government budget. Thus, NIS allocates expenditure between consumption and investment based upon expenditure categories. As such, the NIS investment figures are representative of actual investment levels. This implies that statistical considerations are not likely to form part of the explanation why growth rates in real GDP per capita stayed below 5 percent prior to 1996. Accordingly, it seems that the productivity of investment undertaken in the past has been lower than what could reasonably be expected. With reference to the apparently good 1997 GDP performance, it may nevertheless be that a turning point has been reached.

Investment expenditures have during the adjustment period relied heavily on aid grants for financing, due in particular to the poor performance of government revenue. Recent advancements in attracting foreign direct investment and foreign loans indicate that Mozambique has initiated tentative steps towards lowering the dependence on foreign aid transfers. Moreover, a number of externally financed so-called mega projects has been outlined, including in particular an aluminium smelter and a reduced iron plant, both to be placed in Maputo. Nevertheless, aid transfers will in general have to play a big role as a source of investment finance in at least the short- to medium-term future. Donor dependence is not likely to go away rapidly. This is underpinned by the critical fact that relative investment goods prices have risen over the adjustment period.

As regards consumption, an overly high private consumption share of GDP, amounting to 96 percent in 1991, had been reduced to slightly more than 80 percent in 1996. Since the government consumption share of GDP also fell over this period, reasonable progress was made in reducing the initial consumption to GDP imbalance. This trend is confirmed by preliminary data for 1997. One of the major features of the seemingly stable and continuous economic growth of recent years, is that growth in the informal agricultural sector has been high. Thus, the private household budget share of consumed marketed goods is decreasing rapidly while the budget share of home consumed production is increasing. This development must be viewed as a good thing, in the sense that increasing home consumed production promotes food security at the family level. It also allows peasants to allocate scarce financial resources for other more productive use. Yet, this development can also be seen as an indication that the investment efforts, which have gone into improving informational networks and the marketing opportunities for rural people, have not as yet been sufficient to ensure broad based market-oriented

[7] Official government investment figures amounted, in 1995, to about 45% of total investment as estimated by NIS.

economic development. It must also be kept in mind that consumption still remains at very low levels in absolute terms. In other words, poverty remains widespread.

A most pertinent issue among macro-economic stabilisation problems yet to be addressed effectively is fiscal adjustment. Despite recent improvement in the government budget balances, the development of the government revenue side is unsatisfactory. Thus, poor performance in most of the government revenue items, has meant that overall government revenue has consistently failed to keep pace with GDP. The privatisation of the much criticized customs administration is likely to increase not only the efficiency and attractiveness of the Maputo port as a provider of transit services to South Africa but also import tariff revenues due to a better custom declarations control. Nevertheless, widespread tax exemptions, which have in the past detracted substantially from the revenue generating capability of the important goods related taxes, is a thorny issue. Accordingly, the envisioned introduction of a VAT in the near future is expected to retain a significant number of tax exemptions. Finally, since it is difficult to tax the growing informal sector activities, government is clearly faced with a need to pursue further fiscal reforms, including in particular the design of more efficient mechanisms for generating revenue in a market oriented economy.

Due to the poor performance of the government revenue side, all of the budget adjustments have so far taken place on the expenditure side of the budget. A large part of the adjustment was achieved through the so-called peace dividend. However, instead of cutting back on the work force, the government compressed wages and salaries of civil servants as part of the process of returning to a recurrent budget surplus. Accordingly, the government of Mozambique is now faced with the double-edged challenge of wage decompression and the need to reduce the number of employees. Furthermore, much attention must continue to be directed towards the modernisation of budgetary and financial administrative procedures. In this context, corruption has been on the increase both as a consequence of inappropriate legislation, still to be modified, and due to the failure of the legal system to address this issue in the transition from a command-type to a market economy. In sum, while fiscal adjustment has taken place, this remains a fragile area of the reform efforts.

Throughout the adjustment period, the balance of payments has been strongly affected by developments in debt-rescheduling, debt reductions and aid grants. Foreign debt originally started accumulating in the late 1970s and early 1980s, and the build-up intensified during the war period. In the early 1990s all debt indicators had reached massive and clearly unsustainable levels, and in spite of debt relief, new loan financing of the continuing current account deficits meant that the debt stock stood at 5.78 bn. US$, or 16 times export earnings, in 1995. The debt-service obligations related to this huge foreign currency debt, has continuously put strains on the balance of payments, and it will continue to do so until the debt burden has been substantially reduced. Some cautious optimism for the future can be expressed here, as negotiations with the Bretton Woods institutions towards reaching an agreement within the Heavily Indebted Poor Countries (HIPC) initiative is envisioned to reduce outstanding debt by some 85 percent by mid-1999. This would reduce the debt burden to a more sustainable 200 percent of yearly export earnings.

The debt reduction initiative is all the more important given that foreign capital transfers in general and aid grants in particular have been decreasing in recent years. The sharp negative trend, which can be observed in the numbers from 1994-96, is largely explained by the external funding of special programmes in 1994. Nonetheless, there appears to be an additional downward movement in aid grants awarded to Mozambique. The combination of decreasing grants and increasing investment expenditures has been realised due to increasing loan inflows and reductions in amortization payments. Given that the actual debt-service has fluctuated between 17 and 27 percent of amounts due in recent years, the expected HIPC initiative should be able to help facilitate a continued capital account surplus, ensuring the positive real resource inflow needed for investment purposes. Nevertheless, to avoid a recurrence of the debt problem, continued aid inflows at a high level and on grant and concessionary terms are indispensable to help close the financing gap from the current account. In this sense, Mozambique continues to be one of the most aid dependent countries in the world.

Great concern has in the past been attached to the large deficit on the foreign trade account, where imports and exports have hovered around respectively 50 and 15 percent of GDP. More recently, exports have been picking up, and since the import-to-GDP ratio declined in 1996-97, the trade balance deficit to GDP ratio was brought down substantially. Optimism has been spurred by the fact that the import compression has been achieved without impairing GDP growth or investment spending. Accordingly, the drop in the trade balance deficit has not affected investment expenditures, but has mainly been achieved through a decrease in imports of consumer goods, particularly agriculture. Given the scarcity of foreign exchange and the importance of imports for investment purposes, the decreasing imports of consumer goods is a positive development.

Putting the interrelated consumption and trade balance patterns into perspective, the progress realised is notable, but caution is required when looking to the future. While some transformation of production has taken place on the import side, further possibilities for relatively easy import substitution and recovery may be limited. This is so since investment goods and essential intermediate inputs such as fuel, are not produced locally. Moreover, progress on the export side cannot be attributed to a structural shift in the transformation of production. Accordingly, major breakthroughs are yet to be made on the export side, if the current trend of reducing the dependency on net capital transfers including aid from abroad is to continue. Furthermore, the decreasing consumption share of GDP has not so far been associated with the necessary shift in consumption pattern, towards a better balance between private and public consumption. There is, for example, a need to increase expenditures in particular in regard to the educational sector, where pressure is mounting due to a quickly expanding population.

The excessive monetary growth and high inflation rate were two of the problem areas identified by the ESRP programme. Though lack of monetary control was identified as a problem from the outset, progress towards stabilizing monetary growth was only made rather late in 1996-97 when reconstruction and privatisation of the commercial parts of the formerly state-owned financial institutions was carried out. The fact that monetary growth has essentially made up for nominal GDP growth, has meant that the velocity of circulation of M1 has remained fairly constant at slightly less than 4.0 since 1992. The very high monetary growth rates have over the years generated substantial seignorage revenue, amounting to around 10% of GDP per year. This income has, however, mainly been directed to the state enterprise sector via the previously mentioned soft loans. The new low-inflationary environment is likely to be associated with a gradual lowering of inflationary expectations. Accordingly, the velocity of circulation should start falling in the near future, allowing the government to capture some seignorage revenue without risking a renewed spurt in inflation. Similarly, the real rate of interest, which has only recently turned positive, should gradually start to come down from the very high current levels.

The developments of the sectoral income shares of GDP at factor cost, show that the relative price of value added across sectors has changed significantly. The relative price of value added in capital intensive sectors like the commerce and construction sectors has risen, while prices in agriculture have declined. This is a clear indication that capital has remained a scarce and constraining factor during the 1992-96 period.

Following the drought of 1992, major emergency packages of food aid were flowing into Mozambique from abroad. Good weather conditions in more recent years have meant that domestic production has increasingly been able to substitute for this emergency assistance. Thus, the large decreases in food imports of maize were associated with concurrent increases in the real value of production of 30-40 percent, in each of the years 1995-96. Following another bumper crop in 1997, Mozambique has achieved self-sufficiency in maize, and some progress has even been made towards exporting surplus production. However, the potential for relatively easy import substitution as part of the recovery process has now been used up, and further expansion of production will depend on more fundamental changes in the development constraints faced by agricultural producers.

In this regard, significant efforts and resources have been put into improving primary and secondary roads as well as rehabilitating the rail networks. These efforts have been first steps in promoting Mozambique as an efficient provider of transport services to neighbouring countries, and as such they have provided Mozambique with possibilities for generating additional foreign exchange earnings. Transit services have since 1991 been the major export article of Mozambique, even surpassing the critically important fisheries sector. Nevertheless, extension of infrastructure to underdeveloped rural areas remains inadequate. Mozambique has a large untapped potential for agricultural development, not only as a supplier of the domestic market, but also as a provider of exports. This potential cannot, and will not, be utilized effectively until major extensions of the economic infrastructure are made.

While improvements in infrastructure are likely to boost the livelihood of some peasants, this is by itself insufficient to reduce poverty on a major scale. The current production technology, used in small-scale agricultural production, continues to be of a very rudimentary nature. Since little has been achieved over the adjustment period in this area, technological improvements are going to be critical, in any future agricultural development strategy. Nevertheless, the financial needs associated with improved production methods means that technological extension on any larger scale will have to go hand in hand with an extension of the branch network of the financial system to the rural areas. This is, however, only likely to materialise in the longer perspective, and then only in connection with increased marketing opportunities, and enhanced legal enforcement of contract laws.

Small-scale agricultural development is also going to depend on a proper solution to the emerging problem of land entitlements. This has only recently started to attract attention. Mozambique is blessed with an abundance of cultivable land, and only in the southern provinces of Maputo, Gaza, and Inhambane, does the area required by traditional extensive techniques exceed the quantity of available land. Some parcels of land are, however, more valuable than others due to natural fertility, and access to irrigation water and markets. Moreover, the current land law, which does in principle protect the rights of smallholders, is difficult to enforce by the government due to a lack of skill and money. Consequently, dispossession of smallholders is a looming problem, which is likely to become steadily more prominent as the possibilities for resettlement on favourable land become more limited.

Developments in processed food production also bear evidence to the poor state of the road network. Overall grain milling production has remained at roughly the same level during 1993-96, and since the real value of grain milling imports still makes up almost 75 percent of domestic production, there seems to be some further potential for domestic expansion and import substitution in this sector. However, grain milling imports consist mainly of processed rice and wheat flour while domestic production is mainly maize flour. Following the 1993 price liberalisation for maize flour, output increased in 1994 only, so domestic production is still hovering around the 1991 level. Moreover, the large effective protection afforded to domestic wheat flour milling and the 1996 domestic price liberalisation have not as yet resulted in any import substitution. Accordingly, the potential for import substitution in processed food production remains untapped.

Summing-up, one of the primary aims of the reform measures introduced in the adjustment process, was to shift the composition of domestic output towards tradeable goods. In fact, while the export share of GDP has gone up by about 50 percent, this is mainly due to a leap in export of services. Earlier food aid is no longer imported. Accordingly, a major part of the import substitution has occurred as part of the return to more normal conditions, following the severe drought and the cessation of hostilities in 1992. Due to the fact that the major import substitution possibilities associated with the recovery of the agricultural sector have already been exploited, it follows that there is a need for a future development strategy to include a focus on how the tradeability of Mozambican goods can be increased.

The micro-economic efficiency enhancing instruments, employed as part of the ESRP programme, includes the privatisation of state enterprises and the liberalisation of prices. During the period with socialist rule, all banks and the vast majority of companies had been nationalized, and the efficiency of production declined. Thus, there was a large potential for efficiency gains at the outset of the privatisation programme. Coming off from a slow start, the privatisation of the important larger state companies has accelerated more recently. However, an authoritative assessment of this process seems premature, as the final verdict on the privatisation of the larger firms is still out. Nevertheless, it is fair to conclude that the privatisation of the commercial parts of the formerly state-owned banks, together with the entrance of new banks, has helped to increase competition in the financial sector. In addition, the stated goals regarding domestic price liberalisation has essentially been met. Accordingly, domestic price liberalisation is no longer regarded as a major policy issue.

Rehabilitation of the social sector continues to present major challenges for the government. Revitalisation of the health care system is reflected in a decreasing child mortality rate, but a lot remains to be done. Improvements to the devastated educational system have also taken place. Hence, almost all of the school network, which was closed down due to the civil war, has been reconstructed, and the number of primary school teachers has increased. These improvements have not, however, been able to meet the increasing requirements of a country, characterized by a significant return of refugees and other displaced people as well as a rapidly growing population. Thus, significant budgetary reallocation towards social sectors is necessary in the future, if major improvements are to be achieved.

6. Conclusion

More than a decade after the start of the stabilisation and structural adjustment programme in Mozambique, and after five years of peace, macroeconomic stabilisation has as shown in this paper been arrived at in Mozambique. Recent indicators show that monetary control is effective and inflation is low. Furthermore, stable growth has set in over the past few years, and there is little left in terms of policy induced distortions. As such, key recommendations of the liberal reform programme have been achieved. While some see the results as fully satisfactory it is also clear that much of the progress realised to date can be attributed to economic recovery from an extraordinarily suppressed situation. In any case, it is evident that the long climb towards greater prosperity has only just begun. Many basic requirements for economic growth, such as physical infrastructure, functioning government administration, and human capital are still suffering from prolonged neglect and underdevelopment. In addition, structural imbalances continue to be endemic, including severe aid dependency.

Progress since 1992 includes that the excessive consumption share of GDP has been reduced. In addition, the foreign trade position has improved. Yet, the composition of private consumption remains highly focussed on home consumption of own production. Moreover, while the question of how large the government should be is a subtle one, it is clear that there is a critical need for fiscal and administrative changes. The turn around in the trade balance has in particular been achieved through a decrease in the imports of consumer goods. The actual import substitution, which has occurred so far, has however in large measure been related to the recovery of the agricultural sector, following the 1992 drought and the cessation of hostilities. Some possibilities for import substitution remain, e.g. in grain milling activities. Nevertheless, the continuing need for imports of investment and essential consumer goods to underpin development put a strict limit on the effectiveness of further import compression. This puts focus on the need to improve the tradeability of Mozambican products and their competitiveness in domestic and international markets.

It is widely recognised that the agricultural sector will have to play a key role in any poverty reducing development process in Mozambique. Yet, this sector is in spite of some progress far from attaining its full potential. Prices may have been liberalised, but major infrastructure impediments continue to hamper market integration of the typical small-scale farmer. To this can be added that production technologies are extremely crude, requiring both technological and extension breakthroughs on a massive scale. A wide range of institutional preconditions, including a financial and judiciary system with the ability to enforce contracts and land entitlements, is also far from being in place. Accordingly, a coherent development strategy directed towards poverty reduction remains to be implemented.

In sum, the successful stabilisation of inflation and monetary growth as well as the high and stable investment level reported in this paper give rise to optimism for the future of Mozambique. Many distorting policy induced interventions have also been removed. Nevertheless, plain recovery has played a vital role in the turn around over the past few years. The underlying real development constraints remain much the same, and while market forces have been set free, the government is caught with little capacity and ability to act. The alleviation of widespread poverty will remain an elusive goal unless institutional requirements, such as an effective regulatory framework, and the promotion of agricultural production and food security, beyond mere market liberalisation, are put at the top of the list of priorities for the future. In fact, the more difficult development challenges lie ahead.

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