The HIPC Initiative in Mozambique
A Missed Opportunity?

Carlos Nuno Castel-Branco[1]
17th March 1999
Africa Centre - London

INTRODUCTION

In 1998, the World Bank decided that Mozambique is one of the heavily indebted poor countries (HIPC) of SSA that should qualify for the debt relief initiative under the HIPC. The debt alleviation initiative under HIPC is based on the following two fundamental principles:

(i) the amount of debt to be eliminated is decided on the basis of fiscal sustainability analysis. This requires the calculation of what the optimal debt service ratio is, so that the ratio debt service/public expenditure is reduced to a reasonable size and does not put too much pressure on public expenditure, particularly on social expenditure. Thus, the HIPC initiative is expected to free resources for development.

(ii) the HIPC country has to agree an economic programme with the IMF, under the enhanced structural adjustment facility (ESAF). This programme defines the economic and development policy of the country and the conditionality for the country to receive the various trenches of grants, soft-loans and debt relief. Thus, the HIPC initiative should encourage the recipient countries to pursue "sound" economic policies that will improve their development prospects.

The HIPC does not eliminate the debt stock of the poor countries, but only reduces the stock to the level that the World Bank considers to be sustainable. There are no rigorous criteria to define the level of debt sustainability. On one hand, the level of sustainability is a function of what the World Bank thinks the country can afford to pay and is willing to pay. On the other hand, the level of sustainability is also related to the bargaining power of the country, which, in turn, is associated with political interests, and the size of the economy and debt relative to the world economy.

The Mozambican government, Mozambican and international non-governmental organisations, forums and coalitions have rejected the HIPC initiative as being inadequate, and have called for total debt cancellation without conditionality rather than debt reduction with conditionality. The remaining of this paper explains the rationale behind the critique of HIPC initiative and its alternatives.

---

[1] The author is a Mozambican economist, lecturer at the University Eduardo Mondlane, Maputo, and member of the Mozambican Debt Group, currently enrolled in a PhD programme in the Department of Economics of the School of Oriental and African Studies (SOAS), London University. Contact: carlos.castelbranco@dial.pipex.com. The author thanks Anna Locke for extensive and valuable comments on an earlier draft.

NET GAINS AND DEBT SUSTAINABILITY

When the agreement between the Mozambican government and the World Bank concerning the HIPC initiative was signed, the World Bank and the IMF announced that Mozambique would benefit from huge debt relief. They argued that more than half of the debt stock would be wiped out, and this would reduce the debt service to a quarter of its current size. Therefore, resources worth between US$250 million and US$280 million per year would be saved due to debt relief and would be made available for development. The Mozambican government, however, was much less enthusiastic and declared that the agreement was welcome but the overall result is far from what the country needs and the government expected. The reason for this difference in opinions can easily be understood with a more detailed analysis of what the actual debt relief means.

Estimates of Net Gains

The World Bank and the IMF estimated the size of the resources saved and made available for development through debt relief (i.e., the net gains from debt relief) by comparing the current debt service due (before HIPC) with the debt service due after HIPC. This comparison is highly misleading because the Mozambican government pays only 30 per cent of the current debt service due (before HIPC). Mozambique's current debt service due before debt re-scheduling and alleviation is estimated at US$350-US$380 million per year. This is more than one and half times Mozambique's current export revenue and 25 per cent of Mozambique's GDP.

Mozambique has never paid that amount and would never be able to pay it. Annually, creditors negotiate with the Mozambican government the re-scheduling and alleviation of debt through the Paris Club and in the Consultative Meeting. After debt alleviation, Mozambique has been paying, on average, between US$113-US$115 million a year. The difference (between current debt service due and current debt service actually paid) is either cancelled or re-scheduled. In the later case, the re-scheduled debt service accumulates as part of the debt stock, which compounds into the debt service in following years.

In practical terms, Mozambique's net gains from the application of the HIPC initiative have to be estimated not against the current debt service due (which Mozambique does not pay), but against the 30 per cent of the current debt service due (which is what Mozambique has been paying). This is the only realistic way to estimate the net gains resulting from the application of the HIPC initiative. Even some of the IMF/World Bank economists have accepted this argument, which was put forward initially by an economist from the IMF. If this methodology is adopted, Mozambique's net gains fall from the initial US$250-US$280 million a year to a more realistic and much less significant US$13 million. This means that, out of the amount of debt service that Mozambique is already paying, only US$13 million will be deducted. In other words, the HIPC initiative reduces the actual debt service paid by the Mozambican government by 11.5 per cent. This is hardly significant for a poor, heavily indebted country.

Fiscal Sustainability and Development

The debt service after the HIPC initiative will continue to represent a huge burden on public finances. It will absorb between 15 and 20 per cent of total public current expenditure, which is roughly the same share of public resources enjoyed by the health and education sectors, and 4 to 5 times the level demanded of West Germany after World War II. Total debt cancellation would enable the Mozambican government to more than double its expenditure in health and education.

After debt relief under the current HIPC terms, Mozambique's annual debt service will continue to be approximately equal to 40 per cent of annual export earnings and 5 per cent of Mozambique's GDP. Total debt cancellation could reduce the current balance of payment deficit by 20 per cent, increase the resources available for investment in the economy and social sectors, and reduce the country's dependency on foreign loans and grants for balance of payment and import support.

A World Bank study has argued that Mozambique has to invest an extra US$50 million a year in education (in addition to the existing foreign grants and loans and public money) in order to meet UN education targets. This amount could easily come from the resources saved through total debt cancellation, but otherwise will have to come from more foreign loans and, thus, further indebtedness.

Finally, the Mozambican government has to borrow about US$90 million a year from abroad to meet its basic health and education expenditure targets, which reinforces the dynamics of external debt build-up. Total debt cancellation would release about US$113 million a year to this end.

As it can be seen, as far as the release of resources is concerned, the HIPC initiative misses the opportunity to make a real difference in terms of development prospects for Mozambique. As it does little to release the already huge fiscal pressure, the HIPC initiative is unlikely to lead to any form of debt/fiscal sustainability.

The IMF/World Bank have already acknowledged this problem. In a conference in Maputo, in September 1998, the World Bank resident representative (RR) in Mozambique said that the major advantage of the HIPC initiative is that Mozambique does not need to rely on the creditors' will for debt re-scheduling, because what Mozambique cannot pay is wiped out rather then renegotiated. Thus, the HIPC initiative is no longer a means for substantial debt relief – as the World Bank stated initially – but is more a matter of some political leverage given to the recipient country. The words of the RR of the World Bank in Mozambique need further qualification. First, the data above shows that there is no evidence that Mozambique can afford to pay the debt service resulting from the HIPC initiative without jeopardising development and economic growth. Hence, the HIPC initiative does not eliminate all of the debt that Mozambique cannot afford to pay. Second, the HIPC initiative has been, and continues to be, a process of negotiation with international financial institutions (IFIs) and major creditors. It is equally dependent on creditors' will as it used to be during the process of debt re-scheduling before the HIPC initiative, as it is going to be shown later.

Debates about Total Debt Cancellation

Mozambique has demanded total debt cancellation. The Government, the Parliament, other social organisations (such as the Trade Unions and Peasant Associations), social forums (such as the Mozambique Debt Group), and international NGOs (such as Oxfam and Save the Children) have all called for total debt cancellation. The arguments for total debt cancellation are straightforward, and most have been discussed earlier: Mozambique cannot afford to pay the debt without jeopardising further its own development rights and objectives, and any initiative that involves debt repayment, rather than cancellation, is unsustainable. There are, however, various arguments against total debt cancellation, all of which have been part of the debates concerning Mozambique, namely: the prohibitive cost of cancellation, the need for fiscal discipline and the problem of moral hazard that may emerge with total debt cancellation.

Creditors' Cancellation Costs

Some argue that it is too costly for the IFIs and major creditors to cancel the whole debt of the poor, heavily indebted countries. This argument is ridiculous, because whilst Mozambique is asked to transfer 5 per cent of their GDP and 15 per cent of their public expenditure to major creditors and IFIs, the impact of total debt cancellation of all HIP countries on the economy of major creditors is negligible. Moreover, the selling of part of the IMF gold reserves that may help to pay for total debt cancellation of the HIP countries could act as an incentive to increase investment, accelerate growth and expand trade in the world economy. The investment of surplus accruing to one side of the world economy in the economies in deficit (for example, through total debt cancellation), could dramatically improve the prospects for world-wide growth and development. It is much more costly to everybody, rich and poor countries alike, to maintain more than 40 countries and half a billion people in a perpetual state of charity dependency and mass poverty. What can the world economy gain from this?

Fiscal Discipline

Another argument against total debt cancellation of the HIP countries is that some sort of pressure is needed to maintain fiscal discipline in such countries. This argument also does not bear close scrutiny. First of all, fiscal discipline is not a development goal in itself. Second, debt repayments in Mozambique absorb between 15 and 20 per cent of public expenditure. If these resources are released from debt repayment, they can be used for investment in infrastructures, social sectors and the economy. As a result, the government will be capable of reducing borrowing abroad and in the domestic market, and the fiscal deficit may even decline. The pressures of basic needs, such as basic education, health services, legislative and regulatory capabilities, statistical and planning capacities, defence and security cannot be avoided. If the government own resources are insufficient to meet these very basic social needs, the government will borrow more. Hence, debt repayment tends to inflate, rather than deflate, public expenditure, and force the government to borrow more particularly when public expenditure is already below a very basic social threshold.

Moral Hazard and Economic Mismanagement

A third, more complex argument attributes the origin of current debt to economic mismanagement, and claims that the moral hazard[2] associated with debt cancellation would promote future accumulation of further debt. Under this argument, the Mozambican government is held directly responsible for having created the current, unsustainable level of debt. Moreover, it is argued, if debt is completely cancelled, the Mozambican government will assume that it can avoid repayment of future debts by claiming that the country is poor and cannot afford payments. If, on the other hand, only part of the debt is cancelled, the Mozambican government will be much more careful in the future in order to avoid going into debt crisis again. Hence, partial debt cancellation is an incentive for debtor countries to be responsible for and be prudent with their economies and borrowing. There are two sides in this argument, the issue of moral hazard and the issue of the responsibility for the debt situation.

There are several fundamental flaws in the moral hazard argument. First, the argument assumes that debtors have a preference for systematically misappropriating and misusing creditors' resources for individual gain rather than employing them in the development of the country as a whole. This argument could be applied in notorious cases such as Mobutu of

---

[2] Moral hazard can be defined as "…the lack of incentive for individuals to take care", or take actions that prevent, or affect the probability of a negative event to occur (Varian 1990:588-9)

Zaire, the Duvallier clan in Haiti, Marcos of Philippines, Somoza in Nicaragua and the Suharto clan in Indonesia. But even in these cases, the arguments ignores the fact that many of these individuals were able to stay in power long enough to enrich themselves because they were kept there by the political, economic and military support that they received from major creditor countries during the Cold War. The money they have stolen is likely to be deposited in banks belonging to the creditors' countries. The peoples of these countries should not be made to bear the cost of dictatorships they never wanted but were forced to live with. However, the most important issue is that these notorious cases of corruption and abuse cannot be generalised to all debtor countries.

Second, the argument neglects the fact that *creditors* are as likely, if not more likely to, suffer from moral hazard as debtors. Creditors have plaid a central role in the dynamics of debt generation and build-up: they control the international monetary system and the private financial system, as well as production, knowledge and trade. They operate as a group that co-ordinates international economic policy and debt management, for example through the IFIs and the Paris Club. Yet, they failed to recycle current account surpluses and deficits, to ensure fair trade and prices, to facilitate debtors access to new knowledge and technology, to control irresponsible lending by their banks. Their power and their own interests are the cause of their moral hazard.

Third, the argument incorrectly attributes the responsibility for the creation of Mozambique's debt purely to government economic mismanagement, and ignores the context in which the debt arose. In reality, Mozambique's economic stagnation and collapse resulted from the combined effects of the war, expensive and scarce finance, the oil price boom of the 1980s and the fragility of an underdeveloped economic structure and dynamics. Most of Mozambique's debt, and its inability to serve it, were created in the two decades of military, economic and social aggression against front line states by the regime of apartheid in South Africa and by Ian Smith's illegal regime in former South Rhodesia. It is estimated that this aggression cost Mozambique US$17 billion in direct costs and lost production, and US$5.8 billion in debt. A large part of these costs were incurred whilst fighting against regimes that the West criticised, yet took no concrete action to combat or to help the people and countries that were on the front line of combat.

Even without the costs of war, it was inevitable that Mozambique had to incur in some debt in order to invest and develop its economy after Independence. The economy that Mozambique inherited from colonialism was characterised by institutional, technological, organisational and financial constraints that generated a cycle of underdevelopment and dependency. Mozambique could not provide the resources necessary to break this cycle purely from its own export earnings and needed to borrow abroad. Like many other HIP countries, Mozambique was (and continues to be) a producer and exporter of a narrow range of primary products,[3] which has made it vulnerable to small changes in demand and relative prices of these products.[4] The relative prices of the majority of Mozambique's exports relative to its imports (terms of trade) have tended to deteriorate over time, reducing Mozambique's export

[3] For example, in 1997, six primary, largely unprocessed products accounted for 76 per cent of Mozambique's exports: crustaceans (37 per cent); raw cashew nuts (13 per cent); ginned cotton (10 per cent); sugar and cereals (6 per cent each); and timber (4 per cent).

[4] For example, in 1989, the quantity of cashew nuts exports in Mozambique was 81 per cent higher than in 1981, but cashew export earnings were only 12 per cent because of a fall in the international price of cashew by 43 per cent (Castel-Branco 1994a).

purchasing power.[5] In addition, significant fluctuations in the prices of certain primary products means that Mozambique was deprived of a stable revenue base which it could use to plan investments to further national development.[6]

Deterioration and fluctuation of export relative prices and demand need not be a big problem if Mozambique's exports and export markets were diversified, and Mozambique had a more knowledge base and higher productivity economy. In order to change its economic structure, Mozambique had to invest more than could save, and import more than its export earnings allowed. Therefore, Mozambique had to borrow abroad. When Mozambique did turn to international finance for help to supplement its own resources, it encountered prohibitive borrowing costs and strong credit constraints, which contributed to raising the level of debt that it incurred. Having decided to follow a socialist development strategy, Mozambique was the target of an undeclared economic blockade by the G-7 countries in the first decade after independence, which, along with international credit rationing and high interest rates, inflated Mozambique's debt.

DEBT CANCELLATION AND CONDITIONALITY

Leaving aside the debate about how to tackle the current debt of Mozambique and other HIP countries, how can new and unsustainable debt stock be prevented from building up again as soon as the current debt is cancelled? Mozambique's economy continues to rely heavily on

[5] For example, between 1980 and 1989, the purchasing power of the four most important exports of Mozambique, which represented two thirds of total export earnings, deteriorated by 66 per cent (sugar), 43 per cent (cashew nuts), 37 per cent (cotton) and 9 per cent (prawns). Because prawns are the single most important export and its international terms of trade deteriorated less, the global terms of trade of Mozambique's exports deteriorated by "only" 15 per cent (Castel-Branco 1994a).

[6] The deterioration of the purchasing power and the instability of the prices of Mozambique's main exports are due to the following main factors:

(i) *demand side:* the income and price elasticities of demand for primary products (with exception of oil) are low relative to manufacturing, science and technology and oil products. Thus, very large increases in income or very large falls in prices are required for a small increase in the demand of these products. Additionally, the largest markets (the USA and the European Union, EU), protect heavily their domestic producers of commodities with tariff and non-tariff barriers (for example, the Common Agriculture Policy in the EU and the sugar preferential quotas in the EU and the USA). Thus, large falls in prices are required before small increases in demand for exports can be achieved.

(ii) *supply side:* Mozambique's productivity is low and its economic activities involve and generate very little skills and knowledge. Thus, the economy cannot compensate for price falls with higher productivity and lower costs, not can it change quickly to take advantage of the market opportunities that develop in new industries;

(iii) *market structure:* international commodity markets are controlled by large corporations that speculate in futures markets and, because of oligopolistic competition, tend to create excess capacity and/or excess production that is cyclically dumped (or recycled).

In addition, the markets for Mozambique's exports are extremely concentrated, with three countries (Spain, South Africa and USA) absorbing 50 per cent of Mozambique's exports (INE 1997). Hence, the likelihood of boom and collapse in prices and demand for Mozambique's exports is compounded by the joint effect of narrow specialisation and concentrated markets.

external resources and continues to face the same structural constraints on its ability to develop as before. Mozambique’s public investment in entirely financed by external resources, and the annual balance of payment deficit is three times larger than the annual export earnings of the economy. Mozambique’s imports are equivalent to half of Mozambique’s GDP, and four times as large as Mozambique’s exports. Meanwhile, Mozambique has not diversified its productive base, and continues to be heavily dependent on the export of a few primary products. Moreover, the global environment is likely to become more hostile for economies such as Mozambique, which are characterised by low productivity and a low knowledge base. Thus, everything seems to indicate that debt will start to build-up again from the first day after debt cancellation.

The debate that follows addresses the issue of what should happen after, or simultaneously with, debt cancellation. The next sections discuss whether the IMF economic reform programmes that HIP countries must adopt in order to obtain debt relief (so-called conditionality) are the best means of preventing the recurrence of unsustainable debt.

HIPC initiative, ESAF and Conditionality

For a country to qualify for debt alleviation under the terms of the HIPC, it has to agree with the IMF the use of the Enhanced Structural Adjustment Facility (ESAF). After three years of implementing stabilisation and structural adjustment policies, the country may or may not qualify for debt relief under the HIPC initiative. The final decision depends on the country’s economic performance.

The ESAF allows the recipient country to receive, from the IMF, loans for amounts over and above its statutory rights, at lower interest rates, and longer grace and maturation periods. However, the IMF attaches strong political conditionality to the use of ESAF by any country. This means that the use of the IMF borrowing facilities under the ESAF is constrained by the recipient country’s willingness and ability to conform to the IMF’s conditions. These conditions are formalised in a Policy Framework Paper (PFP), which sets out economic policy and targets to be met, usually over the following two years.[7]

The use of the IMF's borrowing facilities also influences the ability of a country to borrow from other creditors, and the conditionality imposed with the ESAF is very much in line with what the major creditors would accept.[8] This is not surprising, since the major creditors own the vast majority of the votes, and so the power, in the IMF decision-making process.[9] Most official, bilateral creditors would not accept any negotiation of the debt or the concession of soft-loans and grants to a country without agreement with the IMF. The agreement with the IMF operates, therefore, as a sort of an insurance mechanism for the creditors.

---

[7] The PFP also incorporates the conditionality imposed by the World Bank. Indeed, according to Tarp (1993), Mosley, Harrigan and Toye (1995) and Killick (1995), the PFP is an attempt to merge and coordinate the IMF and World Bank programs of stabilisation and structural adjustment.

[8] Usually, the conditionality imposed by the IMF is related to macroeconomic stabilisation, and includes monetary, balance of payments and fiscal targets. The World Bank's conditions, also embodied in the PFP, usually comprise privatisation of economic and social productive assets and services, market and price liberalisation, reduction of tariff barriers and elimination of non-tariff barriers to trade, financial liberalisation, exchange rate liberalisation and public administration reform.

[9] The votes and power of each country are a function of the relative size of their economies. The USA, alone, owns about 30 per cent of total votes in the board of the IMF.

Thus, although the borrowing from the IMF is normally a small share of total borrowing from official, concessional sources, the economic policy agreement with the IMF is absolutely crucial for the survival of a poor country. Without such an agreement, a country would not qualify for any form of debt and loan negotiation with major creditors, nor would commercial banks consider the country credit-worthy.

The Mozambican Case

Since January 1987, Mozambique has been implementing a classical program of macroeconomic stabilisation and structural adjustment. As far as compliance with conditionality is concerned, the Mozambican government has been considered a good performer by most of the IFIs and creditors. Despite these facts, the Mozambican government had to put pressure on the World Bank to be exempt from the three-year clause.[10] However, Mozambique is not exempt from the ESAF clause,[11] despite the fact that the country has implemented a programme for economic rehabilitation for three years (1987-89), and four successive ESAF agreements (1991-1999).

The new PFP, under the new ESAF agreement, has reinforced the focus of the previous PFPs on tight monetary and fiscal policies (for macroeconomic stabilisation), market and price liberalisation, privatisation of public utilities and large companies, and public sector reform. Additionally, the new agreement has specifically made debt relief conditional to two main points: introduction, by April 1999, of the Value Added Tax (VAT) and the approval of legislation, by the Parliament, for significant increases in user fees for health services.

The legislation on VAT is not yet properly regulated, neither firms nor the government institutions are prepared for all the paper work required or have the accounts adequately organised, and the vast majority of small business are completely incapable of implementing the VAT legislation so soon. It is expected that corruption will thrive in a world of institutional incapacity to implement the new legislation. Moreover, the value of government indirect taxation is very likely to fall significantly, with large negative effects on total public revenue and fiscal sustainability. The issue is not whether the introduction of VAT is a good or bad thing in itself, but what its objectives are, whether there are more realistic and cheaper alternatives to achieve the same objectives under the current circumstances, and whether the fundamental organisational and institutional conditions are created for the policy to be implemented and have a fair chance of success.

The legislation on user fees is likely to reduce significantly the access to public health services of the vast majority of the people who are dependent on the national health system. Two recent UNDP reports on Human Development have emphasised the need to reduce user fees, not to increase them, as a pre-condition for the poor (the vast majority of the population in HIP countries) to be able to benefit from public health services. The IMF/World Bank argument for increasing user fees is that users should help to pay for the huge public investment in health, and that higher user fees are also necessary to help reducing the fiscal deficit. However, if by doing so, the vast majority of the population is excluded from the health service, what is the point of increasing public investment in the health system?

---

[10] As mentioned earlier, to qualify for the HIPC initiative the recipient country has to agree to use the ESAF and implement a classical stabilisation and structural adjustment program for three years.

[11] As mentioned earlier, to qualify for the HIPC initiative the recipient country has to have an ongoing ESAF agreement with the IMF.

Hence, in order to gain US$13 million from the HIPC initiative as it stands at the moment, Mozambique is likely to pay with more corruption, less tax revenues and a significantly more restrictive national health system.

The Arguments for Conditionality

The case for conditionality is put forward by creditors. There are two sets of arguments: those that argue for conditionality in generic terms, and those that argue for the specific conditionalities that are usually imposed with the IMF/World Bank programs.

There are three major arguments for generic conditionality. One states that if creditors give their money to debtors, it is only logical that creditors should be able to decide what their money is going to be used for. For example, often creditors claim that the governments they represent are accountable to their taxpayers and Parliaments for the use debtors make of their money. Another one states that conditionality attaches a cost to grants and soft loans, and thus imposes economic discipline on the debtor. Otherwise, the argument goes, recipient countries could waste the resources or their governments could embezzle creditors' money. A third argument, which encapsulates the two previous arguments, is based on a paternalistic view that creditors know better what is good for development than debtors do – after all, it is argued, haven't creditors developed and debtors not?

The argument for specific conditionalities imposed under IMF/World Bank programs is that countries that are allowed to benefit from ESAF and the HIPC initiative need to implement sound economic policies to help their economies to adjust and recover. Without such reforms, these economies would not be able to overcome the causes of their current indebtedness and economic instability.

More specifically, the argument for adopting stabilisation measures as the core policies of the programme is based on the assumption that the rate of growth and the income of debtor economies have to be reduced in order to reduce imports to sustainable levels. Therefore, the money supply should be restricted and the fiscal deficit should be reduced so that aggregate demand can be contracted. The argument for adopting structural adjustment measures, in addition to stabilisation, is that the economy should be helped to become more competitive by removing price, market and institution constraints that prevent the supply side of the economy to improve. Therefore, market and price liberalisation (including liberalisation of exchange rates and access to foreign exchange, financial liberalisation, and capital and goods markets liberalisation), privatisation of productive and social assets and public sector reform would enable agents and markets to develop, and the overall allocation of resources to become more efficient. Hence, the arguments for stabilisation and structural adjustment apparently address fundamental issues on the demand side (contraction of excessive aggregate demand) and on the supply side (promotion of market efficiency).

The Arguments against Conditionality

There are four sets of arguments against conditionality, namely the *efficiency* argument, the *moral* argument, the *political economy* argument and the *economic* argument.

Efficiency Argument

The efficiency argument is usually put forward by the right, and states that conditionality is a costly and inefficient way to impose sound economic policies on recipient countries. The argument is based on several points: that recipient countries have more information than creditors; organising monitoring is costly; that countries which adopt sound policies only because this is the price they have to pay for aid are less likely to ensure that such policies are successfully implemented; and that creditors that have committed themselves to helping a particular country are unlikely to withdraw their support if the recipient country defaults on policy implementation. Hence, the system through which creditors support all debtors irrespective of their economic performance, and attach conditionality to ensure that sound policies are implemented, should be replaced by a rather more efficient system in which creditors select the debtor countries to be supported on the base of their proven record with respect to economic performance. In other words, rather than trying to impose sound economic policies through conditionality, creditors should only support those countries that have already been implementing successfully sound economic policies of stabilisation and adjustment. It is clear, however, that the *efficiency* argument does not eliminate conditionality from the system, but only changes the way the same conditionality is implemented.

Moral and Political Economy Arguments

The *moral* and *political economy* arguments come often from the traditional left, the dependency school and international solidarity organisations. The *moral* argument states that it is immoral to attach any sort of conditionality to the realisation of basic human rights – no human should be enslaved by foreign debt, poverty, ignorance or sickness. Hence, no one has the right to attach a cost to poverty alleviation and debt cancellation. The commitment to eliminate poverty and debt should be unconditional. The *political economy* argument is that conditionality reflects power relationships and the profound inequalities that have been created in the world economy between the centre and periphery, creditors and debtors, large corporations and small countries, poor people and the power of the financial system. Hence, the conditionality imposed rather than reflecting sound economic policies, reflect the power of the creditors. They refused to expand their incomes and import more from debtor countries, they protect their domestic producers of primary producers, and then they impose policies that force the contraction of debtor countries' economies.

Economic Argument

The *economic* argument has two radically different sides to it. One is the argument from the right, that states that stabilisation and adjustment policies that form the base of the conditionality are too cumbersome and difficult to implement. The argument goes that states of HIP countries do not have the capacity to implement such huge set of reform policies, and slow reform tends to allow entrenched interests to adjust to and capture the reform process. Additionally, it argues, stabilisation is better achieved if the economies grow faster and export more, which in turn requires fast privatisation and liberalisation, along with state investment in human capital and infrastructures. Thus, it is argued, it is better to build a minimalist state that guarantees low taxes, security, order, fair rules and investment in human capital and in infrastructures, and simply does not interfere with trade, markets and private business decisions. This argument is not precisely against all forms of conditionality, but rather against the specific cumbersome IMF/World Bank type of programme focused on stabilisation.

The other comes from the left, and argues against conditionality in various different grounds. First, it would agree that economic policies reflect power relationships, irrespectively of being formulated within or outside a particular country. Therefore, the main issue is not whether policies are domestically based or imposed from abroad, but which forces, inside and outside national borders, determine which policies are adopted and implemented and which are not. For example, the fast process of privatisation in Mozambique was imposed through conditionality, but privatisation has been a process of negotiation between the government, domestic and foreign investors and IFIs. The liberalisation of exports of raw cashew nuts have been also imposed by the World Bank through conditionality, but has been well accepted by traders that control local cashew markets and have acquired a new source of rent, and rejected by industrialist that have lost their source of rent. The number one issue is which economic polices have a fair chance to be implemented and to succeed given the objective agents and linkages that operate in the economy.

Second, the classical policies of stabilisation and adjustment are those that minimise adjustment costs for international and domestic capital, but do not create new developemtn opportunities. These policies ensure that:

- (i) the cost of adjustment is paid by the debtor economy that has to contract to stabilise;
- (ii) wages are low to increase the profitability of capital in traditional sectors;
- (iii) producers of commodities in developed economies are protected against low wage economies;
- (iv) least developing countries find it more difficult to build skills, capabilities and experience to catch up with newly industrialising economies;
- (v) no coherent industrial policies are developed and implemented; and
- (vi) IFIs continue to subsidise exports and investment from developed economies to HIP countries through the various mechanisms of aid and conditionality.

As a result of this dynamics of capital accumulation, the narrow pattern of specialisation of productive capacities in the adjusting economy tends to be reinforced. Mozambique's experience supports this analysis, with the performance of Mozambique's manufacturing sector over the last five years providing a good example.[12] Between 1993 and 1997, manufacturing grew significantly faster than GDP, and as a result its share of GDP, and its contribution to GDP growth increased sharply. The share of manufacturing exports in total exports of goods was more than twice as high as the share of manufacturing in GDP, which could have been an indicator of increasing competitiveness of the Mozambican manufacturing industry.

However, a more detailed analysis of the data shows that these conclusions are highly misleading. Growth has been centred on three industries (food, beverages and tobacco, textiles, clothing and leather, and wood and cork), which are the largest employers of manufacturing workers, but have the three lowest average nominal wages in the manufacturing sector. One industry, food, beverages and tobacco, represents almost 62 per cent of total manufacturing output and 10 per cent of total GDP. Engineering industries (equipment, machinery, spare parts, electric equipment) and basic metals represent less than 5 per cent of total manufacturing output, which is similar to the contribution of sugar and less than the contribution of soft-drinks.

Four products, beer (17 per cent of total manufacturing output), wheat flour (12 per cent), soft-drinks (7 per cent) and sugar (4 per cent) represent 6.4 per cent of GDP, 40 per cent of total manufacturing output and 65 per cent of the output of the food and beverages industry. With the exception of sugar, the products that most contribute to manufacturing output growth are import based and produced by foreign owned firms.

Total manufacturing exports are less than exports of prawns and lobsters (US$ 82.5 million in 1997). Of the US$ 81 million worth of manufacturing exports, US$ 52 million (64 per cent) are due to four products: semi-processed, ginned cotton (US$ 21.5 million), sugar (US$ 12 million), wood and wood coal (US$ 9.5 million) and tobacco products (US$ 6.5 million). Whilst the exports of raw nuts and fruits (raw cashew nuts representing about 90 per cent of these) reached US$ 30 million in 1997, exports of processed fruits and nuts (including

---

[12] Data on the manufacturing industry is from INE (issues from 1985 to 1997).

processed cashew nuts) were less than US$ 120 thousand. On the whole, prawns and lobsters, unprocessed minerals and the above mentioned four products of the manufacturing industry represent 75 per cent of total exports of goods. The principal export products are resource-based, involve very little, if any, processing, and are produced by foreign owned firms.

As it was discussed earlier, the dynamics of capital accumulation in Mozambique, that has generated the narrow pattern of specialisation, is one of the chief causes of the debt crisis in Mozambique. It has not been changed so far; thus the programme of stabilisation and adjustment has not helped to change the conditions conducive to debt crisis.

A fourth point against conditionality argues that the stabilisation and adjustment programmes assume that by perfecting domestic markets operations, the Mozambican economy can shake off the crisis. There are two problems with this assumption. First, perfect markets are more difficult to build (if at all possible) than adequate, selective industrial policies. Second, the crisis of the Mozambican economy can only be understood in a wider regional and international context, and this context is completely forgotten in the design of stabilisation and adjustment policies.

Fifth, the IMF and World Bank are at least as likely to make gross mistakes as the Mozambican government, but are not accountable to Mozambique for its errors whilst the government is. For example, the World Bank decision to liberalise exports of raw cashew nuts has paralysed the cashew processing sector, increased unemployment, reinforced the market power of traders, not helped peasants to get better prices for raw cashew nuts and has helped to create some international market power for the Indian cashew processing industry.

Finally, the goals and measures imposed in the stabilisation and adjustment programs are not coherent with each other, and may aggravate structural problems of the economies of Mozambique and other HIP countries. Short-term stabilisation is not compatible with fast and sustained growth, and often one objective has to be sacrificed. Trade liberalisation and financial liberalisation may not be compatible with reducing current account and fiscal deficits, particularly when the domestic economy is not competitive and strong, access to foreign currency is liberalised and there is no coherent industrial policy in place. Exchange rate liberalisation is largely insufficient to promote and diversify exports, may not reduce imports, yet may increase import expenditure, and may help to avoid monetary and fiscal discipline.

CONCLUSIONS

This paper has argued that Mozambique and other HIP countries have little to gain from the HIPC initiative. The net gains from debt relief are insignificant, if the debt service after HIPC initiative is compared with what these countries have actually been paying. The arguments against total debt cancellation are significantly weaker than the arguments for total debt cancellation.

The paper has also discussed the issue of conditionality attached to the HIPC initiative, and argued that this is not efficient and that the type of conditionality is not conducive to economic change and development. The economic policies imposed through conditionality have not helped to address the main structural problems of the Mozambican economy, which are the chief domestic causes of the debt crisis. These policies have not addressed the issues that arise from the regional and international context of the HIP countries' problems. Hence, there is no evidence that conditionality will help HIP countries in the long run to escape the trap of debt and underdevelopment. Therefore, there is no economic rationale for attaching political conditionality to debt relief, and total debt cancellation should be unconditional.

REFERENCES

Action for Southern Africa (ACTSA). Mozambique's Apartheid Debt.

Castel-Branco, C.N.. 1994a. Problemas Estruturais do Desenvolvimento Agrário. in Castel-Branco, C.N. (editor). 1994. Moçambique, Perspectivas Económicas. UEM & FFE: Maputo.

Castel-Branco, C.N.. 1994b. Problemas Estruturais de Industrialização: a Indústria Transformadora. in Castel-Branco, C.N. (editor). 1994. Moçambique, Perspectivas Económicas. UEM & FFE: Maputo.

Gibson, H. and E. Tsakalotos. 1992. The International Debt Crisis: Causes, Consequences and Solutions. in Hewitt, T. H. Johnson and D. Wield (editors). 1992. Industrialisation and Development. Oxford University Press & The Open University:Oxford.

Economist. 1998. Figures to Fret About (July 11: pp. 104).

Government of Mozambique, World Bank and IMF. Policy Framework Paper (1996-98 and 1997-99).

Instituto Nacional de Estatística (INE). Anuário Estatístico (issues from 1985 to 1997).

Killick, T. 1995. IMF Programmes in Developing Countries. Routledge:London and New York.

Mosley,P., J. Harrigan and J. Toye (editors). 1995. Aid and Power, The World Bank and Policy-Based Lending (second edition, volume I). Routledge:London and New York.

Mozambican Debt Group. 1998. Creditors Positions.

Mozambican Debt Group. 1999. The Need to reform the Current HIPC Initiative: Contribution to the 1999 HIPC initiative review process – phase I.

Tarp. F. 1993. Stabilisation and Structural Adjustment. Routledge:London and New York.

Varian, H.R. (1990). Intermediate Microeconomics (second edition). W.W. Norton and Company: New York and London.