Workshop on
"Influence of economic policy for recovery and reconstruction on state-building in countries emerging from war"

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THOUGHTS ABOUT THE MOZAMBICAN CASE

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Introduction

Over the last 34 years of its history (from the end of colonialism), Mozambique has gone through several radically different transitions: from colonial-capitalism under a fascist regime to independence towards a model of collective and popular socialism (1974-1976), which was quickly replaced by a more bureaucratic and centralized model of state socialism along the lines of to the so-called Soviet state socialism of the time (1977-1982); from state-focused socialism to the reforms of the mid-1980s, were a type of perestroika was adopted in face of the crisis of the state-focused model (1983-1985); from the short-lived perestroika to a more comprehensive program of economic stabilization and structural adjustment under the aegis of the World Bank and the IMF, in the late 1980s, when the Program of Economic Rehabilitation (PRE) was introduced (1987-1990); from PRE to a more complete program in line with orthodox neo-liberal capitalism, introduced together with the end of the war (1992) and the emergence of a multiparty system (1990); from this orthodox and socially insensitive neo-liberalism to the post-HIPC, apparently more humane form of neo-liberal economics aimed at tackling global poverty. Mozambique might be starting another transition, aiming at replacing an essentially subservient, corrupt, inept and unproductive national capitalist group by a more aggressive, assertive and pro-active one, extremely ambitious politically and economically. This new nationalist capitalist dynamics is built along the lines of *black economic empowerment* and its economic power is based upon private appropriation and control of national resources (land, water, minerals) that, by constitutionally established rights, are the property of the state on behalf of the people.

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The transitions and half and full turns in the Mozambican recent economic history were contemporaneous with crucial transitions and changes in the regional and world political and economic contexts: the liberation of Zimbabwe from minority, white rule (1980), the liberation of Namibia from apartheid South African rule (1991) and the end of the apartheid in South Africa (1992-1994). Without these changes at regional level, the war in Mozambique may not have stopped (as the apartheid regime in South Africa was its major cause) nor would the full neo-liberal economic program been introduced. The end of the Cold War (late 1980s, early 1990s) also contributed to create the space for a hegemonic economic paradigm to dominate the direction and the economic policy of transition – towards a neo-liberal model of capitalism. These changes affected not only Mozambique but also the entire Southern African region. For example, SADC, which was created following the end of apartheid in South Africa and replaced SADCC, quickly moved away from its goal of emancipating cooperation and integration to a neo-liberal approach of integration by market liberalization.

Together with all these changes, several pro-poor and pro-Africa programs have been developed by the Western capitalist World: the Millennium Development Goals (MDG), the Millennium Challenge Account (MCA), the New Economic Partnership for African Development (NEPAD), the UN (and Jeffrey Sachs) Millennium Villages project, the Africa Commission Report (the UK initiative), the Chirac initiative, several preferential trade arrangements (AGOA, EBA, EPA, SADC common market, South African trade arrangements with India, China, the USA, the European Union, Brazil, the sugar protocol…) the energy driven (including bio-fuels) new scramble for Africa, the Chinese expansion, and so on. It seems that everybody else in the rest of the World has something to say about Africa and, interestingly, changes in tune between different initiatives are not enough to mask the basic neo-liberal paradigm that underlies all of them.

Any of these numerous transitions involved conflict (sometimes war), crisis, state building, recovery, reconstruction, and so on. To understand the full extent and dynamics of each of these transitions, one would need to understand the whole, because the picture is complex and deep rooted in a dynamic history. This, however, would require a large book and a whole workshop solely dedicated to Mozambique, rather than a short paper and a various country case-study based workshop.

A compromise could be achieved by focusing on one of the major transitions and borrowing some information from other periods and processes without studying them in depth. Given that future developments will be drawn from current dynamics, the focus of this study is on the last of the major transitions – the full implementation of the neo-liberal model of capitalism and of its apparently more humane version focused on poverty reduction.

This paper is developed in three further sections. The first discusses some of the concepts involved in the theme of the workshop, *the influence of economic policy for recovery and reconstruction on state-building in countries emerging from war.* The second develops a brief history of economic policy and state building since 1987. The third analysis some lasting impacts of economic policy on the state, and further implications for economic policy.

This is an unfinished paper that mostly aims at starting some discussion and benefit from such a discussion.

Notes about concepts

Before engaging in the discussion of the Mozambican case, it is necessary to critically discuss the concepts that underline the theme of this workshop.

First, to discuss "economic policy for recovery", one needs to ask what the economy (or society at large) is recovering from. If it is recovering from a short term or longer term and structural problem, from a random and exogenous shock or a shock whose impact depends on longer term and structural dynamics, from an essentially economic problem or from one that is fundamentally of political and social nature, from a conflict that is violent and destructive or one whose violence does not involve war and bloodshed, from "economic policies for recovery" that have gone badly wrong?

It is not always clear what the recovery is from. For example, what does a balance of payment crisis show? The result of a short-term oil price shock, an institutional problem associated with misaligned or inadequate policies, a structural and dynamic problem created by narrow economic specialization, a domestic problem related to all of the above or an international one related to the dynamics of international goods, factors and financial markets? The interpretation of the problem the economy is recovering from is, thus, a key element of conflict about the nature and direction of recovery and of the related economic policies.

Moreover, one needs to clarify what "recovery" means. Often, "recovery" refers to processes by which the economy approaches a "normal" condition, meaning from "recovering" of previous levels of economic activity (for example, the level and rate of growth of GDP and related indicators – consumption, investment, exports and imports, per capita GDP) to "reestablishment" of "normal" institutions for economic growth (for example, liberalization of goods, factors and capital markets,

deregulation, allocation and protection of property rights, etc.). This "normal" condition is explicitly or implicitly seen as the platform future stages of development may start from. Thus, "recovery" is a pre-condition stage for future economic development in societies emerging from some sort of crisis.

This lead to another issue, namely that "recovery" requires direction that needs to be given by the direction of development. Development options, opportunities, patterns and directions are not neutral with respect to the "platform" that is set during the "recovery period". There is no such a thing as "recovery to the past", and "recovery to the future" requires that "recovery" is just an organic part of the longer term path of economic development.

Thus, the debate and social conflict about "recovery" are about the nature of the problem(s) to recover from, the meaning and goal of recovery and the options, directions and patterns of development that "recovery" is implicitly or explicitly part of. The idea that "development" follows "recovery" makes no economic sense.

The same debate applies to "reconstruction".

Second, to discuss the influence of economic policy on state-building, one needs to clarify what state-building is, what the relationship between state-building and economic policy is, and where economic policy comes from. If state building is a continuous process of transformation of the social and political nature and capacities of the state and public policy, associated with social, political and economic conflict for change, then state building and economic policy are inseparable endogenous dynamics, drawn from and shaped by the relationships between social forces, interest groups and conflicting development options.

Third, to discuss "recovery, reconstruction and state-building" in countries "that are emerging from war", one needs to be more specific about the historical, social and political meaning of "emerging from war": which war, the nature of the war, the meaning of "emerging".

In the end, this debate is only a small part of a wider debate on the political economy of economic policy of social transition and change, which provide the framework to understand economic policy and its relationship with the state and social conflict.

> *The wider institutional dynamics which are part of this process are, for better or for worse, the product of social and political actions, and link changes in international forces to the context of domestic political economy.* (Bairoch and Kozul-Wright 1996, pp. 26).[2]

Brief history of economic policy change and state transformation since 1987

The PRE (1987-1990)

The first economic stabilization and structural adjustment program (SAP) to be introduced under the aegis of the Bretton Woods institutions in Mozambique started, formally, in January 1987. This program aimed to achieve four major goals.

First, ***to halt the sharp economic decline*** that Mozambique was facing at the time. Between 1981 and 1986, GDP had fallen by one third, exports had fallen by more than one half, basic consumer goods were rationed and shortages of fuels, raw materials, spare parts and other equipments and inputs were felt across all sectors of the economy, forcing firms to work, on average, at 20% of installed capacity. Firms started to borrow to pay salaries and wages, the state deficit was increasing and the country was unable to serve its external debt.

To halt this decline, a series of measures, of monetarist nature, were adopted, namely: sharp depreciation of the currency (to balance the Balance of Payments), sharp increase in domestic interest rates (to control money supply and inflation), fiscal reform aimed at increasing tax revenue preferably from indirect taxes (taxes on consumption), a full revision of price and firms subsidies and of government expenditure on social sectors (health, education…) to reduce government expenditure.

As expected, outside the monetarist group, these measures were not particularly effective. For example, to halt the decline in production and trade the economy needed massive imports of raw materials, fuels, equipment and spare parts before it could re-start exporting. However, the devaluation of the currency, which was aimed at reducing imports and promoting the profitability of exports, would be effective only if the economy could find close substitutes for imported productive capacity, which was not the case. The sharp increase in interest rates made capital more expensive, which had a huge impact on the ability of firms to invest and modernize to be become competitive particularly in a

[2] Bairoch, P. and R. Kozul-Wright. 1996. Globalization myths: some historical reflections on integration, industrialization and growth in the World economy. UNCTAD discussion paper 113 (March).

situation where equipment and technology of the vast majority of the firms was completely obsolete. The focus on reduction, rather than changing, public expenditure prevented the state to play a more proactive role in promoting strategic recovery and modernization of productive capacity and dynamic linkages.

Thus, although there is no doubt that structural measures were required to tackle economic crisis, the option for monetarist structural measures led to a situation in which stabilization acted against structural change and recovery, and the resulting depressing effects had to be tackled by scaling up foreign aid. The basic foundations of aid dependency had been created.

Second, ***to start the rehabilitation (or recovery) of economic activity at sector level***. Each sector was asked to evaluate its priorities and needs for external financing and for privatization. Priorities were set with clear economic goals in mind: contribution to tax revenue, exports, import substitution, crucial linkages with other sectors and employment. For example, some of the priority industries identified at the time were beer and tobacco (because of fiscal revenue), textiles and clothing (because of exports and employment), metal engineering, rubber (tyres) and some basic consumer goods (because of linkages with transports, rural production and trade and, therefore, import substitution). The idea was to mobilize the necessary finance for investment and working capital to enable firms to re-start production and increase capacity utilization through an injection of foreign exchange that was to come from the Bretton Woods institutions, donors and privatization (total or partial) of large plants and factories. The systems of price and wage and salary definition were changed to introduce productivity related incentives, prior to full liberalization at a later stage.

Although overall economic priorities for sectors (exports, tax revenue, employment and linkages and import substitution) were clear, there was no attempt to address the basic structural weaknesses of the industries. Given that foreign exchange was increasingly made available to re-finance growth and recovery, there was no serious effort to utilize the momentum of recovery to address the need for structural change. Hence, when the first SAP ended and before the second started (two years later), most of the production and trade gains of the late 1980s were lost at the same time that the external debt stock of the economy had almost doubled.

Hence, the stabilization and the recovery goals were in conflict with each other.

Third, ***to restore (or recover) production and trade in the rural areas***. This was an interesting goal. On the one hand, it provided a concrete goal to articulate public and private economic activity. For example, there was a sharp increase in the assembly of trucks, manufacturing of tyres, production of

tools and equipments for agriculture and of some basic consumer goods of high demand in rural areas, as they were crucial in order to achieve this goal. On the other hand, it was an attempt at promoting economic recovery with a broad social, regional and resource base.

However, this was a goal adopted in the midst of the war, which was concentrated in the rural areas and on systems of transports and communication, thus preventing the goal from being achieved. As a result, firms that were most successful at producing for rural production and trade (transports, tyres, agricultural equipments, etc.) were also the ones that witnessed their unsold stocks of final products increasing and debts mounting. Some of them managed to successfully export to the region, at least in the short run, others failed to do so and were back in trouble.

Fourth, ***to promote the role of private sector and attract private financial accumulation, by traders, to the realm of productive investment.*** This goal was to e achieved through privatization of public owned and public managed companies, thus offering traders the possibility of spending their accumulated speculative finances in industry and agriculture. Privatization also aimed at attracting foreign direct investment and, above all, at transferring property and economic power away from the state and into private hands. Finally, privatization was also geared towards contributing to fiscal balance by generating revenue from sales and from long term fiscal gains due to expected efficiency gains of private firms, and by reducing subsidy costs.

However, the depressing effects of stabilization, the risk of having a recovery with no clear strategy for sustainability, the continuation of the war and the lack of interest of traders for industry (as trade continued to face lower sunk costs and higher and faster returns than elsewhere in the economy) prevented the massive privatization program (that later led to more than one thousand firms being privatised) from achieving their broader recovery goals, with a few exceptions of oligopolistic industries taken by large foreign investors (such as, for example, beer and beverages and sugar). In the end, transfers of property and power were the only major goals that were generally achieved with privatization.

During this period, the state was still a major player in all fronts of economic policy: many firms were still in state hands, economic and investment strategy beyond the provision of infra-structures and human capital was still largely a state matter, and government was still performing a role, although limited, in direct resource allocation to firms. However, the state role had started to change away from conceptualization of the major economic framework (which was being taken by the Bretton Woods

institutions) to focus more on organization and implementation of the overall economic framework. The agenda of reform was still in the hands of the state but the tides were beginning to change.

The fuller economic reform program (1992-1998)

Between 1990 and 1992, while the government of Mozambique (GoM) and the Bretton Woods group negotiated another agreement, a few other crucial processes were also taking place: the multiparty system was introduced in Mozambique at the same time that the Cold War came to an end; the peace was negotiated and won at the same time that the apartheid regime was defeated and Namibia gained independence; the Mozambican economy stalled and went back into downfall because foreign exchange flows had stopped during the negotiation period.

In 1992, a new program was in place. This time around, the focus of the program was more orthodox – strengthening stabilization measures with focus on the liberalization of the exchange rate and of the interest rates and on tackling the fiscal deficit by controlling expenditure; acceleration of the privatization and liberalization programs; implementation of tougher conditionality and controls on GoM activity. Economic policy goals started to be focused on processes and means – stability, privatization, liberalization – rather than on more fundamental and articulated goals linked to development. Hence, evaluation of success moved from development impact to processes and means.

This is the period when hundreds of large and small firms were privatized; when the entire banking system was profoundly restructured and privatized in less than one year; the liberalization of exports of raw cashew, which finished the industry and led to thousands of job losses, was accomplished; foreign investment started timidly to arrive; most markets and prices were liberalized.

This is also the period when it was acknowledged that the program of economic reform produced undesirable side effects, namely a disproportional negative impact on the poorer groups of society as a result of the restriction on government social policy. Thus, a social network program, means targeted, was introduced with minor, if any, effects.

The end of the war also brought about some major challenges, namely the need to demobilize and reintegrate more than a hundred thousand soldiers and the return, from displacement, of hundreds of thousands of peasant families. Thus, the period 1992-1996, a package of special programs was introduced to deal with these challenges.

A massive UN led peace keeping program was also introduced with thousand of UN soldiers and officials arriving to take charge of basic functions of the state namely in defense and security, law and order, and some areas of the administration.

Hence, the combined effect of the Bretton Woods driven economic policy and the UN driven peace administration, from 1992 to 1995-96, led to the fundamental dismissal of the Mozambican state. Interestingly, the fundamental economic policy program was not deeply linked with the peace effort and challenges, as stabilization, liberalization and privatization were goals in themselves to be pursued irrespectively of such political issues as peace keeping. These political issues were to be dealt with by the UN and its special programs and peace keeping force.

Three examples can demonstrate the insensitivity of the economic program relative to the political situation of that time. Firstly, the liberalization of the cashew industry, which led to the loss of more than ten thousand jobs, affected mostly the coastal rural areas of the North of the country, were tension during the war was huge. Secondly, the attempted (and failed) liberalization of the sugar industry would have driven twenty thousand workers into unemployment in the Central regions of Sofala and Zambezia and rural areas of Maputo, were the impacts of the war had been stronger. Thirdly, the IMF was ready to declare Mozambique off track in 1995 (one year after the first multiparty elections were held and only three years after the war had finished) because the GoM failed to comply with tough monetary targets (growth of money supply) and, subsequently, with inflation targets. This would have implied an interruption of fundamental external economic assistance for two years, which could have led Mozambique into economic, social and political collapse. It was the intervention of other donors, together with the GoM acceptance of even tougher conditionality targets for the future, which convinced the IMF to stop its planned withdrawal from Mozambique.

At the end of this period, the GoM was facing a deep crisis of identity – it had almost no power, beyond the organization and implementation of decisions made by Bretton Woods institutions or the UN and had lost the control over the direction of change. The GoM became a follower of economic tides. Almost all donors could decide about future directions of reform in the most unarticulated fashion, as donors were highly disarticulated amongst themselves and pursued different agendas.

External debt was also increasing out of control and ten years after the first comprehensive economic reforms were introduced, the Mozambican economy was still insolvent and incapable of serving its debt. The resources that were being poured into the economy were adding to the debt trap, and annual

negotiations of debt re-scheduling were not improving the situation as arrears were accumulating and the debt stock was acquiring a momentum by itself.

HIPC and the poverty reduction program

The acknowledgement of the weight of the debt trap on economic options led to the Highly Indebted Poor Country initiative, HIPC. This initiative aimed at reducing the debt stock to a level consistent with a debt service that was sustainable from a fiscal point of view. This was to be achieved by cancelling a large share of the debt stock. The fiscal gains accruing to the recipient country from debt cancellation were to be invested in social sectors, thought to be the key to unlocking a global poverty reduction momentum.

To qualify for significant debt reduction under HIPC, countries had to produce a poverty reduction strategy (PRS), which was to be formalized in to a poverty reduction strategy paper (PRSP) of a certain format. The PRSP framework reflected the monetarist and neo-liberal approach of the Bretton Woods institutions, supported by the views of the G-8. It gave priority to macroeconomic stabilization, enhancing the environment for private sector development (mainly, in terms of liberalization, privatization, deregulation and provision of infra-structure), and set particular targets for the share of public expenditure on education, health, water and sanitation, social infra-structure and good governance (defined as democratization, decentralization, justice system and anti-corruption). Hence, the economic and political framework of the PRSP was defined from the outset as a blueprint for poverty reduction across the globe, irrespectively of the underlying cause, dynamics and nature of poverty.

HIPC I did not produce the expected new resource gains, because it only reduced the debt stock to a level consistent with what each poor indebted country was already paying. HIPC II pushed debt reduction further but failed to achieve the Jubilee 2000 goal of full debt cancellation.

The most important point, however, is that the momentum had been created to globalize a vision and version of poverty reduction that has the following characteristics:

- It takes economics and politics away from poverty analysis, which is then reduced to measuring poverty. As a result, a large and sophisticated literature has emerged that thrives on academic debate and desire to produce the ultimate technique of measurement, without much of a

concern to understanding poverty within the context of the dynamics of economic and social development;

- As a result, poverty reduction, defined within the measurement parameters adopted, becomes a parallel goal treated outside the patterns of economic and social development…
- …although progressive, structuralist approaches tend to evaluate whether growth patterns are conducive to poverty reduction by looking at how it deal with small and medium scale firms, employment creation and the focus on rural poverty and gender;
- There are a lot of myths associated with the various different models of poverty reduction:
    - Monetarist concepts that the ultimate weapon against poverty is macroeconomic stability and control of inflation;
    - Neo-liberal approaches that focus on market failure and on what they call individual and social capital (this is, individual failure);
    - Orthodox growth *cum* poverty reduction approaches that argue around the hypothesis of trickle down effects from wealth concentration for poverty reduction via investment and employment creation;
    - Orthodox and heterodox approaches, alike, which suggest that agricultural and rural development, basic primary education, small farms and gender and child sensitive income distribution are the keys for reducing poverty.
- …none of which makes any sense outside specific historical, social and economic contexts.

A series of international programs, like the MDGs and the MVPs, were developed along these lines. Poverty reduction became a function of government activity for tackling the most obvious effects and symptoms of poverty, and such activity is heavily dependent on external assistance.

Thus, economic and social programs became dualistic. On the one hand, there is the growth component of the program: large project, investment incentives, mobilization of foreign direct investment (FDI), and so forth, without any concern with the pattern of growth, distribution and development. On the other hand, there is the poverty component of the program: small scale, family or individually based, rural, also without much concern for the patterns of growth, distribution and development.

Another implication is that poverty reduction becomes a matter for the realm of aid financed public expenditure, whereas investment and growth thought to be are driven by market forces. In a way, the government performs the role of freeing capitalist accumulation from social responsibility and from the social costs of labor reproduction. Extremely generous tax incentives for large foreign investment is just one example of the type of policy that can only be adopted and maintained if the host government is heavily financed by external assistance to perform its role in "poverty reduction".

Not surprisingly, this approach to poverty and public policy creates its opposite, the argument that instead o focusing on poverty reduction economic policy should focus on wealth creation. Once again, there is no analysis of wealth creation and distribution patterns and how they link with inequality and poverty.

Dependency, economic policy and the state

At this point, a few conclusions can be made about dependency, economic policy and the state.

First, aid dependency is not only related to economic and financial weaknesses – fiscal gap, foreign exchange gap, technical capacity gap, and so on. Dependency is mostly driven by the economic policy model adopted, which leads to a conflict between stabilization and recovery and development, and a dichotomy between growth and investment and poverty reduction. These conflicts are solved by massive external assistance. Over time, aid dependency becomes inbuilt as an essential component of the model and patterns of growth and development and of economic policy and state activity, and an essential factor for the survival of the state.

Second, aid dependency is associated with policy and other institutional conditionality. Generally, conditionality is focused on processes and means that, under the assumptions of a given model of development, are expected to yield some outputs: macroeconomic stability, balanced growth, poverty reduction, etc. Conditionality is focused on processes and means for two major reasons. On the one hand, because of the principal-agent problem (under separation of ownership and control and asymmetric information), donor agencies find it easier to control the course of action of the recipient than to link the course of action with some evaluation of the final social impact. It is easier to check whether the recipient government privatized firms or devalued the exchange rate than it is to attribute positive or negative social impacts to specific economic policies. On the other hand, by controlling the

process and means donor agencies exert a closer control over the type of state, economic policy and options that are developed.

Hence, conditionality becomes a tool to promote a certain type of capitalism, state and economic policy and, in doing so, affects the options, directions and opportunities for development.

Furthermore, conditionality contributes to structure social and class relations and their relative influence upon economic policy and the state. In a context of conflict over development options, representing a conflict between different social positions, the options that are more likely to succeed are those that can also be articulated in alliance with external pressure.

Third, aid dependency and policy conditionality help government and national *elites* to justify economic policy options without having to openly assume social and political responsibility for them. It means that even when the state and national *elite* groups benefit from and are interested in the policies that form part of the conditionality, they can always say that these policies have been imposed from abroad and, given aid dependency, there is no alternative. Hence, conditionality plays a role in *ownership* because it helps to solve domestic social conflict over development options and directions (this is, conditionality helps to define the social basis of *ownership*). Furthermore, conditionality helps to protect economic policy options once they have been made.

It follows that *conditionality*, *ownership* and *voluntary reform* are only different parts of the same process, rather than alternatives to each other. If one looks at the aid negotiation process as a continuum, with different rounds of negotiation, it is possible to observe that:

- Adoption of the policy conditionality guarantees flows of resources;
- Some of the economic policies that form part of the conditionality package are supported and desired by domestic interest groups. Hence, these conditionalities help to solve domestic conflict related to options and protect the options that have been adopted and the groups that have adopted them;
- Recipients learn the policies that are needed for the aid flow to continue and I the next round of negotiation they volunteer to adopt and implement the required reforms.

Fourth, success under aid dependency is generally narrowed down to the degree of implementation of policies, rather than to the social and economic impact of such policies. Demonstration of success is important for various reasons:

- To promote the goodness of the options, models and economic policies in place;
- To help fight resistance;
- And to protect the state and other interest groups that eventually support the options and policies in question.

Fifth, under these circumstances, state accountability and the economic policy analysis and debate are more likely to be linked with and aligned around donor agencies. Moreover, actual policy space is likely to be small not only because of donor interference but also because of the limited options created by the cumulative effects of external assistance based policies and by the limited and narrow interests of emerging national *elites.*

Sixth, state capacities are also shaped in a biased manner by this process. One the one hand, over time most of the qualified and top civil servants are educated and trained within the framework of orthodox economics. On the other hand, tacit knowledge develops only in the areas of activity (economic stabilization, finance management, procurement) and not around heterodox economics, structuralist policy analysis and development, etc.

In a recent evaluation of the aid process in Mozambique undertaken by the OECD/DAC, the consultant was claiming that the Mozambican government lacked capacity in procurement and finance management. During the debate, someone argue that the most important problem was that the Mozambican government lacked capacity in policy analysis and development and policy impact analysis and cost-effectiveness. The OECD/DAC consultant, a Mozambican, replied that although this was true, this was a minor problem because the World Bank and the IMF could provide the policy analysis, whereas the government needed to develop its implementation capacity.

Seventh, donor agencies are not autonomous and insulated from the domestic interest in the host country. They may use those interests for negotiation but in the end they need to take them into consideration.

For example, recently in Mozambique GoM, donors and domestic economic *elites* were faced with an unprecedented level of revolt by urban working classes because of ever increasing living cost and depreciation of wage purchasing power. The basic question was that if Mozambique is such a great example of economic success, why that is the purchasing power of average citizens is falling while social islands of concentrated wealth float amid the sea of poverty? Interestingly, the street

demonstrations, that lasted for a few weeks and reached several cities and provinces of Mozambique, started the day after the departure of the President of the World Bank who, during his short visit to Mozambique, declared this as one of the most impressive stories of economic of recent economic success.

The GoM and donors had to find answers for the demonstrations and accepted that a certain level of subsidies for basic goods is inevitable and unavoidable. At the same time, they also started to look more seriously at public goods as social policy (such as in the case of public urban and inert-urban transport). Furthermore, for the first time they were forced to acknowledge that the focus on rural poverty has driven the analysis away from urban poverty and their dynamic linkages with the rural areas. Finally, an explicit link has started to be made between fiscal revenue and the scope of public policy, such that tradeoffs between tax incentives for FDI projects and public provision of basic goods and services have started to be analyzed. All of these are departures from orthodox and common approaches in Mozambique. Thus, it is possible to exert influence upon economic policy, the state and donors as long as political activity

On the other hand, the new capitalist groups have started an offensive of their own in order to influence future directions in allocation of aid. They are claiming that in order to tackle the problem of social insatisfaction and arrest, aid should be reallocated to directly support small and medium enterprises (which are owned by these groups) and law and order (to protect the property of these groups). These, they claim, would reduce poverty through trickle-down effects. These claims are starting to resonate with some politicians, government officials and donors.