Central Banking in Africa: The Case of the Bank of Mozambique. 1975-2010

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Abstract

The history of financial institutions in decolonising countries and newly independent states, especially in Africa, shows the political contentious nature of control over financial institutions, especially the central bank. This article investigates the particular circumstances around the emergence of a central bank in Mozambique: how local conditions influenced the shaping of new financial institutions in Mozambique. The question is: How did an independent central bank emerge in Mozambique after independence? The article explains the impact of the metropolitan identity of Portuguese financial institutions in Mozambique, the political economy of the new political leadership and finally the formation of a central bank

Key words: Mozambique, Post-colonial, central bank, FRELIMO, *Banco de Moçambique,*

Introduction

Mozambique was under Portuguese control for a period of almost five hundred years since Vasco da Gama called on the East Coast of Africa in 1498 on his way to India. Mozambique was subjected to direct Portuguese administration enforcing political segregation and the extraction of human resources for the purposes of labour for a settler economy. European settlers were encouraged to settle in the colony, where the Portuguese state introduced policies of racial discrimination in economic and social activities (Wuyts, 1989; Meneses, 2010). A growing settler population made it possible for Portugal to develop local industries and commercial activity. The traditional subsistence production in agriculture continued undisturbed in the southern regions. In the northern region the colonial authority encouraged intensive export crop production. The colonial authority exported 'surplus' labour to mines in South Africa, southern Rhodesia and to large commercial agricultural plantations in Nyasaland, Tanganyika and the island of Sao Tome (Wuyts, 1989; Hedges, 1993). Through the development of infrastructure, Mozambique was gradually integrated into the world economy. The ports of Lourenco Marques and Beira linked Umtali in Southern Rhodesia since 1897 and Nyasaland since 1922. With railway lines connecting the northern and southern regions of Mozambique, the export of labour to neighbouring countries' mines and plantations, Mozambican peasants were integrated into a monetary economy. The Portuguese authority used forced labour *(chibalo*), the hut tax system and the payment of labour rent (*mussoco*) to increase the production of export crops (Wuyts, 1989; Hedges, 1993).

The Portuguese state resorted to chartered companies from Britain, France and Germany, to address the high cost to maintain a colonial administration by effectively giving those companies "indirect rule" over two thirds of Mozambique since 1821. One such company was *Companhia Sociedade Madal*, and also *Companhia do Niassa*, which administered part of the territory up to 1904. The transfer of administrative rights to chartered companies was the result of the Berlin Conference in 1885 mandating effective territorial control and occupation to secure colonial control (Manuel, 2012). Portugal did not undertake administrative, military or monetary control for its colonies, but allowed the companies to exercise authority. Portugal received the revenue from export crops and seasonal labour from the chartered companies (Wuyts, 1989). Agriculture was organised on large agricultural estates, *prazos*. In the Zambezi Valley the *Prazo da Coroa* was land ceded to Portuguese settlers by the Portuguese monarch for the purposes of agricultural production. The settlers charged taxes on behalf of the Portuguese government. The *prazos* system proved an effective mechanism of land control and cultivation also in the southern province of Gaza, in Inhambane and Maputo, as well as in the northern most province in Nampula (Pateguana, 2016; Hedges, 1993; Wuyts, 1989).

Financial organisation in the colony

In 1864 the *Banco Nacional Ultramarino*, a private bank, was established with the exclusive right to issue, tender and to explore the colonial financial market. In 1877 the bank was introduced in Mozambique. This private bank issued the escudos that circulated in the colonies, (convertible in Portugal), except in Angola where it was replaced by Banco de Angola in 1926 with the same functions. These banks (*Banco Nacional Ultramarino* and *Banco de Angola*) formulated and implemented colonial monetary policies. The banks provided the financial mechanisms for asset and capital transfer for the Portuguese colonies. The *Banco Nacional Ultramarino* was the only Portuguese commercial bank in Mozambique, except for the expatriate banks, Standard Bank and Barclays Bank until the emergence of the new banks at the beginning of the 1960's. The *Banco Nacional Ultramarino* was the main investor in the Mozambican economy. The bank was a shareholder in several companies such as the *Colonial Buzi Company, SOCAJU, CUF, Matola Cement Company*, the *Vinicola* de Mozambique, in the insurance industry, the *Companhia de Seguros Lusitana* and *Companhia Nautilus*, in the sugar industry and the *Açucareira de Moçambique.* The Bank also established the FIUL for housing finance.

The coup d'état on 28 May 1926 put Antonio de Oliveira Salazar in power in Portugal. He introduced a policy of "economic and political nationalism" (1930-1960). The 1930 Colonial Act introduced financial and economic reforms facilitating direct Portuguese control over the territories. The chartered companies' territorial authority reverted to the control of Portuguese state. The new economic nationalism promoted the integration of Mozambique into the Portuguese economy, in particular through the "industrial constraint policy" protecting colonial industrial development from local competition. This policy required colonial production of raw materials for Portuguese industrial development. Primary products sourced from the colonies included cotton, rice, sugar, tobacco, tea and oil.

In 1928 Portugal entered a bilateral agreement with South Africa for the provision of labour to South African mines up to the parallel 22nd from Lourenco Marques to south of the Save River in Sofala province. The *quid pro quo* was that South Africa received the right to use of Lourenco

Marques port. A percentage of miners' wages was credited in gold to Portugal, which then paid miners in escudos - the "deferred payment system" - an important source of foreign exchange to Portugal (Pateguana, 2016, P.44). Portugal promoted immigration after the Second World War to secure her right over the colony. This stimulated economic activity, in particular in agriculture, tourism, transport trade and light industry, and those sectors stimulated the establishment of banks. The Decree-law 45296 of 8 October 1963 introduced the first regulation of banking operations in Mozambique (Wuyts, 1989). Portuguese oligopolies operating in foreign trade, such as the *Borges & Irmãos* group, opened the *Banco de Credito Comercial e Industrial (BCCI)* in 1965. The Champalimaud group opened the Banco Pinto e Sotto Mayor – *BPSM, the Banco Standard Totta de Moçambique – BSTM*, both opened in 1966. The last bank BSTM was the successor of Standard Bank. BSTM formed a joint venture with the Portuguese *Companhia Uniao Fabril* – CUF, the Anglo-American corporation from South Africa and the local Portuguese settlers. In August 1971, the *Banco Comercial de Angola* replace Barclays Bank and was a joint venture between Barclays Bank and *Banco Portugues do Atlantico*. Three state banks were established to finance housing and social projects, agriculture and development plans. These were the *Caixa Económica de Montepio de Moçambique, Instituto de Credito de Moçambique* and *Banco de Fomento*, respectively (Wuyts, 1989, Pateguana, 2016).

The consolidation by Salazar of colonial control stirred nationalist indigenous opposition to colonialism. From the mid-1950's many former African colonies became independent. This inspired the mobilisation against Portuguese rule. This protracted liberation struggles between 1961 and 1974 devastated the economy. In 1962, *FRELIMO*, the *Frente de Libertação de Moçambique* was established to force the Portuguese hand for decolonisation.

The Lusaka Accord: Clause 16.

In September 1974 Frelimo and the Portuguese government signed the Lusaka Agreement, preparing for a ceasefire and national independence in 1975. After the military coup of General Spinola on 25 April 1974, the Portuguese attitude towards its colonies changed. The casualties were extensive: more than 27 000 Portuguese soldiers and 6 500 Frelimo guerrillas died (Lloyd-Jones & Costa Pinto, 2003). The new military junta realised the futility of the war and agreed to sign the Lusaka Accord, which confirmed the independence of Mozambique on 25 June 1975. The date 25 June was of symbolic significance to Frelimo, being the date the organisation was established in 1962.

The Lusaka accord contained an outline of the structure of the financial system of the new independent state. For the liberation movement political and economic independence was inseparable. For Frelimo control by the new state over its financial system was non-negotiable. *Banco Ultramarino* would no longer control the financial system in Mozambique. The Lusaka Accord made specific provision for the withdrawal of BNU's mandate and the establishment of a new central bank for Mozambique. This bank, was named *Banco de Moçambique (BM)*. Oscar Monteiro, who proposed clause 16 in the Lusaka Accord (which established the need for a central bank) envisaged a new central bank performing the functions of the former *Banco Nacional Ultramarino* (BNU) in the economy. Real independence was conditional on the termination of BNU's mandate. BNU had control over 70% of the economy. Clause 16 of the Lusaka Accord therefore confirmed the Portuguese government's commitment to the transfer of BNU assets and liabilities to constitute the new *Banco de Moçambique*. That would allow the new country to reformulate its own monetary and financial policies, as an imperative for national independence (Monteiro, 2012). *BM* replaced BNU, taking over all its functions, namely commercial bank functions and protecting the national economy (Pateguana, 2016).

Since the 1920's international agreement existed on the importance of central banks for newly independent states. At international conferences in Brussels in 1920 and Genoa in 1922 it was agreed that newly independent countries should establish central banks upon achieving independence in order to restore and maintain monetary and financial stability. Such new central banks could benefit from international cooperation and support. The government of newly independent Mozambique acted in accordance with this international precedent when establishing *Banco de Moçambique* in 1975.

The Portuguese Council of Ministers chaired by the Prime Minister, Vasco Goncalves, nationalised the issuing banks operating in the colonies on 27 August 1974. The *Banco de Portugal, Banco de Angola* and the *Banco Nacional Ultramarino* were nationalised to protect Portuguese interests from potential social and economic turbulence following decolonisation. The nationalised BNU was no longer a private bank, but a bank of the Portuguese Government operating in Mozambique, a newly independent African state. This context reinforced the need to confer upon new institutions in the newly independent countries the authority to issue legal tender to display monetary sovereignty.

Samora Machel, the President of *Frelimo*, appointed a working group, chaired by Joaquim Chissano, to plan the economic and financial transition from Portugal to Mozambique. Machel appointed a Joint Economic Commission (JEC). The JEC included Alberto Cassimo, later the Governor of the *Banco de Moçambique* (BM) and Adrião Rodrigues, who prepared the operational organisation of BM. The first matter was the transfer of BNU assets to BM. Then there was the question of how to retain the Portuguese bank employees (52% of the staff) in Mozambique to ensure effective operational transfer to BM. Mass emigration of BNU employees rendered BM unable to perform the tasks of a new central bank.

A more pressing issue was Mozambique's balance of payments deficit. The so-called 'debt litigation' addressed the deficit in Mozambique resulting from mandatory exports from Portugal to its colonies, in this case, Mozambique. In 1961 Portugal established the Portuguese *Escudo* Monetary Zone and the New Inter-territory Payment System (Langa, 1995). Portugal channelled foreign exchange from the colonies via this system, which was kept on a positive balance in Portugal (Pateguana, 2016). During the transition negotiations Frelimo refused to take responsibility for the former colony's debt. In May 1975 the Portuguese Prime Minister officially withdrew the claim on Mozambique, thus paving the way for the transfer of BNU assets to BM. On 17 May 1975 the BM was formally constituted by Decree-Law 2/75.

BM commenced operations with a majority Portuguese staff. Mozambique did not have adequately trained professional staff to perform the functions of a central bank. Within the first two years most Portuguese employees returned to Portugal. Conditions in Mozambique were still volatile, exacerbated by the armed civil insurgence against Frelimo immediately after independence. The BM adopted the BNU organisational structure. Preparations in London to replace the Portuguese currency with a Mozambican 'metica' were completed. The new currency was issued and transported to Mozambique, but never officially approved. The new 'metica' was withdrawn and only introduced as official tender much later (Pateguana, 2016).

Banco de Moçambique: Central bank in a socialist economy, 1977-1983

BM was not a central bank in the sense of an institution overseeing a financial and monetary system. In the newly independent Mozambique, the bank performed a political role, as had been anticipated after decolonisation (Uche, 2000).

The Portuguese government nationalised all issuing banks on 14 March 1975. This included the commercial banking and insurance institutions in Portugal, but not foreign, mutual agricultural, savings and credit banks. The Portuguese government wanted to mitigate the harmful effects of decolonisation on the Portuguese economy. Widespread nationalisation of social services, health and education, land ownership and funeral services between 1974 and 1975 set the example for Mozambique. FRELIMO followed that model for the socialist development of Mozambique, but had to deal with 'economic sabotage', in the form of the massive exodus of skilled Portuguese technicians. The indigenous population was 90% functionally illiterate. The commercial expatriate banks facilitated the outflows of capital and goods with falsified import orders (Preamble of Decree-Law 5/77, December 31, 1977). The Third Congress of FRELIMO in February 1977 decided on a centrally planned socialist strategy and economic policy. The financial strategy was driven by the *Banco de Moçambique*. The Congress resolved that “the *Banco de Moçambique* should be an instrument of the Economic Plan execution and control of the activities of all productive entities.” (Pateguana, 2016; Banco de Moçambique, 2010). The then Minister of Planning and Agriculture, argued that socialism could not be implemented without such a definitive economic plan (Gaspar, 2000).

- **The reform of the financial system**

Nine banks conducted business in Mozambique in 1975. These banks were the Banco de Moçambique and the overseas branches of Portuguese banks such as *Banco Comercial de Angola*-BCA , with headquarter in Luanda, *Banco de Crédito Comercial e Industrial-BCCI, Banco Pinto e Sotto Mayor*-BPSM, *Banco de Fomento Nacional*-BFN, *Banco Standard Totta de Moçambique*-BSTM, *Casa Bancária da Beira*-CBM, *Caixa Económica de Montepio de Moçambique*-CEMM and the *Instituto de Crédito*-ICM. The last two were state banks (Pateguana, 2016). Most of these banks suffered financial difficulties before independence due to bad investments. Once the “Central Bank", BM, took control of foreign exchange transaction on 5 November 1975 to halt the massive outflow of currency, the banks’ financial solvency could be restored. (Pateguana, 2016; Pitcher, N.D.).

BM had to create a supportive financial system and financial policy framework defined by the Third Congress. The banking system was integrated in terms of Decree-Law 5/77. The *Casa Bancària* in Beira, *Banco de Crédito Comercial e Industrial,* and *Banco Comercial de Angola* ceased operations since their assets and liabilities were integrated into the "Central Bank", BM. The *Banco Pinto Sotto Mayor* and *Banco de Fomento Nacional* was dissolved and ordered to close operations in Mozambique within a year.

The criteria for integration or dissolution were whether the bank had its head offices in Mozambique, Lisbon or Luanda and whether it had been nationalised by the Portuguese Decree-Law 132-A-75. These actions followed a meticulous analysis of the soundness of the bank and negotiations with the existing management. Decree-Law 6/77 established the *Banco Popular de Desenvolvimento*-BPD, a state bank, by the merger of *Instituto de Crédito de Moçambique* with the *Caixa Económica de Montepio de Moçambique.* The Angolans followed the Mozambique development. In August 1975, Angola registered the same reforms to protect the Angolan banking system against massive capital and skilled people flight. In November 1976 the *Banco Nacional de Angola* was created to replace the Banco de Angola (Banco Nacional de Angola, 2016).

After the Portuguese state nationalised the private banks operating in Mozambique in 1974, the Frelimo government decided to restructure and integrate the remaining operations of banks in Mozambique with the centralised banking system under BM (Comiche, N.D; Pateguana, 2016). This, in practice, meant nationalisation of the banks in Mozambique. Ownership and control of one or more banks from the shareholders was transferred to the government (Elliot, 2009).

After this reform, the Mozambican financial system consisted of two state banks and one private bank. The banks were, the *Banco de Moçambique,* which controlled all offshore banking transactions, 80% of the credit market and 90% of large companies' deposits. *Banco de Moçambique* had to extend credit to state enterprises, in compliance of the central state plan. BM realised that credit extension meant that there was little prospect of repayment and non-compliance with the commercial criteria. The second state bank was *Banco Popular de Desenvolvimento* (BPD), which had to finance state infrastructure, the industrial and agricultural sectors. The private bank was the *Banco Standard Totta de Moçambique,* which was allowed to provide credit to the private sector.

The integration of private banks under the auspices of the "Central Bank" was to avoid potential risks that may arise from the planned socialist economic and social revolution. The risk was the possible collapse of those banks, since their business was credit extension to Portuguese oligopolies and not socialist economic restructuring programme. The Standard Bank survived the BM integration and continued operating as a private bank after 1977. This was because of its healthy financial structure. Standard Bank was never mentioned in relation to acts of economic sabotage.

The concentration of the banking system under state-controlled BM was followed by the introduction of a new monetary and credit policy. The state controlled the system but allowed BPD to attract deposits, because of its strategy to prioritise small savers. It became known as the “bank of the barefooted”. BPD unfortunately delivered poor results, mostly due to cultural reasons. Indigenous Mozambiqans were unfamiliar with savings accounts, had no culture of banking and conducted a very limited monetary economy. The broad population first needed education on savings and credit.

- **The Metical – New national currency**

BM was the state bank of the newly independent Mozambique. It served the political economy goals of the socialist state. It financed state owned enterprises, state development projects and was managed by political loyalists appointed by the Frelimo government. By the late 1970’s the global economic recession brought serious economic difficulties to developing countries. African economies experienced contraction and growing balance of payments problems. State centralised economic and financial reforms stabilised the Mozambican economy to a degree. Absolute state control soon appeared inconsistent with sustained economic progress. By the early 1980's Frelimo considered the need for economic adjustment. Slight indications of economic recovery were recorded by 1981.

The use of a Mozambican legal tender was of symbolic significance to Frelimo. The first attempt to introduce the 'metica' was aborted, but President Machel instructed the Governor of the BM on 28 April 1978, to resume the process. The new BM Governor, Sergio Vieira, appointed in April 1978, instructed preparation for the introduction of the Mozambican national currency. By 1980 Prakash Ratilal observed that the time was ripe for the introduction of a new currency as the basis for monetary stability. The new currency was the 'metical' from the "mit'cal", an Arabic-Swahili ancestral name of a currency that circulated in pre-colonial Mozambique. "Operation Zero" was the process of replacing the escudo with the metical on 16 June 1980 in terms of Decree-Law 2/80.

Following the introduced of the metical, Frelimo, wanted to gain control over the foreign reserves that were historically held in trust by South Africa and Portugal. The South African Reserve Bank transferred the Mozambican reserves to the Union Bank of Switzerland, while Portugal reluctantly abdicated from its trust depository role. With the mediation of the Banque de France the foreign reserves of Mozambique were transferred back to BM in 1981.

The central bank's role in the transition from socialism to the market economy (1984-1992)

- **The Fourth Congress of FRELIMO and policy reform**

The OPEC oil price hikes of 1973 and 1979 sent the international economy into a recession, which finally also caused economic collapse in the third world. Mozambique suffered the impact of the world recession because of the openness of its economy (Alves, 2015). Mozambique soon experienced financial shortages, worsened by the decline in oil production in 1983 following the loss of Iraq as main supplier of crude oil. Mozambique had to seek foreign aid. The collapse of the USSR in 1989 placed socialist economies at risk and Mozambique lost an important source of oil supply and external financing. The economic crisis mandated a re-conceptualisation of the Mozambican development model. The country reconsidered the advantages and disadvantages of the socialist development policy, in particular the role of state owned enterprises.

The role of state-owned enterprises came under severe international scrutiny towards the late 1970's. The macro-economic reappraisal of the liberal market and the growing consensus around market reforms, coincided with serious debt problems emerging in the developing world. The Washington Consensus called for a contraction of state intervention in economic policy, privatisation and the promotion of private enterprise. Developing countries lost their support from centrally planned USSR. Alternative sources of foreign aid were only available from the developed western capitalist economies. Developing countries had no option but to change their foreign policy and economic models. Mozambique's foreign exchange reserves were completely depleted. A fundamental reorientation of its socio-economic model was imminent (Pateguana, 2016). When the application in 1982 by Mozambique to become a member of COMECON Council for Mutual Economic Assistance (Community of Eastern European countries) was turned down, Mozambique turned to the Bretton Woods institutions.

Frelimo displayed a change of political economy orientation towards the beginning of the 1980's. The Fourth Congress of FRELIMO (April, 1983), expressed the need to "make more friends" in international community in the interest of the economy and the society. This policy changes were displayed in the signing of the Lomé Convention and the deliberations with the International Monetary Fund and World Bank. Frelimo also adopted significant liberalisation measures to open the economy to the private sector.

Mozambique signed the International Monetary Fund and World Bank protocols on 24 September 1984, making the county a member of the International Bank for Reconstruction and

Development (BIRD - World Bank) and the Association for International Development (AID). Both granted long-term and tax free loans, to low-income and developing countries (Decree-Law 6/84). As a member of the BIRD, Mozambique received shares of USD$ 93-million and a 0.06 per cent voting power as AID member. Mozambique was eligible to access foreign aid from multilateral and bilateral international institutions. The first agreement was the General Debt Rescheduling Agreement with the Paris Club of 25 October 1984, followed by seven more rescheduling agreements. Good economic reform performance made the country eligible on 17 November 2001 to debt rescheduling in terms of the Heavily Indebted Poor Countries Initiative (HIPC). This initiative allowed up to a 90 percent write-off of the country's external debt (Pateguana, 2016).

As a member of the AID, Mozambique received the first tranche of AID long-term credit amounting SDR 45,5million (about US$ 59 Million) on 23 July, 1985. Mozambique also received concessional loans for economic reconstruction to the poorest countries. The first Financial Agreement with the IMF was signed on 8 June 1987 as a Structural Adjustment Facility (SAP). Additional to these loans Mozambique benefited from successive IMF Financial Agreements, either SAP's, SAF or ESAF as Poverty Reduction and Growth Facility (PRGF). The first facility of 8 June, 1987 amounted to SDR 28, 87-million (about USD$37 Million), was valid until 1990.

The loans were intended to support the reconstruction of industry, agriculture and transport sectors in alleviating poverty and promoting growth. These concessional loans were received periodically and in tranches. These facilities supported gradual market reform of the Mozambican economy. Since the signing of the Bretton Woods protocols, the implementation of reforms gained substance and from 1987 the country started to implement the Economic Readjustment Program, ERP. The reforms aimed to reduce both the effect of the inherited backwardness from colonialism and the weakened production during the socialist period.

Following the policy reforms of the Fourth Frelimo Congress, the financial system was also reformed. In 1990 Frelimo introduced a set of reforms, managed by a joint team from BM and the Ministry of Finance, formulated in the "Guidelines for Financial Reform". These reforms aimed at the specialisation and consolidation of the "Bank" as a central bank performing the typical functions of a central bank, such as banking regulation, monetary control and subsequent separation of commercial bank functions from its central bank role (Banco de Moçambique, 2010; Patel, 2010.)

- **Central bank reforms**

The introduction in 1984 of the Economic Action Plan (PAE - acronym in Portuguese), aimed to restructure and stimulate the productive sector. One of the reform measures was to revise the 1975 restrictive direct monetary control policy. This was the management of monetary policy utilising direct credit control, domestic liquid assets ratios, currency value exchange rate and interest rates. These policy reforms aligned to the SAP policy framework.

In May 1985 the Council of Ministers approved price and salary liberalisation and the free movement of goods in the country. This triggered the appearance of an informal currency market, the "*candonga*", including an informal market in foreign currency. In order to facilitate the inflow of foreign currency, BM in June 1987 authorised resident nationals to open deposit accounts in foreign currency. In February 1988 foreign residents were given the same authority, subject to the control of the central bank. To capture foreign currency in circulation from citizens who earned in dollar or rand, the government opened duty-free shops, the "*Interfranca*". The weakening economic conditions had rendered the "dollarisation" of the economy inevitable. To reform the credit policy in line with the principles of the liberal market, BM announced annual credit limits (1988/1989) in consultation with the IMF. As a result from

1987 to 1992 the total credit to state-owned companies was reduced by 48.3 percent, while credit to the private sector was expanded (Patel, 2010; Abreu & Hallan, 1993.)

Between 1975 and 1977 the Mozambican Escudo was pegged to the Portuguese escudo. The foreign exchange rate was linked to the Banco de Portugal. On 25 February 1977 Mozambique suspended this relationship and adopted parity with a basket of eight currencies relevant to Mozambique's international trade. This gave the Mozambique independence from the Portuguese foreign exchange table and introduced a Mozambican self-managed exchange rate.

Between 1988 and 1989 Mozambique introduced an exchange-rate adjustment program, known as "Shock Therapy". The immediate effect was the depreciation of the metical from 38.28Mt/USD on 31 January 1987 to 620.00Mt/USD on 15 October 1988. The exchange rate was determined by daily successive and progressive devaluations to adjust the exchange rate automatically as determined by the open market.

The "Shock Therapy" was followed by a period of "Crawling Peg". This was a period of interest rate adjustments in monthly mini-devaluations from January 1989 to 1990. These adjustments mitigated the negative effects of the previous period to promote a more flexible interest rate and promote foreign exchange market liberalisation. This led to a market related exchange rate and minimized government intervention in the allocation of foreign funds.

On 18 September 1990, the Secondary Foreign Exchange Market was created by Decree-Law 20/90. This market provided an additional and legal source to purchase and sell foreign currency. *Banco do Moçambique* authorised and supervised the Secondary Foreign Exchange Market. From September 1991, BM introduced the Daily Crawling Peg, taking into account the official market exchange rate, equivalent to 78 percent of the secondary market exchange rate. The goal was a future harmonisation of these two exchange rates. In April 1992 the BM commenced the alignment of the official exchange market and the secondary exchange market (Pateguana, 2016).

In following the policy reforms proposed by the IMF and World Bank, Mozambique gradually adjusted interest rates. From 1989 to 1992 successive interest rate adjustments reduced structural and conjectural imbalances. The objective of the reform was to arrive at real interest rates, lower inflation and reduce the pressure in domestic credit (Pateguana, 2016).

The gradual liberalisation of interest and exchange rates paved the way for the transition from direct to indirect monetary policy instruments. The central bank Administrative Order 09/84 permitted companies that generated foreign currency, through the New Foreign Exchange Management System, to retain a percentage of funds as consigned funds for their productive cycle.

BM also introduced the payment of interest on deposits on call at the BM. This was decreed by Resolution 10/86, which revoked the 1980 decision, prohibiting interest payments on mandatory deposits. Commercial banks could pay interest on deposits and accepted fixed deposits at all branches. BM thus liberated its commercial bank functions in order to compete effectively with other private banking institutions such as Standard Bank.

Eneas Comiche (one of the former Central Bank Governors) initiated the internal separation of the central bank functions from commercial bank functions of BM in May 1987 under the framework of the "Guidelines for Financial Reform". This action defined a new organic structure for BM where separation of functions was introduced to enable the central bank to perform its oversight role. On 27 September 1991 Adriano Maleane approved a new organic structure and the Organisational Manual of the central bank. Commercial bank functions were also clearly defined, including the role of the central bank towards all other categories of financial institutions (Pateguana, 2016).

- **The separation of central bank functions**

The Fifth Congress of Frelimo (July 1989) finally decided to separate the central bank's operations from those of a commercial bank. This happened in terms of Decree-Law 1/92. These developments signalled the beginning of a liberal financial services environment (Pateguana, 2016). The banking structure remained dominated by the two state-owned banks: the *Banco de Mozambique* and *Banco Popular de Desenvolvimento.*

From 1989 the central bank decentralised foreign exchange transactions to all its branches and agencies and abdicated from the monopoly of external operations authorising. Henceforth the *Banco Standard Totta de Moçambique* was allowed to conduct such transactions (Banco de Moçambique, 2010). To alleviate the domestic demand for credit, the central bank resorted to external financing, in coordination with the Minister of Finance, to finance domestic productive activities (Abreu and Hallan, N.D; Mosca, N.D). Although credit extension was well controlled and the currency stable, a growing distortion emerged in the market due to the growing foreign credit extension to the economy (Abrahamson & Nilsson, 1994).

The *Frelimo* government ultimately realised that the socialist centrally planned economic model failed to secure the country‘s economic development and an improved standard of living to its citizens (Pateguana, 2016). In 1990 the Constitution of Mozambique was changed to confirm the adoption of a market economy (Banco de Moçambique, 2010). The statutory authorisation for financial reform was the Decree-Law 1/92, that defined the central bank's functions, the Exchange-Law Regulation 3/96 which decentralised the exchange rate regime, Credit and Financial Institution Decree-Law 28/91 of 31st of December 1991 and 15/99, which regulated the operations of the different financial institutions (Banco de Moçambique, 2010).

The Credit Institutions Decree-Law 28/91 defined commercial bank operations. The Decree Law allowed commercial banks to operate in the market for private banks in what had been a central bank monopoly since 1975 (Banco de Moçambique, 2010). This Decree-Law conjugated with the Law of Credit Institutions of October 1992 in compliance with the new Constitution of 1990. It established the legal framework for new private bank operators. Subsequently two new Portuguese banks were authorised by Decree Law 35 and Decree Law 36/92 to enter the market. These banks were the *Banco de Fomento Exterior* and *Banco Português do Atlãntico* (Banco de Moçambique, 2010). Since then a number of banks, both domestic and foreign, were allowed to operate in the Mozambican financial market.

In a market oriented economy, the demand for money will align with aggregate demand and supply. Once the Frelimo government agreed to the macro economic adjustment policies of its donor institutions, the country needed a central bank to perform the financial sector oversight and money supply regulating functions of such an institution.(Patel, 2010). The first step in that direction was the separation of central bank functions from commercial bank financial intermediary functions (Maleiane, 2010). With macro-economic restructuring it became imperative that the central bank assumes its role in securing low and stable inflation as an acceptable approximation for price stability. Central bank independence was important to secure monetary stability, which was a prerequisite for macro-economic restructuring (Pateguana, 2016).

Financial liberalisation implied greater financial inclusion of people formerly marginalised from such services. To that end and to take banking activity to rural areas, the central bank opened regional branches in Beira (1995) and Nampula (1996) districts. Within the framework of reforms since 2005, the central bank licensed new credit institutions, changing the previous procedures in which the Ministry of Finance performed those functions on advice from the central bank. In 5 years 18 credit institutions with 430 branches, 8 microfinance banks, 22 Exchange Houses and 7 credit cooperatives were licensed across Mozambique (Pateguana, 2016). The benefit of technological reform reached remote areas as electronic payment systems were introduced at Post Offices and ATM's. The use of electronic payments rose by 133% between 2005 and 2008 and 4633 ATM's were opened (Pateguana, 2016). The Economic Rehabilitation Program delivered structural and regulatory reforms of the central bank. BM established the Department of Economic Studies and Statistics in 1989 to provide the bank with specialist technical information to accomplish its research and advisory role (Viola, 2010).

The Technical Committee for Monetary Policy, a top-level policy decision forum, was created on 9 June 1994, to support the decisions of the BM Board. Technical expertise was also provided by the Ministry of Finance (Banco de Moçambique, 2015).

Three years later, in February 1997, the technical committee was replaced by the Monetary and Exchange Policy Committee. The Chairman of BM chaired this forum, and included the participation of the Minister of Finance and Executive Directors of some public sector economic agencies (Banco de Moçambique, 2015). This Committee adapted its operations as macro-economic reforms mandated.

An Information and Documentation Centre was established at the central bank to conduct training of bank employees. This department published regularly publishing BM periodicals, such as the statistical bulletin, Annual Report, Staff Papers, prices and financial conjecture. The Information and Documentation Centre also supplied occasional papers and other leading articles, analyses and research reports as required by the bank.

After 1997 the consolidation of the central bank operations reached maturity, in particular the intervention in the interbank market.

Consolidation of the central bank (1992-2010)

The separation of the functions of the central from those of a commercial banks in 1992 was an important milestone in the development of BM. The bank matured to perform its role as a central bank. As a necessary condition to economic rehabilitation supported by the World Bank in the context of structural adjustment management, the central bank performed reforms enabling its role in introducing monetary and credit policies reforms.

The former role, where BM appointed directors to perform both central and commercial bank functions, was changed by the Internal Directive 20/2000. This directive approved a new organic structure of the bank. The number of managerial levels were therefore reduced from 11-12 to 3-4. Management was thereby decentralised, regional branches harmonised and technical functions centralised at BM head office (Banco de Moçambique, 2015).

Since 1994, credit policy was based on setting expansion limits to the Centralised Net Domestic Assets (AILs, acronym in Portuguese), instead of credit limits to the commercial banks. The limits of AILs were announced twice a year, later annually and then ceased to exist (Banco de Moçambique, 2010). On 10 January 1996 the BM Central Risk Centre was formed to centralise information of credit applicants for distribution to all banks (Banco de Moçambique, 2015). From 1995 a system of mandatory reserves was introduced, lowering the coefficient progressively from 15% of liabilities to 6,8% in 1999. An International Reserves Management Committee was formed to establish operational and prudential principles in the management of its offshore assets (Pateguana, 2016).

These reforms led the country away from direct (centrally determined) monetary instruments and began the restructuring of the management of these variables aligned to a realistic and flexible interest and exchange rate dispensation in harmony with the market.

Sustained modernisation of BM's central bank functions unfolded gradually. Responsive, flexible and safe information systems and technologies were introduced in terms of the automation project supported by World Bank since 1989 (Pateguana, 2016). In 1998/9 the Central Bank introduced the Computer System Re-engineering Project (PSRI2000) to address the impact of the millennium transition and to ensure the implementation of sustainable computer solutions. The new IT platform brought flexibility to the National Payment System and contributed to reform state finances (Pateguana, 2016). From 24 March 2003, *Banco de Moçambique* developed a banking supervision function with the support of central banks in South Africa, Angola, Swaziland, Tanzania, Uganda and Zambia (Banco de Moçambique, 2015).

The new management approach from 2005 was based on Strategic Planning. This approach defined the mission, objectives and values of the central bank. This assisted the bank to modernise managerial skills and improve its performance (Banco de Moçambique, 2015). Financial sector developments challenged the *Banco de Moçambique* to create new organic structures, such as the Supervision Department in 1991, to address the need of financial system oversight (Santos, 2010), and the Market Department in 2001, to address money market development and monetary policy reforms as the bank's role changed in a restructured macro-economic environment (Pateguana, 2016).

The transformations that consolidated the *Banco de Moçambique*, to the conventional role of a central bank, were a result of both internal evolution and external influences from regional and international developments.

Conclusion

The development of the central bank in Mozambique followed a similar path as in other decolonising developing countries. As Alexopouls and Juif (2015) noted, the colonial period impacted directly on the formation and operation of central state functions, such as the fiscal and monetary sectors. Chandavarkan (1996) acknowledged the political economy of central banking in developing countries, which in the case of Mozambique, impacted on the development of central banking functions for a very long time. The political economy of the newly independent Mozambique delayed the establishment of bank regulatory and oversight functions at BM. The nationalist Frelimo leadership sought to exercise political control over the financial sector. This development mirrored the experience in Nigeria and West Africa, as explained by Uche (2001). At the pre-independence negotiations, Frelimo insisted on Clause 16 in the Lusaka Accord (Monteiro, 2013). This clause provided for the establishment of a state controlled central bank in Mozambique. The financial sector in Mozambique was controlled by expatriate Portuguese banks of which BNU performed central banking functions (Wuyts, 1989). The newly independent state wanted full control of its economy, which implied control over the banking sector (Wuyts, 1989).

Banco de Moçambique had a monopoly in the financial sector. Most Portuguese banks were nationalised. BM operated within the political economy of a centrally planned socialist economy since 1975 until the early 1980's. Frelimo ascribed to the Marxist-Leninist ideology and BM was an instrument of the state to implement the socialist development plan of the Third Frelimo Congress in 1977 (Wuyts, 1989). BM first nationalised foreign banks, managed the financial resources of the state to implement the development plan and then attempted to implement a dual set of operational functions. BM was both central bank and commercial bank. By the late 1970's when the international economy went into a prolonged recession following the oil price hikes, international funding dried up (Wuyts, 1989).

Mozambique experienced dwindling international finance, collapsing primary product export earnings and growing balance of payments disequilibria. The experience of Mozambique was similar to many recently decolonised countries experimenting with socialism. Once the Soviet Union disintegrated, international ideological support for the Eastern Communist bloc also disappeared (Wuyts, 1989). The growing third world debt crisis mandated fundamental macro-economic restructuring. Many African countries turned to the Bretton Woods institutions for balance of payments relief. Structural adjustment programmes were rolled out across Africa – also in Mozambique.

The Frelimo government accept liberal market reforms, both in macro-economic policy as in financial sector reforms. As Mozambique implemented its SAP, financial sector liberalisation resulted in the functional overhaul of BM. It can therefore be concluded that Mozambique only got a central bank in the early 1990's. BM's dual role ended and the state introduced an oversight role for the bank. Credit policies, foreign exchange transactions, interest rate determination and the organisation of specialist function banks developed (Pateguana, 2016). BM opened the market for different financial institutions, modernised the organisational form of the bank and introduced modern technology (Pateguana, 2016). The liberalisation and modernisation of the banking sector resulted in improved financial inclusion and attracted foreign investment. Financial sector liberalisation benefitted from the central bank oversight and regulatory role performed by BM.

The former Portuguese colonies all progressed along the same historic path, which influenced developments of the financial system. The reason for the introduction of central banks in the former Portuguese colonies after independents was because the *Banco Nacional Ultramarino* became defunct. After independence, all the colonies replaced the *Banco Nacional Ultramarino* by a national central bank. The common aspect among these central banks was that initially they performed a dual function of a commercial and central bank inherited from BNU.

After independence the former Portuguese colonies needed an institutional authority to regulate the financial system and foster development in support of new economic policies. BM was instrumental in implementing the socialist model of development and subsequently, to adapt to the liberal market. The course of BM from independence to the consolidation as a conventional central bank, benefited from the experiences of regional and international central banks. At the same time BM served as a point of reference to the reform of other emerging central banks in the region. Central banks' communication and co-operation promoted co-operation in the banking system. These reforms were likely to be adopted by others. Ultimately, *Banco de Moçambique* as a central bank, contributed to the development of the Mozambican economy.

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