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# **The Great Cashew Controversy in Mozambique**

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# What's the controversy?

- Notorious case of how economic reform can “go wrong”
- Fuel for anti-globalization movement
- Stimulus for conditionality reform by IMF and World Bank
- Spill-over to other trade policy issues
- Lessons for economic reform programs

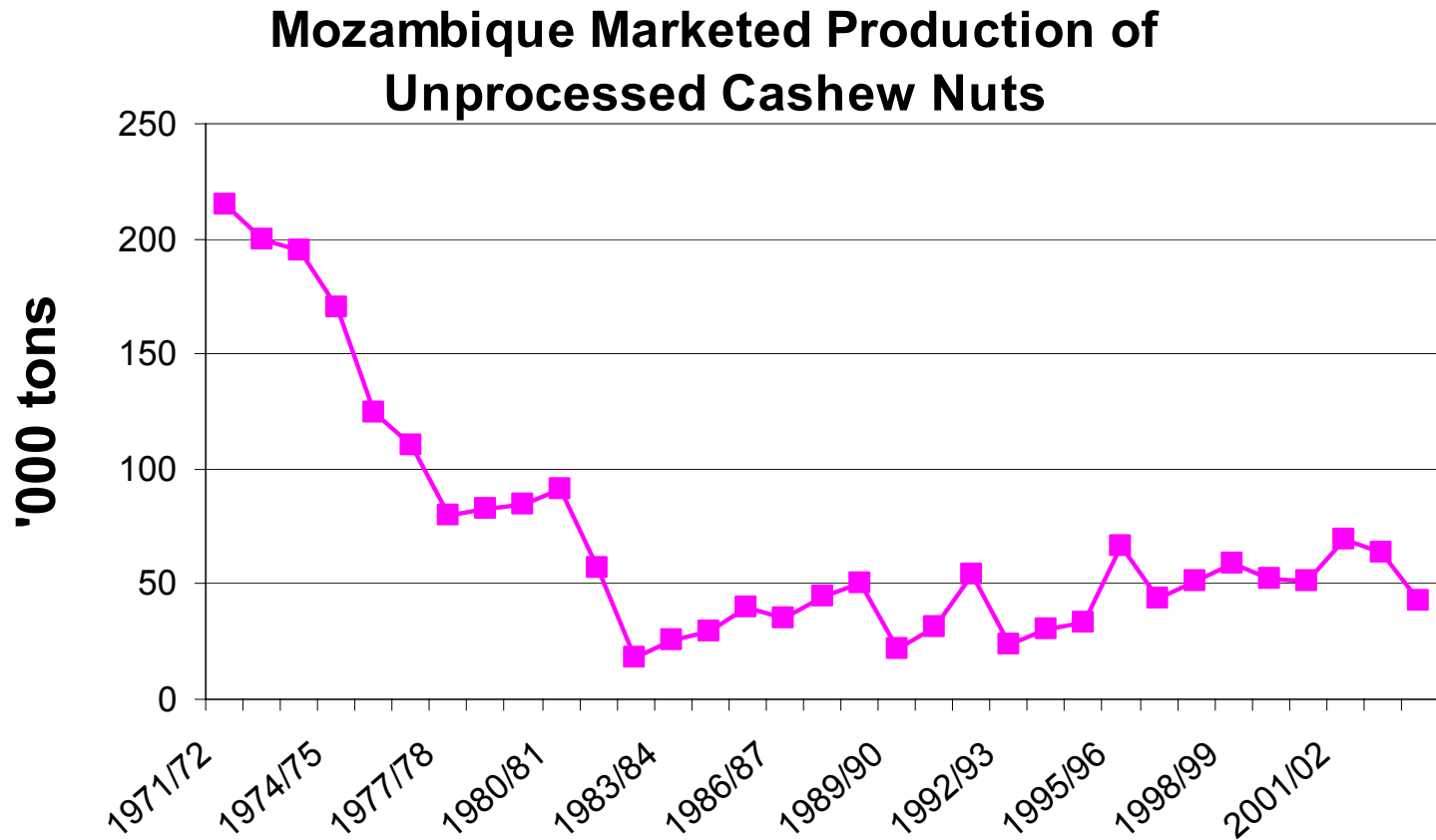


# The Story Line – in a nutshell

- Mozambique dominated global cashew market in early 1970s
- Collapse of sector after 1974
  - Nationalization
  - Breakdown of trading system
  - Export ban on raw cashews (1978)
  - Civil war (until 1992): massive dislocation of rural population, destruction of infrastructure
- World Bank conditionality 1995: Liberalize
  - Economic and political consequences



# Marketed harvest, 1972-2004



# Conditions in early 1990s

- Old, badly maintained trees, serious disease problem = low yield & quality
- Farm-gate price averaged 28% export price (compared to 50% in Tanzania)
- Most state factories shut: debt & mismanagement
- Ban on export of raw cashew ended 1991
- Replaced by quantitative restriction + 60% export tax (reduced to 30% in 1994/95)
- By 1992/93, most raw cashews exported
- Then privatization of most factories by 1994



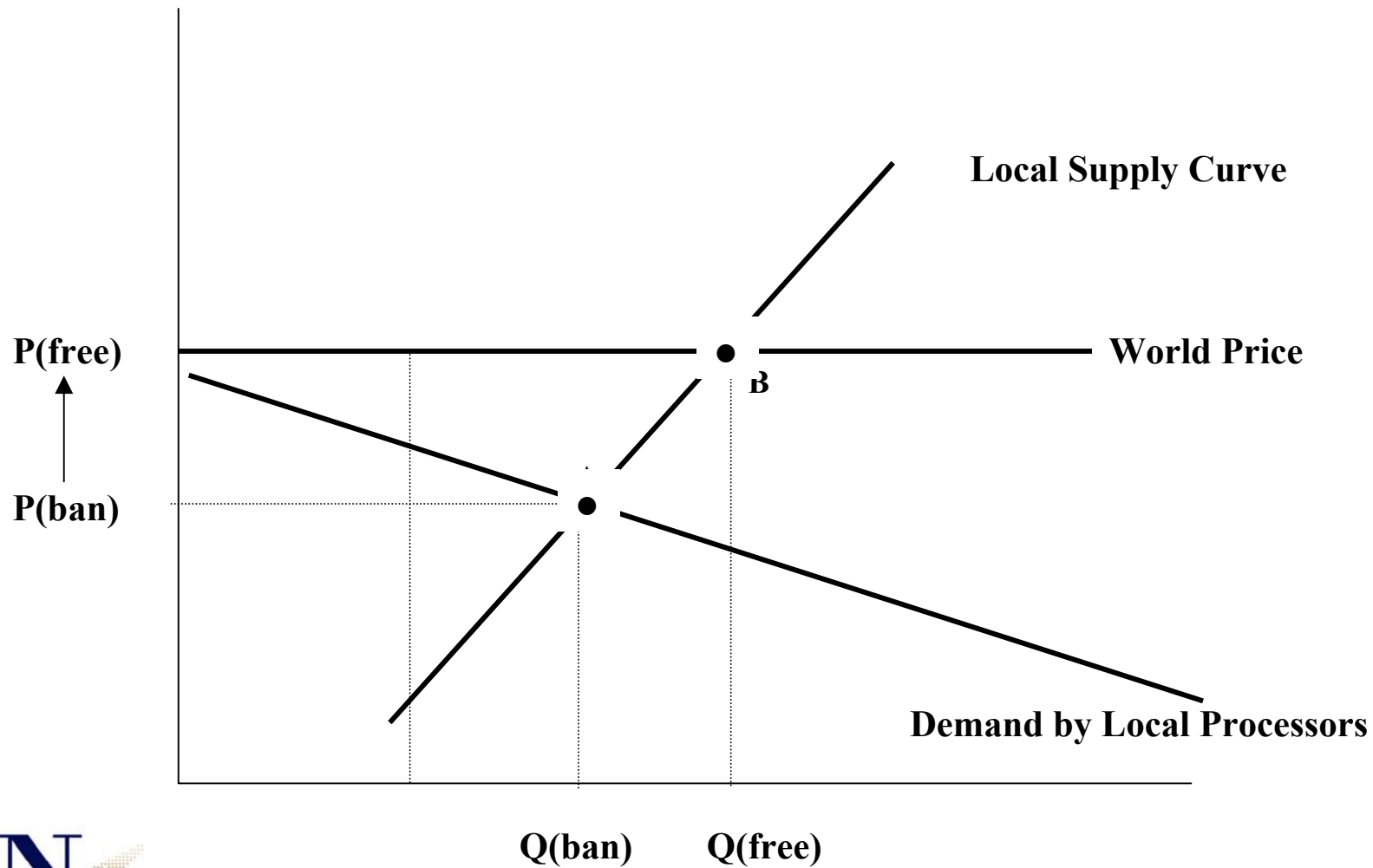
# Rationale for liberalization policy

- Controls in place to support non-viable industry – complication: privatization!
- Cost born by one million small farmers (40% of farm households)
- Reform expected to:
  - Increase price to small farmers: *pro-poor intent*
  - Improve incentives to increase harvest and revitalize cashew orchard
  - Induce processing industry to restructure
  - Enhance competition among traders

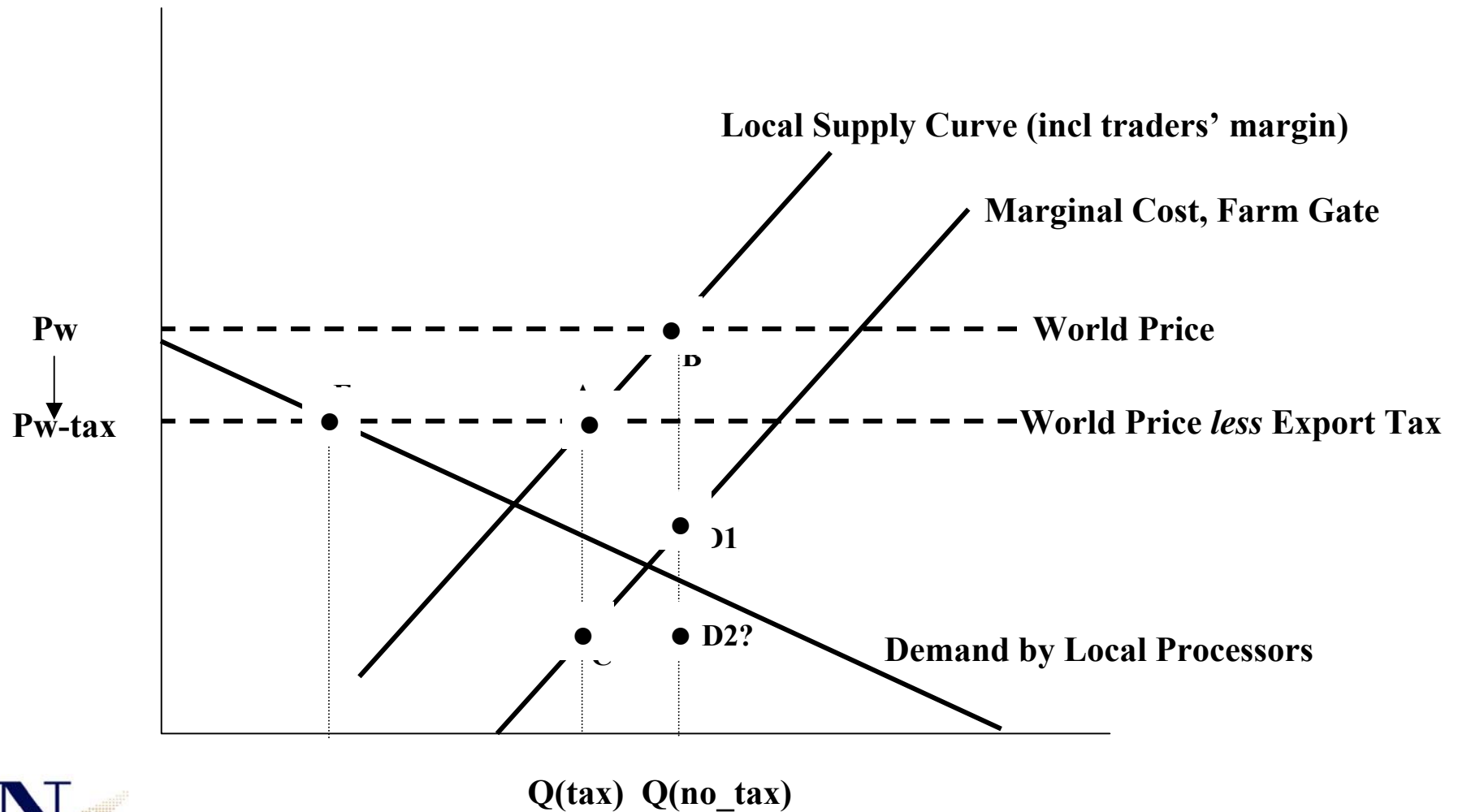




# Textbook effect of export ban



# Textbook effect of export tax





# World Bank conditionality (applied to 1996 adjustment loan)

- End administrative allocation of raw nuts to processors
  - End export restrictions
  - Reduce export tax to 20% & phase out over 3 years
- Tax phase-out re-negotiated as per table

Export Tax	Industry Preference	Negotiated Phasing	Actual Tax
1995/96	20%	20%	20%
1996/97	20%	14%	14%
1997/98	20%	7%	14%
1998/99	20%	5%	14%
1999/00	20%	0%	18%
2000/01	14%	0%	18%
2001/02	7%	0%	18%
2002/03	0%	0%	18%

Source: K. Patel (private communication) and McMillan, Rodrik and Welch (2002)



# The outcome

- Collapse of processing industry
  - Couldn't compete for raw cashew
  - Lack of financing for restructuring
  - Labor law constraints
- Widely reported that farmers worse off: alleged victims of monopsony traders
- Weak supply response by cashew farmers

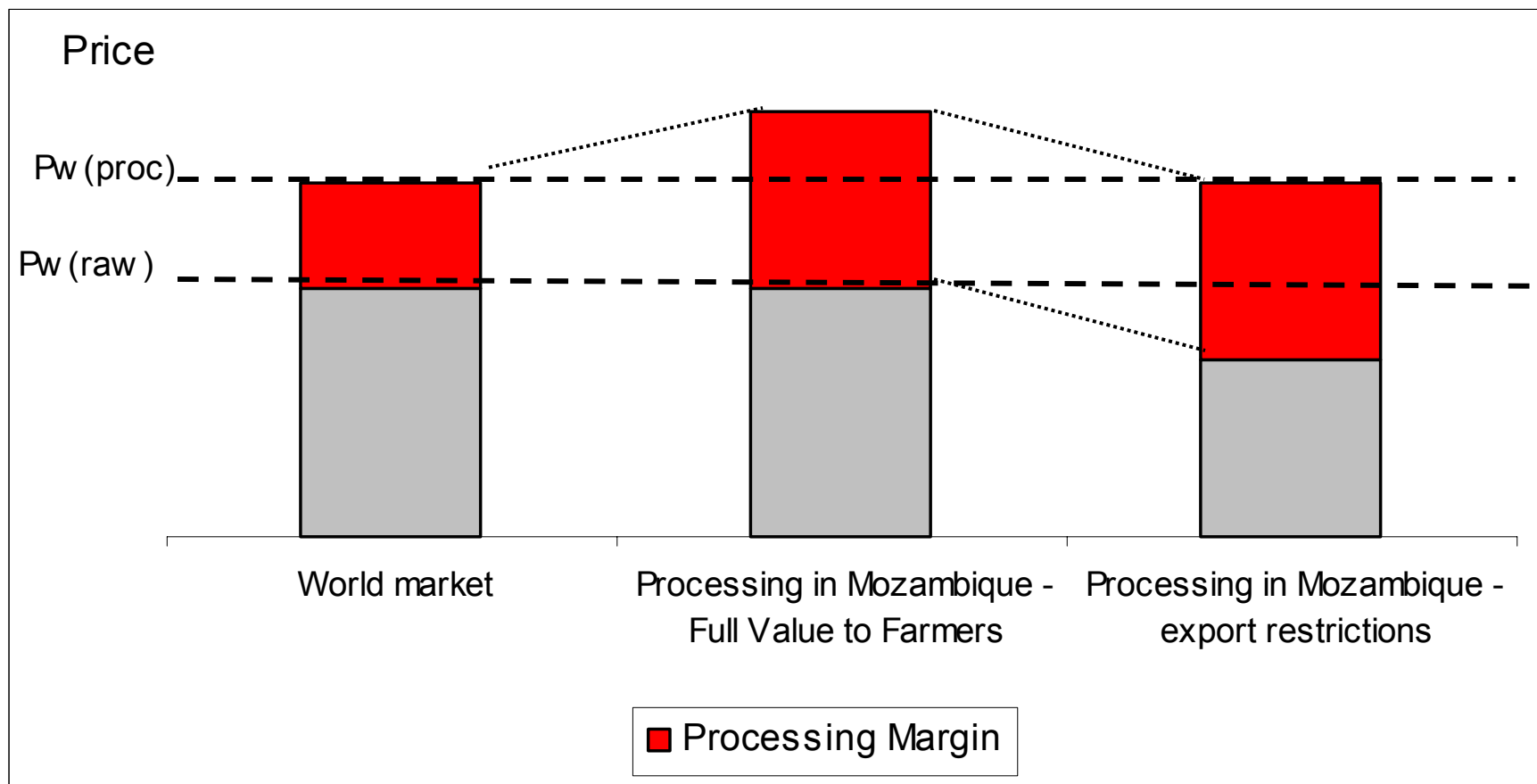


# Backlash and retreat

- Firestorm of opposition: industry, labor, civil society, church groups, media...
  - World Bank destroyed cashew industry
  - Loss of 10,000 jobs (BBC report: 40,000 jobs)
  - Loss of value added, export earnings
  - Only beneficiaries: traders and processors in India
- 1999 bill presented to reinstate export ban and price controls
  - Decision to maintain 18% export tax → INCAJU
- Retreat by WB and IMF
- Renewed interest in industrial policy interventions
  - Surtax on sugar imports
  - Zero duty on inputs to selected industries
  - Consideration of surtax on rice imports



# Loss of value added and export earnings??



# McMillan, Rodrik, Welch Analysis

- Farm-gate prices rose, raw cashew exports increased, but...
- Net static benefits negligible
  - Gains to farmers “puny”: World Bank neglected market structure
  - Benefits largely offset by cost to factory workers
- Dynamic benefits weak
  - Policy imposed → lacked credibility
  - poor supply response



# Critique of “Rodrik” analysis

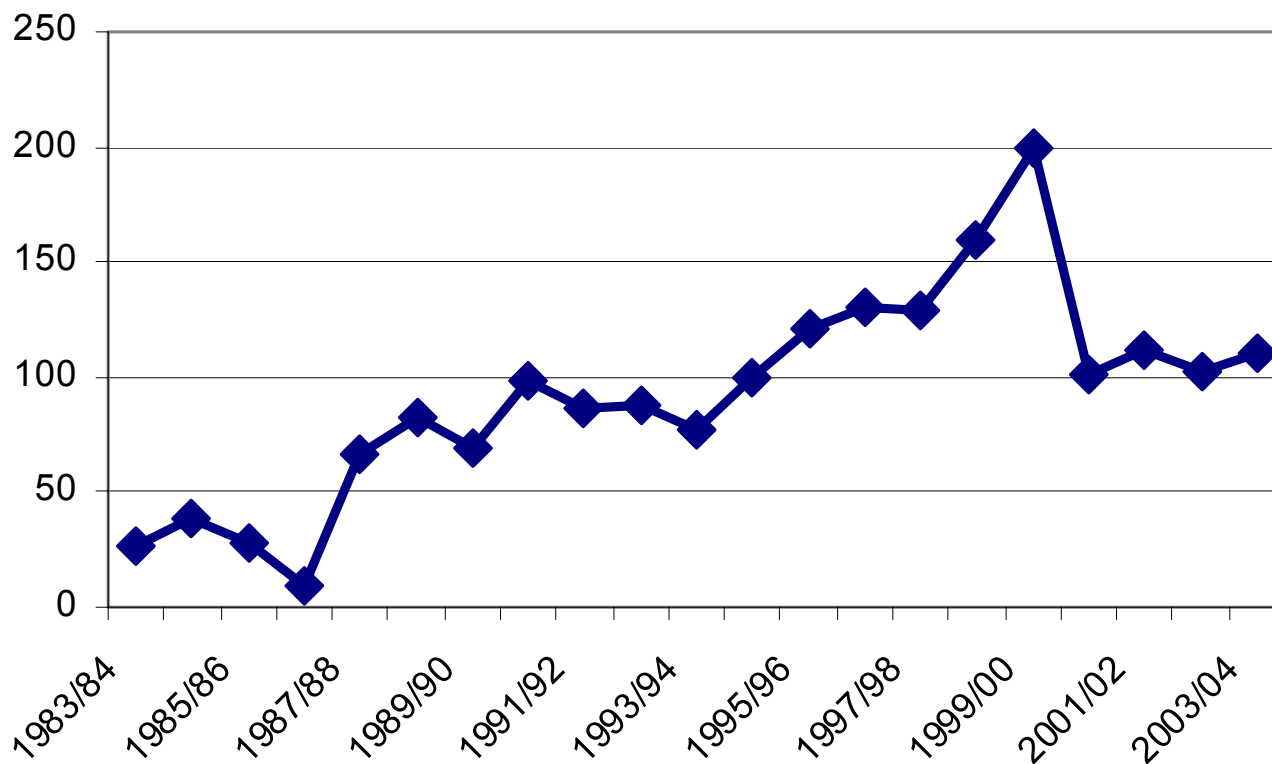
- Cost estimate: # jobs lost; unemployment
- Benefit estimate: Net present value
- Market power of traders
- India as monopsony; target self-sufficiency
- Weak supply response
  - 4-year average: before = 35 m.t., after = 55 m.t.
  - Credibility or viability ?
- The alternative? Cost of not liberalizing
  - Imperative to increase raw cashew production
  - Imperative to restructure processing industry





# Mozambican producer prices for cashew nuts

**Inflation-Adjusted Producer Price for Cashews in Mozambique (Index: 1995 = 100)**

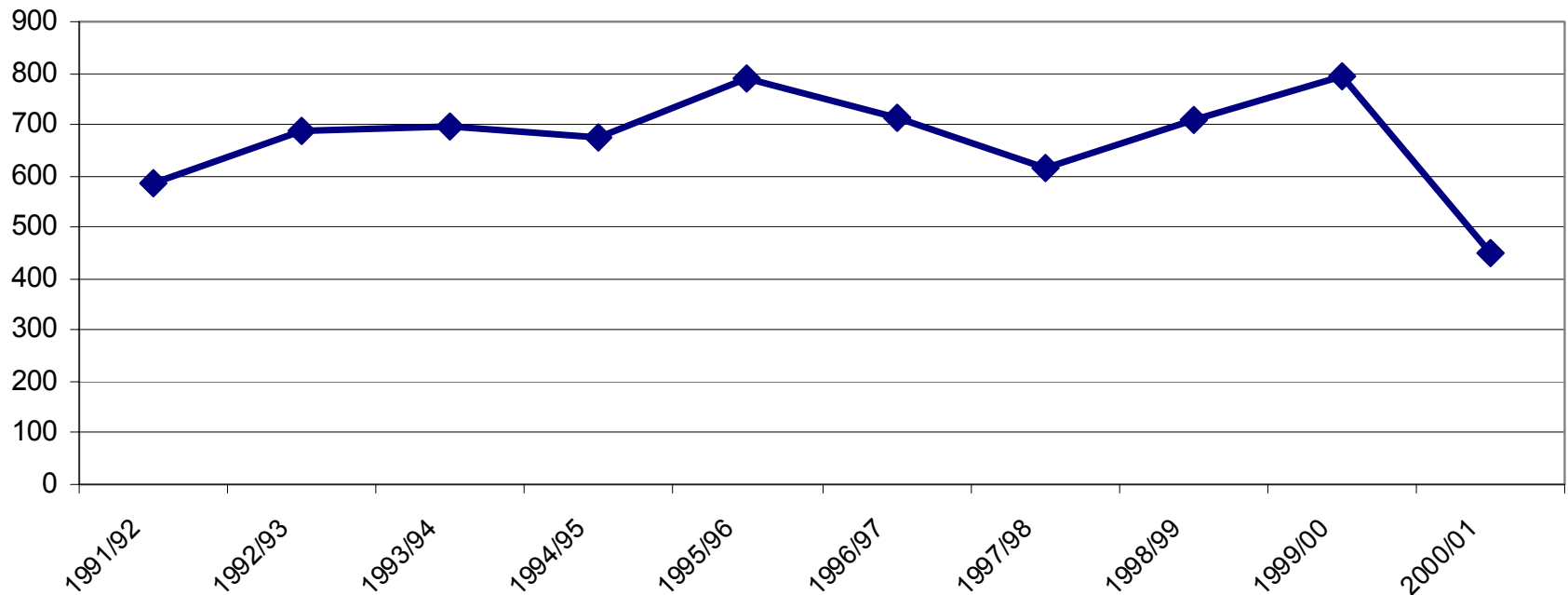


Source: Cashew price data from INCAJU (Cashew Development Institute), June 2004.  
CPI index from INE (National Statistics Institute)



# Export price for unprocessed cashews from Mozambique

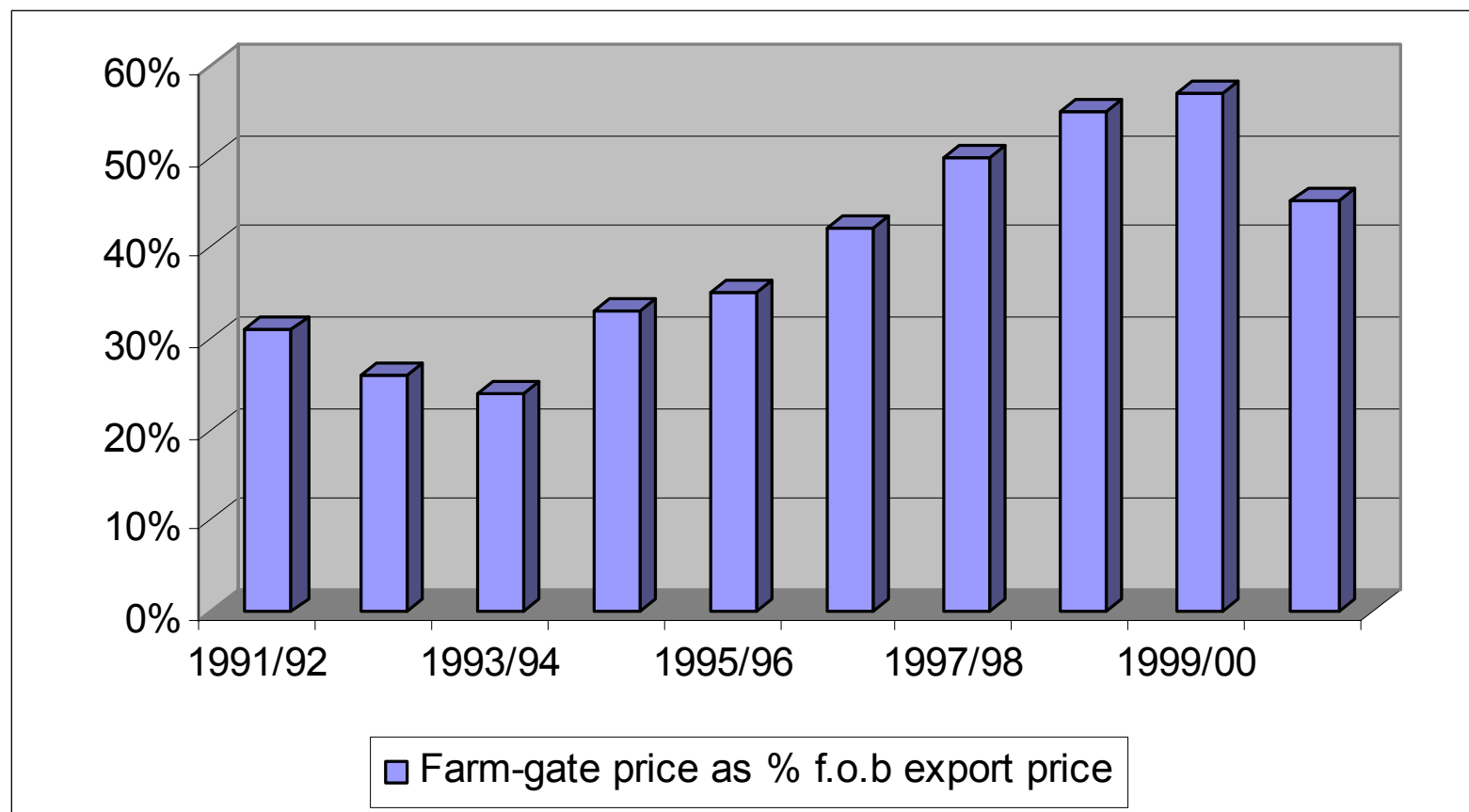
Export Price (\$ per metric ton, f.o.b.)



Source:: McMillan, Rodrik and Welch (2002), based on data from Desai (2001)



# Farm-gate price relative to export price, 1991/92-2000/01



Source: McMillan, Rodrik and Welch (2002), from Desai (2001)



# Situation today

- 53 million cashew trees -- 1.2 million small farmers
- Old trees, lack of maintenance, disease, low yield, low quality, low replanting
  - ***The central problem***
- Cashew 7% total exports 2002 (18% excluding aluminum and electricity) – World Bank, CAS (2003)
- Low export price
  - low quality (& perhaps under-valuation to evade export tax)
- Main beneficiary of export tax: INCAJU
- Industry restructuring slowly
  - Plagued by low volume, low quality
  - Protected by 18% export tax



# Lessons for trade promotion

- *Politics* of trade reform
  - Pitfalls of pro-poor trade policy
  - Risk of backlash, appeal of protectionism
  - Management of perceptions, expectations
- Importance of Poverty and Social Impact Analysis
- Sequencing/phasing (industry offer 1995)
- Facilitation of supply response
- Mitigation of transition costs



# Conclusion

- Central focus: rehabilitation of cashew orchard
  - Boosting supply essential for revival of processing industry
- Export tax effects
  - Hurting poor farmers
  - Impeding replanting and maintenance of trees
  - Let the private sector & farmers have the extra money!
  - Private incentives vs. INCAJU programs
- Mozambique cashew case *not* a template for trade policy as tool for industrial protection

