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# Mozambique
# Country Economic Memorandum
## Growth Prospects and Reform Agenda

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## CURRENCY EQUIVALENTS
(as of January 2001)

Currency Unit: Metical (Mt); plural: Meticais
US$1 = Mt 16,950

## FISCAL YEAR
January 1 to December 31

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| **AGRICOM** | State Enterprise for Agricultural Marketing |
| **BCM** | Banco Comercial de Moçambique |
| **BM** | Bank of Mozambique |
| **BPD** | Banco Popular de Desenvolvimento (now renamed Banco Austral) |
| **BRI** | Boletim de Registo de Importação |
| **CFM** | Caminhos de Ferro de Moçambique (state-owned ports and railways company) |
| **CIRR** | Commercial Interest Reference Rate |
| **CPI** | Consumer Price Index |
| **DINAGECA** | National Directorate for Geography and Cadastre |
| **DSA** | Debt Sustainability Analysis |
| **DPT** | Diphtheria, Pertussis, and Tetanus |
| **EEZ** | Exclusive Economic Zone |
| **ESSD** | Education Sector Strategic Program |
| **EU** | European Union |
| **FAO** | Food and Agricultural Organization of the United Nations |
| **f.c.** | Factor Costs |
| **FDI** | Foreign Direct Investment |
| **f.o.b.** | Free on Board |
| **GDP** | Gross Domestic Product |
| **GNFS** | Goods and Nonfactor Services |
| **GNP** | Gross National Product |
| **HDI** | Human Development Index |
| **HIPC** | Heavily Indebted Poor Countries |
| **HIV/AIDS** | Human Immunodeficiency Virus |
| **ICM** | Instituto de Cereais de Moçambique |
| **IFC** | International Finance Corporation (World Bank Group) |
| **IMF** | International Monetary Fund |
| **INE** | Instituto Nacional de Estatistica (National Institute of Statistics) |
| **MICOA** | Ministry of Environmental Coordination |
| **MICTUR** | Ministry of Industry, Commerce, and Tourism (now renamed Ministry of Industry and Commerce) |
| **MISP** | Maputo Iron and Steel Project |
| **Mozal** | Mozal, aluminum smelter |
| **m.p.** | Market Prices |
| **MPF** | Ministry of Planning and Finance |
| **Mt** | Metical/pl. meticais (currency of Mozambique) |
| **MT** | Ministry of Labor |
| **NGO** | Non-governmental Organization |
| **NHS** | National Household Survey |
| **NPV** | Net Present Value |
| **PARPA** | National Action Plan for the Reduction of Absolute Poverty |
| **PRES** | Economic and Social Rehabilitation Program |
| **PROAGRI** | Program Nacional para o Desenvolvimento Agricola (Agricultural Sector Investment Program) |
| **ROCS I and II** | Roads and Coastal Shipping Projects I and II |
| **RPED** | World Bank's Regional Program on Enterprise Development |
| **SADC** | Southern Africa Development Community |
| **SDI** | Spatial Development Initiatives |
| **SEMOC** | Sementes de Moçambique (state-owned seeds company) |
| **TAC** | Total Allowable Catch |
| **TDM** | Telecomunicações de Moçambique (state-owned telecom company) |
| **UNDP** | United Nations Development Program |
| **USAID** | United States Agency for International Development |
| **UTRE** | Unidade Técnica de Restruturação Empresarial (Enterprise Restructuring Technical Unit) |
| **WDR** | World Development Report |

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# EXECUTIVE SUMMARY

Having weathered the ravages of war and abandoned central planning for a market based system, Mozambique seems headed for a promising future. A program of reconstruction and economic reform—begun in 1987 and accelerated in 1994—has reduced inflation and increased growth. These achievements have increased optimism about Mozambique's future. To continue to grow rapidly and reduce its very high levels of poverty, however, Mozambique will need to adopt a new set of reforms. Those reforms—which focus on increasing the profitability of agriculture and promoting labor-intensive manufacturing activities—hold the best hope for moving millions of Mozambicans from poverty to prosperity.

***Mozambique's economy has undergone remarkable change over the past five years***

The transformation of Mozambique's economy in recent years has been impressive. Real output growth has averaged more than 8 percent a year from 1994 to 1999, and average output growth for the past three years exceeded 10 percent, making Mozambique one of the fastest-growing economies in the world. Annual inflation fell from an average rate of 60 percent a year in 1994 to less than 10 percent since 1997. And private investment is on the rise. These changes have made Mozambique one of the Sub-Saharan African countries with the most promising prospects for sustained growth and development. In fact, in 2000 it ranked third among 24 countries on an "optimism index" of businesspeople active in Africa (Center for International Development, Harvard University and World Economic Forum, 2000).

Three factors—increased political stability, deep economic reforms, and foreign assistance—contributed to these positive developments. First, the civil war, which devastated an already weak human and physical capital resource base, ended in 1992. A democratic regime replaced the one-party system, and two rounds of presidential and parliamentary elections have since taken place. Second, the government decisively started moving away from a closed, centrally planned economic model toward reliance on market mechanisms underpinned by private ownership. Third, strong external financial and technical support helped the government resettle displaced populations, conduct elections, and launch a large reconstruction and recovery program.

***Optimism is justified, but serious problems and challenges remain***

These political and economic developments are extraordinary, and they represent a very promising start. But Mozambique is still in the early stages of economic and social development, and poverty remains very widespread. Average income is just US$220 a year, and poverty, isolation, illiteracy, and disease still characterize the lives of most of the population. More than two-thirds of the population live in absolute poverty, and most of the poor live in the country's vast rural areas, where infrastructure and communications are weakest. Most Mozambicans are also unable to take advantage of their country's growing opportunities. Sixty percent of the adult population—and 76 percent of all women—cannot read or write, and life expectancy at birth is only 46 years. This sobering portrait underscores the need for rapid and sustained progress in improving living standards.

***Without new reforms, double-digit growth rates cannot be sustained***

The successes of the past few years in stabilizing and jump-starting the economy set a good foundation for sustaining rapid growth. However, long-term adherence to some basic principles will be necessary if the economy is to continue to grow rapidly. Sustaining annual real growth rates of 5–7 percent requires maintaining a stable political regime and a sound macroeconomic framework. To grow even more rapidly, a new round of reforms is needed.

Against the backdrop of recent history, the national panorama has brightened considerably. During the 1980s Mozambique was riven by a civil war that exacted a devastating social and economic

toll. With more than 4 million Mozambicans displaced (internally and to neighboring countries), and destruction of large amounts of infrastructure and other productive assets, Mozambique became one of the world's poorest nations in a very short period of time. Things began to change during the 1990s, as Mozambique's government confronted the political and economic crisis with determination, setting in motion a remarkable process of reconciliation and economic recovery. In the absence of new reforms, however, growth is likely to slow, for two main reasons. First, some of the factors behind the recovery, such as postwar population resettlement, were one-time developments that are unlikely to help sustain growth in the future. Some of the recent growth thus represents a bounce back to earlier levels of output—a common phenomenon in Sub-Saharan African countries that restored peace and liberalized their economies after years of economic and political turmoil. Other factors, such as weather, represent exogenous factors that may or may not be favorable in the future. Though the country has benefitted from generally good weather, the droughts of 1992 and the floods of early 2000 highlight the country's vulnerability to negative shocks.

Second, distortions and weaknesses in key sectors of the economy will constrain continued growth, even in the short run. An unfinished agenda of reform and deregulation remains in key sectors of the economy, such as transportation, power, and telecommunications, which have a cross-cutting impact on the economy as a whole.

With postwar and post-privatization recovery nearly exhausted, output in fisheries virtually stagnant, and the construction phase of the Mozal aluminum smelter completed, overall growth rates are likely to decline to 5–7 percent a year. For a middle-income country this rate of growth may be satisfactory. For a country as poor as Mozambique, it is not. Given growth of 5–7 percent a year and moderate population growth, it would take a century for per capita incomes in Mozambique to reach current incomes in Mexico or Mauritius. Making a significant dent in poverty in Mozambique requires that the economy grow more rapidly.

Sustaining very rapid growth while reducing poverty is thus the challenge Mozambique's newly elected government faces. The government has much to build on: an external donor community ready to assist the country in its path to development, an improvement in the perception of the country by the domestic and foreign business community, and a tenacious people who have had to prevail against external threats and adversities of nature. Moreover, in 1999 the government published its National Action Plan for the Reduction of Absolute Poverty (PARPA), which sets out a strategy for addressing the poverty question over the medium term. But the government also faces momentous obstacles: a fragile political and macroeconomic situation, inadequate infrastructure, a very weak human capital base, and a high-cost business environment. Policymakers also face growing opposition to further opening and privatization of the economy.

There is a risk that after the sweeping reforms of 1995–98, the government may move toward a more gradual approach to reform, or even reverse some measures implemented earlier. Some policies implemented in 1999—such as the increase in the export tax on raw cashews, the increase in import surcharges on some commodities, and increased restrictions on the hiring of foreign workers—reveal hesitations about the direction and pace of reforms. Such hesitations are common in many countries undertaking major reforms, but they have generally proved costly.

## Reform agenda

Over the next 5–10 years, a two-pronged strategy based on agricultural growth combined with encouraging labor-intensive, private sector-led manufacturing and service activities, holds the key to continued rapid economic growth and poverty reduction. The proposed strategy thus recommends focusing on agriculture and removing impediments to private sector development, while redirecting public spending toward sectors with the highest potential for reducing poverty, such as education, health,

water, and roads. Avoiding a slowdown in growth requires that the government act decisively in five areas. These include strengthening the macroeconomic environment, unleashing agriculture's poverty-reducing potential, removing impediments to private sector growth, improving human capital, and protecting the country's natural resources.

***Strengthening the macroeconomic environment***

With strong growth, single-digit inflation, and a fiscal deficit after grants of about 1.6 percent of GDP, Mozambique's economy in 1999 was on a better footing than it had been since independence. Despite the fact that the macroeconomic environment is more stable now than in the early 1990s, the country faces serious internal and external imbalances. Difficulties in macroeconomic management in early 2000 revealed the instability of Mozambique's economy. Furthermore, financial difficulties experienced recently in two of the partially privatized banks—which are now being restructured—highlighted deficiencies in supervision. These macroeconomic and financial challenges can only be fully resolved over the long run, but doing so requires action in the short run. Key measures include gradually reducing the fiscal deficit before grants by (a) increasing tax revenues, (b) improving the effectiveness and transparency of public spending, and (c) improving the external balance.

***Reducing the fiscal deficit by increasing tax revenues***

Gradual fiscal adjustment should be a priority of government policy over the next decade. Although the deficit after grants is relatively low (1.6 percent of GDP), the overall fiscal deficit before grants stood at 13.4 percent of GDP in 1999, reflecting the country's high degree of reliance on external aid. The overall balance also deteriorated to about 17 percent of GDP in 2000, partly as a result of the floods, but also as a result of sharp increases in expenditures associated with losses in the financial sector and increases in civil service wages for the lowest salary grades. So far, the government has rightly avoided implementing an excessively rapid fiscal adjustment, which would inevitably raise the overall level of taxation, reduce expenditures, or both. This strategy, made possible by the availability of external aid, was appropriate at a time when the demands of reconstruction were high and the potential revenue from a paralyzed economy relatively low. Strong growth will facilitate a gradual fiscal adjustment over the medium run, while the availability of external assistance will allow spending to be protected and increased in real terms. Over the long run, however, aid flows are likely to decline, indicating the need to reduce dependence on foreign assistance. The question for the government, therefore, is not whether to reduce fiscal imbalances but how to reduce them and how quickly to do so.

Reducing reliance on external aid and sustaining broad-based growth will require that domestic revenues be gradually increased over the medium and long run. Increasing revenues through the current distortionary tax system—which favors particular activities and overtaxes external trade—could threaten growth, however. The government can now use the opportunities created by strong growth and available external assistance to put in place the foundations of a more efficient and equitable tax system. In the short run, increasing domestic revenues can be based only on a broadening of the tax base, mainly by eliminating special tax incentives for particular activities, enterprises, or regions and increasing value added tax (VAT) collections. The trade and indirect tax system have already improved considerably as a result of the replacement of the turnover tax with a VAT and the reduction and simplification of trade taxes. However, while the economy underwent deep transformations, the direct tax system has not undergone any significant modification since independence (except *ad hoc* changes in tax rates and exemption regimes, such as the Zambezi Valley tax regime). The result has been an erosion of the tax base that has adversely affected both the efficiency and the equity of the tax system. The government should enlist the help of tax specialists to carry out a comprehensive study of the tax system, including an analysis of the incidence and equity of taxation. Moreover, an overhaul of the tax administration itself needs to be put squarely on the reform agenda.

***Increasing the effectiveness and transparency of public spending***

The ability of Mozambique to continue to grow rapidly is constrained by inadequate and unevenly distributed public services. The issue is not simply one of low overall expenditures, but also of inefficient intersectoral allocation and overall effectiveness of domestic and externally-financed public expenditures. The extent to which domestic and external resources (including debt relief) are able to foster rapid growth and alleviate poverty will depend not only on the uses to which specific funds are put but also on the overall profile of public expenditures. As a result, expenditures and service delivery in key sectors—education, health, the judicial system, water, power, and road rehabilitation and maintenance—remain well below needed levels and the budget process remains donor-driven to a large extent. This requires that the government builds on the progress made so far in improving budget programming, to focus on strengthening execution and accounting of public funds.

To improve the efficiency and transparency of public spending, four actions should be implemented without delay. First, the budget execution and accounting system should be overhauled. Second, consolidated fiscal accounts—including those of all provincial authorities and financially autonomous institutions, such as public enterprises and institutes—should be developed. Third, a review of public expenditures, including both on- and off-budget spending, should be carried out to help ensure that the profile of government expenditures is consistent with the government's growth- and poverty-oriented strategy. Since a large share of expenditures are financed through donor aid (which accounts for about half of government expenditures registered in the budget and possibly more when all off-budget flows are included), such an exercise will require the collaboration of all major donors. Fourth, the government should empower the elected officials of the newly autonomous municipalities to raise their own revenue and allocate expenditure according to local priorities. This would require transferring funds through block grants and granting effective authority over local staff to the municipalities.

***Strengthening the external balance***

Notwithstanding favorable external prospects and the progress made since 1995 in improving the current and capital accounts, Mozambique's external position continues to be vulnerable in several ways. First, merchandise exports remain small, and despite substantial liberalization, the ratio of the current account deficit to GDP remains high. Second, the export base remains heavily concentrated on a few products, most based on natural resource use. Although the export of electricity and aluminum by Mozal will improve the country's external position and is expected to more than double exports by 2001, most of the country's traditional exports are far below peak levels. Some major exports at independence, such as manufactured goods and cash crops, have yet to recover fully and are expected to recover only slowly. Third, macroeconomic management is more difficult in the presence of large aid inflows. Unless an open trade regime is maintained and a competitive exchange rate policy pursued, the economy can be steered toward production of nontradables. Given the substantial external aid flows that are expected to continue at least over the short run monetary policy and central bank interventions in the foreign exchange market should aim at maintaining a stable price level and a competitive exchange rate, in order not to discourage exports in favor of imports.

While much progress was achieved in opening Mozambique's economy during the 1990s, the reform agenda in this area remains unfinished. A more active stance should be adopted in promoting exports of electricity, gas, aluminum, agriculture, fisheries, tourism, and manufacturing. Reducing external vulnerability will require an aggressive strategy to eliminate both legal barriers, in the form of import and export duties, and administrative impediments to trade. Doing so will require continuing to improve customs procedures and administration, ensuring that exports are not taxed by promptly processing VAT refunds, resuming the reduction of import and export taxes, and eliminating import surcharges. Complemented by actions discussed below to lower the costs of doing business in

Mozambique, these measures would go a long way to improve the competitiveness of firms in domestic and external markets.

***Unleashing agriculture's poverty-reducing potential***

Strong economic growth—particularly growth in agriculture—is the most effective engine driving poverty reduction. A recent study of 35 developing countries estimated that a 10 percent increase in per capita agricultural GDP led to a 16 percent increase in the per capita incomes of the bottom fifth of the population (Timmer 1997). A study of 38 small and medium-size developing countries found that growth in agriculture and basic services reduced poverty more than growth in industrial output (Bourguignon and Morrison 1998).

Although over the long run it is unlikely that agriculture alone (and smallholder agriculture in particular) will provide rising incomes or employment for the 70 percent of Mozambique's population currently employed in agriculture, over the next 5–10 years agricultural growth will hold the key to continued economic growth with poverty reduction. A strategy based on unleashing the power of agriculture to reduce poverty needs to focus on three areas: facilitating rural trade, improving access to land and security of tenure, and promoting improvements in productivity.

***Facilitating rural trade***

Mozambique is sparsely populated, at about 20 inhabitants per square kilometer. While this means that much of the country has not suffered from pressure for cultivable land, it has also made it difficult to develop infrastructure and integrate markets. Facilitating domestic and foreign trade by repairing roads, building and maintaining feeder roads, and eliminating obstacles to trading activities are crucial for reducing poverty in rural areas.

Recovery of roads should be the first priority. Efforts should focus first on recovering those roads damaged by the recent floods and those in areas in which the social rate of return is highest, namely, the densely populated provinces of Nampula and Zambezi. This will provide lower cost market access for the rural sector, translating into higher farmgate prices for outputs and lower prices for inputs.

Abolition of licensing requirements would encourage entry into trade. There is no reason why traders should be required to do more than register for tax purposes. The new commercial law approved in 1998 opens the way for easier entry into trading activities, but it is important that the regulations be completed and widely publicized. At the regional level, district officials have been reported to have prohibited trading out of fear of lack of food supplies in their areas. And instances of *ad hoc* restrictions on trading activities at the provincial level have been reported for instance in Niassa, where active border trade in food crops and consumer goods takes place. These practices both inhibit exports and hold down producer prices. An unambiguous and widely publicized statement of current government policies regarding the requirements for trading would help dispel confusion at the provincial level. In addition, alternative mechanisms not based on trade prohibitions or restrictions should be devised to address food security concerns.

***Improving access to land and security of tenure***

Property rights, in particular land use rights, are ill-defined in Mozambique, and the framework for exchanging land use rights is rigid, unclear, and therefore inefficient. This lack of definition and inadequacy of the land titling process is a constraint on smallholder production and larger-scale activities alike. Currently, the national land law does not allow for freehold tenure. Instead, long-term (50-year) leases are issued. Leasing rights are not formalized for the vast majority of smallholders, who may have

some security of tenure under traditional systems, but who live with the uncertainty of administrative interference in their economic affairs.

The fact that the current law stops short of permitting full private ownership of land impedes development, not only in the resource sectors but more broadly as well. First, where land is not owned, it cannot be used as collateral, which reduces access to credit. Second, because land cannot be owned, the price of acquiring land—determined by what is essentially an administrative process—is likely to be artificially low, reducing allocative efficiency. Third, the lack of a true market in land creates rigidities, and the bureaucratic process by which leases are traded creates opportunities for rent-seeking. An entrepreneur who believes she could make better use of a piece of land than the current tenant cannot simply offer to buy the land. Instead, she must pursue a bureaucratic process in which the current tenant relinquishes his usage rights and the entrepreneur establishes new usage rights. In late 1999 a backlog of more than 10,000 applications for land use permits prevented land transactions from taking place and discouraged investments by both large- and small-scale farmers. Smallholders, who have less access to the bureaucracy, are likely to be particularly vulnerable to the inefficiencies and lack of transparency of the process. Lack of security of tenure is also a serious problem for investors and tourist operators, whose legitimacy is frequently called into question and who fear reprisals by farmers or arbitrary cancellation of their titles.

An active and efficient land market is a fundamental piece of an agricultural growth strategy. Substantial improvement in the efficiency of land allocation could be achieved by allowing land use rights to be traded with minimal bureaucratic interference. Credible, tradable long term leases to land can help mitigate many of the obstacles inherent in the current system. Genuine tradability would permit lease holders to use their land rights as collateral, which would facilitate access to credit. Tradability would also foster a more efficient allocation of lease rights, thus providing some of the benefits associated with a private land market. For the current system to approach conditions of market tradability, however, bureaucratic discretion and involvement in the trading process should be reduced, especially once titles are issued. At the same time, the success of this approach is premised on the existence of an effective bureaucratic apparatus to administer the process competently, fairly, and transparently. Several measures deserve prompt attention. First, the disagreement about the proper roles of DINAGECA and the Ministry of Justice should be resolved expeditiously. Second, the issue of land disputes should be addressed by a countrywide campaign, in which claims and disputes would be filed, evaluated, and settled. Third, administrative procedures must be reviewed and revised to simplify and expedite the entire process.

***Promoting improvements in productivity***

Agricultural productivity is low in Mozambique. Maize yields, for example, averaged 0.5 tons per hectare between 1991 and 1995—half or less of yields in Malawi, Zambia, and Zimbabwe. Agricultural output could be increased by increasing applications of nutrients, particularly in peri-urban zones, where population growth is creating pressures for intensification. Increasing fertilizer use in Mozambique is difficult, however, because most farmers are too poor to afford it.

To increase productivity, the government could reduce impediments—be they tariffs or administrative barriers—to importing seeds, fertilizers, and other inputs. Along with improved road rehabilitation and maintenance, this could help lower input costs to producers. An updated approved list of agrochemicals and seeds should be transmitted to customs regularly in order to eliminate the need for registration with the Ministry of Agriculture. Agreements with other SADC countries to recognize seeds or agrochemicals certified by other member countries would also reduce the administrative burden on the Mozambican administration and help increase input supply and reduce prices.

***Removing impediments to private sector activities***

The main source of growth and diversification in Mozambique in the long run will have to be outside agriculture. Along with transport and tourism, labor-intensive manufacturing offers the greatest potential for continued growth with poverty reduction over the next 10-20 years. Enclave projects (large capital-intensive projects like the Mozal aluminum smelter) can play an important role in the economy by contributing to growth, and generating foreign exchange and potentially tax revenues. But they cannot be the main vehicle for development. Development and employment creation will come from increased business activity, both by foreign and domestic firms.

Businesspeople feel confident about Mozambique's prospects. Yet surveys of 650 businesses active in Africa reveal that Mozambique ranks only 18th out of 24 African countries in terms of competitiveness. In all six measures included in the competitiveness index—openness, government regulation, finance, infrastructure, labor market, and institutional indicators—Mozambique was systematically judged weaker than two-thirds of the countries surveyed. The consistent message from the private sector is that Mozambique is still an impoverished economy, with a very small domestic market, high operating costs (due to poor infrastructure), low productivity of labor (due to low skills and poor health), and high transaction costs (due to poor security and an inefficient bureaucracy). The cost of doing business in Mozambique is high, particularly for small and medium-size enterprises and for foreign firms. In a world in which technological change is reducing transport costs, hastening globalization, and changing the nature of competition, firms must acquire skills to survive and grow. Thus, despite optimism about Mozambique's prospects, new investments and economic activity may not materialize to their fullest potential unless an aggressive strategy to improve the business environment and reduce costs to the private sector is pursued.

The tardiness of the judicial system—stemming from antiquated law, deficient capacity and corruption—is a brake on commercial activity, *inter alia* because the banks are unable to use collateral in order to extend loans to new clients. The Government is committed to a process of comprehensive judicial reform, which will inevitably be long-term. It will be necessary to issue a policy of legal and judicial reform and then to implement reforms encompassing institutional change within the Ministry of Justice, legal changes and further upgrading of the skills capacity of the judicial system.

Removing these impediments to private sector activity requires strategic and decisive action from the government. In the short run, reforms should include increasing flexibility in the labor market, renewing reform and investment efforts in the infrastructure and telecommunications sectors, and simplifying business licensing requirements.

***Increasing flexibility in the labor market***

Coupled with the shortage of skilled labor, Mozambique's labor legislation is becoming an obstacle to increasing productivity. The legislation governing layoffs, as well as that which governs the hiring of foreign workers, discourages employment creation and knowledge transfer and encourages the proliferation of short-term contracts. In addition, the burdensome reporting requirements to the Ministry of Labor increase the costs of doing business. This introduces labor market rigidities, adds to the already considerable costs of doing business in the country, and discourages existing firms from expanding and foreign firms from locating in Mozambique. The government is rightly concerned with improving opportunities for more Mozambicans to participate in the labor market and with employment generation. A strategy combining revamped higher education, technical, and vocational training programs with measures to reduce constraints on the labor market could help make the Mozambican workforce more competitive and attractive to businesses, while allowing them to adjust and define their workforce according to need.

***Improving infrastructure and telecommunications***

Mozambique's poor infrastructure is a serious impediment to growth, especially in the center and north of the country and for larger firms, which distribute their products over a wide geographic area. Infrastructure and telecommunications bottlenecks are considerably more severe in Mozambique than in most countries, reflecting decades of conflict, a dearth of resources, and an inadequate institutional and regulatory structure. The lack of adequate infrastructure penalizes all sectors of the economy and contributes to the isolation and lack of market orientation of rural households.

Renewing pro-competition and investment efforts in the infrastructure and telecommunications sectors should be among the government's top priorities. The government should remove administrative and regulatory obstacles to private sector entry and competition in telecommunications (in particular value-added and complementary services such as cellular phone), domestic and international air transportation, and coastal shipping, while strengthening regulatory bodies. It should accelerate the privatization of management, through competitive and transparent means, of the national railroad company, CFM. And it should prioritize rehabilitation and maintenance of the road network, particularly in the densely populated agricultural areas of Zambezia and Nampula.

***Simplifying business licensing requirements***

Surveys of manufacturing firms reveal that the most frequently cited problem in Mozambique is the country's ineffective bureaucracy. A recent report (Emery et al., 1999) revealed that firms need to spend almost 10 percent of their initial foreign investment just to incorporate, a process that on average takes a year to complete. In addition, obtaining title to land and premises can cost up to US$50,000. Managers in the manufacturing sector report that while policies are improving and the government is trying to be more business friendly, most civil servants have not yet adopted the new philosophy. The bureaucratic burden is a particularly serious problem for foreign firms, among which it ranks second only to finance. Given that large foreign firms are responsible for much of the recent growth in the dynamic manufacturing sector, this should be of great concern to the government.

***Improving education and health and curtailing the spread of HIV/AIDS and malaria***

Investing in human capital—by improving education, particularly of girls and women, and health services—and curtailing the spread of HIV/AIDS and malaria are critical to Mozambique's continued economic and social development. In East Asia and elsewhere, studies have shown that universal primary education has been a significant factor contributing to high growth rates and substantial reductions in poverty. The ability to move into more remunerative off-farm employment, adopt riskier and more complex agricultural technology, and make a successful transition to an urban livelihood are all closely linked to literacy and levels of education.

An illiterate work force will find it difficult to learn about and adopt new technologies. To prepare Mozambicans for a better future, the government should continue to endeavor to increase basic education opportunities for children and adults. So far, much of the effort has been placed on increasing access to education. However, greater focus on improving the quality of education is becoming increasingly necessary. To achieve the dual objectives of greater access and higher quality, the government will have to increase the number of qualified teachers, through enhanced pre-service and in-service training.

Immediate action must be taken to limit the spread of HIV/AIDS. According to UNAIDS, 14.5 percent of Mozambique's adult population—1.2 million people—are HIV-positive, including about 120,000 children. Other estimates suggest that HIV prevalence rates in some areas (such as Tete and the Beira corridor) are as high as in Zimbabwe, where more than 20 percent of the adult population is

infected. These high rates of infection—which could rise to 35 percent of the population if the epidemic is not contained—could prove ruinous to Mozambique's economy. Because it kills so many adults in the prime of their working and parenting lives, HIV/AIDS decimates the work force, fractures and impoverishes families, orphans millions of children, and shreds the fabric of communities. It also places heavy demands on the already weak health system and reduces the ability of households to accumulate savings. The government has begun to address this with the development of an HIV/AIDS plan, which is presently being implemented.

Malaria remains the leading cause of death in Mozambique. Controlling malaria is difficult because much of the population lacks access to adequate preventive interventions, diagnosis, and treatment. The National Directorate of Health is currently implementing the malaria control plan, which focuses on insecticide spraying. An advisory group will be developing recommendations for dealing with the limited absorptive capacity and human resource constraints of the Ministry of Health, expanding health coverage to the 50 percent of the population that currently lack access to health services, and creating awareness, in a largely illiterate population, of the seriousness of malaria as a health problem. Addressing HIV/AIDS and malaria should be done in the context of a coherent health sector strategy, which would also direct attention and resources to other important health issues, such as malnutrition.

***Protecting the country's natural resources***

Prospects for economic growth in the natural resource sector are good. To maximize the returns from its rich resource base, however, Mozambique will have to adopt policies and set priorities that promote environmentally and socially sustainable development. Four resource management issues should be addressed immediately: transparency and resource usage rights, forest management, artisanal mining, and water supply. An additional issue—not covered in this report because of inadequate information—is the apparent decline in fishing output, which may indicate overfishing and thus poor management of fisheries.

The sustainability of Mozambique's resources is determined by the institutions that govern access to and use of the natural resource base. Mozambique has new and largely untested policy frameworks for the management of the environment and natural resources. Environmental institutions in Mozambique are young and undeveloped, and the principal environment ministry, Ministério da Coordenação Ambiental, is a coordinating ministry with few legislative tools to enforce behavior. As growth and pressures on natural resources increase, the government should move to turn these broad frameworks into effective policies.

## Making the difference between poverty and prosperity

Despite the floods that ravaged parts of the country in early 2000, Mozambique should be able to sustain rapid growth over the next decade. The visionary governments of the past decade have set in place a foundation of peace, democracy, and increased economic opportunity. Yet Mozambique's democracy is young and the path to democratic consolidation is fraught with the dangers of violence and instability. The spate of violence in late 2000, while beyond the scope of this report, raises serious concern about underlying political tensions and respect for the rule of law. Moreover, the country starts from a very low base. With a favorable environment in the business and donor communities, the challenge facing the newly elected government is to set in motion a second round of reforms that will allow the country to continue on a rapid growth path. The reforms proposed here are expected to have a cross-cutting impact in the economy. They will encourage businesses to expand and set up new activities, thus creating jobs, and small-scale farmers to go beyond subsistence agriculture to the production and marketing of surpluses, thus reducing poverty.

Some reforms will be controversial. Some will go against the interests of politically powerful interests, others will reduce rent-seeking opportunities, and some reforms will add costs before they reap savings. Over time, however, these reforms would go a long way to make the difference between poverty and prosperity for many Mozambicans.

# PART I. FROM CRISIS TO GROWTH

1. Immediately after independence in 1975, the mass exodus of the Portuguese settlers, the laying off by South Africa of Mozambican mine workers, and climatic shocks (heavy rains in 1977 and 1978, followed by drought in 1982) plunged Mozambique into a deep recession that brought much of the population to the edge of starvation. The government's initial response to the crisis was to nationalize assets that had been abandoned and install managerial teams, most young and unprepared, to run them. A highly centralized development plan identified the modern sectors of the economy—such as industry and the 3,000 large-sale farms, created partly from the abandoned estates of the Portuguese settlers—as the engines of growth. Small-scale agriculture was largely ignored. Aid began to arrive from the Eastern Bloc, financing technical assistance and technology for the economy's modern sectors. There was a fundamental disjunction, however, between the weak capacity of the state on the one hand and the responsibilities invested in it on the other.

2. By the mid-1980s it had become clear to the government that the strategy of achieving growth through the state-owned sector had failed. Mozambique was unable to feed its people, let alone service its debt. The political situation became increasingly unstable and civil war broke out, dislocating an estimated 3 million people and further eroding the already weak physical and human resource base. As a result, per capita gross national product (GNP) fell an estimated 45 percent over the 1981–86 period, gross domestic product (GDP) declined about 30 percent, and exports fell 75 percent.

## A. MACROECONOMIC PERFORMANCE, 1987–99

3. After the failed attempt at central planning and the civil war paralyzed Mozambique's economy, the government undertook the dual tasks of reaching a peace settlement and effecting the transition to a market economy. With substantial external financial and technical assistance and within the general framework of its 1987 Economic and Social Rehabilitation Program (ESRP), it began rehabilitating the country's infrastructure and human resource base, while simultaneously stabilizing and jump-starting the economy. The stabilization and structural reform program sought to address the fundamental causes of Mozambique's economic crisis. Initial reforms focused on bringing the level of demand and its composition (tradable relative to nontradable goods) into line with the level of output and external balance. Because external financial assistance has been large, overall demand has been able to expand in real terms every year since 1987.

4. Output has grown steadily since 1987, averaging 9.3 percent from 1996 to 1999. Increased political and economic stability, postwar population resettlement, economic reforms, large inflows of aid, and favorable weather contributed to annual GDP growth rates of 6.5 percent between 1987 and 1999, (Table 1.1).[1] Inflation rates, which despite improved fiscal and monetary control remained stubbornly high until 1994, started declining in 1995 (Figure 1.1). They fell sharply following the privatization of the state-owned banks in 1996 and 1997, as annual monetary growth was reduced from 55 percent in 1995 to 35 percent in 1999.

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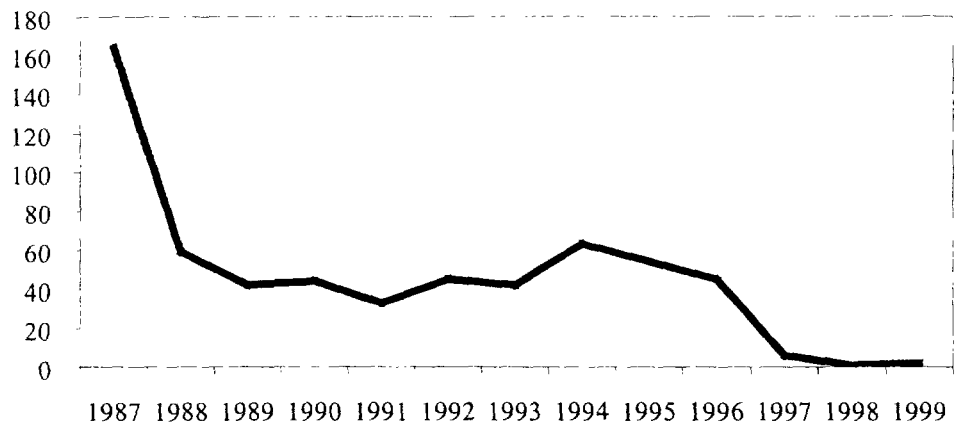
[1] Mozambique's economic data, while improving, are based on a small number of primary statistical sources. The reliability of these data deteriorated after economic reforms were implemented, as statistical practices failed to adapt to the changing economic structure. A vast amount of economic activity is either informal or unrecorded in official sources, and the accuracy of statistical information is poor and uneven, making econometric analysis of time-series data infeasible. The creation of the National Institute of Statistics (INE) in 1996 and its ongoing strengthening are expected to improve economic and social data. Substantial upgrading of the national and external accounts has already taken place in the past three years.

**Table 1.1: Changes in GDP, by Sector, 1987–99**
**(percent)**

| Item | 1987–99 | 1987–95 | 1996–99 |
|---|---|---|---|
| GDP at market prices | 6.5 | 5.3 | 9.3 |
| GDP at factor cost | 5.4 | 3.8 | 9.0 |
| Agriculture (incl. livestock) and fisheries | 6.4 | 5.4 | 8.7 |
| Agriculture (incl. livestock) | – | – | 9.0 |
| Fisheries | – | – | 1.9 |
| Industry | 6.5 | -0.4 | 22.0 |
| Construction | – | – | 18.7 |
| Gas, electricity, water | – | – | 98.2 |
| Mining and quarrying | – | – | -4.6 |
| Manufacturing | – | – | 18.2 |
| Services[a] | 7.2 | 5.4 | 11.2 |

– Not available.
[a] Includes government services.
Sources: 1987–91: Ministry of Planning and Finance; 1992–99: INE (National Institute of Statistics); World Bank staff estimates.

**Figure 1.1: Average Annual Inflation Rate (Maputo CPI), 1987-1999 (percent)**




Sources: Ministry of Planning and Finance; INE (National Institute of Statistics)

5. The positive growth rates of the past decade have been impressive, but they started from the extremely depressed output levels of the mid-1980s. With a GDP of just US$4.0 billion in 1999, the Mozambican economy remains small, and while output has grown, per capita incomes remain at approximately the same levels as in the early 1980s. Moreover, while in 1980–81 the economy was fairly diversified, with a relatively developed industrial base, in 1997–99 it was more concentrated on services and agriculture (Table 1.2). In addition, Mozambique's economy remains less trade-oriented than other African countries, such as Botswana, Ghana, Namibia, and Zimbabwe (Table 1.3).

**Table 1.2: Structure of Output and Exports, 1980–81 and 1997–99 averages**
**(percent, except where otherwise indicated)**

| Item | 1980-81 | 1997–99 |
|---|---|---|
| GDP at factor cost | 100 | 100 |
| Agriculture and fisheries | 36 | 34 |
| Industry | 34 | 22 |
| Services[a] | 30 | 44 |
| Exports of goods and services | 100 | 100 |
| Agriculture and fisheries | 20 | 22 |
| Industry | 50 | 21 |
| Services | 30 | 56 |
| Memorandum items: | | |
| GDP at factor cost (US$ millions) | 3,155 | 3,440 |
| Exports of goods (f.o.b.) (US$ millions) | 281 | 249 |

Note: Until 1991 industrial sector value-added included fisheries. [a] Includes government services.
Sources: Ministry of Planning and Finance; INE (National Institute of Statistics); Ministry of Industry, Commerce, and Tourism; World Bank staff estimates.

**Table 1.3: International Trade as Share of GDP, 1997–99**
**(percent)**

| Country | Exports plus imports of goods and services as share of GDP | |
|---|---|---|
| Mauritius | 133 | (1997-99) |
| Namibia | 119 | (1997-99) |
| Zimbabwe | 86 | (1997-98) |
| Botswana | 93 | (1997-99) |
| Zambia | 73 | (1997) |
| Ghana | 56 | (1997) |
| South Africa | 49 | (1997-99) |
| **Mozambique** | **42** | (1997-99) |
| Uganda | 32 | (1997-98) |

Source: World Bank.

6. Consumption and even more so investment have increased strongly since 1987 (Table 1.4). Private consumption grew moderately until 1995, financed almost exclusively by foreign aid inflows, which ensured the maintenance of minimum consumption levels. Government consumption declined until 1995, but it has recovered since then. In response to increased political and economic stability, private investment grew at an average rate of more than 21 percent a year (albeit from a low base). Flows of foreign direct investment (FDI) more than quintupled between 1996 and 1999, rising from US$72.5 million to US$381.7 million (of which an estimated US$330 million reflects the start of construction of the Mozal aluminum smelter, described in Box 1.1).

**Box 1.1: Investments in Infrastructure in the Maputo Corridor**

Flows of foreign investment have increased substantially in recent years, albeit from a very small base. Most new investments are located in the Maputo area, where work has begun on several large projects:

- Construction of the 440-kilometer N4 toll road, which links South Africa's industrial heartland with Maputo, commenced in May 1998. The 30-year concession will be operated by Trans African Concessions, a consortium that includes the French company Bouygues (and its majority-owned South African subsidiary, Basil Read) and the South African company Stocks and Stocks. The concessionaires financed the operation with about US$250 million of debt (US$140 million from South Africa's major banks, US$75 million from South African institutional lenders, and US$33 million from the Development Bank of Southern Africa) and US$55 million in equity. The project is expected to be completed in mid-2001.

- Ground was broken for the $1.3 billion Mozal aluminum smelter, located near Maputo, in June 1998. Key to the viability of Mozal, a capital- and energy-intensive operation, is the availability of low-cost energy. Of total equity of US$520 million, the primary private operator, Billiton (spun-off from the South African mining house Gencor), will contribute US$244 million. Mitsubishi and South Africa's parastatal Industrial Development Corporation will each contribute US$125–$130 million. The equity share of the Government of Mozambique amounts to US$21 million. The remaining US$820 million will be in the form of debt and quasi-equity, with the International Finance Corporation contributing US$120 million. Much of the debt will be provided by or under cover of export credit agencies. Production is expected to start in mid- to late 2000.

- ESKOM, the South African power utility, in a consortium with the Mozambican power company EdM and the Swazi Electricity Board, has laid two 400-kilovolt transmission lines from South Africa to Maputo (one via Swaziland) to supply Mozal with its power needs, corresponding to a capacity of approximately 450 MW. By comparison, maximum power demand of Mozambique in 1999 amounted to about 260 MW, of which the southern region represented about 150 MW, most of it supplied by HCB through ESKOM's and EdM's southern system. The project cost of Motraco amounted to about US$120 million, and was financed with about US$32 million of equity and US$93 million of debt. The new power lines, even though initially dedicated to Mozal, have in fact increased available transmission capacity in Southern Mozambique, as they are designed with spare capacity beyond Mozal's supply and stand-by needs. They are also expected to improve the quality of power supply to the greater Maputo area as they are linked to EdM's southern system near Matola. Construction of the power lines and substations was essentially completed during the first half of 2000, with power being provided to Mozal for test runs from April, and for operational start-up from June.

**Several other projects are under consideration:**

- The Maputo Iron and Steel Project (MISP) is intended as the primary purchaser of natural gas from the Pande gas fields in central Mozambique. It would also consume magnetite, delivered in slurry form through a pipeline from South Africa. The sponsor of the project, ENRON, has exclusive marketing rights over the Pande gas fields. The project is projected to produce 3.5 million tons of steel slab a year, making it the world's largest steel slab producer. Projected output would represent close to 20 percent of total steel slab currently traded internationally. The capital cost of MISP is estimated to be US$2 billion, with additional capital costs of US$500 million for developing the Pande gas fields and a 600-kilometer pipeline. Financial closure and construction start are expected during the first half of 2001.

- The South African company Sasol and its U.S. partner Arco are considering exporting gas from the Temane and Pande fields through a 900-kilometer pipeline to South Africa. The US$600 million project appears in competition with MISP based on known gas reserves. However, since additional reserves are likely to exist, it may be possible to implement both projects and maximize the use of Mozambique's gas resources. Although the impact of this project in the Maputo area would be small, it would increase low-cost and environmentally friendly energy supply to the Maputo corridor, particularly on the South African side. The Maputo port and port services and the rail links between Maputo and South Africa are in the process of being concessioned by the Government of Mozambique. The project, which requires only small initial investments, would have a substantial impact on transport efficiency by increasing throughput and lowering costs.

**Table 1.4: Changes in GDP, Consumption, and Investment, 1987–99**
**(percent)**

| Item | 1987–99 | 1987–95 | 1996–99 |
|---|---|---|---|
| GDP | 6.5 | 5.3 | 9.3 |
| Consumption | 3.8 | 2.1 | 7.7 |
| Public | 2.4 | -2.3 | 12.9 |
| Private | 4.5 | 3.2 | 7.3 |
| Gross fixed capital formation | 12.2 | 8.5 | 20.4 |
| Public | 5.4 | 2.6 | 11.5 |
| Private | 25 | 21.6 | 32.4 |
| Foreign balance | | | |
| Exports of goods and services | 15.8 | 15.9 | 15.6 |
| Imports of goods and services | 4.7 | 0.4 | 14.2 |
| Memorandum items: | | | |
| Current account balance before grants/GDP | -23.1 | -33.3 | -20.6 |
| Gross domestic savings/GDP | -10.1 | -14.6 | 3.2 |
| Foreign direct investment/GDP | 0.6 | 0.9 | 4.8 |

Sources: 1987–91: Ministry of Planning and Finance; 1992–99: INE (National Institute of Statistics), World Bank staff estimates. Figures based on constant Metical prices.

7. Mozambique's external accounts have improved since 1987, but the large external imbalances and lack of diversification in the export base remain causes for concern. After deteriorating sharply in 1993 and 1994, the current account deficit before grants decreased from an average of 33 percent GDP until 1995 to about 21 percent of GDP since 1996 (Table 1.4).[2] Exports of transportation services have expanded moderately since 1994, as have inflows associated with workers' remittances, mostly from Mozambican miners in South Africa. After grants, increases in transfers reduced the current account deficit to about 19 percent of GDP. In response to the depreciation of the exchange rate and the reduction in import and export restrictions—and thus of the anti-export bias implicit in the previous trade regime—exports have increased by more than 11 percent a year since 1987 (Table 1.5). Between 1987 and 1995 agricultural and fishery exports grew at about the same rate as manufactured exports. Manufacturing exports started a strong recovery in 1996, after privatization accelerated and macroeconomic reforms started to bear fruit.

8. Despite substantial improvement since 1994, Mozambique's external position remains vulnerable. Exports of goods in 1999 were no more than 96 percent of their 1980–81 level. Moreover, the balance of payments is highly sensitive to climatic and terms of trade shocks, with three commodities (prawns, cotton, and cashews) accounting for 50 percent of the country's exports of goods.

[2] The deterioration in the current account balance in 1998 resulted from higher imports associated with the construction of the Mozal aluminum smelter, but they were financed by a corresponding increase in FDI flows.

**Table 1.5: Growth Rate of Exports of Goods and Nonfactor Services, 1987–99 (percent)**

| Sector | 1987–99 | 1987–95 | 1996–99 |
|---|---|---|---|
| Total | 11.5 | 12.3 | 9.6 |
| Agriculture (incl. livestock) and fisheries | 8.7 | 10.0 | 5.8 |
| Agriculture (incl. livestock) | 65.9 | 78.9 | 36.5 |
| Fisheries | 6.2 | 9.1 | -0.3 |
| Industry | 14.7 | 11.7 | 21.7 |
| Mining and quarrying | 37.1 | 58.7 | -11.5 |
| Manufacturing | 9.5 | 10.8 | 6.4 |
| Services [a] | 13.0 | 15.3 | 7.8 |

[a] Includes government services.
Note: Exports are measured in nominal US dollars.
Source: Ministry of Industry, Commerce, and Tourism.

9. Foreign direct investment (FDI) of US$382 million in 1999 is 15 times higher than in the early 1990s. Mozambique has become an increasingly attractive destination for investors from South Africa, Portugal, and most recently Mauritius. Until 1996 FDI figures largely reflected investment in medium-scale recently privatized firms in industry, tourism, and the banking sector. Since then a number of large-scale capital-intensive projects, based mostly on natural resource extraction, have become increasingly economically and politically visible (the role these "enclave" projects can play in Mozambique's development strategy is discussed in Part II). So far, most of these initiatives have been concentrated in the Maputo corridor, which links the Maputo area and port to South Africa's industrial heartland (Box 1.1).

10. Employment in Mozambique is concentrated largely in agriculture. While the industrial and service sectors of the economy are now growing rapidly and have the potential to absorb increasing shares of formal sector employment in the long run, Mozambique remains largely an agricultural country. The 1997 census indicates that more than 80 percent of the economically active population is employed in the agriculture, forestry, and fishing sectors. The service (including government) sector employs 15 percent of the work force, with industry absorbing just 5 percent.

11. Mozambique's agricultural sector comprises a large and heterogeneous smallholder sector and a variety of commercial enterprises. The smallholder sector produces mostly food crops for own consumption (but increasingly for the market) and a few cash crops, such as cashews and cotton. Commercial enterprises principally produce cash crops, such as cotton, sugar, tea, and, to some extent, cashews. About 95 percent of value-added in the agricultural sector is generated by the smallholder sector (Table 1.6).

**Table 1.6: Value-Added in Agriculture, 1997–99**

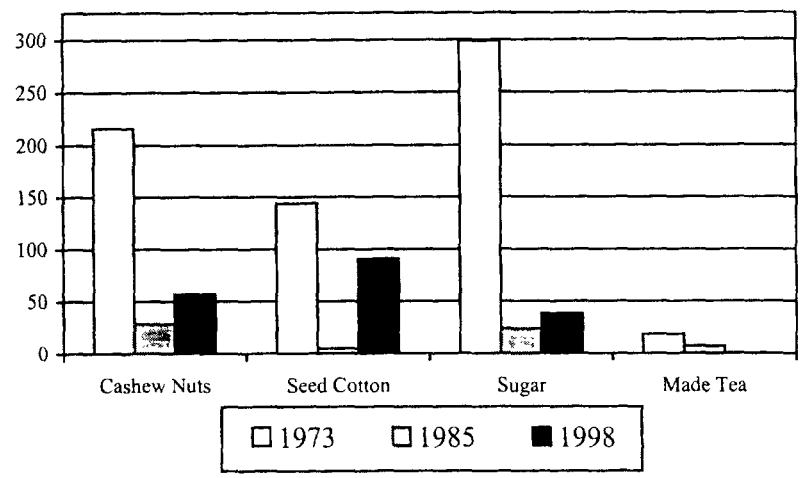
| | 1997 | | 1998 | | 1999 | |
|---|---|---|---|---|---|---|
| Item | $US millions | Percent | $US millions | Percent | $US millions | Percent |
| Total value-added in agriculture | 975 | 100 | 1,096 | 100 | 1,012 | 100 |
| Smallholders | 926 | 95 | 1,041 | 95 | 961 | 95 |
| Of which own consumption | 315 | 32 | 426 | 39 | 375 | 37 |
| Large-scale agriculture | 49 | 5 | 55 | 5 | 51 | 5 |

Note: All figures include livestock and forestry.
Source: INE (National Institute of Statistics).

12. Output recovery was initially led by smallholder agriculture, which expanded rapidly as soon as security conditions allowed displaced populations to return to rural areas. Between 1987 and 1999 value-added in the agriculture, livestock, and fisheries sectors grew at an average annual rate of more than 6 percent (Table 1.1), accelerating to nearly 9 percent after 1996.[3] The return of about 3 million people to rural areas between 1992 and 1994, the restoration of key transport links following the reopening of roads, the improvement in price incentives brought about by economywide reforms, reduced competition from food aid imports, and good weather lead to an increase in planted areas of both food and cash crops and the restoration of rural markets. Between 1992 and 1996 smallholders expanded planted areas from 2,780 to 4,730 hectares. The number of licensed traders increased from about 3,000 in 1996 and more than 10,000 in early 1999. These changes fueled the rapid recovery of the rural economy.

13. Large-scale commercial agriculture has yet to recover. In the early 1970s cash crops accounted for almost two-thirds of Mozambique's export revenues. Despite the significant volume of resources channeled to state farms and agroindustrial complexes during the 1980s, production of cash crops declined sharply (Figure 1.2). By 1985 raw cashew nut, seed cotton, and sugar production had fallen to the levels of the 1930s; tea production fell to a third of the levels attained in 1981 and 1982.

**Figure 1.2: Production of Cash Crops, 1973, 1985, 1998**
**(hundreds of thousands of metric tons)**




Source: Wandschneider et al., 1999

14. ***Several factors are responsible for the collapse of cash crop production and processing activities in little more than a decade.*** First, during and immediately after the transition to independence, the decline in cash crops was caused largely by the departure of the vast majority of Portuguese settlers and large segments of the Indian population, who occupied most managerial and technical jobs in the economy. Second, the policies adopted by the government until the late 1980s contributed to poor performance by worsening the rural terms of trade. Overvalued exchange rates, for instance, eroded the profitability of export crops. Cashew and cotton farmgate prices were set at such low levels that farming households had little interest in allocating resources to these crops. Moreover, the acute shortage of consumer goods in rural areas following the collapse of the rural marketing network provided farmers with little incentive to export. Low administrative sugar prices, in turn, greatly contributed to accumulated financial losses in the sugar sector. Third, the escalation of the internal conflict after 1982 hit all cash crop sectors hard. Direct attacks on sugar and tea production units and sabotage actions targeted at their transport and energy support infrastructure practically paralyzed these key sectors of the economy. Fourth, transfer of ownership to private hands with the adequate expertise and capital to return these units into production began to take place only in the mid-1990s. Fifth, international prices for some cash crops—namely, sugar and copra—have declined since the 1970s.

[3] Time series sector GDP figures are not strictly comparable due to different sector aggregations over time.

While the performance of some cash crops—particularly cashews and more recently cotton—has improved since then, output levels remain well below pre-independence levels.

15. ***Agricultural growth has been robust in the north and the center of the country,*** which together account for more than 85 percent of maize, rice, sorghum, cassava, cotton, and cashew production. Informal exports of agricultural goods to neighboring countries, in particular Malawi and Tanzania, are reported to have increased substantially since the early 1990s, improving price incentives for producers in the northern provinces (Box 1.2). This vigorous crossborder trade provides local traders with a source of employment and farmers with higher prices for their outputs. Stronger trade ties with neighboring countries also increases Mozambique's food security.

16. ***Mozambican farmers are extremely isolated.*** The most striking characteristic of Mozambique's agriculture is the high degree of isolation and inward orientation of rural households. Three agricultural household surveys (*Trabalhos de Inquérito Agrícola*), conducted by the Ministry of Agriculture and Fisheries in 1993, 1994, and 1996, and the National Household Survey of 1996–97 portray a picture of rural households with limited commercial interactions with the market. This is the case throughout the country, but it is particularly striking in the south. Although the degree of market participation has increased since 1993, in 1996 only half of all agricultural households sold any of their output, and those that did sold only about a third of their harvest. Nampula is by far the most trade-oriented province, with 80 percent of all farmers selling some of their output. Zambezia and Inhambane make up the second tier, with 52–56 percent of households selling part of their crops. In the third tier, which includes Niassa, Cabo Delgado, Manica, Sofala, and Gaza, 40–50 percent of households sell some of their output. The least market-oriented provinces is Tete, where only a quarter of households sell any of their output.

17. ***The explanation for the weak market integration is likely to lie in low productivity levels (Table 1.7) and the difficulty of marketing output.*** Low population density in the south of the country and poor transportation and communications infrastructure in the north create scattered concentrations of households and markets that are too small for competitive exchange transactions with the larger economy to occur.[4] As a result, in much of the country, particularly in the less integrated southern provinces, crop selection is driven almost exclusively by food security concerns.

[4] Binswanger and McIntire (1987) have analyzed the effect of low population densities and poor infrastructure on market orientation.

**Box 1.2: Crossborder Trade on the Mozambique-Malawi Border Can Increase Growth**

A recent Oxfam report (Oxfam 1991) documents the active crossborder trade of agricultural and consumer goods between Mozambique and Malawi. Trade occurs in both directions, with maize, beans, and salt coming from Mozambique and consumer goods (bicycles, plastics, toiletries) and sugar coming from Malawi. Trade involves direct selling and buying by border dwellers as well as by traders. More than half the trade is probably informal and does not enter national statistics.

Malawi is the key market for Mozambican smallholders in much of Niassa, some of Nampula, the western part of Zambezia, and some of Tete province. Only the Malawi market currently offers prices that make the sustainable intensification of maize in northern Mozambique viable (using purchased inputs). Food imports from Mozambique have helped close the gap in Malawi between production and consumption, preventing even greater price rises and hardship for food-deficit households in Malawi. Without this market, economic development in these communities would be even more difficult than it is.

Malawi is a main source of consumer goods for up to 8 million Mozambicans in the Niassa, Nampula, Zambezia, and Tete provinces, supplying an estimated 80 percent of Zambezia's consumer goods. This trade, which makes up 30–50 percent of southern Malawi's wholesale turnover, is very important for thousands of small traders and for the households to which they sell consumer goods.

The synergy between trade from Malawi to Mozambique and from Mozambique to Malawi is important—if trade in one direction falters, it affects trade in the other direction. While southern Malawi is probably a natural market for northern Mozambican food products, the comparative advantage Malawi currently enjoys in the supply of consumer goods to northern Mozambique is less secure.

Despite the mutual benefits identified from these crossborder interactions, many communities struggle with official indifference, restrictive regulations, and rent-seeking behavior by officials. Rent-seeking, identified as a problem particularly on the Mozambican side of the border, increases the costs of trade to producers and consumers alike. Moves to simplify trade regulations in Mozambique are welcome. However, while the strengthening of customs administration is reducing rent-seeking and corruption, it may also be creating additional barriers because of enforcement of the relatively high import duties for consumer goods. Reducing import duty rates and eliminating import surcharges for key consumption goods such as sugar should thus continue to be a priority for the government, as discussed in Part II.

Within the Mozambican government views differ over whether the role of government is to control or facilitate trade. Views also differ over whether the government should aim to increase national food self-sufficiency or raise household security. Supporters of the national food self-sufficiency approach see selling agricultural produce to Malawi as a threat rather than an opportunity. As a result (and in response to lobbying by Mozambican traders unused to competition), the maize-buying activity of Malawian informal traders has been restricted by local officials in Niassa. These actions, which are currently under review, seem to hurt the interests of both Mozambican smallholders and the Malawian poor.

With supportive policies, crossborder interaction is likely to make a major contribution in the medium term to the development of large areas of northern Mozambique.

*Adapted from: Oxfam (U.K.), 1991, When the Whole is More than the Sum of the Parts: The Effect of Cross-border Interactions on Livelihood Security in Southern Malawi and Northern Mozambique.*

**Table 1.7: Estimates of Average Crop Yields (tons/hectare)**

| Crop | Average yields in Mozambique | Potential yields in Mozambique | Average yields in Zimbabwe | Average yields in Africa |
|---|---|---|---|---|
| Beans | 0.2–0.4 | 0.4–0.6 | 0.7 | 0.7 |
| Cashew | 0.1–0.2 | 0.4 | – | – |
| Cassava | 5.0–7.0 | 10.0–15.0 | 4.0 | 7.5 |
| Cotton | 0.3–0.6 | 0.6–1.2 | 1.2 | 0.8 |
| Maize | 0.3–1.3 | 1.0–3.0 | 1.4 | 1.2 |
| Rice | 0.5–1.0 | 1.0–2.5 | 2.8 | 1.6 |
| Sorghum | 0.3–0.6 | 0.5–1.5 | 0.6 | 0.8 |

– Not available.
Note: Average yields vary with agroecological conditions. Potential yields are based on yields achieved with intermediate technology.
Sources: World Bank and FAO statistical reports.

18. ***The reopening and reconstruction of roads, the revival of tourism, and the first steps in reforming the banking system brought about strong recovery of services, which grew at an average annual rate of 6 percent between 1987 and 1999.*** Transport (road and rail) and communications expanded at an average rate of approximately 10 percent a year since 1987. After the 1996 and 1997 privatization of the two state-owned banks (which in 1995 accounted for 70 percent of total commercial bank assets), the banking sector grew rapidly, with output growing 27 percent from 1996 to 1998. Data on the tourism sector are unavailable before 1994, but growth since then has surpassed 13 percent a year.[5]

19. ***Unlike agriculture and services, industry has not yet recovered.*** While growth has helped agriculture and services recover to their 1980–81 levels, the industrial sector is now only 60 percent of its 1980–81 size.[6] Most enterprises were nationalized or taken over by the state during the 1980s. Managerial capacity was weak and access to foreign exchange for imports—and thus to raw materials and parts—severely constrained. Simultaneously, key markets for Mozambique's outputs—such as the Soviet Union, which purchased virtually all of Mozambique's textile production—collapsed. Production capacity was either destroyed or operating at very low levels (10–30 percent of capacity), and average labor productivity declined by more than 60 percent (World Bank 1993). As a result, the industrial sector contracted by an average 3 percent a year between 1985 and 1994, shrinking about 30 percent over the period.

20. The reforms introduced by the ESRP initiated infrastructure rehabilitation and started to improve the incentive structure. But two major factors prevented the sector from recovering until 1994: most industrial firms were still owned by the state, and key markets, particularly in textile and garments, were lost after aid and trade with the former Soviet Union collapsed in 1991. Not until 1995—when privatization accelerated and macroeconomic, trade, and financial reforms began to bear fruit—did private sector confidence and manufacturing growth take off.

[5] Most of the growth in the services sector since 1987 is due to the expansion of transport, tourism, and financial services. The share of government services in the sector has steadily declined over the past decade.
[6] Value-added in the agricultural sector in 1997–98 was estimated to be 5 percent above its 1980–81 level. Value-added in the service sector rose an estimated 60 percent above 1980–81 levels. These comparisons should be made with caution, however, as national accounts during the 1980s included weak estimates of smallholder agriculture and services.

21. ***Mozambique's manufacturing sector is small, with production highly concentrated in a few sectors.*** The resurgence of growth has begun to reshape the structure of manufacturing (Table 1.8). The food (food, drinks, and tobacco) and minerals (nonmetal) sectors have experienced the largest increases in their shares of aggregate output. This has skewed the structure of manufacturing output even more heavily toward food, drinks, and tobacco than before independence. The drinks subsector (led by Coca Cola, Macmahon, and Manica), which now represents the largest share of output in the food sector, exhibited the highest growth rates over the period. The food processing subsector has not grown much at all. Metal working and engineering—whose share in total value-added is often taken as a measure of industrial diversification and modernization—declined steeply over the period as a proportion of total manufacturing output. Textiles and clothing also saw a sharp reduction in their share of output after 1991. This decline can be attributed mostly to the loss of textile and clothing markets in Eastern Europe. Recent official figures indicate that the drinks subsector continues to grow and textile and clothing and nonelectrical machinery are beginning to show signs of a revival. All three subsectors recorded gains in output (at current prices) in 1997 of more than 50 percent, leading the way for a 49.3 percent nominal increase in manufacturing output.

**Table 1.8: Structure of Manufacturing Output, 1973–99**
**(percent of total manufacturing)**

| Sector | 1973 | 1988 | 1991 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|
| Food, drinks, and tobacco | 43.9 | 41.5 | 43.7 | 61.8 | 63.6 | 72.3 |
| Textiles and clothing | 15.8 | 23.0 | 18.2 | 6.9 | 5.0 | 2.0 |
| Wood, paper, publishing | 10.3 | 8.2 | 5.4 | 4.4 | 4.0 | 3.5 |
| Chemicals | 8.8 | 10.7 | 13.3 | 11.1 | 9.5 | 7.1 |
| Minerals (nonmetal) | 7.0 | 4.5 | 6.9 | 11.2 | 10.3 | 10.7 |
| Base metals | 1.2 | 1.2 | 4.2 | 1.1 | 1.7 | 1.1 |
| Metal/engineering | 12.3 | 10.8 | 8.1 | 3.4 | 5.7 | 3.3 |
| Other manufacturing | 0.5 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 |

Source: INE (National Institute of Statistics).

22. In 1998 the World Bank conducted a survey of 150 manufacturing firms in major urban centers in Mozambique (World Bank 1998). Termed the Regional Program on Enterprise Development (RPED), the survey indicates that the average annual growth rate of sales in manufacturing firms (in constant prices) has been robust (Table 1.9).[7] Growth in employment in the sample firms has been flat, however, suggesting that growth has been mostly the result of increased capacity utilization rather than of expansion of existing capacity or new entry.

[7] The survey, carried out in conjunction with the Mozambique Council of Business Associations polled businesses in Maputo, Beira, Chimoio, Quelimane, Nampula, Nacala, and Mozambique Island. It was designed in conjunction with this report to research a number of basic issues, including the composition of manufacturing growth, sources of and impediments to further growth, the composition of the labor force, and accessibility of finance. This report draws on the findings of this survey and the RPED Survey Report (Biggs, Nasir and Fisman 1999).

**Table 1.9: Real Growth Rate of Sales and Employment 1992–97 (percent)**

| Period | Sales growth | Employment growth |
|---|---|---|
| 1992–95 | 0.4 | -2.1 |
| 1995–96 | 39.0 | 0.8 |
| 1996–97 | 40.9 | 1.4 |
| 1992–97 | 30.0 | 0.3 |

Source: World Bank 1998.

23. In terms of sales growth, firms outside Maputo appear to be growing as rapidly as firms in the capital (Table 1.10). This finding, which is contrary to public perception in Mozambique, is unexpected, because firms outside Maputo operate at a distinct disadvantage (lower quality infrastructure, reduced access to government services). One reason for the high average growth rates of sales outside Maputo in recent years may be that firms are bouncing back from a lower base rate of output. In terms of employment growth, firms in the central and northern regions had larger average increases than firms in the south.

24. ***Increased capacity utilization has made the most significant contribution to recovery in the manufacturing sector.*** Capacity utilization in manufacturing averaged about 48 percent in 1997, up from 10–30 percent in 1989, depending on the industry and the location of production (World Bank 1998).

**Table 1.10: Real Growth Rate of Sales, by Region, 1992–97 (percent)**

| Region | 1992–95 | 1995–96 | 1996–97 | 1992–97 |
|---|---|---|---|---|
| Northern | -15.5 | 24.0 | 49.5 | 25.0 |
| Central | 15.3 | 32.5 | 64.6 | 38.0 |
| Maputo | -0.3 | 48.2 | 30.5 | 30.0 |

Note: Central region includes Beira, Chimoio, and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island.
Source: World Bank 1998.

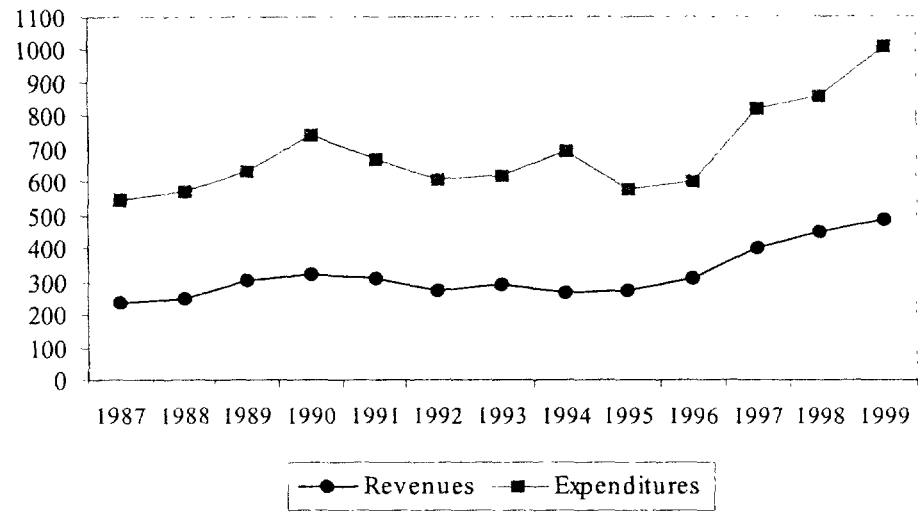
25. The RPED survey also indicates that all three types of firms (private firms established before 1991, new entrants, and privatized firms) have experienced strong growth in sales. Average sales growth rates for privatized firms have kept pace with the sales growth of private firms. However, employment growth in privatized firms has been declining or flat over the period, as they restructure to improve efficiency. New entrants are creating most of the new jobs in manufacturing: new firms recorded a 6 percent average rate of employment growth from 1992 to 1997.

## B. PROGRESS IN ECONOMIC REFORMS

26. Economic reforms began in 1987 and accelerated beginning in 1994. On the macroeconomic side, reforms were aimed at increasing growth by lowering inflation, establishing competitive real exchange and interest rates, and improving Mozambique's fiscal and external position. Although imbalances remain, macroeconomic stability has been achieved, and both the fiscal and the external accounts have improved. On the structural side, price liberalization, deregulation, and a wide-ranging privatization and enterprise-restructuring program were implemented, providing the basis for the strong recovery of the past five years.

27. ***The main objective of fiscal policy in Mozambique since 1987 has been to rebuild the country's economic and human infrastructure and stimulate growth while gradually reducing domestic financial imbalances.*** To reconcile these objectives, the government has emphasized eliminating monetary financing of the budget deficit and curtailing leakages associated with the banking sector, thus reducing quasi-fiscal pressures. Simultaneously, budgetary expenditures increased to support the postwar rehabilitation of the economic and social infrastructure. An average increase in fiscal revenues of just under 7 percent a year combined with sustained external assistance has been the basis for an expansion in overall expenditures (Figure 1.3). Between 1987 and 1999 aggregate government expenditures increased by an average rate of about 6 percent a year. Mozambique's fiscal situation has thus remained largely unchanged over the period. In fact, the overall deficit (before grants) has increased only slightly from 13 percent of GDP in 1987 to 13.4 percent of GDP in 1999 (Table 1.11).[8] In addition, the absence of a set of consolidated public sector accounts that includes state-owned enterprises and financially autonomous institutions and the lack of complete information on liabilities resulting from the privatization program means that the central government accounts may not provide an accurate depiction of the government's fiscal position and the full extent of liabilities on future budgets. (This problem is discussed in Part II.)

**Figure 1.3: Government Revenues and Expenditures, 1987-1999 (US$ millions)**




Source: Ministry of Planning and Finance.

[8] Fiscal policy in Mozambique has rightly not entailed drastic cuts in expenditures or increases in the level of taxation during the postwar years, when concessional and grant external financing have been available. The existence of external support has allowed reforms to be introduced. Some of these reforms entail a reduction of revenues over the short run but will improve the government's fiscal position over the long term. Indeed, while some of the structural reforms, such as privatization and public enterprise restructuring, improved the government's fiscal position, others have had a relatively high fiscal cost. Customs reform, reductions in import tariffs, the lowering of direct tax rates, and the rationalization of excise taxes cost as much as 1.0–1.5 percent of GDP.

**Table 1.11: Revenues, Expenditures, and Grants, 1999**

| Item | US$ millions | Share of GDP (percent) |
|---|---|---|
| Domestic revenue | 489 | 12.2 |
| Total expenditures and net lending | 1,010 | 25.2 |
| Current expenditures | 516 | 12.9 |
| Capital expenditures | 473 | 11.8 |
| Overall deficit before grants | 538 | 13.4 |
| Grants received | 476 | 11.9 |
| Overall deficit after grants | 62 | 1.6 |
| Memorandum item: | | |
| GDP | 4,005 | |

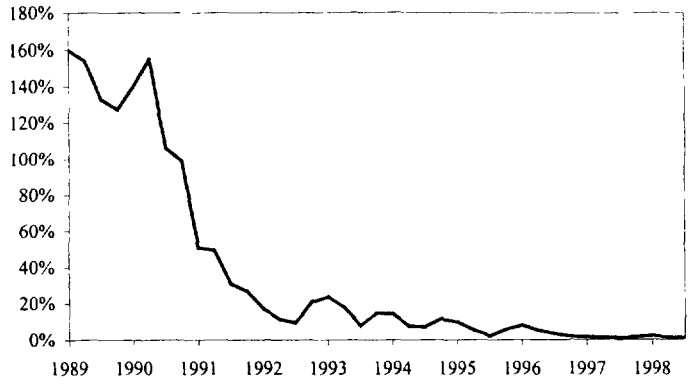
Source: Ministry of Planning and Finance; World Bank and IMF staff estimates.

28. ***Simultaneously, deep structural reforms were introduced that affected almost every sector of the economy.*** In 1986 price controls were pervasive, the economy was virtually closed, and most of Mozambique's production, transport, commerce, and service sectors were in the hands of the state. Today most prices are liberalized, improving incentives for producers and traders. In the agricultural sector, for instance, the state-controlled system of fixed prices run by AGRICOM was dismantled and AGRICOM was replaced by ICM, the Cereals Institute of Mozambique (discussed further in Part II of this report). The prices of a small group of essential consumer goods and services—public transport, communications, oil products, utilities, housing rents, medical services, and four basic food staples (maize, maize flour, wheat flour, and bread)—are still determined administratively. But most administered prices have been replaced with "indicative" or "reference" prices, and only cotton has a minimum producer price (set at 45 percent of the world lint price).

29. ***Trade reforms have begun to open Mozambique's economy, which now has one of the most open trade regimes in southern Africa.*** In the mid-1980s Mozambique's economy was virtually closed. The metical was grossly overvalued, with the exchange rate against the U.S. dollar reaching nearly 40 times the official rate in the parallel market. Average import tariffs were above 20 percent, but many enterprises faced negative effective protection. Significant nontariff barriers, including import and export licenses and export prohibitions, also existed (World Bank 1995).

30. ***An important element of Mozambique's adjustment package was the change in economic incentives that raised the profitability of the tradables sector.*** A major achievement of the ESRP has been the substantial adjustment of the exchange rate system since 1987. The premium between the official and the parallel market rates declined to 6 percent in late 1995 and has remained below that level since then (Figure 1.4). Since mid-1993 the exchange rate has been determined by the market. An interdealer foreign exchange market was launched in 1996, and its operations have expanded since then. Along with the elimination of import licensing and the reduction of import tariffs and export barriers, real devaluations have allowed the export sector to begin its recovery. They have helped attract new investment into the tradables sector, enhancing the country's prospects for sustained growth and external viability.

**Figure 1.4: Exchange Rate Premium 1989–99 (percent)**




Sources: Bank of Mozambique and World Bank staff estimates.

31. The adjustment of the exchange rate proceeded in steps. The metical was sharply devalued in 1987 (from Mt. 39 to Mt. 202 per U.S. dollar), and the exchange rate, which had been pegged to a basket of six currencies, was pegged to the U.S. dollar. Devaluations continued at irregular intervals until April 1989, when a system of monthly devaluations was instituted. In 1990 a secondary market for foreign exchange was introduced with market-determined exchange rates. After another substantial devaluation in mid-1991, foreign exchange transactions began to be shifted increasingly to the secondary market. In April 1992 official and secondary market rates were unified, but a special (more appreciated) rate for tied aid was introduced. In June 1993 the special rate for tied aid was abolished. The metical depreciated further after mid-1992 but more gradually than in previous years.

32. Mozambique's trade regime has improved markedly over the past decade. Import licensing was abolished in the early 1990s. Administrative requirements—such as the need for an import registration permit (Boletim de Registo de Importação)—were abolished in 1998. Although the dispersion in the tariff remains high, average (trade-weighted) statutory import duties were reduced from more than 20 percent in the late 1980s to 10 percent in 1999. Simultaneously, duty exemptions were limited and monitoring improved. Export barriers on raw cashews and cotton were also reduced. Together with the overhaul of customs administration initiated in 1996, these reforms have contributed to an increase in trade flows, transparency of customs operations, and access to external markets. Export barriers on raw cashews and cotton were also reduced starting in the mid-1990s. Increased barriers to trade in key commodities, such as cashews, and the maintenance (or in some cases increased use) of import surcharges (on sugar, cement, and steel) in late 1999 could indicate a move toward a more protectionist stance, however.

33. ***The government has privatized and restructured many state-owned enterprises.*** Until 1995 poorly performing state-owned enterprises were a drain on the state-owned banks and the government's budget, as well as an obstacle to private sector initiative and recovery. Although economic reforms had started in 1987, in the early 1990s the public sector still dominated infrastructure, industry, agricultural marketing, finance, transportation, and telecommunications. Initial attempts to improve their performance focused on efforts to impose hard budget constraints on enterprises or reform them without change in ownership. In virtually all cases, these attempts failed. Reductions in budgetary transfers were

replaced with concessional credits by state-owned banks (a large share of which was never serviced) and with government lending of donor funds at below-market interest rates.

34. Since 1995 the government has made substantial progress toward privatizing state-owned enterprises. Privatization has been a key factor behind the reduction in inflation and the acceleration of growth. Once predominantly under state control, economic activity is now conducted primarily by the private sector: state-owned enterprises now account for less than a fifth of industrial output, down from more than two-thirds in 1990. The government's privatization and restructuring program (which included concessioning to the private sector and liquidation) had restructured and privatized majority shares of more than 1,200 companies by June 1999.

35. The program was implemented on four fronts. The first front was the privatization and restructuring of large enterprises. The Unidade Técnica de Restruturação Empresarial (UTRE) was set up to oversee the privatization and restructuring of about 20 large-scale enterprises. Privatization of these enterprises progressed slowly at first, but it accelerated after 1995. With the exception of the national airline, all of the enterprises in the original privatization list were either restructured or privatized by early 1999. (Because of the lack of acceptable bids, the government converted the airline into a limited liability company, with the intention of selling the state's shares on the stock exchange.) Of the original enterprises, majority shares of more than 85 large companies were privatized.[9] The state retained shares in virtually all of the large-scale companies that were privatized. The second front was the privatization and restructuring of small and medium-size enterprises. A program targeting an initial set of 222 enterprises was virtually completed in 1999. This stage of the reform left the government with majority ownership in only 33 companies: 10 public enterprises owned 100 percent by the government and 22 companies in which the state holds 51–95 percent of the capital. On a third front the government privatized the majority of shares in the two banks, Banco Comercial de Moçambique (BCM) and Banco Popular de Desenvolvimento (BPD).

36. Outside the privatization program, the government undertook the deregulation and concessioning of activities and state-owned enterprises. This process included the ongoing concessioning of railways, ports, and port services owned by CFM (the national ports and railways company) and the concessioning of water delivery in five major cities (Maputo, Beira, Pemba, Quelimane, and Nampula). Deregulation was the appropriate first step toward improving service quality and plugging the unsustainable drain on public finances. That is, deregulation was chosen as a short term substitute for privatization, based on the urgent need to reduce pressure on the fisc from financially insolvent state-owned enterprises. However, privatization should still be the medium term goal.

37. ***Privatizing the two state-owned banks marked the turning point in the government's reform efforts.*** Financial development in Mozambique since independence suffered because of misguided efforts to speed up economic growth through government intervention. The government believed that it would be possible to accelerate economic development by identifying promising sectors and activities and using subsidized credit and selective credit controls to promote them. The banking system had been nationalized, and the provision of credit was seen as a powerful instrument of economic development. The result was misallocation of resources and a dramatic increase in nonperforming loans.

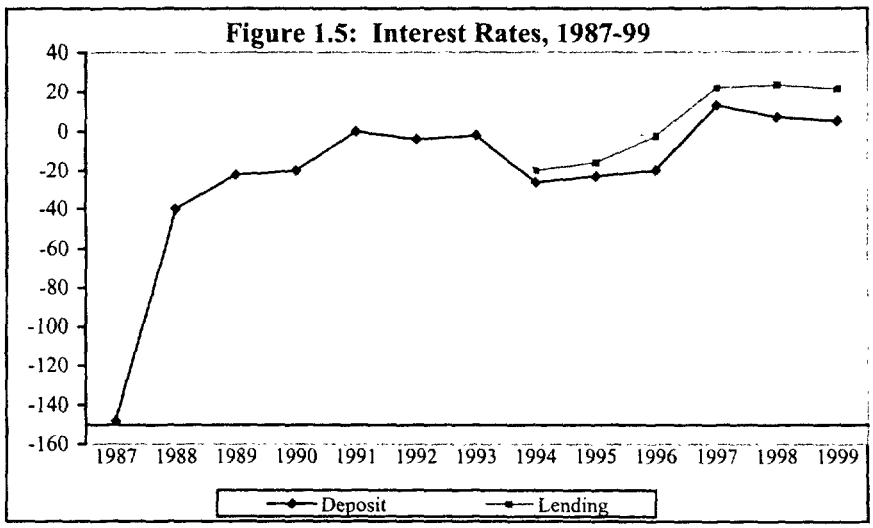
38. In 1992 the government embarked on a program of financial sector reform, but it insisted in holding on to ownership of the state-owned banks. The first steps, taken between 1992 and 1995, included the separation of the central bank from BCM and the deregulation of entry into banking and insurance activities. In addition, regulations were adopted on bank licensing, capital adequacy, provision

[9] Of the original 20 enterprises, which were themselves a result of enterprise consolidation during the years of central planning, 85 enterprises resulted which were either restructured or privatized under UTRE's program.

policies, and exposure limits. Although these developments helped provide a much improved legal and regulatory basis for the development of a competitive and well-diversified financial sector, they were not sufficient to stop the macroeconomic instability associated with the banks' poor performance.

39. While the economic reforms initiated in 1987 and the growing inflows of external assistance eliminated the climate of crisis felt until the early 1990s, monetary outcomes continued to be unsatisfactory until 1995, with the losses associated with the banking system creating difficulties for monetary control. As in other countries, initial attempts to reform the financial sector focused on restructuring of the two state-owned banks, for which the government bore the entire cost. The reforms stopped short of changing the incentive system, however, or the structure of ownership in the banking sector. After attempts at restructuring the banks failed to improve behavior and the accumulation of nonperforming loans in their portfolios continued, the government decided to sell majority shares of both banks.

40. ***Privatization of the banks opened the way for improvements in the health of Mozambique's financial system and in the government's ability to control the quasi-fiscal deficit and monetary policy.*** Following the privatization of BCM in 1996 and BPD in 1997, inflation fell sharply (Figure 1.1), and real lending rates have been positive since 1997 (Figure 1.5). Between 1995 and 1998 credit to the economy more than doubled in real terms, the share of deposits in broad money increased from 77 to 81 percent, and the share of time deposits in total deposits rose from 11 to 24 percent. An interbank market was introduced in 1997, and a market for short-term central bank and treasury bills is being developed.




Source: Bank of Mozambique.

41. Management of both banks is now in private hands, though the government retains a 49 percent interest in BCM and a 40 percent interest in BPD, which was recently renamed Banco Austral. BCM remains the largest bank in terms of assets, deposits, and credit; in fact, as of 1999 BCM accounted for 32.4 percent of deposits in Mozambique. At the same time Austral holds a 14.9 percent market share in terms of deposits. Together, BCM and Austral account for just under fifty percent of deposits in the national banking system. Given the weight of these two banks in the financial sector, the importance of commercially-oriented management becomes even more critical. The ability of BCM and Austral to strengthen further the financial sector will depend, in part, on their ability to become more efficient and

responsive to market signals.[10] This task is complicated, however, by the fact that both banks have experienced some problems with non-performing loans inherited from the pre-privatization era.

42. ***The structure and behavior of the banking sector has started to change.*** Over the past several years, Mozambique's financial system has been transformed from an oligopolistic, government-dominated structure into a more diversified and competitive system. The banking system in 1987 consisted of two state-owned banks. Today there are 8 commercial banks, a credit cooperative, a leasing company, a venture capital company, several investment bank representatives, and about 20 exchange houses—all privately owned or controlled. As a result of these new competitors, the combined market share of BCM and BPD fell from 71 percent in 1995 to about 60 percent in late 1998.

43. At the same time, there is a need for strengthened supervision, which must be backed up by the implementation of credible sanctions, when necessary. Toward this end, the central bank should be empowered with greater independence in bank licensing and de-licensing. Greater competition and lower inflation rates open the way for increased efficiencies in banking services that, if coupled with effective banking supervision and enforceable sanctions, can lead to more effective capital mobilization and reallocation. Privatization combined with a credible regulatory regime can reduce both lending spreads and lending rates, which serve as a brake on growth.

43. Changes in macroeconomic policy have come relatively quickly in Mozambique over the past decade, as they often do in reforming countries. For the most part, however, these changes did not require overhaul of government institutions proper. Public administration and the judicial system, for instance, have undergone little change. With political support for change, reforms were undertaken rapidly by a small group of competent technocrats. Other reforms—dealing with regulations, social services, public finance, infrastructure, and public works—are not being (and in most countries cannot be) accomplished as rapidly, because they involve changing institutional structures established within the central planning development model. This kind of institutional reform involves deep changes in the way government agencies think and act, and it often requires a complete overhaul of long-established systems of patronage and rent-seeking. Such change is essential if Mozambican state institutions are to improve. Together good policies and more capable state institutions produce much faster and more sustainable development, as worldwide experience shows (World Bank 1997).

44. ***The government launched a comprehensive reform program for public administration in 1997, but much needs to be done.*** The first steps, taken in 1998 and 1999, were aimed at civil service reform. They included the development of a public administration training system, the improvement of the structure and levels of civil servants' salaries, and the development of career streams, aimed at encouraging qualified civil servants to remain in public service.

45. ***Reform of the budgetary process began in 1997.*** Simultaneously, the government began implementing a reform of the budgetary process, a key step in which was the 1997 approval by the National Assembly of the Budget Framework Law. This law put in place the fundamental principles for preparing, managing, executing, controlling, and accounting for the budget, commencing with the 1998 budget. The government has also developed a rolling five-year medium-term expenditure framework. This framework aggregates programmed sector expenditures within the overall framework of the medium-term macroeconomic program. Budgetary proposals to the National Assembly will thus henceforth be made within the context of a medium-term framework.

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[10] The re-emergence of problems has raised serious questions about the health of the banking sector and of the role of the state as owner of large shares in the two largest commercial banks.

46. ***Reform of customs has had positive results.*** The government's most radical and visible step toward creating a more transparent public service was the overhaul of customs administration, which was combined with reforms in trade and indirect tax policy. An improved preshipment inspection contract was signed in 1996, and the three-year process of privatizing customs management began in 1997.[11] Since 1997 a wide-ranging training, rehiring, and restructuring program has been implemented. The results have been higher revenues and collection rates (in spite of a decline in statutory rates) and increased transparency. Collection rates increased from an average of 6 percent of imports (when the average statutory rate was 18 percent) in 1996 to about 9 percent in early 1999 (when the average statutory rate was 11 percent).[12] The response from the private sector has also been very positive, and the government is now considering relying on technical assistance from the customs management company for an additional period.

## C. THE KEY ROLE OF EXTERNAL ASSISTANCE

47. ***Joint efforts by the government and the international community made it possible for Mozambique to achieve stabilization and structural adjustment without reducing growth or cutting spending.*** In many aspects, the fact that stabilization and structural adjustment were achieved in the context of output recovery and increased allocations of public resources to priority sectors such as health and education, goes against the stereotypical view of adjustment. This was made possible by the joint efforts of the government and of the international community. The government actively promoted peace and national reconciliation, launched the reconstruction effort, and introduced deep changes in economic structures and incentives. The international community supported every aspect of Mozambique's recovery, from the peace agreement, to the resettlement of populations, the first multiparty elections, to the reconstruction of physical and social infrastructure.

48. ***External assistance allowed Mozambique to break out of the vicious circle of low savings and low growth.*** Between 1987 and 1999 an estimated US$8.3 billion of grants and concessional credits (about US$500 per capita) was channeled to Mozambique (Figure 1.6). External assistance was crucial in overcoming the humanitarian crisis of the late 1980s and early 1990s, providing for the maintenance of minimum levels of consumption, consolidating peace, jump-starting the economy after the 1992 peace accord, and carrying out the first multiparty elections. After the 1994 election-related peak, aid flows have stabilized in nominal terms at more than US$550 million a year— nearly 17 percent of GDP and more than four times the value of industrial exports in 1999. This aid allows the government to increase investment without cutting into consumption.

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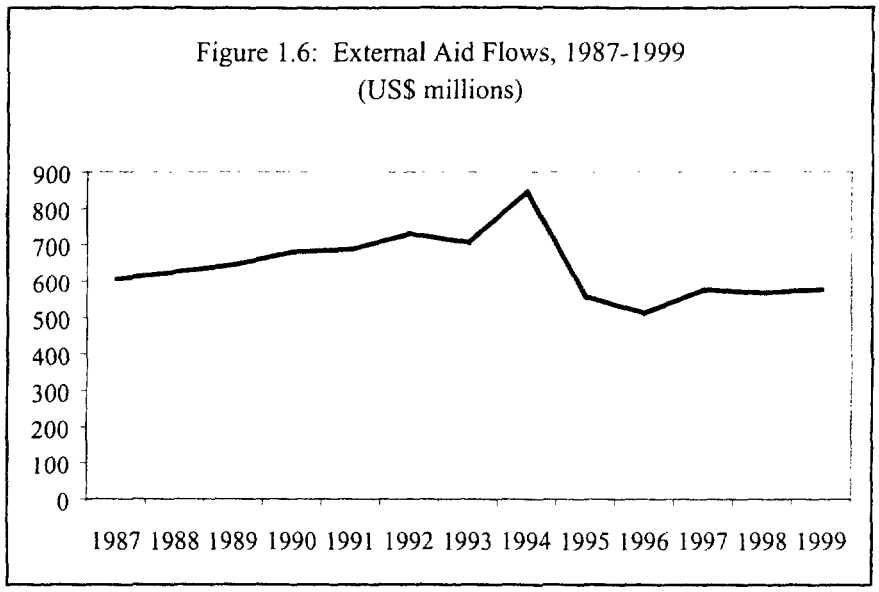
[11] The preshipment inspection company has been Intertek Testing Services. Management of customs has been contracted to Crown Agents.

[12] The import base, however, is not expanding as rapidly as expected, which, together with discrepancies between Mozambican and partner country data, may indicate that illegal imports continue to be a problem.




Source: World Bank staff estimates.

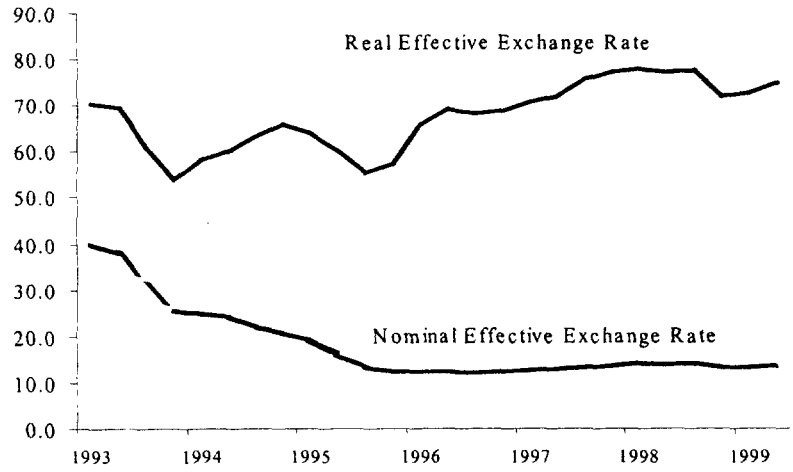
49. ***Since 1987 aid has provided more than 65 percent of all foreign exchange available to Mozambique.*** External assistance currently finances about 54 percent of government budgetary resources and about seventy percent of public investment. From 1987 to 1999 about 56 percent of total budgetary resource were derived from external assistance, either in the form of direct project financing or through counterpart funds for general budget support. Project financing averaged about 16 percent of GDP over the period 1987 to 1999. Counterpart funds averaged 9 percent, with grants providing most of the financing.

50. ***Simultaneously, large flows of external assistance also impose on the government the difficult task of accounting for and coordinating a large number of external donors and non-governmental organizations (NGOs).*** The quality of information on the nature and volume of foreign assistance disbursed directly through project assistance, while improving, remains a problem. Many donors still face difficulties collecting and reporting these data to the government, while the government has difficulties collecting this information at the provincial and sectoral levels. There is evidence that the share of externally-financed expenditures which is not part of the government's overall expenditure planning process and is unaccounted for in the government budget is large. As a result, information on both the level and uses of external aid is unreliable and the overall effectiveness of these expenditures cannot be assessed.

51. The large-scale external transfers have had a strong positive effect on growth, investment, and poverty reduction. However, in many ways, the impact of large aid inflows is comparable to that of economies dealing with inflows associated with commodity booms, an effect commonly known as the Dutch disease.[13] The inflow of foreign exchange, primarily to the public sector, tends to cause the real exchange rate to appreciate as demand for and the price of nontradables increase. The increased weight of the service sector in the Mozambican economy may reflect this effect, as may the appreciation of the metical since 1996 (Figure 1.7). Continuation of the flexible exchange rate policy, coupled with continued low inflation and the expected accumulation of reserves in 1999, will help consolidate the real effective depreciation observed since mid-1998.

[13] For applications of the Dutch disease effects of aid to Africa see Collier and Gunning (1992). On the effects of natural resource–induced Dutch disease on growth, see Sachs and Warner (1995).

**Figure 1.7: Real Exchange Rates 1993–99 (1990=100)**




Note: Movement toward 100 signifies appreciation of the currency.
Sources: IMF and World Bank staff estimates.

## D. POVERTY AND ISOLATION

52. ***Poverty in Mozambique is extensive, with more than two-thirds of all Mozambicans living in absolute poverty.*** Sixty-nine percent of all Mozambicans and 62 percent of urban residents live in absolute poverty (Table 1.12). While poverty is widespread throughout the country, its incidence, depth, and severity are greatest in rural areas, where 71 percent of people live in poverty.[14]

53. ***Poverty is exacerbated by many factors, including the isolation and poor market integration of rural households and the weak coverage of basic services.*** The vast majority of poor people—91 percent—are employed in agriculture. The highest poverty headcount indexes (above 80) are in Sofala, Inhambane, Tete, where isolation is highest, followed by Niassa (71) and the densely populated provinces of Nampula and Zambezia (68). The lowest headcount indexes are in the city of Maputo (48), Cabo Delgado (57), and Manica (63).

[14] Until recently, little was known about the characteristics of the poor and the determinants of poverty in Mozambique. The data reported here are from the first national Poverty Assessment (based on the 1996–97 National Household Survey on Living Conditions), completed in December 1998.

**Table 1.12: Mean Consumption and Poverty Estimates, by Region, 1996–97**

| Region | Percent of population | Mean consumption (US$/person/year) | Poverty headcount index |
|---|---|---|---|
| Rural | 79.7 | 158 | 71.3 |
| Urban[a] | 20.3 | 214 | 62.0 |
| | | | |
| North[b] | 32.5 | 177 | 66.3 |
| Center[c] | 42.6 | 150 | 73.8 |
| South[d] | 24.9 | 194 | 65.8 |
| | | | |
| Mozambique | 100.0 | 170 | 69.4 |

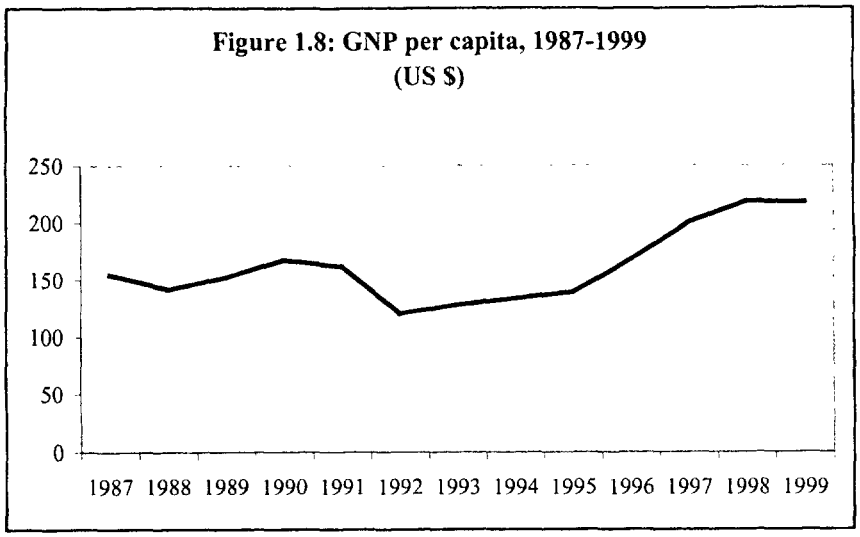
a. Includes Maputo city, provincial capitals, and small urban centers.
b. Includes Cabo Delgado, Nampula, and Niassa provinces.
c. Includes Manica, Sofala, Tete, and Zambezia provinces
d. Includes Gaza, Inhambane, and Maputo provinces, plus Maputo city.
Sources: Ministry of Planning and Finance and IFPRI.

54. ***The incidence of poverty in Mozambique is likely to have fallen over the past decade.*** The fact that only one poverty assessment exists makes it impossible to analyze the evolution of poverty in Mozambique directly. Variables that are good proxies of poverty, such as growth, inflation, and smallholder agricultural production, have all improved since 1987, however, suggesting that the incidence of poverty may have declined over the past decade (Box 1.3). Improvements in social indicators, such as measures of malnutrition and access to basic health and education services, also suggest that living standards have improved. Per capita incomes in 1999, although still very low, are nearly 50 percent higher than in 1987 (Figure 1.8).[15] Production increases in the smallholder sector made possible by population resettlement and the gradual decline of food aid improved food security and have played a major role in improving the living standards of the rural population (Figure 1.9).

**Box 1.3: Does Growth Reduce Poverty?**

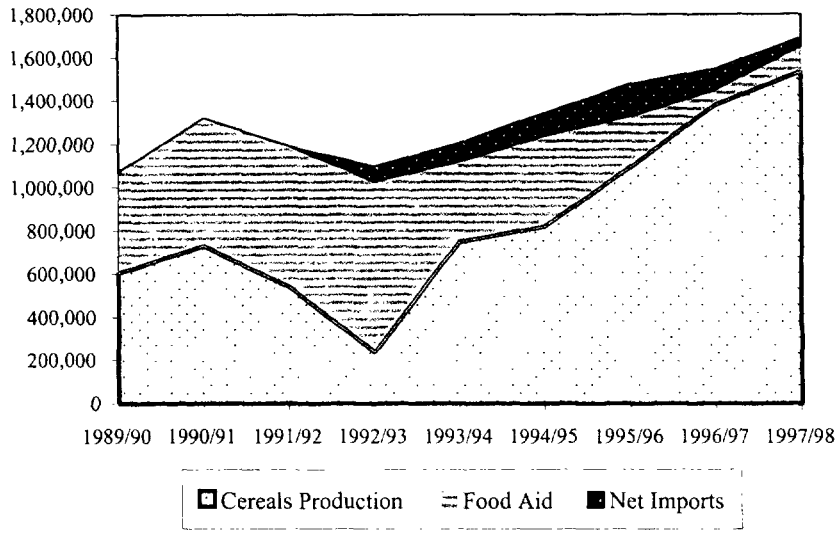
A vast literature suggests that there is a strong relationship between overall income growth and the incomes of the poor. A recent cross-country econometric analysis of Gallup, Radelet, and Warner (1998) finds that the average income of the poor tends to grow proportionately with the average income of the population (Gallup, Radelet, and Warner 1998). Deininger and Squire (1996) find a similar result. The results of these studies are inconsistent with the Kuznets hypothesis (1955) that income distribution tends to worsen at early stages of development and only later improves as incomes rise. But even if the Kuznets hypothesis were proven correct, overall economic growth remains one of the few successful anti-poverty programs. Poverty reduction depends primarily on raising the incomes of the poor rather than improving income distribution.

[15] GDP grew 7 percent in 1999. In US$ terms, however, GDP p.c. stayed constant due to depreciation of the Metical.




Sources: MPF, INE, and World Bank staff estimates.

**Figure 1.9: Cereals Production and Food Aid 1989–98 (thousand metric tons)**




Note: Cereals include maize, rice, sorghum, and millet.
Sources: Ministry of Industry, Commerce, and Tourism; FAO.

55. ***Despite these improvements, there is a perception in some quarters that poverty has increased in Mozambique.*** Transition and structural reforms such as privatization and liberalization produce winners—the dynamic, the better educated, those who were ignored by previous policies. But they also impose costs on visible groups. With the feeling of crisis now in the past, the tension between the interests of these two groups has become more palpable. Policy reforms such as agricultural price liberalization and the reduction of export barriers and barriers to domestic trade reduced poverty directly by increasing the value of smallholder production. Some of these reforms, however—such as privatization, the liberalization of commodity markets, and the partial liberalization of cashew exports—have exposed structural weaknesses in key sectors of the economy and in some cases may have increased

unemployment in urban areas.[16] Increased unemployment and discontent in urban areas should not be ignored and measures to facilitate technical change and the reallocation of resources be envisaged. Yet as in other developing countries, the views of urban dwellers in Mozambique, generally those employed in the formal sector of the economy, are more prominent in the public debate than those of rural populations. As in many other countries, Mozambique's rural poor lack voice and power to influence policy decisions. Nevertheless, as the poverty assessment indicates, it is the rural population that is facing the most severe hardship in Mozambique. A development strategy that encourages the growth of agriculture and the rural economy and supports the development of competitive labor-intensive industries is most likely to achieve rapid, balanced, and equitable development.

[16] Results from the 1998 survey of manufacturing firms, for instance, indicate that in Maputo there has been a contraction in employment in the manufacturing sector, while in the northern and central regions of the country employment in the sector has increased (World Bank 1998).

## PART II. GROWTH PROSPECTS AND REFORM AGENDA

56. ***Mozambique has emerged over the past three years as one of the Sub-Saharan African countries with the most promising prospects for sustained growth and development.*** Private investment is on the rise, average GDP growth has exceeded 10 percent in the past three years, and a 2000 poll of business people active in Africa ranked Mozambique third among 24 countries on an "optimism index" (Center for International Development, Harvard University, and World Economic Forum, 2000).

57. ***Serious macroeconomic problems and structural weaknesses remain, however, that can threaten prospects for sustaining the rapid growth of the past few years.*** First, Mozambique is still facing serious fiscal and external imbalances. These imbalances will have to be corrected over the long run, but doing so requires action in the short run. Because of poor savings performance, Mozambique still relies on foreign aid to deliver public services, and more than half of the government's budget and a large share of the country's imports are still financed through foreign aid. Second, small-scale agriculture—which generates more than a third of the country's output and is the main source of employment for more than 90 percent of the country's poor—is still penalized by *de facto* restrictions on trade and misallocated public spending for rural development. Third, while recent developments have generated much optimism among both domestic and foreign investors, Mozambique's economy remains impoverished, with a very small domestic market, high operating costs (due to poor infrastructure), low productivity of labor (due to low skills and poor health), and high transactions costs (due to poor security and bureaucratic tangles). Fourth, infrastructure and telecommunications bottlenecks are more severe in Mozambique than in almost all other countries, reflecting decades of conflict, a dearth of resources, and an inadequate institutional and regulatory structure. These bottlenecks penalize all sectors of the economy and contribute to the isolation and weak market participation of small-scale agricultural households. Fifth, Mozambique's human resources are considerably weaker than in most other countries in Sub-Saharan Africa. As a result, welfare and labor productivity are low, and the economy has little capacity to adopt new production technologies.

58. ***The economic performance of the recent past suggests that the economy is on course to grow at an average rate of 5–7 percent a year over the next decade. Making a significant dent in poverty, however, will require that the economy sustain the double-digit growth rates of the past three years.*** Doing so represents a challenge. At least part of the recent surge in growth is likely to represent a bounce back to earlier output levels—a common phenomenon throughout Sub-Saharan Africa among countries that restored peace and liberalized their economies after years of economic and political turmoil. Some of the factors behind Mozambique's recovery—the postwar population resettlement, which allowed for the resumption of small-scale agriculture; privatization, which launched production in the industrial and service sectors; the end of the apartheid regime in South Africa, which opened the way for increased foreign investment and trade; external debt relief; and, until very recently, favorable weather—are either one-time developments or exogenous shocks that are unlikely to help sustain growth in the future.

59. Economic and social recovery starts from a very low base in Mozambique, and poverty remains widespread, as Part I discussed. Per capita income remains so low that even with moderate population growth of 2.5 percent a year and real annual GDP growth of 5 percent, Mozambicans would have to wait more than a century before per capita income reached just US$3,500 a year.

60. ***With 69 percent of the population living below the poverty line and the majority of the poor engaged in agriculture, a growth strategy based on increasing the profitability of this sector has the best likelihood of reducing poverty in the short and medium run.*** Over the long run, agriculture alone (particularly smallholder agriculture) will not be able to provide rising incomes or employment for a rapidly growing rural population: the main source of growth and diversification will have to be outside

agriculture. Over the next 5–10 years, a two-pronged strategy based on agricultural growth combined with encouraging labor-intensive manufacturing and service activities, holds the key to continued economic growth and poverty reduction. The proposed strategy thus recommends focusing on agriculture and removing impediments to private sector development, while redirecting public spending toward sectors with the highest potential for reducing poverty, such as education, health, water, and roads.

61. Large-scale projects can undoubtedly contribute to Mozambique's growth. They cannot and should not be the main element in a poverty-reducing sustainable growth strategy, however. In recent years, there has been much public debate over large investment projects in Mozambique. Some view these projects as a panacea for the country's economic problems. Others view them as setting Mozambique on an irrevocable path of economic dualism and inequality. Is there a need to choose between a strategy based on large capital- and energy-intensive projects and one that focuses on improving economic and social opportunities for the Mozambican population? In principle, the answer is no. Large capital-intensive projects like the Mozal aluminum smelter or the proposed Maputo Iron and Steel Project can benefit the economy if they produce value added, generate foreign exchange, create employment, and have the potential to generate tax revenues. If these projects do not cause deterioration in the country's natural resource base, these can all be positive outcomes. Aluminum production from Mozal and electricity production from the Cahora Bassa dam, for instance, are expected to contribute about 5 percent of GDP after 2002. Both projects will contribute to the rise in Mozambican exports, which are expected to more than double by then. Mozal is also expected to create about 800 new jobs in the Maputo area. As long as the government is able to tax these enclave projects at rates comparable to those applied to the rest of the economy and does not allocate resources to infrastructure that will be used almost exclusively by these projects, there need not be a tradeoff between a strategy that supports large-scale investment projects and one that supports improving economic and social opportunities.

62. The principle of concentrating infrastructure in areas of economic activity is a good one for a country as large as Mozambique. In the short and medium run, concentrating infrastructure around clusters of agricultural or manufacturing activity makes sense. Pursuing this strategy would mean focusing infrastructure efforts on the Maputo and Beira-Chimoio areas and the densely populated areas of Nampula and Zambezia. Developing infrastructure in more densely populated areas can have a very large impact, in terms of both growth and poverty reduction. For government-financed infrastructure investments outside these areas, such as the Sena rail line, the government should ensure that all investment increases employment, output, and exports while preserving or using sustainably the country's natural resource base.

63. ***If Mozambique is to continue to grow rapidly, it will need to continue to maintain a stable political regime and a sound macroeconomic framework. In addition, it will need to implement the next generation of reforms and policy changes.*** The successes of the past few years in stabilizing and jump-starting the economy represent a good start. To sustain real growth rates of 5–7 will require, at a minimum, the maintenance of a stable political regime and a sound macroeconomic framework—not itself an easy task. Growing at an even faster rate—as Mozambique will need to do—will require implementing the next generation of reforms, described in this part of the report. These reforms will need to address a variety of issues:

- Reducing fiscal and external imbalances, by reallocating public spending, increasing domestic revenues, and reducing domestic and external vulnerabilities.
- Reducing rural poverty, by facilitating trade, improving transport and road quality, strengthening land rights, diversifying agriculture, and increasing agricultural productivity.
- Improving the business environment, by improving the government's policy toward business, modifying labor regulations, reducing administrative requirements and the bureaucratic burden,

improving contract and law enforcement, fostering private sector participation, and investing in infrastructure and telecommunications.

- Investing in human resources, by improving education and health.
- Ensuring that Mozambique's natural resources are used in a sustainable manner.

## A. STRENGTHENING THE MACROECONOMIC ENVIRONMENT

64. Mozambique's macroeconomic environment has improved markedly over the past several years, but continued improvement will be necessary if rapid growth is to be sustained. The program of reform will require correcting fiscal imbalances—by adjusting spending priorities and increasing domestic revenues—and reducing external vulnerabilities.

### *Correcting Fiscal Imbalances*

65. ***With strong growth, single-digit inflation, and a fiscal deficit after grants of about 1.6 percent of GDP, Mozambique's economy in 1999 was on a better footing than it had been since independence.*** Despite the fact that the macroeconomic environment is more stable now than in it was in the early 1990s, the country faces serious internal and external imbalances. Macroeconomic difficulties in the first half of 2000, with a sharp increase in the fiscal deficit before and after grants due to a substantial increase in public expenditures, reveal the fragility of Mozambique's economic management. The fact that the symptoms of the country's economic problems—high inflation, declining investment, a foreign exchange crisis—are now more controlled does not mean that addressing the root causes of these ills should not remain a priority.

66. ***Over the long run, gradual fiscal adjustment will be necessary.*** The government has rightly avoided implementing an excessively rapid fiscal adjustment that would inevitably raise the level of taxation, reduce expenditures, or both. This policy—made possible by foreign aid—was appropriate at a time when the demands of reconstruction were high and the potential revenue from a paralyzed economy relatively low. As long as economic conditions in donor countries remain favorable and the Mozambique government's policies continue to encourage poverty reduction and growth, foreign aid is not likely to decline sharply in the short or medium run. (It is possible that some foreign assistance, especially from some bilateral agencies, may be converted into debt relief, which could leave overall aid flows constant or slightly reduced.) Over the long run, however, aid flows will probably not continue at current levels. Without fiscal adjustment, the maintenance of a high fiscal deficit will tend to keep interest rates high and/or limit credit available to the private sector, reducing private investment. *Gradual fiscal adjustment should thus be a priority of government policy over the next decade.* The question for the government, therefore, is not whether to reduce fiscal imbalances but how and how fast to do so.

67. Signs of weakening control over expenditures are already visible in early 2000. The fiscal deficit before grants is expected to increase from 13 percent of GDP in 1999 to 16.4 percent of GDP in 2000, mostly due to a 30 percent real increase in expenditures. Part of this increase, around 43 percent, is due to increased social spending made possible by HIPC debt relief. However, 31 percent of the increase is due to the government's share in recapitalizing the two formerly state-run banks, an expenditure that could have been avoided if more stringent enforcement of banking supervision rules had been implemented and the state did not maintain a significant share of ownership in these banks. Another component of the expenditure increase, around 17 percent, was due to a large increase in the civil service wage bill, associated with increases of salaries for the lowest paid civil servants (and not salary decompression, as expected under the civil service reform). Flood reconstruction expenditures are expected to take place mostly in 2001. Overall, increased expenditures in 2000 will more than offset modest gains in tax collection.

68. The high expenditure growth in 2000, if not corrected thereafter, will further contribute to Mozambique's being fiscally imbalanced in the foreseeable future. A combination of a moderate revenue effort, combined with restraint on the expenditure side (including measures to drastically reduce the risk of further liabilities from the banking system), will be able to reduce the deficit only to around 12 percent by 2005. On the revenue side, the gradual reduction in the fiscal deficit should be accomplished mainly through continued improvement in revenue collection. Revenues can be expected to increase by at least one percentage point of GDP between 2000 and 2005, to around 14 percent of GDP. Increases in revenue collections can be achieved mainly through the broadening of the tax base and not generally through increases in tax rates.[17] On the public expenditure side, a reduction from the extraordinary levels of 2000-2001, where it reached 30 percent of GDP, to around 26 percent of GDP is required. This would still allow for an expansion of expenditures of nearly 50 percent in US dollar terms relative to 1999.

69. ***Debt relief under the HIPC (Heavily Indebted Poor Countries) Initiative will lighten Mozambique's debt burden.*** Until recently, Mozambique had a serious debt overhang problem: as of December 1998 its stock of external public and publicly guaranteed debt stood at US$6 billion in nominal terms, or US$2.731 billion in net present value terms. Almost two-thirds of this debt (US$1.712 billion in net present value terms) was owed to bilateral creditors (Table 2.1). The resulting NPVs of debt-to-exports ratio of 538 percent and of debt-to-revenue ratio of 608 implied that, between 1999 and 2010 and in the absence of HIPC assistance, about 24 percent of revenues and 20 percent of exports would be channeled to servicing debt.

**Table 2.1: Net Present Value of Debt and Debt-to-Exports Ratio,End-December 1998**

| Item | Amount (US$ millions) | Share of total (percent) |
|---|---|---|
| Net present value of debt | 2,731 | 100 |
| Multilateral creditors | 1,019 | 37 |
| Bilateral creditors[a] | 1,712 | 63 |
| Net present value of debt-to-exports ratio (percent) | | |
| Before committed assistance | 538 | n.a. |
| After debt relief under HIPC | 200 | n.a. |
| Memorandum items | | |
| Exports of goods and services (1998) | 534 | n.a. |
| Exports of goods and services (3-year average) | 507 | n.a. |

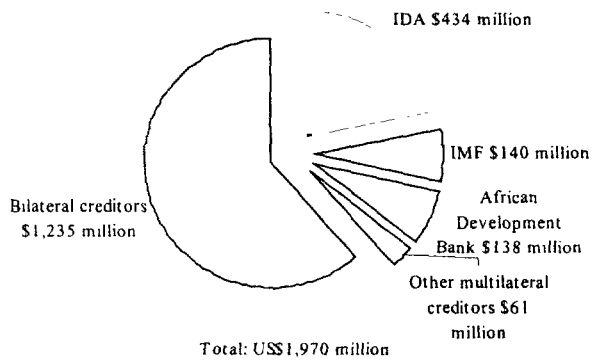
n.a. Not applicable.
Note: Figures are based on reconciled end-1998 data, using end-1998 exchange rates and the six-month average Commercial Interest Reference Rate (CIRR) at end-December 1998.
a. The NPVs of debt for bilateral and commercial creditors reflect a hypothetical stock-of-debt operation on Naples terms at end-1998. Actual stock-of-debt operations on Naples, Lyon, and Cologne terms have not been implemented but are expected to be consolidated into one operation at the completion point. This could result in some revisions.
Source: Government of Mozambique; World Bank and IMF staff estimates.

70. ***In view of the remarkable progress made in introducing economic reforms, including an increased focus on delivery of health and education services, Mozambique's creditors agreed in June***

[17] Tax rates on personal income are now substantially lower (20 percent) than those on company profits (35 percent), which might require that the rates across the two taxes be rationalized.

***1999 to reduce the country's debt burden*** under the original HIPC Initiative.[18] In addition, Mozambique is receiving additional debt relief under the Enhanced HIPC Initiative, agreed upon in September 1999 and targeting a NPV of debt-to-exports ratio of 150. Under the enhanced HIPC initiative, Mozambique is expected to receive a total of US$1.97 billion in NPV terms at the floating completion point, which the government expects will take place in March 2001 (Figure 2.1). Taking into account the assistance under the enhanced HIPC initiative, the ratio of NPV of debt to exports is projected to fall gradually to 99 percent in 2003, to 75 percent in 2010 and to about 55 percent by 2017. The additional debt relief under the enhanced initiative is expected to provide about US$600 million in debt service savings over 40 years, and about US$18 million until 2010. This would be additional to the estimate US$3,700 million in debt service savings made available by the original HIPC initiative. Debt service due after the enhanced HIPC is projected to fall below 5 percent of exports in 2002 and remain below this level thereafter. The fiscal burden of debt would also decline, with the debt service-to-revenue ratio falling to 7 percent by 2002 and declining steadily thereafter.

**Figure 2.1: Structure of Enhanced HIPC Debt Relief (US$ millions in net present value)**




Sources: Government of Mozambique; World Bank and IMF staff estimates

71. Given the continued need for substantial low-cost financing, ensuring that the full benefits of debt reduction materialize requires that the government carefully assess the terms and uses of newly contracted debt and strengthen its debt-recording and debt management capabilities. The maintenance of sustainable external and fiscal positions requires that the government implement policies aimed at expanding and

[18] The HIPC Initiative entails coordinated action by the international financial community, including multilateral institutions, to reduce to sustainable levels the external debt burden of heavily indebted poor countries that pursue IMF and World Bank–supported adjustment and reform programs but for whom traditional debt relief mechanisms are insufficient. The initiative is the first comprehensive relief package established for poor countries. Mozambique's debt relief package is the largest approved in the context of the initiative. Details on the package are available in the joint World Bank-International Monetary Fund *Mozambique Completion Point Document* (World Bank-IMF 1999). See also *Mozambique HIPC Debt Initiative: President's Memorandum and Recommendation and Decision Point Document* (World Bank 2000).

diversifying the export base and, given the current availability of low-cost external financing, follow a strategy of borrowing only on highly concessional terms.

*Adjusting Spending Priorities*

72. ***Mozambique's ability to continue growing rapidly is constrained by inadequate and unevenly distributed public services.*** Expenditures and service delivery in key sectors—education, health, the judicial system, water, power, and road rehabilitation and maintenance—remain well below needed levels. The availability of foreign assistance means that Mozambique will not need to cut spending in the short run. Furthermore, the significant reduction of the external debt overhang brought about by debt relief under the HIPC initiative has made it easier to allow for the economy to be taxed at a lower level and expenditures to be higher than they would otherwise be. The extent to which external resources and debt relief foster rapid growth and alleviate poverty will depend, however, on the composition of public spending.

73. ***The next step towards ensuring that the profile of government expenditures reflects a growth and poverty oriented strategy should be the carrying out of a public expenditure review (PER).*** The PER is motivated by two main concerns. First, in spite of some progress in recent years, Mozambique's budget management system suffers from weaknesses that hinder fiscal transparency and accountability, and that may limit the efficiency and poverty impact of public expenditures. Second, there is a growing demand for an assessment of the public expenditure program, both to satisfy the fiduciary concerns of donors who finance a large share of Mozambique's public expenditures, and to rationalize public intervention and improve the efficiency and the impact of budgetary expenditures. A public expenditure review would focus on the profile of expenditures effectively carried out, including the incidence of expenditures on the poor, and with the appropriate regional disaggregation. To the extent that a high share of expenditures are financed through donor aid (around half of the government expenditures registered in the budget, but possibly more when all off-budget flows are accounted for), such an exercise will require the close collaboration of all major donors. The results of this exercise should guide a possible reorientation of expenditures towards those activities with the highest payoff in terms of poverty-reducing growth. Other priority areas for the improvement in public resource management are (i) increasing the coverage of the budget; (ii) strengthening and increasing the transparency of the process through which the budget is executed and accounted for, including not only the expenditures and revenues of the central government, but also those of local governments, state-owned enterprises, and financially autonomous institutions; and (iii) moving gradually towards more regionally decentralized revenue and expenditure management. The municipal decentralization reform of 1998, which established thirty-three autonomous municipalities with elected assemblies and council presidents, was a major step in this direction. To make decentralization operational, the municipalities need to have control over staffing and block grants through the Autarkic Compensation Fund. In addition, they need to establish effective mechanisms for financing and providing infrastructure and social services. On the other hand, rural Mozambique, which still falls under provincial and district administration, has yet to move toward effective decentralization. In fact, a source of conflict at these levels is the ambiguous division of responsibility between sectoral and regional authorities. Fiscal decentralization in rural regions, which must be an integral part of public finance reform in Mozambique, would help to align public spending with local priorities, thereby ensuring a more efficient use of funds.

74. ***Further deregulation and privatization of public enterprises could contribute to growth.*** The government remains the major shareholder in 33 enterprises, 11 of which are wholly owned by the government. Freeing up public resources from most of the remaining loss-making enterprises in favor of funding higher-priority activities—basic health and education, roads, water delivery—could yield large dividends. Diverting explicit and implicit subsidies away from loss-making state-owned enterprises

increased central government education expenditures by 50 percent in Mexico, 74 percent in Tanzania, and 160 percent in Tunisia. In Mozambique the reduction in military expenditures after 1992 allowed the government to redirect expenditure to health and education. Privatization can also promote improvements in labor productivity, investment, and capacity utilization, as Part I of this report documents. Further divestiture of state assets— preceded by liberalization of entry into the sector, creation of the appropriate regulatory and institutional framework, and appropriate compensation of displaced labor—can pave the way for improved, lower-cost goods and services in key sectors of the economy, such as transportation and telecommunications.

75. The performance of several financially autonomous public institutions or funds that are not subject to audits appears to be inadequately monitored by the government (and parliament). In fact, some of these institutions (such as the Cereal Institute of Mozambique, ICM) or the recently created road administration (*Administração Nacional de Estradas*), have more the characteristics of public enterprises than of government institutions. While some of these public enterprises and institutes may be profitable, most generate profits and dividends that are insufficient to compensate the government for the cost (let alone the opportunity cost) of the funds invested in them through equity increases by the state or funds lent by the government. Initially, the government planned to limit public enterprise support through the budget and remove their monopoly privileges, so that public enterprises would be forced to be more efficient, and gradually reduce its equity holdings by selling the remaining shares. This plan is being implemented only slowly, however. While the government may want to retain control of some "strategic industries" in the short to medium term, these strategic sectors should be deregulated so as to allow for greater efficiency and better service delivery. Deregulation would permit the government to meet its strategic objectives while reducing the economic and financial costs of public sector ownership.

76. ***The current system of implicit transfers discourages fiscal discipline*** because transfers to public enterprises—in the form of onlending of external funds at below-market rates, loan forgiveness, refinancing, or repeated debt-equity swaps—are often used to cover state-owned enterprise operating deficits. These transfers produce the expectation of future debt relief and create incentives for poor performance. The first step in rationalizing transfers to public enterprises was achieved through privatization of state-owned banks in 1996 and 1997. More recently, a second step, aimed at improving the performance of these enterprises, corrected the terms under which new lending is extended to enterprises and strengthened collection procedures of outstanding debts. The next step should be to clarify and settle cross-enterprise debts and audit public enterprises' accounts. The results of the audits should become part of the set of consolidated public sector accounts to be presented to parliament annually, in accordance with the 1997 Budget Framework Law.

77. ***Both consumers and taxpayers would gain if most public services were liberalized as soon as possible, many of the remaining state-owned companies were privatized through a transparent process, and a regulatory agency were established to keep them in check.*** Reforming the public enterprise sector requires more than simply divesting state assets, however. It requires devising sector-by-sector policies; establishing competitive policies; introducing transparency in transactions, negotiating, monitoring, and enforcing contracts with private suppliers of management and financing; redeploying resources to productive uses; and adequately compensating displaced workers.

78. Advancing this reform agenda is important from the fiscal point of view. It is also key to improving service delivery in ways that will attract private sector activity. Reducing the hold of the state in key sectors, such as air, transportation, coastal shipping, and telecommunications, is fundamental not only for continued overall growth but also for increased North-South integration. Removing the monopoly on air routes, for instance, including those currently held by the national airline, *Linhas Aéreas de Moçambique* (LAM); completing the concessioning of the rail and port operations of *Caminhos de Ferro de Moçambique* (CFM); and effectively opening the coastal shipping market to private activity,

domestic or foreign, would expand the range and improve the quality of transportation services. Effectively increasing competition in telecommunications, by eliminating the monopoly of *Telecomunicações de Moçambique* (TDM) over voice services and removing legal and administrative barriers to entry into value-added services would reduce the costs of telecommunications and improve the quality of service.

79. ***Government ownership of shares in privatized enterprises reduces their investment and growth prospects.*** The government's retention of shares in privatized enterprises adversely affects the allocation of scarce public resources and, in certain cases, constrains private actors' ability to invest in the enterprises they own. Investments in these enterprises are sometimes delayed or not carried out because the government is unable to increase capital in the same proportion as the private investors. It is thus important that the government establish a time-bound action plan to reduce its presence in enterprises—not only in those in which the state still owns a majority of shares but also those in those in which it holds a minority position.

*Increasing Domestic Revenues*

80. ***Reducing reliance on foreign aid and sustaining broad-based growth will require gradually increasing domestic revenues over the medium and long run.*** This should be accomplished by introducing tax reforms that reduce distortions and distribute the tax burden equitably. Critical elements of the strategy to broaden the tax base will be a reform of the direct tax system, an overhaul of domestic tax administration (much in the same manner as it was done successfully in customs), increased collections from the value added tax, and the elimination of most exemption regimes and *ad hoc* exemptions. Because of weaknesses in tax administration and widespread direct tax exemptions, tax revenue performance started improving only since 1997, and revenue growth has been modest since then. Increasing revenues through the current distortionary tax system—which favors particular activities and regions and overtaxes international trade—could threaten growth, however.[19]

81. ***The fiscal deficit could be reduced by raising the tax revenue-to-GDP ratio*** from 11.3 percent in 1999 to 13.7 percent of GDP in 2005 (nontax revenue as a percentage of GDP is expected to increase from 0.9 to 1.0 over the same period). While the VAT will contribute to greater revenues through a broader tax base, other policy and administrative reforms are necessary to ensure such rapid increases in revenues, including immediate measures to curtail exemptions.

82. ***Important changes in the tax system have already been made.*** Much progress has been made in the past three years to improve the structure of the trade and tax system. With the reduction in import and export taxes, the government initiated a shift from taxation of international trade to taxation of domestic transactions. With the introduction of the VAT and the lowering of profit taxes, it started a shift from the taxation of production to the taxation of consumption. With the reduction in customs exemptions and the reform of customs administration, it broadened the tax base and reduced rent-seeking behavior.

83. ***But not all changes in the tax and trade system have been improvements.*** The increase in import duties for some commodities since 1996 (through the introduction of commodity- specific import surcharges) raised the price level and will foster the development of activities that cannot compete without protection.[20] The recent increase in the export tax rate for raw cashews or the broadening of the

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[19] A World Bank study of 30 Sub-Saharan African countries over the 1966–82 period suggests that a 1.0 percentage point increase in the tax revenue-to-GDP ratio is associated with a 0.25 percent reduction in the growth rate.

[20] Since 1996 import surcharges of 12.5–65.0 percent were introduced for cement, two types of steel products, and sugar (yellow and white).

import surtax for sugar, while providing a palliative for some processing enterprises in the short term, will not solve their underlying profitability problem or encourage producers to increase production of higher-quality raw nuts.

84. The current tariff structure could, in addition, benefit from further reduction of the top rate, discouraging smuggling and the growth of uncompetitive activities. Finally, it is important that Mozambique's trade liberalization, which the SADC Trade Protocol encourages, be carried out in a multilateral manner. Although for Mozambique, greater integration with other Southern African economies should remain a priority, maintaining trade barriers *vis-à-vis* the rest of the world will limit Mozambique's prospects.

85. The government's increasing preference for using tax reductions and exemptions to attract particular types of activities, promote growth in particular regions of the country (such as the Zambezi Valley regime), assist particular state-owned or private companies, and attract large-scale investments represents a worsening of the tax regime and introduces distortions and inequities into the system. Although many countries use fiscal incentives, empirical studies suggest that few incentives are cost effective and most are detrimental (Box 2.1). Investors care more about the quality of the country's infrastructure, the reliability and predictability of its legal system, and the presence of well-defined property rights and flexible labor laws than about tax exemptions. Moreover, corporate tax rates in Mozambique (about 30 percent) are already low by international standards, suggesting that there should be no need for exemptions.

86. ***Continuing to reverse the declines in tax revenue collections will require broadening the tax base, eliminating most exemption regimes, continuing to reduce reliance on trade taxes for revenue, and making the taxation system more equitable.*** The government has put much effort into replacing the turnover tax with a VAT. The new tax will help broaden the tax base. Increases in domestic revenue could be achieved by eliminating exemption regimes, which, together with incremental VAT revenues, would more than offset the planned decreases in trade taxes. Combined with a strengthening of tax administration, the 1998 reductions in profit and income tax rates would also help increase the tax base and eliminate the need for exemption regimes. The next steps should include conducting, with technical assistance, a comprehensive study of the tax system, including an analysis of the incidence and equity of taxation. Such a study is needed because, while the economy has undergone deep transformations, the direct tax system has not been significantly modified since independence (only *ad hoc* changes in tax rates and exemption regimes have been made). An analysis of the tax system with a view to modernizing and rationalizing direct tax policy and administration should thus be high in the list of priorities for the government. In terms of tax administration, serious consideration is being given to the creation of a semi-autonomous revenue authority, along the lines of those in other African countries. A properly implemented revenue authority reform would improve taxpayer compliance by reducing evasion and lowering taxpayer compliance costs, thereby increasing revenues. Measures to improve the structure of the tax system include correcting features of the current tax system that generate distortions in the economy, such as taxing services and commercial activities at rates that are 10 percentage points higher than rates in industry and 20 percentage points higher than rates in agriculture. Consideration should also be given to reducing the VAT rate—currently 17 percent—to the levels charged by neighboring countries (in South Africa VAT is 14 percent).

**Box 2.1: Do Tax Incentives Work?**

Tax policy incentives are widely used by developing and industrial countries alike to foster industrial and technological development. Commonly used tax incentives include preferential tax rates for certain types of activities or organizations, either on a temporary or permanent basis (tax holidays are an extreme but prevalent form of this type of incentive); investment tax credits; and fast write-offs (accelerated capital consumption allowances and expensing of investment). Most of these tax incentives involve some degree of administrative discretion, which often encourages rent-seeking behavior. Moreover, the fairly generous tax holidays provided by Brazil, Lesotho, Morocco, Pakistan, and Thailand have failed to provide sufficient stimulus to new investment. Recognizing that lost revenues exceeded investment stimulation, several countries, including Brazil, Indonesia, and Mexico, have curtailed these measures significantly.

Empirical studies of the effectiveness of different tax policy regimes in promoting private capital formation in developing economies have reached the following conclusions (Shah 1995):

Tax incentives that are not properly targeted and do not take into account limitations in tax administration capabilities more often than not bring in less than a dollar of investment for each dollar of forgone government revenues. Broad tax incentives—such as tax holidays and general corporate tax rate reductions that are below comparable levels in industrial countries—are thus not cost-effective in promoting investment.

Tax holidays, as currently used in a large number of developing countries, are poor instruments for promoting new investment by domestic investors or investors from capital-exporting countries that allow foreign tax credits to be used against domestic liabilities.

Corporate tax rate reductions beyond the level found in capital-exporting countries (say, below 30 percent) often reduce revenues by more than they increase investment.

Selective tax incentives that are targeted to new investment in machinery and equipment and R&D and that provide upfront incentives are cost-effective in stimulating investment.

Tax incentives matter for domestic and foreign investment, but elimination of tax and nontax distortions (lack of infrastructure, legal framework, institutions) matters even more.

Source: Shah, A., in *Fiscal incentives for investment and innovation*, Oxford University Press, 1995.

87. Broadening the tax base is particularly important in Mozambique, as much of the population in the rural areas does not pay any taxes, except for those levied indirectly through commodity export taxes such as cashew and cotton, or import and consumption taxes through purchase of basic consumption goods such as sugar, oil, or soap. As a result, the tax burden falls on the rest of the economy and an analysis of the ratio of domestic revenues over total valued added (GDP) minus value added from smallholder agriculture and fisheries suggests that the tax burden on some enterprises and activities may actually be relatively high (Table 2.2) relative to other sectors of the economy. In 1999, formal sector value added was taxed at approximately 14.8 percent. When value added from some of the largest enterprises that benefit from company–specific tax reductions is excluded, this translates into an even higher burden (15.5 percent), falling mostly on medium-scale businesses.[21]

[21] The World Bank Regional Program on Enterprise Development survey (1998) of manufacturing firms provides indirect evidence that the tax burden is borne largely by medium-size firms. Larger firms are able to obtain more favorable treatment from the tax authorities, while the smallest firms operate mostly in the informal sector, leaving the bulk of the tax burden to be borne by medium-size producers.

**Table 2.2: Tax Revenues and Revenue Base, 1997–99**
**(percent, except where otherwise indicated)**

| Tax revenues as a share of | 1997 | 1998 | 1999 |
|---|---|---|---|
| Total GDP at market prices | 10.4 | 10.6 | 11.3 |
| GDP m.p. less smallholder (family) agriculture | 14.2 | 14.5 | 14.8 |
| GDP m.p. less smallholder agriculture and large projects | 15.0 | 15.0 | 15.5 |
| *Memorandum items:* | | | |
| Total GDP m.p. (billion Mt.) | 40,554 | 46,427 | 50,827 |
| Tax revenues (billion Mt.) | 4,235 | 4,932 | 5,733 |

Sources: INE (National Institute of Statistics); World Bank staff estimates.

88. ***Off-budget flows need to be incorporated into the budget and contingent liabilities identified.*** Fiscal adjustment as measured by the central government deficit may not fully reflect all claims on government resources (or all of its revenues). For instance, off-budget expenditures and revenues as well as liabilities and claims arising from pensions or other sources assumed during Mozambique's privatization program (such as severance pay for displaced workers) mean that fiscal projections based on the actual fiscal deficit do not fully reflect the government's liabilities. A Ministry of Planning and Finance 1999 study of off-budget financial flows for a group of ministries and provinces found that off-budget revenues ranged from 34 percent of the recurrent budget of the Ministry of Health to 107 percent of the recurrent budget of the Ministry of Public Works and Housing. These revenues—along with disbursements from donor sources that do not use Treasury accounts or are not reported to the Ministry of Planning and Finance—finance expenditures that are often off-budget as well. In some cases, no legal basis exists for collecting such revenues, and the revenues do not enter into the state accounts. These revenues are therefore neither accounted for in the state budget nor audited. A major effort to include all flows of a budgetary nature in the budget and to increase the coverage of the budget, coordinated with the medium-term framework process, is fundamental to ensure the effectiveness and transparency of public resource use.

89. ***Minimizing and anticipating budgetary liabilities arising from the financial sector remains a concern.*** The privatization of the two state-owned banks has done much to improve the health of the financial sector. However, financial difficulties experienced by these two banks recently—now being corrected through restructuring—highlighted deficiencies in supervision and limitations in the effectiveness of the judicial system. Effective supervision, including the enforcement of rules of entry and exit into the banking sector, will now be critical to maintain the stability of the sector and of the macroeconomic environment.

### *Reducing External Vulnerabilities*

90. ***Notwithstanding favorable external prospects and the progress made since 1995 in improving the current and capital accounts, Mozambique's external position continues to be vulnerable, in several aspects.*** First, merchandise exports remain small: despite substantial liberalization, the ratio of the current account deficit to GDP remained high (at 26 percent) in 1997–98, down from 38 percent in 1992–94. Second, the export base remains heavily concentrated on a few products, most based on natural resource use. Although the resumption of electricity exports and aluminum from Mozal will improve the country's external position and is expected to triple Mozambique's exports by 2002 (from US$245 million in 1998 to about US$735 million in 2002), Mozambique's export base will continue to be concentrated on only a few products. Moreover, most of the country's traditional exports are far from

recovering to peak levels. Some major exports at independence, such as manufactured goods and cash crops, have yet to recover fully and are expected to recover only slowly. Third, as noted earlier, in the presence of large aid inflows macroeconomic management will tend to encourage production of nontradables. Heavy dependence on foreign aid also encourages the development of the nontradables sector, in much the same manner as do foreign exchange windfalls from mineral rents. Given the substantial foreign aid flows that are expected to continue at least in the short run, monetary policy and central bank interventions in the foreign exchange market should aim at maintaining a stable price level and a competitive exchange rate, in order not to discourage exports in favor of imports.

91. ***One of the most important factors affecting Mozambique's growth is the government's stance on promoting exports,*** not only from large-scale activities, such as electricity, gas, or aluminum, but also from agriculture, fisheries, tourism, and manufacturing. Reducing external vulnerabilities will require an aggressive strategy to eliminate legal barriers (in the form of import and export duties) and administrative impediments to trade. It will also require making the import process more rapid and flexible, especially outside Maputo. While the government has done much to encourage a consensus for market liberalization, there is still work to be done to transmit this message throughout the country. This is particularly important for the agricultural sector. Ensuring that exports are effectively taxed at a zero rate (by promptly processing VAT refunds) should be an important part of this strategy, as should the continued reduction of import and export taxes, in particular the reduction of the top import duty for finished goods. In addition, an aggressive strategy to lower operating costs to producers by improving roads and other infrastructure, creating more flexible labor laws, and making land transactions more flexible and transparent would go a long way to improve the competitiveness of Mozambican firms in domestic and foreign markets.

## B. Increasing Rural Incomes

92. ***Raising smallholder incomes is the most effective way to combat poverty in Mozambique over the next 5-10 years.*** The majority of Mozambique's population—and most of the poor—are employed in agriculture, limiting the scope for a switch into other activities in the short run. Moreover, this sector provides the greatest potential for increases in productivity. Going beyond subsistence production to production of marketable surpluses will require viewing small-scale (family) agriculture as part of the private sector, however, rather than as a distinct and separate entity.

93. ***East and Southeast Asian countries, such as China, Malaysia, and Thailand, have reduced rural poverty by achieving high rates of economic growth.*** Growth in these countries was initially based on labor-intensive agriculture, combined with investment in human capital. Agricultural incomes were initially boosted by improved technologies that smallholders were able to adopt and by provision of rural infrastructure linking these areas to larger markets. Rising rural incomes boosted consumer demand and strengthened demand-supply linkages to rural nonfarm activities, such as agroprocessing, industries producing farm-related products, and basic consumer goods and services. Rural-urban migration played a relatively small role in poverty reduction in these economies.

94. ***Following such a strategy in Mozambique would require policies that improve the terms of trade for agriculture*** (that is, increase the share of the world price paid at the farmgate for both food and cash crops and reduce the prices of consumer goods). Such policies would help expand marketed surpluses and encourage the adoption of improved technologies. Key actions would include facilitating rural trade, improving access to land and security of tenure, making land transactions more flexible, and promoting improvements in productivity, through effective delivery support services, such as research and extension.

*Facilitating Rural Trade*

95. Marketing and rural trade are the key elements permitting the flow of goods and services to and from rural areas. The two-way nature of the flow is perhaps the most important difference between an extractive strategy, followed in colonial times, and a strategy aimed at rural development. The government's aim should be not only to encourage the creation of marketable surpluses but also to increase rural welfare by raising both the value of crop sales and the volume of sales of goods and services to the rural population. Increased incomes would increase welfare by generating a multiplier effect both within rural areas and between urban and rural areas.

96. ***The single most important problem facing most agricultural households in Mozambique is isolation.*** With a population of about 17 million and a large land area, Mozambique is relatively sparsely populated (about 20 inhabitants per square kilometer). While this means that much of the country has not suffered from pressure for cultivable land, it also means that it is difficult to develop infrastructure and integrate small with larger markets. With the population spread out over large areas and poorly served with roads and other infrastructure, it is both expensive and time consuming to make the linkages through which farm households interact with the larger market economy. In addition, the low population density makes the per capita cost of building roads and other connective infrastructure high. Farmers are thus isolated from both markets for their goods and suppliers of consumer goods.

97. Neither Zambezia, the most densely populated province, nor other densely populated provinces, such as Nampula, is connected to the rest of the country (including Maputo or Beira) with paved roads. And many of the areas with the highest population densities are not located near viable roads of any kind. Many producing areas, such as the main maize, cashew and cotton producing regions, have few road links with major consumption centers on the coast or in the interior. Partly because the road network was designed to sustain the colonial economy, there is no apparent relation between the importance of districts in terms of production and the extent to which they are served by the transport system. With the exception of Tete province, which has good road links to the west and east, and the Beira corridor, the main producing areas for both cotton and maize have poor linkages with potential markets in other countries in the interior. There are viable roads in the northern provinces in coastal areas, but transport links to other countries and other parts of Mozambique are poor. All of this adds up to small local markets, high input and low output prices, and overall isolation for the rural sector, limiting its poverty-reducing potential.

*Improving the Road Network*

98. ***Improving the road network—by repairing and maintaining key trunk and feeder roads—is the single most important factor that can accelerate the short- and long-run growth of agriculture and the Mozambican economy.*** Indeed, it would be difficult to overemphasize the importance of improving transportation and road quality in Mozambique. Efforts should focus first on areas in which the social rate of return is highest, namely, the densely populated and poor provinces of Nampula and Zambezi and linking these areas to the larger markets of Beira, Maputo, and large markets in neighboring countries.

99. ***Better roads would increase farmers' incomes.*** Lower transport costs (as a result not only of improved roads but of improved security along transport routes as well) simultaneously reduce input costs and raise farmgate prices for outputs. Creating these links is necessary to meet the government's stated desire to increase the extent of integration of smallholders into the market economy. Reducing the cost of travel time and depreciation of trucks would have a profound effect both on the marketing margins required for services, especially to more remote areas, and on the ability of traders to compete in any given area. Improved roads could do more to sustainably improve rural incomes than any other intervention.

100. ***The initiation of road rehabilitation has been instrumental in jump-starting growth in Mozambique.*** Given the limits to economic recovery due to bottlenecks in the transport sector, targeting road rehabilitation as a priority made sense. The Post-War Emergency Recovery Program aimed at quickly opening access to areas that had been obstructed due to war and lack of maintenance. Subsequently, the multidonor Roads and Coastal Shipping Programs rehabilitated 3,800 kilometers of priority trunk roads and improved road maintenance. As a result of the improvement in infrastructure, the transport sector has recovered strongly since 1993.

101. ***Much more needs to be done, however. Road rehabilitation needs to be expanded to the densely populated and economically active regions of the north and center, and road maintenance needs to continue to be a priority in the government's public expenditure program.*** A key part of the government's strategy to reduce poverty in the short and medium run should be expansion of both current expenditures for and investment in road and bridge rehabilitation and maintenance. Under the 2000 medium-term expenditure framework, the share of the investment budget allocated to the road sector is slated to increase between 2000 and 2003. Given that maintenance of the rehabilitated roads alone will cost an estimated US$30 million a year, more resources should be devoted to current expenditures as well. An increased allocation to the sector, including locally generated funds, coupled with an appropriate institutional framework that involves increased oversight and an appropriate prioritization of the roads and bridges to be rehabilitated and maintained would allow the government to make a substantial dent in poverty. Simultaneously, the government should move toward a more appropriate institutional framework for managing roads, one that would separate the functions of oversight, guidance, and monitoring of the roads program from road administration.

102. In sum, ensuring better road services in Mozambique requires that:

- The allocation of resources (both domestically generated and external) to the roads sector be substantially increased.
- An improved administrative and financing structure be implemented.
- Road rehabilitation and maintenance be prioritized based on current and potential economic activity, population density, and poverty concentration.

*Reorienting Trade toward Exports*

103. ***Economic growth will accelerate only if a successful transition from subsistence farming to the marketing of surplus crops takes place and agricultural exports increase.*** Attainment of self-sufficiency at the national level, which is likely in many agricultural products, would maintain Mozambique at a low-level equilibrium.[22] A shift in focus from the domestic to the external economy needs to take place. But there need not be a tradeoff between increased exports and increased production for the domestic market. An incentive structure that reflects relative prices in international markets will not only encourage development of an economy that is able to export, it will also help create a competitive domestic market.

104. ***In much of Mozambique, foreign markets are closer than the nearest domestic market of any significance.*** Most of Mozambique's agricultural production remains concentrated in the north. The higher density of population, more regular rainfall, and better soil characteristics make it likely that a large share of agricultural outputs from the northern and possibly the central region will be exported to neighboring counties, such as Malawi and Zimbabwe. The reduction in trade barriers within the Southern

[22] This is also true in other sectors of the economy. However, the goal of self-sufficiency is more often stated by officials in agriculture than in other sectors.

African Development Community (SADC) is likely to accelerate this regional integration and greatly benefit Mozambican farmers.

105. This trends towards cross-country integration is not new. Historically, Maputo and the southern areas of the country were not supplied with food from domestic sources. The southern region was a net exporter of labor and transportation services and a net importer of food. Nampula is more than 650 kilometers from Chimoio (Manica); the distance between Nampula and Maputo (the main consumption center) is more than 900 kilometers. These long distances add as much as 200 percent to the price of commodities such as maize. The South African and Swazi markets are less than 200 kilometers from Maputo. The proximity of these markets is even more important than the superior condition of the road. Although coastal shipping costs are expected to decline if coastal shipping is effectively liberalized, it is unlikely that they will fall enough to make north-south shipping efficient.[23] Because of these long distances, provision of food to Maputo from domestic sources would require the development of marketing links that did not exist in the past. Accordingly, it would probably be more advantageous for the northern provinces to export their output to neighboring countries than to truck their output to the coast, transfer it to a boat, and sell it in Maputo.

### *Easing Entry into Domestic Trade*

106. Abolition of licensing requirements would encourage entry into trade and could increase government revenue by increasing tax collections. The new commercial law approved in 1998 opens the way for easier entry into trading activities, but it is important that the regulations be completed and widely publicized. At the regional level, district officials have been reported to have prohibited trading out of fear of lack of food supplies in their areas. And instances of *ad hoc* restrictions on trading activities at the provincial level have been reported in Niassa, where active border trade in food crops and consumer goods takes place (see box 1.2). At the Malawi border in 1997, traders were reportedly paying an export tax of Mt. 5,000 per sack of maize, based allegedly on phytosanitary regulations of the provincial Department of Agriculture. These practices both inhibit exports and hold down producer prices. An unambiguous and widely publicized statement of current government policies regarding the requirements for trading would help dispel confusion at the provincial level. If outright abolition of licensing requirements were not possible in the short term, simplifying such requirements, so that they could be met if a matter of hours or days, would ease the administrative burden on economic actors.

### *Improving On-Farm Storage and Privatizing ICM's Assets*

107. ***Creating national storage facilities is not likely to be profitable.*** Conditions in Mozambique and the experience of other countries make it very unlikely that large-scale storage would be advantageous. A report conducted in 1994 (Conway, Coulter, and Trotter) concluded that sufficient storage capacity exists for Mozambique to operate on a commercial basis. More important than national or provincial-level facilities is the dissemination of adequate on-farm storage technologies to eliminate the need for higher-level storage facilities. Many years of panterritorial pricing with little or no seasonal variation all but eliminated incentives for farm-level storage and arbitrage. Creating such incentives would be a far better solution from both the welfare and efficiency point of view than creating national reserves.

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[23] Although entry into coastal shipping activity was opened to private sector activity with passage of the new *Lei do Mar* in 1996, a number of administrative and bureaucratic barriers to entry remain and no foreign operators are allowed to provide regular coastal shipping services, thus keeping north-south transport costs prohibitive.

108. A related concern is the role of the Cereals Institute of Mozambique (ICM), which has performed poorly. ICM has been unable to act consistently as a buyer of last resort, as its original mandate indicated. With the phasing out of food aid, the providers of which were ICM's main customers, ICM's financial viability and the rationale for maintaining this entity will be called into question. A good case can be made for selling ICM warehouses and trucks to the private sector. The sale of ICM's assets should be made to multiple buyers, as there is no reason to prefer a private entity with monopoly powers over a public one. Moreover, establishment of a group of independent storage facilities and transport providers would help promote competition and services to a broader range of producers.

*Strengthening Land Rights*

109. One of the most important attributes of economies that foster private sector activities is that individuals are free—and believe themselves to be free—to take all actions in their economic (and social) interest that are not specifically prohibited. The legal framework in these market economies has at least four basic economic functions:

- It defines the universe of property rights in the system.
- It sets a framework for exchanging those rights.
- It sets the rules for entry and exit of actors into and out of economic activities.
- It oversees market structure and behavior in ways that promote competition and protect consumers and the environment.

110. ***Definition of property rights, in particular land rights, remains unclear in Mozambique.*** Regulations for implementing the Land Law in urban areas are still lacking, and the framework for exchanging land rights is rigid, unclear, and thus inefficient. For the most part, security of tenure does not exist, and the lack of definition and inadequacy of the land titling process is a constraint on smallholder production and larger-scale investment alike.

111. The current framework Land Law (No. 17/97 of October 1) replaces the earlier laws of 1979 and 1986. The new law clarifies the processes of acquisition, title, registration, and transfer of land as well as the terms under which usage rights hold. The law, which applies to agricultural and urban land, recognizes customary uses of land by local communities and groups that have used a piece of land for 10 years; establishes a renewable 50-year usage right to land for activities other than local community exploitation, individual dwellings, or exploitation by families of nationals; and revokes the right of use if the holding entity fails to carry out its stated plan of exploitation without providing justification.

112. Perhaps the key provision of the new law is the conditions under which the usage right is revoked. One of the features of the post–civil war land grab in Mozambique was the ease of speculation: once usage rights to a parcel of land had been acquired, there was no penalty for leaving the land undeveloped, and land taxes were extremely low and often not collected. As a result, under the old land regime, large acquisitions of land were made at extremely low cost, simply in the hope that the tenure regime would eventually shift toward establishing free market values for land. While the new provision is potentially an improvement, it leaves the question of whether usage rights should be revoked in the hands of the government. Users may therefore be subject to abuse by the administrative authorities. The question of transparency is clearly a key issue in terms of how the land law is implemented and how usage rights are granted in the first place.

113. ***Mozambique's national Land Law does not allow for freehold tenure.*** Instead, long-term (50-year) leases are issued. Leasing rights are not formalized for the vast majority of smallholders, who may

have some security of tenure under traditional systems (but who may be subject to actions by formal authorities as well).

114. ***The fact that the law stops short of permitting full private ownership of land impedes development, not only in the resource sectors but more broadly as well, for several reasons.*** First, where land is not owned or securely leased, it cannot be used as collateral, which reduces access to credit. Second, because land cannot be owned, the price of acquiring land—determined by what is essentially an administrative process—is likely to be artificially low, reducing allocative efficiency. Third, the lack of a true market in land creates rigidities, and the bureaucratic process by which leases are traded creates opportunities for rent-seeking. An entrepreneur who believes he or she could make better use of a piece of land than the current tenant cannot simply offer to buy the land. Instead, he or she must pursue a bureaucratic process in which the current tenant relinquishes his usage rights and the entrepreneur establishes new usage rights. Currently, a backlog of more than 10,000 applications for land use permits at the National Directorate for Geography and Cadastre (DINAGECA) prevents land transactions from taking place and discourages investment by both large and small farmers. Smallholders, who have less access to the bureaucracy, are particularly vulnerable to the inefficiencies and lack of transparency of the process. Lack of security of tenure is also a serious problem for investors and tourist operators, whose legitimacy is frequently called into question and who fear reprisals by farmers or arbitrary cancellation of their titles.

115. ***With increased opportunities for high returns in agriculture and the urbanization of peri-urban areas, land pressure and conflicts are likely to continue increasing.*** The low level of land taxes and the even lower level of collections is also leading to growing pressure, mostly from Mozambican nationals, for (low-cost) access to agricultural and urban land, often for speculative rather than productive purposes. This has strong implications for the private sector's ability to grow. The lack of credit history and organized accounts of many entrepreneurs makes collateral the only viable way to obtain credit. The fact that land cannot be used as collateral makes it impossible for these entrepreneurs to borrow for investment or working capital.

116. ***Substantial improvement in the efficiency of land allocation could be achieved by allowing land use rights to be traded with minimal bureaucratic interference.*** Credible, tradable long term leases to land can help mitigate many of the obstacles inherent in the current system. Genuine tradability would permit lease holders to use their land rights as collateral, which would facilitate access to credit. Tradability would also foster a more efficient allocation of lease rights, thus providing some of the benefits associated with a private land market. For the current system to approach conditions of market tradability, however, bureaucratic discretion and involvement in the trading process should be reduced, especially once titles are issued. At the same time, the success of this approach is premised on the existence of an effective bureaucratic apparatus to administer the process competently, fairly, and transparently. Several measures deserve prompt attention. First, the disagreement about the proper roles of DINAGECA and the Ministry of Justice should be resolved expeditiously. Second, the issue of land disputes should be addressed by a countrywide campaign, in which claims and disputes would be filed, evaluated, and settled. Third, administrative procedures must be reviewed and revised to simplify and expedite the entire process.

### *Improving Agricultural Productivity*

117. ***Agricultural productivity is low in Mozambique, even by African standards*** (Table 1.7). Only 7 percent of farming households use fertilizers, with use even less prevalent in less densely populated provinces. According to surveys, land tenure has no correlation with fertilizer use, but use is greater among households with more than 3 hectares of land.

118. ***Agricultural output could be increased by increasing applications of nutrients,*** particularly in areas such as the south and peri-urban zones, where population growth is creating pressures for intensification. One study suggests that 50–75 percent of the increase in maize yields in developing countries outside Africa from the mid-1960s to the 1980s can be attributed to fertilizer use (Viyas 1983). That such a strategy could be viable in Mozambique is supported by the fact that in three of Mozambique's neighboring countries—Malawi, Zambia, and Zimbabwe—half or more of the maize area was fertilized in 1990. Maize yields in Mozambique averaged 0.5 tons per hectare between 1991 and 1995—half or less of yields in Malawi, Zambia, and Zimbabwe. These large differences suggest that considerable potential remains untapped.

119. ***Several problems are associated with increasing fertilizer use in Mozambique, however.*** First, fertilizer represents the largest cash outlay for those who use it. Many smallholders can use purchased inputs only if rural traders are willing to extend credit. Second, given the erratic nature of rainfall in some areas, risk-averse smallholders will apply risk-increasing inputs such as fertilizer in suboptimal amounts. Third, fertilizer is bulky, and both transport and storage costs are high.

120. Both informal and formal systems of seed supply are important. Mozambique has a variety of seed supply systems, ranging from informal systems based on farmer retention of own-seed to formal systems. The largest formal system is SEMOC, the national seed company, a joint venture between the government and the private sector. In addition, there are direct private sector seed supply operations in such crops as cotton, with JVCs providing seed to farmers growing in their areas. It is likely that Mozambique will continue to have a variety of seed sources and supply mechanisms. This is beneficial, given the diverse needs and conditions of production in different sectors and areas of the country. Widespread adoption of modern varieties often depends on informal as well as formal seed supply systems. Informal systems can be cost-effective in getting seed to dispersed low-income populations. This is particularly true in Mozambique, where low population density and poor transport conditions increase the costs of centrally directed operations.

121. ***Extension and research can do much to disseminate information on new production technologies.*** The Agricultural Sector Investment Program (PROAGRI) can improve public service delivery of extension and research services. Although the payoffs from research and extension may take years to materialize, investment in these services could produce massive increases in agricultural output and incomes. Not all of these investments need be public, however.[25] An extension approach open to multiple delivery mechanisms, including private sector enterprises, associations, and NGOs, is being adopted by the government.

122. ***Improving infrastructure and creating mechanisms for group purchases of inputs could help increase the availability and reduce the price of inputs.*** Reducing transport and storage costs through improved roads and facilitating group purchases at local and higher levels by establishing cooperatives or other mechanisms could help farmers benefit from economies of scale.

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[25] The role of the government may not necessarily extend beyond varietal development, depending upon the public good properties of the seed in. The private sector cannot be expected to engage in production if benefits accrue to a broad audience and cannot be recouped by any individual or company. This characteristic often applies to breeding and research; it is much less often true of multiplication or marketing and distribution. Where necessary, government support can be effectively provided through such mechanisms as the joint venture approach now used in Mozambique. In this way, the benefits of quality control and marketing support can be provided where needed without sacrificing the financial discipline the private sector can provide. Nevertheless, many farmers in Mozambique will continue to rely on informal sources. Permitting and encouraging these systems can help promote efficiency and growth.

123. ***The government should also reduce administrative and bureaucratic impediments to imports of seeds, fertilizers, and other inputs.*** Impediments to imports of agricultural inputs, be they tariffs or administrative barriers, reduce input availability, increase costs, and thus delay or impede productivity improvements for the poorest Mozambicans. An updated approved list of agrochemicals and seeds should be transmitted to customs in order to eliminate the need for registration with the Ministry of Agriculture. Agreements with other SADC countries to recognize seeds or agrochemicals certified by other member countries would also reduce the administrative burden on the Mozambican administration and help increase input supply and reduce prices.

## C. IMPROVING THE BUSINESS ENVIRONMENT

124. ***Mozambique's private sector, including informal businesses and smallholders, has been the engine driving the rapid growth of the past decade.*** Much progress has been made since 1987 (and especially since 1995) to reverse the conditions that had stifled private initiative. Over the past 10 years, the government has made vast strides toward becoming more business friendly. Those efforts are evident in the results of the World Bank Regional Program on Enterprise Development (RPED) survey of the Mozambican manufacturing sector (Table 2.3). Almost all surveyed firms believe the government will continue its reform program, including improving the business environment, and consequently plan to make substantial investments in the next three years. While there are still many areas that could benefit from improved policies, firms seem satisfied with the government's actions in several areas. Almost no firms in the manufacturing survey complained about restrictions on activities in which they can engage, repatriation of profits, joint venture restrictions, or hiring local workers.[26]

**Table 2.3: Percentage of Firms That Cite Problems with Selected Regulations**

| *Regulation* | *Full sample* | *Foreign firms* |
|---|---|---|
| Restrictions on activities | *95.0* | *91.2* |
| Joint venture restrictions | 97.0 | 98.0 |
| Restrictions on repatriation of profits | 98.0 | 97.0 |
| Hiring procedures for local workers | 91.3 | 90.1 |
| Hiring procedures for foreign workers | 65.3 | 46.0 |
| Reporting labor data | 79.2 | 72.6 |
| Dealing with inspectorate of labor | 62.8 | 53.3 |

Source: World Bank, 1998.

125. ***Despite the many problems cited in the survey, entrepreneurs in Mozambique are confident about business prospects, especially in the medium term.*** More than 70 percent of the firms interviewed expect sales to rise in the next year, while less than 20 percent expect them to fall. A similar pattern emerges for sales in the next three years, with almost 77 percent of respondents expecting sales to increase in the next three years (Table 2.4). In order to support these higher sales, about 60 percent of firms expect to make major investments in the next three years (Table 2.5). A higher proportion of firms in the Nampula area plans to make major investments in the next three years than in the Maputo region. This probably reflects the fact that the north is starting from a lower base and must catch up with the rest of the country. The fact that firms are confident about their prospects three years into the future reflects the perception in the business community that the government is committed to continue improving the business environment.

[26] The fact that manufacturing firms cited no problems with current regulations restricting entry into certain activities does not mean that no such restrictions exist. In telecommunications, coastal shipping, and the main north-south air transport routes, for instance, entry remains restricted.

**Table 2.4: Expectations about Sales in the Next Three Years**
**(percent of respondents)**

| Response | Maputo | Central | Nampula |
|---|---|---|---|
| Lower than today | 11 | 11 | 0 |
| Same as today | 6.5 | 3 | 15 |
| Higher than today | 75 | 86 | 75 |
| Don't know/not applicable | 7.5 | 0 | 10 |

Source: World Bank, 1998.

**Table 2.5: Firms Expecting to Invest in the Next Three Years**
**(percent of respondents)**

| Response | Maputo | Central | Nampula |
|---|---|---|---|
| Yes | 56.5 | 71.4 | 70 |
| No | 36 | 28.6 | 15 |
| Don't know | 7.5 | 0 | 15 |

Source: World Bank, 1998.

126. ***While confidence in Mozambique's prospects is high, however, the country ranked only 18th out of 24 African countries on an index of competitiveness (Table 2.6).*** On all six measures of competitiveness, its environment was systematically judged weaker than two-thirds of the countries surveyed. The institutional and infrastructural indicators included in the World Bank 1997 World Development Report survey confirm this pattern. There, too, Mozambique's business environment was rated worse than many of the 22 Sub-Saharan African countries surveyed. Crime, bureaucratic hassle, policy instability, inefficiency of government services, lack of predictability of the judiciary, and weak infrastructure emerged as especially severe weaknesses.

**Table 2.6: Mozambique's Ranking in Surveys of Business Environment in Africa**
**(1 = highest score)**

| Indicator | Mozambique's ranking |
|---|---|
| **Africa Competitiveness Report, 2000 (24 countries)** | |
| Competitiveness index | 18 |
| Improvement index | 3 |
| Optimism index | 3 |
| **World Development Report Survey, 1996–97 (22 countries)** | |
| Crime | 21 |
| Time spent dealing with officials | 19 |
| Policy instability | 17 |
| Excess bureaucracy | 16 |
| General efficiency of government services | 15 |
| Predictability of judiciary | 15 |
| Quality of infrastructure | 14 |
| Threat of coups | 7 |
| Unexpected changes in rules | 5 |
| Retroactive changes in rules | 3 |

127. Private sector conferences and surveys of firms continue to document the maze of restrictive regulations—covering labor, licensing, investment, monopoly or monopsony privileges—that continue to segment markets, encourage rent-seeking, and discourage efficient resource allocation. The consistent message from private sector conferences and the RPED survey is that the cost of doing business in Mozambique is high, particularly for small and medium-size enterprises. In a world in which technological change is reducing transport costs, hastening globalization, and changing the nature of competition, firms must be able to quickly acquire skills to survive and grow. Thus while there is much optimism among business people about Mozambique's prospects, that optimism will fail to translate into new investments and economic activity unless an aggressive strategy to improve the business environment and reduce costs to the private sector is pursued.

128. The most important problem identified by businesses is the weak financial market, which hampers their ability to operate and invest (Table 2.7). This problem, however, is common among developing economies. Much improvement has taken place since 1996 and is expected to continue provided that banking supervision continues to be strengthened and the definition and enforcement of property rights is improved. Government policy, followed by the bureaucratic burden and administration, are the next most important categories, followed by lack of demand, inadequate infrastructure, and the lack of skilled labor, adequate enforcement, competition, local inputs, and business support. Most firms still view inadequate government regulations and bureaucracy as imposing substantial costs on their operations. The most important government-related issues are the import regime and labor regulations. Although the import regime was still undergoing major reforms in 1997, when the survey was conducted, most firms reported that the regime was improving and was clearly better then than only two years earlier.

**Table 2.7: Problems Facing Businesses Operating in Mozambique**
**(percent of respondents)**

| Problem | Most important problem | Second most important problem | Third most important problem | Total | Weighted score[a] |
|---|---|---|---|---|---|
| Lack of finance | 38 | 39 | 22 | 99 | 214 |
| Government policy | 23 | 26 | 11 | 60 | 132 |
| Bureaucratic burden and administration | 16 | 15 | 23 | 54 | 101 |
| Lack of demand | 19 | 11 | 9 | 39 | 88 |
| Inadequate infrastructure | 12 | 17 | 16 | 45 | 86 |
| Lack of skilled labor | 9 | 9 | 11 | 29 | 56 |
| Lack of enforcement | 8 | 12 | 6 | 26 | 54 |
| Lack of competition | 9 | 7 | 11 | 27 | 52 |
| Shortage of local inputs | 8 | 5 | 4 | 17 | 38 |
| Lack of business support | 2 | 1 | 3 | 6 | 11 |

a. Weighted score is determined by weighting the number of times a problem appears by whether it was cited as the first, second, or third most important problem.
Source: World Bank, 1998.

### *Creating an Efficient Financial System*

129. An efficient and vibrant financial system contributes much to economic development. It mobilizes savings and allocates them to investments by private entrepreneurs. It screens borrowers, manages risks, and operates the payment and settlement system. And it ensures that the dynamic parts of the economy are well funded.

130. ***Many improvements have taken place in Mozambique's financial sector since 1996, but much still needs to be done.*** The first step in financial sector reform—privatization of the majority of shares of

the two state-owned banks, Banco Comercial de Moçambique (BCM) and Banco Popular de Desenvolvimento, now known as the Banco Austral—allowed the government to stop the hemorrhaging of resources that lay at the root of Mozambique's fiscal and monetary imbalances and the problems in the banking system. The move made a significant contribution to the decline in inflation. The entry of new banks has somewhat increased the quality, variety, and accessibility of financial services. Many banks, however—notably, BCM and Austral—remain overstaffed and continue to carry a substantial share of nonperforming loans. In addition, the sector lacks adequate supervision and regulation. To follow up, the government should make a commitment to implement sanctions when necessary. Moreover, the Bank of Mozambique should be made the sole authority in licensing and delicensing banks and non-bank financial institutions.

131. ***High real interest rates remain a problem.*** With the exception of the flood-related increase in early 2000, inflation rates have declined significantly since 1996, following the privatization of the two state-owned banks. Interest rates, however, have been slower to fall. This stickiness reflects a variety of problems that affect both the supply of and demand for banking services, as well as the institutional and legal framework that supports economic and financial activity in Mozambique. On the supply side, problems include inefficiencies within the banking sector, bank-by-bank credit ceilings, the low level of competition, and conservative expectations regarding inflation and other indicators of macroeconomic performance. On the demand side, the main problems are the lack of bankable credit demand, problems in contract enforcement, and lack of transparent information (Box 2.2). On the institutional side, weaknesses in contract enforcement mechanisms and inadequate definition of property rights constrain the ability of financial intermediaries to lend. The institutions required to provide accounting and creditworthiness information and enforce contracts do not exist in Mozambique, or they function inadequately. Until these institutions are strengthened, manufacturing firms in Mozambique will continue to face a shortage of funds.

132. ***Bank-by-bank credit ceilings, which were binding on the most dynamic banks, may also have slowed the decline in interest rates.*** Until recently, bank-by-bank credit ceilings were the main instruments of monetary control. Banks, especially recent entrants, wishing to expand their loan book needed to expand their deposit base and compete for deposits. The transition to indirect monetary control methods that took place in 1999 is likely to ease this constraint, encouraging banks to compete for lending business (putting downward pressure on lending rates) and expand into currently unserved higher-risk market segments. The extent of competitive downward pressure on lending rates, however, will depend on the existence of unsatisfied bankable credit demand, as well as on the speed with which other limitations on the bankability of credit demand are eliminated. These constraints—poorly defined property rights, lack of availability of assets that can serve as collateral, weak institutions to enforce contracts—all increase the costs of financial intermediation.

**Box 2.2: Why Don't Credit Markets Work Better in Mozambique?**

Lack of information, inadequate communication, and imperfect enforcement are at the heart of credit market problems in Mozambique. These problems appear in every country, but in Mozambique they are particularly severe for three reasons. First, many firms in Mozambique are owned by new entrants, who have just started in business or have bought newly privatized firms. These firms have not had time to establish a track record or a strong reputation in business. At the same time, many older firms that do have track records are heavily indebted because of a combination of currency devaluation, which raised the value of their foreign debt, and increased borrowings for restructuring and other purposes. In short, the real side of the economy—populated by many untested firms and highly indebted firms—is not in a very good position to receive credit.

Second, the institutions designed to reduce information costs and opportunistic behavior are not yet well developed. Accounting standards and the accounting profession are weak, and banks and other lenders are only starting to share information. In addition, contract enforcement through the legal system is costly, lengthy, and uncertain.

Third, state ownership and uncertain title to land use reduce the assets firms can use as collateral. In a financial system in which collateral is acting as a substitute for information and enforcement, this lack of collateralizable assets seriously reduces the ability of financial intermediaries to lend.

In many countries, banks have an advantage over individual lenders in gathering information because they have long-term relationships with their borrowers and gather information on them when they provide other services, such as checking and savings accounts, letters of credit, or financial advice. In Mozambique, however, very little information is available to banks, because firm accounts are notoriously inadequate and banks do not provide many services. Very few firms have full-time accountants, and most bookkeepers are not formally trained. Company books are sometimes falsified to mislead the tax collector, and few outside accounting firms are available to certify company accounts. The few accounting firms that do operate in Mozambique charge high fees, which only the largest corporations can afford. In addition, many company managers are not financially sophisticated and lack experience in approaching banks with business plans. Many firm managers consider bookkeeping as necessary only for tax purposes and do not realize the benefits of financial management. Given this lack of information, anticipating potential problems and writing complete contracts is often impossible. Moreover, detailed contracts are useful only if they can be adequately enforced, and enforcement is problematic under the weak Mozambican legal system.

Because lenders are unable to accurately assess risk and control firms' behavior with detailed contracts, banks are forced to depend on collateral to secure loans. Collateral requirements of 125–300 percent of the loan value are one of the primary reasons firms report for not wanting to borrow. For collateral, banks prefer tradable goods, such as cashews, imported consumer goods, automobiles, which they can quickly sell in the case of default.

### *Improving the Government's Attitude toward Business*

133. Given that most firms produce for the domestic market and rely on imported raw materials and capital equipment, it is not surprising that most complaints concern smuggling, high tariffs, and inefficient customs administration. Many firms believe that they are at an unfair disadvantage with respect to smugglers because they must pay high duties on legally imported inputs.[27] They view the government as doing little to stop smuggling.

134. ***Mozambique's long border makes the cost of enforcing tight border controls prohibitive.*** To reduce smuggling, important import duties need to continue being reduced. Although import duties for

[27] An additional problem concerned the *Boletim de Registo de Importação* (BRI). Before the government abolished the BRI in late 1998, firms had to obtain a BRI and have their imports assigned to a tariff category before they could import.

most raw materials and capital goods are now low (below 10 percent), import duties for consumer (finished) goods are 30 percent and import taxes on some commodities (such as sugar) are as high as 65 percent. These high tariffs encourage smuggling, which can translate into a low (or even negative) effective rate of protection. Lowering import duties for consumer goods and eliminating import surcharges and export taxes would complement the government's innovative and far-reaching reform of the customs administration, which could serve as a model for other African countries. Though there is still work to be done, especially regarding tax policy, and though sustainability of the reform will require continued attention, the government's solid progress in this area is noteworthy.

*Modifying Labor Regulations and Reducing Administrative Requirements*

135. ***Skilled workers are in short supply in Mozambique.*** Lack of trained workers is a problem for Mozambican firms, especially large and foreign-owned firms, which use more sophisticated production techniques than smaller firms. The problem is probably much more serious than survey responses to questions about the labor force indicate. Responses to other survey questions suggests that firms have unmet needs for better-trained workers. Even smaller firms indicated that they are unable to produce high-quality goods due to the lack of skilled workers.

136. ***Labor legislation is becoming a significant deterrent to new investment in Mozambique and an obstacle to growth.*** Until the Mozambican work force acquires basic education and on-the-job training, flexible labor laws that allow for the hiring of foreign workers will be needed. If they were able to identify Mozambican workers with the appropriate qualifications and experience, firms would normally not hire foreign workers (who cost more than domestic workers and who lack knowledge of local conditions). Preventing firms from hiring expatriates thus reduces the ability of those firms to produce. The fact that interviewed firms believe it is becoming more difficult to hire expatriates is thus a worrisome sign. The new restrictions recently approved by the government—which establish new rules governing the share of foreigners companies in Mozambique can hire as managers and make it more difficult to obtain entry visas—may exacerbate the problem. The result may be a loss of the spillover effects associated with foreign direct investment (Box 2.3).

**Box 2.3: Does Foreign Direct Investment Have Spillover Effects to the Economy as a Whole?**

The growing influence of foreign investors in the Mozambican economy is becoming a source of anxiety for weak local institutions and businesses and has generated demands for the "Mozambicanization" of economic activity. This manifests itself in a variety of ways, often contradictory. The hiring of foreign workers, even by private firms, is subject to scrutiny and individual approval by the government (the difficulty of obtaining work permits to enter the country is now a common complaint of the private sector). Restrictions on asset ownership by foreign nationals limit the contribution they can make to growth, investment, training, and employment. Tax incentives are granted to attract new investment (a substantial share of which is at least partly foreign), but foreign companies are subjected to higher levels of harassment by tax officials.

Do these policies make sense? There are good a priori reasons to expect foreign direct investment (FDI) to have a very positive effect in host countries whose economies are not subject to major domestic policy distortions. Recent thinking on the nature of FDI stresses foreign investors ownership of proprietary, largely intangible, value-creating assets, such as technological knowledge, capacity for innovation, or design, production, marketing, management, and other skills necessary for successful private-sector led growth. In the absence of artificial inducements, such as high trade protection of domestic markets or fiscal incentives (see box 2.2), it is mainly these proprietary assets that attract FDI and allow foreign investors to offset the natural advantages possessed by local firms, such as better knowledge of domestic resources and conditions.

Empirical research supports the idea that FDI generates significant productivity gains in host countries. A large body of cross-country evidence documents direct positive effects. These effects occur because foreign-owned companies have a higher level of labor and total factor productivity than local firms; they transfer technology, management, and quality control standards to local suppliers; and they supply previously unavailable products to customers. There is also considerable, albeit not uniform, evidence for a variety of indirect or spillover benefits. These include the spillover benefits of training local labor and management, the effect of increased competition in forcing efficiency improvements among local firms, and the more rapid spread of knowledge about new technologies, products, management techniques, and foreign markets to unrelated local businesses.

137. ***Regulations governing layoffs contribute to unemployment.*** While the law allows firms to reduce their work forces, employers are forced to make such high severance payments—even when an employee is terminated for theft or some other just cause—that firms often keep unproductive workers on the payroll. This policy leads many firms, especially smaller ones, to hire only temporary workers, who do not benefit from the same job protection as permanent workers. Such labor market rigidities add to the already considerable costs of doing business in Mozambique and discourage firms from expanding. This legislation thus has the unintended effect of encouraging the proliferation of short-term contracts and, ultimately, unemployment, protecting only those who currently hold a job. A pro-employment policy should make adjustments in the work force more flexible.

138. ***Administrative requirements are burdensome.*** Rather than seeking to protect workers' safety and basic rights in the work place and encourage employment creation, Mozambique's labor legislation still reflects the principles of a centrally planned economy. Regulations require, for instance, that firms file monthly reports with the Ministry of Labor, including the names of workers they employ, what jobs they hold, how much they are paid, when they go on vacation, and so forth. While reporting was not cited as a major problem, requirements are sufficiently onerous that almost 21 percent of firms surveyed cited them as a problem.

139. The government is rightly concerned with improving opportunities for more Mozambicans to participate in the labor market and with employment generation. A strategy combining a revamped technical and vocational training program with measures to reduce constraints to the functioning of the labor market could help make the Mozambican workforce more competitive and attractive to businesses, while allowing them to adjust and define their workforce according to need.

*Reducing the Bureaucratic Burden*

140. ***The bureaucratic burden is a major problem for businesses in Mozambique, particularly for small formal sector firms*** (Tables 2.6 and 2.7). A study carried out by the Foreign Investment Advisory Service revealed that firms need to spend between 6 and 10 percent of their initial foreign investment just to incorporate, a process that takes between 3 to 12 months to complete (Emery et al., 2000). An enterprise may have to spend up to US$50,000 simply to obtain titles to land and premises (in the State of Maryland, in the United States, the cost of registering an enterprise is less than US$100). The lack of notary publics—a market in which entry is restricted—drives up official and unofficial costs. Many managers in the manufacturing sector stated that while policies are improving and the government is trying to be more business friendly, most civil servants have not yet adopted this new philosophy. They retain the attitudes acquired under the central planning regime (that they are there to regulate and control business, not to offer a helping hand). The result is increased opportunities for corruption and lower investment.

141. ***Delays and difficulties caused by customs and the import regime were reported to be in 1997/98 the biggest administrative problem.*** Almost 63 percent of firms that import reported that they had difficulty bringing in raw materials or capital equipment. Almost 73 percent of these importers said that the problem involved delays caused by customs or preshipment inspection. The time it takes to process import requests and the delays caused by disputes or improperly filled out paperwork all add significantly to the cost of doing business in Mozambique, particularly outside Maputo. In fact, for raw materials and capital equipment, these costs are reportedly more burdensome than tariff rates. Several firms reported that they had turned down opportunities to export because delays in the import regime made them uncertain about meeting export schedules. The problem of delays in the import regime are so severe that most firms admit regularly smuggling in goods, especially spare parts. Even firms that were willing to pay duties engaged in smuggling, because they could not afford the time it takes to import legally. The problem is particularly acute outside Maputo, where new management and improved procedures have not yet had the desired effects of improving administration significantly.

142. ***Corruption appears to be less of a problem than the bureaucratic tangle.*** Only 43 percent of the 81 firms that responded reported that corruption by customs officials is a problem. This figure is lower than in many other countries, revealing an improvement in transparency and a reduction in rent-seeking behavior by customs administration, likely due to the government's customs reform program. However, while corruption might have declined in the specific case of customs, it is unclear if these gains can be sustained in the long run; there is also a general perception that governance is deteriorating.

143. ***The bureaucratic burden is a bigger problem for foreign-owned firms, among which it ranks second only to finance, than it is for domestic firms.*** As a result, it discourages foreign direct investment. While only 35 percent of firms in the full RPED sample reported hiring expatriates to be a problem, almost 64 percent of foreign firms did so. A greater percentage of foreign firms, as compared with the overall sample, also claimed that having to report labor data and deal with the labor inspectors was a problem. Foreign firms suffer more from bureaucracy for two reasons. First, they do not know or understand all of the government regulations and do not have personal contacts in the government to help them resolve problems. Second, because foreign firms are both wealthier and more vulnerable than firms owned by Mozambicans, they are more frequently targeted by officials seeking favors. Given that large foreign-owned firms are responsible for much of the recent growth in the manufacturing sector and the need for Mozambique to continue attracting long-term capital inflows, this should be of great concern to the government.

*Increasing Domestic Demand*

144. ***Low demand is a big problem for small and medium-size firms, which often fail to produce products consumers want to buy.*** Many small- and medium-size domestic firms complain that the small size of the domestic market in Mozambique constrains their ability to grow. Low demand appears to be much less important for large firms and firms owned by foreigners. Insufficient demand in Mozambique reflects more than just low domestic consumer purchasing power, which affects all firms. Smaller firms and firms owned by Mozambicans also face low demand because their products lack the style and quality necessary to attract local consumers, let alone the export market. Many of these firms started and prospered under the protection accorded by central planning and war but are struggling now that partial liberalization has forced them to compete on the world market. Larger firms, most of them foreign-owned, are used to competing on the world market and would not have entered Mozambique had they not been confident that their products were competitive.

145. The difference in importance attached to the lack of demand and competition by domestic and foreign-owned firms points to deeper issues. The opening of the market brought about by liberalization policies and the end of the war has created many opportunities for Mozambican firms. Not all firms are able to take advantage of them, however. Domestic firms, which until recently had been cut off from the world market, lack the knowledge and skills needed to compete against imported goods or international firms. Most of these companies continue to use the same processes to make products of the same quality and design that they did when they faced little competition. Providing small and medium-scale businesses with specialized management training and support for product development, technical change, and marketing could help many of these companies improve their competitiveness.

*Improving Law and Contract Enforcement*

146. The RPED survey of businesses revealed significant dissatisfaction with the law and contract enforcement environment in Mozambique. Problems with lack of law enforcement ranked relatively low on the survey, but they did so because all of the firms surveyed provided their own security. More than a third of these firms indicated that crime and theft represent significant costs of doing business. Firms avoid seeking recourse in the courts to solve business disputes and very rarely call the police when they are the victims of crime because the legal system does not function effectively. Many firms said that they do not distribute their goods nationally because it is too expensive to provide security for goods shipped outside the local area.

147. Mozambique's weak legal system is impeding further financial sector deepening, and it will increasingly be perceived as a constraint to business activity as the economy grows. A major effort to revamp the legal system—that includes disseminating legislation throughout the country, improving property rights, publishing and disseminating major court rulings, and strengthening the court system, the Ministry of Justice, and the police—should be launched immediately. Improving the legal system is particularly important because firms report that the effectiveness of the system is one of the main factors they consider when deciding to invest or expand.

*Improving the Infrastructure*

148. Lack of adequate infrastructure—including electricity and water supply, roads, railroads and ports, which years of civil war and neglect left in ruins—is a serious impediment to growth. The problem is particularly acute in the center and north of the country and for larger firms, which distribute their products over a wider geographic range.

*Power and Water*

149. Measures of infrastructure performance—such as the number of power outages per month or the proportion of firms that own their own generators—show that the quality of the infrastructure differs across the country. The percentage of firms that rely on their own power generators is much higher in the north, for example, reflecting the greater need to generate power when the public supply fails (Tables 2.8 & 2.9).

**Table 2.8: Firms Owning Generators, by Region**

| Region | Number | Percent |
|---|---|---|
| Northern | 13 | 53 |
| Central | 15 | 52 |
| Maputo | 23 | 24 |
| Total | 52 | 34 |

Note: Central region includes Beira, Chimoio, and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island.
Source: World Bank, 1998.

**Table 2.9: Mean Number of Power Outages per Month, by Region**

| Region | Mean |
|---|---|
| Northern | 24 |
| Central | 14.5 |
| Maputo | 4.4 |
| Total | 10 |

Note: Central region includes Beira, Chimoio, and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island.
Source: World Bank, 1998.

150. Water infrastructure also varies by region. A much higher proportion of firms in the central region has built their own cisterns, presumably in an effort to cope with greater water problems there (Table 2.10).

**Table 2.10: Firms Owning Own Cistern, by Region**

| Location | Number | Percent |
|---|---|---|
| Central | 21 | 72 |
| Maputo | 43 | 45 |
| Northern | 10 | 42 |
| Total | 76 | 50 |

Note: Central region includes Beira, Chimoio, and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island.
Source: World Bank, 1998.

151. ***Inadequate electricity and water delivery increase firms' overhead costs (Table 2.11).*** Firms in Nampula spend the highest fraction of their costs on electricity and water. Transportation costs are highest in the north. Total overhead costs are actually lower in Nampula than in the south.

**Table 2.11: Estimated Share of Overhead Costs to Total Costs**
**(percent, except where otherwise indicated)**

| *Region* | *Electricity and water* | *Transport costs* | *Total overhead costs (excluding rent)* |
|---|---|---|---|
| Central | 6.4 | 3.9 | 34.5 |
| Number of firms | 20 | 21 | 21 |
| Maputo | 4.0 | 0.8 | 3.6 |
| Number of firms | 71 | 69 | 67 |
| Northern | 4.4 | 1.3 | 25.7 |
| Number of firms | 23 | 23 | 22 |
| All firms | 4.5 | 1.5 | 33.8 |
| Number of firms | 114 | 113 | 110 |

Note: Central region includes Beira, Chimoio, and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island. Electricity and water are aggregated because the survey did not data on water and electricity costs separately.
Source: World Bank, 1998.

### *Roads and Transportation*

152. Survey results reveal that firms in the central region complain most about poor roads, followed by those in the northern region (World Bank 1998) (Table 2.12). This finding is somewhat surprising, as the roads around Nampula are acknowledged to be among the worst in the country. One explanation is that the central region is close enough to Maputo that firms there perceive it as a potential market but are inhibited by the lack of good roads. Firms in the northern region, in contrast, may be so cut off from such markets that they never even consider the possibility that they might be accessed.

**Table 2.12: Firms' Perception of Roads as a Problem**
**(percent of all firms)**

| Location | Not a problem | Somewhat of a problem | Serious problem |
|---|---|---|---|
| Central | 10 (3) | 14 (4) | 76 (22) |
| Maputo | 36 (33) | 20 (18) | 44 (40) |
| Northern | 22 (5) | 22 (5) | 57 (13) |
| Total | 29 (41) | 19 (27) | 52 (75) |

Note: Figures in parentheses show number of firms. Central region includes Beira, Chimoio and Quelimane. Northern region includes Nampula, Nacala, and Mozambique Island.
Source: World Bank, 1998.

### *Improving Telecommunications*

153. The high cost of telecommunications and the lack of service in much of the country exacerbate the inward-oriented character of Mozambique's economy and contribute to the isolation that characterizes the lives of many Mozambicans. Among SADC countries, Mozambique is still at the tail end of the group in terms of availability of phone lines (Table 2.13). Surprisingly, few firms in the manufacturing sector cited telecommunications as a major constraint to growth.

**Table 2.13: Phone Lines per 100 Persons, Southern Africa, latest year**

| Country | Phone lines per 100 persons |
|---|---|
| Mauritius | 19.52 |
| South Africa | 10.12 |
| Namibia | 6.25 |
| Botswana | 4.83 |
| Swaziland | 2.41 |
| Zimbabwe | 1.72 |
| Lesotho | 0.94 |
| Angola | 0.48 |
| **Mozambique** | **0.46** |
| Malawi | 0.35 |
| Tanzania | 0.30 |

Source: Ministry of Transport and Telecommunications.

154. ***Entry into the telecommunications sector remains restricted.*** Lack of competition contributes to the high cost of doing business in Mozambique, cuts the country off from foreign markets, and exacerbates the isolation of rural populations. Telecomunicações de Moçambique (TDM) has a monopoly over voice services, and there are restrictions on foreign ownership for providers of complementary and value-added services, such as cellular telephony. While entry into complementary and value-added services was recently opened to the private sector, restrictions on entry into the sector remain. Among other constraints, at least 50 percent of companies' capital in the sector needs to be owned by Mozambican nationals.

155. ***Liberalization of the sector and the creation of a regulatory authority, followed by privatization of at least the majority of TDM's shares, should be implemented as soon as possible.*** In addition, given the high cost of providing phone service through a fixed network in a country with a widely dispersed population, an aggressive pro-competition policy to facilitate the entry of additional cellular phone providers could offer a lower-cost alternative to fixed lines.

## D. Investing in Human Resources

156. ***Investing in human capital—by improving education and health services and curtailing the spread of HIV/AIDS— is more important than ever in Mozambique.*** It will help give the skills and empower Mozambicans to improve their lives and to participate and benefit more fully in their country's recovery. An illiterate work force, on the other hand, will find it difficult to learn about and adopt new technologies; a population in poor health will be unable to contribute much to growth. A cross-sectional study of 58 countries indicates that increasing average schooling by one year could lead to a 3 percent rise in GDP (World Bank 1990).[28] At least four years of schooling are needed to achieve levels of literacy that enable people to make significant productivity gains. Education is especially important in enabling farmers to understand and take advantage of extension services and technological innovations. Given the position from which Mozambique started to rebuild its human resource base, a continued focus on improving human capital, not only by expanding coverage but particularly by increasing the quality of education and health, will generate high economic and social returns.

[28] For a review of the literature, see Haddad, Carnoy, Rinaldi, and Regel (1990).

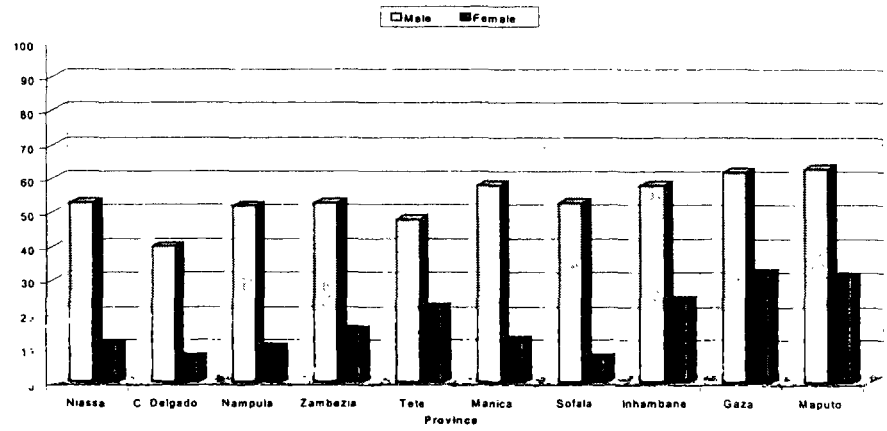
157. ***Both health and education outcomes appear to have improved since 1995, and the government has set new targets for 2001*** (Table 2.14). The government and the international community have rightly targeted the education and health sectors as priorities for expanded public expenditures and programs for improved service delivery.

**Table 2.14: Selected Health and Education Indicators and Targets, 1996–2001**

| *Indicator* | *1995 or 1996 actual* | *1997 or 1998 estimate* | *2001 target* |
|---|---|---|---|
| ***Health*** | | | |
| Personnel of health posts staffed with trained personnel | 70 | 86 | 90 |
| Proportion of first-level health facilities stocked with essential drugs, program kits | 40 | 88 | 90 |
| Vaccination coverage with DPT (diphtheria, pertussis, and tetanus) third dose | 58 | 77 | 80 |
| Service units per inhabitant[a] | 2.6 | 3.1 | 3.6 |
| Geographic inequity index[b] | 3.6 | 3.0 | 2.8 |
| ***Education*** | | | |
| Gross primary enrollment rate | 62 | 71 | 73-75 |
| Repetition rate | 33 | 25 | 21-23 |

a. Weighted sum of inpatient days, hospital deliveries, vaccination doses, outpatient consultations, and Maputo Central Hospital visits.
b. Number of health units serving the 25 percent most favored population divided by the number of units servicing the 25 percent least favored population.
c. Based on the new population census data, the gross primary enrollment rate was 92% in 1998. However, the repetition and drop out rate continue to remain one of the biggest obstacles to improving literacy levels.
Source: Ministry of Health and Ministry of Education.

**Figure 2.2: Rural Literacy for Adults 18-65, 1996-97 (percent)**




Source: Census data (1997) from INE (National Institute of Statistics).

158. Despite progress, however, much needs to be done in both sectors. Illiteracy rates in Mozambique are among the highest in the world, the HIV/AIDS epidemic threatens the lives of millions

of Mozambicans, and malaria—the country's leading cause of death—reduces life expectancy to just 46 years.

*Improving Education*

159. ***Educational attainment by people over 16 is a crucial factor in determining a nation's medium-term growth path.*** In East Asia and elsewhere studies have shown that universal primary education has been a significant factor contributing to high growth rates and substantial reductions in poverty. The ability to move into more remunerative off-farm employment, to adopt riskier and more complex agricultural technology, and to make a successful transition to an urban livelihood is closely linked to literacy and to levels of education. Efforts to improve education in Mozambique are thus critical.

160. ***Although Mozambique's education (literacy) indicators are improving, they remain extremely weak, even by Sub-Saharan Africa's standards.*** Table 2.15 shows the literacy level by gender and age group. Sixty percent of Mozambicans (and 85 percent of women) aged 15 and older cannot read and write. Seventy-eight percent of Mozambicans either never went to school or never completed primary education. Illiteracy is higher in rural areas than in cities and among the older population than among the young. Average rural literacy rates of females stand at only 16 percent, and in many of the northern provinces the figure drops below 10 percent (Figure 2.2 above). Given that much of the agricultural work in Mozambique is done by women, the low level of female literacy has important implications for adoption of technology and other interventions aimed at raising agricultural productivity, whose efficiency is enhanced by literacy and numeracy.

**Table 2.15: Literacy and Illiteracy Rates by Age, Gender Group, and Area, 1996-97 (percent)**

| *Age* | *Literate (Can read and write)* | *Illiterate (Cannot read and write)* |
|---|---|---|
| Total: Age 15 and older | 40 | 60 |
| Female | 26 | 74 |
| Male | 55 | 45 |
| Urban | 67 | 33 |
| Rural | 28 | 72 |

Source: Census data (1997) from INE (National Institute of Statistics).

161. ***Although literacy rates vary (inversely) with the level of poverty, region and gender have a greater effect than income*** (Ministry of Planning and Finance, Eduardo Mondlane University, and International Food Policy Research Institute 1998). Adult literacy rates are 46 percent for the non-poor and 37 percent for the poor, a difference of 9 percentage points. Literacy rates for males and females are 60 and 24 percent, a difference of 36 percentage points, and the difference in literacy rates between urban and rural regions is 39 percentage points. Focusing on increasing access to and quality of education for women and under-served regions may thus have a greater impact than attempting to target the poor throughout the country.

162. ***Considerable progress has been made in increasing access to—and to a lesser extent improving the quality of—basic education.*** The share of the government's own-financed current spending devoted to education has continued to increase, rising from 12.4 percent of total spending in 1993 to 18.0 percent in 1998. Progress in increasing access to primary education has generally met or exceeded the targets set out at the decision point. Between 1992 and 1998 the number of primary classrooms increased by more

than 60 percent, and the total number of primary schools in the country has now surpassed prewar levels. The primary gross admission rate reached 79 percent in 1998.[29]

163. ***An Education Sector Strategic Program (ESSP) was developed by the government and agreed on with donors in 1998.*** The strategy is based on the medium-term objective of achieving education coverage for all by the year 2010, ahead of the DAC/OECD target of 2015, with substantial quality improvements. Under the five-year integrated expenditure program, which brings donors together under a sector wide approach, real current expenditures in education are to continue to increase annually, both in real terms and as a share of total current expenditures. The ESSP targets improvements of 1–2 percentage points a year in the gross enrollment rate and in the proportion of students passing key examinations, as well as a 1–2 percentage point annual reduction in the average repetition rate in primary and lower-secondary schools. The program will also support expansion of the school network and emphasize the promotion of higher enrollment rates for girls and those living in under-served regions.

164. ***To achieve the dual objectives of greater access and higher quality, the government will have to increase the number of qualified teachers, through enhanced pre-service and in-service training.*** The increase in the number of qualified teachers has not kept pace with the expansion of enrollment. The scarcity of teachers and the poor quality of their training has been limiting the government's ability to increase the quality of schooling and literacy levels. In the short run, recruiting teachers from other Portuguese-speaking countries could help overcome the teacher shortage, however, in the longer term it is neither a social nor a sustainable solution.

165. To make better use of teaching staff, lower and upper-primary education will be merged in 1999. The curriculum and evaluation processes for grades 1–7 are being revised to better reflect local needs and will be completed by 2001. By improving quality and efficiency, these measures are expected to reduce repetition rates and increase completion rates. Implementation of the ESSP will be supported by strengthening the institutional capacity of the Ministry of Education, especially its capacity to manage resources at the provincial, district, and school levels.

166. ***Increasing basic education opportunities for children and adults, combined with a renewed emphasis on girls' education-especially in the north of Mozambique, should continue to be the priority in the near future.*** However, the government recognizes the critical importance of balanced development of the education system for supporting the longer-term effort to sustain social and economic development. Specific programs to support higher education, vocational education and technical training, and adults education are expected to be developed in 2000-2001. To give further emphasis to tertiary education, the Government has established a new Ministry for Higher Education, Science and Technology.

### *Improving Health*

167. ***Despite improvement, aggregate health indicators in Mozambique remain among the worst in the world.*** In 1997/98 the under-5 mortality rate was 200 per thousand live births, the infant mortality rate was 134 per thousand live births, and life expectancy at birth was just 46 (Table 2.16). Maternal mortality rates are also high, at 1,100 per hundred thousand live births in 1995. As chilling as these figures are, they probably understate the problem in rural areas, because urban populations generally fare better than rural ones. Malnutrition is widespread, with the average rural household suffering from food insecurity for about 3.7 months a year. Poor health is caused by a variety of factors, including poverty; the poor state of infrastructure, which isolates rural households; lack of extension or basic medical

[29] As mentioned earlier based on the new population census data the gross primary enrollment rate was 92% in 1998 and the gross admission rate 94%; in some provinces the gross admission rate was 131%.

services, which could help communicate basic health and sanitation information; and the lack of market integration.

**Table 2.16: Selected Health Indicators for Mozambique, 1995, 1997/98**

| *Indicator* | *1995* | *1997/98* |
|---|---|---|
| Infant mortality rate (deaths per 1,000 live births) | 162 | 134 |
| Child mortality rate (deaths per 1,000 live births) | 282 | 200 |
| Maternal mortality rate (deaths per 100,000 pregnancies) | 1,100 | – |
| Institutional maternal mortality rate (death per 100,000 deliveries) | 234 | 160 |
| Prevalence of HIV/AIDS (percent of population) | – | 14.5 |
| Life expectancy | – | 47 |

–Not available.
Source: Ministry of Health and UNAIDS.

168. ***The government's Health Sector Recovery Program (HSRP), adopted in 1995, is based on a strategy of increasing access to health care and improving the quality of services by rehabilitating and constructing first-level care facilities and rural hospitals and providing adequate medical supplies.*** The strategy also emphasizes improving institutional and management capacity at the Ministry of Health (at both the central and provincial levels) and developing human resources in the health sector by training health workers and enhancing university medical training.

169. ***Access, delivery, and quality of health services have all improved since 1995.*** The share of the government's current expenditures devoted to health reached 9 percent in 1998, exceeding the target of 8 percent. Vaccinations continued to increase, reaching a coverage rate of 77 percent in 1998 (exceeding the target of 60–65 percent), and progress continued to be made in reducing geographical inequities and expanding the overall delivery of health services (albeit at a somewhat slower pace than planned). Indicators of health service quality, such as the proportion of health centers stocked with basic drug kits and trained personnel, have improved at the planned rates.

170. ***The government plans to continue to strengthen its health sector programs.*** The share of current health expenditures in total current expenditures is budgeted to rise in 2000, and the government will be using key outcome indicators to monitor progress on access and quality. By 2001 DPT (diphtheria, pertussis, and tetanus) coverage is targeted to increase to 80 percent (from 77 percent in 1998), the index of geographical inequality in the provision of health services will be reduced to below 2.8 (from 3.0 in 1998), the proportion of health posts and centers stocked with drug kits will be increased to 90 percent (from 88 percent in 1997), and the proportion of health posts and centers staffed with trained personnel will be increased to 90 percent (from 86 percent in 1998). The government is also planning to intensify its strategy against HIV/AIDS. Toward that end, in 2000 it intends to implement a National Multisectoral Strategic Plan.

171. ***Donor support has been key to the government's ability to extend the health care system.*** The government has thus prepared a draft financing strategy aimed at establishing longer-term sustainability of the system. Cost-sharing is viewed primarily as a means of engaging community support and expanding local services rather than ensuring financial sustainability per se.

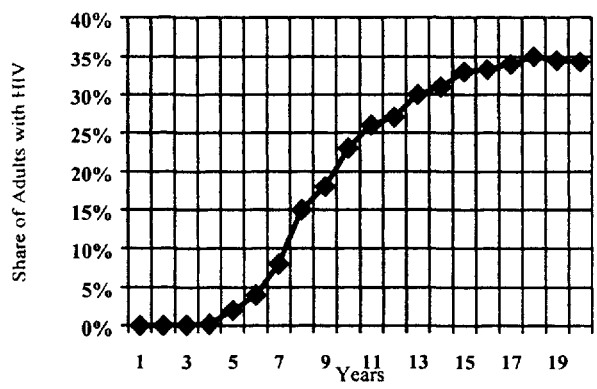
172. ***The government and donors recognize that the health sector is moving from a phase of recovery after the devastation caused by the civil war to a longer-term focus on improving basic health services.*** Consequently, at a joint review of the Health Sector Recovery Program 1998, it was agreed to move toward a sector-wide approach for health development. The new approach includes the formulation

of a new health policy and establishment of common donor procedures for financial and administrative systems. The government's own program of financial management reform is continuing to be implemented and will benefit from the completion of a joint government-World Health Organization (WHO) evaluation of the health information system put in place in March 1999. As a follow-up to the annual review, the Ministry of Health has taken the initiative of preparing a longer-term strategy and policy for the sector that will outline the specific program for the period 2000–04. By December 2000 the government is expected to complete and begin implementing a new Health Sector Strategic Plan that will establish sectoral policies, programs, and targets for the new decade. The plan will provide the policy framework for the development of a sectorwide approach in which the government will work with donors to develop joint procedures for budgetary support in the health sector.

173. ***Two serious health problems, HIV/AIDS and malaria, affect the lives of millions of Mozambicans and threaten the growth prospects of the economy.*** UNAIDS estimates that 14.5 percent of Mozambique's population—some 1.2 million people, of which about 10 percent are children— are HIV positive. The highest rates are found in Tete and the central provinces of Manica, Sofala, and Zambezia. In Tete and the Beira corridor, HIV prevalence rates may be as high as in Zimbabwe and Zambia, where more than 20 percent of the adult population is infected. Infection rates are lowest in the south, where 5–10 percent of the population is believed to have HIV. The orphan population, already large because of high maternal mortality and the civil war, is now rapidly growing because of HIV and is expected to reach 800,000 by 2002, according to UNAIDS.

174. ***The full consequences of the epidemic have not yet been seen,*** as many people infected with HIV have yet to develop AIDS. In the next 10 years, more and more people will become ill, and prevalence rates could reach 35 percent (Figure 2.3).

**Figure 2.3:**
**Typical Pattern of the Spread of HIV**




36. ***Two-thirds of the world's AIDS cases are in Africa,*** where more than 11 million people have already died of the disease and another 22 million are now living with HIV/AIDS. As a result, life expectancy—the best overall measure of development—is now declining in a host of African countries, a reversal of the rapid progress in the years following independence. In the worst-hit nations, such as Zimbabwe, life expectancy a decade from now will be 30–35 instead of about 70 years had AIDS not developed.

175. The 21 countries with the highest HIV prevalence are all in Africa, and several of these countries are neighbors of Mozambique. In Zimbabwe one in four adults is infected, and a child born in Zimbabwe today is more likely than not to die of AIDS. In South Africa the prevalence rate grew tenfold in five years. In many other African countries the lifetime risk of dying of AIDS is greater than one in three. AIDS already accounts for 9 percent of adult deaths from infectious disease in the developing world. By 2020 that share will quadruple to more than 37 percent.

176. ***Factors associated with increased economic activity can also be associated with the spread of HIV/AIDS.*** Labor migration and urbanization all spread the disease. As a result, HIV/AIDS is swiftly undoing the achievements of the past 30 years. Research in selected Sub-Saharan African countries reveals that:

- HIV prevalence rates are rising in rural areas, which are disproportionately bearing the costs of HIV/AIDS.
- Economic development is contributing to the spread of HIV/AIDS in rural areas, by strengthening urban-rural linkages and improving population mobility.
- The pattern of child and adult mortality is changing dramatically in countries with mature HIV/AIDS epidemics. Life expectancy is declining dramatically, due largely to deaths among young adults.
- HIV/AIDS reduces crop production, area cultivated, yields, and the range of crops grown.

177. ***There is growing concern that the epidemic will have a devastating impact on the Mozambican economy.*** HIV/AIDS may exacerbate the process of impoverishment by eroding rural formal and informal institutions, reducing the supply and quality of labor availability, increasing demands on the already weak health system, and reducing the ability of households to accumulate savings.

178. ***Ignorance and inaction have helped feed the flames of the disease.*** Ignorance is rapidly vanishing, largely extinguished by the pandemic itself. Inaction remains common, however. In too many countries the official response to AIDS has been late, timid, and limited to the health sector.

179. ***Effective AIDS prevention includes sectors other than the health sector.*** As experience has shown, the health sector alone cannot reduce the spread of infection, because young healthy adults who get infected do not get in touch with the health system until it is too late. Migrant workers, for instance, who work on road construction projects need to be educated about the risks of HIV transmission during the project. HIV/AIDS education messages should be widely disseminated in rural and urban communities.

180. ***Malaria is the leading cause of sickness and death in Mozambique. However, the true burden of malaria is unknown,*** because information systems are weak. Between January and October 1998, malaria was responsible for about 44 percent of outpatients visits at rural and general hospitals, nearly 60 percent of admissions in pediatric wards, and about 29 percent of hospital deaths. Transmission seems to be high and constant in the north, moderate and cyclical in the south.

181. ***Controlling malaria is difficult in Mozambique because of the limited access of much of the population to adequate preventive interventions, diagnosis, and treatment.*** The network of health facilities reaches only 40 percent of the population, and levels of chloroquine resistance are high in urban and peri-urban areas (information on resistance levels in rural areas is not available). Little has been done in terms of community-based malaria control.

182. Traditionally, malaria control has relied on indoor residual spraying as one of its principal interventions. In the past two years, the government has begun to develop a broader approach by trying to improve the quality of diagnosis and treatment. It has also initiated information, education, and communication (IEC) activities and begun to monitor drug efficacy.

183. ***An advisory group has been formed under the leadership of the National Directorate of Health to revise the current malaria control plan.*** The group is paying particular attention to the scaling up of effective malaria prevention and control strategies. The critical issues to be addressed—and which require policy decisions by the government—include the following:

- The limited absorptive capacity and human resource constraints of the Ministry of Health, which hinder planning, implementation, and monitoring of malaria control program activities. The government may wish to consider alternative ways of addressing this issue, such as redeploying and rapidly retraining Ministry of Health staff, contracting out to consulting firms and research institutions, and collaborating more closely with Brazilian or other Sub-Saharan African institutions.

- The need to expand health coverage to the 50 percent of the population that currently lack access to health services. Possible options to consider include training traditional healers, empowering communities to deliver community-based services, and creating competitive contracting arrangements for service provision by NGOs and the private sector. Provision of antimalarial drugs by school teachers, agricultural extension workers, and others could also be explored.

- The need to create awareness, in a largely illiterate population, of the seriousness of malaria as a health problem. Strengthening household and community capacities to prevent, treat, and refer malaria cases should be considered as one of the priority objectives. Doing so requires developing social mobilization and a multimedia IEC strategy. Such a strategy should bring about a change in treatment-seeking behavior, increasing use of vector-control measures.

## E. MAKING THE MOST OF MOZAMBIQUE'S NATURAL RESOURCES

184. ***Prospects for economic growth in Mozambique's natural resource sector are good.*** Natural resource–based economic activities (agriculture, fisheries, mining, and tourism) already contribute about 45 percent of GDP and 70 percent of merchandise exports (and anecdotal evidence about smuggling of timber, gold, and gemstones suggests that the contributions of forestry and mining may well be understated). In addition, energy, already a major source of foreign exchange earnings through electricity exports from the Cahora Bassa dam, has the potential for making increasing contributions to growth in the future.

185. ***To reap the full benefits of its natural resources, Mozambique will have to develop environmentally and socially sustainable policies.*** Whether policies are sustainable—that is, whether current actions limit or augment the opportunities future generations face—is determined by the institutions that govern access to and use of the natural resource base. This is especially true in a resource-dependent economy like Mozambique's. Mozambique has new and largely untested policy frameworks for the management of the environment and natural resources. Environmental institutions in Mozambique are young and undeveloped, and the principal environment ministry, the Ministry of Environmental Coordination (MICOA), is a coordinating ministry with few legislative tools to enforce behavior. As growth and pressures on natural resources increase, turning these broad frameworks into effective policies for sustainability should become a priority.

186. Four resource management issues should be addressed: transparency and resource usage rights, forest management, artisanal mining, and water supply. Each of these areas is examined below.

### *Increasing Transparency and Strengthening Resource Usage Rights*

187. Decisions about the allocation of natural resource wealth have important implications for both the quantity and quality of growth in Mozambique. These decisions will be important to development and will affect the economy as a whole, not just the environment and natural resource sectors. Because all land in Mozambique is owned by the state, the government determines who has access to environmental resources and under what terms. Concessions, including wildlife concessions, are needed to develop

tourism. Forest concessions need to be demarcated and allocated. And the regime for the mining and energy sector needs to be solidified (Box 2.4). The willingness of entrepreneurs, both foreign and national, to risk capital to develop the resource sector will be profoundly affected by their perception of how fair and open the mechanism for allocating land is.

**Box 2.4: Strengthening the Mining Code**

While Mozambique has abundant mineral potential, the ability of this sector to contribute to growth is limited by several aspects of the legal framework for mining:

- Terms and conditions for exploration are overly stringent.
- Surface rental fees for exploration are high, and the validity periods for exploration licenses are short. In addition, 50 percent of the areas must be relinquished when the lease is renewed.
- The potential for government intervention remains, particularly with regard to the provisions for government participation in mineral ventures and the reservation of special areas exclusively for government entities.
- The mining code provides too little detail concerning licensing procedures and the terms and conditions of mining titles.
- Regulations for environmental protection and the management of the small-scale mining sector are lacking.
- The fiscal regime requires reform. The current system is weighted toward specific royalties and does not place enough emphasis on taxes on profits. Exemptions on import duties and tax holidays appear to be unnecessary, and surface rental fees are high in the first years of exploration.
- No standard mining agreement for prospective mine operators exists. Preparation of such an agreement would reduce delays due to red tape and diminish the scope for discretionary actions by the government.
- The rights of local communities with regard to the use and occupation of land for mining are unclear, leading to potential conflict.

188. ***The land law promulgated in July 1998 and its regulations lack precision and specificity on key points, inviting conflict over resource allocations.*** Box 2.5 highlights some of the key concerns.

189. ***Concrete steps can be taken to improve resource allocation in Mozambique.*** The first step is to classify and zone land. The next step is to design transparent allocation processes, such as a system of bidding for resource rights. Creating a legal process for challenging allocation decisions is also necessary to ensure transparency.

*Improving Forest Management*

190. ***The forestry sector has considerable potential that could benefit the private sector, local communities, and the government.*** Realizing this potential will require dealing with several emerging problems:

- High dependence on traditional fuels and illegal logging in several areas of the country, particularly Zambezia, are causing deforestation.

- The government is currently forgoing significant revenue as a result of low stumpage fees and institutional weaknesses within the forestry and wildlife departments (including low salaries, understaffing, and the absence of the political will to enforce logging rules and regulations).

**Box 2.5: Imprecision and Lack of Specificity in the Land Law**

While the new land law embodies many positive principles, its lack of specificity on many key points threatens to reduce its effectiveness substantially. Without greater specificity, application of the law will be subject to nonuniform interpretations across state jurisdictions and possible abuse of discretionary powers by state authorities. A number of specific concerns bear highlighting:

- The land law grants significant authority to the state with regard to areas deemed to be "total" or "partial" protection zones. This raises a range of issues concerning the definition of the public domain, based on specific criteria; community inputs and rights in determining areas of public domain; and the right to compensation when the state declares certain areas to lie within the public domain.
- No right of appeal of government decisions exists in the law or regulations. This could lead to arbitrary government decisions concerning such issues as the extent of progress an entity is making in complying with exploitation plans, declarations by the government that a certain area is in the public domain, amounts of compensation for terminating land use rights, land taxes, and the determination that certain customary norms and practices that communities and individuals have relied on to occupy land are deemed "contrary to the Constitution."
- The framework law and draft regulations do nothing to clarify the status of "concessions in the pipeline"—requests for land concessions made in the past that have not been resolved definitively. The number of requests in the pipeline for agricultural concessions is huge: 1,800 requests totaling 500 thousand hectares in Maputo province, 1,350 requests in Nampula province totaling 400 thousand hectares, and 1,000 requests in Zambezia province totaling more than 1.5 million hectares. Unless these requests are made subject to the provisions of the new land law, including the right to public consultation, local communities and thousands of smallholders could be dispossessed.
- Classification of land uses is chaotic, and the draft regulations do little to remedy the situation. This lack of clarity has led to conflict in the past. The implementing regulations for the land law must define usage rights, their degree of exclusivity, and the order of precedence with precision.
- Clarification of the rights of local communities and smallholders is required. Consultation of local communities should be extended to include decisions by the government over the extent of the public domain. More formal definition of community representation in the consultative process is needed. There is also ambiguity concerning the distinction between "delimitation" and "demarcation" of community lands. Currently, only demarcated lands lead to full legal title.
- While the law and draft regulations grant significant rights to women, they should be expanded to include marriages according to local customs and norms that may not be legally registered with state institutions.
- The law grants smallholders land use rights if they occupy land on the basis of customary norms and practices that do not contravene the Constitution. This raises questions about the definition of customary practices.
- Ambiguities exist in the regulations concerning how competing claims for land use should be resolved. The main issues concern standards for "occupation" of a parcel of land and the principle of temporal precedence of acquired rights. Only sufficient clarity and precision in the drafting of the regulations will permit security of tenure.

Source: Kloeck-Jenson (1997).

- Short-term forest extraction licenses, on which the government currently relies, are difficult to monitor. Moreover, usage rights are uncertain under this scheme, and forest companies have few incentives to consider sustainability.

- The government's new emphasis on long-term forest concessions could alter the incentives for sustainable management. To do so, however, there must be increased willingness and capacity to enforce usage rights. Local communities are generally not involved in the concession-granting process, which could lead to conflicts.

191. Since forestry concessions do not grant exclusive land use rights, they are likely not to be subject to the measures in the new land law that require local communities to be consulted in the land titling process. These measures allow local communities to negotiate use rights.

*Reducing the Environmental Impact of and Increasing Yields from Artisanal Mining*

192. ***Artisanal mining activities are beginning to have a serious effect on Mozambique's environment.*** Uncontrolled emissions of mercury and other reagents used to recover gold and large quantities of silt and toxic materials from crude extraction methods are contaminating waterways, and toxins are leaching into the water table. Even if the deposits worked by artisanal miners could be commercially exploited, the inefficiency of the production methods used would in effect dissipate resource rents. Doubts about commercial viability and reluctance to shut down the livelihood of the 50,000 poor people who mine gold and gemstones on a seasonal basis have lead the government to suggest a variety of means to upgrade these mining activities. One proposal is to create a Department of Small-Scale Mining within the National Directorate of Mines to deal with the problems resulting from mining activities, particularly from small-scale and artisanal mining activity.

193. ***To guide government action, a baseline survey of the sector could be carried out.*** The aim of the survey would be to obtain quantitative information on production and productivity of artisanal and small-scale mining, so that proper policies could be designed. The survey would cover economic, social, organizational, technical, marketing, environmental, health and safety, and institutional issues affecting the sector. Pilot programs could then be prepared to improve knowledge of mining techniques and simple processing of minerals, improve environmental behavior, disseminate information about equipment, and demonstrate alternative technologies.

194. ***The major objective of policy in the sector should be to increase recoveries and reduce environmental impact.*** Meeting this objective would require the strengthening of small miners associations and the mobilization of NGOs and communities affected by mining operations.

*Reducing the Vulnerability of Water Resources*

195. ***It is widely believed in government circles that unless satisfactory arrangements can be made for more equitable sharing of water among the riparian countries, Mozambique will face increasing economic constraints on development and recurring crises due to lack of water.*** Mozambique depends on its major rivers, almost all of which have their sources in other countries, for most of its water. The government is rightly concerned about upstream riparian extraction from the eight transboundary rivers that flow into Mozambique and drain into the Indian Ocean. The concerns are about both the quantity and the quality of incoming water resources. Over the past three decades, people living upstream have diverted much of the yield of several of these rivers for irrigation and other uses. From 1991 to 1996 Mozambique faced severe water shortages, which caused shortages of water for irrigation, saline water intrusion into estuaries, and interruptions of water supply in various parts of the country.

196. ***Water resource management capacity is rudimentary in much of Mozambique.*** The lack of capacity impairs the management of domestic water resources and limits Mozambique's ability to support the technically challenging negotiations that will be required to reach agreements with other countries. While there is adequate primary legislation to support this, subordinate legislation will need to be developed to help the water resources management organizations develop the necessary systems and capacities.

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## SOCIAL AND ECONOMIC DEVELOPMENT DATA

GNP per capita (1999): US$230 [1/]

**Gross Domestic Product**

| | US$million | Shares of GDP | Real annual growth rate | | |
|---|---|---|---|---|---|
| | 1999 | | 1987-99 | 1987-95 | 1996-99 |
| GDP at market prices | 4,005 | 100.0% | 6.5% | 5.3% | 9.3% |
| Gross domestic investment | 1,305 | 32.6% | 12.2% | 8.5% | 20.4% |
| Gross domestic savings | 268 | 6.7% | .. | 32.0% | .. |
| Current account balance before grants | -1204 | -30.1% | .. | .. | .. |

**Output and Employment (1999)**

| | Value added | | Labor force |
|---|---|---|---|
| | US$million | Shares of total | Shares of total |
| Agriculture, livestock and fishing | 1,208 | 33.3% | 80% |
| Industry | 847 | 23.4% | 5% |
| Services | 1,572 | 43.3% | 15% |
| Total [2/] | 3,627 | 100.0% | 100% |

**Government Finance**

| | Millions of US$ | | | Shares of GDP | | |
|---|---|---|---|---|---|---|
| | 1987-99 | 1987-95 | 1996-99 | 1987-99 | 1987-95 | 1996-99 |
| Total Revenues | 320 | 279 | 411 | 12.0% | 12.4% | 11.5% |
| Total Expenditures | 689 | 629 | 824 | 25.9% | 27.9% | 23.0% |
| *of which:capital expenditures* | 332 | 302 | 400 | 12.5% | 13.4% | 11.2% |
| Surplus/Deficit(-) before grants | -369 | -350 | -412 | -13.8% | -15.5% | -11.5% |
| Net external assistance | 378 | 335 | 475 | 14.2% | 14.9% | 13.3% |

**Money, Credit and Prices**

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|
| | (Billions of Mt., end of period) | | | | | |
| Money and Quasi Money | 3,181 | 4,920 | 5,958 | 7,413 | 8,720 | 11,785 |
| Bank credit to Government (net) | -1,141 | -1,636 | -3,087 | -4,429 | -5,612 | -5,616 |
| Bank credit to the economy | 1,711 | 2,536 | 3,565 | 5,406 | 6,725 | 8,720 |
| | (Percentage or index number) | | | | | |
| Money and Quasi Money as % of GDP | 23.7% | 23.1% | 18.2% | 18.3% | 18.8% | 23.2% |
| Consumer Price Index (1990=100) | 449 | 693 | 1,002 | 1,066 | 1,072 | 1,105 |
| Annual percentage change in: | | | | | | |
| Consumer Price Index | 63.1% | 54.4% | 44.6% | 6.4% | 0.6% | 3.1% |
| Bank credit to Government (net) | .. | .. | -89% | -43% | -27% | 0% |
| Bank credit to the economy | | | -41% | 52% | 24% | 30% |

**Social Indicators**

| | 1995-96 | 1997-99 | | 1995-96 | 1997-99 |
|---|---|---|---|---|---|
| Infant mortality rate (per 1,000 live births) | 162 | 134 | Illiteracy rate | .. | 60 |
| Child mortality rate (per 1,000 live births) | 282 | 200 | Gross primary enrollment rate | 62 | 71 |
| Prevalence of HIV/AIDS (percent of pop.) | .. | 14.5 | Repetition rate | 33 | 25 |
| Life expectancy at birth | .. | 47 | | | |

1/ Atlas method; direct calculation yields US$217.

2/ GDP at factor cost.

## SOCIAL AND ECONOMIC DEVELOPMENT DATA

**Balance of Payments (US$ millions)**

| | 1987-99 | 1987-95 | 1996-99 |
|---|---|---|---|
| Total exports of GNFS | 352.8 | 275.7 | 526.2 |
| Merchandise (fob) | 167.2 | 133.7 | 242.8 |
| Non-factor services | 185.5 | 142.0 | 283.4 |
| Total imports of GNFS | 937.9 | 855.2 | 1124.0 |
| Merchandise (cif) | 795.1 | 752.9 | 889.9 |
| Non-factor services | 142.9 | 102.3 | 234.1 |
| Resource balance | -585.2 | -579.6 | -597.9 |
| Net income receipts | -178.9 | -167.3 | -205.1 |
| Balance on current account | -764.1 | -746.8 | -803.0 |
| Direct foreign investment | 70.3 | 20.3 | 182.8 |
| Official grants | 400.8 | 436.1 | 321.2 |
| Net long term borrowing | -26.7 | -102.2 | 143.4 |
| Other capital flows | 366.7 | 415.4 | 257.1 |
| Overall balance | 47.0 | 22.8 | 101.5 |
| Changes in net reserves | -47.0 | -22.8 | -101.5 |
| Gross Foreign Reserves | 319.4 | 215.9 | 552.3 |

**Exchange rate (Mt/US$)**

November 20, 2000 16,408

**Merchandise Exports (average 1996-99)**

| | US$million | Shares of total |
|---|---|---|
| Prawns | 73.4 | 30.2% |
| Electricity | 24.8 | 10.2% |
| Cotton | 23.6 | 9.7% |
| Raw cashew | 22.8 | 9.4% |
| Cashew nuts | 14.6 | 6.0% |
| Manufacturing products | 14.1 | 5.8% |
| Timber | 10.8 | 4.5% |
| Sugar | 9.9 | 4.1% |
| Fisheries products | 7.7 | 3.2% |
| Copra | 4.2 | 1.7% |
| Copra oil | 3.6 | 1.5% |
| Other minerals (excl. petroleum) | 4.1 | |
| Petroleum | 2.7 | 1.1% |
| Tires and tubes | 2.5 | 1.0% |
| Other | 24.1 | 9.9% |
| Total exports | 242.8 | 100.0% |

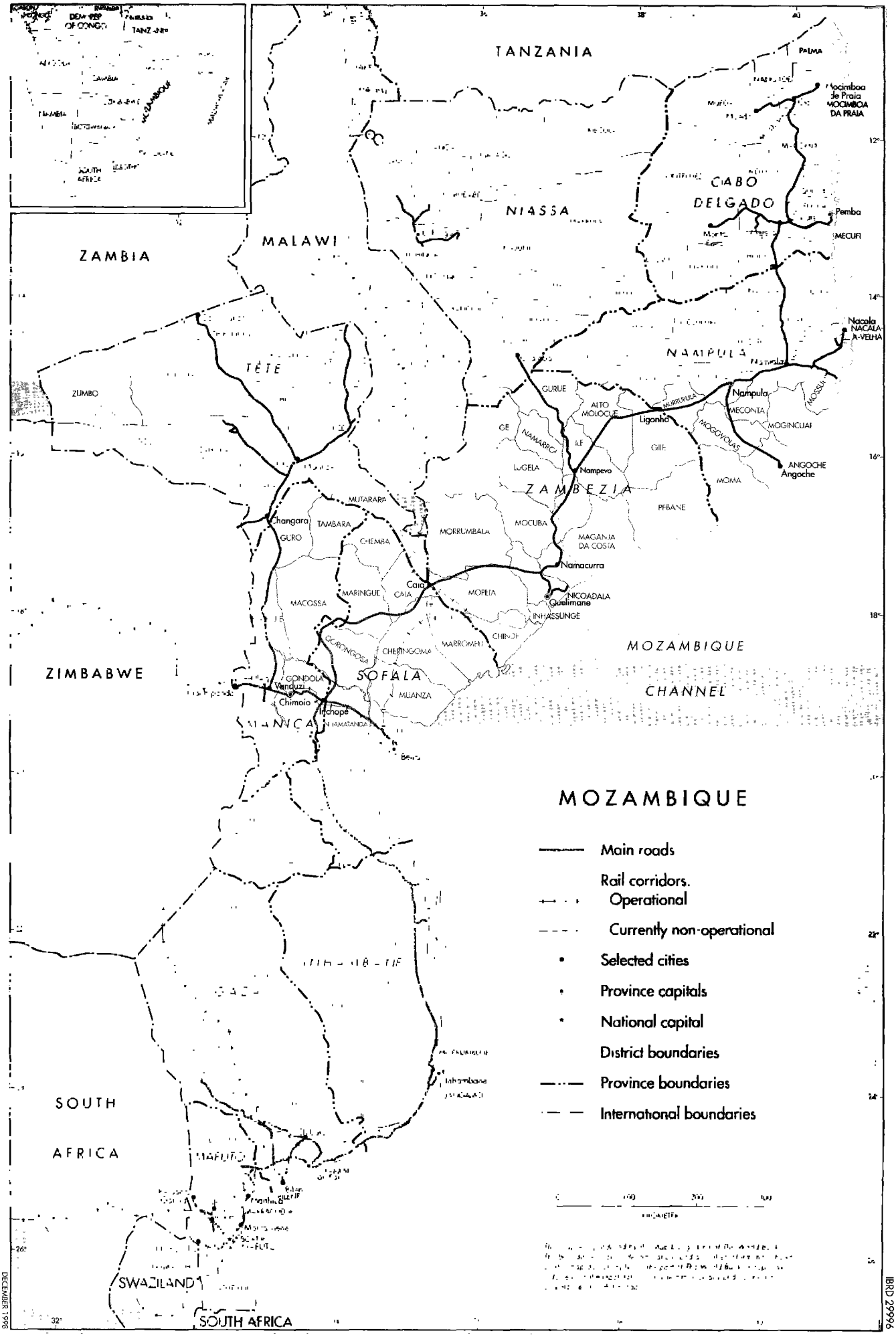
**External Debt, Dec.1999 1/**

| | US$million |
|---|---|
| Public and publicly guaranteed | 4,825 |
| Private non-guaranteed | 1,747 |
| Short term | 387 |
| Total incl. IMF | 6,959 |

**IDA Operations as of October 31, 2000 (US$m)**

| | Disbursed | Undisbursed 2/ |
|---|---|---|
| Credits | 1,492.0 | 450.1 |
| Grants | 150.0 | 0.0 |
| Total | 1,642.0 | 450.1 |

1/ Estimate.
2/ Excluding cancellations.
.. Not available.


MOZAMBIQUE
Main roads
Rail corridors.
Operational
Currently non-operational
Selected cities
Province capitals
National capital
District boundaries
Province boundaries
International boundaries
TANZANIA
ZAMBIA
MALAWI
ZIMBABWE
SOUTH AFRICA
SWAZILAND
MOZAMBIQUE CHANNEL
NIASSA
CABO DELGADO
NAMPULA
TETE
ZAMBEZIA
SOFALA
MANICA
MAPUTO
GAZA
INHAMBANE
Palma
Mocimboa de Praia
MOCIMBOA DA PRAIA
Pemba
MECUFI
Nacala
NACALA-A-VELHA
Nampula
Ligonha
Nampevo
Namacurra
Quelimane
NICOADALA
Angoche
ANGOCHE
Caia
Changara
Vanduzi
Chimoio
Inchope
Beira
Inhambane
ZUMBO
GURUE
ALTO MOLOCUE
MECONTA
MOGINCUAI
MOGOVOLAS
MOMA
PEBANE
GILE
LUGELA
MOCUBA
MAGANJA DA COSTA
MORRUMBALA
MUTARARA
TAMBARA
CHEMBA
GURO
MACOSSA
MARINGUE
MOPEIA
INHASSUNGE
CHINDE
MARRONEI
CHERINGOMA
GORONGOSA
GONDOLA
MUANZA
NHAMATANDA
DECEMBER 1996
IBRD 29996