Mozambique

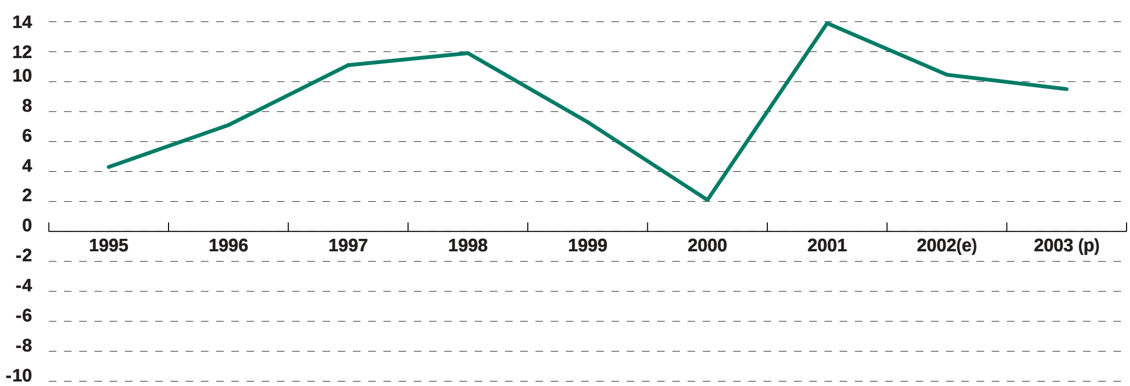
key figures

• Land area, thousands of km²	802
• Population, thousands (2001)	18 644
• GDP per capita, $ (2001)	193
• Life expectancy (2000-2005)	38.0
• Illiteracy rate (2001)	54.7

MOZAMBIQUE HAS BEEN REPORTED as a post-war rehabilitation success. Since the end of the civil war in 1992, the country has embarked upon a series of impressive macroeconomic and structural reforms that have resulted in a remarkable rate of economic growth over the last five years. Mozambique's economic growth is however very volatile. This volatility reflects the structural fragilities of its productive basis, the concentration on farming or agriculture-based industries, and a geographical location that makes the country vulnerable to natural disasters, as patently demonstrated by the 2000 and 2001 floods and the 2002 drought. Economic activity which was down to about 2 per cent in 2000, recovered in 2001 – reaching 13.9 per cent – underpinned by the post-flood reconstruction activities and the first full year of output from the Mozal aluminium smelter. Growth is expected to continue at 10.5 per cent in 2002 and 9.5 per cent in 2003. Moreover, new large foreign investments are planned and are expected to have a strong impact on growth in the years to come. Against these prospects lies the shadow of the HIV/AIDS epidemic. With a prevalence rate of 13.2 per cent, it is estimated that HIV/AIDS may result in the reduction of growth by up to 2 per cent per annum. Another major challenge to Mozambique's prospects is the absolute poverty of the vast majority of the population, usually without any links to markets and dependent on subsistence

"Mega projects" will continue to fuel economic growth in Mozambique

Figure 1 - Real GDP Growth[a]

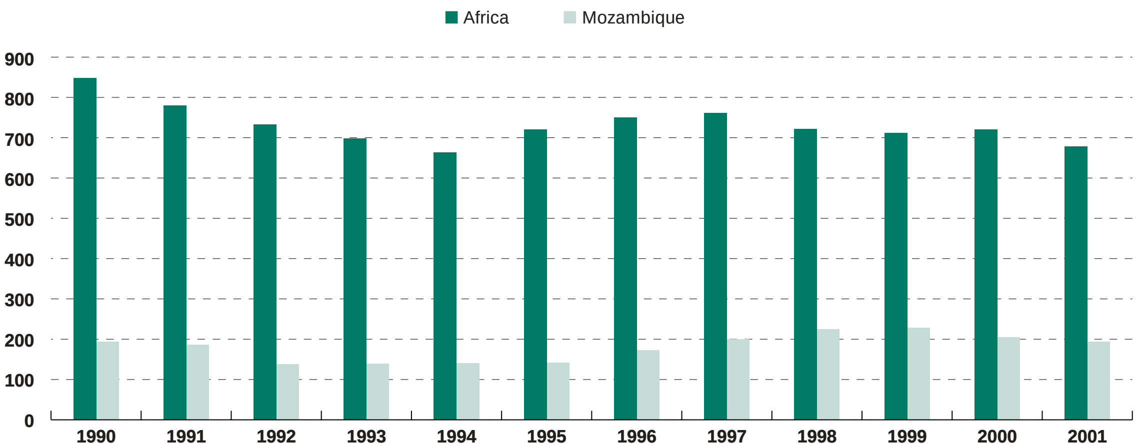


a. The percentage scale is different from the other countries since GDP growth exceeded the level of 10 per cent.
Source: Authors' estimates and predictions based on IMF and domestic authorities data.

agriculture. Sustainable development of the country also has to contend with the prevailing large inequalities between the southern and northern regions.

As part of the effort to reduce the incidence of poverty and fight the spread of HIV/AIDS, in April 2001 the government launched an Action Plan for the Reduction of Absolute Poverty, which contemplates increased spending on education and health and focuses on the development of agriculture, transportation and commerce. The authorities are also committed to continuing efforts to stabilise the economy and improve the government's financial management.

Figure 2 - GDP Per Capita in Mozambique and in Africa ($ current)



Source: Authors' estimates based on IMF.

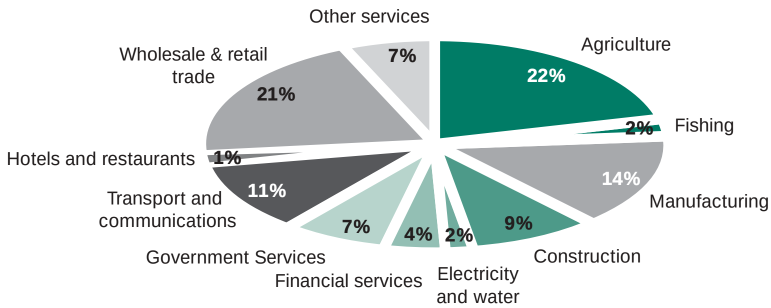
Recent Economic Developments

After almost a decade of persistent efforts, and taking advantage of the newly-achieved peace, enthusiastic international support for post-war reconstruction and good weather, in 1996 the authorities succeeded in bringing macroeconomic stability to Mozambique's economy. As a result of the combination of these factors, over the past five years, the country has registered a remarkable growth rate in a non-inflationary environment, with average real GDP estimated to be around 8 per cent, or about 5.5 per cent in real per capita terms. The decline experienced in 2000, owing to the devastating floods that hit the country, was reversed in 2001, thanks to the first full year of production from the Mozal smelter, as well as a recovery in the agricultural, construction and transport sectors. The substantial growth in the construction sector results partly from work on the second phase of Mozal – Mozal II - (which will double the smelter's capacity), and partly from post-flood reconstruction. The latest government estimates for 2001, suggest that Mozambique's GDP growth rate was close to 14 per cent. The strong recovery of transport and construction, as well as investment in new large-scale projects continued to be the main determinant of growth performance in 2002 (estimated at 10.5 per cent). The start of production of Mozal II and the construction of a gas export pipeline to South Africa are expected to underpin growth in 2003, which is projected at 9.5 per cent.

In spite of these gains, Mozambique's development process remains vulnerable to internal and external shocks, such as political instability, which followed the political election of 1999 and natural disasters that hit the countries in 2000 and 2001. These shocks affected the economy in a way that required complex policy responses which neither the domestic authorities nor the international partners were always able to deliver. As a result, macroeconomic tensions built up that found their way into a currency crisis during the first half of 2001. The strong monetary measures taken to tighten liquidity and stabilise the currency resulted in a sharp increase of interest rates and tighter commercial bank lending, with consequences on economic activity of an economy that was still recovering from a major negative supply shock.

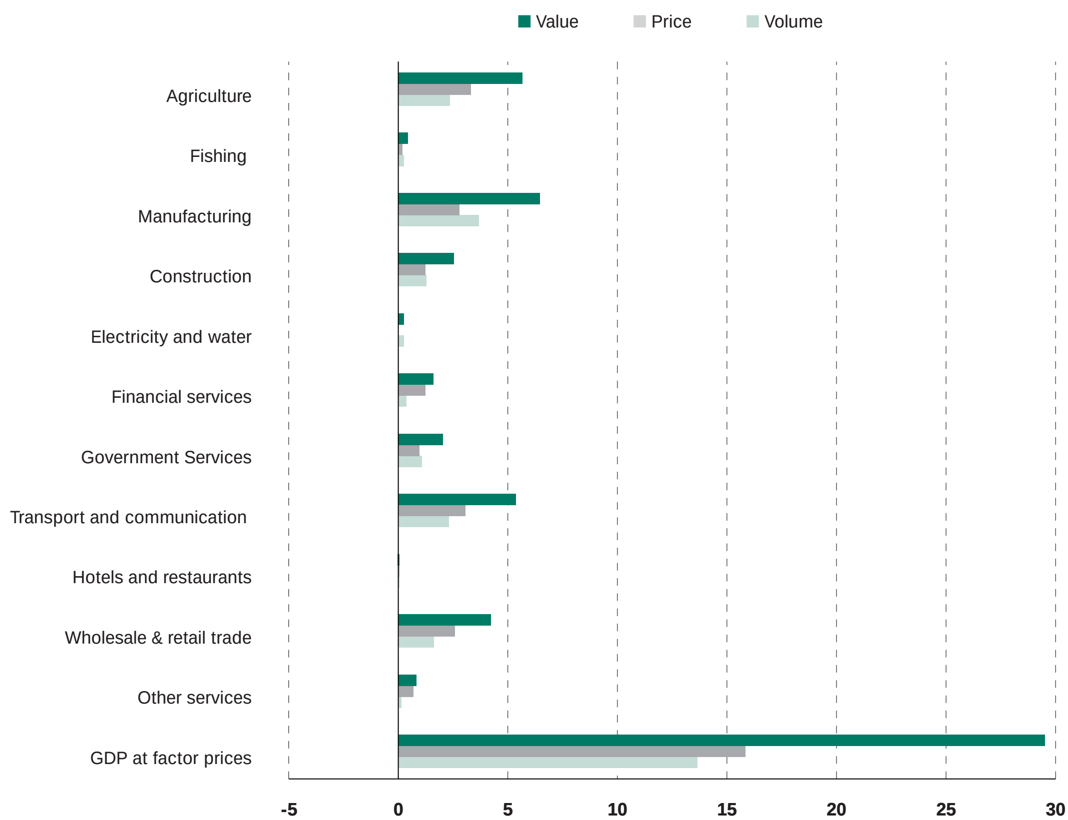
Agriculture still represents the bulk of the economy involving some 80 per cent of the population. The sector comprises a large smallholder sector that produces around 95 per cent of value-added in agriculture, mainly as food crops, such as maize and cassava and some cash crops such as cotton, cashews and, more recently, sugar. Far from reaching their full potential, sugar and cotton have done reasonably well in recent years, although cotton production is highly dependent on world market prices. The sugar industry is currently protected and is being rehabilitated with major foreign investments which have resulted in the output of four sugar estates to increase to 214 000 tons in 2001/02

Figure 3 - GDP by Sector in 2001



Source: Authors estimates based on National Institute of Statistics data.

Figure 4 - Sectoral Contribution to Real GDP Growth, 2001



Source: Authors' estimates based on National Institute of Statistics data.

compared to 67 000 in 2000/01. It is estimated that total sugar production will reach 400 000 tons in 2005, with the mills operating at full capacity. Although current production is less than internal consumption, Mozambique has been allowed to export a limited amount of sugar to the EU under the "everything but arms initiative". However, sugar producers suffer large losses as imports, particularly from Zimbabwe, circumvent the import surcharge[1]. In order to alleviate this pressure, in April 2002 the government granted a temporary VAT exemption for sugar.

Cashew nuts production – of which Mozambique was a world leader in the early 1970s – has collapsed following controversial policies in the mid-1990s. On the advice of the World Bank, in 1995 the Mozambican authorities liberalised domestic raw cashew marketing and foreign trade, lifting a then existing ban on the export of unprocessed cashew nuts from the world's largest producer of processed cashew kernels. Given the financial advantages of exporting raw nuts rather than processing, and the willingness of the Indian processing industry to acquire the raw material to feed its expanded processing capacity, traders have been able to compete the domestic processing industry out of the market. As a result, almost all local factories have been forced to close, leaving tens of thousands of workers and their relatives without an obvious alternative livelihood. These cashew trade liberalisation measures came into effect immediately after the privatisation of the industry and had not been subject of negotiations in the process. They were largely opposed by the new owners and management of the privatised companies who were still having to undergo rehabilitation and were not ready to face the competition from India. Furthermore, liberalisation also turned out to be detrimental for the peasants, who were supposed to secure higher prices for their nuts on the world market and who are now worse off, since, with next to no competition from local factories, the domestic traders and exporters of raw nuts have been able to push prices down.

Agriculture in 2001 is estimated to have grown about 10.8 per cent. Despite localised flooding that occurred in early 2001 in some areas of the central provinces, and which resulted in the loss of about 77 000 hectares, agriculture had a good crop year, especially for maize. In the 2002 crop season, severe dry weather in some parts of Mozambique's central and southern regions caused a drop of more than 60 per cent of the total expected output of cereals and grains. According to the World Food Programme (WFP) estimates, the number of people in need of food aid amounted to around 600 000 (about 3 per cent of the total population) in October 2002. However, in the main cereal growing areas of the north central parts of the country, production actually increased. Taking the country as a whole, the 2002 maize harvest is estimated at 1.24 million metric tons, an increase of 8 per cent compared to 2001. While this means that the country has an estimated surplus of 100 000 tons in the north, high internal transport costs make it uncompetitive to move this down to areas of shortages in the south. It is therefore estimated that the northern surplus will be exported to neighbouring countries, most particularly Malawi, and that import requirements for the affected regions are estimated at 642 000 metric tons of which 70 050 will be provided in the form of food aid.

In addition to the poor condition of roads, which represents a major impediment to food access, the agriculture food system suffers from a series of weaknesses and bottlenecks. Of the 36 million hectares of potentially arable land, it is estimated that only 10 per cent are presently of productive use, mainly due to absence of irrigation systems and other agricultural infrastructures. Moreover, the lack of an adequate rural financial system to create incentives for savings and provide credit, undermines the marketing of agricultural and livestock products. Access to credit is also hampered by the prevailing land tenure arrangements which means that land cannot be privately owned, as well as by the absence of an open market for land titles, which means that land cannot be used as collateral in credit applications. The inputs and equipment used are of very low quality and fertiliser use is very limited, owing to high costs.

In order to assist the development of the sector, the Ministry of Agriculture and Rural Development has launched the Agricultural Sector Investment Programme (PROAGRI) which has received substantial financing from the donor community. Started in 1999 and with a 5-year time frame, the programme aims at raising the productive capacity and productivity of agriculture using labour-intensive technologies and sustainable management

1. According to the National Sugar Institute (INA), about 80 000 tons of sugar are smuggled into Mozambique a year.

of agricultural resources. These objectives are reached through a series of initiatives, such as: dissemination of improved cultivation techniques and post-harvest management methods for the priority food and cash crops, improvement of access to market, facilitation of access by small rural producers to financial services, dissemination of market information, and promotion and support of the formation of farmers' associations and private investment in the marketing system.

The manufacturing sector output has grown dramatically over the last five years, with an average growth of 16.1 per cent in the period 1995-99. This reflects a substantial recovery of capacity utilisation and the start of more efficient operation of privatised enterprises. The sector was seriously damaged by the 2000 floods but recovered in 2001, recording a growth rate of about 30.5 per cent. In addition to recovery from a very low start, growth in 2001 reflects Mozal's first full year of production. This FDI project – the biggest in the country ($1.3 billion) – started production in June 2000. Following the announcement in June 2001 of an $840 million expansion that will double capacity at the aluminium plant, many of Mozambique's larger and better qualified construction companies have been involved in the works on Mozal II, contributing to a growth in construction of about 13.8 per cent in 2001.

Mega-projects and development corridors appear to be the principal means by which the authorities seek to promote the structural changes in the economy of Mozambique. So far, these new initiatives, including the Mozal project, have been concentrated in the Maputo Development Corridor – conceived by the South African and Mozambican governments – which is the direct link between the port of Maputo and the industrial heart of South Africa. Plans also exist, or are in advanced stages of development, financial negotiation and formation of partnerships, for a number of development initiatives along the Beira (Centre) and Nacala (North) corridors.

The development of the southern economy of Mozambique based on large FDI projects is finding a new boost with the beginning in May 2002 of the construction phase of the gas pipeline between the Pande and Temane gas fields (Inhambane Province in Southern Mozambique) and Secunda (South Africa). The purpose of the gas project is to supply the large South African gas market. The 895 km long pipeline is budgeted at $1 billion and will be owned in a joint venture between the South African Company Sasol, and the governments of South Africa and Mozambique.

Other large investment projects have been implemented or are planned. These include mineral projects such as the heavy sands projects in Chibuto (Gaza province, in the South) and Moma (Nampula province, in the North).

The water and electricity sector grew by 11.5 per cent in 2001, mainly owing to the power generated by the dam Hidroelectrica Cahora Bassa (HCB), owned at 82 and 18 per cent by the Portuguese and Mozambican governments, respectively. From the western province of Tete, where HCB is located, the power is routed south to South Africa and back into Mozambique. By contract, more than 50 per cent of the electricity is sold to South Africa under special price arrangements, about 40 per cent to Zimbabwe and less than 10 per cent to Mozambique. A recent agreement signed in April 2002 with the South African Eskom allows Mozambique to purchase electricity from HCB, at the domestic price and in local currency, paying Eskom a transit fee for the use of its transmission lines.

There are ongoing negotiations between Mozambique and Portugal concerning the future of HCB[2]. Despite the government's efforts in the last few years to expand rural electrification, at present only about 6 per cent of the population has access to electrical power, leaving the rest dependent on biomass.

2. The management of the dam complains that the price paid by Eskom for HCB power is so low that HCB has been unable to pay off its enormous debt to the Portuguese Treasury or act as a motor for the development of the Zambezi Valley. Recently the Portuguese authorities have voiced concern that this arrangement appears to subsidise the South African economy at the expense of the economies of Mozambique and Portugal.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Gross capital formation	**28.0**	**36.8**	**35.2**	**36.6**	**43.1**	**49.0**
Public	16.1	11.5	13.3	14.0	13.5	12.6
Private	11.9	25.3	21.9	22.6	29.6	36.4
Consumption	**98.9**	**90.8**	**92.5**	**79.9**	**72.1**	**63.0**
Public	7.8	12.2	13.5	11.4	11.5	11.1
Private	91.1	78.6	79.0	68.5	60.6	51.9
External sector	**-26.9**	**-27.6**	**-27.7**	**-16.5**	**-15.2**	**-12.0**
Exports	12.1	10.1	12.3	21.9	22.9	24.7
Imports	-39.0	-37.7	-40.0	-38.5	-38.1	-36.7

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

The strategic location of Mozambique provides the country with a vast potential in the area of transport and communication infrastructure. The government has undertaken programmes aimed at modernising transport infrastructure (port, rail network, road network) of the Maputo, Nacala, and Beira corridor, connecting with South Africa, Malawi and Zimbabwe, respectively. In 2001, transport grew by 24.6 per cent as a result of a return to normality in the southern road and rail systems which were completely disrupted during the 2000 floods.

The high economic growth that occurred in Mozambique in the period 1996-99 has been sustained mainly by the rise of domestic demand. Private consumption has been supported by external aid inflows to ensure maintenance of minimum consumption levels. However, the boom in investment from 1999, as an impact of the large inflow of FDI resulted in a substantial shift in the demand composition of GDP. Together with the remarkable pick-up of investment, Mozambique's external position has improved dramatically since 2001 thanks to the exports of aluminium produced by Mozal.

Macroeconomic Policy

Fiscal and Monetary Policy

A rolling five-year medium-term expenditure framework was introduced in 1997 and the government is now required to make budget proposals to the National Assembly in a medium-term framework. However, the existence of extra-budgetary activities has hampered the proper conduct and analysis of fiscal and other macroeconomic policies.

In order to improve the efficiency, transparency and accountability in the management of public funds, the government has carried out a Public Expenditure Management Review and adopted for the 2002 budget a more detailed functional classification system. The budget execution report for 2002 will include the review of extra-budgetary activities, especially donor-financed programmes and Treasury lending operations. Moreover, at the end of November 2001, the cabinet approved a new Public Finance Management Law which provides a sound basis for centralised budgetary control and reporting and adopts modern principles of fiscal responsibility and transparency.

Macroeconomic stability is still highly dependent on aid inflows. In 2001, foreign aid represented 46 per cent of total public expenditure and, in particular, two thirds of public capital expenditure.

In 2001, the revised budgetary programme contained a significant rise in expenditure, reaching 31 per cent of GDP, partly financed through additional aid inflows. The increase reflects a rise in priority expenditures, in response to the economic and social impacts of the floods, and the cost of re-capitalisation of two of the largest private commercial banks (with some public shareholding) - *Banco Austral* and *Banco Commercial de Moçambique* - which faced liquidity and solvency problems. The cost of servicing the bonds issued to re-capitalise the two banks was equal to 2.3 per cent of 2001 GDP and is planned to be over 1 per cent of GDP in 2002.

Efforts have been made to increase revenues in order to balance the large deficits (the overall deficit before grants stood at 18.2 per cent of GDP in 2001). The consolidation of the value added tax, introduced in 1999, together with the favourable impact of the depreciation on customs collection led to a revenue outturn in 2001 higher than programmed by 0.5 per cent of GDP.

The medium-term fiscal targets call for a significant reduction in Mozambique's level of aid dependency and prioritise fiscal consolidation. In 2002, the government attempted to achieve a substantial reduction of total expenditures, below 30 per cent of GDP, aided by the end of the emergency and reconstruction costs relating to recent floods and the bail out of *Banco Austral* and BCM. However, the amended budget approved in September 2002 envisaged a rise of expenditures above target. Over the medium term, expenditure rationalisation will be reached by improving expenditure control and effectiveness and cutting non-essential spending. Nevertheless, the government will continue to raise social spending substantially – particularly on primary health and education. Thus priority sectors account for 68 per cent of non-interest budgetary resources in 2002[3], compared to 66.2 per cent in 2001.

On the revenue side, the medium-term framework has set a target of increasing revenue to 15 per cent of GDP by 2005. For this, the authorities have planned and started to implement a series of reforms aiming at increasing the efficiency of the tax system. In particular, a new fiscal incentive code has been introduced in 2002 in order to limit the type and scale of tax exemptions granted to investors thereby allowing for effective control and tracking. This new measure, in tandem with the enforcement of tax collection, led to a 5 per cent higher tax raising in the first half of 2002, compared to the same period last year. Moreover, a new income tax law was submitted to parliament in December 2001 and its full application is expected in 2003.

Since the mid-1990s, the capacity of the authorities to control broad money growth and curb inflation has increased substantially in Mozambique. Following the

Table 2 - Public Finances[a] (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Total revenue and grants[a]	**20.9**	**23.6**	**24.3**	**25.8**	**23.8**	**25.0**
Taxes	10.2	11.0	11.6	11.5	11.9	13.1
Grants	9.7	11.7	11.6	12.9	10.5	10.6
Total expenditure and net lending[a]	**23.9**	**25.1**	**28.4**	**31.1**	**31.7**	**29.2**
Current expenditure	10.1	12.2	13.3	14.0	15.1	13.7
Excluding interest	*8.5*	*11.6*	*13.1*	*13.4*	*13.5*	*12.9*
Wages and salaries	2.3	5.8	6.5	6.6	6.5	6.4
Interest on public debt	1.6	0.6	0.2	0.6	1.6	0.8
Capital expenditure	13.3	11.5	13.3	14.0	13.5	12.6
Primary balance	**-1.4**	**-0.8**	**-3.9**	**-4.7**	**-6.4**	**-3.4**
Overall balance	**-3.0**	**-1.4**	**-4.1**	**-5.3**	**-7.9**	**-4.2**

a. Only major items are reported.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

3. In the period January-June 2002, in the recurrent expenditure, 21 per cent had been spent on education, 10 per cent on health and 8 per cent on security and public order. As for capital expenditure, 22.5 per cent has been allocated to roads, 11.8 per cent to other public works and 12.1 per cent to agriculture and rural development.

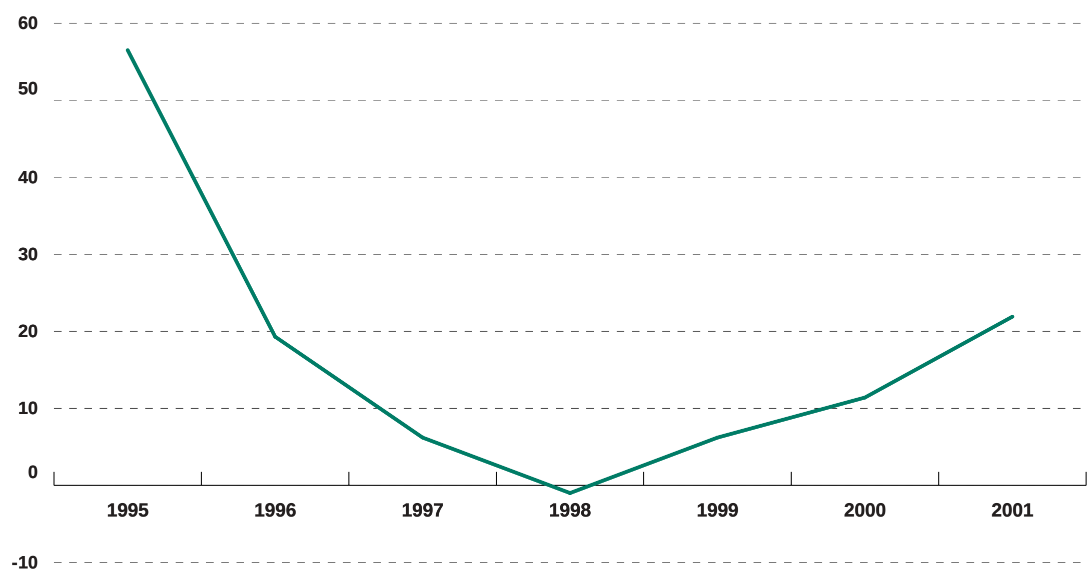
partial privatisation of the state-owned banks in 1996 and 1997, control of money growth has been helped by the fact that the monetary losses of the banking system no longer underpin broad money expansion. Thus, broad money expansion was reduced from 55 per cent in 1995 to 35 per cent in 1999. Inflation rates declined from a yearly level of 52 per cent in 1995 to a level that rarely exceeded 4 per cent during the 1998-99 period.

Following the disruption of distribution networks in the aftermath of the floods, the annual inflation rate in 2000 returned to a two-digit level, ending the year at 11.4 per cent. Inflation increased further in 2001, peaking at 21.9 per cent in December, well above the government target of 7 per cent. This was due to exchange rate weakness during the first half of 2001, as well as the monetary and fiscal implications of the banking crisis.

As a response to the upsurge in inflation, the authorities tightened monetary policy considerably by raising interest rates, with the Central Bank's Standing Lending Facility increasing to 35 per cent by September 2001, from 30 per cent in March and 22.5 per cent in January. In parallel, the monetary authorities strengthened the reserve requirements[4]. In addition, *Banco de Moçambique* (the central bank) stepped up its open-market position, leading to a 30 per cent increase in Treasury bills outstanding between June 2001 and March 2002, and increased sales of foreign currency to ensure adequate sterilisation of aid-financed government spending.

Broad money growth, which was around 48 per cent in August 2001, declined to 30 per cent in March 2002 and the target for end-2002 has been set at 19 per cent, while the end of 2002 inflation target has been set at 8.1 per cent. In 2002, consumer inflation increased to a high of nearly 25 per cent year-to-year in February but the tight monetary policy has been successful in reducing it to a rate of 9 per cent year-to-year in November 2002. The average inflation for 2002 is estimated to be about 9.5 per cent , while 2003 inflation is projected at 8 per cent.

Figure 5 - Inflation Rate (end of period)



Source: IMF and domestic authorities' data.

4. In particular, the fortnightly requirements have been changed from 7.95 per cent to 11.51 and a daily minimum of 10 per cent has been established.

Under a flexible exchange-rate regime, during 2000 the metical – the national currency – depreciated by 18.6 per cent in nominal terms against the US dollar. In 2001, currency depreciation accelerated, having been 28 per cent between December 2000 and June 2001. The depreciation of the metical could be considered the outcome of a combination of different forces. The floods in 2000 produced a surge of imports, with subsequent heavy pressures on the financial system. On the other hand, political turbulence in 2000 has produced an increasing dollarisation of the economy since a larger share of bank deposits were being converted into dollars. The currency finally stabilised in the third quarter of 2001, in response to the monetary tightening measures. Thus, between December 2001 and June 2002, the domestic currency had depreciated by only 2.1 per cent against the US dollar, almost 26 percentage points below the rate in the same period of the previous year, underpinned by high interest rates and strong exports. During the 2nd half of 2002, it continued to hold steady against the US dollar.

External Position

Thanks to the reforms implemented during the 1990s, Mozambique has now one of the most open trade policy regimes in Southern Africa. Import licensing was abolished in the early 1990s, and administrative requirements in 1998. Tariff structure has been simplified and *ad valorem* tariffs have been re-grouped for different kinds of goods. In the context of the Southern African Development Community (SADC) trade protocol, which aims at eliminating tariffs on intra-SADC trade, the government will reduce the top tariff rate from 30 per cent to 25 per cent, effective from January 2003.

In December 2001, Mozambique was declared eligible to the African Growth and Opportunity Act (AGOA) by the US Congress. Under AGOA, Mozambique will have duty-free trade access for textiles, clothing and footwear to the US market. However, the extent of the benefit of the act is difficult to gauge owing to the limited development of the textile sector in the country, which was aggravated by the failure of most of the privatised and other still state-owned companies to stand up to foreign competition (as the latter is aided by both trade liberalisation and smuggling).

Total exports have for long depended on a few agriculture and fishery products, such as prawns, cotton, timber and cashew. While timber and cotton exports are slowly recovering to pre-war levels, cashew exports have declined substantially since the mid-1990s and accounted for less than 2 per cent of total export earnings in 2001. The sector has also suffered from the sharp fall in world prices which in 2001 were less than half of the average prices recorded in 1995-2000. Nevertheless, the composition of exports is starting to diversify: since 1998 the mega-projects in the Maputo Corridor have boosted electricity exports, which accounted in 2001 for the third major export after aluminium and prawns.

In 2001, the import structure was characterised by a slowdown in imports of consumer goods, equipment and machinery, mainly due to the lower imports of emergency aid, and the end of post-2000 flood reconstruction works, respectively. However, imports of fuel and electricity, owing to the investment project in the Maputo corridor have increased considerably. The balance of trade improved dramatically in 2001. The deficit fell from $447.9 million in 2000 to $307.6 million as Mozambique's exports almost doubled in value from $364 million in 2000 to $703.7 million in 2001 – a rise of 93.3 per cent – owing to the export of aluminium produced by Mozal which brought in about $400 million. The value of imports fell slightly, from $1 162.3 million in 2000 to $1 117.5 million in 2001.

Despite the increasing trend in imports of goods and services related to further large-scale foreign investments (including Mozal II, the gas pipeline project, and the heavy sands mining projects), buoyant exports are expected to help narrow the current account deficit in 2002 and 2003.

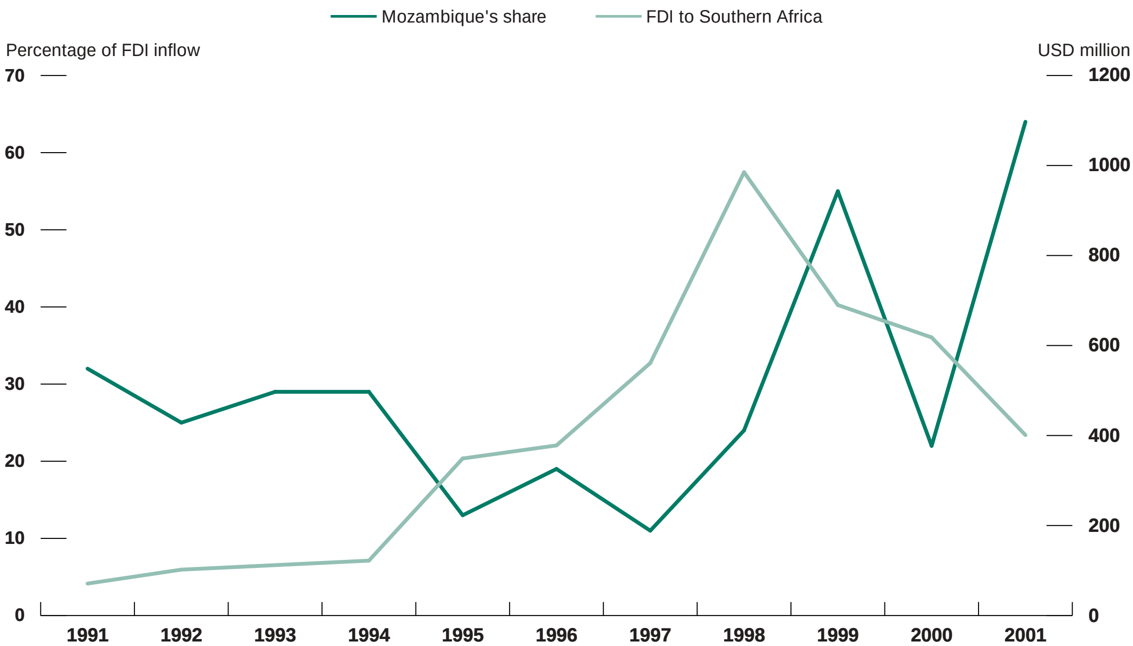
FDI is booming and has come to play a central role in Mozambique since the mid-1990s. The privatisation of firms in the tourism, industry and banking sectors largely characterised the FDI until

Table 3 - Current Account Balance (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Trade balance	-23.6	-22.9	-20.8	-12.6	-11.3	-8.2
Exports of goods (f.o.b.)	7.4	7.1	9.5	21.4	22.4	24.2
Imports of goods (f.o.b.)	-31.0	-30.1	-30.3	-34.0	-33.7	-32.4
Services[a]	-5.3	-5.9	-5.6	-11.0		
Factor income[a]	0.0	0.0	0.0	0.0		
Current transfers	14.5	10.9	14.8	14.3		
Current account balance	**-20.7**	**-18.0**	**-11.7**	**-9.4**		

a: Factor income is included in services.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 6 - Mozambique's Share of FDI Inflows in Southern Africa[a]



a. FDI in Botswana, Mauritius, Mozambique, Zambia, Zimbabwe.
Source: UNCTAD (2002), World Investment Report.

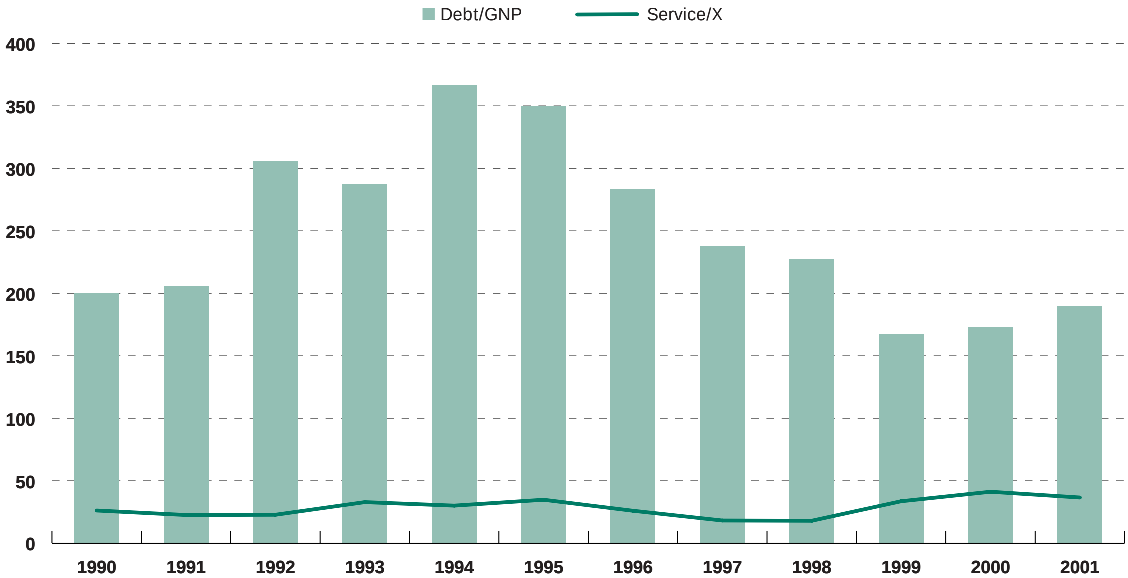
242

1996. Since then, FDI has been mainly directed towards the exploitation of natural resources, and large scale/capital-intensive projects have started. Several reasons make Mozambique attractive for investors, including: tax exemptions and fiscal incentives; liberal policies on the remittance of profits and dividends; low energy prices; and extensive hydroelectric and gas resources. According to UNCTAD's World Investment's Report 2002, the building of the Mozal mega project and its expansion has placed Mozambique in sixth place in the ranking of FDI recipients in Sub Saharan Africa, behind South Africa, Angola, Nigeria, Sudan and Côte d'Ivoire.

In 2001, 129 projects were approved, totalling approximately $2.5 billion, which corresponds to an actual rate of project approval of 82 per cent against 68 per cent in 2000. According to the Investment Promotion Centre (CPI) estimates, if all these investments are implemented, around 15 000 jobs will be created. The bulk of the projects are in industry (46 per cent) and tourism (40 per cent). The traditional countries of origin of FDI are South Africa, Portugal and the United Kingdom. More recently also Japan, Mauritius, Italy, Hong Kong, and China have started investing in big projects in the banking and manufacturing sectors. More than half of total investments are concentrated in the Maputo area where the proximity to government offices and the presence of the Investment Promotion Centre facilitate investors in obtaining all the required official approvals for establishing and operating business.

External assistance has been crucial so far in balancing the current account deficit and more broadly in overcoming the humanitarian crisis of the 1990s and early 2000s. As a corollary of hefty external assistance during the 1980s, Mozambique accumulated a large external debt which reached the impressive level of 352.2 per cent of GNP in 1994 (in face value). Since 1987, there has been a series of debt negotiations and rescheduling with international donors, notably the IMF and World Bank and the Paris Club official bilateral creditors. In the light of the remarkable economic reforms undertaken by the country in the 1990s and of the unsustainable burden of the external debt, creditors agreed, in April 1998, to include Mozambique in the original HIPC Initiative. The country reached the completion point – the point at which debt relief is actually granted – in June 1999 and received $1.7 billion of cash flow relief in NPV terms (about $3.7 billion in nominal terms). Moreover, the country has received additional debt relief under the Enhanced HIPC Initiative (launched in 1999) for which it reached the completion point in September 2001 (the third country after Bolivia and Uganda). Following these developments, Mozambique received further debt relief from the Paris Club of bilateral creditors on 17 November 2001. Total debt relief in 2001 has been about $482 million and a similar magnitude is programmed for 2002. Adding to previous relief operations, this has moved Mozambique's external debt from $8.3 billion in 1998 to $6.03 billion in December 2001.

Figure 7 - Stock of Total External Debt (percentage of GNP) **and Debt Service** (percentage of exports of goods and services)



Source: World Bank.

Structural Issues

Recently, Mozambique has embraced a vast programme of structural reforms addressing privatisation, financial sector development and public sector reform.

The privatisation programme began in 1989, with the approval of the first legislation regulating the administrative procedures for the sales of state-owned enterprises (SOEs) through public tenders. A Technical Unit for Enterprise Restructuring (UTRE) was established in 1991, with the function of co-ordinating the restructuring of medium- large-sized enterprises. Small- and medium-sized companies had a National Valuation Sales Commission within each sectoral ministry charged with overseeing their restructuring.

By the end of 1997, 840 out of 1 248 SOEs were privatised in all sectors of the economy, of which over 90 per cent were mainly small- and medium-sized enterprises acquired by Mozambican nationals. With regard to the sales completed by UTRE – medium- to large-sized enterprises – approximately 50 per cent of the equity was bought by foreigners, namely from Portugal, South Africa, the United States and Mauritius.

By mid-2002, 20 large and 200 small SOEs remained to be privatised mostly in the transport and communication sectors. While the privatisation process of Telecommunication of Mozambique (TDM), the fixed-line operator, is still in its infancy, tenders for a mobile phone service to compete with the existing parastatals company, MCel, have been recently called. In June 2002, the majority South African owned Vodacom Mozambique was awarded the $15 million licence to set up the country's second mobile telephone network. In the transport sector, although the domestic airline market was liberalised in May, the national airline is still state owned owing to the industry specific crisis and lack of acceptable bids. The Mozambique Ports and Railways Company (CFM) is in the process of being privatised and some ports, port services and railways have been successfully deregulated. The divestiture of the remaining SOEs will be carried out by the recently constituted Institute for Management of State Shares (IGEP) which will replace the outgoing UTRE.

The privatisation process in Mozambique was first of all mainly driven by the necessity to reduce the drain on the government budget by loss-making SOEs. Many SOEs were already under performing and highly inefficient when they were sold and in several cases the new owners did not manage to reverse the situation.

Although it is difficult to gauge the impact of privatisation since there was no agency appointed to monitor the performance of the former SOEs, there is evidence that during the process many companies encountered serious financial difficulties (70 per cent in the public work sector) and many of them went bankrupt (40 per cent in public work). However, in some sectors, such as cement, beer, tobacco and sugar, privatisation led to an overall improvement in their performance based on increases in sales and production levels.

There is therefore a mixed feeling about the impact of privatisation in Mozambique. It is, however, certain that the privatised companies were constrained by a series of bottlenecks in terms of regulatory framework, access to credit and managerial capabilities. It was only in 1997 that the privatisation legislation of 1989 was modified in order to provide support to national entrepreneurs namely, extending the terms of payments up to ten years, applying a more favourable interest rate and giving owners the possibility of mortgaging up to 60 per cent of the value of the acquired assets before all the payments had been made. However, the bulk of privatisation took place before the introduction of such guarantees and before the development of capital markets and institutions well tuned to serve the industry.

Even now, although financial services have been expanding in recent years mainly through greater foreign involvement, many firms face enormous difficulties in borrowing working capital owing to the high interest rates. Only firms with relatively easy access to capital in other markets, such as South Africa, can overcome the high cost of capital. Thus, the financial policy environment seems to be tilted towards foreign investors rather than towards national entrepreneurs. Given that the vast majority of privatised SMEs were acquired by nationals, a financial policy biased against nationals is bound to hit more heavily this segment of the firms, as they are the least capable of resorting to foreign markets for financing.

Another major constraint to the development of national enterprises is the lack of managerial capabilities.

Over the years, some programmes providing technical training and financial assistance have been launched to involve more Mozambican investors in the privatisation process and improve the competitiveness of the privately-owned Mozambican firms. Among them, the Fund to Support Economic Rehabilitation (FARE), implemented in 1996, used some of the proceeds from privatisation to provide loans to micro-enterprises. However, the impact of this programme has been very limited. More recently, the Ministry of Industry and Trade and the World Bank have launched another project for the development of national enterprises (PoDE). It identifies two main areas of assistance: technical and financial. While the technical assistance component, which is funded on a 50 per cent cost-sharing basis by the government and the company involved, has brought positive result so far, the credit line to small and medium enterprises is not working well because it lacks guarantee schemes and the commercial interest rates applied are too high.

In order to help overcome these barriers to investment, a donor directly implemented a programme of concessional loans to private entrepreneurs to help them rebuild their production facilities after they were severely damaged by the 2000 floods. Under this scheme, the metical equivalent of $22 million has been channelled through the commercial banking sector to flood affected enterprises. Families and private businessman received support on concessional terms (8-10 per cent interest rate compared to the commercial rates of 34-36 per cent) to re-establish their economic base and to start producing for the market again. The commercial risk is shared 50/50 between the donor agency and the banks. The implementation of such a credit scheme started in mid-2000 and the evaluation of the project reveals that many enterprises that benefited from this credit scheme have now re-established themselves, and the repayments of the loans are on track.

In the financial sector, the solvency problems of two banks – BCM and *Banco Austral* (BA) – which represented more than half of the entire banking sector, forced the government, in agreement with private shareholders, to intervene in the market. The BCM — for which solvency problems were mainly due to bad loans inherited before privatisation — was re-capitalised and the restructuring plan apparently completed in March 2001. In October 2001, BCM was merged with the International Bank of Mozambique (BIM). The major shareholder in both banks was the Portuguese Commercial Bank (BCP), the largest financial institution in Portugal. The new bank takes the name BIM and enjoys an absolutely dominant position in the market, with 48 per cent of total bank credit and 52 per cent of total deposits.

Banco Austral, the country's third largest bank, was taken back to entire state ownership after private investors refused to re-capitalise the bank and handed back their shares in April 2001 to the government. In late October 2001, the government reached an agreement for the purchase of BA with Amalgamated Banks of South Africa (ABSA). The two parties are reported to have agreed a final sale price of $10 million for an 80 per cent share of the Bank and the remainder is to be held by the government. The bank started operations again in January 2002. The central issue remains what arrangements will be made for the bank's loan portfolio. A very tight restructuring plan has been agreed between ABSA and the Ministry of Planning and Finance (MPF). The parties have agreed that all non-performing loans considered unrecoverable by ABSA should be transferred to the Treasury. Moreover, the authorities are committed to including the results of the loan recovery effort in published quarterly budget execution reports and are willing to launch an investigation into the causes of the banks' difficulties.

Since the soundness of the domestic financial system relies mainly on the health of BIM and BA which account for two-thirds of the assets, the central bank has already taken some steps to strengthen monetary supervision. In particular, in April 2002, it changed the frequency of the commercial banks' reporting on compliance with capital adequacy requirements from semi-annual to monthly.

Political and Social Context

Since the signing of the 1992 Rome Peace Agreement that brought Mozambique's 16-year civil war to an end, political developments have been characterised by deep-rooted antagonism between the *Frente de Libertação de Moçambique* (FRELIMO) and the *Resistência Nacional de Moçambique* (RENAMO). In both the country's multi-party elections, held in 1994 and 1999, FRELIMO won a majority of parliamentary and presidential votes. Nevertheless, in the 1999 elections, the RENAMO-led coalition won the vote in six of the country's ten provinces, confirming its popularity in the central and northern regions of the country.

In 2001 – from 29 October to 1 November – RENAMO held its fourth party congress, the first since the end of the war in 1992. Afonso Dhlakama consolidated his control over the party since his two opponents received only 5 per cent of the votes. The congress symbolised the shift of the party from a military structure to a civilian one. Nonetheless, the process still needs to be completed: the party is still strongly dominated by its leader and its administration and organisation has to be consolidated. In June 2002, FRELIMO also held its eighth party congress. The congress led to the election of a new central committee and political commission. Armando Guebuza, until then the head of parliamentary group, has been selected as the party's new secretary general, and the party's candidate for the 2004 presidential elections, since Mr Joaquim Alberto Chissano, president since 1986, has already announced that he will not stand. Armando Guebuza is seen by his supporters as a leader who will fight against the corruption climate that characterised Mr Chissano's presidency. However, he is very unpopular in large parts of the country where he was involved in human rights abuses during the decolonisation years of 1975-77 and the early 1980s. Moreover, his extensive business interests raise concerns over their origin and potential conflict of interests if and when he comes to power.

Municipal elections are due to take place in 2003 and national elections, both presidential and parliamentary, are due in 2004. Preparation for these elections is delayed owing to the disagreement over the reform of electoral legislation. A consensus appears to have been reached on both fronts during the September 2002 extraordinary sitting of the Assembly of the Republic.

In 2001, the government and civil society embarked on a vision design exercise for the future over the next 25 years: the Agenda 2025. The practical steps towards this exercise were facilitated by the establishment of an advisory board which then set a programme of activities that has led to public debates and the establishment of thematic working groups to reflect and develop alternative development options. The exercise – which is seen as an important tool to set commonly shared long-term goals and strategies for the country's development – could represent a remarkable opportunity to improve collaboration between all political actors since all major wings are involved in the definition of the agenda.

Mozambique's international reputation as a hallmark of an emerging democracy has however been tainted by recent events. The crisis of the banking sector has disclosed the rising official corruption and the related issues of the enforcement of the rule of law. In spite of the programmed reforms, the judicial system is still very weak and the degree of independence from the political sphere needs to be improved. The murder of Carlos Cardoso, a respected investigative journalist, during his investigation into cases of corruption and financial fraud and of Antonio Siba Siba Macuacua, interim chairman of the *Banco Austral* in August 2001 raise concerns about the degree to which criminals may have succeeded in capturing important segments of the government and judicial state apparatus. These perceptions have been deepened even more by the escape from jail of one of the six people held in a maximum security prison for Cardoso's murder in September 2002, just a few weeks before the trial of all the accused was due to take place and raise concerns about the issue of corruption. The ensuing events, including the naming during a court hearing of names linking the President's son to events that led to the murder of Cardoso, casts a dark shadow on the otherwise remarkable achievements that the authorities and the people of Mozambique have recorded in rehabilitating their livelihoods and the economy as a whole, after a long period of destructive conflict.

Despite the successful economic growth trajectory, poverty is still overwhelming in Mozambique. Its Human Development Index is still well below the sub-Saharan African average, ranking it 170 out of 173 countries and 69.4 per cent of the country's population live below the national poverty line ($ 0.40 per day). The country is characterised by a highly unequal distribution of income with the Maputo city per capita GDP ($1068) six times higher than the national average and 12 times higher than the figures in the Zambesia provinces (northern region), where 20 per cent of the population lives. The most affected population is concentrated in rural areas where farmers and households have not been able to take full advantage of the favourable macro-environment.

Poverty in Mozambique tends to be assimilated to high household dependency rates, low levels of education (particularly in rural areas and among women), limited access to basic health services, and to infrastructural bottlenecks, principally in rural areas, as demonstrated by the problems of physical access to markets for the provisioning of food during the drought that affected the country in the first half of 2002.

The government has put the eradication of poverty at the top of its agenda since at least 1995 and with the introduction of Action Plan for the Reduction of Absolute Poverty (*Plano de Acção para a Redução da Pobreza Absoluta* — PARPA) finalised in April 2001, the overall objective of reducing the incidence of absolute poverty by about 30 per cent in ten years – from 70 per cent to less than 50 per cent by 2010 – has become the key national priority. In order to achieve this goal, the government is pursuing actions and policies aimed at promoting a sustainable expansion concentrating in sectors with the broadest impact on the poor including agriculture, transportation and commerce.

Regarding health, despite improvements, the indicators in Mozambique are among the worst in the world. According to the UNDP Human Development Report 2002, life expectancy has been estimated at 40.6 over 1995-2000 compared to 42.5 over the years 1970-75. The infant mortality rate in 2000 was 126 per 1000 births while the under-5 mortality rate is 200 per 1000 births (compared to 163 and 278 in 1970, respectively). Regional disparities are striking as an average gap of 21 years in life expectancy between Zambezia and Maputo city clearly shows. The epidemiological profile of Mozambique reveals that amongst children aged under-5, the major causes of death are malaria, diarrhoea and acute respiratory infections. For the adult population, the major causes of illness and death are tuberculosis and malaria. In this scenario, as for the rest of Southern Africa, the spread of HIV/AIDS is large. UNAIDS estimated that 13.2 per cent of the population was living with HIV/AIDS in 2000. A new assessment by the Ministry of Health, in 2001, gives a lower infection rate – equal to 12.2 per cent – due to the availability of new data from the more isolated provinces in the North, where infection rates are lower than expected. Nonetheless, in a study published in 2001, life expectancy including the impact of HIV/AIDS is estimated to decrease to 35.9 years in 2010 compared to an increase of life expectancy up to 50 years over the same period without the inclusion of HIV/AIDS. The impact of HIV/AIDS on the economy may be particularly severe in Mozambique since it affects a small pool of people with technical, managerial and administrative skills. Studies carried out by the IMF and the World Bank indicate that if the government does not react to the pandemic, the overall impact of HIV/AIDS on the growth rate will increase over time, ranging from about 1 per cent in 2004 to about 4 per cent difference in 2010, compared with no Aids scenario. Moreover, another study on the education sector estimated that the costs of education will rise by 6.9 per cent due to HIV/AIDS, just to keep the system at the same level of service delivery as in 2000. In general, the government's Health Sector Recovery Program (HSRP) has markedly improved the quality of services and access, and delivery and quality of health services have all been enhanced since 1995 as the rehabilitation or construction of 300 primary health care facilities clearly shows. However, the impact of HIV/AIDS could hamper the recent progress in the provision of health services: although the care of the vast majority of Aids patients is provided by their home communities, the care of those patients is overwhelming health services both in terms of the number of beds occupied and in the high cost of treatment.

The upgrading of the education system ranks high in the government's poverty reduction strategy and for the country's overall development. The education profile in Mozambique is characterised by a relatively low rate of school attendance, outdated curricula, low quality of teaching, and by great disparities in access to schooling amongst the different provinces and between boys and girls. The net enrolment rate is 60 per cent in primary school (49 per cent for girls) and it drops dramatically to below 2 per cent in secondary school. Low quality of teaching and the nature of the secondary school curricula, very academic and encyclopaedic, have been often advocated as two of the main reasons for such large drops in the attainment level. In addition, high repetition rates mean that to graduate from primary school it takes more than twice the normal five years duration. The other striking feature of the education system in Mozambique is the great disparity between South and Central and Northern regions in terms of education attainment that ultimately could be considered as the outcome of poor supply of classrooms in the Northern and Central provinces. Despite great emphasis given by the government to the development of the education system, the role played by the State has not changed notably during the 1990s. In 2002, the Ministry of Education has started a pilot project to introduce a major change in the teaching methods through the implementation of new curricula in 22 primary schools with the aim of applying the new curricula at national level by 2004.