Mozambique's economic growth after 1992 and the poverty alleviation achieved since then constitute an extremely successful development take-off. Average real GDP growth rate soared from 0 percent (1981–1992) to 8.1 percent (1993–2008), making Mozambique the fastest-growing non-oil economy in Sub-Saharan Africa over the period (AfDB 2009) (figure 3.1). As a result, per capita GDP has doubled since 1992 (figure 3.2). The poverty headcount dropped rapidly during the early years of this process, falling from 69 percent in 1996 to 54 percent in 2002.

The political stability brought about by the end of the armed conflict in 1992, a first wave of structural reforms coinciding with responsible macroeconomic policies, and the support of the international donor community have been the bedrock of Mozambique's transformation. They have enabled the country to better face the development challenges that lie ahead—in particular, how to tap into the country's resources (labor and land) and the entrepreneurial drive of its people to promote strong, sustainable, and inclusive economic growth. Large mineral resources and the recent growth in extraction activities is allowing Mozambique to expand further its development strategy. On the one hand this new revenue source can allow the country to become less dependent on foreign aid and define with more independence new elements of its development agenda. On the other, it raises a number of textbook challenges such as how to trigger externalities (e.g., job creation) in other sectors and how to effectively employ these revenues, while improving governance and accountability.

This chapter provides a brief overview of Mozambique's profound economic transformation and highlights the major drivers of change and the challenges ahead. It does not discuss the macroeconomic policies and performance that underpinned the economic transformation over the past two decades (for a detailed discussion of macroeconomic and stabilization issues in Mozambique, see Clement and Peiris 2008).

**GROWTH DRIVERS AND ECONOMIC TRANSFORMATION**

Sound macroeconomic environment allowed donors to contribute substantial amounts of aid to Mozambique, averaging about 14 percent of GDP a year since 1993 (figure 3.3). That aid inflows have remained fairly constant as a percentage of GDP over the period, during a period when the economy grew at an average annual rate of more than 8 percent, reflects the rapid growth in aid inflows in U.S. dollar terms. These large inflows financed investments in education and health, as reflected in the rapid improvements in human development indicators (table 3.1). They also financed substantial investments in rebuilding the country's roads, ports, and railways, which had been shattered by 16 years of war.
Good macroeconomic management also attracted substantial foreign direct investment (FDI). FDI inflows increased from an average of 1.5 percent of GDP in 1993–98 to an average of 5.2 percent of GDP in 1999–2010 (figure 3.4). In 2009 and 2010 FDI reached an estimated $900 million, about 9 percent of GDP. A large part of these inflows has funded large investment projects in the mining sector, underpinning recent export performance in Mozambique.

From a supply-side perspective, capital accumulation, higher quality–adjusted labor input, and positive aggregate productivity performance were important determinants of
growth in Mozambique. Growth accounting exercises indicate that physical investments partly associated with mega-projects and significant improvements in education led to growth dynamics heavily influenced by the accumulation of human (quality-adjusted) and physical capital between 1993 and 2008. Figure 3.5 shows the average capital contribution to growth strengthening from 1999 onward, a result consistent with the timing of mega-projects. Aggregate productivity growth (total factor productivity)—measured as the residual of output growth after labor and capital contributions are subtracted—was also important. Figure 3.6 suggests roughly balanced growth of inputs and productivity. Productivity increases contributed about a third to overall growth between 1993 and 2008. These results are broadly consistent with those of Jones (2006) and Vitek (2010). Jones presents evidence suggesting a positive contribution (crowding in) of public capital accumulation in the aftermath of the civil war, which opened the door for private investment to play an increasingly important role in Mozambique’s growth.
A level change in aggregate investment from mega projects triggered strong export and import activity from 1999 onward, with direct impact on aggregate demand. The expenditure components of output (figure 3.7) indicate that GDP and consumption have been trending up since the end of the civil war but that growth after 1999 has been different. Strong investment performance starting in 1999—which matured into strong export performance from 2001 onward—allowed for continued increases in output and consumption at the same time that imports were growing. This pattern inaugurated a different growth model for Mozambique, whereby strong exports, though offset by accompanying imports, reflected stronger private sector activity.

More recently, as a result of sharp increases in the price of aluminum from 2004 onward, the pace of profit repatriation
associated with mega-projects has widened the gap between GNP and GDP (figure 3.8). This stylized fact is a reminder of a key challenge for the country: the need to compliment the current export drive based on mega-projects with a diversification strategy that activates a broader set of growth drivers and taps more effectively into Mozambique’s more abundant factors of production, particularly labor, land, and entrepreneurial drive.

Although the private sector has spearheaded large mega-projects in the mining sector, its role in economic growth over the past decade should not be overemphasized. Sonne-Schmidt, Arndt, and Magaua (2008) developed a
methodology to evaluate the direct contribution of three key operational mega-projects (Mozal, Sasol, and Moma) to growth at factor cost. They conclude that the direct effects of these mega-projects were an increase in the average annual growth rate between 1996 and 2006 of about 1 percentage point (average annual growth rate was about 8 percent). Moreover, as foreign-owned, capital-intensive, export-oriented companies benefiting from fiscal exemptions, mega-projects made only a small contribution to job creation, tax revenue, use of domestic intermediate inputs, and profit reinvestment in Mozambique.

Benito-Spinetto and Moll (2005) present similar results. Using a computable general equilibrium (CGE) model to replicate the performance of the Mozambican economy, they find that about half of the 8 percent average GDP growth during 1994–2004 was driven by catch-up growth in the agricultural sector (as people returned to the fields following the end of the war), a quarter was driven by the growth in aid inflows (and the resulting investments in social and physical infrastructure sectors), and a quarter was equally divided between mega-projects and growth in other private sector activities. Clearly, the initial bet on mega-projects, despite the usual uncertainty in quantifying their precise economic effects, rested more on their capacity to generate immediate revenue rather than truly create downstream externalities (especially jobs and demand for industrial and services inputs).

Indeed, the positive total factor productivity reflects the reshuffling of labor resources and a rapid transformation in the output structure of the economy. In a postwar context—where reconstruction efforts, a first wave of structural reforms, and a stabilized macroeconomic environment spurred private sector activity—the Mozambican economy posted double-digit growth rates in mining, manufacturing, construction, electricity, gas, and water. Sectoral output shares experienced substantial changes between 1993 and 2006, especially in agriculture, which nearly halved its output participation, despite the positive contributions of agriculture to overall economic growth (figures 3.9 and 3.10). Sectoral output reflects a deep transformation to more productive sectors that generated positive composition effects in aggregate productivity. Nevertheless, although economic growth has been strong and has underpinned the process of economic transformation, the structure of the economy still remains narrowly based on subsistence agriculture and a few isolated, albeit large, mega-projects. Agriculture, which employed about 78 percent of the economically active population, accounted for 25 percent of GDP in 2009. It was followed by manufacturing (12 percent, two-thirds of which was accounted for by one large aluminum smelter); trade and retail services (11 percent); transport and communications (10 percent); financial services (7 percent); and extractive industries (1 percent). Going forward, a key
challenge is not only to support the continuation of intersectoral (structural) transformations but to ensure within-sector productivity gains by addressing impediments to microeconomic efficiency (World Bank 2008a).

Economic transformation in Mozambique entailed a profound rebalancing of sectoral roles, with the (private) service sector absorbing labor at a particularly strong pace. Agriculture displays the lowest level of labor productivity of all sectors (figure 3.11). Between 1996 and 2003 its output contribution to GDP fell by 6 percentage points (to 27 percent), and its share of employment in the total labor force fell by 8 percentage points (to 82 percent) (figure 3.12). Although output shares were gained primarily by the industry sector, employment shares were gained by the private service sector.

While the increase in the employment share of the private service sector has benefited the poor (World Bank 2008b), the challenge to generate an even greater number of jobs at higher levels of the value chain remains. The overwhelming concentration of employment (more than 78 percent) remains in agriculture. In urban areas, retail trade and vehicle repair employ a quarter of all workers; manufacturing industries employ 7.5 percent (table 3.2).

Formal employment generation has been very limited in recent years and is confined to a few large companies. Establishment-level data from a sample of 600 firms suggest that large firms (more than 100 employees) and some medium-large firms (about 100 employees) were responsible for the majority of jobs created in the manufacturing, services, construction, and transportation sectors between 2003 and 2006 (table 3.3). The dominance of large companies in formal employment generation reflects the lack of growth in small and medium enterprises. The “entry margin” (creation of formal jobs through new firms) also appears considerably more stifled for micro and small firms than for medium and large firms, perhaps a reflection of the fact that entry costs and overall business environment constraints impinge more severely on smaller producers.

The concentration of the economy in a few large companies is also reflected in export patterns. The export basket remains extremely limited, with only 15 products registering exports of more than $1 million a year. More than half of Mozambique’s exports remain concentrated in the Mozal aluminum smelting enclave (figure 3.13), virtually all of whose production goes to the European Union. Electricity and gas are also important export products (bought largely by South Africa).

Overall, Mozambique’s exports increased significantly (in real terms), with average annual growth rates of 14.9 percent over 1995–99 and 19.8 percent over 2000–08. Most of this growth, however, was driven by exports from the mega-projects; although excluding mega-projects, exports grew at an average rate of 10 percent a year during 2000–08, which represents a reasonable performance. Progress in penetrating Southern Africa Development Community (SADC) countries continues; Mozambique should position itself to exploit non–SADC markets as well. Mozambique exploits only 2 percent of the potential

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Figure 3.10 Changes in Sectoral Output Share in Mozambique, 1993–2008

Source: World Bank various years.
bilateral flows for all the products it exports (Gillson 2008). Although this is comparable to other countries in the region, it is far lower than the levels achieved by more advanced and better integrated economies (such as South Africa) (figure 3.14).

A STRATEGY FOR BROADLY SHARED ECONOMIC GROWTH

Rapid economic growth was accompanied by significant strides in reducing poverty during the stabilization phase, after the peace accords and up to 2003. Household survey
Table 3.2  Distribution of Employment in Mozambique, by Sector, Gender, and Location, 2004/05
(\textit{percent})

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total</th>
<th>Men</th>
<th>Women</th>
<th>Urban</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and fishing</td>
<td>78.5</td>
<td>68.0</td>
<td>87.3</td>
<td>40.1</td>
<td>92.7</td>
</tr>
<tr>
<td>Extractive industries</td>
<td>0.3</td>
<td>0.6</td>
<td>0.0</td>
<td>0.4</td>
<td>0.2</td>
</tr>
<tr>
<td>Manufacturing industries</td>
<td>3.1</td>
<td>5.4</td>
<td>1.2</td>
<td>7.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Electricity, water, and construction</td>
<td>1.2</td>
<td>2.6</td>
<td>0.1</td>
<td>3.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Retail trade and vehicle repair</td>
<td>9.2</td>
<td>11.7</td>
<td>7.0</td>
<td>25.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Transport and communication</td>
<td>0.8</td>
<td>1.6</td>
<td>0.1</td>
<td>2.6</td>
<td>0.1</td>
</tr>
<tr>
<td>Financial services and rental</td>
<td>2.9</td>
<td>3.9</td>
<td>2.0</td>
<td>9.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Administration</td>
<td>1.7</td>
<td>2.9</td>
<td>0.7</td>
<td>5.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Education</td>
<td>1.6</td>
<td>2.3</td>
<td>1.0</td>
<td>3.5</td>
<td>0.9</td>
</tr>
<tr>
<td>Health and social work</td>
<td>0.7</td>
<td>0.8</td>
<td>0.5</td>
<td>1.6</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: INE 2006.

Table 3.3  Number of Full-Time Employees in Sample of 600 Firms in Mozambique, by Firm Size, 2003 and 2006

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Growth rate in number of employees between 2003 and 2006 (percent)</th>
<th>Number of employees in 2003</th>
<th>Number of employees in 2006</th>
<th>Change in number of employees between 2003 and 2006</th>
<th>In firms created before 2003</th>
<th>In firms created after 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>63</td>
<td>408</td>
<td>666</td>
<td>190</td>
<td>68</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>35</td>
<td>2,064</td>
<td>2,803</td>
<td>493</td>
<td>246</td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>36</td>
<td>4,630</td>
<td>6,323</td>
<td>992</td>
<td>701</td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>60</td>
<td>2,922</td>
<td>4,685</td>
<td>772</td>
<td>991</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>44</td>
<td>10,024</td>
<td>14,477</td>
<td>2,447</td>
<td>2,006</td>
<td></td>
</tr>
</tbody>
</table>


Note: Full-time employment in 2003 was used to determine firm size. For firms created after 2003, employment in 2006 was used to determine firm size.

Figure 3.13  Mozambique’s Main Exports, 2008
data indicate that the national poverty headcount fell rapidly, from 69 percent in 1996 to 54 percent in 2003 (MPD 2004). Reduction in rural poverty was even more pronounced, declining from 71 percent to 55 percent during the same period.

The pace of poverty reduction appears to be slowing, however, now that the post-war reconstruction effort and the agriculture catch-up has been exhausted, and the existing pattern of economic growth is not generating a sufficient number of jobs. The preliminary results of the 2009 nationally representative household budget survey are mixed. Although there was significant progress on many nonmonetary poverty indicators (such as access to education and health services, increase in asset ownership by households, and improvements in housing quality), the poverty headcount suggests that poverty may have stagnated at about 55 percent during 2003 and 2009 (MPD 2010). Urban poverty continued to decline, although at a much slower rate, reaching 50 percent, but rural poverty increased to 57 percent. Although the food and fuel crisis played a role in this outcome, the stagnation of poverty reduction while the economy continued to grow at high rates suggests that growth has become less inclusive in the past few years.

These results are important because they seem to corroborate what many academics in Mozambique (see, among others, Castel-Branco 2002; Castel-Branco and Ossemane 2009) have been arguing for a number of years: that even though GDP growth rates have been very high in Mozambique, the current development strategy is lagging behind expected promises. The model—which focuses on maintaining macroeconomic stability, making public investments in infrastructure and increasing access to public services (education, health, water, and electricity), and attracting capital-intensive mega-projects (which are capital intensive)—is still not bringing the increase in jobs and productivity required to set the economy on a more diversified growth pattern and eventually to reduce poverty by more than under the current strategy. In addition, lack of progress on the good governance agenda is putting strain on Mozambique’s relationship with some of its development partners, and raising further questions about the sustainability of Mozambique’s development strategy (box 3.1).

A more inclusive, labor-intensive economic growth strategy is needed to reduce poverty and improve living standards (World Bank 2010a). Diversifying the economy into labor-intensive sectors (including agriculture, agroprocessing, manufacturing, and tourism) and increasing the competitiveness of domestic production to replace imports and diversify exports requires a new strategy focused on eliminating barriers to private investment (both domestic and foreign). Such a strategy would attempt to reduce excessive regulation; simplify the trade and tax regime; reduce the costs of hiring and firing workers; improve labor force skills; eliminate the rigidity in the land tenure system (freeing up access to land use rights and allowing their tradability); strengthen transport logistics and facilitate better services/articulation for exports; address the lack of standards; and maintain sound fiscal, monetary, and exchange rate policies. A number of constraints have to be addressed through a
Box 3.1 Signs of Political Maturity: Is Mozambique’s “Aid-Supported Growth Engine” Beginning to Shift?

Aid flows needed to finance public investments and expand service delivery are becoming increasingly uncertain in Mozambique but also for other Low Income Countries. This is due, in part, from the budgetary consequences of the 2008 global financial crisis in ODA allocation in many OECD countries.

OECD donors have been considering Mozambique an emblematic success story since the 1990s, especially since the end of the Civil War (1992). Official development assistance flows were significant and relatively stable both for projects and for direct budget support, given the country’s good performance and “donor-agencies” high ratings. Throughout the early 2000s changes occurred in Mozambican politics: from a relatively strong showing in the first, post–Civil War elections in 1994, RENAMO’s electoral results declined subsequently and posed a lesser threat to FRELIMO-dominated politics. Changes also affected the FRELIMO leadership, rotating toward a more business-oriented framework. With more investment opportunities brought by macroeconomic stabilization, positive donor sentiment, and increased aid inflows, among other things, a shift toward a market-oriented framework took place, accentuated by the discovery in the mid-2000s of significant mineral resources that triggered private sector interest and investment. In recent years, the discovery of such sizable reserves of minerals began to engender business interest in the country by global players, triggering expectations of large, private sector-led investments in these areas but also in the accompanying infrastructure for export corridors.

Inevitably these prospects brought more attention to issues of economic governance such as the relationship between an emerging class of businesses and entrepreneurs with the dominant political elite. Following several years of unhappiness about mixed progress in the good governance agenda and fears that increasing growth of non-aid revenue would allow Mozambique to become less aid-dependent. Some OECD donors in late 2009 threatened to “cut budget support” if very specific actions on political reforms were not urgently undertaken. While the 2009–10 standoff has since been largely resolved, some of the reasons and the political dynamics that led to the impasse appear to signal a structural change in Mozambique’s relationship with the budget support donors. Many donors, however, consider such interference in the country’s political affairs as unwarranted and refrain from entering into this type of conditionality. In fact, the government has also started to consider different possible scenarios to reduce its political vulnerability to aid-dependence, ranging from the possibility of revising some contracts with some mega-projects that benefit from generous tax incentives, or turning to some of BRIC countries for support, in addition to the need to expand the tax collection base and diversify revenues, among other strategies.

Mix of simultaneous policy reforms, investments, and strengthening of institutions. They can be categorized as business environment, factor markets, trade logistics, and export-supporting institutions.

Aggressive reforms are required to improve the business environment and entice potential investors. First, the regulatory environment is very unfriendly to small and medium enterprises, and licensing, inspections, and red tape are a heavy burden. This is arguably the most important priority needing attention to unleash private sector potential, starting with domestic investors. Second, the Mozambican tax and tariff system is characterized by many different exemptions whose cumulative effects are unclear. Additionally, small entrepreneurs normally do not benefit from current exemptions, because they cannot afford the fixed cost involved in applying for them. The standard statutory tax regime (excluding incentives) continues to place a substantial burden on investors, notably small domestic entrepreneurs. The combination of a statutory tax regime with relatively high tax rates with a generous system of tax incentives influences investment decisions and the allocation of resources in a way that is not immediately visible but distortionary in the long run. One widely recognized distortion is that the past tax regime encouraged industries that used more capital rather than labor. Mozambique’s fiscal climate could be significantly improved by simultaneously reducing fiscal incentives and the number and level of tax rates without compromising government revenues. Third, despite progress in recent years, tax administration remains another impediment to Mozambique’s competitiveness.
and productivity. A large number of the firms interviewed in the recent Investment Climate Assessment (World Bank 2010b) reported that tax administration is a major or severe obstacle to doing business. Reducing the number of taxes on the books and simplifying compliance with tax legislation would reduce transaction costs of businesses.

Factor markets—land, labor, and capital—need to allocate resources to their most productive uses. The 1997 Land Law is generally considered to be exemplary in Africa. However, 10 years after its approval, its implementation is weak, and the reality on the ground is one of extensive extralegal land markets, multiple claims to the same pieces of land, and a lack of guidance on how to protect or compensate customary and good-faith occupation rights. This situation has led to extensive land speculation and corruption, potentially leading to land conflicts and landlessness in the future. In the short run, the land situation acts as a deterrent to investors, particularly in tourism and agribusiness. Access to land for productive purposes needs to be improved. The new labor law approved in 2007 has substantially improved labor regulations for new investments. However, the labor market could and should be allowed to work even better to attract more domestic and foreign investment and sustain high growth rates.

In addition, despite significant progress, education levels in Mozambique are still very low and constitute a structural constraint for job creation in the formal sector. Quality of education is key for inclusive growth. Professional services (such as engineering, auditing, legal, and medical services) are expensive and in short supply in Mozambique; at the same time, many highly skilled Mozambicans are emigrating because they can earn more money abroad. This paradox of not having enough supply of skills (making professional services very expensive) while at the same time not having enough demand for them (leading to emigration) needs to be analyzed carefully to come up with an appropriate package of policy reforms. Inappropriate standards often stifle demand for services in areas such as engineering and accounting. Professional associations can play a key role in creating, with government support, a framework for regulation and appropriate standards, and also monitor quality and skills development. Immigration rules for qualified specialists who can provide managerial and technical expertise to Mozambican enterprises are still very restrictive, particularly for companies providing professional services. In the short run, a more liberal policy of granting work visas to skilled foreigners would help to develop the market for professional services in Mozambique and would enable Mozambican companies to compete better with foreign companies providing such services.

Legislation for the financial sector has been evolving continuously, and all banks were privatized in the 1990s. However, capital markets remain very shallow. The banking system is now sound and highly profitable. Exceptionally high ratios of capital adequacy (17 percent on Basle I) and liquidity (55.4 percent) of commercial banks raise a legitimate question as to whether there is sufficient financial intermediation for a fast-growing economy. Only a quarter of all districts have any kind of banking service, housing finance faces big constraints, and trade finance is still underdeveloped.

Trade logistics remain a serious constraint. Mozambique has the potential to be a major outlet for southern Africa based on its strategic location and congestion in Durban port, provided that it becomes more logistics friendly. Maputo port is the closest route for the largest mining and manufacturing region of South Africa, while Beira and Nacala are the closest ports for the other neighboring countries. Yet corridor traffic potential remains mainly untapped. Traffic going to and from Gauteng and Mpumalanga provinces equals at least 700 million tons. If Maputo could capture 1 percent of this traffic, its total throughput would be doubled and port revenues would be increased by several tens of millions of dollars. Despite a rather successful concession process, transit traffic at Maputo port remains relatively low, and the port operates at less than 30 percent of its capacity. Beira port has also operated at less than 40 percent capacity for the past five years. Mozambique’s main deficiencies for trade mostly derive from logistics problems and low transport reliability. Low ratings in the logistic performance index (LPI) (2.29) and in the timeliness index (2.83) put Mozambican ports at a disadvantage compared with the port of Durban (with an LPI of 3.53 and a timeliness index of 3.78). The World Bank’s 2008 Doing Business report highlights a web of procedures taking 27 days for exports and 38 days for imports. Some large South African shippers are still reluctant to shift their transport routes from Durban to Maputo because they still perceive the business climate there as unpredictable, including a higher incidence of bribe payments for the port of Maputo than for Durban (World Bank 2010a). Also, the poor integration of trucking services with the rest of the subregion explains why South African shippers are still reluctant to use Mozambican ports. High transport unpredictability is closely linked to low traffic volumes. As a result, shipping lines do not call directly in Maputo and cargo has to be transshipped in Durban or Mombasa. Physical investments and reforms of customs procedures should be carried out simultaneously to reach a critical mass
in port transport volume. At that point, international shipping lines will make direct calls, which will greatly improve predictability. Constructing the “one-stop border post” in Ressano Garcia for trade with South Africa is of highest priority and should be quickly emulated in other large border posts. At the same time, all the customs clearance procedures including at the dry ports have to be revised. Long truck immobilization creates unnecessary delays and costs for shippers and transporters. Capital dredging of the Beira port is also very important, as is the reconstruction of the road between Nampula City and the border of Malawi.

Strengthening specialized export-supporting institutions that can assist small- and medium-size exporters is important for product and market development. Needed are a national system for standards and quality controls; an ICT-based proactive trade information system; product ID cards, and CITEs (centers supporting knowledge, innovation, and technology transfer and services otherwise not available). In addition, more “articulators” are needed to connect Mozambican businesses and products with regional and global markets. For a country where production is highly fragmented, such articulation initiatives are critical to secure scale benefits and knowledge transfer. There are already a number of ongoing articulation efforts in Mozambique through nongovernmental organizations, producer associations, private sector firms, and government agencies. But more needs to be done to get the benefits of economies of scale.

CONCLUDING REMARKS

The government of Mozambique has consistently pursued sound fiscal, monetary, and external policies, demonstrating a clear understanding of the benefits of a solid underlying macroeconomic framework for fostering further private sector-led growth. Mozambique’s stable macroeconomic environment has allowed the economy to undergo significant transformation over the past two decades, in part supported by a stable source of ODA funding. Sectoral output composition has witnessed significant changes, with the participation of agriculture in output diminishing as more productive sectors grow. Although employment is still overwhelmingly concentrated in agriculture, job growth in the private sector (mostly informal) has led to increased participation of private services in output. Nevertheless, Mozambique’s current growth model is not creating enough jobs or widening the productive base in order to create an economy in which wealth is broadly shared. However, the strategy implemented since the discovery and exploitation of large mineral resources has produced positive results. The country has achieved high growth rates, is getting significant amounts of export revenue and has begun to reduce its aid-dependency, especially vis-a-vis traditional Western donors. However, the trickle-down effect of such a bet has not (yet) produced the expected impact on local businesses and labor markets. Moreover, uneven income distribution in urban areas and rising food prices during the last global commodity price cycle triggered protests.

Shifting growth dynamics toward a more inclusive pattern based on economic diversification and increased participation of small and medium enterprises will require policy action. Businesses’ interest in expanding and initiating operations in Mozambique is palpable. This ongoing diversification of productive activities is bound to spur transformations in the economic landscape. Economic diversification and increasing engagement of small and medium enterprises leveraged by sustained efforts to participate in world markets represent a strategic orientation in the Mozambican growth model that is required to accelerate growth and reduce poverty. Harnessing such transformations for economic development will require strategic policy steps. By promoting competition and trade integration measures, the government should induce further private sector demand for Mozambique’s factors of production, diversifying the economy and achieving shared and sustained economic growth.

A more balanced growth path, that would rely on local business initiatives, is fundamentally about creating the right incentives and necessary underlying conditions to foster entrepreneurial drive. These conditions can be achieved through policies to improve the business environment, the functioning of factor markets and land allocation, and the trade infrastructure, aiming to strengthen or create the institutions necessary for more absorption of labor, in particular helping small and medium enterprises to succeed. Such a shift requires political commitment and attention to new institutional bottlenecks and implementation capacity.

The bet that Mozambique has taken is showing some positive results. It was perhaps, given its chronic aid-dependency during most of its post-independence history, the only possible way to depart from it. This bet is not exempt from risks, and there are several indications that the political leadership is fully aware of many of them. Losing too soon significant portions of ODA would certainly be harmful to both macroeconomic stability and the quality of policies, although it should be acknowledged that the country has fully owned and implemented the standard
agenda aimed at stability. The benefits from the export windfall could be captured by vested interests and not reinvested into the rest of the economy. There could be a substitution of aid-dependency by an excessive reliance on the business interests of large private groups.

Nevertheless, it is overall quite a success story, despite these risks and perhaps because of these risks. To the extent that the country understands these challenges and works to address them, especially in the efficient allocation of windfalls to development purposes, chances are that Mozambique could be a bright spot in terms of a successful strategy that overcame a civil war, instabilities of all sorts, lack of initial resources, lack of human capital, poverty and excessive dependency on external assistance.

NOTES

1. In primary education (grades 1–7), the number of children more than tripled, from about 1.3 million in 1992 to 4.2 million in 2008. Net enrollment rates in primary education doubled, from 45 percent in 1998 to more than 96 percent in 2008, with rates for girls rising from 40 percent to 93 percent. The number of primary school teachers increased from 30,000 in 1992 to 73,900 in 2008. The gross enrollment rate in lower secondary education (ES1) increased from 4.8 percent in 1998 to 28.0 percent in 2008. The gross enrollment rate for upper secondary school (ES2) increased from 1.3 percent in 2008 to 8.0 percent in 2008. Under-five mortality rates decreased from 212 per 1,000 live births in 1996 to 178 in 2003 and 138 in 2008. Infant mortality decreased from 145 per 1,000 live births in 1996 to 122 in 2003 and 93 in 2008. Maternal mortality fell from an estimated 1,000 per 100,000 live births in the early 1990s to 408 in 2003 and 340 in 2007. The share of the population with access to an improved water source increased from 39 percent in 1995 to 48 percent in 2008. Although the rate of HIV prevalence remains very high, the capacity of the health system was expanded to start providing free antiretroviral treatment for HIV infection.

2. The methodology applied to obtain the decomposition was based on a Cobb-Douglas production function with capital and quality-adjusted labor as inputs. Shares of the inputs were considered fixed at 0.4 and 0.6. Data from the Instituto National de Estatistica (INE 1998, 2004) were used to adjust for labor quality.


4. The shrinking of the labor force in agriculture in favor of other more productive sectors is a general pattern in the development process of many other advancing economies and should not be viewed as a negative phenomenon.

5. Job creation in the nonagricultural informal sector between 1997 and 2003 was also an important determinant of poverty reduction (World Bank 2008b). It provided economic opportunities to the poor and led to economywide productivity gains.

6. The enterprise survey of 600 firms was carried out in 2008 by the World Bank for the Investment Climate Assessment (World Bank 2010b). Each firm in the sample was visited to collect employment information on 2003 and 2006.

7. The index essentially compares each product Mozambique exports with all importing countries of the product from all world sources. By tracing all bilateral flows for each exported good, Gillson (2008) proposes a measure that captures the extent to which markets have been penetrated by Mozambican products. For instance, if country A exports good X only to country B, but good X is also imported by countries C and D only from country E, then country A is exploiting one of three (or one-third of) bilateral flows for good X.

8. Market penetration measures disaggregated by largest export partners indicate that Mozambique is already exploiting 80 percent of its potential bilateral flows to South Africa.

9. This section draws heavily on the recent Country Economic Memorandum on “Reshaping Growth and Creating Jobs through Trade and Regional Integration” (World Bank 2010a).

10. These results should be treated with caution, however. Substantial underreporting of food consumption has been identified in the 2008/09 household survey data, which could affect both the poverty levels and their trend over time. The data problem also affects the 1996/97 and 2002/03 household surveys, albeit to a different extent. Additional analytical work is required to test the robustness of the poverty analysis in Mozambique by correcting for the data problems.

11. The considerable amounts of aid and the presence of a great number of aid agencies led to the establishment of donor coordination mechanisms that were considered best international practices until recently. A number of donor-government working groups were established during a “golden era” for coordination that brought benefits to both
donors and the government—in terms of transaction costs—and culminated with the adoption of the Paris and Accra Declarations. In parallel, a distinction began between donors providing direct budget support (such as a regrouping into a group of nineteen OECD countries or the G-19) and those involved in more traditional project activities. While important donors (such as the United States) concentrated efforts in specific sectors (like health and clean water), the G-19 elaborated a memorandum of understanding to define quasi-contractual rules for disbursing budget support, considered as a sign of a more mature relationship with recipient governments. In fact, while Mozambique’s success led the country to benefit from larger shares of aid under direct budget support (by the G-19), this theoretically more “advanced” form of aid, adequate for countries with a solid track record, also makes the country more dependent on the political and budgetary cycles of OECD donors (see box 3.1).

REFERENCES


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