

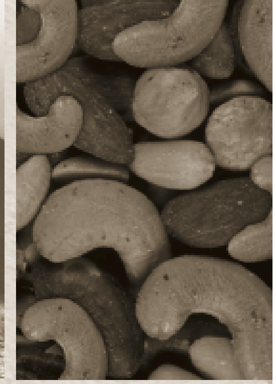


REMOVING OBSTACLES TO ECONOMIC GROWTH IN MOZAMBIQUE

A DIAGNOSTIC TRADE INTEGRATION STUDY

VOLUME 2, MAIN REPORT

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December 2004

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Acronyms

ACP	African, Caribbean, and Pacific
AD/CVD	Antidumping Duty and Countervailing Duty
AFD	French Development Agency
AGOA	African Growth and Opportunity Act
AMODER	Associacao Mocambicana para o Desenvolvimento Rural (Mozambique Association for Rural Development)
ANE	National Road Administration
APHIS	Animal Plant Health Inspection Service (of U.S. Department of Agriculture)
BDV	Brussels Definition of Value
BLNS	Botswana, Lesotho, Namibia and Swaziland
BOT	build, operate, transfer
CACM	Center for Arbitration, Conciliation and Mediation
CEMAC	Economic and Monetary Community of Central Africa
CET	common external tariff
CFM	Port and Railway Administration
CGE	Computable General Equilibrium Model
CIF	cost, insurance, and freight
CISPOC	Inter-Sectorial Committee for Trade Policy
CMT	Council of Ministers
COMESA	Common Market for Eastern and Southern Africa
COMTRADE	Commodity Trading Statistics Database of the United Nations
CPI	Investment promotion center
CSTA	Customs Superior Technical Council
CTA	Confederation of Mozambican Business Associations
CVA	Customs Valuation Agreement
DBSA	Development Bank of Southern Africa
DDA	Doha Development Agenda
DFID	Department for International Development

DGA	Directorate General for Customs
DINA	National Directorate of Agriculture
DINAP	Department for Livestock
DNC	National Directorate for Trade
DNEP	National Directorate for Roads and Bridges
DNI	National Directorate for Industry
DNPO	Direcção Nacional do Plano e Orçamento (National Planning and Budgeting Directorate)
DRC	Democratic Republic of the Congo
DRI	Directorate for International Relations
DSV	Department of Vegetal Sanitation
DTI	direct trader interface
EAC	Eastern African Community
EBA	Everything But Arms
ECOWAS	Economic Community of West African States
EPA	Economic Partnership Agreement
EPZ	export processing zone
ESA	Eastern and Southern Africa
EU	European Union
EU-ACP	European Union-African Caribbean and Pacific
FAO	Food and Agriculture Organization
FARE	Fundo de Apoio a Reabilitacao Economica (Economic Rehabilitaion Support Fund)
FDI	Foreign Direct Investment
FFPI	Fundo de Fomento a Pequena Industria (Small Industry Support Fund)
FIAS	Foreign Investment Advisory Service
FOB	free on board
FTA	free trade agreement
GAPI	Sociedade de Gestao e Financiamento para a Promocao da Peqena e Media Empresas (Center for Management and Promotion of Small and Medium-Sized Enterprises)
GASP	Gabinete de Apoio ao Sector Privado (Private Sector Support Office)
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GIM	Grupo Inter Ministerial (Inter-Ministry Group)
GoM	Government of Mozambique
GSP	Generalized System of Preferences
GPSCA	Office to Promote the Agricultural Sector

GSTP	Global System of Trade Preferences
HCB	Hidroeléctrica de Cahora Bassa (Hydroelectric for Cahora Bassa)
HCR	Head Count Ratio Index
HIPC	Heavily Indebted Poor Country
HIV/AIDS	human immunodeficiency virus/acquired immunodeficiency syndrome
HS	Harmonized System (of tariff nomenclature)
IAF	household consumption survey
IBRD	International Bank for Reconstruction and Development
ICEIDA	Icelandic International Development Agency
IDA	International Development Agency
IF	Integrated Framework
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFZ	industrial free zone
IIP	Institute for Industrial Property
ILO	International Labor Organization
IMF	International Monetary Fund
INCAJU	National Cashew Institute
INCM	National Institute for Communications in Mozambique
INE	National Statistics Institute
INNOQ	National Institute of Normalization and Quality
IPEX	Export Promotion Agency
IPPC	International Plant Protection Convention
ITC	International Trade Centre
JITAP	Joint Integrated Technical Assistance Program
LDC	least-developed country
MADER	Ministry of Agriculture and Rural Development
MCLI	Maputo Corridor Logistics Initiative
METR	Marginal Effective Tax Rates
MFA	Multi-fiber Arrangement
MFN	most favored nation
MIC	Ministry of Industry and Trade
MISP	Maputo Iron and Steel Plant
MMTZ	Malawi, Mozambique, Tanzania, Zambia (least developed countries of SADC)
MPF	Ministry of Planning and Finance
MT	Metical
NAMA	non-agricultural market access

NSFNS	National Food Security and Nutrition Agency
NGO	non-governmental organization
NORAD	Norwegian Aid Agency
NTB	non-tariff barrier
NTS	National Trade Strategy
NTSC	National Trade Strategy Committee
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
OP	Observatório da Pobreza (Poverty Observatory)
PAF	Performance Assessment Framework (PAF)
PARPA	Plano de Acção para Redução da Pobreza Absoluta (National Action Plan for the Reduction of Absolute Poverty)
PCI	per capita income
PDD	Partido para a Paz, Democracia e Desenvolvimento (Party for Peace, Democracy and Development)
PEC	Trade Policy and Strategy
PES	Economic and Social Plan
PIB-IFZ	Parque Industrial de Beluluane (Beluluane Industrial Park - Industrial Free Zone)
PO	Poverty Observation
PODE	Projecto para o Desenvolvimento Empresarial Program (Business Development Project)
PPP	purchasing power parity
PROAGRI	National Program for Agricultural Development
PRE	Economic Rehabilitation Program
PRSP	Poverty Reduction Strategy Paper
PSI	pre-shipment inspection
RCSA	Regional Center For Southern Africa
ROR	rate of return
SABS	South African Bureau of Standards
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADC-A	SADC Cooperation in Accreditation
SADC-MET	SADC Cooperation in Measurement Traceability
SADC-STAN	SADC Cooperation in Standardization
SDIs	Special Development Initiatives
SEMOC	Mozambique state-owned seeds company
SIDA	Swedish International Development Cooperation Agency
SIMA	Information System for Agricultural Markets

SME	small- and medium-scale enterprises
SOCREMO	Sociedade de Credito de Mozambique (Credit Society for Mozambique)
SOM	Senior Officials Meeting
SPS	sanitary and phytosanitary standards
SQAM	standardization, quality assurance, and measurement
SSA	sub-Saharan Africa
TBT	technical barriers to trade
TCB	trade capacity building
TDM	Telecomunicações de Moçambique (Telecommunication for Mozambique)
TEU	twenty-foot equivalent unit
TFCA	Trans-Frontier Conservation Area
TIA	Trabalho de Inquerito Agricola (Agricultural Investigation Work)
TIPS	Trade and Investment Policy Strategies
TNF	Trade Negotiations Forum
TPR	Trade Policy Review
TPRM	Trade Policy Review Mechanism
TRALAC	Trade Law Center for Southern Africa
TWG	Trade Working Group
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
USITC	United States International Trade Commission
USTR	United States Trade Representative
UTCOM	Technical Unit for Commercial Protocol
UTRA	Technical Unit for Customs Restructuring
VAT	value-added tax
WB	World Bank
WCO	World Customs Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
WTTC	World Travel and Tourism Council
ZAR	South African Rand (Africa Rand)
ZMM-GT	Zambia, Malawi, Mozambique Growth Triangle

Foreword

In October 1997, trade ministers of the World Trade Organization (WTO) established the Integrated Framework (IF) for Trade-related Technical Assistance to least-developed countries (LDCs). The IF is a multi-agency, multi-donor program that coordinates trade-related technical assistance to LDCs by first assisting them in identifying barriers to the expansion of trade and then providing technical assistance to remove those barriers. The six agencies that comprise the IF are the WTO, the International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Program (UNDP), the World Bank, and the International Trade Centre. A number of multilateral and bilateral donors also participate in the program.

The IF was redesigned in 2000 to ensure that trade issues are more fully integrated into the poverty reduction strategies of LDCs. IF collaborators agreed to conduct pilot diagnostic trade integration studies (DTIS) in LDCs seeking assistance and committed to trade reform. The diagnostic studies, which identify constraints on trade integration, are used to develop a national consensus on and action plans to address constraints, including technical assistance needs. The action plan forms the basis for consultations with donors on how technical assistance needs may be met. As of mid-2004, studies of 13 countries have been completed and work has commenced for studies of 6 more countries.

The DTIS for Mozambique will help build national consensus on the importance of trade to the country's development objectives, including sustainable growth that benefits the poor. A significant step in building consensus was the National Validation Workshop, held in Maputo in September 2004, to discuss the conclusions and recommendations presented in this report. The workshop included leaders of Mozambique's public and private sectors, non-governmental organizations, and donor organizations. It focused on the importance of trade to Mozambique's economic growth and poverty reduction strategies, identified and prioritized constraints on export growth, considered the consultants' preliminary recommendations and priorities for overcoming constraints, and discussed more generally the implications for the Mozambican economy and citizenry—especially the poor—of adopting a more pro-trade policy and regulatory environment.

The study team consisted of Bruce Bolnick, Lance Graef, Ashok Menon, Erin Endean, Irene Visser, Leila Calnan, Peter Minor, Leonardo Iacovone, Andrew Lambert, Tyler Biggs, David Harrell, Alice Rigdon, Rene Meeuws, Gerry Marketos, and many other contributors. Erin Endean directed the study. The study team is grateful for the insights provided by Mozambican government officials, economists, and business leaders, as well as the comments and suggestions received from donor and technical assistance agencies participating in the IF process in Mozambique.

Introduction

Despite regional conflict, devastating floods, and fluctuating world prices for key commodities, Mozambique has registered remarkable achievements over the past decade in growth, stabilization, and reform. Yet the country is still one of the poorest in the world, with more than half of its population living in extreme poverty.

To lift its citizens from poverty, Mozambique must continue to grow rapidly over the next decade. These improvements will necessarily depend on export growth, because the internal market is too small and the purchasing power of Mozambican consumers too low to support the required growth rate through domestic demand alone. Furthermore, even in countries with large domestic markets, like China, export activities provide a strong impetus to growth by attracting investment, stimulating innovation, and enhancing efficiency. The challenge, then, is *to develop a strategy that will help Mozambique achieve rapid export growth while ensuring that such growth provides economic opportunities and higher incomes for the poor*.

The position of this study is that international trade must be an integral part of Mozambique's strategy to sustain rapid growth and reduce poverty. The public and private sectors must address the many barriers to trade and investment in a comprehensive and collaborative manner. This process will enable domestic entrepreneurs and foreign investors to take full advantage of opportunities to increase exports and create jobs on a broad base, which is essential for continued poverty reduction. Efforts to improve the climate for doing business in Mozambique will also help domestic firms improve efficiency and compete more effectively against import competition. Addressing these constraints implies a broad but essential agenda, one that can only be accomplished with full endorsement at high political levels, as well as effective intergovernmental coordination, public–private partnership, and targeted donor-funded technical assistance.

For Mozambique, developing export capacity requires improvements in three areas that will have economy-wide effects: (1) in the business-enabling environment, to stimulate domestic and foreign investment in labor-intensive sectors of the economy, (2) in the transportation infrastructure and in border clearance procedures, to reduce the high transaction costs that currently render Mozambican products uncompetitive in global markets,[1] and (3) in Mozambique's trade and investment policies, trade institutions, technical and analytic skill levels, and policy coordination processes, to address impediments to exports in a coordinated and comprehensive fashion.

Although this is an ambitious agenda, resource constraints must be kept squarely in mind in evaluating reform measures and setting priorities. Even with all of the funding available from donors and multilateral financial institutions, Mozambique faces very serious limitations in fiscal resources and administrative capacity for implementing public sector programs. These constraints underscore the importance of streamlining government operations, reducing inessential interventions, and harnessing private sector capital and initiative.

This study presents an assessment of Mozambique's trade integration needs and the relationship of those needs to poverty reduction goals in three volumes. Volume 1 presents a summary with recommendations and an action item matrix. Volume 2, the main report, examines cross-cutting themes and issues and sector-specific trade opportunities and constraints. Volume 3 contains supporting materials: detailed crop subsector analyses, and the results of a trade transport facilitation audit conducted by the World Bank.

The main report begins with a broad overview of the economy in Chapter 1. Chapter 2 profiles the poverty situation in Mozambique, as well as trade and poverty linkages. Chapter 3 describes the regulatory environment, sometimes referred to as the business-enabling environment. Chapter 4 focuses on trade facilitation, especially issues related to Customs, transport, and logistics. Chapter 5 discusses Mozambique's opportunities for increasing access to foreign markets through trading arrangements—multilateral, regional, and preferential. Chapter 6 describes the institutions and processes involved in trade and investment policy, negotiations, and public–private coordination in Mozambique. Chapter 7 examines trade and investment policy *per se*, particularly insofar as current policies may thwart export competitiveness or mar the country's investment environment. Chapter 8 introduces the key elements of a poverty-focused trade strategy in Mozambique. And Chapter 9 discusses mechanisms to implement a national trade strategy that seeks to provide

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[1] The study focuses on international trade because that is the primary objective of the Integrated Framework process. Measures aimed at reducing transactions costs and enhancing efficiency in domestic trade are also vital for successful development. One reason, among many others, is that high domestic trading costs are themselves a major barrier to broad-based expansion of international trade.

greater opportunities to Mozambique's poor, while cushioning disruptive short-term effects of economic liberalization that will provide for improved competitiveness and growth opportunities.

In chapters 10-13 of the main report, we profile opportunities for and challenges to the expansion of Mozambican exports in sectors that are key to the Mozambican economy and to the impoverished in particular: agriculture, fishing, labor-intensive manufacturing, and tourism. Persons interviewed for this report are listed in Appendix A and sources consulted are listed in Appendix B.

Recommendations for capitalizing on Mozambique's inherent strengths, for addressing constraints, and for pursuing opportunities are highlighted in the summary and recommendations section and in the matrix of technical assistance action, and elaborated throughout the report.

Part I. Cross-cutting Themes

1. Overview of the Economy

This trade integration diagnosis opens with a background survey of current conditions in Mozambique.[2] Following a synopsis of the country's political environment, geography, and resources, we focus on macroeconomic performance, covering growth, inflation, the exchange rate, the budget program, and financial markets, and the economic impact of HIV/AIDS. We also review trends in foreign direct investment and structural changes in output, ending with a summary of trade trends, including exports, imports, and the balance of payments.

Political Environment

After Mozambique won independence from Portugal in 1975, the economy declined rapidly in the wake of an exodus of Portuguese settlers and Asian traders and the adoption of central planning. This was followed by a devastating civil war that led to a collapse in production, destruction of infrastructure, a large build-up of foreign debt, and the displacement of more than four million people (out of a population of 12 million in 1980).

Mozambique began to move away from central planning as early as 1984 when it joined the World Bank, the International Monetary Fund (IMF), and the Lomé Convention. In 1987, the government adopted an Economic Rehabilitation Program (PRE)[3] that emphasized market-based economic policies, including privatization, market determination of prices and the exchange rate, and rationalization of public expenditure and fiscal balance. The 1992 peace settlement enabled the government to move ahead with the reform program. Since then, the government has earned a reputation for prudent macroeconomic management and a commitment to the

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[2] The analysis is based on data and information available as of June 2004.
[3] Acronyms for government entities and programs are based on their Portuguese names (e.g., the National Directorate of Trade or Direccao Nacional Comercio is DNC).

alleviation of poverty through market-based economic growth and pro-poor budget policies.

The current constitution was adopted in 1990, and the first multiparty elections were held in 1994. The President and members of Parliament are elected by direct popular vote for 5-year terms. The current president, Joaquim Chissano—who has led the nation since 1986 and through the first 10 years of the democratic era—will step down in 2004. New presidential elections are expected in December 2004.

The ruling party, Frente de Libertação de Moçambique (Frelimo), is favored to win both the presidential and legislative elections in 2004. Armando Guebuza, Frelimo's presidential candidate in 2004, is already exercising considerable authority as he prepares the party for the election. In municipal elections held in November 2003, Frelimo won majorities on 29 of the 34 municipal councils. The main opposition party, Resistência Nacional de Moçambique (Renamo), failed to win in many northern and central towns where it had been favored. This suggests that its support has been weakening since 1999, when its leader, Afonso Dlakhama, came very close to winning the presidency.

Mozambique's most prominent independent politician, Raul Domingos, formed a new political party in October 2003. A former member of Renamo, Mr. Domingos has been leading efforts to create a "third force" in Mozambican politics. The new party, Partido para a Paz, Democracia e Desenvolvimento (PDD), is working to establish a national presence in time to contest the 2004 elections. Some observers anticipate that the PDD will become a credible alternative to the current bi-polar political scene dominated by Renamo and Frelimo.[4]

Because the major parties support similar development strategies, it is unlikely that management of the economy will change materially after the 2004 elections. The main aim of economic policy will be to improve pro-poor social services, maintain macroeconomic stability, and improve the climate for private investment, in order to achieve rapid, broad-based, and sustainable growth. International trade must be an important component of the national development strategy, with emphasis on exploitation of Mozambique's abundant natural resources and low-cost labor. With consistent and credible policies, international support should remain strong.

[4] The Economist Intelligence Unit, *County Economic Report: Mozambique,* January 2004.

Geography and Resources

Mozambique occupies 800,000 square kilometers along the southeast flank of Africa, bordering South Africa, Swaziland, Zambia, Zimbabwe, Malawi, and Tanzania. The country has a coastline of 2,700 kilometers on the Indian Ocean and is well served by major rivers and several deep ports. Mozambique's geography and resources offer vast potential for trade, growth, and poverty reduction, especially in sectors such as agriculture, fishing, tourism, regional transportation, hydro-electricity, natural gas, and minerals. At the same time, Mozambique is highly vulnerable to recurrent droughts, floods, and cyclones.

Land for agricultural development is abundant. Although about 70 percent of the population of 18.4 million lives in rural areas, most of country is lightly populated. Forty percent of the people are located in two of the ten provinces, Nampula and Zambezia. Pressure on natural resources is an issue at some locales along the coast, in urban areas, and along major transport corridors.

A wide range of fertile soils and climatic conditions permit cultivation of a wide variety of crops, from traditional subsistence crops such as maize, cassava, coconuts, and vegetables, to cash crops such as cotton, sugar, cashew nuts, fruits, tobacco, cut flowers, and spices. The central and northern provinces have fertile soils and plentiful rainfall, and large areas of indigenous forest, whereas the southern regions have poorer soil and less dependable rainfall. About 46 percent of Mozambique's land area, or about 36 million hectares, is suitable for agricultural production—but less than 15 percent of arable land is under cultivation, and average yields are very low. The low utilization rate, combined with the ability to produce a variety of crops, suggests great potential for expansion of agricultural output. The timber industry is also a significant source of exports, but with more limited prospects for growth unless investors pursue plantation forestry. Indeed, deforestation presents a serious challenge for sustainable resource management.

The sea provides another major natural resource in the form of fish and prawns. Until the Mozal aluminum project reached full operation in 2001, the fishing industry was Mozambique's leading source of foreign exchange. More than 80 percent of fish exports consist of shallow-water prawns caught on the Sofala Bank. Most of the shrimp are exported to Spain, Japan, and South Africa from foreign industrial vessels that have little relation to the domestic economy. However, small-scale artisanal shrimp fishing is a major source of food and employment. Direct employment in the sector is estimated to be between 75,000 and 80,000, and an estimated 480,000 people are economically dependent on the sector. Unless well managed, this resource is in danger of being overexploited.

Mozambique's tourism resources are virtually untapped. The potential speaks for itself. With 2,700 km of Indian Ocean coastline, abundant marine life, coral reefs, mountains, wetlands, game conservation areas, rich biodiversity, and a fascinating culture, Mozambique has all of the ingredients of a major tourism destination. The main constraints are lack of investment in tourism facilities, including tourism training, and inadequate transportation systems.

The most important trade routes run east-west along the major regional corridors. These corridors provide Mozambique with great opportunities to service trade to and from South Africa, Zimbabwe, Zambia, and Malawi. Efforts underway to improve Mozambique's ports, especially at Maputo, Beira, and Nacala, will position the country to be a major regional trade hub. Transportation from north to south is limited, though important progress has been made in recent years, including completion in 2003 of the first all-weather road between Sofala and Zambezia provinces, via Caia. The government has recently succeeded in obtaining approximately US$90 million in financing to build a bridge over the Zambezi River at Caia, which will complete the north-south link.

Other principal resources include

- ***Hydroelectricity.*** Hidroeléctrica de Cahora Bassa (HCB) is one of the most cost-effective power generation facilities in the region. A new hydroelectric capacity is planned for Cahora Bassa and a new dam for Mepanda Uncua.
- ***Natural Gas.*** The South African energy company, Sasol, heads a joint venture that has invested US$1.2 billion to exploit natural gas fields at Temane and Pande, including construction of a pipeline to South Africa. The venture, which has at least 25 years of gas reserves, went into production in 2004.
- ***Minerals.*** Mozambique has the largest unexploited and economically viable deposit of titaniferous mineral sands in the world. Major deposits at Moma in Nampula province are being developed. A second large titanium project near Chibuto in Gaza province, known as the Limpopo Heavy Sands, is at an advanced stage of planning. The Limpopo deposit is estimated to have reserves as large as 14

billion tons, which could last for more than 50 years.[5] Mozambique also has potential to exploit gems, coal, and other rock minerals.[6]

If well managed, Mozambique's natural resources can be the foundation for diversified export growth, job creation, income generation, and value-added processing. At the same time, resource wealth can make it difficult to develop other sectors, a problem faced by many resource-rich developing countries. The reason is that earnings from resource exports can strengthen the currency value to the point of eroding the competitiveness of other industries.[7] This does not appear to be a serious problem so far in Mozambique because the demand for foreign exchange has risen in tandem with the supply, but it could become a problem as more resource projects are implemented.

Macroeconomic Performance

Since 1987, the nation's adverse path of development has been transformed by a sweeping program of structural adjustment, followed by the adoption of a democratic constitution in 1990, a successful peace agreement in 1992, and multi-party elections in 1994 and 1999. Over the past 10 years, Mozambique achieved one of the highest rates of economic growth in the world as a result of political stability, favorable economic policies, large foreign investment flows, re-integration into regional and global markets, and generous support from the international community. In the process, Mozambique emerged as a model of successful conflict reconciliation, political transition, and strong economic recovery. Even so, the country is still extremely poor: per capita income was under $240 in 2003, and more than half the population—fully 10 million people—cannot afford a minimally adequate level of consumption.

Growth

During the turbulent period after Independence real GDP fell steadily, declining by more than one-third between 1974 and 1986. The tide turned in 1987 with the adoption of the Economic Reform Program. Over the next decade, growth was erratic, but the economy expanded by an average of 5.3 percent per year. This expansion was sparked by resettlement of the displaced population, unfettering of

[5] Ibid.
[6] The Mozal aluminum smelter, however, depends on imported supplies of alumina; its location in Mozambique was determined mainly on the basis of inexpensive power supplies and access to sea transportation.
[7] This is the essence of "Dutch disease."

market forces, and massive donor support for post-war reconstruction. Since macroeconomic stability was achieved in 1996, the growth rate has accelerated to an average of 8 percent per year (see Figure 1-1), despite disastrous floods that cut GDP growth to 2.1 percent in 2000.[8] The following year the economy rebounded, expanding by 13 percent thanks to the recovery in agriculture and large expenditures on post-flood reconstruction, as well as the first full year of production at the US$1.3 billion Mozal aluminum smelting plant outside Maputo. For the past two years, the growth rate has been sustained at more than 7 percent.

Figure 1-1
Real GDP Growth, 1980–2003

SOURCES: 1975-1980 from Sulemane (2002); 1981-2001 from WDI online; 2002-2003 from IMF (2004).

This outstanding record has been supported by high rates of capital investment. Since 1999, private investment has ranged between 25 and 30 percent of GDP and public-sector capital expenditure has been above 10 percent of GDP. A large fraction of private investment has gone into a handful of capital-intensive “mega-projects” such as Mozal. Some critics therefore contend that the rapid growth in GDP reflects

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[8] Floods in the south in February and March of 2000 killed 700, displaced 490,000, and required nearly US$300 million in emergency aid. In 2001, another flood affected the Zambezi valley; emergency aid totaled about US$100 million.

enclave activities that benefit very few people. IMF estimates indicate that the mega-projects account for only one to two percentage points of the annual growth rate. The mega-projects garner the headlines, yet growth has actually been broad-based. Since 1996, the national accounts indicate that agriculture has expanded by 6 percent per year, and services by 7 percent.

According to Government and IMF projections, growth of 7 percent per year or more is likely to continue over the medium term. The main sources of vulnerability are susceptibility to erratic weather conditions and lack of export diversification, which makes the economy less resilient to adverse world market conditions.

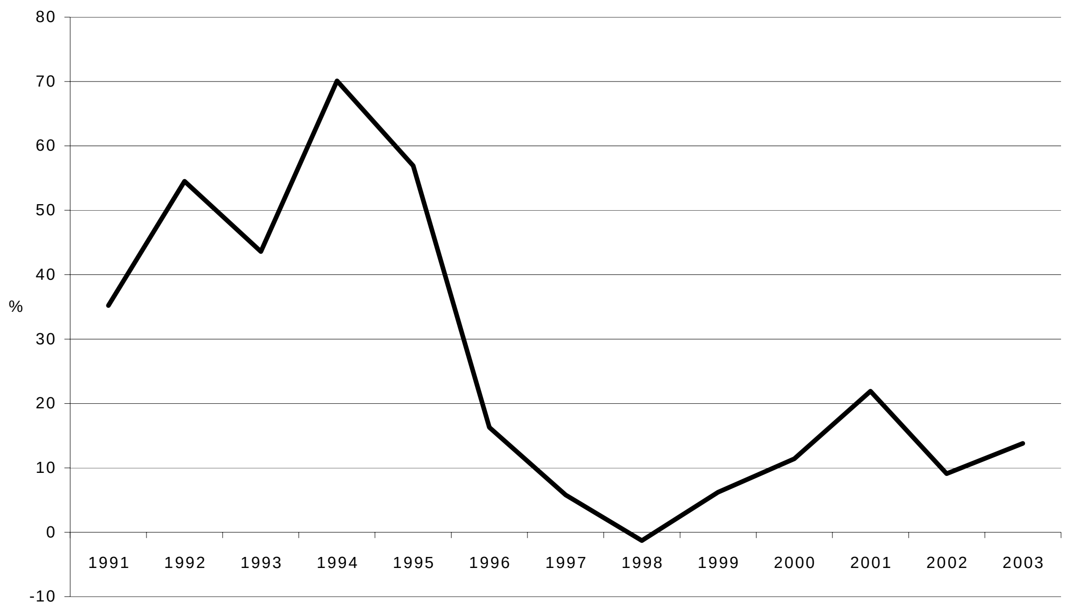
Inflation

Inflation averaged more than 50 percent per year in the early 1990s, but then declined to an average of just 3.5 percent per year from 1997 through 1999 thanks to careful monetary and fiscal management and stabilization of the exchange rate (Figure 1-2). In 2000, inflation rose to 11.4 percent in the wake of devastating floods and rapid monetary growth resulting from an inflow of aid for emergency relief and post-flood reconstruction. The inflation rate accelerated in 2001 to 21.9 percent, largely because of monetary expansion relating to the bail-out of two large banks. As price shocks faded and money growth subsided, inflation returned to single-digit levels by the end of 2002. Inflation then jumped to 13.8 percent in 2003 in the face of regional drought, a steep appreciation of the *rand* (which pushed up the cost of consumer goods in southern regions, particularly in Maputo), and rapid monetary growth. The government expects inflation to return to single-digit levels over the next year, and then remain within the medium-term target range of approximately 5 to 7 percent.

Exchange Rate

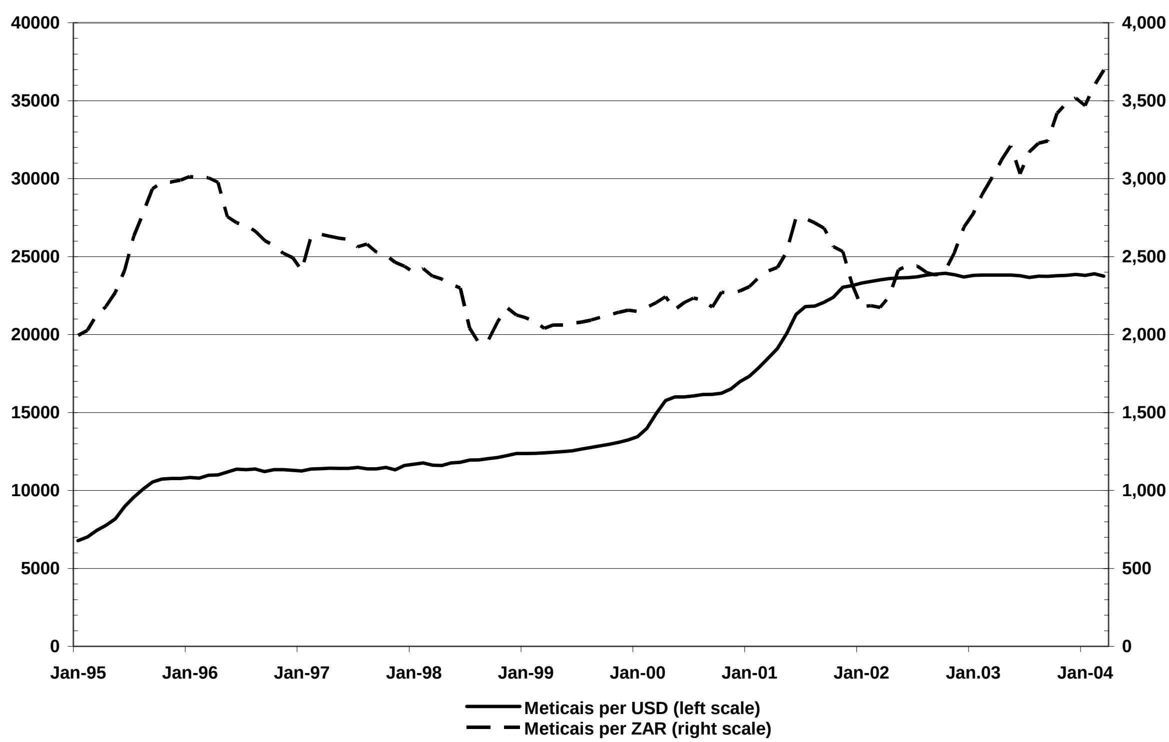
The *metical* was severely overvalued at the beginning of the 1990s. As the market sought an equilibrium in the face of high inflation, the U.S. dollar exchange rate climbed more than tenfold, from MT1000 in 1990 to more than MT11300 per U.S. dollar by mid-1996 (Figure 1-3). Thereafter, the currency stabilized for three years. Beginning in mid-1999 the *metical* again began to depreciate, reaching MT 23,000 per U.S. dollar in late 2001. Since then, the dollar rate has remained broadly stable in nominal terms. Movements in the *rand* rate have been rather different from those of the dollar rate. Starting in mid-2001, the *rand* rate dropped by 20 percent in nine months, and then reversed to rise by 70 percent from 2002 to early 2004, reflecting the *rand's* strength against the dollar.

Figure 1-2
Consumer Price Inflation Rate (December-December), 1991–2003



SOURCE: IMF and Ministry of Planning and Finance data.

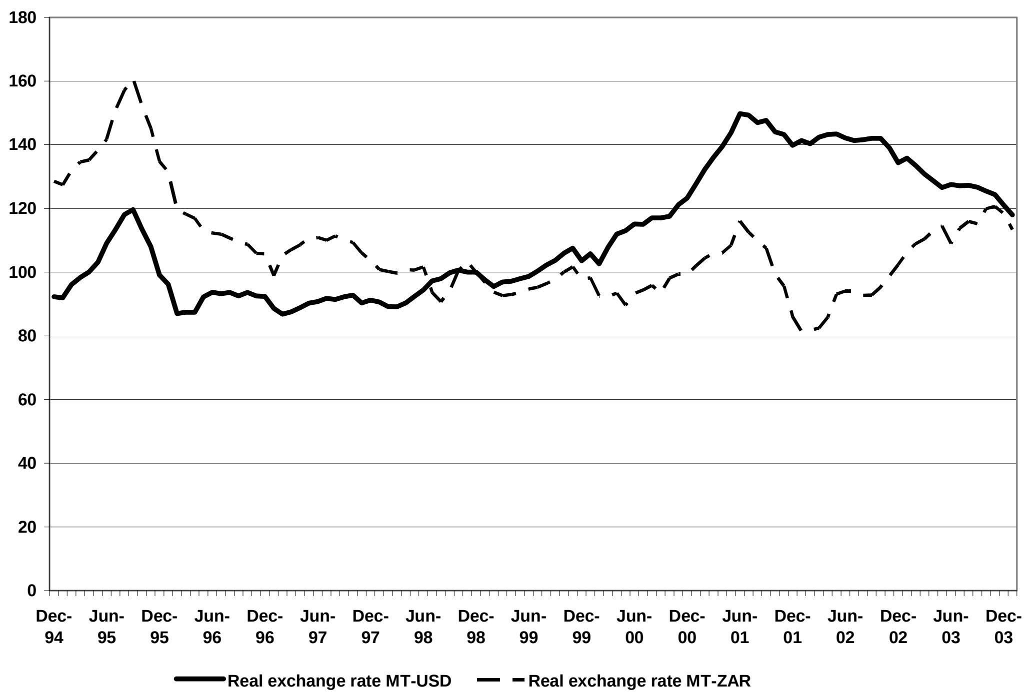
Figure 1-3
Nominal Exchange Rate MT-USD, MT-ZAR, December 1994– January 2004



SOURCES: Banco de Moçambique and study calculations.

To assess how currency movements affect competitiveness it is necessary to examine changes in the *real* exchange rate, which takes into account differences in the inflation rate between trading partners. If prices and costs in Mozambique rise by 10 percent relative to those in South Africa, a stable *rand* rate actually puts Mozambican goods at a price disadvantage, whereas a 10-percent increase in the price of the *rand* leaves cross-border relative prices unchanged (on average). Trends in the dollar and *rand* real exchange rates are shown in Figure 1-4. Against the dollar, the real exchange rate fell (that is, the *metical* appreciated) by 17 percent over the past two years, but against the *rand* the real exchange rate rose by 45 percent (the *metical* depreciated). Thus, since early 2002 Mozambican products have become less competitive against goods that are priced in dollars, but more competitive against goods that are priced in *rand*.

Figure 1-4
Real Exchange Rate MT-USD, MT-ZAR, December 1994– January 2004 (Dec-1998=100; increase signifies real depreciation)



SOURCES: *Banco de Moçambique and study calculations.*

The net effect of currency movements since 1998 is that the *metical* has depreciated 15–20 percent in real terms against both major trading currencies. This is consistent with IMF calculations showing an 18 percent depreciation of the *metical* between 1998 and 2003 in terms of real effective exchange rate (which is based on a trade-weighted basket of currencies adjusted for inflation). In short, exchange rates have been erratic, but the net effect has been to improve the competitive position of Mozambican products vis-à-vis foreign products, both in external and domestic markets. Some of the issues associated with management of the exchange rate are discussed in Exhibit 1-1.

Budget Program

The government's preliminary report on the budget outcome for 2003 shows that domestic revenues were 14.3 percent of (estimated) GDP. As shown in Table 1-1 and Figure 1-5, this figure has risen by three full percentage points over the past five years. The largest revenue gain has come from the introduction of the value added tax (VAT) in 1999, replacing an inefficient and ineffective sales tax. As a result, taxes on goods and services increased to 7.6 percent of GDP, compared to 6.1 percent five years earlier. Income tax revenue also increased by a full percentage point over this timeframe, to 3.1 percent of GDP, following major tax reforms enacted in 2002 and 2003.

Revenue from taxes on international trade has been relatively stable at about 2 percent of GDP for the past five years, despite reductions in the maximum import duty rates. Trade taxes now account for 16.5 percent of domestic revenue. In 1995, the corresponding figure was 26.3 percent. Thus, the government has sharply reduced dependence on trade taxes while boosting overall revenue through a combination of tax policy reforms and improvements in tax administration. More improvement is expected as the government moves to establish a central revenue authority in 2006.

Government expenditure has been far higher than domestic revenue. In 2001 and 2002, expenditures amounted to 34 percent of GDP. This has been reduced to just under 30 percent in 2003. The government projects that expenditure will decline to less than 28 percent of GDP in 2004, and to under 26 within the next three years, in accordance with the medium-term expenditure program. Even at 30 percent of GDP, the government has less than $80 per person to spend each year on everything—schools, health care, road construction, debt service, and every other government program—inclusive of foreign aid. This fiscal resource constraint puts a high premium on careful prioritization, efficient design, and effective administration of all government programs.

Exhibit 1-1
Exchange Rates, Liberalization, Competitiveness, and Foreign Aid

Exchange rates directly affect competitiveness. A real devaluation (i.e., an increase in *metical* price of foreign exchange, adjusting for inflation) acts as an export incentive because it makes local goods less costly in foreign markets, and increases the *metical* value of any given export receipts. A devaluation equally provides support for producers serving the domestic market, because it increases the local cost of competing imports. To be sure, a devaluation also increases the cost of inputs imported by local producers. But inputs account for only a portion of the product price, so local producers still end up with a relative price advantage. As a byproduct, a real devaluation gives local producers an incentive to use domestic supplies instead of imports. On the downside, the devaluation leads to higher prices for tradable goods (exportables and importables) , and increases the local currency cost of servicing foreign debt.

Domestic producers lose the advantage of a nominal devaluation if prices and costs rise rapidly. Thus, the real exchange rate—which takes into account inflation differentials among trading partners—is a better gauge of how currency movements affect the competitiveness of local industry.

Many governments have used devaluation to cushion local producers from the effects of trade liberalization, by increasing the cost of competing imports. To some extent, devaluation may occur naturally as trade liberalization boosts the demand for imports and increases the demand for foreign exchange, thereby reducing the value of the local currency.

Mozambique does not have much scope to use devaluation as a tool for supporting local industry, because the *metical* does not appear to be overvalued. Indeed, the real effective exchange rate has depreciated nearly 20 percent over the past 5 years. This suggests that large inflows of foreign aid and rapidly rising exports are not interfering with the maintenance of a competitive real exchange rate.[9] The rising supply of foreign exchange has evidently been matched by a corresponding rise in demand, allowing Mozambique to avoid the "Dutch disease" that can plague recipients of large amounts of aid. (Dutch disease refers to the adverse effect on development incentives caused by currency appreciation linked to a large increase in foreign exchange from resource exports or donor inflows.)

Nevertheless, exchange rate is a prime concern for trade policy. The exchange rate has wide repercussions on investment and production, so misalignments can significantly effect resource allocation. In particular, an overvalued currency would undermine Mozambique's advantage in low-cost labor, making it much more difficult to develop the labor-intensive industries that are needed for rapid job creation.

The Bank of Mozambique has a key role to play in analyzing structural determinants and dynamics of the exchange rate, as well as managing foreign exchange reserves to maintain a competitive exchange rate and provide a cushion against unexpected external shocks, consistent with overall monetary targets.

[9] In 2003, external aid represented nearly 20 percent of GDP, over half of total government spending, and 70 percent of public investment. External aid in 2003 was approximately US$48 per capita (Ministry of Planning and Finance budget data).

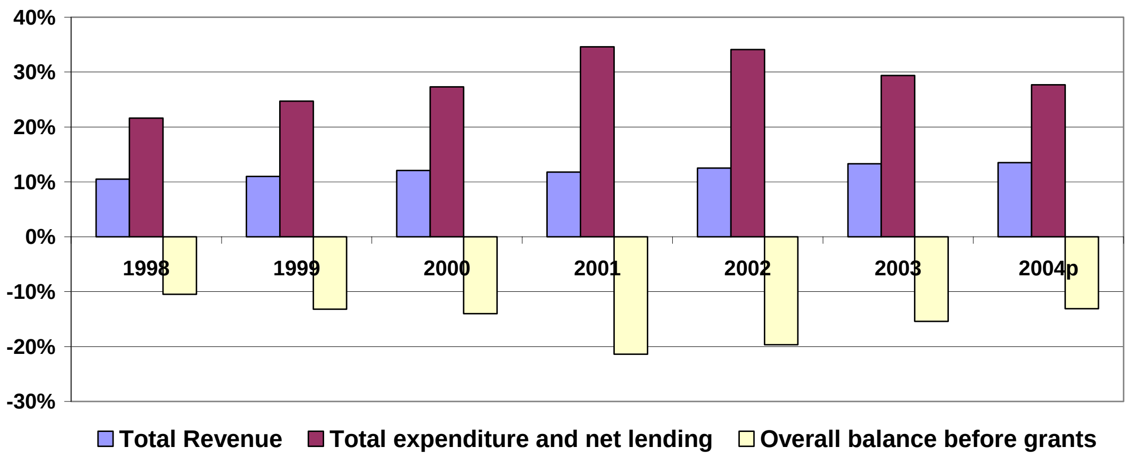
Table 1-1

Mozambique: Government Finance, 1995-2004 (% of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004p
Total Revenue	11.7	10.6	11.4	11.3	12.0	13.2	13.3	14.2	14.3	14.6
Tax revenue	10.6	9.8	10.4	10.5	11.0	12.1	11.8	12.5	13.3	13.5
Taxes on income and profit	1.9	1.9	2.2	2.1	1.7	1.8	2.1	2.5	3.1	3.3
Taxes on goods and services	5.6	5.3	5.9	6.1	7.0	7.6	7.3	7.5	7.6	7.8
Taxes on international trade	2.8	2.1	2.0	2.0	2.0	2.2	2.1	2.2	2.2	2.1
Other taxes	0.3	0.4	0.4	0.3	0.4	0.4	0.3	0.3	0.4	0.4
Nontax revenue	1.0	0.9	1.0	0.8	0.9	1.2	1.5	1.7	1.1	1.0
Total expenditure and net lending			23.4	21.6	24.7	27.3	34.6	34.1	29.4	27.7
Current expenditure	10.6	9.4	10.5	11.2	12.2	13.7	14.6	15.8	15.9	15.6
Of which:										
Compensation to employees	2.4	2.2	3.6	4.5	5.8	6.7	7.0	7.3	7.5	7.3
Goods and services	3.0	2.4	3.3	3.3	3.2	3.6	3.4	3.3	3.9	4.0
Interest on public debt	1.7	1.4	1.3	1.0	0.6	0.2	0.7	1.5	1.3	1.2
Domestic			0.1	0.0	0.0	0.0	0.5	1.1	1.0	0.9
External			1.2	0.9	0.6	0.2	0.2	0.4	0.3	0.3
Current balance	1.1	1.2	0.9	0.1	-0.2	-0.3	-1.2	-1.7	-1.6	-1.0
Capital expenditure	13.8	11.3	11.9	9.8	11.6	10.6	16.6	14.3	13.0	12.0
Of which:										
External project grants	6.7	4.1	3.9	4.5	5.2	4.4	8.5	7.3	na	na
External project loans	4.1	5.2	3.5	3.6	2.5	4.2	3.0	3.1	na	na
Overall balance before grants	-13.3	-10.1	-11.7	-10.5	-13.2	-14.0	-21.4	-19.7	-15.4	-13.1
Grants received	10.1	7.0	9.1	8.1	11.7	8.0	14.8	11.8	10.6	9.4
Overall balance after grants	-3.2	-3.1	-2.5	-2.4	-1.5	-6.0	-6.6	-7.9	-4.9	-3.8
External borrowing (net)	3.9	4.2	5.7	4.6	1.8	3.5	3.9	6.3	4.6	3.8
Disbursements	5.3	5.3	6.8	5.7	2.7	4.0	4.4	6.9	5.2	4.5
Cash amortization	-1.4	-1.1	1.0	-1.1	-0.9	-0.5	-0.4	-0.6	-0.6	-0.7
Domestic financing (net)	-0.8	-1.1	-3.2	-2.3	-0.3	1.7	1.9	0.9	0.1	-0.3

SOURCES: IMF, MPF and study calculations.(P=projected)

Figure 1-5
Revenue, Expenditure, Budget Balance as a percent of GDP (1998-2004)



SOURCES: IMF, MPF, and study calculations.

Over the past five years, current expenditures increased from 11.2 to 15.9 percent of GDP. Better revenue mobilization has financed part of the increase, but the government's current balance (excluding grants) deteriorated from a surplus of 1 percent of GDP during the stabilization period in the mid-1990s to a deficit of 1.6 percent of GDP in 2003. The main source of the budget deficit, however, is capital expenditure, which amounted to 13 percent of GDP in 2003.

In programmatic terms, approximately 66 percent of total expenditure is allocated to sectors designated as priorities for the poverty reduction strategy (see the discussion of poverty in Chapter 2.) These sectors are education, health, basic infrastructure, agriculture and rural development, and governance (including domestic security and the legal/judicial system).

Although the budget deficit (before grants) was extremely high in 2003, at 15.4 percent of GDP, this is an improvement over the previous two years when it reached 20 percent of GDP. Even so, it is much higher than the deficits incurred in the late 1990s, which averaged 10–13 percent of GDP.

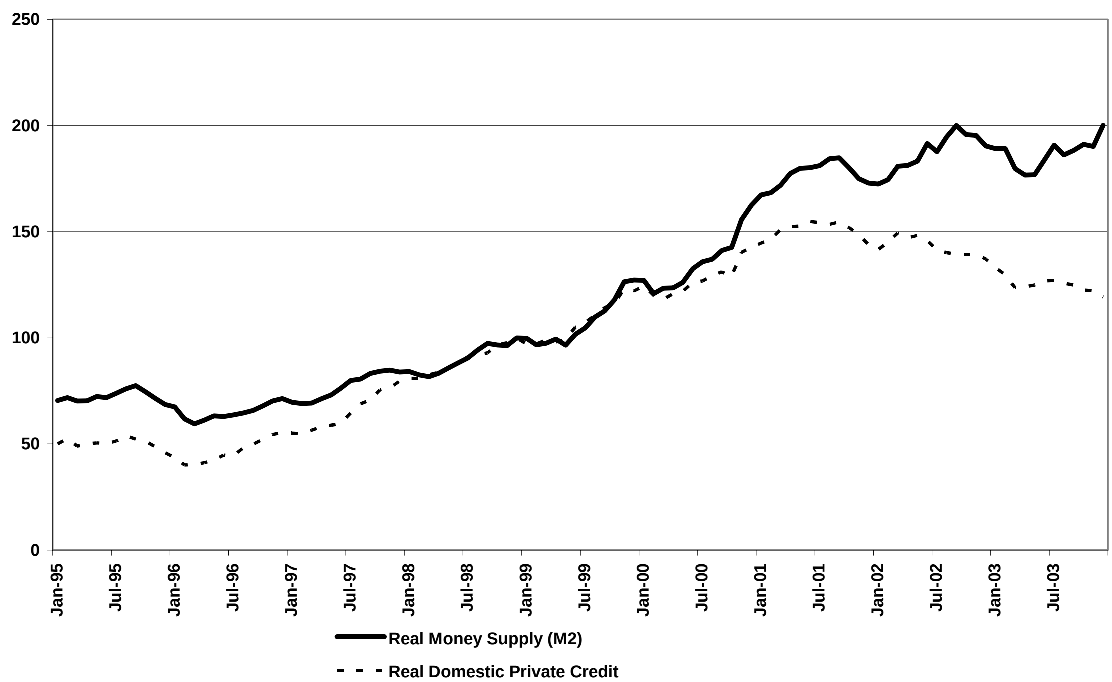
Most of the budget deficit is funded by donor grants, which totaled 10.6 percent of GDP in 2003. After taking grants into account, the deficit was 4.9 percent of GDP, which was covered almost entirely by net foreign financing. Net domestic borrowing was negligible, following three years in which the government had to issue bonds totaling 4.4 percent of GDP to finance the restructuring of two large commercial banks.

Given the large net inflow of donor support, the budget program is adequately financed without creating large macroeconomic imbalances. The IMF projects that aid flows will be stable over the medium term at about US$660 million per year. This dependence on donor funding is a major risk factor, yet it is also an important restraint mechanism that helps to keep the macroeconomic program on track.

Financial System

After the government ended the inflationary spiral in the mid-1990s, and relaxed interest rate controls, the monetary system expanded rapidly. From 1996 to 2003 the supply of broad money climbed from 16.3 percent of GDP to 26.9 percent (Figure 1-6). This trend reflects increased monetization of transactions and general confidence in management of the economy. Over the same period, real credit to the private sector doubled, but from a small base.

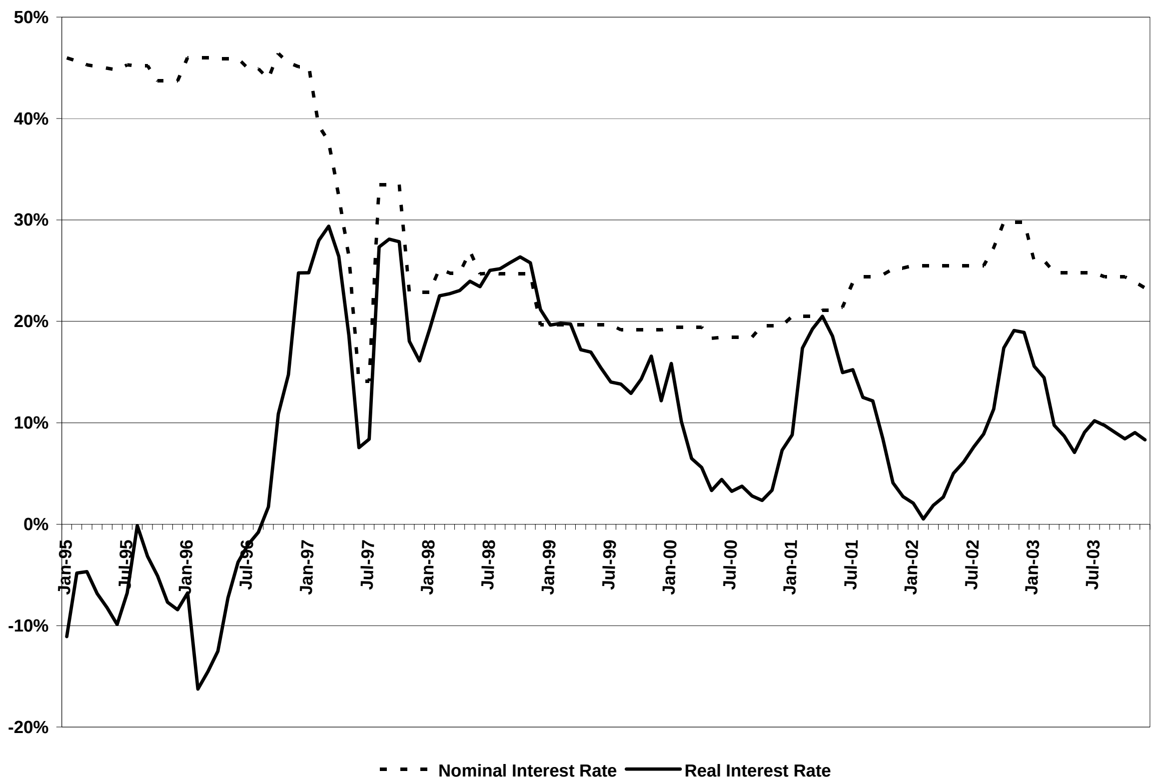
Figure 1-6
Real Money Supply (M2) and Real Domestic Private Credit (January 1995-December 2003, Dec 1998=100)



SOURCE: *Banco de Moçambique.*

Despite this expansion, the private sector is still greatly constrained by lack of access to financing. In 2003, the banking system held deposits amounting to 23 percent of GDP, but lending to the private sector amounted to just 8 percent of GDP. Indeed, credit to the private sector has declined in real terms by 25 percent since the two largest banks failed in 2001. In addition, real interest rates are high for those who do qualify for loans (Figure 1-7). In 2003, the prime lending rate averaged more than 24 percent. With inflation averaging nearly 14 percent, the real interest rate for prime borrowers was about 10 percent. Also, the spread between lending rates and deposit rates is extremely high. In 2003, the average loan rate was 16-17 percentage points higher than the average deposit rate.

Figure 1-7
Mozambique Nominal and Real Prime Lending Rates (January 1995-December 2003)



SOURCES: Banco de Moçambique and study calculations.

These indicators are signs of high overhead costs, high lending risks, and lack of effective competition in the banking sector. Since the near collapse of the two largest banks in 2001, the banks have been recapitalized and restructured. Yet the banking system is still burdened by a large volume of non-performing loans. This problem is due to poor lending practices in the past.[10] But the problem is also rooted in

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[10] The IMF's *Financial System Stability Assessment* (November 2003) states that non-performing loans accounted for 22 percent of all loans—and the rules for classifying loans as non-performing are, if anything, too lax.

fundamental weaknesses in the supporting institutional structure, including the absence of tradable title to land to serve as security, and problems with laws and systems for enforcing contracts and foreclosing on collateral (see Chapter 3). As long as banks lack effective recourse for recovering loans, access to credit will be a serious problem for private sector development and expansion of trade.

More broadly, the financial system has been transformed over the past ten years from a virtual state monopoly with centralized controls, to a market-based and largely privately owned system, with extensive foreign control. Nonetheless, the banking system is still highly concentrated. As a result, the vast majority of Mozambicans have no access to banking services. In 2003, there were only 95 bank offices outside of Maputo province (which alone had 112 offices). All of the offices are located in the main towns. Non-bank financial institutions are poorly developed, and even supplier credits are not commonly available. Thus, most Mozambicans have to depend on internal funds or traditional informal financial transactions.

Debt

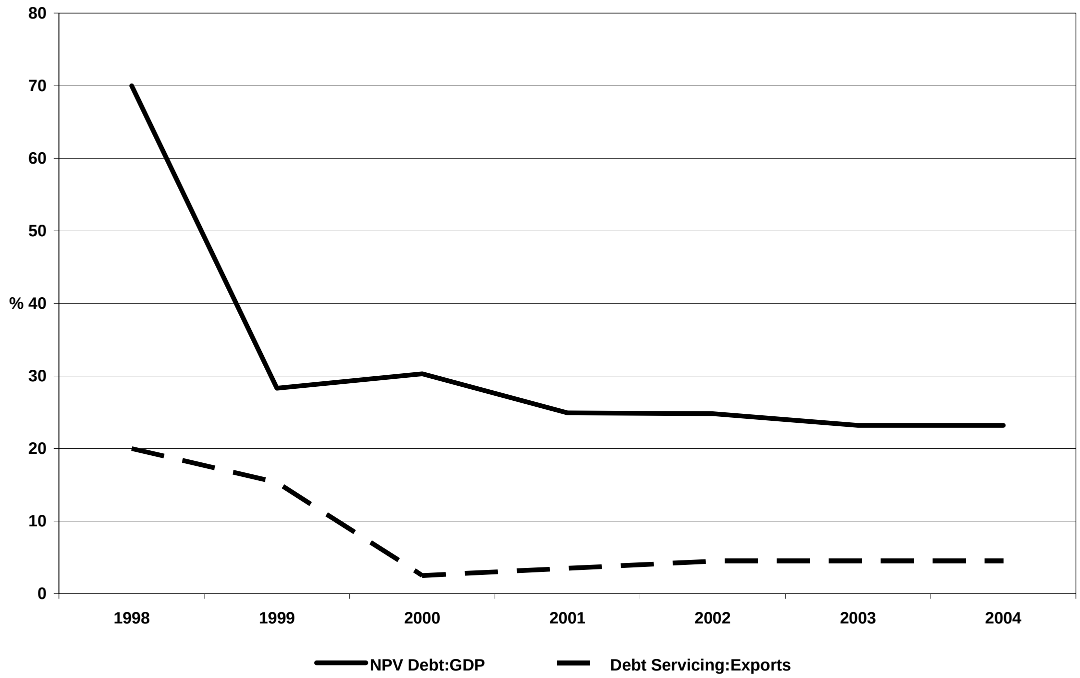
Ten years ago Mozambique faced the heaviest debt burden in Africa. In 1995, the country's external public debt exceeded US$7 billion (including more than US$5 billion of arrears), which was more than three times GDP. Scheduled debt service payments totaled 74 percent of annual export earnings.[11] Mozambique then became a leading beneficiary of debt relief under the Heavily Indebted Poor Country (HIPC) initiative. By the end of 2001, the HIPC process eliminated US$4.3 billion worth of debt obligations. As illustrated in Figure 1-8, in 2003, the external debt declined to 52 percent of GDP. Measured in terms of the present value of payment obligations (rather than the nominal face value), the external debt amounted to just 23 percent of GDP. At the same time, debt service payments fell to a very manageable 4.5 percent of export earnings, and 1.7 percent of GDP—less than one-tenth the amount of foreign aid inflows.

HIV/AIDS AND ECONOMIC PERFORMANCE

HIV/AIDS is not just a health problem; it is also a serious economic development problem, with potentially major implications for macroeconomic performance, poverty dynamics, the budget program, the delivery of public services,

[11] Actual debt service payments were 31 percent of export earnings. The difference represented an addition to the country's arrears.

Figure 1-8
Net Present Value of Debt to GDP vs. Debt Servicing to Exports, 1995-2004



SOURCES: *IMF reports 2001, 2002, 2004, and study calculations.*

and the well-being of millions of Mozambicans. Latest estimates from the Ministry of Health indicate that the HIV prevalence rate has risen to 14.9 percent among adults age 15-49. Fully 1.4 million people are now living with the virus. As a result, life expectancy has declined to 38 years. [12]

Because of the virus's long latency period AIDS-related sickness and death are not yet widespread and the pandemic *so far* has had little aggregate effect on the economy. But in the medium term, according to a major simulation study by the World Bank, the disease is likely to reduce annual GDP growth by nearly 2 percentage points per year, implying a reduction of about 0.7 percentage points per year in per capita income growth. [13] The adverse growth impact arises through four channels: slower growth of the labor force through morbidity and mortality; lower productivity growth and higher costs of doing business; a reduction in human capital investment; and lower rates of saving and investment.

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[12] These estimates are based on the 2002 sentinel survey site data, projected to 2004. See Ministry of Health, *et al.* (2004).
[13] Arndt, 2001. The impact on per capita income is less than the impact on GDP because the disease causes slower population growth, as well as slower economic growth.

HIV/AIDS then affects poverty in three ways.[14] First, slower growth weakens the most powerful engine for sustainable poverty reduction: rising national income. For example, estimates using the model used for poverty projections in the Poverty Reduction Strategy Paper for Mozambique (2001) show that a one percentage point decline in per capita income growth leads to an increase of 5 percentage points in the poverty head count over the period 2001 to 2010.[15] This translates into an extra 1.1 million people living in conditions of absolute poverty, compared to what would prevail in the absence of effective treatment and prevention. Even this figure understates the negative effect, because the economic projection models do not measure the suffering of victims and their families, or the travails of AIDS orphans.

Second, at the individual level, the poor are far more vulnerable to the disease than the rich. They also have far fewer mechanisms for coping with the AIDS-related loss of income and the added burden of first caring for and then burying the victims. For families living in or near poverty, the onset of AIDS and associated illness in even one parent can be tragic. The sequence of adjustments often includes reducing household saving, pulling children out of school or sending them to live with relatives, cutting back on the consumption of necessities (including health services for other family members), selling family assets, and, ultimately, incurring debt. Where the virus is widespread, traditional social networks cannot cope with the consequences.

Third, intensified poverty heightens the risk of further transmission of the disease as a result of malnutrition, lack of education, inability to afford condoms, and economic pressure on women to turn to transactional sex to augment family income.

The good news is that Mozambique has embarked on a widespread prevention campaign, and recently started an anti-retroviral treatment program in several locations. In addition, intensified economic reforms can mitigate the economic impact of HIV/AIDS by fostering stronger performance in education achievement, productivity growth, and capital investment. In the long term, effective efforts to halt the spread of the disease will have huge benefits for the economy. The bad news is that the adverse effects could be much worse than indicated here if additional effective measures are not vigorously pursued.

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[14] This passage is based on Nathan Associates, 2004.
[15] Bolnick, 2003. These projections are based on 1996-1997 household survey data.

Foreign Direct Investment and Strategic Investment Projects

Since 1987, the government has worked to create an attractive climate for domestic and foreign investors through economic reforms and privatization. With a few exceptions, such as fishing, 100 percent foreign ownership is permitted, including commercial banking. In 1993, a new Investment Act was passed, and in 1997 the Investment Promotion Center (CPI) was restructured to serve as a primary agent for promoting and facilitating investment in Mozambique. In 1999, Mozambique adopted legislation providing for the establishment and operation of industrial free zones, the local term for export processing zones (EPZs). The fiscal benefits associated with EPZ status were revised in 2002 as part of the overall income tax reform program.[16] Fiscal benefits were restructured for approved investments in general, with special provisions for agriculture, hotels and tourism, large-scale projects, regional Rapid Development Zones,[17] and mining and petroleum investments. These considerations are discussed in more detail in Chapter 12. To promote investment in the manufacturing sector, the government introduced additional legislation in 2003 permitting qualifying firms in particular sectors (garments, chemicals, engineering, food and printing) to import inputs duty free.

The combination of political stability, macroeconomic stability, economic reform, trade integration, and investment promotion has attracted large flows of investment, including important mega-projects. As shown in Figure 1-9, foreign direct investment (FDI) amounted to US$64 million in 1997. The following year construction began on a US$1.3 billion Mozal aluminum smelter, with investment from Australia, Japan, South Africa, the United Kingdom, and the Government of Mozambique. Foreign investment was also the key to construction of the Maputo-Witbank toll-road, which transformed the road transport link between Mozambique and South Africa. These two investments catapulted FDI inflows to US$213 million in 1998 and US$382 million in 1999, placing Mozambique sixth among FDI recipients in Africa, just behind Angola, Egypt, Nigeria, South Africa, and Morocco—countries whose oil and diamonds served as a magnet for foreign investment. While FDI inflows declined to US$139 million in 2000, they rebounded to $255 million in 2001 and US$380 million in 2002, on the strength of an additional investment for the expansion of Mozal, and the development of natural gas fields and a pipeline to South Africa by SASOL.

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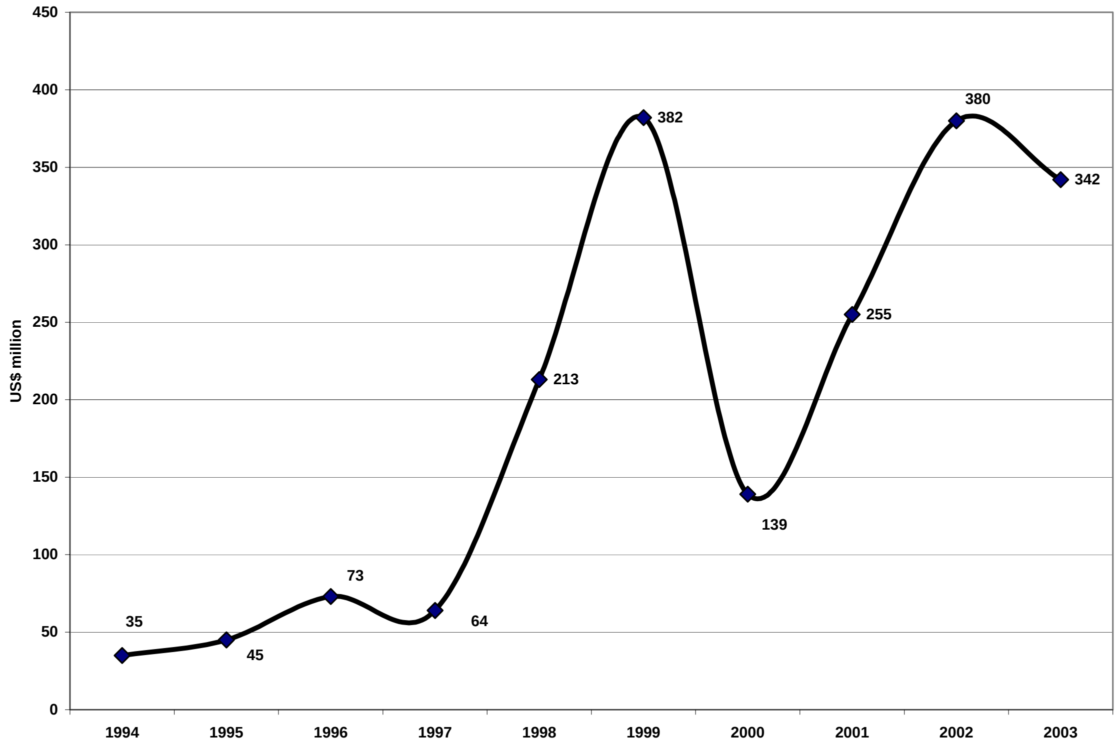
[16] Council of Ministers, Decree 16/2002, 27 June.

[17] This term includes the Zambezi Valley, Niassa Province, Nacala District, Mozambique Island, and Ibo Island.

Figure 1-9
Foreign Direct Investment in Mozambique, 1994-2003



SOURCE: IMF.

The stock of FDI capital in Mozambique has risen dramatically over the past 3 years, from 29.1 percent of GDP in 2000, to 37.4 percent in 2001, and 44.8 percent in 2002. [18] That large investments have come in despite major impediments to doing business in Mozambique suggests that foreign investment could be an even more dynamic force for development if problems with the investment climate were addressed more effectively. See Chapter 7.

By tapping Mozambique's natural resources,[19] a handful of mega-projects are contributing to a very rapid rise in exports and forging stronger links to the global market. They are also bringing technology, management expertise, and workforce training to the country, while showcasing Mozambique to other potential foreign investors. In some cases, including that of Mozal, large foreign investments also stimulate improvements in the infrastructure, which can benefit other sectors.

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[18] This information is based on UNCTAD's *World Investment Report*, 2003.

[19] The location of several energy-intensive mega-projects—Mozal and Corridor Sands—was influenced by the availability of low-cost power in Mozambique. Mozal also benefited from the European Union's treatment of Mozambique under the Lomé convention, which permits primary aluminum produced in Mozambique to be imported duty-free into the EU.

Still, these large projects are very capital-intensive. Apart from serving as a showcase that may help to attract more labor-intensive investments, the large projects create few jobs and contribute little to absorption of the growing labor force or to poverty reduction. For example, a careful study of large projects underway or planned in 2000 found that they would ultimately create only 5,000 direct jobs and perhaps 15,000 indirect jobs in supporting industries, with each direct job "costing" well over US$1 million in investment.[20]

The large projects are essentially enclave activities with few linkages to the rest of the economy. One donor program (MozLink) is devoted to promoting linkages between the Mozal aluminum smelter and local small businesses. As of early 2004, the project website reports that "To date 12 companies have won 21 contracts valued at $3 million."[21] A parallel Enterprise Development Project (PoDE), with funding from the World Bank, is providing matching grants and technical support to help Mozambican-owned firms establish linkages as suppliers to joint-venture and foreign-owned companies, including the mega-projects. As of mid-2004 the linkage promotion office has helped local entrepreneurs obtain a cumulative $30 million in contracts, while enhancing standards of quality and timeliness.[22] Nearly two-thirds of the contracts—nearly $20 million—involved the construction phase of the foreign investment projects.

Furthermore, factor returns from the mega-projects are skewed toward profits accruing to the foreign investors and to debt service, instead of wages or other local incomes. Hence, their contribution to GDP—which measures domestic production—is much larger than their contribution to Gross National Income—which measures economic benefits earned by Mozambicans. The greatest contribution of the mega-projects to national income and poverty reduction should be in the form of revenues for the government. In this way, the mega-projects can help expand the fiscal resource envelope for financing essential public goods and services. For investments tied to the exploitation of natural resource capital—especially non-renewable resources such as natural gas, titanium sands, and coal—the government should be seeking to maximize domestic revenue, rather than granting generous tax breaks for projects that are location-bound and fundamentally viable.[23]

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[20] Per-Ake Andersson. The Impact of the Mega Projects on the Mozambican Economy. Gabinete de Estudos Discussion Paper No. 18.

[21] See: www2.ifc.org/sme/html/sme_linkages1.html.

[22] Source: Memorandum prepared by the PoDE project for the DTIS. Just over half of the total represented contracts with mega-projects.

[23] See Nathan Associates, The Effectiveness and Impact of Tax Incentives in the SADC Region (2004).

Table 1-2 provides a selective list of strategic investments that have registered with the Investment Promotion Agency (CPI) as of May, 2004. Other major projects at various stages of planning include development of the Moatize coal fields in Tete province, construction of the Zambezi River bridge at Caia, a major expansion of hydroelectric generating capacity at Cahorra Bassa, and construction of a new dam. on the Zambezi at Mepanda Mecua.

Table 1-2
Selected Strategic Projects Registered with the Investment Promotion Agency

Name	Investor	Location	Activity	Investment Value (US$)
Moma Heavy Sands	Kenmare Resources PLC (Ireland)	Moma, Nampula	Mining	100 million
Limpopo Heavy Sands	Corridor Sands (SA), Yangara (SA), WMC (Australia)	Chibuto, Gaza	Mining	1.2 billion
Rehabilitation of Sena Railway Line	Rites & Ircon International Ltd (India) & CFM	Sofala-Tete	Sena railway line rehabilitation	315 million
Texlom	Aga Khan Fund & GoM	Matola, Maputo	Textile and clothing manufacturing for export	8.0 million
Texteis do Pungue	Palmar Group (Mauritiues)	Beira, Sofala	Textile and clothing manufacturing for export	3.0 million
Mozambique Leaf Tobacco	Universal Leaf Company of the United States (USA)	Tete	Tobacco processing for export	53.0 million

SOURCE: CPI, 2004.

Structural Changes in Output

Table 1-3 shows how the structure of the Mozambican economy has been changing since 1996. The statistics indicate the growing importance of the industrial sector, which now accounts for 32 percent of GDP, compared to 16 percent in 1996. This includes mining, manufacturing, electricity and water, and construction. Correspondingly, the share of agriculture in GDP declined from 30 percent to 22 percent, and the service sector went from 50 percent to 43 percent. These data include value added from implementation of large enclave projects. The structural shifts are much smaller if one focuses on output shares *excluding* the mega-projects. Figures compiled by the Ministry of Planning and Finance indicate that these projects added 9 percent to GDP in 2003. Excluding this component, agriculture's share of GDP would be 24.4 percent, whereas industry and services would have shares of 26.5 percent and 47.1 percent, respectively. The share of GDP from manufacturing would be 10.3 percent, up slightly from 8.7 percent in 1996.[24] As shown in Figure 1-10, nearly every major sector sustained growth rates of at least 5 percent per year over this period.

Table 1-3
Structure of the Mozambican Economy: Composition of Gross Domestic Product, 1995-2003 (Percentages of GDP, at current prices)

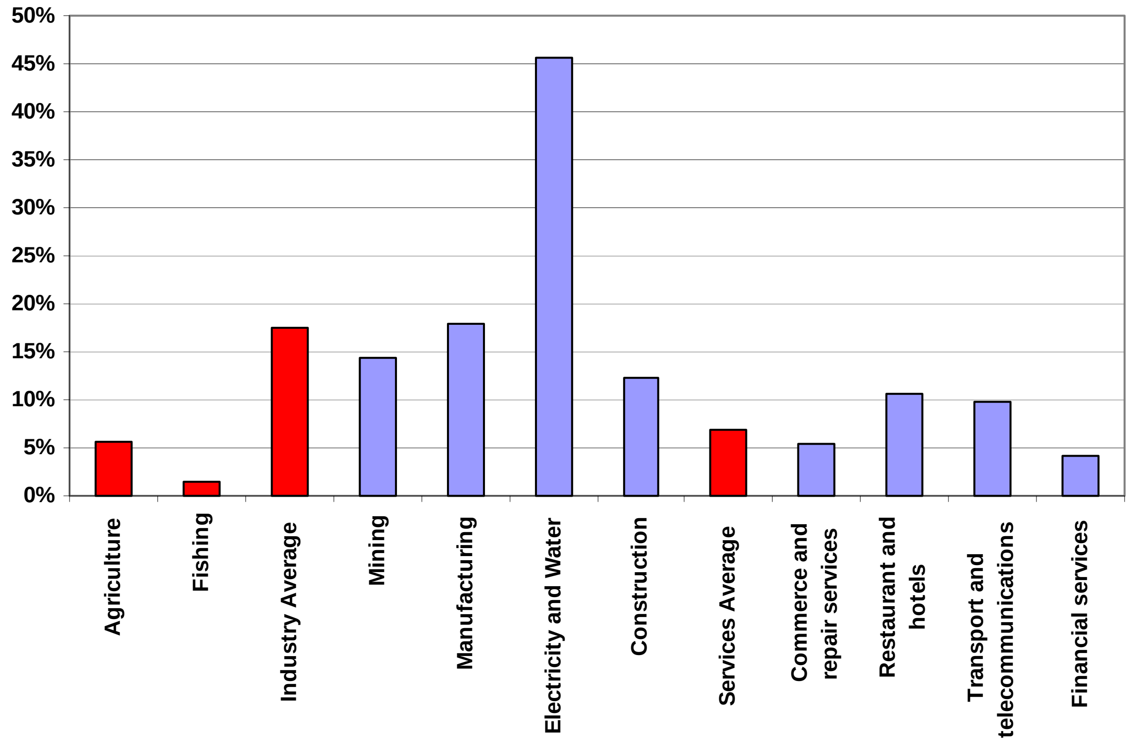
Sector	1995	1996	1997	1998	1999	2000	2001	2002e	2003p
Agriculture	29.0	30.5	30.2	27.2	25.5	21.7	21.9	19.5	22.4
Fishing	4.8	4.0	3.9	3.0	2.5	2.4	2.3	1.6	2.0
Industry	14.1	16.0	17.4	21.5	22.2	23.9	24.9	30.6	32.4
Mining	0.3	0.2	0.3	0.3	0.1	0.4	0.4	0.3	1.3
Manufacturing	7.4	8.7	9.6	10.9	11.5	12.0	13.8	11.4	16.2
Electricity and water	0.3	0.5	0.8	2.0	2.8	2.2	2.1	3.1	1.6
Construction	6.2	6.6	6.7	8.3	7.7	9.3	8.7	15.9	13.4
Services	52.1	49.5	48.5	48.3	49.8	52.0	50.9	48.2	43.2
Commerce and repair services	22.8	23.8	23.2	22.3	22.0	21.7	21.0	18.6	18.3
Restaurant and hotels	0.7	0.8	1.2	1.1	1.2	1.4	1.3	1.0	1.1
Transport and telecommunications	8.9	8.6	8.9	9.2	9.5	9.3	9.6	11.1	8.7
Financial services	5.1	3.7	3.2	2.7	2.0	3.9	3.9	3.5	3.5
Real estate rentals and corporate services	4.8	3.9	3.7	3.6	3.1	2.7	2.4	1.5	1.9
Government services and defense	5.5	4.4	4.5	5.1	6.9	7.4	7.7	6.3	5.4
Others services	4.3	4.1	3.7	4.3	5.1	5.5	4.9	6.2	4.4
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: e=estimated; p=projected.

SOURCES: 1995-2002 from IMF; 2003-2004 from DNPO; and study calculations..

[24] Even though these figures strip out the direct value added from mega-project operations, no adjustment has been made for their impact on the construction sector, which rose from 6.6 to 14.6 percent of GDP over the period. It is not possible to determine from the available data how much of this increase is due to donor rather than mega-projects. It is clear that other sectors' shares would be a bit higher if value added in the construction sector relating to the mega-projects were excluded.

Figure 1-10
Average Annual Sectoral Growth, 1996-2003



SOURCES: 1995-2002 from IMF; 2003-2004 from World Bank.

Even though the *relative* share of agriculture has declined, the sector has been growing strongly. Value added in agriculture grew at an average annual rate of 5.7 percent between 1996 and 2003—despite an 11 percent drop in 2000 due to severe floods. Most of this growth is derived from small family farms, which still account for 99 percent of all farm units, 90 percent of total output, and 75 percent of commercial production.[25]

Trade Trends

EXPORTS

Over the past five years, gross export earnings have more than tripled in dollar value, to an estimated US$880 million in 2003. They are expected to rise by half again

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[25] INE, Censo Agro-Pecuario 1999-2000 (2001), and MPF, Balanco do PES 2004.

over the next two years (Table 1-4).[26] Export earnings have climbed from 6 percent of GDP in 1998 to 20 percent in 2003.[27] But virtually the entire gain is attributable to three large capital-intensive projects: the restoration of electricity exports from Cahora Bassa; the Mozal aluminum smelter; and the SASOL natural gas pipeline. In 2003, mega-project exports amounted to 15 percent of GDP. Other exports—which are far more labor-intensive and have a much stronger linkage effect—grew by just 0.5 percent per year between 1998 and 2002 (in U.S. dollar terms).[28]

An examination of the composition of key exports since 1999 (Table 1-5) reveals an enormous increase in gross earnings on aluminum production from Mozal. Specifically, aluminum exports rose from zero in 1999 to US$361 million in 2001, exceeding the total value of all other exports. As noted in the next section, net earnings are much smaller because of the smelter's dependence on imported raw material. Electricity exports from Cahora Bassa also grew rapidly, rising by more than US$30 million in three years. The only other major export expansion over this timeframe was in the sugar sector, reflecting new investment to rehabilitate the industry, along with the availability of limited quota access into the EU and U.S. markets.[29] Wood exports also experienced a substantial increase, from a low base.

Other major export products experienced declines or erratic patterns between 1999 and 2002. For prawns—the single largest export item at the start of this period—earnings rose in 2000, but then fell back to the starting point of US$64 million in 2002. Cashew exports and oilseed exports both fell sharply, while earnings from cotton were flat in the face of adverse world price conditions. Notable by its absence is any increase in labor-intensive manufactured products such as clothing and footwear. This reinforces the observation that trade liberalization[30] has not produced jobs in the manufacturing sector, despite the benefits offered by AGOA and other trade preferences. Given the importance of labor-intensive export growth for overall economic development and poverty reduction, these observations are very disturbing. They underscore the vital need for further reforms in the environment for doing business in Mozambique, so that the country can benefit more fully and more

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[26] Trade data from the IMF, the World Bank, and the government often differ, depending on the timing of the calculations and how exchange rates are calculated. Final figures are produced by the National Statistics Institute (INE) with a long lag. Projections obviously differ as well because of different assumptions and methodologies.

[27] One would expect to see much lower growth of exports expressed as a percentage of GDP, since the latter has also been rising rapidly. But, as discussed, the *metical* has devalued against the dollar and the *rand* over this period, which increased the local currency value of export earnings (and import costs).

[28] Their share of GDP actually rose slightly because of the depreciation of the *metical* against the dollar.

[29] Chapter 3 and Volume 3 discuss the policies used to rehabilitate the sugar industry.

[30] In this report we use the terms "trade liberalization" and "trade reform" interchangeably.

widely from opportunities to gain from trade. These issues are explored in more depth in the remainder of the study.

Since 2002, commodity prices have been rising in the world markets because of the economic recovery in the United States and strong demand from China. Hence, commodity exports outside of the enclave mega-projects are likely to perform significantly better over the next few years. According to IMF estimates, they are likely to grow by around 7 percent per year.

OECD countries provide the main market for Mozambican products, accounting for just over half of the total earnings in 2002 (including sales of aluminum ingots to Europe). Another 18 percent went to South Africa. Zimbabwe has declined as a major customer, at least for registered trade. In 1998, this country accounted for nearly 20 percent of total exports; in 2002 only 6 percent. Malawi is the only other country in the region to absorb more than US$10 million worth of exports from Mozambique (just barely) in 2002. These exports, however, are important for the well being of poor farmers in regions of Mozambique that adjoin Malawi.[31]

IMPORTS

Imports have also boomed, rising from US$817 million in 1998 to an estimated US$1445 million in 2003, or 33 percent of GDP (Figure 1-11). Much of this increase is also associated with mega-projects, both for construction and then procurement of inputs.[32] Still, other imports have also increased by 7 percent per year (in U.S. dollar terms), more or less in line with overall real growth of the economy (outside of the mega-projects). Taking into account exchange rate movements, these other imports have risen to 24 percent of GDP, from less than 19 percent five years earlier.

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[31] This trade with Malawi raises the question of whether similar opportunities can be developed to expand cross-border trade with neighboring regions of Tanzania and Zambia. Malawi differs from the other countries in that it has chronic food deficits and well developed tobacco auctions. Exports to the other two countries will have to evolve along other lines.

[32] Mozal processes imported alumina.

Table 1-4
Key Exports, 1999-2002 (US$ million)

Product Group	1999	2000	2001	2002
Fish	74.8	99.6	99.6	66.5
Prawns	64.6	91.2	90.2	63.7
Agriculture (excluding fish)	87.0	82.7	79.5	80.1
Cashews	33.1	20.0	13.8	13.2
Citrus	5.8	0.8	0.3	0.1
Other fruit, nuts and vegetables	9.5	2.0	0.6	3.2
Tea	0.2	1.0	0.3	0.5
Maize	1.2	1.6	1.6	1.7
Sugar	5.5	4.3	8.0	22.3
Oilseeds	10.0	1.3	1.7	2.1
Coconut oil	5.3	3.6	6.2	2.0
Oilcake	2.8	6.5	16.2	2.4
Copra cake	0.6	4.1	13.9	0.3
Cottonseed cake	0.9	0.9	0.9	0.2
Tobacco	2.6	7.8	9.1	4.9
Cotton	20.2	25.8	18.3	19.4
Other fiber	0.8	0.7	0.7	0.4
Wood	9.2	14.3	12.3	17.4
Textiles and clothing	5.8	6.7	18.1	6.0
Rubber products	1.1	0.3	4.6	0.8
Footwear	0.9	0.6	0.2	0.0
Minerals and fuel	7.8	10.9	11.6	14.4
Salt	0.1	0.4	0.0	0.0
Graphite	2.1	0.1	0.3	0.0
Bentonite	0.4	0.5	0.7	0.2
Machinery	6.6	6.0	5.0	6.1
Transportation Equipment	5.9	5.1	8.9	3.7
Aluminum	-	60.2	383.6	361.3
Electricity	62.8	67.0	57.3	95.3
Miscellaneous	8.9	10.5	22.5	30.37
TOTAL	270.8	364.0	703.1	682.0

SOURCES: *INE, Customs Bulletins, MOZAL Report, HCB.*

Table 1-5

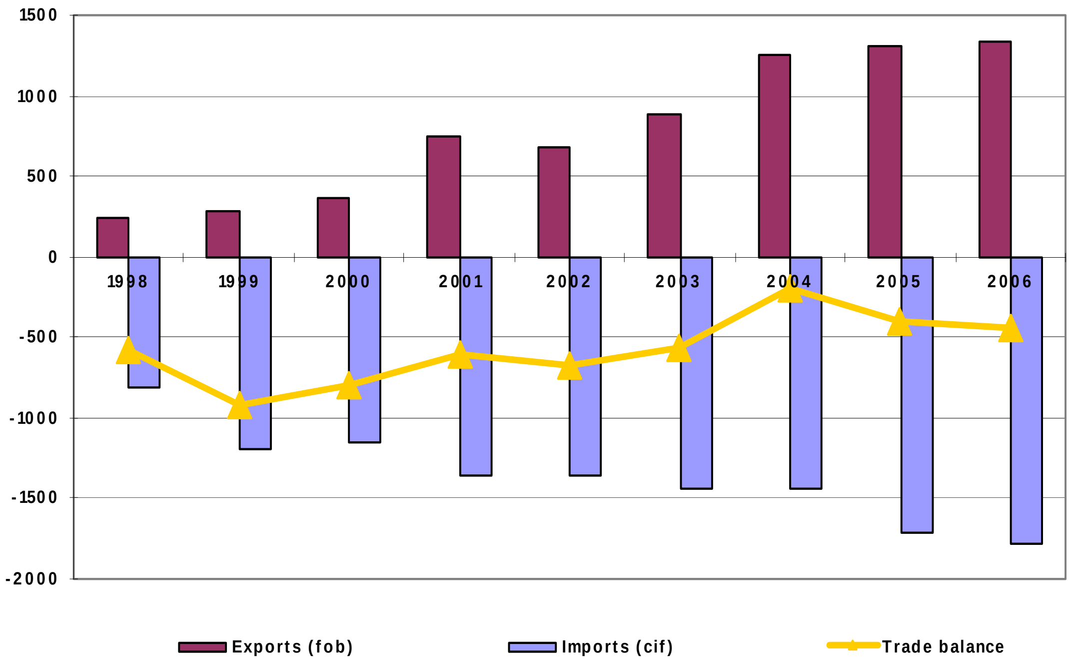
Actual and Projected GDP, Exports, Imports, and Balances, 1998–2005 (US$ million)

	1998	1999	2000	2001	2002	2003[a]	2004 [a]	2005 [a]	2006 [a]	Growth 98-02 (%)	Growth 02-06 [a] (%)
Exports (fob)	245	284	364	744	680	880	1,257	1,311	1,341	29.1	15.1
Large projects	35	76	127	487	466	649	1,010	1,047	1,060	91.7	17.8
Other exports	210	208	237	257	214	231	247	264	281	0.5	6.7
Imports (cif)	-817	-1,200	-1,157	-1,353	-1,351	-1,445	-1,446	-1,712	-1,777	13.4	7.1
Large projects	-87	-514	-177	-392	-402	-415	-339	-532	-523	46.5	8.0
Other imports	-730	-685	-981	-961	-949	-1,030	-1,107	-1,180	-1,254	6.8	6.8
Trade balance	-573	-916	-793	-609	-671	-565	-189	-401	-436		
Large projects (net)	-53	-439	-49	95	64	234	671	515	537		
Other (net)	-520	-478	-744	-704	-735	-799	-860	-916	-973		
Services and incomes (net)	-176	-236	-243	-606	-205	-238	-457	-486	-502		
Current account (excl. grants)	-749	-1,152	-1,037	-1,215	-876	-803	-646	-887	-938		
Current account (incl. grants)	-436	-718	-478	-497	-457	-267	-95	-385	-436		

SOURCES: IMF, Republic of Mozambique.

[a] *Projection.*

Figure 1-11
Trade Balance of Mozambique, 1998-2005 (projected)



SOURCES: IMF reports 2001, 2002, and 2004.

Table 1-6 shows trends in the composition of imports from 1999 to 2002. The impact of Mozal appears in the form of a US$411 million increase in imports of "other metals," as well as the large jumps in imports of machinery, iron and steel, and electricity. The steep rise in fuel imports, to US$150 million in 2002, was driven mainly by rising world prices in the petroleum market. The only other items accounting for at least 5 percent of total imports in 2002 are cement (11.8 percent) and transport equipment. Agricultural products, in total, accounted for 10 percent of total imports, with rice being the largest item in that category. Recovery of domestic sugar production is evident in the decline of nearly US$10 million in sugar imports between 1999 and 2002. There also appears to be significant import substitution in vegetable oil, fruits and vegetables, and beverages, perhaps in response to real depreciation of the *metical*. The increase in insecticide and fungicide imports suggests attempts to increase productivity of several agricultural crops, including cashew. Notably, imports of textile and clothing products in 2002 were more than three times higher than the value of exports from this sector. Most of these imports consist of used clothing.

Table 1-6
Key Imports, 1999-2002 (US$ million)

Product group	1999	2000	2001	2002
Fish	7.0	8.7	7.8	16.3
Agriculture (excluding fish)	131.2	156.8	143.6	123.3
Rice	40.6	31.4	45.9	42.2
Wheat	22.2	16.9	25.3	26.4
Maize and maize flour	2.9	4.4	4.4	5.7
Vegetable oil	20.5	12.4	12.4	1.5
Sugar	13.8	12.2	12.2	4.1
Fruits and vegetables	2.9	6.3	6.3	1.0
Processed food products	6.5	17.4	17.9	7.6
Beverages	5.2	15.9	9.2	3.9
Minerals and fuel	80.3	190.2	183.6	160.5
Cement	5.2	6.8	12.4	10.1
Fuels	72.2	158.8	169.7	149.6
Electricity	14.1	14.6	28.5	30.7
Pharmaceuticals	8.5	14.5	19.3	24.8
Fertilizers	3.2	2.2	4.0	2.3
Other chemical products	28.3	59.9	78.3	87.2
Soap and detergents	3.5	6.9	6.4	6.7
Insecticides and fungicides	5.6	12.6	4.5	9.1
Plastics	8.2	17.6	50.3	53.1
Rubber products	6.1	16.4	9.5	10.1
Wood and paper products	10.5	30.1	40.1	26.5
Textiles and clothing	29.9	41.5	26.2	19.7
Textiles	11.4	17.3	12.0	18.8
Clothing	9.2	6.7	4.1	3.3
Used clothing	6.2	10.3	8.8	5.3
Iron and steel	26.2	68.9	39.7	50.6
Other metals	4.4	10.6	234.7	415.2
Machinery	60.5	188.9	131.7	136.1
Transportation equipment	174.7	174.8	80.5	135.5
Scientific equipment	7.9	23.6	10.7	13.8
Furniture	7.8	17.1	7.3	11.7
Other	15.6	26.0	28.1	26.5
TOTAL	656.5	1162.3	1063.4	1262.9

SOURCES: *INE, Customs Bulletins; Reports from IMOPETRO, EDM, MOZAL, and MOTRACO.*

South Africa has long been Mozambique's most important supplier, particularly for its southern districts. In 2002, 30 percent of all imports came from South Africa. In previous years the figure was as high as 57 percent (in 1999, presumably due to construction of Mozal and the Maputo-Witbank toll road).

TRADE BALANCE AND CURRENT ACCOUNT BALANCE

The export and import trends have reduced the merchandise trade deficit from 14.5 of GDP in 1998 to an estimated 13.1 percent in 2003 (US$565 million), with large fluctuations from year to year depending on the status of the big projects. With the completion of Mozal-II and the natural gas pipeline to South Africa, the net effect of mega-projects will be far more positive this year. Consequently, the trade deficit is expected to decline to 4 percent of GDP in 2004. Apart from the mega-projects, however, the rest of the economy is still running a huge trade deficit, estimated at more than 18 percent of GDP for 2003.

The deficit on services and income increased from 4.5 to 5.5 percent of GDP. Interestingly, external debt service payments have declined by more than three percentage points, to 0.6 percent of GDP due to the HIPC process, but this relief has been more than offset by a rise in factor service payments, again largely relating to the mega-projects.

In 2003, the current account balance (excluding grants) was similar to that of 1998—about 19 percent of GDP. During the intervening years, however, the deficit had risen to more than 28 percent of GDP. This resource gap is likely to remain around 15 percent of GDP over the medium term. Grants, however, cover a sizeable fraction of this foreign exchange gap. Grant receipts have varied from 8 percent of GDP in 1998 to more than 15 percent in the flood year of 2000, falling to 12.4 percent in 2003. Including grants, the current account deficit was 6.2 percent of GDP, the lowest figure in many years. IMF estimates indicate that it will remain at 6 to 7 percent.

BALANCE OF PAYMENTS

The large current account deficits have been more than offset by a combination of net capital inflows and debt relief. In 2003, the capital account surplus was 9.4 percent of GDP. Direct foreign investment alone amounted to 7.9 percent of GDP, slightly above the average for the previous five years. Consequently, the Bank of Mozambique has been steadily building up foreign exchange reserves. In 2003 alone, reserve accumulation totaled 4 percent of GDP, as gross reserves climbed to just over US$1 billion, the equivalent of seven months of imports of goods and non-factor services. By exerting a large net demand for foreign exchange, the central bank has been supporting a higher exchange rate and leaning against a market-driven appreciation of the *metical* against the dollar.

2. Poverty Trends and Trade-Poverty Links

This chapter provides further background for the trade integration diagnosis by focusing on poverty. In the opening section we explain how poverty reduction emerged as a central policy objective in Mozambique over the past decade, and summarize the country's Poverty Reduction Strategy Paper (known locally as the PARPA), with special attention to the role of trade policy. This is followed by a review of the latest poverty profile, based on recent data from the latest national household expenditure survey. In the third section we discuss the links between trade, growth, and poverty reduction in general terms, then present a more detailed analysis of how trade affects poverty in Mozambique through its impact on livelihoods, consumption, and government revenue.

Poverty Reduction as a Central Policy Objective

In the early 1990s, Mozambique ranked as the world's poorest country.[33] Shortly after the national elections in 1994, the government adopted a poverty reduction strategy with five priorities: rural development, investment in human capital, social protection networks, population policy, and capacity building for poverty analysis and monitoring. At that time, the exigencies of reconstruction, structural adjustment, and macroeconomic stabilization overshadowed the issue of poverty, but progress was made in improving poverty data. In particular, the National Statistics Institute

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[33] See rankings in the *World Development Reports* for 1990-1995, based on exchange rate conversions to U.S. dollars. Using purchasing power parity estimates, however, Mozambique was not at the bottom of the list. Also, the low ranking was partly due to large errors in the national accounts. The 1996-1997 national household survey showed that per capita consumption was far higher than what was shown in the official statistics, while the 1997 census showed that population estimates had been too high. With the new data factored in, the measured level of per capita income (PCI) jumped by more than half.

(INE) completed the first nationally representative household survey (IAF) in 1996-1997. The survey revealed that 69.4 percent of the population was living below the national poverty line (Exhibit 2-1).[34]

Exhibit 2-1
Definition of the National Poverty Line

The poverty analysis for 1996-1997 and for 2002-2003 defines the poverty line using the *cost of basic needs* approach. Basic needs are defined, first, by a minimal level of calorie intake (2,150 kilo-calories per person per day),[35] and second, by an empirically determined average level of non-food consumption for households at the poverty threshold. As consumption patterns vary from one household to the next, the threshold is expressed in value units (*meticais* worth of consumption per person per day), at prevailing local prices. The poverty lines are then computed using price indices compiled for each region. Using the World Bank standard of US$1 per person per day *adjusted for purchasing power parity* (PPP), INE (2004, p. 29) calculates that the incidence of absolute poverty is 20.3 percent. This implausibly low figure arises from the way the PPP adjustment is made, especially for household subsistence consumption. Using the $1 PPP approach with first round of household survey data, the poverty rate for 1997 was 37.9 percent, as compared to 69.4 percent using the national poverty line.

In 1999, the government issued *Guidelines for the Eradication of Absolute Poverty* and a medium-term *Action Plan for Reducing Absolute Poverty*, known as the *PARPA 2000-2004*. After the second national elections in December 1999, the National Assembly approved a five-year *Government Program,* with poverty reduction as the top priority.[36] Along with this wave of planning documents, the government was also reallocating budget resources; between 1994 and 1999, the share of government expenditure for education and health doubled, from 14 to 28 percent.

[34] See Ministry of Planning and Finance, Eduardo Mondlane University, and IFPRI, *Understanding Poverty and Well-Being in Mozambique: The First National Assessment (1996-97)*, December 1998. The national poverty line was determined using a basic consumption needs standard, as explained in the next section.

[35] The calorie threshold varies slightly by region depending on average household demographics.

[36] The documents referred to in this paragraph are, respectively (1) Linhas de Acção para Erradicação da Pobreze Absoluta; (2) Plano de Acção para Redução da Pobreza Absoluta (2000-2004); (3) and Programa do Governo 2000-2004.

THE POVERTY REDUCTION STRATEGY PAPER (*PARPA 2001-2005*)

A concerted focus on poverty was therefore well established in Mozambique before the World Bank and the IMF adopted the Poverty Reduction Strategy Paper (PRSP) approach in September 1999 as a condition for future support and for debt relief under the enhanced HIPC initiative. Work on the PRSP—known locally as the *PARPA 2001-2005*—required extensive consultations among ministries and with non-government stakeholders. As the name suggests, the new PARPA drew heavily on existing programs. But where previous plans focused on measures benefiting the poor directly, this time the government recognized that economic growth reduces poverty. Thus, the strategic vision presented in the new PARPA emphasizes "promoting human development and creating an environment for rapid, inclusive and broad-based growth," in addition to peace and sociopolitical stability.

Priorities among many competing needs were established on the basis of two questions. First, is government action in this area essential for successful poverty reduction in the medium term? And, second, does action in this area affect the majority of the people, either directly or indirectly? With these criteria in mind, the PARPA identifies six "fundamental" strategic priorities:

- Education
- Health
- Agriculture and rural development
- Basic infrastructure (especially roads, energy and water)
- Good governance (legal-judicial reform, decentralization, red tape, corruption)
- Macroeconomic and financial management.

Within each area, the PARPA covers a broad range of issues and identifies "principal measures." It also identifies "complementary areas" of action, including employment policy, domestic business development, social action, housing, the environment, and natural disasters.

The fundamental objective of the PARPA is to reduce the incidence of absolute poverty from 69.4 percent in 1997 to less than 60 percent in 2005 and less than 50 percent in 2010. The PARPA envisions broad-based economic growth as the main engine for achieving this objective. In particular, it projects that GDP growth will average 8 percent from 2001 through 2010, with rapid expansion in all key sectors to ensure that the poor share fully in the economic benefits. Technically, the baseline poverty projections are based on the assumption that real per capita *consumption* will grow by 5 percent per year, and that the distribution of consumption will remain stable.[37] The projections show that poverty reduction objectives can actually be surpassed by a wide margin if macroeconomic targets are achieved.

The PARPA also links the strategy and the macroeconomic framework to the medium-term budget program. The program targets an allocation to priority sectors of between 65 and 67 percent of total expenditures over the PARPA period. Finally, the PARPA presents a detailed matrix of results indicators and a plan for monitoring and evaluating results.

Currently, the macroeconomic program outlined in the PARPA is on track, the fiscal program is very close to being realized, and the poverty reduction target for 2005 has in fact been surpassed (as discussed below).

The PARPA has become a key planning tool. As intended from the outset, it is the programmatic basis for IMF funding for Mozambique through the Poverty Reduction and Growth Facility, and a focal point for the World Bank's Country Assistance Strategy. Equally important, the government has integrated the PARPA action plan into the policy management process through the Medium Term Fiscal Framework, the annual budget program, and the annual Social and Economic Plan. The latter two instruments are statutory requirements, subject to approval by the National Assembly. To institutionalize the monitoring process and refine the performance indicators, the government adopted a new Performance Assessment Framework (PAF) in 2003. At the same time, the government established a new Poverty Observatory to serve as a regular forum for open discussion of the poverty reduction strategy and its implementation (Exhibit 2-2). With this institutional framework in place, the government next year will conduct a full review of the poverty reduction strategy and produce a new PARPA for 2006-2010.

THE ROLE OF TRADE POLICY IN THE CURRENT PARPA

The PARPA includes trade policy as one of six components of the priority area of macroeconomic and financial management.[38] For poverty reduction, the main objective of trade policy is to be an instrument for rapid and broad-based growth. According to the PARPA, this entails maintaining an open economy and a competitive exchange rate, eliminating barriers to exports and imports, and creating

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[37] The target for consumption growth is less than that for GDP growth because of a projected increase in the ratio of investment to GDP.

[38] Along with monetary and fiscal policy, revenue mobilization, public expenditure management, financial market development, and public debt management. The PARPA also addresses trade issues in the Macroeconomic Context section of Chapter 3.

better services for the promotion of traditional and non-traditional exports. More specifically, the strategy calls for combining careful monetary policy with strong management of international reserves to foster a gradual real depreciation of the *metical*, as a "critical incentive" for exports and for domestic production competing against imports. The strategy also specifies a need to develop procedures for more rapid customs clearances and faster VAT refunds for exporters through computerization of these control systems. Other "key actions" include implementing the SADC trade protocol, developing better options for export credits, and promoting exports to the United States and Europe to take advantage of AGOA and ACP,[39] respectively. Another trade measure is listed in the section on revenue mobilization: reducing the top import duty rate to 25 percent. (The rate was reduced in 2003, and the government is targeting a further reduction to 20 percent in 2006.)

Exhibit 2-2
The Poverty Observatory

In 2001 the Government of Mozambique approved its poverty reduction strategy and action plan—the *Plano de Acção para a Redução da Pobreza Absoluta 2001-2004 (PARPA).* The plan built on goals established in the *Programa do Governo 2000-2004*, augmented by a comprehensive consultation process that included contributions from NGOs, labor unions, religious leaders, and private sector groups. To institutionalize the consultation process, the government in 2003 established a new approach for poverty monitoring by setting up the Poverty Observatory—*Observatório da Pobreza* (OP). The OP is a forum whose goal is to ensure open and transparent interaction between the government and partners in discussing the poverty reduction strategy and reviewing its implementation. The main body is a Council composed of 60 to 70 members including high-level government, civil society, the private sector, and donors. The government provides administrative support through the Ministry of Planning and Finance.

In April 2003, President Chissano opened the first session of the OP, which was chaired by the Minister of Planning and Finance. Participants discussed a government report on PARPA implementation for 2001 and 2002. At the second session in April 2004, the process broadened to include discussion of a critical paper from a group of NGOs (the G20)., entitled "Combating the Causes of Poverty."

SOURCE: *Gabinete de Estudos, Ministry of Planning and Finance.*

More generally, the PARPA emphasizes many of the trade-facilitation measures identified in this report, such as macroeconomic stability, development of financial markets, institutional reforms to strengthen the legal and judicial system, revision of

[39] ACP refers to the special EU trade preferences for countries in Africa, the Caribbean, and the Pacific.

the Labor Law and the Commercial Code, significant elimination of red tape to facilitate private investment, development of market-supporting infrastructure, and a strong emphasis on human resource development.

Although the poverty reduction strategy incorporates important elements of trade policy and trade facilitation, the operational matrix lists only two indicators relating directly to trade: first, managing monetary policy to maintain trade competitiveness; and second, finalizing an action plan to streamline customs clearances and VAT refunds. The analysis in the present DTIS should provide the basis for more thorough treatment of trade-related measures and indicators in the new PARPA that will be prepared next year.

Poverty in Mozambique 2002–2003

In 2002-2003, the INE carried out the second national household consumption survey (IAF2002/03) that covered a representative sample of 8,700 households from rural and urban areas in every province, over all seasons of the year. The first survey, conducted in 1996-1997, was the source of the widely cited statistic indicating that 69.4 percent of the population lives in absolute poverty. The structure of the new IAF paralleled that used in 1996-1997. Hence, for the first time, analysts can now assess *changes* in poverty by comparing high quality household data from nationally representative surveys, undertaken six years apart.[40]

MAIN RESULTS

Table 2-1 summarizes the main results of the 2002–2003 poverty assessment. There are three principal observations:

- First, the national poverty rate fell from 69.4 percent of the population in 1996-1997 to 54.1 percent in 2002-2003. Thus, the poverty reduction target set for 2005 has already been attained and surpassed.
- Second, rural poverty fell more than urban poverty. In rural areas, the poverty rate declined by 16 percentage points, from 71.3 percent to 55.3 percent. In urban areas, poverty incidence declined by 10.5 percentage points, from 62.0 percent to 51.5 percent.

[40] References: MPF *et al*., Understanding Poverty and Well Being (1998); INE (2004); Simler (2004); MPF *et al.,* (2004).

- Third, poverty is still severe and widespread. More than half the population—more than ten million people—are unable to obtain a minimally adequate standard of consumption.

Table 2-1
Poverty Headcount (% population living in poverty)

	1996-1997	2002-2003	Change
National	69.4	54.1	-15.3
Urban	62.0	51.5	-10.5
Rural	71.3	55.3	-16.0
Niassa	70.6	52.1	-18.5
Cabo Delgado	57.4	63.2	5.8
Nampula	68.9	52.6	-16.3
Zambezia	68.1	44.6	-23.5
Tete	82.3	59.8	-22.5
Manica	62.6	43.6	-19.0
Sofala	87.9	36.1	-51.8
Inhambane	82.6	80.7	-1.9
Gaza	64.6	60.1	-4.5
Maputo Province	65.6	69.3	3.7
Maputo City	47.8	53.6	5.8

SOURCE: MPF et al., Poverty and Well-Being in Mozambique: The Second National Assessment *(2004). Results using "flexible bundle" approach.*

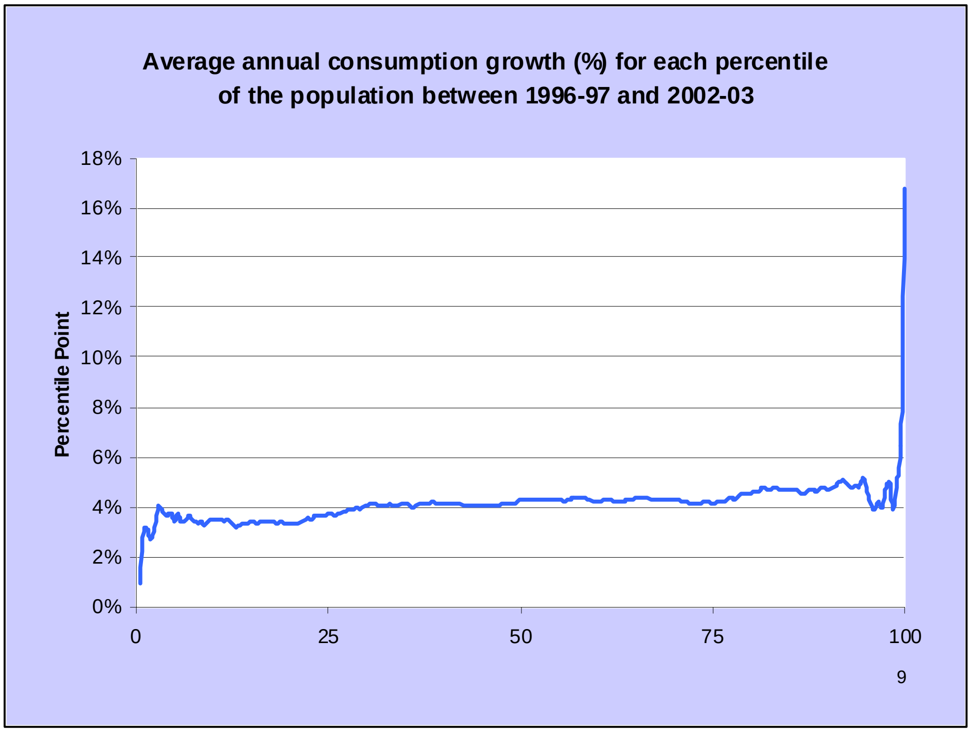
The extent of poverty reduction indicated by the 2002-2003 household survey surprised many people in Mozambique. There was a widespread perception that the poor were not benefiting from growth because the gains were driven by the enclave mega-projects. As discussed earlier, this perception has been dispelled by recent evidence. Growth has actually been broad-based, with large gains registered in every major sector, including agriculture, and poverty has declined sharply in recent years.

The premises underlying the poverty projections in the PARPA have largely been borne out by the IAF2002-2003 results: real per capita consumption has been growing rapidly and the distribution of consumption has remained relatively stable.[41] As shown in Figure 2-1, real per capita consumption has increased by around 4 percent per year virtually across the spectrum of households, from poor to rich.[42] The figure

[41] Source: DNPO slideshow presentation, April 23, 2004. These results have not yet been published.
[42] The national income accounts show that real per capita consumption rose by 50 percent over this period, implying a growth rate of 7 percent per year. See INE (2004). Consumption expenditure in the

shows a slight tilt in favor of higher income households. This is largely an urban phenomenon. The Gini coefficient for urban household consumption rose from 0.47 to 0.48 between 1996-1997 and 2002-2003. For rural areas—where 70 percent of the people reside—the Gini remained unchanged at 0.37.[43]

Figure 2-1
Average Annual Consumption Growth for Each Percentile of the Population, 1996-1997 to 2002-2003



SOURCE: *MPF/DNPO slideshow presentation to donors, April 23, 2004. Preliminary analysis of income distribution results from IAF2002-2003.*

CORROBORATING DATA

The basic indicator used to measure the incidence and depth of poverty—consumption per person per day—is derived from a calculation that takes into account price variations across regions and over time. The precise results are sensitive to the methodology used for this purpose.[44] Fortunately, other indicators

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national accounts is estimated as a residual, however, so this figure is less reliable than direct measures from the two IAF surveys.

[43] The Gini coefficient is a widely used measure of income inequality, ranging from 0.00 (total equality) to 1.00 (zero income for everyone but the richest person). For comparison, the Gini coefficient in South Africa is estimated to be 0.57, indicating much more severe inequality than in Mozambique.

[44] See MPF (2004). The poverty head count would be 63.2 percent if one defines the poverty line using the same bundle of goods in 2002–2003 as in 1996–1997. This figure unquestionably understates the

corroborate the favorable trends and patterns in well being. For example, Table 2-2 shows that the percentage of households owning a functional bicycle more than doubled between 1996–1997 and 2002–2003, from 13 percent to 28 percent, with the largest increase in rural areas. Other objective indicators exhibit similar trends. To cite just a few, between 1996–1997 and 2002–2003

- Radio ownership rose from 29 to 45 percent of households;
- The percentage of children attending school rose from 49 to 69 percent;
- Use of solid roofing material rose from 16 to 25 percent of households;
- Access to sanitation facilities rose from 35 to 44 percent of households;
- Per capita production of cereals rose by a cumulative 20 percent; and
- Own account income, including subsistence production, declined from 67 to 55 percent of average household income.

Table 2-2
Bicycle Ownership (percent of households)

	1996-1997	2002-2003	Change
National	13.3	28.1	14.8
Urban	10.0	19.4	9.4
Rural	14.0	31.8	17.8
Niassa	24.1	56.9	32.8
Cabo Delgado	14.8	24.1	9.3
Nampula	10.9	26.7	15.8
Zambezia	13.9	38.7	24.8
Tete	20.3	27.9	7.6
Manica	18.3	38.5	20.2
Sofala	11.9	35.5	23.6
Inhambane	7.8	11.7	3.9
Gaza	14.4	16.7	2.3
Maputo Province	9.4	10.2	0.8
Maputo City	2.6	7.8	5.2

Source: MPF et al. *(2004).*

gain in living standards, however, because it neglects the fact that households consume less of goods that become relatively more expensive, and vice versa. The results in the text take this into account.

SPATIAL AND SECTORAL PATTERN OF POVERTY

Poverty estimates at the subnational provincial level are less reliable than the aggregate figures because of the smaller size of the respective sample. Bearing this in mind, the lowest poverty rates in 2002-2003 were recorded in Sofala (36 percent), Manica (44 percent), and Zambezia (45 percent). The highest rates were recorded in Inhambane (81 percent), Maputo province excluding Maputo city (69 percent), Cabo Delgado (63 percent), and Gaza (60 percent). The largest reductions in poverty were seen in the northern and central regions. In Sofala, the poverty head count declined from 88 percent in 1996-1997 to 36.1 percent. The government report attributes much of this astonishing decline to an anomalously high figure in the first IAF round, due to widespread flooding in 1996-1997. Other declines of more than 15 percentage points were registered in Zambezia, Tete, Manica, Niassa, and Nampula. Data on bicycle ownership and other objective indicators largely corroborate the finding that living standards rose substantially in these areas of the country.

Contrary to the conventional wisdom, the benefits of growth have not gone disproportionately to Maputo. In fact, the IAF results indicate that the incidence of poverty in Maputo was higher in 2002-2003 than six years earlier. The main explanation for this unexpected result (MPF *et al*., 2004) is that the urban cost of living, and hence the poverty threshold for Maputo, was pushed sharply higher because of two main factors: the rising relative price of housing and transportation and sharply higher prices for tradable goods in Maputo due to appreciation of the *rand* during the survey period. In addition, the evidence suggests that Maputo residents chose to obtain their calories from a higher quality basket of goods in 2002-2003, which pushes up the estimated "cost of basic needs."[45] The results for Maputo may also reflect the impact of rural to urban migration.

The most important spatial fact is that poverty remains overwhelmingly a rural phenomenon. Even though urban and rural poverty *rates* are not much different, 70 percent of the population resides in rural areas. In sectoral terms, the survey shows that agriculture provides the primary source of livelihood for 93 percent of the rural population—and 47 percent of the population classified as living in urban areas. Nationally, agriculture is the primary economic activity for 80 percent of the population. Fully 86 percent of the labor force is either own-account workers or unpaid family workers. In contrast, just 0.8 percent of the economically active population has jobs in manufacturing.

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[45] Another factor is that the 1996-1997 poverty rate appears to have been understated by as much as 4 percentage points because of a technical problem in measuring the food bundle required to obtain the target calorie intake.

Almost all of the people who depend on agriculture for their livelihood toil on small family farms, using traditional farm techniques. According to a recent rural income survey (TIA 2002)[46] 97 percent of farmers cultivate less than 5 hectares, with fully two-thirds cultivating less than 1.75 hectares. Fewer than 8 percent of all farmers use chemical fertilizers, pesticides, or irrigation, and barely one in ten uses animal traction.[47] As a result, yields remain extremely low even in comparison with those in neighboring low-income countries. For example, among households cultivating maize the median level of production was less than 250 kilograms (TIA 2002).

Links between Trade and Poverty: Lessons from International Experience

Before examining the main affects of trade on poor households in Mozambique, it is useful to review lessons from international experience regarding the links between trade and poverty, as well as some of the related controversies.

TRADE AS AN INSTRUMENT FOR POVERTY REDUCTION: THE STANDARD CASE

In the mainstream view, trade liberalization is a strong instrument for poverty reduction. This view is based on three important findings from an extensive body of empirical research on the determinants of economic growth and poverty dynamics.

- First, *economic growth is the most powerful determinant of poverty reduction.* For a poor country like Mozambique, any substantial reduction in poverty requires a large increase in productive capacity (see Exhibit 2-3). International experience clearly indicates that sustained rapid growth *does* lead to enormous progress in poverty reduction. Indeed, the incidence of poverty almost always declines when per capita income increases by at least 2 percent per year, and almost never declines when per capita income fails to grow.[48] Empirical studies find a one-to-one relationship, on average, between the growth of per capita income at the national level, and growth of income for the poor (generally defined as households in the bottom 20 percent of the income distribution).[49] Thus, a 10 percent rise in per

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[46] TIA 2002. Information taken from Thomas Walker, *et. al., Determinants of Rural Income in Mozambique in 2001-2002*, draft, February 2004.

[47] INE, *Censo Agro-Pecuario 1999-2000*. Specifically, 7.2 percent of farms used chemical fertilizers, 4.5 percent used pesticides, and 3.9 percent employed irrigation.

[48] See Cline (2004), UNDP (2004), Dollar and Kraay (2000), Fields (2000) and Aghion *et al*. (1999).

[49] Literature surveys include Andrew Berg and Anne Krueger. *Trade, Growth, and Poverty*. Presented at the Annual Bank Conference on Development Economics, World Bank, April 2002. Also DAI/BIDE

capita income is accompanied, on average, by a 10 percent rise in incomes of poor households.

Exhibit 2-3
The Arithmetic of Growth and Poverty Reduction

Consider a simple illustrative calculation. Average annual consumption for the poorest 50 percent of the population in Mozambique is below US$100 per person. If consumption per-capita grows by 2 percent per year, equally shared (in line with the one-to-one relationship cited above), this segment of the population would remain deeply impoverished for generations to come. By 2050, their average consumption would still be under US$250 per annum. However, in the optimistic case of 5 percent growth, consumption for the bottom half of the population would approach US$1000 per capita over the same timeframe.

The same arithmetic applies to funding for pro-poor expenditures on health, education, agriculture, and infrastructure. Total government expenditure in these areas, including donor support, amounted to less than $40 per person in 2003—an abysmally small budget for such vital services. Only minor gains can be achieved through further budget reallocations or tax reforms. In contrast, fiscal resources double each decade with sustained growth of 7 percent or higher.

- Second, *openness to trade is strongly associated with higher growth in developing countries*. Many empirical studies have demonstrated that openness is a significant determinant of growth—along with "strong institutions, macroeconomic stability, a supportive international environment, avoidance of conflict, and a host of other factors."[50] For countries like Mozambique, internal markets are too small to support rapid and sustained growth. Trade liberalization creates opportunities for efficient producers to tap vast new markets in line with comparative advantage, and to increase efficiency through scale economies. By fostering competition, trade reform enhances productivity and stimulates a more efficient allocation of resources. Openness is also an important lure for new investment, which is often packaged with technology, skills training, modern management practices, quality

(2004). Winters, McCulloch and McKay (2004). Major original sources include Dollar and Kraay (2001); Gallup, Radelet and Warner (1998); Roemer and Gugerty (1997); Timmer (1997). Easterly (1999) and Stryker and Pandolfi (1997) get similar results using a variety of other poverty measures, including indicators of education and health.

[50] Krueger and Berg (2002), p. 32. The authors also say that "trade openness has important positive spillovers on other aspects of reform so that the correlation of trade with other pro-reform policies speaks to the advantages of making openness a primary part of the reform package." In a careful survey paper, Winters, McCulloch and McKay (2004) find clear evidence that trade reform leads to higher productivity growth. The positive impact of exports on growth (on average) is also affirmed by UNCTAD (2004).

standards, and market contacts. Furthermore, export growth is essential for expanding import capacity, which allows the economy to acquire more of the capital goods, raw materials, and intermediate goods needed for growth.[51]

- Third, *openness to trade does not weaken the positive link between growth and poverty*. The international empirical record does not support the common perception that openness leads to a *pattern* of growth that is unfavorable to the poor. Research indicates that variations in the relationship between growth and poverty are not affected, on balance, by openness to trade. If anything, trade may impart a pro-poor bias,[52] implying that trade reform may benefit the poor directly, over and above its impact on growth. As Winters, McCulloch and McKay (2004) suggest, "pro-poor growth seems more likely to occur where initial conditions, including openness, give the poor the ability to take advantage of the opportunities it generates."[53]

Together, these three empirical regularities imply that trade policy (in combination with other economic and institutional reforms) is an important instrument for poverty reduction in low-income countries. As Berg and Krueger conclude, "trade openness has contributed to growth that has resulted in an unprecedented decline in absolute poverty over the past 20 years."[54] Looking to the future, Cline calculates that a move to global free trade would lift more than 500 million people out of poverty over the next 10 to 15 years.[55]

CHALLENGES TO TRADE LIBERALIZATION

The impact of trade reform on poverty remains highly controversial. At the technical level, some scholars have criticized the validity of the empirical evidence outlined above.[56] And at the political level, many stakeholders continue to harbor deep reservations about the impact of international trade on poor and vulnerable groups.

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[51] UNCTAD (2004) emphasizes the importance of expanding import capacity.
[52] In their survey of the empirical literature, Winters, McCulloch and McKay (2004) find some indication of a progressive impact of trade on the poor. See also UNCTAD (2004).
[53] Winters, McCullough and McKay, p. 80.
[54] Berg and Krueger, *op. cit.*, pp. 31-32.
[55] Cline (2004).
[56] Cross-country statistical analysis is used to reveal insights about systematic relationships between economic variables, controlling for the effects of other important interactions. The results often vary depending on the time period covered, the sample of countries included, the way the variables are measured or categorized, and the specification of the model. Even when results are empirically robust—meaning that they appear consistently using different samples, methods, and specifications—it is difficult to be clear about cause and effect.

Technical Challenges

The strong link between growth and poverty reduction is well accepted, but the link from trade reform to growth has been seriously challenged.[57] One problem is that the direction of causality is difficult to pin down. While trade may be an important stimulant for growth, the relationship may also work in reverse, with growth stimulating trade. Moreover, the two variables may move in parallel because of underlying institutional changes that create the appearance of a causal link even if none actually exists. Another problem is that many empirical studies measure "trade" using an index of openness, such as the sum of exports and imports as a percentage of GDP. Yet openness can rise or fall for reasons that have nothing to do with trade *policy*. Hence, evidence of this sort does not support a clear inference that trade *reform* stimulates growth. Some researchers, however, have used more sophisticated techniques to overcome these technical problems and the results broadly confirm that trade liberalization does enhance growth in developing countries.

One point that is *not* supported by the empirical record is the widespread idea that protection is a viable path to sustainable, pro-poor development. Even harsh critics of the standard viewpoint, such as Rodriguez and Rodrik (2001), acknowledge that "there is no credible evidence…that trade restrictions are systematically associated with higher growth."[58] Particularly in small countries, where there is little scope for competition or scale economies, protection typically diverts capital and labor into high-cost "infant" industries that do not "grow up" to become competitive drivers for development.

Averages versus Actual Results

The statistical evidence on links from trade to growth to poverty reduction represent average relationships. This does not imply that trade reform produces favorable poverty outcomes in all circumstances. First, exports may not respond strongly to trade liberalization, especially in the short run, if other supporting policies and institutions deter investment and production. For example, poor infrastructure, bureaucratic impediments to doing business, and a weak financial system can weaken the supply response.[59] This is an important consideration for Mozambique, which has a troubled investment climate (see Chapter 7).

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[57] Rodriguez and Rodrik (2001); Rodrik (2000). Birdsall and Hamoudi (2002).
[58] Rodriguez and Rodrik (2001), p. 317.
[59] New World Bank research provides evidence that trade liberalization may not lead to accelerated growth when excessive regulations impair structural adjustments—that is, when they prevent entry,

Second, as shown in UNCTAD (2004), many cases are observed where rapid export growth (over five-year periods) has failed to deliver broad benefits at the household level—as proxied by per capita private consumption.[60] The link between export growth and poverty reduction can be weakened in several ways. Higher output of export goods may fail to produce more foreign exchange earnings if offset by falling world prices or cuts in foreign aid. Export growth may deliver few benefits if the production is concentrated in enclaves, or heavily dependent on imported capital and inputs. Also, in countries with a strong comparative advantage in primary products, trade liberalization may stimulate commodity exports without promoting structural transformation that would lead to higher levels of development. This is sometimes called the natural resource "trap."

The lesson is that trade reform in isolation is not an automatic ticket to prosperity. Other structural and institutional reforms are needed to ensure that trade liberalization stimulates pro-poor outcomes. Trade reform is part of a package of policy tools to create incentives and opportunities for the private sector to expand productive capacity, improve efficiency, and create better opportunities for the poor.

Microeconomic Costs and Benefits

Trade reform creates losers as well as winners. For example, the removal of import restrictions or a reduction in import duty benefits companies and households by lowering prices for imported goods and comparable domestic products. Yet enterprises that compete against imports in the domestic market are likely to suffer a loss of income and employment. Not infrequently, high-cost businesses fail in the face of intensified import competition. The adjustments may cause serious hardships for the poor if inexpensive imports lead to a widespread loss of jobs or a decline in farmer incomes. A reduction in import duty rates also has revenue effects, which can reduce funding for public goods and services that benefit the poor.[61]

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exit, and labor mobility. See Bineswaree Bolaky and Caroline Freund, "Trade, Regulations and Growth," World Bank working paper, March 2004.

[60] UNCTAD (2004), Chart 20, p. 137. Real private consumption per capita is used in the UNCTAD analysis as the best macroeconomic proxy for poverty reduction. For Mozambique, the same variable was used as the basis for poverty projections in the *PARPA 2001-2005*.

[61] The revenue effects are not always negative. When import duties are high, a reduction may actually increase revenue by diminishing incentives for smuggling, evasion, and bribery. Also, revenue losses can often be offset by administrative improvements, or by adjustments to the exchange rate (see Figures 1-3 and 1-4). For example, in the 1990's Kenya sharply reduced tariff rates and raised revenue at the same time.

Even export promotion measures can have mixed effects. While exporters clearly benefit, those who consume exportable goods or use them as inputs for production[62] may face higher prices, as supplies shift into more profitable external markets.

Whereas the costs of trade reform are largely transitional, the benefits should be permanent and cumulative. Over the medium term, displaced resources are absorbed into other productive activities, and the adverse effects are more than compensated for by income gains. When import duties are reduced, some local businesses may learn to compete, adapt, and to innovate—activities not encouraged by sheltered markets. Other businesses may fold. Those that survive the transitional period of heightened competition tend to be stronger in the longer term. Nonetheless, in a weak economy, the benefits can be slow to materialize and the adverse impacts can have serious repercussions for households living on the margin of survival. Neglecting the cost side of the adjustment can create a backlash that may undermine the sustainability of reforms.

The distributional effects of trade reform depend critically on the structure of production. Where trade creates broad-based gains—as in Ghana for cocoa farmers and Uganda for coffee farmers—it stimulates growth that favors the rural poor. Trade reform also benefits the poor as well as the non-poor by reducing the cost of consumer goods.[63] In contrast, the poor may derive few benefits if trade is concentrated in enclaves as in Angola or in estates and monopolies as in Malawi during the 1970s.

Political Economy of Trade Liberalization

Controversies over trade reform are fueled by groups with vested interests in maintaining (or increasing) protection against trade competition. These groups tend to be well informed, well organized, well connected, well financed, and intensely focused on maintaining existing advantages. In contrast, many of the benefits of

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[62] This, of course, was the main issue in the well-known case of liberalizing the export of raw cashew in Mozambique.

[63] World Bank studies show that the impact of import tariffs reductions on disposable incomes of the poor may be relatively small. In Mauritania, a 23 percent tariff reduction on clothing and footwear was calculated to improve disposable incomes for the lowest 60 percent of the population by only 2 percent plus. A similar reduction in tariffs on meat, poultry, and rice led to a 5 percent improvement in disposable income. This result is in part driven by income loss suffered by smallholder producers of these goods. (See World Bank, "Madagascar: Increasing Integration into World Markets," pp 64-65). In Cambodia, a lowering of tariffs on food products, clothing, and footwear from 28-30 percent to 7 percent was projected to improve household purchasing power from 3.2 to 3.9 percent for poorer groups. (Cambodia Ministry of Commerce, *Cambodia: Integration and Competitiveness Study*, Part A, p. 15.) While a 2 or 3 percent gain in real consumption may not push many people out of poverty, when multiplied by 60 percent of the population the aggregate welfare impact may be large.

trade liberalization are dispersed among large numbers of consumers who are not well informed about trade issues nor well organized to express their interests in the political arena. Since the asymmetry of political influence usually reflects differences in wealth, the politics of trade often favor affluent groups over the interests of the poor.[64] Yet many civil society groups also oppose trade reform out of genuine concern that liberalization hurts the poor. These groups react to observed or perceived adverse effects, including overt cases of de-industrialization as a result of import competition.

One antidote for protectionist political pressure is the emergence of countervailing interests, such as progressive business organizations and think tanks, which recognize the benefit of trade reform and can help the public understand the impact of trade liberalization. Equally important, the government must do its homework in designing trade reforms and complementary measures to ensure that the poor truly benefit.

SYNTHESIS

The central lesson from this review is that an outward-looking trade strategy is essential for growth and poverty reduction in a small, low-income country like Mozambique—subject to two important qualifications. First, the benefits of trade reform are dampened by structural impediments to investment, production, and job creation. Second, the gains are accompanied by adjustment costs that can impose a significant burden on poor and vulnerable households. Thus, a full picture of the impact of trade on poverty requires careful consideration of the impediments to adjustment and analysis of the microeconomic gains and losses. In particular, one must examine the impact of trade reform on income and employment opportunities for the poor, prices for key goods and services, and government revenues. It is also important to assess the availability of coping mechanisms, such as alternative income generating activities, substitute goods, and safety nets, which help poor households cushion the adverse effects of trade reform.

The presence of structural constraints and adjustment costs does not reverse the basic case in favor of using trade reform as an instrument to expand the availability of goods and services, create new opportunities for income generation, and thereby stimulate economic adjustments that improve welfare. In the process, one expects

[64] This is just as true in rich countries. The fact that Europe or the United States adopt protectionist measures in no way implies that the policies promote the public interest or contribute to economic development.

less competitive producers to contract or exit, while new opportunities emerge for more competitive activities to expand. This is a natural part of the dynamic process of structural transformation, which Joseph Schumpeter called "creative destruction."

Thus, a progressive strategy for pro-poor trade reform is to steadily reduce trade barriers while pursuing complementary measures to facilitate broad-based gains from trade, mitigate the costs of adjustment, and manage the risks of trade-related shocks.[65] Elements of this strategy will be discussed more fully in Chapter 8.

The alternative of maintaining protectionist trade barriers is a retrogressive way to deal with the problems associated with trade reform.[66] Protection favors the production of high-cost goods, drawing labor, capital, and financial resources into pursuits that are ultimately unsustainable. It inhibits competition, and discourages both upstream and downstream linkages. Protection also creates an anti-export bias in the allocation of resources, as discussed in Chapter 6, and stimulates socially unproductive rent-seeking behavior. The distributional effects of protectionism are usually regressive because the main beneficiaries are industrialists and urban workers who earn a premium from specialized skills,[67]while poorer consumers and rural households bear the burden of supporting high-cost production activities. All of these outcomes work at cross purposes to the goal of pro-poor growth and economic transformation.

A common reaction to the constraints and costs of trade reform is to conclude that, while trade liberalization is a good idea, it should be deferred until major impediments are overcome. This approach is self-defeating. Very poor countries cannot attain the quality of infrastructure and institutions of a middle-income country without a long period of sustained growth, and they will not achieve this growth through inward-looking development. Furthermore, delaying liberalization also prolongs the regressive effects of protectionism and postpones the benefits of reform—constrained though they may be.

This is not to suggest that liberalization has to be rapid. There are well-known cases, such as Mauritius, Korea, and China, where gradual liberalization has worked well because the strategy included strong incentives for investment in competitive

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65 This accords with the analysis presented in the Trade Policy chapter of the World Bank's *Poverty Reduction Strategy Sourcebook* (www.worldbank.org / poverty / strategies / chapters / trade / trade.htm).

66 Michael Porter. 1998. *The Competitive Advantage of Nations.* New York: Free Press.

67 Steven Matusz and David Tarr found that "workers who have accumulated significant amounts of firm-specific or sector-specific human capital" bear most of the "adjustment costs" of market reform when they lose the wage premiums they once enjoyed in a protected industry. See Matusz and Tarr, "Adjusting to Trade Policy Reform," World Bank, July 1999, p. 21.

outward-looking industries. Even in these cases, however, the protection of inward-looking industries has come at a cost in terms of lower efficiency and higher prices for domestic consumers.

Trade and Poverty in Mozambique

This section focuses on the links between trade and poverty in Mozambique. The analysis follows McCulloch, Winters and Cirera (2002) in examining three main channels through which trade reform affects poor households: income and employment; consumption; and government revenue, which is needed to finance pro-poor goods and services.

EFFECT OF TRADE ON SOURCES OF LIVELIHOOD

The most powerful impact of trade on poverty arises from its effect on jobs and earning opportunities. In Mozambique today this impact works predominantly through rural incomes. In 2002–2003, the primary sector provided the main source of livelihood for 80 percent of the economically active population; 93 percent of all rural workers; 90 percent of women in the labor force; and 90 percent of the workers with no formal education (Table 2-3). In contrast, manufacturing was the main source of livelihood for less than one percent of the economically active population; even in urban areas, the figure was less than 2 percent.

Agriculture, in turn, is largely synonymous with very small farm units (Table 2-4). According to the 1999–2000 agricultural census, farms with fewer than 5 hectares accounted for more than 99 percent of all farm operations—more than 3 million units—and 95 percent of the cultivated land. Within this category the average farm size was 1.2 hectares. Most small farmers continue to rely on traditional, low-yield, hand-hoe technology. At the time of the agricultural census there were also 10,000 medium-sized farm units (5 to 20 hectares), and slightly more than 400 large-scale operations—farms having more than 20 hectares with the majority falling in the 20 to 50 hectare range.

Table 2-3

Economically Active Population by Primary Field of Activity (%)

Primary Field of Activity	National	Rural	Urban	Men	Women	Private Sector Employees	None	Primary-I	Primary-II	Secondary or more
Agriculture, forestry, fishing	80.5	93.0	47.8	69.3	89.9	16.4	90.3	60.7	32.7	9.0
Mining	0.5	0.3	1.0	1.0	0.1	6.3	0.4	1.0	1.0	0.7
Manufacturing	0.8	0.3	1.8	1.5	0.1	9.4	0.4	1.7	2.0	2.5
Construction	2.1	0.9	5.2	4.5	0.1	15.4	1.1	4.9	7.4	4.6
Transportation	1.0	0.2	3.1	2.1	0.1	6.9	0.4	2.0	4.9	5.6
Commerce	7.0	2.7	18.2	9.2	5.2	12.0	4.6	15.0	20.8	10.1
Services	5.0	1.2	15.1	7.3	3.1	31.4	2.4	11.1	17.1	21.6
Education	1.5	0.9	3.2	2.5	0.7	1.2	0.1	1.3	7.3	26.8
Health	0.5	0.2	1.2	0.6	0.4	0.6	0.2	0.5	1.8	5.6
Administration	1.1	0.2	3.4	2.1	0.3	0.4	0.2	1.8	5.0	13.5
Total	100.0	99.9	100.0	100.1	100.0	100.0	100.1	100.0	100.0	100.0

SOURCE: INE, IAF 2002/03.

Table 2-4
Agricultural Production by Size of Farm Unit, 1999-2000

	Small	Medium	Large
Number of farm units	3,054,106	10,180	429
Percentage of farm units	99.7	0.33	0.01
Percentage of cultivated land	95.2	1.7	3.1
Average farm size (ha)	1.2	6.7	282.0
PERCENTAGE OF FARM UNITS GROWING MAJOR FOOD CROPS			
Maize	79	88	48
Cassava	63	29	13
Cowpea	42	51	16
Groundnut	41	54	19
Rice	21	9	10
PERCENTAGE OF FARM UNITS GROWING MAJOR CASH CROPS			
Cotton	6	5	4
Sugar cane	2	2	2
Tobacco	2	3	2
Sunflower	1	1	6
PERCENTAGE OF FARM UNITS GROWING MAJOR TREE CROPS			
Cashew	42	27	21
Mango	49	50	9
Papaya	36	37	4
Banana	30	33	14

Source: INE, Censo Agro-Pecuario 1999-2000.

Small farmers mostly grow basic food crops, especially maize and cassava. Other major food crops include beans, groundnuts, rice, and sweet potatoes, as well as mangos, papayas, and bananas. Cashew is the most common cash crop (grown on 42 percent of the farms) followed by coconuts (20 percent),[68] cotton (6 percent), and sugar cane and tobacco (2 percent each). Chicken, ducks, goats, and pigs are also widespread. Large regional differences exist in the output mix. For example, maize is produced by more than 98 percent of the farms in Manica, compared to 62 percent in Nampula.

[68] This number is from Walker, *et al.*, (2004). The other numbers cited are from the 1999-2000 Agricultural Census.

Farm families consume most of the farm output themselves. The 2002–2003 household survey revealed that subsistence consumption accounted for 51 percent of rural household income, compared to 18 percent from cash sales.[69] The marketed share is lowest for farms that are remote from major roads and markets, and for poorer households. Nonetheless, most rural households do earn a portion of their income through the market. Indeed, the sale of farm products is a more important source of income than wage labor or business earnings, which generated 11 and 8 percent of household receipts, respectively.[70]

What does this imply about the effect of international trade on earnings for poor rural households? Consider the main primary exports shown in Table 1-4 in Chapter 1:

- Prawns ($64 million in exports, f.o.b., in 2002). Nearly all prawn exports are from commercial operations that employ only a small fraction of workers in the industry. Most of the jobs are in artisanal fishing, with sales to the domestic market. With better supporting infrastructure and lower transactions costs, artisanal fishers might break into the higher value export market, but their growth potential is limited by the threat of resource depletion and degradation of habitat.
- Sugar ($22 million). Earnings from sugar exports accrue mainly to large-scale corporate estates. Yet these estates provide jobs for more than 20,000 poor rural workers. They also serve as processing hubs for satellite production by adjoining small-scale sugar growers. Export growth potential is constrained by quota access to Europe and the United States; sale to other markets is not profitable because of low world prices resulting from market distortions.
- Cotton ($19 million). Cotton is a primary cash crop for some 350,000 small farmers, mostly in the northern provinces. Earnings have been erratic in recent years because of unstable world market conditions. With favorable prices, the potential for expansion is strong. Current production is around 80,000 tons but by some estimates the industry is capable of producing 400,000–600,000 tons of raw cotton each year.
- Wood ($17 million). Most exports of wood are supplied by a handful of companies holding forest concessions. The companies provide thousands of jobs in selected localities, but the aggregate impact on rural income is small, and the growth potential is limited, unless sustainable plantation forestry is introduced.

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[69] Cash sales account for 21.5 percent of rural income, of which 84 percent is from the sale of crops, livestock products, and processed agricultural products (including home-brewed beer).

[70] Other income sources were rents (5 percent), extraordinary income (2 percent), and gifts in kind (1 percent). This survey did not cover remittance income.

- Cashew ($13 million). Earnings from cashew exports accrue to hundreds of thousands of rural households. Average earnings are very low, however, because of low yields and the low quality of nuts from old and poorly maintained trees. Cashew output is less than one-fourth the level achieved in the early 1970s, so the potential for growth is tremendous. Though some replanting is taking place, price incentives in recent years have not been sufficient to stimulate widespread investment in rehabilitating the national cashew orchard. Factors contributing to the slow recovery include high marketing margins and transactions costs, and the 18 percent tax on raw cashew exports, which tends to depress farm-gate prices.
- Tobacco ($5 million in the official statistics; over $30 million from other estimates). In the past, tobacco has been a smallholder cash crop for farmers near the border with Malawi and Zimbabwe. Many farmers in the north switched from cotton to tobacco when cotton prices were depressed. Recently, farmers who fled from Zimbabwe have established large-scale tobacco farms. Production has reached the point where private investors are now building a tobacco-processing factory in Tete.[71] In addition to facilitating exports from the new tobacco estates, this development should improve earning opportunities for small tobacco farmers.
- Maize ($2 million). Although the recorded value of maize exports is quite low, informal cross-border trade in maize is a very important income source for farmers in districts bordering Malawi, Zambia, and more recently, Zimbabwe. The unrecorded trade in maize is estimated to be valued at two to ten times the recorded value. This trade may be an important reason for the strong reduction in poverty recorded in these regions between 1997 and 2003.

The basic picture, then, shows that hundreds of thousands of farm households and millions of people are benefiting from international trade in agricultural products. Nonetheless, the aggregate benefits are still relatively small, particularly for the poorest households, who have least to sell and least access to markets.

Yet the current situation is just a prelude. The main story of trade and rural poverty in Mozambique lies in the future. Currently, less than 15 percent of the arable land is under cultivation. Fewer than 10 percent of existing farms use high-yielding seed varieties or modern inputs. As a result, yields are very low, even by regional standards. The problems are rooted in low levels of education, poorly developed transportation networks, high port costs, high marketing margins that render modern inputs unaffordable and erode the farm-gate value of outputs, weak farmers' organizations, lack of access to finance, and insecure land-use rights.

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[71] Investment is also building schools, hospitals, and water treatment plants in the region.

As these constraints are overcome, broad *opportunities* will emerge for poverty reduction through diversified trade in primary products. Many of the problems are gradually easing: education levels are rising; the transportation network is expanding; ports are being modernized; and markets are becoming more competitive. As these conditions improve the potential benefits from trade will expand: modern inputs will become more widely available and affordable, and farmers will gain better knowledge of market opportunities. Mozambique is well placed to benefit from private investment in large-scale farms, which can create tens of thousands of new farm jobs. But much of the potential benefit, in terms of poverty reduction, will have to come from the creation of market conditions and incentives that lead hundreds of thousands of small-scale farmers to increase yields, improve the quality of existing products, and introduce new cash crops.

To reap the benefits from overcoming constraints to agricultural development, Mozambique must pursue an outward-looking trade regime. The domestic market, alone, cannot absorb a large increase in the supply of food crops or cash crops. This is especially true for high-value crops. Expanded trade opportunities also deliver a bonus in the form of additional jobs in commerce and transportation, and local multiplier effects from farmers spending cash crop earnings on everything from a new roof to shoe repair services.

This is an optimistic scenario, but also a realistic one if Mozambique puts in place a strongly supportive policy framework, including effective measures for trade promotion. But prospects are tempered by several qualifications. First, export growth for important products like cotton, sugar, and maize is constrained by barriers to access in major markets, including quotas, high out-of-quota tariffs, export subsidies, and domestic support programs. This is a major problem for poverty reduction through trade. Second, many of the domestic constraints are not being addressed very quickly or effectively. Indeed, for some of the problems—such as land-use rights and rural finance—there is little sign of progress. And third, over the next decade HIV/AIDS will have a critical effect on the supply of labor to agriculture and the transmission of knowledge to the next generation of farmers. Effective health programs are therefore an essential part of the supporting policy framework.

The emphasis here on agriculture reflects the current profile of poverty in Mozambique. But in the medium to long run, successful pro-poor development will require the rapid creation of productive *off-farm* jobs. As explained in Exhibit 2-4, structural transformation is a key to achieving large efficiency gains that are needed to eliminate absolute poverty and boost the country to middle-income status for future generations. Furthermore, rural to urban migration will accelerate as bettereducated entrants to the labor force seek new opportunities. To absorb the growing non-agricultural labor force, investments outside agriculture must be stimulated, especially in labor-intensive industries, including tourism. Agro-industry can be particularly important because it simultaneously creates non-farm jobs and expands market opportunities for cash crops.

Exhibit 2-4
Structural Transformation as a Key to Higher Labor Productivity

Let us define an index of labor productivity by saying that output per worker for the economy as a whole equaled 100 in 2003. That year, approximately 80 percent of the labor force was engaged in agriculture, which accounted for slightly less than 25 percent of GDP (excluding mega-projects). Using the index just defined, labor productivity in agriculture therefore equaled 31.

In contrast, less than 1 percent of the labor force worked in the manufacturing sector, producing 10 percent of GDP (again excluding mega-projects). Each worker in manufacturing produced 10 times the average pro-rata share of output, so the index of labor productivity for this sector is 1000.

Therefore, output per worker was 32 times greater in manufacturing than in agriculture. This simple calculation highlights the importance of structural transformation in the quest for national prosperity. However great the potential may be for improving agricultural productivity and bringing more arable land into cultivation, prosperity in the medium to long run will require a large reallocation of labor to efficient non-farm activities.

EFFECT OF TRADE ON CONSUMPTION

The second major channel through which trade affects poor households is by altering the price and availability of consumer goods. Import barriers and duties increase the price of imported consumer goods in the domestic market, and also the price of competing domestic products (and their close substitutes). In turn, higher prices reduce real incomes of consumers.[72] The opposite effects result from a reduction in import barriers or duties. Prices for consumer goods are also affected by export market conditions. For example, when good harvests in Malawi reduce the demand for maize grown in Mozambique, the price of maize in local markets is strongly affected. Maize surplus households suffer a loss of income, while maize deficit households benefit.

[72] With competitive labor markets, the equilibrium wage will adjust over time to reflect the higher cost of living. This is one way in which import duties reduce the competitiveness of domestic products in the export market and impair growth.

The starting point for tracking this channel is to see how tradable goods enter the consumption basket for poor households in Mozambique. Table 2-5 shows the composition of consumption expenditures by quintile for rural and urban households. Table 2-6 provides a more detailed breakdown of food expenditures. The data are from the latest national household survey (IAF 2002-03) and include goods produced within the household (auto-consumption[73]) as well as goods purchased in the market or received as payments in kind. [74]

Looking at rural households, two features are striking. First, consumption is largely devoted to meeting basic needs. For households under the poverty line—the first three quintiles—food accounts for more than 60 percent of total consumption, while food plus housing and fuel account for 86 percent (Figure 2-2).

Second, roughly three-fourths of the food "expenditure" by poor households is actually subsistence production—mainly maize, tubers (primarily cassava), maize and cassava flour, beans, and greens. Food acquired through market transactions accounts for only 15 percent of total consumption. Within the food category, the largest transactions are for fish (3 to 4 percent of total consumption), rice (2 to 3 percent), grain flour (2 percent), and maize and fruit (1 to 2 percent). Apart from food, the rural poor purchase few tradable products in significant amounts, mainly clothing (2 to 4 percent) and kerosene.[75]

Even these very low expenditure shares overstate the extent to which trade policy may affect poor rural consumers. Many of their purchases involve low-quality local products whose prices are largely insulated from border conditions because of low quality and high transportation costs. For example, furniture and decoration expenses account for 5 to 6 percent of total consumption, but most of these expenditures (in rural areas) involve products that are effectively non-tradable. As the rural incomes rise and the marketing network develops, the pass-through of international prices will become increasingly important to poor rural consumers throughout the country.

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[73] Auto-consumption is the consumption of goods produced by the household itself.

[74] We are grateful to Director Pedro Couto, Gabinete de Estudos, Ministry of Planning and Finance, for authorizing special data runs for this study, and to Professor Channing Arndt and Sr. Jacinto Chiconela for producing the results.

[75] In the data table expenditure on kerosene is lumped together with housing and other fuels (notably charcoal). Note, too, that this paragraph refers to "market transactions" rather than "purchases" to describe non-subsistence consumption. This is because the consumption data can include wages paid in-kind as well as cash expenditures, as such.

Table 2-5

Structure of Household Expenditures, by Quintile and Location

Product group	Rural					Urban				
	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food	61.8	67.3	67.8	67.2	62.9	50.9	52.9	51.4	44.3	28.9
of which auto-consumption	*46.0*	*52.1*	*52.8*	*54.0*	*47.4*	*11.7*	*16.6*	*16.2*	*12.4*	*4.6*
Beverages	0.8	1.0	1.0	1.7	1.7	0.6	1.0	1.1	1.8	2.5
Clothing	2.3	3.7	4.6	6.3	7.8	2.8	3.7	6.0	6.5	8.7
Housing and fuel	25.5	19.4	17.1	15.4	13.3	31.7	27.7	25.3	26.7	28.9
of which auto-consumption	*11.4*	*8.3*	*6.8*	*6.8*	*4.8*	*7.1*	*4.3*	*3.5*	*1.7*	*0.5*
Furniture and decoration	6.1	5.1	5.4	5.5	7.3	6.6	6.7	7.5	9.7	14.6
Health	0.9	0.7	0.6	0.7	0.7	1.0	1.1	1.2	1.5	1.5
Transport	1.0	1.3	1.8	1.7	3.8	2.7	3.1	3.1	4.0	6.1
Communication	0.0	0.0	0.0	0.1	0.1	0.1	0.3	0.5	0.8	2.0
Recreation and leisure	0.5	0.3	0.5	0.3	0.4	0.8	0.7	0.6	0.9	1.8
Education	0.3	0.1	0.1	0.1	0.1	0.8	0.7	0.6	0.6	1.1
Restaurants, hotels	0.4	0.6	0.7	0.7	0.9	0.9	0.7	1.0	1.8	1.6
Other goods and services	0.3	0.5	0.4	0.5	1.1	1.1	1.3	1.8	1.5	2.3

Source: MPF calculations based on IAF 2002/03 household survey data.

Note: Figures are percentages of total household consumption, including auto-consumption. Quintile breakdowns computed by MPF differ from those reported by INE because the former use regional deflators to normalize expenditure levels.

Table 2-6

Structure of Household Expenditures, by Quintile and Location

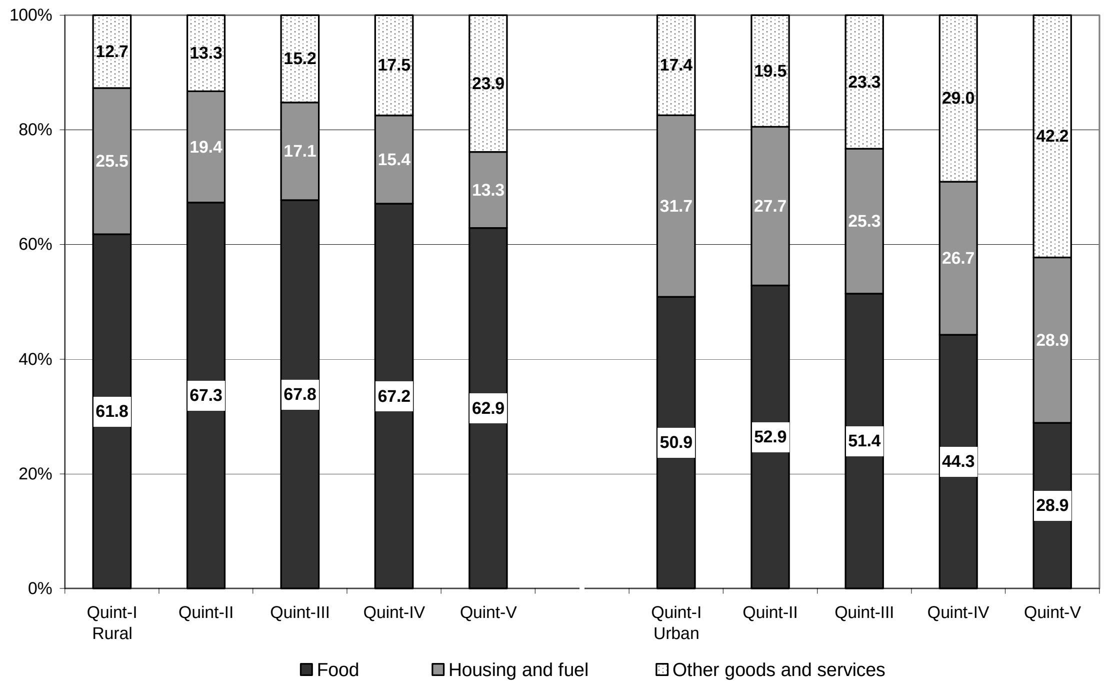
Product group	Rural					Urban				
	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V
Food products (selected items)										
Maize	1.8	3.0	2.7	1.6	1.4	0.7	0.8	0.5	0.6	0.4
of which auto-consumption	*1.4*	*2.4*	*2.1*	*1.2*	*1.1*	*0.1*	*0.3*	*0.2*	*0.3*	*0.1*
Flour (from grains)	9.7	17.2	21.0	24.8	25.3	6.6	10.1	10.7	8.0	4.0
of which auto-consumption	*7.5*	*15.3*	*19.1*	*23.7*	*24.0*	*3.2*	*7.0*	*7.4*	*6.2*	*2.6*
Tubers	6.1	4.9	3.4	3.0	2.1	5.7	3.4	5.3	2.3	0.8
of which auto-consumption	*5.4*	*4.6*	*3.3*	*2.9*	*1.9*	*1.9*	*1.4*	*2.1*	*1.1*	*0.1*
Flour (from tubers)	5.1	8.7	8.6	7.3	4.5	1.3	2.8	2.1	1.4	0.4
of which auto-consumption	*4.8*	*8.4*	*8.3*	*7.0*	*4.3*	*1.0*	*2.6*	*2.0*	*1.3*	*0.3*
Rice	3.6	3.7	3.4	3.2	4.1	4.9	4.9	4.4	4.0	2.5
of which auto-consumption	*0.7*	*1.6*	*1.8*	*1.8*	*1.9*	*0.3*	*0.5*	*0.9*	*0.8*	*0.5*
Bread	0.4	0.4	0.5	0.5	0.7	2.7	3.5	3.0	3.3	2.7
of which auto-consumption	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Meat	1.1	1.3	1.5	1.7	2.6	0.5	1.1	1.3	2.4	2.4
of which auto-consumption	*0.3*	*0.3*	*0.3*	*0.5*	*0.6*	*0.4*	*0.4*	*0.5*	*0.6*	*0.9*
Fish	3.6	4.7	4.8	4.9	4.0	4.6	5.2	5.3	4.5	3.7
of which auto-consumption	*1.0*	*0.9*	*1.2*	*1.2*	*0.7*	*1.3*	*1.1*	*1.3*	*1.6*	*1.2*
Milk products and eggs	0.3	0.1	0.3	0.2	0.3	0.1	0.2	0.2	0.3	0.7
of which auto-consumption	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Oil and fats	0.2	0.4	0.5	0.6	1.0	1.6	1.7	1.8	1.7	1.5
of which auto-consumption	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Fruits	7.5	5.5	4.9	4.0	3.4	4.6	4.1	3.1	2.6	1.4
of which auto-consumption	*4.4*	*3.3*	*3.0*	*2.7*	*1.6*	*6.0*	*4.5*	*3.9*	*3.4*	*2.8*

Product group	Rural					Urban				
	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V	Quint-I	Quint-II	Quint-III	Quint-IV	Quint-V
Greens	11.3	7.0	6.2	5.0	3.7	7.3	5.8	4.6	4.1	2.6
of which auto-consumption	*10.4*	*6.2*	*5.4*	*4.2*	*2.9*	*2.6*	*1.7*	*0.9*	*0.7*	*0.2*
Beans	4.5	5.0	4.4	4.5	3.5	2.6	2.7	2.0	2.2	1.1
of which auto-consumption	*3.7*	*4.4*	*3.9*	*3.9*	*2.7*	*0.8*	*0.8*	*0.3*	*0.5*	*0.2*
Sugar	0.6	0.6	0.7	0.6	0.7	1.5	1.8	1.6	1.9	1.1
of which auto-consumption	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*

Note: All figures are percentages of total household consumption, including auto-consumption. Quintile breakdowns computed by MPF differ from those reported by INE because the former use regional deflators to normalize expenditure levels.

SOURCE: MPF calculations based on IAF 2002/03 household survey data.

Figure 2-2
Structure of Household Expenditures, including Auto-consumption



SOURCE: *MPF calculations based on IAF 2002/03 household survey data.*

The transmission of border prices is stronger for rural consumers living nearest to roads, markets, and borders and weakest for those in more remote locations. Also, consumption patterns vary significantly by region. For example, the purchase of rice ranges from 6.3 percent of total consumption in Gaza to just 0.9 percent in Tete. Similarly, the purchase of vegetables ranges from 5.7 percent of total consumption in Maputo Province (excluding Maputo City and Matola), to 0.5 percent in Nampula.[76]

Turning to the urban poor, food represents about 50 percent of total consumption (Tables 2-5 and 2-6). Compared to rural households, the urban poor spend significantly more on flour, rice, bread, cooking oil, greens, and sugar. For non-food items, the largest difference is the cost of housing and fuel. In fact, the combined cost of food, housing, and fuel is around 80 percent of total consumption in both urban and rural areas. Transportation expenses are also significantly higher in urban areas.

Not surprisingly, auto-consumption is far less important for urban consumers, accounting for less than 20 percent of total expenditure. Hence, urban consumers are much more dependent on market prices, and they face prices that are highly

[76] Data from IAF 2002-03, processed for this study by the MPF.

responsive to border price conditions. Thus, the trade-poverty link via prices for consumer goods is much more important for urban than for rural households.

Three observations require emphasis. First, the 25 percent duty that applies to most food imports substantially increases the price of food and reduces the standard of living for poor urban consumers. Second, rice accounts for nearly 5 percent of total consumption for the bottom urban quintiles; therefore, the proposal to protect domestic rice growers by imposing a high surtax would have a large negative effect on the urban poor. By comparison, sugar accounts for less than 2 percent of consumption for urban poor households; hence, the adverse welfare impact of the sugar surtax is less significant, though still tangible. Third, elimination of barriers to importing second-hand clothes clearly improved real incomes for the poor by increasing the availability and reducing the price of adequate quality clothing.

EFFECT OF TRADE ON GOVERNMENT REVENUE

Trade flows also affect the poor through their impact on revenue needed to finance essential public goods and services. As shown in Table 2-7, the government continues to rely on foreign aid for more than 40 percent of its current income. But domestic revenues have risen significantly since 1998, from 11 percent of GDP to more than 14 percent.

In 2003, import duties and export taxes accounted for 15 percent of domestic revenue, compared to nearly 18 percent in 1998. The apparent drop reflects an increase in other sources of revenue, not a decline in trade tax collections. Trade taxes have been reasonably stable at around 2 percent of GDP throughout the period. Because GDP has grown, this means that trade tax revenue has increased steadily. Adjusted for inflation, trade taxes generated 37 percent more revenue in 2003 than in 1998—a result of a rising volume of imports, depreciation of the exchange rate (relative to domestic inflation), and improved customs administration. Clearly, the country has not encountered revenue problems as a result of reducing trade taxes.

As the relative importance of trade taxes has declined, there has been an offsetting increase in revenue from the value added tax (VAT) on imported goods. The collection of VAT on imported goods instead of duties is highly desirable. The key difference is that VAT applies equally to imports and domestic products, whereas trade taxes create a bias against imports that distorts the allocation of resources and reduces efficiency and growth potential.

Table 2-7
Government Revenue, 1998-2003

	1998	1999	2000	2001	2002	2003p
REVENUE AND GRANTS (% OF GDP)						
Total revenue	11.3	12.0	13.2	13.3	14.2	14.3
Tax revenue	10.5	11.1	12.0	11.8	12.5	13.2
Taxes on income and profit	2.0	1.7	1.8	2.1	2.5	3.1
Taxes on goods and services	6.1	7.0	7.6	7.3	7.5	7.6
Turnover tax	3.3	1.8	--	--	--	--
Value added tax - on domestic supplies	--	1.1	2.1	2.1	2.3	na
Value added tax - on imports	--	1.6	3.0	2.9	3.1	na
Consumption taxes (excises)	1.2	1.1	1.1	1.1	1.1	na
Tax on petroleum products	1.6	1.5	1.3	1.2	1.0	1.3
Taxes on international trade	2.0	2.0	2.2	2.1	2.2	2.2
Other taxes	0.3	0.4	0.4	0.3	0.3	0.4
Nontax revenue	0.8	0.9	1.2	1.5	1.7	1.1
Grants	8.1	11.7	8.0	14.8	11.8	10.6%
Total revenue and grants	19.4	23.7	21.2	28.1	26.0	24.9%
COMPOSITION OF REVENUE (% OF TOTAL)						
Tax revenue	92.6	92.4	91.1	88.7	88.2	92.6%
Taxes on income and profit	18.1	14.0	13.7	16.0	17.5	22.0%
Taxes on goods and services	54.1	58.6	57.3	54.6	53.1	53.0%
Turnover tax	29.3	14.8	--	--	--	--
Value added tax - domestic goods and services	--	9.2	16.0	16.0	16.3	na
Value added tax - imports	--	13.3	22.6	21.7	21.7	na
Consumption taxes (excises)	10.7	9.1	8.5	8.2	7.9	na
Tax on petroleum products	14.1	12.2	10.2	8.7	7.2	8.9%
Taxes on international trade	17.6	16.8	16.9	15.6	15.4	15.1%
Other taxes	2.8	2.9	3.1	2.5	2.1	2.5%
Nontax revenue	7.4	7.6	8.9	11.3	11.8	7.4%
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0%

SOURCE: *IMF and study calculations.*

One attractive feature of VAT is that it is designed to avoid encumbering exports. This is achieved through zero-rating, which means that VAT is not charged on export sales *and* exporters qualify for a refund of VAT that has been paid on inputs. In Mozambique, however, the VAT refund system is subject to long delays. These delays increase financing costs and therefore impair export incentives. All parties recognize that this situation needs to be addressed.

Although exports should not be subject to indirect tax, producers should still contribute to the cost of public goods and services through taxes on income and profits, royalties on the exploitation of national mineral wealth, and profits accruing to the government from equity shares in export investments. This revenue channel is the main link between mega-project exports and poverty reduction. Unfortunately, the available data do not show the contribution of mega-projects to the government budget. As discussed in Chapter 7 special fiscal incentives are granted to large projects—as well as to many other types of investment. If tax breaks accrue to projects that would be viable anyway, or if the incentives exceed the minimum necessary to attract particular investments, then the government is foregoing revenue that could be used to support pro-poor public expenditures.[77]

Looking ahead, the IMF projects that the ratio of domestic revenue to GDP will continue to rise over the next few years, despite programmed cuts in taxes on international trade. Further tax reforms, and the introduction of a central revenue authority, should more than compensate for the revenue effects of programmed cuts in trade taxes.

CONCLUSION

The purpose of this chapter has been to review the poverty profile in Mozambique, and to outline the basic linkages between trade and poverty. The analysis points to five critical considerations for trade policy.

First, although the incidence of poverty has fallen rapidly in recent years, severe poverty remains widespread. Thus, the government cannot relax its efforts to foster rapid and broad-based growth. Second, trade is an indispensable instrument for stimulating growth and reducing poverty; even so, trade reform creates costs as well as benefits, and the adverse effects must be taken into account in the design of trade policy. Third, poverty in Mozambique is overwhelmingly rural. Hence, a critical consideration is the effect of trade reform on rural households, particularly in expanding opportunities for cash crops. In the medium to long run, however, the critical issue is how trade contributes to transformation of the economy by facilitating the creation off-farm jobs. Fourth, on the consumption side, trade policy affects the price and availability of many basic goods. In rural areas this link is weak,

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[77] Nathan Associates. 2004. The Effectiveness and Impact of Tax Incentives in the SADC Region.

since most consumption is derived from subsistence activities. This will change as rural incomes rise and rural markets develop. In urban areas, market purchases are much more important. Thus, trade taxes substantially reduce real incomes for poor urban households by increasing the price of food and other major consumer goods. Finally, despite much concern about the possible loss of revenue due to lower trade taxes, this has proved not to be a problem in Mozambique.

The links between trade and poverty can be strengthened through measures to facilitate the gains from trade, mitigate the costs of trade liberalization, and manage the risks of greater openness. These programmatic issues will be examined further in Chapter 8.

In view of the broad impact of international trade on poverty, trade promotion should be prominently integrated into the next PARPA, which is to be prepared in 2005. The new poverty strategy should include specific measures to enhance the benefits of globalization for the poor, along with relevant performance indicators and monitoring procedures. This recommendation coincides with Mozambique's commitment, as a signatory to the Brussels Declaration and Programme of Action (POA) for the Decade 2001-2010, to "strengthening efforts to integrate trade policies into national development policies towards poverty reduction."[78]

[78] The Brussels Declaration and POA were adopted by the Third UN Conference on Least Developed Countries in 2001. The Declaration is a commitment to "the eradication of poverty and the improvement of the quality of lives of people in LDCs by strengthening their abilities to build a better future for themselves and develop their countries." This is to be achieved through "equitable and sustained economic growth" based on "nationally-owned and people-centred poverty reduction strategies." The POA establishes a framework for global partnership to achieve these aims and integrate LDCs more fully into the world economy, through seven commitments: fostering a people-centred policy framework; good governance at national and international levels; building human and institutional capacities to make globalization work for LDCs; enhancing the role of trade in development; reducing vulnerability and protecting the environment; and mobilizing financial resources.

3. Business-enabling Environment

Although Mozambique has improved its investment climate in recent years, the regulatory environment still imposes heavy costs on business. Small and medium-sized enterprises—producers with substantial potential for export growth—have been especially disadvantaged by Mozambique's complex and burdensome system of approvals, licenses, and special levies that impede market entry and raise the costs of doing business. The fact that export growth has been very sluggish outside of the mega-projects attests to the severity of problems with the business-enabling environment. Removing unnecessary or excessive constraints embodied in policies, practices, laws, and regulations can greatly facilitate economic activity, promoting exports and reducing poverty.

In this chapter, we analyze the main constraints that impede export expansion, and recommend ways to minimize those constraints. Our analysis focuses on administrative, regulatory, and commercial legal barriers, encompassing registration, licensing, and inspections; land and labor issues; and contract enforcement and adjudication of disputes. We then turn to tax policy and enforcement, before covering Mozambique's financial sector, including the availability of export finance. In the final section, we consider an approach to competition policy suitable to Mozambique, and discuss how competition policy might be strengthened over time.

Trends in the Quality of Mozambique's Investment Climate

Mozambique's investment climate has undoubtedly improved in the last decade. The advent of peace and two successful national elections have significantly reduced political uncertainty. Economic reforms have improved monetary and price stability, deepened economic integration with world markets, strengthened the financial markets, and reduced state involvement in production. Institution-building measures have been adopted to strengthen public administration and promote private investment. At the same time, public investment in roads, ports, and telecommunications have begun to lower business costs. Furthermore, most observers would agree that these reforms are permanent: Mozambique has reached the point at which reforms will be sustained.

These advances notwithstanding, Mozambique still has much to do to create conditions for broad-based, self-sustaining growth and poverty reduction. First-generation economic reforms have produced high rates of growth in the last decade, but the outcome has been less robust than expected for employment. Signs of sustained labor-intensive, private sector-led exports and growth remain weak. Much of the growth and poverty reduction can be attributed to post-war recovery, foreign aid, and foreign-owned mega-projects. Several huge foreign direct investments provided the lion's share of private investment capital over the decade, outpacing registered local investment by four to one. In industry, agriculture, and to some extent tourism, a few strategic investment projects have been major drivers of output and export growth. But these projects will not provide nearly enough jobs to absorb the estimated 3.7 million workers expected to enter the labor force between 2001 and 2010. Why hasn't more labor-intensive, private sector-led growth materialized?

A principal reason is the regulatory environment: administrative, regulatory, and legal barriers to investment. Recent research on development shows that macroeconomic stability and getting prices "right" are necessary but not sufficient for sustained growth. Cross country differences in the quality of regulatory regimes and legal and judicial institutions are crucial, and may even trump other growth determinants. In Mozambique, weaknesses in administrative, regulatory, and legal institutions have received some attention in recent years, but so far these "second-generation" reforms have been half-hearted and have not led to a meaningful improvement in the investment climate. As stated in a FIAS study of administrative barriers in 2001:[80]

> Overall, the situation on the ground seems to have improved little [since the last FIAS study in 1996], and, in some areas investors perceive more difficulties now than in the past…Furthermore, inconsistent implementation and interpretation of laws and regulations across investors and between regions … has given rise to discrimination between investor groups—foreign vs. domestic, large vs. small—and between

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[79] Rodrik, Arvind Subramanian, and Francesco Trebbi. 2002. Institutions rule: The Primacy of Institutions over Geography and Integration in Economic Development. KSG Harvard University.

80 Foreign Investment Advisory Services (FIAS). 2001. Mozambique: Continuing to Remove Administrative Barriers to Investment. World Bank.

> investors in different locations (capital city vs. provinces), resulting in major constraints for many businesses … these bureaucratic procedures and discretionary practices have allowed for corruption … which is not only eroding the country's financial resources, but also damaging the credibility of the government and its policy reforms.

In the following sections we examine problems in the regulatory environment and recommend reforms that can reduce obstacles for business and improve Mozambique's competitiveness in regional and world markets—crucial requirements for long-term growth and poverty reduction.

Administrative, Regulatory, and Commercial Legal Barriers

In the mid-1990s, the government and the donors began to recognize that administrative and regulatory barriers stemming from antiquated laws and regulations, inefficient administrative capacity, and corruption were frustrating Mozambique's economic reform program and new policies to attract investment. It was clear that addressing these issues required concerted effort and that institutional reforms would have to be integrated fully into the national development strategies. In the following years, several second-generation reforms were initiated, introducing new laws and regulations and revising old ones, in areas such as licensing and business registration, customs procedures, labor law, land law, and environmental regulation. These reforms began to shift Mozambique's administrative procedures closer to standard international practices. During the same period, the government promoted several large and strategic foreign investments. One result of this experience was a corps of officials in ministries and agencies with the knowledge and capacity to advocate further administrative reforms and to help other investors navigate government bureaucracy.

Even with such changes, Mozambique remains one of the world's most difficult places to do business. Companies continue to complain about administrative, regulatory, and legal obstacles, and investors assert (in surveys) that Mozambique is still viewed as an extremely risky investment location. For example, the World Economic Forum's *African Competitiveness Report for 2004* ranks Mozambique's business environment 20th among 25 sub-Saharan countries. Even by regional standards, the rating was poor on the "contracts and law" subindex as well as the "macroeconomic environment" index. Similarly, in its report on *Doing Business in*

2004: Understanding Regulation, the World Bank rates Mozambique's "administrative barriers and institutional weaknesses" among the world's worst.[81]

Table 3-1 lists the ten most highly regulated countries according to the *Doing Business* study, and compares their regulation scores to that of Mozambique in three areas—starting a business, labor hiring and firing, and contract enforcement. Scores for the three "least regulated" countries are also presented to facilitate comparison with "best practice" countries. In the following subsections, we examine vital areas where new reform and improved implementation are needed to enhance the regulatory environment. We begin with impediments to starting a business.

Table 3-1
Investment Climate Indicators: Mozambique Versus World's Most Regulated and Least Regulated Countries

Country	Starting Business		Hiring and Firing Workers		Enforcing Contracts		
	Number procedures	Time (days)	Employment law index	Flexibility of firing	Number procedures	Time (days)	Procedural complexity
MOST REGULATED							
Azerbaijan	15	104	.67	.30	25	115	3.54
Belarus	20	143	.79	.73	19	135	3.67
Bolivia	18	77	.64	.57	44	464	5.04
Burkina Faso	15	39	.53	.23	24	376	4.25
Cameroon	13	56	.50	.45	46	548	3.79
Ecuador	14	90	.60	.67	33	333	4.29
Madagascar	15	66	.65	.56	29	166	3.79
Mexico	7	51	.65	.71	47	325	3.71
Niger	11	27	.73	--	29	365	3.79
Philippines	14	62	.56	.57	28	164	4.50
Mozambique	16	214	.77	.71	18	540	4.25
LEAST REGULATED							
Jamaica	7	37	.39	.13	11	202	2.29
Denmark	3	3	.30	.12	14	83	2.42
UK	5	4	.34	.20	12	101	2.51

SOURCE: *"Doing Business in 2004," World Bank Washington, DC 2003.*

[81] World Bank,2003.

COMPANY REGISTRATION, LICENSING, AND INSPECTIONS

As shown in Table 3-1, entrepreneurs in Mozambique face too many procedures and substantial time delays in establishing a business. The number of procedures required to register and license a company is above the average even among the group of most regulated countries, and three times higher than in the best practice countries. Time delays associated with these procedures are twice those found in the most highly regulated countries. In addition, the cost of registration for even a modest investment of is reportedly more than double per capita income; this makes it very difficult for small and medium businesses to formalize operations.[82]

Foreign investors setting up a firm in Mozambique may choose between operating as a Mozambique-registered company (incorporated locally) or operating as a branch of a foreign company. The procedural steps involved with incorporation involve (1) notarization of the articles of association or statutes; (2) publication in the official Government gazette; and (3) registration with the commercial registrar as provided for by the country's commercial legislation. The enterprise may take the form of a private limited liability company, formed by at least two members, or a public limited liability company, which requires at least ten members, unless the state is a partner, in which case only two members are required. Before beginning operations, companies must register for tax, labor, and social security purposes and obtain all necessary operating licenses. These procedures look innocuous on paper, but in practice, say investors, the administration of these requirements involves time-consuming and costly twists and turns.

The entry of new firms is an important driver of exports and growth in all successful transition countries. To facilitate the formation of new firms, investment constraints associated with business entry need to be reduced as much as possible. The biggest problem in Mozambique concerns time-consuming and duplicative company registration procedures. Many government agencies (e.g., the Investment Promotion Center and the Notary Office, the Public Commercial Registry, the Government Printing Office) require similar information but share little of it among themselves. Lack of computerization further burdens the registration system. The overlap of regulatory authority between national, provincial, and local councils is also problematic.[83] Investors often need to request licenses in each jurisdiction. Different government agencies issue licenses for the same activity and apply different

[82] FIAS, 2001.
[83] FIAS, 2001.

standards. Too often, these agencies do not coordinate with, or necessarily respect or accept, each other's authority.

Official inspections add another layer of bureaucratic burden. While the government needs to ensure that taxes are paid and safety, health, and environmental standards are met, the inspections regime is overly intrusive—yet it does not appear to be very effective in guaranteeing that standards are actually respected. Firms are inspected by many official agencies: national and local tax authorities, health, safety and environmental authorities, labor authorities, and so on. Companies report in the World Bank's Investment Climate Assessment that these inspections are numerous, time-consuming, and often costly.[84] In addition, firms are subject to fines without clear standards or criteria. FIAS reports that inspection agencies fail to provide clear information on the standards used by inspectors, or to assist firms that are trying to meet standards.[85] Inspectors are often perceived as incompetent and intimidating. On many occasions, companies are denied an explanation of why they were fined and how the fines were determined. The low degree of transparency creates a highly discretionary system, which is especially onerous because inspectors reportedly share in the fines. In theory, this sharing may provide incentives for due diligence, but in practice, when combined with low government salaries, opaque requirements, and an absence of effective channels for appeal, it inevitably fosters predatory behavior.

To reduce the burden of excessive and arbitrary inspections, the government should develop fully transparent rules for planned an unplanned inspection visits, and seek to coordinate various inspections, with safeguards against unwarranted repeat inspections. In addition, firms need practical procedures for appealing decisions of the inspecting agencies, based on clear rules defining legal inspections, the requirements for compliance and noncompliance, the level of fines, and the rights of the business during an inspection. These rules should also help the judiciary, which has few guidelines to use when a firm complains about inspections. Inspecting agencies must pay more attention to information dissemination, and training of inspection staff to increase the effectiveness of essential inspections, reduce corruption, and improve the government's public image. Finally, inspectors should be paid well enough to do their job objectively without receiving a share of the fines, to end regulatory intimidation of businesses.

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[84] World Bank, 2002. Mozambique: Investment Climate Assessment. Washington, D.C.
[85] FIAS, 2001.

LABOR

Labor regulations are another major problem for employers. While the purpose of establishing regulations to protect workers is well intended, the associated costs greatly impair labor mobility and the creation of new jobs. According to the *Doing Business* study, Mozambique is one of the most difficult countries in the world when it comes to flexibility in hiring and firing workers. The study's employment law index (composed of indices gauging flexibility of hiring, conditions of employment, and flexibility of firing) shows that Mozambique has a more highly regulated labor market than all but one of the ten most regulated countries in the world (Table 3-1). Retrenchment of workers is a particular problem: for Mozambique the index used to measure inflexibility in firing is 50 percent higher than the average for the most highly regulated countries and five times higher than the average for best practice countries.

Two studies of Mozambique's Labor Law (Decree 8/98 of 20 July and other decrees) observe that the law offers unusually generous protection for workers.[86] The problem is that this translates into unusually high costs for employers. Moreover, the high standards of protection apply to very few workers—only those in the formal sector—and discourage new formal hiring. The following aspects of the law are identified as problematic:

- Limitations on forms of employment contract (e.g., time restriction on how long a person can be employed before automatically triggering permanent employment) compel many firms to hire only day workers or part-time workers, or to outsource from service providers who themselves are indifferent to the law.
- Vacation and leave time, compared with other countries in the region, are overly generous. Generous pregnancy and sick-leave provisions compound the costs of investing in labor-intensive operations.
- Legally hiring a replacement for sick workers (permanently disabled) takes too long and therefore poses serious difficulties.
- The notice period for dismissal is longer and severance is more generous than in other countries that compete for labor-intensive investments. High statutory severance requirements make it costly to dismiss redundant labor, and more risky to hire new workers in the first place. By the same token, companies that inherited a bloated pre-privatization labor force have found it difficult to raise productivity

[86] SAL (Consultoria and Investmentos, LDA). 2003. The Legal and Administrative Framework for Labor Relations in Mozambique. Sam Levy. 2002. Mozambique: Legal and Judicial Sector Assessment. World Bank: Washington D.C.

by restructuring. Problems with legal aspects of retrenchment lead firms to keep senior low-skilled workers at low wages rather than hire new, better-trained staff at higher wages. Firms also claim that ambiguity regarding the proper calculation of severance pay and the accrual of vacation is the cause of much litigation.

- The rules enforced by labor inspectors allow too much discretion. For example, Decree 25/99 allows fines on the employment of foreign workers to vary from 10 to 80 times the minimum wage,[87] which opens the door for harassment and corruption.
- Dispute resolution procedures are inadequate. Under the terms of the Labor Law and the Arbitration, Conciliation and Mediation Law, collective labor agreements are subject to arbitration but individual labor contracts are not. These cases are difficult to process through the courts in a timely manner, limiting workplace justice. Private dispute resolution could greatly improve the system.
- Procedures for calling strikes are unduly complex. Disagreement over whether a strike is legal worsens resentment between workers and employers, and prolongs strikes.
- One of the most discouraging facets of the Labor Law, particularly for foreign investors, is the provision governing the employment of foreign workers. These workers are an important channel for the transfer of new technology into the country. Given the shortage of skilled and experienced managers and technicians in Mozambique, foreign investors (and some local firms) often need to use expert foreign workers, despite the high cost of doing so. Under Decree 25/99, companies must go through an expensive and time-consuming authorization procedure before hiring foreign citizens. This rule applies to directors, managers, delegates, partners, proxies, and representatives if they perform work in Mozambique and receive remuneration. The World Bank's Investment Climate Assessment found that it takes a company, on average, 90 days or more to get a work permit for a foreign worker, at an average cost of $400 in bribes. Under Decree 25/99 companies are subject to a 15 percent quota for foreign workers; firms report that work permits must be obtained even within the quota limits.
- Restrictions on overtime work are also constraining. The ability to employ labor in overtime and shift work is crucial to labor-intensive export industries, such as garment manufacturing.[88]

[87] SAL, 2003.
[88] Cockcroft, John. 2004. The Textile and Garment Sectors in Mozambique: An Appraisal.

- Circumvention of the law is possible because of uneven enforcement stemming from corruption in the Labor Inspectorate.

A revision of the Labor Law is needed to make it more flexible and clear, and therefore easier to obey and administer. Provisions dealing with labor retrenchment need special attention. Requirements for worker dismissal notices and severance pay should be in accord with international standards. Ambiguities in the law regarding the calculation of severance pay and accrual of vacation should be clarified. Procedures for calling strikes should be better defined. To facilitate foreign investment and improve technology transfer, the processing of work permits should be streamlined by (1) creating clear rules and procedures that can be applied to each case; (2) simplifying the application procedure, which now requires advertisements, letters, opinions from unions and line ministries, and approval by the Ministries of Labor and Immigration; and (3) reducing the need for applications and approvals by multiple ministries. Further, provisions for shift work and overtime should be more flexible. Also necessary is improved training of workers, managers, and government officials in various areas, to ensure sound labor relations. Corruption in the Labor Inspectorate should be eliminated, lest it undermine the other improvements. Here, clear and transparent rules and procedures are especially helpful. Finally, labor reforms should allow broader options for dispute resolution. It should be possible for workers and managers to choose among government and private providers. To begin facilitating such choice the Labor Law and the Arbitration, Conciliation and Mediation Law should be revised to permit labor arbitration and mediation of labor contracts.

LAND

In the World Bank's Investment Climate Assessment, firms reported that acquiring land is one of the most difficult obstacles facing investors, especially for start-up or "greenfield" projects. All land in Mozambique is officially state-owned. As a matter of constitutional principle, it cannot be sold, transacted, mortgaged, or otherwise used as security. The state, however, may grant land-use rights to individuals for up to 50 years; these rights can be renewed for another 50 years.

There are several major problems with the system. The difficulty begins before an investor applies for land-use rights.[89] The investor may observe suitable unused land, but records indicating whether the land is available often do not exist, or are not readily accessible. The investor must ascertain if anyone else has rights to the

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[89] FIAS, 2001.

land, and then find the person and negotiate, or look for another plot. Once access to a plot is established, the process for obtaining land-use rights lacks transparency and predictability. This can be a long, complicated, and costly task (see Exhibit 3-1 for an example of the procedures for getting land-use rights to a plot of less than 1,000 hectares in a rural province).[90] And once acquired, the land-use rights are merely provisional. The investor must fulfill at least part, if not all, of an approved land-use plan within the legally prescribed timeframe—two years for foreigners, five for foreign nationals. The investor must also survey the land within one year. Failure to do so may lead to expiration of the land-use grant (though the holder may apply for a three-month extension). Only after meeting these requirements—often involving many "side-payments"—does the investor have definitive right to use the land, and a corresponding title.

Exhibit 3-1
Summary of Procedures for Accessing Land

- Identify a plot and prepare request for the Land Cadastre Service, which channels the request to a District Administrator (DA).
- The DA, with help from DPA (Director of Provincial Agriculture), prepares a written public notice reporting the investor's request and inviting anyone with a contrary interest to lodge an objection.
- The DA then organizes meetings with the local community to determine any community interests and vested rights in the plot.
- Results of meetings are documented and signed by no fewer than three and no more than nine members of the community, as well as by the holders of rights with respect to all the land contiguous to the plot.
- If nobody registers a prior interest or rights to plot (or objects to the use plan), this fact is recorded in an "opinion" of the DA.
- If some individuals (or community) have prior rights acquired by good faith occupation, the investor must negotiate with these persons, and the agreement reached is to be reflected in the DA's opinion.
- Investor is now ready to supplement the initial request with the required documents. If the Governor approves the application, the investor issues a provisional authorization, valid for 5 years in case of nationals and 2 years in case of foreign investors.
- At end of provisional authorization period (or before if requested) the DPA will conduct a site inspection to determine whether the use plan has been fulfilled. If it has, definitive authorization and a title attesting thereto is issued.
- Rights to use of the land are valid for as long as the corresponding authorization states—the limit is 50 years.

SOURCE: *Sam Levy. 2002. Mozambique: Legal and Judicial Sector Assessment.*

[90] Levy, 2002.

While the process for obtaining land-use rights is unduly interventionist and cumbersome, a more serious problem is that these rights cannot easily be marketed, at least not legally. As the World Bank's Legal and Judicial Assessment observes, "In many countries, developed and developing, land may not be owned in perpetuity. But in all such countries, there must be a fair and transparent market in land rights—something Mozambique lacks." Without such a market, it is extremely difficult for land to be transferred to its most productive use. Lack of easily marketable land rights also prevents businesses and farmers from using land as collateral to raise capital, and deters agricultural producers from making long-term investments. In addition, insecure tenure deters agricultural producers from making long-term investments, such as installing irrigation or planting tree crops.

Undeniably, the land issue is highly political and the problems are complex, but steps must be taken to accelerate the process of creating a free market for land rights, to stimulate job-creating investment and exports. One practical way to proceed would be to demarcate special pilot zones for the development of industry, agriculture, and tourism. Within these zones, the government can introduce special procedures to expedite the process for obtaining secure land-use rights, and allow the purchase and sale of these rights subject to simple and transparent registration requirements and zoning regulations.

CONTRACT ENFORCEMENT

To smooth the progress of trade and investment, Mozambique's legal and judicial system must be reformed and modernized. A strategic plan for reform of the justice system was produced in early 2001, but reforms have been implemented very slowly. For example, Parliament is taking years to pass a new Commercial Code to replace the archaic code inherited from colonial days. Even once the new law is passed, its administration is likely to be a serious problem. Court decisions often take years, which makes it difficult to adhere to or enforce contracts. Dissemination and enforcement of laws is poor, especially outside major cities. Weakness in the legal system impedes progress of private enterprise in every sector of the economy. It also impairs trade, and deters investment.

As Table 3-1 shows, Mozambique has ranked among the world's worst venues for contract enforcement, as measured by time delays and procedural complexity. While the number of procedures is less than in many other countries, this does not matter as much as the delays, which are extremely long. These delays, and the associated costs of contract enforcement, have major implications for the ability to conduct business or obtain credit. Also very restrictive are the legal impediments to closing a business in Mozambique (not shown in Table 3-1). In the Doing Business study, Mozambique ranks among the bottom ten countries in terms of achieving the goals of insolvency through its bankruptcy procedures.

Weak contract enforcement is due in part to antiquated laws and procedures. According to the World Bank's Legal and Judicial Sector Assessment, Mozambique's Code of Civil Procedure is, with few changes, essentially the Portuguese code inherited at independence. This code is highly complex and at times overwhelms the technical capabilities of support personnel in the legal and judicial sector. Judges reportedly find it challenging as well, especially when lawyers use it for purposes of delay. Modernization of the civil procedure, to eliminate bottlenecks and reduce delays, is on the government's legal reform agenda.

The legal treatment of bankruptcy and business reorganization is very important for modern commercial activity. These sections of the code are not as stodgy as other commercial legislation still in force. For example, the code sets forth detailed procedures on declaration of insolvency, rescheduling agreements with creditors, and agreements among creditors to assume the management of insolvent firms, among other matters, are set forth in considerable detail. Yet the code lacks provisions allowing a debtor in arrears enough bankruptcy protection (a suspension of execution and grant of management discretion) to reorganize as an economically viable venture—a feature that increasingly characterizes modern bankruptcy law.

If better bankruptcy protection were introduced, would it be widely used? The World Bank's Legal and Judicial Sector Assessment reports that neither creditors nor debtors make frequent use of existing bankruptcy provisions of the code to compel or resist the payment of debts. In 1999 and 2000, only three cases were filed under the code's bankruptcy provisions. Why? First, businesspeople may not be aware of code provisions that allow for organized rescheduling of debt. Second, they may regard the courts as too slow or too corrupt to be used for this purpose, or judges as too poorly trained to properly adjudicate the case. Thus, improving transparency and fairness in the administration of the legal and judicial system, and people's knowledge and trust in the system, may be even more important than rewriting laws. In any case, Mozambique's business community may not be disposed to force a debtor into bankruptcy when the debtor's assets are few, and little value would be gained from liquidation because of the country's general economic situation.

The judicial execution of debts also needs attention, as evidenced by the backlog of cases. Judicial execution can be expedited by separating administrative from judicial tasks. Administrative tasks, such as preparation of documents or service of process, can be entrusted to a private contractor.

Aside from antiquated laws and procedures, insufficient human resources, poor management, and corruption plague the legal and judicial system. Introduction of a market economy has increased demand for court services faster than services can be provided. Especially for labor disputes, and to a lesser extent commercial litigation, the judiciary has not had the resources to respond. Particularly constraining is the shortage of skilled personnel in all parts of the legal and judicial sector, especially outside of Maputo. Case backlog has grown while the public image of the legal and judicial sector has plummeted.

Resources are not only constrained but also poorly managed. For example, young, expensively trained magistrates are not placed in judicial positions in a timely manner, and drift to the private sector out of frustration. Substantial resources that could have been allocated to improving system-wide administration and training are spent building courts and housing for judges in districts with very small dockets.

Compounding the other problems, corruption is “poisoning the legal and judicial system,” according to the World Bank’s Legal and judicial Sector Assessment. This has eroded public confidence in the sector’s institutions. To build public trust, a much more determined effort is needed to fight corruption.

Legislative reform, while important, should not be the sole focus of legal and judicial sector reform. The biggest problem is not the laws but their administration. Legislative reform will make little difference if laws are enforced indifferently or corruptly. But even antiquated or complex laws need not lead to high costs or undue delays if enforced transparently and fairly. Much more attention, therefore, should be given to day-to-day management of institutions that administer the laws and interact with the public. Refocusing legal and judicial institutions on the effects their activities have on the public, and on managing for practical results, will be more fruitful than rewriting laws and procedures.

Thus, most observers agree that reforming the legal and judicial sector and improving contract enforcement in Mozambique will also require

- Providing training in all legal and judicial institutions;
- Strengthening managerial skills in legal institutions and adopting more exacting goals for performance and accountability; and,

Attending to reform the administration of justice (including corruption) rather than simply revising legislation.

Finally, we note that reform of Mozambique's legal and judicial system is progressing. A strategic plan for the entire system and operational programs for reforming its four branches (Ministry of Justice, Supreme Court, Administrative Court, and Attorney General) have been completed. An interministerial legal reform commission was created in 2002 to oversee the reform process. Selective reform of civil procedure is currently underway and the government is developing a new bankruptcy law. The government has also begun to focus on actions that will yield positive results quickly: selective revision of the Code of Civil Procedure, strengthening the capacity of notary registries, establishment of a judicial inspection unit to improve the quality of judicial services.

GOVERNANCE

To eradicate administrative barriers to investment and private sector development, effective reform programs require more than redrafting laws and procedures. They must address governance more generally. Reform efforts may include restructuring and building the capacity of executing agencies and building consensus and commitment among government leaders to adopt and implement reforms, including anti-corruption programs.

During the 1990s, not enough political will was devoted to managing and implementing administrative reform. A FIAS review in 2001 cited the following weaknesses with the reform process.[91]

- First, although the highest levels of government wanted to reform administrative and legal barriers to investment, that desire was not expressed in "a shared vision or commitment adopted by all political parties, responsible ministries, and executing agencies." FIAS observed that the 1997 Action Plan for reform, developed by the Ministry of Industry and Trade and the Confederation of Mozambique Business Associations (CTA), and presented at the private sector conference that year, was not thoroughly discussed by all relevant ministries and agencies, nor was it formally endorsed by the government. FIAS noted further that "the lack of ownership, support, and participation by the respective stakeholders has resulted in implementation that has been half baked at best."
- Second, Mozambique could benefit from a faster and more comprehensive civil service reform. In all procedural areas, "the investment process was hindered by fundamental weaknesses of the current civil service system." Reform

[91] FIAS, 2001.

> implementation problems partly stemmed from the overlapping structure of government institutions and a lack of clarity concerning responsibilities and accountability. But "passive resistance" among unmotivated executing agencies and officials was widespread, as was corruption at all operational levels.

FIAS concluded that solving such problems requires reform of the civil service to complement reform of regulations and legal procedures.

We note that the government is taking action to accelerate public sector reform. Programs to decentralize activities and improve the effectiveness of the civil service through training and salary reforms have accelerated. All ministries are mapping their operations and identifying areas to be restructured. Restructuring plans are being integrated by a central policy unit in charge of the reform and key ministries will soon begin restructuring. Salary reform will be introduced in each ministry civil service staffing needs are assessed.

Corruption

Corruption is a central governance issue in Mozambique. According to several international rating sources, the level of corruption is high compared to most other countries. The widely cited Corruption Perceptions Index (CPI) of Transparency International suggests, however, that the situation may be improving. In 2000, Mozambique ranked 81st out of 90 countries; in 2003, it ranked 86th out of 133 countries, which was above the median for least developed countries. Nonetheless, corruption remains widespread. In a survey of domestic investors conducted by ETICA, 45 percent of those interviewed in three provinces (Maputo, Sofala, Nampula) had been solicited recently or paid a bribe.[92] Most paid between US$4–US$40, but 9 percent paid between US$40–$400. Fifty-eight percent of ETICA survey respondents believed corruption to be pervasive in the judicial system and the regulating ministries. More alarming, those surveyed believed that the institutions most involved in corruption had the least interest in stopping it, even though almost half believed the government had the capacity to do so.

> Bribery Out of Control in Vilanculos
>
> *A survey of 100 registered businesses in this tourist town found that 82percent paid bribes averaging 9.5 percent of gross revenues. Mozambican companies paid more in bribes than did foreign companies. In so doing, these firms were able to evade approximately two-thirds of the taxes they should have paid—costing the government the value revenue needed for social and economic programs.*

Corruption distorts the competitive system by changing the "rules of the game" for investors. In addition to demoralizing legitimate business persons, corruption

[92] Cited in Nathan Associates, Mainstreaming Trade: A Poverty Reduction Strategy, USAID, 2002.

imposes an arbitrary additional tax on investment returns, while increasing risk and uncertainty. The result is lower efficiency, less effective public service delivery, and lost investment—not to mention the hardships created by unofficial payments extracted by government officials from the poor. If the institutions of governance are corrupt, then efforts to revise legislation, modernize procedures, and restructure public agencies will make little difference. Therefore, it is essential for the government to intensify the fight against corruption. Developing stronger institutions and capacities to curb corruption at all levels is an essential part of any administrative reform, and a critical element of Mozambique's national trade strategy.

Effective action has been slow in coming, but the government has recently taken some steps to deal with the insidious problem of corruption. These include enacting an anti-corruption act in May 2004, and establishing an Anti-Corruption Unit in the Ministry of Justice. The government is also undertaking a national corruption survey, which will provide a benchmark for measuring changes in the future. Other measures include the ongoing civil service reform program, and improvements to the public expenditure management system and procurement procedures.

Still, fighting corruption will require sustained cooperation among government, business, civil society, and international agencies. The business community must push for greater transparency in administration of procedures, regulations and laws, as well as government procurement. Civil society must lobby for more government transparency and scrupulous administration of laws and the judiciary. International agencies must promote more transparency in government administration and accounting, and condition aid on government action to reduce corruption. All segments of society must support political candidates who are committed to eliminating corruption. Within government the following actions are needed to further address the problem: (1) develop more effective procedures and sanctions to reduce official corruption and improve implementation and enforcement of existing anti-corruption programs; (2) improve public accounting, auditing, and reporting procedures for principal public agencies; (3) build the capacity of the Ministry of Finance to perform audits while

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Bottom-Up Efforts to Fight Corruption Are Promising…

Mozambique's civil society anti-corruption group, ETICA, is conducting a comprehensive survey of corruption. Mozambique's confederation of business associations (CTA) has pressed for simplification of rules and regulations. The Mozambican press has encouraged the fight against corruption.

But Top-Down Efforts Have Stalled

Mozambique recently passed an anti-corruption law and established an anti-corruption authority—both, many years in the making. No senior officials identified as corrupt have yet been prosecuted. Critics assert that some senior figures have blocked efforts to bring corruption under control.

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audit and accounting reforms proceed; (4) develop a systemic capacity-building program to improve administration of regulations, inspections, and service delivery.

Taxation System

EVOLUTION OF TAX POLICY

Mozambique has done much to reform its tax policies during the last decade. Before 1993, when the first of a series of tax reforms was introduced, companies were subject to an income tax of 50 percent, a turnover tax of 5-10 percent, a consumption tax of 20-150 percent, stamp taxes (small lump sums), and a 4 percent payroll tax (the ISS) covering the employer's contribution to the pension system. Today, after a lengthy process of simplifying the tax system and broadening the tax base, the corporate tax (IRPC) is 32 percent, and the cascading turnover tax has been replaced by a value-added tax (VAT) with a single rate of 17 percent and few exemptions.[93] Other taxes include the following:[94]

- Capital gains 32%
- Branch tax 32%
- Withholding on:
- Dividends 20%
- Interests 20%
- Royalties 20%
- Social security tax (ISS) 4% (plus 3% paid by employee)

The VAT is now the most important source of tax revenue. In 2002, it generated 38 percent of revenues, more than twice the next largest component of revenue, income and company taxes. Taxes on international trade contribute 15 percent of tax revenue, while excise taxes and the petroleum tax add just over 8 percent each. The VAT collection rate in Mozambique amounts to 5.4 percent of GDP, which accords roughly with experience of other developing countries.

IMPACT OF TAXES ON INVESTORS

Despite these improvements, Mozambique's standard statutory tax regime (excluding concessions) places a substantial burden on investors. A recent study of

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[93] Standard company tax rates in the SADC region range from 25 to 40 percent, clustering around 30 to 35 percent.

[94] Ernst & Young. 2004. Worldwide Corporate Tax Guide.

tax structures in SADC countries shows that the tax burden on investors under the standard tax system is slightly higher than average in Mozambique[95] (Table 3-2, first column). Even with the reduction to 32 percent in the company tax rate in 2003, the combined burden of the company tax plus the tax on dividends is 45.6 percent, versus a regional average of 40 percent.

Table 3-2
Marginal Effective Tax Rates in SADC: Standard Tax Regime vs. Concessions

Country	Standard Statutory Tax (%) (1)	Average METR Standard Tax (%) (2)	Average METR with Tax Concessions (%) (3)
Mozambique	46	56	14
Angola	45	55	38
Botswana	26	34	13
DRC	53	61	39
Lesotho	45	64	17
Malawi	37	48	0
Mauritius	25	23	6
Namibia	35	26	0
Seychelles	40	39	16
South Africa	39	38	16
Swaziland	37	51	6
Tanzania	41	45	0
Zambia	52	35	0
Zimbabwe	44	44	4

SOURCE: Bolnick 2004, Tables 7-2 and 7-4. Estimates based on simple average of four different investment types. See report, Chapter 7, for details on data and methods of analysis. The figures for Mozambique have been recalculated here to reflect the reduction in the company tax rate to 32 percent in 2003.

The second column of Table 3-2 shows the marginal effective tax rate (METR) in each SADC country, assuming that investors operate under the standard tax regime. The METR is used to assess the degree to which taxes reduce the rate of return to investors.[96] In the SADC study, the METR calculation takes into account technical features such as depreciation allowances, tax loss carry-forward, and capital gains on

95 Nathan Associates. 2004. Effectiveness and Economic Impact of Tax Incentives in SADC Region. Nathan-MSI Group.

96 Defining ROR_bt and ROR_at as the rates of return before and after tax, respectively, the METR is defined as (ROR_bt – ROR_at) / ROR_bt. Thus the METR shows the extent to which the rate of return is diminished by the tax system.

the sale of assets. The effective tax burden also depends on characteristics of the investment. Hence, the METR is calculated for four illustrative investments, which differ in the composition of the capital stock and the extent of debt financing.[97] Each figure given in the table is an average METR for the four illustrative investments.

To focus on foreign investments, these METR calculations use the dividend tax for non-residents. On this basis the METR for Mozambique, at 56 percent, is significantly above the regional average of 44 percent. This means that comparable investments, with equal *pre-tax* rates of return, would produce an *after-tax* rate that is lower in Mozambique than in 9 other SADC countries.[98] The main reason for this is the taxation of dividends and capital gains.[99] Dividends are taxed at 20 percent, while the regional average is 13 percent (ranging from 10 percent to 25 percent, clustering around 15 percent). Capital gains in Mozambique are taxed at 32 percent. In about half of the SADC countries capital gains are taxed at the standard rate, but in several, such as Mauritius and Zambia, capital gains from the sale of business assets attract no tax.

Investment Incentives

The tax picture changes when one takes into account fiscal incentives, which are offered in every SADC country. Mozambique enacted a new Code of Fiscal Incentives in 2002, which establishes standard concessions for approved investments, and special benefits for seven types of investment[100] (Exhibit 3-2). The third column of Table 3-2 shows the METR for each country, assuming this time that investors obtain the benefits of special tax incentive programs applied to the export of manufactured goods. The figures show that tax concessions greatly reduce the METR facing investors in nearly every country. In Mozambique, tax incentives reduce the METR sharply, making it a much more competitive investment location. Mozambique's average METR for the illustrative investments is 14.3 percent, which

[97] Specifically, the illustrative investments involve two types of capital stock (machinery only, or machinery plus buildings) and two forms of financing (equity only, or equal amounts of equity and debt). To control for other factors, the illustrative METR calculations also assume a 20 percent target real rate of return, a 10 percent inflation rate, a nominal interest rate of 25 percent, a 10 percent duty on imported manufactured goods, reinvestment each year to maintain the capital stock, and sale of the assets in year 10.

[98] The numbers given here for Mozambique differ slightly from those in the original source This is because Nathan Associates (2004), used the old 35 percent company tax rate for Mozambique, whereas the METR is calculated here using the new rate of 32 percent.

[99] Capital gains tax enters the picture because the analysis assumes that project assets are sold after ten years.

[100] The designated types are agriculture, hotels and tourism, large-scale projects (undertakings having investment exceeding US$500 million), rapid development zones, industrial free zones, mining, and petroleum.

Exhibit 3-2
Investment Incentives Offered by Mozambique

Capital Allowances

- Investment tax credit of 5 percent for the first 5 years (10 percent in Gaza, Sofala, Tete and Zambezia, and 15 percent in Cabo Delgado and Niassa, and 20 percent in designated Rapid Development Zones, with higher limits for large-scale projects).
- Accelerated depreciation on new immovable assets at twice the normal rate.
- Full deductibility of advanced technology equipment up to 15 percent of taxable income for 5 years.
- 120 percent deductions for infrastructure-related expenditures for 10 years (150 percent outside of Maputo City).
- Five-year loss carry forward on unused credits.
- For hotels and tourism, additional 3 percentage points on investment tax credit, and accelerated depreciation at triple the normal rate.

Tax Holiday

- Agriculture, 80 percent tax reduction until 2012.
- Industrial free zones, 60 percent reduction for 10 years.
- Mining investments exceeding US$500,000, 25 percent reduction for 5 years.
- Petroleum, 25 percent reduction for 8 years.

Differential Tax Rates

- 10 percent for agricultural enterprises.

Treatment of Dividends

- Exemption under IFZ and regional incentive schemes.

Additional Benefits for IFZs

- Exemption from customs duty, VAT, and special consumption tax (excises) on purchase of construction materials, machinery, equipment, accessories, spare parts, or other goods destined to the exercise of the activity.

Import Duties

- Exemption from import duties on capital goods (Class “K” of the Customs Tariff Schedule).

Large-scale Projects and Public Domain Infrastructure Concessions

- Exceptional incentives may be granted under a contractual regime by the Council of Ministers for up to 10 years.

SOURCE: *Council of Ministers Decree 16/2002 of 27 June.*

falls in the middle of the range for SADC countries. Several SADC countries have gone further, offering tax incentives that reduce taxes to zero by fully exempting manufactures in export processing zones (EPZs) from company tax, dividend withholding, capital gains, and duty on capital equipment. In some cases, these schemes have been wholly ineffective.[101] In any case, Mozambique has opted not to forgo all of the revenue from export-oriented investments. Given the country’s revenue constraints and pressing needs, this approach is highly advisable.

[101] Zambia introduced the zero tax regime for EPZs in 2003 and suspended its operation before it took effect due to concerns about revenue impact. In Malawi, the zero-rate regime has gone virtually unused. In Namibia, only a few projects have been implemented under the zero tax regime; they are highly controversial, and the number of jobs created to date is small.

Tax incentives unquestionably improve Mozambique's competitiveness as an investment location. Some analysts argue that the incentives may be warranted, to compensate for problems with the infrastructure and supporting institutions. But these concessions are controversial. Are generous tax breaks necessary? Do the benefits offset the lost revenue? Are they effective in attracting investment? According to critics, a supportive investment climate—including stable macroeconomic conditions, secure property rights, and a minimum of red tape—is more important than tax rates in attracting foreign investment.[102] Certainly, tax relief has no impact whatsoever if investments are unprofitable due to poor underlying conditions. Nor do tax breaks affect investment decisions for projects that are location-dependent and highly profitable in their own right, such as natural resource projects. These projects are viable without tax breaks. Consequently, fiscal benefits amount to a straight transfer in favor of the investor at the expense of the Treasury.

To date, most FDI entering Mozambique has been for mega-projects. These investors are capable of dealing with constraining features of the investment climate, such as cumbersome government regulatory and administrative barriers, particularly with the help of influential political allies. Smaller, labor-intensive investors, with fewer resources and less political muscle, are deterred from investing by Mozambique's investment climate, despite generous tax incentives. Further, many of the mega investments may have occurred with less generous tax concessions. For example, investments in aluminum smelting, gas, and mining were motivated primarily by cheap energy or natural resources. Macamo found that 75 percent of recent investors interviewed would have invested in Mozambique even without the special fiscal benefits.[103]

Incentives may be necessary to attract more "footloose" investments that stimulate export growth. But most foreign investment so far has been highly capital-intensive, resulting in little job creation. The World Bank's Investment Climate Assessment shows, for example, that the projected $10 billion in mega-project investments slated to begin operating in the next few years (equal to twice Mozambique's current GDP) are likely to generate only 5,000 direct jobs and 15,000 indirect jobs among suppliers and service providers. This is just a drop in the bucket compared to the estimated 3.7 million new entrants to the job market between now and 2010.

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[102] Nathan Associates, 2004.

[103] Macamo, José Luís. 2002. Barreiras Administrativas ao Investimento em MoçambiqueÇ Liçoês Aprendidas da Experiência de Investidores Recentes. In Rolim, Franco, Bolnick and Anderson, *A Economia Moçambicana Contemporânea: Ensaios.* Ministério do Plano e Finaças.

TAX ADMINISTRATION

The statutory tax rates, designated investment incentives, and METR calculations tell just part of the story of how the tax system influences investment decisions. In reality, the tax burden hinges on the quality of tax administration. There is evidence that Mozambique has substantial difficulties in this area. In the recent World Bank Investment Climate Survey, 50 percent of the firms interviewed reported that tax administration is a major or severe obstacle to doing business. Problems identified by respondents included arbitrary implementation of the tax code; frequent and time-consuming tax inspections; unqualified tax inspectors; overly complicated paperwork; inability to get VAT refunds; and inadequate dispute resolution procedures.

The most widely heard criticism is directed at the discretionary nature of tax administration. Firms contend that tax laws are unclear and open to interpretation by tax officials, who use the ambiguities to set arbitrary fines and extract bribes. Some respondents claim that large, politically connected companies are able to negotiate special arrangements such as EPZ status or other tax concessions, while smaller companies cannot get access to such concessions. Indeed, many firms state that they have been unable to get legal tax concessions when entitled to them (e.g., exemptions on imported capital equipment), or that they must wait three or four months to get entitled exemptions, hampering investment planning. Finally, many firms criticize the fact that other companies avoid VAT and customs duties because of corrupt customs officials, giving them a competitive advantage over those that comply with the tax laws.

Many enterprises have to contend with frequent tax inspections (on top of inspections by labor officials, health and safety officials, and so on). Inspections take time and often involve bribes or heavy penalties for alleged infractions (which are often not clear to the firms involved). In addition, a meaningful system for tax dispute resolution, to which a company can turn when it feels mistreated or wants to challenge penalties, does not yet exist. The court system is very slow and sometimes corrupt, and effective means for resolving disputes outside the judicial system do not exist.

Unpaid tax refunds are another serious matter. The Ministry of Planning and Finance (MPF), which collects import duties and taxes, also refunds VAT to qualifying companies. The VAT does not apply to some essential goods and services (e.g., medical services, drugs, housing, wheat flour, rice, bread, agriculture, fishing), but must be paid upon import of goods, including capital goods, raw materials, and intermediate inputs. For exporters, the tax paid on inputs is supposed to be refunded upon proof of export. The World Bank's Investment Climate Survey and other reports note, however, that firms have experienced significant delays in obtaining the refunds, and some claim that they never got them. Most exporters reported VAT refund delays of three or four months, with some cases taking up to a year. Some firms also claimed that they had to pay a bribe of up to 10 percent of the refund due, or face indefinite delays. At prevailing real interest rates of about 25 percent, tying up cash in VAT payments that are due for refund represents a significant additional cost of doing business.[104]

Part of the problem is that VAT refunds are handled as budget expenditures, rather than being netted out of VAT receipts (as would be appropriate, since the refundable amounts do not actually belong to the government). As such, the process of clearing them is time-consuming. To reduce delays for exporters, the government should change how it handles these refunds. The process can be expedited by establishing a special registry of regular export enterprises to provide fast-track "green light" handling of their claims, subject to intermittent inspection.

Finally, local and national tax authorities are not as transparent or well coordinated as they should be. Local tax authorities, especially in the northern provinces, often have inadequate communication with decision makers in Maputo. For example, a manufacturer in the Zambezi Valley EPZ reports that he attempted to import machinery that would expand his capacity. Although the machinery was exempt from customs duty and VAT, local customs required that he pay duty and taxes, amounting to almost US$20,000. The manufacturer refused to pick up the machinery because the duty and tax would tie up too much of his working capital, perhaps for as long as a year. The implementing officer for the EPZ was located in Maputo and unaware of the customs ruling or its consequences.

Collectively, these problems with tax administration reduce investment returns and influence business' negative view of the tax system. According to the World Bank's Investment Climate Survey, many foreign investors feel that Mozambique has earned a reputation for not following through on commitments on tax incentives. In particular, a priori concerns about long delays in getting VAT refunds increase the expected marginal effective tax rate significantly. Many local firms, on the other hand, feel that the only way to deal with the system is to opt out by hiding from the

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[104] For example, suppose that material inputs represent 80percent the final price of an export product, with 60 percent of the materials being imported, at an import duty of 7.5 percent. The 17 percent VAT on imported materials then represents 8.2 percent of the sales price. If the VAT refund takes 6 months, at an interest rate of 26 percent, then the delay adds just over 1 percent to the product cost. In highly competitive world markets, this extra cost can make a big difference.

tax authorities in the informal sector, or under-reporting income. Improvements in tax administration must therefore be given priority in future efforts to enhance the investment climate in Mozambique.

In the last few years, the government has taken several steps that should make a difference in this area. A large taxpayer unit was launched in the Domestic Tax Administration Directorate in 2002. The unit is staffed with qualified tax personnel and is managed more efficiently than its predecessor. Numerous discretionary and time-consuming inspections have been eliminated. The government plans to unify tax administration by placing the Domestic Tax Administration Directorate and the General Directorate of Customs under one organization: a central revenue authority (Autoridade Tributária de Moçambique). An action plan for implementation of the new authority was approved in 2003. To bolster public confidence in the tax system, a new organic law for tax tribunals was submitted to the National Assembly in 2003, to create a more transparent system for tax appeals.

Financial Sector

Mozambique's financial system has changed a great deal since the 1980s. A series of reforms have separated commercial lending functions of the Bank of Mozambique from its central banking function, introduced new instruments for monetary control, instituted prudential regulations for banking, and privatized commercial lending. These changes helped improve management of monetary policy and economic stabilization. Recent reforms have also paved the way for a substantial increase in the number and variety of operating financial institutions (Table 3-3).

Despite these advances, weaknesses in the financial market have to be remedied to improve private sector access to credit and export development. First, inadequate supervision of banking practices led to major bank insolvencies in 2001, creating a loss of public confidence in financial institutions, and a large bail-out cost to the Treasury. Second, as reported in the World Bank's Investment Climate Survey, persistently high real lending rates (19 percent in 2002, and 10 percent in 2003) and difficulties getting credit without meeting high collateral requirements discourage firms from forming or expanding, and constrain investments that are needed to increase productivity. These credit constraints, in turn, create problems for export development and growth. As Table 3-4 shows, the Investment Climate Study in 2002 found that only about 10 percent of firms in Mozambique had access to bank credit, versus 21 percent in China and 36 percent in India. Lack of access to bank credit obliges firms to finance investment from internal funds, as evidenced by the fact that

70 percent of Mozambican firms use only internal resources to finance investments. This would not pose a problem if businesses were booming and profits growing rapidly. Under such circumstance, retained earnings could be sufficient to finance investment. Unfortunately, the business environment in Mozambique has not supported high earnings and rapid capital accumulation.

Table 3- 3
Evolution of Financial Institutions in Mozambique

Type of Institution	1991	2002
Central bank	1	1
Commercial banks		11
Investment banks		1
Credit unions		6
Real estate finance institutions		3
Venture capital firms		1
Group purchase firms		1
Other intermediate credit institutions		2
Micro-finance institutions		14
Representation offices		2
Foreign exchange houses	4	32
Insurance companies	1	5
Insurance brokers		8
Inter-bank markets		2
Capital markets		1

SOURCE: *SME Country Mapping: Mozambique, World Bank, 2002.*

Table 3-4
Sources of Investment Finance in Mozambique, China, and India

	Mozambique	China	India
Internal	70	52	30
Bank loans	10	21	36
Trade credit	0	4	--

SOURCE: *Mozambique: Investment Climate Assessment, 2002, World Bank.*

CAUSES OF HIGH LENDING RATES AND LOW INTERMEDIATION

Structural and institutional weaknesses are mainly responsible for the high real lending rates and low financial intermediation in Mozambique. First, according to the World Bank's Financial Sector Assessment Program for Mozambique, competition in the banking system is still insufficient to instill competitive pricing and product development for financial services. The lack of effective competition has resulted in inefficiency, high costs, and highly conservative banking practices.[105]

Second, the real side of the economy is still fragile, creating substantial lending risks. Formal private sector firms fall into two categories: (1) a handful of large firms, mostly foreign-owned and capital-intensive, that contribute to the country's high growth rates and exports, and (2) a multitude of micro and small-scale enterprises, mostly owned by Mozambicans and selling to local markets. While most of the large firms readily qualify for credit, most Mozambican-owned firms have limited technical capability and high debt (accumulated debt from war years, privatization debt, debt from bad economic conditions, such as the floods, and debt from bad management). The business environment for these firms has not been conducive to sustained and growing profitability. Without a strong balance sheet and solid market position, such companies will either be denied loans or charged high interest rates to cover the credit risk.

Third, information and contract enforcement problems, brought on by poor accounting information and an inefficient judicial system, reduce the ability of banks to assess credit risk, and raise the risks and costs of loan recovery.

Fourth, lack of effective land title or marketable land-use rights greatly diminishes the availability of assets that can be secured as collateral, limiting private sector access to credit, and exacerbating the loan recovery problem.

Finally, the bank failures in 2001 necessitated a large bail-out that was financed by issuing government debt. This large increase in the government's demand for credit and helped push domestic interest rates higher.

These problems have also restricted the development of financial institutions outside of banking. The stock market was established in 1999, but has only one company stock listing, and negligible trading activity. One leasing company started up in the mid-1990s (and was recently taken over), but the volume of business is small. Supplier credit between firms is not well developed, even when compared with other African countries.[106] In this atmosphere, the financial system continues to lack depth and breadth.

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[105] World Bank. 2003. Financial Sector Assessment Program for Mozambique. Washington, DC; IMF. 2003. Republic of Mozambique: Financial System Stability Assessment. Washington, DC.

[106] Ibid. "Investment Climate Survey Mozambique."

AVAILABLE EXPORT FINANCING

Credit is available in Mozambique for large, reputable firms, and for firms that can have adequate collateral (100–150 percent of the loan amount). Although the range of acceptable collateral is narrow, export financing—particularly post-shipment financing, but also pre-shipment working capital for completing an order—is available to established exporters with confirmed orders. Fees and real interest rates for these loans, however, are much higher than in competitor countries (e.g., Asia, Latin America), often twice as high. Credit in foreign currency is also available for established exporters at lower rates of 8–10 percent. Some modern forms of credit instruments, such as back-to-back letters of credit, which would be useful for export development in labor-intensive activities like textiles and garments, are not available.

On a modest scale, some banks have begun lending to smaller enterprises, and are developing their retail lending departments. At least 14 micro-finance institutions (MFIs) are serving about 30,000 clients. Novobanco, a subsidiary of the largest bank in Mozambique, BIM, specializes in micro and small enterprise finance. It offers loans from $300–$15,000 for fixed investment, working capital, and housing improvement. Most loans are made around Maputo, but the bank is expanding into Beira and Nampula. Maximum duration for loan repayment is two years at a higher than market interest rate. This MFI has about 3,000 clients. Another major source of financing for micro and small enterprise is SOCREMO (Sociedade de Credito de Mozambique), which extends loans of up to $5,000 in Maputo and Beira and has about 4,500 clients. The average loan size is $300. This MFI is supported by German technical assistance.

Several banks have investment or venture capital wings or subsidiaries, and most have done some small- and medium-scale project financing. Still, most external financing for micro, small, and medium enterprises continues to come from special institutions, many of which are funded by donors. The most prominent among them are described in Exhibit 3-3. Rural areas in Mozambique are especially disadvantaged in financial services. This hinders prospects for development of agricultural exports. Farmers face difficulty obtaining normal bank services because there are no financial institutions nearby providing deposit and remittance facilities, let alone loans. In many developing countries, special non-bank financial institutions provide most of the financing that farmers need. Other sources of rural credit that are commonly found in developing countries—such as credit unions, village banks, and supplier credit from equipment dealers, seed and fertilizer suppliers, and rural stores—are largely absent in Mozambique.

Exhibit 3-3
Special Financing Institutions

GAPI (Sociedade de Gestao e Financiamento para a Promocao da Peqena e Media Empresas)

- Seventy percent of GAPI is owned by the government, 30 percent by a German foundation, Friedrich-Ebert-Stiftung. The firm manages funds for German, French and Danish donors. Clients are mainly concentrated in Maputo but are to open branches throughout the country. Focused on fixed asset financing, average loan size $35,000. The fund has about $13 million in assets.

World Bank Enterprise Development Program (PODE) Credit Line

- The loan limit for established enterprises is $300,000; for a new borrower $40,000. Few loans have been made because terms are not attractive to banks. Also, firms need extensive documentation and collateral to access loans.

FFPI (Fundo de Fomento a Pequena Industria)

- A government fund that makes working capital loans to SMEs. This fund concentrates lending in Maputo. The maximum loan is $50,000 (average loan is $13,000), the required collateral 110 percent, and the duration of the loan is 12 months at above-market rates with fees – 15 percent deducted upfront.

FARE (Fundo de Apoio a Reabilitacao Economica)

- Offers loans accompanied by training for small-business. Loans are highly subsidized at 50 percent of central bank discount rate for 1-3 years. Lending amounts have been limited. Also offers loan guarantees to rural stores.

AMODER (Associacao Mocambicana para o Desenvolvimento Rural)

- NGO that lends to rural trading enterprises – outstanding loans of approximately $2 million.

SOURCE: World Bank. 2002. SME Country Mapping: Snapshot of SME Activities in Mozambique.

THE TASK AHEAD

Although the financial system is on a favorable development path, many structural and institutional weaknesses still hinder financial intermediation, which is required for private sector development and broad-based export growth. The government has to take steps to encourage more robust competition in financial markets by fostering the entry of new financial institutions. Banking supervision must be strengthened to improve the soundness of the financial system and increase public confidence. Above all, not enough has been done in Mozambique to strengthen institutional foundations for financial market development. The World Bank's Financial Sector Assessment Program, and interviews with businesspeople in Mozambique, make it clear that three areas need particular attention to improve access to credit and reduce intermediation margins: (1) financial information systems, (2) legal and judicial reform, and (3) establishment of a free and transparent market in registered land-use rights or titles, to expand the base of assets that can be used as collateral.[107] The issues of legal and judicial reform and land-use rights were covered above; here we focus on requirements for better financial information.

Lack of accurate financial information on prospective borrowers constrains the ability of banks and other financial organizations to assess credit risk and, in turn, to intermediate financial resources efficiently. Accounting standards and skills are a major part of the information problem in Mozambique. As one accountant put it,

> We have been raising the issue of no proper accounting standards and the lack of an accounting institute for training accountants for the last decade with the government and the donors, but nothing tangible has been done. Despite money for a stock market and for financial sector reform, there have been no real efforts to develop the underpinnings of these markets.[108]

As a result, proper financial information on firms is lacking. A leading accounting firm contends that Mozambique has only about 50 “bankable” companies with proper audited accounts. As a result, Mozambican banks are fully lent out in terms of “good borrowers.” For the same reason the new stock market has only one listed stock and three debt issues.

The government has recently shown some commitment to doing something about the problem of financial information. An independent audit of the country’s four largest banks is being conducted, based on International Accounting Standards (IAS). The government will then develop a timetable to move the financial sector toward IAS. This should help improve accounting standards, but the government should consider supporting efforts to raise accounting standards in the rest of the private sector and to increase the number of skilled accountants in Mozambique.

Financial institutions are also constrained by lack of systematic information on the credit history of prospective borrowers, and inadequate systems for registration of property rights and the priority of claims. Many countries are now realizing the importance of developing well regulated credit information bureaus, and transparent registries of movable and immovable property, as the basis for reducing lending risks and expanding the supply of assets that can be secured as collateral. As noted earlier, broader use of non-judicial procedures for enforcing loan repayment claims and foreclosing on collateral can also be immensely important in broadening access to the financial system.

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107 World Bank, Financial Sector Assessment Program for Mozambique.
108 Interview with local accounting firm.

To mitigate deficiencies in rural finance, the Ministry of Agriculture and Rural Development is considering the establishment of a venture capital fund for agriculture. This approach merits a careful critical evaluation to gain a clear picture of the potential benefits, possible pitfalls, and critical requirements for success. A similar analysis could be undertaken to assess the possibility of establishing a venture capital fund or credit guarantee fund for promising commercial enterprises in rural areas. Venture capital funds and credit guarantees might also be considered as tools to promote export financing. It must be recognized, however, that these popular ideas for expanding access to credit often fail in practice, at high cost. In any event, the central problem lies with the underlying institutional foundations for extension of credit, as discussed here.

Competition Policy

Competition policy has been accepted as a tool for addressing competition problems in many transition economies that have pursued extensive privatization and deregulation. Ostensibly, competition policy wards off the ill-effects of cartels and the transformation of public monopolies into private monopolies. But in most transition economies, the main source of anticompetitive practices is not from traditional cartels or monopoly power, but rather from special interests that lobby for market restrictions or other advantages (such as special tax incentives) to create or capture valuable economic rents. These activities are neither proscribed by antitrust legislations nor amenable to antitrust law enforcement.

The implementation of competition policy in other countries has often been the result of conditionality or quid-pro-quo for financial assistance. Mozambique is among the few nations that is seeking information for a genuine debate on competition policy before deciding on the adoption of competition laws.

Competition policy is often conflated with antitrust law—a dizzying array of complex laws spanning all areas of business conduct. Mozambique could simply copy a foreign competition law and adopt the full array of practices. But competition *policy* is not the same as antitrust law.[109] It embraces the broader goals of liberalization and deregulation, and provides a clear voice for strengthening market forces, often at odds with influential special interests. Competition policy contains

[109] See, generally, William E. Kovacic's "Institutional Foundations for Economic Legal Reform in Transition Economics: The Case of Competition Policy and Antitrust Enforcement," *Chicago-Kent Law Review*, Volume 77 (2003).

advocacy tools to challenge anticompetitive behavior stemming from government, as well as elements of consumer protection. To be effective, a competition policy for Mozambique should reflect the country's institutional and economic context, based on careful examination of the present stage of transition. Simply adopting foreign laws, procedures, and practices will not work.

For example, some of the main problems threatening competition in Mozambique are pressures for protection through non-tariff and tariff barriers. Measures presented as nationalistic imperatives are often veiled efforts to restrict competition and increase prices for consumers. Such restrictions are not law-enforcement problems. They cannot be prosecuted.

Thus, liberalized trade and investment policies are a primary tool for ensuring competition, and doing so less expensively than antitrust laws.[110] Lower import barriers, free entry, and institutional reforms to facilitate new investment are efficient market-based mechanisms for effecting price discipline and enhancing consumer welfare.[111] For Mozambique, liberalization policies, rather than competition laws, will provide, as one commentator puts it, the most "bang for the buck."[112] At the same time, ***competition advocacy*** is consistent with Mozambique's efforts to liberalize and deregulate. To be sure, the prohibition and prosecution of horizontal price fixing are indispensable to a competitive environment. The initial competition law should focus exclusively on price-fixing behavior.

A first step is to *assemble a working group on competition policy within the Ministry of Industry and Trade*, as a focal point for garnering support, funding, assistance, and training, and for constituency building. The group can include participants in the competition policy workshops. Recommended tasks for the working group are as follows:

- *Begin developing a competition policy*. The working group should begin developing a competition policy focused on challenges to government anticompetitive practices and prohibition of horizontal price-fixing.

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[110] Blackhurst, Richard. 1991. Trade Policy is Competition Policy. In *Competition and Economics Development*. Paris: OECD.

[111] See James Levinsohn's "Testing the Imports-as-Market-Discipline Hypothesis," in the *Journal of International Economics*, vol. 35 (1993) 1-22, which contributes to a steady stream of empirical papers that conclude that imports constrain domestic prices. See also, "Symposium on Antitrust Law and the Internationalization of Markets" in the *Chicago-Kent Law Review*, vol. 64 (1988).

[112] Hoekman, Bernard and Petros C. Mavroidis. 2003. Economic Development, Competition Policy and the World Trade Organization. *Journal of World Trade*, vol. 37 (1): 1-27, at 5.

- *Draft a competition law proscribing naked cartels, prohibiting price fixing, and empowering a competition agency.* Naked cartels are associations of competitors assembled solely to capture monopoly gains with no countervailing efficiencies.
- *Examine alternatives to antitrust law enforcement.* Civil enforcement (private cause of action) of competition law is an obvious candidate.

The proposed competition agency should

- *Be independent.* Ultimately, the competition agency should be constituted as an independent agency staffed by trained attorneys and economists. It should be as independent as possible in order to enjoy some immunity from pedestrian political influences, gain public confidence, and speak with authority and professionalism.
- *Gradually undertake more enforcement.* Additional proscriptions of business practices, vertical or horizontal, should be added to the agency's mission as it matures, trains its staff, forges jurisprudence, and builds a constituency, instead of being saddled with an expensive array of law enforcement practices and procedures at the outset.
- *Embrace advocacy functions.* The agency should be an active advocate for competition, primarily by publicizing anti-competitive behavior and challenging governmental measures creating market barriers that are not counterbalanced by concomitant social benefits.

Ensuring the viability of the competition regime will require considerable expenditure. Given current budgetary constraints and priorities, it is unlikely that the government will fund preliminary steps to implement this program. Thus, the working group should solicit funds from multilateral and bilateral agencies interested in supporting efforts related to competition policy. The working group should also monitor international discussions about competition policy so that Mozambique will be able to prepare for possible negotiations in the near future.

Summary of Recommendations to Improve the Business-Enabling Environment

Given the overriding importance of the issues discussed in this chapter, it is useful to conclude with a summary of the main recommendations for improving the business enabling environment in Mozambique.

ADMINISTRATIVE, REGULATORY, AND COMMERCIAL LEGAL BARRIERS

Entry

Continue to streamline business entry requirements. Company registration procedures are still time-consuming and duplicative. Efforts must be made to cut registration time requirements and to eliminate duplication among agencies through enhanced sharing of registration-related information. Computerization should be improved to reduce burdens in the registration system.

Clarify and streamline regulatory authority over business entry between national, provincial, and local entities. Investors should not be required to request licenses in each jurisdiction. In addition, different government agencies should better coordinate work on licenses and standards, and respect or accept each other's authority.

Official Inspections

Develop more transparent and less discretionary procedures for planned and unplanned inspections by official agencies. Governments everywhere must ensure that taxes are paid and that safety, health, and environmental standards are met. Mozambique's inspections regime, however, is too intrusive and discretionary while not guaranteeing that standards are met. The inspection process needs to be more transparent to the private sector, with safeguards from unjustified inspections and effective channels for appealing decisions. Rules on what constitutes compliance and noncompliance need to be clearer, as do the rights of businesses during the inspection process. Agencies conducting inspections should improve procedures for disseminating information to the public, and train inspection staff to increase competence, reduce corruption, and improve government's public image. One way to achieve a more objective inspection process is to reduce inspectors' range of discretion and discontinue the practice of allowing inspection agencies to retain a share of fines.

Labor Issues

Revise the Labor Law to make it flexible, clear, and easier to obey and to administer. Provisions dealing with retrenchment of workers need to be improved. Requirements for worker notice for dismissal and severance should be brought into accord with international standards. Ambiguities in the law regarding the calculation of severance and accrual of vacation should be clarified, as should procedures for calling strikes. Provisions for shift work and overtime should be made more flexible.

Expedite the processing of work permits. Work permit processing should be clarified and expedited by creating objective criteria that apply equally to each case, simplifying the application procedure, and improving coordination between the labor and immigration ministries to reduce delays and uncertainties about work permits.

Improve administration of labor law. Mozambique should develop training programs for labor, management, and government officials in labor relations. Moreover, the Labor Law and the Arbitration, Conciliation, and Mediation Law should be revised to permit labor arbitration and mediation of individual labor contracts. Finally, steps should be taken to reduce corruption in the Labor Inspectorate; unchecked, corruption will distort even an improved Labor Law and undermine the benefits of better training.

Land

Establish a free market for transacting land-use rights in pilot development zones. Procedures established under the Land Law are complex and time-consuming for investors. And the way the law is abused in application is an even greater problem. Mozambique, like many countries, does not allow private ownership of land. Even so, a free and transparent market in land-use rights permits transactions that lead to an efficient use of land resources. At least officially, Mozambique lacks such a market. The government has to do more to create a market for land rights as an institutional cornerstone for stimulating investment, growth, and job creation. Creating a national market in land-use rights is neither politically feasible nor necessary at this time. Instead, the government should establish pilot systems for free trade in land-use rights in special development zones.

Enforcing Contracts

Strengthen contract enforcement by reforming the Code of Civil Procedure. The Code is highly complex and at times overwhelms the technical capabilities of support personnel in the legal and judicial sector. Judges reportedly find it challenging as well, especially when lawyers use it for purposes of delay. Civil procedure reform is on the government's legal reform agenda. Reforms need to focus on reducing the number of procedures, the time, and the costs involved in enforcing commercial contracts. Moreover, the Code is still deficient in some provisions for modern commercial activity, particularly those dealing with bankruptcy and reorganization of indebted firms to restore their economic viability. Selective reform of civil procedure is underway, and the government is developing a new bankruptcy law. It is important that these efforts be completed.

Improve the judicial execution of debts. This is another area of civil procedure in need of attention, as evidenced by the substantial backlog of cases. The process of judicial execution could be expedited by separating administrative tasks from those requiring judicial discretion. Administrative tasks, such as preparation of documents and service of process, can be contracted to private process managers.

Improve administration in the legal and judicial sector. Aside from antiquated laws and procedures, insufficient human and material resources, poor management, and corruption plague the performance of the legal and judicial system. Reforming the legal and judicial sector and improving contract enforcement in Mozambique will require the following complementary efforts: (1) training in all legal and judicial institutions; (2) strengthening managers' skills in legal institutions and adopting enhanced performance goals and accountability; (3) focusing more on reforming the administration of justice (including eliminating corruption) rather than on simply revising legislation. While many laws need revision, the greatest bottleneck is not the laws but their administration. Much more attention should be paid to day-to-day management of institutions that administer the laws and interact with the public.

GOVERNANCE

Better governance is vital to the removal of administrative barriers. Good governance is hindered by weak public finances; bureaucratic attitudes that contribute to "passive resistance" in executing agencies and among officials, as well as pervasive corruption; weak civil service capacity; and organizational problems, such as unclear or overlapping functions and responsibilities. Efforts to improve governance must include (1) programs to strengthen public finances and rationalize the civil service, (2) capacity building and restructuring to address weaknesses in civil service staff and executing agencies, (3) achievement of political consensus and commitment by government leaders to adopt and implement required reforms, and (4) programs to fight corruption. The government has recently begun accelerating some of its plans for public sector reform by decentralizing government activities and improving the effectiveness of the civil service through training and salary reforms. These efforts should be intensified.

Strengthen anti-corruption efforts. Fighting corruption will require cooperation among government, business, civil society, and international agencies. Within government the following actions are needed to further address the problem: (1) develop more effective procedures/sanctions to reduce official corruption and improve implementation and enforcement of existing anti-corruption programs; (2) improve public accounting, auditing, and reporting procedures for principal public agencies; and grant the Ministry of Finance stronger authority to perform audits in the context of the ongoing audit/accounting reforms; and (3) develop a capacity-building program of training and visits for public officials to improve administration of regulations, official inspections, and service delivery.

TAXATION SYSTEM

Improve administration of tax regime. Mozambique's tax problems are largely the result of poor administration. Business firms complain about the arbitrary nature of tax administration, frequent and time-consuming tax inspections, unqualified tax inspectors, needlessly complicated paperwork, inability to get VAT refunds, and inadequate dispute resolution procedures. To address these issues the following actions should be considered: (1) clarify tax laws and regulations to make them less open to discretionary interpretation, and (2) continue eliminating frequent and time-consuming tax inspections. The government has already taken several steps to improve tax administration. In 2002, it established a large taxpayer unit, staffed with qualified tax personnel and efficiently managed to avoid multiple, discretionary inspections. It is also preparing to establish a central revenue authority that will unify tax administration.

Introduce an effective system for tax dispute resolution. A transparent system for tax appeals would provide a formal mechanism for taxpayers to seek redress when they feel mistreated by tax officials, or when the want to challenge what they view as arbitrary penalties. At the same time, interest charges on overdue taxes must be structured to prevent abuse of the appeal process (e.g., to delay legitimate tax obligations). Mozambique's court system is known to be slow and sometimes corrupt, but no alternative mechanism for resolving such disputes exists. A new organic law for tax tribunals was submitted to the National Assembly in 2003. This should bolster public confidence in the tax system, but attention to effective implementation will be critical.

Expedite VAT refunds. The government should change the way it handles VAT refunds because the process for clearing VAT refunds is time-consuming. In particular, the government should consider establishing a special registry of export enterprises to expedite refund claims.

FINANCIAL SECTOR

Strengthen competition in the financial markets, and further improve banking supervision. The government needs to address structural and institutional weaknesses that hinder financial intermediation for private sector development and the expansion of exports. It should consider (1) encouraging robust competition by supporting the entry of new financial institutions, subject to proper prudential controls, and (2) further improving banking supervision to bolster the soundness of the financial system and increase public confidence.

Improve financial information and accounting standards. In addition to improving the administration of legal and judicial systems and creating a free market in land-use rights, this is one of the most important ways to reduce intermediation margins and improve access to credit. The government has recently taken steps to improve financial information. The country's four largest banks are now undergoing an independent audit based on International Accounting Standards (IAS). On the basis of the auditor's recommendations, the government will develop a timetable to move the financial sector gradually toward IAS. This should help improve accounting standards, but more will need to be done. The government should also support private-sector efforts to raise accounting standards and increase the number of qualified accountants in the country.

Develop credit information bureaus, transparent property registries, and alternative (non-judicial) dispute resolution (ADR) channels for enforcing debt contracts and foreclosing on collateral. Many countries have come to recognize the importance of these basic institutions to the broadening and deepening of financial markets. By providing financial institutions with essential information on the credit history of prospective borrowers, credit information bureaus help reduce lending risks and enhance the incentives for debtors to repay loans. Property registries establish transparent recording of the ownership of movable and immovable properties, and claims or liens on such properties. These systems make it easier for banks to accept a wider variety of assets as collateral. Effective ADR institutions similarly reduce lending risks and enhance the acceptability of assets as collateral.

COMPETITION POLICY

Initiate staged adoption of a competition law. At this stage in its transition to a market-based economy, Mozambique is unlikely to derive significant near-term benefits from a full competition program. Robust markets can be realized more easily and at less cost by continued concentration on trade liberalization and reduction of barriers to market entry. Considering other economic problems and constraints on the government's institutional capacity to manage an antitrust enforcement program, staged adoption of a competition law is recommended. Initially, the law should focus on cartels and price-fixing. The government should also pursue competition advocacy. A first step is to assemble a working group within the Ministry of Industry and Trade to (1) develop a competition policy; (2) draft a competition law forbidding naked cartels, prohibiting price fixing, and empowering a competition agency; and (3) examine alternatives to antitrust law enforcement. Any competition agency should be independent, embrace advocacy functions, and undertake enforcement only gradually.

4. Customs and Transport Trade Facilitation

In this chapter, we analyze institutional and logistical factors that constrain customs and transport development in Mozambique and thereby trade flows to and from the country and recommend ways to minimize those constraints. We analyze the legal framework for the primary border institution, Customs; consider the institutional issues affecting Customs' management, organizational capacity, and operations; review the role of other institutions involved in trade facilitation— Immigration, Agriculture and Border Police; assess trade facilitation at the country's major trade sites; and review transport infrastructure, identifying ways to speed the movement of freight. We recommend measures that address Customs and transport bottlenecks and improve the competitiveness of Mozambican exports.

Overview

Mozambique has made progress in facilitating trade[113] over the past few years. An ambitious program to improve the country's major north-south highways is underway; a new bridge over the Zambezi River in Caia, a critical gateway for north-south trade, is being built; privatization of the Ports of Maputo, Beira, and Nacala has significantly improved port operations; and railways and highways in east-west corridors are being improved. The Directorate General for Customs (DGA), as well as other institutions that deal with imports and exports, have done much to become

[113] Trade facilitation is the sequence of actions leading to the movement of freight from producer to consumer. It involves physical and institutional aspects that affect the movement of freight. It applies generally to three logistic stages—production, trade, transport—and it encompasses institutional policy, regulations, documents, procedures, and physical freight logistics. Facilitation means improvement, and the easiest way to improve is to examine the various layers of the institutional or logistic problem until the weakest layer is found. Simplification efforts can then begin.

modern public service agencies, making significant changes in their laws, organizations, and operations.

At the same time, delays, administrative burdens, and corruption associated with trade-related institutions still drive up traders' transaction costs. Eliminating unwarranted and onerous constraints embodied in laws, regulations and procedures can help reduce costs—by as much as 30 percent of the value of traded goods. This, in turn, will help Mozambican exporters become more competitive, lower prices for consumers, and make the country more attractive to investors.

Challenges facing Mozambique in trade facilitation include (1) improving management, (2) integrating border institutions, (3) improving risk management, (4) streamlining Customs' clearance processes, (5) addressing Customs' infrastructure needs, (6) improving technology utilization, and (7) developing stronger and more collaborative public–private sector relationships. Perhaps the most pressing concern is corruption, a resurging problem that can seriously undermine progress made to date and inhibit future advances.

Customs

To facilitate trade, Mozambique must improve the laws, institutions, and operations of its trade-related institutions. Modern institutions that are managed, staffed, and equipped to balance facilitation and control appropriately will result in lower transaction costs. Indeed, Mozambique has been implementing an ambitious Customs reform program since 1995, one aimed at increasing budget revenue; facilitating legitimate trade by combating corruption and smuggling; and creating a modern, effective, and reliable administration. The DGA, for example, has made numerous and significant changes in its laws, regulations, organization, and operations. It has passed laws compliant with international standards, including conventions and recommendations of the World Customs Organization (WCO) and World Trade Organization (WTO); lowered the average import clearance time to less than 48 hours for fully compliant entries;[114] improved the education level of Customs officers; and provided higher salaries and more flexibility within pay grades in order to link performance to pay. Mozambique also brought in outside expertise to manage Customs' operations and utilized pre-shipment inspection (PSI) services to assist in the determination of the dutiable value of the imports. Crown Agents, which has

[114] Perceptions of clearance time differ, and the way clearance time is defined is important.

been directly involved in managing Customs' operations,[115] is expected to complete its work with Customs. It may be asked to assist in the formation of a new central revenue authority.

While progress has been significant, serious obstacles hinder the efficient and secure movement of goods across borders. Measures such as improving management, integrating border institutions, enhancing risk management, streamlining clearance processes, addressing infrastructure needs, improving technology utilization, and developing stronger and more collaborative public–private sector relationships are needed.

LEGAL FRAMEWORK

A sound legal and regulatory framework provides a strong authority structure for trade-related institutions, as well as clear regulations and procedures for implementation. The framework for an orderly and well-functioning trading system is in place in Mozambique, with the law providing appropriate authority for most essential Customs activities, including personnel, integrity, procedures, automation, law enforcement, and adjudication. While the framework has been changing for many years, Customs has made about 95 percent of necessary legislative changes in the past two years. Implementation of these changes now needs improvement. In addition, Mozambique needs to enact laws that provide a basis for handling express consignments in accordance with WCO guidelines. It also needs to add and amend laws to comply with WTO intellectual property rights requirements, especially with regard to enforcement of smuggling counterfeit goods.

ORGANIZATION

As the major implementing institution for facilitating trade, Customs should be managed, staffed, and equipped to achieve an appropriate balance between facilitation and control. A modern customs administration should have basic organizational capacity, with solid leadership in management, reliable and sufficient equipment, and well-trained staff in appropriate numbers with the ability to execute key functions, such as risk management, payment collection, automation, basic procedures, inspections, public–private sector cooperation and regional integration. Customs has accomplished much of what is needed. It also has a good planning process that has addressed a number of changes that need to be made, and these are

[115] In 2000, the number of agents was reduced from 47 to 11, and 9 of these work in sensitive areas.

in the plans for the current and next year. More, however, needs to be added to the implementation plan to achieve a fully organized and effective system.

Headquartered in Maputo, Customs is organized along geographical and operational lines, with three regional offices in Nacala, Beira, and Maputo, as well as 76 frontier locations. Approximately 80 percent of the volume of imports and exports come from the southern region, with most cross-border traffic to and from South Africa at Ressano Garcia. Crown Agents has helped reorganize the agency and improve staff recruitment and resource allocation. Again, Customs has made significant progress, but further work is required to achieve an organized and effective system capable of handling all of its functions. Customs management is still too centralized, and lacks real delegation of authority.

Human Resources, Personnel, and Training

Customs has 1,500 employees, with a final target of 1,852, a number justified by the need to enhance management capacity; expand operations in anti-corruption, legal investigations, special operations, and post-import audits; and to reopen border stations. Recent efforts to hire well-educated and skilled individuals have been successful. Salaries for Customs officers are adequate and actually higher than those for most other state officials, and pay now relates to performance, with premiums as high as 18 percent within each pay grade for outstanding performance. The training plan for new and current employees is well developed, and evaluations occur twice each year. Training that incorporates international technical training is also provided for all levels of staff and management. Along with these measures, the assigning of more staff to key border locations initially reduced smuggling and corruption at the borders, but this trend has reversed since Crown Agents personnel were withdrawn from the ports. While Customs has made progress in hiring personnel with special skills, such as risk management, auditing, and information technology, some additional recruitment is needed. Furthermore, curbing corruption is a critical challenge that must be addressed.

More broadly, Customs needs to promote the internal cultural change that will allow it to focus less on bureaucratic control of imports and exports and more on facilitation of legitimate trade. Customs personnel must understand that accelerated processing, and improved integration of operations with the border processes of other agencies (e.g., Border Police, the Ministry of Agriculture and Rural Development, and Immigration), has a profound impact on the country’s global competitiveness and economic growth.

Fiscal Performance

From 1995-2001, Customs' revenue doubled from US$102.5 million to US$213.5 million (Table 4-1). This increase was largely the result of income from the value-added tax (VAT), since custom duties remained the same. The share of Customs' revenue in GDP increased from 3.6 percent in 1997 to 6.0 percent in 2001. On July 23, 2004, the Public Relations Department of the DGA publicized that during the first semester of 2004, 3,500 billion *meticais* (approximately US$151,844) had been collected (e.g., duties, specific consumer tax, VAT). This is an increase of 21 percent over revenues of the first semester of 2003. Here, Customs has achieved its goal of increasing the budget revenue.

Table 4-1
Fiscal Performance of Customs Administration, 1995-2001

	1995	1996	1997	1998	1999	2000	2001
MILLIONS OF US DOLLARS							
Circulation tax/VAT	10.2	10.7	19.6	21.5	74.1	112.3	104.9
Consumption tax on imports	14.4	14.2	15.5	18.2	16.9	14.3	12.2
Custom duties	64.8	62.5	70.3	80.2	81.5	82.3	71.22
Total customs revenue	102.5	106.3	125.4	146.1	198.1	236.0	213.5
Taxes on imports	89.3	87.5	105.3	119.9	172.5	208.9	188.3
Value of imports	727	783	760	781	790	821	832
PERCENT							
Customs duties as a share of imports	8.9	8.0	9.0	10.2	10.3	10.2	8.6
Total taxes on imports as a share of imports	12.3	11.2	13.9	15.4	21.9	25.4	22.6
Customs revenue as a share of total fiscal revenue	-	-	-	-	43.9	52.7	51.1
Custom revenue as a share of GDP	-	-	3.6	3.8	4.9	6.1	6.0

SOURCE: *Anthony Mwangi, Final report of the Survey on Customs Reform and Modernization in Mozambique; March 2003.*

Information Technology and Automation

Though sufficient, Customs' IT system needs to be connected to the rest of the trade community. Electronic data exchange from Customs and other border agencies should be encouraged. Technical staff dedicated to IT have been hired and trained and the equipment needs of each location have been inventoried. Over the next few months, 75 computers are to be added. As computerization of internal and external processing advances, Customs intends to have direct trader input (DTI) of import and export documents into the automated processing system, with the first interface scheduled for September 2004. At present, the entry process is all on paper, even though brokers prepare documentation by computer. Under the new DTI system, paper entries will still be required for other documents (e.g., invoices, bills of lading), but much of the data input by Customs will be eliminated.

Unlike its neighbors who use ASYCUDA—the UNCTAD automated data entry system—or a system compatible with it, Mozambique uses a proprietary system not compatible with ASYCUDA, and this can hinder present and future data exchange with its neighbors. Customs should evaluate its system development in terms of this incompatibility and its consequences.

The quality of trade statistics are also a matter of concern.[116] Customs is developing an internal administrative system for personnel and financial accounting functions, and other automation projects are being planned, including automated payment of collections, better statistical reporting, and an intranet system for employee information and notification.

Infrastructure

Lack of resources, limited use of vehicles, inadequate communications equipment, minimal provisions for employees, and insufficient field offices and equipment all hinder operations and reduce efficiency. Border posts lack basic infrastructure such as water, electricity, telecommunications, parking space, and banking facilities. Equipment and facilities are in short supply at most locations and personnel at remote border posts need proper housing and office space.

Integrity

The trading community has witnessed a gradual resurgence of corruption at the border (especially since the reduction of Crown Agent personnel at border stations). "Facilitation fees" for Customs officers and other border officials to expedite clearance are common.[117] Among small and medium enterprises, direct demands for money are rare; instead, bribery is encouraged through bureaucratic delay. The trend toward privatization in many sectors, and the injection of competition, can spur correction. Many businesses, especially the large and powerful, for example, often

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[116] It is unclear if the software now in use contributes to the problem or whether more edits for data input are needed.

[117] Some traders in the informal business sector admitted to paying lower duties than owed at South African border ports of entry in collusion with Customs officials. Smaller payments in the form of bribes allow these traders to avoid full payment.

simply refuse to pay bribes. The government, Customs' management, and the trade community must address corruption, which can seriously undermine the trading system and revenue collections.

GENERAL CUSTOMS OPERATIONS

Trade facilitation depends on simple, transparent, and coherent procedures. While legislation and regulations have improved, procedures still need to be clearly documented and shared with the private sector and trade community.

Import Procedures

Progress on import procedures includes Mozambique's use of the Harmonized System (HS) of Classification and the WTO Valuation Agreement; a newly initiated risk management system that has helped reduce inspection rates; and a cargo release time tracking system to measure progress. Release times—measured from the presentation of a complete entry document to the time Customs releases the goods—have in fact improved substantially. Most cargo, however, is released in 24 to 48 hours. Failure to release in 24 hours or less adds significantly to warehouse charges, which are assessed for a full week, once 24 hours has been exceeded. For some traders, the process sometimes takes three to four days or even a week.[118] Providing paperwork and payment before goods arrive has substantially reduced clearance time for some importers.

Issues related to automation, risk assessment, specialization, pre-shipment inspection (PSI), and interpretation of regulations and disputes still need to be addressed. For example, document processing is extremely time-consuming. About 95 percent of the time, officials keystroke data from documents that were prepared electronically. Further automation can put an end to this redundancy. And while the inspection rate has been reduced to the 30–50 percent range, it is still too high. Here, better risk management can help. For example, Customs could track the number, kind, or recipient of rejected submissions to better target true risks and reward compliant traders with faster import and export clearance. Operations could be further simplified by creation of a post-entry audit function that complies with WTO

[118] In 2000, FIAS estimated the average clearing time in Mozambique to be 18 days. According to Crown Agents times have since fallen to 4-7 days (land 4 days; sea 5 days; air 6 days), based on the time lapsed between submission of the declaration to collection of the delivery order, which can be done only after duties have been paid. Some importers still mention 15 days as the usual waiting time for clearance. Note that some traders, forwarders, and transporters still do not comply with documentary requirements and blame delays on government officials, especially those in Customs.

valuation standards. By improving its administration of rules and its audit targeting, Customs could move to a culture of voluntary compliance. Customs is planning such an audit unit, but it is not yet functioning.

Using PSI can create unnecessary delays, especially for some high-value merchandise, such as automobiles. The PSI company checks for value, tariff coding, quantity of covered imports, and identified prohibited imports. PSI fees are paid by the importer and can add three additional weeks to the clearance process. The scope of PSI inspections has been reduced since 2003 and now applies only to commodities that have been identified as sensitive.[119] PSI penalties have also been reduced, from 30 percent of c.i.f. value for first offense, and 50 percent for second, to a flat 10 percent. The use of PSI company inspections has been greatly reduced and appears to be on track for elimination.

Warehousing

Trucks importing goods to Mozambique using the border posts at Ressano Garcia and Namaacha, the border points with South Africa and Swaziland respectively, must proceed for Customs clearance to the Matola Cargo Terminal (FRIGO), a privately owned inland clearance terminal 75 kilometers from the border with South Africa. The usage charge, based on the value of invoice rather than volume of goods, is seen as unfair and excessive. The terminal charges storage / parking fees according the following schedule:

- Less than two days—0.28 percent of the Customs value c.i.f.
- More than two days—0.7 percent of the Customs value c.i.f.

An extra 5 percent is levied on bulk goods. The minimum payment is 560,000 *meticais* (US$24) for packaged commodities and 590,000 *meticais* (US$26) for bulk. And with an estimated 10-15 percent of trucks failing to report, not all cargo arrives as required. Ideally, Mozambique will no longer need the facility once the proposed dry port[120] at Ressano Garcia is operational. But cost and security issues will still need to be addressed because the new warehouse will need good physical and audit controls.

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[119] If goods for import are on the sensitive product list, the importer notifies the PSI company by lodging the supplier's pro forma invoice, and notifies his supplier of the need to submit the goods for inspection. The PSI company physically inspects the goods as requested by the exporter. After approval, the company issues a certified single document that the importer will use for clearance of the goods at Customs.

[120] A proposal for a dry port is being considered, and the terms of reference are to be issued in September 2004. The plan includes construction of a large warehouse, an examination station and sufficient parking near the border station for road and rail freight traffic. Thus, only passenger vehicles would be processed at the current Ressano Garcia location.

Export Procedures

With Customs spending almost as much time controlling exports as it does imports, Mozambique's export procedures are hindering development of the country's exports. All export documents and goods must be presented to Customs before export. In some locations, Customs examines more than 50 percent of export cargo. While large firms reported no particular problems with export procedures, small- and medium-sized firms reported lack of transparency and inconsistent interpretation of laws by Customs officials, and problems with certificates of origin required by the government. Export controls should be imposed only on a high-risk basis, with inspections for only the most critical of goods (i.e., weapons, drugs, currency). Customs must understand the role of exports in the country's economy and how important facilitation in this area is.

Transit Procedures

Transit traffic arrives mainly from South Africa, Swaziland, and Zimbabwe, and is destined for ocean ports in Mozambique. Transit freight is usually containerized and arrives sealed. No audit or control procedures, however, exist to match incoming containers and their seals with outgoing containers and their seals. An increasing portion of this traffic arrives at the seaports by rail, which greatly increases both the speed and the control of transit traffic. In 2002, the Minister of Planning and Finance issued a new Regulation on Transit known as the global guarantee system. The new legislation enabled transit shipments to pass easily if 10 percent of the customs value was paid. Traders have commented that the implementation of this law still faces many obstacles. The duty drawback system is not in use in Mozambique.

Law Enforcement

Customs law enforcement needs to focus more on major risks and less on broad control. Investigations and intelligence units are based in Maputo, and plans to build teams in other regions are underway.[121] Their principal task is to increase revenue collection by identifying those who have avoided legitimate customs processes. They have focused on stolen cars, the illegal movement of money from Mozambique, and following up on other officers' seizures. In 2003, they collected duties, taxes, and fines valued at about 6 percent of Customs' revenues for the year. While offenders have been arrested, none have been jailed. Teams dedicated to special enforcement activities, such as cargo blitzes and the interdiction of drugs, lack equipment. The

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[121] The units in Maputo can be deployed to other regions.

main law enforcement problem is corruption, as well as the control process for trucks and goods that are supposed to report to the FRIGO terminal.

Broker Regulation

Mozambique's regulation of brokers encourages a competitive, professional, and knowledgeable brokerage community. Recently, Customs opened the licensing process to anyone who could pass the test and meet the requirements. The numbers of licensed brokers has increased from 10 to approximately 125, and many of these brokers have solid expertise. Increased competition has lowered costs and increased the number of service providers. But some of the small firms will need to further develop professional competence to stay in business. Monitoring broker quality and performance will be a critical role of Customs in the newly expanded market.

Private Sector Cooperation

Customs maintains dialogue with the trade community, and cooperation between Customs and the public sector on trade facilitation issues has improved. The Confederation of Mozambican Business Associations (CTA), comprising representatives of more than 50 trade organizations representing some 3,000 firms, has formed public–private consultation groups in several business and trade areas, and the government is striving to maintain dialogue with the private sector through such bodies. Such public–private partnership can allay concerns expressed by small and medium-sized enterprises about access to changing official requirements and procedures for exporting and importing goods.

International Public Sector Cooperation

Mozambique's Customs is a member of the WCO and generally enjoys good relations with the customs administrations of neighboring countries. Reports of joint law enforcement with neighboring administrations to combat drug smuggling and trade of stolen vehicles are numerous. Mozambique also cooperates with neighboring countries in controlling transit traffic in accordance with trade protocols under SADC and COMESA (although Mozambique is no longer a member of COMESA). The countries of Southern Africa intend to improve cooperation on transit cargo by using a common transit document and by exchanging information in the ASYCUDA format.[122]

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[122] All except Mozambique now have ASYCUDA or ASYCUDA-compatible automated customs systems.

Supporting Institutions with Responsibilities at the Border

Though Customs is the main implementing institution for the movement of goods, other public sector institutions are important in facilitating trade. Their capacities and performance can result in significant costs (or savings). Traders, forwarders, and transporters still complain about the lack of coordination among and between the agencies involved in border crossings and with the respective authorities of neighboring countries.

While cooperation among Border Police, Immigration, and Agriculture is generally good, operations need to simplified. At present, each agency performs its function separately, with no cross-designation of officers to perform the functions of another agency. At most port locations, meetings between local managers of different agencies are held as needed, but scheduled meetings among them all do not occur. At most land border ports of entry, physical scrutiny is unnecessary and duplicative, with the Border Police sometimes inspecting persons and vehicles before *and* after the Customs entry process. Public sector partnerships are needed to streamline trade processes and resolve problems.

BORDER POLICE

Responsible for the security of the country's international borders, the Border Police are primarily concerned with drug trafficking, firearms smuggling, and stolen vehicles. At the land border crossings, except for the ports on the border with Zimbabwe, Border Police are the first stop in the entry process. They examine documents and, at their discretion, conduct physical examinations of persons, vehicles, and goods. Their activities appear to duplicate Customs' functions; and cooperation with Customs is strained by resentment of Customs officers' higher education and pay. Border Police activities in the ports of entry tend to hinder rather than facilitate trade, compound opportunities for corruption, and further delay the movement of goods and people.

DIRECTORATE OF AGRICULTURE

Processes for handling agricultural issues are cumbersome. The Ministry of Agriculture's National Directorate of Agriculture (DINA) has three offices that enforce regulations and requirements dealing with plant and fruit products, timber, and animal products. All are represented at major border entry and exit points, and traders of these products must use ports where DINA personnel are stationed. In addition, traders must be licensed by the Ministry of Industry and Trade.

Agriculture officials practice some risk management by carefully examining imports intended for human consumption. When necessary, they subject some items to laboratory analysis. Here, the main weakness is that DINA's budget and personnel shortages prevent its deploying representatives to all critical border locations. Customs does not release or give export clearance to goods without approval from DINA. Trade facilitation could be enhanced by (1) consolidating Agriculture offices at the border into one unit instead of three; (2) consolidating licensing at the Directorate of Agriculture; and (3) inspecting only shipments that pose a real risk.

IMMIGRATION

Except for border crossings with Border Police, Immigration is the first stop for people entering the country. Mozambique now allows foreigners to purchase visas from Immigration officers at the border or airport upon arrival. Though a great improvement, such purchases can take more than 30 minutes. Cross-designation of Customs and Immigration officers to perform each other's functions should be considered and the entire process streamlined (e.g., combine passport review with visa issuance).

Transport Infrastructure and Policy

Mozambique's transport infrastructure has long been regionally focused, directed toward neighboring landlocked countries and South Africa (Figure 4-1). Through its ports of Maputo, Beira, and Nacala, it is an important transit country for South African, Swazi, Zimbabwean, Malawian, and Zambian imports and exports. The main railway network goes from east to west and as do the main roads. The north-south road connection, not functioning during the civil war, has only recently come back into use. The scant linkages between Mozambique's rural economy and its main transport infrastructure make the commercialization of agricultural produce difficult and expensive. The road network, however, has improved considerably during the last ten years. Mozambique has more than 25,000 km of classified roads, of which 22 percent are surfaced. About 4,300 km are primary roads. More than 50 percent of classified roads are tertiary. The share of good and fair roads increased from 25 percent in 1996 to 56 percent in 2002 (Table 4-2).

Figure 4-1
Key Transport Infrastructure

SOURCE: Manica Freight Services Mozambique.

Table 4-2
Quality of the Road Network in Mozambique (in km)

	1996	1997	1998	1999	2000	2001	2002
Total	29,190	28,463	29,951	31,955	28,463	28,463	28,463
Good	3,529	4,731	6,441	8,068	7,003	7,363	7,429
Fair	3,823	5,907	11,464	10,290	7,422	8,275	8,454
Weak	6,017	2,874	...	2,610	5,332	5,649	5,977
Bad	8,277	9,524	9,178	8,418	5,424	4,390	4,241
Impassable	4,548	2,430	2,868	2,540	3,282	2,786	2,362

SOURCE: *Ministry of Public Works.*

The cost of road works, however, is very high. Here, the government's goals are to increase the coverage of access roads, especially those that will help poor regions with agricultural potential reach national markets; help expand markets and reduce transport costs; and promote development of the main transport corridors.[123] Mozambique has faced difficulties in realizing its road construction and maintenance targets, especially after 2001 when the Second Roads and Coastal Shipping project was completed. In 2003, problems with rehabilitation of primary roads (23.2 percent accomplishment rate) and periodic maintenance (20.4 percent accomplishment rate) were considered serious.

With public sector entities not generating enough surplus to keep assets in good condition, the maintenance backlog for road and rail has grown enormously. Consequently, freight transport costs are high and railway operations unpredictable, weakening prospects for producers and exporters attempting to compete in international markets.

Mozambique's transport policy, however, promotes the use of concession regimes to manage basic transport infrastructure and improve conditions for public-private partnerships in transport infrastructure. Recent achievements in this respect are impressive. The government has granted concessions to

- Trans African Concessions Inc. for the road—now a toll road—between Maputo and Witwatersrand in South Africa, the N4;
- Maputo Port Development Company, which started operating in 2003, to run the privatized Port of Maputo;
- Cornelder Mozambique to run the privatized Ports of Beira and Quelimane; and

[123] Review of 2003 Economic and Social plan, Republic of Mozambique, March 2004, page 85.

- An international consortium to run the Port of Nacala.[124]

The government is privatizing and planning to grant concessions for Mozambique Railways CFM, and concessions have been granted for the Ressano Garcia and Limpopo Line and the Beira-Machipanda and the Sena Line. Privatizations of the main airports and LAM Mozambican Airlines are being planned.

Nevertheless, outdated legislation and regulations hamper progress in concessioning transport infrastructure and privatizing transport services and operations. Stakeholders' lack of capacity and experience in transport infrastructure, services, and operations burden operations within this new framework with bureaucracy and corruption. In addition, some are trying control assets. For example, Mozambique Railways is trying to remain involved in most investment and operational projects in the sector by negotiating shares in the new consortia.

ROADS AND ROAD TRANSPORT

Mozambique's road transport sector is largely liberalized, though access to road transport markets is still constrained by legal and institutional problems. And despite efforts to create an attractive environment, investment is inadequate to meet and sustain demand for transport-related goods and services. Rural areas especially face problems in commercializing products and in accessing main roads.

The international road transport market is dominated by foreign-registered companies and trucks (in particular, South African companies in South Mozambique and Zimbabwean companies in Central Mozambique), but the share of Mozambican companies is increasing. A few large and relatively many medium-sized companies are subcontracting with very small companies (driver-owner). The fleet of vehicles for international transport is relatively new.

Mozambique has signed the SADC Protocol on Transport, Communications and Meteorology, which requires that member states liberalize market access with respect to the cross-border carriage of goods.[125] The Protocol encourages members to

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[124] Serious problems among the main shareholders must be resolved before operations can begin.

[125] The SADC Protocol on Transport, Communications and Trade states that liberalization may go through three stages: "Member States shall introduce the following liberalization phases: Phase 1 Abolition of restrictions on carriers of two Member States to carry goods on a defined route between – (1) such States; or (2) in transit across the territory of another Member State en route to a third Member State or non-Member State: Provided that such transit traffic may only be undertaken if the carrier's vehicle traverses the territory of its home state. Phase 2: Abolition of restrictions on carriers of one Member State to carry goods on a defined route between another Member State and a third Member State or non-Member State, irrespective of whether the carrier's vehicle traverses the territory of its

conclude bilateral agreements to liberalize access to the regional road transport market. Mozambique has also signed road transport agreements with South Africa (1998), Malawi (1998), Swaziland (2002), and Zimbabwe (2003). To facilitate international road transport between countries, these agreements establish joint committees to monitor implementation, resolve disputes, and help countries harmonize cross-border regulations and exchange information. The committees include representatives from the Ministry of Transport, Customs, and Immigration, as well as traffic police, road inspectors, and industry representatives.

Mozambique has established the autonomous Road Agency (ANE), out of the National Directorate for Roads and Bridges (DNEP), to make the road sector more efficient. A road fund, initially under ANE, is now independent. A mechanism for directly transferring road fund revenue has been agreed on, but is not yet working because the transfer of resources to the fund is not timely.

Road transport is regulated by Decree no. 24/89 Road Transport Regulations as approved by the Council of Ministers on August 8, 1989. This decree is amended by Decree no. 15/96. The regulations concern mainly the licensing system for road transport operations. The main problem is that the regulations mix passenger transport and freight transport. Therefore, we recommend the following:

- Draft new and separate legislation for road passenger transport and road freight transport.
- Introduce qualitative requirements for obtaining an operator’s license (e.g., financial standing, professional competence).
- Reduce the validity of the license from 20 years to 5 years and establish a system to check compliance with the basic requirements for obtaining an operator’s license.
- Liberalize tariffs and prices completely.
- Remove any quantitative restrictions to access the national and international road transport market and the issuance of operator’s licenses and permits.

In 1997 a concession contract for a toll road linking Witwatersrand in South Africa with Maputo was signed. Development of an all-weather, secure road will link Maputo with the Johannesburg market, just 6 hours away. Of the investment amount of ZAR 3 billion (1996), ZAR 1.5 billion was spent in 3.5 years. The road is fully operational and the concession will last until 2028 under build-operate-transfer (BOT) regime. In conjunction with Vodacom’s 147 Emergency Service, the road has

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home state; and Phase 3: Abolition of restrictions on carriers of one Member State to carry goods between another Member State and a third Member State or a non-Member State.”

SOS call boxes at 4 km intervals. These are linked with ambulance and emergency services, the South African Police Service, traffic authorities, the fire brigade, and towing and rescue services.

Congestion at Ressano Garcia

Mozambique's main land border crossing is at Ressano Garcia along the border with South Africa. Ressano Garcia receives more traffic than any of the other 75 land border crossings, handles almost all truck crossings to and from South Africa, and processes about 750 cars a day. Correcting problems at Ressano Garcia can significantly lower trade transaction costs.

First, Ressano Garcia is too small. Second, incoming trade flows are poorly managed; Immigration, Customs, Agriculture, and Border Police have separate processing centers.[126] Third, anything requiring more than a cursory visual inspection must proceed to FRIGO. Fourth, control measures for ensuring that trucks move directly to the warehouse are inadequate. Customs officers sometimes accompany trucks carrying high-risk cargo, and Customs uses mobile "FAST" teams to conduct random stops. But no post-audit process to verify that trucks arrive at the bonded warehouse or to assess the amount of diversion that occurs exists.

The long-planned "dry port" could help solve most of these problems. The dry port would consist of a large warehouse, examination station, and adequate parking and be dedicated to road and rail freight traffic and located within a few kilometers of the border station. Only passenger vehicles would process at the present Ressano Garcia location. The dry port design includes other border agencies as well as South African Customs personnel.[127] Project terms of reference are expected to be issued in September 2004, and construction is expected to take one year from award of the contract. The estimates for the construction, including a new roadway, are approximately US$35 million.

RAILWAY TRANSPORT

Management and operation of Mozambique Railways is gradually being handed over to the private sector through concessions for specific railway tracks.

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[126] Ressano Garcia processes miners who work in South Africa, but the special system for their passage takes place at a table in an adjacent parking lot with lines snaking among vehicles. Returning miners bring in large trailers of goods, and Customs has no facilities to examine them.

[127] Mozambican officers would also be stationed at the South African cargo location.

- Resolution on Transport Policy No. 5/96 permits private capital to participate in the rehabilitation, operation, and management of railway infrastructure and railway operations.
- Decree No. 31/2002 grants the concession for exclusive use, operation, and management of the railway track Maputo-Ressano Garcia to Ressano Garcia Railway. The Government of Mozambique has granted an international consortium with South Africa's rail utility, Spoornet, the right to operate this line, which is on the border with South Africa. An important component of the concession agreement is the commitment to invest $10 million to rehabilitate the Mozambique section of the line, bringing it to the same standards as the South African line. The Spoornet consortium plans to start operations in 2004. The concession is for 15 years, renewable for 5 years or additional periods according to the concession contract.
- A similar decree (No. 21/2000) granted the concession for the exploitation of the railway network in the north—Nacala-Cuamba-Entre-Lagos/Lichinga—to the Corridor of the Development [128]of the North. This concession has not yet been implemented because of uncertainties among partners of the concession holders.
- In 2004, the management and operation of the railway network in the center, including the lines Beira-Machipanda and the Sena Line, was concessioned to an Indian consortium, RITES/IRCON.

The role of Mozambique's Port and Railway Administration (CFM)[129] after the concessioning of the main railway lines is not clear. CFM has shares in the consortia, which have concessioned the operations of the main railway lines. This presence risks "false" privatization and may impede efficient and effective operations. The Government of Mozambique is the owner of the railway infrastructure.

A new Railway Code is needed to integrate developments in the restructuring of the CFM, the concessions, and bilateral negotiations with railway companies of neighboring countries to strengthen cooperation and facilitate the operations of block trains and railway shuttles.

In 2000, coal accounted for more than 71 percent of the volume transported by rail between South Africa and Maputo. The imbalance between east-west and west-east

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[128] The decree mentions that the concession holder must pay $2 million up to 7 days before the start of the operations; a fixed annual amount of $1.7 million; and a variable amount of 7.5 percent of the gross annual revenues, as well as another 7.5 percent of gross revenues if traffic during the previous year is more than 4 million tons. The service level of passenger transport has to be approved by the Minister of Transport and Communications.

[129] Empresa de Portos e Caminhos de Moçambique.

volumes is striking: 97.7 percent of the volume goes from South Africa to Maputo and only 2.3 percent from Maputo to South Africa. The amount of coal to be exported through the Port of Maputo would increase substantially if the railway could handle more and do so more efficiently. Many South African industrial producers, such as Xstrata/Lydenburg and Lion, are using road transport on the corridor because the railways are not reliable and lack capacity. Other rail lines are similarly unbalanced. For example, the Goba Line is used mainly to export sugar from Swaziland through the Port of Maputo. The huge imbalance between east-west volume (98.7 percent) and west-east volume (2.3 percent) makes transport costs high on this line as well.

PORTS

Mozambique has four primary ports. With the highest volume of traffic, the Port of Maputo has an installed capacity of 9.3 million tons per year and terminals for fish, coastal shipping, general cargo, coal, fruits/citrus, sugar, molasses, containers, and steel. The total length of berths is 3,876 meters. The Port of Matola, near the Port of Maputo, has an installed capacity of 4.75 million tons per year with a total berth length of 865 meters, including dedicated terminals for coal, petrol, cereals, and aluminum. The Port of Beira, with the second highest volume of traffic, has a sea terminal for containers, break bulk, and bulk; a fuel depot for fuel imports; and a beer production facility that Customs monitors for control of excise taxes, which are at 65 percent ad valorem.[130] The Port of Nacala has a capacity of 2.6 million tons per year, but is being underutilized.

Mozambique's transport policy envisages privatizing port operations on broadly the same terms as the railways. The ports of Maputo and Beira have been given into concession and are operating accordingly. The concession of the port of Nacala has not yet been formalized because of problems within the consortium that won the tender (this same consortium won concession rights to operate the northern railway lines.)[131] In July 2004, the secondary port of Quelimane was given into concession to a consortium led by Cornelder Mozambique, which also holds the concession on the port of Beira.

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[130] Customs in Beira has participated in joint operations with the Border Police to interdict sugar smuggling from Zimbabwe, which has been a serious problem. Port security at Beira was observed and found to be good.

[131] Although the concession agreements for the port of Nacala and the northern railway lines are separate, the two concessions were linked.

In general, the trading community is satisfied with the Port of Maputo. Since 2003, when the Maputo Port Development Company took over port management, infrastructure has been rehabilitated at the main port and at the nearby bulk and break bulk port terminal of Matola. The road and railway networks, wharves, and warehouses are also being reconstructed or rehabilitated, and port security is adequate. Port operations are more than 50 percent computerized. Space is leased to private firms for their terminals within the port, including some business and shipping companies that manage their own operations. MAERSK, for example, operates its own terminal in the port. Mozambique International Port Services has been operating the container terminal under a 10-year, renewable lease agreement since 1996. Relations with Customs are good and incoming containers are usually cleared within 48 hours of arrival. Customs inspects incoming containers, for which they often send advance notice. Bonded warehouse service has been considered good as well but there is still room for improvement. Port users complain about the lack of adequate equipment for the Port of Maputo. The main challenge for the Port of Maputo is to attract international shipping lines and increase the frequency of the calls. Most shipping lines are still using the Port of Durban as a hub.

The Port of Beira is the natural freight port for Zimbabwe, but can also be important for Malawi, Zambia, Botswana, and Congo. At present, land connection with Malawi is by road only; the railway connection awaits rehabilitation. Cornelder Mozambique has been managing the port since 1998, with 70 percent of the shares held by Cornelder Holding and 30 percent by Mozambique Railways. Its multipurpose container terminal has a capacity of 100,000 TEU per year, but in 2001 used only 30 percent of its capacity. [132]

The Port of Nacala is one the best deep sea ports on the Indian Ocean not requiring dredging. Its hinterland would benefit from a well-functioning rail connection between Nacala and Malawi. Domestic traffic through the Port of Nacala in 2000-2001 was 204,900 tons and 158,800 tons per year, respectively according to statistics of CFM-North.[133]

[132] The terminal has a storage place of 200,000 m2 for 3,117 TEUs and a bonded transit warehouse of 8,400 m2. The general cargo terminal has a capacity of 2.3 million tons with five covered warehouses of 15,000 m2 and 12,000 m2 of open space.

[133] More optimistic about port statistics for Nacala, SATCC documents 746,000 tons in 2001.

MARITIME AND COASTAL SHIPPING

In 2002 new regulations on maritime transport were approved. Decree No. 18/2000 regulates the licensing of maritime transport for coastal shipping. In principle, coastal shipping between Mozambican ports is only permitted for national vessels or vessels contracted by Mozambican persons or institutions. The Minister of Transport and Communications may authorize a license to other companies with Mozambican agents if this is in the social or economic interest of the country. A license is valid for 10 years and may be renewed for 10 years. A new license costs about $1,500; a renewal about $1,100.

AIR TRANSPORT

Air transport is being deregulated and liberalized. In 1999 Mozambican Airlines (LAM), which had just been privatized, obtained a five-year concession to operate flights between Maputo, Beira, Quelimane, Nampula, and Pemba. In 2004 new tenders will be let for operating international and domestics flights in Mozambique.

Passport review, visa issuance, and customs clearance at Maputo International Airport is uncoordinated and difficult. Arriving passengers receive no instructions and have no writing tables or government facilitators. Security lapses are common, and the Customs area is often occupied by people who work for neither Immigration nor Customs, including private “facilitators” who assist passengers for a fee and hotel bus drivers seeking guests. While these operations do not impose significant costs on traders, they do give tourists and trade-related travelers seeking to do business in the country their first impression of Mozambique. Simplifying processes and securing the premises would be inexpensive and of significant benefit.

Cargo operations need to be upgraded as well. At present, one cargo freighter arrives per week from Johannesburg with all other cargo arriving in the hold of passenger planes, which land seven days a week from either Johannesburg or Portugal. All imported cargo is placed in a bonded warehouse, where it remains until Customs releases it. Some elements of the operations do serve traders. For example, security in the warehouse has been increased, and there appears to be some accommodation for low-value, low-risk express consignment document packs. Traders, however, encounter inconsistent and irregular procedures for their goods, as well as bureaucratic obstacles for issues outside the routine. Further, rates of inspection are unreasonably high—50 percent for exports and imports.

Transport Costs

Transport and logistics costs are high and vary widely between sectors and regions. Prices on the Maputo–Johannesburg railway line varied between US$0.027 per ton km for bulk and US$0.046 per ton km for other cargo (Table 4-3). Railway transport applies highly variable prices for container transport in Mozambique. The price per container through the Nacala corridor costs four times as much as transport of a container from Maputo to Harare; shipment through the Nacala corridor is also twice as expensive as the Beira Corridor. This is certainly due to the duration of the trip and the state of the railway infrastructure and availability of rolling stock. Rail cargo sometimes takes 14-20 days from Nacala to Blantyre because of congestion, derailments, equipment failures, and administrative confusion. From the shipper's perspective, railways lack certainty and commitment, and port services in Nacala are unreliable. The average costs of railway transport in Mozambique are more than US$0.05 per ton-km, which is about twice the normal price (US$0.025 per ton-km). Mozambique Railways is both expensive and unreliable.

Table 4-3
Rates for Railway Transport for Selected Port Corridors (in US dollars)

Line	Distance	14 tons/6 m	22 tons/12m	36 tons/B/Bulk
Maputo – Johannesburg	616	393	620	600
Maputo – Harare	1228	960	1,686	N / A
Maputo – Blantyre	1780	N / A	N / A	N / A
Maputo – Lusaka	1,996	N / A	N / A	N / A
Maputo – Lubumbashi	2,588	N / A	N / A	N / A
Beira – Harare	593	500	1,000	N / A
Beira – Lusaka	2,027	1,033	2,021	N / A
Nacala – Lilongwe	995	896	1,408	
Nacala - Blantyre	806	840	1,320	

SOURCE: *SADC Freight Transport Corridors 2001 and other studies.*

Freight rates for road transport vary widely by route. The wide variations in rates are caused by many factors, including the imbalance of the commodity flows, the lack of competition, and existing non-physical barriers in transport. Many forwarders and road transporters calculate tariffs based on a return trip as well. If they succeed in obtaining backload, prices may vary substantially and will, in general, be much lower than usual.

A survey among freight forwarders and transporters in July 2004 pointed to the huge variations in costs for road transport (Table 4-4). Prices varied from US$0.021 per ton-km from Maputo to Lusaka to US$0.139 per ton-km for transport between Beira and Lusaka. The substantially lower costs for road transport from Maputo (average US$0.045 per ton km) in comparison with road transport from Beira (average US$0.09 per ton km) are particularly noteworthy.

Table 4-4
Rates for Road Transport on Selected Corridors 2004 (in US dollars)

Line	22-30 tons	Average price per ton-km
Maputo – Johannesburg	625-950	0.040-0.060
Maputo – Harare	1,008-1,344	0.023-0.031
Maputo – Blantyre	1,260-2,380	0.029-0.055
Maputo – Lusaka	1,064-2,100	0.021-0.041
Maputo – Lubumbashi	2,520-2,940	0.039-0.046
Beira – Harare	1,200	0.082
Beira – Blantyre	1,700	0.079
Beira – Lusaka	3,700	0.139

SOURCE: *Survey of Freight Forwarders, Mozambique, 2004.*

The quality of service provided by the road transport companies and / or forwarders has not been assessed. Discussions with forwarders and road transport companies indicate that shippers experience huge differences in quality. Just-in-time shipments are obviously more expensive. Currently, the road transport sector is competitive with the railway sector because it is flexible and more reliable, although its prices are higher—an average of US$ 0.07-0.08 per ton-km.

Sea cargo from Asia to one of the ports of Mozambique costs between $2,550-3,250 per container and from Europe between $2,650-2,950 per container. The main challenge for Mozambique is to attract more international shipping lines to its ports. The Port of Maputo is receiving regular calls of six international shipping lines for break bulk and six for containers. Most shipping lines are still using the Port of Durban in South Africa as a hub, with feeder services to the ports of Mozambique.

The coastal shipping market is still protected by legislation and cabotage by foreign vessels is, for all purposes, not allowed. Complete liberalization of coastal shipping would likely reduce tariffs on coastal shipping and boost national integration.

Development Corridors in Mozambique

A fully operational corridor—integrating ports, maritime and coastal shipping, railways, road transport, terminals and warehouses and distribution centers—is still far from implementation. Integrated modal connections and multimodal transport hardly exist. The government and the business community have recognized this weakness and are developing the corridor concept in a public–private partnership.

Mozambique used to be a transit country for import and export involving South Africa, Swaziland, Zimbabwe, Zambia, and Malawi, using the ports of Maputo, Beira, and Nacala. The main rail and road connections are therefore east-west, linking the ports with the hinterland in the neighboring countries. In the 1980s, the Beira Corridor Authority was established to lead socioeconomic development of the Beira Corridor: rehabilitate the port of Beira, acquire investments for railways and roads, promote industrial and agricultural development along the corridor, and provide social infrastructure. War and inexperience caused failure, but costly lessons were learned.

The concept of development corridors revived in the mid-1990s when the Government of South Africa introduced the Spatial Development Initiative (SDI) to attract export-driven investments and public–private partnerships to areas with untapped potential. This resulted in a plan to develop the Maputo Corridor and restore trade and investment ties that had been destroyed during apartheid in South Africa and during the civil war era in Mozambique. The success of that corridor stimulated other SDIs in SADC. SDI methodology is becoming an integral part of SADC's programs; and the Development Bank of Southern Africa (DBSA) has established a unit dedicated to strengthening intergovernment and public–private sector relationships—the African Partnerships unit.

Mozambique is attending to the corridor concept in its development policy by concentrating on the Maputo Corridor, the Beira Corridor—including the development of the Sena Railway line and the Zambezi valley—and the Nacala Corridor. The challenge is to link import, export, and transit traffic from and to neighboring countries through the corridors to facilitate national socioeconomic development and integration.

MAPUTO DEVELOPMENT CORRIDOR

The approach behind the Maputo Development Corridor integrates the virtues of the following to enable development: a toll road N4 linking South Africa and Maputo;

commercialization of the Port of Maputo and of railway connections (Maputo–South Africa and Maputo–Swaziland); attraction of major industries and establishment of free industrial zones; upgraded telecommunications and electricity; improved Customs facilities; and an improved business climate. With members from South Africa and Mozambique, the Maputo Corridor Logistics Initiative (MCLI) consists of infrastructure investors, service providers, and users who work closely with organized business and authorities to promote the corridor. MCLI engages the governments of South Africa and Mozambique to reinforce public–private partnerships in logistics and to ensure that the corridor is the first choice for regional importers and exporters. It has identified the following areas as needing much work:

- Border procedures and operational hours.
- The scope and competitiveness of transport services (e.g., additional capacity, higher service levels and competitive rates for road, rail, port, terminals and shipping lines).
- Information services.
- Coordinated and accelerated promotion of investment zones.

MCLI has only three permanent staff and has been operating for only three years, but its impact is substantial. Large South African exporters, South African authorities, Spoornet, port authorities, the Government of Mozambique, and Mozambican companies view it as a serious link in the logistics chain.

BEIRA DEVELOPMENT CORRIDOR

In 1995 the Beira Corridor transported more than 1 million tons by rail between Beira and Machipanda. In 2000 the volume fell to 743,300 tons, but has recovered and will return to approximately 900,000–1 million tons in 2004. The main cause for the decline was the instability of the Zimbabwean regime. The volume of road transport using the Beira Corridor to Zimbabwe is estimated at 400,000 tons per year, or about half of the total volume transported on this rail line.

Beira is waiting for a mega-project like Mozal to help boost activity in other economic sectors in the region. While a proposed iron and steel plant remains in discussion, hopes are focusing on the agricultural zones of Manica and Sofala. Earlier this year the government selected RITES/IRCON as the preferred bidder for rehabilitation and operation of the Beira Railway System, comprising the Sena and

Machipanda lines.[134] Plans are underway to grant a concession for the Moatize coalmines, at which time traffic is expected to grow rapidly. The private sector is very interested in this concession. Full operation of the corridor may attract another 4-6 million tons of freight.

NACALA DEVELOPMENT CORRIDOR

The Nacala Corridor is not operating yet because of the concession holder's internal problems.[135] The Corridor for the Development of the North (CDN) consists of the Railroad Development Corporation from the United States, Edlow Resources (an investment fund based in Bermuda), a Malawian partner through CEAR (concession holder of Malawian Railways), Manica Freight Services Mozambique, small local investors, and CFM.

Operations on this railway line are very limited because the 77 km section from Cuamba to Lagos is in poor condition. In addition, a dearth of locomotives, slack operating procedures in Mozambique, and frequent washouts on lines in Malawi have harmed the line's reputation. Of CFM-North's 14 mainline diesel locomotives, only eight are operational and some are not in good condition. Of the 965 revenue-earning freight wagons, only 546 are serviceable (57 percent)—far below the minimum 80-85 percent that should be operational.

Nacala should improve its port facilities, cargo-handling equipment, and management to an international standard. Together with an efficiently operating rail connection with Malawi, improvements in the port facilities would encourage Malawi, Zambia, and Congo to use the corridor. Nacala could even become a mini-hub port for the Comoros Islands (Mayotte, Moroni) and the northern ports of Madagascar, for which shipments are being handled by feeder services from Durban, Dar es Salaam, and Mombasa. Discussions are underway with the Ministry of Defense for full commercial exploitation of the airport of Nacala.

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[134] The concession is for 25 years and the fees comprise an entry fee of US$2 million; an annual fixed fee of US$1 million from year 11 to 25; and an annual variable fee assessed as 3 percent of the company's gross revenue for traffic up to 300 million net-ton / km and 5 percent between 300 million and 1 billion net ton-km and 7.5 percent for traffic over 1 billion net ton-km.

[135] The Malawians wanted to increase their share after the concession agreement was completed, thereby delaying ratification of the agreement.

Recommendations for Improving Customs and Transport Trade Facilitation

Customs has made considerable progress in its modernization and is approaching final implementation of world-standard laws and procedures. The next challenge is to move away from excessive bureaucratic control of imports and exports toward true facilitation of international trade. Customs personnel must understand these changes in the context of free and open trade and their impact on economic activity and growth. Many of the following recommendations require changes in organizational culture as well as concrete actions. The actions will likely be easier, but the change in organizational culture is critical.

Seek additional avenues to attack corruption. Corruption remains a serious problem, and may be on the rise. A special department at the Deputy Director level of Customs is very active in spotting corruption, but Customs must seek more avenues for attacking it. As a first step, first- and second-line supervisors should be empowered to be responsible for anti-corruption efforts. They need to be in the workplace with their officers and to manage by walking about. Second, fighting corruption throughout the workplace will require cooperation with other agencies operating in the port environment. Third, Customs should be very clear about which parts of their offices and facilities are open to the public. A casual mingling of officers and the public provides opportunities for the exchange of money. Fourth, no money should be allowed in the open, except at cashier stations. Fifth, Customs must ask its own first-line supervisors and other officers for ideas to prevent corruption, since they see it every day.

Customs needs to ***empower its supervisors and managers and to clarify their roles and responsibilities***. Having hired intelligent and capable people, the organization must capitalize on this talent. For example, communication at the highest levels of management is good, but not at the lower levels. Problems from the public should be solved at the lowest level of supervision and these supervisors should be empowered and expected to make independent decisions in which they will be supported.

A clear understanding of Customs' role in facilitating the movement of goods and people, and its consequences for economic growth, must be instilled in personnel so that Customs can ***move away from controlling trade to identifying and taking facilitative approaches.*** Export controls should be imposed only on a high-risk basis, with exams for only the most critical goods (i.e., weapons, drugs, currency). In some locations more than 50 percent of exports—as well as some imports—are subjected to physical examination. For both imports and exports, the results of these examinations should be reported and analyzed to see if the high rate of examination is warranted. Many locations report minimal results for such a large number of exams. Moreover, while Border Police are operating in the ports of entry they do nothing that is beyond the scope, mission, and authority of Customs, Immigration, or Agriculture. Their activities in the ports of entry tend to hinder trade, increase opportunities for corruption, and further delay the movement of goods and people.

Customs should build on its working relationships with traders and recognize the trading public's need for awareness and understanding of the rules, regulations, and procedures that apply to the cross-border flows of goods, people, and money. The trading public needs and wants ***Customs procedures to be published in clear, easy to understand language*** so that it and Customs officers have the same understanding of the rules. The trading public also needs to be informed of changes in rules, and in this regard, transparency and predictability are important. Customs should implement public training or awareness sessions on policies, procedures, and other subjects important to the trade community. In addition, trade organizations should begin training their members. Here, Customs could provide "training of trainers" so that some members of the trade community would be qualified to train others. Customs' website should be used to inform and educate the public, and an employee or a team should be dedicated to maintaining the website.

Customs should ***tighten control of transit cargo and truck freight arriving at Ressano Garcia.*** While the new cargo "dry port" close to the border with South Africa is being developed, Customs needs to better control freight arriving at this border. This could be accomplished with technology (e.g., transponders, cameras) and by running control and auditing blitzes to ensure that every truck reports to either the Frigo warehouse or the Port of Maputo. Trucks have 24 hours to report to the warehouse, even though Ressano Garcia is only 75 kilometers away. When the dry port becomes operational and Ressano Garcia becomes a clearance station for passengers only, a study of the flow of vehicles and people should be conducted to determine how to best manage the traffic while maintaining appropriate control.

Plans to implement direct trader interface (DTI) and the automated collection of revenue should proceed at a fast pace, along with other computer and technology enhancements. Customs should consider acquiring some off-the-shelf risk management and data mining software. Automation will not only provide for quicker release times, but also free staff for other jobs and substantially assist anti-corruption campaigns. Apparently, all countries in southern Africa are striving for a common transit document. All the other countries have ASYCUDA—the UNCTAD customs automated data system—for entries, or a system compatible with it. Mozambique does not now have compatibility with ASYCUDA, and this will hinder present and future data exchange with its neighbors.

Customs should understand that for the public "customs clearance" includes all formalities related to exporting and importing. The traveling and trading public wants to clear Customs with a ***one-stop process at borders and airports that incorporates the needs of Customs, Immigration, and Agriculture***. In fact, at land borders the public wants one-stop processing that coordinates or addresses the border administration needs of both countries. This is not strictly within the scope of Customs' technical responsibilities, but Customs needs to address this concern and, in recognition of its significant progress in reform, lead such change.

To identify and address their problems and advocate for solutions, trade groups should consider the model of the UNECE (United Nations Economic Commission for Europe) for the ***creation of public–private trade facilitation committees***. These groups, known as Pro-Committees, comprise influential members of government trade-related departments (e.g., Ministry of Trade, Ministry of Interior, Customs) and private sector trade organizations, such as chambers of commerce, carrier organizations, and export/import groups. Pro-Committees elect their leaders, meet regularly, establish and work from formal agendas, prioritize trade facilitation problems and solutions, and lobby for reform. They also work to influence and coordinate donor assistance for trade facilitation. Donor assistance with the establishment of such a committee in Mozambique would be a worthwhile investment.

Customs needs ***support for improvements in infrastructure***, as officers and line personnel do not have the tools and equipment they need. Equipment and facilities are in short supply at most locations and personnel at remote border posts lack proper housing and office space. Customs needs a major investment in its infrastructure—by its own estimate at least US$65 million for basic improvements and for the development of the Ressano Garcia dry port.

Continue developing transport infrastructure. Liberalization of transport and terminal operations is well underway and upgrades of major highways, railway lines, and bridges are planned, as well as privatizations of ports, terminals, airports, railway lines, and airlines. When upgrades and privatizations are complete, transportation and related services will be much improved. In addition, Mozambique must ensure that new infrastructure is maintained. For example, control and enforcement with the help of weighing stations for trucks should ensure that overweight trucks do not damage roads. Moreover, additional investment—including from the private sector—is needed in dry ports, terminals, and basic transport infrastructure. Border facilities must also be improved to accommodate efficient transport of goods, passengers, and services.

Improve the legal and regulatory framework for transport. Existing transport legislation should be updated and enforced to reflect socioeconomic realities. A new Road Haulage Act, a new Road Passenger Act, a new Railway Code, and legislation on maritime transport, coastal shipping, and aviation should be developed. A legal base for coordination and streamlining of border regulations should clearly define the mandates of border agencies and controlling authorities to avoid overlapping operations. International agreements, such as the SADC Protocol on Transport, Communications and Meteorology and the SADC Trade Protocol, can be converted into national legislation to obtain legal enforcement authority.

Improve multi-modal integration. A fully operational logistics corridor concept—integrating ports, maritime and coastal shipping, railways, road transport, terminals, and warehouses and distribution centers—is still far from implementation. Integrated modal connections and multimodal transport hardly exist. Recognizing this weakness, the Government of Mozambique and the Mozambican business community are developing the corridor concept in a public–private partnership.

Provide training in transport and logistics management, financial management, marketing, and regulations. Training should target providers of logistics services, road transport operators, forwarders, and clearing agents.

5. Access to Export Markets

Mozambique is a member of the World Trade Organization (WTO). In addition, it enjoys preferential access to key export markets under trade arrangements that reduce duty rates on its exports absolutely and relative to suppliers that do not have such preferences. Mozambique is also accorded preferential access to certain markets, including those of some of its neighbors, under reciprocal and binding trade agreements between countries or groups of countries. Among these, perhaps the most significant is the Southern Africa Development Community (SADC).

Internal constraints and complex rules of origin have limited Mozambique's ability to take advantage of preferential access. To improve its export performance, Mozambique must take advantage of market opportunities created by margins of preference, including new access to regional markets and new preferential access schemes in developed countries. At the same time, it must recognize that margins of preference are transitory and that most favored nation (MFN) reductions in duties in major markets provide investors and producers more certain market access. Further, the reduction in producer and export subsidies needed to permit agricultural trade flows based on Mozambique's competitive advantage can only be achieved through multilateral negotiations in the WTO Doha round of negotiations. Mozambique's opportunity to achieve significant permanent market access under the Doha Development Agenda appears to be reviving with the mid-2004 reinvigoration of those negotiations.

Mozambique must also carefully analyze how imminent revisions to these arrangements will affect opportunities and competitive pressures in key markets. One of the most significant sources of change is the ongoing negotiation of a free-trade agreement (FTA) between the United States and the five countries of the Southern African Customs Union. The agreement is likely to provide SACU countries preferential access to the U.S. market on terms better than those accorded to Mozambique while gradually reducing Mozambique's preference market in SACU markets relative to U.S. suppliers.

Mozambique's market access under preferential arrangements is also being affected by the European Union replacing preferences accorded former colonies in Africa, the Caribbean, and the Pacific (ACP) with Economic Partnership Agreements (EPAs); by amendments to the U.S. African Growth and Opportunity Act (AGOA); and by changes in the rules of origin under the EU's General System of Preferences (GSP) and Everything But Arms (EBA) arrangement. Meanwhile, the SADC mid-term review might be used to accelerate implementation of the SADC FTA.

Mozambique's producers, exporters and importers, and government officials need a better understanding of these trade arrangements to improve Mozambique's market access and to benefit fully from the opportunities they offer. In this chapter we examine Mozambique's access to foreign markets, including opportunities and impediments in those markets.

World Trade Organization

As a WTO member, Mozambique benefits from the certainty and transparency governing the exchange of goods and services across national frontiers. The WTO creates rights and obligations between Mozambique and its trading partners, provides dispute settlement procedures for enforcing rights, provides a forum for negotiating market access, and ensures transparent policy through notification requirements and review procedures. Mozambique must understand these rights and obligations to enforce them and to prepare for negotiations to improve access to and integration with international markets. Mozambique's preparation for these negotiations depends heavily on the government's capacity to receive and analyze information from other countries and the private sector in Mozambique. The country's importers and exporters must therefore understand their rights under the WTO and communicate problems to the government for resolution in the proper forum.

MISSED OPPORTUNITIES FROM THE URUGUAY ROUND

The Uruguay Round agreements resulted in trading partners reducing permanent MFN tariffs on many products of export interest to Mozambique. But reductions on products of special interest to Mozambique were often less than the average of all reductions; in addition, the Uruguay Round agreements failed to address important non-tariff measures on many such products. For example,

- A proposal for permanent bound tariff elimination, including intermediate and finished products, in the wood and fisheries sector failed during the Uruguay Round;
- Wood was liberalized significantly, but tariffs on fishery products were cut less than half the average cut of 40 percent in developed markets (Table 5-1);
- Quotas and reference price systems on fishery products in important markets, such as Japan and the EU, were not addressed;
- It was agreed that textile and clothing quotas of the Multi-Fiber Arrangement (MFA) would be eliminated, but tariffs were reduced by less than half the average for all products and remain the highest of any sector in developed country markets; and
- Developed countries' duty reductions on leather and leather products, including footwear, were the smallest of any sector.

As a result, significant barriers remain in developed country markets of interest to Mozambique.

NEW OPPORTUNITIES UNDER THE DOHA DEVELOPMENT AGENDA

In light of remaining market access impediments, Mozambique should participate actively in the Doha Round, individually or in concert with others such as the African, ACP, and least developed country (LDC) groups and the Group of 90 (G-90) to ensure that products on which tariffs remain high in developed and developing country markets are meaningfully addressed in this round of negotiations.

The Doha Development Agenda, the ninth round of multilateral trade negotiations, was launched in November 2001. This round has been referred to as the development round because it calls for eliminating tariffs on imports from LDCs; making technical cooperation and capacity building an integral part of negotiations; strengthening special and differential treatment for developing countries; and including all countries in more transparent negotiations.

Table 5-1
Developed Countries' Uruguay Round Tariff Reductions on Products of Interest to Mozambique

Product	Pre-UR (%)	Post-UR (%)	% Reduction
All industrial products	6.30	3.80	40
Without fish and textiles	5.40	2.90	46
Non-electrical machinery	4.80	1.90	60
Electrical machinery	6.60	3.50	47
Wood, paper and furniture	3.50	1.10	69
Metals	3.70	1.40	62
Chemical, photo supplies	6.70	3.70	45
Manufactured articles	5.50	2.40	56
Textile and apparel			
Tariff only	15.50	12.10	22
Fish and fish products	6.10	4.50	26
Leather, rubber, and footwear	8.90	7.30	18
Industrial tropical products	4.2	2.0	52
Natural resource-based products	3.2	2.1	24

SOURCE: WTO.

The September 2003 Ministerial in Cancun, Mexico, was to be a mid-term review of the negotiations. Instead it ended abruptly without agreement on a framework for proceeding. Ministers called for resumption of negotiations by senior officials in Geneva not later than mid-December 2003. Unresolved issues include

- How ambitious the agriculture negotiations should be (e.g., how deep reductions in protection will be);
- Reducing and / or eliminating support in developed countries for cotton production;
- An approach to non-agricultural market access (NAMA) negotiations; and
- Whether negotiations should encompass new issues (i.e., the "Singapore Issues," so named for the location of the WTO Ministerial at which these topics were first raised in 1998), especially trade facilitation measures and transparency in government procurement.

Mozambique has a significant interest in the resolution of each of these issues. In agriculture, Mozambican producers of sugar, cotton, groundnuts, tobacco, and maize face tariff-rate quotas in many markets and must compete with producers who enjoy domestic and export support programs. During the Uruguay Round, access for these products was "tariffied." This means that non-tariff measures were converted to tariffs—and at exceptionally high rates of duty (Table 5-2)—but lower rates were set for in-quota imports to achieve minimum market access levels.[136] In this round, Mozambique needs to secure (1) a reduction in the high out-of-quota tariff levels that were previously agreed, and, (2) the possibility of minimum market access so producers will have meaningful access to key foreign markets. Because Mozambique's production of so many of these products is only now recovering from the period of disruption and civil strife, it is not a historical supplier of these markets, but a new supplier. If "new LDC suppliers" are accorded preferences under minimum market access levels, Mozambique will secure new opportunities in markets it does not now supply. Commitments to the reduction of domestic support or the elimination of export subsidies should result in higher world prices and thus improved farm-gate and export prices for Mozambique.

Table 5-2
Examples of Uruguay Round Tariffication

Product	South Africa (%)	United States	European Union	Japan
Cotton	60	31.4 c / kg	Free	Free
Tobacco	44	32.7 c / kg	30Ecu / kg	Free
Sugar	105	33.9 c / kg	419Ecu / mt	71.54y / kg
Rice	5	Free	211 Ecu / mt	617y / kg
Maize	50	Free	94 Ecu / mt	Free
Groundnuts	70	163.8c / kg	Free	617y / kg

SOURCE: *WTO Agricultural Tariff Schedules.*

At the end of July 2004, WTO members reached agreement on a framework for the Doha Round's agricultural negotiations. They also agreed on the need to address issues raised by the erosion of longstanding tariff preferences and to achieve ambitious results in the cotton sector. They have yet to agree on specific formulas for reducing domestic support measures, eliminating export subsidies, and substantially improving market access.

Mozambique's interests in fisheries, clothing, wood products, and footwear are to be addressed in the non-agricultural market access negotiations. Developed and developing country tariffs remain quite high on apparel, footwear, leather products,

[136] Converting non-tariff measures to high tariffs, while more transparent, would have reduced market access in many cases. Thus, minimum market access was provided for, most often in the form of tariff rate quotas. Within the quota, rates are very low or non-existent; once minimum access levels are reached, however, high tariffied rates apply. Table 5-2 provides several examples of such rates.

and textiles. Tariff escalation (i.e., imposing higher duties on higher value goods) is common for these product groups, as are tariff peaks of 50 percent or more. Mozambique should seek bound MFN tariff reductions in developed and developing country markets. In the current round, it should request duty reductions on commercially meaningful product groups.

The July 31 Framework Agreement on the Doha Work Program seeks substantial improvement in market access for agricultural and non-agricultural goods, including the need to reduce tariff peaks and escalation to achieve deep tariff reductions on products of export interest to developing countries. The agricultural agreement, however, recognizes the need to address issues raised by the erosion of longstanding tariff preferences caused by reducing MFN tariff levels. Mozambique must resolve for itself how to balance the benefits of MFN tariff liberalization against the benefits of preferential access, taking into account its own performance under preferential schemes.[137] MFN tariff cuts are permanent ("bound"), which makes them more attractive to potential investors than preferential access schemes, which are subject to periodic renewal and may be revoked unilaterally. Deciding whether to pursue individual MFN tariff reductions implies that Mozambique can affect the outcome of the negotiations, which may not be the case. Regardless of its choice, Mozambique must closely follow its product interests in the negotiations and forge alliances with countries that have similar interests on particular issues or products.

WTO members also achieved consensus on negotiating a new WTO agreement on trade facilitation. Such an agreement could spur economic growth in Mozambique, especially if technical cooperation and institution building are integral to the agreements. A commitment to trade facilitation measures (e.g., to moving imports and exports more rapidly and transparently) usually attracts investment (see discussion in Chapter 4).

To gain further negotiating leverage, Mozambique can make commitments—consistent with its development, trade, and financial interests—that will balance the requests it makes of trading partners. Trading partners would consider it significant if Mozambique committed to bind current applied tariff levels or policies. Doing so would also afford Mozambique an opportunity to consolidate reform measures by

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[137] Preferential coverage is often poorly used because rules of origin or other administrative requirements are not met. According to UNCTAD calculations of trade in 2001, 62 percent of imports into Quad counties by GSP beneficiaries were covered by preference, but only 39 percent of these benefits were actually used. LDCs used 67 percent of available preference in 2001 (UNCTAD, 2004, p.5-6). In almost all ACP countries, EBA preferences are rarely used and use by non-ACP countries amounts to only about 50 percent (Brenton, 2004, p. 12, 31-32).

committing to them internationally. For example, the 2002 Mainstreaming Report noted that Mozambique was the only country in Southern Africa that did not make full commitments in its General Agreement on Trade in Services (GATS) schedule in the tourism sector.[138] This means that conditions for outside investors were more certain in all of Mozambique's neighbors than they were in Mozambique, even though Mozambique has no restrictions on equity investments in the sector. Mozambique has made significant reforms in the telecommunications sector that could be the basis for another offer. In return, it could seek more access for its sugar. Sugar production is being restored in Mozambique but because it has been absent from international markets for many years, Mozambique has limited quotas. Such quotas are most often based on suppliers' recent performance.

Regional and Subregional Trade Agreements

Mozambique is a member of SADC and has completed but not implemented an FTA with Zimbabwe. It is negotiating an FTA with Malawi[139] and Zambia and an EPA with the EU as a member of the Southern Africa Group.[140]

SOUTHERN AFRICA DEVELOPMENT COMMUNITY

Implementation of the SADC Trade Protocol, which establishes a free trade agreement in Southern Africa, began September 1, 2000.[141] The intention is to fully implement free trade in the region by 2008.[142] Negotiations covering trade in services began in 2002, but have faltered. In contrast, progress in harmonizing customs and trade documentation has been substantial, and negotiations on product standardization, quality assurance, and measurement (SQAM) have so far been

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[138] Nathan Associates. 2002. Mainstreaming Report, p. 4-13.

[139] To complete negotiations with Malawi, rules of origin must be agreed on.

[140] Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, Tanzania.

[141] Eleven SADC members are implementing the protocol: Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, Tanzania, and Zimbabwe. Angola is preparing its tariff reduction offer to accede to the protocol. The Seychelles and the Democratic Republic of the Congo complete the original roster of signatories. Botswana, Lesotho, Namibia, South Africa, and Swaziland are also members of SACU. (For SADC information, see http://www.sadc.int/overview/vision.htm.)

[142] Under the agreement asymmetric implementation was agreed, the more developed members agreeing to reach duty free status more rapidly. In January 2004, the five members of SACU are to have completed implementation for all but sensitive products. Other members will not complete implementation of reductions on sensitive products until 2012, except for Mozambique, which is permitted to complete implementation in 2015.

successful.[143] SADC's mid-term review this year should result in recommendations for fast-tracking implementation.

Why this concern with progress? Trade ministers from SADC countries want to begin negotiating a SADC Customs Union in 2005 and complete negotiations by 2010. Meanwhile, SADC has discussed expediting implementation of the SADC protocol for several years. Instead, they have failed even to agree fully on rules of origin for all products. Several commentators have viewed agreed-on rules as trade-restrictive or trade-diverting. Reflecting "inward regionalism," such rules attempt to protect certain sectors from outside competition by providing incentives (via minimum content requirements) for producers to forego more efficient input sourcing from suppliers outside of SADC.[144] Mozambique requested a study of SADC's rules of origin but the SADC Secretariat chose not to release it.

Other unfinished business in SADC includes deciding on Mozambican proposals to better enable LDC members to participate in the dispute settlement process, and to take temporary safeguard measures consistent with the agreement. Meetings of SADC's negotiating groups—the Trade Negotiations Forum (TNF), Senior Officials Meeting (SOM), and the Council of Ministers (CMT)—have become less frequent. Those that have been convened have focused on EPA negotiations.

Mozambique completed its implementation of the SADC protocol in August 2001. Nearly the last country to submit its tariff offers, Mozambique was one of the first to deposit with the SADC Secretariat the legal instruments necessary to implement tariff reductions. Its tariff reduction schedules were "gazetted" and regulations on rules of origin and certification were published in October 2001. Much of Mozambique's implementation is "backloaded," with reductions on sensitive products only beginning in 2005, and with improved import access for South Africa delayed until 2008.

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[143] The objective of SQAM is the progressive elimination of technical barriers to trade among members and the promotion of quality assurance and quality assurance infrastructure in member states, something especially important for LDC members.

[144] See Lesotho DTIS (p. xi), and "Rules of Origin and the World Trading System," by Anton Estevadeordal and Kati Suominem.

SADC Export Opportunities

More than 25 percent of Mozambique's trade—imports as well as exports—are destined for or originate in SADC countries. South Africa accounts for the largest share: 25 percent of Mozambique's imports and 20 percent of its exports.[145]

SACU MARKETS

The Southern Africa Customs Union (SACU) consists of Botswana, Lesotho, Namibia, South Africa, and Swaziland. These countries account for more than 75 percent of GDP in sub-Saharan Africa, with South Africa dominating. SACU members have a complex common external tariff (CET) of 38 bands and 216 rates. SACU acts as one country with regard to tariffs on imports from other SADC members. January 2002 marked the third phase of SACU implementation, in which all duties 25 percent and below were eliminated. In January 2004, SACU members were to have eliminated CETs to SADC members on all but the most sensitive products. Remaining SACU tariffs on textiles and clothing are scheduled to be eliminated in January 2005, on footwear in January 2006, and on automotive products in 2008. Sugar is excluded from duty reduction, trade from SADC partners being controlled by annual quotas.

Goods produced in Mozambique have benefited from this CET elimination. In addition, certain Mozambican products are no longer subject to the tariff-rate quotas under the former preferential Mozambican–South African trade agreement. These products include cashews, citrus fruit, coconut oil, fishery products, and wooden furniture. Equally important, preferences afforded Mozambican suppliers under SADC have created new opportunities to export products to South Africa (e.g., bananas, dried beans, footwear, mangoes, peas, pineapples, processed agricultural products, and stranded-wire products)[146] (See Tables 5-3, 5-4, and 5-5). Processed or manufactured products from the aluminum, natural gas pipeline, and titanium sands mega-projects may also enter South Africa on a preferential basis vis-à-vis

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[145] South Africa accounts for 48 percent of Mozambique's 2002 exports, if data are adjusted to exclude aluminum exports to Europe and prawn exports to Japan, Portugal, and Spain. Prawns are harvested and directly exported by joint-venture fishing fleets involving Mozambican, Spanish, Portuguese, and Japanese partners.

[146] Sanitary and phytosanitary (SPS) requirements have limited access for several fruit and vegetable products. The requirement that Mozambique have an up-to-date pest study, which it does not meet, has also discouraged exports. South Africa's requirement for certification has also been reported as delaying footwear exports.

non-SADC suppliers. Capitalizing on this preference, however, will require new investment.[147]

Table 5-3
Mozambican Exports to South Africa Previously Subject to Quotas under Bilateral Agreement

Product	1997 Quota Level (MT)	Product	1997 Quota Level (US$)
Fresh, frozen, dried fish	2,000	Cigarettes	600,000
Crayfish	200	Cotton fabrics	500,000
Shrimps and prawns	2,500	Clothing	790,000
Crabs	500	Blankets	250,000
Langoustines	1,000	Asbestos (cement roofing tiles)	300,000
Squid, octopus, clams	150	Wooden furniture	500,000
Cashew nuts	1,000	Handicrafts	300,000
Citrus fruit	5,000		
Coconut oil	5,000		
Cashew nut oil	500		
Cotton-seed oilcake	6,000		
Tires and inner tubes	830		

SOURCE: Mozambique–South Africa Trade Agreement.

147 Mozal only converts bauxite into aluminum ingots. New investment in rolling and extruding mills would be required to create flat and round products. We are not aware of any plans for such investment. Potential investors are studying the potential of an aluminum foundry in Beira.

Table 5-4
Selected SACU Tariff Reductions

HS Code	Description	SACU Offer	
		Base Rate	2004 Rate
FISHERY PRODUCTS			
0302xx	Fish, fresh or chilled	25%	0
0303xx	Fish, frozen	25%	0
030559	Other dried fish	6c / kg	0
03061300	Shrimps and prawns	5c / kg	0
03061400	Crabs	5c / kg	0
0307	Mollusks	6c / kg	0
FRUITS AND VEGETABLES			
08051000	Oranges	5%	0
080530	Lemons	5%	0
080540	Grapefruit	5%	0
COFFEE, TEA AND SPICES			
090121	Coffee, roasted	6c / kg	0
090240	Black tea	4R / kg	0
OILSEEDS AND DOWNSTREAM PRODUCTS			
12072000	Cotton seeds	10%	0
23061000	Oilcake from cotton seeds	6%	0
23065000	Oilcake from coconut or copra	6%	0
Cotton			
52010020	Ginned cotton	1.6R / kg	0
5203	Carded cotton	15%	0
TEXTILE PRODUCTS			
520811xx	Cotton fabric	30%	5%
520819xx	Cotton fabric	30%	5%
CLOTHING PRODUCTS			
6109xx	Of cotton	72%	15%
6203xx	Of other textile materials	72%	15%
6204xx	Of cotton	72%	15%
6205xx	Of other textile materials	72%	15%
WOODEN FURNITURE			
94033000	Wooden furniture	21%	0

SOURCE: *SACU offer.*

Table 5-5
Products Not Currently Exported to South Africa that Will Benefit from SACU Duty Reductions

HS Code	Description	SACU Offer	
		Base Rate	2002 Rate
04090000	Natural honey	24%	0
Fruits and Vegetables			
070810	Peas (pisum sativum)	15%	0
07133290	Other dried beans	10%	0
07133990	Other beans	10%	0
08030000	Bananas	5%	0
08043010	Pineapples	15%	0
080450	Guavas and mangoes	35%	0
Cereals and Downstream Products			
1101	Wheat flour	Var	0
110220	Maize flour	Var	0
190220xx	Pasta	20%	0
190530	Biscuits	25%	0
Processed Agricultural Products			
200920	Grapefruit juice	25%	0
200930	Other citrus juice	25%	0
200940	Pineapple juice	20%	0
240110	Tobacco, not stemmed / stripped	8.6R / kg	0
240120	Tobacco, stemmed / stripped	8.6R / kg	0
Minerals			
2501	Salt	14%	0
282300	Titanium oxide	12%	0
Plastics			
3921xx	Laminated plastics	17%	0
3923xx	Plastic packing materials	17%	0
3924xx	Plastic utensils	25%	0
3925xx	Plastic reservoirs	25%	0
Wood and Paper Products			
440920	Laminates non-coniferous	12%	0
441820	Doors and frames	17%	0
441890	Other building products	16%	0
442010	Wood statuettes	30%	0

HS Code	Description	SACU Offer	
		Base Rate	2002 Rate
FOOTWEAR PRODUCTS			
64034090	With toe-cap & leather uppers	30%	10%
640590	Other footwear, nes	40%	10%
640610	Parts other than from rubber	22%	0
640699	Parts other footwear products	22%	0
METAL PRODUCTS			
731210	Stranded wire, not electrically insulated	5%	0
7604	Aluminum bars and rods	12%	0
7605	Aluminum wire	12%	0
AUTOMOTIVE PARTS			
870891	Radiators and parts	20%	0

SOURCE: SACU offer

OTHER SADC MARKETS

The markets of Malawi, Mauritius, Tanzania, Zambia, and Zimbabwe have not opened to Mozambican exports as rapidly as South Africa's market. Under differentiated offers, however, they will open more rapidly to Mozambican than to South African exports. But for most products of export interest, Mozambique will have to wait until 2008 and in some cases 2012 to benefit from zero duty rates (Table 5-6).[148] These SADC partners designated many of Mozambique's current and potential export products as sensitive, often backloading the staging to maintain the current duty. Many reductions, therefore, will not begin until the fifth year, or 2005.[149]

[148] Significant "unrecorded" cross-border trade already occurs, particularly in agricultural products. Many Mozambican traders have eschewed trade with locations more distant from the border based on the belief that transportation costs are too high. This should be studied more closely because trade through Mozambique's corridors has the potential to be two way. Mozambican exporters have shipped products to Angola successfully.

[149] Malawi is making reductions all at the same time in the eighth year. Zambia is beginning reductions in the fifth year and completing them in the eighth. Zimbabwe and Tanzania are staging concessions annually. Implementation by Zimbabwe, Malawi and Zambia has been delayed.

Table 5-6
Partner Duty Base Rates and Staging on Selected Mozambique Products

Product	Malawi %, yr.	Zambia %, yr.	Zimbabwe %, yr.	Tanzania %, yr.
Vegetables	10% (8th yr.)	25% (6 yrs.)	40% (7 yrs.)	30% (8 yrs.)
Cashews	10 / 30% (8th yr.)	25% (6 yrs.)	25% (3 yrs.)	30% (8 yrs.)
Fruits	30% (12th yr.)	25% (6 yrs.)	40% (7 yrs.)	30% (12 yrs.)
Tea	30% (12th yr.)	25% (12 yrs.)	40% Immediate	30% (12 yrs.)
Maize	Free	Free	30% (7 yrs.)	30% (12 yrs.)
Flour (maize)	30% (12th yr.)	15% (12 yrs.)	40% (7yrs.)	30% (8 yrs.)
Vegetable oils	30% (12th yr.)	25% (6 yrs.)	40% (7 yrs.)	30% (8 – 12 yrs.)
Tobacco	30% (12th yr.)	15% (6 yrs.)	100% (12 yrs.)	30% (8 yrs.)
Cement	Free (5th yr.)	5% (12 yrs.)	20% (3 yrs.)	30% (12 yrs.)
Fabric	30% (6th yr.)	15% (6 yrs.)	15 / 25% (3-5 yrs.)	30% (12 yrs.)
Clothing	30% (6 yrs.)	25% (12 yrs.)	40 / 60% (7 yrs.)	30% (8 yrs.)
Footwear	30% (7th yr.)	25% (12 yrs.)	60% (7 yrs.)	30% (8 yrs.)
Tires	30% (6 yrs.)	25% (6 yrs.)	30% (5 yrs.)	30% (8 yrs.)
Plastic containers	30% (6-8 yrs.)	25% (6 yrs.)	25% (3 yrs.)	30% (8-12 yrs.)
Wood products	10 / 30% (6 yrs.)	25% (6 yrs.)	15 / 25% (3-5 yrs)	30% (5-8 yrs.)

NOTE: Only Tanzania has an import barrier on fish. It imposes a 30 percent tariff on fishery products, beginning reductions in the fifth year and completing them in the eighth year.

SOURCE: SADC offers.

Mozambique itself will be slow to give preference to SADC partners. So far, it has reduced duties on 1,600 raw materials from 2.5 percent to zero, responded positively to a few requests from trade partners, and made reductions on an MFN basis for all partners as required by the International Monetary Fund (IMF). Duty reductions that result in a margin of preference to SADC partners (a difference between the MFN and SADC rates) will not occur, with few exceptions, until the sixth year, 2006.

To SADC partners other than South Africa, Mozambique made differential concessions. It immediately eliminated its 35 percent duties on 90 products (3 percent of its SADC trade) and its 7.5 percent duties on 300 products (8 percent of its SADC trade) (see Table 5-7). It made other immediate reductions on raw materials (11 percent of SADC trade). Mozambique also designated 14 percent of SADC trade as sensitive to SADC members other than South Africa. Tariffs on those products will be reduced over 12 years.

Mozambique will not reduce duties on products originating in South Africa until the seventh year. Sensitive products with respect to South Africa cover 26 percent of SADC trade. Duty reductions on these products will be staged over 15 years.

Table 5-7
Mozambique's SADC Offer—Phased Reductions of Duties on Imports

Timeframe	Duty Level and Percent of Imports Covered			
Staging level	35 %	5.0 – 7.5%	2.5 %	Free
Immediate	3.2	7.8	11.2	3.0
Years 7 – 8	11.1	49.6		
Years 9 –12	4.9	9.0		

SOURCE: *Mozambique Offers to SADC (excluding South Africa).*

Several proposals have been made in SADC to accelerate tariff reduction. In March 2001 it was proposed that Mozambique, Malawi, Tanzania, and Zambia (MMTZ) eliminate tariffs for each other on all but a few products, such as sugar or maize. Malawi and Zambia already accord each other's imports duty-free treatment under COMESA. Along with Mozambique, the two countries have also been designated the "Southern African Growth Triangle." Discussions of the MMTZ tariff elimination proposal have languished because of the infrequency of SADC negotiating sessions, the nearly complete turnover in negotiators, and the impact of sharp increases in cross-border trade from Zimbabwe on markets in Malawi, Mozambique, and Zambia. This proposal should be revisited.

SADC Trade Protocol Challenges

Membership in SADC could represent an important opportunity for Mozambique. Greater market access could spur economic activity. At the same time, the consequences of rules of origin and extended transition times for protected industries must be considered. Negotiations to accelerate the achievement of the free trade area and to relax the rules of origin have stalled.

Regional trade arrangements often divert imports from low-cost worldwide sources to higher-cost regional ones. Such trade diversion is most likely to occur when regional preferential rates are significantly lower than MFN tariffs. For example, to meet SADC requirements and sell to South Africa, Mozambique must shift from cost-efficient sources of raw material to South Africa for plastics, and to the region for fabrics (for out-of-quota clothing exports). South Africa may have a larger and more developed economy than other SADC members, but it is not a low-cost producer by international standards. Furthermore, because South Africa has a large comparative advantage in the production of tradable items, the benefits of the regional trade arrangement may accrue mostly to it. Finally, South Africa is negotiating FTAs with the United States, India, and MERCOSUR—all efficient producers of inputs. In the future, therefore, if Mozambique wants to sell in the SACU market it must meet current rules of origin by purchasing from South African suppliers, while SACU firms competing in domestic markets can import from more efficient producers duty free. For these reasons Mozambique has worked hard to liberalize SADC rules of origin. Indeed, completion of SADC agreement on rules of origin has been delayed at least in part because Mozambique and other members are trying to liberalize those rules (Exhibit 5-1).

Exhibit 5-1
SADC Rules of Origin and Mozambican Export Prospects

In many cases, the rules of origin thus far agreed to in SADC seek to encourage production and consumption of goods with a high degree of regional content. This often requires SADC manufacturers who want preferential duty rates to switch from external suppliers to less competitive regional suppliers of raw materials and intermediate goods.

In other cases, SADC suppliers may be unable to meet the proposed rules applying to some important products, effectively removing trade in these products from the SADC agreement. Because of these trade-diverting or excluding effects, the rules of origin for several key product groups have yet to be agreed to fully.

For example, the issue under the rules of origin for textiles and clothing is whether two or more changes of tariff heading in SADC countries are required for the product to qualify for SADC rates. For example, under the proposed rule, a fabric producer would have to start from *fiber* produced in the region, while an apparel producer would have to start from *yarn*.

SADC’s least developed countries—Mozambique, Malawi, Tanzania, and Zambia, or MMTZ—have a special need to rehabilitate or establish apparel manufacturing. Therefore, a special rule allowing single transformation has been adopted for the first four years. MMTZ suppliers to the South African market can supply apparel made from fabric imported from external sources free of duty, but subject to an annual quota. The application of this rule will be reviewed next year in order to adopt a single rule in 2005.

During the scheduled 2004 midterm review, SADC members have an opportunity to re-examine rules of origin. Sector studies of the effect of the protocol’s rules of origin, on global competitiveness and regional investment would be useful for that review. Rules of origin—or other protocol provisions—that have hindered regional economic integration or had a neutral or negative effect on regional producers’ global competitiveness should be discarded.

Because it is among the poorest countries in SADC, Mozambique was allowed a longer transition period to lower its tariffs to South Africa. It is assumed that during this period industries will become more competitive, infrastructure will improve, the workforce become more skilled, and industrialists acquire the knowledge and capacity to export competitively. At the same time, industries are still protected while facing market costs above international levels. But lengthy transition periods are rarely successful, tending instead to decrease competitiveness by postponing the need to compete with imported goods.[150]

Leaving aside the complexities of rules of origin and other non-tariff measures, a small, poor country such as Mozambique participating in a regional trade arrangement must ensure that regional preferences accord with MFN-based tariffs. It must also promote domestic market reform.[151] Whether negotiations are regional or multilateral, they should be approached in the context of a national approach to trade policy. Mozambique's trade decision-makers must grapple with fundamental trade policy and negotiating strategy questions such as: Should Mozambique set high binding tariffs to allow greater flexibility in later negotiations, or set low binding tariffs to "provide stability and credibility in the country's trade policy framework?"[152]

If Mozambique wishes to implement its FTA with Malawi (see below) it must do so with reference to Articles 27 and 28 of the protocol. Article 27, the MFN clause, requires that duties applied to one member be applied to all, while Article 28 allows an exception to this rule if the agreement in question predates the protocol. Nonetheless different levels of SADC tariffs already exist, one applying to South Africa and the other most often applying lower rates to all other members (under differentiated offers). Mozambique's FTAs do not require it to raise any duty above the level agreed with other SADC members, but to eliminate duties between partners immediately. This is consistent with objective of SADC to eliminate duties, even though under SADC's current terms, elimination will not occur until 2012 (2015 for Mozambique's sensitive products). Perhaps accelerated action by Mozambique and its bilateral FTA partners would jolt the rest of SADC into action to advance tariff reductions.

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150 "Special and different provisions for … developing countries… is problematic. Rather than being guidelines for 'good' policy they are more realistically viewed as escape clauses for bad policy." See World Bank, Cambodia p. 17.

151 Frank Flatters. 2002. SADC Rules of Origin: Impediments to Regional Integration and to Global Competitiveness, page 24.

152 WB, Cambodia, p. 17.

In sum, if Mozambique ignores current and future changes to regional or international trade arrangements, it may lose market access. In approaching trade arrangements, Mozambique should first determine what it stands to gain—or lose—by the arrangements and changes to them. Doing so will require substantial new resources for policy analysis and impact modeling (see Chapter 7).

SACU AS AN OPTION

Mozambique's most significant current and potential market within SADC is South Africa, which is also the largest single source of its imports. But almost 90 percent of Mozambique's exports to SACU are already duty free and 50 percent of its imports from SACU enter duty free. Under the protocol all products (except sugar and arms and ammunition) exported from Mozambique to SACU will be duty free in 2008 and all products exported from SACU to Mozambique will enter duty free in 2015. Why then is accession to SACU considered an option, and what are the costs and benefits of acceding to this customs union?

The costs and benefits of a CET are probably the most important. The cost is that Mozambique will have to adopt SACU tariffs. The benefit is that the SADC rules of origin will no longer apply. This means that the basis for assessing SACU membership expands from the current pattern of trade under SADC, which is limited by rules of origin, to potential trade based on relative costs and efficiencies with an expanded SACU. Specialization might develop first in the textiles and clothing sector, allowing a regional supply chain unhindered by trade-diverting rules of origin. (Current SACU MFN tariffs on yarns and fabrics are similar to Mozambique's. [153]) Most other SACU duties on inputs to production are equal to or lower than current duties in Mozambique, the exception being plastics. The cost of increasing tariffs to SACU levels for motor vehicles, ceramics, inorganic chemicals, and wadding does not seem unacceptably high.[154] Within the SACU market, all producers will have to compete with suppliers from the EU under the current Trade and Development Cooperation Agreement between South Africa and the EU[155] and under the FTA being negotiated between SACU and the United States. These two agreements will ameliorate trade diversion that might have occurred by entry into SACU. Other costs and benefits will have to be assessed, including the effect on

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[153] Current SACU tariffs of 25 percent on fabric are too high and would divert Mozambican producers from lower-cost Asian sources. This might be compensated for by reintroducing the full SACU textile policy, which allowed the duty-free import of a yard of fabric or yarn for every yard exported.

[154] The Services Group. 2004. Should Mozambique Join SACU? A Review of Key Policy Issues.

[155] Nominally the TDCA applies only between South Africa and the EU. BLNS states could apply SACU MFN rates to EU trade at their borders but so far have not.

revenue (e.g., lost tariff revenue offset by revenue sharing within SACU and increased economic activity).

Political aspects must also be considered. In implementing SADC, Mozambique delayed opening its market to South Africa for 15 years—as long a period as it could negotiate. Accession to SACU is unprecedented, so Mozambique has no clear roadmap to follow or consider. While Namibia joined on independence it did not accede, and its prior trade policy was determined by South Africa. Whether Mozambique could enter on a phased basis, removing its tariffs to SACU and adjusting MFN rates to SACU rates over a number of years, would likely be determined by negotiations. A longer phase-in period for Mozambique to eliminate tariffs to SACU partners and/or to change its tariff to SACU CET levels might be acceptable to the Mozambican private sector, which remains concerned about what Mozambique does and will produce. Whether Mozambique would be welcomed into SACU under current SACU policy, including the revenue-sharing agreement that is already under stress, is also arguable.[156] Despite these potential obstacles, Mozambique should continue assessing the value of joining SACU, especially because SADC remains frozen in its schedule of reaching an FTA.

COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA

COMESA was formed in December 1994.[157] Tariffs among members were to be gradually reduced until full elimination in 2000. In October 2000 nine members[158] fully implemented COMESA's provisions for tariff elimination. These included SADC members Malawi, Mauritius, Zambia, and Zimbabwe.[159] In January 2004, Rwanda and Burundi began fully implementing the agreement. In December 2004, COMESA is scheduled to begin implementing a CET as its members establish a customs union. The CET will likely have five bands. The highest level of 30 percent

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[156] The SACU revenue sharing formula was the most contentious issue in negotiations. Under the customs component of the formula, which accounts for almost half of total revenues, the revenue is shared on the basis of intra-SACU trade leading to a relatively equitable distribution among the five SACU partners. Revenue of course is collected on the basis of extra-SACU trade, with most imports by South Africa. See Flatters, Kirk and Trask.

[157] COMESA's 20 members have a population of more than 385 million and annual combined 2002 imports of around US$35 billion. Members are Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe. Lesotho, Namibia, Tanzania, and Mozambique have withdrawn from COMESA.

[158] Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia, and Zimbabwe.

[159] These countries accord better tariff treatment to Egypt, Kenya, and Madagascar than to Mozambique. Mozambique sought restoration of COMESA rates under SADC's MFN provisions, but to no avail. It then sought accelerated elimination of tariffs on priority products through direct requests in SADC negotiations—also to no avail.

will apply to final goods. In January 2005, two members, Uganda and Kenya, along with SADC member Tanzania, will begin implementing a customs union in the East African Community (EAC).[160] Rules of origin under COMESA are far less complex and restrictive than under SADC. Meeting one of the following criteria confers origin: the good was wholly produced in a member state, with import material content of not more than 60 percent of ex-factory cost; its value added is at least 25 percent of ex-factory cost; it underwent substantial transformation during production.

Mozambique withdrew from COMESA in 1998, but is considering rejoining. Exports of many of the products noted in Table 5-4—especially exports to Malawi, Zimbabwe, and Zambia—ceased when Mozambique withdrew from COMESA. Mozambique withdrew because it could not afford the human and capital resources to participate in both agreements effectively, and its trade with SADC countries was far more significant. As will be seen in the following chapter on trade institutions and processes, this remains true. All of Mozambique's neighboring countries are SADC members and nearly all of Mozambique's trade in sub-Saharan Africa is with SADC partners.

Bilateral Agreements

Mozambique has negotiated a bilateral FTA with Zimbabwe, and is negotiating agreements with Malawi and Zambia. The agreement with Zimbabwe covers nearly all products.[161] Implementation of the agreements after ratification by the parties will be immediate; there will be no phase-down of tariffs. Rules of origin under the agreement with Zimbabwe are far simpler than under SADC. Origin is conferred if a good is wholly produced in a member state; if imported material content is not more than 60 percent of ex-factory cost; if value added is at least 25 percent of ex-factory cost; or if the good has undergone a change in tariff heading.

Mozambique has yet to seek ratification for the agreement with Zimbabwe. In fact, the private sector has voiced some opposition to the agreement. Many producers fear an economic recovery in Zimbabwe, which has a far more developed manufacturing base than Mozambique. Others claim that they are unlikely to benefit from such an agreement because Zimbabwe's sluggish economy lacks effective demand.

[160] The CET will be phased in over five years: raw materials will be rated at zero; intermediate goods at 10 percent, and finished goods at 25 percent. Uganda is also interested in joining SADC.

[161] The agreement with Zimbabwe excludes sugar, cigarettes, soft drinks, beer, and motor vehicles.

Mozambique shares a long border with Malawi and Zimbabwe. Mozambique's official trade with each is more significant than with other SADC partners (except South Africa.) Unofficial cross-border trade, especially between Mozambique and Malawi has been estimated to be significant (25–50 percent of official trade).[162] Much of this trade is in agricultural goods deemed sensitive in the SADC offers of each country; accordingly, SADC implementation will begin and end in Malawi in 2008. Mozambique's SADC reductions to Malawi on sensitive products will begin in 2008 and will be completed in 2012.

SADC and Overlapping Requirements

In addition to a possible bilateral agreement between Mozambique and Zimbabwe, two other events will force SADC to address the question of overlapping membership. When COMESA and EAC begin to implement CET rates, duties applying to non-members that are in SADC will rise above the rates agreed under SADC. It will not be possible for members of both SADC and COMESA, or of both SADC and EAC, to comply with both agreements. Pressure will build for SADC and COMESA to become a single agreement, although it is not clear that they will in fact result in one.

Mozambique is hesitating to implement these agreements in part because the SADC Trade Protocol will require it to grant duty-free treatment to other SADC members under the protocol's MFN requirements.[163] The agreement with Zimbabwe calls for immediate implementation, so duties applied under this agreement will be lower than those required by SADC schedules. One strategy for Mozambique to follow would be to seek a waiver from or amendment to the protocol to implement this agreement bilaterally rather than SADC-wide. Free trade between Mozambique and Zimbabwe is consistent with the objective of SADC, and would not require either Mozambique or Zimbabwe to raise duties above those committed to in SADC. In fact, the example of immediate free trade between SADC members might kick-start SADC's efforts to accelerate implementation of the FTA.

Preferential Access Arrangements

Mozambique has significant but under-exploited market access opportunities in developed countries that provide preferential access to products from least-developed countries. Preferential access schemes include the GSP in the United States and EU, ACP tariff preferences that will be replaced by EPAs under the EU's

[162] Whiteside. 2002. Neighbors in Development. Whiteside estimates that cross-border trade ranges from one-third of official trade to more than double. Mozambique's unofficial exports of maize, vegetables, beans, dried fish, salt, and vegetable are estimated to be as much as $20 million.

[163] The protocol's MFN requirements do not apply COMESA tariff levels to SADC members because COMESA pre-dated SADC. Mozambique had an agreement with Zimbabwe dating from colonial times but whether this agreement was ever implemented is not clear.

Cotonou Partnership Agreement or EBA initiative, and the U.S. AGOA. Mozambique also benefits from preferential tariff treatment by Australia, Canada, Japan, and New Zealand under the GSP.[164] India grants preferential access to Mozambique under the Global System of Trade Preferences (GSTP).[165] In 1986, Denmark, Finland, Norway, and Sweden signed the Nordic–SADC Accord, which provides market opportunities for SADC-made products on highly favorable terms. To increase Mozambican exports, government officials and private sector producers must understand preferential trading arrangements. Strategies for pursuing such opportunities should become part of the country's national trade strategy.

EUROPEAN UNION

The EU's preferential market access programs for Mozambique are regulated by two main trade arrangements: the EBA initiative and the Cotonou Partnership Agreement.

Everything But Arms

EBA, which took effect in 2001, provides duty- and quota-free access to the EU market for all products originating in beneficiary LDCs. Excepted products include arms, ammunition, and three sensitive products—bananas, rice, and sugar. Duties on these products will be phased-out as follows:

- ***Bananas***. The tariff will be phased out by 20 percent every year until it reaches zero in January 2006.
- ***Rice***. Starting in September 2006 the tariff will be reduced to zero by September 2009. In the meantime, the EU has instituted a tariff-rate quota that permits entry into the EU up to the quota amount duty free. Quotas will increase by 15 percent every year until 2009, when they will be eliminated.
- ***Sugar***. Starting in July 2006, the tariff will be reduced to zero by July 2009. Sugar imported from LDCs (up to the quota amount) can enter the EU duty free. Such quotas will increase from 74,185 tons in the first year to 197,355 tons by 2009. Mozambique's quota for sugar, under EBA, varies by a formula favorable to Mozambique.

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[164] Other countries with GSP schemes include Belarus, Bulgaria, Czech Republic, Hungary, Norway, Poland, Russian Federation, Slovak Republic, and Switzerland.

[165] WTO document WT/LDC/HL/20, 23 October 1997. Turkey indicated its intention to grant Mozambique preferential tariff rates under the GSTP (WTO document WT/COMTD/W/ 39, 30 March 1998.)

The EBA covers all other agricultural products, many of which may offer opportunities to Mozambique, such as fruit, vegetables, maize, oilseeds, and processed fruit and vegetable products. As with most GSP schemes, EBA preferences may be withdrawn at any time depending on a number of circumstances, including unfair trading practices and failure to comply with rules of origin or international conventions for drug trade or money laundering.

In addition, EBA uses the GSP rules of origin, which are often difficult for Mozambique to meet.[166] These rules are characterized by a system of cumulation of origin that is more stringent than the system for ACP countries under the Cotonou Partnership Agreement. For most woven articles of apparel and clothing accessories classified in Chapter 62 of the Harmonized System of Tariffs, "origin" requires manufacture from yarn; this means that using imported fabric does not confer origin. On the one hand, this is a problem for Mozambican exporters because most textile mills in Mozambique have closed down. On the other hand, these rules of origin, as well as those for the AGOA program, could induce foreign investment in Mozambique and help apparel producers meet the EBA and AGOA requirements.

The EU is reviewing the GSP's and EBA's rules of origin this year and will make revisions. The Ministry of Industry and Trade submitted Mozambique's comments on the current scheme earlier this year, advocating several changes that would make the rules more liberal by, for example, allowing cumulation among LDCs.[167] If the EU were to allow such cumulation, garments in Mozambique could be produced from fabric made in Malawi from yarn made in Zambia. Developments during this review should be monitored very closely, not only because of the EBA opportunity, but also because of the EPA negotiations. EBA rules of origin should be the starting point in EPA negotiations if Mozambique's market access into the EU is to improve under the EPA.

Cotonou Partnership Agreement

Signed in June 2000, the Cotonou Partnership Agreement is the successor to the Lomé IV convention.[168] It provides unilateral preferential market access for ACP

[166] Virtually all preferential exports from ACP LDCs are under the Cotonou Agreement because the GSP and EBA rules of origin are more difficult to comply with. Other LDCs, including Bangladesh, Laos, and Cambodia, qualify for origin under EBA rules for about 44 percent of their covered trade with the EU. See Brenton (2003) and Inama (2004).

[167] DfID and GTZ asked the Ministry to comment on the EU Green Paper. Its major comment was that EU seemed to be aiming revision toward streamlining EU administration of rules of origin, rather than proposing measures to make the rules of origin more flexible and liberal.

[168] The first Lomé Convention between the EU and its ACP trading partners became effective in 1975. The conventions were part of a tradition of privileged relations between ACP states and their former

countries until 2008, after which it will be replaced by EPAs negotiated between the EU and the ACP countries. The agreement provides duty- and quota-free access for all industrial products, including oil and mineral products, fish products, and agricultural and processed products. It was granted a waiver from the WTO's MFN provisions during the Doha Ministerial meeting in November 2001. To secure the waiver, the EU made the agreement more reciprocal.

The agreement constitutes a 20-year partnership with 77 countries and expresses a joint commitment to eradicating poverty, promoting sustainable development, and integrating LDCs into the multilateral trading system. Through EPAs, ACP states will commit to removing barriers among themselves and improving cooperation in all trade-related fields.

EPA negotiations have started and are scheduled to conclude by 2008. Four SSA regional groupings have launched negotiations with the EU:

- The Economic Community of Western African States (ECOWAS) plus Mauritania;
- The Economic and Monetary Community of Central Africa (CEMAC);
- Eastern and Southern Africa (ESA) including Burundi, Comoros, DRC, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, and Zimbabwe*;* and
- SADC, which includes the SADC-only members Botswana, Lesotho, Namibia, Swaziland, Angola, Mozambique, and Tanzania.

The EAC has formed a coordinating committee because one member, Tanzania, is negotiating with SADC, while the other two, Kenya and Uganda, are with ESA. Both the ESA and SADC groups are open to expansion but for the moment are coordinating at the level of the SADC–COMESA Task Force mechanism. Within the SADC group, Mozambique has been assigned the lead in the non-agricultural market access (NAMA) negotiations.

Specific objectives for EPA negotiations were agreed during Phase 1 of the negotiations between all ACP states and the European Commission.[169] They include promoting sustainable growth, increasing production and supply capabilities and diversification in ACP economies, and supporting regional integration. The current level of market access into the EU is supposed to be maintained and improved.

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colonizers. Since 1975, four conventions have governed preferential tariff programs for ACP states exporting to the EU. The last one expired on February 29, 2000.

[169] See ACP-EC EPA Negotiations, Draft Joint Report on the All ACP– EC phase of the Negotiations,ACP-EC / NG / NP / 43, Brussels, 2 October 2003.

Special and differential treatment should be provided, particularly to LDCs such as Mozambique. At the end of the negotiations, no ACP state is supposed to be worse off than it is currently.

EPA negotiations will likely encompass issues trade in services as well as market access. Mozambique has significant interests in tourism, and possibly in construction and the movement of natural persons to deliver services across borders (Mode 4 in the WTO's General Agreement on Trade in Services—GATS) in the region. The so-called "new issues" (or "Singapore Issues" of competition policy, investment, transparency in government procurement, trade facilitation) may also arise.

UNITED STATES

Signed into law in May 2000, AGOA gives products from sub-Saharan Africa preferential access to the U.S. market. Duty-free access for eligible countries is provided for more than 1,830 items that were excluded from benefits under the U.S. GSP. Burley tobacco, footwear, luggage and handbags, and citrus and pineapple juices previously excluded from the GSP now enjoy preferential duty access to the U.S. market, improving their prospects for Mozambican exporters.

AGOA Eligibility

Mozambique was declared AGOA-eligible in October 2000. Eligibility under AGOA's apparel provisions requires an effective visa system and an enforcement mechanism to prevent illegal transshipment. A special rule under the apparel provisions permits less-developed countries to ship apparel duty free to the United States until September 30, 2004. Mozambique became eligible under the provision on February 8, 2002, and is eligible to take advantage of the special rule. Mozambique and Tanzania qualified one year after Mauritius, the first SADC country to qualify. Most SADC members completed qualification requirements by August 2001.

In mid-July 2004, President Bush signed legislation to extend AGOA until 2015, thus extending the special rule allowing third-country fabric inputs through September 2007. Referred to as AGOA III, this new legislation also provides the possibility of technical assistance for ecotourism, and funds assistance from the U.S. Department of Agriculture's Animal Plant Health Inspection Service (APHIS) in meeting agricultural product sanitary and phytosanitary standards.

Experience Under AGOA

Mozambique exported US$2.5 million worth of goods under AGOA in 2003. Clothing exports began in November 2002, with three producers taking advantage of AGOA and exporting to large U.S. buyers, including Target, Fubu, and Sara Lee. Clothing exports have fallen off in 2004. Only one of those three producers is still selling to the U.S. market. Reasons for the slow supply-side response in textiles and apparel are discussed in Chapter 12.

Producers in other sectors that were identified as having potential, including fruit juices and tobacco, also did not demonstrate increased exports as a result of AGOA, although other African countries did show gains.

Mozambique has not performed as well as other SADC members under AGOA. Total SADC exports under AGOA almost tripled between 2001 and 2003, rising from US$605 million to US$1.7 billion, led by South Africa with almost US$1 billion in AGOA exports, which included more than US$600 million in automobiles. BMW, the leading exporter, has speculated about shipping vehicles through the port of Maputo should the business environment improve, representing a significant opportunity for Mozambique. Malawi, the only significant exporter of non-clothing products under AGOA, appears to have exported under AGOA an average of US$20 million of tobacco during the 2002/2003 period. Total SADC clothing exports under AGOA nearly quadrupled during the same period, rising from US$212 million to US$835 million, led by Lesotho at US$373 million (45 percent), and Swaziland at US$127 million.

AGOA Opportunities

AGOA continues to provide a significant opportunity for Mozambican textile and apparel exporters. Duties on apparel in the United States are between 17 and 23 percent on a trade-weighted basis, providing a significant margin of preference for qualifying suppliers. Apparel suppliers also benefit from the special rule that allows LDCs to qualify for the tariff preference regardless of the source of the fabric used in the apparel. Now that AGOA III has been signed into law, this special provision applies until September 2007, and accessories such as collars can also be sourced outside the region. Mozambique will have another three years to export apparel to the United States under the special rule and eight more years under more restrictive rules of origin at preferential rates of duty.

Since the special rule permitting extra-AGOA imports of fabric will expire in 2007, AGOA also presents an important opportunity for rebuilding Mozambican yarn and fabric production. To qualify for tariff preferences, apparel exported from South Africa and Mauritius needs to be made of regional yarns or fabric. South Africa and Mauritius together imported more than US$300 million of cotton yarn and fabric (mostly from outside the region) in 2000, and another US$52 million in fiber, mostly from SADC partners.[170] Swarp, a firm located in Zambia, spins yarn from local cotton produced under an outgrower scheme. Its sales to South Africa have increased significantly since AGOA went into effect. Producers in South Africa and Mauritius need to increase their regional supply of yarn and fabric to maintain market share in the United States. That market share will be under pressure when the Multi Fiber Arrangement (MFA) quotas expire in December 2004.[171] In 2003, South Africa improved its percentage of AGOA-eligible exports as a share of total textile exports to 47 percent from 20 percent, and 50 percent of Mauritian apparel exports qualified for AGOA preferences.[172] A good location for spinning and weaving, Mozambique also has local supplies of cotton and could increase its sales to South Africa and Mauritius.

Even beyond 2004, the AGOA program provides opportunities for Mozambique. After September 30, 2007, preferences will be accorded only to apparel produced using regional yarns and fabrics.[173] If Mozambique can create good investment conditions, it could attract investment to its textiles sector from apparel producers wishing to qualify for AGOA preferences in the U.S. market.

Summary of Recommendations to Improve Market Access

To enhance its export performance, Mozambique must make a number of choices in trade policy. We have identified opportunities for doing so in this and previous chapters. Mozambique must strive to achieve more liberal access for its products multilaterally in the WTO, regionally in SADC and through EPA, bilaterally with its neighbors, and unilaterally to enable supply responses to the expanding market access opportunities it will—and does—enjoy.

The Government of Mozambique must also consider and analyze alternatives to whatever choices it makes. The environment for trade policy is constantly changing and requires flexibility to readily re-evaluate and reprioritize goals. For example, if

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[170] Calculated from ITC TradeMap data.

[171] Investors in both countries can invest in LDCs that benefit from the special provision. Belita, a Mauritanian firm, has opened a second and larger factory in Beira to produce for the U.S. market.

[172] Total imports and AGOA imports were calculated from USITC Data Web.

[173] U.S. fabric may also be used, but transport costs to Mozambique would be prohibitive.

SADC is truly stalled, seeking SACU and/or COMESA membership might make more sense. A liberal EPA with the EU or FTAs with other major partners may be important complements to regional integration and the diversion to higher-cost suppliers that integration could cause. These choices, however, contractually commit partners to granting Mozambican suppliers better-than-MFN treatment. They also commit Mozambique to opening its borders. At present, Mozambique is limiting its commitment to multilaterally liberalized trade and delaying its commitment to liberalized trade in SADC.

Mozambique must make its own choices in pursuing alternatives, analyzing each current agreement and the country's performance under each. Just as access in trade partner markets ("beyond the border") can be improved, so can policies and practices within Mozambique ("behind the border barriers") to enable Mozambican producers to respond effectively to improved access. Access to foreign markets for Mozambican goods must be certain and transparent for Mozambique to attract the investment necessary to increase production of export-quality goods. Mozambique must wholeheartedly choose to focus trade negotiations on opening foreign markets for the products it exports, rather than preserving longstanding domestic protection for sectors that, lacking outside competition, will remain uncompetitive. In making these trade policy choices and identifying and pursuing alternatives, it is important for the Government of Mozambique to consider the following recommendations:

- ***Identify country interests and possible trade-offs and participate actively in the Doha Round*** to ensure that products of interest to Mozambican producers still subject to high tariffs and export subsidies or producer supports are meaningfully addressed in this round of negotiations. Agricultural products of special interest to Mozambique include sugar, cotton, groundnuts, tobacco, and maize. In many markets, these products face tariff-rate quotas and prohibitively high out-of-quota tariffs. At the same time, Mozambican producers must compete with producers who receive domestic support or export subsidies, or both. Products of interest to Mozambique that will be addressed in the non-agricultural market access negotiations include apparel, footwear, leather products, and textiles, as well as fish and wood products. Mozambique can leverage tariff and investment reforms that it has already made by committing to them during the Doha Round negotiations.

- ***Participate in tariff acceleration discussions within SADC.*** The markets of Malawi, Mauritius, Tanzania, Zambia, and Zimbabwe have not opened to Mozambican exports as rapidly as South Africa's market. For most products of interest, Mozambique must wait until 2008 (in some cases 2012) to benefit from tariff elimination by these SADC partners. Efforts to accelerate free trade in SADC have languished. The mid-term review offers an opportunity to try again to accelerate tariff reductions. Regardless, Mozambique should move implementation of its own offer on sensitive products to 2012 rather 2015. The fact of parallel negotiations of an EPA with the EU, and the decision of SADC Ministers to begin negotiations in 2005 to make SADC a customs union are further reasons to accelerate internal tariff reductions.

- ***Continue efforts to liberalize SADC rules of origin.*** To meet SADC requirements and sell to South Africa, Mozambique must shift from cost-efficient sources of raw material to South Africa for plastics and to the region for fabrics. South Africa is not the low-cost producer by international standards, so these SADC rules of origin encourage trade diversion. Meanwhile, since South African (or SACU) firms competing in the SACU markets are free to import from more cost-efficient producers, Mozambican producers are at a competitive disadvantage in one of their most important markets.
- ***Continue bilateral negotiations to permit acceleration of duty reductions between reciprocating partners within SADC.*** Mozambique has negotiated an FTA with Zimbabwe and nearly completed another with Malawi. Each provides for immediate elimination of duties. Free trade between Mozambique and Zimbabwe is consistent with the objectives of SADC, and implementation would not require either country to raise duties above those committed to their SADC partners. In fact, by setting an example, free trade between Mozambique and bilateral trade partners in the region might kick-start SADC's efforts to accelerate implementation of the FTA.
- ***Complete the evaluation of joining SACU.*** Mozambique recently considered the costs and benefits of joining SACU. Were it to join, it would no longer have its exports to South Africa circumscribed by SADC's stringent rules of origin. It would also have an opportunity to participate in the Trade and Development Cooperation Agreement between South Africa and the EU and the FTA being negotiated between SACU and the United States. SACU membership would require Mozambique to adopt SACU's CET. This would raise Mozambique's duties on motor vehicles, ceramics, inorganic chemicals, and wadding, but lower them on a number of other products, where it might as a result feel keener competition from its SACU partners. The recently completed evaluation of joining SACU did not address all aspects such membership. Thus, Mozambique should explore the terms under which it might join SACU to complete its evaluation of membership as a means for accelerating free trade in the region.

6. Trade and Investment Institutions and Processes

In this chapter we examine Mozambique's institutions responsible for trade policy and how dialogue on policy is coordinated within the government and between the government and the private sector. We first describe the institutions responsible for formulating, negotiating, and implementing trade policy. We then describe the formal and informal institutions involved in public–private dialogue on trade policy, institutions and agencies involved in export and investment promotion, and institutions that monitor compliance with standards and quality control metrics. We conclude by identifying constraints on policy development and needs related to training and human capacity development; data collection, dissemination, and analysis; and interministerial coordination.

Formulating, Negotiating, and Implementing Trade Policy

The Ministry of Industry and Trade (MIC), sometimes in conjunction with other ministries, formulates and implements trade policy and is involved in the negotiation of trade agreements. Other ministries involved in preparing trade policy include the Ministry of Agriculture and Rural Development (MADER); the Ministry of Planning and Finance (MPF), particularly the Directorate of Customs (DGA); the Ministry of Transport and Communications; the Ministry of Tourism; and the Ministry for Coordination of Environmental Affairs. Most significant trade policy decisions are made only after debate in the Council of Economic Ministers. The Minister of Industry and Trade, with support from the Private Sector Support Office

(GASP),[174] coordinates dialogue between the government and the private sector on economic issues.

MINISTRY OF INDUSTRY AND TRADE

The MIC formulates and implements trade policy[175] under delegation of the Council of Ministers, the government's highest executive body. At present, trade policy is not coordinated through a formal body. Three directorates in MIC handle various aspects of trade policy formulation: the National Directorate for Industry (DNI), the National Directorate for Trade (DNC), and the Directorate for International Relations (DRI).[176] These directorates are guided by Mozambique's Trade Policy and Strategy (PEC) document, which was drafted in 1997 and approved by the Council of Ministers in 1998.

The PEC presents a vision for moving Mozambique to a market economy so that growth in internal and external trade will reduce absolute poverty. It does not include a detailed description of Mozambique's international trade, trade policy options, nor an analysis of trade flows. Though the PEC presents priority areas for implementation that match the MIC's structure, it does not relate the priorities of each directorate to those of the others, nor does it consolidate the activities of each into a unified approach to reducing poverty. A revised strategy should not only coordinate priorities among MIC directorates but also incorporate the responsibilities of other ministries. Coordination of policies affecting trade but implemented by other ministries needs to be improved. The MIC and its Directorate of Trade did much to update the PEC in 2002 and 2003, but further work has been deferred until 2005. The updating effort attempted to address problems of coordination not only within the MIC but also among other implementing ministries and the private sector. This work on a national strategy needs to be completed.

The MIC, with support from DNI formulates and implements industrial policy, develops policy related to small- and medium-sized industries, and administers textile and clothing quotas under SADC. The DNI's Department of Industrial

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[174] Gabinete de Apoio ao Sector Privado (GASP).

[175] The MIC is also responsible for promoting exports, setting and enforcing standards, and protecting certain intellectual property through its subsidiary agencies, the export promotion agency, IPEX; the National Institution of Normalization and Quality (INNOQ); and the recently created Institute for Intellectual Property (IIP).

[176] Much of the material in this chapter is drawn from the MIC's report submitted in 2003 to the Joint Integrated Technical Assistance Programme (JITAP) identifying trade-related technical assistance that it was receiving and its trade capacity-building needs. We supplement that material with material from interviews with directorate and department managers. Mozambique will finalize its JITAP submission in the near future.

Property handles the protection of intellectual property. The DNI focuses on downstream agricultural industries, garment manufacturing, metals and metallurgy producers, wood product manufacturers, and supplying industries. It is trying to update colonial-era legislation regulating individual sectors. It is also responsible for informing the industrial sector of opportunities arising from trade agreements and arrangements. During the negotiations of the SADC Trade Protocol, it engaged the private sector in discussions of appropriate SADC rules of origin. It recently began administering the MIC's program to exempt inputs imported for certain domestic industries from tariffs.

The DNI did not receive technical assistance until this year, when an economist from the U.K.'s Overseas Development Institute (ODI) was placed in the policy office, which is now staffed by two economists and two engineers. DNI's top technical assistance needs are training in (1) trade agreements, especially rules of origin; (2) the performance of inspections as required by trade agreements; and (3) analytical skills to monitor Mozambique's performance under various trade agreements.

Working directly with the MIC's provincial and district offices, the DNC has three departments, one for policy, one for licensing, and one for commercialization of agriculture. The policy department has been working since 2002 to update the PEC.[177] Recently, it has focused on institutional reform within the MIC.[178] In late 2002, the licensing department completed formalities necessary for Mozambique to become eligible under AGOA. Through its licensing function the DNC also focuses on internal trade. The department for commercialization of agriculture recently led a task force that studied the regional market for agricultural products identified as having new export opportunities.[179] It disseminates information on Mozambique's trade agreements to the provinces, and keeps producers informed of historical and current market prices and conditions for certain agricultural products.

DNC staff and outside experts, including under the auspices of JITAP, have identified needs for training in commercial policy, market research, export

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[177] DNC's mandate implicitly covers internal and external trade. Negotiations of trade agreements are the responsibility of the National Directorate for International Relations (DRI), which does not have a policy department.

[178] The MIC is far advanced in its plans for institutional reform. Plans call for retrenching about 200 employees, or 25 percent of the workforce (mostly at or near retirement age). Plans for reorganization, which will address overlapping responsibilities, are not yet final. Provision is also being made for training to upgrade skills, including in-service graduate-level training for senior managers. The MIC's Permanent Secretary is directing the work.

[179] The task force included representatives from MADER, IPEX, and the private sector. The products are honey, beans, ginger, cassava, sweet corn, paprika, and bananas. Task force findings are discussed in the sector-specific analyses in Part 2 of this report.

promotion, and trade negotiations. DNC also requires technical assistance in computerizing licensing procedures and records and analytic support for development of a national trade strategy and for market research, particularly relating to timely information on markets and prices for agricultural products.

Financed by the European Community (EU) and executed by the Food and Agriculture Organization of the United Nations (FAO), the "Marketing Management Assistance for Food Security" project has been operating in the MIC since September 1997. The project initially supported the DNC, but is now formally linked to the Technical Reform Unit (UTR) from which it supports the functional and structural reorganization of the ministry. The objective of the project is to assist the Government of Mozambique in attaining national food security by ensuring that the country's potential for agricultural production, marketing, and trade is realized and that agricultural products are more available and better distributed to Mozambicans.

The DRI has final responsibility for trade negotiations, including the Doha Round, SADC, and bilateral negotiations with Malawi, South Africa, Zimbabwe, and Zambia. Mozambique has decided to negotiate an Economic Partnership Agreement (EPA) with the European Union along with six of its SADC partners—the Southern Africa Group—and will lead the non-agricultural market access and fisheries negotiations for the Group. (See Chapter 5.)

Though DRI has led Mozambique's preparations for all trade negotiations, it has had to seek external expertise for negotiations on trade in services and agriculture. Its staff of 14 is divided into three sections: multilateral, bilateral, and special organizations. Both the Director and Deputy National Director of DRI have attended the WTO's trade policy course in Geneva.

DRI also evaluates trade policy options. For example, it is now considering whether Mozambique should rejoin COMESA and whether it should accede to the Southern African Customs Union (SACU). Each set of negotiations affects the policies of other ministries, especially the ministries of agriculture and finance. During SADC negotiations, DRI convened an interministerial group, Grupo Inter Ministerial (GIM), before negotiating sessions to coordinate Mozambican positions. Representatives of MADER, DGA, and MPA also attended negotiating sessions. Such coordination proved essential in presenting and implementing Mozambique's tariff reduction schedule offer. GIM has reconvened since the SADC Protocol was implemented, but not often, and with only limited representation from ministries other than MIC. Interministerial discussions—as well as dialogue with the private sector to discuss other bilateral, regional, or multilateral negotiations—continued in many different fora, but informally. For example, DRI has invited representatives of MPF, Customs, and MADER to assist with preparations for EPA negotiations and to discuss other trade negotiation options.

Given the number of trade policy negotiations and decisions now facing Mozambique, other ministries must be more involved in policymaking. For example, this year SADC is conducting its mid-term review, which presents an opportunity to address its shortcomings. SADC members this year also will begin discussing adding services to the protocol. Negotiations with the EU are underway to form a reciprocal free trade agreement to replace unilateral preferences long accorded to the EU's former colonies in Africa, the Caribbean, and the Pacific. And the Doha Development Round is at a watershed. Each of these negotiations is complex and involves matters of domestic regulation and other issues for which MIC may not be the sole—or even lead—ministry with jurisdiction.

According to Mozambique's JITAP document DRI staff need training in specializations (e.g., agriculture, services, rules of origin), in analytical skills for devising alternative responses to negotiation issues and for monitoring progress in negotiations, in international economic relations, and in negotiation techniques and simulations. DRI acknowledges the need for significant undergraduate and post-graduate trade-related curricula to be developed and made available to staff through colleges and universities in Mozambique and elsewhere in the region. It has sought donor assistance to this end. The WTO under JITAP, USAID, the Commonwealth Secretariat, and the Trade Law Center for Southern Africa (TRALAC) and the European Commission have sponsored studies and seminars for DRI (see Exhibit 6-1).

Joint Public-Private Body Reviews Tariff Classifications

The classification of individual tariff lines may be changed on the basis of a review by the Customs Superior Technical Council (CSTA), a joint committee of the government and private sector that makes recommendations to the Minister of Planning and Finance. Difficult decisions are referred to the Council of Ministers. Reclassifying a consumer good to an intermediate good would lower the tariff from 25 percent to 7.5 percent and significantly cut landed cost of inputs for domestic manufacturers.

MINISTRY OF PLANNING AND FINANCE

The MPF handles other aspects of trade policy implementation, such as setting and collecting import duties and taxes. In 1996, the structure of the tariff was simplified into four bands applying to basic goods, raw materials, fuel and equipment, intermediate goods, and consumer goods. In 1999, Mozambique introduced a value-added tax (VAT) of 17 percent.[180] The MPF also collects excise taxes on alcoholic beverages, tobacco, certain luxury goods, and automobiles. (A nominal customs user fee is collected, but only on imports that are free of duty.) A joint body of MPF and private sector representatives reviews tariff classifications (see sidebar). The Gabinete de Estudos provides analytical support to MPF on trade and economic issues. It is receiving some technical support from Purdue University.

Exhibit 6-1
Coordinating Donor Assistance

Mozambique receives external assistance from different bilateral and multilateral sources. Executed by the ITC, UNCTAD, and WTO, the Joint Integrated Technical Assistance Program (JITAP) is a capacity-building program. Like the Integrated Framework (IF), its broad objective is mainstreaming trade to reduce poverty and increase integration into the multilateral trading system by improving the effectiveness of trade negotiations, the formulation of trade-related policies, and supply capacity and knowledge of market opportunities.

The work programs of JITAP and the IF overlap significantly. For instance, both require the establishment of a National Steering Committee, so one committee that addresses both JITAP and IF should be created. JITAP, however, has a narrower focus and less funding for implementation than the IF.

Mozambique is also eligible to receive direct assistance from any of the IF and JITAP agencies as well as bilateral donors. For example, under the WTO's 9-month paid internship program a Mozambican could be sponsored to work with the Mozambique Mission to Geneva. The intern would gain practical experience and knowledge about trade policy implementation, and the mission would gain capacity to participate more effectively in discussions of multilateral trade issues.

DGA is responsible for implementing the WTO Customs Valuation Agreement (CVA), certifying the origin of exports, and verifying the origin of imports. (Its role in administering tariffs is discussed in the next section, and its role in administering the border is described in the trade facilitation and transport audit done by the World Bank and provided in Volume 3. Mozambique began implementing the CVA in 2003 and performance must be evaluated to determine the revenue effect. To ensure that undervaluation does not prevent Customs from capturing the revenues due on imported goods, risk assessment and post-clearance audit procedures must also be

[180]The VAT does not apply to essential goods and services (e.g., medical services and drugs, housing, wheat flour, rice and bread, agriculture, fishing).

developed and introduced. Average unit values are important selection criteria for both techniques, but aggregated data on imports in Mozambique do not include volume data. The collection and aggregation of volume data must be improved. Certifying Mozambican origin and enforcing SADC rules of origin are important services that Customs officials provide. The failure to properly certify goods in a timely manner has raised costs significantly or prevented exports. Training and technical assistance for these two important tasks is a high priority in Mozambique's JITAP submission.

THE NATIONAL INSTITUTE FOR STATISTICS

An independent agency, the National Institute for Statistics (INE) collects, assembles, and makes import and export data available to government officials and the interested public. Availability has not improved since the 2002 report on mainstreaming trade. The time lag in making these data available is still six months, and when data are available they cover only value information. Because data are not disaggregated, it is impossible to determine whether imports entered under preferential duties, were exempt, or paid the full rate. Trade policy analysis, including the effect of the SADC Agreement, is based on such disaggregated data and must be performed on a timely basis. INE and DGA need to better coordinate trade data assembly and analysis to expedite the release of data for analysis.[181] Mozambique's JITAP submission identifies assistance to INE as critical to building analytic capacity. INE's technical assistance needs are related to the hardware and software necessary to improve its collection of external trade data.

Public–Private Policy Dialogue

The Minister of Industry and Trade has traditionally been the liaison between the government and the private sector. He is supported by GASP, whose goal is to eliminate administrative barriers to domestic and foreign investment. GASP promotes public–private dialogue through the Annual Conference of the Private Sector in Mozambique, an event now in its eighth year and jointly sponsored by the Confederation of Mozambican Business Associations, or CTA.

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[181] MIC, in preparing for the mid-term SADC review, has been limited by the lack of data for 2003. SACU completed the elimination of duties 25 percent and below in the beginning of the year. The authors of this report were similarly limited. In the absence of INE data (six months into 2004) data from Customs were made available, but did not cover major exports such as aluminum and electricity. The Customs data also varied significantly from INE data for prior years and the differences have yet to be resolved.

When the conference last convened in March 2003, participants expanded the number of permanent working groups between sector-specific producer associations and senior officials of ministries relevant to the sector.[182] For example, the private sector resolved to begin a dialogue on trade and "red tape" with each relevant ministry. In addition to MIC, these include MADER, MPF, Labor, Tourism, Transport and Communications, Justice, Public Works and Housing, and State Administration. The Prime Minister continues to be the principal government contact for this dialogue.

Going the Extra Mile for a Stamp

An exporter of fresh vegetables from Chimoio to Zimbabwe and South Africa ships daily in season. His product's origin must be certified to receive SADC preferential rates. Recently this exporter could not get his produce certified when the single agent authorized to certify took vacation for 30 days. Instead, he had to drive 6 hours roundtrip to find an alternate official, significantly raising the costs of his truck load.

At present, Mozambique's private sector, academic institutions, and unions contribute to trade policy formulation through informal, ad hoc consultations. As the ultimate bearer of the effects of policy, the private sector should contribute formally to the formulation and evaluation of policy options. Private sector perspectives will be diverse. Some in the private sector will resist trade and investment liberalization, while others will seek greater access to regional or global markets for their goods. On the whole, regular contact between the public and private sector will help to ensure that trade policy decisions are made with broad appreciation of their impact on Mozambican interests.

Confederation of Mozambican Business Associations

CTA's 54 members represent more than 3,000 firms from various sectors of Mozambique's economy. Its members are also geographically representative, including associations from all provinces. CTA tries to address constraints that businesses and exporters face in Mozambique. At its last annual conference, CTA continued its partnership with government, expanding the number of joint task forces addressing specific sectoral issues to ten and agreeing to semi-annual reviews of progress.

The public–private dialogue already covers many trade facilitation issues, such as customs and business licensing, as well as other critical issues, such as land, labor, and product market functions. But dialogue on specific trade negotiations, export promotion, and other crucial matters does not seem to be part of the current framework.

[182] For the detailed agendas see the final report, which was edited by CTA: 7th Private Sector Conference (VII GASP) Mozambique, Maputo March 5, 2003.

Export Promotion

EXPORT PROMOTION AGENCY

Operating under MIC jurisdiction and in existence since 1990, Mozambique's export promotion agency, IPEX, promotes Mozambican exports by identifying export markets for Mozambican producers, providing information on those markets, and promoting export-oriented production. IPEX is implementing an UNCTAD Trade Point Program, a single center for trade information and training, but funding limitations have curtailed development. IPEX has also received assistance from the International Trade Centre (ITC) in using its Trademap and Productmap tools to better understand export markets and the competition for them. IPEX has a training center for entrepreneurs, but must subcontract training to other providers because it lacks training staff of its own. It has several market study initiatives underway, again most often completed with donor financial and/or technical assistance. For example, the ITC in Geneva undertook a study of the artisanal wood sector. The study could be expanded into an examination of which value-added wood products afford the greatest opportunity for Mozambican exports; however, the funds necessary to expand the study have not been made available. MIC has also requested that IPEX identify potential exports by province and prepare a strategy for each product.

A proposal to transform IPEX into an institute of external trade is being considered. The new institution would assist importers and exporters by providing market studies and market entry and other services to private sector companies in Mozambique. At present, only limited donor assistance is available to IPEX. Mozambique's JITAP submission details IPEX technical assistance needs of more than US$2 million.

OFFICE FOR THE PROMOTION OF COMMERCIAL AGRICULTURE

Reporting to MADER, GPSCA was formed two years ago at the urging of the private sector. It promotes the development of a commercial agricultural sector and value-added agricultural production in Mozambique. Specifically, GPSCA

- Works with producers to learn about specific challenges and to find solutions to those challenges,
- Promotes coordination among institutions of MADER and facilitates interministerial cooperation,
- Promotes investments in the agricultural and agro-processing sector,

- Analyzes the competitiveness of specific crops by conducting in-depth value-chain analyses, and
- Provides economic analysis and information on markets, investment, policy development, data, and a wide range of agriculture-related activities.

In June 2004, GPSCA coordinated a strategy document ("vision") for MADER, identifying priorities for agricultural development. GPSCA has been the major point of contact for significant agricultural investors. Along with IPEX, it is conducting or commissioning studies on crops such as a rice, sugar, and horticulture in order to identify export opportunities. GPSCA also seeks to identify opportunities for import substitution, particularly in crops and products that Mozambique once produced as exportable surplus. To improve access to credit in the agricultural sector and improve chances for the commercialization of agriculture, GPSCA will soon propose creation of a venture capital fund. Along with MADER's Department of Policy Analysis (DAP), GPSCA has identified agriculture's main problem as lack of capacity to produce for export. MADER's limited knowledge of trade agreements exacerbates this problem. MADER needs a better understanding of ongoing negotiations (e.g., WTO, EPA, SADC mid-term review) and barriers to Mozambican exports. MADER should work with MIC to pursue improved market access opportunities in these negotiations. Producers and investors also need help identifying opportunities arising from completed agreements (i.e., SADC, bilateral agreements) and recent preferential trade initiatives, such as the U.S. African Growth and Opportunity Act (AGOA) and the EU's Everything But Arms arrangement.

Investment Promotion

The purpose of the Investment Promotion Center (CPI), which operates under the jurisdiction of the MPF, is to attract and facilitate domestic and foreign investment and, ultimately, to stimulate job creation. After approving investment licenses, CPI staff assists investors in obtaining other licenses and permits and provides fast-track set-up services to assist investors in obtaining land, utilities, and related services.[183] Fast-track services are important in converting a licensed investor into an actual investor. Unfortunately, no statistics on conversion from licensed to actual investment are available.

[183] Commercial entities must be registered with MIC before receiving a certificate of investment from CPI.

CPI also administers Mozambique's export processing zones (EPZ) and certifies the status of export processing firms. In 2001, the law establishing EPZs was amended to permit individual firms to be declared zones.[184] By late 2002 only one firm, Mozal, had been designated an EPZ. The number approved has now risen to eleven: three mega-projects,[185] five clothing manufacturers of which only two are producing apparel,[186] the management firm for Maputo port, a tire company, and a sisal producer.

CPI has received technical assistance and budget support from the World Bank and its Multilateral Investment Guarantee Agency (MIGA). The worldwide slowdown in FDI in recent years has affected investment in Mozambique. It is now more critical to convert potential investors to actual ones, and to create inward linkages between mega-investments and local goods and service providers. So far, the only successful inward linkages have been with Mozambican metallurgy service firms providing services to Mozal. They themselves have located within the Beleluane EPZ. Inward investment in tourism appears to offer an opportunity for linkage to Mozambican domestic providers. With respect to investment promotion, CPI's linkage to MIC and other trade agencies identifying export opportunities should be strengthened. Mozambique's JITAP submission notes the successes of Mauritius, Costa Rica, and Vietnam in this regard.

Standards and Quality Control

NATIONAL INSTITUTE OF STANDARDS AND QUALITY

Under the jurisdiction of the MIC, INNOQ is responsible for developing rules and regulations on product quality and safety and is the WTO enquiry point for the Agreement on Technical Barriers to Trade (TBT).

The 2002 mainstreaming trade reported that INNOQ had adopted standards for six products by mid-2001 and had set a goal of twelve more product standards by year's end. Many of the targeted standards covered important potential exports, such as copra, cotton, honey, fruit juices, seafood products, and vegetables. Adoption of standards may be prolonged because INNOQ is required to seek the comments

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[184] To qualify, the firm must employ more than 250 workers and export more than 85 percent of its annual production.
[185] Mozal, Limpopo Heavy Sands, and Moma Heavy Sands.
[186] Belita and Maputo Clothing (Sabrina) are producing apparel.

and/or clearance of other ministries, institutions, and the private sector before adopting them, and such comments have not been forthcoming. Since mid-2001, 100 new standards have been drafted but none have been adopted. INNOQ staff and facilities have remained largely unchanged since 2001. In 2003, however, a mobile laboratory provided by South Africa was deployed. Four metrology labs opened in 2002, but INNOQ has not been approved to accredit the labs. Product certification, when required, must also still be done by SABS.

INNOQ has been active in training. It has conducted training to introduce quality systems and prepare private sector firms for ISO certification in Maputo, Beira, and Nampula. Six Mozambican firms have been certified under ISO-9000 (albeit by SABS) and several more are in the process of certification. INNOQ has trained ISO trainers and auditors, including several on its staff. Nonetheless, INNOQ needs to be accredited itself. This year it plans to provide training in Hazard Analysis Critical Control Points (HACCP), which is now implemented only in the fisheries sector. INNOQ has been active in all of the SADC standards bodies.

Since 2002 several donors had suspended technical assistance to INNOQ believing that, without the commitment of other resources from the Mozambican government, such assistance alone could not sustain the organization. In 2003, INNOQ prepared terms of reference for a US$12 million technical assistance program, but is not currently supported by any long-term donor assistance. The JITAP report summarizes INNOQ's problems as inadequate facilities, a lack of personnel, and a lack of equipment.[187] The report blames these problems on poor coordination, especially between and within the government institutions that are INNOQ's main partners in implementation.

STANDARDS DEPARTMENTS OF MADER

MADER's Department of Vegetal Sanitation (DSV)[188] is the enquiry point for vegetables and fruit and its Department for Livestock (DINAP) for animals under the WTO's Agreement on Sanitary and Phytosanitary Standards (SPS). The Department of Quarantine is responsible for protecting the country from pests and diseases. The potential for agriculture exports in Mozambique is great, but could be limited by the necessity of meeting the requirements of the SPS agreement. For example, recent successes of Mozambican exporters in European and South African markets could be

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[187] See page 45 of the JITAP report.

[188] JICA provided DSV personnel training in pest management. The JITAP report notes that a number of trained inspectors have left government service.

halted abruptly if Mozambique does not update its pest status reports or obtain phytosanitary certificates. Under the International Plant Protection Convention (IPPC), which sets requirements for implementing phytosanitary standards, national plant protection organizations are required to update surveys of pests and diseases affecting export crops. Most of Mozambique's most recent surveys are out of date, which alone is sufficient reason for an importing country to stop accepting Mozambique's exports. The Department of Quarantine is urgently seeking assistance from FAO to start updating Mozambique's pest status report.

Recommendations for Strengthening Trade Institutions and Processes

BOOST TRAINING AND STRENGTHEN HUMAN CAPACITY

Conducted in 2000, the WTO's Trade Policy Review (TPR) for Mozambique indicated that trade-related institutions in Mozambique suffered from very limited human capacity, poor interministerial coordination, and weak organizational structure. According to the review, only the MIC was familiar with the WTO. The TPR identified major technical assistance tasks that would benefit Mozambique: (1) increase awareness of the WTO in the government and the private sector; (2) build capacity of individuals and institutions implementing trade agreements, especially mid-level and technical officials in agriculture, customs, fisheries, and industry; (3) improve quality control and consumer protection through better equipment and staff training; (4) provide assistance and training to identify and overcome problems in accessing external markets; (5) provide assistance to make local laws and decrees conform with WTO agreements; and (6) provide assistance in preparing for and participating in WTO negotiations.

Mozambique's JITAP submission revalidates the findings of the TPR. The submission emphasized the need for training and technical assistance to improve (1) public and private sector capacity to analyze policy options and participate in trade policy deliberations and negotiations; (2) understanding of the benefits and obligations of WTO, regional, and bilateral agreements, particularly as these relate to agriculture, services, trade preferences, rules of origin, standards, and negotiations; (3) the management skills of the private sector so it can respond to trade opportunities; and (4) the market analysis, accounting, language, business, and financial planning skills of individual firms and business associations.

Human capacity in the public sector poses another challenge. Turnover is high and skills and experience among public sector employees are limited. Effective civil service reform offers one way of strengthening human capacity in the public sector. Training must also be considered a long-term structural problem, one that requires interventions at many levels. Because skill levels within government are not only weak but also sparsely distributed, on-the job training must be provided while undergraduates and graduate students are trained.

Exhibit 6-2 summarizes trade-related training now available in Mozambique. Two new programs merit special citation. The first is a master's-level course introduced by the Faculty of Law at Eduardo Mondlane University. This degree program, which combines both law and economics, was developed with technical assistance from TRALAC and USAID.[189] More recently the Aga Khan Foundation began offering training programs for garment workers ranging from basic sewing skills to production management.

Basic skills—such as computer training, English language skills, and writing—can be developed in many different centers across the country. But training in the skills required of trade specialists is very limited in Mozambique. Universities in South Africa, the United States, and the European Union are providing short-term and master's-level programs.[190] The programs offered in South Africa are reasonably priced; the master's programs cost less than 20 percent of equivalent programs in the United States.

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[189] Although much-needed and useful, this program may not be sustainable. Most professors are from abroad and require per diem, daily fees for their services, and accommodations, which makes the program expensive and impossible to sustain without donor support. The lack of interest in a train-the-trainers program is demonstrated by the absence of potential local trainers in the courses. Without local trainers, the courses continue to be taught only in English, which limits their impact and utility. Moreover, the university only recently relaxed requirements that bar professors without Ph.Ds from teaching. Most professors of international trade do not have Ph.Ds—though they do have valuable practical and on-the-job experience. Although the program has a full-time coordinator, the lack of a full-time administrator also jeopardizes the program.

[190] The University of Cape Town (School of Economics) runs a master's program in trade and regulation policy. Twice each year, the University also offers a two-week executive course on applied international trade bargaining. See www.commerce.uct.ac.za/tarpog The Faculty of Law of the University of Stellenbosch runs an LLM program in international trade. Only one module of this program focuses on aspects of public law and international trade; the rest focus private business transactions and international arbitration. The University of Pretoria Faculty of Law runs an LLM program in trade and investment.

Exhibit 6-2
Availability of Trade Training in Mozambique

The Superior Institute for International Relations, established in 1990 by the Ministry of Foreign Affairs and Cooperation, offers a five-year course in international relations and primarily trains Mozambican diplomats.

The Faculty of Economics at the Eduardo Mondlane University offers a five-year curriculum in economics and management so graduates are able to assume managerial positions in the private sector or executive posts in the government. The Faculty of Law offers a master's program in International Trade Law and Economics. The Faculty of Agronomy has developed a master's program in agribusiness.

The Center for the Formation of External Trade has offered short-term courses (40–100 hours) for technicians and business operators. At present, the center is only offering courses in business English and computer operations.

The Mozambique Institute of Export Promotion offers 4-week courses on trade and export development in the provinces of Sofala, Zambezia, and Nampula.

Trade-related training can also be integrated into other forums. These include the Catholic University in Beira, the Catholic University in Nampula, the Instituto Superior Politécnico e Universitario, and the Instituto Superior de Ciencias e Tecnologia. The latter is interested in developing undergraduate and graduate courses in economics and international trade but requires support in designing the curriculum.

Funding should be made available so government officials and private and non-governmental sector representatives can attend trade-related programs in South Africa, the United States, and the European Union. University scholarships should be made available to promising university graduates who, in return for such scholarships, would be required to spend some time working at the MIC, other relevant government agencies and relevant private sector and non-governmental organizations when they complete training.[191] Because managers do not want to give up their best and most productive staff for long-term training, using consultants as replacements for long-term staff should be considered. Technical assistance to Mozambique's trade policy institutions thinly covers needs even in MIC, which receives most of such assistance.

STRENGTHEN DATA COLLECTION, DISSEMINATION, AND ANALYSIS

At present, data is scarce in Mozambique and collection and dissemination are inconsistent. Trade and investment data, especially trade statistics, are neither adequate nor reliable. Volume data on exports and imports can be obtained only

[191] USAID / Mozambique recently launched a trade and economics scholarship program for 2005.

from original sources and even then common units of measurements are not always used. Data provided by different government ministries and departments are often contradictory or inconsistent. This hinders

- Analysis of export performance generally, as well as in markets in which Mozambique receives preferential access (e.g., under the SADC Trade Protocol);
- Identification of changes in the volume of imports that affect the health or competitiveness of domestic industries;
- Forecasting of trends in trade;
- Analysis of trade policy options; and
- Adequate support services for exporters and importers.

Some trade information is available from the INE, CPI, Customs, and IPEX, but the private sector is either unaware of it or does not know how to use it. Statistics on foreign markets, even such large, data-rich markets as the United States, are even scarcer.

INE and DGA need to better coordinate trade data assembly and analysis. Mozambique's JITAP submission identifies assistance to INE as critical to building analytic capacity, and specifies its technical assistance needs including needs for hardware and software. Customs needs to improve its accuracy and speed in collecting and entering data. Customs has met with officials and clearing agents to emphasize the need for proper classification and quantity information.

To improve analytical capacity the MIC will need to deepen its knowledge of and ability to analyze issues related to trade and industrial policy. The MIC enjoys the services of an excellent research and information provider, the Market Management Assistance Project (Projecto de Assistencia a Gestão do Mercado), funded by the EU. It also receives support from USAID and the World Bank under PODE. At present, however, these projects are too narrow to support the development of a national trade strategy. We recommend expanding the scope of the projects or incorporating them into a more broadly defined institutional support mechanism. South Africa's Trade and Industrial Policy Strategies (TIPS) project could be examined as a model for Mozambique.[192] The resulting institutional support mechanism would research trade and industrial issues and link into worldwide trade policy networks.

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[192] See www.tips.org.za. Other institutional arrangements include a collaborative arrangement between the organizations in South Africa and Mozambique, or expanding the mandate of TIPS to cover SADC. However, following on OECD recommendations, the TIPS approach might be broader still, linking

STREAMLINE STANDARDS-SETTING PROCESS

The Government of Mozambique needs to decide which institution will set standards. Currently several institutions, none with sufficient resources, participate in the process. Combining resources and authority under a single institution might accelerate the adoption of the 100 standards pending and smooth the adoption process for future standards.

FORMALIZE INTERMINISTERIAL COORDINATION

Mozambique's trade policy is still ambiguous, reflecting the influence of both pro- and anti-trade interest groups, and its trade policymaking process is plagued by coordination problems. The MIC has primary responsibility for trade policy formulation, but other ministries also participate. Each ministry pursues its mandate in its own way: the agriculture ministry may promote food security over external trade; the finance ministry will tend to defend revenue collections; and the transport ministry may wish to develop north-south links, rather than more export-friendly east-west infrastructure. Even the MIC has conflicting internal interests because it represents industries that favor trade liberalization and those that seek shelter from foreign competition.

Mozambique's increasing global integration means that the government must participate in more and more negotiations and agreements and must administer policy so that Mozambican importers and exporters benefit from these agreements. Mozambique must effectively use tariff preferences granted under the U.S. AGOA and EU EBA programs.

In addition to their growing number, negotiations and agreements now cover a growing number of subjects that go far beyond the traditional matters of tariffs, quotas, and trade remedies. Mozambique's international trade rights and obligations extend to new trade agreement rules in textiles, agriculture, SPS measures, intellectual property rights, and services. In addition, the competitive position of Mozambique's producers is affected by a wide range of government policy and practices: customs practices, labor law, VAT refund practices, company registration practices. Many different ministries and government agencies establish and administer these policies. Mozambique's international trade is significant enough for it to establish a mechanism that will enable it to make government-wide trade policy decisions on a continuous basis. Multilateral, regional, and bilateral negotiation

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donors, the Government of Mozambique, and the private sector into various trade policy networks. See OECD, Strengthening Trade Capacity for Development, 2001, p.42ff.

strategies must be integrated, and conflicts between ministerial mandates as they affect international trade must be resolved. Mozambique's major trading partners—South Africa, the EU, and the United States—have long recognized the value of a coordinated trade policy and have coordinating mechanisms in place. In fact, most major trading nations have a single entity with authority to conduct trade policy. The mandate for a coordinating unit must be strong enough to overcome the propensity of busy ministries not to consider trade policy objectives outside their jurisdiction.

At present, the MIC forms interministerial coordinating committees when issues arise. It identifies members, invites them to serve on the committee, and convenes meetings of the committee. These committees usually cover only one topic at a time. In addition, usually the same representative from a ministry, private sector organization, or NGO serves on each committee. This lack of a formal interministerial process that handles multiple issues simultaneously (e.g., SADC, EPA, the Integrated Framework) wastes resources and time.[193] The Government of Mozambique is now developing a mechanism for coordinating trade policy among government agencies.

Ministries' Failure to Coordinate Costs Apparel Exports

In SADC, MIC negotiated preferential quotas to SACU destinations for Mozambican apparel manufacturers. Performance under these quotas has been poor, hampered by (1) delays in training new workers because of delays in issuing visas to expatriate experts with knowledge of SACU market requirements; (2) failures to exempt duties on imported inputs used to produce exports; (3) delays in refunds of value-added taxes, which tied up scarce operating capital; and (4) delays in export and import clearances, which then delayed shipments. Of the seven firms shipping to South Africa at the time quotas were negotiated under SADC, only two are still producing, and only one is now exporting to South Africa.

[193] If necessary, this formalized interministerial committee can form technical groups to analyze specific issues.

7. Trade and Investment Policy Environment

In the past decade, the Mozambican government has done much to create an attractive trade and investment environment. It has made many improvements to its trade regime and institutions, trade and investment policy, trade facilitation measures and institutions, regulatory policies, and physical infrastructure. All of these affect Mozambican export production and price competitiveness. In this chapter we describe how Mozambique has improved trade and investment policies in recent years and offer recommendations for further improvement.

Tariff Structure

Mozambique's tariff book, *Pauta*, was simplified in 1996. Import duties, which are assessed on the basis of cost-insurance-and-freight (CIF), range from 2.5 percent to 25 percent, depending on the classification of the goods (Table 7-1). A rate of 2.5 percent is applied to raw materials, 5 percent to fuel and capital equipment, and 7.5 percent to intermediate goods. The rate on consumer goods recently dropped from 30 to 25 percent and is scheduled to drop to 20 percent in 2006.[194] Surcharges in addition to regular tariffs are applied to imports of sugar, cement, galvanized steel, and certain steel tubes while these domestic industries are rehabilitated. The surcharge on sugar, for example, adjusts import prices to a target domestic price. The cement and sugar industries have had significant exports in the last two years, suggesting the need to review and adjust the application of these surcharges.

[194] The reduction to 25 percent was scheduled for 2002 but the government delayed it until 2003 to conform reductions to the scheduled SADC phase down, which was delayed one year while negotiations were completed.

Individual tariff lines may be changed upon review of the essential nature of the goods by the Customs Superior Technical Council (CSTA), a joint committee of the government and private sector that makes recommendations to the Minister of Planning and Finance. Difficult decisions are referred to the Council of Ministers. Reclassifying a product from an intermediate to a consumer good hikes the duty rate from 7.5 percent to 25 percent. The 2002 mainstreaming report cited plastic and cardboard packaging material as industrial inputs that were assessed at the consumer good rate of 30 percent. Many such inputs have since been reclassified as intermediate goods and the tariff dropped to 7.5 percent.

Only 13 of Mozambique's current industrial tariffs are bound to most favored nation (MFN) suppliers in the WTO.[195] Its tariff rates on all agricultural products are bound at the ceiling level of 100 percent. Mozambique, however, has committed to the rates shown in the Table 7-1, as well as the phased reduction to zero, in its SADC tariff schedule. The phase down period ranges from immediate to 15 years for sensitive products imported from South Africa. So far, Mozambique has implemented three stages of its phase down, and thus applies as many as three different duties on a single tariff line—one to MFN suppliers, one to South Africa, and the rest to SADC.

Table 7-1
Classification of Goods for Import Duties

Product	Class	Rate (%)
Basic goods	E	0
Raw materials	M	2.5
Fuel	N	5
Capital goods	K	5
Intermediate materials	I	7.5
Consumer goods	C	25

SOURCE: PAUTA.

Mozambique's tariff structure (Table 7-2) is among the more liberal in the region. The average tariff rate is 12.1 percent and the trade-weighted average is below 9 percent.[196] Tanzania and Malawi have a higher maximum rate of 30 percent applying

[195] All the products Mozambique has bound can be found in Chapter 84 of the Harmonized System of Tariffs—machinery and mechanical appliances.

[196] In addition, an excise tax is assessed on four different categories of goods, but applies to less than 3 percent of the tariff lines. Accordingly, the excise tax averages less than 1 percent. The 17 percent value-added tax applies to more than 5,000 items, or 95 percent of tariff lines. Because of its breadth of coverage, it averages 16.1 percent.

to consumer goods. Zambia's tariff structure is similar to Mozambique's, with a maximum level of 25 percent, but its intermediate rate of 15 percent is twice that of Mozambique. Mauritius, Zimbabwe, and the Southern African Customs Union (SACU) have more complex tariff schedules with significantly higher tariff peaks.

Table 7-2
Structure of Customs Duties, 2003 (all except SADC)

Ad Valorem Rate	Number of Lines	Percentage of Lines	Percentage of Lines at or Below Ad Valorem Rate
0	116	2.2	2.2
2.5	1,151	21.4	23.6
5	662	12.3	35.9
7.5	1,564	29.1	65.0
25	1,877	35.0	100.0
TOTAL	5,370	100.0	

SOURCE: *Nathan Associates analysis.*

Zimbabwe and SACU also have a number of specific tariff rates (e.g., ZAR/kg), which Mozambique does not. The weight of specific rates varies with exchange rates and product prices. Many apply to agricultural products and offer significant protection in times of weak prices since the tariff's ad valorem equivalent (percent of the value of the imported good) is highest when unit values for the import are lowest.

Lowering the ceiling tariff rate to 25 percent in January 2003 narrowed the gap between the highest and lowest rate. Nonetheless, that gap is still significant and can distort the allocation of resources in Mozambique's economy by creating a high effective rate of protection for some manufacturing processes. Also referred to as tariff escalation, a structure of low tariff rates on raw materials and intermediate goods that are inputs to production provides effective protection to final goods far in excess of nominal rates. A simple illustration of effective tariff protection is provided in Exhibit 7-1.

Exhibit 7-1
Import Duties, Effective Rate of Protection, and Economic Efficiency

The effective rate of protection (ERP) measures the extent to which import duties shelter inefficient domestic producers from import competition. Consider a domestic firm that produces cooking oil worth $100 per unit in the world market. If the import duty on cooking oil is 25 percent, then the firm can charge the *meticais* equivalent of up to US$125 and still compete against imports in the domestic market. Suppose the firm uses imported inputs that cost $60 in the world market, bearing an average duty rate of 2.5 percent, the cost of the inputs in the domestic market is $61.5. This firm can meet or beat import competition as long as the margin between the output price and the cost of imported inputs does not exceed $125 – $61.5 = $63.5, the domestic value added, or VAd. In the world market, competitive producers convert the same inputs into cooking oil with a value added margin of VAw = $100 - $60 = $40.

The ERP is the difference between VAd and VAw, expressed as a fraction of the latter, which represents the international competitive standard. In this case, the ERP is

$$\text{ERP} = (\$63.5 - \$40) / \$40 = 59\%$$

This is called the effective rate of protection, because it shows the extent to which domestic production is protected, in the sense that the transformation process can operate at 59 percent higher cost (in this example) than international rivals and still compete in the domestic market. The level of the ERP depends on the duty rates applied to imported outputs and the respective inputs. The ERP also depends strongly on the domestic content of the production activity. The following calculations show how powerful the protection effect can be, assuming the same duty rates as given above:

Domestic content[197]	*ERP*
20%	115%
40%	59%
60%	40%
80%	31%
100%	25%

The lessons here are somewhat remarkable. First, the tariff differentials in place in Mozambique can shelter highly inefficient activities. Second, protective tariffs favor investments with low domestic content; this distortion discourages the development of backward linkages. Third, very high levels of protection can be delivered without reducing the duty on imported inputs to zero.

Under the *Pauta* many final goods are subject to this type of protection, including most processed agricultural products, paint, matches, tableware and utensils of all materials, leather bags, cast metal products, and plastic goods.[198] Many agricultural products including virtually all meat, dairy, and fruit and vegetable products are also charged the consumer good rate of 25 percent. Notable exceptions are cereals

[197] Domestic content is defined as the difference between the value of the product and the cost per unit of imported inputs (valued at world market prices).
[198] Other consumer goods not produced in Mozambique such as home appliances, air conditioners, and automobiles also attract the highest tariff. In agriculture, 85 percent of all tariff lines attract the 25 percent rate.

such as wheat, maize, and rice, which attract a tariff of 2.5 percent. Only 15 percent of agricultural lines are subject to rates of 7.5 or 2.5 percent. These low rates apply to live animals, seeds and bulbs, unrefined vegetable oils, and similar products. Mozambique's tariffs, moreover, increase the cost of goods produced for exports—even goods that do not contain imported inputs (see Exhibit 7-2).

Duty Exemptions

Thus far, Mozambique has been using tariff policy to make its manufacturers more competitive in domestic and foreign markets by creating export-processing zones (EPZ) and by permitting duty-free entry of goods in certain approved industries.

EXPORT PROCESSING ZONES

In 1999 Mozambique adopted legislation providing for the establishment and operation of EPZs in specified geographic areas (these are known as multiple-use EPZs). The legislation was amended in 2000 and 2001 to allow qualifying individual companies operating anywhere in Mozambique to be eligible (these are known as stand-alone EPZs). Several activities are precluded from EPZ status, including fish and cashew processing. At the time of the 2002 report, CPI had licensed only one stand-alone EPZ: Mozal Aluminum. As of mid-2004, it had approved 11. The major benefits of an EPZ include duty-free entry of components and machinery, tax incentives, and on-site Customs facilities.[199] Other benefits include a 60 percent reduction in the corporate income tax rate—currently 32 percent—for a period of 10 years and exemption from

- Customs duties on imported construction materials and other goods destined for licensed activities,
- Customs duties on imported goods and merchandise used in licensed activities,
- Real property transfer tax (acquisition and use of immovable assets), and
- VAT and the Specific Consumption Tax.

[199] Several other important incentives include hiring flexibility with respect to foreign managers and skilled laborers (up to 15 percent of employees), and permission to use foreign currency accounts in Mozambique.

Exhibit 7-2
Taxes on Imports Also Act As Taxes on Exports

Any tax that increases the cost of inputs for domestic producers makes their products less competitive in external markets. But import taxes (and other import barriers) act as tax on exports in a much more pervasive way. The basic function of an import tax is to increase the domestic market price of importable goods *relative to the price of other goods.* On the supply side, this creates an incentive for producers and investors to allocate more resources into producing importables (i.e., import substitution). On the demand side, the tax creates an incentive for consumers to purchase fewer importables because the relative price is higher. At the market equilibrium, there is more domestic production, less domestic consumption, and fewer actual imports.

Consider the effect of an export tax. For small countries the world market price is a given, so an export tax reduces the domestic market price of exportable goods *relative to the price of other goods.* This creates an incentive for producers and investors to reduce the production of exportables and for domestic consumers to purchase more of them because the relative price in the domestic market is depressed.

The critical point is that a general tax on imports creates the same anti-export bias as a general tax on exports. Both policies have the same effect on the *relative price* of importables versus exportables in the domestic market. This is called the *Lerner symmetry theorem*.[200]

In practical terms, an import tax pulls resources into the production of importables, whereas an export tax pushes them out of producing exportables. By reducing the demand for foreign goods, an import tax strengthens the equilibrium exchange rate, and makes exports less competitive. An import tax can also discourage exports by increasing labor costs through its effect on the cost of living.

Successful countries have neutralized the adverse effect on exports through offsetting subsidies (Korea) or by insulating exports from domestic market prices through EPZs (Mauritius). This brings us to another important symmetry: the combination of a general tax on imports with a comparable subsidy on exports has the same effect on economic behavior as currency devaluation except that the tax and subsidy approach is more complicated to administer.

To qualify as a ***multiple-use EPZ***, a specified geographic area must contain qualifying firms with at least 500 permanent Mozambican workers, and every firm within that EPZ must employ at least 20 workers. Firms within the zone must export 85 percent of production. So far, only one multiple-use EPZ has been approved, *the Parque Industrial de Beluluane* (PIB-IFZ). The initial investment to develop this zone was approved in 2001. Eight companies (Table 7-3) have been approved for PIB-IFZ, which is located in Maputo next to the Mozal Aluminum smelter. Six companies provide engineering and metallurgical services to Mozal, a seventh is intended to be

200 Abba Lerner. 1936. The Symmetry between Import and Export Taxes. *Economica,* 3 (August): pp. 306-313.

a garment factory but it has yet to break ground, and the eighth provides management in the zone. Both donors and government are trying to determine why so little activity has occurred. Meanwhile, EPZs are being considered near the port of Beira in central Mozambique as part of the Beira Development Corridor, and near the port of Nacala as part of the Nacala Development Corridor.

Table 7-3
Industries in Beleluane Industrial Park - EPZ

Name	Activity	Investor	Investment Value (US$)
ECL Services	Engineering	ECL (SA), ECL DPG Engineering (Proprietary) Ltd	1.0 million
Duys Engineering Moçambique	Engineering	Pieter M. Duys (Pty) Ltd (South Africa)	0.8 million
AES-Kempe-Alutec Engineering Services	Engineering	Macquire Holding Ltd	1.2 million
Bearing Man Moçambique	Engineering and production of industrial components	Bearing Man (SA)	0.65 million
Cosmos Controls Moçambique	Engineering	Cosmos Controls (South Africa)	0.58 million
Hytec	Manufacturing of pneumatic and hydraulic components	Hytec Holdings (Pty) Ltd, Tesuco Services (Pty) Ltd	0.5 million
Kangelo Confecções	Garment factory for exports	Cheng Garment Ltd (China)	0.82 million
Chiefton Moçambique	Management of the BIP-IFZ	Chiefton Management Ltd (Australia)	0.42 million

SOURCE: CPI, 2004.

To qualify as a ***stand-alone EPZ***, a firm must employ at least 250 permanent Mozambican workers. In considering applications for stand–alone status, the EPZ Council pays special attention to the social, economic, and environmental impact of the proposed investment. As with multiple-use EPZs, the firm in a stand-alone project must export at least 85 percent of its production. Table 7-4 presents information on Mozambique's stand-alone EPZs,[201] which includes three mega-projects, along with eight other smaller projects, mainly in the clothing industry.

201 In October 2002 Mozal was the only firm with EPZ status.

Table 7-4
Industrial Free Zone Investment—Stand-alone EPZ

Name	Location	Activity	Investor
Mozal	Beleluane-Maputo	Aluminum production	Billiton SA, IDC (SA)
Moma Heavy Sands	Moma-Nampula	Mining	Kenmare Resources PLC (Ireland)
Limpopo Heavy Sands	Chibuto – Gaza	Mining	Corridor Sands (SA), Yangara (SA), WMC (Australian)
Maputo Clothing Company	Maputo	Clothing industry for exporting garments (shirts)	Sabrina Clothing Manufacturing, SA (Pty), South Africa
Umar Textiles Moçambique	Maputo	Clothing industry for exports	Umar Textiles, FZE
Humza Ra Creations Moçambique	Matola - Maputo	Textile & clothing industry for export	Humza Ra Creations (Pty) Limited SA
Cicomo	Nampula & Nacala	Sisal and synthetic fiber industry	Companhias de Cordoarias, Portugal
Strang Rennies Mozambique	Maputo & Matola	Port harbor transportation for Mozal	Strang Rennies South Africa, Manica Service (Moz)
Mabor de Moçambique	Maputo	Tires, safety belts and inner tubes production	Governments of Mozambique and Portugal
Belita Mozambique	Beira – Sofala	Textile and clothing	Palmar Group of Companies -Mauritius
Pungue	Beira – Sofala	Textile and clothing	Palmar Group of Companies -Mauritius

SOURCE: CPI, 2004.

DUTY EXEMPTIONS ON INPUTS

In 2003, after considerable discussion with the private sector directly and in CSTA, the MIC issued a Ministerial Diploma (directive) permitting manufacturing firms in particular sectors (textile, clothing, and footwear; food processing; other agro-based industries; metal mechanical; chemicals, plastics and rubber) to import pre-approved production inputs duty free. To be eligible, firms needed to have annual sales of US$250 thousand (6 billion *meticais*)[202] and to demonstrate that they added at least 20 percent to the total value of their output. Applications needed to be supported by several official documents, demonstrate from accounting records the minimum value-added required, and project the volume and value of the inputs they would use for the period of approval. As of early May 2004, nine months after MIC's action,

202 There is no requirement to export or demonstrate potential to export.

response to this program is disappointing: only 30 firms have applied for duty exemptions and 16 have been approved. Of these, only one was located outside of Maputo. Three more were approved in late May (Table 7-5).

Table 7-5
Firms Approved for Duty Exemption on Inputs, 2004

Name of Company	Activity	Authorization Date (D/M/Y]
Ferpinta Beira Mocambique	Engineering	23 / 12 / 2003
Industria Onda Lagoa	Engineering	26 / 12 / 2003
Mozrih Metais Lda	Engineering	17 / 05 / 2004
Topa International	Garments and footwear	12 / 03 / 2004
CIM-Comp. Industrial da Matola	Food industry	23 / 03 / 2004
Fasol Saborel	Food industry	17 / 05 / 2004
Merec Industries	Food industry	13 / 02.2004
Maputo Industria Lda	Food industry	19 / 03 / 2004
Socimol	Food industry	05 / 02 / 2004
Protal Lda	Food industry	29 / 01 / 2004
Luxoflex Lda	Agro-industy	23 / 12 / 2003
Academica Limitada	Printing industry	02 / 04 / 2004
Sociedade do Noticias	Printing industry	19 / 03 / 2004
Multipac Lda	Printing industry	17 / 05 / 2004
Colgate Palmolive Moçamb	Chemical industry	23 / 03 / 2004
Unilever Moçambique Lda	Chemical industry	26 / 03 / 2004
Tudor Sarl	Chemical industry	20 / 04 / 2004
Poliplasticos Lda	Chemical industry -plastics	05 / 02 / 2004
Vulcanizadora de Moçambique	Chemical industry	23 / 03 / 2004

SOURCE: *Ministry of Industry and Trade, 2004.*

Applying firms had to provide documentation from MPF that all taxes had been paid, from Customs that the firm had no problems pending, and from the courts that the firm was not bankrupt, along with a number of other business records, including a copy of its business license. Assembling this documentation took on average one and one-half months, the longest delays occurring for certificates from MPF. Many firms have expressed unwillingness to complete this cumbersome application process. Most of the firms that applied and were approved do not export.

Because of the limited number of firms that could become eligible for the duty exemption, and because of the onerous process of qualifying, CTA and MIC entered into discussions in 2004 to revise the duty-free exemption legislation. A proposal now being considered would change the legislation to reduce the required annual turnover of qualifying firms from US$250,000 to US$125,000 and open eligibility to *all* manufacturing firms. The proposal would also simplify certification, requiring only that firms get certification from the tax authorities that they are not past due on any tax payments and from Customs that they have not been involved in any illegal importing or smuggling.

Requirements for the duty-exemption program on imported inputs has increased effective rates of protection for these industries by widening the gap between the tariffs for finished products and the inputs required. Expansion of the program to all firms with annual sales in excess of US$125,000 will only further increase the range of industries with elevated effective tariff protection—the equivalent of a tariff increase.

Recommendations for Changes to Trade and Investment Policy

REDUCE THE TARIFF RATE APPLIED TO CONSUMER GOODS

At present, Mozambique is scheduled to reduce its highest tariff rate from 25 to 20 percent in January 2006. Lowering the gap between the highest and lowest rates will reduce effective protection, providing incentive to domestic firms to become more competitive. Thus, opportunities to accelerate its schedule for the planned tariff reduction, which might arise in the context of regional or global trade negotiations, should be embraced, not resisted. In addition, MIC's response to the request by export industries for exemption of tariffs on imported inputs can be made less complex, less onerous to apply for, and more targeted. For example, tariffs on required imported inputs to production that are not produced locally—tariffs that penalize export industries (e.g., fabric)—might be suspended pending a CSTA review of the tariff level.

CONSIDER A UNIFORM TARIFF RATE

Another way to narrow the gap between tariff levels for different categories of products is to eliminate the gap altogether by instituting a flat-rate system. Under a flat-rate system a tariff's nominal and effective protection are equal, so tariffs do not distort the allocation of resources in an economy. Consideration of a flat-rate tariff in Mozambique is driven in part by the discrepancy between revenues received from tariffs and those imputed by published tariff rates and actual imports. A recent study[203] has estimated that tariff revenue would have been more than 60 percent higher had published tariff rates been paid on all imports, including those that were unrecorded (i.e., circumvented Customs).[204] More than half of the under-collection occurred in categories that had the highest tariffs—beverages and tobacco, processed foods, and processed primary products. The study does not provide the share of this trade that was legally exempt, but implies that it is significant. If legal exemptions account for most of the under collection, then the administering authority has a much more "open" trade policy than is suggested by official rates, and revenue neutrality could be achieved by lowering nominal rates while reducing the number of legal exemptions. A single rate applied to all imports would have to be in the range set by average and weighted average rates of 7–12 percent to achieve revenue neutrality.[205]

PREPARE FOR TARGETED, CONTINGENT TARIFF MEASURES

The ability of the government to offer temporary protection to domestic producers builds trust between government and the private sector. Reducing protection as part of a pro-poor trade agenda will give rise to concerns about injurious and disruptive surges of imports. Contingent protection measures may provide the assurance necessary for across-the-board liberalization.

As a result of these liberal trade policies, trade is increasingly important in Chile's economy: the share of trade in goods and services in Chile's GDP increased from 56 percent in 1997 to 66 percent in 2002.

Lessons Learned from Chile's Uniform Tariff

Chile adopted a uniform tariff in the 1970s as part of a strategy to liberalize trade. In 1991, it reduced the tariff from 15 percent ad valorem to 11 percent. It is currently 6 percent, after annual reductions of 1 percent per year over the last five years. Tariffs on most products are bound at 25 percent under the WTO (since the Uruguay Round). Ninety-five product lines in the tariff schedule enter duty-free.

As with many other least developed countries, Mozambique does not have legislation or institutional mechanisms for raising tariffs temporarily in response to import surges. This does not prevent Mozambique from

[203] Channing Arndt and Finn Tarp. 2004. Trade Policy Reform and Missing Revenue: An Application to Mozambique. These estimates were based on 1997 data and thus were not influenced by inputs of raw materials and capital equipment for the mega investments that began in subsequent years.

[204] Unrecorded cross-border imports were estimated to equal 10 percent of total recorded trade in 1996, based on observations made at major border checkpoints.

[205] Chile and Mongolia have instituted flat-rate tariffs. In the late 1980s Chile's flat rate was 14 percent. By 1999 it had reduced the rate to 9 percent and in 2003 to 6 percent. Chile permits only a few exceptions to the single tariff, mostly for wheat and other cereals.

taking temporary measures against imports from other WTO members,[206] but new legislation and institutions will be necessary to take trade remedy actions under SADC. To provide temporary protection for domestic industries harmed by imports, consistent with SADC requirements, the obligations of WTO agreements must also be met.

Temporary measures that comply with WTO rules include anti-dumping duties, countervailing duties (together known as AD/CVD), and safeguards. Administering anti-dumping measures is complex, expensive, and time-consuming, requiring more resources than Mozambique has and diverting resources from more important tasks. Countervailing duties protect domestic industry from imports subsidized by governments in originating markets. Safeguards offer time-limited digressive protection against import surges resulting from lowered duties. Under the WTO Safeguards Agreement, developing countries are permitted 10 years of progressively reduced protection. A safeguard duty of 35 percent would be progressively eliminated over a period of 10 years. Taking action under the WTO Safeguards Agreements requires finding that imports have harmed domestic industries. There is thus discipline in the process.

Safeguards legislation to allow a temporary increase in tariffs when import surges threaten fundamentally sound domestic industries should be considered a part of Mozambique's national trade strategy. Such legislation is less burdensome to administer than AD/CVD duties. Mozambique has tabled a proposal in SADC negotiations to simplify safeguard procedures while SADC members introduce safeguards legislation consistent with WTO requirements.[207]

STRENGTHEN THE INVESTMENT PROMOTION CENTER AND MAKE IT INDEPENDENT

Despite significant improvements in Mozambique's investment environment over the past decade, the interest of foreign and domestic investors is limited. Complicated regulatory procedures stifle business startup and expansion. Inconsistent application of laws and jurisdictional overlap among government agencies destabilize the commercial environment. Few businesses understand the

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[206] Mozambique has bound (committed in a GATT Schedule) only a few tariffs at current levels, thus preserving its ability to raise tariffs above most applied levels, provided it does so on a most-favored nation (MFN) basis (i.e., without discriminating against suppliers from among other WTO members).

[207] It is believed that only South Africa has the laws and institutional mechanisms necessary to take action consistent with the SADC Protocol. Mozambique's proposal is based on the safeguard provisions of COMESA, under which countries can take action for one year after notifying all parties. Investigations are conducted during that year.

convoluted procedures for acquiring licenses, permits, and land title or rights. In addition, the decision-making criteria of many local and national agencies are unclear, arbitrary, and rarely available to the public. This lack of information and inconsistent decision making increase transaction costs for those seeking to start and operate businesses, while affording unscrupulous officials opportunities for personal enrichment. Foreign and local investors have little incentive to bring into the country the capital, best management practices, or technology necessary for competitiveness.

The CPI is viewed as especially effective in introducing potential investors to Mozambique and taking them through the process that culminates in an investment certificate. As investment activity slows, it has become important to convert these investment approvals into actual investment. While no data are maintained on the status of investments after approval, it appears that many are not completed. For example, several mega-projects reported in the 2002 mainstreaming report never materialized, including the Maputo Iron and Steel Plant, the Beira Petrochemical Complex, and the Korean Industrial Park.

CPI needs to become a true one-stop shop that assists investors in obtaining the business licenses, land rights, tax registrations, and customs duty exemptions they need to begin operations. While some of these activities could be carried out by private sector business advisers, the fees charged are proportional to the difficulty of securing approvals and exemptions, which raises the costs of doing business. CPI, acting on behalf of the government, could streamline the process. Mozambique's reputation as one of the most difficult countries in the world[208] in which to start a business needs to be changed.

CPI's subordinate relationship to the MPF appears to have interfered with its ability to advocate for investors. In 2002, garment manufacturers in Maputo sought EPZ status, to which they are entitled by law. But their efforts appear to have been blocked by MPF's position at the time that EPZ status be given only to firms operating in contiguous zones. Only two of the seven garment manufacturers producing in 2002 are still in operation. We continue to recommend that CPI be made an independent agency with its work to be reviewed by several ministers, each with authority to unsnarl bureaucratic impediments in specific ministries, but under collegial scrutiny. In this manner CPI could become an effective advocate for investors.

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[208] Doing Business 2004, p. 160.

8. Pro-Poor Elements of a National Trade Strategy

The analysis of trade-poverty linkages in Chapter 2 affirms that trade reform can and should be accepted as a major tool for poverty reduction in Mozambique. The benefits of a trade-oriented development strategy are likely to far outweigh the associated costs or the prospects under alternative approaches, particularly in the medium to long term. Further steps to facilitate trade should figure prominently in the next Poverty Reduction Strategy Paper (PARPA 2006-2010), which is to be prepared next year. Clearly, the poverty impact of trade depends on supporting policies and the institutional environment. To maximize benefits for the poor, trade reform must be embedded in a wider agenda of measures that facilitate the gains from trade, mitigate the costs of adjustment, and manage the risks of trade-related shocks. Well-designed policies also require effective systems for monitoring the impact of trade on poverty. The issue of phasing also has important implications for poverty: are the poor likely to benefit from faster pacing of trade liberalization? This chapter discusses each of these points, though briefly, and concludes with recommendations for strengthening the pro-poor impact of trade reform.

It is critical to emphasize at the outset that financial, human, and organizational resources are limited in Mozambique. Every public sector program competes for scarce resources with other pressing needs. Thus, it is not enough for an intervention to be “important”; it must also be efficient and cost-effective. The constraint on public sector resources places a premium on careful analysis of the costs and benefits for any particular intervention, and gives priority to solutions that mobilize private capital and private initiative.

Facilitating Broad-based Gains from Trade

High transactions costs, lack of market information, and uncompetitive market conditions diminish the transmission of price signals and market opportunities from trade reform. Measures to relax these constraints magnify and broaden the gains from trade and the benefits from trade reform, particularly in relation to agriculture, which is the main source of livelihood for most of the poor in Mozambique. The most effective channel for spreading benefits to agricultural households is through expansion, improvement, and maintenance of the road network.[209] Other programs for expanding market opportunities for the rural poor include continued development of rural communications networks and market information systems, and policies to intensify competition throughout the marketing chain.[210] (See Part II, Chapter 10, for more detailed discussion of constraints, opportunities, and recommendations relating to agriculture.)

A second major channel for facilitating the impact of trade on poverty reduction is through broad policies and reforms that facilitate efficient investment in all sectors of the economy, and strengthen the overall export supply response. This involves a familiar set of development policy issues: macroeconomic stability; infrastructure development; eliminating excessive administrative barriers to investment (red tape); improving access to and security of land-use title; strengthening the legal and judicial system, especially in relation to property rights and contract enforcement; increasing the flexibility of labor market regulations; reducing corruption; deepening the financial markets; and maintaining dialogue with the private sector on barriers to investment. Many of these issues were discussed in detail in Chapter 3. Not to be overlooked is the importance of maintaining a competitive real exchange rate, which strengthens export incentives and helps efficient domestic producers compete against imports (see Chapter 1, Exhibit 1-1). In addition, measures to upgrade labor force skills are a bedrock for achieving higher productivity, attracting more investment, and competing more successfully in local, regional, and world markets.

Beyond general measures to improve the climate for investment and business development, poverty reduction calls for activities that are likely to have the greatest impact on income and employment opportunities for the poor, notably agriculture;

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[209] J. Dirck Stryker. 1997. Impact of Outward-Looking Market-Oriented Policy Reform on Economic Growth and Poverty. Consulting Assistance on Economic Reform II Discussion Paper No. 6: pp. ii-iii.

[210] Alan Winters has described how liberalization of the maize market in Zambia led to two private firms colluding to keep farm prices down. In contrast, when Zimbabwe liberalized the cotton market, three private buyers—one a farmers' cooperative—effectively competed, to the benefit of the farmers. Winters. 2000. Trade Liberalization and Poverty. Center for Economic Policy Research, London, and Center for Economic Performance, London School of Economics: p.11.

labor-intensive manufacturing; manufacturing activities with strong linkages to the rural poor, such as food processing; and tourism (which can also generate strong upstream linkages). As these labor-intensive sectors develop, they will bring in their wake more jobs and income opportunities in transport, commerce, and services. In contrast, capital-intensive enclave investments contribute little to job creation or poverty reduction, except as a source of revenue.

In addition, targeted interventions can enable the poor to take better advantage of potential gains from trade. Key instruments can include research and extension on export crops, facilitation of private-sector supplies of seeds and other inputs to increase agricultural productivity, programs to increase the availability of export financing, and systems to improve quality standards (including sanitary and phyto-sanitary standards for agricultural exports). To be sustainable, such interventions must be structured to support private investments that are fundamentally viable, and not foster inefficient activities that require long-term protection or subsidies.

Mitigating the Costs of Adjustment

Adjustment costs associated with trade liberalization are a serious concern, in part because they fuel political resistance to reform, but more fundamentally because some of the costs fall on the shoulders of poor and vulnerable groups. The most acute problem is the loss of jobs for low-income workers as a result of increased import competition or—as in the case of cashew processing—export competition in the market for raw materials.[211] Evidence from other developing countries indicates that most displaced workers are re-employed within two years.[212] The adjustment costs are least troubling in economies that liberalize and then succeed in attracting substantial investments in labor-intensive industries, especially those involving high-growth exports. To date, this is not the case in Mozambique. Hence the emphasis throughout this study on the importance of improving the investment climate.

No systematic information about the experience of workers who lose jobs in Mozambique is available. Census results show that open unemployment is extremely low, so one would expect that most displaced workers do find alternative

[211] Large adjustment costs for labor are usually associated with high wage premiums in heavily protected industries. While some Mozambican industries are protected, such protection is not extreme and adjustment is not likely to be very disruptive.

[212] A recent World Bank policy research report concluded that despite high turnover in the labor market workers gain from global economic integration in the long run,. Wages tend to grow twice as fast in “globalized” developing countries than in those less so. World Bank. 2002. Globalization, Growth, and Poverty: pp. 14-15.

sources of livelihood fairly soon, including work on family farms or in the informal sector. In the short-term, however, many poor workers (and their extended families) undoubtedly face severe hardship.

One way to mitigate hardship for displaced workers is to help employers adjust to new competitive challenges. Tools that can be used for this purpose include (1) phasing in the most disruptive reforms over a period of, say, five years; (2) providing transitional technical assistance to enhance the competitiveness of affected industries, clusters, or firms; and (3) providing transitional support for the restructuring of affected enterprises and re-training of their workers.

A more direct approach is to help displaced workers help themselves through transitional assistance. Mozambique does not have the fiscal resources to provide broad-based safety nets for unemployed workers. Nonetheless, targeted schemes can be used to help particular groups cope with the loss of income due to trade liberalization. The most flexible and cost-effective approach is to provide transitional adjustment grants to displaced workers. Another option is to provide special vocational and technical training, including small business management, to impart portable and marketable skills.[213] However, experience in other countries suggests caution in turning to government-run training programs, because they often turn out to be ineffective.

An important consideration in Mozambique is the labor law mandating relatively rigid labor laws, including generous severance pay for workers who face redundancy. When these payments are made, they serve the same purpose as an adjustment grant. But companies that are forced to fold or restructure as a result of trade competition (or indeed any other reason) typically lack the financial capacity to afford the severance payments. Thus, the effect of the law is to block the adjustment process rather than facilitate the creation of new jobs.[214] The policy also discourages labor-intensive investment in the first place.

In addition to the possible loss of industrial jobs, trade liberalization can also have an adverse effect on farmers by depressing the domestic market price of food products. In Mozambique, a reduction in the duty rate on food imports, now at 25 percent for

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[213] Employers tend to under-invest in this kind of training because they cannot capture the full benefit of imparting transferable skills (as distinct from job-specific skills). Workers with transferable skills can move to other jobs. The social rate of return is higher than the return accruing to the employer, so the level of investment in transferable skills is sub-optimal. And while workers themselves have incentives to pursue training, they often face financial constraints that preclude doing so.

[214] SAL Consultoria. 2003. The Legal and Administrative Framework for Labor Relations in Mozambique.

many products, could reduce food prices in domestic markets, to the detriment of local farmers supplying these markets. The main effect would be felt in urban markets, where food prices are more strongly linked to import costs. This aspect of trade adjustment has not been a prominent issue in Mozambique—perhaps because farmers who sell commercially to markets affected by import prices are not organized. Certainly the problem is less salient here than in countries like Mexico (for maize) and Japan (for rice). In any case, any adverse effect of trade reform on farmers would be balanced by benefits to consumers, as well as general gains in economic efficiency. Currently, the number of commercially-oriented farmers who sell to urban markets is probably much smaller than the number of poor consumers who would benefit from lower tariffs on food products. Consequently, the most constructive course of action for dealing with the adverse effect on farm prices is to create a supporting environment in which farmers can readily adjust to price changes by increasing productivity or shifting to other cash crops, if necessary. This brings us back to the types of measures discussed in the previous section.

Another approach to mitigating the cost of trade liberalization is the use of safeguard measures to temporarily protect sectors harmed by import competition, within the rules of the WTO. In theory, these tools are meant to facilitate an orderly adjustment. In practice, they are often used to protect inefficient producers, at the expense of consumers. Such protectionist applications only benefit the few, at the expense of overall growth and poverty reduction.

Managing Risks of Trade-related Shocks

Trade also affects poor households through its impact on risk and vulnerability to trade-related shocks (as distinct from costs associated with the adjustment to a new equilibrium with more open trade). In many ways trade has a favorable effect on risk and vulnerability. It provides households with a wider set of production and marketing options, allowing them to reduce risk by diversifying their sources of income. It also helps stabilize prices and supplies in the face of domestic shocks, such as droughts and floods.

At the same time, trade creates risks. For example, producers who depend on particular exports are vulnerable to changes in global market conditions, such as the sharp decline in world cotton prices in the late 1990s. The consequences can be disastrous for households at the margin of subsistence, with few assets to cushion their consumption and few skills for finding alternative sources of livelihood. The near-poor, too, can be thrown into poverty when they lose cash-crop earnings or wage jobs in industries that are forced to close because of trade shocks.

At the microeconomic level, constraints on public sector resources limit the scope for cushioning widespread trade shocks. If the shocks are concentrated in particular areas or subsectors, however, well-targeted interventions such as labor-intensive public works programs may be feasible.[215] Institutional innovations, such as the development of market-based micro-insurance schemes, might also be used to supplement traditional coping mechanisms.

There is more room for policy measures to cushion the poor from *macroeconomic* risks that may result from trade-related shocks. Important steps can be taken to reduce vulnerability at this level. Important instruments include sound management of foreign exchange reserves, along with strong prudential regulation and supervision of the banking system to minimize the risk of international shocks threatening the financial system. The government can also be more proactive (or more effectively so) in promoting investments to diversify export earnings, as Malaysia did with outstanding success in the 1970s.[216] In addition, one of the main lessons of the Mexican and Asian crises in the mid-1990s was the importance of greater transparency about macroeconomic and financial conditions, as a tool for calling attention to emerging problems before they become severe vulnerabilities.

Monitoring the Impact of Trade on Poverty

Any major economic policy decision should be based on evidence rather than supposition, and the results should be monitored rather than presumed. Figure 8-1 presents a schematic outline of the types of considerations that should be examined in assessing the impact of trade policy decisions on the poor. This is not to say that the methodology should be rigidly applied, since the analytical exercise could itself impede reform. Rather, the idea is that better information of this kind yields better decisions and outcomes.

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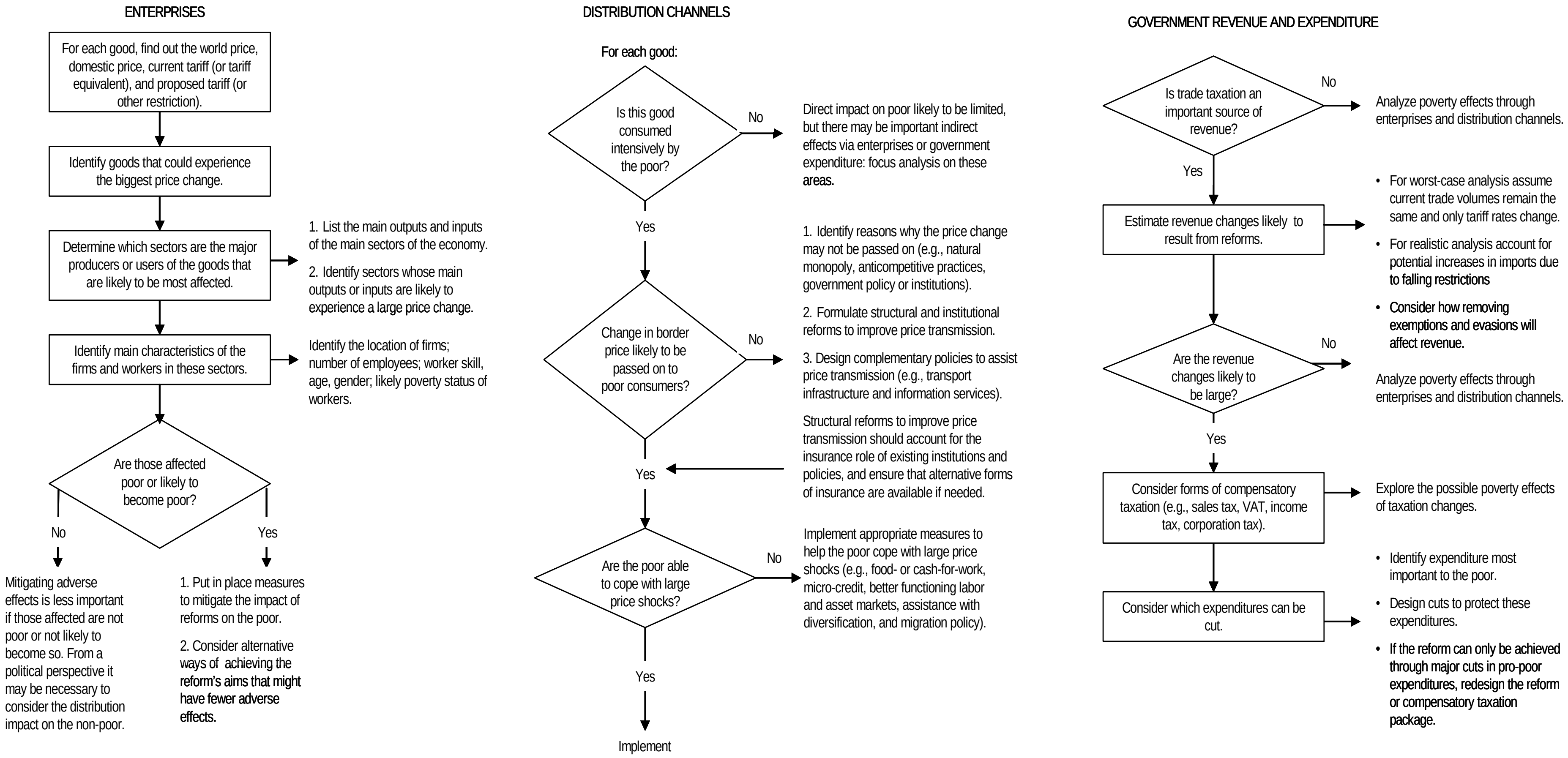
[215] There may also be some scope to manage household vulnerability ex ante through extension services and public information programs to encourage diversification. However, most poor farmers and low-income workers are very astute about diversifying their income sources, where possible.

[216] Lindauer, D., and M. Roemer. 1994. Asia and Africa: Legacies and Opportunities for Development. ICEG / HIID. Notably, CPI does not proactively pursue any such focus.

Figure 8-1
Decision Process for Policymakers



SOURCE: *McCulloch, Winters, and Cirera. 2002.* Trade Liberalization and Poverty: A Handbook. *Center for Economic Policy and Research.*

Monitoring is a responsibility not only of the government, but also other participants in the Poverty Observatory (see Chapter 2, Exhibit 2-2), including representatives of civil society. In addition, the press should be trained to spot the costs of trade reform and inform the public about corresponding benefits.

Critical information on poverty conditions and trends comes from the national household survey. The latest survey, IAF 2002–2003, was discussed in Chapter 2. But the analysis here only touches the surface. Far more insight on the relationship between trade and poverty can be obtained from more thorough comparisons with the previous household survey (IAF 1996-1997), and detailed analysis of data on trade patterns and the structure of trade taxes. The next IAF survey is not scheduled until 2007-2008. Meanwhile, the monitoring of poverty dynamics and the relationship between trade and poverty can be pursued through a variety of technical approaches:

- ***Macroeconomic and sectoral indicators.*** The PARPA uses real per capita private consumption as the best proxy for changes in poverty. This indicator is better than per capita GDP, because the latter is greatly affected by mega-project production, which may yield little net income for the people of Mozambique. Unfortunately, the method used in the national accounts to estimate private consumption is not very reliable. Thus, sectoral data may provide the best gauge of whether the poor are benefiting from growth. Specifically, the monitoring process should focus on whether growth is broad-based, with special reference to agriculture and its sub-components. At the same time, the National Statistics Institute (INE) should make a concerted effort to improve the accuracy and reliability of the national accounts data on agriculture. This is a priority area for technical support from the donor community. Other useful macroeconomic indicators include tracking trends in the real exchange rate against the *rand* and the dollar, and detailed data on trends in consumer prices.
- ***Trade statistics.*** Inferences about the links between trade and poverty can be obtained from monitoring national and international trade statistics. From the national statistics, poverty analysts should focus on the trends in the composition of exports and imports. As early as possible, the Customs Directorate and INE should develop systems for accurately recording the volume and unit price, not just the value, of imports and exports. This will permit a much more thorough appraisal of the changes in trade over time, as well as the implications for poverty.

The monitoring system should also regularly analyze trends in world prices for major exports and imports, including changes in the terms of trade.[217]

- ***Survey resources.*** In addition to the IAF surveys, the government compiles more frequent data on poverty from a periodic survey of basic well being (QUIBB). The QUIBB is a standard survey instrument to which specialized modules can be appended. We recommend developing a simple set of supplementary questions to elicit regular information about the production of cash crops, particularly those that enter international trade. A second source of periodic information on poverty is the participatory rural appraisal (APP). Here, too, it would be very useful to develop a set of questions on changing opportunities for rural households to benefit from trade as producers and consumers. Other important data come from less frequent field surveys: the last national census was undertaken in 1997. The latest agriculture and livestock census (CAP) provides detailed farm data for 1999-2000. Data from the survey of rural income (TIA) for 2001-2002 are still being processed.

- ***Poverty and social impact analysis.*** Within the government, the Ministry of Planning and Finance (MPF) has primary responsibility for monitoring and analyzing poverty trends. But trade issues fall squarely in the portfolio for the Ministry of Industry and Trade (MIC). Thus, MIC should develop the capacity and institutional procedures for monitoring and evaluating the impact of trade on poverty, in collaboration with MPF. This endeavor should include regular analysis of the type of data identified in the preceding paragraph, as well as special data collection to obtain more detailed information about particular trade issues. For example, the lengthy debate about the impact of liberalizing the export of raw cashews could have benefited from hard data on the labor force transition experience of the workers who were laid off from cashew processing factories. The debate over the sugar surtax would be much clearer with regular information about the cost structure of the sugar plantations, and data on the response of consumers to higher sugar prices.

- ***New data instruments.*** The data framework for analyzing trends in economic performance and the impact of trade on poverty has serious gaps. The most serious is the absence of regular data on the labor force, employment, unemployment, and average earnings. Other major shortcomings include lack of regular data on industrial production, and regular surveys of realized investment, to supplement

[217] The "commodity terms of trade" is the ratio of (1) an index of the average world price of exports, to (2) an index of the average world price of imports. An increase in the terms of trade indicates that world prices are changing in favor of Mozambique, while a decrease indicates the opposite.

data on *approved* investments published by the Investment Promotion Center (CPI).[218]

The Pace of Trade Liberalization

Trade liberalization in Mozambique has been proceeding steadily but gradually. The average import duty rate is now down to 12 percent, with a trade-weighted average rate of just 9 percent. The top duty rate has declined from 35 percent a few years ago to 25 percent today, with a further reduction to 20 percent scheduled for 2006. These are among the most liberal rates in the region. Duty rates on imported capital goods and raw materials have also declined quickly, so effective rates of protection remain quite high for many domestic producers (see Chapter 7, Exhibit 7-1). Under the SADC trade protocol, the government is also moving steadily toward free trade within the region, though duty reductions to date have been relatively small, and duties on "sensitive" products will not be fully removed until 2012.

In many circles, the value of trade liberalization is still hotly debated, and in a few cases, steps in the opposite direction have been taken. For example, import surcharges are in place for cement, sugar, and some steel products, and the export tax on cashew has been retained at 18 percent. More recently, two studies have proposed protectionist measures to encourage local rice production (without discussing the cost to poor consumers).[219] With these notable exceptions, the basic strategy of gradual liberalization has not been seriously challenged, and is not likely to be reversed.

A gradualist approach gives domestic producers more time to adjust to the prospect of import competition, and allows them to take advantage of ongoing improvements in the infrastructure and reforms in market-supporting institutions. Gradualism also defers and spreads out the cost of adjustment, minimizing the risk of backlash that could arise from a combination of early job losses and a sluggish supply response. And politically gradualism is the path of least resistance. It is also often justified by the manifest barriers to investment and business expansion, which we have highlighted throughout this study. These barriers constrain the supply response to

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[218] See José Luís Macamo, Barreiras Administrativas ao Investimento em Moçambique Liçoês Aprendidas da Experiência de Investidores Recentes, in *A Economia Moçambicana Contemporânea: Ensaios*.

[219] See MADER, Strategies and Actions to Promote Rural Economic Growth in Mozambique (Estrategias e Acções para Induzir o Crescimento Económico Rural em Moçambique), pp. 34-5. See also MIC, The Markets for Rice and Wheat in Mozambique (Os Mercados de Arroz e de Trigo em Moçambique), p. 54.

new export opportunities, and impair re-absorption of labor and capital displaced by import competition. In addition, the experience of countries such as China, India, Mauritius, and Korea is cited as a precedent for moving slowly to dismantle import barriers.

The alternative of pursuing liberalization more rapidly—for the sake of poverty reduction—has been little debated. Faster liberalization has important advantages. These follow directly from the analysis of how trade benefits the economy in general, and the poor in particular. Cutting protectionist import duties more quickly will reduce the anti-export bias in the allocation of resources, and accelerate the benefit for consumers (mainly urban) of lower prices and a wider range of choice. A more outward-looking strategy offers advantages of scale economies in suitable market niches and better prospects for attracting investment. Reducing the prevailing high rates of effective protection also removes a drag on economic efficiency and a constraint on the main catalyst for innovation: competition. In all of these respects, more rapid liberalization facilitates rapid growth and poverty reduction.

More rapid trade reform has process advantages. Trade liberalization creates pressure for complementary policy and institutional reforms, which increase the prospects for achieving broad-based benefits early in the process. This in turn helps to build political momentum for following through on further reforms: "Once it is accepted that reform will occur, business is keen to adjust rapidly."[220] The success of liberalization hinges on visible, comprehensive, and credible political commitment and strong complementary policies to ensure that the potential benefits are realized, and to cushion the associated adjustment costs.

Balancing the transition costs and fundamental benefits of trade liberalization, we do not recommend a "big-bang" approach. Rather, it is appropriate to phase in major adjustments over a limited period of years. Dragging out adjustment, however, would be a mistake, unduly deferring the advantages of trade as an instrument for attracting investment, encouraging competition, promoting efficiency, stimulating innovation, and facilitating structural transformation, while reducing prices and expanding the range of consumer choice. Thus, the PARPA 2006-2010 should establish aggressive targets for further trade liberalization by the end of the decade.

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[220] DFID, p. 29.

Summary of Recommendations for Pro-Poor Trade Reform

Highlight trade reform in the next Poverty Reduction Strategy Paper (PARPA 2006-2010). An appropriate strategy for pro-poor trade reform requires a steady reduction in trade barriers along with complementary measures to facilitate broad-based gains from trade, mitigate the costs of adjustment, and manage the risks of trade related shocks. Trade reform should therefore figure prominently in the next PARPA (2006-2010).

Encourage increases in agricultural yields, diversification in agricultural trade, and off-farm employment. In the short run, poverty reduction requires increased farm incomes through increasing yields and diversifying agricultural trade. Policies to achieve this objective should include research and extension on export crops, export financing schemes, and systems to improve quality standards. In the medium to long-run, however, pro-poor development will also require the creation of off-farm jobs—primarily in labor-intensive, export-driven manufacturing and tourism—and structural transformation of Mozambique's economy.

Reduce high transaction costs, strengthen rural markets, and improve market information systems for rural areas. To increase the benefits of international trade for the poor, policies should aim to reduce high transaction costs and strengthen rural markets. This will require (1) improving and maintaining rural roads, (2) developing rural communications and market information systems, and (3) implementing policies that enhance competition throughout the marketing chain.

Strengthen the export supply response. Broad policies and reforms that stimulate investment and strengthen the export supply response are essential to rapid growth that benefits the poor. Priorities include macroeconomic stability; infrastructure development; eliminating red tape; improving access to, and security of, land-use title; strengthening the legal and judicial system; increasing labor market flexibility; reducing corruption; maintaining dialogue with the private sector on barriers to investment; sustaining a competitive real exchange rate; and investing in education and training to upgrade the quality of the labor force.

Phase in trade reforms and complementary polices, and evaluate options for providing transition assistance. To mitigate the transition costs borne by poor workers, the government should carefully schedule trade reforms and complementary policies, and consider the cost-effectiveness of highly targeted transitional technical assistance to enhance the competitiveness of affected companies. Equally important is consideration of transitional assistance for displaced workers through transitional adjustment grants or retraining programs. Public works schemes can be used to help particular groups cope with the loss of income due to trade liberalization.

Assess the options for using WTO safeguard mechanisms to cushion the adjustment process for industries that may be adversely affected by import competition. Safeguard duties may be employed under specific circumstances, but appeals should be treated with due caution to prevent the system from becoming a tool for protectionism.

Cushion trade-related risks of the poor. To reduce trade-related macroeconomic risks and adverse shocks borne by the poor, the government can (1) promote investments that result in more diversified export earnings, (2) effectively manage foreign exchange reserves, (3) pursue measures to strengthen the soundness of banking system, and (4) improve the quality and transparency of macroeconomic and financial statistics so that problems can be identified before they become severe vulnerabilities.

Base trade liberalization policy on evidence and systematically monitor the impact of trade on the poor. Major policy decisions relating to trade liberalization should be based on evidence and poverty impacts should be monitored. Monitoring should be conducted not only by the government, but also by civil society and the media, using existing survey data, national accounts data, and trade statistics. Another useful approach would be to develop a module for the QUIBB to elicit periodic information about the production of export crops by small farmers. The information framework should also be expanded to include new data on the labor force, realization of investment, and industrial production.

Monitor and evaluate the impacts of trade and poverty. As the authority responsible for trade policy, the Ministry of Trade and Industry needs to develop the capacity and institutional procedures for monitoring and evaluating the impact of trade and poverty, in collaboration with the Ministry of Planning and Finance.

9. Implementing a National Trade Strategy

As discussed in Chapter 8, pro-poor trade reform requires a comprehensive approach that encompasses a steady reduction in trade barriers, complementary measures to improve producers' responses to expanded opportunities in foreign markets, and measures to mitigate the costs of adjustment and reduce the risk of trade-related shocks. More specifically, using trade as an engine of pro-poor growth will require

- High-level endorsement of trade as central to the country's development strategy;
- Effective coordination among ministries with unifying goals of reducing transaction costs, increasing competitiveness, and increasing exports;
- Intensive collaboration and consultation between the public and private sectors;
- Developing and prioritizing goals and the actions for achieving them; and
- Creating a mechanism for ensuring accountability for and assessment of progress.

High-level Support

To be successful, the NTS must be promoted from the highest levels for two practical reasons. First, NTS development and implementation will require work that crosses ministerial and agency boundaries. Second, changes will need to be comprehensive and coordinated. Broad trade liberalization programs in other countries have benefited from the leadership of presidents and prime ministers. Often, high-level support convinces government officials at all levels that they must effectively implement programs consistent with and in support of an NTS.

The election of a new President in late 2004 presents a good opportunity for affirming the importance of trade as a vehicle for economic growth and poverty reduction in Mozambique. Such an affirmation would send a clear signal that Mozambique actively seeks to reduce red tape and lower high transactions costs borne by producers and potential exporters. It would also send a strong signal about future policy direction to local and foreign investors. This could be followed by a campaign to foster appreciation among mid-level government officials of how trade liberalization can lead to pro-poor growth. Officials involved in Customs, inspections, tax policy and collection, business registration, labor, land, and other matters often do not understand how their actions affect exports and employment. For example, it is common that small irregularities in documentation delay transactions related to imports, exports, and business licenses. When businesses cannot complete their transactions in a timely manner, they may be forced into bankruptcy, costing jobs, tax revenues, and foreign exchange earnings. Rather than restricting trade, official activities can actually encourage trade once officials are aware of the sum effect of their activities on business—and once trade promotion is backed by a high-level mandate for system change.

Intergovernmental Coordinating Mechanism

In Mozambique, as elsewhere, national decisions on trade policy involve a range of public institutions and agencies, all of which need to work together to ensure that trade contributes to development. [221] Many aspects of national economic policy—fiscal policy, exchange rate management, regulatory frameworks in sectors such as transport and, of course, design of public expenditure plans—affect trade performance and competitiveness. Poor coordination across government can have significant and immediate negative effects when policies intended to expand trade and competitiveness are undermined by other economic policies.

Many governments deal with trade policy coordination using either a single lead agency or a formal coordinating mechanism. For a number of developing countries, the creation of such a coordinating mechanism is a relatively recent phenomenon. In many cases, this effort has been supported with technical assistance from donors. In fact, countries receiving technical assistance through either the Integrated Framework or the Joint Integrated Technical Assistance Program (JITAP) are required to establish national steering committees to help coordinate, monitor, and implement national trade policies.

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[221] See Tom Pengelly and Victoria Waite (2003), Improving Trade Policy Coordination and Dialogue in Developing Countries: A Resource Guide (The TCB Project: Nathan Associates Inc.).

Countries that have developed a coordinating mechanism within government often designate one agency (usually the trade ministry) as the lead on trade policy while using interagency committees, at the level of senior officials and cabinet ministers, to coordinate policy. Given the broad scope of the trade agenda, establishing subcommittees to cover specific areas (e.g., agriculture, services trade) has also proven worthwhile.

In Mozambique, the development of an NTS, and ongoing interministerial coordination of trade policy, could be facilitated with the assistance of an interministerial committee for trade policy, consisting of representatives of key economic ministries and chaired by the Minister of Industry and Trade (MIC) or his designate. Ideally, the committee would report to the Council of Economic Ministers. It could not only assist with the coordination of trade policy formulation, but could also oversee the design and implementation of an NTS; have input to trade policy, including tariff levels; and coordinate the trade-related aspects of the PARPA.

As an institutional mechanism, an interministerial committee could ensure coordination on trade policy issues, build consensus on the NTS, and implement the many components of such a strategy.[222] In addition to MIC, other ministries that should participate include Agriculture and Rural Development, Planning and Finance, Labor, Tourism, State Administration, Fisheries, Transport and Communications, and Public Works and Housing. The Annual Private Sector Conference already promotes a dialogue between each ministry and representatives of concerned private sector groups and Conference recommendations can be incorporated into the Committee's deliberations.

COORDINATING PROCESS AND STAFF SUPPORT

Existing offices within MIC could provide administrative staff to serve as an executive secretariat for an interministerial committee. The secretariat would handle the day-to-day logistics of meetings (e.g., securing meeting locations, inviting attendees, distributing the agenda, taking minutes, distributing relevant material) and would follow-up on the committee's decisions. The committee would organize

[222] On the basis of recommendations in the 2002 Mainstreaming Trade Report, a detailed terms of reference (TOR) has been developed to launch an interministerial committee. The TOR is being discussed at various levels within the Ministry, and if accepted, could be implemented in the near future. The committee could not only oversee development of the NTS, but could also handle a variety of international trade issues that require different ministries to be present. As necessary, it could be expanded to include representatives from the private sector, NGOs, and donors. It could also form technical working groups to address specific topics.

working groups on topics important to Mozambique, such as land tenure, customs, intellectual property rights, and tariffs. Management-level staff from the appropriate ministry would chair each working group (e.g., the Customs Administration would chair a working group on customs issues). Working-level staff from ministries with a stake in the issue would attend working group meetings and research ways to resolve the issue. Once the issue is resolved, the working group would arrive at a resolution and draft a memo for the committee. The committee would approve the resolution and send it to the relevant ministry for action, perhaps recommending that the ministry raise the issue to the Council of Economic Ministers for validation. Once validated, the resolution could be passed to the MPF for integration into the PARPA or to the relevant ministry for action.

Public–Private Sector Dialogue

The policy and regulatory reform agenda for making Mozambican producers more competitive in domestic and export markets overlap in a few respects. Many of the proposed member ministries of potential interministerial committee and the private sector have already agreed on a significant work program. At the Sixth Private Sector Conference, sponsored by MIC and CTA, permanent working groups were established between sector-specific producer associations and senior officials of relevant ministries. A dialogue was initiated with each ministry on trade or red tape issues. (In addition to MIC, these ministries include MADER, MPF, Labor, Tourism, Transport and Communications, Justice, Public Works and Housing, and State Administration.) The Prime Minister has agreed to become the principal government contact for this dialogue.

The progress of these working groups was reported at the Seventh Private Sector Conference, held March 2003. Participants attempted to turn the recommendations of the working groups into consensus-based reform measures that would accelerate the pace of actual reforms and thereby improve competitiveness and export performance. Despite some successes resulting from the recommendations of the working groups, overall progress has been slow. The Eighth Private Sector Conference is scheduled for November 2004. Additional stocktaking of reforms will be concluded before the conference in order to measure results. New areas for reform will also be highlighted. The results of this conference, as well as the future agenda for reforms still to be addressed (as defined in working groups and this report), should become the basis for an interministerial committee’s consideration of reforms.

DIALOGUE FOCUS AND MECHANISM

The private sector is the immediate beneficiary of a trade-led growth strategy. Such a strategy is, after all, designed to increase producers' access to foreign markets while improving their capacity to supply those markets—markets with far greater purchasing power than domestic markets. To be sure, some in the private sector will resist policies that might negatively affect their interests. But most, we believe, will expect to benefit from improved access to and cost-competitiveness in international markets, such as South Africa and the United States. The Mozambican private sector has considerable insight into the steps needed to reduce costs and to make itself more competitive in foreign markets. Its participation in the trade policy process is essential.

Private sector input on trade policy and the NTS will be critical. The private sector should continue to articulate its positions on trade policy and seek to have the government create an environment conducive to businesses operations and trade. At the same time, the government will need to elicit input from the private sector on trade policy and on the NTS.

Labor unions should be included in public–private consultation. Labor market rigidity, comprising such issues as overtime and procedures for hiring and firing, has proved a divisive subject. Although Mozambican workers should gain from a pro-poor export strategy, highly protected industries will need to adjust to competition from imports, and retraining programs for workers in these industries will help facilitate that adjustment.

National Trade Strategy and the Poverty Reduction Strategy Paper

Because the PARPA assesses progress on a regular basis, incorporating the NTS into it will help ensure that trade issues receive steady attention and benefit from interministerial collaboration and consensus, as well as high-level and regular dialogue between government and private-sector leaders. The PARPA also provides for accountability in the achievement of results: it not only defines a broad policy roadmap but also assigns responsibilities for specific areas. Most important, including the NTS in the PARPA will ensure that trade policy decisions are evaluated for their contribution to poverty reduction, rather than narrower interests or pressures.

The NTS should be developed within the institutional framework already established by Mozambique's PARPA process, which is driven by MPF, rather than a parallel process initiated by the MIC. This does not preclude MIC from initiating work on an NTS, which it could propose to the MPF for inclusion in the five-year rolling plan framework for the PARPA. Institutionally, the NTS will be subordinate to the government's poverty strategy. The PARPA was developed after numerous consultations with stakeholders. The NTS should be developed in a similar manner and its medium-term poverty impact should be carefully assessed.

Part II. Selected Sector Studies

10. Agriculture

Long the mainstay of Mozambique's economy, agriculture still contributes approximately 20 percent of GDP and accounted for 35–40 percent of exports until the Mozal aluminum project began operating in 2001. At the time of the 1997 census, agriculture employed 80 percent of the workforce. Moreover, the sector is important in reducing poverty, as recent improvements in national poverty levels attributed to improvements in agricultural output show. Agriculture will continue to be essential to poverty reduction and thus a key element of the national development strategy under the Poverty Reduction Strategy Paper (PARPA). This is because Mozambique has only 10,000 medium and 400 large farms but more than 3 million small farms.[223] The average cultivated area of these farms is 1.22 hectares and 84 percent of that is devoted to staple food crops (e.g., maize, cassava, sorghum and pulses). Horticultural and commercial cash crops make up less than 10 percent of smallholders' cultivated area.

In this chapter we examine Mozambique's potential for further integration into regional and global markets for agricultural products, analyzing the agriculture sector's strengths and weaknesses, examining development opportunities in export markets, and describing internal and external risks that must be faced in pursuing those opportunities. We conclude by proposing a strategy for intensifying and diversifying agriculture production to guide export development. Volume 3 presents detailed discussions of the organization of production, subsector performance, and export constraints and prospects for specific crops and crop types.

[223] The agricultural census of 2001 showed that 99.7 percent of agricultural exploitation can be defined as small farms (less than 10 hectares), and this occupies about 96.7 percent of cultivated land.

Major Crops

Figures 10-1 and 10-2 depict changes in the use of agricultural land since 1970, for export crops and for basic crops. We discuss specific crops in the paragraphs below.

CASHEW

Despite a prolonged period of decline from its international prominence in the colonial period, cashew remains an important cash crop for about 40 percent of Mozambique's farmers. In 2002, 540 tons of kernels were exported, earning revenues under US$1 million; in 2002/2003 36,000 tons of raw nuts were exported, earning US$14.2 million or 7 percent of national exports in 2002.[224] Key production is in the coastal areas of Nampula, Cabo Delgado, and Inhambane. The processing industry went through a difficult restructuring because of hotly debated liberalization but is slowly emerging with a new business model that could make the industry globally competitive.

COCONUT

Coconut production along the coastal belt involves primarily smallholders, even in regions like Zambezia where private estates dominate. Approximately half of the 60,000 tons of annual coconut total production in Mozambique is consumed directly by smallholders; the rest is either sold on the domestic market in its raw state (fresh or as copra), processed into soap—mainly for the domestic market—or exported as copra or oil. After facing major disruptions during the civil war, coconut production is still in critical condition; diseases and lack of investment for diversification hamper sector development and growth.

COTTON

Cotton has long been a key sector for Mozambique as a source of income for rural smallholders and as a major export crop. Production has ranged between 55,000–80,000 tons of seed cotton (18,000–26,000 tons of lint), with export revenues ranging between US$10–30 million, depending on international prices. Ginning capacity exceeds cotton production, which leads to unfair competitive practices in the sector. Exogenous factors (i.e., international prices), the organization of domestic

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[224] When aluminum and electricity exports are excluded, raw nut exports made up 18 percent of national exports in 2002.

production, and input constraints have stymied productivity, which are still very low even in comparison with other African producers.

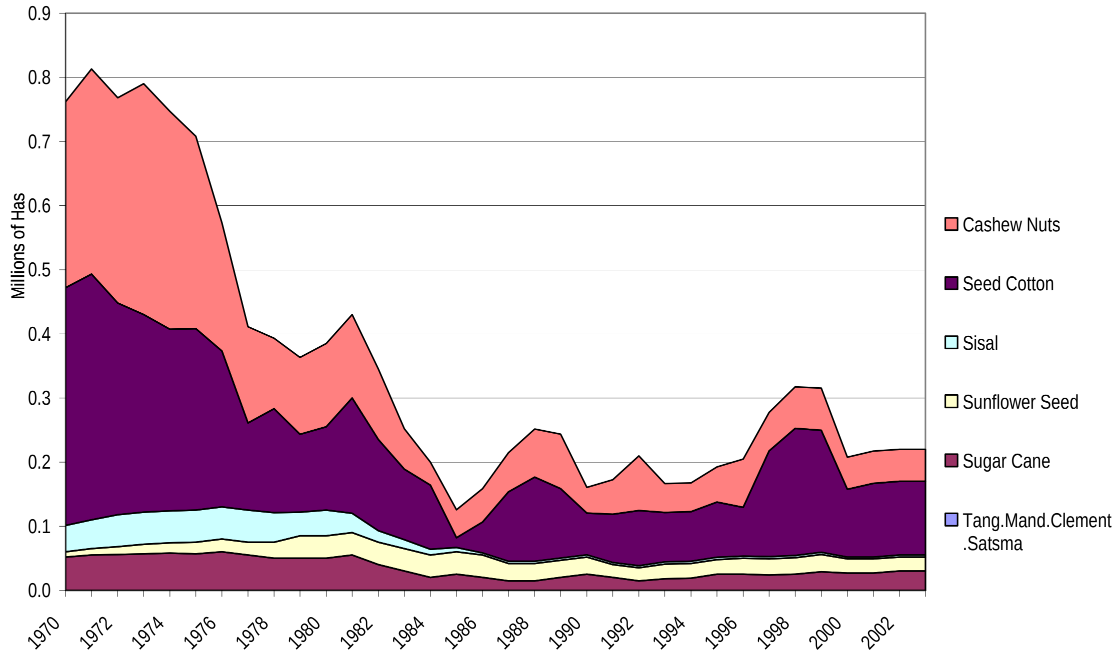
HORTICULTURE

Until very recently Mozambique's horticulture industry served only the domestic market. Growth was slow and quality variable, while penetration of South Africa's market was weak. The most successful sector appears to be grapefruit, with sales of high-grade fruit from southern Mozambique being shipped through Maputo for export to Europe. Manica Province, which lies on the Beira-Harare axis, has recently experienced an influx of foreign investment in intensive horticultural crops as a result of the instability in Zimbabwe. Experienced Zimbabwean and South African exporters have started shipping roses, open-field cut-flowers, and vegetables such as baby corn and bell peppers through Harare to the EU. Paprika exports to Spain are also developing fast. Considerable technical resources are being mobilized to support these initiatives, both by the operators themselves and by the non-governmental organization.

RICE

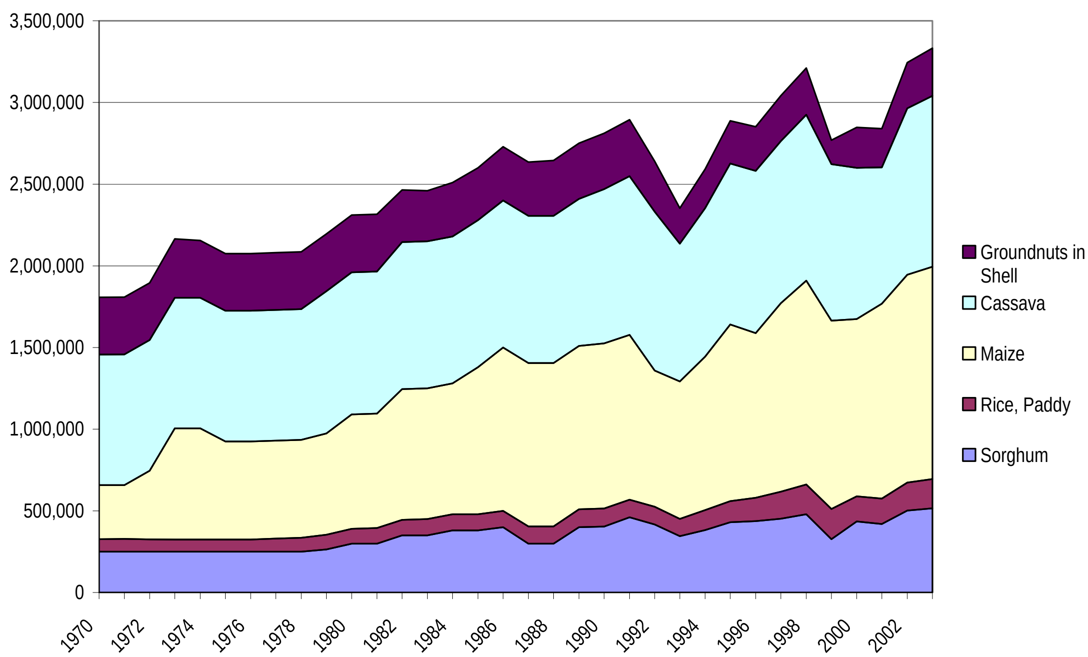
Smallholders produce rice by rain-fed methods on low-lying land in Zambezia and Southern Nampula and by irrigated commercial methods in Chokwe and Gaza. (Rehabilitation of Chokwe's irrigation district, which includes 16,000 hectares, should be completed in 2005.) Total annual production in Mozambique is about 167,000 tons. Mozambique imports 200,000 tons to meet national consumption needs totaling 367,000 tons. In 2000, smallholder production accounted for about 90 percent of domestic supply, mostly for home consumption. Small family producers are 70–80 percent of producers and achieve yields of 2.5 tons per hectare. Present yields could be doubled to 5 tons per hectare with proper water management techniques and better seeds. Agro-climatic conditions in Zambezia make it ideal for growing rice, but production potential is limited by transport and drainage infrastructure.

Figure 10-1
Structure of Total Production of Main Exports by Harvested Area



SOURCE: FAO Statistics.

Figure 10-2
Structure of Total Production of Basic Crops by Harvested Area



SOURCE: FAO Statistics.

Mozambique possesses the agricultural conditions for being not only self-sufficient in rice production but also a net exporter in a region where the structural deficit of rice is expected to reach more than 6 million tons by 2020.[225] In addition, the EU market under the Everything But Arms (EBA) zero-tariff arrangements offers new opportunities. Optimism, however, should be tempered by a realistic assessment of world market conditions. Asian suppliers such as Vietnam, Pakistan, and Thailand are strong in EU and world markets. A 2003 study of Mozambique's market indicated that these suppliers could deliver rice to the Maputo market at approximately the same price as production arriving from Chokwe.[226] Grupo Consultivo do Arroz (Consultive group on Rice) was created in 2004 to promote development of a national policy for developing a competitive rice subsector. GCA includes members from government, private sectors (producers, processors, traders), and independent experts. Major commitments from both the public and the private sector will be required to achieve the required investments in infrastructure and support services for Mozambique to compete.

BASIC FOOD CROPS

Mozambique's basic food crops are cassava, maize, rice, and sorghum. Maize, the main food crop, is particularly important to smallholder households in Niassa, Tete, Manica, and Sofala where it occupies more than 50 percent of the cultivated land. Maize is produced under rain-fed and zero-input agriculture systems, except when it follows the harvest of tobacco and receives some residual fertilizer from the prior crop. Less than one-fifth of maize is sold on the market. Nevertheless, maize trade between Malawi and Mozambique is an important source of revenue for smallholders. Recorded exports totaled more than US$1.5 million each year between 2000 and 2002 and, if unofficial exports were included, would be at least twice as much, according to conservative estimates. Policy actions in Malawi, however, have resulted in large price fluctuations and an unpredictable export environment.

Cassava, the second most important "subsistence" crop by cultivated area, is important in Nampula, Cabo Delgado, Zambezia, and Inhambane. Sorghum is a significant household crop in the central regions of Sofala and Manica. Most smallholders produce maize and cassava simultaneously, which explains the crops' broad geographic distribution.

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[225]Global Food Projections to 2020: Implications for Investment. Food, Agriculture, and the Environment. Discussion Paper 5. International Food Policy Research Institute. Washington, D.C.
[226] Muendane and Zandamela, 2003.

DIVERSIFICATION CROPS

Diversification crops—beans, pulses, oilseeds, and groundnuts—are grown for food and cash as a complement to basic food crops. Pigeon peas (lentils) have been grown for several years, exported to Malawi, and processed into paste for the dahl market in India and South Africa. A producer in Mozambique recently began processing pigeon peas for the domestic market as well. Groundnuts are grown principally in Nampula, Cabo Delgado, Inhambane, Gaza, and Maputo; beans in Niassa and Tete; other pulses in Zambezia. Producers also tend to grow a mix of diversification crops simultaneously to minimize losses in case of adverse market and growing conditions.

SUGAR

Before its post-colonial collapse, the sugar sector experienced a peak in 1972, producing 325,000 tons and employing 45,000 workers. It is now the second agricultural export subsector after tobacco, with export revenues totaling nearly US$19 million and production of 212,000 tons in 2003. Production in 2004 is estimated to be 253,000 tons and exports to reach US$30 million. Sugar yields in 2003 ranged from 6 to 10 tons per hectare, the latter level equal to international standards. The evolution of the sector is very much linked to the expansion of the export quotas in European, SADC, and U.S. markets. (See discussion of sugar quotas in Chapter 5.)

TOBACCO

Tobacco production, mainly of the Burley variety, gained significance in the late 1990s and has brought far-reaching change to production areas in the central-northern provinces, where its high value dramatically improves household incomes and farmers use its modern production techniques for other crops. Export revenues from tobacco are estimated to be more than US$22 million for 2003. Most producers are smallholders—approximately 120,000 families—working in Tete, Zambezia, Niassa, and Nampula. Commercial growers in Manica are believed to employ about 1,000 wage workers. The construction of a processing unit in Tete will provide momentum for sector expansion and increase domestic value added. Tobacco exports are subject to tariff rate quotas in some major markets, which puts Mozambican producers as new suppliers at a disadvantage. (See Chapter 5 for discussion.)

Sector Strengths

The importance of the rural economy to the nation is the country's principal motivation for developing its agriculture along more commercial lines. The sector has several important attributes that can give Mozambican producers a competitive advantage over other suppliers of the regional and global market.

NATURAL RESOURCES AND LOCATION

Forty six percent, or 35 million hectares, of Mozambique's 800,000 square kilometers have agricultural potential. At present, only 5 million hectares are cultivated, leaving 30 million available for development.[227] The climate varies from tropical to temperate and is generally favorable, while soils are fertile and rainfall adequate. The south of the country suffers from periods of drought, sometimes prolonged, as well as heavy rains that can lead to flooding on extensive but highly fertile floodplains. The central plateau and mountainous areas of the interior, with their cooler climate, provide a wide range of growing conditions for commercially valuable crops. Abundant surface water—100 river basins, 1,300 lakes, and 10 dams—has enormous potential for irrigation. Mozambique has four times the renewable water resources of South Africa, though utilization is negligible. Its more developed neighbor already withdraws 22 percent of its total renewable water resources for irrigation alone.[228] Irrigation and drainage infrastructure are also absent in Mozambique, except for a 16,000 hectare (potential) development in Chokwe district.

Mozambique's coast, complemented by a network of ports, roads, and railways, gives it a natural trading advantage over the hinterland countries of Zimbabwe, Malawi, and Zambia and easy access to South Africa via the Maputo Corridor. With its strategic location, range of climatic and soil conditions, and abundance of land and water, Mozambique could become a substantial supplier of food and other agricultural products to its neighbors, especially the larger and more affluent market of South Africa. Mozambique is also well-positioned geographically to sell to growing markets, including the Middle East and India.

MARKETS

Mozambique enjoys preferential access for its agricultural products in the SADC regional market, especially countries of the Southern African Customs Union

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[227] Land closer to infrastructure and more economically attractive is already being fully used.
[228] FAO, Aquastat: http://www.fao.org/ag/agl/aglw/aquastat/water_use/irrwatuse.htm.

(SACU). Sanitary and phytosanitary (SPS) protocols and rules of origin on downstream production, however, impose limitations on Mozambican exports to SACU countries. Under the Everything But Arms (EBA) and impending European Partnership Agreements (EPA), Mozambique's access to European markets for most agricultural products is also unrestricted but could be similarly limited by SPS requirements. (See Chapter 8).

While unit prices for many of Mozambique's agricultural exports are tending to fall, the "yield gap" between Mozambique's average and the best regional performers (e.g., South Africa, Kenya, and, until recently, Zimbabwe) shows great potential for productivity gains that could ensure stable margins for the future. Prices remain favorable in some high-value export crops, such as flowers and exotic vegetables; even the much-maligned cotton market is performing better than it has for several years and some analysts forecast a shift in OECD domestic support programs for this and other commodity crops.

To strengthen its market position, Mozambique has at its disposal many strategic resources: diversification, value adding, technological change, private sector development, infrastructure investment, and development finance to exploit current and future market opportunities in the more profitable commodities.

Mozambique's principal agricultural exports tend to be highly concentrated in a few markets. Whether this is the result of longstanding economic relationships (i.e., cashew with India, cotton with Portugal) or more recent ones (i.e., fish and shrimps with Spain, wood with China), it reveals how little Mozambique has diversified products and markets for its agricultural exports. Mozambique must diversify its markets and consider unexplored opportunities (i.e., South Africa, India, Middle East).

INVESTMENT TRENDS

Investment in agriculture, as in the rest of the economy, expanded by 23 percent between 1990-2002. Investment, however, is concentrated in Sofala and Maputo provinces, demonstrating that investors are attracted by infrastructure and economic incentives rather than the quality of agricultural resources, which is higher in some of the more isolated northern provinces.

Sector Weaknesses

Weaknesses that undermine the potential of Mozambique's agriculture assets include poor access to finance, the absence of tradable land use rights, low productivity, an obsolete approach, the absence of SPS control, weak agro-processing, costly logistics, the absence of effective producer organizations, scant export development services, and obstructive red tape. Correcting these weaknesses could allow a strong export sector to emerge and compete globally.

FINANCE

Mozambique's banks provide little credit to the agriculture sector in general (less than 10 percent of the total), and very little to smallholder agriculture.[229] High nominal and real interest rates have made obtaining credit for agriculture a major problem. Competition between the private and public sectors for the same scarce resource results in nominal interest rates of 25–30 percent. The lesser risk of lending to the government accentuates the risks of lending to the agricultural sector. To mitigate risk, commercial banks typically seek collateral equal to 120 percent of the loan and 30 percent participation in the investment.

LAND USE RIGHTS

Access to financing is further hampered by the difficulty of obtaining and registering land use rights. Improved regulations have expedited the process, but discretion in enforcement can still cause delays and additional expense.[230] At present, private growers can obtain a 50-year lease renewable for another 50 years. Smallholders usually avoid the costly process of obtaining land use rights, relying instead on customary property rights and tradition in rural areas. And while larger commercial farmers seek rights because land is their principal asset, they have been unable to use it as collateral against which to borrow to expand production. A market for land use rights would facilitate entry into or exit from agriculture depending on the relative returns to alternatives, such a wage work.[231] Such a market would also make it possible for productive farmers to expand capacity.

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[229] See Nathan Associates, "Export Finance Limitations as a Barrier to Export."

[230] Direcção Nacional de Geografia e Cadastro (DINAGECA) administers the process of obtaining land use rights.

[231] Negrao J. 2002. Land in Africa—An indispensable element toward increasing the wealth of the poor, Oficina dosCentro de Estudos Sociais, No. 179, Universidade de Coimbra; Pagiola S. 1999. Economic Analysis of Rural Land Administration Projects, Working Paper, World Bank.

PRODUCTIVITY

Low productivity, the sector's major weakness, is the result of smallholders' subsistence farming of staple foods crops. Except for sugar and irrigated rice, yields are barely sufficient to cover subsistence requirements and are a major cause of rural poverty and weak growth in most commodity subsectors. A recent survey[232] established that minor changes in production technology and inputs can increase yields significantly and thereby do much to reduce poverty. These changes include improving transport infrastructure to foster better market linkages; improving extension services for smallholders to increase technology use; and improving access to agricultural inputs, especially fertilizers and insecticides. Even cash crops such as cotton suffer from minimal use of such inputs. Input prices are high by regional standards,[233] partly because the small size of the local market precludes volume discounts. But even if input prices were lower and their use economically viable it is not clear that smallholders would be able to access them because they lack of affordable credit[234] and doubt the remunerative value of inputs.[235]

APPROACH

Mozambican agricultural development harks back to "pre-independence levels," even though the external environment and domestic conditions for agricultural exports have changed radically. The concentration on a few once-profitable export crops implies increasing vulnerability to fluctuations and downward trends, while the productivity levels of colonial commercial growers seldom obtain today.

SANITARY AND PHYTOSANITARY CONTROL

Unprotected from the risks of pests and disease by effective SPS services and infrastructure, the agriculture sector suffers major pre- and post-harvest losses each year. Mozambique needs to update its pest survey study to be in strict conformity with SPS requirements. Mozambique's phytosanitary services are very weak. Its phytosanitary certificates have little international credibility, endangering the whole

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[232] Poverty and Well-being in Mozambique: the Second National Assessment. 2004. National Directorate of Planning and Budget, Ministry of Planning and Finance, Economic Research Bureau, IFPRI, Purdue University.

[233] Based on an interview with AGRIFOCUS, the leading agrochemical supplier in Mozambique.

[234] The difficulties of the new commercial farmers in Manica illustrate these problems.

[235] Ann Gordon. 2000. Improving Smallholders Access to Purchased Inputs in Sub-Saharan Africa. NRI Policy Series No. 7.

value chain.[236] Exports of banana and mandarin to South Africa have been hampered recently by these weaknesses, despite more favorable growing conditions in Mozambique. Increasingly stringent world-market regulations governing pesticide use and social and environmental responsibility (and against bio-terrorism in the case of the United States) place several more layers of requirements on producers to ensure the safety, quality, and consumer-acceptance of their food products for foreign markets. New EU laws on food safety and traceability will take effect next year, placing an even greater burden on the government's phytosanitary services. Mozambique faces a major task in dealing with these challenges and could be excluded from regional and world trade opportunities if it does not.

AGROPROCESSING

Agro-industrial activity in Mozambique is minimal. The millions of small farmers on whom agro-processing plants would have to depend are inefficient and widely dispersed, rendering investments in processing costly and frequently unviable.[237] The sugar sector has modern industrial plants capable of competing internationally, but logistical and transport constraints and high financing costs erode profitability. Capability for molasses processing is limited. Only a small portion of raw cashews are processed, most for domestic consumption, with the rest exported to India where they are processed, some for re-export. Rice cannot be processed properly in Zambezia because hulling equipment is concentrated in Gaza, reducing paddy prices in the north. New polishing facilities are necessary. Coconut is exported as copra and unrefined oil, rather than in higher-value forms. Cotton ginning is somewhat in excess of requirements but cotton is exported in bales of raw lint, as Mozambique now lacks spinning and textile capability. Some cotton-seed is also exported raw, mainly to South Africa, where it is pressed for oil and its byproduct, cotton seed cake, which is a valuable ingredient in cattle feed.

LOGISTICS

The high cost of transport in Mozambique reduces profitability along the value chain. This is especially so for export markets, whose growth is stymied by

[236] Mozambique's farmers have not sought certification of conformity to voluntary retailer protocols, such as Eurepgap.

[237] To overcome the shortage of good quality raw material and the effects of a large number of individual suppliers, the cashew and pigeon-pea processing industries invest in their own agricultural production capabilities to ensure consistency in the supply of raw material. They then benefit from vertical integration of field and plant, forcing farmers to increase productivity as prices fall for poor quality product (Based on interview with producers in northern Mozambique).

inefficient ports that handle low volumes at high costs. Crop collection and storage—as well as input supply to rural areas—are inefficient because of the small size of plots and the geographic dispersion of farmers. This has led to a proliferation of small traders and high transaction costs for input and output sales. Margins for farmers are low, traders have strong market power, and incentives to expand production or increase productivity are weak. With improved storage farmers could sell crops through the year, rather than solely during harvesting season when prices are lower. In addition, better storage conditions might improve the quality of the product (e.g., better drying and storage should limit aflatoxin affecting groundnuts).

PRODUCER ORGANIZATION

Effective producer associations are absent in most of Mozambique's non-estate sectors. Without such associations producers cannot enjoy economies of scale in input supply, technology transfer, value adding, transport, logistics and storage, produce marketing, regulatory reform, or government services. Financial services for the rural sector are also more costly and risky when a large number of small individual borrowers is involved, or when farmer associations are not credible guarantors of their membership. The structure of linkages between producers and agro-industry is also neglected. Problems at this level can be solved by vertical integration of agro-industry (i.e., sugar and cashew are becoming more vertically integrated) or through contract farming arrangements popular among cotton and tobacco producers.

EXPORT DEVELOPMENT SERVICES

Export development services such as post-harvest management, enterprise development, market linkages, access to finance, and compliance with import regulations can strongly influence the development of viable export ventures in Mozambique (e.g., horticulture in Manica Province,[238] cashew in Nampula, grapefruit in Maputo). Improving these services will require investment and working capital for export-oriented agro-business and better market information and linkages. Finance, however, is costly in Mozambique, especially if denominated in *meticais* and provided by local banks. Greater bank confidence in export agriculture (bolstered by effective producer organizations and better technical support for the commercial agriculture) would lead to a wider range of cost-effective financial services for the sector.

[238] With Technoserve support.

Mastering the dynamics of international markets and understanding the many barriers to entry is costly, especially for smaller entrepreneurs of limited experience. Strong exporter associations with adequate technical support can help reduce these costs, reduce or avoid mistakes, and speed establishment in target markets. Speedy establishment is becoming more and more important. As barriers to entry fall globally producers' margins will also fall; the longer a sector takes to achieve market share, the lower the returns on investment and the margin on each unit of sale.

By improving customs clearance of inputs (e.g., effective duty drawback, temporary exemption system, fast-track clearance) and of expedited clearance of exports, especially perishables, the government can do much to facilitate export growth.

RED TAPE

Excessive bureaucracy impedes investments in agriculture and reduces the competitiveness of existing businesses in Mozambique. The main problems are associated with VAT reimbursement on inputs for export products, Customs delays, difficulty obtaining import exemptions granted by law, and the high costs of administrative procedures (i.e., SPS certificates, export-related certificates). These problems drive up operating costs and can ruin start-ups, for example, in the highly competitive horticulture business. In addition, implementation is often poor and perishable export products are not given the priority at the border that they deserve.

Opportunities

Through subsector analyses carried out in Mozambique, we have identified viable opportunities for large-scale agribusiness and commercial smallholder production. We present them here in approximate order of export potential.

CASHEW

Small-scale cashew processing has great potential: productivity and product quality at the new plants is good and demand is strong; producers are creating a quality brand for Mozambique that attracts a premium price; and labor-intensive technology and rural location do much to reduce poverty. The productivity of the old cashew tree stock, however, urgently needs to be improved. This presents an opportunity to introduce farmer- and processor-oriented development schemes that encourage orchard renewal using more compact plantations; higher yielding, better quality varieties; and more effective approaches to plant health.

Sector policies need to promote the processing industry and capture the sector's medium-term production capacity by revitalizing stagnant or declining production. Encouraging the processing industry to develop without harming producers will require focusing on measures such as duty and tax exemptions, the labor regime, infrastructure, and financing rather than the old standby of tariff protection. Policies should aim to encourage closer integration between sector players; more compact, densely populated, and productive growing areas; lower transaction costs (e.g., through associations); and research and extension activities that raise productivity and quality.

COTTON

Cotton is a source of income for 350,000 farmers, many of them in the northern provinces. Potential for expansion is strong. Current production is about 80,000 tons but the industry may be capable of producing 400-600,000 tons of raw cotton each year. At present, cotton is a low-input, low-output cash crop with production highly dependent on purchased inputs and on crop practices, especially pest management. As with most crop sectors in Mozambique, fertilizers and pest management products are hardly used, which explains most of the sector's low yields. This scant usage is due largely to failures in input marketing channels that reflect problems with agricultural credit. The time lag between the import of inputs by private companies and the sale of cotton lint and seed is about 18 months. This places a heavy financial burden on private companies (yearly interest rates are about 25 percent).

Accounting for more than 98 percent of cotton seed production in Mozambique, smallholders operate under contract to private companies who provide them with inputs and technical assistance. In exchange they have the right to buy their seed cotton after deducting the costs of those inputs. This system is established by law (i.e., *regulamento do algodao*) as the private companies (known as *fomentadoras* or "promoters") obtain from the government the legal monopsonistic power over certain areas for up to 20 years.

Since the late 1980s the Government of Mozambique has based its cotton policy on a system of closed concessions as a way of overcoming market failure in the supply of inputs and credit. The system gives concessionary companies exclusive rights to buy cotton and distribute inputs and extension services on credit. By the end of the 1990s the government moved toward a more open system, relaxing the exclusive rights so farmers could sell cotton to a company other than the concessionaire--so long as they did not receive inputs or support from the concessionaire. This system aimed to intensify competition among companies and reduce their market power to the benefit of the weaker smallholders. But difficulties in monitoring and control gave rise to conflicts between companies and with the farmers because of "pirate" buying—especially in Nampula where demand for raw cotton was highest. In 2001 the government returned to the system of closed concessions.

Each year at the beginning of the season (i.e., April-May) the National Commission for Prices and Wages (Comissão Nacional de Salários e Preços) sets a minimum national price for raw cotton for the entire season. That price is negotiated between MADER and the Cotton Institute of Mozambique (IAM), cotton companies, and smallholders' representatives. The purpose of the minimum price is to (1) prevent companies from abusing their legally granted monopsonistic position, and (2) provide farmers with a reliable minimum price to reduce under-production because of the high degree uncertainty in the international market.

The price system has been heavily criticized and two alternatives to link the system more closely to prevailing seed cotton conditions and to international prices have been proposed: (1) a two-tier price with a basis determined before the season and another linked to international prices and quality incentives; (2) avoid a "national" price and allow greater freedom for prices to reflect quality and availability at the regional level. The proposals are not mutually exclusive and both require improving the system of classification. A more regionally based, market-sensitive system that rewards gains in productivity and quality should replace the pan-territorial minimum price.

The main justification for mandating exclusive buying rights is the problem of "side-selling," or selling to a company or ginnery instead of the concessionaire that advanced seed and inputs. This is fundamentally an issue of contract enforcement. If contracts requiring repayment (plus interest) for seeds and other inputs advanced by the concessionaire were enforceable, then farmers could sell to the highest bidder, rather than a designated concessionaire. This would enhance competition without interrupting the supply of inputs. Enforcement through local arbitration clauses can be used to streamline the process.

Expansion of cotton production will require better linkages and coordination among stakeholders, horizontally and vertically. In particular, smallholders require better support. IAM is best placed to oversee such support. Their role should be supervisory, with farmer and industry associations, civil society, and NGOs taking the lead. In poorly organized subsectors such as this, government agencies are prone to adopt paternalistic relationships with smallholder producers and can lose accountability vis-à-vis stakeholders. Strong trade associations are the most effective vehicles for subsector development and should be at the center of the country's cotton strategy.

HORTICULTURE

Mozambique has an opportunity to develop a major export industry in the Beira Corridor, where Zimbabwean growers experienced in production of a variety of export crops for European markets are immigrating. Provided substantial progress is made in addressing the constraints identified in the previous section, the required market conditions can be met for the crops best suited to the Beira Corridor. Considerable technical resources are being mobilized to support these initiatives, both by operators themselves and NGOs. Technoserve, which has examined prospects for export development in Manica, estimates that annual export revenue from horticultural crops in that Manica alone could reach US$36.2 million in 10 years (Table 10-1).

Table 10-1
Projected Production and Revenue by Horticulture Commodity in Manica

Crop	Commercial Hectares	Outgrower Hectares	Annual Revenues (US$)
Paprika	500	120	3,100,000
Roses	50	0	9,000,000
Hypericum	50	0	4,585,000
Summer flowers	50	0	1,650,000
Vegetables	1,200	500	5,304,000
Large fruit estate	2,000	200	11,000,000
Fruit farm	1,200	100	1,560,000
Total	5,050	920	36,199,000

SOURCE: *Technoserve.*

Farmers in Maputo and Gaza provinces are already exporting horticultural products to South Africa. Recent exports include melons, peppers, citrus, and bananas. Proximity to main markets and existing infrastructure such as roads, ports and air transport are significant advantages A grower in Maputo province has established his viability as a high-quality exporter of grapefruit to the EU market. In contrast, mandarin production needs to overcome serious plant health problems before it can pursue market opportunities in the South African market. Reportedly, South Africans are interested in high-productivity banana plantations in Mozambique's south-central provinces, highlighting again Mozambique's potential as a supplier of high-quality fruit to its wealthier neighbor. Opportunities also exist for such products on Asian and Middle East markets.

TOBACCO

The tobacco subsector presents an opportunity for high margins and quick returns among smallholders. Mozambique can raise the level of agricultural technology and diversify production by using a variety of crops in rotation with tobacco to avoid disease (break crops). Land clearance necessary for production removes vegetative cover, and the firewood extraction needed to process Virginia and dark-fired tobacco destroys forests and destabilizes watersheds. Thus, a land management strategy should be integrated with the tobacco development strategy. An integrated strategy will protect the natural environment and stimulate the use of modern farming technologies among small and large growers, encourage value-adding through further processing of raw products, and facilitate the emergence of an agricultural credit and input supply system that responds to the rural sector's broader needs.

SUGAR

Mozambique's agroclimatic conditions, installed capacity, technical expertise, and multinational management all favor development of a sugar industry that could be competitive in regional and world markets. And potential gains from molasses processing are not yet being pursued. World market prices continue to be depressed by supply responses to domestic support levels and export subsidies in many countries whose markets are protected by prohibitively high out-of-quota tariff levels. While the sector's dependence on international markets is considerable, new opportunities for quota acquisition are opening up in the EU and SADC. Though not permanent, the expansion of sugar quotas could provide the industry with financial resources to overcome financial troubles, develop molasses processing, and establish a stronger presence in global markets.

Because of Mozambique's competitive position it should seek more permanent liberalization of world sugar markets, including the reduction of subsidies to producers and exporters. Realistically, any liberalization of trade in sugar will be phased in over many years and Mozambique, as a new or "rehabilitating" LDC supplier, should seek increases in quotas in major markets. Phased liberalization will will also time for infrastructure to be completed. Nonetheless, as subsidies are reduced the world market will increasingly be determined by competitive position, so protectionist surcharges at Mozambique's border should be reduced and eventually eliminated.[239]

RICE

Mozambique has favorable growing conditions for intensive rice production in Chokwe, close to Maputo and the corridor with South Africa, which imports more than US$100 million in rice annually. Few countries in the region have the agro-climatic conditions for large-scale commercial rice production. The EU market under the EBA zero-tariff arrangements offers new opportunities. More generally, investment in transportation and drainage infrastructure in Zambezia would greatly increase production, lead to exports, and benefit one of Mozambique's poorest and most populous provinces. Major commitments from both the public and the private sector will be required to achieve the required investments. Under current conditions, Asian producers can deliver rice to Maputo at approximately the same price as domestic producers. Whether Mozambique can compete with these producers in domestic and regional markets must be assessed.

COCONUT

Mozambique can improve the competitiveness of its copra and oil exports while diversifying along the lines of the Philippines model. Producers should exploit market potential by processing byproducts into charcoal, activated carbon, coir, and coir pith. Acquiring the technology, knowledge, and machinery to enter these markets has proved expensive, requiring a supportive policy framework that minimizes unnecessary transaction costs.[240] Such an environment would create investment conditions that will attract new partners and market linkages. All stakeholders should get involved in halting the decline of the country's aging and diseased stock of coconut trees.

BASIC CROPS

Maize producers may be able to increase exports to Malawi by combining low levels of inputs with better agronomic practices. An investment opportunity for a new

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239 A study on the impact of the sugar surcharge commissioned by the National Institute for Sugar (INA) should be completed this year.

240 The 2002 Mainstreaming Report detailed the trials of a coconut oil producer's standoff with Customs on the requirement to pay duties and VAT on capital equipment imported to expand production. The firm did not want to tie up working capital especially when a quick refund was unlikely. The firm was located in the Zambezi Valley free zone.

maize mill in Lichinga exists. The June-August window on the regional export market for maize (i.e., before the North American harvest comes onto the market) should be explored further. Over time, market mechanisms such as commodity exchanges, crop insurance, and inventory credit could be introduced and strengthened.

Mozambican producers may be able to increase their sales of starch for the South African market. They will need to reduce raw material supply costs through intensive production for industrial processing. Demand could rise if cassava is used more in animal feed.

DIVERSIFICATION CROPS

Diversification crops are annual crops that smallholders cultivate using traditional techniques, partly for cash and partly to complement their own food supply. Pulses and oilseeds are the most common. Their production helps minimize farmers' exposure to market and climatic risk and is linked to the development of a more market-oriented agriculture. They therefore have much potential. For example, Mozambican pigeon pea is exported to Malawi for processing and re-export to India, but could be processed in the country and exported directly to India during the short period of peak prices. Mozambican dry beans, cowpea, and green and black grams are in demand in South Africa. Oilseed production (sunflower and soybeans) for animal feed and edible oil in the domestic market also holds promise.

Further afield, Norway has shown interest in importing raw soy beans from Mozambique because of its zero tariff status. Exports of groundnuts to Europe could be feasible when the danger of aflatoxin contamination is eliminated. Gaining access to niche markets, such as the UK fair trade and organic markets, will require new seeds and better agronomic techniques. A private outsourcing scheme in Nampula linking smallholder production of groundnuts with cashew production has already taken some steps in that direction. Such initiatives show how relatively simple crops can lead to new export opportunities and income for smallholders who have the resources and commitment to sustain a diversified cropping system.

Risks

Major risks to the development of a more commercial and export-oriented agricultural economy in Mozambique include weather, transportation, plant health, market factors, inefficient development programs, and bureaucracy.

Weather. Drought and flooding in the south are constant risks and impose an enormous toll on production that is often reflected in the country's GDP. The only provisions against such risks are

- Adoption of environmental conservation measures that ensure adequate watershed protection from deforestation and erosion upstream, though much of the damage actually occurs beyond Mozambique's western and northern borders and would require participation in regional resource management programs and fora; and
- Major investment in large-scale irrigation and drainage schemes.

Irrigation infrastructure would allow dry season production to complement existing rain-fed farming, while drainage schemes would render water management in irrigated areas much more viable, as well as opening to production land that is too heavily flooded each year to be of use to most farmers. Expansion could be significantly accomplished through private investment. Regulations concerning land and water use rights need to reviewed and changed if necessary to facilitate such investments. Such development would be a boon for agriculture as it would allow more intensive production techniques focused on the market rather than home consumption.

Transportation. Secondary and tertiary roads remain in poor condition in many agricultural areas, seriously hampering development and driving up logistical costs for exports.

Plant Health. The absence of effective plant health services exposes Mozambique to major annual losses to pest damage and restricted access to foreign markets, including South Africa. Unless action is taken quickly to improve such services, Mozambique will not be able to develop horticulture, which presents a major opportunity that competitors will soon exploit.

Market Factors. Intense competition in horticultural exports between African and other origins could severely limit Mozambique's prospects unless timely improvements in the business environment are made.

Inefficient Development Programs. Failure to invigorate declining or dying plantation crops, such as cashew and coconut, could lead to the collapse of these sectors. Failure to protect the natural environment from destructive practices in tobacco cultivation could lead to major losses in natural resources.

***Bureaucracy*.** Persistent inability to eliminate the red tape that hinders and discourages new investment in agriculture threatens to deflect investors toward more promising sectors and more inviting host countries.

Recommendations for Stimulating Agriculture Exports

To confront these constraints and risks, and to help Mozambique plot a course for sustainable growth and international competitiveness in it agricultural sector we propose a three-pronged development strategy based on

- Intensification of production through the promotion of commercial farming among smallholders and larger operations;
- Diversification into higher value product lines; and
- Investment in irrigation and drainage infrastructure, agricultural technology, and agro-processing.

INTENSIFICATION

To raise productivity, reduce rural poverty, and increase exports in the agriculture sector, Mozambique must adopt advanced techniques and promote commercial farming, large and small. Given the large number of farmers and the physical size of the sector, the strategy of intensification should focus on growth poles for existing crops where commercial farmers and advanced smallholders have demonstrated good productivity and enough social organization to facilitate dissemination of good agricultural practice and better management and marketing.

Intensification, however, will only deliver sustainable development if accompanied by improvements in sector organization along the value chain and an enabling policy environment. Otherwise it will merely reinforce basic food crops’ dominance of production and the concentration on traditional exports. This would damage prospects for a commercially viable farming sector. Hence, diversification is also essential.

DIVERSIFICATION

Mozambique should consider diversifying into

- High-value and niche products—inter alia, horticultural exports to Europe; mangoes to the Middle East and the Indian subcontinent during their off-season (weeks 10-20); ginger and honey to South Africa;[241] organic and fair trade groundnuts, cashew, and dried tropical fruits to OECD markets.

- Value-added and agro-processed products—Molasses, coconut products, fruits, beans, maize, oilseeds, cashew, pulses, pigeon pea.
- Traditional crops with clear market opportunities where Mozambique has competitive advantages (e.g., tobacco, cassava, rice).

Given the greater purchasing power in South Africa, Mozambicans should use regional trade agreements and integration initiatives to gain access to the South African market and to establish production linkages there, using such access and linkages as a springboard for integration in global supply chains of high-value products and agroindustrial products.

To reduce its dependence on traditional markets (e.g., cashew to India, cotton to Portugal, fish and shrimps to Spain, wood to China), Mozambique should diversify into new markets. It should seek to exploit its preferential access to EU and U.S. markets and the family and ethnic ties of Mozambique-based traders to develop export production that targets the Indian subcontinent, the Arabian Peninsula and Gulf States.

NEW INVESTMENT

Agriculture cannot intensify, diversify, and develop value adding without substantial new public and private investment in infrastructure, industrial plant, production technology, and marketing. Intensification and diversification depend on the capacity of export agribusiness to attract investment. To do so, it needs to be perceived as profitable and sustainable. Some investments will have to be mobilized from within Mozambique, but others will be regional and global FDI, linked not only to financial resources but also to technical expertise and markets. Thus, the promotion and expansion of investment in export-oriented agribusiness is an essential element of this development strategy.

In its favor, Mozambique is perceived, at least regionally, as a country of vast opportunities. But the costs and complexity of doing business reflect a weak political commitment to private sector development that affects commercial agriculture. The

[241]See the recent report financed by the EC / FAO Facility for the Provision of Consultancy Services and produced by the External Market Task Force, an interministerial group formed by the Ministry of Agriculture and the Ministry of Trade to promote the development of agricultural and agro-industrial export opportunities.

country's uncertain business environment has dissuaded many potential investors, as missed opportunities in textiles and apparel under AGOA attest.

If the country is to promote agricultural exports in regional and global markets, it needs to streamline procedures for investors and remove the many bureaucratic obstacles to international competitiveness that investors and businesses encounter and have catalogued in a multitude of fora. The most important improvements to the business environment for agriculture include making progress on land use rights, reducing transaction costs by making timely VAT refunds, reducing the time and cost involved in obtaining export certificates and inspections, and making export inspections more predictable and transparent.

The procedure for accessing land needs to be simplified and, once granted, the rights should be registered, an important step to collateralizing the use of land. If simplifying procedures is too difficult to proceed with on a national basis, perhaps special procedures can be established in pilot zones designated for agricultural development. A related improvement would be establishment of an accessible database to indicate available land.

The urgent need to use registered, transmittable land-use rights as bank collateral illustrates the other major issue in the sector: credit. The lack of bankable collateral and high real interest rates in Mozambique have made obtaining credit for agriculture a major problem. In addition, banks often seek collateral at 120 percent of the loan, and 30 percent participation in the investment. MADER is completing a study on establishing a venture capital fund as an alternative to commercial bank financing. The purpose of the fund, managed by a private company, would be to increase productivity in agriculture by 5 percent per year by focusing on start up and agricultural processing. It would be financed by a public-private partnership and would support investments ranging from US$25,000-250,000.[242] Legal and management details are being defined.

HIGH-LEVEL CONSENSUS ON STRATEGY AND PRIORITIES

The recommended delivery mechanism for this strategy is a ***national policy of agricultural development adopted by all stakeholders***, with unambiguous priorities, clear lines of responsibility, firm funding commitments, and accountability for implementation. Development of such a strategy could build on the Draft Vision of the Agrarian Sector being developed by GPSCA in MADER, and the work of the

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[242] Initial public financing will be sought from donors.

External Market Task Force (EMTF) established in MIC. The Draft Vision—based on the PARPA goals of poverty reduction and increased food security—emphasizes programs to direct growth to the neediest groups in Mozambique. Based on market chain analysis, the document focuses on adding value to products destined for internal and external markets. The EMTF explored possible export markets and constraints on production and delivery. The EMTF integrated the work of several ministries, while focusing several different directorates in MIC on the same potential export products.

The government, the private sector, smallholders, commercial farmers, and their elected representatives from the legislature should be equal partners in this strategy. Special task forces, EMTF-style, could help ensure that the government implements accords. Targets for new investment and the feasibility studies that precede them would be set and monitored.

11. Fishing and Fisheries

More than two-thirds of the population of Mozambique lives within 90 miles of the coast. The fishing sector is thus an important source of food, employment, and revenue. An estimated 480,000 people, or more than 3 percent of the population, are economically dependent on the sector, which directly employs 75,000–80,000 people. In recent years, fishery products, including prawns, have represented 40–50 percent of Mozambique's exports. More than 80 percent of fish exports consist of shallow-water prawns caught on the Sofala Bank. Most of the shrimp are exported to Spain, Japan, and South Africa.

In this chapter we examine opportunities and constraints in Mozambique's fishing sector, especially opportunities in seaweed farming, fresh fish, and shrimp aquaculture. We also describe the recent EU-Mozambique fisheries access agreement and the implications of this agreement for Economic Partnership Agreements (EPA) with the EU. We conclude by identifying some cross-cutting constraints on the fishing sector in Mozambique and propose recommended actions for stimulating fisheries exports.

Resources

Mozambique has a coastline of 2,780 km, with an exclusive economic zone (EEZ) of 562,000 km^2, of which 104,300 km^2 is within the continental shelf. Mozambique also has numerous lakes and inland rivers that hold potential for inland fishing.

MARINE FISHERIES

Mozambique's marine fishery resources are mostly located in two major shelves: the Sofala Bank in the center and the Delagoa Bight in the south, as well as in the bays of the two regions. Major resources include shallow-water shrimp, deep-water crustaceans, scad and mackerel, and demersal fish. Large artisanal fisheries along the coast fish for shrimp and mollusks.

The estimated annual sustainable yield of fish in Mozambique is about 350,000–400,000 tons. From 2000–2003, the recorded amount of marine fish at the landings was 126,000 tons, with an average annual landing of about 31,000 tons over the period. For 2004, the recorded landing will be close to 123,000 tons.[243] Actual production, including artisanal fish catch, is estimated to be double the recorded catch.

The marine fishery sector has three broad segments: ***industrial fishing (including shrimp), semi-industrial*** fishing and ***artisanal*** fishing. The industrial segment is characterized by foreign vessels outfitted with processing facilities that target shrimp and tuna, and sufficient resources to support modernization of the fleet while exporting their products direct to international markets. The industrial tuna fishery is composed of purse seiners fishing for skipjack tuna, which is then sold to canneries in Seychelles, Madagascar, or Mauritius for approximately US$650–US$900 per ton and commercial long-line vessels that fish for higher value tuna species (e.g., yellow-fin, big eye, albacore) sold to international markets for fresh and frozen consumption at US$5,000–US$15,000 per ton. Marlin and swordfish are important by-catch of the tuna fishery. The industrial fleet has more than 70 percent of the quotas of the Total Allowable Catch (TAC).

Shrimp is the most important commercial fishery in Mozambique and one of the higher earners of foreign exchange. In 2002, exports reached US$84 million or 75 percent of total fishery exports.[244] More than 70 percent of the active shrimp fleet targets deep-water and shallow-water shrimp. Catches from the industrial fleet are usually frozen on board and exported directly. Shrimp farming is a recent venture in this market segment that offers potential for expansion.

The semi-industrial fleet consists of mostly national companies with multiple vessels of 10 to 30 meters with onboard holding facilities that catch shrimp and fish, mostly for export (smaller shrimp vessels chill their shrimp on board and freeze on shore). This segment is challenged by limited financial capacity for modernization of vessels. The majority of motorized vessels target shrimp that is later sold to industrial enterprises for processing and export. The average catch volume for each vessel is 2000 tons / year.

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[243] Sikela, Eusebeo. 2004. Texto de Apoio Para a Entrevista Televisiva Sobre o Balanço do Plano Quinquenal do Governo 2000 – 2004. Ministry of Fisheries, Republic of Mozambique.

[244] International Trade Centre Trademap database www.trademap.net

The artisanal segment includes individual fisherman or small groups of fishermen with weak financial capacity. They use primarily small vessels, non-motorized canoes, and sailing skiffs and fish principally for the domestic market. Handlines, beach seines, and gillnets are their commonly employed fishing gear. The artisanal segment is scattered along the coastline. Mozambique has close to 70,000 artisanal fishermen trolling for and catching an estimated 9,000 tons of fish per year.[245] They sell their catch on the domestic market. Ninety percent of people employed in Mozambique's fishing sector are artisanal fishers or are associated with the handling and distribution of artisanal catch. Helping these people expand production and move into the export market can do much to improve their welfare.

FRESHWATER AND INLAND FISHERIES

Freshwater resources are mostly located in Lake Niassa and in the Cahora Bassa reservoir. The annual recorded catches are about 30,000 tons; the estimated potential is about 90,000 tons. Since 1995, reported landings of freshwater fish—mainly *Capenta*—have grown threefold. Similar to sprat or white-bait, freshwater fish is very popular in the regional market. This dramatic growth is most likely a result of market demand, renewed access to the lakes at the end of the war, and de-mining. The inland fishery sector is well exploited and does not appear to have much potential for expansion.

Central and northern Mozambique offer excellent conditions for shrimp aquaculture, and Mozambique is promoting it as an investment opportunity. Indian Ocean Aquaculture (IOA) is building a US$40-50 million facility in Pemba to farm shrimp for export to the United States and the EU. The investment is American, South African, and English in origin. One investment of Chinese origin is in Beira and another of French and Mauritian origin is in Zambezia.

Institutions and Resource Management

The Ministry of Fisheries (MOF) manages the fishing sector. Since its establishment in 2000, the ministry has made significant advances in providing support to the fishing sector to tap export potential and manage resources. The ministry comprises three national directorates, three departments, and four financially autonomous institutions: (1) the Fisheries Development Fund (FFP), (2) the National Fisheries

[245] Ibid.

Research Institute (IIP), (3) the National Small-scale Fisheries Development Institute (IDPPE), and (4) the Fishing School (EP). At the provincial level, the ministry is represented by the Provincial Services for the Fisheries Administration (SPAP), which monitors and controls fishing. The Maritime Administration (ADMAR), under the Ministry of Transport and Communication (MTC), controls artisanal fisheries.

The MOF grants access to fishery resources through a licensing system for commercial vessels, which are allocated quotas under a TAC system. A three-month closed season (December–March) helps keep the catch below the TAC, as does a mesh size regulation of nets (the minimum legal mesh size is 55 mm).[246]

The MOF estimates that the industrial fleet spends about 300,000 hours fishing for shrimp in Mozambique; the sustainable level is about 180,000 hours. To cut hours, the ministry has reduced the number of licenses issued to the industrial and semi-industrial fleet for shrimp fishing. For shrimp fishing in the Sofala Bank, for example, it recently licensed 61 industrial vessels and 51 semi-industrial vessels (22 with freezing capabilities and 29 that use only ice). This is 6 fewer licenses for industrial vessels and 2 fewer for semi-industrial vessels than in 2000.

Mozambique's extensive coastline makes it vulnerable to illegal, unreported, and unregulated (IUU) fishing. The MOF has been working through the SADC Fisheries Monitoring, Control, and Surveillance (MCS) Programme to develop its capacity to monitor and control the country's vast fishing resources. For instance, MOF is implementing a vessel monitoring system that will monitor boats by satellite and is completing a pilot study that will provide guidance on where and how to mount the system in the country. Greater cooperation with entities like the Indian Ocean Commission (IOC) and with neighboring countries can improve monitoring, control, and surveillance.

Donors' Support for Fishing Sector

EC/EDF. Artisanal fisheries in Inhambane Province; monitoring, control, and surveillance; quality management; Beira Cannery; direct technical assistance.

DFID. Shrimp by-catch utilization, management information systems.

IFAD. Artisanal fisheries development in Nampula.
Danida. Boat building, fisheries master plan, direct technical assistance

NORAD. Direct technical assistance.

ICEIDA. Fishing laboratory and training in laboratory routines in Maputo; training center at the MOF; assistance in quality control and standards.

[246] Lopes, S., and M.A. Pinto. 2001. *Illegal Fishing: The Case of Mozambique.* International Collective in Support of Fish workers and the International Ocean Institute Conference.

The International Fund for Agricultural Development (IFAD) and other donors have provided significant technical assistance to Mozambique fishermen to help them develop exports and improve their standard of living (sidebar). And the MOF and donors together have been providing assistance to artisanal fishermen. For instance, in Sofala, new technologies affecting maritime motors, including maintenance and repair of these motors, were demonstrated to fishermen. In Nampula, Pebane, and Zambezia, technologies for preserving and processing fish were presented to artisanal fishermen. Fish prices are published weekly to help artisanal fishermen receive fair prices for their catch. Since 2003, 93 associations of fishermen have been organized in Nampula and Zambezia. In that same year, five schools—two in Moma, one in Angoche, and two in Mogincual—were constructed. Donors have also supported financial activities, disbursing US$3.3 million to be used as credit to finance fishing-related activities and to support post-flood recovery programs.

Fishing Sector Potential

SEAWEED FARMING

With relatively low investment costs and high community participation, the farming of seaweed for carrageenan holds significant potential for Mozambique. Harvested wild or farmed, seaweed is used for a wide range of industrial, pharmaceutical, and food purposes. Red seaweeds (Phylum Rhodophyta), specifically Kappaphycus and Eucheuma, which are used in the production of carrageenan, hold the most promise.

Carrageenan is the name given to a family of food-grade polysaccharides (complex unsweet carbohydrates) obtained from red seaweeds. With a unique ability to form an almost infinite variety of gels at room temperature, carrageenan is used in many food products and in toothpaste, cosmetics, and pharmaceuticals. In industrialized countries, its use in food has grown by at least 5-7 percent each year. Carrageenan has unique properties that cannot be substituted by other gums and its future is assured in all areas of the world that demand convenience foods. Developing countries such as China are already creating convenience foods and the trend will accelerate in the coming decade, boosting carrageenan's annual growth rate.

Tanzania is producing seaweed for export and may offer a model for Mozambique. There, the government licenses a small number of locally owned seaweed purchasing companies to develop seaweed farming in a specific area. The companies train nearby villagers in seaweed farming, supply them with farming materials, and provide storage facilities. Dried seaweed is purchased and pressed into 100kg bales for export to end processors.

Seaweed production requires little technology and much labor. It is very likely that incremental production from Mozambique could be marketed easily. Production, under the Tanzania model, demands community involvement and interaction between producers and buyers. And, because the semi-processed product has a long shelf life, the industry can be developed in remote locations.

FRESH FISH

Until the Mozal aluminum project reached full operation in 2001, the fishing industry was Mozambique's leading source of foreign exchange. Mozambique's fresh fish exports totaled more than US$113 million in 2000, US$132 million in 2001, US$114 million in 2002, and US$71 million for the first three quarters of 2003.[247] More than 50 percent of the catch in Mozambique, however, is estimated to be by foreign vessels. Worldwide demand for fresh fish remains strong and, because fishery resources are being depleted in major developed markets, fresh fish exports hold great potential. To remain competitive, however, Mozambique must manage its resources effectively, focusing on product and quality certification and supporting the development of processing, cold storage, and transportation infrastructure. Increased onshore processing, resulting from greater catches and subsequent export of fresh fish, will also generate local value-added income and employment.

At present, Mozambique's fresh fish supply chain has weak infrastructure for handling and distributing fishery products and large numbers of geographically dispersed artisanal fishers with weak communication channels. For high-value fishing, artisanal fishermen prefer line fishing because it preserves the quality of the catch better than net methods.[248] If they had quick access to cold storage facilities they might be able to export their catch.

All catch must be carefully handled and iced. Fish can be frozen at sea and transshipped to export markets or processed onshore. In Mozambique, fish are usually delivered on ice to a processing facility. Delivery from remote locations can be problematic because catch must be trucked from prearranged landing sites. At the processing facilities, fish are sorted, cleaned, graded, and packaged for export.

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[247] INE. Export data provided to Nathan Associates for the DTIS included only the first three quarters of 2003. Total exports for 2003 are expected to be similar to those for 2002.

[248] When nets are used the time between capture and landing on a vessel erodes catch quality because fish decay very rapidly in tropical waters.

Certain products may require further processing, such as filleting. The goal of processing is to get the fish from the vessel to the market as quickly as possible. Thus, the location of the processing facility, market access, and hygiene and other standards are all important.

For export products especially, processing facilities must meet stringent quality and health standards. Poor sanitary conditions, lack of secure and healthy water supplies, poor personal hygiene, tropical climates, insects, and rodents increase hazard levels and make certification by competent authorities difficult at best. Mozambique needs to overcome all of these challenges to meet the standards of export markets.

Increasing investment in processing facilities can help increase Mozambique's exports of fresh fish—but only if such processing is economically viable. Processing facilities require chilled storage, frozen storage, some freezing capacity, and access to significant amounts of ice (e.g., one tone of ice is needed to process one ton of fish). Facility designers need to carefully consider expected throughput and how to maximize utilization rates. Environmental issues, such as disposal of waste, must also be taken into account and comply with local legislation.

SHRIMP AQUACULTURE

Having created a brand name in the shrimp market, Mozambique needs to take advantage of its reputation. The worldwide market for shrimp is large, but Mozambique supplies only about 2 percent of that market. The United States and Japan are the world's two largest importers of frozen shrimp. Over the past few years, U.S. imports have been increasing steadily, rising from 264,206 tons in 1996 to 400,337 tons in 2001. Japanese imports have fallen slightly, dropping from 288,000 tons in 1996 to 245,049 tons in 2001.

While the opportunity for increasing shrimp exports is great, natural shrimp resources are being depleted and Mozambique is tightening control over its shrimp resources by granting fewer licenses and instituting greater monitoring, control, and surveillance. In this context, shrimp aquaculture could help Mozambique increase its shrimp exports. Some caveats, however, are in order. The rapid expansion of commercial shrimp aquaculture throughout the world has sometimes harmed the environment and local communities. Many shrimp farms have been abandoned after 5-6 years, often rendering the land unfit for any other productive use. Some also argue that shrimp aquaculture threatens food security because farmed shrimp are fed fishmeal processed from fish consumed by local people. If Mozambique is to seriously pursue shrimp aquaculture, it should use methods and policies that contribute to sustainable shrimp aquaculture and develop mechanisms to ensure that guidelines and best management practices are implemented. The World Wildlife Fund could provide information on best practices in shrimp aquaculture.

In addition to alleviating many of the business and investment environment constraints detailed later in this report as well as those outlined in the preceding section on fresh fish, Mozambique needs to improve (1) its capacity to certify shrimp exports as meeting SPS criteria in developed country markets, and (2) the capacities of facilities at ports such as Beira and Maputo to export frozen shrimp quickly and efficiently.

EU-Mozambique Fishing Agreement

Signed in October 2002, the Fisheries Access Agreement between the EU and Mozambique became effective January 1, 2004, and will expire when EPAs are ratified. Although the “cash-for-access” agreement provides Mozambique with nearly €10 million annually, it does little to encourage Mozambique to develop a processing industry, meet international standards, or monitor and control fishing activities.

The agreement gives the EU and its fishing fleet access for 10 shrimp trawlers with an annual allowable catch of 1,000 tons of shrimp and 535 tons of other fish (e.g., lobster, crab, squid, octopus, langostines) and 49 tuna vessels with unlimited quota. Annual compensation for the capture of 1,000 tons of shrimp and 535 tons of other fish in deep waters is fixed at €3,490,000. Annual compensation for the capture of up to 8,000 tons of tuna is €600,000. If the EU fleet captures more than 8,000 tons of tuna, the EU will pay €75 per ton. The maximum compensation to Mozambique by the EU for tuna will not exceed €1,800,000 (or 16,000 tons of tuna).

Financial compensation, in addition to the shrimp and tuna compensation, for access to Mozambican waters is fixed at €4,090,000 per year and will finance activities as follows:

- €1,500,000 for inspections and auditing of maritime fishing activities
- €1,000,000 for institutional development
- €1,000,000 for investigations
- €430,000 for training
- €100,000 for quality control and standards
- €60,000 for participation in meetings with the European Commission and other international meetings.

IMPLICATIONS FOR EPA NEGOTIATIONS

The EU's proposed EPA envisions a broad, development-oriented relationship between the EU and its former African, Caribbean and Pacific (ACP) colonies. ACP countries now enjoy unilateral trade preferences and other non-trade related development programs. The EPAs will be vehicles for making tariff and non-tariff concessions and will include a comprehensive package of aid and trade measures that include fishery access terms.

During EPA negotiations, the EU is likely to attempt to make tariff and non-tariff concessions conditional on fishery access (direct or indirect) for the EU long-distance fleet.[249] This occurred during negotiations between the EU and South Africa for the Trade Development and Cooperation Agreement (TDCA) completed in 1999. In that case, the EU pressed for a fisheries component that made export tariff concessions for South African fishery products conditional on South Africa signing a fishery access agreement acceptable to the EU. So far, South Africa has refused to give in to EU pressure. It is therefore highly likely that the EU will again condition access to EU markets on EU access Mozambican (and other SADC EPA country) waters. Mozambique should press the EU to make fishery access a true partnership by ensuring that the EU invests in sustainable fishery policies—and the EU appears to be prepared to do so. Either way, Mozambique should scrutinize any fishery access language in the EPA.

Though it is too late to amend EU-Mozambique Fisheries Access Agreement, it is not too late to ensure that a better access agreement is negotiated during EPA negotiations and with other countries seeking access to Mozambique's waters. For those negotiations, Mozambique should consider a regional fisheries framework agreement that covers policies for resource management; monitoring, control, and surveillance; and post-harvest arrangements.[250]

Summary of Major Constraints in the Fishing Sector

- Mozambique's extensive coastline makes it vulnerable to illegal, unreported, and unregulated fishing.
- Infrastructure, including dispersion of artisanal fishers and communications channels, for handling and distributing fishery products is weak.

[249] Grynberg, Roman. 2003. Fisheries Issues in WTO and ECP-EU Trade Negotiations. Economic Paper 56, Commonwealth Secretariat.
[250] Ibid.

- Poor sanitary conditions, including lack of secure and healthy water supplies, poor personal hygiene, insects and rodents and a hot, tropical climate make certification by competent authorities difficult at best.
- Natural shrimp resources are being depleted, causing Mozambique to limit fishing licenses and institute greater monitoring, control, and surveillance at high cost.
- The capacity of national standards agencies to certify shrimp exports as meeting SPS criteria in developed country markets is weak.
- Facilities at key ports such as Beira and Maputo need to be upgraded.
- The negotiating capacity of the Government of Mozambique is weak, an especially significant constraint given pending EPA negotiations in which fisheries will be a key issue.

Recommendations for Stimulating Fisheries Exports

A variety of studies have recommended ways that Mozambique can support development of exports from the fisheries sector.[251] Some of these recommendations are reflected in the section on tapping export potential across sectors (e.g., improving infrastructure and helping producers understand and meet the needs of foreign markets). Recommendations specific to the fishing sector include the following:

- ***Promote the development of non-traditional marine products such as seaweed farming and shrimp aquaculture.*** Opportunities exist to expand fisheries exports through the development of non-traditional products with demonstrated potential.
- ***Undertake research to identify potential of new species for commercial exploitation.*** Evidence of high-value species, including demersals (haddock, cod, black marlin) and cephalopods (squid and octopus) with strong demand in existing export markets exist. Achieving increases in the value of fisheries exports will depend on identifying and developing species of high-value.
- ***Improve capacity of standards agencies to certify products for export to major markets***. Greater efficiency among regulatory agencies charged with certification of exports will improve competitiveness of Mozambique suppliers.
- ***Develop cold storage and transport capabilities and upgrade shore processing facilities.*** Ice is crucial to the development of the artisanal fishing sector. With it, the artisanal fisher can sell fresh fish, which command a much higher price than

[251] International Fund for Agricultural Development. 2001. Appraisal Report, Sofala Bank Artisanal Fisheries Project.

dried fish. Currently, ice is available in only in a few places along the coast. Access to freezers, refrigerated storage, and refrigerated transport must also be improved if fish are to reach export markets safely.

- ***Undertake research to determine sustainable volumes of fisheries capture.*** Obtaining and updating reliable scientific data on fishery stocks is critical to the sustainable management of high value species such as shrimp and tuna.
- ***Improve regional cooperation with border countries for fishery stock monitoring and surveillance.*** To better monitor the health of fishery stocks and to combat vessels entering Mozambique's waters to conduct illegal, unreported, and unregulated (IUU) fishing, Mozambique should seek cooperation with other fishery agencies.
- ***Develop strategy to combat IUU fishing.*** The large coastline invites opportunities of IUU fishing that can jeopardize the health of managed fishery stocks such as shrimp and diminish opportunities for artisanal fishers.
- ***Build negotiating capacity for fisheries aspects of EPA negotiation with the EU.*** EPA negotiations will include a fishery access component. Mozambique (along with Tanzania, Namibia, and Angola) has a significant interest in fisheries access, so it should build its capacity to monitor, and even lead, discussions on fishery-related aspects of the EPA negotiations.
- ***Participate in a fisheries framework agreement with either COMESA or SADC.***
- ***Improve quality standards and ability to meet SPS requirements.*** Developed country markets for fresh fish have stringent criteria for fresh fish imports. Mozambique must be able to meet these criteria if exports are to continue.

12. Manufacturing

Mozambique's industrial sector, which includes mining, manufacturing, electricity and water, and construction, accounted for 30.6 percent of GDP in 2002. The manufacturing sector, though small, has been growing substantially since 1998, maintaining its share of GDP. Specifically, value added in manufacturing accounted for 10.9 percent of GDP in 1998, and 11.4 percent in 2002. In this chapter we survey the major characteristics of the sector, then examine in greater detail opportunities and obstacles to the development of two subsectors: leather products and apparel.

Overview

Mozambique's industrial sector has three notable characteristics: a very small industrial base; sectoral composition dominated by the output of a single large-scale mega-project; and geographic concentration in the Maputo city area.

While the share of Mozambique's manufacturing output relative to GDP is similar to that of some African neighbors (Table 12-1), the figures here are distorted by production from the $2.2 billion Mozal aluminum smelter that began operating in 2001. Excluding Mozal, the industrial sector is very small. It is also highly concentrated. Based on survey data from MIC, the top ten firms (excluding Mozal) produce more than 67 percent of industrial output (excluding water and electricity and construction). Including Mozal, the top eleven firms account for more than 90 percent of industrial output.

As shown in Table 12-2, manufacturing activity is now highly concentrated in the metallurgy subsector because of the dramatic increase in output from the Mozal aluminum smelter. Excluding aluminum, the main subsectors are beverages and food processing, followed by paper and wood products, textiles and clothing, and chemical products. The beverage industry has grown rapidly, mainly because of investment from large foreign-based companies such as Coca-Cola, South African Breweries, and Parmalat. Paper and wood products have also shown signs of rapid growth.

The industrial sector is also highly concentrated geographically. Table 12-3 shows that the Maputo region accounts for slightly more than 80 percent of all industrial activity in the country. Thus, any increase in productivity and welfare in the industrial sector would favor the Maputo region.

IMPLICATIONS OF LOW PRODUCTIVITY

Mozambique's low productivity, despite very low wages, is undermining its competitiveness. The Ministry of Industry and Trade has reported that capacity utilization of Mozambican manufacturing firms is between 25-30 percent.[252] In a World Bank study of industrial performance, Mozambique was found to have the lowest labor productivity in a sample of eight sub-Saharan African (SSA) countries.[253] The same study found total factor productivity to be very low, at 0.38 on a scale of 0 to 1. The Ministry of Industry and Trade shares these concerns, highlighting productivity problems in a recent quarterly survey of the industrial sector.[254]

Table 12-1
Comparisons of Industrial Sector and Manufacturing Value Added, 2002

Country/Region	Industry Value Added as % of GDP	Manufacturing Value Added as % of GDP
Mozambique	34	13
Zambia	26	12
Namibia	31	11
Malawi	15	10
Tanzania	16	8
Madagascar	13	11
Sub-Saharan Africa	29	15
Low income countries	26	11

SOURCE: World Bank, World Development Indicators On-Line (WDI). WDI figures for Mozambique are not fully consistent with those presented in Table 12-2.

252 Ministry of Industry and Trade, DIC document: Balanço da Produção Industrial Referente ao Ano 2002.
253 Mozambique Industrial Performance and Investment Climate 2003. August 2003. World Bank.
254 Balanço da Produção Industrial – 1º Tremestre de 2003. Ministry of Industry and Trade, Mozambique.

Table 12-2
Manufacturing—Main Subsectors, 1998–2002 (% manufacturing output)

Subsector	1998	1999	2000	2001	2002
Including aluminum					
Food processing	21.8	20.9	15.6	7.7	8.5
Beverages	23.8	28.2	20.0	8.8	10.1
Tobacco	3.0	2.7	1.5	0.8	0.8
Textiles	3.0	7.3	4.4	3.1	2.8
Clothing	5.0	4.5	3.0	1.9	1.6
Wood and cork	5.0	4.5	4.4	1.9	2.0
Paper	7.9	7.3	9.6	5.0	6.9
Chemical products	5.0	4.5	3.7	1.9	2.0
Rubber	3.0	0.9	0.7	0.4	0.4
Metallurgy (except machinery)	2.0	0.9	23.7	69.0	64.5
Of which: aluminum	0.0	0.0	22.2	68.6	64.1
Excluding aluminum					
Food processing	21.8	20.9	20.0	24.4	23.6
Beverages	23.8	28.2	25.7	28.0	28.1
Tobacco	3.0	2.7	1.9	2.4	2.2
Textiles	3.0	7.3	5.7	9.8	7.9
Clothing	5.0	4.5	3.8	6.1	4.5
Wood and cork	5.0	4.5	5.7	6.1	5.6
Paper	7.9	7.3	12.4	15.9	19.1
Chemical products	5.0	4.5	4.8	6.1	5.6
Rubber	3.0	0.9	1.0	1.2	1.1
Metallurgy (except machinery)	2.0	0.9	1.9	1.2	1.1

SOURCE: *Study calculations based on Table 7 from IMF Country Report no. 04/51, March 2004.*

Table 12-3
Spatial Distribution of Industrial Activity

Location	Annual Growth, 2002-2003	% Share 2003
Maputo City	12.1	11.9
Maputo Province (includes Mozal)	42.8	80.8
Sofala	3.1	3.9
Nampula	-11.4	1.7
Manica	13.0	1.2
Zambezia	6.3	0.4

SOURCE: *Ministry of Industry and Trade (MIC).*

Because wages depend fundamentally on productivity, growth in productivity—in Mozambique as elsewhere—is essential for increasing wages and improving worker welfare. Recent studies have found that productivity growth, in general, can account for up to half of economic growth.[255] Thus, for Mozambique, productivity, specifically in manufacturing, is important not only in improving workers' welfare and boosting GDP, but also in winning the bigger battle against poverty.

The linkages are clear. A key factor in determining the destination for such labor-intensive manufacturing investment is the effective cost of labor. In terms of wage rates, as such, Mozambique enjoys a decided advantage at present—its minimum wage of approximately 963,000 *meticais* ($41) per month is much lower than comparable rates in South Africa or Mauritius. If other impediments to doing business in Mozambique were less onerous, the country would have high potential to create jobs by attracting "footloose" labor-intensive industries from elsewhere in the region where wages are rising (such as Mauritius). These industries include garments, footwear, toys, sporting goods, simple electronic assembly, and agro-industries. Location decisions in many of these industries are very sensitive to costs. For example, in the garment industry "a 10% differential can make buyers shift from one country to the next."[256]

Producers, however, consider more than wages in evaluating destinations for labor-intensive manufacturing investment. They consider the "effective cost of labor," which, in turn, is determined by productivity and the wage rate (in international equivalent value). Mozambique is not the only low-wage country in the region that can tap into foreign investments in labor-intensive manufactures. Ghana, Namibia, and Botswana, for example, are also competing for these investments. Given that productivity (and not just wages) is a crucial factor in the investor´s decision, a concerted effort is underway in some of these countries to attract the investment that may be displaced from countries in the region with rising wages. Where wages are equally low, the key variable in this competition is labor productivity rates.

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[255] Productivity Growth and Poverty Reduction in Developing Countries, Centre for the Study of Living Standards, September 2003.

[256] From the text of a speech by Maurice Vigier de Latour, Marketing and International Director of Floreal Group, Mauritius.

Promising Labor-intensive Subsectors

In identifying promising labor-intensive manufacturing subsectors for Mozambique to examine closely as case studies, we considered a variety of criteria:

- Resource base, including location;
- Existence of or potential for upstream linkages to raw material producers;
- Existence of or potential for downstream linkages to national and regional manufacturers;
- Current or recent exports establishing a presence for Mozambican products on regional or international markets;
- Market access opportunities, regionally or globally, resulting from Mozambique's advantaged position under trade agreements and preferential arrangements.[257]

On the basis of these criteria, potential non-agricultural labor-intensive growth subsectors include yarn and fabric; garments; footwear; aquaculture; prepared and preserved fruit, fruit juices and concentrates; wheat and maize flour; wood products; plastic packaging and other plastic products; crude and refined marble; coal; and after-market auto parts. (In the service sector, promising labor-intensive activities include tourism, as discussed in Chapter 13, corridor transport and port services, and call centers and document processing centers.) Significant expansion opportunities exist for exports of footwear and garments to Southern African Customs Union (SACU) and U.S. markets; wheat flour and maize flour to regional markets;[258] finished building products such as doors, parquet panels, and office furniture to regional markets; and articles of plastic to regional markets. Pineapple canning or juicing in Mozambique was deemed promising, both for the South African market and the U.S. market; Mozambique's margin of preference for these products in both markets is more than 20 percent.

Of these subsectors, apparel and leather products ought to be able to show significant increases in exports, if problems with the investment environment are addressed effectively. Mozambique has in the past produced for export in both of these subsectors. In addition, both are labor-intensive, and demand for apparel and

[257] We identified products with high margins of preference (the difference between the most favored nation rate of tariff and the preferential rate) using a margin of preference in excess of 10 percent as our reference point. We considered products from AGOA when they were covered by AGOA but not GSP. We did not consider products under the EU's Everything But Arms preference program—despite their being duty- and quota-free—because the rules of origin under GSP and EBA are the same; therefore EBA access is rarely utilized by Mozambique or other African, Caribbean, and Pacific countries.

[258] Provided a deadlock on rules of origin within the Southern African Development Community (SADC) is resolved.

leather products is significant in foreign markets where Mozambique enjoys preferential access. Although clothing exports have declined in recent years, opportunities provided by AGOA and duty-free access to the South Africa market offer potential for the growth of clothing manufactures in the near term. In addition, negotiations for the WTO Doha Development Agenda (DDA), the European EPAs, and SADC offer significant opportunities for Mozambique to gain market access concessions, such as reduced tariff and non-tariff barriers for industrial and manufactured products.

In the rest of this chapter we examine opportunities and constraints in Mozambique's leather subsector and textile and apparel subsector. Leather manufacturing can be improved by developing backward linkages with local supply and processing and by improving the price competitiveness and quality of local supply. In evaluating the potential viability of Mozambique's textile and apparel industry we consider major changes in global markets and evaluate three critical industry dynamics: (1) markets for Mozambican textiles and apparel and changing market access; (2) Mozambique's business environment; and (3) vertical integration of the textile and apparel industries. We also recommend actions for promoting Mozambique's textile and apparel production and exports that could be implemented by the Government of Mozambique and aid donors and/or technical assistance providers.

Leather Products

Mozambique's exports of raw hides and skins have risen dramatically since 2000—nearly 100 percent in the last year alone. Footwear exports, however, have declined steeply, dropping from US$338,000 in 2000 to a little over US$1,000 in 2003 (Table 12-4). Leather products and footwear manufactured for export from 2000 to 2002 used locally obtained and imported material. Products assembled from local material went largely to Malawi and Zambia under COMESA preferences; products assembled from imported material were exported to South Africa and Europe. In 2003, footwear was exported only to Angola (approximately 1,000 pairs of shoes) using leather products imported from Portugal.

Table 12-4
Footwear and Other Leather Exports from Mozambique, 2000-2003 (US$ 1,000)

Export Item	2000	2001	2002	2003
Raw hides and skins and leather	21.6	60.0	111.3	227.2
Articles of leather	0.0	2.0	11.5	0.1
Footwear	338.5	203.3	9.1	0.1
Total	360	265.3	131.8	227.4

SOURCE: INE.

Though Mozambique's exports of raw hides and skins have increased dramatically, much of these exports are destined for Portugal, where they are processed and then imported back into Mozambique for manufacture of shoes and leather products for the local market. Mozambique has one leather manufacturer but the company is not able to produce leather of sufficiently high quality at a competitive price to meet the requirements of footwear manufacturers. Reportedly, the local supplier can supply leather at approximately US$1.20 per square meter whereas imported leather can be purchased at approximately US$0.70 per square meter. If Mozambique is to produce leather competitively, backward linkages to local hides, skins, and tanning should be investigated.

Only two footwear manufacturers exist in Mozambique: Peter Industries, which produces industrial footwear, and Ipanema, which produces fashion and regular footwear. Peter Industries depends heavily on government contracts and ties sales of its footwear to sales of its uniforms. The company has been hurt severely by less expensive footwear imported from China and is struggling to compete. At present, it does not export products but believes that if it is certified by the South African Bureau of Standards (SABS), it will be able to export to South Africa. The current margin of preference for Mozambican suppliers under SADC is 20–30 percent.[259] The National Institute for Standards and Quality (INNOQ) should work with Peter Industries to help it obtain SABS certification as soon as possible.

In contrast, Ipanema is successfully producing shoes for the domestic market. In 2003, the company produced approximately 24,000 pairs of men's, women's, and children's shoes and about 5,500 wallets and belts. Ipanema's factory, which began operations in May 2004, has an installed capacity of 28,000 pair of shoes per month (in three shifts). The company, however, has no interest in exporting to regional or

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[259] Footwear is included in AGOA, providing affording a 20–37 percent margin of preference in the U.S. market. Footwear is not included on GSP; therefore AGOA gives SSA suppliers a margin of preference over Asian suppliers.

international markets. Greater awareness of export opportunities might convince Ipanema to attempt to take advantage of those opportunities.

Mozambique's leather subsector stands to benefit from a number of worldwide trends and local developments. Worldwide demand for hides, skins, leather, and leather products remains strong.[260] The world's footwear and leather products sector is increasingly interested in relocating from high-cost industrialized countries to lower-cost developing countries, such as Mozambique, because the production of leather and leather products is labor-intensive. In recent years, Mozambique's livestock herds have increased substantially, offering significant opportunity to strengthen its leather products sector. New preferential access to the South African, U.S., and EU markets should allow Mozambique to reverse its decline in exports. The country still needs even greater access to foreign markets, so it should make reductions in tariffs on leather products a high priority in the current round of multilateral trade negotiations. Meanwhile, Mozambican producers will need to take steps to meet the quality and marketing demands of importing countries. The government should also seek new investment in the footwear industry because it has significant potential for exports and for employment in Mozambique.

Textiles and Apparel

The apparel sector generates the most unskilled manufacturing employment in the world. Like other light and medium manufacturing industries, it can lift large segments of the population out of the informal sector's subsistence wages and urban and rural poverty. It can also employ some of the most disadvantaged members of society, including young uneducated workers with few options. While statistics are scarce, workers in the apparel industry are often the sole sources of income for their households, in effect forming the essential component of the informal safety nets that keep even larger portions of the population from sliding into deep poverty. It is therefore crucial that Mozambique consider carefully the potential viability and promotion of the sector, along with the related, but generally much more capital-intensive textile (yarn, fabric, dying) sector.

For the past 30 years, quotas have affected textile and apparel trade in U.S. and EU markets. These quotas have guaranteed many smaller, less competitive countries

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[260] The global value of production of hides and skins exceeded US$14.5 billion in 2000 and the value of world leather production was estimated at about US$28 billion. The value of leather footwear was approximately US$70 billion in 2000.

access to these markets. Tax incentives and efficient export processing zones led transnational apparel producers seeking to avoid the high costs of purchasing quotas in more competitive locations to invest in less competitive countries. In late 2000,[261] AGOA gave these producers a new incentive to locate in the most remote regions of SSA: high quota caps along with duty-free treatment for apparel meeting liberal rules of origin. Small, relatively remote countries such as Lesotho and Swaziland quickly implemented programs to attract the largest transnational firms whose investors were often of Asian origin.

Transnational producers that invested early were assured nearly five years of exports before the elimination of textile and apparel quotas on January 1, 2005, under provisions of the WTO Agreement on Textiles and Clothing. Their remaining in Africa after 2005 depends on their ability to use third-country fabrics and yarns (i.e., fabrics originating in neither the United States nor in SSA)—something which is permitted under an AGOA waiver provision that will expire in September 2004. Their remaining in Africa also depends on their ability to source competitively priced fabrics regionally. Many firms are expected to leave less competitive African countries after quotas are eliminated. Mozambique, a latecomer to the industry, must come to grips with this uncertain environment and it must do so on the verge of fundamental changes in global market conditions—like the elimination of quotas.

At present, Mozambique's formal production capacity for apparel exports is extremely limited. One medium-sized factory with about 500 employees in Beira produces most of the clothing currently exported from Mozambique to the United States and South Africa.[262] Aga Khan Development is seeking to set up a basic cut-and-sew training facility near Maputo and is planning to import some used sewing machines for this purpose. Aga Khan also intends to begin producing from a large cut-and-sew operation near Maputo as early as 2005. It intends to employ 2,000 production workers and has plans to begin operations with 1,000 sewing machines. Affiliated Aga Khan companies in eastern and southern Africa sell to Sara Lee, Wal-Mart and J.C. Penney.

Upstream fiber and textile capacities are even less developed, although Mozambique once had as part of its colonial industrial base a vibrant textile industry.[263] Today's

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[261] Because countries had to obtain special visas from the U.S. government through a lengthy certification process, the first SSA countries did not obtain benefits before the first quarter of 2002.

[262] Two former exporters to the United States have closed their doors: Magin and Umar Textiles. Umar's contract with U.S. vendors was expanded, but several "red tape" problems affecting production and shipments, and a desire of the parent firm to produce in one African location, caused the firm to leave Mozambique.

[263] World Bank. 2001.

capacities include (1) 40,000 tons of raw cotton production per year; (2) cotton ginning facilities and about 90,000 spindles that are in disrepair and not operating; (3) approximately 200 weaving looms that are at least 20 years old and in various states of repair; and (4) printing equipment that stands idle. Vacant buildings are available around the country but usually lack proper ventilation, insulation (from heat), and reliable supplies of water and electricity.

Major markets for apparel have been moving toward shorter cycles for development, production, and delivery. This trend is driven by the rapid rationalization (reduction) of retailer's inventory costs, which include markdowns on unsold merchandise. The elimination of quotas is expected to accelerate this trend. This trend puts Mozambique at a distinct disadvantage because it is more than 30 days' ocean shipping time from major developed markets. Moreover, scheduled airfreight links to major markets are non-existent. These limitations will define the types of products for which Mozambique can compete against other suppliers. Producers locating in Mozambique will likely have to specialize in standardized apparel with few short re-order requirements (e.g., men's trousers and shirts, men's and women's knit tops, underwear, pajamas). Competition for the production of these products in a quota-free world is expected to be keen.

FOREIGN MARKET ACCESS

In the past, SSA countries could rely on textile and apparel orders arriving on their shores because quotas in the U.S. and EU markets constrained Asian producers.[264] Global trade in textile and apparel products, however, is beginning to be affected by the elimination of textile and apparel quotas; shifting preferential arrangements (including AGOA and other FTAs); the accession of China to the WTO in December 2001; and the rise of trade remedies, such as safeguards and anti-dumping duties. For example, buyers who source apparel from producers with liberal quota access to developed country markets will soon source from producers that are cost-competitive and efficient and that can guarantee that products reach the market reliably and rapidly. If Mozambique pursues policies that support the development of apparel and/or textile industries, those policies should promote market fundamentals, such as efficient infrastructure, customs, and regulations, rather than preferential access.

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[264] See Cline 1990; Minor, 2002; and U.S. International Trade Commission, 2004.

Major Developed Markets

The terms under which textile and apparel products from Mozambique and elsewhere enter developed economy markets are going through a period of exceptional uncertainty and change. Preferential trade arrangements, such as AGOA and the African, Caribbean, and Pacific Islands (ACP)/Cotonou Agreement, have motivated the bold and aggressive development of regional textile and apparel industries. Incentives include zero tariffs and near quota-free access to U.S. and EU markets. Even so, the elimination of textile and apparel quotas on January 1, 2005, will likely have a negative impact on apparel exports from SSA countries, including Mozambique,[265] because it will nullify a primary reason for apparel producers locating in SSA: to gain entry to developed markets with quota restrictions constraining entry from the producers' home base or existing production locations.

Uncertainties associated with the remaining tariff preferences compound the uncertainties arising from quota elimination. The U.S. AGOA and EU Cotonou arrangements are unilateral preference programs, so the United States and the EU can change them unilaterally. The recent and intense debate over extension of AGOA benefits beyond their originally envisioned expiration dates demonstrates the uncertainty inherent in unilateral preference programs and the potential effect of that uncertainty on beneficiaries.

Under AGOA's standard rule of origin, apparel assembled in SSA from fabric wholly formed in SSA from U.S. or SSA yarns is eligible for duty- and quota-free treatment. More liberal than its standard rule of origin, AGOA's special rule for least-developed countries (LDC) permits such beneficiaries to use fabric and yarns that are not from the United States or SSA in their AGOA apparel exports to the United States. President Bush signed AGOA III legislation in mid-July 2004, extending the AGOA special rule until September 2007 and the standard rule until September 2015.[266] Because Mozambique has extremely limited textile capacities and is only now developing regional supply linkages, its ability to meet AGOA's standard rule of origin is questionable. Expiration of the AGOA special rule for LDCs in September 2007 would, therefore, eliminate a key benefit of AGOA for Mozambique. Nonetheless, a three-year window has opened again for Mozambique to integrate into a regional supply chain by adding value to cotton it produces. Yarn from regional sources will be important to regional garment producers.

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[265] USITC, 2004.
[266] The quota under the special rule will be reduced by 50 percent in the last year, falling to 1.178 of U.S. consumption.

Mozambique's exports of apparel to the EU enjoy tariff-free entry to the EU through the ACP / Cotonou Agreement and the EU General System of Preferences (GSP) program for least-developed countries, also known as Everything But Arms (EBA).[267] The ACP / Cotonou Agreement is perhaps the more generous of the two programs because its rules of origin permit Mozambique to export duty free to the EU apparel constructed from regional fabrics and yarns (e.g., material from Mauritius).[268] The EBA program does not permit the use of such regional fabrics and yarns in qualifying for duty-free entry to the EU. Set to expire in 2007, the ACP / Cotonou Agreement will be replaced by EPAs that the EU is negotiating with countries and regional groupings that have preferential access under the Cotonou Agreement. If Mozambique does not conclude an EPA by 2007, its preferred access to the EU will be governed by the EBA program which does not permit the use of regional fabric. Mozambique's textile capacities are extremely limited so the rules of origin that govern its access to major markets are critical to Mozambican apparel producers.

The elimination of global textile and apparel quotas will end two major benefits of preferential access that many African countries have enjoyed under AGOA and the ACP / Cotonou preference program. Both generally provide quota-free access and tariff-free treatment for apparel meeting their rules of origin.[269] Asian competitors incur costs for purchasing quotas that vary by product, but SSA countries do not because they are not constrained by quotas. Nor do SSA exporters pay MFN tariffs if they meet U.S. rules of origin. Tables 12-5 and 12-6 list these costs (quota and tariff costs) for the U.S. and EU markets for several leading apparel products, including cotton trousers and knit shirts, which comprised almost three-quarters of U.S. and EU imports from SSA countries in 2002. Together, the cost of purchasing U.S. quota and U.S. MFN tariffs constitute a margin of preference on SSA cotton trousers of more than 60 percent. More than two-thirds of this benefit is derived from the quota costs. Thus, in effect, two-thirds of Mozambique's potential margin of preference in the U.S. market for apparel will be eliminated on January 1, 2005.

Although the cost of quota will be eliminated and the margin of preference reduced accordingly, Mozambique can still exploit its tariff preferences in EU and U.S.

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[267] EU GSP and EBA rules of origin are being revised this year.

[268] South Africa is not an ACP country, so the use of South African yarns and fabrics does not qualify apparel constructed of these materials for tariff relief under ACP \ Cotonou. A special provision for the use of South African yarns and fabrics is in the ACP \ Cotonou arrangement, but it has never been implemented through legislation in South Africa and ACP countries.

[269] The EU agreement does not support the use of third-country yarns (except in exceptional cases) and the status of the AGOA third-country fabric derogation is uncertain.

markets. For example, apparel constructed from manmade fibers, including synthetic and artificial fibers, will maintain a margin of preference in excess of 30 percent in the U.S. market. U.S. buyers have indicated that they will likely seek out preferential suppliers for these products where tariff savings are substantial and not offset by other costs.[270] Table 12-7 presents manmade fiber apparel products for which tariffs will remain as a significant benefit of preferential access. Table 12-7 also presents corresponding tariffs on products made mainly of cotton fibers.

Table 12-5
Average Tariff Equivalents of Quotas and MFN Tariffs for Selected Categories of Apparel Imported into the United States, 2002

Product	Cost of Purchasing Import Quotas for China, Hong Kong, and India Producers (% of factory gate prices)	Weighted Average of MFN Tariff [a]
Cotton trousers	44	17
Cotton underwear	17	10
Synthetic trousers	18	28
Cotton knit shirts[b]	32	18
T-shirts and tank shirts	12	17
Knit shirts	43	18

[a] *MFN tariffs are the duties that WTO members pay. These are averages because each category represents many products for which duties vary.*

[b] *Quotas for China and Hong Kong are subdivided into T-shirts and tank shirts and all other knit shirts of cotton Quota costs for China and Hong Kong are calculated by the author from public auction quota action data. Data for Indian quota costs are from Kathuria and Martin 2001.*

Table 12-6
Average Tariff Equivalents of Quotas and MFN Tariffs for Selected Categories of Apparel Imported into the European Union, 2002

Product	Cost of Purchasing Import Quotas for China, Hong Kong, India Producers [% of factory gate cost]	Weighted Average of MFN Tariff
Shirts T-shirts lightweight fine knit roll polo or turtle necked jumpers and pullovers	23.2	12.0
Men's or boys' underpants and briefs cotton or synthetic knit	8.9	11.6
Cotton and synthetic trousers and shorts	19.0	12.1
Babies' garments and clothing accessories other than knit	15.9	11.5

SOURCE: *Author's calculations.*

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[270] USITC 2004 and author's interviews of buyers.

Unfortunately, the opportunity for bold and aggressive steps to attract international producers has passed for SSA and Mozambique. Subsidizing large transnational textile or apparel producers in order to attract them to Mozambique may not be justified because of the market risks and fundamental costs associated with doing business in SSA, including long transit times to major developed markets, corruption, and government red tape.[271]

Table 12-7
U.S. Apparel Imports, 2003

Product	Cotton Fiber		Manmade Fiber	
	World Imports (Million US$)	MFN Tariff	World Imports (Million US$)	MFN Tariff
TROUSERS, BREECHES, AND SHORTS				
Knit	1,267.2	~15.5	937.1	28.2
Woven	10,115.5	16.6	2,203.1	~28.3
SHIRTS AND BLOUSES				
Knit	2,196.0	20.0	624.5	32.0
Woven	3,434.9	~17.6	1,364.5	~26.4
DRESSES				
Knit	137.3	11.5	173.0	~15.5
Woven	220.0	8.4	708.7	16.0
NIGHTWEAR, BATHROBES, AND PAJAMAS				
Knit	765.3	~8.9	467.8	16.0
Woven	365.2	~8.9	220.7	16.0
COATS, OVERCOATS, CAPES, AND WINDBREAKERS				
Knit	414.1	15.9	429.8	28.2
Woven	89.4	8.9	101.0	27.2
Average \ Total	19,004.9	13.2	7,230.2	23.4

"~" indicates average values since there are often small variations in tariffs within product categories that do not amount to more then 5 percent of the average tariff value.

SOURCE: US Harmonized Tariff Schedule, 2004 – http://USITC.gov.

[271] USITC 2004.

Differences between the EU and U.S. markets are important. For example, the costs of EU quotas are estimated to be about half that of the U.S. quotas.[272] The range of EU duties, 10-12 percent, is narrower than that of the U.S. duties.[273] In addition, the U.S. AGOA special rule of origin for LDCs permits the use of “third-country fabrics” (i.e., fabric from other than SSA and the United States); by contrast the ACP/Cotonou arrangement requires “two-stage transformation. This means that fabrics must go through two stages of transformation: be “formed” as in knit or woven and then “made-up” into a garment in one or more of the ACP countries. Further, AGOA permits cumulation of origin within SSA, including with South Africa while the ACP/Cotonou agreement effectively does not permit the cumulation of yarns and fabrics from South Africa, an important regional supplier of textiles, with those sourced from ACP countries. The U.S. market usually requires producers to meet higher minimum orders, and U.S. quality requirements are, on average, higher than those imposed by EU buyers. Channels of distribution in the United States are dominated by large buyers, such as K-Mart, Gap, Sears, and J.C. Penney, but in the EU smaller chains fragment the market and provide more opportunities for niche products and producers.

The advancement of U.S. and EU regional trade agreements will also affect Mozambique’s market access for apparel products. The United States has concluded negotiations for free trade agreements (FTAs) with several countries that have significant apparel production, including five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua), the Dominican Republic, and Morocco. Negotiations involving other countries with significant apparel industries from the Andean region, Thailand, and the Southern African Customs Union (South Africa, Botswana, Namibia, Lesotho, and Swaziland) could soon yield similar agreements with the United States. The EU is also proceeding with its EuroMed program by inviting North African, Middle Eastern, and Eastern European countries into a PanEuro free trade area. Free trade partners of the U.S. and EU markets seek to combine permanent duty-free access to these markets with new rules of origin permitting the use of yarns and fabrics from within expanded regional blocs. These blocs will then be able to attract investment that might otherwise have located elsewhere.

While the pace of these agreements and their impact on SSA countries are hard to predict, they do increase the number of duty-free competitors to be confronted in those markets and will only increase competitive pressures and decrease the

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[272] Kathuria 2001 and Minor 2003.
[273] Minor 2003 and Minor and Velia 2004.

advantages of duty-free access. They will also make it all the more imperative for would-be competitors to get products to destination markets quickly and reduce barriers to investment and doing business.

Protective measures, such as safeguards and anti-dumping (AD) and countervailing duties (CVD), will be on the rise and their effects will be uncertain and, perhaps, short-lived.[274] While safeguards and AD/CVD actions against large apparel-producing countries such as China and India may provide Mozambique an opportunity to export in the short run, Mozambique should not depend on these measures to access markets because (1) the terms of a textiles safeguard against China will end in 2008, after which normal safeguard rules under the WTO Agreement on Antidumping and Countervailing Duties will prevail for all WTO members; and (2) capable and efficient suppliers are abundant and might not be the target of AD/CVD actions.

Although AGOA III legislation has extended the LDC fabric provision to 2007, the provision cannot be extended a second time. This final extension provides just three years of incentives for transnational firms to locate in Mozambique before the third-country fabric provision is revoked. Apparel producers usually require 2-3 years of production at a new location to justify the expense of starting operations there. Each day that passes weakens apparel producers' willingness to invest and locate in Mozambique. Therefore, a garment promotion program should take into account the regional availability of competitively priced fabrics and yarns that meet stringent international requirements. Building links with regional suppliers of fabric and yarn, including other members of SADC, could prove to be a significant competitive advantage to a potential apparel industry in Mozambique.

Other Markets

Potential markets for Mozambique's textiles and apparel should include not only the United States and the EU, but also regional markets such as SADC and local markets in Mozambique. Regional markets can be more secure and offer more potential than traditional markets. And replacing current imports with domestic and regional products in a competitive and open market can provide another growth opportunity for a nascent apparel industry. Malawi, for example, exports nearly 20 million dollars in textiles and apparel to South Africa alone.

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[274] The special textile safeguards included in China's WTO accession agreement will expire at the end of 2008, if applied.

LOCAL BUSINESS ENVIRONMENT

The opportunity to capitalize on the advantages offered less-competitive producers by the global quota regime has been extended only briefly.[275] Mozambique still has some of the business elements sought by world-class apparel producers: abundant low-cost labor; port and shipping access; and a stable government and economy. Mozambican producers, however, will have to compete with producers operating in superior business environments. Such environments are characterized by flexible labor laws that support the rights of workers but permit shift work, retrenchment, and employment of foreign workers, especially skilled middle managers; customs offices that clear imported materials and supplies on a duty-free basis in less than 24 hours; customs offices and ports that clear and load finished products in an environment free of corruption and secure against terrorism; reliable and swift ocean and air transportation networks; access to capital and equipment on a tariff-free basis; freedom from excessive red tape; and a skilled, trained, and productive labor force.

The best way to encourage an export-oriented apparel industry in Mozambique is to put in place government policies that promote transparency; reduce the risks and uncertainties of starting a business for local, regional, and foreign investors; and promote productivity, innovation, and incentives for the labor force.[276] Such policies would also encourage development and growth in a broad range of industries and services.

If Mozambique decides to pursue policies to develop textile and/or apparel industries, it will also need to attract foreign investors. This will require ensuring rapid and consistent clearance of goods through ports and customs offices. Garment producers, who are subject to the rigorous demands of retailing, are very dependent on supply chains. Indeed, a one-day delay in shipping in the international garment industry is estimated to be equal in cost to a tariff of 0.8 percent.[277] Because Mozambique is, at best, 30 days by ocean freight (Maputo-Durban-New York) from the U.S. market, it is at a distinct disadvantage compared to East Asian suppliers (12 days) and regional suppliers (3-12 days). In other words, Mozambique's location

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[275] With the certainty of 3-5 years of nearly guaranteed access to the U.S. and EU markets based on quotas, some SSA countries, such as Namibia and Lesotho, have offered generous subsidies and investment incentives to textile and apparel investors to locate in their countries. With the impending expiration of these quotas, however, investors face considerable risk in recouping even part of these investments. Recent research by the U.S. International Trade Commission in these countries indicates investment in garment production has received considerable attention, but not in textiles (USITC 2004).

[276] Buyers and retailers in the United States revealed that these issues strongly affect the decisions of foreign investors in the textile and apparel industries (USITC 2004).

[277] Hummels, 1999.

alone can negate its tariff advantage in the U.S. and EU markets. It is therefore essential that hindrances within the control of Mozambique's producers and government—customs, red tape, transportation—be reduced because they can quickly render Mozambique's products non-competitive.

The reliability of shipping times is also of concern. It can take 1–17 days for goods, imports or exports, to clear customs in Mozambique.[278] Goods that arrive late in the major markets are often subject to severe discounts and orders not received on time can be cancelled. How important is it to get garments to market on time? Even Asian suppliers, who are closer to the U.S. market than Mozambique, airfreight one-quarter or more of their U.S. shipments. Table 12-8 lists some major garment suppliers to the U.S. market and the proportion of their shipments sent by air as well as the costs of ocean and airfreight.

At present, airfreight carriers to major developed markets do not call in Maputo under normal circumstances. This means that goods need to be shipped to the nearest airport capable of air freighting garments. Reportedly, this is not feasible because the movement of goods (even for export) across the South African border requires payment of duties and VAT taxes. These are rebated 90 days after proof of onward shipment is provided to South African officials. This process can tie up scarce working capital for long periods. Therefore, access to regional airports, with scheduled air freight capabilities needs to be secured, but without burdensome costs and bureaucracy.

Another impediment to the development of competitive textile and garment industries in Mozambique is its inflexible labor laws. The world market for apparel is in constant flux. Buyers frequently cancel orders or place large re-orders if realized commercial sales clear shelves more rapidly than anticipated. At the same time,

Rigid Labor Laws Hasten Textile Mills' Demise

As recently as the late 1990s, Mozambique had one of the largest textile mills in Africa, as well as several thriving apparel firms. These mills and factories have, with few exceptions, all closed.

The beginning of the industry's demise can be traced to labor laws enacted in 1991. These retroactively required employers to pay employees' social benefits. Another provision, in the same law, reduced the length of the work day to a single shift. Without multiple shifts of workers, factory productivity declined sharply and production costs rose.

Today, most of the equipment and facilities that were once part of a vibrant textile industry are in disrepair. Ironically, labor laws intended to benefit workers ultimately cost those workers their jobs.

[278] Local sources report that in exceptional circumstances, Mozambique customs will work extra hours and weekends to meet a shipper's schedule. At the same time, if paper work or a shipment's status is not in perfect order, delays can be excessive.

producers of textiles inputs also require flexibility. Even under the best of circumstances they must run expensive capital equipment for extended periods, pausing only for maintenance or to switch patterns and designs. Running machinery through multiple shifts allows them to meet surges in demand

Table 12-8
Ocean Vessel and Air Freight Shipments and Charges, 2002

Country/Region	Average Charge (% f.o.b)		Percent of Shipments by Air
	Ocean	Air	
Dominican Republic	1.6	4.5	8.7
Haiti	1.8	6.2	8.1
El Salvador	2.0	5.9	6.5
Nicaragua	2.8	4.8	11.1
Honduras	1.9	8.0	2.7
Guatemala	2.5	8.1	10.0
Costa Rica	2.4	4.7	7.6
Mexico	2.2	5.6	2.0
Argentina	6.9	11.8	33.4
Brazil	7.0	10.0	39.3
Colombia	1.6	4.3	56.3
Ecuador	5.0	15.3	36.3
Peru	2.6	7.2	41.5
Bangladesh	5.3	22.9	11.3
China	3.6	11.1	24.3
Hong Kong	2.8	12.4	24.0
Indonesia	4.2	17.0	17.0
Sub-total Asia	4.2	17.0	17.0
Kenya	4.5	20.3	19.3
Lesotho	4.3	18.5	16.5
Mauritius	4.1	14.4	27.6
South Africa	5.1	17.1	18.2
Subtotal Africa	5.1	17.1	18.2

SOURCE: *U.S. Bureau of the Census, Imports of Merchandise Trade, 2002.*

with higher operating rates rather than risky investment. Higher operating rates and profits, in turn, encourage investment and capacity expansion. Clearly, apparel and textile suppliers require a flexible labor environment, wherein workers are permitted to work multiple shifts (even for a premium) and hiring and retrenchments can take place in accordance with the performance of the industry and supply and demand (most producers retrench labor very reluctantly because the hiring process imposes high costs).[279]

Under Mozambique's laws, however, it is difficult to hire foreign managers, difficult to have employees work overtime and in shifts, and costly to retrench workers. Producers, for example, must make large severance payments if a worker is retained for more than two years.[280] Retirement and retrenchment laws are most often cited by local industry representatives as the reason for the poor conditions of the textile and apparel industries. High absentee rates and worker turnover, encouraged by laws discouraging retrenchment, can also deter international investors and will erode the competitiveness of Mozambican firms competing against imports. Retirement and unemployment pay might be feasible under a government tax system that is on a pay-as-you-go basis and a proportion of the worker's wage. At the same time, international investors will also be checking the credibility of Mozambique's government institutions and whether it has laws guaranteeing that international labor standards are being met.

TEXTILES AND VERTICAL INTEGRATION

Integrating a local textile industry with a garment industry may be the single most important strategy for the competitive production of apparel. Vertical integration can

- Reduce lead times for materials,
- Lower materials costs, and
- Meet rule-of-origin requirements for international trade.

Vertical integration, however, poses challenges. The local textile industry must be experienced in producing high-quality, cost-competitive fabrics and responding to the needs of local apparel producers. If a local textile industry is poorly managed, under-funded, outdated, and unresponsive, local apparel producers are forced to buy textiles from foreign sources and suppliers and government institutions end up providing subsidies and other support to the local textile industry. The end result is a less competitive textile and apparel industry.

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[279] Labor codes of conduct for many branded apparel companies permit a 48-hour work week with up to 14 hours of overtime (compensated at a higher rate).

[280] Supposedly this requirement can be easily circumvented by periodically retrenching experienced workers and then re-hiring them later. Clearly, this is not the best way to train and retain qualified staff capable of greater productivity and management.

Materials often account for half the cost of a piece of clothing. If locally produced textiles are costly the advantages of preferential access erode rapidly. When EU and U.S. market quotas are eliminated, the development of local textile industries can no longer be underwritten by high-cost and low-quality garments being sold in those markets. An integrated textile and apparel industry should not be discouraged, but market forces, and perhaps foreign investors, are better able to cope with the risks and uncertainties of this capital-intensive industry; merely having a cotton crop does not guarantee success in textiles. Instead, success will be more readily achieved in an economy that supports manufacturing with appropriate laws and regulations and minimal red tape. SSA producers note that downstream integration of cotton into competitively priced yarns and fabrics that can be made into garments poses significant challenges. This observation is borne out by data on South Africa's imports of cotton fiber and textiles in 2003 (Table 12-9). More than three-quarters of South Africa's raw and semi-processed cotton imports are from regional producers, but less than half of its cotton thread and yarn and less than 10 percent of its fabric are imported from regional producers. With weaving capacity in place, South Africa and Mauritius have an incentive to work with regional fiber and yarn suppliers to increase their AGOA-eligible exports. Less than half of each country's apparel exports meets AGOA rule of origin requirements.

Table 12-9
South Africa's Imports of Cotton Fiber and Textiles, 2003 (US$ millions)

Import Item	Zimbabwe	Mozambique	Zambia	India	China
Raw and combed cotton	32	3	34	0	0
Cotton yarn and thread	9	0	0	9	1
Cotton fabrics	3	0	0	3	24

SOURCE: South African imports from GTIS data systems.

The challenges and opportunities facing SSA textile producers are perhaps best addressed through regional cooperation that capitalizes on the comparative advantages of each SSA and SADC country.[281] Under such an approach, Mozambique would improve the productivity and quality of its cotton crops, at first selling raw materials to South Africa. It could then integrate into the spinning stage, if practical. Processed cotton and yarn could then be shipped to South Africa for weaving and dying of export-quality fabrics (a capital-intensive process). The fabrics could then be made-up by Mozambican garment producers and shipped to end

[281] Coughlin *et al.*, 2001.

markets through South Africa or directly. This approach has many variations. For example, if water and electricity were plentiful and reliable for Mozambican garment producers, they could integrate into knit fabrics because globally competitive knitting operations can be established almost anywhere with minimal support from skilled operators. The success of this approach depends on regional producers cooperating to ensure that the entire value chain is cost-competitive and driven by market forces, leveraging all the strengths of the region. Without such cooperation, vertical integration, on anything but a small or niche scale, is unlikely to succeed.[282]

In addition, it is unlikely that Mozambique's textile machinery, long left idle, can be brought back to highly productive, quality, and cost-effective production for its most important intended purpose: to meet U.S. and EU rules of origin. It could, however, prove useful in production of specialized apparel with unique local prints and designs for the domestic market (import substitution) and regional markets. For example, existing printing equipment could be used for unique styles and designs. Printing that adds sufficient value to fabric can qualify non-regional fabric for preferential access to the EU. (This is an exception to the EU-ACP rule of origin which requires that fabrics be constructed in an ACP country to receive duty-free access.) Even a strategy of producing cost-competitive fabrics for local markets will be difficult to implement if financing, red tape, and labor law constraints are not addressed. The recent failure of Mozambique's textile and garment firms demonstrates this.

RECOMMENDATIONS

The pending elimination of U.S. and EU textile and apparel quotas and the uncertainties of preferential trade agreements have severely narrowed Mozambique's opportunities for attracting foreign textile and garment producers. The new trade environment for textiles and apparel will be based on business fundamentals: low costs, high quality, rapid service, and remaining tariff preferences and rules of origin. The ability to capitalize on the quirks of the global textile regime by attracting investors eager to capture sales to quota-restricted markets is a fast fading virtue. Instead, Mozambique will be best served by improving its business

[282] Novel Denim, one of the largest transnational producers of denim and chino products in SSA, has continuously scaled back its production lines and has cited in its profit and loss statements operations in South Africa as the source of large losses. "Rationalizing" its South African operation in 2005 is a major objective of Novel's recent corporate strategy. Local producers of textiles in South Africa report a narrowing of product lines to reap the advantages from specialization, including cost reductions.

environment. We therefore recommend the following actions to promote the production and export of garments in the next three to five years:

- ***Encourage micro, small, and medium enterprises in the apparel sector to service local consumer demands and institutional buyers*** (e.g., school and government uniforms) through worker training (cutting and sewing), better access to micro-enterprise loans and financing for fabric purchases, and low import duties on materials.
- ***Create an apparel industry task force to identify and prioritize requirements and recommendations for improving the business environment***. Recommendations for improving the environment for textile and apparel industries should be based on metrics of best practices in the global market. This will likely require devising reforms addressing a wide range of issues, including those that concern apparel producers (e.g., shipment times, labor laws, red tape).
- ***Seek to attract several medium- to large-scale foreign apparel firms (500–2,000 employees) to invest in Mozambique***. These firms will probably have to be located near the best ports to ensure minimum and reliable shipping times. Once these firms are successfully established, an aggressive marketing campaign could lead to a self-sustaining apparel industry.
- ***Support development of a strong apparel industry association***. The apparel industry is demand-driven and the requirements of buyers are sure to change, even over the near term. A strong industry association will be an important bridge between industry and government to ensure that regulations and government services continue to be responsive to market requirements.
- ***Support the improvement of value addition at the level of raw cotton production and spinning***. The productivity and quality of cotton crops needs to be improved. The development of downstream textile production (fabrics) should be based on business fundamentals (e.g., access to reliable and cheap water and electricity, access to capital, transportation, skilled workers).
- In the near term, address strategic concerns about access to textiles by ***building links and partnerships with regional textile suppliers*** and ensuring that regional trade agreements, such as ACP / Cotonou, continue to permit the use of regionally available materials.
- ***Explore the role that regional producers of manmade fabrics could play in global investment and marketing efforts***. Apparel products of manmade fiber fabrics offer a particular advantage in the form of higher–than-average U.S. duties (on average 10 points higher than for apparel made of natural fibers).

- ***Encourage private interest in establishing an increasingly vertical cotton-to-garment textile and apparel industry.*** This approach, which emphasizes demand pull rather than supply push, is appropriate for an industry entering a highly competitive market driven by markets and buyers' needs rather than product availability.

13. Tourism

Until the early 1970s, Mozambique was a premier tourism destination, rich in cultural heritage, natural beauty, and wildlife. Decades of armed conflict destroyed much of Mozambique's tourism infrastructure and severely depleted its wildlife resources, especially large animals on nature reserves. Since the 1992 peace accord, the economy has grown steadily and investment in the tourism sector has increased. Tourism arrivals continue to rise and are returning to levels of visitors typical of the colonial period; approximately 400,000 tourists visited Mozambique in 2001. The government's strategic planning and recent institutional changes[283] affecting the sector demonstrate that Mozambique is committed to protecting its coastlines, implementing conservation policies, and using tourism responsibly as an instrument of poverty alleviation and general economic growth.

Mozambique has all the ingredients of an exciting tourism destination. Development of the sector, however, is constrained by poor infrastructure; expensive and low-capacity transportation; weaknesses in other service-related infrastructure, including air transport (Exhibit 13-1); lack of skilled human resources; weak institutional capacity; and poor regional and international marketing. Mozambique could once again be a premier tourist destination in southern Africa if it strengthens related institutions and invests heavily in product development, infrastructure, and marketing.

In this chapter, we describe opportunities for and constraints on the development of Mozambique's tourism industry and provide recommendations for further

[283] Since 1994, the Government of Mozambique has adopted policies and passed legislation to improve natural resource management and other areas related to tourism. The Ministry of Tourism (MITUR) created in 2000, has two instruments to guide development of the tourism sector during the next decade : the National Tourism Policy and Implementation Strategy (approved in 2003), and the Strategic Plan for the Development of Tourism in Mozambique (SPDTM), which is likely to be approved in 2004.

developing the sector while ensuring sustainable growth. We also summarize current and planned donor projects in the sector.

Exhibit 13-1
Domestic Services –Critical Input to an Efficient Economy

Mozambique's service sectors have long played a key role in the economic activity of the country and of the region. Its transport and energy systems are vital components of regional networks. For almost all hinterland countries of SADC, it is a port of entry and exit. In the energy markets, it is an important supplier and is fast becoming a significant consumer and trader. It has been a key player in the labor markets of the most developed economy of the region. And Mozambique was once a privileged destination for South African, Zimbabwean, and international tourists.

While traditional services are fundamental to the domestic economy, new categories of services are increasingly adding value to economic activities in Mozambique. Because they affect other economic activities, services must be efficient and competitive. Liberalization programs for particular services sectors can help attract FDI that can improve productivity, price competitiveness, and assist with other economic activities, especially those related to export.

In general, Mozambique needs to (1) develop efficient domestic services to increase general economic efficiency and (2) pursue opportunities for appropriating technologies in knowledge- and science-intensive services to ensure technological viability and to start import substitution in these services. This will entail improvements in education and professional training, particularly in construction engineering, architecture, internationally certified accounting and auditing, IT for management, and modern technology telecommunications.

To attract foreign operators into these areas, Mozambique should streamline or eliminate regulations that limit business in service sectors. It may also need to enact laws and regulations in certain service sectors. The WTO's General Agreement on Trade in Services (GATS) and the current round of GATS negotiations offer Mozambique a forum for improving the transparency of its laws and regulations governing services and for making its business environment more predictable.

In sum, to improve its domestic service supply, Mozambique needs to

- Expand and deepen the education, health, technology, and science systems to supply the economy with qualified and skilled workers and new technologies;
- Upgrade infrastructure related to transport and tourism to improve domestic supply of these services and export to regional markets;
- Attend to newer services that are in high demand in a modern economy; and.
- Modernize the legal and regulatory environments for banking, finance, publishing, data transmission and other IT-based and near-virtual platform service production and provision.

Overview

Data from Mozambique's Ministry of Planning and Finance (MPF) suggest that tourism's contribution to Mozambique's GDP is relatively low—only 1.2 percent in 2001. This is in sharp contrast to global tourism contributions in developing and least developed countries, especially South Africa, where tourism contributes approximately 8 percent to the economy. Indeed, in many developing countries, tourism accounts for a far higher share of economic activity than it does in Mozambique. The World Tourism Organization estimates that tourism accounts for 43.3 percent of all services in developing countries and 70.6 percent in LDCs. The World Travel and Tourism Council (WTTC) estimates that in 2004, the greater travel and tourism economy of sub-Saharan Africa will directly and indirectly account for more than 9.4 million jobs (6 percent of employment) and US$3.5 billion of GDP, equivalent to 7.4 percent of total GDP. These comparisons suggest that Mozambique has considerable opportunity to develop its tourism sector and, moreover, that such growth should have important benefits for many of Mozambique's poor (see Exhibit 13-2).

Since the early 1990s Mozambique's tourism industry has been slowly recovering. Though physical evidence of increased tourism activity and infrastructure abounds, it is difficult to measure and analyze the impact of tourism on the local economy because statistics are scant. Building national capacity to collect and analyze tourism data is a priority for the Ministry of Tourism (MITUR), but existing capacity is limited and the reliability of data is questionable.

POLICY ENVIRONMENT AND STRATEGY

Tourism involves many economic sectors and is affected by various legal instruments and laws relating to investment, employment, community rights and community involvement, national parks and reserves, and other aspects of the environment. Since 1994, the Government of Mozambique has adopted policies and passed legislation to improve natural resource management and other areas related to tourism. These include the

- National Forestry and Wildlife Policy and Strategy (1995),
- Forestry and Wildlife Law (1999),
- Land Law (1997),
- National Environmental Management Program (1995),
- Environmental Framework Law (1997),

Exhibit 13-2
Tourism and Pro-poor Growth

As reported by the UN Commission for Sustainable Development's Agenda 21, "tourism absorbs more women and unskilled laborers than other sectors, and is economically significant in the vast majority of low-income countries. It is particularly important for women, as employment in the tourism sector is more flexible than traditional manufacturing or agriculture sectors, and there is an expanded informal sector, allowing for economic activity consistent with family life."

Analysis of WTO data by the Pro-Poor Tourism Partnership funded by the Department for International Development (DFID) suggests that

- Tourism is a principal export earner for 83 percent of developing countries, and is *the* principal export for 33 percent of them.
- In 2000, tourism ranked third among the major merchandise export sectors for least developed and developing countries. If petroleum industry exports are discounted, tourism is the primary source of foreign exchange earnings in the 49 LDCs studied. Tourism is a much larger part of their economies than in other developing countries, or the EU and OECD economies (accounting for more than 15 percent of all goods and services exported)
- In countries most dependent on it (particularly small islands), tourism can account for 30-90 percent of GDP, 50-90 percent of exports, and can employ 20-50 percent of the population.
- Travel statistics show that tourists are attracted to remote areas because of the culture, wildlife, and natural beauty found there. These areas are also usually where the poor of developing countries reside.

Tourism products developed in these areas can draw on the assets of the poor—cultural knowledge, natural resources, and rural space. The tourism sector can employ and train significant numbers of vulnerable groups, including women, youth, and unskilled laborers. Tourism can also provide opportunities to develop small enterprises and the informal sector. Finally, the infrastructure necessary for tourism—communications, transportation, clean water, sewage, and energy—can significantly improve the lives of the rural poor.[284]

- Investment Law,
- Tourism Policy and Implementation Strategy (2003), and
- Tourism Law (2004).

Recognizing the importance of tourism to the national economy, the Government of Mozambique created MITUR in 2000. Responsibility for national parks and reserves was transferred from the Ministry of Agriculture and Rural Development (MADER) to MITUR in 2001, demonstrating the strategic importance of conservation areas to tourism development. MITUR, which is still developing its institutional mandate,

[284] Pro-Poor Tourism Partnership 2004: PPT and Poverty Reduction. www.propoortourism.org.uk

has about 600 employees, including central staff and staff in provincial directorates and the national parks and reserves.

Interministerial bodies that regulate tourism and directly related areas are the Tourism Facilitation Commission (Commissão de Facilitação de Turismo), which is chaired by MITUR with members of all related ministries and the National Commission for Sustainable Development (CONDES); and the National Commission for Sustainable Development, an executive organ headed by the Ministry of Environment (MICOA) that aims to coordinate the integration of sectoral policies and plans related to environmental management at the highest level.

MITUR now has two instruments to guide development of the tourism sector during the next decade. The first, the National Tourism Policy and Implementation Strategy, was approved in April 2003. It defines the government's objectives in developing a thriving tourism sector. These objectives balance economic, sociocultural, and environmental interests. It also defines general principles to guide sector development and areas for intervention. Fundamental development themes are integrated planning; access to land for tourism development; infrastructure and public services; sustainable and responsible tourism; conservation areas for tourism purposes; product development; valorization of cultural heritage; tourism marketing; human resource development and training; community involvement; social development; financing; priority areas for tourism development; and regulation and control.

The second instrument is the Strategic Plan for the Development of Tourism in Mozambique (SPDTM), likely to be approved in 2004. Building on the policy instrument, the SPDTM sets priorities, defines products and markets, identifies priority areas for tourism investment (PATIs), and focuses resources for 2004-2013.

The SPDTM recognizes the spatial nature of tourism and identifies three platforms as the core of Mozambique's spatial framework for the sector: (1) priority areas for tourism development, (2) conservation areas and transfrontier conservation areas, and (3) tourism routes and circuits.

Priority Areas for Tourism Investment

PATIs are prime zones selected in consultation with national and local stakeholders for their uniqueness and tourism potential. Every province has at least one PATI. A few PATIs, especially those in the south, already have some level of development (Type A PATIs); those in remote central and northern areas are relatively undeveloped (Type B). PATIs are the focus in government planning, development initiatives, and resource allocation.

Conservation Areas

Mozambique has 6 national parks, 6 national reserves, and 12 hunting areas, which together cover about 15 percent of its land surface. The success of Mozambique as a tourism destination will be influenced largely by its ability to establish nature and wildlife-based tourism. The government recognizes the interdependence of tourism and conservation and is committed to effective management of conservation areas within the country and through joint conservation initiatives known as transfrontier conservation areas (TFCAs). In these cross-border regions different geographical areas have different forms of conservation status, such as a private game reserve or communal natural resource management areas, or are designated for hunting concessions.

> **The Niassa Reserve**
>
> *One of Africa's last great wildernesses, Niassa Reserve has fantastic fauna and flora. Wildlife experts report common sightings of elephants with magnificent tusks, an extreme rarity in tourist parks like Kruger, Serengeti, and Masai Mara. Surveys by the World Conservation Union in 1998 estimated that the reserve contains 12,000 elephants and 9,000 sable antelopes. Big herds of the endangered African Wild Dog and buffalos exist alongside a rich diversity of bird life. The reserve comprises woodland, open savannahs, seasonal wetlands and riverside forests along rivers Rovuma and Lugenda. Inselbergs render the landscape spectacular. The highest of these rock formations is the Mecula Mountain (1441 m) in the center of the reserve.*

Tourism Routes and Circuits

Tourism routes and circuits are based on the idea that a group of products providing diversity of experience is more attractive than the individual components. Routes refer to ***national*** "visitor journeys" while circuits refer to ***regional*** (between countries) tourism movement. Most Mozambican tourism routes can be part of regional tourism circuits.

PROVINCIAL PERFORMANCE

In 2003, approximately 360 establishments in Mozambique registered 660,000 room-nights. Mozambique has a lodging capacity of approximately 12,500 beds, of which less than 5,000 are luxury or "three-star" standard or better. In contrast, the City of Cape Town has approximately 30,000 beds and Mauritius about 19,600. The supply remains very limited and the quality is often below international and regional standards, especially in the provinces.

The dominant form of tourism in Mozambique is still business-related, with Maputo City at the center of the tourism industry (Table 13-1). Maputo accounted for more than 50 percent of registered room nights and guests in 2003, and 70 percent of total revenues. It has about 33 percent of the bed supply and most luxury beds.

The three regions do not show significant differences in room nights sold and number of registered guests, but the south performs better than the center or north (Table 13-1 and Figure 13-1). The south has significantly more tourism beds, with Inhambane leading with more than 1,800. Tourism receipts also demonstrate that Inhambane is Mozambique's leading province in leisure tourism. The data, however, should be interpreted with caution because the reliability of tourism statistics in Mozambique is questionable. The Tourism Master Strategy for Inhambane Province (August 2003) found that registered room nights in Inhambane were underreported for 2002 by at least a factor of four. It also found that the province should have about 2,300 beds, while MITUR data suggest between 1,500 and 1,800. It is likely that the Inhambane data are more distorted than data from other provinces because Inhambane is the only province with a significant supply of leisure beds and has a problematic record of administration in the tourism sector.

Table 13-1
Regional Distribution of Tourism

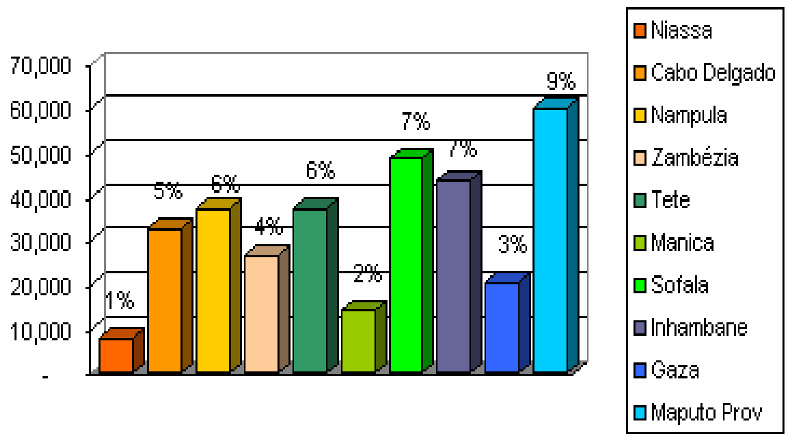
	Maputo	South	Center	North	Total
Arrivals	55,383	491,451	617,364	1,821	1,166,019
% of total	4.7%	42.1%	52.9%	0.2%	1,166,472
Room nights	335,744	124,076	100,150	104,405	664,375
% of total	50.5%	18.7%	15.1%	15.7%	664,375
Guests	163,051	50,483	55,076	47,266	315,876
% of total	51.6%	16.0%	17.4%	15.0%	315,876
Number of beds	4,121	4,025	1,741	2,700	12,587
% of total	32.7%	32.0%	13.8%	21.5%	10,511
Receipts	$27,330,091	$4,241,599	$3,470,141	$2,536,084	$37,577,916
% of total	72.7%	11.3%	9.2%	6.7%	$37,577,916
Investment		$243,927,622	$73,732,797	$1,042,095,073	$1,359,755,492
% of total		17.9%	5.4%	76.6%	$1,359,755,492

SOURCE: MITUR. Data refer to 2003 except for investment (total period 1998-2003) and beds (2002).

Opportunities for Developing the Tourism Sector

The tourism potential of Mozambique lies in its resources—wildlife, land, coastal areas, and natural and cultural heritage. The success of the tourism industry will depend on responsible development of these resources: effective regional coordination and planning, sustainable use and management of biodiversity, and preservation of cultural heritage.

Figure 13-1
Room Nights in 2003



SOURCE: MITUR

Note: Maputo City is not included in these figures and accounts for 51 percent of room nights and 33 percent of beds.

Covering almost 800,000 km^2 and with a coastline of more than 2,700km, Mozambique is too vast and diverse to be considered and managed as a single destination. Its three regions—the South, Center, and North—have distinct identities, strengths, development priorities, and regional partners (Table 13-2). The tourism profile of the South emphasizes regional and domestic tourism, coastal tourism, and water sports; the Center is best positioned to concentrate on ecotourism and adventure-based tourism for international niche markets; the North could develop into an exclusive beach destination with a strong cultural component.

Tourism holds promise for Mozambique with respect to the attraction of foreign investment. Tourism accounted for 16 percent of total foreign direct investment in Mozambique over the 1998–2002 period. This makes tourism, with US$1.3 billion in FDI over the period, the third largest sector for FDI in the country, after industry (33 percent) and energy and natural resources (18 percent).[285]

[285] Centro de Promoção de Investimento (Investment Promotion Centre).

Table 13-2
Mozambique's Regional Tourism Strengths

Location	Provinces	Regional Integration	Strengths
South	Maputo Cidade, Maputo Province, Gaza and Inhambane	South Africa, Swaziland	Vast coastline, warm tropical waters, rich coastal / marine resources of exceptional quality for diving, fishing and water sports, Bazaruto Marine National Park Culture and cosmopolitan ambience of Maputo.
Center	Sofala, Manica and Tete	Zimbabwe, Zambia, Malawi	Wilderness areas with high bio-diversity with opportunity for hunting, safaris, bird watching, lake tourism, ecotourismand adventure, Gorongosa National Park.
North	Cabo Delgado, Nampula, Niassa and Zambézia[a]	Tanzania, Malawi, Comoren, Indian Ocean Islands	Rich cultural heritage, Ilha de Moçambique (UNESCO Heritage Site), tropical beaches, pristine wilderness, Quirimbas Archipelago.

[a]*For the purposes of tourism, Zambézia is considered part of the northern region, though common regional divisions have it as part of the central region.*

SOURCE: *SPTDM.*

REGIONAL TOURISM

To grow and expand, Mozambique's tourism industry must place regional tourism integration at the top of its agenda. At present, most of Mozambique's tourists arrive from South Africa. Approximately 300,000 South African visitors came to Mozambique in 2001—75 percent of all visitors (see Table 13-3 and Figure 13-2). South Africa's tourism patterns and strategic planning are likely to affect the future of Mozambique's tourism industry. Linking into those tourism patterns and flows will help Mozambique reposition itself in the international tourism market. Positioning southern Mozambique as an add-on destination to South Africa's mainly wildlife-based tourism experience is a key opportunity for both South Africa and Mozambique. Mozambique's proximity to Kruger Park, the Limpopo Trans-Frontier Conservation Area (TFCA), and the Inhambane / Gaza beaches provide an ideal opportunity to develop "bush-beach" linkages as a tourism product. In addition, by developing innovative tourism products and packages and marketing them in South Africa and elsewhere before the 2010 World

Integration with Neighboring Countries *No country in Africa will be able to compete in the international marketplace on its own. And all countries in southern Africa will need to pursue regional integration and develop a southern African destination. Mozambique will take a lead in regional integration by developing and promoting bush-beach linkages with neighboring countries, initiating and developing TFCA initiatives with neighboring countries, and participating in regional marketing and development initiatives.*

SOURCE: *Strategic Plan for the Development of Tourism in Mozambique p. 58.*

Cup, Mozambique could attract many of the vast number of tourists who will be visiting South Africa for the tournament.

In addition to exploiting geographic linkages, Mozambique should participate in regional marketing and development initiatives to increase inbound tourist arrivals. Special Development Initiatives (SDIs) and Development Corridors, which aim to promote the socioeconomic development of southern Africa through infrastructure provision and common policy agenda, will be important means for developing tourism in the region.

Table 13-3
Top Five Source Markets for Mozambique Tourism Arrivals in 2002

Country	Visitors	Share (%)
South Africa	408,636	35.0
Zimbabwe	291,903	25.0
Malawi	257,862	22.1
Swaziland	48,816	4.2
Portugal	22,410	1.9

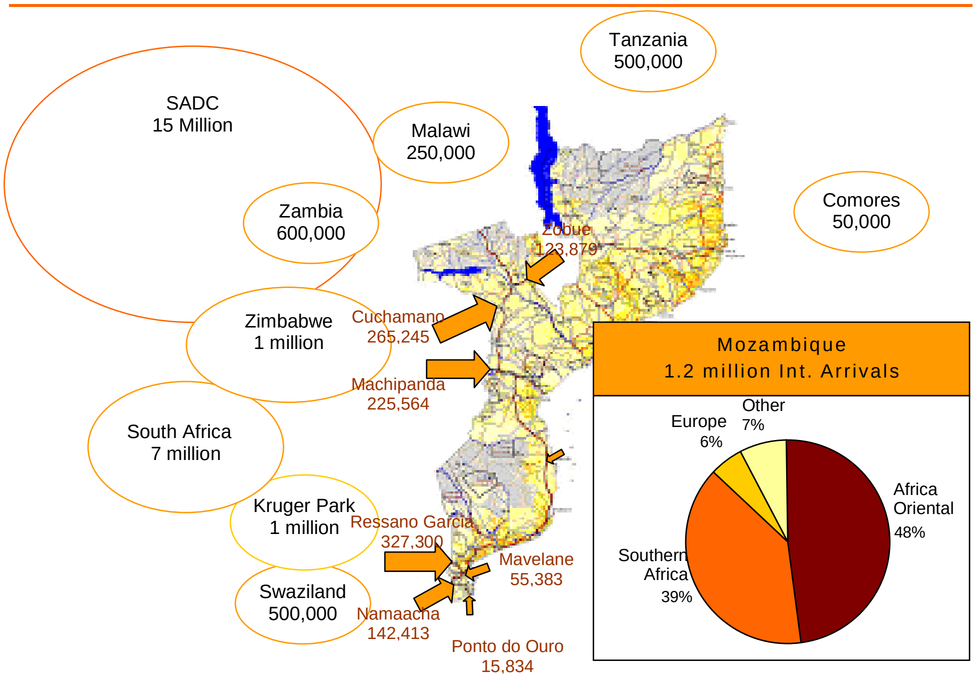
SOURCE: MITUR.

Multiple-country trips, a growing trend in international travel, underscore the importance of participating in the planning of regional tourism development. To capitalize on the trend, Mozambique should diversify its tourism experience in cooperation with neighboring countries. Relative to South Africa, Mozambique's national parks and game reserves will not meet current market expectations for a nature-based experience. TFCAs are also a key instrument for regional integration. They aim to create collaborative schemes in which contiguous areas in neighboring countries are formed into a "joint management" regime, effectively enlarging the conservation area. Involvement in TFCAs will help Mozambique develop and move more quickly into this market. Growth through participation in TFCAs will position Mozambique to link its national reserve with its beaches and extend tourists' visits.

ECOSYSTEMS AND BIODIVERSITY

Worldwide, ecotourism is growing rapidly. Ecotourists include birders, nature enthusiasts, scientific researchers, and independent nature travelers. If properly developed and managed, Mozambique's natural settings can meet the demands of this market segment. The country's nature reserves, mountains, lakes, lagoons, and

Figure 13-2
Patterns of International Tourism Arrivals in Mozambique and the Region



SOURCE: *Ministry of Tourism. 2004. Strategic Plan for the Development of Tourism in Moçambique (2004– 2013) Vol. I.*

flora and fauna provide ample opportunity to expand and develop nature-based tourism. Mozambique must first rebuild its infrastructure in and around these areas, and replenish and protect the wildlife and surrounding natural resources. And while it is not the largest market segment in nature-based tourism, *avitourism*, or birding, is growing fast. The Gorongosa Mountains, Panda in Inhambane, the Coastal Lagoons in Bazaruto and Matutuine District—famous among ornithologists—offer significant potential for Mozambique to develop into a leading avitourism destination in Africa.

HISTORY AND CULTURAL HERITAGE

Its architecture, music, art, language, and cuisine, mark Mozambique as an exotic destination quite different from the region's other previously colonized countries. Having once been used as a trading post by Arabs and then the Portuguese, Mozambique possesses a rich cultural heritage. Tourism products can be expanded and new ones developed around the architecture of historic sites, music and dance, and even gastronomy. For example, the UNESCO World Heritage site, Ilha de Mozambique, is a fortified city and former Portuguese trading post. Tours featuring historical interpretation, storytelling, and traditional music and dance could be developed for select cities and historic towns. The town of Ilbo and the city of Maputo, for example, could be developed as cultural heritage attractions in the coastal tourism circuit.

Lake Niassa

Situated in the western part of Niassa province, Lake Niassa is one of Africa's largest lakes. On calm days underwater visibility can be up to 30 meters. Getting there requires a 4x4 vehicle that can be hired in the capital city of Lichinga. The road to the lake passes through fantastic scenery. Three small fishing villages, Meponda (42 km from Lichinga), Metangula (138 km), and Cobue (190 km) are around the lake.

NICHE MARKETS

The market size for leisure tourists remains unknown. Market opportunities for Mozambique lie in the regional market, which concentrates on beach and water-sports tourism, and in international markets. In cultivating international markets, Mozambique should develop high-potential products and services for selected source markets to make the best use of its marketing resources.

For example, the ***cruising industry*** is seeking to include the Indian Ocean among its destinations. Historically, Inhaca and Ilha de Mozambique were included in cruise itineraries. Upgrading Mozambique's ports and marketing the attractions available at them could turn them into competitive destinations for ships currently visiting the Seychelles, Comoros, Madagascar, Mauritius, Dar es Salaam, and other coastal cities. Mozambique's coastline is dotted with historical towns that can provide another lucrative tourism product. At present, however, few cruise lines include Mozambique in their itineraries. Few establishments in Mozambique can cater to the often large groups (500+) of cruise tourists on one ship; the embarking conditions along the shore are poor; and the taxes and fees that cruise tourists must pay to the Mozambican authorities are unsettled.

Appealing to the more exclusive luxury market, ***deep-sea fishing*** is a high-yield segment that should be developed in Mozambique, which has long been known for its big game fish (e.g., tuna, marlin, sailfish). Government officials, however, exert little control over recreational fishermen in licensing and monitoring catch within allowed quantities. Illegal fishing, including fishing for turtles and other large marine species, poses a serious threat to Mozambican waters.

In addition, diving appeals to many age groups and income brackets and is regaining popularity among the traveling young. Professional divers consider Mozambique, with its beautiful coral reefs, a world-class destination. Inhambane Province is famous for large marine species including dolphins and whales, whale-sharks, and sea-turtles. Many international tourists (e.g., an estimated 80 percent of backpackers to Inhambane) come to Mozambique expressly to dive. Constraints on this niche include an absence of sector control (e.g., maximum amount of dive operators or daily divers for specific areas or a code-of-conduct for dive operators), leaving the execution of this environmentally sensitive activity up to the operators themselves.

Adventure tourism takes place in unusual, exotic, and remote wilderness, and is associated with varying amounts of physical activity, much of it risky. A growing market segment, this form of tourism represents about 5 million travelers worldwide annually. Mozambique offers a number of remote destinations for canoeing, rafting, hiking, rock-climbing, off-road 4x4 driving, mountain-biking, and other physically challenging activities. A form of adventure tourism, ***hunting*** is a small, lucrative business across Africa. This highly specialized market requires little marketing. Northern Mozambique in particular has a good variety of species with hunting quotas in place. Developing this niche market would also help Mozambique market its nature-based tourism, which will take longer to develop in relation to South Africa's more mature market.

Recommendations for Stimulating Tourism Earnings

Constraints on the development of Mozambique's tourism sector are common to many developing countries. Infrastructure is poor in many subsectors; expensive, low-capacity transportation is a particular weakness. Human resource capacity constraints impede not only tourism development but also development in other sectors. The enabling environment for private sector development and investment is often discouraging and does little to promote foreign direct investment. If the tourism sector is to grow, Mozambique's policy framework needs to be liberalized and streamlined.

IMPROVE INFRASTRUCTURE

To compete in the international tourism market, Mozambique will need to improve its infrastructure, particularly systems that surround and affect destinations, accommodations, and tourism services. ***Public transport*** is neither safe nor reliable, and air transport is expensive and of low capacity. Improving these systems will also facilitate other social and economic development and should therefore be planned and coordinated at a regional and national level. The ***air transport*** system, for example, could be improved by liberalizing or reforming air space, allowing for competitive landing rights allocation, upgrading of international airports, and increasing access and capacity for international and regional flights. These sorts of changes would affect passenger volumes. ***Road networks*** also need to be improved to ensure safe access to tourism destinations; and alternatives to the low-capacity and expensive public transportation network need to be explored. ***Supplies of gas and electricity*** should be consistent, as should ***domestic and international communications*** (e.g., telecommunications, cellular networks, internet connectivity). In addition, upgrading ***water quality*** and ***solid waste management*** would facilitate tourism while helping protect Mozambique's natural resources.

REFORM POLICY AND IMPROVE THE INSTITUTIONAL ENVIRONMENT

A host of policies and regulations impede development of the tourism industry and the private sector overall in Mozambique. For example, ***land-use rights and land tenure*** pose serious problems. Prime coastal sites have been occupied and developed without official permission, while others are improperly allocated—a situation often attributed to corruption. Land use needs to be controlled, while rationalizing the use of land needs to be systematic and planned appropriately. To attract large-scale investment in tourism, Mozambique needs to make streamlining of land allocation and standardizing of concession agreements and tender procedures a priority. ***Application, registration, and licensing processes*** need to be streamlined and transparent. Areas with high tourism potential should be designated exclusively for the development of tourism projects. Moreover, ***integrated development planning*** is essential in areas with tourism potential. Planning should be decentralized yet well coordinated between sectors and the government's administrative entities. So far, however, tourism development has been largely uncontrolled; plans, when developed, are rarely implemented. Correcting these weaknesses is especially important for land-use decisions in areas with potential. Otherwise, Mozambique's ability to protect the environment that attracts tourists will be compromised, as will its ability to attract investment. In fact, implementing sound coastal management in the coastal zones is now urgent.

Labor regulations that address the employment of seasonal workers and the employment of expatriate workers necessary for the tourism industry need to be enacted. ***Customs and immigration procedures***, perceived as complicated and inconsistent, cause unnecessary delays. For example, different entry points follow different immigration procedures when issuing visas to tourists. Such processes must be streamlined and simplified to ease tourists' movement in and out of the country. ***Tourism statistics and data*** are limited and often thought to be unreliable. Satellite accounting and more comprehensive and accurate collection of tourism statistics is necessary to measure the economic impact of tourism on the economy, and to guide national and regional tourism planning and marketing.

The government's recent decentralization plans should help provinces and districts promote and develop tourism locally—but only with sufficient financial and human capacity to act on those plans. Building this capacity, particularly at the district level, is essential. Capacity building is needed not only to ensure proper tourism planning, marketing, and promotion, but also to control and monitor conservation areas and coastal zones—both critical to Mozambique's tourism products.

BUILD CAPACITY OF HUMAN RESOURCES

A lack of skilled labor is impeding the growth of Mozambique's tourism industry. Trained, high-quality personnel for hotels and other tourism sector support services are in short supply. Training institutes that offer the curriculum appropriate to ensure skilled workers are few and far between. Education about tourism and provision of related services is also weak across many supporting sectors (e.g., police, transportation, immigration). Communities in or around tourism destinations are not aware of the significance of tourism or the potential economic benefits tourism offers those communities. Training should target not only those in the tourism industry but also immigration authorities, police, transport providers, and service providers in communities.

Upgrading human resources will require accessible education programs that meet the needs of the tourism industry as well as international standards. Skill development should cover all supporting services—cooking, housekeeping, gardening, computing, accounting, management, marketing, language training, transportation services, and others. In addition, the government's capacity to deliver on tourism development plans needs to be strengthened.

More generally, public health concerns such as HIV/AIDS (and other diseases) should be addressed through education and awareness campaigns. Other African countries have been reporting an increase in AIDS-related deaths of tourism workers (e.g., lodge employees, guides). Such tragic deaths often presage the closure of tourism operations. Marketing must be strengthened to revive a positive image of Mozambique in regional and international markets.

IMPROVE INVESTMENT AND BUSINESS CLIMATE

Domestic and foreign investors will examine Mozambique's business environment before investing in the tourism industry. The country's private sector has expressed concern with the government's planning and management of the sector, which often leaves investors confused about investment procedures, as well as policies concerning land, labor, licensing, tariffs, and industry regulation. This lack of clarity and confidence has also affected the availability of capital to allow the private sector, small enterprises, and even communities to invest in tourism development.

The Government of Mozambique needs to establish a clear financial and legal framework, and to adopt investment policies that encourage the participation of domestic and foreign investors, as well as communities and small and medium enterprises. Helpful actions would include

- Properly implementing reduced tariff schedules, for example, by exempting some equipment from import duties;
- Minimizing bureaucratic procedures related to land allocation and investment in tourism enterprises;
- Facilitating an efficient and expedient process for investment to increase the number of large-scale investments in tourism; and
- Facilitating access to credit-schemes and funding alternatives through financial institutions.

In addition, the lack of private–public partnership in the tourism industry is a major impediment to sector development. All stakeholders must work together to develop, position, and market Mozambique as a tourism destination. A cluster competitiveness approach—which engages all interested parties in the public and private sectors, local communities, academia, and non-governmental organizations—can contribute to this partnership. An industry cluster can help define the tourism product mix, establish industry norms and standards, monitor quality control, develop human resources, improve (or even establish) regional tourism organizations and supporting institutions, and identify other policy reforms and infrastructure improvements.

Further, Mozambique could make itself more attractive to potential investors in the tourism sector were it to make binding commitments under the WTO's General Agreement on Trade in Services (GATS).[286] For example, Mozambique does not

[286] With the exception of Seychelles, which is not a member of the WTO, Mozambique is the only member of SADC that did not include one or more tourism subsectors in its GATS schedule of

restrict foreign equity participation in tourism investments, but it does apply other types of limitations, such as regulatory and legislative restrictions on expatriate labor. If Mozambique were to commit to binding tourism services at the status quo, it would increase the transparency and predictability of its regulatory regime—which potential investors might find attractive. Failure to make this commitment, conversely, disadvantages Mozambique relative to other countries in the region that are vying for foreign investment in the tourism sector. A number of countries in Southern Africa have made significant market access commitments in tourism services (e.g., pledging that they will not introduce new measures that restrict foreign establishment).

INVOLVE LOCAL ENTREPRENEURS AND COMMUNITIES

Participation of local communities and local entrepreneurs in Mozambique's tourism industry is weak to marginal. Community ownership of tourism resources is rare, employment benefits or opportunities for skill enhancement are minimal, and economic benefits from tourism development remain undemonstrated. Yet most of Mozambique's tourism potential exists around pristine areas—coasts and nature reserves—where many of the country's rural poor live. Consistent with the Government of Mozambique's action plan for the reduction of poverty, involving local entrepreneurs and communities in tourism initiatives can help protect marine environments and conserve natural areas and biodiversity, while improving the economic well-being of the local poor. Tourism development planners should work with local entrepreneurs and communities in specific areas, such as ecotourism and ecolodge development and management, wildlife interpretation, community-managed conservation areas, and marine conservation and tourism. Programs to increase awareness of tourism and to strengthen business and tourism skills among entrepreneurs and communities, especially in high potential zones, are necessary.

DEVELOP AND MARKET INNOVATIVE PRODUCTS AND PACKAGES

Mozambique has ample opportunity to attract international tourists. But once products are developed they need to be marketed nationally, regionally and internationally. Private sector tourism operators, perhaps through a tourism

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commitments. In fact, 34 WTO members from sub-Saharan Africa made some type of commitment in tourism services; only 5 did not (Mozambique, Madagascar, Burundi, Central African Republic, and Togo). Tourism services are categorized under the GATS as hotels and restaurants, travel agencies and operators, tour guide operators and other tourism services.

competitiveness council, can work on innovative tourism products and on sharing information and marketing of these products. In addition, to attract tourists, strong linkages to regional tourism hubs, such as Johannesburg and Dar-es-Salaam, need to be forged.

Existing and Planned Donor Assistance in the Sector

Given MITUR's weak human and financial resources, development of Mozambique's tourism sector will depend on technical assistance, capacity building, and financial assistance from donors. Growing interest in using "pro-poor tourism" to raise living standards should facilitate cooperation in tourism development projects among donors. The following donors have programs or have shown a strong interest in tourism development in Mozambique:

- ***USAID*** is preparing for a 3–5 year tourism development program focusing on private sector development and northern Mozambique.
- ***World Bank.*** The World Bank has funded the first phase of the TFCA project in Mozambique. This included institutional development of the TFCA support unit, provision of legal support to facilitate establishment of TFCAs, and support in management and infrastructure development in selected TFCAs. The Bank is preparing the second phase of the program, which is likely to last another five years. The Bank's second program, the Program for Sustainable Tourism and Conservation (PROTUSC), will focus on capacity building and institutional strengthening in MITUR. The Bank has also helped fund the Coastal Management Program, along with DANIDA, through the Ministry of Environment (MICOA).
- ***IFC.*** The IFC's South East Tourism Investment Program (SEATIP) is supporting development of regional tourism between Mozambique, South Africa, Swaziland, Zimbabwe, Malawi, and Tanzania. The program promotes tourism routes: a southern circuit integrating southern Mozambique, Swaziland, and Mpumalanga and Kwazula-Natal province in South Africa and a northern circuit in northern Mozambique, southern Tanzania, and Malawi. SEATIP will finance up to US$1.5 billion in privately managed tourism projects (mainly lodges and hotels).
- ***Sweden.*** Through its Malonda program, the Government of Sweden is funding private sector development in Niassa Province. Although tourism is not a core activity, the program has funded marketing of the province in Mozambique, development of a tourism website for the province, and brief studies of tourism opportunities.

- ***GTZ,*** the German Development Cooperation, has funded several initiatives in tourism development in Inhambane Province through its Private Sector Development Program. It funded a study of coastal zone management, a tourism and tourism marketing strategy, and a small project to promote cultural activities (US$500,000). No continuation of funding for tourism development has been confirmed. GTZ also funded some ecotourism-related activities in Manica province, in the Chimanimani Reserve.
- ***KfW,*** the German Investment and Development Bank, has been a major donor in the Limpopo TFCA. Most of its funds have been channeled through the Peace Parks Foundation, which has been involved in wildlife management, including translocation of elephants and other large mammals to the park.
- ***Irish Aid.*** The Irish development program is focused on Niassa and Inhambane Provinces, particularly road construction and rehabilitation. It is funding the Niassa component of the new road between Lichinga and Pemba, which will dramatically improve access to Niassa Province and will speed tourism development in the north. It is also funding a feasibility study on the new road between Pafuri and Mapinhane (near Vilankulos) that will form the northern edge of the proposed southern tourism circuit, connecting the Limpopo TFCA with the Inhambane beaches.
- ***DANIDA*** has embarked on a long-term coastal management program with MICOA. Though the program emphasizes natural resource management, tourism development and coastal zoning are important. The Center for Sustainable Development (Centro de Desenvolvimento Sustentável, or CDS) is the executing agency and is handling the micro-zoning aspects of the project. The CDS has completed zoning proposals in zones with high potential for tourism and has planned zoning projects for many other districts along the coast.
- ***France*** is spending US$5 million on biodiversity conservation and livelihood work with communities in the Quirimbas Archipelago in northern Mozambique. The World Wildlife Fund (WWF) is its implementing partner.

Other donors and development partners include Peace Park Foundation; the IUCN; SNV, a Dutch development NGO that has expressed interest in conservation management in Nampula Province; TechnoServe, an American NGO focusing on enterprise development; WWF, conservation management in the Quirimbas and Bazaruto Archipelago; and the Carr Foundation, an American entity interested in ecotourism development in Gorongosa National Park in central Mozambique. Previous donors include AusAID, which funded development of the national tourism policy; the Ford Foundation, which supported community tourism in Tete and Manica provinces; and the EU, which funded development of tourism master plans in 1997.

Appendix A. Persons Interviewed

Abdulla, Diaglo	SIMA, MADER
Afonso, Rui Santana	Consultant, Technoserve
Agige, Farouk	General Manager COPROMOL (Mozambique Coconut Products Ltd)
Alcobia, Jose	President, FRUTISUL
Alfieri, Andrea	Economic Advisor, INA (Institute of Sugar) and GPSCA (Unit for Promotion of Commercial Agriculture and Private Sector), Ministry of Agriculture and Rural Development
Alves, Jose	President Conselho de Adminidtracao, Agro Alfa, S.A.R.L.
Amela, Hipólito	USAID
Archondo, Sherri	Financial Specialist, World Bank
Arndt, Channing	Advisor, Budget and Planning Directorate, MPF
Bamber, Jonathan	Head of Commercial Section, British High Commission
Balói, Oldemiro	Executive Board Member, Banco International de Moçambique
Barrington, Clare	DFID
Bastos, J. Teixeira	Centro CIMPOR
Benfica, Rui	Officer – Research Specialist, Department of Analysis and Policy, Ministry of Agriculture and Rural Development – MSU
Berggren, Lars	Senior Adviser, Private Sector Development Division SIDA
Bettencort, João	Agro-Industrial, Chimoio
Blanco, Enrique	Trade Adviser, Ministry of Industry and Trade

Born, Tim	Enabling Environment Team Leader, Infrastructure Division Chief, USAID
Botas, Gilberto Antero	Administrative Analyst, UNDP
Boughton, Duncan	Visiting Professor, Michigan State University
Byers, Bruce	Economist, Budget and Planning Directorate, MPF
Cassim, Rashad	Chief Executive Officer, Trade and Industrial Policy Strategies
Castel-Branco, Carlos Nuno	Professor (Economics), Eduardo Mondlane University
Chiconela, Jacinto	Economist, Budget and Planning Directorate, MPF
Chitará, Sérgio	Executive Director CTA
Cirera, Xavier	Trade Advisor, MIC
Cóme, Elias	Director, CADI
Compton, Julia	Rural Livelihoods Advisor, DFID
Cordon, Roberto	Training Officer, Human Resource Development Section, Division of Trade Support Services, International Trade Centre
Costa, Carlos	Managing Director, Technoserve
Cota, Pedro	Director, Gabinete de Estudos
Coughlin, Peter E.	Industrial Economist, Maputo
Couto, Pedro	Director, Office of Studies, MPF
da Conceição de Quadros, Maria	Jurist, MADER
da Cruz e Sousa, Daniel Libório	Agricultural Services, World Bank Resident Mission
Dassat, Alibhai Hassan M.	Vice Chairman, Magin—Confecções, Lda., Maputo
Davis, Carrie	Link Consulting Lda., Beira
de Armas, Enrique Blanco	Economist, Ministry of Industry and Trade
de Barros, Gilberto	Senior Private Sector Specialist, AFTPS, World Bank
de Marrule, Higino	Coordinator, DAP (Department of Policy Analysis), Ministry of Agriculture and Rural Development
de Santos, Antonnio Victor Barros	Director-General, General Directorate of Customs
de Voest, Joop	Marketing & Planning Consulting Services, South Africa
de Waal, Anton	General Manager, National Distributor of Sugar

Dombo, Horácio Eugénio	Head of Free Zone Division, CPI
D'Oliviera, Joaquim Campos	Adminstrador Delegado, ToPack
Droste, Rainer	Chief Technical Advisor, FAO Manica
Edson de Oliverira, Bourgvignon	Executive Director, Ipanema
Eusebeo Sikela	National Director, Ministry of Fisheries
Evans, Brandon	President, Association of Manica Investors – Commercial Farmer
Fellingham, Simon	General Manager, Manica Freight Service, Beira
Dr. Ferrao	Director, Associates Consultant Manica (CAM); and Mozambique Leaf Tobacco Manica (MLT)
Ferrão, Felisberto	President, IPEX
Ferrera, Joaoquim	Provincial Director, MIC, Beira
Franco, António	Macroeconomist, World Bank, Maputo
Franco, Paulo	General Manger, Fresh Produce Terminals Port of Maputo
Frans, Van de Ven	Chief Technical Advisor, Ministry of Industry and Trade – FAO Marketing Management and Assistance Project
Freita, Egr.	Plantation Manager, Agrimo, Morumbala
Freitas, Maria Rita	Forestry Engineer, IPEX
Gamito, Alfredo	Diputado
Ganar, Yunuss	General Manager, Gani Comercial
Garrido-Mirapeix, Julio	Coordinator, Food Security Unit, EU
Gomes, Antonio	Owner and Manager, SAPEL
Graca, Jose	Director, Manica Provincial Directorate of Agriculture, Ministry of Agriculture and Rural Development
Grönvall-Branks, Monika	SMME Development Specialist, Verde-Azul Consult Limited
Henriquez, Rogerio	Regional Director, Madal, Quelimane
Highton, Nick	Economic Councilor, DFID
Hilton, Brian	World Vision
Hoobash, Niazi	Belita Mozambique Lda
Jaiantral, Dipac	World Bank
James, Peter	Project Director, Crown Agents

James, Robert	Economist, Budget and Planning Directorate, MPF
Jones, Sam	Economist, Budget and Planning Directorate, MPF
Jossias, Jose Fernando	Director Geral, IPEX
Jusob, Rafique	Director, CPI
Mr. Jutha	Owner and Manager, Africaju
LaFleur, Jim	Sr. Economic Advisor, Confederation of Business Associations of Mozambique (CTA)
Levy, Samuel	SAL Consultancy and Investments Limited
Locke, Anna	Advisor, INA (Institute of Sugar) and GPSCA (Unit for Promotion of Commercial Agriculture and Private Sector), Ministry of Agriculture and Rural Development
Low, Jan	Visiting Associate Professor, Michigan State University
Lucas, Maria José	Permanent Secretary, MIC
Mabote, Anabela	Market Information Officer, DAP (Department of Analysis and Policy), Ministry of Agriculture and Rural Development
Machado, Guillermo	General Manager, Export Marketing
Macia, Agonias Antonio	Chief, Specialized Organizations Section, International Relations Department (Chefe de Departamento, Organizações Especialízadas, Direcção de Relações Internacionais)
Maiopue, Filomena	Regional Director, Incaju – Northern Delegation
Magaya, Helder	Economist, MIC
Malhambe, Norberto	Head of Department of Projects and Studies, Institute of Cotton, Ministry of Agriculture and Rural Development
Manuel, Felisberto	Associação Moçambicana de Armadores de Pesca Industrial de Camargo
Mapilele, Elsa	Rural Enterprise Advisor, USAID
Mapouse, Nuno	Head of Investment and Facilitation Division, CPI
Marketos, Gerry	Managing Director, Consulting, Management and Participation, CIMPOGEST
Massingue, Venâncio	Vice Rector, Administration and Resources, University Eduardo Mondlane
Matule, Raimundo	Deputy Director, Incaju
McGrath, Ron	Senior Consultant, Crown Agents

Menon, Umesh	Entrepreneurship Development Institute of India
Miranda, Antonio	General Manager, Miranda Caju
Mr. Monty	General Manager, Walluro (Horticulture Firm Manica)
Morgado, H.E. Carlos	Minister of Industry and Commerce (MIC)
Mucavel, Carlos Pedro	Economist, National Director, Directorate of Economy, MADER
Muendane, Cardoso	Director, Organization of Industry, Trade and Services
Nala, Danilo	Customs
Namburete, Salvador	Deputy Minister of Industry and Commerce
Nhancale, Henoch	Officer, INA (Institute of Sugar) and GPSCA (Unit for Promotion of Commercial Agriculture and Private Sector), Ministry of Agriculture and Rural Development
Negrao, Paolo	Owner and General Manager, CITRUM (Mozambique Citrus Company)
Nila, Danilo	Customs Commissioner, Director for Internal Control
Normamade, Yussufo	General Administrator, SANAM
Osman, Abdul Magid	Chairman of the Board, Banco Comercial e de Investmentos
Pal, Shakti	Business Advisor, Technoserve
Patel, Kekobad	Vice-President Marketing, Enacomo SARL
Pereira, Luis	General Manager, Agrimo
Pintado, Clover	General Manager, Novo Banco
Pinear, Pine	Shareholder and General Director, Manica Oil – Optima Industrial Ltda
Prosperino, Galcipoli	Executive Director, Unão Geral de Cooperativas
Raimundo, Susana	Chef de Departmento Cooperacção Internacional, Direcção Geral das Alfândegas
Rawjee, Afzal	Delta Corporation, Beira
Ribas, Joao	General Administrator, JFS
Ribeiro, Ana Maria	Economist, Food Security Unit, EU
Ribeiro, Arnaldo	Director, INA (Institute of Sugar) and GPSCA (Unit for Promotion of Commercial Agriculture and Private Sector), Ministry of Agriculture and Rural Development
Ribeiro, Simplicio	General Administrator, Canam
Risopoulos, Jean	Food Security Advisor, EC Delegation

Rodríguez, Alex Warren	Economist, Departamento de Análise e Previsão, Direcção Geral das Alfândegas
Rodriguez, Armando	Professor of Economics, University of New Haven
Rodriquez de Sousa, Beatrice	Provincial Director, MIC, Quelimane
Ruface, Celso	Consultant, Technoserve, Chimoio
Rui, Monteiro	Director of Operations, Rani International
Rui, Santana	Agro-business advisor, Technoserve
Salimo, Omaña	Executive Director, Small Industry Development Fund
Salvador, Jorge	Economic Advisor, UTCOM, MIC
Sandrana, Sr.	Administrator, TextAfrica
Sarasan, C.J.	Managing Director, Geralco
Schafer, Stephan	CIM
Schalke, Alexander	Agricultural Economist, Market and Trade Information Expert, Ministry of Industry and Trade, National Directorate of Internal Trade, Marketing Management Assistance Project, FAO, EU
Schlotthauer, Julius	Senior Economic Development Advisor, USAID
Sequeira, Ricardo	General Director, Agrifocus
Silva, Gabriela	Director, INNOQ
Simoa, Alberto	Director, Policy Studies, MADER
Simons, Scott	Agricultural Policy Advisor, USAID, Mozambique
Sipanela, Jorge Aquimo	Senior Economist, NDE, MIC
Sitoe, Luís Eduardo	National Director, Directorate for International Relations, MIC
Story, James	Economic / Political Officer Third Secretary, U.S. Embassy
Tinga, Jorge	Agribusiness Advisor, INA (Institute of Sugar) and GPSCA (Unit for Promotion of Commercial Agriculture and Private Sector), Ministry of Agriculture and Rural Development
Thumbo, Hermenegilda Ruth Moisés	Office of Studies and Projects, Associação Moçambicana para o Desenvolvimento Rural (AMODER)
Trindade, José Carlos	Executive Director, Associação Moçambicana para o Desenvolvimento Rural (AMODER)
Ubisse, Adriano	Economist, Office of Studies, MPF

Usman, Mussa	Director Ajunto, CPI
Ussene, Mário	Director Centro de Arbitragem, Conciliação e Mediação da CTA (CACM) formerly Executive Director CTA
Van de Ven, Frans	Chief Technical Advisor, Marketing Management Assistance Project, National Directorate of Internal Trade, MIC
Van Dyk, Bernhard	General Manager, SEMOC
Van Seventer, Dirk Ernst	Senior Economist, Trade and Industrial Policy Strategies
Veloso, Alvaro	Operations Coordinator, CLUSA
Veloso, Luis	Director General, AON
Viola, José	Administrator, Bank of Mozambique
Viseu, Joao	Aga Khan Foundation
Waite, Graeme	Managing Director, Tete Dalmann
Walker, Tom	Training Coordinator, MSU University and Department of Policy Analysis, MADER
Wathier, Sylvie Millot	First Secretary, EU Mission
Watson II, James	Program Officer, USAID, Mozambique
Werner, Englert	Director, Fabrimetal & Peter Industries
Whitaker, Eric	First Secretary, Economic / Political Section Chief, U.S. Embassy
Wilson, John	Commercial Farmer, Horticulture
Wojtyla, Lauren	SAL Consultancy and Investments Limited
Ynaraja, Ramon	Trade and Private Sector Officer, EC Delegation
Zandamele, Alexandro do Conciecao	Ambassador, WTO / UNCTAD Geneva
Zimbabwean Farmers (various)	Tobacco, Maize, Paprika

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