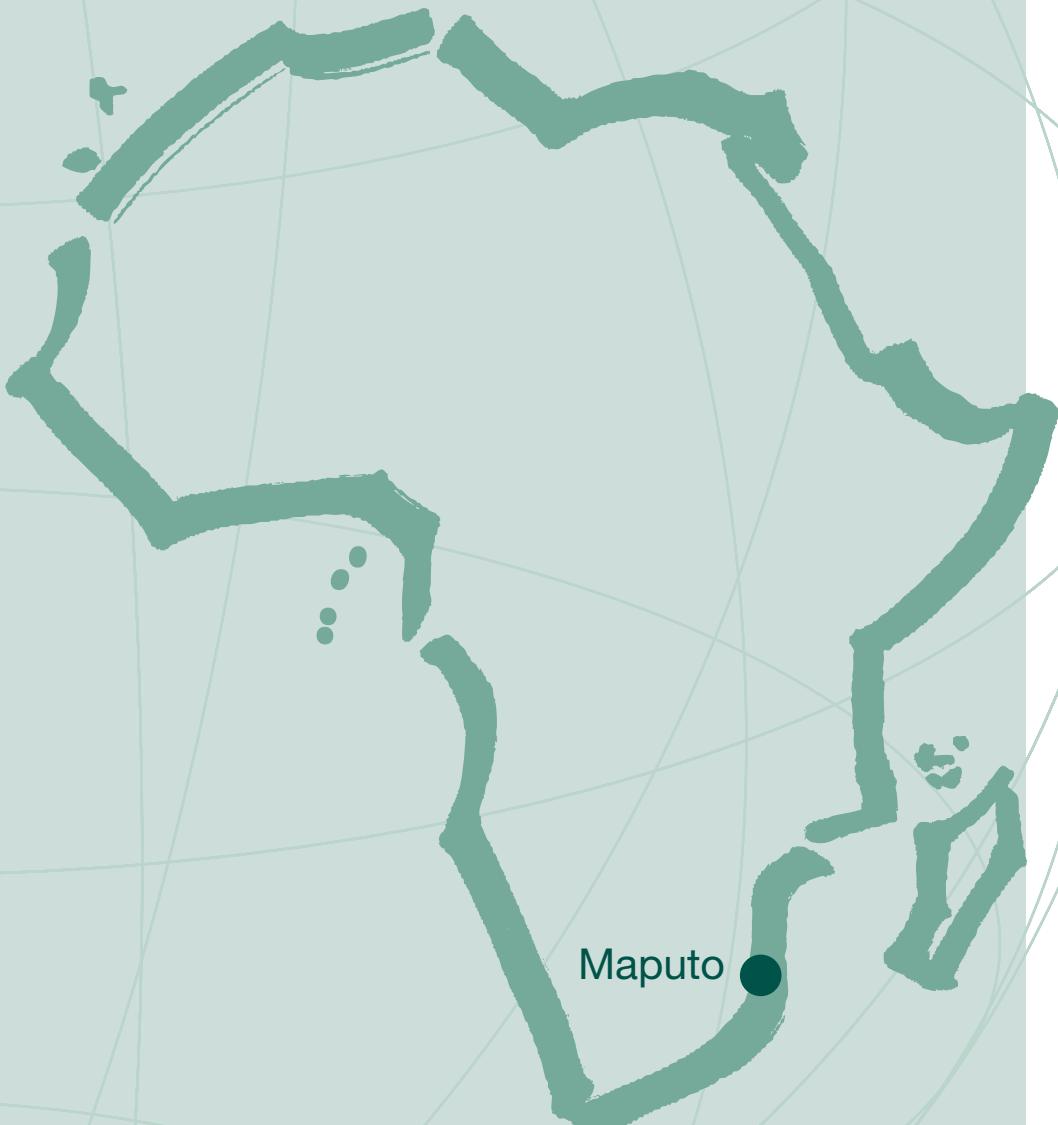


# Mozambique



## key figures

• Land area, thousands of km <sup>2</sup>	802
• Population, thousands (2005)	19 792
• GDP per capita, \$ PPP valuation (2005)	1 469
• Life expectancy (2000-2005)	41.9
• Illiteracy rate (2005)	49.6

# Mozambique



**M**OZAMBIQUE REMAINS A MODEL of successful post-conflict transition, with impressive economic growth averaging 8 per cent over the past decade and sustained political stability. Strong economic growth, reaching 7.7 per cent in 2005, continues to be driven primarily by foreign-financed “mega-projects” and large aid inflows. Agriculture is also increasingly contributing to economic growth, despite a drought that has caused severe hardship in the southern part of the country. The outlook for 2006 and 2007 is favourable, with growth expected at 7.9 and 7.3 per cent respectively, sustained by a new wave of mega-projects in titanium mines as well as strong growth in construction and agriculture.

While Mozambique’s recent growth rates are extraordinary, some observers, including Prime Minister Luisa Diogo, worry about the pattern of growth and its sustainability. Despite some progress in boosting

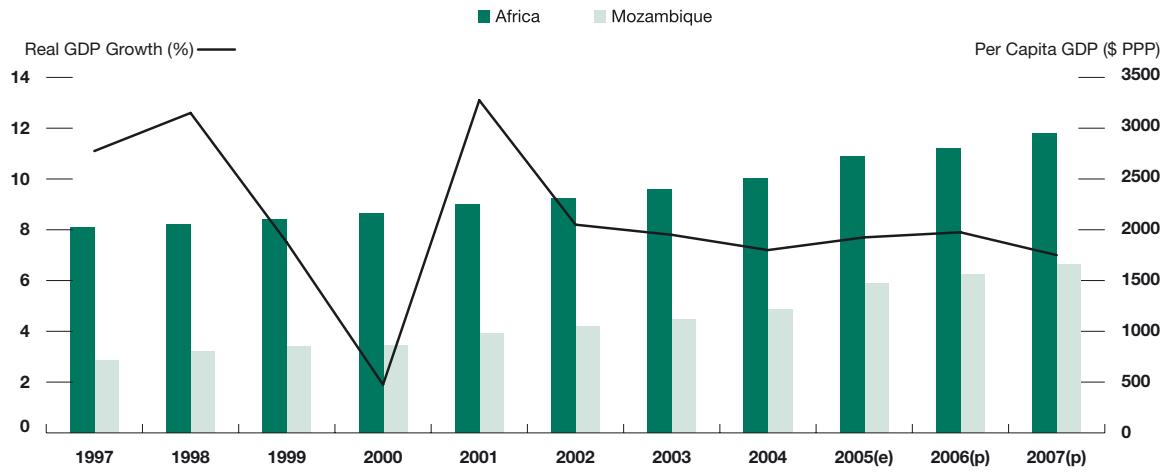
agricultural production, achieving broad-based growth remains a key challenge. Capital-intensive mega-projects generate few spillover effects on the rest of the economy, in terms of either job creation or tax revenues, as they benefit from substantial tax holidays. Unemployment and poverty remain critical problems. Furthermore, growth that is not related to mega-projects may begin to moderate, given the absence of comprehensive structural reforms and decreasing post-war reconstruction expenditure.

**New mega-projects are sustaining growth but unemployment and poverty persist.**

Fiscal management improved in 2005, with increased expenditure in priority sectors such as education, increased tax revenues, and moves towards decentralisation. This progress paved the way for the inclusion of the country in the G8 debt reduction initiative that is expected to halve the net present value of debt to about 10 per cent of GDP.

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**Figure 1 - Real GDP Growth and Per Capita GDP**  
(\$ PPP at current prices)



**Source:** IMF and National Institute of Statistics data; projections based on authors’ calculations.

Nevertheless, structural reform has been slow, notably in public sector human resource management and salary structures as well as in the judicial system.

Reflecting in part these delays, the business climate remains unfavourable. The preparation of a new poverty reduction strategy (PARPA II), to be completed in

2006, is expected to address these issues so as to provide a renewed impetus for private sector development and export diversification. It is hoped that PARPA II will also focus on improving the flexibility of the formal labour market and on fostering rural development through increased extension services, irrigation and strengthened micro-finance institutions.

## Recent Economic Developments

Mozambique has been one of the world's most rapidly growing economies over the past five years, with much of the impetus coming from reconstruction efforts and extensive foreign investment in natural resources-based projects.

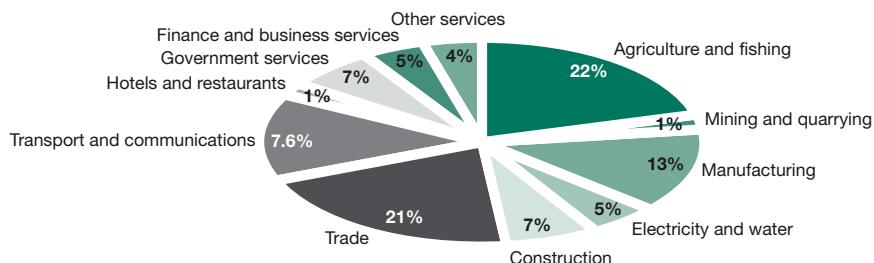
Thanks to increasing foreign investment in sugar and tobacco, agricultural performance has also improved, with output growing at 8.7 per cent in 2004 and 7 per cent in 2005. Nevertheless, for the fourth consecutive year, drought affected the country's arid southern regions, while in the northern and central regions rainfall was abundant. Cereal production was 4 per cent lower in 2004/05 than in the previous season, despite good harvests in the north, due to a 43 per cent fall in output in the southern regions. This shortfall left about 800 000 people in dire need of food aid at the end of 2005. Moving maize from the surplus areas in the north to the south remains very costly due to the poorly functioning internal transportation system, which resulted in a surge in imports of emergency maize, rice and wheat in 2005. The government appealed for \$21 million in international food aid, but as of November 2005, the response has been insufficient. The World Food Programme (WFP) was only able to feed about 30 per cent of those in need. Famine relief also suffered from inadequate rural roads, which furthermore are impassable during the rainy season. The situation improved in January 2006, as the WFP managed to distribute emergency food aid to about 700 000 Mozambicans. Despite good rains experienced since October 2005 leading to projected cereal output growth of 6 per cent in 2006, food shortages are likely to remain critical until the next harvest in March 2006.

As a longer-term solution to food insecurity, the government has instituted a \$2 million plan to boost rice production in the north and drought-resistant crops (e.g. cassava and sweet potatoes) in the southern provinces through the provision of seeds and fertilisers. The PARPA II agriculture development strategy also focuses on raising productivity through increasing extension services and irrigation, improved access to credit, notably by fostering micro-finance institutions, and investment in rural and feeder roads.

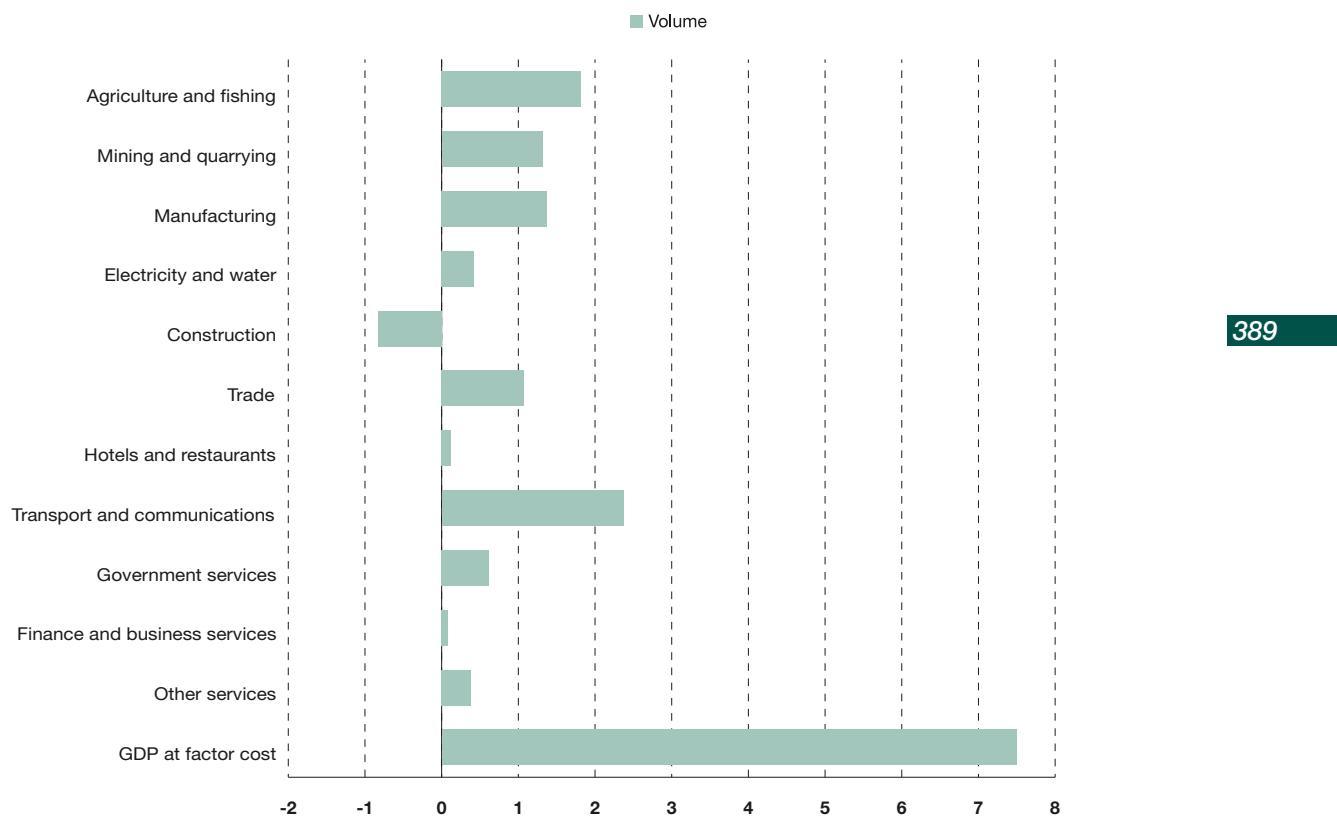
In contrast with the diminished production of food crops, production of the main cash crops (cashew nuts, cotton, sugar and tobacco) exceeded the levels of the previous year. Sugar cane production in particular grew by an estimated 3 per cent in 2004/05 following the 130 per cent increase in 2002/03. The sugar production boom is the result of large South African and Mauritian investments of about \$300 million for the rehabilitation and partial privatisation of four sugar-processing plants in the Maputo and Sofala provinces, which allowed the country to become a net exporter. Investment by Zimbabwean farmers in Manica province helped lift tobacco production by 20 per cent. Foreign investment in prawn farming also aided the fishing sector, which expanded by 7.7 per cent in 2005, thus reversing a declining trend.

The sugar sector will be affected by the combined effects of the phasing out of the EU's Everything But Arms (EBA) sugar protocol (2006-09) and the overall reform of the EU sugar regime (2006-15). On the one hand, producers will face a gradual but substantial reduction in the EU raw sugar reference price, although it will still be 50 per cent higher than the world price. On the other hand, the phasing out of European import duties on sugar between 2006 and 2009 will increase EU market access for Mozambican sugar.

Industry share of GDP has expanded sharply from 16 per cent in 1996 to 27 per cent in 2004; this increase is largely due to mega-projects. The Mozal aluminium smelter in Maputo province, created with a \$2.1 billion investment by Australian and South African interests, now accounts for half of manufacturing output, and has made Mozambique one of the world's leading

**Figure 2 - GDP by Sector in 2004 (percentage)**


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

**Figure 3 - Sectoral Contribution to GDP Growth in 2004 (percentage)**


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

exporters of aluminium. Other capital-intensive manufacturing industries, such as cement, beverages and tobacco-processing all recorded good performances, especially subsequent to the opening of a cement factory in Nampula and a tobacco factory in Tete.

After expanding by 230 per cent the previous year, the mining sector grew by another 40 per cent in 2005, following the completion of the Sasol gas pipeline

from Inhambane province to South Africa and the consequent increase in gas production. Foreign investors have stepped up exploration activities in base metals and industrial minerals. Kenmare Resources of Ireland is the lead investor in a new \$450 million titanium mine and smelter in Moma, which is expected to begin operations in late 2006. Australian and South African-based companies are also initiating the \$500 million Corridor Sands Titanium Project in

Gaza province, which has the world's largest deposit of titanium-bearing sands. The Corridor Sands project will be even larger than the Moma project, and will include the construction of either a port terminal on the coast of Gaza or a railway linking the smelter to the port of Maputo. Nevertheless, due to high capital intensity, profit repatriation and fiscal incentives, the mega-projects generate relatively minor benefits in terms of employment, linkages and foreign currency earnings.

The construction sector is heavily influenced by mega-projects. Following the start in October 2004 of the Moma titanium mining project, construction expanded by 8 per cent in 2005 rebounding from a contraction of 9 per cent in 2004, which reflected the completion of the Mozal and Sasol projects. Construction also benefited from the rehabilitation of the Sena railway line from Tete to Beira and road maintenance and rehabilitation works within the framework of the donor-supported 2004-06 ROADS-3 programme. Further expansion in construction is expected in 2006, thanks to continued road and bridge rehabilitation and the start of the Corridor Sands Titanium Project.

In the service sector, transport and communications grew by 13.2 per cent in 2005. Growth in transport reflected investment in roads around the three so-called "corridors": Maputo to South Africa, Beira to Zimbabwe and Nacala to Malawi (see section on transport infrastructure). Air traffic decreased by 2.2 per cent in 2005 however, owing to safety concerns about the

national carrier, Linhas Aéreas de Moçambique (LAM). Prospects for air travel are improving as LAM is undertaking measures to improve safety and has signed a code-share agreement with Kenya airways to expand Mozambique's international connections. Better communications performance in 2005 is the result of the mobile telephony boom, with the entry of a second mobile operator in late 2003. To encourage competition, in May 2003 M-Cell was separated from the state-owned telecom company TDM, and both entities became limited liability companies under majority state ownership. The government seeks a strategic partner to take a majority stake in TDM in order to attract funds for the expansion of the network. In April 2005, parliament passed a bill liberalising telecommunications, and a second fixed-line operator is to be licensed before the end of 2007.

Private investment in GDP doubled between 1997-2003, mostly reflecting the influx of foreign investment in the Mozal project, which was concluded in 2003. This ratio dropped in 2004-05, but is expected to increase substantially in 2006 and 2007, due to a new wave of foreign investment in mining mega-projects. Public investment, notably in donor-supported road building and other infrastructure development, increased in 2005 and is expected to grow further in the next two years. Increased foreign assistance is also expected to boost public consumption in 2006. Private consumption as a share of GDP fell in 2004 and 2005, mainly reflecting the effects of the drought. Strong export growth and reduced import growth reflected the completion of the Sasol and Mozal projects. The next

**Table 1 - Demand Composition** (percentage of GDP)

	1997	2002	2003	2004	2005(e)	2006(p)	2007(p)
<b>Gross capital formation</b>	<b>19.2</b>	<b>29.8</b>	<b>25.9</b>	<b>20.1</b>	<b>21.2</b>	<b>22.7</b>	<b>23.3</b>
Public	12.1	12.5	11.7	9.1	10.3	10.8	10.9
Private	7.1	17.3	14.2	10.9	10.9	11.9	12.4
<b>Consumption</b>	<b>93.2</b>	<b>89.0</b>	<b>89.9</b>	<b>88.2</b>	<b>87.7</b>	<b>88.4</b>	<b>89.6</b>
Public	7.5	12.6	13.2	12.9	13.6	14.2	14.3
Private	85.7	76.4	76.7	75.3	74.1	74.1	75.2
<b>External sector</b>	<b>-12.4</b>	<b>-18.8</b>	<b>-15.8</b>	<b>-8.3</b>	<b>-8.9</b>	<b>-11.0</b>	<b>-12.9</b>
Exports	14.7	29.0	28.3	30.0	30.6	29.7	27.5
Imports	27.2	-47.8	-44.1	-38.3	-39.5	-40.7	-40.3

**Source:** IMF and National Institute of Statistics data; projections based on authors' calculations.



wave of mega-projects will lead to a strong increase in capital goods imports over the next few years, while export growth is expected to slow down until the Moma titanium project begins production, anticipated in late 2006. Fiscal policy exhibited little change between 2004-05, but is expected to be less expansionary in 2006 and 2007.

## **Macroeconomic Policies**

### **Fiscal Policy**

Over the past five years, substantial progress has been made in macroeconomic stability as mandated by the 2001-05 PARPA and the three-year Poverty Reduction Growth Facility agreed with the IMF in July 2004. Reporting and management of expenditure has improved considerably, in areas such as the wage bill and debt management. Nevertheless, additional efforts to mobilise tax revenues are necessary in order to reduce dependence on foreign aid, which currently finances 50 per cent of the budget.

The 2005 joint review (government, donor and civil society) noted that the overall performance of fiscal policy was encouraging. Although expenditure increased towards the end of the year due to emergency grain imports in response to the drought, the budget deficit inclusive of grants for 2005 as a whole is estimated at 5.5 per cent, just under the 6 per cent target.

On the expenditure side, the wage bill was contained within the programmed range and there was some scaling back of capital expenditure. Expenditure on priority sectors – education, health, agriculture, infrastructure and good governance – increased from 63 per cent of total expenditure in the first half of 2004 to 66.9 per cent in the first half of 2005, exceeding the PARPA target of 65 per cent. Much of the increased spending was on health and education. Overall, the quality of financial reporting improved, reflecting the implementation of a new computerised system for recording expenditure (e-SISTAFE). After some delays, e-SISTAFE was instituted in three pilot ministries by the end of 2005. Also, a task force was established to further shift off-budget spending onto the official budget.

In 2006, the main objectives are the extension of e-SISTAFE to all ministries' spending and increasing fiscal decentralisation. The government has allocated \$300 000 per year to each district to finance small-scale infrastructure projects on the basis of a participatory planning process. While this fiscal decentralisation is potentially beneficial, its success depends on strengthening administrative capacity at local level and clarifying the responsibilities of provinces, districts and municipalities.

The 2006 budget also calls for recruiting 10 000 teachers and 2 000 health workers, which will entail a substantial increase in recurrent expenditure. Capital

**Table 2 - Public Finances** (percentage of GDP)

	1997	2002	2003	2004	2005(e)	2006(p)	2007(e)
<b>Total revenue and grants<sup>a</sup></b>	<b>20.9</b>	<b>22.8</b>	<b>22.5</b>	<b>19.6</b>	<b>20.1</b>	<b>22.3</b>	<b>22.9</b>
Tax revenue	11.6	11.0	12.0	11.4	11.6	11.8	12.5
Grants	9.3	10.3	9.5	7.3	7.6	9.5	9.5
<b>Total expenditure and net lending<sup>a</sup></b>	<b>23.5</b>	<b>29.8</b>	<b>26.9</b>	<b>24.0</b>	<b>25.6</b>	<b>26.4</b>	<b>27.0</b>
Current expenditure	10.7	13.7	14.8	14.1	14.5	14.9	14.9
Excluding interest	9.4	12.4	13.6	13.1	13.7	14.2	14.4
Wages and salaries	3.6	6.4	6.8	6.7	7.1	7.4	7.5
Interest	1.3	1.3	1.2	1.0	0.8	0.7	0.5
Capital expenditure	12.1	12.5	11.7	9.1	10.3	10.8	10.9
<b>Primary balance</b>	<b>-1.3</b>	<b>-5.6</b>	<b>-3.3</b>	<b>-3.4</b>	<b>-4.7</b>	<b>-3.5</b>	<b>-3.5</b>
<b>Overall balance</b>	<b>-2.6</b>	<b>-7.0</b>	<b>-4.5</b>	<b>-4.4</b>	<b>-5.5</b>	<b>-4.2</b>	<b>-4.1</b>

a. Only major items are reported.

**Source:** IMF and Ministry of Finance and Planning data; projections based on authors' calculations.

outlays are also projected to increase, while the share of spending on priority sectors out of total primary expenditure will remain above the 65 per cent level. This increased investment and social spending is enabled through increased foreign assistance and debt relief.

On the revenue side, measures to identify and collect corporate and individual tax arrears from 2003/04 were adopted in 2005. The 2006 budget calls for continued strengthening of tax administration, notably through the establishment of a Central Revenue Authority. The scope for increased revenues is limited, however, by the special tax regimes for mega-projects, including preferential corporate tax rates, tariff exemptions and tax deductions for social and environmental expenditures, which lack transparency.

Given that tax revenues are expected to increase moderately as a share of GDP and increased social spending is anticipated to be more than offset by increased aid and the restraint of other expenditure, the budget deficit is forecast to decline to just above 4 per cent of GDP in 2006 and 2007.

### **Monetary Policy**

Since 2004, the Bank of Mozambique has undertaken a series of measures to strengthen monetary management, through daily liquidity forecasting and the use of foreign exchange and Treasury Bill sales to sterilize the changes in the monetary base that are associated with balance-of-payments shocks.

In 2005, central bank targets for growth of broad money stock and inflation were set at 14.5 per cent and 8 per cent respectively. Nevertheless, the money supply increased by 25 per cent in 2005. After appreciating by approximately 20 per cent in 2004, the metical has trended downwards since early 2005 – depreciating by around 60 per cent from February–November. The currency also experienced some volatility following the introduction of a foreign exchange auction system in January 2005 but stabilised towards the end of the year as the market and monetary authorities gradually adjusted to the new system. Strong inflows of foreign

direct investment and additional food aid are expected to put upward pressure on the metical in 2006.

The effects of the 2004 world oil price rises on domestic petrol prices were partly offset by the appreciation of the exchange rate, but in the first half of 2005 further oil price increases were instead compounded in local currency terms by the depreciation of the metical, forcing the government to raise domestic fuel prices. In the first half of 2005, there were four fuel price hikes, cumulatively increasing retail fuel prices by 50 per cent. Two further fuel price increases of 20 per cent and 8 per cent occurred in October and November 2005 respectively.

Despite these large increases in fuel prices, inflation trended downwards in 2005, averaging 7.4 per cent for the year compared to 12.6 per cent in 2004, largely as a result of lower food prices between March–August 2005. However, overall inflation rose back up to 14 per cent in the last quarter of 2005, partly due to the drought in the southern part of the country and the fuel price rises. On the assumption of normal weather conditions and continued monetary restraint, inflation is expected to decelerate to 7.2 per cent in 2006 and 5.6 per cent in 2007.

### **External Position**

Mozambique's current account deficit dropped to 5 per cent of GDP in 2004 from 9.2 per cent in 2003. Exports rose from \$1.04 billion to \$1.50 billion in 2004, which is a proportionally greater increase than the rise in imports, from \$1.75 billion to \$2.03 billion. In 2004, aluminium from the Mozal project accounted for nearly two-thirds of export revenue. Natural gas (associated with the first full year of operation of the Sasol pipeline to South Africa), and fish and crustaceans (chiefly prawns) were a distant second and third in the list of exports. Mozambique's imports are dominated by mechanical and electrical machinery, vehicles, and iron and other inputs used by mega-projects. The country is a substantial importer of cereals, and recently increased these imports in response to the drought, as noted earlier. Despite sluggish exports in some key sectors, such as prawns, sugar and tobacco in the first



half of 2005, and a jump in the oil import bill, the trade balance improved slightly, largely thanks to buoyant aluminium exports. The construction of the Corridor Sands project and the Moma project are expected to boost imports of capital goods in 2006, but will also start to contribute to export growth towards the end of 2007.

Mozambique's principal export market is the Netherlands, to which 100 per cent of Mozal's aluminium is exported, reflecting Rotterdam's role as a hub for the trans-shipment of aluminium. Other important destinations for Mozambique's exports include South Africa, Malawi and Portugal. The largest source of imports is South Africa, followed by the Netherlands, Portugal, India and the USA. In short, Mozambique's trade is at present dominated by the Mozal and Sasol mega-projects.

Mozambique's membership of the South African Development Community (SADC) will impose a schedule of tariff reductions on intra-regional imports beginning in 2008, leading to complete elimination of tariffs by 2015. Separately, Mozambique plans to reduce the maximum tariff rate from 25 to 20 per cent on imports from all countries, including non-SADC countries, in 2006. The negotiations for the SADC Economic Partnership Agreement (EPA) with the European Union, which began in 2002, entered a new round in September 2005, and are scheduled to be completed in late 2007. The objectives of the EPA include liberalised trade between SADC and the EU in the longer term, and EU support for trade capacity building in the medium term. At present, Mozambique benefits from tariff-free access to the EU under the EBA initiative, but the latter is scheduled to expire, so trade relations with the EU will be governed by the EPA.

**Table 3 - Current Account** (percentage of GDP)

	1997	2002	2003	2004	2005(e)	2006(p)	2007(p)
Trade balance	-15.4	-17.9	-14.6	-8.7	-8.5	-10.3	-11.9
Exports of goods (f.o.b.)	6.7	19.8	21.8	24.7	26.2	25.5	23.5
Imports of goods (f.o.b.)	-22.0	-37.7	-36.4	-33.4	-34.7	-35.8	-35.4
Services	2.9	-0.9	-1.2	0.5			
Factor income <sup>a</sup>	-5.3	-4.2	-4.1	-5.6			
Current transfers	5.2	9.8	10.7	8.9			
<b>Current account balance</b>	<b>-12.5</b>	<b>-13.3</b>	<b>-9.2</b>	<b>-5.0</b>			

a. Factor income is included in services.

**Source:** IMF and Bank of Mozambique data; projections based on authors' calculations.

Abundant natural resources have made Mozambique one of the magnets for foreign direct investment (FDI) in southern Africa. The stock of FDI has risen to over \$4 billion in 2004, mostly due to mega-projects.

Although mega-projects contribute positively to the balance of payments through exports and FDI, their net impact on this balance is smaller, owing to imports of capital goods, and repatriation of profits and remittances. Moreover, FDI remains concentrated in industry in the south of the country, and has yielded limited backward and forward linkages with local business. In order to extend foreign investment contribution to the rest of the economy, the authorities announced their plans in late 2005 to set up a "Special

Economic Zone" in the northern port of Nacala; to launch fisheries projects, particularly fish farming, in Sofala, Zambezia and Cabo Delgado; to attract investment in irrigation and agricultural projects in the Zambezi valley; and to promote tourism ventures in Cabo Delgado, Niassa and Nampula.

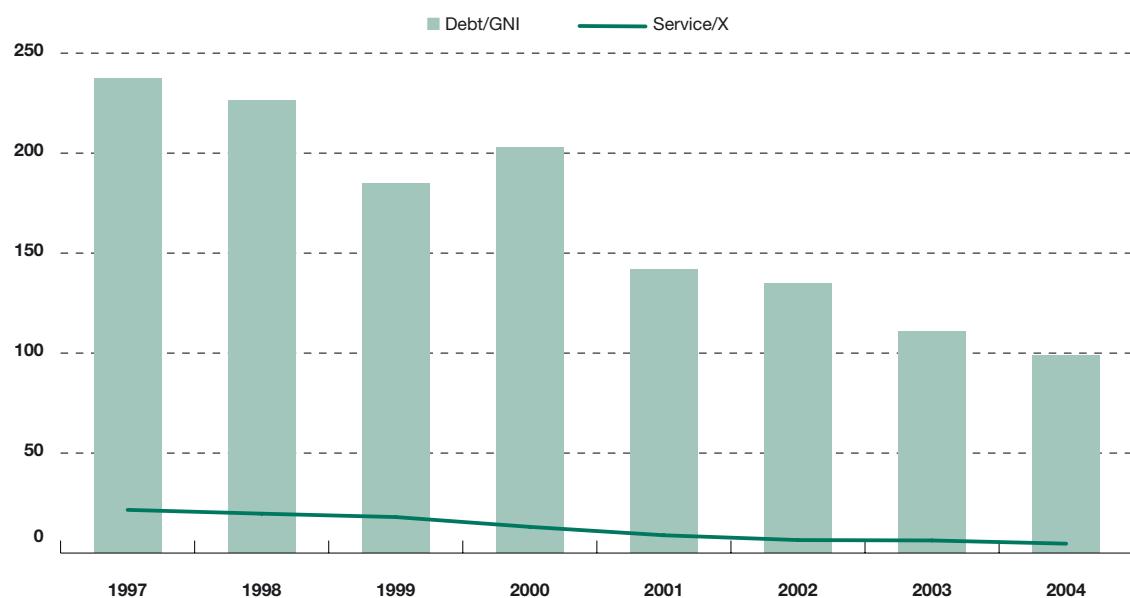
Foreign aid has been a critical source of resources for Mozambique since the end of the civil war, placing it among the world's top recipients of aid. Net official development assistance rose by 18 per cent in 2004, yielding an aid-to-GDP ratio of 20 per cent. Seventeen donor countries (G17) recently formed a committee to co-ordinate their programmes. The G17 currently provides 27 per cent of total aid but their share is

expected to increase to 60 per cent as a result of multilateral debt relief and promised increases in aid flows. In order to align donor programmes with government planning and implementation cycles and reduce the volatility of disbursement, G17 has signed a Memorandum of Understanding with the government to undertake joint reviews of government programmes.

Mozambique's stock of foreign debt stood at \$4.4 billion in December 2004, remaining virtually

unchanged from one year earlier; 52 per cent of this debt was owed to multilateral creditors. The recently announced cancellation of multilateral debt, following the July 2005 G8 meeting in Gleneagles, signifies that the net present value of the public external debt-to-GDP ratio will decline precipitously to approximately 10 per cent. Debt service in 2004 totalled \$57.9 million, \$3 million of which was rescheduled. As a result of bilateral and multilateral debt relief, public debt service is expected to be reduced by 0.5-0.6 per cent of GDP in the next few years.

**Figure 4 - Stock of Total External Debt (percentage of GNI) and Debt Service (percentage of exports of goods and services)**



Source: IMF and World Bank.

## Structural Issues

### Recent Developments

Firms cited three key factors in an IFC-sponsored survey on perceptions of impediments to private sector development. In order of importance, these obstacles were: *i*) the high cost of and lack of access to finance; *ii*) the policy environment, including taxation, corruption regulatory and administrative barriers (licences, labour regulations, access to land); and *iii*) inadequate infrastructure, especially electricity and roads.

Regarding finance, firms reported that 90 per cent of working capital and nearly two-thirds of investment are financed using their own funds. Firms are deterred from bank credit by high interest rates (13 to 18 per cent in real terms) and prohibitive collateral requirements (approximately 140 per cent of the credit amount). Increased private sector access to loans can be fostered through improved bank balance sheets, reduced crowding-out from public-sector borrowing, and by offering incentives to commercial banks to hold a greater share of their assets in the form of industrial and commercial loans. Efforts to promote bank lending must nevertheless be balanced against safeguarding the



solvency of the banking system. In July 2005, prudential regulations were tightened, with banks required to hold reserves equal to 50 per cent of foreign currency loans to non-exporters, effectively precluding such loans. This measure is likely to have an adverse effect on many industries, especially construction and tourism, which are dependent on imports and often need to borrow in dollars. The IMF nevertheless endorsed the stricter prudential regulations during its 2005 review of the Fund's Poverty Reduction and Growth Facility.

The second structural factor identified by Mozambican firms in the IFC survey concerned the policy environment, especially corruption. Sixty four per cent of firms cited bribes to government officials as a major or severe problem (although only 27 per cent claimed to have made such payments). These findings are complemented by the Pesquisa Nacional sobre Governação e Corrupção, published in 2005, supporting the IFC finding that corruption is a major problem.

Despite the stated government commitment to promoting the private sector, regulatory and administrative barriers to private sector activity remain pervasive. Firms cite labour-market rigidities related to hiring temporary workers and lay-offs, government procurement procedures, judicial problems and uncertain property rights.

Nearly two-thirds of firms ranked electricity supply as a major or severe problem in the IFC survey. Nearly a quarter owned generators and the median loss from power outages was equivalent to 2 per cent of sales revenues. It is hoped that the impending transfer of ownership to the Mozambican state of one of Africa's largest hydroelectric plants, the Cahora Bassa dam (HCB), might help alleviate the electricity shortage. The stumbling block to negotiations between Portugal (until recently owner of 82 per cent of the capital of the dam) and Mozambique (18 per cent ownership) was Mozambique's insistence that Portugal forgive some \$2.3 billion of debt owed by the dam to the Portuguese treasury. Under the new agreement, the situation is to be reversed: Mozambique will gain ownership of 85 per cent of HCB with Portugal retaining only 15 per cent, for which Mozambique will pay the Portuguese

government \$950 million by end-2006, which constitutes about 15 per cent of 2005 Mozambican GDP. Resolution of the lengthy negotiations between Portugal and Mozambique may allow long-delayed investments in generating capacity and other improvements to get underway, with some private participation. This is probably of particular significance for the projected new dam on the Zambezi river at Mepanda Ncua, 70 km downstream from Cahora Bassa. The Mozambican authorities had feared that failure to solve the Cahora Bassa issue would dissuade companies from investing in Mepanda Ncua.

Agriculture also faces an adverse institutional environment. The June 2005 announcement made by the João Ferreira dos Santos group, a major commercial agricultural operator in Mozambique since the late nineteenth century, that it would join a long list of firms exiting agricultural operations, symbolises the problems faced in the commercial agriculture sector. Despite initiatives such as increased telephone coverage in rural areas, rural electrification, rehabilitation and maintenance of rural roads, and the World Bank-funded Agricultural Sector Public Expenditure Programme (ending in 2005), no national rural development programme is in place. The authorities have promised to launch such a strategy in the near term.

### **Transport Infrastructure**

With more than 2 500 km of coastline, Mozambique is an important economic gateway for neighbouring landlocked countries. Since colonial times, the country has exploited this strategic position, developing three main corridors linking Malawi and Zimbabwe to the ports of Nacala and Beira respectively, and South Africa and Swaziland to the Maputo port.

The Maputo Development Corridor linking the South African provinces of Gauteng and Mpumalanga to the port of Maputo is the most important transport link. The corridor was intended to encourage the integrated development of the area, with the construction of a toll road, increasing the role of the private sector in the Maputo port and of the railway lines through concessions. It was also intended to

encourage the establishment of industrial free trade zones. The concession for operating the 503 km highway linking Maputo and Witbank was awarded to Trans African Concessions, and the highway became a toll road in 2000. The toll road is currently operating successfully and benefits from substantial traffic to and from the Mozal smelter (see box). The Maputo port has been managed by the Maputo Port Development Company consortium as a 15-year concession that began in 2003. The consortium, led by a UK company, has implemented a \$70 million three-year rehabilitation programme for the port and its connecting roads. Major South African exporters are already using Maputo port instead of the more distant and congested ports of Durban and Cape Town.

In 2002, the Mozambique government granted South Africa's rail utility Spoornet operating rights for the railway line from Maputo to Ressano Garcia on the border with South Africa. An important component of the concession agreement is the commitment to invest \$10 million in upgrading the lines, bringing the Mozambique section up to South African standards. However, the consortium did not take over management of the line or invest in its rehabilitation. The cargo shipments from South Africa to Maputo are falling short of the levels envisaged in the agreement, as cargo is being diverted to Durban. Consequently, the government cancelled the lease in 2005, and the Mozambican port and rail company CFM will rehabilitate the Maputo-South Africa line in 2006.

### Lessons Learned from the South Africa-Mozambique Toll Road

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The governments of Mozambique and South Africa signed a 3 billion rand, 30-year concession in 1996 with a private consortium, Trans-African Concessions (TRAC) to build and operate the N4 toll road from Witbank to Maputo. Since the road was completed in 2000, traffic has been rising at a rate of about 6 per cent a year. The high volume of traffic, averaging about 60 000 vehicles daily, originates primarily from the Mozal smelter and the industrial parks. The road facilitated further private sector investment in Mozambique and helped to increase tourism in the region, leading in turn to further increases in traffic.

The success of the project stems also from its financing, with commercial risk being shared by a wide range of investors. The toll road was financed with 20 per cent equity and 80 per cent debt. Three construction companies contributed 331 million rand worth of equity with the rest of the capital provided by many investors. The lenders include South Africa's four major banks and the Development Bank of Southern Africa. The governments of South Africa and Mozambique jointly guaranteed the debt of TRAC and, under certain conditions, the equity as well. At the time, it was the biggest project finance deal in southern Africa.

In order to reduce the burden on low-income Mozambique, TRAC subsidised the Mozambican portion of the road with the higher revenues from the South African side, and also provided substantial discounts to regular Mozambican users. The toll varies according to the size of vehicles. The substantial benefits for trucks include: the avoidance of border tax for vehicles entering Mozambique at Ressano Garcia, 24-hour roadside assistance through TRAC patrols, improved road conditions and regular road maintenance.

The main problem for the concession-holder is damage to the road as the concession agreement did not specify regulations on truck loads. At the beginning of 2004, TRAC began to assist both the South African and Mozambican governments in establishing axle load control measures. The percentage of overloaded vehicles has already fallen from 23 per cent in 2001 to 9 per cent in 2004.



The Beira corridor has been severely impacted by the economic crisis in Zimbabwe, which accounts for the vast majority of its traffic. Nevertheless, traffic is expected to rise following the reconstruction of the Sena railway line, linking Beira to the Moatize coal mines in Tete province, with the work to be carried out by an Indian consortium, Rites and Ircon International. This railway will enable the huge investments planned by the Brazilian Companhia Vale do Rio to go forward. Additional traffic is expected to arise from the increasing development of the agricultural zones of Manica and Sofala.

The Nacala corridor is likely to see expanded use, as it is the natural route to the deep sea port of Nacala for Zambian copper destined for China and India. In addition, an 800 km railway connects the port with Malawi. Nevertheless, the rail line is in very poor condition and traffic volume remains very low. The management of the port and railway has been awarded to an American, South African, Portuguese and Mozambican consortium, the Nacala Corridor Development Company (SDCN), which took over management in early 2005. However, the government has been dissatisfied with decisions made by SDCN to close railway stations and dismantle the communication system between the stations and the trains. SDCN also failed to operate the promised regular service on the branch line between the cities of Cuamba and Lichinga in Niassa province. After pressure from the government, SDCN reinstated the communication system, but many stations remain closed.

In contrast with the well-established east-west corridors linking Mozambique to its neighbours, north-south transport is virtually non-existent. A small ferry service on the Zambezi river is the only direct link between the food surplus-producing areas in the central and northern regions to the southern regions, where all the main industrial and trading activities are concentrated. This lack of north-south transport limits the development of national markets, reduces the mobility of people and goods, raises transport costs and has exacerbated the food crisis. According to the World Bank Value Chain analysis, moving a product from Pemba to Maputo by road requires crossing into

Malawi, Zambia and Zimbabwe to travel southward, and then re-entering Mozambique. The cost of trucking a 22-24 tonne container from Maputo to the north (Pemba) is about \$7 000, which is nearly 2.5 times the cost of shipping the same container from Dubai or Guangzhou, China to Maputo.

The long-planned construction of a 2.4 km bridge over the Zambezi river at Caia is finally underway. In November 2005, the EU launched an international tender to select a contractor to construct the bridge. A formal contract between the Mozambican government and a Portuguese contractor was signed in February 2006. The construction of the bridge, budgeted at \$80 million, is expected to take three years and is being jointly funded by the EU, Sweden, Italy, Japan and the Mozambican government.

Over the past 15 years, government and development partners have embarked on major projects to improve the road system through the Roads and Coastal Shipping Project (ROCS), and now the Third Roads Programme (ROADS-3), which are expected to end by mid-2006. The ROCS/ROADS-3 programme includes: the rehabilitation of the Estrada Nacional 1, which connects the north and the south of the country; the rehabilitation of feeder roads; the periodic and routine maintenance of roads; and reconstruction of bridges. The ROCS programme has been quite successful. So far, approximately 6 000 km of roads have been opened and rehabilitated or are in the process of being opened. Approximately 18 000 km of roads are undergoing routine maintenance.

Nevertheless, government resources allocated to road maintenance remain limited as the fuel levy, which constitutes the chief source of financing of the Road Fund, is often diverted to other government priorities. Also, payments to contractors and consultants are often overdue, resulting in late payment fees, interest and lawsuits. As a result of such disputes, work on all N1 road contracts financed by the World Bank has been suspended in 2005. Since the beginning of 2005, donors have sought to provide technical support for the Road fund and the National Road Agency (ANE) in planning and project design, implementation of projects,

and supervision. In addition, measures have been introduced to reduce dependence on the fuel levy in funding road maintenance and development.

## Political and Social Context

The December 2004 presidential and legislative elections – the third to take place since the end of the civil war in 1992 – brought Armando Emílio Guebuza to presidency and maintained Frente de Libertação de Moçambique (Frelimo) in power. The party has had an uninterrupted hold on power for 30 years, 18 of which were ruled by Guebuza's predecessor, Joachim Chissano. Guebuza has focused attention on poverty reduction, improvement of justice and policing, and especially on the eradication of corruption. Critics claim that the government's anti-corruption efforts have mainly targeted low-level functionaries and those associated with the previous administration. One of the biggest challenges facing the new government is to make significant improvements in co-ordination and articulation between institutions, policies and strategies at all levels – central, district and provincial, which is particularly important given the drive of the new government to promote decentralisation and to encourage a more active role for state institutions. This issue has been highlighted in most of the speeches made by the new President.

PARPA and its replacement PARPA II lay out the country's strategy for attaining the Millennium Development Goals (MDGs). A 2005 report by the Instituto Nacional de Estatística (INE) provides important information on Mozambique's progress towards the MDGs.<sup>1</sup> The INE measures poverty on the basis of the cost of a basket of goods and services. Survey data reveal a substantial decrease in the incidence of poverty, from 69 per cent in 1996/97 to 54 per cent in 2002/03. Rural (55 per cent) and urban (52 per cent) poverty rates are similar, but there are substantial regional variations: the central provinces (Manica, Sofala, Zambézia) have the lowest poverty rates, while

the southern provinces (Gaza, Inhambane, Maputo) and northern provinces (Tete, Niassa, Cabo Delgado, Nampula) have much higher rates. Further reducing poverty to below 50 per cent will be more challenging, as progress so far mainly reflects improved agricultural production thanks to good rains and the re-establishment of peace. Structural reforms to increase agricultural productivity and promote labour-intensive industries are required to increase employment and income for the poor.

According to the 2002/03 IAF survey, the overall primary and secondary school enrolment rate is 68 per cent for boys and 64 per cent for girls, 79 per cent for urban children and 60 per cent for rural children. There is a marked north-south divide for enrolment rates. The overall literacy rate is 46 per cent, with 34 per cent in rural areas and 70 per cent in urban areas, and the literacy rate increases steadily as one moves from north to south.

According to the same IAF survey, infant mortality is 178 per 1 000 live births. While this rate is a substantial improvement on the 1996/97 rate of 219 per 1 000, it is still quite high by international standards. Also, there remain important differences between urban (143 per 1 000) and rural (192 per 1 000) rates of infant mortality, and between regions. Mortality for children aged under five has exhibited the same downward trend and the same regional variations. Vaccination against measles between the ages of 12 and 23 months is one of the key measures required for reducing child mortality. Over 90 per cent of children in this age range in southern regions have been vaccinated, but in northern regions the proportion is much lower, ranging from two-thirds to three-quarters, with a low of 52 per cent in Niassa.

As in many other countries in the southern African region, HIV/AIDS is a major health problem in Mozambique. The results of the 2004 round of the Ministry of Health's Epidemiological HIV Monitoring programme reveal a national prevalence rate of 16.2 per

1. Much of the information is based on the Inquérito aos Agregados Familiares Sobre Orçamento Familiar (IAF) surveys of 1996/97 and 2002/03.



cent for adults between 15 and 49 years old, versus the rate of 13.6 per cent observed during the 2002 round. Prevalence rates vary across regions: in the south (Maputo City and Province, Gaza and Inhambane) the rate is 18.1 per cent, in the north (Niassa, Nampula and Cabo Delgado) it is 9.3 per cent, and in the centre (Sofala, Manica, Tete, Zambézia) it is 20.4 per cent. These rates are growing in all regions, but there is evidence that in the centre (with the exception of Zambézia), the epidemic has reached a plateau. The most rapid rate of increase is observed in the north.

In 2004/05, drought and the acute poverty in some regions of Mozambique led to marked food insecurity. Reports that food stocks have been essentially depleted

in Gaza, Inhambane and Tete mean that even if the rainfall situation improves during the 2005/06 crop season, rural households will face critical food shortages before the harvest. The World Food Programme, in addition to ongoing initiatives such as providing food to children at school, has established some 300 emergency food distribution centres.

Although unemployment and underemployment of workers is significant in Mozambique, existing data make it very difficult to judge the magnitude of the problem. A detailed labour-force survey organised by the INE is expected to shed considerably more light on employment in Mozambique when results become available in 2006.

