



**MOZAMBIQUE  
PRIVATE SECTOR  
COUNTRY PROFILE**  
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**AFRICAN DEVELOPMENT BANK  
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## Acronyms and Abbreviations

|            |  |
|------------|--|
| ADB        | African Development Bank   |
| AIDS       | Acquired Immune Deficiency Syndrome  |
| ANE        | Administração Nacional de Estradas (National Road Administration)                            |
| BdM        | Banco de Moçambique (Bank of Mozambique)   |
| CEMPRE     | Censo de empresas (Firm census)  |
| CFM        | Portos e Caminhos de Ferro de Moçambique (National Ports and Railroad Company)               |
| CMH        | Companhia Moçambicana de Hidrocarbonetos (National Hydrocarbon Company)                      |
| CTA        | Confederação das Associações Economicas de Moçambique  |
| DFID       | Department for International Development (United Kingdom)                                    |
| DRC        | Democratic Republic of Congo   |
| EdM        | Electricidade de Moçambique (National Electricity Company)                                   |
| EIB        | European Investment Bank   |
| EU         | European Union   |
| FDI        | Foreign Direct Investment  |
| FIPAG      | Fundo de Investimento e Patrimonio de Abastecimento de Aguas (Water Supply Investment Fund)  |
| GDP        | Gross Domestic Product   |
| GNI        | Gross National Income  |
| Government | Government of Mozambique   |
| GTZ        | Gesellschaft fur Technische Zusammenarbeit   |
| Ha         | Hectare  |
| HIV        | Human Immunodeficiency Virus   |
| IFC        | International Finance Corporation  |
| INE        | Instituto Nacional de Estatistica (National Statistics Institute)                            |
| KfW        | Kreditanstalt für Wiederaufbau   |
| Km         | Kilometer  |
| MCC        | Millenium Challenge Corporation (US Government)  |
| MZM        | Mozambican Metical   |
| MW         | Megawatt   |
| NGO        | Non Governmental Organization  |
| NWDP       | National Water Development Program   |
| PAP        | Program Aid Partners   |
| PARPA      | Plano de Acção para a Reduccion da Poverta Absoluta (National Poverty Reduction Action Plan) |
| PPP        | Public Private Partnership   |
| PRSP       | Poverty Reduction Support Program  |
| PSWG       | Private Sector Working Group   |
| RSS        | Road Sector Strategy   |
| SADC       | Southern African Development Community   |
| SISTAFE    | Sistema de Administração Financeira do Estado (National Financial Administration System)     |
| SME        | Small and Medium-sized Enterprises   |
| SWOT       | Strengths, Weaknesses, Opportunities, Threats  |
| Tcf        | Trillion Cubic Feet  |
| UNDP       | United Nations Development Program   |
| UNESCO     | United Nations Educational, Scientific and Cultural Organization                             |
| USAID      | United States Agency for International Development   |
| USD        | United States Dollar   |
| VAT        | Value Added Tax  |
| WB         | World Bank   |
| WHO        | World Health Organization  |
| WTO        | World Trade Organization   |

# MOZAMBIQUE

## PRIVATE SECTOR COUNTRY PROFILE

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### 1. Introduction

1.1 The private sector is increasingly viewed as an engine for growth across the African continent. Mozambique is no exception. While the private sector in Mozambique languished for years during the period of civil war and centralized economic management, the country's prospects are now more favorable than ever to promoting the private sector as a major tool to accelerate development and contribute to poverty alleviation. The African Development Bank (ADB) has established support to private sector development as one of its key medium-term strategic objectives. However, to support the private sector effectively, it is important first to have an understanding of the country context, the potential and constraints, so that an effective assistance strategy can be mapped. The main objective of this report is to provide an overview of the context for private sector development in Mozambique. The report is based on deskwork, data assembled by ADB, as well as field visits to discuss major issues, test assistance ideas, and acceptability; and identify new directions for stimulating solid and sustainable private sector growth.<sup>1</sup> Efforts have been made to identify the most recent data, critical in a rapidly evolving country, and to identify specific opportunities or actions to be undertaken to open new opportunities. Following this introduction, section 2 provides an overview of the business environment in Mozambique today. Section 3 looks at strengths and potential, while section 4 examines key constraints to be overcome. Section 5 provides an overview of the critically important labor market. Section 6 proposes actions to be undertaken by the Government and donors to achieve the common objective of developing a vibrant private sector in Mozambique.

### 2. Business Environment Today

2.1 **From post-conflict to progress** After 30 years of warfare that came to an end in the early 1990s, Mozambique has made remarkable progress. GDP growth over the last five years has averaged close to 8% and is expected to remain high in the coming years. At the same time, Mozambique has had some success in tackling inflation. The Government's primary budget deficit is declining and debt is being kept within sustainable levels. The country's recent economic performance has been grounded in overall macroeconomic stability, policy reform and pro-poor government expenditure. Although poverty remains a major problem, the percentage of the population living in absolute poverty has fallen from 69% in 1996 to 54% currently, and the Government hopes to reduce poverty to 45% by 2009. Progress on macroeconomic and governance reforms has brought strong donor support. During the last 15 years, Mozambique has received about USD 8 billion in foreign aid, almost USD 600 million per year, which is 50% of annual budget and 17% of country's GDP.

**Table 1 : Recent macroeconomic trends and projections**

|                       | 2003  | 2004  | 2005  | 2006  | Est. 2007 | Proj. 2008 | Proj. 2009 |
|-----------------------|-------|-------|-------|-------|-----------|------------|------------|
| GDP (million USD)     | 4,789 | 5,904 | 6,579 | 6,948 | 10,892    | 11,604     | 12,154     |
| GDP growth (%)        | 7.9   | 7.5   | 8.4   | 8.0   | 7.2       | 7.0        | 6.8        |
| GNI per capita (USD)  | 230   | 270   | 310   | 340   | ..        | ..         | ..         |
| Inflation (%)         | 13.5  | 12.9  | 6.4   | 13.2  | 7.9       | 7.1        | 5.3        |
| USD/MZM exchange rate | 23.78 | 22.58 | 23.06 | 24.98 | 27.07     | 28.23      | 28.89      |

Source: African Economic Outlook, February 2008 & WB 2007

2.2 **Driven by mega-projects and the South African market** Mozambique has managed to attract investors in several "mega-projects". These projects are concentrated in the energy (Cahora

<sup>1</sup> This profile has been prepared based on a detailed report compiled by a team from SOFRECO, under the leadership of Mrs. Annie Cordet-Dupouy, with the support of Jean Michel Netter and Eric Granry.

Bassa, Pande/Temane gas fields), industrial (Mozal Aluminum plant) and mining sectors (Moatize coal mines, Moma Titanium). While they have been the primary drivers of growth and exports, they have also been criticized in the past for not generating enough employment or developing linkages with the broader economy. Several initiatives have improved this situation by increasing mega-project procurement from local SMEs. However, future growth is expected to come from high-potential sectors, such as agriculture, which already account for the bulk of exports beyond the mega-projects. Mozambique has significant potential in traditional products such as sugar, cotton, cashew nuts, tobacco and shrimp, as well as new ones such as bio-fuels, fruits and vegetables, and forestry. There is also potential to increase in-country processing and transformation to increase the value of exports. It will be critical to help local SMEs exploit this potential.

2.3 Mozambique's economy is deeply dependent on South African markets. The Maputo harbor is essentially an export corridor for South African goods (i.e., coal, sugar, citrus, and cars). The electricity generated at Cahora Bassa is transmitted via a South African line to the Southern grid (Mozambique does not have its own line and must pay a rental fee), then imported back by Mozal. The Government's immediate priority for the Cahora Bassa Dam is to proceed with the development of a second station 70 km downstream at Mpanda Uncua for which feasibility studies are under way. The gas from Pande/Temane is sold to Sasol, a South African enterprise. Mozambique's small tourism industry is dominated by South African operators and is often an extension of tours to South Africa. Some of the main companies (Mozal, Standard Bank, the Maputo Corridor, the main brewery, etc.) are subsidiaries of South African companies. South Africa is Mozambique's main trading partner (excluding mega-projects).

2.4 **A mixed business environment** Mozambique has made considerable progress in removing administrative barriers to establishment and operation of private enterprises. Government policy is focused on providing incentives to promote investment and the key laws and regulations are already in place. Banking and foreign exchange have been liberalized. Momentum should build as implementation leads to more tangible results. The Government's privatization program is well advanced and has facilitated investment, especially in infrastructure PPPs such as ports and railways.

2.5 In spite of significant efforts on the part of the Government and strong donor support, on the actual results of the business environment reforms is mixed. As shown in Table 2, Mozambique still scores poorly in international assessments of business environment and its ranking has stagnated in recent years. The country did manage to improve its ranking in the most recent World Bank Ease of Doing Business survey. Notable achievements include reducing the time it takes to start a business from 113 to 29 days, while decreasing the costs of business registration by two-thirds and reducing the number of procedures from 13 to 10. Significant problems remain including minimum capital requirements for the creation of businesses, labor market inflexibility, customs and in dealing with licenses and enforcing contracts, which still involve lengthy procedures.

**Table 2 : Business Environment Indexes**

|                                | 2008  | 2007  | 2006  | 2005  |
|--------------------------------|-------|-------|-------|-------|
| Ease of Doing Business         | 134th | 140th | 137th | n.a.  |
| Global Competitiveness Index   |       | 128th | 121st | 112th |
| KPMG Business Confidence Index | 98.3  | n.a.  | 101.4 | 100.3 |
| Corruption Perception Index    |       | 111th | 99th  | 97th  |

Source: World Bank, UNDP, KPMG, Transparency International

### 3. Developing a Vibrant Private Sector: Advantages and Opportunities

3.1 As Mozambique continues to develop its economy and private sector, it can build on several core advantages including its natural resources and geographic location. These advantages lead logically to a number of high-potential sectors, including agribusiness, energy, minerals, tourism and logistics.

- *Natural resources* The country is well endowed in natural resources. A number of major rivers run across Mozambique providing development opportunities, particularly in power.

Arable land is abundant, a major asset for the country, particularly in the current context of rising food prices. Mozambique's long coastline is rich in marine resources. Minerals, coal, metal ores have not been fully explored, but recent developments indicate major deposits of valuable commodities with high export potential.

- *Geographical location* The country's position on Africa's south-eastern coast is highly strategic. It has excellent access to the sea. With its long Indian Ocean coastline, Mozambique offers port and transportation facilities to landlocked neighboring countries. This same coastline provides opportunities to develop tourism activities. Mozambique's integration into SADC offers investors easier access to a significant regional market of approximately 200 million people. Maputo's proximity to Johannesburg and Gauteng economic area is an enormous advantage. The highway from Maputo to Johannesburg is the shortest road connection from Johannesburg to the coast, and it is in excellent condition.

### **Agribusiness**

3.2 Agribusiness is one of the key contributors to growth and job creation in Mozambique. Agribusiness employs 80% of the work force and accounts for 25% of GDP. Although agribusiness' relative share of GDP has decreased over the past decade, a sign of Mozambique's economic transformation, value added by agribusiness has increased at an annual rate of nearly 8% over the past five years in absolute terms. While growth has been strongest in crop production, there has also been solid growth in livestock, forestry and fishing.

3.3 Nonetheless, Mozambique has barely scratched the surface of its tremendous potential, and there are opportunities to increase both the scope and efficiency of agricultural production. Under use of agricultural land is clear: (i) only 10% of its 36 million hectares of arable land is being exploited leaving the vast majority uncultivated; and (ii) of its 46.4 million hectares of forest only 20 million hectares are productive while another 8.8 million hectares have been classified as natural reserves. A significant number of very large estates have been allocated, but are not farmed, or have been frozen awaiting commercial farmers. The National Zoning study identified approximately 7 million hectares that are not allocated or are not under productive use. With an abundance of low-cost labor and favorable climatic conditions, it should be relatively easy to attract investment to develop unused land. There also appears to be scope to expand fishing production although sustainability must be ensured. According to the Government, the country's fishing potential is 240,000 tons per year compared to current production of just 90,000 tons.

3.4 There are also opportunities to increase the efficiency of agricultural production in Mozambique. While commercial agriculture is slowly growing, household/subsistence farming techniques are still used on roughly 95% of cultivated land. Subsistence farming in Mozambique is characterized by small plots, rain-fed water, traditional plant varieties, low intensity fertilizer and pesticide use and little or no mechanization. For example, only 15% of its 3.3 million hectares of irrigable land is actually irrigated. The more widespread use of basic commercial farming techniques, including modern seed varieties, more and better inputs and irrigation, could result in significant increases in labor productivity and yields of traditional products like corn, sugar, cotton, cashews and tobacco.

3.5 In addition, there are a number of opportunities to expand and diversify Mozambique's agribusiness sector:

- *New commercial cultures* Mozambique's soil and climatic conditions are suitable for growing a wide variety of cash crops. In addition to traditional crops, Mozambique has the potential to develop production of tea, flowers, tropical fruits and vegetables, paprika, soy, sunflowers and plantation forestry. In light of the international food crisis the Government has been promoting the expansion of rice and wheat. New higher value added cultures are being tried and implemented, often by farmers displaced from Zimbabwe:
- *Demand for biofuels* Concerns about rising oil prices and global warming have stimulated significant demand for biofuels. Agricultural production for bio-fuels in Mozambique has attracted significant interest and several projects are being developed. Production has already started in some places, such as Procana with 35,000 hectares for ethanol production. Currently there is a zoning exercise being carried out to earmark

certain areas for the introduction of new crops for biofuels for export.

- *Counter-seasonal production* Given Mozambique's geographical position in the Southern Hemisphere, its growing seasons are generally opposite those in the Northern Hemisphere. There are significant opportunities to produce fruits and vegetables for sale "off-season" in the more affluent markets of the Northern Hemisphere when their own producers are out of season. In addition, fair trade marketing is developing both in Europe and the United States. This may offer a strong niche opportunity to Mozambique.
- *Rebuild livestock capacity* Mozambique's once substantial livestock resources were decimated during the war. Since then, the country has made progress in reconstituting these stocks. In 1994, the cattle and goat populations were estimated at 1.1 million in total but had grown to roughly 6 million in 2004 as the result of a restocking program and improvements in animal health. Like crop production, however, there is very limited use of commercial techniques despite opportunities for investment. The Southern area of the country, which is drier and less suitable for crop production, is an ideal area for more intensive livestock production.

### ***Energy and Minerals***

3.6 Mozambique is well endowed with mineral and energy resources, providing strong potential in these sectors. The energy sector in Mozambique is playing an increasingly important role in the economic development of the country. Mozambique's largely unexplored natural resources are attracting substantial foreign direct investments in large energy-intensive industries as well as in the mining, exploration and transformation sectors. This comes against a backdrop of favorable global demand trends for these products. The International Energy Outlook 2007 forecasts, in its base scenario, an average annual increase of 1.8% for worldwide energy demand over the 25-year projection period from 2005 to 2030. China and India will account for 45% of this increase while other developing countries will account for an additional 29%.

3.7 The international context for minerals is also favorable. As emerging countries such as China and India industrialize, the demand for metals and minerals is soaring. Strong price increases for mineral products are creating a bullish market; this is driving the search for new resources and new investments. Chinese companies in particular, and to lesser extent Indian ones, are eagerly prospecting African countries for natural resources. Interest in Mozambique's mineral resources is high. There are opportunities for Mozambique to increase the value-added of some of its ores in high demand through local processing. For example, production of titanium (a metal in very high demand in the aviation industry) requires ore and electricity. Promoting the use of both local ore and cheap power, and good port facilities, Mozambique may attract specialized producers to become a low-cost world titanium producer like Russia.

3.8 Mozambique has the potential to become a strong low-cost regional electricity supplier as regional demand is growing very rapidly while supply is short. The strong demand for electricity in Southern Africa, and in the region is already creating very serious shortages<sup>2</sup> affecting South Africa and Swaziland. An emerging study on Africa's infrastructure needs suggests that investments of up to USD 9 billion will be required across the Southern African Power Pool (SAPP) just to maintain access rates at their current low levels. Mozambique has great energy potential in a number of areas:

- *Coal* The majority of Africa's coal resources are located in Southern and Western Africa with major deposits in Botswana, the DRC, Mozambique, Nigeria, South Africa and Zimbabwe. South Africa holds the majority of the continent's estimated recoverable coal reserves with 34 billion tons (in 2005), making it the sixth-largest holder of coal reserves in the world. Mozambique is expected to become the second-largest coal producer in Africa with the development of the Moatize Project in 2009. The Moatize coal field is believed to hold reserves of 2.4 billion tons of thermal and metallurgical coal. Major investments have been announced by international steel companies in Mozambique's coal mining sector. The world largest steel company, Arcelor-Mital, under a joint venture with India Tata Steel will develop a coal reserve estimated at 1.2 billion tons.

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<sup>2</sup> Recently several South African mines have had to be stopped due to lack of electricity, and they will get only 90% of their current needs until 2012.

- *Hydropower* With the construction of the Cahora Bassa hydro dam in 1974, before independence, Mozambique became a large producer of hydroelectricity. Mozambique's hydropower generation potential is estimated at roughly 15,000 MW per year of which only 2,100 MW is currently being exploited. The Government has identified roughly 100 locations with hydropower potential including Manica, Tete and Niassa. As electricity demand across the SAPP grows, developing Mozambique's hydropower potential, and the necessary transmission links to neighboring countries, will be one of the keys to keeping costs and carbon emissions low.
- *Natural Gas* Africa's largest deposits of natural gas are located in Algeria (162 trillion cubic feet), Nigeria (182), Egypt (58) and Libya (53). Mozambique is a small and new player, with 4.5 tcf.<sup>3</sup> However, it is well located to serve the South African market and has the most reserves of any SADC country. Mozambique's first gas field has been in operation since 2004 in Pande/Temane. Most of the gas is being exported to South Africa through a pipeline. Sasol is currently working on a second phase that would increase gas supply to Mozambique and provide gas for a power plant near Maputo.
- *Oil* Exploration is on-going to find oil in Mozambique, in particular in the Rovuma Basin (on the border with Tanzania), and in the Inhambane province. Exploration contracts have been signed with Artumas (Canada/Norway), Andarko (United States), Petronas (Malaysia), ENI (Italy) and Norsk Hydro for the Rovuma basin. ENH (Empresa Nacional de Hidrocarbonetas), the State energy company, is retaining a share in those explorations.
- *Gemstones* Garnet is extracted in Cuamba. A tourmaline/aquamarine mine is expected in 2008. The mine has been privatized and the exploitation should regain activity after new investments. The production of dumortierite is likely to increase with the completion of access roads near existing mines. Seven companies and one individual have been selected in a tender to prospect for diamonds in the basin of the Save river, which marks the conventional border between southern and central Mozambique.
- *Metals* Mozambique is a producer of gold, iron and titanium. Major operations to be fully operational by 2008 include the Moma titanium and the Corridor Sands projects.

### **Tourism**

3.9 In Mozambique, visitors coming for business trips and family reunions make up the bulk of arrivals. Long-distance tourists are accommodated in only a few high-quality resorts in the North. Those resorts are operated by South African companies, and access is provided directly through Johannesburg. Of all arrivals in Mozambique in 2004, only about 20% were for tourism, including leisure, recreation and holidays. The remaining 80% was composed of business travelers, visiting friends and relatives and transfers. This has to be compared to neighboring countries where the leisure segment accounts for more than 70%. The low level of leisure tourism largely explains the very short average length of stay (just over 2 days in 2006) and low level of receipts (expenditure was slightly above USD 200 per person per trip in 2004).

3.10 A number of new forms of tourism could be rapidly developed provided a few barriers are overcome. In particular eco-tourism, exclusive or new destination tourism, offer great potential. In 2003, tourism represented some 30% of world service exports. It is a fast growing but highly cyclical industry. Tourism in sub-Saharan Africa is increasing faster than in other parts of the world (9% in 2005 and 10% in 2006) but sub-Saharan Africa still only captures 3% of the total number of arrivals.<sup>4</sup> Mozambique has also made progress in attracting more tourists. The number of visitors has grown steadily from 115,816 in 2001 to 416,546 in 2006.

3.11 There is a significant opportunity to develop the leisure tourism segment in Mozambique:

- *Coastal and marine resources* Thanks to its long coastline, Mozambique is an ideal location to develop tourism around diving, fishing and water sports. The coastline features rare habitats such as sea-grass beds and virgin coral reefs, with diverse marine life including turtles, humpback whales, dugong and whale sharks. The country also has

<sup>3</sup> Energy Information Administration, Oil and gas journal, 2007

<sup>4</sup> WTO

many secluded beaches, in particular in the northern islands, making it an ideal destination for the “sun, sea, sand” market.

- *Wilderness and ecotourism* Mozambique also has tremendous biodiversity with rare natural wilderness resources such as coastal forests. There are numerous opportunities to develop activities centered on hunting, safaris, bird-watching, lake tourism, eco-tourism and adventure sports. Animal populations include elephant, buffalo, hippopotamus, lion, leopard, wild dog and antelope. High potential areas include the Niassa reserve, Quirimbas National Park Manica, Tete (hiking), Coutadas (hunting), Limpopo National Park and the recent rebuild of Gorongosa National Park.
- *Cultural tourism* Mozambique features a unique culture that blends native African and Portuguese influences. Mozambique Island, with its colonial fortress and trading post, was named a UNESCO World Heritage Site in 1991.
- *Unknown destination* According to the World Economic Forum (2007) there is a clear lack of knowledge about Mozambique as a tourist destination outside South Africa or Zimbabwe. However, this may change as this destination is being advertised as a luxury holiday spot (Conde Nast, Herald Tribune). Furthermore, in a December 2007 survey, Mozambique’s Bazaruto Islands were named as one of the upcoming 50 destinations in the world. Mozambique also expects to profit from the 2010 Football World Cup in South Africa, and expects 150 000 visitors linked to this event
- *Building on regional tourism* Mozambique can leverage its proximity to South Africa and other border countries to develop its tourism industry. There are numerous opportunities to develop cross-border safari trips, or other “regional packages” that would add Mozambique as an extension to tours in South Africa, for example.

### **Logistics and Transport Services**

3.12 Mozambique is strategically positioned to serve as a regional trade hub. As previously mentioned, Mozambique’s proximity to South Africa is an advantage with Maputo port providing the most direct shipping point for Johannesburg. But there are a number of opportunities to develop transport services if both hard and “soft” infrastructure can be further improved:

- *Serving landlocked neighbors* Mozambique shares a border with four landlocked countries and has a long coastline with excellent port potential. These countries need access the sea to participate in international trade. Developing high-quality infrastructure and efficient logistics services will serve not only the country’s interests but the region’s interests as well.
- *Privatization* The opening of sectors currently under explicit or de facto monopolies such as air transport and coastal shipping should diminish costs and facilitate growth.
- *Building on mega-projects* Often transport infrastructure and services are developed specifically for mega-projects. These opportunities can be used as a stepping stone to develop know-how sub-contractors that can then serve a broader client base (i.e., transport companies working under the leadership of a large experienced foreign contractor).
- *Development of free zones* The acceleration of the development of free zones, offering not only fiscal incentives, but also simplified and flexible labor regulation can stimulate creation of labor intensive activities and demand for logistics services. A free zone is currently being developed in Nacala.

### **Other Areas of Focus**

3.13 As Mozambique continues to develop, economically and socially, it will likely transition from a largely agriculture-driven, rural society to a more diversified, urban economy. Since 1990, the urban population percentage has increased from 21% to 35%, and this trend is likely to continue.<sup>5</sup> We have also noted that although agricultural production has increased in absolute terms, it has fallen in

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<sup>5</sup> UNFPA (<http://www.unfpa.org>)

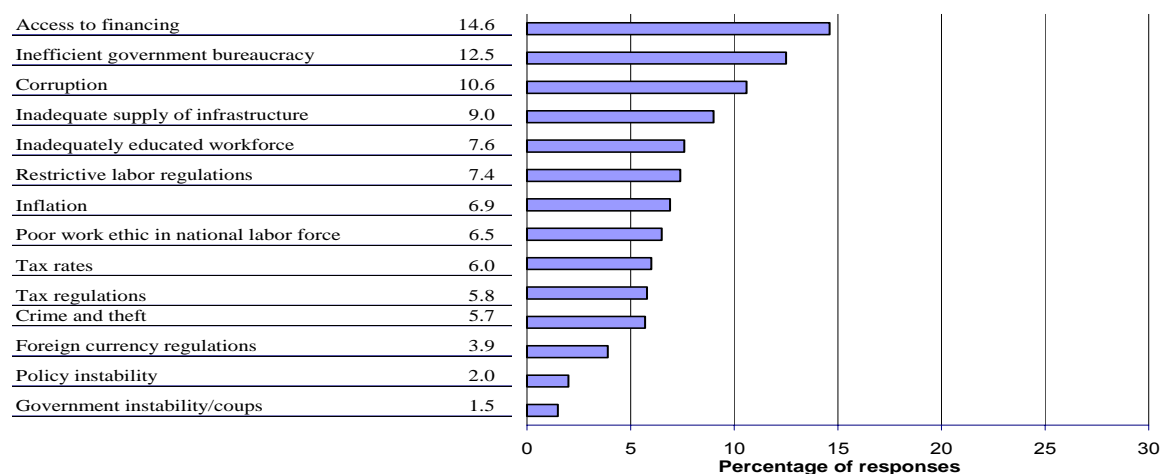
relative terms as the Mozambican economy has diversified. As agricultural productivity continues to increase, it is likely that rural labor will be freed up and migrate to seek employment in population centers. This transformation is both an opportunity and a challenge. It will be critical to develop over time sectors capable of creating jobs in urban centers. Two such areas are manufacturing and services.

- *Services* . Services are a cross-cutting activity that exists to a certain degree across all sectors. Mozambique shows promise in developing services in a variety of sectors, including financial services, communications and transport and tourism (i.e., hotels and restaurants). Although many service sectors are small in relative terms, they are among the most dynamic. For example, financial services only accounted for roughly 5% of GDP in 2006 but grew at a rate of more than 17% during 2007.
- *Manufacturing* Manufacturing already represents a relatively large share of GDP (13% in 2007 making it the second largest sector after agriculture). This is somewhat misleading however, because it is composed primarily of the Mozal project. To be competitive internationally in manufacturing requires a strong enabling environment, abundant labor

#### 4. Developing a Vibrant Private Sector: Challenges and Constraints

4.1 In order to capitalize on opportunities for growth and private sector development, Mozambique will need to overcome a number of significant obstacles. While progress to date has been significant, much more must be done to encourage investment and entrepreneurship. This is particularly true for SMEs who do not have the capacity or bargaining power to overcome many of these obstacles. Graph 1 below summarizes the most significant problems to doing business in Mozambique. This section provides a more detailed assessment of the four biggest problems, while section 5 looks at the labor market and workforce, which are also cited among the biggest problems.

**Graph 1: The most problematic factors for doing business<sup>6</sup>**



Source: The Africa Competitiveness Report 2007, World Economic Forum on Africa 2007

##### **Access to Credit**

4.2 Access to credit, as reflected in all of the investment climate surveys on Mozambique, is one of the major constraints mentioned by companies and entrepreneurs, particularly SMEs. The difficulties come from various sources:

- *Banks will only lend against significant collateral* Much of the economy is informal. Banks cannot ask for financial documentation. All land belongs to the State and usage rights cannot be transferred. As a result, land cannot be used as collateral. Only in some

<sup>6</sup> From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between

cases (urban buildings) can a building be used as collateral. The bankruptcy procedures are slow and inefficient; banks know that they will recover only part of their loan (in the distant future), and so demand more collateral.

- *Lack of capacity* Most entrepreneurs have little management experience and are unable to write solid business plans – and most banks do not have enough staff capable of evaluating a business plan. This situation is far from being unique to Mozambique, but nonetheless impedes information flows and the development of confidence between borrowers and lenders.
- *Credit is costly* Credit spreads and bank fees are abnormally high. The concentration of the banking sector reduces the competition. Fee income accounted for 43% of the income of the banks in 2005 and 2006. The rates are only bearable for short-term, high-margin trade operations – not for agriculture or industry.
- *Physical access to banks can be difficult* Half of bank branches are located in the Maputo province. In other areas of the country, there are few branches and access is difficult. The Central Bank has been promoting the expansion of financial services in rural areas by reducing the minimum capital requirements and providing tax and imports exemption. As a result, some Banks, such as BCI-Fomento and BIM, plan to have branches in 45 districts by 2009.

4.3 Agriculture financing has additional problems. Agricultural investment and development is hindered by the lack of short-term campaign credits and medium- to long-term credits, for example for tree cultivation. A network of local bank branches with intimate knowledge of their clients and therefore able to lend without collateral, does not exist. However, some alternative financing methods can be used. Remittances from migrant workers employed in South Africa<sup>7</sup> provide an important form of rural finance. Those remittances amounted to USD 50.4 million in 2006. A major actor in the future could be GAPI, which combines financing with technical assistance in various schemes, and is now starting a new agricultural bank (Banco Terra) which is managed with Rabobank, a professional agricultural cooperative bank in the Netherlands with a track record of activity in a number of developing countries.

#### **Governance and Bureaucracy**

4.4 Currently, Mozambique is broadly perceived as a highly bureaucratic operating environment for private companies characterized by high levels of regulation involving multiple, time-consuming procedures that impose high costs and discourage entrepreneurship. As pointed out by several reports,<sup>8</sup> governance and bureaucracy remain weak points, in spite of the efforts of the Government. The main problems are the low level of training of public employees, the complexity of the regulations and the lack of enforcement. All indexes show low levels of governance – although they are in line the regional average. More worrying, some of the indicators are not progressing significantly from year to year.

4.5 Inefficiency in government and the provision of key services can be seen in several areas:

- *Judicial Systems* The judicial system is not perceived as independent and prosecution can be slow in some high visibility cases. Access to justice is often impossible in practice for many citizens because of the high costs involved. The inadequacy of transport infrastructure (difficulty to travel to the court) further complicates the situation. Courts are slow (it now takes 1,010 days, to enforce a contract compared to the regional average of 643), and contract enforcement is costly (142% of the contract value compared to 49% for the region). These are disincentives to conducting formal business or using the courts to enforce contracts. The judicial system is composed of three levels of courts: district courts, provincial courts, and the Supreme Court. There are also specialized courts such as administrative courts and customs courts. The Mozambican Constitution allows the creation of other specialized or intermediary courts, which could relieve the load on the existing courts: labor, tax, maritime, arbitral and community courts. Community courts, a remnant of the past system, are recognized and used, but left outside the judicial system.

<sup>7</sup> Microfinance in Mozambique, MMF report 2006

<sup>8</sup> In particular: Donors Joint Review April 2007, ADB, 2005; World Bank Country Assistance Strategy, 2003, World Bank Country Partnership Strategy 2008-2011

The Government is well aware of the problems and is responding. In 2008, 181 new staff will be hired in the courts, including 22 judges. They have also created the function of judge administrators, which should help speed up judicial processes.

- *Customs and trade* Mozambique currently scores poorly on international trade logistics assessments. According to the World Bank 2007 Logistics Performance Index, Mozambique ranks 110th out of 150 countries surveyed. Customs duties are being lowered, in particular through the SADC agreements, and are now among the lowest in Africa. In 1997, the Government entered into a contract with Crown Agents for the management of Mozambique Customs. However, obstacles remain to expedite the movement of goods. New procedures, aimed at improving transit, can actually be counterproductive and lead to excessive charges. Due to the lack of telecommunications and electricity infrastructure, most border posts cannot be linked to a computer network. This precludes the use of fast, computer-based procedures in all but a few border posts. Even at the main border posts, procedures can be slow. Negotiations to keep the main border post with South Africa open 24h/24 are still dragging on. These border delays and additional costs diminish the attractiveness of the port of Maputo for South African exporters. Mozambique has the highest cost and some of the longest delays of all neighboring maritime countries and international comparators (i.e., Vietnam).
- *Tax regulation* Tax compliance represents a major burden for most businesses in Mozambique, particularly SMEs. According to Doing Business 2007, medium-sized companies must make 36 payments, spend 230 hours and pay 39% of profit in order to comply with current tax legislation. The private sector in Mozambique has had to adapt to numerous fiscal changes in recent years that have increased the complexity of the tax system. This has resulted in relatively high compliance costs, in particular for an economy where nearly 80% of companies have only five employees or less.<sup>9</sup> In terms of fiscal policy Mozambique is not particularly competitive when compared with its neighbors. The new tax code, adopted in November 2007, should simplify the tax system, reduce taxes and allow entrepreneurs to file taxes on line. The Government expects this reform to improve tax compliance and ultimately increase tax returns. There also can be a 20% withholding tax when the beneficiary of the payment is not registered. (This is the case when a registered company is buying from an individual or a non-registered supplier, which is frequent in agriculture.) This taxation is a heavy burden in some sectors, which rely heavily on informal outsourcing to produce formal products, for example, cane outgrowers (informal), are an input for the sugar mills (formal). On the other hand, special arrangements and tax holidays exist for the main mega projects (in particular Mozal, which is reported to pay 1% on sales). The main issues identified in the fiscal system are: (i) very small tax base (some 28,000 private sector companies and some 300,000 formal employees); (ii) numerous tax exemptions or reductions for new investments and mega projects (Government revenues would increase by an amount equivalent to 3% of GDP if they paid normal taxes); (iii) high tax rates and the proliferation of different payments; and (iv) often arbitrary implementation of the tax code. VAT refunds are a source of complaints, particularly exporters, and enterprises with heavy investments.
- *Decentralization* The Government aware of the efforts to be made in order to reach the necessary level of efficiency at Government and provincial level, and has implemented public financial management reforms (i.e., e-SISTAFE, procurement, internal control, external audits). Some of the major challenges recognized by the Government are the decentralization of this new system to the provinces, the incorporation in the system of certain elements (i.e., salaries of civil servants) and the improvement of the budgeting and planning process. However, the decentralization process has been slowed down by a lack of appropriate human resources at the provincial level.

### **Corruption**

4.6 The problems of governance, inefficient bureaucracy and corruption are closely intertwined. Indeed, in many cases corruption is a direct result of weak institutional capacity, limited transparency and the lack of accountability. Despite the significant progress made by the country in the post-war

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<sup>9</sup> INE, 2004

period, corruption remains persistent and represents a significant risk to further growth and development. According to studies on corruption in Mozambique,<sup>10</sup> corruption is generally observed at two levels: (i) petty corruption involving low-level civil servants; and (ii) grand corruption involving higher-level government officials.

- *Petty corruption* In the course of everyday business, companies are exposed to a variety of corrupt practices. Typically, this might involve being asked for bribes to obtain services from police, inspectors, customs officials and other civil servants. Petty corruption is perceived to be much higher in urban areas where private companies tend to be located. Myriad regulations and processes create opportunities for poorly paid civil servants to seek rents when they control access to services. The result is hidden, but very real, operating costs for firms that ultimately discourage investment and formal sector activity.
- *Grand corruption* There is some concern that corruption at higher levels of government is increasing. Among the issues cited are nepotism and favoritism in the allocation of government positions and resources and allegations of potential insider dealing and links to organized crime. Mozambique lacks conflict of interest laws, which means that regulators can operate businesses in their own jurisdictions. Particularly problematic is the perception that the judiciary is highly corrupt and driven by political agendas. It is generally believed that judges and prosecutors can be bought or pressured, a perception that has been punctuated by several high-profile cases that have not been resolved. Lack of judiciary transparency is not only a source of corruption itself, but also undermines the ability to root out corruption in other spheres.

4.7 Corruption is possible due to narrow political competition, limited accountability and transparency, a weak legislature, and lack of civil society oversight. The government is well aware of the problem and is taking measures to combat corruption and promote checks and balances.<sup>11</sup> Many laws have been passed and an Anti-Corruption Strategy was launched in 2006. A Central Anti-Corruption Office (GCCC) exists and has investigated more than 50 cases. However, implementation of anti-corruption measures has been slow and difficult. For example, the GCCC has not provided any results from the investigations it has undertaken. Improvement of Governance is the first pillar of the PARPA national development and poverty reduction program. “Accountability” is also one of the cultural values the Government wants to promote, within the framework of PARPA. In other instances, officials have been sacked to send a message that the government is serious about fighting corruption. A key emerging issue is revenue transparency as Mozambique develops its potential in the extractive industries.

### ***Weak Infrastructure***

4.8 Mozambique’s infrastructure development has been hampered by long-lasting civil wars and floods. Railway and port charges once made up a large share of the country’s public revenue and rail, road and port handling were major service industries. There is a significant difference between the extreme South of the country (Maputo and Maputo province) and the rest of the country. Infrastructure (access to energy, transport), though not perfect, is much more developed around Maputo than elsewhere. Administrative services (customs, licensing offices, tax offices) are also reputed to be more effective in Maputo. For this reason, many enterprises which operate outside Maputo tend to relocate to the Maputo area, or at locate their head office in Maputo. The Spatial Development Initiatives<sup>12</sup> will have to take this difference into account to become effective. Some regions are thriving (Nacala), but mainly thanks to informal activities which may not be reflected in the statistics.

4.9 The lack of basic infrastructure poses significant problems for companies operating in Mozambique. For the manufacturing sector, poor access to electricity ranks as the most serious infrastructure problem. In addition to electricity, rural areas lack telecommunications networks and other service networks such as banks, which make daily operations more challenging.

4.10 **A “corridor” approach to transport** Transport is based on a “corridor” concept, providing

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<sup>10</sup> A detailed assessment of corruption in Mozambique is provided by USAID, Mozambique Corruption Assessment (2005).

<sup>11</sup> Program Aid Partners, Joint Review (2007).

<sup>12</sup> Spatial Development Initiatives target the development of regions or corridors, drawing in both public and private investment in a concentrated area, including investments in infrastructure, and maximizing the synergies between these various investments to promote development.

export outlets for mineral and agricultural resources situated inland, whether in Mozambique or in neighboring countries. The main corridors are: (i) The Maputo corridor, to South Africa; (ii) The Nacala corridor, to Malawi and Zambia; and (iii) The Beira corridor, to Zimbabwe. Transport links are quasi inexistent between the north and the south of the country. This is important in particular for food products, which must pass through neighboring countries in order to reach other parts of Mozambique. Since 1988, a transport development policy has been implemented, which targets the rehabilitation of the transport network (including de-mining) and privatization of infrastructure. This privatization is now complete – though in many cases a State monopoly has just been replaced by a private monopoly. In some cases, the first leaseholder did not perform, and had to be replaced (Maputo corridor).

**4.11 Rebuilding roads** According to ANE data, Mozambique possesses 17,805 km of “classified” roads, of which only 5,083 are paved. At the end of the 30-year war period, only some 10% of the roads were reported to be in good condition. On average, 41% of the population has access to a road (lives less than 2 km away). However, in rural zones, this percentage could be as low as 11%, hence the need for a “feeder” network. The poor condition of the road network increases significantly the cost and difficulty of doing business. Mozambique has implemented various programs to restore its road network and is extending those efforts with the aid of donors.<sup>13</sup> Already, a large part of the network has been rehabilitated. However, delays were experienced, attributed to bureaucratic procedures for procurement (in particular VAT refund or exemption) and insufficient management capacity.

**4.12 Lack of competition in air transport** Air fares are high due to the absence of competition, which makes business more expensive and discourages tourism. This system protects the national carrier Linhas Aereas do Moçambique (LAM), which is reported to be in precarious financial condition. The Government has pledged to liberalize air traffic, perhaps as early as 2009. Liberalization of air transport has been shown to boost foreign direct investment, trade and tourism, ultimately leading to job creation. According to a recent study, air liberalization would increase tourist arrivals by 37%, increase tourist spend by USD 5 million, and add USD 9 million to Mozambique’s GDP. It would create 1,000 new jobs in the tourism industry, and about 2,000 more in the wider economy.<sup>14</sup>

**4.13** The only direct flight to Europe is operated by TAP, to Lisbon. Most international travelers fly through Johannesburg with South African Airlines. Air links between Maputo and Beira are provided by LAM and some other small companies. Air Corridor, another airline company, has recently filed for bankruptcy. There are three international airports: Maputo, Beira and Nampula. The other main airports are: Pemba, Quelimane, Vilanculos, Inhambane, Tete, and Lichinga. The airports are being modernized, starting with the Maputo airport, expected to be ready for the 2010 Soccer World Cup in South Africa. There is no air transport with cold storage for fresh produce exports (shrimp, fruits and vegetable, flowers) and, until recently, flowers and vegetables were exported through Harare (Zimbabwe), which had a daily British Airways direct flight to London.

**4.14 Under-developed potential in ports** The main ports and harbors are located at Maputo, Beira and Nacala. In addition to Mozambique’s own transportation needs, the ports serve the neighboring landlocked countries of Malawi, Zambia, Zimbabwe and Swaziland, and as a secondary port for the Durban and Johannesburg regions.

- **Maputo** Since 2003, the port has been privately managed by the Maputo Port Development Company.<sup>15</sup> The commercial port has facilities for fruits, sugar, containers, steel and molasses, and the Matola industrial complex has facilities for aluminum, coal, oil and cereals. In particular, the new sugar terminal should permit a twofold increase in sugar exports from the region (Mozambique and neighboring countries). A car terminal has also been built recently by Grindrod (South Africa), with an annual capacity of 63,000 vehicles, expandable to 250,000.
- **Beira** The port of Beira has been rehabilitated with EU aid. British Petroleum opened an oil terminal in 2003. It should become the exit port for the Moatize coal field, and other coal mines. Part of the traffic comes from Zimbabwe, and the port has been

<sup>13</sup> In 2005, the stakeholders developed a Road Sector Strategy (RSS, 2007-2011) which has been integrated into PARPA II. In 2006, the Government has adopted the PRISE (Programa Integrado do Sector de Estradas) to invest USD 1 billion, 70% of which should be financed by donors, over the 2007-2009 period.

<sup>14</sup> Clear Skies Over Southern Africa, The ComMark Trust, October 2006

<sup>15</sup> Consortium formed by: Mersey Docks Group, Skanska, Liscont, Grindrod, the CFM and the Government.

affected by the economic deterioration in this country. The port could be revitalized by the rehabilitation of the Sena railway and the construction of a coal terminal.

- **Quelimane and Pemba** The port of Quelimane is being rehabilitated by a South African consortium, CMC South Africa. The port of Pemba, in the extreme north of the country, has a theoretical capacity of 650,000 tons/year but is currently loading only 100,000 tons. The improvement of the Pemba Montepuez Lichinga road system to access the now under-developed hinterland, and the use of the port as an overflow for nearby Tanzanian ports, could allow it to reach 50% of the capacity.

**4.15 Railways** In total there are 3,123 km of railways in Mozambique. 2,983 km of the railways are of 1.067 meter gauge, and 140 km are of 0.762 meter narrow gauge. Railways are operated by the Portos e Caminhos de Ferro de Moçambique (CFM). The system has been rehabilitated, through various programs, in particular the World Bank's "Railways and Ports Restructuring Program" (USD 100 million loan over 40 years), with a view to rehabilitating the lines and granting concessions for sub-systems. Concessions have been granted for the ports and some railway lines, while CFM retains a percentage of the shares in the concessionary company. The railway network follows the "corridor" approach and links other countries to Mozambican ports.

**4.16** The main rehabilitation concerns the Sena railway. The 600 km long Sena Railway runs from Beira to the coal region of Moatize. It also branches to the sugar-producing region along the Zambezi. Its reconstruction is being undertaken but the line needed to be cleared of landmines, which was completed in October 2006. A first leg is to be opened in December 2008, and the line should be opened in totality in 2009. The rehabilitation of the Maputo-Ressano Garcia railway along the South African border has fallen behind schedule.

**4.17 Lack of electricity** Electricity is supplied by Electricidade de Moçambique (EDM). At the end of 2006, only 9.4% of the population has access to the electricity grid (against 7.8 % in 2005 and 6% in 2004). Electricity interruptions are also a significant problem. In 2003, the PARPA goal was to electrify the 128 district capitals. As of today, 60 districts remain without electricity. Nearly all of Mozambique's electricity is produced by the Cahora Bassa Dam, built and completed before independence. Some 60% of Cahora Bassa electricity is used by the Mozal aluminum plant, 30% is a net export to South Africa and, to a lesser extent, Zimbabwe, and the rest used in Mozambique. However, there is no direct line within Mozambique to the main consumption center, the Maputo province. The main line goes through South Africa.

**4.18** Electricity access and cost is one of the most serious infrastructure problems for the Mozambican manufacturing sector. It is reported to be one of the reasons for the failure of some industries (clothing in particular). All businesses, except Mozal, are constrained by very high electricity costs. In addition, service is unreliable. It is estimated that service is available only 60–70% of the time. As a result, many business and individuals purchase small fuel generators (adding to investment costs and pollution). A 2002 survey indicated that 31% of enterprises have their own generator and the median loss to production from power outages represented 2% of sales. In the World Bank Investment Climate Report (2003), 64% of the sampled companies identified energy as a major problem with 17 power cuts registered per month.

**4.19 Telecoms are poor, except mobiles** Telecomunicações de Moçambique (TdM) is the only fixed line operator. There were only 73,592 fixed telephone lines in 2006, down from 81,318 in 2003<sup>16</sup>. 98% of them are in urban areas. This dearth of fixed lines means that: (i) mobile telecommunications, as elsewhere in the developing world, are taking over as the main communication channel; and (ii) all forms of data transmissions that use fixed lines (internet in particular) are slow. There are two mobile operators: (i) Moçambique Celular Lda or "mCel"; and (ii) Vodacom Mozambique (a subsidiary of Vodacom South Africa). The lack of fixed lines is hindering the spread of the internet network. There are 11 Internet suppliers, but only an estimated 178,000 internet users<sup>17</sup> due to lack of fixed lines and electricity, and 1,700 ADSL lines, only in cities (TdM, 2006).

**4.20 More progress on water and sanitation needed** Although water and sanitation has improved in recent years, the overall picture is still precarious with a significant impact on the health of the population (cholera, diarrhea), and in particular on the mortality rate among children.

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<sup>16</sup> TdM annual report, 2006

<sup>17</sup> Central Intelligence Agency Factbook estimates, 2006 data

**Table 3 : Access to water and sanitation**

| Percentage of the population with access to... | 1990 | 2004 |
|--|------|------|
| Sustainable access to improved sanitation      | 20%  | 32%  |
| Sustainable access to improved water source    | 36%  | 43%  |

Source UNDP Human development report 2007/2008

4.21 The Government has implemented two National Water Development Programs: NWDP I followed by NWDP II. One of the focuses is to decentralize the responsibilities of water supply and sewage to local authorities and to encourage private sector participation. The main features of those programs are: (i) covering the basic needs of the population, increasing the water supply and sanitation coverage rate, especially for low income groups; (ii) improving the use of resources by involving beneficiaries in the planning and implementation, and delegation of responsibilities to local agencies; (iii) cost recovery, while keeping the price socially sustainable; (iv) transferring services to the private sector, leaving to the Government a role in regulation, planning and supervision; and (v) integrating the national water policy in a wider regional framework.

## 5. Labor market

### *The Formal Sector*

5.1 Mozambique is a predominantly rural country. Although 80% of the population lives in rural areas, agriculture's contribution to GDP stands at 24%. With the exception of some agro-industries (tobacco factory, sugar mills and cotton) the agricultural sector, is predominantly informal. For the rest of the population and the economy, there are three very distinct categories: (i) large companies, mostly foreign owned; (ii) the Mozambican formal sector; and (iii) the Mozambican informal sector.

**Table 4 : Total formal employment**

| Status                     | Employees      | %          |
|----------------------------|----------------|------------|
| Private enterprise         | 274,275        | 52.6       |
| State or public enterprise | 26,870         | 5.2        |
| Public Administration      | 173,495        | 33.3       |
| Non profit Institutions    | 46,567         | 8.9        |
| <b>Total</b>               | <b>521,207</b> | <b>100</b> |

Source: Censo das Empresas 2002/2003

5.2 According to INE (CEMPRE, 2004), formal employment in 2003 accounted for slightly over half a million persons, a dismal number in a country of 20 million habitants. There were only 28,870 formal enterprises (public and private) in 2004, employing 301,145 people. A small number of large enterprises make up one quarter of the output (one company only -Mozal- accounts for half the industrial output of the country).

**Table 5 : Formal private sector employment, by size**

| Size         | Definition: staff | Number of companies | %          | Staff employed | %          | Sales billions MT | %          |
|--------------|-------------------|---------------------|------------|----------------|------------|-------------------|------------|
| Large        | > 100             | 396                 | 1.4-       | 60,149         | 20.0       | 38,843            | 58.5       |
| Medium       | 10-99             | 2,621               | 9.1        | 69,076         | 22.9       | 11,649            | 17.5       |
| Small        | <10               | 25,853              | 89.5       | 171,920        | 57.1       | 15,952            | 24.0       |
| <b>TOTAL</b> |                   | <b>28,870</b>       | <b>100</b> | <b>301,145</b> | <b>100</b> | <b>66,444</b>     | <b>100</b> |

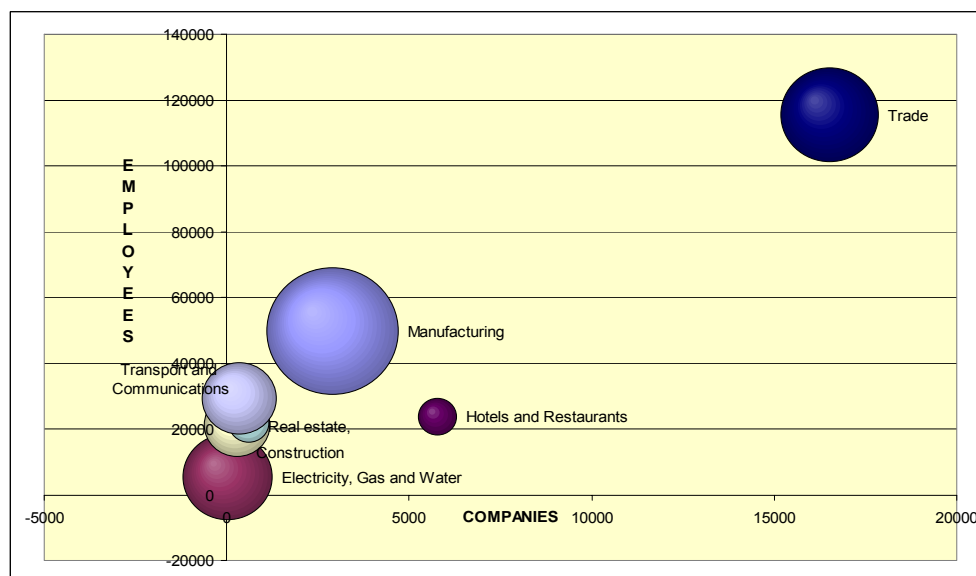
Source: INE, CEMPRE

5.3 Of these companies, 254 limited liability companies employ 18.9% of the formal workforce, and produce 40.7% of the total output. At the other end, 24,660 personal enterprises (85% of the total) produce less than 20% of the total output. The sectoral distribution of registered companies

does not correspond to the sectoral distribution of the GDP (agriculture: 24% of GDP, only 1.5% of the output of registered enterprises), the difference being attributable to the informal sector, which comprises some 3 million small households. The data, which dates from 2003, also underestimates the current share of mining and energy, at least in terms of revenues, as the exploitation of the SASOL gas fields and Moma titanium mine started later.

5.4 The graph below shows the importance of the trade sector as a major employer, compared to the energy sector, with an equivalent turnover (in 2003) but much reduced employment. Agriculture is quasi inexistent in the formal economy, but tourism already represents a high proportion of the formal sector (20% of the companies, 8% of the employment)

**Graph 2: Forma Sector Employment (2002-03)**



Source: Censo das Empresas 2002/2003

5.5 Most formal-sector companies are located in Maputo and Maputo province. This is due to: (i) the importance of the province as an industrial centre; and (ii) difficulties dealing with red tape leading many companies locate their head office close to the Maputo administrative center, where the paperwork can be processed more rapidly and effectively.

### ***The Informal Sector – Bringing it into the Formal Economy***

5.6 The informal sector employs the bulk of Mozambican workers because of financial disincentives to formal sector participation, the rigidity of the labor laws and the complication and arbitrary implementation of regulations. The results of the First National Survey of the Informal Sector in Mozambique in 2005, estimates that there are 7.7 million workers in the informal sector of which 7 million in agriculture and 700,000 in other activities. Moreover, a high percentage of formal workers are reported to carry out secondary informal activities.

5.7 The labor market operates under highly restrictive employment regulations inherited from years under a command economy. Excessive regulation hinders employment and productivity growth. Although wages and benefit costs can be low, but there are rigid regulations on increasing or contracting the number of work hours, on hiring and laying off workers and on employing foreign staff. Hiring can be quite difficult, and the cost of firing is one of the highest in the region. Changes are under way: those regulations have been softened with the 2007 labor law, but implementation has yet to produce results.

5.8 The current government strategy has been to attract foreign investors and to develop SMEs using business linkages with these large, foreign-owned projects. However, many have criticized this strategy for not delivering results. For example, it is alleged that only a handful of local-owned SMEs have been able to take advantage of opportunities for industrial linkages with large projects. In very rare cases, Mozambican SMEs have managed to establish and benefit from such linkages, mostly because they either have associated themselves with the foreign partners, or they are affiliates of

foreign firms. The lack of information about business development, norms and standards, and difficult access to credit often prevent small companies from taking advantage of business opportunities that could lead to more formal sector employment. However, some programs have shown that with proper support, SMEs can develop links with large projects and use these as a platform for expansion.<sup>18</sup>

### **Quality of the Labor Force**

5.9 The population of the country is young and mostly rural with high illiteracy levels. Women account for 52% of the labor force and 88% of employed women are unskilled agriculture workers. Women represent only 25% of the skilled labor force<sup>19</sup> and are still clearly a minority within the skilled labor pool, leading to obvious salary imbalances compared to men. While labor is abundant, skill levels are low, hindering job creation and business development. The cashew industry provides an interesting example: while the first cashew processing plants were designed to be labor intensive rather than relying on machines, the processing industry has now reverted to greater use of machines, because the rural population is not used to working in factories, and is not efficient. Education is a concern among businesses, as they cannot find the necessary skilled people. The enrolment in primary schools is improving, but few students pursue to secondary or tertiary education.

5.10 The education level of general managers is low (32% of them have only primary education). Firms' staff training policies are very weak. The majority of them don't provide any kind of training to strengthen the capacity and quality of their employees.

## **6. Private Sector Development Strategy**

6.1 The preceding chapters outline the opportunities and challenges to private sector development in Mozambique. While the country has a private economy, the private contribution comes mainly from two sectors with few links: the mega-projects (large, sophisticated, foreign-run operations with modern technology), and agriculture and agro-processing (small holdings, informal activity and low technology). Between the two there is a large gap to be filled.

**Table 6: SWOT Analysis**

| STRENGTHS  | WEAKNESSES  |
|--|---|
| <ul style="list-style-type: none"> <li>- Political and macroeconomic stability</li> <li>- Success case among international community</li> <li>- Considerable natural and mineral resources; and good geographical location</li> <li>- Preferential access to import markets</li> <li>- Low wages</li> <li>- Proximity to large South African market</li> </ul>             | <ul style="list-style-type: none"> <li>- Poor quality of labor force</li> <li>- Rigid labor laws</li> <li>- High cost and limited access to financing</li> <li>- Red tape (registration, licenses)</li> <li>- Highly degraded basic infrastructure</li> <li>- Poor export capability</li> <li>- High HIV/AIDS prevalence, malaria</li> </ul>      |
| OPPORTUNITIES  | THREATS   |
| <ul style="list-style-type: none"> <li>- Become trade hub for Southern Africa</li> <li>- Become a global agricultural producer/exporter</li> <li>- Potential for tourism, FDI</li> <li>- Natural resources to be further developed</li> <li>- Develop linkages between mega projects and local firms</li> <li>- Increase competition in transportation services</li> </ul> | <ul style="list-style-type: none"> <li>- High level of corruption, low governance</li> <li>- Food crisis</li> <li>- Excess bureaucracy</li> <li>- Increase oil prices</li> <li>- Foreign competition threatens local firms</li> <li>- Inadequacy of infrastructure (blackouts, etc.)</li> <li>- Global warming (floods, drought, etc.)</li> </ul> |

6.2 Improvements in the business environment will be a key, but this is a necessary, but not sufficient condition. Certainly supports actions will be needed to jump start some activities and create role models. The government will need both technical assistance and funding to implement reforms.

<sup>18</sup> See for example the IFC-sponsored a SME development program focused on the Mozal project.

<sup>19</sup> The ADB recently approved the Women Entrepreneurship Project to enhance the skills of female agriculture workers.

There will be also the need to “incubate”<sup>20</sup> medium size companies, with growth potential, moving them from the informal to the formal sector. Also special institutions may have to be designed for a sector like agriculture linking financing and technical assistance with close monitoring to ensure that the program is effective and sustainable since many previous programs have no proven sustainable. Providing financing only or technical assistance / extension services alone will bring no results. Training will also be critical to the positive evolution of sectors such as agriculture and tourism.

6.3 A solid sustainable strategy implies (i) careful business planning, and (ii) skilful implementation. The private sector should become a major driver for sustainable growth in Mozambique. The Government must contribute in a major way, focusing mostly on the business environment reforms, on incentives to stimulate growth in the main high potential sectors: agriculture, tourism and industry; and support institutions such as training centers and normalization and standardization institutions.

6.4 Donors, including institutions such as the ADB, have an important role to play as well to complement to the Government’s efforts, and should focus on projects aimed at accelerating implementation, and projects with demonstration and leverage effects. ADB projects should be seen as a catalyst for private sector investment and growth.

### ***The Role of the Government***

6.5 The government has an important role to play in private sector development. In light of the challenges the country is facing, there are three areas where the Government should focus.

6.6 ***Business environment*** While Mozambique has attracted several large capital-intensive investments, it has had far less success in attracting investments that capitalize on abundant labor resources, and that would contribute in more direct way to employment creation and poverty reduction. Removal of these administrative, legal and systemic barriers to business has been a slow process and implementation is ongoing. In the public sector it will require re-training of staff, changes in incentive packages (to avoid corruption due to low salaries, or bias due to bonuses based on percentages of cases, etc.) and in public employment policies. Greater coordination and support is needed, not only from various ministries, but also from the civil society and political parties. The Government, under the stewardship of the Ministry of Industry and Trade, is intending to launch a strategy aimed at improving its ranking in the Doing Business report, which means acting on the most critical problems identified by the business community.

6.7 ***Training*** In addition to the work on laws and regulations, the Government will need to strengthen or create, or provide incentives to create, institutions providing support and training for the private sector. The most urgent tasks are: (i) strengthening INNOQ, the quality and norms setting body, in coordination with SADC norms and standards; (ii) strengthening of IPEX, the export promotion body, so that they provide information for all producers, even if they are not located in the Maputo province, using alternative means such as mobile phones; (iii) set-up or rehabilitate professional vocational schools for tourism, both in Maputo and in other regions to train tourism professionals (the training hotel in Maputo does not operate properly); and (iv) providing incentives to support the creation of new private initiatives such as the recently established Banco Terra.

6.8 ***Agriculture*** While it will not happen overnight, focus on modernization and formalization of agriculture (in parallel with attraction of foreign investors) will ensure development, poverty alleviation and social stability. Agriculture should become a major source of employment and export if the technology level, financing and organization improve. At the same time, investments in more productive agriculture should have a positive impact on poverty alleviation in Mozambique. This sector needs special attention and should be supported by actions that aimed at:

- improving commercial agriculture and agro-processing to enable some operators to gradually formalize, modernize and move to a modern production model;
- promoting private sector value chain linkages, not just agro-processing, including selection, packing, transport and storage.
- diversifying foreign-owned projects and modifying the incentives to accelerate the creation of efficient, modern sub-contractors and out growers; and

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<sup>20</sup> To provide financing and assistance/ mentoring in a coordinated manner.

- providing efficient infrastructure, access to water and power to sustain growth of private activities, be it small or large.

### ***The Role of Private Operators***

6.9 Private operators also have an important role to play in helping the country develop.. First, private companies should strive to be good citizens and develop a strong track record on corporate social responsibility. This would include taking measures to ensure that environmental and social good practices are respected, engaging with local communities through social funds and outreach programs and making efforts to procure inputs from local sources. Second, private operators must accompany government efforts to stamp out corruption. Private enterprises will not be able to solve this problem themselves, but corruption is a two-way street and it will take efforts from both sides. Finally, companies should play a major role in training and skills development. This can be accomplished through on-the-job programs where companies invest in the development of their employees or by offering specific training programs. The role that SMEs play in private sector development is critical, but will be constrained to an extent by their limited capacity. However, large projects, often involving foreign investors, have the greatest organizational capacity and the greatest responsibility.

### ***The Role of Donors***

6.10 Currently the three largest donors are the World Bank Group, the EU and the ADB. Aid is provided to Mozambique through two main channels: (i) budget support (funded collectively by many donors); and (ii) direct project support (financing and technical assistance). Given the multiplicity of projects and the need for coordination and co-financing, donors have created various groups addressing specific aid programs or targets. The “Program Aid Partnership” (PAP) targets mainly budget support and programs aimed at direct poverty alleviation. Budget support is provided by the 19 countries and NGOs of the PAP Group. This group announced in May 2007 that its support for the 2008 budget will only slightly rise to US\$ 385 million, from US\$ 369 million in 2006. More was initially planned, but some countries have scaled back their commitment because of “poor performance”.<sup>21</sup>

6.11 The Government and donors are fully aware of the importance of the private sector and there is a Private Sector Working Group (PSWG), including main donors active in this field, government representatives, and the local private sector represented by CTA. The work of this group has been mainly focused on the business environment; and in this framework, the US (USAID and MCC), the EU and the World Bank are assisting the Government in preparing a strategy to improve the business environment. Several studies have also been carried out to identify obstacles in the business environment and trade, or obstacles to the growth of certain sectors (tourism, horticulture, textiles, etc.). Support has already been mobilized to improve certain key barriers (e.g. modernization of the customs office by DFID).

6.12 To better identify the private sector support activities of donors, the PSWG has launched an inventory of all projects. Among the main activities underway currently are an MCC program focused agriculture land tenure and KfW and Norfund (and to a smaller extent the Dutch government) supporting the creation of a new bank, Banco Terra, with funding for equity, lines of credit, and technical assistance. In parallel, important institutional and enterprise support is being provided by the EU, DFID, Swiss cooperation and others to improve export specifications and quality standards, with an initial focus on fish products, nuts and fruits. The WB, EC and Italian cooperation are also providing support to CEPAGRI, which promotes private sector agricultural activities.

6.13 In addition to the work on the business environment, other private sector support projects have been implemented in the past five years. The World Bank, EU and other donors cofinanced the Enterprise Development Project *Projecto para o Desenvolvimento Empresarial* (PoDE) to provide both direct support and advice to enterprises to improve their bankability. IFC, EIB and ADB have been supplying significant amounts of capital to mega projects (Mozal, MOMA, Sasol and CMH, Sasol pipeline). The IFC has developed a national tourism promotion program, has provided direct support to a few selected enterprises as well as advisory services to banks to increase their SMEs lending.

### ***The Role of the African Development Bank***

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<sup>21</sup> World Bank, Country Partnership Strategy, 2008-2011

6.14 The Bank Group began its operations in 1977 and has since approved 74 operations in Mozambique amounting to approximately to USD 1.6 billion. The current portfolio amounts to roughly USD 650 million, mainly focused on infrastructure development (roads, water supply and sanitation, and electricity), agriculture, multi-sector, health and education.

6.15 The Bank approved a new Country Strategy Paper (CSP) in June 2006 to guide its interventions and activities in Mozambique for the period 2006-2009. The strategy is aligned with the Government's PRSP (PARPA II), which covers the same period. The two main pillars of ADB's new strategy are governance and infrastructure. The first one is addressed primarily through direct budget support and the second one through direct project investments.

6.16 So far, the Bank's direct financing of the private sector in Mozambique has been limited to the provision of debt financing of mega-projects and some advisory assistance to the financial sector. Through the ADB private sector window, the Bank approved two projects namely the Sasol Gas Pipeline in October 2003 and the Moma Titanium mine in May 2003 for a total of USD 130 million. However, there are a number of areas where the Bank can play a bigger role, including lending and non-lending activities. Priorities will have to reflect: (i) the most critical needs; (ii) the assistance already provided by other donors, or to be mobilized in partnership; and (iii) the ADB's own financial and human resources.

- *Improving infrastructure* As mentioned above, the lack of proper infrastructure is a major obstacle to business growth. With its strong experience in infrastructure, ADB may develop projects building on its experience and combining public and private financing. In many cases, PPP structures can be used to mobilize private capital and expertise. Given Mozambique's potential and the evolution of the situation in neighboring countries, power should be a major component, both to supply the local market and for export to the SAPP.
- *Advisory* The ADB can play a positive role in improving the business environment (to strengthen the action of the Government as outlined above in coordination with other donors). Focus should be on improving the regulatory framework, in particular stimulating competition and making labor markets more flexible, modernizing inspection, hygiene and security at work, and easing responsibly the rules around the hiring of foreign workers which are essential to attract new foreign investments.
- *Support for reform implementation* As previously mentioned, reform implementation is one of the major problems in Mozambique. There is no point in formally decreasing taxes (a very positive driver to move business from informal to formal ) if tax inspectors continue to harass businesspeople. Focus should be on both training, and advice to modernize the incentive packages of civil servants.
- *Improving access to finance* Lack of financing has been identified in all analysis as one of the main constraints. The Bank should work with both: (i) financial institutions to assist them in developing instruments suitable to small private entrepreneurs and farmers; and (ii) enterprises and farmers to make them bankable. This would require pairing finance and TA support.
- *Catalytic transactions* Co-financing a few large projects that will generate export revenues and employment and help pave the way for more investment in the future. In order to learn from past experience, emphasis should be placed on developing local linkages around these larger projects.

### **Infrastructure**

6.17 Although infrastructure has traditionally been financed by the Government, more and more infrastructure projects are financed and operated as PPPs. There is a strong need for investment in roads, bridges, airports and power plants. Mozambique has experience with PPPs and private management of infrastructure. ADB may provide support at several different levels: (i) assistance with project development and structuring; (ii) support to the Government in concession negotiations; (iii) direct financing of the public or private operators through loans; and (iv) participation in infrastructure investment funds, a number of which already exist.

6.18 The energy crisis in South Africa needs to be addressed urgently. However, the planning of

the production and distribution of electricity should be carefully crafted in terms of both markets and prices within the context of the SAPP. The ADB may be in key position to provide much needed advice on planning, prices, exports and financing. As a great deal of financing will be needed for both generation and transmission, the ADB can provide significant financing directly and act as a catalyst to mobilize private financing.

### **Advisory Role**

6.19 The Bank must participate actively in the PSWG to be recognized as a credible private sector actor. Through the work of this group, the Bank will be better informed of other donor's private sector activities, strengthen the PSWG with an "African" voice, and be immediately and directly informed on the strategies proposed by the Government.

6.20 In addition to a business environment advisory role (in coordination with other donors active in this field), the Bank may also provide sector advisory work. Two sectors with strong potential, agriculture and extractive industries, may need such work, with focus on specific regulations pertinent to the sector (e.g. land titles for agriculture, mining laws and regulations for the extractive sector, tax and pricing issues), and specific issues (from production to infrastructure and trade) of the sector. This type of work would not only bring support to the Government decisions in these fields, but also improve the design the financing instruments and the projects in these fields.

6.21 The Bank may also support institutional strengthening. As mentioned above, a new policy will have no impact if it is poorly implemented. With other donors, the Bank will have to mobilize funding and expert teams to design new human resources policies and incentives, to assist in the restructuring of certain institutions and departments and to re-train a number of civil servants. The implementation of the new tax regime (announced in November 2007) will require institutional change and human resources training to ensure the intended positive impact on the business community.

6.22 If it is able to mobilize the appropriate experts, the Bank may also provide a much needed negotiation advisory role. For example, the Bank can work to improve the economic impact of investment in the country (i.e., appropriate use of tax holidays, customs exemptions, use of local sub-contractors, etc.). Again, even if the Bank has limited capacity in this area, it can help the Government to recruit the best advisors to negotiate or renegotiate certain contracts. The recently create African Legal Support Facility would be a key vehicle for delivering such expertise and assistance.

### **Improving Access to Finance**

6.23 The main objective is to ensure that the enterprises, and in particular farmers most in need of finance, can get it. As described at length above, the gap is immense. Such activity may involve:

- *Improving information flow and relations between banks and borrowers* Most banks lack information on appropriate techniques for serving new markets profitably, while small and medium-sized businesses often do not understand the requirements of the lender and lack the capacity to provide necessary accounting data and business plans. Carefully crafted interventions can help financial institutions test new markets (like agriculture) and services and help local businesses become more "bankable" through better management and financial controls. Careful coordination and partnership with other donors, in particular IFC and USAID, will be necessary to avoid overlapping.
- *Developing lending to new sectors* Micro-finance is a good example of lending to new segments of the population, which has developed outside of traditional banks. For the time being, financing of agriculture is the major gap in Mozambique's financial sector. Traditional banks have no branches in rural areas, do not understand the agribusiness and its risks and are put off by the absence of collateral due to the problem associated with land titles. (Many small farmers do not have a proper title, and when they have one, it cannot be used as collateral as there is no free market for land titles.) There is certainly room for more players like ADB and, together with IFAD, it is currently funding a USD 34 million government program that aims to expand financial services in rural areas. It may also play an important role as adviser to the Government to improve the issuing of land titles to facilitate title transfers at a later stage. It may also work on parallel programs with farmers to improve their bankability, set-up monitoring schemes to follow-up the

implementation of projects, and strengthen their operations and sales through support to institutions providing farmers with advice on technology and marketing.

- *Guarantee schemes* The ADB can provide guarantees that may be designed and implemented (as usual with no more of 50% of the loan guaranteed) to catalyze lending. ADB may help design and finance such schemes.

### ***Developing New Financing Instruments***

6.24 Equity capital for investment is generally in short supply. While there are a growing number of equity funds focused on Africa, in general, these funds cater only to larger investments, above USD 5 million. Often, the needs of enterprises in Mozambique are below this level. . There is an opportunity to increase the availability of equity funding for SMEs through the creation of funds focused on this niche. A good example is the funds managed by Business Partners<sup>22</sup> in South Africa or Madagascar, which target SMEs and provide both funding and mentoring. ADB could sponsor the creation of such a fund, which could play a significant role in the transformation of informal businesses into formal ones. Such funds could be combined with technical assistance funding (from ADB or other donors) to finance the coaching and mentoring necessary to improve the operations of these SMEs.

### ***Co-financing Catalytic Transactions***

6.25 This is an area where the Bank has already been active in the past (for example the Moma project). Although large projects launched by multinational groups can generally raise significant financing on commercial terms, the presence of ADB may bring comfort to the large investors and their banks by providing greater protection against political risk. The Bank can also ensure that environmental and social good practices are enforced and improve the design of projects to increase the development benefits for the Mozambican economy. The Bank is selective in choosing to support such transactions. ADB may also play a significant role in financing projects by companies or in sectors that may not attract sufficient commercial finance. Although they may be financially and economically viable these projects may be more difficult to finance as they do not have the asset backing and track record of larger players.

6.26 In conclusion, ADB may act as both: (i) a catalyst and a facilitator either through advice to the Government, or through the development of much-needed infrastructure; and (ii) financing and advising private sector development through new or enhanced instruments. In focusing its action mostly on private farming and agro processing, it would have great impact on poverty alleviation and gender equality, one of Mozambique's major development goals. This strategy will also provide much-needed employment and increased purchasing power. The high global demand for agricultural products and raw materials will provide a positive environment increasing the chances of success of the proposed strategy.

| <b>How the ADB can Stimulate Private Sector Development in Mozambique</b>  |
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| ▪ Working closely with other donors, in particular by participating in the PSWG  |
| ▪ Provide finance for strategic projects with strong development impact  |
| ▪ Promote public-private partnerships and dialogue, in particular to build infrastructure (i.e., power generation/ transmission) |
| ▪ Collaborate with local financial institutions to improve access to credit for SMEs   |
| ▪ Design programs combining finance and technical assistance for local firms to bridge the gap, in particular in agribusiness    |
| ▪ Help unlock entrepreneurship and build local technical and management capacity   |

<sup>22</sup> A venture Capital and mentoring company, which started in South Africa and is now expanding in the region.