AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

MOZAMBIQUE

Driving Mozambique's Transformation

The Reform of the Global Financial Architecture

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ACKNOWLEDGEMENTS

The 2024 Country Focus Report for Mozambique was prepared in the Chief Economist and Vice-Presidency for Economic Governance and Knowledge Management Complex, under the direction and supervision of Prof. Kevin C. Urama (Chief Economist and Vice-President, with support from Amadou Boly (Chief Assistant) to the Chief Economist), and Amah Marie-Aude Ezanin Koffi (Executive Assistant).

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The team thanks (i) the Mozambique Country Team led by Leila Mokaddem (Director General for South Africa), Kennedy Mbekeani (Deputy Director General for South Africa); and Macmillan Anyanwu Bhebhe (OIC, Country Manager for Mozambique); (ii) the Macroeconomics Policy, Forecasting and Research led by Abdoulaye Coulibaly, Director, Officer-in-Charge; (iii) the Transition States Department led by Yero Baldeh, Director, (iv) the African Natural Resource Center led by Désiré Vencatachellum, Director, Officer-in-Charge; and (v) the Macroeconomics Policy and Debt Sustainability Division and Microeconomic and Institutional Impact Assessment Division led by Anthony Simpasa, Division Manager, for their contributions.

The data in the report was compiled by the Department of Statistics led by Babatunde Samson Omotosho, Director, with significant contributions from Louis Kouakou (Manager of Socio-Economic Statistics Division, Department of Statistics), Ben Paul Mungyereza (Manager of the Statistical Capacity Building Division, Statistics Department), Anouar Chaouch (Senior Statistician, Division 1 of the Statistics Department) and Momar Kouta (Senior Statistical Information Systems Officer, Division 1 of the Statistics Department).

Peer-review comments were received from Tshinde Matos, Development and Portfolio Consultant from the Mozambique Country Office; Rejoice Rumbidzai Musakaruka, Senior Fragility and Resilience Officer from the Transition State Coordination Office (RDTS); Hammed Adedeji Amusa, Chief Research Economist from the Macroeconomics Policy, Forecasting and Research; and Philippe Dominique Tous, Principal Natural Officer from the Macroeconomics Policy, Forecasting and Research. Dr Joseph Atta-Mensah, Senior Fellow from Africa Centre for Economic Transformation, acted as an external reviewer.

The cover of the report is based on a general design by Laetitia Yattien- Amiguet and Justin Kabasele of the Bank's External Relations and Communications. Copy-editing was done by the Bank's Language Services Department (TCLS) and layout was done by Eighth Wonder.

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ACRONYMS AND ABBREVIATIONS

ADF	African Development Fund
AFDB	African Development Bank
AGOA	African Growth Opportunity Act
AT	Mozambique Revenue Authority
BM	Banco de Mozambique
BVM	Bolsa de Valores de Mozambique
COP28	United Nations Climate Change Conference (held in Dubai)
CPLC	Community of Portuguese Language Countries
CSP	Country Strategy Paper
ENDE	Estrategia Nacional de Desenvolvimento
FDI	Foreign Direct Investment
FRELIMO	Frente de Libertação de Moçambique
GDP	Gross Domestic Product
GHG	Greenhouse Gas
ICT	Information and Communications Technology
IFIs	International Financial Institutions
IMF	International Monetary Fund
LIC	Low-Income Country
LNG	Liquified Natural Gas
LSE	London School of Economics
MIMO	Interbank Money Market Rate (Central Bank Policy Rate)
NDS	National Development Strategy
PAE	Pacote de Medidas de Aceleração Econômica (Economic Acceleration Measures Package)
PBOs	Program-Based Operations
PPP	Public-Private Partnership
RENAMO	Resistência Nacional Moçambicana
SADC	The Southern African Development Community
SDGs	Sustainable Development Goals
SDG8	Decent Work and Economic Growth Goal
SDG13	Climate Action Goal
SDR	Special Drawing Right
S&P	Standard and Poor
SWF	Sovereign Wealth Fund
TSF	Transition Support Facility
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value-Added Tax
WTO	World Trade Organization

EXECUTIVE SUMMARY

Chapter 1 on Mozambique's macroeconomic performance and outlook, indicates that the country has mounted an impressive recovery in the past two years. It registered a growth of 5% in 2023 (2% in per capita terms), compared to 4.2% in 2022, and a reduction in inflation, from 10.3% in 2022 to 7.1% in 2023. Growth is expected to remain high at 5% or above in 2024 and 2025, higher than the African average.

Downsides to the outlook include: (i) the persistently high risk of debt distress will continue to negatively affect Foreign Direct Investment (FDI) inflows, with the exception of those for mega projects; (ii) Mozambique's increasing dependence on mega projects for revenue has increased its exposure to external commodity shocks, which will likely continue, given the Liquified Natural Gas (LNG) industry's vulnerability to shifts in global energy prices; (iii) inclement weather is expected to continue, especially in the central and southern parts of the country, with longer droughts and negative impact on agriculture and the agroindustry; (iv) the relative appreciation of the metical, thanks to gas related production, and investment, is beginning to hurt the competitiveness of the non-gas sectors, notably manufacturing.

Tailwinds: (i) Mozambique's resolution of the external debt debacle from the mid-2010s, which had soured its relations with multilateral and bilateral institutions, is the main tailwind. This means that it can once again count on concessional sources of financing, especially for social, and economic infrastructure projects. (ii) The Maputo Port has become a key gateway to external trade for many landlocked countries, and the South African industrial heartland, with the potential for economic growth, and job creation in Mozambique.

A mix of short-term and long-term policies will be needed to address Mozambique's macroeconomic challenges and put it back on the path to sustainable growth. Short-term measures should include ensuring that monetary easing helps to make credit more affordable for local firms, probably through the creation of lines of credit at the newly proposed Development Bank of Mozambique. Gas sector activities and their spending effects have eroded the competitiveness of manufacturing and agricultural exports, with negative implications for investment, and employment. It will be important to construct incentive-compatible measures, such as building industrial parks, or reducing some taxes, that could attract investment into the non-gas sectors by reducing startup costs. The long-term goals are, above all, to diversify the economy, raise its climate resilience, and strategically integrate it into the Southern African Development Community (SADC) region, and the rest of Africa through trade. The gas sector is transient, and it will be important to use the newly created Sovereign Wealth Fund (SWF) to start the building of a diversified economy for the country, based on its vast non-gas resources, and the sea.

Chapter 2 on taking stock of Mozambique's structural transformation presents both challenges and opportunities in the quest for economic diversification and sustainable growth. However, like other African countries, Mozambique has been transforming without a marked level of industrialization but through a low-skill services sector, mainly because of low manufacturing activity. The economy remains hugely informal, with low income per capita, a high poverty incidence, and levels of income inequality that are above the African average. Fragility challenges in the Northern region of the country remains a concern. To promote structural transformation, Mozambique needs a high and sustained infusion of investment, especially FDI, to develop its private sector, extend its infrastructure, foster its human capital base, create employment at scale, and boost the country's climate resilience. It must establish a conducive business climate that is also attractive to local investors, while the maintenance of peace, good governance, and strong and accountable state institutions are also crucial factors.

Mozambique's growth momentum is the result of large FDI flows into the extractive sector, mostly in LNG, but also in minerals, coal, and modern agriculture. There is a general expectation that the mega projects will eventually have positive impacts on the traditional sectors of the economy, agriculture, manufacturing, and fishing, where most of the population currently derives a livelihood. However, although the mega projects have brought a new dynamic to the economy, especially around the capital, Maputo, with positive impacts on modern services, notably banking, insurance, transport and logistics, and housing, and have boosted government revenue, it is now quite clear that their linkages to other sectors are limited, while their scope for job creation or economically boosting the regions where they are hosted remains narrow. The new projects must be linked better to job-creating growth in Mozambique and help to attract the rural sectors into the modern economy.

Chapter 3 on financing structural transformation in Mozambique, discusses the multifaceted challenges that the country is facing in financing its growth needs, given the complexity and high costs of the options available in the international financial market. Although Mozambique's financing requirements have changed drastically in the past decade because of external shocks, COVID-19 pandemic, and the impacts of climate change, the cost of resources readily available to the country is high and would not be suitable for social, and economic infrastructure.

The efficient mobilization of resources for structural transformation will require strong and efficient domestic financial institutions, some of them relatively new and emerging, such as the Sovereign Wealth Fund (SWF), and the nascent stock exchange. The banking system should be agile at financial intermediation, attracting remittances from the diaspora. Debt, domestic and external, is an important resource for domestic funding and how it is managed will determine the success of the structural transformation efforts overall. However, domestic resource mobilization is the most important source of domestic financing and requires adequate attention from the authorities in terms of policies and institutional development. Climate financing is a crucial resource for addressing the impacts of climate change in Mozambique. The country has so far only attracted a small portion of the funding that it will require to meet its climate-change response needs. It is important to make credible assessments of the climate resources needed, and how they can be delivered.

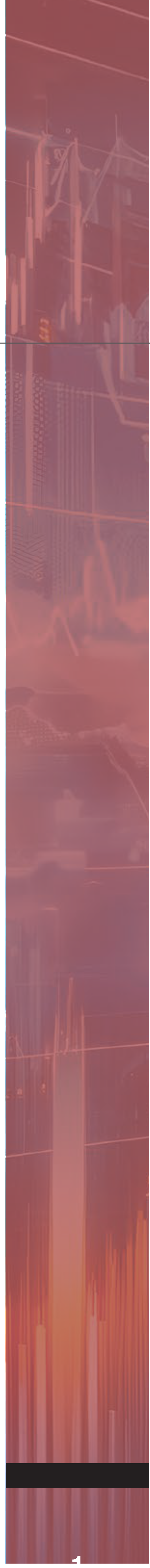
GENERAL INTRODUCTION

Mozambique enjoyed two decades of stellar economic performance, with growth rates averaging 7% annually, after the signing of the peace agreement between Frente de Libertação de Moçambique (FRELIMO) and Resistência Nacional Moçambicana (RENAMO) in 1992. But the discovery of hidden external debt accounts in 2016 forced the International Financial Institutions (IFIs) and bilateral donors to suspend their projects and programs. However, the crisis had a silver lining as it forced the government to take a hard look at its institutional procedures, undertake reforms and make good governance, and seeking urgent solutions to debt, climate, and poverty, policy priorities under its Economic Acceleration Measures Package (PAE). The mega extractive sector projects introduced in Mozambique in the past decades have real potential to change the country's economic landscape. They will be deemed successful only if they can engender inclusive growth and help to propel the country's structural transformation agenda forward.

This Country Focus Report (CFR) discusses Mozambique's quest for structural transformation, which is highlighted in all its plans and strategies, and why its financing will require change in the international financial architecture. The rest of the report proceeds as follows: chapter one looks at Mozambique's recent macroeconomic performance and outlook, while chapter two discusses the progress that the country is making in the quest for structural transformation. Lastly, chapter three highlights several modalities for financing structural transformation in Mozambique and elaborates why their success will not only require further domestic reforms and institution building, but also more consequentially reforms of the international financial architecture.

1

MOZAMBIQUE’S ECONOMIC PERFORMANCE AND OUTLOOK



KEY MESSAGES

- **Mozambique’s recent macroeconomic policies have brought about positive per capita growth, reaching 2% in 2023, and lower inflation, at 7.1% during the year.** The key policy question today is how to ensure that the growth recovery, thanks partly to activities of the mega extractive sector projects, including LNG, and services sector, is sustained, and will benefit as many people and across as many provinces of the country as possible.

- **In the face of elevated debt servicing demands and scaled-up social responsibilities, Mozambique’s fiscal room for maneuver will continue to be extremely limited.** Trade-offs will be inevitable but must be informed by the goals of financial and social inclusion as well as those of bridging the spatial gaps in the country.

- **Looking ahead, Mozambique’s increasing dependence on natural resource revenues, the country’s inclement weather, exacerbated by climate change, and the insurgency in the north pose real risks to performance in the short- to medium-term.** However, the recent growth rebound and calmer political climate, ahead of the 7th general elections, will help to preserve peace in most of the country as well as the climate for continued pursuit of economic reform.

1.1 Introduction

This chapter discusses Mozambique's recent economic performance and examines the government's policy priorities during a period marked by domestic and external shocks, as well as inclement weather and commodity price fluctuations, among others. It then looks at the medium-term outlook of the economy and the medium-term risks, including the challenge of debt escalation. The chapter ends with a presentation of policy options for fostering high and resilient growth, and hence, hastening structural transformation.

1.2 Growth Performance

Mozambican economy grew by an estimated 5% in 2023 from 4.2% in 2022, driven by the extractive industry.

The Mozambican economy grew from 4.2% in 2022 by an estimated 5.0% in 2023. This was a doubling of the growth rate from 2021 and reflects the economy's strong post-COVID-19 recovery (Table 1). In terms of drivers of growth, the extractive industry was the most significant in 2023, contributing close to half of the change in growth. The start of production of LNG in the Coral South field in October 2022 has been a significant factor. On the other hand, the extractive sector's investment and production spillovers have boosted the demand for private transport, logistics, and financial services.

The recovery of the non-extractive sectors, notably manufacturing and agriculture, livestock production, and fishing, has, however, been slower than expected. The causes include inclement weather, mostly in the central and south of the country, lack of credit, owing to stiff financial market segmentation[1], and the gas boom's erosion of the competitiveness of agriculture and manufacturing in domestic, and regional markets.

1.3 Other Recent Macroeconomic and Social Developments

Monetary policy, inflation, and the exchange rate. Mozambique's stringent pursuit of tight monetary policy in recent years has brought about price stability and helped the Bank of Mozambique to rebuild its international reserves. In recent years, the relative stability of the metical, the domestic currency unit, has helped to moderate inflation. However, the proliferation of mega projects and their revenue-expenditure effects have led to relative price appreciation. The metical has in turn appreciated against the Rand and the Euro since mid-2021 (it is de facto pegged to the US dollar). The relative appreciation of the metical is beginning to hurt the country's regional competitiveness – notably Mozambique is no longer considered to be a bargain holiday destination in the region. Inflation was estimated at 7.1% in 2023, a notable reduction from 10.3 % the previous year, while the Interbank Money Market Rate (MIMO) stood at 17.25 %. The lack of credit has constrained activities in the non-extractive sectors, notably manufacturing and agriculture, although structural rather than macroeconomic barriers bear most of the blame for lack of liquidity, especially at the tail end of the business sector.

The manufacturing sector had a share of 14 % of the credit to the economy in December 2022, but it had declined a year later to 9%. During the same period, agriculture's share declined from 2% to 1.4% . In spatial terms, about 70 % of the credit went to Maputo province. However, several provinces in the hinterland got less than 1% of the credit, on average, raising challenges for the government's

[1] The main banks, controlling over 70 % of the domestic lending, are well capitalized and liquid (thanks partly to deposits from the mega projects) but are not lending to the informal sector, and the rural farmers (see African Development Bank (2023), and Canavan et. al. (2023)).

financial inclusion strategy. In early 2024, the Bank of Mozambique reduced its MIMO by 150 basis points to 15.75 %. Moreover, the authorities reformed the forex market by ending targeted allocations of foreign currency to domestic fuel importers.

Table 1 : Mozambique: Macroeconomic and Social Indicators, 2019-2025

Indicators	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP Growth (%)	2.3	-1.2	2.4	4.2	5.0	5.2	5.2
Real GDP Growth per Capita (%)	-0.6	-4.2	-0.5	1.4	2.2	2.3	2.4
Inflation	2.8	3.1	5.7	10.3	7.1	5.0	4.6
Overall Fiscal Balance, Incl. Grants (% GDP)	0.3	-5.7	-4.7	-5.1	-2.8	-3.4	-1.3
Primary Fiscal Balance (% GDP)	--	-2.0	-2.3	-2.2	0.7	0.9	2.0
Public Sector Debt (% of GDP)	98	120	104.3	99.3	91.6	96.9	94.7
Debt Service (% of GDP)	2.1	3.3	3.2	2.8	3.0	3.0	3.1
Current Account (% GDP)	-19	-27.4	-22.3	-34.2	-11.1	-38.1	-43.0
Gross International Reserves (USD Millions (Months of Traditional Imports in Brackets))	--	4,070 (5.9)	3,470 (4.5)	2,888 (3.7)	2,433 (3.7)	2,235 (3.0)	3,438 (3.9)
GDP per Capita (USD)	507.8	453.4	503.4	582.9	632.5	690.7	704
Total Population (Millions)	30.3	31.2	32.1	33.0	33.9	34.8	--
Life Expectancy at Birth (Years)	61	61	59	60	62	63	--

Sources: Data from Mozambique authorities, AfDB Statistics Department, IMF, and World Bank; estimates (e) and prediction (p) based on authors' calculations.

Fiscal policy and public debt. The fiscal deficit for 2023 is estimated at -2.8% of GDP, down from -5.1% of GDP in 2022. It is the expected to rise to -3.4 of GDP in 2024 before declining substantially to -1.3% of GDP in 2025. Tax revenues for 2023 totaled 357 billion meticais or 17.5 % of GDP. This is a significant turnaround, given that the COVID-19 pandemic had decimated traditional revenue sources, and eroded fiscal buffers. The public sector wage bill, at about 15 % of GDP, accounted for over 50 % of current spending in 2023, while capital expenditure was less than 2.5% of GDP. This starkly illustrates the challenges that the government faces in moving towards a more balanced current-capital expenditure profile. In 2023, Mozambique remained at a high risk of debt distress, owing to its elevated public sector debt (amounting to 91.6 % of GDP in 2023), relatively weak debt management capacity and low GDP per capita. In 2022, domestic debt was about 24.5 % of total debt and the rest (75.5 %) external debt. Of the latter, multilaterals, African Development Fund (ADF) of the African Development Bank (AfDB), World Bank, and International Monetary Fund (IMF), accounted for 28 %, bilaterals for 23.8 %, commercial debt for 5%, and LNG project-related debt for 18.5 %. Interest rate payments on public debt have grown steadily in recent years, and are now, on the average, above 3% of GDP. Lenders and rating agencies have affirmed that because of Mozambique's strong reforms, as well as agreeing with a three-year Extended Credit Facility with the IMF in 2022, Program-Based Operations (PBOs) with World Bank and AfDB, establishing a SWF, and committing to contracting only concessional debt in the future, its debt is sustainable in a forward-looking sense.

External position and external financial flows. The current account was estimated at -11.1% of GDP in 2023, a threefold improvement compared to -34.2% of GDP in 2022. Mega projects have been a major factor on the import side. When material, equipment, and specialized services were brought into the country to commence gas production, the current account adjusted quite substantially. On the other hand, completed mega project are also having a strong impact on exports, contributing about two-thirds of the estimated USD8,037 million exports in 2023. Mozambique has become an important regional exporter of power, notably to South Africa, through exports of coal and electricity, and is a conduit to the sea for landlocked Malawi, and Zimbabwe. The Bank of Mozambique estimates that its gross international reserves will remain at about 3 months of imports in the medium term.

Social developments. Poverty eradication has been at the center of government policy in Mozambique for decades. All the country's national development plans and flagship strategies, and now mega extractive projects, have set economic development and poverty eradication as their ultimate goals. However, inequality remains elevated, with the Gini-coefficient from 0.47 in 2002 to 0.54 in 2024. On the other hand, the poverty incidence was 62.8 % or 18.9 million people in 2020 from 48 % or 13.1 million people in 2014/15.

Box 1: Impact of Tighter International Financial Conditions (Transmission Channels)

In terms of impact, the tighter international financial conditions have mostly affected the non-extractive sector, through higher cost of credit (mega project companies have lines of credit with foreign banks and are not affected to the same extent), and the government debt servicing. With Mozambique maintaining a largely floating exchange rate, while trying to contain domestic inflation and the escalation of the fiscal deficit, the policy rate has been the main instrument for addressing the tighter conditions on the international markets. There are second and third round effects as the impacts work their way through the system, mostly though the impacts on inflation and the relative exchange rate, and lower government revenues. As the costs of inputs escalates, exports of non-extractives will be affected. Meanwhile the government is forced to adjust its social expenditure, with negative impacts on welfare.

Increases in poverty levels when the economy was growing at rates of 7% and above suggests that Mozambique's growth has not been inclusive, because it did not create sufficient employment. This leads to high levels of inequality, and the persistence of structural barriers which include the sharp north-south/rural-urban divide, inadequate access to infrastructure, markets and social services, notably health and education, a high disease burden and generally low levels of human capital, notably in the hinterland provinces.[2]

1.4 Macroeconomic Outlook and Risks

1.4.1 Outlook

Economic growth. Real growth of the economy (GDP) in Mozambique is expected to remain high at 5% or above in 2024 and 2025, higher than the African average. Gas production will continue to be the main economic driver. However, for the growth momentum to be sustained, it will require higher production in agriculture and manufacturing, the traditional sectors of the economy.

[2] Several studies on Mozambique have been undertaken at UNU-WIDER Helsinki, covering issues of multidimensional poverty, the labor market, and the implications of natural resource dependence. See for example Cruz et. al. (2023) for essays from "The Institutional Diagnostic Project" done there.

Monetary policy and inflation. Inflation is projected to remain at around 5% or below for 2024 and 2025, respectively, which is well within the program targets agreed upon with the IMF. However, to get inflation where it is today, the government deployed unusually tight monetary policies. The critical issue going forward will be how quickly the Bank of Mozambique can loosen monetary policy, notably the policy rate, without risking undoing the country's hard-earned macroeconomic stability.

Fiscal and current account balances. The overall fiscal deficit, including grants, is expected to expand in 2024 to -3.4% of GDP before reducing to -1.3% of GDP in 2025, because of lower external debt repayments. The current account deficit is expected to rise and remain high at -38.1% of GDP in 2024, and -43% t of GDP in 2025, due to high levels of imports by the megaprojects in gas, and agriculture.

1.4.2 Risks

Mozambique has shown considerable resilience in recent years and a willingness to engage with its creditors and domestic constituencies in addressing the debt overhang and returning the economy to growth. Looking ahead, the headwinds and tailwinds are presented below:

Headwinds:

- The high risk of debt distress and negative ratings continue to negatively affect FDI inflows, except for those for mega projects, and hence the pace at which the country can diversify its economy.
- Mozambique's increasing dependence on mega projects for revenue and as the main source of exports has increased its exposure to external commodity shocks, which will likely continue, given the LNG industry's vulnerability to shifts in global energy prices.
- Climate change and its impacts are already notable in Mozambique. The effects of cyclone Freddy from early 2023, have superimposed on previous ones by cyclones Idai and Kenneth. The impact on agriculture and farm household welfare has been devasting. Inclement weather is expected to continue, especially in the central and southern parts of the country, with longer droughts, and negative impact on agriculture and the agroindustry.
- The relative appreciation of the metical, thanks to gas related production and investment, is beginning to hurt the competitiveness of the non-gas sectors, notably manufacturing.
- Mozambique's pool of educated young people has expanded rapidly in recent decades. However, with so little employment being created, the postulated demographic dividend might not happen. There is a risk of young people becoming increasingly disgruntled and turning to any activity to fill their time.

Tailwinds:

- Mozambique's resolution of the external debt debacle from the mid-2010s, which had soured its relations with multilateral and bilateral institutions, is the main tailwind. This means that it can once again count on concessional sources of financing, especially for social and economic infrastructure projects.
- The Port of Maputo, run by the Maputo Port Development Company as a Public-Private Partnership (PPP) with the government, has registered rapid growth in business in recent years. It is part of the Maputo-Johannesburg transport corridor, which also connects several landlocked countries to the sea. Mozambique is now a net exporter of services, while also exporting power (coal and electricity) to South Africa through the corridor.
- The creation of a new SWF to manage

the country's extractive resources will create the basis for effective resource mobilization and utilization, with the benefit of future generations in mind. If run efficiently and transparently, the SWF could have positive impacts on governance in the rest of the public sector National Development Strategy (ENDE).

1.5 Policy Options to Foster High and Resilient Growth; Supporting Macroeconomic Stability and Economic Transformation

Mozambique's pillar policy documents, Agenda 2025, and the National Development Strategy (NDS) 2015-2035, share the vision of promoting a prosperous, competitive, sustainable, secure, and inclusive country. Their common objective is to raise the living conditions of the population through the structural transformation of the economy, and the expansion and diversification of the productive base. The measures to be pursued in the short-term and medium- to long-term are as follows:

Short-term:

- Tight fiscal policies have helped to anchor inflation in Mozambique, but growth in the non-gas sector, notably manufacturing, agriculture and services, has been sluggish because the sectors have been starved of credit, while imported imports have been constrained. Among possible ways to address this is to create quick-disbursing lines of credit dedicated to businesses in these sectors at the Mozambique Development Bank. Increased domestic production, especially of domestic staples, will help lower domestic inflation pressure.

- The metical has appreciated in recent years, thanks to the spending effects arising from FDI in mega projects. This, has in turn, eroded the competitiveness of Mozambique's exports, as well as agricultural products to neighboring countries, especially South Africa. Given a floating exchange, however, the policy choices are limited. The Bank of Mozambique (BM) should reduce the dollars from the market in various ways, including a quicker retirement of domestic debt.

- To stimulate local production and cause the linkages desired in the broader economy, it will be important to reinforce local procurement by the mega projects. This would boost local production in the machine and chemicals industries. While megaprojects have embarked on several projects as part of their corporate responsibility it is necessary to have a more formalized approach. In agriculture, for example, a chain approach should be developed which would help develop agro-industries, and markets in the countryside.

- Mozambique is experiencing high debt distress, partly owing to poor debt management in the past. The country's debt management capacity has been strengthened, while the government has vowed to henceforth contract external debt from concessional sources. A way of multiplying available concessional financing, such as from the AfDB, is to use it to generate partial credit guarantees that can make it possible to borrow at affordable rates from the private sector. However, debt is an important source of financing, and the government must strengthen its debt management capacity even further. With time, the SWF might provide financing of its own.

Medium to long-term:

- As part of its diversification strategy, Mozambique should use some of the revenues from the gas projects to expand social and economic infrastructure throughout the country. This will open the country to internal trade, create jobs, and reduce pressure on the urban centers.

- The government must find ways of incorporating young people into the labor market, if necessary, through public works programs. With up to 500,000 people expected to enter the labor market each year in the near-term, employment creation is paramount. There are many areas where young people could be deployed in large numbers in Mozambique, including rural infrastructure development, agricultural outreach services or literacy campaigns in the countryside. At tertiary levels of education, there should be increased emphasis on subjects with a practical, and labor market relevance.

- The effects of climate change are already being felt in Mozambique with the proliferation of extreme weather events, notably cyclones in the south of the country, and long droughts in the north. There is need for considerable planning into finding ways to address the complex issues involved, as well as how to engender climate-smart agriculture, and how to climate proof rural infrastructure, and to get acquainted with the financing available to support the country's climate resilience, and its mitigation and adaptation strategies.

- Mozambique's rural sector can contribute to growth and employment if small-holder households are provided with the opportunity, through infrastructure improvements and access to credit, to gradually evolve from a livelihood currently based squarely on subsistence to one with greater access to markets, and where cash incomes matter.

- In Mozambique's search for a new growth impetus, the focus accorded to one of its most obvious resources in recent years, the long coastline, and the sea, has been modest. As a national resource, the sea gives the country an unprecedented comparative advantage, which can be the basis for the development of a blue or marine economy, with implications for fishing, tourism and sporting, and leisure activities, and hence robust economic diversification, growth, and transformation.

TAKING STOCK OF MOZAMBIQUE'S STRUCTURAL TRANSFORMATION PROGRESS 2

KEY MESSAGES

- **Mozambique requires a steady accumulation of physical and human capital, rapid job creation, and increases in productivity to begin reducing its poverty incidence and embark on sustainable structural transformation.** It must establish a conducive business climate that is also attractive to local investors. The maintenance of peace, good governance, and strong and accountable state institutions are also crucial factors.

- **Mega projects must be better linked to the local economies.** Recent growth in Mozambique has principally derived from the new mega projects, notably offshore investments in gas, but with limited linkage to domestic demand, and supply streams. Unless these new projects can be sufficiently linked to job-creating growth in Mozambique and help to attract the rural sectors into the modern economy, their current premise as an innovative idea to engender growth, and development might eventually wear off. They might continue as enclaves but would have lost the opportunity to transform the country.

- **The informal sector in Mozambique is an important part of the economy and how it operates will have implications for structural transformation and poverty reduction.** New arrivals in the cities, and those already there depend on it for livelihood. It is imperative to find ways to enhance its potential for generating jobs by crafting supportive legislation, as well as simplifying setting-up procedures and improving access to credit and advisory services.

- **Structural transformation, private sector development, and urbanization will be closely intertwined in Mozambique.** Hence policies for urban development must also consider the needs of the private sector, including economic infrastructure, and amenities for workers.

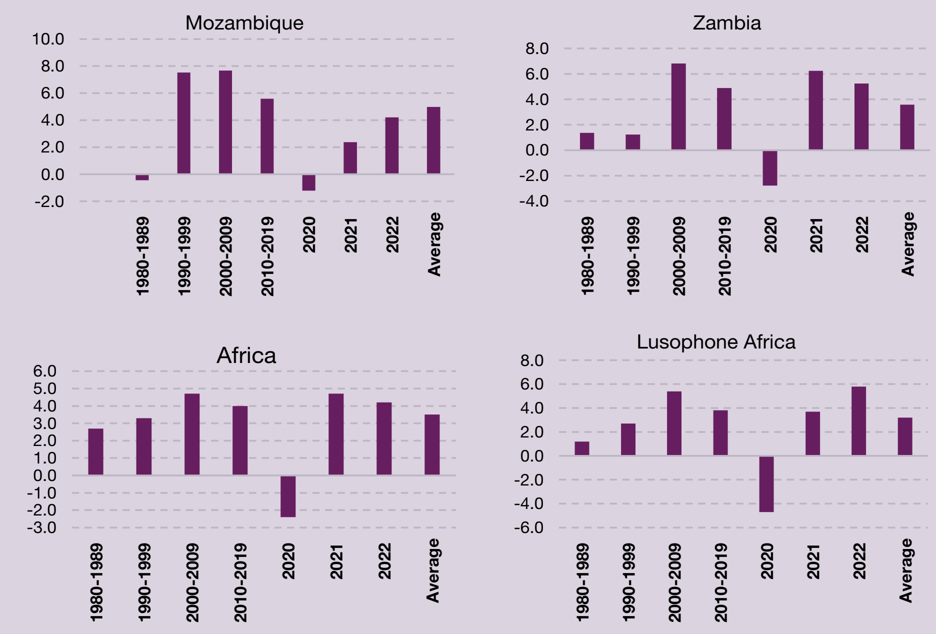
2.1 Introduction

Mozambique's structural transformation effort, that is to shift the economic structure from low-productivity, labor-intensive activities to higher productivity, capital and skill intensive activities has been difficult, and susceptible to reversal. The main obstacles to progress have included domestic insurgencies, inclement weather, and external shocks and high inequality, and extensive rural-urban gaps.

2.2 Mozambique: Taking Stock of Economic Performance and Transformation

Mozambique was engulfed in civil war during the 1980s and its attempts at reform during that decade were fruitless. Figure 2.1 compares Mozambique's growth performance with that of Zambia, a country, like Mozambique, belonging to the SADC region, but also sharing its dependence on extractives, and hence its economy is subject to frequent external shocks, Lusophone Africa, and Africa as a whole. While the 1980s were a difficult decade for all African countries, they were devastating for Mozambique. Steeped in civil war, it recorded, on the average, a negative GDP growth rate of -0.4% in the period between 1980-1989 (per capita growth of -1.9%), compared to 1.4 % for Zambia (per capita growth of -1.8%). For Lusophone Africa, average growth was 1.2% (per capita growth of -0.9%), and for Africa as a whole, 2.7% (per capita growth of -0.1%).

Figure 2.1: Mozambique's GDP Growth (%) vs Africa and Peers, 1980-2022



Source: African Development Bank.

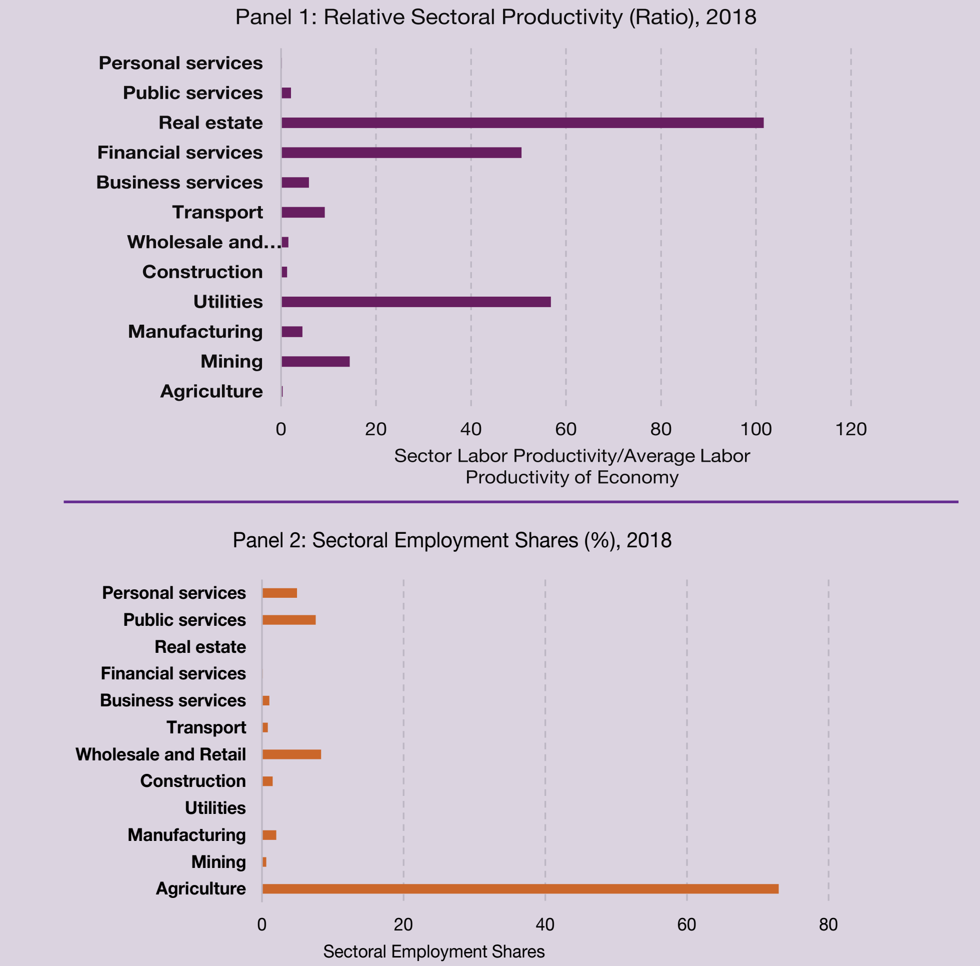
Between 1990-2009, Mozambique witnessed an unprecedented growth, between 7-8%, above the Lusophone Africa, and African averages. The country recovered spectacularly from cyclone Leon-Eline, the worst in 50 years, which struck in 2000, killed over 800 hundred people, and thousands of cattle, and destroyed vast tracts of arable land. The growth momentum continued during part of 2010s but was disrupted by the new insurgency mounted by RENAMO in 2013 (it ended in 2019) as well as the flareups in the Cabo Delgado province in the north, which hosts some of the country's largest gas finds. During COVID-19 and the contingent difficulties arising from the multi-shocks, Mozambique shown considerable resilience, with its mega projects continuing, and returning to growth. In retrospect, the past decade has been marked more by survival than transformation.

2.3 Mozambique's Structural Transformation: Drivers, Bottlenecks and Opportunities

2.3.1 Structural/Economic Transformation

Mozambique's labor productivity depicts considerable sectoral variation. A snapshot from 2018 shows that personal services had the lowest productivity at 0.17, while agriculture was at 0.36 (Figure 2.2, panels 1 and 2). Combined, the two sectors accounted for 78 % of total employment or about 9.8 million people. The extremely low productivity in the two sectors explains to some degree the persistence of poverty in Mozambique. Researchers have detected a high degree of feminization in agriculture, as men have abandoned farms for the cities, leaving women, children, and the elderly to work on them. If subsistence farming productivity is directly compared to that for personal services, the latter is higher. The relative productivity of construction (1.2), retail sectors (1.5) and public services (2.1) is closer to the economy's average. The three-sectors accounted for 17 % of total employment (or 2.1 million people) in 2018.

Figure 2.2: Mozambique: Snapshot of Relative Sectoral Productivity and Employment Shares, 2018



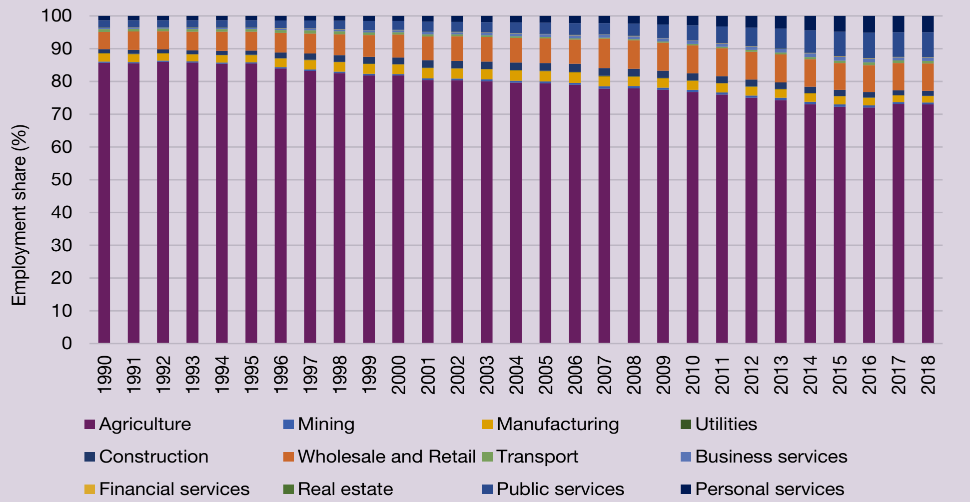
Source: African Development Bank.

Mozambique requires a steady accumulation of physical and human capital, rapid job creation, and increases in productivity to embark on sustainable structural transformation.

In 2018, the intermediate to high productivity sectors in Mozambique included manufacturing (with a relative productivity of 4.9), business services (5.9), transport (9.2), and mining (14.4). Together the four sectors had a 4% share in employment (or less than half a million people). Notably, manufacturing, the sector most often identified as the vehicle for propelling structural transformation had a share in employment of only 2% (or a quarter million people). There are currently too few people engaged in sectors with relatively high productivity and deemed capable of causing structural transformation. Owing to structural distortions, increasing employment in the higher productivity sectors of the economy will require targeted measures on both the supply and demand sides, such as skill upgrading, and infrastructure provision.

In terms of productivity, the topflight sectors in Mozambique are financial services, with a relative productivity of 50.6, utilities with 56.8, and real estate with 101.6. For all practical purposes, however, these are enclaves, with only 0.2% employment share or a total of 25,000 people working there. Notably, while the real estate sector has the highest relative productivity, its employment share is only 0.03%, that is less than 3,000 people.

Figure 2.3: **Mozambique: Sectoral Employment Shares, 1990-2018 (%)**

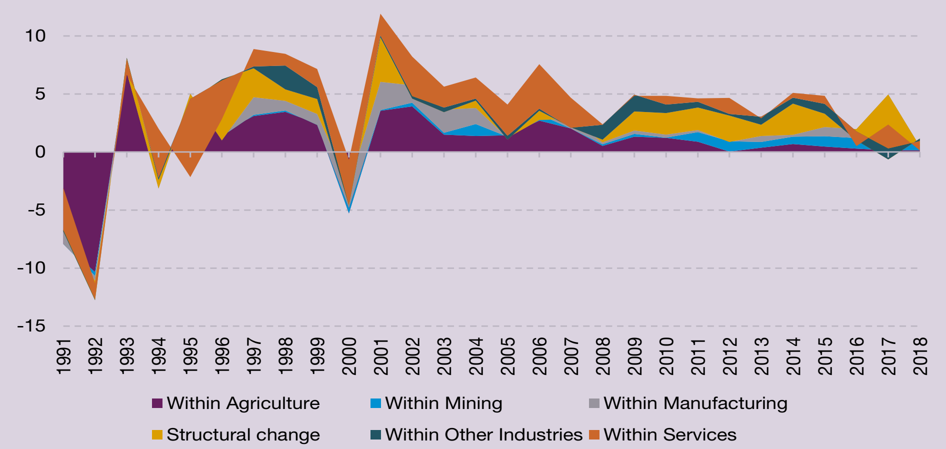


Source: African Development Bank.

Figure 2.3 presents changes in sector employment shares from a long-term perspective, 1990-2018. It suggests that there have been modest movements toward structural change in Mozambique. The sectors which have drawn labor, mostly from agriculture in the last 30 years, including personal services, public services, wholesale and retail, and construction, had shares in total employment of about 10 % in 1990. By 2018, these sectors accounted for 22 % of employment, a doubling over two decades. On the other hand, agriculture's share in employment had shrunk from 86 % in 1990 to 73 % in 2018, while that of manufacturing was 2.0% in 2018, that is below where it had been 30 years previously.

Figure 2.4 shows that there has been a considerable within sector productivity growth in Mozambique during the past three decades, with most of the changes taking place in the service sectors, but subject to much variation. In agriculture, within productivity growth suffered during the early 1990s, before the civil war ended, and in 2000, owing to Cyclone Leon-Eline, it shows increases between 2001-2012, with the entry of mega projects into agriculture. The period after 2010 shows that there was more structural transformation, if far from dramatic, than in previous periods.

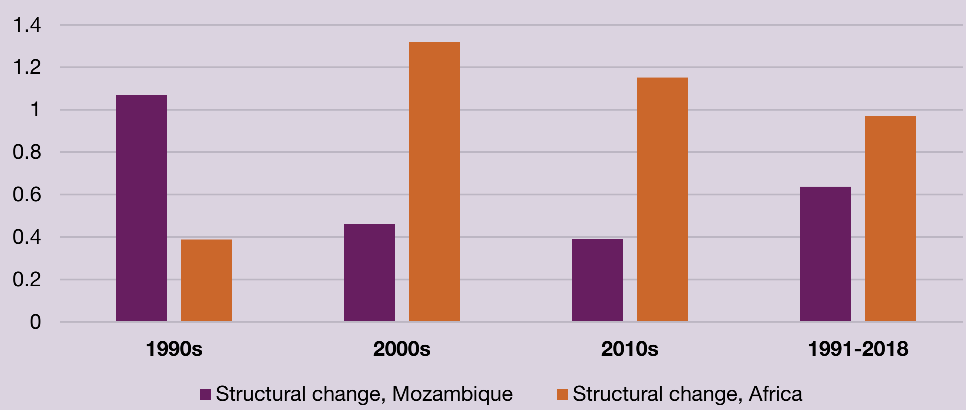
Figure 2.4: **Mozambique: Within Sector Productivity Growth and Structural Transformation, 1991-2018**



Source: African Development Bank.

There has been less structural change in Mozambique during the past three decades than in Africa as a whole (Figure 2.5). Although structural change was pronounced in the 1990s, when the civil war ended, and the government embarked on extensive macroeconomic and institutional reforms, the following decades showed a sharp decline in the rate of the country's structural change, falling to below half of the African average. In the 2000s, the change in productivity was mostly determined by within sector changes in services, and other industries.

Figure 2.5: **Three Decades of Structural Change in Mozambique, 1991-2018**



2.3.4 Drivers to Accelerate Structural Transformation

At the macrolevel, empirical research has identified several drivers of structural transformation that have broad relevance for Mozambique, as already highlighted in the sections above.[3] The rigid exchange rate regime adopted by Mozambique in earlier decades to support import substitution was a de facto tax on small-holder producers of commodity exports. However, the challenge of exchange rate appreciation

[3]See for example, McMillan and Zeufack (2021)'s discussion on labor productivity, growth and industrialization in Africa.

has returned with the country's heavy dependence on extractives. The government must find ways to counter the appreciation of the exchange rate, as it will erode the structural transformation efforts.

With respect to trade policy, Mozambique is poised to benefit from its position as a gateway to parts of South Africa and the landlocked countries and is already making inroads in the export of services. The government has invested heavily in the Maputo port and in railway links to its neighbors in the hinterland. Additionally, Mozambique should encourage value-addition within its gas sector, with the view of developing a petrochemical industry, which would have a ready market in the region. The bigger challenge, however, is how to seek out profitable niches in the plethora of trade arrangements currently available in global trade, and commerce.

Box 2: The African Development Bank (AfDB)'s Role in Supporting Growth and Structural Transformation in Mozambique

The AfDB has been a key supporter of economic development in Mozambique for decades, with the country eligible to resources from the ADF and several of its trust funds and programs, including, notably, the Transition Support Facility (TSF) which was created 2008 to assist countries affected by conflict consolidate peace, build resilient states, and return to growth. The accumulated portfolio of over 100 projects indicates that a considerable focus was put on infrastructure, especially transport and communications, although energy and climate resilience have also been prominent. As of June, 2024, the current portfolio comprised 42 operations, grouped in 35 projects, valued at $1.35 billion, of which 44 % where in the private sector.

The Bank's current Country Strategy Paper (CSP) for Mozambique for the period between 2023-2028 is squarely focused on catalyzing Mozambique's structural transformation with the goal of boosting the country's fiscal outcomes, raising its capacity for creating decent jobs, and for engendering inclusive growth. The two priority areas for the CSP include, improving economic governance and the business environment to facilitate private-sector investments, and mobilize resources; and sustainably transforming agricultural value-chains by strengthening rural transport networks, and improving Information and Communications Technology (ICT) based communications. Other focus areas also include energy, water and sanitation. The Bank also supports transformative regional transport and energy projects in which Mozambique is involved, including rail transport for the Maputo-Johannesburg corridor, and regional climate resilience initiatives. The Bank has also provided the country with relevant knowledge generating opportunities as well as advisory services.

Mozambique's policymakers have straddled between the need to make the business environment attractive and the demands of workers, labor unions, and climate-change activists for "ethical" treatment. There is always a dilemma between a keen promotion of FDI and insisting on high social corporate responsibility standards, and affirmative action – there is always the fear that if investors find the regulations onerous, they will move elsewhere. With respect to flexible wages, the government is forced to walk the fine line between ensuring that private companies thrive while preventing overt exploitation of domestic workers but has sometimes faced challenges in maintaining the balance.[4] However, businesses have interest in having an enthusiastic and productive labor force

[4] The Danish Trade Union (2017) conducted a study on the Mozambican labor market in 2017 and makes interesting inferences on the sources of policy inertia, with most of the regulatory framework flouted by the employers.

and many could be persuaded to pursue a moderate stance. The more acute challenge will be how to encourage investors in non-farm businesses to setup in the countryside, given the low skills levels in the countryside. This is important to pursue nevertheless, because raising rural productivity, to reduce poverty, through the launch of a thriving rural economy, is one of the government's top priorities.

2.3.4 Key Bottlenecks to Fast-Paced Transformation

Mozambique's quest to raise productivity, and lift people out of poverty, during its two-decades-long growth spurt, remains a constraint to speeding up structural transformation. The lack of productive, high-skill jobs seriously constrains the structural transformation agenda. Nonetheless, the government has made strides by approving a new labour law 13/2023, which entered into force on 21 February 2023, emphasizing its objective of improving workers' rights and adapting to modern employment practices. The legacy of low education and paucity of skills could be overcome by the provision of market-oriented technical skills, and by improving the education system, more broadly.[5]

In subsistence farming, productivity is so low that any small innovation, such as the introduction of fertilizer or pesticides, will instantly raise output.[6] The question is why it is not done on a broader scale. Similarly, in urban areas, enhancing manufacturing productivity could be achieved by promoting labor-intensive industries with export potential. These industries are crucial for long-term productivity improvement in Mozambique. There is a recognized need for strategic state intervention to stimulate job creation and steer market forces in a productive direction.

2.4 Finance to Fast-Track Mozambique's Structural Transformation: How Much is at Stake? Country's Commitments to Structural Change.

2.4.1 Structural Change Strategy in Mozambique's Strategies and Plans

Mozambique launched its National Development Strategy (NDS) 2015-2035 at the end of 2014. Like the earlier Agenda 2025, presented in 2003, the strategy emphasizes economic diversification, structural transformation, and the harnessing of the demographic dividend. Its pillars include human capital development, basic infrastructure construction, promotion of research, innovation and technological development, and the elevation of good governance, and public sector coordination. It also underlines the importance of creating strong linkages between the mega projects in the extractive sector, and agriculture, and manufacturing. The strategy is implemented under Five-Year government programs and operationalized through annual issues of the economic and social plan, and the state budget. The government expected the national strategy to be financed from domestic resources. It also counted on the private sector to finance parts of the strategy, using concessions and/or private-public partnerships.[7]

In August 2022, President Filipe Nyusi announced the program for accelerating the economy. It contains 22 measures in the areas of (i) fiscal and economic stimulus, and (ii) improving the business environment, governance, and accelerating strategic infrastructure. It also underlines the importance of decentralization and the need for a portion of the revenues from

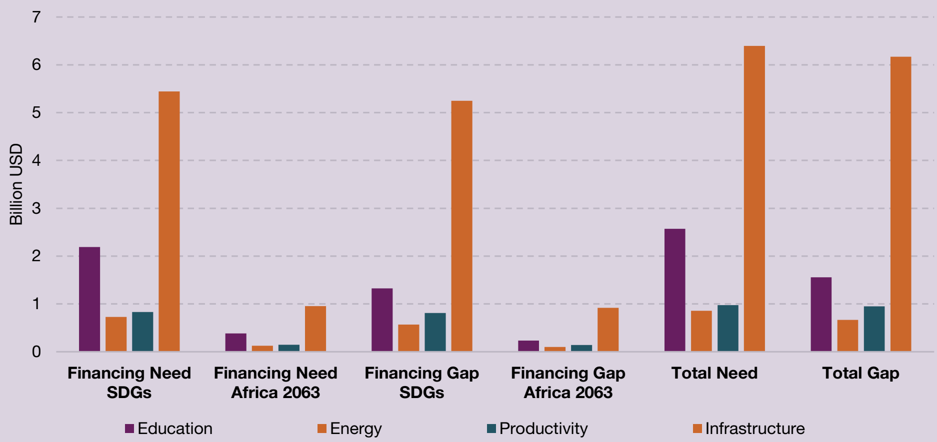
[5] Jones and Tarp (2013) discussed these issues exhaustively a decade ago, i.e., they are hardly new.
[6] See for example the paper by Zavale et. al. (2020) on the fertilizer value-chain in Mozambique.
[7] See Repúblicade Moçambique (various issues) for examples of the extensive planning efforts. Resource constraints have bedeviled implementation, however.

the extractive industries to be returned to host communities for their socio-economic development.

2.4.2 Financing Needs and Financing Gap

The staff of the African Development Bank has estimated that Mozambique would need close to USD11 billion per year to meet its Sustainable Development Goals (SDG), and Africa 2063 commitments, with the bulk (USD6.4 billion) going to infrastructure (Figure 2.6). However, the financing gap is quite substantial, with only about USD200 million available per year for infrastructure, leaving an annual gap of USD6.2 billion. The amounts of investments needed in education would be just above USD2 billion per year. The financing gap is lower, presumably because of the large projected public outlays on education of close to 20 % of GDP per year under the NDS. The needs and gaps in energy and productivity are smaller because the private sector has already assumed a prominent role in their provision. The SDG Index for 2021 indicated that Mozambique was on track to meet only SDG8 on productivity, and SDG13 on climate action.

Figure 2.6: Estimated Annual Financial Needs and Financing Gap to Fast-Track Structural Transformation in Mozambique

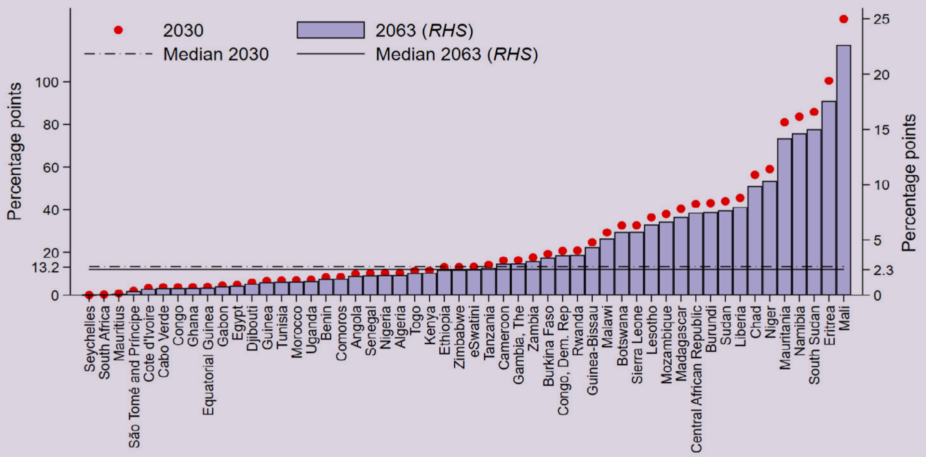


2.4.3 Closing the Financing Gap Through Domestic Resources Mobilization

Mozambique has posted revenues in the past decade that are, at above 25 % of GDP, above the African average. Thanks to the presence of large foreign companies in the extractive sector, Mozambique has relatively high corporate income tax receipts (about 11 % of GDP, of which 5.9% is Value-Added Tax (VAT), on average). However, reliance on gas revenues has led to destabilizing fluctuations in revenue flows to the government, and hence distorted plan implementation.

The government has strengthened the Mozambique Revenue Authority (AT), including its technical capacity and governance. Key reforms there have included the introduction of VAT, capital gains tax, eradication of double taxation, and heightening ethics and integrity among staff. Still, Despite these efforts, the estimates undertaken by the staff of the AfDB for African countries (Figure 2.7) suggest that the country would need to raise its tax-to-GDP ratio to at least 42 %, to close the financing gap on its own.

Figure 2.7: Required Increase in Tax-to-GDP Ratio to Close Estimated Annual Financing Gap in Africa



Source: Staff calculations and database from African Development Bank statistics, Sachs et al. (2023), UNESCO, CIA, NASA, IMF, and World Bank.

2.5 Concluding Remarks and Policy Conclusions

The Mozambican government recognizes structural transformation is crucial for sustained poverty eradication, and climate-change resilience. It has thus embarked on several strategies and plans in the past decade aimed at changing the structure of the economy. However, the intended goals of enhancing agricultural and manufacturing productivity, as well as bridging rural-urban gaps, have seen limited impact as completion of implementation of these strategies and plans are still lagging.

With an estimated 500,000 people expected to enter the labor market per year in the short-term, decisive action is needed to create job opportunities in Mozambique. Among several proposed solutions is the formalization of the informal sector. Recognizing its vital economic role, which supports a significant portion of the population and supplies essential goods and services to low-income groups, highlights its importance. Currently, access to credit for these entrepreneurs is limited, with existing alternatives often being costly and impractical. Many rely on loans from family and friends, known as 'angel investors,' to sustain their businesses. Enhancing access to formal and affordable financial services for informal sector entrepreneurs would enable them to compete more effectively for public sector opportunities.

The mega extractive sector projects have introduced a new paradigm in Mozambique's development. On the one hand, they promise to link the country to superior technologies and regional and global trade networks, while boosting government revenue. Already the export of gas, raw materials, and services has changed the face of the Port of Maputo, which is the starting point of the multi-modal Maputo-Johannesburg transport corridor. Mozambique is now inextricably part of the associated regional and global economies, with 70 % of the traffic through the port generated by South African businesses, leading to fast-paced economic growth around the capital, Maputo. On the other hand, this is in turn raising the specter of the emergence of a dual-speed economy, with the Maputo province as the metropolis and the hinterland provinces, relying on subsistence agriculture for livelihoods, as the periphery. Looking ahead, it will be crucial to leverage the revenues coming from the megaprojects to establish transformative projects across the country that raise the quality of infrastructure and boost human capital, instead of merely boosting current spending.

3

FINANCING STRUCTURAL TRANSFORMATION IN MOZAMBIQUE: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

KEY MESSAGES

- **Mozambique's financing requirements have changed drastically in the past decade because of external shocks, COVID-19 pandemic, and the impacts of climate change.** To respond adequately to its needs, as indeed to those of other African countries, it must entail changes in the international financial architecture. Hence, Mozambique must add its voice to those of African countries in demanding change in how the international financial architecture operates.

- **Domestic resource mobilization is key to financing government and should be the first port of call.** The Tax Authority of Mozambique has collected close to 23 % of GDP in the past five years, which is above the African average. However, the bulk of the revenue is from the mega projects, and much more needs to be done to expand the tax base.

- **The country's financial sector should be agile at financial intermediation, attracting remittances from the diaspora, and able to support the stock exchange for resource mobilization, both locally and externally.** In several cases, the financial institutions are operating in a new and challenging environment and capacity building will be crucial.

- **Debt escalation reflected domestic policy weaknesses, rather than solely from insufficient supervision by the IFIs and the rating agencies.** However, debt is an important resource for domestic funding and how it is managed will determine the success of the structural transformation efforts.

- **Climate financing is a crucial resource for addressing the impacts of climate change in Mozambique. The country has so far attracted a small portion of the funding that it will require to meet its climate-change response needs.** It is important to make credible assessments of the resources needed and how they can be delivered.

3.1 Introduction

For a Low-Income Country (LIC) at a remove from the global financial centers, Mozambique cannot singly influence the shape and form of the international financial architecture. However, the situation changes radically when the country is seen as only one of several countries in Africa and elsewhere, who see the current international financial architecture – defined simply as how resources for economic development are deployed around the world – as ill-suited to meet the needs of their populations and those of the global community, and thus, wish to see it changed. For once, the ephemeral term "win-win" would make sense, because financing development that enhances welfare in LICs would boost that of the rest of the world.[8]

Reform of the global financial architecture will be critical in helping the country to increase concessional financing and facilitate restructuring of the country's existing debt.

Building on chapter 2, this chapter presents Mozambique's stand on the need to reform the international financial architecture, which is drawn largely from policy statements of the government. It looks at the way in which additional resources for Africa's transformation could be derived, with a focus on Mozambique. Lastly, the discussion also focuses on the evolution of debt in Mozambique, as well as its climate financing needs.

3.2 Mozambique's Stand on the Need to Reform the International Financial Architecture

As a country, Mozambique has also stressed the need for the Reform of the Global Financial Architecture towards an equitable distribution, and most importantly how the resources for economic development flow to the countries that need them the most. The arguments for the change in approach are as follows:

The role of the private sector in African development is now universally acknowledged, not least in LICs with natural resource wealth such as Mozambique. However, in the absence of robust industrial policies, and given asymmetry of capacities between project drivers and potential beneficiaries, the transfer of knowledge and technical capacities is limited. There is invariably little local training or well-laid out strategies for technical capacity transfer. Hence the deployment of the private sector in the extractive sectors on the scale witnessed in Mozambique must be accompanied by transparent and effective accountability mechanisms. The international community can play a critical role in helping in negotiating and enforcing such agreements. Inevitably, more privately driven development operations will require a better understanding of how to manage country and project risks, and how to ensure that host countries benefit from their natural resources.

How risk ratings are assigned to African countries and their impacts on inward investment are issues of much concern among African policymakers, not least in Mozambique. While climate change, natural disasters, and geopolitical shocks have radically heightened the risk profiles of many African economies, at least when measured in the traditional sense, many African governments are arguing that the traditional view of risk, based on ratings from the agencies, should be accompanied by a nuanced and a more informed view of risk taking. Mozambique is a good example of this. Its mega gas projects in the south of the country are flourishing, although there is insurgency in Cabo Delgado, a gas rich province of the country in the north. If investors had not undertaken their own due diligence and squarely depended on the country's sovereign rating of CC Standard and Poor's (S&P) affirmed by S&P in November

[8] These sentiments were expressed unequivocally at the AfDB's Annual Meetings held in in May 2024, in Nairobi, Kenya.

2016, the gas investments would not have happened. It will not be possible to raise capital on the scale required by African countries without revisiting the issue of how African risk is assessed. Changing the approach is not a request for charity, it is a plea for injecting realism in a rapidly changing landscape.

Mozambique used its share of the SDR allocation (worth USD305.9 million) post-pandemic to relieve its fiscal pressure, including the payment of principal on debt and interest. But like other African countries, Mozambique was concerned that its share of the SDR was small, and disproportionate to its needs. Few African countries were able to use their allocation to, in the words of the United Nations Development Programme (UNDP), "secure a green and inclusive" recovery from COVID-19. For Mozambique, the funds were not enough to enable it to tackle the subjects of debt and climate change, although emphasized at the time by the IFIs, and the rest of the international community. Hence, AfDB's proposal to the international community to use its already established institutional modalities to help recycle the SDRs owned by the wealthier countries has been positively received by Mozambique and its peers, although the road ahead is yet to be determined.

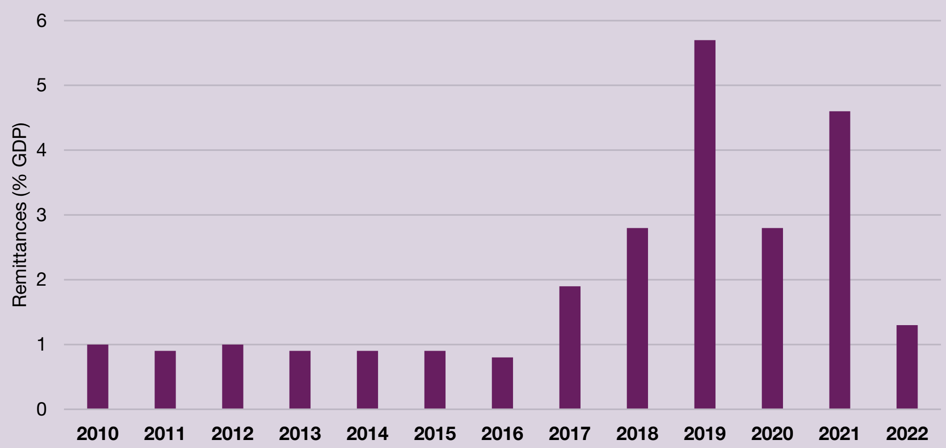
3.3 Mobilizing Additional Resources for Mozambique's Transformation

This section looks at five issues related to mobilizing additional resources for Mozambique's transformation, focusing on enhancing domestic technical, and institutional capacities for financial intermediation and multiplication.

Boosting the financial sector's readiness is critical. Researchers at the London School of Economics (LSE) have noted that companies running the mega projects in Mozambique are not constrained by high interest rates or difficulties of accessing credit from the local banks because they have access to lines of credit from their shareholders and sponsors. Their freedom from depending on a weak financial sector in Mozambique should nevertheless be of serious concern to the authorities – a financial sector intent on leading the charge on financing structural transformation of the economy cannot afford to be overlooked. IFIs could support these institutions by providing lines of credit to local businesses and contribute to the dynamism of the financial sector. Moreover, insurance companies, and pension funds could also be part of the institutional framework for mobilizing resources.

Remittances have become a key source of foreign resources and must be encouraged, while the Mozambican diaspora must be courted. Table 2 shows that while remittances were under 1% of GDP for several years, they started increasing strongly after 2016, when the exchange rate was adjusted. In 2019, remittances reached 5.7% of GDP, greater than FDI inflows at 5%. Policy documents refer to the need to encourage the sense of patriotism that the Mozambicans living abroad might have for their country, as a way of ensuring that these flows continue unabated. Yes, the populations abroad care about their relatives and the money they send acts as a social safety net in Mozambique, and many other countries. However, public overtures of gratefulness must be accompanied by serious incentives. In Ethiopia, for example, the government and private companies have constructed real estate projects which can be purchased by people in the diaspora on terms mutually agreed by both parties. Other countries have established offices dedicated to diaspora affairs. The potential here is enough to warrant inclusion in the broader mobilization strategy for development.

Figure 3.1: Mozambique: Personal Remittances (% of GDP)



Source: World Bank, WDI.

The question of how to foment local capitalists as the basis for structural transformation has come to the fore in many countries, not least Mozambique. In early June 2024, the President of the country was visiting South Korea to attend the Korea-Africa Summit on the subject of "building the future together: economic growth, sustainability and solidarity." South Korea became the industrial giant it is today because it promoted local or domestic capitalists relentlessly. During the 1950s and 1960s, South Korea only allowed projects that could be implemented jointly with its own citizens and where technologies could be shared. Although that type of orthodoxy might not work today, the issue of nurturing local capacities alongside each new project is still relevant. Otherwise, when Mozambique's mega projects come to an end, locals would have gained little in terms of technical knowhow.

Stock exchanges have been set up in several African countries, with varying levels of success. Nevertheless, they have added a level of complexity to the financial sector in several countries, with some already attracting capital from abroad. Also important, the due diligence required of firms before they are registered helps to set high standards for business management.

In Mozambique, the stock exchange, Bolsa de Valores de Mozambique (BVM) was established in 1999 but did not take off in earnest until much later. Today it has about 20 companies registered, while another 20 companies are in the pipeline. It is planning to internationalize its operations, although investors can already buy shares from the businesses via the BVM's website. It also serves as a market for government paper. With increased sophistication, the stock exchange will be crucial in introducing new financing modalities including blended finance instruments, or those linked to climate financing.

3.4 Dealing with Mozambique's Debt

Whether Africa's second debt crisis in 30 years was entirely a surprise to African governments and their advisors is debatable. Prior to the COVID-19 pandemic, there were indications that many countries in Africa were grappling with issues of debt sustainability. Yet several African countries still lined up for Eurobond deals even when coupon rates were in double digits in the late 2000s.

In retrospect, Mozambique's borrowing, in contrast with that of its neighbors, was initially quite productive. It helped engender the growth rates, averaging 7% during the 1990s and the 2000s, that were seen in the country. During eleven years, from 2004 to 2014, S&P gave Mozambique a rating of B or B+. Total debt as a %age of GDP, doubled in three years, from 41.1 % of GDP in 2012 to 88.1 % in 2015. The country seemed to be spending the money sensibly on the right things, and the sharp increase in debt did not bother the rating agencies until news of the "hidden loans" to government entities surfaced. The rating agencies went into several iterations, but S&P finally downgraded the country to CC in November 2016.

3.5 Financing Climate Action

Mozambique, because of its still low level of industrialization and development, contributes only minimally to Greenhouse Gas (GHG) emissions (estimated at 0.21% by the World Bank). However, owing to climate change, and the geography and topology of Mozambique, the country is already unduly exposed to extreme weather patterns, in the form of frequent droughts, and cyclones. According to the country's updated first nationally determined contribution to the United Nations Framework Convention on Climate Change (UNFCCC) from 2021, the country has encountered 21 cyclones, 20 floods, and 12 droughts since 1980. The total costs in terms of destroyed animal stock, crops, property, and public infrastructure amount to billions of dollars. To paraphrase the UNDP, Mozambique is both debt and climate vulnerable and has a high incidence of poverty. The World Bank has estimated that in the absence of adaptation, a total of 1.6 million people could be driven into poverty in Mozambique in the near term. To achieve climate resilience, with respect to its human, physical and natural capital dimensions, it will cost an estimated USD37.2 billion. In terms of financing, the government is committed to leverage revenue from the gas projects and mining operations to address climate change, as well as by building critical infrastructure. However, support from the international community will be required.

Climate finance and related initiatives have thus become important vehicles for financing the transition needs of Mozambique, while the debate on how best to design mitigation and adaptation strategies has received a lot of policy attention. The government has been enthused by the idea that the country's nationally determined contributions should be pro-poor, locally led, and science based, although what this really means in terms of application, given paucity of resources is not clear. The government has two programs funded by the climate trust fund, the first is a pilot program for climate resilience, which has financed among others infrastructure upgrades, and a project dedicated to addressing deforestation.

At the United Nations Climate Change Conference (COP28), held at the end of 2023, President Filipe Nyusi presented Mozambique's energy transition plan which is costed at USD80 billion. However, despite innovative proposals, including production of e-cars, and increasing clean energy by 67 % through the construction of a 2000MW dam, it is imperative to make sound evaluations of the project shelf life, ensuring sustainability and to take in account the impact of adverse ratings.

3.6 Discussion and Policy Recommendations

- Mozambique is a member of the Community of Portuguese Language Countries (CPLC), the Commonwealth, as well as a shareholder and client of the IFIs, and the UN system. It thus has a broad network which it can use strategically, together with African countries and institutions, to influence the international financial architecture. This was in full evidence at the 2024 Annual Meetings of the African Development Bank in Nairobi.

- It is a concern to the government that the country's low ratings attributed by the rating agencies have discouraged FDI inflows and could have derailed the billion-dollar investments flowing into the country today to finance mega projects. Voices have been raised in Mozambique and other African countries about setting up an African rating agency. However, it is important for African countries to be given an opportunity to meaningfully participate in resource allocation decisions to unlock vital resources for their investments needs.

- Mozambique experiences adverse weather events more frequently than many other countries in the region, except for its neighbor Malawi. It receives support on a frequent basis from the IFIs, as well as the AfDB, bilateral donors, and the UN system, to address weather emergencies. A dedicated fund for emergencies, under semi-autonomous management, should be established to manage all aspects of disaster management and delivery of support.

- The government could consider pursuing the greening of the economy with support from the international community as a matter of priority. There will, however, be tension between the need for revenue to run the government and the switch from economic development based on the exploitation of non-renewables.

- The private sector is poised to play a pivotal role in financing Mozambique's development, as evidenced by its involvement in mega-projects. However, Mozambique should ensure that its industrial vision is not solely determined by private companies but is instead firmly shaped by its own strategic direction. Achieving structural transformation requires implementing robust policies and frameworks. It is crucial to capitalize on current opportunities to utilize resources for development, as extractive resources are finite. Many African countries missed such opportunities during periods of natural resource abundance. Therefore, Mozambique needs to carefully deliberate on the type of private sector it intends to foster and how it can contribute to sustainable, long-term economic development.

- Developing an entrepreneurial class deeply rooted in the country is essential. Despite the significant revenue expansion from mega projects in Mozambique, their connections with local firms, beyond those providing logistical services, are fragile. Encouraging the formation of a coalition is crucial.

- There are already suggestions of how Africa could address is burgeoning debts through the establishment of a debt relief for climate initiative, where participating countries would get partial debt relief in exchange for their commitment to investment savings into climate action-related projects. Mozambique should continue to leverage support from African Countries and regional stakeholders, including the Africa Union and the AfDB, to navigate international financial architecture.

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