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Paper 18: Mozambique Phase 2

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INSTITUTO DE ESTUDOS SOCIAIS E ECONÓMICOS

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2 Instituto de Estudos Sociais e Económicos (IESE).

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Acronyms

BM	Bank of Mozambique
CPI	Investment Promotion Centre
EITI	Extractive Industries Transparency Initiative
ESF	Exogenous Shocks Facility
EU	European Union
FDI	Foreign Direct Investment
GASI	Group for the Monitoring of the International Situation
GDP	Gross Domestic Product
GoM	Government of Mozambique
IESE	Instituto de Estudos Sociais e Económicos
IFI	International Financial Institution
IFTRAB	Comprehensive Survey on Work Force
IMF	International Monetary Fund
INE	National Institute of Statistics
ODA	Official Development Assistance
PARPA	Action Plan for the Reduction of Absolute Poverty
SDR	Special Drawing Rights
US	United States
USAID	US Agency for International Development
VAT	Value Added Tax

Abstract

This paper assesses the impact to date of the global crisis in Mozambique by exploring the main transmission channels, namely, external trade, remittances and inflows of private and official capital, and further analysing subsequent impacts on several fiscal and monetary aspects, external balances, sector performance, investment and employment. The paper provides a critical analysis of the anti-crisis measures that the country has been taking and their potential impacts on the country's growth prospects.

The growth rate in Mozambique fell from 6.8% in 2008 to an estimated 6.5% in 2009 (according to the government of Mozambique (GoM)), lower than the 7% growth rate projected for 2009 before the crisis.[3]

Given high inflows of aid and private capital, and weak linkages between private foreign investment and the economy as a whole, the negative impacts of the crisis have been transmitted to the economy mainly through external trade. Exports have suffered as a result of a high concentration on aluminium and on other primary commodities, such as seafood and cashew nuts, with high income and price elasticities of demand, and on commodities such as cane sugar and cotton fibre, which face high rates of substitution and imperfect markets (preferential markets, subsidised prices and so on). As a result of price and/or demand reduction, it is estimated that export values have decreased by one-fourth.

This paper also finds that the resilience of the economy to the crisis comes from its main structural weaknesses. Given that the policies adopted by the GoM to deal with the crisis and those projected for 2010 do not address these structural problems, the paper concludes by agreeing with the IMF (2009) statement that, while Mozambique has weathered the global crisis relatively well, it will also benefit less from the global recovery.

3 The International Monetary Fund (IMF) projected growth rate for 2009 was 4.5%. In the last quarter of 2009, both the GoM and the IMF adjusted their projections upwards – government initial projections pointed to an annual growth rate lower than 6% and the IMF started with a 4.2% growth rate projection – but IMF projections continue to be more conservative than the GoM's. Recently, the IMF Representative in Mozambique said to the media that the difference between the IMF and the GoM projections owes to a lack of data and data inconsistencies. There is wide speculation about what the actual rates of growth for 2009 and 2010 are going to be, with the GoM favouring significantly higher rates of growth than everyone else.

1. Introduction

High levels of global economic integration have left no country completely immune to the global financial crisis, although some countries are not showing evidence of economic slowdown. Mozambique was not directly affected by the crisis. The low integration of its domestic financial sector with international capital markets and the fact that international bank subsidiaries in the country are managed independently from their parent institutions – which themselves did not suffer major losses – largely explain why the first-round impacts bypassed the country. It has been through the effects of the global economic downturn that the global crisis has been transmitted to the domestic economy.

Naturally, the impact of the crisis on the Mozambican economy reflects the structure of accumulation and distribution and the ways in which the Mozambican and the global economy are linked. The structure of accumulation and distribution is characterised by high levels of concentration of production and trade in primary products, high dependence on external flows of capital (official aid and private investment) and the disarticulation of economic activities owing to weak backward and forward linkages, underdeveloped domestic markets, lack of dynamics of import substitution and weak fiscal linkages.[4] This structure is the foundation of a systemic crisis, including a series of short-term cycles from which the economy has seemed incapable of departing for the past five decades.[5]

The Mozambican and the global economy are linked by means of three major mechanisms, trade, private investment and official development assistance (ODA); it is through these that the effects of issues in the global economy are felt in the Mozambican economy. Trade and private investment are highly concentrated in primary products, mostly in minerals and energy, both reflecting and reproducing existing structures of accumulation and distribution and the vulnerabilities associated with them (as described above). Owing to weak fiscal and backward and forward linkages with the Mozambican economy, foreign investment in large projects has an impact on gross domestic product (GDP) growth and a resulting impact on the trade balance, but its actual impact on the economy is small in periods of boom or crisis. ODA finances more than half of public expenditure, the deficit of the current account and the building-up of external reserves, creating an image of apparent economic resilience and relative stability. Interestingly, the small impact of the global crisis in Mozambique has been attributed by the government of Mozambique (GoM), the local media and even international financial organisations to the resilience and robustness of the Mozambican economy, despite the fact that this economy is so heavily dependent on aid and other foreign sources of capital.

Paradoxically, the resilience of the economy in this period of crisis also comes from some of its main weaknesses, namely, external dependency and disarticulation of the economic structure. Given the high dependence of performance on external flows of capital and the increase in ODA inflows (including International Monetary Fund (IMF) support to the balance of payments and to the build-up of external reserves) and in inflows of private capital (and also a reduction in dividends' expatriation owing to reduced economic activity of the megaprojects), all the main components of the overall balance (current, capital and financial accounts) have improved and deceleration of growth has been softened. Also, given the disarticulation of the economy, negative impacts registered in some export sectors will be transmitted only marginally to the rest of the economy. The fall in international prices of some of the main import commodities has contributed significantly to its economic performance, reducing outflows of foreign exchange and allowing for a more expansionary monetary policy thanks to reduced levels of imported inflation. However, given the policies defined by the GoM for 2010 to

4 The economy has been caricatured as exporting what it produces (primary products) and importing what it consumes (means of production, fuels and consumer goods). Therefore, the sectors of the economy do not link to each other directly, although there is an obvious link resulting from pecuniary linkages (for example, revenues that accrue from migrant labour or taxes on income of sectors that export may finance imports). See, for example, Brum (1976); Wuyts (1980; 1989).

5 For a detailed discussion of the structural characteristics of the Mozambican economy (concentrated, disarticulated, dependent on external capitals and unstable) see Brum (1976); Castel-Branco (2002a; 2002b; 2009); Castel-Branco and Ossemane (2009); Wield (1977a; 1977b); Wuyts (1980; 1989).

reverse the effects of the crisis, and the reintroduction of 'business as usual' policies, it is likely that the country will miss out on the opportunity to learn from the crisis and boost structural change, and that it will in fact deepen its tendency towards concentration, disarticulation and external dependency.

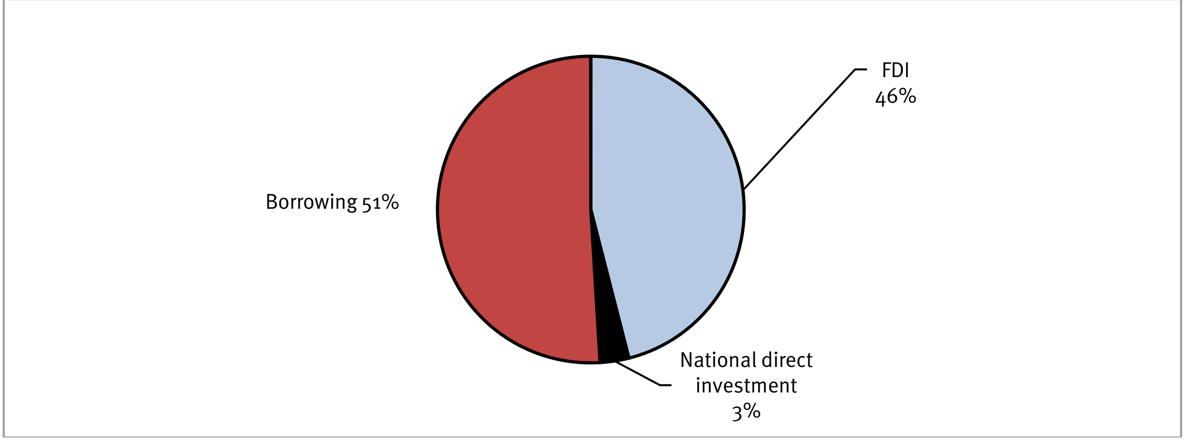
2. Effects of the global financial crisis on Mozambique: Key transmission channels

Mozambique's financial sector has not been directly affected by the financial crisis because it barely possesses so-called toxic assets and because subsidiary banks have been able to keep their activities shielded from the impacts of the crisis in their parent institutions. This section analyses the other key transmission mechanisms of the crisis, namely, external trade, private and official capital inflows and remittances. The data indicate that, in the case of Mozambique, exports are the only relevant channel with regard to transmission of the crisis, because inflows of foreign aid have continued at very high levels (if these had fallen a huge crisis would have been registered in public finances and the current account).

2.1 Private capital flows

Private investment in Mozambique is highly dependent on foreign investment. Figure 1 shows that, from 2000-2008, 46% of private investment approved in Mozambique was foreign direct investment (FDI) and 51% came from borrowing, the majority of it being external borrowing linked to FDI. National direct investment's share of total investment was only 3%.[6]

Figure 1: Average share of private investment approved, by source, 2000-2008 (%)



Source: CPI (approved investment database).

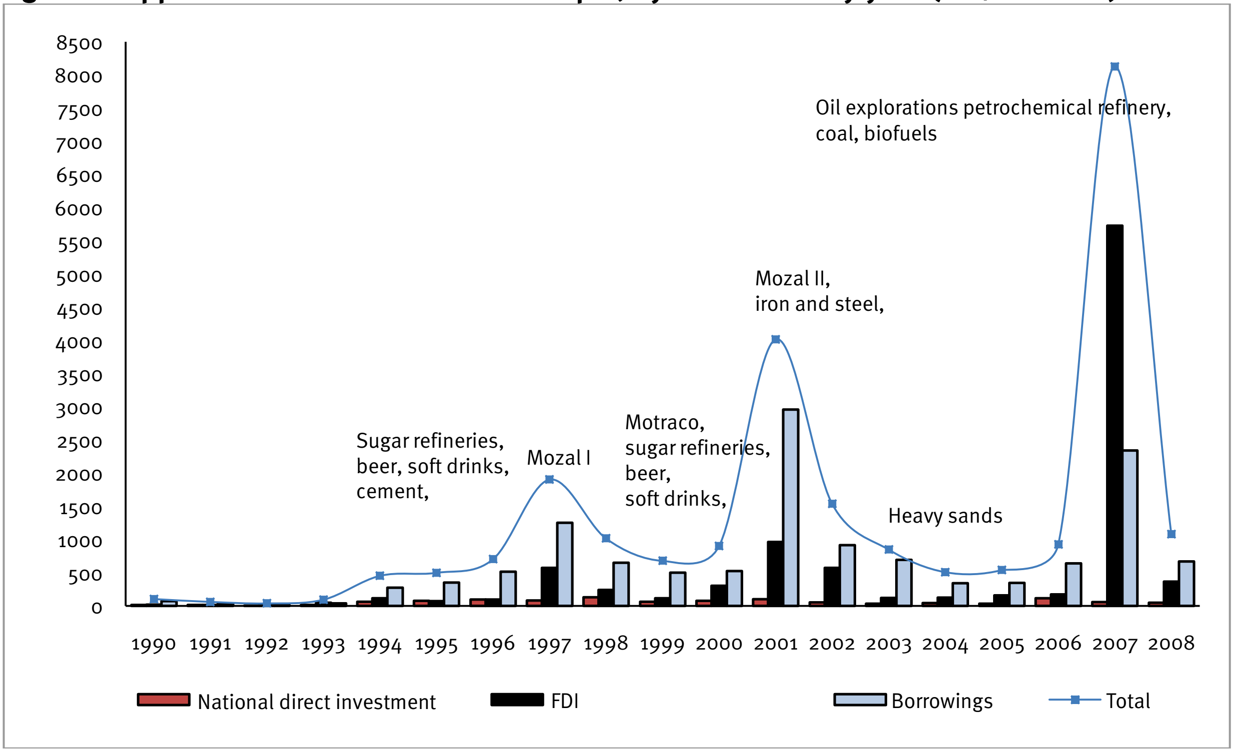
Figure 2 shows approved investment in Mozambique. It is evident that total private investment is dependent on inflows of FDI and borrowing (mostly external borrowing, as the borrowing share of total approved investment during the period – $9.4 billion – exceeds total domestic bank lending capacity by several times). It also shows that a handful of megaprojects concentrated in minerals and energy (see also Figure 3, showing the average share of approved investment by sector in 2000-2008)[7] can boost investment in particular years, which makes total approved private investments highly volatile.[8]

6 Investment data from the Investment Promotion Centre (CPI) divide investment into three categories: FDI, national direct investment and borrowing. Borrowing could be money lent to nationals for investment purposes (which would, therefore, be added to the national direct investment share of total approved investment) or to foreign investors (which would add to the FDI share of total approved investment). Data from the CPI do not specify the share of borrowing that is lent to nationals or to foreign investors. However, data from the major projects suggest that more than 90% of borrowing adds to the FDI share of approved investment.

7 The concentration in the mining sector has increased in recent years, reaching a 62% share of total approved investment in the period 2005-2008.

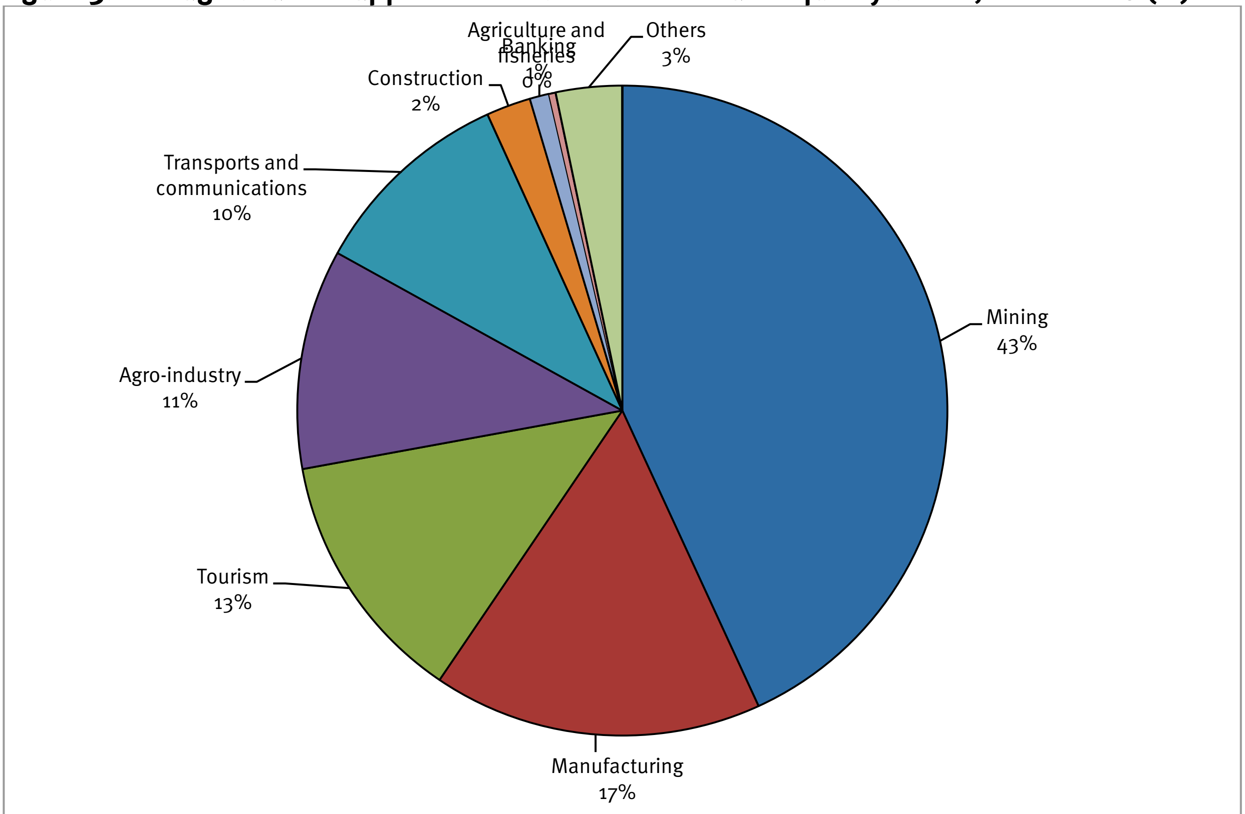
8 It should be noted that not all of the approved investment is translated into implemented investment. Implemented investment is less volatile than total approved investment, as the latter reports the total value of the project in a single year whereas data for the former distribute the total value of the investment along several years of the project's implementation.

Figure 2: Approved investment in Mozambique, by source and by year (US$ millions)



Source: CPI (approved investment database).

Figure 3: Average share of approved investment in Mozambique by sector, 2000-2008 (%)

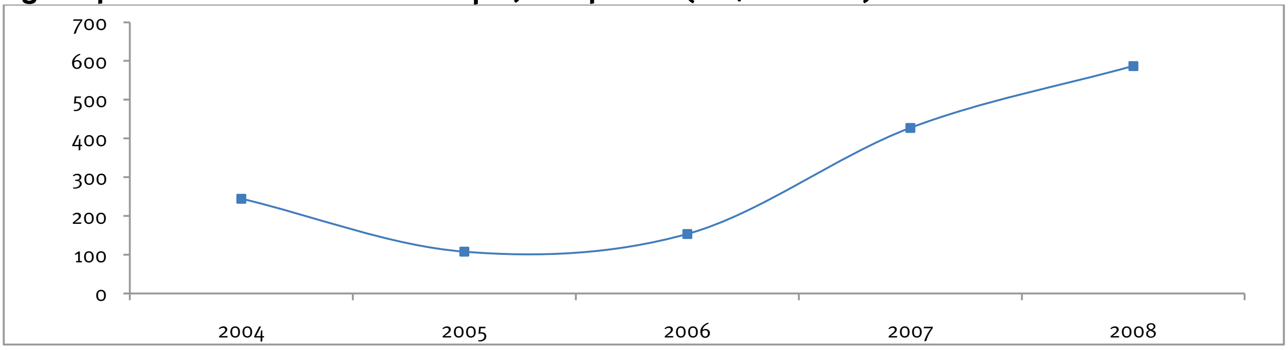


Source: CPI (approved investment database).

This structure of private investment has two main implications: consolidation of narrow patterns of production and trade and high dependence of the level of private investment on FDI. Data from the Bank of Mozambique (BM) indicate that FDI increased in January-September 2009, reaching $601 million, $90 million more than in the same period of 2008. This increase confirms the past three years' (2006-2008) upward trend of FDI inflows (Figure 4), which resulted in an increase in the share of FDI in

GDP from 0.2% in 2005 to 6% in 2008. However, given this small share of FDI in GDP and the weak linkages of FDI with the rest of the economy, even if inflows of FDI had reduced the impact on GDP growth would have been limited.

Figure 4: Inflows of FDI in Mozambique, 2004-2008 (US$ millions)



Source: BM data on balance of payments (various years).

This increase in FDI over the past five years comes mainly from the implementation of megaprojects which, given their dimension, have generated significant inflows of private capital. In January-September 2009, both megaproject and non-megaproject FDI increased, from $246 million to $266 million and from $265 million to $335 million, respectively. Although non-megaproject FDI increased more than megaproject FDI and represented a bigger share of total FDI in the period, it is not clear whether this reversed trend will prevail for the whole year, as this was also the scenario for the same period of 2008 but not for the whole year (see Table 1). Commercial credits and external borrowing, mostly linked with FDI, also provided positive inflows of capital, which reversed the expected reduction of external capital flows that prevailed until the first semester (six months) of 2009.

Table 1: Megaprojects' contribution to total FDI, 2004-2008

	2004	2005	2006	2007	2008	2004-2008
FDI (US$m)	244.7	107.9	153.7	427.4	587.1	1520.8
Megaprojects FDI (US$m)	177.5	15.1	86.3	220.1	295.4	794.4
Megaproject FDI/total FDI (%)	72.5	14.0	56.1	51.5	50.3	52.2

Source: BM data on balance of payments (various years).

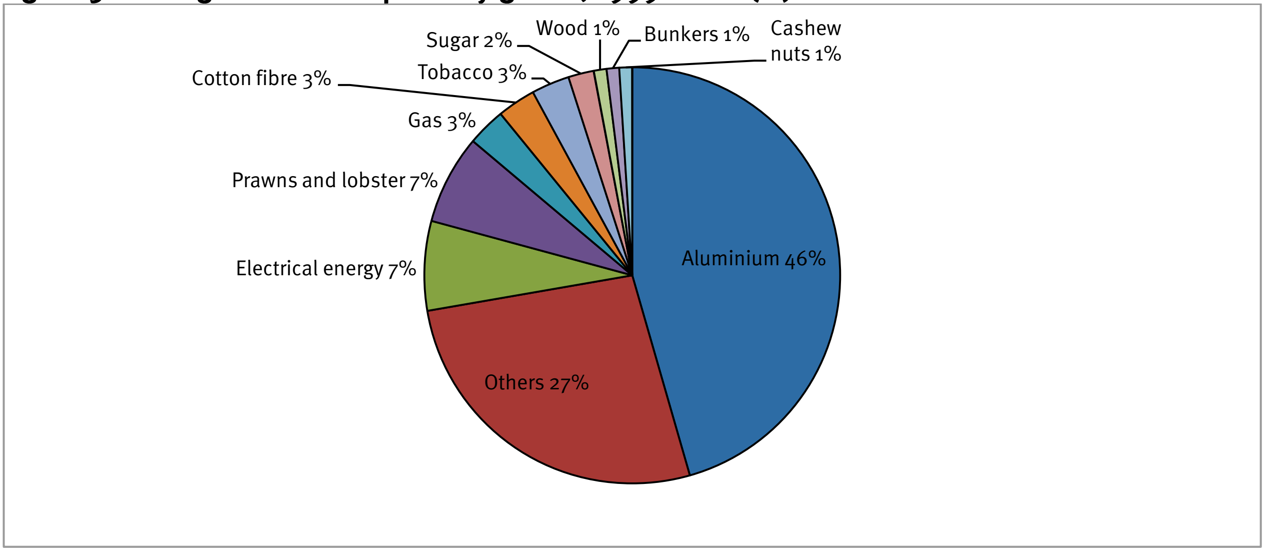
The financial account balance has improved by $401 million, owing also to IMF support to the balance of payments under the Exogenous Shocks Facility (ESF) ($132 million) and reserve building support ($170 million).

However, there are some indications of projects being withdrawn or postponed, mainly in the industry and tourism sectors, because of liquidity constraints and global demand contraction. For instance, the Corridor sands titanium project in Chibuto, Gaza province, worth $700 million, has been postponed. The company Arcelor-Mitall suspended production in Maputo, laying off 90 workers, and cancelled construction of its new factory in the district of Boane, an investment worth $40 million in steel production that would employ 200 workers and *that* was supposed to become the biggest steel factory in Southern Africa. The decision by Arcelor-Mitall was taken on the basis of the reduction in the price of steel and contraction of demand in its main projected markets, namely, the US, China and the Middle East. Highland African Mining, an investment from the British group Noventa worth $70 million and with a potential to produce 300.000 pounds/year of tantalite (making of it the third largest tantalite project in the world), suspended activities in May 2009, laying off 314 workers. Recent declarations from the group indicate that the project will resume production in 2010 because the future of the industry looks bright, with demand outstripping supply in 2010 and 2011. In the tourism sector, nine touristic complexes have been affected by demand reduction, resulting in 106 workers losing their jobs (Simione, 2009). The Procana project (biofuels), worth $500 million, has been cancelled by the GoM because of minimal progress by investors in relation to the plan, and the Nacala oil refinery project, budgeted at $5 billion, has been put on hold because of difficulties obtaining the financial resources to back its planned investment.

2.2 Trade

Figure 5 shows that Mozambican trade is highly concentrated. From 1999-2008, exports of aluminium represented 46% of total exports of goods. Electricity and gas represented 7% and 3%, respectively. Other major exports are primary commodities with high income demand elasticity and/or high substitutability, such as seafood (7%), cotton fibre (3%), sugar (2%) and cashew kernels (1%). This high level of concentration is increasing, with megaproject exports (aluminium, electrical energy and gas) accounting for 71% of total exports in 2007-2008. This suggests that the country's export revenues may be highly vulnerable to shocks affecting its main export sectors.

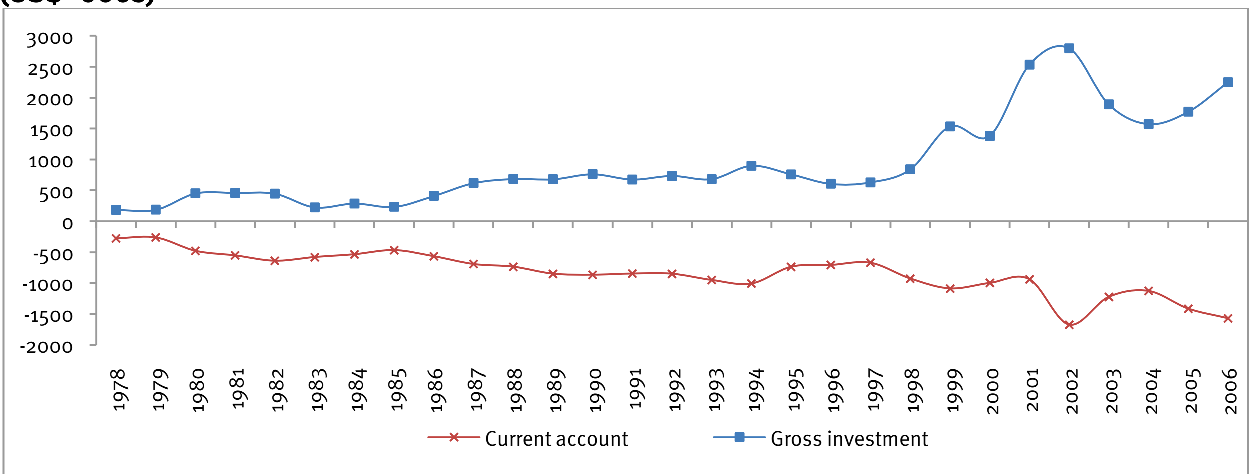
Figure 5: Average share of exports by goods, 1999-2008 (%)



Sources: BM balance of payments data; Castel-Branco (2002a; 2002b; 2003); INE data.

Figure 6 shows the relationship between gross investments and the current account before grants. The figure shows an important characteristic of the structural imbalances of the economy: when investment expands, the current account deficit (before grants) increases significantly, with future recovery related to contraction of investment. In other words, when the investments undertaken are not being used to develop import substitution capacities, and this is associated with weak productive and fiscal linkages in the domestic economy, the only way of reducing the current account deficit is by contracting the economy. This relationship can also be explained by the fact that, during the period under analysis (1978-2006), while investment has been very dependent on imports, the elasticity of export with respect to investment has been quite rigid.

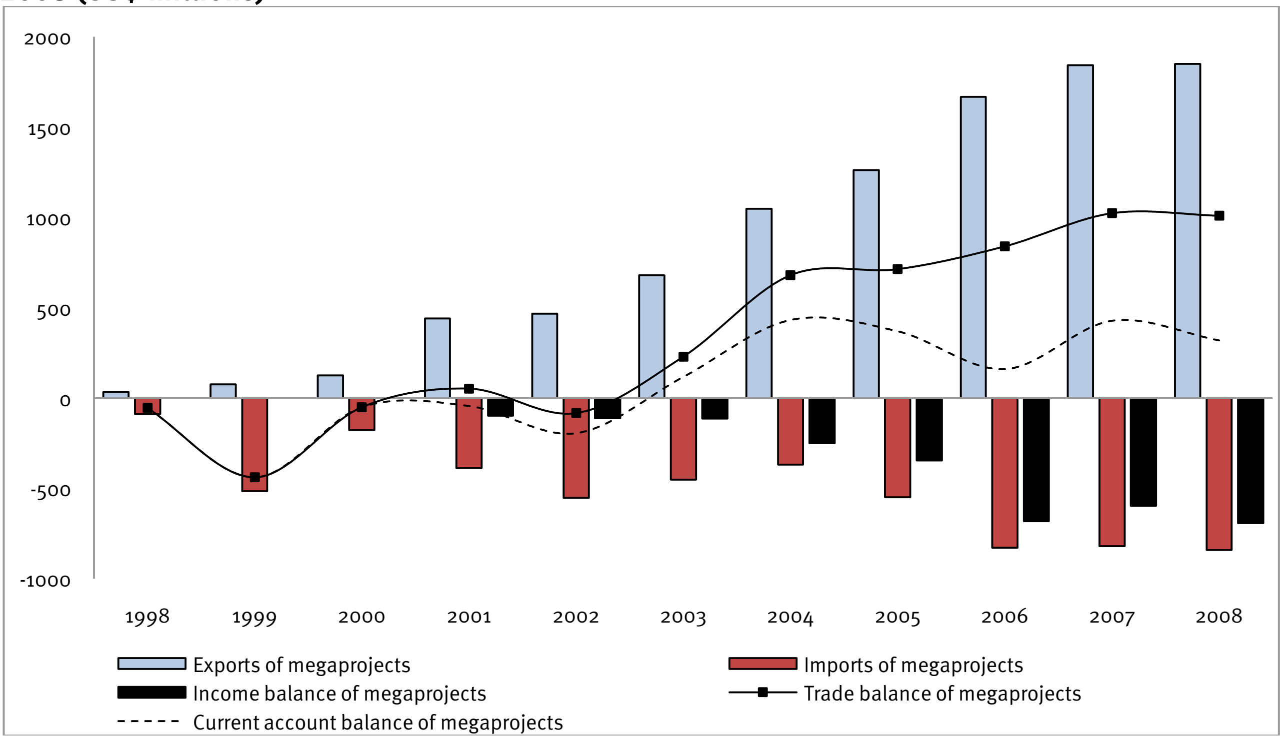
Figure 6: Relationship between gross investment and current account before grants, 1978-2006 (US$ '000s)



Sources: BM balance of payments data; Castel-Branco (2002a); INE data.

This rigidity has reduced in recent years, with large investments in export-intensive megaprojects such as Mozal (an aluminium smelter) and the Panda Gas project. However, these megaprojects are also intensive exporters of their dividends, interest on external borrowings and salaries of expatriate workers. The magnitude of capital exports by megaprojects is exacerbated by the fact that the national economy only marginally retains the wealth created by them (Figure 7). This is because of limited fiscal and backward and forward linkages developed by the megaprojects with the Mozambican economy, associated with strong fiscal incentives and limited industrial capacities in the country. For example, while three megaprojects, namely, the aluminium smelter Mozal, the Moma heavy sands project and the Sazol gas project, represent about 60% of national GDP and produce nearly 70% of total industrial production, Cavadias (2009) notes that megaprojects' fiscal contribution is less than 3% of total fiscal revenues and less than 1% of GDP. In terms of employment generated, the three megaprojects mentioned employ only 4% of total formal wage labour (Castel-Branco, 2008). Therefore, although megaprojects are intensive exporters, they do not contribute towards changing the structural relationship between expansion of investment and the current account deficit mentioned above.

Figure 7: Difference between trade balance and current account balance of megaprojects, 1998-2008 (US$ millions)



Source: BM data.

Figure 7 shows that the trade balance of megaprojects in 2008 exceeded $1 billion (dark continuous line). However, when income account transfers (dividends, interest on external borrowings, foreign workers' income) of these megaprojects are taken into account, only $320 million is absorbed by the Mozambican economy (dark interrupted line). The value absorbed corresponds roughly with the current expenditure of these two megaprojects. Hence, the Mozambican economy retains very little of what these projects produce – had fiscal incentives of only two megaprojects (Mozal and Sazol) been removed (which, according to Castel-Branco (2008), are redundant), the economy would be able to retain about $250 million more. This explains why the crisis in aluminium exports, for example, does not transfer into the Mozambican economy, but also why megaprojects contribute only marginally to the development of the economy.

As it will be shown later in this section, this relationship, suggesting that increased/decreased economic activity levels lead to higher/lower deficits, is one of the explanations for the positive impact registered in 2009 in the current account as a result of reduced economic activity. In fact, while exports have reduced substantially, the reduction in imports and dividend transfers has improved the current account balance by $54.5 million.

Data from the central bank show that exports of goods fell from $2045 million from January-September 2008 to $1285 million in the same period of 2009. This reduction is mainly the result of a 50% fall in the price of aluminium, which reduced the value of its total exports by $547 million. Other main products have also reduced their export value: prawns (-$31.9 million), sugar (-$19.8 million), cotton (-$17.3 million), cashew kernels (-$9.6 million), tobacco (-$18.7 million), gas (-$58.3 million) and timber (-$11.7 million). Of the main export products, only electrical energy ($18.7 million), ilmenite ($17.8 million) and cashew nuts ($1.3 million) have shown increases.

Of the products showing decreased export values, prawns, sugar and gas did so mainly because of reduced export quantities. Cotton, cashew kernels and timber export value reductions combined both price and demand reductions. The reduction in the export value of tobacco resulted from delays in shipping times. In fact, it is expected that annual export quantities of this product in 2009 will surpass the 2008 export value, as the country will export an additional 4000 tons. All products showing increased export values did so mainly as a result of increased export quantities. Although data for exports by country and by product are not available, the fact that 68% of Mozambican exports go to the European Union (EU) (59%) and to South African (9%) markets, which have been severely impacted by the crisis, is an explanation why exports have declined sharply. Other main destinations for national exports are Zimbabwe, China (mostly timber), Malawi (mostly tobacco) and India (mostly cashew nuts).

Table 2 compares the values of the main components of the current account balance between January-September 2008 and the same period of 2009. Although imports of goods reduced by $483.7 million (a large part of this thanks to the fall in fuel prices, which reduced the value of fuel imports by $246.9 million) and exports of services increased by $20.2 million, the reduction in exports of goods and the increase in imports of services by $63.3 million resulted in a $320 million deterioration in the balance of goods and services.

Table 2: Current account, Jan-Sep 2008-Jan-Sep 2009 (US$ millions)

	Jan-Sep 2008	Jan-Sep 2009	Difference
Current account	-1283.5	-1229.0	54.5
Goods account	-604.0	-880.9	-276.9
Exports of goods	2045.5	1285.0	-760.5
Imports of goods	-2649.6	-2165.9	483.7
Services account	-300.4	-343.6	-43.2
Credit	386.3	406.5	20.2
Debit	-686.8	-750.1	-63.3
Income account	-379.1	-4.5	374.6

Source: BM (2009).

2.3 Remittances

Inflows of workers' remittances and employees' compensation come mainly from the salaries of Mozambican migrant workers in the South African mines. These have represented less than 1% of GDP in the past five years. More recently, outflows of remittances related to FDI have increased. Data show that workers' remittances reduced in the first three quarters of 2009 in relation to the same period of 2008, by around $2 million, contradicting, so far, the past four years' continuously increasing trend (from $50 million in 2005 to $82 million in 2008). Reductions in remittance inflows could lead families into poverty, as South African mine workers are in general members of highly poverty vulnerable families. However, the income balance deficit reduced by 98.8%, falling from $379 million in the first three quarters of 2008 to $4.5 million in the same period of 2009.This is mostly a direct consequence of reductions in the dividends of the megaprojects, which fell from $322 million to $49 million in January-September of 2009.

2.4 Aid

In 2007, total ODA to Mozambique reached 22.5% of GDP. This makes Mozambique the 11th most dependent country in the world. ODA represents about half of the total government budget and government investment is determined mainly by ODA.

In general, donors kept their ODA commitments in 2009, which suggests an increase in relation to 2008 levels. Given the enormous importance of external aid with regard to the country's economic performance, this is probably one of the main reasons why the economy will not face a severe deceleration of its growth rate, in spite of some delays registered in disbursements. It is worth highlighting the World Bank increase of its support budgeted for 2010 from $85 million to $110 million, and the advanced disbursement of this amount in 2009. However, according to the IMF (2009), the increase in aid flows has been smaller than initially expected.

For 2010 and beyond, flows of ODA are uncertain. For 2010, donors have announced a reduction in the budget support component of ODA, which will result in a reduction of the aid coverage of the budget by seven percentage points, from 52% to 45% of the budget. However, it is still not clear whether this means a reduction in total inflows of ODA. The positive recovery signs that the developed economies are showing contribute towards restoring some optimism in relation to future assistance. However, some friction between donors and the GoM, related to the way in which the electoral process was conducted, seems to be adding uncertainties with regard to the level of assistance that donors are willing to provide in the near future.

In addition to donor support to the state budget, the IMF has provided $176 million in support of the balance of payments under the ESF (of which $132 million was disbursed in the second quarter of 2009) and a $170 million allocation to build external reserves. Inflows of Special Drawing Rights (SDR) from the IMF were used to restore the external reserves level from around 3.9 months of imports in June back to 6 months in September. Therefore, the effect of the crisis on external reserves cannot be derived directly from an analysis of the figures because external reserves are built largely using external aid.

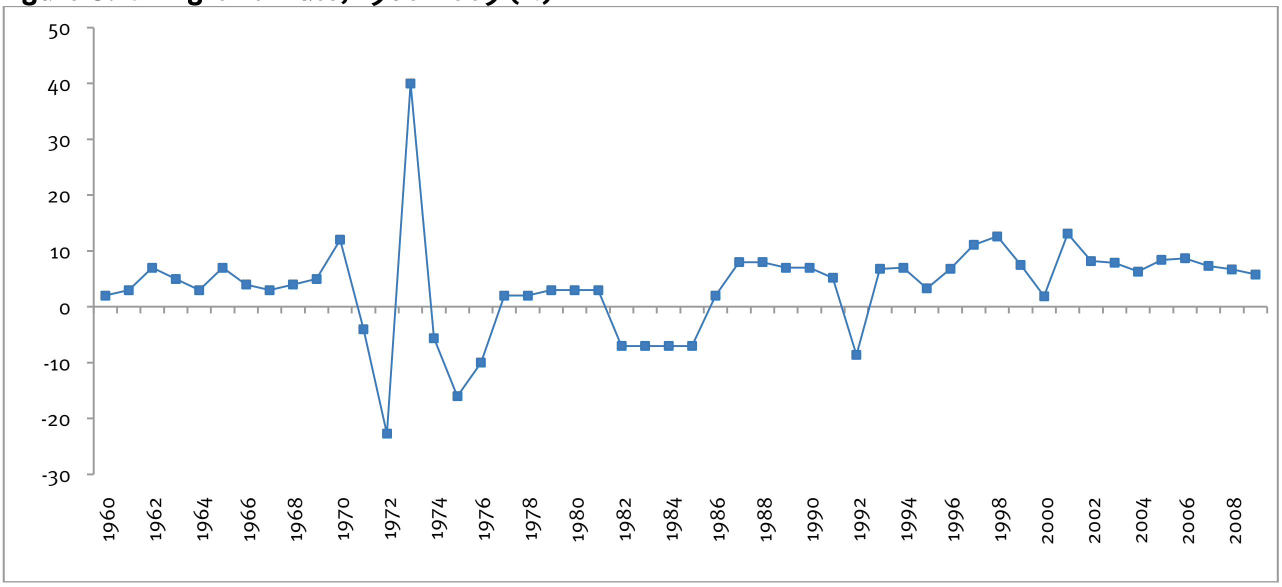
2.5 Summary: Balance of payments effects

The year to September 2009 showed significant improvements in the overall balance of payments owing to a slight improvement in the current account ($6 million), in the capital account ($46 million) and in the financial account ($401 million). However, the improvement in the balance of payments is in fact a result of the main weaknesses of the economy: the reduction in the current account deficit is related to the contraction of the economy, aid dependency, a reduction in dividends' exports owing to a contraction of the activities of the megaprojects, weak linkages between megaprojects and the economy and the overall disarticulation of economic activities. On the other hand, some elements of the global crisis have benefited Mozambique: for example, the fall in the prices of fuel, raw materials and food has contributed towards attenuating the increase in the import bill. It should also be noted that part of this improvement is the result of measures aiming at the partial offset of potential crisis, for example the World Bank advanced disbursement and the IMF/ESF reserve building and balance of payments support.

3. Growth and development effects

Mozambique has been growing at a remarkable annual average rate of 8% during the past decade, making it one of the fastest growing countries in the world (Figure 8). In 2003, poverty decreased to 54%, from 69% five years earlier, exceeding official expectations. However, this picture is blurred by the high external dependency of the country's economic performance and its failure to change its structure of accumulation and distribution.

Figure 8: GDP growth rate, 1960-2009 (%)[9]



Sources: Castel-Branco (2002a); INE data.

For 2009, different growth projections consistently point to a reduction in the annual rate of growth, although of different scales. The GoM estimates a 2009 annual growth rate of 5.8%, but the IMF puts it at 4.5%. Both projections reflect a decrease from the 6.8% growth rate of 2008. GoM quarterly data show that real GDP grew by 5.9%, 6.1% and 6.5% in the first, second and third quarters of 2009, respectively. To September 2009 and according to the National Institute of Statistics (INE, 2009), GDP grew by 6.1% in relation to the same period of 2008.

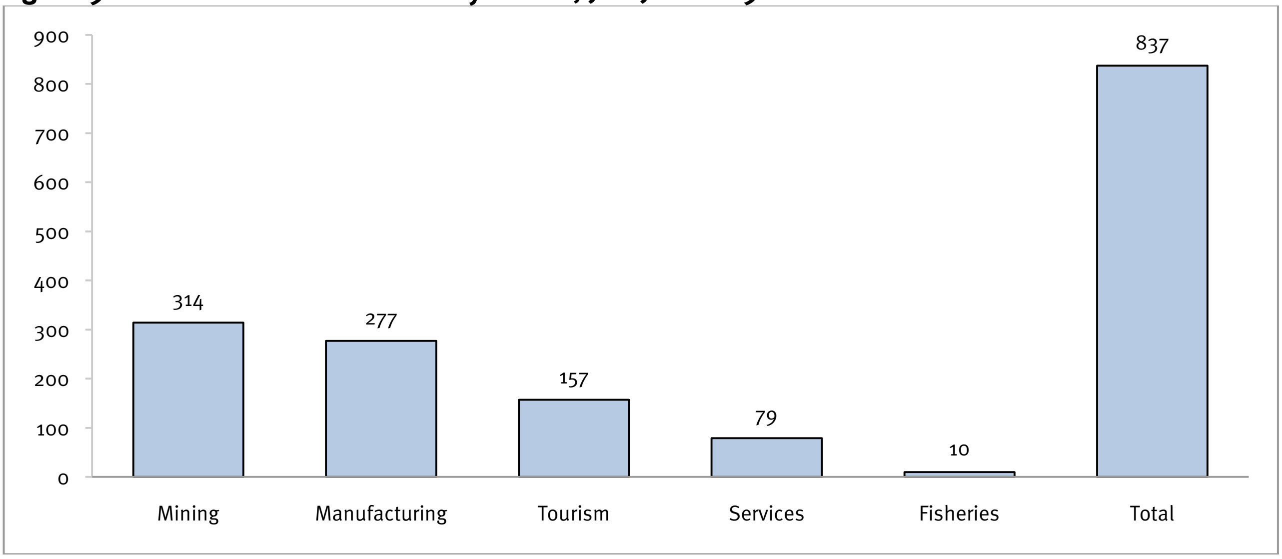
3.1 National-level growth, investment and employment

Data from the CPI related to approved investment in the first semester of 2009 show that the most important recipient sector of private investment was agriculture and agro-industry (21.6% of total investment approved), followed by tourism and hotels (16.5%) and industry (16%). However, data from the balance of payments, which refer to actual inflows of foreign investment, confirm high investments in mining and in agriculture and agro-industry but do not reflect the same importance for tourism, which may confirm the strong impact of the global crisis in this sector through reduced demand and subsequent postponing/cancelling of several projects. It should be noted that data from the Mozambican economy show that in every sector there is high concentration of investment in a handful of large projects (Castel-Branco, 2009; Castel-Branco and Ossemane, 2009). This implies that the weight of one or another sector on total investment in one particular year *per se* does not show a tendency to structural change. For example, the majority of investment in agriculture is related to biofuels and timber projects.

9 The growth rate for 2009 is that estimated by the GoM (5.8%).

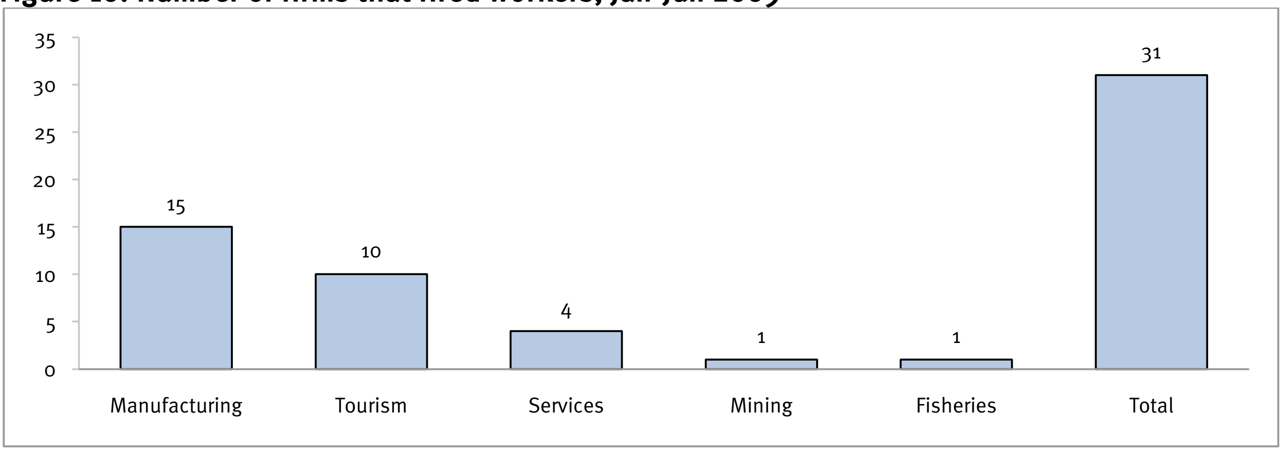
Employment data in the country are scarce and not systematised. Some of the reported data for the first semester of 2009 indicate that more than 800 jobs were lost during this period. Mining is the leading sector in terms of number of laid off workers (314), all of them from a single company, Highland African Mining. The manufacturing sector follows, with 277 laid off workers from 15 enterprises. In the tourism sector, 10 firms have laid off 157 workers (Figures 9 and 10). However, it should also be noted that a large part of the economy is informal, with no data available.[10]

Figure 9: Number of fired workers by sector, Jan-Jun 2009



Source: Simione (2009).

Figure 10: Number of firms that fired workers, Jan-Jun 2009



Source: Simione (2009).

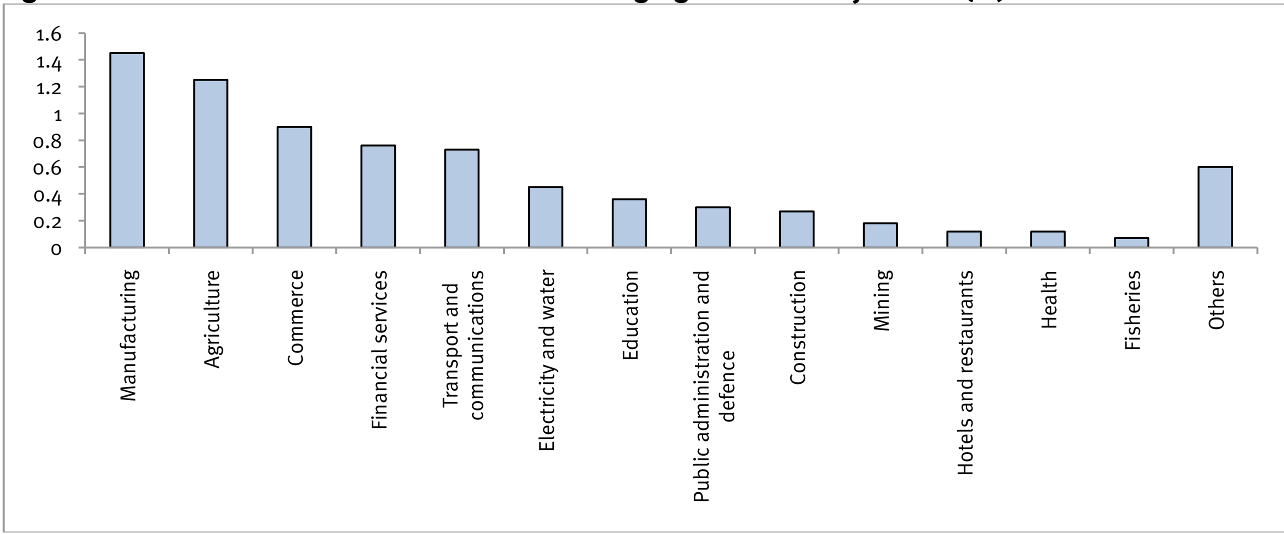
3.2 Sectoral-level effects

Figure 11 shows the contribution to the 2000-2008 GDP average growth rate by sector. Figure 12 shows the accumulated growth rate by sector, 2000-2008 (in percent). Figure 13 shows the average sectoral contribution to GDP in 2000-2008. Figure 11 shows that manufacturing, agriculture, commerce, financial services and transport and communications were the leading sectors in terms of contribution to the GDP growth rate. Manufacturing, the leading sector in terms of contribution to the GDP growth rate, ranks third among the sectors, with the fastest accumulated sectoral growth rate over the period 2000-2008. Although agriculture ranks only 11th in terms of accumulated growth rate, because of its

10 Unfortunately, it is not possible to provide the share of jobs lost in national or sector employment because employment data are very scarce and outdated. The most recent published official data on employment date from 2005 (Comprehensive Survey on Work Force – IFTRAB), in which some sector definitions differ from those presented in Figures 9 and 10.

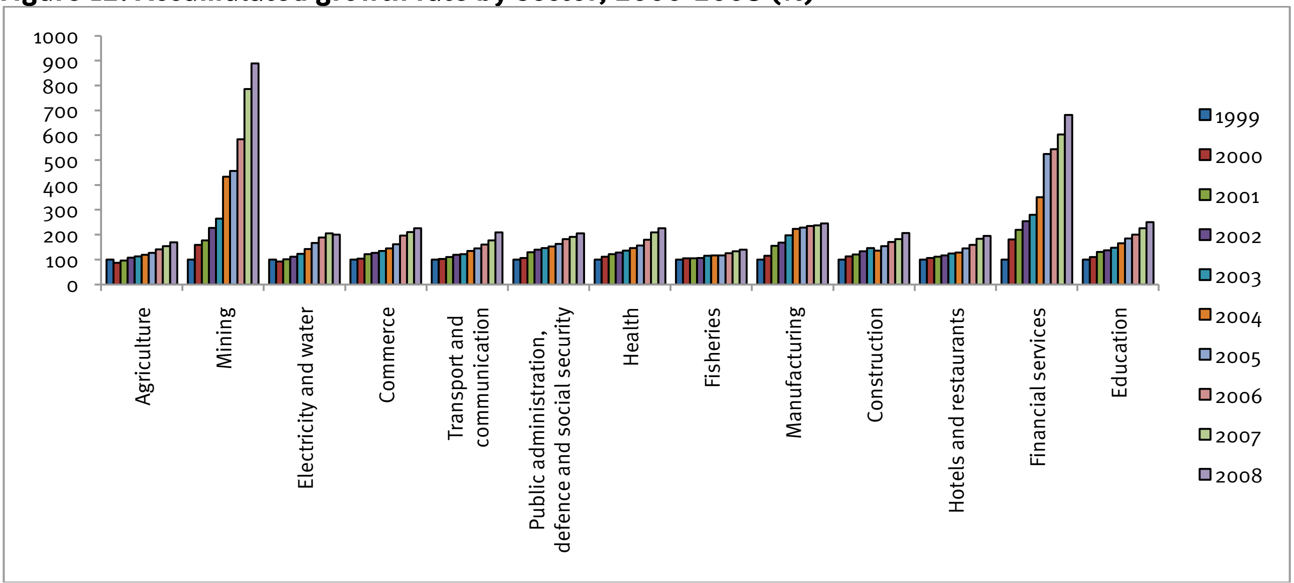
big share in GDP it is the second biggest contributor to the GDP growth rate. Mining was the fastest growing sector in the period, with an 888% accumulated growth rate, but, because of its still small share in total GDP (1%), its contribution to the GDP growth rate has still been modest.

Figure 11: Contribution to 2000-2008 GDP average growth rate by sector (%)



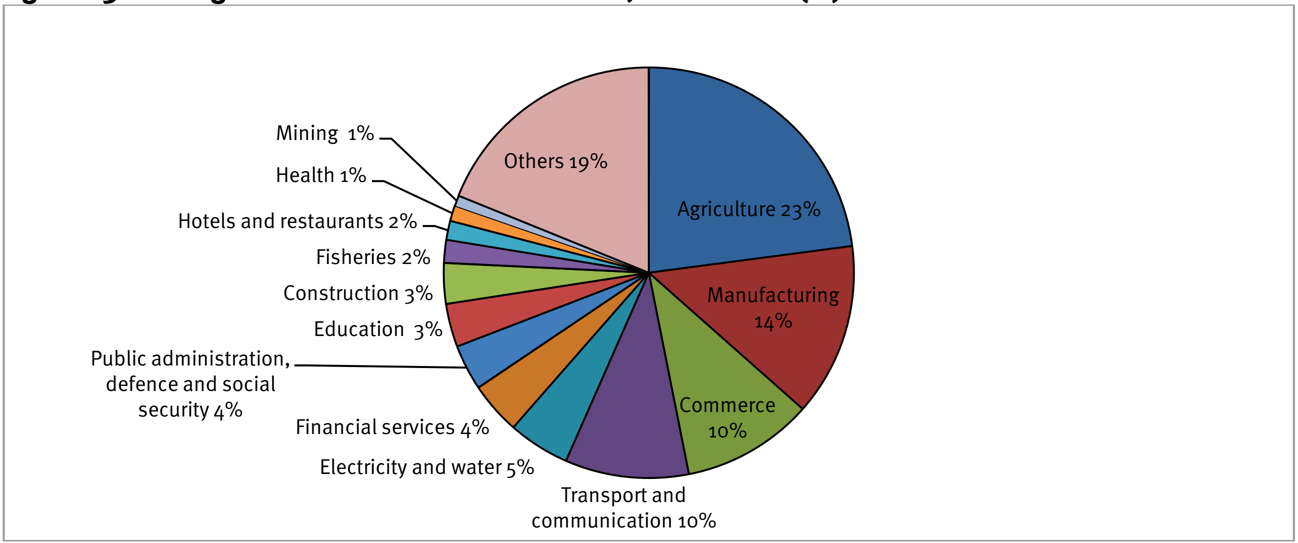
Source: Mapa Fiscal for 2008.

Figure 12: Accumulated growth rate by sector, 2000-2008 (%)



Source: USAID (2009).

Figure 13: Average sectoral contribution to GDP, 2000-2008 (%)



Source: INE (2009).

Table 3 shows the evolution of real production volumes in selected sectors in the first three quarters of 2009 compared with the same periods of 2008. Services was the only sector showing negative growth in production volumes from January-September 2009. The most affected sub-sectors were undoubtedly transport and communications and hotels and restaurants. In the period January-September 2009, the former contracted by 4.7% relative to the same period in 2008, which can be explained by the reduction in levels of economic activity in landlocked neighbouring countries with regard to usage of Mozambican ports. The latter declined by 2.4% relative to the same period of 2008 as a result of the decline in touristic activities. The third quarter showed signs of recovery in both sub-sectors.

Agriculture has shown remarkable growth thanks to a good harvest, evidence that it is more vulnerable to climate than to crisis-related factors. Production grew by 11.7% in the first three quarters of 2009 and, given its contribution to GDP, it has been the main driver of overall economic growth. Industry has also grown, mostly because of mining (up by 6.7%). Manufacturing output contracted slightly, by 0.1%. The financial sector grew by 12.5%. This can be explained by the fact that the crisis did not affect the sector directly and by the expansive monetary and fiscal policies adopted. Expansive fiscal policy also explains the fast public administration increase of 16.4%. Other sectors showing remarkable growth in the first three quarters of 2009 compared with the same period in 2008 were water and electricity (9.4%), mostly because of expansion in exports of gas and electricity to South Africa, and construction (10.7%), mainly because of public expenditure on infrastructure and investment in megaprojects.

Table 3: Quarterly evolution of real production volumes in selected sectors compared with the same period of the previous year (%)

	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3
Agriculture	11.7	9.3	11.5	17.7	13.8	11.6	9.6
Fisheries	6.7	7.4	7.4	6.7	4.2	2.0	2.1
Mining	15.9	11.4	14.7	8.7	7.4	7.7	5.3
Manufacture	1.0	-8.8	5.0	7.1	-2.9	8.8	-5.2
Water and electricity	-13.2	0.2	7.4	5.1	17.4	9.2	2.8
Construction	16.2	7.6	15.6	-4.2	17.3	8.4	8.0
Commerce	4.4	6.3	6.1	7.0	4.0	3.4	3.4
Hotels and restaurants	12.0	-5.2	8.2	13.0	-8.8	-7.7	8.6
Transport & communications	15.4	26.8	10.2	6.1	-4.6	-13.2	4.3
Financial services	9.1	6.0	-2.7	3.1	7.5	12.2	18.0
Public administration	-0.3	24.6	7.6	9.3	21.6	14.7	13.2
Education	7.8	8.2	8.3	8.1	0.7	0.3	0.1
Health	9.6	7.0	5.5	4.9	5.4	5.7	6.0

Source: INE (2009).

3.3 Fiscal effects

In spite of the reduction in the real rate of growth in relation to the first semester of 2008, from a 13.2% growth rate in 2008 to 8.7% in 2009 (see Figure 14), revenues surpassed expectations in the first semester of 2009. As Table 4 shows, while total revenue programmed for the first semester of 2009 by the government was MZN19.86 billion, preliminary data show that total revenues were higher than programmed for this period, reaching MZN21 billion.

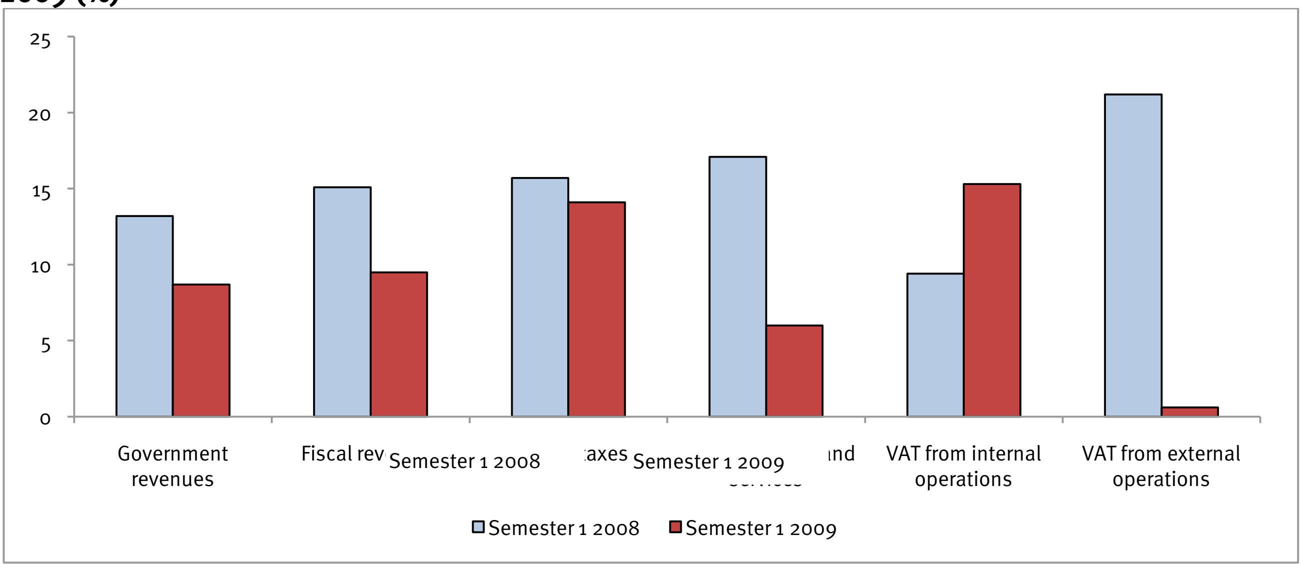
Table 4: Government revenues, 2008-2009 (MZN billions)

	2008	2009		
	Actual	H1 prog.	H1 prel.	Proj.
Total revenue	38.27	19.86	21.0	42.55
Tax revenue	34.02	17.41	18.54	37.21
Income and profits	11.72	5.56	6.61	12.35
Goods and services	18.05	9.74	9.74	20.18
International trade	3.59	1.75	1.83	3.85
Other	0.65	0.37	0.36	0.83
Non-tax revenue	4.25	2.45	2.46	5.34

Source: IMF (2009).

Figure 14 shows government revenues' real growth rate, in the first semester of 2008 and the first semester of 2009 (in percent). Figure 15 shows the average contribution to fiscal revenues by type of tax in 2000-2008. The real rate of growth of government revenues was 8.7% in the first semester of 2009 (13.2% in the first semester of 2008). Fiscal revenues, which in 2000-2008 accounted for on average 87% of total government revenues, grew at 9.5% (15.1% in 2008). Taxes on goods and services, the most important component of fiscal taxes, accounting for 65% of total fiscal revenues, grew by 6.0% in the first semester of 2009 (17.1% in the same period of 2008) and income taxes, which accounted for 25% of fiscal revenues, grew by 14.1% (15.7%). VAT, which accounts for more than 40% of taxes on goods and services, also grew. However, VAT from external operations, which is the most important component of taxes on goods and services, accounting for 55%, showed a sharp reduction in its growth rate in the first semester of 2009, falling to 0.6% (from 21.2% in 2008).

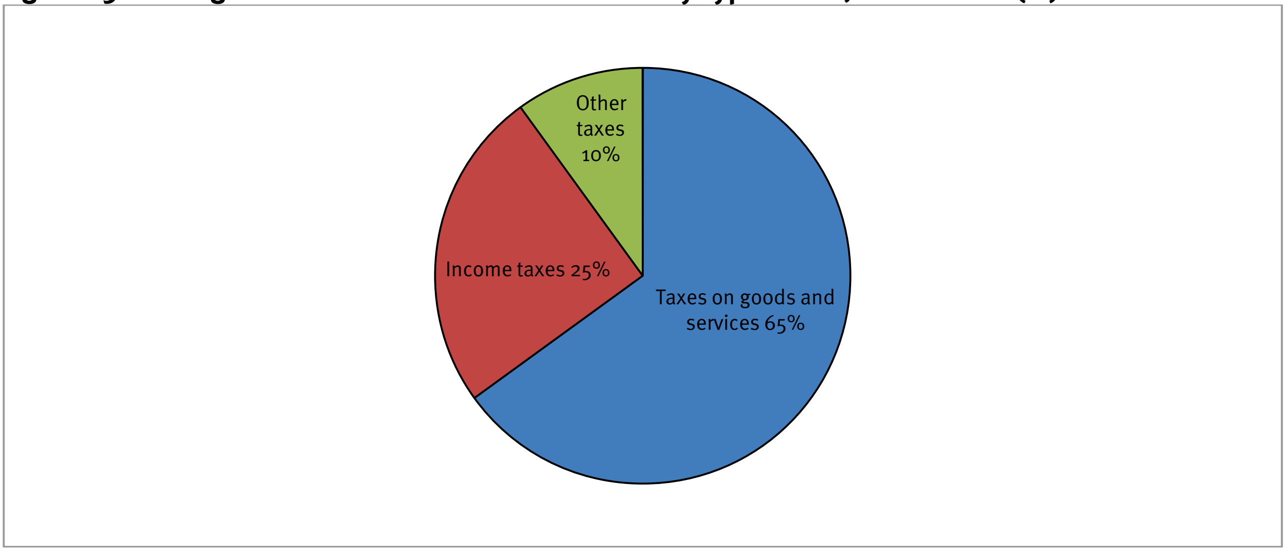
Figure 14: Government revenues real growth rate, first semester of 2008 and first semester of 2009 (%)[11]



Source: Simione (2009).

11 VAT from external operations refers to VAT collected in imports. VAT from internal operations refers to VAT collected from the commerce of goods and services internally.

Figure 15: Average contribution to fiscal revenues by type of tax, 2000-2008 (%)



Source: USAID (2009).

4. Policy responses: A critical review

The GoM has created an inter-ministerial group to monitor the development of the crisis in order to inform policy decisions. The Group for the Monitoring of the International Situation (GASI) was created in March 2009. It is coordinated by the Ministry of Finance and includes the Ministries of Agriculture, Planning and Development, Industry and Commerce and Labour and the BM.

4.1 Macroeconomic policies to manage the impact of the crisis

At the macroeconomic level, the GoM has responded to the crisis by relaxing its usually tight macroeconomic policies (fiscal and monetary).

4.1.1 Monetary policy

Monetary policy has been relaxed in order to increase resources available to both the government and the private sector, seen as necessary because of international capital markets' hardening of conditions for private sector external borrowing and the expected reduction in economic activity, reducing government revenues. The central bank has also reduced interest rates on its standing lending and deposit facilities, lowered banks' reserve requirements and left unanticipated foreign exchange flows unsterilised (IMF, 2009).

The reduction in imported inflation, resulting from the fall in import prices and the fuel price subsidy, has opened space for the correction of the overvalued currency, without putting strong pressures on inflation. Therefore, from January-September 2009, the currency depreciated 10% against the US dollar and 16% in real effective terms, while accumulated inflation until October was 1.4%, with an expected annual rate of 3.5% (IMF, 2009).

The appropriateness of an expansionary monetary policy in a year with weak inflationary pressures – the annual inflation rate is estimated to be around 3.5%, the lowest in recent decades – does not seem to be leaving much space for contestation.

4.1.2 Fiscal policy

As a result of the expected reduction in government revenues in 2009, fiscal policy was loosened, allowing for a higher primary deficit. While the primary deficit before grants in 2008 reached 3.4% of GDP, the programmed deficit for 2009 was 5.6% of GDP. However, fiscal revenues surpassed expectations and grew by 8.7% in January-June 2009 when compared with the same period of the previous year. By the third quarter of 2009, updated projections pointed to an increase in government revenues by the end of the year in relation to 2008, and the primary deficit before grants projected for the whole year was adjusted to 5.3% of GDP (lower than the previous projections of a 5.6% deficit) mainly as a result of the increased government expenditures.

The increased spending included the implementation of a new civil service pay scale and of the fuel subsidy, implemented to prevent an increase in domestic fuel prices when international prices were rising. Bank borrowing was allowed to increase but this allowance was barely used because of two factors: the World Bank advanced disbursement of $110 million and the increase in government revenues above initial expectations. The GoM also cut expenditures in non-priority areas, although expenditure in the Office of the President and in Defence and Security increased significantly.

There are three major comments about these measures. First, they are short-term responses to a shock rather than ways to address the structural weaknesses of the economy. Second, they are the opposite of the country's current restrictive macroeconomic policy, but are seen as an occasional response to a shock rather than a reversal of policy. This means that crisis is dealt with through expansionary policies while tight policies prevent structural change between crises. Third, these policies were partially redundant in the context in which they were adopted because of increased aid flows and the smaller than expected decline in government expenditure. As a result, they were only partially implemented.

4.2 Social policies to respond to the impact of the crisis

Given that the shock waves of the crisis did not transmit deep into the Mozambican economy, there have been no significant changes in the already high levels of vulnerability and poverty. However, some potentially negative effects on poverty could still arise from the impact of the crisis on export sectors, especially in the cotton, cashew kernels, timber and prawns sub-sectors, which involve many people vulnerable to poverty. However, specific data for unemployment effects in these sectors are not available. Other sectors showing a decrease in export values do not seem to be contributing towards increased unemployment, at least in 2009, because production in those sectors has increased. In the case of sugar, although production has decreased, an additional 3231 jobs in sugar companies were created in 2009 and additional jobs were created in out-grower cane sugar production fields and by sugar cane transport service providers. According to the Economic and Social Plan balance for the third quarter of 2009, the reduction in production was the mainly result of so far unsuccessful new technologies adopted in the sector. Tobacco production has also increased.

The decision to allow the government to build a higher primary deficit was taken so that the country could continue following its anti-poverty policies expressed in the PARPA (Action Plan for the Reduction of Absolute Poverty), one of the most important guides to short- and medium-term policies and the definition of priority areas. According to the IMF (2009), the primary deficit before grants in 2009 was expected to reach 5.3% of GDP (3.4% in 2008). Also, government social interventions related to the crisis targeted the prevention of higher levels of redundancies in the workforce. For example, the GoM negotiated with some companies to limit the number of workers made redundant.

4.3 Economy-wide and sectoral structural policies for getting the country out of the crisis

According to the IMF, the GoM has defined four main areas for structural reforms, as presented in Box 1. These reforms reflect the same strategic views existing prior to the crisis, and it is not clear from them how they will seek to reverse the perverse effects of the global financial crisis.

Box 1: Structural measures to sustain growth

At the **fiscal** level, the GoM is implementing reforms in revenue administration and public financial management to shore up the government's medium-term fiscal strategy and to mitigate fiscal risks. Tax administration measures centre on simplifying tax collections and helping improve the strategic framework and organisational structures underpinning the reform effort.

In the **financial sector**, the central bank is pressing ahead to strengthen its monetary policy instruments and operations, with a view to possible moving away from reserve money targeting towards inflation targeting in the medium term, and strengthening financial intermediation and banking sector supervision. To this end, supported by technical assistance, the central bank will finalise an action plan to implement the recommendations of the 2009 Financial Sector Assessment Programme Update and to develop a financial sector contingency plan that will strengthen the authorities' ability to deal with banks in financial distress.

Business environment: Mozambique's business environment ranks poorly compared with other countries in the region and is impeding private sector activity and external competitiveness. The GoM, in consultation with the World Bank, has identified specific measures that it intends to fast track and implement by end-2010. This is intended to improve the business environment, help raise growth potential, diversify exports and stimulate new investment.

Extractive Industries Transparency Initiative (EITI): A key priority is to improve the public management of the country's large natural resource endowment, with a view to increasing the benefits spilling over to the domestic economy, strengthening transparency and limiting budgetary liabilities. The government sees full membership in the EITI as critical to these objectives. Following the acceptance of Mozambique as an EITI candidate country in May 2009, the creation of an EITI Secretariat will help carry the reform process forward and ensure that Mozambique will be able to comply with EITI requirements during the country's two-year candidacy status.

Source: IMF (2009).

4.4 Multilateral and bilateral donor responses in Mozambique

In general, bilateral donors maintained their commitments for 2009, which reflects an increase in ODA flows in relation to 2008. Multilateral donors substantially increased their support, with the IMF providing total support of more than $300 million and the World Bank increasing the total amount of its 2010 support from $85 million to $110 million and advancing it to 2009.

For 2010, donors have announced a reduction in the budget support component of ODA, which will result in a reduction of the aid coverage of the budget by seven percentage points, from 52% to 45% of the budget.

At this point, it is worth commenting on the relevance of the additional support proffered by the international financial institutions (IFIs) to the country, given the limited effects of the crisis on the balance of payments (being restricted to the trade balance), fiscal revenues and ultimately economic performance.

The IMF's $170 million assistance targeted balance of payments deficits, as the trade balance had deteriorated by $320 million. The improvement in the current account deficit was illusory, as it was mostly a reflection of reduced profits from megaprojects and in the import bill, and not the fact that the economy had generated more foreign exchange revenues than in the previous year. Therefore, there was a need for additional resources to finance imports (the import export coverage rate reduced from more than 70% in January-September 2008 to less than 60% in the same period of 2009). Any improvement in the financial account balance without the IMF's support would have been substantially less. And, even though inflows of private capital increased, this was less than what would have occurred without the global financial crisis (see the list of projects postponed or withdrawn in Section 2.1). Therefore, increased support seems to have been relevant in order to reduce the negative impacts of reduced export revenues and FDI flows. IMF support was also crucial to restore the BM's capacity to control currency devaluation.

World Bank support was mainly aimed at addressing the GoM's reduced revenues to finance its projects. Government revenues surpassed expectations because they were projected taking into account the negative effects of the crisis. The crisis did not severely affect them, but they would probably have been higher if not for the crisis. Therefore, World Bank support may have helped compensate for some reduction in the government revenue growth rate. What is certain is that World Bank support helped the GoM expand its fiscal policy with less recourse to the banking system and without increasing its domestic debt and competing with the private sector for domestic resources.

It is difficult to disentangle completely the effect of the IFIs' support on the achieved growth rate. However, it should be noted that $250 million corresponds to about 2.5% of GDP. The contribution to the GDP growth rate would be the share of this amount that was used to purchase domestic goods and services as a percentage of GDP (not considering its effects on increased production and productivity). In sum, it is very likely that the IFIs' additional support made an important contribution to the 2009 economic performance in Mozambique. Even though initial projections exaggerated the potential negative impacts of the crisis, it should be noted that it is better to put in place too many growth promoting measures than the opposite. In fact, it should not be forgotten that, even with the additional support and with fiscal and monetary expansionary policies, the annual growth rate is still estimated at less than what was projected before the crisis.

5. Conclusions

5.1 The impact of the crisis: An update

Available data suggest that the impact of the global crisis on the Mozambican economy will be minor. So far, the real GDP growth rate has reached 6.1%, 0.7 percentage points below the 2008 growth rate. With the exception of exports, most of the potential transmission mechanisms of the crisis have not been effective, as both private and official net inflows of external money have increased. The overall balance of payments is showing an improvement.

However, some sectors have clearly felt the negative impacts. Transport and communications, tourism and manufacturing have been the most affected, with more than 800 jobs lost by June 2009. Other sectors have shown immunity to the crisis, with agriculture, financial services, water and electricity and construction some of the most impressive.

5.2 Looking ahead: How well is the country positioned to gain from a future recovery and grow sustainably?

The reasonable performance of Mozambique's economy in this period of global crisis should not be treated as a sign of robustness of the economy, but instead as yet another warning of the structural problems of Mozambique's growth path. It has become even more obvious that, without external aid, the negative impact of the crisis would have been much more severe. It has also became obvious that reduced economic activity reduces some structural imbalances – such as the current account deficit – just like increases in economic activity levels lead to stronger imbalances. Therefore, most of the structural factors that make the country resilient to the crisis are reasons for concern. In fact, the economy is not resilient but dependent and fragmented, and it is this dependency and fragmentation that have shielded the economy from the crisis.

While initially expected reductions in foreign exchange inflows and fiscal revenues led to the loosening of fiscal and monetary policy, fear of future fiscal and monetary imbalances means that in 2010 these policies will be more restrictive. This means that, while the economy felt little impact of the crisis in 2009, this was achieved partly at the expense of performance in 2010. More restrictive policies for 2010 are an indication that 'business as usual' policies will be implemented, prioritising short-term stability of fiscal and monetary indicators, with no substantial efforts put in place to address structural weaknesses by diversifying and articulating production and trade, diversifying exports, substituting imports, reducing economic dependency and thus creating a more equitable society. As such, it is worth repeating the IMF (2009) conclusion about the future prospects of the economy: 'Mozambique has weathered the global economic crisis better than other countries in the region, but will also benefit less from the global recovery'. The policy of the GoM of actively promoting FDI in minerals and energy areas is likely to accelerate growth when financial resources are again made available in global markets. However, this strategy will consolidate and expand, rather than change, current economic structures and dynamics that are responsible for the weaknesses and cyclical crises of a short-term nature of the Mozambican economy.

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