CHAPTER 5

INDUSTRIAL POLICY IN MOZAMBIQUE

The previous chapter identified the main pressures that influence and shape the process of industrial development in Mozambique, and concluded that these pressures are referred to, but not adequately addressed by the main studies and debates about the manufacturing sector. This is because most studies are influenced by neo-liberal core stabilisation and liberalisation policies, fragmented lobbies focused on private capital accumulation with little concern for the direction and pattern of development, and the reactive and defensive characteristics of state activity. This chapter extends this discussion to the analysis of industrial policies and strategies in place, focusing both on formal and informal industrial policies and how these, combined with more general economic policies, affect the opportunities and direction of manufacturing development. The chapter is organised into three sections. The first discusses general industrial policies and strategies. The second discusses selected, core issues in manufacturing development and how they are affected by more general economic policies and specific industrial strategies alike. The third draws conclusions for industrial policy formation in Mozambique.

5.1 Official industrial policy in Mozambique – content and analysis

Since the early stages of the process of neo-liberal economic reform in Mozambique, which started in 1987, the government has been concerned with the formulation of an industrial policy. This concern results from three practical factors: the role of industry in import substitution, exports and job creation; the need to address the fundamental weaknesses and pressures faced by the sector; and the need to replace central planning with indirect and "softer" forms of influencing industrial development. Industrial policy would provide a direction and incentives without interfering with business decisions. Therefore, although formal industrial policy is not part of the core mainstream policies, it plays its role in market-conforming economic reform. To do so, official industrial policy announces government intentions to the business community and avoids action and intervention by the state in any specific issue.

The marginalization of active industrial policy reflects three major problems. First, macroeconomic and trade policies are determined exogenously with respect to the needs of development of industry, as they mainly respond to stabilisation and liberalisation concerns. Therefore, industrial policy has no impact on these variables. Second, the dominant ideology in economic management in Mozambique, since the neo-liberal reforms started, is that the government should not interfere with business decisions. Therefore, industrial policy also has no influence on micro economic decisions. The government is concerned that the appropriate level of investment is made because of its impact on growth and income, employment, wages and balance of payments. However, it pays little attention to the allocation of investment and direction of industrial development, as these should reflect businesses decisions. Third, apart from organized foreign capital (e.g., in aluminium, sugar, beverages and finance), there are no other strong and organized political and economic interests that would seek the formulation and implementation of a clear strategy and put the necessary pressure upon the state. Hence, public policy is open to capture and/or influence by a great variety of interests that are fragmented and do not necessarily result in coherent strategies, as indicated by the examples, discussed later, of cashew, sugar and mega projects.

Current official industrial policy documents, general or industry specific, have a common and complex, if not bureaucratic, ethos.[1] More than half of each document consists of definitions, generalities, principles, and aims, before presenting lists of sectoral priorities. No realistic programme and practical system of implementation, monitoring or evaluation are included. The law defines the role of industrial policy as providing guidelines and transparency with respect to government intentions, whereas decisions concerning the implementation such intentions are a matter for the private sector.[2]

The documents define six principles upon which industrial development should be based: (i) industrial policy conforms with general economic policy; (ii) manufacturing development is a matter for the private sector and should be based upon private sector initiatives; (iii) industrial firms need to modernise, not only rehabilitate; (iv) domestic regional inequalities and imbalances in development should be solved; (v) development should be environmentally sustainable; and (vi) regional integration within SADC is an opportunity for accelerating development through access to investment, technological and institutional externalities, and trade. This list suggest the tension between laissez-faire ideology and the demand of equitable

[1] The documents analysed in this section are GOM 1997a, 1998a, 1999i, 1998e and 1999k, which cover general and sectoral industrial policy, licensing and free trade zones. Finance and privatisation, as well as cashew and sugar will be discussed separately.

[2] GOM 1997a.

and sustainable development. It also confirms that industrial policy is constrained by core stabilisation and liberalisation polices and is mainly an informational and rhetorical device.

The following sectoral priorities are defined: food (sugar, beverages, cereals, copra and cashew, for domestic consumption and exports), textiles (satisfaction of basic needs and exports), metal engineering (provision and maintenance of capital goods) and building materials (diversified building materials for post-war reconstruction). Opportunities for development are identified in basic metals (intra-sectoral linkages and linkages with mining), chemicals (consumer goods and material inputs) and packaging and paper industries.

The strategy defined to implement these goals and priorities includes: (i) the adoption of three stages of manufacturing development, namely: rehabilitation, modernisation and diversification, and exporting; (ii) small and medium enterprises (SMEs), together with the private domestic sector, are considered to be the base for industrialisation; (iii) FDI is important from the point of view of promoting linkages with domestic firms and investors. At a general level, this strategy is expected to be enforced through an enabling business environment that results from stabilisation, trade and financial reform, de-bureaucratisation, and public provision of infrastructures and training. At a more specific level, SMEs will be supported by general investment incentive schemes,[3] especial funds,[4] export credits, access to the stock market and other support services. FDI will be supported through the introduction of free industrial zones (FIZ)[5] and other specific incentives that may be negotiated in each case.

However, these policies and strategies are not in line with the real dynamics of the manufacturing sector. This inconsistency is the result of several related problems. First, the dynamics of industrial accumulation are overlooked partly because of the dominance of orthodox economic policies based upon simplistic and inadequate assumptions about markets, agents and the working of the economy. Second, the role played by industrial policy in

[3] The general package of incentives is restricted to different combinations of tax exemptions: corporate tax may be reduced by 50% to 80% for up to 10 years, depending on location of the project; firms that train their workers qualify for a further 5% rebate on corporate tax; imports of equipment are exempt from import duties; foreign firms also qualify for full repatriation of capital invested and profits.

[4] Such as FFPI (small industry promotion fund) and FARE (enterprise rehabilitation support fund, created out of state revenue from privatisation).

[5] Industrial free zone (IFZ) status is given to all manufacturing firms that export at least 85% of their output, with exception of processing of cashew nuts and sea products of national origin, as well other sectors that may be reserved to the state. Firms with IFZ status enjoy exemption from import duties in all imports of material inputs, equipment, machinery, parts and other required materials; no output taxes (VAT or turnover tax) because their output is for export; no corporate tax, but only a fixed levy of 1% of gross revenue from the 7th year of operation, and free import and repatriation of capital. See GOM 1999k and 1999l.

Mozambique is marginal, constrained by targets determined exogenously with respect to manufacturing, and aimed at making sure that the government does no more than announcing intentions. There are very few tools the government can use to implement industrial policy objectives successfully. Third, given macroeconomic constraints, the government is more interested in aggregate capital formation than in the pattern of investment and direction of development. Fourth, the government does not have the political and technical will and ability to pursue active industrial strategies, nor has acknowledged the need to acquire such capabilities. The better educated and more experienced civil servants are overburdened with current management. This is aggravated by the fact that the government has made many of them members of the board of various large privatised companies, in order to keep them working in the civil service despite low public wages. Fifth, the political and economic interests that are better organized and stronger are associated with FDI and large companies, not with domestic SMEs. In this connection, it is believed that active industrial polices deter investment, although the evidence rejects this view.[6] Hence, the priorities defined in the policy documents are not respected by the state or the private sector, and the targets established have not materialised.

In three of the seven priority industries output has been declining. In the remaining four, output has became specialised around a narrower range of branches, such that about 80% of manufacturing production is now generated by large foreign firms in aluminium, beer, soft drinks, sugar, cereal milling and cement. These firms have also made three quarters of investment in manufacturing between 1990 and 1999, which has become more dependent upon FDI and concentrated in Maputo (see chapter 3).

Existing strategies concerning the establishment of special funds for SMEs and manufacturing support services have not been implemented or have been too modest to make a difference. Policy documents do not address and, given the core economic policies, may not be able to address the issue of how to finance such services and institutions. Thus, under the current circumstances strategies concerning special funds and support services cannot materialise unless a donor or multilateral agency decides to implement projects in this area. In this case, donor agendas may become more important than specific needs of the manufacturing sector and industrial policy. More importantly, the state may cease to be, or never grow to become, a

[6] Refer to the different fates of the sugar and cashew industries. In GOM 2000e, businesses discuss the role of industrial policy and strategy as an information, quality and credibility device to improve credit conditions and performance in the economy. Commercial bank officials argue that industrial strategies that enhance the viability of industrial projects would help to mobilise cheaper finance for manufacturing investment. See Harris 1997 for a similar discussion with respect to South Africa.

crucial part of the dialogue within the manufacturing sector, being substituted for by a donor or group of donors and multilateral agencies.[7]

The dynamics and structure of manufacturing production reflect the dependence of the sector upon FDI for financing of investment projects, as well as the narrow focus of FDI projects that correspond to business interest and strategies of international corporations. Unless alternatives to FDI are found, foreign investment has to become a central component of the analysis and formulation of industrial policy and strategy. To do this, the state has to acquire information and become more knowledgeable about international corporations mainly, in the Southern African region. Basic information required about these corporations are their productive and financial capacities, competitive conditions in the market they face and their relative position in it, and their corporate strategies with respect to internationalisation of production, trade and finance. This information would allow state officials to define more realistically the priorities for manufacturing development and how they link with each other; to negotiate better deals with international corporations; to anticipate important issues of policy and implementation of projects; to prepare domestic firms to link with large FDI financed projects; to provide information to domestic firms so that they can organise and associate themselves to negotiate their participation in mega and other large projects through sub-contracting and joint ventures; and to produce credible and operational industrial and investment policies and strategies that would both attract foreign investment but also develop necessary domestic capabilities that complement and go beyond FDI.[8]

5.2 Selected issues in industrial policy in Mozambique

It would be a mistake to restrict the analysis of industrial policy in Mozambique to the study of official industrial policy legislation. There are many other areas of policy that directly influence the performance of the manufacturing sector – such as investment incentives, private sector support programmes, finance, licensing, labour market policy, trade agreements – and which do not form part of the legislation on industrial policy. These areas of policy are often un-coordinated and fragmented because they respond to pressures that act upon different government departments rather than to a coherent strategy. This section analyses

[7] See, for example, comments by businesses related to this point in GOM 2000e.

[8] See GOM 2000e. Hirschman 1992: Chapter 1, who mentions external pressure mechanisms to bring forth the development potential of LDCs. For the role of linkages in determining the worth of FDI in economic development, see Agosin and Mayer 2000, Aitken and Harrison 1999, Blomström, Kokko and Zejan 2000, Borensztein, Gregório and Lee 1995, Chang 1999 and 1998b, and Weiss 1998. For the need to address the power of FDI in development strategy, see Fine 1997b.

five issues that are crucial in the context of manufacturing development in Mozambique: linkages, private sector development, market structures and dynamics, corporate strategies and finance. Linkages, market structure and corporate strategies are discussed with respect to selected case studies. The remaining issues are discussed with more aggregate data. These issues have been selected because together they form a chain of fundamental analytical problems in industrial policy in Mozambique.

Linkages and industrial policy

The ability to generate and take advantage of development linkages, or to make one thing lead to another,[9] is a fundamental issue in studies of the manufacturing sector and industrial policy in Mozambique.[10] Linkages can be forward and backward, restricted to input-output or applied to more complex economic processes, and can also have a pecuniary component in the form of fiscal revenue, foreign exchange gains and wages. The opportunity for linkages emerges when: (i) specialisation, complexity and economies of scale and scope prevent internalisation of complementary or related activities and encourage the emergence of a network of suppliers; (ii) firms are willing to outsource from domestic markets; (iii) sub-contracting is possible and viable; (iv) externalities can be appropriated and transformed into additional and upgraded capacities; and (v) pecuniary linkages have an effect on national economic development.[11]

The studies and policy documents about industrialisation and industrial policy refer to four types of linkages, namely: (i) input-output linkages associated with diversification of the manufacturing structure, viable and efficient import substitution and increase in value added; (ii) technological linkages resulting from knowledge spillovers, sharing of information, learning from best practices, as well as technological diffusion through production and provision of capital goods and material inputs; (iii) complementary investment and pecuniary linkages; and (iv) structural linkages that occur between economic processes, along product and business cycles, and during different stages of development of the manufacturing fabric (for example, gradual backward import substitution). The documents identify SMEs and FDI

[9] See Hirschman 1981 and 1958, and Sender and Smith 1986.

[10] As a result, a linkages division was created in CPI. This unit was created in the context of implementation of Mozal's project.

[11] See, for example, GOM 1999c, 1998c and 1997a, Hirschman 1981 and 1958, Kaldor 1967 and 1957, Stewart and Ghani 1991, and Weiss 1985.

as the two vectors through which opportunities for linkages are created and materialise.[12] Mega projects are the main source of pressure that may result in development linkages because of the scale, sophistication, product and management quality, finance, networks and experience that FDI could bring. Additionally, FDI projects are the most dynamic and fast growing in the manufacturing sector, and the single major source of investment finance.

Input-output linkages have been developing in a limited number of cases, mainly between foreign owned firms. For example, energy from Motraco is mostly consumed by Mozal, which exports its entire production of aluminium. It is expected that Motraco will, in the future, also help to stabilise the supply of electricity to the manufacturing industry in the South. However, given that Motraco's electricity comes from the South African grid, this project actually links the manufacturing sector in Mozambique with the energy sector in South Africa. The sugar industry can also supply local firms with material inputs, particularly in the beverage industry of which the larger consumers of sugar – beer and soft drinks – are foreign owned.

Inter and intra sectoral linkages may not develop in the absence of coordinated strategies. For example, Kanes, a domestic metal-engineering firm originally specialised in mechanical and other simple agricultural equipment, but was forced to re-direct its activities because agricultural producers have no access to finance. Farmers want the equipment but cannot afford to buy it without bank or trade credit, and Kanes cannot afford to extend trade credit. Therefore, the firm is constrained to producing to order a wide variety of metal structures and products, and also depends on the buyer being able to extend trade credit. The firm runs the risk of losing skills and experience related to production of agricultural equipment, and the economy misses the opportunity to develop inter-sectoral linkages. Additionally, simpler but less specialised production to order is not conducive to an intensive innovation and learning experience, and therefore does not help the development of technological linkages.[13]

Some investment linkages have developed between domestic and foreign capital, as is illustrated by the fact that 72% of total DDI in manufacturing is concentrated in the same

[12] For a general discussion of the growth impact of positive linkages between FDI and domestic enterprises see, for example, Agosin and Maayer 2000. Aitken and Harrison 1999, Borensztein, Gregório and Lee 1995, Kuamar 1998, Mello Jr. 1999 and UNCTAD 2000a and 1999d.

[13] Interview with Justino Francisco (Kanes). According to Hirschman, the existence of a "bottleneck" creates development pressures, or linkages, so that in this case finance would be provided. This is, however, a conclusion based on the assumption that there is a tendency of demand and supply of complementary activities to balance at no extra cost. The analysis of the financial sector (later in this section) explains why the sector would not respond to such "developmental pressures".

industries and firms as FDI. However, this is mostly associated with investment by the state and state-owned corporations and by one large private company, Coca-Cola. Additionally, this investment does not tend to be complementary in the sense of creating linkages and externalities throughout the economy, but is simply a share in given investment projects.

Technological linkages have also developed between firms involved in joint ventures and consortia created to attend specific and specialised industrial demands, such as the supply of metal structures and aluminium smelter pots to Mozal. Even in these cases there are serious difficulties in sustaining linkages because of backwardness of most Mozambican firms and irregular demand pressures. For example, one joint venture that supplies equipment to Mozal was forced to recruit 80 qualified and certified welders from South East Asia. In another case, demand existed for one specific good at one particular time period – the supply of metal structures for Mozal's smelting furnaces – that occupied a medium, local metal engineering firm for half a year, after which the firm returned to routine, small and irregular orders for a variety of customers. A joint venture with a more experienced foreign firm was created for the production of the metal structures, but this was a short-lived, occasional experience, therefore not conducive to cumulative creation of new capacities, skills, organization and management routines, or to effective technology transfer.

Given the magnitude of fiscal incentives, most large and foreign owned projects do not generate significant fiscal linkages. Projects with FIZ status, like Mozal, pay virtually no taxes. At the moment, Mozal is the only large project generating very significant export and foreign currency linkages. Wages tend to be higher in large projects, but most of these projects are capital intensive so that wage linkages through demand for basic consumer goods are limited.

Mozal is currently the main potential creator of demand linkages.[14] Investment of about $US 1.34 billion was made in the construction phase. Mozal, which outsources everything that is not direct production of aluminium, creates at least US$ 100 million worth of contracts for other firms every year. If domestic firms can compete successfully for contracts with Mozal, domestic demand for these firms may increase, and they would have the incentive and means to upgrade and achieve internationally competitive standards because selling to Mozal is similar to exporting to top markets. Thus, getting long-term contracts with Mozal may work as a springboard for entry in the world market directly.

[14] Mozambican officials argued that the main reason why the Mozambican government approved Mozal was the project's huge potential to generate linkages (see detailed discussion later).

However, firms based in Mozambique were awarded only 3% of construction phase contracts. Of these contracts, 50% were awarded to domestic firms in joint ventures with foreign firms and 30% were awarded to subsidiaries of international corporations. Two thirds of these contracts are for provision of services, namely: software installation and maintenance, training of software operators, transports, rental of installations, and environmental impact assessment. Very few of these contracts involve Mozambican based manufacturing firms, and when they do it usually is a one-off, short-term programmes.[15]

According to CPI reports,[16] the main reason why Mozambican firms cannot get access to more and better sub-contracts is that they are not capable of producing with the rigorous standards that Mozal demands.[17] CPI carried out an evaluation of about 370 Mozambican firms to identify those that could be easily upgraded to Mozal's standards.[18] Of this universe of firms, 99% have serious problems with product quality; 95% do not have the required professional profile, portfolio and experience; 92% operate with old, worn out and outdated equipment, and inadequate technology; 90% suffer from serious management deficiencies and inadequate financial structure and capabilities; and 85% have serious deficiencies with respect to marketing capabilities and business attitudes. Only one firm, not in manufacturing, was certified under ISO 9000 standards. Thus, only a very small proportion of the firms can be easily upgraded, and the vast majority requires a process of complete restructuring, which would involve business strategy reviewing, training and access to finance.

The scope for demand driven linkages with Mozal is limited. First, the most important material inputs that Mozal needs are alumina (which comes from Billiton's own mines) and electricity (from Escom and the South African grid).[19] Second, Mozal produces one basic, primary product of manufacturing origin, aluminium, which generates few dynamic product linkages. Mozal's linkages are almost exclusively process related. Third, the aluminium market, as most primary products, is unstable and sometimes volatile; booms and slumps

[15] GOM 1999c.

[16] GOM 1999c and 1998c.

[17] MIC officials also argue that because Mozal was not an initiative of the Mozambican government, but was developed by insistence of the foreign investors, the Mozambican government was not prepared to help domestic firms to upgrade and had not thought through the problems associated with linkages (interviews with Luis Sitoe and Manuel Mbeve).

[18] Mozal's officials claim that the project creates a market for industrial goods and services, but its suppliers have to be of highest quality and reliability (interviews with Ian Reid and Peter Cowie).

[19] Alumina and electricity constitute about 60% of Mozal's costs. With other material inputs that have to be imported, the import share of costs, excluding equipment, rises to 80% of the costs structure.

affect aluminium exporters and buyers, as well as their network of suppliers. It is, thus, dangerous to use any single FDI project as the only or main source of linkage opportunities.

If linkage pressures come from a single, narrowly specialised industrial project, no matter how large it is, it is not capable of maintaining a continuous demand for equipment, parts and materials that is large enough to sustain the development of the domestic manufacturing fabric. One way around this is if many other, eventually smaller industries and services re-locate and develop in the proximity of an anchor project, such that the combined demand of these industries and services may help to develop long-term, structural linkages. This is the philosophy behind the creation of industrial estates around anchor projects.[20]

The Beluluane industrial estate is being created around Mozal, the anchor project. The development of the estate involves investment of around US$ 500 million.[21] Because the estate has free industrial zone status, all firms benefit from duty free imports of equipment, parts and material inputs. Anchored firms are required to give priority to supplying the anchor project rather than exporting directly. Therefore, the cycle, pattern and scope of activity in the industrial estate is dictated by the anchor project, and the anchored firms may not have an incentive to outsource from domestic markets. Even if many more firms join the Beluluane industrial estate, domestic firms may not benefit from a larger pool of linkage opportunities in the absence of other significant and continuous pressures from diversified sources. The development of domestic firms cannot be tied to a few mega projects of narrow specialisation and industrial estates anchored to them.

Demand pressure may create new business opportunities, but actual linkages may only develop if domestic capabilities are created, existing assets restructured, intra and inter sectoral investment strategies coordinated and financial resources mobilised. More complex linkages, such as technological and structural processes, require that demand and supply pressures are continuous and wide ranging. Long-term, sustained and broad ranging linkages depend upon strategic coordination and domestic capabilities of the economy and the manufacturing sector.[22]

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[20] Interview with Víctor Tivane from CPI.

[21] Interview with Víctor Tivane. Notice that the investment cost of this industrial estate is equivalent to 2.5 times total DDI in manufacturing in the period 1990-1999, and 20% of total manufacturing investment during the same period.

[22] Strategic coordination does not necessarily mean an attempt to implement a big push strategy, by which everything is supposed to happen at the same time. However, being critical of the big push approach is different from rejecting the role of strategy. Hirschman's (1981 and 1958) assessment that linkages, and thus development, occur as a result of imbalances, does not exclude the need for strategy to address the imbalances. He emphasis the role played by economic pressures, or imbalances, in

Private sector development and industrial policy

The private sector, domestic and foreign, is the cornerstone of the industrial policies and strategies in Mozambique. GOM (1997a) defines manufacturing as a private sector activity, and industrial policy a response to private sector initiatives. Thus, the success of industrialisation strategies depends on how capable the private sector is.

Orthodox studies of the manufacturing sector in Mozambique[23] and policy documents emphasise that the development of the private sector depends upon three factors: (i) the business environment created through stabilisation and liberalisation; (ii) privatisation; and (iii) specific support programmes and institutions. This section briefly discusses the last two factors, as well as some characteristics of the domestic private sector.

World Bank (1996b), Castel-Branco and Cramer (forthcoming), Cramer (2001) and Biggs, Nasir and Fisman (1999) analyse the experience of privatisation in Mozambique. The World Bank study emphasises the role of privatisation in improving the efficiency of resource allocation through transfer of property rights from the state to the profit maximising private sector.[24] It analyses the success of the privatisation process with respect to two criteria: (i) how many firms were privatised and how fast; and (ii) how privatised firms perform from the point of view of the economic goals of privatisation. The study argues that with respect to the first criterion, the Mozambique experience is one of the most successful in Africa. More than 1,200 firms were privatised, four fifths of which over the last six years of the privatisation programme. Included in that number are not only SMEs but also large utilities and the largest firms in manufacturing, finance and transport sectors.

With respect to the second criterion, the study analyses the performance of the privatised firms relative to efficiency, competitiveness, investment and the fiscal impact of revenue from sales. Biggs, Nasir and Fisman's survey performs a similar analysis (table 5.1).

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creating opportunities, and by the entrepreneurship to take advantage of them. Public strategy is part of entrepreneurial capability.

[23] See, for example, World Bank 1999, 1996b, 1995b and 1990b, Biggs, Nasir and Fisman 1999.

[24] In the view of the study, this transfer of property rights also increases competition by reducing state intervention in the goods and factor markets.

The two studies show that, with the exception of large and foreign owned firms, the economic performance of privatised firms was worse than that of any other group of firms (firms that had always been private, new firms and public enterprises). More worryingly, most privatised firms have failed to invest in new equipment and technology, which, given the poor state of the capital stock and technological backwardness at the time of privatisation, raises serious doubts about heir ability to survive. This is partly due to the fact that, with exception of traders, domestic entrepreneurs do not have capital to invest.[25] It is also an indicator of failed linkages with foreign investors and the inability of the financial system to channel resources for manufacturing development. This also explains the reasons why domestic investors try to diversify their activities away from the manufacturing sector and into trade and services, as they need to minimise risk improve access to finance.[26] This type of diversification is not conducive to creating linkages and generating positive spillovers from manufacturing into the rest of the economy, and therefore does not contribute to developing the productive fabric of the economy.

Castel-Branco and Cramer (forthcoming) and Cramer (2001) argue that privatisation in Mozambique has been affected by three fundamental errors. First, it was made a panacea for almost all economic and management problems, without adequate analysis of the economic and institutional implications of the massive transfer of resources to the private sector. Second, the notion that privatisation would unleash the domestic private sector and bring forth its potential was based upon unrealistic assumptions about the private sector in Mozambique. Third, privatisation did not form part of a clear industrial strategy that could have helped with: (i) the selection and restructuring of the firms; (ii) the identification of simple and concrete targets for the privatisation of each firm, in accordance with the type of firm and industry and the goals of industrial policy; (iii) the identification of, and negotiation with, most adequate potential buyers; (iv) the establishment of adequate incentive, support and linkage mechanisms; and (v) the definition of the methods of state divestiture adequate for each case and objective. Neither of these two studies, however, discusses the interest groups more likely to influence industrial policy (for example, in a finance scarce economy, FDI projects may acquire disproportionate influence), and how such influence would have shaped the final result of privatisation.

[25] See Biggs, Nasir and Fisman 1999, Castel-Branco 1994b, Castel-Branco and Cramer (forthcoming), Haarlov 1997 and Weiss 1992.

[26] See, for example, Biggs, Nasir and Fisman 1999, who claim that 70% of owners of Mozambican manufacturing firms also own other unrelated business, mainly in trade and services. See also Haarlov 1997 and Weiss 1992.

Table 5.1: Performance of privatised firms in Mozambique

Indicators	Study/Assessment	
	World Bank 1996b	Biggs, Nasir and Fisman 1999
Efficiency gains		
- output	Sales doubled, but mostly because of large, foreign owned firms. Overall growth was short-lived	Privatised firms grew slower than all other groups of firms, and growth was short-lived.
- employment	Declined.	Declined very significantly more than in any other group of firms.
- capacity utilisation	Increased, mostly because of large, foreign owned firms; and growth is concentrated in a few industries.	Grew slower in privatised firms than in any other group of firms; concentrated in a few industries and large, foreign owned firms.
- labour productivity	Increased.	Increased but only because capacity utilisation increased & employment declined sharply.
- modern management	Almost only in large, foreign firms.	Almost only in large, foreign firms.
Competitiveness		
- at firm level	--	Technical efficiency of privatised firms is lower than in any other group of firms.
- competition in the economy	Evidence of concentration: beer, soft drinks and cement.	Evidence of concentration: beer, soft drinks, cement and cereals.
New investment	Increased, but mostly in foreign owned firms.	With exception of foreign owned firms, privatised firms invested less in new equipment and technology than any other group of firms.
Fiscal impact (privatisation proceeds)	Mozambican buyers paid 16% of agreed value of firms sold to nationals (US$ 8 million); foreign buyers paid 85% (US$ 43 million) of agreed value of firms sold to foreigners.	--

The process of privatisation in Mozambique is better understood from the point of view of the real pressures that forced it to happen, namely: (i) the limited capacity of the state to manage all the firms that it owned or administered; (ii) the interests of an emerging potential domestic entrepreneurial class keen to inherit state property at low costs; (iii) the need to capture excess liquidity controlled by traders and speculators in order to make it available to finance productive investment; and (iv) donors' ideology and its impact on policy direction.

To help the domestic private sector blossom, three private sector development programmes (tables 5.2 and 5.3) were formulated by multilateral agencies and started to be implemented in

2000.[27] It is remarkable that private sector support programs were introduced only thirteen years after market-led economic reforms were initiated.

These projects were developed without any coordination between the proponents. Not even the government encouraged the proponents to coordinate, which may be explained by two factors: (i) the government wishes to maximise resources invested in private sector development; and (ii) having more than one donor, and particularly when they have different approaches, improves the bargaining power of the government. Institutional conflicts emerged, partly because UNIDO and the World Bank have to compete with each other for finance from the same bilateral donors.[28]

These conflicts and the need to compete with PoDE encouraged UNIDO to finance a study about possible complementarities and overlap between the two projects.[29] The study concluded that there is more complementarity than overlap, and that the few cases of overlap could easily be resolved.

Table 5.2: Private sector development projects – proponent, financing and life span

Program	Proponent/Agency	Cost (US$ million)	Financing	Life span
PoDE Enterprise development program	World Bank	47.6	55% IDA 10% NORAD 10% EU 5% DfID 20% GOM & firms	6 years
IP Integrated Industrial Programme	UNIDO	10.4	10% UNIDO 35% bilateral 55% still to be raised	3 years
EM Enterprise Mozambique	UNDP	2.0	No money raised yet	3 years

Source: Project documents (World Bank 1999, UNIDO 1999 and UNDP 1999).

[27] UNDP 1999, UNIDO 1999 and World Bank 1999. See Coughlin 2000 for an assessment of the complementarities and overlapping between these projects.

[28] Interviews with Jan Thomas Odegard (UNIDO programme officer) and Luís Sitoe (MIC).

[29] See Coughlin 2000. EM is too small and at the time unlikely to even begin implementation. Therefore, it is dropped from the analysis.

There are, however, other more significant problems with these programs than the simple issue of overlap.[30] First, they have different approaches to the problems of the private sector: UNIDO is focused on non-market, institutional failure, and the World Bank is focused on market conditions. Simplistically, it can be said that the projects do not overlap and are complementary in the sense that each addresses one side of the same coin. The problem, however, is that MIC is going to have to deal with two different projects, reflecting different philosophies, having different focuses, emphasising different priorities, and the two ideas are different, not complementary. Who is going to make them complementary? Does MIC have the bargaining power to force changes in both projects? Should and could MIC, instead, design the government's policy with respect to the development of the private sector? Or is MIC going to become absorbed with the management of conflict and reporting to each donor rather than working on industrial policy?[31]

Second, none of the projects discusses the private sector within a specific socio-economic context and strategic framework. It is as if the private sector is homogeneous and can be efficient or inefficient in general, independently of what it does and within which context it operates. UNIDO's project is slightly more specific by focusing of the food industry, but this is still too vague to make a real difference.

Third, the financing of the private sector is still an unresolved problem. UNIDO does not discuss finance at any significant length, whereas the Bank intends to introduce special funds. These funds absorb just over 20% of the money available for the project. It is highly unlikely that US$ 10 million spread over six years will have a significant impact on domestic manufacturing investment.

Fourth, both projects define their own priorities and institutional organization independently of each other. Given fiscal constraints, it is likely that the department in charge of coordinating these projects becomes absorbed by administrative matters, having little to say about policy and no resources to do anything different or complementary. The existence of two distinct coordinating units, one for each project, may aggravate this problem.[32]

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[30] Coughlin 2000 makes the same point in the very last paragraph of his study, in which he argues that it is necessary to create public and private institutions properly staffed and equipped to ponder and choose industrial strategies and policies. (pp. 8)

[31] See, for example, Doriye and Wuyts 1993, Tarp 1993 and Wuyts 1995, for debates about the role of aid and conflicting donor priorities in confusing state capacity and activity.

[32] Counghlin 2000 argues that the experience of these projects may lead to a consolidation and amplification of the two coordinating units so that MIC would be positioned to think about strategy and policy, instead of merely sketching out main lines of action and avoiding overlapping and the grossest inefficiencies (pp. 8). This, however, would require that the government, not donors, set the agenda.

Table 5.3: Comparative description of enterprise development project (PoDE) and integrated industrial programme (IP)

Program	Analysis of the problems of the private sector	Objectives of the program	Activities
PoDE (World Bank)	Private sector is small, fragmented and inward-oriented. Business and learning support services are underdeveloped. Second generation reform policies are necessary (liberalisation, de-regulation and simplification). Finance, though improved and diversified through liberalisation, is not easy to access and is not cheap.	Improve competitiveness of the private sector through strengthening their access to services external to the firm. Promotion of efficient markets for training and capacity building services, and linkages to domestic and foreign investors and buyers. Improve access to term finance. Capacity building in MIC, CPI and business organizations.	Institutions: regulatory reform and simplification of business legislation; promotion of support services; facilitation of regular round tables between the private and public sectors. Finance: (i) finance CPI and FIZ; (ii) finance quality firms to compete in the consultancy, training and technology markets by providing 50% of financial needs at commercial rates; (iii) term finance for SMEs, by providing 50% of financial needs at commercial rates. Operation of a linkages office that seeks to identify foreign partners for domestic firms.
IP (UNIDO)	Inadequate capacity for policy formulation (public and private sector). Regional deficiencies for private sector development, particularly in the Centre and North of the country. Inadequate capabilities and mechanism to attract investors and technology suppliers. Inadequate institutional arrangements and mechanisms to ensure competitiveness and sustainability.	Improve policy formulation as an interactive process between the state, enterprises and population. Improve the quality of the firms and access to services, namely through provision of technology and training, as well as quality management and standardization. Focus on food industries and SMEs.	Policy formulation: (i) information networks and statistical capabilities; (ii) industrial surveys: opportunities human resources, firms; (iii) strengthening capacities of the public sector and business associations; (iv) establish a permanent forum public/private sectors; (v) develop specific policies: environmental, quality and standards and industrial policies. Training: train trainers and national consultants who will train business people. Technology: examples through pilot projects in the food industry. Linkages: food industry and information networks.

Source: Project documents (World Bank 1999 and UNIDO 1999).

Fifth, the Bank's project plans to create and manage a linkage office, despite the fact that a linkage division exists in CPI. It is likely that more institutional linkages may occur if the national institutions are strengthened rather than duplicated or replaced.

Donors and the government are repeating, with the support programs, the same errors committed during privatisation: adopting a simplified and inadequate analysis of the agents involved, and separating agents performance from strategy and policy and the overall socio-economic conditions under which they operate. This is more notorious in PoDE, but also evident in IP. The policy implication of defining private sector support strategies outside the more general context under which the manufacturing sector develops is that the support programs may become irrelevant for manufacturing development and for the development of domestic entrepreneurial and government capabilities.

Market structure and dynamics and implications for policy

Current economic policy in Mozambique takes for granted that the degree of incentive to the private sector is determined by the degree of liberalisation of goods and factor markets. This vision is based on neo-classical assumptions about how firms seek profits through the market and how goods and factor markets behave. The resulting policy documents do not take into consideration two fundamental aspects. Firms can influence the state, the direction of policy and market conditions. Thus, competitor firms' capabilities, strategies and actions have to be taken into consideration because they influence market outcomes. Hence, the option of liberalisation may not be available or may be irrational. This also creates a dynamically cumulative problem for industrial policy that cannot be avoided, namely the need to understand how one's strategies and actions change the very conditions in which the strategy is based, and changes the influences that act upon the state and strategy in the next round of policy negotiation.

A comparative analysis of recent developments in the sugar and cashew industries may illustrate these points. Table 5.4 presents the main similarities and differences between these two industries, apart from technical differences associated with their production processes.[33]

[33] For information on sugar and cashew, see GOM 1999d, 1999e 1999f, 1999g, 1999h, 1998b, 1996b, 1995 and 1993, Cramer 2001, Delloite and Touche Ltd. 1997, Hanlon 2000, Africa America Institute 2001, Pereira Leite 1999 and 1995, and Sellschopp, Dorsey and Cuamba 1999.

Under the coordinated pressure of investors, three large international sugar corporations, the government approved a sugar industrial policy developed around three main points: (i) definition of the priorities for privatisation and rehabilitation to avoid excess capacity; (ii) pricing policy based on a flexible levy on the price of imports, when this price falls below a certain historical, average price. The domestic rent is shared between producers and the state, not by domestic traders or dumping industries: and (iii) development of mechanisms of coordination of marketing strategies between the firms to take advantage of preferential quotas and avoid having to dump sugar into world markets.[34]

The World Bank and IMF opposed the pricing policy because it was inconsistent with trade liberalisation. Recently, and based on a technicality, the IMF tried to force the government to abandon the policy and, having failed to do so because of pressure from the industry, demanded a study on the impact of the pricing policy on poverty reduction using static, welfare economics. However, the World Bank and the IMF have not questioned the other two core elements of the sugar strategy, coordination of investment and of exports, which are not more "market conforming" than the pricing policy. The demands for price liberalisation in the sugar industry were abandoned after a study commissioned by the industry indicated that this policy was central for the survival of the industry. The IMF still insists that liberalisation is the first best option and that the pricing policy should be reviewed annually, as if the world market conditions faced by the industry, which are highly "imperfect", do not matter.[35]

Three factors forced the IMF to withdraw pressure for liberalisation: (i) the backing of the policy by international sugar and financial corporations and other multilateral agencies; (ii) the scale of investment already made[36] and the threat, by investors, to withdraw in case the pricing policy was reversed; and (iii) the oligopolistic character of the industry that encourages and facilitates coordination, which is reinforced by the existence of a sugar producers' association, which is capable of financing and organising its own lobbies.

[34] To facilitate this coordination, one of the estates exports the entire Mozambican preferential quota, and the four estates share the proceeds.

[35] Or it is as if IMF officials are incapable of understanding real, rather than textbook type, markets.

[36] Sugar is second only to Mozal with respect to the share of total investment and total FDI in the manufacturing sector.

Table 5.4: Differences and similarities between the sugar and cashew industries

SUGAR	CASHEW
Differences	
The structure of the industry: Mostly unified, as agriculture and processing activities are integrated. Tongäat-Hüllet owns the majority of assets in two sugar states, and Illovo and Sena Holdings (a consortium of sugar companies from Mauritius) are majority shareholders in one sugar estate each. They are all international sugar corporations that control production of sugar in Southern Africa.	Mostly fragmented: small peasants collect the raw, unshelled nut; retail traders buy the nut from peasants and sell it to larger traders, who in turn may export the raw nut or sell it to 16 processing factories of different sizes and technology. Mocita is the only factory owned by a large international corporation, Anglo-American. However, 11 of he 16 factories are owned by seven large and diversified, domestic economic groups, of which 5, owning 8 factories, are also involved in commercialisation and export of raw cashew nut.[37]
The size of the firms: The four sugar estates are by all criteria very large companies, employing thousands of factory and plantation workers.	The average factory used to employ 600 workers, and a couple employed more than 1,400. This, however, does not say much about the economic groups that own most of the factories.
Business specialisation: All corporations are specialised in sugar and control sugar production and marketing in other countries.	Only workers of the processing factories are entirely depend on the industry. Peasants also work as wage labour produce other crops. All traders are involved in wide-ranging rural commercialisation, money lending, and provision of trade credit and other services. Owners of processing factories own many other businesses, including rural commercialisation.
Investment: Of the US$ 230 million invested, 70% is foreign borrowing from international financial corporations and multilateral agencies.	Of the US$ 37 million invested, 60% comes from borrowing mostly from the domestic banking system.
Similarities	
State of the firms at privatisation: Firms were devastated during the war; were privatised after the economic reform program started.	
Market conditions: Both industries face highly complex and "imperfect" international markets. Less than 10% of the sugar production is traded in the world market, and the remaining is either traded domestically or through systems of preferential quotas. All sugar producer countries adopt protective measures of different degrees and forms (quotas, tariffs, etc) against imports of raw and refined sugar, as well as sugar containing products. The availability of sugar in the world market is unstable because it depends on uncertain climate conditions; the surplus over domestic consumption and preferential quotas is dumped into the world market. The world sugar price is, therefore, volatile. In the cashew sector, most producers protect domestic processing. India uses fiscal and other industrial policy measures, including financing of imports of raw cashew nuts, to ensure supply of raw materials to the factories. Brazil introduced a total ban, and Vietnam and Indonesia apply high tariffs, on exports of unshelled nuts. Therefore, large imports of raw cashew nuts are likely to be transitory, during periods where domestic supply of raw cashew is adjusting to demand of raw materials by the processing industry.	
Policy support requirements: Both industries need restructuring, protection, access to capital for rehabilitation and modernisation, market coordination, amongst other industrial policy measures, to build efficient productive capabilities and respond to market conditions.	

[37] Traders that are also industrialists have the option to export unprocessed cashew nuts or process it, according to changes in international relative prices and the quality of the nut [interviews with Raimundo Matule (INCAJU), Rogério Nunes (Entreposto) and Kekobad Patel (Enacomo)].

Unlike sugar, the cashew industry is fragmented, peasants, traders and industrialists have conflicting interests and the more powerful agents are large traders. Before privatisation, exports of raw cashew were discouraged by an export tariff. After privatisation, the government was put under pressure by the World Bank to liberalise these exports. The Bank's argument was based on two points. First, value added of domestic processing firms, at world prices, was negative, so that the economy could earn more foreign currency by exporting raw nuts. This was due to three factors: (i) the poor conditions of the firms at the time of privatisation; (ii) the low and volatile world price for processed cashew nuts; and (iii) the unusually high, but equally volatile price for unprocessed cashew nuts due to massive imports from India to supply its processing industry, while cashew orchards were being expanded to achieve self-sufficiency. Second, peasants would benefit from liberalisation because the exporting price of cashew would go up and the peasant share of that price would also increase due to increased competition between traders. As a result, peasants would invest in the rehabilitation and expansion of cashew orchards.[38]

This analysis failed to understand the oligopolistic nature of rural commercialisation in Mozambique,[39] particularly with respect to commodities for export, and its impact on the distribution of gains from liberalisation in favour of large traders. It also failed to understand that given the dynamics of the peasant economy in Mozambique,[40] it was unlikely that price incentives alone would enhance the viability of cashew production.

Because of the fragmentation of the industry and the reactive action of the state, no coherent policy emerged. Large traders sought liberalisation because they would be able to earn significantly more by exporting unprocessed nuts than by selling them to domestic cashew processing factories.[41] Manufacturers sought protection to have access to raw materials at low price. Trade unions supported manufacturers because of the threat to wages and jobs arising from liberalisation. Traders and manufacturers created their own associations to coordinate strategy and lobbying, but because of the structure and dynamics of the industry collective action by each part reinforced industrial fragmentation and rent seeking.[42] The World Bank

[38] Hilmarsson 1995, World Bank 1996b, 1995b.

[39] See, for example, Mackintosh 1987 and 1986.

[40] See, for example, Bowen 2000, Castel-Branco 1994a, O'Laughlin 1981, Wuyts 1989 and 1981.

[41] Pereira Leite 1999.

[42] This does not suggest that more competition has been introduced, but rather that, in the absence of an active and coherent industrial strategy, competition for rents and resources spent on trying to capture the rents have increased, because nobody can decide where the rents go and enforce this decision. See, for example, Castel-Branco and Cramer (forthcoming) and Khan 2001.

made the continuation of its support to small and medium industries in Mozambique conditional on liberalisation of the cashew industry.[43] The debate about the cashew industry blossomed, but was narrowly focused on the discussion of the export tax and factor prices.[44] Generally, there was no systematic analysis of all the other, more important, conditions that could help the industry to develop. These included access to finance for working capital and equipment, new technology and research and innovation, infrastructure rehabilitation, a regulatory framework for quality standards and control, rehabilitation and expansion of the cashew orchards, and the integration of the different, fragmented parts of the industry.[45]

With no alternative strategy, defensively reacting to pressures, and under threat by the World Bank, the government opted for liberalisation. This decision, which two years later was partially reversed by the Parliament and put under review by the MPF, resulted in the closure of all cashew processing factories and more than 10,000 jobs were lost. By 1999, the export price of unprocessed cashew nuts had fallen by almost 50% due to different factors, the most important of which was the reduction in Indian imports.[46] Additionally, as would be expected, the main winners have been the large traders/exporters of raw cashew. By exporting unprocessed cashew nuts, their margins increased by 50% to 10 times relative to what they would get by selling to local industries, depending on the fluctuation of relative prices of unprocessed and processed cashew nuts in the world market. Had traders continued to sell the raw material to local processing firms rather than exporting, their margins would have averaged 38%.[47]

It has been argued that if manufacturers intervene directly in the commercialisation of the raw nut they could obtain the raw material at a lower cost, thus rendering processing viable at a lower level of protection.[48] However, this argument misses two important points. First, traders own more than two thirds of the factories, including the largest ones. Some of them have become traders and exporters of unprocessed cashew nuts because of the unfavourable conditions faced by the processing industry.[49] Diversification into trade is a means to wider

[43] World Bank 1995c.

[44] See, for example, Delloite and Touche Ltd (1997). For a critique, see Cramer 1999.

[45] Castel-Branco and Cramer (forthcoming) and Cramer 1999.

[46] See, for example, Africa America Institute 2001 and Hanlon 2000.

[47] For data on trading margins, see Pereira Leite 1999: pp. 45.

[48] See, for example, Cramer 1999, GOM 2000e, 1999g and 1999h.

[49] Interviews with Rogério Nunes (Entreposto) and Raimundo Matule (INCAJU). See also GOM 2000e and 1999g and 1999h. Not all factories were bought by traders of unprocessed cashew, but larger domestic economic groups diversified into cashew processing and then into trade in unprocessed cashew nuts as part of the group strategy to minimise risk and ensure viability.

business options and to maintain a foot in the industry. By getting involved in trade, manufacturers have the option to export processed or unprocessed cashew nuts, depending on relative advantages at any point in time. However, firms would under invest in the factories if they have no commitment to processing the nut.[50] Firms cannot base medium and long-term investment decisions upon volatile and unstable international prices, which are also affected by the capabilities, strategy and actions of competitors. As manufacturers became more involved in trade, the prospects for the processing of cashew nuts become bleaker. Thus, state policy – driven by the combined influence of large traders/exporters, the World Bank and the IMF – has driven the industry and its agents away from manufacturing. As the quantity of raw cashew nuts available is not yet increasing,[51] the next step in the restructuring of the cashew nut industry in Mozambique might well be the rationalisation of marketing, which may require, amongst other policies, further concentration of power and establishment of market barriers to entry by the incumbent traders.

The second point is that firms need extensive and loyal networks to succeed in large-scale rural commercialisation in Mozambique. Large traders/exporters trade in a wide variety of goods and services with retail traders and farmers: purchasing of a variety of surpluses from farms, and supplying of manufactured consumer and investment goods, trade related credit, transports and the services of small cereal milling and peeling units that are crucial for the peasant economy. Large traders have the social and economic base upon which to build loyal networks with retail traders and farmers.[52] Some of these large traders also own cashew nut processing factories that have closed or scaled down because of shortage of raw materials. Thus, they make conscious decisions to export unprocessed rather than processed cashew nuts. In a way, their gradual move into the manufacturing component of the industry has undermined processing of cashew nuts. New entrants into cashew nut trading may not have the advantage of these networks and may not be able to compete with incumbent traders.[53]

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[50] See GOM 2000e, where strategic commitment is also associated with lowering of risk and more efficient links between manufacturing investors and the banking system. For a more general and theoretical discussion, see Bigsten *at all* 1999, Chandler 1977, various articles in Chandler, Hagström and Sölvell (eds.) 1998, Leahy and Neary 1999 and 1994, Rasmussen 1994.

[51] See Pereira Leite 1999 and 1995.

[52] It is unlikely that peasants and retail traders in rural areas will shop around to see who can offer the best conditions for each of the crops, each of the services, for money, etc. They do not have many options, and there is a considerable cost in shopping around, including that of losing the contact with the established network.

[53] Pereira Leite (1999: pp 45) shows that the number of large traders/exporters of unprocessed cashew nuts increased from 3 in 1991 to 11 in 1997 after liberalisation of the industry. The data show no clear relationship between the number of exporters/large traders and the size of trading margin. The margin is determined by the volatility and instability of the world market and the strategies and actions of foreign competitors. The lack of a clear relationship between the number of traders and the size of the margin is not surprising because most trade of cashew is done through large trading groups. The

The comparative study of the sugar and cashew industries reveals two common problems in policy-making in Mozambique. First, the World Bank, the IMF and the government take for granted that liberalisation is almost always possible and beneficial. In the case of these industries, they failed to understand that in a market where the strategy and actions of each agent affect market outcomes and pay-offs, each agent's strategy has to include the knowledge it has about the capabilities, strategy and action of the other agents.[54] In other words, it would be irrational for the sugar and cashew industries to give away protection if they have to operate in a market where the other agents are protected in one way or another (see table 5.4). Second, in the two cases the government was a reactive agent following the lead and pressure of the more dominant forces. Therefore, the exercises on policy and strategy were narrow and limited in scope and vision. They resulted in very different policy decisions and processes of industrial restructuring because of differences in the capabilities, structures and dynamics of industries and firms, which affects firms' capacity to influence policy.

The study reveals two other important aspects for policy making. First, the organisation of producers associations tends to reinforce industry structures and dynamics in absence of a solid strategy for change, and also tends to influence the direction of policy towards the dominant interest groups. In the sugar industry, the producer association consolidated the oligopolistic nature of the industry and investors' ability to cooperate, coordinate and influence policy, even against the wishes of the IMF and the World Bank. In the cashew industry, the associations reinforced each of the groups and, by doing so, the fragmentation of the industry and the power of the dominant trading group.

Another side of this problem is that, in the sugar case, rent seeking was limited because rents were clearly allocated from the outset and the producers' association facilitated cooperation in the share of rents. Even in the presence of a reactive state, sugar producers imposed a policy and enforced its implementation. In the cashew industry, associations of producers and traders emerged to organise rent seeking, because the allocation of rents was an open matter. As large traders/exporters became the dominant side in the debate and policy process, the level of rent seeking reduced because traders, within an oligopolistic market structure, appropriate most of the rents. Ultimately, this would be immaterial if the development of the sector were to be valued enhancing. Unfortunately, this is not the case in the cashew industry.

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increase in the number of exporters/large traders is associated with established, large groups starting to trade in cashew nuts. This undermines the World Bank and IMF arguments according to which liberalisation brings about more competition, and efficient resource allocation and income distribution.

[54] Rasmussen 1994.

Second, exit was always an easier and more realistic option for cashew than for sugar manufacturers, and corporate strategy played a more important role in investment decisions in sugar than in cashew. Cashew nut processing is done in small and medium labour-intensive factories, which are part of horizontally diversified economic groups, where cashew is only one of many, unrelated activities. Thus, cashew manufacturers have more options and less commitment to manufacturing. To develop their commitment to manufacturing, which may make sense in terms of industrialisation and long-term export gains, policies and strategies have to discriminate in favour of manufacturing. This would require a strategy to restructure the whole industry, including vertical integration of the industry.

Sugar producers are large, international corporations concentrated in international sugar business. Exit was prohibitive for sugar producers because of the large amounts of investment and sunk costs involved in establishing the industry, as well as the implications of exit in terms of market power relative to competitor corporations. Although incentives, in particular the establishment and allocation of rents, are important to enhance the chances that investment occurs, the investment decision function of sugar producers include other factors as well: market strategy, the strategy and actions of competitor sugar corporations, and production conditions. The government has the opportunity to use corporate strategy and production conditions as tools to impose performance targets tied to investment incentives. This could be done by encouraging profits to be re-invested in the diversification of the industry into sugar based or sugar containing products, development of independent cane grower schemes, or more investment in rural infrastructures, which could develop domestic linkages and increase the social benefit from the industry's rents.

Corporate strategy and implications for policy

The policies and strategies resulting from the current economic and industrial policy context rely on FDI to guarantee adequate levels of investment and growth in manufacturing.[55] This dependence on FDI results from the inadequacy of available forms of finance to sustain high rates of investment and growth; the deficiencies of the entrepreneurial class; and also from the

[55] In the late 1990s, FDI and balance of payment support grants became the most important sources of finance of the trade deficit. FDI is also the single most important source of finance for the manufacturing sector. The combined value of FDI projects implemented, approved and moving into implementation, or in later stages of design and appraisal is about twice as large as Mozambique's current GDP (see, for example, Castel-Branco 2001, GOM 1999b).

aggressive strategies played by interested corporations.[56] In spite of this implicit dependency, FDI is not discussed in depth, nor any form of FDI strategy or implications of a FDI based strategy are analysed.[57] The policy documents take for granted that macroeconomic stability, combined with economic liberalisation and investment incentives, is sufficient to ensure dynamic FDI inflows.[58]

Heterodox literature suggests very different approaches. In particular, it argues that the positive contribution of FDI to the economy depends on the degree of domestic linkages and investment complementarity enabled through FDI, not only on the gross value of investment. Thus, public policies that develop domestic capabilities and promote specific uses and allocation of FDI do matter.[59] This is even more important because LDCs are usually more affected by the slowdown of inflows of FDI during the downward period of international business cycles. Between 1999 and 2000, FDI inflows into Southern Africa fell by 26%, which has partly been explained by declining opportunities for mergers and acquisitions in the region as massive privatisation programs in Mozambique and other countries are completed.[60]

Furthermore, it is argued that FDI is not very sensitive to "sound" macroeconomic policies. Economies may be penalised for getting macroeconomic balances hugely wrong, but they are not rewarded for getting macroeconomic balances right above a certain minimum threshold. The asymmetric response of FDI to varying degrees of "bad" and "good" macroeconomics

[56] Multilateral and bilateral aid and grants are unlikely to increase, macroeconomic stabilisation targets limit foreign borrowing under commercial terms and domestic credit to the economy, and export revenue is still too low to sustain any meaningful level of trade and investment. For a discussion of the context and conditions of the domestic private sector, see Castel-Branco and Cramer (forthcoming), Cramer 2001 and GOM 2000e. Elsewhere in this thesis, projects intended to support the development of the private sector are discussed. World Bank 1999 and 1996b, which emphasise the success of the program of privatisation, also acknowledge the deficiencies of the domestic private sector. GOM 1999c and 1998c argue that the development of the domestic manufacturing fabric and economic linkages require "intelligent partnerships" to be developed between domestic and foreign firms, because the domestic private sector does not have the finance, networks and expertise required. Biggs, Nasir and Fisman 1999 argue that large and foreign owned firms have been the main sources of manufacturing growth, whereas the domestic private sector that emerged with privatisation is the worse performing.

[57] MIC officials claim that FDI is not properly addressed by industrial policy documents because massive inflows of FDI were unexpected and depend totally on the investors' initiative (interviews with Luís Sitoe and Manuel Mbeve). Businesses argue that it is the role of the government to study what corporations in the region intend to do in order to implement strategies to develop domestic capabilities, including domestic firms, to be prepared for and take advantage of FDI (GOM 2000e).

[58] Mozambique has become an FDI-friendly economy, where investment opportunities for foreign firms are identified in practically all sectors, and it is believed that economic stability and high incentives, including the possibility of award of FIZ status, will attract the necessary amounts of FDI. See, for example, GOM 2000a, 2000b and 2000c, UNCTAD 1999a and 1999d.

[59] See, for example, Aitken and Harrison 1999, and Borensztein, Gregório and Lee 1995, and Lall 1997, 1992a and 1992b.

[60] UNCTAD 2001.

arises mainly from four factors. First, there is significant controversy regarding the definition of what "sound" and "unsound" macroeconomic policies are. Second, there is considerable uncertainty regarding the forecast of what the impact of particular macroeconomic policy is likely to be on variables that affect investment decisions directly. This uncertainty results from the controversies about what makes sound macroeconomic policy, and also from the fact that the impact of a policy, no matter how sound it seems to be, depends not only on the policy itself but also on the socio-economic and political environment, nature of the problem that has to be addressed, combined effect with other policies and how the policy is implemented. Third, there is significant uncertainty regarding the accuracy and stability of macroeconomic indicators in LDCs because of data deficiencies and the vulnerability of these economies to shocks that they cannot control. Fourth, corporation put more weight on market and production conditions that affect their businesses directly – demand, technology, labour, competitive conditions, exchange rate, access to finance, institutions – than to aggregate, controversial macroeconomic data and assumptions.[61]

Finally, it has also been argued that countries spend excessive amounts of resources through incentive packages to attract foreign investment, which increases the social cost, and reduces the social net benefit, of FDI. Incentives are often redundant because they give away social resources to attract FDI that foreign firms may not need because they would have invested (or not invested) even in the absence (or presence) of such incentives for other reasons associated with their own strategies.[62]

This analysis applies especially well to Mozambique. One example illustrates it.

Mozal is a large aluminium smelter built in the late 1990s in the outskirts of Maputo city. It has the capacity to produce 256,000 tons per year, which is expected to increase, in the second stage, to 512,000 tons by 2003. The initial cost of the project was US$ 1.34 billion, which is projected to reach US$ 2.4 billion when the second stage is completed. Current shareholders are Billiton (47%), IDC (24%), Mitsubishi (25%) and the Mozambican government (4%). The shareholders in the second stage will be Billiton (85%) and IDC

[61] See Bird 1990, Fitzgerald 1997 and 1996, and Khan 2001 and 1995. For a contrary view, see Corden 1980.

[62] Incentive packages tend to be more costly socially the scarcer FDI is and the more dependent an economy is on FDI as an alternative source of foreign currency and credit. See Helleiner 1989, UNCTAD 1999a, 1999d and 1999e and Weiss 1980. Mike Müller, managing director of 2M, one the largest beer factories bought by SAB in Mozambique, argued that SAB's strategy of expanding direct investment in breweries all over the Southern African region is mainly associated with existing trade barriers. Protection of national breweries make exports to protected markets less profitable and domestic production very profitable.

(15%).[63] The finance for the project has the following structure: 43% comes from South Africa (IDC and South African financing system); 23% from the UK; 14% from other European countries (including the shares of the Mozambican government which were paid for by a loan from the European Investment Bank); 10% comes from Japan, 9% from IFC and 1% from Mozambique.[64] Production started in 2000, and its main market is the automobile industry in Asia. During construction, Mozal employed up to 9,000 occasional workers, and now employs 900 permanent workers for operation. Of these workers, 85% are Mozambicans.

Mozal has been attributed FIZ status. This means that it is exempted from paying duties on imports of material inputs, equipment, parts and any other imports that are required for the activity of the company. It is also exempted from paying value added tax and turnover taxes because its production is for export, and from paying corporate tax. The project can import and export capital freely after registering with the central bank.[65]

Mozal's impact on investment and trade balance is very large, on GDP is considerably less so and on employment is very small (table 5.5). This was to be expected because of the scale of the project relative to the small size of the Mozambican economy; the import dependence of production that minimises the contribution to GDP; and the capital intensity of a project designed to be successful against the toughest competitors in the world market.

With initial capital cost per direct job equivalent to 20 direct jobs elsewhere in the manufacturing sector, each worker in Mozal produces as much as 18 workers and exports as much as 159 workers from other manufacturing firms (table 5.6).[66] In absolute terms, Mozal is far more productive than any other firm in Mozambique, but relative to its initial capital costs its huge advantage is its export capability.

[63] Billiton, included in the FTSE 100 index, has recently become the largest aluminium producer in the world, controlling mining of alumina and smelters. Its business is focused on minerals and non-precious metals. Billiton acquired the South African minerals and metals corporation, Gencor, and is, thus, strongly associated with the minerals complex in South Africa. IDC (South African Industrial Development Corporation) is a para-statal investment agency. Mitsubishi is one of top world competitors in the automobile industry.

[64] Given the close relationships between the South African financial system and the minerals-energy complex of South Africa, the predominant role of South African financing in Mozal is another indicator of the link between Mozal and the minerals-energy complex (see Fine and Rustomjee 1996).

[65] See GOM 1999k for the Mozambican legislation on FIZ.

[66] It is argued that Mozal can generate as many as 2,500-3,000 indirect jobs through linkages. This estimate is not taken into consideration in the above analysis because it depends on linkages that have not yet materialised and also because each one of the predicted, indirect jobs requires more investment.

Table 5.5: Mozal's economic impact

	Investment	GDP	Trade Balance			Direct Employment	
			Exports	Imports	Net contribution	Number of workers	Investment per worker
Value (US$ million)	1,340	157	430	260	170	900	1.49
Mozal's share of total… (%)	82 (a) 46 (b) 30 (c)	4 (e)	61 (e)	19 (e)	19 (d)	2.25	--

Sources: Own estimates based on GOM 1999b, GOM/Statistics 2001 and 1995-1999, and Mozal 1999.

Notes: (a) share of total FDI in manufacturing; (b) share of total investment in manufacturing; (c) share of total investment in the economy (data based on investment projects approved between 1990-1999). (d) Measures by how much trade deficit before grants falls as a result of Mozal's net contribution (exports – imports) to the trade balance. (e) Mozal's share of total GDP, exports of goods and imports after Mozal's contribution has been added.

Table 5.6: Comparison between Mozal and the average manufacturing firm

	Initial capital cost per direct job	MVA per worker	Exports per worker
Mozal (US$ 1,000) (1)	1,490	175	478
Average firm (US$1,000) (2)	73	10	3
Ratio [(1)/(2)]	20	18	159

Sources: Own estimates based on GOM 1999b, GOM/Statistics 2001 and 1995-1999, and Mozal 1999.

According to state officials, the Mozambican government became closely involved with the project after investors demonstrated the potential benefits benefit from the expected demand related linkages that Mozal could generate, as well as from employment creation, and the opportunity to change the structure of the economy and improve the balance of trade.[67] The success of Mozal is expected to improve business confidence in the Mozambican economy and attract more FDI. The government also sees mega projects like Mozal as desirable because they accelerate the pace of industrialisation and the development of the domestic private sector.

From previous discussions and data, it is obvious that expected linkages are not happening at a significant rate, and that high tech mega projects are not the way to address unemployment.

[67] Interviews with Luís Sitoe, Manuel Mbeve and Sérgio Macamo (MIC), and António Macamo (CPI).

The slow development of domestic entrepreneurship is one of the reasons why linkages are difficult to come through. This suggests that mega projects are not perfect substitutes for strategies and policies that promote the development of domestic capabilities. Instead, these projects may be significantly more efficient if they are part of such strategies and policies.[68] Fiscal linkages have been prevented from happening because of the package of incentives that Mozal enjoys.[69] Mozambican officials claim that for public finances to benefit from Mozal the government needs to own shares in the project. However, the government has to pay back the foreign loan that was used to buy the shares, which attaches risks to public financial returns on a project like Mozal.

Amongst Mozambican officials, it is believed that survival pressures will force Mozambican firms to become efficient, and that these pressures are what Mozambican firms need to become efficient. "Intelligent partnerships", meaning joint ventures with foreign firms with expertise in the area, are seen as the only available way to promote domestic firms because no other forms of investment are available on a systematic basis and joint ventures are seen as the most adequate ways for transfer of technology, skills and experience. The experience, discussed elsewhere, shows that "intelligent partnerships" were used for less than 2% of Mozal's sub-contracts, and that little real technology transfer took place because the projects were almost always short-lived.

Mozal does not seem to be changing the structure of the economy. On the contrary, it is reinforcing the economy's dependence upon a smaller bundle of primary products, only this time it is the transformation of alumina and electricity into aluminium that dominates manufacturing output and exports of goods, rather than sugar, tea, cotton or cashew nuts. Similarly, whereas the project's net contribution to the balance of trade is significant, the export structure of the economy is becoming more concentrated and narrow, and therefore more vulnerable to volatile booms and slumps of primary commodity markets.[70]

Mozambican officials also argue that Mozal was established in Maputo because of Mozambique's comparative advantage in power supply (associated with the large Cahora Bassa dam on the Zambezi River, in Tete), cheap labour and the package of incentives. However, a closer examination shows that cheap labour (meaning low wage labour) was

[68] See, for example, Borensztein, Gregório and Lee 1995, Eayon and Kortum 1995, Hirschman 1981 and 1958, Lall 1997, 1992a and 1992b, Mello 1999 and Nelson and Pack 1999.

[69] See Helleiner 1989, Hirschman 1981 and Weiss 1980, for a more general discussion of this problem.

[70] See, for example, Edström and Singer 1992 for an analysis of the booms and slumps of primary commodity markets and their de-stabilising impact on the economy and business confidence.

relevant for Mozal only during the construction phase. The vast majority of Mozambican workers in the plant are either skilled or semi-skilled, and company is reported to be recruiting skilled workers from many other firms because they can pay higher wages.[71] Mozal is capital-intensive and the wage bill is a small proportion in company's cost structure.

Motraco, a joint venture of three electricity corporations, namely EDM (Mozambique), ESCOM (South Africa) and SEB (Swaziland), which supplies Mozal's energy requirements, is linked with the South African power grid. Therefore, while it is obvious that Mozal has strong links with the energy sector,[72] such links are with the South African energy sector, not the Mozambican. Thus, whether or not Mozambique has comparative advantages with respect to power supply, it is irrelevant for Mozal.[73]

Mozal's officials argue that the project was located in Mozambique for three main reasons: energy, incentives and Mozambique's fast economic growth in recent years.[74] Their analysis of energy and incentive issues differs from that of Mozambican officials.

The link with energy is through Escom's expansion strategy in the region. This corporation controls most of the energy generated in South Africa and also by Cahora Bassa, and is involved in new projects to expand energy production (Mepanda Uncua in Mozambique, and potential projects elsewhere in the Continent), as part of SDI promoted by the South African government and large corporations. Mozal was conceived as part of the energy strategy because of its energy intensity making it a determinant factor of the viability of investment in the energy sector, and also integrates Mozambique and its manufacturing sector into the

[71] Interview with Manuel Mbeve (MIC), and Ian Reid and Peter Cowie (Mozal). See also "Metical", various issues in January and February 2001. Ian Reid and Peter Cowie also argued that one of the major constraints faced by Mozal and any other future mega project in Mozambique is the acute shortage of skilled and experienced workers. Reid and Cowie also emphasised that the current labour law does not help industrialisation because the domestic supply of skilled workers is very limited and the new law makes recruitment of foreign workers very difficult. They suggest that the government should concentrate on training large numbers of professionals of required quality and improving the quality of the education system. They argue that Mozal is not only recruiting skilled workers but also providing training and scholarships to increase the supply of skills.

[72] Motraco, build primarily to supply energy to Mozal, is proof of this link. The fact that Mozal consumes twice as much energy as the remaining of Mozambique, and that Motraco can, in addition to Mozal, supply the entire manufacturing sector in the South, including two new potential mega projects in Gaza, heavy sands, and Maputo, iron and steel, is proof of the strong role of the South African energy sector in the Mozambican economy.

[73] Costs and unreliability of supply of electricity are the main infrastructure related problems faced by the manufacturing sector in Mozambique, as identified by Biggs, Nasir and Fisman 1999. Thus, even if Cahora Bassa is capable of producing large quantities of energy, the Mozambican economy is not capable of using it. Therefore, arguing that Mozambique has comparative advantages in power supply requires a strong qualification: in relation to whom? Definitely, is not against South Africa.

[74] Interviews with Ian Reid and Peter Cowie (Mozal).

South African energy grid. Thus, the motivation to establish Mozal in Mozambique, particularly in the South, can only be properly understood within this more general, strategic framework that combines the capabilities, interests and strategies of Escom, Billiton, the South African financial system and minerals-energy complex.

In addition to the package of incentives received from the government of Mozambique, Mozal enjoys incentives provided by the South African government, namely export related finance and lower energy fares for a number of years as part of export incentive policy.

There are other factors that should be taken into consideration in this analysis. First, Mozambican officials said that Mozal was developed not from government initiatives but fundamentally because of the insistence of the investors, even before the revised and more generous version of the FIZ legislation had been approved. Therefore, incentives at the level of FIZ status were not the fundamental issue in the decision to invest.[75] Second, when Mozal was still developing as an idea, Kaiser, a USA based multinational, was trying to convince the Mozambican government to build a large aluminium smelter in the outskirts of Maputo. Kaiser failed in large part because Mozal came along. According to Mozal's officials, Kaiser did not have the financial structure or the influence upon the world market to be able to succeed.[76] Mozal's aggressive business strategy seems to have been motivated also by the need to eliminate Kaiser as a competitor. Third, Mozal's officials also claim that no mega project can succeed in Southern Africa without going through the South African financial system and operating together with some large South African corporation.[77] The argument is that South Africa has the capability and the experience of the region, and also the integration strategy that links the economies of the region. For example, in Mozal (1999) it is argued:

> *Since the project will import a substantial proportion of its inputs from South Africa, it will stimulate regional trade between the two countries. This trade will also enhance the viability of the road and rail system that is being implemented as part of the Maputo corridor. (…) The new transmission line will contribute to regional integration and enhance the Southern Africa power pool. (…)* (pp. 61-2).

[75] Interviews with António Macamo, Luís Sitoe and Manuel Mbeve. This information is confirmed by Ian Reid and Peter Cowie (Mozal), who said that it was only after several visits by members and officials of the Mozambican government to Mozal's twin project in Richard's Bay, where they could see the linkage potential of a large aluminium smelter, that the Mozambican government finally decided to go ahead with Mozal.

[76] Interviews with Ian Reid and Peter Cowie.

[77] Ian Reid.

Fourth, Mozal creates important dynamic linkages with other South African firms that are the main suppliers of parts, equipment, services and assistance. Fifth, Mozal's location in Mozambique also opens the access to the Indian Ocean directly through the Port of Maputo, where investors initially wanted Mozal to be built.[78]

Sixth, large South African corporations, associated or not with the MEC, are globalizing instead of vertically and horizontally integrating within the South African economy. Apart from the market power they acquire by expanding worldwide, globalisation helps these corporations to become less sensitive to government policy and to increase the influence of their strategies upon public policy.[79]

Therefore, although the FIZ status helped Mozal to be established in Mozambique, it may have done so only in conjunction with the other factors. In other words, Mozal may have happened in Mozambique even if the incentive package made available by the Mozambican government was far less generous.

This analysis points to four fundamental issues. First, massive investment incentive packages increase the social costs of FDI, reduce its social benefit, and are often superfluous. Second, incentives should not be used without thorough consideration of the corporate strategies and motivations behind investment decisions because it may almost always be possible to minimise the social costs of incentives and increase the social benefits of the project. For example, Mozambique could have used the competition between Mozal and Kaiser to reduce the magnitude of tax exemptions awarded to Mozal.[80] Third, the analysis of investment projects should only incorporate externalities (indirect employment, linkages, etc.) if the costs and possibilities of making such externalities happen are thoroughly estimated and evaluated; otherwise, projects may be approved on the basis of benefits that will not occur. Fourth, no matter how much FDI flows into the Mozambican economy,[81] there is no substitute for

[78] Manuel Mbeve.

[79] See Fine 1997b, Fine and Rustomjee 1996 and Roberts 2000.

[80] See, for example, Chang 1998b for a more general discussion of the bargaining process between LDCs and multinational firms, and Blomström, Gregório and Lee 2000, and Weiss 1998 for a more general analysis of the relationships between the state and multinational firms.

[81] Large inflows of FDI, such as the case of Mozal, are likely to be highly concentrated in a few areas because of corporate strategies and Mozambique's limited capabilities. This does not offer very good prospects for vertical integration and diversification of the Mozambican economy. Furthermore, FDI inflows into the economy are unstable and the current boom seems to be running out of steam (UNCTAD 2000a and 20001). The current capabilities of the Mozambican economy – infrastructures, skills, entrepreneurial, institutional and financial – would easily be exhausted by a couple of projects of the scale of Mozal. Therefore, it should not be taken for granted that Mozambique will continue to receive massive inflows of FDI and that it has the capacity to absorb more mega projects.

strategies and policies that effectively create domestic, including entrepreneurial, capabilities. These strategies cannot be general and abstract, and should take into account the various forces that influence the development of the Mozambican economy, including the processes of restructuring and expansion of South African capitalism.

Finance

In the current economic context in Mozambique, financial reform is identified as a major contributor to a dynamic business environment. Financial liberalisation is expected to increase competition in the financial sector and therefore improve the efficiency, diversity and quality of services. Real interest rates that reflect the prevailing relative factor intensity and market conditions are expected to increase domestic savings and improve allocation of investment resources towards labour intensive projects with high rates of return. The launching of the Mozambican stock exchange (BVM), is expected to mobilise more investment resources by creating new opportunities for savers and by offering cheap access to finance, risk sharing and equity capital particularly to large firms.[82] In Biggs, Nasir and Fisman (1999) and GOM (1999i and 1997a), it is mentioned that the small and medium firms may benefit from the BVM by having access to cheap finance.

The discussion that follows is focused on three issues, namely a brief description of the process of financial reform, the general structure of the financial system after liberalisation and privatisation, as well as an assessment of how the financial system performs with respect to its role of raising resources and financing the economy.

After independence, the banking system in Mozambique was nationalised, with exception of BSTM, a private commercial bank that continued to operate. Two new banks were formed. The central bank, Banco de Moçambique, was created to perform three distinct activities – currency management, financing of centrally planned projects and of the foreign currency component of investment, and commercial operations. For most of the period until 1987, exchange and interest rates were fixed according to the objectives of the material plan, because the implementation of the large development projects then approved required imports and massive borrowing for investment. Interest and exchange rates played a marginal role in

[82] See GOM 2000a and 1999i, GOM, IMF and WB 1999, and KPMG 1999, on Mozambique. See Itoh and Lapavitsas 1999, and Aybar and Lapavitsas 2001 for a theoretical discussion. Harris 1988 discusses similar topics with respect to the interpretation of South Korea, and Fine 1997b analyses the case of South Africa financial system in the context of industrial dynamics and policies.

economic decisions because the scarce investment and foreign currency resources were directly allocated to planned projects and firms that qualified under the central investment plan. The bank was an instrument of the plan and almost an extension of public finance in that firms that qualified under the central plan were allocated financial resources in proportion to their needs and losses.[83]

The other bank, BPD, was created to finance the domestic currency component of planned projects, and to support small and medium projects, cooperatives and rural areas. BPD developed branches and counters in each district of the country partly to encourage local savings and attract them to the official banking system, and also to provide credit and management assistance to local economic projects.

Neo-liberal financial reform started in 1986-87, and followed five fundamental stages: (i) gradual liberalisation of interest rates following the introduction of PRE in 1987; (ii) the separation of the commercial activities from the central bank, formation of a new, state-owned commercial bank (BCM), and concentration of BM's activities on monetary management and banking supervision; (iii) the opening of the financial system to private banking, so that new mostly foreign owned banks were allowed to operate in Mozambique; (iv) privatisation of the state-owned commercial banks, BPD and BCM; and (v) the creation of the stock exchange. BPD and BCM were privatised by five years later had run into severe financial losses, partly associated with corruption linked with top official nomenclatura, to the point of becoming a source of economic instability. The main private shareholders of BPD, a Malaysian bank, returned its shares to the government, which has had to start a new process of privatisation of the bank. BCM was acquired by BIM. It is interesting to mention that both banks were privatised very quickly under World Bank[84] pressures because of fears that by remaining under public ownership they would be used to finance the emergence of a corrupt business class based on the official nomenclatura.

Currently, there are 11 banks and credit institutions in operation in Mozambique, the majority of which are totally or partially owned by Portuguese banks. As a result of the financial collapse of the two privatised commercial banks, BPD and BCM,[85] BIM (the second largest commercial bank in terms of share of operations) and BCM (the first) were allowed to merge.

[83] For an analysis of the financial system in this period, see Wuyts 1989. Castel-Branco 1994b and Weiss 1992 discuss briefly the financing of firms and projects under the central plan.

[84] World Bank 1995c.

[85] See GOM, IMF and World Bank 1999, IMF 2000 and 1998, World Bank 1999, and "Metical" various issues in the first semester of 2001.

The majority shareholder of the new bank is BCP, a large Portuguese bank. After the merger, the structure of the banking system became as shown in table 5.7:

Table 5.7: Main banks' share of banking operations in Mozambique (%)

	Deposit Operations	Credit Operations
BIM+BCM	55	62
Austral (ex-BPD)	17	15
BSTM	17	11
Sub-Total	89	88
Others	11	12
Total	100	100

Sources: BM (various yearly reports) and KPMG 1999.

The total number of bank counters fell by almost 20% between 1997 and 1999, mainly because of the reduction of the number of counters of Banco Austral (ex-BPD) by 33%.[86] Banco Austral argues that this reduction is caused by the need to rationalise the operation of the bank because of competitive pressures to cut costs and of low savings and credit operations in most rural areas. Therefore, closure of counters occurred mostly in the rural areas. The distribution of counters is concentrated by bank (BIM+BCM, Austral and BSTM owning 93% of all counters)[87] and by region (table 5.8).

The financial system is concentrated in two ways: it is dominated by one bank and the regional distribution of financial activity is skewed towards Maputo. This evidence suggests that privatisation and liberalisation did not result in more competition and in financial deepening in the whole country, although financial services have diversified and improved in Maputo. The closure of more than 70 counters in rural districts does not give much hope either to agricultural activities or to local micro and small manufacturing projects.

Biggs, Nasir and Fisman (1999) show that access to finance is the number one problem identified by manufacturing firms. Two thirds of the surveyed firms do not have a bank loan. Although the share of larger firms with bank credits is higher (50%) than the sample average

[86] KPMG 1999.

[87] KPMG 1999.

(35%), this is still very low (table 5.9).[88] Of the firms that have no bank loans, 88% (57% of the total sample) never applied for a bank loan. Of the firms that never applied for loans, 75% (43% of the total sample) consider that interest rates are excessively high (tables 5.10 and 5.11) and 11% (6% of the total sample) blame lack of collateral. Of the entire sample, only 8% of the firms claim that they do not need credit, and only 6% have an alternative to bank loans in the form of parent firm financing (table 5.10).

Table 5.8: Regional distribution of bank counters and exchange shops in Mozambique (1999)

	Bank Counters		Exchange Shops	
	Number	Percentage	Number	Percentage
Maputo	103	41	29	81
Gaza	21	8	1	3
Inhambane	12	5	--	--
Manica	14	6	1	3
Sofala	26	10	3	8
Tete	13	5	--	--
Zambézia	14	6	--	--
Nampula	24	10	1	3
Cabo Delgado	14	6	1	3
Niassa	9	4	--	--
Total	250	100 (a)	36	100 (a)

Source: BM (various annual reports) and KPMG 1999.

Note: (a) Actual sum is 101 due to rounding.

Table 5.9: Firms with bank loans (% of total firms in the group)

Full sample	Firms with…		
	5-50 workers	51-100 workers	> 100 workers
35	21	38	50

Source: Biggs, Nasir and Fisman 1999

[88] Larger, foreign owned firms receive most of their finance from abroad through borrowing, parent firm support or multilateral involvement with large projects.

Table 5.10: Firms without bank loans (% of total firms in the sample)

Without bank loans	Reason for no loan		Why did not apply for bank loans?		
	Applied but rejected	Never applied	Do not need	Expect rejection for lack of collateral	High interest rates
65	8	57	8 (a)	6	43

Source: Biggs, Nasir and Fisman 1999.

Note: (a) 75% of the firms that do not need credit receive finance from parent firm; the remaining 25% claim that they operate at extremely low levels of capacity utilisation, which does not justify applying for credit.

Table 5.11: Average interest rates and spreads (%)

	1997	1998	1999
Real deposit rates (1)	9	8	8
Real lending rates (2)	33	26	27
Spread (3) = [(2) – (1)]	24	18	19
Margin {[(3) – (1)]/(1)}	170	125	138
Inflation	6	1	2

Source: BM 2001 and KPMG 1999.

According to World Bank (1999), to be profitable banks need spreads of around 9%. KPMG (1999) shows that spreads in 1999 averaged 19%, down from 24% in 1997 (table 5.11).

KPMG's business confidence index shows that the performance of the banking system is the single most important determinant of the increasing business confidence, despite the facts that two thirds of the manufacturing firms have no access to credit and access to finance is the number one problem identified by manufacturing firms.[89] In spite of this, GOM/Statistics (1999) shows that industry is the single largest recipient of credit to the economy (26%).[90] Hence, it can be concluded that the domestic banking sector plays a marginal role in the finance of the economy. The evidence also suggests that the performance of the financial system, which has been praised, has not been successful with respect to the mobilisation and deployment of financial resources in guaranteeing productive investment.

[89] Biggs, Nasir and Fisman 1999 and KPMG 1999.

[90] This assessment should be qualified carefully. First, mineral resources and fishing are also included in the category "industry". Second, domestic trade, domestic consumption and housing between them receive 47% of domestic credit. Third, export related credit is almost zero. Fourth, lending by domestic banks represents a small proportion of total investment in the economy.

By 1998, the total sum of deposits in the domestic banking system was US$ 707 million, of which only 16% were savings deposits.[91] This sum is half of the initial capital costs of Mozal, and the savings deposits are equivalent to capital investment in the rehabilitation of two sugar estates. Given the high reserve ratios established by the central bank, domestic banks can raise autonomously approximately 16% of the credit demands of the economy. The remaining 84% come from foreign borrowing, FDI, grants and special credit lines established by multilateral and bilateral financial and development agencies. A very large share of commercial banks' credit operations consists on being the agency through which multilateral especial funds and credit lines are channelled.[92]

Informal trade credit has been used in manufacturing: 50% of the firms have extended, and 69% have received trade credit. However, trade credit accounts for a small share of credit to manufacturing and business transactions. Only large firms with market power, or firms with long-term business or personal relations, extend trade credit. Market power and long-term relations act as a substitute for information.[93]

Biggs, Nasir and Fisman (1999) argue that the inability of the financial system, formal and informal, to provide finance for development is caused by information failure. High interest rates, preference for short-term loans and heavy collateral requirements[94] are used by the financial system to price risk and substitute for information. Only a few firms, usually large and foreign owned, have access to credit on the basis of past performance.[95]

The study identifies four main causes of information failure. First, the real side of the economy is not ready to receive credit because firms are untested, owners of privatised firms are inexperienced, management is deficient and most firms do not have adequate business plans and strategies. Second, the accounting systems are weak and unreliable, so that accounting and financial information about firms is either non-existent or very deficient. Third, the banks do not have yet a system of sharing information about credit-borrowers. Fourth, the costs of enforcing contracts are high because the systems are not in place and the

[91] BM 2001 and KPMG 1999.

[92] Interview with Manuel Figueira, Vice-President of BCI.

[93] Biggs, Nasir and Fisman 1999.

[94] All credit, even short-term loans, must be fully backed by collateral.

[95] For a critique of the information failure approach to the analysis of the financial system see Itoh and Lapavitsas 1999, and Aybar and Lapavitsas 2001. For the alternative view, which analysis the structure of the financial system in relation to information failure, see Sing 1992 and Stiglitz and Weiss 1981.

legal system is very deficient. Information failure, thus, arises from lack or unreliability of data and inadequate enforcing institutions.

The information failure based explanation is excessively simplistic and narrow. This does not mean that information is not an important issue, but that the study ignores several more fundamental aspects related with the structure and dynamics of the financial system and the way in which it interacts with manufacturing and the economy as a whole.[96]

First, macroeconomic policies and targets shape the functions and possibilities of the financial system. A senior official of the central bank, who said that there is legal incompatibility between being a guarantor of monetary and economic stability and pursuing development objectives, confirmed this point.[97] For example, the imposition of tight constraints on domestic credit is a central economic policy instrument and objective within the framework of orthodox stabilisation policies. Therefore, credit constraints for productive investment do not result from market and information failures but are a fundamental component of current economic policy objectives. Under tight credit constraints, banks may be keeping high spreads in order to maximise their profitability and increase autonomous financial resources that may then be used in projects that are safer than manufacturing and yield higher returns.

Second, the study fails to address power and interests within the financial system, how these may shape the way finance is raised and deployed, may determine the financial markets, institutions and firms that are developed, and how finance interacts with the rest of the economy. The information failure analysis is based on the assumption that between lender and borrower information is asymmetric, and the borrower has more information and power over the relationships with the lender once a transaction occurs. Therefore, not lending is the lender's insurance. These assumptions abstract from the fact that the Mozambican financial system is highly concentrated and further rationalisation and concentration may yet take place, as at the moment banks are trying to hold to their position in the market, or expanded if possible, which may have already created overcapacity at least in Maputo. They also ignore the fact that the development of the financial system is dynamically linked, in a symbiotic way, with what happens elsewhere in the real economy.[98]

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[96] See Fine 1997b for a similar analysis with respect to financing of South African industrialisation.

[97] Interview with António Pinto de Abreu, member of the board of Banco de Moçambique.

[98] The expansion of Portuguese banking, for example, is associated with the strategy of internationalisation of Portuguese firms (interview with Manuel Figueira, Vice-President of BCI, whose majority partner is Caixa Geral de Depósitos, a large Portuguese financial institution).

Larger banks may be more interested in expanding market power and establishing stronger links with sectors of the economy and industry that may offer more profitable long-term prospects. This may explain why BIM (Portuguese) bought BCM and ABSA (South African) is going to buy Banco Austral, despite the fact that BCM and Austral have been running huge deficits for more than 3 years, and have been affected by huge corruption and criminal problems. It may also explain why credit is skewed towards larger, foreign owned firms, and why manufacturing projects where FDI is concentrated also absorb 72% of DDI and almost two thirds of bank loans. The ability of the banking system to keep high spreads also results from oligopolistic market power in the sector, not only from an opportunity created by macroeconomic policies. These strategies and actions do not result from information failure but from the internal interests and dynamics of the financial system and its interaction with the whole economy.

Third, there is a problem of strategic decision with respect to finance: there are no obvious sets of priorities, direction of investment and complementary measures to make investments viable. As discussed before, the industrial policy package is limited to setting rules and lists of intention. Industrial investors and banks alike are unwilling to take the risks that are associated with the absence of explicit policies and mechanisms of implementation.

Banking officials have argued that development credit for the manufacturing sector depends not only on the availability of funds, but most importantly it depends upon the existence of industrial strategies that enhance the viability of the projects, enable timely corrections and adjustments when necessary, take into consideration the real conditions of the market and adopt a long-term vision.[99] Selection of priority targets for finance can and has been determined differently from what is viable and important exclusively from the bank's profitability point of view, but it has to be done elsewhere through industrial strategy, not by banks.[100] In the sugar industry, for example, multilateral and commercial credit was made available on the conditions that investment priorities were defined and a pricing policy established. Investors' pressure forced the IMF to withdraw its demand for the liberalisation of the industry.

The simple rehabilitation of old, outdated and worn out equipment and technology does not attract financial resources from commercial banks because Mozambican firms, given the age and poor state of their capital stock, need innovative investment and modernisation to be

[99] See GOM 2000e.

[100] Interview with Manuel Figueira, Vice-President of BCI.

acquire competitive capabilities. Otherwise, investment may be wasted and industrial firms and banks will loose.[101] Innovation and modernisation are determined by firms' capabilities, strategies and access to finance, and these three factors are strongly associated with market power or clear industrial strategies. This may partly explain why investment in new equipment and technologies is significantly more frequent in large and foreign owned firms than in privatised and small and medium domestic firms.[102]

Fourth, the Mozambican banking system is clearly unable to finance the whole economy, even in the absence of information failure and policy constraints, because the Mozambican economy is highly dependent upon external aid. Autonomous finance covers less than 16% of investment needs,[103] and a significant share of credit operations involves domestic banks as agents through which especial multilateral and bilateral funds are channelled. Budget and import support grants are not directed at sectoral strategies and priorities, partly because donors and multilateral agencies have a record of not supporting state promoted industrialisation.[104] Special funds and credit lines are too small. For example, only 20% of the funds made available for the World Bank private sector support program (PoDE), US$ 10 million spread over six years, are used for partial financing of short-term trade related credit to firms with good performance records.[105] FDI is the only large source of finance for manufacturing, and FDI financed projects have also attracted the largest share of DDI and loans invested in the manufacturing sector.

The stock market has been identified as a viable alternative to the banking system. This approach is based on the notion that the financial system operates efficiently if the right set of institutions and rules are introduced.[106] According to KPMG (1999), the stock market has several advantages over the banking system: creates new opportunities for savers, guarantees cheap access to finance, ensures that risks are shared between shareholders and provides much needed equity capital. Another economic advantage is that the risk of takeover provides incentives for firms to be profitable. The first assets to be traded in the stock exchange are treasury and banking sector bonds and shares of the largest 12 companies.

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[101] See GOM 2000e.

[102] See Biggs, Nasir and Fisman 1999.

[103] Banco de Moçambique 2001, Biggs, Nasir and Fisman 1999, and KPMG 1999.

[104] See Haarlov 1997.

[105] World Bank 1999.

[106] For a summary of the theoretical debates about the relative merit and demerit of the stock exchange, see Itoh and Lapavitsas 1999, Aybar and Lapavitsas 2001 and Singh 1992. See also Fine 1997b for an analysis relative to South Africa.

There are some general and specific theoretical and practical problems with this analysis of the role of the stock market in Mozambique. Singh (1992) argues that stock markets increase the volatility and instability of LDCs' economies and exacerbate their vulnerability to external shocks that may easily be reflected in fast inflows and outflows of speculative capital through share trading. Aybar and Lapavitsas (2001) and Itoh and Lapavitsas (1999) argue that corporate takeover is mainly associated with corporate strategy. This has little to do with the profitability of the shares, but it is strongly correlated with the size of the company, its market share, technology made available, brand name, and network of suppliers and customers.[107]

In more specific terms, there are several problems with the expectations about the stock market in Mozambique. First, BVM does not necessarily change the internal dynamics of the financial system, which is shaped by macroeconomic policies and targets, interest of the financial institutions, their relationships with the economy, absence of investment strategies and the heavy dependence of the economy relative to external finance.

Second, one of the causes of this dependency is the low level of productivity, income and savings by domestic firms and households. Thus, they are less likely to provide the savings for stock market transactions. Third, large traders, exchange shop owners and speculators control a significant share of the circuit of money and liquidity, but they are more likely to invest in bonds, which yield real rates of return more than three times higher than deposit real rates of interest.[108] Therefore, whereas BVM may attract speculative money, it may only do so for assets traded well above what returns on manufacturing projects can achieve. Fourth, given the structure and dynamics of the financial system, proceeds from banking sector and treasury bonds are unlikely to be used to finance small and medium manufacturing firms. Fifth, only the 12 largest companies are registered in the stock market; therefore, if anything, stock market transactions may divert financial resources away from other manufacturing firms and may concentrate such resources in corporations that already have market power and access to other sources of finance.

This analysis suggests that solving information failure – which clearly should be done – or building new financial institutions do not address the fundamental problems discussed because they are not caused by information failure or lack of institutions. The challenge ahead

[107] This is consistent with, for example, the privatisation of the larger state-owned commercial banks.

[108] Banking sector and treasury bonds have been sold with real rates of return between 22% and 29% (see Banco de Moçambique 2001).

is how to mobilise the financial system to support selective strategies that are credible,[109] and that promote diversification of the economic fabric and exports. Large projects are financed from abroad: multilateral agencies, commercial borrowing and parent firm finance. These are the cases of sugar, beer, soft drinks, cement, Mozal and other mega projects.

The problem seems to be with the financing of a diversified network of smaller firms and activities that strengthen economic linkages. These are the majority of the firms and any strategy of industrialisation must decide what to do with them, how to restructure them and upgrade and use their capacities. They are important to build the industrial fabric that links the different aspects of the economy, including the different mega projects, and to generate employment and industrial experience. One way of mobilising finance for these firms – amongst many other possibilities that should be investigated – is to identify and select firms and industries that are linked with the dynamic areas of the economy, and concentrate support to build their competitive capacities, namely: finance, technological innovation and training capabilities, standardisation of quality and certification, management assistance and innovation, etc.[110] These firms may be linked with viable mega projects, programs of industrial and sectoral restructuring and rehabilitation, and significant export markets. This requires strategic intervention by the state, negotiations between the state, banks and industrial firms, better coordination between state departments, the definition of performance targets for supported firms, introduction of incentive mechanisms to encourage banks to participate collectively, and rationing of financial resources for non-priority firms and industries. At the moment, two thirds of the firms do not have access to finance; this "market-driven" rationing does not serve strategic economic objectives and has consolidated market and economic power.

4.3 Conclusions

This chapter has shown that industrial policies and strategies in Mozambique are marginal with respect to core economic policies. This results from a combination of factors: the focus of core policies on economic stabilisation and liberalisation; the constraints imposed by such focus on the content of industrial policy and strategy particularly because core targets are

[109] Harris 1997 discusses, with relation to South Africa, the role of credible growth and investment strategies in mobilisation of finance.

[110] Making finance available is far from sufficient. A strategy is required to identify priorities, enhance the viability of the projects, define the actions and targets to be achieved, and establish mechanisms to mobilise participation, enforce implementation and guarantee monitoring and learning.

exogenously determined with respect to manufacturing, the belief that economic incentives are proportionally and directly correlated with stabilisation and liberalisation and the reactive and fragmented role of the state which creates policy inconsistencies. It has also shown that existing industrial policies and strategies are simple information devices about the intentions of the government, and are out of line with the real dynamics that influence and shape the development of the whole economy and the manufacturing sector. Finally, the chapter argued that the marginalization of industrial policy has underdeveloped the institutional capacity to formulate, pursue, implement, monitor and learn from industrial policy.

The chapter analysed five selected issues in industrial policy, namely linkages, private sector development, the role of market structure in policy-making, corporate strategy and finance. The analysis of these issues identified dynamics forces at work that result from the interplay between agents and linkages, and how they affect the pace, pattern and direction of economic and industrial development and allocation of resources.

Although these five issues were analysed individually, they are closely inter-related. In particular, the chapter argues that the dynamics and structure of markets and industries and the strategies, interests and actions of the different agents are part of the dynamic forces to take into consideration in the development and implementation of active and relevant industrial policies and strategies. They also influence the range of opportunities, the direction and patterns for linkages, private sector development and mobilisation of finance for productive investment.

The symbiotic relationship between linkages, private sector development, mobilisation of finance and industrial strategy calls attention to the fact that industrial strategies and policies may only make sense if they are integrated in the wider context of socio-economic development as a whole. Manufacturing development is not a sectoral matter, but reflects the process and dynamics of the industrialisation of the whole economy and society.