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Business in Africa Research Project

‘Every Continent Needs an America’

The Experience of South African Firms Doing Business in Mozambique

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About the Author

Neuma Grobbelaar is the deputy director of studies at the South African Institute of International Affairs and heads the SAIIA Business in Africa Research project. She would like to express her sincere appreciation to Laroushka Reddy, a SAIIA–Konrad Adenauer Foundation intern, for the research assistance provided during the completion of this report.

Methodology and Rationale

This report is based on a series of interviews that were conducted in Mozambique in November 2003 with resident South African companies to research their experience of the Mozambican business environment. SAIIA surveyed just under twenty South African firms currently operating in Mozambique. The focus group denoted a representative segment of South African corporate and parastatal involvement in Mozambique and covered all sectors such as construction, retail, services, franchising, agriculture and industry. The one-on-one interviews were supplemented with follow-up interviews with some of the Head Offices of those companies in South Africa. In addition, interviews were conducted with a range of government representatives and departments that are directly involved in this field.

The key data was provided by the CPI and proved invaluable in the conduct of this research. The Mozambican environment is characterised by a paucity and fragmentation of data that makes it extremely difficult to draw conclusions and comparisons over time. The data provided by the CPI assisted to overcome these problems. The study was also informed by research conducted by the BusinessMap Foundation, the Organisation for Economic Co-operation and Development (OECD), the UN Economic Commission of Africa (UNECA), the World Bank and the IMF.

The purpose of the study was to identify some of the pitfalls associated with doing business in a country such as Mozambique, while also giving credit to some of the success stories.

This case study on Mozambique is the first of a series of country and sectoral studies that will be conducted over the next two-and-a-half years, with a view to extrapolating specific policy recommendations for African governments on how to create a more supportive business environment in Africa. The New Partnership for Africa's Development (Nepad) initiative emphasises the critical importance of the private sector in mobilising resources for the continent's development. South Africa's expanding track record as a significant investor and, moreover, a fellow African investor is an important indicator of business confidence in the future of the continent, and is paving the way for the private sector to play a stronger role in Africa's development.

Although it is generally presumed that South African investors are less averse than others to taking risks in view of their knowledge of, and proximity to, the African market in terms of appropriate technology and well-suited products, this study aims to verify whether this is indeed the case. Moreover, this report identifies critical areas requiring reforms that are essential to ensuring a more active role for Africa's private sector in the development of the continent.

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Executive Summary

Over the last 10 years, Mozambique, sometimes touted as South Africa's tenth province, has emerged as one of the most significant South African investment destinations on the African continent. South Africa is a leading investor in that country representing 49% of total foreign direct investment (FDI) from 1997–2002. South African companies have capitalised on Mozambique's geographical proximity to expand their reach into the continent.

Yet the sizeable number of South African businesses in Mozambique does not imply that the country offers a trouble-free, uncomplicated business environment. The unexpected withdrawal in 2001 of Rand Air, an air compressor and generator hire company on the grounds of the level of corruption and red tape in Mozambique, is an indicator of some of the difficulties facing South African investors.[1] Mondi Forests, part of the Anglo American group, abandoned a projected $80 million eucalyptus plantation in the Sofala Province in 1998. There are several other examples of disinvestment or retractions of interest by companies who lost their initial enthusiasm to invest once they were confronted by some of the problems on the ground. Most South African companies in Mozambique have encountered some of the

Although there are many South African firms in Mozambique, the country is not a trouble-free, uncomplicated environment.

[1] Development Bank of Southern Africa, *Financing Africa's Development: Enhancing the Role of Private Finance*, Development Report 2003, Development Bank of Southern Africa, 2003, p.119.

risks and challenges traditionally associated with doing business on the African continent.

Some of the main findings are:

- South African investors cover *a* ***broad and diverse spectrum of business activity*** (parastatals and private sector companies), and include small, medium and large enterprises. However, in terms of net value of investment, the ***mining-industrial complex dominates***. Investment in the ***sensitive agricultural sector has been relatively small, but has led to significant job creation***.
- That South Africa and Mozambique are neighbours has been a critical consideration in the decision of many South African businesses to expand into that market. ***South Africa is an anchor economy***, both for South African businesses and international subsidiaries based in South Africa who are venturing north.
- The successful implementation of mega-projects such as the Mozal aluminium smelter and the Sasol pipeline has had a huge impact on the South African, other foreign and domestic business confidence in Mozambique. Both projects have been used ***to showcase the ability of Mozambicans to absorb and respond to the demands and requirements of large investors***.
- Government co-operation and support (from both the Mozambican and South African sides) of big investors through ***public-private partnerships (PPPs) have been particularly critical to the success of these projects***.
- The introduction of South African products to the market, combined with the development and expansion of the local distribution network, has led to a ***more consistent supply of***

goods and greater price stability. It has also created higher consumer awareness in Mozambique.

- *South African companies* ***engage in various peer-learning and coping strategies to overcome logistical bottlenecks*** imposed by the constraints of the Mozambican economy. As an example of the former, Sasol tailored its engagement model with the Mozambican government on that of Mozal and its community engagement model on that of Shell. The latter was seen in moves such as opting to transport goods by sea rather than over land to bring business costs down and investing in sewerage farms, generators and water boreholes.
- ***The experience of smaller versus larger investors diverges***. The latter are generally insulated from the constraints that the domestic economy imposes, because they benefit from fiscal incentives and exemption from red tape. In contrast, small South African businesses face many of the same difficulties that local business experiences, and are more exposed to petty corruption and harassment by officials.
- The impact of South African investment on economic policy, industrialisation, transfer of technology and the regulatory framework ***has generally been benevolent and positive***. In many instances it has set new standards in labour and business best practice.
- ***Linkages with domestic business are sector-dependent, but generally limited***. South African FDI is primarily capital intensive and highly knowledge-based, making it difficult for local business to link into the opportunities created. However, some mega-projects have made a special effort to transfer skills to local businesses to enable them to work as sub-contractors.

- ***South African FDI has not caused, but has contributed to, the distortion of the Mozambican economy***. These distortions reach across wage and income levels, and manifest both in a geographic divide between the more affluent south versus the poor centre and north, and between rural and urban areas.
- The weakness of the Mozambican regulatory environment (especially the justice system), ineffective bureaucracy, corruption and the cost of doing business were identified as key impediments to business growth, development and confidence. ***The gradual investment saturation of the urban areas implies that the deficiencies in the regulatory environment will grow*** in importance as businesses begin to venture north and extend into the rural areas. Improvement in the granting of land tenure rights and the development of basic infrastructure will be critical to make such an expansion feasible.
- South African business dominates the small private sector of Mozambique, as do other foreign investors. ***Careful management of local sensitivities and strict adherence to good corporate governance practice are*** required to ensure the continued positive reception of South African investors in Mozambique.
- Almost all the South African investors interviewed indicated that they would ***maintain or expand their operations in Mozambique in the near future***. They also have a fairly optimistic view of the economic future of Mozambique.

Introduction

Every continent needs an America…' This is how one South African investor responded when questioned about the importance of South African investment in a country like Mozambique. This comment immediately conjures up the image of the bully on the block, but the intention is subtler. It is widely accepted that the economic growth of Western Europe after World War II and the Asian economic miracle are a direct result of American investment and aid in those regions, and the opening of its market to their exports.

Mozambique is a poor country in a poverty-stricken region. Its geographical proximity to South Africa and its long-standing linkages with the South African economy since the turn of the 20th century place it in a uniquely advantageous, but also difficult, position. On the one hand it benefits from the northward march of South African multinationals on the continent and the positive benefits that this brings, such as the transfer of technology, reform of the economy and job creation. On the other hand, local businesses are left behind and overtaken by the new competition in the domestic market.

But generally, for a country such as Mozambique, with its huge developmental backlog, its substantial dependence on international donor assistance, almost non-existent domestic savings and very low revenue stream, South African investment has been a boon. Yet it is clear that more needs to be done to ensure a virtuous foreign direct investment (FDI) cycle. Lasting, sustainable benefits will follow only if the government creates an environment that also supports domestic investment and business. There should be no distinction made between how foreign and domestic investors are treated.

However, the legacy of Mozambique's 16-year experiment with socialism and its devastating civil war still resonates in its society today, and has directly contributed to the weakness and small size of its private sector and the logistical and regulatory barriers that persists in its economy. The Mozambican government realises that to attract the big investors it has no choice but to offer a range of incentives. The advantage of the entry of 'big' business in a small economy like Mozambique's is that it has the capacity and means to overcome many of the structural barriers that face smaller domestic players. 'Big' business also can bring about positive changes in the regulatory framework because of its impact on the 'bottom line' (be it exports, economic or revenue growth), in a way that could eventually ease entry and access for smaller enterprises (both local and foreign).

The advantage of 'big' business in Mozambique is that it can overcome many of the structural barriers that face smaller domestic players.

Ironically, several studies have shown that the greatest benefit to a local economy in terms of positive linkages with the local business sector is derived from the entry of smaller investors and small and medium-sized entrepreneurs from other countries. Asian and European growth is sustained by the abundance and robustness of small and medium-sized investors and enterprises, especially Germany. As a considerable number of the South African investments into Mozambique fall into this category, the Mozambican government should capitalise on this phenomenon to promote its own growth.

South African Companies and FDI in Africa

The standard response from South African business people, asked about why they do so well in Africa, is often 'because we know Africa so well'. Although there is some truth in this assessment, the key feature distinguishing South Africa from other foreign investors in their assessment of risk relates to the issue of expectation. South African investors expect to be faced with logistical and bureaucratic hurdles when contemplating investment on the continent, even though most agree that they evaluate risk in exactly the same way as their foreign competitors do. There is no magic bullet to overcome the many barriers and pitfalls that accompany investment in Africa. However, South African investors who are often relative newcomers to other countries on the continent have shown remarkable skill at developing coping strategies. They have also found, like foreign investors in Africa, that although the risks are great, the returns are high.[2]

South African investment into Africa generally is motivated by a variety of aims. Andrea Goldstein of the OECD Development Centre describes the investment behaviour of emerging South African companies as typical of developing country multinationals. Faced with growing competition in their own market as South Africa opened itself to international markets, companies found that profit margins began dropping

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2 The average return on investment in Africa is four times as high as in G-7 countries, and twice as high as in Asia according to UNECA. The author would like to thank Ronelle Burger of Stellenbosch University for a useful discussion on South African investment in Africa on 8 March 2004. Also see Grobbelaar N, '*Business in Africa: Can the South African Business Experience in Africa Offer a Way Forward?*' African Union Directory, African Union Publications, 2004, pp.12–13.

significantly. Their investment drive into neighbouring states has been motivated by the belief that they will face less competition from local firms there, and that they can use their superior business practices to position themselves advantageously even in relation to international subsidiaries. Knowledge of the market and geographical proximity (as in the case of Mozambique) also reduce transaction costs for smaller companies considerably, and present a 'natural' space in which to globalise and gain international experience.[3] In this regard the South African economy also plays an important anchoring role as a reliable source of inputs.

The BusinessMap Foundation identifies four principal 'textbook' motivations underlying FDI. They are:

- ***Market-driven or market-seeking FDI**:* The investor seeks to penetrate a specific market and investment decisions are driven by its size; the gross domestic product (GDP) of the country; the per capita income of the population; its real and potential growth; linkages and access to other markets and its economic structure. This has been typical of the investments of Vodacom and Shoprite Checkers into Mozambique.
- ***Resource-seeking or factor-driven FDI**:* The investor is motivated by an abundance of specific natural resources, such as raw materials and minerals; the availability of low-cost, unskilled labour or skilled labour; and physical infrastructure. The size of the Mozambican natural gas deposits combined with the need of South African industry to

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[3] Goldstein A, '*Regional Integration, FDI and Competitiveness: The Case of SADC*', OECD African Investment Roundtable, 19 November 2003, pp.21–23. and Castel-Branco CN, *Economic Linkages between South Africa and Mozambique*, DFID Study, August 2002, p.5.

find a more environmentally-friendly and less expensive energy source have provided the impetus for a company like Sasol to invest in the development of the Pande and Temane gas fields.

- ***Efficiency-seeking FDI:*** The investor seeks to take advantage of the cost-effectiveness of input costs and resources, the productivity of the workforce and the integration of the market into regional frameworks. The establishment of Mozal in an industrial free zone (IFZ), with the accompanying range of export processing incentives, has made it one of the top three most cost-effective and productive smelters in the world.
- ***Strategic asset and capability-seeking investment***: The company enters into a market to protect or further its competitive advantage within the global context. Sasol, Eskom, SAB-Miller, Transnet and BHP-Billiton's investment into Mozambique could be described as products of this thinking.[4]

However, it is difficult to ascribe investment decisions by South African companies to only one overriding purpose. Most of the bigger South African investors show a mix of the above-mentioned reasons for investing in Mozambique.

There is also another dimension to South African investment into Africa which pertains to 'politically motivated' investments, using state-owned enterprises (SOEs) or parastatals as the key instruments. Investments by companies such as Eskom Enterprises are perceived to be largely politically-driven, and are instrumental to the South African government's Nepad

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[4] Investment 2002: Challenges and Opportunities, BusinessMap Foundation, January 2003, p.12.

initiative. The private sector is expected to play a significant role in the implementation of Nepad, and South African parastatals are perceived to be more open to persuasion to enter some of the difficult markets in Africa. This approach seems fraught with pitfalls, especially where governments appear to lack respect for 'bottom line' considerations which are critical to the viability of business. For example, the Economist Intelligence Unit (EIU) describes the delay of over three years in the signing and implementation of the Motraco project caused by the Mozambican government's attempts, through *Companhia de Portos e Caminhos de Ferro de Moçambique* (CFM), to impose unrealistic financial terms.[5]

However, several of the successful large South African investments in Mozambique could be described as having been politically driven, or at least politically sanctioned. The Maputo Development Corridor is a case in point. It is to the credit of both the South African and Mozambican governments that they supported the creation of an environment that provided the impetus for the growth of trade and investment between the two countries. The success of this combined effort to boost economic interaction is illustrated by the myriad bilateral agreements that have been signed since 1992 by the two governments. (See Table 1 on opposite page).

However, at the most fundamental level the decision to invest in countries like Mozambique has also been prompted by the return of political stability and peace to that country, the liberalisation of its market and the introduction of market-based policies. Of all countries in SADC Mozambique has shown the most significant progress in this direction, after the low point represented by its 16-year war, which officially ended

[5] Mozambique Country Profile 2003, Economic Intelligence Unit, 2003, p.27.

with the signing of the general peace accord between Renamo and Frelimo[6] on 4 October 1992. Not surprisingly, Mozambique has emerged as the biggest recipient of South African investment since 1994 in SADC. (See Table 2 on p.12).

Table 1: Selected bilateral agreements signed by Mozambique and South Africa since 1992	
Date	***Title of Agreement***
24 August 1992	Agreement with regard to the establishment of trade missions
31 August 1992	Agreement concerning fishing matters
20 July 1994	Agreement for the establishment of a Joint Permanent Commission for Co-operation
28 February 1995	Agreement in respect of co-operation and mutual assistance in the field of crime combating
28 February 1995	Agreement in the field of tourism
16 January 1996	Memorandum of Understanding on the Natural Gas Trade
6 May 1996	Agreement on agriculture
6 May 1996	Agreement regarding merchant shipping and related matters
26 July 1996	Agreement on the co-ordination of the Maputo Development Corridor
26 July 1996	Agreement on the establishment and functioning of the Joint Water Commission
26 July 1996	Protocol on the design, financing, construction, operation and maintenance of a portion of National Route 4 in the Republic of South Africa and the road from Ressano Garcia to Maputo in the Republic of Mozambique as a toll highway together with development and associated facilities
20 March 1997	Memorandum of Understanding concerning Mepanda Uncua

[6] *The Frente De Libertação de Moçambique* (Frelimo) has ruled Mozambique since 1975, and won the first democratic elections in the country's history in 1994. The *Resistencia National de Moçambique* (Renamo) is the largest opposition party.

Table 1: Selected bilateral agreements signed by Mozambique and South Africa since 1992 (continued)	
Date	***Title of Agreement***
5 May 1997	Bilateral agreement on the carriage of goods by road
5 May 1997	Bilateral agreement on the conveyance of passengers by road
11 February 2000	Agreement on the promotion and reciprocal protection of investment
6 April 2001	Agreement concerning the natural gas trade
18 March 2002	Agreement regarding mutual assistance between their customs administration
10 May 2002	Air Services Agreement
Source: South African Department of Foreign Affairs, *www.dfa.gov.za*	

Table 2: South African Investment into selected countries in SADC				
	Actual 2001		***Actual 2002***	
Country	***R million***	***$ million***	***R million***	***$ million***
Mozambique	10,214	1,182	1,819	188
Tanzania	1,195	166	207	20
DRC	1,616	139	41	4
Zimbabwe	1,094	135	490	47
Zambia	555	68		
Angola	185	19	431	42
Source: *The BusinessMap Foundation*, 2003.				

Overview of the Mozambican Socio-Economic Environment

Mozambique is one of the poorest countries in Africa, and is ranked 170th on the UN Human Development Index. On a global scale only Burundi, Mali, Burkina Faso, Niger and Sierra Leone fare worse.[7] Despite its poor human development ranking and its status as a least developed country (LDC), Mozambique has achieved remarkable economic success since the mid-1990s. After almost a decade of high economic growth, per capita income has doubled, from $139 in 1990 to $220 in 2001. Observers believe that Mozambique stands a good chance of reducing its high poverty rate of almost 65% to between 32–36% by 2006 if the current economic average growth rate is maintained.[8]

Yet the challenges remain enormous. The rural areas show a much higher rate of absolute poverty (71.3%) than the urban

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7 Millennium Development Goals: A compact among nations to end human poverty, *Human Development Report 2003*, United Nations Development Programme (UNDP), 2003, p.240. However, Mozambique's gross domestic product (GDP) of $3.9 billion is higher than that of Namibia and that of its mineral-rich neighbour Zambia.

8 See 'Mozambique — The elusive quest for pro-poor growth', in *Economic Report on Africa 2003*, UNECA, 2003, p.127. Preliminary results released by the Mozambican government following the conclusion of a National Household Survey in June 2003 support this optimistic prognosis. According to the survey the proportion of the population living below the poverty line has declined from above 80% in 1989–94 to 69.4% in 1997, and subsequently to the mid-50% range in 2002. This is well within the target of Mozambique's Poverty Reduction Strategy Paper (PRSP or PARPA) of a poverty rate below 60% by the year 2005. See *Statement by the Staff Representative on Republic of Mozambique*, December 10, 2003 in IMF Country Report No. 04/50, March 2004.

areas (62%).[9] The 1997 national census shows that Mozambique's population of just over 18 million is predominantly rural, with only 23% living in the urban areas (the provincial capitals), and almost half of all urban nationals living in Maputo City.[10]

Although nearly 45% of the population is economically active, formal employment opportunities are severely limited, and only 19% of the population is employed in the formal sector. About 72% of the population is reliant on smallholder subsistence agriculture.[11] This proportion is not entirely rurally based, as a substantial number of 'urban' dwellers have small-scale agricultural holdings on the margins of cities. The profile of the unemployed looking for jobs shows that 90% have less than nine years of schooling, and more than half of these have no previous employment experience. Mozambique's adult literacy rate is estimated to be only 40%,[12] with huge disparities between urban and rural areas. In the latter only 28% of Mozambicans are literate (44% of men and 15% of women), whereas 65% are literate in the urban areas (80% of men and 54% of women). These disparities are also to be found across regions, with only 14% of women and 44% of men literate in the north versus 77% of women and 93% of men living in Maputo City.

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[9] *Mozambique Common Country Assessment 2000.* United Nations System, 2000, p.16.

[10] INE, *Caderno de Informação Rápida 2000*, March 2001, p.12.

[11] *Mozambique Agricultural Sector Memorandum*, Report No.16529 MOZ, Volume 2: Main Report. Washington DC: World Bank, 30 April 1997, p.46.

[12] Recent surveys indicate an increase in literacy from 28.9% in 1985 to 40% in 1997 and 44% in 2000. See Economic Report on Africa 2003, p.143.

It is within this context that the impact of South African investment in Mozambique should be assessed.

Table 3: Selected Macro Financial Indicators							
Indicators as % of GDP#	***1996***	***1997***	***1998***	***1999***	***2000***	***2001***	***2002***
Total population (million)	16.0	16.1	16.5	16.8	17.2	17.7	18.1
GDP per capita (2000) ($)	181.0	215	241.0	243	210.0	195	199.0
GDP (in billions of $)	2.90	3.45	4.0	4.1	3.6	3.44	3.6
Gross national private savings	-2.1	1.9	5.0	7.7	11.5	11.2	19.3
Total revenue	10.6	11.6	11.3	12.0	13.2	13.3	14.2
Total expenditure and net lending	20.7	23.9	21.6	24.7	27.3	34.6	34.1
Grants received	7.0	9.3	8.1	11.7	8.0	14.8	11.8
Central government balance (before grants)		-11.9	-10.5	-13.2	-18.0	-20.1	-19.7
Central government balance (after grants)		-2.6	-2.4	-1.5	-6.0	-6.6	-7.9
Trade balance ($m)	-556.0	-530.0	-572.0	915.0	798.0	360.0	663.0
Gross official reserves ($m)	383.0	532.0	625.0	669.0	746.0	727	823.0
# Unless otherwise stated Source: Mozambican Authorities, IMF estimates, 2004							

Mozambique's embracing of comprehensive economic reforms and its move away from central planning after the end of the civil war[13] have earned it high international praise. Both the donor and the investor community have responded positively.

Mozambique has received more than $9 billion in aid (excluding debt relief) since 1987.[14] This translated into about $51.3 of aid per capita in 2001, which is substantially higher than the Sub-Saharan average of $20.6, and, in LDC countries, of $19.8 per capita.[15] Inflows of concessional loans and grants have averaged about $600 million per year and have declined steadily as a share of GDP, as the positive impact of reform has registered on GDP growth. Initially starting at 33% of GDP per annum in 1987–95, these contributions declined steadily to 15% of GDP per annum in 1998–2002. Despite a small projected increase to $680 million in 2004, this represents a further decline of one percentage point of aid as a share of GDP to 14%.[16]

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[13] Mozambique has introduced four IMF-supported funds since 1987, including a Structural Adjustment Facility (SAF) from 1987–89; two Enhanced Structural Adjustment Facility arrangements (ESAF) from mid-1990–1995 and 1996–mid 1999; and a Poverty Reduction and Growth Facility (PRGF) from 1999–2002. See *Republic of Mozambique: Ex Post Assessment of Mozambique's Performance under Fund-supported Programmes*, IMF Country Report No. 04/53, March 2004, p.5.

[14] See *Mozambique: An Investment Guide to Mozambique — Opportunities and Conditions*. United Nations and International Chamber of Commerce, United Nations, 4 September 2001, p.15.

[15] *Human Development Report 2003*, p.294.

[16] Republic of Mozambique: 2003 Article IV Consultation — Staff Report in IMF Country Report No. 04/50, IMF Washington, March 2004, p.23. Yet official aid has represented about 60% of the government budget over the last five years.

Table 4: Aid Effectiveness in Mozambique

The IMF identifies Mozambique as one of the most aid-dependent countries in the world. The efficient use of this 'abundant' aid has, however, been problematic. Some alignment of donor programmes has taken place since the introduction of the Poverty Reduction and Growth Facility (PRGF), but there are several obstacles hindering the most effective direction of funding, including donor conditionality, aid fragmentation, aid volatility and donor co-ordination.

The IMF writes: [17]

- A large portion of external aid is tied to the meeting of particular conditions. However, donors sometimes have priorities that do not necessarily match the government's objectives.
- Aid is sometimes provided in a fragmented manner through numerous projects; this hurts the government's ability to implement coherent programmes in certain areas. Managing these projects and complying with reporting requirements constitute major challenges for the authorities, given the weak institutional capacity in some ministries. Also government officials working on specific projects benefit from significantly better salaries and working conditions than those provided to other civil servants. This leads to a 'brain drain' within the government and to major difficulties when the projects have been completed.
- Another important problem has been the relatively high volatility of aid disbursements, which adversely affects macroeconomic developments and project execution. This volatility is related to capacity constraints on the recipient side, and, sometimes, to administrative delays on the part of donors.
- In some instances, project implementation without proper co-ordination with the government leads to duplication, outputs do not meet minimum standards, and unexpected recurrent expenditures.

Several efforts are under way in Mozambique, led by the UNDP and the World Bank, to ensure better co-ordination and to simplify the government's task in having to deal with the individual and different requirements of each donor.

[17] *IMF Country Report No. 04/50*, March 2004, pp.19–20.

Investments have tagged on to the inflow of development assistance, and the CPI has approved well over 1,000 investment projects between 1985–2000. FDI has increased significantly since 1996, with high peaks after 1997 and again in 2002. In 1999 accumulated foreign investment reached $1.706 billion, while national direct investment was $294 million (or 17% of foreign investment).[18]

Table 5: Actual FDI inflows to Mozambique in $m, 1986–2000

1986–1990	*1991–1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
5.0	32.0	72	64	235	382	139	255	406

Source: *World Investment Report 2003*, UNCTAD & ICC 2001, p.21

The Mozambican government has been relatively successful in containing inflation, despite the increase in money supply due to the influx of aid and FDI. Inflation averaged 75% in the 1980s (and 62% between 1987–1996),[19] and was brought down to single digits in the 1990s. However, adverse climatic conditions and the volatile position of the local currency have lead to spikes in the inflation rate. In 2001 it reached a high of 22%, was reduced to 9% in 2002, but rose again to 14% in September 2003.

On the positive side, Mozambique's good macro-economic performance has resulted in an average annual economic growth rate of about 10% since 1997. Starting at the respectable average of 6.5% in 1987–96, it rose meteorically to

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[18] Action Plan for Reduction of Absolute Poverty 2001–2005 (PARPA), p.27.

[19] Sulemane JA, *Economic Decline: A Study with Reference to Mozambique*, 2001.

11% in 1997–99 and 13% in 2001–2002.[20] However, this progress has come at a high price. The tight monetary policies introduced by the government following the introduction of the first Economic Recovery Programme (PRE) in 1987 caused severe hardship, and led to a dramatic erosion of the national minimum wage. Recovery of 1987-wage levels in dollar terms was achieved only in 1999.

The downside to the severe contraction in government expenditure has been its negative impact on the public service. It has fuelled corruption to subsidise meagre state salaries, and has contributed to the migration of skilled personnel to the small private sector and international donor agencies. This has resulted in severe capacity constraints in the public sector. Although the government has initiated a series of reforms to raise productivity, improve services to the general public and provide more incentives for qualified civil servants to remain in the public service, implementation has been piecemeal and has not yet achieved the desired results.

Ironically, in recent years the government has been criticised by the IMF for excessive increases in the government wage bill since 1999, and for its failure both to deduct income tax from the salaries of civil servants and to rid the government payroll of 'ghost workers'.[21] The wage bill has increased from 5.8% of GDP in 1999 to a projected 7.8% of GDP in 2003.[22]

A positive feature of the stringent economic policies of the Frelimo government has been the achievement of international debt relief under the Highly Indebted Poor

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[20] See *Economic Report on Africa 2003*, p.29.

[21] See *IMF Country Report No. 04/53, 2004*, pp.2–13.

[22] See *IMF Country Report No. 04/50, 2004*, pp.6, 9. The average wage for government employees increased by 17% on 1 April 2003.

Countries (HIPC) Initiative. Mozambique signed HIPC Initiative debt relief agreements with nine out of 12 of its Paris Club creditors in 2002 and 2003. Seven of these (Austria, Germany, Spain, Sweden, the United Kingdom, Italy and the United States) signed bilateral agreements with Mozambique that brought about a 100% debt cancellation.[23] This has reduced Mozambique's public debt from $5 billion to about $1 billion.[24] Under HIPC I (combined with various moratoria), debt servicing in 2000 was $26.9 million. Without the HIPC scheme the burden would have been $94.1 million from the annual budget. Under HIPC II (the enhanced HIPC initiative), the total debt burden was further reduced to $750 million. This has enabled the Mozambican government to achieve a sustainable debt servicing level.[25]

However, the economy remains very vulnerable to environmental disasters such as the seasonal floods and droughts that affect southern Mozambique in particular. The 2000 floods had a detrimental impact on the Mozambican economy, limiting economic growth to 1.6% for that year. After a recurrence of floods in 2001 in parts of central and southern Mozambique, the south experienced a serious drought, which also affected maize production in countries throughout SADC.

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[23] *Ibid*., pp.37, 18. Russia and France have agreed to a more than 90% reduction in debt at the net present value (NPV), whereas Brazil and Japan have committed to the debt reduction but not yet signed the agreement. Little progress has been made in negotiations with Portugal, although it has made a commitment in principle to the debt reduction.

[24] See *Mozambique: An Investment Guide*, 2001, p.16.

[25] The Minister of Finance, Luisa Diogo, pointed out that a debt servicing level of $20–25 million a year is sustainable.

Thus, despite the high growth rate and other positive achievements, progress in poverty reduction has been slow. The IMF attributes this to the level of devastation after the war and the low socio-economic development starting-point in Mozambique. Furthermore, the government was only able to start redirecting government expenditure to socio-economic upliftment after 1999 following the debt relief obtained under the HPIC Initiative, which ensured better prioritisation of expenditure under its poverty reduction strategy (PARPA). More recently an improved alignment of donor assistance with government objectives has also helped.[26]

In general, domestic capacity to drive economic growth and prosperity still faces considerable hurdles. Opportunities for economic production are limited, and Mozambique has a very small industrial sector. An indicator of the thinness of the industrial base is the impact that the start-up of aluminium production under Mozal has had on the trade balance. Exports grew by 172%, and contributed 7% to Mozambique's GDP in 2001.[27] However, Mozambique has made some progress in privatisation. More than 1,400 public enterprises have been privatised since the early 1990s, yielding revenue to the state of $144 million.[28]

In general, domestic capacity to drive economic growth and prosperity still faces considerable hurdles.

[26] *IMF Country Report No. 04/53*, 2004, p.17.

[27] *Regional Investor Survey 2001: Opportunities in Waiting*, Businessmap South Africa, November 2001, p.70.

[28] See *Mozambique: An Investment Guide, 2001*, p.10. Another source indicates a smaller number: more than 840 companies were privatised between 1989–1997 out of a total of 1,248 that had been

According to the African Economic Commission, most companies (90%) were acquired by Mozambican companies and individuals. The contributions of the key state-owned companies (the so-called 'family silver'), which include telecommunications, the national airline, electricity, oil and gas, accounted for less than one-third of industrial output in 1997, compared with over two-thirds in 1990.[29] The combination of privatisation and FDI has led to a structural transformation of the economy over the last decade.

Mozambique today has a fairly diversified economy by LDC standards. Agriculture, manufacturing, commerce, construction and transport/communication make significant contributions, albeit from a low base, as did agriculture and fisheries in the past. The share of industry and services in GDP has increased remarkably, and produced just over 80% of total GDP in 2002. The industry sector in particular has expanded significantly, from 16% in 1996 to 21.5% in 1998 and 30.9% in 2002, whereas the contribution of services has remained constant as a share of GDP, from 49.5% in 1996 to 49.2% in 2002.

A breakdown of contributors to industry growth reveals that the construction sector has benefited directly from the inflow of FDI and has shown the most significant improvement from 6.6% of GDP in 1996 to 15.9% in 2002.[30] Although construction activity was fairly stagnant after the initial erection of the Mozal smelter, it was bolstered by the domestic upswing in residential housing and several road-building programmes. The construction of the Sasol pipeline and the expansion of Mozal

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earmarked for privatisation. See *Economic Report on Africa* 2003, p.150.

[29] *IMF Country Report No. 04/53*, 2004, p.7.

[30] See *Mozambique: An Investment Guide*, 2001, p.14.

have increased activity again. More than 40 construction companies (predominantly from South Africa and Portugal) have been operating in the country since 1998.[31]

Table 6: Mozambique: Composition of GDP (in % of GDP), 1998–2002					
Sector	***1998***	***1999***	***2000***	**2001**	***2002***
Agriculture	27.2	25.5	21.7	21.9	19.5
Fishing	3.0	2.5	2.4	2.3	1.6
Industry	21.5	22.2	23.9	24.9	30.9
- Mining	0.3	0.1	0.4	0.4	0.3
- Manufacturing	10.9	11.5	12.0	13.8	11.4
- Electricity & water	2.0	2.8	2.2	2.1	3.1
- Construction	8.3	7.7	9.3	8.7	15.9
Services	48.3	49.8	52.0	50.9	49.2
- Commerce	21.5	21.2	20.8	21.0	18.0
- Retail services	0.8	0.8	0.9	0.2	0.7
- Restaurants and hotels	1.1	1.2	1.4	1.2	1.0
-Transport/ Communication	9.2	9.5	9.3	9.6	11.1
- Financial services	2.7	2.0	3.9	3.9	3.5
- Real estate rentals	2.3	2.2	1.9	2.4	1.5
- Corporate services	1.3	0.9	0.8	n/a	n/a
- Government services	5.1	6.9	7.4	7.7	6.3
- Other services	4.3	5.1	5.5	4.9	6.2
Gross domestic product	100.0	100.0	100.0	100.0	100.0
Source: Republic of Mozambique; Statistical Appendix, IMF, 2004					

The contribution of agriculture to GDP has shown the most significant decline, from 30.5% of GDP in 1996 to 19.5%.

[31] *Mozambique Country Profile 2003*, Economist intelligence Unit, p.47.

However, Mozambique is still essentially an agriculturally based economy, and the vast majority of the Mozambican workforce (an estimated 8.9 million) works in this sector. The 1997 census indicated the services sector (including government) employed only 15% of the workforce, while industry employed about 5%.[32]

The decline in the contribution of agriculture and fisheries (due to lower catches, adverse climatic conditions and the fall in international prawn prices since 2001) in relation to the growth in industry and services raises the spectre of uneven growth and the resultant negative impact on poverty reduction. The share of agriculture and fishing in relation to GDP shrank from 34.5% in 1996 to 21.1% in 2002. The export of prawns was the single most important foreign currency earner for Mozambique ($91.5 million or 25% of total exports) in 2000, prior to the start-up of the Mozal aluminium smelter in mid-2000. In 2001 aluminium exports were the country's largest foreign currency earner, at $383.3 million.[33]

It is a particular challenge for the Mozambican government to increase agricultural output and to develop this sector. Although Mozambique has vast tracts of arable land (estimated at 36 million hectares), only 10% of it is currently in productive use. The sector still suffers from logistical hurdles and bottlenecks. In particular, it lacks infrastructure (access roads, distribution networks, production and storage facilities); tenure security; credit services; and a domestic agricultural industry able to provide it with the required mechanical and other inputs (such as fertilizer and seed).

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[32] See Mozambique: World Bank Country Economic Memorandum ? Growth Prospects and Reform Agenda, 7 February, 2001, p.6.

[33] *Mozambique Country Profile 2003*, Economic Intelligence Unit, 2003, p.51 and Republic of Mozambique: Statistical Appendix*, IMF Country Report No. 04/51*, March 2004, p.30.

Table 7: Mozambique: Composition of commodity exports $ millions/1998–2002					
Commodity	***1998***	***1999***	***2000***	***2001***	***2002***
Aluminium	0.0	0.0	60.2	383.3	361.1
Prawns	72.6	65.5	91.5	92.4	63.9
Electricity	36.2	62.9	67.0	57.3	107.4
Cotton	22.3	19.9	25.5	18.3	20.7
Manufacturing products	14.3	13.9	n/a	n/a	n/a
Timber	11.0	8.8	14.2	12.6	17.4
Processed cashew nuts	19.1	7.8	8.4	2.1	1.1
Unprocessed cashew nuts	21.6	25.1	11.9	10.9	16.2
Sugar	8.4	5.3	4.3	8.1	18.1
Tyres and tubes	3.4	1.0	3.6	4.2	0.8
Copra	5.0	3.5	2.1	1.1	1.0
Citrus	0.4	5.8	0.8	n/a	n/a
Fisheries (without prawns)	5.6	8.9	n/a	n/a	n/a
Tea	0.5	0.2	1.0	n/a	n/a
Petroleum	1.3	4.4	9.0	23.3	18.2
Coal	0.2	0.2	0.1	n/a	n/a
Minerals	3.4	3.6	6.9	n/a	n/a
Other	26.9	36.1	65.5	89.6	54.3
Total exports fob	**248.2**	**268.9**	**364.0**	**703.1**	**681.8**
Source: IMF 2004, p.30					

In summary, the economic landscape in Mozambique has changed beyond recognition over the last decade, due mainly to an influx of FDI. Although Mozambique has reduced its overall poverty rate (in terms of GDP per capita income), the spread of the socio-economic benefits and relief is uneven. This poses urgent challenges for the Mozambican government.

Trade and Business Linkages Between South Africa and Mozambique

South Africa and Mozambique have traditionally had close trade and business linkages that date back to the turn of the 20th century. As early as 1928 a bilateral agreement was signed between South Africa and Portugal, which regulated labour, transport and commercial matters between the then colony of Mozambique and South Africa.[34] The former has been a source of migrant labour for the South African mining sector ever since. This arrangement continued after Mozambique's independence and throughout the civil war. In the first half of the 1970s, South African mines employed on average 110,000 Mozambican migrant workers a year, representing 25% of industrial employment in Mozambique.[35] Today the CPI of Mozambique calculates that about 72,000 Mozambicans are working legally in South Africa. Of this number about 12,000 are employed on South African farms, and the rest work in the mining sector.[36] Wage remittances from South Africa are an important source of income for Mozambican families, especially in southern Mozambique.

Trade

Total trade between Mozambique and South Africa has increased significantly since 1992 although South Africa has

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[34] See South Africa's bilateral relations with Mozambique on *www.dfa.gov.za*.

[35] Castel-Branco CN, *op. cit*., p.3.

[36] *Mozambique Daily Business Investor Intelligence*, MB132, 20 January 2003.

consistently been the main beneficiary, with a consistent trade surplus of above 90% over the last 10 years. South African exports to Mozambique increased by 860% from a low value of R899.5 million in 1992 to R6,419 billion in 2002. South African imports from Mozambique have grown commensurately by 900%, from R46.8 million in 1992 to R403 million in 2002. In 2003 Mozambique surpassed Zimbabwe for a brief period as South Africa's biggest trading partner in Africa, representing 18% of South Africa's entire export volume to Africa.[37] The significant surplus in favour of South Africa has been a persistent point of discussion on the bilateral economic agenda, although it is offset somewhat by the growth of South African investment in Mozambique. Ironically, the increased investment has also sparked a rise in imports from South Africa (especially machinery and construction material, as needed for the mega-projects) into Mozambique.[38] (See Table 8)

However, South Africa's favourable trade position in Mozambique is not unique. Mozambique is a net importer of goods, and the value of its overall exports of $681.8 million in 2002 versus its total imports of $1,262.9 million is indicative of the trade deficit that it maintains with its chief trading partners.[39] Mozambique's major export markets are Spain, South Africa, the US, Japan, Portugal, Malawi, Zimbabwe, India and the UK. Exports consist of aluminium, tobacco, citrus, coal, electricity, cashew nuts, prawns, lobsters, cotton and wood. (See Table 7.)

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[37] Mozambique Daily Business Investor Intelligence, MB269, 28 August 2003.

[38] Castel-Branco CN, *op. cit*., p.10.

[39] Presentation by Mahomed Rafique, Director of the Investment Promotion Centre of Mozambique, Paris, 3 October 2003, quoting the National Statistics Office of Mozambique.

The EU is the biggest recipient of Mozambican aluminium exports.

Table 8: South Africa's trade with Mozambique (R million)				
Year	***Exports***	***Imports***	***Trade surplus in SA's favour***	***SA's share of total trade (%)***
1992	899.4	46.8	852.6	95.0
1993	1,380.3	61.5	1,318.8	95/0
1994	1,771.8	92.3	1,679.5	94.0
1995	1,872.3	120.3	1,752.0	93.0
1996	2,294.2	77.3	2,216.9	96.0
1997	2,645.6	172.9	2,472.7	93.0
1998	2,656.2	213.0	2,443.2	92.0
1999	4,073.5	321.6	3,751.9	92.0
2000	4,996.9	362.6	4,634.3	92.0
Source: Department of Trade and Industry, *www.dti.gov.za*				

Table 9: Selected export partners of Mozambique, 1998–2002 (% of total exports)					
Country	***1998***	***1999***	***2000***	***2001***	***2002***
South Africa	17.6	26.2	14.6	15.3	17.7
Zimbabwe	19.5	14.9	17.7	5.3	5.8
Portugal	7.6	9.0	11.6	4.0	4.4
Spain	13.0	12.7	10.7	3.8	2.8
United States	5.7	4.7	4.7	0.9	1.6
Total value in $ million	**244.6**	**283.7**	**364.0**	**703.1**	**681.8**
Source**:** *IMF, 2004*					

Overall, South Africa is Mozambique's largest foreign supplier, providing more than 30% of Mozambique's total imports, followed by Portugal, the US, Japan, India and France. Mozambique's main imports are transport and electrical equipment, machinery (vehicles and parts), processed food products, petroleum products and cereals.

Table 10: Selected import partners of Mozambique, 1998–2002 (% of total imports)					
Country	***1998***	***1999***	***2000***	***2001***	***2002***
South Africa	39.5	57.2	49.8	40.7	30.3
Portugal	7.9	5.6	7.6	8.4	6.2
United States	5.3	6.7	3.5	1.8	4.4
Japan	3.9	3.9	4.6	0.6	3.4
France	2.1	0.9	2.2	1.1	1.7
Total value in $ million	**817.3**	**1,199.8**	**1,163.0**	**1,063.4**	**1,262.9**
Source: *IMF, 2004*					

Requests by the private sector that the Ressano Garcia border post on the South African-Mozambican border should be open on a 24-hour basis are indicative of the volume of bilateral trade between the two countries.[40] This is further borne out by the increase of South African traffic through the Maputo port, from 4.3 million tonnes in 2002 to 4.9 million tonnes in 2003. However, this figure is still much lower than the 16 million tonnes of cargo (mostly from South Africa) that the Maputo port handled in 1975 before Mozambique became independent in that year.[41] South African companies or international subsidiaries based in South Africa that export through the port

[40] *Mozambique Daily Business Investor Intelligence*, MB211, 22 May 2003. The business hours of the border post were extended in October 2003. It is now open from 6:00–22:00 for ordinary public traffic and from 6:00–18:00 for commercial traffic.

[41] Mozambique: Feature on Maputo port privatisation, Integrated Regional Network, 25 July 2003.

include Transvaal Sugar Limited (TSB), Capespan, BHP Billiton, Highveld, Rio Tinto and Columbus Stainless.[42]

Investment

South Africa's business linkages with Mozambique have expanded enormously since 1994. Over the last five years South Africa has evolved into the largest investor in Mozambique, representing 49% of total FDI from 1997–2002. South African investment is followed by that of Britain (30%) and Portugal (11%). Whereas South African investment covers all sectors, investment from Portugal is concentrated in the distribution of petroleum products (Petrogal), cement (Cipor), agri-businesss (cotton and cashew nuts), finance (BPI, BCP, Mello and Caixa Geral de Depositos) and tourism. Mozambique is the 13th largest recipient of Portuguese investment globally, and more than 244 Portuguese-owned companies operate in the country. British investments outside the mining sector involve agro-industry projects such as coffee production and cashew processing.[43]

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[42] *Mozambique Daily Business Investor Intelligence*, MB361, 19 February 2004.

[43] Goldstein A, *op. cit.,* p.29.

Table 11: Foreign direct investment into Mozambique: Top five investors (1 January 1997–30 June 2002		
Country	***Value (in $ million)***	***Percentage***
South Africa	1,164.3	49
Great Britain	717.8	30
Portugal	253.4	11
Japan	130.3	6
Ireland	103.0	4
Source: Rafique Jasob, *CPI Mozambique*, October 2003.		

More than 262 South African projects have been registered by the CPI since its establishment in 1985, resulting in accumulated investment value of $1,330 billion by the end of 2003. Of the overall number of South African projects identified by the CPI, almost 35% have been registered in the last three years (2001–2003). The largest proportion of FDI was committed between 1997–2001. However, a significant slow-down in overall South African FDI began in 2002, resulting in a fairly low value, just over $26 million, in 2003.

Table 12: South African projects registered since the establishment of the CPI		
Period	***Projects***	***FDI (in $)***
1985–1989	5	1,848,850
1990–2000	167	303,054,103
2001	34	892,438,116
2002	26	105,575,872
2003	30	26,629,840
Total	262	1,329,546,781
Source: Investment Promotion Centre (CPI) , Mozambique, 2004		

The Mozambican figures are borne out by data published by the South African Reserve Bank. The results of its sixth survey of South Africa's foreign liabilities and assets confirms that South African investment into Mozambique has grown substantially over the last five years. (See Table 13.) Total South African foreign assets in Mozambique amounted to R4.9 billion in 2001, representing 18% of overall South African investment into Africa during the same period. This also makes Mozambique the second largest recipient of South African FDI in Africa after Mauritius, which received R7.4 billion. BusinessMap, in contrast, estimates that 51% of South African private sector investment into Southern Africa went to Mozambique between 1994–2003.[44]

Table 13: Foreign assets of South Africa in Mozambique, 31 December 2001 (R millions)

Category	*Value*	*Total value*
Direct investment:		
Public corporations		***4,090***
Equity capital	-	
Reinvested earnings	-	
Other capital	4,090	
Banking sector		**-**
Private non-banking sector		***27***
Equity capital	17	
Reinvested earnings	-	
Long-term capital	1	
Short-term capital	9	
Total direct investment		***4,117***
Portfolio investment:		**-**
Other investment:		

[44] BusinessMap 2002, *Investment 2002: Challenges and Opportunities*. Johannesburg: BusinessMap, 2003. p.75.

Table 13: Foreign assets of South Africa in Mozambique, 31 December 2001 (R millions) (continued)		
Category	***Value***	***Total value***
Monetary authorities		-
Public authorities		-
Public corporations		***517***
Long-term loans	517	
Short-term loans	-	
Banking sector		***112***
Long-term loans	-	
Short-term loans	109	
Deposits	3	
Gold reserves		-
Private non-banking sector		***182***
Long-term loans	3	
Short-term loans and trade finance	179	
Total other investment		***811***
Total foreign assets		***4,928***
Percentage of overall foreign assets held in Africa		***18%***
Source: *South African Reserve Bank Survey 1995–2001*		

The leading sector that has attracted South African investment in Mozambique, both in terms of the value and the number of companies, is industry. (See Tables 5 and 6). South African investors control three out of four sugar estates, three out of four breweries, all the soft drinks bottling plants and large cereal mills, and most tourism facilities in Mozambique.[45]

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[45] Goldstein A, *op. cit*., p.29.

Table 14: South African investment by sector: Value in $ million						
Sector	***1998***	***1999***	***2000***	***2001***	***2002***	***Total***
Agriculture/ Agro-Industry	0.4	1.8	11.5	12.7	1.5	**27.8**
Aquaculture and fisheries	0.6	0.1	0.0		0.1	**0.8**
Industry	3.2	0.4	1.9	841.2	11.3	**858.1**
Resources and Minerals	13.1	0.1		1.2	48.0	**62.3**
Transport and Communication	0.2	0.3	0.8	17.7	0.1	**19.1**
Banking, Insurance and Leasing	0.1			0.7	10.0	**10.8**
Construction		0.6	1.4	11.2	20.1	**33.2**
Tourism and Hotel Industry	5.2	0.4	6.0	0.6	8.3	**20.5**
Others	2.6	0.4	0.2	7.1	6.2	**16.5**
Total	**25.3**	**4.1**	**21.8**	**892.3**	**105.6**	**1,049.0**
Source: CPI – Investment Promotion Centre, Mozambique, 2004						

Investment in industry is followed by that in resources and minerals, construction, agriculture and tourism. The year 2001 showed the most significant increase in all sectors, but all other investment in that year was dwarfed by the inflow into industry, most notably the expansion of Mozal II.

Table 15: Number of South African companies per sector						
Sector	***1998***	***1999***	***2000***	***2001***	***2002***	***Total***
Agriculture and agro-industry	7	13	8	5	3	36
Aquaculture and fisheries	1	1	1		1	4
Industry	13	11	6	8	5	43
Resources and minerals	1	1		1	1	4
Transport and communication	1	2	4	3	1	11
Banking, insurance and leasing		1		1	1	3
Construction		9	10	7	6	32
Tourism and hotel industry	9	5	6	3	2	25
Others	5	3	4	6	6	24
Total	**37**	**46**	**39**	**34**	**26**	**182**
Source: CPI – Investment Promotion Centre, Mozambique, 2004						

Table 16: Breakdown of investment by sector: Number of South African companies and value						
Sector and Value ($)	***1998***	***1999***	***2000***	***2001***	***2002***	***Total***
Agriculture & agro-industry						
0 > $50,000	-	4	-	-	1	5
$50,000 >$100,000	7	5	4	-	-	16
$100,000 > $1,000,000	-	4	1	2	1	8
$1,000,000 <	-	-	3	3	1	7
Aquaculture and Fisheries						
0 > $50,000	-	-	1	-	-	1
$50,000 > $100,000	-	1	-	-	1	2
$100,000 >$1,000,000	1	-	-	-	-	1
$1,000,000 <	-	-	-	-	-	-
Industry						
0 > $50,000	1	4	-	-	-	6
$50,000 > $100,000	9	3	1	3	-	16
$100,000 > $1,000,000	2	4	4	3	4	17
$1,000,000 <	1	-	-	2	1	4
Resources and Minerals						
0 > $50,000	-	-	-	-	-	-
$50,000 > $100,000	-	-	-	-	-	-
$100,000 > $1,000,000	-	1	-	-	-	1
$1,000,000 <	1	-	-	1	1	3
Transport and Communication						
0 > $50,000	-	1	-	-	-	1
$50,000 > $100,000	-	-	3	1	1	5
$100,000 > $1,000,000	1	1	1	1	-	4
$1,000,000 <	-	-	-	1	-	1

Table 16: Breakdown of investment by sector: Number of South African companies and value (continued)

Sector and Value ($)	*1998*	*1999*	*2000*	*2001*	*2002*	*Total*
Banking, Insurance and Leasing						
0 > $50,000	-	-	-	-	-	-
$50,000 > $100,000	-	-	-	-	-	-
$100,000 > $1,000,000	-	1	-	1	-	2
$1,000,000 <	-	-	-	-	1	1
Construction						
0 > $50,000	-	5	-	-	3	8
$50,000 > $100,000	-	2	6	-	-	8
$100,000 > $1,000,000	-	2	4	5	1	12
$1,000,000 <	-	-	-	2	2	4
Tourism and Hotel Industry						
0 > $50,000	2	-	1	-	-	3
$50,000 > $100,000	4	4	1	1	-	10
$100,000 > $1,000,000	1	1	2	2	1	7
$1,000,000 <	2	-	2	-	1	5
Others						
0 > $50,000	-	1	-	4	1	6
$50,000 > $100,000	3	1	4	1	2	11
$100,000 > $1,000,000	1	1	-	-	2	4
$1,000,000 <	1	1	-	-	1	3
Total	37	46	39	34	26	182
Source: Investment Promotion Centre (CPI), Mozambique, 2004						

A further breakdown of the value of investments (1998–2002) shows that in global terms the South African stake is small, and that individual outlays are often less than $1 million.[46] Only 15% of companies ventured over $1 million per investment during this period. The largest group (68) committed between $50,000 and $100,000 to Mozambique per investment.

However, two South African investments have made the headlines by virtue of their overriding size relative to all other South African and foreign investment. The development of the Pande/Temana gasfields led by Sasol, committing $1 billion, and the construction of the Mozal aluminium smelter led by BHP-Billiton, contributing $2.2 billion, are the two largest single investments ever made in Mozambique's history. Mozal represents a multi-state commitment, with the following shareholding: BHP-Billiton 47%, Mitsubishi 25%, the IDC 24% and the government of Mozambique 4%. Other large-scale (in excess of $25 million) South African investments into Mozambique include the purchase of three local breweries by SAB-Miller, the rehabilitation of the Ressano Garcia railway by Spoornet, and the purchase of three sugar mills and estates by Tongaat Hulett and Illovo Sugar. (See Annexure I for an overview of South African investments into Mozambique.)

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[46] This trend concurs with general foreign investment patterns in Africa. A survey of foreign investors by the UN Industrial Development Organisation (UNIDO) in 2003 found that nearly 40% of the 758 foreign enterprises that were surveyed had projects worth less than $1 million. The survey group consisted of European, Asian, African and American companies.

Results of the SAIIA Survey

A representative segment of South African companies active in Mozambique in the construction, retail, services, franchising and industrial sectors were interviewed in Mozambique in November 2003. The companies were asked to answer a variety of questions, amongst others how they rated the business-friendliness of Mozambique; their reasons for investing in Mozambique; the main constraints facing South African companies in Mozambique; and lastly, their recommendations to the Mozambican and South African governments on how to improve support for the business community.

How business-friendly is Mozambique?

Contrary to expectations (in view of the large number of South African investors in Mozambique), more than 80% of the sample group described the Mozambican business environment as 'not very business-friendly'. However, the same respondents qualified their statements by emphasising that South African business is not targeted specifically for discriminatory treatment. A Mozambican national leading a large South African parastatal in Mozambique confirmed this assessment, and provided additional context by pointing out that the bureaucratic treatment meted out to foreign business is no different from that applicable to local business. Thus many of the complaints and concerns raised by South African business people during the survey reflect the daily experiences of members of the local business community.

Intriguingly, the survey does show that large investors rate the Mozambican business environment quite differently, and more positively. This could be because many of these businesses receive more government support; are fairly insulated from the domestic economy; and do not experience the normal environmental obstacles and problems that face smaller companies.

One example of a South African company's not having had to contend with bureaucratic bottlenecks is that Sasol was allowed to create its own customs terminal, with support from the Mozambican government. This allowed the company to leapfrog many of the normal delays experienced by companies when importing goods into Mozambique, and ensured the smooth importation of material needed for the construction of the pipeline.

Although South African companies thus do not rate Mozambique as particularly business-friendly, this assessment is qualified by the size of the company, the specific sector in which the company operates (which determines whether there are many opportunities for rent-seeking), and the constraints and problems that all companies, whether foreign or local, experience.

The differentiation between companies also extends to the political access, receptivity and support that they enjoy from government. All the companies surveyed confirmed good access to the Mozambican government at the top managerial and ministerial levels. The responsiveness of these levels of government to problem areas is also good. However, respondents pointed out that most of their problems stem from their interaction with the lower tiers of Mozambican bureaucracy, where capacity is thin and greater opportunities for rent-seeking and extortion exist. Large companies, especially where parastatals are involved, reported that both the Mozambican and South African governments take a direct interest in the implementation of projects, and that problems are sometimes taken up on a bilateral government-to-government level where necessary. Evidently, investments that are politically sanctioned by both governments receive greater attention and support.

However, perhaps the most significant indicator of business confidence in Mozambique, despite some clear shortcomings and constraints, is that most of the companies interviewed indicated that they would be maintaining their presence in Mozambique. Some are even contemplating the expansion of their operations. Companies such as Cervajos de Mozambique (SAB-Miller), hereafter referred to as CDM, have opened a new packaging line at the Manica brewery in Beira, and a new distribution depot in Xai-Xai. Banco Austral (ABSA Bank) has established a footprint throughout the country. Shoprite Checkers is also investigating expansion into the north of Mozambique. The entire investor group agreed *ad idem* that the next significant growth area would be Nampula province.

Main reasons for investing in Mozambique and nature of investments

The survey group offered diverse reasons for the decision to move into the Mozambican market. Most of the larger South African companies (multinationals and parastatals) have invested in Mozambique for strategic reasons, that is, to position themselves advantageously *vis-à-vis* their competitors in sub-Saharan Africa. However, for some of the smaller companies it is the geographical proximity of the Mozambican market to South Africa that has provided the overriding impetus: they hope that they can increase their market share through their presence in Mozambique. There is also a firm belief amongst these companies that the market in Mozambique will grow, as will the population's disposable income. Some companies have opted to invest in Mozambique to diversify their income streams and to earn revenue in a foreign currency. Others have followed their customers. This is especially true of the financial sector and the tourism and leisure industry. Some motivations to invest are tenuous, and not always easy to define. One businessman who is married to a Mozambican national mentioned this family connection as the determining factor in his investment decision.

Very few companies listed profit margins as the main reason for investing in Mozambique. The majority of the companies that were interviewed confirmed that the contribution of their Mozambican operations to their parent company's earnings was small. Not one of these is contributing more than 20% to the overall earnings of its parent company. Of course an enterprise like Sasol will in future make a significant contribution to its parent company's earnings once the project is fully on-line. This is already the case for Mozal.

The profile of South African investment into Mozambique is a good mix of concessions, greenfield development and acquisitions. Several companies have opted to enlist local partners as a risk mitigating choice. Whereas some partners are silent, others are active, although most of the businesses interviewed volunteered that few of their partners have been able to bring equity, assets, or technology/competitive advantage to the table. However,

Several companies have opted to enlist local partners as a risk mitigating choice.

the use of partners is helpful in other ways. One respondent pointed out that the acquisition of a prime spot of land for development would not have been possible without the participation of its chosen partner. However, companies that are bidding for contracts, especially in the construction sector, have generally opted to establish an independent business presence in Mozambique.

All of the companies that were interviewed are major or dominant players in the market, regardless of their size. The majority control between 10–50% of market share, rising with some companies to 80%. However, this does not imply that South African businesses lack competition. Depending on the sector, respondents identified other South African, Mozambican and international companies as their main rivals in the formal economy. However, some companies, especially those in the retail sector, face the greatest competition from players in the informal economy.

The main constraints facing South African companies in Mozambique

South African business listed a series of constraints that hinder their operations in Mozambique. These included corruption; the small market; high duties; differences in language/culture; a weak legal system; lacks in finance, tenure, infrastructure and communications; poor repayment of VAT; payment difficulties; the inefficiency of the bureaucracy; smuggling; theft; and failure by the government to exact payment of taxes and excise from local businesses.

However, these problems are not of equal weight. Moreover, their identification and ranking in terms of affecting productivity and profitability is very sector-specific. Smaller companies are also a great deal more adversely affected than larger companies. There is general agreement that petty corruption, red tape and inefficient or obstructive bureaucratic behaviour in the lower ranks of the civil service are common. The high level of import duties also has a direct impact, both on the profitability of companies and on the pricing of goods to customers. Smuggling and theft are also serious problems.

Interestingly, none of the companies interviewed singled out political uncertainty or political risk as a key problem. There is a general expectation that Frelimo will do well in the elections, as it is much better geared to fight and win the coming elections than the opposition, Renamo. Some conceded that Renamo stands a chance of faring better in the elections than before, but expressed the opinion that not a great deal would change in the operating environment even if the opposition comes to power. Mozambique's heavy donor dependency was advanced as the main justification for this position.

To this argument could be added the astute political manoeuvring executed by the Mozambican government to pacify investors and donors. The appointment of Luisa Diogo, the minister of Planning and Finance, as the country's Prime Minister after the departure of Pascoal Mocumbi is a case in point. Ms Diogo is a former employee of the World Bank office in Maputo, and holds a masters' degree in financial economics. The early announcement by President Joaquim Chissano in 2002 that he would not be seeking a third term in the next general elections due in 2004 and the appointment and grooming of his successor, Armando Guebuza, are also indicative of the extensive efforts by the Mozambican government to build confidence amongst the influential foreign donor and investor community.

Corruption and red tape

All the companies interviewed confirmed that they had an anti-corruption policy. Only one business in the entire surveyed group admitted to paying bribes. The refusal to bribe translates into heavy fines being imposed on companies. Harassment by petty officials is a very common occurrence. The intricate licensing requirements and opaque compliance regulations open the door for the soliciting of rents. One of many examples of the remaining grip of socialist thinking and centralist planning on the bureaucracy is the requirement that official permission is needed to do any maintenance (including painting of the exterior walls) to property. Failure to do so results in heavy fines. Companies are required to post their licences in full public view. Once again, failure to do so can result in a fine. Long delays in the granting of licences and the release of goods from *frigo* (customs) are common, and are generally regarded as avenues to solicit more bribes.

Vertical integration and co-operation between government departments is also problematic. Most South African investors enter the Mozambican market through the CPI, which acts as a one-shop investment stop. However, companies reported that they often encounter a series of delays when they approach other government departments to register their businesses, despite the official approval obtained from the CPI. Although the strengthening of the CPI is promised for 2004, its effectiveness will be negligible unless it is empowered to cut through some of the red tape that companies encounter in other government departments. For example it takes 153 days for a business to be registered in Mozambique, compared with 35 days in Tanzania or 38 days in South Africa.

Table 17: Time taken to register a business in selected African countries in SADC					
Country	*Number of procedures*	*Time (days)*	*Cost ($)*	*Cost (a)*	*Index (b)*
Angola	14	146	5,531	838.0	78
Mozambique	**15**	**153**	**209**	**99.6**	**74**
Tanzania	13	35	557	199.0	61
DRC	13	215	785	871.9	60
Zambia	6	40	80	24.1	46
South Africa	9	38	227	8.7	36
Botswana	10	97	1,076	36.1	35

a — *% of incomes per head*
b — *Employment laws index — lower scores reflect easier labour legislation*
Source: World Bank & EIU, 2003

High import duties, payment of VAT and general duties and excise

Most companies identified high duties on imported goods as a critical problem. For example, duties of just over 42% are levied on most consumer goods and foodstuffs.[47] A comparison of the same basket of goods sold in South Africa and in Mozambique in 2001 (when import duties on consumer goods were 35%) illustrates the implications for the Mozambican

[47] The 42% tax rate is broken up into 17% value added tax (VAT), introduced in 1999, and 25% import duties on consumer goods. The maximum import tariff was brought down to from 35% in 1996 to 30% in 1999 to 25% in 2003, although tariffs on certain imported products have been as high as 75% in the past.

consumer. The combined duties of 52% (17% VAT and 35% import duties) had to be shouldered by the Mozambican buyer.

In recent months the strengthening of the rand against the US dollar has also had a significant effect on the cost of imported goods. Food prices in Mozambique rose by 17.2% between September 2002–2003 and other prices by 9.5%.[48] Whereas some companies transfer the real cost to consumers, others have no choice but to absorb some of the increases themselves. This is particularly true for the number of South African restaurant franchises in Maputo that cater for a very small, select clientele made up of the donor community, tourists and the small middle and upper class group (3% of the population).[49] These businesses are directly affected by the discrepancy between high food prices and the low levels of disposable income in Mozambique.

The result of the high duties is that many Mozambicans do their shopping in Nelspruit or in the smaller towns just across the border, further undermining the viability of local business. One local company representative indicated that it is not unusual for up to 13,000 Mozambicans to be doing their household shopping in Nelspruit over the weekend. This behaviour is also typical for vehicle owners who prefer to have their vehicles serviced in South Africa rather than Mozambique, owing to the expense of replacing parts and the delays that occur in customs when parts are ordered. Another effect of the high import duties is that they encourage smuggling.

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[48] *IMF Country Report No. 04/50*, 2004, p.5.

[49] The purchasing power of the small middle and upper class group is comparable to that of the middle class in South Africa. *Mozambique: An Investment Guide*, 2001, p.8.

Table 18: Comparison of grocery retail prices charged by Shoprite in South Africa and Mozambique, 2001			
Product	***Description***	***South Africa price (R)***	***Mozambique price (R)***
Eggs	6x large (cardboard tray packaging)	3.19	4.71
Cooking oil	750ml plastic bottle	5.69	8.56
White sugar	2kg bag (paper bag packaging)	8.63	14.12
Flour	2.5kg all purpose (paper bag packaging)	7.99	10.59
Chicken	Whole fresh chicken per kg (packaging polystyrene tray and plastic)	14.99	17.11
Tomatoes	Grade 1 per kg (loose sell)	8.79	3.64
Potatoes	Grade 1 per kg (loose sell)	3.49	5.13
Milk	Litre (plastic bag)	3.39	5.34
Bread	Standard brown loaf	2.79	1.28
Cheese	Per kg (cut from block) (plastic wrap)	33.90	58.61
Tea	100g loose tea silver foil pack	3.20	13.90
White rice	1 kg bag (sealed plastic bag)	3.59	6.63
Maize meal	12,5 kg breakfast (roller meal) (cloth bag)	29.99	42.78
Soap	250g body soap (sealed plastic bag)	1.49	3.20
Total		**131.12**	**195.60**
Source: Vink & Kirsten, June 2002[50]			

[50] Vink N & J Kirsten, *Pricing Behaviour in the South African Food and Agricultural Sector*. A report to the National Treasury, June 2002.

This has a significant impact on the business costs for companies that pay their duties and taxes. The sugar industry is a good example. Mozambique is hoping to recover its place as Africa's fourth largest sugar producer after South Africa, Egypt and Mauritius. In 1972, at the height of its production output, Mozambique recorded a record crop of 325,051 tonnes, of which 60% was destined for export. Sugar was the country's third largest export commodity at the time, and one of its main employment generators. Sugar production has grown impressively and reached over 230,000 tonnes in 2003 thanks to the rehabilitation (at a total cost of about $300 million) of four of the country's sugar mills, namely Xinanvane and Maragra in Maputo Province and Mafambisse and Marromeu in the central province of Sofala. Three of these mills were recipients of South African investment. However, despite the good crop, it is estimated that almost 25,000 tonnes of sugar entered the Mozambican market illegally from Zimbabwe, Malawi, Swaziland and South Africa. This significantly undermined the effort of the local industry to raise its annual revenue to $5.2 million.[51]

'[The] fact that many other local merchants … don't pay taxes and excise, places those that perform their fiscal obligations at a frantic disadvantage'.

The costs to business represented by high duties and illegal goods are aggravated by the failure of the Mozambican government to collect taxes and excise duties from local businesses (both formal and informal). As one South African

[51] Mozambique Daily Business Investor Intelligence, MB361, 19 February 2004 and Mozambique Daily Business Investor Intelligence, MB325, 9 December 2003.

businessman put it, the 'fact that many other local merchants (formal and informal) don't pay taxes and excise, places those that perform their fiscal obligations at a frantic disadvantage'.[52]

All the South African companies interviewed supported the establishment of the Southern African Development Community (SADC) free trade area, and emphasised that it would bring significant benefits to local consumers aside from lowering the cost of doing business for them. To a certain extent this unconditionally positive endorsement of a free trade area reflects the import dependency of South African business. Mozambican respondents, in contrast, believe that the introduction of a free trade area will ring the death knell for local producers.

All of the respondent companies confirmed that they are experiencing problems with the repayment of VAT. However, they are hopeful that this matter will be resolved eventually.

Labour and the legal system

There was general agreement amongst the businesses approached that the weakness of the Mozambican legal system poses significant risks for the enforcement of contracts. The courts are highly susceptible to bribes, and the judges have limited knowledge of commercial law. Litigation runs into years rather than months. Outside Maputo the situation is even worse. As a result debt recovery through the courts is very inefficient, and therefore rarely used. It can take up to 540 days to resolve a case in Maputo, where the process is significantly slower than in the rest of the region.

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[52] Interview, Maputo, November 2003.

At the same time employers are expected to be lenient with staff who transgress. In-house theft (often reflected as shrinkage) occurs often, as a consequence of the survival culture in which most Mozambicans find themselves living. The Mozambican labour force is generally not regarded as militant, although a section of the workforce is organised into unions. Labour disputes usually revolve around wages, and are generally resolved amicably in formalised annual negotiations.

On average over 90% of staff in most South African companies are Mozambican. All the businesses interviewed indicated that they follow a strong nationalisation programme which is increasingly being extended to the managerial level, in their employment policies. On the whole, staff turnover was fairly small in all the businesses interviewed, with one exception. (This company also reported the highest theft levels.) However, these respondents also reported that skills levels, language and culture all present particular challenges to foreign investors. Most businesses have dedicated training programmes. While some of these occur in Mozambique, most of the training is conducted in South Africa. The reason is that, because of the fairly small business turnover rate in Mozambique, staff members receive limited exposure to a variety of tasks. They often obtain this experience only in South Africa, where the trading volumes are much higher. In general companies have found training very successful in raising productivity, skills levels and instilling a more business-orientated attitude amongst staff.

Although Portuguese is the national language, an inability to speak it is not considered a major drawback in operating a business in Mozambique. Knowledge of English is growing among the younger generation, and the language has now been introduced at school level. However, competence in Portuguese is essential for dealing with the Mozambican bureaucracy and for understanding and complying with the law, which is written and interpreted in that language. Businesses that import a large share of their products from South Africa also emphasised the importance of using labels in Portuguese.

On a cultural level there are certain peculiarities to the Mozambican management environment. South African managers have found that there is an expectation amongst senior Mozambican staff members that their juniors should always defer to their judgement, which often translates into a lack of initiative among staff. The South African companies interviewed attributed this passivity of the Mozambican workforce to a cultural heritage of respect towards seniors and elders, combined with the vestiges of the many years of socialist rule and central planning. They agreed that this will take some time to change, and ventured the opinion that in general a strong corporate culture is lacking in Mozambique. For example, essential knowledge of the linkages between cost effectiveness, productivity and profits are all markedly absent.

South African business people also emphasised the distorting impact that the aid community has had on the Mozambican labour market. Most of the best candidates are absorbed by the donor community, which pays well and offers a vast range of benefits that are not available outside this sector. Mozambicans who apply for positions in the private sector sometimes have unrealistic expectations of what their employers can provide, for example that the benefits associated with employment will include transport to and from work as well as housing.

Size of the market, a lack of finance and the cost of doing business

The size of the local market is a significant factor in the profitability of some businesses. Disposable income in Mozambique, even in relatively affluent Maputo, is low. Most businesses reported that troughs or dips in sales are common, and that most of these can be traced back to the late payment of public servants' salaries. Although South African business people generally believe that disposable income will eventually grow, this will take time.

Traders in particular felt that the 'dollarisation' of the economy is driving up the cost of doing business significantly, and placing the domestic consumer at a disadvantage. Mozambicans favour hard currencies because of the volatility of the local currency, and the low investment returns in *metical* due to the erratic inflation rate. The majority of banking loans/deposits are now in US dollars. In 1997, 44% of deposits and 30% of loans were in a foreign currency. This figure grew to 51% of deposits and 70% of loans in a foreign currency in 2002.

The lack of credit and the cost of local and foreign finance are the factors that drive up the cost of business most. The substantial credit risk in Mozambique is reflected in the high ratio of non-performing loans to total loans, which was 21% at the end of 2002. Although there is only one remaining bank with minor state participation left in the system, BIM/BCM, this bank is also the largest and accounts for 45% of the country's total deposits and 27% of non-performing loans. State participation in the financial system (which accounts for many of the non-performing debts of parastatals) also imposes a moral hazard. Addressing this issue is a priority, and, if successful, will strengthen transparency and enhance competition in the banking sector. However, the Mozambican financial sector is currently characterised by a poor lending environment, a high credit concentration on a few highly leveraged borrowers,[53] a lack of credit-worthy projects, a weak repayment culture and a number of legal and institutional impediments to effective credit selection and recovery. While deposits are not unusually low (representing 23% of GDP), credit extension as a share of GDP (14%) is very low, and reflects the banking system's difficulty in channelling deposits into loans.

Local banks are reluctant to extend credit to customers owing to the absence of an integrated and shared information system that records the credit-worthiness of clients. Although a public credit registry was established in 1997 and about 22 785 borrowers are listed, it does not cover non-banking financial institutions, other lenders or private parties. The IMF has also identified problems with its data submission requirements and the retention and distribution of longer payment histories. Mozambique's banking system, does not have a blacklisting system and lacks a shared platform for automated banking, such as Saswitch in South Africa. Cheques are also not accepted everywhere.

[53] According to the IMF all but one bank's loans to the largest three borrowers constitute more than 50% of capital; and for two banks they constitute more than 100% of capital. This reflects the restricted access that corporates and private individuals have to credit in Mozambique. Republic of Mozambique: Financial System Stability Assessment, *IMF Country Report No. 04/52*, 2004, p.13.

Table 19: Problems hindering the business performance of firms in Mozambique	
Business constraint	***Percentage***
High cost of financing	84
Poor access to domestic credit	75
Poor access to foreign credit	74
Corruption	64
Unreliable supply and expense of electricity	64
Macroeconomic instability	63
Anti-competitive practices	60
Economic policy uncertainty	58
High tax rates	55
Crime, theft and disorder	54
Source: Bank of Mozambique, 2004	

The absence of dependable information and a poor payment culture result in very high banking costs to mitigate risk. However, some progress has been made. Commercial bank lending rates have declined from 37% to 32% since the end of 2002.[54] All the companies interviewed confirmed that they do not extend credit to their Mozambican customers.

For banks the lack of land tenure also poses a problem, especially in the rural areas. The Land Law that was passed in 1997 stipulates that all land in Mozambique is the property of the state and cannot be sold, alienated, mortgaged or pledged, although it can be leased from the state. The law allows for leases of up to 50 years

Commercial bank lending rates have declined from 37% to 32% since the end of 2002.

[54] *IMF Country Report No. 04/50*, 2004, p.7.

which are renewable. The right to use is authorised by a title deed.

However, the law also recognises rights that are obtained through the customary use of land (for periods longer than 10 years), without the need for a formal title. Thus in the rural sector only about 28% of land used for agriculture is subject to formal land tenure arrangements (about 2% of total land). Although user rights can be transferred by inheritance they cannot be sold; but improvements made to the land can be. The difficulty arises that the sale of such improvements is economically viable only if the new owner can obtain title to land use. In urban areas this is not a problem, because the procedures for the transfer of rights are fairly simple. When real estate in urban areas is sold, the law considers the corresponding land use right as being transferred at the time of sale. However, in the rural areas the law requires the seller to obtain a notarised deed of sale and prior authorisation by a competent state entity before a new title can be procured on improvements.

The complex administrative procedures and the inefficiency of the public agencies involved result in very high transaction costs for both the buyer and the seller. Although more than 11 000 formal requests were lodged for land titles from 1996–2000, only 4 700 were granted. This has resulted in the growth of a large informal real estate market in urban areas that is unprotected by legal instruments, and the very limited marketability of properties in rural areas. The outcome is that few Mozambicans can raise collateral on their properties to obtain credit.

The uncertainty surrounding property rights in the rural areas could develop into a major stumbling-block for future investment in enterprises located outside the urban areas.

Although Mozambique's financial system has come a long way over the last 12 years from a mono-banking system to a market-based financial one, it is still very young, bank-based, foreign-owned and concentrated. Its total assets are only \$2 billion.[55] However, despite the risks associated with banking in Mozambique, it is still highly profitable. The average return on equity for the banking system was nearly 20% in 2002.[56]

Table 20: Specific constraints in Mozambique's financial sector
1. The local market is over-banked and highly concentrated, with the five largest banks accounting for 96% of total deposits.
2. An integrated information system on the credit records of existing and new clientele is absent.
3. A shared automated banking platform such as Saswitch is also lacking.
4. Access to international finance is very difficult to achieve, and very expensive.
5. Unorthodox business practices that encourage corruption and money laundering, especially through the *cambios* (foreign currency traders) are common. In 2001, \$1 billion of approved import cover was unaccounted for.[57] Although a law banning money laundering was passed in February 2002, the Council of Ministers has not yet issued regulations for its implementation of the law.
6. The economy lacks scale, is largely cash-driven and is dominated by the informal sector.
7. There is a poor repayment culture, which translates into high lending risk for banks.
8. The Mozambican system has complicated and poorly defined property rights.

[55] *IMF Country Report No. 04/52*, March 2004, p.9.

[56] *Ibid*., p.4.

[57] Discussion with banker in Mozambique, November 2003.

Table 20: Specific constraints in Mozambique's financial sector (continued)
9. Only one company, CDM (SAB-Miller) has successfully listed on the Mozambican Stock Exchange, which opened in October 1999 and which allows for restricted trading of shares. The total market capitalisation of the Bolsa de Valores de Moçambique (BVM) is less than 3% of GDP.
10. The main preconditions for the further development of markets are absent. The country lacks a strong corporate sector with good disclosure and governance standards owing to an inadequate legal framework and few incentives for companies to comply with high standards. Access to finance through public offerings has been limited due to low demand by investors.

A further critical factor that drives up the cost of doing business is the lack of even basic infrastructure in certain areas. Sectors and companies have to invest heavily in coping mechanisms to overcome these deficiencies. The establishment of company sewerage farms is not uncommon. Although the power supply is now more secure, especially in Maputo, brownouts occur often in the rest of the country, and most companies have installed back-up diesel generators to ensure that they can keep their doors open in the event of a power cut.[58] One South African company had to sink its own boreholes to ensure a steady and reliable supply of water to its factories. Another invested in a water purification system on its roof to ensure a consistent supply should the normal service be disrupted. The poor transport infrastructure across the country also raises business costs. Companies that normally haul bulk cargo from

58 Steady progress is being made in the creation of a reliable power grid in Mozambique. A new 220/110 kV power substation that draws electricity from the Cahora Bassa Dam was inaugurated recently in Manica, and will service Sofala and Manica provinces. See MB371, Mozambique Business Daily Investor Intelligence, 11 March 2004.

one destination to another by land sometimes prefer to transport these goods by sea, as it is more cost-effective.

Many of the concerns raised by the South African business community are echoed by local companies, as this study by the UN Economic Commission for Africa (UNECA) shows:

Table 21: What do Mozambican residents want the government to know or do?

Area	*Areas, concerns and suggestions*
Governance	Commitment to public sector reform is evident from the top of the political hierarchy, but not middle-level personnel.
	Reorientation and retraining of middle-level personnel is required.
	Decentralisation is a key factor to improve public service delivery and reduce corruption
	Progress on decentralisation is too slow.
	The pace of national reconciliation and integration is slow.
Trade and Investment	The Investment Promotion Centre should be strengthened and made independent of the Ministry of Planning and Finance.
	Incentives created for FDI should be extended to local investors, particularly in agriculture and industry.
	Small and medium-sized enterprises face management and financial problems, due to weakness in both human resource capacity and the banking system.
	Customs and tax regulations are cumbersome and uncertain, with a lack of co-ordination among revenue agencies.
	Business wants a logical, rational tax system—not necessarily lower tax rates—to reduce uncertainty in financial planning.

Table 21: What do Mozambican residents want the government to know or do? (continued)	
Area	***Areas, concerns and suggestions***
Trade and Investment (continued)	The high value-added tax (VAT) rate is encouraging underground cross-border trade, undermining local legal business. Prompt refunds of VAT must be ensured.
	Opportunities for trade — under the Southern African Development Community, World Trade Organisation, US African Growth and Opportunity Act — are growing, but the capacity of local firms to meet international standards is low. A national trade strategy incorporating training, research, information sharing, technology, and finance and a supportive environment is needed.
Business and Regulation	Many rules and regulations — particularly for registration, licensing, and corporate taxation — are outmoded, cumbersome, and ambiguous.
	Due to under-financing from central government, municipalities harass local businesses to obtain revenue.
The rural poor	Measures may be needed to reduce the impact on the poor of trade liberalisation in agriculture and agro-processing.
	Access to primary, secondary, and tertiary education is key to rural poverty reduction. Teachers and private investors need incentives to move to rural areas.
	The agro-processing business for cashews, sugar, and fish needs to be revived.
	Food security should be strengthened by installing rural food storage facilities, improving transportation networks, and providing irrigation facilities to small farmers.

Table 21: What do Mozambican residents want the government to know or do? (continued)	
Area	***Areas, concerns and suggestions***
Financial sector	Interest rates are too high.
	The central bank needs to develop an effective microfinance system, linking informal and rural business to modern banking and finance and to a supportive policy and regulatory environment.
Education and training	Lack of an educated and skilled workforce could hinder long-term growth.
	Access to education is a key to reducing poverty and inequality.
	Private participation in the provision of higher education and professional training must be facilitated.
Infrastructure and utilities	The infrastructure linkages between regions and provinces need to be strengthened.
	Effective competition in the sector should be ensured.
Labour laws	Regulations for hiring workers are too cumbersome. Obtaining a work permit is time-consuming.
	The bureaucracy intervenes too much in industrial relations.
	Modern, flexible, and user-friendly labour laws are needed.
	The industrial labour force needs training and re-orientation from its socialist mindset.
Land acquisition	Land is not easily marketed. Its ownership is vested in the government but it is changing hands on the black market at exorbitant prices.

Table 21: What do Mozambican residents want the government to know or do? (continued)	
Area	***Areas, concerns and suggestions***
Medium-term economic prospects	The outlook for Mozambique's economy is weak, because of the high failure rate of local enterprises. There is a need for national corporate empowerment.
	However, the outlook is also good, because improved governance is generating inflows of FDI, donor funds and new opportunities for trade, agro-industry and tourism. The implementation of reforms, especially in governance and business regulations, and commitment to rule of law must be adhered to.
Source: UNECA, 2003	

Impact of the South African Business Presence on the Broader Business Environment in Mozambique

South African investment has had a significant influence on the Mozambican economy. The effects have been both positive and negative. Aside from boosting economic growth, transferring technology, increasing the quality and diversity of products and broadening consumer choice, the presence of South African companies has also led to some crowding out and dominance of local business and a rise in the trade deficit.

One of the main criticisms voiced against the nature of South African investment is that the linkages with domestic businesses are few, and that employment creation under the so-called mega-projects is also fairly limited and short-term. However, the longer-term benefits in terms of raising greater foreign investor confidence and introducing best practice in the market, especially regarding to employee benefits, training and influencing the corporate culture positively, are undisputed.

Impact on the labour market

South African business involvement in the Mozambican economy has had a marked effect on the structure of the local labour market, more specifically on wage levels, job creation, benefits and training.

The low skills levels in Mozambique in conjunction with government restrictions on the appointment of foreign labour have exposed certain rigidities in the local labour market. In the most recent Article IV consultation between the IMF and the government this inflexibility was identified as creating barriers to productivity, external competitiveness and employment growth.[59] Three areas in particular were mentioned, namely retrenchment costs, the hiring of expatriate labour and minimum wages.

The report states that retrenchment costs are high by international standards,[60] and tend to create an anti-employment bias. Moreover, they also complicate corporate restructuring, and have acted as a serious obstruction to recent privatisation efforts by the government. Several companies that are being offered for privatisation have been defunct for many years, but have never been wound up properly. This means that heavy absorption and retrenchment costs will be borne by the buyer, whether foreign or domestic. When CDM (SAB-Miller) bought the Laurentina brand in 2002,[61] it had to take over the entire staff component and pay the resultant retrenchment costs.

The acute shortage of highly educated workers in Mozambique sometimes makes the hiring of appropriately skilled foreign labour unavoidable. In 1999, only 483 students graduated from the country's higher education institutions, which is far short of the 1,200 professionals needed each year

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[59] *IMF Country Report No. 04/50*, 2004, p.20.

[60] Although lay-offs are allowed by law, retrenched workers with an employment duration of longer than three years are entitled to severance packages equivalent to three months' salary for every two years of service.

[61] The Reunidas brewery which produced the Laurentina brand was bought for $8.12 million by a consortium formed by the Commonwealth Development Corporation, Guinness, Castel and local investors.

to fill vacancies in the public sector alone.[62] Yet despite several regulations that have been adopted by the government to ease the approval and accreditation of foreign labour brought in to fill the skills gap, the process is still regarded as 'complicated, time-consuming and often unpredictable'. [63]

Lastly, the recent increases in the minimum wage, though low in global terms, do not take enough cognisance of the skills levels of individual workers or the impact the additional cost will have on employment. Smaller firms, the agricultural sector and the government are forced to comply with the terms set by the minimum wage, but the expense could discourage both employment and productivity.

The minimum monthly wage established by Mozambican law is MT814,602 (R325) for industry, commerce and services and MT570,000 (R228) for agriculture.[64] However, the entry of some of the South African companies into the job market has had a striking impact on wage structures. The highest-paid labour group in the country are the highly-skilled workers at the Mozal smelter. According to the Mozambican News Agency, the lowest wage paid to a smelter worker is US$4,000 per annum or $416 per month. This salary is ten times

The highest-paid labour group in the country are the highly-skilled workers at the Mozal smelter.

[62] *Economic Report on Africa 2003*, UNECA, 2003, p.144.

[63] *IMF Country Report No. 04/50*, 2004, p.20.

[64] An exchange rate of 2,500MT=R1.00 was used. Only 12% of the entire work force was in paid employment in 1999, 60% of them was in the private sector. Eighty-four percent of the labour force can be described as unskilled. Unemployment is considered to be about 21%. *Economic Report on Africa 2003*, UNECA, 2003, p.44.

the statutory minimum wage.[65] CDM (SAB-Miller) pays a minimum wage equivalent to $96 per month, which is more than two-and-half times the statutory minimum.[66]

In general, significantly higher levels of productivity are achieved in some of the South African-owned firms in Mozambique. It is estimated that the productivity per worker in Mozal is 18 times higher than that in the average firm in Mozambique.[67] This finding correlates with the general assessment that foreign-owned companies offer higher real wages and better working conditions than local companies. It is interesting to note that these conditions are associated with higher productivity. A study conducted by Te Velde and Morrisey of wage levels in foreign-owned companies in five African countries confirms that foreign ownership of a company is associated with higher wages at the individual worker level because jobs are generally more skills intensive.[68]

However, this positive news is somewhat tempered by the relatively limited creation of new employment opportunities in Mozambique by foreign investors, although the agricultural sector is an exception. South African investment in Mozambique, as is the case with FDI in other parts in the world, has not necessarily led to the creation of new, permanent positions on the large scale that the Mozambican economy needs. However, the addition of 24,355 jobs (1998–2002) to the Mozambican economy by South African employers is not insignificant.

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[65] Arbitration at Mozal, Mozambique News Agency ? AIM Reports, 199, 23 January 2001.

[66] Goldstein A, *op. cit*., p.47.

[67] Castel-Branco CN, *op. cit*., p.16.

[68] See Te Velde DW & O Morrisey, *Foreign Direct Investment: Who Gains?*, ODI Briefing Paper, April 2002.

The Mozal project created 5,033 temporary positions (70% for Mozambicans) during its construction and expansion phases. However, its full staff complement after completion of the expansion is about 800 staff members. More than 300 Mozambican contractors worked on the construction of the Sasol pipeline, generating wages in excess of $5 million. However, when the pipeline has been laid, its full staff requirement will shrink dramatically, to under 200. (This number does not reflect the expected increase in jobs related to upstream and downstream activities.)

Table 22: South African investment: Employment figures, 1998–2002

Sector	***1998***	***1999***	***2000***	***2001***	***2002***	***Total***
Agriculture	607	2,669	6,551	472	80	10,379
Aquaculture & fisheries	18		100		18	136
Industry	1,218	554	229	162	197	2,360
Resources and minerals	0	17		41	0	58
Transport and communication	25	172	74	390	10	671
Banking, insurance and leasing		16		8	0	24
Construction		399	3,337	2,168	437	6,341
Tourism and hotel industry	346	172	560	71	22	1,171
Others	438	289	167	576	1,745	3,215
Total	2,652	4,288	11,018	3,888	2,509	24,355

Source: CPI, Mozambique, 2004

In contrast, South African investment in just two sugar mills and estates at a fraction of the cost of the Mozal and Sasol mega-projects, created 3,034 permanent positions and 5,398 temporary positions for seasonal workers. This finding is consistent across the agricultural sector and highlights the need for the Mozambican government to attract more investment into this critical area of economic activity.

Despite the relatively limited creation of permanent positions in the industrial sector, one of the main business chambers in Mozambique was unequivocally positive in its assessment of the influence of the large South African investors (especially companies such as CDM, BHP-Billiton and Sasol) on the Mozambican labour market, business culture and economy. The Head of the South African–Mozambican Business Chamber expressed the opinion that because South African companies are introducing best practice into the Mozambican economy through insistence on good corporate governance, their presence will influence the business culture positively in the long run. They are already making a significant social impact in their own spheres of activity, as illustrated by the creation of additional benefits for their employees. Private pension funds and medical aid schemes are non-existent in Mozambique. All companies are obliged to pay contributions into a government-led pension fund, the National Social Security Institute (INSS), but this has a limited financial reach.[69] Some of the large South African investors are currently discussing the development of norms for salaries, company pension funds and company medical aid schemes with other investors. CDM,

[69] The financial soundness of the INSS is suspect. It does not disclose reliable financial statements based on independent actuarial evaluation on a regular basis. It is also the regulator of the pension sector. The IMF strongly recommended in its latest Financial System Stability Assessment that regulatory procedures should be strengthened. *IMF Country Report No. 04/52*, pp.7, 23.

for example, introduced an HIV-AIDS staff education and prevention programme in 2001, and has added the provision of antiretroviral therapy to the programme. Employees and their families now have free access to confidential treatment, counselling and medication, fully funded by the company.

Impact on the trade balance, economic growth and revenue

One of Mozambique's outstanding economic success stories has been its high economic growth rate over the last 10 years. South African-led investment in conjunction with significant foreign aid flows into Mozambique has made the most immediate and visible impact on GDP growth and exports.

The first substantial inflow of FDI began in 1997 with the construction of the Mozal smelter. Investment inflows increased from $64 million in 1997 to $235 million in 1998. (See Table 5.) In 2002, when the smelter came on line, this project single-handedly contributed about 2.1% to real GDP growth. In the same year Mozal was responsible for 53% of total exports and 28% of total imports.

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Although some analysts regard the growth in imports that accompanies the establishment of mega-projects less positively than others, the Mozal project resulted in a net positive impact on the balance of payments of around $100 million in 2002.[70] The outlook for 2004 is significantly better, and is projected to increase to $523 million.

Table 23: Trade Balance, 2000–2004 ($ millions)					
	2000	***2001***	***Preliminary 2002***	***Revised 2003***	***Projected 2004***
Trade Balance	-799	-360	-581	-705	-229
Exports, f.o.b.	364	703	682	896	1,259
Large projects	127	441	468	632	973
Other exports	237	236	213	265	286
Imports	-1,163	-1,063	-1,263	-1,602	-1,488
Large projects	-119	-231	-390	-646	-450
Other imports	-1,044	-832	0873	-955	-1,038
Source: IMF Article IV, p.36					

The IMF predicts that real GDP growth will increase to over 8% in 2004 owing to the coming onstream of both the Aluminium smelter (Mozal II) and the gas pipeline (Sasol). Exports are expected to increase by 40%, whereas imports are expected to decline somewhat because of reduced construction activity resulting from the completion of these

[70] See Castel-Branco, who argues that imports from South Africa have grown with the increase in South African FDI and that export-orientated mega-projects (which are mainly focusing on primary goods) are making the Mozambican economy excessively vulnerable to the volatility of the world market. Castel-Branco CN, *op. cit*., p.17.

mega-projects. At the same time, net international reserves are also projected to rise by $40 million during 2004 to a level of $696 million by the end of the year (translating into 5½ months worth of imports).

South African investment has also bolstered revenue for the Mozambican government. Taxes paid by the Mozambican breweries have increased 700% since the purchase by SAB of CDM in 1995 and the Laurentina brand in 2002 and CDM provides 5% of total tax revenue. Tax revenue generated by the Mozal smelter is much more limited, as the complex has been given the status of an Industrial Free Zone (IFZ).

The impact of these increased revenues and economic growth on poverty reduction is real, despite the problems associated with disparate rates of development in different sectors of the economy. A remaining challenge for the Mozambican government is to sustain high growth levels between mega-projects. Although the economic effect of a mega-project is spectacular in the year that it is launched, its impact understandably taper off in the following years.

Impact on technology transfer, skills levels and industrialisation

It is also clear that South African investment has accelerated the industrialisation of Mozambique. The country's economy was dominated during the 1980s and the 1990s by the agriculture and services sectors, but the situation changed significantly from 1997 onwards. The contribution of agriculture to GDP decreased from 30.5% in 1996 to 19.5% in 2002. In contrast, the share of industry (mostly related to aluminium production and the construction of the gas pipeline) has grown considerably during the corresponding period, from 16% to 30.96%.[71]

However, it is important to recognise that the agricultural sector is still the largest employer in Mozambique. The majority of the Mozambican population in the rural areas (about 80%) are involved in subsistence farming. This has important implications for the Mozambican government. It is a major challenge to harness and develop Mozambique's agricultural potential. Foreign investment in the sugar industry has been welcomed, because not only has South African and Mauritian involvement led to the rehabilitation of Mozambique's four sugar estates and mills, adding to revenue and export growth, but as noted earlier the sugar industry has also emerged as a significant employer of Mozambicans in the agricultural sector.

Other beneficial impacts have been an increase in the skills levels of the Mozambican workforce and the transfer of world-class technology. The Mozal smelter has the highest pot efficiency for AP30 technology in the world. Two important records were established during the construction phase of the smelter. The completion of the first phase of Mozal took place within 31 months, from approval to full commissioning, and came in at US$100 million under budget. The second phase was completed within 26 months and came in at US$195 million under budget.

The Sasol investment in Mozambique will provide a further spin-off in the future — a supply of gas to spur internal industrial growth.

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[71] *Mozambique Country Profile 2003*, Economic Intelligence Unit, 2003, p.51 and Republic of Mozambique: Statistical Appendix, *IMF Country Report No. 04/51*, March 2004, p.30.

Increasing consumer choice and creating price stability

Certainly one of the most positive results of the expansion of South African business into Mozambique has been the increase of consumer choice and a consistent and reliable supply of goods to the local consumer. A spin-off effect of consistent supply is the creation of price stability in the Mozambican market, which is important because of the dominance of the informal sector. As South African retailers pointed out during the survey, the prices they set are a true reflection of the duties and taxes that have to be paid by traders. This creates a new discipline and rigour in the local pricing of goods. Formerly, formal and informal traders could charge whatever they wished, especially in cases where stock was obtained through smuggling.

Impact on foreign business confidence

One of the most intangible but important effects of South African investment has been the bolstering of the confidence of other foreign investors in Mozambique. The country has attracted investment from other countries steadily since 1997.

Moreover, many South African companies have followed in the footsteps of their countrymen. This 'tag-on' effect has been an important factor in determining the entry of new South African investors and the expansion of current projects. For example, the hospitality industry and financial services sector have expanded their presence to cater specifically for South African investors. The cumulative effect has not been limited only to South African companies servicing other South African enterprises. The entry of businesses from Japan, the UK and Australia with South African partners into the mega-projects is a positive show of business confidence.

Indeed the successful implementation of mega-projects such as the Mozal aluminium smelter and the Sasol pipeline (within budget and the projected time-frame) has had a huge impact on general business confidence in Mozambique. Both projects have been used to demonstrate Mozambique's ability to absorb and respond to the demands and requirements of large investors.

Less positive effects

The most significant failure of investment (not only South African) has been the relatively few linkages that have been established with the local business community. Although efforts have been made to address this problem, the results have been mixed. Part of the problem is that South African firms have high levels of knowledge specificity and are capital-intensive. Both are difficult to transfer to local companies.

There are some positive examples of cases where linkages with local business were actively pursued. One was the expansion linkages programme (SMEELP) launched by the International Finance Corporation (IFC), in co-operation with Mozal, to set up specific training programmes for small and medium enterprises. The purpose of the project was to support local companies employed to work as sub-contractors on the expansion of the smelter. The mentoring and training programme successfully linked 12 companies to 21 contracts with Mozal at a value in excess of $3 million.[72] Another example relates to the concession contract won by the Trans-African Concessionaires Consortium (TRAC) in 1996 for the upgrading of N4 national highway from Witbank to the Mozambican capital. The project, which was the first Build, Operate and Transfer (BOT) undertaking in Mozambique, included the obligation to contract 40% of the building work in Mozambique to local firms. The project was deliberately subdivided into contracts of a size that could be handled by small contractors.[73]

However, on the whole South Africa's influence on domestic private investment has been fairly limited. Castel-Branco states in his analysis that there has been no significant inducing, precluding or displacement of local investment because not only is domestic investment capacity poor, even those firms that have been displaced by foreign competition would in any case have been unable to continue their operations.[74]

The superior technology, business knowledge and (relative) financial strength of South African companies in the Mozambican market have also contributed to the domination of the local industry.[75] While this is also the case with other foreign investors, the sheer volume of South African investment in the market has created resentment. Because of

South Africans have been singled out as responsible for the crowding out of local business.

[72] Goldstein A, *op. cit.*, p.28.

[73] *Ibid*, p.29.

[74] Castel-Branco CN, *op. cit.*, p.15.

[75] The South African economy is 40 times as large as that of Mozambique.

their strong presence in the local economy, South Africans have been singled out as responsible for the crowding out of local business. This perception requires careful management by both the companies involved and the government. As Goldstein has pointed out political opposition to FDI is not uncommon in the rest of the world. It is often the result of the manipulation of public opinion by groups that previously benefited from the rents created under previously oligarchic economic systems and who now feel threatened by more efficient foreign competitors.[76]

Most companies interviewed admitted they are highly import-dependent. On average they procure less than 10% of their production inputs from local suppliers. The reasons given were inferior quality, inadequate and inconsistent supply (because of the low volumes produced) and high cost. Certain inputs such as diesel are sourced largely in the domestic economy, but for refined or value-added inputs, companies turn to South African or other suppliers.

The building of the mega-projects (supported by considerable South African investment) also led to spikes in Mozambique's trade deficit. The construction of the Maputo Corridor, Mozal and the Sasol Pipeline all resulted in increased importation of construction equipment, accessories and parts from South Africa and elsewhere. However, it is more useful to judge the contribution of Mozal against the Mozambican government's industrialisation policy through export-led growth rather than through the narrow lens of its impact on imports.

[76] Goldstein A, *op. cit.*, p.75.

Some Policy Recommendations

The representatives of South African businesses interviewed identified a number of policy recommendations that would support the creation of a more sustainable business environment in Mozambique. These are to:

- reduce bureaucracy and red tape, especially related to the registration and licensing of businesses;
- take firmer action on corruption and theft;
- educate the civil service in the requirements of the global investor and the business environment;
- enforce tax and excise payments and resolve the issue of VAT repayments;
- ensure the tax regime remains competitive with that of neighbouring countries, so that Mozambique remains a preferred investment destination;
- reduce import taxes, to make prices more affordable to Mozambican consumers;
- phase out the dollarisation of the economy;
- strengthen and reform the legal system;
- introduce more transparency in tendering processes;
- focus more energy on the development and maintenance of infrastructure;
- ensure that input costs for production (such as the prices of water, electricity and municipal taxes) are realistic and consistent;
- make it easier for smaller businesses to invest in Mozambique (which would also support the local business sector);
- target and attract more labour-intensive industries;

- ensure that labour legislation reform takes cognisance of the high unemployment figure and low skills level in the country;
- expand the existing dialogue with large businesses to smaller businesses;
- address the provision of work permits for foreign workers more effectively;
- ensure better co-operation between the Investment Promotion Centre and relevant government departments to ease the entry of new investors; and
- insist that the positive commitments that are made at ministerial level are implemented by the lower ranks in the public service.

Recommendations were also made to the South African government that would support business co-operation between the countries and enhance the business environment in Mozambique. The government should:

- simplify and streamline import bureaucracy on the South African side;
- improve and strengthen border controls to address the high levels of smuggling across the South African–Mozambican border;
- strengthen police-to-police co-operation to counter corruption and smuggling;
- develop a more responsive and simple visa policy that takes cognisance of the training needs of companies (although most of this is provided in-house in Mozambique, almost all the companies interviewed said that they often need to train their employees in South Africa);

- reintroduce a trade attaché to the South African mission in Maputo and provide more support to smaller South African investors in Mozambique;
- show sensitivity to allegations of domination by South Africa, and develop strategies to counter this perception;
- offer public service training and other skills education to Mozambican government departments;
- create a greater awareness of the implications of Mozambican legislation and accounting systems amongst potential South African investors;
- use more Portuguese-speaking South Africans in government delegations and the South African mission in Maputo; and
- sign a double taxation agreement with Mozambique.

Lessons from Mozambique

Several key lessons for prospective investors, current investors and both governments can be drawn from the South African business experience in Mozambique.

First, government support and involvement has proved to be indispensable in the conceptualisation and implementation of large infrastructure projects. One could argue that the construction of the Maputo Development Corridor, the Sasol gas pipeline and the Mozal smelter could not have taken place without the active involvement of both governments, which ensured the provision of a supportive regulatory framework. In the case of the Mozambique government, a range of special measures had to be introduced to overcome the logistical bottlenecks that businesses commonly encounter in that country. This entailed setting up a series of consultative government task teams that worked with the project teams of both Mozal and Sasol to discuss critical areas, overcome logistical hurdles and ensure that the implementation deadlines were met. Both governments placed the completion of the projects high on the bilateral agenda. Political will was demonstrated in the signing of several agreements between the two countries.

Second, disposable income in Mozambique is still very meagre. This has a direct bearing on the viability of some businesses, especially in the retail, restaurant and tourism industries. The Mozambican government faces several serious challenges, which include the integration of Mozambique's substantial informal economy into the formal economy, to ensure a broadening of the country's revenue base; the lowering of duties to counter smuggling, and to ensure more cost-based competitive behaviour that will broaden consumer choice for ordinary Mozambicans; the 'de-dollarisation' of the economy, which will favour Mozambican consumers, arrest the development of a dual economy and ensure the competitiveness of the Mozambican economy in relation to neighbouring economies. Mozambique also needs to boost the leisure and tourism industry by marketing the country's natural beauty in a more focused manner.[77] Prospective investors in Mozambique in these sectors should be aware that at present the market is considered both thin and over-stocked.

Third, the active targeting and routing out of corruption is a crucial issue. Doing so would require building the capacity of the courts and curtailing and modernising the range of outdated and unhelpful bureaucratic bottlenecks which do not support business (either foreign or domestic), but instead obstruct it and serve as a pretext for rent-seeking. One South African investor suggested that if the customs support contract of Crown Agents were to be withdrawn this would lead the total collapse of any progress that has been made in customs regulation.

Fourth, it is absolutely critical that the Mozambican government introduces a greater number of business-friendly measures to stimulate domestic enterprises. Foreign investors cannot be expected to lead where domestic business should be leading. Incentive measures to attract foreign investors cannot be sustained in the long term, create distortions in the economy and cause resentment amongst local business

[77] In 2002, about 400,000 tourists visited Mozambique, increasing revenue earned by the state to about $50 million. See *Mozambique Daily Business Investor Intelligence*, MB150, 17 February 2004.

people.[78] The government should actively seek to capitalise on the positive impact that FDI makes by improving linkages with the local business community. However, this will not happen automatically, and can be sustained only if domestic business is strengthened through capacity building.

Fifth, important blockages in the investment spread are emerging. Most foreign investment has taken place in the southern part of Mozambique because of the relatively superior quality of the infrastructure there in comparison with that in the rest of the country, as well as its proximity to South Africa. Investment outside the city of Maputo has also been focused predominantly on the provincial urban areas. It is critical that the Mozambican government addresses key infrastructure and land tenure issues[79] (especially in the rural and burgeoning urban areas) to ensure a better spread of investment into the rest of the country. Whereas the needs and sophistication of the South African market have boosted the development of certain projects in Mozambique, such as the gas pipeline to Secunda, Mozambique also faces the unhappy circumstance that other regional feeder and absorption

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[78] As yet Mozambique has not introduced any performance requirements regarding local content or technology transfer. The exception being local management criteria if a foreign company wishes to register as a Mozambican company, which holds some tax advantages. It is assumed that FDI will lead to job creation, growth in exports and revenue. The psychological and structural barriers to investment in a country such as Mozambique are still too high to develop a range of restrictive performance requirements.

[79] The government is in the process of translating the Land Law in a variety of local languages and in English to ensure a better understanding of the legislation. However, these efforts seem fairly ineffectual if the relevant authorities are not strengthened and monitored more effectively in terms of the implementation of the legislation.

economies are in serious difficulties. Zimbabwe's economic crisis has had a significant impact on the performance of the Beira port and has aggravated the economic growth disparities between the North and the South of the country.

The concentration of FDI in Maputo and southern Mozambique is also reflected in the spread of GDP per capita, which is six times higher in Maputo than the national average.

Table 24: Distribution of foreign and local investment, by province, 2001

Province	***Foreign direct investment***		***National direct investment***	
	$000	***% of total***	***$000***	***% of total***
Maputo (city and province)	479,630	92.7	23,844	71.4%
Sofala (centre)	17,370	3.4	137	0.4
Cabo Delagado (north)	8,859	1.7	3,694	11.0
Nampula (north)	5,818	1.1	455	1.4
Inhambane (south)	3,006	0.6	2,842	8.5
Manica (centre)	740	0.1	220	0.7
Zambezi Valley	706	0.1	805	2.4
Zambezia (centre)	706	0.1	916	2.7
Gaza (south)	445	0.1	478	1.4
Tete (south)	280	0.1	5	0.0
Niassa (north)	0	0.0	0	0.0
Total	517,561	100.0	33,396	100.0

Source: CPI, 2002 & UNECA, 2003

Conclusion

In conclusion, Mozambique has made considerable progress since the early 1990s in establishing a more enabling environment for the smooth conduct of business and as a consequence has attracted substantial foreign business interest led by South African firms.

South African and other foreign investment in Mozambique has been immeasurably positive in its contribution to growth in productivity and income through its introduction of modern capital goods and more sophisticated management practices. It has also assisted to bridge the savings/investment gap and support the drive to reform economic policy.

The most striking characteristic of the South African investors in Mozambique is their capacity for peer learning and for developing strategies to overcome structural barriers. This motivation to succeed has been complemented by the Mozambican government's willingness to engage with serious (read big) investors in an appropriate and responsive manner, despite all the deficiencies of the country's regulatory framework.

However, if the Mozambican government wishes to broaden growth and reduce poverty, it is incumbent on it to introduce further fundamental structural reforms, such as developing appropriate institutions and frameworks within which the market can operate efficiently; improving good governance and transparency; encouraging private investment; and boosting productivity. In particular, the government should reduce the amount of red tape, develop basic infrastructure, reduce labour rigidities, reform the justice system and combat corruption more effectively.

Annexure A

Significant South African investments in Mozambique since 1994				
Investment	***Investor and project details***	***Type***	***Amount***	***Date***
Cervejas de Moçambique (CDM)	South African Breweries	Acquisition	$25m	1995
Banco Standard Totta de Moçambique	Standard Bank Group	Acquisition	$6m	1995
Mocita Cashew Nut factory	Anglo American		$13m	1996
Shoprite Checkers	Shoprite Checkers	New	$3m	1997
Mozal I	Multi-state including the IDC (24%)	New	$1.34bn	1997
Maragra Sugar Mill	Illovo Sugar	Privatisation	$52m	1997
Maputo Development Corridor	Basil Read, Stocks and Stocks and other (Trans African Road Concessions TRAC)	New	$1bn	1998
Motraco	Eskom Holdings	New	$120m	1998
Holiday Inn	Southern Sun Hotels	New	$13m	2000
Mozal II	Multi-state including the IDC	Expansion	$860m	2001

Significant South African investments in Mozambique since 1994 (continued)				
Investment	***Investor and project details***	***Type***	***Amount***	***Date***
Pande & Temane gasfields, Temane processing facility	Sasol SA: Pipeline to Secunda completed in December 2003	New	\$1.2bn	2001
Banco Austral (formerly Banco Popular de Desenvolvimento (BDP)	80% by ABSA (re-privatisation)	Privatisation	\$10m	2001

Annexure B

Investment Guarantees and Incentives in Mozambique

1. Guarantees

The Government gives the following guarantees to investors:

- security and legal protection of property over goods and rights in connection with investments made;
- freedom to import equity capital or to acquire loans to carry out activities related to investments;
- the remittance of funds abroad, in connection with:
    - exporting foreign investors' profits,
    - payment of royalties and other charges abroad,
    - loan repayments and interest charges due abroad, and
    - any amounts paid as just and equitable compensation;
- repatriation of capital invested upon liquidation or sale, total or partial, of goods or rights of an investment undertaking; and
- just and equitable compensation in event of expropriation based on absolutely necessary and weighty reasons of public and national interest, health or public order.

Mozambique is a member of MIGA and OPIC (insurers against non-commercial risks), and offers recourse to arbitration through the International Centre for the Settlement of Investment Disputes (ICSID) and the Paris-based International Chamber of Commerce (ICC).

2. Incentives

The Government offers exemption from customs duties and Consumption and Circulation Tax on:

- equipment for carrying out project feasibility studies, and for investment project implementation;
- building materials and equipment necessary to carry out an approved investment project;
- light passenger cars for company representation, provided that the relevant value does not exceed 1% of the value of the total project investment;
- raw materials, intermediate products and packaging materials for production of export goods, medicines, educational materials and foodstuffs;
- a 50% reduction in the normal Customs Handling Fees (paying only 2.5% of the total value of the above-mentioned imported goods); and
- the personal belongings of foreign investors and expatriate technical staff.

Regional distribution of fiscal incentives			
Region A (Niassa, Tete and Cabo Delgado)	***Applicable taxes (%)***		
	Agriculture	***Industry***	***Others***
80% reduction in the Industrial Contribution Tax	7.00	8.00	9.00
80% reduction in the Supplementary Tax	3.60	3.60	3.60
+ 6 years 50% reduction in the Industrial Contribution Tax	17.50	20.00	22.50
Region B (Nampula, Zambézia, Manica and Sofala)	***Applicable taxes (%)***		
	Agriculture	***Industry***	***Others***
65% reduction in the Industrial Contribution Tax (outside the provincial capitals);	12.25	14.00	15.75
65% reduction in the Supplementary Tax (outside the provincial capitals)	6.30	6.30	6.30
50% reduction in the Industrial Contribution Tax (within the provincial capitals)	17.50	20.00	22.50
50% reduction in the Supplementary Tax (within the provincial capitals)	9.00	9.00	9.00
+ 3 years 40% reduction in the Industrial Contribution Tax	21.00	24.00	27.00

Regional distribution of fiscal incentives (continued)			
Region C Inhambane, Gaza and Maputo)	***Applicable taxes (%)***		
	Agriculture	***Industry***	***Others***
65% reduction in the Industrial Contribution Tax (outside the provincial capitals);	12.50	14.00	15.50
65% reduction in the Supplementary Tax (outside the provincial capitals)	6.50	6.50	6.30
50% reduction in the Industrial Contribution Tax (within the provincial capitals)	17.50	20.00	22.50
50% reduction in the Supplementary Tax (within the provincial capitals)	9.00	9.00	9.00
+ 3 years 25% reduction in the Industrial Contribution Tax	26.25	30.00	33.75
Normal Rates	***Agriculture***	***Industry***	***Others***
Industrial Contribution Tax	35.00	40.00	45.00
Supplementary Tax (with progressive rates from 33–40%, being the average 18%)	…	…	…

***For new or paralysed undertakings*:** During the period of recovery of investment expenditures (10 fiscal periods maximum), the Industrial Contribution Tax and Supplementary Tax rates shall be reduced by:

- 80% for investments in Niassa, Tete and Cabo Delgado;
- 65% for investments located in other provinces, outside their respective provincial capitals; and
- 50% for investments located in other provinces within the provincial capitals.

***For investments in operating ventures*:** 100% of investments made in new equipment and construction of plant and infrastructures shall be deducted from taxable income of (for up to 5 fiscal years).

***Additional incentives for investments located in less-developed provinces*:** The reduction of Industrial Contribution Tax shall be extended by:

- 50% for six years in cases of investments made in Niassa, Tete and Cabo Delgado;
- 40% for three years for investments made in Sofala, Manica, Zambezia, Nampula (excluding the provincial capitals); and
- 25% for three years for investments made in Inhambane, Gaza and Maputo (excluding the provincial capitals).

***The expenditures accountable as losses for taxation purposes are those made in*:**

- construction or rehabilitation of public infrastructures (roads, schools, hospitals, sewerage, electricity, etc) up to 120% of their value;
- purchase for private ownership of works of art or other actions which contribute to the development of Mozambican culture (as per Law No. 10/88, of 22/12/88); and

- training of Mozambican workers (up to 5% of total taxable income).

***No taxes are payable on own equity capital, loans and accrued interest*:** Capital gains, are however, taxable.

3. Industrial free zones

With effect from 1 January 1994, Mozambique introduced new legislation allowing for the development, by private agents, of Industrial Free Zones (IFZs) for the promotion of export processing activities.

IFZs are defined as industrial estates or industrial units geographically delimited and governed by a special customs and tax regime, under which they and the investors operating therein, (namely the IFZ development and/or administration companies and the IFZ certificate holders? industrialists), enjoy the following benefits:

Full exemption from customs duties, Consumption and Circulation taxes and Customs Handling Fees on imports of:

- civil construction equipment and materials;
- machinery and the industrial and transport equipment and the accompanying parts, accessories, spare parts and raw and subsidiary materials;
- telecommunications equipment (faxes, telexes, telephones, terminals for transmission of data), photocopiers, air-conditioners, fans, air-extractors, typewriters, computers, word-processors, electrical office equipment, equipment for running professional training programmes such as projectors, video recorders and televisions, and the relevant accompanying spare parts and accessories;

- raw materials and intermediate products to be used exclusively for the production of articles for export; and
- up to 20 light passenger cars for representation, provided that their value does not exceed 1% of the total project investment value.

Full exemption from any taxes on exports and profits, subject only to the payment of one of three modalities of an IFZ single royalty tax:

- **For IFZ development and/or administration companies** (payable only from the 6th year of operation and exempted during the first 5 years):
  - 1% of gross turnover (on a quarterly basis), or
  - \$75/ha/month for the land area granted for the IFZ, or
  - \$1,000/ha/year for the land area granted for the IFZ;
- **For industrial companies operating within the IFZ** (only from the 2nd year of operation, and exempted during the first year):
  - 1% of gross turnover (on a quarterly basis), or
  - \$0.75/m^2/month for the land area occupied by the company, or
  - \$10/m^2/year for the land area occupied by the company.

Individual export-oriented enterprises or factory units located outside the specified zones may also apply for registration as IFZ companies to benefit from this special incentive regime.

4. Exploration for minerals, petroleum and gas

The registration of investments for prospecting and exploration of mineral resources is regulated by the Mining Law (Law No.

2/86, of 2 April). Investments in the area of prospecting hydrocarbonates (petroleum and gas) are regulated by the Law on Petroleum (Law No. 3/81, of 3 October).

The concession and exploitation of mineral resources can be covered by three regimes, namely:

- area of mining concession;
- area of mining licence; and
- area of mining certificate (or *alvara*).

The taxes on exploitation of mineral resources (royalties), applicable on the production of minerals, in areas of concession and/or of licence, are indicated in the section on the Fiscal and Exchange Regime.

Concerning areas of exploitation under the regime of a mining certificate, the taxes on exploitation (royalties) are indicated in the same section.

The tax on the exploitation of petroleum and gas (royalties) is negotiable, and can be paid in money or in kind, depending on the State's preference.

The applicable Industrial Contribution Tax rate for mining activities is 40%. The incentives from the Code of Fiscal Benefits for investments in Mozambique described in section 6 are also applicable to the mining sector.

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