Public-private pacts in poultry and cotton for economic transformation in Mozambique

In brief

• Over the next decade, the Mozambican economy will receive enormous FDI inflows linked to the exploration of the large natural gas reserves in the Rovuma basin which will have a significant impact on economic growth.

• However, this natural resource extraction does not guarantee sustainable socio-economic development, meaning there is a need to create a robust and balanced economy and for the government to focus on effective policies to boost the (agro-) industrial sector.

• This paper examines Mozambique’s poultry and cotton sectors in order to identify opportunities for public-private interactions that could bring about innovation and growth.

• The main finding is that the government should aim to negotiate sector-specific “pacts” with relevant private sector stakeholders. Through these pacts, the government commits to resolving specific constraints through targeted public investments or policy initiatives, including regulatory reforms. The private sector, in turn, commits to specific investments in capacity expansions, productivity improvements or technological upgrading.

• The authors make three policy recommendations on how the government can identify opportunities and effectively negotiate these public-private pacts in order to create inclusive economic development.
The challenge of (agro-) industrial growth

Over the next decade, the Mozambican economy will receive enormous FDI inflows linked to the exploration of the large natural gas reserves in the Rovuma basin. This will have a significant impact on economic growth, and generate substantial fiscal revenues that the state can use for public investments in relevant areas. Despite this potential, however, the natural resource extraction does not guarantee sustainable socio-economic development. Firstly, the resource exploration is capital-intensive, and will not be able to create the number of jobs that the economy needs. Secondly, it may threaten other productive sectors through negative Dutch Disease effects if the resource inflow is not neutralised and leads to the appreciation of the Metical. In this context, in order to create a robust and balanced economy, now is the time for the government to focus on effective policies to boost the (agro-) industrial sector.

While there is no shortage of economic transformation strategies on the African continent, many have not been effectively implemented. Most strategies are general and multi-sectoral and thus fail to address important sector-specific constraints. Additionally, failure to effectively integrate the private sector in policy design and implementation often leads to poor results. Most examples of successful industrial policies illustrate the importance of an effective dialogue between the state and the private sector, the build-up of trust, and the ability to make mutual credible commitments (Te Velde 2013, ACET 2014, Balchin et al. 2017).

For a long time, the predominant advice to developing country governments was to focus on high-level public-private dialogue as the basis for business environment reforms. While important, it is difficult to transform this dialogue into a concrete plan of action with feasible mutual commitments. The high-level constraints discussed usually involve complex political economy issues, which could redirect attention away from sector-specific barriers that may be easier to fix. One of the main aims of public-private dialogue is to reduce policy uncertainty and create trust so that the private sector feels confident to increase investments. It may be easier to build such bridges around sector-specific objectives. As pointed out by Whitfield and Buur (2014), sector-level predictability and credible commitment can occur even when the overall business environment is poor.

From dialogue to pacts

The government of Mozambique approached the IGC to examine the poultry and cotton sectors and identify opportunities for public-private interactions that could bring about innovation and growth.

The main recommendation from these studies is that the government
should aim to negotiate sector-specific “pacts” with relevant private sector stakeholders. Through these pacts, the government commits to resolving specific constraints, through targeted public investments or policy initiatives, including regulatory reforms. The private sector, in turn, commits to specific investments in capacity expansion, productivity improvements, or technological upgrading. Such pacts result in the active involvement of the private sector in industrial policy design and implementation and could boost investment and growth by creating clarity and certainty around feasible reforms.

The pacts may function as signalling mechanisms, showing that the government is committed to a specific sector. This signal, in turn, could not only help firms get access to finance, knowledge, and other important drivers of firm growth, but more importantly, could stimulate entrepreneurs to invest in these markets.

An important, and possibly critical, caveat is that such pacts will not be consistent with the public interest if they undermine competition. Public-private agreements based exclusively on protectionist measures or those favouring incumbents at the expense of entrants are not, in principle, welfare-improving. The two agribusiness value chains that we focused on in Mozambique – poultry and cotton – have demonstrable potential for significant expansion on a competitive basis without artificial barriers.

The Mozambican poultry and cotton sectors differ in many important ways – poultry is an import-substitution sector, while cotton is export-oriented, and they have very different capacity utilisation rates. The formal slaughterhouses producing frozen chicken are operating at, or even beyond, their installed capacity. The cotton ginneries, on the other hand, have been operating at less than 40% capacity utilisation for lack of raw material, which increases their unit cost. Farmers achieve very low yields and, in most years, simply do not produce enough cotton at the prices that can be paid by the ginning companies, considering international market conditions.

The pacts, therefore, would take very different forms and reflect the nature of the specific constraints identified in each sector. In poultry, for instance, the private sector would commit to increasing processing capacity, while in cotton, the ginners would expand investments in input and technical assistance packages for cotton farmers to increase productivity. In each case, the government would then commit to specific reforms that could maximise returns to these private sector investments. While the details are different, we uncovered broader themes that are highly relevant in both value chains.

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1 The IGC studies make detailed proposals for such pacts.
Regulatory clarity

Regulatory clarity on sector-specific issues is key for firm-level investment and growth. In the case of poultry production, current regulations are not clear on, for instance, whether brining (the injection of a mixture of salt and water) is allowed. Brining alters the taste and texture of the meat but also increases the weight, reducing the production cost per kilogram. It is allowed within legislated limits in South Africa, the economic powerhouse of the Southern African Development Community Free Trade Area and the origin of a substantial part of Mozambique’s chicken imports. Not allowing Mozambican chicken producers to apply the same technology would place local production at a disadvantage vis-à-vis imports. Because it has an impact on slaughterhouse design, the uncertainty could also discourage further investments in slaughterhouses.

In cotton, regulatory clarity is needed regarding the organisation of the whole sector. In Mozambique, cotton production has been organised in a concession model, with cotton ginners awarded specific geographical concessions. Within a concession, the ginner is the sole buyer, but is also responsible for providing inputs and technical assistance to the cotton farmers. A minimum price is established each year in discussions involving the government, the ginners, and the cotton farmers. In 2008, the government approved a document indicating that the sector should move towards liberalisation within seven years. Since then, there has been no official communication to clarify whether liberalisation has been abandoned indefinitely, or if it is still in the cards for the short- to medium-term. Uncertainty over the future of the organisational model does not incentivise further investments by incumbents or entrants. In fact, experience seems to indicate that in sub-Saharan Africa, the concession model is a superior alternative.

Looking at the entire value chain

The analyses from IGC research reveal the importance of considering the entire value chain in formulating an effective approach to reform and transformation. Feed costs represent up to 60% of chicken production costs, and about 40% of that is accounted for by soybean meal. Brazil’s competitiveness in poultry production can be largely traced to its soy boom starting in the 1960s. The most valuable product was the soy oil, but its extraction resulted in large quantities of soybean meal, which was then sold to the animal feed industry. The soybean meal, essentially a by-product, was cheaper than the actual soybeans. In Mozambique, however, soy production emerged on the back of demand for poultry feed, while there is no strong market for the soy oil. As a result, the soybean meal is actually more expensive than the soybeans. With a more vibrant value chain for other soy-based products, the price of the meal could go down, making poultry production more competitive.
A similar dynamic is present in the cotton sector. In this case, the main objective of production is the fibre that is then turned into cotton lint in the ginneries. However, the cottonseed that is left can be crushed and used for the production of various by-products, with cottonseed oil being the most important. In many cotton-producing countries, the seed represents 20% of the value of the cotton crop. In Mozambique, however, it makes up only 10%, again as a result of an underdeveloped market. By promoting the consumption of cottonseed oil and other by-products through coordinated public and private initiatives, the value of cotton would increase. This would allow ginners to pay a higher price to farmers, thus generating additional production, increasing the ginners’ capacity utilisation, lowering their unit costs, and allowing for better farmer prices. This virtuous cycle would create further opportunities for productivity-enhancing investments.

**Customs administration**

A common barrier facing these and other sectors is the lack of effective customs administration. Mozambique officially has a poultry import quota, but our study found that it is not being adequately enforced. We found a large discrepancy between Mozambique’s official poultry import figures and export figures declared by its trade partners. Actual imports appear to be at least twice as large as those that are officially declared. In other words, smuggling seems rampant.

Imported palm oil is a cheap (and less healthy) alternative to soybean and cottonseed oil. The import tariff on refined palm oil is much higher than the import tariff on crude oil, to stimulate domestic refining. However, we find that 96% of palm oil exported to Mozambique by Southeast Asian countries is registered as refined oil, while in Mozambique, 99% of palm oil imported from those same countries is registered as crude oil, therefore paying the lower import tariff. Importers are systematically misrepresenting the nature of their imports, with adverse consequences for both border tax collections, and more importantly, the development of the cotton sector, on which nearly 200,000 farmers directly depend.

The use of trade policy as part of industrial policies has merits and drawbacks and is a hotly debated issue, but less controversial is the importance of establishing clear rules and enforceable policy measures. Most important is to ensure that domestic production is not affected by negative protection and illegal activities, or by policies and regulations that fail to level the playing field for domestic producers.

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Policy recommendations

• Industrial policy should focus on public-private collaboration at the sector level.

Successful industrial policies depend on an effective public-private dialogue, build-up of trust, and the ability to make mutual credible commitments. While efforts to address high-level cross-sectoral constraints are vital, our work in Mozambique has identified the importance of designing public-private pacts at the sectoral level. By focusing on concrete obstacles and feasible solutions, the dialogue becomes more action-oriented, with clearly defined objectives and timelines. This facilitates mutual accountability, which further reinforces trust-building and confidence between the different parties.

To formalise the dialogue, the negotiated commitments can be put together in a sectoral public-private pact, through which the government commits to specific policy measures and reforms, while the private sector commits to specific investments. This could be a viable mechanism to support the implementation of important government strategies, such as the National Development Strategy (2015-35) and the Industrial Policy and Strategy (2016-25).

• Identify key sectors for economic growth

The Mozambican economy is growing more vibrant and diversified. All the different (sub-) sectors have their own challenges and may require government attention to support transformational change. However, in the context of limited resources, both in terms of financial resources and policy-maker time and attention, these should be allocated to competitive priority sectors, including value chains in agribusiness and other sectors with high growth potential.

• Use sector-level pact to help support inclusive economic development

The pacts can underpin a more effective long-term collaboration between the state and the private sector, thus promoting economic transformation and inclusive growth. From the government’s perspective, industrial policy-making through sectoral pacts may also serve as a tool to better align the pattern of economic growth with the public interest, through the negotiation of the private sector commitments. The government could suggest, for instance, that these include targets on job creation, local content or collaboration with SMEs.
References


