

Executive Summary: Mozambique Country Strategy Note

1. Country Context

At the end of the civil war in 1992, Mozambique appeared in many rankings as the poorest country in the world. After a chaotic process of decolonisation, followed by a bloody civil war lasting 15 years, the country was left with a bare minimum of physical and social infrastructure. The 10 years following the first multiparty elections in 1994 represented a period of solid progress, with economic growth at 9% per year. During this period Mozambique rapidly evolved into a 'donor-darling', and foreign aid represented an important part of external funds. Importantly, strong economic growth was accompanied by significant progress in poverty reduction, from 69.7% in 1996 to 52.8% in 2002.

Since the early 2000s, the country's economic growth has continued to be among the highest in the continent. There has been a substantial shift in the sources of growth, however. Growth in the 1990s was essentially linked to the peace dividend of an economy returning to a normal state after a decade-long conflict. In the 2000s, GDP growth was to a large extent driven by the services sector, including transport, real estate and financial services. Agricultural growth was also important, accounting for more than 25% of GDP growth until 2010. Since then, however, its contribution has fallen to 10%. In this most recent period, the contribution of the extractive sector, driven by large FDI projects in coal and gas extraction, has exceeded the agricultural contribution to growth. Manufacturing contributed significantly in the early 2000s, although this was based on a unique large project, the Mozal aluminium smelter. Since then, the manufacturing sector's contribution to economic growth has languished, at less than 5%.

Currently, Mozambique is in a difficult financial position. Between 2014 and 2016, the gradual disclosure of previously unknown external debts, to a total value of USD 2.2 billion, had serious implications, adding to the depreciation of the currency that was already being driven by lower international commodity prices, accelerated inflation and a ballooning of the debt-GDP ratio. The failure to meet interest payments has resulted in a downgrade on international capital markets. Furthermore, the donors halted all budget support, forcing the government to adopt fiscal austerity. The tight fiscal situation will most likely continue for the coming years and growth prospects for this period remain relatively subdued, compared to the 1990s and 2000s.

In the longer term, however, such prospects are still highly favourable, as the full-scale exploitation of the world-class offshore natural gas reserves in the Rovuma basin will provide an unprecedented boost to growth, export earnings and fiscal revenues. With that scenario in mind, it will be crucial, for both socio-economic and political reasons, to identify the elements of an inclusive growth path that combines the accelerated resource-based growth with job creation and poverty reduction.

The period since 2013 has seen a return of political tensions, as some opposition Renamo members took up arms again, alleging that the benefits of growth were not being shared sufficiently. At the end of 2016 a temporary cease-fire was agreed to by all parties, and there are good prospects that a renewed peace agreement may be reached soon. For all purposes, it will be vital to ensure that peace is achieved on a sustainable and lasting basis.

2. IGC Mozambique Country Programme

The IGC Mozambique Country Programme was established in 2010 and has since managed to promote a series of high-quality policy-relevant research projects, both large and small, across a wide variety of policy areas and with diverse institutional counterparts in the Mozambican government and broader society. The Memorandum of Understanding with the

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Ministry of Economy & Finance, where the local IGC office is located, and the close relationship with the Directorate of Economic and Financial Studies, have been extremely valuable in expanding its network across different Ministries and government agencies. The Country Team consists of a Country Director, two Lead Academics, one Country Economist, one Programme Officer and one Office Manager.

3. Thematic Areas

(a) Firms

Since the start of its activities in Mozambique, the IGC has promoted a strong body of research work on mobile money and financial inclusion. The IGC's work in this area created a platform for a constructive dialogue between the Bank of Mozambique and the private operators of mobile money services, something that had been lacking before. Following the conclusion of the first round of research projects in this area, discussed in a series of workshops organized jointly by the IGC and the Bank of Mozambique, there have been follow-up requests from the Bank of Mozambique, resulting in a recently delivered study on payment interoperability of financial institutions and a related dissemination Workshop in September 2017. The Bank has requested further IGC support in research inputs to the implementation of the National Financial Inclusion Strategy. The IGC will seek to respond to this through further research on financial literacy, both at the level of micro-entrepreneurs and larger firms, and would like to develop research on incentive structures for banking agents.

A fundamental growth challenge is increasing firm productivity and private sector development. Mozambique's exports are already highly concentrated on natural resources, and the natural gas development will exacerbate this pattern, while the country continues to depend on imports for many basic consumer goods. As such, the government has been requesting support on policies that can help diversify exports and substitute imports of basic commodities that could be produced locally. The IGC assisted the government with the drafting of the National Development Strategy. Subsequently, again at government's request, the IGC conducted applied value chain studies, in poultry and cotton, that propose a model of industrial policy-making, based fundamentally on effective inter-ministerial coordination and public-private dialogue. This approach consists of sector-specific agreements that can leverage private sector investment in capacity expansion and technological upgrading. Further work in this area could involve additional analyses for industrial value chains. Research that can help Mozambique design the best policies to stimulate the link between large-scale FDI projects in natural resource extraction and local firms will also be highly relevant.

Further to this, improving agricultural productivity remains a fundamental growth challenge for Mozambique. The adoption of technology and best practices such as the use of improved seeds and fertilizer is very low and constitutes one of the main reasons for extremely low levels of agricultural productivity, even in comparison with neighbouring countries. Finding policy solutions that can address this would be of great benefit. In this context, the above-mentioned sector studies on poultry and cotton resulted in effective engagement with the Ministry of Agriculture, which then led to a follow-up request for another study, on pigeon peas, which provided the government with key information for determining a course of action in response to the sudden disappearance of the market for this important cash crop, produced by more than 1.5 million farmers. Finally, the IGC Mozambique project portfolio includes a pilot project on how to improve rural extension services.

The IGC is also actively engaged in developing research aimed at improving the functioning of the labour market and enhanced job-creation. The IGC Mozambique has started work in this area through a scoping project that identified a fundamental mismatch between supply and demand in the labour-market. The challenge of finding skilled workers, especially in

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technical matters, is one of the main constraints raised by the private sector. We have specifically supported research on the financial literacy of firm managers. The IGC aims to continue this line of research, and identify the best ways of developing more effective models of vocational training.

(b) State

In the long-term, the lack of skilled workers can only be addressed through broader human capital development, which depends fundamentally on improving state capacity in service delivery. Mozambique is lagging far behind in terms of basic health and education indicators, despite the fact that both sectors account for a large part of government spending. While continued investments in clinics and schools will certainly be part of the solution going forward, it is also crucial to think about how existing resources can be used in more efficient ways. In health, we are engaged in a strong partnership with the Ministry of Health to increase the efficiency of the health system, by looking at cost-effective ways to improve management at the clinic level. In education, we are funding research that could help identify low-cost interventions with a significant impact on female dropout rates. The IGC is currently developing an additional set of projects that take a managerial lens to challenges in health system and education system reform.

Effective natural resource management will be a crucial growth challenge for Mozambique. The development of the mammoth natural gas reserves in the North can be a major game-changer for the Mozambican economy. While it represents an enormous opportunity to change Mozambique for the better, it also brings major political and economic risks. The IGC has started a stream of research on the political management of natural resource extraction, which can prove highly valuable in stimulating effective debate on this important issue.

Finally, maintaining peace is the first and foremost challenge in the short-medium term, and an absolutely fundamental one for sustainable growth. If deemed useful by the government, the IGC could provide research support and policy advice on aspects of the implementation of a new peace agreement, such as the economic implications of further decentralization.

(c) Energy

Mozambique has enormous unused potential for electricity generation, yet the lack of stable electricity supply continues to be a major obstacle to private sector growth, especially outside Maputo. Mozambican policymakers have voiced ambitions to turn the country into a regional energy hub, but South Africa apparently no longer needs additional Mozambican energy. The IGC aims to develop projects on electricity planning, regulatory framework and transformative projects.

(d) Cities

Although cities has not been one of the main priority themes, we have worked on the analysis of the construction industry, in close collaboration with the Ministry of Public Works, Housing and Water Resources, resulting in the development of a policy framework for the construction and building materials sectors. Going forward, the IGC will seek to develop projects related to municipal taxes, housing and secondary cities.

4. Engagement Strategy and Collaborations

The strategy of the country programme is based on early and broad engagement with policy-makers and other relevant stakeholders. The long-term research projects in the financial sector, as well as the more recent ones in health and education, have shown this approach to pay off, even if it leads to initial delays. It ensures that the projects are directly aligned with

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policymaker concerns and paves the way for profound engagement along the life of the project, internalisation of the findings and enhanced impact in the long run.

The table below provides a non-exhaustive overview of key institutional partners. In the future, the IGC would like move into new areas of work with existing partners, but also to develop new partnerships with other institutions, such as the Ministry of Mineral Resources and Energy. In terms of extending existing partnerships into new areas, priorities would be to work on macroeconomic issues with the Ministry of Economy & Finance and the Bank of Mozambique, efficient resource allocation with the Ministry of Education, export promotion and Special Economic Zones with the Ministry of Industry & Trade and vocational training with the Ministry of Labour.

Several IGC projects have involved capacity-building components, mostly through seminars, workshops and structured discussions, and sometimes by directly engaging policymakers as co-PIs. Capacity-building could be further expanded by targeted courses on specific topics, such as the use of economic analysis tools at line ministries that are mostly staffed by non-economists, such as the Ministry of Health.

Theme	Partner	Research Issues
Firms	Ministry of Economy and Finance	National Development Strategy, Construction, Sector Work (Poultry & Cotton), Financial Literacy of Managers
Firms	Bank of Mozambique	Financial Inclusion, Mobile Money, Interoperability, Financial Literacy
Firms	Ministry of Agriculture	Rural extension, Poultry, Agricultural Insurance, Pigeon Pea
Firms	Ministry of Industry & Trade	Industrial Policy
Firms & State	Ministry of Labour	Labour Market Information, Labour Market Expectations
State	Ministry of Health	Management of Health Clinics
State	Ministry of Public Works	Construction, Building Materials
State	Ministry of Education	Girls education
State	Provincial Government of Cabo Delgado	Natural Resource Management

There is also a strong relationship with stakeholders outside the government. Frequent interactions with the local DFID team are extremely useful to explore synergies with other DFID-funded initiatives, such as FSD-Mozambique and the Let's Work programme. In the context of specific projects, we have also engaged in close collaboration with multilateral organisations, principally the World Bank and the World Food Program. Private sector engagement has been highly valuable in relevant projects, such as banks and telecommunication firms around the research agenda on mobile money, and poultry and cotton firms around the work on value chains.