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REPUBLIC OF MOZAMBIQUE

SYSTEMATIC COUNTRY DIAGNOSTIC

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International Development Association
Southern Africa Country Department 2
Africa Region

International Finance Corporation
Sub-Saharan Africa Department

Multilateral Investment Guarantee Agency
Sub-Saharan Africa Department

WORLD BANK GROUP

Republic of Mozambique – Government Fiscal Year
January 1 – December 31

Currency Equivalents
(Exchange Rate Effective as of June 15, 2016)

Currency Unit	=	New Mozambican Metical (MZN)
US$1.00	=	MZN 60.8

Abbreviations and Acronyms

AfDB	African Development Bank
ALRI	Acute Lung and Respiratory Infections
ANS	Adjusted Net Savings
ASM	Artisanal and Small-Scale Mining
BdM	Bank of Mozambique (*Banco de Moçambique*)
DHS	Demographic and Health Survey
DSA	Debt Sustainability Analysis
DUAT	Land Utilization Rights (*Direitos de Uso e Aproveitamento da Terra*)
EdM	Mozambique Electricity Company (*Electricidade de Moçambique*)
EITI	Extractive Industries Transparency Initiative
EMATUM	Mozambican Tuna Company (*Empresa Moçambicana de Atum*)
ENH	National Hydrocarbon Company (*Empresa Nacional de Hidrocarbonetos*)
ENSSB	National Strategy for Basic Social Security (*Estratégia Nacional de Segurança Social Básica*)
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HDI	Human Development Index
IAF	Household Consumption Survey (*Inquérito aos Agregados Familiares*)
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
INE	National Institute of Statistics (*Instituto Nacional de Estatística*)
INSS	National Institute of Social Security (*Instituto Nacional de Segurança Social*)
IOF	Household Budget Survey (*Inquérito ao Orçamento Familiar*)
MDM	Mozambique Democratic Movement (*Movimento Democrático de Moçambique*)
MIGA	Multilateral Investment Guarantee Agency
MINAG	Ministry of Agriculture
MPD	Ministry of Planning and Development
MSME	Micro Small and Medium Enterprises
PASD	Direct Social Support Program (*Programa de Acção Social Directa*)
PASP	Productive Social Action Program (*Programa de Acção Social Produtiva*)
PPP	Public-Private Partnership
PSSB	Basic Social Subsidy Program (*Programa de Subsídio Social Básico*)
ROC	Regional Operations Committee
SACMEQ	Southern and Eastern African Consortium for Monitoring Education Quality

SADC	Southern African Development Community
SAPP	Southern African Power Pool
SCD	Systematic Country Diagnostic
SEZ	Special Economic Zone
SSA	Sub-Saharan Africa
STEM	Science, Technology, Engineering and Mathematics
TFP	Total Factor Productivity
TFR	Total Fertility Rate
TIA	Agricultural Survey (*Trabalho de Inquérito Agrícola*)
TVET	Technical and Vocational Education and Training
UNDP	United Nations Development Programme
UNHDI	United Nations Human Development Index
UNECA	United Nations Economic Commission for Africa
VAT	Value-Added Tax
WASH	Water, Sanitation and Hygiene
WDI	World Development Indicators
WHO	World Health Organization

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Acknowledgements

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1. Overview

1.1. Economic Growth and Poverty Reduction in Mozambique

1. **Over the past two decades Mozambique has maintained macroeconomic stability and experienced robust and accelerating gross domestic product (GDP) growth.** Following the end of the civil war a combination of sound macroeconomic management, large-scale foreign investment projects and substantial donor support enabled Mozambique to become one of the fastest-growing economies in Sub-Saharan Africa (SSA). GDP grew by an average of 7.9 percent per year from 1993 to 2014, an impressive rate compared to nonoil economies in SSA (4.4 percent), low-income countries (4.7 percent), upper-middle-income countries (5.4 percent) and the world economy (2.8 percent).

2. **However, rapid economic growth has yielded only modest progress in poverty reduction and enhancement of shared prosperity.** As the civil war ended a rebounding agricultural sector drove a broad-based economic recovery, boosting living standards and raising incomes for a large share of the population. The result was a steep drop in the national headcount poverty rate, which fell from 70 percent in 1993 to 54 percent in 2003, a decline of 14 percentage points over the decade. However, once the initial recovery had run its course the pace of poverty reduction slowed, and between 2003 and 2009 the national poverty rate fell by just 2 percentage points. This period was marked by a dramatic increase in investment in capital-intensive megaprojects, beginning with the construction of the Mozal aluminum smelter in 2001-03. Since 2003 these projects have accounted for an increasingly large share of overall growth, yet they have generated relatively few jobs and have limited ties to the broader national economy. The rise of megaprojects has been accompanied by slowing growth in the agricultural sector—by far the country's largest source of employment. The transition to this new economic model has greatly weakened the relationship between overall growth and poverty reduction. After the end of the civil war in 1993, Mozambique was the third poorest country in the world. By 2013 it was the 13th poorest.

3. **Poverty in Mozambique is overwhelmingly concentrated in rural areas, particularly in the country's central and northern regions.** Between 2003 and 2008 poverty rates increased in Zambezia, Sofala, Manica and Gaza provinces, even as they fell in the rest of the country, and while the overall depth of poverty remained essentially unchanged during this period, the poverty gap widened in Nampula and Zambezia. These two provinces receive the least amount of public spending and the lowest social transfers per capita, and their education and health indicators are among the worst in the country. As population growth rates remain high nationwide, the absolute number of people living in poverty is increasing even in provinces where the poverty rate has declined.

4. **Pervasive underemployment and poor human development indicators underscore the limited inclusiveness of recent growth.** Despite its high rates of employment and labor force participation, most of Mozambique's workforce is engaged in low-productivity subsistence agriculture and household enterprises. And while some key social development indicators have improved, such as primary school enrollment and infant mortality rates, Mozambique continues

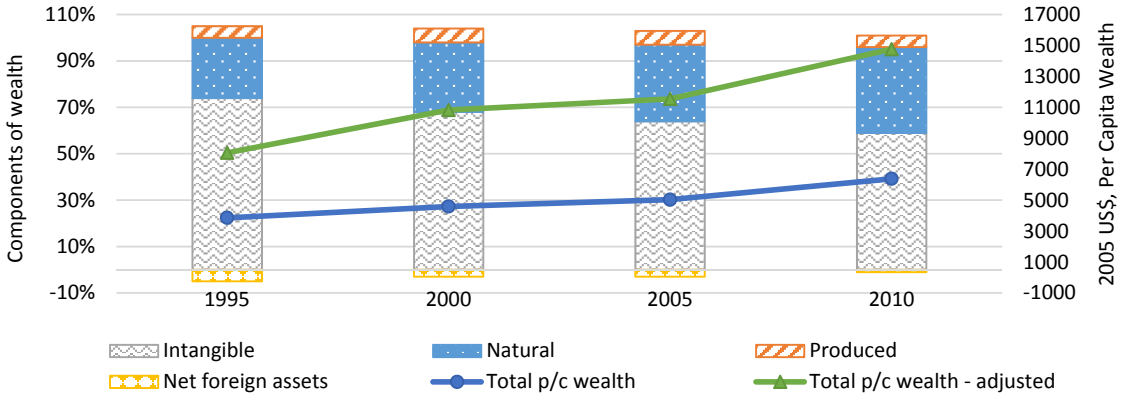
to rank extremely low in the United Nations Human Development Index (UNHDI) at 178th out of 187 countries. Moreover, progress on both economic and social development has been uneven, with gender, geographic location and household wealth acting as major determinants of inclusiveness. Women have less access to land, lower literacy rates, are less likely to be formally employed and are paid less than their male counterparts. Meanwhile, wealthier urban households have greater access to public services and are better positioned to benefit from a growing economy.

1.2. Opportunities and Challenges as a Resource-Rich Nation

5. **Mozambique is endowed with substantial renewable and nonrenewable natural resources.** The country has an estimated 36 million hectares of arable land, of which only about 5 million are currently cultivated. Extensive river systems and substantial rainfall provide abundant water for irrigation, and diverse environmental conditions facilitate the production of a wide range of agricultural goods. Mozambique is rich in biodiversity, with over 5,500 plant species, 222 mammal species and 600 bird species, many of which are endemic. Its coastline is unique in the East African Marine Region in terms of its environmental quality, diversity and abundance of species. National parks and other protected zones cover about 18.5 million hectares, or 23 percent of the country's land area. Mozambique has a large stock of both natural and planted forests that produce high-value hardwoods, other timber and natural fiber, as well as a range of non-timber products with commercial and subsistence applications. Ensuring the sustainability of its renewable resource base, particularly its forests and fisheries, is critical to Mozambique's development. However, inconsistent policy implementation, weak local administrative capacity and land-tenure insecurity present serious challenges to the effective and responsible management of the country's abundant natural resources.

6. **Recent large discoveries of coal, natural gas and other nonrenewable resources have increased Mozambique's natural wealth, yet managing the growth of the extractive industries poses considerable challenges.** Mozambique's coal deposits are estimated to exceed 20 billion tons, and annual coal exports could reach as much as 100 million tons at peak extraction capacity. Known gas reserves in the Rovuma basin are estimated at over 130 trillion cubic feet, and at peak production Mozambique could become the world's third largest gas exporter. In addition, Mozambique has considerable deposits of gemstones, heavy sands and other valuable minerals. Adjusting Mozambique's 2010 wealth estimates to account for sub-soil assets increases the country's per capita wealth from approximately US$6,300 to US$14,700 (Figure 1). However, slowing growth among major coal, gas and mineral importers and rising international concerns about the environmental cost of fossil fuels qualify these estimates, and the ultimate value of Mozambique's nonrenewable resources may be significantly less than what current prices would predict.

Figure 1: Mozambique's National Wealth Stock, 1995-2010[1]



Source: World Bank staff calculations

7. **Whether Mozambique is able to leverage the full potential of its resource wealth to reduce poverty and promote inclusive growth will depend on a number of related factors.** New investments in extractive industry megaprojects could boost annual resource revenues to as much as US$9 billion by 2032, representing a full 7 percent of GDP. However, the continued focus on capital-intensive megaprojects could further accentuate Mozambique's current development pattern, in which rapid growth does not generate significant gains in poverty reduction, employment or household income. Moreover, the direct and indirect environmental impacts of these projects will need to be carefully managed, particularly those affecting marine areas, forests or other fragile ecosystems.

1.3. Household Assets, Economic Connectivity and the Distribution of Public Spending

8. **Inclusive growth and sustainable poverty reduction will require a more diversified and productive Mozambican economy, one capable of effectively transforming natural wealth into human, physical and institutional capital.** Mozambique is in a transition period, and over the next several years it will continue to adapt to its new resource-driven growth model. In order to ensure that future growth contributes to poverty reduction and shared prosperity, and that the expansion of the extractive industries does not undermine macroeconomic stability, encourage rent-seeking or erode the competitiveness of the non-resource sectors, policymakers must take decisive steps to diversify the economy away from its dual focus on capital-intensive megaprojects and labor-intensive, low-productivity agriculture. Creating a more diverse and competitive economy will require investing resource revenues in human, physical and institutional capital—a long-term challenge that the authorities have struggled to meet. Over the past 15 years Mozambique's adjusted net savings rate[2] has been close to zero or even negative, underscoring the limited extent of investment in reproducible capital. Building the country's stock of human, physical and institutional assets will bolster economy-wide competitiveness and enable the development of nontraditional sectors, contributing to a more diverse, productive and inclusive growth model.

[1] Intangible capital refers to institutional, human and social capital.
[2] Adjusted net savings is a wealth-accounting concept that attempts to gauge net changes in a country's stock of natural, human, physical, financial and institutional capital over time.

9. **Developing an appropriate framework for realizing the returns to individual and household assets is equally important to promoting inclusive growth and enduring poverty reduction.** In Nampula and Zambezia, where the depth of poverty has increased in recent years, individual and household assets—such as the number of adults with completed primary education—yield lower returns than in other parts of the country. Based on the rate of asset accumulation, if households in these two provinces had achieved similar returns to assets between 2003 and 2009, their poverty rates would have been reduced by almost 50 percent.[3] Low asset returns are in part the result of the relative isolation of these two provinces, which limits household access to services and income-generating opportunities. Integrating more remote and rural areas into the national economy by linking them to urban centers, regional value chains and international export points could greatly increase the return on individual and household assets, speeding the pace of poverty reduction.

10. **Public spending in Mozambique is marked by vast regional disparities, with the poorest provinces typically receiving the lowest per capita expenditures.** From 2009 to 2014 the government introduced a series of fiscal deconcentration measures, enabling provincial and district governments to execute a greater share of public spending. However, the poorest, most isolated and most populous provinces—Nampula and Zambezia—continue to receive lower fiscal transfers per capita than the rest of the country. They also receive the least in per capita social protection spending, despite the demonstrated ability of social transfers to reduce poverty in the short term. This suggests that government spending is not effectively targeting the poor.

1.4. Productivity, Employment and Diversification

11. **While greater economic diversity is critical to long-run growth, increasing agricultural productivity could have a major impact on poverty reduction in the short-to-medium term.** An estimated three quarters of Mozambicans work in the agricultural sector, and most are engaged in low-productivity subsistence farming. In order to increase agricultural productivity, policymakers will need to address a number of constraints, including the limited use of productivity-enhancing inputs and modern technologies, inadequate irrigation systems, transport connections and other hard infrastructure, an underdeveloped and unreliable electricity grid, a complicated land-tenure system, inadequate extension services, and limited access to credit. Moreover, the sector is highly vulnerable to droughts, floods and cyclones, as well as the long-term effects of climate change.

12. **Infrastructure gaps are an especially binding constraint on agricultural productivity and inhibit diversification of the rural economy.** Despite rising rates of capital investment Mozambique continues to suffer from a profound infrastructure deficit. Physical capital was estimated to represent just 5 percent of total wealth in 2010, far below the SSA average of 13 percent. Rural electrification rates are very low, and only 1.3 percent of rural households use electricity for lighting. Inadequate electricity restricts opportunities for value addition and

[3] Counterfactual estimates indicate that the combined poverty rate in these two provinces could have been reduced from 62.5 percent in 2003 to 33.9 percent in 2009, instead of the observed increase to 65.8 percent.

stifles the growth of the rural economy. Transportation access is also very limited, and just 17 percent of the rural population lives within two kilometers of a good road. The resulting truncation of rural markets reduces farm-gate prices, increases input prices, and narrows the range of consumer markets and services available to farmers and rural firms. In Nampula and Zambezia, where households are especially isolated, income from farming activities is three times lower than in the rest of country.

13. **Strengthening interregional economic connectivity, increasing external trade and logistics capacity, and more effectively integrating megaprojects into domestic value chains will be crucial to inclusive growth and diversification.** The development of growth corridors, growth poles and special economic zones can boost private investment, increase the supply of key transport and logistical services through public-private partnerships, and optimize the utilization of both public and private infrastructure, including capital assets developed to serve megaprojects. Meanwhile, improving backward and forward linkages between large investments in the extractive industries and local companies can expand access to the benefits of resource-driven growth. A comprehensive growth and diversification strategy that integrates business climate-reform, support for small and medium enterprises, dual-use agreements for infrastructure, the strengthening of risk-management mechanisms, and workforce-skills development can help maximize the benefits of growth corridors and enhance the developmental impact of megaprojects.

14. **A large and growing share of both the urban and rural workforce is engaged in household enterprises, but this sector is overwhelmingly informal and largely unsupported by public policy.** Household enterprises, defined as sole proprietorships with no paid employees, provide livelihoods for an estimated 25 percent of the rural workforce and 40 percent of the urban workforce, with many households relying on them as a key secondary income source. Household enterprises are associated with higher levels of household consumption, as well as lower poverty rates and greater upward mobility in rural areas. However, limited credit access, inadequate infrastructure, vulnerability to crime and corruption, and bureaucratic barriers to formalization inhibit their growth and reduce their contribution to poverty reduction and shared prosperity. Implementing a comprehensive strategy for supporting and formalizing household enterprises would not only have positive effects on employment and income, but would also promote greater competition in domestic markets.

15. **Business-climate reform is essential to attract private investment in new industries and sectors.** Mozambique's declining rank in the *Doing Business* report underscores its limited progress in strengthening the regulatory framework for the private sector. While the authorities have adopted new legislation designed to streamline administrative procedures, reinforce property rights and encourage international investment, petty corruption in the public administration and rent seeking by political elites are both widespread. Bureaucratic hurdles are used to enforce patronage systems, and the ability of officials to "expedite" administrative processes is a key tool for extracting rent from the private sector. Meanwhile, cronyism in the public contracting system has caused or contributed to several high-profile scandals, and many

Mozambicans increasingly feel disenfranchised by a public administration that they perceive to be dominated by a distant and self-interested elite.

1.5. Investing in Human, Physical and Institutional Capital

16. **As resource revenues continue to increase, strengthening the government's capacity for public financial and investment management will be critical to ensure that Mozambique's natural wealth is effectively converted into human, physical and institutional capital.** The authorities will need to adopt a fiscal policy framework appropriate to the size and composition of their resource envelope, and they must take steps to ensure that increases in public spending are consistent with the expenditure capacity of the public administration and the absorptive capacity of the domestic economy. This fiscal framework must be supported by sound public financial management practices, broad political consensus and an enduring government commitment to fiscal responsibility. Strengthening public investment management will help to ensure that the country's rapidly expanding investment portfolio generates adequate and equitable socioeconomic returns. Enhancing fiscal risk management will be a priority as the country seeks to improve its oversight over commercial entities with majority state shareholdings that have benefitted from large, state-backed guarantees.

17. **Reforms designed to accommodate a larger and more volatile resource envelope should be accompanied by efforts to manage expectations as to how resource revenues will be used.** Political pressure to increase public-sector salaries, boost public spending and expand support to special interest groups is likely to intensify as resource revenues rise. A failure to manage expectations may exacerbate political and social tensions generated by the perceived unfairness of natural resource management or resource-driven growth. While revenue-sharing mechanisms have been established to compensate local communities in areas impacted by extractive industries, frequent land-use conflicts and the displacement of populations in resource-rich areas are a cause for concern.

18. **The international experience demonstrates the importance of a strong institutional framework in ensuring the effective use of resource revenues.** The quality of governance, the strength of public financial management systems and the integrity of public institutions play a pivotal role in the relationship between natural resource revenues and long-run growth. While Mozambique has made substantial progress in improving the legislative and policy framework for the public administration, Mozambique's worsening governance indicators reflect serious weaknesses in the implementation of these reforms.

1.6. The Demographic Transition

19. **High fertility rates and declining infant mortality have contributed to a rising population of young people, and this trend is expected to continue over the next several decades.** Mozambique's demographic transition will strain the capacity of public agencies in education, health and other social sectors. Moreover, ensuring adequate productive employment for a burgeoning cohort of young workers will present a major economic policy

challenge, particularly given the small size of the formal sector and the low rate of job creation in the nonagricultural economy. While Mozambique's increasingly young population could become a driving force in the economy, leveraging the country's demographic potential will require major improvements in employment dynamics and in the quality of core public services such as health, education and water and sanitation.

20. **Facilitating the ongoing urbanization process and enhancing economic connectivity in rural areas will be critical to create new opportunities for young workers.** Urban population growth is outpacing the national average, as individuals move to cities in search of new jobs and better services. The growth of urban centers is also critical to improving agricultural productivity by linking farmers with a wider range of input options, larger and more diverse consumer markets, and increasingly sophisticated regional and international value chains. However, maximizing the benefits of the urbanization process will require substantial improvements in transportation, communication and logistical connectivity between urban and rural areas.

1.7. A Note on Data Limitations

21. **Incomplete or outdated data limit the scope of the analysis.** Poverty figures are based on the 2008/09 household survey data. While the preliminary findings of the 2014/15 survey were made available to the team, updated poverty statistics had not yet been finalized. Similarly, the lack of a recent labor force survey qualifies the analysis of employment and labor market dynamics. Mozambique has completed only one World Bank Enterprise Survey, which was carried out in 2007, and data limitations constrain the analysis of firm characteristics, financial access, demand for workforce skills and land use. Although Mozambique was included in the Findex exercise for 2011, it was excluded in 2014, complicating an assessment of trends in access to finance and financial inclusion. Given the important and complex issues surrounding land tenure in Mozambique, more information on how land is allocated and utilized, especially by megaprojects, would greatly facilitate future diagnostics. These constraints highlight the importance of generating high-quality, up-to-date statistics to inform evidence-based policymaking.

1.8. Outline of the Systematic Country Diagnostic

22. **This Systematic Country Diagnostic (SCD) is designed to assess the key constraints and opportunities facing Mozambique as it strives to sustain robust growth and macroeconomic stability while accelerating poverty reduction and promoting greater economic inclusiveness.** The SCD is organized into six chapters. Chapter 2 describes the evolution of poverty and inequality, explores their regional and demographic dimensions, and identifies strategies for accelerating poverty reduction. Chapter 3 analyzes key economic constraints and opportunities, identifying the drivers of recent growth, describing developments in the real sector and assessing emerging challenges associated with the rise of the extractive industries. Chapter 4 examines the inclusiveness of growth, presenting an in-depth analysis of the labor market, the social sectors and the ongoing urbanization process. Chapter 5 discusses fiscal, institutional, political, social and environmental risks to the sustainability of growth and poverty reduction.

Chapter 6 completes the analysis by identifying a set of priority objectives for accelerating progress on the World Bank's twin goals of eliminating extreme poverty and promoting shared prosperity. Figure 2 summarizes the SCD's conceptual framework, and Figure 3 illustrates the relationship between identified priority interventions. Strengthening public institutions to enhance public financial management and reinforcing social and economic resilience by empowering local communities to better manage natural resources are core focus areas of the SCD.

Figure 2: Overview of the SCD Framework and Priority Interventions

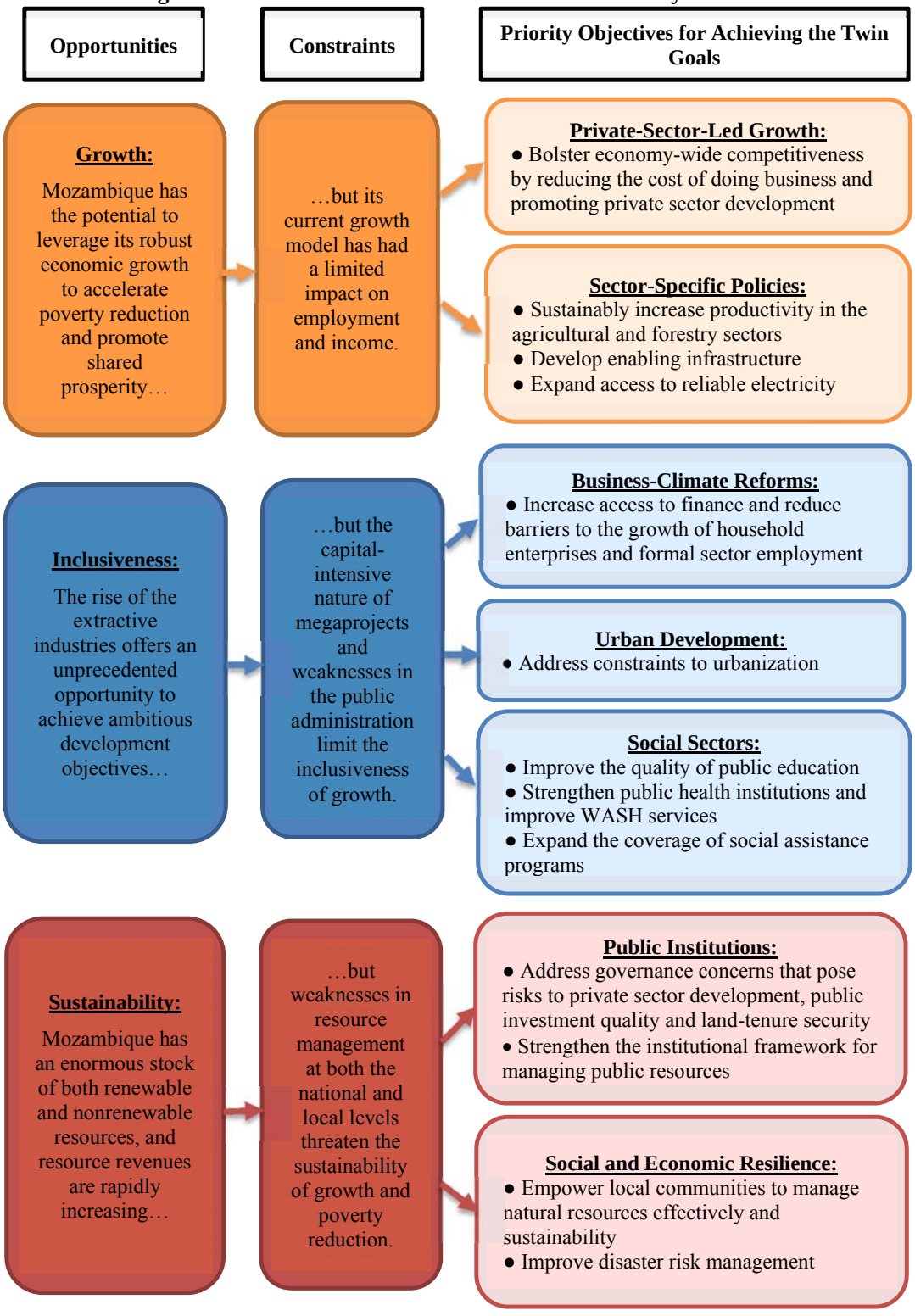
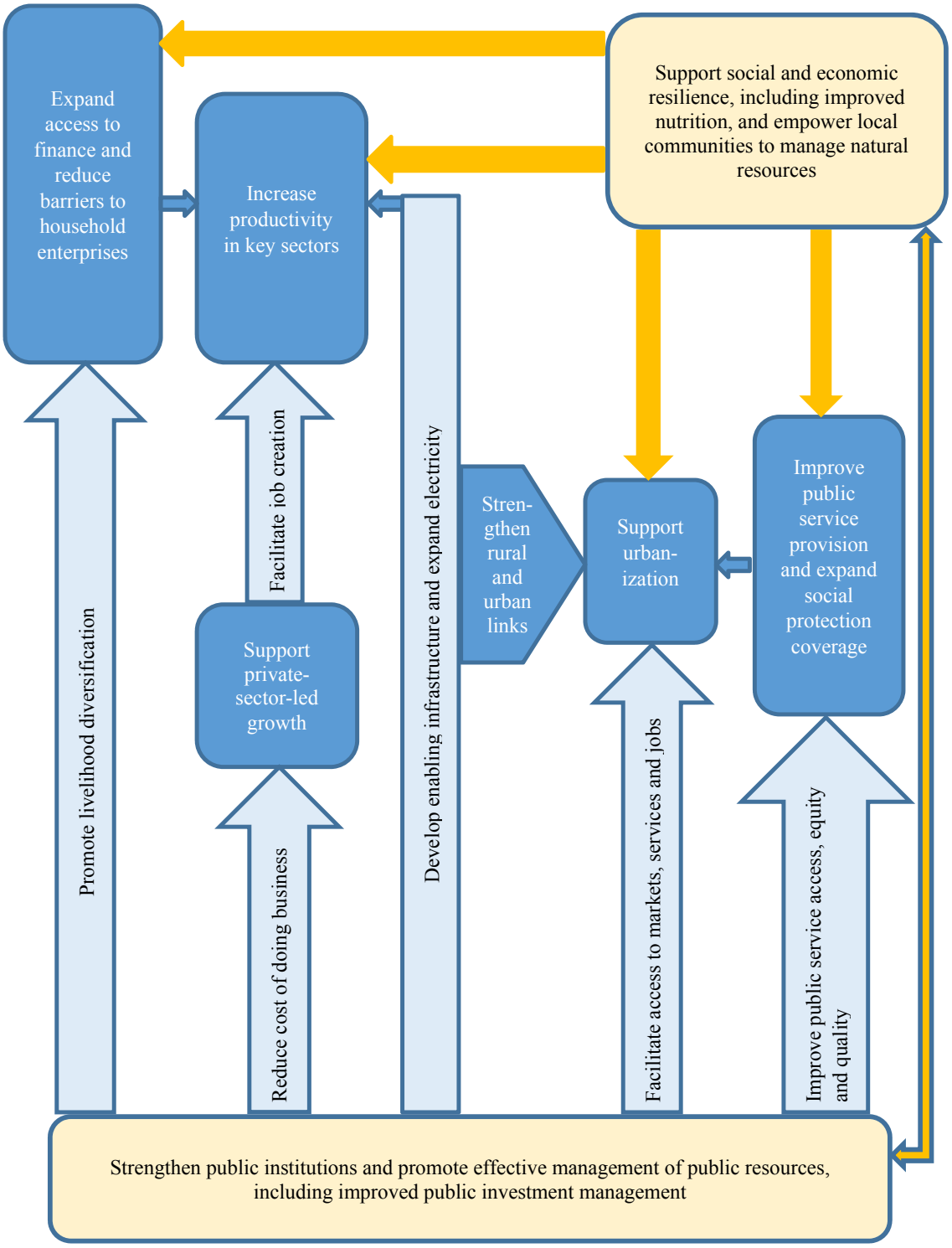


Figure 3: The Relationship between Priority Interventions



2. The Evolution of Poverty and Inequality in Mozambique

- **The pace of poverty reduction is slowing.** Between 1997 and 2003 the national headcount poverty rate dropped rapidly, falling from 68 percent to 56 percent. Between 2003 and 2009, however, the poverty rate declined by just four percentage points to 52 percent.
- **The distribution of poverty reduction has been highly uneven.** Poverty is concentrated in rural areas, and 70 percent of the nation's poor reside in the provinces of Gaza, Manica, Nampula, Sofala and Zambezia. Nampula and Zambezia alone account for nearly half of the country's poor. While the overall depth of poverty remained essentially unchanged between 1997 and 2009, the poverty gap widened in Nampula and Zambezia.
- **Poverty reduction is less responsive to economic growth in Mozambique than it is in comparable countries.** In SSA a 1 percent increase in GDP per capita is associated with a 0.5 percent drop in the poverty rate. Yet in Mozambique a 1 percent increase in GDP is associated with a decline of just 0.26 percent in the national poverty rate.
- **Regional inequalities weaken the relationship between growth and poverty reduction.** Mozambique's high inequality indicators are partially explained by increasing poverty rates in the country's two most populous provinces, Nampula and Zambezia. The relative economic isolation of these two provinces is compounded by low rates of public investment, and as a result the returns to assets in these two provinces are lower than in the country as a whole.
- **Household characteristics contribute to poverty**. The poor tend to live in rural areas, have more household members and a higher number of dependents, are often female-headed households, and generally have lower education levels, all of which limit future employment opportunities.
- **Mozambique is unprepared for the demographic transition**. Persistently high fertility rates have resulted in rapid population growth and an age structure that is dominated by a very large proportion of child dependents. In the absence of transformative economic change, it will be challenging to find productive employment for new workers entering the labor market, and social services are likely to become increasingly strained.

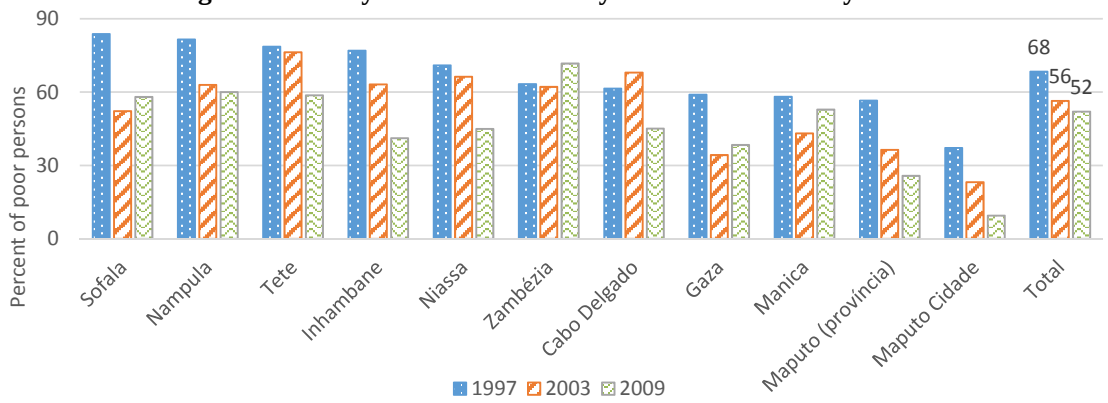
2.1. The Slowing Pace of Poverty Reduction

23. **The poverty rate fell sharply between 1997 and 2003, but the pace of poverty reduction slowed after 2003, and in 2009 more than half of all Mozambicans continued to live in extreme poverty.**[4] The national headcount poverty rate dropped by 12 percentage points to 56 percent between 1997 and 2003. Since 2003 poverty has declined at a much slower pace, falling to 52 percent in 2009. Poverty rates in rural areas followed a similar pattern, with a sharp decline in 1997-2003 followed by a more modest reduction. Poverty levels vary significantly by region (Figure 4 and Figure 5). Maputo City has the country's lowest poverty rate, and urban provinces tend to have lower poverty rates than rural provinces, particularly

[4] The poverty figures discussed in this note are based on Mozambique's national poverty line, which in 2009 was approximately 16 meticais per capita per day, or approximately US$0.90 per day in 2005 PPP terms. This is 28% lower than the international extreme poverty line of US$1.25 per day used by the World Bank. We therefore use the terms "poverty" and "extreme poverty" interchangeably, since all of the poor in Mozambique live below the international extreme poverty line.

those in the central and northern parts of the country.[5] Between 1997 and 2009 population growth outpaced poverty reduction, increasing the number of Mozambicans living in extreme poverty by 400,000 to a total of 11.2 million.

Figure 4: Poverty Headcount Rates by Province and Survey Year



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF 2008/9

Box 1: Preliminary Results of the IOF 2014/15

A preliminary analysis of the latest household budget survey, *Inquérito ao Orçamento Familiar (IOF)* 2014/15, suggests that poverty levels have continued to fall, though significant disparities between urban and rural areas remain. The average proportion of the monthly household budget spent on food items dropped from 51.4 percent in 2008/9 to 35.6 percent in 2014/15, suggesting an improvement in overall living standards. Living standards in urban areas, however, improved at a faster pace. The proportion of the monthly budget allocated to food declined by 43.4 percent in urban areas (from 36.6 percent to 20.7 percent) over the same time period, while in rural areas, where most of the country's poor reside, it decreased by only 18.2 percent (from 64.8 percent to 53.0 percent).

Overall real per capita monthly expenditures have risen, yet they vary substantially by province. Between 2008/9 and 2014/15 real per capita monthly expenditures rose by 39.8 percent. Per capita expenditures increased faster in urban areas, rising by 49.3 percent compared to 26.7 percent in rural areas. Maputo Province experienced the largest increase in real per capita expenditures (143.8 percent), followed by Maputo City (59 percent). Meanwhile, expenditures in Zambezia and Nampula grew by just 30.6 percent and 5.8 percent, respectively, and real per capita expenditures in Niassa Province actually declined, suggesting that local living standards have worsened over time.

Updated poverty figures are not yet available. Based on a preliminary analysis, regional and rural/urban inequalities appear to have persisted according to the general pattern described in this diagnostic. The Ministry of Economy and Finance and the World Bank are expected to produce a joint poverty assessment in mid-2016. In the meantime, the available statistics appear to validate previous findings on poverty reduction rates and regional disparities.

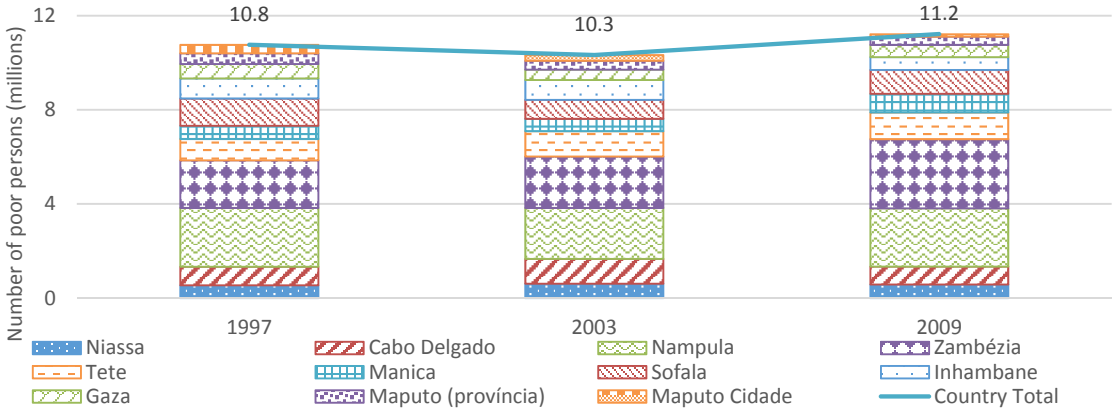
Source: World Bank staff

24. **While poverty rates fell in most of Mozambique's provinces between 2003 and 2008, they increased in Zambezia, Sofala, Manica and Gaza**. In Nampula province, where more than 22 percent of the country's poor reside, poverty levels remained practically unchanged during the period, while almost three quarters of Zambezia's population lived in extreme

[5] Alfani et al, 2012

poverty in 2009. The number of people living below the poverty line in these five provinces increased by 1.6 million between 2003 and 2009, and together they represented approximately 70 percent of the country's poor population in 2009, up from 59 percent in 2003. Zambezia and Nampula alone accounted for almost half of the country's poor (48 percent), up from 42 percent in 2003.

Figure 5: Number and Share of the Poor by Province

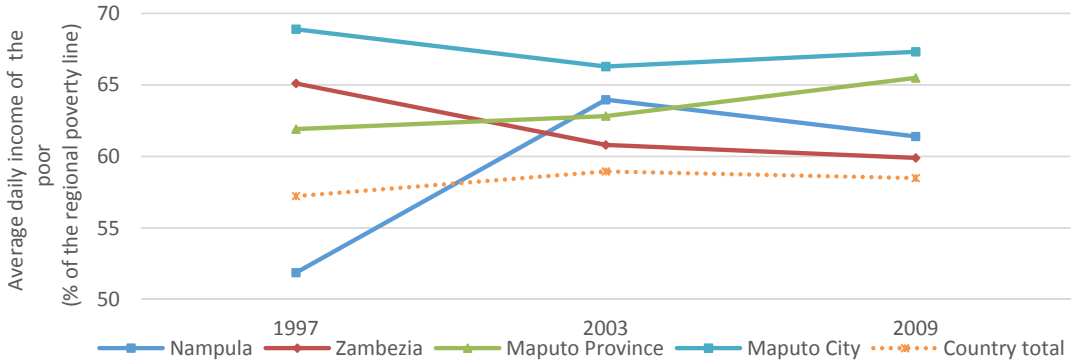


Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

2.1.1. The Depth of Poverty

25. **The depth of poverty, as measured by the poverty gap,[6] remained practically unchanged between 1997 and 2009, ranging from between 57 and 59 percent of the poverty line (Figure 6).** The poverty gap indicates how far the average poor person is from escaping poverty. In the country as a whole, the poor had approximately the same daily consumption levels relative to the poverty line in 2009 (58.5 percent) as they did in 1997 (57.2 percent) and 2003 (59 percent). Most of the reduction in the depth of poverty seems to have occurred in Maputo province, whereas in the rest of the country individuals living in poverty today appear to be as poor as 20 years ago. Moreover, the depth of poverty increased in both Zambezia between 1997 and 2009 and Nampula between 2003 and 2009.

Figure 6: The Poverty Gap, Mozambique and Selected Provinces

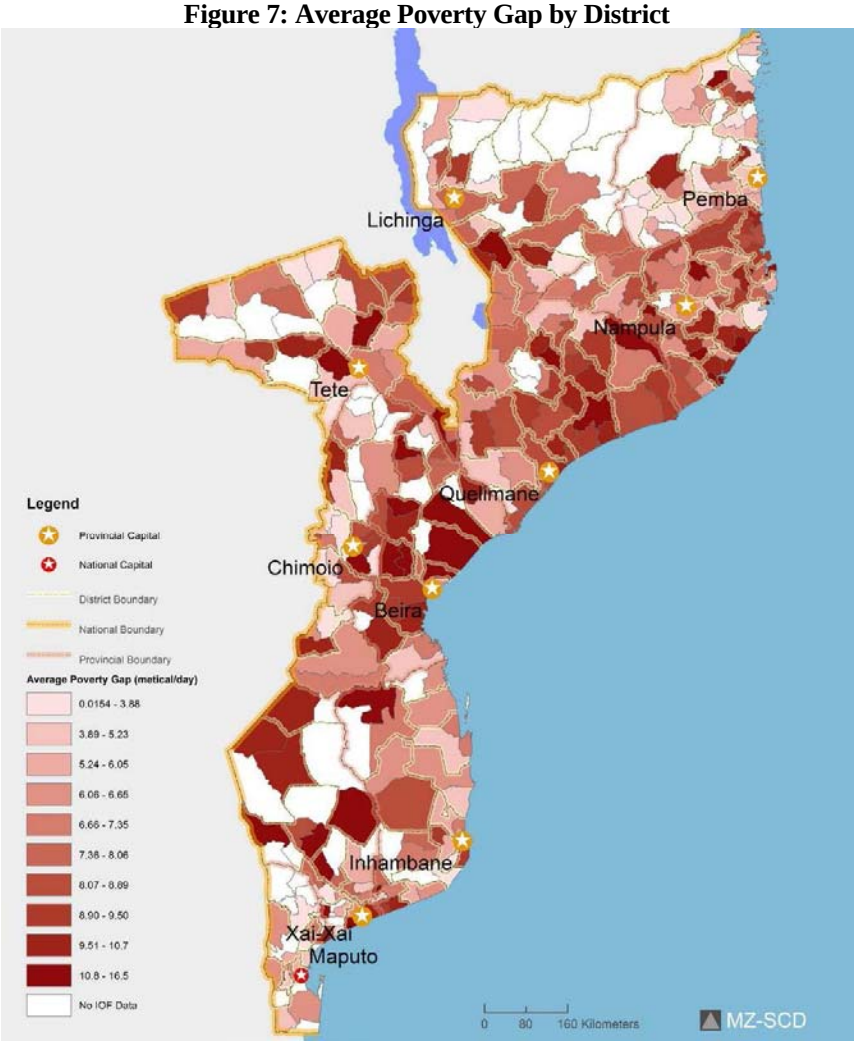


Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

[6] The poverty gap (also referred to as the depth of poverty) is the difference between the average poor person's income and the national poverty line.

26. **While deep poverty is concentrated in Nampula and Zambezia provinces, substantial areas of deep poverty can be found in other parts of the country.** Significant areas of Sofala, Manica and Tete provinces in the central region and Gaza in the south show large average poverty gaps (Figure 7).

Figure 7: Average Poverty Gap by District



Source: World Bank staff calculations based on the IOF2008/9 and Dobbin, 2015

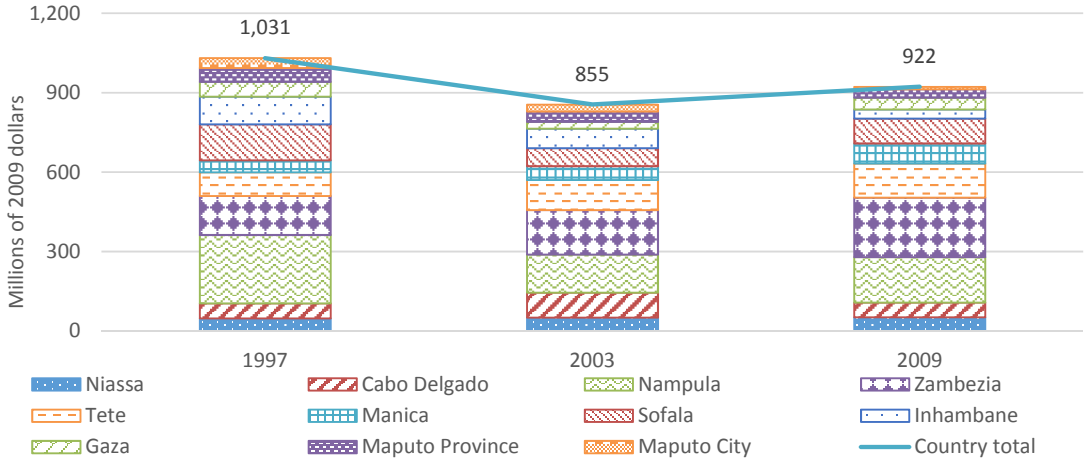
2.1.2. The Poverty Deficit

27. **The aggregate poverty gap, or "poverty deficit," increased by 18 percent between 2003 and 2009.** The poverty deficit reflects the total increase in the income of every poor person needed to lift them all above the poverty line.[7] In 2009, this was approximately US$987 million (in 2009 dollars) for the country as a whole, lower than the US$1,072 million estimated in 1997, but considerably higher than the US$910 million estimated in 2003. The poverty

[7] The value of the poverty deficit, however, is not the same as the cost of ending extreme poverty. It reflects the size of the problem, not the cost of the solution.

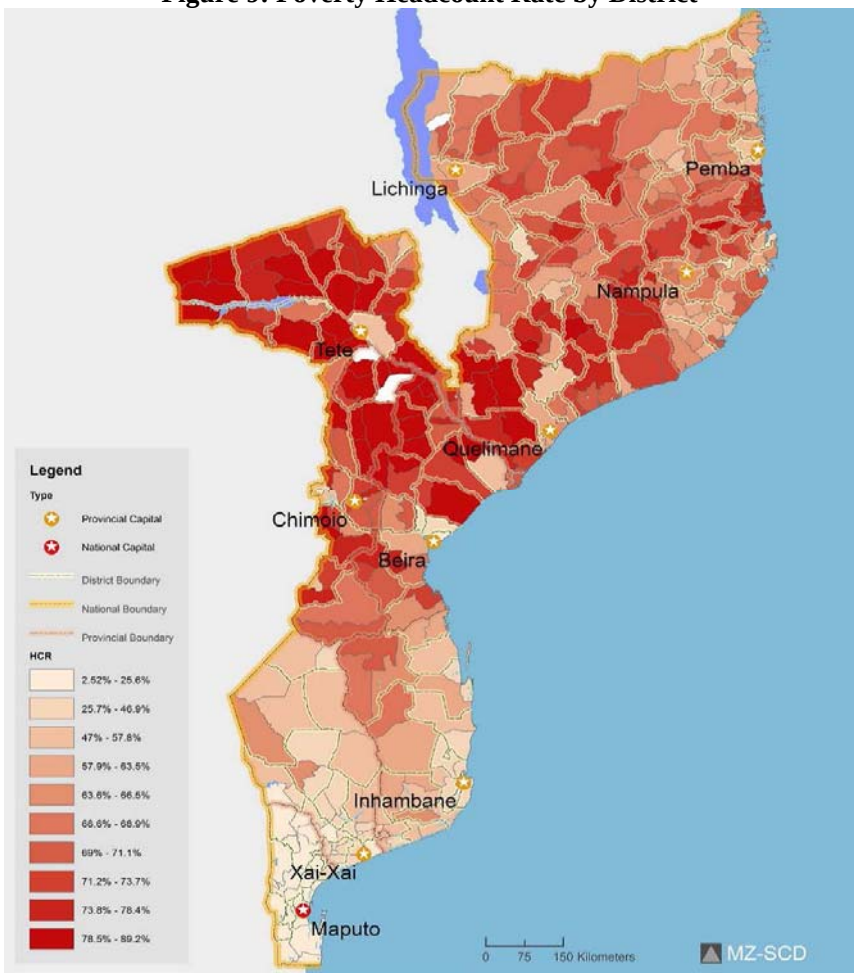
deficit has increased fastest in Zambezia and Nampula, and together these two provinces represent more than 40 percent of Mozambique's total deficit (Figure 8).

Figure 8: Poverty Deficit, Mozambique and Provinces



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

Figure 9: Poverty Headcount Rate by District



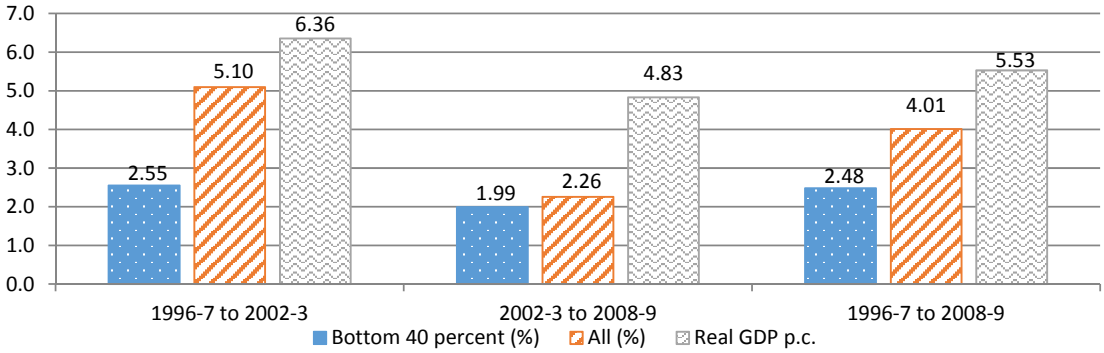
Source: World Bank staff calculations based on the IOF2008/9, and Dobbin, 2015

2.1.3. Growth, Poverty Reduction and Inequality

28. **Mozambique is among the fastest-growing economies in SSA, but it has struggled to translate its rapid growth into widespread poverty reduction**. Poverty rates in Mozambique have been considerably less sensitive to economic growth than in other SSA countries. Or, in other words, the country's growth elasticity of poverty reduction (GEPR) is relatively low. In SSA, between 1997 and 2009 a 1 percent increase in per capita GDP was associated with a 0.5 percent drop in the poverty rate. In Mozambique, however, a 1 percent increase in GDP was associated with a decline of just 0.26 percent in the poverty rate.

29. **Two factors underlie the relatively low responsiveness of poverty reduction to economic growth in Mozambique.** First, an increase in GDP per capita might be expected to generate a proportionate increase in average consumption, yet this is not the case. Second, an increase in consumption levels might be expected to have a commensurate effect on poverty reduction (on average), yet this is also not materializing.[8] For each 1 percent increase in per capita GDP between 1997 and 2009 mean per capita consumption increased by 0.73 percent. The per capita GDP growth elasticity of mean per capita consumption was approximately 0.81 between 1997 and 2003 and declined to 0.47 between 2003 and 2009. While the economy grew at very similar rates during these two periods, consumption growth was much slower in the second period. As discussed in Section 3.2, this phenomenon is largely explained by a shift in the drivers of growth from agriculture in the first period to large capital-intensive investments in the second period. This shift was accompanied by a widening disparity between provinces, as more urban and economically integrated areas were better able to benefit from the change in growth drivers than their more remote, largely agricultural counterparts.

Figure 10: Per Capita GDP and Mean per Capita Consumption Growth in Mozambique



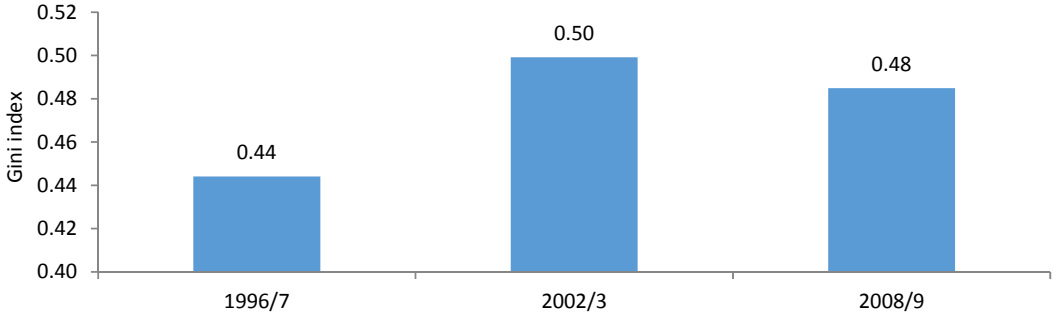
Source: World Bank staff calculations based on IOF and INE
Note: Poverty figures for 1996-7 and 2002-3 are based on consumption

30. **Consumption growth has not generated commensurate levels of poverty reduction.** For each 1 percent increase in mean per capita consumption between 1997 and 2009 poverty declined by just 0.44 percent, well below the estimated SSA average of 0.7 percent. The period of robust growth between 1997 and 2003 exhibited a slightly lower consumption elasticity of poverty reduction (-0.50) than the slower-growth period between 2003 and 2009 (-0.54).

[8] For example, in Zambezia consumption expenditures did increase between the two survey periods, and overall poverty rates increased.

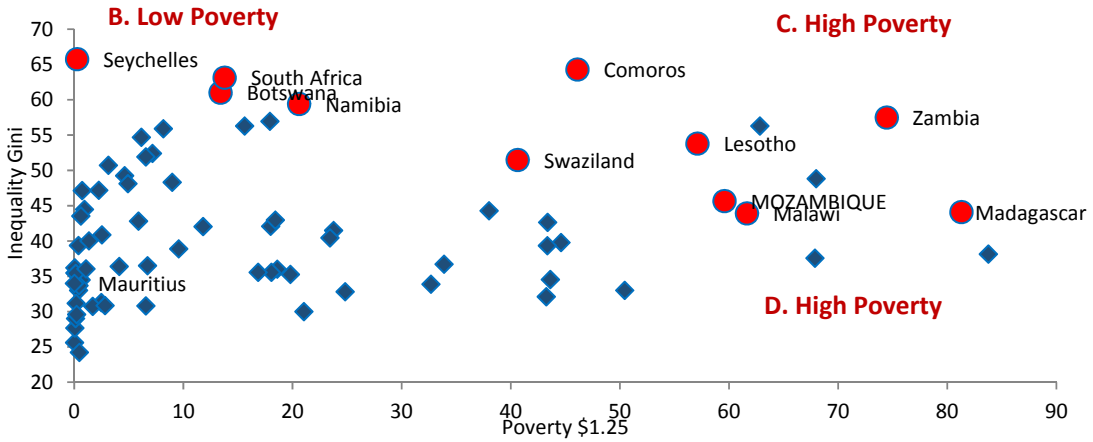
31. **Inequality indicators in Mozambique worsened considerably between 1997 and 2003 and remained elevated through 2009.** The Gini index rose from 0.44 in 1997 to 0.50 in 2003, then slid to 0.48 in 2009 (Figure 11). Mozambique belongs to a group of high-poverty, high-inequality countries (Figure 12), and extreme inequality tends to diminish the impact of economic growth on the bottom of the income distribution. High and rising levels of inequality between 1997 and 2009 partially explain the relatively modest decline in poverty despite the rapid growth of GDP and mean per capita consumption observed during the period.

Figure 11: Inequality Dynamics, 1997-2009



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

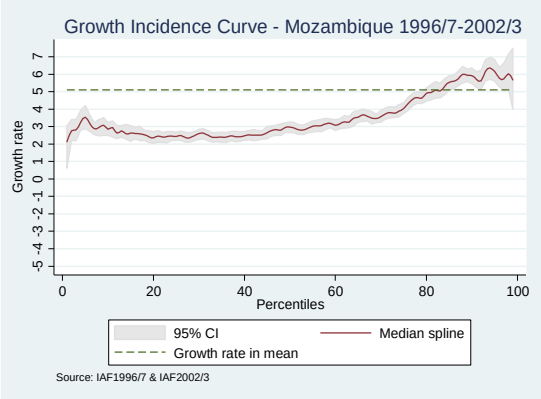
Figure 12: Poverty and Inequality Across Countries

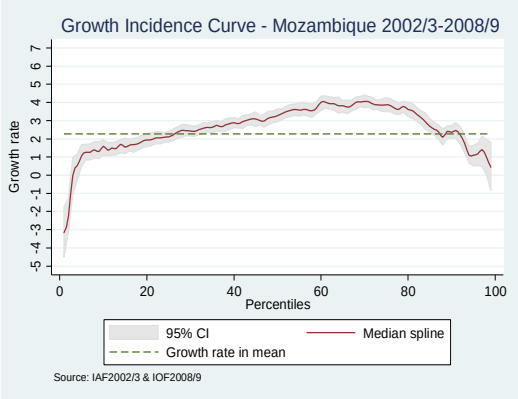


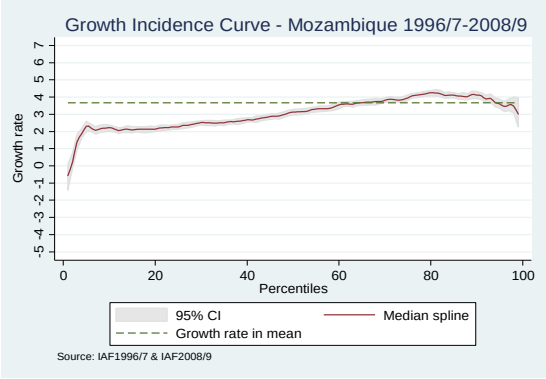
Source: World Bank staff calculations

32. **Inequality indicators improved slightly between 2003 and 2009, but the slowing growth of per capita consumption resulted in a relatively modest reduction in the poverty rate.** The growth incidence curves in Figure 13 illustrate the uneven returns to growth. While overall consumption increased between 1997 and 2003, households in the top 20 percent of the income distribution benefited significantly more than average. Between 2003 and 2009 the consumption growth rate slowed, and households at the top and bottom of the distribution benefited the least from growth.

Figure 13: Growth Incidence Curves







Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9
Note: Constant 2009 prices

33. **Growth would have had a much larger impact on poverty reduction had its effects not been offset by an increase in inequality**. The poverty rate declined by 16 percentage points between 1997 and 2009 (Table 1). However, if inequality indicators had not worsened, Mozambique's observed growth during the period would have reduced the poverty rate by almost 27 percentage points, yielding a rate of 42 percent instead of an estimated 52 percent. Conversely, if the economy had not grown at all during the period, the rise in inequality would have increased the poverty rate by 3 percentage points.

Table 1: Growth-Inequality Poverty Decomposition

Head-count poverty rate (%)		Change in poverty	Growth component	Redistribution component	Residual
1997	2009		1997-2009 (in percentage points)		
68.4	52.1	- 16.3	-26.8	3.2	7.3

Source: World Bank staff calculations using IAF1996/7 and IOF2008/9

34. **Growing disparities between provinces—and especially between Nampula and Zambezia and the rest of the country—appear to be driving inequality trends nationwide.** Since 2003 the gap between Nampula and Zambezia and the rest of Mozambique has widened dramatically. Together, these two provinces saw their poverty rates rise by more than 5 percent between 2003 and 2009, while poverty rates fell by 17.3 percent in the rest of the country. Although Nampula's headcount poverty rate remained unchanged, due to its large and rapidly

growing population the province is helping to drive the increase in the total number of people living below the poverty line. In 2003, Nampula and Zambezia represented 38 percent of the population and 42 percent of the poor; in 2009, their population share remained the same, but their share of the poor increased to 48 percent.

35. **Poverty rates in Nampula and Zambezia are the least responsive to economic growth.** If these provinces were excluded Mozambique's GEPR would be -1.18, significantly higher than the SSA average of -0.7. Table 2 presents counterfactuals for changes in poverty rates, per capita expenditures, and the GEPR for each province and for Nampula and Zambezia together. The counterfactual for a given province is the change in the poverty rate, per capita expenditure growth and GEPR that would result if that province was excluded from the calculations. For example, if Maputo province were excluded, the poverty rate would have fallen by 3.8 percentage points between 2003 and 2009 instead of the observed decline of 4.4. Nampula and Zambezia have the highest counterfactual GEPRs. If they were excluded from the calculation, the national GEPR would have more than doubled.

Table 2: Counterfactual Changes in Poverty, per Capita Consumption and Growth Elasticity of Poverty Reduction, 2003-2009

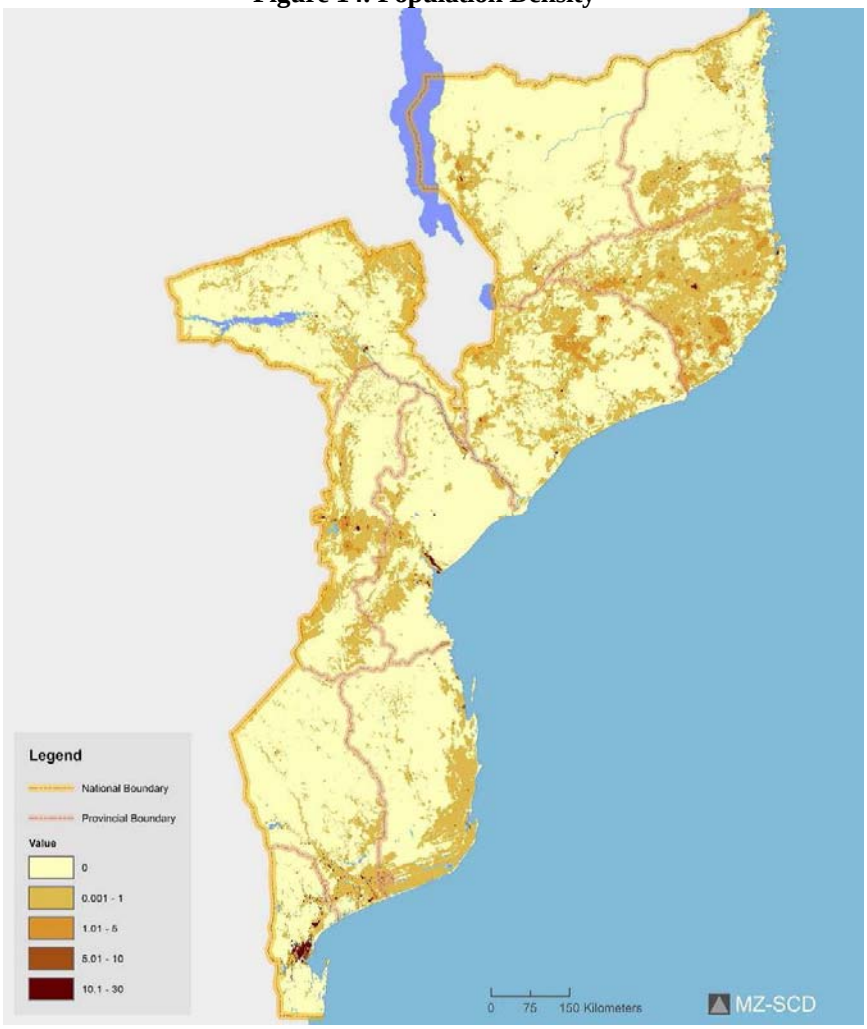
2003 - 2009	Change in Poverty		Per Capita Expenditure Growth		GEPR	P-value
	PPs	%	PPs	%	PPs	%
Mozambique	**-0.0435**	**-7.7049**	**3.0725**	**14.3503**	**-0.5369**	**0.0000**
Niassa	-0.0337	-6.0356	2.6653	12.3330	-0.4894	0.0081
Cabo Delgado	-0.0269	-4.8562	3.0337	14.1204	-0.3439	0.0000
Nampula	-0.0471	-8.5838	2.8706	12.4242	-0.6909	0.0000
Zambezia	-0.0759	-13.7911	3.7840	16.5157	-0.8350	0.0000
Tete	-0.0335	-6.1150	2.8154	12.7453	-0.4798	0.0005
Manica	-0.0536	-9.3341	3.2207	15.0568	-0.6199	0.0000
Sofala	-0.0526	-9.2534	3.5437	16.6161	-0.5569	0.1242
Inhambane	-0.0311	-5.5581	2.6784	12.2336	-0.4543	0.0000
Gaza	-0.0510	-8.7749	3.3946	16.1124	-0.5446	0.5219
Maputo Province	-0.0376	-6.5226	2.9197	14.2563	-0.4575	0.0000
Maputo City	-0.0403	-6.8944	2.9656	15.9218	-0.4330	0.0000
Nampula & Zambezia	*-0.0909*	*-17.2526*	*3.7467*	*14.6430*	*-1.1782*	*0.0000*

PP - percentage points
Source: World Bank staff calculations using IAF2002/3 and IOF2008/9

36. **An Oaxaca-Blinder decomposition can help shed light on the limited impact of economic growth on poverty in Nampula and Zambezia.** It is important to note that these provinces are

the country's most populous, and Nampula is especially densely populated (Figure 14). Households in these provinces may be unable to benefit from growth due to a lack of productive assets (including human capital), which limits their access to economic opportunities, or because the assets they do possess generate low returns. An Oaxaca-Blinder[9] decomposition can determine the extent to which disparities between these two provinces and the rest of the country can be explained by differences in the stock of household assets versus differences in the returns to those assets by examining poverty rates and mean per capita consumption levels in Nampula and Zambezia compared with the rest of Mozambique.

Figure 14: Population Density[10]



Source: Dobbin, 2015

[9] The counterfactual decomposition technique was popularized by Blinder (1973) and Oaxaca (1973) and is widely used to study mean outcome differences between groups. For example, the technique is often used to analyze wage gaps by sex or race.

[10] This dasymetric map depicts population density by showing the 2007 population distribution adjusted for types of land-use within each administrative post (based on, for example, Land Use and Land Cover (LULC) data, village data points and proximity to major roads and cities). It reveals the population footprint in each administrative post rather than just population size. In addition to highlighting strong regional variations in population density, it shows the dense settlements along major rivers and roads.

37. **Households in Nampula and Zambezia tend to have fewer assets than average; they also face a number of disadvantages, including their predominantly rural location, lower rates of educational attainment and large share of adults working in the primary sector (Table 3).** Progress between 2003 and 2009 was mixed, as households in Nampula and Zambezia increased certain assets at a faster rate than the rest of the country, yet they continued to lag behind the national average. For example, primary education rates in Nampula and Zambezia rose faster than in the country as a whole, yet their educational attainment levels remain below average. Meanwhile, the number of adults who completed secondary education and the share of the labor force in the tertiary sector grew more slowly than in the rest of the country.

Table 3: Average Household Assets for Nampula and Zambezia and the Remainder of the Country

	Remainder of the Country				Zambezia & Nampula			
	2003	2009	Change	Change %	2003	2009	Change	Change %
Rural Area	58%	65%	7 pp	11.76	71%	78%	6 pp	8.49
Adults average age	29.00	29.77	0.77	2.64	28.97	29.12	0.15	0.52
Number of adult females	2.46	2.11	-0.35	-14.24	1.74	1.72	-0.03	-1.48
Number of adults with primary education	0.65	0.84	0.19	29.79	0.29	0.44	0.14	48.70
Number of adults with secondary education	0.08	0.10	0.2	20.64	0.03	0.03	-0.003	-8.93
Number of adults in primary sector	2.00	2.35	0.35	17.27	2.07	2.55	0.48	23.30
Number of adults in secondary sector	0.12	0.14	0.03	21.08	0.04	0.06	0.02	44.18
Number of adults in tertiary sector	0.53	0.39	-0.14	-26.29	0.30	0.16	-0.14	-46.66
Number of adults working in the health & education sectors	0.07	0.06	-0.014	-19.48	0.07	0.05	-0.02	-29.79
Number of adults in public administration	0.04	0.04	-0.001	-1.44	0.02	0.02	-0.004	-18.33

pp – percentage points
Source: World Bank staff calculations using IAF2002/3 and IOF2008/9

38. **Nampula and Zambezia's relatively poor performance in alleviating poverty is due primarily to lower returns to household assets rather than slower accumulation of assets.** If the level of household assets in Nampula and Zambezia had changed at the same rate between 2003 and 2009 as the level of assets in the rest of the country, poverty in Mozambique would have in fact increased by approximately 8 percent instead of decreasing by 7.7 percent. If the returns to assets in Nampula and Zambezia had increased at the same pace as in the rest of the country, Mozambique's poverty rate would have fallen to 33 percent instead of 52 percent. In 2003, differences in the stock of household assets explained about half of the difference in poverty rates between Nampula and Zambezia and the rest of the country, and differences in the returns to those assets explained the other half. Yet by 2009, the returns to assets explained approximately 72 percent of the difference.

39. **The returns to assets among households in Nampula and Zambezia, particularly education and land, were lower than in the rest of the country between 2003 and 2009**

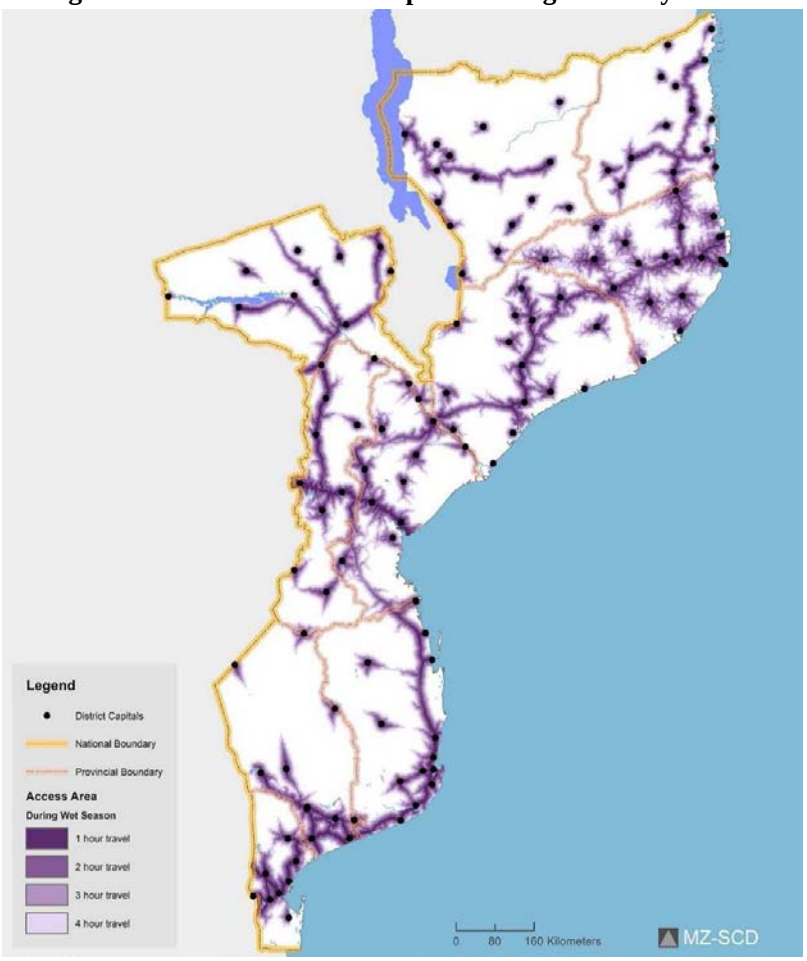
due in part to their relative economic isolation. Remote rural households tend to receive lower prices for their crops, pay higher prices for inputs and have access to fewer nonagricultural income opportunities. Households in Nampula and Zambezia are more remote, on average, than households in the rest of the country (Table 4). Not only are households in Nampula and Zambezia farther from markets, bus stops, schools, police stations and healthcare facilities, but a poorly developed road network in Zambezia leaves many communities virtually cut off during the rainy season (Figure 15).

Table 4: Travel Time, on Foot, 2012

	Mozambique	Nampula & Zambezia	Rest of the country
Market			
0-60 minutes	85.7%	79.0%	89.3%
60+ minutes	14.3%	21.1%	10.7%
Bus stop			
0-60 minutes	84.6%	81.7%	86.0%
60+ minutes	15.4%	18.3%	14.0%
Primary School			
0-60 minutes	84.3%	81.2%	86.3%
60+ minutes	15.7%	18.8%	13.7%
Police Station			
0-60 minutes	34.3%	24.3%	40.4%
60+ minutes	65.7%	75.7%	59.6%
Health Facility			
0-60 minutes	42.2%	32.0%	48.5%
60+ minutes	57.8%	68.0%	51.5%

Source: World Bank staff calculations using IOF 2008/2009

Figure 15: Access to District Capitals During the Rainy Season



Source: Dobbin, 2015

40. **Farm-gate prices are typically lower in Nampula and Zambezia than in the rest of the country.** In 2012 farmers in Nampula and Zambezia received lower than average prices for many key local crops (Table 5). Moreover, between 2008 and 2012 prices for several crops rose at a slower pace in Nampula and Zambezia than in the rest of the country. The price of cassava, for example, increased by 2.45 percent (from 3.06 MZN/kg to 3.45 MZN/kg) in Mozambique as a whole, but by only 0.39 percent (from 0.77 MZN/kg to 1.29 MZN/kg) in Nampula and Zambezia. The same pattern was observed for maize, rice, sorghum, large groundnuts, kidney beans, cow peas, pigeon peas and mung beans.

Table 5: Output Prices, by Type of Crop, 2008-2012, (MZN/kg)

	Nampula & Zambezia			Rest of the country		
	2008	2012	%	2008	2012	%
Maize	4.00	4.31	3.31%	4.00	4.45	3.45%
Rice	8.25	12.17	11.17%	11.18	12.38	11.38%
Sorghum	7.98	5.04	4.04%	4.01	5.22	4.22%
Millet	5.94	N/A	N/A	5.94	26.02	25.02%
Large groundnuts	12.49	20.20	19.20%	13.82	23.53	22.53%
Small groundnuts	11.20	19.21	18.21%	9.77	12.76	11.76%
Kidney bean	16.82	16.82	15.82%	16.82	17.56	16.56%
Cowpea	7.61	8.90	7.90%	7.47	9.19	8.19%
Jugo bean	5.42	9.86	8.86%	8.95	7.79	6.79%
Pigeon pea	5.43	7.79	6.79%	5.03	7.88	6.88%
Mung beans	5.51	10.00	9.00%	2.97	10.32	9.32%
Cassava	0.77	1.39	0.39%	1.85	3.45	2.45%
Sweet potato OF	2.38	6.90	5.90%	2.85	4.48	3.48%
Sweet potato WF	1.48	3.97	2.97%	3.06	2.99	1.99%

Source: World Bank staff calculations using TIA 2007/08, TIA 2011/12

41. **Farming households in Nampula and Zambezia report much lower average incomes from both farm and nonfarm activities.** The average annual income from farm activities in Nampula and Zambezia was around US$50.99 per household in 2008 and US$82.43 in 2012, far below the averages of US$201.92 and US$255.62, respectively, observed in the rest of the country (Table 6). Moreover, the average annual income from nonfarm activities in Nampula and Zambezia was around US$110.38 per household in 2008 and US$266.03 in 2012, compared to US$467.89 and US$785.35, respectively, in the rest of the country.

Table 6: Mean Farm and Non-Farm Yearly Income per Household, 2008 and 2012, US$

	Nampula and Zambezia	Rest of the country	Mozambique
Farm income, 2008	50.99	201.92	163.02
Farm income, 2012	82.43	255.62	209.74
Nonfarm income, 2008	110.38	467.89	375.69
Nonfarm income, 2012	266.03	785.35	646.28

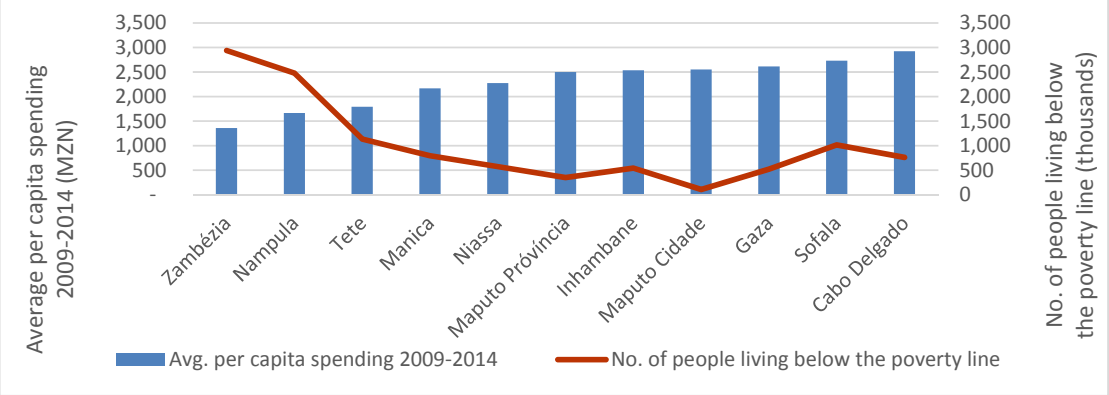
Source: World Bank staff calculations using TIA 2007/08, TIA 2011/12

42. **Nampula and Zambezia have considerable potential for agriculture and forestry development, but carefully targeted interventions will be necessary to realize it.** These two provinces encompass some of Mozambique's most productive agricultural land and forestry resources. However, inadequate transportation infrastructure and a highly problematic land-tenure system inhibit investment and diminish productive efficiency. In addition, both provinces require production systems that are compatible with densely populated areas, including irrigation networks and other forms of commercial infrastructure.

43. **Nampula and Zambezia receive less public spending per capita than the rest of the country, which likely contributes to the diminishing returns to household assets.** Between 2009 and 2014 average annual per capita public spending in Nampula and Zambezia was MZN

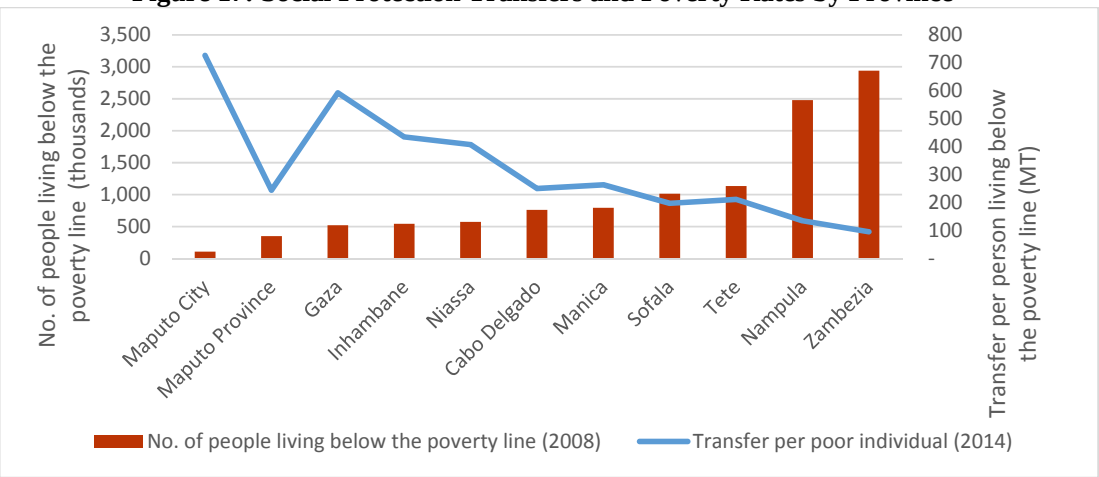
1,686 and MZN 1,378, respectively, significantly lower than the national average of MZN 2,315 (Figure 16). Moreover, as discussed in Section 4.5 there are also considerable regional disparities in the distribution of social transfers. Though they are home to the country's largest poor populations, Nampula and Zambezia receive the lowest levels of social transfers per person living below the poverty line at MZN 135 and MZN 96, respectively, far below the national average of MZN 324 (Figure 17).

Figure 16: Per Capita Public Spending and Population Living below the Poverty Line by Province



Source: Ministry of Economy and Finance

Figure 17: Social Protection Transfers and Poverty Rates by Province[11]



Source: Ministry of Economy and Finance and World Bank staff estimates

44. **Significant progress in poverty alleviation in either or both provinces could have a major impact on national poverty levels.** Several growth corridors already run through these provinces, including Nacala, Beira and the proposed Zambezi corridor. Yet boosting agricultural production and diversifying economic opportunities away from traditional sectors will require substantial investment in well-targeted projects focused on both physical infrastructure (i.e. transportation) and administrative reform (i.e. land tenure). Better integrating Nampula and Zambezia into the national economy could dramatically accelerate

[11] The transfer amount only considers budget execution on social protection programs and excludes all operational costs.

the pace of poverty reduction, but building the physical and institutional foundation for robust growth will require sustained political will.

2.2. Poverty Profiles over Time

45. **The demographic structure of Mozambican households has remained largely unchanged since the country's first household survey in 1997.** The average household had 4.8 members in 1997 and 2003, and 4.7 in 2009 (Table 7). In 2009, Mozambican households had an average of 1.2 children under the age of 7, 1.1 children aged 7-14, and 2.4 adults. Non-poor households tend to have fewer members, and this pattern is consistent over time. Poor households, however, tend to have a higher ratio of children to adults.

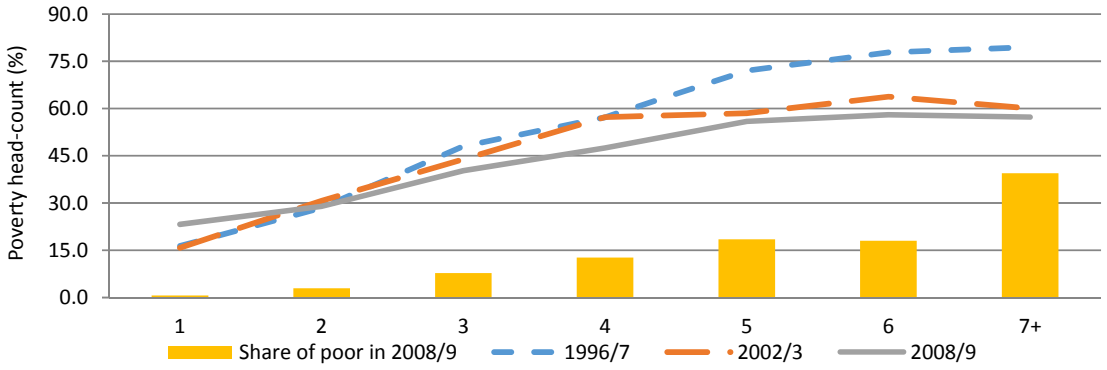
Table 7: Household Characteristics

	Poor			Non-Poor			Total Population		
	1996/7	2002/3	2008/9	1996/7	2002/3	2008/9	1996/7	2002/3	2008/9
Household size	5.51	5.28	5.16	3.75	4.30	4.23	4.80	4.81	4.67
Number of children under 7	1.32	1.44	1.50	0.69	0.90	0.92	1.06	1.18	1.19
Number of children aged 7-14	1.43	1.27	1.28	0.72	0.84	0.89	1.14	1.06	1.07
Number of adults 15+	2.77	2.57	2.38	2.35	2.56	2.42	2.60	2.56	2.40
Average age	22.21	21.85	22.10	27.88	27.39	26.29	24.50	24.55	24.31
Average age of head	42.97	42.54	42.49	41.12	42.91	42.02	42.22	42.72	42.24

Source: World Bank staff's calculations using IAF1996/7, IAF2002/3, and IOF2008/9

46. **Larger households are poorer on average and comprise a major share of the poor population.** Households with one member, meanwhile, have the lowest average poverty levels. In 2009, single-member households represented less than 1 percent of the poor, while households with 7 or more members represented almost 40 percent (Figure 18).

Figure 18: Poverty and Share of the Poor Population by Household Size

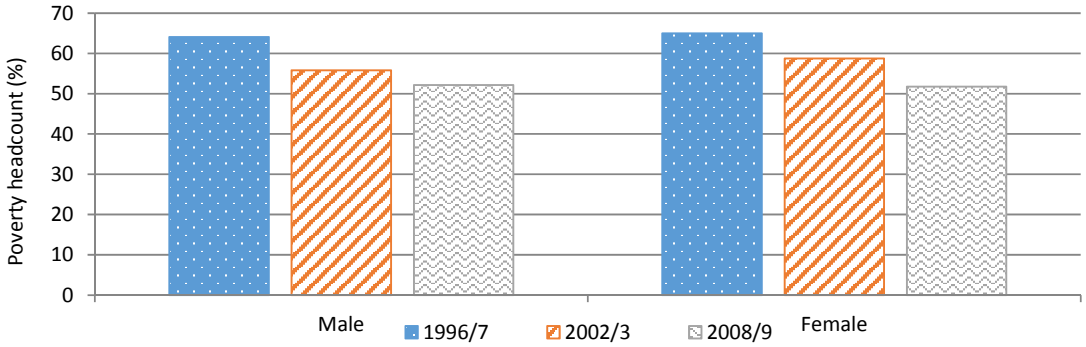


Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

47. **People living in female-headed households were initially poorer than those in male-headed households.** In 1997, 64 percent of people living in male-headed households were poor compared to 65 percent in female-headed households. By 2003, poverty had declined overall,

but the gender gap had increased to 3 percentage points. By 2009, the differences in poverty rates in female-headed households compared to male-headed households had narrowed to 51.8 and 52.2 percent, respectively (Figure 19). However, female-headed households with a single or divorced head experience higher levels of poverty (Figure 20). In 2009, people living in single female-headed households experienced significantly higher levels of poverty than those living in single male-headed households, at 23 and 18 percent, respectively. The gender gap between divorced or separated household heads is especially striking: the poverty rate among households headed by a divorced or separated man was 27 percent, less than half the rate for households headed by a divorced or separated woman, which at 59 percent was the highest incidence of any demographic group.

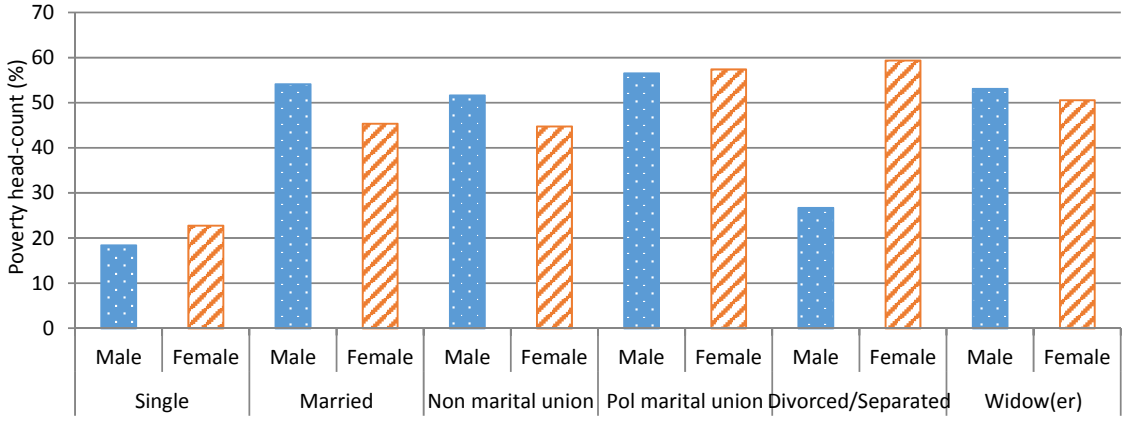
Figure 19: Poverty by Gender of Household Head



Source: World Bank staff calculations using IOF2008/9

48. **Household size, number of children and rural location all correlate with poverty.** A multiple regression analysis found that large households with numerous children, particularly young children, are more likely to be poor. Households headed by single people tend to be poorer than those headed by married couples, and households headed by divorced or widowed people experience the highest poverty incidence.

Figure 20: Poverty by Household Head's Gender and Marital Status, 2008/9

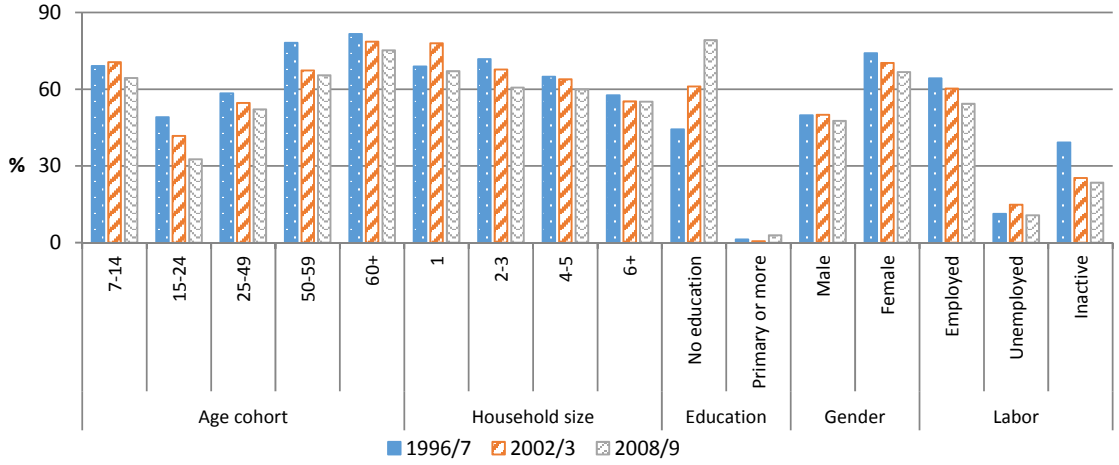


Source: World Bank staff calculations using IOF2008/9

49. **Illiteracy rates correlate with poverty, age and gender, and the economic gap between the literate and illiterate has increased over time.** Access to education has increased

substantially over the last decade, yet education indicators among the poor have worsened. Over time, the difference in poverty rates between illiterate and literate people has tended to increase. In 1997, poverty among the illiterate was 73 percent, compared to 58 percent among the literate. By 2009, poverty had declined for both groups, but the decline was faster among the literate. Among the literate poverty declined by 56 percent, compared to 19 percent among the illiterate. Illiteracy rates tend to be higher among women and lower among young people. Illiteracy rates are lowest among those aged 15-24 (Figure 21). In 2009, the illiteracy rate was roughly 70 percent for women and 50 percent for men.

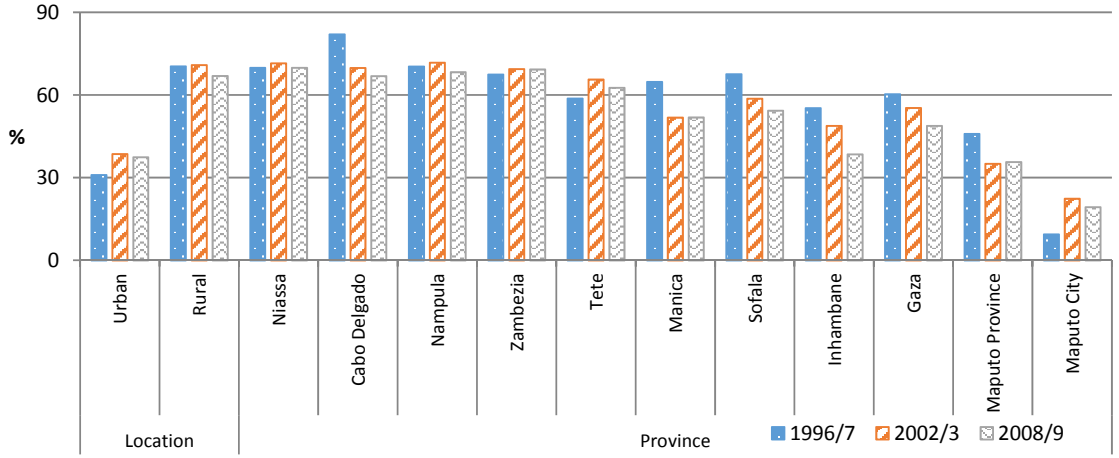
Figure 21: Illiteracy Rates by Demographic Characteristics



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

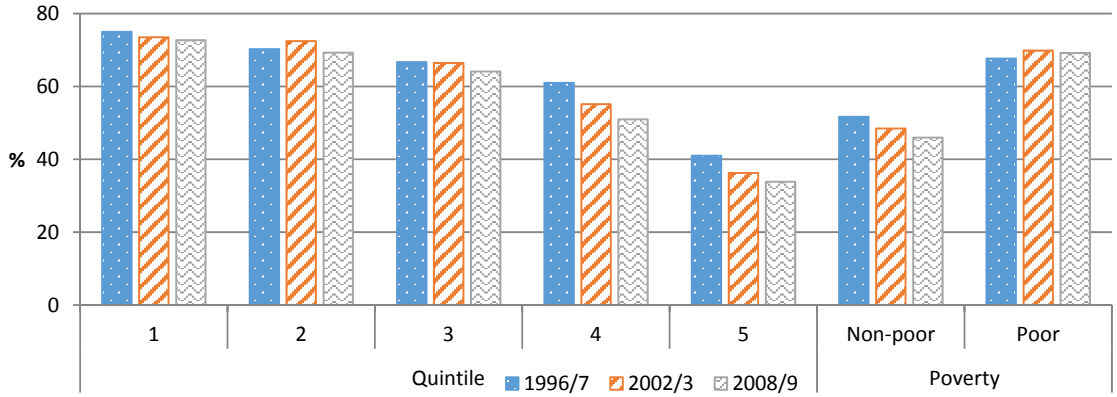
50. **Illiteracy is most prevalent in rural areas**. In 2009, over 65 percent of rural Mozambicans were illiterate, almost double the urban rate of 36 percent. Maputo City had the lowest illiteracy rate, while Niassa Province had the highest (Figure 22). However, while most provinces saw their illiteracy rates decline, illiteracy in Maputo City increased from 9 percent in 1997 to 20 percent in 2009. This may be an effect of rural-urban migration.

Figure 22: Illiteracy Rates by Location and Province



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

Figure 23: Illiteracy Rates by Income Level and Poverty Status



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

51. **Poverty is correlated with the educational background of the household head.** More educated heads of household have lower poverty rates (Figure 27), and over time poverty rates have fallen faster among households headed by more educated people (Figure 24, Figure 25 and Figure 26). In 2009, heads of households with no formal education had a 58 percent poverty rate, while those who had completed primary school had a rate of 30 percent, those who had completed secondary school had a rate of 9 percent, and the poverty rate among households headed by individuals who had completed tertiary education was negligible. Between 1997 and 2009, poverty declined by 15 percent among households whose head had no formal education, while it fell by 49 percent among households whose head had completed secondary education. The share of people living in households headed by an individual with no formal education declined over time, albeit marginally.

Figure 24: Education and Poverty, 1996/7

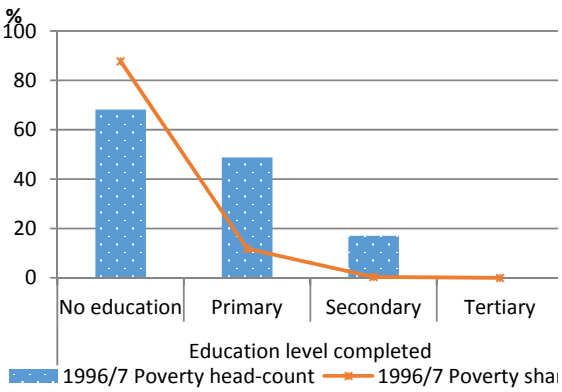
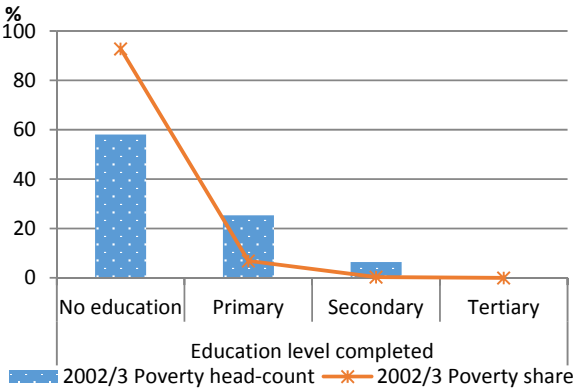


Figure 25: Education and Poverty, 2002/3



Source: World Bank staff calculations using
IAF1996/7, IAF2002/3, and IOF2008/9

Figure 26: Education and Poverty, 2008/9

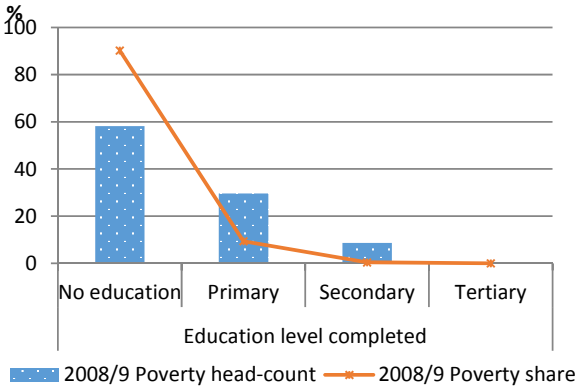
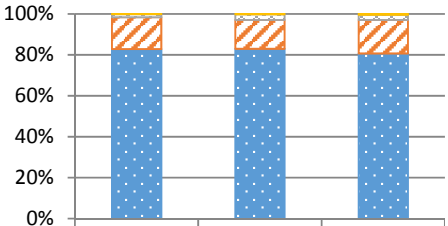


Figure 27: Education among Household Heads



	1996/7	2002/3	2008/9
Tertiary	0.1	0.2	0.4
Secondary	1.5	2.7	2.4
Primary	15.6	14.1	16.4
No education	82.9	83.0	80.7

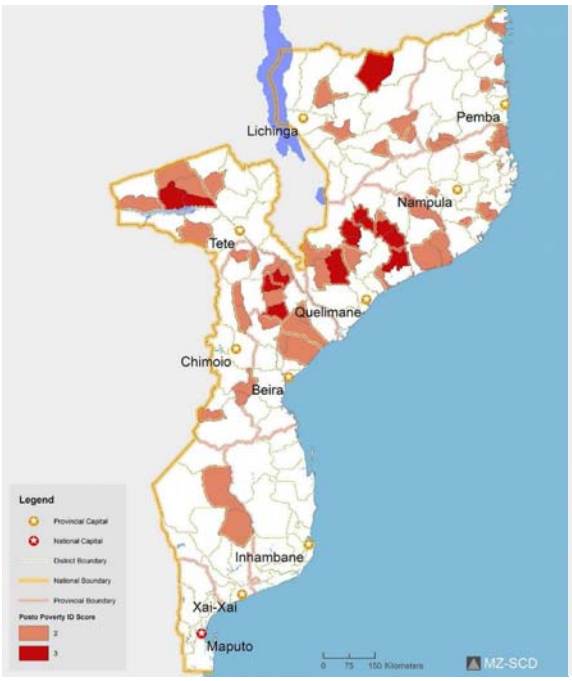
Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

2.3. Regional Poverty Dynamics

52. **The poorest administrative posts are primarily located in three distinct clusters in the country's central region.** A poverty composite model was developed to determine which administrative posts were among the 100 poorest based on the 2008-09 household survey, the human development index and the national poverty headcount ratio. Figure 28 shows the 14 administrative posts that were identified as among the 100 poorest in all three datasets, representing approximately the bottom 2.5 percent of Mozambique's 411 administrative posts. Nearly all of these fall within three areas of the central region: the northern side of Lake Cahorra Bassa in Tete Province, another in central Zambezia Province and the third in northwestern Sofala Province. These three areas are home to almost 600,000 people, or 3 percent of the national population based on the 2007 census.

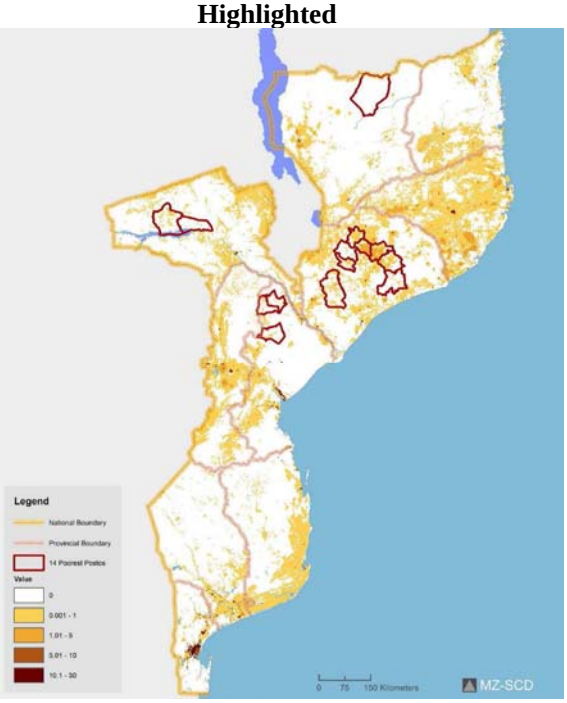
53. **These three poverty clusters are located within larger regions of multidimensional poverty.** Many of the 66 administrative posts that were identified among the 100 poorest by at least two of the three metrics in the poverty composite model are near or adjacent to the three poverty clusters (Figure 28). The poverty cluster in Zambezia Province is located in a particularly densely populated area (Figure 29), making it by far the most dominant poverty cluster in terms of population. This cluster includes the administrative posts of Ile, Mulevala, Namarroi and Regone, each of which has a household-level extreme poverty rate of between 97.7 percent and 100 percent.

Figure 28: The Poorest Administrative Posts as Defined by Poverty Composite Model



Source: Dobbin, 2015

Figure 29: Population-Density Distribution with Poorest Administrative Posts Highlighted

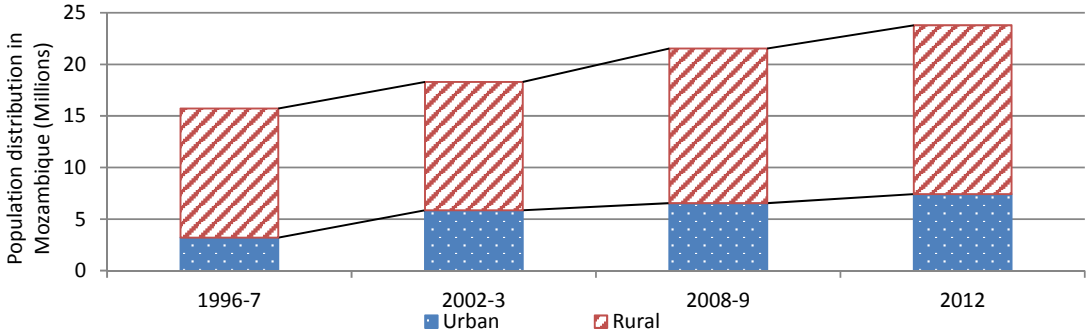


Source: Dobbin, 2015

2.4. Changing Demographics and Challenges for Poverty Reduction

54. **Mozambique's population grew at an average rate of 2.5 percent per year from 2002 to 2009, and the total population is expected to double in the next 30 years**. According to the 2009 household survey the country had about 22 million inhabitants, but recent estimates suggest that this figure has increased to roughly 25 million, with most of the population gains occurring in rural areas (Figure 30). 70 percent of the population lives in rural areas, with Nampula and Zambezia provinces together accounting for a full 38 percent.

Figure 30: Urban/Rural Population Distribution



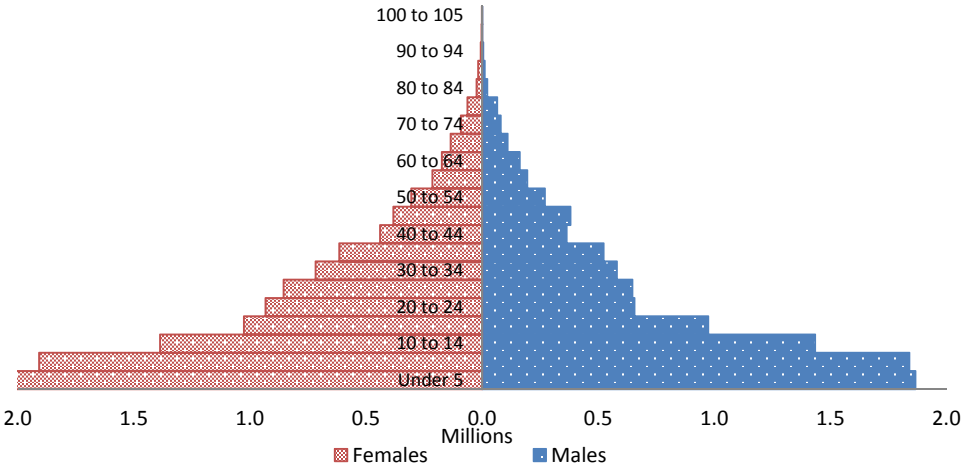
Source: Estimated from three HBS (IAF1996-7, IAF2002-3, and IOF 2008-9) and first quarter data of a continuous household survey (*Inquérito Contínuo Aos Agregados Familiares*, INCAF), 2012.

55. **High fertility rates persist even as infant mortality rates are declining, leading to a growing population of young people and a high dependency ratio**. Adolescents represent approximately 21 percent of Mozambique's population, and the country has the world's 10th

highest rate of child marriage. Approximately 48 percent of girls are married, and 40 percent become pregnant before they turn 18, with negative impacts on infant and child wellbeing, maternal health and girls' educational outcomes. The unmet need for contraception among married women is also extremely high, and as many as 29 percent of married women lack access to desired contraceptives. Wealthier, urban and educated women exhibit lower overall fertility levels.

56. **As a result, Mozambique is in the early stages of a demographic transition.** Forty-five percent of the population is under the age of 15, and another 20 percent is aged 15-24; together, almost two-thirds is under 25 (Figure 31). This is not likely to change in the near term, and UN projections indicate that in 2030 41.5 percent of the population will be under the age of 14. Changes in fertility can have a significant impact on the age structure in the medium and long term, which in turn can impact living standards and economic growth. For example, under the low-, medium- and high-fertility UN population scenarios, the share of Mozambicans under the age of 15 in 2030 would be 39.3, 41.4 and 43.4 percent, respectively. The difference is expected to be even larger by 2050 at 32.2, 35.2 and 37.9 percent, respectively.

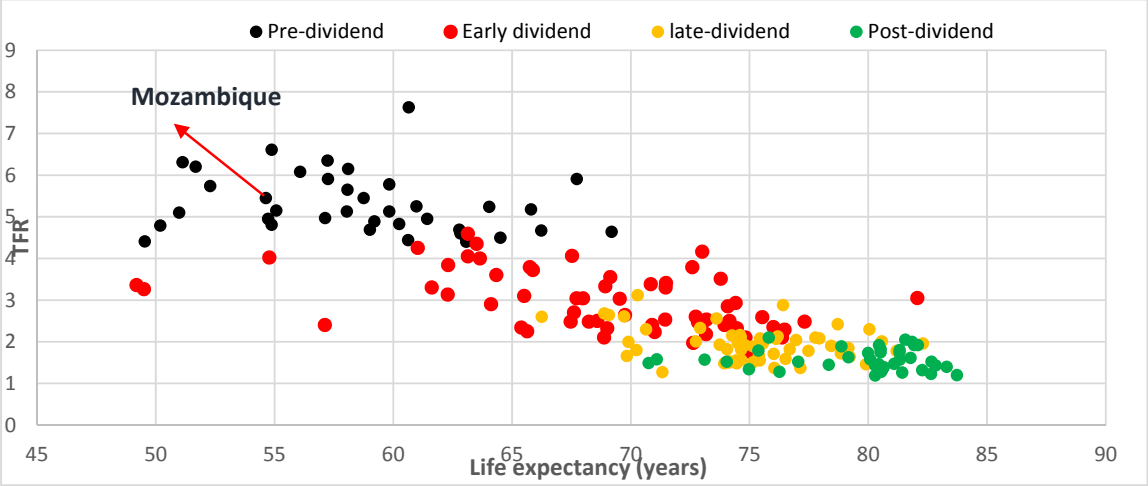
Figure 31: The Gender-Age Pyramid for Mozambique



Source: IOF 2008-9

57. **Mozambique faces major challenges in harnessing its potential demographic dividend.** According to the 2015/2016 Global Monitoring Report, Mozambique is a pre-demographic dividend country with a rapidly growing population of young people and high age-dependency ratios. However, Mozambique will not realize its potential demographic dividend unless it can provide access to productive employment for the rising number of young workers entering the labor force. High fertility rates and declining infant mortality rates are likely to continue over the next three to four decades, putting considerable pressure on education and social services and likely slowing the pace of poverty reduction. In this context, expanding access to comprehensive family-planning services, improving educational outcomes among girls and enhancing workforce skills could help Mozambique leverage the positive economic impact of demographic trends.

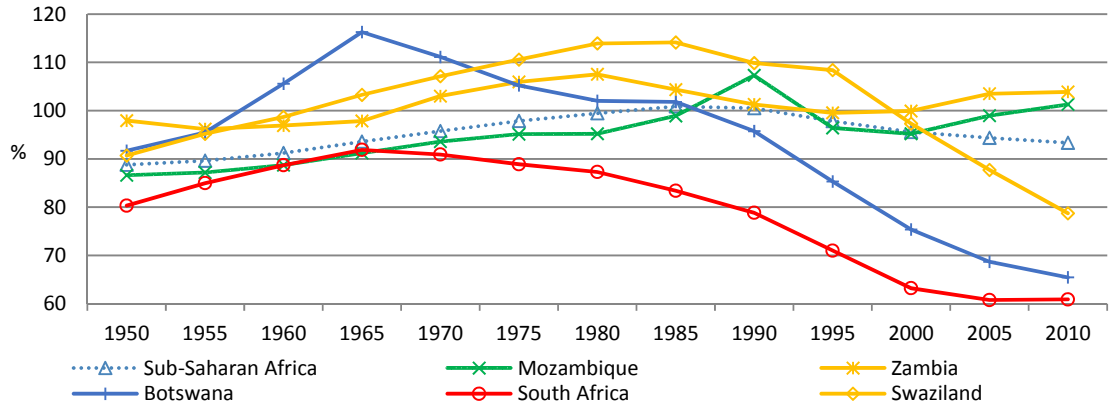
Figure 32: Fertility Rates, Life Expectancy and the Demographic Dividend



Source: Adapted from 2015/2016 Global Monitoring Report

58. **Mozambique's rising dependency ratio stands in contrast to most other countries in the region.** Average dependency ratios have declined in SSA over the past 3 decades, including in neighboring South Africa and Botswana (Figure 33). Only Mozambique and Zambia appear to be deviating from this trend. Dependency ratios in Mozambique are increasing not only due to high fertility rates, but also because women represent almost 57 percent of the population aged 15 and above. This is largely due to lower male life expectancy and the tendency for men to leave the country for work.

Figure 33: Dependency Ratios, Mozambique and Selected Comparator Countries



Source: UN Population Projections

59. **Population growth rates will intensify pressure on public services at a time when Mozambique is already struggling to transform rapid economic growth into positive development outcomes.** The United Nations Development Programme (UNDP) 2014 UNHDI ranked Mozambique 178th out of 187 countries worldwide. While Mozambique's UNHDI indicators have improved since 1990, albeit from a very low base, the coverage and quality of public service provision remains low, particularly in rural areas. Education quality is a particularly serious concern. Although the country's UNHDI education index score has risen significantly since the 1990s, it peaked in 2010 and has since marginally declined. In 2014, Mozambique's aggregate UNHDI indicators for education were comparable to those of

Burundi, Guinea-Bissau and South Sudan.[12] The country's growing population of young people could drive broad-based growth, but leveraging its potential will require sustained improvements in social services, especially education, as well as a strong institutional and policy framework capable of supporting robust private-sector-led growth.

2.5. Accelerating Poverty Reduction: Challenges and Opportunities

60. **Poverty in Mozambique results from complex causes, and addressing it effectively will require a multifaceted strategy.** Poverty is predominantly concentrated in the country's central and northern regions, especially Nampula and Zambezia provinces. This is due in large part to the limited economic connectivity of these areas, which reduces the returns to productive assets. Low rates of public investment have compounded the negative effects of their relative isolation, and social transfers in these provinces have been inadequate to address the depth and severity of poverty.

61. **The following chapters will discuss how Mozambique can tackle some of the root causes of poverty by alleviating constraints to economic growth, improving inclusiveness and addressing issues of long-term sustainability.** In light of its current challenges, Mozambique must focus on developing a diversified and productive economy by closing its infrastructure gaps, investing in a productive and healthy workforce and strengthening its public institutions and regulatory framework to facilitate private sector job creation. Short-to-medium term options for accelerating poverty reduction include scaling-up a cash transfer program and promoting household enterprises to encourage livelihood diversification, especially among the rural poor. These policies are discussed further in Chapter 4.

[12] UNDP, 2014.

3. Key Growth Constraints and Economic Opportunities

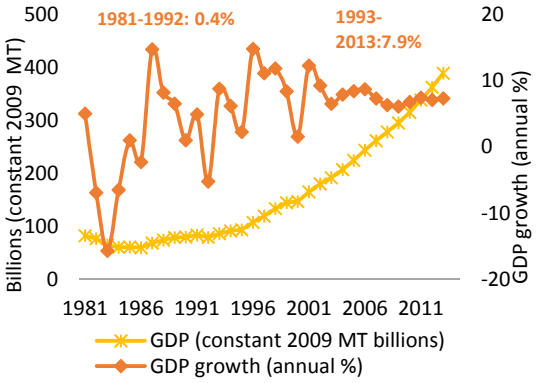
- **Though its economy has grown rapidly in recent years Mozambique remains extremely poor.** Macroeconomic stability and a rapidly expanding resource sector enabled Mozambique to achieve an impressive average growth rate of 7.9 percent per year from 1993-2014. Yet the country remains very poor, rising from the 3rd poorest in the world in 1993 to the 13th poorest in 2013.
- **Mozambique's growth pattern has shifted over time.** Post-war reconstruction (1993-1997) led to the incorporation of more workers into the labor force, and the agricultural sector drove economy-wide growth. Since 1998, however, capital-intensive megaprojects focused on the country's natural resources have dominated the growth pattern, but generated limited formal employment opportunities.
- **The rising importance of megaprojects has contributed to a high degree of export concentration.** A narrow range of natural resources and low-value-added agricultural commodities dominate the export basket, reflecting the low productivity of other economic sectors. Moreover, the country's natural wealth is not being effectively translated into human and physical capital, further slowing long-term productivity growth.
- **In order to capitalize on emerging opportunities for diversification and private sector development, Mozambique will need to overcome a number of significant challenges.** Inadequate physical and logistical infrastructure, excessive bureaucracy, weak public institutions, credit constraints and a complicated land-tenure system continue to discourage investment and narrow the range of economic opportunities available to domestic firms. Over the medium term, the emergence of Dutch Disease effects could erode the competitiveness of the non-resource economy.
- **Though it faces significant challenges, Mozambique has a number of important opportunities to foster broad-based growth.** Limited use of modern technologies, land-tenure insecurity and poor transportation infrastructure constrain productivity and inhibit the expansion of value chains in agriculture, fisheries and forestry. Meanwhile, high trade costs and a poor logistics environment hinder export potential. The information and communication technology sector has considerable scope for continued growth and diversification, but greater market competition and stronger regulatory and financial incentives will be necessary to extend its coverage in rural areas.
- **As extractive industries are expected to continue to play an increasingly important role in the economy, Mozambique will need to tighten linkages between the resource and non-resource sectors in order to expand the distribution of the returns to growth.** The continued development of strategic growth corridors can both encourage private investment in upstream and downstream sectors and spur diversification in the non-resource economy. Further efforts to improve transportation infrastructure and develop agricultural value chains could increase the productivity of smallholder farmers and promote more inclusive growth.

3.1. Economic Growth in Perspective

62. **Mozambique's economy has grown rapidly in the last two decades compared to other SSA countries.** Mozambique grew at an average rate of 7.9 percent per year from 1993-2013

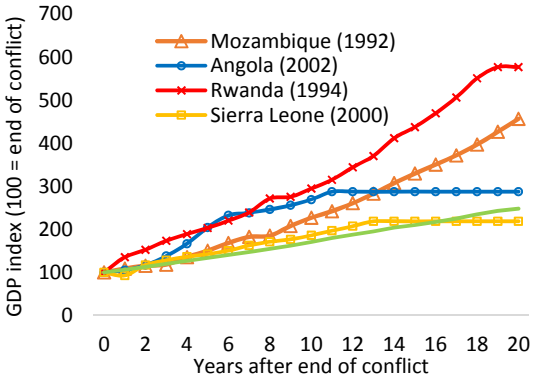
(Figure 34), making it one of the continent's fastest-growing economies. Its growth rate has been particularly high compared to nonoil economies in SSA (4.4 percent), low-income countries (4.7 percent) and the global economy (2.8 percent). Moreover, the country's post-conflict recovery has been among the most robust in Africa. Twenty years after the end of the armed conflict Mozambique's GDP had quintupled, reflecting a 50 percent higher growth rate than the average for post-conflict countries in SSA (Figure 35).

Figure 34: GDP Growth in Mozambique



Source: WDI

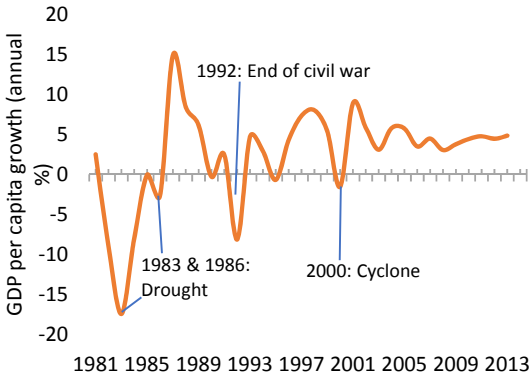
Figure 35: GDP Growth in Post-Conflict SSA



Source: World Bank staff calculations based on WDI and INE data

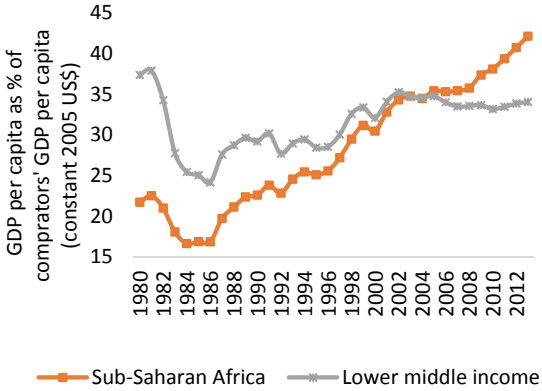
63. **Mozambique is slowly closing the income gap with other SSA countries (Figure 37).** Per capita GDP growth averaged 4.4 percent from 1993-2013. At the end of the civil war in 1992, Mozambique's per capita income (in constant 2005 US$) was 23 percent of the SSA average and about 28 percent of the average for lower-middle-income countries. Mozambique's per capita GDP grew to 42 percent of the SSA average in 2013, and the country rose from the third poorest in the world in 1993 to the 13th poorest in 2013.

Figure 36: Per Capita GDP Growth in Mozambique



Source: World Bank staff calculations based on WDI data

Figure 37: Mozambique's per Capita GDP as a Proportion of SSA and Lower Middle Income Countries

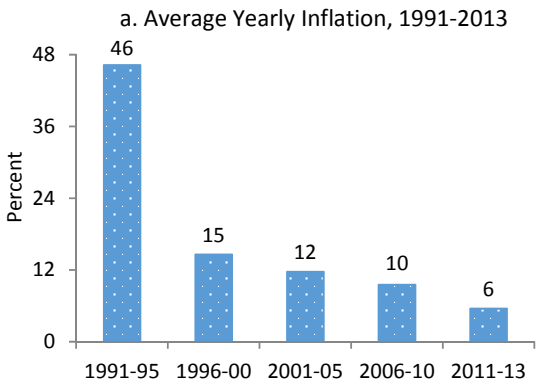


Source: World Bank staff calculations based on WDI data

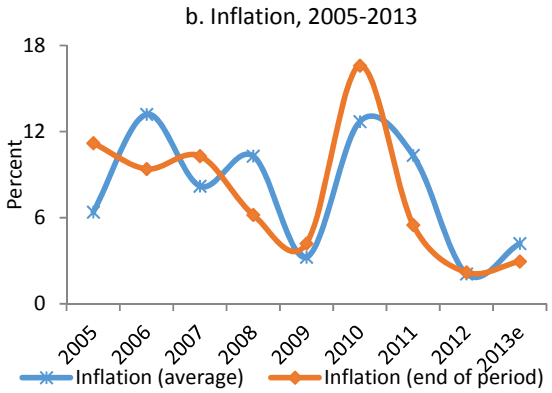
64. **Mozambique has achieved strong GDP growth rates in the context of relative macroeconomic stability and a rapidly expanding resource sector.** A return to political

stability following the end of the civil war provided a foundation for responsible macroeconomic and structural policies. Improved macroeconomic management contributed to a steady decline in the inflation rate, which fell from over 40 percent in the early 1990s to around 5 percent in recent years. Inflation rates have fluctuated, with end-year inflation dropping from almost 17 percent in 2010 to 5 percent in 2011 and 2 percent in 2012 (Figure 38). Food- and energy-price volatility, flooding and other environmental shocks, and fluctuating import prices have all contributed to variations in the inflation rate.

Figure 38: Trends in Inflation



Source: Bank of Mozambique, various years



Source: Bank of Mozambique, various years

65. **Sound macroeconomic management helped attract sufficient donor support and foreign direct investment (FDI) to finance a large current-account deficit**. From 2004 to 2010 the current-account deficit averaged around 11 percent of GDP, with donor grants covering a large share. Foreign-aid inflows helped finance investments in education, health and infrastructure.[13] In the past few years the current-account deficit has widened to 40 percent of GDP due to large-scale capital-intensive imports demanded by the natural resource and infrastructure sectors. The large deficit does not represent a structural imbalance, however, as it is driven by FDI-financed capital investment, much of which is focused on megaprojects. This trend is expected to continue over the next 4-5 years, as most of these projects are still in their early stages. As new projects are completed, commodity production and exports are projected to rise toward the end of the decade, narrowing the current-account deficit.

[13] Nucifora and Pereira de Silva, 2011.

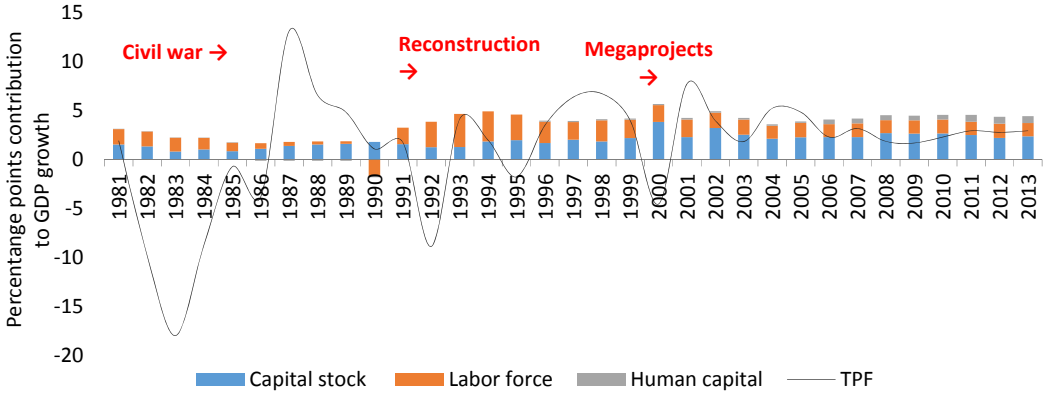
Figure 39: The Current Account

Source: IMF database

3.2. Drivers of Growth

66. **The civil war had a deeply negative effect on total factor productivity (TFP), which was compounded by severe droughts in 1983 and 1986.**[14] GDP grew by only 0.4 percent between 1983 and 1986. Growth accounting estimates indicate that falling TFP reduced the GDP growth rate by 1.7 percentage points from 1983 to 1986, reflecting the damaging effects of the war, which destroyed physical infrastructure and displaced labor. Capital contributed 1.3 percentage points to growth, 1.5 times more than the contribution of labor.

Figure 40: Growth Decomposition by Factors of Production and TFP



Source: World Bank staff calculations based on WDI data

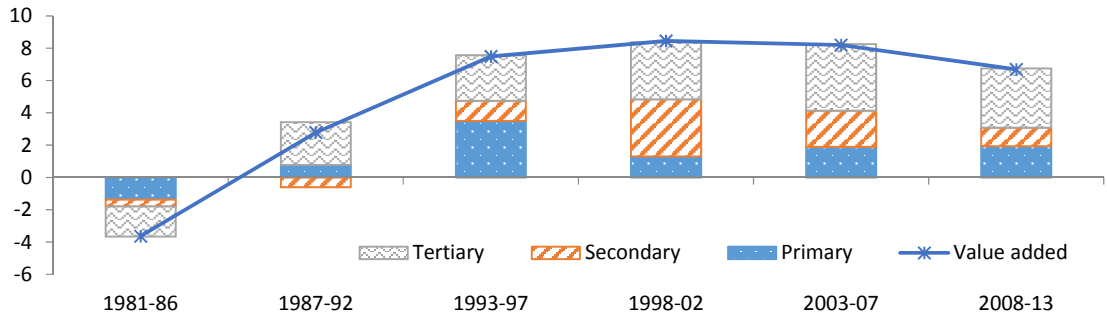
67. **Post-war reconstruction and the incorporation of new workers into the labor force pushed the growth rate to an average of 7.2 percent during 1993-97.** The agricultural sector led growth in the early postwar period. An expanding labor force contributed 36 percent to overall growth, while changes in the capital stock contributed 24 percent. During reconstruction, TFP became highly positive, contributing an average of 2.8 percentage points to the GDP growth rate.

68. **Since 1998, capital accumulation and TFP have driven growth.**[15] Investments in megaprojects led to the rapid accumulation of physical capital. During 1998-2013, the

[14] Total factor productivity accounts for variations in total output not caused by changes in labor and capital. Once all factor inputs are accounted for, TFP typically measures an economy's long-term technological dynamism.
[15] See Indermit et al., 2014; Jones, 2006; and Nucifora and Pereira de Silva, 2011.

contribution of capital and TFP to GDP growth reached 2.5 and 3.1 percentage points, respectively. The quality of labor seems to have marginally improved, though perhaps not enough to accommodate the capital-intensive nature of megaprojects. The contribution of labor and human capital decreased from 2.6 to 1.9 percentage points between Mozambique's post-war reconstruction and megaproject-based development phase. The contribution of TFP was almost double that of labor.

Figure 41: Real GDP Growth by Sector



Source: World Bank staff calculations

69. **The marginal product of labor has increased in all sectors, with the largest gains observed in the primary sector.** Since the launch of the first megaprojects in 1997, labor productivity has increased by an average of 5.31 percentage points. Labor moved from the lower-productivity agricultural sector to the higher-productivity secondary and tertiary sectors, magnifying the inter-sectoral component of productivity growth. While the marginal product of labor increased fastest in the agricultural sector following the end of the civil war, the sector now has the lowest output per worker. Estimates from 2012 indicate that output per worker in the tertiary sector is 8.5 times higher than in the primary sector, though this gap has narrowed significantly since 1997.

Figure 42: Labor Productivity by Sector

Source: World Bank staff calculations using the Shapley decomposition growth tool and data from WDI and Household Surveys.

70. **The rising prominence of megaprojects in Mozambique's economy has raised concerns about the inclusiveness of growth**. The economy shows some signs of a structural transformation, with agriculture contributing less to GDP growth and megaprojects driving employment. The movement of labor out of the agricultural sector, however, has been moderate

and largely attributable to rural-urban migration.[16] Most of the workforce remains employed in the agricultural sector (74 percent in 2012), in which labor productivity is low even by regional standards. Meanwhile, the capital-intensive nature of megaprojects has exacerbated labor productivity differences across sectors. The impact of physical capital accumulation on job creation has been relatively small compared with its impact on growth (Table 8) and the weak performance of the manufacturing sector suggests that the benefits of megaprojects have failed to spill over to other sectors of the economy.

Table 8: Growth Decomposition in Mozambique, 1981-2013

	Civil war period	Postwar reconstruction	Megaprojects phase
	1981-1992	1993-1997	1998-2013
GDP growth	**0.4**	**7.2**	**7.4**
		a. Percentage points	
Capital	1.3	1.7	2.5
Labor	0.9	2.6	1.5
Human Capital	-0.1	0.0	0.4
Productivity	-1.7	2.8	3.1
		b. Percent	
Capital	323.6	24.3	33.3
Labor	223.0	36.3	20.5
Human Capital	-13.3	0.0	4.7
Productivity	-433.3	39.3	41.5

Source: World Bank staff calculations based on data from WDI and Barro and Lee, 2013

Box 2: The History of Megaprojects and Their Contribution to Growth

Following the postwar reconstruction period, megaprojects became a key feature of Mozambique's economy. Restoring power generation at the Cahora Bassa dam in 1998 was Mozambique's first megaproject. The construction of the Mozal aluminum smelter in 2001-03 marked the start of FDI-financed megaprojects, with a total investment of US$2 billion. Other megaprojects have included gas extraction (Sasol), heavy sands (Kenmare) and coal mining in Tete province (Rio Tinto and Vale). These projects have similar characteristics—they are large, focused on natural resources, capital-intensive, export-oriented and financed through FDI.

Megaprojects have boosted GDP growth by an estimated 1-2 percentage points. While megaproject investment and rising exports have a positive impact on aggregate demand, this is often offset by large imports. Sonne-Schmidt, Arndt and Magaua (2008) estimate that megaprojects boosted Mozambique's average annual GDP growth rate by about 1 percentage point between 1996 and 2006. Benito-Spinetto and Moll (2005) find that about half of the 8 percent average GDP growth rate observed during 1994–2004 was driven by the postwar recovery of the agricultural sector, while a quarter was driven by increased aid inflows and aid-financed investments in social development and physical infrastructure, and a quarter (2 percentage points) was equally divided between megaprojects and growth in other private sector activities.

Despite their potential, megaprojects have made only a limited contribution to job creation, tax revenue and profit reinvestment. Aside from the construction of infrastructure, megaprojects have few upstream or downstream linkages with local industries. As a result, employment creation has been limited and mainly focused on highly skilled jobs. Megaprojects have also benefited from generous fiscal exemptions, reducing their revenue impact. While Mozambique has proven its capacity to attract FDI, diversifying to foster local private sector development and job creation remains a persistent challenge.

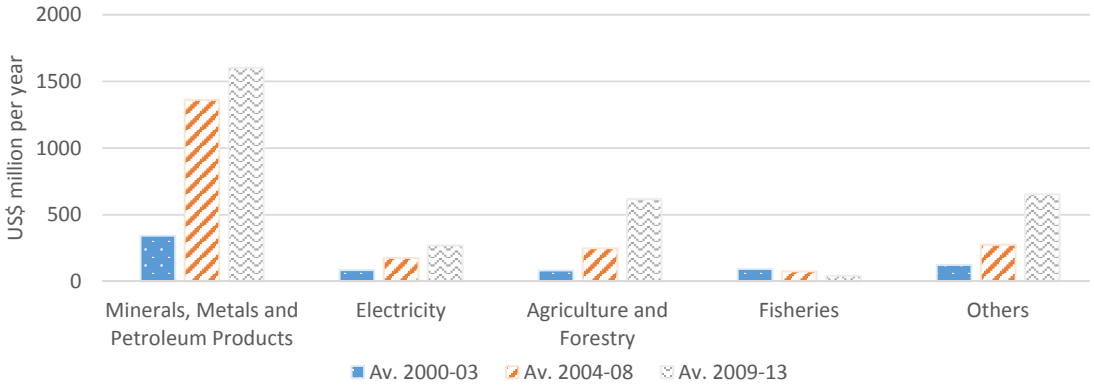
Source: Adapted from Xiong, 2014

[16] Jones, 2012.

3.3. The Challenge of Diversification

71. **The rising economic importance of megaprojects has contributed to a high degree of export concentration.** Mozambique's export basket is highly concentrated in a narrow range of low value-added agricultural commodities and natural resource products (Figure 43). Moreover, the projected rise of mining and natural gas exports suggests that the export basket may become even more concentrated in the medium term due to limited agricultural diversification and the decline of certain traditional exports such as fishery products.

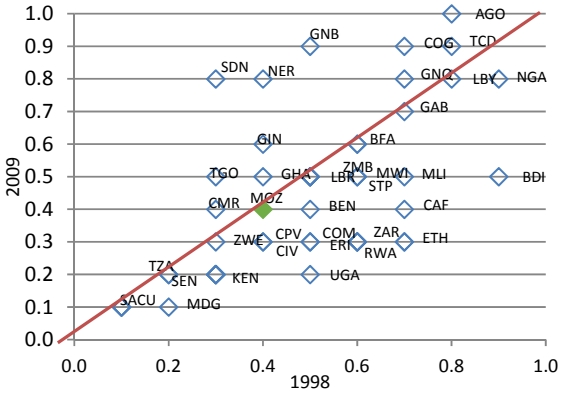
Figure 43: The Evolution of Mozambique's Export Basket



Source: National Institute of Statistics

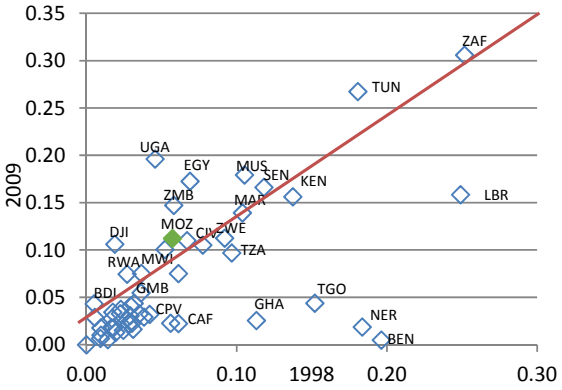
72. **Mozambique's high degree of export concentration reflects the low productivity of other economic sectors.** A recent study by the United Nations Economic Commission for Africa (UNECA) reveals that inter-industry trade, as measured by the normalized Herfindahl-Hirschman index, changed little between 1998 and 2009 (Figure 44). However, the measure of intra-industry trade captured by the Grubel-Lloyd index shows an improvement despite limited linkages between the resource sector and the rest of the economy (Figure 45). Excessive export concentration is often a sign of a weak productive base and low productivity.

Figure 44: Export Diversification in SSA



Source: UNECA, 2011

Figure 45: Intra-Industry Trade in SSA



Source: UNECA, 2011

73. **Mozambique's lack of economic diversification has important implications for its long-term growth.** Research shows that diversifying away from natural resources leads to (i) increases in productivity and income through learning processes inherent to manufacturing; (ii)

the diffusion of technologies and information; (iii) job creation in more labor-intensive sectors; and (iv) less macroeconomic volatility.[17] The international experience indicates that a successful diversification strategy should focus on a country's asset base, and natural wealth should be transformed into other forms of wealth, namely human, physical and institutional capital. Broad increases in productivity can in turn lead to a more diversified production or export base, and the international experience suggests that investing in a balanced portfolio of economic assets is preferable to focusing on specific industries or sectors.[18]

74. **Mozambique is not effectively transforming its natural wealth into physical and human capital, which further inhibits diversification.** Estimates of a country's adjusted net savings (ANS) can be used to measure the extent to which revenue from extracted resources is being invested in other forms of capital. Mozambique's ANS has been negative or close to zero for the past 15 years, and recent research[19] suggests that Mozambique's wealth is becoming more concentrated over time, rather than less (Table 9). At 5 percent in 2010 physical capital represents a relatively low share of total wealth, particularly in comparison with regional averages, which range from a high of 35 percent in East Asia to 17 percent in Latin America and 13 percent in SSA. Furthermore, low levels of human capital are compounded by persistently high levels of malnutrition. These findings suggest the need to balance Mozambique's asset portfolio through investments in human, physical and institutional capital.

Table 9: Mozambique's Wealth Portfolio

	Natural Wealth (of which subsoil assets represent)	Physical Capital	Institutional and Human Capital	Financial Assets
1995	26% (0%)	5%	74%	-5%
2000	30% (0%)	6%	68%	-3%
2005	33% (2%)	6%	64%	-3%
2010	37% (7%)	5%	59%	-1%

Source: Global Competitiveness Report 2014 - 2015

75. **The government is striving to diversify away from the extractive industries and revitalize traditional sectors such as agriculture, forestry and tourism, but a weak business environment undermines competitiveness in the non-resource economy.** Due to high bureaucratic costs, limited infrastructure and obstacles to financial access many sectors are dominated by a small number of very large firms alongside a large number of mostly informal micro, small and medium enterprises (MSMEs). This "missing middle" pattern reflects the difficulty that small firms face in scaling up their operations, which prevents them from accessing markets and operating competitively. However, data constraints prevent a thorough analysis of the obstacles faced by MSMEs, as an Enterprise Survey has not been completed since 2007. Yet despite the limited availability of firm-level information, it is clear that the excessive concentration of domestic markets and the imperfect functioning of competitive incentives cause distortions that adversely affect economic growth and diversification.

[17] Gelb, 2010.
[18] Indermit et al., 2014.
[19] Armas et al., 2014.

3.4. Constraints to Private-Sector-Led Growth and Competitiveness

76. **Mozambique's private sector is pivotal to its diversification strategy.** Mozambique's private sector comprises multinational investors in the natural resource and megaproject sectors, large foreign banking and agribusiness companies, and domestic firms of various sizes. However, the private sector is underdeveloped, and many Mozambican firms are not internationally competitive. This is illustrated by the 2007 Enterprise Survey, in which 63 percent of surveyed firms had fewer than 20 employees and only 6 percent exported their products (Figure 46). Moreover, most domestic firms focus on low-value-added sectors such as food, metal products and retail (Figure 47).

Figure 46: Mozambican Firms by Size

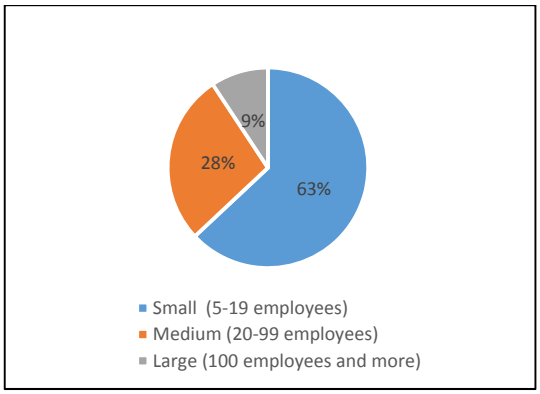
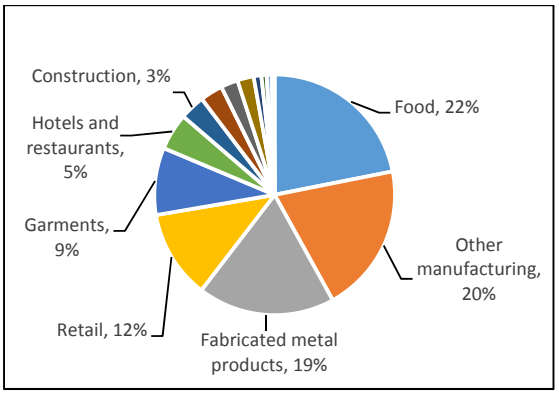


Figure 47: Mozambican Firms by Industry



Source: Enterprise Survey, 2007

77. **A number of factors constrain the competitiveness of Mozambican firms.** In the most recent *Doing Business* report Mozambique ranked 133rd out of 189 countries, down from 128th in the previous year. Mozambique ranked 133rd out of 144 countries on the 2014-2015 Global Competitiveness Report, in which access to financial services was cited as the most important obstacle to competitiveness, followed by corruption, inadequate infrastructure, and an inefficient government bureaucracy. KPMG's annual Business Confidence Index for 2000-2012 shows minimal improvement in business confidence despite the government's various reform efforts.

78. **In order to capitalize on emerging opportunities for diversification and private sector development, Mozambique will need to overcome a number of significant challenges.** Despite repeated reform efforts, Mozambique's business climate could be more amenable to investment and firm expansion, particularly in the non-resource sectors. Burdensome administrative procedures, the difficulty of acquiring permits and licenses, and a complicated land-tenure system are major impediments to investment, particularly for foreign agribusiness firms. Domestic producers also face a wide range of constraints arising from inadequate physical and logistical infrastructure, limited credit access, excessive bureaucracy, weak public institutional capacity, and insufficient workforce skills.

79. **Business climate reforms have been unevenly implemented, with government agencies based in Maputo making far more progress than their provincial counterparts.** An

assessment of an IFC investment climate project in December 2014 identified inadequate reform implementation at the provincial level as a key factor limiting the project's performance. While business registration reforms in Maputo City and Maputo Province were substantially enforced, considerable variation elsewhere in the country contributed to persistently low levels of business formalization.

80. **Given an adequately supportive business environment, the private sector could become an engine of broad-based economic growth and diversification.** Private investment in infrastructure, human capital and the development of new industries can catalyze economy-wide development. Diversification within and across sectors could support productivity improvements, spur job creation and improve living standards, establishing virtuous cycles throughout the economy. Mobilizing domestic and foreign capital will be essential to leverage Mozambique's comparative advantages and realize its development potential.

3.4.1. Cross-Cutting Constraints to Growth: Infrastructure

81. **Mozambique's inadequate infrastructure diminishes private sector competitiveness, perpetuates regional inequalities and distorts the allocation of productive factors.** The poor quality of Mozambique's road network increases travel times and costs, raising consumer prices and making exports less competitive on international markets. Its rail system is primarily designed to serve specific megaprojects or connect resource-rich areas to export points, rather than linking producers and consumers in the domestic economy, and the railway sector lacks a clear strategy for sharing public and private infrastructure. Insufficient power generation and limited, unreliable power access further increases production costs, discourage investment, and narrow the range of economic opportunities. Moreover, the concentration of infrastructure in and around the capital compels many large enterprises to base their operations in Maputo, limiting development prospects in the rest of the country.

The Road Network

82. **Mozambique has a large but underdeveloped transport sector that strives to serve both a large, far-flung rural population and a number of densely populated urban centers.** Mozambique's road network comprises 29,266 km of classified roads, 23 percent of which are paved. Roads are the most important mode of transport, accounting for half of freight traffic and 98 percent of passenger traffic. Road density is fairly low at just 2.9 km per 100 km^2 of land, below the regional average and significantly lower than that of comparable countries such as Kenya (10.8 km) and Tanzania (5.5 km) (Figure 48). Approximately 32 percent of the population lives in urban areas, slightly less than the SSA average (Figure 49). About 40 percent of the urban population lives in the cities of Maputo, Beira and Nampula.

Figure 48: Road Network Densities

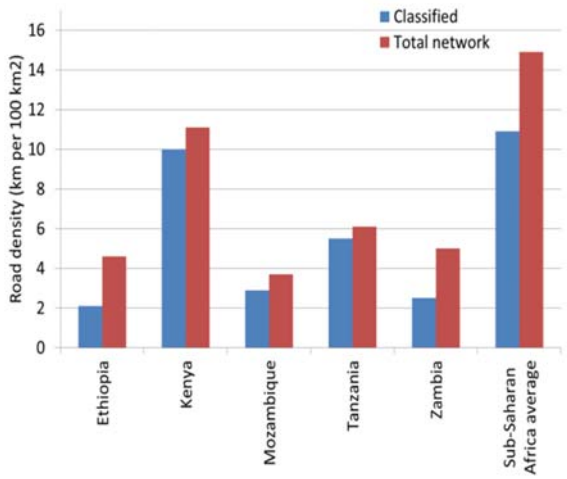
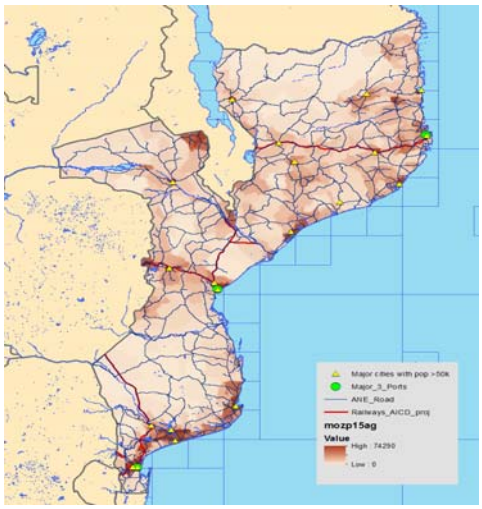


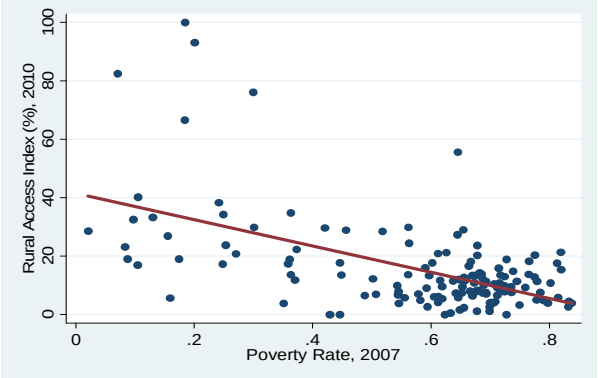
Figure 49: Population Distribution, 2015



Source: Gridded Population of the World, WorldPop

83. **In rural areas limited connectivity affects access to markets and key services.** Only an estimated 17 percent of the rural population lives within 2 km of the nearest road in good condition, leaving about 16 million people unconnected.[20] By contrast, 58 percent of rural Kenyans have access to a quality road. In Mozambique road accessibility varies significantly by location. The city of Pemba has the highest road access rate at 93 percent, followed by the city of Xai-Xai at 82 percent. In most rural areas, however, and particularly in northern and inland provinces, the road access rate is estimated at less than 5 percent. Rural access is highly correlated with poverty incidence (Figure 50), and areas in which fewer than 20 percent of the population has access to a quality road also have poverty rates of 60 percent or higher.

Figure 50: Rural Access Index and Poverty in Mozambique



Source: World Bank staff calculations

84. **Insufficient maintenance and a lack of professional asset management have reduced road quality.** In 2010, 64.7 percent of the national road network was rated as being in good or

[20] This is far lower than the previously estimate of 27 percent in 2004 due to a methodological change that accounts for road quality.

fair condition (Table 10). However, primary roads were by far the most likely to be in good condition, and secondary and tertiary roads were frequently in need of rehabilitation.[21]

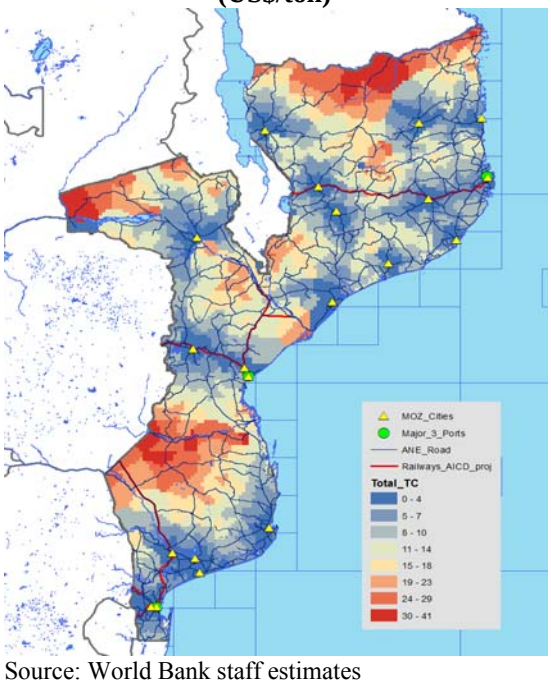
Table 10: Road Network Length by Road Class and Condition (km)

	Paved				Unpaved			Un-known	Total
	Good	Fair	Poor	Very poor	Good	Fair	Poor		
Primary	2,376	2,293	4	3	74	322	667	206	5,946
Secondary	431	432	0	0	358	2,111	1,346	133	4,811
Tertiary	252	250	40	0	824	6,383	3,089	1,445	12,283
Vicinal	9	38	10	0	43	2,814	2,426	983	6,323
Total	3,068	3,013	54	3	1,299	11,630	7,529	2,767	29,363
%	10.4	10.3	0.2	0.0	4.4	39.6	25.6	9.4	100.0

Source: National Road Administration (*Administracao Nacional de Estradas*)

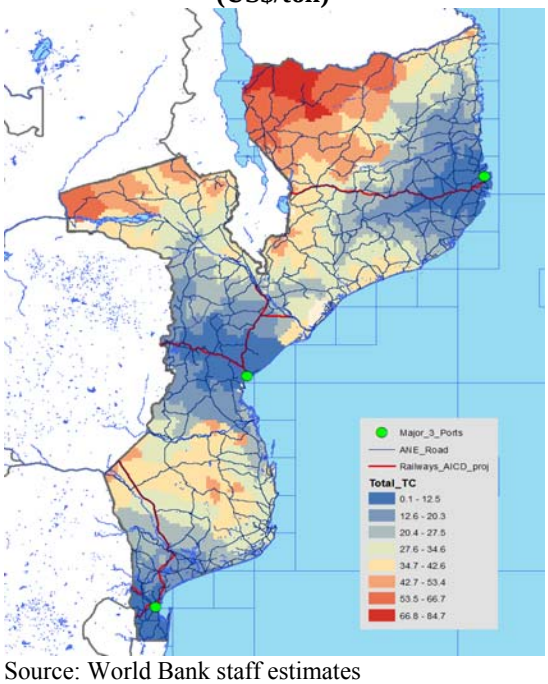
85. **Transportation costs vary considerably by region.** In some inland areas in Manica, Niassa and Tete provinces transport costs exceed US$30 per ton (Figure 51). Transport costs to the ports of Maputo, Beira and Nacala are also very high in these regions. Transport costs to ports can reach US$50 per ton in Tete and Niassa provinces, constraining agricultural exports and increasing import prices (Figure 52).[22] Reducing transport costs from inland areas by investing in improved roads or extended railways could yield substantial economic gains, particularly among the poor.

Figure 51: Transport Costs to a Large City (US$/ton)



Source: World Bank staff estimates

Figure 52: Transport Costs to a Major Port (US$/ton)



Source: World Bank staff estimates

[21] Mozambique's road network is classified into primary, secondary, tertiary and vicinal roads. Primary roads, which link major economic centers, are generally paved and well maintained. Only about one-third of secondary roads are paved or well maintained, and few tertiary roads are either paved or well maintained.

[22] This does not include handling costs and fees at ports. The cargo-handling cost is US$155 per twenty-foot equivalent unit (TEU) at the port of Maputo and US$125 per TEU at port of Beira, respectively. Gwilliam, 2011.

86. **The infrastructure deficit in the transport sector in general and the road network in particular presents a serious public policy challenge given the government's limited resources and competing demands.** A lack of reliable data hinders the government's ability to prioritize infrastructure projects and deploy funds effectively and efficiently. While Mozambique has focused on expanding its road network, maintenance has often been neglected. Some road construction and maintenance projects have varying levels of quality, and existing systems are deteriorating through everyday use, annual flooding and the idiosyncratic impact of climate change**.**

87. **Despite recent improvements, weaknesses in the institutional framework for the road sector present a serious challenge**. Several institutions are responsible for managing transportation policy in Mozambique, and responsibility for tertiary and vicinal roads remains unclear. An inadequate planning and budgetary process also undermines expenditure efficiency. Moreover, there is a widespread perception that taxpayers do not receive adequate value for money in physical infrastructure, particularly domestically funded public works. While a database of roads, bridges and other structures has been established, a lack of regular, systematic updates impedes the professionalization of asset management in the sector.

Railways

88. **The private sector is responsible for a large share of total investment in rail transportation.** While the government has invested in some key rail links, its approach has been piecemeal.[23] The railway sector lacks a clear strategy for sharing existing public and private infrastructure, managing cross-border operations with Malawi and Zimbabwe and eventually involving third-party operators. The government must also devise a plan to expand the use of mining-related rail lines for passengers and freight. Intermodal connectivity between roads and ports needs to be strengthened, and investments in logistics, such as passenger platforms and non-mining commercial ports, should be encouraged. Policymakers should focus on modernizing sector infrastructure and business management practices, including passenger services, rather than investing in direct rolling stock, which should be supported by private investors under a proper regulatory framework.

Energy

89. **Mozambique's energy sector is underdeveloped and suffers from major inefficiencies in generation and transmission.** The sector is governed by the Ministry of Energy and Mineral Resources under the 1997 Electricity Law, and the state-owned Mozambique Electricity (*Electricidade de Moçambique*, EdM) is responsible for generation, transmission and distribution. While Mozambique currently generates electricity through coal, gas and solar technologies, the Cahora Bassa hydropower facility in central Mozambique supplies the majority of the country's energy. Mozambique's power grid was developed as three separate systems covering the northern, central, and southern regions, and while there are some

[23] The government has invested in rehabilitating the 600 km Sena Line, but the 312 km Machipanda Line linking the country to Zimbabwe still requires rehabilitation. The Nacala Corridor rail and port project is a US$4.5 billion investment in the rehabilitation and upgrading of the Nacala Line and the completion of a 912 km link between the Tete area and the Indian Ocean.

connections between the northern and central grids, they largely remain separate. For example, energy produced at the Cahora Bassa facility in the central region must first be exported through South Africa before it is supplied to Maputo.

90. **Electrification rates in Mozambique are very low and represent a sizeable drag on the economy as a whole.** In 2014, all 128 district centers were connected to the distribution network, but there were large gaps with no grid access. Only 25.2 percent of the population had access to the grid, and less than 2 percent of all rural households had access to electric lighting, with most relying on kerosene or wood fires for light (Table 11). Kerosene and indoor wood fires are associated with deeply negative environmental and health consequences, and they also significantly increase household costs, as the price of kerosene is 15 percent higher than current electricity tariffs. This is in addition to the opportunity costs of inadequate access to reliable electricity, which reduces agricultural output, discourages investment in productive assets and narrows the range of economic opportunities.

Table 11: Share of Mozambican Households by Lighting Source

% of households	Electricity	Generator/ Solar	Gas	Oil/ Paraffin/ Kerosene	Candles	Battery	Wood	Other
All households	13.1	0.2	0.0	44.5	4.1	0.6	24.8	12.7
Rural	1.3	0.3	0.0	45.1	3.4	0.7	32.2	17.0
Urban	41.7	0.1	0.1	43.0	5.6	0.3	6.8	2.5

Source: World Bank staff calculations

91. **Electricity demand has steadily increased over the past several years, and unless additional generating capacity is developed it will eventually exceed supply.** In 2014, peak demand on the system was 831 MW, and demand growth has averaged more than 11.6 percent per year for the past 5 years. Demand for electricity as measured by billed energy (including exports), has risen by an average of more than 9 percent per year for the last 5 years and is expected to continue increasing rapidly in the future. EdM had 1.38 million retail customers at the end of 2014, reflecting a growth rate of over 13 percent per year over the last 5 years, and it plans to increase this number by at least 100,000 per year.

92. **The physical condition of the system is poor, with frequent breakdowns and high rates of electricity losses.** Approximately 25.5 percent of electricity generated in 2014 was lost through inefficiencies in transmission and distribution (Table 12). By comparison, Kenya Power reported an overall loss of about 17.5 percent. In addition, Mozambique experienced over 59 hours of transmission interruptions in 2013. An unreliable power supply adds considerably to the cost of doing business and is cited as a major concern among entrepreneurs and investors.

Table 12: Reported Losses (% of gross available energy)

Customer	2011	2012	2013	2014
Transmission losses	4.7%	4.7%	4.6%	5.2%
Distribution losses	19.3%	18.5%	15.4%	17.0%
Station losses	0.9%	1.1%	1.0%	1.0%
Public lighting	1.5%	1.6%	1.5%	1.5%
EdM consumption	0.2%	0.2%	0.2%	0.2%
Energy billed but not paid	0.9%	0.9%	1.0%	0.6%
Total losses or energy not paid for	27.6%	26.9%	23.7%	25.5%
Total losses or energy not paid for (GWh)	927	1,057	1,014	1,227

Source: EdM's annual statistical accounts for 2011-2014

93. **A recent increase in tariff rates was necessary to cover the cost of operations and capital investments**. Tariff-based customers comprise 90 percent of EdM's non-export sales by volume. In the past, revenues generated by increasing the number of connections have proven insufficient to cover EdM's connection and supply costs. Tariffs decreased by about 20 percent in real terms between 2010 and 2014, and a 27 percent increase in the average tariff rate in November 2015 has not enabled the utility to achieve full cost recovery. EdM maintains a positive cash flow by foregoing critical maintenance expenditures that are necessary to sustain the system and ensure the quality of the electricity supply.

94. **Mozambique has tremendous potential to boost its electricity supply through investment in both renewable and nonrenewable resources.** Mozambique's renewable generation potential is estimated at over 23,000 GW, with solar representing the vast majority. Of this, a set of priority projects totaling 7.5 GW have already been identified: 5.6 GW of hydropower, 1.1 GW of wind, 0.6 GW of solar, and smaller quantities of biomass and geothermal energy. Mozambique also has abundant nonrenewable energy resources, including 277 trillion cubic feet of natural gas and 20 billion tons of coal. Leveraging its potential would enable the country to not only produce sufficient energy to meet domestic demand, but also to expand its position as a low-cost regional exporter. Rising regional electricity demand is already creating serious shortages in South Africa and Swaziland.

95. **Electricity exports could play an important role in facilitating the development of Mozambique's power sector by providing the investment needed to realize large-scale projects.** Mozambique is linked with neighboring countries as a member of the Southern African Power Pool (SAPP), giving it access to a large export market. Comparing domestic and export tariffs indicates that an integrated domestic and export-driven approach would help to ensure EdM's long-run financial viability. Increased export volumes could also be used to partially subsidize domestic tariffs. Export revenue during 2015-30 will have an estimated financial value roughly 5 times that of new domestic customers in present value terms. While the private sector could play a key role in developing large energy sector projects, inconsistencies between the energy sector law and public-private partnership (PPP) legislation limits the government's ability to attract private investment to the power sector.

96. **Several new projects are currently in development**. The biggest potential driver of domestic production is the 400 MW Temane MGTP gas-to-power project being developed by Sasol and EdM. Other projects in development such as the Ncondezi coal-fired IPP will also

contribute to positive cash flows over the next several years. While EdM will get a smaller amount of energy from the Mphanda Nkuwa hydropower project, this energy is expected to cost EdM significantly less. Finally, gas discoveries in the Rovuma Basin could be large enough to be both exported and used for domestic energy generation. While gas production is not expected to start until 2019 at the earliest, estimated total revenues could be in excess of US$300 billion over the life of the project.

3.4.2. Cross-Cutting Constraints to Growth: Governance

97. **A highly bureaucratic operating environment poses serious challenges to private sector growth in Mozambique**. Burdensome regulations involving numerous time-consuming procedures greatly increase administrative costs, discourage entrepreneurship and multiply opportunities for corruption. An inadequate supply of trained public employees, a complex and erratically enforced regulatory framework, and insufficient capacity to adapt to the changing needs of the private sector all contribute to an adverse business climate. Numerous reform efforts have attempted to address these issues, but implementation and follow up actions have been highly uneven.

98. **Mozambique's generally weak and deteriorating governance indicators are at odds with regional trends.** The country's score on the World Development Indicators for rule of law has been declining since 2010 (Figure 53), and its score on the strength of legal rights fell sharply in 2012 (Figure 54). Aspiring market entrants, both foreign and domestic, report various informal means of harassment, extortion, diversion of market power, and other forms of rent-seeking by officials and local interest groups. In addition, inappropriately close ties between public officials and the private sector distort competition by systematically favoring well-connected companies. An adverse regulatory climate also inhibits business formalization, further reducing formal sector competition and increasing the market power of established firms. As a result, weaknesses in Mozambique's institutional framework both directly and indirectly constrain access to finance, infrastructure, land and other critical inputs. Companies operating in Mozambique continue to report a highly uncertain business environment marked by unpredictable regulatory enforcement and informal barriers to investment.

Figure 53: WDI Score for "Rule of Law" (2.5 = High; -2.5 = Low)

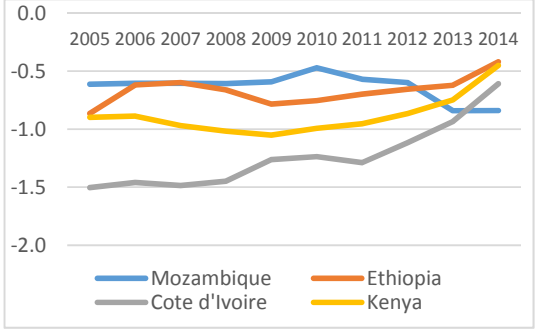
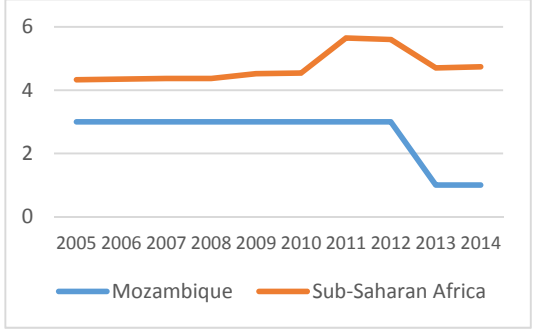


Figure 54: WDI Score for "Strength of Legal Rights" (0=Weak; 12=Strong)



Source: World Bank WDI

99. **Contract enforcement is a major issue.** While Mozambique scores well on dealing with construction permits and resolving insolvency, it is among the worst performers both in the SSA and globally in terms of enforcing contracts. Over the past decade, the amount of time required to enforce contracts in Mozambique has remained largely unchanged at about 950-1,000 days, compared to an SSA average of about 650 days. Contract enforcement is inhibited by the high cost of claims and the slow, often opaque operations of the judiciary.

3.4.3. Cross-Cutting Constraints to Growth: Access to Credit

100. **Credit constraints seriously limit firms' ability to grow.** The 2014-2015 Global Competitiveness Report found that access to financing was the top constraint to doing business in Mozambique, and in the latest World Bank Enterprise Surveys more than 50 percent of firms cited access to finance as a "major" to "very severe" obstacle. While more than 75 percent of firms reported having a bank account, fewer than 15 percent had access to an overdraft facility, a credit line or an active loan. Unfavorable terms strongly discourage firms from applying for credit. Collateral is almost always required, interest rates are close to 20 percent and maturities tend to be less than 12 months.

101. **Access to finance is a particularly serious obstacle for certain sectors and for MSMEs.** In a 2012 survey over 50 percent of manufacturing firms identified access to credit as a top constraint to the growth of their business, though this figure has improved somewhat over time. Lending to the agricultural sector is particularly limited, and while agriculture contributes more than 25 percent to GDP, the sector represents only about 5 percent of total lending. Moreover, a full 75 percent of MSME owners, or about 3.4 million firms, indicated that they do not use any financial services, formal or informal.[24]

102. **A lack of physical access to banks, limited capacity to demonstrate creditworthiness, and cumbersome bureaucratic procedures all limit access to finance.** Information asymmetry and the erratic enforcement of legal rights also constrain access to credit.[25] Some of these challenges could be addressed through the creation of a credit bureau and movable collateral registry, which would help resolve information asymmetry issues. However, the dense concentration of the financial sector reduces efficiency and limits competitive pressures.

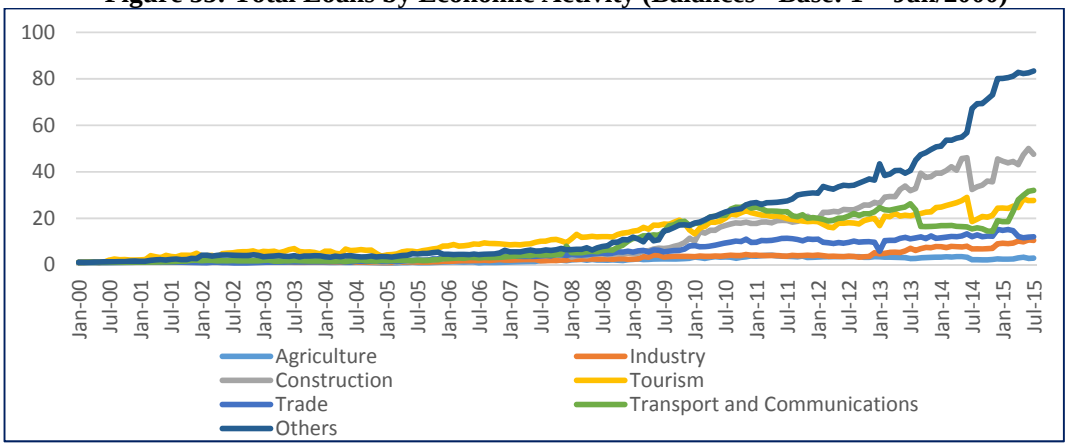
103. **Mozambique's ancillary financial and business service subsectors are also underdeveloped.** While numerous institutions provide microfinance, the sector remains relatively shallow. The insurance market remains small, though new firms have recently entered. Capital markets in Mozambique also remain at a very early stage of development. The stock market is nascent, bond markets are underdeveloped, with sporadic and fragmented government borrowing, and the trading of securities in the secondary market is virtually nonexistent.

104. **Banking sector concentration contributes to the high costs of financial services in Mozambique, while the substantial presence of foreign-owned banks may exacerbate**

[24] FinScope MSME Survey Mozambique, 2012.
[25] World Bank, 2016.

international contagion risks. There are 19 banks registered in Mozambique, but the 5 largest hold 95 percent of the country's banking assets.[26] Most of these are subsidiaries of Portuguese and South African banks.[27] The gap between deposits and credit indicates that the financial sector is unable to effectively channel resources to the larger private sector. Credit constraints slow the growth of promising industries, hinder competitiveness and inhibit economic diversification.

Figure 55: Total Loans by Economic Activity (Balances - Base: 1 = Jan/2000)



Source: BdM

105. **While there have been improvements in the financial sector's regulatory and supervisory environment, stronger mechanisms are needed to cope with contingencies**. Increased credit provisions, particularly to households, raise concerns about over-indebtedness, especially given low levels of financial literacy and still-emerging standards of financial consumer protection. A number of banks that focus on serving MSMEs and providing agricultural credit have recently faced difficulties with loan collections and profitability. The entry of new pan-African banks into the financial sector underscores the need to strengthen cross-border supervision and better analyze and mitigate transnational banking risks. The capacity for financial institutions to identify and manage non-financial risks is another important component of a sustainable system.

106. **Credit is also highly concentrated, with the bulk of new loans going to households, the real estate market, and a few select few corporations.** Indeed, while total credit has more than doubled over the past five years, rising by 125 percent between December 2009 and April 2014, the increase has focused on consumer credit and construction, rather than on more productive sectors such as industry, tourism, agriculture and commerce (Table 13).

[26] Santos et al., 2015
[27] World Bank, 2015f.

Table 13: Evolution of Total Credit Distribution

	Dec-2009	Apr-2014
Agriculture	7.0%	3.9%
Industry	12.9%	12.8%
Construction	6.4%	10.1%
Tourism	2.5%	2.0%
Commerce	23.4%	15.3%
Transport / Communication	12.2%	5.3%
Other Sectors	35.7%	50.8%

Source: BdM

107. **While financial outreach is improving, most formal financial institutions still serve only a small fraction of the population, and penetration in rural areas is particularly limited.** In 2013 Mozambique's bancarization rate was just 27 percent.[28] Physical access to financial services remains much more limited than in other countries in the region, and in 2013 Mozambique had about 3.91 bank branches and 7.83 ATMs per 100,000 adults.[29] Financial access rates are especially low in rural areas, where only 19 percent of adults report having a bank account, credit line or other financial product, compared to 46 percent of the urban adult population.

108. **Constraints to financial access include not only limited physical banking infrastructure, but also the high cost of credit, a lack of awareness of the benefits of financial services, mistrust of financial institutions, and legal and regulatory obstacles, particularly regarding land tenure.** Rural financial penetration is limited by the high cost of building and operating banks branches and other infrastructure in rural areas. To address these issues the central bank is encouraging banks and microfinance institutions to expand rural services using innovative solutions such as agency banking.[30]

109. **In 2007, the BdM launched a strategy to encourage banks to expand their presence in rural districts.** In May 2013, the government approved a 10-year Financial Sector Development Strategy that aims to promote financial inclusion, strengthen financial stability and develop financial markets. Recent steps include the enactment of the law for Private Credit Bureaus in July 2015. In the 2015 *Doing Business* report, Mozambique was recognized as the country that had improved the most globally on the resolving insolvency indicator, and this was a major factor in its overall improvement in the annual rankings.

110. **Persistently high interest rates on bank loans present a challenge to inclusiveness.** Efforts to reduce the policy rate between 2011 and early 2015 have not resulted in a commensurate reduction in commercial bank interest rates, which average well above 20 percent.[31] This trend is raising concerns, both among the authorities and private firms, regarding the impact of banking sector concentration. Recent increases in the central bank's

[28] World Bank FinCap Survey.
[29] This compares to 12.77 branches and 21.39 ATMs in Angola, 10.34 and 61.88 in South Africa, and 5.57 and 9.99 in Kenya
[30] Agency banking refers to the use of contracted agents, rather than bank employees, to provide a limited range of basic banking services.
[31] The banks' position has been that their rates are not determined by the BdM's reference rate, but rather by the rates they pay on term deposits, which remain high, as well as the risk they have to absorb, operating costs, expected provisions, and a profits margin.

reference rate intended to curb inflation and mitigate the depreciation of the metical are also influencing commercial interest rates.

3.4.4. Cross-Cutting Constraints to Growth: Land Tenure

111. **Mozambique's land-tenure system is based on the principle that the state is the owner of all land.** Articles 109 and 110 of Mozambique's 2004 Constitution affirm that land ownership is vested in the state and that land may not be sold, mortgaged or otherwise alienated. The 1997 Land Law and related regulations reassert the state's ownership of land, but enable individuals, communities and private companies to obtain long-term land-use rights through government titles known as Land Utilization Rights (*Direitos de Uso e Aproveitamento da Terra*, DUATs). DUATs can be transferred, but not sold or mortgaged. They can be obtained through public recognition of longstanding occupancy—defined as good-faith use for a period of at least 10 years or according to customary norms and practices—or they can be explicitly granted by the government.

112. **Under Mozambican law, investors seeking to develop an agribusiness on existing farmland must engage in negotiations with affected persons or communities and receive their full, free and informed consent to relinquish their land use rights.**[32] The government is obliged to confirm that consultations took place before approving any investor's application for a DUAT. This measure is meant to protect customary rights to land and encourage local participation in rural development. In practice, however, consultations with affected communities are often limited in scope and conducted without meaningful community representation.[33]

113. **The new mining law creates additional challenges in establishing and transferring land use rights.** When an area has been identified for mining purposes, the governing legislation is no longer the land law but rather the mining law, a new version of which was passed in August 2014. The mining law establishes that preexisting land-use rights are considered void once "just compensation" has been paid to the previous user. However, "just compensation" is not adequately defined in the current law, while under the previous law it was determined through a negotiation process.[34] Moreover, the precise geographic extent of land concessions is also frequently indeterminate, leading to conflicts between holders of different DUATs, especially those with overlapping claims to subsoil rights and agricultural rights.

114. **Inadequate consultative processes, limited community participation, and a lack of capacity among government officials to manage the DUAT application process have delegitimized land transfers and led to conflicts over land.** In recent years there have been several cases in which individuals or communities transferred their land rights to investors for industrial or agribusiness initiatives under ill-defined or opaquely negotiated terms. This has resulted in land disputes, especially around coastal and industrial developments, as well as

[32] Steven et al., 2015
[33] USAID, 2011.
[34] Steven et al., 2015

mining and agricultural megaprojects. Notable examples include conflicts involving Vale and Rio Tinto projects in the Moatize area of Tete Province, as well as more recent concessions in Changara. The development of biofuel farms in the Nacala corridor has also caused disputes with local communities.

115. **Conflicts involving land discourage investment and reduce the efficiency of land use.** In an effort to increase the efficiency of land use the authorities recently completed a process for simplifying and streamlining DUAT procedures for land parcels under 10 hectares, and the government is currently drafting new regulations for third-party land-use rights led by the multi-stakeholder National Land Consultation Forum. However, land tenure insecurity among rural communities remains a serious obstacle to investment in agriculture, forestry and rural industrial projects.

116. **Loss of land can also have a long-term destabilizing effect on communities by negatively impacting social networks.** As government services in many rural areas are minimal, social networks are critical to ensuring access to public goods, livelihoods and social safety nets. The loss of land to investment projects or environmental degradation can disrupt communities and deprive them of scarce resources, leading to a breakdown in critical social networks.[35]

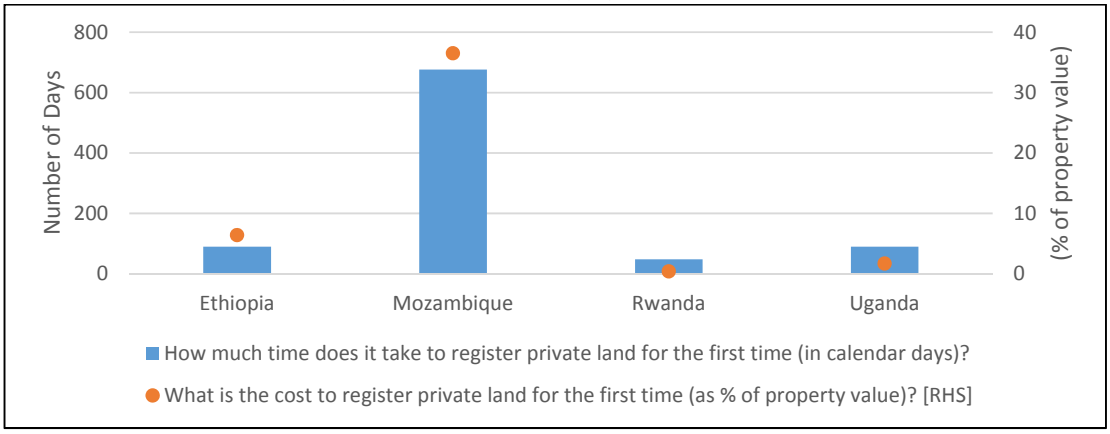
117. **Mozambique's land tenure system is characterized by cumbersome bureaucratic procedures, which contribute to the insecurity of land rights.** Mozambique's growing economy is increasing demand for certain types of land, especially in urban areas, agricultural areas near major transportation routes, and areas suitable for specific purposes, such as resource extraction, forestry or tourism. However, the high cost of formally transferring land rights and the complexity of the transfer process itself discourages formal transfers and increases the ambiguity of land tenure. The requirement that the government approve the transfer of each DUAT significantly increases the cost and time required to reallocate land rights, and the discretionary authority of public officials and uneven enforcement of relevant laws exacerbates the uncertainty of the process. Mozambican law does not expressly allow the partitioning of land under a DUAT, and it is often unclear whether the DUAT holder can subdivide land for other uses.[36]

118. **The difficulty of accessing and utilizing land creates serious challenges for investors in agribusiness, forestry, tourism and other high-potential sectors.** The cost of formally registering land rights averages 36 percent of the property's value and the process takes far longer than in comparable SSA countries.[37] Expensive and uncertain land rights create additional complications in accessing finance, developing infrastructure and exploiting investment opportunities. A thorough, regularly updated land registry and cadaster supported by a well-functioning system for adjudicating land disputes would help address these challenges.

[35] Astill-Brown and Weimer, 2010.
[36] USAID, 2011
[37] World Bank, 2015a.

119. **As the Mozambican economy continues to grow and diversify, systemic challenges in allocating, transferring and enforcing land rights are becoming an increasingly serious constraint**. Convoluted land management policies and inadequate state capacity have led to overlapping claims to land, heightening investor uncertainty. Moreover, multiple government agencies are responsible for land management, which results in administrative redundancies and inefficiencies.[38] Building on recent research into community-based land rights and building local governance capacity to address and resolve land use issues can increase both the efficiency of the land tenure system and its responsiveness to local priorities. Meanwhile, the central government must clarify the social responsibilities of investors and actively support the efforts of local authorities to act in the best interest of the communities they represent.

Figure 56: Registering Agricultural Land



Source: World Bank, 2015a

3.4.5. Cross-Cutting Constraints to Growth: Dutch Disease

120. **The development of Mozambique's vast natural resource potential could compromise the country's competitiveness through the "Dutch Disease" effect.** Dutch disease refers to a situation in which an increase in resource exports generates large inflows of foreign currency, causing the real exchange rate to appreciate. This weakens the competitiveness of the non-resource tradable sector, as non-resource exports become effectively more expensive on foreign markets and imports become effectively cheaper in the domestic market. Meanwhile, investment in the extractive industries and the domestic non-tradable sector tends to crowd out investment in other sectors. These processes can severely damage the growth prospects of agriculture, manufacturing and tradable services, leaving the economy increasingly dependent on the extraction of nonrenewable resources.

121. **Mozambique does not yet appear to be experiencing Dutch Disease, but the risk is intensifying as the resource sector matures**. Prior to its depreciation in 2015, the metical was estimated to be overvalued by around 10 percentage points. However, the economic impact of overvaluation was relatively modest, as large inflows of foreign currency in the form of FDI were offset by large outflows resulting from the import-intensive nature of investments in extractive industries. However, as the investment phase comes to an end and exports of coal

[38] Centro de Integridade Pública, 2013

and gas increase toward the end of the decade, pressures on the exchange rate may increase, with negative effects on competitiveness. If Dutch Disease effects materialize, a decline in manufacturing—and especially in agriculture—could stifle employment and income growth and exacerbate existing socioeconomic and regional inequalities. The agriculture sector is particularly vulnerable to the risk that exchange-rate effects could serve as an implicit tax, which could undermine progress on poverty reduction due to the heavy reliance of poor households on the agricultural sector.

122. **Several steps can be taken to mitigate the potential for Dutch Disease effects.** First, policymakers can attenuate the distortive impact on the domestic non-tradable sector by keeping the growth of public spending in line with the absorptive capacity of the economy. Investing natural resource revenues in a sovereign wealth fund can facilitate this process. Second, the government can focus on increasing the competitiveness of agriculture, manufacturing and tradable services through a combination of regulatory reform, human capital development and infrastructure investment.

3.5. Opportunities for Growth in the Agricultural Sector

123. **Agriculture is the largest sector in the Mozambican economy; it is estimated to account for over a quarter of GDP and more than two-thirds of employment.** The sector is dominated by crop production, which represents 78 percent of agricultural output. Forestry, livestock and fisheries represent 9.1 percent, 7.1 percent and 5.6 percent, respectively.[39] The growth of the agricultural sector (including livestock and forestry) is highly variable, ranging from 5.8 percent in 2008 to 1.4 percent in 2012 and 8.8 percent in 2014, due in part to the influence of weather conditions on annual output. The Ministry of Agriculture and Food Security reports that commercial agriculture (excluding livestock and forestry) has grown by 7.2 percent on average since 2010, while medium- and small-scale agriculture has grown by just 4 percent.

124. **The agricultural sector has enormous potential to contribute to poverty alleviation, yet it faces a number of key constraints.** Productivity growth in the agricultural sector can narrow income disparities between rural and urban areas and reduce poverty in those regions that have benefitted the least from recent economic gains. However, the slow adoption of improved inputs and productive technologies, limited irrigation infrastructure, low rates of mechanization and animal traction, the lack of a reliable and efficient electricity supply, land-tenure insecurities and in some cases trade restrictions all pose obstacles to the growth of the sector.[40] Moreover, poor infrastructure quality increases the costs of commercial farming and restricts farmers' access to markets, particularly during the rainy season. Commerce and trade are especially constrained between northern and southern Mozambique, as well as with neighboring countries such as Malawi and Tanzania.[41]

[39] All statistics in this section are from the Ministry of Agriculture and Food Security unless otherwise noted.
[40] Trade restrictions continue to bar Mozambican fruit exports to markets in southern Africa and Asia because of concerns over the prevalence of fruit flies. However, experts have determined that such concerns are unfounded. World Bank and Cambridge Economic Policy Associates Ltd., 2015
[41] FAO, 2010.

125. **The dominance of subsistence farming has limited the agricultural sector's contribution to rural poverty reduction.** The share of the value of marketed smallholder production in total output barely changed between 2002 and 2012, marginally increasing from 12 percent to 13 percent. In 2012 only 18 percent of smallholder farmers sold maize and 13 percent sold rice. In addition, post-harvest management and infrastructure challenges persist. In 2012 only 11.4 percent of households had improved granaries, and post-harvest losses can reach as high as 30-40 percent.

126. **While marginal productivity remains low, total agricultural output has grown substantially.** Despite a significant increase in the production of staple crops, notably maize, rice, beans, cassava and sweet potato, Mozambique remains a net food importer. Marginal yields for rice, maize, cassava and pulses are low even by regional standards. Mozambique has the lowest marginal cereal yields among low-income countries in the Southern Africa Development Community (SADC), at an average of less than 1000 kg per hectare. Between 2002 and 2010 maize and rice yields averaged 0.8 and 1.01 tons per hectare, respectively. Total maize production grew by just 0.2 percent per year from 2000 to 2013, below the rate of population growth. However, agricultural exports are growing steadily, encouraged by a more liberal trade regime. Cash crops, including sugarcane, tobacco, cotton and cashew, account for a small proportion of the total cultivated area, but they represent the vast majority of agricultural exports.

Table 14: Marginal Yields, Selected Crops

	Maize	Rice	Pulse	Wheat	Roots and tubers
		Yields in 2013 (Ton/Ha)			
Mozambique	1.0	1.2	0.6	1.7	7.2
Malawi	2.2	1.9	-	1.4	-
South Africa	3.8	2.6	-	3.6	-
Zambia	2.5	1.2	0.5	6.5	-
Zimbabwe	0.9	2.3	0.9	2.5	10.0
		Average annual yield growth 2000-2013 (%)			
Mozambique	0.2	1.4	1.4	4.0	2.8
Malawi	1.7	1.2	-	4.5	-
South Africa	2.3	-0.9	-	2.6	-
Zambia	2.8	0.2	0.9	0.4	-
Zimbabwe	-3.9	0.9	2.8	-5.8	3.3

Source: FAOSTAT, 2015

127. **Low marginal productivity is a binding constraint on smallholder farmers, and improved seed and fertilizer access are essential to increase per-hectare yields.** Less than 10 percent of Mozambique's staple crop area is planted with certified seed, which is a contributor to low average yields. Fertilizer use averages just 4 kg per hectare, far below the average of 14 kg for low-income SADC countries.[42] Following decades of public-sector-driven interventions the government is now striving to promote the use of improved agricultural inputs through support for the development and marketing of fertilizer and seed technologies by the private sector.

[42] World Bank, 2014e.

128. **Mozambique has enormous untapped potential for agribusiness investment**. Only about 5 million of the country's 36 million hectares of arable land are currently being cultivated. Countrywide, there is abundant water for irrigation, good rainfall and diverse conditions allowing for a range of products. The recent growth in commercial agriculture underscores the country's unexploited potential. Contract farming and out-grower schemes have enabled smallholder farmers to join emerging value chains. Meanwhile, traditional value chains in sugar, cashews, and tobacco processing, are strengthening and expanding over time.

129. **Opportunities in the agribusiness sector include both the development of large-scale farming and the commercialization of smallholder operations.** There is significant scope to expand sustainable cultivation of agricultural land and fisheries. The private sector can promote new commercial models focused on both the domestic and export markets. Box 3 explores some of these opportunities in greater detail.

Box 3: Value-Chain Development in the Agricultural Sector

There are several promising value chains based on contract farming and out-grower business models, which integrate smallholder farmers into larger commercial operations. These include:

- **Poultry/maize/soya** is an integrated value chain combining animal feed and animal protein production, reflecting an increasing demand for poultry products in the urban market.
- **Sesame** has developed as a major cash crop in Mozambique with high farm-gate prices, low input costs, and scope for investment in production and processing.
- **Sugarcane** enjoys a competitive advantage and offers out-grower opportunities involving thousands of farmers.
- **Fruit trees** such as lychee, avocado and mango have export potential in Asia and Europe.
- **Legumes** including carmen beans, butter beans and pigeon peas are also in high demand on international markets.
- **Cassava** processing could add value to a widely grown crop, while also strengthening domestic food security and smoothing seasonal fluctuations in food prices.
- **Cashew** value chains face strong competition from other low-cost producers and will require investments in transportation and processing in order to remain competitive.

Efforts to better integrate smallholder farmers in agribusiness value chains will require a comprehensive approach that recognizes smallholders' diverse livelihood strategies. For example, while the cultivation of cash crops can be expanded, most small farmers will continue to produce food for household and/or community consumption. Smallholder farmers also tend to be highly risk-averse, and new crops, technologies and production models must be introduced gradually and supported by crop insurance or other risk-mitigation mechanisms whenever possible.

Public sector support could help address the constraints that inhibit the development of existing value chains. Such support could include agricultural extension services, marketing facilitation, and campaigns promoting public awareness of new crops, technologies and production models.

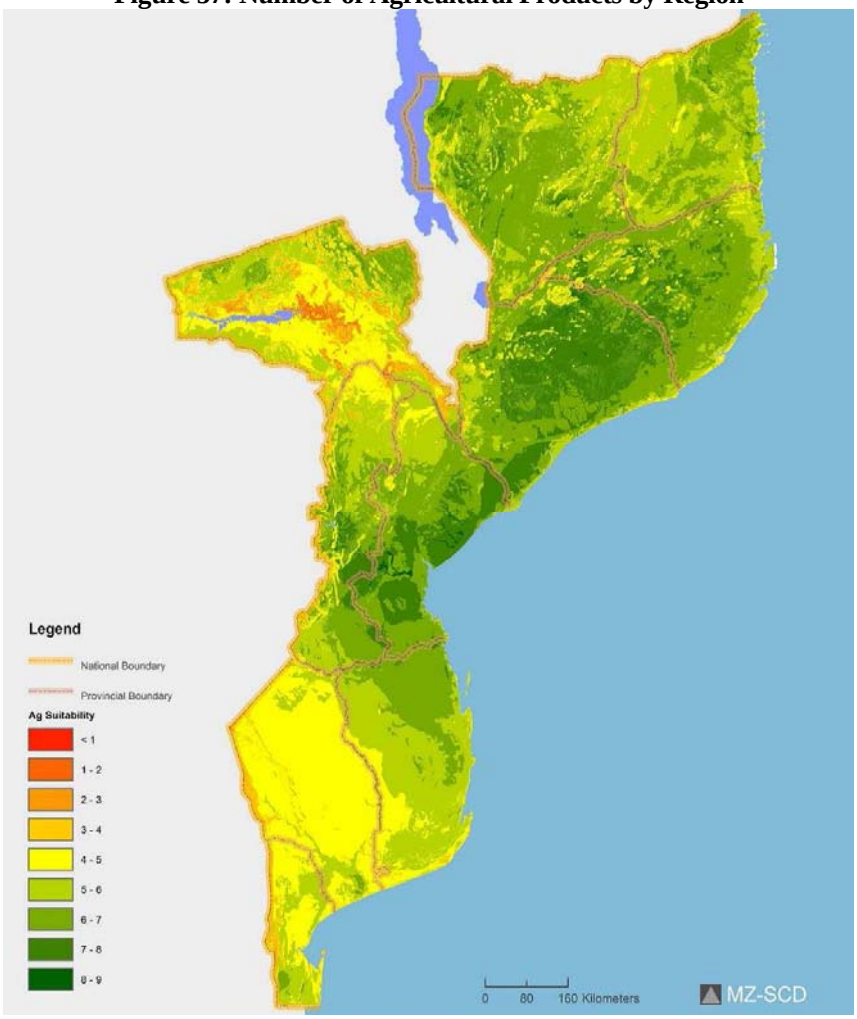
Source: World Bank staff

130. **Contract farming has proven to be a successful model for certain crops and is expanding market and technology access among smallholder farmers.** Contract farming and out-grower schemes that link smallholders with processors, large commercial farms and export companies have proven successful in traditional value chains such as sugar, cashews

and tobacco. However, there is considerable scope to both improve and expand contract farming systems. Low literacy rates and limited organizational resources make it difficult for smallholder farmers to coordinate their decisions or bargain collectively. Out-growers often face strong incentives to violate their contracts, and an inefficient legal and institutional framework complicates contract enforcement. Risk-aversion can make farmers resistant to contract farming and out-grower schemes involving new crops such as horticulture products. Finally, poor infrastructure can limit access to large markets and export points.[43]

131. **Mozambique's northern and central regions have especially strong agricultural potential (Figure 57).** In particular, Beira and Nacala offer attractive opportunities to develop value chains in commercial and contract farming and smallholder agriculture.[44] Significantly, many high-potential agricultural zones are also protected areas, which provide critical ecosystem services such as water regulation, biodiversity conservation and protection against extreme weather events, as well as the global public good of carbon storage.

Figure 57: Number of Agricultural Products by Region

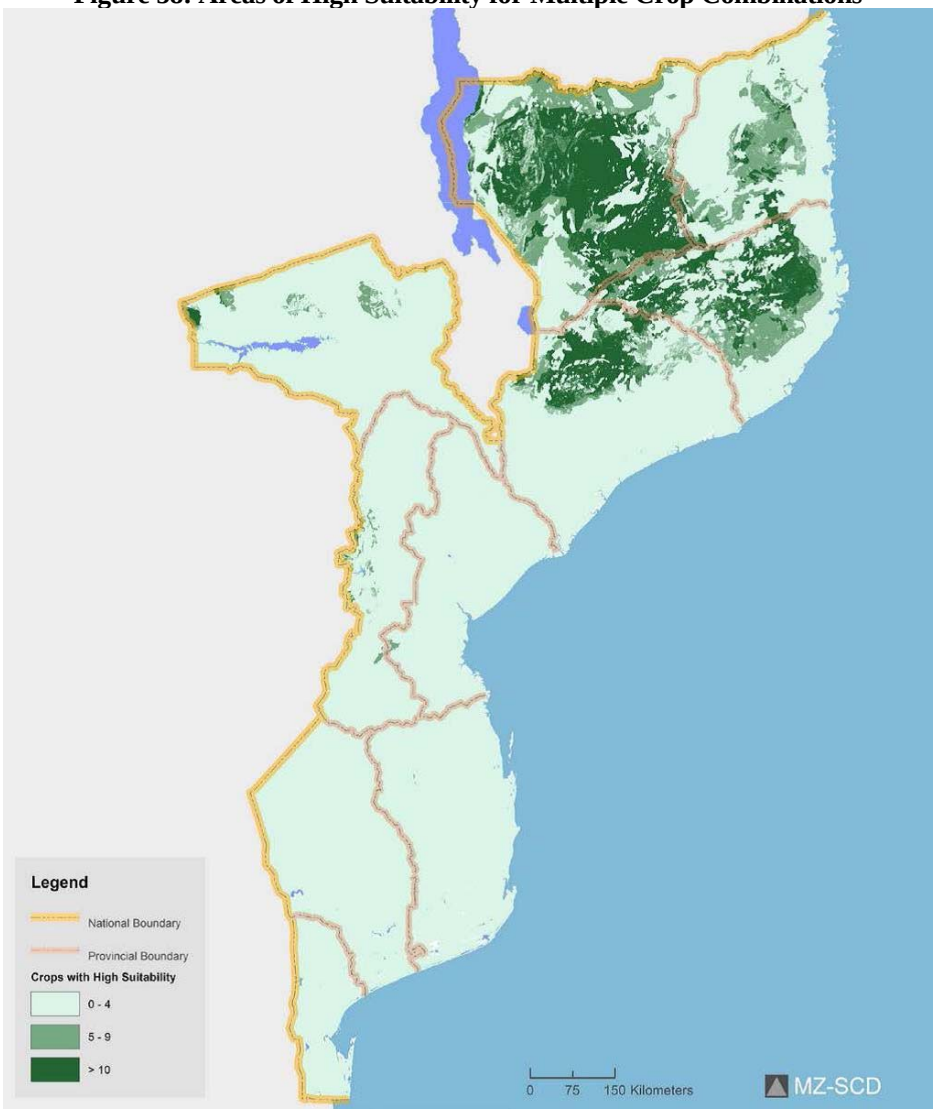


Source: Dobbin, 2015

[43] World Bank, 2015a.
[44] Opportunities include maize, wheat, horticulture, poultry, soya, rice and cattle production in Beira, and maize, cotton, fruit, poultry, groundnut and cassava production in Nacala.

132. **The areas most suitable to high-performing crop combinations are primarily located in Mozambique's central and northern regions.** Figure 58 shows areas that are suitable for different crop combinations. Practically all of the areas with the most diverse production potential fall within a clearly defined, largely contiguous zone covering most of Niassa and Nampula provinces and large parts of Cabo Delgado and Zambezia.

Figure 58: Areas of High Suitability for Multiple Crop Combinations



Source: Dobbin, 2015

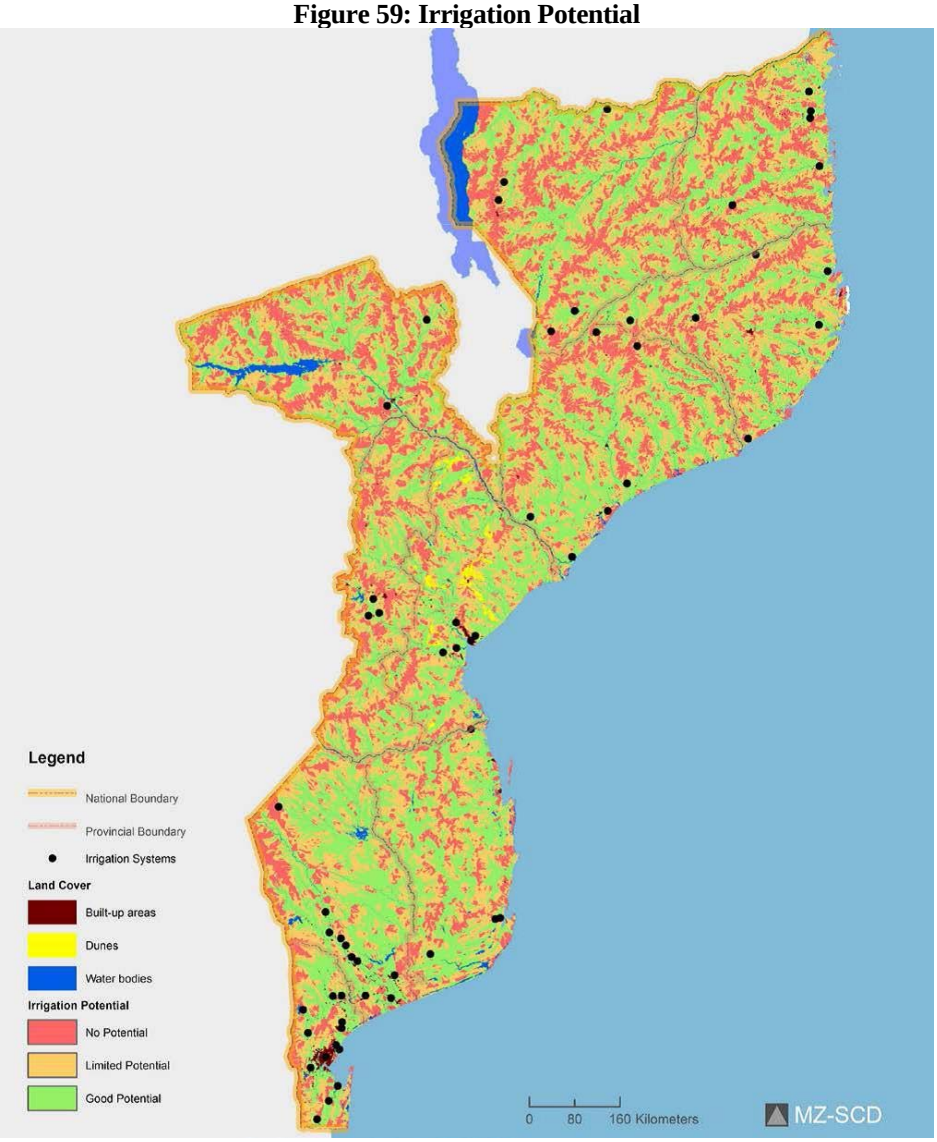
133. **Farmers in high-potential zones are well positioned to diversify away from subsistence crops and expand cash crop production.** Crop-combination suitability has important implications for agricultural livelihoods. However, improved rural infrastructure and market access remain essential.

134. **The current distribution of public spending is inconsistent with agricultural production patterns.** Between 2005 and 2007 about 32 percent of Mozambique's grain was produced in Nampula and Zambezia provinces, which are home to about 44 percent of the

country's rural population. However, the rate of public spending per holding was lowest in those two provinces.[45]

135. **Irrigation coverage is low, and current investment patterns are not focused on areas with the highest agricultural potential.** Although up to 3 million hectares are suitable for irrigation, only about 180,000 hectares have irrigation infrastructure, just half of which is currently in use. As a result, the vast majority of smallholder farmers in Mozambique rely entirely on rainfall. Irrigation coverage does not reflect agricultural potential (Figure 59). Instead, most irrigation infrastructure is located near large domestic consumer markets in the southern region, especially Maputo and Gaza provinces, where agricultural productivity and irrigation potential are lowest. Meanwhile, the northern and central regions, where agricultural potential is highest, have substantially lower levels of irrigation coverage.

Figure 59: Irrigation Potential



Source: Dobbin, 2015

[45] World Bank, 2014f.

136. **Targeted public support could promote diversification and facilitate growth.**[46] Key areas include: (i) boosting agricultural production, marginal productivity and resilience to shocks by enhancing access to improved seed, fertilizer, and irrigation technology and infrastructure; (ii) providing investment incentives for farmers and agribusinesses by supporting socially responsible land-tenure arrangements; (iii) improving smallholder output and marketing by promoting rural credit and warehouse receipt-based financial and trading services; (iv) enhancing nutritional value by promoting food fortification; and (v) encouraging private investment in primary production, marketing, value-addition, seed and fertilizer technology development and marketing, including via the provision of agricultural credit. Other priority areas for sector growth include rural infrastructure investment, extension services, market linkages and livestock development.

137. **Agricultural support programs could have a major impact on poverty reduction in Mozambique's northern and central regions.** These areas, where both agricultural fertility and poverty levels are highest, have the greatest scope for enhancing productivity and improving incomes. This is particularly true in Nampula and Zambezia, which are also densely populated. Seven of the country's poorest administrative posts have favorable conditions for agriculture and/or forestry development. These posts are tightly grouped, making them conducive to a coordinated, targeted approach, and all 7 are located within Mozambique's dominant poverty cluster in Zambezia Province.

3.6. Renewable Natural Resources

3.6.1. Fisheries

138. **Fisheries are an important component of food security and rural livelihoods, and they make a modest contribution to public revenues.** Fish represent 36 percent of all animal protein in the Mozambican consumption basket. Approximately 850,000 households, or 20 percent of the population, rely on fisheries for some part of their income. The fisheries sector contributes to public revenues, and the development of related infrastructure, such as ports, cold storage and processing plants, has spurred construction activity and enabled seafood exports. However, many fishing communities are small, isolated, poor, and locked in semi-subsistence livelihoods. Women make up almost half the sector's labor force, and most are engaged in ancillary activities such as gathering shellfish in intertidal areas and working in post-harvest processing and marketing.

139. **Artisan fishing makes up the bulk of the fisheries sector, and commercial fishing operations are limited but growing.** In 2012, artisan fishing accounted for 88 percent of the sector's US$552 million in output and represented 94 percent of sectoral value-addition. Artisan fishing is estimated to provide direct income to at least 353,000 people,[47] including 286,000 directly engaged in fishing and 67,000 in ancillary activities such as gleaning, processing, marketing, and boat building and repair. Employment in the sector has increased by 260 percent since 2002, due in part to the development of processing and

[46] Pauw et al., 2012.
[47] Mozambique 2012 census on artisanal fishing

commercialization. However, despite the increased sophistication of the fisheries sector, access to credit and the development of co-management plans remain a major challenge. Aquaculture potential is high, but a weak overall investment climate—particularly for new industries—combined with limited skills and worker training, constrains innovation and slows the adoption of new production models. Moreover, the sector was recently affected by a high-profile public investment in a large commercial tuna fishing operation through EMATUM, a public enterprise that is described in detail in Section 5.1.1.

140. **Commercial fisheries and aquaculture have recently faced exogenous and external challenges.** Shrimp farming has been impacted by a combination of white spot disease and increased global price pressure. Better oversight is necessary to secure the sustainability of this valuable subsector and attract new investment. Aquaculture can improve the export mix, offset food imports and reinforce resilience against the effects of climate change. However, it remains a nascent industry in Mozambique, and the sustainable development of the sector will require strong government commitment, the expertise of commercial companies, and technical assistance in the form of studies and research programs. Efforts to develop the value chain should consider opportunities to add value during the harvest process and reduce post-harvest losses, which could help expand sectoral employment, especially for women.

3.6.2. Forestry

141. **The forestry sector consists of two separate but related subsectors, natural forests and planted forests.** The natural forest subsector produces high-value hardwood timber, various non-timber forest products for both commercial and subsistence use, as well as environmental services. The planted forest subsector produces large volumes of timber and natural fibers for processing or sale on both the domestic and export market.

142. **Forests contribute significantly to rural livelihoods.** Forests contribute to the income of rural populations, which include a majority of the poor, and serve as a safety net in times of economic or environmental stress. Roughly two-thirds of Mozambique's land area is covered by forests and woodlands, which provide over 80 percent of the country's total household energy supply in the form of firewood and charcoal. In addition to providing fuel, timber and income, forests enhance the livelihoods of many rural communities through the harvesting of medicinal plants, honey, mushrooms and fruits. Forests also provide vital ecosystem services, including biodiversity conservation, carbon storage[48] and water regulation. Forestry contributes an estimated 1.7 percent to GDP, but the sector's economic potential remains largely untapped.

143. **Expanding the multipurpose forest plantation model could sustainably enhance the sector's contribution to growth, but a number of constraints must first be addressed.** Much of Mozambique's land is suitable for multipurpose forest plantations, and there is considerable overlap between land that has a high potential for agriculture and forestry. However, lengthy and expensive bureaucratic procedures for establishing plantations, limited

[48] Greenhouse gas emissions from deforestation and agriculture account for 83 percent Mozambique's total emissions.

governmental support and extension services, a complex and inefficient land-tenure system, and a lack of transport infrastructure increase the cost of investment and inhibit the development of forest plantations. Government estimates suggest that up to 7 million hectares are suitable for forest plantations,[49] but investment has been limited and sporadic. An estimated 574,000 hectares have been allocated to plantation companies, but many companies have not yet planted their full land area. Areas currently allocated for planted forests are largely concentrated in Zambezia, but also include significant parts of Manica and Sofala (Figure 60).

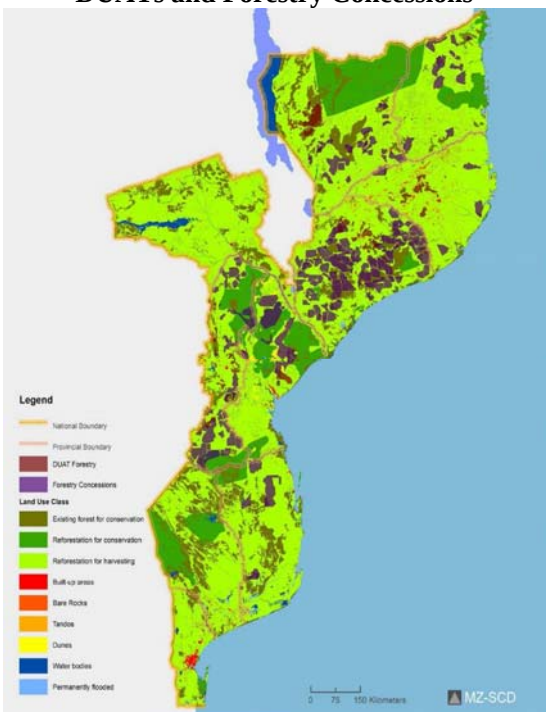
144. **Reliable and efficient administrative processes for conducting land negotiations and acquiring key documents, including DUATs, environmental impact assessments and operating licenses, will be critical to the development of the forestry sector**. Once a company has acquired a DUAT it may be confronted with a number of issues, including the presence of households, cultivated areas (*machambas*), existing fruit trees, or sacred places on the specified land, as well as demands to assume other social responsibilities, which can increase investor uncertainty and provoke conflict. Moreover, interviews with representatives of forestry companies in Mozambique reveal serious concerns over the length of waiting periods for licenses and other documents. The process can take years, increasing investment costs and potentially creating or exacerbating tensions between firms and local communities, as the latter may not fully understand why the process is delayed.

145. **The allocation of land for planted forests should be based on thorough and reliable information regarding current land use.** Mozambique has not had a national forest inventory since 2007. Many forestry companies have difficulty qualifying for Forest Stewardship Council certification due to the lack of an official definition of "natural forest," though the UN-REDD program in Mozambique is working on a uniform definition. Current, past and projected land use must be assessed to ensure that plantations do not displace local populations or negatively affect their livelihoods. Biodiversity values must also be fully accounted for and planted forests should not be considered a replacement for natural forests. Plantation development should be accompanied by rural employment and community livelihood support programs. It is estimated that 1,000 hectares of planted forests generate between 20 and 50 seasonal jobs.

146. **Mozambique's domestic forestry market is still dominated by the informal logging of unmanaged natural forests**. Limited transparency, inadequate accountability mechanisms and low institutional capacity create strong incentives for illegal logging. Weak local governance complicates investor interactions with local communities. Local governments often lack the capacity and legitimacy necessary to fulfil their role as a facilitator of rural development at the district level. Formalizing the forestry sector and expanding forest plantations will require a combination of local capacity building and anticorruption efforts.

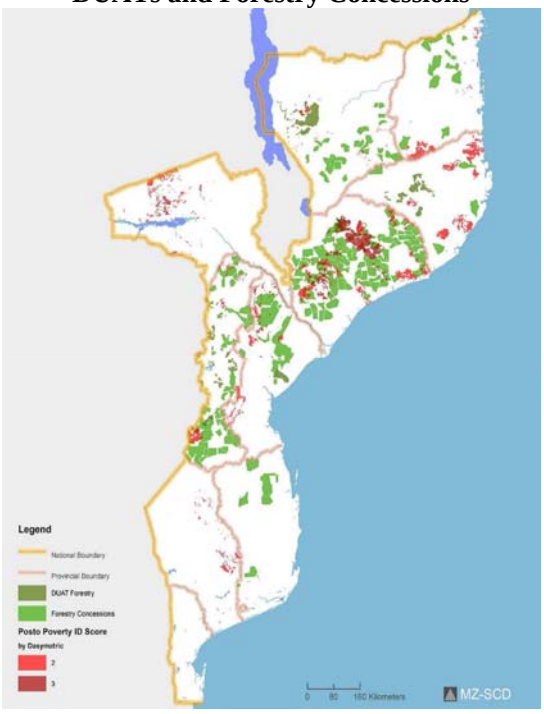
[49] These estimates are included in the National Reforestation Strategy (*Plano de Acção para o Reflorestamento*, 2009) and the Strategic Plan for Agricultural Development (*Plano Estratégico de Desenvolvimento do Sector Agrário*, 2010-19).

Figure 60: Reforestation Analysis with DUATs and Forestry Concessions



Source: Dobbin, 2015

Figure 61: Poorest Administrative Posts, DUATs and Forestry Concessions



Source: Dobbin, 2015

Box 4: Integrated Agriculture and the Landscape Management Approach to Natural Resources

A landscape is a mosaic of natural and human-modified ecosystems, including agricultural lands, natural forests or wilderness, and populated areas. The integrated landscape management approach entails recognizing the importance of sound governance arrangements to responsible natural resource development, as well as the interdependencies and tradeoffs among different resources and their use by humans in a given landscape. The approach strives to optimize the uses of different landscape resources to achieve local and national development goals.

Sustainable landscape management entails: (i) adopting a geospatial approach to organizing and managing land, water, crops, biodiversity, forests and infrastructure in the context of recent, current and future human population and climate dynamics; (ii) promoting resilient land-use practices at the local level, such as climate-smart agriculture, reduced-impact forest management or improved hydrological management; and (iii) promoting multi-stakeholder governance arrangements to facilitate the integrated management of land, water, biodiversity and forests. A well-managed landscape should improve local livelihoods, protect and sustain ecosystem services, and ensure sufficient production of food- and non-food goods to meet local needs.

Source: World Bank staff

3.7. The External Sector

147. **In recent years, the Mozambican economy has become increasingly integrated into global markets.** Goods and services exports have more than doubled as a share of GDP, rising from 14 percent in 2000 to an estimated 34 percent in 2014. Meanwhile, the rapid growth of FDI has caused goods and services imports to rise from around 40 percent of GDP in 2000 to

more than 70 percent in 2014. This trend is indicative of both the growing openness of the Mozambican economy and the rise of megaproject-related FDI. Over the past decade Mozambique has progressively liberalized its trade regime: its average most-favored-nation applied tariff rate fell from 13.8 percent in 2001 to 10.1 percent in 2012, while its maximum tariff rate was reduced from 30 to 20 percent in 2007.[50]

148. **Service exports are rising rapidly and currently represent more than 20 percent of merchandise exports (Figure 62).** Mozambique has significant unexploited potential in transportation and travel services (Figure 63), as well as energy and logistics.

Figure 62: Services Exports (US$ millions)

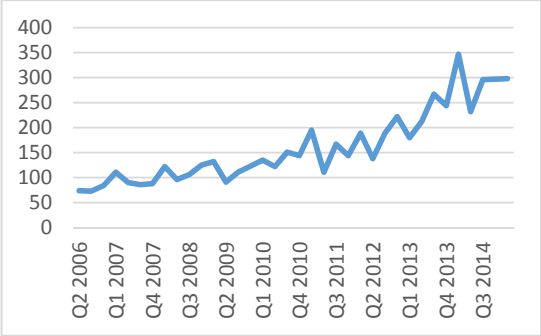
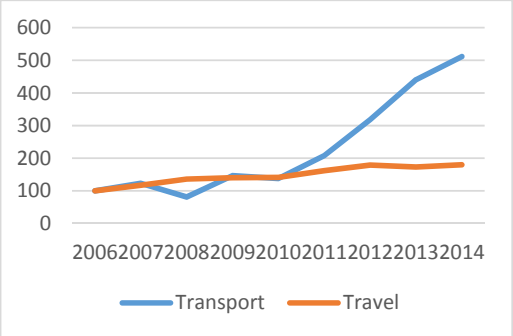


Figure 63: Service Exports (100 = 2006)



Source: UNCTAD

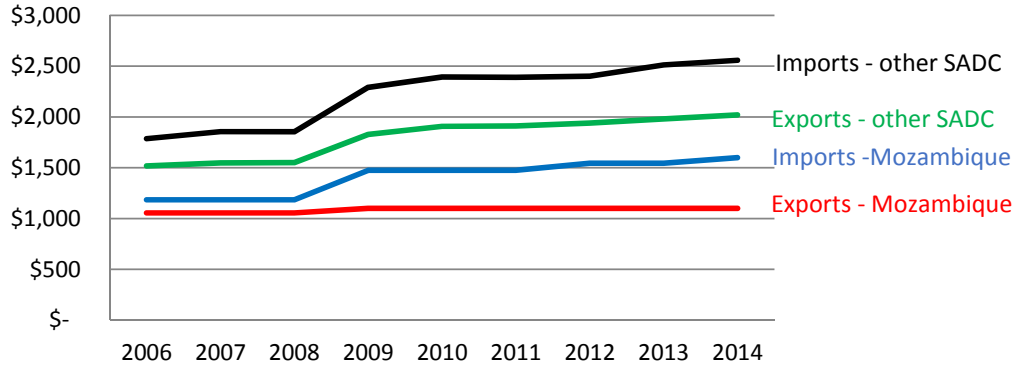
149. **However, high trade costs and a poor logistics environment continue to hinder Mozambique's export potential.** Despite recent improvements at port facilities, Mozambique ranked 147th out of 160 countries in the most recent Logistics Performance Index. Non-tariff barriers such as scanning fees, import and export licenses, extensive documentary requirements, cumbersome procedures and inefficient customs checks along major corridors increase costs and generate delays. A recent survey indicated that only 3 percent of Mozambican firms are exporters.[51] While about 20 percent of medium-sized firms export, this figure drops to less than one percent for small firms and microenterprises.

150. **Mozambique's geography could enable it to serve as a regional transit hub.** The country's position between southeastern Africa and the large economies of South and Southeast Asia could allow it to develop important trade and logistical corridors, but only if the structural and administrative costs of trade can be reduced. In this context, the recent expansion of the Port of Nacala in the north of the country and the signing of a concession agreement for the Maputo/Matola port are highly positive developments.

151. **Despite its infrastructure and trade logistics limitations, Mozambique's external sector performs well by the standards of comparable countries.** On average, it is both cheaper and faster to transport goods into and out of Mozambique compared to other SADC countries (Figure 64).

[50] Enhanced Integrated Framework, 2014.
[51] Ministry of Planning and Development, 2013.

Figure 64: Average Cost to Move Containers in Mozambique and Other SADC Members



Source: *Doing Business*

152. **Efforts to develop Mozambique's trade infrastructure could help to promote regional economic integration and accelerate growth in the country's more remote provinces.** For many producers in Mozambique the closest large market center lies outside the country. This is especially true in the country's central and northern regions, which suffer from high poverty rates despite their considerable agricultural potential (see Section 3.5). Closer integration with neighboring countries could reduce the cost of inputs and expand access to large consumer markets. Moreover, increased regional trade in staple foods could reduce domestic food prices and reinforce food security.

153. **Efforts to expand the capacity of the ports of Beira and Nacala could further reduce import prices, enhance export competitiveness and create a substantial number of jobs**. Linking the ports more effectively to inland economies and attracting additional transit trade would increase traffic volumes at ports and reduce shipping costs. Mozambique's evolution into a major transit hub could provide a major boost to the services sector, creating jobs in logistics, transportation and all types of business services.

3.8. Information and Communication Technology

154. **The information and communication technology (ICT) sector has become an increasingly significant contributor to macroeconomic growth, employment and economic diversification in Mozambique.** Mobile phone penetration rose from of 32 percent in 2011 to 59 percent in September 2015.[52] Between 2005 and 2014, ICT services exports increased from 20.6 percent to 26.1 percent of total service exports, and over the same period telecommunications revenue rose from 1.5 percent to 5.9 percent of GDP.[53] The opening of the telecom market to new operators in 2003 and 2012, coupled with investments in submarine fiber-optic cables in 2009-2010 and terrestrial fiber-optic networks, accelerated the growth the ICT sector. ICT development has boosted economy-wide productivity, while also creating a wide range of jobs—from MSMEs selling telecommunications products and services at kiosks to large firms employing highly skilled IT professionals.

[52] Telegeography, 2015.
[53] World Bank, 2015b.

155. **The ICT sector enjoys considerable scope for continued growth and diversification.** Though it has increased rapidly in recent years, Mozambique's mobile penetration rate lags the 80 percent average for the region and broadband penetration is extremely low at around 1 percent of households. In 2014, an entry-level mobile broadband subscription cost 69.5 percent of average monthly income, far above the UN Broadband Commission's target of 5 percent, while a fixed connection cost 150 percent of monthly income.[54] Fewer than 6 percent of Mozambicans report having some form of access to the internet.[55] While infrastructure investment has accelerated, large coverage gaps remain, and significant upgrades will be required to accommodate new technologies.[56] Compared with regional peers, Mozambique has been slow to adopt emerging services such as mobile payment systems, and the infrastructure necessary to support digital innovation and entrepreneurship is in its nascent stages. These factors present both a significant challenge and tremendous opportunity.

156. **A series of reforms and investments will be required to fully harness the potential of Mozambique's ICT sector.** The top priority should be to increase market competition and strengthen regulatory and financial incentives to provide affordable broadband access to rural areas and underserved populations.[57] The second should be to develop the country's ICT skills base by enhancing digital literacy, training domestic IT workers to meet rising employer demand, and promoting digital entrepreneurship and innovation as a source of job growth and diversification. Finally, the government will need to address its own institutional capacity and infrastructure constraints in the increasingly vital area of e-governance.

3.9. Extractive Industries

157. **Mozambique's burgeoning extractive industries sector is playing an increasingly pivotal role in the broader national economy.** Foreign investors entered the sector in the 2000s following large-scale discoveries of natural gas and coal. Gas exports commenced in 2004, followed by coal exports in 2011. In addition, Mozambique has substantial proven or suspected reserves of titanium, ilmenite, rutile, zircon, iron ore, tantalum, limestone, and a high potential for gold, platinum, uranium, graphite, and bauxite deposits. Private investment in the mining sector is currently estimated at close to US$10 billion, not including ancillary investments in regional rail and port infrastructure. Mozambique's natural gas reserves are estimated at a staggering 277 trillion cubic feet, of which 128 trillion have already been discovered. Mozambique also has significant deposits of precious and semi-precious gemstones (Box 5). Given their capital-intensive nature and limited ties to the domestic economy, tax revenue is expected to be the principal benefit generated by the extractive industries.

[54] International Telecommunications Union, 2014
[55] World Bank, 2015b.
[56] While the broadband market is formally liberalized, competition is limited by the dominance of the incumbent operator (TDM) and its affiliated companies, which together control most network infrastructure and benefit from partial government ownership.
[57] Mozambique is currently preparing its first National Broadband Strategy to address these issues.

Box 5: Mining and Precious Gemstones

Mozambique's artisanal and small-scale mining (ASM) sector faces similar issues to those of comparable industries worldwide. Mozambican ASM operators are mobile and often seasonal. They use basic tools and produce a limited quantity of minerals. In 1999, following a major economic adjustment reform and a series of droughts, the number of gold panners reached 20,000 in Manica Province alone. An estimated 70,000 to 80,000 people currently work in the ASM sector, and over 400,000 people depend on the income it generates.

Mozambique has known deposits of aquamarine, morganite, and tourmaline, which are mined in Zambezia Province. Dumortierite is mined in Tete Province, and garnet in Niassa Province. Copper-containing tourmaline has been mined from an alluvial deposit in Zambezia Province since early 2004. Ruby, aquamarine and tourmaline are mined in Cabo Delgado Province. Yet Mozambique has only one fully licensed and legally operated gemstone mine, an industrial scale ruby mine in Cabo Delgado operated by Gemfields, UK. This mine is believed to be sited on one of larger global deposits of rubies. Gemfields' first Mozambican ruby auction took place in Singapore in June 2014.

Artisanal and small-scale gemstone mines are typically unlicensed, and precious stones are often smuggled out of the country. Gemstone smuggling is especially common on the border between northern Mozambique and Tanzania, as the latter has better developed infrastructure and greater access to markets. ASM mines are generally unsafe, and accidents are common. In 2014 there was a fatal soil collapse in a major artisanal mining area in Cabo Delgado. Child labor is also frequently employed in the ASM sector. It is difficult to obtain a reliable estimate on revenue loss and employment in these mines. While the sector could bring thousands of miners into the economy, this potential is hindered by geographical remoteness, lack of trust, and lack of education.

Source: World Bank staff

158. **While the effective use of resource revenues has tremendous potential to lift people out of poverty and finance critical investments in infrastructure and public services, large-scale resource revenues can also have a profoundly negative impact on democratic institutions.** Extractive industries can undermine public sector transparency, accountability and responsiveness while incentivizing corruption and rent-seeking, as various interest groups may vie for control over resource revenues. Institutional quality is often the decisive factor in how effectively the extractive industries contribute to positive development outcomes.

159. **There is mounting evidence that government officials in Mozambique have benefitted from privileged access to information regarding the country's natural resources to form business alliances and extract rents from the public sector.** Recent reports indicate that informal links between technical managers and politicians are especially common in the National Hydrocarbon Company (*Empresa Nacional de Hidrocarbonetos*, ENH) and in the Ministry of Mineral Resources and Energy. Increasingly common business relationships between technocrats and the private sector present a serious conflict of interest.[58]

160. **Rent-seeking manifests in different forms at different stage of the extractive industry value chain.** Public officials may purchase resource-rich lands or properties slated for future development, then profit when they increase in value. They may also provide preferential tax or regulatory treatment to certain firms in exchange for lucrative consultancies or other forms

[58] Machel, 2012.

of indirect remuneration. The lack of transparency in the contracting and procurement processes for large public investments creates further opportunities to trade on political influence.

161. **Transparent decision-making processes and the effective implementation of anti-corruption regulations would send a strong signal that the government is committed to minimizing the potential for rent-seeking in the extractive industries.** Mozambique has strong anti-corruption laws, which include measures to address conflicts of interest. However, enforcement has been highly uneven. Clear lines of institutional accountability are necessary in areas such as mineral-rights licensing, which could include an inter-ministerial committee to vet allocation decisions. Empowering stakeholders outside the executive branch, such as the legislature or civil society groups, could further bolster external oversight.

162. **Mozambique achieved compliance with the standard of the Extractive Industries Transparency Initiative (EITI) in 2012, providing a positive indication of the government's commitment to transparency in the management of the extractive industries.** Nevertheless, ensuring the free flow of information remains an important challenge. EITI compliance has helped to clarify administrative processes in the resource sector and strengthen public trust, but transparency and accountability mechanisms should be expanded to encompass the entire value chain, including logistics, contracting, procurement, revenue management, and the disclosure of ownership stakes and conflicts of interest.

163. **Environmental concerns and global market conditions have created substantial uncertainty regarding future demand for coal.** The development of related infrastructure such as the proposed Tete-Macuse railway corridor could boost coal exports and provide key transit links in relatively remote parts of the country. However, the global coal industry is already suffering from excess supply and low global energy prices. Going forward, the joint impact of environmental policies and increased competition from cleaner energy technologies may further weaken demand for coal. In order to reach the 2-degree global temperature target set by the Paris Agreement, global coking and steam production through 2040 could consume just 75 percent of the in-situ reserves of currently operating mines. If coal exports fail to generate the expected returns, investments in the Tete-Macuse railway corridor and other infrastructure projects may become commercially unviable.

164. **The rise of Mozambique's extractive industries presents important opportunities to increase the participation of the domestic private sector.** Facilitating upstream and downstream linkages between local firms and international investors could bolster employment, support diversification and broaden the distribution of the benefits of Mozambique's natural resource wealth. Some investors are actively attempting to establish closer ties to domestic firms, but they face challenges finding domestic companies that are able to meet their standards for quality, cost and time.

165. **Enhancing the contribution of the extractive industries to Mozambique's growth and development will require addressing a number of market failures.** High barriers to entry, including excessive startup costs or insufficient market knowledge, reduce private sector

competition. In addition, positive externalities, such as technological spillovers and the transfer of workforce skills, are not adequately rewarded by market mechanisms. The existence of these market failures could justify well-targeted public policy interventions to help develop and integrate the domestic private sector. However, interventionist policies carry their own risk of creating market distortions. Any state involvement should therefore be informed by a candid, professional and detailed cost-benefit analysis.

3.10. The Role of Growth Corridors

166. **Mozambique's currently has three major rail lines: the Sena line from Tete to Beira, the Zimbabwe line from Harare to Beira, and the Tete-Malawi line from Tete through Malawi to Nacala.** A fourth line, the Tete-Macuse line, is still in the planning stage. Spatial analysis has revealed a large region of influence (144,000 square km) that would benefit from the rail link. However, its primary purpose would be to ship coal from mines in Tete to the coast, and as noted above, the uncertainty of future global coal demand has called the viability of this project into question.

Box 6: Defining Growth Corridors

The official boundaries of growth corridors are of limited use for planning purposes, and policymakers should reconsider how these boundaries are defined. Growth corridors currently are based on administrative units (districts or provinces), which are not very useful for regional planning purposes. By contrast, identifying geographical boundaries based on spatial analysis and characteristics such as agricultural suitability allows planners to better understand both the core development zones and the potential linkages and synergies between regions. For example, the Nacala Development Corridor officially covers 12 districts in Nampula, Zambezia and Niassa provinces, but redefining its boundaries on the basis of areas of high suitability for agriculture shows where in this corridor potential benefits to farmers could be expected to materialize. These highly fertile areas are mostly limited to parts of the corridor in Nampula and Zambezia.

Source: World Bank staff

167. **The country's north-south growth corridors are relatively underdeveloped.** Mozambique's three principal development corridors are the Beira Corridor, the Maputo Corridor and the Nacala Corridor, each of which corresponds to one of the three rail lines mentioned above. All three run in an east-west direction, connecting Mozambique with the rest of the continent and linking inland areas to seaports. While investment in roads and railway lines has accelerated development, especially along the Nacala and Beira Corridors, Mozambique's current infrastructure pattern does little to connect the country's disparate regions to one another.

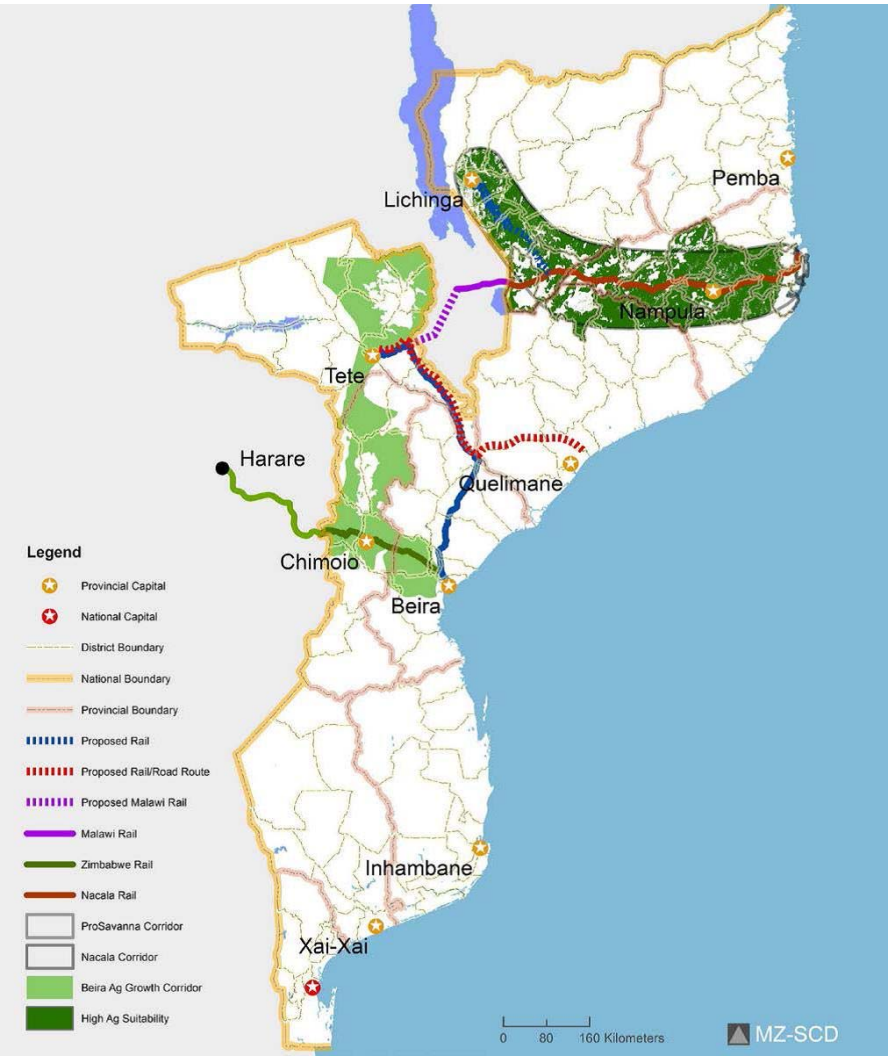
168. **The country's current development corridors have not broadened the economic impact of megaprojects.** While much of Mozambique's transport infrastructure is related to large-scale investment projects, transportation connections by themselves have proven insufficient to integrate megaprojects into the broader national economy. A "growth poles" approach could leverage synergies between domestic firms and megaprojects through public-private partnerships and mechanisms for optimizing the utilization of megaproject-related

infrastructure. An integrated strategy that addresses the business environment, the capacity limitations of local firms, infrastructure sharing and skills development could help to maximize the developmental impact of megaprojects. In this context the government has recently increased the number of Special Economic Zones to 5 in an effort to encourage diversification away from agriculture and the extractive industries.

169. **Furthermore, Mozambique's growth corridors bypass its seven poorest administrative posts.** Along with other extremely poor communities in Zambezia Province they lie between the Nacala and Beira corridors. The proposed Zambezi transport corridor could greatly improve access to these seven impoverished yet high-potential administrative posts, along with the larger regional poverty cluster, by connecting them to a major international port and rail line. However, care would need to be taken to verify their prioritization, as national spatial planning cannot replace detailed district planning.

170. **The proposed Zambezi Growth Corridor could open up a huge area of economic potential.** This corridor, based on the proposed Tete-Macuse rail link, would include some of the poorest administrative posts in the country, many of which also have high levels of agriculture and/or forestry potential. By connecting these areas to an international port and rail line, the corridor could significantly accelerate poverty alleviation and economic development in Zambezia Province, one of Mozambique's poorest areas. The Zambezi corridor would also link several different growth corridors together into an integrated domestic network (Figure 65). However, as noted above the Tete-Macuse rail link hinges on the profitability of exploiting coal deposits in Tete, and an evolving international energy market has created substantial uncertainty regarding the ongoing commercial viability of coal.

Figure 65: Redefining Mozambique's Growth Corridors



Source: Dobbin, 2015

3.11. Promoting Private-Sector-Led Growth: Challenges and Opportunities

171. **While Mozambique's current growth model, based on megaprojects and the development of the resource sector, has led to relatively fast economic expansion, its impact on income dynamics and poverty reduction has been limited.** Private sector growth and the productivity of the country's vast agricultural sector are constrained by an adverse business environment and a lack of critical infrastructure. Promoting private-sector-led job creation and broad-based income growth will require a renewed focus on diversification. The establishment of growth poles, growth corridors and special economic zones can further integrate the domestic economy, strengthen its international connectivity, and facilitate the expansion of the private sector by targeting areas with untapped economic potential. Table 15 summarizes the constraints to broad-based growth in Mozambique and how they relate to the World Bank's twin goals of eliminating extreme poverty and boosting shared prosperity by increasing the incomes of the bottom 40 percent of the income distribution.

Table 15: Private-Sector-Led Growth and the Twin Goals: Issues, Challenges and Recommendations

Issues	Challenges	Recommendations
Bolster economy-wide competitiveness by reducing the cost of doing business and promoting private sector development		
Megaprojects are not well integrated into the broader national economy	• A lack of forward and backward linkages diminishes the impact of megaprojects on job creation and income growth	• Address market failures to alleviate economy-wide growth constraints • Promote growth poles and growth corridors to integrate and expand the private sector in areas with high economic potential
	• The domestic private sector has limited capacity to supply inputs at the scale and quality required by international investors	• Vocational education programs should focus on meeting the demands of the market • Improve the institutional environment for doing business
The high costs of doing business slows growth	• A generally adverse business environment imposes additional costs on firms, further reducing export competitiveness and discouraging investment	• Pursue further business climate reforms in areas identified as major constraints in the *Doing Business* survey
Limited access to finance hinders private sector development	• Entrepreneurs identify access to credit as a key obstacle to expanding their businesses • Credit constraints have an especially negative effect on the growth of MSMEs and limits their ability to compete with larger firms	• Support the development of a rural banking network • Address high borrowing costs to improve access to credit among MSMEs
Insecure land rights contribute to low productivity	• Uneven enforcement of the DUAT system creates land-related conflicts and reduces investment incentives in agriculture and forestry	• Operationalize DUAT regulations and build the capacity of local governments to efficiently establish and enforce land rights
The rise of the natural resources sector may have negative macroeconomic consequences	• The risk of Dutch Disease effects from large-scale resource exports could further compromise competitiveness	• Spend resource revenues in line with the absorptive capacity of the economy • Promote economic diversification by boosting competitiveness in the non-resource tradeable sectors
Sustainably increase productivity in the agricultural and forestry sectors		
Smallholder farmers have low marginal productivity	• Farmers have been slow to adopt productivity-enhancing agricultural inputs and technologies	• Increase utilization of improved seeds and fertilizer by liberalizing the agricultural input market
	• Low rates of irrigation limit productivity and increase vulnerability to rainfall patterns	• Focus irrigation development on areas with greatest agricultural potential
Agribusiness value chains are underdeveloped	• Value chains in the agribusiness subsector are not well integrated with the larger agricultural sector or other sectors of the national economy	• Prioritize value chains that integrate smallholder farmers and promote upstream and downstream linkages

Develop enabling infrastructure		
Underdeveloped road and rail infrastructure limits trade and constrains private sector growth	• The limited scope and inadequate quality of the road and rail network reduces access to markets for farmers, domestic firms and international investors	• Focus on improving transportation networks and logistical capacity to better connect rural areas to urban centers and export points
High administrative and logistics costs hinder commerce and trade	• Burdensome bureaucratic procedures and a poor logistics environment reduce export competitiveness and limit investment opportunities in sectors with high growth potential	• Leverage opportunities for developing logistics infrastructure • Capitalize on the country's geographic advantage in transit trade and regional trade logistics
Expand access to reliable electricity		
Low electrification rates are a major obstacle to private sector growth and diversification	• The demand for energy is progressively outstripping supply	• Increase energy generation from both renewable and non-renewable sources

4. The Inclusiveness of Growth

- **Low rates of formal sector job creation and pervasive underemployment limit the ability of workers to benefit from economic growth.** A large share of the population is engaged in low-productivity agriculture and household enterprises, and formal wage employment is rare. Despite low unemployment levels and high rates of labor force participation, improving employment opportunities remains a persistent challenge, particularly given the rising number of young workers entering the urban labor market.

- **Gender is a key determinant of inclusiveness.** Women have less access to land, lower literacy rates and less knowledge about their rights. In urban areas women are less likely to work in the small formal sector and are paid less. Despite recent improvements in school enrollment rates among girls, substantial gender disparities in education persist.

- **Education access is expanding, but quality remains low and uneven.** Enrollment rates at all education levels have increased, but completion rates have not kept pace. Students from urban areas and wealthier households are more likely to attend school. Although the supply of education services is expanding, aggregate quality indicators are deteriorating.

- **Progress in the health sector has been mixed.** While infant and child mortality rates have declined, these improvements are modest in comparison to other countries in the region. Moreover, significant disparities in healthcare access and quality remain, with southern, urban, and richer households enjoying better coverage and health outcomes. Public spending on health services in Mozambique is low by SSA standards, and the health sector is constrained by a chronic shortage of skilled healthcare workers.

- **Access to water and sanitation is limited and uneven.** Fifty-three percent of the population has access to safe drinking water, though access rates are far lower in rural areas. Poorer, largely rural districts have considerably worse water and sanitation indicators, negatively impacting the health and labor productivity of their populations.

- **Mozambique's social protection programs reach a very small share of the population.** Just 14 percent of the poor receive benefits from a social assistance program. While important progress has been made in expanding coverage, current programs do not effectively target poor households with children or urban youth. Moreover, there are considerable regional inequalities in the distribution of social transfers, with Nampula and Zambezia provinces receiving the lowest amount of spending per poor person.

- **Investing in urban infrastructure, improving rural-urban connectivity and alleviating constraints on the competitiveness of small enterprises will be critical to promote inclusive growth.** As an expanding urban population intensifies demand for better jobs and services, policymakers should strive to maximize the economic potential of rural-urban linkages. Greater domestic connectivity could better integrate the poor into national markets, while strengthening international trade links could accelerate diversification.

4.1. Labor Market Characteristics and Challenges

172. **Mozambique has high rates of employment and labor force participation, but underemployment is widespread.** Mozambique's labor market is typical of a low-income country: wage employment is rare, underemployment is common and unpaid family workers comprise a large share of the labor force. The unemployment rate was very low at just 2 percent in 2009, reflecting the fact that most Mozambican workers cannot afford to be unemployed for a substantial period (Table 16).[59] However, strong employment figures obscure low job quality. If unpaid family workers are counted as unemployed, the unemployment rate rises to almost 40 percent. Mozambique also has a high rate of child labor, which reached over 30 percent in 2009.

Table 16: Labor Market Indicators (%)

	1996/7	2002/3	2008/9
Unemployment rate (ILO definition)	0.6	1.9	2.0
Unemployment rate (national definition)	24.7	37.9	38.6
Employment to working-age-population ratio	81.3	81.5	86.4
Working-age population as a share of total population	54.1	53.4	51.5
Youth (aged 25-24) as a share of total population	18.6	18.3	16.7
Youth to working-age population ratio	34.4	34.3	32.4
Child labor rate	19.2	10.3	31.5

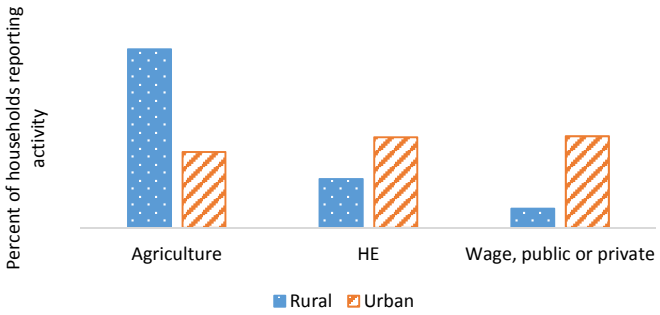
Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

173. **A large share of the workforce is engaged in low productivity self-employment and informal employment in agriculture and household enterprises.**[60] The Mozambican labor market can be divided into three basic segments: wage employment in the urban economy; paid, unpaid or in-kind employment in household-based agriculture; and nonwage self-employment in household enterprises. The two household-based forms of employment tend to have lower productivity than the formal wage sector, resulting in lower and less secure incomes. Almost all rural households and 40 percent of urban households depend on agriculture for at least some of their income (Figure 66). In both rural and urban areas, women are more likely to be employed in agriculture, leaving men largely responsible for livelihood diversification. Household enterprises are the second most important source of income by volume for both urban and rural areas. The wage sector has grown by over 8 percent over a 4-year period, and over 50 percent of households in urban areas report receiving wage income. Wage income is very important to households that are also engaged in household enterprises or smallholder farming, as it can stabilize consumption and ease credit constraints.

[59] Unless otherwise indicated, this section will present estimates based on the International Labour Organization (ILO) definition of employment and unemployment. The main difference between the ILO and Mozambican national definitions is that under the latter unpaid household workers are treated as unemployed.

[60] Household enterprises include self-employed workers in the non-agricultural sector with no employees outside the household.

Figure 66: Labor Force Participation



Source: National Institute of Statistics INCAF, 2012

174. **The economic sector in which workers are employed and type of employer both influence poverty rates.** Poverty is especially prevalent among farmers, who have a poverty rate of 59 percent. Senior managers, experts in intellectual professions, technicians, and clerks experience much low poverty levels, at an average of less than 12 percent. Unpaid household workers, self-employed workers without employees, domestic workers and agricultural workers have the highest poverty rates at above 50 percent. Meanwhile, public sector workers, formal private sector workers, and self-employed workers with employees have the lowest poverty rates (Figure 67 and Figure 68).

Figure 67: Poverty by Occupation and Employment Status

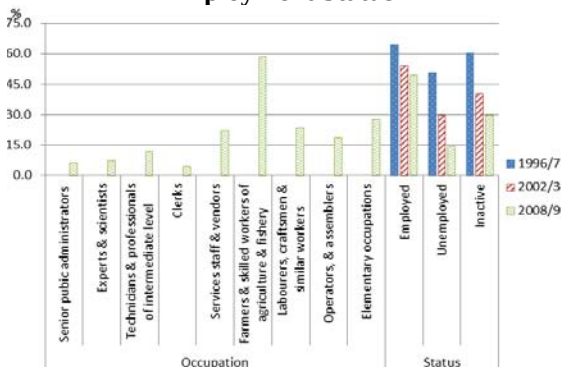
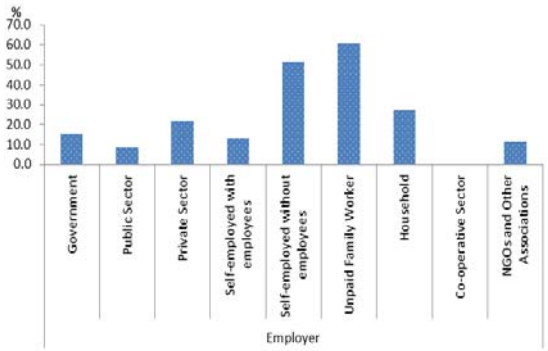


Figure 68: Poverty by Type of Employer



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

175. **The poor are primarily employed in the agricultural sector.** According to 2008/09 household survey data, in 2009 85 percent of Mozambique's poor population worked in the agricultural sector, 9 percent in trade and services, 2 percent in public services, 1 percent in industry and mining, 2 percent in construction, and less than 1 percent in transport. Among the non-poor, 77 percent worked in agriculture, 14 percent in trade and services, 4 percent in public services, 2 percent in industry and mining, 2 percent in construction and 1 percent in transport. Poverty incidence was highest in the agricultural sector at 53 percent and lowest in the transport sector at 25 percent.

176. **Unemployment rates vary by geographic location and income level.** Unemployment levels are lowest in the central and northern provinces and highest in the south, though most provinces have very low unemployment levels by international standards (Figure 69). In 2009

Maputo Province and Maputo City had the two highest unemployment rates. In Maputo city the unemployment rate increased from 4 percent in 1997 to 17 percent in 2009.

177. **While one might assume that higher unemployment rates reflect worse economic conditions, in Mozambique the opposite is the case.** The observed pattern of unemployment across provinces is directly and positively correlated with income level (Figure 70). Higher-income workers have higher unemployment rates, while unemployment rates are lowest among the poor. This reflects that wealthier workers have an adequate support system to remain unemployed while searching for a better job. Poorer workers, however, have no option but to work in whatever form of employment is available.

Figure 69: Unemployment Rates by Province

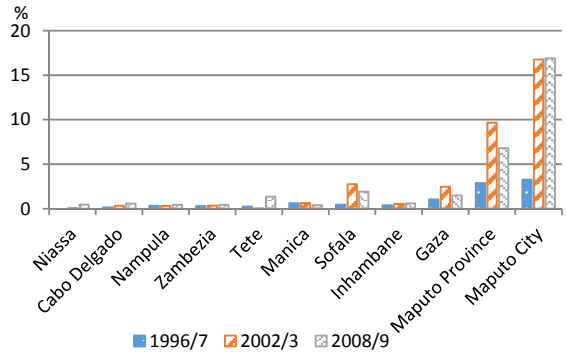
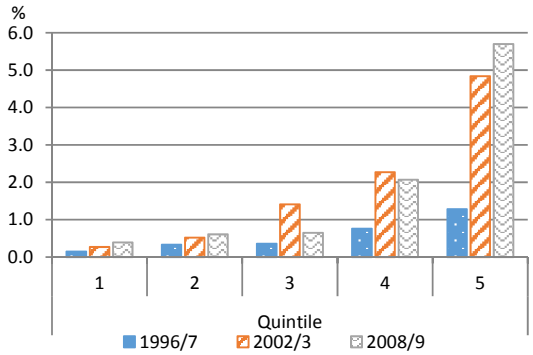


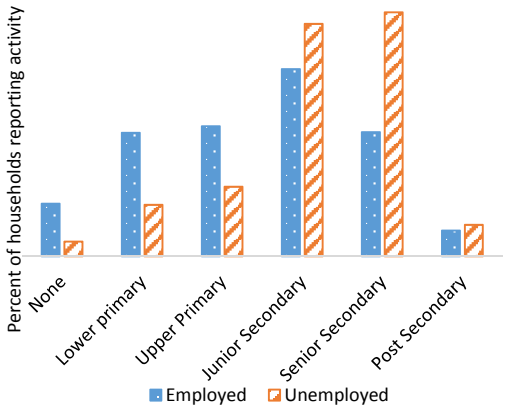
Figure 70: Unemployment Rates by Income Quintile



Source: World Bank staff calculations using IAF1996/7, IAF2002/3, and IOF2008/9

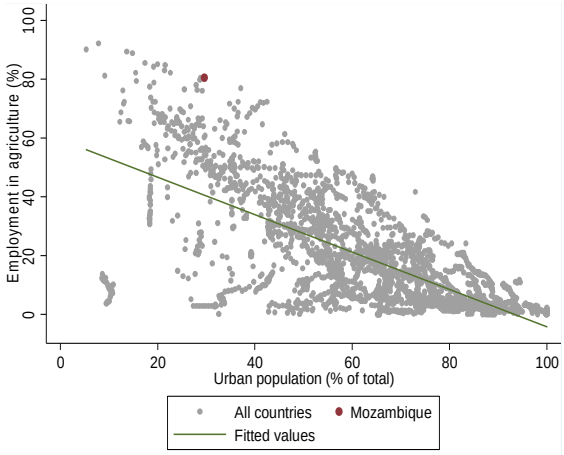
178. **Despite low overall unemployment levels and high rates of labor force participation, youth and urban unemployment remain a challenge**. 86 percent of working-age men and 82 percent of women participate in the labor force. However, despite recent gains in education and training, youth unemployment is heavily concentrated in urban areas. 20 percent of urban youth reported being unemployed and actively searching for a job in 2012, with two thirds reporting that they had been unemployed for over a year. Urban unemployment is highest among relatively well-educated workers, and 79 percent of unemployed urban youth had some post-primary education. This suggests that the supply of unskilled entry-level workers significantly exceeds demand; a trend that will only continue as job opportunities for educated workers increase over time. Furthermore, given the size of the urban population, the share of the labor force engaged in agriculture is relatively high, indicating that the economy has not yet shifted toward high-productivity employment.

Figure 71: Urban Employment by Education Level



Source: National Institute of Statistics INCAF, 2012

Figure 72: Share of the Labor Force Employed in Agriculture Compared to the Urban Population



Source: WDI

179. **An analysis of urban employment by region reveals that employment growth has been concentrated in Maputo.** Employment in Maputo has almost completely diversified away from agriculture, with only 11 percent of workers employed in the primary sector, but in other cities agriculture employs about 40 percent of the labor force. Maputo Province alone accounts for 36 percent of all urban employment, as well as almost 60 percent of private sector wage jobs and 42 percent of household enterprises. Public employment is more closely proportional to the labor force in each region. Urban workers generally work longer hours than their rural counterparts: most male workers and half of all female workers report regularly working more than 40 hours per week.[61]

180. **Gender disparities hinder the ability of female farmers to lift themselves and their families out of poverty.** Discriminatory customary practices, inadequate enforcement of legal protections, lower literacy rates and more limited knowledge of their rights all undermine female land ownership.[62] Less secure access to land may reduce women's incentives to make productivity-enhancing investments.[63]

181. **Women typically assume a greater share of the domestic responsibilities, leaving them with less time for income generation.** Gender is the strongest determinant of the household division of labor, and women are almost exclusively responsible for household chores and for the care of dependents.[64] Across SSA, female farmers are less likely to use various productive inputs, and the inputs they do use generate lower returns.[65]

182. **Urban women are less likely than men to work in the formal sector and are paid less.** Only 12 percent of Mozambican workers receive regular wages, and 80 percent of workers who receive wages are men.[66] Women represent 59 percent of informal workers, due in part to

[61] Fox, 2015.
[62] Fox 2008; USAID, 2011.
[63] Goldstein and Udry, 2008; and Ali et al, 2015.
[64] World Bank, 2006.
[65] O'Sullivan et al, 2014.
[66] World Economic Forum, 2014.

their lower education and skill levels, which also partially explains why men have been more able to move out of agriculture and into higher-income employment.[67]

183. **Among women, female heads of household are particularly vulnerable to economic shocks.** They are more likely to be poor, to work in agriculture, to be self-employed without employees, to have no formal education, and to care for a large number of dependents (Table 17). Most female heads of household are widowed or divorced,68 and they lack the capacity of married women to circumvent structural and social constraints by accessing assets through their husbands. Fox (2008) finds that in Mozambique the death of a man of prime working age is more likely to reduce household assets and income than the death of a working-age woman. Consequently, households headed by widows tend to be especially poor and less able to cope with future shocks.[69]

Table 17: Characteristics of Female and Male Heads of Household

Characteristic	Female household heads	Male household heads
Below the poverty line	62.5	51.9
No formal education	51.9	22.0
Employed in agriculture	86.2	71.5
Self-employed without employees	60.1	46.6
Average dependency rate	1.44	1.16

Source: Marques, 2008

4.2. Education

184. **There is a clear link between education and employment prospects, and more educated heads of household have more job opportunities and receive better pay.** Over 97 percent of workers with completed tertiary education work as senior public administrators and managers, technical experts, or mid-level professionals (Table 18). Fewer than 1 percent of those without any formal education have similar jobs. Workers with no formal education are overwhelmingly farmers. The type of occupation in which a head of household is employed appears to be one of the main determinants of a household's ability to benefit from growth and escape poverty. Educational attainment has important consequences for economic productivity and inequality, as uneven access to education and poor education quality translate into significant disadvantages in the labor market.

[67] Silverio Marques, 2012; Fox, 2008.
[68] Tvedten, 2011.
[69] van de Walle (2013) finds that the gender-related effects of marriage shocks among Malian women are passed on to the subsequent generation, as they have a greater negative impact on human capital investment in daughters than in sons.

Table 18: Labor Occupation and Education in 2008/9

Occupation	Completed Education Level (%)				
	None	Primary	Secondary	Tertiary	Total
Senior public administrators & managers	0.13	1.18	5.54	21.78	0.45
Experts of the intellectual professions & scientists	0.03	0.99	13.11	57.16	0.58
Technicians & professionals of intermediate level	0.25	9.29	40.16	18.78	2.40
Clerks	0.12	2.06	6.86	0.73	0.53
Services staff & vendors	5.23	19.14	14.16	0.00	7.44
Farmers & skilled workers of agriculture & fishery	88.80	48.13	7.90	0.00	81.01
Laborers, craftsmen & similar workers	2.63	9.46	7.15	0.60	3.72
Operators, & assemblers	0.43	2.79	3.79	0.95	0.84
Elementary occupations	2.38	6.96	1.33	0.00	3.03
Total	100.0	100.0	100.0	100.0	100.0

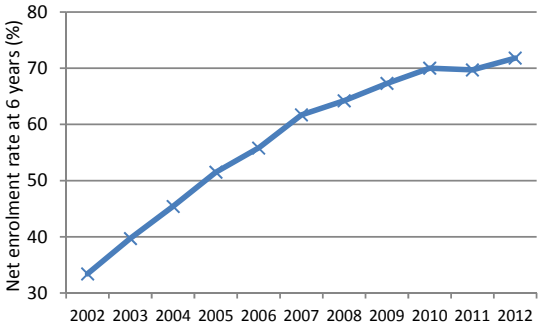
Source: World Bank staff calculations using IOF2008/9

185. **A lack of skilled workers presents a serious challenge for private sector firms.** Highly qualified workers are difficult to find and expensive to employ, turnover is high, and the pool of skilled workers is too small to enable companies to expand and adapt to a dynamic business climate. Skills shortages also affect the public sector, reducing service quality and inhibiting the government's ability to implement sophisticated reforms. However, given limited employment opportunities for highly skilled workers, policymakers should continue to prioritize improvements in the quality of primary and secondary education as the foundation for strengthening human capital.

4.2.1. Primary and Secondary Education

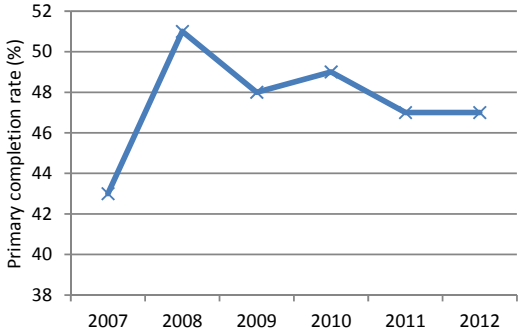
186. **Primary school enrollment rates in Mozambique have increased substantially over the years, but completion rates are low and quality indicators appear to be deteriorating over time.** Net enrollment in primary education reached 97 percent in 2014 after increasing by a remarkable 55 percentage points over the past decade (Figure 73). After rising sharply from 2007-08 completion rates stagnated from 2008 t0 2010 due to low promotion rates. Promotion rates have risen since 2011, and primary completion rates are expected to improve from 2016 onward. However, student absenteeism is on the rise, especially in the central and northern regions, which report truancy rates of over 60 percent, compared to 20 percent in the south. Rising absenteeism has contributed to the relatively low primary completion rate, which remains at around 47 percent (Figure 74).

Figure 73: Net Enrollment Rates at 6 Years Old



Source: Mozambican Ministry of Education

Figure 74: The Primary Completion Rate



Source: Mozambican Ministry of Education

187. **Secondary enrollment has tripled over the past ten years from a base of 331,000 in 2004 to nearly one million in 2014; however, there are significant disparities across regions.** Gross secondary enrollment in urban areas was 67 percent in 2014, compared to just 15 percent in rural areas, and while a larger share of young people is completing secondary education, Mozambique's completion rates are far below the SSA average. The lower secondary completion rate rose from 9 percent in 2006 to 19 percent in 2011, compared to an SSA average of 42 percent. The upper secondary completion rate is much lower but rose from 2 percent in 2006 to 8 percent in 2011.

188. **Despite recent progress, gender disparities in educational enrollment and outcomes persist, with negative implications for the inclusiveness of economic growth.** Gender parity has improved over the years, with girls accounting for 47 percent of primary enrollment in 2014. However, enrollment rates and educational attainment at higher levels are heavily skewed in favor of male students, and gender disparities remain especially acute in rural areas and among lower-income households. Between 1999 and 2004, the increase in the number of educated women in the labor force accounted for only 11 percent of GDP growth, while the number of educated men accounted for 17 percent, underscoring the negative economic effects of gender disparities in education.[70]

189. **Early marriage and childbearing have a deeply negative impact on educational attainment among girls.**[71] The assumption that girls will leave the household after they marry may reduce incentives to invest in their education, and girls primary school enrollment appears to be especially sensitive to the direct cost borne by households.[72] A World Bank analysis found that education reforms in 2004-05, which reduced direct education costs, disproportionately benefitted girls. Female enrollment rates rose by 13.1 percent, compared to 11.6 percent for the population as a whole.[73]

190. **Children from urban areas and wealthier households are more likely to attend both primary and secondary school.** In 2011, the net primary enrollment rate among children in urban areas was 86 percent, compared to 74 percent in rural areas. Urban literacy rates

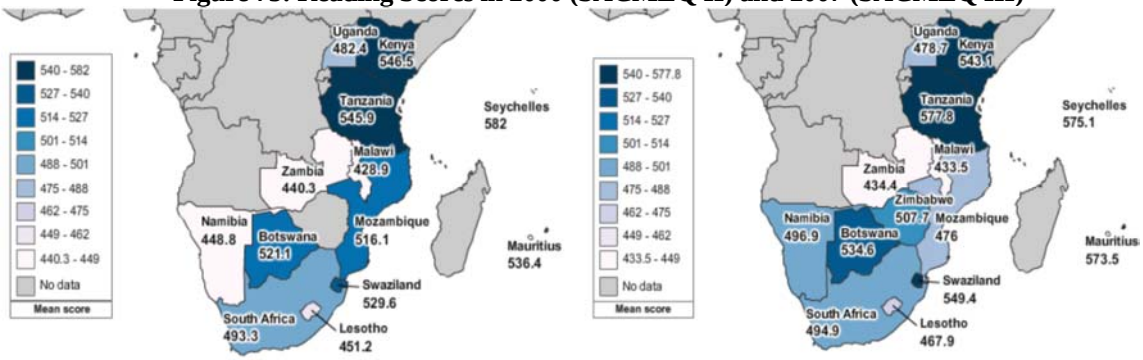
[70] Fox, 2008.
[71] Fox et al., 2012.
[72] Fox, 2008.
[73] Fox et al., 2012.

increased by about 20 percentage points from 1997-2003. While 91 percent of children from families in the top income quintile attended primary school in 2011, the net enrollment rate among families in the lowest quintile was only 67 percent. This divergence is even more dramatic in secondary school, where the gross attendance rate among families in the highest income quintile was 85 percent, versus a rate of just 5 percent among those in the lowest quintile.

191. **Education quality in Mozambique remains far below the standards of comparable countries.** In 2013, only 6.3 percent of lower primary students had grade-appropriate reading skills. In a 2014 survey Mozambican 4th graders scored lower in language, math, and non-verbal reasoning skills than students in the five other countries included in the study: Kenya, Nigeria, Tanzania, Togo and Uganda. Only 49 percent of Mozambican students could add single digits and only 5 percent could subtract double digits. The government has identified a set of priority interventions focused on enhancing the learning environment, addressing school governance issues and boosting retention rates.

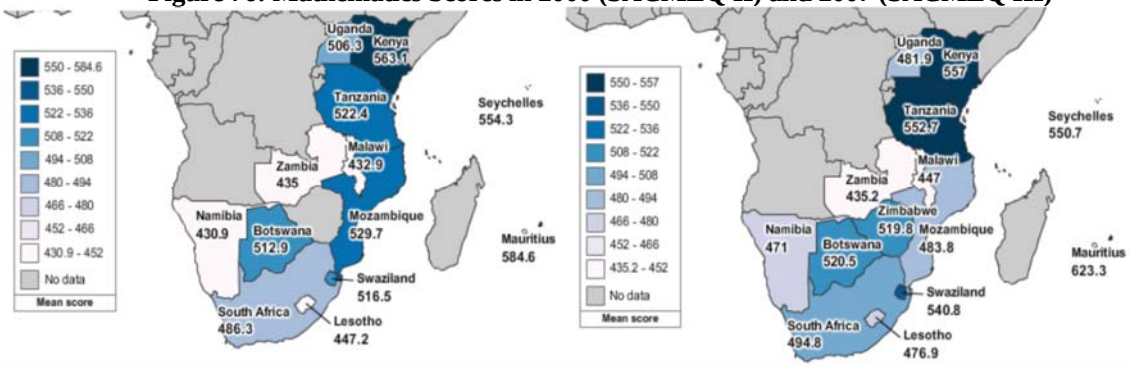
192. **The decline in education quality in Mozambique is especially stark compared to other countries.** According to the Southern and Eastern African Consortium for Monitoring Education Quality (SACMEQ), between 2000 and 2007 performance on standardized reading and mathematics tests declined sharply (Figure 75 and Figure 76). As a result, Mozambique went from being one of the best-performing countries in SACMEQ II to one of worst-performing countries in SACMEQ III.

Figure 75: Reading Scores in 2000 (SACMEQ II) and 2007 (SACMEQ III)



Source: World Bank staff calculations using SACMEQ data

Figure 76: Mathematics Scores in 2000 (SACMEQ II) and 2007 (SACMEQ III)



Source: World Bank staff calculations using SACMEQ data

193. **Mozambique has rapidly increased the number of trained primary school teachers, but there are serious issues regarding their qualifications and attendance rates.** Between 2004 and 2011 the share of trained primary school teachers increased from 58 percent to 80 percent, close to the SSA average. This reduced the student-teacher ratio, though it remains very high at 62 students per teacher. However, Mozambican primary teachers score very poorly on Portuguese, math and pedagogy assessments. In 2014, only 1 percent of 4th grade teachers had mastered 80 percent of the grade 4 curriculum.[74] Test scores were consistently low across regions and in both urban and rural areas. Moreover, a recent study found that 45 percent of teachers were not in school during an unannounced visit and a further 11 percent were at school, but not in the classroom when they were supposed to be teaching.[75] Rates of teacher absenteeism were heavily influenced by the presence of a school director, suggesting that they are at least in part the result of poor leadership.

4.2.2. TVET and Higher Education

194. **The government is reforming the technical and vocational education and training (TVET) system to make it more flexible and better aligned with the demands of the job market.** TVET reforms have focused on the relevance of qualifications and the quality of training, as well as issues involving access and equity, governance and institutional arrangements, and sustainability. However, there is still significant room for improvement in the preparation of TVET teachers and in the management of institutions. Currently, 21 TVET institutions implement 67 new competence-based qualifications designed with input from private firms, primarily in tourism, management and administration, industry, agribusiness, mining, and information and communication technology.

195. **Mozambique's TVET system is increasingly dedicated to preparing technical specialists and highly trained professionals to meet the demands of the extractive industries.** Currently, less than 1 percent of students in the national education system are enrolled in one of the country's 109 TVET institutions. The expansion of both TVET and tertiary education in science, technology, engineering and mathematics (STEM) could help to increase the employment and income effects generated by the growth of the extractive

[74] World Bank, 2015c.
[75] Ibid.

industries. As different skills are required during the investment and operational phases of extractive industry projects, TVET institutions must be prepared to rapidly adjust to shifting labor demand. In addition, if policymakers succeed in tightening linkages between the extractive industries and the broader national economy, demand for skilled workers may increase at multiple levels of the value chain.

196. **Higher education has expanded rapidly in Mozambique in recent years**. Average wages for workers with a tertiary degree are 148 percent higher than for those with completed secondary education, and workers with degrees face lower unemployment rates. Since 1992, Mozambique's higher education system has expanded from 3 Maputo-based public institutions to 47 private and public institutions in all provinces. The number of students rose from about 3,750 in 1990 to 13,600 in 2000 and reached 128,073 in 2014, 41 percent of whom are women. Yet the country's rapid economic growth seems to have increased demand for higher education graduates even faster than supply, especially in STEM fields. In this context, promoting more equitable higher education access for students in the bottom 40 percent of the income distribution will be critical to reduce inequality.

197. **Similar to the trends observed in the rest of the education system, as the scope and scale of higher education have expanded, quality has declined**. Only 24 percent of higher education faculty have a master's degree, and just 7 percent have a doctorate. The rapid growth of higher education has also led to rising student-teacher ratios and a lack of educational resources, especially laboratory equipment and computers. Moreover, the deteriorating quality of secondary education has diminished the preparedness of new higher education students. Employers often complain of a lack of hands-on technical competences, especially among STEM students. Reforming curricula in collaboration with employers, introducing more experimental learning and investing in modern classroom equipment could help improve higher education outcomes.

198. **High tuition fees at private institutions present a serious obstacle to higher education for low- and middle-income families.** Expanding higher education access is an important part of the government's education strategy. In addition to broad improvements in the quality of basic education, especially in central and northern Mozambique, expanding access to higher education among lower-income students will require sustainably increasing financial aid through student loans and creating education scholarships for promising TVET students.

4.3. Health

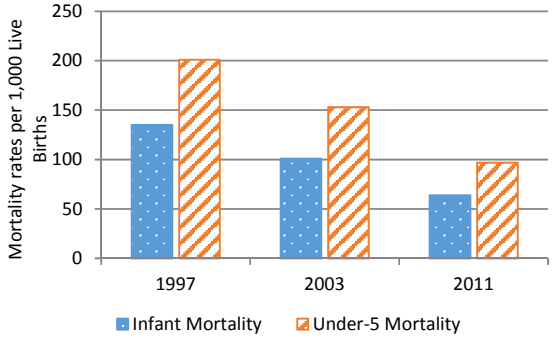
199. **Despite impressive improvements in health outcomes over the last two decades, and especially after the end of the civil war in 1992, Mozambique's health sector still faces significant challenges.** Life expectancy at birth is just 50.3 years, one of the lowest rates in the world. The infant mortality rate declined significantly between 1997 and 2012, falling from 106 to 64 deaths per 1000 live births, while the child mortality rate dropped from 158 to 97 deaths per 1000 live births (Figure 77).[76] However, significant regional, provincial and rural-

[76] Ministry of Health et al., 2011.

urban disparities persist, and urban areas in the south have significantly lower infant and under-five mortality rates. Moreover, Mozambique's progress does not compare well with peer countries both in SSA and around the world (Figure 78).

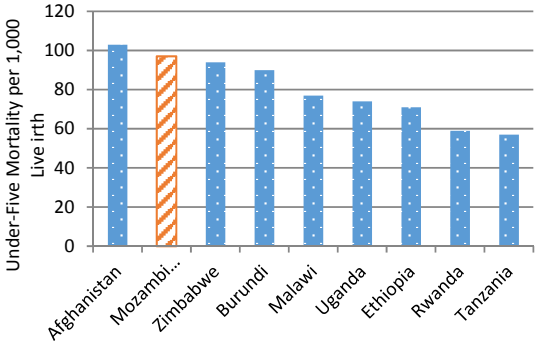
200. **While the incidence of acute malnutrition has decreased, high levels of stunting (43 percent of children under five) have remained unchanged over the last decade.** High rates of stunting are a major obstacle to Mozambique's social and economic development efforts due to their negative effects on physical productivity, cognitive development, educational attainment and lifetime earnings, as well as a substantial direct cost in terms of healthcare resources. The disproportionate incidence of malnutrition and stunting among children of poor households reinforces existing inequalities, and large disparities in healthcare access and quality limit the ability of poor workers to participate in, and benefit from, the growth of the Mozambican economy.

Figure 77: Infant and Under-Five Mortality Rates in Mozambique, 1997-2011



Source: Mozambique Demographic and Health Surveys, 1997, 2003, and 2011

Figure 78: Under-Five Mortality Rates, Mozambique and Comparators



Source: Mozambique Demographic and Health Surveys, 2010 to 2011

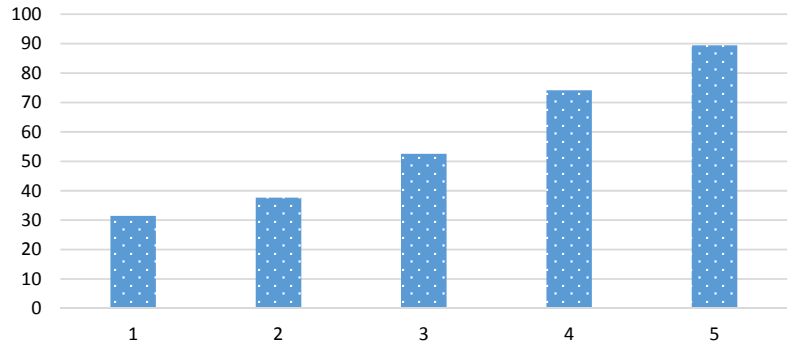
201. **Communicable diseases, especially HIV and malaria, account for a large share of the disease burden, which disproportionately affects children under 5, pregnant women and rural populations.** Mozambique has one of the world's highest HIV prevalence rates at 11.5 percent,[77] and the disease continues to inflict high rates of morbidity and mortality despite the availability of preventive measures and treatments.[78] The HIV epidemic also exacerbates morbidity and mortality for tuberculosis and other infectious diseases, especially among young adults, significantly impacting the labor supply and perpetuating poverty.

202. **Despite steady progress, Mozambique's maternal mortality rate of 408 deaths per 100,000 live births is far above the 2015 Millennium Development Goal target of 228.** While access to prenatal care is fairly high, even among the poorest women, the quality of care is inconsistent. The most recent demographic and health survey (DHS) found that only 40 percent of women who had received prenatal care over the preceding five years had been informed of symptoms of pregnancy complications, only 59 percent had their blood pressure measured, and only 50 percent had a urine sample taken. Assistance by a skilled health

[77] Instituto Nacional de Saúde et al., 2009.
[78] Ibid.

professional is one of the most effective means to reduce maternal mortality, but in Mozambique only 54 percent of all births and 32 percent of births to women in the lowest wealth quintile were attended by a healthcare professional (Figure 79).

Figure 79: Percentage of Births Attended by a Skilled Health Professional by Wealth Quintile (1=poorest, 5=richest)

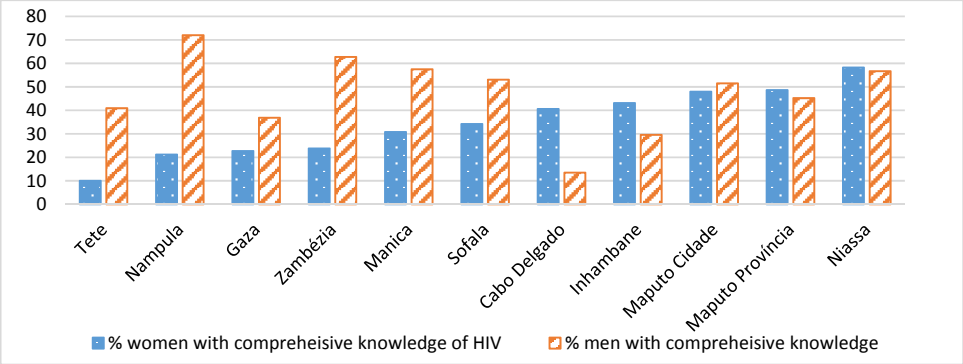


Source: Mozambique Demographic and Health Survey, 2011

203. **Inadequate access to health services deter women from seeking care.** Eighty-nine percent of women in the lowest wealth quintile report difficulties in accessing healthcare. Distance to a healthcare facility and the cost of treatment were cited as obstacles by 80 percent and 66 percent of women, respectively.[79] Travel time may be an especially serious barrier for women due to their greater domestic responsibilities and personal safety concerns.[80] It is also likely that some women who have to ask their husbands for money to travel and use health services simply do not go.[81] While public health facilities are legally obligated to provide free healthcare services to pregnant women, this is being inconsistently applied in practice.[82] Contraceptive use among women of reproductive age dropped from 17 percent in 2003 to 12 percent in 2011, and stands at just 3 percent among the poorest women.[83] Women, and especially younger and poorer women, face a disproportionate risk from HIV, with a female to male youth prevalence ratio of 2.3 (Figure 80). HIV infection rates are also higher among women (13.1 percent) than men (9.2 percent).[84]

[79] Ministry of Health et al., 2013.
[80] Fox, 2008.
[81] Ibid.
[82] Silverio Marques, 2012.
[83] Ibid.
[84] Instituto Nacional de Saúde et al., 2009.

Figure 80: **Comprehensive Knowledge of HIV among Women and Men, by Province**



Source: Mozambique Demographic and Health Survey, 2013-14

204. **Large disparities in healthcare access and quality reflect differences in household location and income level.** Southern, urban, and richer households enjoy better healthcare coverage and health outcomes than the general public. Infant and child mortality rates are highest in northern Mozambique and in rural areas nationwide. The three northern provinces of Cabo Delgado, Nampula and Niassa have the highest incidence of stunting. In addition, the share of births attended by skilled health personnel is over 85 percent among the wealthiest households and less than 40 percent among the poorest. Differences in education level among female patients are also associated with wide disparities in maternity care.

205. **Public spending on health services in Mozambique is low compared to other countries in SSA.** Per capita healthcare spending amounted to US$33 in 2012, far below the SSA average of US$95, and represented 11.4 percent of total government expenditures, well below the Abuja Declaration target of 15 percent.[85] Moreover, Mozambique is heavily dependent on external resources to finance its health sector.

206. **Rising demand for healthcare services is putting pressure on the authorities to increase expenditure efficiency.** Improved targeting and planning are necessary to identify and prioritize low-cost, high-impact interventions that effectively reach the poor and vulnerable. For example, infant and under-five mortality rates could be reduced by combining community outreach with improved facility-based services.

207. **Mozambique's health sector suffers from a chronic shortage of skilled professionals compounded by an uneven distribution of health staff across regions.** Mozambique has the lowest number of health staff per capita in SSA at just 0.4 physicians and 4.1 nurses or midwives per 10,000 inhabitants, compared to an SSA average of 2.6 physicians and 12 nurses or midwives. Moreover, most health staff are concentrated in the south and in urban areas. In addition to training more staff, the health sector must adopt new approaches to increase staff retention and professional satisfaction, such as a well-designed system of incentive payments.

208. **Underdeveloped sector-specific logistics and support infrastructure, including input supply chains, health information systems, a weak institutional framework and**

[85] World Bank, 2015d.

governance issues negatively impact health system performance. Achieving universal health coverage requires a strong system to deliver a package of services that meets quality standards in every geographical area and for every socioeconomic group, especially the poor and vulnerable. The health sector in Mozambique needs to take into account existing providers including the private sector when developing its health services package in order to safeguard financial protections of the poor and vulnerable. Similarly, improving the quality of care requires a performing health system with the right structures, processes, and outcomes.

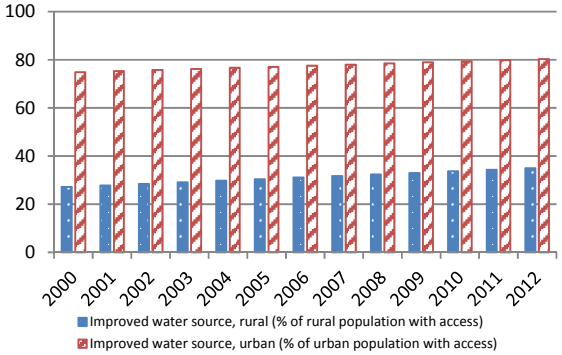
209. **Accelerating progress in the health sector will require a focus on preventative measures, both in terms of healthcare provision and broader public health policies.** Increasing investment in quality reproductive health services and proactively addressing demand-side constraints—including social and cultural barriers to care—will reduce the long-term costs of care for future generations. Beyond the narrowly defined health sector, investing in nutrition, safe drinking water and improved sanitation, education (especially of girls), indoor air quality and other environmental factors will improve health outcomes and reduce marginal healthcare costs. Policymakers in the health sector should therefore assume an active role in shaping health-related interventions in other sectors.

4.4. Access to Water and Sanitation

210. **There is compelling empirical evidence that safe water and sanitation are among the key determinants of human development, with critical implications not only for health outcomes, but also for education, income and poverty reduction.** Access to improved water and sanitation in Mozambique is limited compared with its regional peers**.** Nationwide, 53 percent of the population has access to safe drinking water and only 24 percent has access to improved sanitation facilities.[86] In urban areas 45 percent of people have access to an improved sanitation facility, 40 percent use traditional latrines or shared facilities, while 15 percent practice open defecation. In rural areas almost 40 percent of the population practice open defecation, which is a major disease vector. The poor assume a disproportionate share of the impacts of inadequate water and sanitation access. This is particularly true of women and children, who often spend hours fetching water, and who face greater exposure to pathogens. Inadequate sanitation is also a contributing factor to child mortality, and increases mortality rates for malaria, acute lung and respiratory infections (ALRI), measles and other diseases.

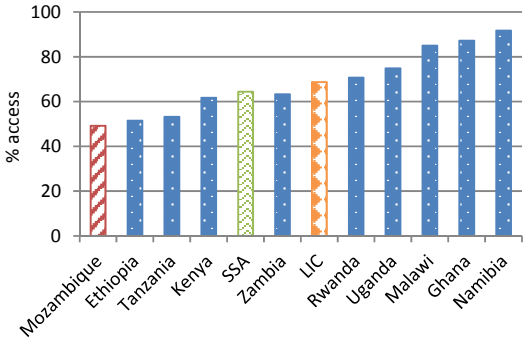
[86] Ministry of Health et al., 2011

Figure 81: Access to an Improved Water Source in Mozambique, 2000-2012



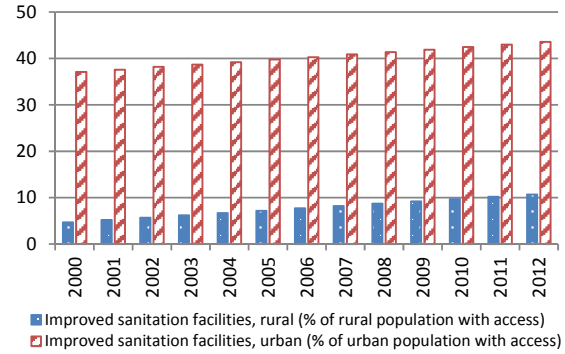
Source: World Development Indicators

Figure 82: Access to an Improved Water Source, Mozambique and Comparators



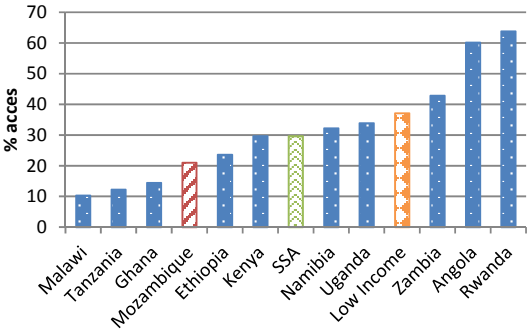
Source: World Development Indicators, 2012

Figure 83: Access to Sanitation Facilities in Mozambique, 2000-2012



Source: World Development Indicators

Figure 84: Access to Sanitation Facilities, Mozambique and Comparators



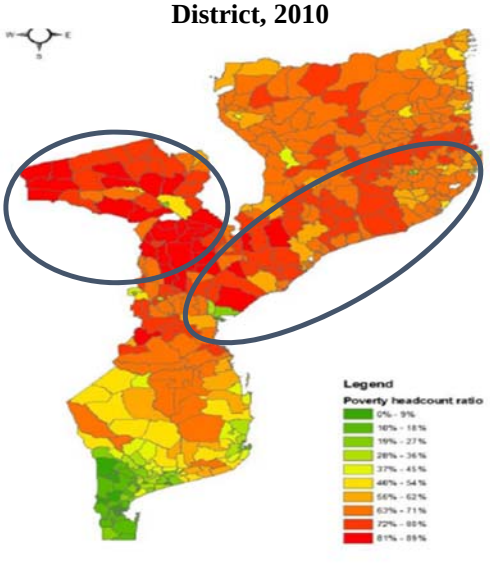
Source: World Development Indicators, 2012

211. **Improving access to adequate water, sanitation and hygiene (WASH) services is critical to accelerating broad-based growth and sustainable poverty reduction.** Poor sanitation costs Mozambique an estimated US$124 million per year.[87] This is equivalent to US$6 per person per year or 1.2 percent of GDP. In addition, fecal contamination of the environment is the root cause of an annual average of 8,000-10,000 cases of cholera, the treatment of which costs and estimated US$5.1 million each year.[88] Across provinces, high rates of poverty are closely associated with high rates of open defecation and only a small fraction of the sludge from urban latrines is being adequately managed.

[87] According to a desk study by the World Bank Water and Sanitation Program.

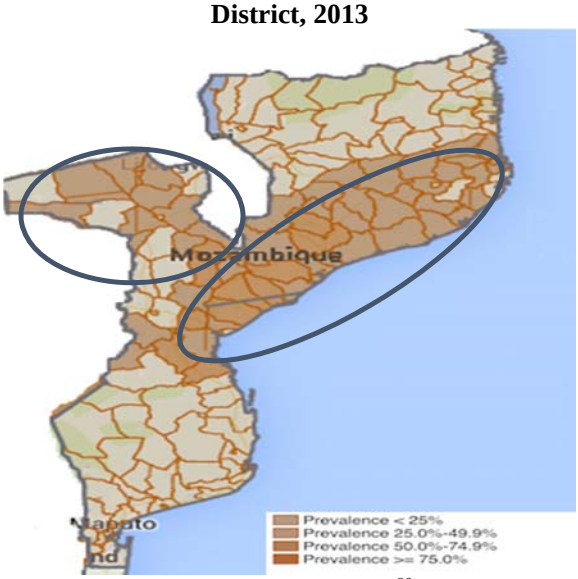
[88] Open defecation costs Mozambique an estimated US$70 million per year, and eliminating this practice would require 2 million latrines to be built and maintained. Each person practicing open defecation spends almost 2.5 days a year finding a private location to defecate, leading to lost productivity. This cost falls disproportionately on women, who may spend additional time accompanying young children or sick or elderly relatives.

Figure 85: Poverty Headcount Rate by District, 2010



Source: IOF, 2008/9

Figure 86: Prevalence of Open Defecation by District, 2013



Source: The NTD Mapping Tool, 2014[89]

212. **Approximately 14,400 Mozambicans, including 10,700 children under five, die from diarrhea each year, and nearly 90 percent of diarrhea cases are caused by poor WASH services.** In addition to directly facilitating the spread of fecal-oral diseases such as typhoid and cholera, inadequate WASH access increases morbidity and mortality from insect-borne diseases such as malaria, filaria and trypanosomes, particularly among poor communities with limited public infrastructure and health services.

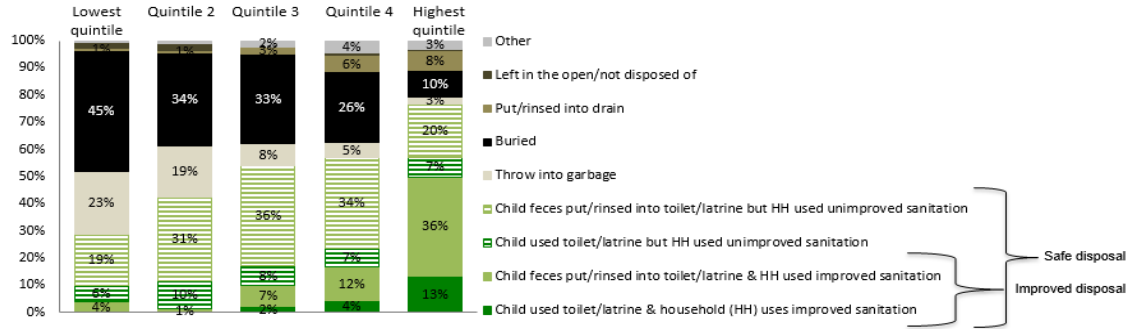
213. **Limited and inequitable access to WASH services impact the poor through three main channels: direct health costs, time and productivity costs, and indirect costs arising from negative effects on cognitive development.** The first channel reflects the out-of-pocket costs of treating WASH-related diseases. The second includes lost labor productivity or educational time due to illness, treatment time and time spent caring for ill dependents.[90] The third and arguably most important channel reflects the negative effect of diseases such as diarrhea and chronic enteropathy on the absorption of nutrients from food, which causes or exacerbates nutritional deficiencies, leading to stunting, impaired cognitive development and lower lifetime productivity.[91]

214. **Household location and income level are closely correlated with access to sanitation facilities.** In urban areas almost 50 percent of households in the lowest income quintile lack access to adequate sanitation. In 2011 81 percent of urban households in Maputo, 60 percent of other urban households and 41 percent of rural households reported that their children under three defecated into a latrine or that their feces were disposed of in a latrine. Among the 41 percent of rural households with safe child feces disposal, 8 percent have access to an

[89] Global Atlas of Helminth Infection at the London School of Hygiene and Tropical Medicine, Task Force for Global Health, International Trachoma Initiative, African Programme for Onchocerciasis Control, Mectizam Donation Program, and the International Coalition for Trachoma Control. www.ntdmap.org
[90] Water and Sanitation Program, 2012.
[91] Hathi et al, 2014.

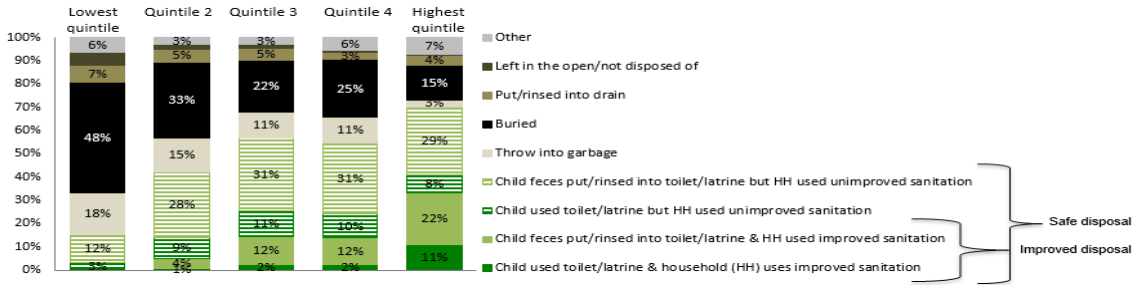
improved sanitation facility (Figure 87 and Figure 88). Similarly, only 25 percent of urban households outside Maputo have access to an improved sanitation facility, while 62 percent of Maputo's urban households have access to an improved sanitation facility.

Figure 87: Human Waste Disposal by Income Quintile, Urban Mozambique, 2011



Source: World Bank staff calculations based on Mozambique Demographic and Health Survey, 2011

Figure 88: Human Waste Disposal by Income Quintile, Rural Mozambique, 2011



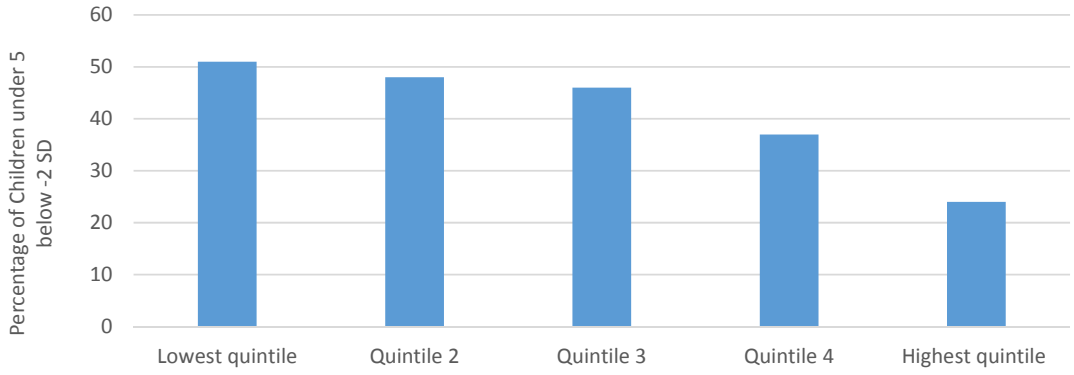
Source: World Bank staff calculations based on Mozambique Demographic and Health Survey, 2011

215. **High out-of-pocket costs further impede access to WASH services.** Water tariffs among poor households in Mozambique are higher than in comparable countries, due in part to the 12 percent value-added tax (VAT) applied to water. Mozambique has the third-highest VAT rate for water in SSA, behind only Rwanda and South Africa.[92]

216. **Due to the combined effects of deficiencies in healthcare, nutrition and WASH services more than 50 percent of children in the bottom income quintile suffer from severe stunting, compared to fewer than 25 percent in the highest quintile.** Environmental factors such as open defecation and water contamination disproportionally affect the nutritional status of poor children. Households with improved toilets and piped or protected water sources have significantly lower levels of both stunted and underweight children. In addition, there is a positive correlation between a lack of basic hygiene and diarrhea, and the presence of good water quality and flushing toilet facilities is strongly associated with better health outcomes. The close relationship between investments and outcomes in healthcare, nutrition and WASH underscores the potential to successfully integrate policies and programs across these sectors.

[92] Gill and Punt (2010) analyzed the socio-economic effects of water and irrigation VAT in South Africa. They found that the socio-economic effects of increasing tariffs via VAT are regressive. Thus, increasing water tariffs may not be a useful demand management tool.

Figure 89: Incidence of Stunting in Children under Five by Income Quintile, 2011[93]



Source: World Bank staff calculations based on DHS 2011 survey for Mozambique

4.5. Social Protection

217. **Mozambique spends relatively little on social protection, and a large share of social protection spending is devoted to regressive interventions such as public sector pension schemes.** The government currently implements three core social assistance programs (i) the Basic Social Subsidy Program (*Programa de Subsídio Social Básico*, PSSB), a social pension for poor households without adults able to work; (ii) the Productive Social Action Program (*Programa de Acção Social Produtiva*, PASP), a labor-intensive public works program for poor households with adults able to work, and (iii) the Direct Social Support Program (*Programa de Acção Social Directa*, PASD), a temporary support program for households experiencing idiosyncratic shocks affecting their consumption and income.

218. **Mozambique's social protection system suffers from a number of important coverage gaps.** Current programs do not effectively target poor households with children or urban youth, and programs that were initially designed for rural areas have not been appropriately adapted to urban settings. However, the government has focused on more progressive and pro-poor programs in recent years, especially social pensions and public works. Furthermore, the upcoming national public works program has significant poverty reduction potential.

219. **Overall, Mozambique's social protection programs reach only a small fraction of the population.** An estimated 2 million people benefit from one of the country's three key programs, including approximately 14 percent of the poor, or 8 percent of the entire population.[94] Only 4.5 percent of the employed workforce is covered by social security, and in 2009 only 11.8 percent of people over 60 years received a pension.[95] Moreover, very few elderly people who received a pension were in the poorest quintiles of the population.

220. **While important progress has been made in expanding the coverage of social protection policies, weaknesses in the payment system are constraining their growth.** The National Institute of Social Action (*Instituto Nacional de Acção Social*) has invested in

[93] Stunting is defined as having a height-for-age more than two standard deviations below the median of the WHO's reference population.
[94] This calculation is based on a national average household size of 4.7 people
[95] World Bank, 2012b.

developing a common targeting system for social protection policies[96] as well as a management information system that will include a single registry of beneficiaries. However, cash transfer payments are still executed manually with no reconciliation, leading to high fiduciary risks. The government is currently preparing to privatize the payment system, which will facilitate the expansion of social protection programs.

221. **The benefits offered by the social protection system have improved,[97] but this has not been systematic.** While the value of the basic social subsidy has increased over time, this is not the case for all social protection programs. For example, the transfer value of the PASP has remained unchanged since 2012, with households receiving MZN 650 per month for a maximum of four months. This is equivalent to MZN 217 per household per month or MZN 1.6 per household member per day (on average), which is only 17 percent of the median per capita consumption of the poor.[98] Social security benefits are also relatively low. The minimum retirement pension paid by the National Institute of Social Security (*Instituto Nacional de Segurança Social*, INSS) in 2014 was MZN 3,000 per month,[99] which simply covers the basic food needs of the poorest families. The projected value of social pensions is only about 27 percent of the average taxable wage, while pensions for Ministry of Finance employees are estimated at 75 percent more than the average INSS pension.[100]

222. **There are considerable regional disparities in the distribution of social transfers.** The provinces with the largest share of the poor, Nampula and Zambezia, receive the lowest amount of spending per person living below the poverty line, in part because social protection transfers in these provinces are primarily pension payments targeting the elderly.[101] This leaves a large programmatic gap for poor families with children in Nampula and Zambezia, where malnutrition rates are very high. Rural-urban disparities are also substantial. In urban areas only around 4.7 percent of the target population is covered by social protection programs, and approximately one-third of all beneficiaries are in Maputo Province, which has the nation's lowest poverty rate. Any further expansion of the social protection system must account for the distribution of the poor, particularly in provinces where the poor are relatively isolated and where alternative opportunities to reduce poverty in the short-term are limited.

223. **The current social protection system does not specifically aim to improve human development outcomes.** The international experience demonstrates that cash transfers can have a positive impact on poverty and social development, and that they can also effectively promote the demand-driven expansion of health and education services. The latter is particularly true when transfer policies involve a conditional or co-responsibility component, under which receipt of the transfer is contingent on the utilization of a particular social service, such as school attendance or antenatal healthcare. In Mozambique a conditional cash transfer

[96] The targeting system includes (i) geographical targeting through the use of highly disaggregated poverty maps; (ii) community-based targeting using local councils; and (iii) a proxy means test to minimize inclusion errors.
[97] In this context "improvement" is defined as an increase in the amount of the program transfer relative to the average consumption expenditure (excluding durable goods, housing and health care) of households in the lowest income quintile.
[98] This is calculated as MZN 650 multiplied by the four-month limit and divided by twelve months, then divided by the average number of household members (4.7) and expressed as a percentage of median per capita consumption of the poor for each household member.
[99] INSS, 2014.
[100] ILO, 2014.
[101] This calculation is based on real current transfer values for major social action programs and general operating expenses.

focused on improving school attendance rates could be an effective addition to the existing social protection system. This type of intervention could help to address coverage gaps for poor households with children while also improving school attendance and completion rates, as children from poorer households are among the most likely to drop out.

224. **The Ministry of Gender, Children and Social Welfare has developed a new National Strategy for Basic Social Security (*Estratégia Nacional de Segurança Social Básica*, ENSSB) for 2015-2024, which is expected to be presented at the Council of Ministers by November 2015**. The ENSSB has four main objectives: (i) to protect and increase consumption and reinforce economic resilience among the poor; (ii) to promote human capital development; (iii) to increase access to social services; and (iv) to strengthen institutional capacity. The ENSSB sets very ambitious targets and prioritizes the poorest areas. It also aims to gradually improve existing social transfer programs, and it envisions a new cash transfer program designed to promote human capital development, which will include a child grant.

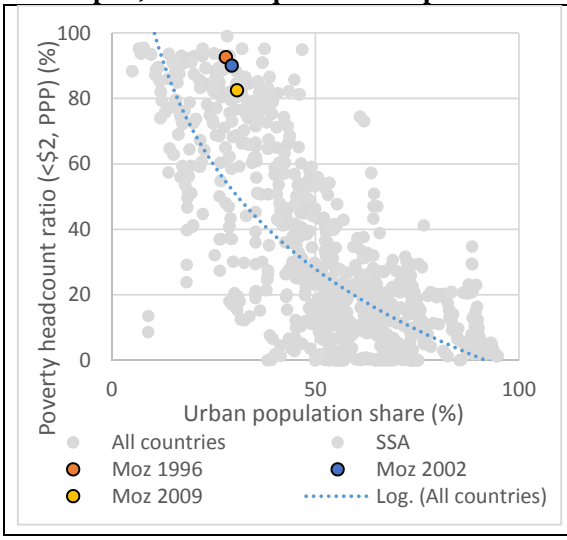
225. **Increasing resource revenues could generate the necessary fiscal space to expand cash transfers and accelerate poverty reduction.** Increasing pro-poor cash transfers by 1 percent of GDP could reduce the poverty rate by an estimated 4 percentage points, and an increase of 2 percent of GDP could reduce the poverty rate by an estimated 7 percentage points.[102] Cash transfers financed by resource revenues could offer a cost-effective strategy for reducing poverty in the short term while also promoting a more equitable distribution of Mozambique's resource wealth.

4.6. Urbanization

226. **Mozambique's urban population is rapidly expanding as large numbers of people move to cities in search of better jobs and services.** Between 1997 and 2007, the urban population grew from 4.6 to 6.2 million. The urban population is growing at an annual rate of 3 percent, significantly faster than the overall population growth rate of 2.5 percent. An estimated 30 percent of Mozambicans live in urban areas, slightly below the SSA average of 37 percent, though this share is expected to rise. Better living standards and access to key services are largely driving the urbanization process, rather than higher productivity in the urban economy. Relative to its level of urbanization Mozambique's per capita GDP is low and its poverty rate is high (Figure 90 and Figure 91).

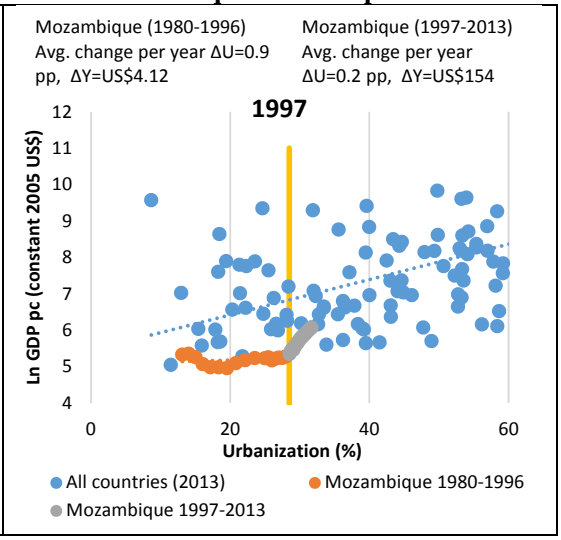
[102] World Bank, 2015e. These calculations are based on a simulation exercise that incorporates the likelihood of targeting errors.

Figure 90: Urbanization Rates and GDP per Capita, Mozambique and Comparators



Source: WDI

Figure 91: Urbanization Rates and Poverty, Mozambique and Comparators



Source: WDI

227. **Despite recent improvements, housing conditions and access to basic infrastructure and services is low in urban areas outside Maputo.** Approximately 80 percent of Mozambique's urban population lives in settlements with slum characteristics.[103] In 2011 fewer than half of urban households had access to electricity, though Maputo's electrification rate was 90 percent.[104] Similarly, while 97 percent of households in Maputo had finished floors, the same was true for fewer than half of urban households outside Maputo. Access to piped water was 95 percent in Maputo and 66 percent in other urban areas. Urban sanitation facilities remain underdeveloped nationwide: toilet coverage was 48 percent in Maputo and only 12 percent in other urban areas.

Table 19: Access to Basic Services and Housing Quality (% of households)

	Piped water		Toilet		Electricity		Finished floor	
	2003	**2011**	**2003**	**2011**	**2003**	**2011**	**2003**	**2011**
Maputo (city)	95.1	93.9	21.1	48	52.1	87.9	94.8	96.5
Other Urban	51.3	66.3	4.6	12.1	19.1	48.5	48.2	47.6
Total urban	*59.1*	*70.5*	*7.5*	*17.6*	*25*	*54.5*	*56.5*	*55.1*
Rural	*5*	*15.2*	*0.2*	*0.6*	*1.1*	*5.4*	*6.7*	*10.3*
Total	**20.9**	**31.8**	**2.3**	**5.7**	**8.1**	**20.2**	**21.3**	**23.8**

Source: Mozambique Demographic and Health Surveys, 2003 and 2011

228. **Maputo City exemplifies many of the challenges of urbanization.** With almost 2 million inhabitants in the metropolitan area, Maputo is Mozambique's largest city, and its economy produces about 30 percent of the country's GDP. However, Maputo faces high rates of unemployment and underemployment,[105] and three-quarters of its population lives in

[103] "Slum characteristics" include dense unregulated population growth, a lack of core infrastructure and services such as water, sanitation, solid waste removal, drainage, and electricity, and homes made of inferior materials.
[104] Ministry of Health et al., 2011.
[105] Fox, 2015. Estimates based on ICAF, 2012.

informal settlements.[106] Maputo also lacks the basic infrastructure and services necessary to manage a large and increasingly concentrated population. However, access to basic services in Maputo is still far better than in other cities and rural areas, which encourages people to move there in search of improved living standards.

229. **The rise of the extractive industries could further strain Mozambique's urban centers.** As described in Section 3.3.5, Dutch Disease can undermine domestic manufacturing and export competitiveness, while driving up prices for non-tradable services. This can contribute to the rise of "consumption cities" that are largely populated by workers in the non-tradable service sector.[107] This can put upward pressure on urban prices, increasing the cost of living and further slowing down the process of structural transformation. Access to land has already become a more significant constraint for firms in Maputo than in other cities, and rising resource revenues are likely to further increase real estate prices.

230. **Expanding wage employment will require greater private investment in labor-intensive sectors.** Given the inherently capital-intensive nature of the resource sector, the government should focus on facilitating the growth of labor-intensive industries such as fishing, light manufacturing and agro-processing by investing in industrial and commercial infrastructure. The growth of the urban manufacturing and commercial sectors, especially in cities outside of Maputo, will be important to employ a rising number of educated young workers.

231. **Investing in urban development and strengthening rural-urban linkages can help promote a more inclusive growth model.** Urbanization is often associated with structural economic transformations, in which the focus of production shifts from agriculture to manufacturing and services. However, the growth of cities is also central to improving agricultural output. Small cities connect farmers to input and output markets. Medium-sized cities serve as logistical and transport hubs and host larger consumer markets with a more diverse demand profile. Finally, large cities link the rural economy to international markets and offer sophisticated value-adding processes and services. However, in much of Mozambique travel time to the nearest urban center is more than 10 hours, and improving connectivity between rural and urban areas could magnify the positive spillover effects of urban development on the rural economy.

232. **Effective management of the urbanization process will enable policymakers to leverage its impact on economic growth, poverty reduction, and access to jobs, housing and services.** Mozambique must develop a comprehensive national urban development policy and ensure that municipal institutions have the capacity to implement it. Municipalities will face five key challenges during the urbanization process: (i) increasing urban productivity, (ii) expanding infrastructure in line with urban population growth, (iii) addressing the specific needs of areas with slum characteristics and taking steps to manage their future growth, (iv)

[106] Cities Alliance, Mozambique Country Program.
[107] Jedwab et al., 2013.

managing the concentration of assets in high-risk areas, and (v) implementing institutional accountability and financial management reforms.

4.7. Fostering Inclusive Growth: Challenges and Opportunities

233. **Mozambique's current growth model has failed to effectively address the country's high levels of underemployment and uneven access to public services.** While Mozambique's economy has grown rapidly since the end of the civil war, and public service delivery has expanded dramatically in recent years, the country's employment, education, health, water and sanitation, social protection and urban development indicators remain far below the standards of comparable countries. In addition, access to critical infrastructure and services varies dramatically by location, gender, age and income, underscoring the complex challenge posed by multidimensional poverty. Table 20 presents a summary of the constraints to inclusive growth in Mozambique and how they relate to the World Bank's twin goals of eliminating extreme poverty and boosting shared prosperity.

Table 20: Inclusive Growth and the Twin Goals: Issues, Challenges and Recommendations

Issues	Challenges	Recommendations
Increase access to finance and reduce barriers to the growth of household enterprises and formal sector employment		
Limited livelihood diversification in the rural sector reduces income opportunities	• Constraints on the diversification of livelihoods away from farm-based activities limit opportunities to increase household consumption	• Reduce borrowing costs, support the development of a rural banking network, foster financial linkages between rural and urban areas, and promote lending to MSMEs
Address constraints to urbanization		
Municipalities are struggling to keep pace with rapid urbanization	• Rural-urban migration is increasing, but many cities are characterized by low productivity, poor infrastructure, and inadequate social services, which limit the growth impact of urbanization	• Promote investment in urban infrastructure, support the development of the non-resource tradable sector, and strengthen the institutional and financial capital of municipalities and district centers.
Limited connectivity between urban and rural areas reduces positive spillovers from urban development	• Mozambique is sparsely populated, and poorer households are especially isolated; limited access to markets and public services constrains rural development	• Upgrade transportation infrastructure, especially links between rural and urban areas • to increase access to markets and logistics hubs
Improve the quality of public education		
Education access is expanding, but the quality of education is relatively poor	• The school system is unable to cope with the rapid influx of new students, and as a result primary completion rates are declining, secondary completion rates are low, and quality indicators are deteriorating	• Address the decline in primary completion rates and low levels of secondary completion • Continue to focus on improving education outcomes among female students • Improve school governance

Strengthen public health institutions and improve WASH services		
Progress in the health sector has been mixed, and health indicators remain low by regional standards	• Infant and child mortality rates are declining, but high levels of malnutrition and HIV persist • Income, location and gender play a major role in healthcare access • Mozambique has the lowest number of health workers per capita in SSA	• Build the logistical and support systems necessary to provide a package of core health services • Improve the allocative efficiency of spending to address the low numbers of health workers • Address high rates of stunting through a coordinated program of nutritional support and diarrheal disease prevention in collaboration with the WASH sector
Access to WASH services is limited and inequitably distributed	• Inadequate access to WASH services contributes to poor health outcomes and lost labor productivity • Disparities in WASH access perpetuate poverty through the high opportunity cost of obtaining care and the long-term impacts of stunting and diminished cognitive function	• Significantly increase public investment in WASH infrastructure • Implement a competitive fund-allocation mechanism at the subnational level • Develop an appropriate institutional and regulatory framework for urban sanitation similar to the framework for urban water utilities
Expand the coverage of social assistance programs		
Social assistance programs have very low coverage rates	• A large majority of the poorest households do not receive any type of social assistance • Due to the unbalanced targeting and distribution of programs the poorest provinces receive the lowest social transfers • Social protection programs do not include a specific human development component	• Improve the design and targeting of social protection programs to reduce regional variations in transfers • Use the fiscal space generated by resource revenues to significantly scale-up cash transfers • Introduce a conditional cash transfer program designed to increase school attendance and completion rates

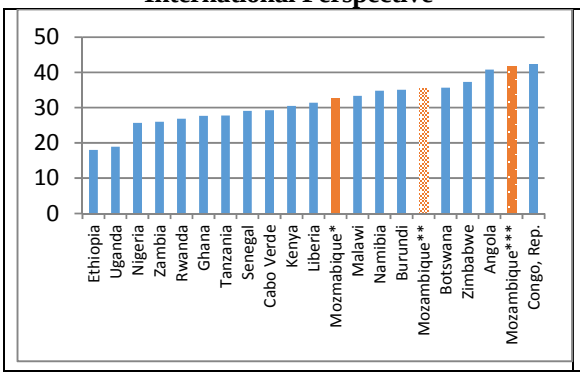
5. Risks to the Sustainability of Growth and Poverty Reduction

- **Public spending is increasing rapidly.** Public spending grew at an average rate of 12 percent per year in real terms from 2000 to 2013, and the trajectory of expenditures has raised concerns regarding long-term fiscal sustainability.
- **Public investment is on the rise, but fiscal risks are intensifying.** The anticipated influx of resource revenues has expanded the government's access to more complex mechanisms for financing investment projects, which has increased the government's exposure to contingent liabilities.
- **The government's overall institutional framework remains relatively weak.** The authorities have made significant progress in legal and public policy reform, but major implementation gaps pose a serious risk to the responsible management of resource revenues.
- **Ongoing political and social instability exacerbates fiscal risks and heightens policy uncertainty.** While a return to large-scale conflict is unlikely, ongoing tensions between the two major political parties could distract the government's attention from critical policy issues and divert its limited institutional resources away from the structural reform agenda.
- **Over the past decade partisan political dynamics have slowed and in some cases reversed the decentralization process.** Instead, the government has opted to pursue a policy of fiscal deconcentration, marginally increasing its transfers to provincial, district and municipal governments while retaining administrative control.
- **Climate change and extreme weather events impose high and growing economic costs.** Mozambique experiences recurrent floods, cyclones and droughts, which reduce agricultural output and contribute to food insecurity, increase transportation costs and limit market access, damage private property and public infrastructure, and directly endanger human lives. Inadequate water resource management and unsustainable practices such as overfishing, deforestation and wildlife poaching compound these risks.

5.1. Fiscal and Macroeconomic Sustainability

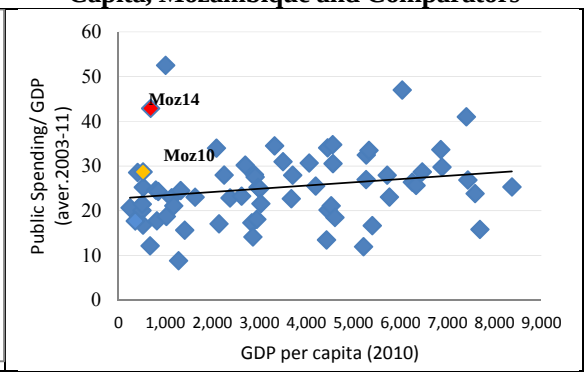
234. **Public spending in Mozambique has increased substantially over the past few years, but the limited absorptive capacity of the country's small domestic private sector has raised concerns regarding the macroeconomic impact of fiscal expenditures.** Real spending grew at an average rate of 12 percent per year from 2000 to 2013, somewhat lower than the pace of revenue growth. The approved 2014 budget increased public spending to 42 percent of GDP, a very large share by international standards, especially relative to per capita GDP (Figure 92 and Figure 93). This has raised concerns regarding the potential macroeconomic impact of Mozambique's expenditure trajectory, as rapid increases in government spending can increase domestic demand, which may cause overheating in an economy with a limited supply response capacity.

Figure 92: Public Spending in Mozambique in International Perspective



Source: IMF
Note: Mozambique* = 2012, Mozambique** = 2013, Mozambique*** = 2014

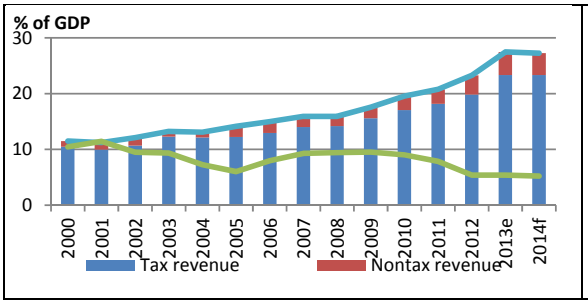
Figure 93: Public Spending and GDP per Capita, Mozambique and Comparators



Source: WDI and Government of Mozambique

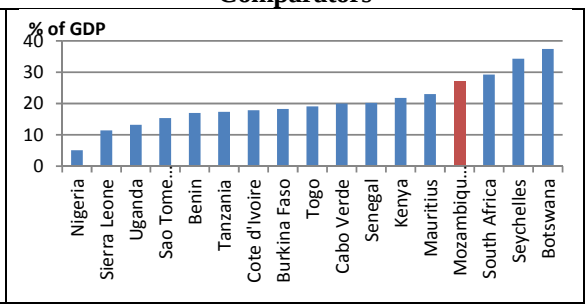
235. **The rapid increase in spending has been matched by a similar increase in revenue collection, but this may be difficult to maintain over the medium term.** Domestic revenue growth averaged 13 percent per year from 2000 to 2013 in real terms, and revenues increased from 11 percent of GDP to 27.5 percent (Figure 94 and Figure 95). Revenues from natural resources and megaprojects have increased, and by 2013 they accounted for almost 5 percent of total government revenues. Meanwhile, grants from development partners are declining as a share of GDP, tempering the expansion of the fiscal envelope. Since 2000 the overall budget balance before grants averaged 12 percent of GDP, but this masks large year-on-year fluctuations, with deficits varying from close to 5 percent of GDP in 2005 to almost 15 percent in 2009 (Figure 96).

Figure 94: Composition of Domestic Revenues, 2000-2014



Source: IMF databases

Figure 95: Tax Revenues, Mozambique and Comparators



Note: Mozambique* = 2013
Source: World Development Indicators, 2012

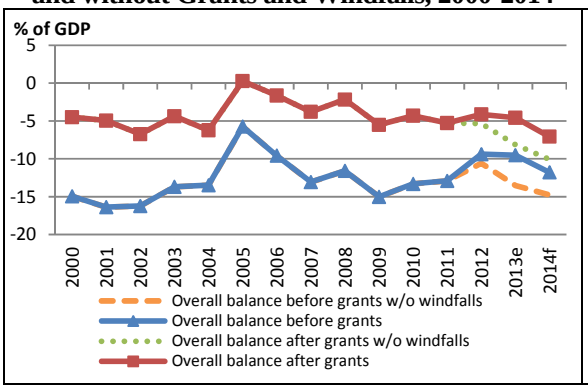
236. **Tax reforms and improved tax administration have boosted revenue collection, but structural factors continue to constrain Mozambique's revenue potential.** The economy's large informal sector and small formal workforce narrow the tax base. Potential measures to increase domestic revenue mobilization include reforming the country's generous system of fiscal incentives and abolishing special regimes for corporate and personal income tax, especially since a special regime for MSMEs is already in place.

237. **VAT reforms should strive to ensure that the tax is being administered efficiently and that it serves as a pure tax on consumption.** A large number of non-export, zero-rated

items narrows the base for VAT collection, and its impact on the poor is unclear. The system for VAT refunds should also be rationalized, as delays impose a hidden cost on firms, discouraging investment and incentivizing informality.[108] While projected net (i.e. post-refund) VAT revenues for 2015 and VAT arrears from previous years have been securitized, challenges in implementing the VAT on a net basis have led to the accumulation of new arrears. To address this issue the authorities plan to create a subaccount of the Treasury Single Account specifically dedicated to the payment of VAT refunds.[109]

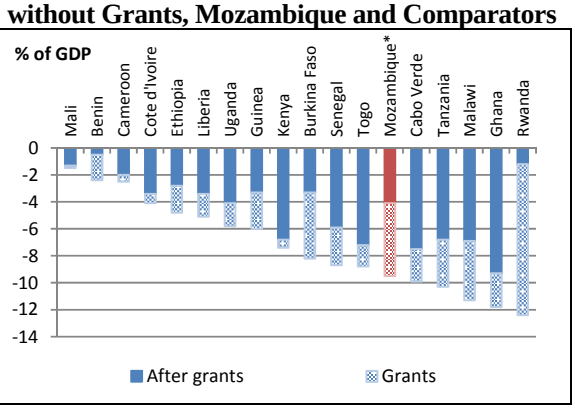
238. **The recent deterioration of the budget balance was mitigated by significant capital gains tax windfalls**. As these are one-off revenues, the balance may continue to worsen in the near term unless the government can successfully reduce spending and consolidate its fiscal stance. Grants also play an important role in financing the deficit (Figure 96 and Figure 97). The deficit before grants widened to 15 percent of GDP in 2014, a large share compared to other countries in the region.

Figure 96: The Overall Budget Balance, with and without Grants and Windfalls, 2000-2014



Source: World Bank staff estimates based on IMF and IDA, 2014

Figure 97: The Overall Deficit, with and without Grants, Mozambique and Comparators



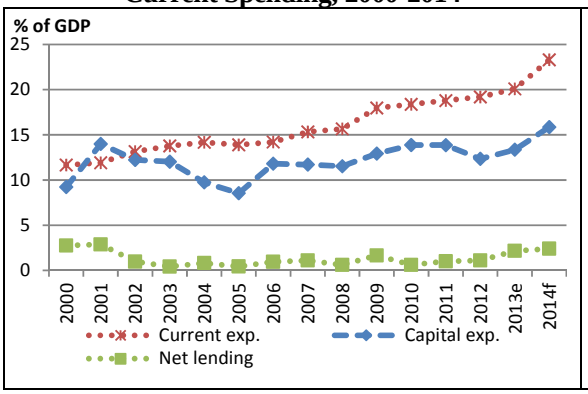
Source: IMF
Note: Mozambique* = 2013

239. **Rising current and capital expenditures may pose a long-term risk to fiscal sustainability.** Public spending grew rapidly between 2000 and 2012, with current expenditures modestly outpacing capital expenditures (Figure 98). Net lending, which reflects on-lending by the government to public entities (primarily to finance infrastructure investments), has increased in recent years. Personnel costs represent the largest share of current expenditures, followed by goods and services (Figure 99). Capital expenditures, which have historically been financed by donors, are increasingly funded through domestic resources and commercial borrowing. However, this may not be sustainable over the long term, and the government will likely need to tighten its fiscal policies in order to preserve fiscal stability. Fiscal consolidation will require both reprioritization and increased expenditure efficiency. Due to budgetary rigidities, future spending priorities may tend to focus on the wage bill at the expense of public investment, which has grown very rapidly over the past few years. However,

[108] World Bank, 2014a.
[109] IMF, 2016

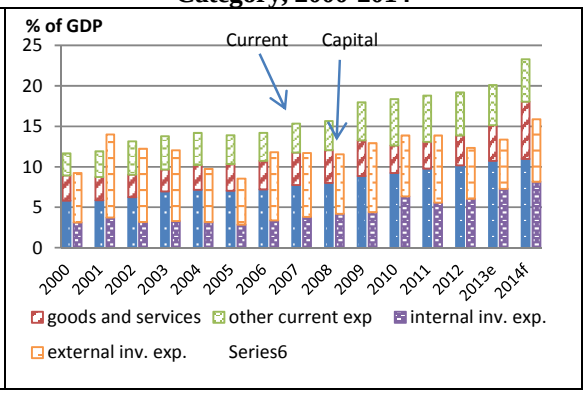
a prospective increase in the ratio of current to capital spending could diminish the overall returns to public expenditures.

Figure 98: The Evolution of Capital and Current Spending, 2000-2014



Source: IMF database

Figure 99: Capital and Current Spending by Category, 2000-2014

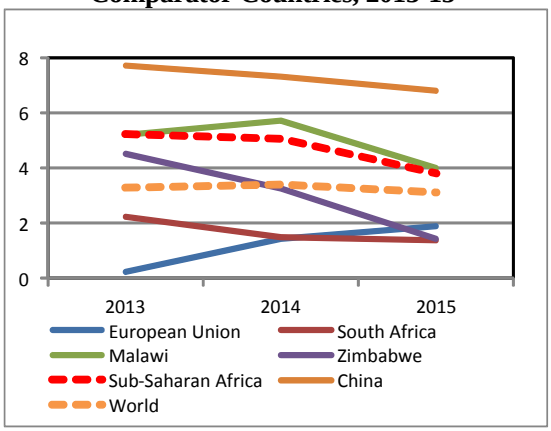


Source: IMF database

240. **A large fiscal deficit and rising inflation rates have undermined macro-fiscal stability.** The fiscal deficit reached 10.6 percent of GDP in 2014. Despite a modest fiscal adjustment in 2015, inappropriate monetary and exchange-rate policies pursued during the first half of the year resulted in a significant depreciation of the metical, lower net international reserves and a return to double-digit inflation (11.1 percent) by year's end. The central bank significantly tightened its monetary policy stance in the last quarter of 2015, complementing the tighter fiscal policies reflected in the 2016 budget. As a result, the metical appreciated in the final months of the year following a record low in October. In an effort to make good on its commitment to sustainable macroeconomic policy, the government requested a standby credit facility from the IMF, which was approved in December 2015.

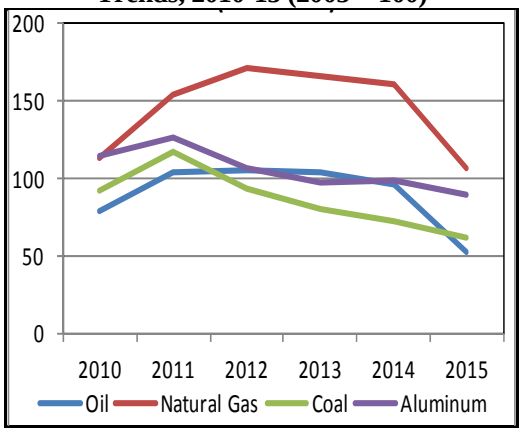
241. **The decline in global commodity prices has adversely impacted the economy by weakening the balance of payments and intensifying exchange-rate pressures.** Aluminum, coal, refined petroleum and natural gas dominate Mozambican exports, and the country's especially heavy dependence on coal mining has left it highly exposed to low coal prices—a trend which is expected to continue over the next several quarters. Lower overall commodity prices and the weakening of the external and fiscal accounts have also discouraged foreign investment in megaprojects.

Figure 100: GDP Growth Rates in Selected Comparator Countries, 2013-15



Source: World Bank and IMF

Figure 101: Selected Commodity Price Trends, 2010-15 (2005 = 100)



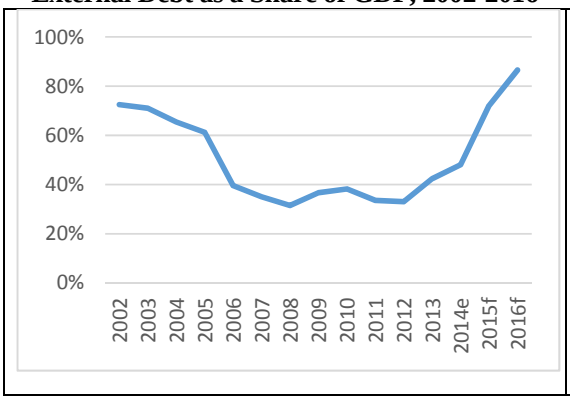
Source: World Bank and IMF

242. **Despite a return to appropriate macroeconomic policies in late 2015, the negative effects of the delay in fiscal and monetary tightening will persist over the medium term.** The combination of commodity-price shocks, a large fiscal deficit in 2014 and an inadequate policy response in early 2015 undermined the sustainability of the macroeconomic framework and slightly slowed economic growth from a previously projected 7 percent to an estimated 6.3 percent. In addition, maintaining macroeconomic sustainability will require even tighter fiscal and monetary policies in 2016, with negative implications for growth.

243. **Public and publicly guaranteed debt levels are rapidly increasing.** The public and publicly guaranteed external debt burden rose from 34 percent of GDP in 2012 to an estimated 87 percent in 2016 (Figure 102). This steep rise follows the recent disclosure of publicly guaranteed debt over the period 2009-2014 for previously unknown companies in which the government has a majority shareholding (see box 7). The overall fiscal balance has been declining (Figure 103). Notably, in 2014 the overall fiscal balance fell due to increased spending on the wage bill and public investment.[110] The rising share of loans relative to grants is striking (Figure 104), especially as these loans are increasingly non-concessional in nature (Figure 105), contributing to a substantial increase in overall public liabilities.

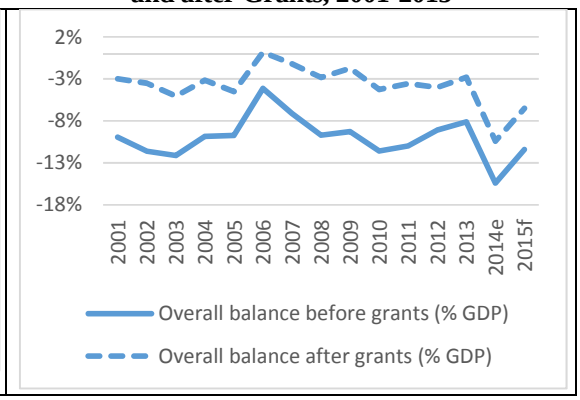
[110] This trend was accentuated by the expenditure demands of the election cycle and the impact of windfall revenues from one-off capital gains taxes related to the consolidation of gas ownership structures in the Rovuma Basin in the previous year.

Figure 102: Public and Publicly Guaranteed External Debt as a Share of GDP, 2002-2016



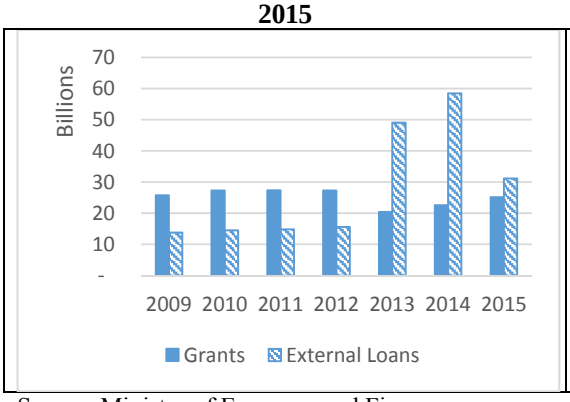
Source: IMF

Figure 103: The Overall Fiscal Balance before and after Grants, 2001-2015



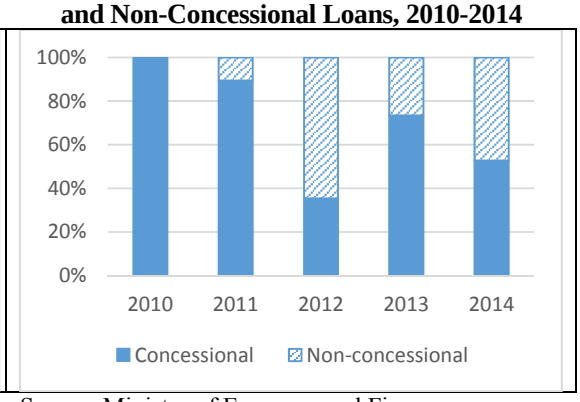
Source: IMF

Figure 104: Loans and Grants in MZN, 2009-2015



Source: Ministry of Economy and Finance

Figure 105: Relative Shares of Concessional and Non-Concessional Loans, 2010-2014



Source: Ministry of Economy and Finance

244. **The recent disclosure of publicly guaranteed loans increases Mozambique's level of debt distress to high risk.** The joint WB-IMF Debt Sustainability Analysis for Mozambique (April 2014) increased the country's debt distress risk rating from low to moderate. The most recent DSA conducted in November 2015 maintained the moderate risk of debt distress assessment, with the indicators being close to the thresholds for high risk. Much of the reported borrowing was used to finance a large increase in infrastructure investment related to developments in the liquefied natural gas industry, including increasing security provisions. The next joint DSA will reflect Mozambique's debt sustainability status after incorporating the recently disclosed debt. Since Mozambique was already a borderline case under the most recent DSA, the forthcoming DSA will downgrade the assessment to high risk.

245. **The mechanisms Mozambique uses to finance its public investment program are exposing the country to heightened fiscal risks.** First, the rising debt burden is financing a growing share of public investments, adding to the government's direct liabilities. Second, public corporations are increasingly engaged in public investment,[111] elevating the risk of

[111] Under this scenario US$1 is projected to have the following values in MZN: 2015 (45.0), 2016 (45.9), 2017 (46.9), 2018 (47.8), 2019 (48.8) and 2020 (49.8)
[111] This scenario's exchange-rate projections are in line with those of the previous DSA, and US$1 is projected to have the following values in MZN: 2015 (33.4), 2016 (34.2), 2017 (34.9), 2018 (35.7), 2019 (36.4) and 2020 (37.2)
rivate companies, which are not fully disclosed.

contingent liabilities. Third, PPP arrangements involving public corporations are also becoming more prevalent and in some cases may implicitly oblige the government to intervene to maintain the financial viability of the PPP even if no explicit guarantee is included in the arrangement.

246. **The government's recent establishment of a major tuna fishing operation backed by a state guarantee presents a substantial fiscal risk.** In 2013, the Mozambican Tuna Company (*Empresa Moçambicana de Atum*, EMATUM) was founded as a private entity, with the government serving as majority shareholder.[112] EMATUM was capitalized by international creditors through an US$850 million bond issue backed by a government guarantee.[113] US$350 million was dedicated to tuna fishing activities and US$500 million to maritime security. The value of the EMATUM guarantee far exceeded the ceiling specified in the 2013 budget law. In 2014 government-issued guarantees amounted to US$392.6 million,[114] significantly higher than in previous years, with the bulk of the guarantees assigned to EMATUM. EMATUM's financial and commercial viability are in doubt, and in 2014 EMATUM recorded losses of US$25.3 million. The government has already moved the US$500 million maritime security element of the initial bond onto the public accounts, and it is increasingly likely that it will be forced to assume the entire debt.

247. **The EMATUM bond issue and its implications for public finances were key factors contributing to the recent downgrading of Mozambique's sovereign credit rating.** In order to attract foreign investors, the EMATUM bond was primarily denominated in foreign currency.[115] The first repayment tranche contributed to a decline in US dollar reserves, increasing the financial strain on the economy. The government has since negotiated a debt swap with investors, exchanging the 2020 amortizing bonds that pay an interest of 6.3 percent for new bullet notes that mature in 2023 and have a coupon of 10.5 percent.[116] Mozambique's sovereign credit rating was further downgraded by the ratings agencies in response to the distressed debt exchange.

248. **In addition to EMATUM, details have recently emerged of a previously undisclosed sum of US$1.3 billion in non-concessional debt contracted between 2009 and 2014.** The bulk of the debt includes two guarantees for loans contracted by commercial companies formed with state equity participation, amounting to US$1.16 billion. In addition, US$133 million was contracted in direct loans from bilateral lenders between 2009 and 2014. The debt was raised to provide maritime security services and port logistics for the LNG gas projects for which the final investment decisions have not been made. Therefore, the expected benefits in the short term are low and potential revenue generating capabilities would depend on whether service contracts with LNG investors have been secured and the value of the contracts. Meanwhile, the

[112] The Mozambican government's Institute for the Management of State Holdings (*Instituto de Gestão das Participações do Estado*) owns 34 percent of EMATUM's shares, the Mozambican Fishing Company (*Empresa Moçambicana de Pesca*) owns 33 percent and the final 33 percent is owned by the Management of Investments, Holdings and Services company (*Gestão de Investimentos, Participações e Serviços*), which is majority owned by the government's social services agency.
[113] Credit Suisse raised US$500 million, while a Russian bank, VTB, raised a further US$350 million.
[114] US$392,640,127.39 is equivalent to MZN 12,328,900,000 based on the 2014 exchange rate: US$1 = MZN 31.4.
[115] The loan is comprised of US$516 million, €291 million and MZN 1.1 billion.
[116] Under the original terms EMATUM was financed by a seven-year bond with a guaranteed yield of 8.5 percent and a two-year grace period. The bond's amortizing structure gives it a weighted average life of 4.5 years.

impacts on the economy are already being felt. Mozambique has foregone additional IDA financing, the IMF has suspended its programs, and donors are withholding budget support. Given the worsening debt situation the growth outlook is expected to deteriorate further in the medium term, reflecting the need for further fiscal and monetary tightening, low commodity prices, effects of the ongoing drought on agricultural production and slowing FDI levels. (See box 7 for a fuller discussion of the loans and the impact on the economy.)

Box 7: Disclosure of Non-Concessional Loans

The disclosure of US$1.3 billion in non-concessional debt, equivalent to an estimated 10 percent of GDP initially surfaced through the international press in April 2016. Subsequently, the details of the debt were disclosed to the IMF and the World Bank, and later to Parliament.

- A loan of US$622 million was provided for Proindicus through Credit Suisse to finance the purchase of military grade patrol boats to secure gas industry installations and infrastructure.
- A loan of US$535 million was contracted for Mozambique Asset Management (MAM) through VTB to provide port and logistics services in Pemba, a large town in northern Mozambique that houses the Rovuma basin gas fields.
- A set of four loans were contracted from bilateral lenders totaling US$133 million by the Ministry of Interior. The source of these has not been disclosed.

Both Proindicus and MAM were newly established as private, commercial companies without any track record of operations prior to contracting the debt. The state is the majority shareholder and the loans benefited from a state guarantee. Following the disclosure, the rationale proposed is that domestic companies could secure some of the business opportunities that accompany the expected gas boom and generate returns that may benefit the state through its equity shareholding. The reasoning behind the lack of disclosure is that the debts are related to national security concerned, which may have obscured normal reporting. Further, the authorities claimed lack of knowledge of the loans which were contracted under the previous administration.[1]

The disclosure of the debt has negatively impacted the economy. A material deterioration of the macroeconomic framework is expected. The financing sources from the suspended IMF and World Bank programs, as well as budget support amount to an estimated 1.5 percent of GDP. The previously undisclosed debt adds a further 2-3 percent of GDP in debt service. Taken together, budget support cuts and higher debt service are estimated to contribute 4.5 percent of GDP to the fiscal and balance of payments financing gaps. Non-budget support aid disbursements may be affected as well. A large fiscal and external financing gap is likely to persist over the medium term, while the effects of currency depreciation and inflation are increasingly evident. Further details around the context and impact of the non-concessional loans will be elaborated in the Country Partnership Framework.

Source: World Bank staff

249. **The EMATUM situation and the disclosure of non-concessional loans also raises concerns regarding the quality of Mozambique's public financial management institutions.** Raising loans through commercial means can be an attractive option for increasing investment capital, as governments can access large amounts of financing quickly and without increasing the tax burden. However, for a loan to be undertaken on non-concessional terms the project incurring the debt must be financially viable and have the

capacity to generate adequate returns. A project's financial viability and prospective returns can be assessed through appraisals and feasibility studies, neither of which were used to evaluate EMATUM. The project was not included in the government's investment portfolio, and procurement was completed without tender. Similar scenarios are also unfolding with the Proindicus and MAM loans, where any types of financial returns are dependent on fruitful negotiations with LNG investors and for the final investment decisions to be agreed upon soon.

250. **Following the EMATUM situation, efforts have begun to improve fiscal transparency.** Mozambique was the first country in Africa to make its public finances available for an IMF fiscal transparency evaluation, which is publicly accessible. The authorities are also taking steps to improve reporting on fiscal operations, for example by reporting on the operations of public enterprises and the issuance of new guarantees in the audited state accounts. In November 2015 the country also published its first fiscal risk statement. While the document does not fully disclose public liabilities, it represents a positive step toward improving transparency.

251. **However, the recently disclosed loans highlight the need to further strengthen the public financial management system, particularly fiscal risk management.** Several shortcomings in the current system have been identified. Firstly, the government does not maintain or publish a comprehensive list of all companies in which the state has direct or indirect shareholdings as well as subsidiaries, rendering it impossible to monitor exposure to fiscal risks. Secondly, private companies are governed by the commercial code which has very limited provisions for state oversight, even for companies such as Proindicus and Mam which are effectively government owned and controlled. Thirdly, mechanisms for approving guarantees for loans contracted by private companies is highly discretionary, lacking sufficient controls. And finally, existing institutions mandated to monitor public enterprises and private companies with state shareholdings have limited capacity, where there are generally weak provisions for monitoring performance. Based on requests from the authorities the Bank has recently been supporting the strengthening of fiscal risk management, which will continue to be an ongoing and prioritized area of focus.

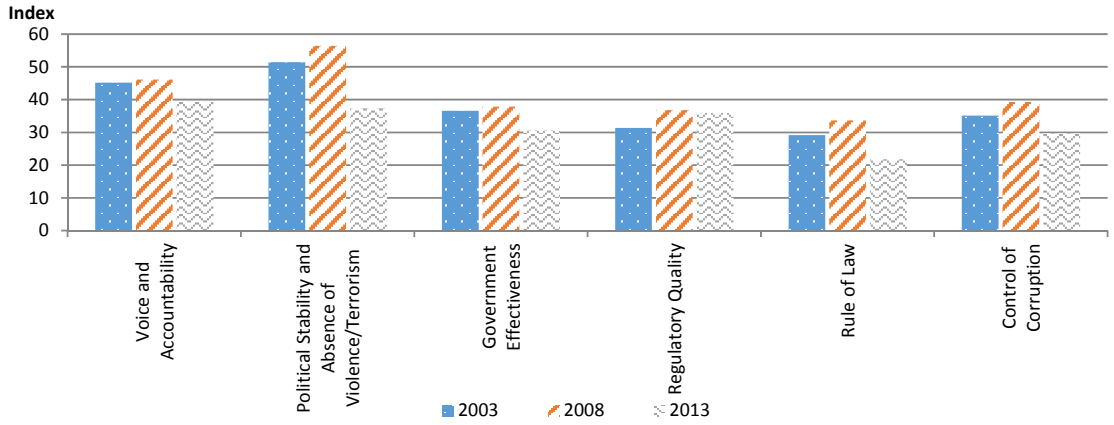
252. **The expected influx of natural resource revenues toward the end of the decade will likely strain the government's macro-fiscal management capacity.** Effectively utilizing resource wealth poses a number of complex challenges: rising public revenues can outstrip the absorptive capacity of government agencies, commodity price volatility can pass through to the budget, excessive public expenditure growth can undermine short-term macroeconomic stability, and Dutch Disease effects can erode competitiveness and promote unsustainable growth patterns. Addressing these challenges will require adopting an appropriate fiscal framework underpinned by mechanisms to reinforce macroeconomic stability, maintain adequate levels of spending and savings, and insulate the budget from price and production shocks.

5.2. Weak Public Institutions and the Challenge of Natural Resource Management

253. **Mozambique has strengthened its public administrative framework over the past decade, but sustainably managing the country's natural resources continues to pose a serious challenge to its institutional capacity.** The government has developed a public sector reform strategy that focuses on key areas such as public financial management (PFM) and human resource management. In 2013, it passed a set of major legislative reforms, including anticorruption laws, whistleblower protections, mandatory asset declarations for public officials and expanded public access to government information.

254. **However, significant gaps remain in implementing legislation, as illustrated by the country's declining scores on the World Bank's Worldwide Governance Indicators.** Over the 2003-2013 period, Mozambique's governance scores fell across all indicators except regulatory quality, and the country's overall score recently dropped below the SADC average. "Voice and accountability" decreased by 5.85 points, "government effectiveness" by 5.97 points, "rule of law" by 7.39 points and "control of corruption" by 5.45 points. "Political stability" and "absence of violence/terrorism" experienced the largest decline at 14 points (Figure 106). Mozambique ranked 86th out of 133 countries on Transparency International's 2003 Corruption Perceptions Index, but by 2008, it had dropped to 126th out of 180 countries. In 2014, Mozambique moved up seven places to 119th out of 174 countries, but its score of 31 out of 100 is well below the global average of 43.

Figure 106: Mozambique's Worldwide Governance Indicator Scores, 2003-13



Source: Worldwide Governance Indicators

255. **Stronger governance will be necessary for Mozambique to avoid the resource curse.** Experience from other countries shows that strong public institutions and participatory decision-making systems are critical to effectively manage resource revenues and minimize adverse macroeconomic effects. However, resource revenues can undermine public accountability by providing an independent source of domestic financing that is not linked to taxation. In some cases this has encouraged the rise of authoritarianism, corruption, poor public

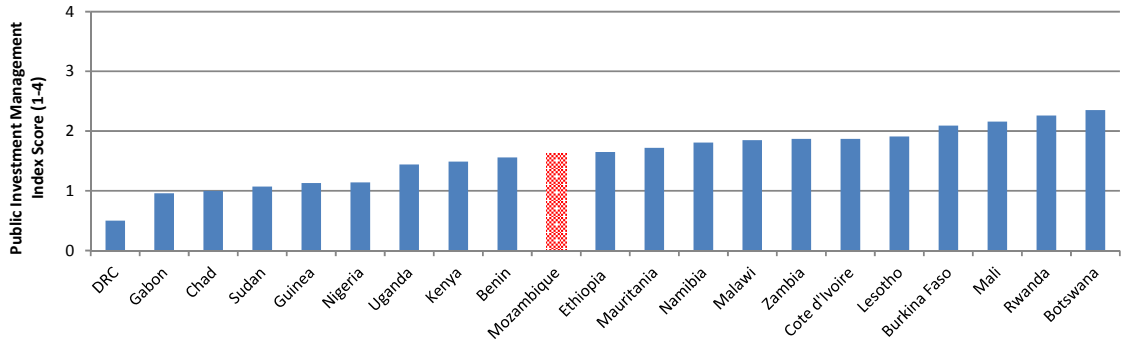
service delivery and other characteristics associated with the political culture of a "rentier state."[117]

256. **Enhancing the institutional framework for resource-revenue management will require significant PFM reforms.** Well-designed PFM systems are critical to: (i) ensure transparency in the extractive industries; (ii) promote sound budget processes and expenditure accountability; and (iii) strengthen financial management procedures to address the unique characteristics of resource revenues. Mozambique's substantial progress in PFM reform is evident from its relatively high scores on World Bank Public Expenditure and Financial Accountability assessments, though there are significant gaps between policy design and implementation.[118] Certain aspects of PFM are especially critical to effectively managing resource revenues, including the presentation of resource revenues in budget documentation, medium-term forecasting capabilities and comprehensive fiscal reporting.

257. **Mozambique has made progress in improving the resource sector's governing legislation.** In 2014, the government passed new laws on petroleum products, petroleum taxes, mining regulations and mining taxes. Mozambique has also become a member of the EITI and has published five EITI reports covering the period from 2008 to 2012. The government has also committed to publishing all pre-2011 contracts and reporting on project payments.

258. **To ensure that resource revenues are effectively transformed into physical capital, Mozambique will need to strengthen its public investment management system.** At present, the quality of Mozambique's public investment management processes is slightly below the regional average (Figure 107). Enhancing public investment management will involve strengthening systems for formal project appraisal, evaluating and prioritizing public investment projects and conducting ex-post project evaluations. Improving these functions is becoming more and more urgent as Mozambique allocates an increasingly large share of its income to public investment. Over the medium term, addressing broader institutional issues such as limited competition for public contracts and inadequate contract management mechanisms will further improve the quality of public works.

Figure 107: Quality of Public Investment Management Systems, Mozambique and Comparators



Source: WDI and Dabla-Norris, et.al, 2011 and World Bank staff estimates

[117] Moore, 2004.
[118] Andrews, 2013.

5.3. Political Stability

259. **Mozambique's transition to a fully functioning multiparty democracy is incomplete, and many key political institutions are "weak, embryonic or absent."**[119] The parliament is not an effective forum for democratic representation, legislative debate or executive oversight, and its capacity for resolving policy conflicts is limited. Some provisions of the General Peace Agreement between Frelimo and Renamo were never implemented, including a commitment to the equal representation of Renamo soldiers in the armed forces. Renamo has also refused to fully disarm or renounce political violence. Mozambique ranked 107th out of 167 countries in the Economist Intelligence Unit's 2014 Democracy Index, down from 96th in 2006. Its weakest score was in "functioning of government."

260. **Frelimo has won every election since the 1992 peace agreement, and it dominates the country's politics, institutions and economy.** Political patronage is common, and access to jobs and contracts frequently depends on party allegiance. This is true in both the public and private sectors, due to increasingly dense linkages between the party and major business interests. Despite the 2012 passage of a Law on Public Probity, which limits direct business involvement of members of the government, the families of senior Frelimo figures continue to control much of the economy.

261. **The country has held five relatively peaceful general elections since the end of the civil war, but both the opposition and international observers have cited serious shortcomings.** Renamo has rejected the results of all elections since 1992, and it was joined by the smaller Mozambique Democratic Movement (*Movimento Democrático de Moçambique*, MDM) in rejecting the results of the 2014 election. The final report of the European Union's Election Observation Mission determined that the official results were compatible with independent projections, but the report noted that these results were influenced by "the advantage of the ruling party over its adversaries through the use of material and human resources of the state" as well as serious issues with the tabulation process, including "attempts to manipulate and fabricate results and restrictions to the movements and access to information of observers and political parties' representatives." The report also cited problems with the implementation of a new complaints and appeals process, in which most cases, including those brought by the opposition, were rejected on procedural grounds.

262. **Though it poses a serious obstacle to the further development of democratic institutions, Frelimo's dominance has been a stabilizing force in Mozambican politics.** The party has long been a broad and flexible coalition, able to resolve internal tensions and adapt to new political currents in order to maintain its relevance and grip on power. The party has had no single consistent ideology since its abandonment of Marxism in 1990, following the collapse of the Soviet Union. Former president Armando Guebuza's allies and opponents retain considerable influence within the party and government, and there is still a risk that divisions between them could cause a split in the political leadership. However, current president Filipe Nyusi's consolidation of power, especially since his assumption of the party

[119] Astill-Brown and Weimer, 2010.

leadership from Guebuza in March 2015, may indicate that the influence of modernizing forces is rising.

263. **Frelimo's continued dominance appears assured in the absence of a credible political alternative.** Renamo may engage in further protests or other forms of opposition, but it is unlikely to win a national election or govern effectively. It lacks a coherent policy platform beyond its opposition to Frelimo and demands for greater political power and increased autonomy for the central and northern provinces that are the base of its support. The MDM, which broke off from Renamo in 2009, garnered just 6.4 percent of the vote in 2014, down from 8.6 percent in 2009.

264. **While elements of the media and civil society are able to openly voice policy concerns, they lack the political strength to hold public officials to account**. Civil society organizations have grown stronger and more effective at policy advocacy and government oversight, yet they remain small and largely dependent on foreign donors, particularly European bilateral agencies whose civil society funding has been shrinking. While vocal, these organizations generally do not have the capacity for mass mobilization or a credible claim on public representation. The press is relatively free and often critical of the authorities, but the government retains direct control and ownership over major media outlets, including the national radio and television stations and two national newspapers. The government recently dropped a controversial case against a prominent economist and the editor of an independent newspaper, who had been accused of libel for criticizing former president Guebuza, possibly signaling a renewed commitment to freedom of expression under the Nyusi administration.

265. **Religious organizations are a major contributor to peaceful conflict resolution, particularly in rural areas.** The General Peace Agreement was mediated in Rome by the Community of Saint'Egidio, a lay Catholic organization. Churches have long played a local peacebuilding role, especially in the reintegration of ex-combatants and the resettlement of displaced persons, as well as by providing a channel for community education, assistance and development in areas where the state may be largely absent.

5.4. Social Sustainability

266. **In recent years Mozambique has experienced significant and occasionally violent social unrest.** From April 2013 to July 2014, armed conflict flared, mostly in Sofala province, between Renamo forces and the Frelimo-dominated government. In 2008, 2010 and 2012 price hikes for transportation and staple foods triggered urban protests. The compulsory resettlement of residents in mining areas of Tete Province and around biofuel projects in the Nacala corridor has also resulted in violence.

267. **The country remains susceptible to further political and social conflict, though a return to full-scale civil war seems highly unlikely**. While the risk of military clashes will persist as long as Renamo remains armed, the more immediate risk is that ongoing tensions will continue to distract the government's limited institutional resources away from key policy issues. Meanwhile, localized violence, protests and other forms of instability could disrupt

production, deter foreign investment and slow infrastructure projects, in addition to destroying property and lives.

268. **A number of related causes have undermined social cohesion and led to a widespread sense of economic and political exclusion.** Recent economic growth largely driven by FDI-financed megaprojects has created few employment opportunities for Mozambicans. An impoverished and underdeveloped agricultural sector is spurring rapid rural-urban migration and contributing to the growth of informal settlements around major cities. Poverty levels are persistently high, formal employment rates are low, and the 300,000 young adults with limited skills entering the labor market each year outstrip the absorption capacity of the private sector. Unemployed and under-employed youth, particularly in urban and peri-urban areas, appear to have been a critical factor in the 2008 and 2010 riots.[120]

269. **The country's dependence on imported food and fuel further undermines stability in urban and peri-urban areas, where livelihoods are more vulnerable to shocks.** The February 2008 riots in Maputo and Matola, which left at least six dead and 178 injured, were triggered by an increase in minibus fares due to a rise in fuel prices. The September 2010 riots in Maputo, which killed 13 and left several hundred injured, were apparently sparked by an increase in food prices, particularly for bread, driven by international grain markets. Due to their large shares in the consumption basket of poor households, food and transportation prices are a critical driver of social conflict.[121] Government subsidies for basic goods, which were expanded in 2010 to quell the protests, have stabilized prices, but the government may find it politically difficult to reduce or eliminate them. Longer-term solutions are required, particularly efforts to strengthen domestic food security.

270. **Inadequate public services, widespread corruption and the increasing public perception that a distant Frelimo elite rules for its own benefit are undermining the legitimacy of the state.** Dissatisfaction with the government was especially acute during the Guebuza administration, when public officials were widely believed to be profiting from a close relationship with the private sector. Core public services, including education, are unable to meet the needs of the population and are perceived to be getting worse over time.[122] Voter turnout fell from a high of 88 percent in 1994 to a low of 49 percent in 2014 due to growing political apathy and distrust of the political process. Frelimo's share of the presidential vote dropped from 75 percent in 2009 to 57 percent in 2014. The recent disclosure of wasteful and allegedly illicit contracts signed during the Guebuza administration, and especially the EMATUM experience, has contributed to the public's perception that the country's political elite acts primarily in its own self-interest.

271. **A lack of independent forums for collective representation, dialogue and conflict resolution between the government and the public, and between employers and workers, contributes to social instability.** Frelimo's hegemonic control over the public administration limits the space for political engagement and advocacy via nonviolent mass political

[120] Vines et al., 2015.
[121] Ibid.
[122] de Brito et al. 2014

demonstrations, petitions, boycotts and union-led strikes. Without an organized civil society capable of meaningfully influencing political policy, the only outlet for social unrest is violent street protests, as was the case in 2008 and 2010.[123] Labor disputes follow a similar pattern, and unofficial strikes are increasingly common. In recent months, strikes have disrupted operations at the Moma titanium mine, the Chirodzi coal mine, a cashew-processing factory and a bridge construction project. Trade unions represent only around 2.5 percent of the workforce, and most have close ties to Frelimo and are partially funded by the government. The absence of an organized labor movement makes it difficult to negotiate with strikers, and as a result labor disputes are more common and less easy to resolve.[124]

272. **The state's monopoly on the legitimate use of force and its capacity to guarantee public security are questionable.** The relative weakness of the armed forces was demonstrated in 2013 by their failure to decisively defeat a few hundred Renamo fighters, many of whom were nearing retirement age. Meanwhile, the growth of organized crime, drug trafficking and petty crime is straining the capacity of law enforcement. A 2014 report by the US State Department[125] found that the police force was "under-funded, under-staffed and poorly equipped," that police corruption was widespread, and that law enforcement power declined as distance from the capital increased. A rally in Maputo in October 2013 protesting a recent increase in violent crime drew around 20,000 people.

273. **While resource revenues could both reduce poverty nationwide and address regional inequalities, the failure of the resource sector to meet public expectations could have profoundly negative consequences.** Some extractive industry projects are progressing more slowly than planned. Global prices for natural gas have fallen, and slowing growth in emerging markets such as Brazil and China may continue to put downward pressure on a range of commodity prices. Meanwhile, rising concerns about the environmental impact of coal may greatly diminish the value of Mozambique's coal reserves. The introduction since 2013 of a mechanism for sharing resource revenues with affected communities is a positive step, but the failure to specify a fixed percentage of revenues to be shared coupled with institutional weaknesses among local governments could reduce its effectiveness.[126] Indeed, the development of mineral resources has thus far disproportionately benefitted the elite, threatening to exacerbate inequality rather than reduce it. Many senior Frelimo figures stand to profit from the expansion of the extractive industries,[127] and the Guebuza family alone reportedly holds at least seven prospecting licenses.[128]

5.5. Decentralization

274. **The 1994 Constitution emphasized the role of administrative decentralization in promoting post-conflict stabilization, but over the past decade partisan political dynamics have slowed and in some cases reversed the decentralization process.** Following the

[123] Ibid.
[124] Economist Intelligence Unit, 2015b.
[125] US Department of State Bureau of Diplomatic Security, 2014.
[126] Nombora, 2014.
[127] Details of these holdings are published by Mozambique's Center for Public Integrity in "*Elite Política Moçambique à Caça de Contratos de Prestação de Serviços na Indústria Extractiva.*"
[128] Nhachote, 2014.

adoption of the 1994 Constitution locally elected municipal governments were established in selected parts of the country.[129] While the creation of new municipalities was expected to continue over time, the government slowed the decentralization process as the opposition began making significant gains in municipal elections.

275. **Over the past decade, the legislature has persistently attempted to limit or roll back decentralization.** In 2013, the parliament enacted a territorial division law, which allows the central government to redefine the boundaries of municipalities that it deems incapable of performing their core functions. This law gives the central government significant leverage over the municipalities and effectively enables it to disenfranchise local voters. The law also authorized the creation of new districts, some of which overlap with municipal territories. In the opposition-controlled city of Quelimane this resulted in the loss of land for the local garbage dump, causing serious problems for the civil administration, while in Beira it enabled the central government to gerrymander the municipal electorate in order to increase the chances of a Frelimo victory.

276. **In lieu of administrative decentralization, the government has opted to pursue greater fiscal deconcentration.** Under this strategy the central government increasingly transfers fiscal resources to provincial and district governments while retaining political control over the public administration. Approximately 63 percent of all spending is currently executed at the central level, 35 percent at the district and provincial levels, and just 2 percent at the municipal level. However, this distribution obscures significant disparities between provinces, with Zambezia and Nampula receiving the lowest levels of transfers per capita. In order for subnational governments to effectively deliver public services increases in subnational institutional capacity must be accompanied by greater own-source revenue mobilization and a stronger, more equitable system of deconcentrated transfers.[130]

5.6. Sustainable Natural Resource Management

5.6.1. Natural Disasters and Climate Change

277. **Climate change and extreme weather-related shocks pose a significant risk to growth, poverty reduction and shared prosperity**. Mozambique is the only country in Africa considered to be at high risk from three major natural hazards: recurrent floods, cyclones and drought.[131] About 58 percent of the population and more than 37 percent of economic output is vulnerable to two or more natural hazards, which cost the economy an average of 1.1 percent of GDP per year. Droughts affect the largest number of people by far, but floods and cyclones occur more frequently and have more destructive impacts on public and private property. Coastal erosion, storm surges and rising sea levels threaten Mozambique's coastal zone, cities, ports and other infrastructure.

[129] The authorities initially planned to implement political decentralization through the establishment of municipalities across the country. However, this initiative was later revised under the Decentralization Policy of 2012, and municipalities are now being gradually introduced. Constitutional amendments have recently been proposed to enhance regional autonomy, but none have yet been adopted.
[130] World Bank, 2014a.
[131] Mink, 2013.

278. **Mozambique is also exposed to seismic activity due to its location on the East African Rift fault line**. A magnitude seven earthquake struck the southern province of Manica in 2006, killing four people, destroying almost 300 houses and damaging the power grid. Rapid urbanization and high rates of population growth are increasing the country's exposure to seismic risks.

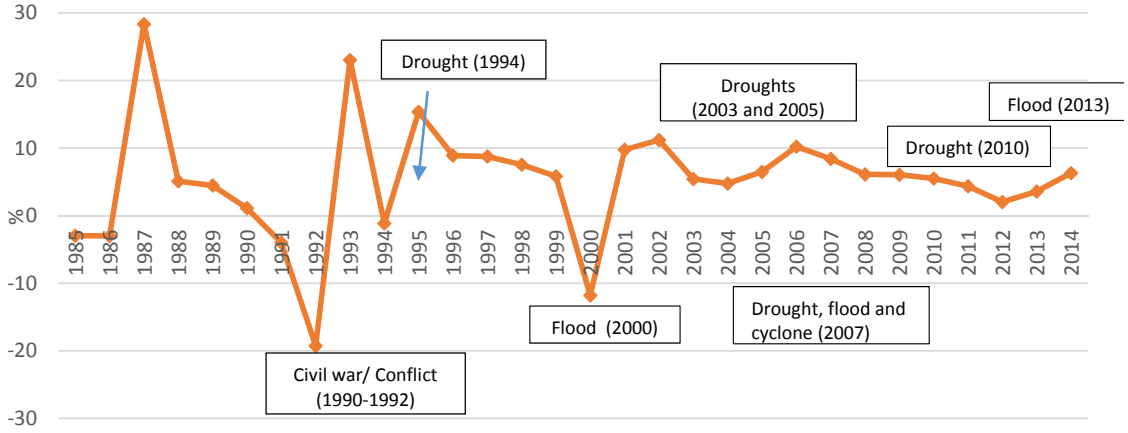
279. **Over the past decade the country has greatly increased its capacity to prepare for and respond to natural disasters.** The establishment of Emergency Operation Centers and Local Disaster Risk Management Committees, improved early warning systems, annual contingency planning and regular simulation exercises have enabled Mozambique to reduce the death toll caused by disasters. However, natural hazards continue to undermine the country's economic growth. Widespread flooding in 2015 is estimated to have cost around US$384 million, or 2.4 percent of GDP. Overall recovery and reconstruction efforts are estimated to reach US$485 million, or 3.1 percent of GDP. Vulnerability to natural disasters also perpetuates poverty by discouraging innovation and compounding risk-aversion, which keeps poor household locked in low-risk, low-return activities.

280. **The ongoing process of climate change is expected to increase the frequency and severity of weather-related shocks, imposing a significant economic cost**. Climate change could cost Mozambique an estimated US$2.3 billion to US$7.4 billion over 2003–2050.[132] The Mozambique Agricultural Risk Assessment indicated that droughts and floods cause substantial income and asset losses among farming households, create food shortages, generate price spikes and food inflation, contribute to food insecurity and slow agricultural growth (Figure 108). Climate change can also cause or exacerbate pest and disease outbreaks, which reduce agricultural output and increase production costs. Together, these effects are becoming an increasingly important source of both international and domestic food-price volatility.

281. **As it continues to strengthen its disaster preparedness, Mozambique will need to take long-term steps to reduce its fiscal vulnerability to natural hazards and reinforce the resilience of its infrastructure**. Mozambique has recently introduced a range of policy and institutional reforms, including a new national climate change strategy, a disaster risk management law and mandatory climate screenings for all new road investments. In addition, a more comprehensive and systematic mechanism for analyzing the economic and fiscal impact of disasters would enable the government to design a cost-effective strategy for insulating the public finances from natural shocks, including the establishment of a national disaster fund. The authorities will also need to leverage the growing number of risk assessments and resilience guidelines into actual investments in climate-resilient social and economic infrastructure.

[132] World Bank, 2010a.

Figure 108: Natural Disasters and Annual Percentage Growth in Agricultural Value Added



Source: World Development Indicators

5.6.2. Water Resource Management

282. **Among Mozambique's most pressing challenges is to manage seasonal floods and droughts through integrated water-system management.** Mozambique's frequent flooding is due to a combination of tropical cyclones hitting the coast[133] and nine major international river systems passing through its inland territory.[134] Current low and erratic levels of government financing are not sufficient to prevent flooding or provide resilient water infrastructure. Strong institutional coordination is necessary to promote the best use of available resources. Effective cooperation at the regional level is also essential, though it has proved challenging in practice.

283. **Household water supplies are being strained by the increasing use of irrigation.** Irrigation systems account for a large share of total water consumption and contribute to water-source risks. Integrating extraction and storage and using reclaimed water for irrigation can improve the overall efficiency of water use.[135] Fresh water withdrawals increased as a share of total renewable water by 53 percent from 2000 to 2010, from 45.7 cubic meters per person per year to 70.2. Agriculture withdrawals represent slightly more than 80 percent of total renewable withdrawals.[136] Greater coordination and integration between the irrigation and household water supply sectors is critical to prevent the overexploitation of water resources. Furthermore, efforts to improve information systems can help maintain water balances and provide better impact estimates for agricultural and agroforestry projects.

284. **The economy's reliance on subsistence agriculture and its limited access to irrigation highlights the economic potential of its water resources.** Inadequate water management institutions, weak market integration, and the degradation and abandonment of irrigated land

[133] While few cyclones actually make landfall in Mozambique, an average of 3-4 come close enough each year to cause high winds and heavy rain, which leads to flooding.
[134] Severe floods in Mozambique have occurred every two to three years along the Incomati, Limpopo, Sabe, Buzi, Pungue, Zambezi and Licungo rivers. The severity of the flooding affects catchment areas outside Mozambique, interrupting regional water supplies and contaminating water sources.
[135] In particular, Maputo, Umbeluzi, Incomati, Limpopo and Sabe are characterized by low runoff coefficients (only 45 percent generated in Mozambique), deep saline intrusion (reaching up to 50 km inland) and shallow rivers valleys with low storage, with consequent high evaporation losses and large flood-plain areas. These conditions may affect drinking water quality and availability over the long run.
[136] FAO Aquastat Indicators and World Bank World Development Indicators.

can reduce the returns to irrigation projects. The expansion of irrigation should be accompanied by improved management arrangements, public-private investment solutions that ensure economic and financial viability, and scale-appropriate irrigation technologies tailored to the needs of smallholders.

5.6.3. Fisheries Management

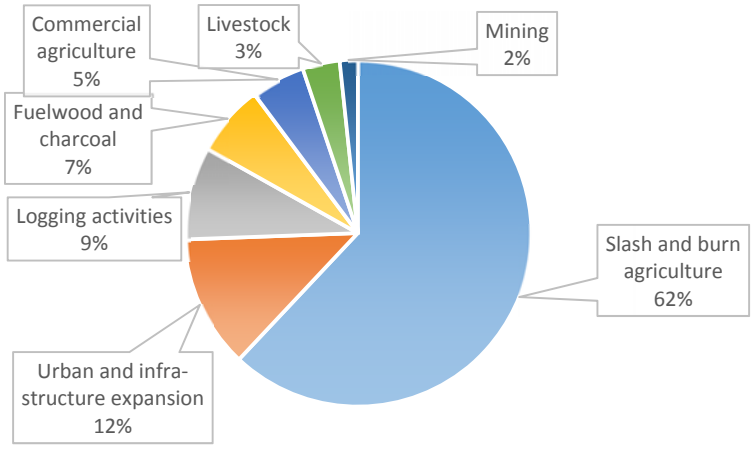
285. **An estimated 28 percent of southeastern Africa's regional fishery resources are overexploited or depleted, and another 40 percent are fully exploited.** Shrimp exports have declined by 75 percent in absolute terms over the past decade, dropping from 25 percent of Mozambique's total exports in 2000 to less than 1 percent in 2014. Furthermore, rising seafood imports indicate that domestic supply is now failing to meet demand despite the rising number of fishing operations, which has significantly increased pressure on natural stocks.

286. **The institutional framework of the Mozambican fisheries sector is growing stronger over time, but further support is required**. Monitoring, control and surveillance capabilities have dramatically improved over the past few years, while the process for granting fishing licenses and concessions has become more transparent. However, the implementation of sector policies and strategic plans has been slow and uneven, due in large part to excessively ambitious targets and limited institutional capacity. Few cost-effective implementation and monitoring mechanisms are available, and there is a widely recognized need to improve data collection systems to inform policy decisions and monitor their impact.

5.6.4. Natural Forests

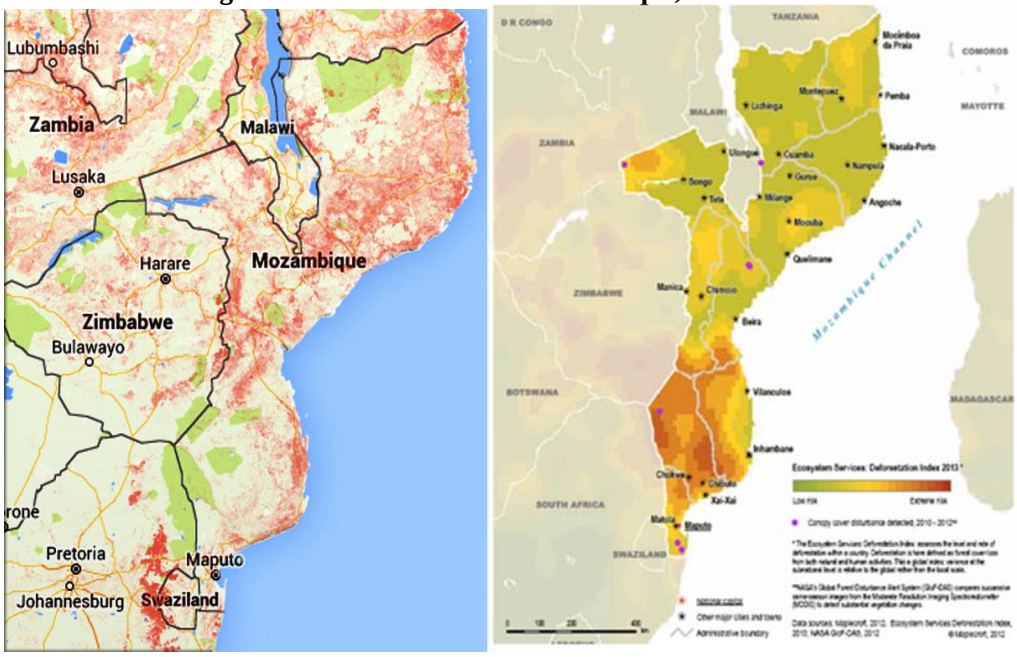
287. **Mozambique's natural forests are not being managed sustainably.** The deforestation rate is high, and around 0.5 percent or 220,000 hectares of forest are lost every year. Agricultural encroachment, infrastructure expansion, logging and unsustainable harvesting for charcoal and firewood are the main causes of deforestation and forest degradation, though illegal mining and logging also pose a risk to woodlands and forests, even in protected areas (Figure 109 and Figure 110).

Figure 109: Causes of Deforestation in Mozambique



Source: World Banks staff estimates

Figure 110: Deforestation in Mozambique, 2003 to 2013



Source: Winrock, Analysis of Causes of Deforestation and Forest Degradation in Mozambique, 2015

288. **The management of natural forests is undermined by weak governance, widespread illegality, low value addition and unsustainable rates of forest exploration**. It is estimated that over 90 percent of Mozambican wood is traded illegally, a large share of which is exported to China. The illegal timber trade imposes economic, environmental and social costs through unsustainable deforestation, as well as fiscal costs through foregone revenue. Inadequate law enforcement, a lack of incentives for responsible long-term forest management and the protection of ecosystem services, and limited decentralization of forest management to local communities have all contributed to unsustainable rates of exploration. The resource base and sustainable yield rate for natural forests is not well established. The latest forest inventory was conducted in 2007, and rampant illegal logging since then has contributed to forest depletion.

289. **The natural forests sector can realize its potential through stronger implementation of existing legislation and further investment in value addition.** More effective law enforcement, including the tracking of lumber could help curb illegal logging. In addition, the transparent publication of active forest concessions and explored volumes could improve forestry management and accountability. Finally, new incentives for in-country timber processing and partnerships between communities and the private sector could promote the sustainable exploitation of forestry resources.

5.6.5. Wildlife

290. **Poaching is decimating Mozambican wildlife.** A recent census of Mozambique's African elephant population showed a decline of 48 percent over the past five years, with particularly large decreases in Niassa Province.[137] Other species have also been affected. White

[137] Paul G. Allen Great Elephant Census, 2015.

rhinos have been eliminated from Mozambique entirely, and other species exist only in greatly diminished numbers. Mozambique is also an important conduit for the Illegal trade and transportation of wildlife parts—particularly ivory and rhino horn, the latter mainly from South Africa, which is driven by organized criminal groups. These issues have important implications for biodiversity conservation and pose a reputational risk that could undermine Mozambique's efforts to promote itself as an international tourism destination. Organized crime also undermines state institutions and poses a major challenge to law enforcement.

291. **The depletion of natural resources represents a significant lost opportunity for the Mozambican economy.** According to the Ministry of Land, Environment and Rural Development, the estimated costs of environmental degradation in Mozambique amounted to nearly US$370 million in 2009. Of this, US$50 million reflects depletion of the natural resource base, including both soil degradation and deforestation.

5.7. Reinforcing Sustainability: Challenges and Opportunities

292. **Despite its robust economic growth, a large share of Mozambique's population remains not only poor, but also highly vulnerable to a wide range of economic, political, social and environmental shocks.** The government has rapidly increased public spending, but concerns about expenditure quality and exposure to revenue shocks threaten its ability to maintain its fiscal stance. This risk is intensified by the complex challenge of managing a burgeoning extractive industries sector and effectively translating the country's considerable stock of natural wealth into human, physical and institutional capital. While the government has strengthened its legislative and institutional framework for natural resource management, progress in these areas can only be sustained in a context of political stability, which is threatened by unresolved tensions between the two major political parties. Meanwhile, conflicts over land and resources, rising consumer prices and increasingly frequent labor disputes are contributing to social unrest.

293. **Over the short and medium term, climate change will continue to exacerbate weather-related disasters.** Climate shocks pose a particularly serious risk to agricultural productivity, which directly impacts the livelihoods of the poor. Unsustainable fishing, logging and wildlife poaching further intensify the risk to rural livelihoods. Institutional deficiencies in resource management are compounded by underdeveloped public and private systems of social support, increasing the vulnerability of poor households. Table 21 presents a summary of the constraints to sustainable growth and poverty reduction in Mozambique and how they relate to the World Bank's twin goals of eliminating extreme poverty and boosting shared prosperity.

Table 21: Sustainable Growth and the Twin Goals: Issues, Challenges and Recommendations

Issues	Challenges	Recommendations
Strengthen the institutional framework for managing public resources		
Mozambique's expansionary fiscal stance may prove unsustainable over the long term.	• Absorptive capacity constraints limit the effectiveness of additional spending, and expansionary policies could pose a threat to fiscal stability,	• Continue fiscal consolidation efforts focusing on the sustainability of the wage bill and the implementation of public investment management reforms.

	particularly if the debt-to-GDP ratio increases.	• Maintain spending in line with the absorptive capacity of the economy.
	• The use of more complex mechanisms for financing public investments, such as sovereign guarantees and PPPs, heightens exposure to fiscal risks.	• Improve the management of contingent liabilities and other fiscal risks.
Address governance concerns that pose risks to private sector development, public investment quality and land-tenure security		
Governance indicators are poor and deteriorating over time.	• Rising levels of corruption and persistent institutional weaknesses undermine the social contract, discourage political engagement and exacerbate social unrest.	• Improve transparency in the use of public resources by strengthening accountability mechanisms and encouraging civil society oversight.
The management of public resources is constrained by the uneven implementation of policy.	• While the PFM framework is relatively well designed, significant implementation gaps compromise the integrity of public spending.	• Focus the PFM reform agenda on the thorough implementation of existing policies and procedures.
	• Public investment expenditures are rapidly increasing, but the government's capacity to manage these investments is inadequate.	• Improve the quality of public administrative processes, including systems for evaluating and prioritizing public investments.
Empower local communities to manage natural resources effectively and sustainably		
Unsustainable management of natural resources threatens rural livelihoods.	• The overexploitation of fisheries, forestry and wildlife resources intensifies environmental vulnerabilities.	• Strengthen community land rights. • Strengthen oversight and co-management of fisheries, devolve forest-management authority on local governments, and take coordinated action against poaching.
The exploitation of natural resources does not always adequately benefit local communities.	• The limited management capacity of local communities prevents them from leveraging the full potential of renewable natural resources such as forests and fisheries	• Promote the participation of local communities in the management of natural resources and expand opportunities for local employment and income generation
Improve disaster risk management and reinforce social and economic resilience		
Increased exposure to weather-related shocks poses a significant risk to growth, poverty reduction and shared prosperity.	• Mozambique is at high risk from recurrent floods, cyclones and drought, which adversely affect agricultural productivity.	• Establish integrated water management systems and strengthen local social and economic support networks.

6. Prioritizing Constraints and Opportunities

6.1. Introduction

294. **Mozambique faces a number of complex challenges as it strives to reduce poverty, alleviate inequality, maintain macroeconomic stability, enhance the competitiveness of the non-resource economy and expand the inclusiveness of growth; given its limited institutional resources, careful prioritization will be crucial to effective policies.** Efforts should focus on addressing constraints and seizing opportunities that have the greatest potential to advance national development objectives**.** As discussed throughout this diagnostic, Mozambique's recent economic expansion has failed to translate into deep and sustainable poverty reduction, and the returns to growth have been narrowly distributed. As Mozambique transitions to an increasingly resource-focused economic model, with megaprojects representing an ever-larger share of GDP, these effects are likely to become more pronounced.

295. **To maximize the potential of Mozambique's natural wealth, steps should be taken to better integrate the development of the extractive industries into the broader national economy while also encouraging the sustainable development of other sectors.** Mozambique has considerable underutilized potential in agriculture, fisheries, forestry and tourism, among other areas. However, robust diversification will require substantial investments in human and physical capital, as well as stronger sectoral governance and the responsible management of scarce natural resources.

296. **Limited workforce skills, inadequate access to capital, an adverse business climate and poor physical infrastructure are binding constraints on the private sector, which slow the growth of high-quality formal employment.** A strong institutional framework and good governance will be essential to curb rent-seeking and ensure responsible management of Mozambique's natural wealth. Expanding the range of economic opportunities offered by a growing economy will require improved connectivity between urban and rural areas, and special attention must be devoted to linking remote and impoverished regions with national and international markets.

6.2. Summary of Key Policy Objectives by Thematic Area

297. **Mozambique faces a diverse range of constraints and opportunities.** Table 22 describes these challenges, grouping them under the three thematic areas of growth, inclusiveness and sustainability, and presenting a list of key policy objectives for each area.

Table 22: Summary of Key Policy Objectives by Thematic Area

Thematic Area	Key Policy Objectives
Growth: *Promoting Diversification and Boosting Productivity*	1. **Bolster economy-wide competitiveness by reducing the cost of doing business and promoting private sector development.** Alleviating policy constraints on the business environment, especially the key obstacles faced by MSMEs, building workforce skills, implementing supportive legislation, increasing productivity and promoting diversification in the non-resource

	tradable sectors would encourage investment and promote the growth of non-resource exports. 2. **Sustainably increase productivity in the agricultural and forestry sectors.** Developing agricultural value chains, strengthening land tenure security, and integrating smallholder farmers into commercial agriculture could boost productivity in the non-resource primary sector. 3. **Develop enabling infrastructure.** Improving transportation networks and logistical capacity with an emphasis on linking rural and urban areas could improve market access for agriculture and forestry products and promote international trade. 4. **Expand access to reliable electricity.** Increasing connections, broadening the distribution grid and boosting power generation from both renewable and non-renewable sources could accelerate growth and diversification in both the urban and rural economies.
Inclusiveness: *Generating Employment, Facilitating Urbanization, and Expanding Access to Quality Services*	5. **Increase access to finance and reduce barriers to the growth of household enterprises and formal sector employment.** Reducing borrowing costs, supporting the development of a rural banking network, fostering financial linkages between rural and urban areas, and promoting lending to MSMEs could expand employment opportunities and increase competition in domestic markets. 6. **Address constraints to urbanization.** Promoting investment in urban infrastructure, supporting the development of the non-resource tradable sector, and strengthening the institutional and financial capital of municipalities and district centers would help maximize the social and economic benefits of the urbanization process. 7. **Improve the quality of public education.** Addressing the decline in primary completion rates, low levels of secondary completion, particularly for girls, and school governance issues would leverage the impact of increased education spending. 8. **Strengthen public health institutions and improve WASH services.** Reducing disparities in access to healthcare and WASH services based on income, location and gender would mitigate differential health outcomes—especially stunting—and boost lifetime earnings capacity among the poor. 9. **Expand the coverage of social assistance programs.** Improving program design and targeting would help to ensure that the poorest receive support, and using the expected increase in natural resource revenues to scale-up cash transfers would promote a more equitable distribution of the returns to resource-driven growth.
Sustainability: *Addressing Risks to Growth and Poverty Reduction*	10. **Strengthen the institutional framework for managing public resources.** Ensuring the long-term sustainability of the public finances will require continued fiscal consolidation, responsible wage bill management, prudent public investment policies, adequate containment of contingent liabilities and

	other fiscal risks, and the maintenance of resource-revenue spending in line with the absorptive capacity of the economy. 11. **Address governance concerns that pose risks to private sector development, public investment quality and land-tenure security.** Improving transparency in the use of public resources, including public contract awards, strengthening accountability mechanisms and encouraging civil society oversight will reduce policy uncertainty and promote public sector efficiency. 12. **Empower local communities to manage natural resources effectively and sustainably.** Mitigating the impact of climate change and eliminating unsustainable agricultural, fishing and forestry practices will require a strong policy framework and the active involvement of local communities. 13. **Improve disaster risk management and reinforce social and economic resilience.** Integrated water management could help alleviate the risk of both floods and droughts while also boosting agricultural production and reinforcing food security; strengthening local social and economic support systems could help attenuate the impact of unpredictable natural disasters.

6.3. Approach

298. **Each of the policy objectives presented in Table 22 was assessed and prioritized according to a set of criteria designed to evaluate its prospective impact.** The largest weight was given to outcomes that advance the World Bank's twin goals of eliminating extreme poverty and promoting shared prosperity by increasing the incomes of households in the bottom 40 percent of the income distribution. The evaluation criteria include:

- *Implications for the Twin Goals*: This dimension assesses each policy objective's potential impact on extreme poverty and shared prosperity. Higher scores reflect objectives that are likely to have a positive impact on both goals. Medium scores reflect an anticipated positive impact on only one of the twin goals.
- *Time Horizon*: This dimension reflects the timeframe during which impacts are likely to materialize. "Short term" refers to one year, "medium term" to three years, and "long term" to five years or more.
- *Preconditions*: Accomplishing certain objectives is necessary to achieve other policy goals. This is treated as a binary distinction in the analysis: either a given objective is a precondition for other objectives, or it is not.
- *Complementarities*: This describes the degree to which progress on a given objective would positively influence other objectives, even if it is not strictly necessary to achieve them.
- *Evidence*: This reflects the empirical rigor of the analysis underpinning each objective.
- *Political Feasibility*: This describes the extent to which objectives are realistically achievable given the country's political-economy dynamics, governance quality and institutional framework. As the SCD is designed to highlight more urgent priorities regardless of their political feasibility, this criterion does not affect the ranking of

objectives. Instead, it is assessed in order to inform the development of a future Country Partnership Framework.

Table 23: Criteria for Prioritizing Policy Objectives

Objective	Impact on the Twin Goals	Time Horizon	Pre-conditions	Comple-mentarities	Evidence	Political Feasibility
1. Bolster economy-wide competitiveness by reducing the cost of doing business and promoting private sector development	High	Medium to Long	No	High	High	Weak
2. Sustainably increase productivity in the agricultural and forestry sectors	High	Medium	No	High	High	Weak / Medium
3. Develop enabling infrastructure	Medium	Long	Yes	High	High	Medium
4. Expand access to reliable electricity	Medium	Long	Yes	High	High	Medium
5. Increase access to finance and reduce barriers to the growth of household enterprises and formal sector employment	High	High	Yes	High	High	Medium
6. Address constraints to urbanization	Medium	Long	Yes	High	Medium	Weak / Medium
7. Improve the quality of public education	High	Long	Yes	High	High	Medium
8. Strengthen public health institutions and improve WASH services	High	Medium to Long	Yes	High	High	Medium
9. Expand the coverage of social assistance programs	Medium	Medium	Yes	High	Medium	Medium
10. Strengthen the institutional framework for managing public resources	High	Long	Yes	High	High	Weak

11. Address governance concerns that pose risks to private sector development, public investment quality and land-tenure security	High	Long	Yes	High	Medium	Weak
12. Empower local communities to manage natural resources effectively and sustainably	High	Medium / Long	Yes	Medium	Medium	Medium / High
13. Improve disaster risk management and reinforce social and economic resilience	Medium	Medium	Yes	Medium	Medium	Medium

6.4. Assessment of Priority Objectives

299. **Bolster economy-wide competitiveness by reducing the cost of doing business and promoting private sector development.** Alleviating key constraints to private sector growth in areas such as public infrastructure, economic governance, access to credit, access to land, macroeconomic competitiveness and workforce skills will promote diversification and accelerate job creation. Efforts to level the economic playing field will have a significant impact on the twin goals by facilitating the growth of MSMEs and household enterprises, which provide livelihoods for a large share of poor households. A more enabling private sector environment is a precondition for diversification in agriculture, forestry, fisheries, tourism, trade and ICT, and it is essential to broaden the economic impact of the extractive industries. The evidence base for this objective is supported by numerous statistical analyses, private sector surveys, and the annual *Doing Business* report. However, gaps in granular firm-level data represent an important limitation. Addressing binding constraints to economy-wide competitiveness is a medium- to long-term objective, and it will require a coherent and focused government strategy. Given the considerable scope of the governance challenges involved and the complex relationship between private sector interests and the state, the political feasibility of addressing these constraints is relatively weak.

300. **Sustainably increase productivity in the agricultural and forestry sectors.** There is significant overlap between land with high agriculture and forestry potential. Improving access to land and reinforcing the security of land tenure is an important entry point, which could significantly improve productivity in both sectors. However, the political feasibility of successfully resolving the bureaucratic constraints involved is relatively low. Supporting the transition from subsistence to commercial farming requires improving the productivity of smallholder farmers and integrating them into sophisticated value chains. Key interventions in this area include increasing the use of improved inputs, modern technology and irrigation systems, facilitating the spread of contract farming and out-grower business models, providing

a supportive institutional environment, and ensuring an adequate supply of extension services and rural infrastructure. As large majorities of poor and lower-income households are engaged in subsistence farming, this objective's potential impact on poverty reduction and shared prosperity is very high.

301. **Develop enabling infrastructure.** Strengthening road and rail connections and expanding logistics services can broaden the returns to growth, unlock the potential of underdeveloped regions and facilitate the rise of new economic sectors. Improving connectivity between rural and urban areas reduces the cost of inputs and expands access to urban consumer and service markets, while linking rural areas to export points can bolster export competitiveness. Achieving this objective not only requires developing hard infrastructure, but also reducing logistics and transport costs by encouraging competition in the commercial sector. While the government has made improving infrastructure a key priority, the political feasibility of this objective is not assured, as recent infrastructure investments have not been strategically targeted.

302. **Expand access to reliable electricity.** A more robust and expansive energy sector could facilitate the growth of agribusiness, ICT and financial services, especially in rural areas. This objective has a high degree of complementarity with the goals of diversification and private-sector-led job creation. As a result, it is expected to make a substantial contribution to poverty reduction and shared prosperity. Key interventions include increasing energy generation from both renewable and non-renewable sources such as solar and natural gas, as well as measures to ensure the financial viability of the state-owned utility company, EdM. While there is strong government support for expanding the electricity supply, as demonstrated by a recent increase in tariffs, there is scope to improve the efficiency of EdM.

303. **Increase access to finance and reduce barriers to the growth of household enterprises and formal sector employment.** As household enterprises provide livelihoods for a large share of poor households, removing obstacles to their growth will contribute to poverty reduction. Meanwhile, promoting the expansion of the relatively narrow formal sector will enable lower-income workers to secure high-quality jobs, bolstering shared prosperity. Key interventions in this area include reducing borrowing costs and developing a rural banking network, for which access to electricity is a prerequisite. Developing stronger transport links between rural and urban areas will also facilitate access to financial institutions. This is primarily a long-term objective. The government has stated its commitment to increasing access to finance, but the political feasibility of accomplishing this goal is rated as medium in light of recent economic developments, which have led the government to increase interest rates, indirectly influencing commercial bank borrowing rates.

304. **Address constraints to urbanization.** Population growth in urban areas is increasing at a faster rate than in the rest of the country, as large numbers of people move to cities in pursuit of new economic opportunities and better public services. While urbanization can improve access to markets and create economies of scale in public service provision, realizing its full potential will require substantial investment in urban infrastructure, a business environment that facilitates the growth of the non-resource tradable sector, and measures to strengthen the

institutional and financial capital of cities. All of these are medium-term goals. Successfully managing the urbanization process will require a national urban development policy supported by strong institutional capacity at the municipal level. The political feasibility of this objective is rated as medium due to the political-economy dynamics that have stalled the decentralization agenda.

305. **Improve the quality of public education.** Education is closely linked to a range of positive social and economic outcomes, and improving education quality could have a significant impact on the twin goals. Education also has close complementarities with development objectives ranging from public health to workforce skills. The government's efforts to expand the supply of education has strained the physical and institutional resources of schools, undermining school governance and encouraging the hiring of underqualified teachers. While education spending in Mozambique has risen rapidly, quality indicators are far below those of peer countries. Key interventions should focus on improving school governance by strengthening the role of school councils and by creating more effective performance incentives for school principals and administrators, which can improve teacher attendance. While the government is taking steps to strengthen school councils, there is considerable scope to improve the policy response to teacher absenteeism. The political feasibility of this objective is rated as medium, and given the scope of the challenges involved, improvements in education quality are a long-run goal.

306. **Strengthen public health institutions and improve WASH services.** Access to health services is inadequate and unevenly distributed, and poor households often face considerable challenges in reaching health facilities and paying for care. Improving WASH services is a precondition for better health outcomes, as poor hygiene and sanitation either cause or exacerbate a wide range of diseases and conditions. The negative impact of inadequate WASH services on childhood health, growth and cognitive development are especially severe and disproportionately affect children of poor households. Improving healthcare and WASH services will have a major impact on the twin goals via the close relationship between health outcomes and lifetime earnings potential. The health sector must build the logistical and support systems necessary to provide a package of core services. Priority areas include the development of supply chains and health information systems. Mozambique has one of the lowest numbers of healthcare workers per capita in the world, and measures to increase the efficiency of the health sector wage bill are essential to maximize the impact of the sector's limited human resources. Extending public health outreach in underserved rural areas will be necessary to address geographic and income-based inequalities in healthcare access. Increased investment in the WASH sector should focus on more densely populated centers, while in rural areas policymakers should consider implementing a competitive funding mechanism for WASH resources. In major cities, an improved regulatory framework for urban sanitation is required. The political feasibility of addressing this constraint is rated as medium given that budgetary allocations to the WASH sector have not increased in real terms for several years.

307. **Expand the coverage of social assistance programs**. Ensuring that social transfers effectively reach poor households could increase consumption levels and accelerate poverty

reduction. Furthermore, as revenue from the extractive industries continues to rise, a scaled-up cash transfer program could provide a mechanism for sharing resource wealth more broadly with the population. Consequently, achieving this objective is expected to make a strong contribution to the twin goals. Cash transfer programs can also have a positive effect on education, health and nutrition, especially if appropriate conditions are attached to the transfer. Due to their immediate impact on the consumption of poor households, targeted cash transfers are the most effective means to substantially alleviate poverty in the short-to-medium term. Other key interventions in this area include addressing coverage gaps in existing social assistance programs, particularly among urban youth and poor households with children, improving overall targeting, and revising the regional distribution of programs in order to better target provinces with a large share of poor households. The government has progressively increased the size and scope of social assistance, though both remain low by international standards. Moreover, the government did not respond favorably to a World Bank study on design options for scaling-up a cash transfer program financed by resource revenues. As a result, the political feasibility of achieving this objective is rated as medium.

308. **Strengthen the institutional framework for managing public resources.** Better implementation of existing PFM legislation, continued efforts to promote fiscal consolidation and ensure that spending remains in line with the absorptive capacity of the economy, and reforms designed to improve expenditure efficiency are a prerequisite for successful social and economic development policies. While PFM does not directly impact the twin goals, improperly targeted or wasteful spending will fail to benefit the poor and may result in slower growth or macroeconomic instability. Strengthening the public investment management system to favor investment projects that are likely to generate large socio-economic returns can have especially strong complementarities with other development objectives. The government continues to pursue fiscal consolidation, but fiscal slippages in 2014 and the implementation of projects of questionable social or economic value (e.g. EMATUM) suggest that political feasibility is relatively weak.

309. **Address governance concerns that pose risks to private sector development, public investment quality and land-tenure security.** While Mozambique has improved the regulatory framework for the public administration, its worsening performance on the World Bank's Worldwide Governance Indicators highlights important weaknesses in implementation. Due to the close relationship between governance quality, economic growth and poverty reduction, reversing this trend could have a highly positive impact on the twin goals. However, given the scope of the interventions required, this should be regarded as a medium- to long-term objective. Key interventions include improving the quality of public administrative processes, including systems for evaluating and prioritizing public investments, as well as strengthening fiscal risk management, engaging civil society in the budget process, improving reporting on quasi-fiscal activities, and reforming the land-tenure system. Improving audit coverage and oversight of the audit process are critical to efficient public financial management. More transparent and participatory processes for negotiating land rights and more robust enforcement of land-tenure legislation will facilitate investment and reduce the potential for land-related conflict. And broad improvements in the business environment, including the

consistent implementation of governance reforms and efforts to streamline bureaucratic procedures will help to alleviate administrative constraints on private sector growth. However, the existing governance framework largely benefits a small and powerful elite, limiting political incentives for reform; as a result, the feasibility of this objective is rated as weak.

310. **Empower local communities to manage natural resources effectively and sustainably.** A significant portion of Mozambique's natural resources, particularly forests and fisheries, are ostensibly managed by local communities, many of which have low levels of administrative capacity. This undermines the sustainability of resource management and prevents local communities from fully realizing the economic value of their natural capital. Strengthening community land rights and supporting the engagement of local civil society and private firms in the management of natural resources could facilitate the sustainable development of agroforestry, artisanal and commercial fishing and ecotourism. This objective enjoys broad support among policymakers, and its political feasibility is rated as medium to high.

311. **Improve disaster risk management and reinforce social and economic resilience.** The passage of a new disaster risk management law in 2014 was an important achievement, but further efforts will be required to fully implement its provisions and strengthen disaster preparedness and prevention systems, as well as early warning mechanisms. Mozambique is at high risk from recurrent floods, cyclones and drought, which not only threaten lives and property, but also reduce agricultural productivity and exacerbate food insecurity. Integrated water management could have a highly positive impact in terms of reducing the incidence of both floods and droughts, but creating the necessary infrastructure will require considerable public investment. Due to the multidimensional nature of natural hazards in Mozambique, mitigating disaster risk is a medium- to long-term objective.

6.5. Prioritization

312. **To complement and enrich the analysis presented above, consultations were held with key stakeholders in the government, the private sector, civil society and the donor community**. Internal consultations with the Mozambique country team focused on appropriate interventions to address the core constraints identified in the analysis. Discussions with civil society and the private sector demonstrated broad support for the priority objectives. These consultations were particularly effective in highlighting key entry points, synergies and complementarities, as well as identifying potential technical and political obstacles and defining strategies to overcome them.

313. **As noted above, priority objectives were identified and analyzed according to a common set of criteria.** Each objective's impact on the twin goals was rated as either high = 3, or medium = 2. Objectives that were entry points (or preconditions) for achieving other policy goals were rated as either not a precondition = 1, or precondition = 2. Finally, the estimated political cost over the short, medium and long term was also assessed and rated as either -3 = high political cost, -2 = medium political cost, or -1 = low political cost. Table 24 presents the results of the exercise.

Table 24: Cost-Benefit Analysis for Each Priority Objective

Objective	Short Term	Medium Term	Long Term
1. Bolster economy-wide competitiveness by reducing the cost of doing business and promoting private sector development	Highly Negative	Highly Negative	Medium Negative
2. Sustainably increase productivity in the agricultural and forestry sectors	Medium Negative	Medium Negative	Medium Positive
3. Develop enabling infrastructure	Medium Positive	Medium Positive	Medium Positive
4. Expand access to reliable electricity	Medium Negative	Medium Positive	Medium Positive
5. Increase access to finance and reduce barriers to the growth of household enterprises and formal sector employment	Medium Positive	Highly Positive	Highly Positive
6. Address constraints to urbanization	Medium Negative	Medium Negative	Medium Negative
7. Improve the quality of public education	Medium Positive	Medium Positive	Highly Positive
8. Strengthen public health institutions and improve WASH services	Medium Positive	Medium Positive	Highly Positive
9. Expand the coverage of social assistance programs	Highly Positive	Highly Positive	Highly Positive
10. Strengthen the institutional framework for managing public resources	Highly Positive	Highly Positive	Highly Positive
11. Address governance concerns that pose risks to private sector development, public investment quality and land-tenure security	Medium Positive	Medium Positive	Highly Positive
12. Empower local communities to manage natural resources effectively and sustainably	Highly Positive	Highly Positive	Highly Positive
13. Improve disaster risk management and reinforce social and economic resilience	Medium Negative	Medium Negative	Medium Positive

314. **Certain objectives may be politically costly to implement, but are nevertheless crucial**. In particular, objectives that are preconditions for the achievement of other objectives, such as reducing the cost of doing business and promoting private sector development, should not be de-prioritized due to their limited political feasibility over the short or medium term. Rather, the political difficulty of achieving these goals should guide engagement with policymakers, and low political feasibility should be regarded not as a deterrent, but as a challenge to overcome. The appraisal of political feasibility at this stage provides an important opportunity to formulate politically sensitive policies and interventions during the development of the Country Partnership Framework.

6.6. Conclusion

315. **Mozambique is at a critical juncture in its development, and the rise of the resource sector presents policymakers with an unprecedented opportunity to accelerate progress**

on poverty reduction and shared prosperity. While the extractive industries have driven its recent growth, Mozambique possesses much more than a rich endowment of subsoil assets. Abundant agricultural land, forests, fisheries, and conservation areas represent a major and largely underutilized endowment of natural capital. With a demographic transition underway, leveraging the full range of Mozambique's assets will be critical to creating quality employment and broadening the returns to economic growth.

316. **A multifaceted approach to development policy will be necessary in order for Mozambique to realize its considerable potential.** Economic diversification and private sector growth can be supported by developing enabling infrastructure—especially in growth corridors—and by facilitating access to credit, streamlining bureaucratic procedures, strengthening land-tenure protections, and hedging against the risks to macroeconomic competitiveness posed by Dutch Disease. Efforts to promote diversification and accelerate private-sector-led growth require a healthy, educated and productive workforce, and improvements in public services must account for geographic disparities and the unique challenges faced by women and girls. Finally, the prevalence of poverty and underemployment in Mozambique's vast agricultural sector underscores the crucial importance of facilitating urbanization and expanding economic connectivity in remote and marginalized regions.

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