

What paths should Mozambique follow to ensure a greater contribution of the extractive industry for growth and structural economic transformation?



1 Introduction

International experience shows us that the abundance of natural resources in a country does not automatically imply economic development and improvement in the living conditions of the population. In fact, depending on policy options and macroeconomic management capacity, resource abundance can be either a blessing or a curse.

The debate on economic growth and structural transformation is framed within the National Development Strategy 2015 - 2035,

which defines inclusive and sustainable growth and development as a priority for Mozambique.

To achieve inclusive growth, the Government of Mozambique has proposed a comprehensive and integrated approach consisting of structural transformation, focused mainly on diversification of production and import substitution. Thus, industrialization is at the core of the program and both agriculture and extractive industries are aligned with

the objective of structural transformation of the economy.

The structural transformation process is defined as the reallocation of economic activity in the broad sectors: agriculture, manufac-

turing and services¹. It becomes relevant to analyze the structural transformation in order to identify the degree to which structural change is sustainable, and if not, a set of policies should be implemented to correct it.

2. Brief analysis of the evolution of Mozambique's economic structure

2.1 Agriculture lost importance in the economic structure to the extractive industry

The structural transformation of the Mozambican economy started with the formation of the first government of independent Mozambique. The first attempt at reforms dates back to the period when the centrally planned economy was in force, when the first independent Government of Mozambique implemented the Indicative Prospective Plan (PPI) between 1980 and 1990.

Subsequently, and due to the failure of the PPI, in 1987 Mozambique introduced the Economic Rehabilitation Plan (PRE), with technical and financial assistance from the Bretton Woods institutions (World Bank and International Monetary Fund).

With the end of the civil war and the holding of the first elections in 1994, several programs were implemented to rebuild the economic infrastructure destroyed by the war, thus promoting the country's economic growth and development.

The common denominator of all the programs mentioned above was the materialization of the precept of the Constitution of the Republic of Mozambique, which established agriculture as the basic activity and industry as the driving sector of the economic activity.

This was reflected in the structural panorama

of the economy between 1991 and 1999. As illustrated in graph 1, agriculture was, in the period under consideration, the most important activity, contributing about 36% to the Gross Domestic Product (GDP). It is also important to note that, in the period under review, the extractive industry was almost non-existent, having contributed only 0.5% to the GDP.

The economic structure of Mozambique underwent profound changes with the advent of the "megaproject era". Between 2000 and 2010, Mozambique saw the operationalization of large investment projects in manufacturing (Mozal) and extractive industry (in 2004 the natural gas projects of Pande and Temane led by Sasol in Inhambane province; in 2007 the heavy sands project in Moma in Nampula province led by Kenmare Moma Mining; the coal projects of Rio Tinto and Vale in Tete province)².

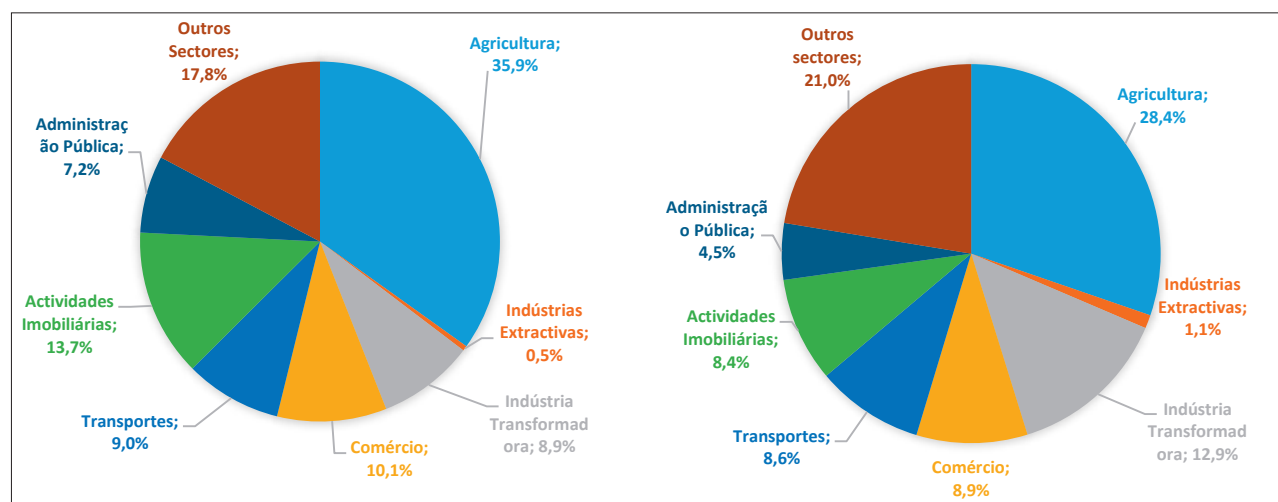
The effects of the operationalization of these projects was predictable: manufacturing industry increased its contribution to GDP by about 4 percentage points (pp.). During this period, the extractive industry doubled its contribution, to 1.1%. On the other hand, agriculture saw its weight in the economy decrease by 7.5 pp.

¹ https://www.nber.org/system/files/working_papers/w18996/w18996.pdf

² Deloitte e EITI (2018). Relatório Final, I\TIE Moçambique. Maputo: EITI Mozambique.

Figure 1: Structure of the Mozambican economy between 1991 and 1999

Chart 2: Structure of the Mozambican economy between 2000 and 2010



Source: Instituto Nacional de Estatística (2021)

Agriculture continued to lose prominence in the economic structure. As shown in graph 3, agriculture reduced 4.4 pp. of its weight in the country's economic structure, while the extractive industry increased by another 2.6 pp. The manufacturing industry saw its contribution to GDP, in the period under review, reduce by 3.1 pp.

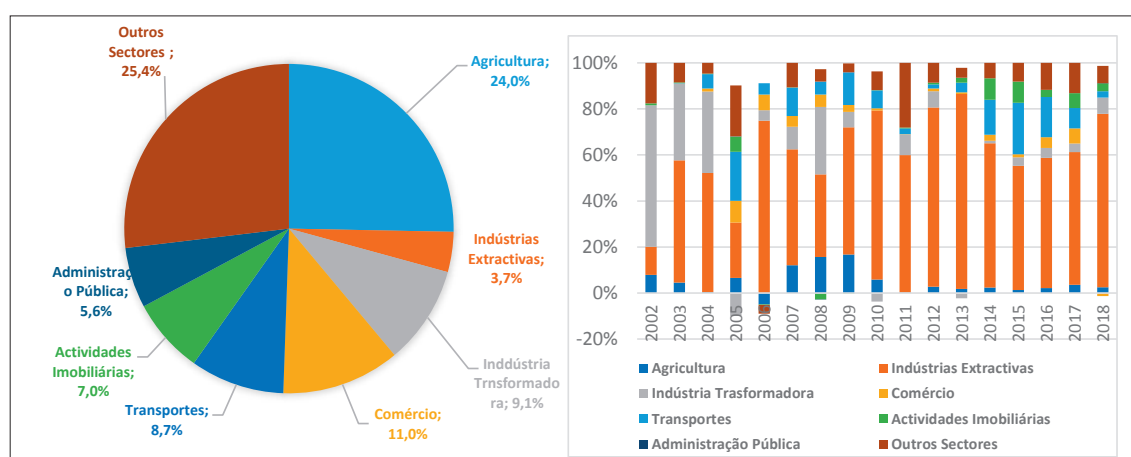
These changes are justified by the high level of Foreign Direct Investment (FDI) that was concentrated in the extractive industry. Chart 4 shows that the evolution of the distribution of FDI by sectors of economic activi-

ties, between 2002 and 2018, reflects structural transformations compatible with those presented in the previous sections.

The analysis of the figure in question allows us to make the following conclusions: i) Agriculture has never been a priority for FDI in Mozambique; ii) At the beginning of the period under analysis, FDI was concentrated in the manufacturing industry. This is linked to the implementation of the Mozal Project; iii) From 2010 until 2018, the extractive industry absorbed on average 70% of FDI inflows in Mozambique.

Graph 3: Structure of Mozambique's Economy between 2007 and 2018

Graph 4: FDI in Mozambique between 2002 and 2018



Source: Instituto Nacional de Estatística (2021) & Banco de Moçambique (2021)

2.2 The natural resource boom has not allowed the strengthening of other sectors and the country is moving towards an extractivist economy

The recent discoveries of large natural gas reserves in the Rovuma Basin (Cabo Delgado province), which would contribute an estimated US\$50 billion to the country's revenues up to 2050³, have placed Mozambique in the restricted group of countries rich in natural resources.

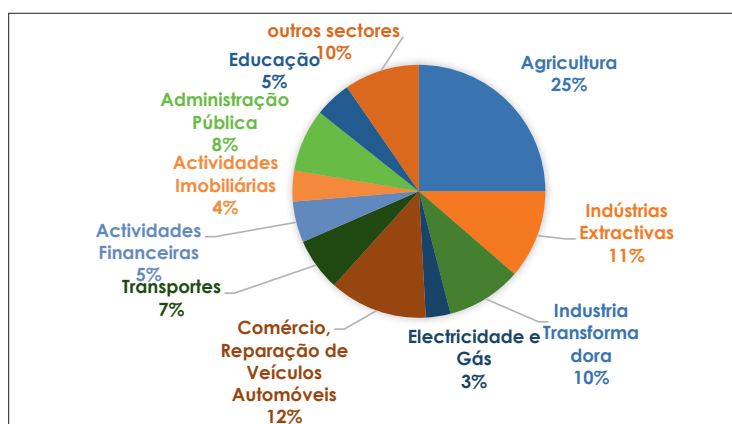
After the natural national euphoria at the discovery of yet another source of wealth on Mozambican soil, alarm bells are ringing about the fear that, as is the case with some economies abundant in mineral resources, such as Nigeria, the Democratic Republic of Congo, and Venezuela, Mozambique will become an extractivist economy, dependent on extractive industries that have no links with the other sectors of the economy (mainly agriculture, which employs most of the Mozambican population), and which therefore does not generate development for the country.

Despite the fact that agriculture is in free-fall regarding its contribution to the GDP (currently contributing about 25%, as illustrated in graph 5), it continues to be the main source of employment for most Mozambicans. Para-

doxically, the increase in the weight of the extractive industry in GDP is not reflected in the absorption of labor (it contributes less than 1% to total employment). Therefore, it contributes very little to the direct sharing of revenues from the exploitation of natural resources among Mozambicans. Data from the World Labor Organization (ILO) suggest that low productivity remains one of the major structural problems of the Mozambican economy.

Manufacturing industry is practically non-existent and services are mostly dedicated to the marketing of imported products with little added value in the country's GDP. In fact, the majority (66.8%) of the Mozambican population still lives in rural areas with difficulty in accessing basic services such as education, health, and water. Furthermore, more than 50% of the population lives in extreme poverty and with considerably high levels of food insecurity and malnutrition, with the central and northern regions being the most affected. The current direction of the economic structure is worrying and suggests the need for the implementation of new policies.

Graph 5: Mozambique's Economy Structure 2020



Source: Instituto Nacional de Estatística (2021)

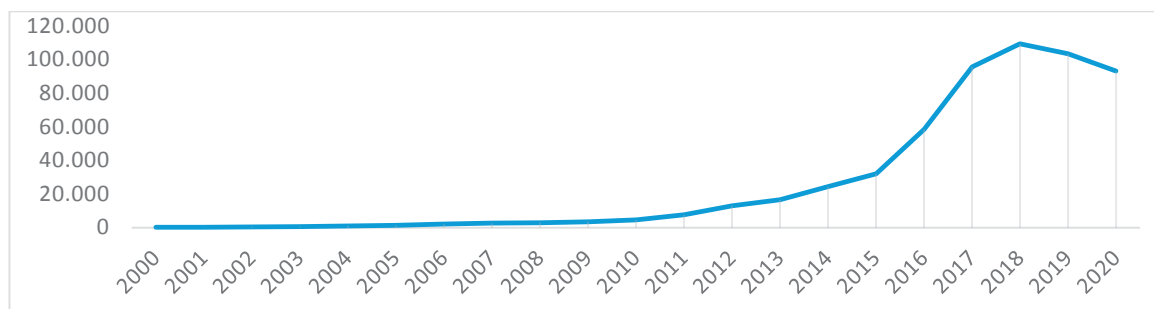
³ República de Moçambique (2018). Projected Government Revenues From Gas Projects. Maputo: Ministério da Economia e Finanças.

3. Quick analysis of the contribution of the extractive industry to economic growth

The extractive industry has shown exponential growth over the last two decades, as illustrated in graph 6. Even with the reduction in

production in the last two years, the extractive industry production still remains 20 times higher than at the beginning of the last decade.

Graph 6: Evolution of Extractive Industry Production



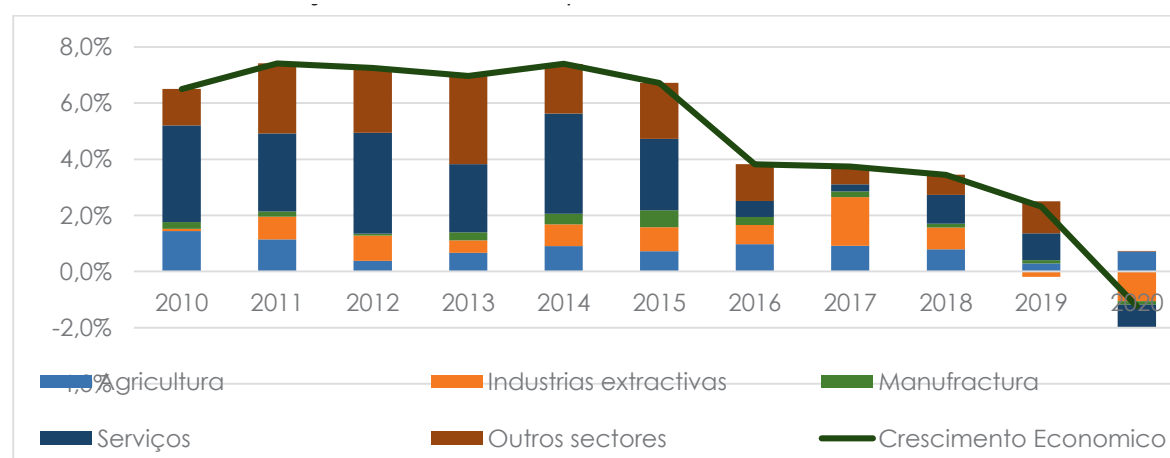
Source: Instituto Nacional de Estatística (2021)

Notwithstanding the rapid growth recorded in the extractive industry in recent decades, its relatively smaller place in the economic structure has not allowed it to have an extraordinary contribution to economic growth.

With the exception of the year 2017 (as illustrated in Chart 7) when the revenue le-

vels of the extractive industry allowed it to be the main contributor to considerable economic growth, in a period when the country was facing numerous economic difficulties caused by the high level of foreign debt that put all sectors of the economy operating below their potential.

Graph 7: Contribution of sectors to economic growth 2010-2020



Source: Instituto Nacional de Estatística (2021)

3.1. The problem of non-inclusive resource governance: The Case of Tete Province

In general, although extractive industry investments have contributed to a strong economic sector in the last decade, this growth has not had the desired impact on poverty reduction and economic diversification. In fact, the most recent economic outlook does not allow for much hope.

An example of this scenario is the case of Tete province. Tete is home to mineral coal, precious, ornamental, and semi-precious stones, gold, anorthosites, graphite, mineral water, gabbro, agates, labradorite, tourmaline, rose-quartz, uranium, iron, copper, black granite, limestone, vanadium, fluorite, and others⁴.

This abundance of natural resources allowed Tete to receive large investments that created high expectations for development at the local and national level, so much so that

Tete was seen as the “EL Dourado”, with the beginning of large-scale coal mining by Vale and Rio Tinto in 2011 and 2012, respectively.

Even with all this abundance of mineral resources, the population continued to register one of the highest poverty rates⁵. Local communities complain, to this day, of high levels of pollution, weak community consultation mechanisms by mining companies, discontinuity in development funding programs, in addition to the high cost of living caused by those projects.

Throughout all these years, the abundance of natural resources has not been transformed into wealth for that community. In-depth interviews suggest that, in general, “people do not feel included in the process of exploitation of mineral resources”.

4 Policy Recommendations

A. Inclusive natural resource governance as a flag to promote greater input from the extractive industry

One of the key determinants for transforming natural resource abundance into wealth for the country or region is the establishment of an inclusive governance model⁶, especially ensuring that all stakeholders have a voice and participate in decision making⁷ in a transparent process about the management of these resources which are a public good.

It is estimated that the country will collect about USD 96 billion (more than 6 times the current GDP) during the lifetime of the Rovuma Basin liquefied natural gas (LNG) exploration projects. In this sense, the Bank of Mozambique presented a proposal in 2020 for a model of a Sovereign Wealth Fund of Mozambique, an instrument that is expected to be a vehicle that will lead to better management of non-renewable natural resources.

We must ensure that the governance of this fund is first and foremost inclusive. The current proposed governance model for the future Sovereign Wealth Fund does not include supporting institutions to ensure that decisions are politically independent and that the management of revenues is open and democratic (in line with Generally Accepted Principles and Practices - GAPP 6).

Experiences from several SWFs suggest that the governance model of the fund should rely on its governance structure with an Advisory Council. This council should include representatives from the communities directly affected by the extractive industry activities, as well as representatives from civil society and the private sector.

Achieving the structural transformation

⁴ <https://www.tete.gov.mz/por/A-Provincia/Potencialidades/Recursos-Minerais-e-Energia>

⁵ <https://igmozambique.wider.unu.edu/sites/default/files/News/Mozambique-A5-web-24022017.pdf>

⁶ https://mpira.ub.uni-muenchen.de/58598/1/MPRA_paper_58598.pdf

⁷ <https://includeplatform.net/publications/inclusive-governance-for-economic-structural-transformation-in-mozambique/>

of the national economy is still possible, but for this to happen, an inclusive governance model must be established to allow

all Mozambicans to have a voice in defining the model for managing the country's wealth.

B. Natural gas for national development

Mozambique has expectations of earning large revenues from gas projects, resulting from royalties, the IRPC, and later from production sharing. Recent developments in the gas sector, including projected investment over the coming decades, have caused significant changes in expectations regarding its contribution to the economy.

However, the policy challenges associated with capturing the benefits of extractive activity, while avoiding the negative aspects, are numerous and span a wide range of government policy areas, including macroeconomic, fiscal, environmental and community aspects.

Indeed, there are a number of strategic decisions that the country must take, particularly in view of the current structural economic trend. Firstly, the recent sharp drop in the price of natural gas motivated by the COVID-19 pandemic has reaffirmed the degree of uncertainty regarding price and demand.

Secondly, and also at the global level, climate change and the need for an energy transition will certainly affect the development of natural gas projects. So, the longer you wait for natural gas prices to rise in order to raise significant revenues and confront violent extremism, the chances that projects in Mozambique will be affected by the global wave of energy transition increase. And Mozambique would risk leaving its gas underground.

That said, there are strategic decisions that Mozambique must make to leverage gas for national development:

- I. The use of gas for power generation - for the electrification of all administrative posts that do not yet have access to the national electricity grid, but also to export to countries in the region with low rates of electricity coverage.
- II. Production of fertilizers in large quantities and at low cost to promote greater productivity in agriculture - Agriculture is still the basis for the country's development, employing more than 80% of the labor force. Although the country has arable land and abundant water, it has not yet been able to transform these resources into food and wealth for Mozambicans. The adoption of such a strategy would enable the transition from subsistence agriculture (small family production units) to market-oriented agriculture (large production units belonging to cooperatives or agricultural enterprises).
- III. Production of fuel and related products - Fuel is one of the main imported products in Mozambique, so the adoption of this strategy also fits into the national strategy of promoting import substitution.

C. Local content as a catalyst for the structural transformation of the national economy

Although extractive industry activity does not directly create many jobs, the long value chain of LNG projects can generate a wide range of opportunities to diversify the economy through the promotion of manufactu-

ring and services under local content policies. We need to ensure that local content is a reality first in the affected regions, but also in the country as a whole.



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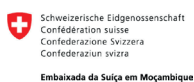
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