

*Study on how to integrate private sector development in Denmark's new Country
Programme in Mozambique for the period 2005-2009*

BUSINESS AND PRODUCTIVE CAPACITY DEVELOPMENT
IN ECONOMIC GROWTH AND INDUSTRIALISATION

By

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1. Introduction

This background paper has been prepared to support arguments and proposals presented in the main report of the consultancy carried out by a team of consultants for the DANIDA private sector support program.

This paper provides an overview of current trends and paths of economic and industrial growth and investment in Mozambique, their macroeconomic impact and the trends with respect to industrial policy. It then develops an analysis about why a business and productive capacity program is necessary, as well as the main issues such a program should respond to. The paper concludes with some key remarks regarding donor experiences with private sector development programs.

2. Current trends/paths of industrial growth and investment in Mozambique

Over the past decade, growth and investment trends in the Mozambican economy have become narrower and more concentrated than ever. Gross Domestic Product (GDP) and Manufacturing Value Added (MVA) have been growing in real terms, but the sources of growth are increasingly narrower. Private investment has been very unstable on a yearly basis, but has reached significant levels over the last 13 years or so. It has also been narrowly focused and has tended to reinforce the narrow and disarticulated structure of economic growth. The dynamics of growth and investment have kept the Mozambican economy trapped in a situation where growth is unstable, unstabilizing and unsustainable. These, and other issues, are discussed in detail in this section.

2.1. Dynamics of growth and exports

The major sources of growth of GDP have been services (mostly trade, finance, transports & communications, tourism and construction), and mega and large projects in industry, energy, minerals and agriculture (aluminium, natural gas, heavy or mineral sands, energy, cement, beverages (particularly beer), sugar and cereal milling).

With the exception of tourism, all the other service sectors are heavily concentrated in Maputo: about 70% of trade and transport & communications services, and 75% of financial services and construction activity take place in Maputo. Furthermore, almost 80% of investment in transports takes place around the big corridors (Maputo, Beira and Nacala), with emphasis on the Maputo Corridor that links Mozambique and South Africa. Construction is concentrated around industrial mega projects, road programs with emphasis on the Maputo-Witbank toll road, and luxury housing around Maputo and Matola. Trade is fundamentally urban and retail and rural trade networks are very slow to develop. Finance is either speculative or related to large projects linked with international capital. Thus, services are developing around and helping to create economic dynamics

that are narrowly based and that operate against the broadening of the development basis.¹

Production and exports of goods have similar trends to services, as it would be expected. Although cereals for household consumption are estimated to be the dominant agricultural production, dominant agro-industrial activities are sugar (for the domestic market, but also a very important export good), tobacco, wood and cotton (all for export). These four agro-industrial products account for less than 15% of total industrial output, but represent more than 80% of agro-industrial output. Manufacturing output is heavily concentrated around aluminium, beer, cereal milling and soft drinks, which represent more than 70% of total output. Aluminium, alone, represents some 48% of total manufacturing output.²

In 2002, exports of goods represented almost 70% of export revenue, more than doubling the revenue from services. The ratio between exports of goods and services has been, on average, 0.82 for most of the last three and a half decades. This means that, roughly speaking, services usually represent around 55% of export revenue and goods 45%. However, between 1980 and 1983, and again in 2002, this ratio changed radically to 2.33, meaning that exports of goods represented 70% of export revenue in the period. In both periods, manufacturing industry became the most import source of export revenue.

In the early 1980s, this change was due to two factors: the oil crisis and the collapse of transport services to and from the hinterland. Mozambique used to export refined oil products, although it was a net importer of oil and oil products. The oil price boom of the early 1980s pushed the oil products share of manufacturing exports from 10% to over 30%. At the same time, the implementation of the UN mandatory sanctions against the illegal UDI regime of Ian Smith in Rhodesia, and the war against such a regime, reduced the rail and port traffic to and from the hinterland very significantly. At the time of the application of the sanctions against the illegal UDI regime, port and rail traffic to and from Rhodesia through Mozambique accounted for more than half of all revenue from transport services in Mozambique.³

In 2002, the dynamics of change of the export ratio were different, as the single most important factor explaining such a change was the introduction of aluminium exports. Since Mozal, the large BHP-Billiton aluminium smelter, started operation, Mozambique's exports of goods more than trebled. Mozal, which is responsible for 48% of total industrial output and 24% of MVA, also represents approximately 75% of manufacturing exports, 60% of exports of goods and 42% of total export revenue of

¹ INE (various issues of the statistics yearbook); Banco de Moçambique (various annual reports); KPMG 1999.; Castel-Branco 2003 and 2002a.

² INE (various issues of the statistics yearbook) and Castel-Branco 2003, 2002a and 2002b.

³ INE (various issues of the statistics yearbook); Wuyts 1989 and 1984, Castel-Branco 2003, 2002a and 2002b.

Mozambique.⁴ Put together, exports of goods from fishing, agriculture and all other industries (except aluminium) add to no more than two thirds of total aluminium exports.

Outside the dynamics of mega and large projects, particularly of Mozal, industrial output and exports are stagnant, manufacturing output has actually declined in 2003, and the MVA share of GDP, without Mozal, has fallen to the levels of 1971.⁵

2.2. *Dynamics of private investment*

Private investment, which has represented about 60% of gross capital formation in Mozambique between 1990 and 2003, is concentrated in a few mega and large projects, dependent on flows of external capital. Between 1990 and 2003, such projects or industries,⁶ comprising not more than 20 firms, have accounted for about 75% of all Foreign Direct Investment (FDI) accruing to Mozambique; 40% of National Direct Investment (NDI); and two thirds of all private investment. Natural gas and heavy/mineral sands (controlled by 4 large multinationals, two of which South Africans), absorb almost 90% of all investment in minerals. Aluminum and energy, sugar, beer, soft drinks, cereal milling and cement (some 16 firms, all of which are foreign owned, including 8 multinationals), absorb 94% of FDI, 50% of NDI and 73% of all private investment in manufacturing.⁷

Investment estimates, based on an analysis of 1,800 investment projects approved and implemented (or under implementation) during 1990-2003,⁸ also show that South African (SA) corporations are leading determinants of flows and patterns of investment in Mozambique. Directly, they are involved in 18% of all investment projects of the set of 1,800, and are responsible for about 40% of FDI and 15% of total private investment in Mozambique during the period. However, the total (direct and indirect) impact of SA corporations on private investment in Mozambique is much more significant than the direct impact: as a whole, the projects in which SA corporations are directly involved have absorbed 85% of all FDI accruing to Mozambique, 35% of NDI and 75% of total private investment. Additionally, 73% of all directly productive, financial loans (from commercial, multilateral or other sources) are associated with these projects.

SA investment is mainly associated with the minerals-energy complex (MEC) of SA: aluminium and energy, natural gas, heavy and mineral sands. Investment around MEC is heavily supported by the small number of very large SA multinational corporations (SA

⁴ INE (various issues of the statistics yearbook); Castel-Branco 2003; and Castel-Branco and Goldin 2003.

⁵ Castel-Branco 2003; Castel-Branco and Goldin 2003.

⁶ Aluminium and energy, heavy/mineral sands, natural gas, sugar, beer, cereal milling, soft drinks and cement.

⁷ Castel-Branco 2004, 2003 and 2002a.

⁸ Data base kindly provided by the investment promotion centre (CPI), and checked through contacts with provincial directorates for the respective sector.

MNEs, such as BHP-Billiton), large minerals and energy capital from around the world (Australia, the UK, Ireland, Japan), SA public enterprises (such as ESKOM and SASOL), investment and development agencies (IDC, IFC, EIB and others).⁹

In addition, SA investment has expanded quickly into areas of oligopolistic or quasi monopolistic competition, in a bid to globalize by using the region as a trampoline for world markets, or simply as an expansion of the domestic market. Mains areas of investment are: sugar (Illovo and Tongat Hullet control 3 out of 4 sugar estates, and IDC helped a Mauritian consortium to control the fourth); beer (SAB control all three breweries); soft drinks (SABCO has control, through a local branch, Coca-Cola, of all bottling plants), cereal milling (Namib Management controls or is involved with the largest cereal milling complexes, except one), mega tourism projects (Limpopo and Libombos), and mega infrastructures (management of major ports, major toll roads, communication systems and industrial parks developed around anchor projects associated with the MEC). Tourism and infrastructures are developed around the concept of spatial development initiatives (SDI), a SA public policy to expand the SA economy into the region.¹⁰

Associated with the MEC and oligopolistic expansion, SA investment has also moved into dependent industry and industrial services.¹¹ On the one hand, MEC, SDI and other large projects represent demand for certain industrial activities and maintenance and engineering services. SA firms were initially reluctant to move to Mozambique, as they could supply all services and goods from SA and did not know enough about industrial capabilities in Mozambique. This led to a quick expansion of linkages between supplier SA firms, based in SA, and mega and large projects in Mozambique.

In the meantime, Mozal's expansion and the starting or development of other mega and large projects intensified demand for such goods and services. Thus, SA firms were quick to move and take the opportunity to expand into Mozambique. However, they are still reluctant in making serious commitment and investment. Usually, they relocated to Mozambique workshops and warehouses that stock parts and make small repairs, employing a very small number of workers, and involving very little fixed (and sunk)

⁹ Industrial development corporation (IDC), a SA parastatal; international financial corporation (IFC), a member of the World Bank group; European Investment Bank (EIB). For sources: Lutchman and Naidu 2004; Rumney 2004, Fine and Rustomjee 1996; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004, 2003, 2002a and 2002b.

¹⁰ Lutchman and Naidu 2004; Rumney 2004, Fine and Rustomjee 1996; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004, 2003, 2002a and 2002b, Roberts 2000.

¹¹ The concept of dependent industrialization is linked to the following characteristics: import dependency; dependency with respect to exogenous dynamics of industrialization (including access, to markets, technology and capital, product design, investment decisions, etc.); dependent partnerships (such as in the case of integration with oligopolistic, international product and value chains); lack of dynamic backward and forward linkages within the economy outside the mega and large projects that have initiated the process. This pattern of industrialization cannot be identified as import substitution (even when firms produce only or mostly for the domestic market), as it does not substitute, but rather creates, import pressures. True import substitution would involve backward and forward linkages that this pattern of industrialization does not, usually, develop outside economic enclaves.

costs. Others have engaged in joint ventures with Mozambican firms, renting and, thus, taking advantage of the existing fixed capital, and making little and narrowly focused investment in upgrading some core capacities to provide specialized services for specific mega projects. Almost all these firms are import dependent, and a very large share of their imports comes from intra and inter firm trade with SA suppliers.¹²

Thus, links with mega and large projects have created dependent industrial capacities for the domestic market, but usually involving little commitment by the SA firms that have made the investment. However, as demonstrated by the capacities and number of firms involved, developing linkages with mega projects could be one of the core pillars of a strategy to support business and productive capacity development in Mozambique. Given the type of capacity that has been developed, concentrated in engineering and other services, such a focus of business and productive capacity development could help not only the firms involved but the business and productive dynamics as a whole, because it could help to provide capacities and services for all and reduce marginal costs of productive investment in Mozambique.

On the other hand, dependent business dynamics have developed around product chains controlled by SA or other MNE large corporations: this is happening in export of fruits and some basic agro-industrial products (honey, cassava products, animal food), some areas of metal engineering in which SA firms provide reputation and access to markets, tourism related activities, and others. On the whole, a very large proportion of existing and relatively successful (or at least not unsuccessful) small and medium firms have developed linkages with SA firms, some of which within the “black economic empowerment” (BEE) scheme.¹³

SA capital has long been a driving force in the Mozambican financial market. The literature on finance in Mozambique usually emphasizes that the Mozambican financial system is controlled by Portuguese financial interests. This is only partially true when one looks at the domestic financial system and abstracts from its international interactions. Worse still, this argument only holds if one abstracts from the relationship between finance, investment and production.

¹² According to Castel-Branco and Goldin (2003), some of the core industrial capacities and services developed around Mozal are as follows: *Engineering/manufacturing industry firms*: Cometal-Mometal (pots, chimneys and pipes); Tubex (tools and spares); Kempe/Metech (maintenance of pot lines); Forjadora (containers); Kanex (spares, metal structures and maintenance); Agro-Alfa (repair of start up equipment); MC Engineering (repair of start up equipment). *Construction firms*: Marcleusa (electricity substation in the plant and acoustic barrier in the port of Matola); Construções Chemane (maintenance, water drains, removal of temporary buildings); SORADIO (electric installations and wiring, and repairs); and Wade Adams (housing construction and maintenance of buildings). *Industrial services*: TDM (phone and phone data base network); EDM (shareholder and represented in Motraco); Strang Rennies Mozambique Consortium, SRMC (export of aluminium); Diesel Eléctrica (suppliers and maintenance of hydraulic equipment); Interwaste (industrial waste removal); and Transaustral (employee transport). *Other services*: Eurest Support Services (catering); Gray Security (manned security, reception, and armed response); Thsala Mozambique (catering and cleaning); Cinderella (laundry and uniform management); and Flor Real (landscaping earthworks).

¹³ Lutchman and Naidu 2004; Rumney 2004; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004.

In other words, Portuguese banks own most of the banks in Mozambique, and the larger banks from the point of view of domestic banking operations. However, the domestic banking system is responsible for less than 20% of financing of investment and production in Mozambique, and a significant share of their activity is limited to being an agency in channeling international capital flows. Most of the private capital invested in Mozambique over the last decade or so comes from SA and international financial institutions that also operate through SA banks. Thus, SA banks are far more important than Portuguese ones, but they used to operate mostly through direct relationships with mega and large projects and firms rather than through direct, physical presence in Mozambique.

More recently, the SA banking system has started to expand, physically, into the Mozambican economy in line with the dynamics of FDI in Mozambique. Hence, one new commercial bank was created and two commercial banks were bought by SA banks over the last two years. Given their experience in financing productive activities and their superior financial linkages and muscle, SA banks may be in a better position to expand their domination of the Mozambican financial system and, therefore, strengthen the dominance of the key investment dynamics in SA that are influential in Mozambique: MEC, oligoplistic competition, SDI and associated, dependent industrialization.

From the analysis of growth and investment dynamics, it seems that corporate strategies of SA firms (MEC, oligoplistic globalization, SDI and BEE) are the main determinants of levels and patterns of capital flows into Mozambique, and of the magnitude and patterns of economic growth and trade. This has, of course, strong implications for the determination of how Mozambican businesses and productive capacities can be developed, and in what direction.

2.3. Macroeconomic impact of current dynamics of growth and investment

Macroeconomic, productive and trade conditions in Mozambique are closely and dynamically related. On the one hand, productive and trade dynamics affect macroeconomic balances: employment, fiscal deficit, balance of trade and balance of payments deficits, savings, investment and growth. On the other hand, macroeconomic limits also constraint growth and investment dynamics. Finally, macroeconomic policy, aimed at providing monetary balances through monetarist approaches, contributes to shape the patterns of investment and growth, and may not help to address the productive and trade dynamics that may affect the imbalances that monetary policies are trying to address.

Thus, any approach to developing business and productive capacities has to take into account the dynamic relationship between macroeconomic, productive and trade conditions, including macroeconomic policy. To do so, it should start by looking at the impact of current patterns of growth, trade and investment on macroeconomic conditions, and how macroeconomic policies affect macroeconomic, productive and trade dynamics.

The macroeconomic-production/investment-trade *nexus* in Mozambique involves three main characteristics. First, the productive base of the economy is heavily import-dependent, such that imports of investment goods are highly and proportionally sensitive to investment. Second, the export basis is highly concentrated and narrow, established around primary products and up to 2001 was not elastic with respect to investment. Thus, investment and economic expansion have always been associated with chronic and increasing trade balance deficits. This is, every time the economy expands, the trade balance deficit increases to the point of crisis. Third, investment is highly dependent upon inflows of foreign capital. Thus, when investment and the economy expand, the capital balance becomes highly positive. In the short run, the capital balance surplus may offset some of the trade deficit generated by economic expansion. In the long run, if foreign inflows of capital are not continuous, capital repatriation and interests (and other investment services) payment will contribute to exacerbate the overall balance of payment deficit. This is, the trade deficit is chronic, while the capital balance surplus is short to medium term. Thus, the lasting effect of fast growth is balance of payment imbalances.¹⁴

This general trend has been slightly modified recently because exports have become more elastic with respect to investment. This is only due to the export impact of Mozal (aluminium), and the forthcoming export impact of SASOL (natural gas). As mentioned earlier, the other sectors have had a very small impact on increase of exports.

Mozal's net trade gains in 2004 are expected to be around US\$ 350 million, which will reduce Mozambique's trade deficit by more than one third. Between 1998 (when construction started) and 2003, Mozal's net trade gains were either negative or close to zero due to high import intensity of construction and production and a larger and longer than expected fall in the world price of aluminium. As production and exports approach steady state at full capacity, and world prices recover and stabilize, net trade gains tend to become highly positive.¹⁵

However, Mozal's impact on trade is not the only impact of Mozal on the balance of payments. Mozal also affects the capital balance and the balance of services through capital inflows (investment), payment of investment services, profit and wage repatriation, and so on. When the overall impact of Mozal on the balance of payments (BoP) is accounted for, net BoP gains are only about 30% of net trade gains. Furthermore, if one considers weak wage linkages (due to high capital intensity) and weak fiscal linkages (due to low wage linkages and high fiscal incentives) between Mozal and the rest of the economy, it is not that clear what the real macroeconomic impact of Mozal is, as very little of Mozal's net financial gains is retained by the Mozambican economy.¹⁶

¹⁴ Castel-Branco 2003, 2002a and 2002b.

¹⁵ Castel-Branco and Goldin 2003.

¹⁶ Ibid.

Additionally, there is the problem of export concentration: a 10% variation of world aluminium price will immediately change export revenue by more than US\$ 80 million, which is more than the overall exports of the manufacturing sector (excluding Mozal). At the same time, the trade deficit will change by about US\$ 40 million. Between 2000 and 2002, the world aluminium price fell by 15%, such that only in 2004 is Mozal expecting positive net trade gains. If BHP-Billiton adjusts output to a longer than expected fall in aluminium prices, export revenue loss will be even larger.¹⁷

Thus, leaving the solution of the macroeconomic-production/investment-trade *nexus* to mega projects seem to be not only unwise but dangerous. First of all, multiplier effects of such MEC projects are limited, unless they continue to expand (which is unlikely). Second, the import substitution effect of such projects is also very limited. For example, Mozal could reduce production related imports by one sixth at best, provided that the Mozambican economy can supply everything that is not electricity and alumina (which is unlikely to happen during the lifetime of Mozal's project). Third, the overall balance of payments, wage and fiscal linkages emerging from such projects are very limited: a cereal milling or beverage firm producing 1% of Mozal's output pays far more taxes than Mozal.¹⁸ Fourth, the economy becomes more volatile as exports become more narrowly based. In periods of boom, the economy tends to suffer from "Dutch disease", such that the exchange rate and the non-MEC productive basis become uncompetitive, domestic prices may go up and external trade trends may actually become more chronically imbalanced. In periods of doom, the economy may lose at least the equivalent to the exports of the entire manufacturing sector (MEC projects excluded). Fifth, policy and institutions will tend to develop around the dominant interests of the MEC and oligoplistic expansion, thus failing to systematically address the issues related to broadening the basis for growth, investment, trade and development.¹⁹

In the short run, mega projects can increase the elasticity of exports with respect to investment and have a huge impact on net trade gains, provided that prices are stable and productive and pecuniary linkages are developed with the rest of the economy. However, a strategy that is solely focused on mega projects to promote equilibrium, stability and dynamic economic linkages is bound to fail if the issues related to promoting a broad basis for development are not seriously addressed.

¹⁷ Ibid.

¹⁸ It can be argued that mega projects usually implement larger social projects than other firms. Together, Mozal and SASOL, for example, spend a total of about US\$ 10 million per year in social programs. However, this is less than half of what a 1% increase in turnover taxes of these projects would contribute to the state budget (these projects benefit from the largest tax holidays available in Mozambique due to their status as free industrial zones). Additionally, these mega projects' social programs tend to be focused on infrastructure building: schools, health centers, roads, housing complexes, and so on. The management and operation of such infrastructures is, however, assumed by the government and translated into pressures upon current expenditure. Thus, capital expenditure in social programs by individual projects may well crowd out the ability of the state to sustain such programs or to develop other social programs. Therefore, social programs would be better served if such projects pay more taxes.

¹⁹ Castel-Branco 2002a and Castel-Branco and Goldin 2003.

At the same time, since 1987 that the government has been trying to address serious macroeconomic imbalances through monetarist policies aimed at controlling aggregate demand and money supply. If external aid is excluded from the picture, progress with respect to macroeconomic stability has been minimal over the last 17 years. Although fast GDP growth has resumed, employment is continuing to fall, skills have been lost and entire industries have disappear, fiscal revenue has not kept pace with economic growth, and trade and balance of payments deficits are and tend to continue to be strong, unsustainable and rooted in the patterns of economic, business and productive capacity development.²⁰

Monetarist policies have a strong impact on real economic variables (investment, savings, growth, employment): they affect the level, type and allocation of resources available; the behavior of economic agents, including of the financial institutions, employers and employees; the ability to mobilize and deploy new resources and capacities; the dynamics that are more influential upon economic growth, investment, trade and development. Such policies have not coped well with monetary variables (except for inflation, that has been below 20%, but unstable, for 8 years, no other monetary variable improved significantly). Aid flows are going to start declining and mega projects will not replace the (apparent) “stabilizing effect” of aid flows. Thus, the time may have arrived when the costs and benefits of pursuing monetarist policies to stabilize macroeconomic conditions should be seriously and rigorously reassessed. Most importantly, data clearly shows that there is a clear macroeconomic-production/investment-trade *nexus* that is far more important in determining macroeconomic balances and long term development prospects than pure monetary variables as they are perceived by monetarist policies.

Thus, any program to develop business and productive capacities has to confront the macroeconomic-production/investment-trade *nexus*, or will tend to do little for sustainable and dynamic capacity development.

2.4. Trends in industrial policy²¹

The development of business and productive capacities cannot be conceptualized and implemented outside specific institutional, policy and economic contexts – capacities to develop, actions to develop them and the nature and type of business and linkages that may be developed, all depend, also, on institutions and policies in place. Therefore, it makes sense to look at the policy context of industrial development in Mozambique over the last decade or so.

In first instance, no coherent and relevant, explicit and formal industrial strategy exists in Mozambique. In August 1997, through its resolution 23/97, the Council of Ministers approved the document “Industrial Policy and Strategies”. This document has since never

²⁰ INE (various issues of the statistics yaerbook); Banco de Moçambique (various annual reports); Castel-Branco 2003, 2002a and 2002b, and 1994.

²¹ Section based on Castel-Branco 2002a and Government of Mozambique 1997a.

been utilized or developed by the government of businesses. Few civil servants, and even fewer businesses, are acquainted with the content of this document, and getting hold of a readily available copy of the document is not so easy. In addition, industrial policy documents were also approved for textiles and clothing (in the process of being revised), paper and graphic industry, cashew marketing and processing and sugar (focused on the price policy). With the exception of sugar, none of the others have been implemented in any significant way.

However, since the early stages of the process of neo-liberal economic reform in Mozambique, which started in 1987, the government has been concerned with the formulation of an industrial policy. This concern results from three practical factors: the role of industry in import substitution, exports and job creation; the need to address the fundamental weaknesses and pressures faced by the sector; and the need to replace central planning with indirect and “softer” forms of influencing industrial development. Industrial policy would provide a direction and incentives without interfering with business decisions. Therefore, although formal industrial policy is not part of the core mainstream policies, it plays its role in market-conforming economic reform. To do so, official industrial policy announces government intentions to the business community and avoids action and intervention by the state in any specific issue.

The marginalization of **active** industrial policy reflects three major problems. First, macroeconomic and trade policies are determined exogenously with respect to the needs of development of industry, as they mainly respond to stabilization and liberalization concerns and pressures. Therefore, industrial policy has no impact on these policies, and is constrained by them. Stabilization goals have led to cost cutting exercises that have been utilized as economic justification for the elimination of instruments of active policy (such as the development bank, BPD, subsidies to rural trade and key industrial sectors, public financing of training and provision of other key industrial services), for the weakening and marginalization of institutions and capacities of the state that are not directly linked with monetarist stabilization, and for the construction of a narrowly short-term focused financial system. Liberalization blindness has been the economic argument for withdrawal of the state from supporting a broad based development process. In a recent meeting with government officials, cashew nut producers (small peasants and larger farmers) complained that the price traders pay for the raw nut is not only very low, but it is falling in real terms. Government officials replied that the problem is exogenous: (i) there are not enough buyers of cashew nuts to promote competition and increase the producer price; and (ii) Mozambique has no processing, industrial basis and so has to rely upon the monopsony price that the Indian industry is willing to pay for Mozambique’s raw cashew nut. What these officials did not mention is that: (i) the domestic cashew processing industry was destroyed primarily by the liberalization policy of the government; (ii) this liberalization policy led to total dependency upon the Indian demand and price for Mozambican raw cashew nuts; (iii) the idea behind liberalization was that competition would emerge and, as a result, would increase the producer price and the incentive to invest in the production of cashew. The officials also did not offer any

alternative view or strategy about how to develop the cashew business.²² Their answer was like “the state washes its hands out of the cashew problem”.

Second, the dominant ideology in economic management in Mozambique, since economic reforms of neo-liberal orientation started, is that the government should not interfere with business decisions. Therefore, industrial policy also has no influence on micro economic decisions. The government is concerned about the level of investment because of its impact on growth and income, employment, wages and balance of payments. However, it pays little attention to the sources and allocation of investment and direction of industrial development, as these should reflect businesses decisions. In addition, the government does not seem to be particularly interested in the social costs of investment incentives and other strategies that promote almost any sort of capital inflows irrespectively of their costs and benefits for the society.

Third, apart from organized foreign capital (e.g., in aluminium, sugar, beverages and finance), there are no other strong and organized political and economic interests that would seek the formulation and implementation of a clear strategy and put the necessary pressure upon the state. Hence, public policy is open to capture and/or influence by a great variety of interests that are fragmented and do not necessarily result in coherent strategies.

Current official industrial policy documents, general or industry specific, have a common and complex, if not bureaucratic, ethos. More than half of each document consists of definitions, generalities, principles, and aims, before presenting lists of sectoral priorities. No realistic programme and practical system of implementation, monitoring or evaluation are included. The law defines the role of industrial policy as providing guidelines and transparency with respect to government intentions, whereas decisions concerning the implementation such intentions are a matter for the private sector.

The documents define six principles upon which industrial development should be based: (i) industrial policy conforms with general economic policy; (ii) manufacturing development is a matter for the private sector and should be based upon private sector initiatives; (iii) industrial firms need to modernise, not only rehabilitate; (iv) domestic regional inequalities and imbalances in development should be solved; (v) development should be environmentally sustainable; and (vi) regional integration within SADC is an opportunity for accelerating development through access to investment, technological and institutional externalities, and trade. This list is an indication of the tension that exists between laissez-faire ideology and the social and political demand for equitable and sustainable development. It also confirms that industrial policy is constrained by core stabilization and liberalization policies and is mainly an informational and rhetorical device.

The following sectoral priorities are defined in the industrial policy documents: food (sugar, beverages, cereals, copra and cashew, for domestic consumption and exports), textiles (satisfaction of basic needs and exports), metal engineering (provision and

²² “Jornal Notícias”, 12/04/2004, first page.

maintenance of capital goods) and building materials (diversified building materials for post-war reconstruction). Opportunities for development are identified in basic metals (intra-sectoral linkages and linkages with mining), chemicals (consumer goods and material inputs) and packaging and paper industries.

The strategy defined to implement these goals and priorities includes: (i) the adoption of three stages of manufacturing development, namely: rehabilitation, modernisation and diversification, and exporting; (ii) small and medium enterprises (SMEs), together with the private domestic sector, are considered to be the basis for industrialisation; (iii) FDI is important from the point of view of promoting linkages with domestic firms and investors. At a general level, this strategy is expected to be enforced through an enabling business environment that results from stabilisation, trade and financial reform, de-bureaucratisation, and public provision of infrastructures and training. At a more specific level, SMEs will be supported by general investment incentive schemes, especial funds, export credits, access to the stock market and other support services. FDI will be supported through the introduction of free industrial zones (FIZ) and other specific incentives that may be negotiated in each case.

However, these policies and strategies are not in line with the real dynamics of the manufacturing sector. This inconsistency is the result of several related problems. First, the dynamics of industrial accumulation are overlooked partly because of the dominance of orthodox economic policies based upon simplistic and inadequate assumptions about markets, agents and the working of the economy. Second, the role played by industrial policy in Mozambique is marginal, constrained by targets determined exogenously with respect to manufacturing, and aimed at making sure that the government does no more than announcing intentions. There are very few tools the government can use to implement industrial policy objectives successfully. Third, given macroeconomic constraints, the government is more interested in aggregate capital formation than in the pattern of investment and direction of development. This bias in investment strategy favors large, narrowly based and foreign owned investment projects, and penalizes small and medium, more diversified investment projects, foreign or national owned. Fourth, the government does not have the political and technical will and ability to pursue active industrial strategies, nor has acknowledged the need to acquire such capabilities. The better educated and more experienced civil servants are overburdened with current management. This is aggravated by the fact that the government has made many of them members of the board of various large privatised companies, in order to keep them working in the civil service despite low public wages. Fifth, the political and economic interests that are better organized and stronger are associated with FDI and large companies, not with domestic SMEs. In this connection, it is believed that active industrial policies deter investment, although the evidence rejects this view. Hence, the priorities defined in the policy documents are not respected by the state or the private sector, and the targets established have not materialised.

As a result, in three of the seven priority industries output has been declining. In the remaining four, output has become specialised around a narrower range of branches, such that about 80% of manufacturing production is now generated by large foreign firms in aluminium, beer, soft drinks, sugar, cereal milling and cement. These firms have also

made three quarters of investment in manufacturing between 1990 and 2003, which has become more dependent upon FDI and concentrated in Maputo.

Existing strategies concerning the establishment of special funds for SMEs and manufacturing support services have not been implemented or have been too modest to make a difference. Policy documents do not address and, given the core economic policies, may not be able to address the issue of how to finance such services and institutions. Thus, under the current circumstances strategies concerning special funds and support services cannot materialize unless a donor or multilateral agency decides to implement projects in this area. In this case, donor agendas may become more important than specific needs of the manufacturing sector and industrial policy. More importantly, the state may cease to be, or never grow to become, a crucial part of the dialogue within the manufacturing sector, being substituted for by a donor or group of donors and multilateral agencies.

The dynamics and structure of manufacturing production reflect the dependence of the sector upon FDI for financing of investment projects, as well as the narrow focus of FDI projects that correspond to business interest and strategies of international corporations. Unless alternatives to FDI are found, foreign investment has to become a central component of the analysis and formulation of industrial policy and strategy. To do this, the state has to acquire information and become more knowledgeable about international corporations mainly, in the Southern African region. Basic information required about these corporations are their productive and financial capacities, competitive conditions in the market they face and their relative position in it, and their corporate strategies with respect to internationalization of production, trade and finance. This information would allow state officials to define more realistically the priorities for manufacturing development and how they link with each other; to negotiate better deals with international corporations; to anticipate important issues of policy and implementation of projects; to prepare domestic firms to link with large FDI financed projects; to provide information to domestic firms so that they can organize and associate themselves to negotiate their participation in mega and other large projects through sub-contracting and joint ventures; and to produce credible and operational industrial and investment policies and strategies that would both attract foreign investment but also develop necessary domestic capabilities that complement and go beyond FDI.

However, FDI and FDI based dynamics, alone, cannot address the set of factors that makes the development of business and productive capacities so crucial. Thus, industrial policy will also have to diversify away from large FDI and FDI related projects, and provide a more effective framework for broad based industrial and economic development, which strengthens the links between processes, sectors, regions and capacities within the economy and between the domestic and the world economy.

3. The need for a business and productive capacity development program

The three big questions that the future development of the Mozambique economy has to be able to answer are: (i) how the macroeconomic-production/investment-trade *nexus* could be addressed in a sustainable and innovative way; (ii) how the development basis (sectoral, regional and social) of the economy can be broaden; and (iii) how the interests and capacities of economic agents (workers, managers, investors, policy-makers, and so on) can be mobilized to support and engage with virtuous dynamics of accumulation, growth and broad based development. It seems that significant increases in factor productivity, significant improvements in production and work standards, significant increases and diversification of exports and development of true import substitution are all core parts of the answers.

3.1. *Businesses and productive capacities*

One way of addressing the questions asked is to support broad based, business and productive capacity development. It should be noted, however, that business and productive capacity development differs substantially from the traditional “private sector support program” that donors and development agencies have become found of. Whereas the “business and productive capacity” (BPC) approach looks at all core aspects related to such capacities, the “private sector support” (PSS) approach is mainly focused on the issues that can create or consolidate private ownership and control (only some of which are part of the required capacities, or answers to developing capacities). For example: (i) BPC has to be selective with respect to capacities and dynamics to create, whereas PSS is not; (ii) BPC emphasizes the positive relationship between public, social and private capacities, whereas PSS opposes them; and (iii) BPC calls attention for labor organization, development and empowerment, whereas in PSS labor is a cost.

Although developing a BPC program is not the only, nor even the most important, response to the questions asked, it is, nonetheless, a crucial one. Why is it so?

First of all, the productive capacity of the economy (including direct productive linkages, infrastructures, services, skills, investment capacities, and so on) have to be developed in order for Mozambique to be able to face major development challenges associated with poverty reduction and increasing competitiveness of the economy. The Mozambique based private sector has been asked to perform such a central role in developing such productive capacities. However, for a number of reasons such section of the private sector is generally fragile, uncoordinated, lacks managerial, technical and economic knowledge to develop and to directly benefit from linkages with foreign markets and capital. Furthermore, businesses are unlikely to develop efficiently if productive capacities, at large, are weak and fragile. Finally, around the strengths and weaknesses of the domestic private sector, strong and entrenched interest are developing that often result in conflicts between firms, conflicting pressures for policy change, pressures that are damaging for the economy as a whole and very little clarity with respect to strategies that could bring about growth, stability and social justice and development simultaneously.

Thus, supporting business development requires a broader approach to developing business and productive capacities.

Second, Mozambican businesses and productive capacities should grow and develop in such a way as to benefit the balance of payment, increase fiscal revenue in a sustainable way, result in significantly more jobs, but also better and better paid jobs under better working conditions, and increase the rate of savings and investment. These goals, which are required to sustain high rates of growth and of poverty reduction, can only be achieved together if the productivity and efficiency of the economy improve as a whole. Thus, the private sector has to rise to this challenge, rather than continue to be trapped in a vicious circle of low or high profits, but always at a high cost to the economy and society.

Third, and in relation to the previous point, Mozambican businesses and productive capacities must rise, very quickly, to the challenges posed by regional and international commitments and trends, which will force Mozambique into furthering trade liberalisation with its partners in the region and the world. To benefit from trade liberalization, and to stop trade liberalization from damaging even more the current account balance, fiscal revenues and employment levels and standards, Mozambican businesses have to achieve the productivity, scale, scope, quality and reliability standards that are required to become competitive, build good reputation and be able to compete in the regional and world markets. These standards have to be achieved very quickly, which requires improved strategies and actions to develop such productive capacities and standards.

Fourth, Mozambican businesses and productive capacities must diversify into a broader social, sectoral and regional development basis. Recent economic growth and business development has been highly concentrated and narrowly based around a few FDI based mega projects (such as the large aluminium smelter, BHP-Billiton's Mozal, its power station, Eskom's Motraco, Sasol's natural gas project, the heavy or mineral sands projects), or around other relatively large FDI based investment in industries that operate under monopolistic or oligopolistic corporate strategies (such as CIMPOR's cement industry, SAB's beer industry, Coca-Cola SABCO's soft drink industry, and Illovo's and Tongat Hullet's sugar industry). As a whole, 6 industries and not more than 20 firms account for three quarters of private investment and two thirds of growth recorded over the last decade or so. These trends have narrowed the scope of economic activities and capacities, made the economy more vulnerable and volatile, and excluded large sections of business and population at large from benefiting from growth. Thus, business and productive capacities have to develop in order to significantly increase domestic linkages with mega and large projects and to develop other sources and poles of growth and development dynamics that help a broad (social, sectoral and regional) development path to emerge. This path should not only improve export conditions through diversification, but also strengthen domestic linkages and effective import substitution through backward and forward linkages emerging from major and diversified growth poles.

Fifth, the effects of "peace dividends" are coming to an end, such that the economy will tend towards stagnation if domestic investment and productive capacities and

organization do not improve very significantly and very quickly. Given the low level of economic activity and high, deep and wide spread poverty, an average real rate of GDP growth of 8% or higher over the next decade is necessary to make a significant difference towards social and economic development. Over the last decade, it was possible and relatively easy to achieve such high rates of growth because of the end of the war and normalization of life, resettlement of millions of peasants, massive aid, FDI based mega projects, and because of massively underutilised, existing capacities. High rates of growth could also be relatively easily reached because the starting point of the economy was so low. These “peace dividends” no longer work, or, at best, are not enough to continue to pull the economy towards higher rates of growth and social and economic transformation. Unless the productive capacities of the economy, and the strategies that guide and support them, are very significantly and quickly improved, Mozambique’s development goals will be jeopardised.

Hence, the chances that economic support to Mozambique results in sustainable economic growth and development are significantly improved by the adoption of a coherent and articulated program to support the development of productive and business capacities.

3.2. Policy, strategy and coordination

As mentioned earlier, the development of business and productive capacities cannot be conceptualized and implemented outside specific institutional, policy and economic contexts – capacities to develop, actions to develop them and the nature and type of business and linkages that may be developed, all depend, also, on institutions and policies in place. Therefore, it makes sense that business and productive capacity development addresses some of the key issues related to economic strategy and policy.

There are some key issues that have to be looked at if businesses and productive capacities are ever going to develop in ways as to respond to the three big questions asked earlier. First, is the issue of definition of growth, investment and development priorities, and of capacities, mechanisms and willingness to pursue them, support them, monitor the results and learn. It seems that agro-industry, and other forms of industrialization around broad-based and sustainable development and deployment of national capacities, linkages and resources, could well provide the focus for core policies. Additionally, given the dynamics of mega and large projects already in place or coming into place, it would also make sense to identify core linkages that are developing and could be developed further to strengthen dynamics of growth and increase the positive impact of mega and large projects on the macroeconomic-production/investment-trade *nexus*.

Second, there is the issue of institutional coordination of goals and objectives, responsibilities, strategies and policies and activities e capacities. The responsibilities for industrial strategies and policies are fragmented and bureaucratically distributed, with no relevance whatsoever for capacity creation. Supporting institutions and instruments of

policy (quality and standards, technological innovation, training, incentives, information, linkage promotion, finance, business centers and so on) either do not exist or are pursuing goals on their own, or are disarticulated from strategies and policies that core sectors try to pursue (when there is any). Although writing strategies has become fashionable and an important occupation for top civil servants, department based strategies are actually weakening coordination and promoting fragmentation, reducing overall capacity and weakening the link between, and relevance of, public sector programs and development of businesses and productive capacities.

One key and typical example is the issue of agro-industrialization. The Ministry of Agriculture and Rural Development (MADER) is interested in local agro-processing of small and micro scale as a last resort strategy to cope with small amounts of un-traded agricultural surplus due to market fragmentation; but has no vision of agro-industrialization as a process to develop businesses and productive capacities, and to transform and modernize agriculture and the economy. The Ministry of Industry and Trade (MIC) is developing strategies to rehabilitate and bring back to life the vast number of bankrupt or underutilized agro-industrial plants. MIC suggests doing this at any cost, including by facilitating cheap and duty free imports of the basic raw materials. However, no one is bringing these different institutions and pressures together and trying to identify what should be changed about agriculture and industry such that the country agro-industrializes. If this type of fragmentation continues to exist, none of the three big questions (asked earlier) will be answered.

Another typical case is that of incentives. On the one hand, they are too general and wide ranging to support any specific set of priorities. On the other hand, they are too wide and generous for very large projects, to the point of reducing their economic contribution to very close to zero. Finally, in many cases they may actually be irrelevant and redundant, particularly if one considers that investment decisions have more to do with globalizing corporate strategies than with any specific attractiveness of the Mozambican economy.

These two examples bring to the agenda another angle of the coordination problem: the focus of coordination or, in other words, the goals/objectives around which coordination takes place, and how coordination is performed. Which interests and dynamics should drive coordination of industrialization processes? Why and how are such goals/objectives/industries and firms selected and not others? What are the economic criteria that justify such selection and impose discipline upon the performance of the firms? Which institutional and political basis would be more likely to favor the development of “successful” industrial policy, and against what criteria would such successes be measured?

Third, there is the issue of development of cheap, easily accessible and good quality business services in training and technical and managerial education, information, finance, quality and standards, certification, advise, regulation, monitoring, systems of innovation and product and process development, marketing and market strategy support (particularly for exports), and so on. Public services have to become more business oriented and links between them and business and productive capacity needs have to be strengthened. Information has to be developed and made accessible through universal

platforms; and a culture of basing decisions and analysis on sound data and data processes has to be created and developed.

Fourth, there is the problem of business strategies: partnerships, specialization, choices of markets and technology, product and process development and adoption of known best practices that apply to specific conditions, accounting, and continuous analysis of costs, analysis of markets and developments in the industry.

Mozambican firms and industries are weakly organized, and very difficult to organize in networks, partnerships, and so on. There is an implicit and explicit idea and practice that firms should compete against each other, rather than against problems that prevent their sustainable development; and that cooperation between firms is more dangerous than beneficial. Many analysts attribute this problem to business culture, but they fail to explain the origin and resilience of such business culture. This is obviously a problem that seriously hampers the development of productive and business capacities, and that seems to be strongly linked with issues of public and private strategy and coordination, with the development of economic and technical complementarities and linkages between different types of firms, as well as with the broad (or narrow) range of opportunities for benefits from growth and developing accruing to a wide range of different agents: small and large firms, exporters and domestic suppliers, employers and employees.

3.3. Donor support to business and productive capacity development

It is not the aim of this paper to develop a comprehensive analysis of donor programs in support of business and productive capacity development. However, it is important to mention some key points, as it seems that before starting something new it would be interesting to learn from past experience.

First, donor programs in this field tend to support “private sector” development rather than the development of “business and productive capacities”. This emphasis might be ideologically driven, or may result from the simplistic, if not wrong, assumption that development of private ownership and control of economic assets equals development of business and productive capacities. Thus, the emphasis of most programs is on what may prevent transfer and control of assets and transactions between agents, rather than on what capacities should be developed (at business and government institutions, strategy, policy and capacities alike). Apart from mentioning red tape, bureaucracy, liberalization policies and simplification of procedures, donor programs almost never consider that business and productive capacities, and capacities of public institutions and quality of their strategies, are directly and positively related. Thus, private sector programs are often presented as an alternative or in opposition to development of overall (including public and social) capacities, and fall in an economic and strategic vacuum, which voids their relevance and effectiveness.

Second, donor approaches are not always complementary, and often they are fragmented and reflect the focus view of each organization. For example, with respect to private

sector development, the USAID is mostly concerned with red tape and simplification of procedures. While red tape is a problem, removing it does not add to capacities. However, if one sees the problem from a pure neo-liberal perspective, removal of red tape helps markets to operate better and lowers the costs of transactions. All the rest is left for market and private sector decisions. This, however, is fundamentally different from the more micro and less orthodox approach of UNIDO, for example, that focus on productive capacity creation and provision of systems of information and focus of policy-business coordination. Whereas the USAID assumes that capacities at micro level are better left to the market and businesses, UNIDO is concerned with creating such capacities in a more dynamic link between public institutions and private businesses. Thus, the fact that different donors operate at different levels does not necessarily mean that their programs are complementary; it may actually show how conflicting, or at least different, their approaches are.

Third, donors tend to create a donor coordination group for almost all big actions in order to pressurize the government to follow a certain path and agenda of policy. In a way, donor coordinate their strategies vis-à-vis the state, and by presenting common agendas transform their ideas into dogmatic truth. On this light, one should be careful and cautious about the recent creation of the donor group on “Private sector and economic growth”. What Mozambique needs is an articulated, national strategy, not a donor driven one. As one can see from the topics discussed/addressed by the donor group (facilitation, red tape, trade mainstreaming, and the like), the focus of the group is not on growth dynamics and business and productive capacities, but is, very clearly, on the donor’s agenda: trade mainstreaming and market liberalization.

Another problem related to this form of donor coordination is that if donors set the agenda on growth and private sector, they will “impose” such an agenda on public and private institutions alike. This happens independently of any donor direct pressure, because the only activities that take place on a systematic way at the level of public and private institutions alike are those financed by donors – CTA’s programs and approaches, as well as the focus of MIC on trade and on the relationship with CTA, are just two examples of this.

Thus, donors should rather support the emergence of an articulated and coordinated approach to growth and business and productive capacity development within national institutions (involving the government, trade unions and the businesses and business organizations), rather than developing their (donors) own institutional framework to articulate and impose an agenda that cannot articulate economic dynamic processes in Mozambique. The risk is very much that the disarticulation of domestic institutions will weaken private sector development and the political and economic framework in which it is based.

In conclusion, and generally speaking, there are three major and common problems with all private sector programs, bilateral and multilateral: (a) they do not form part of a broader and coherent strategy to develop business and productive capacities and the economy as a whole; (b) they do not strengthen domestic institutions and help them to become more sustainable and capable of developing strategies and policies; (c) the

programs, themselves, put conflicting pressures on public and private sector capacities. By lacking an articulated strategy and institutional setting, private sector support programs tend to become another of many donor financed programs and pressures that crowd out domestic capacities and initiatives.

There is urgent need to understand national experiences with respect to development of business and productive capacities, and to identify major strategic issues that have to, and can be addressed. For example, the government of Mozambique has created and developed organizations that deal with investors, investment and private sector development: the bureau for promotion of commercial agriculture (GPSCA), national institutes for cashew and cotton (INCAJU and INAM, respectively), bureau for private sector support (GASP), centre for investment promotion (CPI). In addition, there are private organizations that work for development of the private business productive capacities, such as, for example, Technoserve, the general union of cooperatives of the Maputo city (UGC) and GAPI. Each of these organizations represents different approaches and experiences, but also shares common knowledge and experiences.

How much do public and private domestic institutions and donors know about them and their knowledge and experiences, as well as capacities to conceptualize and implement articulated strategies? If any donor is ever going to support private sector development in a meaningful way, it has to learn from the existing experience, and it has to base its support upon existing stock of institutional capacities. Unless, of course, donors are more concerned with imposing their own agenda and weakening the state, rather than being concerned with developing business and productive capacities.

It would be better and more effective to support existing institutions to develop articulated approaches and interventions. For example, it would be more sustainable, more effective and would generate more multiplier effects to support GPSCA to become a core capacity in promoting articulated agro-industrialisation in close relationship with businesses, than it would to develop a coordinated donor approach based on donors' agendas that would impose priorities and directions of capacity building into national institutions.

Additionally, there are many fundamental points that emerge from studies and from experiences with private sector support programs that should be taken into account as possible general guidelines to develop strategies. These include, in addition to articulation of institutions, the need for information systems, business centers, business advice, strategies to build capacities, to advise and inform business and investment decisions, and so on.

In relation to this last point, it would be important to identify consultancy and advice capacities that exist in Mozambique and that can be easily mobilized (not only consultancy firms, but also banks, industrial associations, public sector institutions like CPI and GPSCA, etc.).

Maybe, the most radical and innovative role that could be played by a donor program on growth and business and productive capacity development would be to help the

government, businesses, trade unions and donors to understand the need for an articulated approach and institutional setting (including such aspects as incentives, policies, procedures, facilities and organizations). These could evolve into an institution that, around certain goals (such as, for example, agro-industrialization and linkages with mega and large projects), could coordinate business and productive capacity development within a clear industrialization strategy.

These goals could only be developed and achieved if the overall picture of business and productive capacity development, including the macroeconomic-production/investment-trade *nexus*, is far better understood and considered.

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