SUPPORTING ECONOMIC TRANSFORMATION

BRIEFING PAPER

Megaprojects and economic transformation in Mozambique

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Key messages

- Despite strong recent growth, Mozambique's economy has not developed structurally. The bulk of economic activity and employment is in agriculture, with little diversification into manufacturing or high value-added services.
- Boosting local content and linkages with megaprojects could raise value-added in domestic processing and manufacturing in Mozambique, and enable domestic producers to integrate better into global value chains.
- Mozambique needs to improve technical capacity to analyse and negotiate deals for megaprojects that explicitly promote local upstream and downstream industrial and service linkages with the domestic economy.

The challenge for economic transformation in Mozambique

Although Mozambique has grown steadily over the past decade – with gross domestic product (GDP) expanding by 5–7% in real terms each year – the economy has not developed structurally. Most economic activity and employment is in agriculture, with little diversification into manufacturing or high value-added services (Balchin et al., 2017).

Mozambique has struggled to create enough jobs for inclusive growth. GDP per capita is low, unemployment is high (currently 27%) and many people are employed in low-productivity and low-paying activities. The jobs crisis is being exacerbated yearly by 420,000 new entrants to the labour market (Balchin, 2017).

Mozambique needs to transform its economy, diversify into high-productivity industries and develop linkages from these to agriculture, fisheries and other natural resource-based sectors. This would improve the economy's resilience and help create much-needed jobs in a sustainable way.

A role for megaprojects in supporting economic transformation and job creation?

Megaprojects can be important engines for economic growth and transformation and poverty alleviation. They facilitate technology and knowledge spillovers and help link domestic firms to global value chains. They also burnish the country's image and profile in the eyes of investors and thereby help attract more foreign investment. Moreover, megaprojects can make major fiscal contributions for state coffers, for example via taxation or profit-sharing. If used effectively (e.g. by investing fiscal revenues to improve infrastructure and education to support industrial production), such revenues can promote economic transformation.

Megaprojects also generate jobs. While the projects themselves are often not major job creators, given their capital-intensive nature,[1] they do generate much employment *indirectly*, for instance in construction of infrastructure and industrial and service facilities and in local firms supplying goods or services. Megaprojects also create opportunities to develop local skills through training and on-the-job knowledge transfers.

The extent to which megaprojects have vertical or horizontal linkages with the rest of the economy greatly affects their spillovers, their net contributions and whether employment, fiscal and other transformational impacts are achieved.

For example, the development of backward linkages from megaprojects to domestic firms that supply services, materials and machinery promotes local industries, creates jobs, develops skills and boosts access to technology. Analogously, forward linkages create value chains comprising entirely new industries, for example in aluminium rods and wire and steel bars and flats. Such linkages enhance local production and drive improvements in local industrial capabilities.

Enhancing local content in industrial production is one of several ways to transform the Mozambican economy and create jobs. Moreover, megaprojects could better stimulate backward and forward linkages with multinational corporations and local small and medium enterprises (SMEs) in Mozambique (Balchin et al., 2017).

Experiences elsewhere suggest that raising the quantity, quality and variety of inputs sourced locally for use in megaprojects could help develop Mozambique's industrial base. Local content policies in Nigeria's oil and gas sector helped deepen backward linkages to local industries such as fabrication and construction, the construction and completion of wells, installation and maintenance of control systems and other information and communications technology (McCulloch et al., 2017). Norway gradually built up domestic capabilities in the oil and gas sector and prioritised procurement from local suppliers that could compete internationally on price, quality and delivery metrics (ibid.). In Bangladesh's successful garment sector, local content policies were backed by the creation of specialised institutions to boost garment industry skills and mechanisms to encourage technology transfers from foreign investors (GPRB, 2010, 2016; Yunus and Yamagata, 2012; UNIDO, 2016).

If implemented effectively, efforts to boost local content and backward and forward linkages with megaprojects could facilitate higher value-added in domestic processing and manufacturing in Mozambique. Partly reorienting demand from export-focused megaprojects towards goods and services supplied by local firms may also enable domestic producers to better integrate into global supply chains of the large corporations and major multinationals.

The impact of existing megaprojects in Mozambique

Though megaprojects can contribute to Mozambique's economic transformation, their impact has been mixed. Megaprojects such as the Mozal aluminium smelter, the Temane gas projects in Inhambane and the Moma titanium ore and heavy sands project in Nampula have been major catalysts for significant inflows of private foreign direct investment into Mozambique (Castel-Branco and Ossemane, 2010). Megaprojects have also contributed significantly to recent economic growth (Xiong, 2015). The International Monetary Fund (2011) cites historical evidence indicating that annual economic growth in Mozambique is boosted by 2–4 percentage points in the years following the start of a major megaproject. The Mozal, Sasol and Moma megaprojects alone raised Mozambique's average annual growth by 1 percentage point between 1996 and 2006 (Sonne-Schmidt et al., 2008).

Megaprojects in Mozambique are major exporters, accounting for 60–70% of the country's total exports (Xiong, 2015). Much of the growth in exports from Mozambique since 2000 has been driven by megaprojects (Nucifora and da Silva, 2011). These projects have thus made a significant net contribution to Mozambique's balance of trade and helped increase the elasticity of exports relative to investment, albeit in many cases by targeting exports of primary goods (Castel-Branco, 2010).

At the same time, many inputs used by these megaprojects are currently imported. Based on 2011 data, megaprojects accounted for 36% of all goods imported into Mozambique (OECD, 2013). This reflects their inadequate linkages with the local economy and limited use of domestic intermediate inputs. Megaprojects have generated few productive linkages, either upstream or downstream, to domestic firms, in part because of the limited productive and technological capabilities of local firms (Castel-Branco, 2002, 2004, 2010).

The fiscal contribution of megaprojects has also been limited. Between 2007 and 2011, they accounted for just 0.5% of total fiscal revenues in Mozambique,

[1] Mozal, for instance, contributes around 5% of Mozambique's GDP but employs only 0.02% of the country's labour force (Xiong, 2015).

mainly because they benefit from special tax regimes (e.g. reduced corporate tax rates, tariff exemptions, reductions on standard income tax rates). Mozal, for example, benefits from tax concessions with no expiry date (Coughlin, 2018). Similarly, there has been limited reinvestment of profits from megaprojects in Mozambique (Nucifora and da Silva, 2011). Instead, significant shares of their revenues go overseas to pay for imported inputs, debt servicing, royalties, dividends and workers' remittances (IMF, 2006; Castel-Branco and Ossemane, 2010).

Inadequate linkages and large financial repatriations have thus reduced the ability of megaprojects to transform Mozambique's economic structure, generate jobs, advance social development and reduce poverty. This has led to criticism that megaprojects contribute little to the wider economy and the lives of most Mozambicans.

Ways to ensure megaprojects support economic transformation and create more jobs in Mozambique

Past attempts at creating backward and forward linkages between multinational corporations and local SMEs in Mozambique have been only partly effective in enhancing local capacity (Krause and Kaufmann, 2011). Evidence suggests this owes partly to a failure to negotiate advantageously with multinational companies investing in megaprojects.

In a related study for ODI's Supporting Economic Transformation (SET) programme, Coughlin (2018) evaluates six case studies of large and megaprojects involving diverse industries – aluminium smelting and ingot production, aluminium rods and conductors, iron ore mining and iron and steel refining and rolling, motor vehicle assembly, beer production and crude oil refining – and finds evidence of flawed negotiation processes that were disparate, uncoordinated and largely bureaucratic and legalistic. The study shows that, in many cases, Mozambique's negotiators were admittedly ill-prepared, lacked technical expertise and experience in conducting large international negotiations and were negotiating from a competitively disadvantaged position, often because of their failure to thoroughly research the history, needs and capabilities of the would-be investors.

Being fragmented, the negotiations involving different ministries often allowed Mozambique's negotiators to make excessive concessions, in the absence of strategically oriented central supervision and insufficient technical analysis to guarantee an integrated, development-oriented approach to negotiating such deals. Among other flaws during the six negotiations, detailed discussions were never held about how to promote upstream or downstream industrial or services linkages with the megaprojects (Coughlin, 2018).

To address these issues, Coughlin (2018) highlights a range of reforms that could improve Mozambique's capacity to ensure megaprojects are negotiated more effectively. Among other proposals, the creation of a Central Negotiations Authority is suggested, with well-trained and experienced staff to guide negotiators and analyse and approve investment authorisations.

Coughlin (2018) also emphasises the need for the newly constituted Agency for Promotion of Investment and Exports to play a proactive role in supporting negotiations for new megaprojects, especially by 1) conducting due diligence research of investors' financial and technical structures, alternatives and motives; 2) carrying out technical and economic evaluations of proposed land and fiscal concessions for megaprojects; and 3) monitoring the implementation of major components of investment agreements. It is also suggested that future agreements for megaprojects include contract clauses to specify the investors' quantitative and financial commitments, particularly to support training and promote upstream and downstream linkages.

The latter could also be supported by efforts to improve the public transparency of deals involving megaprojects. This could involve greater transparency about megaprojects' revenues and tax contributions and the details of their specific commitments to support local industrial development. Transparency would make it easier to monitor whether investors fulfil their contractual promises with the government.

These measures would help ensure that future megaprojects contribute more to transforming Mozambique's economy and help the country face its very challenging short-term macroeconomic situation, build a resilient and diversified economy and create jobs.

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