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Mozambique — Completing the successful transformation of the development model

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Mozambique — Completing the successful transformation of its development model

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Summary: Mozambique, a country in southern Africa that stretches for 2,800 km along the Indian Ocean, is the fifth-poorest state on the planet, with alarming human development indicators. Despite having had robust economic growth for the last thirty years, this growth is largely due to the exploitation of raw materials with no, or only minimal, local processing. This results in an extractivist and extremely unequal development model. A fragile state that has been marked by decades of fighting and corruption scandals, Mozambique also appears to be one of the most vulnerable countries in the world to climate change.

Nonetheless, the current trend is positive. In May 2022, the authorities agreed a financing program with the International Monetary Fund (IMF), marking the return of donors after six years of absence. In this context, Mozambique is benefiting from an influx of external financing, and ambitious budget reforms are being carried out, with initial results already tangible. Above all, exploiting the vast gas reserves could enable a real economic boom in the medium term, since the country potentially has the tenth-largest reserves of natural gas in the world off the coast of Cabo Delgado Province in the far north. Although these gas megaprojects have been threatened and delayed by recurrent Islamist attacks in the region, they would result in a total economic benefit of around USD 300 billion by 2050, according to the World Bank, equivalent to 15 times the country's current GDP.

The arrival of a huge gas windfall represents a historic opportunity for Mozambique's economy, which could lead to significant growth. While the prospect has given rise to great expectations among the population, the path to harmonious socioeconomic development still seems fraught with difficulties. With a general election on the horizon for fall 2024, the challenge for the future president will be to complete the successful transformation of the country's development model.

Thematic area: **Macroeconomics**

Geographical area: **Mozambique**

1. Despite thirty years of strong economic growth, Mozambique remains one of the poorest countries on the planet

Mozambique has been one of the most dynamic economies in the world for the last thirty years, having achieved an average annual growth rate of 6.6% between 1992 (the end of the civil war) and 2023. This gives it the eighth-highest growth rate in the world over this period, and the third-highest in sub-Saharan Africa, beaten only by Equatorial Guinea and Ethiopia (14.1% and 7.9%, respectively). However, these good macroeconomic results stand in sharp contrast to the slow improvement in the country's human development indicators. With a GDP per capita that remains below 1,500 USD in purchasing power parity in 2022 (equivalent to 647 current USD), **Mozambique is the fifth-poorest state on the planet**, ahead of only Burundi, the Central African Republic, the Democratic Republic of the Congo, and Somalia. Consequently, it is on the list of Least Developed Countries (LDCs) and Low-Income Countries (LICs), ranking 185th out of 191 countries on the UN's Human Development Index (HDI). In addition, three-quarters of the population lives in extreme poverty (threshold of 2.15 USD PPP), and the figures for literacy (60%), life expectancy (59 years), access to electricity (31%), and HIV prevalence (12% of adults) have not improved sufficiently, or have seen no improvement, over the long term.

Table 1 - Mozambique's human development indicators

	Years				Δ 2000-2022	
	1990	2000	2010	2022*	*Absolute*	*Relative*
GDP per capita (constant USD, PPP)	461	621	1044	1251	*+630*	*+101%*
Human Development Index	0,28	0,30	0,41	0,46	*+0,16*	*+53%*
Level of extreme poverty (%, 2.15 USD 2017 PPP)	/	83	71	76	*-7*	*-8%*
Literacy level (%)	27	39	51	60	*+21*	*+54%*
Life expectancy (years)	42	49	54	59	*+10*	*+20%*
Level of infant mortality (‰)	179	112	71	51	*-61*	*-54%*
Level of access to electricity (%)	/	6	19	31	*+25*	*+408%*
Level of HIV prevalence (%, 15-49 years)	/	9	12	12	*+3*	*+35%*

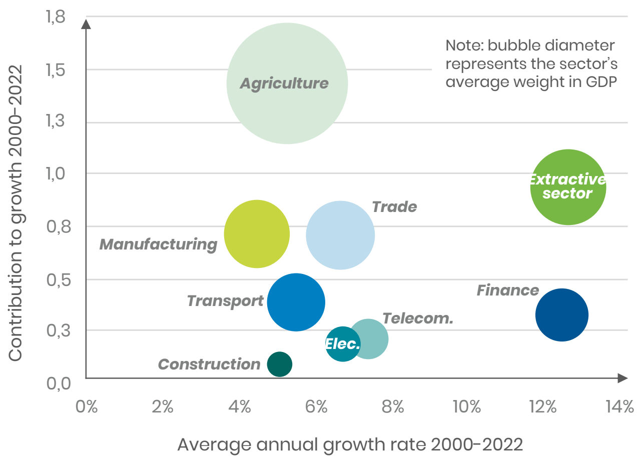
**2022 or last data available*

Sources: World Bank, UN, AFD calculations

This paradox between robust economic growth and a deterioration in human development indicators is largely due to the nature of Mozambique's development model. As the east-west orientation of its infrastructure attests—historically, this was in order to export raw materials from the country itself or from neighboring landlocked states toward the Indian Ocean—**the economy is focused on the exploitation of raw materials with no, or only minimal, local processing.** Agriculture (mainly subsistence agriculture), the extractive sector (coal, rubies, graphite, titanium, zirconium), and the production of aluminum therefore constitute the main drivers of growth. This extractivist model is both outward-looking (trade openness at 100% of GDP) and externally financed (FDI inflows reached 24% of GDP on average between 2010 and 2022, the third-highest in the world over the period).

This model, which is not very inclusive and is oligopolistic, leads to limited redistribution of the fruits of growth: with a Gini index of 50 in 2019, **Mozambique is the tenth most unequal country in the world** (average of 41 in sub-Saharan Africa, according to the World Bank). The extraction of raw materials with no, or only minimal, local processing prior to export also results in a very low level of job creation, which accounts for a pervasive informal sector, absorbing 95% of workers. These inequalities seem to be largely regionalized. Historically, economic activity is mainly clustered around coastal towns and along export corridors. In a country that stretches across a length of 2,800 km and which has few north-south transport routes, the dominance of a few coastal towns (including the capital Maputo, in the far south) has led to the sidelining of large parts of the territory, particularly the inland and northern provinces.

Graph 1 – Agriculture and the extractive sector are the main drivers of economic activity



Sources: Mozambique National Institute of Statistics, AFD calculations

This slow socioeconomic progress can also be attributed to the breakdown in governance. **Marked by decades of fighting, public policy is tainted by accusations of electoral fraud and high-profile corruption cases** (especially the "hidden debt scandal" of 2016[1]), which undermine citizens' trust in the state and the civil service, the effectiveness of macroeconomic policy, and the quality of public services. Five out of the World Bank's six Worldwide Governance Indicators therefore place the country in the lowest quartile in the world: political stability (11th centile), rule of law (16th), control of corruption (22nd), regulatory quality (23rd), and government effectiveness (25th). In addition, Mozambique ranks 145th out of 180 countries on Transparency International's Corruption Perceptions Index.

Finally, Mozambique's high exposure to natural disasters must be identified as a major obstacle to its development. As illustrated by the damage caused by Cyclone Freddy in early 2023, the World Bank estimates that storms and floods have affected a total of 8.8 and 6.2 million people, respectively, over the last forty years. Almost half the population is also affected by periods of drought and, more generally, by extended periods of limited access to water each year. Ultimately, the cost of damage linked to natural disasters is estimated at an average of 5 GDP points, with significant variability (11.3 points in 2019). Therefore, **Mozambique was the fourth most affected country in terms of human and material damage from extreme climate events in 2000-2019**, only beaten by Myanmar, Haiti, and the Philippines (proportional to population size and GDP, according to German Watch).

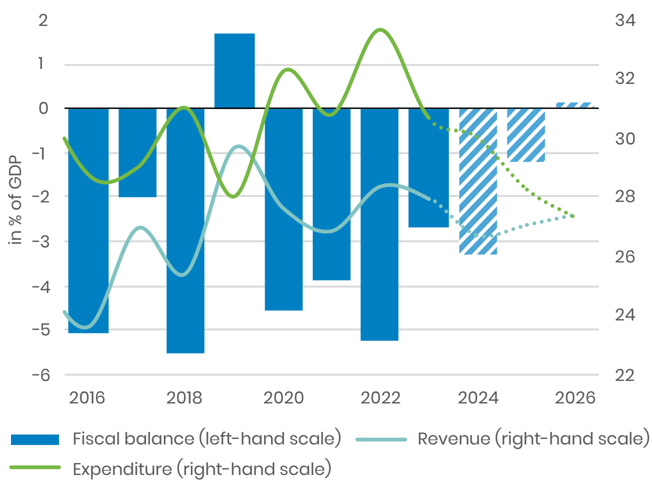
[1] Over 2013-2014, USD 2.2 billion in loans (12% of GDP) were taken out by three state-owned enterprises in order to purchase a tuna fishing fleet and shipping equipment. These loans benefitted from sovereign guarantees without parliamentary approval and without informing Mozambique's donors in advance (even though the country was the beneficiary of an IMF program), and a large proportion of the loans appears to have been misappropriated. The exposure of this "hidden debt scandal" in 2016 damaged Mozambique's international reputation greatly and led to the suspension of budget support from donors and a downturn in foreign investment, throwing the country into an economic crisis.

2. Between a political will for reform, the return of donors, and the prospect of gas revenue, the current macroeconomic situation is positive

Public finances are one of the main weaknesses of Mozambique's economy. The budget appears to be weighed down by the salary costs of the growing public sector (absorbing two-thirds of revenue), the pervasiveness of the informal sector, the burden of security expenditure, the failures in cash management (recurrent arrears), the various tax exemptions granted, corruption, and, more generally, a great deal of opacity. The exposure of the "hidden debt scandal" in 2016 only highlighted the imbalances that already existed: while the country relied essentially on the inflow of concessional debt, the suspension of donors' budget support forced the authorities to resort to expensive alternative financing (local banks, international markets), leading to a rapid rise in the debt burden.

Significant efforts at consolidation have been made since 2022, however, including an ambitious reform of the public sector,[2] the reintroduction of an adjustment mechanism for fuel prices,[3] and the removal of a series of VAT exemptions. In the short and medium term, the reforms are set to continue, with new measures aiming to reduce the salary costs of the public sector (ideally, to reach 10% of GDP in 2028, 7 points less than in 2022),[4] to modernize the terms of cash management, and to reinforce supervision of state-owned enterprises. These reforms can be linked with **the "return of donors"[5] to Mozambique, after six years away.** The approval of an IMF program (Extended Credit Facility of around USD 450 million over 2022-2025) enables an inflow of concessional external financing, notably of grants, which reached more than 4% of GDP in 2022 and in 2023 (compared with less than 2% over 2016-2021). Ultimately, the reforms that have been put in place and the return of donors enabled the budget deficit to be almost halved between 2022 and 2023, from 5.2% to 2.7% of GDP. Even if it increases slightly in 2024, notably due to the organization of the election, the fiscal balance is likely to move toward equilibrium, and a small surplus is even projected from 2026 by the IMF.

Graph 2 – Reforms and the return of donors enable a net fall in the budget deficit



Sources: IMF, AFD calculations

[2] Salary decreases of 20 to 30% (except for four lower income brackets), suspension of the "13th-month salary" in 2022, non-replacement of two out of three civil servants (except for health, education, justice, and agriculture).

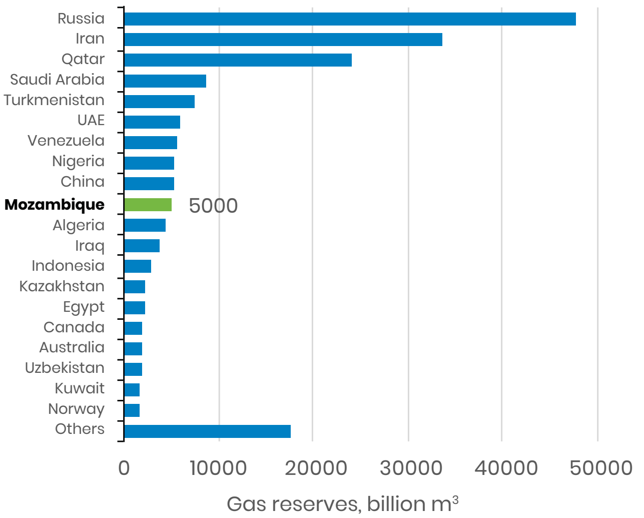
[3] Mechanism suspended from August 2022 to May 2023.

[4] Non-replacement of two out of three civil servants until 2028, salary freeze until 2025 then adjusting for inflation, recalibrating bonuses (the "13th-month salary"), promotion freeze until 2026, early retirement for 25,000 civil servants (out of a total of 500,000), and an audit carried out to remove "phantom employees" in the civil service.

[5] The majority of donors' budget support was suspended between 2016 and 2022 (excluding the pandemic), but project support was maintained.

In parallel with these budgetary aspects, the economy could expand significantly in the medium term by becoming a major producer of natural gas. Between 2010 and 2013, vast offshore gas reserves were discovered off Cabo Delgado Province (in the far north). With 5,000 billion m^3 of potential assets, **Mozambique may well have the tenth-largest reserves of natural gas in the world** and could rapidly become the third-biggest exporter of liquefied natural gas (LNG) on the planet (after Qatar and Australia). The extraction and liquefication of natural gas would take place via three separate megaprojects: Coral South FLNG (floating liquefied natural gas) to be carried out by Eni, *Mozambique LNG* to be carried out by TotalEnergies, and *Rovuma LNG* to be carried out by ExxonMobil.

Graph 3 – Mozambique may have the tenth-largest reserves of natural gas in the world



Sources: CIA, AFD calculations

Requiring a total investment of around USD 60 billion, **these megaprojects could result in an economic benefit of around USD 300 billion by 2050, equivalent to 15 times the country's current GDP** (World Bank). However, forecasts vary according to the assumptions made, especially since current projects might be extended, and bidding was recently held for new blocs. Besides a significant increase in GDP, this gas windfall would generate substantial budgetary revenue, since the state would gain around a third of the economic benefit. Similarly, LNG exports would allow consolidation of the balance of payments, notably enabling the current account (in a permanent deficit since 1977) to achieve a surplus rapidly.

After five years of construction, **production was launched at *Coral South FLNG* in November 2022, but it is still a long way off at *Mozambique LNG* and *Rovuma LNG*.** These two megaprojects, which are considerably larger, require onshore liquefaction trains to be developed, in contrast with *Coral South FLNG*, which uses a floating gas liquefaction platform. However, attacks in Cabo Delgado by Islamist groups (around 5,000 deaths, up to 800,000 internally displaced persons) have led to numerous delays since 2017. TotalEnergies declared "force majeure" on the *Mozambique LNG* project in April 2021, and *Rovuma LNG* is awaiting a final decision regarding investment. Consequently, these two megaprojects will not be launched until 2027 and 2029, respectively, according to the IMF.

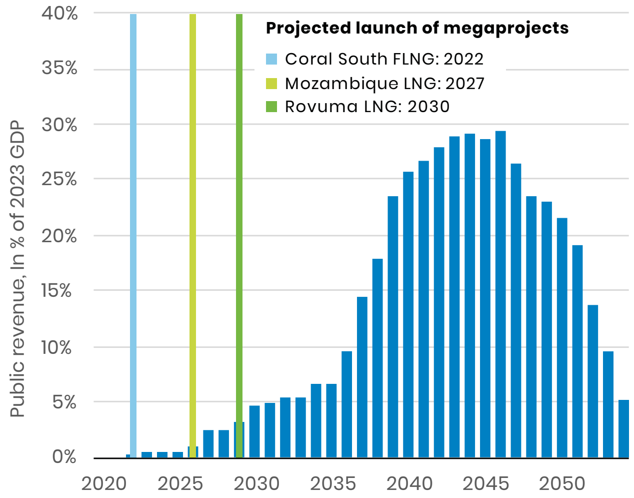
Given that commitments to carbon neutrality imply a rapid fall in worldwide consumption of hydrocarbons, **an increased dependance on natural gas represents a significant vulnerability.** However, it is likely that global demand for natural gas will be maintained in the medium term, at least during a transitional phase. In addition, **the risk of a downturn in demand and in prices appears to be under control, in theory**, since a large proportion of Mozambique's as-yet unextracted production has already been sold via long-term contracts (the first 20 years of *Coral South FLNG*'s production, and 90% of *Mozambique LNG*'s production).

3. At a turning point: The challenge of transforming Mozambique's development model

While Mozambique faces considerable challenges concerning development, the arrival of a huge gas windfall represents a historic opportunity for transforming the country's growth model. Nonetheless, the path to harmonious socioeconomic development still seems fraught with difficulties.

Firstly, **the risk of budget overruns is still non-negligible, at least until 2030**. Despite reforms and the support of donors, Mozambique is still one of the most indebted countries in sub-Saharan Africa. With public debt representing 92% of GDP at the end of 2023, Mozambique has the fourth-highest debt ratio in the region (after Cape Verde, Zambia, and the Republic of the Congo). While the sharp rise in revenue linked to gas exploitation should eventually enable fiscal consolidation, the economic benefit is likely to remain marginal until 2030 and not to increase significantly until 2035, due to the slow ramp-up in production and contracts that provide for an initial cost-recovery period for the major companies involved. As a result, **during a long transitional phase, the country will have to juggle reduced fiscal space and very limited sources of financing**: donors that are already facing high demand, a prohibition on non-concessional external debt (terms of the IMF program), and very expensive domestic borrowing. In this context, it seems crucial to continue consolidation reforms and to maintain donors' support, especially since the risk of economic shock and/or further delay to the megaprojects is not out of the question. Despite the pressing need for investment, a large proportion of the windfall will be deposited in a sovereign fund. While this option aims to stabilize the budget in case of a shock, to generate post-gas exploitation revenue, and to ensure transparent management of the windfall, it will mean that 40% of the state's gas revenue (then 50% after 15 years) will be invested in foreign assets (and will therefore not directly contribute to the budget).

Graph 4 – Revenue from gas exploitation may remain marginal until 2030



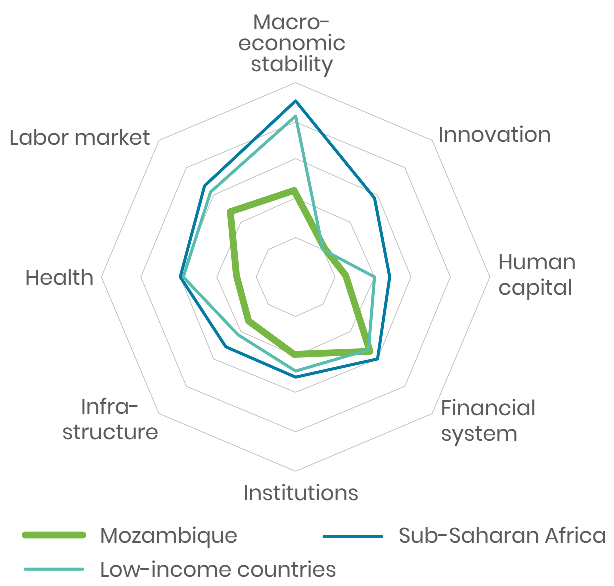
Sources: Ministry of Finance, IMF, AFD calculations

The transformation of the development model cannot be carried out by Mozambique's state–already heavily in debt–on its own, and recent economic history attests to the fact that economic activity that focuses essentially on extractive and industrial megaprojects does not guarantee sufficient job creation. Consequently, initial measures aiming to stimulate economic activity beyond raw materials and to encourage investment have been implemented over the last few years, notably the *Pacote de Medidas de Aceleração Económica* in mid-2022.[6] However, **the emergence of a dynamic formal private sector is still greatly limited by the poor state of the business climate**. There are still numerous obstacles: a dire lack of infrastructure, failings in the banking sector (private sector credit worth 18% of GDP in 2023, compared to 25% in sub-Saharan Africa), the state's recurrent arrears, significant

[6] Notably, these measures include a one-point decrease in VAT, tax exemptions in several target sectors (agriculture, transport, energy), the creation of a guarantee fund of USD 120 million for SMEs, simplification of procedures for capital repatriation, and visa exemptions for businesspeople and tourists.

centralization of power and wealth in Maputo, lack of local expertise, endemic corruption, kidnapping of businesspeople, etc. More generally, **prospects for diversifying the economy seem limited**. Given that most gas production is intended for export, the massive inflow of foreign currency could well lead to a sharp appreciation of the local currency and, ultimately, a loss of competitiveness in non-gas activities. While the economy today is based almost exclusively on the exploitation of raw materials, efforts to develop new sectors risk being undermined rapidly by the "Dutch disease."

Graph 5 – Mozambique's business climate appears to have deteriorated sharply



Source: World Economic Forum, AFD calculations

Unless use of this windfall is strictly controlled, it would seem hard to avoid an increased dependence on raw materials, with the risk of macroeconomic aggregates being exposed even more than currently to international prices.

Finally, and despite their stated intention, **the authorities' capacity to implement large-scale structural reforms risks clashing with questions of political economy**. The fundamentally unequal nature of Mozambique's economic model, the ambiguous links between the political sphere and the business world, the poor record of corruption in the country, and a history of violent conflicts mean that there is a valid concern that the revenue may be captured by a minority. Consequently, it is impossible to rule out the risk of similar development to that in Angola, the Republic of the Congo, or Nigeria — three middle-income African countries that are extremely unequal and whose macroeconomic equilibriums are overexposed to hydrocarbon prices.

Given that the general election must be held in fall 2024 and that President Filipe Nyusi cannot stand for a third term, **the transformation of Mozambique's development model is bound to represent the major challenge for whoever is elected president**. It is a considerable task, and the path is fraught with difficulties, but it seems imperative. The discovery of gas reserves in Cabo Delgado–already more than ten years ago–has indeed given rise to great hopes and expectations among the youthful population (two-thirds of whom are under 25 years of age), which may well double in size by 2050.

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List of acronyms and abbreviations

FDI	Foreign direct investment
HDI	Human Development Index
IMF	International Monetary Fund
LDCs	Least developed countries
LICs	Low-income countries
LNG	Liquefied natural gas
PPP	Purchasing power parity
WGI	Worldwide Governance Indicators

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