MOZAMBIQUE ECONOMIC UPDATE

Getting Agricultural Support Right

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The World Bank's Mozambique Economic Update (MEU) series is designed to present timely and concise assessments of recent economic trends considering the country's broader development challenges. Each edition includes a section on recent economic developments and a discussion of Mozambique's economic outlook, followed by a focus section analyzing issues of importance. The thematic section in the present edition explores the potential offered by agriculture to promote a sustainable and more inclusive recovery, and outlines reform options for realigning agricultural support policies and programs towards competitiveness, climate resilience and food security objectives. The MEU series seeks both to inform discussions within the World Bank and to contribute to a robust debate among government officials, the country's international development partners, and civil society regarding Mozambique's economic performance and key macroeconomic policy challenges.

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Acknowledgements

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Abbreviations and Acronyms

AfCFTA	Africa Continental Free Trade Area
Ag GDP	Agriculture gross domestic product
BdM	Bank of Mozambique (Banco de Moçambique)
CAADP	Comprehensive Africa Agriculture Development Program
CAD	Current account deficit
COVID-19	Coronavirus disease
CSA	Climate smart agriculture
CSE	Consumer support estimate
DSA	Debt sustainability analysis
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign direct investment
FID	Final investment decision
FTA	Free trade area
GDP	Gross domestic product
GHG	Greenhouse gases
GSSE	General services support estimate
Ha	Hectare
IADB	Inter-American Development Bank
IFC	International Finance Corporation
IFPRI	International Food Policy and Research Institute
INE	National Institute of Statistics
LNG	Liquefied natural gas
MADER	Ministry of Agriculture and Rural Development
MAFAP	Market-oriented Smallholder Agriculture Project
MEF	Ministry of Economy and Finance
MFN	Most favored nation
MPS	Market price support
MSME	Micro, small, and medium enterprise
MT	Metric ton
MZN	Metical
NAFTA	North American Free Trade Agreement
NEPAD	New Partnership for Africa's Development
NPL	Non-performing loan
NSmartAg	Nutrition smart agriculture
OECD	Organisation for Economic Co-operation and Development
PEDSA 2	Second Agrarian Sector Development Strategy
PNIDSA 2	National Agriculture Investment Plan
PSE	Producer support estimate
PV	Present value
SADC	Southern Africa Development Community
SCT	Single commodity transfer
SOE	State-owned enterprise
SREP	Sustainable Rural Economy Program
SSA	Sub-Saharan Africa
TSE	Total support estimate
USD	United States dollar
WB	World Bank
WDI	World Development Indicators
WFP	World Food Programme
WTO	World Trade Organization
y-o-y	Year on year

Executive Summary

The first part of this Economic Update assesses Mozambique's economic recovery from the COVID-19 crisis, and its outlook. The thematic section (Part II) discusses the potential offered by agriculture to promote a sustainable and more inclusive recovery, and outlines reform options for realigning agricultural support policies and programs towards competitiveness, climate resilience and food security objectives.

Mozambique's recovery is underway – can it be sustained?

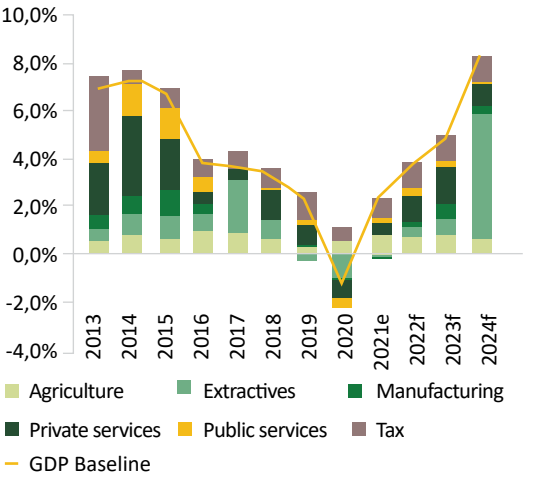
Despite considerable challenges, the economy is experiencing a timid recovery from the COVID-19 crisis, which hit the services and extractive sectors hard. Several constraints dampened the recovery at the beginning of 2021, with the economy growing at a meager 0.1 percent, the lowest in the last four years. As the year progressed, the slowdown in COVID-19 cases allowed some easing of social distancing measures globally and domestically, leading to a pickup in aggregate demand. GDP growth is estimated to have reached 2.2 percent in 2021, compared to a contraction of 1 percent in 2020.

A rebound in the agriculture and service sectors has helped underpin the incipient recovery, offsetting a contraction in extractives and manufacturing output. Agricultural growth was supported by favorable climatic conditions and the impact of investments in improved seeds, machinery, and irrigation. The gradual lifting of containment measures boosted private consumption, improving the service sector's performance.

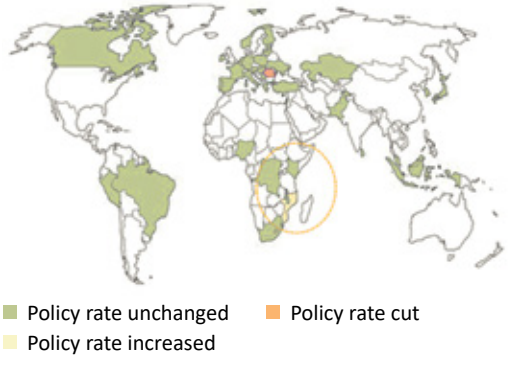
Despite the gradual uptick in domestic and global demand, growth in the extractives and manufacturing sectors remained subdued, with

The economy saw a modest recovery in 2021

GDP growth (% change), 2013–2024



Mozambique was the first country to raise interest rates following the onset of the COVID-19 pandemic



the suspension of major LNG projects playing a dominant role. A marked production decline in extractives and manufacturing in the first quarter of 2021 overshadowed the solid growth posted in the second half of the year. Business indicators

fluctuated significantly throughout 2021, due to the recurring waves of the pandemic, showing, on balance, only marginal improvements.

Although the pandemic and other shocks posed significant fiscal pressures, revenue collection has held up, and total expenditures have been contained. The overall fiscal deficit is estimated to have declined from 5.7 percent of GDP in 2020 to 4.5 percent in 2021. Fiscal consolidation is expected to resume in the medium term, but the public sector wage bill continues to increase, reaching 13.8 percent of GDP in 2021, driven by rises in compensation beyond the basic salary. However, the authorities have started taking important steps to improve spending efficiency, including through establishing a new regulatory framework to manage the wage bill.

Public debt has continued to rise as the authorities resorted to the expensive domestic market to fufil financing needs. The domestic debt stock reached 22 percent of GDP in 2021, up from 16 percent in 2019. Apart from COVID-19, higher spending to address the security and humanitarian situation in northern Mozambique and short-term financing for underperforming SOEs have elevated domestic debt levels.

Growth is expected to accelerate in the medium term, averaging 5.7 percent between 2022 and 2024, mainly reflecting the start of LNG production at the ongoing offshore Coral project in 2022 and expected resumption of investments in the largest (Total-led) LNG project. The escalation of insurgency in northern Mozambique in early 2021 led to the postponement of LNG projects, but they have not been canceled. Agriculture should maintain a positive performance in the upcoming years supported by continued investments in inputs. Recovery in global demand and commodity prices will continue to support export growth, and FDI inflows (mainly linked to LNG) will sustain investments. However, downside risks are substantial and could lower growth to 1.9 percent in 2022 (from a projected 3.8 percent). These include rising import prices owing to the Ukraine conflict, further COVID-19 infection waves, and insurgency in the north.

While a prolonged war in Ukraine would weigh on economic recovery, Mozambique will benefit from the broad-based rise in commodity prices. The Ukraine war will likely impact Mozambique through direct and indirect channels, although the country has weak (direct) trade linkages with Russia and Ukraine. The rise in international oil and cereal prices may undermine economic activity and strain the external balance in 2022. Oil and wheat represent 12 and 3 percent of Mozambique's total imports, respectively. The authorities have partially passed on the rise in international oil prices to consumers, exacerbating pre-existing inflationary pressures. To tame inflation and stabilize the currency, the Central Bank raised interest rates on March 31, 2022. The Bank of Mozambique was the first central bank globally to increase interest rates in January 2021. A rise in coal and gas prices, combined with higher coal production and the start of LNG production at the Coral offshore project in 2022, will largely offset the increased trade deficit owing to rising import prices.

With the right support, agriculture can be a source of growth, poverty reduction and food security

Part II of this Economic Update discusses reform options that could help Mozambique maximize its agricultural potential. Agriculture remains the main economic activity. The sector has vast growth potential given its agroecological diversity. Mozambique's strategic geographical position allows it to play an entrepot role for agricultural trade with the neighboring landlocked countries. Agricultural growth is critical to ensure food security as approximately 70 percent of the country's population is engaged in the sector.

Despite its potential, agricultural productivity remains low by regional standards, with Mozambique having one of the lowest cereal yields per hectare. This is largely due to low input access and intensity, weak technology adoption, limited provision of agricultural services, high seasonality in production and climate vulnerability. Given Mozambique's dependence on climate-sensitive agriculture, increased frequency and intensity of storms, droughts, and floods put further pressure on

agricultural income and food security.

Available evidence shows that agricultural growth would decrease poverty and inequality over three times faster than growth in any of the other sectors. Thus, how the sector is supported is key, and must be aligned with the broader goals of sustained growth and poverty reduction. Over the last two decades, Mozambique has seen low and declining public spending on agriculture, falling to only 4 percent of the national budget—less than half of the New Partnership for Africa's Development (NEPAD) target of 10 percent. As much as 95 percent of total support to the sector involves producer support, largely in the form of market price support (MPS) through trade protection measures. This mainly benefits a small number of commercial producers, while putting up food prices for the majority of agricultural households, and the urban poor.

Targeted and productivity-enhancing agricultural support is associated with improved agricultural trade balance and growth performance. This means increasing support to activities providing general benefits or public goods—such as agricultural innovation (R&D and human capital), animal/plant health services, marketing, and rural infrastructure. However, in Mozambique, this type of agricultural support represented only 0.6 percent of agricultural GDP in 2018—the lowest of all countries analyzed.

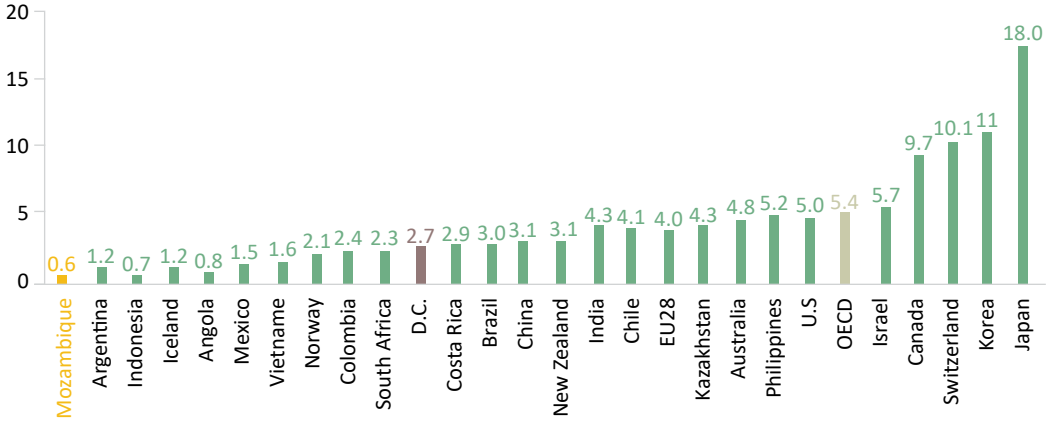
How to sustain the recovery?

Mozambique needs to diversify its growth model away from excessive dependence on the extractive industry, including through increasing agricultural productivity and creating a vibrant commercial agricultural sector. As it defines its 10-year strategy and investment plan for the sector, Mozambique has an important opportunity to realign agricultural support policies and programs towards competitiveness, climate resilience, and food security objectives. This requires, among others:

- **Shifting agricultural support to public goods and services**—rural infrastructure, animal and plant health services, and agricultural research—which can deliver higher economic returns. This shift will require mobilizing financial resources to ensure that it is as neutral as possible to the state budget, while also addressing some of the current structural issues with agriculture public spending (e.g. most sector expenditures are on salaries rather than investments).
- **Shifting away from distortive measures towards competitive agricultural policy support.** MPS needs to be phased out to allow Mozambique's farmers to produce based on market signals and to move towards full

Mozambique has the lowest support to agricultural public goods

GSSE as a share of agricultural GDP, 2018



Source: World Bank (2021).
Note: GSSE=General services support estimate.

participation in regional free trade agreements (SADC and the African Continental Free Trade Area—AfCFTA). The gradual reduction of border measures could be accompanied by direct, decoupled, support to farmers who produce protected commodities.

- **Reducing implicit taxation of food and increase support to food-insecure households.** Mozambican food consumers are funding the bulk of support to the agricultural sector by paying an implicit tax due to border protection measures (MPS). This hits the poorest households hardest. Gradually reducing the MPS would consequently increase the welfare of the poorest.

- **Shifting support towards smart subsidies.** Producer support could be reformed to help: (i) allow farmers to choose what to produce; (ii) crop production intensification (contrary to area expansion); and (iii) expand access to safe and nutritious food. Climate-smart, nutrition-sensitive agricultural technologies and practices should be integrated into input and technology support incentives to promote productivity growth, build resilience and achieve environmental and nutrition objectives.

This agricultural policy reform is urgent and opportune as it can help to build back better from COVID-19, while also taking advantage of SADC and AfCFTA. However, it needs to be planned and implemented carefully to avoid adverse impacts on the most vulnerable, and be accompanied by growing support for the constant improvement of agricultural practices, the adoption of technology, access to high-quality inputs and financial services, and investment in productive infrastructure (roads, irrigation, etc.).

Part One: Recent Economic Developments and Outlook

Recent Economic Developments

Economic Growth

After multiple consecutive shocks, including the pandemic, which led to the first recession in almost three decades, the economy has started to recover at a modest pace but under considerable uncertainty.

Mozambique saw its first economic contraction in almost three decades in 2020 owing to the pandemic, which hit the services and extractive sectors hard. The economy entered the pandemic on a weak footing due to a series of shocks, including the hidden debt episode in 2016, the insurgency in northern Mozambique from 2017, and the cyclones in 2019. Growth had decelerated sharply, from an average of 8 percent over 1993-2015 to 3 percent in 2016–2019. In 2020, the pandemic led to a 1 percent GDP contraction, the first in 28 years, as domestic and global demand fell and liquified natural gas (LNG) investments were delayed. Production dropped in all sectors except agriculture. The services sector (notably the hospitality and restaurant industries) was disproportionately affected in 2020. The extractives sector also saw a sharp contraction as demand and prices declined globally.

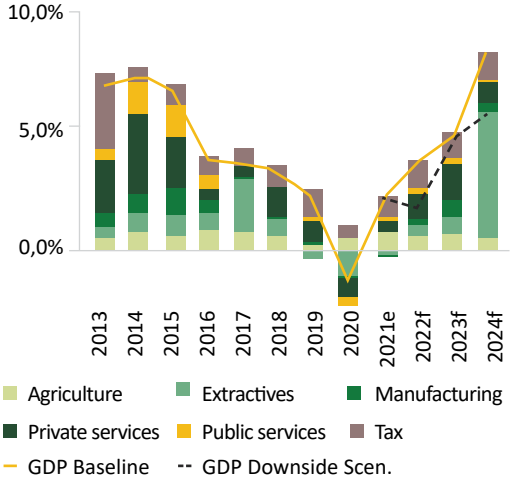
A modest recovery is underway, although substantial challenges remain. Several constraints dampened the rebound at the beginning of 2021, with growth in the first quarter reaching a meager 0.1 percent, the lowest in the last four years. First, terrorist attacks near LNG project sites in the northernmost province of Cabo Delgado caused the suspension of the multi-billion TotalEnergies-led project and the postponement of the final investment decision (FID) of the ExxonMobil-led project.[1] Second, repeated waves of the COVID-19 pandemic led to strict containment measures. Third, monetary policy was tightened in early 2021 amid rising inflation expectations. As the year progressed, the slowdown in COVID-19 cases allowed some easing of social distancing measures globally and domestically, leading to a pickup in aggregate demand. GDP growth is estimated to have reached 2.2 percent in 2021, significantly below the 5.1 percent initially predicted. However, the uncertainty surrounding the pandemic, the security situation in the north, and rising import prices owing to the Ukraine conflict pose significant challenges (Box 2).

[1] Following a deadly terrorist attack in March 2021, *TotalEnergies* declared a *force majeure* on April 26, 2021, and announced the suspension of activities at the Mozambique LNG project for at least a year. The expectation was that development operations would resume subject to improvements in on-site security conditions and the northernmost province of Cabo Delgado, more generally. Despite the suspension, FDI inflows related to the project continued in 2021, although the magnitude is smaller compared to the years prior to the suspension. The expectation is that the project resumes operations in 2022 and starts production in 2026. The *ExxonMobil*-led LNG project postponed the final investment decision (FID) for the second consecutive time in 2021, following the deterioration of the security conditions in Cabo Delgado. The FID is expected to be taken in 2022, and the project would launch operations from 2023 with a view to starting production in 2028.

The agriculture and service sectors helped underpin the recovery. The modest growth rebound in 2021 reflects a combined outcome of agricultural growth and relatively strong recovery in services on the one hand, and weak performance in extractives and manufacturing, on the other. Agriculture accounted for 40 percent of total growth (Figure 1). The sector grew 3.8 percent in 2021 (from 3.3 percent in 2020), supported by favorable climatic conditions and the impact of investments in improved seeds, irrigation, and machinery in 2019. The gradual lifting of social distancing restrictions boosted private consumption, positively impacting the services sector performance; finance, social protection, and public administration services combined saw 3 percent growth in 2021, albeit from a low base.

Figure 1: GDP saw a modest recovery in 2021...

GDP growth (% change), 2013–2024

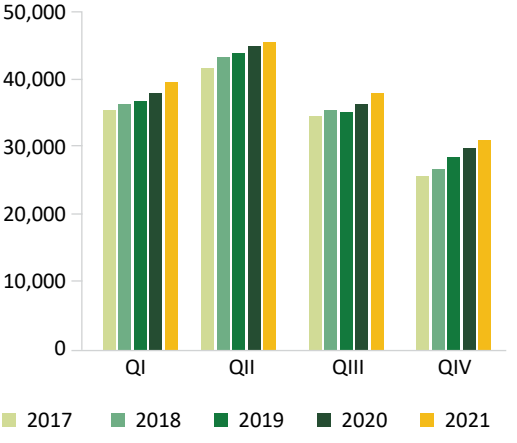


Note: e = estimate; f = forecast

Source: Data from Institute of National Statistics (INE), various years; World Bank staff estimates.

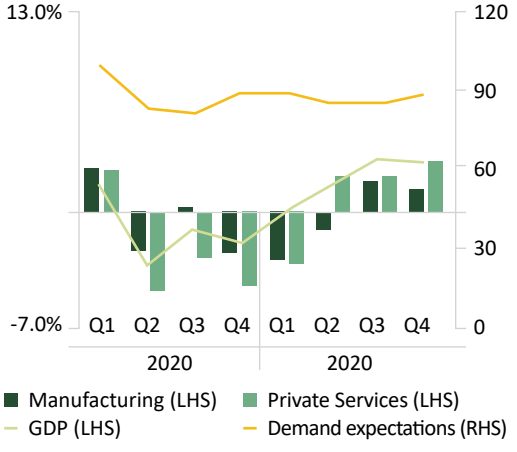
Figure 2: ...underpinned by good agricultural production

Real agriculture production (million MZN) (100=2014)



Source: INE data, various years; World Bank staff estimates.

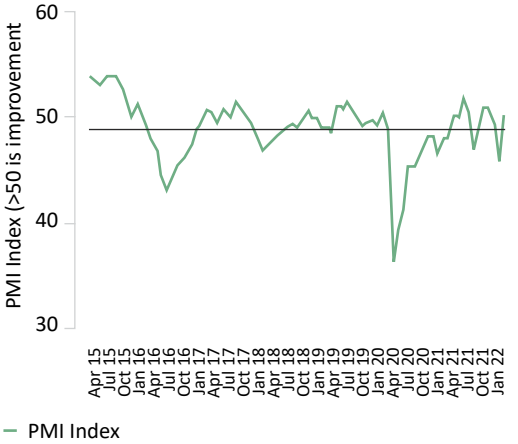
Figure 3: Stronger demand supported services recovery, but manufacturing remained subdued...



Source: INE data, various years; World Bank staff estimates.

Figure 4: ...With business conditions changing erratically reflecting COVID-19 waves

Purchasing manager's index



Source: IHS Markit (2015, 2021).

Despite a gradual uptick in aggregate demand, the extractives and manufacturing sectors remained subdued. While prior growth forecasts for 2021 were premised on significant LNG investments and related demand effects, the suspension of the TotalEnergies-led project dampened growth in 2021. A marked production decline in extractives and manufacturing in the first quarter of 2021 led to an overall contraction in these sectors, overshadowing the solid growth posted in the second half of the year (Figure 1). Although far from the 14 percent negative growth observed in 2020, extractive sector production shrank by 1 percent in 2021, mainly dragged down by an 18 percent contraction in the first quarter of 2021. This reflected a slower-than-expected global trade recovery, as well as ongoing operation and maintenance activities in the largest coal mine. Manufacturing output declined by 0.1 percent in 2021 compared to a 1.7 percent drop in 2020. The weak performance reflected the tightening of COVID-19 containment measures during the second and third infection waves, and global supply chain disruptions which impacted production in the electricity and construction subsectors.

Business conditions remained weak, owing to the recurring waves of COVID-19. Business indicators fluctuated considerably throughout 2021, showing only marginal improvements. The Purchasing Manager's Index (PMI), an indicator of business conditions reported by private companies, averaged 50.5 in 2021, higher than the 46.4 points registered in 2020 but still below the 51 average for 2019.[2] However, the second and third COVID-19 waves in early and mid-2021, combined with subdued global and domestic demand, led to erratic fluctuations in business sentiment throughout the year (Figure 4.). Challenges reported by firms included access to inputs, partly due to the supply chain disruptions, and decline in orders when the government tightened containment measures with rising COVID-19 cases.[3] During the troughs, worsening business conditions were particularly felt by the construction, hospitality, commerce, and electricity sectors.

Table 1: **Recent growth has been driven by agricultural growth and recovery in the services sector**

	2015	2016	2017	2018	2019	2020	2021e
Agriculture	0.7	1.0	0.9	0.7	0.4	0.8	0.9
Extractives	0.9	0.7	2.2	0.8	-0.2	-1.0	-0.1
Manufacturing	1.1	0.5	0.1	0.0	0.1	-0.1	0.0
Private services	2.2	0.5	0.5	1.2	0.8	-0.8	0.4
Public Services	1.5	0.8	0.3	0.2	0.4	-0.4	0.4
Tax	0.6	0.5	0.3	0.6	0.9	0.3	0.6
GDP growth	**6.9**	**4.0**	**4.2**	**3.5**	**2.3**	**-1.2**	**2.2**

Source: National Statistics Institute, World Bank staff estimates.

Exchange Rate and Inflation

The global recovery and, to a lesser extent, ongoing supply-chain constraints, impacted food, energy, and fuel prices, with inflation reaching 7 percent in the first two months of 2022.

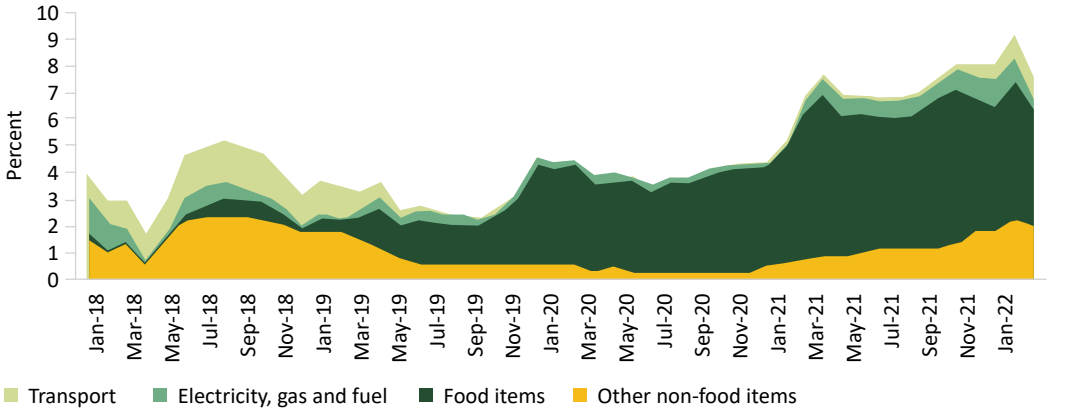
Inflation rose steeply in 2021. Average annual inflation reached 5.7 percent in 2021, almost double the rate registered in 2020 (Figure 5). The rise mainly reflected higher food, energy, and fuel prices, owing to the global economic rebound and, to a lesser extent, supply chain disruptions. Food inflation—which accounts for just under a third of the consumer price index (CPI)—reached an average of 11 percent between January and December 2021. This sharp increase

[2] IHS Markit Mozambique (various months). A PMI above 50 indicates improvements in businesses conditions.
[3] Under the PMI, firms reported an average supplier delivery time index of 51.9, against 58-54 points in the years prior to the pandemic.

was driven by higher fuel prices, which affect food transport costs, and currency depreciation affecting the food basket at the start of the year. To tame inflation and stabilize the currency, the Central Bank raised interest rates on March 31, 2022. The Bank of Mozambique was the first central bank globally to increase interest rates in January 2021.

After a substantial depreciation against key trading currencies in 2020, the metical (MZN) started appreciating during the second quarter of 2021, before stabilizing for the remainder of the year. Following the depreciation against the US dollar, South African rand, and euro in 2020, the metical recovered in 2021. The recovery in exports and external capital inflows, combined with the Central Bank's increased sales in the forex market, supported a sharp appreciation of the metical, completely offsetting the 2020 depreciation. Another measure that underpinned the currency recovery was the vigorous reduction in the reserve requirements for foreign currency, from 34.5 to 11.5 percent. Despite the nominal exchange rate appreciation, the real exchange rate remained stable, continuing to bolster the recovery in exports.

Figure 5: Inflation accelerated in 2021



Source: World Bank staff based on INE data.

The External Sector

Recovering trade and delayed implementation of LNG projects led to a stable current account deficit (CAD) in 2021, helping Mozambique maintain a reasonably comfortable external position.

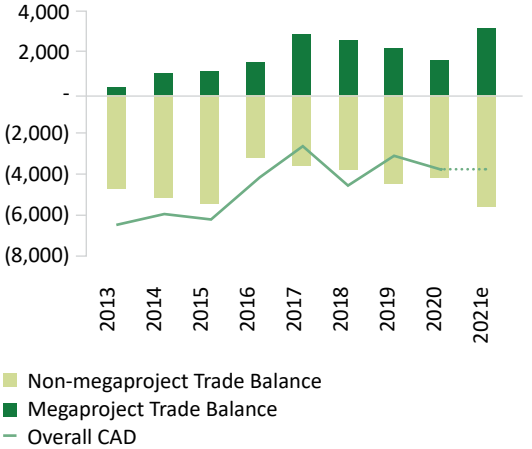
Trade recovery and delayed implementation of LNG projects stabilized the CAD in 2021. The CAD declined from USD 3.9 billion (25.7 percent of GDP) in 2020 to USD 3.6 billion (22 percent) in 2021 (Figure 6). Total exports grew by 55 percent in 2021, following a decline of 23 percent in 2020 (Figure 7), explaining the drop in the CAD. Extractives–primarily coal, heavy sands, and gas–drove the boost in export receipts. This increase mainly reflected a recovery in global demand and commodities prices and the clearing of inventories accumulated in 2020, rather than increases in output. Aluminum, coal, and gas average prices were respectively 45, 130, and almost 190 percent higher in 2021 compared to 2020 (Figure 8). Price effects combined with higher quantities exported helped offset a 33 percent growth in imports, driven by consumption of goods and fuel. In addition, imports for megaprojects slightly declined compared to 2021, reflecting delays in the TotalEnergies-led LNG project, which minimized growth in services imports.

FDI inflows posted a strong rebound in 2021, surpassing pre-pandemic levels and reaching levels seen during the 2012-2014 foreign investment boom. Total FDI reached USD 5.1

billion in 2021 (Figure 9), almost 70 percent higher than in 2020 and representing a third of GDP. The steep recovery in FDI was mostly driven by megaproject investments related to operation and maintenance works at the Moatize coal mine and the development of the Total and Coral-South LNG projects. Non-megaprojects also saw significant FDI inflows, notably the transport and communication sector, which jumped from USD 16.5 million to USD 1.7 billion between 2020 and 2021. Total private debt inflows, mostly contracted by megaprojects, stood at USD 684.3 million, around the same levels as in 2020. Commercial advances remained a critical source of capital inflows, sitting at USD 2.6 billion, and mainly financing LNG investments.

Figure 6: **The current account deficit fell in 2021...**

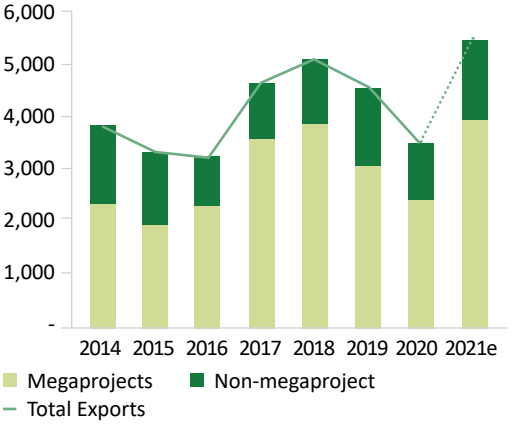
Current account deficit (CAD), megaproject and non-megaproject trade balance (USD million), 2013-21



Source: Bank of Mozambique (BdM) data; World Bank.

Figure 7: **... driven by recovery in megaproject exports**

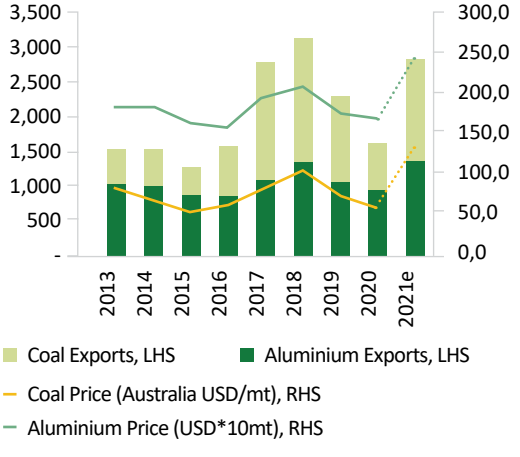
Megaproject and non-megaproject exports (USD mil), 2013-2021



Source: BdM data, various years; World Bank staff estimates.

Figure 8: **Key commodity exports increased considerably**

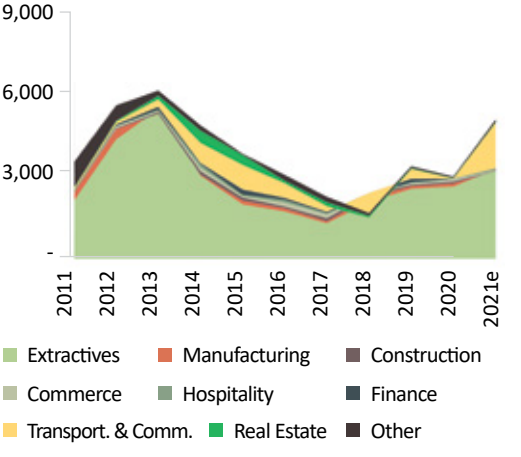
Exports (USD million) and price index (2005 = 100)



Source: BdM data, various years; World Bank staff estimates.

Figure 9: **...while FDI surpassed pre-Covid levels, reflecting investment in extractives, transport, and communications**

FDI (USD million)



Source: BdM data, various years; World Bank staff estimates.

Mozambique has maintained a broadly adequate external position. With savings from COVID-19-related official development assistance (ODA) and a relatively low level of imports, the country closed 2021 with a comfortable level of external reserves. In 2020, a considerable amount of ODA was disbursed towards the end of the year, allowing the government to accumulate significant savings in 2021. As a result, in the first quarter of the year, net external reserves reached a historical high of USD 3.9 billion. However, international reserves declined throughout the year driven by increasing imports and considerable private debt payments. Despite this, the International Monetary Fund *special drawing rights* (SDR) allocation of USD 310 million helped to offset the use of reserves, which closed at USD 3.3 billion at the end of 2021 – enough to cover five months' worth of imports (excluding megaprojects).

Table 2: **The balance of payments deficit is projected to continue rising**
(USD millions, unless otherwise stated)

	2020 Actual	2021 Est.	2022 Fore.	2023 Fore.	2024 Fore.	Δ 19/20	Δ 20/21	Δ 21/22	Δ 22/23	Δ 23/24
Current account (% of GDP)	-27.6	-22.3	-45.0	-39.2	-37.9	...	...	...	...	...
megaproject	1.7	12.8	10.0	7.0	2.5	...	...	...	...	...
non-megaproject	-29.3	-35.1	-55.0	-46.2	-40.4	...	...	...	...	...
Current account	-3,603	-3,589	-8,120	-7,616	-8,095	20%	0%	126%	-6%	6%
Trade balance	-3,994	-3,975	-8,591	-7,888	-8,261	1%	0%	116%	-8%	5%
Goods, net	-2,294	-2,258	-6,288	-2,507	-1,829	10%	-2%	178%	-60%	-27%
Exports	3,588	5,579	6,702	7,073	8,194	-23%	55%	20%	6%	16%
megaproject	2,504	4,032	4,712	5,623	5,240	-21%	61%	17%	19%	-7%
non-megaproject	1,084	1,547	1,546	1,666	1,798	-28%	43%	0%	8%	8%
Imports	5,883	7,837	12,990	9,580	10,023	-13%	33%	66%	-26%	5%
megaproject	774	794	1,714	2,121	3,256	-14%	3%	116%	24%	54%
non-megaproject	5,109	7,043	7,726	7,212	8,343	-13%	38%	10%	-7%	16%
Services, net	-1,700	-1,716	-2,303	-5,381	-6,432	-10%	1%	34%	134%	20%
Income and transfers, net	391	386	471	272	166	-59%	-1%	22%	-42%	-39%
Capital & financial account	5,524	3,176	7,593	7,700	8,328	34%	-42%	139%	1%	8%
of which										
FDI, net	3,035	5,106	2,529	2,226	2,306	37%	68%	-50%	-12%	4%
megaproject	2,568	3,080	1,538	1,219	1,270	169%	20%	-50%	-21%	4%
non-megaproject	466	2,026	991	1,007	1,036	-63%	335%	-51%	2%	3%
Other, net	2,354	-2,048	4,831	5,241	5,823	30%	-187%	-336%	8%	11%
Overall balance	1,920	-412	-527	84	233	...	...	...	...	...
Errors and omissions	0	0	0	0	0					
Financing gap	-1,920	412	527	-84	-233					
Reserves (- = inflow)	-726	402	394	-187	-351					
Net use of credit	281	-26	133	103	118					
Exceptional financing (1)	261	220	0	0	0					
Memo:										
Current account (% of GDP), excl. capital gains	-25.7	-22.3	-45.0	-39.2	-37.9	...	...	...	...	...
non-megaproject	-27.4	-36.2	-37.0	-32.9	-35.6	...	...	...	...	...

Source: World Bank staff estimates, BdM data; Δ=percentage change.
(1) Other flows include net portfolio investment; net currency and deposits; loans; insurance, pensions, and standardized guarantee schemes (net); net trade credits and advances; net other accounts payable/receivable.

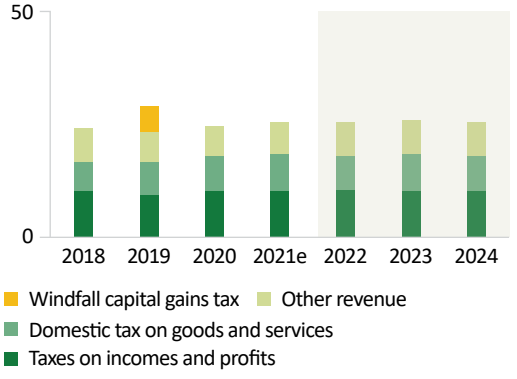
Fiscal policy and developments

Fiscal management has generally remained prudent, despite repeated shocks, but financing gaps are significant, and increasingly financed by expensive domestic debt issuances.

The authorities' resolute fiscal response has helped weather recent shocks well, but fiscal pressures persist. Despite the spending pressure from the pandemic and the security and humanitarian situation in the north, fiscal management has remained broadly prudent. The overall fiscal deficit is estimated to have declined to 4.5 percent of GDP in 2021, from 5.7 percent in 2020 (Table 3). Total public expenditure has fallen significantly—from 33.5 percent of GDP in 2020 to 30.6 percent in 2021 (Figure 13). Total revenues held up at around 25.3 percent of GDP, reflecting increased receipts from income taxes and non-tax revenues. With this revenue performance and the slow execution of investment spending, fiscal balances (excluding grants) improved somewhat in 2021. Debt service deferrals under the debt service suspension initiative (DSSI) in 2021 are estimated to have reached 1.1 percent of GDP. However, donor grants declined to 2.2 percent of GDP (from 3.6 percent in 2020), with shortfalls covered by the withdrawal of deposits from past capital gains and rising domestic debt issuances.

Figure 10: **Revenues have held up well despite the various shocks…**

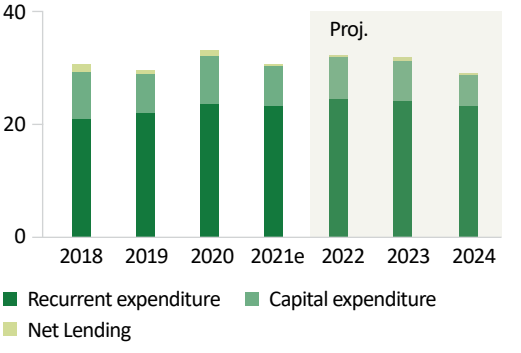
Revenue collection (in percent of GDP)



Source: World Bank and Ministry of Economy and Finance.

Figure 11: **…but spending needs remain well above pre-pandemic levels**

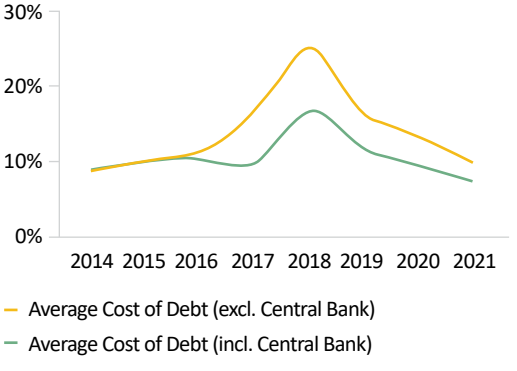
Total expenditure and net lending (in percent of GDP)



Source: World Bank and Ministry of Economy and Finance.

Figure 12: **…increasingly financed through expensive domestic debt issuance…**

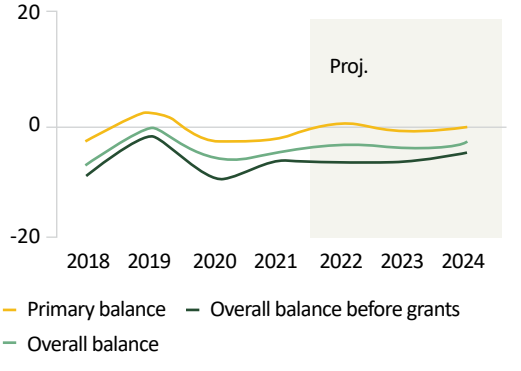
Average domestic debt cost



Source: World Bank and Ministry of Economy and Finance.

Figure 13: **…delaying fiscal consolidation**

Budget balances and budget support (in percent of GDP)



Source: World Bank and Ministry of Economy and Finance.

Total public expenditure has returned to pre-COVID levels, reaching 30.6 percent of GDP in 2021, driven by lower-than-budgeted public investments and currency appreciation. The public sector wage bill continues to grow, reaching 5.5 percent in real terms in 2021, or 13.3 percent of GDP, up from 8 percent of GDP in 2008. This growth has been driven by discretionary rises in compensation elements beyond the basic salary. In 2021, the Parliament approved a draft law introducing a new civil servants' remuneration structure, but it needs to be complemented with structural reforms to bend the wage bill trajectory to a more sustainable path. Further, the insurgency in the north of the country, while contained in recent months, has been posing additional challenges, with military spending remaining close to 2 percent of GDP in 2021, four times the 2019 ratio.[4] Despite these developments, a capital spending execution rate of 77 percent and lower-than-budgeted debt service, partly due to currency appreciation, have kept total spending hovering around 30 percent of GDP, well below 2020 levels.

At 25.3 percent of GDP, revenues registered a solid performance in 2021 driven by the recovery in growth and remaining at a comparable level to 2020. Revenues from income taxes remained stable at around 10 percent of GDP (Figure 12), reflecting the recovery in economic growth and tax enforcement measures, such as strengthened payroll withholding for individuals. Non-tax revenues increased from 4 to 4.2 percent of GDP between 2020 and 2021, driven by higher dividends from the railways state-owned enterprise and the Cahora Bassa hydropower station concession. Reflecting a partial recovery in mining and volume growth in electricity, the contribution from megaprojects in the extractive and energy sectors increased 40 percent in nominal terms, expanding their share of total receipts by 2 percentage points, reaching 10.6 percent of total revenues.

Domestic public debt has continued to rise as the authorities resorted to the expensive domestic market to address financing needs. The domestic debt stock is estimated to have reached 22 percent of GDP in 2021, from 16 percent in 2019 (Figure 14). Total public debt declined to around 104 percent of GDP in 2021, from 121 percent in 2020, but mainly due to currency appreciation. Apart from the pressures posed by COVID-19, elevated domestic debt levels reflect defense spending needs to address the security and humanitarian situation in Cabo Delgado, short-term financing needs of underperforming SOEs, and debt servicing on treasury bonds. Debt service remains high, and the domestic debt profile presents considerable maturity concentration. Almost 75 percent of the treasury bonds' stock is due between 2021 and 2023, which increases debt rollover risks. Domestic debt financing comes at a high cost, with the interest rate on Treasury bills with a maturity of more than two months averaging over 13 percent during 2021. The effective interest rates on domestic debt issuances (excluding Central Bank loans) stood at 10 percent in 2021, compared to to 5 percent in 2015 (Figure 14). This is discussed in more detail in Box 1.

The authorities completed the MOZAM 2023 Eurobond restructuring in late 2019 and are challenging the two other undisclosed debts. They concluded negotiations of the US$727 million MOZAM 2023 bondholders, resulting in a swap to a US$900 million bond. Under the agreement, the maturity was extended from 2023 to 2031, and the annual coupon rate reduced from 10.5 to 5 percent until 2023 and 9 percent from 2023 onwards. The restructuring offered cash flow relief. Mozambique also took steps to legally challenge the two other hidden loans, Proindicus and MAM debts, by initiating legal proceedings to contest their validity. In parallel, in May 2020, Mozambique's constitutional court ruled that these debts were illegally contracted. Based on these developments, the Mozambique DSA does not include the Proindicus and MAM debts in the baseline, treating them instead as contingent liabilities. In October 2021, Credit Suisse was fined by the UK's Financial Conduct Authority for its role in the long-running debt scandal and required to write off US$ 200 million of Mozambique's debt.

[4] Since 2017, Mozambique has been battling an insurgency orchestrated by militants allegedly linked to the Islamic State in the northern province of Cabo Delgado. The conflict has already cost the country more than 2,000 lives and led to about 700,000 displaced people in the past three years. The authorities have sought military support from SADC and Rwanda and training by the US and the EU, with positive initial results.

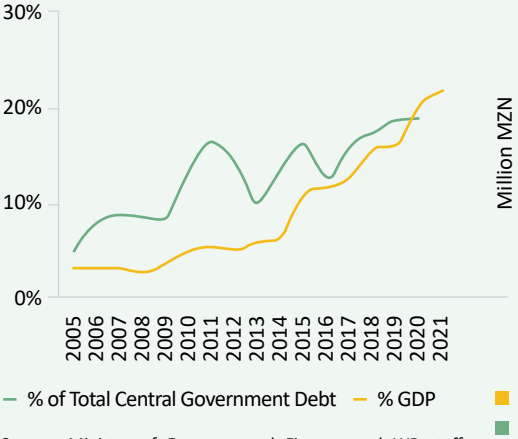
Box 1: Growing domestic debt requires an urgent management strategy

Domestic debt has grown rapidly, particularly since 2016. Following the 2016 debt crisis, the cuts in donor budget support and limited access to external financing led the authorities to resort to the domestic debt market. Domestic debt stock surged from 12% to 22% of GDP between 2016 and 2021 (Figure 18). Besides the spending pressures posed by recurrent shocks, this was driven by the need to refinance maturing obligations, support underperforming SOEs, and address arrears to domestic suppliers.

At the same time, the domestic debt stock has seen considerable changes in its structure, with debt from the Central Bank gaining ground (Figure 18). Prior to 2016, the Government had minimized recourse to Central Bank financing, in part due to inflationary concerns. But, in recent year, Central Bank financing has become one of the dominant financing mechanisms since 2016, making up about 30 percent of the total domestic debt stock. There has also been an increase in the use of treasury bills (TBs) for budget financing, resulting in a yearly accumulation of TB stock and repayments failing to be made within the same fiscal year. Such changes in structure have increased pressures on the domestic financial markets. With commercial banks being the main buyers of TBs, the Government's increased borrowing adds pressure on domestic credit demand, already characterized by high interest rates (also compared to peer countries). Also, with the TB risk being close to zero, the already low financial market appetite to lend to MSMEs is further discouraged. On top of this, direct Central Bank financing reduces the space for monetary easing.

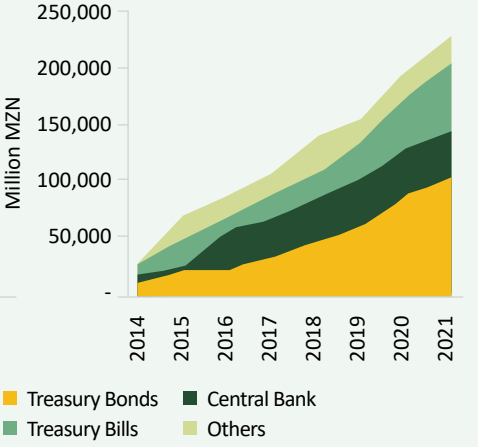
Figure 14: Domestic debt has grown fast …

Domestic debt stock



Source: Ministry of Economy and Finance and WB staff calculations.

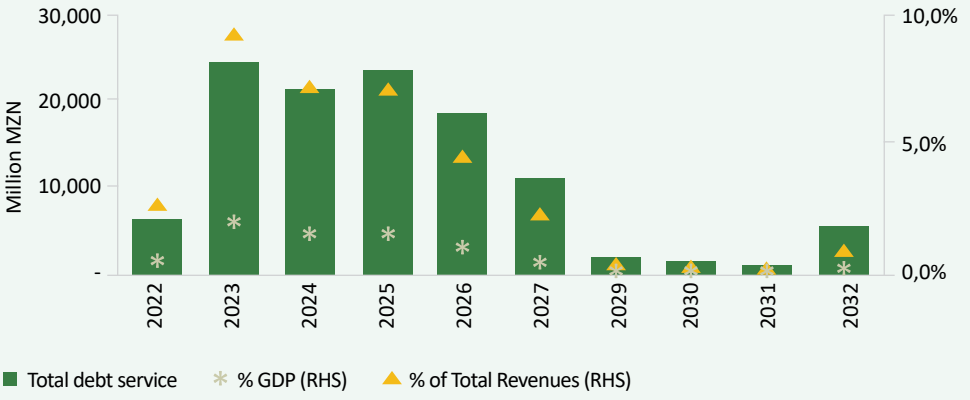
Figure 15: … and its structure has changed in recent years



Source: Ministry of Economy and Finance.

Figure 16: ...and the debt profile poses a high rollover risk

Treasury bonds debt service (2022-2032)



Source: Ministry of Economy and Finance and WB staff calculations.

Domestic debt pressures are likely to continue to build up in the medium-term unless its management improves. Treasury bonds—which make about 50 percent of the total domestic debt stock—present a very concentrated maturity profile. More than 80 percent of the stock of this instrument is due between 2022 and 2026, and its debt service alone may absorb up to 7 percent of total revenues during the period (Figure 20). With total revenue growth projected to be minimal, the rollover risk is very high and adds pressures to the already tight budget. These problems highlight the need for improved domestic debt management strategy.

The April 2022 IMF-World Bank debt sustainability analysis (DSA) concludes that Mozambique is at high risk of debt distress, with debt assessed to be sustainable in a forward-looking sense (Box 1). The risk of debt distress is high both for overall and external public debt. Debt is assessed as sustainable in a forward-looking perspective because a significant share of projected borrowing reflects the state's participation in sizable LNG projects, which will be repaid directly from future gas revenues. Regarding external debt, although the overall assessment remains unchanged, sustainability indicators have somewhat worsened and are projected to reach the prudent thresholds later than the last DSA (April 2020). The delayed return of most indicators to sustainable levels is because of additional financing needs associated with the pandemic and the postponement of large LNG projects.

Table 3: Selected fiscal indicators

% of GDP	2016 Actual	2017 Actual	2018 Actual	2019 Actual	2020 Actual	2021 Estimates
Revenue + grants (excl CGT)	23.9	24.6	25.8	**24.4**	27.9	27.1
Total revenue	22.0	25.1	23.8	**28.9**	24.3	25.3
Tax revenues	18.4	20.0	20.5	**25.0**	20.9	21.2
.....of which:						
capital gains		2.5		**5.7**		
Non-tax revenue (incl. capital revenue)	3.6	5.1	3.2	**3.9**	3.3	4.2
Grants	1.9	1.9	2.0	**1.2**	3.6	1.7
Total expenditure & net lending	30.6	30.3	31.2	**30.5**	33.5	30.6
Current expenditure	19.2	19.4	21.3	**20.6**	23.6	23.3
.....of which:						
Compensation to employees	10.4	10.6	10.8	**11.8**	13.4	13.8
Interest on public debt	2.5	3.0	4.4	**3.3**	3.2	2.6
.....of which						
..... arrears	0.5	1.5	0.0	**0.3**	0.2	0.0
Capital expenditure	8.1	6.7	8.1	**7.6**	8.9	7.0
Domestically financed	3.2	3.2	3.7	**4.7**	4.5	3.2
Externally financed	4.9	3.5	4.4	**2.9**	4.4	3.8
Net lending	1.8	3.0	1.6	**1.5**	0.7	0.3
Fiscal balance - commitment basis						
Primary balance	-4.3	-0.3	-2.4	**2.8**	-2.5	-1.9
Overall balance	-6.7	-3.3	-6.8	**-0.5**	-5.7	-4.5
Primary balance (excluding capital gains tax)	-4.3	-2.8	-2.4	**-2.8**	-2.5	-1.9
Overall balance (excluding capital gains tax)	-6.7	-5.7	-6.8	**-6.1**	-5.7	-4.5
Financing						
External financing	3.9	6.8	3.3	**2.2**	4.4	0.9
Net external financing (commitment)	2.0	2.8	0.1	**1.6**	3.8	0.4
Disbursements	4.9	4.6	4.0	**3.9**	6.3	2.4
Amortization	-2.9	-1.7	-3.9	**-2.3**	-2.5	-2.1
Exceptional external financing - debt*	1.8	4.0	3.2	**0.6**	0.6	0.5
Net domestic financing	2.9	-1.1	3.6	**4.0**	1.2	3.6

Note: CGT for capital gains tax.
Source: MEF and IMF data, World Bank staff calculations.

Monetary Policy and Financial Sector

The monetary authorities have struck a balance between managing inflationary pressures and supporting the economic recovery.

Amid increasing inflationary pressures in 2021, the Central Bank reversed the monetary easing stance adopted in 2020 with a contained increase in policy rates. After easing rates in 2020 to stimulate the economy, monetary policy was tightened at the beginning of 2021. The Monetary Policy Committee (CPMO) increased the policy rates by 300 basis points in January of 2021 to contain inflationary pressures and shore up the currency (Figure 17). These measures contributed to a decline in the monetary base by 19% in the year to November 2021, against a 16% increase over the same period of the previous year. The authorities counteracted the impact

of these measures by substantially reducing reserve requirements. The reserve requirements for foreign and domestic currency deposits were reduced from 34.5 to 11.5 percent, and from 11.5 to 10.5 percent, respectively. Despite these developments, the financial system benchmark rate rose further, from 15.9 to 18.9 percent in the year to December 2021, limiting credit growth.

Figure 17: **Mozambique was the first country to raise reference rates following the onset of the COVID-19 pandemic**

The BoM's changes in policy rate as of January 2021

Policy rate unchanged Policy rate cut
Policy rate increased

Source: Bloomberg.

The financial sector's vulnerability to shocks worsened due to the sluggish recovery, high exposure to sovereign risk, and foreign exchange volatility. While the financial sector had entered the COVID-19 crisis with broadly adequate capital buffers, pre-existing vulnerabilities—particularly non-performing loans (NPLs) and exposure to sovereign risk—worsened with the pandemic-induced recession. Credit growth rebounded in 2020 as firms and individuals prepared for the onset of the pandemic, but stalled in 2021. Following strong real growth in 2020 (13.2 percent), credit growth to the private sector turned negative (-5.1 percent y-o-y in December 2021). The system-wide capital adequacy ratio (CAR) and leverage ratio have remained stable over the last 12 months (28 percent and 13 percent, respectively, as of November 2021). As of Q3 2021, one small bank was insolvent, and another small bank was short of the minimum CAR of 12 percent. System-wide NPLs stood at 10 percent of total loans in November 2021, down from 11 percent a year before. Banks have proactively restructured about 10 percent of their loan portfolio due to COVID-19, bringing stability to credit in the short term. However, these restructurings pose future vulnerabilities as they did not require additional provisioning. By November 2021, net lending from the financial sector to the government stood at MZN 99.5 billion (9 percent of GDP), almost 50 percent growth (y-o-y).

Previous and ongoing reforms have strengthened regulatory oversight of the financial sector, with supervision measures tightening in 2021. The BdM has enhanced reporting of prudential indicators. Since 2017, commercial bank systemic risk reports have been published quarterly, allowing for greater transparency and better oversight of the sector. The bank also disseminates financial soundness indicators, including the annual financial stability report, first published in March 2019 (Table 4). Further, Mozambique approved a new financial institutions law in December 2020, including a framework for resolving weak banks and strengthening deposit insurance. However, some features of the new law (including those related to the bank resolution framework) still need to be regulated.

Table 4: **Financial indicators track the health of Mozambique's banking sector**

(percent)	BIM	ABSA Bank	BCI	S. Bank	System
Total capital to total assets	44.8	19.6	24.2	22.2	27.7
Non-performing loans	14.8	3.5	14.2	1.9	8.6
Provisions	108.7	122.8	40.8	80.9	88.3
Return on assets	5.5	0.9	2.7	3.5	3.2
Return on equity	27.7	6.6	23.8	22.0	20.0
Liquid assets	59.7	46.1	48.9	67.0	55.4

Note: BCI= Banco Comercial e de Investimentos; BIM= Millenium BIM bank; S Bank = standard Bank ;
ABSA = Amalgamated Banks of South Africa
Source: Banco de Mocambique (BdM) (November 2021).

Outlook and Risks

The outlook is favorable but subject to considerable risks stemming from further COVID-19 waves, natural disasters, and instability in the north of the country. The recent Ukraine-Russia conflicts adds to the challenges.

The medium-term growth prospects are positive, supported by the gradual global recovery and LNG and agriculture developments. Growth is expected to accelerate in the medium term, averaging 5.7 percent between 2022 and 2024, mainly reflecting LNG production. The Coral-South offshore LNG project is expected to start production in the second half of 2022 and will likely achieve full capacity between 2023 and 2024. Assuming favorable weather conditions, agriculture will maintain a positive performance in the upcoming years due to continued investments in inputs. Recovery in global demand and commodity prices will continue to support export gains, and FDI inflows (mainly linked to LNG) will sustain investments. Further, assuming that the pandemic subsides and global mobility gains momentum, tourism, trade, and public services are poised to rebound. This will be reinforced by the resumption of LNG projects, boosting FDI and domestic demand for services, particularly real estate, hospitality, transport, and construction.

Mozambique's economy is likely to be adversely affected by the global impact of the Russia-Ukraine conflict. Prior to the outbreak of the conflict, 2022 GDP growth had been projected at 4.0 percent. Growth has now been revised to 3.8 percent as the country will see a higher import bill, given the large weight of fuel and wheat in the import basket (Box 2). Continued high fuel prices will hold back economic activity. As fuel has a large share in total consumption basket and is a key determinant of the prices of other essential goods, higher prices will exacerbate inflationary pressures. On the demand side, rising prices and interest rates will hamper consumption and investment. On the supply side, producers are facing increased input costs. The transport sector will be especially hard hit. However, part of these pressures are likely to be offset by higher exports, notably of coal and gas. Further, the start of LNG export in the second half of 2022,[5] combined with rising in coal production, will partly offset the negative effects of the Ukraine conflict.

Downside risks are considerable and could narrow growth to 1.9 percent in 2022 if they materialize. In addition to those mentioned above, other risks stem from the insurgency in the north, and further COVID-19 infection waves. Under a downside scenario (Figure 1 and Table 2), instability threatens the resumption of the Total-led project and the final investment decision (FID) of the Exxon Mobile-led project. Under a downside scenario (Figure 1 and Table 5) instability threatens the resumption of the Total-led project and the final investment decision (FID) of the Exxon Mobile-led project. This scenario would slow down the recovery of sectors with forward and backward linkages to the LNG projects, including manufacturing, construction, real estate, and other services sectors. Prices of essential imports, such as fuel and cereals, would continue to increase due to the global recovery and supply constraints induced by the Ukraine conflict, exerting pressure on inflation and reducing consumption. Additionally, if the country faces a new wave of COVID cases, it would have important implications for mobility and demand for services.

Despite the broadly positive outlook, the extractive-driven model is expected to continue, calling for greater diversification and private sector participation. Over time, Mozambique has seen a limited shift in the structure of the economy away from low-productivity subsistence agriculture, accounting for around 70 percent of employment but only 25 percent of GDP. LNG developments are expected to reinforce the current extractive-

[5] The off-shore Coral project, led by ENI – which is the smallest of the three LNG projects underway in the Rovuma Basin – is expected to start production in the second half of 2022. The assumption is that the project will reach 17 percent of the total 3.4 mtpa production capacity in 2022.

centric growth model with limited local linkages and job creation. Critically, in the short- to medium-term, LNG revenues channeled to the government will be minimal until the projects amortize debt accumulated by the state during their development phase. At the same time, physical and human capital deficits remain significant, constraining growth in non-extractive industries. Against this backdrop, Mozambique needs to unleash growth in non-extractive activities, promoting a more interconnected and competitive economy that shares growth more equitably. The country has strong potential to diversify its growth model, developing commercial agriculture and a competitive services sector focusing on the backbone services of ICT, telecom, transport, and logistics. This shift will require some fiscal space to invest in physical and human capital and greater private sector participation in non-extractives sectors.

Table 5: **The growth outlook depends on whether several risks materialize**

Real GDP, %	2021e	2022p	2023p	2024p
Baseline scenario	2.2	3.8	5.0	8.3
Downside scenario	2.2	1.9	4.7	5.9

Source: National Statistics Institute, World Bank staff estimates. e = estimate; p = projection

As LNG investments resume, the CAD is expected to increase, staying around 41 percent in the medium term.

The CAD is projected to widen in the medium term as the major LNG projects resume. Increased megaproject imports, particularly LNG-related services, will add pressures to the CAD. Although in 2022, the deficit is anticipated to be partially offset by the start of LNG exports from the Coral-South project and rising commodity prices, the CAD will practically double to 45 percent (Table 6). As the implementation of LNG projects resumes and imports increase in other sectors, the CAD is projected to continue high averaging about 38.5 percent of GDP in 2023/2024. Despite this outlook, gross reserves are expected to remain at comfortable levels, supported by FDI inflows, grants, and concessional financing.

Table 6: **The external outlook could be boosted by a rise in gas and coal earnings**

Nominal commodity price	2020	2021e	2022p*	2023p	2024p
Aluminum USD/mt	1,704	2,550	3,250	2,500	2,400
Coal, Australia USD/mt	60.8	140	197	90	86.4
Natural gas, Europe/MMBtu	3.3	14.5	33	8.8	8.4
Tobacco USD/mt	4,336	4,200	4,225	4,275	4,293

Source: World Bank Commodities Price Forecast October 2021; World Bank Commodities Price Data (The Pink Sheet) April 2022; e = estimate; p = projection; MMBtu = metric million British Thermal Unit; mt = metric ton *2022 prices reflect the average of the first three months of the year.

The rise in international oil and wheat prices that ensued the Ukraine conflict may further add pressures to the CAD in 2022, but there are also some upsides. At the start of the conflict, oil prices jumped by more than 40 percent from USD 76.9 a barrel at end-December 2021 to USD 109.8 a barrel on March 21, 2022. Similarly, wheat futures climbed to USD 11.7 per bushel as of March 21, the highest level in more than a decade (Figure 1.b). Compared to the October 2021 projections, the increase in the price of fuel and wheat combined may add a total USD 700 million (4 percent of GDP) (Table 5) to Mozambique's import bill, estimated at USD 13 billion at end-2022. While the increase in imports cost is likely to be offset by higher

exports in 2022, the CAD is anticipated to expand considerably to USD 8.1 billion at end 2022, more than double the level of 2021. The recent rise in gas prices, combined with increased coal and LNG production may add about USD 500 million to total exports. Overall, the trade balance will jump from the initially anticipated USD 4.5 billion to USD 8.5 billion, bringing the CAD to 44 percent of GDP in 2022 from the previously projected 30 percent. (see Box 2).

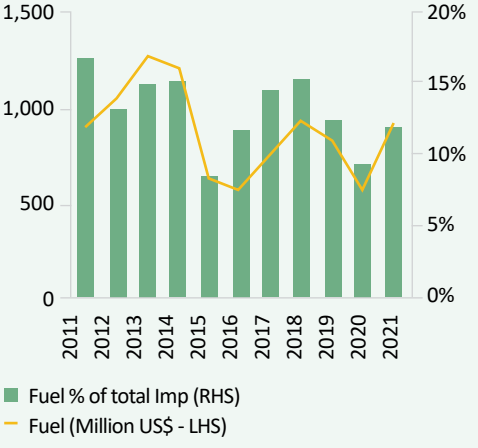
Box 2: What do rising international commodity prices mean for Mozambique?

The Russia-Ukraine conflict has led to a surge in the prices of Mozambique's key import commodities. Crude oil (Brent) prices increased by over 40 percent, from USD 76.9 a barrel at end-December 2021 to USD 109.8 a barrel on March 21, 2022. Similarly, wheat prices climbed to USD 11.9 per bushel as of March 21, 2022, the highest in over a decade. Natural gas (Europe) increased from USD 16 per metric million British Thermal unit (mmbtu) to USD 30 between December and March (Figure 12).

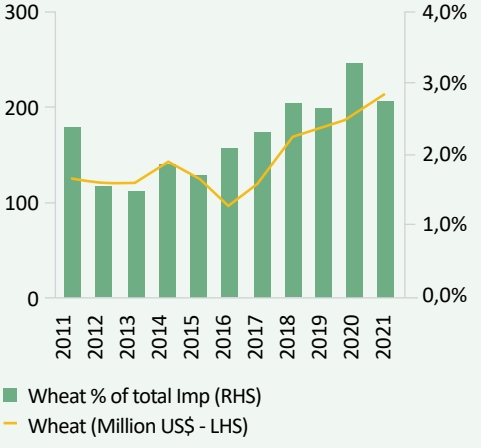
Figure title

Mozambique is a net oil and wheat importer. Imports of oil and refined products account for about 12 percent of the country's total imports. Mozambique's main import partners are the United Arab Emirates (28 percent), South Africa (22 percent), and India (21 percent). Wheat imports represent 3 percent of Mozambique's total imports. The main origin countries for the country's wheat imports include Pakistan (14 percent), South Africa (11 percent) and Russia (8 percent).

Mozambique: Oil imports (%, million US$)



Mozambique: Wheat imports (%, million US$)



The authorities have increased fuel pump prices amid rising global oil prices. Following the surge in oil prices, the authorities made upward adjustments to domestic fuel prices. Pump prices were revised according to a formula that reflects the base international price, exchange rate, transport and warehouse costs, distributors profit margin, and taxes. However, the international price increase was not fully passed through to the domestic market,[6] with the government taking measures to reduce the logistics and transportation cost of fuel. The pump prices of petrol and diesel—the refined products mostly consumed on the domestic market—increased from MZN 69 and MZN 61.7 per liter, to MZN 77.4 and MZN 71, respectively. Cooking gas, gasoline, and kerosene prices were adjusted by 14.5, 11.8 and 4.6 percent, respectively. Domestic adjustments in wheat prices are not clear yet.

The partial pass through of the international fuel price increase could lead to a total fiscal cost of 1 percent of GDP (Table 8). The rise in oil prices has two expected fiscal effects: (i) an increase in tax revenue collected on fuel imports and purchases; and (ii) an increase in fuel subsidy the difference between pump prices and the effective fuel cost. Although international fuel prices grew by 40 percent, pump price increases were around 15 percent. Also, the government reduced fuel taxes, which includes distributors' margins, port handling fees, storage fees, among others. Accounting for the adjustments in the fees, while keeping everything else constant, net fiscal flows—the differences between fuel related revenue collection and estimated rise in subsidies—would reduce from 1 to 0.2 percent of GDP between 2021 and 2022 (Table 4). In effect, the Government would see an increase in fuel-related revenue collection that would be offset by a sizable increase in subsidies.

[6] In 2008 and 2010, full adjustments to domestic fuel prices following the increases in international prices led to riots in the main urban centers. The possible social instability may partly explain the only partial pass through of the increase in global oil prices.

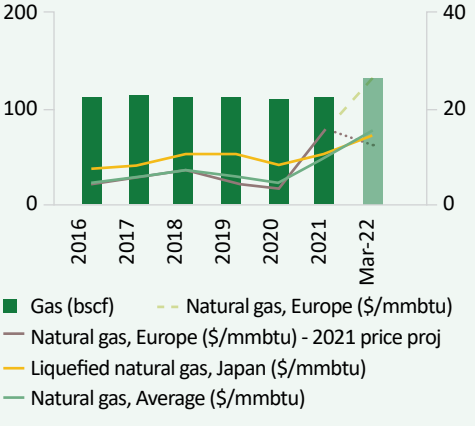
Table 7: The fiscal impact of rising international oil and wheat prices based on two possible scenarios

		2021	2022_Scen1 (12% increase in petrol + 15% increase in diesel)	2022_Scen2 (17% increase in petrol + 20% increase in diesel)
Fuel revenue (A)	Million USD	318	371	371
Fuel subsidy (B)	Million USD	132	335	305
Net fuel revenue (A-B)	Million USD	185	36	66
Net revenue loss in 2022 (compared to 2021)			-80%	-63%
Net revenue loss in 2022 (percent of revenue)			3.2%	2.5%
Net revenue loss in 2022 (percent of GDP)			0.8%	0.6%

Source: MEF and Ministry of Natural Resources and World Bank staff calculations.

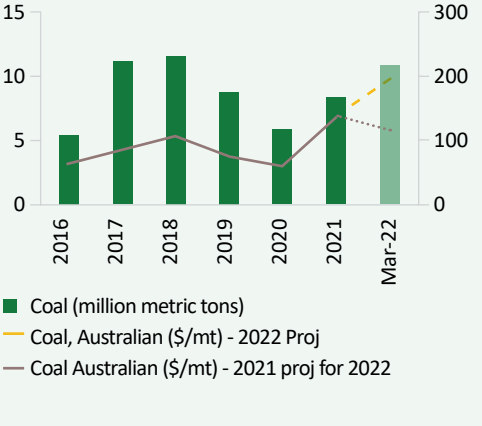
External pressures from the increase in oil prices, but there are also some upsides. According to the World Bank's Commodity Market Outlook (April 2022), oil prices averaged at USD 112.4 per barrel in March 2022. Compared to the October 2021 projections, the increase in the price of fuel and wheat combined may add a total USD 700 million (4 percent of GDP) (Table 5) to Mozambique's import bill, estimated at USD 13 billion at end 2022. The increased import costs will be partially offset by higher export volumes in 2022. A rise in gas prices, combined with the start of production in one LNG project in 2022 and increased coal price and production, may add USD 500 million to total exports. Overall, the trade balance may drop from the initially anticipated USD 4.5 billion to USD 8.5 billion, bringing the CAD to 45 percent of GDP in 2022 from the previously projected 30 percent.

Figure 18: Gas production and prices are set to increase



Note: bscf = Billions of standard cubic feet; mmbtu= metric million British Thermal unit.
Source: WB CMO, Sasol reports and WB staff.

Figure 19: Coal production and prices are also projected to rise



Source: WB Commodity Markets Outlook, Vale Sa Report (2016 –2022) and staff calculations.

Table 8: **Rising international oil and wheat prices could play out through several scenarios**

	Oil 2021 avg	Oil 2022	Wheat 2021 avg	Wheat (% inc.) 2022
	USD 70.4/bbl	USD 112.4*	USD 7/bushel	USD 10.7/ bushel*
Increase in imports (USD mil)		500.0		200.0
Increase in imports (% GDP)		2.8%		1.1%

Memo items: (i) Gross Domestic Production (2021): 16.3bn; GDP (2022): US$ 18.1 bn; (ii) Total Imports (2021): US$13bn
*Average March price

Gross financing needs will stay elevated over the medium term, underscoring the need to resume fiscal consolidation and enhance revenue collection and management before LNG receipts start flowing.

Fiscal financing requirements will remain considerable in the medium term. A range of supportive fiscal measures have helped contain the COVID-19 recession, but have delayed fiscal consolidation. The fiscal deficit is projected to average 3.3 percent between 2022 and 2024 (Figure 15). While additional financing needs are expected to decline gradually, they will remain considerable over 2022–2024, at an average of 1.7 percent of GDP. The new salary structure for civil servants in 2022 promises greater control in the medium term, but at a near-term cost. Between 2021 and 2024, the wage bill reforms' cumulative savings are expected to be 0.7 percentage points of GDP. In addition, higher capital costs reflect the externally-financed vaccination program (recorded as a foreign-financed investment) and the need to continue addressing the security and humanitarian situation in the north. The authorities are planning some fiscal measures to mitigate the adverse socio-economic effects of the wheat and oil prices shock resulting from the Ukraine conflict, which may increase financing needs. The additional financing needs between 2022 and 2024, is expected to be covered by the IMF ECF program (US$ 456 million over 2022-2023) and the WBG Development Finance Policy operation (US$ 300 million for 2022). The remainder is anticipated to be covered by support from other development partners.[7] Debt service may increase from 2023, as the restructured Mozam bond interest rate adjusts upwards, as per the 2019 restructuring.[8]

The recent surge in fuel prices will add to the financing needs. The Government may lose about 1 ppts of GDP in net fuel-related fiscal revenues. On the one hand, the government's fuel tax collection will likely increase amid higher prices, although the government has reduced a number of taxes. On the other hand, subsidies[9] will rise as the increase in international prices has not been fully passed to domestic pump prices. In 2021, the government collected about USD 318 million in fuel taxes (9 percent of total tax revenue), and spent USD 130 million on fuel subsidies. In net terms, fuel-related revenue inflows amounted to USD 185 million, about

7 IMF financing under the planned program supported by the Extended Credit Facility is expected to start in 2022 and cover external financing needs worth 0.6% of GDP. A planned World Bank Development Policy Financing programmatic series (FY22-FY24) is equivalent to 1.7% of GDP (annually).

8 In 2019, authorities swapped the 727 million MOZAM 2023 bond to a USD 900 mil bond. Under the new bond structure, the maturity has been extended from 2023 to 2031, and the annual coupon rate reduced from 10.5 to 5% until 2023 and 9% from 2023 onwards. Capital amortization will start from 2028.

9 The determination of pump fuel prices in Mozambique is managed by ARENE (the Authority For Energy Regulation). Normally, approved pump prices are managed around an effective cost which reflects the international price of fuel, logistical costs (storage, port handling, transport, among others), distributor and seller margin, and taxes (VAT, and costums duties). Accounting for all price elements, pump prices were supposed to be much higher. For instance, at an international cost of USD 100 per barrel, the diesel pump price should be at almost MZN 90 a liter, compared to the current MZN 71.

1 percent of GDP. As a result of the partial pass through, subsidies to keep pump prices below the effective cost may rise to more than USD 300 million in 2022. Revenue collection is likely to remain unchanged or increase as fuel price rises offset the drop in some tax collection (Box 1).

On the spending side, the Government plans to resume fiscal consolidation, including through structural wage bill and pension reforms, and reducing fiscal risks from SOEs. A new draft law to restructure public sector remuneration was approved in September 2021. Following the law, additional measures would be required to bring the wage bill down to a more sustainable path, including by prolonging a temporary hiring freeze or implementing an attrition policy, as well as conducting a functional review of public employment, among others. Separately, the authorities are initiating legal and parametric reforms to ensure the pension system's long-term sustainability. They intend to move away from the existing Pay-as-You-Go (PAYG) system, whereby employees' contributions are considered as revenue in the state budget, and pensions are entirely paid from general revenues. Finally, following the SOE law, the Instituto de Gestão das Participações do Estado (IGEPE), the body managing the state's participation in SOEs, has embarked on several reforms. IGEPE is looking to streamline the SOE portfolio, including assessing options for restructurings, mergers, and liquidations, reducing fiscal risks from the sector. Together, these measures are expected to yield a spending reduction of around 3 percentage points of GDP.

Despite the challenges posed by the lingering pandemic, the authorities continue to strengthen revenue collection and administration. The government's medium-term fiscal plans foresee improving tax collection on imported goods through (i) implementing a system to track and control merchandise transiting the national territory; and (ii) simplifying import duties procedures. The authorities also expect to expand the tax base gradually through technological improvements, and spread collection centers across the national territory. Planned reforms also include improving the billing and sealing of beverages and tobacco and enhancing stamp duties and VAT collection on these products. Under the planned IMF program, the authorities are also embarking on reforms to remove exemptions and domestic zero-rating on VAT to increase tax collection. Finally, significant fiscal receipts are expected from the sale of LNG through state profit petroleum, once cost-recovery has been achieved, and through income tax receipts and non-tax revenues. However, substantial LNG revenues are not expected until well into the 2030s.

In the near term, the authorities should maximize concessional external financing and reduce recourse to expensive domestic debt. It is essential to secure financing from the planned IMF program and the World Bank's Development Policy Financing. The authorities could reduce domestic borrowing costs through active debt management, including more efficient use of government deposits, enhanced cash management, and IT systems for debt recording and reporting.

In the medium term, it is critical to establish fiscal objectives and an institutional framework for managing LNG wealth and making public investments more resilient. Mozambique needs to strengthen its medium-term fiscal framework (MTFF) and gradually transition towards a fiscal policy based on fiscal objectives and fiscal rules. The planned Sovereign Wealth Fund (SWF) law needs to include clear rules governing deposits and withdrawals, embedded in a sound MTFF and fiscal rules. No institutional structure can guarantee successful SWF management unless there is a broader commitment to fiscal discipline and fiscal rules that can help manage spending volatilities. These rules should account for spending pressures from recurrent climatic shocks. Further, it is crucial to ensure the participation of independent, non-state actors in the oversight of the Fund. Additionally, the government needs to capitalize on its recent public investment management reforms to introduce climate-smart standards for more resilient public infrastructure and lower future fiscal pressures.

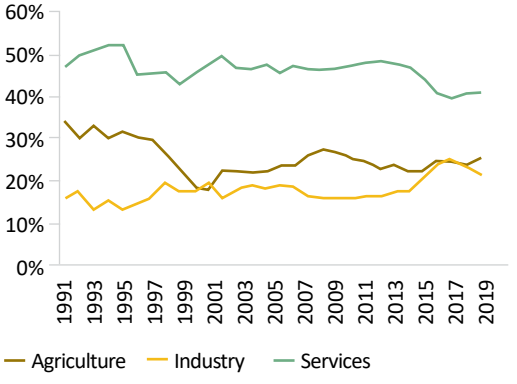
Part Two: Agriculture can be a source of growth, poverty reduction and food security. What reforms are needed?[10]

What is the role of agriculture in the economy and household incomes?

Mozambique has seen a limited shift in the structure of its economy. Over the last three decades, three main phases are apparent. On the return of peace in the early 1990s, Mozambique was predominantly an agricultural economy. Starting in the late 1990s, the country experienced strong growth in manufacturing, dominated by capital-intensive investments, particularly in the aluminum sector. The late 2000s saw a shift to a third phase, characterized by an emphasis on extractives, driven by large increases in foreign direct investment (FDI) into coal and liquefied natural gas (LNG). Agriculture's share of total employment fell from 86.6 percent in 1997 to 71 percent in 2015 (Figure 21). In contrast, its share of total output barely declined, from 28.7 percent in 1997 to 25.6 percent in 2020 (Figure 20). The output share of industry rose from 15.3 to 23.6 percent over the same period, mostly due to mining. However, the relatively fast growth of industrial output did not translate into employment growth. The share of jobs in industry has only increased from 4.4 to 4.9 percent. The services sector represents the largest share of GDP, reaching 41 percent in 2020. The employment share of services rose from 9 to 24 percent between 1997 and 2015.

Figure 20: **Agriculture's output share remained stable...**

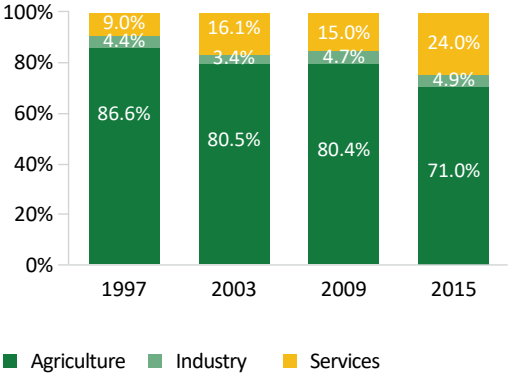
Sectoral shares in gross value added



Source: World Bank World Development Indicators.

Figure 21: **...while its share of employment is declining**

Sectoral shares of employment



Source: World Bank World Development Indicators.

[10] This chapter was written by Diego Carballo (Lead Agriculture Economist) and Hector Peña (Consultant). The chapter draws mainly on the World Bank (2021) Mozambique Agriculture Policy Review and has received support from contributors cited therein.

Agriculture remains the main economic activity in Mozambique. The sector has vast growth potential given its agroecological diversity. Mozambique's strategic geographical position allows it to play an important entrepot role for agricultural trade with the neighboring landlocked countries. There are about 4 million smallholder producers in Mozambique (Table 9), and these account for approximately 98 percent of the total workforce and production in the sector, with the remaining 2 percent accounted for by micro, small, and medium enterprises (MSMEs), and larger agribusinesses and commercial farms. Even though 45 percent of the land country is suitable for agriculture, less than 16 percent is currently cultivated.[11]

Most agricultural output involves crop production by small landholders. Crop production and processing accounted for about 80 percent of the agriculture value added. The other sub-sectors (livestock, fishing and aquaculture and silviculture) accounted for the remainder, at around 6-7 percent each (Figure 22). While area expansion has been the main factor driving the increase in crop production since the end of the civil war in the early 1990s, the scale of production remains low. Overall, the median area cultivated by smallholders in the main growing season is about one hectare. There are, however, large differences across regions and income groups. At around 1.4 hectares, the median plot is slightly larger in the Central Region (Figure 23). But poorer smallholders (those in the bottom 40 percent of the income distribution) cultivate less than a third the number of hectares as wealthier farmers, for all annual crops considered.

Agriculture is the main source of income for rural households, but most remain net food consumers. The rural poor farm largely for self-consumption, but they remain net food consumers, meaning that increases in food prices affect them negatively. Figure 24 shows that the most valuable agricultural products are cassava (mandioca), tomatoes, and maize, together contributing 85% of agricultural GDP. Available evidence shows that food price increases in Mozambique reduce food consumption and increase rural poverty (World Bank, 2018). Policies that increase domestic prices of food and agricultural products therefore have an overall negative welfare impact on poor smallholder farmers, while benefiting the relatively larger commercial farmers who produce food surpluses.

Table 9: **Small farmers make up the bulk of Mozambique's farming sector**

Farmer category[1]	Number	%
+--+	Number of farmers	
Small farmers (million)	3,9	98.91%
Medium farmers (million)	0.044	1.08%
Large farmers (million)	0.436	0.01%
Total (million)	4.04	100.00%
	Cultivated area (ha)	
Small farmers (million)	5.21	96.69%
Medium farmers (million)	0.12	2.17%
Large farmers (million)	0.06	1.14%
Total (million)	5.4	100.00%

Note: [1]Small farmer (less than 5 hectares); medium farmer (between 5 and 10 ha); large farmer (more than 10 ha).
Source: Ministério da Agricultura e da Segurança Alimentar (2014). *Inquérito Agrário Integrado* [Integrated Agricultural Survey].

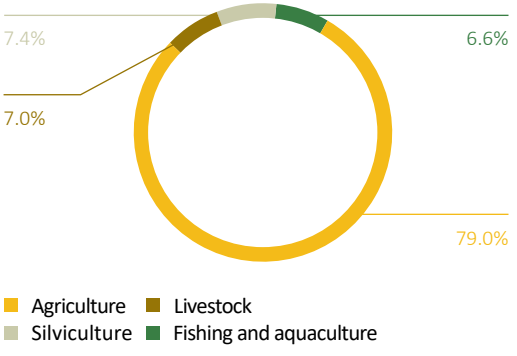
[11] World Bank (2020).

Overall, crop productivity is low, both by regional standards and relative to Mozambique's own potential. Mozambique has one of the lowest cereal yields per hectare in southern Africa (Figure 25). For example, average yields for maize—the most commonly grown staple crop—are still below 1,000 kg per hectare. Productivity gaps are also observed for other crops that are important in the crop portfolio of small-scale farmers. The crops produced by most farmers exhibit relatively smaller profits, signaling productivity gaps and market access challenges (Figure 24). There has been little progress in the last two decades in bringing yields in traditional crops closer to the regional average. Compared to its peers in sub-Saharan Africa (SSA), Mozambique has the lowest levels of land and labor productivity.

Growth in the agriculture sector has the highest relative impact on poverty reduction. Despite the sector's significant untapped potential, agricultural productivity remains low, largely due to low input access and intensity, weak technology adoption, limited provision of agricultural services, and high seasonality in production and climate vulnerability. However, simulations show that agricultural growth would decrease poverty and inequality over three times faster than growth in any of the other sectors (World Bank, 2020).

Figure 22: **Crop production drives agricultural output**

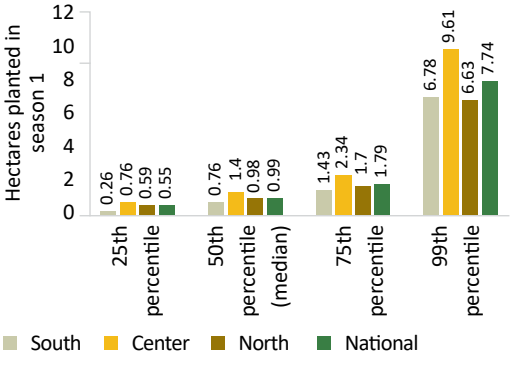
Composition of agricultural GDP



Source: World Bank (2020). Rural Income Diagnostic.

Figure 23: **Small farms account for the bulk of production**

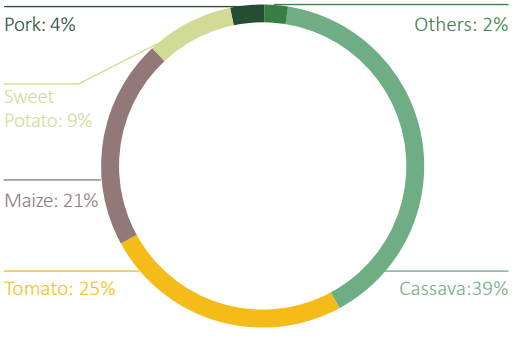
Median area farmed in hectares by region



Source: World Bank (2020). Rural Income Diagnostic.

Figure 24: **Cassava, tomatoes and maize are the most valuable crops**

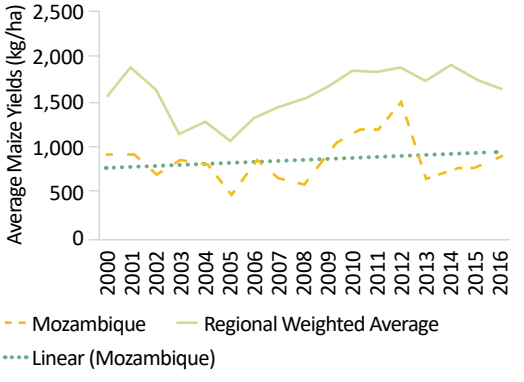
Contribution of products to agricultural GDP (2019)



Source: World Bank (2020). Rural Income Diagnostic.

Figure 25: **Maize yields are below the regional average**

Average maize yields in kilograms per hectare



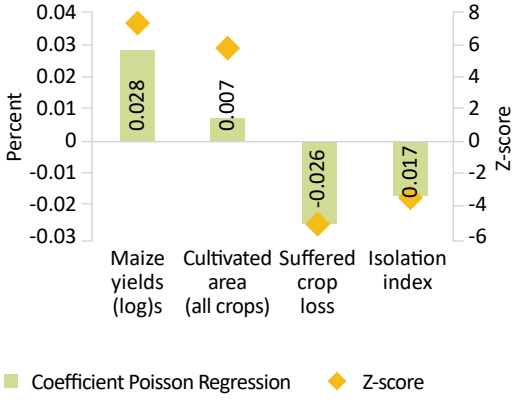
Source: World Bank (2020). Rural Income Diagnostic.
Note: "Regional average" corresponds to the population-weighted average yields for Malawi, Rwanda, Tanzania, Uganda, and Zambia.

The sector also plays a critical role in ensuring food security. Rather than maximizing profit, the production choices of most smallholders are focused on food security (Figure 26), with only a small share of produce being sold in the market (Figure 27). Most poor rural households produce below subsistence level and production decisions are closely linked to their food consumption decisions. Achieving food security in rural areas and transitioning from employment in agriculture to industry and services require an increase in agricultural productivity. Based on empirical evidence in Mozambique, Figure 26 shows the positive correlation between food security, cultivated area and yields. On the other hand, it shows a negative correlation with crop losses (due to production shocks, post-harvest inefficiencies, etc.) and isolation (a variable related to food storage infrastructure challenges for small and remote populations).[12]

Mozambique is ranked the third most vulnerable country to climate change in Africa.[13] Large areas of the country are exposed to tropical cyclones, droughts, and river/coastal storm surge flooding. This vulnerability is heightened by the country's 2,700 km of coastline and its socioeconomic fragility. About 60 percent of the population live in low-lying coastal areas, where intense storms from the Indian Ocean and sea-level rise put infrastructure, coastal agriculture, ecosystems, and fisheries at risk. As the intensity of these storms increases, the impacts are also starting to be felt inland. Access to markets, already a challenge for many rural producers, is increasingly difficult after disasters hit. As 70 percent of the population depends on climate-sensitive agriculture for their food and livelihoods, increased frequency and intensity of storms, droughts, and floods are likely to put pressure on agricultural income and food security. Historical trends show global average temperatures have increased significantly, and future climate projections for Mozambique show more marked temperature increases in the interior, southern, and coastal areas.[14]

Figure 26: **Farmers' production is strongly correlated with household food security**

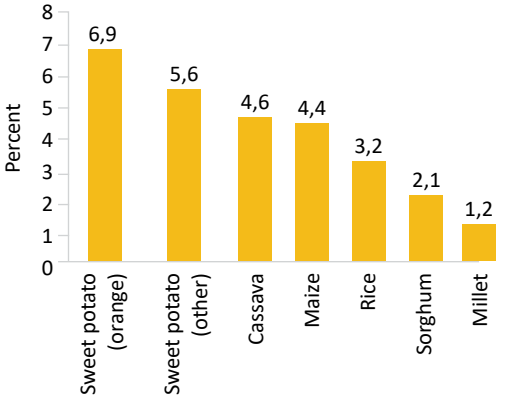
Correlates of average number of meals per person in the lean season for rural households



Source: World Bank (2020). Mozambique Rural Income Diagnostic.

Figure 27: **Only a small share of staples grown by smallholders is marketed**

Percentage of key food crops sold in markets



Source: World Bank (2020). Mozambique Rural Income Diagnostic.

The gender gap in agriculture is extensive. Rural women in Mozambique face more constraints than men in accessing essential productive resources and services, technology, market information, and financing. They are underrepresented in local institutions and governance mechanisms, and tend to have less decision-making power than men. Prevailing

12 World Bank (2019b).
13 UNU (2016); IMF (2018).
14 IPCC (2018).

gender norms and discrimination often lead to an excessive work load for women, and much of their labour remains unpaid and unrecognized. Labor force participation for women is relatively high, at around 80 percent, but women are disproportionately concentrated in subsistence agriculture and the informal sector. Recent data from two World Bank (WB) projects[15] in Mozambique in the agriculture sector show that women benefit less from contract farming schemes than men.[16] Gender-specific obstacles put female farmers at a significant disadvantage. Improving gender equity in the agriculture sector would not only empower women to achieve their highest economic potential but also help reduce poverty and food insecurity.

The COVID-19 pandemic has seen a sizable number of Mozambicans fall back into poverty. Mozambique's already difficult poverty situation is expected to be aggravated further. The February–September 2021 Famine Early Warning Systems Network (FES NET)[17] projection for Mozambique is that by mid-2022 there will be an increase of 14 percent of the population living in areas under crisis or with worse food security conditions, bringing the total number of people in this category of food insecurity to 7.8 million (or 24.6 percent of the total population of the country), from a current level of 6.8 million. The World Bank projects an additional 1.4 million poor in Mozambique due to the growing conflict in the north as well as the slowdown in economic activity.[18] The negative impacts on income are expected to be felt more in urban and peri-urban areas, where social distancing measures and business closures are having the greatest impact. The pandemic is also likely to exacerbate the fiscal situation and availability of public budget for the farming sector, as well as pre-existing factors of fragility, and will widen inequalities across the country. The spatial distribution of poverty is skewed—it is almost twice as high in rural as in urban areas and inequality between rural and urban areas is increasing.

How does Mozambique support its agriculture sector?

Over the last two decades, Mozambique has seen low and declining public spending on agriculture. The average share of agriculture in the national budget was slightly above 4 percent from 2010 to 2014, and fell to 4 percent in the subsequent five-year period (2015–2019).[19] Over the 2008–2018 period, Mozambique ranked around the median of SSA countries in terms of the share of agriculture in total public expenditure, investing less than half of the New Partnership for Africa's Development (NEPAD) target of 10 percent (Figure 28).[20] In addition to the need for greater public investment, there is a heightened need to improve the effectiveness and efficiency of public spending in the current fiscal environment. Sector spending as a share of agricultural GDP – a rough indicator of investment effectiveness – was 14.8 and 19 percent in 2017 and 2019 respectively, as reported by Mozambique to the Comprehensive Africa Agriculture Development Programme (CAADP) Biennial Reviews.[21]

[15] Agriculture and Natural Resources Landscape Management (SUSTENTA, P149620) and South-west Indian Ocean Fisheries Governance and Shared Growth Project 1 (SWIOFish1, P132123).

[16] Within the context of the Agriculture and Natural Resources Landscape Management (SUSTENTA) project, only 14 percent of commercial smallholder farmers (*Pequeno Agricultor Comercial Emergente,* PACE) and 13 percent of smallholder farmers (PA) benefitting from the matching grant scheme (MGS) are women. In the fisheries sector, only 29 percent of the beneficiaries of the Mais Peixe mechanism are women, and, on average, receive smaller grants, totalling 22 percent of the total budget. These numbers refer to data collected from the beginning of these projects up to November 2020.

[17] The Famine Early Warning Systems Network is a leading provider of early warning and analysis on food insecurity. See: www.fews.net/mozambique.

[18] Simulations done by the World Bank of the potential short-term effects of the COVID-19 shock on income and consumption show that a reduction of 10 percent in consumption across all rural households would increase poverty from 50.7 percent (baseline rate projected for 2020) to 56.6 percent. This translates into 1.4 million more Mozambicans slipping below the poverty line.

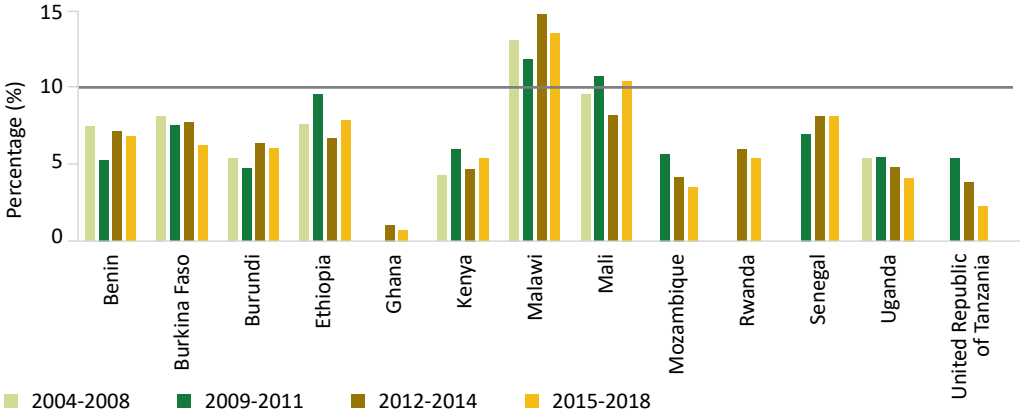
[19] World Bank (2021). Agriculture's share of the national budget declined from 1.10 percent in 2013 (USD 702 million) to 0.41 percent (USD 544 million) in 2015. It is important to note that the budget allocations for the agriculture sector do not only fall under the Ministry of Agriculture (MINAGRIP), but also under the Ministries of Commerce, Industry, and Transport (World Bank, 2017).

[20] Pernechele et al. (2021).

[21] The authors calculated public expenditure on agriculture to be USD 1.47 billion and USD 1.66 billion in 2016 and 2018 by multiplying total public expenditure (from the CAADP AATS Scorecards) by agricultural GDP (from the WDI). In absolute terms, this would indicate a large jump in resources allocated to the sector relative to 2014 and 2015.

Notwithstanding declining budget spending in agriculture, Mozambique provides significant other support to its agriculture sector. The 2018 estimates show that the country allocated USD 509 million (equivalent to 3.3 percent of total GDP) in total annual support to the agriculture sector (Figure 29). This (estimated) level of total agriculture support, which considers all transfers to agriculture derived from agricultural policies (i.e., not only public spending on agriculture, but also other transfers derived from border measures and other regulations; see Annex A), is one of the highest globally. However, when compared to the size of the agriculture sector, it is equivalent to 12.8 percent of agricultural GDP (Figure 30)—higher than in South Africa but lower than in Angola and OECD countries (40.2 percent, on average). As OECD countries are considered to heavily subsidize and support their agriculture sectors, comparing Mozambique with them gives a good sense of the range of levels of support. While Angola and South Africa are also good options for benchmarking, unfortunately no other SSA countries have these estimates.

Figure 28: **Agriculture's share in total public expenditure is well below target**



Source: *Pernechele, V. et al (2021).*
Note : Red line represents the New Partnership for Africa's Development (NEPAD) target of 10 percent.

Assessing the type and size of the agricultural support provided by public policies and programs is important to ensure that the country is providing the right incentives to its farmers to improve sector growth, reduce food insecurity, and protect the environment. Given that a significant portion of farm revenue in Mozambique comes from support via public policies and programs, it is important to assess these in detail to ensure that they are aligned with the broader goals of sustained sector growth and poverty reduction. In assessing agriculture support policies and programs, World Bank analysis[22] uses the OECD methodology (see Annex A) to: (a) provide a systematic and integrated view of agriculture support policies and programs; (b) benchmark results across a large set of comparators;[23] and (c) integrate the results into agriculture public policy analysis conducted by the government and other stakeholders.[24]

Although total agricultural support in Mozambique is high compared to other developing countries, the portion of support going to public goods and services is relatively

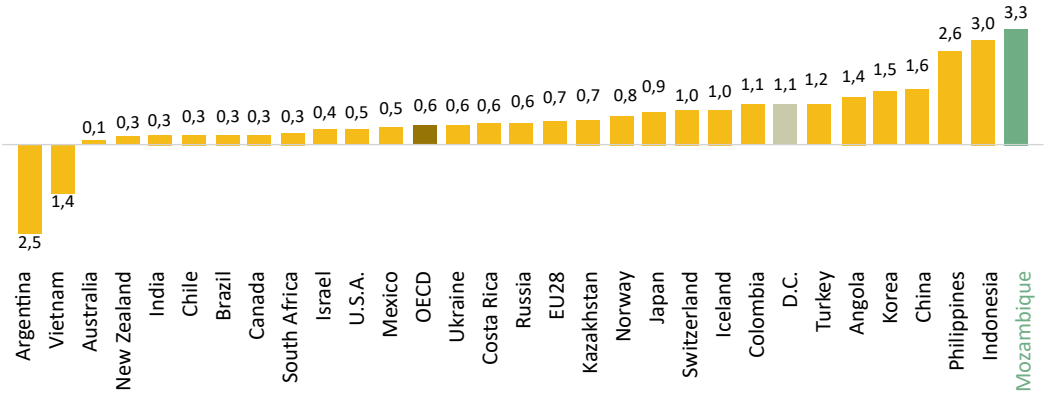
[22] World Bank (2021). Mozambique Agriculture Support Policy Review: Realigning Agriculture Support Policies and Programs.
[23] At present, the OECD methodology for agriculture support estimates covers 109 countries. This includes OECD countries, non-OECD EU Member States (subject to data availability), and a number of developing countries where monitoring is done by the OECD, Inter-American Development Bank, and FAO's MAFAP unit. The 54 countries monitored by the OECD are members and non-members: Argentina, Australia, Brazil, Canada, Chile, China, Colombia, Costa Rica, the European Union, India, Indonesia, Iceland, Israel, Japan, Kazakhstan, Korea, Mexico, New Zealand, Norway, the Philippines, the Russian Federation, South Africa, Switzerland, Turkey, Ukraine, the United States and Viet Nam.
[24] As part of this assessment, a training of more than 15 public sector staff was undertaken to build capacity and allow the government to update the estimates going forward.

low. The OECD methodology allows the total support going to the agriculture sector to be disaggregated (see Annex A). The World Bank (2021) analysis revealed that 95 percent of total support (TSE) to the sector was through producer support (PSE), largely in the form of market price support (MPS – mainly trade protection measures), while just 5 percent went to public goods and services (i.e. the general services support estimate, or GSSE).

On average in 2018, 7 percent of agricultural producers' revenues in Mozambique came from agricultural public support policies, such as production subsidies and trade protection measures. This level of public sector support is 11 percentage points lower than the OECD average for that same year, but slightly higher than the average for developing countries (5.6%). In Mozambique, the support to agricultural producers is largely through trade protection measures, such as tariff and non-tariff barriers. Trade protection measures create a wedge between the international and domestic price for agriculture products, thus creating an "implicit tax" for Mozambiquan consumers: i.e., the MPS transfers money from food consumers to agriculture producers. Furthermore, as it raises local food prices, farmers who consume their own produce do not benefit from the MPS, while farmers who sell most of their production in the market do, boosting even further the large-scale production by existing commercial farmers.

Figure 29: **Mozambique has one of the highest shares of total support to agriculture as a share of GDP...**

TSE as a share of total GDP, 2018



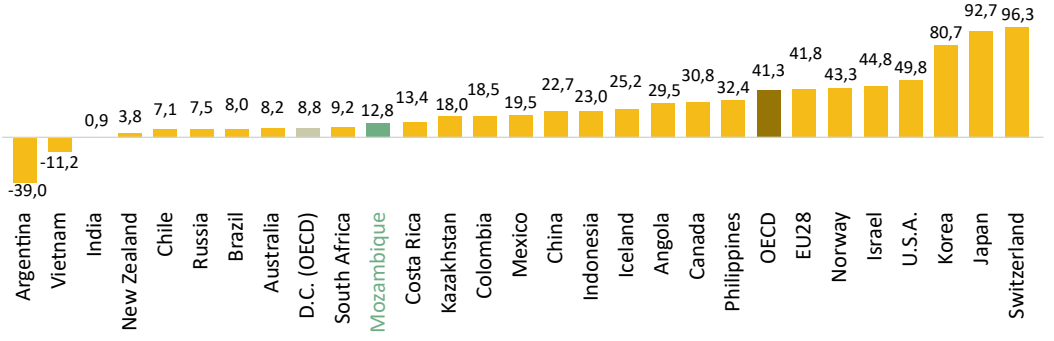
Source: World Bank (2021).

Note: The total support estimate (TSE) is the annual monetary value of all gross transfers from taxpayers and consumers arising from public policy measures that support agriculture, net of the associated budgetary receipts, regardless of their objectives and impacts on farm production and income, or consumption of farm products. See Annex A for further details.

D.C.= developing countries. Includes average figures for those DC (OECD members or not) for whom the OECD makes estimations.

Figure 30: **... but one of the lowest shares of total support to agriculture in agricultural GDP**

TSE as a share of agricultural GDP, 2018



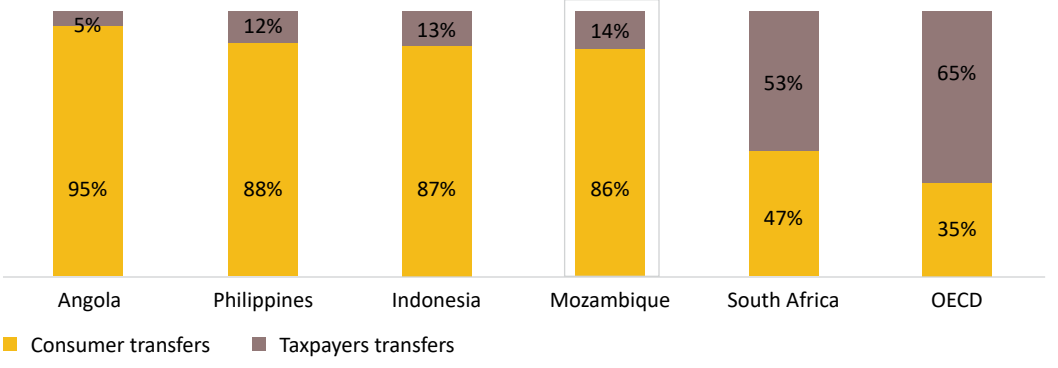
Source: World Bank (2021).

Note: D.C.= developing countries.

The other way to support agriculture is through public expenditures (such as subsidizing farmers' purchases of inputs), but this type of support only represented 5 percent of the total support to agricultural producers in Mozambique in 2018. Figure 31 illustrates the role of consumers and taxpayers as sources of transfers to agriculture in selected countries. As seen, more developed (OECD) countries rely on taxpayers for most of their support to agriculture, while in other countries, such as Mozambique, Angola, etc., consumers represent the main transfer source to agriculture.

The current structure of producer support only benefits a small number of commercial agricultural producers and does not enhance sector competitiveness. MPS policies have been implemented mainly based on food security arguments. However, given that small-scale and subsistence-oriented family farms dominate in Mozambique (Table 11), the effect of MPS is the opposite, benefiting only a small proportion of producers who commercialize their production (only 20% of total) and taxing the majority of agricultural households which are net food consumers.

Figure 31: **Consumers in Mozambique provide the bulk of support to farmers**



Source: World Bank (2021).

Table 10: **Few farmers grow cash crops or commercialize their production**

	% of farmers growing	% of farmers selling	% of farmers selling by region		
			Southern	Central	Northern
Staple crops	100	13	3.1	13.3	23.9
Cash crops	18	8	0.4	14.5	12.1
All crops	100	20	3.5	24.4	32.2

Source: World Bank (2020). Mozambique Rural Income Diagnostic.

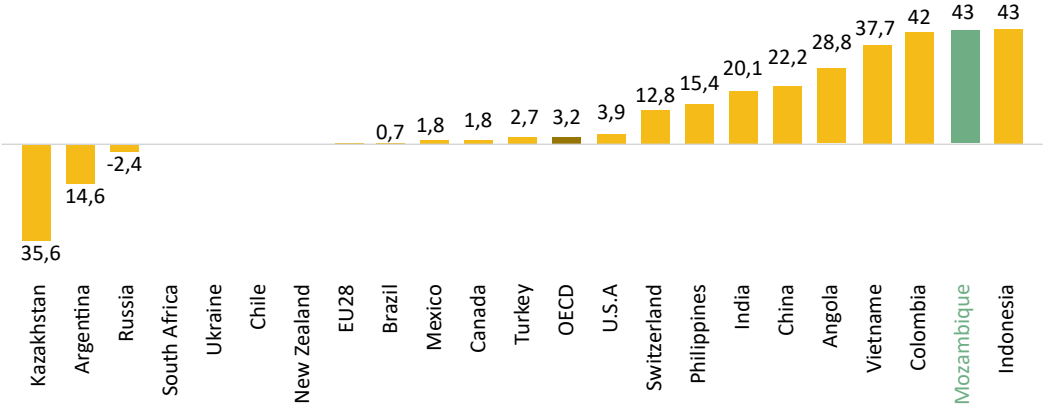
Although MPS measures seek to protect strategic crops for food security reasons (i.e., imposing trade barriers to maize imports), they do not address the sector's structural challenges. MPS does not benefit smallholder farmers and only a few crops are subject to its benefits, reducing sector competitiveness by distorting farmers' decisions on what to produce. It also means that agricultural commodities benefiting from MPA are less likely to be exported because international prices are lower than the domestic price received by producers. Furthermore, they transfer income from Mozambique's lower-income consumers (since

they spend disproportionally more on food) to wealthier landowners. The MPS does little to help farmers with below-average incomes because benefits are distributed in proportion to sales. As Table 11 shows, only 20 percent of farmers benefit from MPS (those farmers selling); and as the more you sell the more support you receive, the MPS is negatively correlated with need.

Food consumers in Mozambique pay an implicit tax of about 5 percent. The agriculture support estimates also include an indicator for measuring the support to food consumers (CSE). The CSE measures the support to (or tax on) food consumers arising from public agriculture policies. Although Mozambique does provide some support to food consumers in the form of food aid and school meal programs, the overwhelming majority of the CSE is negative, due to public policies that protect (raise) domestic prices. CSE as a percentage of total food expenditures by food consumers was approximately 5 percent in 2018. This implicit tax is a transfer from consumers to producers through higher domestic food prices. It is also a regressive tax since the poor spend a larger share of their income on food than high-income consumers.

Figure 32: Mozambique has one of the highest producer support shares for maize in the world...

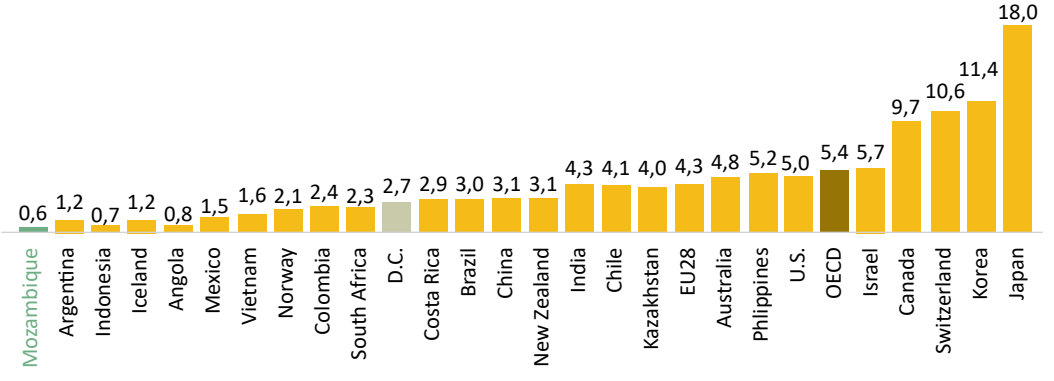
%SCT for maize, 2018



Source: World Bank (2021).
Note: SCT=single commodity transfer; %SCT=the commodity SCT as a share of gross farm receipts for a specific commodity.

Figure 33: ...but the lowest support to agricultural public goods

GSSE as a share of agricultural GDP, 2018

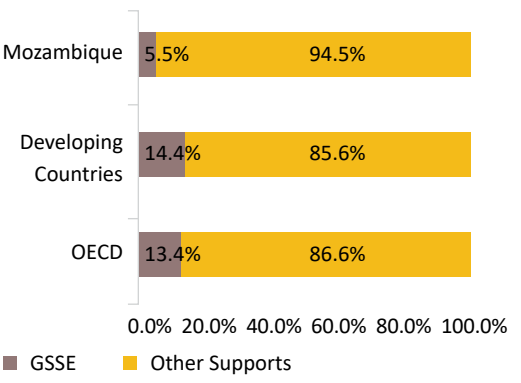


Source: World Bank (2021).
Note: D.C.= developing countries; GSSE=General services support estimate.

Agricultural support to producers in Mozambique is basically concentrated in maize and pork and is higher for these commodities than in other countries. Of the total gross revenues received by farmers producing maize in 2018, 43 percent came from public agricultural support policies and programs (Figure 32), while the share for pork was 31 percent (commodity-specific support is measured by the single commodity transfer, or SCT – see Annex Box 1). In comparison, the %SCT in OECD countries was 3 percent for maize and 8 percent for pork that same year. These high levels of support signal the distortions that farmers face when making production and trade decisions. For example, producer support to sweet potatoes was USD 39/ha, while maize was USD 60/ha and cassava was USD170/ha in 2018.[25]

Agricultural support funded by taxpayers (through public expenditures) is mainly allocated to investments in private goods (PSE) rather than public goods (GSSE) in Mozambique. GSSE—financed by taxpayers in the form of budgetary payments—supports activities providing general benefits or goods with public characteristics, e.g., agricultural innovation (R&D and education), animal/plant health services, marketing and promotion, rural infrastructure, and public stockholding (Annex A). GSSE is positively correlated with agricultural growth and competitiveness.[26] This means that the more a country invests in GSSEs, the higher its agricultural trade balance and its long-term growth. However, in Mozambique GSSE represented only 0.6 percent of agricultural GDP in 2018 – the lowest of all the countries analyzed (Figure 33). In comparison, the corresponding averages for the OECD, developing countries, South Africa and Angola were 2.7 percent, 5.4 percent, 2.3 percent and 0.8 percent, respectively. Similarly, GSSE accounted for 5.5 percent of TSE

Figure 34: **Mozambique's GSSE share in TSE is well below global averages**



Source: OECD and author estimates.
Note: 'Other support' includes: producer support (PSE)+transfers to consumers from taxpayers.

(Figure 34), less than one half of the averages for OECD (13.1 percent) and developing countries (14.3 percent). As for the internal composition of Mozambique's GSSE, infrastructure represented 81 percent, research (10 percent) and marketing and promotion (7 percent) in 2018.

Investments in agricultural public goods (measured through the GSSE) yield higher economic returns than investments in agricultural private goods (direct farmer support – PSE). Although the literature shows that investing in GSSE brings higher economic returns than investing in PSE,[27] Mozambique and many other countries tend to support farmers directly through PSE rather than through GSSE. Mozambique has the lowest level of GSSE investments as a share of GDP of the countries for which OECD estimates have been calculated. This is in part due to its relatively large agriculture sector, but also because it allocates only a small share of its total support to the sector (TSE) to GSSE.

[25] Authors' calculations, based on OECD data.
[26] One interesting point is that in some countries that are currently referenced in international markets, highly market oriented and export leaders (New Zealand, Australia, Canada), the GSSE is the most important way to support their agricultural sector.
[27] Goyal and Nash (2017); López and Galinato, 2007; López, 2005; World Bank (2001).

What reforms can enhance competitiveness and sustainability while protecting the poor?

As it defines its 10-year strategy and investment plan (PNISA 2) for the agricultural sector, Mozambique has an important opportunity to introduce reforms to accelerate progress towards a more competitive and sustainable sector. As we have seen above, agricultural support consists largely of MPS (through border measures), but does not address the underlying competitiveness bottlenecks. This type of agricultural support needs to be phased out to allow Mozambique's farmers to produce based on market signals and to move towards full participation in regional free trade agreements like the Southern African Development Community (SADC) and the African Continental Free Trade Area (AfCFTA). In agricultural trade negotiations, MPS is considered one of the most trade-distorting types of support, given that it creates a wedge between domestic and international prices, and is considered as unfair competition, being subject to trade disputes. The World Trade Organization classifies commodities with MPS measures (tariff, non-tariff barriers) under the amber box (Figure 35). Amber box classification means that these commodities in Mozambique face export difficulties because of limitations imposed by importing countries (i.e., importing countries may apply countervailing measures, limiting trade in those products). Blue box and green box measures are not subject to limitations and importing countries cannot restrict imports.

Figure 35: World Trade Organization boxes

Source: Based on information from WTO webpage.

Table 11: There are four key reforms for a stronger and fairer agricultural sector in Mozambique

Agriculture policy shift	Competitiveness objective (diversification and trade integration)	COVID-19 recovery: building back better	
		Climate resilience	Nutrition-food security
1. Shift from providing private goods (PSE) to public goods and services (GSSE)	✓		
2. Shift within PSE, from supporting farmers via prices (MPS) to supporting farmers via public expenditures	✓	✓	✓
3. Shift from implicitly taxing food consumers to positive consumer support (CSE)			✓
4. Shift to open menu and smart support to producers	✓	✓	✓

Source: Authors' compilation.

Developing agribusinesses is high on the country's development agenda, with an important private sector development program and technical assistance provided by multiple development partners. The multiple natural disasters of recent years and the COVID-19 pandemic have also renewed the urgency of focusing on supporting the climate resilience and nutrition of the poorest rural households.

The reforms and recommendations for realigning agriculture support policies and programs towards competitiveness, climate resilience and nutrition and food security objectives can be summarized in four key areas (Table 12). The first three areas represent changes in public policies that should be introduced gradually over the medium to long term. They will need to be accompanied by a complementary agenda for helping smallholder farmers transition to a new support structure. The fourth area can be introduced in the short and medium term, relying on the gradual design of new programs that are not market-distortive, but are consistent with trade openness and positive impact on sustainability.

- **Shift agricultural support from private to public goods and services.** Agricultural support in Mozambique is mainly geared towards private goods (subsidies and market price support) rather than investments in agricultural public goods and services (GSSE). As shown in Figure 34, in 2018, support to public goods (GSSE) represented only 5.5% of Mozambique's TSE to agriculture. The rest went to private goods, such as payments based on agricultural inputs and services—e.g. programs that subsidize technical assistance, extension services, and agricultural inputs like seeds, fertilizers, machinery and land preparation. Mozambique should consider shifting its agricultural sector support towards investments in public goods – rural infrastructure, animal and plant health services, and agricultural research – which can deliver higher economic returns. This shift will require a fiscal exercise to ensure that it is as neutral as possible to the overall government budget, while also addressing some of the current structural issues with agriculture public expenditures (e.g. most sector expenditures are on salaries rather than investments).

- **Shift away from distortive measures to competitive agricultural policy support.** Given that a very large share of Mozambique's agriculture support is via prices (MPS or coupled to the production of specific agricultural products), a transition plan (including a fiscal plan) for agriculture to move towards a more competitive policy support environment is very much needed. In fact, Mozambique will likely be engaging in MPS reduction commitments as part of its negotiations for agriculture trade agreements, such as the Africa Continental Free Trade Area (AfCFTA), so a complementary trade agenda is needed to help smallholder producers of protected agricultural products transition to market prices and take advantage of trade opportunities. An example of a policy package could include a gradual reduction of border measures (reduction of MPS), along with direct, decoupled, support to farmers who produce commodities protected by border measures. This would allow them to increase productivity and/or diversify into other agricultural products or rural economic activities. In this process, a monitoring and evaluation scheme to follow up progress on the actions implemented would be important.

- **Reduce implicit taxation of food and increase support to food-insecure households.** Mozambican food consumers are funding the bulk of support to the agricultural sector by paying an implicit tax due to border protection measures (MPS). The poorest households, who spend a relatively larger share of their income on food, are hit the hardest by this implicit taxation on food. Therefore, gradually reducing the MPS would reduce the implicit food tax paid by consumers and consequently increase the welfare of the poorest. Furthermore, other public policies and programs could be enhanced to directly safeguard food-insecure households, such as targeting support through social protection programs (food aid, school meals) and countercyclical safety nets.

- **Shift support towards smart subsidies.** Given the country's fiscal limitations, producer support (PSE) should be geared towards achieving objectives beyond supporting farmer incomes. PSE could be reformed to contribute towards (i) allowing farmers to choose what to produce (implementing an "open menu" approach to subsidy programs); (ii) food production intensification (seeking to halt area expansion as a source of agriculture growth); and (iii) nutrition objectives, leveling the playing field to generate access to sufficient, safe and nutritious food, to guarantee the population a state of general welfare that contributes to the achievement of their development. One example would be to support more nutritional products, such as sweet potatoes, rather than cassava. A cassava farmer receives more than double the support of that received by a tomato farmer on a per-hectare basis and more than four times the support received by a sweet potato farmer. This also makes a simple plate of food costlier, as defined by the World Food Programme's "Counting the Beans" methodology.[28] Furthermore, climate smart agriculture (CSA)[29] and nutrition smart agriculture (NSmartAg)[30] technologies and practices should be integrated into farmer input and technology support incentives to promote productivity growth, and fulfill environmental and nutrition objectives. In addition, decoupling producer support from specific agricultural products would enable farmers to make production decisions mainly based on market opportunities (and not on the level of public sector support). For example, support that is conditional on the fulfillment of pre-determined goals and complemented with producers' own resources (matching grant programs) could: (i) allow farmers to producer whatever they like (by not reducing the support for specific products); and (ii) link the matching grant to the adoption of climate and/or nutrition smart agriculture practices/technologies. This scheme contributes more efficiently to achieving goals in a sustained way, empowers project participants and minimizes the probability of rent seeking.

Mozambique can learn from other countries that have already gone through the same transition in their agricultural support (Box 3). Several studies point to potential pathways for transitioning away from protecting a few commodities and producers through market prices, to supporting a more competitive agricultural sector and poor households through targeted and decoupled support. The implementation of this agricultural policy reform strategy is urgent and opportune as it can help in building back better from COVID-19, while also taking advantage of SADC and AfCFTA. Parikh et al. (1995) studied several agricultural sector trade liberalization reforms following the GATT (Uruguay Round). Their conclusions highlight that a policy package that results in superior growth, welfare and distribution effects, without raising taxes, includes: (i) switching from agriculture input subsidies to safety nets (reducing PSE and increasing CSE); and (ii) increasing GSSE, through investments in public goods and services (e.g. rural infrastructure).[31]

It is important to note that the transition away from the current agricultural support policy structure needs to be planned and implemented carefully to avoid adverse impacts on the most vulnerable. Various studies show how agricultural trade liberalization and discontinuity in policy reforms can lead to negative impacts on the most vulnerable farming populations. Nyairo et al. (2010) point to the mixed experience of some African countries in agricultural trade liberalization,[32]and McCorriston et al. (2013) to the mixed experience of a global set of 34

[28] Based on an extrapolation from the World Food Programme's measurement of the cost of a minimum diet globally (https://cdn.wfp.org/2018/plate-of-food/). This methodology defines a simple plate of food as consisting of pulses, a local carbohydrate—such as rice, bread, maize meal—vegetable oil, tomatoes, onions and water. However, Mozambique has not yet made it into the database and this qualitative assessment assumes that maize will be considered part of Mozambique's plate of food.

[29] For a definition and approach to CSA, see: https://www.worldbank.org/en/topic/climate-smart-agriculture

[30] For a definition and approach to NSmartAg see: https://www.worldbank.org/en/topic/agriculture/publication/nutrition-smart-agriculture-when-good-nutrition-is-good-business

[31] Parikh, et al. (1995).

[32] Nyairo, Kola, & Sumelius (2010).

countries, finding clear drawbacks from "stop-go" policy reform programs, and that results depend on the way food security and other impact variables are assessed. Uganda is one of the interesting cases of a mixed experience in shifting from MPS to direct farmer support.[33] Reforms did not automatically translate into higher values for agriculture exports, largely because world prices are beyond the control of small-country exporters. In this context, it is important that this transition be accompanied by growing support for the constant improvement of agricultural practices, the adoption of technology, access to high-quality inputs and financial services. At the same time, investment in productive infrastructure is important; weak infrastructure (roads, irrigation, ports, etc.) actually acts as a tax on the development of a competitive agribusiness sector and a greater share of exports.

Box 3: Mexico and Brazil have valuable lessons to share from their agricultural support reforms

Mexico experienced both sector gains and losses when the country joined the free trade area with the USA and Canada (NAFTA) in 1994[34] and UNCTAD (in 2014). During NAFTA negotiations (1990-1993), Mexico agreed a 15-year gradual tariff reduction (reduction in MPS) for sensitive crops like maize. The total value of agricultural production and exports increased, including for maize. In parallel to the gradual tariff reduction, smallholder farmer support shifted to decoupled payments (per-hectare payments and social safety nets), delinked from the production of specific crops (the decoupled payment program was called Procampo). This meant that farmers could receive the subsidy regardless of the agricultural product they chose to produce. This decoupled support allowed some farmers to shift out of agriculture rather than investing in improving their existing (uncompetitive) production system. The lesson from Mexico is that particular attention must be paid to the food security and transition strategy of smallholder farmers when reducing MPS. Increased public sector support and incentives (in particular investing in agriculture public goods and services) when embarking on an agricultural transition to increased competitiveness is critical to compensate for any loss of income due to reductions in MPS. The Procampo program and other social safety nets (e.g. the Oportunidades Program) were found to be significant in the reduction of rural poverty post-NAFTA. It is also worth mentioning that Procampo expenditure was considered as a WTO green box, which was key in the context of North American Free Trade negotiations.

Brazil offers another important example of policy shifts to reduce the MPS (World Bank (2017). In thirty years, Brazil went from a food-importing country (like most SSA countries), with MPS as the main policy to support its mainly subsistence farmers, to a food-exporting powerhouse, with mainly commercially-oriented farmers. This shift occurred gradually (between the 1970s and 1990s), through a package of public policy reforms including: (i) the reduction of border protection (MPS); (ii) direct support to vulnerable households through safety nets (such as agriculture insurance, conditional cash transfers, and school meals); (iii) direct support to farmers through incentives for technology adoption (through credit programs); and (iv) large investments in agriculture public goods and services (mainly agricultural innovation systems).[35]

[33] Rwamigisa et al (2018).
[34] Patel & Henriques (2003).
[35] Correa & Schmidt (2014).

It is critical therefore, as shown in Brazil and Mexico (Box 3), that reforms are designed and implemented fully, and that they include a clear transition plan for smallholder farmers. Often, the anticipated benefits from reducing the MPS do not materialize because reforms are limited or only partially implemented, i.e., they are not accompanied by a significant increase in incentives for diversifying and/or exporting. This is especially true of many SSA countries.

[45] World Bank (2018).
[46] Inquérito sobre o Orçamento Familiar 2014/2015

Annex A

The OECD's methodology for measuring support to agriculture

While there are various indicators and methodologies for measuring agriculture support policies and programs,[36] the OECD's methodology (and its indicators) in the OECD's PSE Manual[37] is the most comprehensive as it takes into account support via prices as well as fiscal measures. It also measures support to producers and consumers as well as support to public goods and services. The other methodologies and indicators tackle specific sub-groups of agriculture support, and are therefore partial measures. Furthermore, the OECD's standard methodology creates a set of indicators that allow for comparison across countries and crops and over time, which is critical for proposing concrete policy reforms. Below is a description of the methodology linked to each support estimate.

Support to producers estimates

Producer support estimate (PSE): The absolute annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm gate,[38] arising from policy measures that support agriculture, regardless of their nature, objectives, or impacts on farm production or income. The PSE includes market price support and budgetary payments. Specifically, it includes gross transfers from consumers and taxpayers to agricultural producers arising from policy measures based on current output, input use, area planted, animal numbers, receipts, incomes (current, non-current), and non-commodity criteria (considered one of the least distortive).

Percentage PSE (%PSE): %PSE represents monetary gross transfers to producers as a share of gross farm receipts. As it is neither affected by inflation or by the size of the sector, it allows comparisons in the level of support to be made over time, products, and between countries. %PSE is the OECD's key indicator to measure support to agricultural producers, as it provides insights into the burden that agricultural support policies place on consumers (i.e., market price support) and taxpayers (budgetary transfers).

Producer single commodity transfers (producer SCT): The annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm gate, arising from policy measures linked to the production of a single commodity that the producer must produce to receive the transfer.

Producer percentage single commodity transfers (producer %SCT): The commodity SCT as a share of gross farm receipts for a specific commodity.

Support to consumers estimates

Consumer support estimate (CSE): The annual monetary value of gross transfers from (to) consumers of agricultural commodities, measured at the farm gate, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on the consumption of farm products. If negative, the CSE measures the burden on consumers (implicit tax).

[36] See IFPRI's website for more information: http://www.ag-incentives.org/indicator/nominal-rate-protection.
[37] OECD (2016).
[38] The price paid to the farmer at the farm, which excludes transport costs to the market.

Percentage CSE (%CSE): CSE as a share of consumption expenditure (measured at farm gate) net of taxpayer transfers to consumers. It estimates the transfers as a share of consumption expenditure on agricultural commodities (at farm-gate prices), net of taxpayer transfers to consumers. The %CSE measures the implicit tax (or subsidy, if CSE is positive) placed on consumers by agricultural price policies.

Support to general services for agriculture estimates

General services support estimate (GSSE): The annual monetary value of all transfers from taxpayers to policy measures and programs supporting general agriculture public goods and services, such as rural infrastructure, animal and plant health, research and development, promotion of agriculture and agriculture schools, arising from policy measures that support agriculture, regardless of their nature, objectives and impacts on farm production, income, or consumption. The GSSE does not include any transfers to individual producers or activities related to a particular agriculture commodity.[39]

Percentage GSSE (%GSSE): GSSE as a share of the total support estimate (TSE).

Total support to agriculture estimates

Total support estimate (TSE): The annual monetary value of all gross transfers from taxpayers and consumers arising from policy measures that support agriculture, net of the associated budgetary receipts, regardless of their objectives and impacts on farm production and income, or the consumption of farm products.

Percentage TSE (%TSE): TSE transfers as a share of GDP.

[39] There are six main GSSE support categories and the amount of subsidies allocated under them is derived from public expenditure data. Based on the previous budget analysis made by the FAO in Mozambique, we select each program according to its characteristics and classify it into the corresponding category (agricultural research, public Infrastructure, marketing and promotion, etc.). For example, subsidies under the program "Building and maintenance of rural roads" were considered under "Infrastructure GSSE category". Public resources of *Instituto de Investigación Agronomica* were considered under "Agricultural Research GSSE" category.

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