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Privatization and Economic Strategy in Mozambique

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Abstract

Privatization, together with liberalization and deregulation, constituted the core of Mozambique's economic transition. Privatization in Mozambique has taken place on an unusually large scale in comparison with the rest of Africa. Privatization interacted with military demobilization and political transition since military officers, together with members of the main political parties, were amongst the buyers of state assets. Private businessmen who had profited from the war economy also found a new outlet for their capital through privatization, sometimes in joint ventures with foreign investors. However, Mozambique's privatization programme was bedevilled by a lack of transparency. …/…

Keywords: sub-Saharan Africa, Mozambique, conflict, economic reform

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In some cases, traditional community claims—to land and natural resources—were ignored in the scramble to dispose of state farms. Privatization, like all reforms, involves a political process in which some people have more ‘voice’ than others do—often by virtue of their wealth and political power.

1 Introduction

For 16 years, Mozambique's Frelimo (*Frente de Libertação de Moçambique*) government ran a war economy that mobilized resources for its military effort against the rebel movement, Renamo (*Resistência Nacional Moçambicana*). During this time, the government engaged in a radical shift in economic strategy, from state-centred economic management based on the principles of Marxism-Leninism to market capitalism. Economic transition accelerated after the end of the war in 1992 and the shift from a one party state to a multi-party democracy in the elections of 1994. Therefore military demobilization and political transition was accompanied by 'demobilizing' the state's role in the economy.

Privatization, together with liberalization and deregulation, constituted the core of economic demobilization. Privatization in Mozambique has taken place on an unusually large scale in comparison with the rest of Africa. In the decade to 1999 the government privatized some 1,417 companies (UTRE 1999). Privatization interacted with military demobilization and political transition since military officers, together with Frelimo and Renamo party members, were amongst the buyers of state assets. Private businessmen who had profited from the war economy also found a new outlet for their capital through privatization, sometimes in joint ventures with foreign investors (see also Addison 2001 and Wuyts 2001 for discussion of how the war-economy affects the post-war evolution of the private-sector).

As in any reform, there were losers as well as winners. The privatization programme was bedevilled by lack of transparency. In some cases, 'traditional' community claims—to land and natural resources—were ignored in the scramble to dispose of state farms. Members of consumer co-operatives were sidelined in the sale of the co-operatives' assets to private buyers. Privatization, like all reforms, involves a political process in which some people have more 'voice' than others do—often by virtue of their wealth and political power. As a result, the 'technical' agenda of privatization—the drive to increase economic efficiency—is nearly always captured and transformed by powerful actors (state, private, and foreign). The resulting private sector is as much the product of politics as of 'pure' market forces. The transition experiences of Eastern Europe and the Former Soviet Union (EE-FSU) demonstrate this, as does the transition from state socialism to market capitalism and from war to peace in Mozambique (Addison 2001).

This paper critically assesses Mozambique's privatization programme. It begins, in section 2, by outlining why the state intervened in the economy, highlighting both 'defensive' and 'offensive' motives. Section 3 summarizes the first phase of privatization in the 1980s. It highlights the difficulties of implementation, and the gradual erosion of the state's strategic vision of privatization into a process by which assets were sold off almost indiscriminately. Section 4 focuses on the interaction of domestic and donor pressures to accelerate privatization in the 1990s. Far from promoting competition, new forms of market power have been created (section 5). Using the cases of the cashew nut and sugar sectors we emphasize that privatization cannot be effective without strategic state intervention—which is largely absent in Mozambique. Section 6 broadens the discussion out from privatization to examine the related, but distinct, issue of foreign investment. Large mega-projects are planned for

Mozambique—resulting in a substantial infusion of foreign capital and management resources—but these projects may narrow, rather than broaden, the economy's structure. Our conclusions, in section 7, emphasize again the relevance of the EE-FSU transition experiences—which have led the World Bank to rethink its early enthusiasm for privatization—and the crucial need to invest in regulatory capacity, both to protect the public interest and to integrate privatization into a strategic vision of the economy's future.

2 State intervention in the economy

In the early years of independence the government took control of a large number of enterprises and created new state-owned enterprises (SOEs). This development was driven by complex ideological and pragmatic motivations.

At independence many Portuguese owners, managers and technicians fled, often destroying equipment and administrative records on their way. To maintain economic activity and employment, the new government took over the management of abandoned enterprises (these are described as 'intervened' enterprises in the local policy debate). Owners who stayed on kept their shareholdings, as did absentee owners who nominated a local representative—those that did not eventually had their enterprises or shares nationalized. In the Mozambican policy debate it is common to refer to these interventions as 'defensive' in nature, reflecting the exigencies of the time.

Only a few of the intervened firms were transformed into SOEs. These were generally large, of special significance to the central plan, generated foreign exchange and/or had large positive externalities for the country's development. Examples include Emplama, EE (the major producer of plastic and plastic products), Cometal-Mometal, EE (the only producer of freight cars) and Fasol-Saborel, EE (the only producer of cooking oils and soap). Some large firms remained under private ownership or retained their 'intervened' status. These included Tudor (batteries), Mabor (tyres), Metal Box (the largest iron foundry) and various sugar estates and large plantations.

Abandoned retail trade shops and small and medium-sized settler farms—particularly in the south and centre of Mozambique—were exceptions to this general pattern. After the first defensive intervention, the state became more ambitious (Frelimo 1977a and b). Abandoned retail trade shops were first turned into state-owned 'Lojas do Povo' (People's Shops), and later into consumption co-operatives (CCs) under the management of consumers. The co-operatives were responsible for distributing rations to ameliorate the shortage of consumer goods. Rural CCs were intended to free peasants from the power of monopsonist traders and moneylenders (O'Laughlin 1981, Mackintosh 1983, 1986). Peasants were allowed to occupy small and medium-sized settler farms on condition that they formed co-operatives. The land itself became state property.

In addition to the defensive interventions, 'offensive' interventions also took place. The state took over enterprises vital to fulfilment of the plan (Frelimo 1977a and 1977b). These included most utilities, the banking system, large transport companies, oil refining and distribution, mines, and large building material industries. Large SOEs were created in agriculture—a strategic sector—and in external trade (both exports and imports). A few industrial SOEs, for example Agro-Alfa (an equipment manufacturer) were also established.

3 Privatization and reform in the 1980s

Problems in state intervention were increasingly evident by the early 1980s, and were debated at Frelimo's fourth party congress in 1983. Selective privatization was seen as one way to raise economic efficiency and the investment rate (Frelimo 1983, Wuyts 1989). However, other influences were also at work. The government began negotiations with the Bretton Woods Institutions (BWIs) in 1984 and this increased the impetus for privatization. Bilateral donors added to the pressure. USAID focused much of its assistance on the private sector, and the EU excluded SOEs from tendering to supply inputs to its Southern African programmes.

Moreover, businessmen, high ranking army officers, and state officials pressed for privatization; it offered an investment opportunity for capital accumulated during the war through corruption and the extraction of a ‘war tax’ (on the latter see Mackintosh 1986). Modernizing the army entailed demobilizing many veterans, and selling public assets to them at subsidized prices eased their transition into the private sector and avoided political trouble. Many senior officers, generals, and state officials were to benefit from privatization over the next decade.

The new strategy gave SOEs more financial and administrative autonomy and they were allowed to retain a larger proportion of their foreign-currency earnings. The government intended to make them profitable, or at least reduce their losses, and thus the fiscal burden. Smaller and non-strategic SOEs were listed for privatization. Intervened enterprises—mostly the smaller ones—were either listed for privatization or turned into SOEs (therefore clarifying their status). Some strategic SOEs, such as those in the export sectors, were turned into joint ventures with foreign investors.

The government started with a reasonably well-defined strategy for reforming the state sector and for SOE privatization, but its *implementation* and *transparency* were problematic. Privatization was delayed by lobbying and competition for cheap state assets, ambiguities in the criteria for selecting buyers, together with financial and managerial weaknesses among enterprises. Some government departments favoured privatization while others did not. Ministries and provincial governments formed privatization units, but these were administratively cumbersome. Co-ordination was later improved by the creation of CIRE (the inter-Ministerial commission for restructuring of enterprises) and UTRE (the technical unit for the re-structuring of state-owned enterprises, under the Ministry of Planning and Finance) which operated under the direction of the Council of Ministers (GOM 1991, UTRE 1999). Legislation to harmonize and accelerate the process was introduced in 1989; this was subsequently amended as privatization accelerated in the 1990s (GOM 1989, MIE 1990).

The government set a minimum tender price; in theory this reflected the present value of the enterprise's financial and physical assets. But estimating the net present value of future profit flows was exceedingly difficult given the poor quality of enterprise accounts, the government's lack of experience in valuing enterprises and preparing them for privatization, and economic uncertainty. Enterprises were usually sold cheaply.

Minimum tender prices were set low in order to encourage domestic bidders. Given the fiscal crisis, the government also needed immediate revenue; future revenue streams were therefore discounted at rates considerably higher than those of the private sector (Cramer 1998).

Moreover, many buyers delayed payments or paid by instalment—inflation then eroded the real value of the eventual payment (World Bank 1996, UTRE 1996). These mechanisms operated as an implicit 'privatization subsidy' that persisted into the 1990s (Cramer 1998: 22). By January 1996, Mozambican buyers had paid only US$ 9 million of the US$ 52 million owed to the state (UTRE 1996). This subsidy was inefficient, it was not tied to any performance criteria, nor allocated with a view to developing the country's dynamic competitive advantages—in effect it subsidized the least efficient buyers (Cramer 1998: 23-5).

Price was only one among many criteria in selecting a successful buyer. Legislation required open and public tendering, but with the proviso that the prime minister and the president could overrule the result if it was not in the national interest. Legislation gave priority to domestic investors, including veterans, in the tendering process. In practice, veterans lacked the resources of established businessmen, and therefore government departments selected a subset of enterprises and shares for direct sale to veterans outside the framework of the public tenders.

To ensure that privatized assets were rehabilitated and put back to work—rather than sold for scrap or used as warehouses for imports (legal and otherwise)—additional criteria were added to the tendering process (MIE 1990, World Bank 1996). In practice, however, the state was unable to adequately assess the quality of bids or to check that assets had been put to good use after their sale. The overly complex criteria were subsequently abandoned when the legislation was amended (Castel-Branco 1994, Cramer 1998).

The process pleased nobody; investors and bidders complained of delays, red tape and corruption, and the government found it difficult to use privatization to achieve its strategic objectives. By 1990, only about two hundred firms—roughly a sixth of the SOEs and intervened firms—had been privatized.

4 Accelerating privatization in the 1990s

The first stage of stabilization and economic rehabilitation was complete by 1990. Between 1990 and 1991, there was no Enhanced Structural Adjustment Facility (ESAF) in place, and new agreements with the IMF and the World Bank were in negotiation during this period. Privatization became a key conditionality in the Policy Framework Papers (PFPs) of the early 1990s, and this emphasis continued through the 1990s in both PFPs and donor-country strategy papers. The BWIs advanced two main arguments in support of privatization.

First, they argued that SOE inefficiency impeded the supply response to price reforms, citing the economy's deterioration over 1990-91, and the fall in manufacturing output over 1990-94. However, other contributing factors included the war and its aftermath, the interruption in multilateral lending over 1990-91, and the economy's foreign-exchange constraint—to name just three (Castel-Branco 1994 and 1995, Coutinho 1994). The BWIs overemphasized privatization relative to other constraints on the economy's supply-side.

Second, the BWIs argued that reducing the fiscal burden of SOE losses would free public revenues for use elsewhere. The need for investment in basic social services and infrastructure is obvious, and privatization can play a role in generating funds, although its fiscal benefit is largely one-off. But it is much less important than reforming the tax system and other measures to achieve a sustained and higher *flow* of revenues, together with improving public expenditure management so that revenues are allocated to their best uses (Addison and Ndikumana 2001). Constructing better tax and public expenditure systems requires considerable institutional investment (and therefore much time), a task underemphasized by the donors in the early 1990s. In contrast, privatization is much less demanding of donor resources and it allows donors to report quicker 'results'—hence the donor fixation with counting the number of privatized enterprises. Moreover, privatization has not been implemented in the context of an industrial policy that would facilitate the generation of a higher flow of public revenues (corporate taxes etc.) from the new companies (see section 5).

The BWIs not only emphasized privatization in the early 1990s, they emphasized *fast* privatization. They believed that this would send a political signal of strong commitment to reform and thereby stimulate private investment. It would also reduce the time available for rent-seekers to mobilize against reform. In this sense, privatization was viewed as an 'agency of restraint' protecting reforms from political interference and so increasing the strength of policy signals (see Gyimah-Boadi and van de Walle 1996). The BWIs made a similar argument in the Former Soviet Union and Eastern Europe (FSU-EE) at the time. As in FSU-EE, the BWIs saw privatization as an easy solution to the problems of inefficiency, fiscal crisis, and political impediments to reform in SSA (Bayliss and Cramer 1998, Fine 1997).

It is worth pausing, at this point, to note that subsequent FSU-EE experience shows that privatization is no panacea. This has led some in the Bank to question the merit of its earlier advice to engage in fast privatization when institutions of corporate governance and regulation are weak (see Stiglitz 1998, 1999, Nellis 1999). But it is unclear whether these doubts have percolated into the Bank's operations.

In the case of Mozambique, a 1999 World Bank loan to ease privatization of the management of Maputo Port and other ports owned by the ports and rail corporation (CFM) did specify that some of the loan was to be used for institutional reform. However, most of the loan was allocated to smoothing the way for thousands of redundancies, through pension schemes and initiatives to retrain employees to enable them to become self-employed. Transparency in the privatization of Maputo Port appeared to be largely absent. Amid a flurry of rumours of political lobbying (potentially linked to military aid) a British-led consortium seemed on the verge of closing a deal to manage the port. A renowned and powerful local politician, owns the only Mozambican firm holding shares in this consortium. Meanwhile, no action had been taken, by the end of 1999, to set out the institutional and regulatory framework within which the port, and connected rail networks, would operate. Hence, although in principle the Bank has moved away from the naive view of privatization that it held in the 1990s, it is far from evident that this is satisfactorily reflected in Bank-supported privatization in Mozambique in the late 1990s.

The early 1990s, also saw domestic support for faster privatization. Foreign investors typically have access to cheaper finance than domestic investors who face the high interest rates associated with macro-economic stabilization (Bayliss and Cramer 1998). Domestic investors concluded that they could not outbid foreign investors in open tender but that foreign investors would wait until the peace. Therefore they pressed for more privatization before the end of the war. Many workers and managers supported them. By the early 1990s many of the non-privatized enterprises were in a precarious financial position, partly because their unclear status reduced their credit-worthiness. Moreover, the privatization legislation reserved up to 20 per cent of shares in the new private companies for sale to managers, staff, and workers; a higher share was permitted for companies which did not need large new investments to restructure (UTRE 1999). Again, this experience mirrors that of the FSU-EE countries (on the internal institutional dynamics and 'collapse' in the Soviet Union reform period, see Solnick 1998).

Privatization accelerated during the 1990s. In many ways, this and other dimensions of Mozambican privatization are typical of the pattern of privatization programmes in developing countries during the 1980s-90s (Bennell 1997). For example, although Mozambican buyers accounted for most of the transactions (some 90 per cent by 1996), these transactions only accounted for half the total amount of agreed payments for privatized assets (UTRE 1996, 1999 Cramer 1998). Smaller enterprises were sold first, and only after the mid-1990s did the focus shift to larger enterprises, including utilities. The number of firms privatized from 1992-98 was six times greater than the number privatized during the previous seven years (UTRE 1999).

However, during this more rapid phase of privatization the government and donors appear to have learnt little from the experience of the 1980s. That decade was characterized by political competition, absence of a coherent industrial strategy, SOE weakness, and limited government capacity. Fast privatization was supposed to reduce political competition but in the end merely transformed it. Of the other three problems, none was seriously resolved. A good example of the lack of transparency and genuine social concern was the privatization of consumer co-operatives after the end of the war (on the general failure of these co-operatives, see Castel-Branco 1995). The fixed assets of the co-operatives were sold to private investors without the participation of members. Most members strongly opposed the sales, and violent confrontations occurred between co-operative members and the new private investors.

5 The impact of privatization and the role of strategy

At this early stage, any assessment of privatization's impact must, necessarily, be preliminary. Privatization has been one policy among many, and has taken place in an economy making the transition from war to peace. Moreover, privatization has been intended to meet many objectives, ranging from fiscal restraint to improved efficiency; any evaluation faces difficulty in contending with the multiplicity of objectives. These difficulties notwithstanding, it is possible to assess whether expectations have been realized or not. Here, impact analysis of privatization addresses two major themes: changes in market structure and the relationship between privatization and the possibilities for strategic state intervention. Section 5 discusses recent changes in the pattern of investment and productive capacity in the light of plans for very large foreign investment in minerals and basic metals.

5.1 Privatization and market power

Standard economic theory concludes that privatization can reduce market power and increase competition, thereby forcing an increase in efficiency. If markets fail—because of externalities, economies of scale or information asymmetries—state intervention through regulation and competition policies may improve market conditions (Campbell-White and Bhatia 1998, Vickers and Yarrow 1995).

Has market competition increased in Mozambique? A definitive answer is impossible at this stage given the absence of the necessary data—this is itself a result of the lack of attention to regulatory investment. But we can observe the construction of new, and sometimes disturbing, centres of market power. Each of these has a political economy dimension that is usually ignored in conventional economic analysis.

First, new centres of market power have arisen out of changes in the role of the Mozambican state *vis-à-vis* foreign states and international organizations. A few examples illustrate this point. In 1995, the United States government, through its Embassy, threatened to reduce food aid if the government was not prepared to concede monopoly rights for exploitation of the gas reserves in Pande (Inhambane Province) to the US company, Enron. In 1996, the World Bank put pressure on the government to privatize the BCM to the Portuguese consortium formed around Banco Mello, against the will of the government and against the initial terms of reference of the tender.[1] And privatization through debt-for-equity swaps has favoured the enterprises of major creditors in the acquisition of productive assets (Amsden *et al.* 1994, discuss the weaknesses of this form of privatization). Debt-for-equity swap privatization deals have included many Portuguese investments and also African Development Bank investments, for example in the Mafambisse sugar plantation and refinery.

Second, the pattern of foreign direct investment is also creating new sources and centres of market power. Planned investment in five large projects—aluminium, steel and iron, titanium, coal and gas—is valued at US$ 5.35 billion, almost three times the country's GDP (see section 5). With the exception of the aluminium project, all these projects are still in the pipeline. But the large corporations involved are undoubtedly building considerable economic power (and political influence) in Mozambique. This will win them subsidies, tax holidays and other forms of favourable treatment (see Addison 2001 on this point).

Third, domestic actors are attempting to create new centres of market power. In the cashew industry, traders and manufacturers have created strong associations that seek to influence policy making in order to maximize the expropriation of rents. Traders have been helped by World Bank pressure to liberalize exports of raw cashew nuts (Castel-Branco 1995, Cramer 1998, 1999). In the sugar industry, privatization of the three major sugar estates was conditional on the adoption, by the government, of a pricing policy and industrial strategy that protects markets, profits and prevents competition between estates (INA 1996).

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1 In January, 2000 the Prime Minister, Pascoal Mocumbi, made a speech highlighting his fears that the banking sector was becoming increasingly dominated not only by Portuguese interests but by a single Portuguese group that, having recently bought Banco Mello, also has a dominant interest in the Banco Comercial de Mocambique, the Banco de Investimentos Mocambicanos (BIM) and others.

It can be argued that imperfect competition, and even strong market power, may generate dynamic gains and new comparative advantages through innovation, economies of scale and the reduction of uncertainty (Amsden 1997, Chandler *et al.* 1997). Hence, the development of imperfect markets through privatization, corporate restructuring and large-scale investment might be desirable, rather than undesirable. Yet the gains from restricted competition, and from the development of comparative advantages based on market imperfections in production, are unlikely to be maximized without a specific, coherent economic strategy. Where market concentration and the formation of large conglomerates have been central to the experiences of most successful late industrializing countries, this has not occurred without the involvement of a 'developmental' state. The state's role in managing competition may be especially significant in a transition from war to peace, given the intensity of social, economic and political tensions. We now turn to such strategic issues.

5.2 Privatization and strategic state intervention

Mainstream economics suggests that private ownership, coupled with de-regulation and market liberalization, is sufficient to achieve a socially efficient resource allocation. The state's role is confined to reacting to market failure caused by externalities, economies of scale and asymmetric information (Chang and Rowthorn 1995). Any selective and strategic form of state intervention that changes factor prices, incentive mechanisms and patterns of accumulation is undesirable. But can privatization and liberalization ensure a successful transition in Mozambique? Two sectors—cashew and sugar—illustrate the issues.

The cashew nut industry is a classic case of privatization followed by liberalization in the absence of a strategic framework (see Cramer 1999 for a detailed analysis). The industry was one of the first to develop during the colonial period, and was once the country's single most important foreign currency earner. After independence, most factories were abandoned and subsequently 'intervened' by the state. Lack of investment and managerial capabilities, coupled with the war that paralysed the collection of raw cashew nuts and destroyed some of the factories, left this industry in need of extensive investment. In 1993-94, the processing plants were privatized in order to mobilize resources for rehabilitation: "…according to the claims of at least one of the firms, a no-change clause to the protection regime had been written into the privatization contract" (Cramer 1999: 25). Soon after privatization, the World Bank began to lobby very hard for complete liberalization of the sector, allowing for exports of raw cashew to the established processing industry in India. Farm-gate prices would be bid upwards, with poverty-reducing benefits as well as foreign exchange generation. It was also argued that the value added at international prices of the Mozambican factories was negative (not surprising, given the need to rehabilitate factories from scratch). The World Bank made the continuation of its support to small and medium industries in Mozambique conditional on liberalization of the cashew industry. The debate on the cashew industry bloomed, but was narrowly limited to discussion of the export tax and factor prices. Generally, there was no systematic analysis of all the other, more important, conditions that could help the industry to develop. These included access to finance for working capital and equipment, new technology, infrastructure rehabilitation, a regulatory framework and quality control, and the provision of extension services and technical support for the agricultural sector.

Exports of raw cashew nuts have risen (to almost US$ 30 million in 1997) whereas those of processed cashew nuts have declined sharply (to less than US$ 120,000 in 1997). By mid-1999 more than ten factories had shut down (Cramer 1999). And there is no evidence that peasants have benefited from this process in any significant way since they face fragmented markets usually controlled by large traders.

Traders on one hand, and manufacturers on the other, have created their own associations within which they co-ordinate strategy and organize the lobbying of the government and the World Bank. This does not suggest that more market competition has been introduced, but rather that competition for rents has increased and so have the resources spent on trying to capture the rents. The opportunity cost of privatization and liberalization, in this case, is increasing continuously due to loss of jobs and foreign exchange revenue, waste of resources that had been invested and the sunk-costs (or costs of failure), loss of skills and of managerial capacities, and costs of organizing collective action. During the second half of 1999 the World Bank more or less had to concede defeat thanks to parliamentary pressure on the government to reverse the direction of policy. After initially proposing the re-introduction of a complete ban on raw cashew exports, backbench parliamentarians, with some opposition support, forced through a new bill that raised the export tariff back to 18 per cent. Revenue is supposed to flow from this tax to industry support. This about-turn may represent one of the complications of the World Bank's recent preference for greater 'ownership' of economic policy reform. Above all, however, it seems more to have stalled policy making for the cashew sector rather than to have provided a firm basis for a strategic renewal of the sector's prospects. In short, the cashew example seems to confirm the hypothesis that privatization without a strategic framework is unlikely to succeed, particularly if the new firms are immediately forced to face the stiff wind of highly demanding international markets.

In contrast, the sugar sector has undergone a very different experience. The industry was equally badly affected by the war, shortage of investment and of organizational capabilities, and equally in need of substantial investment. The sugar estates were privatized in the later stages of the privatization programme (1997-98). The causes of their relative success so far seem to be associated with three fundamental issues. First, the National Sugar Institute (INA) developed an industrial strategy that defined investment priorities in the sense of estates to rehabilitate and activities for rehabilitation. This allowed the government to target and negotiate potential foreign investors starting from a better position. Second, cheap finance was made available for rehabilitation programs, through the African Development Bank and debt swap initiatives. Third, a fundamental component of the industrial strategy was the pricing policy and the system whereby firms are encouraged to co-ordinate production and marketing strategies and to share the benefits of preferential quotas in domestic and international markets. Without these three components it would be unlikely that any investor would assume the risk associated with high levels of investment and huge sunk costs in an environment dominated by uncertainty.[2]

The evidence discussed suggests that privatization and industrial policy are not necessarily incompatible; and that in fact successful privatization requires clear

2 Investment in two sugar estates, Xinavane and Maragra, reached US$ 143 million in 1997. And these are not the estates most badly damaged by the war.

industrial strategies. By the same token, absence of selective strategies may seriously hamper the achievement of the main objective of the process of transition: successful reconstruction, development and transition. As Amsden *et al.* (1994: 210) put it, “reinventing planning…is the other side of effective privatization's coin”.

6 Investment, economic growth and structural change

Alongside the privatization programme, and interacting with it, has been an inflow of foreign investment, with some very large investment projects now in the planning stage. Much of this investment is in new enterprises rather than in purchasing state-controlled enterprises.

Between 1985 and 1997, the government approved investment projects valued at US$ 3.4 billion, more than half of it (US$ 1.75 billion) in 1997 alone, a big jump from the US$ 558 million worth of projects *approved* in 1996 (data are from UTRE 1999 and Mozambique News On Line, 1998). The average size of investment projects has also jumped—from US$ 2.2 million over 1985-96 to US$ 9.5 million in 1997. Indeed, four projects (aluminium, forests and two sugar estates) total US$ 1.53 billion, of which the aluminium factory, Mozal, alone accounts for US$ 1.3 billion. By 1997, private investment accounted for 82 per cent of the total value of approved investment. In contrast, public and donor projects accounted for the bulk of investment from 1985 to 1994. There are no data on the value of implemented investment projects, but the value of approved investment projects suggests a strong investment response to economic reform and the end of war.

Mozambique's success in attracting these large private projects has, however, taken attention away from deeper issues of strategy. For the period 1997-2000, 80 per cent of the total value of investment projects will be in the mineral and energy sectors (coal, gas, and titanium) together with the production of basic metals (aluminium, steel and iron) using energy and import-intensive technologies. Most of this will be for export. Their sustainability therefore depends entirely on growth in external markets and movements in the world prices for commodities and basic metals. The commodity-price slump associated with the 1998-99 Asian economic crisis (followed by a partial price recovery) highlights the vulnerability of such projects to fluctuating conditions. Moreover, there is a danger that the new private investment projects may exacerbate the economy's already narrow pattern of specialization, since they have limited linkages and externalities. Foreign investment has to be welcomed and at least to some extent it represents a vote of confidence that might itself help to consolidate the transition process. But for FDI to contribute fully to reconstruction and development, inward flows need to be managed effectively, to maximize potential linkages, even if these are largely fiscal or foreign exchange linkages.

Particular attention should be paid to investment in manufacturing. The political success of post-war settlements partly depends on the generation of fast employment growth to reduce social tensions (Paus 1995). In this respect, manufacturing—if developed successfully—can have powerful growth and employment effects.

Between 1993 and 1997, GDP increased by almost 53 per cent (all data are from INE 1988 to 1997). Manufacturing output increased by almost 89 per cent after 1995, achieving its 1989 level by 1997. This reversed the 46 per cent decline in manufacturing output of the 1989-94 period. In 1997 manufacturing contributed 6.2 percentage points to GDP growth (44 per cent of the rate of growth of GDP was due to manufacturing) and accounted for 36 per cent (US$ 81 million) of exports. At first sight, the data indicate the classic ingredients of successful industrialization; manufacturing is growing significantly faster than GDP and therefore its share of GDP is increasing strongly. The share of manufacturing exports in total exports of goods is more than two times higher than manufacturing's share of GDP. However, a more detailed analysis may reveal cause for concern.

Two industries, food, beverages and tobacco (62 per cent of total manufacturing output) and textiles, clothing and leather (6.9 per cent) represent almost 69 per cent of total manufacturing output and 11 per cent of GDP. These two industries accounted for 42 per cent of GDP growth in 1997. Four products—beer, wheat flour, soft-drinks and sugar—represent 6.4 per cent of GDP, 40 per cent of total manufacturing output and 65 per cent of the output of the food and beverages industry. With the exception of sugar, manufacturing depends on imports for its basic materials.

Total manufacturing exports are less than the exports of prawns and lobsters (US$ 82.5 million in 1997). Of the US$ 81 million worth of manufacturing exports, US$ 52 million are due to four products: ginned cotton (US$ 21.5 million), sugar (US$ 1 million), wood and wood coal (US$ 9.5 million) and tobacco products (US$ 6.5 million). Unprocessed, ginned, cotton fibres are the single most important export of the manufacturing sector. Whereas exports of raw nuts and fruits (raw cashew nuts represent about 90 per cent of these) reached US$ 30 million in 1997, exports of processed fruits and nuts (including processed cashew nuts) were less than US$ 120,000. Together, prawns and lobsters, unprocessed minerals and four manufactured products—ginned cotton, sugar, wood and wood coal, and tobacco products—represent 75 per cent of total exports of goods. These data clearly show that the patterns of specialization of investment, production and trade of the Mozambican economy are very narrow. A coherent industrial strategy is needed to overcome this weakness, not just privatization.

7 Conclusions and implications

Privatization in transitional and developing countries has lost its innocence. Successes in Africa are few and far between despite the celebrations over the number of enterprises privatized (Campbell-White and Bhatia 1998). The experience in the FSU has been especially disappointing and has led to a reassessment within the World Bank. After reviewing the FSU experience one of the Bank's most experienced privatization experts, John Nellis (1999), concludes that:

> ... the association between private ownership and restructuring (changes positioning the firm to survive and thrive in competitive markets) is weak or non-existent; firms that are partially owned by the state perform better than privatized companies; few differences are discernible between the performance of state-owned and private firms; clear performance improvements are evident only in the few firms that have been sold to foreign investors.

Many of these points apply with equal force to the SSA experience, and illustrate the importance, in particular, of institutional investment and democratization to ensuring that privatization contributes to equitable reconstruction and development.

Privatization is not a socially neutral, technical, process of achieving Pareto optimality. It is unavoidably political; wealth and economic power is transferred between social groups through negotiation and conflict (sometimes violent). It also takes place within very varied historical, political, and economic contexts that are often more important than the state of property rights in determining enterprise performance.

Using the case of Mozambique, we have argued that privatization that contributes to reconstruction and development is not incompatible with selective industrial policy. On the contrary, industrial policies may help set precise and simple targets for privatization and may even help to accelerate the pace of privatization by offering a clear framework within which enterprises can be selected, potential investors targeted, and appropriate divestiture methods chosen. Indeed, it has become increasingly evident—both in SSA and EE-FSU—that privatization combined with liberalization is unlikely to produce the results expected by the Washington Consensus (Amsden *et al.* 1994, Bayliss and Fine 1998).

It is now clear that regulation is necessary to prevent collusion, price fixing and predatory pricing practices. However, the necessary institutional capacity is often very weak in developing countries, and in many cases—for example Zambia—only begins to develop after privatization is well underway (Cook and Kirkpatrick 1995, van der Hoeven and Sziraczki 1997). The level of institutional investment required should not be underestimated. This can include securing or mimicking a competitive environment through anti-trust legislation or a monopolies and mergers agency, a fair trade agency, competition policy, commercial courts, regulatory bodies overseeing monopolies, effective quality standards, industry associations and so on (Gillibrand 1998). Rules must be predictable, enforceable and—most importantly— enforced (Rock 1997). But the resources required to ensure effective regulation are typically very scarce. Their political authority tends to be slight. And the balance of power within the economy and society tends to preclude any strong regulatory role. The risks of 'regulatory capture' in Sub-Saharan Africa, Latin America and Eastern Europe are becoming increasingly obvious (Bayliss and Cramer 1998, van der Hoeven and Sziraczki 1997).

The consolidation and redefinition of private-sector market power (discussed in section 5) has occurred alongside a weakening of the government's capacity and willingness to regulate the market. The government has largely confined itself to intervening in the tendering process, but has then done little after privatization. The head of the privatization unit in the Ministry of Industry, Commerce and Tourism admitted that the unit had no information about the performance of privatized enterprises because the state was only in charge of privatization, whilst performance was an issue for the new, private owners.[3] In fact, trade unions have much more information about the privatized enterprises since they deal with labour relations, including the large number of labour redundancies during and after privatization. A separate issue, and one that we have not discussed here, is the regulation of the

3 Authors' interview in 1996 with the head of the *Gabinete de Restruturação de Empresas Industriais, do Comércio e Turismo* (GREICT), in the Ministry of Industry, Commerce and Tourism.

privatized financial system and, indeed, whether rapid bank privatization is desirable (see Addison and Alemayehu Geda 2001 which discusses Ethiopia's more cautious approach to financial reform). It is very evident that the central bank is inexperienced in regulating the new private financial system—which is busily engaged in property speculation using funds from some dubious foreign banks—and a future financial-sector crisis is possible.

Therefore institutional investment in regulation—of utilities, strategic industries, and financial institutions—is essential. In 'demobilizing' the state, the government left unguarded the very necessary defences that protect the public interest against the centres of market power that exist. But here a warning note needs to be sounded. Donors, after their longstanding neglect of regulation, should not force a common regulatory 'blueprint' onto developing countries. Regulatory mechanisms only work if they are 'internalized' by society and supported by its balance of political forces so that regulators can work unimpeded by powerful lobbies. Effective and sustainable institutions typically evolve over time as means to resolve conflict (Hirschman 1995).

In Mozambique there are signs of institutional change arising from domestic conflicts within a democratic framework; this has given greater room for different interest groups to exercise 'voice'. The ongoing conflict over cashew policy is a case in point. From this perspective, the cashew policy debate—including lobbying activities, changes in policy direction, and the latest (1999) development of parliamentary overturning government/World Bank policy—does not just involve 'costs' but represents a potentially significant instance of domestic institutional, organizational and policy formation. This process is necessarily messy and non-linear. The challenge for donors is to support such open debate rather than ignore or stifle it. The challenge for Mozambicans is to develop a strategic vision of their economy's future.

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