WHERE CREDIT'S DUE:
LIVELIHOODS, MARKET FAILURE AND FINANCIAL
SECTOR DEVELOPMENT FOR POVERTY REDUCTION
IN RURAL MOZAMBIQUE

by
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ABSTRACT

Mozambique is widely cited as one of the few recent examples of rapid and sustained economic growth in sub-Saharan Africa. Noting that this growth has contributed to appreciable poverty reduction, this paper argues that Mozambique’s economic miracle has yet to generate economic opportunities commensurate with the livelihood needs of the rural population in particular.

The paper begins with an analysis of the development of livelihood strategies amongst rural Mozambican households throughout the country’s modern history. The analysis then shifts focus to the country’s post conflict economy expansion and the emergence of non-agricultural crop production economic opportunities for rural Mozambicans. The lack of such opportunities is seen, in larger part, to result from a poor environment for entrepreneurial activity, limited most notably by the failure of the commercial financial sector to serve adequately the needs of rural Mozambicans. Finally, a number of financial sector institutional alternatives are explored.

Keywords: Mozambique; livelihoods; poverty reduction; credit; financial sector development.
DEDICATION

For Kaitlyn, Leia, Paighton and Eliza.
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1: INTRODUCTION

There has been a miracle in Mozambique. Between the cessation of hostilities in its brutal and protracted civil war and 2007, the country’s economy grew at an average annual rate of 7.5% (World Bank, 2009). That rate of growth indicates that in slightly more than 15 years the country’s economy has trebled in size. Such rapid and sustained economic growth for a country that just 25 years ago verged on total economic collapse amidst a worsening civil war is nothing short of remarkable. And yet, despite this growth, more than half of the country’s twenty-one million-plus inhabitants linger in poverty, the UNDP Human Development Report ranks Mozambique 175th of 179 countries on its Human Development Index and child malnutrition rates, already exceeding 35% in 2003, may actually be rising (World Bank, 2005; UNDP, 2008; Hanlon and Smart 2008).

Although the country’s stellar economic performance since the end of the war and the persistence of widespread and deep poverty might seem paradoxical, their coexistence is at least partially explained by a near total economic deterioration precipitated by thirty years of continuous war. The country’s post-independence conflict itself inflicted and estimated US$20 billion in damages while the revolutionary socialist government’s statist development program by in large failed to mobilize the country’s productive capacity (Pitcher, 2002; Bowen, 2000). The ‘starting conditions’ for Mozambique’s post-conflict recovery were those of the poorest country in the world.
It is, therefore, not to be suggested that Mozambique’s astounding economic growth has failed to reduce poverty. To the contrary, poverty reduction in Mozambique over the past 17 years has been substantial, with the most comprehensive analysis of household consumption over that period indicating a 15% reduction in the poverty headcount ratio between 1996 and 2002 (World Bank, 2005). While some have questioned the methodology behind those figures (see Hanlon, 2007), few if any serious observers deny that substantial poverty reduction has taken place. Moreover, a host of non-consumption welfare indicators from bicycle ownership to the number of infant deaths per 1000 live births point to steady if gradual improvements. Undeniably, economic growth in Mozambique has contributed to poverty reduction.

This paper is chiefly concerned with Mozambique’s continued success in achieving poverty reduction through economic growth or, more specifically, the manner and degree to which economic growth enhances the livelihoods of the more than 13.5 million Mozambicans who live in rural areas. To that end, considerable space will be devoted to investigating the historical development of rural livelihood strategies in Mozambique, how they vary from region to region and how they have or have not been influenced and enhanced by the country’s recent economic expansion. That investigation will show that, as a combined result of numerous historical, geographical and climatic influences, rural Mozambicans have adopted highly diversified livelihood strategies in the context of increasing (though not extreme) socio-economic differentiation.

The investigation of rural livelihood strategies contained in sections 2 and 3 will show agricultural crop production to be unquestionably the single most important source of income generation for rural households. Indeed, more than 90% of rural households in
each income quintile (each quintile being representative of 20% of total households ranked by income from poorest to richest) engage in agricultural production (Walker et al., 2004). At the same time, however, a consistent trend toward household income diversification to augment what tends to be unproductive, small-scale household crop production has proceeded throughout the modern history of rural Mozambique. A key component of that diversification, as section 3 will argue, is that, in recent times, those households that have successfully integrated waged labour and/or value-added self employment into their diversified household income strategies are much more likely to be those sustaining incomes above the level of poverty.

The third and fourth sections will focus on constraints to the development of those two important “off-farm” sources of income (waged labour and value-added self employment). Section 4 will argue that the process of state sector privatization and the influx of foreign direct investment attracted to Mozambique’s improved post-conflict macro-economic environment - while being vital to the country’s economic progress - have produced neither domestic entrepreneurial activity nor employment opportunities on sufficiently grand scales to affect widespread poverty reduction. Private sector development in rural Mozambique, it will be argued, holds the potential to produce such entrepreneurial activity and related employment opportunities, but has been to a large extent constrained by the failure of markets for credit. The fifth section will therefore focus on the financial sector and markets for credit in rural Mozambique as well as their principle structural constraints. Having identified those, the sixth and final section of this analysis will provide and overview of several potential financial sector alternatives that
may provide a possible routes to enhanced private sector development in Mozambique and the expansion of off-farm income opportunities for rural Mozambicans.
2: THE HISTORICAL DEVELOPMENT OF RURAL LIVELIHOOD STRATEGIES

Geographically, Mozambique comprises a long and narrow strip straddling the tropical and sub-tropical zones along southern Africa’s eastern coast. The fertility of the country’s 36-40 million hectares of arable land ranges from excellent to poor and the climate is marred by frequent droughts and floods. Fifteen such calamities were recorded in the country between 1981 and 2006 (World Bank, 2006). Mozambique has been subject to foreign influences and domination since at least the tenth century (C.E.); first by Arabs and, beginning in the 15th century, by the Portuguese (July, 1998). The centuries of Arab influence and the early centuries of Portuguese presence in Mozambique were notable for mercantile exploitation and trade in gold, ivory, shells and slaves (ibid.; Cross, 1987). It was not until the early 20th century that the Portuguese took an interest in the conduct of substantial economic activity within the Mozambican “overseas province”.

The following analysis takes its starting point to be the turn of the 20th century as, while no objective “start-date” for the development of livelihood strategies is practically conceivable, it was during this period that substantial numbers of indigenous Mozambicans began to be incorporated, by their free will or otherwise, into a monetized economy. The modern history of Mozambique thereafter is divided into four more or less
distinct, but overlapping periods. The first corresponds to the late colonial era, characterized by the influx of Portuguese settlers into Mozambique and the incorporation of indigenous Mozambicans into the settler economy. The second comprises the period transformation from colonial rule to socialist collectivization under the government of the Frente de Libertacão de Moçambique (Frelimo). The third period, which overlaps considerably with the second, is that of the wartime economy characterized by intensifying and economically devastating conflict between Frelimo and the Resistência Nacional de Moçambique (Renamo). The fourth and final period is that of economic reform, liberalization, privatization and rapid growth that has continued to the present.

What this analysis will show is that throughout Mozambique’s modern history, and in spite of often-overt attempts by colonial and post-liberation governments to halt the process, rural Mozambicans have developed a progressively more diverse set of multi-variant livelihood strategies in the context of an ongoing process of socioeconomic differentiation. The result has been the emergence of a socio-economically stratified and diverse rural population that defies the characterization of rural Mozambicans as a “homogeneous mass” of subsistence agricultural producers.

2.1 The Late Colonial Period: 1895-1975

After serving for 400 years as an entrepôt along its Indian Ocean trade routes, Portuguese interest in direct colonial administration of Mozambique was piqued in the late 19th century following their abolition of slavery and the discovery of gold in South Africa’s Transvaal (Harris, 1958). A labour code requiring Mozambicans to seek work
was integral to this administration and both colonial authorities the chartered companies that were granted control over large swaths of the Mozambican territory adopted a liberal interpretation of their authority to enforce it (ibid.). By ceding extensive territories to the chartered companies, the colonial authorities alienated large numbers of indigenous Mozambicans from the land and thereby expanded the ranks of the seasonally employable.

Forced labour on foreign-owned plantations, settler farms and on the construction of rail and port infrastructure became the predominant feature of the Mozambican economy in the early 20th century, while at the same time providing extra incentive for Mozambican men to seek employment as migrant labourers in the mining industries of neighbouring countries. Capital accumulation amongst indigenous Mozambicans was curbed by legislative restrictions on the size of their land holdings and their employment of labour, while Portuguese settlers were afforded concessionary credit, coordinated market facilities and agricultural extension services (Bowen, 2000). Later, however, the colonial authorities took a slightly different tact, and began affording limited benefits and liberties to a privileged “assimilado” (or “assimilated”) class of “civilized” Mozambicans who, through their reliance on the colonial state, were to act as a counterweight to the kinds of grass roots liberation movements emerging in other African colonies (ibid.). The emergence of such movements across sub-Saharan African in the 1950s spurred the Salazar government to take a developmentalist approach to the Mozambican “overseas province”, which in turn helped motivate an influx of Portuguese settlers into Mozambique (Pitcher, 2002; Cross, 1987). This influx contributed to the variation in colonial era economic development between Mozambique’s three principal regions.
In the southern region, small-scale settler farming became the defining feature of the economy, while the close proximity to South Africa’s mining industry and the threat of being forced into labour on unfavourable terms led thousands of Mozambican to become migrant labourers (Bowen, 2000). In the central region, a plantation economy augmented by forced cash crop production predominated, while in the north, private marketing companies afforded concessions by the colonial state worked in cooperation with the state to enforce mandatory cash crop production on the part of indigenous farmers (Harris, 1958).

Economic development in the three major regions of Mozambique during the final decades of Portuguese colonial rule took on distinct forms, but in each case contributed, through a mixture of incentive and coercion, to the diversification of household income strategies amongst rural Mozambicans. By the late 1960s and estimated 44% of Mozambican farmers’ incomes were derived from waged employment, while approximately half a million of the country’s 5.5 million economically active Africans were engaged of non-agricultural waged labour (Pitcher, 2002). Such was the character of rural Mozambican livelihood strategies when the growing momentum of the Frelimo movement and a military coup d'état in Portugal signalled the impending collapse of Portuguese colonialism and independence for Mozambique.

2.2 Liberation and Collectivization: 1964-83

In 1964, an amalgamation of disparate anti-colonial movements that had coalesced under the banner of Frelimo began its armed struggle against colonial
occupation in the Northern Mozambican province of Cabo Delgado. The movement succeeded over the ensuing decade in supplanting colonial authority over large areas in Mozambique’s northern and west-central regions. On June 25, 1975, despite never having advanced beyond those regional confines, Frelimo claimed victory and assumed control over the now-independent Republic of Mozambique.

By the late 1960s, sensing the impending collapse of colonial rule, private companies and settler farmers began illegally exporting capital out of the country through such means as using foreign exchange to import goods that never materialized (Bowen, 2000). In addition to exporting liquid capital, some business smuggled machinery out of the country or, more famously, simply sabotaged what they could not carry with them (Pitcher, 2002). Technical documents were destroyed, wages went unpaid and capital was depleted as companies and individuals intent on leaving the country attempted to realize as much profit as possible before abandoning their businesses and farms to the uncertain post-colonial future (ibid.).

Meanwhile, there erupted a mass exodus of Portuguese settlers, who, following official independence in June 1975, were in many cases threatened or intimidated into fleeing the country (Pitcher, 2002). Within a year of independence many as 90% of Portuguese settlers had fled the country (Van de Berg, 1987). The decision taken by the post-Salazar Portuguese government to nationalize many of the Portuguese firms that were actively involved in the Mozambican plantation and manufacturing economies further contributed to this massive economic outmigration (Pitcher, 2002). But it was the large-scale flight of Portuguese settlers that contributed most significantly to Mozambique’s post-colonial economic disorientation. The colonial government had been
so successful in excluding indigenous Mozambicans from skilled labour positions, education, and training that the thousands of vacant administrative and technical positions created by the emigration of Portuguese settlers were met with a dearth of skilled Mozambicans to fill the glaring need.

Initially, the newly formed Frelimo government adopted a pragmatic state-interventionist approach to the country’s economic disarray, but soon the anti-capitalist ideology of the party’s leadership took root in the government’s economic policy and the state began to plan and organize virtually every aspect of the economy (Pitcher, 2002; O’Laughlin, 1996). In rural Mozambique this meant state organization of agricultural production and trade, save for that of a select group of private farmers and companies that were able to successfully resist state pressure and to whom Frelimo turned a blind eye (Pitcher, 2002). For the rest of the agricultural sector, the Frelimo development strategy entailed focused investment in the mechanization of large-scale state farms and rapid collectivization of agriculture and residency in communal villages and cooperatives (O’Laughlin, 1996).

From the outset, Frelimo’s agrarian policy was based on what Bridget O’Laughlin has termed a “dualist” perception of the agrarian economy, which saw the differentiated structure of the agrarian sector as being neatly divided between those unskilled, poorly organized and poorly paid migrant workers who had been exploited under the colonial regime, and a peasant sector who had been exploited under the regulado (ibid.). Indeed, according to Frelimo leader Samora Machel himself, the flight of Portuguese settlers had

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1 The regulado was a typical colonial system of indirect rule utilizing “traditional” authorities to execute colonial policies.
left two remaining classes in Mozambique: Peasants and workers (Machel in O’Laughlin, 1996). According to Ann Pitcher “the new government displayed a surprising lack of awareness of the intricate and fragile blend of land use, wage work and labour exchange that was the local producer’s response to the uncertainties of rural life” (Pitcher, 2002 pp. 76).

Of crucial importance to the mal-operation and eventual failure of Frelimo’s agricultural development strategy, was the belief that a rapid accumulation of capital could be achieved, in part, through severe restrictions on trade in consumer goods in rural areas. This policy was based on the belief that rural peasants could produce for their own subsistence and did not need access to consumer goods for their livelihoods, an illustration of Frelimo’s flawed perception of rural livelihoods (ibid.). The dearth of consumer goods available for purchase eroded the incentive for rural Mozambicans to divert resources from household production to labour for wages on state farms (O’Laughlin, 1996). Meanwhile, state farm managers found opportunities for personal gain and often misappropriated state farm capital for use on their own private plots (ibid.). With access to inputs intended for use on state farms “many skilled workers, rather than becoming the core of the rural proletariat…” as Frelimo had envisioned “became the nucleus of private accumulation of capital, either as commercial producers or in speculative trade” (O’Laughlin, 2000. Pp. 23).

Similarly, the state strategy for collectivization and villagization immediately clashed with the interests of the upper stratum of peasant farmers, among whom one of the primary objectives of the liberation struggle had been the recuperation of land annexed for colonial era settler and commercial farms (Bowen, 2000). The strategy also
failed to appreciate the importance of former “progressive farmers”, who were permitted to participate on the cooperatives only on the condition that they “become poor” by bequeathing their productive capital (typically livestock and ploughs) to the cooperative (Bowen, 2000; Harris, 1980). The failure of the agricultural cooperatives resulted in large part from the actions of cooperative members who, despite the intentions of Frelimo planners, used the cooperatives as they saw fit to achieve their own ends. In the case of non-poor farmers, it has been observed that those who did not abandon the cooperatives in favour of giving up their draught animals and ploughs, tended to assume leadership positions within them (O’Laughlin, 1996; Bowen, 2000). From those positions of leadership, many such farmers used their membership in the cooperative as a means of gaining inputs for their own private production activities, rather than contributing substantially to that of the cooperative (O’Laughlin, 1996).

Conversely, poor farmers tended to join the cooperatives as a means of supplementing their own household production and to secure access to consumer goods and food distributed through state shops attached to the cooperatives (O’Laughlin, 1996). Access to such goods had become an essential element of the diversified livelihood strategies adopted by rural Mozambicans, and when state restrictions on the import and trade in consumer goods led to severe shortages, parallel markets began to emerge and grow. These parallel markets were of particular benefit to an emergent group of traders who profited by virtue of having the right connections and contacts to gain access to consumer goods for sale (ibid).

State collectivization of rural production failed entirely to stoke production levels that had plummeted in the wake of the exodus of Portuguese settlers. Where cooperatives
achieved qualified successes, it was because they provided a measure of security to the poor and a means of defending private production for the relatively better off (O’Laughlin, 1996). Contrary to the socialist ideals and intents of Frelimo, collectivization actually contributed to further socio-economic stratification, while the process livelihood strategy diversification continued almost unabated. This process would continue, albeit in new and different ways, as the conflict between the Frelimo government and the Renamo resistance movement accelerated into one of the most brutal conflicts on the African continent.

2.3 Destabilization and Conflict: 1976-92

Almost from the outset of independence, the Frelimo government was faced with an externally supported counter-revolutionary insurgency, which, to a considerable extent, has shaped the economic and political landscape of the country up to the present day. In addition to putting the lives and livelihoods of rural Mozambicans in great peril, the war opened up new avenues for economic gain that allowed for the rapid accumulation of capital by a small minority, while adding new dimensions to the ongoing and interlinked processes of livelihood diversification and socio-economic stratification.

RENAIMO was established in 1976 with the assistance of a Rhodesian government angered and threatened by Frelimo’s support for the ZANU liberation movement within their own territory (Weinstein, 2002). After initially building its ranks through raids of Frelimo prisons and reeducation camps, Renamo established a foothold
in the country’s northern and central regions, thereafter expanding its campaign to target the schools and health centres that were the principle of not sole source of Frelimo popularity in rural Mozambique (Hanlon, 2005; Hanlon and Smart, 2008). Between 1976 and 1980 this campaign remained relatively low-level, taking a sharp upturn in intensity following the ZANU victory in liberated Zimbabwe. It was at this point that the burden of supporting Renamo fell on the much better financed shoulders of South Africa and, from arms length, the United States (Hanlon and Smart, 2008). Renamo’s ranks soon swelled 8-fold and the movement established a presence in every Mozambican province (Weinstein 2002). Estimates of the damage inflicted by the conflict between Renamo and Frelimo vary, but generally range between US$15 and 20 billion, with over 1 million Mozambicans killed, 1.6 million forced to flee the country and a further 3.7 million displaced internally (Pitcher, 2002; Hanlon and Smart, 2008). The conflict, however, was a civil war only in so far as it was fought between Mozambicans. By the end of cold war and the erosion of foreign country interest in sponsoring this and other sub Saharan African “proxy wars”, however, the conflict in Mozambique had generated a reorganization of livelihoods and survival strategies throughout the country.

Many interpretations of war in rural areas tend to assume that non-combatants affected by intense conflict and the resulting instability tend to “retreat into subsistence”, if not displacement or exile (Cramer, 2007). This perspective, by repeating the error of conceiving the rural population as a homogeneous mass, fails to recognize the opportunities for economic gain made possible by conflict. To be sure, the most notable and widespread implication of violent conflict for the rural people of Mozambique was a sharp reduction in the security of their lives and livelihoods. But for some, the war
created opportunities not only to benefit, but also, in many cases, to become rich (Chingono, 1996). As David Keen has observed, “war is not just the breakdown of society; it is a reordering of society in particular ways” (Keen, 1995 pp. 6).

One of the most notable outcomes of the prolonged conflict from a policy perspective was the high ratio of public spending committed to the war effort (an average of 35% in the 1980s. 70% of that financing the import of war materiel – Chingono, 1996). The resulting need for foreign currency led the government to further curtail trade in consumer goods and to compel rural Mozambicans to produce cash crops (Pitcher, 2002). In addition to having the effect of reinstating the colonial era practice of forced labour, this foreign exchange accumulation strategy exacerbated the goods famine, with the effect of both expediting the collapse of state farms and cooperatives, and of facilitating the emergence of what Mark Chingono has termed the “grass-roots war economy” (Chingono, 1996). As the war came to occupy more and more of the governments attention, the states ability to enforce a prohibition of private employment waned and poor farmers cut off from their principal source of livelihood (through war or collectivization) sought work for wage goods from their more affluent counterparts (ibid.). As goods became more scarce and the ranks of the dispossessed continued to swell, the terms of this employment shifted ever more in favour of employers (ibid.).

Smuggling was essential to the functioning of this economy and provided a lucrative if risky source of income for many, from the smugglers themselves to the drivers who extracted war taxes for the risk they incurred in transporting smuggled goods (Chingono, 1996). Traders who were able to gain access to smuggled goods achieved a powerful position in the grass-root war economy by demanding the sale of food as a
condition for the purchase of consumer goods, thereby gaining access to trade in food
surpluses as well (Wuyts, 2003). The role of traders in the trade for both goods and food
indirectly strengthened the position of labour employing farmers producing food
surpluses, as it was only they who could access trade in scarce goods with traders
demanding a *quid pro quo* in surplus food. As such, goods starved poor farmers had little
alternative but to offer up their labour at ever more exploitative rates (ibid.).

On balance, the protracted conflict between Renamo and Frelimo resulted in
magnitudes greater economic damage and destruction than it did create opportunities.
Hundreds of thousands of young men lost valuable productive years if not their lives as
Renamo and Frelimo soldiers, internally displaced people and refuges were cut off from
the land and the bedrock of their livelihood, and by the end of the war, what communal
villages remained became “holding pens for a hungry and bewildered population”
(Pitcher, 2002 pp. 121). The war inflicted damages on Mozambique’s physical
infrastructure and the human development of its population that continue to hamper
development to this day. What is equally true, however, is that the conditions of war did
not lead the rural population to simply “retreat into subsistence”. Rural Mozambicans, as
they had been doing for generations, relied on their ingenuity to find new and creative
ways to secure their livelihoods and, as far as is possible in conditions of war, to mitigate
risk by relying on various combinations of agricultural production, waged employment,
petty trade while other income generating activities. Through this process, millions
managed to survive and a far smaller group managed to either continue or initiate
processes of capital accumulation that constituted the continuation of socioeconomic
stratification in a new and distinct form. Neither at the war’s outset nor at its end,
therefore, can the rural population be reasonably conceived of, as they often have been, as a homogeneous mass of peasants, subsistence farmers or smallholders (Wuyts, 2003).

2.4 Reform, Structural Adjustment, Peace and Economic Growth: 1983 – Present

By the mid 1980s the Frelimo government was faced with two interrelated and inescapable realities: The Mozambican economy was a shambles and the war with Renamo had become unwinnable. Addressing these problems would mean abandoning the project of central planning in order to both stimulate the economy and persuade the foreign powers that propped up Renamo to desist in that effort. Thus began an initially gradual and soon breakneck process of economic transformation that would eventually lead to lasting peace and sustained economic growth at phenomenally high rates.

In 1978, when Samora Machel quipped that “The state does not sell needles”, a policy shift was taking shape that, over the next five years, would see the partial privatization of the state retail trade network and an end to the state’s monopoly of wholesale trade (Hanlon and Smart, 2008; O’Laughlin, 1996). Facing the increasingly apparent reality that it no longer controlled rural production and trade in any meaningful way, the state took the decision to allow private sector development, including that of a “smallholder” agricultural sector (Wuyts, 2003). Following its Fourth Party Congress in 1983, Frelimo began soliciting international support for agricultural rehabilitation, negotiating joint ventures with foreign investors and redistributing collectivized land,
with a focus on private firms and a newly classified stratum of “private farmers” (Pitcher, 2002).

In 1984, Mozambique became a member of the Bretton Woods Institutions (BWIs) and over the course of the following four years ODA to Mozambique increased by 360% (the largest such increase in the countries recent history – see figure 1). That year also saw Mozambique granted debt rescheduling by the Paris Club, which drastically reduced the share of ODA being directed toward debt servicing (Ball and Barnes, 2000; Arndt et al, 2006). In 1986, following the death of Samora Machel, Joaquin Chissano assumed leadership of Frelimo and Mozambique, and some three months later the country embarked on an IMF sponsored structural adjustment program entitled Programa de Reabilitação Económica (PRE) (Hanlon and Smart, 2008). The PRE revitalized the process of privatization that had begun, however haltingly, in the early 1980s. The new privatization initiative included the divestiture of more than 1200 small and medium state enterprises between 1991 and 2001 (Pitcher, 2004). However, the state struggled to find interested buyers, owing not least to the underdevelopment of an entrepreneurial class throughout the decades of colonial and socialist central planning (Pitcher, 2002). The Mozambican government and donors responded with a host of lending schemes and the establishment of concessionary conditions for the purchase of state enterprises by Mozambican nationals (Hanlon and Smart, 2008). Privatizations initiated prior to the General Peace Agreement (GPA) of 1992 tended to favour members of Frelimo or individuals with connections thereto, but as the privatization process continued and intensified following establishment of the GPA, it was deemed necessary to incorporate former Renamo soldiers into the process, thereby giving them a stake in
the continuation of peace and economic development (Hanlon and Smart, 2008; Castel-Branco et al., 2003).

**Figure 1: Official Development Assistance Inflows 1980-2007**

![Graph showing Official Development Assistance Inflows 1980-2007](image)

*Source: World Development Indicators (World Bank, 2009)*

The key component of the PRE as it pertained to rural Mozambicans was liberalization of prices, which was intended to spur poor farmers recently re-categorized as “smallholders” into increasing production as a uniform response to new market incentives (Wuyts, 2003). What this strategy failed to appreciate is what Marc Wuyts has termed the “household production – waged labour nexus”, the bedrock of rural livelihood strategies and the profitability of the larger-scale commercial farming sector (ibid.). Ultimately, the architects of the PRE would have to wait until the establishment of peace in 1992 and an agricultural bounce-back precipitated by the expansion of low-productivity hoe farming into areas made previously inaccessible by conflict for a resurgence in that sector (Wuyts, 2003; World Bank, 2005). The liberalization of import restrictions and the massive inflow of foreign aid prior to the end of the war did,
however, allow for a substantial increase in the import of manufactured goods, stimulating growth in both informal trading and the employment of labour made possible by access to such goods (ibid.). The trade in imported goods became so lucrative during this period that traders formed private armies, which fanned out across the country to benefit from continued rural-urban price divergence and demand for hitherto scarce consumer goods (Pitcher, 2002).

Early reform efforts and willingness to ascend to donor demands were integral to the Frelimo government’s success in winning the support of western donor countries and the BWIs. The twin benefits of that support were the erosion of international support for Renamo and the arrest of Mozambique’s economic collapse. Subsequent economic recovery was driven by growth in multiple sectors, and the country’s privatization scheme has been hailed as the most successful in all of Africa (Pitcher, 2004). By extending concessionary credit, tax incentives and prolonged payment periods to Mozambican nationals, the Mozambican privatization scheme can be seen as doing more to foster the development of a domestic capitalist class that has been the case in other sub-Saharan African cases (ibid.). It must also be recognized, however, that the government of Mozambique retains control over some of the most profitable sectors in the country, is active in virtually every sector and, where it has privatized larger firms, has largely done so through joint ventures with foreign investors (ibid.). The privatization of small and medium state enterprises has been of greatest benefit to former soldiers (from both sides of the conflict), Frelimo party members and former managers of state firms (Castel-Branco et al., 2003). Many of these individuals have, through access to privatized state firms, gained access to the free market and become genuine entrepreneurs.
(Pitcher, 2004). Others, however, either continue to rely on patronage connections for the profitability of their operations or achieved gain through non productive means including indefinitely delaying payments on their debts to privatization promotion schemes, engaging in land speculation and/or by selling off piecemeal the productive assets of privatized firms (Hanlon and Smart, 2008).

As Ann Pitcher has observed, the privatization process in Mozambique has not been so comprehensive as might be suggested by the number of firms privatized (1,200 by 2001) or the pace at which the process unfolded (Pitcher, 2002; 2004). Rather, the process has been managed in such a way as to preserve a central role for the state in the economy and the privileged socioeconomic position of political elites. Some of those elites have succeeded in becoming successful business people and even entrepreneurs and the transformation of the Mozambican economy has been remarkably successful in comparison with similar processes undertaken in other sub-Saharan African countries. Despite this success, however, the post-conflict economic miracle in Mozambique has yet to produce substantial entrepreneurial opportunities for ordinary Mozambicans.
3: RURAL LIVELIHOODS IN THE ERA OF RAPID ECONOMIC EXPANSION – THE TIA SURVEYS

In 1995-6 and 2001-2 the Ministry of Agricultural and Rural Development commissioned national agricultural sample surveys or *Trabalho do Inquérito Agrícola* (TIA). These surveys covered every district in the country and incorporated samples from several thousand households (Walker et al., 2004). The two studies of these surveys that form the basis for the following analysis - Walker et al., 2004 and Boughten et al., 2006 - show that highly diversified livelihood strategies within the context of significant socio-economic stratification continues the be the defining feature of the rural Mozambican economy. What’s more, these studies show a strong correlation between access to waged labour or value-added self-employment (or both) and the achievement and maintenance of gross household incomes at above poverty levels.

The TIA survey conducted in 2001-2 (TIA02) indicates that non-crop income plays an important role in the livelihood strategies of at least a sizable minority of rural Mozambican households. *Figure 2* shows the frequency of household participation in four major categories of non-crop income generating activities across income quintiles. Three findings are immediately clear: first, self-employment –which includes both value added production of goods or services and extractive activities like firewood collection – makes up the most significant source of non-crop income across income quintiles. Second, participation in all forms of non-crop income generation becomes more common
when moving from the poorest to wealthiest quintiles. Third, wage income is uncommon amongst the poorest 60% of households, slightly more common amongst the next wealthiest quintile and substantially more common amongst the wealthiest 20% of households. Walker et al. note that this finding is in keeping with the literature on rural household income in sub-Saharan Africa, where wealthier households tend to derive income from more diversified sources (Walker et al., 2004). Across all quintiles, however, at least 90% of households derived some income from household crop production, which contributed a weighted average of 67% to rural Mozambican household incomes (ibid.). In contrast to non-crop income sources, however, the percentage of households involved in agricultural crop production decreased when moving from the lowest income quintile to the highest.

Figure 2: Percentage of Households Receiving Non-Crop Income by Source by Income Quintile

Source: Walker et al., 2004, pp. 7
The relative contribution of the four major categories of non-crop income to total household income also varied considerably between income quintiles. As figure 3 shows, self-employment income, while declining from the wealthiest to poorest quintiles in terms of the significance of its contribution to gross household income, still accounted for an average of 10% of household income in the poorest quintile. Livestock income (derived from the sale of livestock) accounted for an evenly small share of 2-3% of household income across all quintiles. Remittances, which on average made similarly small 3-5% contribution to average household incomes across all quintiles, were found to figure most prominently in the income profiles of the richest 20% of rural households. Finally, wages were found to be 8 times more common amongst the richest 20% of households vis-à-vis the poorest and contributed significantly to the household incomes of that richest quintile, less so to that of the next wealthiest 20% and only marginally to the incomes of the poorest 60% of rural households. Importantly, it was found that only 10-15% of rural households have access to the kind of sustained, semi-skilled or specialized employment opportunities that facilitate the propulsion of households out of poverty (Walker et al., 2004). A much more common form of waged employment is seasonal or short-term agricultural employment, which entails neither sufficient wage levels nor duration to stabilize incomes at above-poverty levels (ibid.).
The Boughton et al. study of both the 1996 and 2002 TIA surveys was primarily concerned with changes in the composition of household incomes and the contribution of various components to gross income over time. The TIA surveys utilized various strategies for measuring the income contribution of various factors and adjusted for changes in price levels between the two survey periods using the same corrective factors employed by the Ministry of Planning and Finance (Boughton et al., 2006). For the most part, the study relied on figures derived using a flexible consumption basket inflator, which allows for the fact that families can increase their welfare by reacting to changing price levels and consuming less expensive goods (this method has, however, been criticized due to the fact that it cannot account for the welfare detriments of switching to lower cost, low nutrition foods like cassava – see Hanlon, 2007). However, because the

Source: Walker et al., 2004 pp. 8
TIA surveys provide only two time series data points and especially because incomes derived from agricultural production are particularly subject to significant year on year fluctuations, there is limited scope for observing trends on the basis of these two surveys.

With this caveat in mind, it is at the very least interesting to note that the Boughton et al. study found that 73% of the increase in rural incomes between 1996 and 2002 were accounted for by gains to the highest earning 20% of households. The second highest earning 20% reaped 14% of those gains while the lowest earning 60% of households split the remaining 13%. The poorest 20% gained only 3% of the increase reported between the two survey periods. Secondly, Boughton et al. found that, although agricultural income growth accounted for only 10% of total income growth between the two periods, it accounted for 78% of income growth amongst the poorest 60% of households and -3% of that of the wealthiest quintile. Two preliminary conclusions can be drawn from this: first, growth in agricultural incomes disproportionately benefits poor households and, second, those households that are not poor do not rely on increased agricultural incomes for the growth of their gross household incomes. The first conclusion, however, is problematic in that, as a study by Tschirely et al. in 2006 found, the majority of rural households are net food purchasers and because, according to Boughton et al., the increases in crop incomes were primarily driven by increased prices. This means that, while the gross household incomes of poor households stand to gain from increased crop incomes, a corresponding rise in household expenditures will more than offset any welfare gains.

Boughton et al.’s comparison of the 1996 and 2002 TIA surveys also found that aggregate household incomes had increased by 65% (in real terms) between the two
periods. Over the same period, however, median incomes increased by only 30%, indicating widening income inequality. A recent preliminary study of a third TIA survey conducted in 2005 indicates that between 2002 and 2005 mean incomes rose by a further 18% while median incomes in fact fell by 3% (Pitoro and Mlay, 2007 in Hanlon and Smart, 2008). These three data points taken together indicate a continuing trend of income stratification that may in fact be accelerating. Boughton et al. note that already by 2002 the median income of the wealthiest quintile was already 18-times that of the poorest. Meanwhile, a National Household Consumption Survey conducted in 2002-3 found mean consumption amongst the wealthiest 20% of households in Mozambique to be 8-times that of the poorest (Arndt et al., 2006). Income and consumption inequality in Mozambique are, however, not particularly high by sub-Saharan African standards (ibid.). What is more concerning is the finding by Pitoro and Mlay (2007) that between 2002 and 2005 half of the 30% of households that were considered ‘not poor’ had fallen back into poverty, while a further 18% of poor households had achieved ‘not poor’ status. While this represents a 3% net poverty reduction, the more striking indication is that those who escape poverty do so very precariously.

Both the studies found wage income and self-employment income to be most commonly associated with the income profiles of the highest earning households. Wage income was clearly the least evenly distributed source of income, with only 5% of the poorest quintile and 40% of the wealthiest having access to it (Walker et al., 2004). When self-employment income is differentiated between resource extraction and value added small business operations, it becomes clear that the latter, while resulting in twice as much income generation as the former, is similarly concentrated amongst the highest
earning households. Neither the TIA surveys themselves nor the Walker and Boughton studies indicate directions of causality – whether wealthier households having access to these sources of income is a result of their being wealthier, or whether their being wealthier is a result of their having access to these sources of income – and no doubt the reality lies somewhere in between. What these studies do suggest is that diversified approaches to securing incomes are the norm amongst rural Mozambique households and efforts to enhance the livelihoods of those households should be, therefore, similarly multifaceted in scope.

3.1 Recapitulation

As sections 1 and 2 have shown, numerous complementary and competing processes have culminated in the development of diversified livelihood strategies and significant, while not extreme, socioeconomic stratification in rural Mozambique. The origins of this process were found to be in the late colonial period, when Mozambican labour came to be commodified through the exchange of labour for wages. The process continued through the period of statist economic planning and intervention, when rural Mozambicans adapted the best-laid plans of the Frelimo government to meet their own economic and livelihood needs. During that government’s war with Renamo, the emergence of a grass-roots war economy presented new opportunities for capital accumulation and economic benefit for a few, amidst the disaffection and destitution of the many. More recently, as Mozambique has made the transition toward a capitalist economic development, rural Mozambicans have continued to rely on diversified
livelihood strategies to address the low productivity of their agriculture, the poverty of employment opportunities and the uncertainty that accompanies agricultural production for household consumption – still by far the most prevalent source of income for rural households – in a country prone to climatic shock.

In so doing, thousands of Mozambican households have succeeded, to an extent, in managing uncertainty and risk. Where they have by in large not succeeded, however, is in escaping poverty. As stated above, the most assured way to redress this situation would be to enhance agricultural productivity amongst the more than 90% of rural Mozambicans who produce agricultural crops, often for their own household consumption. Improved seed varieties, inputs like fertilizer and expanded access to animal traction are all important means to achieving this end. But at the same time, the preceding analysis has shown that access to other sources of income, most notably wages and value added self-employment, takes an increasingly central position in household livelihood strategies when moving from the lowest to the highest earning households. Access to these sources of income can provide the sustained increase in income necessary for households to achieve a robust exit from the condition of poverty.

The remainder of this paper will be concerned with strategies to improve access to these income sources. It will argue that, while integral to Mozambique’s hitherto and continued economic growth, foreign direct investment in industrial mega projects has not produced sufficient employment opportunities or economic linkages to achieve widespread poverty reduction. What has been lacking in Mozambique to date has been the development of a commercial private sector in rural Mozambique itself. To that end, numerous challenges present themselves, among which the failure of Mozambique’s
financial sector to serve adequately the rural population is paramount. The following
sections will therefore include an analysis of the Mozambican financial sector, focusing
on how and to what extent it fails to facilitate private sector development in rural
Mozambique and suggesting a range of institutional alternatives that may prove amenable
to rectifying that failure.
4: MACRO-ECONOMIC AND PRIVATE SECTOR DEVELOPMENT IN THE POST-CONFLICT PERIOD

The rapid growth witnessed in Mozambique since the early 1990s has been driven by expansion in several sectors of the economy and has, at the macro level, shown trends consistent with successful industrialization and economic development. The manufacturing sector, which declined by 46% from 1989 to 1995, rebounded to grow by more than 500% between 1995 and 2003 (INE, 2009) and was driven by strong foreign direct investment inflows, which averaged just shy of 5% of GDP over that 9-year period (World Bank, 2009). As billions of dollars worth of investments have met with approval by the Mozambican government, the success of Mozambique’s economic recovery has been attributed to the establishment of macroeconomic stability, market-oriented policy reforms, and massive support from donor countries and the international financial institutions (World Bank, 2005). This strategy, however, has not escaped criticism.

Castel Branco et al. (2003) have been critical of the government’s lack of a coherent economic strategy and have argued that the current pattern of foreign investment both exacerbates the problem of excessive economic specialization while leaving future growth dependant on exogenous factors. They point out that, in the late 1990s, 69% of manufacturing was accounted for by the food, beverage, clothing, textile and leather subsectors (ibid.). Moreover, 80% of investment between 1997 and 2000 was geared
toward the energy and mineral sectors, which are at the same time import dependent, capital intensive and lacking in linkages with the rest of the economy (ibid.). Recent developments have seemingly verified these concerns, as the price of aluminium (Mozambique’s principal manufactured export) has dropped significantly with unfavourable consequences for Mozambique’s export earnings and balance of payments (EIU, 2009). A host of mining projects and a second natural gas pipeline from Inhambane province to South Africa are slated for start-up, as is an oil exploration project in Nampula province, however, recent global economic events have resulted in some of these projects being temporarily mothballed (EIU, 2008; EIU, 2009). While these projects can be expected to contribute significantly to Mozambique’s continued economic growth, they are unlikely to integrate with the rest of the Mozambican economy any further than similar mineral and energy sector investment projects have done to this point. As such, they do little to allay concerns that, where growth is driven by a capital-intensive manufacturing sector that imports its raw materials and fails to create extensive links with the rest of the economy, the poverty alleviation outcomes will be minimal. To the extent that a highly attractive tax environment motivates these investments, the gains to the state from this type of growth are similarly minimized.

Other sectors contributing to Mozambique’s recent economic growth include construction, commerce and agriculture. The construction sector has been buoyed by donor-financed infrastructure reconstruction, which is widely expected to produce positive economic spinoffs in other areas, not least the north-south integration of Mozambique’s agricultural markets (Arndt et al., 2000). In some cases these efforts have been integrated into livelihood enhancement and poverty reduction efforts through the
employment of labour intensive road maintenance schemes (Hanlon and Smart, 2008). The commerce sector includes over 10,000 licensed traders, many of whom are descended of Asian families with several generations of history in Mozambique (Pitcher, 2002). Despite this, members of this group often lack political connections and have difficulty gaining access to credit to expand or maintain their businesses (ibid.). Growth in the agricultural sector contributed over a third to Mozambique’s early post conflict economic growth and was driven by a rapid increase in the area of land under cultivation by mostly hoe farming poor rural farmers returning from wartime displacement (World Bank, 2005). Improving the productivity of those farmers has long been a development priority in Mozambique, but, despite this, recent indications are that agricultural productivity in the country has stagnated (Hanlon and Smart, 2008; Walker et al., 2004). Foreign investment in sugar production more recent investments in bio-fuel production from sugar cane as well a remarkable growth in the tobacco subsector have, at the same time, contributed to continued growth in the agricultural sector (EIU, 2009).

Probably the most vociferous critic of Mozambique’s development strategy over the past decade has been Joseph Hanlon who, along with Teresa Smart, argues that, rather than harnessing the US$11 billion in aid that has flown into the country over the past two decades to develop a functioning and dynamic private sector, the Mozambican government and its foreign advisors have focused on creating favourable market conditions with the expectation that foreign investment would “fall from the sky” (Hanlon and Smart, 2008). Ann Pitcher, on the other hand, draws from the work of Peter Evans in characterizing the shifting role of the state from that of “demiurge” to that of “midwife” or “husbandry” (Pitcher, 2002). She argues that the state has worked to
facilitate capitalist economic development not by becoming minimalist or restraining from economic intervention, but by carefully controlling the process of privatization and foreign investment so as to preserve the centrality of the state’s economic position (ibid.). The transition to capitalist development, according to Pitcher, has been shaped by the historical legacies of colonialism, socialism and war. As sections 1 and 2 have argued, this has been true as much for rural Mozambicans and their livelihoods as it has for the country’s economic transition and development.

One such legacy has been the ‘entrepreneurial gap’ created over the decades of effective colonial rule and failed socialism (Hanlon and Smart, 2008). The model for growth pursued by the Chissano and Guebuza governments, according to critics like Hanlon and Smart, has recognized the diversified livelihood strategies of rural Mozambicans only in so far as it has expected them to rely on subsistence farming, artisanal production, self employment and petty trade in order to eke out a living on the cusp of poverty (Ibid.). The Mozambican National Agricultural Development Plan for 1999-2003 (PORAGRI) drew a clear distinction between the “family sector” and the “private sector” and promoted the development of the former as a subsistence sector integrated into the market through the sale of agricultural surpluses (Pitcher, 2002). What this strategy failed to address, however, was that which surveys have shown rural Mozambicans to desire first and foremost: jobs (Hanlon and Smart, 2008). To the extent that job creation has been recognized as an important factor in rural economic development and poverty reduction it is expected to arise out of state farm privatization, private commercial farm development and foreign investment-fuelled agri-businesses. To an extent this has occurred, as rural Mozambicans employed in the growing tobacco and
sugar sectors can no doubt attest. But as the TIA surveys indicate, access to stable employment remains a rarity in rural Mozambique and it is for this reason that the Mozambican government and donors should give greater attention to the development of rural Mozambican entrepreneurs whose success would in turn result in job creation.

At present, significant barriers to Mozambican entrepreneurship persist. The World Bank’s annual “Doing Business” reports ranks 181 countries based on a number of criteria related to the ease of starting and operating a business. In 2008 Mozambique ranked 144th on this list. One year later that rank had slipped to 149th (World Bank, 2008). Impediments to doing business in Mozambique included the difficulty in registering property, which took an average of 42 days and 8 separate steps to accomplish (ibid.). On average, the cost of this process exceeded 12% of the value of the property itself. The public registry for property in Mozambique was found to extend to only 1.9% of adults, and on the index of legal rights for property owners (or, in the Mozambican context where the state continues to legally own all land, property title holders) Mozambique scored well below the sub-Saharan African average (ibid.). As Hernando de Soto argued powerfully in his 2000 book *The Mystery of Capital*, functional property registration institutions are an integral part of a legal system that can transform the physical assets of the poor into ‘live capital’ with which the poor can affect their own economic advancement (de Soto, 2000). As will be argued in the following section, such a legal system has yet to develop in Mozambique, which is one of the reasons why in 2009 the country’s ‘Doing Business’ rank in terms of ease of access to credit lingered at 123rd (World Bank, 2009). Lack of access to credit remains the principal impediment to would-be Mozambican entrepreneurs.
5: FINANCIAL SECTOR DEVELOPMENT AND EASE OF ACCESS TO CREDIT

As with the majority of state enterprises, the 1990s saw the rapid privatization of Mozambique’s financial sector. When the Frelimo government began making its turn toward the market in the mid 1980s there were only three banks operating in the country, two of which, the *Banco de Moçambique* (BDM) and the *Banco Popular de Desenvolvimento* (BPD) had been created through the nationalization of the colonial era *Banco Nacional Ultramarino* (the central bank of the colonial regime) and two other colonial credit institutions (Hanlon and Smart, 2008). The third was the only private financial institution to survive the statist era: *Banco Totta de Moçambique* (ibid.). The BDM acted as both the central reserve bank and commercial bank for the Frelimo government, while the BPD was a development bank. Both were geared toward the financing of state-centric industrialization and agricultural projects. In 1987 the process of splitting the BDM’s commercial banking function from that of the central bank was initiated under the auspices of the PRE and in 1992 the *Banco Comercial de Moçambique* (BCM) was brought into being (ibid). At the same time, interest rates and foreign-bank investment were deregulated (EIU, 2008).

In 1995 the World Bank produced a country assistance strategy for Mozambique that included the privatization of the BCM as a condition for continued assistance
(Hanlon and Smart, 2008). Shortly thereafter both the World Bank and IMF began recommending the privatization of the BPD as well (ibid.). In both cases the privatization process was pushed through quickly, despite difficulty finding credible investors. Substantial evidence exists suggesting massive fraud during this period, and in 2004 a branch manager was convicted of involvement in the thefts of 114 million MT (US$13 million) from the BCM 6 months prior to the finalization of the privatization process (ibid.). The privatization of the BCM went ahead in 1996 while that of the BPD followed one year later.

In 2000, both the BCM and the newly renamed Banco Austral (formerly the BPD) were declared insolvent owing to high levels of non-performing loans (many of which outstanding to Frelimo party members) and were temporarily renationalized (EIU, 2008). The BCM was subsequently re-privatized through its sale to the Banco Comercial Português, while Banco Austral was taken over by the South African bank ABSA in 2001, which was itself subsequently bought by Barclays (Hanlon and Smart, 2008). In an effort to improve the stability and feasibility of these newly re-privatized banks, the government granted the institution exclusive access to the purchase of government treasury bills (Simonetti et al, 2007). This monopoly right, in combination with the low level of risk associated with treasury bills and the government’s propensity for using their sale as a means of limiting inflation, resulted in treasury bills becoming a major source of profit for the country’s two major banks. While this has effectively shorn-up the stability of the banks, it has eroded, to some extent, their incentive to extend credit (ibid).

A second deleterious effect, from the perspective of would-be rural Mozambican entrepreneurs, has been the retreat of the formal banking sector from rural areas. As a
national development bank, the BPD in particular had a mandate to maintain a presence, however ineffectual, in the rural areas where the majority of Mozambicans live. No such imperative applies to profit-oriented private banks, and between 1995 and 2005 the concentration of bank branches in Maputo city increased from 37% to 57% (Simonetti et al., 2007) The lack of a physical presence in rural areas has exacerbated problems related to information gaps on the part of both the banks and potential borrowers. In keeping with their fiduciary responsibilities, banks have responded to insufficient information with increased requirements for loan collateral, which exceeded 140% of loan values in 2002 (ibid).

Despite recent expansion, the financial sector in Mozambique remains highly concentrated. In early 2007, 13 regular banks were in operation in the country in addition to one investment bank, two micro-finance institutions, five credit and savings cooperatives and three financial leasing organizations (EIU, 2008). While that is a significant improvement over the three banks that existed in 1992, the four largest banks still control 88% of bank assets, 85% of loans and 91% of deposits (ibid.). Reserve requirements in Mozambique are high at over 11.5%, which leads banks to set high margins between the interest rate paid on deposits and that required on loans (USAID, 2007). Figure 4 plots the interest rates on deposits and borrowing from 1998 to 2007 and shows a consistent margin between the two averaging approximately 11%, with some widening of in the early part of the past decade and slight narrowing in 2007. To some extent this margin represents the high level of risk associated with lending in Mozambique, but lack of competition within the sector is also a significant contributing factor (EIU, 2008). Despite the risks associated with lending, the Mozambican financial
sector remains highly profitable, with returns on equity being reported at 36% in 2008 (ibid.).

Figure 4: Interest Rates on Deposits and Borrowing: 1998-2007

Efforts to improve access to credit in Mozambique – particularly term finance for investment – face a number of structural obstacles. First and foremost, the 1990 constitution prohibits the private ownership of land, which is a serious impediment to the use of land as collateral against borrowing (USAID, 2007). At present, land is obtained for commercial use in Mozambique through use rights the transfer of which, as alluded to in the above discussion of the World Bank’s “Doing Business” report, is onerous and time consuming (ibid.). Ease of access to credit in Mozambique could be improved with a streamlined system of use rights registration and transferability, which could be achieved without necessarily affecting constitutional reform. Similarly, the system of asset registry in Mozambique is found sorely wanting. High value assets like industrial equipment
cannot be registered and can, therefore, not be used effectively as collateral against loans (ibid.). The system of asset registry remains largely un-computerized and error prone and, as mentioned above, extends to only 1.9% of the adult population (USAID, 2007; World Bank 2009). Moreover, bankruptcy laws, while sound in letter, are inefficiently administered and fail to instil confidence in potential lenders (USAID, 2007). Recently, the government has introduced commercial law sections in the provincial courts, but inefficiencies and uncertainties remain (ibid.). Mozambique also lacks a central credit registry that could assist lending institutions in more efficiently assessing risk, thereby reducing the cost of borrowing (EIU, 2008). There has also been a perception that government borrowing through the sale of t-bills, which reached 40% of total domestic lending in 2004, has crowded out lending the private sector (USAID, 2007). More recently, however, the Mozambican government has reigned in its fiscal policy and the share of public borrowing from the private financial sector has been reduced substantially (ibid.). Finally, the government has introduced regulation that limit the ability of non-importing firms to borrow in dollar denominated loans. This was motivated by an interest in avoiding the kind of systemic currency risks that precipitated the currency shocks experience in East Asian in the late 1990s (ibid.). While these concerns are justified, they do result in Mozambicans having to borrow more exclusively in Metical loans, which are subject to comparatively higher interest rates.

Meanwhile, the credit worthiness of potential borrowers in Mozambique remains a concern. Would-be borrowers in Mozambique and especially in rural areas are not likely to have a wealth of experience in dealing with banks or with preparing business plans or feasibility studies that might help alleviate the information gaps that contribute
to high interest rates for borrowing. A 2007 USAID study has identified an important potential role for donors in this area, helping potential entrepreneurs develop sound business plans and communicate them effectively to banks and helping banks identify quality lending opportunities (USAID, 2007). There is also considerable room for the development of non-traditional lending institutions including, but not limited to, micro-lending institutions. Regulations and requirements for the establishment and registration of new financial institutions, however, remain cumbersome and should be reformed (ibid.).

The government of Mozambique has introduced some programs to improve the financial sector - including a US$ 28.5 million scheme led jointly by the World Bank and the Ministry of Finance - to improve the soundness of the system and that of debt management and intermediation (USAID, 2007). A US$34 million rural financial support program has also been introduced, led by the International Fund for Agricultural Development, to enhance the viability of rural enterprises through improved access to financial services (ibid). Both can be considered positive developments, but as the USAID study concluded, the financial system remains woefully underdeveloped and “waiting for the market to produce solutions is not an acceptable solution” (USAID, 2007 pp. 2). In the final chapter of this paper, three alternative approaches to improving access to credit for private sector development will be briefly explored. These include microcredit, value-chain lending and the creation of a national development bank.
6: ALTERNATIVE APPROACHES TO IMPROVING ACCESS TO CREDIT

6.1 Micro-Credit

Following the experiences of Bangladesh’s Grameen Bank, micro-credit has become a development buzzword and pet project of the donor community. It is widely held that micro-credit offers opportunities for borrowing that would otherwise be unavailable to “non-traditional” borrowers. In Mozambique there were 32 micro-finance institutions (MFIs) in operation by 2005, with lending portfolios totalling more than US$ 16 million (Hanlon and Smart, 2008). According to a 2006 study of micro-finance authored by Fion de Vletter on behalf of the Mozambican Micro-finance Facility, the stated goal of extending micro-finance loans to 10,000 Mozambicans had been reached by that year (de Vletter, 2006). The major challenge remaining, the report continues, is extending that credit to rural areas, which are currently underserved (ibid.).

In the early stages of micro-credit development in Mozambique, INGOs dominated the sector and operated primarily in rural areas (de Vletter, 2006). Over time, however, two interlinked trends developed: Micro-finance operations were increasingly subsumed by formal financial institutions and became concentrated in urban areas. At
present approximately half of micro-credit borrowers accounting for nearly 70% of micro loans are concentrated in the Maputo-Matola region and the city of Beira (Hanlon ad Smart, 2008). Only 3 of the 32 MFIs in operation can be said to operate exclusively in rural areas (De Vletter, 2006). The trend of micro finance activity concentrating in urban areas is in part driven by higher transaction costs and risks associated with lending in rural areas and the fact that over 40% of trade-related informal sector activity and almost 50% of service related activity occurs in Maputo city (ibid.). What has been more common in rural areas has been the extension of supplier and buyer credit to cash crop-producing farmers by agricultural marketing and processing companies (see IFAD, 2003). The MMF study concluded that micro-finance remains insignificant in meeting the needs of rural Mozambicans (de Vletter, 2006).

Despite the expectation on the part of the MMF study’s author that this condition would soon change, there are reasons to believe that micro-finance will have a limited role to play in developing the kind of employment generating entrepreneurial activity that the TIA income surveys showed to be most common in the livelihood structures of upper income rural Mozambicans. Another study by Athmer and De Vletter found that micro-credit loans in Maputo result in improved livelihoods for the borrowers, but not in any further employment creation (Hanlon and Smart 2008). Yet another indicated that in one rural micro-credit program 100% of the loans extended financed commerce instead of productive investments, largely owning to the fact that interest rates on micro-credit loans ranged from 4-10% monthly, which far exceeds the level at which long-term investment is feasible (in Hanlon and Smart, 2008). A study of rural labour markets in Mozambique found micro credit to reach few women - usually not the poorest - and to have limited
potential to affect structural change (Cramer et al., 2008). A further problem identified in the MMF report is that, in addition to accessing financing, potential entrepreneurs in Mozambique require access to non-financial business services and training, without which they tend to struggle in developing profitable business ventures and servicing their debts (de Vletter, 2006). It is in this area that value-chain oriented lending has made considerable progress.

6.2 Value Chain Lending

In recent years a number of value chain-oriented lending strategies – most notably in the cashew process and poultry sectors – have met with considerable success. At the centre of these efforts has been the Gabinete de Consultoria e Apoio e Pequena Industria (GAPI). First established in 1984, GAPI takes an innovative approach to addressing coordination failures in value chains, addressing both supply and demand side issues in rural financing (Hanlon and Smart, 2008; Simonetti et al., 2006). Its approach differs from that of traditional financial institutions in that it looks for potentially viable ventures and, through a combination of supplying credit and providing business services and training, works towards realizing that viability through the development of entire value-chains within which the businesses operate (Simonetti et al., 2006). GAPI has been called the “only relevant player in rural finance” in Mozambique (ibid. pp. 137).

GAPI operates with a three-pronged strategy that includes integrating the supply of credit with capacity building to help developed the borrowers ability to repay (Simonetti et al., 2006). Second, the institution takes a value-chain approach to lending in
order to ensure the viability of all the parts within that chain (ibid.). Third, GAPI forms partnerships with NGOs and technical training institutions that offer services beyond the scope of GAPI’s expertise (ibid.). By 2003 GAPI had a portfolio including 300 borrowers averaging US$26,000 per loan (Hanlon and Smart, 2008). Many of these loans are provided to producer associations that enhance the profit making ability of their members by accessing economies of scale, supplying public goods or collectively managing finances (ibid.). Some of these associations also translated the loans extended by GAPI into micro-lending within their group (ibid.).

A poignant example of the success of GAPI’s multi-pronged approach has been in the processed cashew sector that nearly collapsed in the wake of over-rapid liberalization in the late 1990s. In this case GAPI provided loans and business services to assist producer associations improve the productivity of their members, to help processors and exporters reach international markets, to promote product quality brand identification through the development of the “Zambique” brand and to finance working capital for processing factories (Simonetti et al., 2006). In this endeavour, GAPI enlisted the services of TechnoServe, an American technical training firm, which evaluated the potential profitability of various aspects of the value chain allowing GAPI to extend loans against future profits (ibid.). Thus, two principal problems in rural finance were overcome: gaps in information between lenders and borrowers and lack of collateral on the part of borrowers. The resurgence of the cashew processing industry is important for several reasons including the approximately 10,000 off-farm jobs the industry generates (Hanlon and Smart, 2008). The industry is also a significant export earner, although the aging and disease-prone condition of cashew trees in Mozambique and evidence
emerging from the TIA surveys suggesting that ownership of cashew trees is not associated with higher household incomes, indicating that problems on the producer side persist (Hanlon and Smart, 2008; Walker et al., 2004).

While engaged in non-traditional lending activates GAPI has remained profitable, but that profitability has been contingent on donor support. GAPI receives concessionary loans from donors, which in on-lends to its own clients (Simonetti et al, 2006). Without access to concessionary credit its profitability would be put in serious jeopardy. Moreover, donors and NGOs supply much of the business and technical service provided to GAPI clients without charge (ibid.). This points to an important consideration with regard to finance for development in rural Mozambique. The lack of credit available through commercial banks indicates a market failure that is a direct result of the high level of risk and low potential for profitability in the rural credit market. This is a condition that can be addressed to a certain extent through measures such as creating a credit registry, improving the asset registry and improving business development training. However, it is reasonable to expect that the lack of enthusiasm for this market on the part of commercial banks will persist for some time, and approaches to rural finance based on concessionary lending and donor support should, therefore, be given full consideration. In 2007 GAPI succeeded in establishing a rural bank, with majority ownership by a group headed by Rabobank of Holland (Hanlon and Smart, 2008). This may go some way to alleviating the problem of commercial bank concentration in urban areas, but is on too small a scale to address the shortage of rural finance at the country level.
6.3 National Development Banking

In 2003 a Mozambican Committee of Councillors released a report in which they noted that the combination of a lack of interest from the commercial banking sector in lending in rural areas and Mozambique’s lack of a development bank resulted in “calamitous effects in the financing of development, especially in commercial agriculture” (Committee of Councillors Hanlon and Smart, 2008 pp. 175). They emphasized that special lines of credit should be made available for borrowers considered “high risk” by the commercial financial sector to facilitate productive investments in rural industries (ibid.). This sentiment is consistent with growing support for the development of a Mozambican development bank (see USAID, 2007). At the same time, opposition from donors and the IFIs has been at least equally as strong.

The type of development bank that advocates in Mozambique typically favour is one that is majority owned by non-government investors and that is both professionally managed and profit-oriented (USAID, 2007). Such a bank would, to some extend, rely on concessionary loans from international agencies that are seen as being necessary to successful operation in a high risk lending environment such as that found in rural Mozambique (ibid.). Much like GAPI, such a bank would need to take “value chain” approach to lending and would necessitate complimentary business and technical training services (Hanlon and Smart, 2008). Proponents point to the important role that development banks have played in the development and reconstruction of other economies, including the role of the Reconstruction Finance Corporation in the United States during the 1930s (ibid.).
Hanlon and Smart, as strong proponents of the development bank initiative, have argued that central and South American examples like the Banco Nacional de Desenvolvimento Económico e Social (BNDE) in Brazil provide a blueprint for the successful creation and operation of a Mozambican development bank. The BNDE has been very successful in supplying large volumes of loans to Brazilian entrepreneurs, with studies showing that firms borrowing from that bank were 50% more successful on creating new jobs and higher salaries than those that did not (Hanlon and Smart, 2008). While this bank has been successfully transformed into a commercial operation, a USAID study of the Mozambican financial sector points to the dearth of skilled personal, domestic market development and infrastructure in Mozambique as compared with Brazil and argues that the comparison between the two countries is unwarranted (USAID, 2007). That study points out that the more common experience with national development banks in developing country contexts has been of government interference and poor management (ibid.). Nordic donor countries have become a major source of opposition to the development bank initiative on the basis of the experience of corruption and fraud during the re-privatization of the BPD and BCM in the early 2000s (Hanlon and Smart, 2008).

Experiences within Mozambique offer differing indications of the potential for a development bank to successfully contribute to private sector development and poverty alleviation in rural areas. For example, over the past 20 years the Mozambican government has created Fundos de Fomento (development promotion funds) to enhance access to credit in rural areas, but while there has been some success in the promotion of trade in the Northern part of the country, the overall experience with these funds has been
poor (Hanlon and Smart, 2008). On the other hand, the experience of GAPI has shown that, where a development finance institution is well structured and has the support of serious investors, it can be successful (USAID, 2007). The USAID report concludes (in spite of Hanlon and Smart’s assertion that USAID is ideologically opposed to development banking) that should such investor support be found to exist, a national Mozambican development bank would be a good idea (ibid.). Alternatives to a national development bank would include the development of a regional development bank or the creation of several smaller institutions following the GAPI model (USAID, 2007; Hanlon and Smart, 2008). Concerns over corruption and fraud, however, are justified. Questions regarding massive irregularities and two high profile murders during the re-privatization of the BPD and BDM remain as yet unanswered. However, there is sufficient international expertise and a precedent of donor involvement with the development of new institutions in Mozambique to suggest that the problems of improper dealings and government interference are not insurmountable. The potential benefits to rural private sector development, job creation and poverty alleviation are such that the issue of creating a national development bank should be given full consideration by the Mozambican government, donors and the international financial institutions.
7: CONCLUSION

The foregoing analysis has highlighted an important gap in the Mozambican miracle. While the economy has experienced sustained growth at remarkable rates for 17 years, that growth has yet to create, on a sufficiently large scale, the kinds of entrepreneurial and employment opportunities that are strongly associated with the livelihood structures of rural Mozambique’s small minority of robustly non-poor people. It has been shown that, while agricultural production is by far the most common and substantial contributor to rural Mozambican household incomes, those households are nonetheless dependant off-farm income sources for the enhancement and stabilization of their livelihoods.

Of late, the Mozambican government and its development partners have begun to recognize this reality. The country’s most recent development and poverty reduction strategy paper (known in by the Portuguese acronym PARPA II) makes the important observation that rural Mozambican households rely on a complex mix of family agricultural production and salaried work both in agricultural and non-agricultural sectors (Hanlon, 2006). Moreover, it recognizes the need for expanded access to credit and the development of new credit mechanisms for agriculture (ibid.). These are positive developments that should lead to a better understanding of livelihood dynamics in rural Mozambique and improved efforts to address still-pervasive poverty in rural areas. The
strategy, however, still fails to adequately address the issue of job creation, as employment fails to factor anywhere in the PARPA II’s 22-page evaluative matrix (ibid.). Mozambique’s strategy for poverty alleviation in rural areas continues to focus on improving agricultural productivity and on encouraging farmers to take up commercial agricultural production. There is good reason for this: Agricultural production continues to form the bedrock of rural livelihoods. But productivity remains woefully low, as the majority of farmers continue to cultivate tiny plots of less than 2 hectares using only hoes and machetes (Boughton et al., 2006). Enhancing agricultural productivity is therefore of paramount importance to increasing rural incomes. Successful development in the agricultural sector is also essential to creating job opportunities, particularly in the central and northern regions of the country where the industrial and manufacturing sectors remain particularly underdeveloped. Increasing agricultural productivity in these areas will be key to spurring growth in other sectors (Walker et al., 2004).

The significance of the complex and multi-faceted livelihood strategies adopted by rural Mozambicans should not be undervalued. These strategies have evolved in response to uncertainties, many of which persist to this day. Underemployment, low agricultural productivity and climatic variability are prominent features of life for rural Mozambicans. By adopting diversified livelihood strategies, they reduce their exposure to shocks in any one area and thereby improve the livelihood security of their households. Mozambique’s government and its development partners have limited scope to address the country’s climatic challenges, and their efforts to increase agricultural productivity, though important, have been of limited impact. As it pertains to underemployment in rural Mozambique, however, there is considerable space for new and innovative action.
Foreign direct investment has been crucial to Mozambique’s economic recovery and will continue to be so in the future, but it has not shown itself to be the answer to the problem of rural underemployment. To this end, the government of Mozambique and its development partners must explore options for strengthening the domestic private sector and enhancing entrepreneurial opportunities and related employment creation in rural areas. Experience to date has shown that profit seeking, development oriented lending in rural Mozambique is possible, particularly where lending agencies themselves have access to credit at concessionary rates, where they take a value-chain approach to lending and where they form partnerships with other agencies and NGOs to develop the profitability of their borrowers. The challenge facing the government of Mozambique is that of scaling up what successful rural lending activities are currently in existence in order to achieve rural private sector development and entrepreneurial activity on a national scale while maintaining the stability of the financial sector as a whole and the rapid economic growth that has been and will continue to be central to the country’s post-conflict recovery and development.
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