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Making foreign investment work: lessons from Mozambique

Mozambique successfully attracts investment for mega-projects, but for them to contribute to sustainable development, the country must also help small businesses to flourish

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There is little doubt that foreign direct investment holds benefits for developing countries. Foreign investors are sources of capital, foreign exchange and technical know-how; they can create jobs, provide goods and services and also procure these from local firms. And they can also be contributors to infrastructure development, which can spur further economic activity. Strategies to attract foreign investment are therefore often central to development strategies as well. In this manner, Mozambique relied heavily on FDI to rebuild its economy and restore growth after 30 years of conflict.

But development gains from investment are not always automatic. It is necessary to use investment policies creatively to nudge investors towards intended outcomes and away from undesirable ones, such as poor labour conditions or environmental degradation.

Unctad conducted an investment policy review of Mozambique at the government's request in 2011. The findings of this review offer useful lessons on how a country can kick start growth through FDI, but also highlight the pitfalls which may prevent investment from yielding sustainable development outcomes.

When Mozambique emerged from two successive wars in 1992, its first priority was to convince investors that it was open for business. Key to the turnaround was macroeconomic reforms which established the country as a market economy. Mozambique adopted a new investment law (pdf), putting in place the requisite regulatory framework to signal a welcoming attitude to FDI.

Then FDI was anchored by two mega-projects - the Mozal aluminium smelter established by mining giant BHP Billiton and the Temane gas field developed by petrochemicals firm Sasol. These projects helped convince other investors that Mozambique was not too risky an investment and sizeable investments also followed for the agriculture and tourism sectors.

Natural resource-based mega-projects have proved to be a particular boon for the Mozambican economy. They have spurred infrastructure development and helped diversify Mozambique's exports away from agriculture. But these investments have not yielded inclusive outcomes.

Despite attempts to stimulate linkages between small and medium size enterprises and foreign investment as well as providing incentives to labour-intensive sectors, Mozambique's developmental challenges remain formidable. Vast numbers of the population remain poor and reliant on subsistence living.

Why have the benefits from FDI failed to reach the wider population? Our review shows that the problem may well lie with those very mega-projects that have been so beneficial for the Mozambican economy.

The regulatory bias in favour of mega-projects (unintentionally) crowds out smaller investments. Small to mid-sized investments could contribute more meaningfully to achieve social objectives such as creating employment and distributing economic activity more widely. It would therefore make sense to tailor the regulatory environment to better suit more - and more modest - projects.

To do this, the IPR recommends, Mozambique needs to "level its regulatory playing field". Small investments, for instance, should enjoy the same perks, which are currently the reserve of mega-projects. Even more pertinently, burdensome, resource-sapping regulatory procedures, which weigh heavily on smaller businesses, should be reduced and simplified to create a more competitive environment for small operators. This could entail a review of licensing procedures through the introduction of e-governance tools.

These changes may encourage investment in sectors where Mozambique has comparative advantages - agriculture, agro-processing, tourism, small-scale manufacturing and services, and infrastructure and logistics.

The IPR does not detract from large investments. Mega-projects remain important. Developmental outcomes can be obtained from these by channelling income from resource-based projects into a stabilisation fund. And pertinently, the IPR also recommends that Mozambique strengthens its public-private dialogue. Through strong, collective and inclusive partnerships Mozambique will be better positioned to identify how resources should be allocated to meet developmental challenges.

Mozambique has shown a willingness to adapt its investment environment to spur further investment. As the country embarks on the next phase of FDI-led growth, the hope is that it will set itself up to reap benefits that touch the lives of the wider Mozambican population and thereby foster outcomes that are more sustainable.

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