

# **Economic Linkages between South Africa and Mozambique**

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## **ABSTRACT**

This paper results from a desk-study about the state of economic linkages between South Africa and Mozambique. Therefore, the paper only considers existing data and has involved no primary research. The study tries to address, amongst other questions, what the weaknesses and strengths of integration of the two economies are. Therefore, it focuses on the analysis of flows of goods and services, labour and capital between the two economies, as well as a speculative analysis of what, and how, key future developments may shape the economic relationship between South Africa and Mozambique. The paper argues that economic linkages between the two countries have been built over the years as a result of dynamic forces (linkages, agents and public policy) that have been operating in both economies. Such dynamic forces, for example, the minerals-energy complex of South Africa, are still in operation. In recent years, the mechanism by which the dynamic forces of South African capitalism influence the Mozambican economy has changed from recruitment of migrant labour to foreign direct investment. This change is happening in other Southern African countries as well. From a regional migrant labour policy, South African capitalism has moved to regional investment policies and strategies that favour expansion and internationalisation of South African firms, and control over production and markets, at the same time that labour and labour relations are restructured at home. Some of the characteristics of the Mozambican economy, such as the high import dependence of, and low export sensitivity to, investment and growth, have favoured the direction of dominant integration that links the two economies. Future developments will depend on what type of economy is developed in South Africa, how Mozambique addresses its weaknesses, and what type of economic integration takes place in the region.

## **INTRODUCTION**

The need to study the economic linkages between the two economies is drawn from the fact that Mozambique and South Africa are major economic partners in the region. Thus, this study's primary goal is to provide a fuller picture of the economic linkages between the two countries and of the opportunities for, and threats to, greater economic integration between the two economies, based on existing data. The study identifies sources of data and of

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analysis of the linkages between the two economies (bibliographic references), as well as areas where new primary research is required.<sup>2</sup>

This paper is organized into four main sections, namely: a brief historical background to the understanding of current trends and patterns of economic linkages between South Africa and Mozambique; an analysis of such current trends and patterns based on descriptive data; an identification of key developments that may shape future linkages; and a final section that draws conclusions regarding the analysis of strengths and weaknesses for future and deeper integration of the two economies.

## **BRIEF HISTORICAL BACKGROUND**

Economic linkages between South Africa and Mozambique were developed from as early as the late XIX and early XX centuries. They have been shaped by four major dynamic factors: the regional strength of the South Africa economy; the weaknesses and public policy options of the Mozambican economy; the international weakness of the South African economy; and the dominant role of the minerals-energy complex around which most of the political, social and economic dynamics of capital accumulation in South Africa is structured.<sup>3</sup> These linkages were initially based on migrant labour and transport services; and, from the 1960s, were extended to trade and investment.

### **Migrant Labour**

The initial forms of economic integration were based on labour migration and transport services. In order to keep labour abundant, cheap and socially disorganised, South African mineral capital developed a regional labour strategy, which resulted in massive recruitment of migrant labour from all over Southern Africa to work in the mines. In Mozambique, the region below the parallel 22 (approximately South of Save river) was defined as a labour reserve for the South African mines, in particular for the gold mines. South African mining capital became the single most important employer of Mozambican wage labour, employing an average of 110,000 migrant workers (25% of industrial employment in Mozambique) per year in the first half of the 1970s.<sup>4</sup> Moreover, in the late 1960s and early 1970s, total income

<sup>2</sup> See DfID-SA. 2002. Terms of reference for a study on the economic linkages between South Africa and Mozambique.

<sup>3</sup> See, for example, Castel-Branco, CN. 2002. "An investigation into the political economy of industrial policy: the case of Mozambique". Unpublished PhD thesis. School of Oriental and African Studies, SOAS (Univ. of London): London; Centro de Estudos Africanos (CEA). 1979a. "Os mineiros Moçambicanos na África do Sul". CEA (Univ. Eduardo Mondlane): Maputo; Fine, B. 1997a. "Privatisation and the restructuring of state assets in South Africa: a strategic view". National Institute for Economic Policy (NIEP) Occasional Paper 7 (March): Johannesburg; Fine, B. 1997b. "Industrial policy in South Africa: a strategic view". NIEP Occasional Paper 5 (April): Johannesburg; Fine, B. and Z. Rustonjee. 1996. "The political economy of South Africa: from minerals-energy complex to industrialization". West View Press: London; First, R. 1983. "Black gold". Harvester Press: London; Haarloy, J. 1997. "Regional cooperation and integration within industry and trade in Southern Africa". Ashgate: Aldershot.; Roberts, S. 2000. "The internationalisation of production, government policy and industrial development in South Africa". Unpublished PhD thesis. Birkbeck College (Univ. of London): London.; Wuyts, M. 1980a. "Economia política do colonialismo português em Moçambique". Estudos Moçambicanos 1, pp. 9-22 (CEA, Univ. Eduardo Mondlane, Maputo).

<sup>4</sup> CEA. 1979; Instituto Nacional de Estatística (National Statistics Institute). "Anuário Estatístico" (Statistics Yearbook): Maputo (various years); Wuyts, M. 1980a and 1989. "Money and Planning for Socialist Transition: the Mozambican Experience". Gower: Aldershot.

accruing to migrant workers was one and a half times higher than total income from commercial agricultural production in the South of Mozambique. The deferred component of migrant workers wages (one third of total wages) was three times as high as income from family farms.<sup>5</sup> Thus, in addition to being the largest employer of wage labour in Mozambique, South African mines were also, by far, the most important source of income and finance for the agricultural sector in the South of Mozambique.<sup>6</sup> Finally, the “gold business” associated with migrant workers’ deferred wage was a very significant contribution to balancing the current account that would otherwise have been systematically negative.<sup>7</sup>

In the mid 1970s, South Africa reduced the number of Mozambican migrant workers from 118,000 in 1975 to 41,300 in 1977.<sup>8</sup> This move by the South African government and mineral complex not only created a large number of unemployed workers in Mozambique (that resulted from the combination of those who lost their jobs and the new entrants into the labour market who could not find a job). It also led to a profound crisis of accumulation of the agricultural sector that became starved of finance.<sup>9</sup> The sudden collapse in the number of workers recruited and the unilateral elimination of the “gold business” by the South African government also created severe current account pressures. On the one hand, the value of the workers’ remittances declined by the combined effect of the fall in recruitment of labour and the elimination of the gold business. On the other hand, the crisis of accumulation in the agricultural sector increased imports of food, particularly cereals, and reduced the production of exportable goods. The migrant labour had created a mode of accumulation and production of surplus. The collapse of job opportunities made this mode of accumulation crumble.

### *Transport system*

The transport system that links South Africa and Mozambique was originally developed around the minerals-energy complex in South Africa. On the one hand, it was built to enable the transportation of thousands of migrant workers recruited to the mines of South Africa. On the other hand, part of the finance to build the system was tied to the minerals-energy complex. Finally, the minerals-energy complex became one of the major beneficiaries of the system of the Port of Maputo for its imports and exports. This system of railway and port become the second largest employer of Mozambican workers. The transport system of the

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<sup>5</sup> See Castel-Branco, C.N. 1994. “Problemas estruturais do desenvolvimento agrário”. in Castel-Branco, C.N. (ed.) “Moçambique: Perspectivas Económicas”. Univ. Eduardo Mondlane e Fundação Friedrich Ebert: Maputo; and Wuyts, M. 1981. “Camponeses e economia rural em Moçambique”. Relatório 8. CEA/UEM: Maputo.

<sup>6</sup> See, for example, Castel-Branco 1994; CEA. 1979a, O’Laughlin 1981. “A questão agrária em Moçambique”. Estudos Moçambicanos 3 (CEA/UEM): Maputo.

<sup>7</sup> CEA. 1979a. The “gold business” resulted from the fact that when labour migration to South Africa started on a systematic and controlled manner, it was agreed between the Portuguese and the South African governments that approximately one third of the miners’ wages would be paid to the Portuguese colonial administration and the workers would only receive this money on return to Mozambique. The agreement also stated that the deferred wages would be paid in gold, and the gold/Rand exchange rate was fixed. Thus, the colonial administration received gold and paid the deferred wages to the workers in Mozambican escudos. On top of this, the world price of gold appreciated significantly over time, which allowed the Portuguese administration to make a profit based on the differential between the world price of gold and the price of gold that had been fixed in the agreement with the South African authorities.

<sup>8</sup> See INE. various issues and Wuyts. 1989.

<sup>9</sup> See Castel-Branco. 1994; CEA. 1978. “Relatório sobre o desemprego em Maputo”. CEA/UEM; Maputo; 1979a; and 1979b. “O desemprego e a sua ligação com o campo”. CEA/UEM: Maputo.

Port of Maputo was also the largest source of foreign currency for Mozambique, and may have contributed as much as 40% of total export revenue of the country. Moreover, net foreign currency income resulting from transport services, together with net workers' remittances, kept the overall balance of payments in equilibrium.<sup>10</sup>

### *Trade and investment*

Finally, the economic linkages between South Africa and Mozambique were also developed around trade and investment. Trade involved traditional and highly concentrated exports to South Africa (mostly prawns and oil products); and South African exports of equipment, raw and intermediate materials, accessories and parts, and a variety of consumer goods to meet the fast growing demands of an increasing urban population and booming manufacturing sector. By the early 1970s, South Africa was the second larger trading partner of Mozambique, just below Portugal.

Prior to the current flow of foreign direct investment (FDI) into Mozambique, large-scale South African FDI took place in association with two main processes. One was the building of the large, hydroelectric Cahora Bassa dam (HCB) over the Zambezi River in the province of Tete, in the late 1960s – the South African government is one of the three current shareholders of the dam. The other one, from early 1960s, was associated with three main factors: the restructuring of labour and industrial relations in Mozambique as a result of political and military pressures to eradicate forced labour; the need for expansion of industrial production as a result of economic opportunities and political pressures; and the insistence by the Portuguese administration on financial austerity and financial autonomy for the colonies, because of the fiscal difficulties faced by the Portuguese state. Whereas the first two factors demanded significant levels of investment in new capacity and modernisation of existing assets, the third prevented such an investment program from being implemented. The answer given by the colonial administration to this dilemma was the adoption of the policy of “open doors” to foreign direct investment. Of the 13 industries already installed in Mozambique up to the early 1960s, when the open door policy was adopted, only 2 had been developed through foreign (non-Portuguese) participation. Of the 12 developed after the adoption of the open door policy, 4 involved joint ventures and 8 required foreign technical assistance. South African capital participated in many of these industries, particularly in the larger ones associated with the minerals-energy complex: Maputo's oil refinery, fertilizers, HCB, metal smelters.<sup>11</sup> Directly (in the South African mines and related industries in Mozambique) and indirectly (transport services), the South African minerals-energy complex employed about 40% of the industrial workforce of Mozambique.

So far, it has been argued that the integration of the two economies has depended on identified economic and political pressures, agents and the relationship between them. How have these forms of integration evolved? Have they changed? If so, why and which new processes and dynamics have emerged? These questions are discussed in the following sections, which analyse current trends of economic linkages.

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<sup>10</sup> CEA. 1981. Wuyts 1989 and 1980b. “A statistical note on post-independence economic development in Mozambique”. CEA/UEM: Maputo.

<sup>11</sup> For a detailed, historical account and economic analysis of these processes, see Castel-Branco. 2002; Pereira Leite, J. 1989. “La formation de l'économie coloniale au Mozambique – pacte coloniale et industrialisation”. Unpublished PhD thesis. École des Hautes Études en Sciences Sociales: Paris.; Wield, D. 1977. “Some characteristics of the Mozambican economy particularly relating to industrialization.” Mimeo. CEA/UEM: Maputo; Wuyts 1980a.

## CURRENT TRENDS AND PATTERNS OF ECONOMIC LINKAGES

### Overall Trends and Patterns

Current, overall trends and patterns of economic linkages between South Africa and Mozambique continue to reflect two fundamental dynamics of the past: (i) the dominant role of the minerals-energy complex of South Africa in shaping the economic linkages and even the structure of economic development in Mozambique; and (ii) the absorption of the Mozambican economy as part of a much stronger dynamic process of capital accumulation in South Africa.

There are, however, two major changes with respect to the past history, which have resulted from the political economy of the regional and world economies. The first change is that regional labour policy is no longer the dominant form of influence of South African capitalism in the region. Trade and foreign direct investment have assumed the driving roles of regional expansion of South African capitalism, as part of the Spatial Development Initiatives and other public and corporate strategies aimed at “...*generating long-term, internationally competitive growth and development, and at restructuring the apartheid space economy.*”<sup>12</sup> This will be shown through the analysis of data in the following sections.

The second change to the past historical pattern and trends, closely related to the first one, is that South African corporations are globalizing at relatively high speed, and the Southern African region is a “natural” economic space to internationalise into and acquire experience of globalisation. This process has been helped by the South African government’s policies towards large corporations, in particular in the minerals-energy complex.<sup>13</sup>

Therefore, it is only natural that control over production sites, trade and capital flows has become more important than flows of migrant labour and transport services. Political and economic processes and pressures that are not fully controlled by the South African large corporations have also forced this change. One of such process and pressure comes from organised labour in South Africa, and is associated with job protection and protection of trade union bargaining power. The second is related to the restructuring of the minerals-energy complex, in particular the mining industry, associated with recent trends in the price and competitive conditions in the world market, as well as with the need for technological progress associated with changing endowment conditions of the mines.

### Migrant Labour

Since 1977, when the number of legal Mozambican migrant miners in South Africa was reduced from 118,000 (in 1975) to 41,300 (in 1977), legal labour migration has varied between 30,000 and 48,000 workers at any one time. Since the mid 1990s, the trend has been towards a further decline in the employment of migrant miners from Mozambique, at an average of about –2% per year. This is due to the restructuring and rationalization of the gold mines, including the closure of some of them. The value of workers’ remittances to Mozambique and the share of the remittances in total foreign currency earnings of the

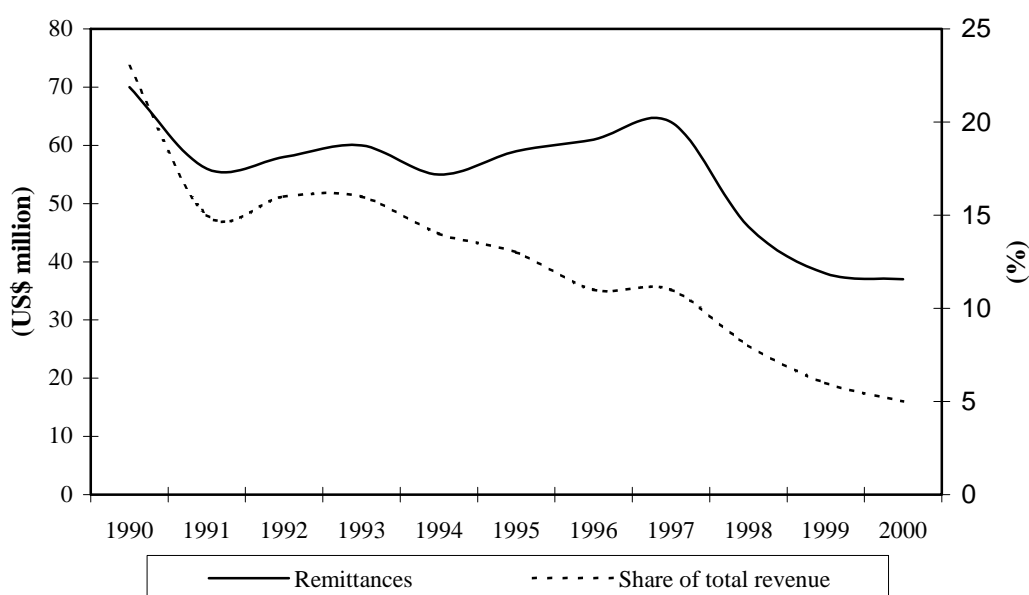
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<sup>12</sup> Industrial Strategy Project (ISP). 1998. “Promoting industrial development in Southern Africa through regional integration and co-operation”. Univ. of Cape Town (Regional Research Project), pp. 12. The process of restructuring the linkages between South African capitalism and the region was accelerated after the end of apartheid in South Africa.

<sup>13</sup> See, for example, Fine and Rustomjee 1996, and Roberts. 2000.

Mozambican economy have also fallen. Between 1990 and 2000, workers' remittances fell from US\$ 70 million to US\$37 million, and the remittance's share of foreign currency earnings (excluding grants) fell from 23% to 5% (graph 1). Furthermore, the outflow of remittances from foreign workers established in Mozambique to their countries (US\$ 35.5 million) is, in 2000, almost equal to the inflow of migrant workers' remittances to Mozambique. Therefore, remittances from migrant workers have ceased to be a crucial source of net foreign currency earnings to Mozambique.<sup>14</sup>

**Graph 1: Mozambique: Migrant workers' remittances - value (US\$ million) and share of total revenue in forex (%)**



Source: INE. various issues. *Statistic Yearbook. Maputo.*

Nonetheless, it should be acknowledged that migrant labour continues to be the single most important source of employment in Mozambique, and the number of legal Mozambican mine workers in South Africa exceeds total employment in the manufacturing sector in Mozambique.<sup>15</sup> Additionally, income from migrant work continues to be the most important source of finance for the family agricultural sector in the South of Mozambique. Also, it is interesting to notice that many Mozambican entrepreneurs that emerged in late colonialism and after independence initiated their process of accumulation by working in the mines. In the South of Mozambique, particularly in the rail and transport services, construction, heavy metal-engineering and other industries that employed skilled or semi-skilled labour, most workers used to be migrant workers who learned their skills and industrial experience labouring in the mines at some point of their working life.

Due to the sequence of wars for the national liberation of Zimbabwe, against apartheid and with Renamo (1976-1992), and the general weaknesses of the economy, Mozambique was not

<sup>14</sup> Data from INE. various issues.

<sup>15</sup> Statistics about migrant labour are not readily available and complete. Apart from the fact that they do not take into account informal and illegal migration, disaggregated data by sex, age, skills, etc., is only available as raw data that needs to be collected from different sources and consolidated.

able to generate the number and quality of jobs required to replace official labour migration as a source of employment, skills, industrial experience and finance for the agriculture sector. Illegal migration and aid have only partially mitigated the sharp and systematic decline in official labour migration.

In Mozambique, the competition for a job in South Africa is fierce<sup>16</sup> because the supply of local, formal jobs paying reasonable wages in Mozambique is scarce, and there is no sustainable and systematic access to financial facilities that could support rural development. In the South of Mozambique, most men are absent from the family farm for most of the year: at least one third of them may be either in South Africa (legally or illegally) or trying to get a contract in South Africa, while the others are seeking wage work elsewhere around the urban areas and feeding the large army of urban unemployed.

Therefore, the decline in the number of migrant workers and in the contribution of their remittances to the balance of payment has not reduced the economic importance of migrant labour for Mozambique. What it has done is to reduce the role of migrant labour as the mechanism by which the minerals-energy complex of South Africa integrates the economies in the region. It is important to acknowledge the dynamic role played by labour migration in terms of developing national capacities (financial, entrepreneurial, skills and industrial organization and experience), because for the last two decades the trends have been showing that alternative sources of economic energy and synergy are required to replace the contracting market for migrant labour.

### **Transport Services**

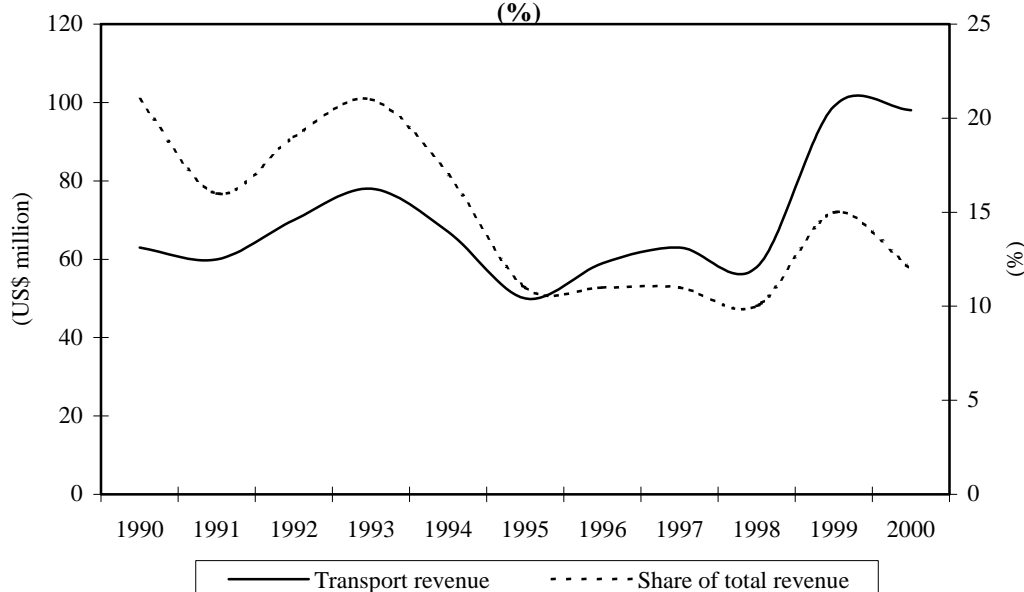
For most of the 1980s and 1990s, the balance of services of Mozambique has been negative. This is a clear change from the situation in the 1960s and 1970s, when the balance of services was responsible for keeping the overall balance of payments in equilibrium, mainly as a result of net foreign currency gains due to the transport service and workers' remittances. Up to the early 1990s, the balance of services became increasingly negative because of the collapse of the transport system (due to the war) and the increase in the size of interest on debt. After the war, following the rehabilitation of the main rail systems to and from hinterland countries (Maputo, Beira and Nacala corridors),<sup>17</sup> and the construction of the Maputo-Witbank toll road, the transport system, in particular its rail and port component, regained its position as a very important source of foreign currency to Mozambique. Over the last decade, the contribution of the transport system to forex earnings increased by one third, from US\$ 63 million in 1990 to US\$ 98 million in 2000. However, the transport revenue share of total forex earnings to the economy fell by almost 43% (graph 2).

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<sup>16</sup> This explains the estimated large number of illegal migrant workers from Mozambique in South Africa. Statistics show that the number of legal migrant workers outside the mining industry is insignificant (less than 2% of total legal migrant workers). However, 93% of total illegal migrant workers seeking legalization of their work permit are working in the farm industry in South Africa. See INE. various issues.

<sup>17</sup> Maputo, Beira and Nacala corridors cover Swaziland, South Africa, Zimbabwe, Malawi and Zambia. South Africa and Zimbabwe are responsible for approximately 85% of the traffic through the Mozambican rail system, and 85% of revenue that accrues to the system. See Wuyts 1989 and 1980b; and INE. various issues.

**Graph 2: Mozambique: Contribution of transport to foreign currency earnings - value (US\$ million) and share of total foreign currency earnings (%)**



Source: INE. various issues. Statistics Yearbook. Maputo.

The opposing trends illustrated in graph 2 are indicative of two major conclusions regarding the system of transport and the integration of the South African and Mozambican economies. As economic integration and level of economic activity between the two countries increase, foreign currency (forex) earnings from transport revenue are likely to increase because cross border trade and investment are transport-intensive activities. However, as new export capacities enabled by foreign investment are created and become operational, transport's share of foreign currency earnings is likely to fall.

It should be mentioned that there are ongoing economic processes that may have a significant impact on the structure of the transport system and its contribution to linking the South African and the Mozambican economies. One of these processes is the possible traffic diversion from the rail to the road system due to the efficient operation of the Maput-Witbank toll road, as opposed to existing severe problems of security and safety that affect the rail system. Such a change, if it happens, would diversify transport services available but would eventually reduce further the role of transport services as a net foreign currency earner for the Mozambican economy.

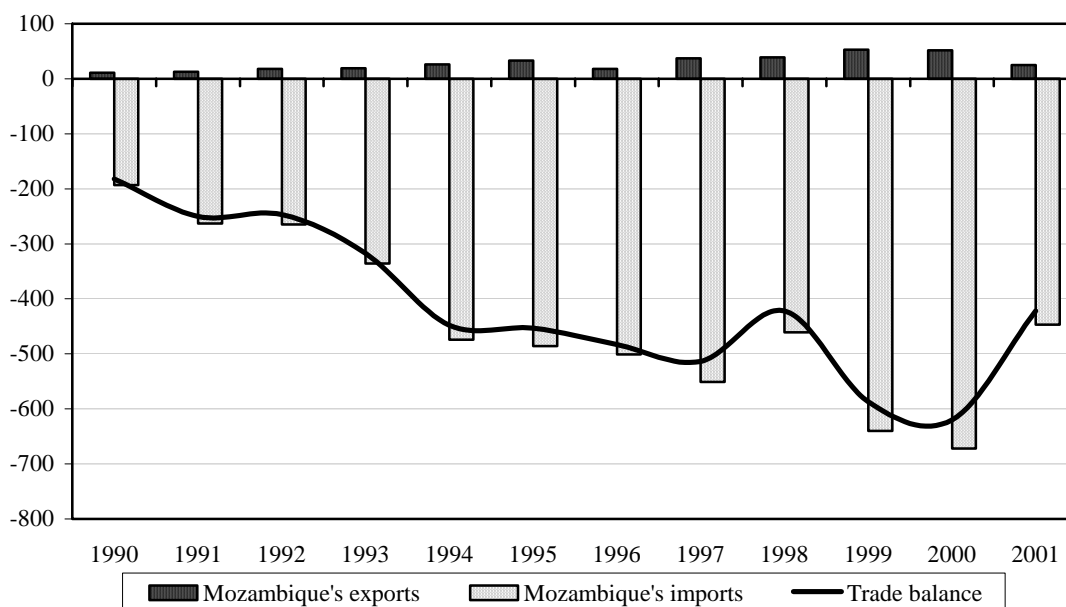
### Trade and Notes about the Current Account

South Africa has become the major trading partner of Mozambique. Approximately 40% of Mozambique's imports and 20% of exports are from and to the South African economy.<sup>18</sup> Mozambique runs a large trade deficit vis-à-vis South Africa (graph 3).

<sup>18</sup> Data about trade between Mozambique and South Africa (INE. various issues and tips.easydata.co.za) are not accurate and consistent all the time. Nonetheless, the data available gives a clear picture of the trends.



**Graph 3: Trade between Mozambique and South Africa (US\$ million)**



Sources: INE. various issues. Statistics Yearbook; and tips.easydata.co.za

The structure of trade between the two countries reflects the dynamic forces that shape economic linkages between Mozambique and South Africa, namely the regional dominance of the South African economy; the role of the minerals-energy complex and the weakness of the Mozambican economy. The dominant exports from South Africa to Mozambique are mineral products (mostly oil and other fuels); prepared foodstuffs (mostly cereals and beverages);<sup>19</sup> chemical products; base metals (iron and steel); energy; and vehicles, equipment and parts. Together, the core and associated minerals-energy industries represent 60% of South African exports. Mozambique's main exports to South Africa include energy; prawns; cotton; construction equipment; and food industry residues.

There are two important trading statistics to mention. First, trade in energy between the two countries, particularly Mozambique's imports of energy from South Africa, increased very sharply in the last two years, mostly due to the establishment of the very large aluminium smelter, Mozal, in Beluluane, province of Maputo.<sup>20</sup> Although energy exports are a small proportion of South African exports to Mozambique, the energy trade is crucial within the strategy of expansion of South African capitalism. On the one hand, ESKOM controls the supply of electricity to Mozal, which consumes more energy than the rest of Mozambique. On the other hand, Mozal has enabled a dynamic and structural link between the electricity grids of South Africa, Mozambique and Swaziland through Motraco, a joint venture company that supplies South African energy to Mozal. Moreover, the 2,500 Gwh of energy that ESKOM is

<sup>19</sup> A significant change in the structure of South African exports of prepared foodstuffs to Mozambique has happened. Beer used to be the single most important component of this group but its share of the group has declined very significantly in the last few years, in line with the penetration of SAB in the Mozambican beer industry by acquiring all of the three major breweries. Thus, trade has been replaced by South African direct investment. Hence, in parallel with falling exports of beer from South Africa, the FDI driven beer industry has become one of the fastest growing industries in Mozambique.

<sup>20</sup> Mozambique's imports of energy from South Africa increased 20 times since Mozal was established.

exporting to Mozambique are an entry point for further South African involvement in the energy sector in Mozambique by strengthening its “big partner” position in projects linked with two large hydroelectric dams, Cahora Bassa and M’panda Uncua, and in negotiating contracts for supplying electricity to other, energy-intensive mega projects in Mozambique, such as heavy sands and iron and steel, in Gaza and Maputo respectively.

Second, a very large component of trade between Mozambique and South Africa over the period 1998-2000 was construction equipment, accessories and parts that are associated with the construction of the Maputo-Witbank toll road.<sup>21</sup> Part of the equipment and accessories needed to build the road on the Mozambican side were supplied by Mozambique. Therefore, these items are registered as Mozambique’s exports to South Africa, but in fact Mozambique had to import them.

Mozambique’s gas pipeline linking the gas reserves in Pande (Inhambane, Mozambique) with the gas-to-liquid refinery in Mpumalanga (South Africa) is going to introduce yet another change in the direction and composition of trade between South Africa and Mozambique. Large flows of gas from Mozambique are likely to make a difference in Mozambique’s exports and trade balance vis-à-vis South Africa, “other things being equal”.

However, given the large differences in economic capacity between the two countries, the operation of any mega project in Mozambique is likely to increase Mozambican imports of electricity,<sup>22</sup> equipment, accessories, parts and investment services. For example, in line with the sharp increase in FDI inflows to Mozambique, imports have increased by almost 50%, and the size of Mozambique’s trade deficit has been mostly determined by what happens to investment, particularly FDI. If an investment project is mainly export-oriented (like Mozal), the size of the trade deficit falls only slightly as the net contribution of any large export-oriented project to exports is reduced by the sheer size of the demand for imports. If the project is not mainly export-oriented (like sugar, beer, cement), the trade deficit increases because a small export share of output cannot compensate for the import dependence of output.<sup>23</sup> As FDI inflows to Mozambique increase, “investment services” and “other service expenditure” have become the major determinants of the size of the deficit of the balance of services.<sup>24</sup> Therefore, “other things are not equal”.

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<sup>21</sup> This road is part of the spatial development initiative (SDI) for the Southern region, and of the expansion of the minerals-energy complex.

<sup>22</sup> At the least in the foreseeable future.

<sup>23</sup> See Castel-Branco, CN. 2002., and the following section of this paper for a statistical analysis of the relationship between investment and the trade deficit in Mozambique. His data analysis shows an almost symmetric relationship between investment and the trade deficit; and between the size of the capital account surplus and the trade deficit. Further, he demonstrates that this relationship is caused by the high elasticity of imports with respect to investment (due to weak investment capacities of the economy and poor inter- and intra-industry linkages), and low elasticity of export with respect to investment (because of weak and concentrated productive and export capacity of the economy). He also discusses that export-oriented mega projects, such as Mozal, Iron and Steel, Heavy Sands and Pande (gas) will increase the export sensitivity to investment but unless the growth and development base are diversified, the Mozambican economy will become a simple extension of the minerals-energy complex of South Africa and growth in other areas will be precluded because of its destabilising effect on the balance of trade.

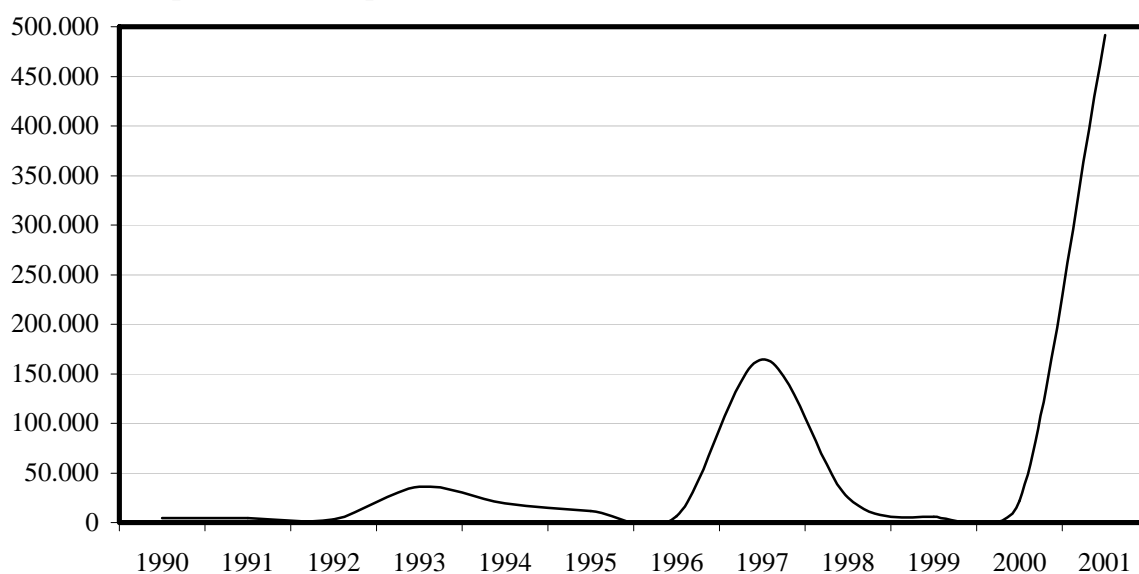
<sup>24</sup> See INE. various issues. Statistics Yearbook.

## FDI and Notes about the Balance of Payments and Employment

### Description of existing FDI

Foreign direct investment (FDI) between South Africa and Mozambique is a **one-way flow**, in the direction of Mozambique. South Africa has become the largest investment partner of Mozambique. South African investors are involved in 300 out of 1,607 investment projects approved between 1990 and 2001. However, the importance of South African investment in Mozambique is much bigger than its share (19%) of the number of projects. South African investment represents 35% of FDI inflows to Mozambique, and the projects with South African participation absorb 85% of FDI inflows, 35% of national direct investment, and 75% of total investment (compare graphs 4 and 5).

**Graph 4: Mozambique - inflows of FDI from South Africa (US\$ thousand)**

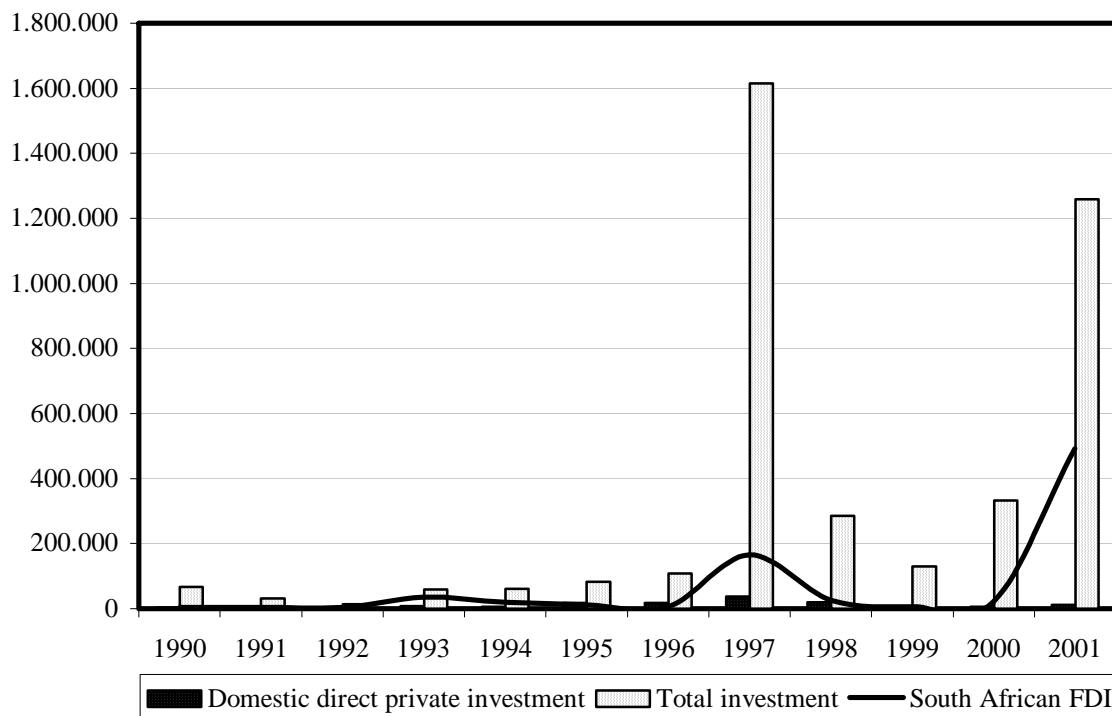


*Source: Estimated by the author, based on project data from CPI.*

South African FDI is mainly involved with the largest projects ever developed, or to be developed, in Mozambique: Mozal 1 and 2 (500,000 ton of aluminium per year, total cost of US\$ 2.4 billion); gas Pipeline Temane-Secunda (Pande gas), US\$ 1 billion; Limpopo Heavy Sands, US\$ 1.2 billion; Maputo Iron and Steel (in serious difficulties after the collapse of Enron), US\$ 1.1 billion; Beira Petrochemical complex, US\$ 1.7 billion; Maputo Corridor (infra-structures in Mozambique), US\$ 1 billion; Motraco (electricity supply to Mozal, seeking other customers), US\$ 140 million. In addition to minerals-energy projects, South African investors control sugar (3 out of 4 sugar estates), beer (3 out of 4 breweries), soft drinks (all bottling plants), large cereal milling, and most of the tourism facilities.<sup>25</sup> They have also moved into various agro-industry projects such as cashew processing, and coffee.

<sup>25</sup> Tourism is becoming an increasingly important area of South African investment in Mozambique. On the one hand, South African investors control, or participate in, almost all investment projects in the sector that have some significance. On the other hand, the amount of South African investment in tourism is very large and growing, and this sector may soon become one of the dominant directions of South African investment in Mozambique, second only to minerals-energy related projects. Apart from

**Graph 5: Mozambique - South African FDI and total investment with South African participation (US\$ thousand)**



*Source: Estimated by the author, based on project data from CPI.*

Some of the main South African companies involved in the minerals-energy investment are Billiton and IDC (major partners in Mozal); Sasol (Pande gas reserves, pipeline Temane-Secunda, and Beira Petrochemical complex); ESKOM (Motraco, Cahora Bassa, M'Panda Uncua); Corridor Sands and Southern Mining (Heavy Sands).

Thus, South African FDI in Mozambique is heavily skewed towards the core and periphery of the **minerals-energy complex**, in partnership with other international corporations working in these sectors (like Mitsubishi, Japan; and WMC-mining, Australia). The South African minerals-energy complex involvement in Mozambique is not only reflected in the concentration of investment in large minerals-energy projects, but also in cross-sectoral investment. Obvious cases are Anglo-American investment in cashew processing and other agro-industry projects; Tongat-Hullet (which used to be involved in non-precious metals) massive participation in the sugar industry; community development in Beluluane being heavily dependent on Mozal; Industrial Parks being developed around anchor projects that, invariably, are from the minerals-energy complex (Mozal and Iron and Steel, in Maputo, Petrochemical complex, in Beira); Maputo Corridor being concentrated in infra-structure development directly linked with the mega projects of the minerals-energy complex. The least obvious cases are related to the extent of financial penetration by the minerals-energy complex into the South African corporate structure, which is reflected on the purpose and

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potential net foreign currency gains to the Mozambican economy, neither minerals-energy nor tourism projects develop other positive and significant linkage effects in Mozambique.

ability of firms and industrial corporations to invest and expand in sectors not located at the core of the minerals-energy complex.<sup>26</sup>

Another important aspect of the dynamics of South African FDI in Mozambique is the **regional and international strategy** that is behind decisions of investment. To a very large extent, industrial policy in South Africa targets the region and globalisation of large South African firms and industrial corporations.<sup>27</sup> This is reflected in the strategies of South African corporations in Mozambique: Sasol and ESKOM's expansion of their control over energy sources, production and distribution; the location of Mozal in Mozambique also as part of the process of regional expansion of the energy sector;<sup>28</sup> Sasol, IDC and Billiton's willingness to engage in "oligoplistic wars" to force the withdrawal of Enron from Pande and iron and steel, and Kaiser from aluminium;<sup>29</sup> SAB's commitment to investment, production and control over the beer industry in the region;<sup>30</sup> SAB's willingness to engage in predatory behaviour to acquire Laurentina, the second largest and internationally more famous brewery in Mozambique, thus killing competition and rationalising the brewery industry in Mozambique; Tongat-Huellet and Illovo's decisions to invest in sugar in Mozambique, each one having taken such decision partly as their response to the regional strategy of the other one; South African's move towards the Zambezi Valley, which is very rich in energy and mineral resources, and is naturally endowed for the development of agro-industries.

Understanding the internationalisation strategies of South African investors is important for several reasons: to understand the trends, future directions, structure, dynamics and opportunities of regional foreign investment; to develop strategies of selective incentives (rather than generalised, redundant and costly systems) to attract desired investment; to identify the bargaining position of Mozambique vis-à-vis specific foreign investment projects; to develop and implement strategies that maximise transfer of capacities, linkages and other dynamic gains, to the Mozambican economy, linked to foreign investment; and to maximise the balance of payment gains from foreign investment without compromising diversification of productive and trade capacities.<sup>31</sup> This is an area of important research that can add significant value to the process of economic and industrial policy making in the region, including the design of more effective and less costly incentive schemes for investment.

### *Economic Impact of FDI*

What is the economic impact of FDI from South Africa on the economies of both countries? The impact of FDI differs according to whether the economy is home or host to FDI. In the case under analysis, South Africa is home and Mozambique host to FDI, given that FDI, in this case, is a one-way flow.

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<sup>26</sup> For a detailed analysis of the minerals-energy complex of South Africa and its penetration of the South African corporate, see Fine and Rustomjee. 1996.

<sup>27</sup> See Fine 1997b, Fine and Rustomjee 1996, Roberts 2000.

<sup>28</sup> See Castel-Branco 2002.

<sup>29</sup> See Castel-Branco 2002.

<sup>30</sup> Mike Muller, managing director of Mac-Mahon, producer of the 2M, one of the largest breweries bought in Mozambique by SAB, argues that SAB's massive commitment to Mozambique is part of the regional strategy of expanding control over production sites to overcome trade and other barriers. He also argues that, as part of its regional strategy, SAB would not let any of its factories in the region to go bust, even if the general economic environment in any country of operation worsens.

<sup>31</sup> See Castel-Branco 2002 and 2001.

The **impact of FDI in the home country** depends on how extra profits and expanded access to resources and markets are used by the corporations undertaking investment, and whether economic pressures resulting from investment abroad expand domestic productive capacity and employment. Detailed and systematic data on these two processes are not readily available and require very specific research not only of the corporations involved but also of the mechanics of the South African economy. This is another area of research that would add value to industrial and competition policy making in South Africa. However, there is circumstantial evidence about ongoing economic processes that may be indicative of real impacts of South African FDI on the home economy.

One piece of evidence is that South African corporations are moving abroad, or trying to, and this is becoming a dominant business strategy target. This tendency might be explained by the fact that the minerals-energy complex needs to develop vertical integration at world level; by a strategy of South African firms to reduce their sensitivity to public policy; by a more orthodox business strategy that identifies and takes advantages of opportunities to expand in the region; or by a rational response of South African corporations to massive privatisation programs undertaken elsewhere in Southern Africa. Whatever the reasons might be, it is apparent that South African corporations are investing more abroad than at home, and using more of their profits made abroad to finance internationalisation rather than expansion at home. This may have implications in terms of rationalisation of production at home, which might have a negative impact on employment. The internationalisation strategy also has obvious implications for the South African financial system, closely linked with large manufacturing corporations (particularly those that belong to the minerals-energy complex), as finance is channelled to large, capital intensive and narrowly concentrated investment of South African firms abroad. Such business strategies receive support from the South African government through various forms of incentives (fiscal incentives, trade, investment and energy related subsidies, etc.). Further research into the extent of the involvement and support of public policy and the financial system with the drive of South African corporations to internationalise would be important for industrial and competition policy making.

This trend, if it is real, may imply that the growth of South African corporations is not creating job opportunities at home, and is resulting in net a drain of capital with implications for the size of the deficit in the capital account and the balance of payments.<sup>32</sup> More data and specific research would be required to match South African FDI in Mozambique with any of these impacts. However, given that South African FDI in Mozambique is not very large relative to the scale of the South African economy (which is more than 40 times larger than the Mozambican), it is likely that even if the hypothetical impacts described are real, they are not very significant, or at least not as significant as the impacts of internationalisation of South African firms to much larger economies and markets.

The other trend is that South African FDI that moves into the Southern African region may create two dynamic effects with a positive impact in the South African economy. On the one hand, the demand for specialised investment and industrial services and goods increases, which may develop a multiplier effect from FDI projects back into the South African economy by creating new opportunities for investment at home. On the other hand, trade, particularly exports from South Africa into the region, also increases and helps to create new investment opportunities in South Africa. There is significant evidence linking the development of small and medium firms in South African regions along the Mozambican border with the emergence of large FDI projects in Mozambique. Data from Mozal shows that, apart from electricity, South African firms supply about US\$ 100 million per year in goods and services imported by Mozal. The construction and operation of the Maputo-

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<sup>32</sup> See Fine 1997b, Fine and Rustonjee 1996, and Roberts 2000.

Witbank toll road, the rehabilitation of the Maputo and Matola Ports and the construction of the Temane-Secunda pipeline rely heavily of South African firms.

Thus, whether the internationalisation of South African firms through FDI in Mozambique has a positive or negative impact on the South African economy, and the type of impact and mechanism by which it occurs, depend on the type of linkages that FDI develops back into the South African economy. Significantly more detailed data would be required to perform an adequate analysis of this point.

The **impact of FDI on the host country's economy** depends on five fundamental indicators, namely: direct and induced impact on investment, economic growth, employment, transfer of capacities and the overall balance of payments. To evaluate the impact on investment it is necessary to take into account the net contribution, not only the scale, of FDI.

The *net contribution of FDI to investment* results from the balance between the amount of FDI actually made (excluding simple transfer of property from domestic to foreign control without involving additional investment),<sup>33</sup> investment induced by FDI (as new opportunities or linkages are created), public investment enabled by fiscal linkages from FDI, and investment displaced by FDI (as incumbent firms may be displaced by the new entrant).

Available data shows that in Mozambique, FDI represents approximately 27% of total investment and 60% of investment in the manufacturing sector. Between 1997 and 2001, FDI represented about 10% of GDP.<sup>34</sup> These ratios (FDI to investment, and FDI to GDP) are very high if compared to other countries in the world.<sup>35</sup> South African FDI represents 35%, and the projects where it is applied represent 85% of total FDI. Therefore, South African FDI has also induced FDI from other sources – for example, the involvement of IDC and Billiton in Mozal has attracted the partnership with Mitsubishi; Corridor Sands and Southern Mining have attracted WMC to the heavy sands project. South African FDI has also induced lending to Mozambique from foreign banks and other financial institutions, such as in the case of Motraco, Mozal and the sugar industry.

There is no evidence that South African FDI has, on balance, affected domestic private investment very significantly, either by inducing, precluding or displacing it. Linkages between FDI and domestic firms are weak (for example, only 3%-5% of Mozal's purchases come from domestic firms), domestic investment capacity is poor, and most domestic firms, including the majority of the few that have eventually been displaced by FDI, would not have been able to carry on.<sup>36</sup> Given the investment incentive structure in place in Mozambique, which is based on tax holidays and exemptions, most large FDI projects generate very little fiscal linkages. For example, Mozal, which has been given the status of Free Industrial Zone, pays virtually no taxes. Hence, South African FDI is not very likely to induce public investment.

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<sup>33</sup> See United Nations Conference on Trade and Development (UNCTAD). "World Investment Report" (2001, 2000a and 1999); and 2000b. "Capital Flows and Growth in Africa."

<sup>34</sup> See Castel-Branco 2002 and 2001; INE. various issues; and CPI (Investment Promotion Centre). List of investment projects approved between 01/01/1990 and 31/12/2001.

<sup>35</sup> See, for example, UNCTAD 2001, 2000a, 2000b and 1999.

<sup>36</sup> See Castel-Branco 2002; CPI. 1999. "Linkage division – report on 6 month pilot programme" and 1998. "Proposal to develop a linkage programme in Mozambique".

Thus, on the whole, the net contribution of South African FDI to investment in Mozambique is larger than the size of South African FDI, but only because it has induced FDI from other sources and lending from foreign financial institutions.

The *contribution of South African FDI to economic growth and employment* is closely linked to what its net impact on total investment is. Over the last five years, the main contribution to productive growth comes from 15-20 firms of the aluminium, sugar, energy, beer, soft drink, cereal milling and cement industries, of which only cement is not heavily influenced by South African investment. Mozal 1 added 5 percentage points to GDP growth, and the Temane-Secunda pipeline may expand GDP by 15%-20%. Economic growth is spectacular in the year when one of these mega projects starts generating output, but very significantly milder in the subsequent years. The mega projects are driving the Mozambican economy to higher stages of economy activity, but growth is not sustained between mega project cycles.

With the exception of sugar, none of the other major South African FDI projects is labour intensive on a sustained basis. For example, Mozal employed almost 10,000 workers for little more than one year during the construction phase, but its normal operation requires only about 800 workers. Thus, despite FDI, the economy has been losing more jobs than it is creating. On the other hand, workers employed by large, foreign owned firms, particularly by the mega projects, achieve significantly higher levels of productivity than in other firms. For example, it is estimated that productivity per worker in Mozal is 18 times higher than in the average firm in Mozambique.<sup>37</sup> Higher productivity per worker, combined with a significantly more skill intensive and better organised labour force in large, foreign owned firms, results in higher real wages and better working conditions in these firms, when compared to average Mozambican firms.

*Transfer of capacities* to the domestic economy is not automatic because it results from linkages between foreign owned and domestic firms and institutions, and from the ability of domestic firms to absorb and adapt new capacities and to innovate. Transfer of capacities outside foreign owned firms has been very limited in Mozambique for two main reasons. First, South African FDI has been mostly concentrated in projects with high levels of asset and knowledge specificity. Thus, their capacities are not transferable to the economy as a whole. Second, linkages between South African and domestic firms are weak. Domestic firms that have managed to obtain medium-term contracts as suppliers to large projects have been able to upgrade their productive capacity, management and general level of skills, particularly when they have developed partnerships with foreign firms. However, the number of such firms is very small, and they usually are anchored to one large project of primary production, which reduces the scope and opportunity for long-term innovation and development.<sup>38</sup>

The *impact of FDI on the balance of payments* depends not only on net trade gains,<sup>39</sup> but also on the balance between inflows of capital (recorded as FDI in the capital account) and profit repatriation (recorded as “investment related services” and “other services expenditure” in the current account). In Mozambique, as already mentioned earlier, there is a strong relationship between the size of investment and the size of the trade deficit, and between the size of surplus in the capital account and the size of the trade and current account deficits (graphs 4, 5 and 6). This is explained by the low sensitivity of exports to economic expansion and high import dependence of imports, which are associated with the structure of the Mozambican

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<sup>37</sup> Castel-Branco. 2002.

<sup>38</sup> Castel-Branco. 2002.

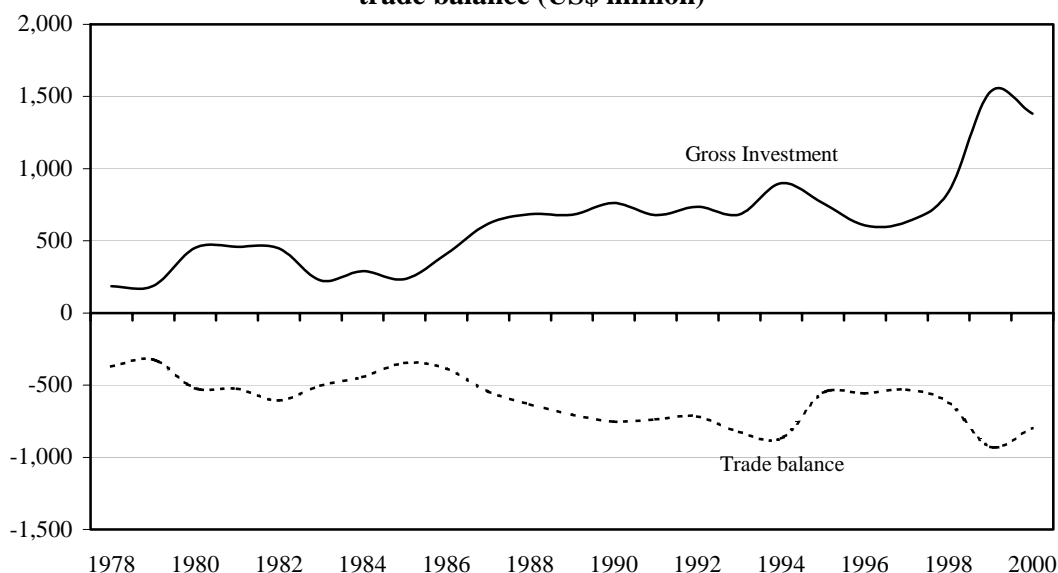
<sup>39</sup> Net trade gains may result from import substitution, export promotion or both. See Fine and Rustomjee 1996; Gore, C. 1996. “Methodological nationalism and the misunderstanding of East Asian industrialization”. UNCTAD Discussion Paper 111 (January).



economy: weak and concentrated productive and export capacity, and underdeveloped intra- and inter-industry linkages. Therefore, the capital account and the trade deficit are linked through the mechanism of investment (graphs 6 and 7).<sup>40</sup>

Export-oriented mega projects, like Mozal and the Temane-Secunda pipeline, will increase the sensitivity of exports to mega project driven economic growth, and the current structure of the symmetric relationship between investment and trade deficit may be changed. However, the economy will continue to be, and eventually will become more, import dependent if mega projects of the minerals-energy type come to dominate the growth strategy in Mozambique. With a very narrow range of primary exports – aluminium, gas, heavy sands – the Mozambican economy, its investment and growth strategy, and its external sustainability may become excessively vulnerable to the (volatile) behaviour of the world market. This raises serious questions about the sustainability and long-term desirability of a growth strategy in Mozambique that is dominated by the minerals-energy complex of South Africa.

**Graph 6: Mozambique - relationship between gross investment and trade balance (US\$ million)**



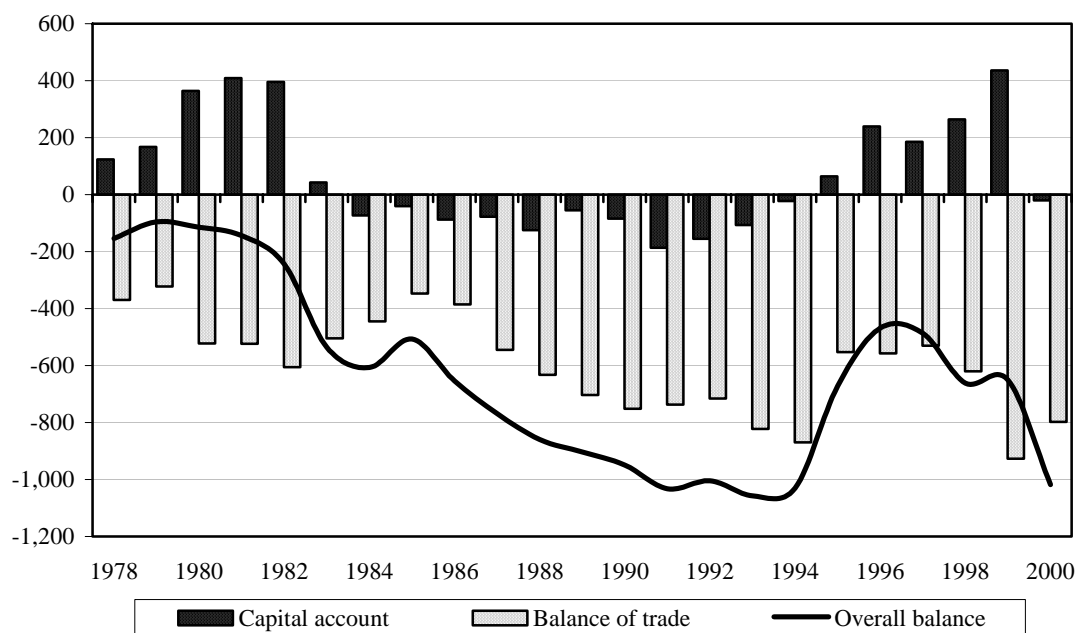
Sources: Castel-Branco. 2002; and INE. various issues. Statistics Yearbook

The overall balance of payment impact of South African FDI in Mozambique depends not only on the trade effect but also on the net capital effect. As part of the investment incentive package made available to FDI, investors are allowed to repatriate profits freely, as long as they register their intention with the Bank of Mozambique. Given that South African FDI is highly concentrated and specialised, it is not very likely that profits will be systematically reinvested in Mozambique on a very significant scale. If all large investors start repatriating

<sup>40</sup> See Castel-Branco 2002. In graphs 7 and 8, the symmetric relationship between the capital account surplus and the trade deficit is broken in the period between 1987 and 1994, and again in 2000. In these periods, investment and imports were mostly financed by grants, which are registered as unilateral official transfers in the current account, as opposed to other forms of capital inflows that are registered in the capital account. Between 1987 and 1994, foreign direct investment was insignificant, the economy had a low degree of credit worthiness, and the macroeconomic stabilisation package prevented Mozambique from borrowing in commercial terms abroad because of the debt crisis. In 2000, the worse recorded floods affected investment negatively and created demand for consumer and investment goods that were financed by flood-related international aid.

their profits, this will be felt very strongly in the balance of payments. If only half of such investors are export-oriented, the effect of generalised profit repatriation will be hugely negative. It has already been mentioned that of the seven most dynamic industries, all of which are dominated by large foreign investors, and all but one involve South African FDI, only one is totally oriented to exports (forthcoming projects, such as the pipeline and heavy sands, will reinforce the export-oriented group). This means that a significant share of profit repatriation may have to be financed by foreign currency generated elsewhere. Data on profit repatriation is not yet readily available for a long enough period to enable a serious analysis of the net capital impact of FDI. This is, certainly, another crucial area of research interest to understand the full economic impact of FDI and help to develop more adequate FDI related policies and strategies in Mozambique.

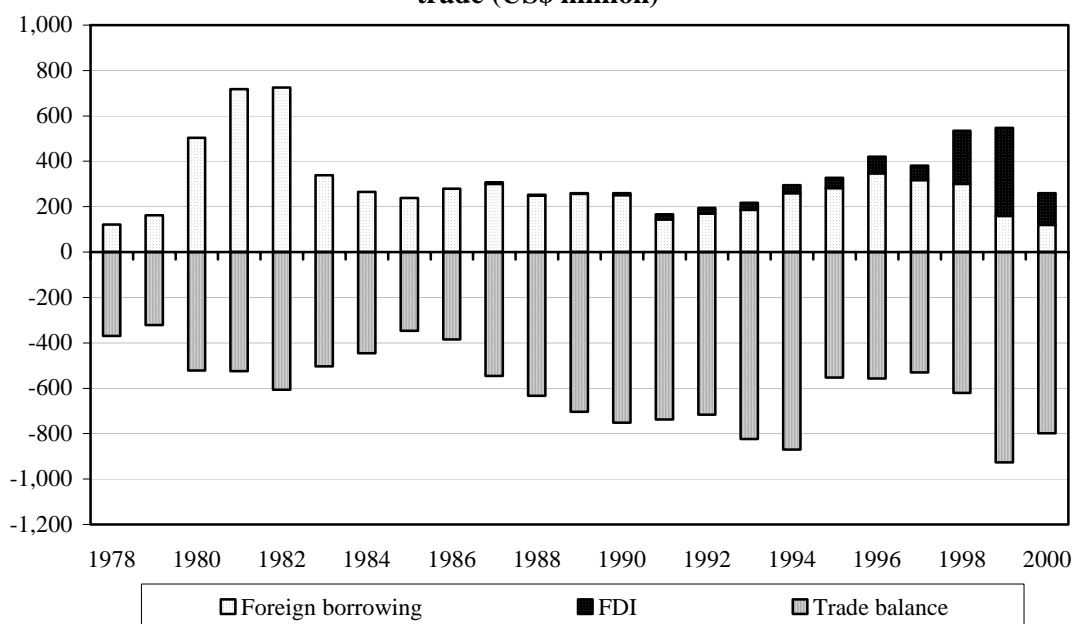
**Graph 7: Mozambique - Relationship between the capital account and trade deficit (US\$ million)**



*Sources: Castel-Branco 2002; and INE. various issues. Statistics Yearbook.*

Therefore, the measurable impact of South African FDI in Mozambique is limited to the short-term increase in investment and economic growth. There are reasons for concern about the sustainability of investment and growth strategies driven by mega projects, particularly because of the low intensity of linkages, employment and capacity transfer, and also because of the excessive degree of concentration and specialisation that is emerging in the economy.

**Graph 8: Mozambique - FDI, foreign borrowing and the balance of trade (US\$ million)**



Sources: Castel-Branco. 2002; and INE. various issues. Statistics Yearbook.

## KEY FUTURE DEVELOPMENTS

The analysis of what key future developments may occur and what their likely impact might be is always highly speculative and subjective. It depends on how far in the future one may wish to look, and also on assumptions and methodologies adopted. One methodology involves listing all events one believes are going to happen, rank them by some probability of occurrence, assume what the impact of each event is likely to be, and reach some vision about the future that more often than not is likely to be completely wrong. Another is less concerned about guessing the future, and more concerned about trying to understand how current events may evolve into the near future as a result of the dynamic processes and forces that shape them. This methodology may not be much more accurate than the former, but at least it starts the analysis from the underlying conditions of development. This is the methodology that is going to be attempted in this section.

Key developments that may influence the shape of the economic linkages between South Africa and Mozambique are likely to be related to four aspects: SADC trade protocol, trade negotiations with the European Union, the continuing expansion of South African corporations and the sustainability of current economic strategies.

### SADC Trade Protocol

The implementation of the SADC trade protocol may result in one of the following. First, Mozambican firms may improve their access to capital and intermediate goods at lower prices, once trade barriers have been removed, which may enable them to become more competitive. This would also increase trade, in particular imports of capital and intermediate goods from South Africa. This is not very likely to happen in the foreseeable future, unless

selective and aggressive industrial strategies and policies are adopted to promote industrial production, because Mozambican firms are weak and the larger Mozambican entrepreneurs are more focused on trade and services than in organising production at an industrial scale.

Second, cheaper imports from South Africa may wipe out completely the productive basis in Mozambique. This is also not likely to happen because it would make trade impossible and would go against the interests of regional expansion of South African corporations. It can be argued that natural barriers to trade, such as high transport costs, would prevent South African exports from destroying Mozambique's industrial basis. This argument does not apply to the South of Mozambique, although it may apply to the Northern areas. However, only less than 10% of Mozambique's industrial capacities are located in the North, against two thirds located in the South. Moreover, transport costs can only act as a natural barrier to trade against South African exports if the importing economy competitively produces similar goods, and if the combined advantage of South African firms with respect to costs, quality, standards and reliability of supply is less than the effect of costs of transport. Thus, it is more likely that the destruction of Mozambique's industrial capacity is prevented because of investment interests of South African entrepreneurs and corporations than because of natural barriers to trade. Such investors' interests may be developed around the areas where Mozambique becomes a large enough importer to generate production dynamics.<sup>41</sup>

Third, foreign investors from outside the region could invest in Mozambican firms to gain access to SADC markets. This may happen but only on a very selective basis, because existing productive assets in Mozambique are poor and the main market in the region is South Africa (whose economy is several times larger than the economies of all other SADC countries put together), with whom foreign investors would have to compete. In order to reach SADC markets, foreign investors from outside the region would have to satisfy the rules of origin, which could increase exports of investment goods from South Africa to Mozambique. The threat of foreign investors establishing themselves in sectors and industries that may compete against important South African interests may encourage South African FDI to make the first move into Mozambique on a slightly more diversified and broader basis.<sup>42</sup> Irrespective of the outcome of the SADC trade protocol, South African exports to Mozambique are likely to increase, but the future trend of Mozambican exports to South Africa is much less clear from the outset.

### **Negotiations with the EU**

If the economies of Southern Africa are going to expand quickly, they have to export and, in this connection, they have to look for markets beyond SADC. Thus, the coming trade negotiations with the European Union may play a crucial role in defining opportunities for growth and diversification of the Mozambican economy, diversification of the sources and allocation of FDI into Mozambique, and diversification of the directions of trade and investment from South Africa. However, market opportunities depend, in first place, on production capacities; they are not derived only from market structures and policies, and from how open (or closed) markets are. EBA (EU) and AGOA (USA) are good examples of this. Under these trade arrangements, Mozambique is exporting slightly more of the same: sugar (EBA) and prawns (AGO). The inexistence of an internationally competitive manufacturing sector prevents the Mozambican economy from benefiting more significantly from EBA and

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<sup>41</sup> Hirschman, A. 1958. *The strategy of economic development*. Yale University Press: New Haven and London.

<sup>42</sup> The threat of competing foreign investment has played an important role in the investment decisions and strategies pursued by Billiton and ESKOM (against Kaiser), SASOL (against Enron), and the beer and sugar investors (against a few potential European and Indian investors).

AGOA to diversify and expand. Even if Mozambique manufactures some of the goods that are covered by these two trade arrangements, it is very difficult to meet the quality and standards demanded. In order to meet those standards, the costs of the investment required would more than offset local costs advantages such as relatively cheap labour, unless firms use the domestic market, or even the SADC market, to expand and create, or take advantage of, economies of scale. In this case, industrial and trade policy would have to be combined to generate industrial capacities and trade competitiveness. Therefore, trade arrangements are not substitutes for aggressive construction of competitive productive capacities.

Nonetheless, it is important that the Southern African region, through SADC, engages with EU on trade and other economic arrangements. This would certainly increase the bargaining power of the region and help to achieve results that each individual SADC country could not. However, it is already clear that South Africa is leading the negotiations with EU from the SADC side, even before they have formally started at a multilateral level. More data and research would be necessary to understand what the direction of such negotiations, and their future impacts, are likely to be.

### **Continuing Expansion of South African Corporations**

South African FDI may continue to play a crucial and growing role in the Mozambican economy, and it may continue to be driven by the minerals-energy complex. However, as investment increases, its diversification should also increase for different reasons. The concentration of the minerals-energy FDI is not sustainable in the long-term (refer to the discussion at the end of previous section); there are physical limits to the expansion of minerals-energy projects; the complex is strong enough to expand to other regions (and is already doing so, as it is shown, for example, by Billiton's strategic moves and predatory behaviour in the aluminium sector); and other South African industries depend very much on the region to be able to internationalise. What Mozambican can gain from this depends on the ability and willingness of Mozambican authorities, businesses and industrial organizations to understand regional strategies of South African firms and other foreign investors, and identify, select and attract more adequate and diversified partnerships. Recording and understanding public and private regional strategies of South African and other investors and governments is an area for further research that is very likely to add significant value to the process of policy making and implementation.

### **SOME CONCLUDING REMARKS**

The major strengths for further integration of both economies are the historical economic links that already exist, the current level of trade and investment between them, as well as the change that is occurring towards replacement of labour migration with FDI. This is more likely to create new capacities in Mozambique and new opportunities for further development of the economic linkages between the countries. The major weaknesses are associated with the essence of the traditional economic links between the two economies, which has been shaped by specific South African interest, as well as with the huge gap between the two economies. As a result, economic linkages between the two economies have resulted in highly unbalanced gains, as can be shown, for example, through the analysis of the balance of trade between Mozambique and South Africa (graph 3).

Major opportunities lie on diversification of investment away from the minerals-energy complex, Mozambique's access to foreign direct investment and the development of systematic and intensive linkages between domestic and foreign investment and firms in Mozambique. Major threats come from continuing concentration of investment around low

linkage sectors, such as the minerals-energy complex and tourism, which would not help the development of domestic capacities in Mozambique and would widen the gap between the two economies.

Also, it is important to call attention to four main aspects already mentioned in previous sections. First, economic integration, no matter how it is defined, is a process that has been going on for decades, and that has shaped the structures of the two economies, their dynamic forces, and the ways and mechanisms by which they affect each other. Elimination or reduction of what is left of trade barriers is a detail rather than the essence of the process of integration. Further integration between the South African and Mozambican economies is likely to continue to take the form of division and specialisation of labour within the South African space economy. Whether this process expands and diversifies productive, investment and technological capacities in Mozambique, and reduces or increases the gap between South Africa and Mozambique, are more worrying issues than the precise level, path and pace of reduction of tariffs and other trade barriers. Besides, existing trade barriers have not helped Mozambique to avoid a huge trade deficit vis-à-vis South Africa.

Second, Mozambique's productive, investment and technological capacities are very limited, to the extent that fast investment and growth, particularly of the type based on mega projects, is bound to be relatively short-lived. One of Mozal's most senior officials argued that 2-3 mega projects would exhaust the capacity to grow of the Mozambican economy, particularly because of lack of skilled and well trained people, industrial facilities, standards and technological capacities and infra-structures, and overall business capacities.<sup>43</sup> Thus, further integration requires development of capacities, not only a share or transfer of resources and an increase in trade flows.

Third, if integration is going to be driven by the dynamic power of the South African economy, and Mozambique is going to benefit from it, then the Mozambican government and businesses have to understand the regional strategies of South Africa (public and private sector), and learn how to use them strategically to benefit business development and capacity creation in Mozambique.

Finally, regional integration within SADC makes long-term sense if it is strategically oriented to gain advantages in the world economy. It means that further integration of the two economies has to address strategically how to look outwards, learn from the world economy and penetrate the world market more positively. Mega projects may be one way of doing this, but real development requires a much broader basis than that.

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<sup>43</sup> See Castel-Branco 2002.