PROMOTING FDI SPILLOVERS IN MOZAMBIQUE

POLICY BRIEF | APRIL 2021 | YI YANG

Executive Summary

- Mozambique faces unprecedented **foreign direct investment** due to resource discovery.
- Empirical evidence supports the existence of **positive spillover from FDI for domestic Mozambican firms** with direct links to foreign investment firms.
- Status quo policy on local content does not address binding constraint to greater spillover: **gap in firm capabilities**. It is further constrained by political dynamics.
- An alternative is incentive-compatible: foreign firms **jointly establish a business collective,** and incorporate **third-party providers** for skills development. Discretion on content is retained by the investing firms, while goverments have oversight power.

Motivation

Despite an inflow of FDI to Mozambique, very little is known about its impact on the domestic economy. This policy brief extends the conceptual framework around FDI spillover linkages to the context of Mozambique, with aim to enable policymakers to have an informed-view of their role for intervening in business for the promotion of firm capabilties – in line with the national agenda on development.

Approach

i) Empirically investigate the extent of spillover since the introduction of FDI. The conclusion seeks to understand the magnitude, under what condition and form, spillovers have existed.

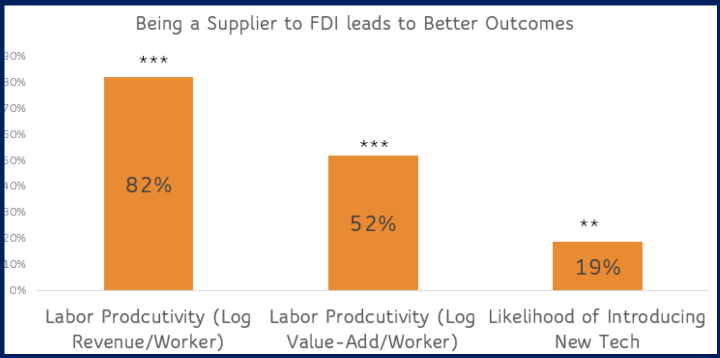
ii) Deconstruct the leading policy proposal against the targeted goal of promoting spillover

iii) Offer policy changes to bridge reality gaps while mindful of political economy constraints

FDI is a big policy issue for Mozambique due to its unprecedented scale and pace. Foreign investments in Mozambique's natural resource sectors (gas, coal, minerals) contribute to half of GDP growth, with expectation to **double GDP in next 10 years.** Resource-led FDI boom leads to investments in ***both*** resource and non-resource sectors.

Empirical Findings: Businesses linked to FDI do better

Survey data controlling for region, sector and firm changes reveal a strong association between being a direct supplier to foreign firms and improved business outcomes (e.g. revenue/worker, value-add/worker likelihood of using new technology).



Domestic suppliers become *more productive* when they act as a direct supplier to FDI.

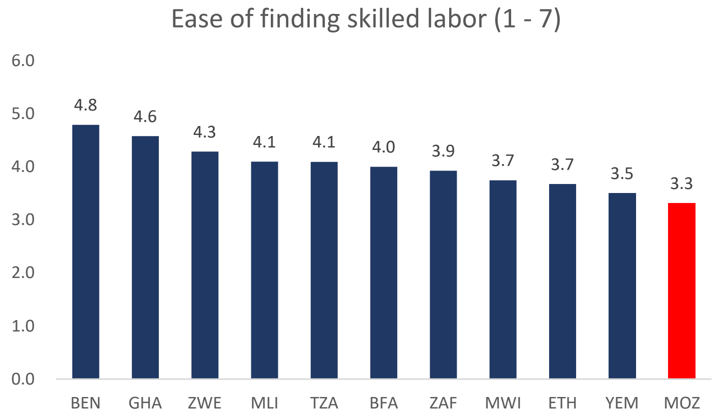
This result is robust across sectors.

However, *very few firms are directly linked*, therefore spillover effects do not generalized to the broader economy, beyond direct linkages.

Supply-Side Constraints: Foreign Investment Firms Express Lack of Capable Domestic Suppliers

Foreign firms prefer to hire locally, but it is difficult to find the right skills match.

"The government has these provisions, the companies come with their strategy. When you go to the field, what you see is that you don't have companies who have competences to provide services. Few companies have certificates. If you don't have standards, you can't provide services." – Former Head of Negotiations, Mozambican National Gas Company



Firm opinions from the World Economic Forum Global Competitiveness Index show Mozambique have the lowest ease of finding skilled labor, relative to peer countries

Lack of domestic ecosystem of appropriate skills means effective policy must address the capabilities gap. In contrast to the experience of many countries, Mozambique's domestic industries with linkages to FDI have the potential for seeing direct FDI spillovers. Policy's role is therefore focused on **addressing the skills constraint** for promoting greater spillover.

Status Quo Policy on Local Content is Inefficient

"For each project, the team sees what you can get in the country, what you cannot… it is a case-by-case negotiation. ENH would come in with what their idea of what local content can do, so you try to make something work" - Lead Lawyer, Major Multinational Oil and Gas Company with Investment in Mozambique

It is **mistargeted**: A minimum quota on local hiring does not address capabilities gap

"No country has ever achieved 90 per cent local content in the history of petroleum production. The highest ever achieved is 74 per cent by Norway in 1994" – (Page and Tarp 2020)

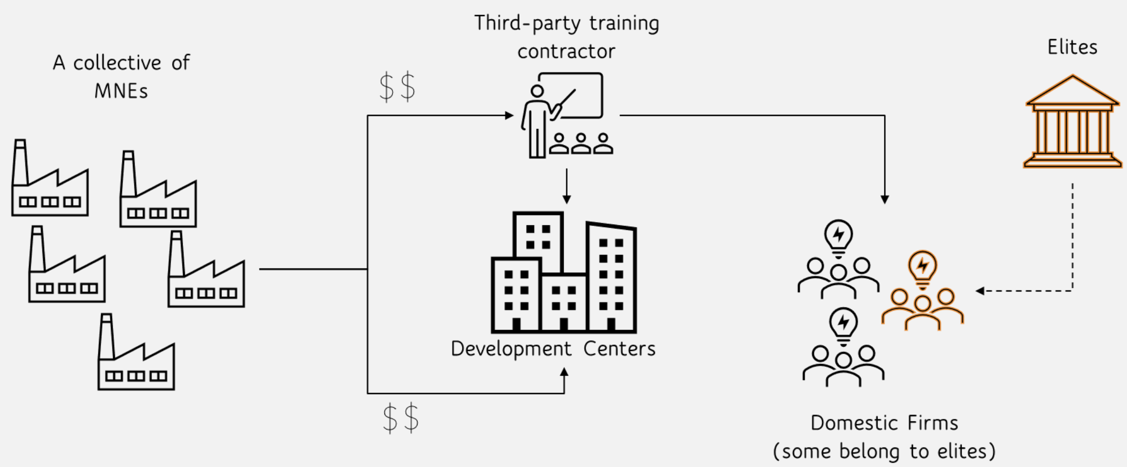
It has **limited technical merits**: no evidence of its success in any country

"There is a real concern among some parts of the ruling elites to lose their share of the pie. Everybody needs to be accommodated. But they are fighting…With local content, if you have free competition, then you lose out. That is why they don't want to work with it." - Associate Professor, Research University

It is **not politically supportable**:government actors have incomptabile incentives

The current Local Content Bill has limited scope to gain stakeholder buy-in. It does not address the true constraint to promoting spillover and lack the technical and political robustness for it to become a sound policy.

Towards Greater Spillover – A Policy Alternative: Introducing a Business Collective for the Provision of Skills Development



How it Works: Foreign Firms form a business collective to **jointly invest** in the establishment of a development center. They **retain ownership over business needs** and the type of training to be provided. The provision is outsourced to a third-party contractor with specialized skills, targeting domestic firms. Some of these firms will have ties to the **government, who serves the purpose of monitoring & oversight**.

Understanding the Key Actors

Multi-national firms (MNEs) benefit when the average capability level of local suppliers improves. Though the cost of developing local capabilities appears too great for one firm to bear, firms can collectively invest in developing training programs for mutual gain. A domestic supplier can serve multiple foreign customers, the risk of substitution effect is limited Most importantly, a business collective puts the decision-making power in the hands of the firms – allowing them directly to target capabilities gaps without the need for political space.

Under this scheme, government incentives are protected as the role of government becomes one of oversight/monitoring. A private initiative removes disturbance to existing political order. In addition, elite fractions may have opportunity to benefit from the scheme via their business subsidiaries. Services such as business advisory, quality certification and safety training are not depletable – and therefore can be serviced to both domestic elites and entrepreneurial class. Any risk of failure would also not fall unto the shoulder of the government, reducing chance of damage to their political capital.

Policy Action Plan for Mitigating Risks

Risks	Potential Causes	Action
Unilateral MNE decision to stop funding program	▪ Poor return to investment ▪ Political unrest ▪ External shock to investment climate	Establish "funding drives" of financial commitment ex-ante (similar to World Bank IDA drivers) from members of collective to ensure programming support is unaffected by individual MNE firm decision to leave. Actor: MNE Collective
Targeting of training misses Mozambican firms (i.e. captured by South African firms)	▪ Loophole in qualification vetting process ▪ Hard to find local firms	Government clearly defines qualification criteria (e.g. no shell companies); information of selected firms are shared to government and published on website. Actor: Government Ministry of Economy
Training only benefits politically connected firms	▪ Non-transparent selection process ▪ Political pressure on MNE	Protect a portion of slots for business elites; but use an open, transparent criteria process (e.g. points system) for selection of domestic firms. Actor: MNE Collective
Lack of gender parity in domestic firm beneficiaries	▪ Information / network barrier ▪ Social constraints ▪ Discrimination	Engage civil society organizations for disseminating information to female business owners. Actively promote inclusion of female-owned businesses and their capacity building through targeted training modules and quota. Actor: MNE Collective + Government.

Policy Suggestions for Government

ACTION 1: Transition away from the "hard law" requirement of local content.

ACTION 2: Invite partnership among multinational firms to establish a "business collective" to commit ex-ante the creation of development centers as a means to bridge the capabilities gap among domestic firms. Provide monitoring oversight to following action plan mentioned above to ensure transferability/generalizability of skills learned.

ACTION 3: Provide a platform for information sharing among domestic firms to build up a registry of service providers and a foundation for networking.