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OECD POLICY DIALOGUE WITH NON-MEMBERS ON AID FOR TRADE:

FROM POLICY TO PRACTICE

TRADE AND AID POLICIES: THEIR IMPACT ON ECONOMIC DEVELOPMENT IN MOZAMBIQUE

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Abstract

We study in this paper the impacts on the Mozambican economy of various trade agreements. We also estimate the impacts of aid and trade facilitation. Finally, we also conduct an in-depth study of one sector, sugar production that our analysis shows to be potentially important in future for Mozambique. It is an important sector also for EU because of its current plans to liberalise the sector.

Mozambique does not seem to gain from the trade agreements studied except from some agreements with EU. The same holds for the Doha round. At the same time trade facilitation has beneficial effects. Adverse impacts of aid (e.g. loss of competitiveness due real appreciation of the currency) are estimated to be very small and may be non-existent. Trade facilitation has large impacts on the production structure with new sectors growing and existing important sectors (except sugar) contracting. The results imply that aid-for-trade programmes have large potential but they must be planned carefully.

Keywords: aid, trade liberalisation, trade facilitation

1. Introduction

We study in this paper the impacts on the Mozambican economy of various trade agreements, both those with EU and with SADC, which are being currently negotiated. The implications of the Doha round on Mozambique are also reviewed on the basis of existing studies. Finally, we estimate the impacts of aid and trade facilitation that reduces international trade costs for the Mozambican economy. This exercise lays ground for evaluating the potential of aid for trade programmes. Finally, we also conduct an in-depth study of one sector, sugar production that our analysis shows to be potentially important in future for Mozambique. It is an important sector also for EU because of its current plans to liberalise the sector.

The paper is organised as follows. Next we present different trade policy arenas for Mozambique. A good source for a thorough description is found in Removing Obstacles to Trade – A Diagnostic Trade Integration Study (DTIS), research carried out by USAID (USAID, 2004). As the impact studies on realizing or fully exploiting these policies are nowadays often based on quantitative modelling with multi-region multi-commodity CGE models, we present the method shortly. Then we present results from quite recent studies on the effects of the Doha Round under negotiations. Against these simulations we study how bilateral agreements for Mozambique especially with Southern African countries (SADC) and / or the EU related to this multilateral option. Our own evaluations as well as the reviewed studies are based on the same methodology. Apart from the basic scenarios we shortly analyse the allocation of aid in AGE framework and discuss on the special role of sugar, which is a good example of aid in the form of trade. The chapter ends with some preliminary conclusions.

The main result from the analysis of trade agreements is that Mozambique does not seem to gain much from them, if at all (except from some agreements with EU). The same holds for the Doha round. At the same time trade facilitation (modelled here to

reduce transactions costs for Mozambican exports both at home and countries importing Mozambican goods) has beneficial effects. As our analysis shows that adverse impacts of aid (e.g. loss of competitiveness due real appreciation of the currency) are at worst very small, aid for trade programmes seem to have large potential. The results indicate, however, also that trade facilitation has larger impacts on the production structure with new sectors growing and existing important sectors (except sugar) contracting. In Haaparanta and Kerkelä (2006) we identified cost and availability of credit to growing firms and the lack of business capacities as the major growth bottleneck in Mozambique. The solution to these problems must thus be found for trade facilitation to fulfil the promise it seems to be have for Mozambique.

2. Mozambique's position in trade regimes

Mozambique is a member of World Trade Organisation (WTO). In addition, it enjoys preferential access to key export markets under trade arrangements that reduce duty rates on its exports absolutely and relative to suppliers that do not have such preferences. Mozambique is also accorded preferential access to certain markets, including those of some of its neighbours, under reciprocal and binding trade agreements between countries or groups of countries. Among these, perhaps the most significant is the Southern Africa Development Community (SADC) (DTIS, 2004).

Apart from the improvement in internal constraints that help Mozambique better exploit the market access within these agreements, another way for improving market access are changes or full implementation of these agreements. For instance, the full implementation of SADC as a free trade area is only at the beginning phase. Within the WTO, the current Doha Development Round aims in improving the market access to the poorest countries. AGOA, the American Contract, is developing. With the EU the Economic Partnership Agreements (EPAs) are being negotiated.

Adverse development in market access, i.e. the preference erosion, may happen when negotiations in other fields develop by deteriorating the market access of Mozambique. One of the examples is the free trade area between SADC and USA which may deteriorate the position of Mozambique. The preference erosion through these contracts is similar to those negotiated in WTO when the relative position of preferences is melted through decreases in MFN tariffs.

For Mozambique, the main market access to developed country markets are organised through preferential GSP arrangements by the European Union and the United States. In GSP arrangements, the development perspective is a starting point for the preferences so the coherence aspect is there even more relevant than in regional trading blocs like free trade areas.

The Everything But Arms agreement (EBA) is an extended GSP arrangement by the EU towards LDC-countries. EBA has a wide coverage for elimination of tariffs and is at first glance a very generous agreement. Based on the evaluation by Castel-Branco et al. (2004), however, the development prospects for expanding exports will be limited by non-tariff barriers including rules of origin (ROOs), sanitary and phytosanitary (SPS) measures and safeguards. Critics of ROOs in particular point to rules that prevent developing countries from participating in effective supply chains and the use of imported inputs. SPS measures are an obstacle that can be overcome by development aid, e.g. by offering technical assistance for testing laboratories. Safeguard measures and graduation mechanisms, in contrast, offer the EU a way to prevent and harm the expanding export industries at very short notice. According to Castel-Branco et al. (2004), of current Mozambican export items citrus and sugar are included in the EBA but sugar is under a special regime. Of potential exports items, three products could benefit from the EBA: oil cakes, maize and some milling products (bran and other residues).

The African Growth and Opportunity Act (AGOA), the GSP arrangement by the United States offers a very wide coverage in tariff free access for the Mozambican exports in the American markets. Similarly to the EBA, the principal problems for growth opportunities by exports to realize are linked to ROOs, SPS and safeguards rules. With regards to ROOs the problems appear to be particularly big for the textile sector but the LDCs have been granted a 'special waiver'. The fear of preferences being temporary and unilaterally withdrawn reduces the prospects for growth through the concession.

The AGOA is offering generous conditions on textile trade where as the benefits in the EBA are bound to be more in agricultural trade. The problems with safeguards in agricultural products, graduation in largely expanding production and rules of origins in processing industries make it however difficult to see clear profitable export opportunities.

In regional trading blocs, reciprocity and a mutual agreement on market access is a starting point. In practice, all free trade areas as well include a branch of sensitive products that are not included in the agreement. The Economic Partnership Agreements "EPAs" that the EU is negotiating with ACP and LDC countries, including SADC and Mozambique, are not an exception. The Southern African Development Community (SADC) formed in 2000, is intended to be fully liberalised in trade by 2008. Although the harmonization processes in trade practices has been evolving, difficulties in integration processes have been also been faced. The most difficult question seems to be the rules of origin that for some SADC, especially SACU countries, favour imports from outside-SADC countries instead of from other SADC countries. Southern African Customs Union (SACU), including the wealthiest part of Southern Africa, seems to favour agreements where their competitive position is protected against poorer SADC countries (see Removing Obstacles to Trade also).

3. Evaluating the impacts of changes in trade policy regimes

Computable general equilibrium (CGE) models have become a useful tool in analyzing a number of varied trade policy issues. These models are oriented to detailed policy analysis, using accurate and current data, including distortions, in such a way that the base data equilibrium includes responses to these distortions (Francois and Reinert, 1997). The theoretical structures of the models are more based on utilising as detailed data as possible instead of relying on sparse theoretical structures. A good example of the last point is the utilization of product differentiation models instead of homogenous goods trade models mainly because bilateral trade flows between countries are available.

Data development work by Purdue University's Global Trade Analysis Project (GTAP) has produced a public cross-sectional database that has been updated every second year. The current database version 6 has 2001 as a base year and it includes nation wide information on 87 countries and 57 industries. The data base includes bilateral trade flows from Mozambique to other countries and an input-output based structure of the domestic economy. In this study we have aggregated the 57 industries to 10 aggregate sectors (below). As international trade is the key inter-regional link in multi-region CGE-models, the current account relations dominate the capital account issues. Other features in the modelling that partly drive the results are the bilateral trade flows that most often are modelled as the Armington structure. This modelling strategy takes the current structure of trade as given, not allowing specialisation in any industry.

In building trade liberalisation scenarios, the choice of baseline levels of protection is a complicated issue, which largely drives the estimated results of liberalisation.[1] Like in GTAP, some aggregation methods from original single tariff lines have to be used when building a database where one industry actually includes thousands of different trading

[1] An introductory survey to issues involved can be found by Laird (1997).

items that all have different tariffs. In each of the actually negotiations, the discussions goes at detailed level, so these numerical methods can be only accomplishing the more detailed analysis.

In this paper, we utilize to some extent the standard GTAP model, built around the GTAP Database.[2] The standard model assumes competitive behaviour by all the agents, markets that clear and a global bank that allocates savings to investments. In the static version of the model investments do not accumulate to the capital stock which narrows the role of savings simply to another component of total expenditures. The model treats the aggregate consumption through the representative household that allocates its expenditure to private consumption, public consumption and savings. The role of aid in public funding and the budget balance is thus not explicitly modelled and we limit the analysis of aid to its role in total regional income.[3]

4 Multilateral trade liberalisation- some results

The ongoing WTO negotiations and the Doha Development Agenda (DDA) have inspired several researchers to quantify the effects of the round with Global CGE models. We have picked some selective results of two such studies. Anderson, Martin (2006) utilise the most recent version of the GTAP Database, version 6. The other study is by Bouët et al. (2005).[4] Though the latter is based on data from GTAP Database 5.0, the authors have produced extensive information on preferential tariffs and added that analysis to the database. In fact their work has been used in building the database 6 so the results reported here are quite comparable.

[2] The model is widely utilized and well documented in Hertel and Tsigas (1997). Access to the bibliography of GTAP based studies can be easily found in the project's webpage http::://www.agecon.purdue.edu/gtap
[3] As with any demand based models that assumes the supply to adapt to new relative prices, GTAP has its limitations in analysing supply responses in developing countries. It does not take into account the missing capacity or the missing links in price transmission.
[4] Bouët et al. (2005) refer to other related studies, as well.

Much of the DDA are concentrated on agricultural trade liberalisation. This package is based on 3 pillars (reform in domestic support, market access and export subsidies). All the elements are included in the two of papers. Anderson and Martin also analyse the effects of all merchandise liberalisation including also agriculture. Both studies take into account the details in tariff counting like the differences between bound and applied tariffs (binding overhang).

Table 1 below summarises the changes in aggregate welfare (in percentages) and in the Anderson-Martin model, also in Millions of US Dollars. Mozambique is treated as a separate country by Anderson and Martin and the aggregate economy effect is negative. The same result is partly shown in the negative outcome for Sub-Saharan Africa in Bouët et al. "(who do not model Mozambique as separate economy). The net gain would be negative especially due to market access liberalisation. The results are mainly due to losses in preferences and trade diversion.

Table 1 Welfare gains from Doha Round as %-change from the baseline ($ Million)

	Anderson Martin				Bouët et al.	
Region	Agriculture		All Merchandise		Agriculture	
	% change	$ Million	% change	$ Million		% change
SACU	0.49	*529*	1.08	*1158*	SubSaharan	-0.03
Mozambique	-0.18	*-6*	-0.52	*-17*	Africa	
OSAfrica	0.72	*275*	0.9	*345*		
OSSA	-0.12	*-167*	-0.76	*-1034*		
Brazil	1.13	*5039*	1.16	*5149*	Cairns Developing C.	0
India	0.29	*1275*	0.38	*1673*	South Asia	0.17
China	0.05	*560*	0.51	*5369*	China	0.15
		…				
Dev. Countries total	0.27	*11930*	0.5	*22088*	Developing Countries	-0.03
					EU25	0.14
					USA	0.05

Abbreviations: OSAfrica = SADC excl. SACU and Mozambique, OSSA= Other Subsaharan Africa

Sources: Table 2.10 in Anderson and Martin (2006) and Table 6 in Bouët et. al. (2005)

Why are the results negative for at least some Sub-Saharan countries? There are two explanations. As liberalisation of agriculture would reduce developed country

production and thereby increase the global net demand for agricultural goods world market prices of these goods would increase. This hurts net importers of agricultural goods, Mozambique being one of them.

The second explanation is based on the fallacy of composition: if all developing countries' market access is increased rapidly they all expand their export production and exports simultaneously. If the developing products are substitutable with each other, the increase in export prices could be much lower, they may even decline, than if the market access were increased only for a smaller group of countries. Even if developing countries as a group could gain some individual countries could lose. This effect is not just a theoretical curiosity. Faini et. al. (1992) estimated export demand functions for manufacturing exports of least developed countries (LDC). They found out that, on average, an individual LDC country would lose 80 % of its export revenues if the other LDCs expanded their exports simultaneously.

The last point may also be important when interpreting the results above. According to Anderson and Martin (2005) the developing countries as an aggregate, would benefit from the Doha Round that includes liberalisation in agricultural products in all negotiated areas. The gains for developing countries would remain below those for developed countries. Bouët et al. are even more critical of the outcome of the DDA on developing countries and claim it mainly benefits developed countries.[5] For Mozambique the current stalemate of the Doha is therefore not necessarily a crisis.

5. How do regional trade agreements compare with Doha?

Regional trade agreements, even with wide coverage in commodities and deep cuts in tariffs, necessarily produce results that remain below those of large rounds of trade

[5] Arndt (2005) is a study of the DDA on Mozambique. Due to binding overhang, he claims, the normal round would results in very small effects for Mozambique.

liberalisation. This is a feature inherent in CGE –models; larger markets and better market access to several markets always increase trade and production more than trade liberalisation within a smaller set of countries. This is behind e.g. the conclusion by Lewis et al. (2002) who argue that the access to the EU markets provides substantially bigger gains for SADC countries excluding South Africa than access to South Africa. South Africa would not be a viable "growth pole" for the region.

A closer look reveals some interesting factors. Table 2 below collects average bilateral tariffs in agriculture for Mozambique and its trading partners.

Table 2 Average tariffs in agriculture between Mozambique and it main trading partners

	Importer							
Exporter	Mozambique	SACU	Rest of SADC	Sub-Saharan Africa	EU 25	USA	Rest of OECD	ROW
Mozambique	0	1.8	21.3	0	0.4	0	0	13.3
SACU	12.8	0	12.1	23.5	8.7	2.8	7.4	28.3
Rest of SADC	0.1	7.1	6.2	9.8	2.4	11.4	3.7	14.2
Sub-Saharan Africa	0	8.1	6.8	9.2	3	0.2	7.3	13.7
EU 25	14	4.7	14.7	9.6	1	1.8	26.4	11.8
USA	2.5	13	11.4	8.1	5.2	0	1.9	32.4
Res of OECD	3.3	5.4	9.2	11	3	0.1	6.6	18.8
ROW	3.3	14.2	11.3	15.2	9.6	1.3	11.3	24.1

Source: GTAP Database

It is clear that there is not much to gain in aggregate industry level for Mozambique in EU and US markets, as the tariffs are so low already. Highest tariffs are between the African regions; Mozambique, SACU and Rest of SADC countries. Moreover, the tariffs are also quite asymmetric. For example, Table 2 shows that Mozambique faces a 21.3 percent tariff on its agricultural exports to other SADC countries, while other SADC countries only face 0.1 percent tariffs on their agricultural exports to Mozambique. In that sense, the largest gains should be available from regional integration in Sub-Saharan Africa. The proximity also makes the markets in Southern Africa easier to access than European markets.[6]

[6] Detailed offers in single tariff lines by SACU for Mozambique are reported and analysed in Removing Obstacles to Trade (Tables 5-4 and 5-5).

How large are the potential gains for Mozambique in the arena of trade liberalisation under preferential arrangements and how do the gains from SADC and EU integration compare? Is preference erosion to blame for the disappearance of such gains over time? To highlight some relative aggregate level effects we simulate five trade liberalisation scenarios (i.e. complete removal of tariffs) with the GTAP model:

1. EBA by the EU only to Mozambique: Simulates the consequences of having the only EBA agreement between Mozambique and EU without any other changes in trade policies.
2. EPA between EU and Mozambique only: Simulates the consequences of having the only EPA agreement between Mozambique and EU without any other changes in trade policies[7].
3. SADC: Simulates the reduction of tariffs within SADC area without any other changes in trade policies.
4. SADC and EPA between EU and Mozambique, SACU and Rest of SADC: Simulates the joint impacts of the reduction of within SADC tariffs and the establishment of EPA agreements by EU with Mozambique, SACU and Rest of SADC.
5. Scenario 4 + EPA between Rest of Sub-Saharan Africa and EU: Simulates the joint effects of the Case 4 and the extension of the EPA agreements to the Rest of Sub-Saharan Africa.

The simulations produce an estimation of impacts of preferential trade liberalization by EU with Mozambique and the extent of preference erosion if the preferential trade liberalization by EU is extended to the neighbouring countries. They also provide information on the impacts of regional trade agreements in South Africa and on their potential role in mitigating (or strengthening) the impacts of preference erosion. The

[7] Economic Partnership Agreement (EPA) here is a pure free trade area between a region and EU, not including any technical assistance or related aid.

interesting issue is whether gains from mutual trade (if any) exceed the potential losses for Mozambique from preference erosion. The essence of preference erosion is based on the fear that increasing access for all developing countries would harm the current preferential position of some countries. This is depicted in the last two scenarios.[8]

Table 3 Effects of trade agreements on welfare (globally) and exports from Mozambique

Scenarios	*1*	*2*	*3*	*4*	*5*
Welfare % change	EBA with MOZ	EPA with MOZ	SADC	SADC and EPA with all	4+ EPA with XSS
Mozambique	0.02	-0.15	-0.09	-0.26	-0.23
SACU	0	-0.02	0.52	1.49	1.4
OSAfrica	0	0	-0.37	0.88	0.81
OSSA	0	0	-0.01	-0.06	-1.27
EU25	0	0	0	0.03	0.07
USA	0	0	0	-0.01	-0.01
ROECD	0	0	0	-0.01	-0.03
ROW	0	0	0	-0.01	-0.02

Scenarios	*1*	*2*	*3*	*4*	*5*
Exports from Mozambique % change	EBA with MOZ	EPA with MOZ	SADC	SADC and EPA with all	4 + EPA with XSS
Agriculture	0.35	0.3	21.82	22.12	21.53
Fishery	-0.16	0.86	11.92	19.88	19.9
Minerals	-0.28	-0.48	-1.43	-2.69	-3.34
Sugar	20.15	20.56	43.11	29.54	29.15
Bev and tob	-0.07	0.84	2.39	1.82	1.92
Other food ind.	-0.26	0.15	4.71	-1.03	-1.02
Textiles	0.61	2.36	228.49	187.72	186.66
Manufacturing	-0.15	1.37	2.5	1.86	2.26
Trade and transports	-0.11	0.13	-0.8	-1.09	-1.03
Services	-0.11	0.44	1.03	3.28	3.09

Abbreviations: OSAfrica = SADC excl. SACU and Mozambique, OSSA= Other Subsaharan Africa

All the aggregate effects remain smaller than those of Doha Round reported above. Of the scenarios only EBA, i.e. unilateral access to the EU market is beneficial in welfare terms to Mozambique. The commodity trade effects are different depending on the scenario. The increase in textile trade will be realised only in Southern African

[8] In the tariff liberalisation scenarios with models that assume constant returns to scale and perfect competition, the only gains in welfare terms can be achieved from the increasing efficiency in so called Harberger triangle as well as the terms of trade effects. They neglect any long terms effects in foreign direct investments or increasing production in increasing returns to scale industries.

integration. EBA and EPA between Mozambique and EU only will be very narrow in commodity sense. The simulations show that Mozambique can face adverse impacts from preference erosion. While Mozambique would not benefit from an EPA excluding other SADC countries and from SADC liberalisation, the losses would be much larger if SADC liberalisation would be carried out and simultaneously all SADC negotiated an EPA with EU. The losses would be larger than the sum of losses from scenarios 2 and 3. The preference erosion seems to be associated with SADC countries as the extension of EPA's to other Sub-Saharan countries mitigates the losses to Mozambique: the loss in scenario 5 is smaller than in scenario 4. The same message comes when the impacts of EU-Mozambique EBA and EPA agreements are compared: EBA gives a better access to EU markets by excluding countries like South Africa.

6. Trade Liberalisation and Mozambique: Sum-Up

Based on the previous analysis on the trade agreements we derive the following preliminary conclusions.

1. In the current trading arrangements, preferences allowed to LDC countries like Mozambique, work as a channel between aid and trade. That is, these trading arrangements provide development benefits (the traditional objective of aid policies). Problems in the details of the preferences still prevent countries fully exploiting them and their temporary, unilateral nature, does not make them so lucrative. This is especially the case for sugar.

2. The evidence is weak that the Doha Development Round, even if it is renewed, will substantially promote growth in developing countries. This view is raised in several CGE-studies in the field.

3. Although in principle, the potential for large increases in trade volumes is smaller in regional integration than EU access, Southern African integration is potentially more promising for Mozambique as its commodity variety is larger and existing mutual trade barriers are high. Surprisingly it seems that Mozambique would not gain but lose from SADC integration even though as a whole SADC countries would gain.

4. Deeper integration with the EU is positive for Mozambique only in the case of unilateral (not reciprocal) tariff cuts.

7. Aid, Aid Dependency, and Donor Behaviour

7.1 Aid allocation

The previous section analysed the potential of various trade-liberalisation scenarios to promote development in Mozambique. Of course, this is the explicit objective of development assistance policy. This section considers, conversely, the effect of aid policies on Mozambique's trade capacity (and on Mozambican development more generally).

Empirical analysis of Mozambican growth generally supports the positive contribution of foreign aid (Haaparanta and Kerkelä, 2006) to growth. Aid has also had a very positive role in poverty reduction (Massuanganhe, 2005). Mozambique has been very favourably treated by donors, in terms of average aid/GDP ratios[9], even though aid has been volatile and its share in GDP has been slowly declining in recent years. Finally, donors have made serious attempts to co-ordinate their activities through Program Aid Partners (PAP) group, and the Integrated Framework (IF) to help in trade capacity building. The PAP donor behaviour is monitored annually, following the guidelines set

[9] As shown in Ernst&Young (2006), this may exaggerate the donor role, as it appears that a large share of aid is composed of recycled debt service, first paid by the Government of Mozambique to some creditors.

up in Killick, Castel-Branco, and Gertner (2004). In addition, there has been extensive coordination of aid to agriculture through ProAgri, a government programme.

Mozambique is one of the countries where donors are prepared to allocate more aid to government budget support (GBS). There are good reasons for doing so. It is harder to increase the government ownership in aid if less aid is given to government budget support. The transactions costs of aid delivery associated with project aid, and aid co-ordination is hard if aid is given as project aid. There is some very preliminary evidence that direct budget support has helped to increase aid efficiency through improving government ownership, and has helped in poverty reduction (Batley et al. 2004, 2006).

Despite the positive impacts of aid in Mozambique, one can seriously discuss whether aid is really doing as much as it could. First, the allocation of aid between various forms of aid is still very much biased to project aid, and the share of project aid has increased: the share of project aid in total aid has increased from 31.8 % in 2004 to 36.3 in 2005 and is projected to grow still in 2006 (Ernst&Young 2006, Table 3). The share of project aid in aid to Government of Mozambique has also increased (ibid.). Thus, the shares of aid going to government budget support (including the balance of payments support) and of sector aid are in decline, though the share of sector aid in aid to the government has increased. At the same time, naturally, the share of aid going to the Government of Mozambique is high, and seems to remain relatively constant, at around 88 % (ibid.). The rest of the aid goes to private sector support and non-governmental (NGO) aid.

Naturally, there are transactions costs associated with direct budget support, as well. Of them the most notable may be the governance problems and capacity of the government to handle increased aid flows. Also, direct budget support may give the central government more power over the local level authorities that may harm the efficient use of aid (Massuanganhe 2005), especially in poverty reduction. Batley et al. (2006) find that all these problems still exist but overall GBS has been a success.

The fundamental issue is that government accountability cannot be increased unless simultaneously the government possibilities to act are improved. The "new aid architecture" (Birdsall and Williamson 2002) requiring the move from ex ante conditionality to ex post evaluation of country performance cannot be achieved without increasing the authorities' possibilities to implement policies consistent with overall policy goals.

As consequence, one must discuss future donor activities more deeply, as donors are currently financing and supporting activities that are normally carried out by the public sector. What are the mechanisms that prevent an efficient delivery of these services through the government budget? The larger issue behind this is whether the current aid allocation is good for the long term development in Mozambique and what the role of government in promoting that development is.

7.2 Donor approaches to private sector development

One of the problems in GBS Batley et al. (2006) identify is that it has not yet led to deep reforms that would support sufficiently private sector development, though the first steps have been taken. The role of the private sector in promoting development and growth has clearly been recognised and identified among donors. Switzerland is a large bilateral donor for which economic development is one of six priority areas (others are health, water and sanitation, rural development, governance and peace promotion). Donor activities in promoting economic reform take the following forms: general budget support, debt relief, capacity building and technical assistance, support to civil society in dialogue on economic policies, and private sector promotion. The programme objective in private sector promotion is to contribute to the internationalisation of small and medium enterprises (SMEs) by combining investment and trade promotion instruments. On the investment side, the programme provides finance and technical assistance to a micro-finance bank. On the trade side, the programme aims at promoting agricultural

exports by addressing quality issues at enterprise level, institutional weaknesses for better quality management and trade policy formulation. Main partners are the Ministry of Industry and Commerce, TechnoServe, UNIDO and SOCREMO. Both the problems of lack in finance and supporting to build the business capabilities are addressed.

As one example to overcome the shortcomings in small projects where partial solutions may face other problems in building business capabilities, Sweden has launched a project called Malonda ("business"). The project is focused in the northern Niassa province primarily on agriculture and agriculture-related business. The pilot phase has supported several initiatives to improve business capabilities in the area like microfinance, an agricultural growers' scheme, a business centre, legal services, the ombudsman etc. As one success of the project, the surplus maize in the area from more than 6 000 farmers was traded to export to Malawi, Zimbabwe and Zambia. The project has also proposed to collect savings through the Post Bank. The programme goals can be claimed to have well identified the intertwined problems in building business capabilities where building trust between different agents is an important ingredient.

A Danish example of a Private Sector Development programme is to support long-term cooperation between Danish and Mozambican companies. So far, support has been given to five long-term business partnerships in the following areas: leather bag production, juice production, printing industry, dried fruit production, and fibre glass production. However, information and search costs may prevent profitable projects from being realised. Moreover, the requirement that both Danish and Mozambican firms express mutual interest as a necessary condition for programme support probably provides insufficient incentives for the general internationalisation of Mozambican firms.

In the development programme of the United States for the private sector (USAID Mozambique), the role of trade and export-orientation is clearly a priority. Under the

Trade for African Development and Enterprise (TRADE) Initiative, USAID is using funds to increase the capacity of small and medium-sized Mozambican companies to compete regionally and internationally. A $400,000 Global Development Alliance with TechnoServe links Mozambican businesses with typically larger and more established South African companies in tourism, wood products, nuts, and horticulture. The South African partner companies provide hands-on assistance in improving quality, introducing best practices, and developing products that can compete in world markets.

USAID programme to increase labour-intensive exports will remove constraints to investment and trade by providing technical assistance, training, and capacity building to the Government of Mozambique and the private sector to: (1) increase international markets access for Mozambican products; (2) enhance Mozambique's competitiveness by reducing the cost of doing business; and (3) increase exports in specific sectors such as tourism, garments, and horticulture. Activities will focus on improving the country's trade policies; creating a more supportive enabling environment; and directly increasing exports in target sectors.

Clearly, building business capacities and trust requires specific agents and institutions to work in the area with local firms. To be independent, these agents cannot be too closely linked to any donor or company, so that new firms can enter the market as well. Technoserve is an example of non-profit organisation that operates outside funding parties to help the firms to improve their technologies.

For multilateral donors, the possibilities for large scale investments are naturally better. The World Bank Group's Country Assistance Strategy (CAS) for Mozambique is aligned with the government priorities set forth in the PARPA, and has three main areas of focus: (a) strengthening governance; (b) spurring broad-based economic growth by improving the business environment; and (c) improving the provision of services, particularly to the poor. Strengthening the investment climate is reflected both in IDA

(International Development Association) lending to infrastructure (54 %) and private sector and industrial development (7 %) of the total 1ending of 20 on-going projects totalled $1.038 billion.

As part of World Bank Group, IFC's (International Finance Corporations) committed portfolio in Mozambique totalled $154 million. It consists of fourteen projects in agribusiness, the hotel industry, banking, and general manufacturing. Six of these projects are in the small-and medium-sized enterprise (SME) sector, 80 % of its funding goes to SME's. IFC's largest initiative in Mozambique has been the Mozal aluminum smelter. IFC support—$120 million for the first phase in 1997—was crucial for financing the US$1.3 billion project and was IFC's largest single investment globally at the time. IFC provided $25 million for the second phase in 2001. IFC has further supported Mozal's HIV/AIDS programmes and is assisting the company with a SME linkage programme to expand its sourcing to local firms.

IFC has a special SME initiative in Mozambique. The initiative combines funding with technical assistance, an approach now used by other donors also, e.g. World Bank. Ex ante, the majority of investments (80-90 %) in SMEs are failures. IFC (along with other donors) knows the problem. The solution has been "handholding", close supervision of the investment project. Funds are given only on the basis of investment plan, the preparation of which is supported. The terms of funds lent are soft: interest rates are low and partly the funding is in "equity-form", i.e. repayment is partly through an IFC share in firm revenues, determined as a share in turnover. Repayment is required and the repayment rates are good.

The main problem in private sector development identified by many donors is how to get production on a sustainable path, i.e. how to get firms to grow. In addition to technical assistance, many donors seek mentors to the firms they are funding to help new firms to learn how to cope with challenges posed by expansion. Mentors can also come from donor countries to help Mozambican firms in their export efforts.

Like the IFC programmes, the World Bank has a programme on private sector development that tries e.g. to build linkages between Mozal and Mozambican firms helping firms both in financing their activities and in building their business capacities. Especially important in this particular case is to organise quality control. Thus, "handholding" is very much used by donors in their private sector activities.

As pointed out by Haaparanta and Kerkelä (2006), bank credit in Mozambique is very costly, and many firms are rationed in the credit market. But also in inter-firm transactions, credit is not provided and transactions are carried on cash-only basis. Thus, getting working capital is a problem for firms, and it is mostly a problem of credit guarantees. IFC has provided guarantees e.g. for cashew-processors.

Another problem identified by some donors that growing firms face, is the tariffs on imported raw materials not produced in Mozambique. Given the time and data constraints, it has not been possible to calculate effective rates of protection for different sectors, but clearly tariffs on imported raw materials are a tax on local production.

The danger in donor programmes is that they can be very fragmented. Some donors have partially solved the problem by pooling funds with IFC and by working with NGO's like Technoserve. Yet, problems of coordination remain. The biggest coordination problem still is how to make donor activities fit to the government development plans.

8. The role of aid

8.1 Trade effects and aid to promote exports

Aid is a transfer of income to a country, and excluding cases of transfer paradoxes (see e.g. Haaparanta 1987), one expects it to improve welfare in the recipient country. But there are several possibilities why aid may slow development. Aid can lead to moral hazard problems, in analogy with redistribution of income between individuals/households. Aid dependency may have been created in part by these moral hazard problems.

The other possibility is to understand aid as analogous to the receiving country getting access to some natural resources[10]. The interaction between aid and trade can, thus, be similar as the 'Dutch Disease'. If foreign aid has an impact of increasing demand for non-traded domestic goods, the real exchange rate appreciates and the tradable goods sector shrinks relative to the non-tradable sector (see Adam 2005 for discussion and evidence).

But considering the aid as just an exogenous increase in income neglects the uses of aid. In fact, a proper use of aid can mitigate the "Dutch disease" and even reverse the impact and magnify the positive effects of aid. This can occur if the aid can contribute to the capacity building and supply side of the economy (see further Adam 2005).

According to Haaparanta and Kerkelä (2006), there is no sign that aid has appreciated the real exchange rate and reduced growth in Mozambique. Castel-Branco and Sulimane (2005) have argued that, over the past few years, aid to Mozambique may have appreciated the Mozambican real exchange rate, but the effect has been small.

In this section we complement these analyses by utilising a computable general equilibrium (CGE) model to analyse the impact of aid both on the real exchange rate and on sectoral allocation of production.

We use the GTAP model to shed some light on (i) the effects of aid on the demand structure of the economy and (ii) the effects under the assumption that aid can raise export capacity. The idea is to look at two extreme alternatives to narrow down the impacts of aid. In the first alternative aid is viewed as a pure income transfer. This maximises the potential for adverse effects from aid and serves as a useful background.

[10] Collier (2006) studies how far this analogy can be pushed in African context. He argues that, though there are similarities, most of the impacts of aid cannot be understood with this analogy.

In the second alternative we study the impacts of reduction in trading costs (costs of trading in international markets). In this case one can think of using aid (trade facilitation, improvements in infrastructure etc) to achieve this reduction.

We first study the impact of aid by looking at aid as an income transfer only. Currently the extent of aid in Mozambique amounts to $700 millions annually which depending on the year varies around 10 percent of GDP. In 2001 the share of grants of GDP was 14.8 % (DTIS, 2004). To illustrate the role of aid we studied how increase in aid is reflected in the production structure and exports. We have simulated a rough increase of aid by -$350 million, which is little less than 10 % of GDP that year (GTAP Database 6). The increase in aid has been calibrated in the GTAP model as an increase in national income that, based on the current expenditures, has an effect on demand for both domestic and imported consumption. The real exchange rate, characterized in the model by the terms of trade, appreciates by 0.3 percent, i.e. there is a Dutch disease effect, though, given the change in aid, the impact is very small. The same holds for aggregate welfare changes. Even though the simulated increase in aid implies a remarkable increase in disposable income, the real net welfare gain is about $4 million. The increasing aid decreases the exports orientation and spurs imports when resources are in efficient use.

In GDP level, the effects in the model outcome are insignificant as the resources are in all cases fully utilised. The changes in factor rewards still show the changes with largest increase in factor rewards for natural resource (0.40 percent) followed by increase in reward for land (0.05 percent) and other factors by 0.03 percent.

Through the increasing price level in the presence of increasing aid, the structure of production as well as trade would change in the model simulations.

Table 4 Effects of increase in regional income (aid) for Mozambique for production and exports

	Simulation result	*Base data*	*Simulation result*	*Base data*
	change in production (%)	Share in aggregate value added	% change in exports	Share of total exports
Agriculture	0.00	18.7	-0.18	5.0
Fishery	0.08	1.1	-0.39	0.1
Minerals, Forestry	0.01	4.1	-0.45	2.4
Sugar	-0.12	0.1	-0.15	0.6
Beverages and Tobacco	0.05	0.2	-0.06	0.0
Other food industries	-0.02	2.4	-0.19	8.8
Textile industries	-0.04	0.4	-0.21	0.5
Other manufacturing	-0.14	5	-0.17	36.5
Trade and transport	0.04	26.1	-0.10	9.0
Services	-0.01	41.9	-0.11	37.2
		100		100.0

Source: GTAP Data Base 6.0 and authors' simulations.

The simulation results show clear decrease in exports in all the sectors. The trade decrease is accommodated by decrease in production in most of the sectors, with only increases in primary production sectors that utilise the resources not applicable to other sectors.

8. 2 Alternative uses of aid in market access

Next we study if the increase in aid could be transferred either to direct market access in the form of declining tariffs or to sectoral aid in sectors where productivity gains through export orientation could be gained. Adam and Connell (2004) discuss the definition of 'donor-equivalence' between aid and trade preferences and define the transfer value of trade preferences as the recipient's revenue gain when tariffs are reduced. For Mozambique, few such gains are possible, given that under current GSP arrangements, there are hardly any remaining tariffs (except for quotas affecting sugar and textiles). If gains in trade are to be achieved for Mozambique, they have to be implemented in the form of technical assistance or trade facilitation which would make it easier for Mozambican firms to export to the OECD markets.

In which sectors could such an improvement be anticipated? A rough measure could be built based on the revealed comparative advantage. This can be measured as the ratio of the share of Mozambique's exports of commodity *i* in the world's export of *i* to the share of Mozambique's total exports in the world total exports. Countries tend to produce and export commodities in which they are superior compared to other countries. From GTAP Data 6 and the aggregation used here, the revealed comparative advantage is shown to be in sugar industry, agriculture and agro-processing industries (neglecting the role of services).

Table 5 Revealed comparative advantage in Mozambican exports

	Exports from Mozambique $ Millions	*Global exports $ Millions*	*Revealed Comp. Advantage*
Agriculture	64.9	167814	2.06
Fishery	1.7	7727	1.2
Minerals, Forestry	31	358828	0.46
Sugar	8.1	8450	5.1
Beverages and Tobacco	0.4	52327	0.04
Other food industries	115.8	238183	2.59
Textile industries	6.1	447632	0.07
Other manufacturing	477.2	4381428	0.58
Trade and transport	106.4	541368	1.05
Services	486.3	706474	3.66
Total	1297.9	6910229	1

Source: GTAP Data Base 6.0, base year 2001

Despite the belief that largest productivity gains could be achieved in industries where trade orientation is already the largest, it is difficult to anticipate how large these gains might be and how responsive the gains in productivity will be to aid. The revealed comparative advantage measures rest on shaky theoretical foundations, and even more so for developing countries. Thus, to base the analysis of potential productivity improvements to which aid can contribute on these measures may not be very illustrative.

Thus, we have made two types of simulations. First, we simulate the implications of improving productivity in a specific sector, sugar. As will be shown in the discussion of sugar below, an increase in Mozambican sugar production can be achieved, even when

the production is not regulated by quotas to EU market and the current practises with quotas only harm their prospects. This is the current way where prices are regulated and regarded as aid. In addition, from the previous section, increased aid flows can deteriorate the sector even further. Thus, there could be strong substitutability between aid and trade in sugar.

The simulation of global sugar trade reform can be interpreted as simulating the effect of improved market access. Here we look on the impacts of improvements in sugar sector productivity. If aid can be used to improve sugar sector productivity, the relationship can become complementary. Given a productivity shock that is needed to increase the production 1.5 fold (150 %), GDP increases by 0.09 percent when the decrease in relative price of sugar is taken into account. The simulation results in production patterns, relative prices and export patterns are described in the table below.

Table 6 Effects of productivity improvement in sugar production

	% change in production	*% change in relative price*	*% change in exports*
Factors of production			
Land		0.93	
UnSkLab		0.22	
SkLab		0.14	
Capital		0.15	
NatRes		0.29	
Tradable commodities			
Agriculture	0.15	0.29	-1.37
Fishery	0.18	0.49	-1.01
Minerals, Forestry	-0.22	0.1	-1.18
Sugar	146.28	-18.65	165.64
Beverages and Tobacco	-0.01	0.12	-0.27
Other food industries	-0.36	0.18	-0.98
Textile industries	-0.51	0.15	-1.11
Other manufacturing	-0.7	0.12	-0.82
Trade and transport	0.11	0.14	-0.48
Services	-0.14	0.14	-0.51
Investments	0.04	0.11	

Source: GTAP Data Base 6.0 and authors' simulations

Secondly, we start to analyse the impacts of improved market access overall. We do this by using a feature of the GTAP-model: it includes a variable that tries to capture transactions costs in international transactions, a cost on exports from a given country

and from a given sector (it is like the iceberg cost on exports). This cost can be interpreted as containing both administrative costs imposed by importing countries and by the exporting country.

We look at the effects of general 10 percent increase in productivity for Mozambican trade flows in all of the sectors and all the destinations. The increase will produce an improvement in terms of trade and change in trade patterns from agriculture to manufacturing. When comparing these results with an increase in aid it is clear that aid allocated to trade facilitation can have changes in production and trading structure.

Table 7. **Improvement in trade practices, effect on exports and production**

	% change in production	*% change in exports*
Agriculture	-1.7	-2.05
Fishery	1.96	-11.45
Minerals, Forestry	1.3	-0.77
Sugar	1.46	5.98
Beverages and Tobacco	-2.42	-3.22
Other food industries	-2.58	2.4
Textile industries	-13.52	4.84
Other manufacturing	4.4	11.92
Trade and transport	0.38	-4.37
Services	0.11	-3.75

Source: GTAP Data Base 6.0 and authors' simulations

Clearly, reductions in real costs of exporting have potential for large structural impacts, even if the costs are reduced in the same proportion for all sectors. The joint impact of increasing aid as income transfer and increase the use of aid in reducing exporting costs is to shift resources to manufacturing (other than textile and food industry), to sugar production and to fishery and forestry. Textile exports would increase but the impact on textile production is unclear. The reverse happens to fishery and forestry: production would increase but exports would fall or remain unchanged. Both beverage and tobacco exports and production would fall.

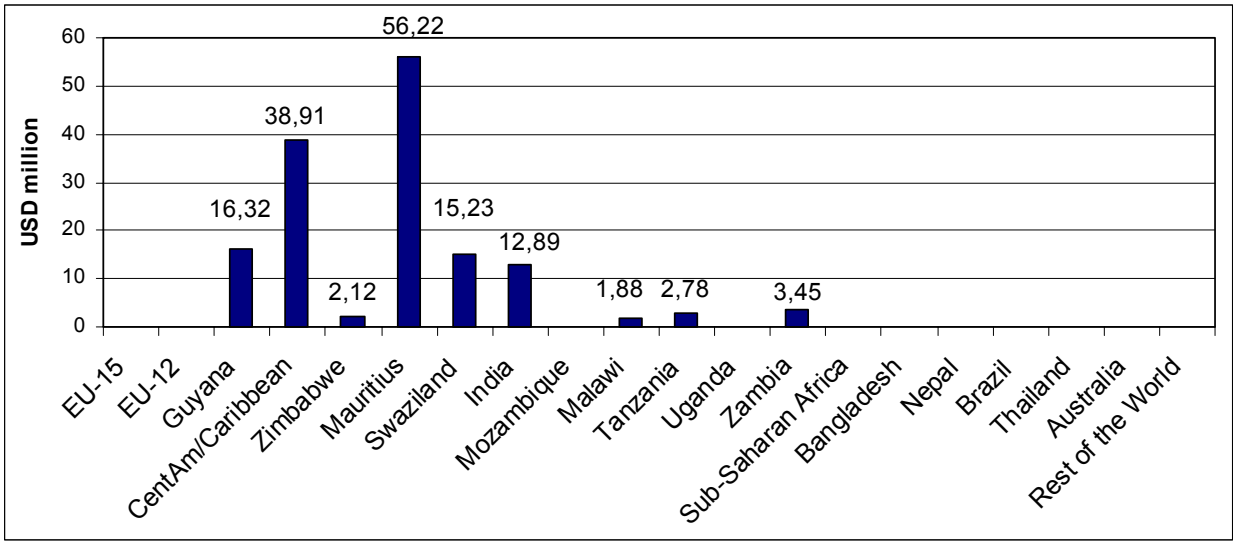
The main message in the results is that "aid for trade" policy as implemented above would shift resources to non-traditional sectors. The largest expansion would be seen in manufacturing excluding food and textile industries. The resources are shifted away

(except in case of sugar) from sectors in which Mozambique currently has a revealed comparative advantage. This is a challenge for policy makers and donors and highlights the importance of solving the problem of insufficient business capacities and lack of coordination of donor activities with the government's development strategies.

9. Special case study – sugar exports to the EU

The EU Sugar Policy towards developing countries is an example of trade where the component of aid is tied to the guaranteed price above the world market price. Current quotas allowed to different ACP and LDC countries form a direct transfer to sugar producers in those countries. Currently the EU is paying these producers the guaranteed intervention price for sugar, over 2 times the current world market price. The high price is a result of the domestic sugar regime. Until the full EBA agreement, this duty-free access was allowed to 19 ACP countries under the ACP/EU Sugar Protocol but within the EBA Agreement, new quotas have been extended to LDC countries. In the figure below the quota rents are evaluated from 1997 trade data.

Figure 1 Quota rents in the EU sugar regime for the 20 regions totalling $ 149.8 million



Note: Figures not reported are exactly zero, as there has been no sugar trade in 1997 between EU and those countries.

Source: Kerkelä and Huan-Niemi (2005) (original source: Authors' simulations and GTAP Database 5).

The quota rents Mozambique earns are very small. For the US market, sugar imports are also regulated by quotas, but the price paid is the world market price. As such, no subsidy element is present in sugar exports except to the EU. In 2003, Mozambique exported 10 400 tons of sugar to the EU at $ 526 per ton (value of $ 5.47 Million) and 13.000 tons to the USA at $ 302 per ton (value of $3.93 Million)[11]

Mostly due to WTO commitments, the EU has been obliged to renovate its domestic sugar regime, which poses a challenge to the current preferences within the EBA Agreement. In the EBA Agreement, full liberalisation of sugar is scheduled to start from 2009, which makes the price paid for the sugar an open question. It is quite obvious that the current intervention price is not affordable for the EU any more and the price will be close to the world market price. An opposite effect for world sugar prices can nevertheless be anticipated from the removal of export subsidies. Due to the EU's

[11] Source: A Sweeter Future, Oxfam Briefing Paper No. 10 (2994)

commitments to remove all the export subsidies, the world market price of the sugar can be expected to increase.

In a simulation study by Huan-Niemi and Kerkelä (2005), the liberalization scenarios for sugar imports to the EU are analysed from the developing country perspective. The experiment analysed assumes that EBA countries have free access to EU markets but EU sugar imports from other countries are subject to current level of tariffs. Mozambique is one of the exporting countries whose position in the outcome of the liberalisation scenarios is very much dependent on which EU country markets are opened. The best outcome is available if the EBA agreement is allowed only for LDC countries. It is still plausible to think that the previous relations with ACP countries will allow free imports within the EPAs.

In the simulations it was assumed that the current quotas prevent the countries from fully adapting to larger demand. So, even without the quota price the countries would adapt to new market conditions. In table 1 we present the aggregate economy effects and results in the sugar sector for some African countries when the EBA Agreement is fully implemented.[12]

[12] GDP results for countries like Swaziland and Mauritius are undervalued as they are aggregated regions in the GTAP Data base.

Table 7 elected results for African countries if sugar markets are liberalised in the EU

	EBA Agreement				
	GDP	Sugar production (%)	Sugar exports (%)	Aggregate exports	Welfare in $ Mio
Zimbabwe	0	3.5	5.3	-0.2	-3.5
Mauritius	0	-41.2	-74.2	-0.3	-12.9
Swaziland	0	2.7	9.1	0	35.3
Mozambique	0.4	236.4	295.5	-9.1	65.1
Malawi	1.2	2124.6	3439.1	0.5	125.5
Tanzania	1.1	131.1	5472.6	13.5	252.7
Uganda	0	21.7	14221.3	0	5.9
Zambia	-0.4	890.7	3083.6	-1.1	70.5
Rest of SSA	0.2	201.1	10374.9	1.7	1552.2
	EBA and EPA				
	GDP	Sugar production (%)	Sugar exports (%)	Aggregate exports	Welfare in $ Mio
Zimbabwe	0.2	207.2	371	0.4	78.7
Mauritius	1.2	1191.8	2002.8	5.3	536.5
Swaziland	0.1	282	977.6	-0.1	562.4
Mozambique	0	60.1	72.2	-0.6	5.1
Malawi	0.3	781.5	1265	0.3	31.4
Tanzania	0.2	36.5	1489.4	3.2	55
Uganda	0	3.8	1876.1	0	-2.1
Zambia	-0.2	362.7	1255.5	-0.1	15.4
Rest of SSA	0	41.1	1899.5	0.2	211.6

Source: Kerkelä and Huan-Niemi (2005), authors' simulations

In Mozambique, the production and exports of sugar could increase to 2 - 3fold from the current values. This would amount to 0.4 percent increase in GDP, or $65 million. The results are magnified compared to the previous results on trade agreements due to the elasticities used. In this study sugar is assumed to be a homogenous commodity where liberalisation would result in large trade flows (Armington elasticities 10/20 vs. 2.7/5.4 default assumptions). With these assumptions, the loss of quota rents implied by the reduction in EU producer prices would be covered by trade increases. The EU sugar reform, if implemented in the way assumed, would clearly be beneficial to Mozambique. The result also shows strong substitutability between aid and trade for Mozambique. In the current regime, aid is a lump sum (quota rent) paid to the Mozambican sugar producers. By removing it and increasing the market access to Mozambican producers the Mozambican aggregate income increases by a large amount. But this substitutability between aid and trade is clearly a product of the very specific nature of aid given.

Interestingly, the expansion of sugar production and sugar exports due to the simulated EU sugar policy reform seems to crowd out other exports. In value terms the crowding out is much smaller as the policy reform improves Mozambican terms of trade.

From the start of EBA agreement, the sugar industry in Mozambique received investments, especially from South Africa and Mauritius, as an option for a gateway to the European market was seen. Now the transitory nature of the current high price is clear. In the short term, only the high guaranteed price in the EU market was an incentive for investments. Still, by most of the surveys, Mozambique is one of the lowest cost producers in the world, as are most of the Southern African countries. In freely determined sugar markets, the competitive position of Mozambique is thus mostly determined by regional allocation of investments in Southern Africa.

As the current sugar preferences are clearly a form of tied aid and there is no clear evidence that the sector could not expand even without the clear subsidy in the form of prices when the markets are fully liberalised there is no reason why the subsidy could not be compensated forms other than a regulated price. The subsidy to improve the productivity in the sugar sector would make the sector more competitive in the future as well. This far the high price seems not to have had such productivity effects in the sector.

The sugar sector's principal challenge is that it is largely run by South African firms. They have located in Mozambique at least partly to gain access to EU markets. With changes in EU policies, one can ask whether they will withdraw from Mozambique. The analysis above does not support the pessimism as Mozambique is not hurt by the policy change as much as some other countries. The possibility of South African firms' withdrawal, however, means that improvements in sugar sector productivity and in local know-how should be supported now. Improving the prospects of the sugar sector

as it faces EU reforms is especially pertinent given its poverty-alleviation potential (especially if one includes processing activities).

10. Concluding Comments

Our first main result is that Mozambique does not seem to gain much, if at all from Doha and various regional trade agreements (with EU and SADC) (except from some agreements with EU) currently on agenda. This is surprising since e.g. in SADC region mutual trade barriers are still very high and one would have expected trade liberalisation within SADC to benefit also Mozambique as SADC liberalisation benefits the region as a whole.

Our second main conclusion is trade facilitation (modelled here to reduce transactions costs for Mozambican exports both at home and countries importing Mozambican goods) has beneficial effects. As our analysis shows that adverse impacts of aid (e.g. real appreciation) are small, aid for trade programmes seem to have large potential. The results indicate, however, also that trade facilitation has larger impacts on the production structure with new sectors in manufacturing growing and current important sectors (except sugar) contracting.

In Haaparanta and Kerkelä (2006) we identified cost and availability of credit to growing firms and the lack of business capacities as the major growth bottleneck in Mozambique. The solution to these problems must thus be found for trade facilitation to fulfil the promise it seems to be have for Mozambique.

To analyse the impacts of aid for trade, we used GTAP model simulations of an increase in aid accompanied by a decrease in the costs of trading in international markets (the presumed objective of aid for trade facilitation and trade capacity building). Specifically, we modelled the increase in aid as an increase in income to the economy; the drop in

trading costs was simulated as a uniform reduction across all sectors. The results were interesting as the sectors which currently have revealed comparative advantage (except sugar) would seem to contract relative to manufacturing excluding food, beverage and tobacco production, today the largest manufacturing sub-sector. Thus, there is potential for a deep structural change.

Current EU sugar policy can be seen as aid for trade policy, whereby countries are given a quota for exports and paid higher than the world market price. Thus, there are fears that the EU sugar reform, leading to reduced prices, will be very harmful. In case of Mozambique this fear may not be substantiated as it makes it possible to expand exports. The Mozambican sugar sector is, according to the GTAP simulations, competitive relative to other producers with access to EU markets. Hence, it is in a position to capture market share.

Finally, while we emphasise here and in Haaparanta and Kerkelä (2006) the lack of business capacities and lack and cost of finance as the major current growth bottlenecks, we do not want to downplay the other problems related to governance, i.e. corruption, and related problems like excessive regulation (red tape). Similarly, there are still problems in treatment of exports and imports. These problems have not, as of yet at least, prevented foreign investors from investing in Mozambique (partly driven by the subsidies and tax breaks available to firms, both for domestic and foreign). In the future, these factors are bound to get more weight in firms' decision making.

In general, we conclude that aid, particularly aid for trade, has a potentially positive role for increasing growth in Mozambique. Of course, realising this potential depends on the effective use of resources earmarked for trade facilitation, trade capacity building, infrastructure and institutional reform. This effort is critical to prepare Mozambican firms for a future in which they have greater access to external markets.

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Note: An excellent source of both documents and research on Mozambican economy is the Mozambican Trade and Investment Project website, http://www.tipmoz.com/, maintained by USAID.

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