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International sharing of experiences on investment policies*

Executive summary

UNCTAD's Investment Policy Reviews (IPR) provide assessment and policy advice on a country's legal, regulatory and institutional framework for investment with the aim to attract increased foreign direct investment (FDI) and to maximize the benefits from it. After completing over 35 IPRs, the programme has accumulated knowledge on investment policy and the common challenges transition and developing countries face.

This document provides a brief overview of experiences learned from the IPR programme over the last decade. It also presents the key findings of the recent IPRs of Djibouti and of Mozambique.

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* This conference room paper has not been edited.

I. Experiences from the investment policy review programme

1. The Investment Policy Review (IPR) programme aims at improving the investment policy framework and strategy of developing and transition economies with the goal of increasing the inflows of FDI and maximizing its developmental impact. Each IPR offers an objective evaluation of a country's regulatory investment framework as well as advice on investment policy strategy tailored to the beneficiary's needs. As part of their assessment, IPRs provide concrete recommendations and technical assistance in implementation where applicable. After completing over 35 IPRs spanning over more than a decade, the programme has taken stock of the investment policy knowledge accumulated and of the key challenges facing transition and developing countries in their efforts to attract FDI for development.[1]

2. Most IPR countries present varying combinations of a number of obstacles to investment and development. Adverse geographical, economic and political conditions combined with poor infrastructure, low levels of education and skills, and an unfavourable business climate for private sector development and weak institutions, may interact to perpetuate a vicious cycle of underdevelopment and poverty. FDI has a potentially key role to play in breaking and reversing this spiral into one of positive reinforcement and the creation of virtuous cycles of growth and poverty alleviation.

3. The aim of the IPRs is to make concrete recommendations to overcome some of these challenges in areas where opportunities are shown to exist. The IPRs are designed to set in motion a series of reforms to the investment framework in recipient countries around the world, and to identify specific strategies for attracting and benefiting from FDI. The next generation of IPRs will integrate the Investment Policy Framework for Sustainable Development (IPFSD) adopted by UNCTAD in 2012.

A. Reforming the investment policy framework

4. A central element of the IPRs is the analysis of the legal and regulatory framework for investment, with recommendations for reform. These are tailored to: (i) the country's overall development strategy; (ii) the available human and institutional capacity; and (iii) the country's stage of development. They cover all aspects of the investment framework, and aim to provide a clear strategic vision, a list of priorities and concrete proposals for reform. The assessment is based on a standard set of components of the investment framework covering FDI entry, establishment, treatment and protection, and a wide range of general measures affecting (local or foreign) investment. Among the most critical issues dealt with in the IPRs are those which concern the overall regulatory framework and FDI laws, taxation, labour, competition, land and governance.

5. In some countries reviewed, an extensive reform of the investment framework was required to modernize outdated regulations or to liberalize regulations derived from a country's State-dominated past. And similarly an overhaul of the foreign investment code was proposed in various countries to ensure a more open environment for FDI attraction. In about half of the IPRs, governance issues were a major constituent of reform of country investment frameworks.

[1] The main policy lessons of the IPR Programme are summarized in: *The Investment Policy Reviews – Shaping Investment Policies around the World,* UNCTAD, 2012.

6. Improving infrastructure is probably the biggest challenge facing developing and transition economies. Infrastructure issues and the significance of the investment framework for infrastructure are assessed in virtually all IPRs. Because of the vast costs and complexities of large infrastructure projects and their long timescales, private sector involvement is both necessary and desirable. However, potential foreign investors require a transparent and stable policy framework supported by the rule of law before committing to such projects. In effect, this means a framework for public-private partnerships (PPPs), since these are the dominant arrangement for FDI in infrastructure.

7. Besides skills upgrading, the major issues in the area of labour regulations concerned labour severance, labour disputes and the employment of foreigners. In the latter instance, regulations and mechanisms for approving work and residence permits required substantial liberalization to support foreign investment and overcome skills shortages. The significant number of countries requiring either new or enhanced competition regulations reflected the requirement to control potential monopolies following privatization and investments in infrastructure, and to provide protection for consumers. Finally, problems of land allocation, ownership and transfer, and specific restrictions on foreigners were also common challenges assessed in the IPRs.

B. Strategies for attracting and benefitting from FDI

8. Particularly prevalent among strategies proposed by the IPRs are those reforming and strengthening investment promotion institutions and national promotion efforts; promoting investment in target sectors; enhancing private sector development, often in collaboration with transnational corporations (TNCs); and developing skills and human resources. Proposals to grow markets through access to neighbouring regional markets are of major significance for countries where small internal markets are a barrier to FDI, especially market-seeking investment.

9. In providing strategic policy advice on investment, IPRs respond to widely varying country circumstances. For instance, the civil war that ended in 2002 in Sierra Leone inflicted huge damage to a small, poverty-stricken country. Since the end of the war, the country has made sound progress in re-establishing the conditions for economic and social development. However, the timescale for overcoming the constraints to FDI attraction was uncertain at the time of preparing the IPR; hence two scenarios were developed to provide dynamic and realistic approaches to the reform process and FDI attraction. For each of the scenarios, guidance is provided on the way ahead to achieving the objectives set, including FDI promotion and targeting.

10. The investment promotion agency (IPA) should have a central role in the marketing of the country to potential investors, from awareness raising and targeting to investment facilitation and aftercare services. Most IPR countries had IPAs, but they varied greatly in their institutional effectiveness, hampered by limitations in funding and lack of professional staff; while others had been established in an era when bureaucratic control over investment decisions was the norm. Thus substantial overhaul of the agencies were sometimes required.

11. Strategies found in IPRs also cover a diversity of targeted sectors, with infrastructure being the most prevalent, followed by agri-business, hydrocarbons and mining; and then banking and financial services, information and communication technology (ICT) and tourism. Some programmes were very much focused; others were wide-ranging or emphasized particular objectives. Nigeria was an exception in its focus on targeting non-

traditional investors (particularly China and India), and diaspora FDI. Specific advice was offered to capitalize on the increasing opportunities arising from the surge in South-South FDI flows, which is common to all IPR countries.[2]

12. The IPRs emphasize the importance of integrating strategies for FDI attraction with those for local private sector development, in recognition that entrepreneurship and absorptive capacity are pre-requisite for the promotion of linkages with TNCs. Among the middle-income countries, a relevant set of strategies related to promoting the internationalization of local firms, either through technological exports or outward FDI.

13. In the recently completed IPRs of Djibouti and Mozambique, special attention was paid to the development of investment strategies targeting job creation and poverty reduction. These two least developed countries (LDCs) face similar challenges in terms of human resources and infrastructure development and, in particular, the need to diversify their FDI inflows. In the two countries, achieving a higher contribution of FDI to the national development objectives requires a package of legal and institutional reforms aimed at improving the investment climate, accompanied by a targeted and cost-effective investment promotion effort. Brief summaries on the major findings of these two IPRs follow.

II. Investment policy review of Djibouti: summary

14. Located on the coastline of the Horn of Africa, Djibouti is strategically positioned between Africa, Asia and Europe. The country also enjoys political stability and relative social peace. Growth in annual gross domestic product (GDP) rose from an average of 3.5 per cent in the period 2000-2010 to 4.8 per cent in 2012. Djibouti is one of the African countries that have explicitly included foreign direct investment (FDI) issues in its policy documents since the early 2000s. In addition, the National Agency for Investment Promotion (ANPI), founded in 2001, is one of the pioneers on the continent.

15. However, Djibouti faces enormous challenges. A significant proportion of the population lives below the poverty line and unemployment affects half of adults and three quarters of youths. The skills level of the labour force is low, while the cost of labour is anomalously high. Moreover, while port development has been prioritized, Djibouti’s road and rail infrastructure remains underdeveloped. At the same time the cost of electricity and telecommunications is among the highest in the region. These factors have dampened Djibouti’s competitiveness and, consequently, its economic and social development.

16. Following public consultations, the Government adopted the National Initiative for Social Development (INDS) in 2007. The development strategy outlined in the INDS refers to the strengthening of economic growth through private sector development. The role of FDI is also mentioned, including the objective of stabilizing inflows at 20 per cent of GDP during the period 2011–2015. This constitutes a significant increase compared to previous years. Despite this ambitious goal, the country does not yet have a formal strategy for attracting FDI.

17. Djibouti has nevertheless received significant FDI flows in the 2000s that peaked in 2008. With an average annual FDI inflows of almost $150 per capita during the period 2006-2011, the performance of Djibouti was markedly better than that of countries in the Common Market for Eastern and Southern Africa (COMESA) and LDCs. Mainly

[2] See UNCTAD (2011). World Investment Report 2011: Non-Equity Modes of International Production and Development. United Nations Publication. Sales no.E.11.II.D.2. New York and Geneva.

concentrated in port and related activities (about 50 per cent), these investments came predominantly from the United Arab Emirates (around 70 per cent). However, the impact of existing investment on the local economy, though difficult to measure, is still limited, and relatively few jobs have been created. Subject to strong competition in international markets and the lasting effects of the recent financial crisis, the prospects of attracting substantial FDI inflows will depend largely on strong political will and a clear strategy.

18. Against this background, the Government of Djibouti requested UNCTAD to undertake an Investment Policy Review (IPR) with the express request for the review to include a strategy to attract FDI. Based on the Investment Policy Framework for Sustainable Development (IPFSD), recently developed by UNCTAD, the proposed strategy in the IPR invokes the 11 principles of the IPFSD, with the aim to leverage FDI to achieve sustainable development and inclusive growth outcomes. Specific recommendations for the development and effective implementation of this strategy follow the IPFSD's guidelines for national investment policies and take into account options for international investment agreements. The IPR also presents various examples of best practices from other countries, including LDCs. These examples show that despite enormous challenges, various options exist to attract FDI and that success depends on the efforts of all stakeholders in the implementation of the reforms identified.

19. Discussions with stakeholders conducted during UNCTAD's fact-finding missions in Djibouti and detailed analysis of the investment policy, regulatory and institutional framework informed the identification of the main weaknesses in the business environment. These weaknesses explain the lack of confidence in the Djiboutian economy and have served as an obstacle to increased investment. Furthermore, an explicit link between FDI and the role it can play in the development process is insufficiently detailed in government policy. The authorities are aware of the need to clarify their vision, develop a strategy to attract FDI and to better target promotional efforts at the sectoral level. These actions should also help to harmonize the Government's message on the role of FDI and its potential contribution to the national development process.

20. In this context, the IPR proposal to the Government of Djibouti comprises a multidimensional strategy to attract FDI, focusing on the following main elements:

(a) Initiate legal and regulatory reforms to improve the business environment;

(b) Invest significantly in infrastructure and human capital;

(c) Target attraction of FDI according to priority sectors;

(d) Stimulate public-private dialogue; and

(e) Strengthen investment-related institutions.

A. Set in motion ambitious legal and regulatory reforms to improve the business environment

21. The analysis of the legal and regulatory framework affecting FDI and the resultant recommendations are a central tenet in Djibouti's IPR. The analysis covers a wide range of national policies ranging from business development to the functioning of the labour market, corporate taxation and land titles. It also deals with international investment agreements, including the treatment and protection of foreign investors.

22. The analysis shows that Djibouti's investment framework is both complex and opaque. Complexity and opacity are detrimental to both the Government and investors, as they increase the costs of doing business and country risk. The lack of clarity in the legislation and changes in its orientation, introduced during the last decade, make their

interpretation and implementation difficult. This is reflected in international rankings which place Djibouti among the countries where it is difficult to do business.

23. Several legal and regulatory reforms are suggested in the IPR to improve the business climate. The adoption of a new investment code based on international best practices is recommended to signal the Government's commitment to establish an environment for investors that is transparent, stable and predictable. Priority elements will include clarity on the conditions of entry, establishment and treatment of foreign investors and better guarantees of protection. In addition, the investment code should specify the degree of openness to FDI advocated by the authorities in Djibouti and establish through a "negative list" areas that are not accessible to foreign investors. This will eliminate the confusion that currently characterizes Djibouti's legal framework on the openness of some sectors to FDI.

24. Improving the business environment also requires a number of measures, including the establishment of simpler administrative procedures that are faster and less costly for business creation and taxation. Entrepreneurship is the starting point for many investments, thus it is important to create the conditions necessary to stimulate the Djiboutian private sector and foster its creativity. To this end, the IPR suggests a corporate taxation regime that contains measures to promote the development of small and medium-sized enterprises (SMEs). In addition to these measures, it is necessary to align initiatives in labour market conditions, competition and access to land to the development objectives of the country and the needs of investors.

25. The establishment of a climate of confidence also encompasses the demonstration of the political will to improve governance and correct irregularities in the judicial system. This includes the application of the law on conflict of interest for public servants, and intensifying the fight against corruption. In this regard, this report urges the speedy completion of the draft law on corruption that is currently under way. The ongoing cooperation with key partners to organize a series of meetings and seminars on good governance and transparency should also help build capacity and improve the efficiency of the administration.

B. Invest significantly in infrastructure and in human capital

26. The competitiveness of a country depends heavily on the availability and quality of infrastructure and human capital. Foreign investment in key sectors such as tourism, agriculture and light industry remains limited in Djibouti because of the lack of competitiveness of its infrastructure and human capital. Reversing this situation requires major structural reforms to allow the private sector to inject some of the capital needed for infrastructure improvements. The country would indeed benefit from a legislative and institutional framework promoting public-private partnerships. The IPR also recommends that the Government consider cutting electricity prices to reflect the recent improvements brought by the connection to Ethiopia's hydro-electricity network. Concerning water, the recent bilateral cooperation agreement with Ethiopia is strategically important to increase the supply and reduce costs.

27. To develop human capital, Djibouti is advised to adopt a national policy for skills formation, with input from all key stakeholders. Such a policy should be guided by the aim to better match training and employment requirements. Tools specific to its implementation include the establishment of a training fund and tax incentives for training.

C. Target FDI attraction in priority sectors

28. The Government has identified a relatively large number of sectors as priorities for the diversification of the economy and facilitating sustainable development. It has also stressed the desire to attract FDI. To achieve this, the Government provides different tax incentives for various sectors. The granting of incentives does not necessarily consider the attractiveness of these sectors for foreign investors nor is it complemented by a sector-specific strategy to attract FDI. Consequently, the impact of these measures is generally limited and rather modest volumes of FDI are attracted in these sectors.

29. The IPR recommends that the Government reprioritize the sectors where it wants to attract FDI so as to better facilitate actual investment inflows into the country In this regard, the IPR suggests a more strategic identification of sectors prioritized for attracting FDI. This would allow for measures aimed at attracting FDI to be tailored around the specific characteristics of a particular sector. These include measures that are regulatory nature as well fiscal ones, such as tax incentives. Specific sectoral targeting will also help to better define accompanying sector-specific investment promotion activities.

30. UNCTAD's IPR identified fisheries, and transport and logistics as two priority sectors in the short term. Tourism and, to a lesser extent, agriculture also hold promise. However, infrastructural and local market constraints temper the potential, at least in the short term. Finally, although the telecommunications sector is not listed among the priority areas of the Government, the IPR suggests that a gradual opening to FDI, guided by an appropriate regulatory framework, would improve the services provided to users in terms of both price and quality. This would also have positive effects on the activities of other sectors, such as services.

31. Achieving and maintaining competitiveness in priority sectors requires keeping an edge over competitors. To achieve this edge, the IPR offers the Government of Djibouti a dynamic approach that focuses on the analysis of competitive drivers of profitability in different sectors and understanding the strengths and weaknesses of competitor countries. To remain relevant, sectoral strategies should be revised regularly, through the use of a monitoring and evaluation mechanism. The effectiveness and credibility of such a mechanism depends on the availability of good quality statistics. The Government is aware of the need to improve the quality of national statistics. To achieve this objective it has developed a master plan for statistics. This plan should be implemented as a matter of priority and be accompanied by capacity-building in data collection and analysis, including statistics related to investments.

D. Encourage public-private dialogue

32. The definition and implementation of a strategy to attract FDI and its sectoral components require joining all the forces of the nation. Such a gathering of forces will release the energy essential for the development of Djibouti's economy. In this regard, the IPR recommends that the initiative to institutionalize the leadership of the Head of State through a mechanism of public-private dialogue — the High National Council of Public-Private Dialogue — is rapidly operationalized.

E. Strengthen the institutions dealing with investment

33. The Djiboutian Government has taken initiatives to reform the institutional framework for investment. Despite these efforts, there are still many overlapping mandates

of institutions involved in investment promotion and private sector development. Similarly, coordination mechanisms are inadequate.

34. To drive its strategy of attracting FDI optimally, it is essential that Djibouti streamlines the institutional framework for investment to make it more conducive to exchanges between all relevant institutions. In addition, the IPR calls for the strengthening of the ANPI so that it is able to better fulfil its mandate to attract investors to the country. The IPR also highlights the need to improve sectoral targeting and the systematic monitoring of investors.

III. Investment policy review of Mozambique: summary

35. Structural reforms, sound macro-economic policies, an opening to the global economy and political stability have generated strong growth since Mozambique emerged from the civil war and started its transition from planned to market economy. As a result, the poverty rate has declined and significant progress has been achieved towards attaining the Millennium Development Goals. Yet, the overall picture is mixed and progress achieved so far insufficient. Mozambique remains one of the world's poorest countries, the decline in poverty appears to have stalled in recent years and income inequality remains high. The country is now confronted with an issue of "quality of growth" and it needs to consider measures to ensure that growth is pro-poor, inclusive and environmentally sustainable.

36. FDI picked up slowly in the five years following the peace agreement in 1992. A major breakthrough occurred in the mid-1990s when a consortium of foreign investors decided to establish the large-scale aluminum smelter Mozal. The project sent a strong signal to the world business community that Mozambique was open for investment and capable of hosting such large-scale projects, and changed risk perceptions. More recently, other mega-projects, mostly in mining, have generated large FDI inflows.

37. The contribution of mega-projects to the economy has been huge in some respects, but very limited and short of — at times excessive — expectations in others. Despite significant efforts by all stakeholders involved to create linkages between mega-projects (Mozal in particular) and local companies, the results remain limited because of the intrinsic mismatch between large-scale, export-oriented and high-technology projects and the capacity of local businesses. There is also an increasing sentiment in Mozambique that the country does not obtain a fair share of the benefits of mega-projects. In addition, Mozambique has come to realize that capital-intensive mega-projects cannot generate employment at a level commensurate with the needs of a labour force in excess of 9 million people. Mega-projects have also not generated, by nature, broad-based growth and economic diversification.

38. The Investment Policy Review of Mozambique stresses the intrinsic limitations of mega-projects and underscores the large untapped development potential of projects by smaller international investors, which have been an underestimated factor so far. Data from the Investment Promotion Centre (CPI) indicate that non-mega projects FDI were expected to create 265 500 jobs — on a registration basis — which is a large multiple of what has been created by mega-projects.

39. Mozambique must generate inclusive and broad-based growth if it is to achieve its development goals and sharply reduce poverty. A particularly challenging task will be to create formal jobs at a rapid and sustained pace. An ambitious strategy of economic development and diversification is called for. Private investment, both national and foreign, should be the driving force of the economy, underpinned by a strong regulatory framework and sustained public investment.

40. The IPR provides a comprehensive assessment of the investment climate and proposes concrete recommendations on the regulatory framework, sectoral policies and investment promotion institutions. Measures are articulated around four key orientations:

(a) Looking beyond mega-projects for economic growth and diversification;

(b) Supporting investment in areas where opportunities best match development needs;

(c) Maximizing the development impact of investments in mega-projects, mining and PPPs;

(d) Improving the effectiveness of investment promotion.

A. Look beyond mega-projects

41. Over the recent past, mega-projects have dominated the policy debate on FDI and its potential contribution in achieving the country's development goals. In contrast, surprisingly little attention has been paid to foreign investments of a more modest scale, despite their large potential development impacts.

42. In light of Mozambique's economic structure and development challenges, it is recommended that Government efforts be better balanced towards also promoting and supporting non mega-projects investments and SMEs, be they national or foreign. It is high time that Mozambique started looking beyond mega-projects as a source of growth, economic diversification and job creation. Promoting investment of a more modest scale, attracting SME-FDI and building linkages with national investors should become a strategic priority for the country, without nevertheless neglecting opportunities offered by mega-projects.

43. Concretely, this means that Mozambique should strive to eliminate the inherent regulatory bias against investors of a relatively modest size, which results from formal legal provisions and from the complexity of certain procedures. In addition, regulatory institutions remain more inclined towards a "control and sanction" attitude towards investors, rather than seeking to support operations and promote partnerships. A key objective of reforms looking ahead should thus be to ensure that businesses are regulated as partners for development.

44. It is recommended that Mozambique adopt a new investment law and use it as a keystone for a partnership-driven reform of the business climate and deeper mentality change among regulators. In line with modern practice in many developing countries, Mozambique could eliminate the CPI licensing requirement, hence also getting rid of the investment licence as a gateway to tax and non-tax incentives. Concerns regarding the protection of the national interest would be covered by other laws and regulations, leaving the investment law to set basic rules on entry, treatment and protection.

45. The investment law should strive to establish a level playing field for all investors and guarantee core standards of treatment and protection without discrimination. As this is done and as investment licences are eliminated, Mozambique would also cease to provide contractual guarantees on treatment and incentives to investors. If need be, entry restrictions for foreign investors could be established on a targeted basis, but the country's open and welcoming stance should be maintained.

46. Moreover, the investment climate should be further improved by streamlining and easing licensing procedures, which remain complex and burdensome. Mozambique could engage in a systematic review of licensing procedures for investment with the view to eliminate requirements that do not serve a genuine regulatory purpose or that are redundant

and to lighten the administrative burden imposed on investors. The introduction of IT and e-governance tools could be used to this purpose place as part of a wider strategy to adopt e-governance at the national and provincial level.

47. The ability to freely transfer legitimate funds — e.g. after-tax profits, payments on external debt or invested capital — is crucial for foreign direct investors. The recently adopted Law on Foreign Exchange and implementation decree represent a major step forward in that they eliminate restrictions on current transactions. Yet, they also introduce new restrictions that represent serious concerns and operational constraints on investors and are likely to discourage FDI. It is recommended that the law and its implementation decree be amended to ensure that foreign investors are free to repatriate earnings and capital, ease some foreign exchange restrictions and to avoid creating special regimes.

48. In spite of recent reforms and significant progress in improving tax administration, Mozambique still lacks a clearly defined strategy to guide tax policy, particularly when it comes to corporate taxation and investment incentives.

49. The IPR recommends adopting a strategy with the following key objectives to: (1) further increase tax revenue as a percentage of GDP; (2) ensure that a fair share of the rent from natural resource extraction is appropriated by the country and put to optimal use; (3) promote the achievement of national development goals; (4) provide a favourable, non-distorted and non-discriminatory environment for investors; and (5) encourage compliance and ease tax administration.

50. Mozambique's economy remains small in spite of the past decade of strong growth, and companies can relatively easily be in a de facto monopolistic position or enjoy dominant market power. As a result, efforts to establish a fair and effective competition framework should be stepped up. The adoption of the draft competition law should be a priority, as should be the creation of an independent competition authority capable of monitoring practices in key markets and with sufficient powers to enforce effective competition. The reduction of barriers to entry, including in terms of administrative requirements and access to financing, should also be used as a tool to foster competitive markets and promote the emergence of SMEs.

51. In this regard, Mozambique should focus on efforts to support its SME sector and foster entrepreneurship. It will be important to ensure that the Instituto para a Promoção das Pequenas e Médias Empresas (IPEME) is adequately resourced to enable it to fulfil its missions and objectives, including in Mozambique's provinces.

52. Access to land remains difficult for many foreign investors, as the system of allocation of land-user rights (DUATs) is complex and lengthy. Existing procedures should be reviewed with the purpose of finding ways to simplify and shorten them and ensure that a clear sequencing is established between various requirements. In addition, municipalities and provincial authorities should promote the establishment of industrial and services parks in partnership with private developers. Such parks could provide turnkey facilities for potential investors on a long-term leasing basis. As far as land for agriculture is concerned, the allocation of large plots to investors will have to be conducted in full transparency and with strict conditions attached. Lastly, best efforts should be made to fight land grabs and speculative uses of DUATs.

53. Access to skills remains a major constraint in Mozambique, and the current system of allocation of work permits for expatriates does not promote the country's long-term development interest well. In addition, the current regime is largely discriminatory towards smaller investors when it comes to negotiating ad-hoc quotas under CPI investment licences.

54. A fundamental reform to the system of attribution of work permits is proposed, which would fulfil this objective, while at the same time protecting the interests of Mozambican workers, promoting job creation and fostering training and transfers of skills to nationals. Rather than operating on an ad-hoc and company-level way to define quotas for work permits, the proposed system would be based on nationwide and occupation-based quotas, to be determined based on an objective evaluation of the country's supply and demand for determined skills.

55. The worldwide trend towards liberalized markets has enabled TNCs to lead a process of globalization and regionalization of production networks. As a result, country-level operations within global/regional supply chains are now a key dimension of corporate strategy. Components of the supply chain are thus located in the country where their activities can be performed best. On the basis of the analysis of this report, it is recommended that Mozambique adopt a strategy to induce and support foreign affiliates, both existing and new ones, to be able to compete regionally and globally in activities with high domestic value addition.

56. Increased competition will most likely increase the need to place more emphasis on securing more competitive supplies, including nurturing local suppliers. To this end, free zones could be converted into economic development zones, where businesses will have access to excellent facilities, including high-quality services. These zones could then be used as incubators for the development of local industrial capacity and insertion into the global value chain.

B. Match needs and investment opportunities

57. International experience with industrial policy has been mixed around the world, with some successes but also notable failures. Governments face the risk of industrial policies being unduly subject to lobbying forces and special interests, thereby leading to wasted resources and favouring the few at the expense of the majority.

58. Mozambique should carefully adopt devised sectoral strategies aiming to support investment in areas where it has clear comparative advantages and whose development can clearly help achieve the country's national development goals.

59. No single project or sector development can ever carry all the desirable effects that Mozambique may wish to obtain from an investment. Each investment or sector will yield specific development benefits, and perhaps potential adverse effects. Based on the country's current economic conditions brief recommendations are provided for strategies in: (1) agriculture and agro-processing; (2) tourism; (3) small-scale manufacturing and services; and (4) infrastructure and logistics. FDI has the potential to make significant contributions in each of these sectors, which themselves are susceptible to underpin broad-based and inclusive growth, job creation and economic diversification. In addition, Mozambique should step up its support for technical and vocational training, in partnership with private investors who are already investing in skills building. Public support for vocational training should be provided selectively and based on an assessment of the needs of the economy and the investment opportunities.

C. Maximize the impact of mega-projects and PPPs

60. The importance of diversifying the economy through a significantly more broad-based investment (and FDI) promotion strategy cannot be over-emphasized. This is not to say, however, that mega-projects in natural resource extraction and other sectors and large PPPs should be neglected. On the contrary, it is essential for Mozambique's long-term

development prospects that their positive impact and contribution to the economy be maximized through adequate and careful project management.

61. It is therefore extremely opportune that Mozambique recently decided to put in place a regulatory framework for PPPs and mega-projects. The law adopted in May 2011, however, has a number of important flaws that should be rapidly corrected.

62. One of the most important flaws of the new law is that it bundles projects of fundamentally different natures under a common set of rules and fails to build adequately on existing sectoral laws and regulations. It is recommended to: (1) abrogate the law on PPPs and mega-projects as it currently stands; (2) prepare a law dealing exclusively with PPPs; (3) regulate mining and other natural resource extraction projects under revised sector-specific rules; (4) avoid imposing unnecessary or impractical blanket requirements on local ownership; (5) regulate purely commercially-oriented mega-projects like other projects; and (6) avoid making general regulations prevail over specific ones. The scope of the PPP law should be restricted to projects where private investors are involved in the provision of goods and services of a public nature, which is not the case for mining.

63. The creation of a dedicated PPP unit in the Ministry of Finance is a welcome initiative that should enable Mozambique to better manage the technical and financial aspects of partnerships with the private sector. As currently envisaged, however, the PPP unit would be almost entirely focused on regulatory issues. It is recommended that a strong promotional component be added to the PPP unit in the future. Its role would be to actively seek private partners to develop projects of particular interest and benefit to the country.

64. Addressing issues on opportunities and challenges from natural resource extraction would be best achieved through two main regulatory channels: sector-specific regulations (as distinct from a general PPP and mega-project law) and the corporate income tax regime applying to mining investments. Sector-specific regulations should ensure that appropriate measures are put in place to protect the environment and local communities. Taxation, in turn, should be the main channel through which Mozambique appropriates its fair share of benefits from mining projects. A special tax regime for natural resource extraction activities should be integrated in the corporate income tax code, which would ensure not only that an adequate share of the rent is appropriated nationally, but also that investors' needs are taken into consideration. As far as the renegotiation of past incentives is concerned, Mozambique should adopt a careful and non-conflictual approach, as tax breaks were granted in full legality and "locked-in" under stabilization contracts. A negotiated settlement should be found, as litigation would prove expensive and highly detrimental to Mozambique's image as an investment destination. Adequate management of windfall revenues will be just as important for the country's development path, and it is recommended that a stabilization fund be established, following the example of successful countries like Chile, Norway or Oman.

65. In addition to direct financial benefits, Mozambique will have to adopt proactive policies to maximize linkages between mining companies and the rest of the economy. Expectations should remain realistic, as it has proved difficult in most countries to create strong backward or forward linkages with export-oriented mining companies and as coal is not a resource that can be subject to local transformation, but synergies should be developed wherever possible. In particular, there is strong potential for synergies in infrastructure development (e.g. transport and electricity).

D. Improve the effectiveness of investment promotion

66. Mozambique could also benefit from improving its investment promotion efforts and sharpening the focus of the CPI on promotion rather than regulation. If adopted, the

recommendation to eliminate investment licences would automatically abolish the regulatory role of the CPI and enable it to focus all its resources on investment promotion and facilitation. Even if the CPI were required to continue to issue investment licences, however, it would benefit from strengthening its promotion efforts. Its core functions would be to: (1) build and promote Mozambique's image; (2) prospect and generate leads among targeted investors; (3) help prospective investors investigate business opportunities; (4) support new investors in their establishment procedures; (5) promote business development and growth in the post-establishment phase; and (6) enhance the integration of foreign-owned companies into the local economy.

67. It is strongly recommended that the CPI adopt a full-fledged and sophisticated customer relationship management IT tool to enable it to track its contacts with all investors (clients) from the initial request for information or self-generated contact to the establishment and operational phases. This should enable the CPI to provide a seamless and high-quality service to investors, while also increasing its ability to understand their needs, constraints and operations.

68. A new organigramme is proposed for the CPI, in order to reflect the rebalancing of its function away from regulation and towards investment promotion. It is based on four key operation departments: (1) international markets and communication; (2) client services; (3) aftercare and linkages; and (4) provincial representations. The client services department would function along sector-specific lines, with specialists in key sectors. The CPI would be headed by a CEO in charge of day-to-day management and relationships with investors.

69. It is also suggested that the CPI be put under the supervision of a board of directors, which would define strategic orientations and be responsible for oversight. The Board would be composed of representatives from all key ministries in order to ensure that the whole of government is on board to promote investment.

70. Implementing investment strategies, policies and regulations geared towards the achievement of national development goals requires a high degree of coordination and coherence among a wide range of issues that cut across ministerial lines. In order to drive the implementation of reforms and ensure optimal coordination of efforts, it is therefore recommended to establish a position of Special Coordinator for Investment Reform and Enterprise Development within either the President's or the Prime Minister's office. The Special Coordinator would have the main responsibility to push for regulatory reforms and to ensure an effective implementation of the country's investment strategy under a coordinated, whole-of-government approach. (S)he would have the primary responsibility for liaison with the ministries whose activities impact on investment. The Special Coordinator would chair the Board of the CPI. Given the cross-ministerial nature of the work and need to drive reforms, it is important that the Special Coordinator be given a senior position within Government.

71. Mozambique has established a formal dialogue between the Government and the private sector for more than a decade. The main channel is an annual conference attended by a large number and wide range of representatives from the private sector and Government officials at the highest level, in combination with more regular consultations at the Ministerial level structured around thematic working groups.

72. This system of consultations has proved useful and is well organized, but it should be further improved. For instance, wider implication of private sector institutions, including the Chamber of Commerce of Mozambique and other chambers of commerce based in the country, should be sought. In addition, it would be worth considering the establishment of a Presidential Council on investment in order to establish a formal and direct dialogue between the President and the private sector.