



investment policy review



MOZAMBIQUE 





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Preface

The UNCTAD Investment Policy Reviews (IPRs) are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered by the UNCTAD Commission on Investment, Enterprise and Development. The recommendations of the IPR are then implemented with the technical assistance of UNCTAD. The support to beneficiary countries is delivered through a series of activities which can span over several years.

The Investment Policy Review of Mozambique, initiated at the request of the Government, was carried out through a fact-finding mission in November 2010, and is based on information made available to UNCTAD until June 2011. The mission received the full cooperation of the relevant ministries and agencies, in particular the Investment Promotion Centre and the Ministry of Planning and Development. The mission also benefited from the views of the private sector, foreign and domestic, bilateral donors and development agencies. A draft version of this report was discussed with stakeholders at a national workshop in Maputo on 11 November 2011. This final version integrates comments received on that occasion.

The relevance and effectiveness of the regulatory regime is assessed against several related criteria: (a) whether the regulation adequately promotes and protects the public interest; (b) whether the regulation adequately promotes investment and sustainable socio-economic development; and (c) whether the policies employed are effective and well administered, given their public interest and development objectives and the legitimate concerns of investors that rules and procedures do not unduly burden their competitiveness. International benchmarks and best policy practices are taken into account in making the assessment and recommendations in this report.

Building on an analysis of Mozambique's economy and a critical assessment of the investment framework, this Review proposes an investment and FDI strategy that focuses on promoting a diversification of inflows and fostering more broad-based and inclusive growth. It suggests a number of measures to improve the investment climate for small and medium businesses and for SME-FDI, which have been neglected in recent years as mega-projects mobilized much policy attention in recent years.

This report was prepared by the Investment Policy Reviews Section under the supervision of Chantal Dupasquier. James Zhan, Director of the Investment and Enterprise Division provided overall guidance. The report was drafted by Quentin Dupriez, Hans Baumgarten and an international consultant. Daniel Levien provided research assistance at the initial stage of the process and Irina Stanyukova provided statistical support. It also benefited from comments and suggestions from UNCTAD colleagues under a peer review process. It was co-funded by the Government of Sweden and the United Nations under the One-UN initiative.

It is hoped that the analysis and recommendations will contribute to improved policies, promote dialogue among stakeholders, catalyse investment and the beneficial impact of FDI and ultimately help Mozambique achieve its development objectives.

Geneva, April 2012

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Abbreviations

ACIS	Associação de Comércio e Indústria (Trade and Industry Association)
ACP	Africa Caribbean Pacific
AGOA	African Growth and Opportunity Act
ATM	Autoridade Tributária de Moçambique (Tax Authority of Mozambique)
BIT	bilateral investment treaty
BOO	build-operate-own
BOT	build-operate-transfer
CEO	chief executive officer
CIF	cost insurance and freight
CNELEC	National Council of Electricity
CPI	Centro de Promoção de Investimento (Investment Promotion Centre)
CRM	customer relationship management
CTA	Confederação das Associações Económicas de Moçambique (Confederation of Economic Associations of Mozambique)
DTT	double taxation treaty
DUAT	direito de uso e aproveitamento de terra (land-user right)
EBA	everything but arms
EIA	environmental impact assessment
EU	European Union
FAO	Food and Agriculture Organization
FDI	foreign direct investment
FRELIMO	Frente de Libertação de Moçambique (Liberation Front of Mozambique)
GATT	General Agreement on Tariffs and Trade
GAZEDA	Special Economic Zones Office
GDP	gross domestic product
ha	hectare
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFZ	industrial free zone
IMF	International Monetary Fund
INCM	National Institute of Telecommunications of Mozambique
IPA	investment promotion agency
IPEME	Instituto para a Promoção das Pequenas e Médias Empresas (Institute for the Promotion of Small and Medium Enterprises)
km²	square kilometer
LDCs	least developed countries
MFN	most-favoured nation

MT	meticals
OECD	Organisation for Economic Co-operation and Development
PARPA	action plan for the reduction of absolute poverty
PFI	Policy framework for investment
PPP	public-private partnership
RENAMO	Resistência Nacional Moçambicana (Mozambican National Resistance)
SADC	Southern African Development Community
SACU	Southern Africa Customs Union
SEZ	special economic zone
SMEs	small and medium enterprises
SPGC	Provincial Services of Geography and Cadastre
TNCs	transnational corporations
TRIMs	trade-related investment measures
TVET	technical and vocational education and training
UNCITRAL	United Nations Center
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
VAT	value-added tax
WTO	World Trade Organization

Executive summary

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.

Foreign direct investment (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.

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.

This Review 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.

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.

This Review provides a comprehensive assessment of the regulatory framework for investment and identifies a number of key weaknesses, including in particular: (1) the general approach to investment rulemaking; (2) corporate taxation and the structure of tax incentives; (3) the employment of foreigners and access to skills; (4) access to land; (5) PPPs and the management of mega-projects; and (6) licensing and inspections. A crucial weakness is that the regulatory framework for investment is not sufficiently geared towards helping small and medium businesses emerge, develop and expand. In many respects,

In spite of progress,
Mozambique is
confronted with an issue
of quality of growth

Mega-projects have intrinsic limitations and cannot alone generate inclusive growth and foster job creation on a large scale

they are not put on an equal footing with larger companies, and insufficient consideration is given to their needs and constraints.

Building on the analysis of chapter I and the assessment of chapter II, chapter III proposes a strategy to attract the type of FDI that could best support Mozambique achieve its development goals and address its main challenges, including job creation. It offers not only strategic orientations, but also concrete recommendations on the regulatory framework, sectoral policies and investment promotion institutions. Measures are articulated around four key orientations:

- Looking beyond mega-projects for economic growth and diversification;
- Supporting investment in areas where opportunities best match development needs;
- Maximizing the development impact of investments in mega-projects, mining and PPPs;
- Improving the effectiveness of investment promotion.

Orientation 1: look beyond mega-projects

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.

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.

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, i.e. that regulators not only enforce clear and transparent rules to protect the national interest, but also act to proactively promote business development and mutually beneficial outcomes. Seven priority groups are identified for regulatory reforms, with these objectives in mind.

Group 1: reform the law on investment and introduce modern regulatory standards

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.

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.

Group 2: provide stronger guarantees and more flexibility on transfer of foreign exchange

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 rapidly amended in order to: (1) ensure that foreign investors are free to repatriate earnings and capital; (2) eliminate the obligation to convert foreign exchange earnings into meticaís and allow them to be held in domestic foreign currency account; (3) treat all foreign investors on an equal footing and avoid creating special regimes.

Group 3: reform tax and incentives policy

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. The contradictions between the recently adopted range of incentives and the desire to ensure that private investment – mega-projects in particular – contribute to the country's development by paying appropriate levels of taxes is symptomatic of this lack of strategy.

It is recommended that such a strategy be adopted urgently. It would seek to achieve a number of key objectives, including 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.

Concretely, this would translate into: (1) a rationalization of tax incentives, which would be more limited and focus on key objectives such as job creation, business linkages, skills transfers and infrastructure development; (2) a small reduction in the headline corporate income tax rate to compensate for the elimination of distortionary incentives; (3) the provision of incentives on a non-discriminatory basis, not related to the size of investment; (4) the elimination of tax stabilization clauses as part of the abolition of the CPI investment licence; (5) the establishment and enforcement of clear transfer pricing rules; and (6) speedy and effective VAT refunds.

The Investment Policy Review proposes measures to maximize the positive contribution of FDI to national development goals

More policy attention should be given to promoting small- and medium-scale investments

Group 4: streamline licensing procedures, reform regulatory attitudes and support SMEs

The investment climate should be improved further by streamlining and easing licensing procedures, which remain complex and burdensome. In addition, regulatory institutions are typically biased towards a “command and control” attitude and fail to see their role as promoters and facilitators of investment.

Mozambique could engage in a systematic review of licensing procedures for investment with the view to: (1) eliminate all requirements that do not serve a genuine and necessary regulatory purpose or have become redundant with other requirements; (2) lighten the administrative burden imposed on investors as much as possible, including through the introduction of IT and e-governance tools; (3) avoid overlaps between different sets of requirements. Such reforms would ideally take place as part of a wider strategy to adopt e-governance at the national and provincial level. A change in regulatory attitude should be pushed for at the highest level of Government, and could be promoted by the preparation of “client charters” for key regulatory agencies in direct contact with investors.

In addition to eliminating the regulatory bias against investors of a relatively modest size, Mozambique should step up its 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.

Group 5: foster fair and effective competition

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.

Group 6: facilitate access to land and DUATs

Access to land remains difficult for many foreign investors, as the system of allocation of land-user rights (DUATs) is complex and lengthy. Within the existing framework that does not allow private ownership of land, the authorities could still aim to find new ways to put the country’s vast resources linked to land to productive use and to facilitate access to land for investors in industry and services. 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.

Group 7: facilitate access to skills and promote skills transfers

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.

Experience from around the world shows that building human capital is essential for long-term development prospects and poverty reduction. Although human capital development is driven first and foremost by education policy, a well-crafted immigration policy could also contribute in three important ways: (1) by filling temporary skills gaps; (2) by contributing to skills building and transfers of know-how; and (3) by cross-fertilizing skills and know-how. The policy should also aim at ensuring that investors can readily access the skills that they need for their operations, whether they are available locally or not.

A fundamental reform to the system of attribution of work permits is proposed, which would fulfill 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. The procedures for the allocation of work permits would be eased for requests falling within quota, including by combining work and residence permits and lengthening their validity to up to three years. Additional work permits could be attributed pending demonstration that no Mozambican could be identified for any given post.

In addition, Mozambique could establish a special scheme to entitle the affiliates of transnational companies to recruit a small number of key managerial staff internationally. A scheme to attract entrepreneurs with viable business projects and capital to invest would also enable Mozambique to attract small-scale but meaningful foreign investors.

Orientation 2: match needs and investment opportunities

International experience with industrial policy has been mixed around the world, with some successes but also notable failures. Not all countries have the same power and capability (financial or otherwise) to implement industrial policies and provide support to emerging sectors. In addition, it is notoriously difficult for government officials to "pick winners", whether they are individual companies to support or specific sub-sectors or clusters to promote. Governments also 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.

In spite of these risks and challenges, Mozambique should nevertheless adopt carefully 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.

Tax policy should be guided by a few core objectives, including promoting SME investment and taxing natural resources projects fairly

Access to skills remains a major constraint, which could be partly alleviated by a more open and proactive policy of allocation of work permits for skilled expatriates

Group 8: adopt development and promotion strategies in key sectors and target matching FDI

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 and prospects, Chapter III briefly assesses the types of foreign investors that would be most likely to be interested in investing in Mozambique, their motivations, the potential benefits that they could bring to the country and the risks that their investment could entail.

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.

Orientation 3: maximize the impact of mega-projects and PPPs

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 public-private partnerships (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.

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 corrected rapidly. Of particular concern is that the law: (1) regulates very distinct issues under a single umbrella and set of principles; (2) seeks to "regulate" benefits; (3) imposes excessive operational constraints on local participation; and (4) contains problematic rules on taxation and the role of the PPP unit.

A number of reforms are suggested to the recently adopted law. They aim to ensure maximum benefits from PPPs and mega-projects for Mozambique, while at the same time providing an attractive environment for projects to take place.

Group 9: reform the regulatory framework for PPPs under a fine-tuned approach

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.

Group 10: promote PPPs and leverage private investment for infrastructure development

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. It could identify, among others, a pipeline of projects and prepare preliminary feasibility studies, focusing on “low-hanging fruits” investments with strong commercial viability, limited technical complexity and demonstrable impact. In this promotional work, the unit would have to work in close cooperation with the CPI.

Group 11: maximize the impact of natural resource extraction (mega) projects

Natural resource extraction offers formidable development opportunities and potential benefits. It also generates challenges, however, including in terms of short-term macro-economic and financial management, long-term development and economic structure (natural resource curse), and environment and social issues. Mozambique is also rightfully concerned about obtaining a “fair share” of the benefits from natural resource extraction.

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, particularly if renegotiation affects projects outside of natural resource extraction. The country’s reputation for meeting its commitments and its recently earned standing as a stable and limited-risk destination are extremely valuable – and a major achievement for a post-conflict country – and should not be compromised for short-term gains.

Mozambique should adopt carefully devised policies to promote the types of FDI that best match its needs and potential

The impact of mega-projects needs to be optimized, including through a more fine-tuned regulatory approach to PPPs

Securing adequate tax revenue from natural resource extraction projects would only take Mozambique half way to optimizing benefits, however. 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.

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). Proactive linkages and outsourcing programmes should also be encouraged. The most important opportunities in the short term should be to involve local businesses and communities in the provision of relatively low value-added services in the short term, progressively building towards the establishment of a more elaborate network of engineering and mining-related services in the medium term.

Orientation 4: improve the effectiveness of investment promotion

If implemented, the reforms advocated above would generate a new qualitative leap in the investment framework and a step further towards achieving sustainable development through mutually reinforcing private and public initiatives. In addition to these structural reforms, 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, and the majority of the operational changes recommended below could still be applied.

Group 12: narrowing down the CPI on investment promotion

Evidence from investment promotion agencies around the world shows that those that are not required to fulfill a regulatory role are significantly more effective at promoting FDI than those that must combine both functions. Eliminating the investment licence would be a useful reform in itself, as elaborated upon above, and it would bring the added benefit to focus the CPI entirely on investment promotion and facilitation. 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.

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.

A new organigram 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 mining and mega-projects, agriculture and agro-processing, tourism, infrastructure and logistics, manufacturing and services. The CPI would be headed by a CEO in charge of day-to-day management and relationships with investors.

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.

Group 13: driving reforms in investment policy and regulations

The best investment strategy and reform programme in the world are useless unless they are translated into concrete actions and improvements in the business climate. Specific plans and institutional arrangements must therefore be made to move from words to action and to monitor progress towards concrete objectives. Implementing investment strategies, policies and regulations geared towards the achievement of national development goals also requires a high degree of coordination and coherence among a wide range of issues that cut across ministerial lines. In addition, this Review recommends significant reforms in the regulatory and institutional framework, which would have considerable implications for the Government moving forward.

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.

Group 14: strengthen the public-private dialogue

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.

Investment promotion efforts need to be strengthened with a more focused CPI

This system of consultations has proved useful and is well organized, but it should be further improved in order to ensure that the views of the private sector as a whole are heard and duly taken into consideration. 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.

CHAPTER 1

FDI trends, impact and prospects



A. Introduction

Mozambique has been one of the fastest-growing least developed countries (LDCs) over the past two decades. Combined with sound macro-economic management, this has enabled the country to initiate a gradual decline in poverty, improve long-term development prospects and attract rising interest from foreign investors. Mozambique nevertheless remains one of the poorest countries in the world and social indicators highlight the poor living conditions of the majority. The challenges ahead therefore remain formidable and it will take decades of sustained and inclusive growth for absolute poverty and income inequality to be reduced sharply.

Mozambique was already one of the poorest countries in the world upon independence in 1975, and the civil war that engulfed the country between 1977 and 1992 brought further devastation and stopped economic development. The conflict between the ruling Liberation Front of Mozambique (FRELIMO) and the Mozambican National Resistance (RENAMO) caused the death of close to one million people through violence or starvation, left many people amputated as a result of landmines and caused millions to migrate internally.

The socio-economic outlook improved with the signature of the Rome General Peace Agreement that put an end to the civil war in 1992. The first multi-party elections were subsequently held in 1994, which established political stability and paved the way for economic recovery. At the same time, the Government embarked on a programme of structural reforms to establish an open market-oriented economy. This has led to two decades of strong growth and lifted GDP per capita from \$138 in 1992 to \$428 in 2009. Despite the strong growth performance, poverty remains extremely high and the decline appears to have stalled recently. Similarly, life expectancy at birth at 48 years and adult literacy rate at 55 per cent remain below the sub-Saharan Africa average.

Mozambique's economic potential is nevertheless vast and promising. The country is not only endowed with significant natural resources – including coal, titanium, natural gas and large underdeveloped agricultural land and fisheries – but also strategically located at the crossroads between South-Eastern Africa and the fast developing emerging markets in South and South-East Asia. The vicinity with South Africa's industrial heartland is also an asset to build upon. FDI can help unfold

the country's potential, and it is the Government's responsibility to ensure that the conditions are established for foreign investment to flourish and make a contribution to poverty reduction and sustainable and inclusive growth.

B. Market structure, challenges and investment policies

1. Transition to a market economy and recent performance

Mozambique has gone a long way in reforming its formerly planned economy by adopting market-oriented policies since 1987. It has privatized most State-owned companies and opened up all sectors to the private sector. The remaining public companies predominantly operate in the provision of services with a public good component, including utilities (electricity, telecommunications, water), airports, ports and railways. There is nevertheless already private-sector participation in these sectors and the Government is keen to attract more private investment in infrastructure. There has also been a general liberalization in trade and prices in a bid to open the domestic economy. Trade subsidies and restrictions have been lifted and price controls were removed in 1997 although subsidies for staple foods, along with other measures, were re-introduced in 2010 in response to riots over rising living costs.¹

Mozambique's liberalization coupled with prudent management has created a stable macroeconomic environment. The Bank of Mozambique has been mostly successful in keeping inflationary pressures at bay and maintaining a stable exchange rate since the late 1990s despite external shocks and in the face of rapid economic growth. Fiscal reforms have widened the tax base and improved revenue collection. Nonetheless, Mozambique is still highly dependent on foreign aid, which contributes between 40 to 50 per cent of the government budget. The country's sovereign debt has been sharply reduced through forgiveness and rescheduling under the IMF's Heavily Indebted Poor Countries initiative.

Mozambique has experienced uninterrupted growth since the end of the civil war. It registered one of the highest

GDP growth rates of any African country averaging 7 per cent per annum in 1993-1999, followed by average growth of 8.1 per cent in 2000-2008. This period of sustained economic growth had a significant poverty reduction effect early on as sectors key to employment were rehabilitated. More recently, however, poverty reduction appears to have stalled, raising concerns about the development effects of economic growth. Indeed, much of the recent growth has been driven by new capital-intensive projects while growth in a range of traditional sectors is lagging. In spite of reforms to date and the strong growth performance, the country still faces considerable developmental challenges.

The private sector in Mozambique remains relatively weak and the economy is characterized by a large informal sector. A large number of hurdles, including of a regulatory nature, remain that put a brake on investment and the development of SMEs (chapter II). Finally, the vast majority of Mozambicans is still dedicated to subsistence farming and has not made the transition to commercial agriculture, a crucial first step toward creating a far-reaching market economy. Thus, Mozambique has taken important steps but further reforms are necessary.

2. The development and poverty challenge

Poverty is still widespread in Mozambique as 60 per cent of the population lives with under \$1.25 a day.² Data from household surveys indicate that the percentage of people living below the national poverty line fell from 69.4 per cent in 1997 to 54.1 per cent in 2003.³ This positive trend was not sustained in the subsequent five years in spite of continued growth, however, as the household survey of 2008 indicated that 54.7 per cent of the population lived below the national poverty line. Evidently, the benefits of the past two decades of strong growth have yet to reach the majority of the population, since Mozambique still only ranks 165th out of 169 in the human development index of the UNDP.

Life expectancy at birth increased slightly since the end of the civil war but remains low for the region. At 47.9 years in 2008, Mozambique is below the sub-Saharan average of 52.1 years. However, maternal mortality rates have fallen dramatically from 890 deaths out of 100 000 live births in 1995 to 550 in 2008. Similarly, the prevalence of malnutrition among children under five years of age decreased from 28.1 per cent in 1997

to 21.2 per cent in 2003, bringing the mortality rate of this age group down to 141.9 deaths per 1000 in 2009. The population with access to improved sanitation increased modestly to reach 17 per cent in 2008 and it is still well below the sub-Saharan average at 31.3 per cent. Finally, the prevalence of HIV/AIDS – 12 per cent of the population aged between 14 and 59 years – and malaria are major public health concerns that have powerful detrimental consequences on the country's development and human capital formation.

In addition, income inequality has risen in recent years, with the Gini coefficient increasing from 44.5 in 1997 to 47.1 in 2003, which places Mozambique among the more unequal countries in Africa, although not part of the worst performers. The top 10 per cent of income earners held 39 per cent of total income while the bottom 10 per cent held only 2 per cent in 2003. Development has scarcely reached communities outside the major urban centres and income disparity between urban and rural population is increasing. It is therefore not surprising that there has been a steady migration flow to the cities over the past two decades. The share of the urban population has grown from 21.1 per cent in 1990 to 37.6 per cent in 2009, with the associated strains on basic infrastructure.

The greatest shortcoming in Mozambique's economic growth has been job creation. In the absence of reliable labour statistics it is difficult to assess growth in formal employment but, given the size of workers registered in the national social security system (roughly 610 000 in 2005) it is safe to say that formal employment represents a tiny fraction of the labour force. The household survey indicates that 81.5 per cent of the labour force is employed in agriculture and another 8.1 per cent were self-employed outside of this sector. Meanwhile, only 7.5 per cent of total workers were salaried employees and out of these just over half worked in the public sector. The number of wage employees in the private sector grew modestly from a share of 2.5 per cent of total employment in 1997 to 3.7 per cent in 2003.

3. The infrastructure and skills challenge

Weaknesses in physical infrastructure and low levels of human capital are major obstacles to Mozambique's development. Efforts to upgrade physical infrastructure are under way but the poor condition of the road and railroad networks constrains economic growth

by impeding the integration of regional markets. Furthermore, access to telecommunications and electricity is still limited in rural areas. The development of human capital is another major challenge as the educational system is not sufficiently strong and there is a scarcity of skilled workers.⁴

Mozambique's transport infrastructure was badly damaged during the civil war. In the post-conflict period, the Government's main priority was to rehabilitate the ports of Beira, Nacala and Maputo and their respective road links to the hinterland to re-establish transshipment trade with Malawi, Swaziland, Zambia and Zimbabwe. With the help of the World Bank and other donors, Mozambique adopted a spatial development initiatives strategy⁵ that incorporated the rehabilitation of transport infrastructure inland from the coast. The Maputo Development Corridor has been successful in attracting private investment in infrastructure but this appears to be the exception.⁶ Transport infrastructure to connect Mozambique from North to South remains poor. The Programa Integrado do Sistema de Estradas has set aside a budget of \$1.1 billion to develop the country's road network in 2007–2011. Finally, the country is also seeking investors to upgrade its airports, particularly in the northern cities of Pemba and Nacala, the fastest-growing tourist destinations.

There has been considerable improvement in the country's telecommunications and electricity infrastructure although significant issues remain. The fixed-line telephony network, solely managed by the public Telecomunicações de Moçambique, only covers a small fraction of the population with an estimated 0.35 telephone lines per 100 inhabitants in 2008. The quality of service is adequate but investment to expand the network has been minimal, particularly since the liberalization of mobile telephony which has grown dramatically in the last decade or so. The number of mobile phone subscriptions per 100 people rapidly escalated from 0.28 in 2000 to 19.7 in 2008.

The Cahora Bassa dam provides Mozambique with a large generating capacity. The national power grid is underdeveloped, however, and many rural areas rely on local generators while over 90 per cent of the population meet their energy needs from traditional fuels. In 2009, an estimated 14.3 per cent of the population had access to electricity, marking a 2 per cent increase from the previous year, but the expansion is highly concentrated

in the south which accounted for 54 per cent of total new connections.⁷ The long-standing plan to restructure State-owned Electricidade de Moçambique is ongoing but has made little progress so far.

Education is a central component of the Government's poverty-reduction strategy and access to primary schooling has significantly improved in recent years. Access to secondary and tertiary education, however, remains limited. Total expenditure on education as share of GDP increased from 2.3 per cent in 1998 to 5 per cent in 2006. It represents roughly 21 per cent of the central Government's annual expenditure. Completion rates at the primary level increased from 16 per cent in 2001 to nearly 57 per cent in 2009, but gross enrolment at the secondary level is only 23 per cent and 1.5 per cent at the tertiary level.⁸

Recent progress in education has been insufficient to create a pool of skilled workers to meet growing demand. A 2008 survey of enterprises revealed that the worker's level of education has increasingly become an obstacle to doing business in Mozambique,⁹ especially for foreign and export-oriented firms as 23 and 27 per cent of these respondents cited this issue as a major constraint, respectively. As a result, foreign skilled workers are in high demand and investors tend to negotiate ways to be able to hire foreigners above the set quotas (chapter II).

4. Economic policies

In order to address Mozambique's development challenges, the Government has adopted various multi-year strategy plans that define objectives and plan concrete actions. The Action Plan for the Reduction of Absolute Poverty (PARPA) is one of the country's key strategies and it has guided economic policy for many years. Several of its objectives have been incorporated into the central Government's five-year plans. In addition, the Government has defined a number of sectoral strategies (including for SME development) that together with PARPA guide Mozambique's economic policy.

The first PARPA was implemented in 2000-2005 and its main objective was to reduce the incidence of absolute poverty to less than 60 per cent by 2005 and below 50 per cent by the end of the decade. PARPA was the country's first comprehensive medium- to long-term poverty alleviation strategy that took on a holistic

approach focusing on three pillars: governance, human capital and economic development. In line with the first action plan, PARPA II was launched for the 2006–2009 period and it retained the same central objectives. However, it differs from the previous action plan in that it focuses more and gives a higher priority to private sector development. Under its economic development pillar, PARPA II sets out to improve the business climate to encourage domestic and foreign investment as one of its top priorities.¹⁰ In particular, it focuses on removing administrative barriers to investment and creating a more flexible and competitive labour market. An updated PARPA was adopted in May 2011 to cover the period to 2014. It aims to reduce the poverty rate to 42 per cent and rests on three pillars: (1) increased output and productivity in labour-intensive sectors, in particular agriculture and fisheries; (2) job creation through an improved business environment; and (3) human and social development. It is to be more closely integrated with the Government's five-year plan for 2010–2014 and is to rely on the maintenance of a sound macro-economic environment and good governance.

The 2010–2014 five-year plan recognizes the increasingly important role private investment plays in Mozambique's economic development and affirms that the Government will continue with its initiatives to attract private investment, both domestic and foreign. The plan seeks to attract investment that will help develop Mozambique's rural areas including infrastructure, agribusiness, fisheries, forestry, tourism, mining and export-oriented manufacturing industries. To this end, it proposes as priority actions: (1) conducting research and feasibility studies to evaluate investment opportunities in new areas of business with a focus on manufacturing; (2) promoting business linkages between large corporations and SMEs particularly in agriculture, agro-industry and fishery; and (3) expanding the special economic zones and industrial parks schemes in the country. Specific macro-economic and sectoral indicators are used to set benchmark goals and progress is to be monitored against these indicators.

C. FDI trends, performance and impact

There are two methodologically distinct sources of FDI statistics in Mozambique. The Bank of Mozambique collects data on a balance of payment basis that record

actual investment flows. Meanwhile, the Investment Promotion Centre (CPI) collects information on investments as part of the licensing procedure (chapter II), which includes planned capital investment, job creation, province of destination and sector. The CPI data are collected strictly on a registration basis, and the value of projects registered are expected investments that do not correspond to actual flow data as compiled by the Bank of Mozambique. Approved projects may take years to be realized, initial investment projections may be scaled back or be stalled indefinitely. As a result, CPI data cannot be used directly to evaluate actual FDI inflows, but they are useful to analyze the type of investment Mozambique attracts in terms of sectors, origin, employment generated, geographical distribution and ownership (e.g. joint ventures, foreign owned). In the analysis below, the source of data is clearly indicated whenever necessary. All observations based on CPI data reflect licensed investment rather than realized outcomes.

1. Overall FDI trends and performance

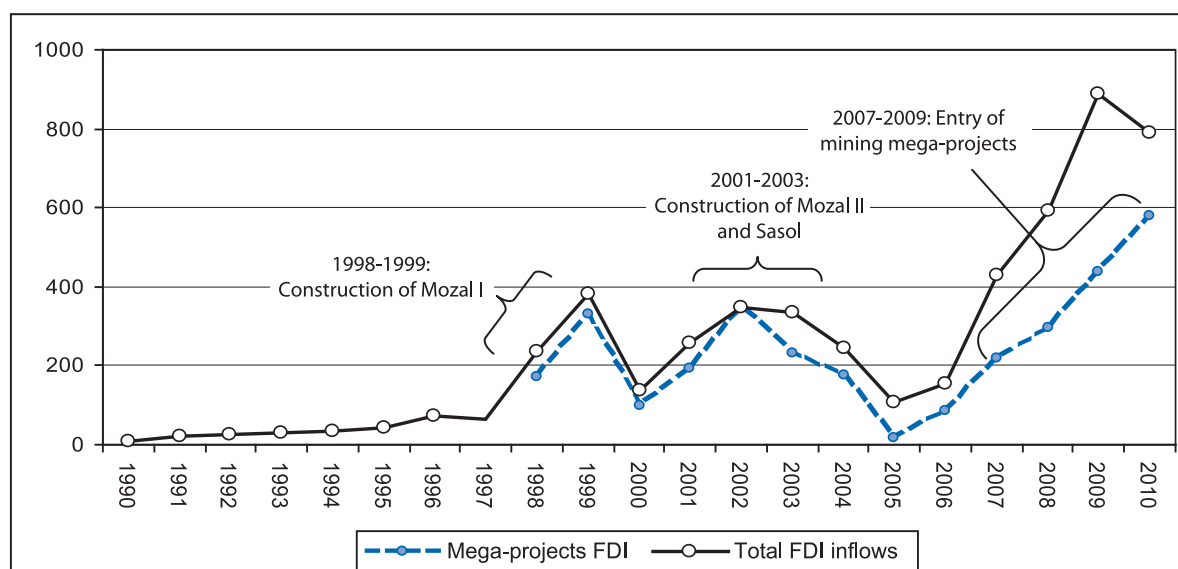
Mozambique has successfully transitioned from a centrally-planned to a market economy and has attracted significant FDI flows since the end of the civil war. In 1987, the country started restructuring its economy under a structural adjustment programme that led to a privatization process and the emergence of a stronger private sector. As reforms gained momentum and as the peace and security were re-established, FDI inflows began to pick up in the late-1990s. While annual FDI inflows averaged only \$32 million during 1991–1995, they grew more than fivefold to \$179 million per annum in 1996–2000 (table I.1). Although the pace tapered off, the trend was sustained during the first half of the 2000s averaging \$258 million per year and then almost doubling in the second half of the decade reaching an historical high of \$890 million in 2009.

Mozambique's ability to attract FDI on that scale so soon after emerging from conflict is remarkable and few post-conflict LDCs have been able to match such a record. An important factor in Mozambique's success story and quick recovery has been the role of large-scale investments in the industrial sector and extractive industries known as mega-projects.¹¹ In particular Mozal, a \$500 million aluminium smelter mega-project, was responsible for the dramatic increase in FDI inflows in the late 1990s and again in the early 2000s during its

\$400 million expansion phase (figure I.1). Mozal raised the country's profile as an investment destination and helped drive subsequent investments (section B.3). The

third wave of mega-project investments in the past five years has come from coal and titanium mining projects, some of which started operation in 2011.

Figure I.1. FDI inflows to Mozambique and share of mega-projects, 1990 – 2010
(Million dollars)



Note: figures for 2010 are preliminary. Share of mega-projects for 1998-2000 are UNCTAD estimates.

Source: UNCTAD FDI/TNC database and Bank of Mozambique.

Mega-projects represented 76 per cent of total FDI inflows between 1998 and 2005. More recently, however, Mozambique has also become more successful in raising and diversifying the types of foreign investments outside of mega-projects. Although much smaller when taken individually, these projects add up to significant total inflows. Mega-projects generated FDI inflows of \$1.6 billion in the 10-year period between 1996 and 2005, with other projects representing inflows of \$0.6 billion. Between 2006 and 2010, however, non mega-projects FDI doubled to \$1.2 billion – in spite of the shorter 5-year period – and accounted for close to 44 per cent of total FDI inflows (figure I.2).

2. Distribution by sector and countries of origin

The sheer size of mega-projects dominates and skews the sectoral composition of FDI. As indicated above,

however, non mega-projects FDI rose in importance over the past five years and inflows have become increasingly diversified. Yet, the sectors that attracted the most FDI in the past decade all received a significant portion of their inflows from mega-projects.

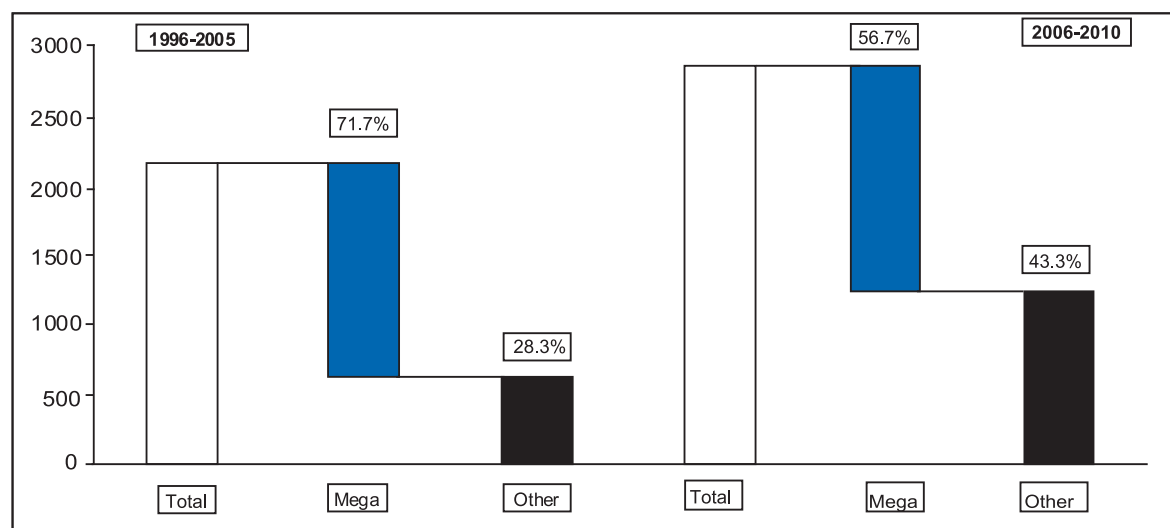
The top recipient of FDI in 2001-2009 was the mining sector with a share of 43 per cent of total FDI inflows (figure I.3). The sector received \$1416 million in FDI of which mega-projects alone are estimated to have contributed \$580 million in the extraction of titaniferous sands and \$171 million in the extraction of coal, all of which amount to 53 per cent of the sector's inflows. Similarly, the manufacturing sector, which attracted 28 per cent of FDI inflows, has benefited from mega-projects, most notably Mozal, which contributed to nearly 92 per cent of the sector's inflows. To a lesser degree, the infrastructure and construction sector also attracted FDI, while agriculture, fishing and forestry,

Table I. 1. Comparative FDI flows with selected countries, 1991-2010
(Dollars and percentages)

Country	ABSOLUTE PERFORMANCE					RELATIVE PERFORMANCE													
	FDI inflows				FDI stock	FDI inflows						As per cent of GFCF					FDI stock		
	Million dollars		Per \$1000 GDP		Per capita (dollars)	Per \$1000 GDP			As per cent of GFCF			Per capita (\$)							
	Average (1991-1995)	Average (2001-2005)	Average (2006-2010)	Average (1996-2000)	Average (1991-1995)	Average (1996-2000)	Average (2001-2005)	Average (2006-2010)	Average (1991-1995)	Average (1996-2000)	Average (2001-2005)	Average (2006-2010)	Average (1991-1995)	Average (1996-2000)	Average (2001-2005)	Average (2006-2010)	2010	2010	
Mozambique	32.0	178.5	258.4	513.5	4 689.2	2.1	10.3	13.7	24.6	14.1	42.0	55.4	56.2	6.5	20.3	24.6	25.9	220.6	48.1
Botswana	-48.2	72.1	304.3	434.1	981.5	-31.6	42.4	172.0	248.0	-13.3	14.9	37.8	35.6	-4.5	5.9	15.2	15.1	564.8	8.4
Cambodia	61.3	216.0	178.2	674.5	5 169.2	6.9	17.8	13.0	45.6	26.8	63.0	34.9	72.3	24.0	45.4	19.3	37.1	339.4	48.2
Ethiopia	8.2	155.1	375.9	242.3	3 790.1	0.1	2.4	5.1	3.0	1.0	19.1	41.3	13.7	0.9	11.1	17.9	5.7	44.6	11.7
Kenya	12.8	39.9	36.4	254.0	2 129.1	0.5	1.3	1.1	7.0	1.2	3.1	2.4	9.2	0.7	1.9	1.5	5.0	56.1	6.5
Namibia	109.0	99.2	253.8	589.1	3 988.3	70.2	55.0	128.1	282.7	36.7	27.2	53.8	67.0	18.9	13.7	27.2	29.4	1 888.8	42.4
Rwanda	3.6	4.4	9.6	83.7	411.9	0.6	0.6	1.1	8.7	2.0	2.4	5.0	20.5	1.3	1.5	3.1	10.5	41.6	8.3
South Africa	376.6	1 517.2	3 306.3	4 967.6	125 085.4	9.2	34.4	70.7	104.0	2.6	10.7	21.3	17.6	1.7	6.6	13.7	8.0	2 617.1	44.0
Tanzania, United Republic of	46.4	251.4	397.5	642.1	7 266.3	1.5	7.5	10.8	16.0	8.1	26.5	32.8	34.4	3.1	15.0	17.2	12.0	1 767.7	31.5
Uganda	54.2	127.0	242.7	740.9	4 987.8	2.7	5.5	8.9	23.4	11.1	20.7	32.1	51.2	7.0	11.5	15.4	24.3	1 498.8	27.8
Zambia	106.1	156.0	288.6	959.4	9 503.9	11.6	15.3	25.4	78.8	31.9	46.0	59.7	77.7	27.7	32.6	24.5	29.7	762.7	74.4
Zimbabwe	43.7	148.5	29.0	55.1	1 603.6	3.8	12.1	2.2	4.2	6.3	21.8	6.0	12.8	2.7	10.7	13.3	8.1	120.4	36.6
SADC	1 174.3	3 719.6	9 917.6	22 226.0	178 839.5	6.6	18.8	50.3	94.3	6.3	19.2	41.4	50.4	3.6	11.1	25.8	24.2	7 405.5	39.3
SACU	526.3	1 791.7	3 923.1	6 145.5	13 193.6	11.3	35.6	73.5	113.0	3.5	11.8	22.9	20.0	2.1	7.0	14.2	9.2	2 423.8	42.6
Sub-Saharan Africa	3244.4	7 135.1	17 919.9	42 627.9	342 620.6	5.8	11.2	25.4	53.6	10.1	21.0	38.3	47.0	6.3	12.8	24.5	25.6	4 178.8	35.5
Developing economies	7 785.9	20 267.8	23 936.7	52 691.4	489 349.4	18.1	43.1	47.4	98.1	15.7	31.1	28.6	34.4	6.4	13.1	11.6	12.2	893.5	29.1

Source: UNCTAD FDI/TNC database.

Figure I.2. FDI inflows, mega-projects and others, 1996-2006 and 2006-2010 (Million dollars)



Source: UNCTAD FDI/TNC database and Bank of Mozambique.

which attracted 11 per cent of total FDI inflows, is expected to generate \$1350 million of inflows from recently approved large-scale investments in eucalyptus plantations and paper pulp mills.

No mega-projects were registered in the remaining sectors that on aggregate accounted for only 7 per cent of FDI inflows in 2001-2009. Although FDI in tourism remains small on aggregate, there have been some significant recent investments by foreign companies in high-end and labour-intensive resorts, which have helped Mozambique tap into its potential for water-based tourism.

Brazil, South Africa and Mauritius account for the bulk of FDI flows to Mozambique with shares of 29 per cent, 21 per cent and 17 per cent of total inflows in 2004-2009, respectively. Brazilian companies have invested heavily in mining, most notably in the Moatize coal mine mega-project. Besides investing in a \$170 million coal-processing plant, Vale has pledged an additional \$130 million to upgrade the rail link to Beira and build a dedicated coal export terminal at the port.

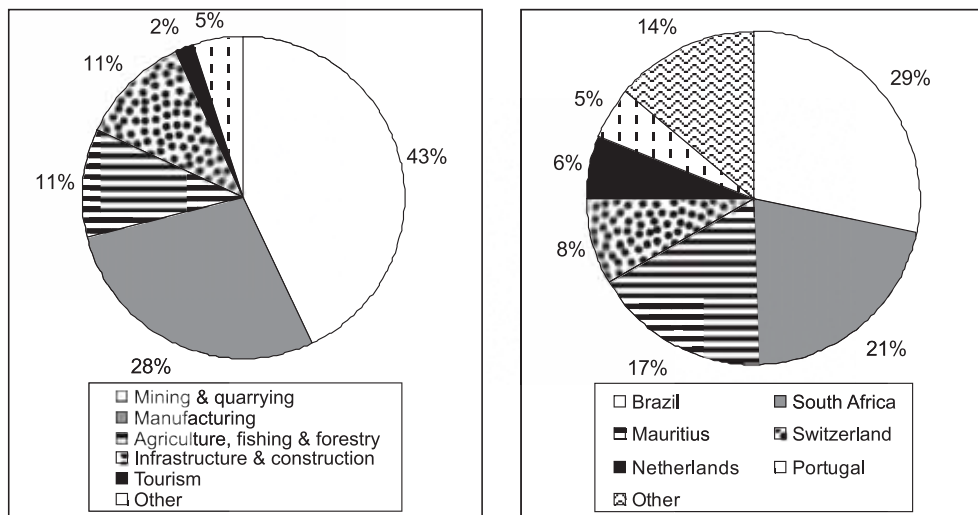
South Africa has been a pioneer and key source of FDI with a well-diversified portfolio in Mozambique. South African companies have a stake in five of eleven mega-projects including in the first such project, the Mozal

aluminium smelter plant. Apart from these high-profile investments, South African FDI has also been directed into smaller projects in various sectors most notably in tourism and agribusiness. Mozambique's investment relation with its neighbour is strategic as increasing trade and FDI flows since the end of apartheid have linked the two economies, generating potential for the attraction of FDI from third countries wanting to serve the region (box I.1).

Mauritius has been another dynamic source of FDI in 2004-2009 as third parties invest through the country to take advantage of the bilateral investment treaty (BIT) and double taxation treaty (DTT) with Mozambique. Other important investors during the aforementioned period include Switzerland with investments in food processing and pharmaceuticals, the Netherlands in cargo port management and Portugal in banking and other services.

So far, Mozambique has been able to attract only a relatively small number of global transnational corporations (TNCs) as many of these have distribution or representative offices but few productive assets. Notable exceptions include British Petroleum, Coca Cola, British American Tobacco, mining giants BHP Billiton, Riversdale and international banks Standard Bank and Barclays. The large majority of investments,

**Figure I.3. FDI flows by sector (2001-2009) and country of origin (2004-2009)
(Percentage)**



Source: Bank of Mozambique.

however, comes from smaller firms that do not have the wide reach of global TNCs but that provide a good match for Mozambique's economy and avail of local business opportunities. Data from the Bank of Mozambique show that 51 per cent of FDI inflows came from inter-company loans in 2004–2009, while 38 per cent came from new equity. Reinvested earnings still account for a small proportion of FDI in Mozambique, perhaps reflecting the relatively recent nature of FDI in the country.

3. Mega-projects: impact and limitations

Much attention has been given to high-profile mega-projects in recent years, and expectations about their impact on the country in terms of growth, development and poverty reduction have been very high. Although it is still too early to determine the impact of some mega-projects, there is a general perception of disappointment in the country, particularly regarding job creation, business linkages and contribution to tax revenues. Many observers in Government, the donor community and civil society consider that Mozambique has been excessively generous with mega-projects and received less than its fair share of benefits. The present dissatisfaction about impact within certain circles has opened up a debate on mega-projects and calls for a rethink of how the Government manages this type of investments. Although mega-projects have generated

substantial benefits, including in terms of growth and risk perception among foreign investors, it is clear that they have not been, and could never be, a miracle cure to Mozambique's development challenges.

A fair evaluation of the impact of mega-projects should weigh the positives and negatives of each investment. This would require detailed company-level information and data, not all of which is readily available. The sections below provide a basic evaluation of the impact of mega-projects on a few key variables, without pretending to be exhaustive. Although the analysis is partial, it is clear that mega-projects have not been and will not be a panacea to solve Mozambique's development challenges. Sustained and inclusive development will depend on a much wider-based growth in private investment and on economic diversification.

a. FDI inflows through mega-projects

As indicated above, data from the Bank of Mozambique show that mega-projects generated FDI inflows of \$3.2 billion – 65 per cent of the total – between the first investment by Mozal in 1998 and 2010. On a registration basis, the CPI database identifies eleven mega-projects that on aggregate amount to close to \$8.5 billion (table I.2). Some of these projects have been licensed by the CPI but have not been launched, however. In

Box I.1. South African FDI in Mozambique

South Africa has played an important role in Mozambique's impressive growth in investment inflows over the past two decades, with close to \$2 billion in approved projects in 1992-2009. The bulk of this investment has gone to the industrial and energy sectors, namely in two mega-projects: the Mozal aluminium smelter plant and the natural gas extraction and pipeline project Sasol.

South African FDI has also helped develop Mozambique's tourism industry with approved projects worth over \$600 million. Tourism is an important source of formal employment including for less developed provinces that have benefitted from eco-tourism projects. Furthermore, South African firms have invested in a wide variety of niche markets from beach resorts to casinos and private safari parks.

Agriculture and agro-industry is another sector that has received a significant portion of South African FDI with a value of \$277 million in approved projects. The injection of foreign capital into this sector has fostered the commercialization of an otherwise mostly subsistence farming in a country with a huge untapped agricultural potential. South African firms have significant investments in sugarcane, cashew nuts and forestry.

The increased economic integration between the two countries is reflected in the bilateral trade flows that were roughly 9 times greater in 2009 than in 1994. In comparison, Mozambique's trade with the rest of the world grew by a factor of 4.3 during the same period. Although natural resource based exports – electricity, natural gas and petroleum – still top Mozambican exports to South Africa, there are indications that industrial goods are becoming increasingly important. In the medium term, the proximity of Mozambique to South Africa's industrial heartland should clearly generate opportunities for local companies to integrate the supply chains of larger South African businesses and industrial clusters.

Source: UNCTAD and CPI.

contrast, non mega-projects FDI as licensed by the CPI between 1992 and 2010 amounted to \$3.3 billion.

In order to assess the impact of mega-projects this report will concentrate on those that are fully operational: (1) the Mozal aluminium smelter in Maputo province; (2) the Sasol natural gas extraction plant and pipeline in Temande and Inhambane; and (3) the titaniferous Moma Sands mine in Nampula.

b. Impact on GDP and value-added

Prior to the establishment of Mozal and Sasol there were no aluminium or natural gas industries to speak of in Mozambique. By 2008, these two activities accounted for an impressive 60 per cent of industrial output. It can be estimated that Mozal and Sasol, together with foreign investors in the mining sector, account for about 10 per cent of GDP in 2008, a number in line with earlier estimates from academic studies. As an additional indication of size, data from KPMG indicate that in 2008, Mozal's turnover was five times bigger than that of Moçambique Celular, the country's second largest company by turnover. Taken together, Mozal and Sasol accounted for 27 per cent of the total turnover

of the country's largest 100 companies. A number of mega-projects in the extractive industries are expected to become operational soon and will further boost the share of large-scale foreign investments in GDP in the near future.

c. Employment and skills transfers

Mega-projects are concentrated in capital-intensive activities and have created few direct jobs in comparison with turnover and their relative size in the economy. According to the CPI database, mega-projects account for only 5 per cent of total expected employment by projects licensed between 1992 and 2010, while it represents 72 per cent of total capital. This means that on average mega-projects create one job per \$590 000 invested while non mega-projects create one post for every \$13 000 invested. These figures do not take into account the temporary positions created during the construction phases, which can span over several years and be significant.

The survey by KPMG of the top 100 companies in Mozambique shows that Mozal directly employed 1153 workers and Sasol 151 in 2008. In addition, Mozal

Table I.2. Mega-projects approved by the CPI

Project name	Year	Sector	Investor	Origin	Million dollars	Jobs	Operational
Mozal I	1997	Industry	BHP Billiton, Mitsubishi, IDC	U.K., Japan, South Africa	500	3 000	Yes
Sasol Oil Moçambique	2000	Other	Sasol	South Africa	5.4	263	Yes
Moma Sands	2000	Mining	Kenmare	Ireland, U.K.	103	250	Yes
Maputo Iron and Steel	2001	Industry	Enron South Africa	South Africa	440	...	No
Mozal II	2001	Industry	BHP Billiton, Mitsubishi, IDC	U.K., Japan, South Africa	400	...	Yes
Limpopo Corridor Sands	2002	Mining	WMC Resources	Australia, South Africa	480	...	No
CCFB Railway	2004	Transport	RITES	India	10.1	1 000	No
Moatize Coal	2007	Mining	Vale	Brazil	170.6	...	No
AYR Petro-Nacala	2007	Mining	AYR Logistics	United States	5 000	470	No
Portucel Moçambique	2009	Agro-Industry	Portucel	Portugal	611.5	2 000	No
Lurio Green Resources	2009	Agro-Industry	Green Resources	Norway	740.5	7 500	No
TOTAL					8 461.1	14 483	

Note: The AYR Petro-Nacala Project is on hold and itself is valued at more than Mozambique's actual FDI stock in 2009. WMC Resources is a subsidiary of BHP Billiton.

Source: CPI.

indicates that it supports 3500 indirect jobs. While Mozal is by far the largest company by turnover, it only ranks 11th in terms of number of employees. Sasol, which ranked 10th by turnover, did not even make it to the top 50 largest employers.

Mozambique's formal job market is quite small compared to the economically active labour force, which is estimated at around 9 million people. The vast majority of Mozambicans depend on subsistence farming and there were only about 610 000 workers registered and contributing to social security in 2005 according to the Ministry of Labour. This number, the latest available, is a good proxy for the size of the country's formal labour market. In this perspective, the contribution of mega-projects to formal employment clearly pales in comparison to their share of GDP, which is to be expected given the very nature of most mega-projects.

Although mega-projects have not been a large source of direct employment, their workers are generally better paid and enjoy more benefits. Over 90 per cent of Mozal workers are Mozambicans who, on account of their skill level command a higher wage than most other industrial workers. Academic studies found that productivity per worker at Mozal is 18 times higher than in the average

Mozambican firm (Castel-Branco and Goldin, 2003) and that the average wage is about ten times the national minimum wage (Pretorius, 2005).

Mega-projects tend to spend more on training their employees than local firms as the nature of their work requires skills that are not easily found in Mozambique. Due to the scarcity of skilled labour, Mozal, for example, provided funding to establish local training facilities for mechanical, electrical maintenance and construction workers in conjunction with the National Institute of Employment and Professional Formation and has actively recruited employees from these centres.¹⁶ The establishment of these training centers created a human resource base that was formerly unavailable in Mozambique, which facilitated the attraction and establishment of other investors, including mega-projects and non mega-projects. Aside from the training given to temporary workers during construction,¹⁷ the company has permanent human capacity building initiatives including a graduate development programme, an operator/maintainer skills extension, and engineering and supervisory programmes. Mozal reports that on average it provided ten training days per employee per year in 2002-2003.

d. Trade diversification and the balance of payments

In 1999, one year before the first mega-project by Mozal came on stream, total exports represented under \$300 million. A decade later, Mozambique's merchandise exports increased sevenfold to \$2.2 billion, off from a peak of \$2.7 billion in 2008. Although non mega-projects exports almost doubled between 1999 and 2010 as well, mega-projects are the driving force behind the surge as they represented \$1.7 billion in 2010. At the moment, aluminium exports by Mozal represent the bulk of mega-projects exports, followed by sales of natural gas by Sasol. Starting in 2011 and 2012, coal will also become a major commodity export with several mines becoming operational, which should further increase the share of mega-projects in total exports.

All mega-projects are export-oriented, but they are also large importers, particularly during the construction phase that requires imports of machinery and other capital goods. Mozal, as a processing centre also relies entirely on imported inputs, as Mozambique does not produce alumina. On balance, however, mega-projects have consistently generated a net trade surplus for Mozambique (figure I.4).

The net positive effect of mega-projects on foreign exchange earnings through the trade surplus is partially offset by outflows on the services and income account, which represent mostly imports of services, repatriation of earnings, interest payments on external debt and the repatriation of foreign employees' remuneration. Overall, however, the net effect of mega-projects on Mozambique's current account has always been positive, at an average of \$283 million per annum in 2003–2010.

e. Linkages and supply chain development

Mega-projects have committed themselves to initiatives fostering business linkages with local SMEs but, given the nature of their economic activities and the international standards they demand from their suppliers, opportunities have thus far been limited. Mozal launched its SME Empowerment and Linkages Programme (SMEELP) during its expansion phase. Under this framework, Mozal set itself key objectives including spending \$80 million in local purchases and executing a minimum of 25 contracts with local SMEs. It worked in partnership with the CPI, which helped screen and develop a roster of candidate SMEs. Mozal prepared "work packages" solely offered to local SMEs¹⁸ that in turn received training on how to tender and execute their contracts on a timely manner. SMEELP was considered

a success¹⁹ and after the end of the construction of phase II, the programme evolved into Mozlink (box I.2).

Apart from the initiatives to train SMEs, an important challenge that remains is facilitating access to financing for SMEs. In this respect, Mozal has also ventured into developing a triangular arrangement with local banks and the SMEs that are awarded contracts. In essence, SMEs may apply for a loan in which Mozal acts as guarantor to the bank and the amount of loan amortization is deducted from Mozal's payments for the services provided by the SME.

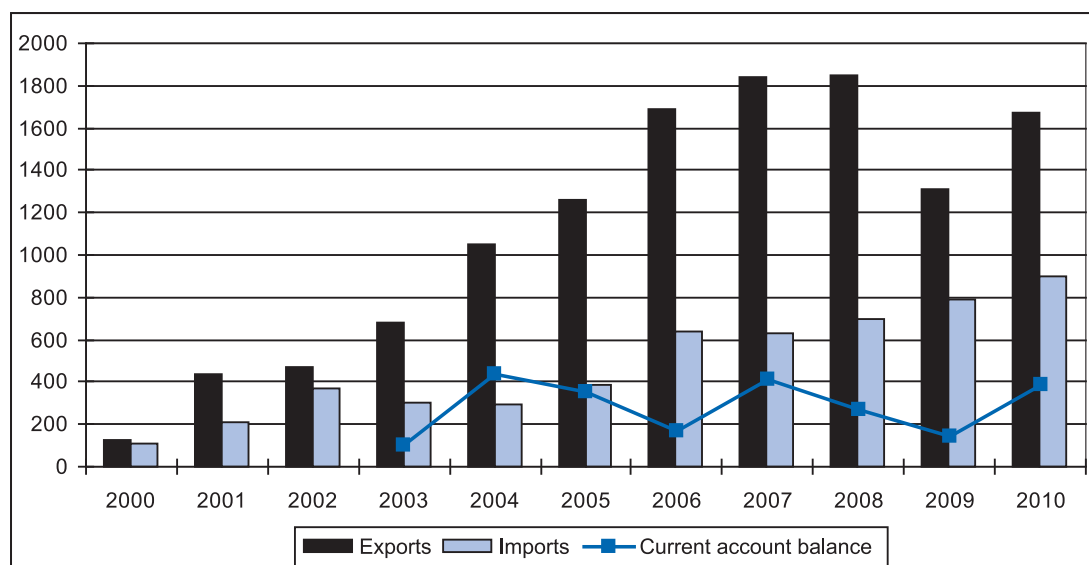
Despite all these efforts made with the best intentions on behalf of all partners it is evident that the potential for creating business linkages between mega-projects and local SMEs has been limited. The quality and quantity requirements that mega-projects impose on their suppliers are extremely demanding and difficult to meet for local companies, with the limited exceptions of certain basic services and inputs (e.g. security services, cleaning, basic business services or supply of goods for workers). Given the different stages of technological development, many mega-projects are bound to operate partly as enclaves with limited linkages with local companies. In addition, opportunities to create clusters around mega-projects are made difficult in the absence of a well-developed manufacturing sector. Mega-projects have clear intrinsic value for Mozambique, but also limitations that highlight the need to attract other investments that provide a better match with local businesses and higher potential for linkages.

f. Other effects and pitfalls

Mega-projects have had other indirect or intangible effects on the Mozambican economy. Mozal's decision to invest contributed to shaking off Mozambique's image of an ex-socialist war-torn country and replaced it with one of a market economy open to investment and capable of hosting world-class investors of the scale of Mozal. This anchor investment sent a strong signal and served as an excellent promotional campaign.

At the same time, the early success in attracting a major industrial investment appears to have focused policy attention on how to attract and benefit from FDI mostly around mega-projects. In addition, expectations about the impact of mega-projects in terms of job creation, technology transfers, linkages and poverty reduction seem to have been set unrealistically high. The development challenges facing Mozambique are deep-

Figure I.4. Trade and current account balance of mega-projects, 2000 – 2010
(Million dollars)



Note: figures for 2010 are preliminary.
Source: Bank of Mozambique.

rooted and cannot be solved with a few mega-projects. As highlighted earlier, it will be key for the Government to look beyond mega-projects and devote a lot more policy attention to other types of investments that can bring dynamic benefits and provide a good match with the country's needs and business opportunities.

Mega-projects have had positive effects on infrastructure development. Although basic infrastructure remains poor outside major urban areas, mega-projects have been instrumental in securing infrastructure investments that are typically difficult to secure in LDCs. Most notably, Mozal acted as the anchor investment for the Maputo Development Corridor that included the construction of the N4 toll road to South Africa, the improvement of electricity and telecommunications connections between the two countries, and the upgrading of the Maputo Port. These improvements in infrastructure are now a major benefit to the economy as a whole.

The tax incentives granted to mega-projects when they were first initiated have become a contentious issue as many observers now consider them to be excessive. Relative to their weight in the economy, the contribution of mega-projects to fiscal revenue is indeed small.²⁰ Early projects like Mozal and Moma Sands pay a one per cent tax on turnover in lieu of the standard corporate

income tax. In addition, as export-oriented companies they benefit from industrial free zone advantages that exempt them from import duties and value-added tax. In turn, Sasol, which negotiated its contract with the government later, pays a 17.5 per cent income tax (Sonne-Schmidt *et al.*, 2009). Applying the one per cent turnover tax, Mozal's tax contribution can be estimated at MT360 million (\$10.5 million) per annum on average in 2002-2008, or about 1 per cent of government revenue.²¹

Although these tax incentives are now being questioned, it is important to note that they were granted in full legality by the Government as part of its efforts to attract large-scale investments in the late 1990s and early 2000s. It is undeniable that tax incentives indeed played a role in attracting mega-projects this soon after the end of the civil war. Whether they were excessively generous or not is a lot more difficult to assess, and should not be judged based on the current economic and political conditions in Mozambique, but on those that prevailed at the time the investment decisions were made.

In addition, Mozambique committed to contractual stability clauses as part of the investment licences issued by the CPI under the law on investment. Circumstances have admittedly changed since then and

Box I.2. Mozlink and other SME linkages development programmes

Mozlink is a partnership between Mozal, the CPI and the International Finance Corporation (IFC). The objective of the partnership is to build the capacity of local SMEs to enable them to do business with large companies and absorb the technological transfers and know-how that result from these linkages. Initially, Mozlink was to replicate the success of SMEELP in a SME capacity-building two year programme that involved 25 SMEs benefitting from training in safety, quality, maintenance and management. Throughout the programme, a performance baseline was established for each SME catering to their needs and reassessed every five months. This tailored mentoring strategy appears to have paid off as at the end of the programme in 2005 all participating firms showed marked improvement in all four areas where they received training and it is estimated that they won contracts worth \$13 million.

Mozlink's pilot project has given way to ongoing activities, chiefly through workshops and trainings given at its SME Development Centre, and its website that aims to bring supply and demand together by providing information on existing local suppliers and job opportunities. In addition, the Beluluane Industrial Park sponsored by the CPI was created to accommodate companies servicing Mozal to further facilitate linkages. Finally, the IFC also financed a separate three-year SME Competitiveness Programme to increase the participation of local firms in the supply chain of capital-intensive industrial projects in sectors such as mining and natural gas. Mega-projects like Mozal, Sasol, Maputo Port and Limpopo Corridor Sands actively participate in this programme.

Source: Mozlink website.

Mozambique partly revised its policy on tax incentives in 2009, including by eliminating the possibility to negotiate incentives on a case-by-case basis (chapter II). The legality of past incentives, however, cannot be questioned, and the contractual obligations of the Government under the investment licences restrain its room for manoeuvre going forward.

Mega-projects have generated other indirect effects that are hard to measure precisely and that can sometimes work positively and negatively at the same time. Their demand for high-skilled labour is high in a country where skills remain scarce. By offering a wage and non-wage premium, large-scale foreign companies risk absorbing a significant proportion of skilled workers, thereby crowding out local firms and affecting their competitiveness. At the same time, however, large-scale foreign companies typically provide training to their workers from the bottom to the top of the skills employed. In many cases, these skills benefit the economy as a whole as workers change employers and bring their skills along. Circumstantial evidence and interviews with investors, for example, indicates that Mozal played a significant role in increasing the availability of skills for

other investors that moved in at a later stage. Evidence from countries in Asia also shows that the net effect of large-scale foreign investors on skills development and dissemination to local companies is positive.

In addition, the presence of mega-projects likely contributed to reduce transaction and marginal costs of investing in Mozambique, thereby increasing the attractiveness of the country. Through their demand for services, mega-projects have supported burgeoning engineering and maintenance industries that were not present in the country previously. These industrial services can greatly improve conditions for new entrants. Perhaps even more important has been the increased coordination among government authorities to deal with mega-projects. This positive effect on institutional capacity is beneficial for the country as a whole and susceptible to facilitate further investments.

Mozambique is at the early stages of developing its mining sector, but prospects are strong for coal and other minerals, and there is even potential for the discovery of oil. Although mega-projects have not led so far to any issue of Dutch disease and overvaluation

of the metical, this is an issue that the Government will have to manage carefully as mining mega-projects develop in the years to come (section D.1).

4. FDI outside of mega-projects: an underestimated factor

Mega-projects played a crucial role in attracting FDI in the early post-conflict era but other investments have consistently grown in importance, particularly during the past five years. Annual FDI inflows from non mega-projects averaged \$65 million in 2001-2005 and increased to \$247 million in 2006-2010. Although it is only a recent phenomenon, this trend suggests that Mozambique has slowly started to diversify the types of FDI it attracts away from mega-projects and that other investments could become more relevant in the future. As indicated earlier, however, relatively little policy attention has been paid until now to smaller (foreign) investments and the spotlight has remained focused on mega-projects.

Registration-based data from the CPI indicate that non mega-projects FDI amounted to \$3.3 billion in 1992–2010, either as 100 per cent foreign-owned projects or under joint ventures with local partners. Over this period, the CPI licensed a total of 2937 projects, of which close to 2000 involved the participation of foreign investors, half as fully-foreign owned newly established companies and half through participation in joint ventures. Similarly, the FDI component of all non mega-projects investments licensed by the CPI in 1992–2010 represents 72 per cent of the total. This is a potent indication of the importance of FDI in capital formation and the development of the business sector in Mozambique. It must also be noted, however, that many national investors proceed with their projects without obtaining a licence from the CPI (chapter II) and are therefore not captured in its database.

The number of projects licensed and investments planned increased in recent years, even though the trend is still somewhat erratic (figure I.5). On average, FDI in non-mega projects amounted to \$1.7 million, which is a reflection of the small size of the Mozambican economy and its limited ability to attract large-scale foreign investments, with the exception of mostly resource-oriented mega-projects.

Non mega-projects FDI has been directed in a wide variety of sectors, with a particular emphasis on tourism, agriculture and agro-industry, industry, banking,

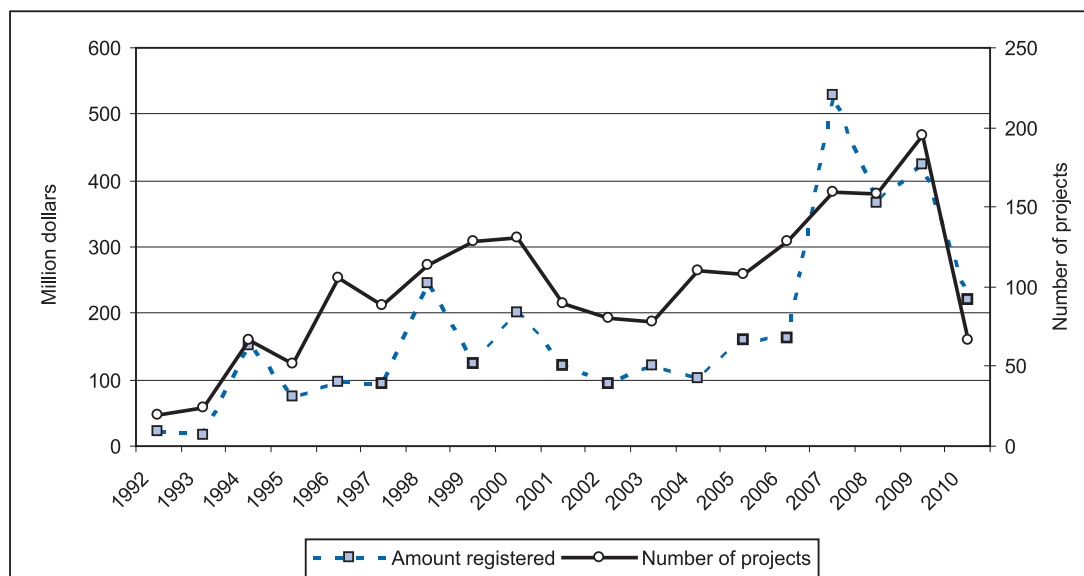
transport and communications (table I.3). As a result, non mega-projects FDI is well positioned to contribute to the diversification of the economy.

Maputo attracts 57 per cent of non mega-project FDI, followed by the provinces of Sofala (9.2 per cent), Gaza (8.5 per cent), Inhambane (7.7 per cent) and Cabo Delgado (4.9 per cent). Although still very much concentrated in the capital, foreign investors are no more focused on Maputo than national investors, for which 57 per cent of investments licensed by the CPI are located in the capital. In addition, there appears to be some degree of complementarity in the location of foreign and national investors outside of Maputo, as the former are more heavily focused on Sofala, Gaza, Inhambane and Cabo Delgado, while the latter are more heavily focused on Nampula, Sofala and to a lesser extent Zambezia.

As indicated earlier, non mega-project FDI licensed by the CPI in 1992–2010 represents less than 30 per cent of the total. Yet, the same investments registered a total of 265 000 jobs, compared with only 14 000 for all mega-projects combined, i.e. a ratio of 1 to 18. This translates into 1.7 job per \$1 million invested in the case of mega-projects compared with 77 jobs per \$1 million invested for other foreign investments. Given the dire need for job creation in Mozambique (chapter III), this gives an indication of the importance to promote non mega-projects FDI.

Non mega-project FDI has not only generated vastly more employment than mega-projects, but also been very important in terms of formal job creation compared with national investors. As far as CPI-licensed projects are concerned, fully foreign-owned companies and joint-ventures indeed account for 81.4 per cent all job creations, with national investors representing only 66 000 jobs. In Cabo Delgado, Manica, Niassa and Tete, projects with foreign involvement account for about 90 per cent of all jobs created.

FDI outside of mega-projects appears to provide a good match with Mozambique's needs and opportunities. A good proportion of projects aim to tap the local market, and the relatively small average size of investments means that investors tend to be more nimble, capable of adjusting to local conditions and in a position to establish linkages with local firms. A strong indication of this is the importance of joint-ventures between foreign and national investors in total FDI projects. A total of

**Figure I.5. Non-mega projects FDI, 1992-2010
(Million dollars)**


Note: 2010 data include only the first three quarters of the year.

Source: CPI.

**Table I.3: Sectoral composition of approved FDI, excluding mega-projects, 1992-2010
(Number of projects, million dollars and number of jobs created)**

Sector	Number of projects		Value of projects		Number of workers	
	#	% of total	\$	% of total	#	% of total
Agriculture and agro-industry	371	19.5	919.6	22.8	138 008	52.0
Aquaculture and fishing	76	4.0	104.2	2.6	4967	1.9
Banking and securities	37	1.9	395.4	9.8	689	0.3
Construction	144	7.6	143.9	3.6	17 696	6.7
Industry	496	26.1	793.8	19.7	44 083	16.6
Mineral resources and energy	25	1.3	99.7	2.5	1576	0.6
Other	268	14.1	361.6	9.0	21 376	8.1
Tourism and hotels	345	18.2	925.3	22.9	27 049	10.2
Transport and communications	139	7.3	294.4	7.3	10 038	3.8
TOTAL	1901	100.0	4037.8	100.0	265 482	100.0

Note: the value of approved FDI of \$4.0 billion includes fully foreign-owned projects and the entire value of joint-venture, including the part of national investors.

Source: CPI

Table I.4. CPI-licensed projects by investor and sector, excluding mega-projects, 1992-2010
(Million dollars and percentage of total of the sector)

Sector	100% foreign-owned		Joint-ventures ¹		100% Mozambican	
	million \$	% of sector total	million \$	% of sector total	million \$	% of sector total
Agriculture and agro-industry	258.7	25.5	660.9	65.1	94.9	9.4
Aquaculture and fishing	34.5	30.7	69.8	62.1	8.1	7.2
Banking and securities	56.4	13.8	339.0	83.1	12.3	3.0
Construction	72.1	38.9	71.9	38.7	41.6	22.4
Industry	383.4	42.0	410.5	44.9	119.5	13.1
Mineral resources and energy	21.7	21.5	78.0	77.1	1.5	1.5
Other	212.4	50.2	149.2	35.3	61.6	14.5
Tourism and hotels	294.6	29.4	630.7	62.9	76.9	7.7
Transport and communications	55.5	12.5	238.9	53.7	150.6	33.8
TOTAL	1398.2	30.2	2648.6	57.5	566.8	12.3

¹ Includes the total capital invested by the foreign and the local partners.

Source: CPI

944 joint ventures were licensed by the CPI in 1992–2010, compared with 955 fully foreign-owned projects.

Joint-ventures between foreign and national partners represent 58 per cent of all CPI-licensed projects in 1992–2010. The foreign component of these joint-ventures amounted to \$1.9 billion, while national partners contributed \$0.7 billion, which indicates that foreign investors typically seek to have a controlling stake in the newly established company. Partnerships outside of mega-projects are a favoured avenue in all sectors of the economy (table I.4) and are an excellent way to promote linkages, transfer of skills and know-how and promote capacity building. Their prevalence is also an indication that non mega-project FDI complements and reinforces national investment, with little or no crowding out effect.

The importance and impact of non mega-project FDI on the Mozambican economy can also be assessed through KPMG's list of the country's largest companies. More than half of the 50 largest companies by turnover are either fully or partially foreign owned (table I.5). These companies are diversified and operate in sectors like manufacturing, banking, energy, transport and commerce. Excluding mega-projects (Mozal and Sasol), the top companies with foreign participation accounted for close to 60 per cent of turnover of the largest 50 enterprises in 2008 and for about 50 per cent of employment. In addition, it can be estimated

that the aforementioned companies contributed about \$73 million in corporate income tax in 2008, equivalent to 92 per cent of the non mega-project tax contribution of the top 50 companies.

Although the data presented in table I.4 are partial, they provide evidence that FDI outside of mega-projects have provided the type of developmental impact that Mozambique needs the most, i.e. job creation, transfers of skills and know-how, economic diversification and local capacity building through linkages with local businesses. These positive impacts and dynamic effects are also illustrated in a number of foreign investments, whose experience is replicated in many instances.

The rehabilitation and expansion of the country's badly damaged infrastructure has been a high priority for Mozambique since the end of the civil war. In order to achieve this objective, the Government actively sought to attract foreign investors in infrastructure. The construction of the N4 toll road under a concession agreement was a major achievement for a post-conflict LDC and it has brought significant benefits to the country as a whole by facilitating trade with South Africa. The Government was also successful in concessioning the port of Maputo to a consortium between DP World of the United Arab Emirates and the Grindrod Group of South Africa, under a public-private partnership agreement in which the Government retains a 49 per cent share in the

Table I.5. Top companies with foreign participation excluding mega-projects, 2008
(Thousand dollars)

Rank	Company	Activity	Turnover (thousand dollars)	Number of employees	Tax paid (thousand dollars) ¹
3	Petromoc	Energy	277 038	674	1834
5	BP Moçambique	Energy	186 353	150	6570
7	Cervejas de Moçambique	Beverages	169 961	788	13 099
8	Motraco	Energy	163 059	7	620
9	BIM	Banking	162 112	1635	13 088
11	Mozambique Leaf Tobacco	Agriculture	125 686	5053	0
14	Cimentos de Moçambique	Industry	102 677	449	3447
15	CMC Africa Austral	Construction	93 001	2658	0
17	Coca-Cola Sabco	Beverages	79 922	750	3926
18	BIC	Banking	75 569	843	4500
19	Standard Bank	Banking	73 723	673	8976
22	Petrogal Moçambique	Energy	68 667	156	1488
25	Cornelder de Moçambique	Transport	45 130	407	4250
26	SIM	Insurance	44 667	127	3223
27	BAT Mozambique	Industry	44 078	131	3430
28	Toyota de Moçambique	Commerce	43 216	335	1033
29	Barclays Bank Moçambique	Banking	40 965	1027	0
32	MPDC	Transport	35 259	450	0
35	Conduril	Construction	33 013	70	0
38	Hollard Seguros	Insurance	24 772	34	763
39	MIPS	Transport	24 137	247	1321
41	GAME Discount World	Retail	23 765	174	496
42	Global Alliance CGSM Seguros	Insurance	23 069	57	275
44	Kangela Comercial	Commerce	21 582	287	136
46	Aguas de Moçambique	Beverages	19 725	566	0
47	Mega-Distribuição Moçambique	Commerce	18 322	122	0
50	Ferro Moçambique	Commerce	16 173	n.a	856
	TOTAL		2 035 641	17 870	73 331
	<i>(per cent of Top 50 companies)</i>		<i>(56.9)</i>	<i>(48.8)</i>	<i>(91.5)</i>

¹ Calculated as the difference between profit before taxes and net profits. Companies that paid zero taxes might have made a loss on the year or used tax credits. This estimate only includes corporate income tax.
Source: KPMG Top 100 Companies, 2009 edition.

port operator. The Maputo Port Development Company obtained a 15 year concession in 2002, renewable for another 10 years.

By attracting a world-class operator, Mozambique has been able to significantly improve its port infrastructure and develop Maputo as a point of service for neighbouring countries, including South Africa. The port has become an essential piece in the country's infrastructure and gains in efficiency and quality of

services should generate dynamic effects across the economy.

The case of Rani Resorts also illustrates how medium-scale investments can generate significant impact in remote areas, including through job creation and linkages. Rani Resorts owned by the Aujan Group of Saudi Arabia established five luxury hotels in Mozambique with a staff of about 50 to 60 per property, bringing total employment to around 300 local workers. These hotels are located in some of the country's

least developed regions, including Cabo Delgado and Niassa. Over time, they have the potential to foster local economic activities including transport, agriculture, traditional arts and crafts, and other related services that can be supplied by local SMEs.

Non mega-project FDI has risen in significance in recent years, even though it remains smaller than inflows under mega-projects. This type of FDI does represent a large number of projects, however, which have created significantly more jobs and linkages than mega-projects, and have proved to be more transformational than mega-projects. Their power is not in the capital contribution that each project provides, but in their diversity, geographic spread and in their sheer number. For a variety of reasons, their impact has been overlooked by the authorities, whose focus has been on the more visible mega-projects. As a result, they have been unwisely neglected from a policy perspective. This ought to be corrected (chapters II and III).

D. Strategic outlook and FDI potential

FDI has been beneficial to Mozambique's development and has been a driver of the country's high growth rate since the late 1990s. The entry of mega-projects, in particular Mozal's decision to invest soon after the end of the civil war, drastically improved Mozambique's image as an investment destination and gave a strong boost to economic growth. FDI outside of mega-projects are now on the rise and are proving to generate significant benefits to the economy, as they offer a good match with the country's needs and opportunities. FDI has bolstered GDP and boosted and diversified exports away from traditional agricultural products. FDI has also been instrumental, both directly and indirectly, in the construction and renovation of key infrastructure with significant development effects. The contribution of FDI to employment and business linkages, however, has been relatively limited so far and has not met high expectations.

As has been highlighted throughout this chapter, proactive government initiatives and policies are necessary to maximize the impact of FDI on development. The structural challenges that slow Mozambique's development must be addressed by cohesive action between the public and private sectors. Although FDI does have a role to play, it will not be a

solution to job creation, human capital formation and SME development by itself. In this sense, the increased role envisioned for the national private sector and the Government's commitment to continue improving the country's investment climate in the 2010–2014 Five-Year Plan and sectoral strategies is a step in the right direction.

Mozambique has the potential to attract considerable FDI in extractive industries, infrastructure, logistics, agriculture, tourism, services and light manufacturing. These prospective areas are identified given the country's natural resources, geography and factor endowments. Strategic planning on behalf of the Government to market integrated investment opportunities involving different sectors can amplify developmental benefits. For example, the coordination of FDI in infrastructure and agriculture can exploit synergies and be a catalyst to the economic development of rural areas. FDI can also make a strong contribution in employment and skills development in labour-intensive sectors like tourism, services and light manufacturing. Finally, FDI in industries where Mozambique has a natural domestic supply base can foster business linkages and strengthen local SMEs. Agribusiness positions itself as one of the best candidates to exploit domestic value chains considering the country's huge agricultural potential and large labour force.

1. Natural resource extraction FDI: prospects and limitations

Given the nature of extractive industries and the list of CPI approved investments, mega-projects will dominate FDI in this sector in the foreseeable future. The mining sector has great potential given that Mozambique is rich in coal, base metals, titaniferous sands, and precious minerals. Several approved FDI projects in mining should become operational in the short term, and as mineral exports grow the sector is poised to become an important foreign exchange earner. Limited business linkages with the domestic market are expected to be generated from the export-oriented mining sector. However, FDI in mining can make a valuable contribution to infrastructure as these projects require the rehabilitation of the rail and road connections. In addition, some investors in the coal mines are planning to build thermal power plants to meet their own requirements and supply electricity to the grid.

Similarly, the natural gas and oil industries are expected to expand considerably in the future. Sasol already

invested \$500 million and the Ministry of Mineral Resources expects the industry to attract \$600 million more in 2010-2019 to increase natural gas production. This increase is foreseen following recent discoveries of natural gas deposits adjacent to the ones being exploited in Pande and Temane, as well as new deposits found in the Rovuma basin. Total natural gas reserves are estimated at 14 trillion cubic feet. Mozambique's oil potential is also being explored by foreign investors, even though it is difficult to estimate the country's oil potential at this stage. Commercial exploitation may nevertheless be possible in the medium term.

The exploitation of natural resources calls for careful macro-economic management in the future, as well as strong transparency, checks and balances in terms of public governance. The authorities will need to be careful to prevent the economy from falling into Dutch disease as growth in extractive industries may undermine the development and competitiveness of other sectors. As stressed before, extractive industries provide relatively few jobs and business linkages opportunities and they are not in a position to solve the country's wide development challenges. As a result, the diversification of the economy and the attraction of FDI in other sectors should remain a top priority, regardless of the growth effects of FDI in extractive industries. In addition, the Government will need to carefully manage and invest the tax revenue coming from these activities following best practices from other developing countries. The Government will also have to maximize the infrastructure and human development opportunities linked to large-scale investments.

2. Infrastructure and logistics FDI: a win-win situation

Mozambique's geography, notably its extensive coastline, makes it a potential transport and logistics hub for South East Africa. With the right transport infrastructure in place, Mozambique's ports could increasingly serve as the primary channels for the trans-continental trade of neighbouring landlocked countries. The demand for maritime transport has increased as the size of the trade of these countries has more than doubled over the past decade. Specifically, the combined extra-regional trade of Botswana, Malawi, Swaziland, Zambia and Zimbabwe went from \$13 billion in 1999 to \$27 billion in 2008.²² Mozambique is well positioned to absorb most of this growth in trade flows through transshipment services if it can upgrade its capacity to handle cargo efficiently from inland road and rail connections to ports.

In this regard, the implementation of the development corridors is a suitable strategy to incorporate improvements in infrastructure that are vital to the rise of a modern logistics industry in the country. As noted earlier, large-scale FDI projects can serve as anchor investments to finance infrastructure development and the success experienced with the Maputo Development Corridor could be replicated. The concession of key infrastructure to foreign investors could accelerate the formation of top quality facilities that could give Mozambique a competitive edge. In order to attract world-class operators, the Government will need to emulate international best practices in public-private partnerships (PPP) policy and regulations and will need to improve the efficiency of customs.

3. Not mega, but transformational

As highlighted earlier, mega-projects have intrinsic limitations in terms of development impact, while other types of smaller foreign investments may be more meaningful in many aspects. Yet, mega-projects have received significantly more policy attention in recent years, leaving the problems and issues facing smaller investors neglected. In the future, the potential to attract FDI of a more limited size, but more diverse in nature, should be promoted much more actively.

FDI outside of mega-projects, including SME-FDI, can have a significant impact on the economy in terms of diversification, regional development and job creation. They are also more likely to be suitable for Mozambique's domestic market and to create linkages with local SMEs. FDI could become an important driver in SME development, which is rightfully one of the Government's top priorities considering that these enterprises tend to generate a large share of total employment and are the backbone of a vibrant domestic economy.²³ Mozambique has the potential to attract highly beneficial smaller FDI in a wide variety of sectors including tourism, agriculture and agribusiness, light manufacturing and services.

Tourism is growing rapidly in Mozambique, based on beach, cultural and wildlife attractions. Driven by FDI, high-end eco-tourism and boutique hotels have started to create successful niche markets. As an emerging destination, prospects are largely influenced by the country's ability to link into existing tourism flows. Mozambique's neighbours attracted close to 15 million international tourists and collected almost \$10 billion in tourism receipts in 2008 which gives a

perspective on the size of the regional tourism market to which Mozambique could link up.²⁴ South Africa is one of the top tourist destinations on the continent and a large share of its tourism is geared towards its nature reserves, most importantly Kruger Park which attracts over a million people annually²⁵ and borders Mozambique's own Limpopo National Park. Small-scale FDI adapted to lodges and resorts could help develop the country's wildlife and eco-tourism, generating employment in some of the less-developed provinces.

Mozambique also has enormous agricultural potential that is far from being exploited, in part due to the lack of support infrastructure (e.g. irrigation, electricity, roads) and finance. The Beira Agricultural Growth Corridor aims to stimulate agriculture production in the country's prime farmland, the breadbasket provinces of Manica, Sofala and Tete. It is estimated that there are 10 million hectares of arable land, of which 300 000 hectares can be commercially exploited in the short to medium-run considering their proximity to water, electricity and transport infrastructure. In 20 years, it would be possible for the region to yield 12 million tonnes of produce from 190 000 hectares of high potential land, generating nearly \$1 billion of revenue per annum.

Mozambique's farmland is suitable for various cash crops including wheat, maize, soya, and rice that are unlikely to be demand-constrained and could be partly absorbed by the domestic market which currently imports over 400 000 tonnes of these types of cereal grains. Moreover, there is potential for the production of export-oriented tropical fruits like banana, mango and citrus as well as horticulture goods like baby corn and chillies.

In 2009, Mozambique imported \$275 million worth in cereals and over \$15 million in fruits and vegetables. This demand could be met by domestic production in the near future given its potential. The market for meat and dairy products is also sizeable as the country imported over \$49 million of these products. Finally, there is prospective expansion for sugarcane and jatropha that are utilized in the production of bio-fuels.

Small- and medium-sized FDI can play a crucial role in rural development creating contract farming opportunities for small producers and investing in agro-processing plants to increase the value addition of agricultural products (e.g. vegetable oils, sugar, ethanol). The commercialization of Mozambique's agricultural sector could have an immense poverty-reduction effect

by generating employment and increasing the income of the large rural segment of the country's population.

Although manufacturing is still underdeveloped, Mozambique has comparative advantages that could appeal to foreign investors and give this sector a promising outlook. Mozambique's close proximity to South Africa (the continent's largest consumer market), its competitively priced labour and excellent access to sea generate opportunities for investors with a regional focus. Given the availability of raw materials and opportunities for downstream linkages, textiles and agro-processing are strategic labour-intensive industries that have clear growth potential. Mozambique's own internal market for basic consumer goods is modest as the imports for these types of goods, valued at about \$600 million in 2009, suggest. Yet, there clearly are market opportunities for foreign investors of a small size.

Domestic demand for agro-processed goods is still small as imports of processed meat, fish, cereals, vegetables and other edible preparations was close to \$57 million in 2009. Thus, the growth potential of the agri-business sector is mostly export-oriented and will rely on access to international markets and good knowledge of sanitary and phytosanitary standards, which foreign investors are in a position to provide. Small FDI in light manufacturing can provide the technology and know-how that might be lacking domestically to make the most of business opportunities, including in niche markets that are difficult to foresee.

The increase in FDI flows and the diversification of the economy has fostered the emergence of a growing services sector in the country. Transport and communications services accounted for nearly 11 per cent of GDP in 2009, while real estate and business services accounted for 7 per cent and financial services for over 5 per cent. TNCs tend to seek service providers that meet high international standard requirements and these can often be difficult to find in developing countries like Mozambique. Small FDI could help close the gap in business support services and contribute to human capital formation in the national market. Foreign services firms typically provide professional training to their employees and introduce international best practices in their field of expertise. As a result, this type of FDI could increase and improve the pool of skilled labour in Mozambique which would benefit the economy as a whole.

Notes

- ¹ A significant subsidy on wheat flour was placed while customs duties on low-grade rice were removed reducing the cost of this commodity by 7.5 per cent. In addition, low income households saw the increases in electricity and water bills reversed to pre-September 2010 levels. It was announced that these measures to alleviate rising living costs would continue in the first quarter of 2011.
- ² This figure corresponds to 2008, the latest World Bank estimate available and it is measured at 2005 international prices. As a result of revisions in purchasing power parities exchange rates, poverty rates for individual countries cannot be compared with poverty rates reported in earlier editions.
- ³ Some observers consider this reduction in poverty rate to be overestimated, however. Hanlon (2007) points out discrepancies in the methodology used in calculating the consumption bundles between the 1997 and the 2003 surveys. He argues that a reduction in the population living under the national poverty line from 69 in to 63 per cent should be a closer approximation to reality.
- ⁴ Mozambique's adult literacy rate of 55 per cent is well below the average for sub-Saharan Africa (62 per cent) and low income countries (61 per cent). This is partly the result of the civil war, which disrupted the education system for a long time.
- ⁵ The aim of these SDIs is to foster the clustering of industries and creating business linkages to exploit the economic potential of the surrounding regions. In the case of Mozambique, three development corridors centred around the country's major ports were identified: Baira, Maputo, and Nacala.
- ⁶ There is interest on behalf of foreign investors to revamp the road and railroad connections from the coal-rich central provinces to Beira port but these are yet to materialize. Progress on the railroad concession awarded to the Indian company RITES has been delayed and at the moment discourages further investment.
- ⁷ While the electrification index in the south reaches 31 per cent, it is only 8.5 per cent in the north and 7.8 per cent in the central region according to EDM's 2009 Annual Report.
- ⁸ Statistics for primary and secondary education correspond to 2009 while the estimate of tertiary education is for 2005.
- ⁹ The World Bank survey presented in Mozambique's 2009 Investment Climate Assessment ranked the workforce education as the 9th greatest obstacle to doing business in 2008 whereas it came in 12th place in 2003.
- ¹⁰ Specifically, PARPA II calls to "improve the business and labor climate in Mozambique in order to: (i) encourage domestic and foreign investment; (ii) facilitate formalization of the economy; and (iii) contribute to creation of high-quality jobs".
- ¹¹ A "mega-project" is legally defined as any investment exceeding \$500 million regardless of economic activity. However, thus far "mega-projects" have been only in heavy industry and extractives with the exception of two projects under development in forestry and paper pulp mills. Under common usage the term mega-project, however, can also refer to other large projects.
- ¹² These numbers are based on data from the Bank of Mozambique, except for the years 1998, 1999, and 2000 for which data on mega-project FDI is not available and were estimated based on Mozal's investment reporting.
- ¹³ Note that figures on FDI inflows by sector come from the BoM, while estimates of individual projects come from the CPI approved FDI projects database. Hence, the actual contribution of mega-projects to a given sector is indicative and not necessarily entirely accurate.
- ¹⁴ This estimate is based on the share of mega-projects in manufacturing and mining output, and the proportion of the manufacturing and extractive industries in total GDP.
- ¹⁵ Sonne-Schmidt et al. (2009) estimate the share of mega-projects to range between 7.3 to 10.1 per cent of GDP at factor prices in 2002-2006. Castel-Branco and Goldin (2003) estimated Mozal's share of GDP, including the direct and indirect effects of construction during its expansion, at 5 per cent in 2002.
- ¹⁶ In its 2007 annual report, the National Institute of Employment and Professional Formation states that 11258 people received professional training throughout the country in that year.

- ¹⁷ During the construction of phases I and II, Mozal trained 5259 and 3136 individuals at a cost of \$3.7 million and \$3 million, respectively.
- ¹⁸ For most of the “work packages” that could be delivered by small, flexible firms with little initial capital investment, Mozal adopted the policy to award contracts only to firms registered in Mozambique. This policy increased the participation of local firms but also encouraged South African firms to establish subsidiaries and/or invest in Mozambican facilities (Castel-Branco and Goldin, 2003).
- ¹⁹ SMEELP was considered useful and helpful by 88 per cent of participating firms. Out of the 33 SMEs that participated in at least one training course offered, 19 firms were awarded at least one contract (Castel-Branco and Goldin, 2003).
- ²⁰ Castel-Branco and Goldin estimate that at steady-state production Mozal II will represent 4.5 per cent of GDP but only contribute 0.5 per cent of total public revenue (Castel-Branco and Goldin, 2003).
- ²¹ This estimate is based on Mozal’s revenue reported in KPMG’s “Top 100 Companies” report.
- ²² This aggregate estimate excludes the intra-regional trade among the aforementioned five landlocked countries and Mozambique.
- ²³ For example, SMEs in the European Union accounted for 67 per cent of non-financial employment and averaged a share of 48.5 per cent of total value added across all sectors in 2007.
- ²⁴ World Tourism Organization data shows that the largest tourism destinations amongst the neighbouring countries are South Africa and Zimbabwe which attracted roughly 9.5 and 2 million tourists respectively, and perceived \$7.9 billion and \$523 million in tourism receipts in 2008. By comparison, Mozambique attracted 2.4 million tourists and earned \$196 million in tourism receipts.
- ²⁵ Kruger Park received 1,429,904 visitors in 2009/2010, up 3 per cent from the previous year. It sold 958,923 bed nights and had nearly an 80 per cent unit occupancy rate.

CHAPTER 2

The investment framework



A. Introduction

Mozambique operated as a planned economy from independence in 1975 until 1987, when President Joaquim Chissano started the transition to a market economy and initiated the political reforms that led to the General Peace Agreement. Initial reforms were supported by a structural adjustment programme with the World Bank and lending from the International Monetary Fund (IMF). Mozambique has continued to benefit from the strong support of the donor community ever since.

As a result, the investment framework has been comprehensively overhauled over the past two decades, and reforms continue. Mozambique has put in place the core regulatory blocks of a market economy, and immense progress has been achieved. Yet, certain aspects of the legal framework continue to reflect a relatively intrusive approach to investment regulation. A number of regulatory institutions are biased towards controlling and sanctioning rather than towards monitoring and enforcing while at the same time facilitating and servicing. In addition, regulations and administrative procedures tend to be excessively complex or burdensome and hence difficult to administer or comply with.

Mozambique's position (139 out of 183) in the World Bank's *Doing Business 2012* ranking is symptomatic of the regulatory burden, even though the ranking should be interpreted with care for methodological reasons.²⁶ The 2012 report also shows that the number of procedures to obtain key licences or authorizations tends to be large compared to other countries in the region (e.g. Botswana, Namibia, South Africa or Zambia).

This chapter analyzes the regulatory framework as it affects all investors. Issues specific to foreign investors are covered in some detail. In contrast, certain issues affecting investment, including intellectual property rights or sector-specific regulations are not covered. This does not mean that they are not relevant, but rather that they are less crucial at this point of time for Mozambique

B. Issues specific to foreign investors

Mozambique adopted its first law on foreign direct investment in 1984. Recognizing the changes in the world economy and in the national policy context, Parliament passed a new Law on Investment (law

3/93) in 1993 in order to “*favour greater participation, complementarity and equality of treatment of national and foreign investments*”. The law established an open and welcoming stance towards foreign investors. At the same time, the approach adopted by Mozambique was somewhat unusual in that the Law on Investment does not apply universally to all types of investments.

The provisions of the law in terms of rights and obligations apply equally to national and foreign investments²⁷ but only to the extent that investors actually seek to benefit from the guarantees and incentives established in the law. Foreign and national investors are not legally obliged to comply with the establishment procedures set by law 3/93, but the rights, protection and incentives defined therein are available only to those who do follow such procedures. In addition, the law specifically excludes investments in petroleum, natural gas and mining from its scope of application.

While the choice of being subject to law 3/93 or not is initially for the investors to make, the law also specifies eligibility conditions. Investments eligible to be approved under law 3/93 must, in principle, contribute to sustainable economic and social development, as defined by a set of 10 criteria that include: (1) development of infrastructure; (2) expansion of productive capacity; (3) job creation for nationals and skills transfers; (4) export creation; (5) import substitution; and (6) improving supply conditions on the local market. Until 2009, regulations required that 7 out of these 10 criteria be fulfilled for an investor to be eligible for an investment licence. This requirement has now been abolished.

In practice, the vast majority of foreign investors choose to follow the entry and establishment procedures set in law 3/93 because this is the only way for them to benefit from key provisions on treatment and protection as well as to access tax and other incentives. National investors, on the other hand, frequently bypass the establishment procedures of law 3/93 and thereby fail to enjoy the benefits and incentives linked with the Law on Investment. This is particularly the case for smaller national investors.

The analysis in sections B.1 to B.3 below is applicable to investors that choose to establish following the provisions of law 3/93. Those that bypass the establishment procedures do not benefit from any of the rights and incentives referred to below.

1. FDI entry and establishment

Mozambique has adopted an unusually strong legal commitment to open its economy to foreign investment as the Constitution of 1992 grants the right to foreigners to invest on the entire territory and in all economic sectors, with the exception of those that are reserved for exclusive public ownership.²⁸ The Law on Investment grants the power to define the areas of economic activity reserved to the public sector to the Council of Ministers. These areas may be under exclusive public ownership or involve private sector participation within certain limits. Where private sector participation is allowed, different percentages of maximum ownership may apply to nationals and foreigners.

Until 2009, the regulations related to the Law on Investment (decree 14/93) defined five areas²⁹ that were reserved for public investment. In July 2009, however, decree 43/2009 abrogated all the provisions of decree 14/93 – with the exception of the one that established the Investment Promotion Centre (CPI). The new implementation decree no longer defines areas that are reserved for public ownership and in which foreign ownership would be restricted.

Prior to establishing operations in Mozambique and complying with company start-up procedures (section C), investors that wish to benefit from the provisions of the Law on Investment must follow a formal registration and authorization procedure. This procedure is administered in the majority of cases by the CPI. Since 2007, the registration and authorization of investments in special economic zones (SEZs) and industrial free zones (IFZs) have been managed by the Special Economic Zones Office (GAZEDA).

The CPI and GAZEDA act as evaluators and prepare proposals for approval by the competent authorities. The authority legally entitled to grant project approval depends on the nature and size of the investment. Projects within SEZs and IFZs are filed to GAZEDA and authorized by the Director General. Other projects are filed to the CPI and authorized by:

- Provincial governors for national investments up to MT1.5 billion (\$46 million). Governors cannot authorize FDI projects of any size.
- The Director General of the CPI for foreign and national investments up to MT2.5 billion (\$78 million).

- The Minister of Planning and Development for foreign and national investments between MT2.5 billion and MT13.5 billion (\$422 million).
- The Council of Ministers for: (1) investments above MT13.5 billion; (2) projects requiring land concessions of more than 10 000 hectares or 100 000 hectares in the case of forestry; and (3) projects with significant political, social, economic or financial implications.

Investors are required to file a relatively detailed project application form, which includes information on the financing structure of the project, infrastructure needs, inputs used, labour requirements – including skills set and salary levels – and project implementation schedule. In theory, temporary land-user rights (DUAT) should be secured at the time the application form is filed. Securing the DUAT, however, is a complex and lengthy procedure (section E). A fee equivalent to 0.1 per cent of total project cost, capped at \$50 000, is charged for all project applications.

Authorization processes with the CPI and GAZEDA are sanctioned by an investment licence that defines specific terms and conditions granted to the investor, including in terms of tax incentives and employment of expatriates (sections F and D). The investment licence and its provisions on incentives and benefits have contractual value.

Decree 43/2009 requires the competent authorities to issue a decision on approval or rejection of a project within 3 to 30 working days. These limits are frequently not respected, however, as the issuance of investment licences typically involves negotiations between the investor, the CPI or GAZEDA and other Government bodies on issues ranging from the acquisition of DUATs to permits for the recruitment of expatriates or the granting of tax incentives.

Similarly, once an investment licence has been issued, investors are required to start project implementation within 120 days, unless otherwise specified in the licence. In practice, however, many projects take longer to start, and a number of others are either only partially or not at all implemented (chapter I). The CPI and GAZEDA have been granted the mandate to monitor project implementation, including by requesting information on company accounts and conducting site visits. However, aside from some of the larger projects, the CPI does not have the resources to closely follow or monitor project

implementation after investment licences have been approved.

As stated above, obtaining an investment licence is not a legal obligation for foreign or national investors operating outside SEZs or IFZs. Yet, the licence is required to benefit from the protection and benefits granted by the Law on Investment. Aside from the treatment and protection clauses dealt with in section B.2 below, investment licences are required for investors to access the following benefits: (1) incentives on corporate income taxation; (2) duty-free import of certain goods; and (3) recruitment of expatriates beyond standard quotas.

These benefits, covered in detail in the sections below, are available only to investors that secure an investment licence. This is true for foreign investors as well as for national investors. The exact nature of the benefits offered is spelled out in the investment licence, which has contractual value and therefore gives a high degree of stability and certainty to investors regarding their future operational conditions. At the same time, it constrains Mozambique's ability to implement changes, in particular regarding tax policy.

2. FDI treatment and protection

The Law on Investment offers a number of guarantees to foreign investors in terms of treatment and protection. These guarantees are granted only to holders of investment licences, which make the latter all the more important. Article 4 specifies that foreign investors have the same rights and obligations as nationals. The law carves out an exception to this general principle, however, by allowing the Government to provide special treatment and support (e.g. through subsidized lending or other direct or indirect measures) to nationals for activities that deserve it due to their scale or nature.

The Constitution establishes the right to private property as a fundamental right protected by the State. It further stipulates that expropriations may only occur for causes related to public need or interest and must lead to just compensation as regulated by law. The Law on Investment is somewhat more specific and stricter on the protection of investors, but again its application is restricted to investments that have obtained an investment licence. It authorizes expropriation or nationalization when "deemed absolutely necessary" for the national interest, public order or public health and entitles investors to "fair and equitable" compensation.

Payment of compensation is to take place within a maximum period of 180 days, which includes up to 90 days to assess the amount and 90 days to execute the payment. Remittance abroad of compensation payments is guaranteed, but the law remains vague or silent on some important aspects, including the methods to determine compensation amounts, the composition of the evaluators and non-discrimination.

Disputes between the Government of Mozambique and foreign holders of investment licences may be referred to international arbitration, but only upon express agreement of both parties. The investment licence itself does not constitute a tacit agreement by the Government to go to international arbitration if the investor chooses to do so. If both parties agree to it, disputes may be referred to: (1) the International Centre for Settlement of Investment Disputes (ICSID); (2) the ICSID additional facility; or (3) the International Chamber of Commerce.

Investors from countries with which Mozambique has ratified bilateral investment treaties (BITs), however, are granted automatic access to international arbitration if they choose so, in most cases after an initial period of 6 months trying to find an amicable resolution to the dispute. As of end-2010, Mozambique had ratified BITs with 21 countries, with three more treaties signed but not yet ratified. Key source countries of FDI such as China, the Netherlands, Portugal, South Africa and Switzerland are covered, but investors from some major countries are not, including in particular Brazil and Canada. As of early-2011 no known investor-State dispute had been taken to international arbitration.

In addition to the ability to access international arbitration upon their choosing, investors from countries that have ratified BITs with Mozambique benefit from stronger protection than that provided in national law in a number of key aspects, in particular the transfer of funds (section B.4) and expropriation or nationalization. BITs also include provisions on national and most-favoured nation (MFN) treatment, but these are well-covered in national law.

3. Institutional arrangements

The CPI was created in 1993 under decree 14/93 to assist the Minister of Planning and Development in the implementation of the Law on Investment. Its statutes and organizational structure were reformed in 2009 under resolution 26/2009. Unlike most investment promotion agencies (IPAs) in wealthier countries, but

similarly to a number of IPAs in Africa, the CPI fulfills both a regulatory role and promotional functions.

As per resolution 26/2009, the main role of the CPI is the “*development and execution of measures of promotion and coordination of foreign and national investments, including the evaluation, support and monitoring of projects undertaken under the Law on Investment*”. Its core competencies touch upon a wide range of functions and include:

Regulatory functions:

- Register and evaluate investment proposals under the Law on Investment.
- Intervene in the decision-making process regarding the issuance of various licences and authorizations.
- Inform investors of the status of their application for an investment licence.
- Monitor the implementation of investment projects as per the investment licence.
- Ensure that the law and Government policy on investment is effectively applied.
- Maintain a comprehensive registry of authorized and realized investments.

Promotional/support functions:

- Image building: develop and coordinate image building campaigns abroad.
- Targeting and lead generation: promote specific investment opportunities nationally and overseas.
- Facilitation: ensure inter-institutional coordination within Government on investment-related issues; support investors in obtaining the required licences and approvals from various agencies.
- Advocacy: define and propose policies to attract and retain foreign and national investment; suggest improvements to the legal and regulatory framework.

The CPI benefits from administrative and financial autonomy. The staff has a distinct status from that of civil servants, which gives the CPI the ability to offer wages on a different scale and recruit more easily from the private sector. Budget resources originate from direct Government support (around 60 per cent of the total) and from the fees charged on investment applications. The CPI currently employs around 50 people, and there

are plans to increase the number to around 70. Most employees are based in Maputo, but the CPI has made efforts recently to strengthen provincial representations, which cover Manica, Nampula, Niassa, Sofala, Tete and Zambezi. The CPI also has resource persons in Brussels, Pretoria and Shanghai.

The CPI is organized around four main operational departments with the following main objectives:

- **Department of information and marketing:** organize marketing and image-building campaigns and events; welcome investors and inform them on investment opportunities and regulations; prospect for potential investors; compile and publish data on investment trends.
- **Department of business development:** identify and promote business opportunities; compile information for investors; identify and propose economic, legal or administrative measures to promote investment; prepare sectoral studies on investment opportunities.
- **Department of project management:** register and evaluate applications for investment licences; coordinate the administrative procedures for the granting of tax and non-tax incentives; ensure cross-agency coordination in the issuance of various licences; facilitate contacts with other administrations; monitor authorized projects; participate in meetings and negotiations on project authorizations; promote reinvestments.
- **Department of business linkages:** promote linkages between local small and medium enterprises (SMEs) and larger investors; assist national investors in building capacity for linkages.

Although the UNCTAD fact-finding mission could not evaluate the budgets dedicated to each of these departments, by far the biggest share of financial and staff resources is focused on the project management department. This is largely a reflection of the important regulatory functions that have been assigned to the CPI under the Law on Investment. This does not mean that image building, generating project leads, facilitation and advocacy have been neglected. Given that resources are limited, however, it does imply that some of these functions are weaker, in relative terms, than in other IPAs elsewhere in the developing world. The combination of a strong regulatory role and of promotion/marketing functions in a single public body is also susceptible to

generate some confusion among investors, as well as potential conflicts of interest.

GAZEDA was established as an autonomous public body in 2007 by decree 75/2007. Similarly to the CPI, it combines regulatory and promotional functions. Its main purpose is to “promote and coordinate all activities related with the creation, development and management of special economic zones and industrial free zones”. For most intents and purposes, GAZEDA is a mirror-organization of the CPI, with a mandate dedicated to SEZ and IFZ investments. As of early 2011, Mozambique had established the Nacala SEZ and the Beluluane industrial park. In addition, some companies operate as IFZs on their own (section F.1).

GAZEDA is organized around four main operational departments with the following main objectives:

- **Department of marketing and public relations:** prepare promotional material and market investment opportunities in SEZs and IFZs.
- **Department of research and projects:** conduct research on issues related to the establishment and development of SEZs and IFZs.
- **Department of SEZs:** conduct all actions needed for the establishment and operation of SEZs, including infrastructure development.
- **Department of IFZs:** conduct all actions needed for the establishment and operation of IFZs.

GAZEDA seeks to operate in partnership with private investors on the development of SEZs and IFZs, rather than building the infrastructure itself. It is funded in part through direct Government support, but also has its own sources of funds, including principally fees charged and 40 per cent of the revenue generated by the operation of the SEZs and IFZs.

4. Transfer of funds and foreign exchange regulations

The transfer of funds related to foreign investments and foreign exchange operations are regulated in a multi-layered way. Two key pieces of legislation are relevant for investors: the Law on Investment, together with its implementation decree, and the Law on Foreign Exchange (law 11/2009), which was reformed in 2009 and its implementation decree (decree 83/2010), which was adopted at the end of 2010. The Law on Foreign Exchange of 2009 introduced major changes to foreign

exchange regulations. Some establish tighter controls, while other should provide more flexibility, particularly for current account transactions. The adoption of Decree 83/2010 paved the way for the acceptance of the obligations of Article VIII, sections 2, 3 and 4 of the IMF articles of agreement on the avoidance of restrictions on current payments, discriminatory currency practices and convertibility of foreign-held balances in May 2011.

The Law on Investment guarantees the transfer of funds regarding: (1) profits; (2) royalties; (3) principal and interest payments on loans; (4) capital arising from the full or partial sale of assets; and (5) proceeds from expropriation or nationalization. The guarantees apply only to holders of licences and are subject to a number of conditions or potential restrictions that have become relatively uncommon practice around the world.

First, decree 43/2009 stipulates that the transfer guarantees for profits and capital require a minimum initial equity investment of MT2.5 million (\$78 000) by the foreign investor. Alternatively, the guarantee can also be granted if the project generates annual sales of at least MT7.5 million (\$234 000), creates exports of MT1.5 million (\$47 000) or employs at least 25 Mozambicans.

Second, while transfers of funds are subject to standard requirements regarding prior payment of tax obligations, the Law on Investment imposes unusual conditions: (1) transfers of profits are conditioned upon the investor generating a positive balance of foreign exchange earnings; (2) alternatively the investor must demonstrate that it has generated foreign exchange savings through import substitution; and (3) transfers of capital or proceeds from expropriated assets may be subject to payments through installments over a period of up to five years in order to avoid negative effects on the balance of payments. Some of those conditions or restrictions could potentially run counter to the obligations regarding avoidance of current account restrictions as set forth in Article VIII of the IMF.

The Law on Investment also authorizes exporters to retain a share of their foreign exchange earnings in convertible currency accounts in local banks. However, this is subject to prior authorization by the Bank of Mozambique.

As indicated above, the Law on Foreign Exchange of 2009 introduces significant reforms. In particular, article 6.2 stipulates that current transactions are not subject to authorization. They remain subject to registration

with the Bank of Mozambique, however, and must be done through an authorized bank. In contrast, all capital transactions are strictly regulated and require prior authorization from the Bank of Mozambique. These transactions include: (1) foreign direct investment; (2) acquisition of fixed assets; (3) credit under all forms; (4) repatriation of capital; and (5) the opening of resident accounts in foreign currency.

The Law on Foreign Exchange requires the remittance by residents of all income from the export of goods and services and earnings on foreign assets. It also carves out a special treatment for certain areas of the economy, including: (1) free zones; (2) border zones; and (3) the stock exchange. In addition, article 27 subordinates the provisions of the law that apply to foreign investors to special dispositions expressly set out in the Law on Investment or other specific legislation.

Law 11/2009 sets the general framework for foreign exchange transactions. Many important provisions and regulations are determined in the implementation decree, which was adopted at the end of 2010. The decree stipulates that residents have up to 90 days to remit foreign exchange earnings resulting from exports of goods and services or income on foreign assets. In addition to this requirement, already stipulated in the law, the decree imposes that foreign currency earnings be converted in meticaís upon repatriation in domestic accounts. The Bank of Mozambique may allow investors, on a case-by-case basis, to retain part of their foreign exchange earnings in overseas accounts to provision for certain payments. No exemption is allowed to the obligation to convert earnings in meticaís in the decree, but the Law on Investment does allow such an exception for holders of investment licences, subject to approval by the Bank of Mozambique.

The decree further consolidates the elimination of restrictions on current payments. Transfers of profits and dividends as well as earnings on other assets held in Mozambique are nevertheless subject to heavy procedural requirements, including proof of payment of tax obligations, statement by the company's auditors that the distributed profits result from the activities of the company, proof of prior registration of the project with the Bank of Mozambique and proof of authorization of dividend payments by the general assembly.

The decree defines the procedures under which capital transactions are authorized by the Bank of Mozambique. Foreign direct equity investments into Mozambique are

subject to a straightforward registration process. Intra-company loans, in turn, are subject to stricter criteria for authorization. In particular, interest rates charged may not exceed market rates and should "preferably be equal to zero". Commercial borrowing abroad is also subject to conditions.

Foreign exchange operations in SEZs and IFZs will be regulated separately. Specific regulations still need to be drafted, but decree 43/2009 specifies that companies operating in SEZs are allowed to open, maintain and transact in foreign exchange accounts held inside or outside of Mozambique. They are also allowed to borrow abroad without the need for previous authorization by the Bank of Mozambique. Oddly enough, decree 43/2009 does not have any such provisions for companies operating in IFZs.

5. Assessment of measures affecting foreign investors

Mozambique has put in place an exceptionally open entry regime for FDI. Yet, the approach of the 1993 Law on Investment on establishment, treatment and protection is dated and at times problematic. At the end of the civil war and during the initial stage of structural reforms, it made significant sense for Mozambique to reassure investors that their operational conditions would remain stable, as the country needed to establish its credibility as an investment destination. This situation warranted the choice to put in place a formal authorization and certification procedure, through which investors could obtain contractual guarantees regarding their terms of operation and protection, including tax incentives and employment of expatriates.

This approach helped Mozambique build its credentials as a country with operational stability. National and international conditions have significantly evolved during the 1990s and 2000s, however, while the overall approach of the Law on Investment has remained the same. The adoption of a new implementation decree in 2009 has not been sufficient to bring about significant changes to the regulatory approach.

A number of key problems arise from the current Law on Investment and associated regulations:

- Conditioning the access to major tax and non-tax incentives to obtaining an investment licence creates an un-level playing field. This is particularly the case between small and large foreign investors, and between national and foreign investors:

- Small foreign investors may be at a disadvantage as they are in a weaker bargaining position to secure access to incentives than large (mega) foreign investors.
 - National investors, in particular smaller ones, may be at a disadvantage as many of them do not even apply for investment licences with the CPI, and hence fail to qualify for incentives.
 - Core standards of treatment and protection that international investors have come to expect are granted only to holders of investment licences. In addition, mining and petroleum activities are specifically excluded from the ambit of the Law on Investment, which excludes key sectors for FDI from basic investment rules and creates unnecessary discrimination between activities.
 - The treatment of foreign investors regarding the transfer of funds and foreign exchange operations is in some cases problematic:
 - The recently adopted obligation to convert foreign exchange earnings into meticaís will be particularly damaging for the operating conditions of existing and prospecting foreign investors, as well as for the promotion of export-oriented activities. Such a measure will impose significant foreign exchange risk on investors, which they will not be able to hedge given the under-developed nature of domestic financial markets.
 - The Law on Investment and its regulations make it possible for certain classes of investors, including those in SEZs and perhaps IFZs, to maintain foreign exchange accounts domestically or abroad and to retain parts of their earnings in foreign currency. It is likely that large investors will succeed in obtaining the authorizations needed, while smaller investors are likely to be submitted to the obligation to convert their foreign exchange earnings. This will create an un-level playing field between large and small investors.
 - The ability to repatriate earnings and capital invested is fundamental for foreign investors. In that sense, the acceptance of the obligations under article VIII of the IMF agreement is a very positive move. The provisions of the Law on Investment and its implementation decree regarding transfer of profits, royalties or interest need to be aligned with this approach. It is, for example, inappropriate that guarantees under the Law on Investment for profit and capital repatriation be conditioned upon a minimum capital investment or job creation. Such a measure further contributes to the creation of an un-level playing field between different classes of foreign investors.
 - The newly adopted foreign-exchange regulations impose a very heavy administrative burden on investors and the Bank of Mozambique.
 - Issuing investment licences with contractual value means that Mozambique's policy space and ability to undertake reforms is partly straightjacketed.
 - The investment certification requirement and strong involvement of the CPI and GAZEDA in granting incentives introduce an uneasy mix of regulatory and promotional roles that may lead to confusion and perhaps even conflicts of interest.
 - The investment certification requirement adds an extra level of bureaucracy in the business establishment procedures.
 - The CPI and GAZEDA have very little ability to monitor project implementation.
 - Certain aspects of the legal regime on expropriations or nationalizations are relatively weak compared to international standards, in particular regarding the determination of compensation amounts.
- Precise recommendations on what could constitute a more appropriate approach to FDI entry, establishment, treatment and protection, given Mozambique's current situation and development objectives, are provided in chapter III.

C. Setting up a business

Start-up procedures have been simplified over the past few years, and a new commercial code brought about a much needed modernization to company law. Yet, licensing requirements remain burdensome for some classes of investors. In addition, the simplification of recent years has focused on start-up procedures *stricto sensu* (i.e. the creation of a legal entity), but complications remain in the process of setting up a going concern, including in terms of obtaining permits to set up facilities, accessing land, securing sectoral licences and obtaining environmental permits.

The Commercial Code of 2005 (law 10/2005) fundamentally overhauled company law and eased registration procedures by eliminating a number of formal requirements, including the compulsory recourse to notaries. At the same time, the new code improved corporate governance and the protection of minority shareholders. This progress is illustrated in Mozambique's position in the Doing Business 2011 indicators on "starting a business" and "protecting investors", where it ranked 65th and 44th out of 183 countries, respectively.³⁰ This far exceeds the country's overall performance on the ease of doing business ranking, where Mozambique places 126th.

Six forms of companies can be established under the Commercial Code, with varying reporting, management and transparency requirements. The most relevant for foreign investors are the *sociedade anónima* (public limited company), the *sociedade por quotas* (private limited company) and the *sociedade em nome colectivo* (limited partnership).

Decree 2/2008 on the simplified licensing regime also contributed to easing start-up procedures. It established a simplified regime for activities that, by nature, do not cause potential threats to the environment, public health or the economy. In parallel, Mozambique established one-stop shops at the provincial level under decree 14/2007, with the purpose of facilitating establishment procedures. A number of sectors benefit from the simplified licensing regime, including agriculture, commerce, industry, construction and tourism. Eligibility within these sectors is quite restricted, however, and clearly aimed at small to micro-enterprises, which makes it relevant and useful for national investors, but less so for foreign investors.

Companies beyond the small-to-micro range still need to undergo a heavier licensing procedure. To begin with, all investors seeking to benefit from tax and non-tax benefits must first obtain an investment licence from the CPI, which has de facto become an establishment requirement for larger investors (section B). All industrial activities must then be licenced under decree 39/2003. Large and medium-size investments are licenced by the Minister of Industry and Commerce, while small and micro investments are authorized by Governors.³¹ In addition to the licensing requirement, decree 39/2003 provides significant powers to inspect facilities (section H).

Aside from standard requirements to register with the tax authorities, social security and other procedural

requirements that do not cause real delays, investors face more difficult and lengthy procedures in their start-up phase when it comes to accessing skilled workers (section D) and securing land (section E). Navigating through the environmental permitting procedures can also prove time-consuming and complex.

Mozambique adopted an essential piece of legislation by passing the Law on the Environment (law 20/97) in 1997. This type of legislation is crucial in order to protect the environment and set a general framework for sustainable development. The law establishes a number of fundamental principles, including precaution in the face of uncertainty regarding environmental effects, the preservation of a sound and healthy environment, ecosystems and biodiversity, and the polluter-pays concept. The law also imposes that all projects susceptible by nature, location or size to have potentially significant impacts on the environment undergo an environmental licensing procedure. Decree 45/2004 establishes three categories of projects, which are subject to the following requirements: (1) a full environmental impact assessment (EIA); (2) a simplified environmental impact assessment; or (3) the observance of established norms and directives on environmental management. A precise list of projects falling within each of these categories is defined in the same decree.

The terms of reference of environmental impact assessments must be defined in coordination with the Ministry of Environment on the basis of a pre-assessment of the project. They must be approved by the Ministry before the EIA can be conducted by authorized agents. In most cases, the EIA will require public consultations, even though it is only optional for projects undergoing simplified EIAs. Environmental licences are valid for only five years but can be renewed upon submission of an updated environmental management plan.³²

Law 20/97 put in place a sound overall framework to protect the environment and foster sustainable development. The administration of licensing requirements, however, needs to be improved in several respects. First and foremost, technical capacity within the Ministry of Environment needs to be strengthened to ensure a comprehensive evaluation of EIAs and environment management plans, to allow efficient monitoring and compliance, and to avoid undue delays in issuing licences. Similarly, the intertwined nature of licences (e.g. environmental licence, investment licence or permit to use land) needs to be

looked at in order to avoid parallel processes delaying or impeding each other.

D. Employing workers and accessing skills

1. General labour regulations

Mozambique adopted a new labour law in 2007 (law 23/2007) following close consultation with trade unions and business associations. It introduced fundamental reforms to labour market regulations with the view to generating a better balance between the flexibility demanded by employers in the formal sector and the need to protect workers' rights and interests. It was a welcome re-balancing in a country where it is estimated that between 80 and 90 per cent of the labour force remains active in subsistence agriculture and where there is a dire need for formal job creation. In part as a consequence of the reforms of 2007, labour market regulations ranked very low among the main operational constraints cited by businesses in the World Bank's Enterprise Survey of 2008.³³ Issues do remain in terms of implementation of labour regulations, however, and difficulties in recruiting expatriates are a constraint frequently mentioned by foreign investors as a key operational hurdle (section D.2).

The principal terms and conditions of the Labour Law are of general application, but certain sectors or contractual relationships are also governed by specific legislation, including mining, rural, port and maritime work. In addition, collective agreements may be negotiated at the company or sectoral levels. All employment relationships require a formal contract, either under a fixed-term or an indefinite duration contract. The reform of 2007 introduced more flexibility in the use of fixed-term contracts. Although they can be used for temporary duties only, fixed-term contracts may extend for up to two years and be renewed twice. In addition, SMEs are granted additional flexibility as they are free to enter into fixed-terms contracts for their first 10 years of operation. As far as indefinite duration contracts are concerned, a probation period of 90 days or 180 days applies, depending on the level of qualification of the employee.

Normal working schedules are capped at 48 hours per week and 8 hours per day. A schedule of working hours defining the start and end of the workday must be

defined by the employer after consultation with workers' representatives and clearly displayed on the workplace. The Labour Consultative Committee, which includes representatives from government, the private sector and labour unions, sets a minimum wage on annual basis for eight sectors. In 2010, the minimum wage ranged from MT1600 (\$50) per month in agriculture to MT3500 (\$110) in financial services. Overtime work is strictly regulated and is capped at 8 hours per week, 96 hours per quarter and 200 hours per year. Depending on circumstances, wage for overtime work is increased by 50 or 100 per cent.

Employees are entitled to annual leave of 12 days in the first year, 24 days in the second year and 30 days subsequently. A schedule of annual holidays must be agreed upon each year in consultation with the workers' representatives and posted on the premises. Employees have the right to demand that annual holidays be taken in one uninterrupted period.

Hiring and firing procedures were eased in 2007 to promote job creation, but workers' rights continue to be adequately protected. Flexibility in managing cyclical events was introduced by allowing contracts to be suspended on a temporary basis by the employer for certain personal reasons or by the employer for economic reasons. The grounds that constitute "just cause" for firing individual employees are strictly defined, and redundancies for structural, technological and market-related reasons are well delineated. Redundancies for economic reasons are considered "collective" if more than 10 employees are affected at the same time. The procedure for firing or redundancies requires that the workers involved, the trade union and the Ministry of Labour be given notice at least 30 days in advance. During this period, the Labour Inspectorate may request any information it deems necessary.

Disputes of all nature must be subject to conciliation, mediation or arbitration before being referred to a court of law. The rights of workers to form trade unions are well protected, and Mozambique is strongly unionized. The right to strike is recognized as a basic right, but it does not extend to workers in the public sector. In essential activities such as medical services, water and power supply or telecommunications, the right to strike is subject to ensuring that a minimum level of service is guaranteed. Prior efforts to resolve disputes through alternative mechanisms are required before a strike can be called, and a 5-day notice must be given to the employer and the Ministry of Labour. The decision to

strike must be taken by absolute majority, and workers on strike are not allowed to prevent others from working. On the employer side, lockouts are prohibited.

The Labour Law grants significant powers to the Labour Inspectorate in order to ensure that regulations are properly complied with and enforced. In particular, inspectors have the power to impose fines for a wide variety of violations, in addition to imposing corrective measures. Depending on gravity, fines range from 3 to 10 times the relevant minimum wage. Although the law states that the Labour Inspectorate “shall favour educating employers and employees about voluntary compliance with labour rules”, the emphasis over recent years has clearly been on inspections and sanctions. Investors frequently complain about intrusive inspections and sanctions for non-compliance with minor procedural requirements that in no way constitute a threat to workers or a violation of their fundamental rights.

2. Employing foreigners and accessing skills

The ability to attract and recruit workers and managers with the appropriate set of skills is a crucial element in the location decision of foreign investors: in many cases, it can be a make or break factor. For national investors, it can also be a key factor of success and growth. In countries where educational levels are relatively low and skills-development institutions are in their infancy, tapping foreign skills may prove extremely valuable not only for businesses, but also for the development of human capital. Even countries with fully-developed higher educational systems and vocational schools frequently resort to and benefit from foreign skills. Australia, Canada and Singapore, for example, have long adopted pioneering policies to attract skilled migrants. Even the United States implements proactive policies to attract worldwide talent for its high-tech industries and top universities.

As highlighted in chapter 1, Mozambique faces severe constraints in terms of skills. Although significant results have been achieved in the past two decades to restore the educational system and improve basic literacy, the devastating effects of the civil war continue to be felt to date. Vocational training schools and institutions of higher education have been strengthened but are only accessible to a relatively small number of people. Access to skills is thus an issue for most investors. This is confirmed by recent investor surveys conducted by the World Bank and the World Economic Forum that list

not only the level of education of the national workforce as a key constraint to business, but also the difficulty to obtain work permits for expatriates when needed.³⁴

The rules for the employment of foreigners in Mozambique were reformed in 2007 as part of the new Labour Law. In addition to law 23/2007, the Law on Immigration (law 5/1993) and the decree on the employment of foreigners (decree 55/2008) define the rules for expatriate work permits. As per the Labour Law, companies are entitled to recruit foreign workers up to set percentages (without “rounding up”) of their total workforce:

- Small companies (10 workers or fewer) may employ up to 10 per cent of foreigners;
- Medium-sized companies (between 11 and 99 workers) may employ up to 8 per cent of foreigners;
- Large companies (100 workers or more) may employ up to 5 per cent of foreigners;
- A special quota of 15 per cent applies to companies operating in special economic zones and industrial free zones.

The recruitment of expatriates within these quotas is a legal entitlement and securing the work permits involves a straightforward declaration procedure with the Ministry of Labour. Work permits for company managers or directors count as part of the quota as they do not benefit from a special regime. No formal requirements are set on the skills level and/or recognition of qualifications or diplomas under the quota, which means that investors are genuinely free to recruit the workers that they wish as long as they operate within quota. Contracts with expatriates are limited to a maximum duration of two years but can be renewed as many times as needed. The issuance of work permits is subject to a fee equivalent to 3 to 10 months of the relevant sectoral minimum wage.

While the procedure to secure work permits within quotas functions on a simple declaration basis, foreigners must secure a visa in order to legally reside in Mozambique. The procedures are separate from those granting the work permit. Three types of residence permits (visas) are relevant for foreign workers. The non-permanent permit is valid for a maximum period of one year and is the first visa that foreign workers may obtain. After five years of residence under a non-permanent permit, foreigners may obtain a temporary residence permit, which must also be renewed annually. After 10 years of residence under a temporary permit, foreigners may

obtain a permanent residence permit, which is to be renewed every five years or can be granted for life for persons above 65.

The requirement to renew residence permits every year for most foreign workers implies a heavy administrative burden. A significant number of official documents and certificates is required upon each application, which is also subject to a fee. In addition, applicants are required to be present in person at the immigration services.

Beyond the numbers allowed under the quota system, Mozambique applies a very restrictive system of allocation of work permits. The philosophy that underpins the work permit policy is grounded on the desire to promote and protect employment for nationals more than on efforts to ensure that businesses are able to access the skills that they need for their growth and development. As per articles 31 and 33 of the Labour Law, “employers should create conditions for placing qualified Mozambicans in the more highly skilled jobs and in positions of management” and “foreign employees (...) may only be employed when there are no nationals having the same qualifications, or where such nationals are insufficient in number.”

Work permits above the quotas are thus allocated on a case-by-case basis and only inasmuch as the employer is able to demonstrate that no Mozambican with the required skills could be found (labour market testing). The application procedure required for each position is complex and lengthy, and its outcome very uncertain. The opinion of the company’s trade union on the relevance of the application must be sought and academic qualifications obtained abroad must be validated and certified by the Ministry of Education, which is complicated. These procedures and requirements have proved frustrating for most investors seeking to recruit expatriates beyond the quota limits.

An alternative channel allows investors to recruit higher proportions of expatriates. Under the Law on Investment, companies may negotiate either a higher percentage of foreign workers, or a pre-defined number of work permits. These negotiations take place with the CPI or GAZEDA as part of the process of application for the investment licence. Although negotiations are conducted by the CPI and GAZEDA, the Ministry of Labour must provide its consent. The law does not set any restriction on the negotiated quotas, which are determined on a case-by-case basis. Upon agreement, the quotas are specified in the investment licence and

become binding for Mozambique. The granting of work and residence permits then follows the same rules as per the quota system.

3. Assessment of employment and access to skills issues

The reform of the labour code in 2007 significantly improved the regulatory framework and should promote job creation without unduly affecting workers’ protection. This is reflected in recent investor surveys, where labour issues are not listed among significant constraints to operations. In contrast, Mozambique does not seem to have reached the appropriate balance between the legitimate objective to ensure that Mozambicans are given priority in accessing jobs at all levels and the need to enable investors to access the skills required for their operation and expansion.

The key problems and issues in terms of labour market regulations and access to skills are as follows:

- ◆ By adopting a strict and restrictive policy on the issuance of work permits for foreigners, Mozambique is exerting a constraint on the operations and a brake on the expansion of existing investors. It also puts a hurdle in front of certain types of investments and may prevent them from ever taking place, particularly smaller projects in skills-intensive sectors. A number of factors should be considered:
 - Expatriates are in most cases more expensive than Mozambicans to recruit, which gives a powerful natural incentive to rely on nationals whenever possible.
 - There are instances however, where relatively low-skilled foreign labour is imported without proper justification. These cases need to be dealt with forcefully to protect the interests of nationals. Nevertheless, they must be addressed without penalizing bona fide investors seeking skills that are in short supply locally.
 - In spite of all its recent efforts on the education front, Mozambique continues to suffer from skills shortages and these are likely to last for decades. Where skills are in short supply, allowing foreign investors to recruit expatriates does not reduce employment opportunities for nationals.
 - Foreign investors are likely to feel more comfortable placing trusted and tested employees in key

managerial positions, at least in the first few years of operations.

- Certain types of investments (e.g. small-scale but skills-intensive) may generate no or very little employment for nationals at first, but become large employers later on. These investments should not be discouraged by an excessively restrictive work permit policy.
- ◆ The ability to negotiate higher quotas of foreign workers on a case-by-case basis through the investment licence has been essential for many investors as it introduced some flexibility in an otherwise restrictive policy. The process, however, is far from satisfactory as it introduces a high degree of arbitrariness. Large investors likely have sufficient negotiating power to secure what they need, but smaller investors are in a much weaker position and are often left trying to obtain work permits through the labour market testing procedure. As is already the case in other parts of the regulatory framework, this introduces an un-level playing field between large and small investors.
- ◆ Although it brought about significant improvements, the Labour Law of 2007 still contains a high number of procedural requirements that are of little relevance for the protection of workers' interests. In addition, the attitude of the Labour Inspectorate in enforcing the law has been more on "controlling and punishing" than on ensuring that key provisions of the law are respected in their spirit.

E. Acquiring land-user rights

With a population density of 29 inhabitants per square kilometre (km²) and a total land mass of 786 000 km², much of which arable and in relatively fertile areas, Mozambique is among the world's top 10 countries with the largest availability of non-cropped, non-protected and non-forested land suitable for agriculture.³⁵ As a result, it has attracted much interest in recent years from foreign investors in agriculture (chapter I). Paradoxically, however, the country has struggled to become self-sufficient in food, as production of foodstuff remains dominated by small-scale and subsistence farmers. Most of the population remains rural and depends on the land for work and subsistence. Land management is thus very sensitive socially and crucial in development terms.

The current legal framework for land titles is the result of modernization efforts to promote the productive use of land while preserving the rights of local communities, particularly in rural areas. A new Land Law was adopted in 1997 (law 19/1997) in order to implement the objective set in the land policy of 1995 to "ensure the rights of Mozambicans to the land and other natural resources while promoting investment and the responsible and equitable use of these resources". As per the Constitution and law 19/1997, land and its associated resources are property of the State and cannot be sold, mortgaged or alienated in any way.

The use of land is regulated under a system of titles allowing individuals, companies or other organizations to obtain land-user rights called DUATs (*direito de uso e aproveitamento de terra*). DUATs provide their owner the right to use the land for specific and authorized purposes. They share many similarities with leasehold titles, but are fundamentally different in the sense that they cannot be transferred as easily and may not be mortgaged. DUATs can be acquired in three ways: (1) customary norms and practices; (2) good faith occupation; and (3) authorization by the relevant administration. Authorization is the only way for businesses and foreign persons to acquire DUATs. The first two ways are recognition of the rights of local communities over their land and of historic occupation of land by nationals. It allows Mozambique to integrate customary rules with modern legal principles.

The authorization process for investors seeking DUATs is complex, lengthy and somewhat uncertain. The power to issue land-user rights rests with the Governor of the province for plots below 1000ha, with the Minister of Agriculture for plots between 1000ha and 10 000ha, and with the Council of Ministers for plots in excess of 10 000ha. The application procedure is managed by the Provincial Services of Geography and Cadastre (SPGC).

After identifying a suitable plot of land, investors are required to engage in consultations with local communities to identify issues and potential conflicts in the use of land. In spite of Mozambique's size and low population density, virtually no suitable land is free of claim by local communities or residents. In addition, claims based on customary norms or good faith occupations are typically not registered in the cadastre, which remains very partial. A representative of the provincial administration must be involved in the consultation process.

Once consultations have been completed, a formal application can be filed with the SPGC. In order to be eligible, foreign-owned companies³⁶ must be incorporated in Mozambique and have an approved investment project, which in most cases means having secured an investment licence from the CPI. Foreign individuals may also obtain a DUAT, on the condition that they have been resident in Mozambique for at least 5 years. A detailed usage plan must be filed with the application, stipulating the exact plans to put the land to productive use. Given the increased number of projects filing for DUATs for areas in excess of 10 000ha and their development implications, additional requirements apply to such requests.

A provisional DUAT may then be issued by the competent authority, subject to payment of a registration fee. Foreigners have a maximum of two years to implement the usage plan while nationals have up to five years to do so. A provisional DUAT may be withdrawn if the investor does not comply with the usage plan within the requested period, but the authorities recognize that it may be difficult to adhere strictly to the deadlines and extensions may be granted. A definitive DUAT can only be issued on the basis of a provisional one and after site inspections by the SPGC to ensure compliance with the usage plan. Definitive DUATs have a maximum duration of 50 years and may be renewed for another 50 years at most.

As mentioned above, DUATs may not be sold or mortgaged, which means they cannot be used as collateral for any form of borrowing. Under the authorization procedure, holders of DUATs are required to pay an annual usage fee, which varies by type of activity, location and plot size. The fee ranges from MT1000 (\$31) per hectare for cattle farming in priority development zones to MT400 000 (\$12 500) per hectare for tourism along the coast of Maputo province or MT30 000 (\$940) per hectare for agriculture and plots in excess of 1000ha. In addition to these fees, investors are required to compensate previous holders of DUATs when the land was not free of claim by local communities or individuals, which is almost always the case. Compensation must cover the loss of tangible and intangible assets, damage to social cohesion and the loss of productive assets.

In practice, securing DUATs is difficult for many investors, including smaller ones. The interactions, overlaps or interdependence between procedures required to obtain the DUAT, the investment licence and

the environmental permits when relevant make the entire start-up phase lengthy and complex. No clear sequence has been established in the steps required to obtain one authorization or the other, which adds uncertainty to the procedure.

F. Complying with tax obligations and obtaining incentives

Taxation is a key tool of investment and industrial policy that countries use in various ways to attract FDI and/or promote specific activities or outcomes. Mozambique is no exception: it has used generous tax incentives in the past to attract FDI and continues to operate a relatively complex set of fiscal incentives to promote investment in a wide range of sectors. The authorities nevertheless recognize the need to balance investment promotion objectives with the need to increase tax revenues to finance essential public services, including health care, education and basic infrastructure. There is also an increasing recognition that the granting of tax incentives must be carefully assessed in terms of costs, benefits, efficiency and fairness. This is particularly the case when it comes to promoting investment in extractive industries, where the debate also extends to the adequate management of revenues from exhaustible resources.

The Government recently initiated measures to rationalize incentives, broaden the tax base and improve tax administration. Efforts have started to pay off, as Mozambique succeeded in increasing the tax to GDP ratio from 12.2 per cent in 2005 to 17.5 per cent in 2010, which compares relatively well with other countries at a similar stage of development. The Government recognizes, however, that tax policy needs to be further reviewed and improved. As part of its Letter of Intent of 8 November 2010 with the IMF, it indicated that it “will adopt (...) an action plan of priority measures to continue to simplify the tax system, expand the tax base, and assess the merits and feasibility of possibly reducing corporate tax rates and of rationalizing incentives under the tax benefits code.”

The sections below provide an assessment of the tax regime as it applies to corporations. In particular, they evaluate the extent to which corporate tax policy adequately serves Mozambique’s investment and

development objectives. Concrete recommendations based on this assessment are provided in chapter III.

1. Corporate taxation

a. General regime

The modernization of the tax regime and its administration started as early as 1994 with technical assistance from the IMF, whose support in the field continues to date. A new Law on Corporate Income Tax (law 34/2007) was introduced in 2007 to replace the previous tax code that had been approved in 2002. It was complemented in 2009 by the Law on Fiscal Incentives (law 4/2009) that separated all tax incentives from the main code. As a result, Mozambique has been able to put in place a modern corporate taxation regime, supported by a competent and strong administration (autoridade tributária de Moçambique, ATM) for a country at this stage of development.

Resident companies are taxed at a base rate of 32 per cent on worldwide income, while non-resident companies are subject to withholding taxes on all Mozambique-sourced income. Capital gains are treated as ordinary income and are subject to an adjustment factor to account for inflation. Taxable income is determined after deduction of all allowed expenses, which are defined in a standard way and include expenses necessary for production and maintenance of productive assets.

Fixed assets are typically depreciated on a straight-line basis, even though companies may be eligible to use declining balances in certain cases. Amortization rates are relatively standard and range from 2 per cent per annum for commercial buildings, around 12 per cent for office equipment, 25 per cent for tools and 20 to 25 per cent for vehicles. Provisions for doubtful debts, inventory losses, court proceedings or environmental rehabilitation costs are also allowed. Mozambique does not differentiate between ordinary and capital losses, and it allows carry-forwards for a maximum period of five years.

Companies are required to maintain accounts either under the organized accounting scheme or the simplified regime. The organized accounting scheme is compulsory for companies with annual turnover in excess of MT2.5 million (\$78 000) and certain types of companies irrespective of turnover (e.g. public companies or companies by shares). This is the only relevant regime for foreign investors. The simplified accounting system, however, is an important element

in the Government's efforts to broaden the tax base. Companies under this regime are subject to a simplified method of calculation of taxable income, which is based on pre-determined percentages of sales and other income. The standard corporate income tax rate of 32 per cent applies. For companies that are not able to maintain proper accounts, the ATM assesses tax due on the basis of a number of indicators including average margins in the sector or location and size of the production unit. In addition to widening the tax base, this is an attempt to encourage formalization. Investor surveys do indeed list unfair competition from the informal sector as a major constraint to operations.

As part of the modernization efforts, the ATM introduced self-assessments for companies operating under the organized accounts system. Tax-payers are required to make advance payments in May, July and September, which amount to one-third of 80 per cent of the value of the previous year's tax due, decreased by the amount of withholding taxes paid during the current year. In order not to penalize cash-flow excessively, companies that can justify that advance payments will likely exceed total tax due for the year as a whole may suspend or limit them. Advance payments are deducted from total tax due upon final assessment, and excess payments are eligible for immediate refund.

Mozambique introduced a number of legal requirements and administrative procedures as part of its efforts to improve tax collection and avoid evasion. The Law on Corporate Income Tax mandates the use of the arm's length principle for valuing transactions between related entities. Precise transfer pricing rules have yet to be established, however, which causes implementation problems both for the ATM and investors. The tax code also defines thin-capitalization rules under which interest payments on "excessive debt" to a related party are non-deductible for tax purposes. Debt is considered excessive if it exceeds twice the net worth held in the company by the related party. In addition, Mozambique established specific rules that apply on transactions with entities resident in tax havens.

Payments of dividends, interest, royalties and fees are subject to a withholding tax of 20 per cent, whether distributed nationally or to non-residents. Mozambique has established a mechanism to avoid double taxation of dividends distributed between two resident companies. It applies as long as the payee holds a minimum of 25 per cent of the capital of the payer. As of early 2011, Mozambique had ratified double taxation treaties with

six countries only.³⁷ While these provide relief on double taxation for non-residents, Mozambique also provides unilateral relief for taxes paid on foreign sourced income of resident companies.³⁸

b. Incentive schemes

Mozambique has long used tax incentives as a tool to promote national investment and attract foreign investors. The landmark investment by Mozal in the late 1990s was granted the incentives provided to investors in industrial free zones, including in particular a one per cent tax on turnover in lieu of the standard 32 per cent tax on income and a full exemption from custom duties, sales and circulation tax. The Law on Fiscal Incentives of 2009 aimed to consolidate tax incentives, but most sectors were left to benefit from one form of special treatment or the other. Paradoxically, at the same time Mozambique has been questioning the legitimacy of and need for incentives granted to mega-projects in the recent past. The informal debate between Government, donors, multilateral agencies and civil society has extended over whether it would be appropriate to renegotiate the terms granted and secured by investors under investment licences.

As mentioned in section B, securing an investment licence from the CPI is required in order to obtain incentives as provided under the Law on Fiscal Incentives, with three exceptions: (1) investments in commercial and industrial activities in rural areas; (2) investment in infrastructure built for retail and wholesale commerce; and (3) manufacturing and assembly industries. In the vast majority of cases, however, the investment licence will be the gateway to tax incentives for national and foreign investors. Although they are administered by the ATM and customs authorities, the CPI plays a significant role in the granting of tax incentives. Once approved, the latter are spelled out in the investment licence and gain contractual value.

As mentioned above, the Law on Fiscal Incentives of 2009 intended to rationalize tax incentives. Although special tax treatment continues to apply to numerous sectors and situations, the law at least regrouped all incentives under a single document. Two broad categories of incentives are defined: (1) general incentives; and (2) specific incentives. As a rule, general incentives apply to eligible investments that do not qualify under one of the specific regimes. General incentives include:

- Imports of capital goods classified as class K under the customs regime are exempt from customs duties and value-added tax (VAT).
- A tax credit of five per cent (Maputo) or 10 per cent (other provinces) of the total value of investment in tangible assets can be claimed against corporate income tax due for a period of up to five years after the start of operations.
- Depreciation rates may be accelerated by up to 50 per cent on certain classes of assets.
- Expenses on basic infrastructure are deductible at a rate of 110 per cent (Maputo) or 120 per cent (other provinces).

Specific incentives are offered in a wide range of sectors that encompass most economic activities: (1) basic infrastructure development; (2) rural commerce and industry; (3) manufacturing and assembly; (4) agriculture and fishery; (5) hotel and tourism; (6) science and technology parks; (7) large-scale projects, i.e. in excess of MT12.5 billion (\$390 million); (8) projects in rapid development zones³⁹; (9) projects in industrial free zones; and (10) projects in special economic zones. The incentives granted for each of these categories vary, but usually include exemptions from import duties and VAT on certain classes of goods, investment tax credits, and in certain cases temporary exemptions or reductions in the corporate income tax rate. The most generous incentives are provided for projects in SEZs and IFZs.

c. SEZs and IFZs

Mozambique has used SEZs and IFZs for over a decade in order to promote export-oriented activities. In particular, Mozal was approved under the IFZ regime, which qualified it for a range of tax incentives. Decree 43/2009 and the Law on Fiscal Incentives of 2009 redefined the regime applicable to SEZs and IFZs. The oversight of the zones was also recently transferred from the CPI to GAZEDA.

Companies operating in the zones benefit from the usual extra-territorial treatment that allows them to import capital goods and inputs free of duty and VAT. Companies operating in established IFZs (as well as zone developers) are exempt from corporate income tax for the first ten years of operation. They are granted a 50 per cent reduction in the corporate income tax rate from year 11 to 15, and a 25 per cent reduction subsequently. Export-oriented companies are allowed

to establish an IFZ outside of pre-determined industrial parks, in which case the corporate income tax exemption is reduced to five years, with the 50 per cent reduction applying from year 6 to 10, and the 25 per cent reduction applying subsequently.⁴⁰

All industrial activities are allowed within IFZs, provided that 70 per cent of output is exported. Sales to the domestic market of up to 30 per cent of output are permitted but subject to payment of import duties, VAT and excise. Exploration and exploitation of mineral resources are specifically excluded from the IFZ regime, even if all output is exported. As of early 2012, the only IFZ was the Beluluane industrial park, which has been developed next to the Mozal aluminium smelter. Beluluane was developed as a partnership between the Government and a private developer over an area of about 700 hectares. Although the developer built part of the infrastructure and provides some turnkey buildings, Beluluane remains under-developed, and almost entirely focused on servicing Mozal. As of early 2012, only 15 companies operated from the IFZ and the infrastructure provided in the zone remains rudimentary.

Special economic zones are conceived as much larger areas than IFZs, and the scope of allowed activities is very wide, encompassing investments in the primary, secondary and tertiary sectors. Projects benefit from the extra-territorial regime as far as import duties, VAT and excise are concerned. Sales to the local market are allowed without limits, pending payment of all relevant taxes and duties. Corporate income tax is waived for first five years of operation. A 50 per cent reduction in the tax rate applies in years 6 to 10, followed by a 25 per cent reduction in all subsequent years.

The Nacala SEZ is the only area that has been set aside at the moment. GAZEDA intends to develop two IFZs within the area in the future, but no private sector developer has been identified yet. Business development within the Nacala SEZ is also in its infancy, as only 19 companies had been certified by GAZEDA as of early 2012.

d. Mining and petroleum taxation

As indicated in section B, activities in mining and petroleum are excluded from the scope of the Law on Investment. As a result, projects in these sectors are not entitled to the tax incentives described above, which are only available to holders of investment licences. The general corporate income tax regime applies to mining

and petroleum activities and Mozambique imposes royalties and a surface tax.

Royalties are charged on the value of the minerals extracted and range from 10 per cent for diamonds and precious metals to 3 per cent for coal and other mineral products. The surface tax is nominal at the prospection phase and increases over time during the exploration phase, from MT250 per square kilometre (km²) in the first two years to MT3000 per km² in year 9 and 10. Upon granting of a concession, investors continue to pay a surface tax of MT2500 per km² in the first five years and MT5000 per km² subsequently.

Mozambique does not offer significant tax incentives for mining activities. The only concession granted is that investors are entitled to import class K or assimilated goods free of duty and VAT, inasmuch as such goods are not produced locally at the required level of quality. The tax exemption is granted for five years from the start of the exploration activities, which is a relatively short period given the time that is usually required for exploration to lead to a discovery and subsequently obtain a mining concession and start mining development.

2. Value-added tax

VAT was introduced in 1999 upon advice and technical assistance from the IMF as part of the general efforts to improve tax collection and administration, and as a replacement for the sales tax. VAT has become the most important source of fiscal revenue, representing almost half of total taxes and duties in 2009. Mozambique has opted for a relatively straightforward VAT system, which is administered efficiently.

VAT applies to the domestic sale of goods and services and to imports. Mozambique enforces a single rate of 17 per cent, which facilitates tax administration. A number of transactions are exempt, in particular as regards health-care, education, financial services, real estate, agriculture, forestry and fishing. These transactions are not subject to output VAT, but companies are not allowed to deduct input VAT either. In turn, exports of goods and services are zero-rated, which enables exporters to claim refunds on input VAT paid.

Recognizing the administrative demands of VAT on companies, Mozambique introduced three regimes of declaration. Under the standard regime, companies are required to file monthly VAT returns. Businesses with annual turnover between MT750 000 (\$23 500) and MT2.5 million (\$78 000) and that do not participate in

international trade may opt for a simplified regime under which they pay 5 per cent of turnover. As no output tax is charged, these companies may not deduct input VAT. Below the threshold of MT750 000, companies remain entirely outside the VAT scheme.

By design, the system of VAT refunds is appropriate and favourable to investors. A refund can be claimed with any monthly filing as long as the credit in favour of the investor exceeds MT50 000 (\$1500). For exporters, this threshold is reduced to MT5000. In cases where claims for refunds are below the threshold, companies compensate the amount on subsequent VAT returns. If net claims continue to accumulate over consecutive months, a refund can be claimed as soon as the credit reaches MT50 000. By law, the ATM is required to process refunds within 45 days for exporters and 30 days for other companies, assuming that all supporting documents are filed appropriately. Interest can be claimed on late payments by the ATM.

The refund scheme is structured so as to minimize the impact of VAT on businesses. Allowing all companies, regardless of whether they are export-oriented or not, to claim refunds is a sensible pro-investment mechanism that is nearly costless to the government. It is particularly important for investors during the early stages of establishment or during phases of rapid expansion in capacity, as input VAT is likely then to significantly exceed output VAT. In a country where access to financing is problematic, such a pro-investment refund system can provide critical support in terms of cash flow.

In order to be effective, a good refund scheme needs to be not only sound on paper, but also effectively implemented. In Mozambique, surveys of investors frequently point out that obtaining VAT refunds remains problematic, mainly because of administrative hurdles. This issue merits attention from the Government and the ATM.

3. Assessment of tax issues

Over the past decade, Mozambique has succeeded in putting in place a well-administered corporate income tax and VAT regime. Reforms have helped progressively raise tax revenues as a percentage of GDP, which is essential if the Government is to provide the basic infrastructure and public services needed to reach the country's development goals. It is also essential to gradually reduce Mozambique's dependence on donor support for basic government operations. In addition, a

well-structured and efficiently administered tax system is a prime determinant of the investment climate and plays a significant role in terms of FDI attractiveness.

In spite of these achievements, Mozambique has not yet struck a satisfactory balance between the dual objectives of fairly and efficiently collecting sufficient revenue and creating a tax environment that effectively promotes investment and supports the realization of development objectives. The Government and other stakeholders are aware of the need to make further progress in that direction. The Law on Fiscal Incentives was a first step in the right direction in that it removed the discretion to grant incentives on a case-by-case basis to privileged investors. It also brought all tax incentives under a single legal document, which clarified the situation.

The proliferation of tax incentives, however, is paradoxical at a time when policy makers are actively debating whether Mozambique obtains a "fair share" of the benefits of private investments (mega projects above all), in particular through appropriate levels of taxation. It must be highlighted indeed, that much of the debate is not so much focused on tax-evasion as it is on tax incentives, which were granted in full legality under previous incentive schemes. Looking forward, it appears that a number of key problems remain to be addressed in terms of tax strategy and administration:

- ◆ A coherent strategy remains to be devised and adopted in order to use taxation as an instrument to promote investment and specific development goals. It is encouraging that the authorities indicated in their letter of intent of November 2010 with the IMF that they are willing to assess the merits of lowering the general corporate income tax rate while rationalizing existing incentives. Clearly, there is a need to:
 - Provide an enabling general tax regime for investment;
 - Rationalize tax incentives;
 - Use tax incentives selectively and as a carefully crafted means to achieve well-defined industrial policy objectives and meet development goals;
 - Conduct strict cost/benefit analyzes when offering tax incentives.
- ◆ The large number of sectoral incentives has the potential to distort market mechanisms and investment decisions.

- As was already highlighted in section B.5, granting tax incentives only to holders of investment licences creates an un-level playing field, particularly vis-à-vis smaller national investors, many of which do not go through the CPI. Involving the CPI in the allocation of tax incentives also creates coordination problems with the ATM and the customs authorities.
- By providing contractual stability to fiscal terms through the investment licence, Mozambique effectively constrains its policy space and ability to conduct tax reforms. While stability clauses may have served the country as it emerged from the civil war, it is questionable whether these remain necessary.
- The lack of clear and detailed transfer pricing regulations not only constrains Mozambique's ability to fight tax evasion, but also generates uncertainty for foreign investors that may apply in good faith pricing rules that do not meet the ATM's requirements.

G. PPPs, concessions and mega-projects

The debate among policy makers, civil society and the donor community on Mozambique's development strategy has very much revolved around the issue of mega-projects, their impact on the country's economic diversification and poverty reduction, and the best way to regulate them. It is in this context that the Government prepared a draft public-private partnership (PPP), concession and mega-project law in 2010. The law was adopted by Parliament in May 2011, even though the deliberations were boycotted by the opposition RENAMO.

Section G.1 below analyzes the new regulatory framework for PPPs, concessions and mega-projects, even though actual implementation of the new rules has not started yet. In addition to the new law that will apply soon, certain (mega) investments are subject to sector-specific regulations. This is particularly the case for projects in mining, petroleum and infrastructure. Sector-specific regulations of particular relevance are discussed in sections G.2 and G.3.

1. Legal framework for PPPs, concessions and mega-projects

The new law regulates activities of extremely different nature and size under a common set of rules. It

applies to: (1) all public-private partnerships aimed at the provision of public services or essential goods; (2) concessions involving the use of public goods or patrimony regardless of size and activity involved; and (3) mega-projects, defined as all those that involve investments above \$500 million, irrespective of sector. As a result, a common set of rules will apply to projects of a strictly commercial and private nature (as long as they reach the threshold of \$500 million), to investments involving the supply of services of a public nature (e.g. port or railway infrastructure or the supply of water and sewerage services), to projects leading to the exploitation of exhaustible natural resources (including mining projects from the prospection phase onwards) and to small-scale concessions at the municipal level.

In a rather unusual regulatory approach, article 55 stipulates that the law on PPPs, concessions and mega-projects regulates all projects that fall within its scope and, complementarily, by other general and specific laws as applicable. The intent seems to be that the new law should take precedence over sector- or area-specific legislation.

Article 8 stipulates that all projects falling within areas pertaining to the public domain will have to go through a public tender procedure. The draft implementation decree imposes more specific requirements and also extends the public tender obligation to projects of a purely commercial nature. As per article 12 of the draft decree, all projects that seek tax incentives or lead to the prospection, exploration or exploitation of mineral and natural resources must also undergo a public tender procedure. In such instances, the initiator of the project is granted some benefits in the tender procedure, including preference in case of equal bids and a 10 per cent margin of preference on the financial aspect of the bid. This means that under the proposed regulations, a purely commercially- and export-oriented industrial project like Mozal would have to go through a public tender procedure. It also means that prospection and exploration licences can only be obtained through public tender, which is unusual in mining countries.

Projects that are required to undergo a public tender process may obtain contracts of a maximum period of 15 years (management contracts) to 25 years (concessions). In all cases, contracts may be renewed at the end of the period, but only through a new public tender. Article 17 of the new law and the draft implementation decree define the different steps required under the tender procedure. A minimum of five

agencies or government departments are involved in the procedure, including the CPI, the Ministry of Finance, the Ministry of Environment and the sectoral regulator.

The driving force behind the PPP, concession and mega-project law is the desire by policy makers to maximize the impact of such investments on sustainable development and poverty reduction and to obtain a “fair distribution” of benefits between host country and investor. Under the law, Mozambique seeks to adopt a forceful and regulations-based way to ensure a “fair distribution” of benefits to all stakeholders and the optimization of developmental impacts. As a general principle, article 19 stipulates that the “direct and indirect” benefits of projects falling within the scope of the law must be shared fairly between parties, including investors, the national economy and Mozambican society as a whole.

Direct benefits are defined to include the involvement of local entrepreneurs, tax revenues, foreign exchange earnings and the sharing of ordinary and extra-ordinary profits. Expected indirect benefits depend on the type of projects but include infrastructure development, job creation, transfers of skills and technology, and contribution to the development of local SMEs. However, the new law and draft implementation decree are vague when it comes to defining what constitutes a fair distribution of benefits. Still, a number of requirements are imposed on investors, either in the law or in the draft implementation decree. The following are the most important and constraining ones:

- ◆ **Local participation:** article 20 of the law stipulates that projects owned by Mozambican investors must “contemplate” the dissemination of at least 20 per cent of capital among small holders. Projects with foreign participation are subject to the same requirement, but must also “contemplate” the participation of national companies in the capital of the company.

Although the word “contemplate” points towards an encouragement and not a legal requirement, the fact that a minimum percentage is set by law does indeed indicate that the spirit of the law is to enforce local participation in foreign-led projects by national companies and small holders. This is confirmed by the draft implementation decree, which specifies that partnerships with national companies must be “contemplated”, but that in addition, at least 20 per cent of capital must be “reserved” for dissemination among Mozambicans. This can be done through direct

State participation on a permanent or temporary basis, shareholding by national institutions representing Mozambicans or other means.

- ◆ **Taxation:** investments falling under the scope of the law are subject to the standard corporate income tax regime. In addition, a number of taxes and measures are imposed on them:
 - Article 26 requires companies to distribute profits earned at the end of each tax year. Exceptions may only be granted for exceptional and duly justified reasons of force majeure.
 - Exceptional profits resulting from favourable price and market conditions must be distributed “equitably” among all shareholders. What constitutes exceptional profits and an equitable distribution is not defined.
 - A number of specific taxes apply on projects attributed through public tender. Non-mining concessions are subject to a fixed tax of 5 to 10 per cent of expected average profit throughout the life of the concession, in addition to a variable tax of 5 to 10 per cent of gross revenue.
- ◆ **Indirect benefits:** article 28 of the law stipulates that concession contracts must explicitly specify the indirect benefits that should be derived from the project. An institutional mechanism is to be set up to ensure compliance with the generation of indirect benefits. The draft implementation decree also imposes that all projects put in place concrete programmes to train Mozambican workers and to generate transfers of technology and know-how.

The law proposes to create a dedicated PPP unit within the Ministry of Finance, which would serve as a gateway for all projects falling under the scope of the law. Such PPP units have been established successfully in a number of developed and developing countries to promote and manage projects. As envisioned in the law and draft implementation decree, the PPP unit will coordinate an oversight mechanism that will also involve line Ministries and sectoral regulatory bodies. The functions and objectives of the unit are very much concentrated upon regulation, monitoring and control and focus relatively little on promotional aspects. Key among the roles to be executed is the monitoring of projects in order to assure that a fair distribution of benefits is effectively achieved.

Although the law should not have retroactive effect in keeping with standard legal practice, article 54 grants

the authority to the Government to renegotiate existing contracts in view of achieving the objective of a fair distribution of benefits. At this time, it is unclear whether the Government will seek renegotiation or not.

2. Legal framework for mining projects

Mozambique has only recently started to tap its mining potential. Little prospection and exploration had taken place during the colonial rule in spite of the country's location in a resource rich region. The mining potential was similarly neglected in the immediate aftermath of independence, and the civil war later made prospection and exploration difficult. However, a small number of pioneering (foreign) companies did prospect the country's mining potential during those difficult times. Interest and investments in mining surged as soon as stability was restored, to the extent that Mozambique has the potential to become a significant mining country. Its proven or expected resources span from coal to titanium sands, gold, gas, oil, ilmenite and other minerals.

Aside from Mozal, mega-projects in Mozambique are dominated by investments in natural resource extraction. The quality of the regulatory framework for mining is thus crucial for Mozambique's ability to derive optimal and sustainable developmental benefits from mega-projects. While the PPP law is expected to provide an overall framework for large-scale mining projects, Mozambique has had well-crafted specific regulations for such investments for years. The World Bank and other donors, including South Africa, supported Mozambique in modernizing its regulatory framework for mining through a \$38 million programme of technical assistance between 2001 and 2007. The programme helped introduce new legislation and associated regulations, build institutional capacity and improve the geological survey.

Mining activities are excluded from the scope of application of the Law on Investment (section B). A number of general guarantees and standards of treatment are thus established in the Mining Law (law 14/2002). Most important among these are protections in case of expropriation and the right to transfer funds abroad (profits and dividends, royalties, debt payments and capital). In addition, article 33 of the Mining Law establishes a tax stability guarantee under which the fiscal regime applicable at the time the mining licence is issued cannot be altered, unless it is to the benefit of the investor. The specifics of mining taxation are described

in section F.1.d. As a general policy, Mozambique has decided not to provide tax incentives to mining investments and to subject them to royalties in addition to the general corporate income tax regime.

As with the investment licences and similarly to many mining countries, Mozambique offers investors the possibility to enter into a mining contract, usually at the time the mining licence is issued but sometimes even at the exploration stage. Mining contracts provide the same stability that is provided under investment licences. The scope and specific provisions of the contract are negotiated on a case-by-case basis, but most cover at least issues related to tax stability, the transfer of funds and the settlement of disputes through international arbitration.

The sector-specific regulations adopted in the Mining Law are standard in comparison to international practice. All mineral resources in the soil, subsoil and territorial waters are the property of the State and require licences to be exploited. Prospection licences are issued on a non-exclusive basis for a maximum period of two years and a surface of up to 100 000 hectares. Exploration licences are exclusive and for a maximum period of five years renewable once and a surface of up to 25 000 hectares. Although both are subject to surface taxes (section F.1), these are low and insufficient to fully prevent speculative licences. In addition, Mozambique does not impose relinquishment of areas under exploration over time.

Upon discovery of a commercially viable deposit, holders of exploration licences are eligible for a mining licence by law, as long as they meet the obligations of mining operators. Investors also have the right to assign all or part of their licences, which allows juniors to enter into partnerships with or to farm out completely with majors. As per international practice, the issuance of mining licences is conditional upon the submission of a full mining programme, demonstration of technical and financial ability, preparation of an investment impact assessment and submission of an environment management plan. Mining licences are issued for up to 25 years, renewable for an equal or shorter period.

3. Legal framework for electricity and telecommunications

Electricity and telecommunications are essential sectors in any country's backbone infrastructure, in addition to roads, railways and ports. Over the past two decades or

more, electricity and telecommunications are also the sectors that have been most liberalized around the world in spite of being previously thought of either as natural public monopolies or as strategic areas that needed to remain under public control and ownership.

Private investment and FDI in telecommunication and electricity have surged as a result of the liberalization in developed and developing countries alike. Transport infrastructure, on the other hand, has not been liberalized as much and government ownership remains more prevalent. Mozambique, however, is among a small group of least-developed countries (LDCs) where concessions have been granted on a significant scale for the operations of ports, railways and roads. Given their importance for economic development, their potential for concessions or PPPs, and their need for sector-specific regulations, the framework for electricity and telecommunications is analyzed briefly below.

Mozambique has significant potential for electricity generation and large and credit-worthy off-takers given its proximity with South Africa's industrial heartland. The Zambezi river has large untapped capacity for hydro-power, and the opening of coal mines will generate opportunities for coal-based power stations, with some projects already in the making. At the moment, the electricity sector still operates under a vertically integrated public monopoly run by Electricidade de Moçambique. The Law on Electricity of 1997 (law 21/1997), however, introduced a well-crafted regulatory framework building on the experience of countries that successfully liberalized their markets. It established the regulations needed for Mozambique to progressively transition towards an open and competitive electricity sector with a mix of private and public sector investment.

The Electricity Law paves the way for the vertical disintegration of the sector and the introduction of private investment and competition. Four segments are defined: (1) generation; (2) transmission; (3) distribution; and (4) retail. All segments operate on the basis of a concession contract with a maximum duration of 50 years renewable. Clear operational rules are defined for the sector as a whole, including in terms of third-party access to the transmission and distribution networks, which are open to private investment, and in terms of the general rights and obligations of operators.

The Law on Electricity and its associated regulations also established a network operator in charge of, among others, dispatching load among generators and

establishing plans for the management and development of the network. This includes the preparation of short-, medium- and long-term demand forecasts and the elaboration of a master plan for infrastructure development in terms of generation, transmission and distribution. Electricidade de Moçambique was assigned the role of network operator by decree in 2005, but was at the same time requested to make an organic separation between this function and those related to power generation, transmission, distribution and retail.

The Law on Electricity also created the National Council of Electricity (CNELEC) as the independent authority in charge of overseeing the sector. It is in charge of conciliation, mediation and arbitration of disputes arising between operators and has a mostly consultative role when it comes to regulatory issues.

The regulatory framework for telecommunications was reformed in 2004 with the adoption of law 8/2004. Its stated objectives include the promotion of private investment, the creation of rules for fair competition and the establishment of universal access. The legal monopoly of State-owned Telecomunicações de Moçambique on fixed-line telephony ended on 31 December 2007, but it remains the sole operator to date. In contrast, competition has been introduced in mobile telephony and internet access.

Telecommunication licences are granted for a maximum period of 25 years through competitive bidding. The Law on Telecommunications sets clear requirements on inter-connectivity and the sharing of physical infrastructure among operators. Relatively strong powers are vested in the National Institute of Telecommunications of Mozambique (INCM), including issuing licences, regulating inter-connectivity, managing the universal access fund, promoting competition and preventing anti-competitive practices. The law establishes a number of general principles on competition and defines what constitutes unfair practices or a dominant position.

The telecommunications market remains highly concentrated with a single operator in fixed-line telephony and two mobile phone operators, one of which is controlled by Vodacom (South Africa). A third mobile licence was issued in January 2011 to Movitel, a joint-venture between a Mozambican investor and the Vietnamese Military Telecommunication Group (Viettel). GSM coverage is concentrated around Maputo and the other major urban centres along the coast. Coverage in the countryside is virtually non-existent.

4. Assessment of the framework for PPPs, mega-projects and concessions

Public-private partnerships have been used successfully by many countries in order to leverage private capital and expertise for the cost-efficient provision of high-quality public goods and services. If they are well-managed and the public interest is adequately protected, PPPs offer significant potential for developing countries to build infrastructure and contribute to development. Similarly, mega-projects in mining and other sectors have significant potential benefits, even though they cannot be expected to solve Mozambique's development challenges and even though most are likely to generate only a relatively small number of critically needed jobs.

Mozambique's efforts to provide a regulatory framework to promote PPPs, mega-projects and concessions and to ensure that the national interest is adequately protected are extremely opportune and should be pursued strongly. Some of the regulatory approaches adopted in the law on PPPs, mega-projects and concessions may not best serve the country's interest and would deserve reconsideration in light of a wealth of international experience in developed and developing countries alike. A number of key issues need to be highlighted.

A monolithic approach

By regulating PPPs, mega-projects and concessions under one law, Mozambique chose to treat a very diverse set of investments and projects in a monolithic way:

- PPPs are by essence contractual or equity arrangements between public authorities (at the national or local level) and private investors whereby the latter take a leading but joint role in providing goods or services of a public nature. They involve an element of risk-sharing and can take many different forms, from basic service or management contracts to build-operate-transfer (BOT) or build-own-operate (BOO) schemes, among others. They have been used for an extremely wide variety of services, from backbone infrastructure (e.g. roads, ports, railways, water supply) to health care, prisons or schools.
- Concessions for the provision of public goods and services are a form of PPP.
- Natural resource extraction does not entail the provision of a public good or service, even though it is conducted under a concession or licence regime. It is a commercial activity by nature.

- Mega-projects outside of mining are purely commercial ventures, which are distinct from other private investments only through an artificial legal definition that sets a threshold of \$500 million.

The approach adopted in the law does not permit a fine-tuned approach to investments that raise different questions in terms of protection of the national interest, a "fair distribution" of benefits and business promotion. Treating these projects as a monolith implies that:

- Provisions that make sense for projects with a public service nature will apply for investments of a strictly commercial nature, even though they are not really applicable in that context, or could even prove detrimental. In particular, requiring that all mega-projects undergo a public tender procedure is not necessary from a regulatory perspective and to protect the national interest, but it could be a major brake to new investments.
- There are inconsistencies between sector-specific laws and the new law that will be difficult to reconcile. This is the case for example in the mining law, which specifies that exploration licences are allocated on a first-come first-served basis, while the new law requires a public tender procedure. It is also the case in the electricity law, under which concessions of up to 50 years can be attributed, while the new law sets an upper limit of 25 years.
- Giving precedence to the law over sector-specific laws means that sensible and necessary provisions may be overruled by general dispositions. Mozambique has set up well-crafted and balanced frameworks for mining, telecommunications and electricity, which may be negatively affected by the new PPP law.

Regulating benefits

The desire to ensure that Mozambique optimizes the development benefits of PPPs, natural resource extraction, mega-projects and investments in general is perfectly legitimate and well-placed.⁴¹ Adequate policies are particularly important in the case of mining, gas and petroleum activities in order to avoid falling into the curse of natural resources, spread the benefits from the exploitation of exhaustible resources throughout the population and ensure sustainable development for future generations.⁴² The law, however, goes too far in trying to regulate direct and indirect benefits upon PPPs, concessions and mega-projects. While it is appropriate and necessary for the State to extract direct benefits

through taxation, it is singularly more difficult to force indirect benefits and experience shows that it can prove counterproductive. In particular:

- The law is vague when it comes to defining what constitutes a “fair distribution” of benefits. This will generate significant uncertainty for investors.
- Additional uncertainty is generated by the requirement that “exceptional benefits” be fairly shared as these are not properly defined. While the law requires a sharing on the up-side, no such risk-sharing mechanism exists on the down-side.
- Putting legal requirements on the transfer of technology and know-how or on linkages with local companies is unlikely to bring the types of benefits that Mozambique wishes to obtain and may discourage potential investors. Experience shows that such requirements have failed in most LDCs, even though they may have been used with some success in countries with large domestic markets and significantly more developed economies. In addition, the experience of Mozal in Mozambique shows that establishing linkages may prove difficult, even if all partners try to do so in good faith.
- The requirement to distribute all annual profits through dividends unnecessarily constrains investors and would prove detrimental in terms of reinvestments and expansions.

Local participation requirements

The local participation requirement is another attempt to enforce benefits that may prove counterproductive, particularly in the case of large and mega-projects. The requirement implies a very significant minimum participation of national investors, including small holders, in all projects, which may not be feasible given the limited size and expertise of the local business sector and the poor level of development of the local capital market. The experience of Mozal and other large investors in mining demonstrates the difficulty in establishing linkages with local companies. Identifying partners for joint-ventures will prove even more difficult.

The law stipulates that the State or public institutions may substitute small-holders or national private investors when the latter are unable to subscribe to the minimum local participation, with the view of transferring ownership at a later stage. While public-sector participation in strategic projects is justified for public

policy and will usually be welcome by private investors as it gives the government a stake in the success of the project, it is important that such participation be based on an actual equity contribution. If that contribution is to reach 20 per cent in mega-projects, even public funds may be stretched to the limit or be insufficient. In such cases, Mozambique should not require a free stake for the public sector as it could prevent a number of projects from ever taking place.

In addition, in cases where the government off-loads its initial participation to private investors, it will have to be particularly careful to do so in a fair and transparent manner, for the benefit of the country at large and resisting pressure from special interests. Failure to do so would defeat the objective of ensuring widespread benefits of mega-projects and PPPs.

Taxation issues

A large number of taxes and fees are imposed on certain types of investments in the law. In an effort to ensure direct benefits from PPPs, concessions and mega-projects, the law somehow seeks to assume the role of a well-defined tax policy. As indicated in section F, Mozambique currently lacks a coherent policy on corporate taxation and the provision of tax incentives for investment. The PPP law does not and should not provide such a policy, which should be considered in global terms for the economy as a whole.

A wider reflection on what would constitute a fair and efficient corporate tax regime ensuring that Mozambique obtains its fair share of profits from investments remains to be defined, as stated earlier. The issue of taxation of mega-projects, investments in natural resource extraction, PPPs and concessions should be addressed as part of that global strategy, which would then be implemented through reforms of the tax code.

A regulation-oriented PPP unit

The establishment of a dedicated PPP unit in the Ministry of Finance is an excellent initiative. Such units have contributed to successful PPPs in many countries. International experience does show, however, that successful units are not focused exclusively on regulatory aspects, but also have a wider mandate to negotiate the technical aspects of partnerships and promote them proactively by approaching reputable partners with high levels of technical expertise.

As envisaged in the law, the mandate of the PPP unit is almost entirely focused on issues of regulation and control. The absence of promotional role is a serious shortcoming. In addition, particular care will be needed to ensure strong collaboration between the PPP unit and sectoral regulators with technical expertise and deeper knowledge of industry-specific factors. Partnerships with the INCM and CNELEC should be a priority.

Renegotiating existing contracts

The authority to renegotiate contracts falling under the scope of the law should be used with extreme caution by the Government. Although conditions have indeed changed significantly since some of these contracts were first signed, the terms and benefits were granted in full legality and most are secured under binding contractual obligations. A hard-line approach to renegotiation could lead to adverse long-term effects for Mozambique, including in terms of risk perceptions and potential litigation costs. An open discussion could easily be envisaged, however.

H. Operational issues

Business conditions are affected by a number of regulatory and non-regulatory issues, in addition to the ones analyzed in the sections above. Three additional operational aspects of significant importance in Mozambique are considered below.

1. Competition issues

Mozambique adopted a competition policy in 2007. Its main objectives are to: (1) guarantee effective competition; (2) foster dynamic markets; (3) control market concentration; (4) ensure the reliable supply of high-quality and cost-effective goods and services; (5) promote price stability; (6) build capacity among national enterprises and SMEs; and (7) safeguard the interest and purchasing power of consumers. The policy called for the adoption of a competition law and the establishment of an independent competition authority.

A draft competition law was being examined by Cabinet as of early 2011. Although that final draft was not available during the fact-finding mission, it was indicated to the UNCTAD team that it contains no major changes compared with an earlier draft that had been prepared with technical assistance from donors.

The draft law stipulates that all economic activities will be subject to competition regulations. It establishes norms and bans on anti-competitive practices, whether through horizontal or vertical agreements or through abuse of dominant position. A detailed list of what constitutes prohibited practices is clearly spelled out in each case.

The draft law plans the establishment of a financially and administratively independent competition authority. Given the universal applicability of competition rules and the powers granted to certain sectoral regulators (e.g. CNELEC or INCM), including in areas relevant for competition, the draft law calls for a close cooperation between the future competition authority and sectoral bodies. The proposed powers of the competition authority are significant, both in terms of investigation and inspection and in terms of sanctions.

The adoption of a regulatory framework for competition and the creation of oversight authorities is crucial if Mozambique is to derive the benefits of a market economy and optimize the gains from FDI. It should make it possible to avoid excessive market concentration or to avoid unfair practices in cases where concentration is inevitable. In order to make the framework effective, however, Mozambique will have to invest rapidly in capacity building within the competition authority. It will need to step up efforts to ensure that new rules are applied, including by undertaking sectoral studies to assess practices in areas of key interest to consumers and investors.

2. Inspections and monitoring

Inspections, monitoring and enforcement are an essential component of a regulatory framework as the best rules are worthless unless they are put into effect. In Mozambique, inspections are frequent and extensive in many areas throughout the life of businesses, and they are often built in as a requirement prior to the issuance of licences. Although perfectly legitimate by nature, inspections are frequently regarded by investors as excessive, uncoordinated and/or leading to somewhat arbitrary and unduly severe penalties.

In particular, investors appear to view inspections on labour issues as problematic. The general perception is that inspections focus on points of detail rather than on issues that are of genuine significance to protect workers or the national interest, and that monitoring

bodies are quick to impose fines instead of working with employers to implement corrective measures.

The complex nature of some regulations and the heavy burden of inspections are highlighted in a recent survey of businesses by the World Bank as one of the key underlying reasons behind the high level of informality in the Mozambican economy, well ahead of the financial burden of taxes.⁴³ The same survey of national and foreign investors, in turn, places the practices of informal competition as the number one operational constraint. Corruption, which in its petty form can be made easier by excessively detailed requirements on businesses, is ranked as the fifth most important constraint (see below).

At the same time, however, it has been highlighted that assessment and monitoring capacity is too weak in a number of areas. This is particularly the case for environmental regulations, but weaknesses also remain within the tax authorities, particularly in terms of transfer pricing issues, and with customs. In addition, monitoring capacity will need to be built in the future competition authority.

3. Governance and access to justice

The efficient delivery of justice and the quality of governance, both public and private, are important components of the investment climate and the country's ability to optimize benefits from FDI. High-quality governance is crucial to long-term development prospects in any context, and even more so in countries richly endowed with natural resources. Strong public governance mechanisms and high standards of private governance among TNCs are key ingredients to ensure that rent extraction at the country level brings benefit to the nation as a whole and that they do not transform into private rent extraction.

The 2009 World Bank survey of businesses indicates that corruption continues to rank relatively high among perceived operational constraints, even though slightly lower than five years earlier.⁴⁴ This is by no means unique to Mozambique, but petty and grand corruption were both highlighted as concerns. Building on a compilation of sources and indices, the World Bank's Worldwide Governance Indicators also point to some improvement in recent years. Yet, Mozambique still only ranked in the bottom 40th percentile in the world on the "control of corruption" indicator. This places the country far ahead

of Angola, at par with Malawi or Zambia, but well behind Botswana, Namibia or South Africa.

The main rules governing the fight against corrupt practices were adopted with law 6/2004. It requires all those with decision-making powers in public administration and institutions or in State-owned enterprises to file an annual statement listing financial and non-financial assets held domestically or abroad. In order to be encompassing, the law covers and defines passive corruption as well as active corruption (both of licit and illicit acts). A number of sanctions can be imposed, in addition to those emerging from administrative, civil and penal proceedings. A dedicated unit to prevent and combat corruption was created in the Attorney General's Office and disposes of relatively wide investigative powers.

The judicial system was reorganized in 2007 under law 24/2007. The judiciary is organized around four levels, topped by the Supreme Court, followed by the court of appeals and courts at the provincial and district level, which deal with most cases in first instance. The law leaves the door open to the establishment of specialized courts, but Mozambique's experience with dedicated commercial courts is very recent. Partly as result, Mozambique only ranks 132nd in the World Bank's Doing Business indicator on "enforcing contracts", behind all its neighbours except Angola, which is last but two in the ranking.

I. Trading internationally

Mozambique occupies a strategic location on the South-Eastern coast of Africa and offers maritime access to vast markets straddling Botswana, resource-rich Katanga in the Democratic Republic of Congo, Malawi, Swaziland, the North-Eastern part of South Africa, Zambia and Zimbabwe. The ability to conduct international trade efficiently and at competitive costs is thus a key necessity if the country is to exploit business opportunities from international logistics services. In addition, access to markets is important for potential export-oriented investors, including mega-projects.

Mozambique signed to the General Agreement on Tariffs and Trade (GATT) in 1992 and joined the WTO upon its creation in 1995. As a least-developed country, Mozambique's opening and tariff reduction commitments under the WTO are relatively limited, and it is not party to any of the side-protocols or agreements.

Bound tariffs apply almost exclusively to agricultural products and at a ceiling rate of 100 per cent. Most other tariff-line items are unbound.

The applied MFN rates are significantly lower than the bound rates in agricultural products, and Mozambique has progressively reduced tariff protection over the past decades. The average MFN duty on a trade-weighted basis fell from 17 per cent in 1997 to 8 per cent in 2010, with current duties applying at rates of 0, 2.5, 5, 7.5, and 20 per cent. Protection is highest for agricultural products, and tariff escalation applies in most industries, with highest tariffs for finished products.

Mozambique is a founding member of the Southern African Development Community⁴⁵ (SADC), which established a free-trade area in 2008 among a sub-set of 11 countries and ambitions to progress towards a customs union, a common market and eventually a monetary union. Progress towards SADC integration has been slow, however, partly as a result of the diverse membership and the political situation in certain countries.

Market access to the European Union (EU) is granted on preferential terms under the “everything but arms” (EBA) initiative, and Mozambique also benefits from the terms granted to African, Caribbean and Pacific (ACP) countries under the Cotonou agreement, whose rules of origin are different from those of the EBA initiative. The unilateral terms granted by the EU under the Cotonou agreement are not compatible with WTO rules, however, and Mozambique is currently engaged in negotiations for an economic partnership agreement between SADC and the EU, which would eventually lead to the establishment of a free-trade area between the two blocks. Negotiations have progressed extremely slowly, however, and it is unlikely that a final agreement will be reached soon. Preferential access to the United States is also guaranteed under the African Growth and Opportunity Act (AGOA).

Imports and exports may only be carried out by operators duly licenced by the Ministry of Commerce, and licences are granted for specific classes of goods. In addition, imports and exports must be carried out through licenced customs clearing agents, which are the only operators allowed to liaise with customs authorities. Pre-shipment inspection still applies to a small number of goods on a positive list that is being reduced further gradually.

Efforts have been made over the past few years to improve customs administration and speed up clearance times. Particular efforts have been undertaken in conjunction with South Africa to set up a one-stop border post at Lebombo Ressano Garcia. While the project still needs to be fully finalized, it has already brought significant improvements at the busiest and most critical land border post of the country.

The time and costs involved in shipping goods internationally remains a concern to outward-oriented investors, however, as evidenced in a number of surveys. The World Bank’s Doing Business 2011 reports that 23 and 30 days are needed, respectively, to export and import a standardized cargo. Although this time period does not compare poorly with other coastal countries in Africa, it exceeds by far the better performers in Latin America and Asia, or the top 25 countries in the world, where the time to import cargo is reported as 10 days or fewer.

J. General assessment

Mozambique has made remarkable progress in the past two decades to establish the core framework and institutions of a regulated market economy. Essential regulatory reforms have been achieved in the areas of taxation, trade, labour, mining, telecommunication, electricity or the commercial code. The country has come a long way since the end of the civil war, as evidenced by its ability to attract significant FDI inflows and by its strong growth performance. Over a relatively short period of time, Mozambique has succeeded in building its credentials as a credible and stable location for international investors in Southern Africa.

Yet, reforms are far from complete and Mozambique could do much better still in the decades to come. The country still lags behind many of its neighbours on a number of regulatory issues of extreme relevance to the achievement of its development objectives and to the promotion of investment by nationals and foreigners. Reforms in the regulatory framework for investment should continue unabated in order to protect the national interest – an even bigger need in the face of the rising exploitation of natural resources – promote national and foreign investment, and facilitate business development.

A number of key areas with outstanding issues have been identified in this chapter, including in particular:

(1) the general approach to investment rulemaking; (2) corporate taxation and the structure of tax incentives; (3) the employment of foreigners and access to skills; (4) access to land; (5) PPPs and the management of mega-projects; and (6) licensing and inspections. Some aspects of the legal framework remain unnecessarily intrusive on businesses in spite of market-oriented reforms over the past two decades. Similarly, a bias persists among regulatory institutions towards controlling and sanctioning rather than towards monitoring and enforcing while also facilitating and servicing investment.

A crucial overall finding is that the regulatory framework for investment is not sufficiently geared towards helping small and medium businesses emerge, develop and expand. In many respects, they are not put on an equal footing with larger companies, and insufficient consideration is given to their needs and constraints. Much could and should be done to promote the emergence of a stronger SME sector,

underpinned by national and foreign investment alike. As evidenced in chapter I, mega-projects will never be sufficient to address the country's development challenges, regardless of how they are regulated and how much FDI is attracted through them. Job creation, economic diversification and poverty reduction require the emergence of a full and deep span of businesses and entrepreneurs, from the micro-level to the mega-projects.

Chapter III builds on the detailed assessment of strengths and weaknesses of this chapter and proposes concrete reforms to the regulatory framework as one component of a strategy to promote foreign and national investment and build linkages between the two. The reforms suggested are geared to benefit and support both national and foreign investors, with a view to helping Mozambique achieve its development goals, key among which are job creation and the reduction of inequality.

Notes

- ²⁶ The ranking is based to a significant extent (e.g. indicators on starting a business, registering property, paying taxes or trading across borders) on the number of steps or days required to comply with regulatory requirements, few being always better. Under this benchmark, the purpose or “quality” of the regulation or step cannot be taken into account. As a result, moving up in the ranking cannot be taken per se as an indication of an improved regulatory framework from a policy perspective. It must be noted that some indicators (e.g. protecting investors, getting credit) are of a more qualitative nature. In addition, the World Bank removed its indicator on the ease of hiring and firing workers from its general ranking as the lowest amount of workers’ protection was considered best.
- ²⁷ With the exception of provisions on transfer rights and international dispute resolution.
- ²⁸ Article 86 of the Constitution defines three types of sectors based on ownership of production means: (1) public sector; (2) private sector; and (3) cooperative and social sector.
- ²⁹ (1) production of electrical energy; (2) public supply of water in urban centers; (3) postal services and public telecommunications; (4) development and operations of national parks; and (5) production, distribution and trade of arms and ammunition.
- ³⁰ The first indicator measures start-up procedures from a relatively narrow perspective (excluding, for example, access to land and environmental or sectoral permits), while the second assesses the protection of a minority investor through legal requirements on disclosure, director liability and ease of shareholder suit.
- ³¹ Industrial establishments are classified as large or medium if they involve investments in excess of \$2.5 million or if they employ more than 125 people. Other investments are classified as either small or micro.
- ³² The environmental management plan is initially prepared as part of the EIA.
- ³³ Source: World Bank (2009). Labour market regulations were cited as a “major or severe obstacle for business” by 5.5 per cent of companies, and the issue ranked 15th out of 16 as top constraints cited.
- ³⁴ This was confirmed by interviews with the private sector during UNCTAD’s fact-finding mission in Mozambique. In a survey of businesses conducted by “Business Leadership South Africa” in 2007, 65 per cent of respondents reported that they had experienced problems with the recruitment of expatriates.
- ³⁵ Based on figures from the World Bank (World Bank, 2011b), Mozambique has about 30 million hectares of non-cropped, non-forested land suitable for agriculture and with a population density below 25 persons per km². This compares with 100 million ha for Sudan, 88 million ha for Brazil, 78 million ha for the Russian Federation and 46 million for the Democratic Republic of Congo.
- ³⁶ A company is considered foreign if more than 50 per cent of its capital is owned by non-Mozambicans.
- ³⁷ Italy, Macao (Special Administrative Region), Mauritius, Portugal, South Africa and the United Arab Emirates.
- ³⁸ The relief is capped at the lesser of: (1) the amount of tax paid abroad; and (2) the tax that would be due on such income under the Mozambican regime.
- ³⁹ Rapid development zones include the Zambeze River Valley, the province of Niassa, the district of Nacala, Ilha de Moçambique and Ibo Island. Projects in 19 widely-defined activities in the primary, secondary and tertiary sectors are eligible for the incentives.
- ⁴⁰ Companies established outside IFZ that wish to benefit from the specific regime must invest either a minimum of MT25 million (\$780 000) or have an installed power capacity of at least 500 kilovolt-ampere.
- ⁴¹ UNCTAD (2007b) and UNCTAD (2008) provide useful policy lessons on how to manage and derive the benefits of FDI in extractive industries and FDI in infrastructure.
- ⁴² The curse of natural resources (or paradox of plenty) is a frequently observed phenomenon through which countries with abundant oil and mineral resources fall into poor development outcomes measured in terms of growth, inequality, poverty

reduction or economic diversification. Underlying causes for such poor performances range from conflict, corruption, inadequate revenue management, Dutch disease or insufficient focus on human capital development.

⁴³ World Bank (2009).

⁴⁴ Corruption ranked 5th in 2008, down from 3rd position in 2003.

⁴⁵ SADC members are Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe.

CHAPTER 3

Investment strategy



A. Key objectives and potential FDI contributions

Chapter I showed that mega-projects have contributed significant benefits to Mozambique over the past decade and a half, but stressed their intrinsic limitations and the dangers of relying on them excessively to achieve the country's development goals. The transformational nature of smaller foreign investments was also highlighted and it was underscored that SME foreign investors could provide an excellent match given Mozambique's needs and stage of development.

Chapter II draws the attention to remaining weaknesses in the regulatory framework for investment and to its inherent bias against small businesses. As they currently stand, laws, regulations and institutions in Mozambique are not sufficiently geared towards addressing the needs and constraints of investors of a relatively limited scale, be they Mozambican or of foreign origin.

This chapter is forward-looking and addresses remaining challenges. It proposes an investment strategy underpinned by three core purposes:

- Enable Mozambique to attract the type of FDI that is most susceptible to contribute to the achievement of its development goals;
- Ensure that mega-projects, in particular in mining, bring long-term developmental benefits and that the returns from the exploitation of natural resources are shared fairly;
- Foster investment by nationals and promote linkages between TNCs and local investors.

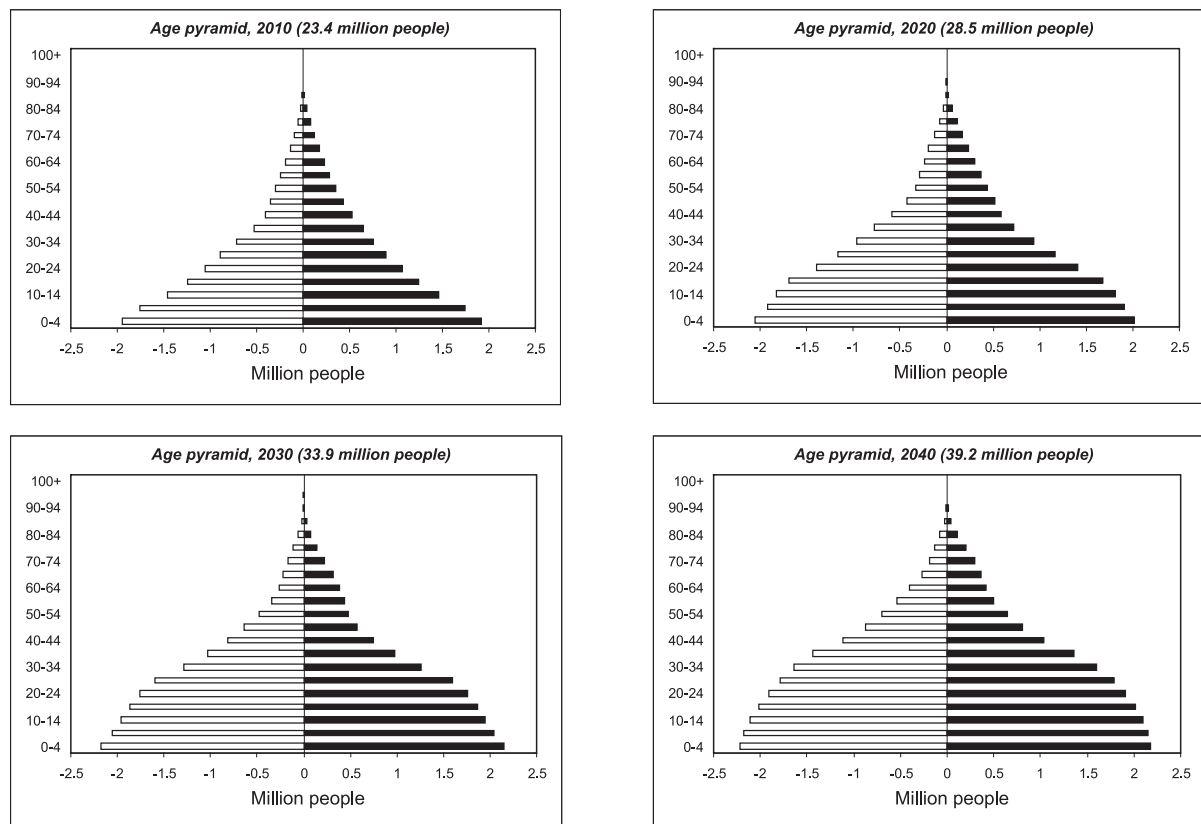
As stated in PARPA II, Mozambique's key objective is to attain socially and environmentally sustainable development over the long term. Concretely, this requires and implies job creation on a massive scale, rapid poverty reduction, lower income inequality, and

sharply improved access to health care and education, among others. Clearly, this can only be achieved by setting Mozambique on a rapid yet socially inclusive and environmentally sustainable growth path, underpinned by high levels of national and foreign investment, technological progress and innovation, a diversified economy, improved infrastructure and stronger public institutions.

The challenges are immense and should be addressed forcefully. One of the most testing issues will be for Mozambique to generate sufficient jobs for its young and growing population in the decades to come. As illustrated in figure III.1, Mozambique's working age population reached around 9.5 million people in 2010.⁴⁶ Given the age structure and high fertility rates, the working age population is projected to increase to 12 million people in 2020, 15.8 million in 2030 and 19.7 million in 2040. In addition, the share of working age population is expected to increase from about 40 per cent of the total in 2010 to 50 per cent in 2040. Providing decent job opportunities on this scale is not only among Mozambique's biggest challenges, but also one of its most critical social and economic issue.

As indicated in chapter I, FDI has significantly contributed to GDP growth and economic diversification in recent years. The capital intensity of mega-projects and the small number of jobs created by such investments was also contrasted with smaller but more labour-intensive projects in a wide variety of sectors. It is therefore encouraging that Mozambique has been attracting sharply rising inflows of non-mega projects FDI since 2005. Foreign investment should nevertheless not be expected to solve all economic challenges, regardless of how successful Mozambique could become in attracting FDI inflows in the future.

Figure III.1. Age pyramid and working-age population, 2010 to 2040



Source: United Nations Population Division, *World Population Prospects*.

In addition, FDI policy objectives should not be considered only from a quantitative perspective. Ultimately, the nature of FDI and qualitative aspects are of utmost importance for development. Setting realistic expectations about what types and levels of FDI can be attracted and what benefits can be derived from foreign investments is, therefore, as important as elaborating ambitious goals and policies for investment attraction. This would allow Mozambique to adequately integrate FDI policy within the wider context of its development strategy and of its plans of action to promote national private and public investment. The latter should indeed constitute the main drivers of development, with FDI working closely alongside them to promote sustainable growth and the emergence of diversified clusters of activities across the country.

It is important to realize also that different forms and types of FDI will bring different types of benefits, and perhaps risks. No project or group of projects will ever generate all the benefits that a country may wish

to derive from foreign investments, which makes FDI diversification all the more important. Given its location, size, natural resources, strategic assets and under-explored nature, Mozambique has vast potential to generate strong interest from the global businesses community and to attract foreign investments of all sizes and types.

The benefits that Mozambique can legitimately hope to derive from FDI include: (1) job creation; (2) poverty reduction; (3) the establishment of linkages with national companies, the stimulation of local entrepreneurship and the building of productive capacity; (4) economic growth and diversification; (5) better integration into the world economy; (6) transfers of skills, know-how and technology; (7) access to capital; (8) infrastructure development; (9) opportunities to leapfrog in the use of certain technologies, including in particular renewable energies; and (10) increased tax revenues. At the same time, the potential risks associated with FDI also vary by types of projects, and can include environmental

degradation, unfair competition, job displacement or negative effects on local communities.

Recognizing that specific projects may only contribute to a sub-set of benefits, national development objectives should guide Mozambique's FDI strategy. Given the crucial need for job creation and poverty reduction, particular care should clearly be given to investments that generate significant levels of direct or indirect employment opportunities.

This chapter proposes a strategy that builds upon these observations and aims to optimize the contribution of FDI to the top development objectives. It is articulated around four main areas of action:

- **Horizontal measures:** they include actions to improve the business climate for all investors, including nationals and foreigners. A particular emphasis is placed on addressing the needs and concerns of SMEs while protecting the national interest. The reforms would also promote investment by larger investors.
- **Matching needs, opportunities and investors:** as is the case in most LDCs, Mozambique offers significant untapped business opportunities for nimble and innovative foreign investors of a relatively modest size. As indicated earlier, such investors may also provide a good match with Mozambique's development needs. In addition to horizontal measures, the FDI strategy aims to identify sectors where the country has most potential not only to attract foreign investors, but also where the latter can have the largest transformational effect and positive impact.
- **Mining, mega-projects and PPPs:** although they may not generate much direct employment, these projects have important development implications and deserve significant regulatory attention from the Government. Recommendations are offered not only to better promote projects, but also optimize their contribution to sustainable development.
- **Institutions:** the strategic recommendations of this Review have profound implications for the institutions in charge of investment promotion, in particular, although not exclusively, the CPI. A number of reforms are suggested to further improve the country's efforts to promote inward investment.

B. Horizontal measures: looking beyond mega- projects

Over the recent past, and for a combination of factors, mega-projects have dominated the policy debate on the extent to which FDI could help Mozambique achieve its national development goals and what measures need to be adopted to promote investment flows. A coherent vision on the role of FDI and a strategy to promote and manage inflows remain to be devised. Surprisingly little care and attention have been paid to foreign investments of a relatively modest scale, despite their large potential developmental impacts.

As Chapter I highlighted, Mozambique has underperformed relative to other countries at a similar stage of development in attracting FDI outside of mega-projects. Analyses at the macro-economic and sectoral levels point out not only that there is significant untapped potential to attract such investments, but also that FDI of a relatively modest size provides an excellent match with Mozambique's economic structure. Compared with capital-intensive mega-projects, investments at a smaller scale tend to be more labour intensive and better integrated with the national business sector while also having higher potential for economic diversification and regional development.

Expectations about the development impact of mega-projects were and remain extremely high. It is crucial, however, for Mozambique to be fully aware of their limitations in terms of development and to realize that they will never provide a solution to the country's socio-economic challenges in and of themselves, regardless of how they are managed. Putting the country on a sustainable development path and sharply reducing poverty and inequality require a broad-based economic diversification that can only be brought about by proactively encouraging and promoting investments of all types and sizes by foreigners and nationals.

Mozambique needs to address more forcefully the challenges confronting its business sector in general, and its SMEs in particular. A strategy that looks beyond mega-projects as engines of development is called for and the focus of government policies needs to be better balanced towards investments of a more modest size. Granting the full care and attention that non mega-projects investments require does not, however, mean

that large projects in natural resource extraction should be neglected. Given their potential economic and social impact, they need to be regulated carefully.

The sections below outline a strategy to promote widespread business development. Section D considers regulatory and strategic issues specific to mega-projects and investments in natural resource extraction.

1. Regulating businesses as partners for development

Chapter II commends Mozambique for successfully transforming its planned economy and regulatory system into market-based ones and achieving strong growth as a result. Deep, widespread and carefully crafted regulatory reforms have been implemented over the past couple of decades that have enabled the private sector to take off and FDI to progressively become an important factor in the country's development (chapter I).

In spite of all the work done, Chapter II nevertheless highlights a number of critical weaknesses and outstanding issues that remain to be addressed in the regulatory approach to investment. Key among these are issues related to business establishment, corporate taxation, access to skills and the management of PPPs and mega-projects. Crucially, it appears that:

- The regulatory framework is inherently biased against investors of a relatively modest size (SMEs), both as a result of formal legal provisions and as a consequence of the complexity of certain procedures. In spite of representing the vast majority of projects and job created investments of a modest size are not given sufficient attention.
- Some regulatory institutions – and the rules they are meant to apply – are more prone to controlling and sanctioning investors than supporting their operations and promoting partnerships.

Although the transition to a regulated market economy has been achieved in terms of laws and regulations, the shift in attitude towards the business community is not complete. Some distrust seems to persist towards investors, which is no longer warranted. While clear rules must be established, monitored and enforced to protect workers, consumers, the environment and the national interest in general, it would be worthwhile for the authorities to go to greater length to ensure that businesses of all sizes, both national and foreign,

operate in an environment that is optimized for their establishment, profitability and expansion.

Mozambique could move a big step further towards achieving its development goals, generating widespread job creation and combating poverty by ensuring that all in Government view businesses as partners for development and as a key driving force behind it. Business development in all its forms, including national and foreign or through joint-ventures and PPPs, should be considered as the sine qua non condition to achieving development objectives and gradually eliminating the dependency towards foreign donors. The sections below outline a strategy to regulate businesses as partners for development and re-balance the attitude of regulators towards investment facilitation.

a. Adopt a new approach to the law on investment

Mozambique is extremely open to FDI. This is a positive factor, but a number of key shortcomings remain in the Law on Investment, not the least of which being that it contributes to creating a non-level playing field between large and small investors and that it restricts Mozambique's policy space (chapter II, section B.5). Other aspects of the law also deserve to be improved from the perspective of foreign investors.

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 a change of attitude among regulators. Based on the assessment of chapter II, the new approach to the law would imply to:

- **Remove the CPI licensing requirement:** investment licences from the CPI are at the core of the Law on Investment as it currently stands. They are not a legal requirement but a de facto necessity for the majority of investors in the formal sector as they condition the access to standards of treatment and incentives. By and large, investment licences are no more than an extra administrative requirement whose regulatory purposes can be easily covered by other establishment procedures already in place, including sectoral licences. To some extent, investment licences also contribute to the regulatory bias towards controlling and sanctioning rather than towards facilitating and servicing.

In order to ensure the availability of data on investment so as to inform policy making, Mozambique could envisage enforcing a registration requirement. In order to avoid duplication of

procedures, this requirement could be merged at the company incorporation stage.

- **Stop providing contractual clauses on treatment and incentives under CPI licences:** eliminating investment licences means that Mozambique would no longer enter into contractual relationships with investors on tax and non-tax issues. The stability that has been provided under the licences regime has been useful to establish the country's credentials since the end of the civil war but contractual obligations are no longer in the country's best interest, even though some investors might be happy to keep them.⁴⁷ By no longer entering into contractual stability clauses, Mozambique would also increase its policy space and give itself the ability to adjust tax and non-tax incentives as needed.
- **Eliminate the role of CPI licences as a gateway to incentives:** eliminating the investment licence would have a number of implications on other aspects of the regulatory framework. Key among those is that the licence is currently used as a condition to obtain tax and non-tax incentives. A revision in the structure of incentives should thus go hand-in-hand with the proposed reform in the investment law. Specific proposals are offered on tax incentives and the allocation of work permits for expatriates below.
- **Create a level playing field for all investors:** the provision of tax and non-tax incentives exclusively to holders of investment licences creates two classes of investors and is detrimental to smaller ones. The new investment law should ensure that all investors are put on an equal footing, regardless of size (small or large) and ownership (national or foreign).
- **Guarantee core standards of treatment to all foreign investors:** provisions on the treatment and protection of foreign investors should apply universally without sectoral or size exception and should not be conditioned on an investment licence. This would allow Mozambique to send a clear message to foreign investors about what they can expect as minimal and guaranteed standards of treatment and protection.
- **Strengthen protection against expropriation:** a clarification and strengthening of the rules overseeing expropriation or nationalization of assets should be considered as part of the new investment law. In particular, provisions on payment timelines,

the valuation of assets and non-discrimination should be properly defined.

- **Provide stronger guarantees on the transfer of funds:** the transfer of funds and other foreign exchange operations are regulated only marginally by the Law on Investment. The new regulations as specified in the Law on Foreign Exchange and its associated decrees, in turn, create a number of serious concerns for foreign investors. As part of the new approach to the investment law, it would be necessary to reconsider some operational constraints. A number of things would be necessary, including to:
 - Harmonize the provisions on foreign exchange operations contained in all relevant laws;
 - Ensure that foreign investors are free to repatriate earnings and capital, subject to complying with tax and other obligations;
 - Allow foreign investors to open and operate foreign currency accounts in Mozambique;
 - Remove the obligation to convert foreign exchange earnings into meticals and allow them instead to be held in domestic foreign exchange accounts;
 - Treat all foreign investors on an equal footing and avoid creating special regimes, with the possible exception of businesses operating in EPZs and IFZs.

This new approach to the investment law would have institutional implications and would require changes in other laws. In particular, new roles and functions for the CPI would emerge, and new approaches to corporate income taxation and the granting of work permits to foreigners would be needed. These issues are addressed below.

b. Balance investment incentives objectives and revenue collection needs

Mozambique has made remarkable progress over the past couple of decades to improve its tax structure and administration, as illustrated in the tax revenue to GDP ratio, which nearly doubled from less than 10 per cent in the early 1990s to 17.5 per cent in 2010. The dependence on general budget support from the donor community nevertheless remains high, and it is crucial that further efforts be undertaken to increase tax revenue. In addition, a number of structural and administrative weaknesses persist, and tax issues are

at the core of the debate on the impact of mega-projects (chapter II, section F.3).

In spite of recent reforms, Mozambique lacks a clearly defined strategy to guide tax policy, particularly when it comes to corporate taxation and investment incentives. The contradiction between the recently adopted range of incentives and the desire to ensure that private investment, mega-projects above all, contribute to the country's development by paying appropriate levels of taxes is symptomatic of a lack of overall strategy.

It is therefore proposed that a comprehensive and coherent tax policy be adopted. It would define broad objectives and general principles not only for corporate taxation, but also for VAT, import duties and personal income tax. It would seek to:

- Increase tax revenue as a percentage of GDP in order to enable the provision of key public services and reduce the dependency on donor support in the long run;
- Ensure that a fair share of the rent from natural resource extraction is appropriated by the country and put to optimal use;
- Provide a favourable, non-distorted and non-discriminatory environment for investment and business development;
- Promote the achievement of national development goals, including job creation, poverty reduction and lower inequality;
- Encourage tax compliance and generate a fair distribution of the tax burden among agents;
- Keep the tax structure as simple as possible to administer, from the perspective of the taxpayer as well as that of the revenue authority, and transparent.

Concretely, this would translate into the following measures as far as corporate taxation and investment incentives are concerned:

- **Rationalize tax incentives:** Mozambique stated in its letter of intent of November 2010 with the IMF that it would “assess the merits” of rationalizing incentives. These efforts need to be pursued in order to eliminate the current proliferation of sectoral incentives. While a small number of them could be preserved if justified, the overall approach should be to target tax incentives in relation to specific and

measurable outcomes directly linked to the country's development goals.

As much as possible, tax incentives should be structured so as to avoid distortions and unintended effects. As a general principle, they should be subject to a cost/benefit analysis and be adopted only to the extent that they support positive outcomes (e.g. development of a cluster or job creation) that would otherwise not be sustained. Rather than being primarily sector-driven, incentives could focus on promoting the following key measurable outcomes: (1) job creation; (2) skills-building and transfer of know-how; (3) business linkages with national companies; (4) business expansion and diversification; and (5) infrastructure development.

Corporate income tax holidays or reductions from the baseline rate should be used sparingly. Instead, accelerated depreciation, tax credits on certain classes of assets, excess deductions of some types of expenses and exemptions on import duties for certain classes of goods would be more appropriate and are likely to generate fewer unintended effects. Mozambique already uses most of these types of incentives to a certain extent.

- **Offer incentives on a non-discriminatory basis:** securing an investment licence from the CPI is currently a preliminary condition for the vast majority of tax incentives, which are defined and granted as part of the licensing procedures. As a result, many smaller national investors fail to benefit from incentives. In addition, it is recommended above to remove the CPI licensing procedure altogether.

Consequently, it is recommended that tax incentives be granted on the basis of pre-defined conditions linked to the measurable outcomes to be promoted. No other condition or licensing requirement should apply. This would ease the administration of incentives in that it would eliminate the CPI's direct involvement in tax issues, which are not its core mandate or area of expertise.

As a result, small national investors would also be granted access to the same tax incentives as larger national or foreign investors. In order to duly take into account the challenges of taxing small companies on the verge of informality and to encourage formalization of the economy, the special tax regime for companies operating under

the simplified accounting system should continue to apply, however.

- **Consider a small reduction in the headline corporate income tax rate:** the rationalization of tax incentives should be considered as part of a wider objective of putting in place a general corporate tax regime that is susceptible to promote investment and private sector growth, while at the same time generating appropriate tax revenue. The rationalization of tax incentives should thus be an opportunity for Mozambique to consider a small reduction in the baseline corporate income tax rate, as already envisaged by the Government.

As Annex I shows, the base case corporate tax regime imposes a relatively high tax burden on (foreign) investors compared with other countries in the region. To a significant extent, the numerous incentives schemes are used to compensate for the unattractive base case. This introduces significant economic distortions (chapter II), lacks transparency and imposes a high administrative burden. The elimination of many incentive schemes, combined with an improved base case could achieve multiple benefits by increasing overall tax revenue, promoting investment, reducing administrative costs, eliminating distortions, closing loopholes and reducing opportunities for tax evasion. A number of countries have followed such a strategy in recent years with significant success, including Macedonia, Mauritius and Mongolia.

- **Stop providing stabilization clauses:** the elimination of the CPI licensing procedures means that Mozambique would no longer provide tax stabilization guarantees to investors. Such assurances are no longer necessary now that the country's credentials have been strongly established. Mozambique's policy space would be enhanced as a result. It would be essential, however, to maintain a strong degree of tax stability to reassure investors and allow them to operate under a predictable environment.
- **Account for tax specificities of natural resource extraction:** investments in natural resource extraction are capital-intensive projects that face specificities in terms of operating conditions and raise issues in terms of sharing of rent extraction. Mozambique has been rightly concerned about ensuring that an appropriate share of the benefits

from the exploitation of exhaustible resources remains in the country. Specific recommendations are provided in section D.2.

- **Establish and enforce clear transfer pricing rules:** Mozambique is rightly concerned that investors may engage in tax-engineering in order to minimize their obligations. Foreign investors may also have more room and ability to optimize the use of legal provisions to lower tax payments. At the same time, however, foreign investors are among the largest tax contributors in Mozambique, as in the majority of LDCs.

As a result, it is essential that a relationship based on trust and predictability be built between large taxpayers and the ATM. The establishment of a large taxpayers' unit was a step in the right direction. The adoption of clear and precise transfer-pricing rules is a second indispensable step that would achieve two key objectives: (1) prevent manipulative transfer pricing practices to shift profits out of Mozambique; (2) provide a predictable environment for bona fide investors to operate under and allow them to avoid possible sanctions. The Organisation for Economic Co-Operation and Development (OECD) would be well positioned to offer technical assistance in this respect, particularly since Mozambique is engaged in a self-assessment of investment measures under the OECD's Policy Framework for Investment.

- **Ensure speedy and effective VAT refunds:** VAT administration is in general quite strong, and Mozambique provides a sound and pro-investment refund system for exporters and businesses in phase of expansion. Yet, investors frequently complain about delays in obtaining refunds. A review of performance and procedures could thus be useful in order to address the issue.

In addition to these issues directly related to corporate income taxation, a comprehensive policy should also address personal income taxes, import duties, excises and other taxes at the national and local levels. These issues are not analysed in this report but would have to be integrated in the policy recommended above.

c. Streamline licensing procedures, refocus regulatory attitudes and support SMEs

As noted earlier, despite the enormous progress made in the past decades, the regulator/investor relationship in Mozambique is still over-burdened by bureaucratic

licensing requirements and regulations. In addition, a strong bias towards “command and control” remains in most ministries and agencies.

In order to genuinely promote investments by small and large investors alike, a new approach is required in which ministries and agencies also envision themselves as facilitators and service providers for businesses, rather than only in a licensing and regulatory role. This does not mean that ministries and agencies should cease to perform their oversight and regulatory roles. However, global best practices suggest that the most successful economies are those where public sector activities underpin and support private investment and where regulatory hurdles are limited to what is required to protect the national interest, while providing room for innovation and entrepreneurship to flourish.

Concretely, Mozambique could engage in a systematic review of licensing procedures for investment with the view to: (1) eliminate all requirements that do not serve a genuine and necessary regulatory purpose or have become redundant with other requirements; (2) lighten the administrative burden imposed on investors as much as possible, including through the introduction of IT and e-governance tools; (3) avoid overlaps between different sets of requirements. Such reforms would ideally take place as part of a wider strategy to adopt e-governance at the national and provincial level.

UNCTAD’s e-regulations tool (www.eregulations.org) would be a useful starting point in this process. As a unique web-based tool, the e-regulations system enables countries to identify, publish and manage administrative procedures related to investment establishment and business operation. It generates transparency on rules and procedures, promotes good governance and allows international benchmarking. As a result, it can also underpin efforts to simplify procedures by facilitating the identification of unnecessary or redundant steps. The system has been successfully implemented in about a dozen countries, including Cape Verde and Rwanda, and would be extremely valuable to Mozambique.⁴⁸

The World Bank’s Doing Business indicators could also serve as a useful benchmark in this administrative simplification drive, bearing in mind its intrinsic limitations to evaluate the quality of regulations. By setting up a Working Committee on Business Licensing, Kenya recently managed to axe a large number of licences. A similar body could be established in Mozambique with the same purpose. Increased

coordination and communication between regulatory agencies should also be fostered. This could involve the consolidation of licences or joint filings and inspections.

In addition to simplifying licensing requirements and procedures, regulating investors as partners for development would also require a culture change among public agencies and regulators. The CPI would have to play a central role in this (section E.1). A reinforced dialogue and consultation mechanism between the public and private sector would also be called for (section E.2).

A change in regulatory attitudes and mentalities would need to be initiated and pushed for at the highest level of Government and to trickle down to all levels of the administration, including managers and front officers dealing directly with investors. Although it is complex to achieve, it could be promoted by mandating all agencies dealing directly or indirectly with investors to prepare “client charters”. Such charters would define each agency’s mission, vision and core values. They would also importantly define a number of “commitments” towards investors, including in terms of time expected to answer questions and provide information, maximum time needed to issue licences or costs of licences. Such client charters would be drawn by the staff of the agencies and be posted publicly. In order to make them effective, management should monitor performance with respect to the commitments undertaken in the charters. In addition, a general review of practices by inspectorates would also be called for.

In addition to eliminating the regulatory bias against investors of a relatively modest size, Mozambique should proactively support its SME sector and foster entrepreneurship. The creation of the Instituto para a Promoção das Pequenas e Médias Empresas (IPEME) in 2008 was a step in the right direction. It will be crucial to ensure that IPEME is adequately funded in the future so as to enable it to fulfill its missions and objectives, including in Mozambique’s provinces. It will also be essential that IPEME work in close collaboration with the CPI in order to promote linkages between foreign investors and local SMEs.

d. Foster fair and effective competition

Mozambique’s economy remains small in spite of the past decade of strong growth, and companies (national- or foreign-owned) can relatively easily be in a de facto monopolistic position or enjoy dominant market power. While such situations may be unavoidable in the short

term, it is important that Mozambique increases its efforts to establish a fair and effective competition framework. 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.

Once established, the competition authority should quickly execute concurrent jurisdiction agreements with regulatory bodies that have been granted authority over certain sectors, including in terms of competitive practices. Where State-owned companies compete with the private sector in the provision of goods and services, or where State-owned companies operate under monopolistic situations, competition rules should apply without exception.

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. In addition, the business community will need to be educated about competition issues, including restrictive business practices, their impact on enterprise efficiency, and their rights and obligations.

e. Facilitate access to land-user rights

Mozambique has opted to keep all land under State ownership and to allocate land-user rights under the DUAT system. The complexity and social ramifications of land ownership are such that it is neither possible nor desirable to propose reforms on the subject in this review. Within the existing legal framework, the authorities should nevertheless seek to find new ways to put the country's vast resources linked to land to productive use and to facilitate access to land for investors in industry and services.

A number of issues deserve particular attention:

- The DUAT system does not allow holders to use their land-user rights as collateral for borrowing. Although this is not a major constraint for many foreign investors, it makes access to credit significantly more difficult for small-holders in agriculture and for small businesses and puts a brake on their development. Creative solutions should, therefore, be sought to ease access to finance for small businesses and perhaps institute limited exceptions to the non-transferability of land-user rights or to private ownership so as to permit their use as collateral.

- Mozambique has vast potential to attract foreign investors in agriculture and has already benefited from significant FDI in the area, including forestry and crops for bio-fuels. It is a safe option that the allocation of plots in excess of 10 000ha must be approved by the Council of Ministers. It will be essential for Mozambique's future and for the protection of local communities and the environment that the allocation of large plots to investors be carried out in a transparent manner and that strict conditions be attached, including in terms of the type of projects that deserve to be granted land, environmental management and the capacity of investors to manage large-scale investments in agriculture. In this context, allocations of large plots should be guided by broad development objectives, including job creation, linkages with local communities, export creation or food security.

- Investors in low environmental impact industrial projects or in services should be able to access facilities with ease, even if they do not themselves possess the land user rights. Mozambique has already put in place a special legal regime for IFZs and SEZs, which are being managed by GAZEDA. In addition to that, municipalities and provinces should be encouraged to promote the establishment of industrial or services parks, in partnership with private developers. Such parks would not need a special tax regime like IFZs and EPZs, but could prove extremely useful in the sense that they could provide turnkey facilities for investors and save them the complexities of securing DUATs on their own. They could be a particularly useful form of PPP at the local level.

- The procedure to attribute DUATs to investors should be reviewed with the purpose of finding ways to simplify and shorten it and to ensure that a clear sequencing is established between various requirements, including those referring to other licences but that are mutually dependent.

- Best efforts should be made to avoid land grabs and speculative uses of DUATs. This may call for a stricter enforcement of the rule according to which land must be put to productive use if it is subject to a DUAT.

2. Building human capital and facilitating access to skills

Access to skills remains a major constraint for investors in Mozambique. In spite of efforts to rebuild the

educational system after the civil war, human capital remains relatively low and is by nature slow to build and accumulate. The current system of allocation of work permits for expatriates is satisfactory neither from the regulator's perspective, nor from the point of view of many investors (chapter II, section D). In addition, the existing regime is largely discriminatory towards smaller investors when it comes to negotiating ad-hoc quotas under the CPI investment licence, which this Review suggests to eliminate in any case (see above).

Experience from around the world shows that building human capital is essential for long-term development prospects and for poverty reduction. Given its current situation, a proactive human capital development strategy is essential for Mozambique. In the long run, building human capital requires consistent and large-scale investments in the educational system at the primary, secondary, and higher levels as well as in vocational training. A well-crafted immigration policy can also contribute in three important ways: (1) by filling temporary skills gaps; (2) by contributing to skills building and transfer of know-how; and (3) by cross-fertilizing skills and know-how.

A number of countries have been able in recent times to rapidly build human capital from a low basis, including the Republic of Korea and Singapore. While the former based its strategy mostly on its domestic education system, Singapore also relied heavily on the attraction of skilled expatriates, and continues to do so to date. Closer to Mozambique, Rwanda has been extremely proactive in recent years in developing its human capital, with some demonstrable success already. Following UNCTAD's advice under the Investment Policy Review programme, Rwanda is setting up an ambitious and innovative immigration policy to attract expatriates with skills in short supply domestically and entrepreneurs (box III.1).

It is beyond the scope of this report to review Mozambique's human capital development strategy and policy. It would be worth, however, for the Government to analyse in further details the experience of other

developing and developed countries in order to identify possible improvements to its current policies.

Technical and vocational education and training (TVET) is an area of particular importance and direct relevance for investors. TVET is also a domain that has been relatively neglected in spite of its implications for job creation and skills building. Significantly stronger efforts and investments should be made to establish technical and vocational schools and training institutes. Individual or associations of private investors have already started to establish their own training centers (e.g. for truck drivers). Public support for or partnerships with such initiatives should be actively sought. Given scarce resources, public support for TVET should also focus primarily on areas where there is strong demand for skills from the private sector. A clear vision of the country's needs and business opportunities should guide this selective support for TVET. Section C and table III.1 below could serve as guidance.

As far as the employment of foreigners is concerned, a number of suggestions can be offered in order to improve the current situation and leverage foreign skills for human capital development.⁴⁹ The guiding principles for reforms are that the new system should: (1) protect the interest of Mozambican workers; (2) promote job creation; (3) enable investors to access the skills that they need to establish operations in Mozambique, prosper and grow; (4) promote FDI by small companies in new and innovative sectors with strong growth potential; (5) foster training and transfers of skills to nationals; and (6) avoid discrimination towards small investors.

Building on these principles, a system based on three avenues to allocate work permits for foreign employees (quota system, labour market testing scheme and key positions scheme) and one avenue to grant investor visas for foreign entrepreneurs is proposed. The programme differs from what UNCTAD proposed to Rwanda in 2005 in that it would be less complex to administer and less proactive in attracting foreign skills. It would nevertheless fulfill all the criteria above.

Box III.1. Rwanda: an ambitious human capital development programme

The Government of Rwanda requested technical assistance under UNCTAD's Investment Policy Review (IPR) programme in 2005. Given Rwanda's economic conditions and its strengths and weaknesses, the IPR recommended an ambitious strategy based on: (1) turning the country into a centre of excellence in soft infrastructure and governance; (2) setting up a proactive skills attraction and dissemination programme; and (3) a number of key sectoral initiatives. In spite of the daunting challenges it faced to rebuild its economy and society in the aftermath of the genocide of 1994, Rwanda has been one of the top reformers in the world in recent years. It has rapidly established a high-quality and attractive regulatory framework, which enabled it to attract FDI inflows of around \$100 million per annum in 2008–2010, ten times more than in the first five years of the decade.

The Government of Rwanda took full ownership of UNCTAD's recommendation to reform immigration and work permitting rules in order to attract skills in short supply locally. The proposed programme built on the experience of other countries, including Australia and Singapore, but was uniquely ambitious for a poor developing country like Rwanda. It built on a dual track approach to attract foreign entrepreneurs and expatriate workers with skills in short supply locally.

The programme was structured from the start as part of a wider strategy of human capital development and required ambitious reforms on many fronts. Following extensive preparation work and with significant technical assistance from UNCTAD, the new rules and framework became operational at the end of June 2011. Other elements of the programme included the establishment of the Rwanda Labour Market Information System, focused on assessing labour market conditions from the supply and demand sides and matching job seekers with employers, and the Workforce Development Authority, focused on workforce development and skills building.

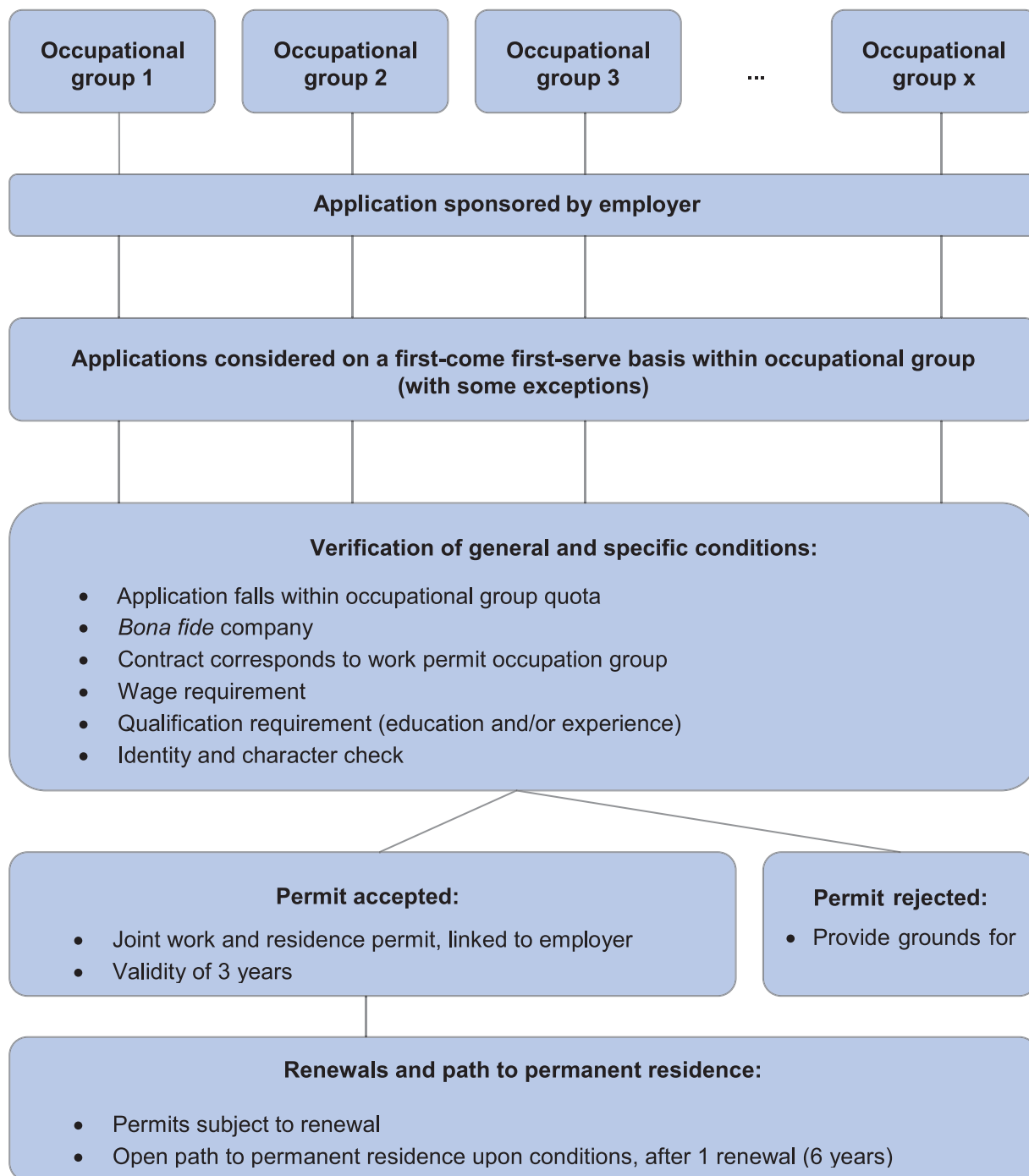
Sources: Investment Policy Review of Rwanda (www.unctad.org/ipr) and Directorate General of Immigration and Emigration (www.migration.gov.rw).

a. Nationwide and occupation-based quotas

Mozambique currently entitles employers to recruit foreign workers up to a set percentage of their total workforce, which varies according to company size. A higher percentage can be negotiated on a case-by-case basis as part of the CPI investment licence. It is proposed to replace this system with one where quotas are determined at the country level for occupational

groups. Applications for work permits would have to be sponsored by an employer, as is currently the case. As long as the overall quota within the occupation group has not been filled, applications would be granted automatically (subject to administrative procedures and other legal requirements), as currently happens for applications within company-level quotas. The system is represented in figure III.2.

Figure III.2. Work permit procedure under nationwide quota system



Source: UNCTAD.

Defining quotas by occupational groups

The authorities would first define a small number of broadly-categorized occupational groups, which would

include occupations for which there is a known shortage of skills in Mozambique. The International Standard Classification of Occupations of 2008 (ISCO-08)⁵⁰ could

be used to draw the list of occupations falling within each group, using relatively disaggregated definitions (e.g. at the two digit level of ISCO-08).

Quotas for work permits would be determined for several occupational groups rather than at a fully aggregated level in order to avoid that specific sectors or industries appropriate all work permits available. It would give the authorities the ability to fine-tune the system based on sectoral needs and specificities, without falling into complex micro-management.

Occupational group quotas would be defined annually on the basis of a continuous assessment of the actual and prospective needs of the labour market (from the employer's perspective) and the availability of skills among nationals. The occupations included within the quota system would be those for which a shortage of skills has been identified. It would be important, in that respect, to recognize that skills in short supply may not necessarily be those that require a high level of formal education. Technicians, welders, chefs or carpenters may indeed be as much in short supply at any given time than doctors, electrical engineers or accountants.

Quotas would have to be evaluated and perhaps revised on a regular basis to ensure that they are set so as to comply with the guiding principles mentioned above. It is suggested that occupational group quotas be set by Ministerial decree following consultations with all relevant stakeholders, including trade unions and industry associations.

Submitting applications

As under the current company-level quota system, applications for work permits would be the responsibility of employers: employees would be eligible for work permits only to the extent that they are sponsored by a bona fide company legally established in Mozambique and offered a formal employment contract. It is suggested that applications are considered on a first-come first-serve basis, until the annual quota is fully used. Some exceptions to this rule could be considered with the view of facilitating the access to work permits for companies that demonstrate a sound track-record of training Mozambicans and complying with immigration and labour regulations. As an incentive, they could be granted priority access to work permits.

Setting up general and specific conditions

The general and specific conditions applicable to work permits would be as follows:

- The application must be sponsored by a bona fide employer and linked to a formal employment contract as per Mozambique's labour law;
- The application and employment contract must correspond to one of the occupations falling within one of the quota groups;
- The qualifications of the suggested person, either academic or based on recent professional experience, must correspond to the occupation and be demonstrated;
- Identity and character checks would be conducted to safeguard Mozambique's security and interest.

In addition, Mozambique could consider a wage requirement as a condition for the issuance of work permits for foreigners under this scheme to avoid unskilled foreign workers taking over positions that could be easily assumed by Mozambicans. Given that such work permits are granted to fill a skills gap, it would be reasonable to impose that expatriates would earn a multiple of the relevant minimum wage.

Administering the scheme

The current administrative procedures for the issuing of work and residence permits are relatively burdensome on employers and employees alike. A simplification ought to be implemented:

- Unifying work and residence permits should be considered.
- The joint work and residence permit could be issued for periods of up to three years.
- Permits should be renewable for similar periods, subject to availability under the quota for the occupational group.
- Permit fees should remain nominal, but a tax on expatriates payroll could be considered in order to finance training schemes (section e).
- The professional or academic qualifications of individual applicants should be verified in order to

avoid abuses. The verification procedure should remain rapid and straightforward, however.

- A path to permanent residence and work rights should be opened for expatriates who have worked and resided in Mozambique for a continuous period of six years in order to retain valuable skills.

b. Labour market testing scheme

Even if quotas are properly defined both in terms of occupations and numbers, there will be cases where investors need to recruit expatriates to perform duties that do not fall within the occupational groups or where overall requests exceed the established quotas. In order to account for these cases, Mozambique should retain the existing labour market testing scheme under which work permits are allocated on a case-by-case basis and upon demonstration that no Mozambican could be found to fill the post. The procedures of the current scheme should be improved, however, in order to make this option genuinely viable for investors.

c. Key positions scheme

Companies setting up affiliates abroad usually want to fill key managerial positions with employees from headquarters, at least in the first few years of operations. Posts like chief executive officer or director, chief financial officer or other high-level positions are sensitive and require both a strong level of trust and prior knowledge of the company to ensure the successful establishment of the affiliate.

In order to promote and facilitate FDI, it is thus recommended that Mozambique adopt a key position scheme for foreign investors, which would entitle all foreign investors to a small number of work permits for high-level managerial positions. In order to avoid abuses, work permits would be granted only to TNCs investing above a certain threshold, within a range of a few hundred thousand dollars. Given the needs of larger investors, the number of work permits could depend upon the amount of the investment, perhaps ranging from 2 to 8.

d. Entrepreneurs scheme

The quota and key positions schemes address the needs of established national investors and TNCs by allowing them to recruit the employees with the skills they require for their operations. A frequently ignored

or neglected source of foreign investment in LDCs, however, arises from entrepreneurs – as opposed to corporations – travelling across borders to settle and establish businesses. Although such types of businesses are usually modest in scale, they can be very meaningful, have the potential to grow and may have significant impact when aggregated. Examples of FDI of this nature abound throughout Africa, and Mozambique is well positioned to attract such investments, including from South Africa.

In order to facilitate these kinds of investments, Mozambique could establish a scheme that would grant entrepreneurs seeking to establish a business in the country a work and residence permit on a temporary basis, upon the condition that a minimum amount be invested and that a viable business be established. The minimum amount would need to be determined in consultation with stakeholders to ensure that the desired type of entrepreneurs are attracted, but should not be set so as to discourage investment in the first place. An investment of \$50 000 to \$100 000 would seem reasonable.⁵¹

Upon successful establishment of the business and compliance with regulatory requirements (e.g. registration with tax authorities), the entrepreneur would be granted a work and residence permit for a longer period (around two years), renewable once upon continuation of activity, say for another three years. After the renewal, a path to permanent residence and/or citizenship should be open to allow continuation of the business activity. In order to protect Mozambique's national interest and avoid abuses, entrepreneurs could be required to demonstrate the availability of funds necessary to support themselves and their dependants for at least one year – in addition to the funds being invested. At the same time, however, entrepreneurs should be allowed to settle with their family, and residence permits should thus be granted to dependants as well.

e. Promoting training and transfers of skills

As mentioned above, investments in education are the key to building human capital in the long run. The work permit policies suggested above mostly provide temporary solutions to skills shortages. By enabling investors to set up increasingly sophisticated operations in Mozambique, they should nevertheless

also make a contribution to human capital development by promoting transfers of skills and know-how.

Such transfers deserve to be encouraged proactively, as they may not automatically materialize at the desired scale. Mozambique could consider, among others, to:

- Establish a fund to help companies train their employees and promote skills development by job seekers.
- Charge a small tax on companies employing expatriates, based on foreign workers' payroll. Revenue would be earmarked to finance the training fund.
- Promote training by granting priority access to work permits under the quota scheme to companies that establish formal skill transfers or acquisition programmes for their employees.
- Involve private investors in the formulation of curriculum in universities and vocational schools.
- Encourage the involvement of the business community in teaching activities in universities and vocational schools.
- Promote FDI in education, including vocational training.

C. Matching needs, opportunities and investors

The measures proposed in section B would go a long way towards improving Mozambique's attractiveness for foreign investors and maximizing their positive impact on the country's development. These measures are of a "horizontal" nature in that they concern all investors, regardless of size and nationality. In order to make them most effective, they should be complemented with targeted measures of a "vertical" or sectoral nature. The latter would allow Mozambique to leverage optimally its economic potential – as determined by a variety of static and dynamic factors, among others geography, natural resources, human capital and infrastructure – including by attracting the type of investors that can most positively help exploit, transform and build it in the future.

International experience with industrial policies – understood widely to encompass sectoral policies,

including in services – is mixed, but they continue to be implemented widely in developed and developing countries alike. While some successes have been achieved, in particular in emerging markets in Asia, it has proved extremely difficult for Governments to pick winners and ensure that resources are spent adequately and for the long-term benefits of the country as a whole.⁵² At their best, industrial policies address market failures through time-bound measures to allow a sector to reach self-sustained international standards of competitiveness and dynamic efficiency. At their worst, industrial policies waste scarce resources and negatively affect the population and the economy by protecting the few at the expense of the majority, negatively distorting pricing mechanisms and generating dynamic inefficiencies.

In addition to the difficulty for government officials to pick winners, countries also face the risk of industrial policies being unduly subject to lobbying forces and special interests. Where public institutions and governance remain weak, such a risk must be taken particularly seriously.

These risks and challenges should not, however, discourage Mozambique from adopting carefully devised sectoral strategies. In recent years, the Government has in fact adopted a number of sector-based policies, including for industry, tourism, mining or biofuels, even though some of them have become dated. Given the risks and difficulties associated with picking precise winners, either at the company level or at the sub-sectoral level, it is recommended that sectoral policies be defined in relatively broad terms, be focused on correcting evident market failures and avoid large government subsidies or expenditures. This would minimize the risk of distorting market mechanisms and wasting scarce resources, while at the same time enabling Mozambique to promote proactively the kind of investments that would best serve its development needs.

In particular, a number of sectors require appropriate regulatory frameworks to develop harmoniously in the best interest of the country and investors. Sectoral strategies should ensure that regulatory concerns are addressed properly and promptly, which entails relatively little cost to the Government but can yield significant benefits.

It is beyond the scope of this Review to elaborate sector-based investment policies, but a number of broad recommendations are suggested. First and foremost, the choice of sectors should be guided by an assessment of the country's potential to attract FDI and the benefits that could be derived from such investments. Efforts should naturally focus on the sectors not only with high attractiveness, but also with high developmental impact.

As indicated above, no single project will ever generate all the desirable effects that Mozambique may wish to obtain from FDI. Table III.1 provides an overview of attraction potential, benefits and risks for eight sectors/areas. For each of them, a rough evaluation of the importance or relevance of four factors is provided: (1) the potential to attract foreign investors seeking a globally competitive production centre, attempting to access the local market, or searching for natural resources; (2) the size of potential benefits that can be expected; (3) the significance of potential risks associated with FDI; and (4) the types of companies that are most likely to be interested in investing in the sector.

The assessment of these factors helps to identify sectors where policy actions are most warranted and define expectations about what can be gained from each type of projects. Agriculture, manufacturing and tourism, for example, have significantly more potential for job creation, direct poverty reduction, and linkages than mining, other mega-projects or infrastructure and logistics. In turn, mega-projects or mining would have significantly larger effects on capital inflows, exports or tax revenues. Given Mozambique's current situation, tourism, services, (small-scale) manufacturing, agriculture, mining and infrastructure and logistics emerge as sectors with both significant FDI attraction potential and significant long-term benefits for Mozambique.

The sections below provide brief recommendations on some of these sectors, focusing on regulatory issues that deserve attention and entail little costs for the Government. They do not seek to provide full-fledged sectoral strategies but provide indications on important issues that will need to be addressed as a complement to horizontal measures. The identification of sectors and issues could also guide the work of the CPI in the future, particularly if its operations are reformed following the lines recommended in section E.

1. Agriculture and agro-processing

Data from the Food and Agriculture Organization (FAO) show that Mozambique made strong progress in the past couple of decades in reducing the prevalence of undernourishment, which plagued 59 per cent of the population in 1990-1992 and fell to 38 per cent in 2005-2007. This level remains extremely high and still places Mozambique among 12 countries classified as having "very high" undernourishment rates by the FAO. The improvement, however, is very clear and confirmed by the share of food aid in total consumption, which plummeted from 24.7 per cent in 1990-1992 to 2.7 per cent in 2004-2006.

Production of food and non-food crops has increased sharply since the end of the civil war, with the FAO's agriculture production index more than doubling from 52 in 1992 to 122 in 2009.⁵³ Output of cereals surged from 242 000 tons in 1992 to 1.6 million tons in 2009 as yields were multiplied by almost five and areas harvested rose a more modest 40 per cent. During the same period, fibre crops (mostly cotton) were multiplied by almost six, with a fourfold increase in areas harvested and a 45 per cent increase in yield. More recently, Mozambique has also started to produce and export rising quantities of industrial roundwood and sawnwood, including as a result of FDI in forestry.

These trends have contributed to the significant reduction in poverty during the 1990s and improved food security and health indicators. The situation remains fragile, however, as illustrated by the food riots of September 2010 and Mozambique is vulnerable to international commodity prices, as food imports represented \$480 million in 2009, or 13 per cent of the total. Imports of cereals, a key staple for the poor, averaged \$213 million per annum in 2007-2010.⁵⁴

This is paradoxical in a country with vast untapped potential that has started attracting significant FDI in agriculture (chapter I). A recent World Bank study⁵⁵ reports that Mozambique has up to 16 million hectares of suitable non-cropped and non-protected land with a population density below 25 people per square kilometre, placing Mozambique among the top 3 countries in sub-Saharan Africa after Sudan and the Democratic Republic of Congo.

Mozambique's agriculture is dominated by small-scale farming and much of it remains to be properly

Table III.1. Matching needs, opportunities and investors: evaluating Mozambique's FDI attraction potential and benefits

	Mega-projects (excl. mining)	Mining	Agriculture & agro-processing	Infrastructure & logistics	Manufacturing (small-scale)	Services (excl. tourism)	Tourism	EPZs
Potential benefits:								
Job creation								
Direct poverty reduction								
Linkages and productive capacity								
Diversification								
Growth								
Transfer of know-how/technology								
Value-addition								
Provincial development								
Exports								
Capital inflow								
Tax revenues								
Global value chains								
Import substitution								
Potential risks:								
Environment								
Competition								
Labour standards								
Governance								
Local communities								
Likely investors types:								
Global TNCs	✓	✓	✓	✓			✓	
Regional TNCs and SME FDI			✓	✓	✓	✓	✓	✓
Entrepreneurs			✓		✓	✓	✓	✓

Note: dark blue = significant; light blue = limited

Source: UNCTAD.

commercialized. Further dents in poverty reduction will require a higher degree of commercialization, improved production methods, higher yields and a progressive transfer of labour force towards productive employment outside of agriculture. The transformation of the agriculture sector is beyond the scope of this report and should not rely principally on FDI. Yet, FDI does have the potential to contribute to structural changes in agriculture, because it can be an important source of capital, knowledge and agri-business expertise. The process nevertheless needs to be carefully managed in order to avoid detrimental effects on local communities and/or food security.⁵⁶

From a policy perspective, a number of issues need careful attention:

- **Land ownership and usage:** the current regime does not allow private ownership of land and DUATs cannot be used as collateral (chapter II). Although this is a sensitive issue, the Government could potentially consider the introduction of private ownership of agricultural land by smallholders (with a size limit) in order to promote their access to financing, which is a critical issue for the development of the sector. As far as large plots of land are concerned, mechanisms already exist to regulate their allocation to investors, which involve the Governor, the Minister of Agriculture or the Cabinet. A comprehensive set of pre-defined, clear and transparent requirements should be defined and publicized to regulate the allocation of land under this procedure.
- **Transparency, food security and sustainability:** these principles should guide the allocation of land to commercial investors so as to ensure that the national interest is protected. The seven principles for responsible agricultural investment as elaborated in 2009 by the FAO, International Fund for Agricultural Development (IFAD), UNCTAD and the World Bank could provide a general framework for the assessment by the authorities of whether land should be attributed to individual projects.⁵⁷ As far as the allocation of land is concerned, it will be particularly important to ensure that the long-term assets and interest of the country are not sacrificed for the short-term economic advantages of the few. This would require, among others, that the contractual terms on any land deal are fully transparent and publicly available.
- **Contract farming:** TNC involvement in agriculture has increasingly taken place through outgrower schemes and contract farming. While this may be a potent way to bring small holders into commercial farming, improve production methods and generate export opportunities, the relationship and bargaining power between parties is very uneven. Mozambique could thus consider establishing a regulatory framework for contract farming in order to protect small holders' rights and help them organize collectively. This could be accompanied by model contracts that could be used by small holders in their negotiations with their buyers.
- **Synergies with other investments:** potential synergies exist between FDI in mining, tourism, infrastructure and logistics and investment in agriculture. While Mozambique has vast arable land resources available, much of it lies in remote areas with poor transport and energy infrastructure and irrigation is little developed. Commercializing agriculture in these areas will require the transport and energy challenges to be resolved and the development of mining and international logistics, including through FDI, offer opportunities to do so. The Government will need to ensure that farming operations are in a position to benefit from the infrastructure developed for other sectors, however.

2. Tourism

The Law on Tourism (law 4/2004) of 2004 provides a basic legal framework for the sector, focusing mostly on issues of organization and definition. It defines the core rights and obligations of services providers, but the regulatory framework for projects in the sector is mainly defined by general investment rules. Additional guidance for the development of the tourism industry was elaborated through the tourism policy and strategy for 2004–2013, which proposes the vision that “by 2020, Mozambique is Africa’s most vibrant, dynamic and exotic tourism destination, famous for its outstanding beaches and coastal attractions, exciting eco-tourism products and intriguing culture, welcoming over 4 million tourists a year.”

The strategy recognizes the importance of the sector for Mozambique's development and poverty reduction, mainly through its effects on income, employment, linkages with small businesses in a variety of sectors, investment, infrastructure, prestige and conservation. It also warns of possible adverse social and environmental impacts and of volatility to external or internal events. It stresses that the potential of the sector remains largely untapped and an analysis of strengths, weaknesses, opportunities and threats is provided in the strategy. Key constraints are rightfully identified as the lack of skilled labour, basic infrastructure (including national and international transport, public health and water), lack of planning in land use and the burdensome nature of investment procedures.

Mozambique aims to develop as a high-end tourism destination rather than as one for mass-tourism and sees three core products: (1) water-based activities; (2) nature-based activities; and (3) people and urban environment experiences. The strategy identifies nine niche markets where the country has strong potential: (1) diving; (2) deep-sea fishing; (3) hunting; (4) birding; (5) eco-tourism; (6) adventure tourism; (7) cruising; (8) high-yield international luxury market; and (9) cultural tourism.

All of these markets require a relatively high-level of skills from the labour force and an excellent knowledge of the niche and requirements of international clients. Both of these components are currently lacking in Mozambique, which means that FDI should play a significant role in the development of the sector, as recognized in the Government's strategy.

A number of FDI-related actions to promote investment in the sector could be put in place:

- **Skills attraction:** developing the niches identified as having most potential will not only require very specific types of investors, but also the ability for them to recruit staff with highly specialized skills, many of which are not or insufficiently available in Mozambique. Such skills would include internationally certified diving instructors, mountain guides, canoeing or rafting guides, chefs or other workers catering to the needs of luxury clients. The implementation of recommendations on facilitating access to skills in short supply (section B.2) is important across the board, but is of particular relevance for the tourism industry.
- **Skills building:** enabling skills in short supply to be imported is an important measure, but Mozambique

should also put in place policies to develop such skills among Mozambicans. While investors are likely to provide training to nationals, the Government could proactively target foreign education institutions providing training in tourism, hotel management or culinary services to set up schools in Mozambique. Such efforts would be most likely to succeed if they were undertaken in association with locally established firms like Pestana, Southern Sun or luxury group Rani Resorts. Targeting investors in tourism education would have to be undertaken by the CPI, in association with the Ministry of Tourism.

- **Investment framework:** developing the niche markets identified in the strategy can succeed only through the joint forces of projects from a constellation of investors of all sizes and types, from the large international hotel chain to the entrepreneur-driven boutique hotel, dive centre or high-end restaurant. Many of the projects, however, are likely to be of a relatively modest size, which makes it crucial for the development of the sector that the general investment climate is further improved along the lines recommended in section B.1
- **Regional synergies:** South Africa attracted over 9 million tourists in 2007, with other countries in the region (Botswana, the United Republic of Tanzania and Zambia) also attracting large number of people.⁵⁸ These countries also offer prime attractions for safari tourism, but they do not have Mozambique's potential for water-based activities. Significant efforts should be developed by the authorities to work with tour operators and investors in the region, South Africa in particular, to include Mozambique in their packages. The CPI and Ministry of Tourism should especially target South African investors in tourism to build such synergies.

3. Small-scale manufacturing and services, EPZs and SEZs

In spite of the strong growth performance over the past couple of decades, Mozambique's manufacturing sector is still in its infancy, and it remains at the margin of the global value chains driven by TNCs, as is the case for most LDCs. The services sector has expanded significantly in recent years, but it is primarily focused on the domestic market and Mozambique has so far not participated in the global outsourcing trend in services that has benefited many more advanced developing countries.

This does not mean that Mozambique has not been able to attract foreign investors in manufacturing and services (chapter I). The constraints in terms of skills and infrastructure do imply, however, that Mozambique's ability to attract foreign investments in manufacturing and services will remain by and large concentrated on companies focused on the local or sub-regional market in the foreseeable future. There will be exceptions, including those driven by tax advantages in EPZs and SEZs or by preferential market access (e.g. garments under AGOA or the everything-but-arms initiative), but they are likely to be limited and may at times not be sustainable.⁵⁹

Small scale and local market-oriented foreign investments, in turn, may bring significant benefits in terms of job creation, diversification, value-addition, building of productive capacity and import substitution, and they could be a stepping stone towards increased participation in global value chains in the long run (chapter I). Section B proposes a number of reforms to the regulatory framework to facilitate the emergence of small-scale foreign investments in manufacturing and services. If implemented, they could go a long way towards making Mozambique a more attractive destination for high-potential investors in manufacturing and services.

In addition, Mozambique could facilitate investment by small companies, domestic and foreign, by establishing multi-facility industrial and services parks. Such parks could be developed by provincial and local authorities in association with private developers and perhaps even with the support of the donor community. Under a public-private partnership scheme that has been tested successfully in other countries where private ownership of land is prohibited (including for example Viet Nam), the local authorities could contribute land to the venture, while private developers would establish basic turnkey facilities for rent or lease by investors in manufacturing or services. This would enable small investors to avoid the complications linked to securing DUATs.

This scheme would differ from EPZs and SEZs in that no requirements would be placed on the export-orientation of activities and in that the general tax regime would apply. The EPZ and SEZ regime would continue to be useful in spite of its limitations, particularly when it comes to promoting Mozambique's role as a logistics platform in the region (see below).

4. Infrastructure and logistics

Mozambique is uniquely located along the Eastern coast of Southern Africa, facing the Indian ocean and fast growing Asian economies, which have become both major suppliers of goods and services in Africa and the prime destination for commodities exports. Four of its neighbouring countries are landlocked and gain easiest access to sea through Mozambique, with some of Botswana and the South-Eastern part of the Democratic Republic of Congo also well placed to be serviced through its ports. In addition, Maputo is extremely well located to provide sea access to South Africa's industrial heartland around Johannesburg and Pretoria.

Rising two-way trade with Asia represents a formidable opportunity for Mozambique to become a logistics hub in the region, which would include not only transit operations, warehousing and inventory management but also a range of packaging, dispatching and basic transformation services. Turning this opportunity into actual businesses, jobs and value-addition requires significant investments in infrastructure, transport and other, that are well beyond the financing capacity of the Government. The sound business fundamentals of Mozambique as a logistics hub, however, mean that it should be possible to attract private investment under various forms of PPPs. In order for PPPs to take off, a sound regulatory framework is fundamental. Mozambique is currently attempting to put in place such a framework and section D below provides recommendations on how to improve the approach recently adopted under the law on mega-projects, PPPs and concessions.

In addition to PPP and core infrastructure issues, the Government should ensure that regulatory matters of key importance to the development of logistics services are brought up to high international standards:

- **Customs:** Mozambique has made efforts to improve customs administration in recent years, but clearance times remain long (chapter II). In order to allow the country's potential for logistics services to unfold, further improvements will be necessary not only at the main seaports, but also at the main border posts with neighbouring countries. A benchmarking exercise could be undertaken, using some of the main logistics hub in the world as references, including Dubai and Singapore. Best practices could be transferred and adapted to Mozambique from such countries.

- **International transport:** Mozambique should pay particular attention to international transport regulations, including agreements with its neighbours on the cross-border provision of trucking and railway services.
- **Freeport regime:** the EPZ regime, which allows single-company zones, could probably be used by companies providing logistics services. Not all logistics companies would necessarily be eligible for EPZ status, however, and it would be worth studying the relevance of a freeport regime, or an adaptation of the EPZ rules, for logistics services.⁶⁰

Aside from logistics services, Mozambique also has significant opportunities to become a major exporter of electricity in the region. Its hydropower potential remains largely untapped, and the proximity to South Africa means that there is a large, sustainable and creditworthy demand for new generating capacity. In addition, the new coal mines that are to come on stream in the near future are likely to generate lower grade coal that may not be exported but that could be used to fuel thermal power plants. This is a rather unusual combination in sub-Saharan Africa that deserves to be fully exploited. Clearly, this could only be done through FDI as local financing and technical capacities are insufficient. Electricity projects should be actively promoted, including through PPPs (section D.4). Further operational reforms should be implemented in the electricity sector in order to increase private involvement in generation and transmission, based on the sound legal framework already in place.

D. Mining, mega-projects and PPPs: maximizing impacts

Chapter I and section B above stress the intrinsic limitations of mega-projects in resolving Mozambique's development challenges and encourage the Government to adopt new measures to improve operating conditions for small and medium businesses and implement targeted strategies to attract foreign investments that suit the country's development needs and business opportunities. While the focus of policy discussions and efforts has been excessively tilted towards mega-projects recently, this is not to say that the latter should be neglected.

Quite to the contrary, it is essential for Mozambique's long-term development prospects that mega-projects be managed carefully and adequately. In particular, mega-projects in natural resource extraction need to be handled with caution as they have strong implications not only on the environment and local communities, but also on macro-economic balances. As the experience of many African and Middle-Eastern countries shows, a strong endowment in natural resources can be a blessing as well as a curse (chapter II, section G.4). It will therefore be crucial that appropriate policies be put in place in order to ensure that Mozambique does not progressively slide into a "curse of natural resources". The measures suggested above to broaden FDI sources and types, promote SME development and diversify the economy are an important component of such policies.

As is the case in virtually all LDCs, physical infrastructure at the national, provincial and municipal levels remains insufficiently developed in Mozambique. This constitutes one of the biggest hurdles to the development of productive capacities and firm-level competitiveness and to the attraction of FDI. Given severe budget constraints and the extent of the needs, the Government alone is not in a position to build all the infrastructure that the country requires, even with significant donor assistance. There is ample room, however, for the private sector to meet some of the investment needs, including in transport, electricity and telecommunications. Mozambique has been able already to attract some foreign investment in roads, railways, ports and telecommunications but there remains significant untapped potential. In particular, PPPs should offer new avenues and opportunities for infrastructure development.

It is, therefore, extremely opportune that Mozambique recently decided to put in place a regulatory framework for PPPs and mega-projects. A law on mega-projects, PPPs and concessions was adopted in May 2011 after some consultations with stakeholders, who raised significant concerns on the approach adopted by the Government. By and large, these concerns have not been taken into account and the law was adopted as initially presented for consultation. Chapter II (section G.4) nevertheless identified a number of flaws in the approach that has been adopted in the law, in particular as it concerns: (1) the integration of very distinct issues under a single umbrella; (2) the desire to "regulate" benefits; (3) local participation requirements; (4) taxation; (5) the PPP unit; and (6) the renegotiation of existing contracts.

The sections below outline general principles and recommendations on how Mozambique could achieve the results it desires when it comes to mega-projects and PPPs, while at the same time ensuring that it provides an attractive environment for projects to take place. Although the law has been adopted recently, it is still recommended to introduce fundamental changes to the regulatory approach, preferably before the implementation decrees are prepared and the law becomes effective. These changes would require a new discussion of the law within Government and renewed consultations with stakeholders, and build on other laws and regulations already in place. Institutional considerations are also taken into account.

Mozambique is currently undertaking a self-assessment of some of its investment policies, using the tools developed by the Organisation for Economic Co-operation and Development (OECD) under its Policy Framework for Investment. This work with the OECD is to emphasize issues related to infrastructure development, and it is critical that the law on PPPs, concessions and mega-projects be subject to a thorough self-assessment before it is enforced and implemented. The recommendations offered in the sections below, and in this report in general, should guide the Mozambican authorities in their self-assessment.

The recommendations below also support some of the comments provided by the donor community and Mozambican private sector associations during the process of consultation on the draft law that took place in mid-2010. In particular, the Confederação das Associações Económicas de Moçambique (CTA), the Associação de Comércio e Indústria (ACIS), the law firm Sal & Caldeira, the European Commission and the United States Agency for International Development provided detailed comments that deserve to be taken into consideration. These, together with the recommendations below, should inform the self-assessment of the law and serve as the basis for a thorough re-writing of the law on PPPs, concessions and mega-projects.

1. Adopting a fine-tuned regulatory framework

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 (chapter II, section G.4). It is therefore strongly recommended

to adopt a more fine-tuned and segregated approach which would mean to:

- **Abrogate the law as it currently stands:** adopting a fine-tuned regulatory framework for PPPs and natural resource extraction projects means that the law in its present form should be abrogated. This is not to say, however, that the concerns that led to the preparation of the law are not legitimate. Quite to the contrary, they are essential to the long-term development prospects of Mozambique. Regulations need to be reformulated with extreme care, in close consultation with all stakeholders involved, and building on international best practices as elaborated through past experiences in developed and developing countries. The United Nations Commission on International Trade Law (UNCITRAL) prepared a legislative guide on privately financed infrastructure projects in 2001 that could be used for guidance.
- **Prepare a law dealing exclusively with PPPs:** Mozambique needs to have a legal framework for PPPs in order to promote private investment in infrastructure and protect the national interest. It is crucial that this framework be specific, however, and that it avoid imposing unnecessary constraints on projects that are not of a PPP nature.

The scope of the law on PPPs should be restricted to projects where private investors are involved in the provision of goods or services of a public nature. This would include roads, ports, airports, water systems, railways and electricity, and could eventually extend to other services of a public nature such as health care or education. It should also cover all forms of PPPs, which have become increasingly varied in recent years.⁶¹ In contrast, the PPP law should not apply to projects of a purely commercial nature (regardless of their size) even if they involve the exploitation of natural resources.

- **Regulate mining projects under revised sector-specific rules:** mineral resource extraction projects do not involve the provision of a public service and have little in common with PPPs, even if they lead to the exploitation of State-owned resources and require the granting of a “concession”. As a result, mining projects should be regulated independently of PPPs under specific rules.

Mozambique expanded significant efforts to prepare and adopt a well-crafted legal framework for mining in the early 2000s. It also managed to build the capacity of its regulatory institutions in the field. This framework has served the country well and is sufficient in itself. If the authorities wish to adopt additional measures to ensure that the country obtains a fair share of the rent from the exploitation of finite natural resources, it would be best achieved by revising some aspects of the existing sector-specific rules.

- **Regulate purely commercially-oriented mega-projects like other projects:** investments of a purely commercial nature have nothing in common with projects carried out as PPPs, regardless of their size and whether the State takes a participation or not. They are instigated strictly on the investor's initiative and size does not constitute ground per se for a project to be subject to regulations that differ from projects of a more modest size. For example, there are no legitimate regulatory purposes that would justify that a project like Mozal should be subject to a concession or bidding procedure, as would now be required under the new law, while a similar industrial project of say \$250 million would not. In order to ensure not only that projects are properly regulated according to their nature, but also that investment is encouraged, it is therefore strongly recommended that general rules be determined not by size, but by nature and impact.
- **Avoid making the general prevail over the specific:** the new law introduces an unusual legal clause that makes it prevail over the provisions of sector-specific laws. Such a clause should be avoided as it risks defeating valuable sector-specific regulations and replacing them with inadequate ones, in addition to generating possible legal contradictions. As indicated in chapter II (section G.4), the new law includes a number of contradictions with the mining law that could be particularly problematic for investors.

2. Maximizing impact through taxation

An important element that fuelled the policy debate on mega-projects and led to the preparation and adoption of the new law is the extent to which past mega-projects, including Mozal and Sasol, have contributed “fairly” to

the Mozambican economy, including by paying taxes. With the rapid growth of mining projects, the authorities are also legitimately concerned that the country needs to have regulations in place to ensure that development benefits ensue from the exploitation of finite resources.

As suggested above, however, policies and regulations regarding the means to achieve a “fair distribution” of profits between investors and the State should be guided by the principle of specificity. When it comes to ensuring that companies are taxed appropriately, the corporate income tax code should be the core tool. In the past, Mozambique determined that it was necessary to provide special tax incentives on an ad-hoc basis to promote certain types of investments, including mega-projects. Since the reforms of 2007 and 2009, the provision of tax incentives has been more strictly guided by law, even though a large number of sectoral incentives still exist.

Section B.1.b provides recommendations on how Mozambique could best achieve its revenue collection needs while at the same time promoting investment. It is suggested that all firms be subject to a single corporate income tax regime regardless of size, which means that mega-projects would be taxed like all other projects, no better and no worse.⁶² It is also recommended, however, that the tax specificities of projects in natural resource extraction be better taken into consideration. In particular, specific taxes should allow Mozambique to ensure that a “fair share” of the natural resource extraction rent remains in the country. This would not constitute a special regime for mega-projects and would also apply to mining investments below the threshold of \$500 million, but most mega-projects would be affected by the measure given their concentration in natural resource extraction.

The specific regime would not only seek to ensure that an adequate share of the rent is appropriated nationally through taxation, but also that investors' needs are taken into consideration. Taxing profits is probably the most effective and least distortive way to ensure that the rent from natural resource extraction is shared fairly between host country and investor. It also allows the country to share in exceptional benefits that may arise from increases in international prices, without putting a penalty in investors when prices are low.

Corporate income is uniformly taxed at 32 per cent and mining projects are not eligible for incentives on the tax

rate. Given the rent-extraction nature of mining projects, Mozambique could consider taxing companies operating in natural resource extraction at a moderately higher rate, e.g. at a premium over the prevailing base rate. In order to be effective and avoid tax-avoidance, ring-fencing of mining and non-mining operations would be required for tax purposes. In combination with existing value-based royalties, corporate income taxation should be sufficient to ensure that a fair share of the benefits are appropriated by Mozambique, while still offering an appropriate return on investment.

For the sake of clarity and predictability, any revision to the tax treatment of mining projects should be carried out within the framework of the law on corporate income tax. In addition, the tax provisions of the law on PPPs, concessions and mega-projects should be dropped. They do not belong to such a law and are problematic in general. In particular, Mozambique should not impose requirements on annual distribution of profits.

Securing adequate tax revenue from natural resource extraction projects will only take Mozambique half way to optimizing benefits. The management of these windfall revenues in the future will be just as important for the country's development path. Several issues will need special attention: (1) macro-economic effects; (2) cross-generational impacts and the use of windfall revenues; and (3) consequences for local communities.

A number of oil- or minerals-producing countries have successfully established stabilization funds including Chile, Norway, Oman and Papua New Guinea. In several instances, they have facilitated fiscal and macro-economic management and contributed to reduce Dutch disease effects. Mozambique should review such experiences and perhaps seek technical assistance in this respect. In addition to helping manage macro-economic effects, the stabilization fund should be used as a means to ensure transparency about revenue from mining. It should also pave the way for the elaboration of a strategy to invest windfall revenue for long-term development gains and for the establishment of a policy to compensate losses to local communities.

3. Maximizing other impacts and linkages

As indicated in chapter II, the law on PPPs, concessions and mega-projects takes a rather interventionist approach to fostering development impacts. Legal

requirements on transfers of technology, linkages and local ownership are particularly problematic and could sharply reduce Mozambique's attractiveness to foreign investors, either under mega-projects or under PPPs. An alternative approach should be adopted with the view of establishing favourable conditions for linkages, transfers of know-how and joint-ventures to take root.

As far as linkages are concerned, the experience of Mozal shows that goodwill and efforts on behalf of foreign investors are not sufficient for linkages to take place on a large scale (chapter I). Imposing legal requirements may thus be counterproductive, and better results could be achieved by focusing efforts on attracting the type of foreign investors that are most susceptible to establish linkages and on facilitating match-making between partners.

Policies to better integrate mega-projects, as well as all other foreign investments, in the local economy and maximize linkages with domestic firms should nevertheless be adopted. A number of tools and measures can be put in place that rely on the mutual interests of both parties rather than on legal requirements. Relying on such mutual interests offers significantly higher chances of success and sustainability (box III.2).

While coal is not a resource that can be subject to local transformation, there is room for Mozambique to proactively support the development of local suppliers to the main mining companies. Basic goods and services, including security, transport, catering and food supply can be outsourced to local companies and help support local communities. In the medium term, the development of large-scale mining projects could also lead to the establishment of a more elaborate cluster of engineering and mining-related services firms. A policy of maximizing impact and linkages should also focus on promoting synergies in infrastructure development (e.g. transport and electricity). Mining activities may be the driving force behind the development of key infrastructure (e.g. a railway) and make it commercially viable. Regulatory authorities should ensure that such facilities are open to non-mining companies on fair terms.

Joint-ventures can be a potent way to build local capacities, but they can only be effective if suitable local partners exist, both in terms of financial ability to participate in projects and in terms of technology. The

Box III.2. Creating business linkages in Mozambique

The CPI and UNCTAD launched a business linkages programme in Mozambique in 2008, with Enterprise Mozambique as the main operational partner to work with local SMEs. Three priority areas were selected: (1) sustainable and cultural tourism; (2) agribusiness; and (3) mining. The programme relied on the voluntary participation of all players, including leading foreign investors.

A pilot project was launched in 2008 with CDM Breweries (a subsidiary of SAB Miller, South Africa) as the anchor firm. Until then, CDM imported all the barley for its local production of beer. Under the project, CDM committed to source part of its barley locally and closely worked with 150 farmers. As a result of supplying barley to CDM, farmers diversified their sources of income and operated on a commercial footing. Average annual income rose from \$300 to \$700 with increases in productivity and improved production techniques.

The Mozambican government was involved in the project through the CPI, which coordinated activities with the Ministry of Agriculture and local authorities, with the purpose of gradually handing over of the project to local communities. UNCTAD took care of farmers training through the Empretec Mozambique Foundation. CDM provided financial support for technical testing and covered part of the costs of the pilot project. It paid salaries to farmers during the first phase, and it pre-financed the costs of seeds, pesticides and fertilizers during the second phase, thereby setting the basis for project activities to run on a quasi-commercial basis. There is ample room for expansion of linkages as CDM is willing to buy more than fifteen times the amount of barley that is currently produced. In addition, CDM is committed to set up a \$10 million malting plant in Mozambique should a critical amount of barley be produced locally.

In mining, two potential partners have been identified for UNCTAD's business linkages project: Kenmare in Nampula and Vale in Tete. Given the geographical isolation and the relatively small scale of operations, Kenmare offers good potential for linkages in agribusiness, security and small repair and maintenance shops. In contrast, Vale and other large coal mining projects have sufficient scale to create a mining cluster and achieve a critical mass for local sourcing. Opportunities exist to build a cement factory, set up specialized transport services and develop other products and services in maintenance, spare parts, safety accessories and engineering.

Key lessons that can be learned from past experience in Mozambique and elsewhere indicate that: (1) sustainable linkages only happen if they are in the mutual business interest of all parties; (2) linkages between SMEs and subsidiaries of TNCs often do not happen automatically, but can be promoted through adequate policies; (3) a conducive business environment is essential for linkages to become generalized and not isolated to a few specific cases; (4) the development of local productive capacities is crucial for linkages to take root; (5) linkages programmes can contribute to the development of clusters of suppliers, making TNCs presence more deep rooted and sustainable; (5) effective measures to promote linkages include provision of information, matchmaking, training and direct financial or technological support to SMEs; and (6) relying on a single client carries significant dependency risks for SMEs, which means that linkages programmes should also aim to diversify the clientele of local suppliers.

Source: UNCTAD.

legal requirement that 20 per cent of capital in mega-projects and PPPs be reserved for local ownership is unlikely to be workable and could deter foreign investment: the stock exchange is not sufficiently developed at the moment to allow the dissemination of large amounts of capital among small-holders, as required in the law. In addition, local partners of a

sufficient size and technological level of development are too few to meet the local participation requirements in a rising number of mining projects.

It is therefore suggested that the local participation requirement as it currently stands be dropped from the law. As an alternative measure, however, the Government could secure participation in natural resource extraction

projects as well as in major PPPs in order to share in the benefits and participate in or be informed of strategic decisions. The stabilization funds suggested above could constitute a financing mechanism to enable Government participation in mining projects as well as in PPPs.

4. Addressing institutional and promotional issues

The law on PPPs, concessions and mega-projects foresees the establishment of a dedicated PPP unit within the Ministry of Finance. As per the letter of intent of May 2010 with the IMF, the unit should introduce “gateway decision points where the consensus of the Ministry of Finance would be required before the PPP can proceed, so as to manage risk (...) and improve financial oversight”. As planned in the law, the PPP unit will indeed be focused almost exclusively on regulatory issues. Although this role is crucial, the unit should also be given a strong mandate to promote PPPs in areas beneficial to the development of Mozambique.

The promotional role of the PPP unit should focus on the identification of projects that would be susceptible to interest private investors and the elaboration of preliminary feasibility and market studies to provide “ready-made” projects for investors to pick up. At first, the unit should focus on projects of relatively moderate complexity where commercial benefits are easier to realize for investors and where the socio-economic gains for Mozambique are also concretely measurable. This would allow Mozambique not only to progressively build capacity for the management of PPPs, but also to build support for such arrangements among the population, which is critical if PPPs are to become significant in the future. As indicated in section C.4, the electricity and logistics sectors have strong potential in Mozambique and should be considered carefully by the PPP unit.

In addition, Mozambique will need to create strong formal institutional links between the PPP unit, the CPI and sectoral regulators, in particular in electricity, transport and mining. Clear mandates regarding how responsibilities and oversight roles are shared will need to be devised, while strong cooperation on promotional aspects will also have to be established. Given the specificity of PPP projects (understood as projects where the private sector is involved in the provision of goods and services of a public nature), it would be advisable

to give the overall leadership on such investments to the PPP unit. Mining projects, in contrast, would not fall within its realm of competences.

E. Institutional implications

If implemented, the reforms advocated above would generate a new qualitative leap in the investment framework following the progress achieved in the past decade, as well as a step further towards achieving sustainable development through mutually reinforcing private and public initiatives. Re-balancing Mozambique’s investment strategy and its FDI attraction efforts and adopting the regulatory reforms advocated above would also have profound implications for the CPI.

In particular, the elimination of the investment licence as a gateway to incentives and benefits means that the CPI would have to reinvent itself and shift its focus entirely on promoting investment. Far from decreasing the importance of the CPI, the reforms would boost its long-term relevance by placing it at the centre of the Government’s efforts to promote private investment by nationals and foreigners alike. A key difference, however, would be that the CPI would have to earn its relevance on a continuous basis by proving its efficiency in promoting investment and effectively serving the interests of the nation and the needs of investors.

Although its regulatory role would be eliminated, the strategy and reforms advocated here envision the CPI to be at the heart of Mozambique’s efforts to promote private investment in general, build partnerships between national and foreign investors and foster a mutually beneficial relationship between the public and private sectors, including under PPPs. The reforms would imply a culture change for the CPI and its staff as it would shift from a licence-issuing agency – a role that absorbs much of its staff and resources currently – to a structure single-mindedly focused on investment promotion.

If the Government were to decide not to eliminate the licensing requirements as recommended here, the thrust of the reforms to the CPI suggested below could nevertheless still be implemented. The majority of recommended operational changes and the shift of focus from regulation to investment promotion are

achievable and desirable regardless of the ultimate decision on the issue of investment licences.

1. Narrowing down on investment promotion

a. Key roles and functions

As highlighted in chapter II, the CPI's mandate to issue investment licences and participate in the granting of benefits and incentives leads to unavoidable tensions between these regulatory functions and the investment promotion and facilitation roles it is meant to play. A recent World Bank study based on a real-life evaluation of 181 investment promotion agencies indicates that those that combine regulatory and promotion functions consistently underperform those that do not in terms of effectiveness in investment promotion.⁶³ Incompatibilities between investment promotion and investment regulation functions are highlighted in terms of the organizational structure, staff skills, knowledge, enabling environment and internal systems. It concludes unequivocally that "the two functions are nearly incompatible, and promotion almost always suffers when they are performed by the same agency".

As the chief investment promoter in Government, the CPI would abandon its regulatory role so as to focus exclusively on attracting, promoting and facilitating national and foreign investment, and to ensure maximum value added for the economy. The core functions would be to:

- Build and promote Mozambique's image among the international investment community;
- Prospect and generate leads among targeted investors and within targeted sectors offering a good match with Mozambique's needs and economic potential;
- Help prospective foreign investors investigate business opportunities through country visits;

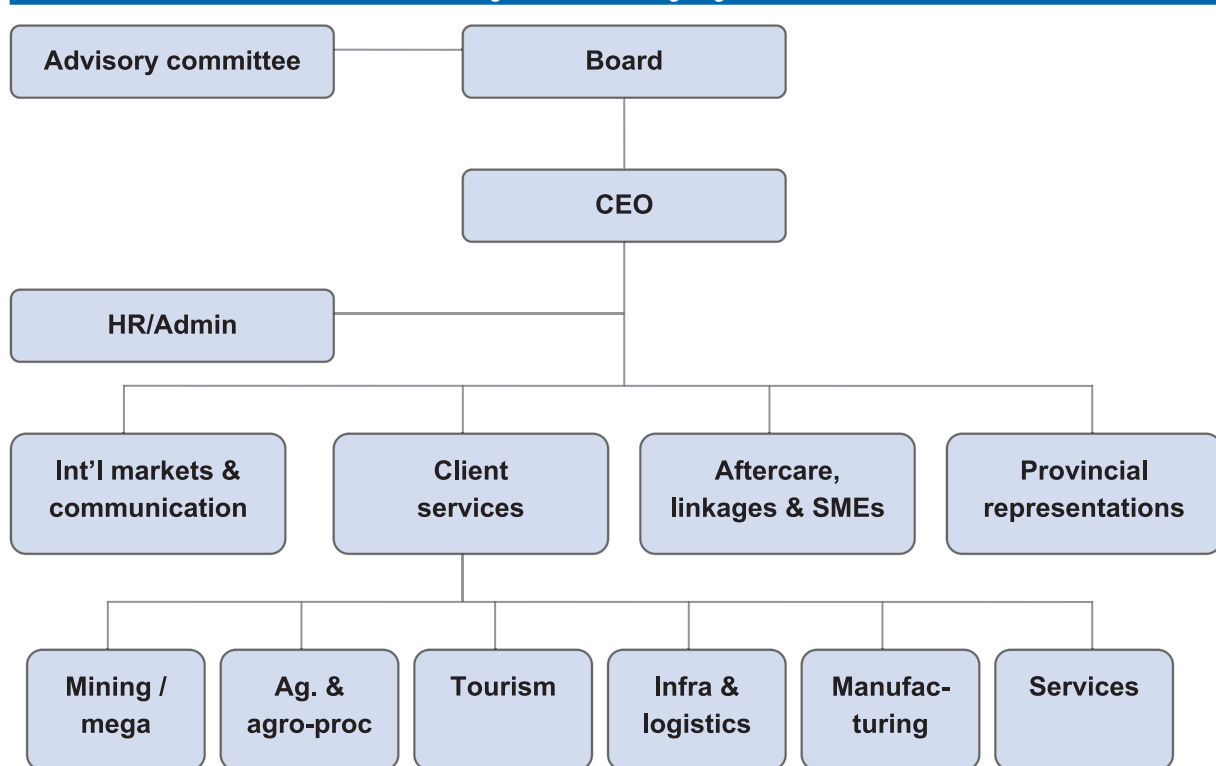
- Provide prospective investors will all the information needed to encourage a positive investment decision;
- Support new investors in their establishment procedures;
- Promote business development and growth in the post-establishment phase;
- Enhance the integration of foreign-owned companies into the local economy and foster business linkages with SMEs;
- Support and inform the work of the Special Coordinator for Investment Reform and Enterprise Development (section E.2).

The following sections suggest reforms to the CPI's organizational structure in order to enable it to perform these functions optimally. They also elaborate further on the functions and tools that can be implemented to fulfil them.

b. Structure

Under a non-regulatory based and promotion-focused programme, the CPI would best be organized around four functional departments, in addition to the human resources, administrative and corporate services department. The functional departments would be the following: (1) international markets and communication; (2) sector-based client services; (3) aftercare, linkages and SMEs; and (4) provincial representations (figure III.3). Apart from the department of project management, which is currently in charge of evaluating investments and issuing licences (by far the CPI's largest department and core function at the moment) the proposed new organigram builds significantly on the existing structure of the CPI, including its department of information and marketing and its department of business linkages (chapter II, section B.3).

Figure III.3. CPI organigram



Source: UNCTAD.

The promotion and service orientation of the new CPI and the fundamental need to closely integrate the work of the four functional departments will place customer relationship management (CRM) at the heart of the CPI's operations. In addition to treating investors as clients to be encouraged and supported, the CPI will need to significantly boost its ability to track its relationships with potential and actual investors at all stages of the investment process and across all functional departments.

The CPI is fortunate to have a comprehensive database of projects and contacts, which is the result of the quasi-obligation for sizeable formal investors to obtain an investment licence.⁶⁴ Relatively little use is made of this database at the moment, besides efforts to promote business linkages, and it is maintained with basic spreadsheet tools that do not allow CRM functions to be put in place.

As an initial but essential step in the reform of the CPI, it is recommended that modern CRM IT tools be adopted, emulating in that respect the work of other IPAs and

service-oriented businesses. The existing database would have to migrate to the new IT tool, which would constitute a starting point for the adoption of more elaborate CRM tools in the future. A variety of platforms exist with different levels of complexity, including some that are available as open-source software.⁶⁵ The CRM tool would enable the CPI to coordinate its work and build synergies among all functional departments. It would also improve the CPI's responsiveness to investor requests and the ability of staff to understand their issues, which should constitute a key differentiation for Mozambique as it seeks to build on its business-friendly reputation.

The CRM system should enable the CPI to track at any moment its relationship with every investor, including: (1) persons contacted, by whom, when and for what purpose; (2) actions taken and follow-up needed; (3) material provided to the investor; (4) details of the investors, including contacts at middle-management and upper management level; (5) investor or potential investor profile, etc. Logging all information, contacts and actions related to an investor into a common system should allow a seamless sharing of information across

departments and a high-quality service to investors, from the initial contact through to the operational phases.

The **international markets and communication** department would lead the CPI's efforts to build Mozambique's image among international investors and attract prospective investors. As such, it would manage all communication tasks, including branding and public relations, and handle investment-related events and seminars, both in Mozambique and abroad. The department would include staff in Maputo, as well as the CPI's personnel overseas. At the moment, the CPI has a representation in Brussels, Pretoria, Shanghai and in the Persian Gulf. The location of these representations will have to be reviewed regularly based on actual and prospective investment flows to ensure maximum effectiveness. The choices would have to be guided by the priorities set for the attraction of FDI offering an optimal match with Mozambique's needs and potential (section C).

In the best of circumstances, the CPI will only have a small number of dedicated overseas representations. As a result, it will be important that image building and investment promotion efforts be coordinated with the Ministry of Foreign Affairs and Mozambique's diplomatic representations. A formal cooperation mechanism should be established with the Ministry, and the CPI should not only ensure that embassies receive necessary promotional material, but also that diplomats are regularly informed of the country's investment priorities and strategies and that they receive some basic training in investment promotion.

A key function of the international markets and communication department will be to prepare and disseminate accurate fact-sheets on the investment climate as well as other marketing documents and more in-depth information on operating conditions and legal requirements. Such resources may need to be customized for overseas representatives, and should also provide province-specific information elaborated in cooperation with the CPI's provincial representations (see below).

The background information collected or prepared by the department should be disseminated using all media available to reach potential investors, including in particular the CPI's website. A key role for the department

will be to make the website informative and dynamic, i.e. regularly updated with relevant information, data, news and links to other websites. Key items to provide include: (1) major laws and regulations; (2) basic macro-economic and sectoral data; (3) indicators on factor costs; and (4) main contacts and addresses.⁶⁶

As part of its promotion efforts, the department would be in charge of managing local and international events and participation in international fairs. A key issue will be to prioritize participation in or organization of overseas events carefully, as these can be time-consuming and expensive yet generate relatively little impact in terms of investment leads. As a principle, events based on an overall presentation of FDI opportunities in Mozambique should be given a relatively low priority. Opportunities to target by sector, in turn, should be further explored in association with the client services department (see below). Sector-oriented meetings are often more effective and spare the country from organizing its own events.

The investment strategy proposed above would add to Mozambique's progress towards the establishment of an investor-friendly environment, including by further changing mentalities in regulatory institutions. Given the progress that has been achieved since 1992, Mozambique has reached the stage where efforts to build a stronger image and establish a "national brand" would be worth the investment. A number of competing investment destination in Southern Africa have already defined clear branding propositions and manage well established communication programmes internationally.

Current image-building efforts are relatively ad-hoc and do not sufficiently reflect the reality of an increasingly open investment climate and rising business opportunities. In addition, communication efforts take time to work, and the new realities about investment in Mozambique have hardly started to permeate the wide international business community.

It is not suggested that Mozambique launch a large scale branding campaign as some countries have done in Asia as this would be well beyond its means and needs, but it is important for the country to articulate a clear national brand and a general message that closely matches the reality on the ground and long-term national aspirations. It is likely that external expertise would be required to devise a communication strategy and suggest cost-

efficient dissemination channels. The strategy would seek to achieve at least the following objectives:

- Deliver the message that Mozambique is open for business and is a welcoming place for foreign investors;
- Position the CPI as a world-class service organization capable of facilitating investment;
- Highlight Mozambique's key advantages, both in general terms and for targeted sectors;
- Institute permanent communication channels with the international business community;
- Ensure that foreign media and leading opinion formers are accurately briefed on developments in Mozambique and ensure that "multipliers" (e.g. international banks, audit and accounting firms or law firms) are consistently well briefed;
- Ensure that a climate of receptivity and goodwill towards FDI is sustained within the country by communicating locally on the impact and benefits of foreign investment.

The **client services** department would be at the core of the CPI's investor targeting, investment facilitation and aftercare functions. It would lead Mozambique's efforts to diversify the types of FDI it attracts and to ensure a good match between the country's needs and business opportunities for foreign investors. In a shift away from project assessment and the issuance of investment licences, the department would focus all its efforts on facilitating the attraction, establishment and expansion of investors in priority sectors.

Responding to the needs and requests of investors requires a relatively sophisticated knowledge of the dynamics of specific sectors, and an ability to work in partnership with prospective investors to help them solve potential problems. The CPI currently lacks specific sectoral expertise, and this will have to be addressed in a number of ways, including training, new recruitments and perhaps secondments. The latter could potentially happen in two directions, with CPI staff seconded in ministries or the private sector on a short term basis, and with staff from ministries or the private sector (e.g. consulting and legal firms or banks, all of which play important roles in FDI processes) seconded to the CPI. This process would have to be carefully managed to

avoid conflicts of interest, but could generate strong benefits for the CPI and the seconding organization if properly managed.

It is important to note also that client services teams at the CPI are not intended to take on a regulatory or policy-making role. These functions are to remain the realm of line ministries and regulatory institutions (e.g. ministry of mining, ministry of transport and communications or CNELEC). The client services department would nevertheless provide a better liaison between prospective investors and the relevant ministries. The main responsibilities of the client services department would include to:

- Work with prospective and existing investors to help them find business solutions in the locations that suit them. This would require an understanding of sectoral dynamics, combined with knowledge of Mozambique's operating conditions and competitive advantages, including in terms of supply-chains, skills base, market conditions and taxation.
- Be the interface between oversight ministries and prospective or existing investors.
- Help address the tangible and intangible hurdles to investments by engaging in discussions with oversight ministries and seeking to further improve the investment climate. Sector specialists could also participate in the issues-based working groups of the CTA that are part of the consultation mechanisms between the private sector and the Government.
- Support the work of the international markets and communication department when it comes to targeting specific sectors.

Given the assessment of Mozambique's potential to attract FDI and the need to diversify away from mega-projects, it is recommended that the client services department be organized around six sectoral areas: (1) mega-projects and mining; (2) agriculture and agro-processing; (3) tourism; (4) infrastructure and logistics; (5) manufacturing; and (6) services.

International experience indicates that re-invested earnings and business development by existing foreign investors are a major but frequently underestimated source of FDI.⁶⁷ In addition, the long-term transformational benefits that developing countries can gain from FDI depend to a large extent on the good

integration of foreign-owned businesses into the local economy. The **aftercare, linkages and SMEs** department would be tasked to support investor development, encourage local value-addition, and promote business linkages with national companies, including SMEs.⁶⁸

Aftercare services would support existing investors to ensure not only that they become advocates of Mozambique as an investment destination, but also that they are successful and seek to expand. This would encompass services at the administrative (e.g. dealing with permits), operational (e.g. support to access export markets or identification of local suppliers) and strategic (e.g. identifying new business opportunities or upgrading local suppliers) levels.

The linkages functions would continue to operate much as they do currently, but with a greater emphasis on building linkages between medium-sized foreign investors and national businesses. The ability to create linkages depends to a significant extent on gap that separates foreign and national investors in terms of technology, management, size and other factors. The wider the gap, the more difficult it is to bridge it and establish strong backward and forward linkages, as demonstrated by the experience with the linkages programme with Mozal.

As a result, the department should work closely with the entire range of foreign investors to identify business solutions that can be realized within the Mozambican economy and it would assist them directly in identifying local suppliers of goods and services. Four core functions should be fulfilled by the department or other branches of Government where relevant: (1) information and matchmaking, including by maintaining updated databases of buyers and suppliers, providing advice on subcontracting or acting as honest brokers in negotiations; (2) training for SMEs; (3) technology upgrading, including through suppliers or industry associations; and (4) financial assistance.⁶⁹

In conducting its work, the aftercare, linkages and SMEs department would have to work in close cooperation with the client services department and the sector-based teams. Cooperation should be greatly facilitated by the use of a CPI-wide CRM IT platform, as recommended earlier. The linkages and SMEs department should also work closely with IPEME to ensure that all opportunities

to turn local companies into suppliers of goods and services to foreign investors are exploited.

CPI operations are currently conducted mostly from Maputo, with one-person representations in some of the largest provinces. Although the bulk of the CPI's work will inevitably continue to be conducted from Maputo, stronger local representations should help provinces implement specific aspects of their economic development strategies, based on relative strengths and assets. Reinforced **provincial representations** would enable the CPI to work more closely with provincial authorities in promoting and facilitating strategic business opportunities. They could also play an important role in the development of regional growth poles and development corridors, which have become part of the country's economic strategy.⁷⁰

Providing support services at the provincial level should not only help provinces build on their comparative advantages, but could also generate a sound emulation between provinces and within the CPI. The qualitative differences in services and support to investors and the responsiveness of CPI representations could create a genuine improvement in overall service to investors and galvanize efforts to improve the investment environment. This mild degree of competition in providing business solutions to investors should generate a "competition to the top" in service delivery. Given that essential investment regulations are determined at the national level, there is no risk that provinces would compete by providing generous incentives or benefits and drive a "race to the bottom".

c. Management, reporting lines and financing

The reforms suggested in the focus and operations of the CPI call for some adaptations in the management structure and oversight of the institution. They would also have major implications on its sources of financing. In order to drive the culture change within the CPI and single-mindedly focus it on investment promotion, the Chief Executive Officer (CEO) of the CPI would focus on operational issues and the day-to-day running of the agency.

The CEO would manage investment projects and relationships with investors. The sector teams in the client services department would report directly to him/her in the first instance, as it would be valuable for the CEO to be directly linked with all teams and have a close

and hands-on relationship with prospective and existing investors. At a later stage, it may become necessary to appoint a director for the client services department as the workload increases.

The CEO would also have the main responsibility for the marketing and promotional campaigns, and would be in charge of driving the culture change within the CPI. Consequently, it is recommended that (s)he have a private sector background and be fully acquainted with the concerns of international investors.

The CPI is currently under the oversight of the Ministry of Planning and Development. In order to reflect the fact that investment affects – and depends on – a wide range of issues that cut across ministerial lines, from the environment to labour and tax to competition, it is recommended that the CPI be placed under the oversight of a dedicated board. This board, to be chaired by a newly established Special Coordinator for Investment Reform and Enterprise Development (see below), would be composed of senior officials from ministries and public institutions that are important stakeholders in investment policy, including: (1) the Ministry of Planning and Development; (2) the Ministry of Finance; (3) the Ministry of Labour; (4) the Ministry of Mineral Resources; (5) the Ministry of Transport; (6) the Ministry of Energy; (7) the Ministry of Agriculture; (8) the Ministry of Tourism; (9) the Ministry of Foreign Affairs; and (10) the Ministry of Education. The CEO would be an active member of the Board as well.

Putting the CPI under the oversight of a board would serve multiple purposes, including a buy-in of all relevant Ministries into investment promotion issues, a better coordination of policies and facilitation efforts, and the dissemination of a change in regulatory attitudes. Establishing a board could also help build consensus within Government to support the policy agenda on investment, in conjunction with other national priorities. The board would conduct standard oversight functions (including verification of accounts), would define the CPI's overall strategy and appoint the CEO.

The work of the Board could be supported by an advisory committee, to be comprised of key private sector representatives whose businesses have interests in Mozambique and who command respect within the wider business and development community. High-level business people active in priority sectors of the

Mozambican economy would constitute the core of the committee. A small number of representatives from international development agencies and/or experienced academics and members of civil society would also bring valuable contributions to the advisory committee, which would serve two key purposes:

- Provide objective advice on the investment climate in Mozambique, and the competitiveness of the country against alternative investment locations. This would be used as inputs into the formulation of recommendations on legislative and other changes to improve the overall investment climate.
- Inform the work of the CPI in terms of image building, investor targeting and investment facilitation services.

As indicated earlier, the recommendation to eliminate investment licences would have major financial implications for the CPI as around 60 per cent of its funds originate from project licensing fees. If the proposed reforms to the investment law and the CPI are implemented, it will therefore be essential that adequate resources are allocated directly from the general government budget. Funds should be guaranteed in the long term in order to ensure proper continuity in investment promotion efforts, and determined upon recommendation from the board.

2. Driving reforms in investment policy and regulations: a whole-of-government approach

The best investment strategy and reform programme in the world are useless unless they are translated into concrete actions and improvements in the business climate. Specific plans and institutional arrangements must therefore be made to move from words to action and to monitor progress towards concrete objectives. Implementing investment strategies, policies and regulations geared towards the achievement of national development goals also requires a high degree of coordination and coherence among a wide range of issues that cut across ministerial lines. In turn, ensuring that policies and regulations are effective in achieving desired outcomes also calls for permanent evaluation and adjustments.

This Review recommends significant reforms in terms of strategy and in the regulatory and institutional

framework, which would have considerable implications for the Government moving forward. 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 be in charge of organizing the implementation of the country's investment strategy and the associated regulatory reforms and ensure that optimal synergies are achieved. This would require considerable time commitment and call for much advocacy work with senior Government officials. (S)he would have the primary responsibility for liaison with the ministries whose activities impact on investment, and will play an important role in championing legislative and other changes needed to attract higher inflows of beneficial FDI and improve the general investment climate for all investors.

The Special Coordinator would chair the Board of the CPI and work in close cooperation with the CEO of the CPI. Separating the two functions would enable the CEO to focus exclusively on operational issues and on investment promotion, without having to devote time to advocacy and matters of legal and institutional reforms. 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.

3. Building a stronger public-private partnership and dialogue

Mozambique has established a formal dialogue between the Government and the private sector for more than a decade. The principal 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, including usually the President, the Prime Minister and most of the Cabinet. The 12th conference was organized in November 2010, with the CTA taking the leadership in channeling private sector views to the Government.

The consultative mechanism also operates on a more frequent basis around the work of CTA-led thematic working groups focusing on nine themes, including agri-business, fiscal policy, transports and tourism. Working groups are meant to meet on a monthly basis

with focal points within the relevant Ministries, on a quarterly basis with the Minister and on a semi-annual basis with the Prime Minister. In addition, the CTA holds regional meetings for its members to deal with issues at the provincial level.

This elaborate system of consultations is very useful and well-thought out. It should nevertheless be further improved to ensure that the views of the private sector as a whole are heard and duly taken into consideration. As currently organized, the public-private dialogue relies almost entirely on the CTA on the private sector side. Other associations, including the Chamber of Commerce of Mozambique and other chambers of commerce based in the country, are left mostly aside. It would be worth giving them a more significant role in the dialogue to ensure the widest possible representation of the private sector.

In addition, it is important that the Government ensure a wide and early dissemination of key draft laws in order to give sufficient time to the private sector to form views and provide detailed feedback. As highlighted in section B.1, the Government should strive to regulate businesses as partners for development and should thus consider very carefully the views of the private sector on draft legislation and be open to revise drafts if necessary.

Although they serve a useful purpose, the impact of annual conferences should also not be overestimated as they tend to be formatted events more than an opportunity to engage in serious dialogue. Given the presidential nature of Mozambique's political system and the prominence of the President in shaping economic and social policy, it could also be useful to establish a formal and direct dialogue between the President and the private sector. A number of African countries have established Presidential Councils on investment to allow the President to be directly in touch with the needs and concerns of the business community with significant success.⁷¹ Ideally, members of the council would be appointed for relatively short terms (not to exceed two or three years) and would represent the entire span of Mozambique's business sector, including all sectors, small and large companies and national and foreign investors. To be effective, the council would have to meet on a semi-annual basis. It would support the implementation of the country's investment and development strategy, and could be the starting point

for the implementation of the partnership approach to business regulation advocated earlier.

F. Conclusion and plan of action

Mozambique has achieved a remarkable economic recovery since the end of the civil war in 1992. Unlike many other post-conflict developing countries, it also succeeded in attracting large-scale foreign investments, most notably Mozal and Sasol, and FDI in infrastructure, which made a significant contribution to the economy. As a result, poverty has started to decline and most social indicators have improved. Recent data suggest that the declining trend in poverty has stalled, however, and Mozambique remains one of the poorest countries in the world. In spite of all the progress achieved over the past two decades, the challenges remain vast, including in terms of absolute poverty reduction, inequality and human development.

The country is at a crossroad and Mozambique needs to build on the successes of the past twenty years while recognizing the flaws, limitations and failures of past strategies and policies. In particular, the rapid development of the mining sector offers major opportunities, but also entails significant risks if not adequately managed. In this context of the emergence of natural resources extraction on a large scale, the long-term prospects for the country and its socio-economic development will be determined by strategic and policy choices implemented in the next few years.

Inclusive growth, widespread poverty reduction and socially and environmentally sustainable development

need to be underpinned by a diversified economy, which can only be created the promotion of private investment across the board and by strong public-private partnerships. Mozambique has a strong potential to attract larger and more diversified foreign investments, as illustrated by the performance over the past few years. Given the right environment and conditions, FDI could make a very significant contribution to Mozambique's development objectives. A number of strategic actions are called for, however, in order to leverage the country's potential to its full extent. In particular:

- SME foreign investors and local SMEs should receive much higher strategic and policy attention, and linkages between the two actively promoted;
- The inherent regulatory bias against small-scale investors should be removed in favour of a facilitator function;
- The inherent limitations of mega-projects should be recognized, even though they should continue to be promoted;
- Investments in natural resources extraction should be particularly carefully managed.

Table III.2 summarizes the main recommendations and concrete actions of this review. They are organized around 14 main themes. Recommendations are rated in terms of priority and financial implications. Indications on time horizons involved, regulatory implications and lead agencies are also provided. They are intended to serve as the basis for a plan of actions in the short and medium term for investment promotion and FDI attraction.

Table III.2. Summary of recommendations and plan of action for implementation

Issue	Recommendations and actions	Priority level	Time horizon	Regulatory implications	Financial implications	Lead agency(ies)
1. Reform the law on investment						
	1.1 Remove the CPI licensing requirement	★★★★	S-MT	Amend law on investment	++	Ministry of Planning and Development (MPD) and CPI
	1.2 Provide tax and non-tax incentives based on pre-defined criteria unrelated to licensing requirements	★★★★	S-MT	Amend law on investment, law on corporate income tax and law on fiscal incentives	++++	MPD, Ministry of Finance (MoF)
	1.3 Eliminate contractual stability clauses	★★★★	S-MT	Amend law on investment	++	MPD
	1.4 Establish a level playing field for all investors: provide equal treatment to all under the law on investment	★★★★	S-MT	Amend law on investment and other laws affecting investors or various sizes	+	MPD, other line ministries
	1.5 Provide internationally accepted standards of treatment and protection to all foreign investors, regardless of size and sector	★★★★	S-MT	Amend law on investment	+	MPD
2. Improve provisions on transfers of foreign exchange for foreign investors and allow them to manage funds more flexibly						
	2.1 Guarantee the right to repatriate earnings and capital for all foreign investors, independently from the CPI licence, but subject to complying with tax and other obligations	★★★★	ST	Amend law on foreign exchange (and regulations) and law on investment	+	Bank of Mozambique (BoM), MoF
	2.2 Remove obligation to convert foreign exchange earnings into meticais and allow foreign exchange holdings in domestic accounts	★★★★	ST	Amend law on foreign exchange and its regulations	+	BoM, MoF
	2.3 Treat all foreign investors equally, with special foreign exchange regime only for EPZs and IFZs	★★★	ST	Amend law on foreign exchange and its regulations	+	BoM, MoF
	2.4 Harmonize provisions on foreign exchange operations contained in all relevant laws	★★	MT	Amend law on investment and other laws as needed	+	BoM, MoF
3. Reform tax and incentives policy to achieve strategic objectives, including revenue generation						
	3.1 Define a tax strategy to underpin the country's investment and development goals	★★★★	S-MT	n.a.	+	MoF, Cabinet
	3.2 Cut sectoral incentives	★★★★	S-MT	Amend law on corporate income tax and overhaul law on fiscal incentives	++++	MoF
	3.3 Establish targeted incentives to achieve priority development goals and offer them on a non-discriminatory basis	★★★★	S-MT	Overhaul law on fiscal incentives	++++	MoF
	3.3 Consider a small reduction in the headline corporate income tax rate	★★★	S-MT	Amend law on corporate income tax	++++	MoF
	3.4 Eliminate tax stabilization clauses	★★★★	S-MT	Amend law on investment	++	MoF
	3.5 Ensure adequate revenue generation from natural resource extraction and account for tax specificities of investments in natural resources	★★★★	S-MT	Amend law on corporate income tax	++	MoF, Ministry of Mineral Resources
	3.6 Establish clear transfer pricing rules	★★★	S-MT	Amend law on corporate income tax and adopt specific regulations and directives	+++	MoF, ATM
	3.7 Build capacity at ATM to monitor and enforce transfer pricing rules	★★★	MT	n.a.	++	ATM
	3.8 Ensure rapid and effective VAT refunds	★★★★	ST	n.a.	++	ATM

Issue	Recommendations and actions	Priority level	Time horizon	Regulatory implications	Financial implications	Lead agency(ies)
4. Streamline licensing procedures, reform regulatory attitudes and support SMEs						
	4.1 Undertake systematic review of licensing requirements and procedures, including through international benchmarking and using the World Bank's Doing Business indicators	★★	MT	n.a	+	Cross-ministerial
	4.2 Eliminate licences that do not serve a genuine and necessary regulatory purpose, or are redundant	★★	MT	Amend relevant laws and regulations	+	Cross-ministerial
	4.3 Enhance the use of IT tools in regulatory procedures in the context of an e-governance strategy	★★	MT	n.a	++	Cross-ministerial
	4.4 Implement UNCTAD's e-regulations tool	★★	MT	n.a	+	Cross-ministerial
	4.5 Foster a change in mentality in regulatory institutions, including by preparing "client charters"	★★★	S-MT	n.a	++	Regulatory agencies
	4.6 Support SME creation and development, together with linkages with foreign investors	★★★★	S-MT	n.a	+++	MPD, IPEME, CPI
5. Foster fair and effective competition						
	5.1 Adopt the law on competition	★★★	ST	Adopt draft law on competition	+	Parliament
	5.2 Establish an independent competition authority, working in cooperation with sectoral regulators	★★★	S-MT	Prepare status of competition authority	+++	Ministry of Industry and Commerce, competition authority
	5.3 Reduce barriers to entry	★★★	S-MT	n.a	+	Cross-ministerial
	5.4 Educate business community on competition issues	★★	S-MT	n.a	++	Competition authority
6. Facilitate access to land and DUATs						
	6.1 Establish fully- or partially-serviced industrial zones at the provincial and/or municipal level, in partnership with private developers	★★	MT	n.a	++	Provincial and municipal authorities
	6.2 Simplify the procedures for the attribution of DUATs	★★	S-MT	Amend regulations to the land law	+	Ministry of Agriculture
	6.3 Consider limited and supervised exceptions to the non-transferability of DUATs to enable their use as collateral by small holders	★★	LT	Amend the land law and perhaps the Constitution	+	Ministry of Agriculture
7. Facilitate access to skills and promote skills transfers						
	7.1 Establish nationwide and occupation-based quotas of work permits for skills in high-demand and in short supply among nationals	★★★★	S-MT	Amend labour law and law on immigration	+	Ministry of Labour, MPD
	7.2 Grant work-permits through a semi-automatic and simplified procedures for requests within quota	★★★★	S-MT	Amend labour law and law on immigration	+	Ministry of Labour, Ministry of Interior
	7.3 Unify work and residence permits for periods of up to 3 years	★★	ST	Amend labour law and law on immigration	+	Ministry of Labour, Ministry of Interior
	7.4 Establish stronger and faster mechanisms for credential and character checks	★★	MT	Amend regulations and directives on immigration	+	Ministry of Interior

Issue	Recommendations and actions	Priority level	Time horizon	Regulatory implications	Financial implications	Lead agency(ies)
	7.5 Establish a labour-market testing scheme to enable workers to be recruited beyond the quotas if needed	★★★	S-MT	Amend labour law and law on immigration	+	Ministry of Labour
	7.6 Put in place a key positions scheme to entitle foreign companies to recruit top managers overseas	★★★	S-MT	Amend labour law and law on immigration	+	Ministry of Labour, MPD
	7.7 Create an entrepreneur scheme to attract skilled individuals with capital and a clearly defined business project in Mozambique	★★★	S-MT	Amend labour law and law on immigration	+	Ministry of Labour, MPD
	7.8 Promote training and transfers of skills, including through a nationwide training fund and a small tax on foreign workers' payroll	★★★	S-MT	To be determined	+++	Ministry of Labour, MoF
	7.9 Support the establishment of technical and vocational schools in partnership with private investors and based on an assessment of the economy's needs and opportunities	★★★		n.a.	++	Ministry of Education and other relevant ministries
8. Adopt development and promotion strategies in key sectors and target matching FDI						
	8.1 Prepare or update carefully crafted policies to support national investment and promote FDI in sectors with utmost development impact, including: (1) agriculture; (2) agro-processing; (3) tourism; (4) infrastructure and logistics; and (5) small-scale manufacturing and services	★★★	M-LT	To be determined	+	Relevant ministries, CPI
	8.2 Agriculture and agro-processing: adopt principles for responsible agricultural investment, protect long-term food security, ensure full transparency in land deals, foster contract farming under protective framework for small holders, and promote synergies with other investments	★★★	S-M-LT	To be determined	+	Ministry of Agriculture, CPI
	8.3 Tourism: facilitate access to skills in niche markets, foster skills building, facilitate small-scale investments and seek regional synergies	★★★	S-M-LT	To be determined	++	Ministry of Tourism, CPI
	8.4 Infrastructure and logistics: improve the regulatory framework for infrastructure development (in particular for PPPs), improve customs administration and benchmark its performance internationally, review transport regulations at the regional level and review the freeport regime	★★★	S-M-LT	To be determined	++	Ministry of Transport & Communications, CPI
	8.5 Small-scale manufacturing and services: facilitate small-scale investments, develop industrial and services parks with private developers	★★★	S-M-LT	To be determined	++	Ministry of Industry and Commerce, CPI
9. Reform the regulatory framework for PPPs						
	9.1 Abrogate the PPP, concession and mega-projects law as it currently stands	★★★	ST	Abrogate law on PPPs	+	Parliament
	9.2 Prepare a new law dealing exclusively with PPPs, adapting global best practices to Mozambique's context	★★★	ST	Draft new law on PPPs	+	MoF, MPD
	9.3 Restrict the scope of the new PPP law to projects where private investors are involved in the provision of goods and services of a public nature	★★★	ST	Draft new law on PPPs	+	MoF, MPD

Issue	Recommendations and actions	Priority level	Time horizon	Regulatory implications	Financial implications	Lead agency(ies)
	9.4 Avoid imposing unnecessary or impractical blanket requirements on local ownership	★★★★	ST	Draft new law on PPPs	+	MoF, MPD
	9.5 Avoid the multiplication of taxes and fees, focus on taxation through corporate income tax and concession fees	★★	ST	Draft new law on PPPs	+	MoF, MPD
	9.6 Govern purely commercially-oriented mega-projects like all other projects, including sector-specific regulations (e.g. mining)	★★★★	ST	Draft new law on PPPs	+	MoF, MPD
10. Proactively promote PPPs and leverage private investment for infrastructure development						
	10.1 Build a strong promotional component into the future PPP unit, in addition to its oversight and regulatory role	★★★	S-MT	Draft new law on PPPs	+	MoF
	10.2 Identify a pipeline of projects and prepare preliminary feasibility studies, focusing on the "low-hanging fruits" with strong commercial viability, limited technical complexity and demonstrable socio-economic gains for Mozambique	★★★	S-MT	n.a.	+++	PPP unit, CPI
	10.3 Proactively promote projects in the pipeline internationally	★★	S-MT	n.a.	++	PPP unit, CPI
	10.4 Establish formal institutional links with the CPI	★★	S-MT	n.a.	+	PPP unit, CPI
11. Maximize the impact of natural resources extraction (mega) projects under sector-specific regulatory framework						
	11.1 Regulate mining projects strictly under sector-specific rules, not under the PPP law	★★★★	ST	Amend mining law if necessary and draft new law on PPPs	+	Ministry of Mineral Resources
	11.2 Maximize the impact of mining investments and secure a "fair share" of benefits through the adoption of sector-specific tax provisions, including royalties, corporate income tax rates or production-sharing agreements	★★★★	ST	Amend law on corporate income tax	+++	MoF, Ministry of Mineral Resources
	11.3 Build on the experience of a few successful countries to adequately manage the mineral resources rent and avoid Dutch disease, including through the establishment of a stabilization fund	★★★★	S-MT	n.a.	+++	MoF
	11.4 Promote synergies with mining projects for infrastructure development, in particular in transport and electricity	★★★★	MT	n.a.	+	Ministry of Transport & Communications, Ministry of Mineral Resources
	11.5 Foster local sourcing of basic goods and services by mega-projects and promote the development of a higher value-added cluster of support services to mining companies in the medium term	★★★★	S-MT	n.a.	++	Ministry of Mineral Resources, MPD, CPI, IPEME
12. Narrow down the CPI on investment promotion						
	12.1 Remove the regulatory function from the CPI	★★★★	S-MT	Amend law on investment	++	MPD
	12.2 Secure adequate financial resources for the CPI to compensate for the loss of revenue from investment certification fees	★★★	S-MT	n.a.	++	MPD
	12.3 Focus the work of the CPI on image-building, lead-generation, investor targeting, facilitation, business development, aftercare and linkages	★★★★	S-MT	Amend resolution 26/2009	+	CPI

Issue	Recommendations and actions	Priority level	Time horizon	Regulatory implications	Financial implications	Lead agency(ies)
	12.4 Structure the CPI around four operational departments: (1) international markets and communication; (2) client services; (3) aftercare, linkages and SME development; and (4) provincial representations	★★★	S-MT	Amend resolution 26/2009	+	CPI
	12.5 Introduce full-fledged customer relationship management (CRM) IT tool to enhance quality of services to investors	★★★	ST	n.a.	++	
	12.6 Build strong sectoral orientation and competence in the client services department	★★★	S-MT	n.a.	++	CPI
	12.7 Mandate the CEO to manage investment projects and relationships with investors	★★★	S-MT	n.a.	+	CPI
13. Advocate and drive reforms in investment policy and regulations through a whole-of-government approach						
	13.1 Put the CPI under the supervision of a dedicated board with representation from wide range of ministries with a stake in investment-related issues	★★★	ST	Amend resolution 26/2009	+	MPD
	13.2 Establish an advisory committee with members from the private sector	★★★	S-MT	Amend resolution 26/2009	+	CPI
	13.3 Establish a position of Special Coordinator for Investment Reform and Enterprise Development within either the President's office of the Prime Minister's office	★★★	S-MT	n.a.	+	Presidency, Prime Minister's office
	13.4 Mandate the Special Coordinator to organize the implementation of Mozambique's investment strategy and the associated regulatory reforms, so as to ensure that optimal synergies are achieved	★★★	S-MT	n.a.	+	Presidency, Prime Minister's office
14. Strengthen the public-private dialogue						
	14.1 Systematically consult the business community and other stakeholders in preparing or amending key regulations, providing sufficient time for feedback and adopting comments/suggestions when warranted	★★★	ST	n.a.	+	MPD, CPI
	14.2 Widen the scope of consultations on the private sector side, without relying exclusively on the CTA	★★	S-MT	n.a.	+	MPD, CPI
	14.3 Avoid strong reliance on formatted events like the annual conference and consider the establishment of a Presidential Council on Investment	★★★	S-MT	n.a.	+	Office of the President

Source: UNCTAD.

Notes

- ⁴⁶ The working age population as defined here includes men and women between the ages of 20 and 59. Projections are from the United Nations Population Division, World Population Prospects.
- ⁴⁷ Some specific exceptions might apply, including in particular in mining or for large concession agreements or PPPs, but these can be dealt with in specific legislation.
- ⁴⁸ See <http://cabo Verde.eregulations.org/> and <http://rwanda.eregulations.org/>
- ⁴⁹ UNCTAD (2011) provides lessons on how to integrate FDI in the skills development process.
- ⁵⁰ International Labour Organization: www.ilo.org/public/english/bureau/stat/isco/index.htm
- ⁵¹ Many developed countries have established this kind of investor visa. In the United States, for example, the E-2 visa requires a “substantial capital investment” to be made. Although no minimum amount is defined by law, projects below \$100 000 require a very strong supporting case to have a chance to be accepted.
- ⁵² Altenburg (2011) provides a useful discussion of experiences and challenges in industrial policy making in developing countries.
- ⁵³ All the data used in this section are from the FAOstat database unless otherwise indicated. The database is available at <http://faostat.fao.org>.
- ⁵⁴ Based on UN COMTRADE data.
- ⁵⁵ World Bank (2011b).
- ⁵⁶ UNCTAD (2009) provides useful policy lessons on how to manage FDI in agricultural production and optimize the developmental impact of TNC involvement in agriculture.
- ⁵⁷ The seven principles are: (1) existing rights to land and associated natural resources are recognized and respected; (2) investments do not jeopardize food security but rather strengthen it; (3) processes for accessing land and other resources and then making associated investments are transparent, monitored, and ensure accountability by all stakeholders, with a proper business, legal and regulatory environment; (4) all those materially affected are consulted, and agreements from consultations are recorded and enforced; (5) investors ensure that projects respect the rule of law, reflect industry best practice, are viable economically, and result in durable shared value; (6) investments generate desirable social and distributional impacts and do not increase vulnerability; (7) environmental impacts due to a project are quantified and measures taken to encourage sustainable resource use while minimizing the risk/magnitude of negative impacts and mitigating them. Additional information can be found at: www.responsibleagroinvestment.org/rai
- ⁵⁸ Data from the World Tourism Organization indicate that South Africa attracted 9.1 million visitors in 2007, including 2.1 million from outside the continent. Botswana attracted 1.5 million visitors in 2004 (170 000 from outside Africa), the United Republic of Tanzania attracted 720 000 tourists in 2007 (413 000 from outside Africa) and Zambia was visited by 900 000 people in 2007 (236 000 from outside Africa).
- ⁵⁹ A number of developing countries have had mixed experiences with export-oriented FDI in export processing zones offering high levels of tax exemptions. Some of these investments have proved to be driven not by market fundamentals but by temporary tax incentives and market access on preferential terms. As a result, they have not been sustainable, have not been integrated with the local economy and have generated little more than temporary job creation.
- ⁶⁰ In particular, logistics companies may not necessarily comply with the 70 per cent export requirement for EPZs, for example if they offer warehousing services for the domestic market.
- ⁶¹ The contractual forms of PPPs include service contracts, management contracts, build-operate transfer (BOT), build-own-operate-transfer (BOOT), rehabilitate-operate-transfer (ROT), build-transfer-operate (BTO) and others.
- ⁶² With the exception of the simplified regime applicable to small and micro businesses, whose aim is to encourage formalization of the economy.

⁶³ World Bank (2011a).

⁶⁴ Although section B recommends that the licensing requirement be dropped, it also proposes to enforce a simple registration requirement, which would help the CPI maintain a comprehensive database of projects.

⁶⁵ www.sugarcrm.com, www.opencrx.org, www.vtiger.com, are among the numerous open source software packages.

⁶⁶ Wherever possible, the CPI should make maximum use of high-quality material prepared by third parties. As far as laws and regulations are concerned, for example, the Associação de Comércio e Indústria (ACIS) prepares comprehensive guides on various issues affecting the investment framework (labour, taxation, company start up and others) that deserve to be more widely used and disseminated by the CPI.

⁶⁷ See in particular UNCTAD (2007a).

⁶⁸ Some of these functions are carried out at the moment by the department of business linkages, but with a relatively weak emphasis on aftercare services. The department has also focused much of its efforts on the linkages programme with Mozal, with less emphasis on economy-wide backward and forward with foreign investors as a whole.

⁶⁹ See UNCTAD (2010) for more details on policy options and country experiences in building linkages.

⁷⁰ A recent technical assistance project from the World Bank assesses the prospects for the development of growth poles in Mozambique and proposes strategies at the provincial level (World Bank, 2010b).

⁷¹ This is the case for example in Ghana, Uganda and the United Republic of Tanzania.

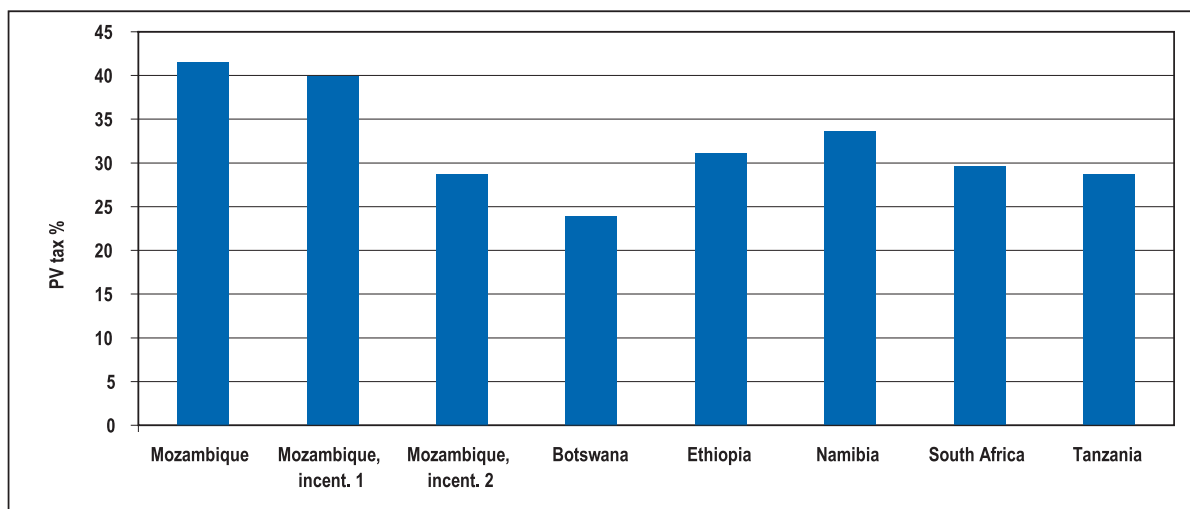
ANNEX I: INTERNATIONAL CORPORATE TAX COMPARISON

UNCTAD developed a simple modeling tool to assess the burden of corporate income taxation on investors. It measures the amounts paid in corporate taxes as a percentage of the total cash received from the project by a foreign investor, in net present value terms (see annex II on methodology). The model uses hypothetical business plans in 13 sectors and enables international comparisons on a comprehensive and objective basis, going well beyond simple comparisons of headlines corporate income tax rates. The modeling is based on projects fully financed by a foreign investor, which means that withholding taxes on dividend payments abroad play an important role, in addition to income taxes paid at the company level.

The modeling was conducted for 13 sectors⁷² and using Botswana, Ethiopia, Namibia, South Africa and the United Republic of Tanzania as comparators. The results are presented below for four key sectors: agriculture, agro-processing, manufacturing and tourism.

The modeling shows that the general level of taxes imposed at the corporate level (income tax and tax on dividends) are relatively high in Mozambique compared to countries in the region. In most instances, the present value of taxes in the base case (excluding potential incentives) represents more than 40 per cent of the cash flow to the investor, pre-tax and post-finance.

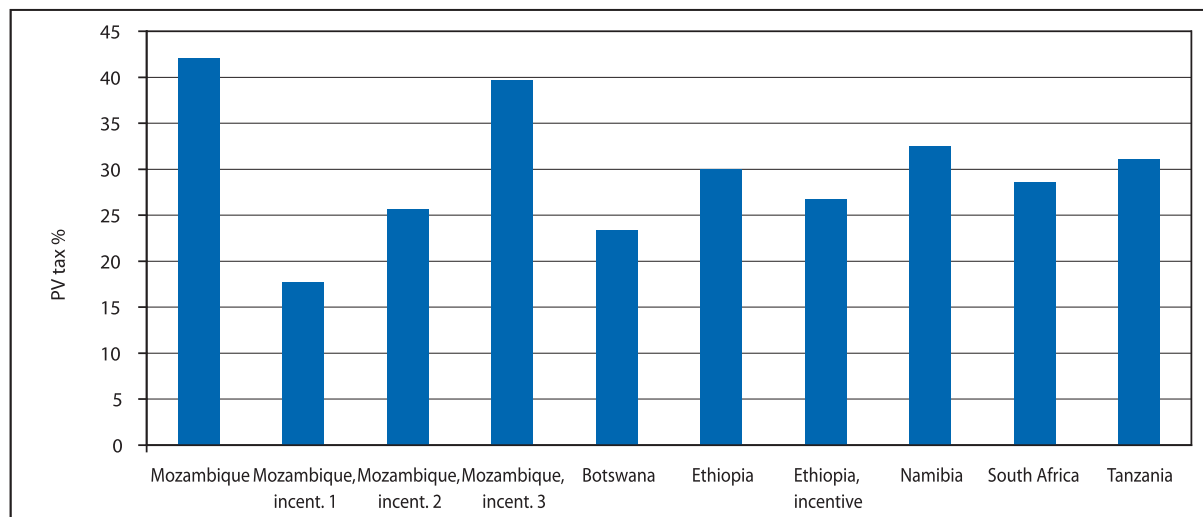
Figure A.I.I. Tax burden comparison: agriculture



Source: UNCTAD.

As indicated in chapters II and III, however, Mozambique maintains a large number of tax incentives that affect most sectors of the economy. When these incentives are taken into account, Mozambique appears to impose a tax burden on investors that is similar to that of comparator countries. Tourism appears to be an exception, however, as incentives in the sector are relatively limited.

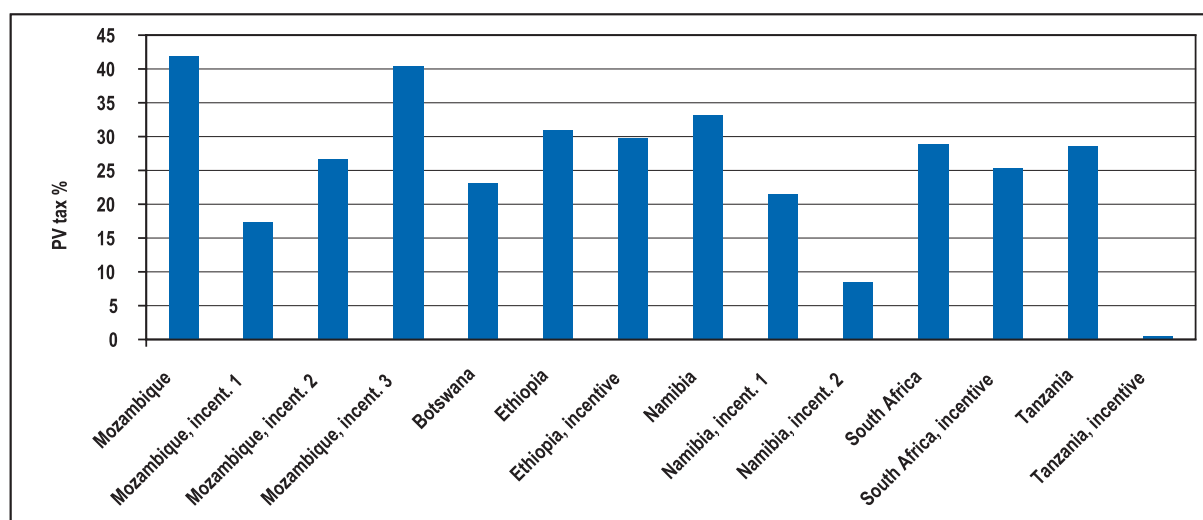
Figure A.I.II. Tax burden comparison: agro-processing



Source: UNCTAD.

It therefore clearly comes out of the modeling that Mozambique uses its widespread scheme of incentives to compensate for a base case that is rather unfavourable to (foreign) investors. As indicated in chapters II and III, this situation is far from optimal as it introduces economic distortions, reduces transparency, increases administrative burden on the tax authorities and investors alike, and discriminates against investors that are unable to access incentives, including in particular investors of a limited size. In contrast, comparator countries offer a much smaller set of incentive, but provide a base case that imposes a lower tax burden on investors.

Figure A.I.III. Tax burden comparison: manufacturing

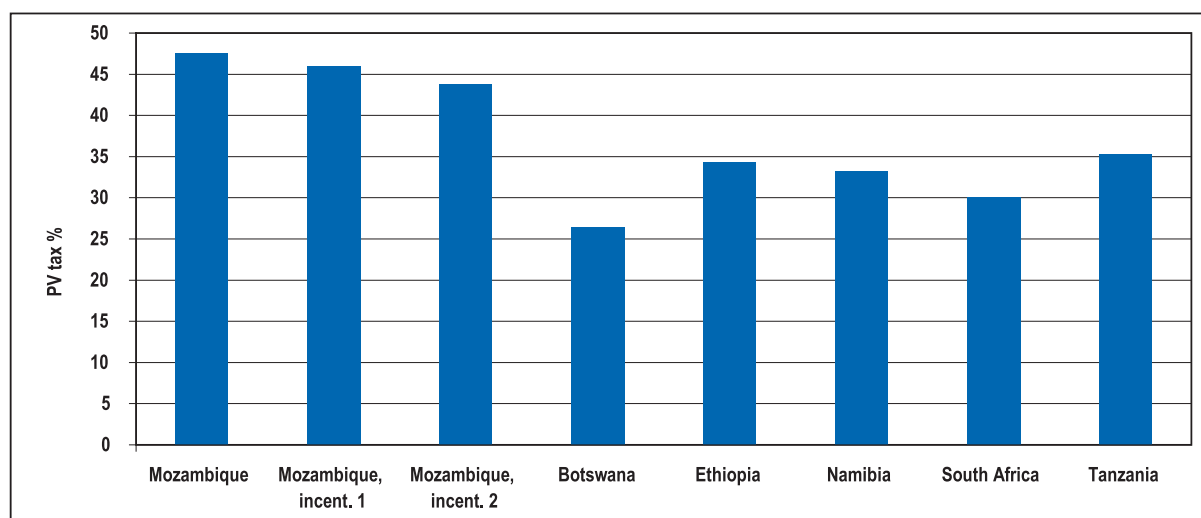


Source: UNCTAD.

It must be noted also that the high dividend withholding tax of 20 per cent plays an important role in increasing the tax burden on foreign investors. When cumulated with the taxation of income at the corporate level, this double

level of taxation for foreign shareholders constitutes a competitive handicap in attracting FDI in Mozambique. While dividend withholding tax rates in Mozambique can be reduced through double taxation treaties, only six such treaties have been concluded so far (chapter II), with rates of 15 per cent (4 cases), 10 per cent (1 case) and 0 per cent (1 case) applying. In contrast, comparator countries apply non-treaty rates of 10 per cent (4 cases) or 7.5 per cent (1 case).

Figure A.I.IV. Tax burden comparison: tourism



Source: UNCTAD.

This comparative analysis supports the recommendation offered in chapter III to introduce additional reforms in the corporate income tax regime, with the view of providing a lower tax burden under the base case, while at the same time eliminating the comprehensive set of sectoral incentives. As the experience of countries that have engaged in such reforms in recent years show, this is susceptible to increase tax revenue, while at the same time promoting investment, reducing economic distortions and fighting tax evasion.

Notes

⁷² Agriculture, agro-processing, business services, consumer electronics, entertainment, fisheries, health, ICT, international financial services, manufacturing (garments), regional headquarters, regional logistics and tourism.

ANNEX II: METHODOLOGY OF INTERNATIONAL CORPORATE TAX COMPARISONS

The Comparative Taxation Survey compares taxation on investment in several sectors in Mozambique with taxation in other selected countries – neighbours and countries elsewhere that have succeeded in attracting FDI to the sectors concerned. These comparisons enable Mozambique to assess the competitiveness of its taxation.

Taxation affects the cost of investment and its profitability, and thus the return on investment. This impact is not just a question of looking at the headline rate of tax on profits. The tax burden on the investor depends on a number of factors and their interaction, including expenses allowed, rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss-carry-forward provisions and the taxation of dividends among other things. Together, these make up the overall fiscal regime that affects the cost of and return on investment.

Comparative tax modelling is a method of taking into account the most important of these variables in the fiscal regime in a manner that facilitates comparison between countries. The tax variables included in the analysis are:

- Corporate income tax;
- Rate of tax including tax holidays, if any;
- Loss-carry-forward provisions;
- Capital allowances, investment allowances and investment credits;
- Tax on dividends.

VAT, sales tax and import duties are not considered in this analysis.

Financial models of project investment and financing, revenues and expenses are utilized for a hypothetical business in each sector. These are based on typical costs and revenues experienced in such businesses in a developing economy. The business models cover a selected business within each sector.

The fiscal regime in Mozambique and the chosen comparator countries for each sector is applied to the standard business model for each sector over 10 years beginning with the initial investment. The financial models calculate net cash flow to the investor, assuming that the company pays out all residual profits after tax (100 per cent dividend pay out) and that the investor gains the residual value of the company, which is sold after 10 years for an amount equal to its balance sheet value.

The impact of the fiscal regime is presented as the present value of tax (PV tax per cent). PV tax per cent is the total of taxes collected by the government over the 10 years as a percentage of the project cash flow pre-tax and post-finance where both cash flows are discounted to a present value at a rate of 10 per cent per annum. PV tax per cent thus measures how much of an investor's potential project return is taken by the Government in taxes and duties. The higher the PV tax per cent, the more the fiscal regime burdens investors and reduces the incentive to invest.

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