

## 4. Policy Recommendations

To meet its poverty reduction goals Mozambique must see broad based private sector investment. It is not enough to merely create more jobs. To effectively raise living standards, there must be more productive jobs that will lead to higher incomes. Government policies should focus on creating an enabling environment that encourages investment and supports efforts to raise productivity levels. While there has been much progress since 1998, the government must continue efforts to create conditions where a dynamic private sector can thrive and make use of Mozambique's natural advantages.

### Macro-Economic Stability

Mozambique has been successful in limiting inflation, preventing undue appreciation of its currency, managing its debt level and generally achieving macro economic stability. It is necessary that they sustain this stability, which will be increasingly difficult in the face of declining aid.

Mozambique must manage public debt prudently and maintain a buffer to accommodate increased public debt when needed. After a recent round of debt relief that cut its external public debt by about two-thirds, Mozambique has such a buffer. Today, the present value of Mozambique's external public debt is about 24 percent of GDP or roughly equal to current value of annual exports, with the debt service to exports ratio at about 4 percent. Prudent debt management, however, calls for preservation of the buffer. Without the necessary fiscal effort, annual fiscal deficits would progressively erode the buffer and leave no room for the government to deal with contingencies, which are a virtual certainty over the medium term. The resulting instability could rapidly choke off growth and make poverty-reduction goals unobtainable.

### Encouraging Investment

The government must resolve administrative barriers that discourage investment increase the cost of doing business and hamper productivity growth.

*Entry and Exit:* The Mozambique economy has been slow to adjust and reallocate resources to their most efficient use. The difficulty in entering the market has reduced competitive pressure to improve productivity. It has also discouraged informal firms from becoming formal and availing themselves of investment incentives other benefits of formality. The government must move immediately to bring the time and cost of starting a new operation in line with its international competitors. The registration procedure must be simplified, expedited and made more transparent. CPI and other organizations must help new investors to of all sizes to negotiate the process. **Do we recommend one stop shops or other specific approaches?** One stop shops seem to be the preferred method at the moment. However these do run the risk of becoming another non-functioning government department. On the whole though I would say that they are one of the simplest methods to put in place right now while other issues are dealt with, such as the privatization of certain departments (the notary and registry offices for example). The basic premise, via one stop shop or any other method is that information should be available in a simple clear form, applicable in the same way throughout the country.

*Bureaucratic Burden:* Though there has been much recent progress, government bureaucracy continues to raise the cost of doing business, many of the reforms have not been effectively implemented. Efforts must be increased to effectively implement reforms and enforce regulations. This is key, if the laws in force at the moment were correctly enforced there would be a lot less problems immediately. Once a firm is registered and begins operations, especially foreign investors, they must continue to receive support in negotiating the government bureaucracy. Government must continue efforts to reduce red tape and improve services.

*Labor Flexibility;* Wages in Mozambique are extremely low by international standards but low productivity and lack of flexibility makes labor costly. The government must provide more flexibility for firms to size their work forces in response to market forces, while still ensuring protection of workers rights. The cost of retrenchment is particularly a problem for large, foreign owned and privatized firms. Labor regulations should be amended to allow the payment of piece rate, which is a standard way of linking pay to productivity in most labor intensive industries.

*Expatriate Work Permits:* The difficulty obtaining expatriate work permits is a major impediment to raising productivity. In the survey it was repeatedly cited as a factor in discouraging foreign investment and the decision not to upgrade technology. Until an adequate local supply of skilled workers develops, the private sector must rely on expatriates for many specialties. Administrative barriers negate the benefits of close proximity to South Africa and other sources of low priced skilled labor, raising the cost of skilled labor above the cost in competitor countries. The government must move quickly to make the process of employing foreign, skilled workers less cumbersome.

*Investment Incentives:* There are a wide range of legislated investment incentives. However, few firms have been able to take advantage of them. IFZ status has not been widely granted and in the survey few firms reported taking advantage of duty exemptions on imports of capital equipment or other incentives. To attract foreign investors the government must assure them that they will be able to actually access legislated incentives. CPI only deals with foreign investors bringing at least 50,000 USD. Help and incentives should be extended to smaller investors as well.

It appears that many of the planned mega projects and enterprises in the mineral processing sector are seeking to follow Mozal's lead and register their projects under the IFZ legislation. This legislation was intended to attract labor-intensive manufacturing exporters, but so far this has not happened in practice. Extending the favorable tax treatment to capital-intensive mega projects and mineral processors will have a detrimental impact on Mozambique's fiscal position and may not be optimal in light of declining aid flows.

*Linkages:* A successful part of Mozambique's recent development strategy has been to attract large scale foreign projects. However, the linkages between the mega project and local companies have been fewer than anticipated. The survey results reveal that the few

enterprises that are supplying Mozal are among the most productive in Mozambique. Most local companies do not have the capability to conduct such business. Attempts must be made to understand the constraints and to strengthen local companies so that they can form links with the mega projects.

*Land:* Obtaining clear right to use land is an expensive and difficult process in Mozambique. It is not a major problem for existing enterprises, however for investors seeking a green field expansion, obtaining access to land is problematic. This is a particular constraint for agricultural enterprises. The inability to own land also serves to reduce its value as collateral. The government must move to improve land registries and stream line to process of obtaining land use rights.

### **Trade**

Given the limited domestic market, Mozambique's best chance for industrial growth is penetration of the regional and world export market. Unilateral domestic actions by the government in overcoming administrative and trade policy barriers can significantly expand trading opportunities for the private sector.<sup>1</sup>

*Customs Clearance:* Delays clearing imports require firms to tie up large amounts of working capital in inventory. Delays exporting make companies unsure of meeting strict delivery deadlines. The time it takes to clear both incoming and out going shipments must be brought in line with international standards. Particular attention should be paid to speeding up clearance of ground shipments from South Africa. Procedures to quickly deal with unexpected problems (such as delivery to the wrong port of entry) must be established to add flexibility to the trade system.

*Border Procedures:* Inter-regional trade is made more expensive by the costs associated with crossing borders. The interviews suggest that a significant part of the cost of transportation is dealing with delays and administrative procedures crossing the border into neighboring countries. The government should make efforts to investigate and reduce these costs.

*Foreign Exchange and VAT refunds:* Of particular importance is ensuring that the trading community has the economic freedom to retain and manage foreign exchange proceeds, which remain considerably restricted. To further improve the competitiveness of export-oriented producers, it is also essential that they have access to imported raw materials and intermediate goods at world prices, rather than having to pay value added tax (VAT) and heavy duties on such items and then await refunds. The delays in making VAT refunds and other payments to qualified firms puts an enormous strain on companies cash flows. They also serve as a signal to potential investors that Mozambique is not serious in providing promised incentives

*Trade Agreements:* The government could also help promote trade by pursuing market access for Mozambican producers through regional arrangements such as the Southern

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<sup>1</sup> For detailed recommendations, see Nathan Associates Inc. 2002, under the aegis of the U.S. Agency for International Development.

African Development Community (SADC) and market-opening measures of industrialized countries, including the United States and the European Union. The government is committed to supporting free trade within SADC through progressive tariff reduction, and this offers considerable potential benefit.

### **Finance**

The lack of affordable finance continues to be a major complaint of the Mozambican private sector. Real interest rates and collateral requirements appear higher than in other countries. The high cost of external funds and the lack of trade credit makes it difficult for companies to undertake needed investments. Efforts must be made to improve the functioning of credit markets. This is worsened by the fact that land can't be used as collateral.

*Dispute Resolution:* A major factor in the high cost of external finance and lack of trade credit is the difficulty enforcing contracts. More effective mechanisms for enforcing contracts and security is critical. Efforts to should be directed to improve the efficiency of the judicial system. Adoption of the proposed commercial code should be expedited. No, apparently (though not many people have actually seen it) the new proposed code is worse than the current one. In fact the code should be revised in a manner which provides for open debate and participation of all those concerned.

*Information:* It is difficult for lenders to assess the credit risk of potential borrowers. Steps to improve accounting standards, create functioning credit bureaus and property registries will help create a safer lending environment.

### **Infrastructure**

The government has made significant progress in reconstructing the infrastructure and this work must continue. The telecommunications system is strong and is not the primary concern for the private sector. But other areas stand out for continued focus.

*Power:* Almost 78 percent of the survey sample ranked power as a severe problem and it was ranked as the biggest infrastructure problem most often. As capacity utilization increases and firms begin to engage in continuous production erratic power supply with become an ever increasing constraint.

*Transportation:* Improved transportation facilities are needed to reduce the cost of shipping and improve competitiveness on the world market. Road transportation continues to be costly.