SPECIAL ECONOMIC ZONES AND ECONOMIC TRANSFORMATION

MAXIMIZING THE IMPACT OF THE SPECIAL ECONOMIC ZONES PROGRAM IN MOZAMBIQUE

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ABBREVIATIONS AND ACRONYMS

AGOA	African Growth and Opportunity Act
CEM	Country Economic Memorandum
CTA	Confederation of Business Associations in Mozambique
ENDE	Estrategia Nacional de Desenvolvimento (National Development Strategy)
EMAN	Business Environment Improvement Strategy
FIAS	Foreign Investment Advisory Service
GAZEDA	Gabinete das Zonas Economicas de Desenvolvimento Acelerado
GOM	Government of Mozambique
ICA	Investment Climate Assessment
IFZ	Industrial Free Zone
MIC	Ministry of Industry and Commerce
MPD	Ministry of Planning and Development
MT	Metical
OECD	Organization for Economic Cooperation and Development
SADC	Southern African Development Community
SEZ	Special Economic Zone
SPEED	Support Program for Economic and Enterprise Development
TIPMOZ	Trade and Investment Program in Mozambique
UNCTAD	United National Conference on Trade and Development
USAID	United States Agency for International Development
WTO	World Trade Organization

EXECUTIVE SUMMARY

This report provides an overview of the existing SEZ program in Mozambique in the light of global experience. The report includes a review and assessment of the goals and objectives, legislation, institutional regime, regulatory framework, processes and procedures and development opportunities and requirements in the context of global experience. The report makes recommendations for enhancing the development impact of the SEZ program.

Based on international experience and the Mozambique record to date can the SEZ program be the catalyst for achieving broad based economic growth? International experience provides examples of SEZ stimulating transformative development, but it also provides many examples of SEZ that have failed to deliver significant growth and in some cases had large losses as badly located and designed zones failed to attract investors. Mozambique is pursuing SEZ as a tool for diversifying the economy from being dependent on agriculture and the extractive industries.

Drawing on global experience, the lessons from SEZ in Sub-Saharan Africa, and Mozambique's record to date serious consideration should be given to making a number of policy regulatory and administrative amendments to the current SEZ program. Recent reports on Mozambique's business enabling environment, trade regime and investment regulations and incentives all highlight substantive progress over the past two decades before going on to identify policies and regulations which continue to prevent Mozambique from being globally competitive. This is perhaps the first major signal that further reforms are required. For SEZs to succeed they must live up to their name and be 'special'-that is they must function in such a way that the facilities, procedures and regulations in the zone are globally competitive. Just being better than elsewhere in the rest of the country is not good enough. Without exception all the SEZ that have succeeded in stimulating broad based economic growth are globally competitive.

Mozambique has achieved impressive rates of economic growth over the past 20 years, however, the growth is narrowly based in mega-projects that employ few people and have limited linkages to the broader economy. Following the peace agreement in 1992 Mozambique returned to political stability, embarked on a program of structural reforms which restored macroeconomic stability and began the transition from a centrally planned economy to a market economy. These initiatives all contributed to Mozambique achieving sustained economic growth in excess of 7 per cent over the past two decades. Despite this impressive achievement Mozambique continues to face development challenges with an estimate 54 per cent of the population living below the poverty line in 2007 and most of the growth taking place in foreign owned, capital intensive, export oriented "mega-projects" which have created few jobs and limited technology transfer to the rest of the economy. The challenge for the Government is how to transition the economy towards sustained broad-based economic growth.

Attempts to leverage the first 'mega-project' provided the stimulus for initiating the Industrial Free Zone at Beluluane close to Maputo Port and the Maputo Corridor. The investment promotion center (CPI) began in 1993 with the goal of attracting direct foreign investment, five years before the first major direct foreign investment was established- MOZAL, an aluminum smelter. In 1998 additional specific incentives were introduced for Special Economic Zones (SEZs) and in 1999 for Industrial Free Zones (IFZs). Initially these applied to MOZAL and the adjoining Beluluane area. The revised incentives for the

IFZ included exemption from customs duty and VAT on inputs used for export production, a 1 per cent of gross revenue 'royalty fee' in place of income tax, and partial tax holidays.

In a survey in 2000 investors in Mozambique cited administrative barriers as the major constraint to doing business. With 75 per cent of the investors responding that they would have made the investment without the tax and customs incentives and more than two thirds of the respondents cited 'strong' administrative barriers as a key constraint to doing business the report by the IMF and the Ministry of Planning and Finance concluded that 'tax holidays' were not cost effective. In 2002 the GOM introduced a comprehensive reform of tax policy and fiscal incentives which reduced the standard rate of corporate tax to 32 per cent (although agriculture remained unchanged at 10 per cent) and abolished the surtax. Tax holidays were eliminated in favor of investment tax credits and accelerated depreciation, although a number of specific tax holidays remained.

Following the global recession in 2008 Mozambique introduced a range of fiscal benefits in 2009 which resulted in widely varying incentives between different types of investor and between different locations within the country. These reforms restored the tax holiday, customs duty and indirect tax exemptions, along with tax credits, and accelerated depreciation for different types of investment locating in the Special Economic Zones and the Industrial Free Zones as well as allowing for firm level zones anywhere in the country. The new incentives resulted in an uneven playing field for investors with small and medium scale investors incurring the much higher statutory rates. The incentive regime is unnecessarily complex with a wide range of potential benefits that are differentiated by type and location of investment. **Ideally Mozambique would offer a single incentive package that would be available to all investors, irrespective of the origin of the investment, the type of product, process or service, and the location.**

SEZ have the potential to serve as effective catalysts for accelerating economic growth but a successful outcome depends on the policies, regulations and institutional efficiency. Drawing on international experience of SEZ from around the world there is strong evidence that SEZ have the potential to be effective pilots for reform and to act as a catalyst for advancing economic transformation. But, a successful outcome cannot be guaranteed indeed there are numerous examples, many within Sub-Saharan Africa, that have failed to generate substantial investment or be large scale employers. Mozambique has a relatively short history of using SEZ as a development tool, indeed outside of the Beluluane SEZ, which was initially aimed at encouraging linkages to Mozal, the second SEZ in Nacala was only created in 2007 and the early years have been dominated by infrastructure development-with the airport scheduled to open in December 2014.

Notwithstanding the short period (essentially 2008-2014) that GAZEDA has been actively promoting inward investment in the SEZ and the IFZ there are positive developments and lessons that can be learned. Mozambique has a generous package of financial incentives, labor relations are not considered a major constraint, and investors considered GAZEDA to be pro-active and helpful in addressing their concerns. The major constraint facing investors has been the poor infrastructure, primarily the unreliable power supply which made generators necessary and significantly increased production costs. There is currently a waiting list of investors to move into Beluluane who cannot commence until additional generating capacity is made available.

In summary the key lessons from international experience include:

1. **Special Economic Zones must be Special**. Simply being better than the rest of the economy does not work-the SEZ must aim to be globally competitive. Successful SEZ offer investors what they need in

order to be able to compete in regional and global supply chains. SEZ offer a genuine improvement on the regular business environment. This means ensuring the SEZ delivers a business enabling environment that is internationally competitive (essential prerequisites-property rights, stable macro-economy, infrastructure, doing business, and trade facilitation).

2. **Pro-Active Government Support is essential**. Political buy from the top is necessary to ensure the whole of Government is committed to the SEZ. This will ensure it is integrated into the overall development strategy permit integrated strategic planning, and allow for funding an effective investment marketing strategy. International best practice points to SEZ regimes being promoted and administered by a powerful and autonomous government controlled entity which: oversees the laws, regulations and practices with the Zones, provides regulatory oversight for the infrastructure developers, and occupants; ensure the efficient delivery of all services including power, water, customs controls; and acts as the main intermediary with private developers and operators.

3. **The rest of the economy should also be moving towards international competitive. Successful SEZ maintain an ongoing dialogue with the rest of the economy,** to encourage linkages, and diversification. The SEZ are spatial enclaves but the extent to which they function well and bring benefits to the entire economy will depend on the wider business enabling environment. There is a direct correlation between the economy being more business friendly and the success of the SEZ in stimulating economic activity both within and outside the zone. For example, an overvalued exchange rate will reduce competitiveness both within and outside the zone. Equally a shortage of skilled labor in the economy will also be a constraint for investors in the zone. In Mozambique infrastructure constraints, primarily the shortage of electricity generating capacity and frequent voltage outages and fluctuations affect businesses throughout the economy and are delaying new investment.

4. **Ensure stable fiscal policy and provide transparent incentives.** Mozambique offers a wide range of fiscal incentives for both new investors as well as investment expansions in the SEZ. International best practice ensures a low stable rate of corporate tax for all activities both in the SEZ and outside in the rest of the country.

5. **The costs and flexibility of employment are important.** Creating large numbers of new jobs requires attracting labor intensive industries. This requires flexible labor markets and while wage levels are important it is also necessary to ensure employment regulations are not unduly restrictive.

6. **Maximize the role of the private sector in SEZs.** The most successful zones allocate responsibilities between the public and the private sector. Government should be responsible for developing the overall policy and strategy, designing the legal framework and enabling regulations and for providing key public goods (e.g. security). In many of the most successful zones the private sector is largely responsible for the development and operation of the SEZ, including management of the zones and promoting inward investment.

7. **Ensure an effective investment promotion strategy.** SEZ are most effective when there is a unified investment promotion approach to attract FDI and are able to act as a genuine 'one stop shop' rather than one more stop. Multiple agencies promoting investment can dilute effectiveness and result in

investors engaging in agency shopping to obtain improved incentives. Targeting investment to particular sectors where the country has a comparative advantage is more successful than a scattergun approach and can encourage external benefits and increased linkages once a critical mass is achieved – the concentration of apparel producers in Lesotho encouraged investment in activities with upstream and downstream linkages.

8. **Do not use SEZ as a platform for regional economic development**. Almost without exception SEZ aimed at serving as a vehicle for developing the poorer regions within a country do not succeed. There are often good reasons why a region may be lagging –lack of infrastructure, poor transport links to distant markets, and a shortage of skilled labor. In such an environment activities aimed at serving the national, regional or global market will only be able to compete with large subsidies.

As a relative late-comer to Special Economic Zones Mozambique has the opportunity to incorporate lessons learned into its own program.

Specific recommendations for Mozambique to consider include:

1. **Ensure SEZ are integrated into the National Planning Process**. The SEZ and IFZ must be linked with the broader economic strategy as outlined in the PARPA and other policy documents. It is important to ensure publicly owned utilities, provincial administrations, land offices, national line Ministries (e.g., Agriculture, Tourism) all integrate SEZ/IFZ into their work plans. This issue could be included on the Standing Agenda for every Investment Council meeting.

2. **Implement a transparent and automatic application and approval process.** It is important to keep these processes free from administrative discretion. Separate the regulatory and promotional functions within the key agencies responsible for investment in SEZ and IFZ and throughout the country. The government and administration of the incentives provided to firms in terms of the 2009 Fiscal Incentives could also be made more transparent.

3. **Strengthen the investment and promotion institutional framework**. Currently the multiple agencies responsible for sector specific investment and export promotion contribute to a confusing institutional framework with evidence of inadequate capacity and limited day -to -day autonomy from the parent Ministry. The recent joint CPI-GAZEDA promotion activities are a welcome development. It is essential these strategies are aligned with appropriate mechanisms put in place to ensure effective coordination by the implementing agencies.

4. **Expand the role of the private sector and increase the Government-Private Sector Dialogue** through ensuring more effective coordination and communication and also considering increased roles for PPP in the development of the SEZ. The relationship between government and private sector investors is characterized by 'regular and conflictual interactions'. Recent policy reforms (e.g., 2007 Labor Law, and the 2009 Foreign Exchange Law) and specific regulatory procedures (e.g., work permit compliance, factory inspections, customs procedures) have led the private sector to question the depth of their dialogue with government and also whether their concerns are understood across the 'whole of government.' Many investors mentioned how they request GAZEDA and CPI to use their offices to address specific problems. The issuing of work permits for expatriate executives and technical

personnel appears to be an ongoing problem. The number of private sector representatives on the GAZEDA Consultative Council should be increased.

5. **Strengthen the Monitoring and Evaluation function within GAZEDA** and develop capacity for undertaking applied cost benefit analysis and impact assessment to guide future implementation, public infrastructure investment and investment targeting based on Mozambique's comparative advantage. This would include establishing a mechanism for collecting relevant data on the financial performance of firms locating in the SEZ in order to ensure the systematic and ongoing evaluation of the impact of the fiscal incentives. All the SEZ should be required to show a financial return on the investments located in the zone.

6. **Prioritize improvements to the Business Enabling environment, including trade facilitation**. Mozambique continues to face challenges in improving the Business enabling environment. In the 2015 Doing Business Mozambique remains a long way from the frontier (best practice) and ranks 127 out of 189 countries, and ranks 129th for trading across borders which takes into account the length of time and costs required to import and export.

7. **Ensure the SEZ delivers reliable and competitively priced infrastructure.** It is imperative to ensure the SEZ are able to meet the demand for electricity and water on the estates. Currently Beluluane industrial area has a waiting list of investors who cannot start until new generating capacity becomes available.

8. **Further streamline regulations and licensing requirements to enable GAZEDA to function as a One-Stop-Shop for Investment Approval**. This will require extensive negotiations with a wide range of government agencies as well as the relevant Municipal Authorities.

9. **Review the Fiscal Incentives to ensure increased transparency and to move towards a single harmonized rate of corporate tax** that does not discriminate between different types of economy activity.

10. **Implement further tariff policy reform and a comprehensive review of trade facilitation in order to reduce trade costs**. The declining importance of tariff revenue in conjunction with increased government revenues from the development of the mega projects and natural resource extraction, and the commitment to further regional integration creates an opportunity to further reduce import tariffs across the whole economy. Previous substantial reductions in the tariff have revealed the importance of also addressing non-tariff measures including all trade facilitation and transport costs.

CHAPTER ONE: INTRODUCTION

Special Economic Zones (SEZ) may be defined, rather broadly, as a demarcated geographical area within a country where the rules of business are different from those in the rest of the country. In fact the SEZ concept is quite flexible-you can think of it as a fenced in industrial estate, or one of the major growth cities in China (Shenzhen with 14 million people) or as a Jebel Ali (in Dubai) or Singapore where the port serves as a basis for a wide range of trade and logistics oriented activities. SEZ are designed as a tool of trade, investment and regional industrial policy and aim to surmount the barriers that are holding back investment.

The past 3 decades have witnessed a massive growth in SEZ from 176 in 47 countries in 1986 to over 3,500 30 years later across 130 countries, employing 68 million workers in 2006 (an increase of 23 million jobs in 4 years. Almost a third of all manufacturing FDI in 2004 was invested in SEZ, and 41 per cent of total world manufacturing exports came from SEZ. In a number of cases SEZ have played a catalytic role in advancing economic growth-particularly in the Asian Tigers, China over the past 25 years and also Latin America. However, the record in Africa has been more mixed and except for the Mauritius success story and also more modest achievements in Lesotho, Kenya and Madagascar the vast majority of SEZ in SSA have not had a transformative impact.

Mozambique began embarking on market oriented reform in 1984 however prior to the peace accord in 1992 there was minimal investment. Following the peace accord of 1992 Mozambique embarked on a more active strategy of attracting foreign investment and introduced new legislation guaranteeing property rights, access to foreign exchange for remittance of capital and profits, and generous fiscal incentives for a wide range of economic activities. This included, in 1993, the first Investment Law (No.3/93 of 24 June) and the Code of Fiscal Benefits (Decree 12/93 of 21 July). This established strategic zones around the ports of Maputo, Beira and Nacala. The investment regime was revised to introduce special incentives for Special Economic Zones (SEZs) in 1998 and for Industrial Free Zones (IFZs) which are exporting processing zones in 1999. The Investment Promotion Center (CPI) and a designated 'competent decision-maker' in the government were responsible for approving investments.

In 2007 the Government of Mozambique passed new investment legislation (Government Decree 75/2007) establishing the Office of the Economic Zones for Accelerated Development (known as GAZEDA after the Portuguese acronym). GAZEDA is responsible for the promotion and coordination of all activities related to the creation, development and managements of Special Economic Zones. The Code of Fiscal Benefits was approved as Decree 4/2009 on 12 January.

Successful SEZ generally offer export-oriented investor's three main advantages relative to the domestic business environment: fiscal incentives (in the form of tax breaks or lower tax rates), world class infrastructure (serviced industrial sites with access to major highways or ports and reliable electricity and water), and enhanced trade facilitation.

Utilizing SEZ as catalysts for economic transformation focuses on their function as an Early Reform Zone (an ERZ) and how it can be a useful policy tool for restructuring a distorted economy that has previously discouraged investment and private investment. It is argued that with the right policies a successful SEZ has the potential to transform the economy within 15-20 years and to achieve substantial positive benefits within five years.

For this to take place the SEZ must address three critical constraints that are preventing businesses in the rest of the economy from being internationally competitive. Specifically the SEZ must ensure that they are able to deliver world class infrastructure, business friendly services (cost and efficiency of doing business), and ensure stable property rights and the rule of law. These should be provided within the SEZ with the aim of inducing a rapid expansion of the market economy. In economies where there are major differences over economic policy adopting an SEZ may provide a testing ground for a trial (or function as an experimental laboratory) for adopting a new approach.

From this perspective SEZ are considered a piecemeal way of introducing economic restructuring within economies which have a large import substituting sector and where the policies are constraining firms from being internationally competitive. Within the framework of a distorted economy the SEZ can play a key role in a dual track reform strategy. The experience of China, South Korea, Malaysia and Mauritius are all very relevant.

The approach of using SEZ as a catalyst for broader economic reform should not be confused with the first generation of Export Processing Zones (EPZ) which was largely based on subsidies that left them vulnerable to being captured by rent seeking activities. The SEZ as a trial policy experiment represents the new generation 21st Century SEZ. Under this approach the SEZ constitutes part of a broader development strategy that eventually seeks to extend the reforms throughout the economy, while at the same time building a pro-reform political coalition as the relative size of the SEZ activities expands becomes politically strong enough to neutralize the lobbying for increased protection from the import substituting firms.

In Sub Saharan Africa many commentators point to the disappointing results from the Structural Adjustment Reforms of the late 1990s when many countries stabilized their macroeconomic balances and began to reduce tariffs. In addressing this criticism it is important to note that the results were disappointing because many of these economies signally failed to establish a business friendly environment –for example weaknesses included unreliable electricity and water services, excessive regulation, rent-seeking customs agencies, unsuitable locations, and high cost low productivity labor (with onerous regulations).

A SEZ aims to surmount these problems by concentrating activity in a specific geographic zone. In this area services would be provided by a reputable commercially oriented management company that promotes the expansion of firms and their interests. Rapid growth can result in internationally competitive firms challenging established monopolies in the unreformed sector that forces them to either become more efficient or close down. Under this scenario the SEZ is a catalyst for reform of the initially much larger rent-distorted economy (in the rest of the economy) through encouraging both internal expansion and exerting a demonstration effect on firms in the distorted sector and encouraging additional SEZ.

In a review of EPZ/SEZ in SSA conducted by the World Bank in 2001 Peter Watson concluded that except for Madagascar and Mauritius the implementation failures were a consequence of deficient infrastructure, unstable incentives, and inadequate government services including zone management. Furthermore during the 1970s and 1980s macroeconomic stability was also a fundamental cause of failure. Ensuring macroeconomic stability and the protection of property rights are essential pre-requisites for a SEZ to be successful and are present in all the success stories.

The standard criticisms of SEZ or EPZ include: low wages; little skill transfer; low net export earnings; foreign firms extract rents from incentives and then relocated when they expire; and tax incentives reduce government revenue. All five of these criticisms are invalid and have been refuted by the evidence. Firstly, large scale un- and underemployment undermines the low wages argument since people are better off with a job. Secondly, it is clear from firm level survey over time that SEZ raise productivity, skill levels and wage levels. Thirdly, even if initially the net export earnings are low over time they increase and increased linkages serve to further increase net exports. Fourthly, SEZ are designed to offer competitive incentives not subsidies. Fifthly, SEZ will generate revenue from the beginning.

Ironically these criticisms only apply to failed SEZ's which have been badly designed and managed (with poor infrastructure, inefficient management and subsidies that are designed to compensate for a very poor enabling environment). The new generation SEZ is not about picking winning sectors –it is about promoting internationally competitive companies and building on a country's comparative advantage. It is important to note that this means one should avoid targeting trying to use an SEZ for a wide range of strategic objectives such as reviving a declining region that work to undermine comparative advantage. It is important that the policy should not attempt to privilege in terms of product, source of investment or intended geographic market. Decisions on products to produce, the location of investment and market are best left to the private sector.

This paper reviews the experience of Mozambique over the past 6 years in promoting SEZ as a catalyst for broader based development and compares this with the major lessons learned from experience around the world on what works and what does not work with the aim of highlighting the essential elements necessary for ensuring SEZ become catalysts for economic transformation.

CHAPTER 2 KEY LESSONS LEARNED FROM GLOBAL EXPERIENCE

Special Economic Zones (SEZ) may be defined rather generically to cover the broad range of modern economic zones including traditional fenced Export Processing Zones (EPZ), single unit zones, hybrid zones and SEZ. Table 1lists the major types of zone. The current study focuses on export processing zones or free zones and large scale special economic zones which frequently combine residential and multiuse commercial and industrial activity. The EPZ model dominated development approaches until relatively recently. Large scale SEZ's began in China in the late 1980s and are considered by many to have been pivotal in contributing to rapid economic growth. This experience, along with China's commitment to invest in SEZ in Africa has contributed to a rapid increase in the number of SEZ in Sub-Saharan Africa in the last decade.

Table 1 Summary of Zone Types

Type of Zone	Development Objective	Typical Size	Typical Location	Activities	Markets	Examples
Free Trade Zone	Promote Trade	<50 hectares	Port of Entry	Entrepot	Domestic and Re-export	Jebel Ali Panama
Traditional EPZ	Export Manufacturing	<100 hectares	Varies	Manufacturing or Processing	Export	Pakistan Bangladesh
Single unit EPZ	Export Manufacturing	Not applicable	Countrywide	Manufacturing or Processing	Export	Madagascar Mauritius Mexico
Hybrid EPZ	Export Manufacturing	<100 hectares, only part is EPZ	Varies	Manufacturing or Processing	Export and Domestic	Thailand
SEZ	Integrated Development	>1000 hectares	Varies	Multiuse	Internal, domestic and export	China Subic Bay (Philippines) Aqaba Jordan

Source: Farole (2011)

The traditional concept of an Export Processing Zone Area (EPZ) was characterized by the twin objectives of promoting inward foreign investment and increasing exports. The regulations usually required at least 70-80 per cent of total production to be exported with the focus on manufacturing while service sectors were ignored along with intermediary suppliers and logistics providers. The main economic incentive was a tax holiday and the activities in the EPZ were rarely subject to any performance criteria. The development approach was based on government control and regulation which resulted in significant political influence on site selection and frequently large investments in advance infrastructure development based on either very limited or no demand analysis. The EPZ Authority which owned, operated and regulated the Zone was traditionally funded by government and provided subsidized services and facilities. Such authorities generally had little power over other government bodies. For customs purposes the EPA was considered a separate customs area outside of the National Customs Administration.

The key weaknesses of the traditional EPZ include: public sector development; the absence of an integrated development approach, weak or inadequate institutional and regulatory structures, and insufficient focus on improving the investment climate. The experience of the Philippines in launching the Bataan EPZ illustrates many of the weaknesses of the early zones.

Learning from a Failed EPZ: Bataan in the Philippines

The Bataan EPZ in the Philippines began in 1972. At that time the size lacked adequate transport, communications, water, sewerage, and power. Despite these serious shortcomings in facilities and infrastructure the government of President Marcos hoped that a combination of expensive, publicly funded infrastructure and access to low cost labor would attract foreign investors and encourage production for export. Foreign investment trickled in slowly and by 1980 exports totaled $134m, and consisted entirely of low skill manufacturing. The working conditions were poor, environmental standards were inadequate and there were virtually no linkages to the rest of the economy. Despite the Government of the Philippines spending almost $200m to improve infrastructure the zone failed to pass a cost-benefit assessment carried out after 15 years of operation (Peter Warr, 1987).

Following the experience in Bataan the Government of the Philippines made major changes when they established new zones in Mactan (1979) and Baguio City (1980)-both were located close to existing large urban industrial centers with access to skilled workers and better infrastructure. The Government owned Zone Authority contracted private companies to develop and operate the Mactan SEZ. After three decades firms in both these zones accounted for 126,000 jobs and exported $4 billion of products.

Latest generation of Best Practice SEZ

The latest generation of best-practice SEZs have learned from the earlier experience of the 'traditional' EPZ and are integrated into the national development strategy, driven by business and increasingly characterized by public-private partnerships. These new SEZ aims to link closely with local communities, follow international norms on labor and environmental standards, follow best practice regulations and offer 'smart' incentives. A commitment to link more closely with the local economy allows for an integrated approach which encourages mixed use on the land and enables the Zone authority to be flexible to changing demand. Learning from the earlier EPZ where coordination with government agencies was frequently difficult the new SEZ act as One-Stop shops for regulation.

Special Economic Zones (SEZ) are not a panacea (or 'magic bullet') that can be used to solve all the problems holding back mobilizing investment, creating sustainable employment and diversifying the production base. However, SEZ can serve as pilots for reform when these are explicitly designed as the harbinger (or catalyst) of much wider improvements in the national business enabling environment and aim to function as a platform for a private sector cluster or growth pole. Many countries have implemented

Public Private Partnership legislation and have successfully encouraged the private sector to actively develop and manage specific zones.

In the past five years the IFC and World Bank have conducted a major research program reviewing the performance of SEZ throughout the world. While a wide number of factors ultimately impact on the performance of a zone, one of the main factors contributing to unsuccessful zones may be the failure to create an investment climate inside the zone that is substantially better than that available in the rest of the country, or only marginally better when what is required is an investment climate that is competitive internationally.

The three key messages from the comprehensive review of performance in SEZ were:

1. Ensure that the SEZ delivers a more effective business enabling environment that is internationally competitive (essential prerequisites-property rights, stable macro-economy, infrastructure, doing business, and trade facilitation);

2. Leverage your economy's existing comparative advantage (stay flexible), do not try and limit investment activities by sector allow the investors to determine the sectors based on their understanding. Governments are less likely to be able to pick 'winners' than private investors who are risking their own capital;

3. Do no rely on solely fiscal incentives and low wages, stable fiscal policy with a transparent tax policy is more effective than offering unsustainable fiscal incentives. From the outset the Government should encourage vocational training (involving a public private partnership), encourage linkages to local firms and safeguard the treatment of workers.

Introducing an effective SEZ program and establishing new zones in the twenty first century can benefit from the rich experience over the past three decades. In addition to the three key messages identified by the World Bank and reaffirmed by parallel work undertaken by the IFC there is now a wealth of information on the sequencing of tasks or actions for implementation and expanding SEZ. The next section briefly outlines the sequence which may be divided into: strategic planning to ensure the SEZ is consistent with both country wide economic objectives and national trade and industrial policy; establishing a comprehensive and transparent legal and regulatory framework; and then setting up the regulatory authority and the institutional structures. Once the enabling legislation and institutions are in place the government can begin to commission SEZ. Once the SEZ has been commissioned the developer/government should embark on investment promotion through marketing the attractions of the new SEZ.

POLICY, PLANNING AND STRATEGY FOR THE SPECIAL ECONOMIC ZONE

At the pre- SEZ stage it is important to carry out a thorough Strategic Planning process before addressing specific implementation details such as the operation and management and marketing of the SEZ. Ensuring the correct sequencing of tasks is essential. At the outset undertake a strategic plan which places the SEZ within both overall economy policy and the national trade and industrial policy framework, and establishes clear and transparent guidelines for the legal and regulatory framework. Once the framework for the SEZ has been established it is necessary to decide on the appropriate model for the SEZ regulatory authority and on the role of the private sector.

PLACING SEZ WITHIN THE OVERALL POLICY OBJECTIVES

One of the most important success factors in the East Asia SEZ programs was strong support and active commitment at the highest levels of political leadership. For example, Vietnam's SEZ strategy was championed by the Prime Minister which sent a signal to all officials that the SEZ was central to the country's industrial development. In Senegal the son of then President Wade was directly involved in implementing the Dakar Integrated SEZ.

Countries which achieved transformation - China, Singapore, Malaysia and Mauritius all had clear long term growth strategies that took account of their strengths and weaknesses, and recognized the necessity of eventually moving away from import substitution and competing in international markets.

SEZ IN THE NATIONAL TRADE AND INDUSTRY POLICY FRAMEWORK

Successful countries place their SEZ within a clear industrial policy framework. This ensures that the SEZ are considered an integral element of the wider economic development objectives. Predictability and transparency in the governments support for SEZ is critical to attract high quality long term investors. Many African zones have lost investor confidence through failing to deliver a predictable policy environment.

STRATEGIC PLANNING IN SEZ

It is critical that SEZ are market tested and responsive to investor needs. A 'build it and they will come' approach only works if there is a pent up demand to invest in the country (as may well have been the case in both China and UAE). Many African SEZs are developed without a serious demand analysis and this is a serious problem given the competition within the global market for investment. The Tanzania EPZ and SEZ programs resulted from government strategies. The programs proceeded ahead of any strategic planning to assess the country's competitiveness, comparative advantage, market positioning, identification of potential opportunities etc.

Successful SEZ programs focus on activities that align with their comparative advantage and develop clear sources of competitive differentiation. The Lesotho investment promotion strategy of attracting apparel and clothing firms is a good example as it the decision of Bangladesh to prioritize labor intensive investments.

One key lesson is keep the objectives simple, many African SEZ have very ambitious objectives which given the competitive market place and limited resources are almost always going to underperform. Simple and focused is fine but is important for the country (SEZ) to retain some flexibility because too much specialization increases vulnerability.

THE SEZ LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework should be comprehensive and transparent with unambiguous ground rules for everyone that is involved –all the actors. While this may not be sufficient to guarantee success it is necessary –the absence of good laws and regulations are generally present when SEZ do not succeed. The framework should also be flexible enough to meet local requirements and be capable of evolving in response to changing policy needs. While the legal framework is important, effective implementation is critical.

Fiscal incentives fail to compensate for a poor investment climate. Furthermore a focus on tax incentives distorts the behavior of investors and managers of the SEZ resulting in too much focus on short term incentives (tax holidays) rather than addressing underlying factors influencing competitiveness. Increasingly there is a trend towards integrating fiscal incentives across the economy and to focus on improving service delivery, non-fiscal incentives. However, it is necessary to move carefully because of the importance of not changing the rules in the middle of the game.

INSTITUTIONAL FRAMEWORK AND SEZ REGULATORY AUTHORITY

The SEZ regulatory authority is the most important institutional actor in any zone program. It must have a strong institutionally founded mandate, be inclusive and have the authority to coordinate across the range of stakeholders that are necessary. International best practice is to establish the regulator as an independent agency under a board of directors that includes both public and private members. This helps to keep the SEZ regime separate from the political processes.

PARTNERSHIPS AND PRIVATE SECTOR PARTICIPATION

In cases where there is limited government capacity in investment marketing and industrial estate management the government may wish to engage the private sector. Contracting or franchising SEZ management to a private company may limit the financial risk to the Government and may also be perceived to reduce the risk and increase the attractiveness of a zone. For example, bringing in a zone developer with a well-known record of managing zones elsewhere in the world will send a positive signal to investors. Throughout Africa the government continues to play a major role and there are many examples where the programs have experienced both governance and capacity challenges. In addition to the challenges of capacity and governance, efficient SEZ require large scale capital investment in infrastructure and site development. Encouraging private sector participation in the infrastructure and zone development investment can reduce the risk to the government. Encouraging Public Private Partnerships and actively involving the private sector in zone planning will assist in attracting investors.

COMMISSIONING AND ESTABLISHING SEZ (DEVELOPERS/OPERATOR)

Once the strategic framework and institutional structures have been agreed the government can proceed with commissioning and establishing the SEZ.

International experience best practices include:

- Allow and encourage the private sector be as actively involved as a developer as is possible-but recognize that government retains key roles and remains a vital player;
- Keep the application process simple and transparent; and
- Require all SEZ to show a return on investment, taking into account market based costing of land, infrastructure and capital.

Institutionally best practice suggests that an SEZ should be administered by an autonomous and powerful government authority which oversees the administration of dedicated laws, regulations and practices inside the SEZs, provides regulatory oversight of developers, operators and end users and ensures the efficient delivery of services (including regulatory services). It regulates economic activities within the SEZs and acts as the principal government interface for private SEZ developers and operators. The text box below summarizes the key activities that remain the responsibility of the government.

Text Box 1 The role and responsibility of Government in using SEZ as a tool for economic transformation

Key activities considered the responsibility of the government:

- Vision and Strategic Planning
- Identify the role for the private developer
- Select and approve the site(s) and coordinate land use
- Provide off-site infrastructure
- Approve developers plan and monitor construction
- Licensing and permits (building/environment)
- Ensure cooperation with revenue authority on customs procedures
- Monitor private developer and tenants for compliance
- Support Marketing of the SEZ
- Develop workforce and other social services (health clinics/schools)

CHAPTER 3 SPECIAL ECONOMIC ZONES AND AFRICA

The World Bank research led by Tom Farole adopted a systematic approach to assessing outcomes and carried out detailed surveys in 6 African countries and 4 comparator countries. African countries were Ghana, Kenya, Lesotho, Nigeria, Senegal, and Tanzania), and DR and Honduras, and Bangladesh and Vietnam.

Anecdotal evidence suggests that success remains limited to a few countries –Mauritius, Lesotho, Kenya, Madagascar while others Nigeria, Senegal, Malawi, Namibia and Mali appear to be struggling to attract investment for a wide variety of reasons including poor locations, lack of effective strategic planning and management, national policy instability and weak governance (all of these findings are consistent with the work of Watson a decade earlier).

Despite the difficulties experienced by many countries there is considerable evidence that SEZ have the potential to address key constraints and can create jobs.

Indeed in economies, emerging from conflict or with a challenging business environment SEZ can potentially be useful as an Early Reform Zone. Since in these difficult situations where for example, the economy faces macroeconomic and supply side constraints an SEZ can be transformational. The SEZ can immediately provide world class infrastructure, business friendly regulations, property rights and the rule of law.

What does a Government want to achieve when it establishes an SEZ (economic transformation)?

An earlier FIAS report in 2008 identified four specific policy goals:

1. The SEZ to serve as a magnet for attracting foreign direct investment;
2. To function as a robust job-creating initiative (for example, even in enclave situations such as the Dominican Republic this is seen as a success);
3. To encourage wider economic reform –SEZ are seen as a tool permitting a country to develop and diversify exports while initially maintaining existing protective barriers in place for import competing sectors –Mauritius, Korea-but then over time dismantling the level of protection throughout the whole economy;
4. As experimental laboratories for the application of new policies and approaches. China is a good example of this category-legal, labor, financial and other policies are introduced and tested within the SEZ before being extended to the rest of the economy.

According to FIAS (2008), 114 zones are located in Sub-Saharan Africa which represents less than 5 per cent of the total number of zones worldwide. Given that almost half of this figure includes single factory ‘zones’ in Kenya the number of industrial parks is considerable lower. Africa is a relatively latecomer to using special economic zones as a means to promote competitiveness, mobilize investment, and diversify the economy. In Sub-Saharan Africa the majority of programs were only initiated in the 1990s and 2000s.

Table 2 Overview of African Zone Programs by Decade of Launch

1970s	1980s	1990s	2000s
Liberia	Djibouti	Burundi	Gabon
Senegal	Togo	Cameroon	Gambia
Mauritius		Cape Verde	Mali
		Equatorial Guinea	South Africa
		Ghana	Zambia
		Kenya	Eritrea
		Madagascar	Mauritania
		Malawi	Tanzania
		Mozambique	Ethiopia
		Namibia	Angola
		Nigeria	
		Rwanda	
		Seychelles	
		Sudan	
		Uganda	
		Zimbabwe	

Source Farole (2011) updated by author.

The timing of the zone program is important as it is unusual for a zone to experience rapid growth at the beginning. Even the most successful zones grew slowly in the first 5-10 years, before transitioning to rapid growth and then slowing down. Given the relatively short time period a degree of caution is required in concluding that some of the newer zones in Africa have either succeeded or failed. Timing is also relevant because the global economic environment in the 1990s and 2000s was very different from that prevailing in the 70s and 80s. The earlier period saw a rapid rise in international trade as global value chains began to emerge. Following the global downturn in 2008 SSA face a more competitive environment with the rise of China and the consolidation of 'factory Asia', and slowing demand in the major OECD markets. The rapid growth in Asia and the Middle East has created opportunities for increased South-South trade and improvements in trade facilitation have increased opportunities for trade in components.

Many of the earlier African economic zones failed to live up to expectations because they were just not internationally competitive, doing business remained high cost and challenging even with generous fiscal incentives. New generation economic zones requires more strategic planning and positioning to be able to attract significant investment. Successful zones in East Asia have focused on attracting activities in which the economy has a recognized comparative advantage. The clustering of similar activities has enabled the industries to benefit from external economies of scale and scope which has encouraged both forward and backward linkages and further enhanced competitiveness. While fiscal incentives have been prominent in the promotional literature, particularly in countries with a small industrial or manufacturing base, the successful economic zones compete on the basis of trade facilitation, and the provision of efficient infrastructure and services.

Identifying the criteria for Assessing the Performance of SEZ

Generally SEZ are assessed in terms of new investment stimulated, new jobs created and increased exports. Sometimes the assessment also seeks to identify the dynamic impact of SEZ by focusing on the creation of backward and forward industrial linkages along and across value chains, stimulating the emergence of new skills and expertise and increasing economic diversification.

Investment-this is invariably the first measure that is used since without investment there is no employment or exports and no possibility of stimulating broader economic change. Despite relatively low level s of investment in SEZ in most African countries the SEZ actually represented a high percentage of the total national FDI flows (except for Nigeria) –this may indicate a weak overall investment climate rather than a failure of the SEZ program.

Also the number of firms in most African SEZ remains quite small, excluding the firm level SEZ such as Lesotho where it is approximately 35 (although Ghana and Senegal has 300 and 200 respectively). This contrasts sharply when compared with the Dominican Republic with more >500, Honduras with more than 350, and Bangladesh 300, and Vietnam with more than 3,500. Although this may be partly explained the relative size of the economies and also many of the African zones only commenced in the 1990's.

While all SEZ begin with foreign investment –this brings in new technology and skills- the successful ones lead to a structural transformation and over time local investment increases in importance. This is the case in Malaysia, Korea and is now emerging in China and Mauritius however, throughout the rest of SSA there is very limited domestic investment in SEZ.

Most investment in SEZ is aimed at exporting and is looking for an efficient location and for most traditional export processing activities the primary determinant of competitiveness is labor cost and productivity. If African SEZ do not have a comparative advantage in labor intensive assembly, it is not surprising that they have not attracted the investment. Africa has a comparative advantage in agro-processing and natural resources.

Standard Performance Indicators: International Comparisons

Standard performance indicators from 2008, just before the global recession is shown in table 1 below. Exports per capita are much smaller in Africa relative to exports from other continents, and similarly the share of SEZ in total exports is much smaller (although Lesotho and Ghana are significant). During the period 2000-2008 many African countries experienced a rapid growth in exports. To a large extent this is explained by the growth taking place from a low base, but it also corresponds with the ending of the MFA in 2005 with many Asian apparel firms relocating to AGOA eligible countries to benefit from AGOA preferences. While very welcome and a positive development it is important to note that this has not been transformational. This contrasts with the experience of China, Malaysia, Vietnam, Republic of Korea, and within Africa Mauritius where growth took off between year 5 and year 10 and 20 years on can certainly be considered transformational.

When the products and markets for goods produced in the SEZ are examined it appears that many of the African SEZs are selling products, such as chemicals, and food products to neighboring countries with very little global or regional value chain based production except for the apparel sector in Lesotho, Kenya and Mauritius.

Table 3: SEZ Performance Indicators

Country	Exports/ per Capita $ 2008	SEZ as % Non-Oil Exports	SEZ as % Manufacturing Exports	SEZ Employment as % of Industrial Sector
Ghana	12	33	59	3.5
Kenya	4	9	25	15
Lesotho	211	64	64	>80
Nigeria	1	4	16	<1
Senegal	4	16	42	n.a.
Tanzania	1	3	14	2.5
Bangladesh	102	15	16	3
Dominican Republic	462	69	96	30
Honduras	550	61	98	30
Vietnam	188	30	41	19

Source: World Bank (2011)

Over time most of the non-African economies witnessed a significant structural shift in their exports as manufacturing shares increased in importance and primary products declined in relative importance. There has been little change in the commodity composition of African exports over the past three decades. For most SSA SEZ has not to date resulted in transforming the structure of the economy through realizing economic diversification.

Clearly the SEZ have created jobs which in economies with large scale unemployment and under-employment is important. However, from a broader development perspective with the exception of Mauritius job creation has not continued. Following initial rapid growth as firms sought to relocate to benefit from special incentives and (usually) preferential market access they have ceased to add new jobs. There has not been a shift onto a higher growth path or into higher value exports.

WHAT ARE INVESTORS LOOKING FOR WHEN THEY INVEST IN SEZ?

What are investors in African SEZ looking for when they choose to locate their investment in a Special Economic Zone? The survey by the World Bank (the results are summarized in Table 2) asked investors to identify in order of importance the factors that influenced their investment decisions. Table 2 shows them in the order of importance for investors in African SEZ and investors in SEZ throughout the rest of the world.

It is significant to that that for investors in African zones taxes is not the most important and access to low cost labor is quite low down the list (8^{th}) of priority issues. The top three issues for investors in African zones are: utilities (cost and reliability); transport infrastructure; and the business regulatory environment. When the same question was asked for investors in non-African SEZ both utilities and transport were in the top 3 but access to low cost labor was the first priority.

What does the survey tell us? The positive message is that the factors that are important such as utilities/transport, tariffs etc. are all capable of being addressed through the SEZ program (effective zone management) and fiscal/customs incentives. That is positive as all of these are capable of being addressed by African SEZ. The finding reinforces the importance of ensuring investors locating in SEZ have reliable utilities and a conducive business environment (ease of doing business). For investors in African zones access to low cost labor was less important than being able to access skilled labor which may reflect the relative scarcity of skilled labor in many developing countries with a small manufacturing base.

Table 4: Survey of Investor Requirements

Relative Importance for Investors	African Zones	Rest of the World SEZ
Cost and quality of utilities (electricity/water)	1	3
Access to transport infrastructure	2	2
Business Regulatory environment	3	5
Tariffs, duties, and rules of origin	4	8
Level of Corporate taxes	5	6
Access to high skilled labor	6	4
Access to suppliers	7	7
Access to low cost labor	8	1
Availability and cost of land and buildings	9	10
Access to local and regional markets	10	9
Access to technology	11	11

Source: World Bank (2011)

IDENTIFYING THE DETERMINANTS OF SEZ PERFORMANCE

At the outset it is worth emphasizing, even at the risk of being repetitive, that the investment climate in SEZ is critical in determining whether the firms will be exporters. Secondly, the national investment climate is significant in terms of determining the overall level (or size of response) for investment and employment. The surveys of African SEZ by the World Bank all highlight the importance of the national investment climate and support the view that the success of SEZ is closely linked to the competitiveness of the national economy.

The investment climate inside the SEZ is critical but specifically infrastructure and trade facilitation are key determinants of success. There is a strong relationship between infrastructure quality and the level of employment and investment.

There is also a strong relationship between the levels of investment and employment and trade facilitation. This should not be surprising as trade facilitation directly impacts on trade costs –each day delay is equivalent to a tariff of between 0.8 and 1 per cent. Factors related to licensing appear to be less important.

Both the locations and market size matter as SEZ with proximate market access to large consumer markets, suppliers, and labor tend to be more successful relative to those located further away from markets.

Many of the reasons frequently cited as key determinants of SEZ performance, such as low wages, trade preferences and fiscal incentives are found to have a low correlation with the economic outcome of the SEZ. One reason is that often low wages, etc. are used as an alternative to making the tough policy choices that will provide for much needed improvements in the investment environment. Indeed granting subsidies and relying on low wages are shown to be very poor substitutes for improving the business environment and having a well-managed SEZ.

Learning from Success the Mauritius Experience

Mauritius created the Export Processing Zone (MEPZ) in 1971, initially with the aim of promoting import substituting activities in order to reduce dependence on sugar exports and to create jobs. At that time sugar exports accounted for 75 per cent of exports and unemployment exceeded 20 per cent of the labor force. At the outset Mauritius attracted investors from the Far East who saw an opportunity to enter the EU market duty free and quota free through the ACP preferences. Domestic investors were encouraged by the Government to invest in the Zone. Within five years the Zone accounted for almost half of total domestic capital investment and had generated 20,000 jobs. In the late 1970's growing government deficits combined with a steep fall in both sugar production (owing to poor weather) and sugar prices encouraged the Government to reduce government spending, improve the business enabling environment, devalue the currency and to prioritize export-led growth. From the early 1980's Mauritius sought to develop a diversified economy based on sugar, the MEPZ and tourism.

With these reforms the MEPZ grew rapidly, surpassing sugar as the largest export earner in 1985 and accounting for 90,000 jobs by the end the decade. The Government of Mauritius adopted a policy in the late 1980s of actively promoting new sectors while also encouraging increased efficiency by the existing industries even at the expense in the short run of job losses. From the early days of the MEPZ the government has produced detailed data and reported on performance. Following rapid growth in employment and investment through the late 1980's, the MEPZ has gone through periods of decline through most of the 1990's and then renewed growth (largely to take advantage of the AGOA preferences) in 1998-2002, followed by a decline since 2003. The slow decline in investment and employment in the MEPZ has been offset by the rapid growth of new sectors in the rest of the economy.

Apparel production continues to be the major sector accounting for almost 70 per cent of exports in the MEPZ although it has declined in relative importance (from over 85 per cent in 2000). The detailed data showing employment and exports indicate that both labor productivity, export intensity and the export productivity of investments have increased substantially in the past decade. Unlike many countries Mauritius has not focused on keeping real wages low through labor market and exchange rate policies. Although labor costs in the apparel sector are low relative to the rest of the economy they are more than 3 times higher than Madagascar. This has encouraged Mauritian apparel firms to invest in neighboring countries as part of a regional division of labor in the apparel value chain.

The recent record of the MEPZ has been one of declining jobs, continued dependence on one sector with limited diversification and modest investment. Recent work quantifying the costs and benefits of the MEPZ concludes that the returns to the economy were negative because the generous fiscal incentives resulted in insufficient revenue to cover the infrastructure costs. However, the record of the MEPZ should not be seen in isolation but considered in the overall context of Mauritius's development record over the past three decades. When viewed through this broader political economy prism the MPEZ may be seen to have served as the catalyst for broader economic reforms which enabled the Government to move from an import-substitution growth model to a dual-regime and then to an export oriented regime. Once Mauritius economic policy was firmly committed to a trade led growth strategy it embarked on substantial reforms which reduced trade costs and improved the business enabling environment throughout the whole economy.

The MEPZ were critical in building the consensus for the broader based reform (see text box below).

Text Box 2 EPZ as Catalysts for Change

> The creation of the EPZ generated new profit opportunities, without taking protection away from the import-substituting groups. The segmentation of labor markets was particularly crucial in this regard, as it prevented the expansion of the EPZ (which employed mainly female labor) from driving wages up in the rest of the economy, and thereby disadvantaging import-substituting industries. Net profit opportunities were created at the margin, while leaving old opportunities undisturbed. There were no identifiable losers. This in turn paved the way for the more substantial liberalizations that take place in the mid-1980s and the 1990s. Rodrik (2007) p.167

Preferential market access to the EU through the Lome Convention and then the Cotonou Agreement and to the US through AGOA also played an important role. Mauritius has also been an active member of both COMESA and SADC and used the implementation of the free trade areas as an opportunity to reduce tariffs multilaterally. Indeed the average tariff declined from 19.9 per cent in 2001 to 6.6 per cent in 2009. Mauritius continued to reform its incentives policy taking into account the applied economic work showing the inefficiency of tax holidays and switched to one low rate of 15 per cent corporate tax for all activities.

In summary the EPZ was pivotal in transforming Mauritius, attracting FDI, showing by example that it was a good place to do business, stimulating technology transfers and, very significantly, integrating the island into global value chains. All of these paved the way for the further reforms that improved the business enabling environment of the whole economy as Mauritius began to emulate the policies in Singapore, Hong Kong model.

CHAPTER 4 SPECIAL ECONOMIC ZONES IN MOZAMBIQUE

INTRODUCTION

The Government of Mozambique promotes the SEZ initiative with the objective of achieving broader based development. The recently approved National Development Strategy (ENDE) has a 20 years vision through to 2034 for Mozambique to industrialize and diversify its economy. It identifies a range of priority sectors including agriculture, fisheries, manufacturing, mining, and tourism. SEZ are envisaged as a key element of the industrial infrastructure pillar. The second Poverty Reduction Action Plan (PARPA II, 2006-2010) identified industrial development including agro-industries and labor-intensive manufacturing as a priority and this has continued with the PARP which stresses the necessity of improving the business enabling environment.

The commitment to improve the Business Climate through simplifying procedures and enhancing competitiveness was supported by EMAN 1 2008-2012 and EMAN 11 2013-2017. Despite these commitments progress has been very modest with Mozambique ranking 146th out of 185 countries in 2013 on the World Bank Doing Business Indicator. A recent assessment of the business environment (SPEED, 2013) concluded that the past 18 years had 'not resulted in substantive changes for most businesses.' High level commitments to reform where not followed through and there was no broad consensus between the public sector, business and civil society on how to achieve reform. The high level statements committing to private sector development (in PARPA, ENDE and EMAN) had not been developed into specific action through new legislation and regulations.

Mozambique is endowed with abundant and relatively unexploited natural resources, located close to the major southern African market and along a global maritime shipping route. Over the past decade Mozambique has realized an annual growth in real GDP of more than 7 per cent. This impressive record at the aggregate level has yet to translate into broad based inclusive growth as Mozambique remains one of the poorest countries in the world with a GDP per capita of $650 in 2012.

The high rates of economic growth are largely a result of a small number of very large capital intensive projects –known as mega projects. While the mega projects have stimulated large investments and created some jobs they are unable to, on their own, address the high degree of unemployment which currently stands at 27 per cent. Each year 300,000 enter the labor market. The formal economy is estimated to account for only one-third of total employment. Employment creation is major objective of the Government of Mozambique's Economic and Social Plan (2010) and the Poverty Reduction Action Plan (2011).

Against this background Mozambique seeks to promote development initiatives that will deliver broad based growth through increasing exports that build on the economies comparative advantage and strategic position as a pathway for regional trade. In order to leverage the resource based mega-projects the Government has designated a number of areas as Special Economic Zones and Industrial Free Zones to link to the Maputo, Beira and Nacala Corridors. The first IFZ dates back almost 10 years while the Nacala Zone was only established in 2009 along with the current legislative and incentive framework. As noted earlier realizing substantial investment and growth within an SEZ can take up to a decade, however, the extensive experience both globally and within Africa provides guidelines for judging the performance in Mozambique. The remainder of this chapter focuses on GAZEDA and the SEZ/IDZ and is organized into the following sections: the legal and regulatory framework; institutional structure and capacity; investment incentives; investment promotion and marketing; trade policy; SEZ and regional integration; investment in the SEZ and IFZ, and SEZ and the resource boom in Mozambique.

LEGAL AND REGULATORY FRAMEWORK

The Investment Law Regulation (Decree 43/2009) sets out the framework and gave legal effect to Mozambique's Special Economic Zones and Industrial Free Zones. The legislation governing SEZ and IFZ is contained in Chapters VII and VIII respectively.The legislation provides for:

a) The Council of Ministers approves the creation of SEZ on the recommendation of the Investment Council;
b) Defines eligibility - All economic activities (that are legal) are eligible for SEZ status;
c) Outlines the licensing and certification process;
d) Provides for the concession of the right of land use;
e) Provides for an environment impact assessment;
f) Outlines the requirements under the Special Regimes for selling into the domestic market and the treatment of imports and exports;
g) Financial provisions including foreign exchange requirements; and
h) Employment requirements (local and foreign employees).

The regulations establishing GAZEDA and outlining its functions, institutional structure and responsibilities is contained in separate legislation.

The brief review of the current legislation highlights:

- The need to redefine the membership of the Consultative Council to provide the private sector with a more prominent voice;
- The need to establish and publish guidelines to determine the criteria for establishing an SEZ;
- The need to review the fiscal incentives;
- The need to ensure GAZEDA has the authority to function as a one-stop-shop covering all the approvals and licenses required for starting a business (currently it is a one-stop licensing center Article 39 paragraph 2);
- Specify all the information requirements for approving an investment project proposal and obtaining a SEZ/IDG license. GAZEDA should develop a detailed checklist which could be put on their website and made available to all potential investors. Currently the legislation for the project proposal lists includes an open ended requirement (Article 9 paragraph 3) which states:

  'During the analysis of the project proposal and consistent with the characteristics and size of the undertaking, additional or supplementary information may be requested as may be relevant for the review of the project.'

  Once approved the issuing of the license is also open-ended (Article 40 paragraph 2)

'GAZEDA may, according to the characteristics of the project to be implemented, request additional information considered relevant for the taking of the decision on the project.'

- The need to include a requirement that providing the SEZ is compliant the SEZ Certificate will automatically renew for a further period of 10 years. The current legislation notes that the license is renewable (Article 41 paragraph 3) but does not explicitly provide for the renewal. In the absence of an explicit reference to renewal at the end of the initial 10 year period it is assumed the SEZ firm would need to reapply in terms of the requirements listed under Chapter IV.

Throughout the report the terms SEZ and IFZ have been used interchangeably, however, they are defined with separately in Article 1 of the 1993 Investment Law (Decree 3/93). The definitions are virtually except the SEZ firms are eligible for 'a free exchange regime including for offshore operations. The IFZ (is defined in Article 1 (v) to be an 'area or unit(s) of industrial activity that is geographically delimited and regulation by a special customs regime' where all the goods are destined for export. An SEZ (defined in Article 1 (w) is an 'area of general economic activity geographically delimited and subject to a special customs regime' where all the goods are destined for export. Given the virtually identical incentives offered to SEZ and IFZ and the equivalence in the registration and licensing process the analysis and recommendations in the paper should be assumed to apply to both SEZ and IFZ.

INSTITUTIONAL STRUCTURE AND CAPACITY

The Office for Accelerated Economic Development Zones (GAZEDA) is the regulating body of the SEZ and IFZ program. GAZEDA was established in 2007 by Decree 75/2007 and has the authority to coordinate all activities relating to the establishment, development and management of Special Economic Zones (SEZ) and Industrial Free Zones (IFZ). GAZEDA responsibilities include:

- Developing Special Economic Zones (SEZ) and Industrial Free Zones (IFZ);
- Facilitating the development of private sector SEZ;
- Reviewing and approving applications for development permits and operator licenses for SEZ and IFZ;
- Verifying and registering investment proposals for the SEZ and IFZ;
- Assisting investors in obtaining licenses, permits, and facilities for or within the SEZ or IFZ;
- Collaborating in the preparation of sectoral national development programs/strategies/policies 'when requested by the relevant entities;'
- Administering, controlling and regulating the SEZ and IFZ to ensure compliance with the enabling legislation;
- Monitoring and evaluating activities, the performance and development of enterprises in the SEZ and IFZ;
- Promotion and marketing for the SEZ and IFZ; and
- Preparing an annual report showing authorized and implemented investments.

GAZEDA comprises a Directorate with executive responsibilities and two consultative bodies (the Management Council and the Consultative Council). The Directorate comprises 51 staff, consisting of the General Director and two Deputy Director Generals (Administration and Operations) and 7 departments. The seven departments include: SEZ Services; IFZ Services; Marketing and Public Relations; Research and Studies; Human Resources; Finance and Administration; and Legal Services. The Management Council of

GAZEDA consists of the General Director, the Deputy General Directors for Operations and Administration and all the Department Heads. It meets monthly to ensure effective management and coordination of activities, including progress reports, and monitoring and evaluation. The Consultative Council also meets monthly and consists of 13 permanent representatives from government[1] and 3 representatives from the private sector[2], with provision for specialists to be invited on an *ad hoc* basis.

GAZEDA reports to the Minister of Planning and Development who recommends the appointment of the General Director. The regulation establishing GAZEDA (Decree 75/2007) which sets down the organizational charter allows for the involvement of the private sector in the Consultative Council although with only 3 members relative to a minimum of 13 government representative there is a risk that their position may be marginalized. In Zambia the Chairman of the Board of Directors of the Export Processing Zone Authority (ZEPZA) is reserved for one of the private sector representatives.

GAZEDA has technical staff to develop policy and facilitate the needs of investors, a marketing department to promote the SEZ program, and administrative and professional staff to monitor the organizations day-to-day activities. GAZEDA has recruited well qualified and experienced staff with more than 50 per cent being graduates.

The GAZEDA staff are responsible for determining the effectiveness of the SEZ program and are required to review licensing application, issue permits, and licenses, direct and facilitate investors, prepare detailed regulations and guidelines, market and promote the program, provide after-care to existing SEZ/IDC investors, and operate the Nacala SEZ.

GAZEDA is not a one-stop agency, like the sister agency, CPI which is responsible for all investment outside the SEZ/IDC, GAZEDA assists investors in an informal manner. Effectively this means that GAZEDA maintains linkages, contacts and networks with all the Ministries and Agency staff who are required to provide approval to a new investor (for example Ministry of Labor for work permits). None of the public sector agencies have a representative physically located in a GAZEDA office.

The Center for Investment Promotion (CPI) established in 1992 continues to be responsible for promoting investment in Mozambique outside the SEZ and IFZ. The establishment of the CPI dates back to when Mozambique began to promote foreign investment following the signing of the 1993 Investment Law (Decree 3/93).

INVESTMENT INCENTIVES

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[1] Representation from Government includes: Ministry of Planning and Development, Finance, Interior, Industry and Commerce, Transport and Communication, Foreign Affairs and Cooperation, Tourism, Energy, Science and Technology, Labor, Coordination of Environmental Action, Bank of Mozambique, Tax Authority, and Ministry of entity that has oversight of the matter under analysis.

[2] Who are all designated by the CTA.

Mozambique investment incentives have evolved over the past two decades to become more automatic and transparent, and also to become less discriminatory. However, the current incentive structure is complex, delivers diverse incentives across regions and by type of activity, is administered by multiple government agencies, and the discretionary element remains.

Investment incentives were introduced in 1993. The 1993 Decree set down nine specific objectives for investment projects and until 1999 investors had to satisfy a minimum of seven criteria in order to qualify for an investment license which was a prerequisite for obtaining the incentives and guarantees provided by the Law. The nine criteria included:

- Infrastructure development or rehabilitation to support economic activity;
- Promotion of increased efficiency and productivity through improved technology;
- Job creation for nationals and skills transfer;
- Expansion and improvement of productive capacity and the increased provision of support services;
- Export expansion;
- Import substitution;
- Improving the balance of payments; and
- Improving supply conditions for local markets.

The restrictive and discretionary investment criteria were eliminated in a major revision of the investment code in 2009. The Investment Regulation Decree 43/2009 removed all these conditions to make entry much more straightforward while also ensuring compliance with the WTO Trade Related Investment Measures (TRIM). Another major change was to abolish the list of sectors that had been reserved for the public sector, going forward there would be no sectors exclusively reserved for Government, however, sector specific regulations continued to discourage private investment in electricity generation, public water supply and the operation of national parks. The regulations for the Investment Law (Decree number 43/2009) identify the 'continued improvement of the national investment climate … in particular with regional to the speedy execution of investment projects' as the key objective. While creating sustainable employment is a development priority the legislation focuses on establishing the legal, institutional and policy framework for private investment.

The 2009 regulations represented a significant improvement as they explicitly addressed the coordination of the investment process by clarifying the responsible agencies and setting out their respective roles. Four ancillary reforms represented a positive step forwards for the private sector. These included the new Commercial Code Law (10/2005) which modernized the requirements for registering a new business (it replaced legislation dating from 1888). The Foreign Exchange Law (11/2009) along with its regulations (82/2010) sought to regularize foreign exchange transactions however the requirement to surrender foreign currency earnings for all firms outside the SEZ and IDZ is a serious constraint. Public sector procurement law was reformed to encourage investment in infrastructure and the Public Private Partnership, Large Scale Projects and Business Concessions (15/2011) addressed the issue of national participation in the 'mega projects'.

The incentives offered in the SEZ are outlined in the Code of Fiscal Benefits 4/2009 which replaced incentives offered under Decree 16/2002. The fiscal benefits are offered to investments which 'have a recognized public interest as well as to encourage the economic development of Mozambique' (Article 2). The fiscal benefits include: deductions from taxable income, deductions from tax, accelerated depreciation, investment tax credit, exemptions, reduced tax rates and a tax holiday. All approved investments in the SEZ

and IFZ are eligible for the fiscal incentives along with investments in infrastructure for wholesale and retail trade, all manufacturing and assembly industries, and commercial and industrial in rural areas.
The regulations set the minimum value of the foreign direct investment at 2.5 million Mts. (approximately $91K in 2009). The legislation defining the minimum investment (Article 6) permits the Ministry of Planning and Development (following consultation with the Government of the Bank of Mozambique and the Minister of Finance) to adjust the minimum value.

Foreign investors are allowed to remit any profits and re-export the invested capital subject to realizing any one of the following:

- Annual sales in the third year of operations exceeding 3 times the initial investment; or
- Annual exports of more than 1.5 million Mts ($55K); or
- Created at least 25 jobs for Mozambican nationals by the end of the second year of operations.

For investments approved for SEZ and IDZ status the firm is permitted to sell into the domestic market providing they pay all the taxes on any of the imported goods. This means that firms located in the IFZ who wish to sell into the domestic market must pay the customs duties, Value Added Tax (VAT) and Excise tax on the inputs. However, firms locating in the Integrated Tourism Establishment Zone (ZETI) remain exempt from customs duties, VAT and Excise even when they sell into the domestic market.

Exemption from customs duties and VAT for the first five years is only granted for goods that are not produced in Mozambique or ‘if produced in Mozambique do not satisfy …for the purpose and function …of the project’. The latter requirement aims to ensure the investor is able to source from the most competitive source. The embryonic manufacturing sector means that in practice all the capital equipment and spare parts required for manufacturing or processing activities will be imported. However, by introducing a qualification on the exemption from Customs Duties and VAT Article 6 the incentive is not automatic but has to be approved by Mozambique Customs.

Investment tax credits are available for projects located in the City of Maputo for up to five tax years to a maximum value of 5 per cent of the total investment. For projects located outside the City of Maputo the tax credit over the five year period increases to 10 per cent. For companies already in production the tax credit begins with the date of the new investment. While for new companies the tax credit begins when ‘operations’ commence, should the project not use its full tax credit within 5 years it can roll forward the balance for a further 5 years.

Investors are also eligible for accelerated depreciation on all new immovable assets. For qualifying investments the deductible costs are increased by 50 per cent over the standard rates published by IRPC. However, Article 16 states ‘may be increased by 50 per cent’ which implies that it is discretionary and approval must be sought. The cost of new equipment and replacement machinery can be used to offset up to 10 per cent of taxable income over five years. The costs of professional training for Mozambique employees can also be used to offset up to 10 per cent of taxable income (when using new technology otherwise up to 5 per cent), also over five years.

The legislation providing specific fiscal benefits is organized into ten separate categories. Distinctions are made between: the creation of basic infrastructure; rural commerce and industry manufacturing and assembly industries; agriculture and fishery; hostelry and tourism; science and technology parks; large dimension projects rapid development zones; industrial free zones; and Special Economic Zones. The Rapid Development Zones (ZRD) refer to areas of natural resource potential which are lacking in infrastructure and have low levels of economic activity. The ZRD include the Zambeze River Valley zone, Niassa Province, Nacala district, Ilha de Mozambique, and Ibo island.

The specific incentives are shown in Table 5 below.

A wide range of generous tax incentives available through the Code of Fiscal Benefits (see Table 5) to firms in the Industrial Free Zones, the SEZ, rapid development zone and specific sectors exist alongside the statutory tax regime with relatively high tax rates. This combination of divergent tax regimes within the same country creates a strong incentive to allocate resources to benefit from the low tax regime. A recent analysis of the tax system by the World Bank found large variations in the Marginal Effective Tax Rate (METR) between sectors and also depended on obtaining the CPI/GAZEDA regime. The way the current fiscal incentives are structured results in small and even medium entrepreneurs being excluded and having the pay the relatively high statutory rates.

The quality and efficiency of the tax administration is also relevant for competitiveness. The Investment Climate Assessment (in 2008) identified tax administration as a major constraint and mentioned a range of issues including arbitrary implementation of the tax code, too frequent inspections, overly complication paperwork, delays and difficulties in obtaining VAT refunds, and inadequate dispute resolute. However, ongoing reforms within the tax administration appear to have resulted in a decline in the share of firms identifying it as a constraint. A balanced panel of firms who were present in both the 2006 and 2012 DNEAP business survey showed a substantial decline in the share of firms mentioning tax administration as a constraint (from 1 in 3 to 1 in 5).

The projected growth in the tax base as additional resource based megaprojects come on stream provides a window of opportunity for Mozambique to embark on a program of streamlining tax incentives to move towards a more transparent and simple tax regime. Fundamental tax reform would address the necessity of streamlining incentives at the same time as reducing the number of level of tax rates levied on the wider economy. The consensus of the literature on tax incentives is that they are not a major factor in deciding where a company locates. And for investors from the United States they are of no benefit as any income returned to the US will be liable to taxation at the existing rate of Corporate Tax in the US. In the absence of a double taxation agreement a US investor is not allowed to offset any of their income earned overseas. Mozambique has double taxation agreements with Macau, Mauritius, Portugal, South Africa, and the United Arab Emirates.

While the target of a unified low rate (of 10 or 15 per cent corporate tax) may be difficult to achieve it is important that Mozambique begins to record the impact of the existing tax regime. Fortunately many of the existing incentives are time-bound which creates the space for announcing reforms several years in advance.

Table 5 Summary of Mozambique Fiscal incentives

Incentives	SEZ	IFZ	Manuf. & Assembly	Agric. & Fishery	Tourism	Science & Tech	Large Projects	Rapid Dev. Zones	Basic Infra.	Rural Commerce
Customs Duty Exemption	Yes on all inputs	Yes on all inputs	Yes on all inputs	Yes, for K items	Yes, for K items plus	Yes	Yes	Yes for K items	Yes for K items	Yes, for K items plus
VAT Exemption	Yes	Yes	Yes on all inputs	Yes (K)	Yes (K plus)	Yes	Yes	Yes for K items	Yes for K items	Yes for K items plus
Corporate Tax Holiday	Yes	Yes	No	Yes, qualified		Yes			Yes	No
100 %	3 or 5	1-10				1-5				
80 %					Until 31.12.15				1-5	
60%					From 2016-2025				6-10	
50%	6-10 or 4-10	11-15				6-10				
25%	Cont.	Cont.				11-15			11-15	
Accelerated Depreciation					Increase by 50 %		Increase by 50%			
Investment Tax Credit							5% in Maputo and 10% rest of M.	20% for five years		
New Tech & Modernization							10%			
Professional Training							5 or 10%	5 or 10%		

Note: SEZ incentives distinguish between developers and enterprises. Current statutory tax rate 32%. Source: Law 4/2009 Code of Fiscal Benefits

INVESTMENT PROMOTION AND MARKETING

Investment promotion and export development in Mozambique is characterized by a multiplicity of institutions with inadequately defined demarcation of responsibilities and weak coordination. GAZEDA operates as an autonomous agency within an institutionally crowded space.

The Center for the Promotion of Investment (CPI) is Mozambique's lead agency for investment promotion. It was established in 1993 (Decree 14/1993) as the economy adopted a more pro-market and private investment friendly environment. Under the 1993 Investment Law CPI was charged with a number of regulatory function which have the potential to create conflicts of interest with its promotion and marketing functions. When GAZEDA was established in 2010 the role of the CPI was narrowed to business promotion, information and marketing. CPI focuses on targeted investment missions, forums, and official government visits, while also continuing to deliver the following services aimed at facilitating access to investment incentives:

- Provision of institutional assistance to investors for approval and implementation;
- Promotion, reception and registration of investment projects;
- Guarantee of fiscal and customs incentives to investors;
- Identification of potential joint venture partners; and
- Promotion of business linkages (national/foreign and SME/large).

The CPI, functions alongside GAZEDA and a range of other sector-specific investment and export promotion agencies. With no national investment strategy the lines of responsibility are not clearly defined and co-ordination is sub-optimal. Investment promotion continues to be constrained by the absence of clearly defined funding mechanisms, a shortage of well trained staff and unclear demarcation of responsibilities among the One-Stop Shops, the line Ministries at Central and Regional level, CPI and GAZEDA and other agencies. Further notwithstanding the 2008 Decree on Simplified Licensing, licenses are still required for virtually every economic activity in Mozambique with the procedures remaining particularly cumbersome in tourism, construction and health (which are not regulated by the Ministry of Industry and Trade).

The PARPA (2011-2014) focus on increasing agricultural productivity stresses food security and subsistence farming with little emphasis on the opportunities for value addition and opportunities for exporting. There is a weak linkage between sector development plans and investment policy.

The 2009 decree created the Investment Council, comprising Ministers, to be the apex body responsible for designing investment policy. This government only entity has been criticized for failing to engage in routine consultations with the private sector in order to learn at first hand the constraints of the existing business climate. Ensuring effective inter-Ministerial coordination remains a major challenge as the Ministry of Industry and Trade is the only one to monitor the business environment while the Investment Council, CPI and GAZEDA all report to the Ministry of Planning and Development. The OECD report on Investment

Policy (2013) reported that it was difficult to obtain copies of the investment related laws in English. This is not the case today as the website for GAZEDA contains copies in English of all the relevant legislation[3].

Table 6 Mozambique: Investment and Export Promotion Agencies

Investment Promotion Agency	Relevant Legislation	Related Activities and Implementation Strategy
CPI (Center for the Promotion of Investment)	Decree 14/1993 under the Ministry of Planning and Development	Promotion and provision of assistance to Investors for approval and implementation. Provision of Investment Licenses which is required to obtain investment incentives.
GAZEDA (Office for Accelerated Economic Development Zones)	Established in 2007 under the Ministry of Planning and Development	Promote and Coordinate activities related to creation, development and management of SEZ and IFZ. Approval of SEZ/IFZ status.
CEPAGRI (Center for the Promotion of Agriculture)	Decree 20/2006 under the Ministry of Agriculture	Facilitates investment and licensing of agro-industrial projects
INATUR (National Tourism Institute)	Decree 36/2008 under the Ministry of Tourism	Promotion and development of tourism, development of tourism zones-focused on Mozambique Tourism Anchor Program with Ministry of Tourism and GAZEDA
IPEME (Institute for Small and Medium Enterprises)	Decree 47/2008 under the Ministry of Industry and Trade	Technical Support to SMEs –four sectors: agricultural commercialization; textiles and apparel; chemicals and rural industrialization
IPEX (Export Promotion Institute)	Decree 25/1990 under the Ministry of Trade	Increasing export base, providing trade information, and assist exporters with focus on SMEs

Source: Derived from OECD (2013) and Interview Notes

One private sector investor observed 'GAZEDA can have a great team but if the country is not on board with the private sector its impact will be limited.' He then added 'the success of GAZEDA will be measured by the success of the country.' This is very true and is a key message. The SEZ cannot succeed in isolation from the rest of the economy. What happens in the economy in trade facilitation, in the business enabling environment and the attitude to the private sector will influence investment in the zones.

[3] http://www.gazeda.gov.mz/index.php?option=com_content&view=section&layout=blog&id=16&Itemid=172&lang=en

TRADE POLICY

Mozambique has a simple average MFN of 12.1 per cent, and a trade weighted average tariff of less than 9 per cent. There are four non-zero bands of 2.5, 5, 7.5 and 20 percent with approximately one third of all tariff lines at 5 per cent or zero. Rates are fairly stable and any adjustments are publicized. Mozambique applies tariff surcharges to sugar, cement, galvanized steel, and certain steel tube products. Goods may also be subjected to VAT at 17 per cent and an Excise tax which ranges from 15-65 per cent. Excise and VAT are also levied on the same products at the same rate when produced domestically.

The Fiscal Code (as noted above) provides for widespread tariff exemptions for specific sectors-agriculture, tourism, mining and petroleum as well as to industries located in the SEZ and the IDZ. The cumulative effect of all these exemptions is substantial with the tariffs actually paid being significantly lower than the published average tariffs. The benefit of these tariff exemptions is almost exclusively captured by large importers.

In the recent Country Economic Memorandum the World Bank calculated that reducing both the tariff exemptions and the tariff rates would reduce distortions in the economy and create a level playing field for all firms irrespective of their size or whether they were producing for the domestic or export market. Eliminating exemptions and reducing the maximum tariff to 10 per cent was found to be revenue neutral.

SEZ AND REGIONAL INTEGRATION

Mozambique is implementing the SADC Trade Protocol and has committed to remove tariffs on all intra-regional trade by 2015. The impact of the SADC FTA has been limited owing to the slow phase out of tariffs, onerous rules of origin on many labor intensive products, and other non-tariff measures. In the 2012 only 43 per cent of imports from SADC entered Mozambique using the SADC trade preferences.

Mozambique is participating in the negotiations for a Tripartite Free Trade Area (TFTA) that would bring together the three Regional Economic Communities of SADC, the Common Market for Eastern and Southern Africa (COMESA) and the East African Community (EAC). Mozambique still has to submit a tariff phase down offer under the TFTA.

In June 2009 Mozambique joined with Botswana, Lesotho and Swaziland signed an economic partnership (EPA) with the European Union. Under the EPA Mozambique has more permanent and legal enforceable access to the EU than under the Everything But Arms program for LDCs. Under the EPA Mozambique has committed to removing tariffs on 80.5 per cent of trade with the EU.

Given the existing commitments under SADC, and the EPA and with the prospect of further regional tariff preferences for the TFTA Mozambique should consider reducing tariffs on a multilateral basis. Reducing the MFN tariff would create a much simpler and easier to administer (because there would be no need to prove the eligibility criteria were met) import regime. Mauritius embarked on multilateral tariff reductions as they moved to implement both the COMESA and SADC Free Trade Areas. Liberalizing on an MFN basis would send a very positive signal to international investors and would reduce anti-export bias.

Under the existing fiscal incentives firms approved for Industrial Development Zone status have to export 70 per cent of their production outside of Mozambique. Should the firm export to Mozambique it becomes liable to pay import duty on both the inputs and on the final product. While the Fiscal Incentives Act allows for firms located in the IFZ to import duty free under the regional trade preference and sell within the domestic market it appears that not all Customs Officials are aware of this provision. One firm in Beluluane, when interviewed stated that when they sold their products into the domestic market Customs considered the firm to be liable to pay the full MFN tariff on inputs from South Africa even though the product was eligible for duty free importation under the SADC Trade Protocol. This is the wrong interpretation of the legislation and required GAZEDA to intervene. GAZEDA reported that they had resolved a similar problem for a company located in the Nacala Zone.

Customs regulations in the IFZ were cited as being too rigid and not responsible to normal business practices. The company services machinery for Mozal and experiences frequent delays in obtaining replacement parts and completing the refurbishment. Customs only allow a release of one month for goods to be moved between companies in the IDZ after which they have to either be returned of subject to a fine.

INVESTMENT IN THE SEZ AND IFZ

In 2012 the manufacturing sector accounted for 2.8 per cent of the total labor force. One company, Mozal employs 1,200 workers and accounts for 75 per cent of manufacturing output and half of total exports.

A 2012 Survey of Mozambican Manufacturing Firms by the Ministry of Planning and Development's Directorate of Studies and Policy Analysis (MPD/DNEAP 2013[4]) found that approximately 25 per cent of all workers in the formal sector received the minimum wage. This represents a significant reduction-from 44 per cent –from 2006, and reflects the difficulty experienced by many firms when the nominal minimum wage was increased in real terms 55 per cent between the two dates. The large increase in the real wage level was not matched by productivity improvements, indeed labor productivity stagnated. It is apparent from firm level surveys that almost half of workers were willing to work for less than the minimum wage. This means that formal sector firms who are subject to frequent visits by the Ministry of Labor face higher wage costs and may create fewer jobs.

The MPD/DNEAP survey compiled a list of the major constraints to business as perceived by the same firms in both the 2016 and 2012 surveys. More than 95 per cent of the firms in the sample produced for the domestic market. From the firms surveyed, virtually all of whom were producing for local sale, more than half of all the firms listed as 'competition from illegal imports' as a constraint. This was closely followed by access to land, the administration of customs and trade regulations, and corruption related to customs, followed by anti-competitive practices, access to domestic credit, transportation, opening up to international markets and macroeconomic stability. Given the relatively high level of natural protection provided by logistics and transport costs the concerns over trade related issues is problematic.

Despite the recent legislative reforms aimed at simplifying registration and accessing the investment incentives the procedures remain rather cumbersome for most medium and small scale investors with the results that they choose not to apply for an investment license and forego the incentives.

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[4] The survey collected questionnaires from over 750 firms in 10 cities and covered 7 provinces in Mozambique. Over 200 of the firms present in 2012 were also present in 2006 and 2009 which permitted a review of firm level data over time.

Since the establishment of GAZEDA in 2009 they have been responsible for promoting investment into the Special Export Zones (SEZ) and the Industrial Free Zones (IFZ). The first SEZ dates from 2007 at Nacala and the first IFZ at Beluluane was launched in 1998 with the establishment of Mozal. Nacala is managed by GAZEDA. A second SEZ, covering 1000 hectares, to be managed by a Chinese investor was launched in 2012 at Manga-Mungasa/Beira. Then in 2013 Crusse and Jamali, also to be managed by the private sector and the entire district of Mocuba totally 10,000 square kilometers was announced as an SEZ in June 2014. GAZEDA will be responsible for promoting the development of the Mocuba SEZ. GAZEDA is still seeking a private sector partner to develop the concept for the proposed integrated tourism SEZ at Crusse and Jamali which is 14 km from Nacala.

Table 7 shows the sectorial breakdown of all investments approved by GAZEDA since they began operations in 2009 through to the end of the second quarter of 2014. From more than 140 projects across a wide range of activities more than 50 per cent are manufacturing and tourism related. In aggregate Services (including health), commercial activities and agriculture account for 20 per cent of the total number of projects, which is relatively low for economy where the majority of the population continues to rely on agriculture.

Table 7 Investments Approved by GAZEDA 2009-2014

Type of Project in ZEE and IFZ	Percentage of Approvals
Industrial	33
Tourism	22
Infrastructure	14
Agro-Processing	11
Services	10
Commercial	6
Health	2
Agriculture	2

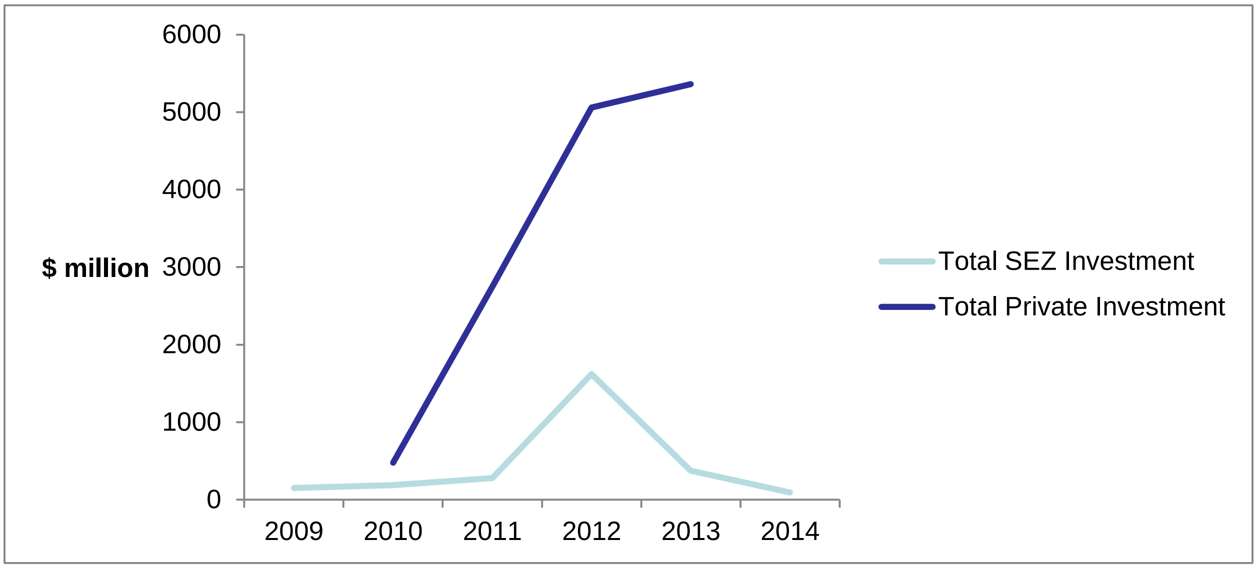
Source: Derived from data received from GAZEDA.

There are three Industrial Free Zones (IDZ) at the Beluluane Industrial Park (700 hectares located just outside Maputo and including the Mozal plant, to date the serviced IFZ totals 24 heactares), Locone (176 hectares located within the Nacala SEZ which is still being developed), and Mocuba (located within the Mocuba SEZ and not yet developed), and for approving factory or unit specific IDZ which can be located anywhere in the country. To date 13 isolated IDZ have been approved. Over the past five years GAZEDA has approved a total of 140 projects with the overwhelming majority being located in the Nacala SEZ which covers a total area of 1,500 square kilometers and includes both Nacala Porto, Nacala a Velha and the Nacala International Airport which is scheduled to open in December 2014.

Figure 1 illustrates the SEZ/IDZ investment approved relative to total private investment (which is defined as all investment excluding government investment. Over the period 2010-2013 approvals by GAZEDA accounted for 18 per cent of total non-government investment in Mozambique.

Table 7 shows the total number of approvals by GAZEDA since it was established, and Table 8 shows the project approvals for Nacala. It is apparent that most of the approvals are for investment in Nacala with very limited new investment in Beluluane or elsewhere as a firm level IDZ. The majority of projects approved for Nacala are either engaged in infrastructure development related to the SEZ, or light engineering and agro-processing aimed at primarily serving the domestic market, although a number of firms are also aiming to export to the region. The firm level IFZ include a garment factory engaged in Cut-Make-Trip aimed at the US market where the goods enter duty free under AGOA.

Figure 1: Investment Approved by GAZEDA and Total Private Investment in Mozambique



Source: Derived from data received from GAZEDA and the IMF Country Report 2013.

The information on the approvals contains data on the value of domestic and foreign investment and the number of local and expatriate jobs. GAZEDA does not routinely collect detailed firm level data on the level of investment, number of jobs and skill levels, value added, source and cost of inputs, value and type of exports. In addition to the quantitative data it would also be useful for GAZEDA to collect qualitative data from the companies relating to doing business in the zones. This would enable GAZEDA to carry out systematic evaluations of performance.

Table 8 GAZEDA Approvals for ZEE and IFZ Projects, 2009-2014.

Year	Number of SEZ/IFZ Projects Approved	Nacala Number of Projects	Total Investment ($million)	Nacala as % of Total Investment	Total Employment	Nacala as % of Total Employment
2009	12	11	152	96.1	5,307	86.8
2010	27	22	187	90.4	3,114	86.5
2011	11	8	281	11.0	5,478	8.3
2012	28	22	1,620	65.4	8,868	67.5
2013	48	47	374	86.4	3,329	93.5
2014*	14	14	95	100.0	1,217	100.0

Notes: 1. 2014 covers the first six months through to June 30. Employment only refers to Mozambique nationals. Both employment and investment data are based on the project submissions to GAZEDA and represent the expected investment and employment when operating at full capacity. Source: From information received from GAZEDA.

Table 9 Projects Approved and Under Implementation in the Nacala SEZ, 2010-2013

Name	Sector	Year Approved	Employment	Investment ($m.)
Bakhresa Grain Milling	Agro-Industry	2010	100	39.2
S & S Refining	Agro-industry	2010	80	40.0
Odelrecht	Construction	2010	500	5.6
China Harbor	Construction	2010	500	36.8
CLIN	Construction	2012	2,125	773.9
OAS	Construction	2012	798	117.4
Moageiras Do Norte	Agro-Industry	2012	157	13.7
NCL & Africa	Construction	2012	92	30.0
CR2OG	Construction	2013	798	80.0
M & M Steel	Engineering	2013	225	30.0
Martifer-Amal	Engineering	2013	203	19.8
Merec Industries	Agro-Industry	2013	56	24.7
Oscacer	Manufacturing	2013	24	26.5

Note: Employment refers to Mozambique nationals only. Source: Data received from GAZEDA.

Interviews with a number of firms located in Beluluane and the Nacala SEZ highlighted a number of constraints on doing business in Mozambique. Almost all the firms mentioned the problem of electricity outages and power fluctuations. In the case of one firm frequent power fluctuation had resulted in sensitive machinery having to be repaired. Most of the firms had invested in stand along diesel generators however this more than tripled the cost of power. While all the firms were very supportive of the work of GAZEDA staff they noted that other responsible government agencies frequently adopted or introduced new procedures and regulations that were unrealistic and took time to resolve. Frequent mention was made of the culture of certain government agencies which assumed all private firms were trying to circumvent the law. The uncertainty over delays in issuing visas for expatriates was a common complaint, although there was no evidence of an outright refusal the firms spoke of the time take to obtain approval.

All the firms interviewed spoke of the shortage of skilled labor and the relatively low productivity levels. The more labor intensive apparel manufactures who are performing cut-make-and trim operations expressed some frustration that the minimum wage was recently increased without any reference to productivity improvements.

Table 10 shows the approved investment and employment for firms locating in Beluluane from the launch in 1998 to 2014. The initial large investment is for the Mozal Mega Project. It is apparent that the zone has experienced difficulties in attracting additional investment beyond Mozal. Even at these low levels of investment the Zone is currently operating at its capacity in terms of the available electricity supply.

Table 10 Beluluane Industrial Free Zone

Year Implemented	Investment ($million)	Employment
1998	1,500.00	1,060
1999	0.27	130
2000	0.00	0
2001	0.00	0
2002	6.79	194
2003	0.00	0
2004	0.16	64
2005	2.05	363
2006	0.00	0
2007	36.99	152
2008	0.00	0
2009	2.40	700
2010	17.88	476
2011	6.66	2,075
2012	3.48	160
2013	0.00	0

Note: 2013 up to March 31. 2004 excludes investment of 1.55 and 414 jobs approved for IFZ status and located in Avenida.

SEZ AND THE RESOURCE BOOM IN MOZAMBIQUE

In the two decades since the end of the civil war Mozambique has been one of the fastest growing economies in the world, with the long run average exceeding 7 per cent. To date most of the growth stems from foreign investments in large export oriented capital-intensive projects that create relatively few jobs, and have few linkages with the rest of the economy. The enclave nature of the existing megaprojects should not detract from their contribution to economic growth, exports, value added and the positive signal to the international community that Mozambique is ‘Open for Business.’

The government has put in place many of the building blocks required for encouraging private sector investment and has tried to encourage both upstream and downstream investments related to the Mozal plant. The first serviced industrial estate at Beluluane is located close to Mozal and was aimed to attract engineering fabrication and engineering service industries that would serve the aluminum smelter.

The recent discovery of large natural gas and mineral deposits provide Mozambique with a unique opportunity to move closer to realizing the Vision 2025 goal of ensuring prosperity for all Mozambican’s by accelerating inclusive growth and reducing poverty. Existing megaprojects include the Cahora Bassa hydropower plant, Mozal, the Sasol natural gas project in Inhambane, and large investments in coal mining (Moatize), heavy sands in Nampula and number of other coal projects all located in Tete province. Currently a further ten megaprojects are under constructions and expected to come on stream between 2016 and 2020.

The expected economic impact of the existing and planned megaprojects is expected to increase government revenues by 21 per cent by 2032 and to account for 7 per cent of GDP. The geographical locations of these natural resource related megaprojects cluster around three identified regional growth poles. These are: Mozambique/Southern Malawi from the Tete Province to Nacala; the Ruvuma Basin in northern Mozambique linking with Songo-Songo in Tanzania; and Central Mozambique/Zimbabwe along the Beira Corridor.

Table 11 Planned Megaprojects 2014 - 2020

Company	Sector	Location	Construction	Production
Mphanda Nkuwa	Electricity	Zambezi River, Tete	2014-18	2018
Anadarko (US)	Natural gas	Rovuma Basin	2014-19	2020
Eni (Italy)	Natural gas	Rovuma Basin	2014-19	2020
Statoil (Norway)	Natural gas	Rovuma Basin		
PETRONAS (Malaysia)	Natural gas	Rovuma Basin		
Minal de Revuboe	Coal	Tete	2013-15	2016
Ncondezi	Coal and Power	Tete	2015	2016/2017
Baobab Resources	Iron ore	Tenge, Tete		
ERNC	Rail Line and Coal	Tete	2014-15	2016
Corridor Sands	Heavy sands	Gaza Province	2014-15	2016

Source: drawn from Table 2.1 IMF (2014)

Exploiting the Tete coal reserves has stimulated large scale investment in transport infrastructure along the Nacala corridor including the construction of a new rail and coal port terminal and the rehabilitation of the rail line through Malawi. The commitment to develop the mine at Moatize (in 2007) along with the complementary infrastructure was a key factor underpinning the decision by the GOM to establish the Nacala SEZ with the aim of attracting additional DFI. While Mozambique has managed to attract resource-based investments the record in attracting labor intensive economic activities with more linkages to the domestic economy is much more modest. Recent reviews of the Mozambique economy, including reports by the IMF, World Bank, UNCTAD and the OECD, agree on the two critical bottlenecks holding back diversified investment and growth, firstly, the shortage of critical infrastructure -access to a reliable power supply and, secondly, the difficult business enabling environment.

Unlike the earlier megaprojects where use of the ancillary infrastructure was restricted to the specific project new infrastructure developments will be more open. For example, the Nacala railway line will primarily be allocated to coal transportation but provision has also been made for passenger and other cargo traffic. The tax revenue from the megaprojects will create additional fiscal space for the construction of public infrastructure and for diversifying the revenue base and reducing the relative importance of trade taxation.

CHAPTER 5 RECOMMENDATIONS

Ensuring the Special Economic Zone program in Mozambique makes a significant contribution to reducing poverty, increasing employment, expanding exports, and promoting a diversified manufacturing and service sector will require a number of administrative and policy reforms to be enacted. Delivering a successful SEZ program is not easy or straightforward as it requires a number of conditions to be present. These include ensuring an appropriate location with good infrastructure, transport links and access to labor, a conducive policy and business enabling environment, sound planning, an effective and transparent legal framework, and efficient zone management. A successful SEZ will not be an enclave but will be closely linked with the national economy, the national investment and business environment and the capacity of the government. A key lesson is that for SEZ to succeed in stimulating transformative growth the zone program is a forerunner for wide ranging economic reform throughout the whole economy.

The proposed reforms are organized according to those that can be implemented within the existing policy and regulatory framework and therefore can be fast-tracked, and those that will take place over the medium to long term.

Short Term

- **Strengthen Investment Promotion coordination**. Develop and implement a national investment policy which clarifies the institutional roles and responsibilities between GAZEDA and CPI.
- **Ensure SEZ are integrated into National Planning Process**. The SEZ and IFZ must be linked with the broader economic strategy as outlined in the PARPA and other policy documents. It is important to ensure publicly owned utilities, provincial administrations, land offices, national line Ministries (e.g., Agriculture, Tourism) all integrate the SEZ/IFZ into their work plans. This issue could be included on the Standing Agenda for every Investment Council Meeting.
- **Strengthen the Monitoring and Evaluation function within GAZEDA** and develop technical capacity for undertaking applied cost benefit analysis and impact assessment to guide future implementation and public infrastructure investment and investment targeting based on comparative advantage.
- **Increase transparency in the investment approval and licensing process**. Separate the regulatory and promotional functions within the key agencies responsible for investment in SEZ and IFZ and throughout the country. Publish a list of information requirements for all investors.
- **Strengthen the Government-Private Sector Dialogue**. Establish a formal mechanism for ensuring the views and perspectives of the private sector are brought to the attention of Senior Government Officials on a regular basis. Increase the number of representatives from the private sector on GAZEDAs Consultative Council.

Medium Term

- **Further streamline regulations and licensing requirements to enable GAZEDA to function as a One-Stop-Shop for Investment Approval**. This will require extensive negotiations with a wide range of government agencies as well as the relevant Municipal Authorities.
- **Review the Fiscal Incentives to ensure increased transparency and to move towards a single harmonized rate of corporate tax** that does not discriminate between different types of economy activity.
- **Implement further tariff policy reform and a comprehensive review of trade facilitation in order to reduce trade costs**. The declining importance of tariff revenue in conjunction with increased government revenues from the development of the mega projects and natural resource extraction, and the commitment to further regional integration creates an opportunity to further reduce import tariffs across the whole economy. Previous substantial reductions in the tariff have revealed the importance of also addressing non-tariff measures including all trade facilitation and transport costs.

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