Mozambique Business Environment 2006

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The Miracle

In the eyes of the world Mozambique is an African economic success story, with high growth rates, real development and visible progress in the reduction of poverty. Mozambique’s economy has been growing at impressive rates over the past years, averaging around 8% per year from 1992 to 2003. In 2004 and 2005 it grew at 7.2% and 7.7% respectively. The poverty headcount has fallen from 69% in 1996/7 to 54% in 2002/3. Inflation has come down from the high levels of the late 1990s of over 60%. On the whole, the consumer price index rose 11.1% in 2005 with an average of less than 8%. The country has been at peace for over 10 years and is politically stable, having held numerous free and fair elections. All this has contributed to increased international confidence and a better “Brand” or reputation for Mozambique resulting in increased foreign direct investment, especially in large capital and energy intensive industries.

The Progress

The business environment has also improved over the last years. Business Registration times have gone down from an average of 153 days to 111 days. The one stop shops of the Ministry of Industry and Commerce have facilitated the registering and licensing of business and business activities lowering the cost and time of both. In 2005 the financial sector and banks have increased credit by 48%, and micro financial institutions gave out 7.5% more credit. Progress has been made in reimbursements of the value added tax credits to businesses. The maximum import tariff rate from SADC countries has been lowered to 20%. The customs system has improved in efficiency and lower cost. The elimination of the visa requirements from South Africa and Swaziland has had a positive impact on business, especially for the tourism sector. There have also been significant improvements in the infrastructure throughout the country.

The Promise

The government is presently working on important issues that will have a significant impact on the cost of doing business and promoting investment. These include comprehensive labor market reforms that aim to promote flexibility in labor contracting while lowering the cost to employers; judicial reform aimed at increasing the efficiency and lowering the time and cost of processes as well as strengthening property rights; improved governance including addressing procurement and corruption; fiscal reform that lowers the time and cost of compliance as well as the promotion of investment without lowering revenues; and continuing major investments in improvements in infrastructure, particularly roads and electricity.

Competitiveness

While all of the above are good and offer progress in economic and social development, it is important to remember that Mozambique competes with other countries for business and investment. As such, a comparison of the country to the rest of the developing world, especially its main SADC competitors, is vital.

Business and Investment Environment

In the World Bank 2006 "Ease of Doing Business", Mozambique ranks 110 out of 155 rated countries. Mozambique is ranked low worldwide but, more importantly, it is lower than the best in SADC, its competitors for business and investment. Its rank is far below that of Mauritius (23rd). South Africa, Mozambique's most important trading partners, is ranked 28th. In individual classifications of ease of doing business, Mozambique is again ranked low compared with the rest of the world and also with its SADC trading partners. This includes starting a business – 139th. (Annex 1: Mozambican Business Environment)

International Trade

The Mozambican international trade regime has improved. There are fewer tariff rates, a lower maximum rate, and customs management has improved. But it still takes an average of 41 days to export (that is, after the contract and letter of credit have already been agreed upon and signed by both parties) and also an average of 41 days to import. Mauritius takes only 16 days to export and import goods. South Africa takes 31 days to export and 34 days to import. (Annex 1)

The Financial Sector

The high cost and lack of availability of credit is one of the most, if not the most important impediment to the development and profitability of the private sector of Mozambique. The Mozambican banks are presently charging double-digit real rates of interest for borrowing. This is exacerbated by the fact that interest spread between savings and borrowing is perceived to be excessive. Mozambican economic development requires and depends on a viable financial system, both banking and non-banking.

Part of the problem of offering more credit at lower cost is structural. The judicial system takes an average of 580 days and 38 processes for a court case in order to enforce contracts. The cost of a court case averages 16.0% of the contract. The time it takes is more than twice that of South Africa (277 days), while the best country in SADC, Botswana, takes only 154 days. In order to close a business or reorganize one, it takes an average of 5 years while in South Africa it takes an average of 2 years and in Namibia it takes only one year. Also, Mozambique's public credit registry has very limited coverage and there is no private credit bureau in the country. The property registry for fixed and movable assets is outdated, manually maintained, and not centralized. (Annex 1)

Employment

Mozambique has a labor force of 9.2 million of which 521 thousand are formally employed in 2003 (INE 2004), representing less than 6% of the total labor force. An estimated 7.4 million people make up the rural labor force, 89.7% of which is employed in agriculture, forestry, and fisheries, but less than 3% have private sector jobs. At least 93% of the rural labor form the small scale farmers and self-employed. (World Bank, Mozambique, Country Economic Memorandum, Sep. 27, 2005, pp 39, 49) The informal economy is estimated at approximately 40% of the GDP and employs an estimated 76% of the urban labor force. The labor employed outside the formal sector is characterized by low productivity, low wages, low incomes, and few social benefits.

There are many reasons for such a large part of the labor force operating outside the formal economy. Mozambique is ranked 113th in the overall index for the hiring and firing of workers. The fixed cost of retrenchment is equal to 141 weeks of salary (for a worker that has been with a firm for 20 years). In South Africa the cost is equal to 38 weeks and the best in SADC, Mauritius, it equals 15 weeks.

Public Finances

In 2002, the government of Mozambique enacted major income tax reform. This reform included an overhaul of the 1993 Fiscal Benefits Code and other special tax regimes, which had been widely criticized as costly and complicated. The new Code simplifies and consolidates previous programs, and reduces the extent of tax relief for most investors.

The total government revenue for 2005 is projected to be 13.8% of GDP, while tax revenues are estimated to be 12.4%. The revised estimates for 2004 are 12.6% and 11.7% for total revenue and tax revenue respectively (IMF February 2006, No 06/46). The problem is that the tax revenue is derived from a very small base, including private sector enterprises (estimated at 32 thousand) and formal employees (approximately 500 thousand). Another problem is that there are numerous tax reductions and tax credits for many of the large new investments and mega projects. One estimate is that if all these projects paid normal taxes the government revenue would increase by over 3% of the GDP.

Mozambique also has too many different taxes and payments making the process more bureaucratic, complicated, costly, and time consuming than necessary. It has 35 taxes and government payments. It takes an average of 230 hours to comply with the tax reporting regulations. Besides, some of the tax rates are too high and form a disincentive to investment. The payable corporate tax rate is equal to 50.9% of enterprises' income (these include the corporate tax, tax on dividends, and others). Mauritius has only 7 payments and it takes only 158 hours to comply with the regulations. Its payable corporate tax is 38.2%. (Annex 1)

Conclusion

The macro and political situations have given Mozambique good statistics/figures, and the government is working on many of the important issues. However, the real state of affairs is not so good. Positive macro economic indicators and a stable political environment are insufficient to promote the growth of the traditional economic sectors. The traditional private sector firms in the formal sector face bureaucracy, red tape, and corruption at all stages of doing business. Traditional exports, with some exceptions, have shown pathetic growth rates. Unemployment and underemployment are not high but astronomically high. The traditional manufacturing sector is stagnant with plant and equipment working at less than 50% of capacity.

In order to compete and be successful in attracting business and investment, Mozambique must offer the best business conditions and environment possible. It is not important that Mozambique's business environment be as good as the average countries in SADC, it is essential that it be better than the best.