9

Strengthening Mozambique's Business Environment: Diagnostics, Strategies, and Outcomes

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Strengthening the business environment has been increasingly recognized as central to accelerating and sustaining broad-based and pro-poor growth in low-income countries. It involves policy and institutional changes in a wide range of areas, from property rights and business regulation to infrastructure and labor markets, as well as deeper institutional reforms to enhance governance and combat corruption.

Recent experience shows, however, that countries do not need to embark on simultaneous and comprehensive reforms but can reap significant benefits from gradual, sequenced reforms.[1] Policymakers need to identify and address the most binding constraints first, so as to give firms the confidence and will to address other constraints as they become more binding. Careful diagnosis and the development of an appropriately sequenced, well-coordinated action plan owned by the government and supported technically and financially by the donor community are essential.

This chapter will attempt to provide further support for this view using Mozambique as an example. Several studies have already been conducted for the purpose of identifying the main obstacles to private sector development in Mozambique. Periodic assessments of the cost of doing business

[1]See World Bank (2005a).

in Mozambique have attempted to quantify and benchmark the country's progress in addressing these obstacles.[2]

Building on this previous work, this chapter

- Introduces some basic tools and best practices that have been shown to foster business environment reforms;
- Benchmarks Mozambique's business environment against that of other countries in sub-Saharan Africa and emerging markets worldwide, with the aim of identifying reform priorities;
- Assesses Mozambique's new strategy, particularly the extent to which the reforms address the most binding constraints, have a noticeable impact, and are implemented in ways that foster ownership and coordination; and
- Drawing on the experience of other low-income countries, summarizes lessons on how to design, implement, and coordinate a reform strategy that promotes private sector development.

Fostering Business Environment Reforms

According to recent studies, there are three main challenges to fostering business environment reforms (Kikeri, Kenyon, and Palmade, 2006). First, the list of potential reforms needed, particularly in low-income countries, is long, and determining the right mix of reforms and sequencing them in a way that enhances welfare is a complex task. Second, because such reforms often have distributional consequences, they can be politically contentious. To overcome political resistance, reform proponents must be aware of the preferences and political clout of various groups and institutions. Third, sustaining reform, even in a supportive political environment, involves strengthening public officials' incentives and their capacity to implement reform and introducing institutional mechanisms for coordinating and monitoring the reform process.

Against this background, this section introduces basic tools and reform strategies that can be used to design, implement, and sustain business environment reforms. It establishes an analytical framework by which to evaluate the design, implementation, and sustainability of Mozambique's reforms to improve its business environment.

[2]See IMF and World Bank (2003); World Bank (2005a); and USAID (2004).

Getting the Priorities Right

Some sequencing of reforms is inevitable, especially in a realm as far-reaching as the business environment. Improving the business environment, particularly in low-income countries, requires governments to tackle a broad reform agenda, ranging from refining macroeconomic policies and pursuing deeper institutional changes to enhancing property rights and combating corruption. Simultaneous and comprehensive reforms, even if technically and politically feasible, could generate so much uncertainty that they might deter rather than encourage investment, at least temporarily. Deep and rapid institutional change can also impose large costs on influential segments of society, undermining public support and jeopardizing reform momentum.

The advantages of a more gradual, sequenced approach to private sector development reforms have been corroborated by several countries' recent experiences. Private sector–led growth has successfully taken off in countries that identified and addressed important constraints, giving firms the confidence to invest, while sustaining the reform process so that other constraints could be addressed as they became more binding (World Bank, 2005b; and Hausmann, Rodrik, and Velasco, 2005). Getting the priorities right is, therefore, essential for a successful reform strategy.

A growing body of new diagnostic tools and information is available to help reformers identify priorities. These tools include business surveys, benchmarking techniques, and growth-enhancing decision-based trees.

Business surveys

The most direct way of identifying business environment constraints is to survey firms. The World Bank's Investment Climate Assessments (ICAs), for example, are comprehensive, subjective reports on the business environments in different countries. ICAs draw on the results of surveys of firms and other diagnostic tools. Business surveys have proved useful in enhancing a government's credibility with firms and helping to identify possible implementation issues. However, such assessments are less effective in identifying policy barriers to competition (entry and exit) since they do not cover firms that have not yet entered the market. Business surveys also tend to overestimate the negative impact of factors such as taxes, whose costs are borne privately but which may yield positive benefits for the business environment, such as the public provision of infrastructure and the consolidation of macroeconomic stability. Reformers must take these factors into consideration when setting priorities.

Benchmarking

Benchmarking the investment climate involves comparing a country with its competitors on various factors that affect investment decisions. For example, the World Bank's Doing Business database ranks countries according to the cost and quality of their business regulations in such areas as business registration, contract enforcement, labor regulations, and access to credit.[3] The World Bank's Governance Indicators also make it possible to benchmark countries in other areas relevant to investment decisions, such as government effectiveness, corruption, and political stability.[4] Low rankings in a particular area relative to potential competitors can thus help identify what a country's reform priorities should be.

However, it is not enough to know a country's ranking. The next step is to understand the reasons for the ranking and how it can be improved. Identifying policy changes, perhaps in line with the policies of the best-performing countries, is the ultimate purpose of benchmarking the investment climate. The growth diagnostic framework provides an alternative and somewhat complementary approach.

Growth Diagnostic Framework

The Growth Diagnostic Framework developed by Hausmann, Rodrik, and Velasco (2005) identifies reform priorities on the basis of the impact of different reforms on output growth. The point of departure is the standard steady-state equilibrium for sustainable private sector growth summarized in equation (1) below. In the steady state, output, consumption, and capital grow at an identical rate γ, which equals the difference between private returns to capital accumulation ($r(1-\tau)$) and its respective cost of financing (ρ), discounted by individual preferences for immediate consumption (σ). In this context, proximate determinants of sustainable growth can be classified broadly in two categories: (1) private returns to the accumulation of production factors, namely human and physical capital; and (2) the corresponding costs required to finance their accumulation (for example, the costs of investment and education). Private returns can be modeled as a function of social return (r) and its corresponding *degree of private appropriability* $(1-\tau)$. Social returns, in turn, are determined by *total factor productivity* (a), the availability of complementary factors of production, such as *infrastructure* or *human capital (x)*, along with external economies (θ).

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[3]Doing Business indicators are available via the Internet: http://www.doingbusiness.org.

[4]Governance indicators are available via the Internet: http://info.worldbank.org/governance/kkz2005.

$$\gamma = \sigma\{[r(a,x,\theta)(1-\tau)]\rho\}. \tag{1}$$

Therefore, under this proposed framework, the most binding constraints to sustainable growth can be diagnosed in two stages. In the first stage, the goal is to identify which of the proximate growth determinants is subject to the greatest economic distortions. Once the most highly distorted proximate growth determinants are identified, the diagnosis moves to a deeper level with an attempt to identify which particular policies or institutional reforms are required to remove these distortions. An appropriate reform sequence requires continuously replicating this diagnostic exercise under the assumption that the initial constraints are removed when the corresponding reform is implemented.

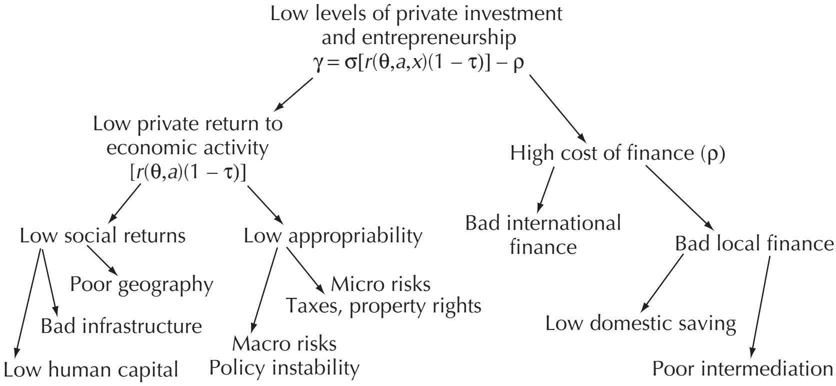
The tree-shaped diagram in Figure 9.1 illustrates this diagnostic process. For instance, if the problem seems to be the high cost of finance rather than insufficient returns, is that cost due to lack of access to external savings or to scarce local finance? If scarce local finance is to blame, does that reflect low domestic savings or poor financial intermediation?

The methodology for performing growth diagnostic exercises is still evolving. Initial growth exercises, including those performed by the original proponents, were conducted mostly through historical analyses of recent growth episodes in individual countries.[5] Such an analysis would basically entail defending the prevalence of a given binding constraint against the alternative, on the basis of direct or indirect measures of prices (or shadow prices) for production factor returns and the cost of financing. The exercise would then move to the second stage, where specific policies or institutional reforms would be selected on the basis of their impact on growth and political feasibility without being guided by any clear methodology.

To overcome that limitation, Johnson, Ostry, and Subramanian (2007) have proposed a simple benchmark approach that identifies constraints to sustainable growth. Their approach compares the quality of policies and institutions widely regarded as essential to sustainable growth in a given country with that observed in countries that have sustained growth at the time growth first took off. In this context, their methodology also includes assumptions to determine where and when growth became sustainable.

[5]Hausmann, Rodrik, and Velasco (2005) have attempted to identify reform priorities for Brazil and El Salvador on the basis of a historical analysis of impediments to growth acceleration.

Figure 9.1. Growth Diagnostics



Source: Hausmann, Rodrik, and Velasco (2005).

Making Reforms Work: Implementation and Sustainability

Correctly identifying the most welfare-enhancing or growth-enhancing priorities is just the first step in the design and implementation of a successful reform strategy. Equally important are (1) packaging and building a consensus for reforms, to ensure their implementation; (2) strengthening public officials' incentives and ability to enforce such reforms; and, (3) introducing institutional mechanisms for coordinating and monitoring the reform process so it can be sustained.

Therefore, from a purely welfare-enhancing perspective, getting reforms implemented often implies that adjustments must be made to the optimal reform sequence so as to overcome political and administrative constraints. Recent experience has revealed the following successful strategies for implementing and sustaining business environment reforms:

- **Build coalitions that can support reform.** Growth-critical reforms of the business environment usually benefit a wider but less influential segment of the population, while the costs are borne mostly by smaller but more politically powerful groups. In such cases, support can be mobilized by empowering pro-reform leaders and organizations and by conducting public campaigns to disseminate information about the benefits of reform. In addition, policymakers can defuse opposition by establishing a process of consultation with reform opponents and, in cases where losses are easily measured, not substantial, and concentrated in a small identifiable group, through compensatory schemes.

- **Act swiftly.** Political resistance to highly contentious reforms usually softens during economic crises, periods of growth, post-conflict situations, and immediately after a legitimate change in political leadership. Seizing these windows of opportunity can ensure that reforms are implemented.
- **Start with reforms that are credible and feasible.** In cases where reformers lack political support and administrative capacity, pilots or other less complex, quick-win measures might reinforce a government's reform commitment, encourage the development of pro-reform constituencies, and jump-start the reform process. Pilot programs can be important catalysts for nationwide reforms through learning and demonstration effects. Identifying and implementing quick-win measures can help build constituencies that will support more contentious measures.
- **Reforms that expose the economy to international competition are a good starting point.** By increasing competition, trade and financial liberalization give domestic constituencies reasons to tackle other important business environment reforms, such as land, labor, and financial measures.
- **Monitoring should be a central part of the reform process.** This function involves several tasks: evaluating the potential costs and benefits of reforms, translating reform objectives into measurable performance targets or indicators, and reviewing compliance and outcomes once implementation begins. Monitoring is critical, as it allows citizens to hold reformers accountable.
- **Sustained reforms require strong oversight and coordination mechanisms.** Business environment reforms touch on cross-cutting issues (for example, anticorruption laws, vocational training schemes, and the provision of basic infrastructure) and therefore involve various departments and levels of governments. In low-income countries, where the bulk of reforms are externally financed, they also require donor coordination. Thus, reformers must create an oversight mechanism in the form of independent coordinating committees comprising donors as well as high-ranking representatives of different government agencies to foster policy coordination and compliance, supply technical support to local levels, and monitor results.

Diagnosing Mozambique's Business Environment

Private sector development has been considered one of the main development objectives under Mozambique's new poverty reduction strategy

(*Plana de Acção para a Redução da Pobreza Absoluta II*, or PARPA II). There has been growing recognition that private firms of all types are key actors in growth and poverty reduction; they create more than 90 percent of jobs, provide most goods and services, and pay most of the taxes needed to fund health care, education, and other services (World Bank, 2005a). A good business environment has been deemed essential in this regard, as it enhances external competitiveness and firm-level productivity, and promotes and attracts domestic and foreign investment, including from labor-intensive small and medium-size enterprises (SMEs). Moreover, as discussed in Chapter 3, Mozambique's main sources of long-term growth are investment and productivity improvements. Thus, reforms to strengthen the business environment will be important if Mozambique is to sustain its remarkable pro-poor growth record once its post-conflict catch-up recovery runs its course (World Bank, 2005a).

Promoting private sector development will require further improvements in Mozambique's business environment. Despite significant progress, Mozambique's overall business environment still has a relatively low ranking on different indices, both international and, to a lesser extent, regional (Table 9.1).[6] It is clear that there is work to be done in several areas to bring Mozambique's business environment in line with its competitors' (and similar developing countries'). However, the fact that Mozambique's ranking is not that much lower than the rankings of China, India, and some of the members of the Association of Southeast Asian Nations (ASEAN)—a particularly successful group in promoting sustainable export-led growth—seems to indicate that an attractive business environment may require only a handful of carefully selected reforms. The relevant question is, therefore, which reforms to start with.

It is useful to begin by classifying the main obstacles to a competitive business environment according to the following broad categories: (1) governance (for example, property rights, government corruption, political

[6]The indices presented in the table are widely used in cross-country comparisons and benchmarking analyses of a country's business environment. Throughout the analysis, Mozambique's reference groups are defined as those countries belonging to the Southern African Development Community (SADC)—namely, Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. Comparisons will also be drawn to India, China, and the members of the Association of Southeast Asian Nations known as the ASEAN-4 (Indonesia, Malaysia, the Philippines, and Thailand), a well-known reference group with successful private sector–led growth strategies that in some cases yielded sustainable growth. For a discussion of sustainable growth episodes and potential correlates, see Johnson, Ostry, and Subramanian (2007).

Table 9.1. Ranking Mozambique: Alternative Business Environment Indicators

	Rank[1]		
	Ease of doing business 2007–08	GCI 2006–07	IEF 2007
Mozambique	**134**	**121**	**101**
Lowest sub-Saharan Africa	178	125	151
Lowest SADC[2]	178	125	118
Lowest ASEAN-4	133	77	110
Highest sub-Saharan Africa	27	45	35
Highest SADC[2]	27	45	35
Highest ASEAN-4	74	26	48
India	120	43	104
China	83	54	119
Total ranked	178	125	157

Sources: World Bank (2007); World Economic Forum (2006); Heritage Foundation (2007).
Note: GCI denotes the World Economic Forum's Global Competitiveness Index; IEF denotes the Heritage Foundation's Index of Economic Freedom.
[1]Most recent available rankings.
[2]SADC = Southern African Development Community.

stability, and security); (2) infrastructure (for example, roads, electricity, and telecommunications); (3) macroeconomic stability; (4) human capital (for example, worker skills and education); (5) regulatory practices (for example, labor regulations, tax administration, customs procedures, and business licensing and registration); and (6) finance (for example, access and cost).[7] The rest of the section will attempt to identify reform priorities among these broad categories on the basis of the tools covered in the previous section.

Business Surveys

The opinions voiced by manufacturing firms participating in ICA surveys provide us with one means of identifying reform priorities. Mozambique's last comprehensive ICA was conducted in 2002 (Nasir and others, 2003), and was recently replicated in a 2006 business survey jointly conducted by the Confederation of Mozambican Business Associations (CTA) and

[7]We use here a slightly narrower definition of governance than that adopted by Kaufmann, Kraay, and Mastruzzi (2007). The set of traditions and institutions by which authority in a country is exercised, governance encompasses the dimensions of voice and government accountability; political stability and absence of violence; the rule of law, including perceptions on crime and enforceability of contracts; control of corruption; and government effectiveness. We deal with issues related to regulatory quality separately, under category (5), as presented above.

Table 9.2. Mozambique: Developments in Perceived Constraints

	2002 survey			2006 survey			Changes	
	Mean	Major/severe obstacle *(Percent of firms)*	Rank	Mean	Major/severe obstacle *(Percent of firms)*	Rank	Mean	Rank
Cost of credit	3.28	84	1	3.00	72	1	–0.28	0
Access to domestic credit	3.08	75	2	2.42	58	3	–0.66	1
Access to foreign credit	2.93	73	3	1.55	38	9	–1.38	6
Electricity	2.65	64	4	2.06	46	6	–0.59	2
General corruption	2.76	64	5	2.11	46	7	–0.65	2
Macroeconomic instability	2.75	63	6	2.65	63	2	–0.1	–4
Anticompetitive practices	2.59	60	7	1.45	32	14	–1.14	7
Unpredictability of policies	2.58	58	8	2.03	44	8	–0.55	0
Tax rates	2.45	55	9	2.15	50	4	–0.3	–5
Crime, theft, and disorder	2.47	54	10	1.79	35	11	–0.68	1
Customs	2.11	49	11	1.70	38	10	–0.41	–1
Tax administration	2.19	48	12	1.74	35	12	–0.45	0
Labor regulations	1.80	38	13	2.07	48	5	0.27	–8
Skills/education of workers	1.79	34	14	1.68	35	13	–0.11	–1
Business registration	1.44	28	15	0.86	10	18	–0.58	3
Transportation	1.43	27	16	1.44	26	15	0.01	–1
Access to land	1.24	27	17	0.82	18	16	–0.42	–1
Telecommunications	1.28	20	18	0.76	14	17	–0.52	–1

Source: Mozambique Ministry of Planning and Development (2006).

Note: Average across firms of judgments on how much the listed factors constrain the operation and growth of their business, where 0 = no obstacle, 1 = slight, 2 = moderate, 3 = major, and 4 = serious obstacle.

the Ministry of Planning and Development (Mozambique Ministry of Planning and Development, 2006).[8]

Firms identified the same constraints in both surveys (Table 9.2):

- Respondents in both surveys named the high cost of credit as the most binding constraint on finance.

[8]The 2002 World Bank survey was preceded by a joint CTA–World Bank survey in 1998 that covered 153 manufacturing firms. However, because of data quality issues, the earlier survey cannot be properly compared with the two latest surveys. In the 2006 MPD-CTA survey, 137 out of 192 firms that had participated in the 2002 World Bank ICA plus an additional 21 replacement firms using a similar questionnaire were successfully interviewed. Of the 55 firms not interviewed, 30 have closed down; the rest refused to participate. While the two surveys could be considered a panel, no claim is made, especially in the 2006 survey, that the sample is representative, and no attempt has been made to correct for survey bias.

- Macroeconomic instability was a source of concern in 2006 because of a temporary bout of exchange rate volatility that subsided later that year.
- Obstacles posed by governance, infrastructure, and regulatory practices appear to be concentrated in specific areas.
  - ◊ In terms of infrastructure, electricity seems to be the biggest issue, but transportation and telecommunications also get low rankings in both surveys.
  - ◊ Governance-related issues represent an obstacle because of perceived levels of corruption, not because of property rights issues (access to land) or security perceptions (crime). Perceptions of other governance-related obstacles (such as anticompetitive and informal practices, on the one hand, and crime, theft, and disorder, on the other hand) have improved.
  - ◊ Apart from labor regulations and taxes, which have recently become a main source of concern for the business community, regulatory practices do not stand out as a major obstacle. Interestingly, regulatory and administrative barriers—namely, business registration, customs, and tax administration procedures—which are commonly identified in the economic literature as important deterrents to business growth in Africa, do not rank high.
- Human capital—in particular the availability of skilled workers—does not appear to be a severe obstacle according to any of the business surveys, even though a majority of workers in both survey samples had only very basic schooling.

Such initial rankings should be considered with caution given the subjective nature of the assessments. In addition, aggregate results may mask variations in perceptions of the business environment depending on the size, age, or sector of the firm surveyed. Labor regulations, for instance, are more binding for large firms, which are subject to greater government scrutiny, than for SMEs.[9] Therefore, the rest of this section uses a combination of benchmarking and growth diagnostic techniques to refine the rankings.

Benchmarking

The most recent World Bank Doing Business report (World Bank, 2007) presents a slightly different picture of the main obstacles in Mozambique's business environment. Regulatory practices in the areas of labor, licens-

[9]This survey was undertaken before the enactment of the new labor law in 2007.

ing, and trade facilitation, followed by governance issues related to the security of property rights, stand out as the most important constraints on private sector development in Mozambique, compared with the country's competitors in the Southern African Development Community (SADC) and some of the fastest-growing countries in Asia (Table 9.3). These constraints are very similar regardless of whether Mozambique is benchmarked against SADC or Asian and Pacific countries.

By increasing employment costs, labor regulations stood out as the most costly obstacle to business growth in Mozambique; the country's employment-related costs were among the highest in the SADC. Labor regulations were particularly rigid with respect to working hours (overtime, night, and weekend work and paid leave) and hiring practices, and costly with respect to firing procedures (Figure 9.2). However, this assessment did not take into account the new labor law that came into effect in 2007, which significantly increased labor market flexibility by relaxing restrictions on the use of fixed-term contracts, reducing the cost of severance pay and leave benefits, and streamlining the conflict-resolution system of labor relations (see Box 9.1).

Other regulatory practices remain burdensome. Business licensing, trading requirements, and business closure procedures are more cumbersome, costly, and time consuming in Mozambique than in other SADC countries or in Asian and Pacific countries (Table 9.3, Figure 9.3). The cost of either importing or exporting a container, though below the SADC average, is about three times as expensive as in China (Figure 9.3). On the positive side, Mozambique's business registration procedures have recently improved significantly.

Governance obstacles related directly to the security of property rights are particularly striking. Contract enforcement stands out as an important constraint, using both SADC and, particularly, Asian and Pacific countries as benchmarks. Despite the relatively small number of legal procedures required in Mozambique (Figure 9.4), it still ranks relatively low, both regionally and internationally, on contract enforcement, in terms of both the time and the cost involved in enforcing commercial contracts. A less binding but still relevant governance-related obstacle relates to the costs involved in the regulation of property transfers and registration (Figure 9.4). Simpler and less costly procedures to register property minimize corruption and, by promoting formal titling, strengthen businesses' property rights as well as financial access by increasing the availability of collateral.

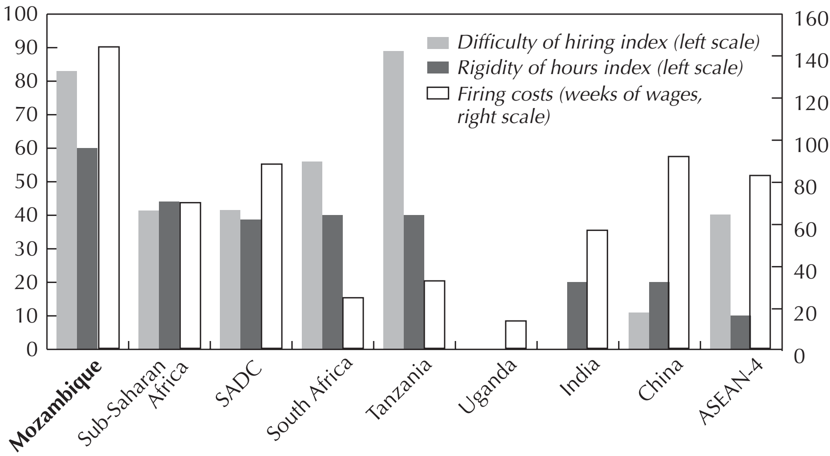
If assessed only on the basis of the Doing Business report's "getting credit" indicator, finance is less of an obstacle for Mozambican businesses. This indicator is dominated by the availability of information on a

Table 9.3. Mozambique: Cost of Doing Business, 2007/08 Rankings[1]

	Ease of doing business	Employing workers	Dealing with licenses	Trading across borders	Enforcing contracts	Closing a business	Registering property	Starting a business	Getting credit	Paying taxes	Protecting investors
Mozambique	**134**	**162**	**147**	**140**	**138**	**134**	**126**	**125**	**97**	**72**	**33**
South Africa	35	91	45	134	85	68	76	53	26	61	9
Tanzania	130	151	170	100	35	109	160	95	115	104	83
Uganda	118	11	81	141	119	48	163	114	158	55	122
India	120	85	134	79	177	137	112	111	36	165	33
China	83	86	175	42	20	57	29	135	84	168	83
Indonesia	123	153	99	41	141	136	121	168	68	110	51
Malaysia	24	43	105	21	63	54	67	74	3	56	4
Philippines	133	122	77	57	113	147	86	144	97	126	141
Thailand	15	49	12	50	26	44	20	36	36	89	33
Distance to SADC[2]	107	151	128	123	105	108	90	117	71	61	24
Distance to Asia and Pacific[2]	119	119	135	119	118	90	97	89	94	16	29
Change to 2006/07 rankings[3]	–6	5	44	–1	–30	8	21	–28	14	–8	–50

Source: World Bank (2007).
[1]Out of 178 countries.
[2]Difference in rank between Mozambique and highest ranked country in the Southern African Development Community, and Asia and the Pacific (ASEAN-4, India, China); + = worse ranked.
[3]Change in rank observed in Mozambique relative to previous year; + = worsening rank.

Figure 9.2. Benchmarking Mozambique's Labor Regulations



Source: World Bank (2007).

Note: SADC denotes Southern African Development Community; ASEAN-4 denotes Indonesia, Malaysia, the Philippines, and Thailand.

borrower's credit history. Access to affordable credit usually increases when lenders can count on credit registries with wide coverage and strong legal rights. Taking both these aspects into account, Mozambique's financial sector ranks better than those of other countries (Table 9.4). However, financial obstacles should not be downplayed. The availability of credit information still needs to be improved, to bring it in line with best practices in South Africa and the ASEAN-4 countries, and the ranking for this indicator seems to be slipping, implying that the availability of credit information may not be expanding fast enough (Table 9.3). Moreover, access to affordable credit is hampered when loan recovery is delayed by weak contract enforcement or constrained by unreliable collateral systems resulting from inefficient property registries—two important shortcomings that have been identified in Mozambique—as is confirmed by the relatively low ranking of Mozambique's legal rights index.

Benchmarking on the basis of the Doing Business report is not without limitations. The report does not attempt to measure the cost of doing business resulting from poor infrastructure, macroeconomic conditions, human capital, or governance in important areas such as the security of property from theft and looting. In addition, to make data comparable across countries, Doing Business indicators refer to a specific type of business—generally a limited-liability company operating in the largest business city. This last point has

Box 9.1. Strengthening Mozambique's Regulatory Practices

Protecting investors

Mozambique was the second fastest reformer overall in the category "Protecting Investors," according to the rankings in the World Bank's report "Doing Business in 2008." It jumped 63 places in the rankings, from 96th place to 33rd place. A new commercial code enacted in 2006 replaced legislation dating from 1888, introduced stricter corporate governance rules, and strengthened the rights of minority shareholders.

Business registration

Progress in reforming business registration has been remarkable. New regulations simplifying the start-up of commercial and industrial activities were issued in 2004. Since then, one-stop shops have been created in all of Mozambique's provinces to facilitate business registration. Business registration was further simplified in 2006 with the enactment of the new commercial code and a code of registry, the computerization of the company registry, and the elimination of the requirement to publish the company's by-laws in Mozambique's Official Gazette. As a result, the start-up time for new firms in Mozambique decreased by almost three months, from, on average, 113 days to 29 days, and Mozambique moved up 32 places in the rankings for the category "Starting a Business."

Progress in Business Licensing and Registration

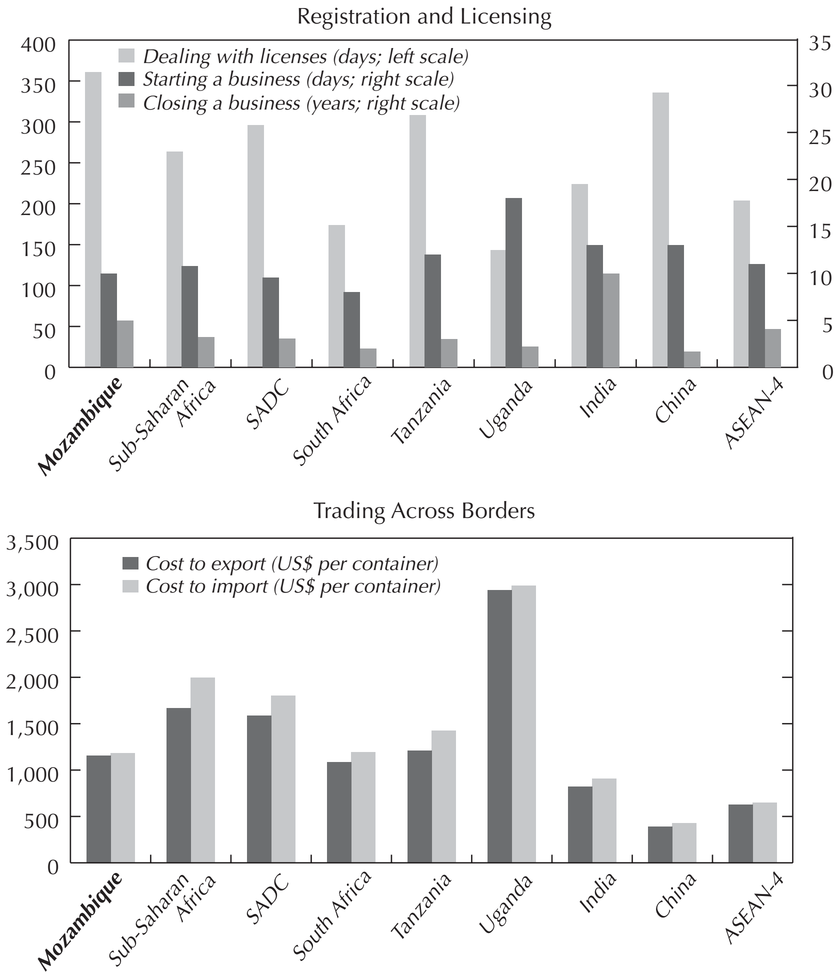
Year	Number of days	Number of procedures
2004	540	18
2005	153	14
2006	113	13
2007	29	10

Source: World Bank (2007).

Labor regulations

Mozambique has also made considerable progress in reforming labor legislation. A decree facilitating the hiring of skilled expatriates was issued in 2004, but a tripartite commission to review the labor legislation was not set up until 2005. A new labor law was approved by the Mozambican Assembly in 2007. The new law (1) relaxes restrictions on the use of fixed-term contracts; (2) significantly reduces the cost of severance pay and other benefits; (3) creates extra-judicial conflict-resolution bodies to reverse the backlog of labor dispute cases in the ordinary law courts; and (4) simplifies the process of hiring expatriates while maintaining a quota system.

Figure 9.3. Benchmarking Mozambique's Administrative Barriers to Business



Source: World Bank (2007).

Note: SADC = Southern African Development Community. ASEAN-4 = Indonesia, Malaysia, the Philippines, and Thailand.

been mentioned as one of the reasons business registration is not consistently cited in business surveys as an important obstacle, unlike in the Doing Business report.[10] We thus perform two additional benchmarking exercises below.

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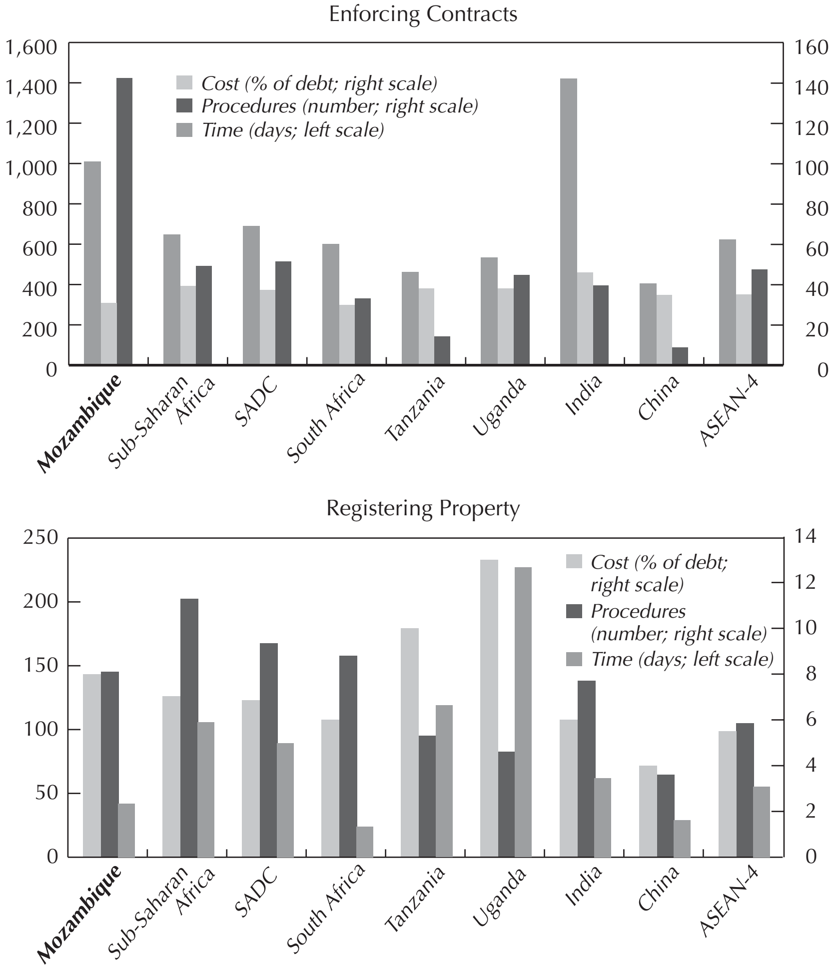
[10]Business surveys conducted in Mozambique have found a positive correlation between firm size and business registration costs, which may explain the discrepancy, given that the

Figure 9.4. Benchmarking Mozambique's Property Rights, Implied Costs



Source: World Bank (2007).
Note: SADC = Southern African Development Community. ASEAN-4 = Indonesia, Malaysia, the Philippines, and Thailand.

representative firm used for the purpose of the Doing Business report may be larger than the median size of the firms in the sample. Differences may also reflect the fact that business registration costs reported in business surveys corresponded to the "most important operating license," whereas the Doing Business report considered the cost and time of acquiring each single license.

Table 9.4. Mozambique: Benchmarking Regulatory Financial Obstacles

	Legal rights index[1]	Credit information index[2]	Public registry coverage *(Percent of adults)*	Private bureau coverage *(Percent of adults)*
Mozambique	**3**	**3**	**1**	**0**
Sub-Saharan Africa	4	1	2	5
SADC	5	2	3	14
South Africa	5	6	0	52
Tanzania	5	0	0	0
Uganda	3	0	0	0
India	6	4	0	11
China	3	4	49	0
ASEAN-4	5	4	16	11

Source: World Bank (2007).
Note: SADC = Southern African Development Community. ASEAN-4 = Indonesia, Malaysia, the Philippines, and Thailand.
[1]Increases with the reliability of loan and collateral recovery procedures.
[2]Increases with the quality and coverage of credit information.

Given its focus on external competitiveness, the World Economic Forum's Global Competitiveness Index (GCI) provides a more comprehensive overview of factors affecting the business environment. The GCI is broken down into nine subindices; the first six closely coincide with the broad categories of business environment constraints described earlier.[11] On the basis of the distances between Mozambique's rankings and those of potential competitors, obstacles related to market efficiency—broadly defined as distortions, such as regulations imposed on goods, labor, and financial markets—are the most prominent, followed by obstacles related to macroeconomic conditions, human capital, institutions, and infrastructure (Table 9.5). As such, these results seem to support the need to prioritize microeconomic reforms to address regulatory obstacles, as indicated by the World Bank's Doing Business report. However, regulatory obstacles should be broadly defined to include those related to financial markets. At the same time, the GCI benchmarking, in line with recent business surveys, finds that macroeconomic conditions, infrastructure, and institutions play a secondary, but still relevant, role in constraining the business environment in Mozambique.

[11]The nine subindices are institutions, infrastructure, macroeconomy, health care and primary education, higher education and training, market efficiency, technological readiness, business sophistication, and innovation. The last three were set aside given the private sector's very low comparative advantage on high-tech activities at this stage. See World Economic Forum (2006) for a detailed description.

Table 9.5. Mozambique: GCI, 2006/07 Rankings[1]

	Market efficiency	Macroeconomy	Health care and education	Institutions	Higher education and training	Infrastructure
Mozambique	**122**	**112**	**117**	**107**	**122**	**99**
South Africa	33	46	103	36	56	49
Tanzania	75	100	118	56	112	93
Uganda	84	66	123	100	107	118
India	21	88	93	34	49	62
China	56	6	55	80	77	60
Indonesia	27	57	72	52	53	89
Malaysia	9	31	42	18	32	23
Philippines	57	62	82	88	63	88
Thailand	31	28	84	40	42	38
Memorandum items:						
Distance to SADC[2]	89	73	73	71	66	57
Distance to Asia and Pacific[2]	113	106	75	89	90	76

Source: World Economic Forum (2006). GCI denotes the World Economic Forum's Global Competitiveness Index.

[1]Out of 125 countries.

[2]Difference in rank between Mozambique and the highest-ranked country in the Southern African Development Community, and Asia and the Pacific (ASEAN-4, India, China); + = worse ranked.

The quality and enforcement of regulatory practices also stand out as important constraints, based on the World Bank's governance indicators (Kaufmann, Kraay, and Mastruzzi, 2007). With respect to governance, as illustrated in Chapter 1, Mozambique ranks above not only the average sub-Saharan African country but also some high-performing ASEAN countries in such areas as political stability and voice and accountability. (See Chapter 1, Figure 1.8.) It has also consistently ranked above the median for the SADC countries in most indicators.[12] However, when it comes to the quality and enforcement of legal rules, the picture is not as good. (See Chapter 1, Figure 1.8.) Mozambique ranks below all ASEAN-4 countries and is among the three weakest performers in the SADC (Macamo, 2006).[13] Previous findings regarding deeper governance constraints related to the effectiveness of courts and the enforceability of

[12]See Macamo (2006) for an overview of Mozambique's governance rankings relative to those of the other SADC countries over the past 10 years.

[13]Regulatory quality reflects government policies affecting the business environment, including measures of market-unfriendly policies, and perceptions of the burden imposed by excessive regulation in areas such as foreign trade and business development.

contracts are also echoed in the poor ranking Mozambique received under the rule-of-law indicator, which is designed to capture such issues.

A similar picture emerges from the Country Policy and Institutional Assessment (CPIA) ratings compiled by the International Development Association (IDA), the part of the World Bank that helps the world's poorest countries.[14] Mozambique's macroeconomic policies fare well in the CPIA's Economic Management ratings in relation to average IDA borrowers and some eligible IDA borrowers in the reference group. On the other hand, Mozambique's ratings do not compare as favorably with respect to the business regulatory environment, property rights enforcement, and perceived levels of corruption (Table 9.6). As will be discussed below, weaknesses on the regulatory and governance fronts are currently being addressed as part of the government's new strategy to reduce the cost of doing business and measures to strengthen the monitoring and implementation of the government's anticorruption strategy.

Growth Diagnostics

As revealed by previous benchmarking exercises, which measure the distances between Mozambique's rankings and those of the best-performing Southeast Asian and SADC countries, the quality and enforcement of regulations appear to be the predominant constraints on Mozambique's business activity. Using growth diagnostic tools, the rest of this section identifies reform priorities through a different and, perhaps, more economically sound metric—namely their growth impact. In the case of Mozambique, this means identifying the institutional measures needed to sustain strong capital inflows and improvements in the quality of the labor force, and to accelerate total factor productivity growth, conditions identified in Chapter 3 as critical in maintaining Mozambique's post-conflict takeoff.[15] As discussed above, the methodology for linking proximate to deep determinants of growth is still evolving. As such, the analysis here should be seen as preliminary and, given its reliance on manufacturing data, particularly relevant to the development of Mozambique's manufacturing sector.

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[14]The CPIA rates countries against 16 criteria grouped in four clusters: (1) economic management; (2) structural policies; (3) policies for social inclusion and equity; and (4) public sector management and institutions. Such ratings serve as the basis for allocating IDA resources among eligible countries.

[15]See Tahari and others (2004); IMF (2005); and World Bank (2005a) for descriptions of earlier growth accounting exercises designed to identify the proximate determinants of growth in Mozambique.

Table 9.6. Mozambique: Benchmarking CPIA, 2006 Ratings, Selected Clusters and IDA Countries[1]

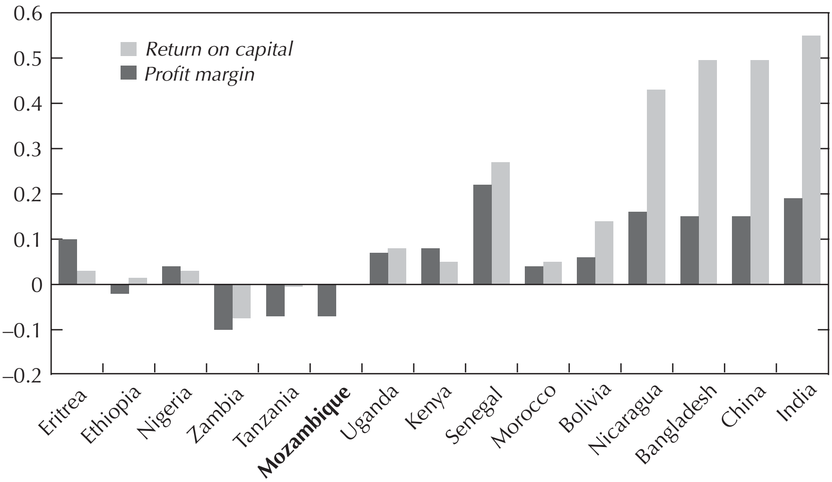
Cluster	**Mozambique**	India	Indonesia	Vietnam	Tanzania	Uganda	Average IDA borrowers[2]
Economic management							
Macroeconomic management	**4.0**	4.5	4.5	5.5	5.0	4.5	3.8
Fiscal policy	**4.0**	3.5	4.0	4.5	4.5	4.5	3.4
Debt policy	**4.5**	4.5	4.5	4.0	4.0	4.5	3.4
Average	**4.2**	4.2	4.3	4.7	4.5	4.5	3.5
Structural policies							
Trade	**4.5**	3.5	4.5	3.5	4.0	4.0	3.8
Financial sector	**3.0**	4.0	3.5	3.0	3.5	3.5	3.1
Business regulatory environment	**3.0**	3.5	3.0	3.5	3.5	4.0	3.2
Average	**3.5**	3.7	3.7	3.3	3.7	3.8	3.4
Public sector management and institutions							
Property rights and rules-based government	**3.0**	3.5	2.5	3.5	3.5	3.5	2.9
Quality of budget and financial management	**3.5**	4.0	3.5	4.0	4.5	4.0	3.2
Efficiency of revenue mobilization	**3.5**	4.0	3.5	3.5	4.0	3.0	3.4
Quality of public administration	**2.5**	3.5	3.5	3.5	3.5	3.0	3.0
Transparency, accountability, and corruption	**3.0**	3.5	3.0	3.0	3.5	3.0	2.9
Average	**3.1**	3.7	3.2	3.5	3.8	3.3	3.1

Note: CPIA denotes the Country Policy and Institutional Assessment ratings compiled by the International Development Association (IDA), the part of the World Bank Group that helps the world's poorest countries.

[1]Scale 1 = lowest, 6 = highest.

[2]Current historical ceiling for IDA eligibility is US$1,735 per capita income, 2006 prices.

Figure 9.5. Mozambique and Comparators: Median Return on Capital and Profit Margins



Source: Eifert, Gelb, and Ramachandran (2005).

Private returns on capital are reportedly low in Mozambique's manufacturing sector, albeit in line with those in important African competitors.[16] Manufacturing firms in Mozambique register much lower median returns on capital (the ratio of profits to capital stock) and profitability (the ratio of total sales to total costs) than firms in better-performing comparator countries, such as China and India. Median returns are near zero in Mozambique—above those in Zambia and Tanzania but below those in Uganda, Kenya, and Senegal (Figure 9.5).

Low private returns appear to be determined by the combined impact of low social returns and limited private appropriability. The scarcity of skilled workers reflected in Mozambique's elevated educational premium explains both the relatively high contribution of labor to total costs and low factory-floor productivity (Figure 9.6).[17] Private returns are further

[16]Comparable data for the ASEAN-4 and most SADC countries are not available. Asian comparators in the description of firm-level measures of profitability and productivity are limited to China and India.

[17]See Chapter 3 and Fox, Bardasi, and Van den Broeck (2005). According to these studies, returns to education are very high (5 percent per year of schooling in urban areas),

Figure 9.6. Mozambique and Comparators: Manufacturing Firms' Cost Structures
(Percentage of total costs)

Source: Eifert, Gelb, and Ramachandran (2005).

depressed by Mozambique's considerably higher indirect costs and output losses, including costs and losses stemming from the country's inadequate infrastructure and burdensome regulations, which squeeze firms' value added and reduce total factor productivity (Figure 9.7).[18]

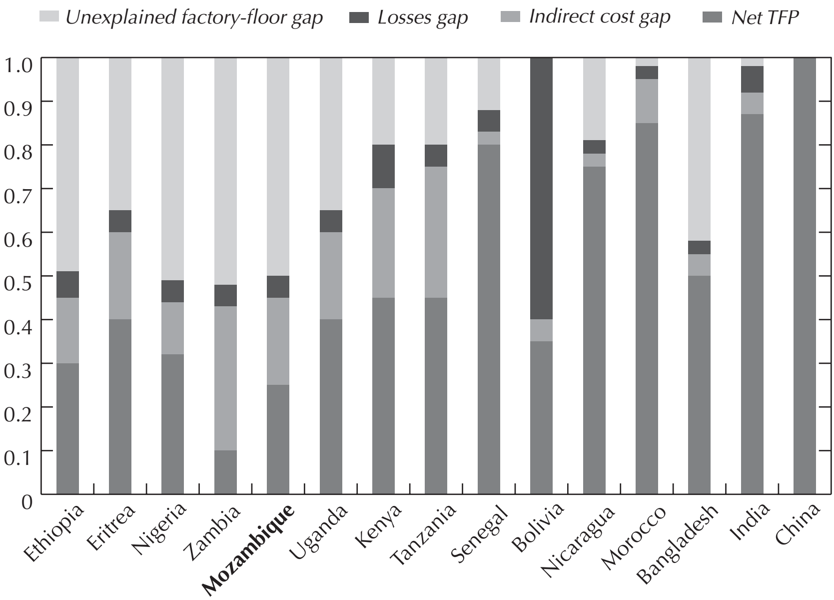
When benchmarked against Asian countries experiencing sustainable growth, prospects for sustainable growth in Mozambique seem to indicate the need to prioritize reforms in infrastructure, regulatory practices, and secondary education to improve private returns to capital.[19] Primary education, on the other hand, does not seem to be as binding. On the basis of the benchmarking approach in Johnson, Ostry, and Subramanian (2007), Indonesia and Thailand were capable of initiating sustainable takeoffs with low levels of primary education similar to Mozambique's (Table 9.7).

increasing sharply at higher levels of education, and have been stable since 1996.

[18]Other factors worth mentioning include the use of obsolete and ill-maintained equipment, and the absence of modern management techniques.

[19]This result corroborates findings in Chapter 3 that further improvements in secondary education are key to delivering the improvements in human capital needed to sustain growth.

Figure 9.7. Mozambique and Comparators: TFP Decomposition
(China = 1)



Source: Eifert, Gelb, and Ramachandran (2005).
Note: TFP = total factor productivity.

The gap in infrastructure is more accentuated, suggesting that there is a need to step up efforts in the area. In the same vein, low expected private appropriability, driven by a relatively high risk of expropriation, seems to be an important obstacle to sustained growth. According to widely accepted indicators, recent levels of economic risk and corruption in Mozambique are significantly higher than those observed in most ASEAN countries at earlier stages of their takeoffs. Once again, this calls for institutional changes that will ensure stronger and more consistent enforcement of laws and regulations, including those designed to curb corruption.

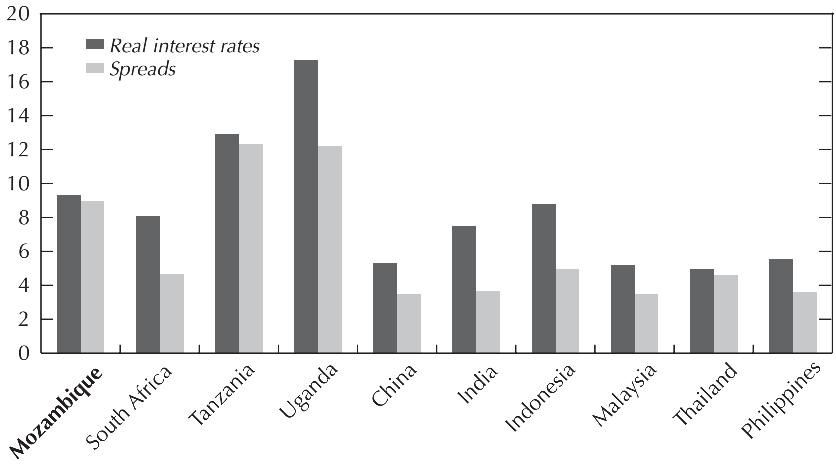
The growth of Mozambique's manufacturing sector is also constrained by the high cost of financial services. Real interest rates and lending-deposit spreads, while below the regional average, are still above those in the best SADC and East Asian performers (Figure 9.8). Lending rates for smaller Mozambican firms are more than double those for larger firms. Lack of access to finance is another major constraint on firm growth in Mozambique: more than 70 percent of Mozambican firms do not have

Table 9.7. Increasing Private Returns: Lessons from Asia

	Human capital		Infrastructure		Private appropriability	
	Primary education[1]	Secondary education[1]	Telephone mainlines *(Per 1,000 people)*	Total road surface area *(In kilometers)*	Economic risk[2]	Control of corruption[3]
			Sub-Saharan countries with growth >=2%[4]			
Mozambique	**86.0**	**8.7**	**4.0**	**38.0**	**25.5**	**1.5**
SADC average	102.0	42.6	66.0	227.5	33.3	2.9
Sub-Saharan Africa average	91.4	31.8	35.6	166.4	31.7	2.5
			Selected Asian countries under sustained growth accelerations (SGs)[5]			
China	112.6	45.9	2.0	123.0	35.5	2.0
ASEAN-4 average	83.4	22.6	6.9	184.5	34.3	3.3
Indonesia	80.0	16.1	1.5	151.6	30.1	3.0
Malaysia	88.7	34.2	13.8	261.2	37.5	4.0
Thailand	81.4	17.4	5.5	140.6	35.2	3.0

Source: Johnson, Ostry, and Subramanian (2007).
[1]Gross enrollment ratio.
[2]Scores range from 1 to 50. The higher the score, the lower the risk. Data for SGs are from 1984, for sub-Saharan Africa from 2004 and 2005.
[3]Scores range from 1 to 6. The higher the score, the less corruption there is. Data for SGs are from 1996, for sub-Saharan Africa from 2004 and 2005.
[4]Data are for the most recent period available. Refer to source for list of countries and periods.
[5]Data refer to year close to growth takeoff. Refer to source for takeoff dates and list of countries.

Figure 9.8. Mozambique and Comparators: Cost of Finance



Source: IMF, International Financial Statistics.

access to bank loans or overdraft facilities (that number is even higher for smaller firms) according to the 2003 ICA and 2006 MPD-CTA survey (Mozambique Ministry of Planning and Development, 2006).

The relatively high cost of finance appears to be the result of insufficient domestic savings. Hausmann, Rodrik, and Velasco (2005) theorize that a country with scarce domestic savings but high foreign debt or a large external current account deficit is probably using its access to foreign savings to the limit. This hypothesis could in principle apply to Mozambique, which has high investment rates, a large external current account deficit, and a low domestic saving rate compared with those of comparator countries (Table 9.8).

However, while high interest rates owing to low domestic savings are an important factor, access to affordable finance is also constrained by Mozambique's poor financial intermediation and weak lending environment, as discussed in Chapter 4. The mobilization of savings is constrained not only by Mozambique's low income levels but also by a thin branch network of banks, particularly in rural areas (Figure 9.9). However, poor access to savings accounts may be only part of the story. Mozambique's low loan-to-deposit rates seem to indicate that, while scarce, domestic savings are not being used to their full potential, given the underdevelopment of the country's credit markets. Tanzania, which also has a thin branch network but higher loan-to-deposit rates, is particularly illustrative in this

Table 9.8. Mozambique: Credit Constraints

(Average for 2000–05, percent of GDP)

	Current account	Total investment	Domestic savings	Private credit
Mozambique	**–21.2**	**26.6**	**10.4**	**14.8**
SADC[1]	–2.3	16.5	17.2	46.2
Sub-Saharan Africa	–2.6	18.3	19.5	30.8
ASEAN-4[2]	4.6	21.3	26.9	71.0

Source: IMF, World Economic Outlook database.
Note: Current account figures exclude grants.
[1]SADC = Southern African Development Community.
[2]ASEAN-4 = Indonesia, Malaysia, the Philippines, and Thailand.

regard. Business surveys seem to corroborate this view by showing that more than half of the Mozambican firms that did not apply for bank loans cited stringent collateral requirements and cumbersome loan application procedures rather than high interest rates as the reason (IMF and World Bank, 2003; and Mozambique Ministry of Planning and Development, 2006). As a result, very few firms rely on bank credit; an overwhelming majority use retained earnings to finance capital accumulation.

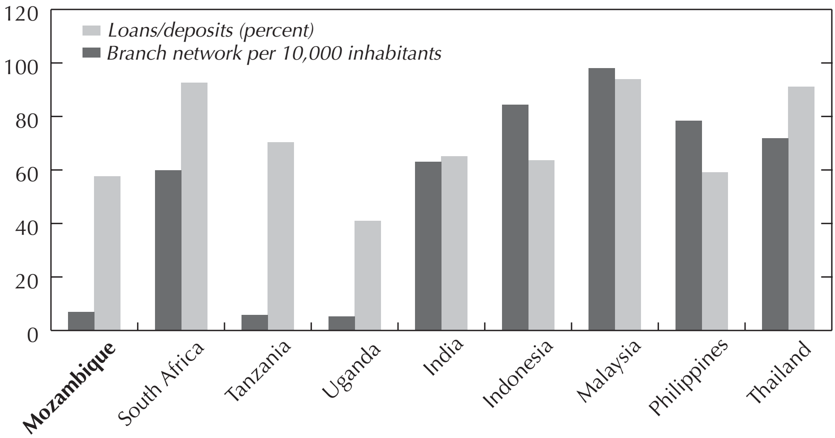
Against this background, reforms to improve access to financial services have become a top priority on Mozambique's business environment reform agenda.[20] Several empirical studies have shown that financial sector development is a strong determinant of aggregate productivity growth.[21] Asia's sustainable growth has been particularly illustrative in this regard. Financial development, which took place at an early stage of the economic takeoff of the successful Asian countries, has sustained growth in the latter mostly by allowing capital to be allocated to the most productive manufacturing activities (IMF, 2006).

Summing Up

Alternative diagnostic tools reveal a number of areas in which Mozambique's business environment lags that of potential regional competitors and of countries that have experienced export-led growth. The analysis conducted above identifies priority areas in Mozambique that have received low ratings in business surveys and widely used business environment indices. The robustness of these results was checked against

[20]See Chapter 4 and IMF (2007) for a detailed account of reforms undertaken to improve access to financial services.
[21]See Levine (2005) for a survey of the empirical literature.

Figure 9.9. Mozambique and Comparators: Financial Intermediation



Sources: Beck, Demirguc-Kunt, and Peria (2005); IMF, International Financial Statistics.
Note: 2005 data.

the relative impact of alternative areas on overall growth, as well as on the growth of the manufacturing sector. Our main findings are as follows:

- *Governance, financial, and regulatory issues top the list of needed reforms.* More specifically, governance issues that affect financial access—namely, contract enforcement and property rights—along with regulatory obstacles to employment, business licensing, and foreign trade, are among the main constraints on private sector development. These factors appear to hurt (1) capital accumulation (and hence growth acceleration) by depressing private returns and increasing financing costs and (2) total factor productivity growth (and hence growth sustainability) by increasing transaction costs and output losses.[22] The remarkable growth performances of a number of Asian countries corroborate this finding. The relative security of property rights, streamlined regulatory practices, and a well-developed

[22]Reforms related to business start-up costs and registration are also important in making it easier for firms to enter the formal sector. This is particularly relevant in the case of Mozambique, where about 76 percent of urban employment is estimated to be in the informal sector.

financial sector have been consistently identified as important factors behind sustained productivity growth in these countries.

- *Infrastructure deficiencies deserve special attention.* When benchmarked against some Asian countries that have experienced sustained growth, Mozambique stands out for its inadequate infrastructure.[23] While the energy sector has been a major source of complaint in the business community, the telecommunications and transportation sectors are far less developed in Mozambique than in Asia and other SADC countries.
- *One of the central government's objectives should be sustaining macroeconomic stability.*

The next section looks at the government's reform agenda with a view to assessing to what extent the priorities identified have been incorporated in a coherent reform strategy. The focus will be mostly on reforms that reduce the risks and costs of doing business in Mozambique in the priority areas of governance, regulatory practices, and access to finance.

The Government's Strategy and Progress

Strategy

With the help of the World Bank, the Mozambican authorities have developed a comprehensive, time-bound, and well-targeted new strategy to make Mozambique's business environment the most competitive in the SADC by 2015. This strategy consists of a number of action plans to operationalize the PARPA II objectives of (1) reducing the cost of doing business; (2) expanding access to financial services; and (3) accelerating reforms in the judiciary sector, particularly in the area of contract enforcement. (See Table 9.9.)

The plan spearheaded by the Ministry of Industry and Commerce (MIC) covers business licensing, closure, and inspection procedures; labor costs; access to credit; energy costs; and property registration. An interministerial committee has been set up to coordinate and monitor the plan's implementation as many ministries are involved.

[23]Given the significant differences in infrastructure provision between Maputo province and the rest of the country, recent benchmarks and, to some extent, business surveys may underestimate the gaps in infrastructure because they tend to be focused on firms located in Maputo province.

Table 9.9. Mozambique: Action Plan to Reduce the Costs of Doing Business

	2006	2007	2010	2012	2015
Ease of doing business (overall rank)	153	110	60	45	26
Starting a business	139	70	45	35	25
Dealing with licenses	103	70	45	28	15
Hiring and firing workers	157	70	60	47	40
Registering property	105	95	65	40	23
Paying taxes	80	70	55	36	14
Trading across borders	141	90	72	46	32
Closing businesses	126	110	60	50	35
Enforcing contracts	168	130	70	45	28
Cost and quality of electricity					
Cost in kWh (US cents)	n.a.	4	3	2	2
Number of power outages/month	60	50	40	28	12
Transportation cost (US$)					
Beira/Maputo 20-foot container (by land)	770	700	450	425	400
Value-added per worker (US$)	1,000	1,500	2,000	2,500	3,000

Source: World Bank staff estimates.

A number of essential initiatives to reduce the cost of, and expand access to, financial services are also envisaged as part of Mozambique's financial sector reform strategy. The Mozambican authorities, led by the Ministry of Finance and the Bank of Mozambique, have developed a comprehensive reform strategy framed on the recommendations of the 2003 Financial Sector Assessment Program (FSAP)[24] and financed by the World Bank and other donors under the Financial Sector Technical Assistance Project (FSTAP) in 2005.[25] This strategy includes measures to improve the institutional lending environment with respect to secured transactions and credit information and to increase the outreach of banks and microfinance institutions to rural households and SMEs.[26] The gov-

[24]The FSAP is a joint IMF and World Bank initiative introduced in 1999 under which the two institutions seek to identify the strengths and vulnerabilities of a country's financial system, in order to determine how key sources of risk are being managed, ascertain the sector's developmental and technical assistance needs, and help country authorities prioritize policy responses.

[25]Under the FSTAP, the IMF plays the important role of delivering technical assistance in the areas of banking supervision and monetary policy operations and formulation.

[26]The government recently launched a package of initiatives to enhance the physical presence of banks in rural districts. Proposed measures are aimed mostly at reducing the operational costs of providing banking services in rural areas through fiscal incentives, infrastructure improvements, and the relaxation of legal reserve requirements in rural branches so as to include cash in vault. Transport costs related to the constitution of legal reserves and cash in vault for immediate withdrawal are being further minimized as the Bank of Mozambique opens branches in selected districts.

ernment is developing multiyear action plans that extend beyond the FSTAP's five-year duration and that have more precise outcomes.

Public sector reforms are also being accelerated to address governance concerns in a more timely fashion. Mozambique is increasing public sector accountability by reinforcing the capacity of the country's main public sector audit institutions—namely, the Administrative Tribunal and the Inspectorate General of Finances. The government is also committed to strengthening the monitoring and implementation of its anticorruption strategy. To this effect, a committee working with the World Bank is refining governance indicators so that they can be used as measurable and easily monitorable targets.

Mozambique has taken important steps to improve the ownership, coordination, and monitoring of its reform strategy. As previously mentioned, the government has set up an interministerial committee to oversee the reform process. This committee will play an important role in promoting intragovernmental coordination, given the cross-cutting nature of business environment reforms, and, to the extent that the committee comprises high-ranking officials, will raise the political clout of reformers. The strategy will also benefit from mechanisms put in place to increase reform monitoring.[27] As part of a number of initiatives designed to improve donor coordination and align priorities with recipient governments' objectives, since 2004 monitoring of reforms has been done jointly by donors and government representatives through the previously agreed Performance Assessment Framework (PAF).[28] The PAF collects actions and the corresponding set of performance indicators for each sector strategy and reform program outlined in PARPA II. Aid disbursements are conditional only on actions and measurable performance indicators in the PAF, which, in turn, reinforces government ownership of the reform program. To further strengthen the monitoring of business environment reforms, it will be important to ensure that some of the key measures are included in the PAF on a systematic basis.

[27]In addition, Mozambique's FSTAP has set in place novel implementation arrangements to facilitate coordination and monitoring (for example, implementation is monitored by a single agency, which is accountable to the Ministry of Finance), and minimize transaction costs. Progress is assessed each quarter on the basis of a matrix that specifies objectives and corresponding performance indicators.

[28]Mechanisms for coordination and dialogue between government representatives and donors are described in more detail in Chapter 7.

Taking Stock of Mozambique's Reform Effort

Mozambique is starting to emerge as a reform champion by regional standards. This is clearly reflected in the World Bank's most recent Doing Business report (World Bank, 2007): Mozambique moved up three notches to rank 134th out of 178 economies surveyed, from 137th in the previous report. Mozambique was among the top four reforming countries in sub-Saharan Africa, the others being Ghana, Kenya (which were among the top 10 reformers worldwide), and Madagascar (Table 9.10). Progress was particularly impressive in regulations designed to protect investors and accelerate business registration (Box 9.1). Recent changes to labor regulations are expected to further improve Mozambique's ranking.

With the steadfast and timely implementation of its far-reaching reform agenda, Mozambique is well placed to become the best country in which to do business in the SADC.

Lessons Learned

Mozambique provides a good example of how low-income countries should get their business environment reforms right. The country has, for the most part, correctly identified its reform priorities, developed mechanisms to promote reform ownership, and started to refine its reform strategy to improve the targeting, effectiveness, and sustainability of its reform interventions. Results are starting to show, with Mozambique emerging as a top African reformer. Some of the useful lessons learned follow:

- *Reformers should make good use of brief windows of opportunity, implementing reforms when there is broad political support for them.* This widely recognized lesson is confirmed in the case of Mozambique. Elected governments in Mozambique's post-conflict years drew on their high stock of political capital to implement first-generation reforms, reestablishing the basis for private sector development. Important financial sector reforms were implemented in the aftermath of the 2000 banking crisis; the restructuring process that followed was an important catalyst for reform of banking supervision and reporting standards.
- *Quick-win reforms must take priority.* Mozambique's recent experience in reforming business registration procedures is particularly illustrative. Its successful implementation—measured and widely publicized in the World Bank's Doing Business report—aroused media awareness of the need for business environment reforms and raised the

Table 9.10. Gauging Mozambique's Reform Impact
(Change in rank for ease of doing business, 2007–08)

Egypt	–26
Ghana	–22
Georgia	–17
India	–12
Madagascar	–11
Indonesia	–10
Kenya	–10
China	–9
Mozambique	**–6**
Mauritius	–3
Thailand	–2
South Africa	–2
Tanzania	1
Uganda	2
Malaysia	3
Philippines	3

Source: World Bank (2007).
Note: Positive value denotes worsening in rank.

political capital of pro-business advocates inside the government and in the donor community.

- *The creation of coordination mechanisms among government agencies and between governments and donors are important preconditions for successful reform in low-income countries.* The cross-cutting nature of business environment reforms requires several ministries and government agencies to be involved in the reform process. This problem is compounded in low-income countries, given their dependency on aid from multiple donors to finance reforms. Donors are important agents for reform in that they directly finance reform programs or tie aid disbursements to reform progress. However, the heavy presence of donors in many low-income countries today introduces conflicting priorities and monitoring standards, thereby undermining government ownership of reform. Therefore, mechanisms capable of generating a reform plan with consensual support inside the government and agreed to by donors and the government must be in place before an implementation plan can be designed to ensure that reform leaders inside the government will own the strategy and effectively allocate donor support. Mozambique's donor coordination model, discussed in Chapter 7, is an important example in this regard.
- G*etting the reform impact right is also important.* Significant improvements in the business environment may require reformers to address the right priorities and to identify measures capable of reducing the

cost of doing business. For instance, reform strategies need to identify not only which regulations should be implemented but also how these regulations should be changed to decrease costs of compliance. This point also highlights the need to select appropriate indicators to monitor reform progress. Mozambique's proposed action plan, which set yearly targets on the basis of the World Bank's Doing Business report, is an example.

- *Identifying the right priorities in low-income countries requires the comprehensive use of all available diagnostic tools and databases.*[29] Getting priorities right is not an easy task in low-income countries, given the wide range of factors constraining the business environment. Identifying the most binding constraints usually requires a careful analysis of business surveys and benchmarking on the basis of alternative business environment indices. Rather than being used as an alternative, growth diagnostics should be used to reconcile the sometimes conflicting results of business surveys and benchmarking exercises.
- *Priorities may shift over time, so reformers should constantly update their diagnostic exercises as reforms progress in order to gauge the appropriateness of their reform strategy.* For example, business surveys only recently identified labor regulations in Mozambique as one of the most severe constraints. With the enactment of a new labor law, the business environment in Mozambique is likely to improve further, and this improvement should be reflected in upcoming business surveys.
- *Reform strategies should also be reassessed if obstacles persist.* Reform strategies aimed at certain obstacles should be revisited if business environment surveys show that these obstacles persist, or if benchmarking exercises continue to give low rankings to a country on certain issues. In the case of Mozambique, the persistence of the high cost of, and limited access to, finance as a major constraint on business growth even after substantial improvements in the banking system suggests that there is a need to further prioritize deeper institutional reforms, with the aim of improving the governance and legal framework that shapes Mozambique's lending environment. Mozambique is rightly addressing these challenges, with the help of the World Bank, by strengthening the monitoring and implementation of its anticorruption strategy and focusing on delivering measurable improvements in governance.

[29]Ideally, these tools should also ensure coverage of both rural areas and the informal sector—two key and often overlooked segments.

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