Mozambique: More Domestic Revenues, Less Aid Dependency

Even after 21 years of the end of the civil war in Mozambique, the country is still facing its own problems and risks. Mozambique largely depends on foreign countries for aid and incentives. This is helpful for Mozambique but cannot be relied upon for long. To maintain its independent growth, the country needs to fight constantly with its internal problems including poverty, diseases and natural disasters says **Dr Richard Gerster**

The country has to live of what it produces itself. Mozambique's tremendous dependency on for-eign aid is unhealthy and risky. One day the international donors will say, we need to take care of our own problems now and reduce aid. We have to prepare ourselves for that moment." Herminio Sueia, director general of the Mozambique Revenue Authority (MRA) knows what he is talking about. 40 cents of each metical (MZM) or dollar in the government's budget of 2012 comes from foreign aid, while 60 cents of the budget are met by domestic resources. Still, he has no sleepless nights as significant progress cannot be overlooked – just five years ago these shares were vice-versa with almost two thirds originating from foreign contributions.

Programme aid

Traditionally, development cooperation is based on specific projects. The myriads of actors and ef-forts, however, led to an incredible rise of transaction costs. On that background, the idea of pro-gramme aid was born. Several international actors jointly support the partner's entire programme like the sector of education adopting aligned and harmonised procedures. The most advanced form of programme aid is general budget support (GBS) with a multi-donor group channelling its support through the partner government's systems, not earmarked for specific projects or expenditure items. Programme aid is no blank check, but combined with a performance assessment framework (PAF) which aims at measuring the government's progress when it comes to pursuing its own specific objectives and implementing agreed reforms.

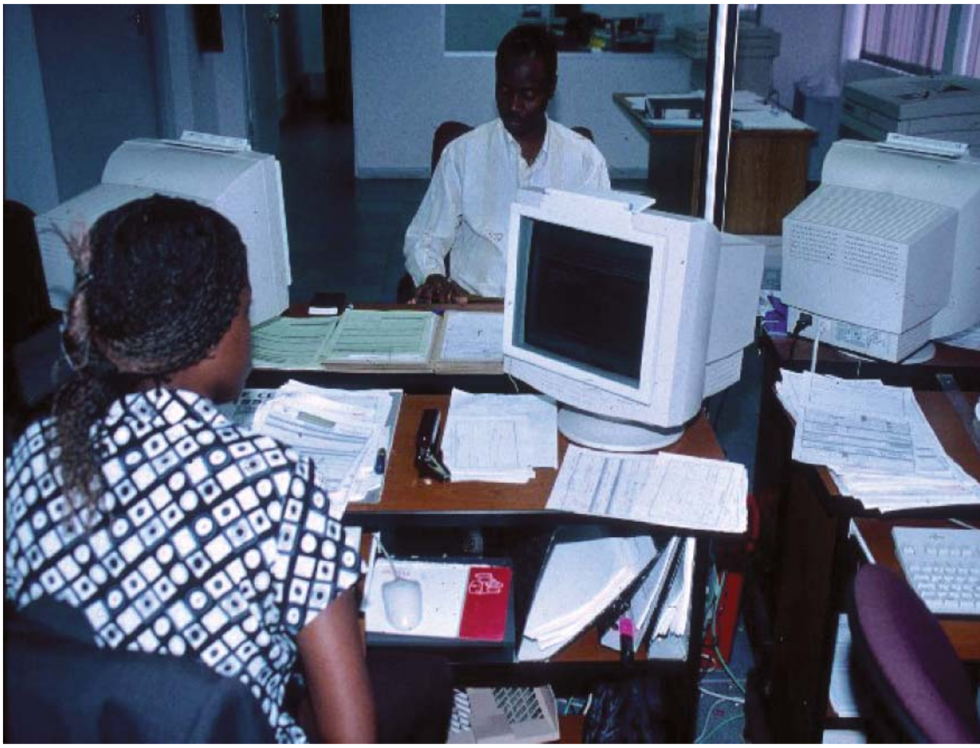
Already in 1994, Switzerland untied its balance of payment support, and soon Denmark, Norway and Sweden adopted the "Swiss model", leading to the first group of donors to directly support Mozambique's national budget from 1996 onwards. Up to 2012 no less than 19 Programme Aid Partners (PAPs) formed the budget support donor group: Austria, Belgium, Canada, Denmark, Germany, the European Commission (EC), Finland, France, Great Britain, Ireland, Italy, the Netherlands, Norway, Portugal, Spain , Sweden, Switzerland, the African Development Bank and the World Bank. Jointly they contributed $449 million (2012), some 15.5 percent of the government budget. In 2013, Belgium, the Netherlands and Spain stopped contributing GBS. Other projects and programmes in key areas complement budget support.

Priority for revenue mobilisation

In the context of budget support, Switzerland has allocated high priority to fiscal policy since the be-ginning. In a first phase from 1996–2000 Switzerland invested an additional $2.85 million in tax reforms. This was followed by a second phase 2001–2004 with another $2.3 million. The implementa-tion was delegated to the International Monetary Fund (IMF). In addition to Switzerland, Denmark and Great Britain co-financed tax and customs reforms. Switzerland's prominent role in this key area is reflected in the fact that the co-chair of the budget support working group on fiscal policy was held by Switzerland until 2008. While the Mozambican government showed an early and lively interest in tax issues and sent several representatives to the working group, the Swiss representative – a Mozambican economist nota bene – remained the sole donor representative over years. Many donors neglected tax issues and focussed on how the government spent its money. The IMF generally participated as an observer of the meetings. More recently, however, an increased interest in the sense of a trend reversal can be observed among the international partners.

A success story

Inspite of the continuing significant role of foreign aid Mozambique's mobilisation of internal resources is an unprecedented success story. In 1996 taxes, customs and other income amounted to 10.8 percent of the gross domestic product (GDP). 15 years later, in 2011, the share stood at 21.8 percent or $2.9 billion. The estimates for



A view of the value added tax office. Value added tax is considered to be a fundamental pillar of the country's income

In the context of budget support, Switzerland has allocated high priority to fiscal policy since the be-ginning. In a first phase from 1996–2000 Switzerland invested an additional $2.85 million in tax reforms

2012 indicate an even higher fiscal ratio. The main sources of tax revenue are the value added tax (VAT) with about 50 percent and increasingly the individual and corporate income taxes at some 30 percent.

This impressive result is above all based on a big effort to broaden the tax base, reaching the registration of 1.789 million taxpayers in 2011. This allowed for more than compensating the decreasing income from regional free trade and international trade due to cuts in customs tariffs. Three other elements are particularly noteworthy:

- Reorganising the tax system, namely by introducing value added tax (17% flat rate with a special provision for basic needs) and revising personal and corporate income taxes which were still strongly influenced by the former colonial power of Portugal
- Professional training and counselling of the staff in order to combine implementing the tax law with a modern customer orientation and advisory services for the tax payers
- Institutional innovations, particularly the reorganisation of the customs authority and assisting the creation of the semi-autonomous Mozambique Revenue Authority mentioned at the beginning. It unifies the former separate customs and tax authorities under one roof

So far it is not clear whether the shift from indirect to direct tax reforms is less of a burden to the poor. A study published by the development ministry's research department DNEAP has shown that a "higher taxation of car fuel, gas bottles, wine and beer with a simultaneous reduction of taxes on kerosene, sugar and tobacco would significantly reduce poor households' tax payments." Combined higher taxes on alcohol and tobacco – so called "sinners' taxes" – would only be an insignificantly lesser burden on the poor than the rich. The scope on the side of the expenses makes constantly flowing taxes the backbone of social progress. The IMF explicitly welcomed the government's intention of increasing its income and focusing 65 percent of its expenses on poverty reduction.

In the context of budget support, targeted innovations in the tax system, based on the government's willingness to reform were effectively combined with the performance framework and the tax dialogue. The matrix of the performance assessment framework (PAF) includes as an indicator the ratio of government revenue to GDP and sets annual targets. Moreover, the fight against corruption in the customs and revenue authority benefited from leverage attributed to budget support. Developing a sustainable financial basis was a permanently present issue on the budget support dialogue's agenda. Tax dialogue was not always without stumbling blocks, as an internal memo documents: "Tax policy is perceived to be a key component of national sovereignty and donors' interest is quickly interpreted as mixing in national affairs."

Local revenue

Procuring one's own income on the long run is not only a pivotal concern for Mozambique's central government, but it also determines the reach of decentralisation. Raimundo Destemberque collects booth fees on the market of Muecate, a tiny place in Nampula province. For one booth he charges 30 cents per day. During a day he collects some 22 dollars. Five percent, just about one dollar, is what he can keep as his salary. He also deals with bike licences. For each bike a licence needs to be bought from the community. Costs: one dollar per year. Furthermore, each household has to pay an annual basic tax of one dollar. Of this amount, however, only 30 cents remain in the community, 70 cents go to the central government. To be a tax collector like Raimundo Destemberque is a matter of trust. All 20 tax collectors in Muecate district work with receipts and accounts which can be examined at any given moment.

In 1997, the first 33 autonomous municipalities were created, followed by 10 more in 2008 and an-other 10 in 2013. For a sample of 34 municipalities it was found that they only cover 37 percent of their expenses with local taxes and duties. Another 48 percent are transfers from Maputo, and the remaining 15 percent are from donations. Looking at the 128 districts, the extent of internal financing is even lower. Municipalities and other local entities are in desperate need of funds to improve the coverage and quality of public services. A recent piece of research published by the German Development Institute revealed untapped and substantial revenue potential at municipal level. In particular the collection of property related taxes is weak. The reasons are simple: property taxes are not popular with local elites dominating municipal politics.

In the context of budget support, targeted innovations in the tax system, based on the government's willingness to reform were effectively combined with the performance framework and the tax dialogue

As an innovation the central government's budget 2013 foresees the earmarking of 2.75 percent – or $1 million (MZM30 million) – of revenue coming from production tax from mining and petrol activities for the "localidades" of Moatize, Govuro and Moma. This new chapter in sharing revenues for local development is based on a law enacted in 2007.

Being a stronghold of federalism itself, Switzerland is well aware of the significance of local income for the communities' independence. That is why in the past years

Municipalities such as Muecate are collecting market fees in order to increase their income

Switzerland supported the development of fiscal decentralisation in Nampula province together with other donors like Denmark. The cooperation with the German GIZ as the lead donor for decentralisation is noteworthy as well. The Nampula model has now spread more widely at the national level thanks to the government's efforts. Budget support as well as targeted assistance for national and local tax authorities is complementing each other.

Future sites of revenue reform

Around 70 percent of the partially autonomous MRA are financed by the state. Another quarter of its expenses are met by a tax share of one percent. The remaining five percent are cofinanced by international agencies through a common fund which was created jointly in 2008. Phase 1 of the fund was financed by Great Britain, Germany, Belgium, Norway and Switzerland. The fund is focussing on the further education and counselling of tax authorities as well as the expansion of infrastructure. Over the first three years, Switzerland contributed $2.4 million to the total sum of $15 million. The Mozambican efforts and successes are acknowledged in the OECD's reference book on Tax and Development, published in 2013 by stating that the "current tax code largely conforms to international good practices for a developing country".

Mozambique's government is not content with what it has achieved. The current level of domestic public revenues still leaves space for further improvement. The government continues to work towards annually increasing state revenues by 0.5 percent of GDP until 2015. The projections of the International Monetary Fund for total domestic revenues are 23.9 percent of GDP for 2015, again strongly reducing external financing of the government budget. In the past decade the target of the 0.5 percent annual increase has been surpassed usually. Therefore the projections can be viewed with confidence. Yet the additional domestic income should not be raised by increasing tax rates, the government does not want to scare away national nor international investors. Rather broadening the tax basis stands at the foreground. A major concrete step to that end was the introduction of a considerably reduced flat rate tax which also covers both value added and community taxes to micro and small enterprises with an annual turnover of up to $82,000 (MZM 2.5 million). Also many of the individuals and micro enterprises at the bottom end of the scale are not yet paying taxes, often lacking accounting or literacy skills being major hurdles in this context.

Mozambique's government is not content with what it has achieved. The current level of domestic public revenues still leaves space for further improvement. The government continues to work towards annually increasing state revenues by 0.5% of GDP until 2015

Taxes constitute an important element of the business climate – the private sector however is still dissatisfied with the tax climate. Today, a good part of the tax burden lies on the narrow middle class. Such an entrepreneur comments: "The tax burden is not unreasonable, but clearly noticeable." Tax payers want to see returns from the state and are increasingly demanding accountability from the government's institutions. They rightly so demand that "ethics and integrity" are anchored in the organisational culture.

Many large enterprises enjoy a preferential tax regime. The biggest company of the country, the aluminium smelter Mozal, contributes less than one percent of Mozambican revenue, while its share of Mozambican GDP is three percent. The reason is that Mozal negotiated exemptions from customs, value added tax (VAT) and corporate profit repatriation taxes for 50 years, paying only a modest one percent turnover tax. The international NGO "Jubilee Debt Campaign" estimates in a recent report that for every dollar being paid by Mozal to the Mozambican Government, $21 are leaving the country in profit or interest to foreign governments and investors.

"Mozal's tax free profits are simply immoral. This will be cause for a fight. We need the donors' sup-port in order to convince the large companies that they cannot enjoy a tax haven in the middle of a sea of poverty for decades," says a local insider. End of 2012 the Government of Mozambique set up a technical team to renegotiate the contracts for the older mega-projects like Mozal. The government's intention to mobilise more revenue from the natural resource companies takes the same direction. Mozambique signed the international initiative promoting more transparency ("Extractive Industries Transparency Initiative, EITI") and has been declared compliant in 2012.

Poverty: Achilles Heel of Development

In contrast to the worldwide financial crisis the rate of Mozambique's economic growth remained at an impressive level. Real GDP growth actually exceeds seven percent and the IMF projects even eight percent annually for the next three years. In the Rovuma Basin, off the coast of the Northern Mozambican province Cabo Delgado, substantial volumes of natural gas have been discovered. Based on the already achieved milestones in revenue reform and these promising prospects, Mozambique may reach within the next 10 years sustainable self-financing for its development. "It could become independent of aid in 2023" projects the work plan of the British Department for International Development (DFID).

However, accountability mechanisms in the country are still weak and it will be crucial to consolidate the young democratic institutions and strengthen civil society in order to arrive at robust checks and balances. Most importantly, economic growth so far did not adequately translate into poverty reduction. The poverty head count index decreased from 69 percent in 1997 to 54 percent in 2003 but the third poverty assessment for 2008-09 showed stagnation at 54 percent. Even the IMF raised concerns that the poor have benefited less than average from the rapid growth. Roger Nord, IMF deputy director for Africa sees it as an issue of concern because it "raises social tensions" and because it is going to be "very difficult for growth to be sustained". The new Poverty Reduction Action Plan (PARP) of 2011 emphasises agricultural production, employment creation and human development. However, even an excellent strategy only delivers if there is a political will backing its implementation. Mozambique ranks 185 of 187 rated countries on UNDP's Human Development Index in 2013. The extreme poverty of the majority of Mozambican citizens living mainly in rural settings is the Achilles heel of Mozambique's development path of the past and for the future.

Dr Richard Gerster, is an economist and works as independent consultant and author (www.gersterconsulting.ch). *This article is a revised and updated version of an earlier text. The support by the Swiss State Secretariat for Economic Affairs SECO is gratefully acknowledged.* *Among his numerous publications, he is the author of* Partners in Development: India and Switzerland *(Social Science Press, Delhi 2008)*