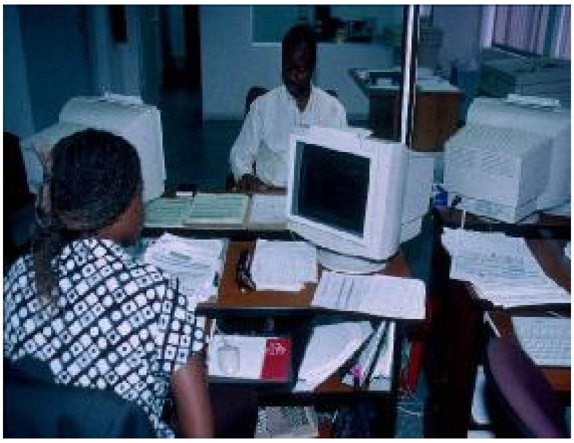
Mozambique: More self generated income, less dependency

*Richard Gerster**

"The country has to live of what it produces itself. Mozambique's tremendous dependency on foreign 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 of Mozambique's Revenue Authority knows what he is talking about. More than half of each Swiss franc in the government's budget comes from foreign aid, more precisely: 55 cents. Still, he has no sleepless nights as signs of progress cannot be missed.



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

The Swiss perspective prioritises tax dialogue

Already in 1996 Switzerland together with three other donor countries was involved in directly supporting Mozambique's national budget. In the meantime (2009) the budget support donor group consists of no less than 19 donors, both other countries and international organisations. Jointly they contribute 448 million US dollars (2008), some 15.6 percent of the government budget. Other projects and programmes in key areas complement budget support. The Swiss contribution of 7,2 million dollars (8 mio CHF, 2008) is no blank check, but rather combined with a performance assessment framework which aims at measuring the government's successes when it comes to fulfilling specific aims and reforms.

In the context of budget support, Switzerland has allocated high priority to fiscal policy since the beginning. In a first phase from 1996 – 2001 Switzerland invested an additional 3,2 million dollars in tax reforms. This was followed by a second phase with another 2,6 million dollars. The implementation was delegated to the International Monetary Fund (IMF), an organisation specialised in economic issues. In addition to Switzerland, Denmark and Great Britain cofinanced tax and customs reforms. Switzerland's prominent role in this key area is reflected in the fact that the chair of the budget support working group on fiscal policy was held by Switzerland until 2008. But while the government shows a lively interest in tax issues and sends several representatives to the working group, the Swiss representative – a Mozambican economist nota bene – remained the sole donor representative over years. Many donors treated tax issues negligently and focused 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 donors.

A success story

In spite of the continuing dependency on foreign aid Mozambique's mobilisation of internal resources is a success story. In 1996 taxes, customs and other income amounted to 10.8 percent of the national income (GDP). 12 years later, in 2008, the share was at 16.4 percent, respectively 1,5 billion dollars (39'109 mio Meticais). This impressive result is above all based on the registration of more than half a million new

Due to a reduction of customs and free trade the income from international trade is decreasing.

taxpayers until 2007. This allowed for more than compensating the decreasing income from regional free trade and international trade due to cuts in customs tariffs. Three elements are particularly noteworthy:

- Reorganising the tax system, namely by introducing value added tax (17 percent 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 helping the revenue authority mentioned at the beginning which is partly subordinate to the Ministry of Finance and semi-autonomous see the light of the day. 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, "including the employment of 12'000 new teachers and 1500 health personnel." In an assessment the IMF noted that Mozambique now disposes of a "comprehensive tax system that is broadly in line with international best practices."

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. Namely 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. The 43 autonomous municipalities only cover 30 percent of their expenses with local taxes and duties. The other 70 percent are covered by transfers from Maputo – co-financed with budget support. Looking at the 128 districts, the extent of internal financing is even lower.

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. Fiver 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 franc. 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.

This is a success of the Swiss supported decentralisation programme in Nampula province. 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 Switzerland supported the development of fiscal decentralisation in Nampula together with other donors like Denmark – an effort which is now being spread more widely at the national level thanks to the government's efforts (see separate article on infrastructure). Budget support as well as targeted assistance for national and local tax authorities are complementing each other.

Future construction sites

Around 70 percent of the partially autonomous revenue authority are financed by the state. Another quarter of its expenses are met by a tax share of one percent. The re-

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

maining five percent are co-financed by international donors through a common fund which was created jointly in 2008. It is financed by Great Britain, Germany, Belgium and Switzerland. Furthermore, Norway, the European Union, the World Bank as well as the African Development Bank have expressed an interest. The fund is focussing on the further education and counselling of tax authorities as well as the expansion of infrastructure. Over the next three years, Switzerland will contribute some 2,4 million dollars to the total sum of 15 million dollars.

Mozambique's government is not content with what it has achieved. It works towards annually increasing state revenues by 0.5 percent of the national income (GDP) until 2015. An assessment of experts which says that Mozambique currently only utilises two thirds of its possible tax revenues is cause for optimism. Furthermore, the current tax yield of 16.4 percent of the national income (GDP) is strongly contrasting with that of other oil importing countries South of the Sahara, which according to the IMF mobilise 20 percent for the public authorities. Yet the additional 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.

Taxes constitute an important element of the business climate – the private sector however is still dissatisfied with the tax climate. 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. Today, the taxes main burden lie on the narrow middle class. Such an entrepreneur comments: "The tax burden is not unreasonable, but clearly noticeable." Many enterprises and people at both the top and the bottom end of the scale, however, are not yet paying taxes. Tax exemption such as it was negotiated by the aluminium smelter Mozal for 50 years respectively lacking accounting or literacy skills play important roles in this context.

"Mozal's tax free profits are simply immoral. This will be cause for a fight. We depend on the donors' support 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. The government's intention to demand more from the natural resource companies by signing an international initiative promoting more transparency ("Extractive Industries Transparency Initiative, EITI") takes the same direction. To micro and small enterprises with an annual turnover of up to 100'000 dollars (2,5 mio Meticais) it offered a considerably reduced flat rate tax which also covers both value added and community taxes. Through this it is hoped that the tax basis can be further broadened.

Starting in 2011 – after 15 years of active cooperation – Switzerland intends to slowly disappears from Mozambique's tax system. Thanks to an awoken interest from the other donors the government will receive adequate support from the common fund also in the future. The worldwide financial crisis and recession will not pass without leaving their traces on the national income. In spite of considerable milestones, Mozambique still has a long way to go until it reaches sustainable self financing for its development.

These bags of aluminium fluoride are used in the large enterprise MOZAL which still enjoys tax exemption.

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