Tax Reforms & Revenue Performance in Mozambique since Independence

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Tax Reforms & Revenue Performance in Mozambique Since Independence

Preliminary Information and Analysis for the Project:
Tax Policy and Incidence Analysis

Ministry of Planning and Development

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1. Introduction

The aim of this paper is to review the information and data relating to tax policy and reforms in Mozambique since Independence and summarise the resulting revenue impacts. It was produced as a preliminary input to the project on Tax Policy and Incidence Analysis to be carried out by the Direcção Nacional do Plano e Orçamento (National Directorate of Planning and the Budget) in conjunction with the Gabinete de Estudos (Research Bureau) of the Ministry of Planning and Finance.

At seventh from last in the Human Development Index (UNDP, 2004), Mozambique is one of the poorest countries in the world and therefore has a clear need for continued high levels of poverty-reducing public expenditure. With approximately 50% of its budget currently financed externally through grants or preferential loans, and despite the possibility that this finance will continue to be available or even increase, there is an underlying need for Mozambique to increase domestic resources in the medium term to reduce this high level of aid-dependence. Consistent with this is the goal of total revenue worth 17% of GDP by 2010 established in the PARPA (Action Plan for the Reduction of Absolute Poverty).

In order to achieve this goal whilst minimising distortions and where possible enhancing investment incentives and economic growth, it is imperative that the Government increase its knowledge and capacity for analyses of the impact of tax reforms and the tax system in general. This will also improve the forecasting of Government resources for the national budget and bring a clearer understanding of the likely impacts and incidence of future tax reforms.

This paper provides a preliminary step in this process, summarising the relevant tax information and data available and carrying out some initial analyses with a view to guiding further deeper analyses. It also serves to give an account of all tax reforms to have taken place since independence and to describe the main characteristics of the current tax system.

Section 2 begins by looking at the institutional organisation through which tax policy is designed and implemented in Mozambique. **Section 3** presents and discusses the main tax reforms introduced in Mozambique since independence and their impact on revenues. The section begins with an overview of revenue performance over the whole period 1975 to 2003, from the demise of the colonial economy, through the socialist planning experiment to a market economy hindered by war, and finally to a market economy in peace time, highlighting the main economic and revenue issues of each period. The main tax reforms from each phase are then presented with an analysis of their impact in five sub-sections roughly corresponding with the phases described above: 1975-1986, 1987-1992, 1993-1999, 2000-2003, and 2004 onwards. **Section 4** then concludes this paper by drawing some general conclusions from the whole tax reform experience and from the analyses carried out in the paper.

2. Institutional Organisation

Perhaps as a result of its central planning past, the institutional organisation of the Mozambican Government is characterised by a large bureaucracy with centralised Ministries, each with a wide range of sectoral responsibilities. Within these, there are at least eight units or directorates with a direct interest in tax policy: from the Ministry of Planning and Finance these are DNIA, DGA, URTI, UTRA, DNPO, GEST, CPI, DNI. From the Ministry of Industry and Trade: DNI, DNRIC, in addition to various elements of MADER, and the private sector CTA. Outside Government, many tax reforms have been carried out inder the supervision of the IMF, more recently with assistance from DANIDA, SECO and DfID.[1]

Communication within and between Ministries can often be limited, with the consequence that policy decisions emerge from an uncoordinated and ad-hoc process with little analysis of likely impacts. In particular, this appears to have been the case regarding tax policy and is compounded by the fact that some decisions on policy matters such as exemptions or rates are taken unilaterally by the Minister of Finance with limited consultation.

The lack of coordination may also stem from external influences in tax policy decisions. In assessing Mozambique's performance under all four of its programmes from 1987 to 2003, the IMF states that "the authorities' ownership of programmes improved over time, as demonstrated by…the adoption of several important reforms in tax policy and public expenditure management in the context of the PRGF arrangement" (IMF 2004). Given that the PRGF arrangement began only in 1999 after twelve years of IMF programmes and tax reforms, this can be understood as a lack of ownership in the early Fund programmes from 1987.

Thus, while it is clear that the MPF is ultimately responsible for all tax-related issues and there have been steps to improve coordination for policy decisions on cross-cutting issues, recent tax policy design continues to indicate weaknesses in Governmental coordination and to reflect externally imposed reforms. Tax policy design often appears to have been either the result of imposed ideas and/or uncoordinated diffuse discussions in various fora, thus reducing the possibility of a coherent tax policy based on strategic Government decisions and impacts on revenue and economic growth. In addition, and possibly as a result, there has generally been very little analysis of likely policy impacts.

3. Tax Reforms & Impacts Since Independence[2]

Over the last three decades Mozambique has experienced major economic and social upheavals with three distinct economic systems spanned by a seventeen-year internecine war. Each of these systems demanded corresponding alterations to public

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[1] See Annex 1 for a more detailed explanation of the institutional organisation of tax reform.

[2] This section draws heavily on time-series of tax data for the period 1975-1992 and 1987-2003 from DNIA and various of the relevant laws and decrees etc., IMF Country Report No. 04/53 from 2004, *Ex Post Assessment of Mozambique's Performance Under Fund-Supported Programmes,* Country Report No. 01/25 from 2001, *Selected Issues and Statistical Appendices*, Ernst & Young, *Fiscal Reforms Impact Study*, 2003,. Cavetas regarding the data can be found in Annex 2.

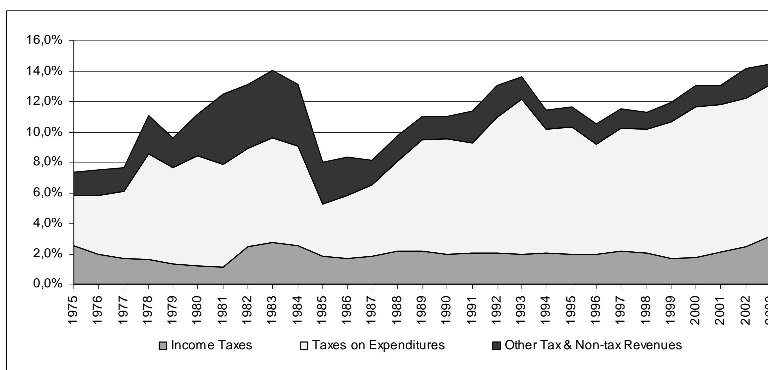
finance systems and thus were accompanied by three major tax reforms. The 1978 reforms coincide with the post-independence transition from colonial capitalism to socialism, those of 1987 represent the beginning of a decade of structural adjustment and move to a market economy, and finally the most recent set of reforms in the period 1999-2003 attempt to consolidate reforms made previously and establish a public finance system with the potential to develop into a sustainable and efficient system.

After summarising overall revenue tendencies for the period 1975 to 2003, this section will study tax reforms and revenue behaviour in 5 shorter periods related to the different economic contexts described above.

3.1 1975-2003 Revenue Overview

Given the economic history briefly outlined above, it should be of little surprise that within this overall period 1975 to 2003, total revenues have experienced a certain amount of volatility, as illustrated in Figure 1. Starting from a very low 7,4% of GDP in 1975, total revenue reached a peak of 14,1% in 1983 before falling to 8,0% in 1985, peaking again in 1993 at 13,6%, sliding again to 10,5% in 1996, before finally achieving continuous growth as a percentage of GDP to an all-time high of 14,4% in 2003 with Government projections of 14,7% of GDP in 2004. However, as Figure 1 also illustrates, Government revenues have increased substantially as a percentage of GDP in the overall period under consideration.

Figure 1 - Overall Revenue as a Percentage of GDP[3]



Within total revenues, Figure 1 reflects the overall dominance of expenditure taxes and thus their weight in much of the overall revenue volatility. Of particular note, and the subject of further discussion below, are the substantial increases in revenues from expenditure taxes following the reforms in 1978, 1987 and 1999. Also worth highlighting, and further discussed below, is the dramatic fall in revenues after 1983 reflecting the economic crisis suffered as a result of a combination of the intensifying internal conflict in the early eighties, expensive socialist Government programmes and inappropriate economic polices.

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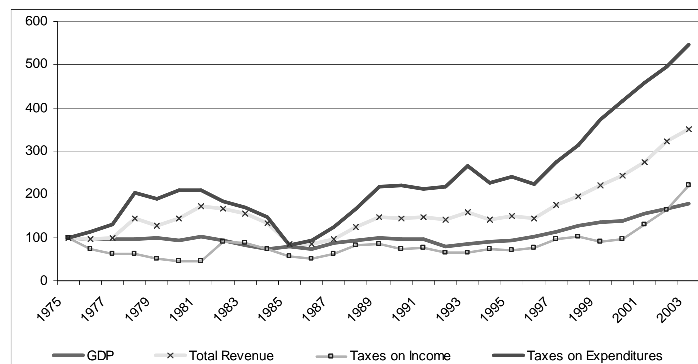
[3] Deflator used from Sulemane, *Economic Decline: A Case Study of Mozambique* (2001).

These fluctuations clearly reflect a wide variety of factors, including a varying tax-base, variations in compliance control and administration, alterations in tax rates and exemptions, all of which will be covered in more detail below.

As Figure 2 shows, GDP growth has also varied considerably during the period 1975-2003, reaching below its 1975 level both in the mid-eighties and early nineties. It has been markedly less volatile than total revenue growth but importantly, Figure 2 also illustrates that continuous economic growth only really began after 1992 and the resumption of peace.

Although revenues appear to be pro-cyclical in relation to GDP, Figure 2 also shows that despite economic growth from 1992, continuous real revenue growth only began in 1997. Since then, revenue growth has been considerably faster than GDP suggesting that the tax-base is widening and/or administration improving. If this is not the case, there is a danger that revenue growth may be unsustainable and therefore be incompatible with the Government's goal of achieving high levels of poverty-reducing economic growth.

Figure 2 - Cumulative Growths of Revenue and GDP (1975=100)



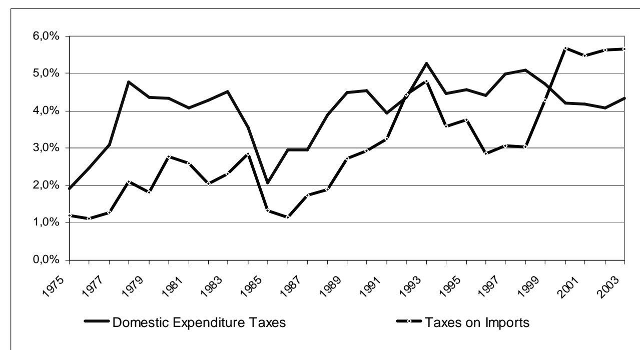
As also illustrated in Figure 2, while expenditure tax revenues have been increasing almost continuously since 1986, reaching more than 5 times there initial 1975 level in real terms in 2003 and well above total revenue or GDP growth, revenues from income taxes were consistently lower than in 1975 until the late 1990s when they finally began to increase, although this was notably prior to the introduction of new income taxes in 2003. Despite this late growth, the contribution of income taxes to overall revenues has continued to decrease in the overall period 1975-2003, perhaps as a reflection of the growing dominance of expenditure taxes.

Figure 3 - Composition of Revenues from Taxes on Income (% of GDP)

Looking in more detail at income tax revenues over the whole period, Figure 3 tracks the progress of revenues from both personal and company income taxes. Of note is the interchanging dominance of these, with personal income taxes higher as a percentage of GDP up to 1982, a sudden increase in business income taxes with the introduction of progressive rates in 1982, discussed below, followed by its decline as a percentage of GDP from 1988 and the return to dominance of personal income taxes from 1995. The precise reasons for this behaviour merit further analysis.

With regards taxes on expenditure, Figure 4 shows the historical dominance of revenues from taxes on domestic expenditures during the period from 1975 to 1999. This is in contrast to the stylised fact that developing countries generally raise most revenue from cross-border trade, with domestic trade taxes only increasing in importance through time as administration and control improve. The reasons for this apparently unusual behaviour are examined in further detail below.

Figure 4 - Domestic and Import Expenditure Taxes (% of GDP)



Having summarised the main characteristics of the Mozambican tax system for the whole period from 1975 to 2003, these are analysed in further depth in the following sections, beginning with the period 1975 to 1986.

3.2 1975 to 1986: Post-Independence Socialism

The period covered in this section extends from the post-independence introduction of socialism up to the economic collapse of the early eighties. The period culminated in the Government taking membership of the World Bank and IMF before embarking on a programme of structural adjustment, covered in the next section.

3.2.1 Post-Independence Tax Reforms

The first post-independence tax reforms of 1978 are best understood by considering the atmosphere of revolutionary socialist fervour in which they took place. This entailed the nationalisation of many private properties and services and ambitious programmes of universal free education and health services (Chabal 2001 p197). These and the accompanying escalation of the internal armed conflict created a need for the Government to raise a large amount of new resources, where possible through taxation. As an initial step this required replacing the previous concept of taxes as a "colonial instrument of domination" (Law No. 2/78) with that of taxes as "… the duty of each citizen to contribute… to the costs of the programmes of the Popular State in order to create the conditions for the introduction of socialism". Also, a new tax system had to be less complex than that inherited, and counteract the disappearance of certain revenues due to the new economic conditions (Decree No.4/78).

These reforms consisted of the introduction of a "National Reconstruction Tax" (Imposto de Reconstrução Nacional), the "Circulation Tax" (Imposto de Circulação), and reforms to the Consumption Tax on textiles, clothes and footwear, with rents from nationalised housing also providing a new additional source of non-tax revenue.

The National Reconstruction Tax was introduced (Law No. 2/78) as a single progressive income tax to simplify the array of colonial-era taxes on income. It replaced the Professional Tax (Imposto Profissional) on salaries, part of the Complementary Tax on overall annual incomes (Imposto Complementar), the General Minimum Tax (Imposto Geral Mínimo) applicable to all adults and the Exploration Tax (Imposto de Exploração) on the profits from small-scale agricultural production or forestry.

The National Reconstruction Tax was applied according to three categories: i) at source on monthly salaries at rates varying between 2% and 15% and up to a maximum of 60% on overall annual income, and at 2% on public sector salaries; ii) on the incomes of peasant cooperatives and agricultural work other than that of households, at a rate of between 4% and 8%; and iii) on non-organised peasants or those without a permanent activity, at a rate to be set by the Minister of Finance.

Simultaneously, Law No. 3/78 introduced a turnover tax in the guise of the Circulation Tax. Its introduction was a simple and attractive option as a generalised consumption tax still did not exist and company income taxes were falling as a result of "economic sabotage" and the low profits resulting from the break-up of the capitalist system. It was applied at a uniform rate of 3% for state or joint state/private enterprises, cooperatives and commercial societies and at specified rates on any other

companies. This was in addition to the Consumption Tax on Beer, Alcohol, Tobacco and "Non-specified Products", in force since 1973.

The introduction of these two new taxes, in particular the National Reconstruction Tax, led to the need to revise the Income Tax Code in order to transform the relatively insignificant Complementary Tax (0,3% of GDP in 1978), previously applied to all incomes including salaries as a "globalising" income tax, into a tax on capital incomes, private property and non-salary incomes (with exemptions for the State and FRELIMO). At the same time it increased the level of taxation on capital incomes whilst suspending tax exemptions and fiscal incentives to industry granted by the colonial regime prior to independence (Decree 4/78).

Following this initial reform, some further smaller reforms were also carried out in 1982 with the abolishment of a category of the Complementary Tax (Imposto Complementar "B") and the Capital Tax (Imposto de Capitais) which then became covered by the Industrial Contribution (Contribuição Industrial) on company profits, the introduction of progressivity into Industrial Contribution which had been a fixed rate proportional tax since its introduction in 1968, and in 1985 the introduction of the Fishing Licence (Licenças de Pescas).

3.3.2 Post-Independence Revenue Impacts

Ostensibly, the main thrust of these reforms was to simplify the tax regime and eliminate certain remnants of the colonial system whilst raising sufficient resources for the Government's expenditure programmes. As is illustrated in Figure 5 below, the initial impact of the reforms was indeed an immediate boost to revenues which leapt from 7,6% of GDP in 1977 to 11,1% in 1978. 1979 saw a slight falter, in particular with respect to Customs Duties which fell by 1,1% of GDP, but the increase was resumed the following year with overall revenues eventually reaching 14,1% in 1983.

As was mentioned, prior to 1978 revenues from taxes on incomes were declining, particularly from business incomes. Despite the reforms, these continued to decline so that the introduction of the National Reconstruction Tax and the adjustments to the Complementary Tax in 1978 had a limited impact on overall income tax revenues.

With respect to expenditure taxes, prior to 1978 most revenue was collected from the Consumption Taxes on Beer, Alcohol, Tobacco and "Non-specified Products" and from import Duties. The introduction of the Circulation Tax therefore widened the tax base and further increased the dominance of revenues from taxes on expenditure. However, after 1981 Mozambique began to experience high rates of inflation so that the increase in expenditure tax revenues may also be understood as a result of higher inflation rates and inelastic demand for certain consumption goods.

In addition, Other Tax and Non-tax Revenues also increased, from 1,5% of GDP in 1977 to 2,5% in 1978, rising to a peak of 5,5% of GDP in 1981, mostly accounted for by the inclusion of public housing rents which in 1978 constituted a new source revenue worth 0,6% of GDP.

Figure 5 - Revenue Categories as a Percentage of GDP 1975-92

The general upward trend of revenues after 1978 was short-lived, as also illustrated in Figure 5. The further intensification of the armed conflict after 1980 destroyed key infrastructures and severely restricted mobility and was accompanied by continuing expensive social programmes, low export levels and inefficient socialist planning which finally led to severe economic decline in the early eighties and collapse in 1986, illustrated by the severe reduction in tax revenues in 1984 and 1985.

Both the Consumption Tax and Customs Duties in particular suffered a marked decline, falling from 3,1% to 1,3% of GDP and 1,5% to 0,3% from 1983 to 1985 respectively, reflecting a sharp drop in consumption due to shortages. After 1985, total revenues remained relatively stable at the low level of around 8,0% of GDP in 1986.

3.3 1987 to 1992: Structural Adjustment

During the crisis of the early eighties, recognising the need for greater economic flexibility and more reliance on market forces and also motivated by a need for external finance, Mozambique joined the IMF and World Bank in 1984. This section then covers Mozambique's first Structural Adjustment Programme (SAP) which ran from 1987 to 1989, closely followed by the first three years of the first Enhanced Structural Adjustment Programme (ESAP), leading up to the peace accords in 1992.

3.3.1 Structural Adjustment Tax Reforms

The SAP was initiated to support the ostensibly Government-designed Economic Rehabilitation Programme (Programa de Reabilitação Económica, PRE), a programme of fiscal adjustment, liberalisation of a number of price controls, monetary restraint, and adjustments to the official exchange rate, designed in conjunction with the IMF in an attempt to reverse the economic decline seen in the first half of the 1980s where GDP fell by almost a quarter (IMF 04/53, p5).

In addition, tax reforms were designed, again under pressure from the IMF and World Bank who "exerted massive influence on the policymaking process" (Tarp et. Al. 2002). For the second time in 10 years, the new economic and political environment

thus brought a major revision of the tax code, re-establishing the foundations of the tax system as a whole.

According to the 1987 Tax Law (3/87), the 1978 tax code "consecrated the principles of social justice… and revealed itself to be effective in permitting, within the prevailing economic conditions of the time, the concentration of increasing amounts of resources in the State Budget…". However, by 1987 there was apparently "a situation where huge legal and illegal profits [were] accumulating in the economy", thus rendering the tax system extremely weak due to its "strong focus on direct taxation of incomes" which had a delayed reaction to changes in the economy (Law No. 3/87, BR 16).

In a clear attempt to justify the switch in tax policy from the previous law set amidst socialist idealism in 1978, its assertions appear misleading, particularly in light of Figure 5 which showed that direct taxes on incomes accounted for only 20% of total revenues in 1986 whilst indirect taxes accounted for 42%.[4] Nevertheless, the new law provided the legal framework to adopt measures to "revitalise and reinforce indirect taxes…" and "perfect the direct taxes on incomes in order to more effectively personalise the tax and reach higher incomes and in particular those from capital" (Law No. 3/87, BR 16).

Specific reforms included further alterations to the Industrial Contribution (Contribuição Industrial), in force since prior to independence, the introduction of the Labour Income Tax (Imposto sobre Rendimentos de Trabalho) to replace the National Reconstruction Tax, the transformation of the National Reconstruction Tax into a form of poll tax, corresponding alterations to the Complementary Tax to focus on overall household and capital incomes in a more progressive way, and the alteration of some of the regulations and mechanisms of the Consumption and Circulation Taxes.

More specifically, the Industrial Contribution was extended to state companies to replace the previously inefficient direct transfer of profits. Also, having been introduced in 1968 at a rate of 18%, and then made progressive up to 50% in 1982, Law 3/87and Decree 3/87 (BR No.4) returned the Industrial Contribution to a set rate of 50% on profits and 55% on those profits distributed to shareholders via dividends or other mechanisms, with domestic industries or those with insignificant resources for salaried labour paying equivalent to a licence fee.

Through the same Law and Decree, a proportional personal income tax was also introduced in the guise of the Labour Income Tax (Imposto sobre Rendimentos de Trabalho). This was applicable in two categories: A) on income received in exchange for work or professional activities carried out at rates of 0%, 6% and 15%, with exemptions for salaries paid from the state budget, foreign diplomats, and personnel of international organisations, and B) on incomes from production cooperatives and individual, agricultural or other activities of a small dimension, applied at rates between 1 and 30% to be decided by the Minister of Finance with assistance from Provincial Governments. Alterations in 1988 made the Labour Income Tax marginally

[4] Information based on a time-series of tax revenues from 1975-1992 provided by DNIA.

more progressive with new rates of 0%, 10%, 15% and 20% for new salary bands (IMF 01/25).

As was also referred to above, the relatively insignificant Complementary Tax (Imposto Complementar), also covered by Law 3/87 and Decree 3/87, was reformed to become a more progressive surtax applicable on overall incomes, including capital, with rates varying from 0% to 70% (with 18 brackets), the amount payable being net of that already paid through the various income taxes.

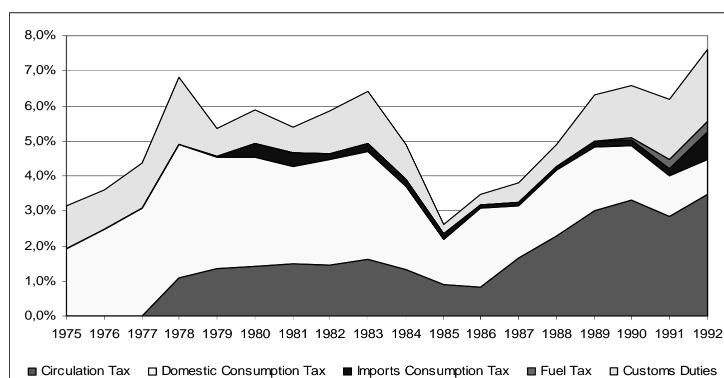
With respect to the Circulation Tax, Decree No. 1/87 explains that although the tax was initially created with the objective of "indirectly and only targeting company profits, today, in practice and in general, it uncontrollably impacts on the consumer" (Decree 1/87). The same decree increased rates from 3% to 5% for wholesalers and 10% for retailers both on domestic transactions and imports, thus creatig a large cascade effect. Exemptions were granted for those small enterprises coming under section B of the Labour Income Tax, justified by the difficulty of capturing the tax from small traders and the need for the State to access resources which "until now, and in most cases, simply increase the profits accumulated by traders and intermediaries". However, in stark contrast to the "uncontrollable impact on consumers", it states that "the increase in the tax should not have a significant impact on general price levels, given that it is simply a way of correctly redistributing profits…". Once again, therefore, the wording of the Law is somewhat contradictory to its substance, perhaps again reflecting the multiple influences and interests in the creation of tax policy.

Following the PRE, Mozambique embarked on its first Enhanced Structural Adjustment Programme (ESAF), originally intended to run from 1990 to 1992 but subsequently extended to 1995. This had the broad objective of continuing the reforms begun in the PRE with further price liberalisation and additional smaller tax reforms. These included the introduction of the Compensation Tax (Imposto de Compensação) on motor vehicle ownership in 1989 and the Special Fuel Tax (Imposto Especial sobre Combustíveis) in 1990, levied as fixed amounts per litre of fuel (depending on fuel type) on domestically consumed fuels with the proceeds transferred to the Road and Bridge Maintenance Fund. In addition it included tariff reforms which eliminated specific import Duties and simplified the tariff schedule as of 1991, establishing a maximum tariff rate of 35%.

3.3.2 Structural Adjustment Revenue Impacts

As mentioned previously, even before the 1987 tax reforms were implemented, Government revenues had begun to increase with the return of some stability in the economy, so that from 1987 to 1992 these climbed from 8,2% to 12,9% of GDP in 1992. This was again mostly due to taxes on expenditure, which rose from 3,8% to 7,6% of GDP whilst taxes on income increased only from 1,9% to 2,3% of GDP.

Figure 6 - Taxes on Expenditure as a Percentage of GDP 1975-1992[5]



As Figure 6 illustrates, the increase in revenue from expenditure taxes was mainly due to the Circulation Tax which effectively doubled as a proportion of GDP, from 1,7% to 3,5%. This is likely to be a result of the increased rates and the resultant cascade effect as the tax was applied all the way down the value chain (with consumers ultimately very affected), but may also reflect a low initial base.

Also noticeable in the data are the jump in Customs Duties from 0,6% of GDP to 2,0% between 1987 and 1992, and revenues from the Consumption Tax on Imports from 0,1% of GDP to 0,8%. This is surprising given the apparent increase in tariff exemptions and Customs administration problems experienced at this time (IMF, 01/25) but may instead reflect rising levels of consumption as a result of increased economic stability brought about by the liberalisation measures of the PRE and ESAP which reduced inflation from 160% in 1987 to below 35% in 1991 (IMF, 04/53). This hypothesis is made plausible by Mozambique's high level of dependency on imports and the resulting strong link between consumption and import levels. However, it is also possibly a reflection of a depreciation of the real exchange rate would have had the effect of increasing the import tax base relative to GDP.

Finally, it is worth noting that GDP growth in the period from 1987 to 1992 was very low and in real terms GDP actually decreased, as Figure 2 illustrated. Thus, the increase in revenues was also in conjunction with poor GDP growth, something which may have had additional long-term effects.

The period from 1987 to 1992 thus saw a rebounding of tax revenues as a percentage of GDP as Mozambique emerged from the economic crisis of the early eighties and began its transformation from a centrally planned economy to a more market-oriented regime with its accompanying tax reform. In 1992, the warring parties finally signed peace accords to end 17 years of civil conflict, thus also bringing an end to the inherent restrictions of a war economy and allowing the reconstruction process to begin.

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[5] The tax categories from left to right in the key correspond to the bands from bottom to top in the graph.

3.4 1993 to 1998: Peace & Structural Adjustment

The most important factor of the period 1993 to 1998 was a much higher level of economic and political stability than previously experienced, with high real GDP growth (average of 8,5% p.a.) and low inflation. This period saw the final part of the first ESAF (1990-95) with its liberalisation of all prices and adoption of a market-determined exchange rate, followed by the second ESAF (1996-1999) which continued to liberalise the trade regime whilst attempting to further reduce the role of the state in the economy and reduce fiscal imbalances (IMF04/53). However, despite the apparently propitious economic environment, tax revenues did not perform well, instead falling as a percentage of GDP from 1993 to 1997.

3.4.1 Peace-Time Tax Reforms

The measures implemented in the major tax reforms in 1987 continued in force but were complemented by some individual adjustments, ostensibly to promote investment and economic activity in general. In particular, in 1993 Industrial Contribution rates were reduced from the high 50% on all activities to 35% for agriculture, 40% for manufacturing and 45% for all other activities (IMF 01/25). This then introduced a semblance of strategic tax policy design.

This was furthered in 1993 with the Investment Law which was passed with the objectives of adopting "a more open and objective economic policy which favours greater participation, complementarities and equality of treatment for national and foreign investments" (Law No. 3/93), partly as a response to the continued liberalisation of the economy and purportedly to limit ad-hoc exemptions and fiscal benefits. This established a legal framework for the carrying out of foreign and national investments with guaranteed security and legal protection of property and rights and guaranteed remittance of funds abroad (provided applicable tax obligations and exchange formalities were satisfied) whilst providing the framework for enterprise eligibility for more uniform fiscal incentives in the form of tax and Customs benefits.[6] To benefit from the guarantees and fiscal incentives, investments of domestic origin had to have a capital value of at least US$5000 whilst Foreign Direct Investments (FDI) required to be of a minimum value of US$50,000 (fob) with the specific incentives to be granted provided in the Specific Terms of Authorisation.[7]

The economic strategy element was introduced to tax policy through the ten guiding objectives for investments carried out under the law. These can be categorised into four broad areas: promoting investment in infrastructures, increasing human capital, improving technology and improving the balance of payments through both exports and substituting of imports[8] (Decree no.14/93 and altered by Decree 36/95).

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[6] This built on earlier legislation from 1984 and 1987 relating to Foreign Direct Investment.

[7] The decision of approval of investments depended on the amounts involved with provincial Governors able to approve projects with a value between US$5,000 and US$100,000, the Minister of Finance those with a value up to US$100,000,000, whilst those worth more than US$100,000,000 had to be approved by the Council of ministers.

[8] Strategic areas, such as electricity and water provision were reserved for the public sector, with or without private participation by the Investment Law Regulations

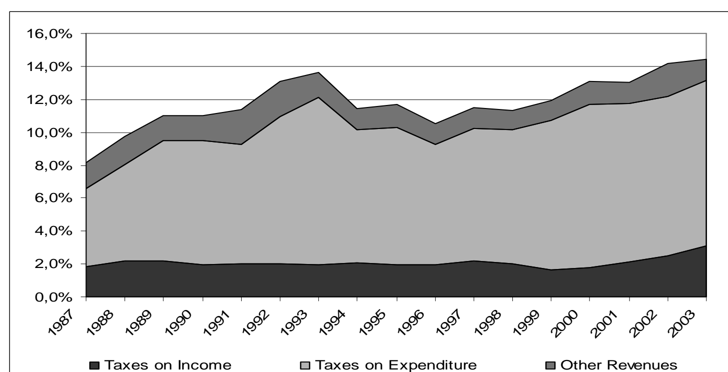
Finally, 1993 also saw the beginning of Customs reforms. Whilst the maximum tariff rate remained at 35%, taxes and tariffs on imports were rationalised, reducing the number of different tariff rates from twelve to five, whilst ad-hoc tariff exemptions were eliminated and Customs control strengthened.

Despite these measures and the apparent economic stability, customs revenues continued to fall. Consequently, as part of the ESAF the Unit for Restructuring Customs (UTRA) was formed in 1996 and a private company, Crown Agents, contracted to take over the management of Customs with the main objective of further improving administrative efficiency and capacity.[9]

3.4.2 Peace-Time Revenue Impacts

As Figure 7 clearly illustrates, the positive impacts of the earlier reforms of 1987 were apparently partially lost in the period from 1993 to 1998 despite the boost one might have expected from the peace accords and subsequent reconstruction. Overall revenues thus declined from 13,6% of GDP in 1993 to 10,5% in 1996 before rebounding only slightly to 11,3% in 1998.[10]

Figure 7 - Revenue Categories as a Percentage of GDP 1987-2003



In terms of individual taxes, the initial decline is attributable to a fall in Circulation Tax receipts, from 4,0% of GDP to 3,0% from 1993 to 1996, but also Customs Duties which fell from 3,5% to 2,1% of GDP. Circulation Tax revenues on imports are directly related to the levels of Customs Duties, thus indicating that the decline of revenue from both these sources is probably due to the weak Customs control and ad-hoc exemptions experienced in this period. In addition, there is a possibility that exemptions resulted from the implementation or abuse of the "specific incentives" granted by the Investment Law, ostensibly implemented to promote investment. Taxes on incomes once again had little impact, remaining steady at around of 2,0% of GDP.

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[9] This was carried out with the collaboration of DfID, SECO and DANIDA.

[10] It should be noted that part of this may be related to the re-estimation of National Accounts for 1996 onwards which therefore increased GDP estimates but not revenue collected.

As was mentioned earlier, overall revenue began to increase continuously only after 1996. However, whilst the Customs administration reforms may have influenced the 0,3% of GDP increase in Circulation Tax receipts on imports, they merely stemmed the decline of revenues from Customs Duties. In fact, the main influence on reversing the decline in revenues is the Fuel Tax, which was revised for inflation in 1997 and thus increased its contribution from 1,0% of GDP to 1,6%.

Thus, despite the peace accords after seventeen years of armed conflict, positive economic growth and lower inflation, this was not reflected in revenues to the Government. Taxes on incomes remained relatively low and a proliferation of ad-hoc benefits on expenditure taxes, possibly resulting from the introduction of the Investment Law and its "specific incentives", led to an overall decline in revenues.

3.5 1999 to 2003: Post-Structural Adjustment Consolidation

The period from 1999 to 2003 corresponds to the first of Mozambique's IMF Poverty Reduction and Growth Facilities (PRGF), the objectives of which were to sustain the GDP growth levels and low inflation achieved in the previous programmes but with a greater emphasis on combating poverty through the Government's Poverty Reduction Action Plan (Plano Estratégico para a Redução da Pobreza Absoluta, PARPA). In order to help finance this, the PRGF also had a specific emphasis on strengthening government revenue (IMF, 04/53) and reversing the poor performance of the previous period, reflected in the array of new tax reforms implemented in this period.

3.5.1 Post-Structural Adjustment Tax Reforms

This period covers rather a larger and more spread-out set of tax reforms. These include the introduction of Value Added Tax (VAT) (Imposto de Valor Acrescentado, IVA), the Specific Consumption Tax (Imposto de Consumo Específico) and the Special Fuel Tax (Imposto Especial sobre Combustíveis) in 1999, followed in 2003 by the introduction of a new income tax code with two new taxes, the Individual Income Tax (Imposto sobre Rendimentos de Pessoas Singulares, IRPS) and the Collective Income Tax on company incomes (Imposto sobre Rendimentos de Pessoas Colectivas, IRPC). These reforms were also accompanied by continued assistance to improve Customs capacity and efficiency.

Whilst the introduction of these reforms was ostensibly intended to widen the tax-base, simplify procedures, do away with the cascade effect of the Circulation Tax and promote exports whilst increasing revenues, the new taxes also brought a new level of complexity, thus increasing the administrative burden on both the authorities and the private sector.

Value Added Tax Law 3/98 simultaneously approved VAT, the Specific Consumption Tax and the Special Fuel Tax. Their introduction was deemed advantageous due to the need for a "more efficient and neutral system" which would eliminate the cascade effect of the Circulation Tax and the Consumption Tax which they were to substitute.

Implementation of the new indirect taxes began on 1 April 1999 with VAT set at 17%, payable on both domestic transactions and imports of goods and services including Customs Duties and other import taxes. Whilst following the basic logic of a standard VAT, with amounts payable calculated as VAT received on enterprise sales minus that paid on inputs, the VAT Code (Decree No. 51/98) also establishes "special regimes" within the overall framework for the informal sector, as well as exemptions for certain products and activities considered of major importance. The special regimes are important, as empirically these are the source of major administrative problems with the implementation of VAT.

The "Exemption Regime" covers small enterprises with an annual turnover of less than Mts100m (approximately US$4,000) which do not participate in import or export activities and are not required to have organized accounts for income tax purposes. These are not eligible to charge VAT on sales or be reimbursed the VAT paid on inputs and thus incorporate VAT in their sales cost, operating as do final consumers.

The "Simplified Regime" is applicable to those non-import/exporting enterprises with annual turnover between Mts100m and Mts250m (i.e. approximately US$4.001 and $US10.500). Under this regime, VAT is payable at a rate of 5% on final sales but again VAT on inputs is not deductible from the amount paid to the Government, thus equating this regime to a 5% turnover tax on these firms.

In addition to these specific regimes, there are an array of exemptions on goods and services. These include basic products such as corn flour, rice, bread and medicines as well as many agricultural inputs such as seeds, animals for breeding, fertilizers, tools and certain agricultural machines. Similarly, goods and services linked to agricultural activity, forestry and fishing are exempt as are those relating to health and education services, insurance and social security, banking and financial operations services and all goods and services destined for exportation. VAT exemption is also granted in the case of exemption from Customs Duties, goods destined for international organisations, Special Economic Zones and Export Free Zones. Finally, the Minister of Planning and Finance can also grant exemption for the acquisition of goods and services destined for "national institutions of public interest and relevant social purposes".[11]

Of the goods and services listed above, exports and the production of some basic goods, such as corn flour, rice and bread are eligible for reimbursement by Government of VAT paid on inputs (Decree 51/98 Art.9). Similarly, where the amount paid in VAT on inputs is in excess of that collected in the final sale and an excess of at least Mts10m (aprox. $416) exists for more than twelve months, as may be the case for enterprises or projects in an early phase of development or where an activity is ceased, reimbursements can also be requested. These should be made by the National Directorate of Auditing and Taxes three months after the respective request and accrue interest in cases of delay beyond that time limit at a rate "equal to that practised in the banking system for current accounts" (Law 3/87). However, in cases where credits result from export activities "the reimbursement will be carried out in

[11] "The importation of goods benefiting from import duty exemption" are also exempt under the terms of the following: Article 15 of Law 7/914, Article 7 of Law 4/94, Article 2 of Law 3/83, Article 18 of Law 2/95, Articles 40, 44, 45 of Law 41/96 (Article 11, Decree51/98).

different conditions…" (Decree 51/98), which are unspecified either in the VAT code or the Regulation for Charging, Paying and Reimbursement of VAT (Decree 77/98).

The question of how VAT is being implemented in practice is very important and illustrates how the introduction of a fairly complex tax system can increase the burden on the tax administration and as a consequence, the private sector. As was mentioned, these relate primarily to the special regimes and in particular to the length of delays in reimbursements which prejudice the operations of companies where the amount to be reimbursed can often be sizeable. Thus, the administrative problems being experienced are equivalent to an additional tax on certain activities, in particular exports.

In addition to the economic impacts of VAT implementation difficulties, it is also unclear what other impacts the switch to VAT may have had. For example, whilst the informal sector is notoriously difficult to reach with a tax such as this, it is possible that the simplified and exempt regimes may have reduced the competitivity of smaller enterprises, unable to reclaim VAT, thus having a greater impact on the poorer income levels of society or alternatively, reducing the incentive for enterprises to become formal. These issues remain to be analysed to better inform about the effects of present and future tax design.

Specific Consumption Tax As VAT is non-discriminatory, the Specific Consumption Tax was simultaneously introduced on imports and domestic sales of particular consumer goods deemed to be "luxury, superfluous, bad for the health, or dangerous for human consumption or for the environment, such as automobiles, alcoholic drinks, beer and tobacco" (Decree 52/98), with exemptions for those goods exempt from VAT and for specific cases such as alcohol for industrial use, scientific investigation etc.. The Specific Consumption Tax is essentially an excise tax and replaced and updated the previous consumption tax, with applied rates varying between 20% (e.g. shampoo, deodorant) and 75% (wine, whisky, cigars, cigarettes)(Decree 52/98).[12]

Trade Taxes Under continuing donor support to improve administration and build capacity, in 2001 Customs began implementation of the Southern African Development Community (SADC) Trade Protocol, signed in 1996 and ratified in 2000, with the long-term aim of forming a free-trade area following a period of adjustment (UTCOM). As a result, the maximum import tariff was further reduced from 35% to 30% and in 2003 to 25%. In addition, 2002 brought a reduction in the maximum allowable import of consumer goods from US$200 to US$50. Although an attempt to increase the revenue captured from small-scale importers, or "mukeristas", as the figures below will show, the impacts were superficially small but may even have increased contraband.

With respect to non-SADC countries, trade policy and thus revenues will clearly depend on specific agreements although in general the top rate is expected to remain at around 20% for the foreseeable future.

In a more limited alteration, a Ministerial Diploma from the MPF and MIC was published in 2003 (No. 99/2003) providing a <u>Customs regime for the manufacturing</u>

[12] See annex for full list of products and rates.

industry. This regime, allegedly a response to the VAT reimbursement delays experienced by large manufacturing firms, gives exemptions on Duties (and therefore automatically VAT) on imported inputs to enterprises in the industrial sector (comprising agro-industry, food, textiles and footwear, metal, mechanic, graphic, chemical, plastic and rubber), where these have an annual income of not less than Mts6bn (approximately US$250,000) and a value-added of at least 20%.

Although not explicitly part of a strategy to promote large-scale industrial firms, this measure clearly deprives the MPF of further revenue, thus effectively transferring funds to large entrepreneurs, increasing their effective protection and increasing the relative costs of small and medium enterprises, whilst simultaneously undermining the philosophy of unifying fiscal incentives under the Fiscal Incentives Code, introduced below.

Tax Reform Law Following the introduction of VAT and in parallel with the continuing Customs reforms, Law 15/2002 was approved by Parliament in an attempt to clarify the tax system for future reforms. In a similar manner to the VAT Law, and reminiscent of Law 3/87 which established the "reformulation of fiscal policy" as a break from the first post-independence reforms, Law 15/2002 methodically set out what the new revenue sources would be in terms of direct taxes on income and wealth and indirect taxes on expenditures, highlighting the introduction of the reformed income taxes, the new Vehicles Tax and the Fuel Tariff, whilst also putting forward the Customs Code (Pauta Aduaneira) and Stamp Duty for revision, all of which will be looked at below.

An important administrative step was taken by obliging that a tax number must be used by all firms. The Individual Taxpayer Identification Number (Número Único de Identificação Tributária, NUIT) was then created by Decree 52/2003, to be attributed to both individuals and companies and used in the payment of all taxes, both direct and indirect.

The potential implications of this innovation are great in terms of improving tax authority control, in particular in terms of checking the consistency of payments and declarations and simplifying administration in the long-run. However, it will rely on continued administrative support before its introduction can be made widespread and the full benefits achieved.

IRPS Personal Income Tax One of the first applications of the NUIT has been in the implementation in 2003 of the new Personal and Corporate Income Taxes (Imposto sobre o Rendimento de Pessoas Singulares, IRPS and the Imposto sobre o Rendimento de Pessoas Colectivas, IRPC respectively) formed in Law 15/2002 and detailed in Decrees 20/02 and 21/02, respectively, thus replacing what was to some "a complex system of five taxes on income whose base had been eroded by generous exemptions and deductions" IMF 04/53.

The IRPS is a progressive tax on all household incomes earned by residents in Mozambique, in money or in kind, from all places and in all moneys, based on five

income categories, namely Income from Dependent Work, Professional and Business Incomes, Capital Incomes, Building Incomes and Other Incomes.[13]

Individual incomes are taxed at source where possible, at a rate of 20% for all incomes except those from capital (at 10%), whilst annual income of less than Mts24m (US$1.000) is not taxed and that from agricultural activity at a maximum of 10%. However, as the IRPS is a tax on all incomes accruing to a household, at the end of the year all incomes, all incomes must be summed and the overall tax which is due calculated using the rates in the following table and subtracting the amount already paid at source.

IRPS - Income Tax Rates

Annual Income	Rate	Subtract from Calculated Tax
Up to Mts28m (US$1.166)	10%	--
From Mts28m to Mts112m (US$1.166-US$4.666)	15%	Mts1,4m (US$58)
From Mts112m to Mts336m (US$4.666-US$14.000)	20%	Mts7m (US$292)
From Mts336m to Mts1.008m (US$14.000-US$42.000)	25%	Mts23,8m (US$992)
Over Mts1.008m (US$42.000)	32%	Mts94,36m (US$3931)

In addition to its application to total household incomes, there are various deductions applied to the initial amount calculated as payable in tax, depending on the marital status of the individual and the number of dependents. Specifically, single people are entitled to a deduction of Mts600.000 (US$25[14]), married to a deduction of Mts480.000 (US$20) with further deductions for dependents: Mts200.000 (US$8,3) for one, Mts300.000 (US$12,5) for two and Mts400.000 (US$16,6) for three or more.

Clearly, such a complex system of taxation requires detailed records not just by the tax administration but also by those private companies required to have an organised set of accounts. Thus, there is also a <u>simplified regime</u> (Regime Simplificado) for calculating the taxable income of self-employed with an annual turnover of less than Mts1.500m (approximately US$62.500), who can opt out of keeping organised accounts. This is done according to "technical-scientific indicators defined for each sector of economic activity" (Decree 20/02) which should be approved by the Minister of Finance. If not, then a coefficient of 20% is applied to total sales and 30% on remaining income.

[13] *Income from Dependent Work* is defined as income from contract work in both private and public sector, bonuses and subsidies etc, and including pensions and disability payments but excluding social security payments by employers, training costs or pensions less than Mts168m per annum. *Professional and Business Incomes* relate to incomes from commerce, industry, agriculture, forestry, livestock as well as self employment or other independent work, one-off earnings. *Capital incomes* are those incomes from interest payments, profits, share earnings, bonds and sale of real estate. *Building Incomes* are those from rental of housing or commercial buildings. *Other Incomes* are those accruing from lottery winnings, gambling, indemnities and all those not covered by the other categories.

[14] At an exchange rate of 24.000Mts to US$1.

Whilst stemming from admirable intentions, it is clear this system raises many issues regarding administrative capacity, particularly in a country where this is already stretched. In addition, the complications of recording detailed information on family incomes and dependents may not be suited to the Mozambican reality of large extended and informal family links. Indicative of the complications of administration is the fact that in its first year of implementation, the Government itself was unable to correctly implement the IRPS on civil servants, instead estimating the overall amount due at the end of the year.

IRPC Company Income Tax Accompanying the introduction of the IRPS was the IRPC, introduced to replace the Industrial Contribution (Contribuição Industrial) on company profits, part of the Labour Income Tax, the Complementary Tax and the Urban Building Contribution (Contribuição Predial Urbana). This is applicable to the profits of commercial, cooperative and public enterprises (and on incomes not liable to IRPS) at a rate of 32% (10% on agricultural activities until 2010). Once again, incomes taxed at source are taxed at 20% (10% for telecommunications and international transport). Although a simplified regime also exists for IRPC, there are no benefits, the company simply being permitted to keep accounts in a simpler format although this may still be overly complex for many small and medium-sized enterprises.

In addition to the introduction of these new income taxes and NUITs, there has been an accompanying increase in controls over large taxpayers with the setting up of a particular unit for this. However, there are also complaints from the private sector that the rate is still too high, and that its impact is mainly felt by small or medium enterprises where the ability to offset profits in their balance sheets is limited.[15] It is possible that this situation is heightened by the Fiscal Benefits Code, presented below, and the manufacturing customs regime described above, which may put extra pressure the Government to raise increasing amounts of revenue from a non-expanding base although this is not supported by the data presented below.

Fuel Tariff Law 15/2002, which introduced the new income taxes, also presented the Fuel Tariff (Taxa de Combustíveis) to substitute the Special Fuel Tax (Imposto Especial sobre Combustíveis) in operation since 1990.

The Fuel Tariff is set as an amount payable per litre or Kg and updated (at a maximum of 5%) on a quarterly basis according to inflation. This contrasts with the Special Fuels Tax which was alterable by Ministerial Diploma from both the Minister of Finance and Industry & Commerce. The introduction of the Fuel Tariff and its updating mechanism resulted in an initial jump of 63% after having remained at the same level since 1997 so that the tax on normal automobile fuel currently represents approximately 30% of the total consumer price (equivalent to an ad-valorem rate of over 40%) and a slightly lower percentage than this for diesel and lead-free petrol.

This increase took place after extensive analysis of its likely impact in a Poverty and Social Impact Analysis, produced in 2003 and one of the few times a detailed analysis has been carried out prior to the introduction of a tax reform. This found that although

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[15] The suggestion that this may be taking place was given by the CTA, citing the KPMG study *Top 100 Companies in Mozambique*, which shows that 15 of these presented net losses in 2002.

a rise in rates would possibly lead to longer-term impacts on vulnerable activities and the purchasing power of some of the lower income levels of society, the share of fuel in the economy was relatively small and that increase could take place as long as these also took place taking into account the cost of fuel in South Africa (DfID, March 2003).

In addition, the new law redistributed fuel tax receipts so that the majority was consigned directly to the improvement of roads, whilst the remainder to the central budget rather than to the city and provincial administrations as was previously the case.

Fiscal Benefits Code As the above tax reforms were taking place, the Government also approved the Fiscal Benefits Code through Decree 16/2002. As has been referred to, since the Investment Law and first Fiscal Benefits Code had been approved by Law 3/93 and Decree 12/93, a proliferation of special tax regimes had come about, resulting in a disparate collection of 30 laws, decrees and decisions on benefits, in some cases with overlaps. Also, the IMF carried out a study under the PRGF entitled "Reduction of Fiscal Benefits" (IMF 2000), which found that the tax incentives in place were overly generous and not cost-effective, resulting in a proposal for less incentives in the form of exemptions from taxes on profits and an emphasis instead on tax credits, temporary suspension of tax or accelerated depreciation.

Thus, a new Fiscal Benefits Code was prepared in 2002, following the IMF recommendations, to unify all fiscal benefits under one code to be applicable to investments realised under the Investment Law (3/93), the Mining Law (14/2002) and the Petroleum Law (3/2001), with an array of fiscal incentives in the form of deductions from taxable income, accelerated depreciation, tax credits, reduction of tax rates, import regimes and deduction of the amount of tax assessed.

In general terms, beneficiary enterprises became from Customs Duties on capital imports where these are not produced in Mozambique or, if produced, where they do not satisfy the characteristics required for the project or particular activity. [16]

In addition, investments carried out under the Investment Law benefit from an investment tax credit (CFI) of 5% of the total investment realised, deducted from the company income tax up to the total amount of the tax assessment over five years, with greater credits for investments carried out in the provinces.[17] In addition, there is accelerated depreciation at twice the normal rate for both new and rehabilitated immovable assets, machinery and equipment for industry and agro-industry while technologically advanced equipment receives an additional 15% deduction from taxable income during the first five years.

There are also income tax deductions of up to 5% of taxable income for training costs of Mozambican workers during the first 5 years (10% where the training involves technologically advanced equipment) and infrastructure expenditures are deductible

[16] Beneficiary enterprises must have conform to the stipulations of the Investment Law, hold a single tax-identification number (NUIT) and approval of the goods to be imported, as well as a maintained set of accounts and records.
[17] For Gaza, Sofala, Tete and Zambézia Provinces, the CFI is 10% of the total investment whilst for Cabo Delgado, Inhambane and Niassa provinces the amount shall be 15%

from company income taxes at 120% in the City of Maputo and 150% in all other provinces.[18]

Investments are also exempt from Stamp Tax during the first five years on company incorporation or the alteration of share capital and benefit from a 50% reduction in the rate of real property transfer tax (a tax with only marginal significance known as SISA) on property used in industry, agro-industry and hotel industry in the first three years.

The Fiscal Benefits Code also provides additional benefits for investments in specific sectors with agricultural investments benefiting from an 80% reduction in the income tax rate applicable until 2012, an 8% tax credit and accelerated depreciation up to three times the normal rate (up to 31 December 2007) for the hotel and tourism industry,

“Exceptional incentives” exist on Customs Duties, Income Taxes, SISA and Stamp Tax for large-scale projects greater than US$500m and those in public domain infrastructures, subject to approval by the Council of Ministers and a contract which establishes the goals, incentives to be granted and penalties in event of breach, granted for a period of 10 years. To receive exceptional incentives, the investment must demonstrate its benefit to national economic development, reducing regional imbalances, and creating at least 500 work posts or induce 1000 posts within three years.[19] Large scale projects also benefit from an investment tax credit (CFI) ranging from 5% to 10% of the total investment realised, deductible from IRPC during the first 5 years of the project with increasing rates for projects carried out in the provinces.[20]

The Fiscal Benefits Code also provides for Rapid Development Zones in the Zambezi Valley, Niassa Province, Nacala District, Moçambique Island and Ibo Island, where agricultural and forestry activities, game exploitation, infrastructure supply and construction, tourism and commerce construction, industry, transport, education and health are, until 31 December 2015, exempt from Customs Duties on both capital and intermediate goods (classes K and I), also benefiting from a tax credit for IRPC of 20% of the total investment for the first 5 years of the project.

Having been approved in 1999, the Industrial Free Zones (Zonas Francas Industriais) regulation was included into the Fiscal Benefits Code. These Zones must provide at least 500 work posts, with each individual enterprise providing at least 20 posts or 250 where the enterprise intends to benefit from the Investment Law. At least 85% of production must be destined for export and companies operating within these zones then benefit from exemption from all Customs Duties, VAT and Specific Consumption Tax on input goods with the exception of food, alcohol, tobacco, clothing and other personal articles. They also benefit from a 60% reduction in the

[18] Infrastructure expenditures include those on roads, railways, airports, mail delivery, telecommunications, water supply, electric energy, schools, hospitals and other public utility works

[19] “National economic development” includes investment projects in agriculture, aquaculture, forestry, agro-industry, manufacturing, infrastructures construction and tourism activities.

[20] The tax credit is between 10% and 20% for projects in Gaza, Sofala, Manica, Tete, Zambezia and Nampula provinces, and between 15% and 30% in Cabo Delgado, Inhambane and Niassa Provinces.

IRPC rate for ten years, exemption from the property tax (SISA) in addition to having a different Labour Law to the rest of the country.

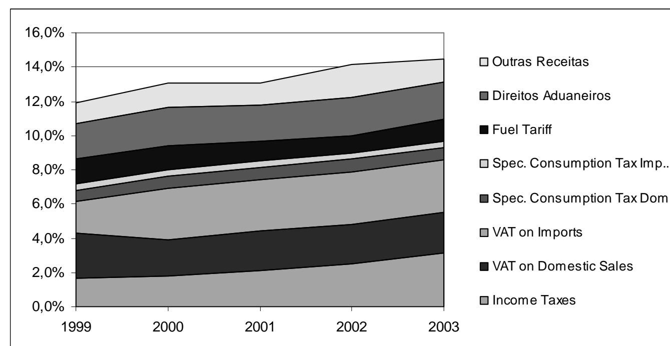
Finally, mining and petroleum operations, on and offshore, are exempt from Customs Duties, VAT and Specific Consumption Tax on imports of equipment, apparatus, materials, spare parts and other supplies for prospecting and exploration and, until 2010, investments greater than US$500,000 will benefit from a 25% reduction in the IRPC or IRPS (2nd category) rate for 5 years (8 years in the case of petroleum).

3.5.2 Post-Structural Adjustment Reform Impacts

The overall impact of the package of reforms described above has been positive in contrast to the earlier period. Total revenue increased from 11,9% of GDP in 1999 to 14,4% in 2003, managing to outstrip the high rates of GDP growth in the same period. Within this period, only in 2001 did revenues not increase faster than GDP due to extremely high real GDP growth (13%) following mostly tax-exempt reconstruction work after the 2000 floods.

As is reflected in Figure 8, one of the main components of the increase in revenues in the period was Income Taxes, the total of which increased from 1,7% to 3,1% of GDP between 1999 and 2003, with a 0,6% jump in 2003, due in equal measure to the introduction of the IRPS and IRPC. With respect to IRPS, its increase is partially explained by the inclusion of civil servants in 2003 which contributed around 10% of total IRPS and therefore 0,2% of GDP. This then suggests that the remaining 0,1% was due to better administration, a widening of the tax base, or possibly salaries rising faster than GDP.

Figure 8 - Revenue Breakdown for 1999-2003 (% of GDP)



In the case of company income taxes, the reasons for the jump in revenue with the introduction of IRPC are less clear. With lower rates than the Industrial Contribution it replaced and still considerable exemptions through the Fiscal Benefits Code as described above, it indicates either profits growth greater than GDP or if not, simply an improvement in administration and possible widening of the tax base with the introduction of the new tax.

In terms of economic sectors, the following table illustrates that the great majority of both IRPS and IRPC came from the services sector. This is distantly followed by the industrial and commerce sectors, with IRPC from commerce considerably higher than IRPS (although the data used here are subject to confirmation).

Comparison with the first column of the table also reveals stark differences between the tax structure and that of the economy according to GDP contribution, and is clearly more a reflection of the structure of the *formal* economy, as well as indicating vast differences in value-added and profit levels between economic sectors. Of particular note is the low weight of services in GDP compared to its income tax contribution likely to be due to the public sector in the case of IRPS, and conversely the high contribution of agriculture to GDP and extremely low contribution to tax revenues due to the small-scale nature of the majority of agricultural activity.

Source of Tax Revenues by Economic Sector

	GDP	IRPS	IRPC	Domestic VAT
Agriculture	24,3%	0.5%	0.5%	0.4%
Industry	19,0%	10.5%	13.6%	17.2%
Construction	13,4%	3.9%	4.6%	14.1%
Transp. & Comm.s	8,7%	3.0%	1.4%	4.1%
Commerce	18,3%	7.5%	14.8%	14.2%
Tourism	1,1%	1.4%	1.9%	3.6%
Services	15,2%	73.2%	63.1%	46.4%

Returning to Figure 8, revenues from VAT on imports also performed very strongly in the period 1999-2003, increasing from 1,8% of GDP to 3,1%, while VAT on domestic transactions actually decreased from 2,6% to 2,4%. In reality this contrast in behaviour reflects the dominance of domestic transactions in the Circulation Tax due to the cascade effect and that of imports in VAT due to the relative increase in rate at the border. As a result of this and an overlap of revenues as VAT was only introduced in April of 1999, receipts for the year were greater overall than in the immediately following years.

VAT revenues from domestic transactions display a similar structure to those from Income Taxes. The dominance of the services sector is reduced however, at 46,4%, possibly due to the exemption of banks from VAT. The main other differences is a substantially greater take from construction at 14,1% and a smaller increase for industry. While reflecting a variation in the ratio of value-added to chargeable income for different industries this may also reflect the different nature of the taxes and their collection.

The considerable dominance of VAT on imports over those from domestic transactions is important and may be expected to have implications for future years when import tariffs are reduced as an element of regional trade agreements. These result from the much higher rate of the new tax, which incidentally also reduced the

effects of import tariff reductions. However, it is interesting to note that although the top rate of Customs Duties dropped in both 2001 and 2003, their revenue marginally increased over the period from 1999 to 2003 from 2,0% to 2,2% of GDP, most probably assisted by the 30% nominal depreciation of the Metical against the Dollar in 2001.

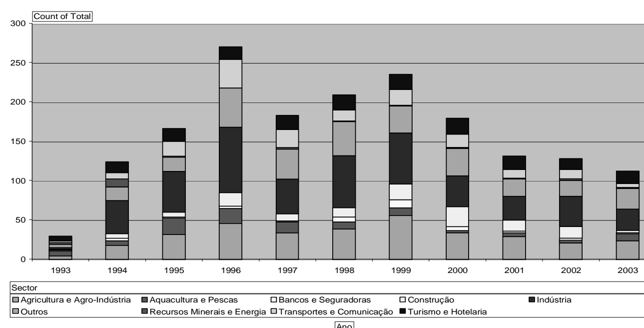
In terms of exemptions, data for the years 2001-2002 show that the value decreased dramatically from 777mdc to 171mdc, equivalent to over 50% and 10% of the revenue actually collected respectively. One of the reasons for the drop is a reduction in “Special Authorisations” from 434mdc in 2001 to 84mdc in 2002, although this still continued as the greatest category of exemption.

Still regarding Customs Duties, it is important to note that a large amount of these are paid by the Government itself. Their value has fluctuated markedly in recent years, from 25% of total Duties in 1999 (aprox. US$21m) to 34% in 2002 (US$27m) and 10% (US$9m) in 2003. Thus, a significant part of the increase in customs revenues during the period has been due to increased public expenditure rather than improved coverage or increasing demand for imports by an expanding private sector.

Finally, the graph above also shows the relative decline in importance of the Fuel Tariff from 1,5% of GDP to 1,0% in 2002 due to inflationary erosion. However, during 2003 this decline was recognised and rectified by the increase mentioned above, thus resulting in a rebound to 1,3% of GDP.

Turning to the Investment Law, as illustrated by Figure 9 the number of firms registered under the Investment Law and therefore eligible to gain from the Fiscal Benefits Code has varied quite dramatically through the years.

Figure 9 - Number of Firms Registered under Investment Law by Sector[21]



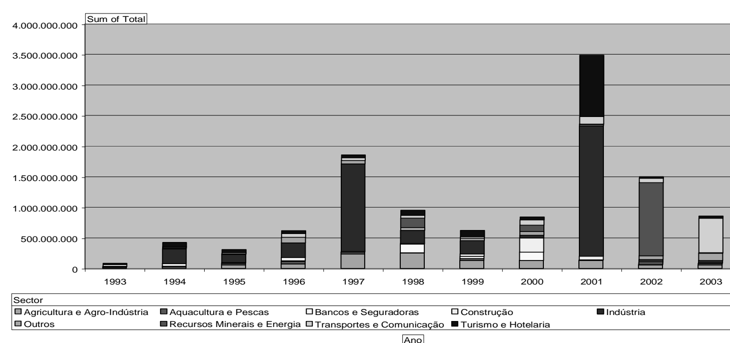
Since the Law’s approval it is clear that the numbers of projects applying for registration under the law increased dramatically, particularly in Agriculture, Industry and Others, with the total number of projects jumping from 23 in 1993 to 270 in 1996 although this is also very likely to be a consequence of the resumption of peace after 1992. From 1996, when ad-hoc exemptions began to be better controlled, to 2003, by

[21] Source: Investment Promotion Centre (Centro de Promoções de Investimento)

which point the new Fiscal Benefits Code was already in force, the numbers of applications had fallen to 112, despite a small recovery in 1998-1999.

However, Figure 10 demonstrates that there is little linkage between the number of investments and their value. The graph shows major investments in 1997, 2001 when Mozal was begun and 2002 when the Gas Pipeline project was initiated. In terms of the impact of the 2002 Fiscal Benefits Code, therefore, the effects appear to have been marginal although, given the nature of the data this can only be a superficial interpretation.

Figure 10 - Value of Investments Made under Investment Law by Sector (USD)



In the case of Industrial Free Zones, again the information available is limited. Despite the Fiscal Benefits offered, there are only 25 companies operating under the Industrial Free Zone regime (CPI) so that, excluding Mozal and the two forecasted heavy sands projects, the revenue effects of these exemptions are relatively small. Anecdotally, those which have set up are mostly capital intensive industries supporting the Mozal aluminium smelter, indicating that the job creating aspect of the innovation has been minimal.

Overall the tax reforms implemented in the period 1999-2003 therefore had a positive impact on revenues and went some way to resolving the problems experienced in the prior period from 1993-1999. However, as was also mentioned, these reforms have also brought some additional complexities, the exact consequences of which remain unclear.

3.6 2004 Onwards: Future Issues

With a second PRGF (2004-06) approved in July 2004 and increasing donor interest in tax policy, it is likely that the issues relating to tax policy and its administration will begin to gain more attention, and in particular with respect to focussing on simply deepening the reforms already implemented. However, in addition to these aspects, further issues relating to administration and tax reforms are currently under scrutiny.

Under the guidance of the IMF and other donors supporting tax reforms, the Government committed itself to amalgamating DNIA and DGA, responsible for domestic and trade taxes respectively, into the Central Revenue Authority (ATM) by

2005 (DfID March 2003). Through discussions involving both the Government and donor representatives, it was decided that the ATM should be established by an Act of Parliament as a semi-autonomous body operating within the public sector and falling under the Minister of Planning and Finance. In addition, it would be advised by a Board of Commissioners ("Conselho Superior") with an Executive Agency ("Conselho Directivo") led by a Chief Executive. The ATM would also enjoy substantial administrative autonomy, operating to an annual budget provided from the central Government budget with a scope embracing national taxation (direct and indirect) and customs, but not local taxation or social security contributions. Although within the same authority, tax and customs functions will continue to be divided at departmental level but will be supported by a set of common service departments in areas such as finance, administration, legal services, IT systems support and Internal Audit.

By granting it greater autonomy, it will be free to establish a separate salary scale in order to attract and maintain skilled and motivated employees and thus improve capacity in addition to reducing corruption, although this latter aim may depend more on the flexibility of the new authority to dismiss workers for misconduct. At the same time, the use of common services described above is intended to increase efficiency both through improved and uniform practices, pooling of information and economies of scale in terms of resources and rationalisation.

The formation of the ATM will also be accompanied by continuing work to improve the administration of all taxes in general, not least through the widening of use of the NUIT for registering individuals and enterprises, thus assisting in improving tax records and reducing tax avoidance.

In addition to institutional reforms, the Mozambican Government is continuing with implementation of the Southern African Development Community (SADC) Trade Protocol and studying other future trade options such as the Southern African Customs Union (SACU), a European Partnership Agreement (EPA) and the American Growth and Opportunity Act (AGOA).

As was stated above, implementation of the SADC Trade Protocol will signify a further drop in the top tariff rate on imports from all SADC countries excluding South Africa to 20% in 2006, then annual 5% reductions from 2009 until reaching 0% in 2012.[22] A slower programme of tariff reductions was agreed for South African products given their dominance in duty revenues (approximately 40%), with the maximum tariff decreasing to 15% in 2009, 10% in 2012 and finally 0% in 2015 (Decree No. 25/2001).[23] This signifies that in the long term, even assuming elastic demand for imports and the continuing existence of VAT and consumption taxes on imports, revenues from imports are likely to fall, thus requiring that more attention be paid to the widening of the tax base on domestic transactions.

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[22] SADC includes the following countries: Botswana, Lesotho, Malawi, Mauritius, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe.
[23] Note that sugar and textiles & clothing are due to receive special treatment under the regime while discussions are ongoing regarding automobiles and their parts.

With regard to SACU, the Ministry of Industry and Trade commissioned a study to be carried out by consultants on the possible impacts of entering SACU (TSG, March 2004).[24] This would entail an immediate reduction of imports tariffs to 0% on imports from all SACU countries, adoption of a common external tariff and increasing excise rates to be in line with the SACU common tariff rates, the proceeds of which would be included in a common revenue fund to be redistributed between the members.[25] The report concludes that whilst one impact would clearly be an acceleration of the reduction of tariff rates in comparison with the established SADC programme, other overall revenue impacts would be negligible due to increased excise revenues and the effects of Mozambique's probable benefits from the common revenue pool. However, given that the study did not fully take into account current or probable resulting trade-flows, it is apparent that further work requires to be carried out on this area.

Similarly, a study was carried out on the impacts of implementing a European Partnership Agreement (EPA) with the European Union. Although this study looked in depth at a range of issues besides revenue impacts, based on the assumption that economic and import structures will not change significantly up to 2030, it concludes that "the fiscal effect is relatively small (in the range of 0,14-0,31%) as a percentage of GDP, and in the range of 0,6% to 1,9% as a percentage of total government revenues, when compared to the baseline scenario of the full implementation of the SADC protocol" (Castel-Branco et al., 2004).

With respect to alternative future revenue sources, it is worth noting that royalties from so-called Mega-Projects and others will begin to play an increasing role in providing revenue to the Mozambican Government. One example already in operation is the Gas Pipeline running to South Africa which pays a royalty of 5% on total production. Similarly, Maputo Port will begin to pay royalties in 2005 as will the Heavy Sands Project at Chibuto from 2007. Despite these new revenue sources, projections do not suggest these will have a major impact, accounting for approximately 1.5% of total revenue in 2005 and 3.8%.[26]

Finally, an issue which may become important for income tax revenues is "band creep" on IRPS as formal-sector salaries, agreed annually in April between the Government, Private Sector and Trade Unions through discussions on the minimum wage, continue to increase at a rate above inflation. Without measures to update tax bands, the implications of this will be rapidly increasing IRPS revenue with a simultaneous reduction in the progressivity of the tax.

In overall terms, the target for revenue collection in 2010 was set at 17% of GDP by the Poverty Reduction Action Plan (PARPA). Although this medium-term goal is relatively low compared with current expenditure levels (around 30% of GDP) recent trends suggest that total revenue will continue to increase as a percentage of GDP, thus suggesting that the target is attainable. However, at the same time, it is clear that the efforts to improve administration and widen the tax base must continue in order

[24] The current members of SACU are South Africa, Botswana, Lesotho, Swaziland and Namibia.
[25] The SACU revenue sharing formula distributes customs revenues according to each country's share of intra-SACU imports, excises based on their share in total SACU GDP, with a small development component (15% of total excise revenues) distributed to the poorest countries
[26] Estimates from DNPO's Macro Framework 2004.

that taxes do not become onerous for a limited number of people and companies and economic growth is not hindered.

4. Final Comments on Mozambican Tax Reform

Apart from the initial post-independence reforms, almost all tax reforms in Mozambique have been carried out as an element of an external financial partner-led exercise but with apparently very little work carried out on analyses of impacts, either a-priori or ex-post. Recently, donor institutions have begun to join the IMF in concentrating on the tax system but have tended to focus on administration of the reforms and their implementation. Although clearly important, the lack of analysis of their economic impacts gives a weak foundation to recent reforms in terms of the Government's economic policy and revenue objectives, thus also providing little capacity for the introduction of future reforms which conform to these objectives.

Partly as a result of this, and also due to the manner in which tax policy decisions are made, there is a perception that the overriding aim of the Government is simply to raise tax revenue as a percentage of GDP, with little regard for its impacts. Whilst recent reforms ostensibly attempt to simultaneously widen the tax-base, simplify administrative processes, reduce tax evasion, reduce exemptions, and promote economic activity and investment, they are often perceived as introducing increased complexity and extracting ever-higher amounts from a relatively static tax-base, introducing distortions through ad-hoc policy decisions, and thus hindering a widening of the tax-base and reduced evasion. The exemption on Customs Duties for industry over a certain size serves as one such example of how tax policy can be uncoordinated and create distortions in terms of economic incentives. The accuracy of these perceptions also requires further analysis.

The overwhelming opinion which emerges is that although the design of the new taxes may be theoretically attractive, the administrative capacity required to make them work as they should has been overlooked or at least under-estimated, and little consideration has been given to their impact on private sector economic activity. In addition, there is concern that the reforms, rather than increasing the tax-base, are merely increasing the tax burden on existing taxpayers in the formal sector.

Other questions relating to the elasticity of the tax base relate to the incentives for firms in the informal sector to enter the formal sector. Both the World Bank study and anecdotal evidence suggest that more than tax levels or even administration, the onerous procedures and costs for registering even a small firm are more of a deterrent to investment. However, this does not detract from the importance of further analysis and understanding of tax policy.

Annex 1 – Details of the Institutional Organisation

The principal authority on Mozambican tax policy, policy implementation and tax administration is the Ministry of Planning and Finance (Ministério do Plano e Finanças, MPF), with administration and collection of domestic taxes carried out by the National Directorate for Taxes and Auditing (Direcção Nacional de Impostos e Auditoria, DNIA) through its 30 tax offices, and trade taxes by the General Directorate of Customs (Direcção Geral de Alfândegas, DGA) with its 64 Customs posts.[27]

In addition, the Unit for Domestic Tax Reform (Unidade de Reforma Tributária dos Impostos Internos, URTI) was set up as a temporary body in 2001[28] to oversee the restructuring of direct taxes and propose institutional restructuring, replacing the Unit for the Implementation of VAT (Unidade para a Implementação do Imposto sobre o Valor Acrescentado, UNIVA) which had been set up to oversee VAT and Consumption Tax implementation in 1998. Also, the Technical Unit for the Restructuring of Customs (Unidade Técnica da Reestruturação das Alfândegas, UTRA) was set up in 1995 and continued to implement Customs reforms until 2003.[29]

Also in the MPF, the National Directorate for Planning and the Budget (Direcção Nacional do Plano e Orçamento, DNPO) is responsible for the "coordination of the country's economic and social development planning and for the budget programming and management" (Ministerial Diploma nº 47/99), and thus is mandated to carry out tax revenue forecasts for the National Budget and analyse the impacts of tax policy changes. Also, the Research Bureau (Gabinete de Estudos, GEST) has a research role in all matters relating to Government economic policy. Finally, the Centre for Investment Promotion (Centro de Promoção de Investimentos, CPI) is responsible for promoting both national and foreign investment through the registration of projects and provision of assistance relating to investments and the fiscal benefits available under the Investment Law.

In addition to the MPF, the Directorates of Industry, Trade and International Relations of the Ministry of Industry and Trade (Ministério de Indústria e Comércio, MIC) and the Ministry of Agriculture and Rural Development (Ministério de Agrcultura e Desenvolvimento Rural, MADER) amongst others, also have a direct interest in tax policy.

Outside Government, the CTA (Confederation of Mozambican Business Associations) has taken the role of representing the interests of its members in an attempt to influence tax policy and administration.

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[27] DNIA is made up of its Head Office in Maputo with 29 combined Tax/VAT offices located around the country; 25 of these offices are local tax offices, two are special tax offices dealing with large companies and two are Justice Tribunal offices. DNIA and DGA are due to be amalgamated into a Central Revenue Authority (Autoridade Tributária de Moçambique, ATM), an issue discussed further on in this paper.

[28] (Despacho, 11 July 2001)

[29] This body, set up by donors and run mainly by foreign consultants should theoretically have been disbanded in 2003 (BR No.39, 24 September 2003) but continues to operate and provide technical assistance mainly on administrative and legal issues in Customs.

Finally, many of Mozambique's tax reforms have been carried out under the auspices of International Monetary Fund (IMF) programmes. As shall be seen, these began in 1987 to accompany the Economic Rehabilitation Programme (PRE) and have continued to date, with the latest approved in July 2004. Since 1996, the IMF has been joined in its work on tax reforms by other donor agencies such as the Danish Development Agency (DANIDA), the Swiss Secretariat for Economic Affairs (SECO), and more recently the UK Department for International Development (DfID).

New organs have been established in an attempt to widen involvement and coordination in the taking of tax policy decisions. One such organ is the Coordinating Council for Customs Policy which was set up by Presidential Decree in 2000 (Pres. Dec. 4/2000), consisting of the Ministers for Planning and Finance, the Interior, Industry and Trade, Transport and Communication, the Governor of the Bank of Mozambique and the General Director of Customs. Similarly, at a more technical level, the creation of URTI was accompanied by formation of a Coordinating Commission, consisting of a member of URTI, the National Director of Taxes and Auditing, the General Director of Customs, the Director of the Research Bureau and a representative of the Ministry of Industry and Trade. However, although these may go some way to improving the framework for tax policy decisions, their creation was only recent, suggesting that previously coordination was limited.

Annex 2 Data Summary

Summary of Data Collected for Tax Incidence Study July-August 2004

No.	Data	Detail Included	Period	Source
1	All taxes	month	2003	DNIA
2	IRPC	7 sectors, where collected & month	2003	DNIA
3	IRPS	7 sectors, where collected & month	2003	DNIA
4	IVA	7 sectors, where collected & month	2003	DNIA
5	Customs Duties	month	2003	DGA
6	IVA	month	2003	DGA
7	Consumption Tax Imports	month	2003	DGA
8	Consumption Tax Domestic	month	2003	DGA
9	Import Value	tariff category	2003	DGA
10	Conceded Fiscal Benefits	Project, Province, Sector	2001	DNIA
11	IVA Import Exemptions		2000-2003	DGA
12	Duites paid by Government	where collected	1999-2004	DGA
13	Projects under Investment Law	sector and province	1990-2004	CPI
14	Circulation Tax	11 sectors	1990-1999	DNIA
15	Industrial Contribution	11 sectors	1990-2000	DNIA
16	Labour Income Tax	9 sectors	1990-1999	DNIA
17	All taxes	where collected	1991-2003	DNIA
18	All taxes		1987-2002	DNIA
19	All taxes		1975-1992	DNIA
20	GDP		1960-2003	Sulemane
21	Companies	No. employees, province, 14 sectors, turnover	2003	CEMPRE
22	Customs Code	Products, duty and IVA rates	2003	DGA
23				
24				
25				

IVA details by sector etc. Requested from DRA Filomena of IVA but waiting for updates to be carried out on Customs data.

Customs data being updated due to errors found on the system. Been promised detailed info on imports ãnd exports by product group and product groups by country by the end of August.

Detailed **IRPC** data by economic sector and companyt been requested form DNIA but only available by contacting individual tax offices. Need to speak to Tapu of DNIA.

Annex 3 - Caveats Regarding the Data

There are several caveats worth pointing out regarding the data. Most of the tax data used in this analysis was received from either the National Directorate for Taxes and Auditing (DNIA) or the General Directorate of Customs (DGA). Both institutions are currently working hard to improve the quality of data with relatively new databases in operation for VAT, company income taxes and import taxes which, over time, will help to improve the coverage, consistency and accuracy of tax records both for analytical and administrative purposes. However, at present these remain as problem areas and thus are likely to have an impact on the analyses carried out in this document and thereafter.

With respect to domestic tax revenue data, official Government data as presented in the Conta Geral do Estado (State General Accounts, CGE) were published only as of 1998 and provide very little detail. Similarly, the Anuário Estatístico (Statistics Annual) only provides tax data at a very aggregate level. Thus, the main source of data used has been that provided by DNIA as their "final version" submitted to the National Directorate of Public Accounts of the Ministry of Finance (Direcção Nacional de Contabilidade Pública, DNCP) based on information from all tax offices around the country on amounts collected. However, there are discrepancies between this and that which appears in the CGE which originate from Treasury information regarding the amount of money actually received which can differ from that registered by tax offices.

Two time-series were provided by DNIA, covering 1975-1992, and 1987-2003. Marginal differences were discovered in the overlapping years which were arbitrarily overcome by selecting the most recent data set.

Data was also requested from the DNIA databases on company income taxes and VAT although, due to technical difficulties with regards VAT on imports (originating from DGA database problems) and implementation problems with the income tax database, this potentially detailed and very useful information was not received.

With reference to data on import tax revenues, it is worth noting that DNIA also provides this to DNCP for compilation of the CGE. However, this data does not always coincide with final DGA customs data, presumably due to communication problems and the constant updating and correcting which occurs in both institutions.

The DGA itself currently operates two systems for the registration of imports into Mozambique and Duties paid. One is the electronic TIMS system, in operation in most though not all border posts, and a manual system which is in operation in all posts. Differences exist between data from the two sources for various reasons, one of which is that the TIMS system is not set up to record the "simplified regime" which is applied to items with a value less than $500. Therefore, ceteris paribus, the manual system will always record higher imports and import duties. In addition, there are various practical issues affecting both recording systems: whilst the manual system is open to manual errors and intentional misreporting, the TIMS system suffers from a lack of conscientious use of the system as well as suffering from power-cuts and network problems which are then not updated for transactions occurring in the interim.

However, although the manual system provides a higher figure for imports, and thus may be considered to be relatively more accurate, the level of detail captured is minimal and the system ultimately provides data which are unmanageable in an electronic format. Therefore, the best solution for more detailed analyses would appear to be the use of revenue aggregates from the manual system, with import structure by category and country estimated from the "sample" provided by the TIMS system. In fact, for the analysis in this document, data used is all from DNIA unless stated otherwise, which itself is based on tax office records and thus (approximately) corresponds with data from the DGA manual system.

Despite the data limitations cited above, it is also recognised that by its very nature, data on taxes and particularly potential revenues are always open to some irregularities. Nonetheless, it is assumed that the data collected captures the most important elements of revenue behaviour and, given the caveats, is still of value for analytical purposes.[30]

[30] A table containing a list of all the data collected is included as an annex to this document.