Fiscal Policy and Tax Incidence

Post-Independence Tax Policy & Revenue Performance in Mozambique

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Abstract

Despite a long history of tax reforms and the recent introduction of a number of significant new taxes in Mozambique, a limited amount of analysis has looked at the impact of these reforms. This chapter outlines the principal reforms to have taken place and their revenue impact since independence in 1975 by way of providing a better understanding of revenue behaviour in Mozambique and a starting point for further, deeper analyses of taxation and tax policy. Although revenues have realised periodic gains as a percentage of GDP, the evidence suggests that recent tax reforms have not been enough to put tax revenues on a sustainable path of growth.

1. Introduction

The purpose of this chapter is to review tax policy reforms in Mozambique since national independence and analyse their revenue impacts. Despite a long history of tax reforms and the recent introduction of a number of significant new taxes in Mozambique, analysis in this area has been limited. This chapter attempts to address this with a view to increasing understanding of the tax system and providing a basis for discussion of future domestic tax policy options.

The importance of understanding tax policy and revenue issues in a resource-scarce country such as Mozambique is clear. At seventh from last in the Human Development Index (UNDP, 2004), Mozambique is one of the poorest countries in the world, requiring continued high levels of expenditures on public goods such as health, education and infrastructures to help reduce poverty levels in the medium to long term. With approximately half of its state budget currently financed externally through grants or preferential loans (MPD, 2005), any medium to long-term vision of reducing Mozambican aid dependence requires that domestic resources be raised through taxation, a point which is explicitly acknowledged in the Government's Poverty Reduction Strategy Plan (the Plano de Acção para a Redução da Pobreza Absoluta – PARPA), the latest version of which foresees revenues at 15.1 percent of GDP in 2009 (GoM, 2005).

The problem of insufficient domestic resources is potentially further exacerbated by the current climate of proliferating regional and multilateral trade liberalisation agreements which remove, or at best reduce, a major source of revenues for most developing countries. Mozambican participation in the SADC Trade Protocol has already brought a reduction in customs revenues while ongoing discussions with the

European Union regarding an Economic Partnership Agreement (EPA) and the possibility of joining the Southern African Customs Union (SACU) have the potential to further reduce trade revenues.

Nonetheless, the government's Five-Year Programme for 2005 to 2009 highlights the importance of private sector development and the need to create a favourable environment for investment and national enterprise (GoM, 2005a). Raising domestic revenues whilst remaining faithful to this objective will therefore require a broader understanding and capacity for analysis of the impact of tax reforms and the tax system in general.

The remainder of the chapter is organised as follows: Section 2 provides an overview of revenue performance from 1975 to 2005. Section 3 discusses the main tax reforms and their impacts in three periods: the immediate post-colonial independence period from 1975 to 1986; the structural adjustment period from 1987 to 1998; and the period covering the most recent wave of tax reforms from 1999 to 2005. Section 4 concludes the paper by drawing some general conclusions from the whole tax reform experience and from the analyses carried out.[1]

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[1] The main source of data used for this work is 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 due to Treasury information regarding the amounts 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 exist in overlapping years which were overcome by using the most recent data. Tax data by their very nature 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. The tax authorities are currently working 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 problematic in terms of usage data for analysis. Official Government data as presented in the Conta Geral do Estado

2. Overview of Post-Independence Tax Reforms & Impacts

2.1. Background

Since national independence, Mozambique has experienced a number of major economic and social upheavals. These resulted from independence itself, the subsequent adoption of a socialist agenda and centrally-planned economy soon after, a debilitating seventeen-year internecine war and economic crisis in the early 1980s. This was followed by membership of the Bretton Woods institutions and accompanying increased tolerance and eventual encouragement of private sector activity, with the government abandoning the earlier socialist rhetoric to embrace the market economy and large-scale privatisation in the late 1980s and early 1990s. The peace accords in 1992 also led to a massive in-flow of foreign aid money which continues to flow today. In addition to these "man-made" events, instability was also brought by periodic flooding and droughts, most recently illustrated by the massive flooding in 2000 and 2001. All of the above inevitably impacted on the economy, placing high and variable demands on public finances, requiring accompanying reforms to the fiscal system at each stage. As government preferences and priorities altered, tax policy was adapted to the times with three major policy reforms occurring in the period between 1975 and 2005.

(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.

The first major post-independence tax reforms took place in 1978 with the objective of altering the inherited colonial tax-system to better reflect the aims of the newly independent socialist state and to finance ambitious public expenditures. After the socialist experiment met with severe difficulties, culminating in economic crisis in the early eighties, moves towards a market economy were accompanied by another major set of tax policy reforms in 1987, once again reflecting a change in the demands made of the fiscal system and the beginning of an extended period of structural adjustment. Finally, after the resumption of peace and several years of high economic growth rates, the most recent wave of tax reforms were introduced in the period from 1999 to 2003, ostensibly to consolidate previous reforms and establish a public finance system with the potential to develop into a sustainable and efficient system (IMF, 2004).

2.2. 1975-2005 Revenue Overview

Given the turbulence of recent Mozambican history, it is of little surprise that government tax revenues experienced a high level of volatility over the period from 1975 to 2005, as illustrated in Figure 1. Starting from a low 7.4 percent of GDP at independence in 1975, total revenues reached 14.1 percent of GDP in 1983, their highest level since independence. Other peaks were reached at 13.6 percent of GDP in 1993, and 12.9 percent in 2000. These were interspersed with drops to just 8.0 percent of GDP in 1985, 10.5 percent in 1996 and 11.7 percent in 2002. Such revenue fluctuations reflect a variety of factors, including sweeping tax reforms in 1978, 1987 and 1999, but also variations in compliance control, administration and alterations in tax rates and exemptions between major reforms. In recent years revenues have

tended to stagnate, remaining between 11.7 and 12.9 percent of GDP from 1999 to 2005, attaining 12.6 percent of GDP in 2005.

FIGURE 1 ABOUT HERE

As Figure 1 illustrates, revenues from expenditure taxes dominate overall revenues and drive the volatility of overall revenues. Of particular note, and further discussed below, is the dramatic fall in expenditure tax revenues (and to a lesser extent other revenues) after 1983 when a combination of the intensifying internal conflict, expansive Government programmes and inappropriate macroeconomic polices led to economic crisis and a resultant steep decline in purchasing power. Figure 2 shows that GDP growth also fluctuated considerably during the period from 1975 to 2005, real GDP remaining below its 1975 level for every year but one (1981) until 1996. Although GDP growth was markedly less volatile than growth in total revenue, Figure 2 also illustrates that continuous economic growth only really began after 1992 and the resumption of peace.

FIGURE 2 ABOUT HERE

Although Figure 2 suggests that revenues are pro-cyclical in relation to GDP, it also shows that despite economic growth from 1992, sustained real revenue growth only began after 1997. Until 2000, revenue growth was considerably faster than GDP growth, implying beneficial revenue effects from a widening tax-base, the impact of new tax policies and/or improved tax administration. However, since 2000, revenue growth as been weaker, raising questions regarding the sustainability of the previous growth.

Underlying total revenue growth, expenditure tax revenues have increased almost continuously since 1986, reaching more than 5 times their initial 1975 level in real terms in 2003 and well above total revenue or GDP growth. In contrast, revenues from income taxes were consistently lower than in 1975 until the late 1990s, when they began to increase and experienced a positive break in 2003 with the introduction of new income taxes. Despite this late growth, income tax revenues as a share of overall revenues have continuously decreased in the period from 1975 to 2003 as a reflection of the growing dominance of expenditure taxes. Figure 3 illustrates the behaviour of both personal and company income tax revenues over the period from 1975 to 2005. This shows the declining contribution of company income tax revenues as a percentage of GDP since 1988 despite the general stagnation and subsequent growth of total revenue seen above. Personal income tax revenues provided a higher but declining proportion of GDP up to 1982, when the introduction of progressive company income tax rates in 1982 brought a sudden increase in those revenues. Personal income taxes then grew from 1987 and overtook business income tax revenues after 1995. The reasons behind this contradictory behaviour of personal and business income taxes from 1988 onwards merit further investigation.

FIGURE 3 ABOUT HERE

Figure 4 presents data on expenditure tax revenues, comparing those from taxes on domestic expenditures with those on imports.[2] Notably, revenues from taxes on imports are generally increasing over the period and overtake those on domestic

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[2] Note that taxes on imports include customs duties, the import consumption tax and VAT on imports.

expenditures in 1999. This was despite measures to liberalise trade, as discussed below, and was due to the introduction of a value-added tax (VAT) in 1999.

FIGURE 4 ABOUT HERE

Finally, Figure 5 compares the contributions of revenues from taxes on imports with overall domestic revenues. Although import tax revenues fell less than domestic tax revenues in the crisis of the early eighties, since 1987 these have increased in importance, in particular with the introduction of VAT as highlighted above. As such, taxes on imports represented 4.7 percent of GDP in 2005, equivalent to 37.1 percent of total revenues, compared with only 1.5 percent of GDP in 1987 and 1.4 percent in 1975.

FIGURE 5 ABOUT HERE

These results and those in Figure 4 are in apparent contradiction to the generalised result that countries switch from dependence on revenues from cross-border trade to those from domestic trade taxes as the economy grows and administration and control improve, thus highlighting the potential importance for revenues of further trade liberalisation.

3. Tax Reforms & Their Impacts by Period

3.1. 1975 to 1986: Post-Independence Socialism

3.1.1. 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. The

nationalisation of many private properties and services and ambitious programmes of universal free education and health services which epitomise this period (Chabal, 2001: p197), were accompanied by an escalation of the internal armed conflict, thus creating a need for large quantities of new resources. According to tax legislation, a principal objective of the 1978 tax reforms was to alter the perception of taxes from a

> "colonial instrument of domination" to "… 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" (GoM, 1978).

Legislation stated that the new tax system was to reduce complexity and counteract the disappearance of certain revenues due to the "new economic reality" (GoM, 1978a).

Reforms included the introduction of a "National Reconstruction Tax" (Imposto de Reconstrução Nacional), a single progressive income tax to simplify the array of colonial-era taxes on income (GoM, 1978), the "Circulation Tax" (Imposto de Circulação), a 3 percent uniform rate turnover tax on consumption, and reforms to the Consumption Tax (GoM, 1978b), while rents from nationalised housing also providing a new additional source of non-tax revenue. The introduction of 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 percent of GDP in 1978), into a tax on capital incomes, private property and non-salary incomes (with exemptions for the State and FRELIMO).

Following this initial reform, some further smaller reforms were carried out in 1982 with adjustments to 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. This also saw the introduction of progressivity into the Industrial Contribution which had been a fixed rate proportional tax since its introduction in 1968 (Source: GoM 1982).

3.1.2. Post-Independence Revenue Impacts

As illustrated in Figure 6, the initial impact of the reforms was an immediate boost to revenues which leapt from 7.6 percent of GDP in 1977 to 11.1 percent in 1978. Although 1979 saw faltering revenues, in particular with respect to Customs Duties which fell by 1.1 percent of GDP, the increase was resumed the following year with overall revenues eventually reaching 14.1 percent of GDP in 1983.

FIGURE 6 ABOUT HERE

The new National Reconstruction Tax had a limited impact on overall income tax as revenues from taxes on incomes, particularly business incomes, continued their pre-1978 decline. The introduction of the Circulation Tax widened the expenditure tax base from its pre-1978 reliance on consumption tax revenues from alcohol and tobacco and import duties, thus increasing the dominance of revenues from expenditure taxes although this may also reflect the high rates of inflation experienced after 1981 and an inelastic demand for certain consumption goods. Other Tax and Non-tax Revenues also increased, from 1.5 percent of GDP in 1977 to a peak of 5.5 percent of GDP in 1981, mostly due to the inclusion of public housing rents which in 1978 constituted a new source revenue worth 0.6 percent of GDP.

Despite the general increase in revenues after 1978, this was short-lived. Further intensification of the armed conflict after 1980 destroyed key infrastructures and

severely restricted mobility, while continued expensive social programmes, low export levels and inefficient socialist planning finally led to severe economic decline in the early eighties and collapse in 1986. This was preceded by a severe decline in tax revenues in 1984 and 1985, shown in Figure 6, particularly for the Consumption Tax and Customs Duties which fell from 3.1 percent to 1.3 percent of GDP and 1.5 percent to 0.3 percent from 1983 to 1985 respectively, reflecting a sharp drop in consumption due to shortages.

3.2. 1987 to 1998: Structural Adjustment

3.2.1. Structural Adjustment Tax Reforms

Mozambique's first Structural Adjustment Programmes (SAP) was implemented from 1987 to 1989 in support of the Government's Economic Rehabilitation Programme (Programa de Reabilitação Económica, PRE), a programme of fiscal adjustment, price liberalisation, 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 when GDP fell by almost a quarter (IMF, 2004). For the second time in 10 years, the new economic and political environment thus brought a major revision of the tax code which was redesigned in collaboration with the IMF and World Bank, although these "exerted massive influence on the policymaking process" (Tarp et. Al. 2002), re-establishing the foundations of the tax system as a whole. This was followed by an Enhanced Structural Adjustment Facility (ESAF) running from 1989 to 1995 and a second ESAF from 1996 to 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 (IMF, 2004).

While the previous 1978 tax code had

> "consecrated the principles of social justice…" and permitted "the concentration of increasing amounts of resources in the State Budget…",

by 1987 "huge legal and illegal profits [were] accumulating in the economy", due to a "strong focus on direct taxation of incomes" (GoM, 1987).

Despite the evidence in Figure 5 that direct taxes on incomes accounted for only 20 percent of total revenues in 1986 whilst indirect taxes accounted for 42 percent (MPD, 2005), the 1987 tax law provided the legal framework 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" (GoM, 1987).

Specific reforms included returning the Industrial Contribution (Contribuição Industrial) to a flat rate of 50 percent on profits and its extension to state companies. A new proportional personal income tax was introduced in the guise of the Labour Income Tax (Imposto sobre Rendimentos de Trabalho) while the National Reconstruction Tax was turned into a form of poll tax. At the same time, Decree No. 1/87 increased the Circulation Tax rate from 3 percent to 5 percent for wholesalers and 10 percent for retailers both on domestic transactions and imports (GoM, 1987b), thus increasing the cascade effect characteristic of this kind of tax although exemptions were granted for small traders.

Following the PRE, reforms under the ESAF 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 percent.

An element of strategic tax policy was also introduced in 1993 with a number of different sectoral rates for the Industrial Contribution. Further, the Investment Law was approved with specific sectoral incentives, aiming to promote investment in infrastructures, human capital, technology and improving the balance of payments through both exports and substituting of imports[3] (GoM, 1993a and GoM 1995). This established a legal framework for foreign and national investments, guaranteeing security and protection of property and rights, and remittance of funds abroad whilst providing fiscal incentives in the form of tax and Customs benefits.[4]

Customs reforms also began in 1993 with the rationalisation of taxes and tariffs on imports, reducing the number of different tariff rates from twelve to five, whilst ad-hoc tariff exemptions were eliminated and customs control strengthened (IMF, 2004). However, as customs revenues continued to fall, the Unit for Restructuring Customs

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

[4] This built on earlier legislation from 1984 and 1987 relating to Foreign Direct Investment. To benefit from these, domestic investments had to have at least US$5000 of capital whilst Foreign Direct Investments (FDI) required to a minimum value of US$50,000 (fob). 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.

(UTRA) was formed in 1996 and a private company, Crown Agents, contracted to take over its management in order to improve administrative efficiency and capacity.[5]

3.2.2. Structural Adjustment Revenue Impacts

As the economy emerged from the crisis period of the early eighties, tax revenues began to increase even prior to implementation of the 1987 tax reforms (see Figure 6). This trend continued following reforms, with total revenues climbing from 8.2 percent to 13.6 percent of GDP between 1987 and 1993. However, thereafter revenues fell once again, reaching a low of 10.5 percent of GDP in 1996 and recovering only slightly in 1997 and 1998 to 11.5 percent.

FIGURE 7 ABOUT HERE

The increase in revenues up to 1993 was again mostly due to taxes on expenditure, whose revenues rose from 3.8 percent to 6.7 percent of GDP whilst taxes on income contributed around 2.0 percent over the period from 1987 to 1997. As Figure 8 illustrates, the increase in revenue from expenditure taxes was principally down to the Circulation Tax which more than doubled as a proportion of GDP from 1987 to 1993, from 1.7 percent to 4.0 percent. This large jump presumably reflects both the increased rates and the resultant cascade effect as the tax was applied all the way down the value chain and the low initial base following the crisis.

FIGURE 8 ABOUT HERE

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

Figure 8 also shows a surge in Customs Duties (including customs services fee) from 1.2 percent of GDP to 3.5 percent between 1987 and 1993, and revenues from the Consumption Tax on Imports from 0.1 percent to 0.9 percent of GDP. This is surprising given the increase in tariff exemptions and Customs administration problems experienced at this time (IMF, 2001) but may instead reflect rising levels of consumption as a result of increased economic stability brought about by the reduction in inflation from 160 percent in 1987 to below 35 percent in 1991 (IMF, 2004). Mozambique's high level of dependency on imports and the resulting strong link between consumption and import levels adds credence to this hypothesis. However, it is also potentially a reflection of a depreciation of the real exchange rate which may have increased the import tax base relative to GDP. In addition, GDP growth in the period from 1987 to 1992 was very low, with GDP actually decreasing in real terms, as illustrated in Figure 2. Thus, the increase in revenues was also in conjunction with poor GDP growth, something which may have had additional long-term constraining effects.

Despite the resumption of peace, relative stability and the beginning of continued economic growth after 1992, total tax revenues fell as a percentage of GDP from 1993 to 1997 (see Figure 7), again mostly attributable to a fall in Circulation Tax receipts, from 4.0 percent of GDP to 3.0 percent from 1993 to 1996. Customs Duties also fell from 3.5 percent to 2.1 percent 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 may have been 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 percent of GDP.

As was mentioned, overall revenue began to increase continuously only after 1996. However, whilst the customs administration reforms may have influenced the 0.3 percent 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 percent of GDP to 1.6 percent.

3.3. 1999 to 2005: 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). The PRGF also had a specific emphasis on strengthening government revenue (IMF, 2004) and reversing the recent poor revenue performance, reflected in the array of new tax reforms implemented in this period. The signing of a second PRGF (2004-06) with the IMF in July 2004 was also accompanied by statements referring to the need to improve revenue performance.

3.3.1. Post-Structural Adjustment Tax Reforms

Tax reforms in this period 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 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 implementation of trade reforms and continued assistance to improve customs capacity and efficiency.

Law 3/98 simultaneously approved VAT, the Specific Consumption Tax and the Special Fuel Tax with the goal of creating a "more efficient and neutral system" (GoM, 1998) which would eliminate the cascade effect of the Circulation Tax and the Consumption Tax. Implementation of the new indirect taxes began on 1 April 1999 with VAT set at 17 percent, 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 destination VAT, with amounts payable by firms calculated as VAT received on enterprise sales minus that paid on inputs, the VAT Code also establishes "special regimes" within the overall framework as well as exemptions for certain products and activities considered of major importance (GoM 1998a).

The special regimes include the "*Exemption Regime*" for small enterprises with an annual turnover of less than Mts100m (approximately US$4,000) and the "*Simplified Regime*", applicable to those non-import/exporting enterprises with annual turnover between Mts100m and Mts250m (i.e. approximately US$4.000 and $US10.500) for whom VAT is payable at a rate of 5 percent on final sales but not deductible for inputs

from the amount paid to the Government, thus equating this regime to a 5 percent turnover tax on these firms.

In addition 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 agricultural inputs, goods relating to health and education services, financial services and exports. VAT exemption is also granted in the case of exemption from Customs Duties and goods destined for international organisations, Special Economic Zones and Export Free Zones.[6] Finally, some basic goods, such as corn flour, rice and bread are eligible for *reimbursement* by Government of VAT paid on inputs (GoM, 1998a).

VAT implementation 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. Problems relate 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, administrative problems are equivalent to an additional tax on certain activities, in particular exports and continue to be the bugbear of the private sector.

Following implementation of VAT, 2001 brought 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

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[6] 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" (GoM, 1998a) although as of 2004, the position of Minister of Planning and Finance no longer exists with responsibilities being divided between the Ministry of Planning and Development and the Ministry of Finance. In addition, "The importation of goods benefiting from import duty exemption" are also exempt under the terms of the following: Article 15 of Law 7/94, 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 (GoM, 1998a).

period of adjustment (Khandelwal, 2004). The maximum import tariff was reduced from 35 percent to 30 percent, to 25 percent in 2003 and to 20 percent in 2006.

In a more limited alteration in 2003, a Ministerial Diploma was published providing a specific customs regime for the manufacturing industry (GoM, 2003). This regime, most likely a response to the VAT reimbursement delays experienced by large manufacturing firms, gave exemptions on Customs 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 percent.

Although not part of a wider strategy to promote large-scale industrial firms, this measure deprives the Government of further revenue while effectively transferring funds to large enterprises, 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.

An important administrative step was taken in 2003 with the introduction of the Individual Taxpayer Identification Number (Número Único de Identificação Tributária, NUIT), attributed to both individuals and companies and used in the payment of all taxes, both direct and indirect (GoM, 2003a). The potential implications of change are great in terms of improving tax authority control and simplifying administration in the long-run. However, its benefit will rely on continued administrative support before its introduction can be made widespread and the full benefits achieved.

One of the first applications of the NUIT was in the implementation in 2003 of the new Personal and Corporate Income Taxes (GoM, 2002). Although this was ostensibly to replace “a complex system of five taxes on income whose base had been eroded by generous exemptions and deductions” (IMF, 2004), its replacement was also complex in nature.

The Personal Income Tax (Imposto sobre o Rendimento de Pessoas Singulares, IRPS) is a progressive tax on all household incomes earned by residents in Mozambique, and is retained at source where possible, at a rate of 20 percent for all incomes except those from capital (at 10 percent), whilst annual income of less than Mts24m (US$1.000) is not taxed and that from agricultural activity at a maximum of 10 percent. However, as the IRPS is a tax on all incomes accruing to a household, the overall tax due at the end of each year is calculated based on all incomes, using the rates in the following table, and paid net of that retained at source. Various deductions apply to the calculated tax, depending on the marital status of the individual and the number of dependents.

TABLE 1 ABOUT HERE

A simplified accounting regime (Regime Simplificado) was also established for firms with an annual turnover of less than Mts1.500m (approximately US$62.500). As these firms are not required to keep detailed financial accounts, indicators based on “technical-scientific indicators” are used to determine taxable income where these are approved by the Ministry of Finance, or if not, this is determined as 20 percent of sales income and 30 percent of all other incomes.

Whilst stemming from admirable intentions, the new income tax raises many issues regarding administrative capacity, particularly in a country where this is already

stretched. Detailed information on household incomes and numbers dependents appears unsuited to the Mozambican reality of large extended family links.[7]

Accompanying the introduction of the IRPS was the companies income tax (IRPC) which replaced 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) and is applied on profits from commercial, cooperative and public enterprises (and on incomes not liable to IRPS) at a rate of 32 percent (10 percent on agricultural activities until 2010). Once again, incomes taxed at source are taxed at 20 percent (10 percent 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, something which may remain overly burdensome for many small and medium-sized enterprises.

Simultaneously with the new income taxes, the Fuel Tariff (Taxa de Combustíveis) was also introduced to replace the Special Fuel Tax (Imposto Especial sobre Combustíveis) in operation since 1990 (GoM, 2002), payable per litre or Kg and updated (at a maximum of 5 percent) on a quarterly basis according to inflation. The introduction of the Fuel Tariff and its updating mechanism resulted in an initial 63 percent rate increase after having remained at a constant level since 1997, so that the tax on normal automobile fuel currently represents approximately 30 percent of the

[7] Indicative of these complications, the public administration itself was unable to correctly implement the IRPS on civil servants in its first year of implementation, instead estimating the overall amount due at the end of the year.

total consumer price (equivalent to an ad-valorem rate of over 40 percent) and a slightly lower percentage than this for diesel and lead-free petrol.

As the above tax reforms were taking place, the Government also approved the Fiscal Benefits Code (GoM, 2002a). Despite the Investment Law and first Fiscal Benefits Code of 1993, a proliferation of special tax regimes had arisen in the intervening period, resulting in a disparate collection of 30 laws, decrees and decisions on benefits, sometimes overlapping. The Fiscal Benefits Code, following the IMF recommendations, unified all fiscal benefits under one code to be applicable to investments previously 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 (GoM, 2002a).

3.4.2. Impacts of Post-Structural Adjustment Reforms

Although less volatile than in the previous periods, the impact of the package of tax reforms on revenues over the period 1999 to 2005 was once again mixed, with revenues increasing up to 2000 before stalling, as illustrated in Figure 9. Over the period as a whole, total revenue increased from 12.0 percent of GDP in 1999 to only 12.6 percent in 2005, having reached 12.9 percent in 2000 and 12.8 percent in 2003. Despite the apparently disappointing revenue performance, the period was also characterised by high GDP growth rates, with real growth of 13.1 percent in 2001 and rates of around eight percent from then on (MPD, 2005). This implies a relatively inelastic revenue response to GDP growth overall.

FIGURE 9 ABOUT HERE

As Figure 9 illustrates, the ambiguous behaviour of total revenues is an aggregation of mixed revenue behaviour in all tax categories. After increasing markedly for most of the period, the importance of Income Tax revenues as a proportion of GDP stagnates around 2.8 percent from 2003 to 2005, after a surge of 0.6 percent of GDP with the introduction of the IRPS and IRPC in 2003. The increase in IRPS revenues is partially explained by the inclusion of civil servants in 2003 which contributed around 10 percent of total IRPS.

The contribution of IRPC to this growth is more difficult to explain given the lower rates than the Industrial Contribution it replaced and considerable exemptions through the Fiscal Benefits Code as described above. Thus it may indicate an improvement in administration and possible widening of the tax base with the introduction of the new tax or if not faster growth of profits than GDP.

VAT on both domestic sales and imports also display mixed behaviour, with VAT on imports increasing markedly to 2.9 percent in 2000 from 1.8 percent in 1999 before declining to 2.5 percent of GDP in 2004 and 2005, whilst VAT on domestic sales declined from 2.6 percent of GDP in 1999 to 1.9 percent in 2002 and 1.8 percent in 2004 and 2005. The notable dominance of revenues from VAT on imports over domestic transactions is important and has implications for the future, when import tariffs are reduced as an element of regional trade agreements.

Thus, although VAT receipts reduced the negative effect of import tariff reductions on overall revenues, Customs Duty revenues declined from 2.2 percent of GDP in 2000 to 1.8 percent in 2005, partly due to the reduction in the top rate of Customs Duties in both 2001 and 2003 and despite the large amount of these which are paid by the

Government itself for imported goods for public expenditure projects. Their value has fluctuated markedly in recent years, from 25 percent of total Duties in 1999 (aprox. US$21m) to 34 percent in 2002 (US$27m) and 10 percent (US$9m) in 2003 (MPF, 2004). Also stemming the decline in revenues from Customs Duties was the reduction in exemptions. Data for the years 2001-2002 indicate that the value decreased dramatically from 50 percent of collected revenue (777mdc) to 10 percent (171mdc). 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.

The impact of the *Investment Law and Fiscal Benefits Code*, introduced in 1993 and 2002 respectively, are more complicated to calculate given the need for hypothetical calculations of foregone revenues and large amounts of firm-specific information. Similarly, with regards Industrial Free Zones, the information available is limited. Only 25 companies operate under the Industrial Free Zone regime (CPI, 2004) so that, excluding Mozal and the two 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 1999-2005 have had a mixed impact on revenues although the level was maintained above the levels 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 and which may be felt in the medium to long term.

4. Concluding Remarks

Despite the introduction of several major tax reforms in Mozambique since national independence and the recent wave of new taxes, analysis of tax policy and revenue impacts has been limited, something which this paper attempts to address.

As this chapter has illustrated, each set of major reforms, most of which accompanied major changes in the economic system, was in general instigated following a period of revenue stagnation and resulted in initial positive revenue impacts. However, in each case, as the above analysis showed, initial gains were often followed by declines due to a constantly changing economic environment. Although partly due to government policy, outside factors such as the civil war and the vulnerability of Mozambique to natural disasters may also have played a role in affecting economic activity and thus tax revenues.

Given the various major economic and social changes, it is perhaps of little surprise that Mozambican tax revenues appear not to fit in with the patterns predicted by tax theories based on the experience of other countries. In particular, the introduction of VAT has led to an *increase* in reliance on trade tax revenues as the economy has grown, rather than a fall. In addition, almost all revenue growth, when this has occurred, has been due to growth in revenues from regressive indirect taxes rather than from more progressive direct taxes.

Efforts to improve administration are going ahead with the creation of the Central Revenue Authority (ATM), however real benefits from these new institutional arrangements will clearly take some time to be felt and continuing efforts to improve tax administration and widen the tax base must continue. In the context of continuing

trade liberalisation and the reduction of aid-dependency, it is of utmost importance that tax policies be coordinated to ensure that the competing demands on public finances are met whilst also remaining faithful to the objective of promoting economic growth.

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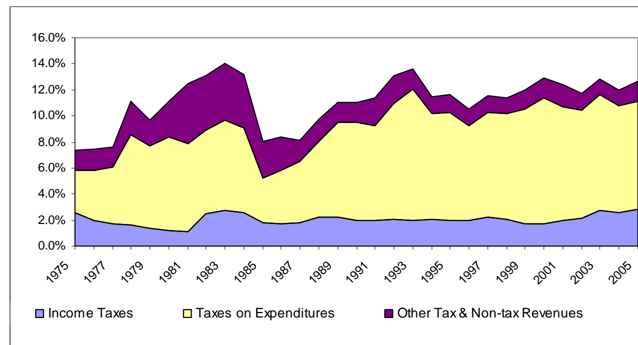
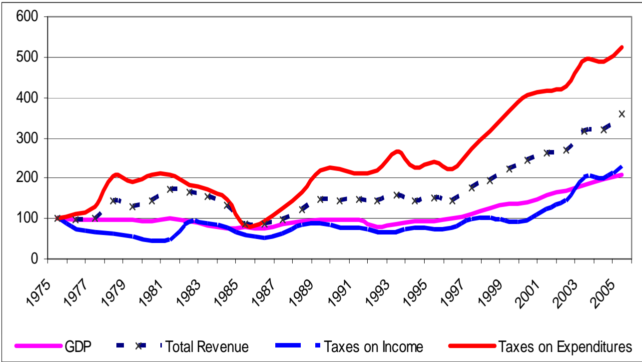
Figure 1: Nominal Tax Revenues 1975-2005 (% of GDP)



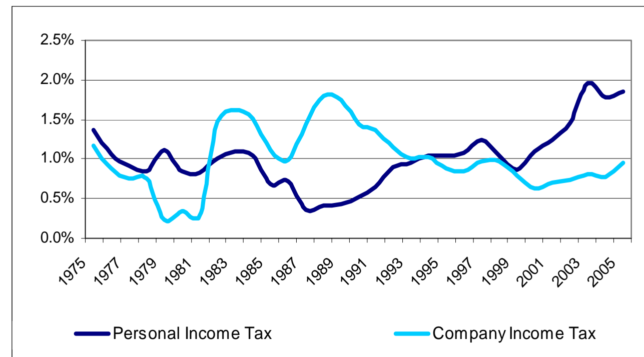
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 2: Cumulative Growth of Revenue and GDP 1975-2004 (1975=100)



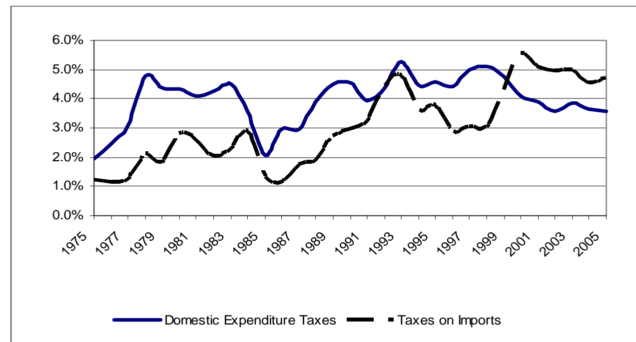
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 3: Taxes on Personal & Company Income 1975-2005 (% of GDP)



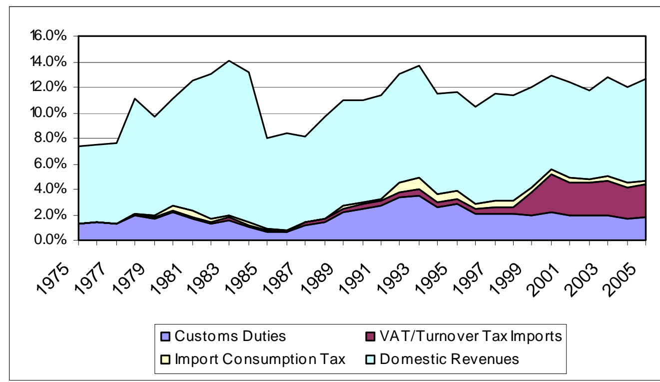
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

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



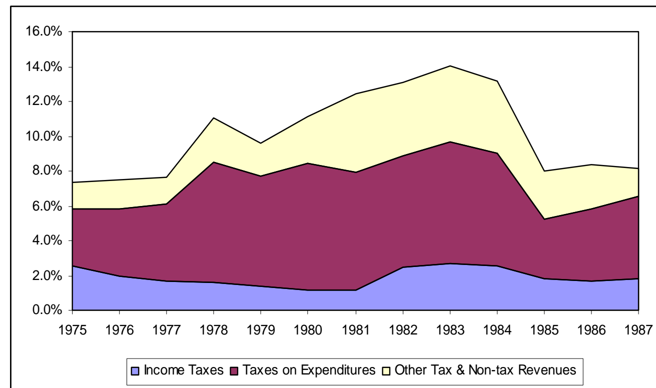
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 5: Domestic and Import Taxes (% of GDP)



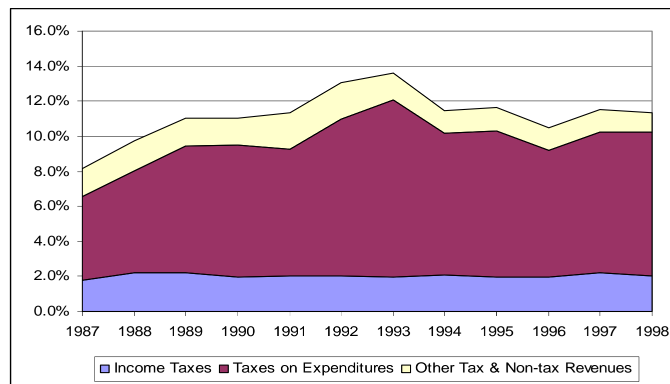
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 6: Revenue Categories 1975-1987 (% of GDP)



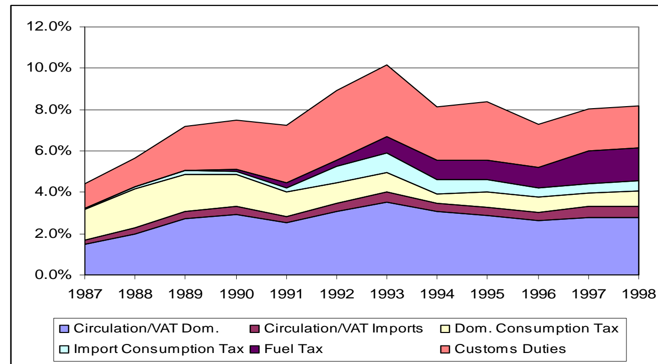
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 7: Revenue Categories as a Percentage of GDP 1987-1998



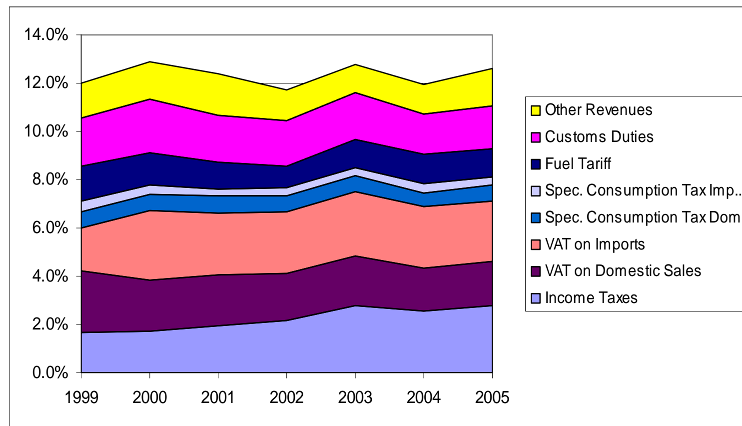
Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 8: Taxes on Expenditure as a Percentage of GDP 1987-1998



Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Figure 9: Revenue Breakdown 1999-2005 (% of GDP)



Source: Compiled by author with data from MPD (2005), MPF (2004) & Sulemane (2001).

Table 1: 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)

Source: GoM (2002)