



## **Fiscal Policy and Tax Incidence**

Tax administration in Mozambique: Institutional design, reform  
and some challenges

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## Chapter 7

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#### **Abstract**

This chapter considers the fiscal status quo of Mozambique, a country struggling to increase tax revenues to a level on a par with its peers in Sub-Saharan Africa. Context is provided through a description, on one hand, of the institutional design of the public agencies charged with the administration of external taxes and on the other, of the taxes levied on domestic economic activity. The achievements attained thus far as a result of their respective reform processes are subsequently analysed, as well as some of the significant challenges yet to be overcome. With this in mind, attention is turned to the imminent implementation of a central revenue authority, charged with the administration of all-things-fiscal, and thus encompassing both institutions.

## 1. Introduction

Over the last few decades, a number of distinct arguments have flowered in the public finance literature to make a cogent case for the need of vigorous state intervention and taxation in less developed economies. Some of those arguments, to a certain degree inspired by concomitant developments in moral philosophy, include prevalent market failures, vulnerability due to extreme deprivation and inequality (for a classic discussion, see for example Burgess and Stern (1993)). Still, even if public finance theory seems increasingly to suggest some role for taxation to play in promoting development, on the practical side developing countries face extremely complex challenges.

Notwithstanding the increasing attention that taxation merits in their economic policy agenda, an overwhelming majority of developing countries generally tends to be affected by weak tax administration capabilities. In this chapter, we consider the institutional design of tax administration in Mozambique, a country often cited as a typical case of successful economic reform in Africa. The chapter reflects real preoccupation with particular problems in fiscal administration and has been approached with an underlying recognition that a muscled, efficient and corruption-free tax administration in Mozambique is critical to contribute with an even more decisive role for the amount of public resource mobilization and for improvements in the lives of the Mozambican population. But recognition as well, above all, that development implies increasing self-reliance.

At the time of writing, the fiscal administration in Mozambique is undergoing significant and far-reaching reform. The responsibility for the administration of internal taxes belongs to the Direcção Geral da Administração Tributária dos Impostos (DGI), while the Direcção Geral das Alfândegas (DGA) manages the collection and control of customs taxes at the national border.<sup>1</sup> Both directorates form part of the Ministry of Finance, with each respective General Director reporting directly to the Minister. These two agencies

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<sup>1</sup> Internal taxes on soft and alcoholic drinks and cigarettes are the only exception as their control and collection is exercised by DGA.

are going through distinct stages of their respective reform processes but are eventually expected to merge into a single central revenue authority from early 2007, with dual responsibility for the administration of internal and customs taxes.

Broadly speaking, in the years since 1997, both fiscal bureaucracies have registered considerable reform. Importantly, however, while the DGA has undergone a sweeping restructuring of its administration and today is able to enjoy a certain degree of autonomy regarding recruitment, human resource development and budget, the DGI is only now embarking on its own phase of internal reorganization. With this context in mind, the present chapter will also seek to outline some of the primary institutional challenges facing these tax agencies and emphasise the extent to which current (proposed and actual) reforms appear to address those. The authors of this chapter served both as economist fellows in each of the fiscal directorates over a two year period, and the below analysis draws a great deal on their firsthand experiences.

The chapter will be split into three broad sections. We begin by reviewing the current institutional architecture of the Mozambican Customs Administration, locally known as *Alfandegas*. We approach the institutional design of *Alfandegas* from the perspective of the recent customs reform, by focusing on the main pillars of the institutional reform program launched nearly ten years ago. The discussion is then supplemented by an appreciation of their impact in conjunction with some persistent challenges that the customs authorities continue to face. We will then outline the primary features of the institutional design of the DGI, and through three representative case studies, consider some of the challenges confronting the authorities. The third and concluding section will focus on the central revenue authority and its design with particular reference to the establishment of fiscal policy.

## 2. Customs Administration: A view through the lens of reform

### 2.1. Background and promises of customs reform

This section takes on the background and chronological events that preceded the customs reform in Mozambique. In a fundamental sense, the reform of the customs institutions is inseparable from the World Bank and IMF adjustment-oriented conditionality<sup>2</sup> which, typically, reduced the government's economic policy space. In Sub-Saharan Africa, early versions of this model of reform culminating in the creation of a central revenue authority were endorsed at first by Ghana as early as 1985, followed by Uganda in 1991. Perhaps of greatest concern, it has been reported in recent times that while those early tax administration reforms were accompanied by short term revenue improvements, in the long run sustainability of such success has shown to be more elusive (Fjeldstad and Rakner, 2003). Worse still, modest improvements in these countries' administrations were not sufficient to prevent replication of the experiment in a large number of African countries or, at least, to commit to a radical rethinking of the overall reform process. Among some of those countries affected can be found Zambia, Tanzania, Malawi or South Africa, all part of the club of Mozambique's neighbouring countries, and of course, Mozambique itself.

In August 1995, the World Bank issued a report entitled "Mozambique: Impediments to industrial sector recovery".<sup>3</sup> There, the institution pointed to a wide array of factors behind poor industrial performance, including the inability of customs administration to enforce payments of duties and taxes on competing imports. In particular, significant focus was given to the high levels of *negative* effective rate of protection faced by domestic producers which required, according to the World Bank, a "radical reform...to address the serious weaknesses encountered in Mozambique's Customs administration". This stated argument mirrored widespread dissatisfaction within the domestic industry, severely hurt by a rampant smuggling activity, especially from South Africa. The report

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<sup>2</sup> See chapter 3 for further details.

<sup>3</sup> Mozambique: Impediments to industrial sector recovery (August 22, 1995). Macro, Industry and Finance Division, Southern Africa Department

justified, in a rather explicit way, the existence of weak and inefficient mechanisms in administration. To be more exact, it asserted that the customs service faced a “lack of appropriate standard operating procedures, weak enforcement mechanisms, lack of computerised information and management systems, and poor human and infrastructure resources”. By that time, the report was already unveiling a reasonably good approximation of substantive dimensions to be tackled by an imminent customs reform. Launched approximately a year later, the reform was perceived as vital if the stabilization programme were ever deemed to be accompanied by real success.

Similarly, from 1991, there was indisputable evidence that industrial activity had plunged, coinciding, especially in 1994, with declining customs tax revenues. Those circumstances were aggravated by a large scale exemption schemes applied under new special legal decrees. Only the first half of the 1990s saw the introduction of an ample legislative package exempting of customs taxes merchandise destined to deputies and political parties. Likewise, goods intended to respond to natural disasters, imports by the Cotton Institute or merchandise meant for cultural purposes (scientific, sports and arts)<sup>4</sup> were all included as part of the new exemption package. With this background in mind, the reform of the Mozambican customs service appeared as a vital opportunity to recover foregone revenue caused not just by inefficiencies and corruption but, so too, by the adverse revenue effects connected to new exemption laws. In that way, by enhancing tax revenue collections and contributing to restore existing fiscal imbalances, the transformation of customs would be able to serve the objective of fiscal stringency embodied in the stabilization programme.

A different but not less significant motivation to trigger a radical change of customs was the acknowledgment of the necessity to curb systematic corruption. The beginning of the 1990s witnessed a severe backlash aimed at the Mozambican government for lack of transparency and political will to eradicate corruption. Faced with continuous accusations from virtually all segments of society, the government felt it had to come up with an appropriate response in order to reverse a thorny state of affairs. Anyhow, to discharge its

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<sup>4</sup> We refer to laws n° 02/95, 07/91, 53/95, 04/94 and decree n° 0791.

developmental functions effectively, a clear belief also developed that modernization of the state was required, including a fundamental contribution coming from the fight against corruption. At the time, *Alfandegas* was considered as a public administration department that could perform reasonably well the function of a catalyst for other departments of government. For that to happen, it was deemed necessary to appoint a foreign company in the complete management of the customs service. Such concern reflected a consensus that smuggling networks also operated with Mozambican nationals from different spheres of public and private life.

To sum up: by the end of 1996, a highly delicate state of affairs in the Mozambican customs, not to mention its pervasive effect, prompted remedial action. With the global reform cost mainly covered by World Bank and DFID assistance, the appointment of Crown Agents as a private contractor to assume the reorganization of the customs service was expected to yield a multiplicity of objectives. These could possibly be classified in the following way: first, modernize the overall customs services; second, boost tax revenues; third, bolster facilitation of legitimate trade while combating deep-rooted smuggling and corruption; fourth, streamline customs legislation and simplify administrative and procedural requirements; fifth, invest, develop and strengthen human resources capacity; sixth, create and implement a strategy to improve and expand infrastructure and the communication systems; seven, computerize the administrative and customs services; and finally eight, ensure the overall sustainability of the reform process.

## 2.2. Overview of strategy and phases of reform

As said previously, the contract for the implementation of the Customs Service reform was awarded to Crown Agents, a British private company, through international tender. Under the auspices of the Mozambican government and the Bretton Woods institutions, Crown agents took over the operational management of Customs in 1997 for a three-year period, in what was clearly a very *sui generis* initiative, bearing into account previous international experiences in customs reform. Crown Agents brought in around 60 customs staff formerly employed with HM Customs and Excise (UK), with a view to fill

in phased sequence senior management and key operational positions at *Alfandegas*. The Crown Agents team was to accomplish the internal reorganization of Customs in the space of three years, before handing over management to a skilled and competent local staff, then operating in an evolved environment with new computerised information systems and simplified procedures (Hubbard et al. 1999).

Within this strategy for reform, the Government established the creation of a special unit commonly known as UTRA, an acronym for *Unidade Técnica de Reestruturação das Alfandegas*, to be in charge of the supervision of the overall customs reform process. UTRA had equally responsibilities in the formulation and proposal of legislation conforming to a modern customs administration. It would surely be inaccurate, though, to view UTRA's scope of action as limited to the reform *per se* since the range of its intervention extended to a few other important areas; in this respect, one should be aware that UTRA was actively involved in matters connected to the delivery of pre-shipment inspection such as carrying out regular monitoring of the quality of pre-shipment service. The government also appointed a company, Intertek, to provide pre-shipment inspection (PSI) services, with local verification of import consignments. At the time of engagement, some adjustment in the course of PSI was envisaged with future action of Intertek expected to focus exclusively on precise tariff headings of the tariff nomenclature. Today, this shift has already occurred while the PSI contract has been renewed until June 2007.

The process of customs transformation is typically divided in three phases. The first phase, as seen above, is marked by the effective management control of the organization by Crown Agents. *Alfandegas* is submitted to broad modernisation, as the organization undergoes a vast recruitment and provides intensive training to new staff; the staff retrenchment gets underway; the capacity of management systems is enhanced through computerisation; the control mechanisms are rationalized and so forth. This phase is subsequently followed by a period where efforts are turned to deepening and consolidating the reform process (2000-2003). In this new phase, Crown Agents management is brought to a halt as *Alfandegas* progressively take back the executive

authority; Crown Agents switch instead to a mentoring role; the rehabilitation of infrastructure is pursued and, in the meantime, the computer and communications networks are considerably expanded. Finally, a transition phase (2003-2006) is still ongoing and should strongly promote the transition to a Central Revenue Authority. During the whole reform programme, a Steering Committee joining together UTRA, *Alfandegas*, DFID, the World Bank and the IMF was engaged in a periodical assessment of the project execution. Interestingly, these discussions also tended to allow an opportunity for donors and other agencies involved in the project to address their pressing concerns and voice their particular interests.

### 2.3. Simplification of the legal and procedural framework

To an increasing extent, tax policy specialists are convinced that aligning tax policy with administrative capacity in developing countries is a necessary condition. Bird (2004) describes well this requirement when he argues that “an essential precondition for the reform of tax administration is to simplify the tax system in order to ensure that it can be applied effectively in the generally low-compliance contexts of developing countries”. A substantial bulk of evidence suggests that a comprehensive simplification in the tax system has led in fact to improvements in administration performance for many developing countries.<sup>5</sup>

During the process of trade liberalization, Mozambique has substantially deepened the internationalization of its economy.<sup>6</sup> Of course, coping with rising demands for their services depends upon the ability to enact an effective and clear legal framework to improve the customs *modus operandi*. In that context, a striking progress has been accomplished in the modernisation of customs legislation and tax procedures throughout the reform process. Previously outdated legislation and procedures have been updated

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<sup>5</sup> The experience since the mid 80s of Latin American countries such as Bolivia, Chile and Colombia is a good illustration of this argument.

<sup>6</sup> For further details, see introduction in chapter 13.

and made more transparent. Most of the obsolete legislation had been in place since the 1940s having lost considerable ground with regard to current internationally accepted standards. The new legal framework, introduced following periodic consultation with the private sector, covers widespread issues related to the customs administrative role, and includes: the regulation of transit goods and customs warehouses (covering fuel products); the licensing of import operators; the adoption of what is commonly called the Harmonized System (HS), making concordance of systems of tariff nomenclature easier (2002 version); the regulation on the implementation of the SADC trade protocol and other bilateral trade agreements signed with neighbouring countries (Zimbabwe and Malawi); and the creation of a Code of Conduct and Ethics applying to all customs staff. In what follows in this section, discussion is strictly consigned to a presentation of the major legal devices set up as part of efforts to promote trade facilitation.

In the past, soaring rates of tax evasion in customs were partly a response to sluggish and cumbersome customs procedures. One of the important advances attained by the reform has been the continuing removal of administrative barriers in trade operations, i.e. reducing both the cost of compliance for taxpayers and the cost of collection for the customs administration. Very significant is the introduction of a legal *customs declaration form* for customs trade operations, a so-called *Documento Unico* (DU), a form which can be used either for import and export operations. By contrast, the pre-declaration, a form submitted to customs authorities to prematurely announce imported merchandise, has been eliminated – and with it, the *ex-ante* payment of a corresponding deposit equivalent to fifteen percent of the value of duties payable.

Furthermore, a major shift in PSI has taken place. One hundred percent PSI of goods has been replaced, on a preliminary basis, by a risk-profiled wind-down of selections. This, in turn, has been followed by inspection of only specific tariff headings<sup>7</sup> (while a complete phase-out of PSI is now due). Intertek conducts verification of import consignments in

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<sup>7</sup> From January 2003, PSI is mandatory for cereals, flour, sugar, vegetable oil, cement, chemical products, pigments, most medicines, dry cells, used clothes, paper, tyres, and vehicles. In the cases of grain, flour, cement, paper, used clothes and vegetable oil, if the amount imported is small (less than 100 kilos or 20 litres), it is considered exempt from inspection.

the country of export and in so doing issues to the importer a *Documento Unico Certificado* from one of its offices in the country. This form is then used to clear the goods in customs. PSI physical inspections are, however, targeted on particular shipments through the use of risk assessment and profiling software. Such a risk-based operational strategy was designed to enable optimization in the use of resources by promoting a fast-track program in which traders with good compliance records are able to benefit from the release of cargo with some degree of celerity.

An additional area of paramount importance for the enhancement of trade facilitation concerns the implementation of the WTO valuation agreement, formally known as the Agreement on Implementation of Article VII of GATT. The agreement forms a part of the WTO agreements and its effective implementation should be complemented by the growing application of audit-based customs control. But in order to be beneficial, the latter ought to take into consideration a number of characteristics of the Mozambican import sector: a) by making use of a newly created intelligence service, attention should be focused towards risk assessment and profiling based on country of origin or product type, for example the fact that there are export countries more prone to underreporting practices like Zimbabwe and Dubai; b) close follow up of products subject to a heavy tax burden or with significant proportion in total tax revenue; c) the number of trade operators in Mozambique is relatively small, so this should lighten up a bit the post-audit task. In this context, pending occasions where the price cannot be taken as a basis and five methods are sequentially adopted as preferred alternatives, the customs value is to be based primarily on the transaction value, i.e. invoice declared by the importer. This sharply contrasts with the previous system where the customs value consisted of a pre-determined reference price as established by the Brussels Value definition. Unequivocally, compared to the old system, customs valuation now favours the promotion of competition in international markets.

In addition, since the aim of the agreement on Customs Valuation is to expedite clearance of legitimate shipment, levels of smuggling could be reduced by inducing more import

traders to opt for the legal importation. This argument can be justified on the following grounds. First, while the need for the pre-declaration is eliminated, the agreement secures also the immediate release of the product in case the customs authorities need to probe deeper into the value of the good. Second, implementation of the agreement has the potential to limit smuggling through reductions in the margins obtained by its operators. The spirits and alcoholic drinks sector provide a good example here. Reportedly, the sector expected to achieve an average fall in customs value in the order of 25-30% following application of the agreement.

#### 2.4. Human resources and computerisation: Two central pillars of reform

##### 2.4.1. Human resources

Jointly with computerisation and IT, human resources policy is believed to be a centrepiece of the Mozambican customs reform. Transformation of the human factor is possibly the most testing component of a customs reform as chances of failure are not negligible. Nonetheless, if successful, the rewards of reform can be extremely high. The purpose for tackling the human resources component of customs organizations in less developed countries is of course commendable: to encourage higher levels of professionalism and improve their performance. In Mozambique, prior to the reform, only 2% out of nearly one thousand customs officers had higher education while a considerable proportion had very modest levels of education. Problems in the shortage of well qualified staff were compounded by the presence of internal networks of corruption and smuggling involving personnel from all sorts of ranks. This all contributed to a general distrust facing the organization.

The human resources reform programme aimed at improving the ethical stance and giving customs staff incentives to upgrade their professional capabilities in administration.

With that in mind, the enactment of career paths requiring paramilitary training constituted a central spotlight. A policy of intensified and systematic training to expand the range of skills has been as well pursued to successive new waves of recruited staff. Only in the first four years of reform, for example, more than one thousand newly recruited officials underwent training courses. While during the probation period (corresponding to the first two years of the assignment), performance for the new staff has been gauged on a quarterly basis, appraisal evolved afterwards to an audit based system that hinged on systems and procedures. A retrenchment programme has also been introduced. All staff from the pre-reform era was subject to basic customs training, competence tests and assessments. In total, as many as 770 customs personnel took part, of which 534 were in the end eligible to be reintegrated in the new career path. The remaining 236 staff with unsatisfactory performance were either transferred to other government departments or agreed to quit upon a compensation payment.<sup>8</sup> In theory, then, assignment to postings is nowadays determined as a function of needs and pre-requisites to fill the task at hand although the multifunctional profile of staff enables the lawful transfer of every single customs official. These days, staff numbers in *Alfandegas* approach a total of 1700 customs officers.

As mentioned before, a new Code of Conduct has been introduced. This served to ensure that customs staff is aware of their duties and rights, but also to help fostering an ethic underscoring service to the citizenry. Staff rotations, at a national level, have been established following the recommendations of the World Customs Organization. A new General Directorate for Internal Control has been established to focus, primarily, on investigating cases of internal fraud and corruption.<sup>9</sup> Recruitment and promotion systems have evolved, at least formally, to a merit-based system whereas salaries have been lifted on average, being at the moment tied to individual performance and assessed every semester in accordance with publicised criteria. The meritocratic system, if operated properly, can engender a variation in income of 25% according to the level of

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<sup>8</sup> Only a very limited number of staff opted, in the end, for retirement.

<sup>9</sup> This Directorate has been sub-divided into four departments: a) audit and technical inspection; b) staff irregularities; c) anti-corruption; and d) order, discipline and security.

performance of the individual. Some emphasis has been placed too on the question of HIV-AIDS, due to its devastating border impact (allegedly, on average 60% of the population in the Mozambican border regions is infected by HIV-AIDS). A prevention programme is therefore ongoing seeking mainly to raise awareness among potentially-at-risk customs officials.

#### 2.4.2. Computerization and IT

The significant improvements made in computerization and information technology merit at least as much special mention. During the customs pre-reform period, computers were virtually lacking. It is widely believed, in fact, that only two computers were available in *Alfandegas*, with perhaps one or two staff members able to use them. Today, the number of computers in use has risen beyond 350, according to the latest *Alfandegas* figures. It remains essential, even so, not to circumvent the important feature of sequencing for the successful computerisation-enhancing in *Alfandegas*. Mechanisms were judiciously built in from the start, like rehabilitation and re-equipment of certain areas of customs, to safeguard against problems of inadequacy in most of customs infrastructure, because of degradation or destruction after war. Hence, a large preliminary investment in infrastructure has been made, facilitated by the assistance of donors in view of addressing this concern.

Another key aspect of computerisation relates to the introduction of an electronic declaration-processing system, consonant with policies and procedures as required by law. The TIMS software, name given to the computerised system developed by Crown agents to support commercial processing of goods by customs, has been developed for a flexible functional usage, i.e. for a variety of trade regimes (e.g. definitive, temporary, transit or export). At another level, the recruitment of approximately 30 highly-motivated computer technicians has made a significant impact in terms of the capacity for IT development and implementation. Prior to redeployment across the country, this team has been offered exceptional training opportunities and, after that, on-the-job training to deal adequately

with the management of the TIMS system. The important point to note here is that, in practical terms, this well functioning system grants the possibility these days of running a fully operational central statistics data warehouse, intended to provide statistical data upon request of either internal or external consumers. The application of Direct Trader Input, whereby the *trader* has the capability to complete from distance the full customs formalities alleviates costs for customs and has seemingly contributed to an increasing speed in declaration processing.

Several other factors have contributed to advances in customs computerisation. Let us take here just a few examples. A system to register and control exemptions has been designed. It enables, especially for customs data analysts, to identify and analyse the fiscal cost of exemptions as well as implicit duty rates. Detailed analysis is likely to be constrained, however, by human errors in the introduction of trade data in the system, resulting too often from officials' lax behaviour coupled by high levels of indulgency from senior managers. In any case, such mistakes are more likely to occur in operations that fail to offer an effective "safety net".<sup>10</sup> Computerisation and information technology are being applied also to internal procedures in managerial tasks of customs administration as diverse as human resources, finance or logistics. But equally important, at a later stage of the reform process, customs communication infrastructure has been bolstered by the establishment of RENA (acronym for *Rede Electronica Nacional das Alfandegas*), a modern VSAT system of communications that permits, for the very first time, voice and data communication between 20 customs clearance posts - as well as access to internet and email to 40% of the personnel. In the case of South Africa, a trade partner with considerable weight for Mozambique, electronic exchange of information is foreseen in the near future between *Alfandegas* and *SARS*, a welcome move that should help curb corruption while improving the speed of declaration processing.

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<sup>10</sup> Van Dunem, J.E. A few preliminary findings in the analysis of Customs Tax Revenue (2002-2004) – Document released internally for the Tax Incidence Project (Ministry of Planning and Development), March 2005

## 2.5. Evidence from *Alfandegas* performance during reform: Some facts

### 2.5.1. Customs revenue

Perhaps a useful way to think about the idea of success of the Mozambican customs reform is in terms of revenue enhancement. The small number of evaluations addressing this aspect makes a very compelling case for the spectacular surge in revenue collections with the onset of reform. An OECD report<sup>11</sup> from 2003 about trade facilitation in developing countries, for instance, documents a surge in Mozambican customs revenue of 38.4% during the first two years of the program, in spite of reductions in duty rates. The same report throws up the conclusion that “whilst costs of customs increased dramatically during the early, very demanding stages of the reform program (as new staff were recruited and trained, and the customs administration’s infrastructure developed) these extra costs have been compensated for by subsequent rises in overall collection levels”. More recently, Crown Agents have formally portrayed the outcome achieved for one of its main product offerings as “*impressive*”, claiming that the 350% increase in collections throughout the entire reform period is merely symptomatic of it.<sup>12</sup> To be fair, there is some truth in both of these arguments and few would doubt that the reform program has been successful in its most basic task: raising revenues. What possibly is not so much consensual is the degree of sustainability in results.

Let us now, for a moment, take a cautious look at some *facts* from *Alfandegas*. During the opening phase of reform, from 1997 to 2000, the overall picture provided by collection indicators from *Alfandegas* fits nicely with the above descriptions. Customs revenues in real terms more than doubled in the space of three years. *Alfandegas* increased indeed its revenues (in USD) by nearly 120% while customs total tax revenues rose from 3.6% of GDP in 1997 to 6.3% in 2000.<sup>13</sup> The corollary of advances in administrative competence and efficiency came in 1999, coinciding with an amendment of customs tax policy inspired by a “keep it simple” rule. To be more exact, this shift in

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<sup>11</sup> Trade facilitation reforms in the service of development (Working Party of the Trade Committee), July 2003, unclassified

<sup>12</sup> <http://www.crownagents.com/uploads/public/documents/downloads/Our%20Work/Public%20Financial%20Management/Mozambique%20Customs.pdf>

<sup>13</sup> Calculations based on data from *Alfandegas*.

tax policy materialized through a rationalization of the tariff structure (reduction in the number of tariff rates from 12 to 5), the introduction of VAT (a rate of 17% and a broader tax base by comparison with the previous *imposto de circulação* (5%)) coupled by a reduction in top-tariff rates (from 35 to 30%) and excises on trade. Simplification in tax policy, *in tandem with* improvements in administration, contributed to boost customs revenues (e.g. only in 1999, revenues in real terms increased by a staggering 36%). As part of a new autonomy-enhancing design, the level of available resources for *Alfandegas* yearly budget has been proportionally tied to efficiency in collecting customs revenue so that higher levels of revenue became soon tangled with enlarged budgets as well.

Oddly enough, analysis of implications of reform for customs revenue tend to skip the second phase and leap to more general conclusions, leaving thereby the second period of reform (2000-2003) without an appropriate independent scrutiny. There is no question that consideration of performance during the course of that particular period should draw an important level of interest mainly because it marks the transfer of management control and power to the hands of Mozambican nationals. If we adopt a similar logic, what the same *Alfandegas* data shows is that revenues in real terms have increased by a mere 4% from 2000 to 2003, with real collections actually dropping in 2001 by nearly 9%, hinting thus at a possible decline in administration efficiency. As a percentage of GDP, total customs revenues have, conversely, maintained relatively stable around the 6.2-6.5% range.<sup>14</sup> In more general terms, notwithstanding a low annual rate of growth in real revenues, it appears that revenues as a percentage of GDP tended to stagnate until recent times by virtue of action from several other factors (e.g. exchange rate fluctuations) that are supposed to influence nominal revenue. The renewal of Crown Agents contract for a supplementary three years (i.e. until 2006) maybe should come as no surprise then, when one takes into consideration veiled symptoms of administrative malaise like the one just depicted. Of course, revenue collections are only partly determined by tax administrations, hence we are aware that they might be a crude measure of performance.

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<sup>14</sup> This trend in customs tax revenue ratios is confirmed by IMF staff data, as we might expect. Republic of Mozambique: Selected issues and Statistical Appendix (Aug 2005).

They are, nevertheless, an easily available indicator which, whenever used, must be done so both with alertness and objectivity.

Having said this, highly marked improvements in trade facilitation constitute more authentic symptoms of the positive effects of reform. The introduction of computerisation, boosted by Direct Trader Input and other customs procedures, and the phasing down of PSI have together amply helped a remarkable decline, on average terms, in processing times for declarations. The quality of the customs service has also been widely regarded as having benefited as a result of a more courteous and friendly customs personnel. These tangible symptoms of trade facilitation may have had a fair share of responsibility in a force for lessening tax compliance costs after the start of reform, i.e. playing a role in the observed short term revenue increases.

#### 2.5.2. Corruption levels

Jointly with customs revenues, relatively moderate (but not sustained) headway has been made in the area of corruption, if we set as basis of assessment a dismal pre-reform state.<sup>15</sup> The pattern of corruption, in a way, sheds light on developments for revenue. It is quite clear that the modest progress in reducing fraud and corruption levels in the Mozambican customs can be, to some extent, attributed to the introduction of automated systems. The TIMS software relies heavily on a standard process in which the amounts of discretion enjoyed in the past by officials have been seriously curtailed. A quick glance at a few simple cases may facilitate a better understanding of the argument.

First, with a well-functioning computerised TIMS system, the levels of control have improved considerably since many functions are *automatically* undertaken by the computer system rather than being hand-made (e.g. calculation of payable taxes, straight connection between the tariff book position and theoretical taxes). Second, clearing

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<sup>15</sup> This important point is made based on prevalent perceptions. It should be noted that, even today, like many customs administrations that have gone through reform in Africa (eg. Kenya), corruption practices still remain quite common.

declarations - i.e. the emission of the notice of release, the so-called *nota de saída* - before actual payment has really taken place happens to be now forbidden. Third, the system permits detailed recording of actions taken by officials involved in the clearance process of goods (e.g. date, time, name of officer and so on) which is likely not to stop malpractice but at least introduces a deterrent device by suggesting that officers can be challenged at any time, culprits can be questioned and - when necessary - disciplined on the basis of evidence made available by the system. Fourth, the possibility to visualize the time taken to carry out certain phases of the declaration process should allow senior managers the opportunity of putting pressure on station managers to clean up the “delay factor”, an additional cause of corruption. Fifth, the system allows setting up a database of importers and exporters as a by-product of the declaration process, thereby enabling a more systematic investigation of trends and repeated behaviour (e.g. one can conduct historical searches on the types of products imported by any given importer over time). Sixth, certain functions have been centralised, taking some activity away from the local *estancias* (clearance posts) and restricting the opportunities for collusion among staff. Finally, with computerisation the customs agency is presently in a much more favourable position to track cheques and alternative methods used for payment; it can also confirm these against bank deposits and other forms of financial information, i.e. making possible to reduce compliance costs.

Introducing a secure computer system has the simple virtue of reducing extensively the discretionary interface between customs and private operators. But, as Bird (2004) cleverly puts it, “even the best computerized system will not produce useful results unless there are real incentives for tax administrators to utilize the system properly”. Unfortunately, with the benefit of hindsight, there are *de facto* a number of arguments that one can level currently to call the actual structure of incentives to collect customs tax revenue into question. One needs to recognise, most importantly, that this structure of incentives is really *endogenous and independent* of the realm of reform per se. Overcoming this thorny problem and moving towards a more encouraging path where the potential of the tax administration is realized, in line with its own capacity constraints, is a responsibility that only the Mozambican government must take. Today, the potential of

the administration is still far from being met. We shift next the attention to a few plausible causes for the failure of reform to impact the performance in terms of customs revenue and corruption *in a sustained way*.

## 2.6. Understanding the core factors behind unsustainable outcomes

### 2.6.1. Weaknesses in professionalizing staff

Less discretion in Mozambican customs procedures nowadays does not mean, still, that the computer system cannot be ignored on occasion or even abused. There is no question that when good incentives are not in place, administrative efficiency can easily be undermined. To illustrate this argument, imagine an automated system like TIMS that offers the opportunity for senior managers to exert countervailing checks and balances over customs stations. If a particular station takes way too long to carry out final verification after payment and things get specially aggravated due to an unprofessional station head and operational superiors who choose to shut their eyes to the delay, the computer is obviously powerless to hasten completion of the procedure: the computer cannot, for instance, refuse to accept declarations pending satisfactory treatment of those already processed in it. In the same line of reasoning, the system has to “believe” consistently the information introduced by customs officers and has no means of knowing that the brand new BMW is worth more than the recorded \$10,000 value or that the country of origin picked for the imported product circumvents fraudulently the tracking down of the risk-profiled system (e.g. Sweden instead of United Arab Emirates). Nonetheless, the system allows to record the names of “actors” involved along the clearance procedure, such that managers are able to know *ex-post who keyed in the value or who verified it*, i.e. they are able not only to identify malpractice and culprits but also to take suitable action accordingly.

The cases presented above suggest that computerisation is a necessary but not sufficient condition to improve the standards of tax administration. Professionalization and ethics of personnel are exceptionally critical requirements. The mechanisms of control and good

management from superiors (complemented by a newly operating anti-corruption unit) should not be, therefore, mutually exclusive. Of course, the shift in human resources policy was meant to address issues of professionalization and ethics of staff. A newly designed semi-autonomous regime allowed a new system of rewards for personnel whereby: a) remuneration levels, unlike the rest of civil service, were raised as an attempt to reduce temptation in corruption activities; b) the system of merit, if operated correctly, could lead to a variation in income of 25% according to the level of performance of the individual; c) from time to time, certificates of honour would be attributed to customs officers with exceptionally outstanding performance.

Thus far, even though there has been some progress in technical competence, the new rewards system has clearly left expectations unfulfilled as corruption remains a serious entrenched constraint. Salaries and awards appear ineffective - and in fact symbolic - when compared with the value of bribes and other advantages derived from fraudulent activity. Experience from the merit based system seems to suggest that the majority of personnel end up receiving the highest classification so, eventually, the incentive becomes eroded. In spite of replication in a few other state agencies, an urgent need to review this system has already been acknowledged and called for. In a context of thriving corruption, one might have valid reasons to admit that the merit-based system of incentives could actually result in counter-productivity by penalising honest officials who attempt to decline infringing the law.

Further, counter-productivity in the incentive mechanisms can be fuelled by staff rotation systems, a very legitimate source of concern in the Mozambican context. The underlying problem is again best described by Fjeldstad and Rakner, who suggest that rotation systems create a danger of “increased corruption as collectors may use the opportunity to try enriching themselves while they are stationed in the most ‘lucrative’ posts”. This complex problem paves the way to other inherent complications as postings swiftly acquire a transaction value. The Namaacha and Ressano Garcia border posts (corresponding respectively to the borders with Swaziland and South Africa) are often

cited as very attractive and always on very high demand. One has to take note that these systemic contributions to inefficiency in administration can augment the risk of generating further distortions in the economy as new taxes are sometimes created or tax rates increased in an attempt to make up for the resulting revenue loss.

Enacting a customs reform process is not, by itself, synonymous of accomplishment. Externally-driven reform can assist to promote tax laws, logistics, competence or even skills as the Mozambican reform has shown. Regrettably, it is harder to buy the commitment, honesty and ethics of public servants. A fundamental lesson from this case study is that the Mozambican government has not succeeded, much in the same manner as other Sub-Saharan African countries, at building up a cadre of civil servants imbued with a spirit of public service for the demanding tasks of administration. Overturning this trend and fostering higher standards of integrity in public life is a task which will require no less than a strong and credible political engagement.

#### 2.6.2. Need for enhanced political commitment<sup>16</sup>

In a sense, the reform of *Alfandegas* - and that of DGI too - has been followed by a positive externality in the form of an increasing public awareness about the need for improvements in administration. Such development is indeed welcome. It appears that, even so, part of non compliance could result from a widely held belief that the current tax system suffers from internal inefficiencies along with severe inequities in tax compliance: the tax law seems to fully apply to the “weak and poor”, while the Mozambican elite tends to receive discriminatory treatment.<sup>17</sup>

The problem of how to improve compliance levels would substantially lighten up the customs tax administration agenda if the present wave of fraudulent and lethargic practices could be effectively beaten back. Put differently, a change in the way the tax

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<sup>16</sup> Interpretations in this sub-section focus on DGA but are equally applicable to DGI whose discussion is reserved for the next section.

<sup>17</sup> In 2006, the government commissioned a poll to survey public perceptions of governance and corruption. According to results, the tax agencies ended up being among those most affected by corruption.

administration is widely viewed by most taxpayers could carry positive benefits resulting from a change of norms and social attitudes, i.e. incentives towards tax compliance. As taxpayers realize they are treated more fairly by the administration, they should be more likely to be willing to follow the law. Part of non-compliance could be, furthermore, explained by an inadequate connection between taxes and social benefits, even though altering this gloomy situation might realistically be a trickier mission.

The government has the responsibility to renew its efforts and give due prominence at reorienting the strategy and purpose of a tax administration tailored to serve the objective of self-reliant development. In our own view, the muscle to radically transform internal incentives into a path of integrity must emanate from the political administration. This could be achieved by relying on a more comprehensive and gradual approach to reform, involving primarily an independent judiciary sector and the backing of a free press. Interestingly, evidence from other developing countries' latest experiences in customs reform (e.g. the Philippines) seems to point out that the involvement and engagement of the President and Ministry of Finance is decisive for the outcome of reform.<sup>18</sup> We believe that establishing and intensifying greater international co-operation with successful tax reform countries with some identical characteristics and problems could also prove to be extremely valuable. By learning the practical lessons which could be drawn from developing countries' past experience, Mozambique could then take the necessary steps to endorse fruitful strategies adopted elsewhere and, as a result, surmount internal problems with less difficulty. In that perspective, to effect change an expansion of South-South cooperation is recommended.

Within a more long-standing perspective, priority should be given to boosting the *human capacities* of the Mozambican people. It will be up to the government to work out the

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<sup>18</sup> Fighting Corruption in Customs Administration: What can we learn from recent experiences? (2001), Working Paper n° 175, OECD Development Centre.

The Philippines, a success story in customs reform, apparently benefited from a strong personal commitment from the President and Customs Commissioner, in contrast to Bolivia and Pakistan, where reform seems not to have replicated the same level of success.

tactics needed and also to determine its own timetable. But if the government is to signal real commitment to reform, this must presuppose preventive public action through conceding a growing prominence to education and health policies for human capital development. As a matter of fact, fomenting specific educative and pedagogical programs aimed at judiciously appointed public servants could be, in our view, justifiable as well. The argument in favour of the application of this measure is that it may inculcate more positive values and cultivate a commitment for change. This last option is in fine tune with recommendations from landmark documents such as the Arusha Declaration drafted by the WCO and the IMF Integrity Paper.

### 2.6.3. Country-specific challenges

A meaningful point worth noting is that the capacity to attract high calibre professionals to work in public sector has been generally strained by low levels of educational standards in the country, let alone the brain-drain to either private or international institutions justified frequently by higher financial rewards. Accelerating the expansion of the educational capabilities of the Mozambican people would necessarily contribute to improvements in the quality of the workforce available for employment not only in the tax administration service but elsewhere too.

A further point that must be taken into account is that it is not trivial to measure the degree of honesty of job market candidates. Despite the promises of autonomy and its ensuing meritocratic recruitment method, *Alfandegas* should be expecting beforehand to attract a large proportion of individuals who see enrolment primarily as an opportunity for a lucrative venture, not a personal contribution to Mozambican public service. But more significantly, getting credit for attracting and retaining technically capable staff would also be very misleading because of systemic incentives. In this respect, insufficient attention has been given to the dilemma of honest and highly-talented university graduates who, as corruption-averse individuals, tend to give preference for more technocratic job postings where the extent and external *reputation* of fraudulent activity

is not so looming. There are presently a few signs that might point towards the existence of such type of apprehension among young job seekers.

By the same token, the causation behind the limited effectiveness of computerisation is probably not a simple one. We believe that it must be understood in terms of the interaction of numerous factors like the complete lack of prior experience of Mozambican staff with computers, aggravated by the lack of existing professionals with IT competence for immediate recruitment. It seems of utmost importance, on the other hand, to acknowledge that a robust and extensive infrastructure critically necessary to ensure a good service provision of the TIMS network backbone was missing. The early days of the reform project, for example, witnessed the transport of customs data in floppy disks. Even nowadays, that service provision is extremely variable. Further, consideration of theft and frequent damage (by world standards) of equipment due to electrical storms, flooding and power surges is an additional source likely to reinforce the difficulties faced by a promising new automated system. One needs to recognise, moreover, the presence of a trading community with an ingrained tradition with corruption habits and actively seeking ways in which to make contact with customs officers and distort the proper use of the system. And in most African countries, cultural idiosyncrasies can simply make this kind of human interaction very easy.

#### 2.6.4. Discretion in administering customs tax systems

A semi-autonomous *Alfandegas* has not, fundamentally, prevented widespread systemic corruption. In the last couple of years, although the widespread practice of corruption has remained a subject prompting high levels of concern, *Alfandegas* figures seem to show surprisingly that the total amount of expulsions corresponds to less than two percent of the total workforce. The reality is that establishing a semi-autonomous customs service has not been conducive to formulating a new disciplinary procedure system for customs staff. The *Estatuto Geral dos Funcionarios do Estado* (EGFE), applying to civil servants, still remains the leading disciplinary system, even with the endorsement of a new Code of Conduct. The rules in EGFE are excessively intricate and, in any event, require a level of

proof almost equivalent to that for murder. This weak repressive mechanism is aggravated by a lack of will to enforce the law as these internal discipline mechanisms have a tendency to exhibit purely decorative functions.

Granting tax exemptions as an incentive to promote investment is frequent in the tax policy agenda of developing countries, including for imported merchandise. Evidence suggests, even so, that effectiveness in attracting incremental investment is doubtful and revenue cost could well be high. In Mozambique, it has been documented by Van Dunem (2005) that the cost of fiscal exemptions in customs has soared in recent years (between 2002 and 2004) due to discretionary exemptions approved by the Minister of Finance, subsequent to proposal from the *Alfandegas* General Director. Currently, the levels of discretionary exemptions are not negligible and end up having a direct impact on fiscal revenues.

The adoption of article VII of GATT should have been complemented by rising post import audits. Until now, progress in this direction has been flawed since the administration has failed to demonstrate real dynamism taking on post import and VAT audits. The principle of post-clearance audits is that *Alfandegas* must release without delay the goods subject to valuation problems while conducting, shortly afterwards, valuation audits. This requires appropriately well-trained personnel in post-clearance audit and increasing staff and resources to do the follow-up which, at the moment, customs still fails to possess. Those two factors are often cited to explain the stalled process (Makanza and Munyaradzi, 2004).

### 3. The General Directorate of Taxation: Institutional Design and Challenges

#### 3.1. Institutional Design and Overview

In this section we will outline the primary features of the institutional design of the DGI, and with this context in mind will consider, through the three windows of the payments system, the process of Value Added Tax (VAT) refunds, and finally the audit and control of corporate taxpayers, some of the challenges faced by the authorities of DGI as they look to increase revenue collection.<sup>19</sup>

As Bird (2004) notes, the simplification of the fiscal regime represents an essential precondition for the reform of the tax administration. With literally hundreds of disparate fiscal laws, it is widely acknowledged that Mozambique was lacking a common thread providing some cohesion to incumbent legislature, and guidelines establishing broad and clear fiscal rules. In response to this, a general tax law was written, and approved in December 2005.<sup>20</sup> Whilst a detailed description of the intricacies of the new legislation, with some 219 articles, is perhaps unnecessary here, broadly speaking, the objective was to adopt mechanisms simplifying and modernizing existing fiscal procedures, guaranteeing, it is hoped, an increased efficiency of the fiscal administration and thus facilitating voluntary compliance of taxpayers. In brief, the law will provide a single point of reference, for the taxpayer and the tax authorities, of the primary fiscal principles and norms.

Turning now specifically to the management of internal taxes, the DGI is structured into organs at the central and local level. Centrally, the DGI is comprised of eight directorates organized into three broad areas: (i) *General Administration*, including the directorates of human resources and training; (ii) *Inspection and Technical Support*, overseeing the directorates of inspection, ‘studies, planning and technical help’, and statistics, and (iii)

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<sup>19</sup> Under the guidance of the International Monetary Fund, in 2007 the DGI will aim to increase tax collections as a percentage of GDP by 50 basis points, to 14.9%.

<sup>20</sup> Lei Geral Tributária, Lei 2/06.

*Technical Operations*, overseeing the directorates of ‘fiscal management, collections and reimbursement’, ‘audit and control’, and ‘fiscal justice’. Whilst it is perhaps beyond the scope of this chapter to provide a full consideration of the duties of all the directorates<sup>21</sup>, we would highlight the directorate of ‘fiscal management, collections and reimbursement’, to give some flavour for the new structure of the tax administration. Activities within this directorate are wide-ranging, but are organized neatly into various smaller departments, including one dedicated to the management of fiscal benefits and incentives. Whilst the analysis of fiscal benefits was of course conducted pre-reforms, the creation of a specific department comprising of c10 people dedicated to the management and administration of such an important component of the Mozambican fiscal profile, represents a significant step forward<sup>22</sup>.

In general terms, it is interesting to note that the current mode of organization of the tax administration, as described above, is explicitly based on *functions*. Departments are organized along broad activities (for example registration and payment, tax refunds, analysis, audit and so on), enabling a standardization of tasks and processes across taxes. Whilst this transition is still very much ongoing, the new directorates described above have nevertheless been constructed, detailed responsibilities defined, and work using the new structure has started.

In addition to these central organs, DGI comprises thirty local tax offices located around the country, and organized into four groups (A-D) based broadly on an index of size measures, including the number of taxpayers serviced, the monetary amount of taxes collected, and the geographical area covered. It is to one these offices that the taxpayer is registered, receives his tax bill, and pays his obligations to the fiscal authorities. It is also here where the majority of DGI staff is employed, and where perhaps the greatest challenges are faced. Relations between DGI central functions and these offices are managed through a series of circulars written if and when the need arises, though

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<sup>21</sup> Specific responsibilities of the directorates are outlined, in some depth, by the Diploma Ministerial n° 265/2004.

<sup>22</sup> See the Tax Benefits Code, Decree N° 16/2002.

currently there is an effort underway to centralize all of these to gain some clarity as to all the obligations that the tax offices must fulfill. Wages of all employees are paid centrally, however, for other expenses such as utility bills, stationary, fuel and other current operational obligations, the offices receive a fixed monthly allocation, depending on their classification (A-D). The use of this money is audited carefully at the central level, with all receipts, invoices and bank statements required to be sent to the head office every month.

This decentralized nature of DGI is emphasized time and time again, with the tax offices located far from the capital apparently following guidelines only very loosely. Again, efforts are underway to address this with, for instance, a significant recent tightening of the control over their monthly budgets at the central level. However, resources in many of the offices remain at a very basic level, and this is often blamed by the head of such offices for any shortfall of revenue collections relative to programmed levels. Nevertheless, the top-heavy nature of Mozambique's fiscal structure, with over 80% of total revenues in 2005 collected in the Maputo area, means that the long tail of local tax offices is, according to many, often overlooked. Collections originating in the Northern zone of Mozambique for example, comprising of nine local tax offices in the provinces of Niassa, Cabo Delgado, and Nampula, represented less than 6% of total tax receipts in 2005.

In 2005, the DGI employed approximately 950 staff, of which 270 work in the head office based in the capital of the country, and 680 in local tax offices. Of those working centrally, over 30% have high levels of education<sup>23</sup>, up from 18% in 2002. Reflecting the lack of capacity outside of the capital, just 4% of staff working in the local tax office had high levels of education in 2005- roughly one person per unit. Approximately 40% of total staff are women. With the introduction of the ATM, a uniform and significantly improved salary scale for workers (relative to normal civil servants), independent to the state and incorporating a performance-based incentive designed to enhance productivity

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<sup>23</sup> 'High' here is defined as to university degree level.

and morale is slowly being introduced. For many mid-range technical analysts in DGI, this has meant a near doubling of their net wages.

### 3.2. Large Tax Payer Units

For many low income countries, one observes a marked skew in the distribution of tax revenue by size of the taxpayer. In direct response to this, the 1970s saw the introduction of large taxpayer units (LTUs) starting in South America, and then spreading to a number of African countries, under IMF guidance, during the early 1990s (*Burkina Faso 1995, Mali 1994, Kenya 1998*). Mozambique is no exception, with a large proportion of total tax collection being accounted for by just a handful of taxpayers<sup>24</sup>, and it was somewhat inevitable, therefore, that the country followed suit with the creation of two LTUs in 2002, and one a couple of years later, located in the three principal cities of the country: Maputo, Beira and Nampula.

As Baer (2002) notes, the fundamental objective of a LTU lies with both facilitating the compliance of large taxpayers with their fiscal obligations, as well as to act as a "...pilot or incubation centre to test administrative reforms..." Official justification for the establishment of the three LTUs in Mozambique cites these aims. It is hoped that such units will provide some stability, influence and control over receipts from large taxpaying entities, and that in time, some of the reforms implemented can become DGI-wide. The vision is of an independent unit located in key points around the country, offering a complete service- registration, declaration, payment, and information- to the taxpayer. At the time of creation, the criteria used to define a 'large taxpayer' were fairly ad hoc and informal. Basic indices were constructed, with sales volume and the type of tax paid as the main inputs, but in reality companies were simply considered on a case-by-case basis. In addition, all financial taxpaying institutions (banks and insurance firms) were registered in the new units.

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<sup>24</sup> In the LTU Maputo, for instance, the twenty largest tax payers contributed in the region of 3.1bn MTn in 2006, representing a sizeable share of total collections.

The lack of a clear and measurable counterfactual, as well as the difficulty associated with isolating cause and effect mean that evaluating the impact that the three LTUs have had on fiscal performance is tricky. Nevertheless, using basic metrics the news is mixed. Total tax collections in the LTU of Maputo, for example, rose by 93% in the period 2002-2005 (versus 87% for DGI as a whole). However, while the three LTUs taken as a whole accounted for a healthy 69% of Fiscal Receipts<sup>25</sup> in 2003, this fell to just 57% in 2005.

Such a centralization of tasks has, however, brought with it problems. The effective creation of a parallel fiscal administration has incited an unhealthy competition for financial and human resources, with the 'normal' tax offices, in particular those located in the same area as a new unit, drained in order to feed the LTU. In a couple of cases, a specific tax office has seen a marked fall in its tax collections as a number of its most important contributors have been transferred. The shift in emphasis, at the central level, away from the other tax offices has also caused a marked fall in staff morale and effort. In part responding to this, in part in recognition of the lack of a written plan for LTUs going forward, work is underway drafting a more formal approach to the operations of a LTU and the criteria employed to define a large taxpayer.

### 3.3. The Tax Payments System

In 2002 the law was passed creating SISTAFE (*Sistema de Administração Financeira do Estado*) a new financial system for Mozambique (Lei 9/02), encompassing the entire budgetary cycle, from the first stage elaboration to final execution. In broad terms, the law aims to address many of the problems previously associated with the budget cycle- in particular, a live electronic budget system has been created, enabling it is hoped, an accurate transferal of approved budget allocations consistent with the pattern of revenue collections over the year. An important component of the system has been the

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<sup>25</sup> Receitas Fiscais- Collections of DGI, excluding non-fiscal receipts, earmarked revenues, and Capital.

aggregation of all National Treasury accounts into a single unified account (Conta Única de Tesouro, CUT), into which all public receipts, including those collected by DGI, enter, and from which all expenditures leave.

While for many, the design of SISTAFE has focused primarily on the expenditure side of the state budget, it is critical that all revenue entering the CUT is classified for the proper functioning of the system. Importantly, the execution of expenditure relies not only on the availability of funding, but on the availability of *classified* funding. The accurate and timely classification<sup>26</sup> of revenues represents a new set of challenges and hurdles for DGI to which we now turn. Such challenges are perhaps best explained in the context of the tax payments process.

How does the money travel from the taxpayer to the Treasury? Firstly, the taxpayer presents himself at his local tax office, receiving his tax assessment, and paying, usually by means of a cheque, the amount due. At the end of the day, the tax office deposits the cheques in its bank account, and finalizes its accounts, using the tax assessment forms as a base for the classification of the deposited revenues. Crucially, Mozambican law does not prohibit the payment of tax obligations by non-validated cheques- such cheques, then, need to be cleared by the bank of the respective tax office. In theory, the bank should clear such cheques within 72 hours, however in reality the time taken can be anything up to two weeks. Moreover, the bank does not provide information detailing the clearance of cheques at the transaction level- which cheque has been cleared, which has not. The tax office will simply learn, on an aggregate basis, the total value of cheques cleared during the previous day.

As a result, the local tax offices are unable in many cases to identify the actual flow of revenue to their bank account- that is, to accurately classify taxes effectively paid. It can and does happen, for instance, that a tax office transfers funds to the CUT (via their bank)

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<sup>26</sup> Unclassified funds in the CUT are granted until the end of the forthcoming month to be classified. If they are still not classified, the SISTAFE system automatically labels them as Fiscal Receipts.

basing the classification on their tax assessment forms from that day that do not accurately represent taxes collected.

In order to address this problem, the smaller tax offices around the country (groups C and D) have been granted some discretion as to when they transfer (and classify) funds from their bank accounts to the Treasury. Waiting a few days for all cheques to be cleared before the transfer of funds to the CUT will, it is hoped, permit the complete and accurate classification of revenues in the SISTAFE system. Unfortunately, perhaps in an over eagerness to fulfill their responsibilities, perhaps to avoid an overly burdensome classification of many days of tax collection, many tax offices still prefer to transfer and classify revenues before they have full information regarding bouncing cheques. For the larger tax offices, from which the Treasury cannot afford to wait for the clearance of cheques, funds are transferred on a daily basis to the CUT, and the classification is based in part on an assessment that is subsequently revised. It is therefore guaranteed that funds will flow without delay, with classification being finalized ex-post.

In conclusion then, the transfer of revenues is not yet happening in a systematic and efficient way. Moreover, there exists no guarantee that the revenues transferred to the CUT are correctly classified. Classification of large numbers of tax receipts into a large number of tax classifiers, by a work force not yet fully familiar with the new tax codes, lends itself to human error. Daily examples of the tendency to group taxes into the same tax code for ease can be found.

Such problems are manifested most clearly when one considers the tax collection data, based on monthly communications from the individual tax offices, which DGI used and continues to use for internal and external purposes. Approximately one week after the end of the month, tax offices will begin to send their tax collections numbers relating to the previous month to DGI central office. These are sent by fax or communicated by telephone, and are then entered manually into a spreadsheet document. The scope for errors is large in this process: Examples encountered on numerous occasions include

human error in the re-keying of data, miscommunication due to the poor quality of a fax printout, and misclassification of revenues often due to a lack of understanding regarding the precise definition of a revenue classifier. In theory, of course, such data should be equal to the amount of money actually entering the CUT described above. In reality, data from 2005 shows large discrepancies. With an undertaking of such magnitude, teething problems are to be expected, though the magnitude of differences in some of the tax offices is surprising.

The introduction and gradual rollout of a computerized system of revenue classification (Solução Informática para Gestão da Cobrança das Receitas, SICR) means that the above situation should be ameliorated greatly, though a large number of the regional tax offices, in particular the smaller ones more prone to error, remain 'off-line'. Nevertheless, by the end of 2006 and moving into 2007, it is anticipated that the majority of revenue flows will be being captured by SICR. One should, however, not get too excited regarding this system. For many, SICR really represents no more than a fairly primitive database, and while the basic data problems described immediately above should disappear as a result of the system, it suffers from one major weakness: That there exists no formal link to SISTAFE or the single treasury account (CUT), or any move to formalize. The discrepancies between taxes actually paid, the money entering CUT, and the tax collections data DGI continues to use for publication and analysis, will therefore most likely persist.

#### 3.4. Value-Added Tax and its Refunds

Following the establishment of a commission in 1996, the Government of Mozambique introduced a Value-Added Tax (VAT) three years later.<sup>27</sup> The VAT is levied on the invoice of goods and services minus the VAT paid on the invoice of inputs and imported goods, and is collected from suppliers who generally pass the extra cost onto consumers. In that sense, the VAT effectively acts as a tax on domestic consumption. Three regimes

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<sup>27</sup> 1st June 1999: Decree 51/98 of September 1998.

characterize the current system. The Normal Regime, in which ‘large taxpayers’ (*minimum turnover of 250,000 MTn pa*) are subject to a 17% VAT, and are entitled to reimbursement of VAT paid on inputs. Secondly, ‘small taxpayers’ are classed in the Simplified Regime, contributing 5% of VAT on sales volume, and not entitled to any reimbursement.<sup>28</sup> Finally there exists a long list of exempted items, upon which no VAT is paid. Of these, certain items are entitled to no refund, including medical supplies (Article 9), while others, including many common foodstuffs such as rice and flour, can claim reimbursement. Importantly in addition, all exported produce do not pay VAT but are subject to a full refund of VAT paid on inputs.

As alluded to above, the amount of VAT due is the difference between the amount of tax collected from purchasers of goods and services (zero for the exempted items listed) and the tax previously paid on goods and services purchased for the use in business. VAT is thus collected on the value added at each stage of the supply chain- as long as the transactions involve registered entities.<sup>29</sup> In cases where the amount due is negative, that is, the taxpayer is in a net credit position, then a refund may be claimed from the government.

An evaluation of the efficacy of the administration of these refunds depends on who you speak to, with the process characterized by a distinct divergence of opinion between the private sector and DGI. In 2001, the target period of the government for reimbursement was 90 days. This was subsequently reduced to 60 days, and further to 30 days more recently.<sup>30</sup> Within this context, the business community cites numerous examples of prolonged delays, sometimes extending to well over a year, and point to implicit and explicit deals to ‘oil the wheels’. In contrast, DGI claim that the majority of valid refunds are treated well within the 30 day period, with any delays due to improper documentation

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<sup>28</sup> This is seen by many as a very innovative component of the VAT regime, rarely seen in other countries.

<sup>29</sup> In this respect, an initiative is underway attempting to assign a personal tax number, and therefore to effectively register to every taxpaying entity - individual or collective in the case of a company paying corporate tax or VAT. In 2005, over 120,000 personal tax identification numbers were issued, taking the total current number to approximately 300,000.

<sup>30</sup> Decree 55/2004.

on the part of the claimant. Indeed, VAT refund forms (*Pedido de Reembolso, Modelo A*) do require a wealth of information, including for example, the past three VAT monthly declaration forms to be attached. Such paperwork is often simply not attached, and more generally, refund staff claim to be constantly faced with forms incorrectly filled in.

Importantly here, any failure to receive reimbursement within the deadline does give the taxpayer the right to claim penalty interest- though the interest will not be attributed unless the claimant makes a specific request for its calculation. DGI for its part may however suspend the payment of reimbursement for six months whenever, "...because of circumstances attributable to the taxpayer, it is impossible to verify the legitimacy of the requested reimbursement."<sup>31</sup> This clause was introduced with the direct intention of controlling more tightly the payment and calculation of reimbursement payments when the supplied documentation contains mistakes or is incomplete.

In acknowledgement of the animosity that exists between the authorities and the private sector in this area, a dialogue between the two parties has been established in the form of a monthly meeting of the department of VAT refunds and the CTA<sup>32</sup>, a society of private sector members and entrepreneurs. The agenda of such meetings follows certain specific cases that both actors wish to be discussed, and by all accounts, the initiative is proving to be extremely constructive, with both sides softening their views considerably having seen the others' point of view.

In theory, of course, refunds for non-exporting companies should only arise in 'exceptional circumstances' (see [www.iva.mz](http://www.iva.mz)), such as a start-up company incurring large initial procurement costs and low sales. Somewhat surprisingly therefore, DGI receives a huge number of refund requests every month, from companies claiming to be in a net credit position vis-à-vis the tax authorities. To address this, in other countries many tax codes incorporate a carry-forward period of a few months, allowing the

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<sup>31</sup> Decree 29/2000.

<sup>32</sup> CTA, Confederação das Associações Económicas de Moçambique.

transient net credit position of such entities to self-extinguish, and thus reducing the administrative burden on authorities. While the period in Mozambique is currently a generous 12 months- seen by many as almost too long- this is offset to some extent by a very low limit over which refunds can be claimed immediately<sup>33</sup>. Though aggregate data detailing the reasons behind refund claims has not been compiled, tax officials do blame a plethora of low-value refund claims for clogging the system- Refund claims that in many cases would almost certainly ‘work-out’ after a few months.

Further slowing the system is the fact that refund payments, once approved, are treated as expenditures, thus requiring approval from the National Treasury. The country budget simply does not include a line item specifically for VAT refunds, with revenue booked on a net basis. Such an arrangement is viewed by many private sector actors as unacceptable- approved refunds represent money rightfully belonging to the taxpayer, not the government.

As a result of the above system and associated complications, the ratio of VAT refunds as a percentage of VAT collections over the past five years has been between 5 and 10%, though rising more recently. Unfortunately no organised and accurate data exists looking at the reasons behind reimbursement requests, though anecdotely a large proportion arises from exporters. Moreover, a significant number involve relatively low amounts, just above the afore-mentioned lower limit over which refunds can be claimed- further giving credence to the argument for raising the bar in this regard.

### 3.5. Audit and Control of Corporate Tax Payers

Like the majority of national fiscal systems, the collection of taxes in Mozambique relies largely on self declaration and assessment. As McCarten (2005) notes, such a system is based on “the presumption that it is possible to attain a reasonable level of taxation

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<sup>33</sup> Currently 50,000 MTn.

compliance by test-checking a small sample of (tax) returns.” This observation can never be more true than in the case of Mozambique, where the audit department suffers from a very real lack of human resources.

As with the case of tax collections, taxpayer registration and so on, it is the local fiscal authorities who are responsible, at least initially, for conducting the audit and inspection of corporate taxpayers. At the start of the year, a plan is submitted detailing target sectors and individual companies to be audited, and inspections are conducted throughout the coming twelve months, with support from the central level. Above all, the process of audit is characterized by a marked lack of human capacity, and in many ways this is the primary influence on strategy. It is simply impossible to conduct audits of the same company on a regular basis. Therefore companies are often targeted according to their track record.<sup>34</sup> Moreover, large companies are prioritized, with the few highly qualified staff working on such cases. The process is also an interactive one- exploiting the fact that, in general, companies are willing to help the auditors and are not necessarily evading their tax obligations on purpose. Informative letters communicating the upcoming visit and its objectives are thus sent to the target company in advance, and following the inspection, findings are communicated to the company giving them a chance to react and implement recommendations before proceedings continue.

Due to the lack of capacity to conduct regular inspections, it is often the case that audited companies in one year are those that were not audited in the preceding year. It is difficult to know exactly what proportion of tax returns are audited, though it is a safe assumption that the number is very low- Currently, there are approximately one hundred qualified auditors in DGI, trying to manage c20,000 corporate taxpayers. As a result, long periods of time can pass between audits, with the only certainty being that a company would expect to receive at least one visit every five years, given that that is the period over which debts to the tax authorities expire.

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<sup>34</sup> For example, VAT credit accumulations and year-on-year losses declared.

The complexity of the tax code also represents a significant hindrance. Taking corporate tax<sup>35</sup>, the tax levied on profits earned by a company, as an example, to arrive at the 'taxable profits' figure, numerous additions and deductions to gross profit are required. Checking the accuracy of the numbers provided by the corporations on their tax forms in this regard, is by no means easy, with a large element of inbuilt trust on the part of the authorities- for instance, when an extract from the bank account of a taxpaying company is required for audit purposes, it is the company who solicits the information from its bank, not the tax authorities. DGI, therefore, has no way of knowing whether the taxpayer is providing the complete picture of all of its bank accounts, and consequently, the totality of its earnings.

In 2006, the objective is to audit over 600 companies, with particular attention on the hotel, wholesaler, and civil construction sectors. However, more broadly, emphasis in the audit department is very much on the training of the existing workforce, as well as the recruitment of an additional fifty qualified accountants. Education of the taxpayer is also a priority, with various initiatives underway to facilitate self-assessment and voluntary compliance. Common problems encountered during audits include the misclassification of expenditure, and in the case of VAT, the lack of any invoice issuance.

In this regard, the recent introduction of a 'tax shop' in Maputo should help. Located centrally, a 'one stop shop' for all fiscal queries has been set-up, offering help on all matters related to tax. The shop currently serves approximately 150 customers per week, primarily advising taxpayers on how to fill in their tax returns and clarifying fiscal legislation. The office also has a computer terminal in which one can register formally for a personal tax identification number (NUIT). Pending on the success of this initiative, other similar units are planned to be installed in some of the other larger towns around the country over the coming years.

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<sup>35</sup> IRPC: Imposto de Rendimento das Pessoas Colectivas.

There is no doubt that the tax administration of Mozambique faces significant and fundamental challenges if it is to increase collections efficiently and equitably. However what is clear, most notably in the recent past, is that many of these problems are acknowledged by the fiscal authorities themselves, and a number of steps have been taken in the right direction. In nominal terms, domestic tax revenue consistently rises by double digit amounts year on year, most markedly in the key items of corporate tax, income tax, and VAT. Importantly, given the high inflationary conditions, the same can be said when analyzing collections growth in real terms. In relation to the taxable capacity of the economy, a crude measure of the ratio of tax receipts to GDP yields more mixed results, though the overall trend is a positive one. There remains, however, a long way to go if Mozambique is to reach levels in-line with its peer group in Sub-Saharan Africa, who enjoy tax collections to GDP ratios in the high teens- as mentioned in footnote 20, under the guidance of the IMF, the DGI aims to attain 14.7% in 2007.

#### **4. The Next Step: A Central Revenue Authority**

In the same month as the general tax law of the DGI was approved, December 2005, the Assembly of the Republic approved a law creating the Autoridade Tributária de Moçambique (ATM)<sup>36</sup>. The ATM is an organ of the state, under the tutelage of the Ministry of Finance but enjoying administrative autonomy. In effect, we see the creation of an authority, with responsibility for the administration of *all* taxes, today collected by the fiscal authorities of both DGI and DGA. The body will be gradually introduced through three broad phases, becoming fully operational, it is planned, by the end of 2010. The ATM then, is basically a fusion of DGA (responsible for the application of customs and excise duties and VAT on the border), and DGI (responsible for the collection, control and audit of domestic taxes) into a central revenue authority. At its core, the broad administrative idea behind its creation is to promote a synergy between the different common functions of the collecting bodies.

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<sup>36</sup> Lei 1/06.

The hope is to present the taxpayer with a unique fiscal representative body, improving relations between taxpayer and the state, and ensuring the efficient application of the fiscal law. Officially, given ATM's autonomy-enhancing mechanisms, justification for its creation cites many of the points one might expect: to improve the efficiency and equality in the application of internal and external fiscal policy; to obtain economies of scale in the use of public resources by rationalizing many of the costs of fiscal administration; to increase capacity to detect tax evasion; to take further action in the area of fiscal education and the public understanding of fiscal obligations; to further disseminate access of the public to all tax-related information; and to facilitate taxpayers to fulfill, voluntarily, their fiscal commitments.

All laudable objectives, certainly, and difficult in many cases to question. It remains unclear, however, as to the true extent of integration between the two collecting bodies that is being envisioned. At the moment, the two institutions, DGI and DGA, have been kept very much separate, operating in their respective silos, and with only some cursory interaction in terms of day-to-day work. Given the different cultures and stages of reform, it may well be some time before one sees a true and complete merger. Moreover, once one moves away from some of the broad textbook rationales outlined above, it becomes difficult to identify many more tangible possible benefits. Working together in the area of audit and inspections, for example cross-checking data and so on, provides one example here.

Having said that, one can broadly identify two areas where the sharing of functions is legislated. Firstly, in addition to the two legs of the DGA and DGI, a third is planned in the form of a Directorate of Common Services. It is potentially here that one will see many of the more tangible efficiencies being gained from the new structure, with common human resource, information technology, internal audit and budget functions. Secondly, is the area of policy formulation, and it is to this that we now turn.

In this regard, two units are envisaged. Interestingly, neither lies within the DGI or DGA. Firstly is the **Conselho Superior Tributário**<sup>37</sup>, the highest organ of the central revenue authority. Comprised of the President and the General Directors of the ATM, and envisaged to convene once every three months, this unit is responsible for the proposal and preparation of fiscal and customs policy, the establishment of the general guidelines which will orientate the ATM, and the definition of the objectives and priorities of the ATM's principal activities. In addition, we see the **Conselho da Fiscalidade**<sup>38</sup>, a unit currently planned to report directly to the President of the ATM, and described as a consultative organ, with the objective of analyzing and accompanying the evolution of the fiscal system and tax policy. Interestingly, the unit is legislated to incorporate a diverse range of actors, led by the President of the ATM, and not only including the General Directors of DGA and DGI and other sub-directors, but also three representatives from the private sector and any invited experts, external to the ATM.

Importantly, a special advisory unit reporting directly to the minister has also been proposed by a number of external actors looking at the tax administration. Such a unit would act to complement, not replace the Directorate of Studies within DGI, and would broadly look to advise the minister on the formulation of tax policy and on any decisions in the area. The office is viewed as highly necessary by its advocates, who worry that tax officials generally will tend to assign a greater emphasis to the ease with which taxes can be collected and to the financial interests of the government, than to the quality of the taxation and the economic implications of different fiscal policies. The unit would sit between the President of the ATM and the Minister of Finance. Given the apparent extensiveness of expertise to be involved in the formulation of fiscal policy within the ATM, and the existent Office of Studies of the Minister of Finance, one may well question the need for an additional policy unit.

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<sup>37</sup> Conselho Superior Tributário, Lei 1/2006, Artigo 7.

<sup>38</sup> Conselho da Fiscalidade, Lei 1/2006, Artigo 10.

## 5. Concluding Remarks

This chapter had a simple purpose: to outline selective institutional features from the two tax agencies that make up the recently-established ATM. This has been done from two different angles. In the case of *Alfandegas*, we focused on the institutional design and challenges from the perspective of the recent customs reform. In the process, we have also attempted to draw some basic preliminary lessons from autonomization based on comparisons of pre and post-reform periods. We noted, at the same time, that customs administration-related outcomes are subject to a multitude of causal (exogenous) factors so that measuring with precision the marginal effect of reform is often complicated, requiring more rigorous quantitative analysis (i.e. including availability of data). One key lesson from this case study of *Alfandegas* is that, more than anything else, it really matters to get internal incentives right (i.e. good top management and professionalization) if the tax base is ever to be successfully expanded in a sustained fashion. In the case of the General Directorate for Taxation, on the other hand, we tackled the institutional design and challenges through the three windows of the payments system, the process of Value Added Tax (VAT) refunds and the audit and control of corporate taxpayers.

We would like, finally, to highlight two important caveats that should be borne in mind having read the above account. First, the fiscal environment of Mozambique is an exceptionally complex one, with a huge diversity of taxpayers, tax legislation, and initiatives being undertaken. As such we do not pretend to have produced an exhaustive account of all of the key issues. The hope is simply to give some *flavour* as to the institutional design, the reforms, and the challenges faced. Second, things are continuously changing as we speak: the exact organizational structure of the ATM continues to be tweaked, and reforms are answering certain problems while new challenges are arising. The chapter is reporting on the fiscal status quo of Mozambique, and it is likely therefore, that certain points written below might become less relevant in the months and years to come.

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