

UNLOCKING MUNICIPAL POTENTIAL:

## Revenue leakages and strengthening the municipal fiscal system in Mozambique



**M**ozambique's decentralization process, while laudable in its aim to empower local governance and improve service delivery, has encountered significant challenges in ensuring the financial sustainability of municipalities. This policy brief delves deeper into the critical issue of revenue leakage in Mozambique's municipal tax system, exploring the complex interplay of factors that contribute to this persistent problem. By identifying these key challenges and proposing concrete, evidence-based policy recommendations, this paper aims to provide a

roadmap to strengthen municipal finances, foster local economic growth, and improve citizens' lives. The analysis reveals shortcomings in tax administration, widespread low compliance by taxpayers, and critical gaps in the legal framework as key drivers of revenue leakage. Addressing these issues through a multi-pronged approach, encompassing institutional reform, capacity building, and enhancing transparency and accountability, is essential to unlocking the full potential of municipalities and achieving sustainable local development.



**Building a strong and sustainable municipal financial system requires strong political will, effective coordination between different levels of government, and the active participation of civil society and development partners. By working together, Mozambique can unlock the full potential of its municipalities and create a more prosperous and equitable future for all its citizens.**



## 1. Introduction:

Decentralization, a cornerstone of governance reform in many developing countries, promises to bring decision-making closer to citizens and adapt public services to local needs. In Mozambique, the decentralization process, which began in the 1990s, aimed to empower local governments and improve service delivery.

However, the devolution of budgetary responsibilities has not been matched by a proportional increase in the capacity of municipalities to effectively mobilise resources. This mismatch between responsibilities and resources is at the heart of the revenue leakage challenge that plagues many Mozambican municipalities. Although Mozambique has shown some progress in

improving its overall tax-to-GDP ratio, with performance above the sub-Saharan average (Tax Justice Network Africa, 2020), significant leakages persist, particularly in the municipal tax system. These leakages, stemming from a complex interplay of administrative, legal and socio-economic factors, severely limit the capacity of municipalities to finance essential services, invest in infrastructure and promote local economic development.

This policy brief provides a comprehensive analysis of the sources of these revenue leakages, with the aim of providing actionable policy recommendations to strengthen municipal finances and promote sustainable local development.

## 2. The Challenge of Revenue Leakage in Municipalities in Mozambique

Revenue leakage, in the context of public finance, refers to the loss of potential revenue due to inefficiencies, gaps or non-compliance within a tax system (Bird & Zolt, 2008). This phenomenon significantly compromises the ability of governments, particularly at the local level, to finance essential public services and promote economic development (Fjeldstad, 2011). In Mozambique, the issue of revenue leakage within municipalities poses a major obstacle to decentralization objectives, pre-

venting these local authorities from effectively fulfilling their mandates (World Bank, 2011). Understanding the scope and underlying factors of this leakage is critical to identifying and implementing appropriate policy solutions.

To fully understand the complexities of revenue leakage in Mozambican municipalities, it is essential to trace the evolution of the municipal tax system within the framework of decentralization and explore the early years of implementation of this framework.

### 2.1. Evolution of the Municipal Tax System

The evolution of Mozambique's municipal fiscal system is inextricably linked to the country's decentralization process, which began in the late 1990s. Prior to that, local governance structures had limited autonomy, relying heavily on transfers from the central government. The drive for decentralization aimed to empower local authorities and improve local service delivery by giving them the ability to raise their own funds.

In 1998, the first municipalities were created, and the early years of decentralization were marked by considerable challenges as nascent local governments struggled to develop capacity and establish effective financial management systems. The

lack of administrative infrastructure and technical expertise in municipal governments, particularly outside large urban centers, made it difficult to implement and enforce effective tax collection mechanisms. A significant step in the formalization of this system was the enactment of Law No. 1/2008 (Municipal Finance Law).

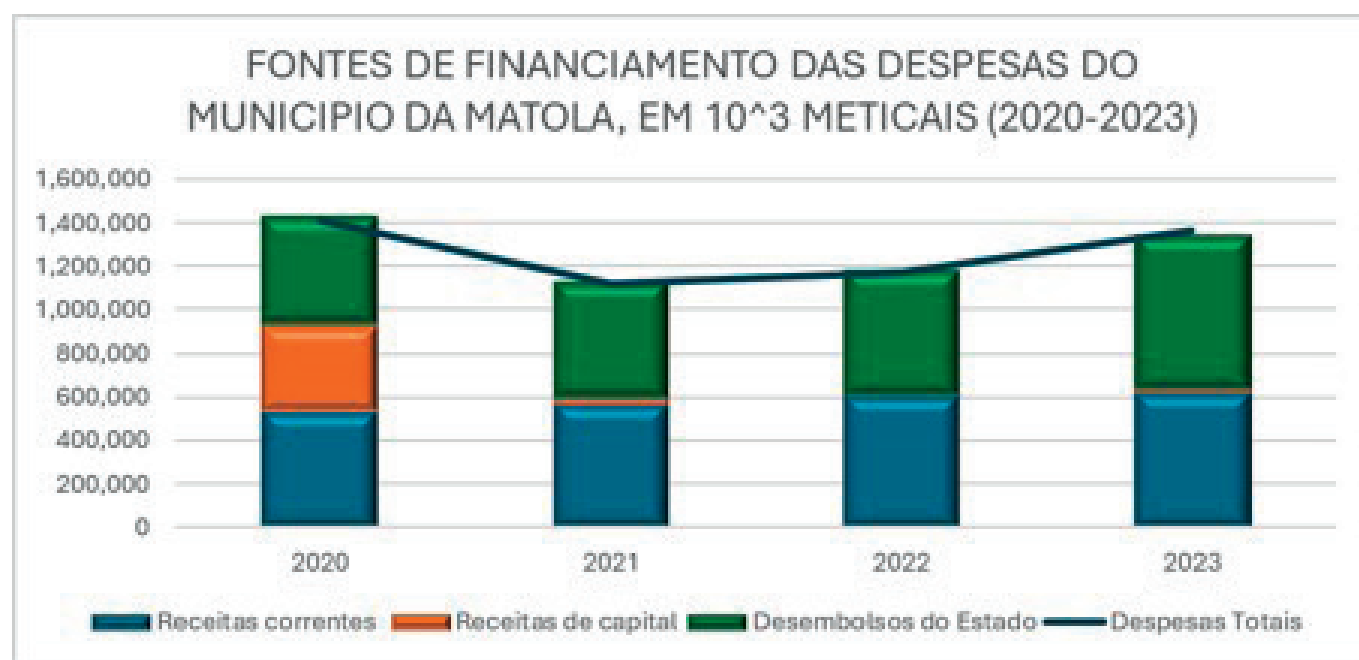
The Municipal Finance Law (Law No. 1/2008) was designed to define the financial, budgetary and asset regime of municipalities and to explicitly enable them to generate their own revenues through a diverse set of taxes and levies. These include the Municipal Property Transfer Tax (municipal SISA), which is levied on real estate transfers; Vehicle Tax,

which is applicable to vehicle ownership; Municipal Property Tax (IPRA), which is levied on property ownership; Municipal Personal Tax (IPA), which is designed as a minimum contribution from residents and replaces the previous National Reconstruction Tax and is levied on residents aged between 18 and 60; the Improvement Contribution, which is applied to properties benefiting from public works; and License Fees and Economic Activity Fees (TAE), which govern commercial activities and the provision of services within the municipal jurisdictions. The operationalization of the Municipal Tax System was finalized with the publication of the Municipal Tax Code, approved by Decree No. 63/2008 on December 30.

Despite this legislative framework, the imple-

mentation of the tax system has faced several difficulties, as evidenced by data from the General State Account (CGE), which show that, although total expenditure tends to increase over time, there is still significant variability in capital and current revenues, with constant pressure on and dependence on State transfers. This fact results in financial instability and challenges in long-term planning and investments. Data from the CGE (2020 – 2023) show that the State disbursed on average 48% of the resources available to municipalities in that period, with expenditure increasing to 53% in 2022 and 2023. This fact also denotes a growing dependence of municipalities on State disbursements, which tend to exceed the total revenue generated by Municipalities (see chart 1).

**Figure 1:** Sources of Financing for Total Expenditure of Municipalities in Mozambique in 10<sup>3</sup> MTs (2020-2023)



Source: CGE Data 2020-2023

For example, the experience in Maputo province highlights the practical challenges faced by municipalities. During the early years of decentralization, municipalities in this province, especially smaller ones such as Boane and Marracuene, faced challenges related to a lack of administrative infrastructure and insufficient technical training, which led to their failure to enforce taxes and raise revenue. The absence of modern tax management systems, such as electronic taxpayer registration and digital tax collection platforms, led to

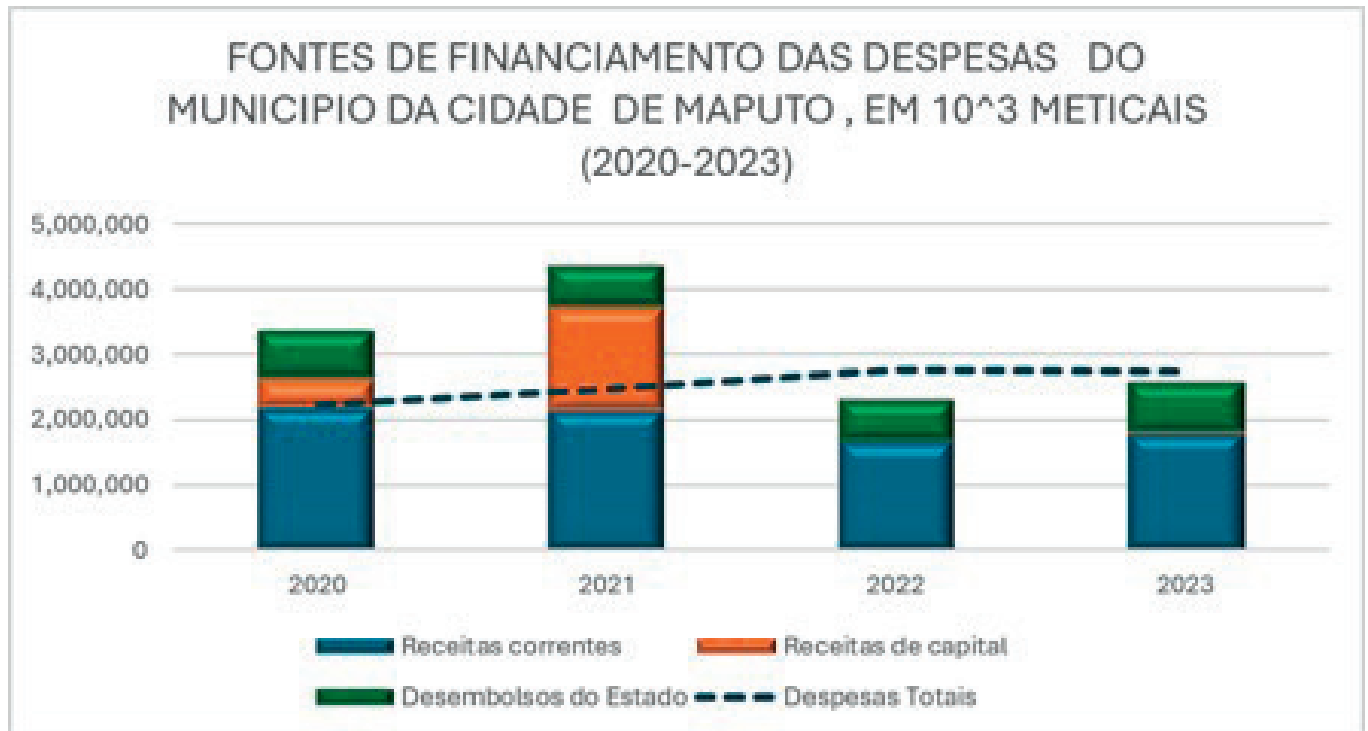
a heavy reliance on traditional, often inefficient, collection methods. Limited technical training of municipal managers, particularly in rural areas, resulted in inconsistent enforcement of tax laws and inefficient revenue management.

Larger municipalities, such as the city of Matola, have made some progress due to urbanization and increased economic activity, but have still faced challenges related to tax evasion and ineffective enforcement. In response, capacity-building initiatives, often supported by international

partners such as USAID, have been implemented to address gaps in technical expertise. The government has initiated efforts to modernize tax systems, as evidenced by the 2008 Municipal Tax Code, seeking to standardize procedures and increase transparency and efficiency. However, the

persistence of revenue leakage, evidenced by the gap between expenditures and revenues generated and safeguarded by government transfers (see chart 2), despite these efforts, indicates that these measures have not yet fully addressed the problem.

**Figure 2:** Sources of Financing for the Municipality of Matola’s Expenses, in 10<sup>3</sup> MTs (2020-2023)

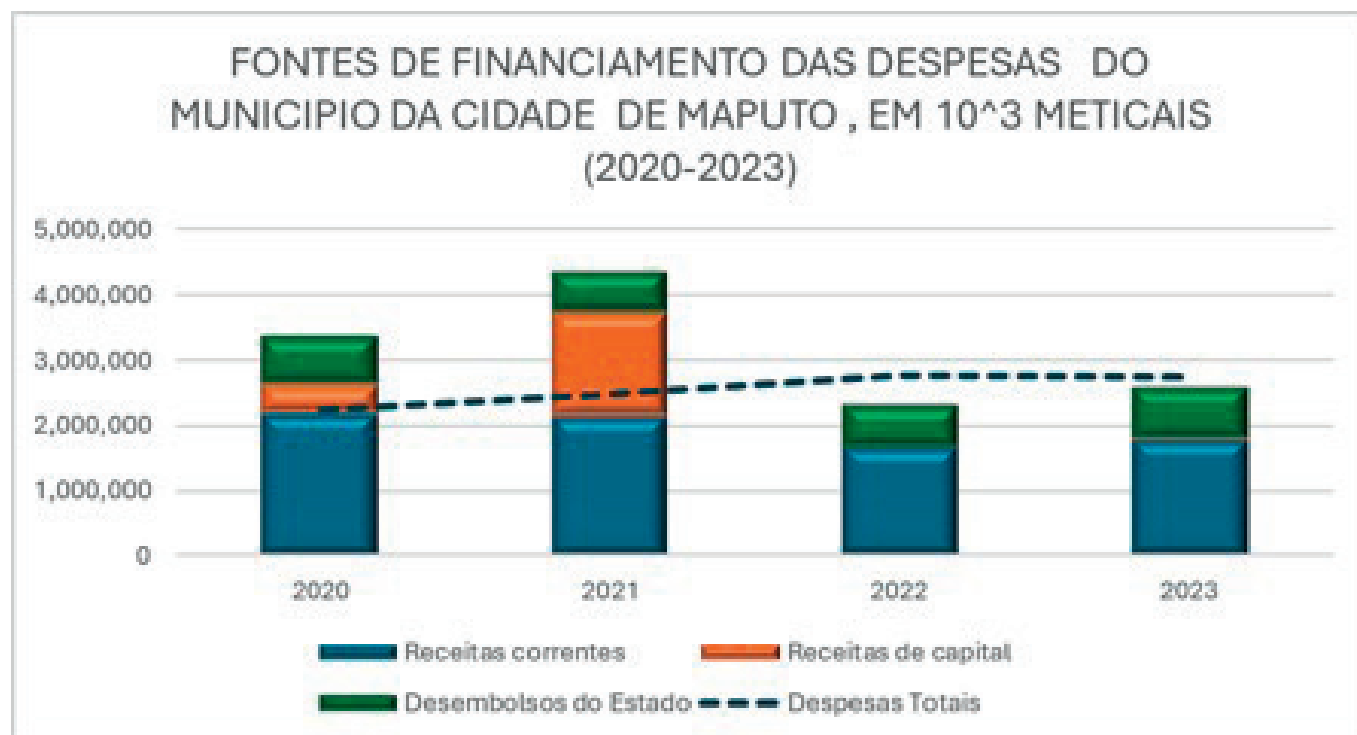


Source: CGE Data 2020-2023

While current revenues in Matola Municipality show stability, in Maputo Municipality there is not the same stability, and capital revenues in both cases have fallen significantly since 2021 in Matola

and 2022 in Maputo (Graphs 2 and 3). This decline may indicate potential challenges with long-term investment or project financing.

**Figure 3:** Sources of Financing for the Expenses of the Municipality of the City of Maputo, in 10<sup>3</sup> MTs (2020-2023)



**Source:** CGE Data 2020-2023

The normal trend over time is for both the municipal population and urban expansion in each municipality to grow, with a corresponding increase in municipal expenditure each year. This increase, when not accompanied by growth in municipal revenues, puts the very concept of decentralization at risk, while increasingly overloading the General Budget. As shown in graphs 1 to 3, the increase in

municipal expenditure tends to be supported by transfers from the State, a fact that results in a high level of dependence on the State General Budget and a relative loss of autonomy. For this reason, it is imperative and urgent to understand the reasons that prevent the growth of municipal revenues and to implement appropriate reforms with a view to sustaining the decentralization project.

## 2.2. Tax Revenue Leakage in Municipalities in Mozambique

Revenue leakage in Mozambique's municipalities manifests itself in a variety of ways, each of which contributes to the overall erosion of the local tax base. Low taxpayer compliance is a widespread issue, with a significant portion of potential tax revenues not being collected due to a combination of factors. A lack of awareness among citizens about their tax obligations, coupled with limited trust in local government institutions and the perception of the complexity of tax procedures, contributes to this widespread non-compliance (World Bank, 2011). In addition, weak tax administration, characterized by limited staff capacity, inadequate IT systems and complex bureaucratic processes, hinders efficient and effective tax collection.

Municipal tax administrations often lack the resources and expertise to enforce tax laws, conduct audits and persuade tax evaders, creating an environment conducive to non-compliance. Compounding these challenges are significant gaps in the legal and regulatory framework governing municipal taxation. Ambiguities and gaps in tax laws, particularly those related to property taxation and business licensing, provide opportunities for tax avoidance and evasion. Inadequate enforcement mechanisms further weaken the system by creating disincentives to voluntary compliance (Prichard, 2015).

The prevalence of informal economic activities in Mozambique adds another layer of complexity

to the problem of revenue leakage. Traditional tax instruments designed for formal businesses are often ineffective in capturing revenues from the informal sector, which constitutes a substantial part of the Mozambican economy (Moore, 2008; Sambo and Lunga, 2025). This informality makes it difficult to assess and collect taxes, further eroding the municipal tax base. These challenges are ex-

acerbated by the limited fiscal autonomy of many municipalities, which rely heavily on transfers from the central government (as demonstrated in Figures 1, 2 and 3). This reliance on intergovernmental transfers can create disincentives to improve own-source revenue collection and limit the ability of local governments to respond effectively to local needs and priorities (Roy, 2008).

### 3. The socio-economic impact of revenue leakage

The consequences of revenue leakages are far-reaching and go beyond mere budgetary constraints. Shortages in municipal revenues have a direct impact on the quality and availability of essential services, including water and sanitation, waste management, public transport and the provision of critical infrastructure. These shortfalls in service delivery have profound implications for public health, quality of life and economic productivity (Fjeldstad, Chambas, & Brun, 2011).

Underfunded municipalities struggle to attract investment, create employment opportunities and effectively address local development challenges, ultimately undermining poverty reduction efforts and exacerbating inequalities between urban and rural areas. A lack of adequate resources also limits municipalities' ability to respond to emergencies such as natural disasters or public health crises,

further compromising their capacity to deliver essential services and protect the well-being of their citizens.

However, it is important to note that these negative effects resulting from underfunding of expenditures can also result from poor management or harmful use of revenues. Overbilling and large budget allocations for non-priority actions and purposes, as well as large investments in non-functional systems, creation of unnecessary demands and outsourcing of essential services that should be performed by idle employees, among others, can give rise to a constant feeling of insufficient revenues. However, it is inflationary forms of expenditure that create serious management problems as they prevent public managers from achieving their municipal socioeconomic development objectives.

### 4. Policy recommendations to address revenue leakage:

Addressing the complex challenge of revenue leakage requires a comprehensive and multi-faceted approach. This guidance document proposes a set of concrete policy recommendations organized around key areas for reform:

#### i. **Strengthening tax administration:**

A robust and efficient tax administration system is the cornerstone of effective revenue mobilization. Investing in human capital is essential. Comprehensive training programs for municipal tax officials should be implemented, focusing on enhancing their technical skills in areas such as tax law, assessment, collection, and enforcement. These programs should also incorporate modules on

taxpayer services, ethical conduct, and anti-corruption measures, fostering a culture of professionalism and integrity within the tax administration.

Modernizing tax administration systems is also crucial. Implementing or upgrading integrated IT platforms is essential for efficient data management, taxpayer registration, revenue tracking and analysis. Developing online tax filing and payment systems can significantly increase convenience and transparency for taxpayers, encouraging voluntary compliance. Exploring the use of mobile money platforms for tax payments can further expand reach, particularly in remote areas with limited access to traditional banking services.

Simplifying tax procedures is another key element

of strengthening tax administration. Streamlining tax processes and reducing administrative burdens for taxpayers, especially small businesses and informal operators, can significantly improve compliance. Simplifying tax forms, providing clear and accessible guidance on tax obligations and establishing dedicated helpdesks to assist taxpayers can make the tax system more user-friendly and encourage voluntary participation.

Finally, strengthening enforcement capacity is crucial to deter non-compliance and ensure that all taxpayers meet their obligations. Strengthening enforcement mechanisms, including sanctions for non-compliance, implementing efficient audit procedures and establishing effective dispute resolution mechanisms are essential steps. Setting up dedicated tax enforcement units within municipal tax administrations can further strengthen the capacity to detect and combat tax evasion.

#### **ii. Reform of the legal framework:**

A clear, comprehensive and enforceable legal framework is the foundation of a fair and efficient tax system. Reviewing existing tax legislation to eliminate ambiguities and gaps, particularly in areas such as property taxation and business licensing, is a critical first step. Clearly defining tax bases, rates, exemptions and payment procedures can minimize opportunities for tax avoidance and evasion.

Strengthening property taxation requires a multi-faceted approach. Implementing a comprehensive cadaster and property registry can significantly improve the accuracy and completeness of property tax assessments. Regularly updating property assessments to reflect market values ensures fairness in the tax burden and maximizes revenue potential. Introducing tax incentives for sustainable development practices can further encourage environmentally responsible land use.

Modernizing business licensing procedures can also help improve revenue collection. Streamlining business licensing processes and introducing online application and renewal systems can reduce administrative burdens for businesses and increase transparency. Developing a clear and transparent fee structure for business licenses, ensuring fairness and predictability for businesses, is essential to fostering a business-friendly environment.

#### **iii. Improve revenue sharing mechanisms:**

The design of intergovernmental fiscal relations

plays a crucial role in the financial sustainability of municipalities. Strengthening fiscal autonomy by allowing municipalities to retain a larger share of locally generated revenues can encourage better revenue collection and empower local governments to respond more effectively to local needs. It is essential to develop fair and transparent revenue-sharing formulas between central and local governments. These formulas should be based on objective criteria such as population, poverty levels and service delivery needs, ensuring that resources are allocated fairly and efficiently.

The introduction of performance-based grants can further incentivise municipalities to improve their own revenue stream and service delivery performance, promoting accountability and good governance.

#### **iv. Addressing the issue of the informal economy:**

Integrating the informal economy into the formal tax system is a crucial step towards broadening the tax base and increasing revenue mobilization. It is essential to develop simplified tax regimes tailored to the specific characteristics of small businesses and informal operators. Such regimes should feature lower tax rates and simplified compliance procedures, facilitating the entry of informal businesses into the formal tax system. Presumptive taxation methods, based on estimated turnover or other readily available indicators, can be particularly effective in capturing revenues from the informal sector. While such regimes are already being implemented at national level, complementing such simplified tax regimes with targeted outreach and education campaigns can further encourage formalization.

Raising awareness among informal businesses about their tax obligations and the benefits of formalization, such as access to credit and government support programs, can encourage participation in the formal economy. Providing training and support to help informal businesses transition to the formal sector can further facilitate this process. Implementing a phased approach to integrating informal businesses into the formal tax system can ease the transition and minimize disruption. Starting with simple registration requirements and gradually introducing more comprehensive tax obligations can allow informal businesses to adapt to the formal system over time.

#### **v. Strengthening transparency and accountability:**

Transparency and accountability are essential to build public trust and ensure efficient and equitable use of public resources. Promoting greater transparency in municipal budgets and expenditures is essential. Publishing budget documents online, conducting public consultations and establishing citizens' budget committees can empower citizens to participate in the budget process and hold local governments accountable. This is perhaps one of the priority challenges for municipalities in Mozambique, given the scarcity of budget data.

Strengthening oversight mechanisms is equally important. Internal audits, independent reviews and citizen monitoring can help ensure that public funds are used effectively and efficiently. Empowering local civil society organizations to play a watchdog role can further improve accountability and transparency.

Public procurement reform is another critical area for enhancing transparency and accountability. Creating a transparent and competitive public procurement system at the municipal level can ensure value for money and prevent corruption, maximizing the impact of public spending on local development.

#### **vi. Technological improvements:**

Harnessing the power of technology can significantly improve tax administration and revenue collection. Implementing electronic tax filing and payment systems can simplify tax processes, reduce compliance costs, and increase transparency. Exploring the use of mobile money platforms and other digital payment solutions can further facilitate tax payment and expand access to the tax system, especially for those in remote areas.

Using data analytics can provide valuable insights into taxpayer behavior and improve risk as-

essment. Identifying patterns of tax evasion and targeting enforcement efforts more effectively can maximize the impact of limited enforcement resources. Developing data-sharing mechanisms across government agencies can further improve tax compliance by enabling cross-referencing of taxpayer information.

Geographic Information Systems (GIS) technology can also play a crucial role in improving property taxation. Mapping property locations, improving property valuations, and identifying unregistered properties can increase the accuracy and completeness of property tax assessments. Integrating GIS data with tax administration systems can further increase the efficiency and accuracy of property tax assessment and collection.

#### **vii. Strengthening intergovernmental cooperation:**

Effective intergovernmental cooperation is essential to ensure the proper functioning of the tax system and maximize revenue mobilization. Establishing clear coordination mechanisms between national and local tax authorities can avoid duplication of efforts and ensure consistent application of tax legislation. Regular forums for dialogue and information sharing between different levels of government can facilitate collaboration and knowledge exchange.

Providing technical assistance to municipalities in developing and implementing effective tax policies and administrative procedures can strengthen local capacities and improve revenue collection. Facilitating peer learning and knowledge sharing between municipalities can reinforce best practices and promote innovation in local tax administration. Joint audits of municipal finances by national and local audit institutions can improve accountability and identify areas for improvement, strengthening financial management at local level.

## 5. The role of civil society and development partners:

Civil society organisations (CSOs) and development partners play a crucial role in supporting the implementation of these policy recommendations and fostering a culture of tax compliance. CSOs can leverage their deep understanding of local contexts and close relationships with communities to advocate for policy reforms that strengthen municipal finances. Raising public awareness of the importance of tax compliance and the link between taxes and service delivery is essential to strengthen public support for tax reforms.

CSOs can also play a vital role in providing training and technical assistance to municipal tax officials and other stakeholders on tax policy, administration and advocacy. Their expertise in areas such as community engagement, participatory budgeting and social accountability can complement the technical skills of government officials and increase the effectiveness of tax reforms.

Monitoring the implementation of tax reforms and assessing their impact on revenue mobilization and service delivery is another crucial role that CSOs can play. Independent monitoring and evaluation can provide valuable insights into the effectiveness of reforms and identify areas where adjustments are needed. Sharing these findings with policymakers

and the public can foster accountability and ensure that reforms are implemented effectively.

Furthermore, CSOs can contribute to the evidence base on municipal finance challenges by conducting research and analysis. Identifying innovative solutions to improve revenue mobilization and sharing these findings with policymakers and other stakeholders can contribute to the development of more effective fiscal policies and administrative procedures.

Development partners can play a complementary role in supporting municipal finance reform. Providing financial and technical assistance to municipalities and CSOs can strengthen local capacity and support the implementation of policy recommendations. Supporting the development of robust monitoring and evaluation frameworks can further enhance the effectiveness of reforms.

Facilitating knowledge sharing and exchange between Mozambique and other countries facing similar challenges can provide valuable lessons and best practices. By working in partnership with government agencies, CSOs and other stakeholders, development partners can contribute to the creation of a sustainable and equitable municipal financial system.

## 6. Conclusion:

Strengthening municipal finances is not just a fiscal imperative, but a development necessity. The ability of municipalities to effectively mobilize resources is crucial for the delivery of essential services, investment in infrastructure and the promotion of local economic growth.

Addressing the challenge of revenue leakage requires a comprehensive and sustained effort from all stakeholders. By implementing the policy recommendations outlined in this brief, Mozambique can empower local governments to deliver on their mandates and contribute to the country's overall development goals.

Building a strong and sustainable municipal financial system requires strong political will, effective coordination between different levels of government, and the active participation of civil society and development partners. By working together, Mozambique can unlock the full potential

of its municipalities and create a more prosperous and equitable future for all its citizens.

The successful implementation of these policy recommendations requires a robust monitoring and evaluation framework. Key indicators to track progress should include:

- **Municipal tax revenue collection:** Monitoring trends in municipal tax revenue collection is essential to assess the impact of reforms on revenue mobilization. This should include disaggregated data on different types of taxes and revenue sources.
- **Tax compliance rates:** Tracking changes in tax compliance rates across different taxpayer segments, including businesses, individuals and informal operators, can provide insights into the effectiveness of compliance improvement initiatives.
- **Tax administration efficiency:** Monitoring the

efficiency of tax administration processes, such as the time taken to process tax returns, issue refunds and resolve taxpayer disputes, can identify areas for improvement and streamlining administrative procedures.

- Citizen satisfaction with tax services: Conducting regular surveys to assess citizen satisfaction with tax services can provide valuable information on the quality-of-service delivery and identify areas where improvements are needed.
- Impact on service delivery: Assessing the impact of increased municipal revenues on the

quality and availability of essential services is crucial to demonstrate the link between improved revenue mobilization and improved service delivery outcomes. This should include indicators such as access to safe drinking water, sanitation facilities and public transport.

Regular monitoring and evaluation will provide valuable information on the effectiveness of reforms and enable policymakers to make necessary adjustments to maximise their impact. Sharing the results of monitoring and evaluation with the public can further enhance transparency and accountability.

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