GREEN economy Mozambique

Fiscal Policy Reforms

Background

Mozambique has made remarkable economic progress over the last two decades. The country has had an average annual GDP growth rate of around 8 per cent since the end of the civil war in 1992. This growth has been driven mainly by the service, light industry, and agricultural sectors and is expected to be sustained in the future with increases in foreign direct investments, particularly in natural resource projects. Despite these positive trends, Mozambique faces a number of socio-economic challenges. Employment levels have not improved with economic growth. Fifty-five per cent of the country's population lives on less than USD 1 per day while spending on social protection, health, and education has been falling since 2008. Moreover, the economy remains highly dependent on natural resources, and there is a large informal sector. Mozambique has also had a persistent fiscal deficit, which reached 23 per cent of GDP in 2014 as a result of an expansionary fiscal stance, poverty reduction policies, and infrastructure investments. In addition, the country faces various environmental challenges and risks, including deforestation, declining fish stocks, land, water, and air pollution, and loss and degradation of wetlands and rivers. These threats are compounded by the impacts of climate change and high population growth.

Key Green Fiscal Policy Measures

At the 2012 United Nations Conference on Sustainable Development, Mozambique committed to working towards a green economy with a vision to become "an inclusive middle-income country by 2030, based on protection, restoration and rational use of natural capital and its ecosystem services to guarantee development that is sustainable, inclusive and efficient, within the planetary limits". Mozambique is one of the first countries in Africa to explicitly state that it wishes to pursue such policy goals. A number of relevant strategies and policies have been developed in recent years to support the transition to a green economy. In 2012, a National Roadmap for the Green Economy was adopted, and this was followed in 2013 by an Action Plan for the Green Economy.

Fiscal policy is an important component of the country's efforts to transition to a green economy. A number of green fiscal policy measures are already in place, including:

- A fairly well-developed system of environmental taxes and fees, which generated MZN 16 billion (USD 470 million) of revenue in 2014, or 12.6 per cent of total tax revenue.
- Fuel taxes accounted for the largest share of environmental tax revenues (43 per cent), followed by income taxes on petroleum (20 per cent), mineral resources (9 per cent), and energy (7 per cent). Income taxes in the energy and mining sectors are an important element of green fiscal policy as they allow the government to recover rents from the exploitation of domestic resources.
- Specific taxes in the energy sector include a petroleum products tax, a fuel tax, and an energy concession tax. Taxes in the transport sector include a vehicles tax, a toll tax, and a road tax.
- A National Energy Fund aims to develop alternative forms of energy, including solar photovoltaic systems and mini-hydro power plants, and improve electricity access in rural areas. The fund also supports petroleum-based projects and activities, pointing to a need for closer analysis to ensure alignment of energy and environmental objectives.
- There are also a number of taxes and charges for the use of water, although due to various exemptions and loopholes, water consumption by industrial actors in the agriculture, energy, and mineral resource production sectors remains uncharged. Other green fiscal policies include fishing and maritime activity licences, taxes, and fees as well as licences in the forestry sector.

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At present, there is little fiscal space in the current budget for significant green investment at the level needed to ensure an inclusive green economy by 2030, in line with the government's objectives. It is therefore crucial to identify fiscal reforms and complementary measures that could fill the financing gap and contribute to meeting the country's green economy goals.

Options for Expanding Fiscal Space for Green Investment

- ***Develop more fiscally advantageous terms with companies operating in the extractive sectors.*** Enhancing efficiency in revenue collection and renegotiating megaprojects' contracts could increase government revenues from the extractive industry sector from the current average of 5 per cent to 30 per cent. These reforms would involve negotiating better royalty rates in contracts and concession agreements, reducing or eliminating direct and indirect subsidies offered to foreign companies, and potentially charging for carbon emissions and pollution from the extractive sector.
- ***Remove subsidies on fossil fuels.*** While the fuel subsidy has been reduced gradually in the past five years, it has not been completely eliminated. These subsidies offset the impacts and effectiveness of existing transport fuel taxes. The prevailing low global oil prices provide an opportunity to remove the subsidy completely and increase fiscal space for development priorities such as investments in improved transport infrastructure. There is also scope to remove current subsidies for small-scale diesel generation as there are no similar subsidies for solar photovoltaics technology or other small-scale renewable energy technologies.
- ***Increasing taxes on the most polluting fuels and less efficient vehicles.*** Mozambique already has a robust system of fuel and vehicle taxes, however there remains scope to further increase tax rates on the most polluting fuels and adopt higher registration or ownership fees on older, less-efficient vehicles. Such provisions can be implemented gradually while a low-carbon public transport system is developed which can provide an alternative to private vehicle use.
- ***Review charges for water abstraction, fishing, and forestry licences*** to ensure they reflect environmental externalities. Charges for water abstraction by the energy, mineral resources, and agriculture sectors could be introduced, and mechanisms for collecting effluent discharge fees could be strengthened. Increasing the price of fishing and forestry licences as well as instituting more substantial fines for illegal harvesting and overuse will help reverse current trends of overfishing and deforestation.
- ***Creation of a sovereign wealth fund*** or similar mechanism that would allow the government to use wealth generated from the exploitation of the country's natural resources for the long-term benefit of its people. The fund could be capitalized by revenues from extractive industries and could potentially be used for strategic investments in low-carbon assets.

These fiscal reform options should be accompanied by complementary measures to enhance their effectiveness, in particular there is a need for improved monitoring and enforcement efforts in the mineral resource, water, fisheries, and forestry sectors. There is also a need to address corruption in the exploitation of natural resources (particularly timber and minerals), as well as a need to clarify institutional responsibilities for environmental protection and improve co-ordination between relevant government bodies.

Way Forward

Overall, Mozambique has a robust system of environmental taxes and levies and a well-articulated green economy strategy. In the coming years, the government aims to increase tax revenues, expand its tax base, tax capital gains of enterprises that exploit natural resources, and improve the efficiency of its tax administration. These planned reforms offer a window of opportunity to introduce or revise environmental taxes and fees where appropriate. Leveraging further green fiscal policy options and improving monitoring and evaluation frameworks could contribute to the realization of Mozambique's green economy goals as well as strengthen the government's fiscal position.