

REPUBLIC OF MOZAMBIQUE



**LOCAL FINANCES SYSTEM
AND
THE FEASIBILITY OF ITS DECENTRALIZATION**

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I - INTRODUCTION

This paper is aiming to analyse the financial system of the cities and the feasibility of its decentralization, to demonstrate how the adoption of an autonomous financial system can led, on one hand, to the solution of the infrastructures' degradation and the inefficient urban management which actually a great number of our cities faces; and in the other hand, if a system like this can generate local resources to promote development.

This option is due to the fact that in these last years, there has been a great number of preoccupations of the local government responsible because of the relatively great complexity in the evolution of the political, economical, social and administrative processes in the territorial areas under their administration; contrasting to the ever greater degradation of the existing infrastructures, as a result of the weakness of the existing material, financial and human means.

The analysis of present problems of the cities' management, and the need of seeking solutions aiming to a greater performance and efficiency, what can result into improvement of the services provided to the citizens, is in the framework of the political, economical and social changes underway in our country brought by the Programme of Economical Adjustment and the 1990's Constitution.

The Law 2/87 of January 19th, approved by the Popular Assembly (Parliament) gives to the Council of Ministers the competence to assess regulations related to the status of administrative and financial autonomy, establishing the competences for the organisations and institutions that, by their nature, may gradually become self-sufficient (Art. 9, a).

The new Constitution of 1990, in its Article 116, says: "local governments ensure the participation and decision of the citizens in matters of their respective community own interest"; and later it says: "the local governments are constituted by representative bodies and executive ones...", Article 186.

These changes created favourable conditions to the involvement of communities and the adoption of participatory methods in the governance process; a system of this nature, requires the adoption of an organizational form of the local government, in which these have administrative, financial and patrimonial autonomy. The mechanism through which local governments acquire this autonomy is "Decentralization". It is in the context of autonomy that is intended to test the feasibility of selfsustained municipal management, and its impact in the provision of essential services to the citizens, and in the promotion of local government.

One of the biggest challenge to become effective the decentralization process is providing to the local governments, resources to enable them to play an effective role in the development of local communities, providing them material, human and financial resources so that they can provide services under their responsibility (local governments competences). If local governments have no resources to perform their functions, their existence will not be much more than simple fiction, and in many countries where this situation happens, they are only electoral territories or merely deconcentrated entities of higher level.

It is in this context of analysis of the public administration system and its role as catalytic agent of the development process, that resources made available by the state may play a relevant role as long as compatible options in public finances systems with autonomous local governments.

II - CONCEPTUAL REFERENCES

Our country has inherited from the colonial past, an administrative structure based essentially on the principle of centralization, that's to say, in the principle of administrative decision making reserved to the high level bodies of administration.

With the Independence, the nature of the regime was substantially modified. Anyway, it was not possible to extend fully such change up to the administrative structure. The need to reinforce the national unity and the leadership of one party, on top of the imperativeness of reaching certain political, economical and social goals went on suggesting centralism on the administrative decision making.

Therefore, the diplomas that first went through the substitution of the colonial administrative structures (laws 5/78, 6/78 and 7/78 of April 22th, 1978) opted for a model based mainly on three levels: national, provincial and local (cities and districts). At the city level these diplomas extinguished the municipal bodies and substitute them with executive city councils as executive bodies of city assemblies.

These changes had, with no doubt, great impact in the public finance system and in the conditions that they took place, it was recommended a strong financial centralization for a great rationality and make the public finances compatible with the option for centrally planned economy. This finished with the certain financial autonomy that the extinguished municipal bodies had.

It is in this perspective that in the present paper I am intending to analyse the present financial system and the feasibility for its decentralization, in a context of a public administration system in which the local government has got administrative, financial and patrimonial autonomy.

The paper will be referred to decentralization seen as concept of political nature and defined as follows:

"Decentralization is government related to decentralised entities" (Diogo Lordello de Melo - pg 1 - April 1990).

Owning government suggests autonomy which should not be confused with sovereignty (sovereignty is an exclusive feature of national states). In an autonomous local government, whatever is the adopted central government (central or federative), the following requirements are essential:

- Government elected by the population. This requirement prevails regardless the kind of government adopted locally.
- Competence of the local government to administrate their services and everything which is locally concern, such as public lighting, solid waste collection, urban cleanness, roads maintenance, construction licenses, construction works control, shop's location, and so on. Such services are, in most countries, defined by sectoral legislation or by high level government sectors.

- Enough revenues so that local governments can effectively play their role in governance process. These revenues are usually of two kinds: owns and shared revenues or central authorities transfers.
- Absence of administrative control of local governments by central authorities, in the sense that local governments do not need previous authorization to perform their actions. Local governments should be subordinated to the law and not to any other authority at other level.

II- LOCAL PUBLIC FINANCES

The present financial system

The country has a fiscal system strongly centralized which reflects the characteristics of a Public Administration Model with a centralism in the administrative decision making; which organization is characterized by the fact that each level of government works based in instructions, regulations and procedures given by the level hierarchically higher. The budgeting process includes a consultation period and budget proposal analysis. The proposals prepared at the local level are consolidated at the provincial level and later revised by the Ministry of Finance and finally included in the budget law that is approved by the Assembly of the Republic (actual name of the parliament). This law provides a limit of the expenditures as well as global amount to be transferred from the central level to each province. The amount of transfers is determined by the difference between provincial revenues structure and the expenditures approved. It is also in this base that the province allocate resources to the cities and districts according to the priorities and taking into account the limits fixed.

This system actually in force, regarding the preparation and approval process as well as its execution, does not stimulate local authorities for expenditures rationalization even for own revenues collection. Definitely, even if the execution of the budget is decentralized, the decision about the level of expenditures is the responsibility of the central authorities. There's no tradition of programming expenditures according to the revenues that may be collected.

In the present budgeting system, the province and its respective budget play an important role and even the transfers to the cities and districts are channelled through provincial budget. This does not mean that provincial authorities, although they have some autonomy in the preparation of the provincial budget

proposal, they are worried about expenditures rationality or taxes collection. This absence of preoccupation is a result of the strong centralization of decision making.

The strong feature of public finances in Mozambique is the fiscal deficit measured by the difference between revenues collected (fiscal and not fiscal), and the total expenditures carried out. In 1990, the state collected 22.2% of GNP, as shown in the following table:

INDICATORS OF BUDGETARY POLICY (IN % OF GNP)

ITEM	1985	1986	1987	1988	1989	1990	1991(a)
1. Total Incomes	13.1	13.1	16.2	19.9	23.4	22.2	23.9
2. Current Expenditures	16.3	25.3	21.9	22.3	26.8	27.5	26.4
3. Current Balance	-3.2	-12.0	-5.7	-2.7	-3.4	-5.3	-2.5
4. Investment Expend.	4.5	5.6	16.1	21.3	22.2	24.2	24.8
5. Total Expenditures	20.8	30.9	38.0	43.9	49.0	51.7	51.2
6. Global Balance I (b)	7.7	-17.6	-21.8	-24.0	-25.6	-29.5	-27.3
7. Donations	2.1	2.4	8.9	14.0	16.5	16.9	21.2
8. Global Balance II (c)	-5.6	-15.2	-12.9	-10.0	16.5	16.9	21.2
9. Financement	5.6	15.2	12.9	10.0	9.1	12.6	6.1
9.1. External Loans (d)					8.5	12.6	6.8
9.2. Others					0.6	-	-0.7

Source: CNP/DNE, "Informação Estatística 1991", pag 22 and 141.

- (a) Provisional data
- (b) Before including donations
- (c) After including donations
- (d) Net.

The problem of deficit become more critical if it is considered the fact that tributary charge in the country is relatively high, about 22.2% of GNP in 1990 and therefore, it would be expected an increase of the Gross National Product.

The principal source of the fiscal deficit financment has been external resources, made available through donations or loans in composition of the state budget for 1991, since incomes and expenditures are still in the same level of 1990.

Being the major part of the external resources related to projects classified as investments, the investment tax (Inv/GNP) increased considerably in these last years from 6.9% in 1985 to 42.7% in 1991. The part corresponding to the public investment in the same period was 4.5% and 24.8% respectively, what shows that the state absorbs the major part of the resources allocate to the investment.

In the present tributary system, it is of central government competence the most relevant taxes, not only as a political economical instrument but also in terms of collection of those taxes. The provinces and executive city councils have the responsibility only with taxes relatively less significants (see next table).

**CURRENT INCOMES OF THE STATE
GENERAL BUDGET BY ITEMS
1990**

ITEM	10 ⁶ of Mt (per year)	Percentage (%)
1. Incomes of central budget	284,067	95.3
1.1. Fiscal revenues	268,261	90.0
. Labour income Section A	12,570	4.2
. Industrial Contribution Sections A and B	39,040	13.1
. Circulation tax	89,409	30.0
. Consumption tax	46,011	15.4
. Fuel tax	2,361	0.8
. Tax on external trade	65,319	21.9
. Other fiscal revenues	13,551	4.6
1.2. No fiscal revenues	15,806	5.3

2. Incomes of provincial budget	13,995	4.7
2.1. Fiscal revenues	2,308	0.8
. National Reconstruction tax	785	0.3
. Tourism tax	952	0.3
. Industrial Contribution tax		
Group C	127	0.05
. Labour tax - Section B	123	0.05
. Other fiscal revenues	321	0.1
2.2. No fiscal revenues	1,953	0.6
2.3. Consignated incomes	9,694	3.3
3. Total incomes State General Budget (1+2)	298,002	100.0

Source: Ministério das Finanças "OGE" pag 3/6.

By this table it can be seen that more than 95% of the total collected in 1990 belongs to the central government, missing only 5% for provincial and local levels. This distribution of competences favouring the central government, associated with the inexistent mechanism based on more objective criterions to transfer resources to the provinces and executive city councils, has led to the adoption of fortuitous system to allocate resources to finance activities executed at the local level.

Revenues

The governments of big cities, have been depending on fiscal transfers from the central government. This tendency was sharpened after the independence and actually become unsustainable. In 1988, they were adopted some measures to try to modify this tendency. Such measures consisted in the reduction of transfers to the executive city councils and the allocation of 100% of the National Reconstruction Tax that was already collected by the cities and districts governments.

On top of the transfers, the sources of revenues for districts and cities include: taxes (12%), tariffs (40%) and other taxes and contributions (15%). Based on these percentage taxes it can be concluded that transfers represent about 33% of total revenues.

The state expenditures at cities level include current expenditures of central directorates and those depending on the office of the president of the city council; some of which are covered by the provincial and central budgets. The first are covered by central and provincial budgets while the last depend on the executive city council budget whose source are: taxes of local nature and subsidies of provincial budget to the city.

Taxes

Some taxes of colonial period are still known by some local officials and some of them are included in the public registrations. Anyway, they have not been collected since 1977/78. Some officials working actually in the local governments don't know the taxes still in force, and even those taxes that are still collected, their figures need to be updated. And to become the situation worst, the mechanisms that the state have to collect taxes usually do not work properly.

The main taxes that were collected then, are:

- National Reconstruction Tax - paid by each national;
- Industrial and Commercial Contribution - applied to the industrial and commercial activities of low scale classified in group C;
- Tax on the work's income - applied only for the rural workers salaries;
- Tax on the sales (actual circulation tax).

Local governments should receive groups B and C and 25% of NRT revenues. Anyway, a great number of local governments have not collected other taxes beyond the NRT since 1988. Taxes are fixed by the central government, except those belonging to group C that are proposed by provincial government and the NRT that are fixed by provincial government and proposed by cities and districts governments.

In 1988, central government policy was changed in order to allow local governments to collect enough revenues to cover all their operational expenditures, and not to depend on the central government transfers. This new policy allow local governments to retain all NRT revenues.

Fiscal Transfers

Transfers to city and districts governments are calculated by the difference between local revenues and expenditures.

This criterion put into action an incentive in the intergovernmental fiscal transfers system of the local governments underestimating local revenues and, on the other hand, overestimating local expenditures. In this way, the current account deficit seems to be higher than it really is, maximizing incomes via transfers. This present system, at the end, compensate the bad financial management, penalting the good management; what is an unincentive to local governments initiatives to explore new sources of local incomes.

The importance of fiscal transfers as source of income varies according to the characteristics and dimension of each city or district. Fiscal transfers represent a source of financement of the big cities, having reached a level varying between 40% and 60% of total incomes in 1989. Related to small cities and districts, the transfers' level is significantly lower representing a level of 4% and 17% in Nacala and Dondo, respectively.

The fiscal transfers in percentage of the global central budget had a sharp reduction from 34% in 1985 to 13% in 1988, what may be as a result of the policy of transfers' reduction that central government adopted since 1987.

The allocation of financial resources through the investment fund, is made through evaluation of local governments proposals to provincial governments. The criterions for investment funds allocation vary, what means that each province adopt priorities according to the specific conditions. Decisions concerning investments are taken by a body called "Provincial Investment Commission" composed by four provincial directorates: Planing, Finance, Construction and Water and Agriculture. Local governments do not take part and do not participate in the debates of investment priorities and none in the phases of decision making. Therefore, Investment funds are seldom allocated efficiently.

Investment Expenditures Financement

Local governments (cities and districts) investment expenditures are financed by central government transfers to provincial governments through investments fund. There are other sources of incomes that are: provincial transfers (taxes participation or other provincial incomes); specific local incomes related to the balance of local governments current account, possibility of city and district governments to have loans to finance some investments. Some cities benefit direct or indirectly of external support as financment or donations.

Capital Expenditures

Local governments submit their project proposals of investment to the provincial government through the provincial directorate responsible for the proposed activity. The financment of the registred project is made through the investment fund after being approved by the central government and allocated resources by the provincial investment commission. Districts and cities have an operational budget referred only to current revenues and expenditures.

The investment fund request submitted to provincial governments has been one of the way to get information about investment activities already executed.

Current Expenditures

The budget for expenditures of each local government is divided in salary and material fund. The salary fund pays government offices costs but does not include salaries for urban services personnel whose payment is through high levels budget (central/provincial). Personnel of other directorates are usually paid by provincial budgets. The material fund covers expenditures on goods and services, including office material, training, equipment maintenance and repair, vehicles, fuel, travels, insurance costs, rent costs, public services, stamps, etc. The material fund covers between 35% and 80% of global local governments expenditures, while salary fund covers the rest.

Financial Control

Cities and districts inform periodically to provincial governments about their expenditures and incomes. This information is carried out in normal process of budget preparation and simultaneously they justify requests of central government transfers. By their turn, provincial governments evaluate estimated revenues, fix limits concerning salaries, goods and services costs, and determine the amount of incomes to be transferred.

The Ministry of Finance is responsible for external auditing to local governments. According to the present central government regulations, local governments send the full accounting monthly to the Ministry of Finance through the Provincial Directorate of Finance, desaggregating by categories and values paid. It is through this justification that they receive the monthly reimbursement.

Auditing is carried out fortuitously and only when it seems to be necessary. Its objective is to verify the need of subsidies at the current levels in order to avoid misuses.

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