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Economic development and institutions in Mozambique

Factors affecting public financial management

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Abstract: Mozambique has achieved incipient but still fragile socio-economic development since 1975. The public financial management system has been reformed and improved, but its performance has weakened since 2013. Applying an institutional economics approach, we have identified the economic growth strategy, the separation of powers principle, and the degree of decentralization as key factors affecting the public financial management system. As the current strategy based on natural resources seems to be failing, we suggest an alternative balanced growth strategy in the context of an effective democratic political system. It would entail the identification of policy priorities required for fostering sustainable and inclusive development.

Key words: democracy, growth strategy, institutional economics, Mozambique, public financial management

JEL classification: H50, H60, O43, P51

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Note: The translated version of the paper in Portuguese is available here (disponível em Português).

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1 Introduction

Mozambique gained independence from Portugal in 1975 and went through various transformations, resulting in an incipient but still fragile socio-economic development process that lasted 45 years. In 2019, the country ranked 180th out of 189 in the United Nations Human Development Index (UNDP 2019). Over the last four decades, governments have not always made the best use of public financial management (PFM) to help achieve its development goals. PFM reforms have coincided with high rates of economic growth for more than 20 years, since 1993. However, as the financial risks became high in the mid-2010s, and the hidden debt crisis became publicly known in 2016, the growth rate decelerated significantly and living conditions deteriorated.

Given the importance of a well-functioning PFM system for sustainable and inclusive development, and considering the assumption that institutions 'structure incentives in human exchange' and shape 'the way societies evolve', this paper aims to identify the institutional factors affecting the PFM system in Mozambique over the last 45 years (Fritz et al. 2017; North 1990: 3; Schick 1998). The focus of this analysis is those factors that affect the way fiscal resources are used to foster economic growth, which is the basis for development (Rodrik 2005: 1).[1]

Drawing on conceptual elements on economic institutions, economic growth strategies, and institutional analysis of PFM systems, and confronting them with socio-economic statistics, this study identifies economic growth strategies, the principle of separation of powers, and the decentralization process as the main institutional factors affecting the PFM system and reforms.

Considering an alternative scenario to the current growth strategy based on natural resources—a more balanced economic growth strategy in the context of an effective democratic political system—this paper proposes a set of priority policies to foster sustainable and inclusive development. These policies require support from PFM techniques in order to be effective. However, these techniques are not the focus of this study.[2]

The rest of the paper proceeds as follows: Section 2 refers to the basic concepts and factors mentioned in the literature. Section 3 presents the main institutional factors influencing the PFM system. Section 4 summarizes the Public Expenditure and Financial Accountability (PEFA) assessments' main message, with reference to various years between 2002 and 2014, the limits of the PFM approach, and the specific issue of policy coordination. Section 5 explains the alternative scenario of a balanced growth strategy, and illustrates a set of priority policies to foster socio-economic development. Section 6 concludes.

[1] In his 2005 paper, 'Rethinking Growth Strategies', Rodrik assumes that it is through economic growth that poor countries 'achieve sustained poverty reduction'.

[2] For interested readers, government reports, PEFA assessments, IMF reports, and other studies provide comprehensive information and an assessment of the PFM reforms in Mozambique (CEDSIF 2015; IMF 2015b, 2019b; MEF 2016b; see also Table 2).

2 The institutional approach

The current analysis draws on concepts and causal factors from the institutional economics approach, the definition of institutions adopted by the Economic Development and Institutions (EDI) research project, the institutional analyses applied to PFM systems, and the diverse nature of academic writings on institutions and economics (Andrews 2010; Fritz et al. 2017; Marx 1859, 1887; North 1991; North et al. 2009; Smith 1776, 1790).

The study of economics, and its relationships with politics, social rules, and history, has evolved through the centuries. Two authors stand out, Adam Smith and Karl Marx, who studied economics in connection with these other fields in the eighteenth and nineteenth centuries. They elaborated theories of social reality that have influenced schools of thought and economic systems since the eighteenth and nineteenth centuries. Many and most advanced countries operating within market economies and democratic political systems are inspired by Smith's school of thought. Socialist countries since the 1917 October Revolution in Russia, including China after the 1949 revolution, operating within the central planning economic system, were inspired by Marx's school of thought. With the collapse of the Union of Soviet Socialist Republics (USSR) in 1991, the Russian Federation implemented a transition from a central planning system to a market economy. China seems to be using a mixed system, combining central planning with a market economy.

In the second half of the twentieth century, Douglass North was among the authors who tried to integrate the study of economics with politics in the context of different historic stages (North 1990; North et al. 2009). This combination would allow for 'systematic thinking about the central problem of violence in human societies' (North et al. 2009: 55). These authors tried to explain how agricultural societies ('limited-access order') from 10,000–5,000 years ago up to the middle ages differ from industrialized societies ('open-access orders') based on the concept[3] of institutions: formal or informal rules of the game, which political, social and economic actors are expected to follow, individually and collectively.

The *limited-access order* is ruled by a dominant coalition. 'People outside the coalition have only limited access to organizations, privileges, and valuable resources and activities' (North et al. 2009: 56). This access to resources creates rents that feed the dominant coalition and allow for the control of violence. This society also limits competition, and persists in time. The transition to the *open-access orders* society occurs when the dominant coalition finds it in its own interests 'to transform the personal and privileged intra-elite' relations into new arrangements institutionalizing the 'open access for all'. However, in North et al.'s approach, it is not clear when and why the dominant coalition would be willing to change the arrangements to open access to all.

When applying an institutional approach that takes into account diverse international experiences, one should consider that not only Western-type democracies have the conditions for sustainable increases in economic productivity and consistent improvement in living conditions; other societies in different stages of political and economic maturity, such as Russia and China, may also have those conditions.

Regarding the institutional approach to analysing PFM systems, a number of scholars identified and analysed politics-related factors in frameworks or models to explain changes in PFM reforms or the effectiveness and efficiency of PFM systems (Andrews 2010; Fritz et al. 2017: 1). These authors applied quantitative and qualitative analysis to explain factors that lead to successful PFM

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[3] This is a summary of the concept on 'institutions', which was also adopted by the EDI research project.

reforms. They incorporate variables that they consider to capture the institutional dimension in statistical frameworks or econometric models.

Applying a quantitative and qualitative analysis, the recent paper by Fritz el al. (2017) identified the main factors influencing the quality of PFM systems: (a) either positively, the 'income per capita', or (b) negatively, the 'high share of revenues being obtained from natural resources'. Other weaker influencing factors are 'GDP per capita growth', 'political stability', 'political regime', and 'population size'. The 'programmatic political parties' factor has a strong influence using PEFA data, but a weaker one using Country Policy and Institutional Assessment (CPIA) data. Other identified factors are 'fiscal shocks', 'growth shocks', 'aid dependency as a share of GDP', and 'revenues as a share of GDP'. PEFA data seems to be a widely accepted data source to analyse PFM reforms.

Andrews (2010) established 'economic growth', 'stability', 'main source of state revenues', and 'reform tenure' as relevant factors[4] influencing PFM performance in 31 African countries. Colonial heritage seems to be a weak factor. Countries with higher per capita GDP growth have stronger PFM systems; non-fragile states deliver PFM progress; countries 'where most revenues are collected domestically from citizens' have stronger PFM systems than countries 'where revenues are accrued from external sources to which government is not accountable, including natural resources, trade taxes and even external donors', or even oil-rich countries; 'Longer periods of broad reform commitment foster PFM progress' (Andrews 2010: 34, 36). These factors were identified based on quantitative and qualitative evidence from PEFA index scores, measured as averages and standard deviations. Quality is enhanced by triangulating the PEFA Secretariat's own controls, supplemented with a PFM performance report (PFM-PR) and various World Bank reports.

3 Institutional factors influencing the PFM system

Based on the EDI's definition of institutions, the literature review, the interviews with key informants, and considering the recent history of Mozambique, three key institutional factors are identified for their impact on the PFM system: the economic growth strategy, the degree of separation of powers, and the advancement of the decentralization process. The following ideas will be further explored:

- The government can affect the actual economic growth strategy, which may influence the PFM system. A growth strategy is perceived as formal and informal rules of the game, which the government, politicians, civil society—including enterprises, individual producers, and consumers—and the international community are expected to follow to achieve an objective. Such a strategy should have sources of financing.
- A doctrine in constitutional law postulates the principle of separation of the executive, legislative, and judicial powers as the basis of a liberal democracy and rule of law. Moreover, when the executive operates independently from the party in power it creates more opportunities for checks and balances.

[4] Indicators for these four factors are: per capita GDP growth rates; fragile states compared to non-fragile ones; fiscal, rentier, or oil-rich states; and number of PRSPs (Poverty Reduction Strategy Papers) and time length of each policy paper, respectively.

- A higher degree of decentralization can have a stabilizing effect on the relationship between central and local entities, or between the state and citizens.

3.1 Economic growth strategies and PFM

Since 1975 Mozambique has followed different growth strategies, which have been shaping the PFM system to better suit the strategy's objectives. Whenever the strategy was perceived as failing or reaching its limits, the authorities changed it and adapted the PFM system to the new strategy.

These *economic growth strategies* and the related *PFM systems* had impacted the *socio-economic development* of the country for the past 45 years. The relationship between these three elements will be further analysed for the periods 1975–86, 1987–2009, and 2010–present, following this structure: main strategy lines; policy measures and instruments; summary of PFM reforms; economic performance and main political, security/military, and social events; summary of PFM performance; strategy period summing-up; and analysis.

Central planning economy, 1975–86

Once independent, the Frelimo government[5] pursued an economic growth strategy based on central planning and management of the economy within a single-party political system (Frelimo 1975, 1977b; GoM 1981). This government pursued the objective of accelerating economic growth and transforming the economic structure through industrialization, building up heavy industry, transforming agriculture by creating large state companies, creating cooperatives and developing collective production units in communal villages, and creating state companies within the country's main economic activities to become the largest sector in the economy (Frelimo 1977b). Production was planned to gradually substitute imports of food. The industrialization programme was to be based on imports of equipment and machinery, which were not yet being produced in the country. Investment in education was considered important for increasing productivity. The sources of financing for this strategy were domestic revenues from companies and consumers, and international grants and loans from the Organisation for Economic Co-operation and Development (OECD) and socialist[6] and other countries, as well as multilateral organizations.

In 1975, the authorities undertook policy measures to replace the colonial state administration with a Mozambican one. They nationalized estate buildings, education, and health services. The management of many companies was taken over by the state and they were run with the participation of workers' representatives. This policy prevented companies from collapsing when Portuguese managers and senior technical staff left the country.

In 1977, the Third Congress of Frelimo defined its ideology as Marxist–Leninist and decided its main course of action for the transition to the socialist revolution (Frelimo 1977a). Its main international partners were countries from the Socialist Bloc led by the Soviet Union, including East Germany and others. The share of imports from socialist countries in total imports increased from 0.5 per cent in 1975 to 14.1 per cent in 1981 (Cruz 1994). The share of exports to socialist countries in total exports increased from 0.01 per cent in 1975 to 20 per cent in 1981. In parallel, Mozambique established relationships with other African countries, became a member of the Non-Aligned Movement, and developed relations with Western countries, including Nordic

[5] Frelimo has been in power since 1975, and it shapes the main government policy options most of the time.

[6] Pickles and Smith (1998) mentioned that Mozambique was unable to obtain subsidies from the USSR in the same way as Vietnam and Cuba were.

countries and Italy. International technical assistance was provided by citizens of these countries, who were called 'cooperantes'.

Due to low education levels and poor health services, urgent investment was required. In 1975, 93 per cent of the population[7] was illiterate and the infant mortality rate[8] was 175 per 1000 (INE 2010c). There was one medical doctor for every 37,000 inhabitants in 1980. A large programme in education was implemented by training teachers, expanding the number of schools, and sending thousands of young students to other countries—mainly in the Socialist Bloc, including Cuba. A programme was implemented to expand the presence of medical doctors in rural areas, and vaccination campaigns were extended across the country, trying to reach most infants.

Throughout 1975–86 the PFM system remained consistent with central planning. Resources were allocated based on information on available quantities. State enterprises were expected to become the main source of revenue for the state budget. Planning and execution of the budget was not transparent, and the public had little opportunity to provide input. The system of checks and balances was poor and precarious.

While the government was pursuing Socialist Bloc-inspired collectivist policies to overcome its underdeveloped status and an internationalist policy supporting pro-independence movements, an armed conflict started with the former Rhodesia in 1976, then with the Republic of South Africa in the early 1980s. Simultaneously, a civil war broke out with the Mozambican National Resistance (MNR), which later took the designation Renamo. As a result of these armed conflicts and the poor performance of the economy from 1981 onwards, including the international oil crisis in 1979–80, the economy entered a period of recession until 1986 (Cruz et al. 2014; Sulemane 2002; Figure 1). Prices were highly distorted; the official exchange rate was 40 meticais to US$1, but 1,500 meticais to US$1 in the parallel market (World Bank 1989). Agricultural production was heavily affected, and so were the main transportation routes.

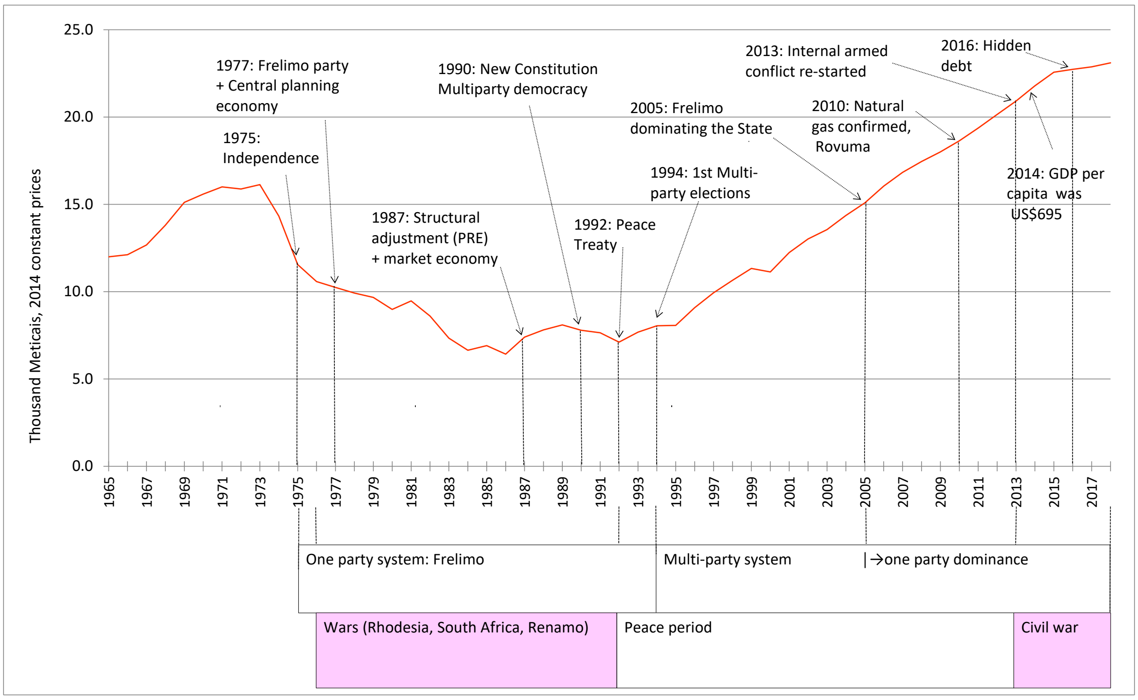
As the civil war spread across the country, the economy became weaker, reducing the supply of food and other basic commodities; as a result, the informal sector grew as a proportion of the total economy. Total revenues declined from 1982, and the overall deficit after grants as a percentage of GDP increased from 10.1 per cent in 1982 to 15.3 per cent in 1986 (World Bank 1989). The public debt including arrears rose to US$3.2 billion in 1986 (World Bank 1987).

In summary, the combination of a central planning and management economy, the authoritarian system of government, the unfavourable international Cold War environment, the civil war, and the regional conflict led to a decline in welfare indicators, in particular for education and health. The poor PFM system was a contributor to this outcome. Under the national and international conditions at the time, this growth strategy failed to create feasible and sustainable companies that would contribute to a balanced economy in both markets, internal and external.

[7] Of those seven years old or older.

[8] This is infant deaths at younger than one year old for every 1000 live births.

Figure 1: Gross domestic product per capita, 1965–2018



Note: [a] the one-party system was under Frelimo in the period 1975–94. The multiparty system has been in place since 1994, though there has been one-party dominance, within this system since 2005. [b] Wars with Rhodesia, South Africa, and Renamo occurred in the period 1976–92, followed by a peace period, 1992–2013, then civil war (with Renamo and later with insurgents in Cabo-Delgado), 2013–present.

Source: authors' illustration based on BM (2018); INE (2016a, 2019a); Orre and Rønning (2017); Sulemane (2002).

Frelimo was increasingly under pressure to find a solution to the military conflict, the economic decline, and the social degradation. Samora Machel, head of the party and the government, was killed in a plane crash in October 1986, and was replaced by Joaquim Chissano. The leftist faction in the party was replaced by a reformist and moderate faction. Mozambique was already a member of the World Bank and the International Monetary Fund (IMF) and had started to liberalize food prices in 1984.

Structural adjustment and the Millennium Development Goals, 1987–2009

As of 1987, the government pursued a different economic growth strategy through a market economy system. It implemented the Economic Reform Programme (PRE), consisting of reducing government expenditure, increasing state revenues, liberalizing prices and trade, pursuing structural adjustment, and privatization[9] (PoM 1987a). From 1989 onwards, it included policy measures to support social sectors, and gradually incorporated the poverty reduction goal and most of the Millennium Development Goals (MDGs). The primary sector, in particular agriculture, lost important supporting policies from the public sector like the marketing system, local supply of ameliorated seeds, and extension services. In the 1990s and early 2000s the authorities adopted a hands-off approach towards the industrial sector. The authorities promoted domestic and foreign investment, letting the market mechanism allocate resources without developing relevant market system institutions such as training, information systems, and competitive financial institutions.

[9] Decree 21/1989, 23 May, 'Boletim da República', Mozambique (Castel-Branco et al. 2001; World Bank 1990).

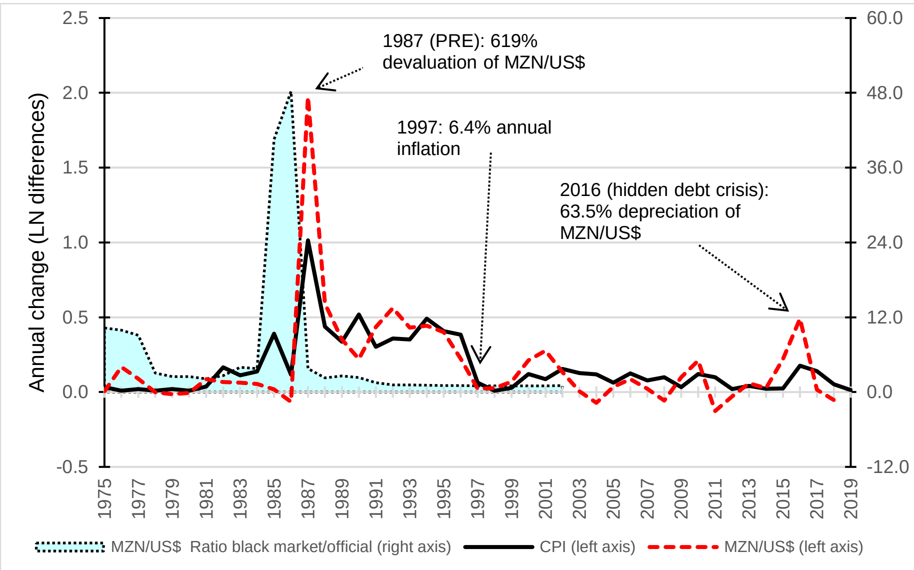
This strategy was financed through foreign aid, concessional loans, and gradually through increasing tax revenues and issuing domestic debt via treasury bonds and bills. An additional source of financing came from debt relief from the Paris Club, the Heavily Indebted Poor Countries (HIPC) Initiative by the IMF and World Bank in 1999 and 2001, the Multilateral Debt Reduction Initiative (MDRI) in 2006, and other sources (IMF 2004b; Ross 2014).

Policy instruments. In the initial stage (1987–1992), authorities took measures to reduce macroeconomic imbalances and to establish foundations for a market-based economy, although the country was still in civil war (PoM 1987b; PoM 1990; IMF 2004b). After the peace agreement, the government deepened the liberalization and structural reforms in 1993–98. The Five-Year Government Programme for 1994–99 considered poverty reduction a priority, as did the programmes in the following political mandates.

Next, it consolidated the first generation of reforms and introduced the Action Plan for the Reduction of Absolute Poverty (PARPA) for 2001–05 in the period 1999–2005, followed by the PARPA for 2006–09. These poverty strategy papers defined priority areas as social sectors (education, health, and social protection), infrastructures, agriculture, good governance, and macroeconomic policies. They also defined the target of allocating 65 per cent of the total government budget to these sectors.

Examples of specific policy measures. The government devalued the metical from 40.43 meticais per US$1 in 1986 to 290.73 meticais per US$1 in 1987 in order to reduce the difference in prices between the black (parallel) and the official markets, and for balancing the external market (Sulemane 2002; Figure 2). This policy measure was part of a long period of gradual step-by-step reforms affecting a wide range of areas. It included creating the central bank separated from the commercial bank, reforming the financial sector and the banking supervisory regime, fully liberalizing interest rates by 1994, increasing flexibility of the exchange rate regime, privatizing housing and enterprises, and allowing for the provision of private education and health services (IMF 2004b; Ross 2014). Aid off-budget was gradually included in the budget and a single treasury account (CUT) was set up to manage the state funds. In 2009 the country submitted the candidature for membership at the Extractive Industries Transparency Initiative (EITI) and was declared compliant in 2012 (EITI 2020).

Figure 2: Stabilization policies, impact on inflation, and recent hidden debt crisis



Source: authors' illustration based on data from BM (1998, 2002, 2018); IMF (2004a); INE (1998, 2003, 2004, 2006, 2010b, 2012, 2014, 2016b, 2018b, 2019b, 2020), and Sulemane (2002).

Examples of taxation reforms. Tax codes have been gradually reformed in 1987, at the end of the 1990s, in 2003, and in 2007–08 (PoM 1987c; Ross 2014). A value-added tax (VAT) was introduced in 1999, replacing the sales tax. The government also ratified the Southern African Development Community (SADC) trade protocol in 1996 to liberalize regional trade until 2015. Customs operations were managed by Crown Agents for a few years from 1996, and the new autonomous Tax Authority was created in 2006 (Table 1).

Table 1: Selected reforms in the PFM system[10]

PFM system	Reforms
Public finance policy documents and reform units	Economic Rehabilitation Programme legislation package (PoM 1987a) Budget Reform Strategy approved, 1997 (Fozzard 2002) UTRAFE, 2001[a]; CEDSIF, 2010[b] State Financial Administration System (SISTAFE) (PoM 2002a) Public Finance Vision (GoM 2012b)
Revenue collection and management	Tax policy reform, 1987 (PoM 1987c) Crown Agents, 1996 (IMF 2004b) VAT introduced, 1999 Tax system basic law (PoM 2002b) Tax Authority creation (PoM 2006)
Budget formulation and approval	State budget Three-year Medium Term Expenditure Framework, first version 1998 (Fozzard 2002)
Budget execution and internal audit	State Procurement decree (GoM 2005b, updated later) e-SISTAFE implementation Single treasury account (CUT) Finance General Inspection (IGF)
Accounting and reporting	Budget execution reports
External audit	Administrative Court State General Account Planning and Budget Commission Reports, Parliament

Note: [a] UTRAFE (Technical Unit for the State Finance Administration) was created in 2001; [b] CEDSIF (Development Centre of Finance Information Systems) was created in 2010.

Source: authors' illustration.

Examples of budget reforms. Similarly, budget planning and execution were gradually reformed in 1987, in 1997 with the new state budget law, and in 2002 with adoption of the new State Financial Administration System (SISTAFE). This new PFM system was implemented in phases and integrated through 'e-SISTAFE', a computerized system to increase transparency in the budget and financial transactions since 2004 (GoM 2012b; MEF 2016b). Other objectives included the increase in efficiency, accountability, and the achievement of higher consistency between the policy objectives, the budget, and its execution (Fozzard 2002; PoM 1987b).

Economic performance in 1987–92. The economy responded positively to the reforms in 1987–89, when GDP per capita grew 8.1 per cent per year on average (see Figure 1). However, the war continued, and conditions were aggravated by a severe drought in 1991–92. GDP per capita declined by 4.2 per cent per year on average in 1990–92. Mozambique became extremely poor in 1992, with a GDP per capita of US$118 (INE 1997, 1999a; Sulemane 2002).

Peace process in 1990–92. The end of the Cold War, the end of apartheid in South Africa in 1990, the extreme poverty in Mozambique due to the 16-year war, poor economic conditions, recent severe drought, the vision quality of the Frelimo leadership at the time, the trust of Renamo

[10] Table 1 summarizes these reforms, revealing a large investment in terms of legislation and regulations, human skills to manage an increasingly complex system, and investment in computer, electronic, and information systems.

in this leadership, and the interest and contribution of the Sant'Egidio Community in Italy and the most pro-active in the international community led to the peace agreement between the government and Renamo in 1992.

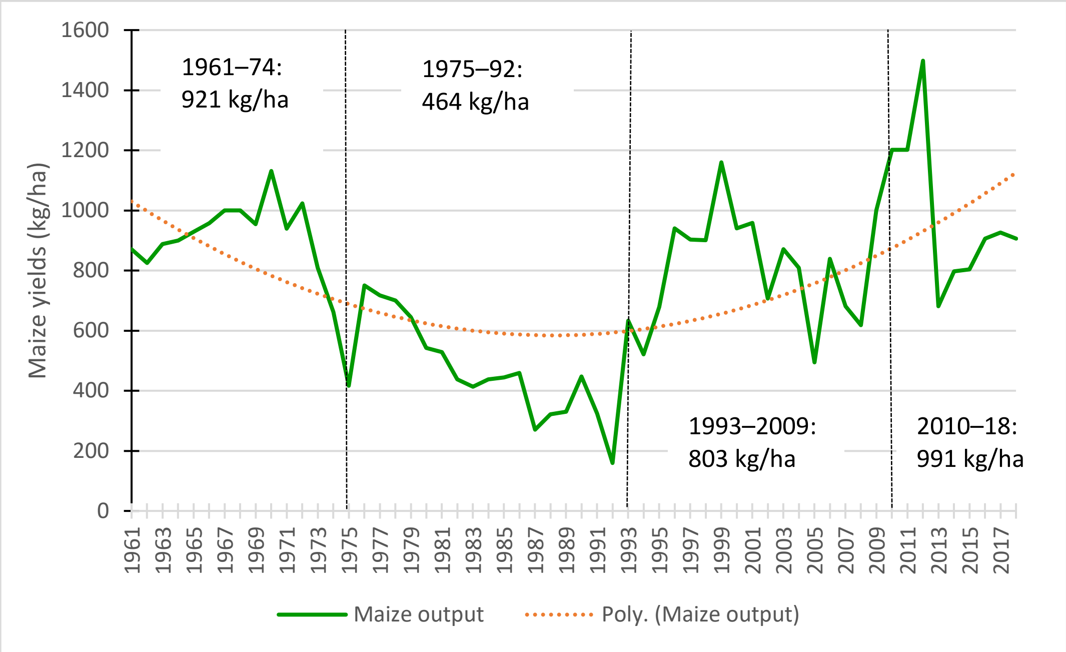
Economic performance in 1993–2009. The multiparty elections and the victory of the ANC in South Africa in 1994 and the multiparty elections in Mozambique in 1994 contributed to creating conditions for the transition to a new political and economic system. The determination of the Frelimo leadership, the extension and continuity of the reforms, the political, technical, and financial support of the international community, and the support and interest of the citizens led to considerable economic expansion between 1993 and 2015. In part of this period, 1993–2009, GDP per capita grew 5.7 per cent per year on average. The ratio of state revenues to GDP increased from 12.4 per cent in 1989 to 17.9 per cent in 2009 (IMF 2004b; MPD 2013). The share of external financing on the total government budget declined from 53 per cent in 1989–91 to 43 per cent in 2008–10 (IMF 2004b, 2010, 2013). The ratio of the debt stock over GDP declined from 164 per cent in 1986–88 to 41.6 per cent in 2009–11 (IMF 2001, 2010, 2015a).

The basis for a market economy system was being established. Local- and foreign-owned private companies were operating in most sectors. Rehabilitation and new investments were under way in public infrastructures like roads, bridges, ports, airports, railways, telecommunications, schools, health centres, and public offices. Mostly public education and health services were being provided for a young and growing population. Private services were also expanding in social sectors.

The expansion of the economy was occurring across most of the sectors. It was a growing economy for the domestic market. Exports were expanding, from 11.5 per cent of GDP in 1993–95 to 30 per cent of GDP in 2007–09 (INE 2018a). But imports were also growing, though at a slower pace, such that the balance of trade for goods and services as a share of GDP improved from −41.4 per cent in 1993–95 to −10.1 per cent in 2007–09. The expansion of exports was concentrated in primary goods from agriculture, natural gas, heavy sands, hydropower electricity, and aluminium ingots. This last product comprised 42 per cent of the total exports of goods and services (BM 2016). Aluminium is produced by Mozal, an international company, in an enclave-like project with few connections to the domestic economy.

Analysis of structural transformation. Little structural transformation has occurred in the country in the past half-century (Cruz and Mafambissa 2016). Productivity in agriculture has improved very little. Figure 3 shows maize yields average 803 kg/ha over the period 1993–2009. Maize represents an important food and cash crop in Mozambique. Although there is a need to improve agriculture statistics and ensure independent compilation and publication, current data shows the limiting effect of manual technology remains prevalent. The share of the labour force in the primary sector (agriculture, forestry, fisheries, and mining) in the total labour force declined from 81.3 per cent in 1997 to 75.9 per cent in 2007 (INE 1999b, 2010a). The share of the labour force in commerce and other services increased from 8.4 per cent in 1997 to 15.1 per cent in 2007. It is most likely that this labour force is migrating to urban areas to work on low-productivity services.

Figure 3: Maize productivity increased little in the past half-century



Source: authors' illustration based on FAO (2020).

The share of manufacturing valued added in total GDP increased slightly from 12 per cent in 1993–95 to 13.3 per cent in 2007–09, influenced by the volume of aluminium smelting, but it was already declining as the GDP share for other sectors was growing more rapidly (INE 2016a). The labour force in the secondary sector increased slightly from 5.2 per cent in 1997 to 5.9 per cent in 2007 (INE 1999b, 2010a).

The privatization programme was ambitious and coincided with the increase in the share of manufacturing value added in total GDP between 1995 and 1999 (Cruz et al. 2014). However, parts of industries collapsed during the privatization process, as was the case for the cashew-nut industry (McMillan et al. 2002). A few authors have written about the privatization challenges in Mozambique (Castel-Branco et al. 2001; Cruz et al. 2014; Pitcher 1996). The state reduced the public cost of managing non-profitable enterprises in the 1990s, but the lack of a consistent industrial policy led to deindustrialization of the economy, and even prevented re-industrialization.

One hypothetical explanation for the lack of structural transformation is that Mozambique is a *limited-access order* society, with no historical experience in managing manufacturing companies (North et al. 2009). Stretching this argument, it may also explain why the public sector is having extreme difficulty in successfully managing state owned enterprises (SOEs). There are many examples of SOEs collapsing, needing extra funds to compensate for financial losses, or a change in the management team in order to survive, like Mabor, Mcel, LAM, and even Mozabank. There is management capacity and law-abiding managers in the country, but the political interference in business is so pervasive that the country has not been able to use this instrument—the SOE—for growth and development purposes.

Rent-seeking behaviour may prevent enterprises and projects from prospering and spreading the benefits across communities and individuals, and even across time. For a long time, and relating to a wide range of cases, there have been stories relating the unethical and illegal abuse of public funds—including through draining SOE resources—including from the banks BCM and BPD (Hanlon 2001, 2018; Haysom et al. 2018; Williams and Isaksen 2016). It is a low-intensity war in which reputable professionals are killed or beaten instead of operating in an open, hard-working environment. Many produce riches, and some profit by force if need be. In times of economic crisis, in particular generated by wrong and abusive policies, the potential for collective prosperity is lost. Consequently, the society resorts to open violence. This hypothesis may explain the insurgency war in Cabo-Delgado that started later in 2017.

In summary, there was rapid and persistent growth in this period. However, the structural economic transformation was negligible, competitiveness[11] was weak in international markets, and poverty reduction was still limited. The headcount poverty index reduced from 69.4 per cent in 1996–97 to 54.7 per cent in 2008–09. Income inequality measured by the Gini coefficient changed slightly, from 0.40 in 1996–97 to 0.42 in 2008–09 (MEF 2016a: 10, 27).

In the 2000s, internal sources of growth were perceived to be limited. The economy was not competitive in international markets. Policies were perceived to be too much under external control. The new government formed in 2005 started moving gradually away from the previous economic growth strategy. Frelimo became openly dominant in government structures. This was one way to gain control over public policies. As a preliminary sign of the shift in the economic strategy, in 2006 the government granted exclusive rights to both AMA1 (Anadarko) and EEA (ENI) to explore and exploit hydrocarbons in Area 1 and Area 4 in the Rovuma Basin, respectively (ERM and Impacto 2014). It was expected that if these companies discovered large hydrocarbon reserves, they would become a significant source of state and private revenues.

Extraction of natural resources, 2010–present

Frelimo's shift to a new economic growth strategy based on the intensive extraction of natural resources took place in 2010 with the confirmation of the existence of natural gas reserves in the Rovuma Basin.[12] The prospects of profiting from the extraction of hydrocarbon resources, mineral coal, rubies and other precious and semi-precious minerals, and heavy sands were combined with a strategy of promoting investment in public infrastructure and other public projects financed also by non-concessional loans.[13] The objective was to further accelerate economic growth, increase opportunities for the development of local entrepreneurs, and extract rents related to the natural gas and other natural resources businesses. State revenues obtained from natural resources would be a key source of financing the budget, besides other tax revenues and the emission of treasury bonds and bills. Economic gains from the expansion of investments and growth would pay for the borrowed money. Therefore, the risk of an increase in the public debt was neglected.

This new strategy was partially substantiated in current investment decisions and partially in the Five-Year Government Programmes for 2010–14, 2015–19, the Poverty Reduction Action Plan for 2011–14, and a series of Medium Term Expenditure Frameworks (MTEFs). These plans had elements of previous ones in terms of support for social sectors, weak policy support for agriculture, and ambitious investment in infrastructure. Public Finance Vision 2011–2025 and the Public Finance Strategic Plan for 2016–19 defined the action lines for the PFM reforms for this period (GoM 2012b; MEF 2016b).

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[11] Vitek (2009) analysed the loss in external price competitiveness.

[12] AMA1 (Anadarko) confirmed the existence of 75 trillion cubic feet (tcf) of natural gas reserves in Area 1 of the Rovuma Basin in 2010 (Crooks 2018; US-EIA 2018). In 2011, ENI confirmed the existence of natural gas reserves in Area 4 of the Rovuma Basin (ENI 2011). US-EIA reported that ENI natural gas reserves amount to 85 tcf.

[13] Non-concessional loans as a percentage of GDP were planned to increase from 0.0 per cent in 2010 to 2.6 per cent in 2014 (IMF 2013). This source of financing would still be used in the following years.

A particular focus was on public investment projects and promotion of private and public–private partnership investments. The main public investments were listed, analysed, and prioritized in the Integrated Investment Plan (MPD 2014). Private investments were managed through the Investment Promotion Centre (CPI) and Special Economic Zones Office (GAZEDA).[14] The CEDSIF Strategic Plan for 2015–19 provided a useful account of the expansion of the e-SISTAFE in 2012–14, covering 73 per cent of the total beneficiary management units (UGBs) and various other indicators (CEDSIF 2015).

The infrastructure projects of a 3 km bridge over Maputo Bay, the road to Ponta do Ouro, and the Maputo city ring road are examples of large public investment financed by non-concessional loans amounting to US$1 billion (MPD 2014). The Nacala Airport investment was also financed with non-concessional loans. The volume of public investment increased in the first half of the 2010s. Foreign direct investment (FDI) increased from US$592 million in 2008 to US$6.2 billion in 2013, equivalent to 38 per cent of GDP (BM 2020; Cruz et al. 2018).

As part of the same strategy, EMATUM, Proindicus, and MAM were established. These are fishing and security public-owned companies that borrowed US$2.2 billion in commercial loans in the international market in 2013 and 2014 (Hanlon 2017). The government issued guarantees for these loans. The US$850 million bond issued by EMATUM in 2013 and guaranteed by the government was public information, but it did not go to the parliament at the time. Guarantees issued for the Proindicus and MAM loans were not included in the budget submitted to the parliament for approval, and only became publicly known in April 2016 (Hanlon 2016; IMF 2016b; Wirz and Wernau 2016). They are referred to as 'hidden debt'.

The Debt Sustainability Analysis with the assistance of the IMF was used to help the authorities keep control of the public debt in the past, in particular the external component. However, it was no longer a concern of the authorities in the first half of the 2010s. Not only public debt increased substantially, but also total public expenditure, such that the public deficit after grants reached −10.4 per cent in 2014 (IMF 2016a). The macroeconomic prudent stabilization policy was not strictly applied in this period. PFM reforms were overshadowed by the relaxation in fiscal discipline. The ratio of the public debt stock to GDP increased from 41.1 per cent in 2012 to 137.6 per cent in 2016 (IMF 2015c, 2019a).

Until 2015 the economy was still growing rapidly, but poverty was declining slowly. GDP per capita grew 3.8 per cent per year on average in 2010–15 (INE 2016a, 2019a). The poverty headcount index declined from 54.7 per cent in 2008–09 to 49.2 per cent in 2014–15. Income inequality measured by the Gini coefficient increased in this same period from 0.42 to 0.47 (MEF 2016a: 10, 27). The overall PEFA assessment declined from 2007–09 to 2012–14, denoting a decline in budget credibility (see Table 2).

After the elections in 2015, the international community delayed disbursements, and in 2016 Programmatic Aid Partners (PAPs) interrupted the general budget support to the government budget, invoking the hidden debt. For the same reason, the IMF suspended assistance to the country until 2019.

[14] CPI, GAZEDA, and the Exports Promotion Institute (IPEX) were merged in 2017 into a new entity, the Agency for Promotion of Investment and Exports (APIEX).

The metical depreciated against major currencies in 2015–16. Inflation accelerated in the same period (Figure 2). However, both indicators stabilized in 2017–18. The ratio of public debt stock to GDP declined to a projected value of 108.4 per cent of GDP in 2019 (IMF 2020).

FDI has been steadily declining since 2013, to US$1.99 billion in 2019 (BM 2020). Although the main reason is related to the international market conditions for natural gas, the domestic economic, political, and security instability may not be inspiring confidence in investors.

Nevertheless, GDP per capita decelerated rapidly to 0.8 per cent per year on average in 2016–18, aggravating poverty levels (INE 2019a). Agricultural productivity has changed little, as has the capacity for smallholder producers to sustainably increase their incomes. The share of manufacturing in total GDP has remained weak.

The value of exports declined to an annual average of US$3.6 billion in 2014–16, but recovered to US$4.9 billion in 2017–19 (BM 2020). The international demand for exports has been favourable in recent years. However, the country was still exporting mostly primary commodities, besides hydropower energy and aluminium ingots. The country ranked 137 out of 141 countries in the 2019 Global Competitiveness Index (WEF 2019).

There is no published PEFA assessment for the period after 2012–14, which is an indication of worsening PFM transparency and quality. The MTEF for 2019–21 has not yet been made available to the public via the ministry website, signalling weakness in transparency and accountability.

In summary, as a consequence of distorted policies related to a growth strategy based on the extraction of natural resources in the first half of the 2010s, and the violation of PFM rules, trust within society and from international partners in the government has been negatively affected. It caused macroeconomic instability and decelerated economic growth. Simultaneously, security levels have been deteriorating, armed conflict is worsening, and irregularities in recent elections are affecting political stability. The welfare of the citizens, and in particular of poor families, has been declining.

Analysis of the three strategies. In the pursuit of strategies for developing viable enterprises in a functional economic system, Frelimo governments have attempted different approaches for 45 years. They faced the dilemma of either taking sovereign policy decisions or accepting key policy options formulated by representatives of foreign interests.

Sovereign policy decisions were taken in the context of a tentative Marxist–Leninist revolution and more recently through the economic growth strategy based on the extraction of natural resources and financing risky public projects through non-concessional loans.

Policy options formulated by representatives of foreign interests were dominant during the transition to the market economy, with liberal economic policies, and during the implementation of policies related to the MDGs. The dilemma consisted of the facts that the pro-sovereign but distorted approaches resulted in relative economic failures, while a more dependent, aid-driven but less distorted approach brought relative successes.

Frelimo governments have also been facing the challenges of morality and legitimacy. In the phase of the central planning economy, moral principles were collectivist. Individuals had to be subordinate to the collective organizations and ultimately to the party central power. Individuals were not supposed or allowed to become rich through economic activities. They could prosper as part of a group. Here, the government had popular legitimacy, even though there were privileges for higher-ranking party members and state officials.

This system of moral values was disrupted with the transition to the market economy. Since there was not a reasonably equitable income redistribution system, informal payments were commonly acceptable but not by everybody. Although, citizens were aware of how distorted and corrupt the system was, it was perpetuated and aggravated over time, until today. Successive generations of leaders have not acted to change the system. These governments have not been entirely legitimate, but have been tolerated. However, whenever food or transportation prices rise too much in the cities, or the economy becomes too weak, citizens complain openly. This lack of legitimacy very likely also explains the opposition behaviour of Renamo and the Islamic insurgents in Cabo-Delgado.

These successive governments have also been facing the challenge of managing political power. In a democratic system, part of the political setup is the openness to power alternation. In Mozambique, the same party has been in power for 45 years. Possible explanations of the party interests and motivations are: to make sure the country keeps its hard-earned independence; to achieve the goal of transforming the country into a developed society; to control access to the main sources of income and rents; and to keep control of a country that freedom fighters perceive to be their own property and that of their families. Whatever the reasons are, recent history has showed that this country did not fare well under authoritarian or semi-authoritarian regimes (Figure 1).

This paper aims at identifying the institutional constraints in these processes at a time when the society is at a crossroads and the world is in the midst of the COVID-19 pandemic. The political, economic, security, and military instability could go on for many years, or spiral downwards on one side, or the society can change the rules of the game and establish a widespread acceptable social contract on the other side.

3.2 The principle of separation of powers and PFM

Checks and balances were introduced in the 1990 Constitution, but became gradually dysfunctional from 2005 onwards. Frelimo increasingly dominated the executive. In a presidential system the role of the president in the government is enhanced. In addition, in Mozambique, traditionally the president of the party has also been the President of the Republic. The president appoints and dismisses the presidents of the Supreme Court, the Constitutional Council, the Administrative Court (external auditor), and the attorney general. In parliament, Frelimo has had an absolute majority since 1994, and party members in parliament respond to centralized party instructions. In such a tightly controlled environment it is not surprising that when the party and government leadership decided to increase the demand for non-concessional credit, there was no mechanism to prevent systematic breach of the law and illegal actions.

While the Mozambican parliament has a good track record in producing legislation and organizing the legislatures, in the case of the hidden debt it did not exercise full oversight in the management of the budget. In 2013–14 the government bypassed parliament and contracted a direct debt in the form of guarantees for the loans amounting to US$1.35 billion, for Proindicus and MAM. In 2016, when this information became public, parliament did not act upon it. There were no immediate or direct consequences for those responsible for violating the Constitution and the budget laws. The lack of action in response to the infringement of key laws implies that the majority of the members of the parliament and the Budget Committee were co-opted politically on this specific issue and did not aim to enforce the law. Similar was the case for the judiciary (Orre and Rønning 2017). It was only recently, in February 2018, that the judicial authorities reacted to the case, after international capture mandates were issued for the officials involved. It was only in May 2020 that the Constitutional Court ruled on the secret debts, considering them 'null and void' (Hanlon 2020).

The risk is that this action could be perceived as another trick to avoid paying the debt, therefore contributing to the mistrust of the Mozambican state.

Similarly to the first historical phase in post-independence Mozambique, when political power was overly concentrated and the system of checks and balances was not operational, recent economic policy decisions can have large and lasting effects on the economic performance of the country and on the welfare of most citizens. This is the case where the party dominating the executive, the legislature, and the judiciary represents an institutional factor worsening the PFM system and therefore affecting socio-economic development.

3.3 Decentralization and PFM

The decentralization principles were embedded in the legislation at the very beginning of the democratization era in the country. The new Mozambique Republic Constitution in 1990, the Local Public Administration Reform Programme (PROL) in 1991, and the Constitution's Amendment through the Law 9/1996 allowed for the creation of municipalities composed of an executive organ, the Municipal Council, and a legislative organ, the Municipal Assembly (Fernandes 2007; Simione et al. 2018). The Mozambican parliament and government approved various laws and decrees leading to the implementation of the decentralization of municipalities (Cistac 2012; PoM 1997, 2008). There were 33 cities and villages considered to be municipalities in 1997, 43 in 2008, and 53 in 2013 (Brito 2019).

The decentralization process led to greater autonomy in urban areas, thus giving more power to the local authorities responsible for improving the livelihoods of their citizens (Weimer 2012). The gradual increase in the number of municipalities means that decentralization was understood as a process of expansion of urban structures to rural areas. However, the transformation of the rural areas into municipalities, as part of the decentralization process, has been highly challenging. Rural areas that are not included in municipalities are governed by the government branches at provincial, district, administrative post, and locality level.

Since 1993, a pilot decentralized[15] planning and budgeting exercise was carried out through the Decentralized Planning and Finance Programme (PPFD), which was replicated in other provinces. Capacity building, including training, application of new procedures, and investment in equipment, has been provided for more than 20 years in this field. The results are positive, but it is necessary to continue the process and further develop the model of decentralization suitable to the country.

Another dimension of decentralization was the establishment of provincial assemblies in 2009 and the election of provincial governors in 2019 (Brito 2019). These are reforms of a primarily political nature, but their viability relies on a well-performing PFM system (PoM 2018). Political, military, and civil society activities have been leading to decentralization reforms, including of the PFM system. However, it is not evident that these reforms will succeed in practice, as they will demand quite large amounts of financial resources. Current organizations in the state apparatus, elected assemblies, and political positions have been under budget constraints since 2015.

PFM reforms ensured that provinces and districts are entitled to decide over and manage public funds. Law 8/2003 of State Local Authorities and Decree 11/2005 established legal principles and norms for the decentralized levels of government (GoM 2005a; PoM 2003). This legislation allowed for greater budgetary autonomy at the provincial and district levels, and has been

[15] When we are dealing with state entities at local levels, it is considered 'de-concentration'. This is also valid for the PPFD.

implemented since then. However, the unequal distribution of the budget in per capita terms among provinces remains a challenge (UNICEF 2017).

Political instability and military conflict are partially explained by the insufficient degree of decentralization. This has been happening possibly due to a perceived risk by the party in power of losing political power at the local level and potentially at the national level. The political bottlenecks in the decentralization process, the per capita inequalities in budget allocations, and the political interference in the budget execution criteria at deconcentrated levels, in particular at district level, distorts the PFM system functionalities

4 PFM reforms

4.1 PEFA assessments

PEFA assessments in Mozambique indicate an overall improvement in the PFM system, with the baseline period set as 2002–04 (Lawson et al. 2006; Table 2). The PEFA assessment for 2012–14 considered that the PFM system 'has been robust enough to ensure fiscal discipline' and that the government has been allocating over 60% of the budget to priority sectors according to Lawson et al. (2016: 17). Matthew Andrews (2010) showed that Mozambique was in second position out of 31 African countries in terms of the quality of PFM systems.

Table 2: PEFA assessments in Mozambique

Indicator	Assessment period			
	2002–04	2004–06	2007–09	2012–14
PEFA, overall	**2.40**	**2.72**	**2.87**	**2.67**
A. PFM-OUT-TURNS: credibility of the budget	2.75	3.25	3.75	2.75
B. KEY CROSS-CUTTING ISSUES: comprehensiveness and transparency	2.42	2.58	2.83	2.83
C. BUDGET CYCLE	2.48	2.76	2.75	2.78
C(i) Policy-based budgeting	2.75	3.00	3.00	3.00
C(ii) Predictability and control in budget execution	2.19	2.94	3.25	3.00
C(iii) Accounting, recording, and budgeting	2.50	2.25	2.25	2.63
C(iv) External scrutiny and audit	2.50	2.83	2.50	2.50
D. DONOR PRACTICES	1.67	2.17	2.50	2.00

Note: [a] PEFA letter classification was converted to numbers as follows, A = 4, B+ = 3.5, B = 3, C+ = 2.5, C = 2, D+ = 1.5, and D = 1. [b] Aggregation was obtained through a simple average. [c] The period 2012–14 is comparable to the previous periods by excluding items PI-2, PI-3, and PI-19, as noted by Lawson et al. (2016).

Source: authors' illustration based on Lawson et al. (2006), Umarji et al. (2011), and Lawson et al. (2016).

However, the PEFA assessment showed a decline in the overall classification for 2012–14 due to due to weaker performance on providing complete 'information included in the budget documentation', 'rate of collection of tax arrears', 'predictability of Direct Budget Support', and 'proportion of aid that is managed' through 'national procedures' (Lawson et al. 2016: 15–19). Another factor contributing to weaker performance is a more rigorous criteria in assessing the delay in refunding VAT to the private sector, the poor 'taxpayer registration and tax assessment' and the persistent 'weaknesses' of 'internal controls for non-salary expenditure' (Lawson et al. 2016: 18, 40, 41, 43, 78).

According to Orre and Rønning (2017: 23), an Adam Smith International 2017 publication on Mozambique Fiduciary Risk Assessment considered that there was *'substantial' fiduciary risk*, *'high risk of corruption', and the government commitment to reform is 'partially credible'.*

4.2 Limits of PFM reforms and the role of policy priorities

Other authors identified the limits of the PFM reforms as they are commonly applied over the world. Andrews et al. (2017: 4) defended that international organizations and domestic agencies often 'produce administrative systems in developing countries that look like those of modern states'. There is no correspondence between what these systems look like (their form) and what they actually do (their function). Hence, the solution is to implement systems that are adapted to local conditions so that they are functional—that is, where there is a closer correspondence between de jure and de facto. This argument seems to make sense, but we will not further explore this approach in this paper.

Taking a critical view of the PEFA assessments, we think that it is not enough to satisfy the PEFA criteria in order to consider that the budget exercise has contributed to attaining key policy objectives. For instance, Lawson et al. (2016) rated 'A' by verifying that over 60 per cent of budgetary resources were applied to priority sectors (i.e. score 4 for PI-1), and rated 'B' the budget classifiers in use (i.e., score 3 for PI-5). PI-5 could have been rated 'A' if the *General State Accounts* (CGE) was prepared also based on *programme classifiers*. Even though the rates could be the highest ('A'), the full budget cycle exercise for the agriculture sector systematically fails to address policies that lead to productivity increases and household producer income improvement, or the quality[16] of educated young people is not satisfying market demand.

One factor that explains the weak impact of public policies in agriculture and education is the source of budget revenues. When a significant portion of revenues comes from foreign aid, the government is not fully accountable and is not under enough pressure to transform the economy such that it becomes competitive in the domestic and international markets (Moss et al. 2006). This government inertia can happen in the context in which one political party makes sure it stays in power for many election cycles.

Another factor is that tax policy gets distorted by relying too much on revenues from international trade and on the small number of taxpayers in the formal market. It allows the informal sector to expand without transforming itself into a higher-productivity sector. This is a comfortable scenario for the government leaders during a period of abundant foreign aid.

Under the current growth strategy, where a greater proportion of revenues could come from the extraction of natural resources, government leaders would likely continue not to be fully accountable and would not be under enough pressure to transform the rest of the economy, since the main source of revenue would not come from other domestic activities. In the literature, countries rich in natural resources with weak institutions fare poorly in PFM quality (Andrews 2010; Fritz et al. 2017).

In 1993–2015 there were factors that helped the expansion of the economy, such as a rapidly growing and young population, a small but growing well-off group of families, and the small but relatively high-income international community. However, Mozambique has not been going through a process of a clear structural transformation. In other words, although the PEFA indicators demonstrated progress and PFM reforms advanced, the quality of the polices related to sustainable and inclusive economic growth remained poor. The low quality of key policies has been a binding constraint for economic development.

[16] Jones (2017) acknowledges the correlation between the significant investment in expanding education services and the low quality of education.

4.3 Policy coordination

In the context of the PFM system, policy coordination is important as it can increase efficiency and transparency in the management of funds. Inter-sector or vertical–spatial coordination mechanisms have been introduced in the planning and budgeting process at different levels in the early 2000s.

The elaboration of general government planning and budget policy documents is coordinated by the Ministry of Economy and Finance (MEF) (Table 3). Five-Year Government Programmes (PQGs) like the one for 2015–19 have been coordinated by MEF. Priorities and the structure of the PQG is based on the Frelimo party electoral manifesto. Other sources[17] of information are sector and province strategy papers, sector ministries new priorities, and policy measures. The draft document is subject to consultation among the ministries and the Council of Ministers. After approval by the Council of Ministers, it is submitted to parliament for discussion and approval. This is the main guiding document for government management actions during the five-year mandate, and will be the basis for the internal government assessment and parliamentary oversight.

Table 3: Main global planning and budgeting instruments

Policy document	Approved by	Period	Participants in the elaboration
Five-Year Government Programme (PQG)	Republic Assembly	Five years	Ministries and members of the Council of Ministers
Poverty Reduction Action Plan (PARP)	Council of Ministers	4–5 years	Working groups represented by government, donors, and civil society
Medium Term Expenditure Framework (MTEF)	Council of Ministers	Three years, rolling	All state units with budget executing management units (UGE)
Social and Economic Plan (PES)	Republic Assembly	One year	Ministries and members of the Council of Ministers
State budget (OE)	Republic Assembly	One year	All state units with budget executing management units (UGE)
IMF Macroeconomic Missions' Reports	Executive Board of the IMF	Three times/year	IMF Mission with MEF and the Bank of Mozambique
Annual review and planning meeting aide memoire and formal agreement	Representatives of the GoM and troika of donors	Two sessions/year	Working groups represented by government, donors, and civil society
Integrated Investment Programme (PII)	Council of Ministers		Ministries with selected investment projects, and the Inter-ministerial Commission for the PII

Source: authors' compilation.

The planning and budgeting instruments and processes mentioned in Table 3 represent the tip of the iceberg in terms of coordination requirements. Until 2014, the coordination time and effort within government entities and between government and the international community used to be overwhelming.

Besides planning instruments, there are reporting and assessment instruments like the PQG report, PES report, budget execution report, State General Account, and more. Indeed, the intensity of coordination is so high that it reduces the quality of various instruments. This institutional

[17] Other national and international references that can be considered are the Agenda 2025, National Development Strategy, Sustainable Development Goals, and African Agenda 2063.

constraint can become a bottleneck as it induces deficiencies or even failure in policy design, reporting, and assessment.

The last PARP expired in 2014. Since then, no new PARP has been produced, donors have interrupted the general budget support (GBS), and the aid coordination platform established by PAPs and the government ceased to exist. The IMF Macroeconomic Missions continued, but only to monitor policies and performance reporting under Article IV, until 2019. While the interruption of the GBS provided an opportunity for the government to focus on managing its own scarce resources, efforts aimed at coordination between the government and international partners were reduced.

Before 2015, international aid partners were coordinating directly with sector ministries. From one point of view, the PAP coordination reduced the leading role of the Ministry of Planning and Development in coordinating and promoting the government development agenda. This argument may be valid, but it would require a systematic analysis to verify it.

Today, there is still aid flowing into Mozambique providing direct support to sectors and projects with some degree of technical coordination.

5 Policy priorities to foster socio-economic development

From the analysis of the institutional factors affecting the PFM system, we confirm that Mozambique has undertaken an ambitious PFM reform programme (Andrews 2010; CEDSIF 2015; IMF 2015b, 2019b; MEF 2016b; Renzio et al. 2011; Table 2). Many laws and norms have been approved, management systems and tools have been established and prepared, professionals have been trained, and equipment and material have been acquired. But the PFM system has not been fully functional because politicians decided differently—that is, tools like the MTEF have been neglected, VAT refunds have been delayed or neglected for many years, and laws have been violated or ignored, as happened with the 'hidden debt' case, for instance.

According to the institutional economics approach, the transition to the *open-access orders* society occurs when the dominant coalition finds it in its own interest 'to transform the personal and privileged intra-elite' relations into new arrangements institutionalizing 'open access for all' (North et al. 2009: 63). In Mozambique it may not have occurred yet.

From the analysis of growth strategies, we have identified the low quality of policies as a binding constraint for achieving structural transformation in the long run. Furthermore, the evidence suggests that Mozambique seems to prosper more under a democratic system of government and economy, and by taking responsibility for sources of its own financing, including debt.

We have concluded that a reasonable approach to achieve sustainable and inclusive development is to pursue a balanced and steady economic growth strategy through maturing home-grown policies. It is within the framework of this strategy that the following policies were considered a priority: tax policies and revenue authority management, natural resources management, agricultural and industrial policies, public investment, and improvement in quality of education. The PFM tools could play an important role in improving policy planning and budgeting.

5.1 Tax policy and revenue authority management

There is a need to gradually and continuously enlarge the taxpayer basis, to consolidate tax revenues as a share of GDP, to create an environment conducive to economic expansion for taxpayers, and to improve the Tax Authority management (IMF 2019b).

After the creation of the Tax Authority in 2006, a substantial effort was made to increase the taxpayer base across the main taxpayer categories. The number of NUIT[18] registered increased 158 per cent from 2011 to 2015 (Table 4). In 2018, new registrations remained at approximately 2011 levels. This means that either the Tax Authority has managed to already register the majority of taxpayers, or that it is focusing the tax collection effort on a limited number of taxpayers. In that respect, publicly available information on taxation is incomplete and affects the quality of the analysis. It would be important to know what is the total number of registered taxpayers and how many do actually pay taxes every year per tax category in order to judge whether the objective of expanding the tax base is being pursued.

Table 4: Uneven variation in the number of NUIT registered

	Total	Single taxpayers	Collective taxpayers	ISPC
Number of new NUIT registered				
2011	327,602	274,982	6,305	46,315
2012	506,000	n.a.	n.a.	n.a.
2013	574,327	544,756	7,994	21,577
2014	625,529	614,311	11,218	n.a.
2015	846,624	746,166	10,458	90,000
2016	n.a.			
2017	n.a.			
2018	304,594	n.a.	n.a.	n.a.
Percentage variation in the period				
2011–15	158	171	66	94
2015–18	−64			

Note: [a] n.a. = not available. [b] In 2013 and 2015, NUIT for ISPC were considered as part of the single taxpayers group, following the explicit procedure for 2011 (GoM 2012a); ISPC = simplified tax for small taxpayers (*Imposto simplificado para pequenos contribuintes*).

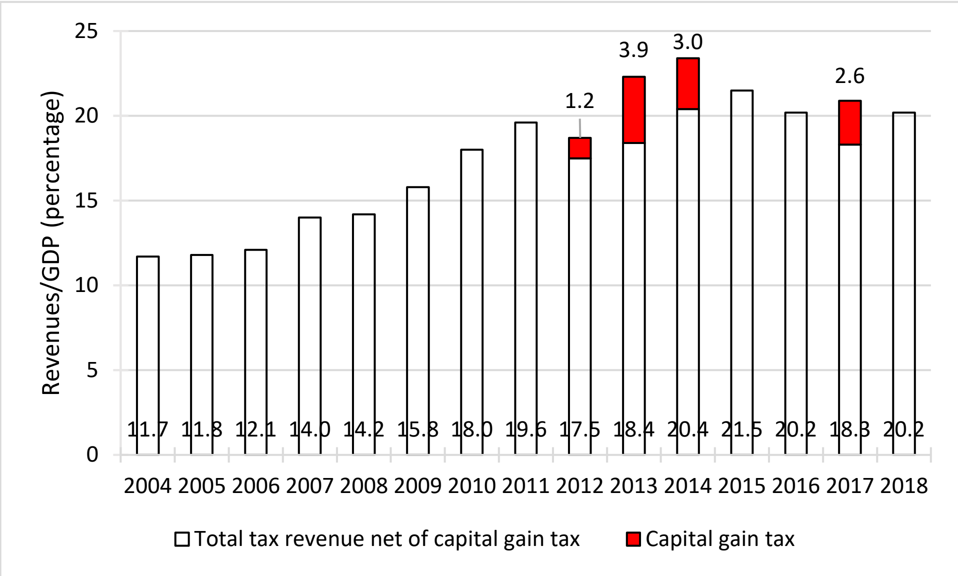
Source: authors' illustration based on GoM (2012a, 2013–2019).

The share of total tax revenue net of capital gains tax increased from 11–12 per cent up to 2006 to 18–21 per cent in 2011–18 (Figure 4). It is important to understand the role of capital gains tax and the taxes on natural resources extraction in relaxing the efforts of the revenue authority in collecting taxes from the rest of the economy. Consolidation of tax revenues as a share of GDP should consider both types of sectors—natural resources and the rest of the economy. One reason for this approach is that the natural resources sector is volatile in terms of international prices and demand, as well as foreign investment inflows. Therefore, it is important to rely on the rest of the

[18] NUIT is the unique tax identification number.

domestic economy in terms of a sustainable source of revenues. However, this does not mean that the tax policy should become a burden for the rest of the economy.

Figure 4: Tax revenues net of capital gains flatten out in 2011–18 (share of GDP)



Source: authors' illustration based on IMF (2007, 2009, 2010, 2013, 2016a, 2019a).

The private sector has been harmed by the delays in refunding the VAT debt. In order to settle this VAT refund debt, a fund could be created based on VAT revenues or extraordinary revenues. The management of VAT and its refund must be rationalized such that requests for refunds are handled within the deadlines defined by law.

Tax policy can improve by increasing transparency of the information concerning obligations and liabilities. Legislation on tax liabilities should be accessible in print and online, with examples of the calculation corresponding to different categories. In the current environment there is a service provider niche for tax payment advisers, although for the wrong reasons: the waiting time in tax offices is too long, the complexity of the requested documentation and bureaucracy is excessive, and the arbitrary estimation of liabilities represent a high cost for individuals and for taxpayers on aggregate. These bottlenecks that taxpayers face when dealing with the Tax Authority create opportunities for corruption (IMF 2019b).

5.2 Natural resources management

A supply-side policy for the natural resources industry would provide an important business growth opportunity, which is currently missing in the country. It would generate local knowledge of the industry and benefit public entities, academia, and local private companies. This policy would entail the establishment of a public company to exploit and extract hydrocarbons. A competitive and transparent policy in line with the best international practices should be developed to hire managers, engineers, and other professionals. The public company would have to be managed with autonomy and independently from direct political interference. It should be supervised by an administrative board, which in turn operates under a transparent management system.

If Mozambique starts exporting natural gas from the Rovuma Basin and the inflow of foreign revenues increases substantially, it is required to adopt macroeconomic policies to prevent and correct the distortions to the domestic economy caused by the appreciation of the real exchange rate (Henstridge and Roe 2018). A sovereign fund and a stabilization fund should also be established to benefit future generations and to insulate the economy from short- to medium-term volatility in commodity prices, respectively (Otto 2018; Roe 2018).

5.3 Agricultural policy

The agricultural sector, in particular smallholder producers, would benefit from a diversified and consistent approach towards agricultural policy. Agricultural policy budget programming should aim at gradually increasing farmers' productivity and income in the medium to long term. These goals should be attained such that the nutrition of society improves, the supply of agricultural products responds to domestic and export demand, and the support to agriculture does not result in a net burden to the budget and society.

The areas that require improvement have been extensively analysed and identified. For instance, investing efficiently in the production and distribution of seeds could reduce costs and increase supply of inputs. Investing in a network of extension service providers would disseminate more efficiently production and distribution technologies. Developing financing and insurance organizations dedicated to supply services for smallholder producers would increase the access to resources and reduce risk. Reallocating part of the state budget currently being spent within public administration to more direct support of farmers would represent a budget management improvement. This could contribute to a decision to increase the share of the agricultural budget in the total state budget.

5.4 Industrial policy

The industrial policy should help the country to develop competitive companies that can be upgraded from low to high value-added products (Rasiah 2017). This approach should be persistent throughout the years, and policy makers should be aware that not all choices would be successful, which would carry a cost for society. However, other choices would be successful, thus contributing to economic diversification, the learning process, and structural transformation (Stiglitz 2017). The economy as a whole would develop competitive goods and services, such that the external market would be balanced. Different policy tools could be applied, such as a competitive and stable real exchange rate, research and development, and educational programmes. Mozambique has already applied a stabilization policy, infrastructure programmes, industrial free zones, and special economic zones, but it has applied these tools in a fragile and inconsistent framework.

A complementary option for this country is to identify industries without smokestack in order to try to compete in the international market. These industries would include products such as fruits and vegetables (baby corn, green beans, citrus fruits, bananas, mangos), cereals (maize and related products, sesame), cut flowers, tourism, electricity from hydropower plants and natural gas plants, and transportation services (Cruz and Mafambissa 2016).

5.5 Public investment

In the last decade, Mozambique has been developing a programming tool for public investment projects, the PII (MPD 2014). This tool aims at projecting investments that would allow for transportation, communications, and the provision of various public services, and reducing transaction costs for the economy. The selection of projects should be based on a cost–benefit and risk analysis, and a set of priority criteria. The economic and financial analysis should support project proposal at the stage of searching for sources of finance. This background preparation should be a prerequisite for the stage of decision-making by politicians.

In 2013, the government established the Public Projects Coordination and Selection Committee (CCSPP), which was restructured in 2015 by MEF. In 2019, MEF decided to elaborate an Integrated Strategy for the Planning and Budgeting Reform, and created an electronic platform for public investment management, the Public Investment National Sub-system (SNIP). Following is a list of challenges to improve the projection and selection of public investment projects:

- adoption of transparent criteria to select investment projects;
- legislation for including *multi-year cash-flow information of recurrent maintenance costs for after the construction period* in the public investment projects;
- elaboration of a document containing the selection of investments, using a sound and recognized methodology to justify the choices made, including cost–benefit analyses;
- separation of both processes: (a) PII elaboration and (b) decision-making by politicians regarding the approval of public investment projects;
- periodical publication of the PII;
- investment in training the personnel working in the PII elaboration, and in 'on the job' specialization of these professionals;
- definition of a clear mandate for the MEF team working on the PII elaboration based on terms of reference;
- elaboration of a project proposal for investment in a development bank to finance public investment projects. This bank must be free from conflicts of interest regarding the political party in power or individuals. It should operate as an autonomous entity without political interference.

5.6 Improvement in the quality of education

The focus of education programmes should be on improving their quality. This way, students finishing their courses could satisfy market demand for their skills. The trained labour force would add human capital to the companies or other organizations, increasing their productivity and contributing to technology advances. Education services should find the appropriate balance between public and private organizations, such that the opportunities include all students. The international experience provides useful lessons for different options to achieve these goals.

6 Conclusion

Mozambique achieved a hard-earned independence in 1975, and ever since has been trying to become a prosperous country through various transformations. In the beginning it also attempted to become an equitable society. In these processes, Frelimo governments managed fiscal resources through what seemed to be the most appropriate approach at each stage.

In pursuit of economic growth strategies to create feasible enterprises in a functioning economic system, governments have attempted different approaches for 45 years. The central planning economic system failed. The transition to the market economy, through the economic rehabilitation programme and MDG-inspired strategies, succeeded in achieving among the highest rates of growth in the world and substantially reforming the PFM system, in particular from 1993 to 2009. However, it failed to achieve a higher degree of inclusive growth and higher autonomy in policy-making. The third strategy of extracting natural resources has resulted in negligible growth rates of GDP per capita since 2016. This option is being revealed to be distorted by violation of basic PFM rules, macroeconomic mismanagement, and failure to influence the increase in agricultural productivity or to improve international competitiveness. Political and security instability have also aggravated armed insurgency. Poverty is still high and income inequality has increased substantially.

In the literature, countries rich in natural resources but with weak institutions fare poorly in PFM quality. Applying the historical institutional approach, Mozambique could be considered as a 'limited-access order' society, not being able to provide free opportunities for all to participate in politics and prosper economically, and improve productivity for long periods of time. It could take generations to be transformed into an 'open-access orders' society if it depends only on the free course of political and economic greed of the elites. Or this transformation could be fostered by changing the rules of the game and establishing a widespread acceptable social contract.

This could be accomplished by pursuing a balanced economic growth strategy in the context of a de facto politically democratic system, an effective separation of powers, and an advancement of the decentralization process. It would be required to identify policy priorities at this stage of development, such as managing fiscal resources to improve the following policies: tax and revenue authority management, transparent management of natural resources and state enterprise participation, agriculture, industry, public investments, and education quality.

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