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**Research Report**

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## Socio-Political and Administrative Determinants of Municipal Revenue Performance: Insights from Mozambique

### Summary

While in most developing countries revenue potential at the subnational level is modest, there are good reasons for donors and development partners to continue and intensify their efforts in this sector. On the one hand, locally collected revenue, although negligible when compared with revenue collected at the national level, can make a big difference for the fiscal space available to municipalities. On other hand, beyond the availability of more financial resources, stronger local revenue mobilisation is expected to come with a “governance dividend”.

As a result, the mobilisation of revenue at the local level is a relevant topic for development, not only from a fiscal point of view, but also from a broader governance perspective. Consequently, stronger revenue mobilisation should not only be seen as an end in itself, but also as a means for promoting good governance.

We argue that to unlock these potential positive effects, donors and development partners need a better understanding of the effects that socio-political and administrative determinants have on municipal revenue mobilisation.

In this paper, we summarise the insights gained in a study on how administrative and socio-political variables at the local level affect the revenue performance of Mozambican municipalities. Thereby, we contribute to an evolving literature highlighting the relevance of local factors in explaining local revenue mobilisation.

Results show that, first, administrative weaknesses lead to strong reliance on certain easy-to-implement revenue instru-

ments that are not necessarily those with the highest revenue potential. Moreover, the results highlight the systemic nature of the process of revenue collection: failure or lack of capacity concerning one single step strongly affects the effectiveness and efficiency of the whole revenue collection system.

Second, municipal governments that are politically aligned with the party governing at the national level show fewer efforts to increase revenue performance than non-aligned governments. This shows how political variables at the local level, especially in the interaction with other levels of government can strongly affect the incentives for municipalities to exploit their revenue potential.

Third, in the context of a generally weak civil society, marginal variations in organisational strength do not seem to affect the fiscal behaviour of local governments. In this line, we find that the civil society at the local level in Mozambique lacks the capabilities to shape and influence revenue mobilisation in any meaningful way, even where they have donors’ support.

These results have strong implications for donors and development partners. Not considering the effects of socio-political and administrative factors on revenue performance strongly limits the capacity of donors to anticipate the prospective effectiveness of policies and measures aimed at increasing local revenue mobilisation. In this line, practitioners need to broaden their approach to municipal revenue mobilisation and more systematically consider how socio-political and administrative variables shape prospects for stronger impacts to be achieved.

### Local revenue mobilisation generates benefits that go beyond the fiscal realm

There are various reasons to support initiatives to strengthen revenue mobilisation at the local level in developing countries. First, although modest when compared with revenue collected at the national level, locally collected revenue can make a big difference for the fiscal space available to municipalities. In many developing countries, subnational units of government are increasingly receiving responsibilities, especially in the provision of basic services such as schools, basic medical care, and waste management. Many observers agree that the success of the Sustainable Development Goals Agenda will be decided at this level of government. In this context, activating the often-under-exploited local revenue potential will play a crucial role in enabling municipalities to implement the required policies.

Second, beyond the availability of more financial resources, stronger local revenue mobilisation is expected to come with a “governance dividend”. Research indicates that the nature of governmental financing affects the relationship between governments and citizens. By enhancing revenue mobilisation, international donors also hope for an effect on politicians’ responsiveness, citizens’ engagement in public affairs and, ultimately, more accountable and inclusive government institutions. This effect can materialise at all levels of government, but it can be expected to be particularly strong at the municipal level, where the interrelation between taxes, fees and public services is particularly visible for citizens.

The decentralisation literature has provided strong and extensive evidence on the relevance of incentives set on municipalities by the fiscal decentralisation system and the role of local economic development. Although socio-political and administrative factors at the local level are receiving increasing attention, far less conclusive evidence exists on their effects, especially in low income economies. Knowing more about the effects of these factors is crucial for development cooperation because these aspects are at the core of what might be called the “political economy of local revenue mobilisation” and relate directly to the challenges that practitioners implementing and designing initiatives to increase local revenue mobilisation deal with daily.

### The effect of administrative capacities on revenue performance is not deterministic

A well-established narrative in the debate on local revenue mobilisation is that municipalities cannot raise more revenue because of substantial limitations in their administrative capacities. This narrative is also very strong and present in Mozambique. Certainly, revenue mobilisation is a complex (and potentially very costly) task that, depending on the specific revenue instrument, may involve a considerable number of steps such as registration, valuation, assessment, bill delivery, collection and enforcement. Lack of technical endowment, human resources and infra-

structure can hinder the effective and efficient implementation of these steps and thereby limit the amount of revenue collected.

Our analysis shows that administrative capacities at the municipal level in Mozambique are certainly an important limitation for municipalities aiming at increasing their revenue performance, but that their effect is far from deterministic. Municipalities facing similar administrative constraints can still perform very differently.

#### Box 1: Measuring revenue performance

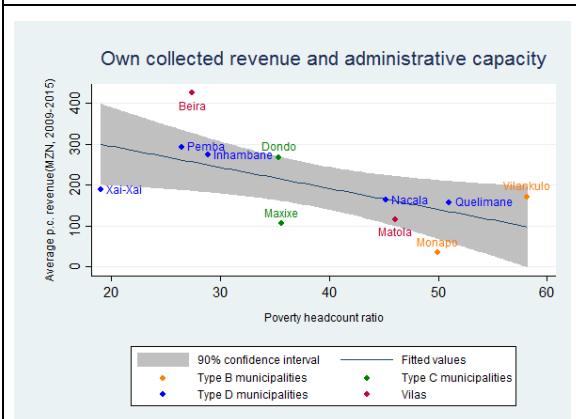
Estimating revenue performance is a challenge in many developing countries due to poor data quality and availability. Those issues are even more pronounced when dealing with subnational units of government. Thanks to data provided by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and United Nations University World Institute for Development Economics Research (UNU-WIDER), we could estimate revenue performance by regressing the municipal poverty headcount ratios (as a proxy for tax potential) on average per capita municipal own collected revenues for a sample of 11 municipalities during the period 2009-2015.

The trend line in Figure 1 illustrates the predicted revenues for the municipalities given their tax potential. By comparing observed revenues with predicted revenues, we can then categorize the municipalities in three groups. Municipalities within the 90% confidence interval around the trend line raise roughly as much as predicted, and are thus classified as average performers. Municipalities above the confidence interval raise significantly more revenue than predicted and are classified as high performers. Municipalities below the confidence interval are classified as low performers.

Figure 1 illustrates this point. Following the Mozambican legal framework, all 53 municipalities are categorised into a city type (A through D) or as a *vila*. This categorisation can be expected to correlate strongly with different levels of administrative capacity. Type A cities are assumed to have the strongest administrative capacity, while *vilas* are assumed to have the weakest.

Figure 1 shows that variance in revenue performance among municipalities of the same type is high. The fact that municipalities at all levels of capacity over- and underperform underscores that although municipal administrative capacity is relevant, it is not the sole determinant of revenue performance.

Furthermore, the qualitative evidence we collected emphasises the relevance of taking into account the systemic nature of the administrative processes involved in generating revenue. Failure or lack of capacity in one step of the process could lead to significant decreases in the effectiveness and efficiency of the whole revenue collection system. This implies that administrative capacity of the municipalities should not be approached as a monolithic concept and different dimensions should be differentiated. For instance,

**Figure 1: Revenue performance**

Source: Authors, using data provided by GIZ and UNU-WIDER.

strong enforcement cannot compensate for weak registration and thinking in terms of an average administrative capacity would be highly misleading.

In terms of major bottlenecks, our analysis indicates that municipal revenue administrations and donors perceived upstream processes (in particular registration and setting up a digital cadastre) as the main challenges due to the need for significant upfront investments, technical capacities and qualified staff.

Beyond influencing overall revenue mobilisation, administrative capacity also affects the revenue composition. Municipalities with strong administrative capacities are more likely to invest in the mobilisation of administratively demanding revenue sources such as property tax, or property transaction tax. However, the overwhelming majority of municipalities, regardless of their administrative capacity, rely mainly on revenue sources with a low level of administrative complexity, such as market and service fees. As a result, some administratively demanding, but potentially highly profitable, revenue sources are underused.

### Political alignment affects municipal revenue performance

The results indicate that in Mozambique the reliance on administratively less demanding revenue sources is rarely based on effectiveness and efficiency arguments but more commonly on political considerations. This is in line with studies in several other developing countries. The implementation of hard-to-collect revenue instruments, such as property taxation, tends to be politically salient and costly. Hence, there are strong disincentives for governments to exploit these instruments, regardless of whether the municipalities have the capacity to implement them.

Against this background, the comparison between the revenue performance of aligned municipalities (meaning municipalities in which the party governing at the local level is the same as the one governing at the national level) with those municipalities governed by opposition parties reveals

an interesting pattern. On average, the nine aligned municipalities included in the study seem not to be particularly interested in acting on the under-exploitation of municipal revenue potential. By contrast, in the two non-aligned municipalities in our sample (Beira and Quelimane are two of the four municipalities currently governed by the opposition), we found a strong discourse around the necessity to increase municipal revenue mobilisation. These municipalities also seemed more open to politically and economically investing in measures aiming at stronger own revenue generation.

Two reasons were identified to drive these differences: (i) fear of receiving a smaller amount of transfers due to a fiscal transfer system perceived to be highly opaque and politicised and (ii) the incentive to present the opposition party governing at the municipal level as a well-performing political alternative to the dominant ruling party at the central level. Yet, in the context of the current fiscal crisis, unreliable transfers to municipalities have become a universal phenomenon in Mozambique and differences between aligned and non-aligned municipal governments in terms of their interest in the topic of revenue mobilisation have become less pronounced.

We also identified how election cycles, regardless of party alignment, play a major role in explaining local revenue performance in Mozambican municipalities. In accordance with experiences from other countries, evidence shows that revenue mobilisation in Mozambique decreases in the years before and after local elections. As main reasons, we identified (i) decreasing collection and enforcement efforts from the municipal government leading up to elections (in order to "not annoy" voters) as well as (ii) the frequent replacement of experienced administrative and political staff when a new mayor takes office.

### The strength of the civil society does not affect municipal governments' fiscal behaviour

Strengthening civil society organisations is an increasingly relevant element of development programmes active in the area of good financial governance. The rationale is that empowering civil society organisations to discuss and monitor state action is crucial to improving policy outcomes. In addition, donors expect that a stronger involvement of citizens causes governments and public administrations to become more responsive and transparent, which should ultimately lead to higher trust in institutions and higher tax morale among citizens.

In the case of municipalities in Mozambique, we did not find substantive evidence supporting this claim. Variations in the strength of civil society organisations at the municipal level did not seem to have an impact on municipal revenue performance and revenue mobilisation strategies. It should be highlighted however, that civil society organisations at the local level in Mozambique are very weak in general. Hence, the lack of an identifiable effect might be driven by the fact that the civil society was not strong enough to have an effect in any of the municipalities included in our sample,

rather than the inexistence of the effect itself. In this sense, we consider the capacity of the local-level civil society to be involved, lobby for citizens' interests or act as a watchdog to be currently too weak to make a difference, even with donors' explicit support.

Although there are doubts in terms of inclusiveness and effectiveness, the existence of opportunities for the civil society to get involved in discussions about fiscal policy does not appear to be the problem. It is safe to say that, at least on paper, in Mozambique local governments implement numerous outreach campaigns and offer a plethora of events, dialogue fora and information campaigns with the aim of clarifying the use and relevance of locally collected revenues. These initiatives, in many municipalities, include formats explicitly designed for citizens and civil society organisations to actively express and discuss policy and budgetary preferences. Donors are heavily involved in supporting these formats.

### Conclusion and implications

Promoting revenue mobilisation at the local level is a relevant topic for development, not only from a fiscal point of view, but also from a broader governance perspective. A technical perspective on strategies to increase revenue mobilisation at the local level is therefore necessary, but not sufficient, to make sure that, alongside the expected fiscal effect, measures also generate a "governance dividend". To

unlock these positive effects more effectively, donors and development partners need a better understanding of how factors beyond the fiscal and economic sphere shape the use of the municipal revenue potential.

The results summarised in this paper show how socio-political and administrative factors are crucial to understanding and explaining municipal revenue performance. The usual caveat of the fiscal decentralisation literature also applies here: the external validity of the results is limited, meaning that findings cannot be transferred easily to other contexts. Still, the results demonstrate that efforts to more systematically analyse and consider the effects of these variables is worthwhile.

A better understanding of these effects is crucial to more effectively identify strategies for the successful implementation of revenue mobilisation programmes at the local level in developing countries. Although nested in the same fiscal decentralisation system, socio-political and administrative specificities of each municipality must be taken into account in order to adjust strategies. While donors and development partners are increasingly aware of this, significantly more time and resources than are currently available should be invested in detailed assessments of the incentives for local governments and administrations to support greater revenue mobilisation, as well as in identifying the specific weaknesses and constraints present in the municipality.

**Note:** This paper addresses theses and recommendations elaborated in the context of the project "The political economy of local taxation in Mozambique". This project was designed and implemented between November 2016 and May 2017 in close exchange and cooperation with our partners Instituto de Estudos Sociais e Económicos (IESE), Good Financial Governance Programme (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) – Mozambique) and Associação Nacional dos Municípios de Moçambique (ANAMM). Opinions expressed here are those of the authors and not the mentioned organisations. Published with financial support from the Federal Ministry for Economic Cooperation and Development (BMZ).

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