



PROMOTING FISCAL TRANSPARENCY AND SOVEREIGN WEALTH FUND IN MOZAMBIQUE (PROFITS)

Sovereign wealth fund to stabilize the economy and catalyze good governance and fiscal transparency



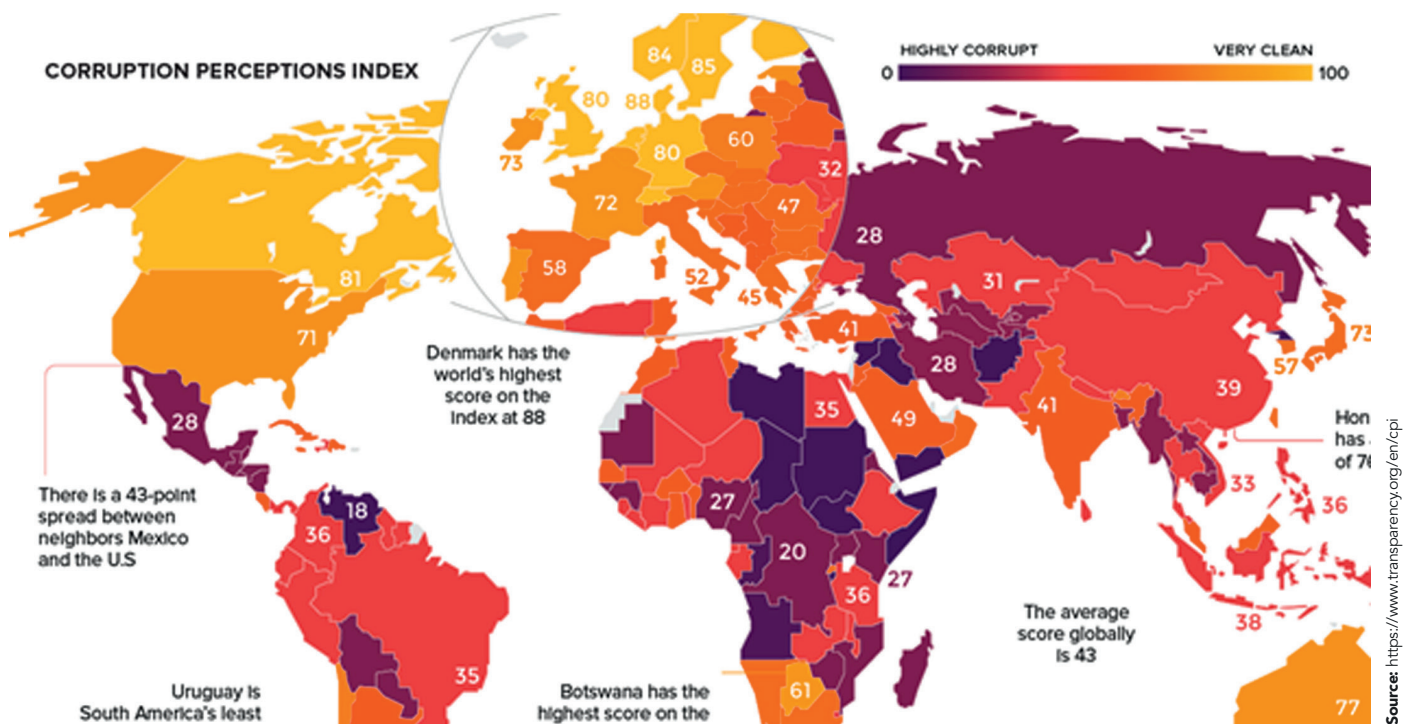
Credits: Presidência da República

1. Background

According to the news, published¹ on July 17 by the North American financial markets news agency - Bloomberg, Total, a French multinational oil company that leads the Mozambique LNG² consortium,

completed the financing of more than US \$ 16 billion that guarantees the investment in the natural gas project in Mozambique, the largest foreign direct investment ever in Africa. With this confirmation that the largest LNG

¹<https://www.bloomberg.com/news/articles/2020-07-16/total-s-mozambique-lng-completes-almost-16-billion-in-financing>
² <https://www.mzlng.total.com/>



project in Mozambique (the total investment cost is estimated at the US \$ 23 million), and one of the most important in Africa, will be a reality, there are perspectives for the Mozambican State to raise about \$ 50 billion during the 25-year term of the natural gas exploration contract, thus having the potential to change Mozambique's economy³.

However, some risk factors threaten the transformation of this investment into tangible benefits for the population. Therefore, they should be taken into consideration. First, Mozambique is seen as a case of "good gas and bad governance"⁴. In addition to this is the recent national and international macroeconomic adversities, especially the sharp drop in the price of commodities in the International market, including natural gas and the negative effect of the Covid-19 pandemic on energy markets in various parts of the world.

The scenario is problematic because although the discoveries in Mozambique are of high quality (more than 125 trillion cubic feet of non-associated gas reserves, free of pollutants such as CO₂ and H₂S) positioning to become one of the world's top 10 LNG suppliers, there are doubts as to whether the government will

truly ensure that the benefits of gas are shared among the population⁵. Considering that in a state without a good record of accountability and transparency, the green light to immediately spend billions of dollars on gas revenues would mean a "recipe for disaster"⁶, and the IMF has been advising the government on this SWF topic. However, African examples, mainly from Angola, suggest that SF is no longer a guarantee to prevent the plundering of state funds for political purposes⁷.

The issue of an SWF has a high level of support in the Bank of Mozambique (BM). Moreover, some circles among development partners in Mozambique recognize that a revenue management scheme focused on savings, following the lines of the Norwegian model⁸, which effectively transfers the wealth of current generations for future generations would not be appropriate, given the levels of poverty in Mozambique and the needs in terms of infrastructure that create the conditions for the desired socio-economic development⁹.

In the present Development Review, CDD proposes that the SWF to be created by the Government of Mozambique should be of a hybrid type, combining economic stabilization

³ <https://www.dw.com/pt-002/total-garante-16-mil-milh%C3%B5es-para-o-g%C3%A1s-de-mo%C3%A7ambique/a-54214731>
⁴ <https://www.africa-confidential.com/home/issue/id/1142>
⁵ <https://www.africaoilandpower.com/2020/03/20/afdb-and-nigeria-launch-sustainable-energy-project/>
⁶ <https://www.africa-confidential.com/home/issue/id/1142>
⁷ <https://media.africaportal.org/documents/Occasional-Paper-304-markowitz.pdf>
⁸ <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol070908a>
⁹ <https://www.imf.org/external/pubs/ft/fandd/2014/12/gupta.htm>

and savings, and catalyzing good governance and fiscal transparency. It involves the structuring of the SWF around the Santiago Principles¹⁰ and governance of the SWF with external oversight, through the participation of the civil society.

Here, not only the result, but the process also

counts. The idea is that the process of establishing the SF is empowering and galvanizing Mozambican and civil society with Parliament serving as a pivot. The process of creating the SWF must be appropriated by the entire Mozambican society with the technical leadership of the Bank of Mozambique (BM).

2. The history of bad governance as a *raison d'être* for hybrid SWF in Mozambique

With the discovery of vast reserves of world-class natural gas in the Rovuma basin, Mozambique became one of the most paramount destinations of international financial capital and, in 2014, it became the largest recipient of Foreign Direct Investment (FDI) in Africa. That same year, the Africa Rising Conference was held in Maputo in which the former Director-General of the International Monetary Fund (IMF), Christine Lagarde, said that Mozambique would be Africa's next Qatar. But against all promises of good governance made to the Director-General of the IMF by the Government of Mozambique, the then Minister of Finance, Manuel Chang, secretly signed guarantees for hidden debts, an unsustainable and totally unnecessary public debt that was not directed to the productive sectors of the economy.

In addition to limiting the State's ability to finance its participation, through the National Hydrocarbon Company (ENH), in LNG exploration projects, this unsustainable level of public debt has led to an increase in the cost of living in the country due to the sharp depreciation of metical against the ¹¹.

In general, the governance processes related to the development of natural gas, mainly the licensing of companies, have been transparent. At least, five successive rounds of public tenders for the granting of natural gas exploration licenses were competitive and well managed with no allegations of corruption concerning the National Petroleum Institute (INP).

In terms of the Extractive Industry Transparency Initiative (EITI), the governance of Mozambique's extractive industry has complied since 2012. Despite the delay in the completion of the 8th EITI Report¹², it is currently awaiting the conclusion of the third validation report by the international EITI secretariat. To avoid the repetition of last years' delay, and despite the adversities generated by the Covid-19 pandemic, EITI Mozambique is working faster to prepare the 9th report within the established deadlines and, for this purpose, already approved the Terms of Reference for the Preparation of the 9th EITI Report.

Despite this progress and governance performance, the capital gains generated from the extractive industry have been poorly managed. All asset sale transactions in the Rovuma basin that took place between 2012 and 2019 involved a payment of capital gains tax. Capital gains legislation improved with the approval of Law No. 27/2014¹³. However, revenue governance has been problematic. Under the leadership of President Filipe Jacinto Nyusi, two main asset sale transactions generated significant tax revenue on capital gains. First, in 2017, Mozambique received \$ 350 million in capital gains tax from the Italian energy company ENI for the sale of a stake in the Coral Sul natural gas field to ExxonMobil¹⁴. Second, during the most recent electoral cycle, Mozambique won \$ 880 million in capital gains tax because of the acquisition of Anadarko Petroleum by Occidental Petroleum in August 2020¹⁵.

¹⁰ <https://www.ifswf.org/santiago-principles-landing/santiago-principles>

¹¹ http://eleicoes.cddmoz.org/wp-content/uploads/2019/12/Que_preco_os_mocambicanos_estao_a_pagar_pela_divida_publica_in-sustentavel.pdf

¹² https://cddmoz.org/wp-content/uploads/2020/02/Industria_Extractiva_Governo_de_Nyusi_despacha_8%C2%B0_Relatorio_de_Reconciliacao_para_cumprir_prazos_e_evitar_a_suspensao_de_Mocambique_da_ITIE.pdf

¹³ <http://www.inp.gov.mz/pt/Politicis-Regime-Legal/Legislacao/Lei-n1-27-2014-Estabelece-o-Regime-Especifico-de-Tributacao-e-Beneficios-Fiscais-das-Operacoes-Petroliferas>

¹⁴ <https://www.portaldogoverno.gov.mz/por/Imprensa/Noticias/Gas-do-Rovuma-estado-encaixa-USD-350-milhoes-de-mais-valias-da-venda-de-participacao-da-ENI-a-Exxonmobil>

¹⁵ <http://opais.sapo.mz/mocambique-encaixa-880-milhoes-usd-de-maisvalias-com-venda-da-anadarko>

President Filipe Jacinto Nyusi promised transparency, but the money “quickly evaporated” from the Treasury. Apparently, it was spent on electoral logistics, payment of the debt to the domestic private sector, and on mitigating the effects of cyclones that hit central and northern Mozambique. But there is suspicion around the use of this money, which seems to have been managed directly by the *Ponta Vermelha* Palace (the State House), setting off alarms about

the quality of public finance governance. This reinforced the understanding that Mozambique is a case of “good gas and bad governance”. The idea of the SWF in the terms proposed here is an answer to this scenario and, at the same time, it is an opportunity for inclusive economic governance in favor of inclusive growth and development. It is, in fact, a stirring of structural incentives for a new paradigm of economic governance in Mozambique.

3. The Sovereign Fund of Mozambique - an instrument for stabilizing the economy and a catalyst for good governance and fiscal transparency

The exceptional circumstances in the global energy and fuel market, created by the outbreak and spread of the Covid-19 pandemic, could lead to a change in the dynamics of the global extractive industry, including Mozambique. Actually, the literature states that the circumstances created by the Covid-19 pandemic may encourage governments around the world to move forward in improving the transparency of the natural gas market to restore the stability of the energy market and meet shared goals globally. However, the materialization of this idea calls for a global platform for inclusive dialogue on the general energy market. In this context, the 7th Ministerial Forum, scheduled to take place virtually on December 3, 2020, and to be hosted by Malaysia¹⁶, will be strategic: “the continuous and inclusive dialogue will highlight the role of natural gas concerning strengthening energy security and accelerating orderly energy transitions to ensure a rapid recovery from the impact of the Covid-19 pandemic in a world increasingly limited by carbon¹⁷.”

Therefore, there is a favorable global environment for the introduction of fiscal governance reforms aimed at improving the transparency and accountability of Public Financial Management (PFM) of extraordinary revenues from Mozambique’s world-class gas reserves. Among the options indicated by the Gas Mas-

ter Plan (GMP) for revenue management, namely the creation of a Sovereign Wealth Fund (SWF); the creation of a National Development Bank or Sovereign Development Fund (SDF); Provide Funding for Public-private Partnerships (PPPs); channel funds to the private banking system; and direct distribution of money to citizens, the creation of an SWF is the idea that reaps consensus from the main stakeholders.

Economic literature indicates that SWFs are usually created when governments have budgetary surpluses and have little or no international debt¹⁸. It is especially the case when a nation depends on exports of raw materials such as oil, gas, copper, or diamonds¹⁹. In these countries, the main reason for creating an SF is to prevent the paradox of the abundance of natural resources from occurring²⁰. Literature teaches that there are two types of SF: savings and stabilization. The stabilization SWF is created to reduce the volatility of government revenues, to combat the adverse effect of boom cycles on government spending and the national economy. The savings SWF saves monetary values for future generations²¹.

It is believed that SWFs in countries with abundant natural resources can help to smooth government spending and dissociate it from the short-term volatility of revenues from the exploitation of these same resources²²,

¹⁶ https://www.ief.org/_resources/files/comparative-analysis/ief-insight-brief_the-impact-of-covid-19-on-natural-gas-markets.pdf

¹⁷ Idem

¹⁸ Ramady, M. A. 2012. The GCC economies: stepping up to future challenges. New York: Springer Science+Business Media. <http://site.ebrary.com/id/10558029>

¹⁹ <https://www.wilsoncenter.org/publication/key-outcomes-the-high-level-meeting-sovereign-wealth-funds-africa-policies-and-best>

²⁰ [https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/\(E\)%20AfricanBank%202007%20Ch4.pdf](https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/(E)%20AfricanBank%202007%20Ch4.pdf)

²¹ <http://documents1.worldbank.org/curated/pt/788391468155724377/pdf/WPS6776.pdf>

²² <https://www.imf.org/external/pubs/ft/scr/2010/cr10163.pdf>

thereby avoiding the Dutch disease²³ or the curse of resources²⁴. However, literature on this issue is controversial²⁵. Other reasons for the creation of SWFs may be merely strategic and of a political nature to deal with periods of military instability²⁶.

However, the Center for Democracy and Development (CDD) proposes a third way: a hybrid SWF between savings and stabilization - taking into account the perspectives of the main stakeholders, such as BM, Ministry of Economy and Finance (MEF), Parliament, Civil Society, Academics, general public, IMF and development partners - while catalyzing good governance in Public Finance Management (PFM). Although it is focused on fiscal transparency, the hybrid SWF is seen as the ideal solution for Mozambique's "good gas and bad governance" situation. It highlights the need not only to design an SWF model that adapts to the specific macroeconomic situation in Mozambique but also to provide it with legal and governance instruments to ensure that, as President Nyusi has argued, "it works independently, financially and operationally with transparency, predictability and the strictest compliance with the law".

It is also proposed that the hybrid SWF design and governance processes are anchored in the 24 generally accepted principles and practices for SWF, designed to promote good governance practices, accountability, transparency, and prudent investment, encouraging a more open and inclusive dialogue and a deeper understanding of the SWF activities, the Santiago Principles²⁷.

CDD is aware of the great political influence on Mozambique's economic governance and public financial management²⁸. Control of Frelimo effectively means control over the state apparatus, political decisions, and business opportunities²⁹. However, based on good existing cases of public financial management such as of the Cahora Bassa Hydroelectric (HCB) and Mozambican Hydrocarbon

Company (CMH), ENH subsidiary; also, there is something concrete in which a hybrid SWF can be structured as the ideal solution to the problem of "good gas and bad governance".

Although the 24 Santiago Principles, mentioned above, are fundamental to guide the design and governance of the SWF proposed here, its sustainability depends a lot on external supervision, mainly by the civil society. It is essential, considering that, over time, mechanisms of horizontal accountability institutionalized in the governance of parastatals like the SWF tend to be co-opted in less competitive dominant party systems, such as Mozambique. Therefore, the active participation of the civil society in the project and governance (in adhocacy and non-permanent way) of the hybrid SWF, proposed here, is fundamental for its sustainability as a system of fiscal transparency, but also as a catalyst for good governance through capacity building of civil society and inherent access to information through participation in the design of the SWF model and governance. In this sense, being sustainable, the hybrid SWF has the potential to send the "right message" to the entire PFM system and, over time, shape its incentive structures for public managers in the country.

As a contribution in this process to solving the problem of "good gas and bad governance" in Mozambique, CDD is designing the Promoting Fiscal Transparency and Sovereign Wealth Fund in Mozambique (PROFIT-S) project, which is a program for mobilizing civil society through a broad national public discussion promoted by the Budget Monitoring Forum (FMO) and the Extractive Industry Platform (PIE) which, together, will organize training and capacity building activities for other civil society organizations for production and a bill which will serve as an advocacy tool for the engagement of the Parliament in this process of creating an SF based on the principles and ideals that were discussed in this article.

²³ <https://www.economist.com/the-economist-explains/2014/11/05/what-dutch-disease-is-and-why-its-bad>

²⁴ <https://www.bloomberg.com/quicktake/resource-curse>

²⁵ Cumming, Douglas, Geoffrey Wood, Igor Filatotchev, Juliane Reinecke, and J. drzej George Frynas. "Sovereign Wealth Funds and the Resource Curse: Resource Funds and Governance in Resource-Rich Countries." In *The Oxford Handbook of Sovereign Wealth Funds*: Oxford University Press, 2017-10-19. <https://www.oxfordhandbooks.com/view/10.1093/oxfordhb/9780198754800.001.0001/oxfordhb-9780198754800-e-13>.

²⁶ <https://novaworkboard.wordpress.com/2017/12/03/how-sovereign-wealth-funds-help-mitigate-the-effects-of-dutch-disease/>

²⁷ https://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf

²⁸ Nuvunga, A. & Orre, A. 2019. 'The Secret loans affair and the political corruption in Mozambique', in Amundsen, I. (ed.), *Political Corruption in Africa- Extraction and Power Preservation*. Elgar: UK, 95 – 11.

²⁹ Idem

COVID-19

STATE OF EMERGENCY AND HUMAN RIGHTS IN MOZAMBIQUE

COVID-19

ESTADO DE EMERGÊNCIA E DIREITOS HUMANOS EM MOÇAMBIQUE

Report human rights abuse during the state of emergency in Mozambique

From June the 30th to July the 29th, 2020

CALL NOW:
87 85 33 330

WhatsApp

Respect human rights in Mozambique spread the word! COVID-19 An initiative of:





Denuncie os abusos contra os Direitos Humanos em Moçambique

De 30 de Junho a 29 de Julho de 2020

LIGUE JÁ:
87 85 33 330

WhatsApp

Respeite os Direitos Humanos na resposta ao COVID-19 Passe a palavra! Uma iniciativa

Help respect human rights Mozambique Spread the word!

Ajude a respeitar os Direitos Humanos em Moçambique, passe a palavra!



EDITORIAL INFORMATION

Property: CDD – Centro para a Democracia e Desenvolvimento
Director: Prof. Adriano Nuvunga
Editor: Emídio Beula
Author: Prof. Adriano Nuvunga e Agostinho Machava

Team: Emídio Beula, Agostinho Machava, Ilídio Nhantumbo, Isabel Macamo, Julião Matsinhe, Janato Jr. and Ligia Nkavando
Layout: CDD

Address: Rua Eça de Queiroz, nº 45, Bairro da Coop, Cidade de Maputo - Moçambique
 Telefone: 21 41 83 36

Twitter: CDD_moz
E-mail: info@cddmoz.org
Website: http://www.cddmoz.org

PROGRAMMATIC PARTNER



FINANCING PARTNERS

