Um Olhar Sobre a Despesa Pública

CIP

Centro de Integridade Pública

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THE GOVERNMENT PREFERS TO MORTGAGE GAS REVENUES RATHER THAN HOLD RESPONSIBLE THE AUTHORS OF THE HIDDEN DEBTS

The Government continues to take decisions without informing the Mozambican people

I. Background

On March 20, 2018, the Government of Mozambique sent a mission to London, United Kingdom, to discuss with creditors a possible forgiveness of 50% of interest payments (and likely related penalties) and capital in arrears (so far amounting to US$ 636 million), a reduction in interest rates and an extended maturity for the repayment of the hidden debts.

A document prepared by the Ministry of Economy and Finance, with the assistance of the financial and legal advisors Lazard Frères SAS and White & Case LLP, respectively, addressed to the foreign debt creditors[1], aimed at presenting the macrofiscal situation of the country, an analysis of the sustainability of the public debt as well as potential proposals of restructuring scenarios to convince lenders to reschedule foreign debt service in the coming years.

After a detailed analysis, the Center for Public Integrity (CIP in Portuguese) wishes to point out that it remains patently clear that the Government has no interest in sharing with the Mozambican people -- including, importantly, civil society -- the substance of the proposal before submitting it to the country's creditors. Severe communication and accountability failures persist.

This restructuring proposal sacrifices the well-being of Mozambicans now and in the future, without at any time there having been any consultation with Parliament or any other institution that represents tax-paying citizens, with the Government knowing very well that the proposal presented has an impact on the country's economy and on future generations. It is a proposal specially prepared for creditors, ignoring the rest of Mozambican society - and CIP considers that this demonstrates that the Government's promise of more transparency in these issues is empty talk.

For CIP, this proposal by the Government to creditors shows categorically that the Government has already assumed the debts of Pro-Indicus and MAM as public debts, contrary to the pronouncements that it would be the companies, which contracted these debts, who take responsibility for the debts.

According to the various social media, following the proposal to forgive 50% of debt in arrears, the representative of the group of investors holding more than 80% of the total of US$ 727.5 million issued in 2016 said that the proposal had been rejected

1 Presentation to Creditors - March 20, 2018, Republic of Mozambique.

1.1 What are the macrofiscal arguments presented by the Government to creditors?

The Government presents prospects for a gradual recovery of real GDP growth from 3% in 2017-2018 to 4.4% by 2022. Among other perspectives presented by the Government the following stand out:

• Real GDP growth remains significantly below the historical mean, averaging 3.4% between 2016 and 2022, compared to 7.4% between 2005 and 2015[2];

• The potential for economic growth resulting from Liquefied Natural Gas (LNG) should begin as of 2023.

The paper focuses on the gains from the restrictive monetary policy implemented by the Central Bank with respect to the deceleration of inflation (a year-on-year rate of 26.4% in November 2016 compared to 2.9% in February 2018) and the relative stability of the exchange rate (in the range of 57-63 MZN / USD in the last 8 months against 76 MZN / USD in November 2016).

But as far as fiscal policy is concerned, the Government suddenly speaks only of actions to be taken, not of measures already taken as in the sectors mentioned above. This is followed by the Government document announcing that it expects to reach a primary balance of 0.0% of GDP by 2022, starting from a primary deficit of 4.5% of GDP[3].

Box 1. What is the Primary Balance?

The primary balance measures the fundamental robustness of the fiscal situation. In arithmetic terms, it is the difference between total revenues (without grants) and total expenditures, excluding interest, foreign-financed investment and foreign-financed net lending. In terms of analysis, the primary balance is used to measure the accountability / lack of accountability of fiscal policy.

Since the primary balance excludes interest payments on debt (both internal and external), a primary balance below zero (zero or negative, i.e., lower than internal and external interest payments) indicates that the Government would have to take out new loans only to pay off existing debt - not to mention borrowing to finance domestic investment.

Only a positive primary balance, equal to or greater than interest payments, would imply that the Government would need not to take out new loans exclusively to pay the debt service[1]. From this point of view, a balance of 0.0%, as projected by the Government for 2022, is not enough. If, of course, it was the intention of the Government to appease the creditors with this projection, the policy makers fell short - and indeed the creditors concluded that the Government's measures to correct the fiscal situation were not strong enough.

It is the interpretation of CIP that the measures presented by the Government are not credible because they emphasize administrative measures related to: (1) revenues - which in no country are achieved as anticipated; (2) general measures on personnel costs; and (3) other low impact administrative measures. In addition, these "measures" would only take place from 2019 onwards- after the elections ???

Nonetheless, the Government insists on its document that it has already taken steps in the direction of fiscal adjustment: the presentation cites a table on page 7 with examples of the measures already taken. But they only show actions that do not convince. For example, the Government says that there is already restraint on staff costs. But the Government Budget for 2018 foresees an increase of 19.2% in these expenditures, well above inflation and any other realistic comparators[4] - the Government has not yet understood that containment implies growth that does not worsen macroeconomic variables such as inflation and the exchange rate.

They also mention the elimination of the subsidy for fuel and wheat flour - measures taken a long time ago that have already had an impact and will not bring new savings.

2 The causes of the fall in economic activity (Gross Domestic Product, GDP) in 2016, among other aspects, are related to the adverse developments in the market of commodities, climatic conditions and the political environment.

3 It should be emphasized that the Government does not think it important enough to present this definition of the fiscal balance to the Mozambicans. In previous publications, the CIP urged the Government to introduce the primary balance in its fiscal accounts, as it is a key tool for guiding fiscal policies.

4 The 2018 Government Budget does show a reduction in personnel expenditure in relation to GDP. But this is based on a real GDP growth of 5.3%, when the Government itself has already admitted in its document that real GDP growth will only be 2.8%!

In this respect it should also be emphasized (as CIP has done in a recent publication)[5] that high interest rates stymie economic activity:

"High interest rates reduce the likelihood that companies will be able to obtain credit, which, in turn, will depress economic activity. Although inflation has returned to manageable levels, the economic environment remains unfavorable - and the cost of living of Mozambicans has increased as a result of high interest rates.

Let's see: companies have to close their doors because they cannot bear the weight of credit at high interest rates, resulting in the loss of jobs and thus decreasing household income. One can also see that the fall in the purchasing power of the population has resulted in a fall in imports, increasing the difficulties for many companies to maintain employment levels (vicious circle)."

Box 2. Natural Resources

In the Oil and Gas sector, the Government presented the progress made in Areas 1 and 4 of the Rovuma Basin and the situation in the current year, highlighting: (i) Anadarko negotiations with potential clients that could lead to the final investment decision by the end of the first quarter; (ii) approval of ENI's development plan for the floating liquefied natural gas (LNG) platform project in area 4; and (iii) signing of a contract for the LNG terminal among ENI, Anadarko and the Government. As an impact of these developments, the document outlines that LNG projects will lead to improvements in GDP growth and balance of payments accounts.

• Gas exports could reach 18 billion cubic meters by 2024, generating over US$ 7 billion in net LNG exports;
• Real GDP is expected to grow by 8-10% in 2023.
• However, the document points out that, at best, government revenues from LNG production will not be significant until the end of the 2020s and early 2030s. It points out as the main factors the operational risks, change of the investment environment for megaprojects and the excess supply of LNG at the international level.

The Government has optimistic expectations regarding the collection of revenues from LNG that may or may not be realized, given the volatility of the prices of this type of resources. If the projections are realized, it is a good from a perspective that the country will probably be able to honor its commitments to repay these and other debts (because one cannot forget the debts contracted with the Government's guarantee in favor of public companies). But the commitment to fight against poverty will be postponed once again.

GDP will continue at high levels of growth, but associated with low levels of social development. Therefore, quantitatively, the country will be able to return to the 2005-2014 growth levels (about 7.5% annually) at the expense of poor public transport, education, health, water and sanitation and infrastructure (qualitatively).

II. Overview Negotiations in London

2.1 Creditors rejected the restructuring proposal

According to the various social media, following the proposal to forgive 50% of debt in arrears, the representative of the group of investors holding more than 80% of the total of the US$ 727.5 million issued in 2016 said that the proposal had been rejected.

From a logical point of view, this would of course be the stance of a group of commercial debt holders. Moreover, this proposal shows exaggerated optimism on the part of the Mozambican Government in expecting that the creditors take a different position.

The refusal of debt restructuring by creditors means that Mozambique continues to be classified as "junk" by international credit rating agencies regarding the country's creditworthiness. The impact that the classification of "junk" can cause in the near future and in the medium / long term, in real terms in people's lives, will be apparent in both the financial sector and the real sector of the economy. In the financial sector, because investors will

5 https://www.cipmoz.org/index.php/pt/financas-publicas/859-porque-a-politica-fiscal-do-governo-esta-a-defraudar-o-povo-mocambicano, página 2

ask for higher interest rates to buy government bonds (the price of bonds issued by the government abroad has already fallen by 9.5%, which implies an increase in interest rates). In the real sector of the economy, there will be no progress in the fight for poverty reduction, since the Government does not have the resources for investments.

Box 3. Restructuring of the Mozambican debt

Mozambique has already benefited from several debt forgiveness initiatives. One of them relates back to June 1999, of around US$ 1.7 billion under the Highly Indebted Poor Countries (HIPC) Initiative launched by the World Bank and International Monetary Fund (IMF) addressing the seriousness of the debt problem in poor countries[2.]

This initiative had preconditions, such as the implementation of a poverty reduction plan, and reforms in the public sector from a legal and regulatory point of view –activities that initially seemed easy to undertake but that later resulted in many constraints.

FINAL COMMENTS

"In economics there is no such thing as a free lunch." The question that does not go away is: to what preconditions is the Government ready to submit in order to propose a debt forgiveness of more than US$ 300 million to creditors? It is CIP's understanding that creditors also want to benefit from the exploitation of gas and subsequently be part of the "banquet" that is likely to be underwritten by natural gas revenues. For CIP, whatever the existing preconditions are, the Government's proposal presented in London could result in a loss for the Mozambican people.

According to the proposal, it is CIP's understanding that the Government is no longer complying with its promise that these debts are the responsibility of the companies and not of the Mozambican Government. Therefore, it is incumbent upon the Government to explain, in the National Assembly, why it is taking a decision contrary to its previous position; and it is also still its obligation to provide crucial details of any proposed debt restructuring to the Mozambican people.

Moreover, the restructuring proposals only confirm the Government's strategy of mortgaging the economic future of Mozambique (see Annex 1), to the detriment of identifying the mismanagement of the public resources of a group of individuals that led the country to bankruptcy. If they are public debts, as the Government admits, why has there been no progress with regard to the criminal liability of the perpetrators? Why is it preferable to protect a handful of people at the expense of the welfare of an entire nation?

With this attitude, the Government continues to protect a group of individuals and authors of this indebtedness, fostering the non-accountability of the owners of the debts, at the expense of present and future sacrifices of all Mozambicans.

Finally, what should concern us Mozambicans is that the Government, in this presentation to creditors, put all hopes of recovery of the economy into a non-renewable extractive resource, without worrying about creating links with other productive sectors to leverage the economy and rely on diversified sources of revenue collection.

It is vital not to marginalize the other sectors of the economy, especially since the Government is mortgaging the profits of the extractive sector to protect mostly corrupt actions.

ANNEX 1

What were the Debt Context and Restructuring Assumptions Presented by the Government?

The original loan agreements with Pro-Indicus and MAM are not publicly available. CIP is also not aware of other proposals prior to the London proposals for debt restructuring. Therefore, CIP is unable to compare the proposals made in London with the initial conditions of these loans.

The Government in its document presented the following in relation to debt:

• Debt as a percentage of GDP increased from 88% to 128% between 2015 and 2016 and decreased to 112% in 2017 due to the stabilization of the exchange rate;

• The commercial debt represents 13% of total debt stock in 2017 and 40% of debt service.

According to the overview of the Mozambique's public debt sustainability analysis with respect to the sustainability limits defined by the IMF, at the end of 2017 Mozambique's indicators (see Table 1) were all above limits (with the exception of the of debt service in relation to exports, if we consider the tools of debt sustainability analysis for developing countries starting in July 2018).

Table 1. IMF limits for countries in the average position of the country policy and institutional assessment (CPIA)

Indicator	Level (2017)	Current Tool	New Tool
Present value of debt / GDP	67	40	40
Present value of debt / Exports	177	150	180
Present value of debt /Government Revenues	266	250	250
Debt Service /Exports	18	20	15
Debt Service / Revenues	27	20	18

Table 2. Situation of the installments in arrears of commercial debt to March 20, 2018 (in millions of USD):

Instrument	Payments in arrears		
	Total	Capital	Interest
Mozam 2023 (EMATUM)	136	0	136
MAM	345	268	78 (Approx.)
PROINDICUS	154	199	35 (Approx.)
Total	636	387	249

Source: Government of Mozambique

CIP considers that the presentation of these figures resulted in the rejection of creditors of the Government's proposals: the figures show a path of debt unsustainability in the medium term, despite the fiscal adjustment of the restructuring assumptions:

- Low interest rates until 2023;
- Moderate interest rates as of 2023 due to debt service constraints;
- 50% haircut of past due interest and possibly penalties;
- Limited amortization of capital until 2028;
- Local currency securities to be offered to national holders of securities in foreign currency.

Table 3. Restructuring options presented by the Government

	Currency	Conversion ratio of eligible amount	Maturity	Reimbursement	Coupon	Coupon payment frequency
Option 1	USD	1	16 years	Equal installments of capital in years 14, 15, 16	Up to year 5: 2% From year 5 to 10: 3% After year 10: 6%	Semi-annual
Option 2	USD	0.9	12 years	Equal installments of capital in years 10,11,12	Up to year 5: 1,5% After year 5: 5%	Semi-annual
Option 3	USD	0.8	8 years	Equal installments of capital in years 6, 7, 8	2.8%	Semi-annual

1 Technically this rhythm of lending is called a "snowball effect" because the Government cannot stop borrowing. Furthermore, without corrective policies, loans to finance the budget deficit would increase year after year - which is the case in Mozambique.

2 http://www.iese.ac.mz/lib/saber/fd_249.pdf

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Informação editorial

Director: Adriano Nuvunga

Equipa técnica: Anastácio Bibiane, Baltazar Fael, Borges Nhamire, Celeste Filipe, Edson Cortez, Egídio Rego, Fátima Mimbire, Inocência Mapisse, Jorge Matine Stélio Bila,

Propriedade: Centro de Integridade Pública
Maquetização: Liliana Mangove

Rua Fernão Melo e Castro,
Bairro da Sommerschild, nº 124
Tel: (+258) 21 499916 | Fax: (+258) 21 499917
Cel: (+258) 82 3016391
@CIP.Mozambique @CIPMoz
www.cipmoz.org | Maputo - Moçambique