



CENTRO DE INTEGRIDADE PÚBLICA  
Anticorrupção - Transparência - Integridade



# COSTS AND CONSEQUENCES OF THE HIDDEN DEBT SCANDAL OF MOZAMBIQUE



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**“This case is very important for Mozambique since these criminal offenses caused devastating effects to the Mozambican economy”**

The Attorney General of the Republic, 23 August 2019

Centro de Integridade Pública (CIP), Moçambique, and  
Chr. Michelsen Institute, Norway

Maputo, Moçambique / Bergen, Norway

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# TABLE OF CONTENTES

<b>EXECUTIVE SUMMARY.....</b>	<b>6</b>
<b>PREFACE.....</b>	<b>9</b>
<b>ACKNOWLEDGMENTS.....</b>	<b>12</b>
<b>ACRONYMS AND ABBREVIATIONS .....</b>	<b>14</b>
<b>1. INTRODUCTION.....</b>	<b>16</b>
1.1 Short history of the hidden debts scheme.....	16
1.2 A redistribution from poor to rich.....	17
1.3 Structure, methodology and analytical logic.....	18
<b>2. THE DIRECT COSTS OF THE HIDDEN DEBTS.....</b>	<b>23</b>
2.1 Methodology and data.....	23
2.2 Direct costs related to the loans as of end-2019.....	24
2.3 Future monetary expenses regarding the loans.....	26
2.4 The financial loss for Mozambican citizens.....	26
<b>3. THE INDIRECT LOSSES CAUSED BY THE HIDDEN DEBTS.....</b>	<b>29</b>
3.1 Introduction.....	29
3.2 Impact of the hidden debts: Methodology and calculation.....	29
3.3 Fiscal Sector.....	33
3.4 Public sector debt.....	36
3.5 Inflation: Fall in purchasing power.....	39
3.6 Monetary and Foreign Exchange sector.....	41
3.7 External Sector.....	44
3.8 Analysis of the Real Sector.....	48
3.9 Conclusions.....	51
<b>4. POLITICAL AND INSTITUTIONAL COSTS AND EFFECTS.....</b>	<b>54</b>
4.1 Introduction: Trends of indices worsened.....	54
4.2 Analytical and methodological framework.....	56

4.3	More tension: the political economy of the hidden debts.....	60
4.4	Credibility of the regime – internal and external.....	70
4.5	Responsibility and impunity: the Executive and its institutional counter-weights.....	73
4.6	Public finances: Less transparency, more concealment.....	80
4.7	Democracy and the public space: freedoms and repression.....	88
4.8	Summary: Theses on the influence of the HD.....	101
<b>5.</b>	<b>SOCIAL CONSEQUENCES.....</b>	<b>106</b>
5.1	Poverty increased.....	106
5.2	Malaise and fewer opportunities because of public expenditure cuts.....	112
5.3	What do Mozambicans say about the socio-economic situation?.....	115
5.4	Summary.....	117
<b>6.</b>	<b>SUMMARY OF THE CONCLUSIONS.....</b>	<b>119</b>
6.1	Fraud and political corruption.....	119
6.2	The direct financial costs.....	120
6.3	The economic losses.....	121
6.4	Political and institutional costs and effects.....	124
6.5	The social impacts.....	126
<b>7.</b>	<b>ANNEXES.....</b>	<b>129</b>
	Annex to Chapter 2.....	129
	Annex 1 to Chapter 3.....	135
	Economic databases (chapters 2-3).....	138
	Databases on governance, institutions, and political analysis (chapter 4).....	139
<b>8.</b>	<b>LITERATURE.....</b>	<b>140</b>

# EXECUTIVE SUMMARY

## *How a \$2 billion hidden and corrupt loan has cost \$11 billion and increased poverty*

In 2013, bankers in Europe, businesspeople based in the Middle East, and senior politicians and public servants in Mozambique conspired to organise a USD 2 billion loan to Mozambique – an incredible 12% of GDP of one of the poorest countries in the world. The loan was kept hidden. None of the borrowed money, except bribes, went to Mozambique, and there were no services or products of benefit to the Mozambican people.

The knock-on effects of such a huge corruption scandal may already have cost Mozambique at least USD 11 billion – nearly the country's entire 2016 GDP – and almost 2 million people have been pushed into poverty. If Mozambique is forced to service this debt, there is USD 4 billion more to pay, on top of future damaging impacts.

This report is an inventory of the huge costs and consequences of the hidden debt scandal – measuring them in numbers where possible and tracing the chain of harmful events and tendencies resulting from it. The impacts were economic (direct costs and damages), social (reducing welfare), and institutional (worsening politico-institutional environment).

### *Economic costs*

There are direct costs associated with the loans, mainly past and future costs of interest and repayments. Past direct costs – those incurred up to, and including, 2019 – amounted to USD 674,2 million. To that will be added another USD 3,93 billion that the country will have to pay to service the hidden debt until 2031.

The economic crisis was caused partly by the debt itself, but even more by the damage that flowed from the secrecy and corruption, and the following discredit. And its impact on Mozambicans was hugely more than the hidden debt. When rumours about hidden loans began to circulate, Mozambican ministers lied to the IMF and ambassadors of Mozambique's development partners, denying the existence of any loans. When the Wall Street Journal revealed the hidden debt in April 2016, the anger was extreme. Donors and lenders had kept the country afloat, and they pulled the plug. The IMF halted its programme and donors cancelled direct budget support and other aid to the government – a reduction of USD 831 million in 2016 compared to the year before. The cascade that followed included a fiscal crisis making the government unable to pay its bills, there was a major currency devaluation, foreign debt became unpayable, the economy slowed down sharply, real GDP per capita fell, unemployment soared, and poverty increased.

This report calculates that damage. The best and simplest overall measure of it is the fall in the value of the GDP caused by the debt, which we calculate to be USD 10.7 billion in the four-year period. Future costs of lost GDP will continue to pile up, since the damage caused by the HDS is perennial.

#### Summary of costs and losses because of the HDS, 2016-2019

Economic costs of the HDS	TOTAL					Per capita in USD
	in USD millions					
	2016	2017	2018	2019	Total	
Direct costs, payments made	674				674	22
Loss from economic slow-down	3,384	3,120	2,339	1,815	10,659	381
<b>Total economic costs</b>	<b>4,058</b>	<b>3,120</b>	<b>2,339</b>	<b>1,815</b>	<b>11,333</b>	<b>403</b>

Summarised, a group of corrupt businesspeople and senior government officials committed Mozambique to a debt of over USD 2 billion and split the proceeds of the fraud. **That cost Mozambicans, in the years 2016-2019 alone, over USD 11 billion – or USD 403 per citizen.**

On top of that, in the decade to come, Mozambique is scheduled to pay nearly USD 4 billion more in direct costs, plus the incalculable economic damage.

## Social costs

The sudden reduction of external donations after the hidden loans were revealed in April 2016 triggered a fiscal and monetary instability that forced the government reduce public spending severely.

In 2016 real public expenditure (in USD) was cut to less than half of what it was in 2014. That reduction in public expenditure hit the sectors aiming at social welfare. Comparing the three-year average of 2016-18 to the three previous years, spending on health and education fell by USD 1,7 billion – entirely due to the debt. Put in per capita terms, the scandal caused, for each Mozambican citizen:

- USD 10 less in the education sector, each year
- USD 7 less in the health sector, each year

There are many indications that **poverty increased** during the years after 2015, in various ways of measuring it. The sudden rise in inflation in 2016 and rising prices drove 2,6 million people under the threshold of consumption-based poverty, as shown by studies projecting poverty levels in 2016 using data from the most recent household surveys (IOF 2014/15). We then estimated the proportion of the increase in poverty to be explained by the hidden debt, and found that:

**- because of the hidden debt scandal, at least 1,9 million people fell below the line of consumption-based poverty by 2019.**

There is no starker measure of the tragedy that the hidden debt scandal has inflicted upon Mozambicans.

## Political and institutional costs

The costs and consequences of the hidden debt scandal on the political and institutional landscape in Mozambique were real and severe, yet no single figure or currency captures its full impact.

Mozambique's performance deteriorated on all relevant indexes measuring aspects of democracy, governance, public financial management and credibility in the decade between 2010-2020. Many of them also registered an acceleration of the deterioration after 2013 when the debt was incurred, and a particularly sharp fall coalescing with the discovery of the secret debt in 2016 – the “smoking gun” evidencing the secret debt's contribution to the deterioration. This report goes beyond circumstantial evidence and also shows how and why the hidden debt contributed to the deterioration of governance.

Knowing that the debt was illegal and fraudulent, some powerful Mozambicans pushed developments contradicting good and democratic governance. They acted to:

- Cover up the deal and the debt, reducing transparency. Senior politicians lied to the public about the debt, and public finance management reforms stagnated or were reversed.
- Seek impunity, manipulating politics and institutions to avoid accountability for punishable offences. So far, no one in Mozambique has been held to account and convicted for manifestly illegal actions. Checks and balances failed. The Justice system and the Assembly of the Republic were unable to control the actions of the Executive. A Special commission of the Assembly of the Republic was highly critical, but no action was taken. The Constitutional Council ruled that the hidden loans were unconstitutional, but the Executive has ignored this.
- Create political conflict, reducing institutional cooperation. Injection of large amounts of money into one faction of the political elite, and the inevitable bickering over responsibility following the fraud, increased factional fights and institutional chaos.

- Discredit the country and its reputation, as the eventual and inevitable discovery of the debt damaged the Government's and country's reputation and integrity. Mozambique's credit rating plummeted, and its reputation as a serious development partner was severely dented.

Some were inevitable costs of the decision to defraud the state and the population. However, some political choices were not inevitable. When Mozambican society reacted to the fraud with demands of accountability and refusal to pay the debt, the state chose to implement:

- authoritarian measures, countering the principles of the liberal-democratic Constitution. Harassment of key individuals reduced the scope for public criticism. Blatant manipulation of elections in 2018 and 2019 reduced chances that the regime would lose power.

Summarised, the hidden debt and ensuing scandal impacted heavily on politics and institutions and led to:

1. More contradictions and debilitating conflicts within the state and political system.
2. Worse governance quality and weakened state institutions.
3. Disrepute of the regime and government.
4. A less democratic and more authoritarian country.



# PREFACE

## *The origin of the report*

This report is a contribution of the Centre for Public Integrity (CIP) of Mozambique and of the Chr. Michelsen Institute (CMI) of Norway towards the understanding of the greatest corruption scandal in the history of Mozambique, commonly known as “the hidden debts scandal”. The report is far from a final narrative about this huge corruption scandal which shook Mozambique, but it will be an important step forward in the debate. It may constitute a starting point for various approaches that could be made about this case. The direction the case has taken, domestically and internationally, is proof of this.

The report presents succinctly the financial, economic, political, and social costs of this enormous financial fraud, in which the protagonists were the Franco-Lebanese company Prinvest, two international banks, namely Credit Suisse and VTB of Russia, and senior figures in the Mozambican government close to the former President, Armando Guebuza.

Although the initial sum received as a loan by the companies Ematum, ProIndicus and Mozambique Asset Management (MAM) was USD two billion, the direct costs and the damage that this fraud has inflicted on the Mozambican economy has already exceeded USD 11 billion. In addition to this, Mozambique will have to pay - in line with the current value of the debt – a further total of USD four billion. Throughout the report, it is possible to see that the discovery of these debts had a domino effect across all sectors, whether productive or not, of the Mozambican economy, damaging the trust which citizens place in political institutions, and the image of the country internationally. One of the direct consequences of the debts is that they drove millions more people into poverty. The additional number of poor people created is estimated here at 1.9 million up to 2019.

In 2019 the Centre for Public Integrity (CIP) invited researchers from the Chr. Michelsen Institute (CMI) in Bergen, Norway, to participate in a team to draw up an inventory of the economic, social and political costs and consequences of the hidden debts, and then to calculate and estimate the size of each cost and consequence. This report is the result. Inspired by important studies which sought to estimate the costs and consequence of corruption in Mozambique (Stasavage 1999; CIP&CMI 2016; Tvedten & Picardo 2019), and others which early on reached partial results of the costs of the hidden debts (Isaksen & Williams 2016; Mosca & Aiuba 2017; Weimer & Carrilho 2017), this study intends to make an overall inventory of the losses.

## *The hidden debts, the pandemic and other disasters*

The final draft of the report was drawn up in the second half of 2020, a time when the Covid-19 pandemic was battering both Mozambique and the rest of the world. This analysis will make no mention of this plague, for the simple reason that the last year included in the report is 2019. It is, however, noteworthy that in that year Mozambique suffered the abnormal consequences and costs associated with the damage caused by the cyclones named Idai and Kenneth. The consequences of these disasters will be included in the due analyses under the relevant indicators.

The reader will have the opportunity to understand that a small group of people linked to the hidden debts scandal, some of them Mozambican and others foreign, caused damage which greatly exceeds the losses caused by the cyclones. The debts which they managed to conceal until 2016 resulted in an economic meltdown, a weakening of the institutions of governance, and a loss of political and international trust. They contributed to a worsening of the social indicators.

While we do not yet know the consequences of the pandemic currently under way, we are sure that Mozambique would have had much greater capacity to face the pandemic – and perhaps also the growing problem of the war in Cabo Delgado – had it not been for the hidden debts. For example, we will show that it is likely that, without the hidden debts, the health services would have been in better condition. Although our analysis is mostly retrospective, it is obvious to us that the costs of the hidden debts will have consequences of delaying development, also in the future – like a coefficient that multiplies the weight of all the other difficulties.

The analysis in the report leaves aside speculations about the future, the forensic debate about the individuals responsible, and the politico-normative considerations about the necessary reforms in governance. It is dedicated mainly to describing and analysing the consequences of the hidden debts, and calculating their costs realistically, from their conception up to the end of 2019.

### *The judicial situation of the HD*

When the CIP and CMI team of researchers finished writing this report, 17 citizens were under arrest in Mozambique, accused by the Attorney-General's Office of being involved and of having benefitted directly from this corrupt scheme. Among them there stand out:

- Ndambi Armando Guebuza, son of the former President of Mozambique, Armando Guebuza;
- Gregório Leão, former director of the State Intelligence and Security Services (SISE)
- António Carlos do Rosário, former Chairperson of the Board of Directors of Ematum, ProIndicus and MAM;
- Inês Moiane, private secretary of President Armando Guebuza;
- Renato Matusse, political advisor to the then President Armando Guebuza;
- Teófilo Nhangumele, one of the Mozambicans who is also accused in this same case by United States prosecutors.

Internationally, the former Minister of Finance, Manuel Chang, has been under detention in South Africa since 29 December 2018, awaiting a decision as to whether he will be extradited to the United States or to Mozambique. While Chang was awaiting this decision, in the United States, in a New York court, Prinvest official Jean Boustani was tried and the jury considered he had not committed the crimes of which he was accused within the New York jurisdiction, and so he was acquitted.

In London courts, other lawsuits are under way. In one of them, the Mozambican Attorney-General's Office is pitted against the bank Credit Suisse and Prinvest, while in others a group of creditors is fighting the Mozambican government, as well as VTB against MAM and the Republic of Mozambique.

So, when the final draft of this report was produced, this case was still far from reaching an outcome in the various jurisdictions where the lawsuits were being waged. However, its effects, as from 2016, are already visible in the lives of millions of Mozambicans who have witnessed a worsening cost of living and the deep economic and financial crisis into which the country has been plunged.

With regard to the lawsuits, although it is regrettable, the delay in the trial of the various cases related with this enormous corruption scheme is understandable. It is justified by the fact that the cases are taking place in several jurisdictions and may potentially have a contagion effect – that is, the decision in one case may influence or produce evidence for the other cases.

### *The path to follow*

However, the same excuse cannot be used for the delay in introducing structural reforms to prevent the occurrence of new scandals on this scale.

Since the discovery of the hidden debts, in April 2016, more than four years have passed and the focus of the analyses is still on the individuals who were behind the contracting of the debts, and never on analysing how the system of checks and balances completely failed to create antibodies so that a fraud of this nature would not happen

The Assembly of the Republic (AR) failed completely in its role of checking the actions of the Executive, and did not redeem itself even after the debts were discovered. The parliamentary commission that investigated the case was a clear example of this failure of the AR. The Mozambican parliament never managed to take the case of the hidden debts as an opportunity to initiate a more profound debate on the role of the legislature as inspector of government actions, probably

because parliament is controlled by the ruling party which benefitted from the swindle (in the New York court, documents were presented which proved bank transfers of about USD 10 million to finance the party's campaign), in which at least part of the leadership was complicit. So, it is an inconvenient matter for the Frelimo parliamentary group.

As for the judiciary, this also showed it did not have enough power to force the Executive to comply with the Constitution. The refusal of the government to obey rulings of the Constitutional Council is the most flagrant example.

It is essential that the country should reflect deeply on the structural reforms that should be implemented so that cases like this are not repeated. And after this reflection, mechanisms must be set up to guarantee that these reforms are undertaken. The Assembly of the Republic should lead this process.

But intellectuals, academics, civil society organisations and the public in general can and should play an important role in helping the political institutions make the necessary reforms.

Currently, the weaknesses of the system persist. Hence, new actors and the knowledge of what went wrong with the hidden debts, could lead to an even more daring swindle, and one which avoids financing from western countries, such as the United States and Britain who have legislation which can act beyond their physical borders.

If the internal control systems remain weak, if the parliament and the judiciary remain decorative bodies, then the Government of the day, under a presidentialist system in which the President of the Republic is all-powerful, can seek financing from creditors who are outside of the western financial systems, but who have liquidity and as a counterpart for the high risks involved, demand in exchange the country's natural resources.

The institutional weakness, the weakness of the institutions that should act as checks and balances raises some questions in the event that Mozambique manages to win the lawsuits that it brought in London, and if it has to be compensated for the damage done to Mozambicans. If this hypothesis comes to pass, where would the money paid to the country in compensation for the damage caused by the HD go? If the institutions are not credible and controlled by the Executive and by the party that controls the government, it raises the possibility of this money returning to the hands of some of those involved in this case, thus overturning all the efforts that are being made so that companies such as Prinvest, Credit Suisse can be held responsible for the damage done to the country.

This report is a contribution to the debate around this matter and may be a useful tool for political decision makers, for public institutions, for the Assembly of the Republic, the Attorney-General's Office, the Administrative Court, the Constitutional Council, the private sector, civil society organisations, intellectuals, academics, and the public at large. We are confident that the report will contribute to constructive and structuring debates. Debate it, criticise it and improve its analyses and estimates! But, above all – use it!

Let the extent and gravity of the injustice committed be known, so that it is never repeated, and so that its lessons may be used to build a more just, equitable and safe society!

Edson Cortez

Executive Director of CIP

May, 2021

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The authors of this study also wish to pay homage to the Mozambican men and women who have tirelessly claimed, questioned, examined, and checked information concerning the conspiracy of the hidden debts – and above all, those who have sacrificed their lives or their health in the fight against corruption.

We wish to extend our deep thanks to all who in this way have contributed and have guided us and encouraged us on this path.<sup>1</sup> Any mistakes or failings, however, are entirely the responsibility of the authors of the research that produced this report.

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## Acronyms and abbreviations

<b>AFP</b>	Agence France Presse
<b>AR</b>	Assembly of the Republic
<b>BBC</b>	British Broadcasting Corporation
<b>BM</b>	Bank of Mozambique
<b>BT</b>	Treasury bills
<b>CC</b>	Constitutional Council
<b>CEO</b>	Chief Economic Officer
<b>CGE</b>	General State Financial Accounts
<b>CIP</b>	Centre for Public Integrity
<b>CMI</b>	Christian Michelsen Institute
<b>CNN</b>	Cable News Network
<b>CPI</b>	Parliamentary Commission of Inquiry or Corruption Perception Index
<b>CPMO</b>	Monetary Policy Committee
<b>CRM</b>	Constitution of the Republic of Mozambique
<b>CTF</b>	Fiscal Transparency Code
<b>DFID</b>	Department for International Development (United Kingdom)
<b>DNT</b>	National Treasury Directorate
<b>DS</b>	Debt Service
<b>HD</b>	Hidden Debts
<b>DW</b>	Deutsche Welle
<b>EIU</b>	Economist Intelligence Unit
<b>EMATUM</b>	Mozambican Tuna Company S.A.
<b>ENH</b>	National Hydrocarbons Company
<b>EU</b>	European Union
<b>EUA</b>	United States of America
<b>EXP</b>	Exports
<b>IMF</b>	International Monetary Fund
<b>FDI</b>	Foreign Direct Investment
<b>FPC</b>	Permanent Lending Facility
<b>FPD</b>	Permanent Deposit Facility
<b>FRELIMO</b>	Mozambique Liberation Front
<b>FTE</b>	Fiscal Transparency Evaluation
<b>GDP</b>	Gross Domestic Product
<b>HD</b>	Hidden Debt
<b>HDI</b>	Human Development Index
<b>HDS</b>	Hidden Debt Scandal
<b>IAF</b>	Household Survey
<b>INE</b>	National Statistics Institute
<b>INEP</b>	National Employment Institute
<b>IOF</b>	Household Budget Survey
<b>KPMG</b>	Klynveld Peat Marwick Goerdeler (accountancy services)
<b>LIBOR</b>	London Inter-Bank Offered Rate
<b>MAIBOR</b>	Maputo Inter-Bank Offered Rate (Average interest rate on the Interbank Money Market in Maputo)
<b>MAM</b>	Mozambique Asset Management, S.A.
<b>MDM</b>	Mozambique Democratic Movement
<b>MEF</b>	Ministry of Economy and Finance

<b>MIMO</b>	Mozambique Inter-bank Market
<b>MMT</b>	Billions of Meticaís
<b>MP</b>	Public Prosecutor’s Office
<b>MT</b>	Metical (currency)
<b>MZN</b>	New Mozambican Metical
<b>NGO</b>	Non-governmental Organisation
<b>OBI</b>	Open Budget Initiative
<b>OE</b>	State Budget
<b>PFM</b>	Public Finance Management
<b>NGO</b>	Non-governmental Organisation
<b>PCA</b>	Chairperson of the Board of Directors
<b>PEFA</b>	Public Expenditure and Financial Accountability
<b>PGR</b>	Attorney-General’s Office
<b>GDP</b>	Gross Domestic Product
<b>SME</b>	Small and Medium Enterprises
<b>UNDP</b>	United Nations Development Programme
<b>pp</b>	Percentage points
<b>PPP</b>	Public-Private Partnerships
<b>PR</b>	President of the Republic
<b>PV</b>	Present Value
<b>RD</b>	Restricted Default
<b>REO</b>	Budget Execution Report
<b>REV</b>	Revenue
<b>RO</b>	Required Reserves
<b>RSA</b>	Republic of South Africa
<b>RWB</b>	Reporters without borders
<b>SC</b>	Civil Society
<b>SD</b>	Debt Service
<b>SG</b>	Secretary General
<b>SIMP</b>	Integrated Monitoring and Protection Service
<b>SISE</b>	State Intelligence and Security Services
<b>SME</b>	Small and Medium Enterprises
<b>TA</b>	Tribunal Administrativo. Administrative Court and Supreme Audit Institution
<b>TIM</b>	Independent Television of Mozambique
<b>TS</b>	Supreme Court
<b>TVM</b>	Mozambique Television
<b>UNDP</b>	United Nations Development Programme
<b>UNU-WIDER</b>	United Nations University – World Institute for Development Economics Research
<b>USD</b>	United States Dollar
<b>VAT</b>	Value Added Tax
<b>VPD</b>	Present Value of Debt
<b>VTB</b>	Vnesh Torg Bank (Russian bank)
<b>WGI</b>	World Governance Indicators
<b>ZAR</b>	South African Rand

# 1. INTRODUCTION



# 1 INTRODUCTION

## 1.1 Short history of the hidden debts scheme

The story of the hidden debts (HD) in Mozambique began when, sometime after 2010, individuals from a Franco-Lebanese shipbuilding company based in the Middle East, Privinvest, contacted managers at the bank Credit Suisse and certain people linked to the Mozambican government, with a proposal for a business deal involving billions of dollars. The assumption was that, due to the future revenues from exploiting the recently discovered natural gas deposits in the Rovuma Basin, Mozambique could accept financial resources from banks with the credible promise that it would easily have the capacity to reimburse them.

This proposed deal – or rather, scheme – led to the scandal of the “hidden debts”. Hidden debts is the term used to describe the debt associated with the loans made in 2013 and 2014 to three public companies – the Mozambican Tuna Company S.A. (EMATUM), Mozambique Asset Management S.A. (MAM) and ProIndicus S.A. – in which the major shareholders included the Intelligence and Security Service (SISE) and the Ministry of Defence. The EMATUM debt became public knowledge in 2013, while the MAM and ProIndicus debts remained hidden until April 2016.<sup>2</sup>

The three companies, set up in the same years in which the gigantic loans were arranged, presented as their justification fisheries and maritime security projects, using Credit Suisse and the Russian Vnesh Torg Bank (VTB) as financial partners. These banks granted loans of about two billion US dollars to the three companies.<sup>3</sup>

**Table 1. Guarantees authorised in 2013 and 2014**

Company	Year of loan	Amount of the loan	
		USD (million)	MT* (million)
EMATUM S.A.	2013	850	59.130
ProIndicus S.A.	2013	622	43.271
MAM S.A.	2014	535	37.218

Source: DNT and Law No 1/2013, of 7 January and Law No. 1/2014, of 24 January. \*At the exchange rate of 2020 with 1 USD=69.6 Meticais (the exchange rate for 2013 was 1 USD=29.84 Meticais).

It is already public knowledge that most of the money lent was used for purposes that had nothing to do with fishing or with maritime security. They were used for quite different purposes - including extravagant bribes for those implicated in Mozambique, in Europe and in the Middle East. An audit of the three companies in 2017, by the auditing company Kroll, removed any doubt about a fundamental question. The companies were built, not to operate, but as vehicles to release money from foreign banks (Kroll 2017). As a result, the companies never functioned as they should have, and ended up going bankrupt. Since they had not been operational, they did not produce any profits to pay their debts, nor could they produce goods, jobs or any public benefits.

Everything indicates that individuals linked to the Franco-Lebanese company Privinvest<sup>4</sup> were decisive as middlemen in the deal. They are accused of promising bribes to the Mozambicans involve in the scheme in exchange for large contracts with the three companies. A Privinvest official, Jean Boustani, told the court in New York that, to facilitate the process, and to guarantee the necessary political support in Mozambique and the first Credit Suisse loans, he paid millions of dollars to Mozambican politicians and middlemen as well as to bankers<sup>5</sup>. The “viability studies of the companies”, which supposedly justified the banks in granting the loans, seemed mere fabrications. Hence, it is correctly said that this was a highly sophisticated corrupt scheme.

<sup>2</sup> We can say that the debts were hidden, because they did not appear on any document accessible to the public, such as fiscal statistics, the state budget, the General State Financial Accounts, or other documents, as they should have done in line with the legal and regulatory framework and good practices.

<sup>3</sup> It is important to note that of the EMATUM loan – the so-called “Tunabonds” – only 782.4 million dollars were disbursed, equivalent to a discount of 8%. These bonds were converted in 2016 into sovereign bonds with a discount (“haircut”), and are now called Mozam Eurobonds, resulting in securities nominally worth 727.5 million dollars.

<sup>4</sup> Here we refer to Privinvest as a single entity, although technically it is a conglomerate of companies associated with its strong man, the Franco-Lebanese Iskandar Safa (<https://www.iskandar-safa.com/>). Some of the companies are registered in Lebanon, and others in the United Arab Emirates (UAE).

<sup>5</sup> Three Credit Suisse officials – Andrew Pearse, Surjan Singh and Detelina Subeva – pled guilty, before an American court, to receiving bribes from Boustani. For his part, Boustani, in the New York trial of 2019, admitted to bribing a long list of Mozambican officials (although technically he justified it with euphemisms such as ‘success fee’ and ‘commission’).



It is the sum of these loans and the issuing of debt – with state guarantees illegally signed by the then Minister of Finance, Manuel Chang – which constitute the package of hidden debts. With the Government guarantees, these loans came to constitute a contingent state debt. However, the debts in question were contracted without the due authorisation of the Assembly of the Republic, mentioned in Article 179, paragraph 2, line p) of the Constitution of the Republic, according to which it is the Assembly that must authorize the Government, laying down the general conditions within the context of the State Budget, to contract or to grant loans. The Constitutional Council ruled twice that arranging these loans was unconstitutional – with regard to EMATUM in June 2019, and with regard to MAM and ProIndicus in May 2020.

Perhaps because they were aware that the scheme was illicit, illegal and unconstitutional (individuals close to the then President, Armando Guebuza, had already received, or would receive, bribes for “facilitation”), those involved decided to conceal the true size of the debt, and succeeded for almost three years. The first discovery of these debts, in September 2013<sup>6</sup>, concerned the bonds issued in the name of EMATUM. It caused some political upsets in Mozambique and difficulties in the relations between the Mozambican government and its partners, particularly with the IMF. But this first phase of the scandal was milder than the discovery of the other two loans<sup>7</sup>.

A greater scandal exploded when, on 3 April 2016, the Wall Street Journal reported on the existence of almost USD 1.2 billion of debt not previously divulged, which concerned the loans to the companies ProIndicus and MAM. Even so, at the beginning, the Government continued to deny the existence of the loans, which reflected the politicisation of the Government’s economic strategy, ignoring the commonly accepted international standards of good governance.

In retrospect, it is obvious that the Mozambican Government, as a collective body, opted to conceal the facts. It was the national and foreign press that began to question the debts. It was civil society in Maputo that campaigned for transparency. It was the donor community which applied pressure to ensure that the three companies were audited. And many of the details we now know were revealed in courts in London and New York. Instead of the Government coming forward with information, lack of transparency reigned. To this were added statements that sought to mislead the public, such as the continued denial that the debt existed<sup>8</sup>. By failing to put its cards on the table, the Government fed a climate of suspicion and distrust which, after April 2016, brought economic, political, and institutional consequences.

The legal recognition of this illegal act suffered from delays, while the impact of the hidden debts grew ever larger. The IMF suspended its programme with the Government, and after a few months all the donors who had been giving direct support to the State Budget suspended their aid. A climate of general distrust set in affecting the relations between Mozambique and its international development partners. The legal imbroglio continued until, in 2020, it sharpened to the point of caricature. While parliament recognizes the hidden debts, and the Executive insists on the need to pay them, the Constitutional Council has declared all the hidden debts unconstitutional (and hence null and void) while the Attorney-General’s Office is suing Credit Suisse and Privinvest in the England and Wales High Court of Justice in London for fraud related to setting up the debt<sup>9</sup>.

## 1.2 A redistribution from poor to rich

Given the history outlined above, we would now like to summarise – in three simple points – what the scheme was all about.

1. **Individual gain.** The beneficiaries were a small group of individuals accused of involvement in designing the scheme. There were three separate groups, all of them from elites and already affluent in their respective countries. Standing out are: 1) bankers in Europe; 2) politicians and people with political influence in Mozambique (those who received bribes or diverted money from the companies); and 3) Privinvest, its owners, its staff, and its middlemen.
2. **No benefit to the public.** These loans did not bring anything that, even with an effort of imagination, we might call a public benefit. In other words, no Mozambican – apart from those implicated in the scheme – benefited

<sup>6</sup> <https://noticias.sapo.mz/actualidade/artigos/cronologia-da-criacao-da-ematum-a-crise-por-divida-escondida> (accessed on 26/08/2019)

<sup>7</sup> The problem with the IMF only came in April 2016. In December 2015, the IMF approved a Standby Credit Facility loan of 282.9 million dollars, even though it knew about the EMATUM bonds.

<sup>8</sup> A further example was the advertising bought in the magazine “Global Business”, which was fantastic and unbelievable propaganda about a tuna fishing fleet that would generate revenue for EMATUM of more than USD 200 million a year. See “EMATUM, fishing for the future of Mozambique”.

<sup>9</sup> The introduction to the case of the Republic of Mozambique against Credit Suisse, Privinvest and others, can be found here: <https://www.bailii.org/ew/cases/EWHC/Comm/2020/1709.html>

from the hidden debts.

3. **Fraud.** The hidden debts were arranged in an illegal and, according to the PGR, criminal way. The Constitutional Council declared them unconstitutional.

Hence, we are faced with a fraudulent scheme which sought to enrich an already influential elite without producing any public benefit. Other research will have to be dedicated to describing and explaining the processes which led to this Mozambican debacle, although forensic and journalistic investigations have already taught us a great deal about those implicated<sup>10</sup>.

But who was defrauded? There are two groups. The first consists of the investors who ultimately invested in the bonds and other debt instruments that were issued and sold by Credit Suisse. They invested in the public debt of one of the poorest countries in the world to make a profit. They did so voluntarily, knowing the high risks of investment that promised such attractive returns. The US Department of Justice declared that the fraudulent scheme “victimised investors from the United States and elsewhere”, which led US prosecutors to put Privinvest official Jean Boustani on trial in a New York court in 2019<sup>11</sup>.

But this report is primarily concerned with the second group, who were implicated involuntarily and are innocent of fraud, but who so far have not been defended in any court. They are the Mozambican people who have to repay the fraudulent debts and who have suffered from the delays in the country’s development. This group includes all the Mozambicans – the living, those who have died since 2106, and those not yet born – who knew nothing of the debts (since they were hidden) and in no way benefitted from them. Even so, because they are Mozambican citizens, they have suffered and will suffer the damaging consequences of this debt, and will pay its costs while the Government continues to insist on using the public treasury to reimburse creditors and to solve the other secondary problems that the HD have brought. This is really the central point: the use of the Mozambican public treasury.

The payment of the hidden debts, through the public treasury, is a redistribution of the country’s resources to favour some people in the Mozambican political and economic elite who enriched themselves through these loans. This redistribution is paid by:

- The Poor: Since the majority of the Mozambican population are poor, and there is a trend for this majority to grow even larger (see Chapter 5), this is a redistribution from poor people to the elite who benefitted from the loans. As is the case with all public debt, it reduced the capacity of the State to provide public services and increases the pressure to gather taxes from citizens. This group will suffer the high fiscal costs of the HD and, because they are an illegitimate debt, will suffer the enormous indirect consequences – political, institutional and social.
- Future generations: In an attempt to minimise the immediate damaging consequences, the postponement of paying the debt will merely result in transferring the weight to future generations. Even if the Government manages to delay payment of the debt to the moment when revenue from the Rovuma Basin gas reserves begin to materialise (currently forecast for 2023), a significant part of this revenue will have to be used to pay the hidden debts, thus delaying or limiting the benefits of the gas revenue for Mozambican citizens. The costs and consequences already incurred can never be recovered, even with the gas revenues.

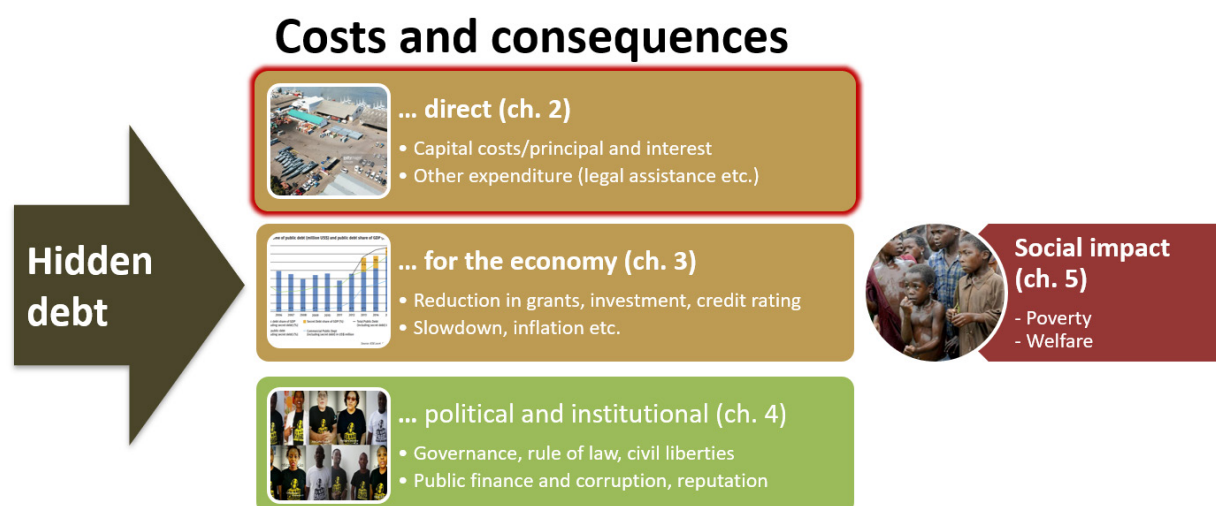
## 1.3 Structure, methodology and analytical logic

The rest of this report seeks: 1) to draw up an inventory, and 2) to calculate, or estimate the size of, the fiscal costs and the economic, political, institutional, and social costs of the HD. Throughout the analysis, we have endeavoured to make explicit the causal mechanisms to strengthen the credibility of the calculations and the estimates of the effects. The discussion of causal mechanisms is necessary in order to estimate the explanatory weight of the hidden debts in each variable or indicator analysed (from the decline in the GDP, to the reduction in the quality of governance and to the increase in poverty).

<sup>10</sup> See the “dossier of the Hidden Debts” on the CIP pages <https://cipmoz.org/category/dividas-ocultas/> the EMATUM indictment <https://www.justice.gov/criminal-fraud/file/1150716/download>, and Kroll (2017).

<sup>11</sup> See press release, 7 March 2019, <https://www.justice.gov/opa/pr/mozambique-s-former-finance-minister-indicted-alongside-other-former-mozambican-officials>.

Figure 1.1: The division of chapters by area of analysis



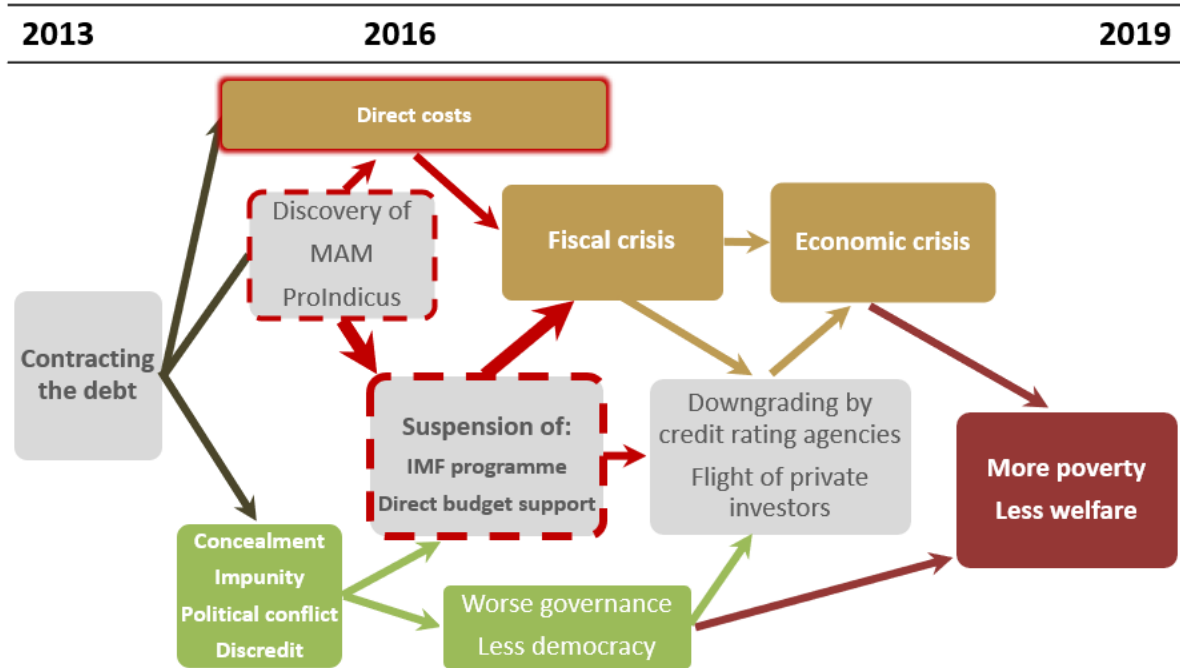
The following chapters are divided, in accordance with the effects of the hidden debts, into four areas:

- Chapter 2: The direct costs associated with the HD. These are the financial costs for servicing the hidden debts and for other expenditure directly linked to them, including the management of the scandal and the litigation in Mozambican and foreign courts.
- Chapter 3: The indirect consequences for the Mozambican economy. The scandal unleashed a series of grave reactions almost immediately after the revelation of the existence of the HD. In the following years, these could be found in the various indices showing the economic situation of the country – the most central of which are analysed.
- Chapter 4: Consequences for the political and institutional system, since the magnitude of the scandal ensured that the HD impacted on the core of the political system and the institutions of governance of the country. The most important indicators in the areas of governance are analysed.
- Chapter 5: The social impacts. The most important indicator is the level of poverty, which was affected by the HD. Furthermore, the HD had an impact on public expenditure in the social sectors, which in turn ultimately had impacts on social welfare.

In analytical terms, it should immediately be stressed that there is a cascade of effects, through mechanisms and variables of causal effects (and some retroactive effects), which can be identified and analysed. That is the main task of this research: to draw up an inventory of these causal effects and to calculate, measure or estimate the consequences of each mechanism and each variable. Making the effects explicit is key for the credibility of the study.

Our hypothesis is that the hidden debts have provoked and will go on provoking serious social impacts through various mechanisms. These may be summarised with a simple chronology (details in the following chapters) and illustrated in the model of causes and consequences in figure 1.2. Clearly, the chronology is merely indicative. The arrows in the graph indicate a causal mechanism. The colours in the boxes indicate the category of effect, which are: direct financial costs (beige with a highlight), other economic consequences (beige), the political and institutional consequences (green), and the social impacts (red). The boxes in grey are events.

Figure 1.2: Model of consequences of the hidden debts



In the first moment (arrows in black), the contracting of the hidden debts caused two effects: i) the direct financial costs associated with payment of the debt, and ii) in the political and institutional field, government members accepted additional costs that were barely made explicit. They acted to conceal the fraud, to guarantee the impunity of those who instigated it, and they took decisions that created more political tension and led to domestic and international discredit.

The second moment (red arrows) is the most dramatic in this sequence of causes and effects: the discovery of the MAM and ProIndicus debts. This provoked strong indignation and anger among the Mozambican government’s development partners. Immediately, they decided to suspend many programmes of financial support. This measure, which was a reaction to political decisions and not to economic developments, contributed strongly to the fiscal crisis and to a drastic reduction of the State Budget. These events, in the second quarter of 2016, were noted by the influential credit ratings agencies, which downgraded the reliability of Mozambique, and by international investors, whose willingness to invest in the country declined. The discovery of the additional hidden debts also led to some added direct costs, worsening the fiscal crisis.

In the third moment (beige arrows), the sudden worsening of the fiscal crisis contributed to the general economic crisis that took hold in the country as of 2016, described in chapter 3. It also contributed to the downgrading made by the ratings agencies, since the fiscal scenario began to show that it was ever less likely that Mozambique would manage to repay its foreign debt. This downgrading in turn led to worse conditions for Mozambique on the international capital markets.

The HD also worsened the growing political and institutional difficulties of the country (the topic of Chapter 4), a logic which applies to this entire period (green arrows). The corruption, the lies and their discovery shook the Government. The clear indications of worsening governance at this time – for example, with respect to public financial management and cases of corruption exposed in the media – contributed to the suspension of financial aid, to downgrading and to less investment. The difficulties of managing the situation created by the HD in turn contributed to less democracy and worse governance.

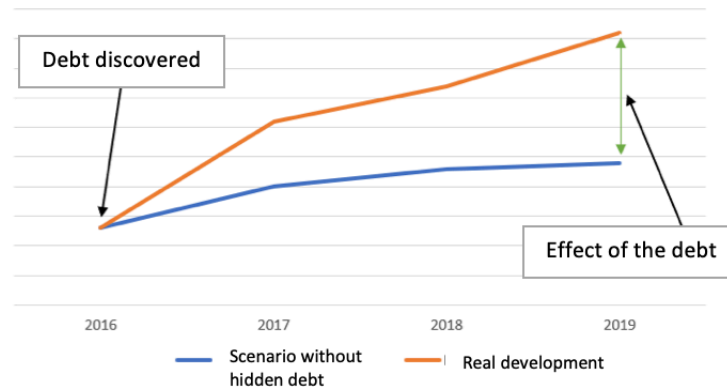
In the final moment (arrows in red), the effect of the economic crisis and the decline in the quality of the political and governance institutions converged to increase poverty and reduce social welfare.

While the direct costs associated with the management of the HD have a single cause – the contracting of these debts – there are clearly other factors that influence the economy, the institutions and social welfare. For example, the environment on the international markets has had impacts on the economy, and natural disasters could have created more poverty.

Hence, in order to calculate the effects of the DO it is not enough to show the causal mechanisms that produced an impact on the indicators of other phenomena. It is necessary to estimate their explanatory weight, compared with other causal factors, which is a methodologically complex task. We do so where possible, but in other instances we have been forced to resort to estimates = which can clearly be debated.

To estimate the effect of the HD, the method applied is, in principle, the same for all variables (indicators or indices):

Graph 1.1: Estimates with and without hidden debts



Baseline – Indicator 2019 = change during the HD years

Change during the HD years x weight of the HD = Effect of the HD

The baseline varies depending on the variable in question. For some variables, the most correct approach is to compare the situation in 2019 with the situation in the year prior to the year in which the impact of the HD is thought to have begun (between 2013 and 2015). For other variables, it is more correct to compare the situation in 2019 with what was expected in qualified projections (for example, the economic forecasts of the IMF).



## **THE DIRECT COSTS OF THE HIDDEN DEBTS**

## 2 THE DIRECT COSTS OF THE HIDDEN DEBTS

This chapter presents, in overall terms,<sup>12</sup> the costs or financial losses taken on by the Mozambican government, associated with the (monetary) expenses related to the hidden debts (HD) scandal. The costs or losses are expressed in terms of the present value of the financial losses associated with the current and future (monetary) expenses, which total 4,618,700,000 US dollars – equivalent to about 159 dollars for every Mozambican citizen – for every man, woman and child.

This sum includes: i) the direct losses related to the loans taken on by the government as of end-2019. These come to 674.2 million dollars paid, and a remaining debt of 2,031 million dollars, and ii) the present value<sup>13</sup> of the direct costs related to the loans in the future, from 2019 onwards, which add up to USD 3,929,800,000. It should be noted that, in the period from 2013 to the present, the amount of the remaining debt rose with respect to the initial amount because of the failure to make interest payments.

Sections 2.1 to 2.3 present the two elements of the financial losses associated with the monetary expenses related to the hidden debts. In section 2.4 the present value of these same costs is shown in terms of opportunity costs. The opportunity costs serve to highlight the losses, that is, what the impact of these expenses are for Mozambican citizens, in terms of the social investments that the Government could have undertaken if it had not accepted this public sector debt as legitimate, as well as the expenditure related to the HD. Some examples are presented, including social investments the the government could have undertaken, had it not acknowledged the hidden debts, and consequently accepted these monetary expenses.

The analysis undertaken in the framework of this study identifies four immediate reactions on the part of the various economic actors and international institutions in April 2016, when they became aware of the existence of these debts. Taken together, these reactions produced a shock to the Mozambican economy and unleashed a recession that caused a rupture in the country's positive trajectory of economic growth, macro-economic stability and good international relations: (1) the financial programme with the IMF was suspended; (2) the country's partners suspended all budgetary and programmatic support; (3) private investors reduced drastically their flow of funds to Mozambique; and (4) the ratings agencies reduced the classification of Mozambique from "CC with negative prospects" to "selective default".<sup>14</sup> These indirect costs are dealt with in detail in Chapter 3.

### 2.1 Methodology and data

The methodological framework of the present analysis is based on quantitative, analytical and descriptive research. Documentary research was also undertaken, based on assorted budgetary documents and reports, including notes/news items published on the Internet. To calculate the financial losses acknowledged by the government on behalf of Mozambican citizens, associated with current and future (monetary) expenditure related to the Hidden Debts, a socio-economic approach was adopted.

To calculate the monetary value, two components were included, the past costs and the costs that will arise in the future:

- i) The direct costs (the monetary expenses) related to the loans, acknowledged by the government by the end of 2019. This includes what had already been paid to the consultants, to the facilitators, and to the financial institutions, including the cost of setting up the three publicly owned companies that served as vehicles for the fraud, and which were created with "fabricated" objectives: EMATUM, ProIndicus and MAM. We exclude costs related to the share capital and to the functioning of these three companies, for lack of information accessible in the public domain.
- ii) An estimate of the present value of the direct costs related to the loans in the future. The calculation of this

<sup>12</sup> That is, this chapter adopts a socio-economic perspective which seeks to capture the economic losses of all citizens.

<sup>13</sup> In this context, "present value" is an economic term which calculates the total amount of a loan adding all the interest to be paid in future years to the existing capital.

<sup>14</sup> Because of this collapse of the reputation of Mozambique on the financial markets to the level of junk, the National Hydrocarbon Company has, to date, not managed to obtain the bank loans required to cover its share of investment in the project to exploit the natural gas deposits in the Golfinho/Atum gas fields in Area 1 of the Rovuma Basin. (A Verdade, 5 April, 2020).

component is based on the terms of the restructuring of each loan known to date,<sup>15</sup> which may change if the terms are altered in the future, either because of non-compliance in the future or because of future restructuring.

The data referring to the first category were extracted from the Budgetary Execution Reports (REO), the General State Financial Accounts (CGE), and from the respective reports and opinions referring to the CGEs of various years as well as other documents relevant to the objective of the analysis in the present study, such as the Opinion of the Administrative Court about the General State Financial Account, referring to the years 2017 and 2018. Also considered was information contained in the financing agreements signed for the three companies, EMATUM, MAM and ProIndicus, namely: amount of the loan, capital, interest, maturity, number of instalments, grace period, and form of payment.

As for the costs in the second category, budget documents, reports and press notes were consulted from, among others, the Ministry of Economy and Finance, the Bank of Mozambique, the Attorney-General's Office, as well as from relevant international institutions.

Still concerning the costs related to the second category, documents signed with international creditors about the restructurings were consulted. But since the only documents signed regarding restructuring concerns EMATUM, the assumption was made that the creditors of the MAM and ProIndicus loans will accept the same terms as EMATUM. To complement the analysis, the likely costs of the Hidden Debts were projected/estimated, taking into account the most recent plan to restructure the EMATUM debt of September 2019.<sup>16</sup>

Also analysed, for purposes of determining the costs relative to the first and second categories, were the report from the audit company Kroll and the note, with the reference CR 18 681, issued by the New York District Court in the United States,<sup>17</sup> formalizing the charges against the former Mozambican Finance Minister, Manuel Chang, Jean Boustani, and others involved in the fraud.

## 2.2 Direct costs related to the loans as of end-2019

In 2013 and 2014, the banks Credit Suisse and VTB lent 622 million dollars to ProIndicus and 535 million to MAM and helped place 850 million dollars of bonds on the international market for EMATUM. Hence, the total amount in loans contracted by the Mozambican government was initially USD 2,007 million. In percentage terms, this sum of the Hidden Debts, in 2018 accounted for 21.5% of Mozambique's foreign debt of USD 9,682 million<sup>18</sup> and 15% of the country's total public sector debt.

However, 217.7 million USD of the initial sum of USD 2,007 million was never meant to be received in Mozambique. It was retained at the time of the first disbursement by foreign entities. The payment of the direct financial costs related to these loans, as of end -2019, had reached a total of 674.2 million USD, as shown in table 2.1.

Before looking at the various cost elements presented in table 2.1, it should be stressed that the total of USD 674.2 million was paid with resources that the government could have used for productive purposes, beneficial for Mozambicans, if those who contracted the debts had acted within the law.

Below we present the various elements of the direct financial costs:

<sup>15</sup> Clearly, the future costs may change, if the terms are altered in the future, either because of future non-payment or because of future restructuring, or in the event that the creditors are forced to withdraw their claims.

<sup>16</sup> Published in the official gazette, the Boletim da República, on 24 September 2019, 1st Series, no. 186, 2<sup>nd</sup> Supplement (GdM 2019).

<sup>17</sup> <https://www.justice.gov/criminal-fraud/fcpa/cases/jean-boustani>

<sup>18</sup> Source CGE 2018 Volume III, Informative Appendix 6 in meticais. 596.698.717 / 61.63 (MZN / USD exchange rate on 31 December 2018) = USD 9.681.952,2.



**Table 2.1: Costs paid by the State between 2013-2019, in the context of contracting the hidden debts (in millions of USD)**

Category	EMATUM	MAM	ProIndicus	TOTAL
Loan contracted	850.0	535.0	622.0	2,007.0
Remaining debt: Principal	900.0	535.0	597.1	2,032.1
<b><u>I. Payments which did not imply use of Treasury resources (either own resources or internal debt)</u></b>				
Banking costs (Bank Fees + Contractor Fees) <sup>i</sup>	93.5	35.0	74.5	203.0
Bribes <sup>ii</sup>	...	...	...	174.4
Other bank fees				28.6
Running fees <sup>iii</sup>	0.0	0.0	14.7	14.7
<b><u>II. Payments with use of Treasury resources (either own resources or internal debt)</u></b>				
Capital + interest <sup>iv</sup> (amounts are disaggregated in Annex 1)	285.0	40.8	96.4	422.2
Capital/Principal Paid	153.0	0.0	24.9	177.9
Interest Paid	132.0	40.8	71.5	244.3
Cost of setting up the companies <sup>v</sup>	0.5	1.0	1.4	2.8
Consultancies <sup>v</sup>	31.4	0.0	0.0	31.4
Total Paid in USD (including amortization)	410.4	76.8	187.0	674.2
<i>Sources: Calculation by the authors based on Reports and Opinions of the Administrative Tribunal, and CGEs.</i>				
NOTES:				
i.- - Kroll (2017), Table 1, page 12.				
ii.— New York District Court, 19 December 2018.				
iii.—Kroll (2017), and Reports and Opinions of the TA				
iv. – Reports and Opinions of the TA.				
v.- Kroll (2017), Table 1, page 15.				

The cost of the interest paid up to the end of 2019 amounts to 244.3 million USD. A sum equivalent to 10% of the debt, 203 million USD, represents fees for banking “services”, including bribes. Over and above these fees, the banks also charged a current fee for which, up to the end of 2019, 14.7 million USD had been paid. The fees paid up to the end of 2019 amount to 15% of the amount of the debt, or 217.7 million USD, and were paid to Credit Suisse, VTB and Palomar Capital Advisory, a subsidiary of the Privinvest group<sup>19</sup>.

However, according to the indictment issued by the New York District Court, United States, on 19 December 2018, **USD 174.4 million were paid in bribes** to members of the Mozambican Government and to others involved in the fraud. The bribes were included in the bank fees and fees to the contractors. They are in the 15% which appear as bank service fees. This confirms that these operations were deliberately orchestrated with the purposes of defrauding the Mozambican state to the benefit of a group of individuals with a criminal intent.

To set up the three companies, namely EMATUM, MAM and ProIndicus, whose shareholding structure includes state institutions, a total of 2.8 million US dollars was disbursed for what were described as consultancy services. The term “consultancy services” is internationally recognized as a euphemism for “payments to corrupt”.

To deal with this expenditure, funds from the State Budget, financed either by revenue or by loans, which led to an increase in domestic indebtedness, had to be used, thus ignoring all the legal and financial principles for the establishment of companies, and injuring the State once again. It is worth repeating what was already mentioned in chapter 1: Funds, which had been intended for purposes that benefitted citizens as a whole, were diverted to be offered to a handful of individuals and their allies.

According to the Kroll report, by 2017, to restructure the EMATUM debt, several consultants were hired at a cost that reached a total of USD 31.4 million. The Kroll report also presents data that show strong signs of over-invoicing, to the

<sup>19</sup> Privinvest is a group, present for more than 20 years on the market, which specialises in building high technology ships, including warships, commercial vessels and mega-yachts.

tune of USD 744.7 million, even despite some factors, such as the specifications of the goods, the fact that the project had to be delivered in a region of high risk, and the need to provide support services such as training and maintenance.

By the end of 2019, the expenses effectively paid in connection with the Hidden Debts were the equivalent of USD 674.2 million. The key point is that, despite the payment of these expenses, by the end of 2019 there remained a debt still to be paid of USD 2,032.1 million – that is, a sum higher than the debt initially contracted. Based on this debt, the following section presents the costs expressed in the form of the present value of this debt yet to be paid.

## 2.3 Future monetary expenses regarding the loans

Apart from the monetary amount of expenses acknowledged so far (in the period including the 2019 calendar year), this section analyses the financial loss that includes the present value of the public expenditure related to the loans of the three companies in the future. Annex 1 shows the calculations. Based on the contractual terms stipulated for the loans, the present value is estimated at about 3,929.8<sup>20</sup> million USD – 1,585.8 million USD for EMATUM, 1,146.4 million USD for MAM and 1,197.6 million USD for ProIndicus. The calculations below show the details:

**Table 10. Calculation of the costs arising from the restructuring agreements (in millions of USD)**

	EMATUM	MAM	ProIndicus
Capital subject to restructuring	900.0	644.02	674.0
Total interest 2020-2031	645.8	462.08	483.6
Other restructuring costs	40.0	40.0	40.0
Overall total – 3,929.8	1,585.8	1,146.4	1,197.6

The calculation of the costs in accordance with the restructuring shows that there is a significant risk of ever high financial costs related to these debts because of the incapacity to comply with the deadlines and repayment terms.

The financial losses by the end of 2019, expressed in terms of present value, is equivalent to the costs paid, 674.2 million USD, plus 3,929.8 million USD in future costs, which comes to a total of 4,618.7 million US dollars.

## 2.4 The financial loss for Mozambican citizens

This section gives some examples of the financial loss for each Mozambican. It establishes the topics to be dealt with in the following chapters to show how much each Mozambican could have benefitted from social investments, if the government had not accepted the HD and, more specifically, if it had not paid the monetary costs of the debt. The payments associated with these illegally contracted loans implied diverting sums that should have been allocated to providing essential infrastructures, goods and social services, as well as for investment in priority and strategic sectors for the development of the economy.

According to a study undertaken by the Budget Monitoring Forum (FMO 2015), in August 2015, the construction of a classroom for 25 pupils costs approximately USD 12,000 and building a Type 2 Health Centre costs USD 750,000. Bearing these figures in mind, with the 674.2 million USD paid by the end of 2019 in servicing the debts associated with the HD, it would have been possible to build about 56,000 classrooms or 898 Type 2 Health Centres. With the still outstanding 3,929.8 million USD, more than 5,000 Type 2 Health centres could be built, or about 320,000 new classrooms; from an

<sup>20</sup> Amount ascertained through the methodology of updating the capital, using the terms of restructuring of EMATUM, under the following formula:  $Co = Cn / (1+i)^n$ , where  $Co$  = Present Value,  $Cn$  = Instalments,  $i$  = Interest, and  $n$  = Number of instalments.

overall point of view, that would be enough classrooms with protection against the sun and rain for all children of school age in Mozambique. The financial costs are equivalent to 159 USD for every Mozambican citizen.

Were it not for the Hidden Debts, it is very likely that the National Hydrocarbon Company (ENH) would have obtained the bank finance to cover its participation in the Rovuma Basin gas projects, which to date it lacks.

The following chapters analyse in more detail the opportunity costs related to the indirect costs of the HD. These costs are in addition to the financial costs related to the monetary expenses associated with the HD that were calculated in this chapter.

**3.**



**THE INDIRECT LOSSES  
CAUSED BY THE  
HIDDEN DEBTS**

## 3 THE INDIRECT LOSSES CAUSED BY THE HIDDEN DEBTS

### 3.1 Introduction

This chapter presents the losses resulting from the decline in international financial inflows. The analysis focuses on the indirect losses to the Mozambican economy triggered by the impact of the Hidden Debts (HD). Based on the calculations made, the losses due to the HD, between 2016 and 2019, amounted to an average of USD 95 (5,782 MZN at the exchange rate of 31 December 2019) per year, per citizen, as detailed below. The total cost to the country, just for these four years, amounts to 10.66 billion USD. It is crucial to note that these losses will extend into the future, because the amount can never be recovered, due to its permanent nature.

The HD caused a break in the positive trajectory of economic growth when the debts became publicly known in April 2016. They caused immediate losses to the public finances, by increasing significantly domestic indebtedness to finance the fiscal deficit. In the post-HD period, the ratio of financing the fiscal deficit with external resources fell from about 5.5 times in 2015 to three times after 2016. The growing financing of the deficit through domestic indebtedness caused a disproportionate growth of debt charges. At the same time, the fall in external resources (foreign exchange) caused a depreciation of the metical, and consequently an acceleration of inflation. Furthermore, the deterioration in the composition of the debt (relatively less foreign debt, and more domestic indebtedness) and in the contractual terms, as a whole, increased the cost and hence the fiscal risk, which led Mozambique into a vicious debt cycle. These increases in fiscal risk reduce the level of foreign direct investment (FDI) and of international cooperation, influence the behaviour of economic agents and of citizens, and contribute to a slowdown in the Mozambican economy.

The specific factors which caused the interruption of the trajectory of strong real growth are analysed in detail in the following sections – covering the fiscal sector (state revenue and expenditure), inflation, monetary policy, the exchange rate, and the balance of payments – culminating in an analysis of the combined effects on economic activity in section 3.8.

All the indirect losses calculated in this chapter are in addition to the 159 USD for each Mozambican citizen estimated in chapter 2, as direct financial losses. In that chapter, it was explained that the USD 159 are the costs per citizen calculated as of end-2019 and include: i) the direct costs related to the loans acknowledged by the Government up as of end-2019 and ii) the present value<sup>21</sup> of the direct costs related to the borrowing in the future, from 2019 onwards.

### 3.2 Impact of the hidden debts: Methodology and calculation

The analytical approach is based on a comparison of the macro-economic performance during 2016-2019, with that of the year 2015, before the discovery of the HD. It relies on an analysis of the counter-factual. The counter-factual is the situation or event which did not happen, but which might have happened. In this case, the assumption is that, without the HD, without the reactions of the various stakeholders and institutions when they became aware of the HD, and without the de facto assumption by the government of these debts as legitimate debts by beginning to make payments related to them, the trajectory of economic growth and of the macro-economic stability of the Mozambican economy would have continued at much higher levels than what happened.

The calculation is centred on an analysis of the impact of the break in the pace of economic activity in Mozambique, which is expressed in terms of GDP (gross domestic product). After the second quarter of 2016 there was an abrupt slowdown in the pace of economic activity in Mozambique reflected in all the macro-economic indicators, not only in GDP, but also in the rate of inflation and thus in the prices of the “basic shopping basket”; in the exchange rate of the metical against the US dollar; in the level of budgetary expenses related to the provision of public services; and in the pace of foreign investment, among other factors and indices.

<sup>21</sup> In this context, present value is an economic term that calculates the total amount of a loan by adding all interest to be paid in future years to the existing capital.

In general, it should be mentioned that high inflation, together with the rapid depreciation of the metical, has not made it possible to compare amounts in meticaais. For a more explicit idea of the impact of the HD on these indicators, the comparison had to be done in USD. This methodology was also applied to the State Budget (OE), which would normally be done in meticaais.

We take as a starting point that the shock to the Mozambican economy resulted from the four immediate reactions by various economic actors and international institutions in April 2016, when they became aware of the existence of the HD. Taken together, these reactions caused a break in the upwards trajectory of economic growth, macro-economic stability and good relations (national and international).

**Table 3.1. Economic and financial impact of the HD in 2016 (in USD millions)**

	2015	2016	Dif.
(1) Suspension of the financial programme with the IMF	120	0	120
(2a) Suspension of direct budget support	306	16	290
(2b) Reduction of financial support from the partners	1.242	821	421
Total direct impact on the budget in 2016	1.668	837	831
(3) Reduction in the flow of FDI	4.033	3.093	940
(4) Reduction in the classification by ratings agencies	B-	CC	(not calc.)

Source: Calculation by the authors.

The consequences of this synthesis of the causal impact of the four immediate reactions impacted the responses by the Mozambican government and the economic trajectory of Mozambique. But these consequences have their final impact on the behaviour of GDP.

Thus we begin with an initial analysis of the combined impact of the HD on GDP, leaving the detailed discussions of the contributions of the various sectors – such as the developments in the fiscal sector, the public sector debt, inflation, the monetary sector and the external sector – for analysis in the followings sections.

For a start, the impact of the discovery of the HD (in 2016) on the Mozambican economy can be calculated. Focusing on the growth of total GDP of 3.8% in 2016 compared with the base (before the discovery of the HD) of 2015, with a GDP growth rate of 6.7%, a fall in total GDP can be calculated of 2.9 percentage points (pp). Based on this variation, the following discusses to what extent this decline can be attributed to the HD.

The methodology takes into account the fact that the Mozambican economy would have faced the same “extra-HD” challenges (i.e. not linked to the HD) in the counter-factual scenario as in the actual scenario with the HD. Among others, the following main “extra-HD” factors stand out, which are intrinsic to the Mozambican economy:

1. Climatic impacts (floods, including cyclones such as Idai and Kenneth in 2019, and droughts) that affect growth in the agricultural sector;
2. Volatility of commodity prices (at this point in the development of Mozambique, especially the prices of coal and other minerals) that affect exports;
3. Politico-military tensions;<sup>22</sup>

Analysing these factors one by one, we reach the following conclusions:

1. Climatic impacts affect growth in the agricultural sector.<sup>23</sup> In comparing 2016 with 2015 one notes that the con-

<sup>22</sup> Here it is assumed that, in the counter-factual scenario (without the HD), there would have been the same politico-military tensions. That said, we cannot disregard the possibility that the politico-military tensions were also exacerbated by the impact of the HD. That is, it is possible that, were it not for the HD, the tensions would not have contributed as much to the slowdown that we are measuring here. To avoid this speculation, we are treating the politico-military tensions simply as an “extra-HD” factor.

<sup>23</sup> In the flood year of 2000, the contribution of the agricultural sector to GDP growth fell from 2.2 pp in 1999 to -4.2 pp. The same happened in 2019, with Cyclone Idai, when this sector registered a fall in its contribution of 0.5 pp in comparison with 2018.

tribution of the agricultural sector to annual growth actually increased in 2016 (from 0.7 percentage points [pp] in 2015 to 1.0 pp in 2016). This leads to the conclusion that the extra-HD effect of climate change during 2016 did not have an impact on the decline in overall GDP growth. This would not be true, however, of the impact in 2019 of cyclones Idai and Kenneth, which is captured in the table below.

2. Volatility of commodity prices. Looking at the data for exports, which in the case of commodities are especially coal and other mining products, one notes that this category increased by 42% in 2016. This leads to the conclusion that the extra-HD effect of commodity price volatility during 2016 did not have an impact on the decline in overall GDP growth.
3. Politico-military tensions. Military tension affects the circulation of people and goods and thus, ceteris paribus, it has a great impact on the trade sector. One notes that the contribution of trade to GDP fell in 2016 by 1.1 pp (from 0.9 pp in 2015 to -0.2 pp in 2016), remaining very close to the latter figure in 2017 and 2018: This leads to the conclusion that the effect of the politico-military tensions from 2016 to 2018 had an impact on the decline in overall GDP growth. It is also true that from 2016 to 2018 there was an important fall in imports. However, it cannot be said that the total fall of 1.1 pp is due to the factor of the politico-military tensions. But, taking a very conservative stance, it can be said that, at most, the impact of this extra-HD factor was 1.1 pp.

**Table 3.2 Explanation of the impact of the HD on GDP**

	2015	2016	2017	2018	2019
(in real terms with respect to 2015)					
A. Real growth of GDP <sup>24</sup>	6.7%	3.8%	3.7%	3.4%	2.3%
B. Variation in the real growth rate of GDP of year “n” minus GDP growth of 2015, in pp		- 2.9	- 3.0	- 3.3	- 4.4
C. Extra-HD factors applied to declines in real GDP (real growth in year “n” minus the real GDP growth in 2015), in pp:					
— trade		- 1.1	- 1.2	- 0.7	- 0.9
— agriculture		0.3	0.2	0.1	- 0.4
— extractive industries		-0.1	0.9	0.0	-1.1
— others		- 0.2	- 1.1	-0.9	- 0.2
— <b>Total adjustment because of extra-HD factors</b>		<b>- 1.1</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-2.6</b>
D. Explanatory percentage points of the HD in the decline in the growth of real GDP (B - C), in pp		-1.8	-1.8	-1.8	-1.8
E. Explanatory percentage of the HD in the decline in the growth of real GDP (D / B)		62.1%	60.0%	54.5%	40.9%
F. Real GDP in MZN millions (base = 2015)	637,760	661,995	686,489	709,829	726,155
G. Real GDP converted to USD millions (base = 2015)	15,944	10,491	10,743	11,656	11,508
H. Δ Real GDP (USD million) with respect to 2015		-5,453	-5,201	-4,288	-4,436
<b>I. Amount (USD millions) of the impact of the HD on the variation of real GDP (E * H)</b>		<b>-3,384</b>	<b>-3,120</b>	<b>-2,339</b>	<b>-1,815</b>
<b>J. Cost of HD in USD millions (sum of line I)</b>		<b>-10,659</b>			
<b>K. Amount (USD) of the impact of the HD on the variation of real per capita GDP (I / population)</b>		-125	-112	-82	-62
<b>Memorandum items:</b>					
L. Deflator index in meticaís of real GDP 2015 to nominal GDP <sup>25</sup>	100.0	113.7	122.4	126.0	131.6
M. Explanatory percentage of the HD in the decline in the growth of nominal GDP (E * L)		70.6%	73.4%	68.7%	53.8%

Source: Calculation by the authors

Based on the analysis of section I of the above table, it can be said that, in looking at the three extra-HD factors whose impact was minus 1.1 pp in 2016, the total impact of the HD in the slowdown of the Mozambican economy **was about 1.8 pp**, resulting in a total fall of real GDP of 2.9 pp between 2015 and 2016. Compared with the other factors, the HD had

<sup>24</sup> The real growth rate eliminates the impact of inflation on the annual variation in GDP.

<sup>25</sup> The deflator measures the specific inflation for each sector of GDP (and therefore for the total GDP). It is different (but with a similar inter-annual behavior) to inflation (consumer price index).

an explanatory value of **62.1%**. As already mentioned, this is the *minimum* impact that the HD had on real GDP in 2016.

**This loss of 1.8 pp of production in real terms in 2016 is permanent, because it can never be recovered.** While the **percentage points** of the break in the real economic trajectory remain at the level calculated for 2016 as the years pass, the **percentage impact** of this break shrinks over time – which is normal because other extra-HD factors are added in subsequent years that are not linked to the effect of the HD to explain the behaviour of GDP. In fact, the weight of the losses from the HD in explaining the behaviour of GDP fell from 62.1% in 2016 to 40.9% in 2019. Thus, in the final year covered by this study, 2019, the importance of other sectors grew, which influenced the additional fall in that year: the agricultural sector and the extractive industries. The agricultural sector declined by 0.4 pp, when 2019 is compared with 2015, as a result of cyclones Idai and Kenneth, while the extractive industry declined by 1.1 pp, comparing 2019 with 2015, due to the fall in coal production.

The losses in real production shown in Table 3.2 can be converted into dollar terms to calculate a financial loss. An initial counterfactual scenario, in applying orthodox economic analysis, could be the argument that without the discovery of the hidden debts, the 2015 real growth could have continued at 6.7%. Such calculations, presented in Annex 3.2, yield lost production of 2.8 billion during the four year 2016-2019 upon applying the parameters of table 3.2.

But orthodox economic analysis tends to underestimate the impact on open economies of shocks to financial flows, because it tends to ignore economic distortions that are directly associated with openness, namely, a country's lack of power to affect its terms of trade by influencing the supply of its products (Corsetti & Pesenti 2001).

While we will not discuss these aspects in our study, we make reference to them because we decided to employ an unorthodox approach. Our approach tries to better capture the effect on the potential purchasing power of Mozambicans and, therefore, on the reduction of welfare of Mozambicans.

References in the academic literature have pointed out that, from a household welfare perspective, devaluation with its concomitant worsening of the terms of trade tends to induce welfare losses. The 'anti-poor distributional effects of large exchange rate devaluations' have recently been discussed by, among others, Cravino and Levchenko (Cravino & Levchenko 2015). The overall welfare effects are pro-cyclical, positively correlated with the degree of openness of an economy and the relative size of the tradable sector. From that point of view, Mozambique is considered a very open economy.

For our nonorthodox approach, we calculated real GDP in meticaís (base of 2015; line F of Table 3.2) and converted it into US dollars (line G). We then took the difference of each year with respect to the 2015 GDP (line H), and applied the explanatory percentage of the impact of the HD to that number (line I). Summing over the four years 2016-2019 yields a total of USD 10,659 million (line J). For this study, we interpret the decline in the value of the economy as consumption that Mozambicans were forced to forego, and hence as a decline in welfare, as a result of the loss in purchasing power caused by the hidden debts.

Finally, this sum is converted into GDP per capita (line K), resulting in an average of USD 95 per year and per citizen as a loss in value of GDP. Section 3.8, and Chapter 5, analyse in more detail the GDP per capita impact.

It is important to repeat that the reduction in the purchasing power of each individual in Mozambique, because of the slowdown in the Mozambican economy, does not represent a one-off economic loss, but rather is an annual economic loss for every future year.



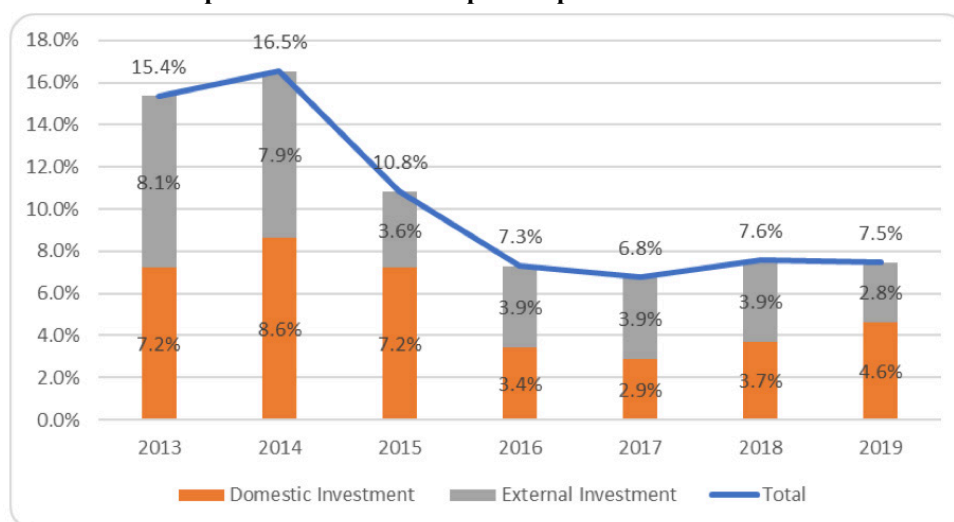
### 3.3 Fiscal Sector

This section details the impact of the public’s perception, national and international, about the HD on the management of the public finances (PFM).

With the suspension of the financial programme with the IMF and of budget support, the state had to make enormous adjustments in its fiscal accounts. Table 3.1 above presents, among others, the amounts of the fall in external resources for the State Budget (OE) resulting from the reactions on the part of the IMF (USD 120 million), the suspension of direct budget support (USD 290 million) and other reductions in financial support from cooperation partners (USD 421 million). This loss of USD 831 million represents a fall in these categories of 50.2% of financial flows that did not enter the public treasury. This fall had a major impact on the functioning of the State Budget.

The first reaction of the Government to this loss of financial flows was to drastically cut domestic investment, from about 7.2% of GDP in 2015 to 3.4% in 2016. While this helped the Government face the decline in revenue from foreign partners, it was not enough to prevent domestic indebtedness increasing significantly. Between 2015 and 2019, domestic indebtedness increased from 69.2 billion meticaais to 154.6 billion; or from USD 1.73 billion to USD 2.45 billion – that is, by 41.6%.

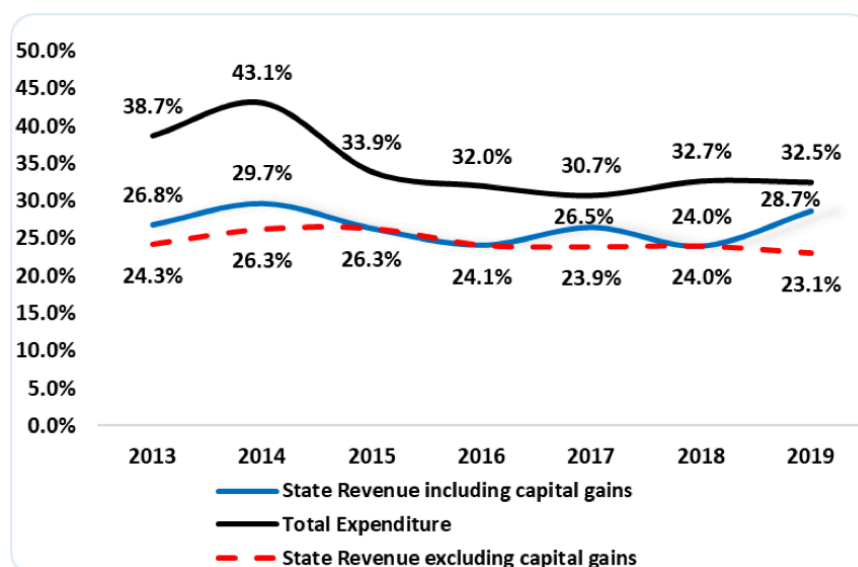
**Graph 3.1: Structure of Capital Expenditure in % of GDP**



Source: CGE 2013 – 2019

As graph 3.2 below shows, State revenue declined in nominal terms as well as a percentage of GDP (about 3.2 pp) between 2014 and 2019, which results from the impact of the HD on the decline in activity in the Mozambican economy. Since 2016, State Revenue has not managed to attain pre-HD levels. The increase in 2017 was driven primarily by obtaining extraordinary tax revenue from capital gains in the extractive sector in an amount equivalent to 2.6% of GDP. Without the capital gains, the increase would have been zero compared with 2016.

**Graph 3.2. State Revenue and Total Expenditure (including Financial Operations) in % of GDP**



Source: CGE 2013-2019

As for the trend of expenditure during the 2013-2019 period in Graph 3.2, the government had to shrink its expenses in order to accompany the decline in revenue. Several subsidies for goods indispensable for the majority of the population were suspended, basic services shrank, and many State institutions did not receive the operating funds envisaged. State expenditure contracted by 10.6 pp, from a peak of 43.1% of GDP in 2014 to 32.5% in 2019. A significant fall (11.1 pp) occurred in the period between 2014 and 2016. In the latter year, the Government was obliged to revise downwards the State Budget (OE) through a revised OE, making significant cuts in expenditure, mainly in the amounts that should have been allocated to the social sectors.

Between 2013 and 2015, direct budget support fell from about USD 470 million to USD 306 million. This decline by more than USD 160 million may have reflected the partners' concern about the EMATUM loan (already known at the time). However, this fact cannot be taken in isolation because there were already international trends diminishing this form of financing governments.

But the indications, that this loss of financing recorded in Mozambique was strongly influenced by the HD, became still stronger in 2016, when the decline accelerated and only USD 16 million was provided in budget support.

In 2016 a Revised Budget was drawn up but, surprisingly, it did not reduce the deficit to be financed by the state. That is, it did not solve the problem of the sudden fall in State financial resources. Even though total expenditure decreased (there was an increase in current expenditure of about 7.2 billion meticaís, but capital expenditure was reduced by about 7.9 billion meticaís), the overall deficit increased because revenues decreased by even more.<sup>26</sup>

A note from CIP<sup>27</sup> showed that the promises to safeguard expenditure in the priority sectors, made at the time the revised budget for 2016 was enacted, were not respected. In particular, the sectors of health, water and sanitation, public works and education (see chapter 5) were the most affected. The analysis shows that the expenses financed with external resources were those with the greatest divergence between what was budgeted and what was attained.

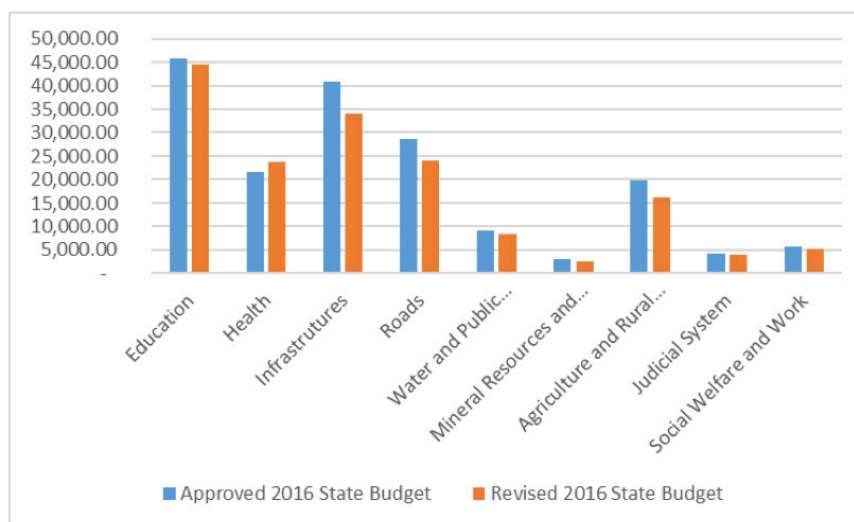
Even though it had guaranteed that expenditure on the social sectors, specifically health, education and water supply, would not be affected by the revision of the 2016 State Budget, the Government, in its document explaining the revised budget, claimed that the adjustments would affect only the construction of administrative buildings, the acquisition of vehicles (excluding ambulances), and fuel, among other items, without specifying exactly which sectors the cuts affected and how much they were.

<sup>26</sup> Internal CIP Document, "Points for Discussion with respect to the Revised Budget", 14 July 2016.

<sup>27</sup> 'O governo não protegeu as despesas nos sectores sociais como prometera'. Issue N° 2/2017 – May. [https://cipmoz.org/wp-content/uploads/2018/08/REO\\_2016\\_PUBLICACAO\\_FINAL.pdf\\_Maio\\_2017.pdf](https://cipmoz.org/wp-content/uploads/2018/08/REO_2016_PUBLICACAO_FINAL.pdf_Maio_2017.pdf)

Regarding the social sectors, Graph 3.3 shows reductions, in the OE, of expenditure on education (3.1%), Infrastructures (14.5%), Agriculture (18.5%), the judicial system (7.7%), and Social Welfare and Labour (5.5%). The only sector which recorded an increase (of about 10.6%) was health.

**Graph 3.3. Total Expenditure on the Social Sectors in 2016 (in millions of Meticaís)**



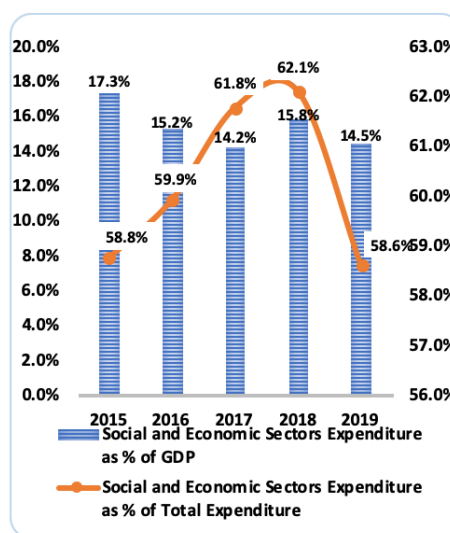
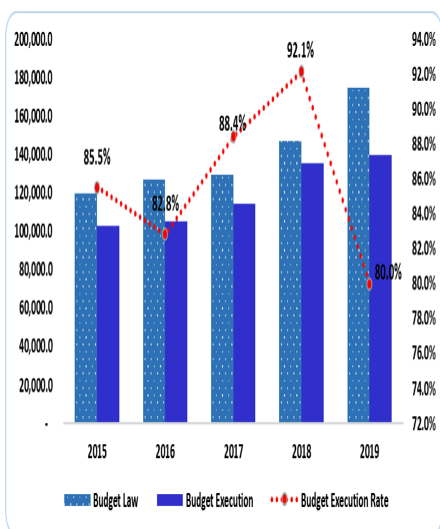
Source: State Budget 2016, original and revised

Despite this increase in the allocation to the health sector, in 2016 the sector only received 78.3% of the sum in the revised budget – just as infrastructures only received 71.7% and education 95.1%. The first two had a rate of execution below the average for the social sectors of 82.8% (Graph 3.4).

Looking at the period up to 2019 the level of execution of expenditure in these sectors oscillated. It recorded a fall in 2016 (because of the influence of the HD) and in 2019, with a lower weight of the HD, there was less effort in terms of the resources allocated to these sectors.

**Graph 3.4:** Levels of Execution of Expenditure in the Economic and Social sectors in millions of Meticaís

**Graph 3.5:** Expenditure in the Economic and Social sectors (Execution) in % of GDP



Source: CGE 2015 - 2019

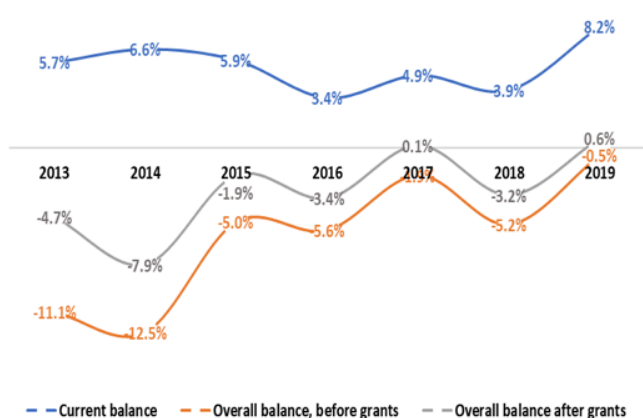
Thus, as graph 3.4 and 3.5 above shows, expenditure on the economic sectors (Agriculture, Infrastructure, Energy, and Transport and Communications) and on the social sectors (Health, Education, Social Welfare, Water and Sanitation and Justice) fell from 17.3% of GDP in 2015 to an average of 14.7% in 2016-2017 (a decline of 2.6 pp).

The shifts observed in the structure of expenditure during the period under analysis clearly show the impact that the hidden debts had on the fiscal sector. The contraction of capital expenditure and the opposite movement of current expenditure, debt service and financial operations bear witness to this fact.

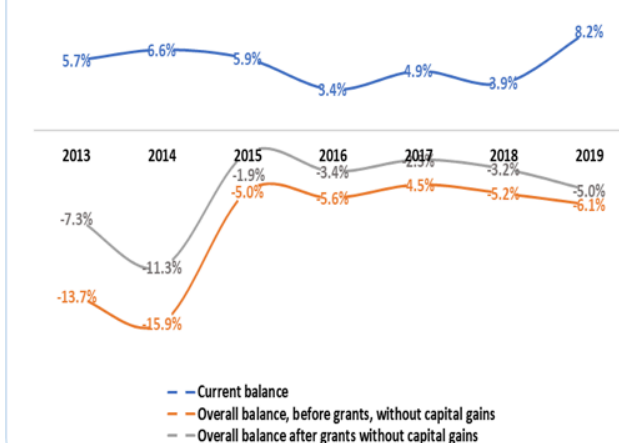
A trend of a slowdown in resources was also seen with regard to grants, which shrank by about 0.9 pp. between 2015 and 2016 and continued to fall until 2018, reflecting the breakdown of trust among cooperation partners due to the lack of transparency in the conduct of fiscal policy in Mozambique.

The analysis of budgetary balances can be viewed from two perspectives regarding the 2015 - 2019 period. On the one hand, considering the effect of the capital gains, the overall balance after grants presented a mixed pattern, with a tendency to improve in the later years (Graph 3.6 below). From a deficit of 1.9% of GDP in 2015, it moved to a surplus of 0.6% in 2019. On the other hand, when the effect of the capital gains is removed (Graph 3.7), the fiscal position of Mozambique has deteriorated over the past five-year period, and the budgetary balance after grants moved from a deficit of 1.9% of GDP in 2015 to 5.0% of GDP in 2019.

**Graph 3.6:** Budgetary balances in % of GDP with capital gains



**Graph 3.7:** Budgetary balances in % of GDP without capital gains



Source: CGE's 2013-2019

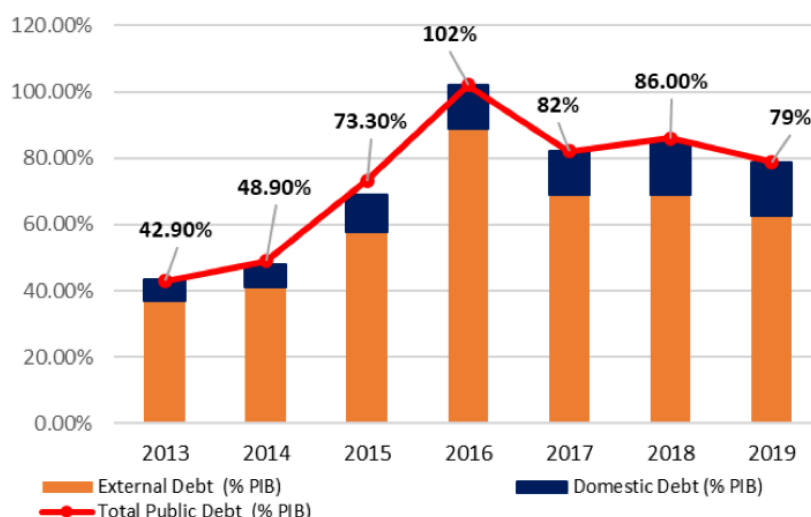
### Box 1: Main Highlights – Impact of the HD on the Management of the Public Finances

- Suspension of budget support by the International Cooperation Partners, reflecting the breakdown in trust due to the lack of transparency in the conduct of fiscal policy;
- Fall in state revenue (without the capital gains) and in total expenditure of 3.2 pp and 10.5 pp of GDP between 2014 and 2019, respectively, leading to reprogramming of the budgets;
- Cuts in capital expenditure of 3.5 pp of GDP in 2016, and 3.3 pp in 2019, compared with 2015, limiting the intervention of the Government in sectors that are strategic for the development of the country, with notably negative impacts on health, education, agriculture and infrastructures.

## 3.4 Public sector debt

In the period under analysis, public sector indebtedness evolved towards unsustainable levels (Ibraimo 2019), as also Graph 3.8 shows. The debt/GDP ratio recorded an increase of 36.1 pp., from the 42.90% recorded in 2013 to 79% recorded in 2019.

**Graph 3.8: Public Sector Debt (in % of GDP)**



Source: *Public Sector Debt Report, various years*

It is important to note that the figures given in the annual public sector debt reports (various years) of the government are lower than the public sector debt figures given in the various reports from the IMF (IMF 2016). The reason for this is that there is a difference in methodology, with the methodology used by the IMF being more comprehensive.

This state of affairs has led ratings agencies to continue classifying Mozambique as a country in a situation of debt distress, since the sustainability indicators are above the recommended limits, with the exception of the debt service to revenue ratio, as shown in the table below.

The indicative limits for the weak capacity category are 30% for the ratio Present Value of the Debt (PV)/GDP, 140% for the ratio Present Value of debt/ Exports (EXP), 10% for the ratio Debt Service (DS)/Exports (EXP) and 14% for the ratio Debt Service (DS)/Revenue (REV).<sup>28</sup> Mozambique is considered as a country with a weak capacity to “support” the debt. These limits apply to the foreign public debt and debt with public guarantees. The parameter for the PV of the total public sector debt applied to the average indebtedness capacity is 35%.

**Table 3.3: Public sector Debt Indicators and Limits, 2013 - 2019<sup>29</sup>**

Indicators	Limits (%)	New Limits							
		2013	2014	2015	2016	2017	(%)	2018	2019
PV/PIB	40	29,6	37	31,9	74,5	67,1	30	66,4	62,6
PV/EXP	150	90,9	98	112,1	208,2	176,7	140	160,1	164,9
PV/REV	250	113,4	129,2	124,8	309,5	265,6			
DS/EXP	20	3,4	3,9	7,5	19	18,2	10	11,7	10,8
DS/REV	20	4,3	5,1	8,7	26,4	27,3	14	20,1	13,9

Source: *Public sector Debt Report, 2015 and 2019*

The triggering of the guarantees issued by the State, in its capacity as guarantor of the EMATUM, MAM and ProIndicus loans, began to be felt in 2015, when the stock of debt rose to 73.30% of GDP, against the 48.90% recorded in the previous fiscal year, in 2014. Strictly speaking, the stock of debt should not exceed 35% of GDP, according to international criteria. However, once the hidden debts crisis was ignited, this ratio has not stopped growing, and the level of indebtedness has even exceeded the production capacity of the country, its GDP.

<sup>28</sup> Public Debt Report, 2019

<sup>29</sup> In table 3.1, the debt is expressed as present value and not as the nominal value, as in graph 3.13.

The discovery of the illegal loans and the Government’s non-compliance with its financial obligations arising from them, plunged the country to the bottom of the risk classification table, and Mozambique came to be considered as defaulting on the international financial market. This situation limited the country’s capacity to contract non-earmarked foreign financing, which obliged the Government to resort to domestic indebtedness.

It is important to mention that the increase of 10% in the stock of foreign debt in 2017 was associated with a greater increase in bilateral debt (USD 473 million) than multilateral debt (USD 388.5 million) that year. The increase in the bilateral debt with China was about USD 300 million. China is a player that has emerged as a debt alternative, since the terms of contracting its debt do not follow the rigour demanded by the multilateral creditors. **Hence, one may deduce that the hidden debts contributed to China becoming Mozambique’s largest bilateral creditor (37% of the stock of bilateral foreign debt in 2019).**

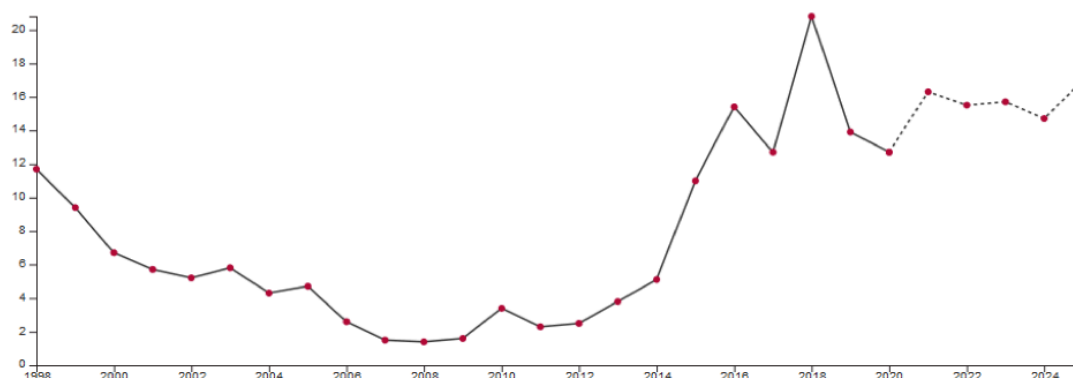
**Table 3.4: Cost of the Foreign Public sector Debt (2015 – 2019)**

Cost of the foreign debt						
(in USD million)	2015	2016	2017	2018	2019	Average
Foreign stock of debt	8,081.5	8,626.3	9,487.9	9,804.5	9,850.2	9,170.1
Amortization of Capital	176.5	195.2	126.1	248.6	284.4	
Interest payments	114.5	151.4	145.2	142.0	185.4	147.7
Total foreign debt service	291.0	346.6	271.3	390.6	469.8	
Variation of the stock of debt		6.7%	10%	3.3%	0.5%	5.1%
Variation of the debt service		19.1%	-21.7%	44.0%	20.3%	15.4%

Source: *Public sector Debt Report, 2019*

The International NGO, Jubilee Debt, estimates that the debt charges, as a percentage of State revenue, increased rapidly after 2013, reaching a peak in 2018 of 20.8%, compared with 3.8% in 2013. According to the same source, it is projected that the percentages will remain in the two digit range until at least 2025.

**Graph 3.9. Payments of foreign public sector debt in percent of revenue**



Source: <https://data.jubileedebt.org.uk/mozambique>

Domestic debt has also grown rapidly. Average annual growth between 2015 and 2019 was 22.5%, due to the HD that plunged the country into the financial classification of “junk”. Domestic indebtedness, which, in the pre-hidden-debt period (2013-2014) was around 6.5% of GDP, reached an average of 13.4% of GDP between 2015 and 2019 due to the continual issuing of Treasury Bills, and an increase in the component of “other debtors” (compensation for the fuel distribution companies, reimbursement of VAT, restructuring of the guaranteed debt, debt assumed in the construction of public buildings, and debt to suppliers of goods and services to the State) in the same period, having surpassed 16% of GDP in 2019.

<sup>30</sup> <https://data.jubileedebt.org.uk/mozambique>.

In the obvious lack of sufficient fiscal adjustments (an option not considered by the Government), the alternative followed was that of resorting to domestic debt, at an extremely high cost (interest rates higher than 20%), and which until 2018 mostly carried fixed interest rates. Otherwise, there was a risk of paralysis of the public administration and collapse of the economy, if the Government did not finance the budget.

**Table 3.5: Cost of the Domestic Public sector Debt (2015 – 2019)**

Cost of the domestic debt (millions of Meticaais)	2015	2016	2017	2018	2019	Average
Domestic stock of debt	69.232,9	87.709,7	106.899,6	139.377,2	154.595,2	106.899,6
Payment of Capital	7.817,9	4.449,1	10.857,7	21.315,5	24.165,3	
Payment of Interest	3.734,7	7.719,1	9.055,4	16.936,5	17.049,4	
Total domestic debt service	11.552,7	12.168,2	19.913,1	38.252,1	41.214,7	
Variation domestic stock of debt		27%	22%	30%	11%	24%
Variation, domestic debt service		5%	64%	92%	8%	36%

Source: *Public sector Debt Report, 2019*

Table 3.5 shows that the stock of domestic debt grew by 123.6% from 2015 to 2019, that is, by an average of 24% a year. This reflects the Government's difficulties in gaining access to international markets to finance the annual budgets. At the same time, the domestic debt service was increasing still further, averaging 36% a year.

#### **Box 2: Main highlights – Impact of the HD on Public sector Debt Management**

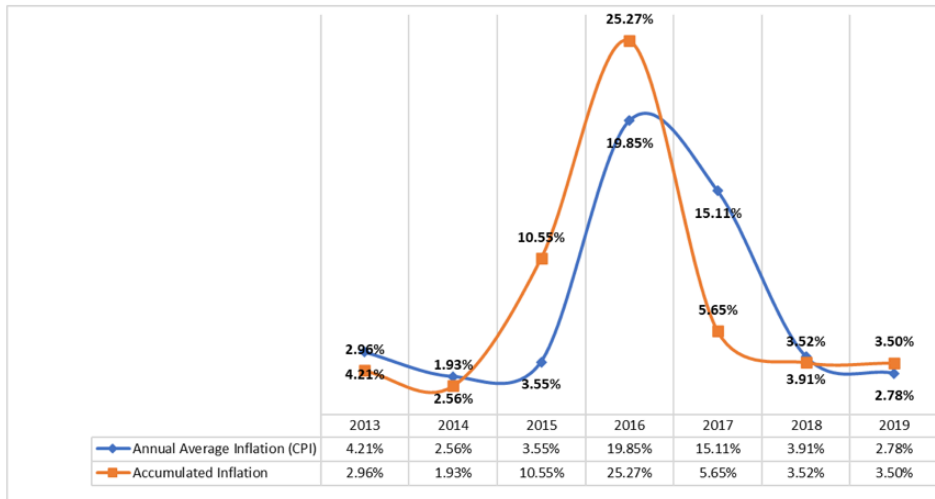
- Increase in the amount of public sector indebtedness to unsustainable levels, from 42.90% in 2013 to 79% in 2019;
- Classification of the country as in default by the ratings agencies, resulting in the reduction of its capacity to contract loans on the international market;
- Risk of paralysis of the public administration and collapse of the economy if the government did not finance the budget through bank credit, resulting in a substantial increase in domestic indebtedness.

### **3.5 Inflation: Fall in purchasing power**

The slowdown of economic activity in the main productive sectors (trade, manufacturing, construction and finance) did not have the same impact on each Mozambican, but it reduced the purchasing power of all citizens because of inflation.

As can be seen from the following graph, during the pre-HD period, average annual inflation fluctuated at around 3.0% up to 2015, while year-end inflation fluctuated around 2.0% until the end of 2014.

**Graph 3.10: Inflation Rate (%)**



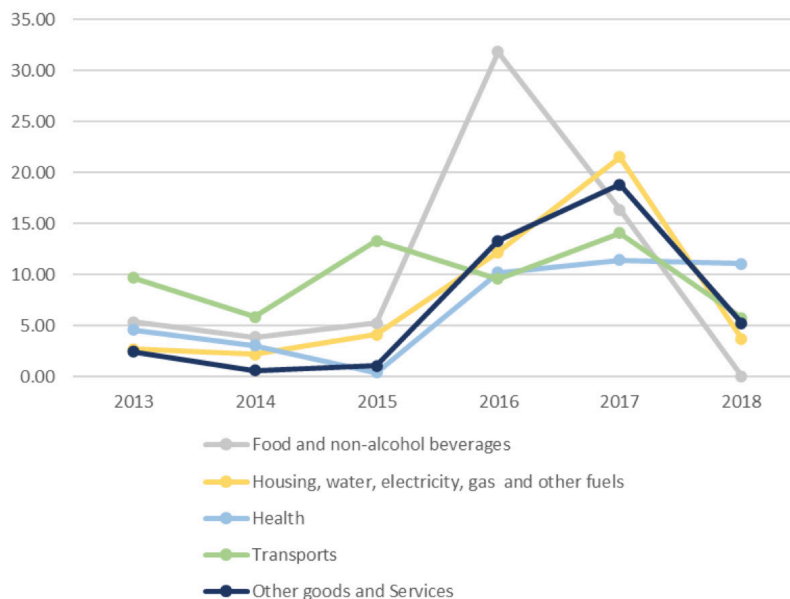
Source: INE

In 2016, the rate of inflation reached its maximum level of the previous 10 years. Average inflation reached 19.85% and year-end inflation was 25.27%. Among the factors that contributed to this galloping increase stand out: (i) the depreciation of the metical, linked directly to the decline in the inflow of foreign exchange, influenced by the hidden debts, and ensuring that the price of all imported goods increased significantly; (ii) restricted circulation of people, goods and services because of the politico-military tensions; (iii) the increase in the administered prices of fuel, electricity, water, bread and public transport, because of the suspension of the subsidies previously granted by the Government; and (iv) the decline in the contribution of the agricultural sector, because of natural disasters.

The suspension of the fuel, electricity and water subsidies was an administrative measure that the Government took as a result of the trigger of the HD, since, with the cooperation partners withdrawing budget support, state revenue shrank significantly, obliging the executive to transfer the cost of these subsidies to the public.

This measure, together with the depreciation of the metical, which affected all activities that had a foreign exchange component, created a contagion effect on the cost of living of Mozambicans, since the cost of production increased, thus increasing the cost for the final consumer. Purchasing power was affected significantly, as can be seen in the following graph.

**Graph 3.11: Average annual inflation (in %) by sectors of activity**



Source: INE



The food sector reflected immediately the impact of the suspension of the subsidies and the rise in the prices of imported goods. Inflation for this sector worsened to 32% between 2015 and 2016, and the prices of basic foodstuffs also rose substantially. In the same period, health, transport, housing, water, electricity and fuel accompanied the accelerating pace of inflation, and it became increasingly difficult for Mozambicans to meet their basic needs.

The hidden debts have had a continuing impact since 2016, despite the slowing down of inflation observed as of 2017, resulting from bold measures taken by the central bank, particularly regarding interest rates. As shown in Section 3.6, this occurred in a context in which many companies had been forced to close their doors, with the decline in economic activity throwing people into unemployment (unemployment increased by at least 4.7% in 2016). Thus, households lost the capacity to meet their basic needs (food, health, transport and housing) due to the high cost of living and up until now they have not managed to recuperate (see chapter 5).

The bold measures taken successfully by the central bank in the area of monetary policy (see section 3.6) sought to calm the inflationary trend unleashed by the Hidden Debts. It is worth recalling that:

In 2015, average inflation for 2018 was projected to be 5.6%, but the average inflation recorded was only 3.9%, a positive difference of 1.7 percentage points (pp);

For 2019 (the year of cyclones Idai and Kenneth), the average inflation projected in 2015 was 5.6%, but the average inflation that occurred was only 4.1%, a difference of 1.5%.

Lower than forecast inflation rates in 2018 and 2019, despite the surge in inflation in 2016 and 2017, made it possible to re-establish macro-economic stability and prevent Mozambique from skidding into hyper-inflation. Although they had a negative impact on market interest rates, which had to be increased to control inflation, it is obvious that without these monetary measures, inflation would have been much higher in 2018 and 2019, thus reflecting the impact of the hidden debts on the economy.

### **Box 3. Main highlights – Impact of the HD on purchasing power**

Acceleration of the average and year-end annual inflation rates, from 4.21% and 2.96% respectively in 2013, to a recent maximum of 19.85% and 25.27% in 2016;

Suspension by the Government of the fuel, electricity, water, bread and public transport subsidies resulting in transferring costs to the public and increasing the costs of basic goods and services;

Reduced capacity to meet basic needs (food, health, transport and housing) due to the worsening cost of living.

Without the monetary measures taken by the Bank of Mozambique, inflation would have been much higher in 2018 and 2019, thus reflecting a positive impact to mitigate inflation, but with negative impacts on the real sector due to the hidden debts.

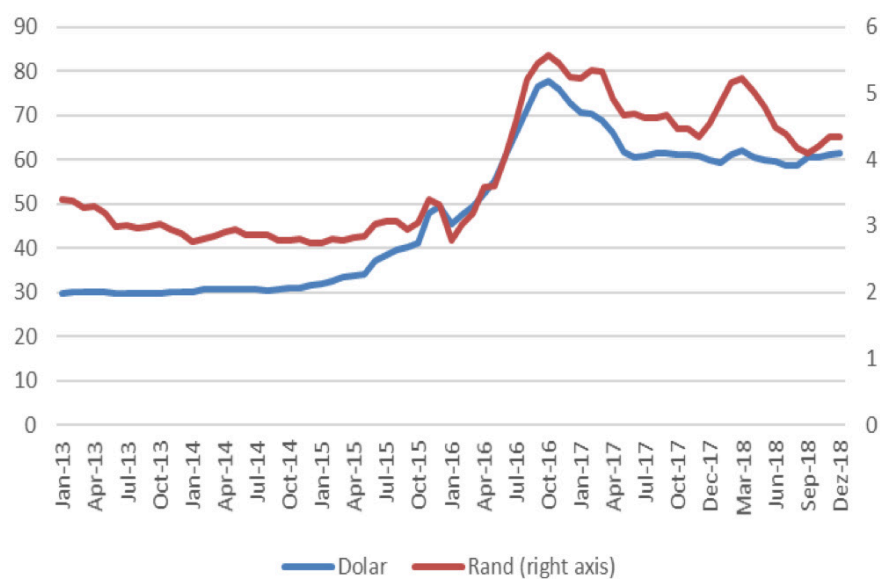
## **3.6 Monetary and Foreign Exchange sector**

The unfolding of the hidden debts led to a gradual deterioration in the national economic environment, which, among other factors, led in 2016 to a galloping acceleration in the average rate of inflation (19.85%) and the sharp depreciation of the metical (reaching 77.58 meticaïs to the US dollar).

### *Exchange Rates*

Prior to the hidden debts, exchange rates had been relatively stable. Between January 2013 and the first quarter of 2015, the US dollar and South African rand fluctuated at around 30.00 meticaïs to the dollar and 2.90 meticaïs to the rand, as shown in graph 3.12.

**Graph 3.12: Exchange rate fluctuations for the USD and Rand**



Source: Bank of Mozambique

Foreign exchange pressures began to make themselves felt from the beginning of the second quarter of 2015, coinciding with the period when information about the hidden debts (specifically the EMATUM debt) became public knowledge. At the time, the US dollar was quoted at 34 metical. Since then, the trend of the metical against the dollar and the rand on the foreign exchange market has been one of depreciation. The metical reached maximum lows (in the period under analysis) of 77.58 MT/USD in October 2016 and 5.57 MT/ZAR in January 2017.

In the period under analysis, the metical depreciated against the US dollar by 61.64%, while against the rand the metical depreciated by 50.63%. This performance is largely explained by the reduction in the inflows of external State Budget support, as well as by the reduction in FDI.

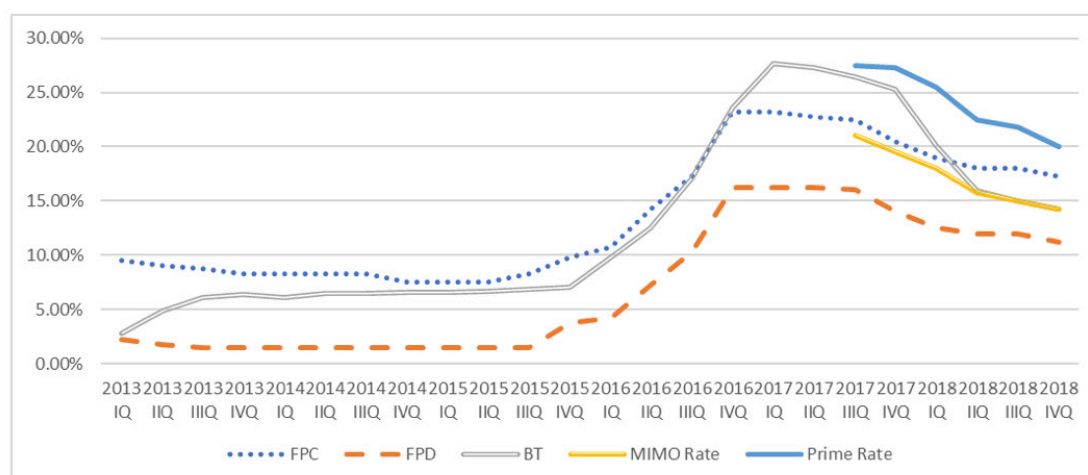
These levels of depreciation of the national currency, of more than 50% against the main foreign currencies traded on the market, considering that Mozambique is a country highly dependent on imports, was one of the determinant factors for the increase in inflationary pressures, and the consequent worsening of the cost of living. Since South Africa is Mozambique's main commercial partner in southern Africa, the impact of the HD, together with the drought that occurred at the time, on trade with South Africa was momentous: there was a reduction in the amount of imports of goods from South Africa of about USD 564.9 million between 2013 and 2018.

However, thanks to the measures taken by the central bank, plus the downward adjustment of public sector expenditure (explained mainly by cuts in the wheat, public transport and fuel subsidies), the trend was reversed. By the end of 2017, the metical had appreciated by 21.87% and 21.53% against the US dollar and the South African rand, respectively. After this relative stabilisation, until the end of 2018, the dollar and the rand continued to be about 50% and 17% more expensive than in 2013, clear evidence that the economy was still feeling the impact of the hidden debts.

### Interest and Benchmark Rates

From January 2013 to the end of the third quarter of 2015, the main reference rates on the Mozambican interbank market were relatively stable (Graph 3.13). During this period the marginal lending facility (FPC) fluctuated at around 8.27%, while the Deposit Facility (FPD) on average amounted to 1.59%. Furthermore, the average weighted interest rate for purchasing securities on the primary Treasury Bill market for 364 days was 5.99%.

**Graph 3.13: Benchmark and Interest Rates**



Source: Bank of Mozambique

From the fourth quarter of 2015, the period during which the HD became public knowledge, the Central Bank had to make a series of upward adjustments of the main benchmark rates, in order to contain inflationary pressures. The FPC reached 23.25% in the fourth quarter of 2016, and the FPD during the same period was adjusted to 16.25%. At the same time, the average weighted interest rate for purchasing 364-day BTs registered an increase of 24.88 pp, to 27.65%, between January 2013 and the first quarter of 2017.

These upward adjustments of the main reference rates increased the borrowing costs of the metical on the interbank market, obliging the commercial banks to pass the costs on to their clients through increasing the interest rate charged on loans. As a result, the amount of non-performing loans in the commercial banks rose by 66% between 2015 and 2016, from 10.6 to 17.6 thousand million meticaís, according to research undertaken by KPMG for the Mozambican Association of Banks in 2016 (KPMG 2016).

In its attempts to continue to staunch the effects of the crisis, as of the second quarter of 2017 the central bank introduced a series of measures, among which stand out the monthly publication of the prime rate that derives from the single reference rate and the market risk premium; the uniformisation of the basis for calculating market interest rates (single reference rate), revoking the MAIBOR agreement; introducing the MIMO rate; and the principle of the single reference exchange rate.

The increases in interest rates caused a noteworthy increase in non-performing loans in the commercial banks. Liquidity problems thus emerged in two banks,<sup>31</sup> which contributed, in addition to other problems, to these banks not respecting the capital ratios imposed by the Bank of Mozambique of a minimum of 8% during this period (Filipe & Matine 2016).

Despite these measures, the situation on the monetary market remained challenging, as can be seen in the above graph. Apart from the non-performing loans, companies' difficulties in obtaining access to capital due to high interest rates contradict the discourse of the Government about the promise of an expansion of the productive base, a clear sign of a lack of coordination between fiscal and monetary policies.

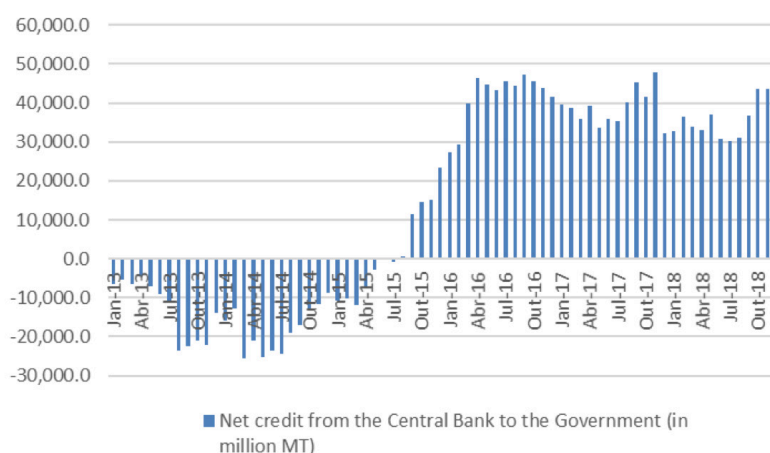
It can be said that, as a consequence of the HD, the increase in interest rates contributed to a relative fall in activity by the private banks (which is not discussed here), with less access to credit for companies and consumers, which contributed to slowing down economic growth.

31 Moza Banco, in which the central bank intervened on 30 September 2016, and Nosso Banco, closed on 11 November 2016.

## Central Bank credit for the Government

The triggering of the hidden debts scandal, which culminated with the suspension of budget aid and the reduction in the Government's capacity to contract loans on the international market due to the loss of trust among its partners, forced the Government to resort to loans from the Bank of Mozambique, as of the third quarter of 2015, as can be noted in the following graph.

**Graph 3.14: Net credit from the Central Bank to the Government**



Source: Bank of Mozambique

Between September 2015 and December 2018, credit from the Central Bank increased by 55.649 billion MT, which was an increase of 492%. It needs to be emphasized that the Government's dependence on credit from the Central Bank grew ever larger, accelerating the growth of domestic indebtedness.

### Box 4: Main highlights – Impact of the HD on the monetary and foreign exchange sectors

- Successive upward adjustments of the main reference rates, resulting in increased interest rates in the commercial banks;
- Increase in the FPC, FPD and 365 day BT Interest Rates of 13.75 pp, 14.00 pp and 24.88 pp, respectively between the 1st quarter of 2013 and the 1st quarter of 2017;
- Reduction in the funds available for loans to the private sector due to the competition imposed by the Government's demand for financing;
- Reduction of procurement for bank financing by companies due to the high cost of credit;
- Increase in the amount of non-performing loans by 66% between 2015 and 2016;
- Non-sustainability of the business sector due to the State's failure to comply with its financial obligations;
- Sharp depreciation of the Metical, by more than 50%, against the main foreign currencies traded in the country;
- Culminating in a worsening of the cost of imports and of the stock of foreign debt.

## 3.7 External Sector

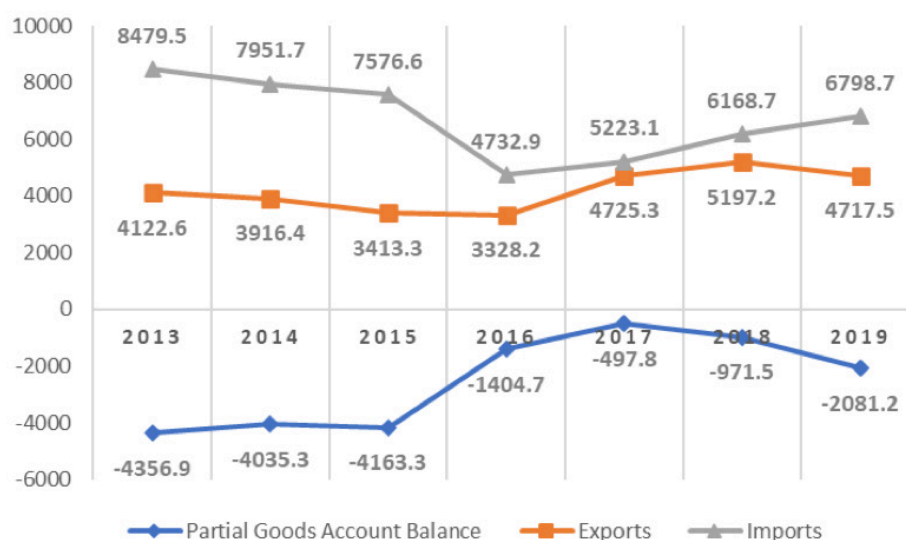
The balance of payments in Mozambique tends to rely on resources from external capital flows. The public sector debt crisis caused by the discovery and the weight of the HD worsened the balance of payments, as a result of the decline in FDI (excluding mega-projects), the suspension of aid from the IMF and of budget support from development partners (which enters the country as foreign currency). This deterioration was made worse by the decline in the amount of exports, resulting from the concomitant fall of commodity prices on international markets.

## Balance of Trade

Mozambique is a net importer of basic consumer goods and of raw materials to supply its industries.

The structure of exports consists mostly of raw materials, that is, of natural resources with little or no added value.

**Graph 3.15: Balance of Trade (in USD millions)**

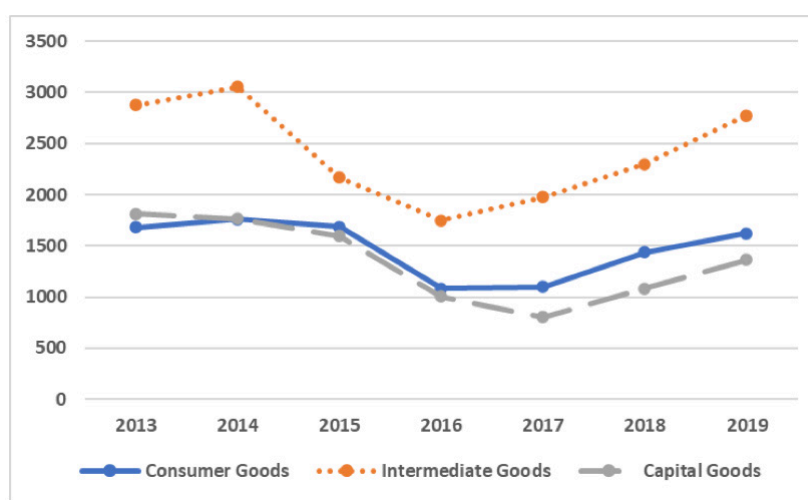


Source: Bank of Mozambique

Graph 3.15, above shows clearly that between 2013 and 2015, before the hidden debts scandal, the balance of trade was a little more than minus USD 4 billion. However, as of 2016, as a result of the fall in domestic demand, including public sector demand, due to the sharp depreciation of the metical against the main foreign currencies traded in the country, and the tightening in the availability of foreign currency, there was an abrupt reduction in the balance, to a minimum of USD 497.8 million in 2017, essentially explained by the sharp fall (37%) in imports between 2015 and 2016.

The decline of imports, by about 42%, between 2013 and 2016, shows the scale of the sacrifices that a country heavily dependent on foreign aid had to make in order to survive the shock caused by an illegal action.

**Graph 3.16: Import of Goods (in USD million)**



Source: Bank of Mozambique

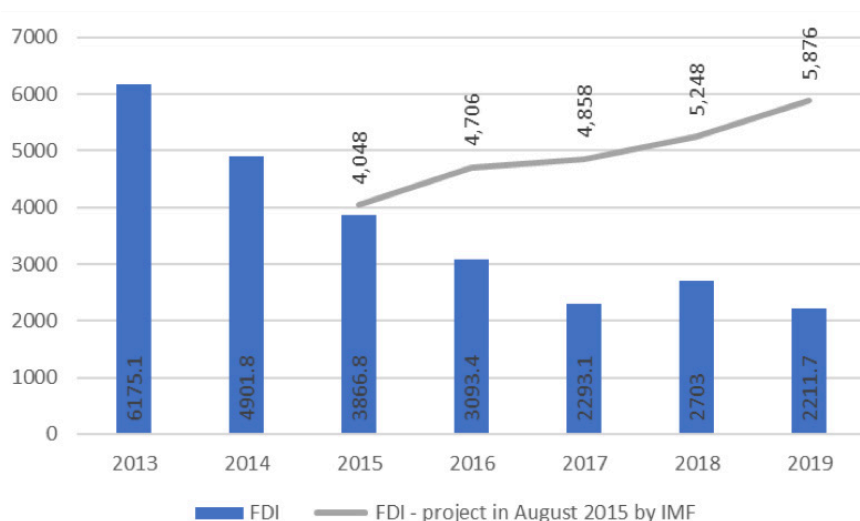
According to graph 3.16, the greatest impact was felt on the import of intermediate goods (fuel, building materials, oils and lubricants, cement and others) that are of key importance for the functioning of a service economy such as that of Mozambique, thus reflecting the slowdown in the tertiary sector and the contagion spreading to other sectors of the economy.<sup>32</sup>

But the amount of imports of consumer and capital goods also underwent a significant slowdown. Given their importance, the magnitude of the impact was severe, since both basic needs (food, medical care and education, among others) and capital requirements had to be greatly restricted.

### Foreign Direct Investment (FDI)

The economic environment tarnished by these acts of corruption, involving senior members of the government and other international agents, significantly affected the trust of foreign investors during the period under analysis.

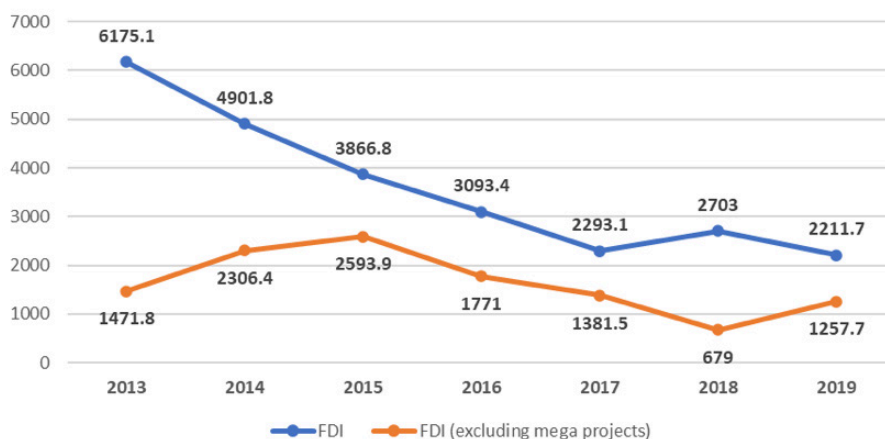
**Graph 3.17: Impact of the HD on Foreign Direct Investment (in USD million)**



Source: IMF and World Bank

The graph above compares the projections made in the IMF report in January 2016 (IMF 2016) for 2015 to 2019 with the FDI actually recorded in those years. The graph shows that FDI was about 50% lower than the projection. For example, of the 4.7 billion dollars projected for 2016, only 3.1 billion dollars entered the country, and the difference increased over time. In 2019, of the 5.9 billion dollars projected, only 2.2 billion dollars were invested with respect to FDI.

**Graph 3.18: FDI including and excluding mega-projects (in USD millions)**



Source: Bank of Mozambique

<sup>32</sup> The fall in 2015 was due to structural factors: with the rehabilitation of the railways, the import of diesel fell by 50%.

As can be seen from the above graph, the amount of FDI, excluding mega-projects, slowed down substantially from USD 2,593.9 million in 2015 to USD 1,257.7 million in 2019. This performance reflects, among other factors, the disrepute the country had fallen into after the scandal of the hidden debts. Manufacturing industry (food, drinks, etc.) and construction, transport and communications as well as the financial sectors were those most affected by the reduction in foreign investment.

According to the graph above (World Bank 2016),<sup>33</sup> the inflow of total FDI contracted by 21.1% in 2015 (compared with the previous year). In the same period, the Bank of Mozambique reported a deficit of almost USD 584 million regarding the overall balance of payments.

Total FDI for the economy of Mozambique fell from USD 4,901.8 million in 2014 to USD 2,211.7 million in 2019, and, excluding mega-projects, from **USD 2,306.4 million** in 2014 to **USD 1,257.7 million** in 2019. This corresponds to a slowdown of 54.9% (See graph 18).

The country's difficulty in gaining access to capital on the international markets, as a result of the HD, also had a negative impact on access to capital by the commercial arm of the State in the extractive sector (the National Hydrocarbon Company, ENH). By June 2020, ENH was unable to obtain financing needed for the State to be able to participate in the great natural gas extraction project in the Rovuma Basin<sup>34</sup>. And the financing eventually obtained was not from a bank but from a company participating in the project, without, however, explaining what interest is to be paid. This loan was given as credit known as "bridge financing" – the loan will have to be repaid directly from the physical proceeds of the exploitation of the gas.

Furthermore, imports intended for mega-projects recorded a reduction of around **62.1% (USD 1,201 million)** between 2013 and 2017, clear evidence of the slowdown of activity and of FDI, in face of a less attractive environment, deriving from, among other factors, the hidden debts

According to the World Bank (World Bank 2016), Mozambique is one of the few developing countries where mega-projects are not financed by grants and loans, but by FDI. Hence, one of the signs that the hidden debts curbed the trust of investors could be the constant delays in taking investment decisions regarding the natural gas extraction projects in the Rovuma Basin.

Although the figures presented above show a slowdown with respect to the extractive sector companies, it was found that the HD did not have a significant effect on investment decisions in the hydrocarbon sector.

#### **Box 5. Main highlights – Impact of the HD on the External Sector**

- Slowdown of foreign trade;
  - Reduction in the amount of imports by about 55%, between 2013 and 2016, resulting in difficulties in meeting basic consumption and investment needs;
  - Modest slowdown in the amount of exports,
- Deterioration in the capacity to import essential goods (fuel and grains, among others) due to the lack of credit for the economy, both in foreign and in national currency, from the commercial banks. Credit to the economy fell in 2017 and 2018, declining, as a percentage of GDP from 38.0% in 2016 to 24.8% in 2018 and to 24.5% in 2019.
- Increase in payments in foreign currency to service the debt contracted illegally;
- Reduction in FDI, excluding mega-projects, by 54.9% between 2014 and 2019, with consequences for economic growth.

<sup>33</sup> See also the document published by the World Bank in March 2016, entitled "Economic Actuality of Mozambique- Navigating in Low Prices" (World Bank 2016).

<sup>34</sup> 'Exploração do gás natural existente nos campos Golfinho/Atum na Área 1 da Bacia do Rovuma.' @Verdade, 5 Abril 2017.

## 3.8 Analysis of the Real Sector

For about a decade and a half (2000-2015), the Mozambican economy grew at a rate of some 7.5% per year. This economic growth rate was, up until 2013, higher than the growth rate of sub-Saharan Africa. This growth, in a context of political stability and of stable government policies, was accompanied by significant financial support from the international community and important inflows of foreign direct investment (FDI)<sup>35</sup>. This virtuous circle produced an apparent stability of the main macro-economic indicators, such as: inflation, the exchange rate, and net international reserves. Because of the apparent good performance of these macro-economic indicators, the Mozambican economy was viewed internationally as an example of success for a developing country in promoting rapid economic growth and stability of the main macro-economic indicators.

However, since the economic growth in the country in the years up until 2015 was anchored on macro-economic dynamics dependent on external capital flows (FDI, direct support for the State Budget, and public sector foreign borrowing), it generated an “economic bubble”<sup>36</sup> with little retention of wealth and development of productive capacities for the economy (Castel-Branco 2015; Castel-Branco, Massingue et al. 2015; Castel-Branco & Massorongo 2017; Mandlate 2017). Taking advantage of the image of success and the fiscal space created by the apparent solid macro-economic performance, the Government chose to put excessive emphasis on public sector indebtedness as a strategy for financing its development programmes.

But this model of support for economic growth based on external flows proved unsustainable after the eruption into the public arena of the hidden debts in 2015 (with information about the issuing of the EMATUM bonds), which culminated in April 2016 with the discovery of two additional loans (to ProIndicus and MAM) in a scheme of embezzlement of State funds.

This scheme plunged the country into a deep economic crisis, adding to the high public sector indebtedness that the country had already been running up, which worsened the unsustainable nature of the public sector debt. Mozambique found itself with a level of debt above its financial capacities. It was unable to pay the debt service, which pushed the financial reputation of the country into the category of “junk” (default) of the international ratings agencies.

This debt crisis drastically changed the image of success that used to characterise Mozambique among its partners, international investors, development agencies, the international markets and the ratings agencies, and seriously affected levels of economic growth. In the three years from 2016 to 2019, the economy had an average growth rate of about 3.3%, far below the more than 7% registered in the years prior to the hidden debts scandal.<sup>37</sup>

As the graph below shows, with the exception of agriculture and livestock, the other productive sectors of the economy, namely trade, manufacturing, construction, and finance, slowed down significantly.

Specifically, the sectors which suffered most from the sharp fall in GDP between 2015 and 2016 were trade, vehicle repair, real estate activities, and services provided to companies, which had made an average contribution to GDP of 1.2 and 0.2 percentage points (pp) respectively, between 2012 and 2015, but in 2016 contributed negatively, with minus 0.2 pp and 0.1 pp, respectively.

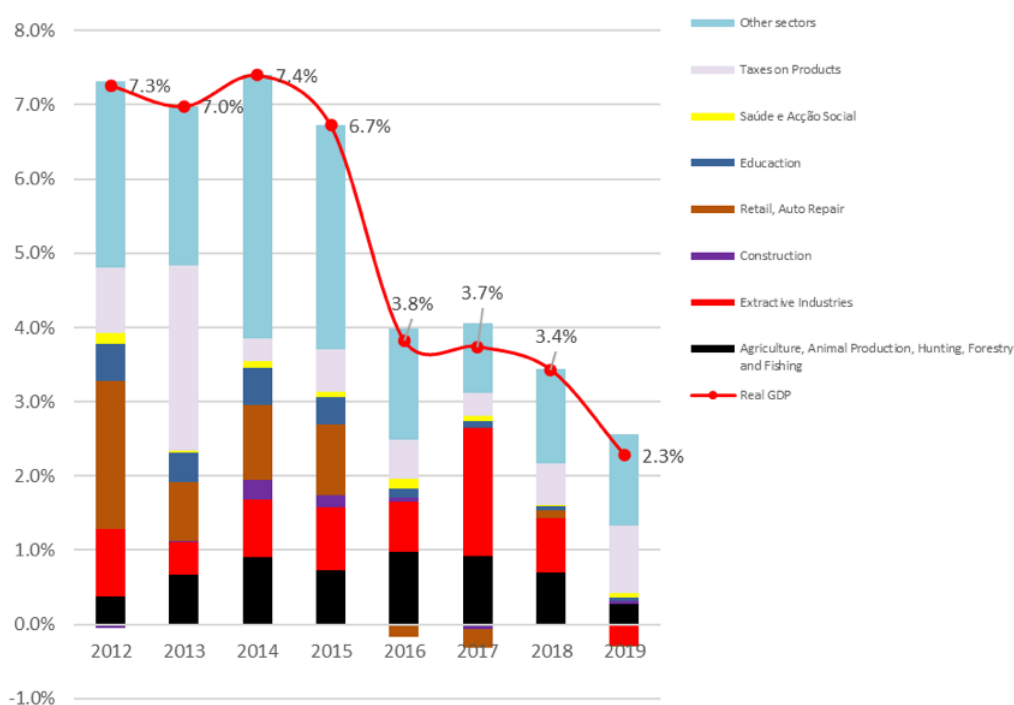
<sup>35</sup> Mozambique become one of the three countries that were the largest destinations for FDI.

<sup>36</sup> <http://www.iese.ac.mz/wp-content/uploads/2017/10/parte-i-divida-publica.pdf>

<sup>37</sup> INE, various years.



**Graph 3.19: Real GDP and Contribution to Growth by Activity**



Source: INE

In the following year, 2017, the trade sector continued to suffer from this crisis, and contributed with minus 0.3 pp to GDP (the worst contribution, when compared with all sectors since 2000). In that year, the sectors of electricity and gas production and distribution, and of construction, also made a negative contribution to GDP (both with minus 0.1 pp).

Since Mozambique has a service economy, the decline and, in some cases, the sharp slowdown of these activities, had a direct impact on employment, purchasing power and income.

It should be noted that, because in the years after 2015 Mozambique had a high rate of inflation, comparisons between years have to be made in real terms: a metical in 2015 was worth more than a metical in 2016, and still more than the metical in later years. Since *per capita* GDP measures social well-being, which means purchasing power, looking only at nominal amounts in meticaís does not measure the dramatic degradation of this social well-being that took place in Mozambique in the years after 2015.

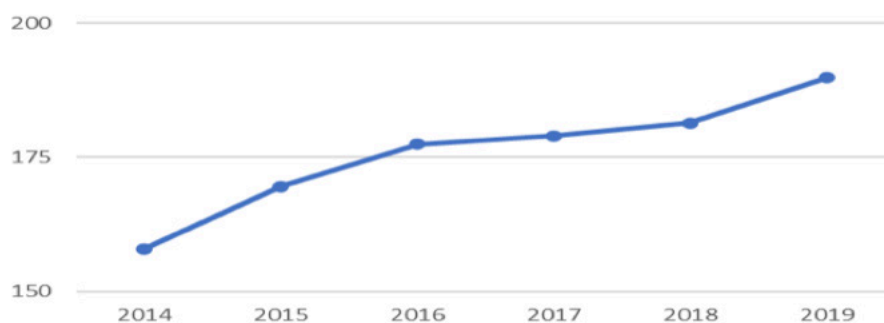
In its reports monitoring performance, such as the Report on the Execution of the State Budget (REO), the Government, in order to explain this abrupt slowdown in the economy, laid more stress on the question of politico-military tensions, on extreme climatic events (drought and floods) that have hit the country in a cyclical fashion, and the fall in the prices of the main commodities on the international markets.<sup>38</sup> Certainly these shocks had their impact on the economy, but the HD made the situation in the country much worse, and with greater impact.

As shown in Table 3.1, the almost instantaneous freezing of the inflows of foreign exchange to Mozambique meant that the productive apparatus was suddenly reined in. The fuel for economic activities was, and in the specific case of Mozambique, still is, external savings – that is, borrowing, grants and investment inflows (both for the government and the private sector). The immediate suspension of the financial programme with the IMF, and of direct support for the State Budget by the international cooperation partners, cut off this fuel. Matters were made worse by the speed in the reduction of FDI, as well as the delays and/or cancellation of disbursements linked to external financing, above all those in the form of grants.

<sup>38</sup> It should be noted that, for 2019, after cyclones Idai and Kenneth, the Government revised downwards its growth forecast to 2.5%, compared with the previous target of 4.7%. According to the 2017 Population Census, between 2007 and 2017 the population growth rate was 2.8% a year. Any real GDP growth rate lower than the population growth rate means stagnation in improving living conditions, because real GDP per capita will fall.

The continuous slowdown in GDP, immediately after the discovery of the hidden debts, had damaging consequences for the Mozambican economy in that new jobs that would have been created, and businesses that would have arisen in connection with those investments, did not materialize on the scale expected. Furthermore, the difficulty of companies in operation maintaining their financing sources led many of them to bankruptcy,<sup>39</sup> worsening unemployment, particularly in the building industry, tourism and catering, among others (Mosca & Aiuba 2017). This affected the formal private sector, but, even more, the informal sector, consisting of a large number of small and medium enterprises (SMEs). Since the SMEs are the motor of employment in Mozambique, factors which hinder the growth of the informal sector have a severe impact on the income, and therefore the well-being, of Mozambicans.

**Graph 3.20: Unemployment registered at the end of each year, 2014 to 2019 (per 1000 unemployed)**

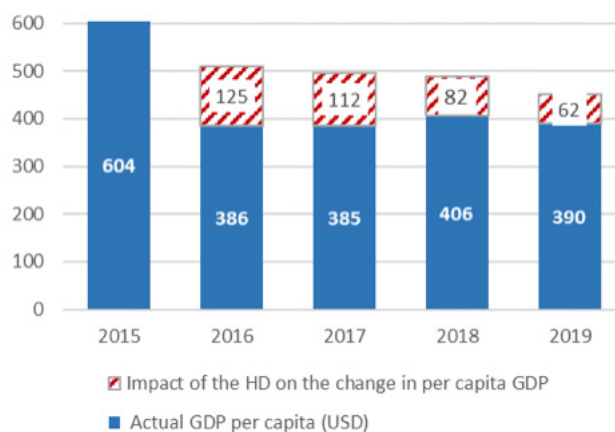


Source: INEP (2020)

Between 2014 and 2019, the number of unemployed registered at the National Employment Institute (INEP) continued to grow, particularly in 2015 and 2016. In 2015 there was a sharp increase of about 7.3% in comparison with 2014, and in 2016 of about 4.7%, based on these figures from INEP. In the following years (2017 and 2018) the increase in the number of unemployed stabilised at an annual average of 1.1%, but in 2019 unemployment accelerated again by 4.7%<sup>40</sup>. If an economy does not grow to produce more jobs, social tensions will increase.

Looking at the well-being of Mozambicans, we can analyse income (GDP) per capita and the losses derived from the HD.

**Graph 3.21: Losses in GDP per capita (in 2015 USD)**



Source: INE and Knoema, 2019

In 2015 annual income per capita amounted to USD 604. Real per capita income fell to USD 386 in 2016, a reduction of

<sup>39</sup> According to one report, about 2,900 companies went bankrupt in 2016 and 2017. 'Crise leva à falência 2900 empresas moçambicanas'. VOA, January 2, 2018.

<sup>40</sup> Labour statistics in Mozambique are sparse. The bulletin of labour statistics, issued by the Ministry of Labour, Employment and Social Security, only makes available information based on enrolment at the National Employment Institute. For purposes of this research, this data was considered insufficient to reflect the real situation of unemployment in Mozambique. Hence the analysis of this indicator concentrates on trends and not on the number of unemployed in itself.

about USD 218 in the potential purchasing power of each individual in Mozambique when compared with 2015. Of this reduction in 2016, USD 125 corresponds to the impact of the HD, as shown in Table 3.2. Using the same methodology, the average impact of the HD between 2016 and 2019 in the reduction of the income of Mozambicans was USD 95 (see the above graph). This is the result of the counterfactual scenario which conjectures what might have been, at least, the purchasing power for Mozambicans had there not been the tragedy of the HD. Chapter 5 explores in greater detail the consequences for poverty in Mozambique.

It is important to repeat, once again, that the reduction in the purchasing power of each individual in Mozambique, because of the slowdown of the Mozambican economy, does not represent a one-off economic loss, but an annual economic loss.

#### Box 6: Main highlights – Impact of the HD on GDP

- Slowdown of economic growth from 7.0% in 2013 to 3.4% in 2018 and 2.3% in 2019.
- The economic loss already suffered expressed, as a decline in average per capita GDP, is 95 USD per Mozambican between 2016 and the end of 2019.
- For 2019 (the year of the cyclones Idai and Kenneth), the factor of 40.9% explained in Table 3.2.II results in an indirect loss for Mozambicans of USD 1.815 billion (in real terms).

### 3.9 Conclusions

The scandal of the hidden debts had a negative impact on all sectors of the economy. As the calculations in Table 3.2 show, the reduction in real GDP that can be explained by the HD was around 60% in 2016 and 2017, falling to about 41% in 2019. In this year, the amount of the loss still reached some USD 1.8 billion, equivalent to USD 62 per capita – equal to a reduction of MZN 3,912 in the potential purchasing power of every individual in Mozambique.

When the per capita economic loss from the economic slowdown in the period 2016-2019 because of the HD is multiplied by the number of inhabitants, the sum total for these four years reaches USD 9.08 billion (table 3.6). But, since this study only covers four years, the effect has only been calculated for 2016-2019. In addition to the amounts lost because of the economic slowdown, Mozambique paid USD 674.2 million in direct costs (see Chapter 2).

Table 3.6 summarises the direct costs and the costs of the economic slowdown precipitated by the HD, with the amount totalling USD 9.769 billion between 2016 and 2019.

Table 3.6 Summary of the losses linked to the HD, 2016-2019

	Year				Total USD millions	Per capita in USD
	2016	2017	2018	2019		
Population in millions	27.1	27.9	28.7	29.5		
Direct costs, payments made (ch. 2) <sup>1</sup>	674				674	22
Costs of the economic slowdown (ch. 3)						
– In GDP per capita, in USD	125	112	82	62		381
– Losses for entire population, USD millions	3,384	3,120	2,339	1,815	10,659	
<b>Total economic costs due to the HD, USD million</b>	<b>4,058</b>	<b>3,120</b>	<b>2,339</b>	<b>1,815</b>	<b>11,333</b>	<b>403</b>

Source: Calculation by the authors

It should be recalled that, in addition to these costs already paid and sacrificed, up until 2031 Mozambique will still have to pay millions in direct costs (interest and amortisations), as shown in Chapter 2. Finally, it should be repeated once more that the annual loss of production remains permanent, because it can never be recovered, although the effects of the HD will decline over time.

The HD caused immediate losses to the **public finances**, with a significant increase in domestic indebtedness in order to finance the fiscal deficit. In the post-HD period this deficit has been **financed through domestic debt**, causing a disproportionate increase in debt service. At the same time, the fall in foreign resources (foreign exchange) caused **depreciation of the metical** and, as a consequence, an acceleration of **inflation**. Furthermore, the deterioration in the composition of the debt and in the contractual terms as a whole increased the cost, and therefore fiscal risk, and led Mozambique into a vicious circle of debt. These increases in fiscal risk reduce the level of Foreign Direct Investment (FDI) and of international cooperation and influence the behaviour of economic agents and of citizens. This deterioration also had a negative effect on the **monetary and foreign exchange** sectors and on the **external** sector.

The consequences of the causal impacts were felt in the responses from the Mozambican government and in the economic trajectory of Mozambique. But these consequences had their final impact on the behaviour of GDP, causing a break in the positive trajectory of **economic growth**.

Because of the suspension of budget support by the cooperation partners, **State revenue and expenditure** contracted by 3.2 pp and 10.6 pp of GDP, between 2014 and 2019. These cuts in expenditure even took place in priority sectors that are strategic for development. Although reforms were also implemented to improve the collection of revenue, it should not have been necessary to wait for a crisis before improving revenue collection.

The cost of living increased considerably with the acceleration of annual average inflation and year-end inflation, to historic maxima of 19.85% and 25.27% in 2016, respectively, making it ever more difficult to meet basic needs (Chapter 5 will explore the consequences in the erosion of minimum wages). The per capita GDP of Mozambicans, expressed in 2015 USD, fell from 604 in 2015 to 386 in 2016-2017, before rising to 406 in 2018 and falling to 390 in 2019. Obviously, real per capita GDP has persistently remained below the level of 2015..

**Public sector indebtedness** evolved to unsustainable levels, with the stock of debt exceeding the productive capacity of the country. The rating agencies came to consider Mozambique as “junk”, which made it difficult to contract loans internationally, thus favouring an increase in domestic debt.

In the **monetary and foreign exchange sectors**, the most notable effects were the successive increases of the main reference interest rates, and the sharp depreciation of the metical, by more than 50%, against the main foreign currencies, resulting in an increase in commercial bank interest rates; a contraction of credit for the economy; an increase in the amount of non-performing loans; and increased cost of imported goods and services as well as of the debt service. These effects show that financial discipline, which necessarily had to be more austere in the absence of fiscal policy measures, caused a fall in the financing available to the real economy, in reaction to the increased interest rates.

In the **external sector**, trade slowed down. There was a reduction in the amount of imports of about 55%, between 2013 and 2016. Since Mozambique is a country that is extremely dependent on imports, it became ever more difficult to meet basic consumption and investment needs. Also noteworthy was the slowdown in the amount of FDI, by about USD 1 billion between 2014-2015 and 2019.

In view of the damage done by the above-mentioned factors, caused by the HD, the pace of annual **economic growth**, between 2013 and 2019, slowed down from an average of 7% to little more than 3%. As mentioned, the productive sectors recorded a significant slowdown, resulting in reduced production, companies going bankrupt and increased unemployment. This aspect affected not only the formal private sector but much more so the vast number of small and medium enterprises (SMEs), which are the engine of employment in Mozambique. Factors that hinder the growth of the informal sector have a severe impact on the income and thus on the well-being of Mozambicans. Every year at least half a million young people come onto the jobs market, and if the economy does not grow to produce more jobs, social tensions will increase.



## **POLITICAL AND INSTITUTIONAL COSTS AND EFFECTS**

## 4 POLITICAL AND INSTITUTIONAL COSTS AND EFFECTS

### 4.1 Introduction: Trends of indices worsened

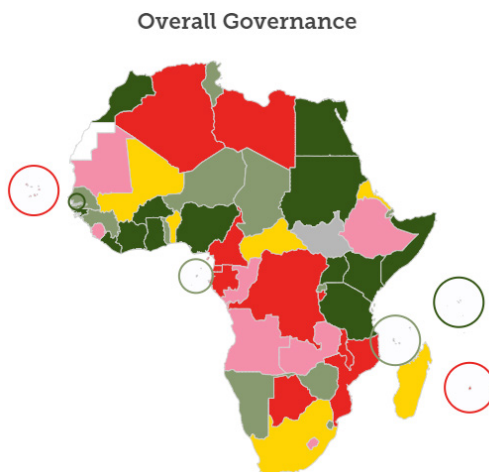
This chapter discusses the effects of the hidden debts on national institutions and on the political system, including the way in which the hidden debts have influenced the relations between the Mozambican government and other national and international stakeholders. It should be recalled that, *de jure* if not *de facto*, the 2004 Constitution set up a Republic governed by the principles of democracy and good governance, the ‘separation and interdependence of powers’, and ‘based on pluralism of expression, on democratic political organisation, and on respect and guarantees for fundamental rights and freedoms’ (Rep. Moçambique 2004: art.3). This chapter will show that the hidden debts resulted in more political and institutional conflicts within the Party-State system. Government institutions weakened and deteriorated, the political regime became discredited, and the country turned less democratic and more authoritarian.

The hidden debts arose when powerful people within the country’s government institutions committed illegal, illicit and unconstitutional acts. Our hypothesis is that this fact in itself created pressure that worsened governance – contradicting the stipulations and spirit of the Constitution – not in a deterministic sense, but pressures that would be difficult to resist in a realistic sense. This is what happened.

In the years following 2013, the trend of governance indicators worsened. Within the range of indices of international reputation and quality, with differing methodologies and foci, which seek to measure the quality of the institutions of governance and of democracy, in general, Mozambique does not score well. More worrying is that the situation is tending to worsen. The reality of Mozambique is thus moving away from the constitutional ideals.

Since it is a project of African origin and with an African focus, the assessment of Mozambique made by the Mo Ibrahim Foundation and its governance index will serve as a starting point.<sup>41</sup>

**Graph 4.1: Mozambique among the red countries: governance in rapid deterioration**



Source: Mo Ibrahim Index of African Governance

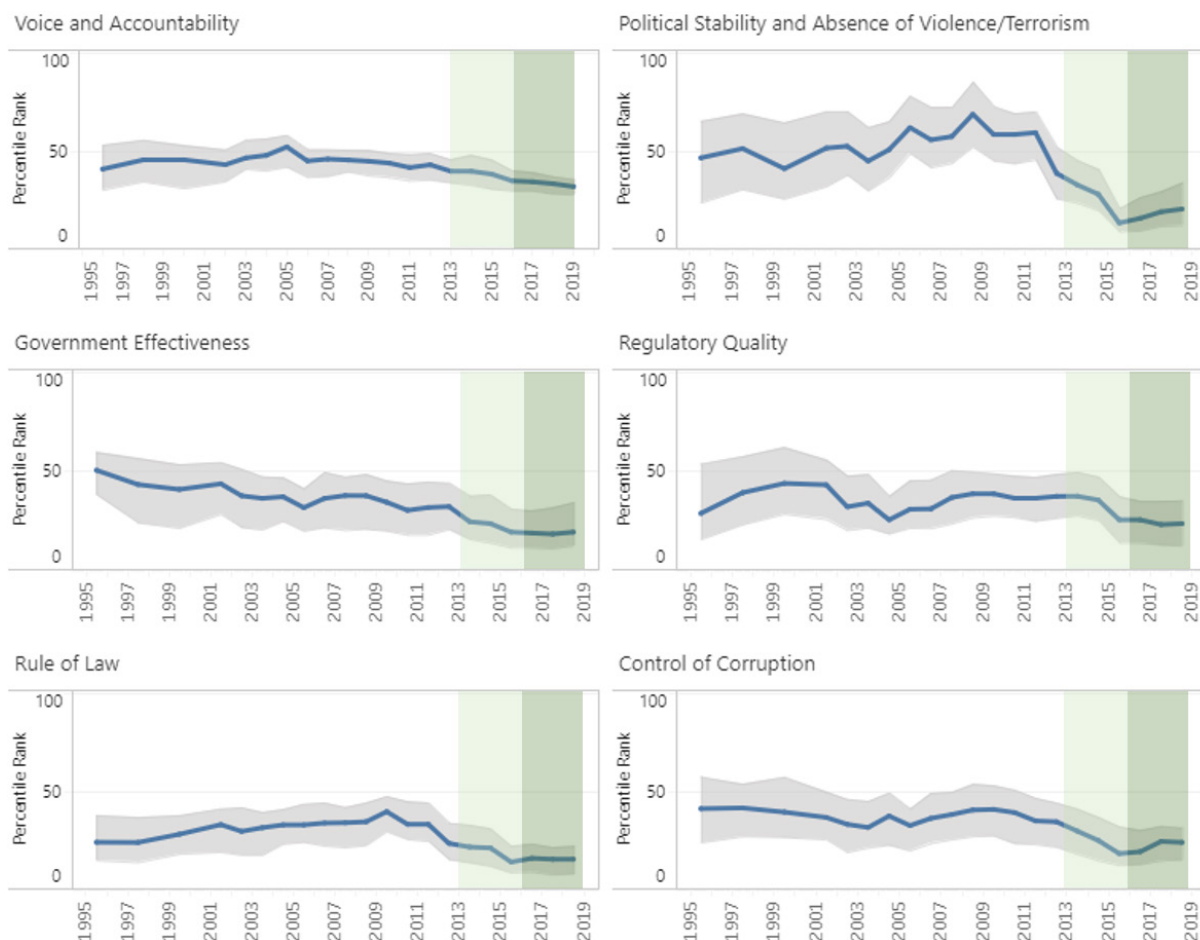
The Mo Ibrahim Foundation classifies Mozambique in 25th place among the 54 African countries, also noting that it is one of only 12 countries to receive a red flag with the note “deterioration increasing”. This is indeed the most worrying grading, given to countries where governance has worsened over the past ten years, and the decline **seems to be accelerating**. The period of accelerating decline of governance in general in Mozambique corresponds, according

<sup>41</sup> <http://mo.ibrahim.foundation/iiaag/> The key components that form the four categories of the IAG as described in the diagram below are Safety & Rule of Law, Participation & Human Rights, Sustainable Economic Opportunity and Human Development. Each of these categories contain subcategories under which we have organised various indicators that provide quantifiable measures of the overarching dimensions of governance.

to the Mo Ibrahim methodology, to the years between 2013 and 2017 – that is, since the contracting of the EMATUM, ProIndicus and the MAM loans.

The World Governance Indicators (WGI) of the World Bank are also among the best known reference points for assessing the quality of governance institutions. Below is a graphic representation of the classification of Mozambique in the WGI. The classification shows six aspects of governance, comparing the performance of Mozambique with all other countries.<sup>42</sup> This representation of all the years included in the WGI (1996-2019) serves to illustrate that also the WGI captures the abrupt fall of Mozambique in the years after contracting the hidden debts in 2013 (shaded in light green) as well as after the public’s awareness of the debts in 2016 (shaded in dark green).

**Graph 4.2: Classification of Mozambique in the WGI**



Source: WGI

The graph shows a general decline in most of the variables during the period beginning in about 2010. But the negative changes after 2013 are brusquer (and significant, with little risk of measurement errors) for all six aspects of governance.<sup>43</sup> In the period after the discovery of the hidden debts in 2016, the indicators seem to have stabilised at a low level.

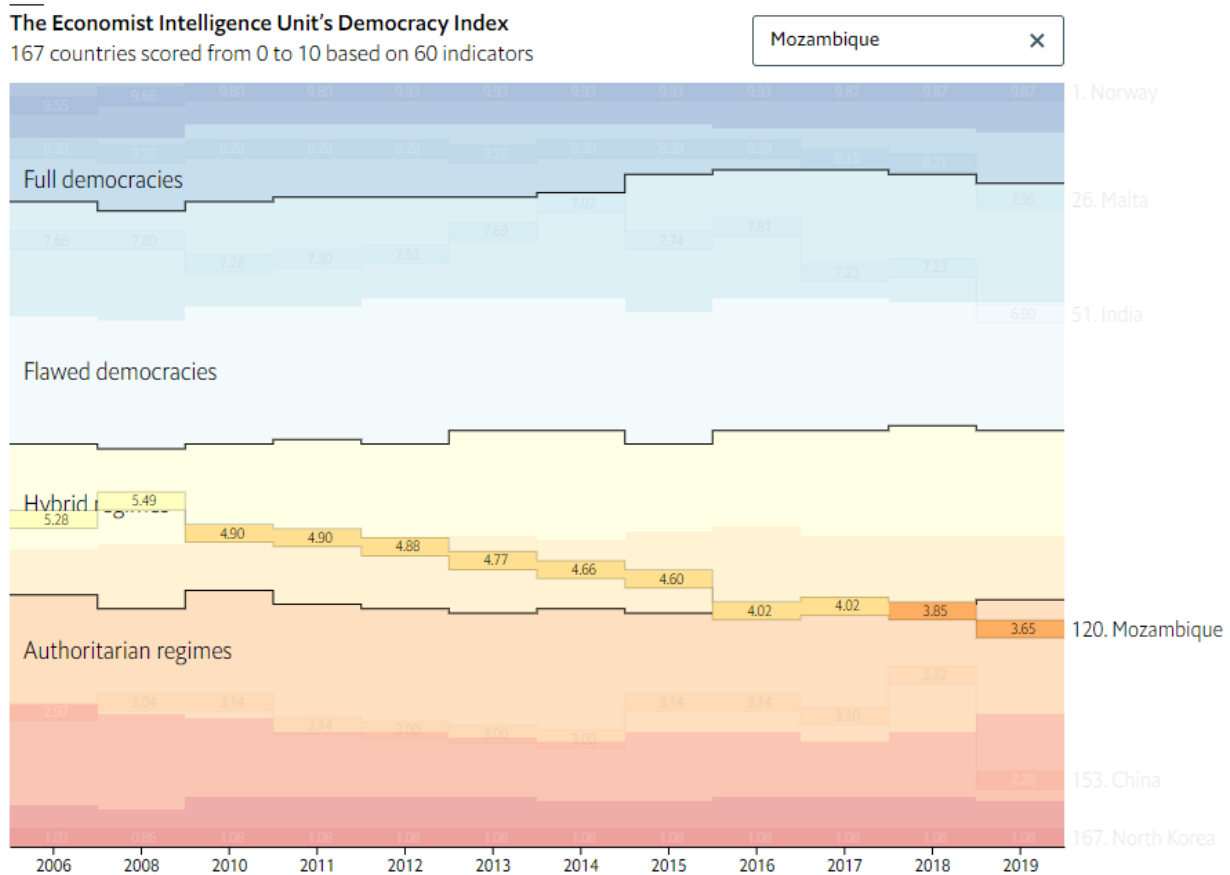
The renowned British magazine *The Economist* and its Economist Intelligence Unit (EIU) classify 167 countries, in terms of democracy, using a continual scale ranging from full democracy, to flawed democracy, to a hybrid regime, and to an authoritarian regime.<sup>44</sup> The graph below shows that in 2019 Mozambique was ranked in 120th position. 2018 was the first year in which Mozambique was classified as an **authoritarian regime**. The EIU considers that Mozambique has been in decline since 2008, and the most abrupt fall in classification happened in the years following the hidden debts.

<sup>42</sup> The (complex) methodology for drawing up these WGI may be consulted on the WGI website <https://info.worldbank.org/governance/wgi/Home/Reports>

<sup>43</sup> The interpretation must take into account the margins of error, shown by the grey areas around the blue line. As is normal, these margins of error demand care in the year-to-year interpretation. On the other hand, one can have more confidence in a result that shows trends over several years.

<sup>44</sup> <https://www.economist.com/graphic-detail/2020/01/22/global-democracy-has-another-bad-year>

**Graph 4.3: Classification of Mozambique, Democracy Index (EIU)**



This fall, noted in all the general indices on governance and democracy – Mo Ibrahim, WGI and EIU –, is the backdrop for this chapter. We shall then see the same phenomenon as a cascade effect for more specific topics. In almost all the indicators and indices, the classification of Mozambique worsened during the period after the hidden debts (after 2013, when the debts were contracted, or after they became public knowledge in 2016). Thus, at first sight this suggests that the HD seem to have increased the gap between the constitutional ideal and practice. Over the period, Mozambique seems to have become less democratic, with worsening governance. What do the hidden debts have to do with this? To what extent the deterioration is a result of the HD, or was even caused by them, is the subject of discussion in the following sub-chapters. Finally, the chapter summarises the sequence of events through which the hidden debts have affected the political and institutional system.

## 4.2 Analytical and methodological framework

The costs (and consequences) of the HD are not measured only in dollars or meticaís, but also in the deterioration in the quality of the relationship between the various political, economic and social actors in the areas we call governance and democracy. The starting point is a theoretical and conceptual assumption that will guide the rest of the chapter. There are four (4) “primordial” or “original” costs, that is, costs that are an integral part of the HD.

### 4.2.1 The four primordial costs in the political and institutional area

Apart from the financial costs directly associated with the management of the Ematum, MAM and ProIndicus debts, the instigators of the hidden debts – who are all people with significant real power and influence in the Mozambican political and institutional system – accepted other “costs” that were less obvious at the moment the debts were contracted. Unlike



the payment commitments expressed in the debt contracts, these costs were not specified in either dollars or meticaais. Nonetheless they were real and came as corollaries – almost as inevitable effects of the initial decision to embark on a clearly illicit project. They have negative effects on the political and institutional system, costs to be borne by all of society. To simplify the terminology, they will be referred to here as *primordial costs*.

These primordial costs created strong negative pressures on the political and institutional system, contradicting the principles of good governance and of democracy:

1. Where good governance extols transparency in the management of public assets, the first cost of the HDs was the opposite: concealment. Concealment was necessary in order to hide the initial offence – the contracting of an illegal debt in a corrupt manner. This motive then had a snowball effect cascading throughout the entire system. The causal mechanism that we would expect was that influential personalities in the Executive used their power to prevent the public from knowing the full truth about what led to the HD, and then to prevent their instigators from being held responsible. With the initial revelations, the need also arose of telling lies: to the public and to the country’s international partners. One example is that high-ranking officials insisted they did not know that any other debts, apart from Ematum, existed. Later it became clear that the opposite was true.
2. One democratic ideal is accountability, which means that politicians and other managers of public interest shall be held to account for their actions, either through the courts or administratively, or, in the case of politicians, at the ballot box. If the instigators (on the Mozambican side) of the initial fraud were holders of high office in the Party-State system, they would have an inevitable interest in guaranteeing the opposite of accountability: impunity. If not in general, then for all those involved – to avoid accountability. Importantly, this pressure to allow impunity produced pressure to be replicated or reproduced in the system as a cascade downwards.
3. Good governance implies institutional cooperation in favour of the public good. The HD, on the other hand, given their scale, would sharpen the struggle for power and the level of political tension in the country. The availability of uncommonly large sums of money to be suddenly distributed as bribes and kickbacks would certainly alter any existing balance, some taking advantage of their inclusion in the clique and others lamenting their exclusion. Furthermore, the funds were intended to strengthen one of the “wings” of the ruling party. This produced tension and conflict within the ruling party, as well as protests from opposition parties upon understanding the political opportunity of being able to criticise the government, already rather weakened by the scandal.
4. Good rulers should act with integrity and personal and public dignity so as to inspire confidence – between the Government and its citizens, and between the State and its international counterparts. In contrast, our analysis is that the HD produced a crisis of trust and discredit at various levels. The international partners and collaborators (above all the “donors” and other financing agencies) lost confidence in the government as the scale of the fraud came to light. Domestically, this case of mega-corruption committed by people in the most prestigious positions in the country discredited the ruling party – the Frelimo Party. But it is also likely, as we know from other countries, that corruption can not only penalise the ruling party, but can also lead to a general crisis of trust in “the politicians”. With discredit comes unpopularity and with that difficulty in winning elections.

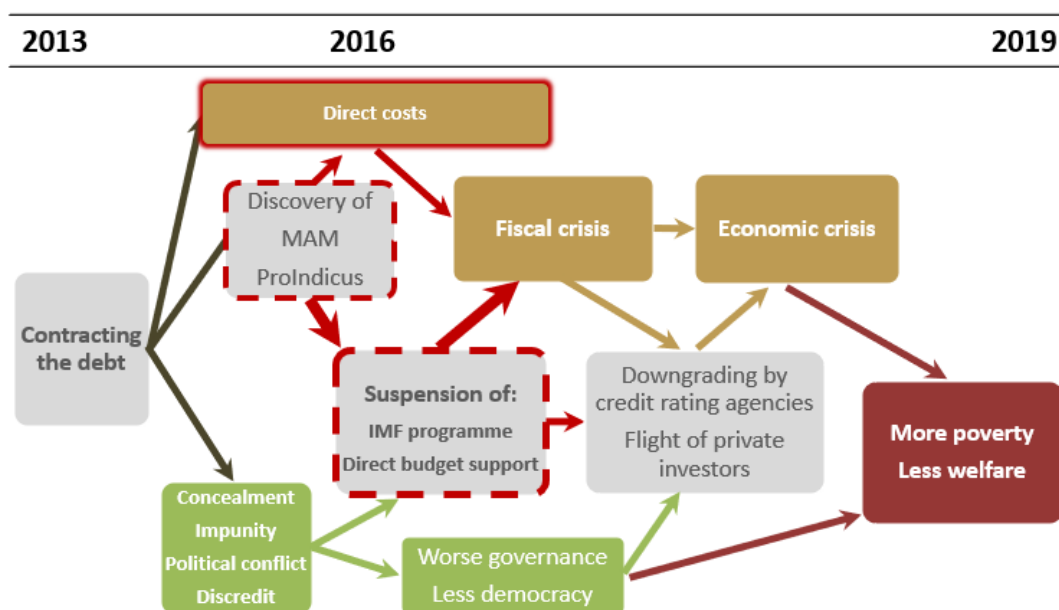
The four primordial costs implicitly assumed with the HD contrast with the corollary of the ideal of democracy and good governance in the following way:

**Table 4.1: The four primordial costs of the HD**

(Ideal) Good governance & democratic regime	(Reality) Costs accepted with the HD
Transparency	Concealment
Accountability	Impunity
Cooperation for the public good	Political tension & struggle for power
Integrity and trust	Lack of credibility

These four costs were part of the deal of the hidden debts – even if the instigators did not accept this, were unaware of them, or ignored them. These costs necessarily expressed themselves in worse governance and less democracy. These mechanisms are summarized in the green boxes in the following graph.

Figure 4.1: Model of the consequences of the hidden debts



#### 4.2.2 Methodology

If governance worsened and the country moved further away from the democratic ideal, that was certainly the result of multifaceted political and institutional processes. The methodological challenge is, here as well as in the other chapters, to isolate the effect of the HD. The particular challenge in this area is that, while the concepts in the area of governance, democracy and institutions are relatively easy and intuitive for readers, there is no single yardstick or standardised measure in which ups and downs can easily be expressed. If a journalist critical of the government is physically attacked after an intervention in the media, and the regime does not investigate or condemn the act, what is the value in which one can express this reduction in “freedom of expression”? In certain areas, the most intuitive value is an indication of the direction of change that has occurred, formulated as more/less, rose/declined or improved/worsened. In these cases, what is important is to explain by what mechanisms the *alteration* took place.

In this chapter, the priority is to make an inventory of the ways in which the HD impacted the political and institutional system – to describe through what mechanisms this may have happened, without pretending to measure the changes with numerical exactitude. What is important is to reach an overall narrative that is coherent and plausible – how the waves created by the scheme of the hidden debts were transmitted to the country’s political and governance institutions. These damaging effects could be entered on the side of “costs”: perhaps with a few exceptions, Mozambicans emerged from these years with a system less ideal than what it would have been had it not been for the HD.

The first step (in 4.3) was based on analysing the political economy of the country – displaying the logic and dynamics inherent to power – and how this combined with the various institutions, which is the basis for understanding the conflicts that arose. In addition, this first step seeks to provide aspects for understanding which groups and individuals won and lost during the period in question. The chapter then analyses the credibility of the country and of the regime in the eyes of development partners (4.4); the system that seeks to guarantee economic and political control and responsibility, the checks and balances (4.5); the public finances and the quality of the use of public assets (4.6); and finally, participation and representation of citizens, that is, “democracy” and individual freedoms (4.7). The chapter ends with a narrative summary of the mechanisms through which the HD led to a worsening of governance and to reducing the space for democracy (4.8).

Each sub-chapter begins by presenting the main international indices which, by using various methodologies and indicators that measure different aspects of governance over time. The score or ranking of Mozambique in the various indices during the period before and after the effects of the hidden debts began to make themselves felt, sometime between 2013 e 2016, will be presented in graphic format. The reference year, or baseline, depends on the variable under discussion. In general, with respect to this chapter, the effects of the HD did not appear suddenly, like the economic shock of 2016, immediately after the discovery of the Prinvest and MAM debts. Rather, the chapter will focus on certain international indices that: a) are well known, prestigious and methodologically ambitious, and b) allow a diachronic comparison for many variables/indicators. This diachronic comparison (over time) tends to confirm the hypothesis that during the period of the HD there was a deterioration in the institutional and democratic quality in Mozambique.

The second methodological pillar seeks to show the mechanisms through which the consequences of the HD are expressed and to order them conceptually. To understand the effect of the HD, it was necessary to describe the political and institutional context of the country – which evidently depends on an interpretation, which is based on the disciplines of the social and legal sciences.

We consulted a vast range of sources and data to draw up this chapter. This includes: reviewing the academic and journalistic literature on political developments since 2013, comparison of the indicators mentioned above and their proper analysis, as well as interviews with key actors and stakeholders in Mozambique.

### 4.2.3 Methodological notes on the indices: Measuring the governance of institutions

In this chapter we shall make repeated use of data from two ambitious undertakings – namely, the World Governance Indicators (WGI) of the World Bank and the project Varieties of Democracy (V-Dem). These two were chosen as the main reference points because: a) they are renowned research projects, b) they are based on great scientific rigour, c) they allow diachronic comparison, that is, comparison over time, and d) they allow comparison between various countries and a large number of indicators/variables (in turn organised into indices). In addition, we have used data from more targeted indices for more specific questions that we think particularly relevant. Other well-known projects that build indices on governance and democracy were considered and discarded for various reasons.<sup>45</sup>

The Worldwide Governance Indicators (**WGI**)<sup>46</sup> contain indicators for six different aspects of governance for 200 countries from 1996 to the present:

- 1) Voice and accountability
- 2) Political stability and absence of violence
- 3) Government effectiveness
- 4) Regulatory quality
- 5) Rule of law
- 6) Control of corruption

In producing the WGI, the World Bank uses a methodology in which it collects and incorporates a large number of other indices. Produced by many organisations and institutions, each one of them, in their own way, focuses on similar aspects of governance. Hence, the WGI are among the most ambitious projects, seeking to fill the gaps in individual indices through the inclusion of many. The WGI is thus intended to serve as the index of indices. All the graphs below presented from the WGI are easily reproduced with a tool for generating graphs on the WGI website.<sup>47</sup>

While the focus of Mo Ibrahim and of the World Bank's WGI is the quality of *governance*, there are other indices that focus on measuring the quality of *democracy*. Just as with governance, there is a wide-ranging debate on normative and descriptive aspects of democracy (Skaaning 2018). At what exact moment does a country become democratic or authoritarian? What is the criterion for establishing the boundary between the democratic and the authoritarian? Is the only

<sup>45</sup> Freedom House, which seeks to measure democracy, only makes data available as from 2017 in a way that does not allow a diachronic comparison. Freedom House presents a classification made by many fewer experts than V-Dem and, by classifying countries in the last instance in numbers between 1 (good) and 7 (bad) in the categories of "political rights" and "civil liberties", Freedom House allows a much less flexible scale than V-Dem. Even so, Freedom House shows the same negative trends as other indices since 2012. Freedom House has classified Mozambique as "partly free" since 1994: <https://freedomhouse.org/country/mozambique/freedom-world/2020>

<sup>46</sup> <http://info.worldbank.org/governance/wgi/index.aspx#home>

<sup>47</sup> It has just one shortcut: <http://info.worldbank.org/governance/wgi/index.aspx#reports>

distinction between democratic and not democratic, or are there degrees of democracy? If there is a scale for classifying a country between “very democratic” and “very authoritarian”, how can rigour and consistency be guaranteed in the methodology of applying a value to country X in year Y?

The project **V-Dem** (Varieties of Democracy) offers a possible solution to measurement problems, leaving it up to thousands of specialists/experts with deep knowledge of each country to make the assessment, by having them answer questions over the most varied indicators/aspects of democracy. V-Dem is, internationally, one of the most ambitious projects for measuring all aspects of democracy. All countries are included in the project, and the data are generated by a large number of experts per country (at least 25).<sup>48</sup> We have chosen to show the results of the graphs of V-Dem between 2000 and 2019 – to include the period of the HD and a sufficiently long period prior, enough to show eventual specific changes during the time of the HD.

Since many phenomena are measured with questions that “attack” the phenomenon from different angles, the related indicators are grouped into indexes – to simplify the presentation and interpretation of the results. All the results can be shown graphically, and they are easily verified on the public website of V-Dem.<sup>49</sup>

Afrobarometer<sup>50</sup> is the last series of indices and indicators that will be presented. Unlike the other tools, which are based on the opinions of experts, Afrobarometer consults the opinions of citizens in more than 30 African countries, including Mozambique. In the form of representative samples, the surveys are repeated regularly, to allow Afrobarometer to capture changes over time. This is another important source of data, although, for the purposes of this report, the challenge remains of how to interpret the answers. If citizens diverge in their opinions, it is difficult to determine which of the opinions is closest to reality. Sometimes all opinions may reflect a part of the reality.

## 4.3 More tension: the political economy of the hidden debts

### 4.3.1 Governance and the presource curse

There is a growing consensus among analysts of development in Mozambique – albeit with differing points of emphasis – about the link between the discovery of major extractive resources, their monopolisation by the political and economic elite centred on the Frelimo Party, the scandal of the hidden debts, and the problems over the past decade which have disrupted the “good years” of economic growth, political stability and poverty reduction (Castel-Branco, Massarongo et al. 2016; Hanlon 2017; Orre & Rønning 2017; Weimer & Carrilho 2017; Cortês 2018; Macuane, Buur et al. 2018; Sumich 2018; Cotterill 2019; Nuvunga & Orre 2019; Borowczak, Kaufmann et al. 2020). It is natural to think that Mozambique could be a classic case of the famous *resource curse*, in which natural resources, instead of producing wealth and well-being in a country, produce imbalances and economic crises, and stimulate corruption, bad governance, authoritarianism, military instability and conflicts (Ross 2015). But in Mozambique natural gas has not yet begun to be extracted, so what could cause a curse?

Here it is useful to put on the table the concept of the “presource curse”, because of its explanatory importance for questions about the HD. *Why* did they happen, and *how* could they happen? The *presource curse* is the mechanism in which all the problems associated with the *resource curse* – the hollowing of institutions, corruption, conflict, dependence on exports, economic imbalances – begin to make themselves felt even before starting to extract resources. Hence the prefix “pre” and the play on words, “presource curse”. In Mozambique, as elsewhere, the mere anticipation of enormous revenues from the resources contributed to an irresponsible contracting of debt. In a recent publication, the researchers Frynas & Buur (2020) explain how this curse began to make itself felt as early as 2010, the moment when the discovery of large offshore gas deposits in Cabo Delgado created expectations – spurred on by a large number of international and national players – that Mozambique was on the verge of receiving astronomical riches. An “economy of anticipation” came into play, which essentially created behaviour that prevents the good use of resources, which then, paradoxically,

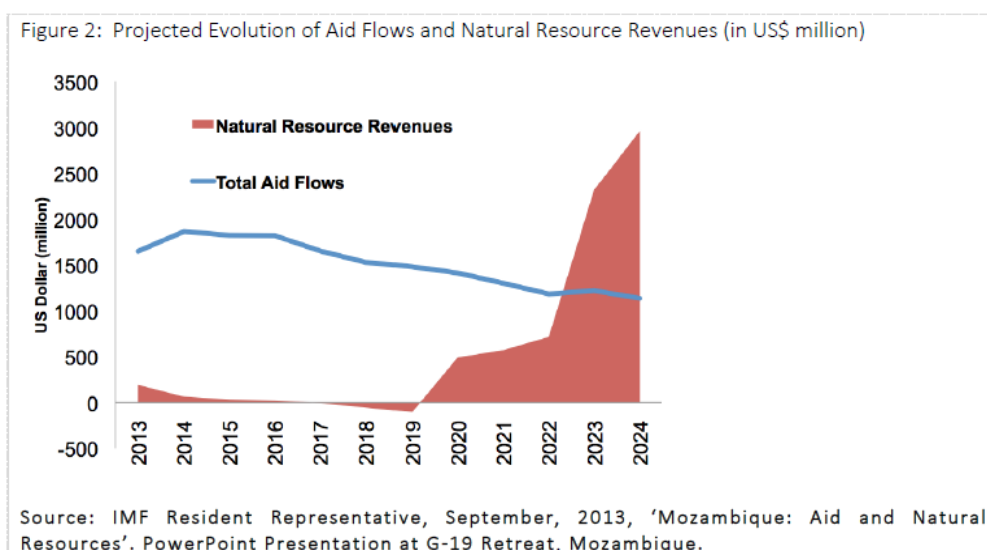
<sup>48</sup> The experts apply a score per question for each year from 1900 to today, also indicating the level of certainty in their response. The greater the certainty, the less the margin of error, when comparing a variable through time, or between different countries.

<sup>49</sup> All the results can be shown graphically on <https://www.v-dem.net/en/analysis/CountryGraph/>

<sup>50</sup> <http://afrobarometer.org/>

ends up preventing the anticipated economic dream (Cust & Mihalyi 2017:38).<sup>51</sup>

**Graph 4.4: The IMF contributed to creating expectations of enormous gas revenues**



While the economy of anticipation explains how it was possible for a country such as Mozambique to embark on a period of imprudent loans that culminated with the HD, it does not explain what motivated individuals to do so. At this level of detail, Nuvunga & Orre (2019), following Cortês (2018), show that the start of the *presource curse* is the hallmark of the last term of office of President Guebuza and is related with the attempt to prolong his Presidency beyond the two terms that the Constitution allows.<sup>52</sup> Below, we go into details in our analysis of the political economy of the country.

### 4.3.2 The Party and the State

Mozambique is a country that, 45 years after its independence, has weak institutions dominated by the political elites of the ruling party. Although the dominant party can only with difficulty be separated from the state that it has built (de Brito 2019), the regime is also of a presidentialist nature, where enormous powers, granted by the successive Constitutions of the Republic, are concentrated in the figure of the President of the Republic.<sup>53</sup>

Although the country has a presidentialist regime, in which significant power is in the hands of the President of the Republic, Mozambique has never experienced a personal dictatorship (such as, for example, that of Malawi under Hastings Banda, or the personalist regimes that, until recently, controlled Angola and Zimbabwe). Hence, since its independence the country has had four Presidents: Samora Machel, 1975-1986; Joaquim Chissano, 1986-2004; Armando Guebuza, 2005-2014; and Filipe Nyusi, as of 2015. In the presidential elections of 15 October 2019, Filipe Nyusi succeeded – under controversial circumstances – in winning his second term of office, and 5 more years to exercise executive power.

The four presidents all came from the Frelimo Party, the political force that has controlled the State since independence. At the same time, as it has always ensured that one of its members occupies the post of President of the Republic, Frelimo has also secured parliamentary majorities, making it possible to approve its policies in parliament.<sup>54</sup>

Frelimo, the movement which brought national independence, installed its party in the state as the sole party, immediately after independence. It led the country without legal opposition, a situation which lasted for more than 15 years. After

<sup>51</sup> "Economies of Anticipation", as "the various ways in which people orient themselves for the future and the ways in which the expected and promised futures conflict or converge" (2015: 426). Here, the concept of the economy of anticipation is used so as to map and draw attention to the multiple future orientations (dreams, visions, expectation, concerns with the future, etc.)

<sup>52</sup> Nuvunga & Orre (2019) suggest the hypothesis that, while the offshore resources permitted the contracting of debts and facilitated the offer by the international actors, which motivated the specific actions and contacts with Prinvest and Credit Suisse, it was the attempt by President Armando Guebuza to maintain his economic and political power that was the determinant factor. The logic of the clientelist political economy suggested that re-election would require large sums in order to continue his network of dependents. The accumulation of wealth and the availability of large sums of money had become the precondition for maintaining political power, and vice-versa.

<sup>53</sup> The first version of the Constitution of the Republic of Mozambique dates from 20 July 1975, followed by versions in 1978, 1990, 1994 and 2004. They all maintained the almost absolute powers of the President of the Republic.

<sup>54</sup> In the second term of President Armando Guebuza (2009-2014), the Frelimo Party obtained a two thirds parliamentary majority, which made it possible to amend the constitution without any political agreements with the opposition.

the introduction of the first liberal-democratic constitution in 1990, Frelimo – now in a multi-party epoch – won all six general elections that have been held since 1994. It consolidated its position as the dominant party, exercising control over the Judicial, Legislative and Executive powers, and also over the local private sector and civil society. This strengthens the interpretation that Mozambique is a democracy with a dominant party – or even in practice, is governed by a Party-State (Orre 2010; Cortês 2018).

Frelimo thus finds itself at the nerve centre of all political decisions that affect the economic and social spheres. This fact means that Frelimo is very attractive to all individuals who aspire to rise – socially, economically and politically. Frelimo officially claims that it has more than 4 million members.

More than 70% of the business of the local private sector comes from tenders for State public procurement. Since the economy is small, essentially directed outwards, a considerable part of the large multinationals in the extractive sector export their merchandise in the primary stage, that is, in the form of raw material for other markets. As a result, there are no linkages and no complementarity with the small and medium Mozambican companies, for whom the State is their largest and most important client. In order to win business with the State, the small and medium enterprises need to take an attitude of subservience towards political power or towards those who control that power. In almost all key areas of business the Party bosses position themselves (or their kin) in order to make a profit from business with, or through, the State – and right before the Hidden Debt Scandal, no sector was potentially so lucrative as the gas- and petroleum sector (ILPI 2013; Salimo, Buur et al. 2020). In this context, trafficking in influence and conflicts of interest become the dominant tune in the relations between the State and the private sector. This strengthens the role or the importance of political power as the determinant element for understanding the political economy of Mozambique.

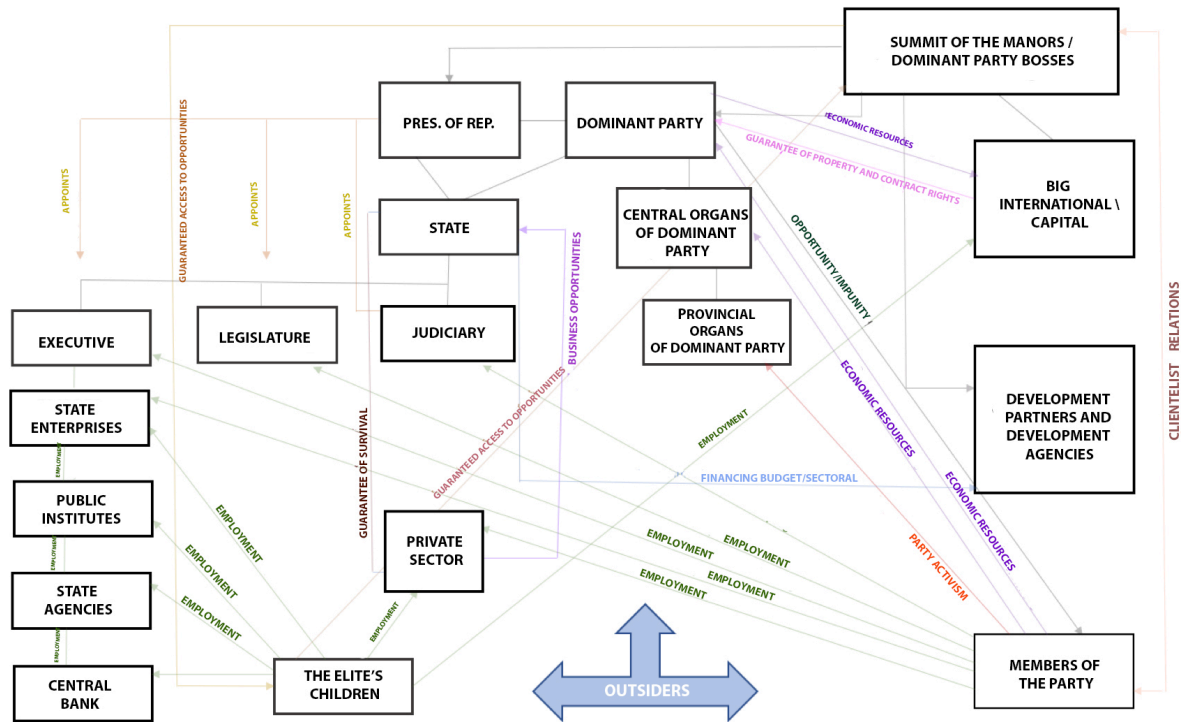
Despite the political dominance of the Frelimo Party, and despite the considerable personal power of some of its Presidents, there has been alternation in power. This implies not only change in leadership, but also in the groups who benefit directly from the control of power, opening room for disputes and for reshaping among the different groups or factions inside the Frelimo Party.

But, when one talks about political power, this may be understood as formal power, which is the power exercised by the holders of public offices or of the sovereign State bodies, almost invariably occupied by members of Frelimo. However, we also consider informal power, which is that exercised by the political elites of the Frelimo Party, represented by their main “bosses” (Eisendstadt & Roniger 1984), which often, in an informal manner, define the direction of public policy in line with their interests of the moment.

### *4.3.3 The flow of informal power in the Party-State*

The figure below may help the reader to understand better the dynamics of the political economy of Mozambique and the trafficking of influence in the networks that constitute the informal power of the main actors and institutions that struggle to control or to influence political power.

**Figure 4.3: Flow of power and influence in the Party-State**



Source: CIP

At the top of this figure one can see the presence of the President of the Republic beside the square that represents the dominant party. The President of the Republic concentrates formal power, and he has constitutionally acquired powers that allow him to appoint his government. The Mozambican political system is formally a presidentialist system with an informal logic that is deeply clientelist – a system where goods and services are traded for political support.

### **The vast powers of the President of the Republic**

‘The control of political power by the figure of the President of the Republic, in the Mozambican case, allows him to be at the centre of the entire system of the political economy of the country, in the public sector, in the legal system, in parliament, and also with regard to the private sector. This also makes it possible for the person holding this power and the individuals closest to him to enjoy privileges from which the remaining groups of society are excluded.’ (Cortês 2018:234).

In addition to appointing his government, the President of the Republic, as head of the Executive, has the power to appoint:

- In the public administration: the Board of Directors of public companies and public institutes, such as the National Statistics Institute (INE) or the National Disaster Management Institute (INGC), as well as the chairpersons of State agencies, such as the Tax Authority and the Central Bank.
- In the judiciary, the Presidents of the Supreme Court, of the Administrative Court and of the Constitutional Council. He can also appoint and dismiss the Attorney-General (see 4.3).

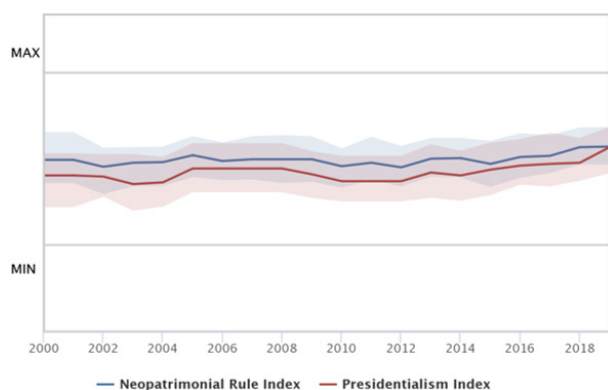
As for the legislative power, Frelimo has always enjoyed parliamentary majorities that made it possible to approve its political intentions.

This control over the 3 sovereign powers of the State permits overall control of the State, which allows the President to redistribute opportunities, in terms of appointments to posts as holders of public office, jobs in the public administration, and in public companies and institutes, career promotions and, above all, access to major State business.

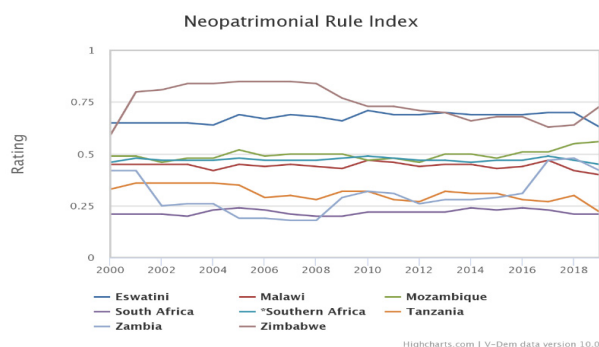
The President of the Republic, in addition to being head of government, is at the same time the President of the Frelimo Party; the statutory arrangements within the Party open room for the new leader, after attaining the position of President of the Party, to begin gradually to shape the party structure, from the Party cells, through the Central Committee that is the highest body of the Party between congresses, to the Political Commission.

Here it is worth mentioning a trend that can be observed in the indices of V-Dem. Mozambique has been classified with a strong tendency of presidentialism and neo-patrimonialism, two related phenomena (these trends were much sharper during the one-party state up to 1991). Broadly speaking, they measure how far the governance of the country is characterised by the concentration of power in the person of the President, political relations dominated by clientelism, and the use of finances and public assets for the political legitimisation of the regime. They are thus phenomena that are incompatible with democratic ideas.

Graph 4.5: Index of neopatrimonialism and presidentialism in Mozambique (V-Dem)



Graph 4.6: Index of neopatrimonialism in Mozambique and neighbouring countries (V-Dem)



During the period of the HDs and the presidency of Filipe Nyusi, V-Dem identifies a slight but clear increase in neopatrimonialism and presidentialism. In the index of neopatrimonialism, Mozambique is classified as rather worse than its neighbours and than the average for southern Africa. Indeed, in the neighbourhood, only Zimbabwe and Eswatini (Swaziland) have a worse score.

Thus, as one may conclude, the system opens space for an enormous concentration of power in the hands of a single individual. However, practical reality shows there is a mitigating factor. This is that the President of the Republic and of the Party faces competition from other Bosses inside the Party, who control their own client networks.

### Counter-powers in the Party

These other Bosses function as counter-weights within the Party, curbing the appetites of those who occupy the posts of President of the Republic and President of the Party. But it is worth mentioning that Armando Guebuza, while he occupied the Presidency, was very close to becoming a real *BIG MAN*, managing to outshine or overshadow the other Bosses of the party.

The choice of people for government posts, the indication of the President of the Assembly of the Republic, positions on the lists of candidates for deputies in the Assembly of the Republic and the provincial Assemblies, names of candidates for provincial governors, mayors of municipalities, members of the boards of directors of public institutes and companies, the choice of members of the Constitutional Council, the Supreme Court, the Administrative Court, the attorney-General's Office, the State Information and Security Service ... in short, the entire administrative machinery of the State, as well as the hand-out of large deals with the State, is based on the agreements existing between the main Bosses of Frelimo.

Because of this fact, the flow chart above could not but present the box that mentions the "Summit of the Manors",<sup>55</sup> or

<sup>55</sup> "Cimeira das Quintas" ("Summit of the Manors") is the name that a former Minister of Education, interviewed on 1 December 2016, gives to the weekend lunches held in the manors or country houses of members of the Mozambican political elite to discuss the main State businesses. This name was also used by a businessman of the financial sector, interviewed on 5 May 2015. He said the main decisions of Mozambique were taken in this kind of forum, and it was the responsibility of the formal institutions to make the decisions viable. (Cortés, 2018:242).



Conference of the great bosses of the Party. The “Summit of the Manors” is a mechanism that makes viable informal agreements between the main Bosses of the Party. These gentlemen’s agreements ensure advantages for them and for the client networks they head. This aspect strengthens the argument that the behaviour of the Mozambican political elites obeys the logic based on the pattern of patron-client networks.

This is the informal power that really governs the country. When there are tensions and disputes between these Bosses, there is an enormous potential for them to drag members of their client networks into this conflict, which may be present in a latent or open form, as the case may be. The hidden debts are a good example of this.

### ***Foreign actors***

The other actors in the flow chart are the large scale capital, represented by the multinationals, mainly in the extractive sector, which influence the political elites, particularly due to their enormous financial power and expertise in the sector, and the great expectations for the development of the country and the enrichment of its elites that are associated with these foreign investors.

Like large-scale international capital, another major structuring vector of the Mozambican economy consists of the international cooperation partners. Mozambique receives enormous financial flows as development aid, in the form of sector programmes. Since this is important for public investment in the social services, such as health, education, water, sanitation and infrastructures, any cuts in this support will always have critical consequences.

All of the cooperation partners, both the traditional ones, the western countries, and the emerging ones, such as India and mainly China, have their own interests. This play of interests, both in the aid sector and also in the economic viability of companies from their countries, creates dynamics and pressures that have always been managed impeccably by the ruling party.

Although relations with the cooperation partners deteriorated during the final term of office of President Armando Guebuza, they support the Frelimo government through sector programmes and other kinds of projects, which, during times of elections, are claimed by the ruling party as gains from its governance.

### ***The local private sector***

The flow chart presents, in summary form, the essentials of the political economy of Mozambique. One of the relevant actors present is the local private sector. It lives essentially off public procurement tenders, where to win it is not sufficient to submit the best financial and technical bids. Rather, the best relations in the trafficking of influence and conflicts of interest win. Hence, it is very common for local businesspeople to invest a considerable part of their time in forming close relations with the State bureaucracy and/or with the political elites at the central, provincial or even municipal level– that is, clientelism in operation. In Mozambique you can count the number of small, medium and large business people on one hand who do not have a FRELIMO membership card.

### ***How disputes are articulated within the Party-State***

In short, all the actors in the flow chart put pressure on the figures at the top of the flow chart in order to meet their aspirations. This gives rise to a sharp struggle between the various factions for control of the party, which would allow control of the state through the President. However, the winner cannot accumulate all the opportunities for rents and for the redistribution of other types of benefits all for himself; he needs to redistribute or else accumulate as much as possible during the period in which he controls power.

In the Mozambican case, both hypotheses are valid. The best opportunities for business with the State and the best positions for holders of public office are with the dominant client network. Positions of less importance and less lucrative deals are offered to the members of other client networks. However, this model only works to the extent that the economy continues to show high levels of growth to make it possible to expand opportunities for other groups.

In the event of the State going through a serious economic or financial crisis, such as is currently happening due to the hidden debts, this clientelist logic breaks down, causing tensions and disputes within the system. These tensions and disputes are not due to ideological divergences, but to the scarcity of opportunities of accumulation for the client networks that are not within the control of the Frelimo Party.

Another weakness of this model lies in the very formulation of public policies. The disputes and tensions between the various client networks or factions, although they do not create splits within the party, can lead to harassment and marginalization of those who have lost power. That is, even the good ideas and public policies created by the faction that previously held power are abandoned or even trivialised publicly by the faction or client network that comes to control the fate of the party and of the State<sup>56</sup>.

This results in a continual process of breaks and discontinuities in the formulation of the country's public policies.

#### 4.3.4 *Winners and losers from the hidden debts*

Within the political elite, who won and who lost with the money from the hidden debts and the discovery of the fraud? How did the HD alter/shake up the situation that existed on the eve of the HD?

The case of the hidden debts resulted from a “perfect stew” of three ingredients. First, a presidentialist political system, which concentrates a great deal of power in the hands of a single individual. Second, a political economy with a purely clientelist logic, where various client networks struggle cyclically to control a party that was never dominated by a single individual, and hence have to obey a rotating cycle. Third, natural resources valued at billions of dollars were discovered, which stirred up the greed, not only of the local political elites, but also of various types of international actors (multinational companies of the sector, banks, investors, financial speculators, etc.).

#### *Guebuza's final term of office and the Presource Curse*

When Armando Guebuza was sworn in for his second term of office in January 2010, we were witnessing a President with near absolute powers. In addition to having at his side a Constitution of the Republic that granted him vast powers, Guebuza was also leader of the dominant party that had a two-thirds majority in the Assembly of the Republic. He had installed himself as the main Boss and leader of the main client network of the party. He was considered the *first among equals* in the Mozambican business world. All the main State business opportunities were controlled by Guebuza and his close circle, including his own children.<sup>57</sup> However, Guebuza was aware that this would be his last term of office (although he tried to achieve a third term). Despite enjoying a two thirds majority in the Assembly of the Republic, the other party Bosses were waiting for the end of his cycle of governance, so that a new race for control of the party could begin.

When, in 2012, the Government of Armando Guebuza began to negotiate with Privinvest the outlines of what is known today as the hidden debts scandal, there were only two years left until the end of his second term of office. And from the delineations of the case, which are public and are included in the indictments of both the Mozambican and American prosecutors (CIP 2019),<sup>58</sup> it is well known that those implicated wanted to close the deal before the end of Guebuza's term of office.

The need to close the deal as quickly as possible, and, if possible, before the end of Guebuza's term of office, is in itself a clear sign that the actors involved in this deal were fully aware of how the Mozambican political economy works. They knew that, once Guebuza's term was over, new actors would take up positions in the dominant client network of the Frelimo Party. As a result, this would affect the commissions and bribes intended for the client network controlled by the former President, Armando Guebuza.

In Mozambique there is a popular saying that “Isto é vez--vez” (roughly equivalent to the saying in other countries that

<sup>56</sup> When the government of Filipe Nyusi took office, it gradually relegated to a secondary plane the programme of “seven million meticais per district”, a flagship policy of the previous government headed by Armando Guebuza, in favour of the “Sustenta” project. As Sustenta gained public visibility, it became the brand image of the Nyusi government and made Agriculture Minister Celso Correia the main Minister of this government. It brought agriculture to the centre of the national debate about development strategies.

<sup>57</sup> Valentina Guebuza, the murdered daughter of President Guebuza, controlled major state business through the company FOCUS 21, such as the migration of the television signal from analogue to digital. This company had interests in banking, telecommunications, real estate, fisheries, transport and mining.

<sup>58</sup> Part of the American indictment can be consulted here: <https://cipmoz.org/2019/01/08/aspectos-chave-do-golpe-da-divida-ilegal-de-acordo-com-a-acusacao-federal-americana-contra-manu-el-chang-e-outros-alegadamente-implicados/>

“it’s our turn to eat”), which is very explanatory of the logic of the client networks that cyclically control the dominant party, so that, when their turn comes, the opportunities that arise for capital accumulation must be taken advantage of, through large scale state business or through accommodating loyal clients in strategic places in the public administration, public companies and institutes, the judiciary, the legislature, etc.

However, the dominant client network of the time, which drew the most benefit from the deal of the hidden debts as shown in the indictments of the Mozambican and American prosecutors, entered the scheme on the assumption that it could gain enormous sums of money before abandoning direct control of party and state power, since their Patron, Armando Guebuza, was preparing to leave office. The entire deal was undertaken on the assumption that the future gas revenues would cover the operations and the debt of the three companies – Mozambique Assets Management (MAM), ProIndicus and Ematum.

Focussing on the HD, and taking into account the various elements that have become public knowledge, such as the viability studies/business plans, it is clear that these were based on very optimistic assumptions and unrealistic projections based on the belief that the first revenue from the Rovuma Basin natural gas would begin to flow as early as 2019, and that there would be an improbably large demand for the services provided by the companies. Furthermore, those who contracted these debts had no control over the Final Investment Decisions of the multi-nationals operating in the Rovuma Basin.

This scenario may have led to a union of forces between Mozambican politicians, holders of public office, and middlemen, hungry to pick up the last great commissions as long as they held direct control over power, and Lebanese businessmen with access to international banks – Credit Suisse and VTB. Greedy officials of these international banks knew where to find rash investors ready to make a profit at any cost. This all depended on guarantees from a country rich in resources, which they supposed was the case with Mozambique. The trap was being laid for what some academics call the Resource Curse and others the Economy of Anticipation.

### ***The earthquake in the party and the decline of the Guebuza wing***

When, in April 2016, the scandal saw the light of day, and the details began to become publicly known, the client network of the former President, including Guebuza himself, started to become unpopular. Those interviewed for this report are unanimous in feeling that, just as Guebuza’s group or faction was the greatest beneficiary inside the Frelimo Party of the money from the hidden debts scheme, it also became the faction that was most damaged.

After the discovery of the hidden debts, a political earthquake struck the Frelimo Party. Various important figures in the party made statements showing their profound disgust and repudiation of the scandal. Graça Machel, one of the main “Bosses” of the party, stated publicly «*I, my children and my grandchildren are not going to pay the debt from the rip-off*»,<sup>59</sup> referring to the debts contracted by the Guebuza government.

Sérgio Vieira wrote in the daily paper “O País” in 2015:

«I believe we really need an operation like Lava Jato, for the good of the country, of the government of the day, and of the State coffers, which should recover the looting and the commissions from A to Z. It doesn’t matter much who stole half a dozen million meticais, what is fundamental is who benefitted directly and via relatives and subordinates from hundreds of millions of dollars and many billions of Meticais. (...) Poor Nyusi, poor Maleiane facing empty coffers that were emptied by predatory elites, from the very top to the base, accomplices, relatives, and double-crossing friends of this country».<sup>60</sup>

Other “historical” Frelimo figures, such as Óscar Monteiro, also joined their voices to this chorus.<sup>61</sup> But there were also members with a less antagonistic position towards Armando Guebuza and his client network, who had been those mainly responsible for contracting these debts. Such is the case of General Alberto Chipande, who, in a statement to television reporters in Beira, on 26 April 2016, said:

«We are asking the Government to explain the debt. We reached the conclusion that, if this debt exists, it is sovereign, and the State should find ways of solving the problem of the debt. It was contracted under the previous Government, but it is up to the current Government to explain the debts and solve the problem» (Cortês; 2018; 274).

<sup>59</sup> Extracts from an article published in the paper O País on 8 December 2015

<sup>60</sup> Extracts from the article published by the paper O País on 8 December 2015

<sup>61</sup> <https://cartamz.com/index.php/politica/item/1908-no-recente-conclave-da-Frelimo-armando-guebuza-disse-que-nao-conhece-teofilo-nhangumele-e-acusou-oscar-monteiro-de-promover-a-caca-as-bruxas> . Consulted on 22 June 2020.

Despite the initial reactions, inside and outside the party, the government of Filipe Nyusi succeeded in managing the case so that it did not cause too many problems for the stability of the party. The sums involved in this scandal, of billionaire proportions, ensured that gradually Frelimo itself began to build the narrative that this was not a scandal of Frelimo corruption, but of some members of the party who had used their privileged positions to defraud the Mozambican state.

While in the first two years after the discovery of the scandal, this narrative was not consensual, because there were still those inside the party who defended Armando Guebuza and the decisions he took around this scandal, after 29 December 2018, with the detention of former Finance Minister Manuel Chang in South Africa, due to the extradition request by the US prosecutors, and the new details made public about the nature of the debts, there was a need for a total change of attitude towards this case, both by the party and the bodies of the administration of justice.

The indictment by US prosecutors against Manuel Chang, Jean Boustani, Teófilo Nhangumele and others, contained aspects that embarrassed the Mozambican justice system. The Attorney-General's Office (PGR), although it received great assistance from the company Kroll Inc. that audited ProIndicus, Ematum and MAM and presented a very detailed report on the case, for two years did not present any significant advances to the public.

The months of January and February 2019 were very tense. The PGR had to go public and say what was happening. It presented an indictment against 20 accused, including Ndambi Guebuza, the oldest son of Armando Guebuza; Gregório Leão, the former director of the State Intelligence and Security Services (SISE); António do Rosário, the chairperson of the boards of EMATUM, MAM and ProIndicus; Inês Moiane and Renato Matusse, respectively the secretary and political advisor to Armando Guebuza; and Teófilo Nhangumele and Bruno Tandane, friends of Ndambi Guebuza.<sup>62</sup> Manuel Chang, who was Finance Minister in 2013, was also charged, although he is still detained in South Africa, awaiting extradition.

All the detainees were part of the inner circle of Armando Guebuza, which increased his unpopularity. The image of Joaquim Chissano, however, moved in the opposite direction. This case brought him back into the limelight as a former President with some degree of morality or credibility in public opinion, enabling him to make a critical analysis of the main matters affecting the country.

The hidden debts scandal caused a shake-up in the structures of the dominant party due to the sums involved in the scandal and the fact that a small group within the party had used this fraud for its own benefit. This created the sense of betrayal and that some had "eaten" a lot, damaging the others, but wanting everybody to pay the bill.

The details of the PGR indictment, as well as that of the American prosecutors, sharpened this perception, because it became clear that a substantial number of party members, who had earlier appeared publicly defending this deal, also had no idea of what it really was and how much money the beneficiaries had put into their pockets. Teodato Hunguana, Minister of Justice during the government of Joaquim Chissano, a judge on the Constitutional Council (2003-2009), and a member of the Frelimo Central Committee, said the following:

«We are being buffeted by a situation that we, who were not directly involved in the government, could never have imagined would be possible (...) The nation has to understand, it has to know what is really going on. What is the scale of this? At the end of the day, we are all Mozambicans, we are not members of Party A or Party B. This is on an extremely serious scale. It's as if a new colonisation of our country had been announced (...) Forty years after independence, clouds are gathering that threaten a new colonisation».<sup>63</sup>

The hidden debts had created the worst crisis inside the Frelimo Party since the death of Samora Machel.

### ***The power of Nyusi***

Just like his party, the current President of the Republic and of Frelimo, Filipe Nyusi, was also affected by this scandal. At the time the debts were contracted, he was Minister of Defence, and his role in this entire process has never been fully explained. And the statements of Jean Boustani, during his trial in New York, in saying that he paid 1 million US dollars to an individual known as "New Man" or "Nyu", helped strengthen the misgivings about the role of Filipe Nyusi in this swindle.

62 The other accused are Elias Moiane, Sérgio Namburete, Fabião Mabunda, Zulficar Ali Ahmad, Cipriano Mutota, Crimildo Manjate, Mbanda Anabela Henning, Khessaujee Pulchand, Simião Mahumane, Naimo Quimbine, and Márcia Bioso de Caifaz Namburete. In an independent legal case, the governor of the Bank of Mozambique in 2013, Ernesto Gove, and Joana Matsombe and Waldemar de Sousa, both former directors of the central bank, are being accused.

63 Extract from the interview with Teodato Hunguana in the newspaper "O País" on 22 April 2016, page 11

The hidden debts represented a great potential for generating conflicts and disputes between the different factions inside Frelimo. Personal or group interests (as opposed to the national interest) were at the centre of contracting the debts, as well as creating projects that served to justify them – the three companies. This favours disputes within Frelimo both because some people felt prejudiced in the distribution of the “profits” and because of the simple fact that some of the important people felt they had been used in order to make projects appear as viable that were in the personal interest of only some.

Setting up the projects that justified the HD involved several State sectors, notably the Presidency of the Republic, the Ministries of Defence, the Interior, Fisheries and Finance, and the State Intelligence and Security Services (SISE). As was shown later in various investigations and indictments (Comissão Parlamentar de Inquérito 2016; US Indictment 2018; PGR 2019),<sup>64</sup> not all those involved in contracting the hidden debts benefitted equally from the “profits” these generated. Some received millions more dollars in bribes than did others. Some are not even mentioned as receiving any personal gain from their involvement in the project.

Between the contracting of the debts and the implementation of the projects for which the money of the debts was intended there was a change in the centre of power in the State and in Frelimo. The hidden debts were negotiated and contracted, and the respective projects created, between 2011 and 2014, during the second term of office of President Armando Guebuza. But implementation of the projects came to coincide with President Filipe Nyusi rise to power. It is true that, as Minister of Defence during the contracting of the hidden debts, Nyusi occupied a central position in negotiating and implementing the projects that served as an umbrella for the debts, but he did not take the most important decisions in the case, nor did he gain the greatest benefits from the debts.<sup>65</sup>

Filipe Nyusi did in fact sign several important documents in the context of the hidden debts, including the concession contract for the Integrated Monitoring and Protection Service (SIMP) under which the State awarded coastal security and defence to ProIndicus. The contract was also signed by the then Minister of the Interior, Alberto Mondlane, and the then Minister of Finance, Manuel Chang. However, the available indictments show that, of the three, only Manuel Chang received a financial reward, of about 12 million US dollars, for his involvement in contracting the debts – not for signing the contract that granted the SIMP to ProIndicus, but for signing the State guarantees that made the loans viable.

What happened next is that when Filipe Nyusi entered the Presidency of the Republic, he ordered that the implementation of the SIMP by ProIndicus be suspended, which condemned the project to failure. He declared that his government had found the state coffers empty,<sup>66</sup> authorising the Parliamentary Inquiry into the debts, so that the commission of inquiry could involve the parliamentary opposition. He also authorised an international audit into the debts, the report of which served as the basis for the Public Prosecutor’s Office (acting on behalf of the Government) to draw up an indictment and order the arrest of people close to former President Armando Guebuza, including his son Armando Ndambi Guebuza, his private secretary Inês Moiane, his director of SISE, Gregório Leão, and the former Director of Economic Intelligence of SISE and chairperson of the three companies that were the umbrella for the debts, António Carlos do Rosário.

In a context of effective separation of the sovereign powers of the State, the actions mentioned above could not have been attributed to a single body such as the Presidency of the Republic. Only cancelling the concession of the SIMP to ProIndicus could have been directly attributed to the executive power. However, this is not how things work in Mozambique. As shown in the introduction to this chapter, the President of the Republic enjoys enormous constitutional powers, which *de facto* allow him to control all sectors of the State. Additionally, the fact that the President of the Republic is, at the same time, the President of Frelimo, extends his powers to the effective control of sectors of society outside of the State, to such an extent that all the achievements (and failures) of the State and society are, with some legitimacy, attributed to the President of the Republic.

In response to the political and legal pressure against his person and his wing, Armando Guebuza supposedly retorted, in a hearing with the Attorney-General’s Office, that the person responsible for the scandal is “the former Defence Minister” – i.e. the now President Filipe Nyusi.

64 Cf. Report of the Parliamentary Commission of Inquiry on the Foreign Debt; Report of the International Audit of the hidden debts undertaken by Kroll Inc., Indictment CR 18 681 and Copy of the Indictment Sheet of the Sixth Criminal Section of the Maputo City Court.

65 The indictment of the Attorney-General’s Office shows clearly who the main beneficiaries were and who received the smaller slices of the cake.  
66 <https://www.africa-confidential.com/index.aspx?pageid=21&articleid=11060> [accessed on 10 September 2019]

### 4.3.5 *The rising level of tension and political conflict*

Since 2020, the political conflict between the present and the former Presidents of the Republic has been public knowledge. This sub-chapter argues that this conflict is a logical consequence of a scandal on this scale. This study is not in possession of enough material to decide on the degree of responsibility of the various factions, but it is assumed that the then Minister of Finance and the Director of SISE did not act – nor could have acted – to plunge the country into debt in this way without the political support of their superiors. It is also likely that not all were equally informed about the conspiracy, and certainly not all the senior officials benefitted from the bribes and kickbacks in the same way – but all the leaders would suffer the consequences of the scandal when it was discovered. These were the ingredients of the conflict. Hence, a predictable imbroglio entangled, in the senior and middle levels, the ruling party that has dominated the State since independence. The HD made more visible, and sharpened, the disputes between the different factions of Frelimo. In the same way that the funds from the HD were associated with the motive for winning the general elections of 2014, it now seems clear that the eventual responsibility – or rather blame – for the HD will be the topic of conflict until the elections of 2024.

In addition to the conflict inside the party, the HD had the effect of sowing conflict, tensions and contradictions in State institutions, also dominated by Frelimo, some contradicting others in the clash between political loyalty and legality. This institutional imbroglio is the theme of the next chapter.

## 4.4 **Credibility of the regime – internal and external**

In the introduction to this chapter, it was postulated that one of the inherent, or “primordial”, costs of the hidden debts was the loss of credibility of the governance institutions of the regime that would be “caught” as responsible for the scandal. A regime displaying good governance will be recognised for the virtues of integrity and credibility. By the same token, a regime that is unable to hold accountable the individuals responsible for major corruption or restore robust management of the finances and other public assets, will be regarded with suspicion and distrust. A series of cases under way in the courts in several countries has brought to light details about the fraud, including the bribes distributed, implicating figures central to the regime in Maputo, and increasingly staining its image in the eyes of the world. One image which, more than anything else, illustrates Mozambique’s lack of credibility because of the HD, is that of the former Finance Minister, Manuel Chang, presented as a defendant before a court in South Africa, the country where he has been in detention since late 2018.

In Mozambique, in the years following the discovery of the HD, this trend can be seen in the indices that seek to measure the credibility of the regime, and it can be seen in surveys of Mozambicans. But before all of this, it was seen in the reactions of the “international community” in Maputo – that is the “partners” or “donors” who for decades had financed significant parts of the government’s programmes. Their reactions form an important part of the narrative of the hidden debts.

### 4.4.1 *The donors and the crisis of trust*

The discovery of the EMATUM case in 2013 complicated the relationship between the donors and the Mozambican government.<sup>67</sup> Although the EMATUM debt could not be hidden, it was clear that it shattered the macro-economic reference points established as the basis of the agreements between the Mozambican government, the IMF, and the “G19” – the group of 19 countries and multilateral organisations<sup>68</sup> that have helped finance the Mozambican State Budget for many years since the start of the century. In addition to direct budget support, many donors also contributed funds to finance various sectors and some institutions through so-called “basket funding”. The whole idea of these forms of support was that they were based on mutual trust.

The trust necessary to justify direct budget support was based on three common objectives: first, the resources would be applied in accordance with the principles of good governance; second, the central goal of the Government’s activities was poverty reduction (these two principles seemed to correspond to the central objectives expressed in the Constitution of

<sup>67</sup> ‘Mozambique attempts to placate donors about \$850m bond’, Mail&Guardian, November 13, 2013.

<sup>68</sup> The “members” of the G19 were the African Development Bank, Austria, Belgium, Canada, Denmark, the European Commission, Finland, France, Germany, Holland, Ireland, Italy, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the World Bank. The United States and the IMF were associate members.

the Republic (article 11)); third, the government would have to remain committed to the macro-economic reference points established with the IMF. The Government trusted that the donors would honour their promises to disburse the funds on time, and the donors trusted that the Mozambican government would act in good faith to comply with the three principles established.

Some representatives of the donor community report that in 2014 this form of support was already running out of steam for various reasons. There were some reasons that had little to do with Mozambique, linked to the political environment in the donor countries and to global discussions on the capacity of this modality to achieve the objectives of good governance and poverty reduction. But among the reasons was growing frustration inside the donor community at the performance of the Mozambican government. In 2010, the publication of IOF 2008/9 posed doubt as to the capacity of the current mode of development to convert economic growth into poverty reduction. Furthermore, tensions between the Government and the donors were already visible in 2010, when, for a period of several months, the donors refused to transfer funds, in protest at the way the 2009 elections were handled; their impression that the Frelimo Party was consolidating its position unduly in State institutions; and that the commitment to good governance and democracy was not sincere (Hanlon 2010). Furthermore, there were signs that some of the macro-economic indicators (such as net international reserves and imports) were running out of control, so that the IMF had to issue waivers so that it would not be obliged to discontinue the programme of support for the country. The number of donors who provided direct budget support shrank from a maximum of 19 to 14 in the years immediately prior to 2016.

The officials of the donor organisations interviewed for this study confirmed that the trust they had in the government was already being eroded due to the factors described above, although the considerable irritation caused by the EMATUM debt was slowly dissipating. This was the situation when suddenly, in April 2016, the discovery of the MAM and ProIndicus debts struck like “a shock”, an expression also used in the long interview granted by the outgoing Swedish Ambassador, Irina Nyoni, to the newspaper “Savana” in March 2017.<sup>69</sup> From that moment, they described the relationship between the donors and the government as “in crisis”. Ambassador Nyoni said: “It was a huge crisis of trust, and it is still difficult to restore trust”. The shock and the anger may not have been distributed equally among the cooperation partners, and there were differences in how to deal with the situation. But the most consequential reaction was unanimous: by May 2016, all member countries of what was now the G-14 had suspended their support of the Mozambican State Budget.<sup>70</sup>

Perhaps the main expression of the extreme distrust that the donors had accumulated towards the Government was their imposition – clearly against the will of the Government – of an international audit of the three companies EMATUM, MAM and ProIndicus. Financed by the Swedish Embassy, the company Kroll carried out the audit.<sup>71</sup> The way in which the authorities conducted the audit process did not inspire trust among the partners. First, the Kroll auditors lamented the lack of sufficient cooperation from the three public sector companies (Kroll 2017),<sup>72</sup> – notably, the CEO for all three, António Carlos do Rosário, refused to provide information to the auditors and expelled them from his office. This lack of cooperation intensified suspicions that illicit acts were being hidden. For this reason, the auditors had to request, several times, an extension to the deadline for delivering their report. This was followed by the PGR’s delay in publishing the report, which had the same effect, particularly because only a synthesis of the report was published, and even that was well below expectations in terms of details about the whereabouts of the money.

#### 4.4.2 Credit rating of the State (S&P, Moody’s and Fitch)

Shortly after the reaction to the HD from the international community represented in Maputo came the reaction of the “financial world”. The map shows the classification by Standard & Poor’s by credit rating (or risk grading), in March 2019. It can be seen that S&P considers Mozambique and Venezuela as the least reliable countries in terms of payment of their sovereign bonds.

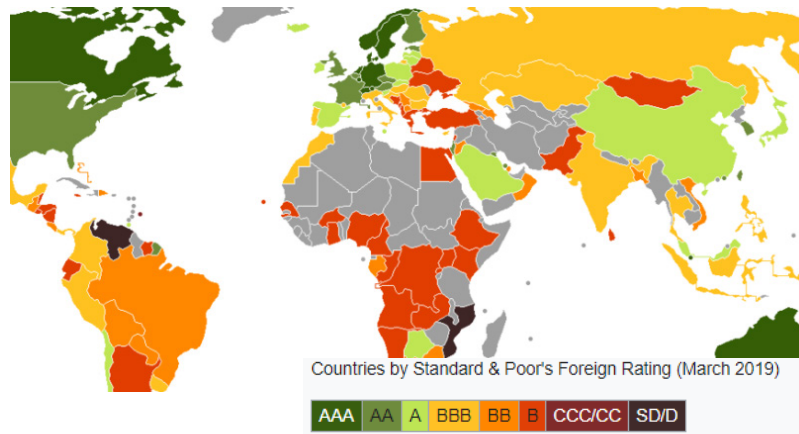
69 ‘Este foi o último adiamento da publicação do relatório da auditoria’, interview in “Savana” on 31 March, 2017.

70 ‘Moçambique: Marcelo Rebelo de Sousa confirma suspensão do G19’, Deutsche Welle, 4 May, 2016. <https://www.dw.com/pt-002/mo%C3%A7ambique-marcelo-rebelo-de-sousa-confirma-suspens%C3%A3o-do-g19/a-19237037>

71 The Kroll report has still not been officially published, but it can be found, for example, here [https://www.dropbox.com/s/52a7vtokihb1ev1/Kroll\\_Mozambique\\_\\$2bn.pdf?dl=0](https://www.dropbox.com/s/52a7vtokihb1ev1/Kroll_Mozambique_$2bn.pdf?dl=0)

72 <https://clubofmozambique.com/news/kroll-report-companies-did-not-cooperate-with-audit-aim/>

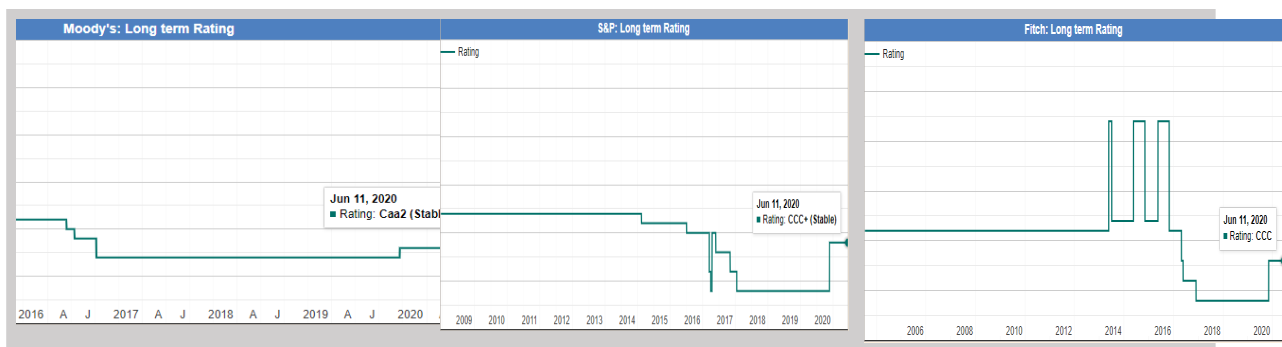
**Graph 4.7: The credit rating of Mozambique, according to S&P in 2019**



Graph by Wikipedia<sup>73</sup>

In its classification, another world-renowned agency, Moody’s, places Mozambique as the penultimate country, better only than Puerto Rico, and worse than Venezuela. The graphs below show how, after the discovery of the DO, the risk associated with investment in Mozambique rose to historically high levels – that is, the credit rating became worse.

**Graph 4.8: The classification of Mozambique in the credit rating agencies**



Source: *Country Economy*<sup>74</sup>

The lowest point was between 2017 and 2019, when S&P’s and Fitch classified Mozambique as SD and RD, defined as “in default and with little prospect of recovery”. In the first half of 2020, the three agencies gave Mozambique a slightly higher classification. Even so, all three kept Mozambique with classifications that implied “substantial risks” (Caa2, CCC+, and CCC).

All the agencies note a dramatic fall after 2014, which is certainly a direct reaction to the news about the existence of the hidden debts and the fact that Mozambique had failed to pay the EMATUM debt in 2016. As discussed in chapter 3, this fall in the eyes of the credit rating agencies is not only measured as a decline in “reputation” or credibility, but it also has costs that can be measured in financial terms: with this extent of downgrading, it would be much more difficult to gain access to credit on the international markets to finance public expenditure or even to restructure and postpone payment of the debt itself (Castel-Branco 2020).

#### 4.4.3 Afrobarometer – the assessment of citizens

Afrobarometer, which seeks the opinion of citizens in surveys of representative samples – the most recent was held in mid-2018, after the discovery of the hidden debts – had the following results from questions about corruption (Afrobarometer 2019:46). Among Mozambicans:

- 50% think that their government is not doing a good job in fighting corruption;
- 35% of users of public services say they paid a bribe in the last 12 months.
- 49% think that corruption has increased over the last 12 months;

<sup>73</sup> [https://en.wikipedia.org/wiki/List\\_of\\_countries\\_by\\_credit\\_rating](https://en.wikipedia.org/wiki/List_of_countries_by_credit_rating)

<sup>74</sup> <https://countryeconomy.com/ratings/mozambique>



These levels of trust are more or less the average for sub-Saharan Africa. In their answers to the various questions, between a quarter and a third of Mozambicans expressed their distrust with governance institutions.

What is the trend over time? Comparing the 2018 results with those from 2015, the percentage of Mozambicans who think that “all or most” are corrupt had risen for the following institutions: President of the Republic, members of parliament, government officials, the police and judges and magistrates (Afrobarometer 2019:46). Hence, there is a clear, albeit timid, trend that more Mozambicans are distrusting the institutions of governance in the area of corruption.

## 4.5 Responsibility and impunity: the Executive and its institutional counter-weights

In sub-chapter 4.2 the informal powers were described. What is the situation, then, with the sovereign institutions of the State? In a constitutional democracy such as Mozambique, there are three sovereign bodies, and none of them should dominate the others: the Executive (in the case of Mozambique, led by the head of the government, the President of the Republic), the Legislature (in Mozambique, the Assembly of the Republic), and the Judicial Power. The argument here is that this system of checks and balances in practice does not work, and the Executive ends up smothering the other powers, relegating them to a secondary position.

The Constitution defines the Assembly of the Republic (AR) as a sovereign body,<sup>75</sup> and as the highest legislative body in the country.<sup>76</sup> Thus, its main task is to produce legal norms that have the force of law.<sup>77</sup> In line with this, another of the activities of the AR is to inspect the activities of the Government and of the Public Administration.

**The judicial power** of the courts is covered under the Constitution where the courts are also regarded as sovereign bodies. The Supreme Court (TS) is at the top of the hierarchy of the courts of law.<sup>78</sup> At the same time, the Administrative Court (TA) represents the top of the hierarchy of the administrative courts.<sup>79</sup> The list of the bodies of the administration of justice also includes the Public Prosecutor’s Office (MP).<sup>80</sup> As the highest body of the MP, and with constitutional relevance, is the Attorney-General’s Office (PGR).<sup>81</sup> The Constitution also grants constitutional dignity to the Constitutional Council (CC).<sup>82</sup>

Since the government is also a sovereign body, these three powers – the three main pillars of the Rule of Law – are not subordinate to each other, but between them there is a duty of institutional collaboration. Apart from other functions, the Legislature and the Judiciary occupy an indispensable role as the sovereign institutions with the power to limit the power of the executive. In English, the term checks and balances is used. Who decides if the Executive, or any member of it, is committing or is suspected of having committed, an illegality, and who holds it accountable? Do the legislative and judicial branches have the capacity to place the (necessary) constraints to inspect and limit the (excessive) power of the Executive?

A crucial area in this context is the capacity of the AR to inspect/control the government in the contracting of debts. As the Constitution states, whenever the Government/Executive intends to contract loans beyond the limits fixed annually in the State Budget, it is obliged to request authorisation from the AR.<sup>83</sup> With regard to the contracting of the HD, the TS, TA, CC and the PGR are the bodies that have been called upon to hold those implicated responsible, each one of these bodies within its own competencies. The question is whether the control has been effective over time.

Before looking at the legislative and judicial branches separately, we shall note the alarming trend in the classification of

<sup>75</sup> Article 133 of the CRM of 2004 and the same Article in the CRM of 2018.

<sup>76</sup> Article 169, paragraph 1, in the CRM of 2004 and Article 168, paragraph 1, in the CRM of 2018.

<sup>77</sup> Article 182 of the CRM of 2004 and Article 181 of the CRM of 2018.

<sup>78</sup> Article 225, paragraph 1, of the CRM of 2004, and Article 224, paragraph 1, of the CRM of 2018. Both articles establish that “The Supreme Court is the highest body in the hierarchy of law courts.

<sup>79</sup> Article 228, paragraph 1 of the CRM of 2004 and Article 227, paragraph 11, of the CRM of 2018, which state that “The Administrative Court is the highest body in the hierarchy of administrative, fiscal and customs courts”.

<sup>80</sup> Article 234, paragraph 1, of the CRM, and article 233, paragraph 1, of the CRM which states that “The Public Prosecutor’s Office is a hierarchically organised magistrature, subordinate to the Attorney-General.”

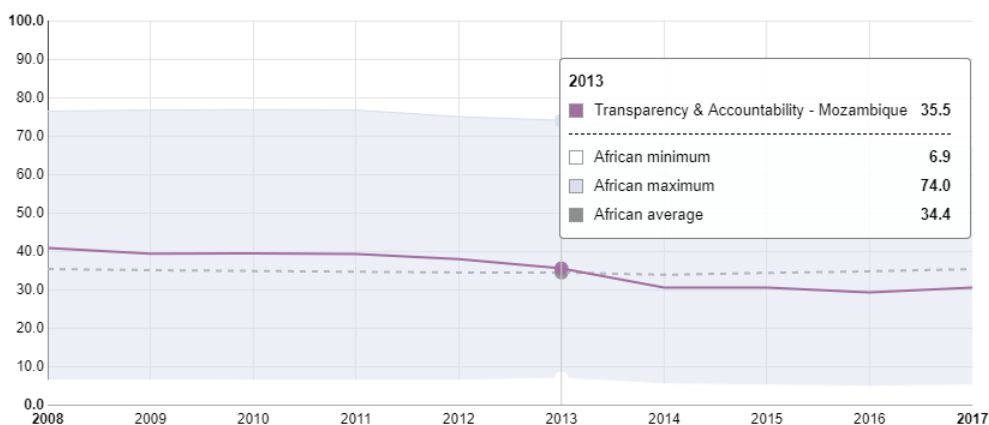
<sup>81</sup> Article 237, paragraph 1, and article 236 paragraph 1, respectively of the CRM of 2004 and 2018.

<sup>82</sup> Article 241, paragraph 1, and Article 240 paragraph 1 of the CRM of 2004 and 2018 respectively, which state that “The Constitutional Council is the sovereign body, which has special competence to administer justice in matters of a juridical and constitutional nature”.

<sup>83</sup> Article 179, paragraph 2, line m) of the CRM of 2004 and Article 178, paragraph 2, line m) of the CRM of 2018.

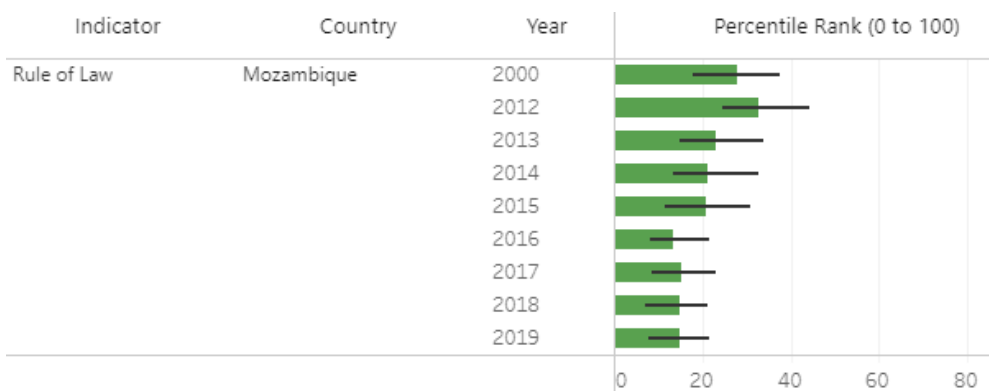
Mozambique in the indicators that measure control of the executive and other aspects of the Rule of Law. Mo Ibrahim identifies a sharp decline in the index of transparency and accountability, an indicator in which Mozambique’s score has fallen below the African average, and precisely after 2013.

**Graph 4.9: Index of transparency and accountability (Mo Ibrahim)**



Also related with the quality of these institutions are the indicators that, as a whole, measure the Rule of Law. The WGI captures the perceptions of social and economic actors about the rules of society and, in particular, about the quality of contractual guarantees, property rights, the police, the courts, and the relative expectation of crime and violence. There has been a notable decline in the quality of the Rule of Law as of 2013, worsening as of 2016 – the years of the HD.

**Graph 4.10: Rule of Law in Mozambique (WGI)**



Source: <https://info.worldbank.org/governance/wgi/Home/Reports>

Hence, in the general, the Mo Ibrahim and WGI indices, which measure accountability and the Rule of Law, show a clear trend of Mozambique worsening in the period beginning in 2013, coinciding with the HD.

What do Mozambicans think about these institutions? The representative sample in the Afrobarometer<sup>84</sup> is clear. The proportion of Mozambicans who expressed “great confidence” in the Assembly of the Republic fell from 62% in 2009 to 35% in 2018. The proportion of those who have “great confidence” in the judicial institutions fell from 60% in 2009 to 40% in 2018. At the same time, confirming the trend, there was a significant increase in distrust in both. Interestingly, the institutions managed to recover some trust between the two surveys in August 2015 and August 2018. It is worth noting that exactly the same trends can be noted about “the ruling party” and “the president”. For both, trust had fallen by approximately 25 percentage points by 2015 but had recovered somewhat by 2018. One hypothesis is that the recovery is due to the “Nyusi effect”.

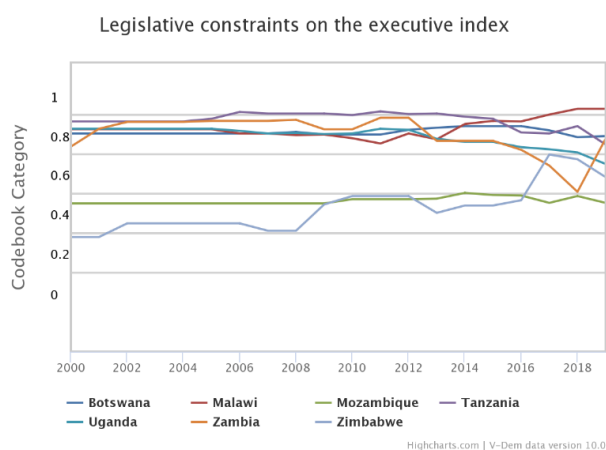
<sup>84</sup> The results may be consulted in the option ‘Institutions and leaders’ in <http://afrobarometer.org/online-data-analysis/analyse-online>

## 4.5.1 Legislative power (AR) – role, constraints and the HD

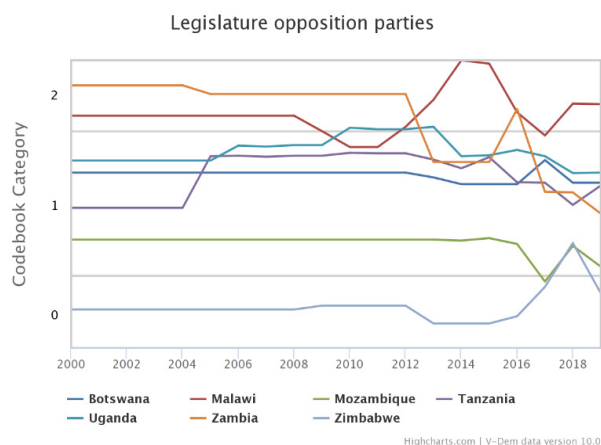
The V-Dem has also created more specific indices that help determine the development of the “horizontal counter-powers” – those found at the same hierarchical level as the Executive – over time. We also include the capacity of the opposition parties to make themselves felt in parliament. As shown by the graphs below, there have been no great changes during the specific period after the HD.

Furthermore, it is worth noting that the Mozambican case is somewhat particular in the region concerning this level of *lack* of control over the Executive. Compared with the neighbouring countries,<sup>85</sup> the following assessment, made by V-dem, may be understood as an expression of the dominance of the majority party in the political system. The index that measures the capacity of the legislative branch and of other State agencies (Attorney-General’s Office, Ombudsman, Auditor-General, etc.) to constrain the power of the Executive also places Mozambique (in green in the graphs) at the bottom, alongside Zimbabwe and Zambia.<sup>86</sup> The graph shows how Mozambique – along with Zimbabwe – is among the countries in the region where opposition parties are least capable of “exercising monitoring/auditing functions and investigations against the will of the ruling party (or coalition)”<sup>87</sup>

**Graph 4.11: Legislative branch vs. Executive**



**Graph 4.12: Parliamentary opposition vs. Executive**



As can be seen in the above graph, Mozambique is among the countries in the region where the legislative power seems least able to constrain the executive power. This is due, in part, to the legislation - the President of the Republic has the power to dissolve the AR<sup>88</sup> – but mainly to the constellation of party forces in the AR. In practical terms, the AR has no powers under any prior process of annulling any possibility of the government contracting loans illegally. One of the aspects mentioned is that, even if the Government had submitted the request to obtain authorisation to contract loans with a value higher than that approved by the AR, because voting and approval of the State Budget is on the basis of a simple rather than a two thirds majority, the Frelimo parliamentary group, which has a majority, could have, if it wanted, voted for approval, without needing the support of the other parliamentary groups.

What one notes is that the AR, with the configuration of the parliamentary groups as it has been over several legislatures, has no ability to prevent cases such as those related with the loans contracted by the government, even if they are above the amount authorised, from being approved. Just with the votes of the majority party in the AR, as the deputies with whom we spoke stated, the loans can be approved. One deputy added that, if the contracting of the debts had been followed by the AR, there could at least have been a public debate, but that would not have meant that the AR would have made the loans non-viable, given the majority that the Frelimo parliamentary group always enjoyed in the Assembly.

The role of the AR with regard to the HD was marked by the approval of Article 1 of AR Resolution no. 11/2016, of 22 August, which approved the General State Financial Accounts (CGE) referring to 2014, which included the EMATUM

<sup>85</sup> <https://www.v-dem.net/en/analysis/VariableGraph/>

<sup>86</sup> Question: Legislative constraints on the executive index (D) (v2xlg\_legcon): To what extent are the legislature and government agencies, comptroller general, general prosecutor, or ombudsman capable of questioning, investigating, and exercising oversight over the executive?

<sup>87</sup> The scale of the replies is No, not at all (0), occasionally (1) and yes, normally (2).

<sup>88</sup> CRM, articles 59 line e) & 188.

debt. What occurred, essentially, was an attempt to legalise the debt contracted by members of the former government under conditions that sought to avoid scrutiny by the Assembly.

After rubber-stamping its own impotence in this way, the Assembly managed to recover a certain initiative when, the following year, it sought to enhance its role. To this end, it issued Decree no. 77/2017, of 28 December, which, among other matters, advocated that “The Government shall, every quarter, inform the Assembly of the Republic about the contracted and guaranteed debt and the specific conditions of the loans signed (...), through the Budget Execution Report”.<sup>89</sup> This is the only reference to the AR in this legal diploma. That is, the AR is informed *a posteriori* about aspects of the debt contracted and guaranteed by the Government.

This is about a process of controlling the current management of the public sector debt and of the loans signed by the government. This means that the decree mentioned above, and specifically the legal provision cited, should always take into account the ceiling authorised by the AR. That is, the Decree in question strengthens its powers in this area. It thus continues to be the AR that should authorize the Government to contract loans and to define their amount in each financial year, as well as inspecting/controlling the behaviour of the Government.

To strengthen the AR’s control over the debt contracted and guaranteed by the State, the Government also has an obligation to include information on the debt as an appendix to the General State Financial Accounts (CGE)<sup>90</sup>. The CGE is then submitted to the Administrative Court that produces a report and an opinion that are, in turn submitted to the AR for approval.

This means that the AR not only has the constitutional prerogative to authorise the Government, after its request, to contract loans up to a particular amount, but also has the power to approve them in the General State Financial Accounts (CGE).

Because of the hidden debts, the opposition parties, namely Renamo and the MDM, forced the establishment of a Parliamentary Commission of Inquiry (CPI) to investigate the profiles of the illegally contracted debts, and Frelimo, even though it had a parliamentary majority, went along with the inquiry. The largest opposition party, Renamo, withdrew from the CPI. However, the CPI questioned the former President of the Republic, Armando Guebuza, on 28 November 2016,<sup>91</sup> in addition to other prominent figures in the case. Essentially, the CPI (Comissão Parlamentar de Inquérito 2016) did not bring new information that would radically alter the direction of the hidden debts scandal. Despite verifying that the government had acted unconstitutionally, the criticism of the government did not go beyond a mild reprimand, insisting that the three companies be held responsible for the debts.

From the developments in the case of the hidden debts, one may easily conclude that the will of the public servants involved in the scandal was that parliament should have no knowledge of the fraudulent operation that was being engineered. So they did not follow the legal procedures to obtain authorization from the AR. The AR was, in our words, a victim of the strategy of concealment.

The measures taken under Decree no. 77/2017, although they may make the occurrence of cases similar to the contracting of the illegal debts more difficult, if they are followed, do not mean that public servants with decision-making powers cannot defraud the AR again – that is, that it could again fall victim to the strategy of concealment.

The hidden debts were an enormous inconvenience for the Frelimo parliamentary group that controls the majority of the votes in the AR, since they exposed a contradiction between the Frelimo group and the Executive that originated in this party. Even so, the case of the HD shows how the AR has been permanently incapable of controlling the Executive, both *a priori* and *ex-post facto*. As we shall see in the next section, the Parliamentary Commission of Inquiry was no more than an inconvenience for the Executive, since the AR voted to include part of the HD in the General State Financial Accounts, in direct contradiction with a ruling of the Constitutional Council. Although the CPI was not the continuation of a previous practice, the case of the HD has crystallised the relative subordination of the AR to the Executive – it did not manage to prevent what happened, it was unable to impose its will afterwards, and it did not take any measures to re-establish the trust of civil society or of the partners abroad.

<sup>89</sup> Cf. Article 2, paragraph 1.

<sup>90</sup> Article 2, paragraph 2, of decree no. 77/2017, of 28 December.

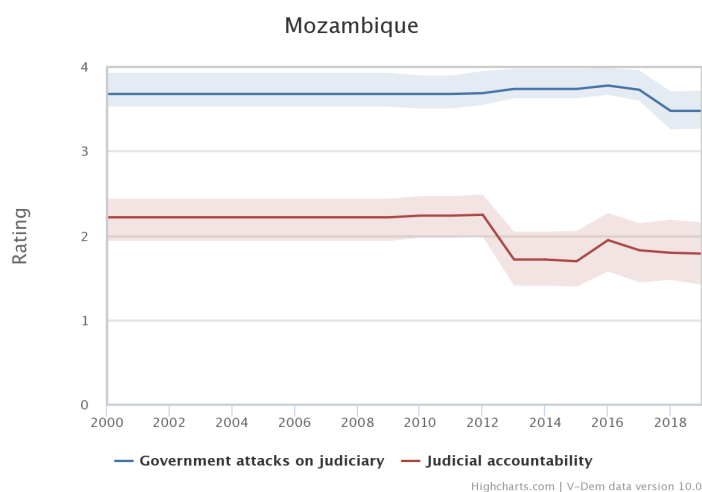
<sup>91</sup> <https://noticias.sapo.mz/actualidade/artigos/ex-pr-mocambicano-armando-guebuza-ouvido-hoje-no-parlamento-sobre-dividas-escondidas>

The Assembly of the Republic also did not remain immune to the lack of credibility that affected the executive and the judiciary. It was the Assembly which inserted the EMATUM debt into the General State Financial Accounts of 2015, even after the Parliamentary Commission of Inquiry into the hidden debts had detected enormous violations of the Constitution. Even so, in a gesture of self-protection, the deputies in the Frelimo parliamentary group used their majority in the Assembly to approve its inclusion in the General State Financial Accounts.

#### 4.5.2 Judicial Branch – Role, constraints and the HD

As for the capacity of the judicial branch to put constraints on the behaviour of the Executive, the average classification of Mozambique for the region is slightly better than the poor capacity of the legislature.<sup>92</sup> As the graph shows, V-Dem does not identify a strong trend for the government to attack the judiciary – which was to be expected, since the judiciary is regarded as close to the party that dominates the Executive. Even so, the decline during the period of the HD, particularly after 2017, is significant. There is also a noteworthy trend for a decline in the capacity of the (internal) accountability of the judiciary, which is another expression of declining quality in the judiciary.<sup>93</sup>

**Graph 4.13: The Judiciary**



#### **The constraints on the Judicial Branch with respect to Independent Activity**

There are institutional mechanisms embedded in constitutional legislation that put constraints on the judicial branch, limiting the probability of independent action with respect to the Executive branch. These constraints are, above all, linked to the fact that the office holders do not have the necessary constitutional/legal guarantees to exercise the functions to which they have been appointed with the necessary independence. Although they have their competencies defined by law, the fact that there is the possibility of interference, particularly of a political nature, create barriers that surreptitiously exert pressure on them.

By way of illustration, the appointment of the top officials in the sovereign judicial bodies (Supreme Court, Administrative Court, and Constitutional Council) by the President of the Republic,<sup>94</sup> should, in other contexts, not be a problem. One factor which contributes towards the accommodation, or even submission, of the judicial bodies towards the holders of political power who appoint them, is the fact that only they can renew their terms of office, for five years, under the terms of the Constitution.<sup>95</sup> This legal opportunity means that they try to stay in their posts for as long as possible, due to the prestige and benefits that come with them.

<sup>92</sup> The classification of Mozambique versus Southern Africa, or other neighbouring counties can be consulted in the variable judicial constraints on the executive index, in <https://www.v-dem.net/en/analysis/VariableGraph/>.

<sup>93</sup> The question about accountability in the judiciary is: ‘When are judges regarded as responsible for serious illegitimate conduct? How often are they removed from their posts or disciplined?’. The range of the answers is: rarely (1), half the time (2), normally (3) and always (4).

<sup>94</sup> Article 225 paragraph 2, of the CRM of 2004, and Article 226, paragraph 2 of the CRM of 2018, on the appointment of the President and Vice President of the Supreme Court, respectively; Article 229, paragraph 2, of the CRM of 2004 and Article 228, paragraph 2, of the CRM of 2018, on the appointment of the President of the Administrative Court; Article 239, paragraph 1, of the CRM of 2004 and Article 238, paragraph 1, of the CRM of 2018, on the appointment of the Attorney-General and the Deputy Attorney-General; and Article 242, paragraph 1, item a) of the CRM of 2004 and Article 241, paragraph 1, item a) of the CRM of 2018, on the appointment of the President of the Constitutional Council.

<sup>95</sup> For the Supreme Court, see Article 53 of Law no. 24/2007, of 20 August. For the Administrative Court, see Article 21ff of Law no. 25/2009, of 28 September. For the Constitutional Council, see Articles 7 and 8 of Law no. 6/2006, of 2 August.

Of all the office holders in the judicial bodies we should mention that the Attorney-General is the figure who seems most fragile and subject to manipulation, since the President may sack the PGR<sup>96</sup> before the end of his or her term of office – that is, at any moment, and without requiring any precondition or justification.

In terms of the Constitution, the Attorney-General answers to the President of the Republic (PR).<sup>97</sup> This means that, although the MP is an autonomous body<sup>98</sup> with regard to other State bodies and institutions, this autonomy becomes diluted or blurred when this connection exists, or when there is a possibility of the PR influencing its behaviour, since the MP is a hierarchically organised magistrature, subordinate to the Attorney-General. In short, if the President of the Republic were to have a political or personal interest in a particular case presented to the Attorney-General, the latter would find it difficult to contradict the interests of the PR without risking his/her job and position.

The situations described above end up constraining the activity of the bodies of judicial branch and lead it to be submissive to the executive. That is, appointments made on an individual basis by the PR to occupy these posts, although they must be confirmed/ratified by the AR, depend more on political trust than on the technical competence or moral and professional suitability of the appointee.

Thus, the legal framework and the practice in Mozambique ends up transforming the MP into almost an extension of the executive branch. There are thus well-grounded suspicions that when particular individuals are involved, who have a high social, political, or economic status with links to the ruling party, this body acts in observance of the principle of opportunity<sup>99</sup>, but when the agents suspected of practicing particular crimes are unknown, then the principle of legality is strictly observed.<sup>100</sup>

Nevertheless, in Mozambique the principle of legality is in force, but is counter-posed to that of opportunity.

#### **Four branches of the judiciary and the Hidden Debts**

The hidden debts opened a schism between the Executive and the Constitutional Council, largely due to pressure from civil society. A consortium of Civil Society organisations addressed a petition to the CC asking it to declare illegal Article 1 of Resolution no. 11/2016 of 22 August, passed by the Assembly of the Republic, which approved the General State Financial Accounts for 2014, including the debt contracted by the Mozambique Tuna Company (Ematum). The CC thereupon issued a ruling, dated 3 June 2019, in which it considered the acts intrinsic to the loan and its respective sovereign guarantee granted by the Government in 2013 were null and void, with all the legal consequences emanating from that. Later, the same consortium of civil society organisations submitted another petition to the CC asking that this body also analyse and declare unconstitutional the debts contracted illegally by the companies Mozambique Asset Management (MAM) and ProIndicus<sup>101</sup>. In its ruling No. 7/CC/2020 of 8 May, the CC also declared ‘null and void the acts concerning the loans contracted by the companies ProIndicus, SA, and Mozambique Asset Management (MAM, SA), and the sovereign guarantees granted by the Government in 2013 and 2014, respectively, with all the legal consequences’ (Conselho Constitucional 2020:III).

After investigating the case of the debts, the PGR, in January 2018, issued a press release (PGR 2018), which states that it had submitted matters concerning the possibility of financial offences to be handled by the Administrative Court (*Tribunal Administrativo*, TA), in order to hold responsible the public servants involved. In total, the PGR asked the TA to hold 16 public sector managers/civil servants responsible. However, up until now, no official position is known from this body charged with managing administrative justice about any developments in the case that would hold anybody responsible for the financial offences.

The PGR has also drawn up a definitive charge sheet concerning crimes related to the hidden debts. Later, a court issued an indictment, and the accused have appealed against it. The court’s decision on the appeal was to keep all the accused, except one, in detention. With the confirmation of much of the indictment, the following phase should be that of the court fixing a date for the trial. It should be mentioned that the PGR’s behaviour has been far from unbiased when we consider

96 See Article 239, paragraph 1, lines b) and c) of the CRM of 2004 and Article 239, paragraph 1, lines b) and c) of the CRM of 2018.

97 See Article 239, paragraph 2 of the CRM of 2004 and Article 238, paragraph 2 of the CRM of 2018.

98 See Article 234, paragraph 3 of the CRM of 2004 and article 233, paragraph 3, of the CRM of 2018

99 The principle of opportunity means that the investigations into those suspected of committing certain types of crime depend on a selection that has the interests of the State in mind.

100 Under the principle of Legality, all those suspected of committing certain types of crime must be investigated, whether known about ex officio by the Public Prosecutor’s Office, or whether this knowledge comes from denunciation, participation of complaint.

101 <https://dev.fdc.org.mz/cidada%C3%A7a-submetem-petic%C3%A7%C3%A3o-ao-constitucional-para-anulac%C3%A7%C3%A3o-das-dividas-da-mam-e-proindicus/>

that it was only after the detention in South Africa (at the request of the US authorities) of one of the main figures involved in contracting the illegal debts, former Finance Minister Manuel Chang, on 29 December 2018 that the PGR released the charge sheet against the individuals implicated in the HD. This list does not even include Chang, since he is to be the subject of an autonomous case.

The depth of the circumstantial material contained in the indictment, its volume and detail, suggest that the indictment had been drawn up a long time ago, and that the PGR was only waiting for some kind of instruction from the politicians in power (given the promiscuous relationship between the PGR and the Executive) to make it public, and for the case to follow legal procedures.

For its part, the TS, in a way that can only be regarded as undignified for the highest body in the hierarchy of the courts of law representing the judicial branch, requested via the AR the preventive arrest of Manuel Chang, who was already being detained in South Africa, alleging that he should be subject to Mozambican justice. However, the action of the TS arose as a way of satisfying political interests, in that the intention was to prevent Chang's extradition to the United States. This conclusion arises from the fact that, later, the Government intervened directly in the case being processed in South Africa<sup>102</sup>, showing its interest in Chang being extradited to Mozambique. However, the request of the TS via the AR, was made in violation of the Constitution<sup>103</sup>, bearing in mind that, in order to detain a member of the AR (and Chang was still a deputy) it is first necessary to lift his parliamentary immunity. This did not happen until Manuel Chang himself decided to resign from parliament.<sup>104</sup>

In these interventions by bodies of the judiciary, the only one which proved truly independent was the CC, noting that it abstracted itself in a high-class manner from political issues and, resorting to the law, took two decisions to consider illegal the debts contracted by the three public companies – even when considering the delay in taking these decisions. However, the MP had already requested the dissolution of the three companies involved in contracting the illegal debts. The action taken by the CC turned out to be an exception, with respect to declaring the debts of EMATUM, MAM and ProIndicus, and the respective guarantees, null and void. This fact showed that, even with the excessive control by the executive over the bodies of the judiciary, in taking an unbiased and impartial action in obedience to the law, it is possible to produce results in line with what is envisaged in the judicial/legal framework. The CC's decision led to a conflict between this body and the government, particularly because the Executive continued to insist on renegotiating the Ematum debt, even after this debt had been declared null and void, so that any act leading to paying off the loan, and the very act of payment, if it happened, would violate the Constitution.<sup>105</sup> Nonetheless, immediately after this decision had been made public, the executive, through Finance Minister Adriano Maleiane, went public to say that it would continue the dialogue with the Ematum creditors, so as to renegotiate payments of this company's debts (because this was the only way the country could regain credibility in the international financial markets).

Despite the media apparatus that surrounded the PGR with the detentions it ordered in March 2019, and the publication of the charge sheet against the accused, this case greatly affected the credibility of the judiciary. Most of those interviewed for this report believe that the judiciary confirmed the popular belief that it is being towed behind the interests of the executive and of the political elites. This perception remained even after the Constitutional Council had declared the Ematum debt null and void.

At the end of the day, the most important aspect of the “test” that the case of the hidden debts has been for the judicial branch is this fact: so far, nobody has been taken to court to face trial in the case of the HD in Mozambique – despite the immense gravity of the case and its importance for the country, although five years have passed since the PGR opened the first case related with the HD (1/PGR/2015). Five years have also passed since the gravity of the case increased with the discovery of MAM and ProIndicus, and three years have passed since the publication of the Kroll audit report that verified the criminal nature of the case, and two years have passed since the PGR ordered the detention of 20 suspects in the case (since reduced to 19) although the preventive detention deadline expired months ago.

<sup>102</sup> At this moment (2021), the extradition of Manuel Chang is at the stage of an appeal to the Constitutional Court of South Africa, awaiting the verdict of this body.

<sup>103</sup> Article 174, paragraph 1 of the CRM of 2004 and Article 173 of the CRM of 2018 state that “No deputy may be detained or jailed, unless caught in the act of committing a crime, or may be put on trial without the consent of the Assembly of the Republic”

<sup>104</sup> As per Article 6, paragraph 1 of the Statute of Deputies, approved by Law no. 31/2014, of 30 December, in line with the provision of Article 11, paragraph 7 of the same Statute.

<sup>105</sup> Cf. Article 247, paragraph 1, of the CRM “The rulings of the Constitutional Council shall be binding for all citizens, institutions and other legal persons, are not subject to appeal, and shall prevail over other decisions”.

### 4.5.3 Conclusion – counterweights: alive, but wounded

What then, overall, is the effect of the hidden debts on the countervailing powers? The answer that this analysis offers is divided into three: first, the countervailing powers were already subordinate to the Executive. Second, they failed the test of the hidden debts. Third, the institutions imbued with counterweights to the Executive emerged wounded from this case. Having failed the test, it will be very difficult for these institutions to recover their influence over the Executive.

Formally, the Mozambican Constitution envisages the separation of powers, and designates several counter-weights to the Executive, but the practical reality shows that the legislative and judicial branches are being towed behind the will of the Executive, and even in the rare exception where, for example, the judicial branch took independent measures apparently without any kind of influence from the Executive, afterwards these decisions were not complied with.

The responses of the judicial system and of the Assembly of the Republic were late and reactive. Instead of signalling a dedication to transparency and responsibility to correct the failings of the system, they appeared with measures to adjust and accommodate the system to the interests of the party faction that is now establishing itself in power. Through this process, the reactive nature of the institutions that ought to serve as counterweights, already weak due to the concentration of powers at the top of the Frelimo party-state, showed that they are still alive. But although alive, they failed the test just the same, because their action was not sufficiently efficient or effective to impose themselves on the Executive. None of the officials and public servants who were indicted a long time ago have been brought to court, and the Executive continues to ignore the rulings of the CC, as apparently does the AR.

The sluggishness of the judicial cases against the authors of crimes related to the HD puts the reputation of the judiciary at risk: unless new and decisive actions are taken in the case, the public may conclude that the judiciary is an accomplice in the concealment and impunity, which so many suspects or assumes in the case. As we shall see in the following chapters, the interpretation in the eyes of the public will also be influenced by noting the energy spent by the same PGR in harassing notable critics of the hidden debts.

As the international assessments of these counterweights in Mozambique show, the institutions have emerged somewhat injured from the period of the HD, just as has the rule of law in general. The Constitutional Council showed that it was independent but ineffective, and so far the other counterweights have failed to impose themselves on the Government. Where the Government failed the test of defending the country's interests, the designated counterweights failed the test of complying with their own role.

One hypothesis, with which we began this chapter, was that the initial decision to contract the HD led key actors to opt for paths that were damaging to good governance, whose echoes would spread throughout the system, in time and space. Two cases suggest how this happened: when the Government ignores the decisions of the CC (in reality, opening a constitutional crisis, but so far without any practical consequences), and when the government ignores its own legislation on the deadlines for preventive detention. It is thus, through identifying this kind of mechanism, that it may be concluded that the judiciary has suffered a decline in quality as a result of the HD. The relative passivity of the Assembly of the Republic in a case as crucial as that of the HD merely confirms the lack of checks and balances to the government, which holds an almost imperial position that the Constitution does not grant it.

## 4.6 Public finances: Less transparency, more concealment

This section describes performance in the area of public financial management (PFM), stressing the key aspects in relation to fiscal transparency, which is the basis that allows the executive to be held responsible by the Assembly of the Republic, by civil society and by citizens, and in the final analysis by the Judiciary for actions outside of the law. The dynamics that led to the deterioration in the quality of financial management – in short, to less transparency and more concealment – fall into two categories:

First, the individuals who contracted the hidden debts had an obvious motive for muddying the waters regarding public



finances: they had illicitly arranged loans involving large sums of money that, sooner or later, would weigh on the public finances. Concealing the event was more attractive than transparency.

Second, in this area too there soon arose indirect impacts of the hidden debts, which accelerated with the four immediate reactions on the part of the various economic actors and international institutions in April 2016 after the discovery of the hidden debts (see chapter 3). The reasoning rests on the assumption that the four immediate reactions, taken as a whole, not only sent a shock to the Mozambican economy, described in the previous chapter (chapter 3), but also influenced the dynamic in the political economy of the public finances, in international cooperation, in the pace of reforms in the area of public finance, and in the room for manoeuvring for institutions. These influenced, in the context of an economy of rapid growth, affected and drove the environment of rent seeking, weakened the controls and the proper working of checks and balances, making accountability less effective and *de facto* calling into question the separation of power of the executive, judicial and legislative branches.

A range of factors is presented that coincided with, and are considered intertwined with, the HD. These factors unleashed a break in the positive trajectory of implementing reforms in the public finances and prejudiced the perception of fiduciary risk and performance in the area of public finance, notably the very integrity and credibility of information, the effectiveness of the legal regulatory and institutional framework, and the mechanisms of internal and external control and scrutiny.

Three perspectives are stressed in the argument:

- i) In the period prior to April 2016 there were various recognised weaknesses in Public Financial Management (PFM) that, at the time, according to the assessments made, represented a risk judged as moderate, with the exception of certain specific areas. Reforms were under implementation with recognised ownership by the Mozambican government, and the country was on a positive trajectory in terms of improvement in the public finances, albeit with some concerns about indebtedness linked to investments in infrastructures, lack of transparency in the issuing of guarantees, and weak management of fiscal risks, among others.
- ii) The assessment of fiduciary risk, or the risk of corruption, depends, on the one hand, on the likelihood of non-compliance or of an infraction and, on the other hand, on the materiality (likelihood and impact) in the event of an infraction occurring. This approach to risk assessment means that risk increases if the likelihood of non-compliance increases, and/or if the materiality increases. In the case of Mozambique, the analysis made under this study shows that the two dimensions have changed: the materiality has increased with the recognition of the wealth of Mozambique in terms of mineral resources and with the political will to exploit and market them. This has opened the stage to new economic agents and the possible gains from participation in the extractive adventure have increased substantially, including gains in the form of predatory rent-seeking. In seeing the successes in predatory rent-seeking, in the case of the hidden debts, there was a jump in other attempts at rent-seeking, which we consider a certain contagion, or social acceptance of taking advantage of the philosophy of “it’s our turn now”.
- iii) After the revelation of the hidden debts, there was a break in the performance of Public Financial Management (PFM), related with the abrupt drop in budgetary and financial support. In response, there was a certain paralysis of the administrative apparatus of the Executive, turning it towards immediate ad-hoc actions imposed by the crisis, rather than the continuation of management itself. These dynamics slowed down the pace of the reforms that were under way and weakened the existing systems of public financial management, including the mechanisms of checks and balances. This abrupt break is notable after April 2016, and these reactions were strongly interconnected with the fraudulent acts associated with the hidden debts.

#### 4.6.1 Methodological approach

The methodological framework of this analysis of the PFM is based on qualitative research, which in turn relies on documentary research using various reports and assessments, including notes/news items published on the internet, particularly the assessments that describe the performance, or assess the risks, associated with systems of Public Financial Management in Mozambique. The following reports were analysed, which follow a methodology that allows diachronic comparison between them:

**Table 4.2: Documentation for the analysis of the PFM**

Assessment reports	Years produced												
	'06	'08	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20
PEFA – Public Finance Management <sup>106</sup>	Ö	Ö		Ö				Ö				Ö	
DFID – Fiduciary risk, national systems <sup>107</sup>				Ö					Ö				
IMF – Fiscal Transparency <sup>108</sup>						Ö	Ö	Ö					Ö
OBI – Transparency, public participation and budgetary supervision <sup>109</sup>			Ö		Ö			Ö		Ö		Ö	

#### 4.6.2 Weaknesses in PFM recognised before April 2016

Various assessments and analyses of Public Financial Management in Mozambique during the 2010-2015 period, up to April 2016, revealed the existence of weaknesses in the PFM system. Based on an analysis of the diagnoses undertaken in these assessments, during the 2011-2015 period the most relevant weak points identified are presented, and were discussed, in the PEFA 2012 and 2015 assessments, in the Open Budget Surveys (OBI) 2012, 2015<sup>110</sup> and in the fiscal transparency evaluation (FTE) undertaken by the International Monetary Fund (IMF). The assessment of fiscal transparency analysed compliance with the Fiscal Transparency Code (CTF).

The high-risk weak points noted in these assessments, referring to the period *before* the revelation of the hidden debts, include:

- Lack of management of commitments, with the risk of contracting and accumulating debt to suppliers. No system to manage and monitor delays in payments. Risk of accumulating debt to suppliers.
- Lack of information about existing public entities. Coverage of the fiscal reports is limited.
- Limited transparency of extra-budgetary expenditure of bodies with financial autonomy (public institutes).
- Weak financial supervision of public enterprises, and lack of information about the public enterprises and state shareholdings in private sector companies.
- Meagre information submitted to the Assembly of the Republic to justify the assessment of fiscal risks and debt sustainability in the approval of fiscal and monetary policy and the State Budget.
- Weak monitoring of the activities of public enterprises and of the participation by the State in the Public-Private Partnerships (PPP). Contingent liabilities are not reported systematically in the General State Financial Accounts.
- Lack of prior analysis (including cost-benefit analysis) in the selection of major investment projects.

Although this list is not complete, it shows that there was already recognition of several weak points in the management of public finances in Mozambique, and that these weaknesses had made room for taking advantage of the “holes” in the system of Public Financial Management.

Table 4.3 summarises the weak points and uses colours to facilitate reading. Green would represent reasonable performance, yellow means an area of performance worse than desired and which needs improvement, and red represents an area of highest importance for improvement.<sup>111</sup>

<sup>106</sup> The assessments of Public Financial Management based on the PEFA methodology at the national level, referring to 2006, 2008, 2011 and 2015, and the comparison of these four assessments with the preliminary result of a fifth PEFA assessment referring to 2019, currently subject to peer review.

<sup>107</sup> Some of these PEFA assessments formed the basis for assessing fiduciary risk of the national systems held in 2011 and in 2016 by independent teams hired by DFID. Under this study, a comparison was made between the fiduciary risk assessed in 2011 and that assessed in 2016.

<sup>108</sup> An IMF team undertook an assessment of fiscal transparency in 2013 and 2014, published in 2015. In February 2020 an IMF team also undertook an assessment of fiscal transparency. Some preliminary results are included in the analysis.

<sup>109</sup> The Open Budget Survey (OBI) also analysed transparency, public participation and budget supervision in 2010, 2012, 2015, 2017 and 2019. The results of the OBIs 2012 and 2015 are compared with the results referring to 2017 and 2019.

<sup>110</sup> Neither the PEFA assessments nor the OBI assess risks, but the performance weak points in public financial management.

<sup>111</sup> The pillars are presented in line with the PEFA methodology, version 2016: [www.pefa.org](http://www.pefa.org).

**Table 4.3: Visualisation of the performance of 7 pillars in the system of Public Financial Management (PFM) during the 2011-2015 period**

Ö	Credibility of the budget
Ö	Transparency of the public finances
Ö	Management of assets and liabilities
Ö	Policy-based fiscal strategy and budgeting
Ö	Predictability and control in budget execution
Ö	Accounts and reports
Ö	Inspection and external auditing

Sources: \*PEFA Assessments for 2006, 2008, 2011, 2015 according to the 2011 methodology, and PEFA 2015 test versions based on the 2016 methodology, and the Open Budget Survey 2012 and 2015, \*\* Assessment of fiscal risk in 2015 according to the methodology of the Fiscal Transparency Evaluation (FTE) of the International Monetary Fund (IMF), \*\*\*Assessment of the Fiduciary Risk in 2011 according to the methodology of the Department For International Development (DFID), Fiscal Transparency Evaluation for 2015, OBI for 2012 and 2015.

The list of the weak points identified in the assessments, summarised in table 4.3, shows that there was a shared recognition of the existence of various weaknesses in the legal and regulatory framework, particularly in relation to the transparency of extra-budgetary activities, the issuing of guarantees, and the management of contingent liabilities linked to public enterprises, to public-private partnerships, and to public institutes, among others.

These weaknesses represented, and still represent, holes in the management system where activities were not, and will continue not to be, subject to scrutiny and counterweights. Furthermore, there was a recognition of a lack of compliance with the legal and regulatory framework, which means that there was a recognition of a discrepancy between *de jure* and *de facto*. Consequently, there was a recognition of the weaknesses in the control systems and in the mechanisms of accountability. It should be stressed that the IMF’s assessment of fiscal transparency, undertaken in 2014, emphasised that the debt sustainability analysis did not include, at the time, an analysis of the issuing of guarantees. Despite these weaknesses, the appreciation of the level of risk was, for the great majority of areas in the context of public financial management, moderate and even low. However, this perception was to change.

### 4.6.3 *The game changes: greater probability + greater materiality = greater risk*

We start from the assumption that the assessment of fiduciary risk or the risk of corruption depends, on the one hand, on the likelihood of non-compliance or of infraction, and, on the other hand, on the materiality, if an infraction occurs. This approach to risk assessment means that the risk increases i) if the likelihood of non-compliance increases, and/or ii) if the materiality increases.

In the case of Mozambique, the analysis undertaken in this study shows that *the two dimensions have changed*: the materiality has increased with the recognition of the wealth of Mozambique in terms of mineral resources and with the political will to exploit and market them. This has opened the stage to new economic agents, and the possible gains from participation in the extractive adventure have increased substantially, including gains in the form of predatory rent-seeking.

These two dimensions are key and are part of the dynamics referred to as the *presource curse*, already discussed. While the second dimension of risk assessment, *the increase in materiality*, may be considered as exogenous to the hidden debts, the first dimension, *the perception of the likelihood of non-compliance or of an infraction*, which also increased substantially post-HD, is intrinsically linked to the discovery of the hidden debts.

Our analysis rests on what we describe as the *impact of contagion*. In seeing the successes in rent-seeking, and the impunity associated with this, there was a surge in other attempts at rent-seeking. Rent-seeking increased, or at least became clearer, and the flagrant theft of the HD led to a certain social acceptance of taking advantage of the “now it’s our turn” philosophy.

#### 4.6.4 The assessment of fiduciary risks and corruption in the PFM post-April 2016

In 2016, immediately after the discovery of the hidden debts, an assessment of fiduciary risk and corruption was undertaken.<sup>112</sup> The assessment identified substantial and looming risks concerning procurement in the extractive sector and regarding the activities of the public enterprises. Table 4.4 presents the synthesis of the assessment in six pillars organised in accordance with the PEFA methodological framework.

The trend of the six pillars indicates an increase in the level of risk associated with the management of the public finances in Mozambique, assessed in the second half of 2016 and compared with 2011.

**Table 4.4: Synthesis of the assessment of fiduciary risk and of corruption in 2016**

PFM Indicator	Risk rating and change from 2011 FRA	Trajectory of risk
Budget Credibility	Deterioration from Moderate to Substantial	↘
Comprehensiveness and Transparency	Deterioration from Moderate to Substantial	↘
Policy-Based Budgeting	Deterioration from Moderate to Substantial	↘
Predictability and Control in Budget Expenditure	Deterioration from Moderate to Substantial	↘
Accounting recording and reporting	Remains Moderate	→
External scrutiny and audit	Deterioration from Moderate to Substantial	↘

In summary, the evaluators considered that the *fiduciary risk* was in general ‘high’, that the risk of corruption was ‘substantial’, that the commitment of the government to reform of the sector (PFM) was only ‘partly credible’, and that ‘the general level of fiduciary risk is SUBSTANTIAL’ (Adam Smith International 2017:9).

What is important is the trend observed since 2011. Just like the general indices mentioned above, the analysts of Adam Smith International detected a deterioration in the years following the contracting of the HD.

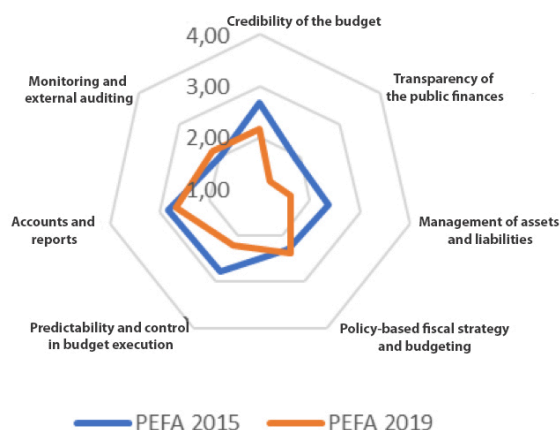
This assessment supports our analysis about the dynamics of the *presource curse* and that (1) there was an increase in the materiality and in the degree of non-compliance, which, in short, took the fiduciary risk from a moderate level in 2011 to a high level in the second half of 2016, and that (2) the risk of corruption became substantial after the HD. The deterioration of the degree of compliance is intrinsically linked to the revelation of the hidden debts.

#### 4.6.5 The break in the positive trajectory of the PFM

Graph 4.14 presents the synthesis of the preliminary result of a fifth PEFA assessment, referring to 2019 (currently subject to peer review). The synthesis shows a comparison between the performance assessed in 2019 and the performance in the PEFA 2015 assessment presented by the seven pillars of the PEFA methodology. It represents a simplified visualisation based on the average score per pillar in line with the PEFA methodological framework. There were some adjustments in the PEFA methodology between 2011 and 2016, but the main point, as shown in the simplified visualisation, is that there was a clear trend of deterioration in performance in the period shown by the orange colour (2019) compared with the blue (2015), which shows how the average score per pillar in 2019 compared with that of 2015 is found in the lower polygons. Polygon 4 corresponds to the best score “A” and polygon 1 to the lowest “D”:

<sup>112</sup> The study was commissioned by DFID in coordination with the other international partners who were involved in budget or programme support. There is a methodological guide developed by DFID that describes the approach and its link with the PEFA methodological framework.

**Graph 4.14: Evolution of the quality of public financial management between 2015 and 2019**

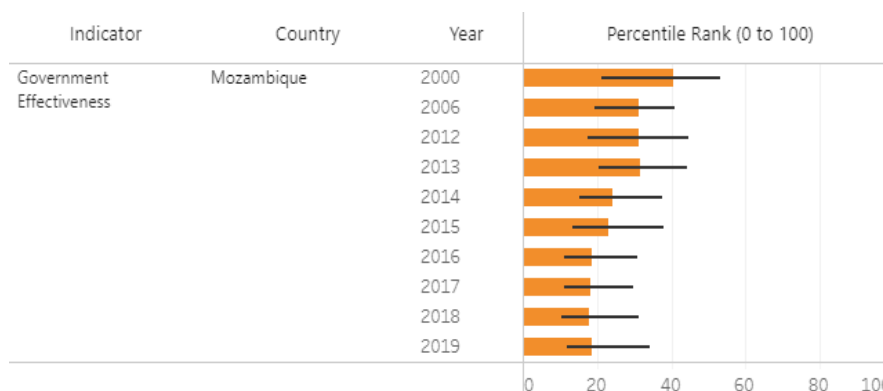


Other indicators that reflect a compilation of various specific indicators also point to a clearly negative trend, with the deterioration worsening after April 2016, which hence support the arguments made in this study.

Below, three dimensions of the World Governance Index are shown. They show a negative trend during the period of the HD in three areas essential for the good management of public finances: (i) the effectiveness of governance, (ii) the quality of the regulatory environment, and (iii) the mitigation or limitation of corruption.

The effectiveness of governance (graph 4.15) measures: (i) the perception of the quality of public services, (ii) the quality of the administrative apparatus of the Executive and its degree of independence from political pressures, (iii) the quality of policy formulation and implementation, and (iv) the credibility of the government regarding its political promises.<sup>113</sup> The dimensions of the WGI show the impact of the deterioration of public financial management as well as the weakening of the control environment and of the functioning of the checks and balances, tracing the impact of these deteriorations along the value chain until the interactions with the public in general, including the business sector. The trend is relatively stable up to 2013, when a decline is observed, but the lowest levels of effectiveness in governance occur in the years 2016-2019, after the discovery of the HD, which supports the argument of this analysis.

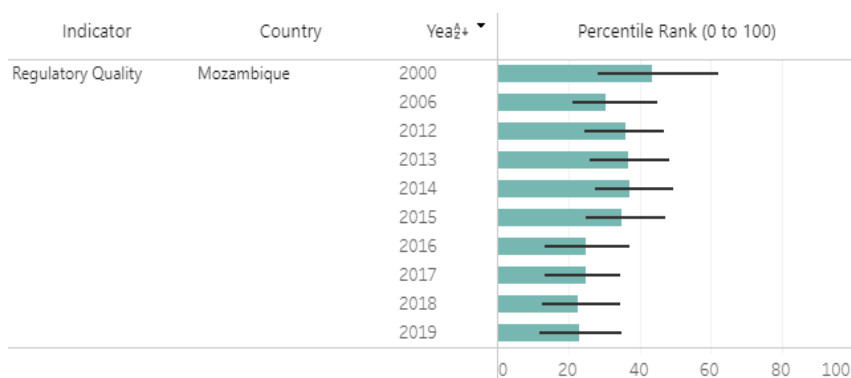
**Graph 4.15: Effectiveness of governance: evolution in the period 2000-2019**



The dimension of the quality of the regulatory environment (graph 4.16) measures the capacity of the government in formulating and implementing policies and a regulatory framework that permits and promotes the development of the public sector. A negative trend is observed during the period from 2000 to 2006, followed by relative stability until 2015. Noteworthy is the lowest level, found during the period from 2016 to 2019. This dimension represents a way of measuring the impact described in another dimension, and is also inter-connected with the study on the Ease of Doing Business.

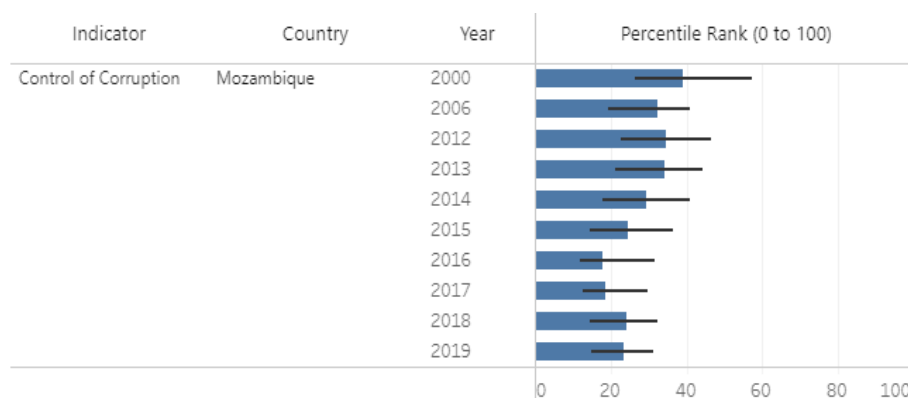
<sup>113</sup> The Open Budget Index is part of the indicators that are aggregated in this dimension.

**Graph 4.16: Quality of the regulatory environment – evolution 2000-2019**



The same trend is seen in the dimension of control over corruption, which measures how public power is used for private gain, and seeks to capture both petty and large-scale corruption and state capture by various elites (graph 4.17).

**Graph 4.17: Control of corruption – evolution 2000-2019**



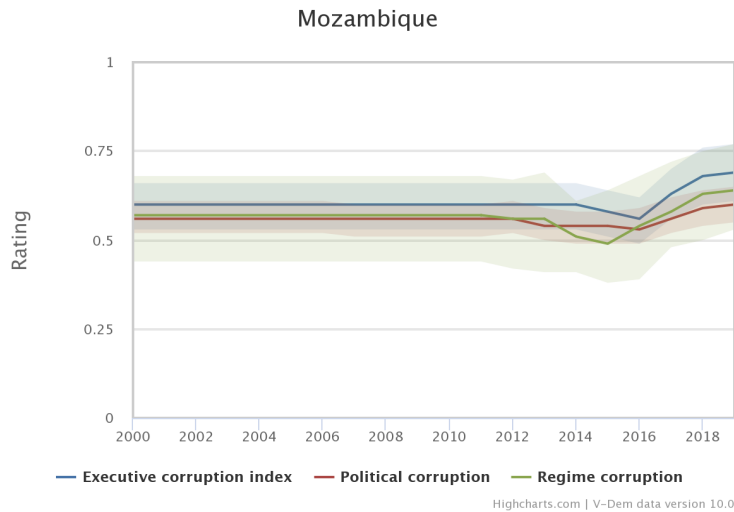
In its most recent classification in the Ease of Doing Business (graph 4.18), the World Bank ranks Mozambique in 138<sup>th</sup> position among 190 countries, according to its methodology. Mozambique achieved one of its best classifications in 2015, a year before the totality of the hidden debts was publicly known. Since then, the country has again fallen in the rankings.

**Gráfico 4.18: Ease of doing business, (World Bank)**



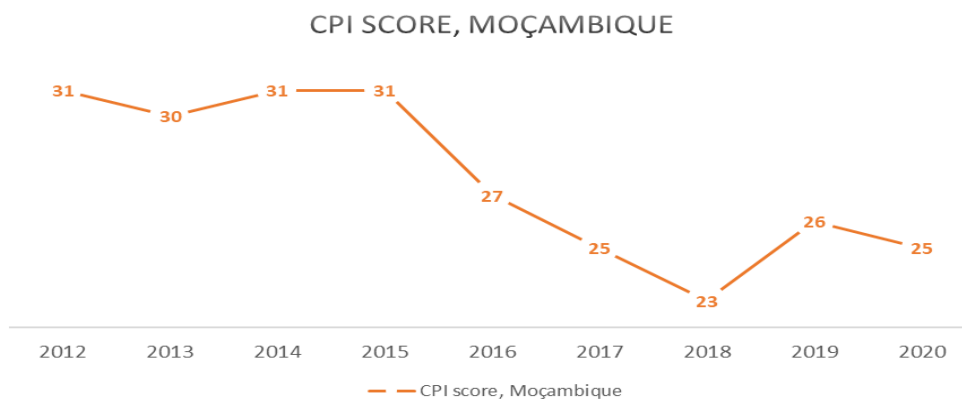
The trends of deterioration are also found by the classifiers of V-Dem, which recorded the deterioration in the indicators that seeks to express various aspects of corruption in the country. Note that in these indicators, the lines measure a *rise* (greater than the margin of error) in corruption from 2013 to 2019, with a particularly sharp rise after the revelation of the HD in 2016, which is, very probably, a direct reflection of knowledge by the classifiers of the HD.

**Graph 4.19: Indices of corruption, perception (V-Dem)**



It is worth mentioning that the most famous measure of corruption at the global level is the Corruption Perception Index (CPI) of Transparency International.<sup>114</sup> The result shows, perhaps to no great surprise, that the perception of the general level of corruption in Mozambique increased significantly after the HD.

**Graph 4.20: Corruption Perception Index (CPI), by Transparency International**



#### 4.6.6 Conclusions regarding PFM

All the indices on the quality of public financial management in Mozambique indicate that conditions worsened after 2014-15, reaching a nadir in the following years with the revelation of the hidden debts. Certainly there may be other causes of this trend, but our initial hypothesis suggests that the imperative of concealment – to hide the HD and other possible “schemes” attractive to the political elites – was more important than the reforms of transparency. There is no doubt that the pace of reforms in the area of public finances slowed down, partly because of the abrupt fall in budgetary and financial support, worsened by the simultaneous decision to freeze financial support by almost all the major financial partners. The credibility of the Government in implementing reforms in order to make the grey areas more transparent and to refine the weaknesses in public financial management suddenly disappeared.

The credibility of the Government in combatting corruption also suffered with the publication, in 2019, of the ‘Report on transparency, governance and corruption’ (GoM 2019). Evidently strongly promoted by the IMF, it was supposedly a ‘diagnostic’ of the problem. The report fails to analyse or scrutinise the HD entirely, and the HD is in fact only mentioned once, in a footnote on page 4, where on top of it all the case is erroneously rendered.

<sup>114</sup> <https://www.transparency.org/cpi2018>

Suspensions began arising of deliberate concealment to facilitate predatory rent-seeking. The international shock and the economic shock coincided and to some extent paralysed the administrative apparatus of the Executive, now concentrating on immediate, ad-hoc actions brought by the crisis, instead of proper management. The gravity of the situation imposed a centralization in decision making that not only reduced the room for manoeuvre of the institutions, but also damaged the quality of the administrative apparatus of the Executive in its role as regulator and service provider, clearly shown by the trend of the indicators in the dimensions of the WGI. Political conflicts and threats to national unity also strengthened centralisation and paralysis in taking decisions.

The analysis shows how the combination of some grey areas, or holes in the system of public financial management in the context of an economy in rapid growth, affected the environment of predatory rent seeking and a certain contagion or social acceptance of taking advantage of the “it’s our turn now” philosophy, precipitating a decline in public morality in favour of private interests.

The condition of a simultaneous institutional and economic crisis weakened the control environment and the functioning of checks and balances, making accountability less effective, and calling into question the de facto separation of the executive, judicial and legislative powers.

## 4.7 Democracy and the public space: freedoms and repression

In addition to formal institutions that, among themselves, guarantee horizontal or mutual control (the checks and balances), a democracy needs mechanisms of control between rulers and citizens. These are commonly referred to as instruments of vertical control. This sub-chapter deals with these mechanisms of vertical control, all of them embedded in the Constitution. It will discuss the possible negative effects that the hidden debts had upon the public civic space, and on the exercise of the freedoms of expression and of the press, in short, all the ways that citizens have to express their voice publicly, in order to scrutinize and control the behaviour of their rulers.

This starts from the assumption that the effort made by the government to minimise the damaging effects of the hidden debts contributed negatively to the exercise of the fundamental rights of citizens. This chapter asks if the phenomena which, in the introduction, were called **costs of concealment, impunity, political tension, and discredit** also led, in turn, to more repressive and authoritarian governance.

### 4.7.1 Measuring democracy: The growing democratic deficit

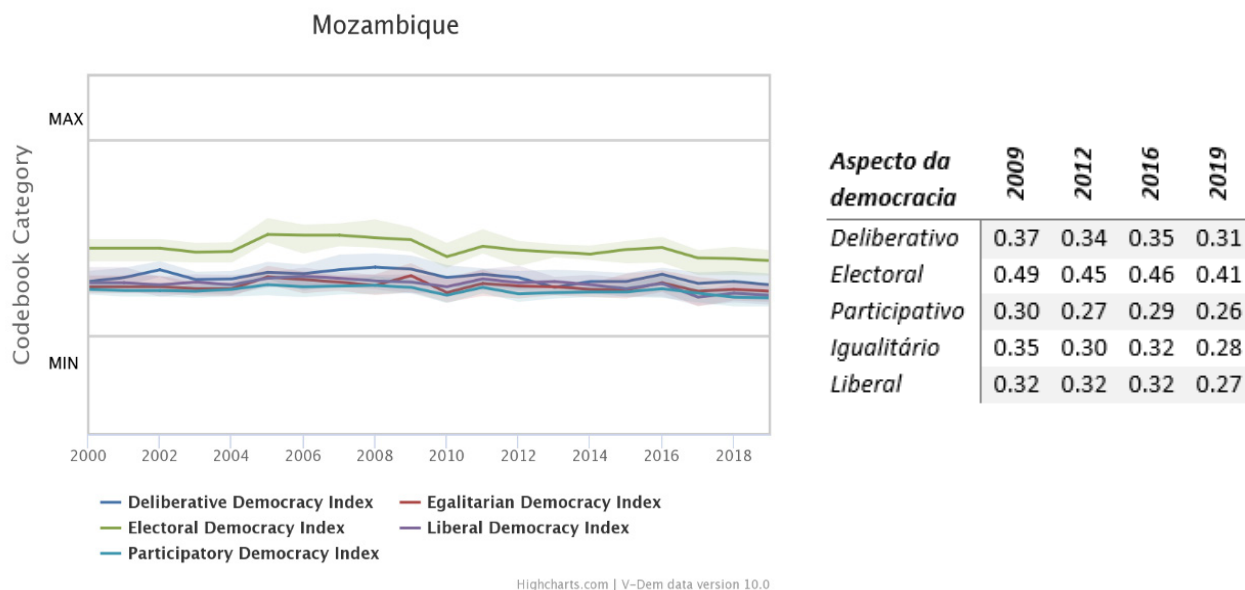
V-Dem makes it possible to follow, in the form of indices, the diachronic development of the institutions that seek to guarantee democracy in Mozambique. The annual results since 2000 for the indices that measure the most important aspects of democracy in various ways are presented in graph 4.21 below. The five indices are built by different indicators of democracy.<sup>115</sup> The scale of the indices varies between 0 (minimum) and 1 (maximum). In all indices, Mozambique is close to the minimum. Although the scale seeks to measure “the degree of democracy”, a score of 0 on this scale means “the absence of democracy”. The terminology is important, and it is necessary to put this decline of “democracy” into context. V-Dem does not consider Mozambique a democracy, but an “electoral autocracy”, a term that it has maintained between 2008 and 2018 (V-Dem Institute, 2019). In comparative terms, V-Dem categorises Mozambique as a “lower medium” country in democratic terms, and ranks Mozambique at 102<sup>nd</sup> out of 179 countries (with North Korea, at no. 179, as the least democratic country).

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<sup>115</sup> Readers who want to know the content of the indices and how they are built may consult the V-Dem Annual Democracy Report of 2019 (V-Dem Institute 2019).



**Graph 4.21: Different aspects of democracy in Mozambique (V-Dem)**



Source: V-dem <https://www.v-dem.net/en/analysis/CountryGraph/>

In the five indices, the situation remains relatively constant during the first two decades of this century, but there is slight, albeit clear, trend of indicators worsening, which is more evident when consulting the scores in the table. In particular, as of 2016 one notes a marked decline in all indices, although there had been a slight improvement (not significant) between 2012 and 2016. The table shows the numbers of the decline (reproduced in the lines of the graph).<sup>116</sup>

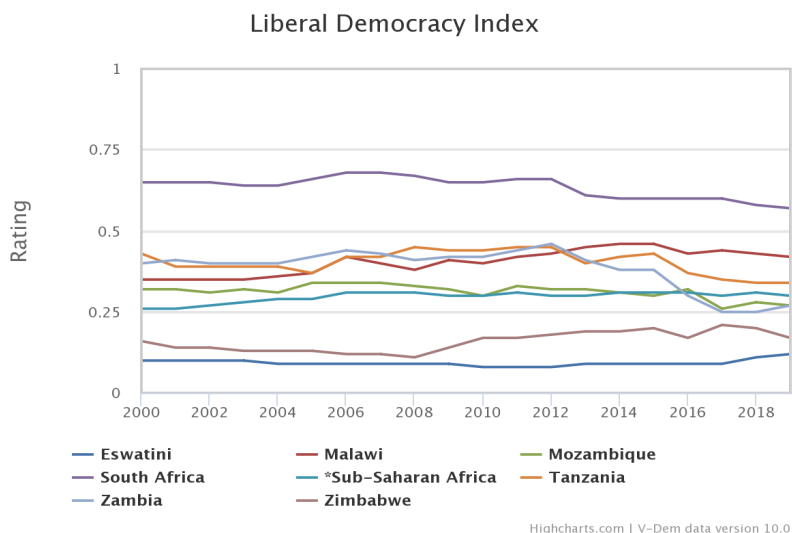
With these numbers, we may conclude the following: the fall in the democracy indices over the last ten years (2009-2019) is moderate, but the declining trend is significant. The fall since the revelation of the HD in 2016 up to 2019 is also significant. The decline observed from 2012 to 2019 is not significant, but the interpretation that there is a real decline (and not the result of errors in measurement) is strengthened because the trend in the four indices points in the same direction. The story that the numbers tell us is, in short, this: regardless of the measurement methodology, there was a decline or fall in democracy over the last decade, and this fall was sharper after 2016, which coincides with the revelation of the HD. Mozambicans confirm the trend with their own assessments, although the year 2015 was the one that registered most discontent with democracy.

Comparing the classification of Mozambique in the most general index on democracy (Index of Liberal Democracy) with that of neighbouring countries,<sup>117</sup> one notes that it is among the countries with the lowest scores throughout the entire period. Of the countries bordering Mozambique, only the closed autocracies of Zimbabwe and Eswatini have a worse classification. As of 2016, Mozambique fell below the average for sub-Saharan Africa. While there has been a decline in almost all the neighbouring countries during the past decade, the average for sub-Saharan Africa has remained stable.

<sup>116</sup> The margins of error for each year, and each indicator, may be consulted at the source.

<sup>117</sup> The comparisons between countries may be confirmed at <https://www.v-dem.net/en/analysis/VariableGraph/>

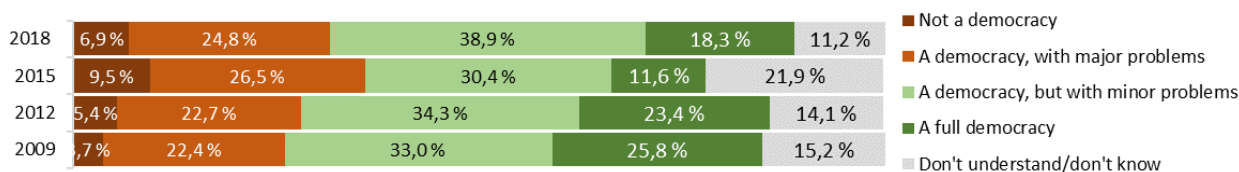
**Graph 4.22: Liberal democracy in Mozambique versus neighbouring countries and sub-Saharan Africa (V-Dem)**



Source: V-Dem

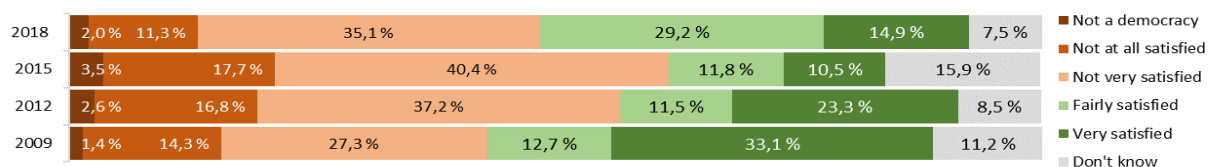
What do Mozambican men and women say about the health of democracy in the country? Afrobarometer asked them. As the graphs below show, the highest point of discontent was apparently in 2015. It is important to note that the last round of opinion polls was taken before the problematic elections of 2018 and 2019.

**Graph 4.23: What do you think about democracy in the country?**



Source: Afrobarometer

**Graph 4.24: Overall, how satisfied are you with the way democracy works today?**

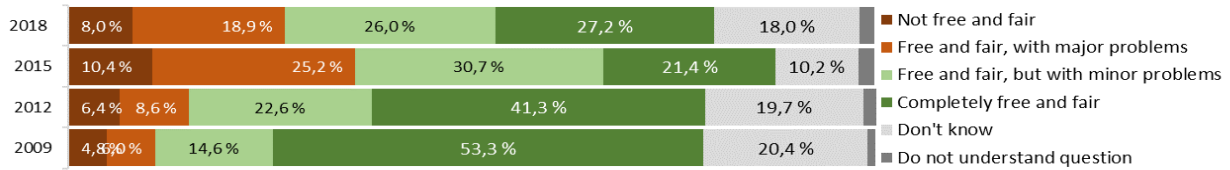


Source: Afrobarometer

The following graph gives us an idea about the reasons for the bad assessment of democracy in Mozambique, since in both the polls of 2015 and 2018 the people interviewed referred to the most recent national elections, those of 2014. Up until then, that had been the electoral cycle that caused most dissatisfaction among the people interviewed.<sup>118</sup>

<sup>118</sup> The average among the interviewees of 2018 was more positive in assessing the elections of 2014 than the average among the interviewees of 2015. It is normal that the passage of four years has an impact on the results: the memory of the respondents is not perfect, and their assessment of the past is influenced by present events.

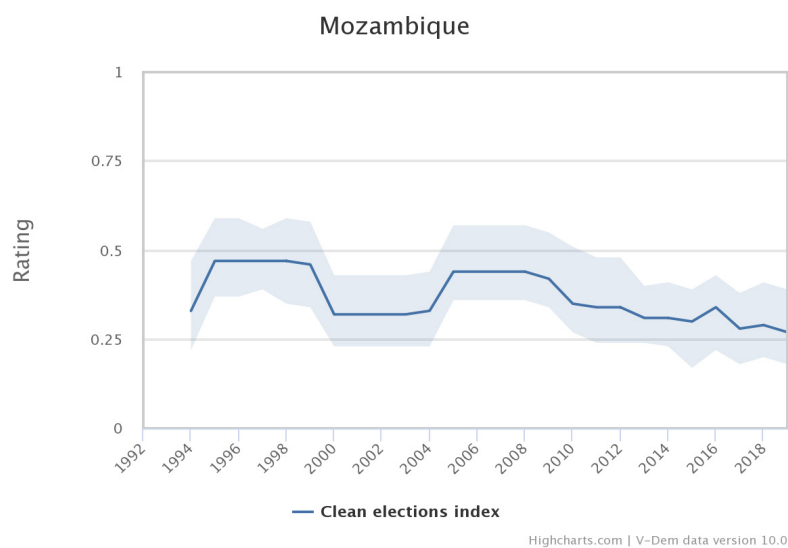
**Graph 4.25: How do you assess the last national elections: were they free and fair?**



Source: Afrobarometer

The Mozambicans who spoke to Afrobarometer and the experts of V-dem converge in noting that the quality of the elections has tended to deteriorate over time. V-dem finds the lowest point in 2019, after the elections of that year.

**Graph 4.26: Index of “clean elections” (V-Dem)**



Source: V-Dem

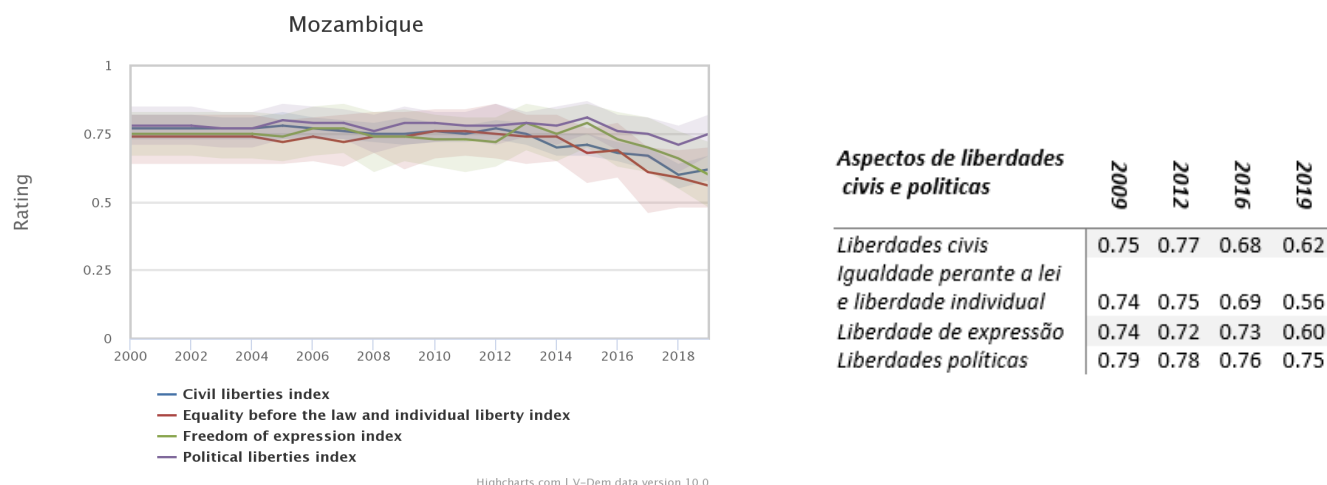
Indeed, the trends in all the ways of measuring democracy point to the same result: that society and the political system are increasingly drifting away from democratic ideals. There is nothing that indicates specifically a causal line between the HD and this deterioration, although there are various indices showing that it was more abrupt after the revelation of the HD. But these lines are more visible in the narrative of the electoral events presented at the end of this sub-chapter.

### 4.7.2 Civil liberty and civil society

The hypothesis that the Government reacted with authoritarianism after the revelation of the hidden debts between 2014 and 2016 is strengthened by studies on the relationship between the Executive and the rest of society in the aspects that measure the degrees of freedom and authoritarianism in the public.

V-Dem observes a slight but persistent fall in the indices of civil liberties, equality before the law, as well as individual freedom, freedom of expression and political freedoms.

**Graph 4.27: Civil and political liberty (V-Dem)**

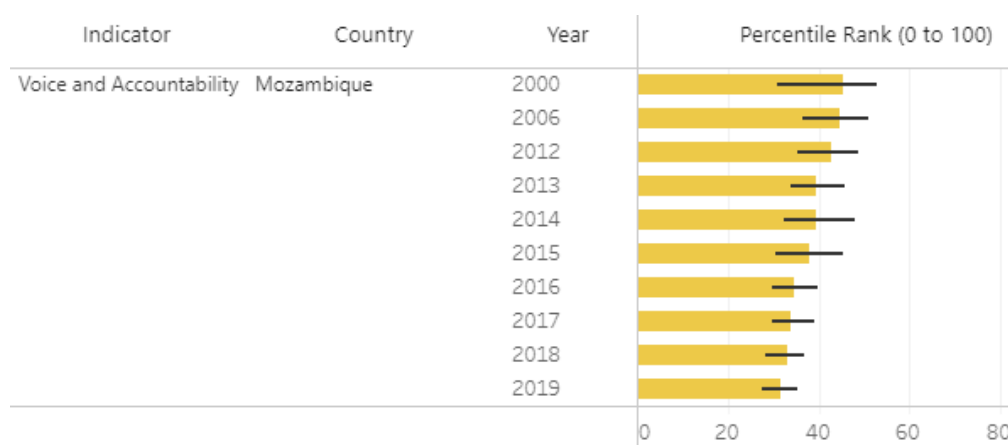


Source: V-Dem

For all the above indices, the deterioration from 2012 to 2019 is significant, as is the decline from 2016 to 2019, except for the index on political freedoms (whose slight improvement in 2019 means that the decline is still within the margin of error). A clear decline can be noted in the four indices during the period of the HD, which is particularly acute from 2015 to 2016.

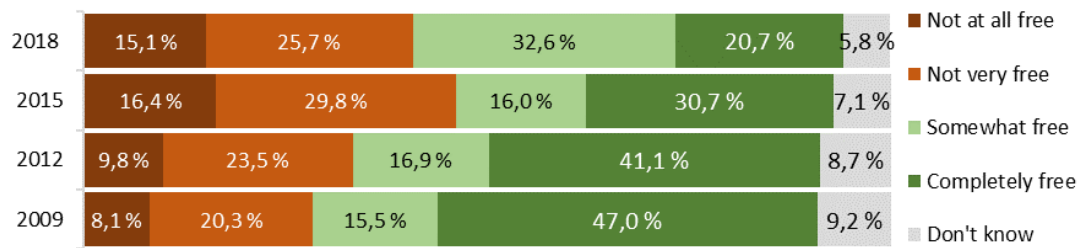
The World Bank has built a rather aggregate index, entitled “Voice and Accountability”. This measures to what extent the citizens of a country can participate in choosing their government and use the freedom of expression, freedom of association and free media. According to the graph below, the situation remained more or less stable during the first decade of the century and up to 2012, when the indices began to worsen with a clear trend. As the graph shows (black lines) the difference between 2012 and 2018 is also statistically significant. The decline coincides with the period of the HD.

**Graph 4.28: Voice and accountability (WGI)**



This trend of deterioration in the feeling of freedom of expression is clearly confirmed by the Mozambicans who responded in the random sample of the Afrobarometer surveys over the years. As can be seen in the graph, Afrobarometer shows us that only one in five Mozambicans feel completely free to express what they think. This percentage has shrunk continuously since 2009, with a particularly sharp reduction after 2015 and the revelation of the HD – although the number of people who do not feel at all free and not very free has also fallen in the same period.

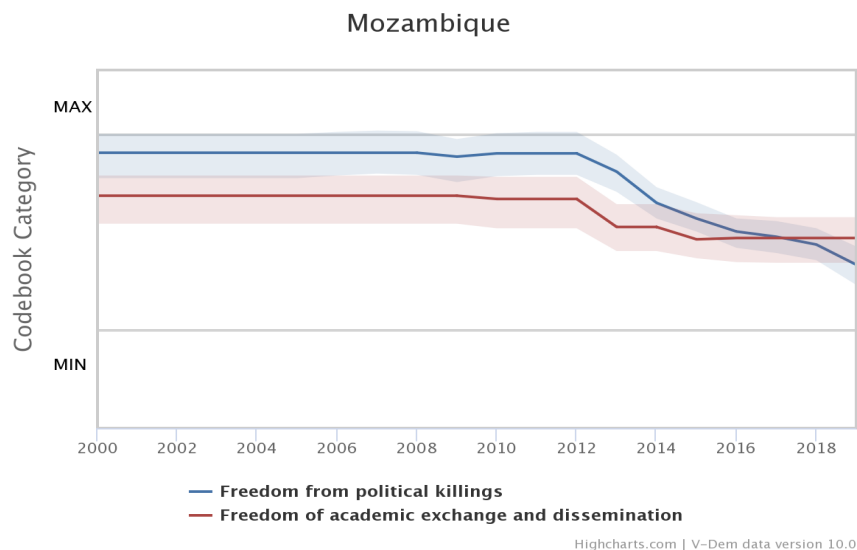
**Graph 4.29: Freedom to express what you think (Afrobarometer)**



Source: Afrobarometer

Of much greater concern are the following two indicators. From a situation in 2012 when the protection against political assassination was “normally respected by the Government”, the experts of V-Dem identify a fall to a situation in 2019 where “Government leaders do not work actively to prevent them” (political assassinations). Likewise, the V-Dem experts identified a situation in 2012 where academics are “free in principle”, and rarely prevented from expressing themselves, to a situation in 2019 in which academics are “moderately restricted”, with occasional episodes of censorship, self-censorship or other restrictions. The deterioration coincides exactly with the chronology of the HD.

**Graph 4.30: Political assassinations and academic freedom (V-Dem)**

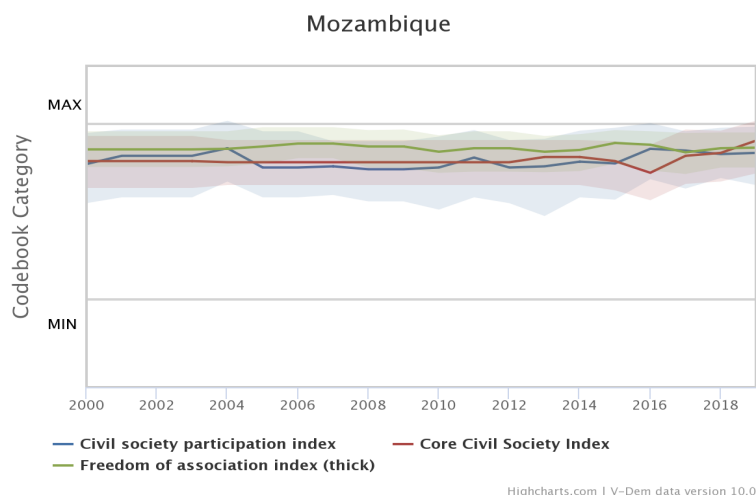


Source: V-Dem

The scenario of the country is not only sombre. One positive point is that the freedoms of association and of participation have not undergone major changes since the end of the civil war and the introduction of the multi-party regime. They have remained at a level since 2000, and without significant changes, as the graph below shows.<sup>119</sup>

<sup>119</sup> The survey of Mozambicans in Afrobarometer tends to confirm the same result, but its interpretation requires more care. When asked to compare the situation in 2018 with “some years ago” in variables such as “freedom for the opposition to function”, “freedom to join a political organisation”, and “freedom for the media to investigate and report”, the sample tends to divide into three more or less equal camps: those who think there have been improvements, those who think the situation is worse, and those who think there were no changes. The difficulty of interpretation is that the method does not allow us to decide if it is the “positive” or the “negative” group who is right. The Afrobarometer data can be consulted in the categories of ‘Democracy and politics’ in <http://afrobarometer.org/online-data-analysis/analyse-online>.

**Graph 4.31: Indices on civil society and freedom of association (V-Dem)**



Source: *V-Dem*

This means that, despite eventual attempts to limit the room for manoeuvre, these indices show no evidence that the HD resulted in negative effects for Mozambican civil society, and its capacity to organise independently of the State. At the same time, they show signs that the situation worsened for freedom of expression and for the protection of individual rights.

Studying all these indices allows us to conclude that there has been a reduction of freedom in the public space, a process that seems to have begun before the HD. Even so, some of the indices suggest, by their coincidence in time, that the HD may have contributed to the deterioration, and that they contributed to speeding up the decline after 2016.

### 4.7.3 Harassment of critics of the HD

It is not difficult to associate the deterioration identified in the above indices with the hidden debts, particularly as regards freedom of expression and criticism of the government. The voices critical of the Government increased in number, as the effects of the hidden debts were reflected in society, notably with the rise in the cost of living. Using the press and social networks, civil society organisations and individuals expressed their opposition to the HD and to their damaging effects on society. The critiques of the HD were not well received by the Government. There was a counter-attack with the closure of public space for debate by resorting to intimidation via threats in social media, as well as criminal proceedings against the voices most critical of governance and against the papers who published critical articles.

Regarding the harassment of critical voices, Prof. Carlos Nuno Castel-Branco, one of the figures who was tried for criticising the governance of President Armando Guebuza in an article published on his Facebook page and reprinted by the local media, wrote on Facebook on 31 August 2019 that ‘denouncing the illicit debt is regarded as a crime against the security of the State, while illicitly defrauding the State to a value equivalent to 15% of the GDP is treated as “corruption”. So citizenship is a crime’.<sup>120</sup>

Many citizens believe that figures critical of the government and of the hidden debts, who were kidnapped and tortured after appearing on television criticising governance, became victims because of the HD.

Two citizens, one a university lecturer and the other a journalist and lawyer, who were both resident commentators of a television programme highly critical of the government, were kidnapped and tortured at different times, after appearing on television criticising governance. After recovering from the torture to which they were submitted, both withdrew from public intervention. They ceased to participate as permanent commentators on the television programme and temporarily

<sup>120</sup> <https://www.facebook.com/carlos.castelbranco/posts/10220066418150541> [accessed on 2 September 2019]

closed their Facebook pages. When they resumed their work, they avoided repeated public appearances in the media and on social networks.

In 2017, after a public debate on the HD and governance, organised by civil society organisations in Maputo, the speakers received death threats and threats of physical assault, obliging some of them to leave the country temporarily in search of safe refuge. The main targets were researchers of the Institute of Social and Economic Studies (IESE), the Budget Monitoring Forum (FMO), the Countryside Observatory (OMR), and the Centre for Public Integrity (CIP), which are all civil society bodies who have played an outstanding role in the repudiation of the HD.

In 2018, the Centre for Public Integrity began a campaign against paying the hidden debts. It printed and distributed T-shirts bearing the slogan “I’m not paying hidden debts”. As a result, CIP was the target of a police operation in which the premises of the organisation were surrounded, forcing citizens wearing the T-shirts to take them off and seizing the T-shirts, even though they were not offensive, and forbidding CIP from continuing to distribute the T-shirts.<sup>121</sup>

At the same time as the T-shirts were being seized and their distribution forbidden, a campaign of character assassination against collaborators and leaders of CIP flooded social media and pro-government papers, labelling the CIP collaborators as “anti-patriotic” and of being in the service of foreign governments opposed to the development of Mozambique. Some of the activists attacked were forced to leave the country temporarily or to change their residence, as the threats to their physical integrity became serious.

But it was not all one-way, since acts of repression tend to produce resistance in civil society and in state institutions, notably those that may have warned the organisers of the harassment about the political limits of intimidation. The academic put on trial for allegedly having insulted the former President was acquitted.<sup>122</sup> There were also always little signs of solidarity (in Mozambican society and internationally) in support of the activists against the HD. One example is that some of the policemen who came to prevent the distribution of the T-shirts against paying the HD that were being offered at the CIP offices, after “hiding from their chiefs” asked CIP researchers for T-shirts “to wear at home”, saying that they too are part of the people.

Even so, there was an effort to shield the HD from public scrutiny, and even to antagonise those who continued to be critical on the subject. Our hypothesis is that the harassment of the best-known critics of the hidden debts – very uncomfortable for some politicians and powerful elite figures – was useful to dissuade not only these individuals, but also society in general. In this way, the HD contributed to reduce civil liberties and criticism of the regime.

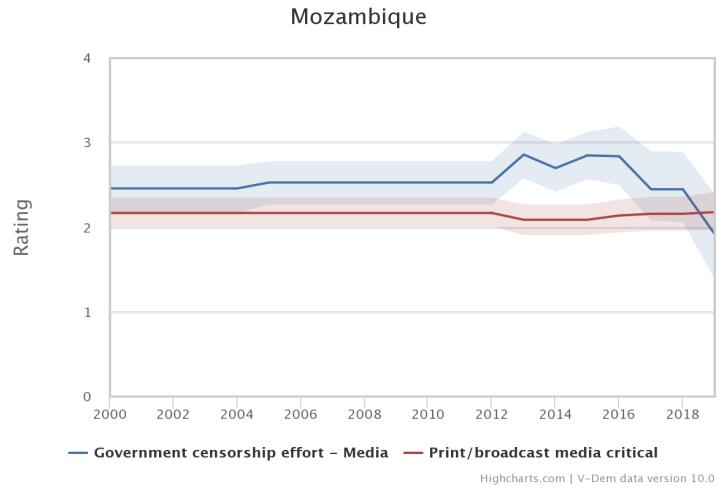
#### 4.7.4 Freedom of the press and the media

V-Dem describes – the red line in graph 4.32 – a more or less constant situation which should be recognisable to Mozambicans: a situation in which some media regularly criticise the government, while others never do. The graph below shows that the government is making some attempts to censor the content of social media. The average score of 2.5 means that government censorship exists, directly or indirectly, in certain cases that the government regards as sensitive. There was an improvement registered in the “Government efforts to censor critics” from 2012 to 2013, but as of 2016 there was a *significant* trend of deterioration.

121 <https://canal.co.mz/2019/01/ultima-hora-policia-cercar-cip-para-arrancar-camisetas-eu-nao-pago-as-dividas-ocultas/> [accessed on 2 September 2019]

122 <https://www.voaportugues.com/a/absolvicao-de-nuno-castel-branco/2966148.html>

**Graph 4.32: Censorship and criticism of the Government in the Mozambican media**

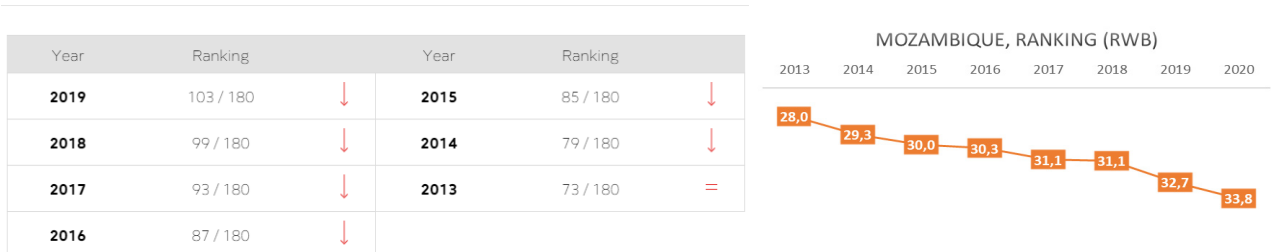


Source: *V-Dem*

Reporters Without Borders (RWB), an international NGO formed by professionals of the sector, believes the situation is more serious. RWB considers that press freedom has declined every year since 2013, the first year it was rated, which by chance happens to be the year when the scandal of the HD began. In 2020 Mozambique was ranked in 104th place, but seven years ago it was in 73<sup>rd</sup> position. This is happening in a global context where press freedom is under great pressure and in decline around the globe. The ranking compares Mozambique with other countries, while the score compares the performance of Mozambique with itself. This shows that the deterioration in the situation of journalists has fallen more rapidly after 2018.

**Graph 4.33: The ranking and score of Mozambique (Reporters Without Borders)**

Ranking since 2013



Source: *Reporters Without Borders*

These indicators support the hypothesis that there has been a general deterioration in the environment for media professionals in the period that corresponds to the discovery of the HD. An analysis of the sector will make these connections more specifically.

The Mozambican media is materially divided into public and private, with each group acting differently from the other, mainly in relation to the Government.

While the Mozambican constitution guarantees freedom and independence of the press, including for the public sector media,<sup>123</sup> in practice the Government controls the public sector media through appointing the editorial heads, allocating funds via contract-programmes that have as their counterpart publicising government programmes, and also the infiltration into newsrooms of figures foreign to the media whose role is to comment or to write opinion articles favourable to the Government. The public sector media are Mozambique Television (TVM), Radio Mozambique and the Mozambique

123 Cf. Art. 48, para. 5 of the CRM



News Agency (AIM). The papers “Domingo”, “Notícias” and “Diário de Moçambique”, although they are officially private, are de facto in the public sector since their majority shareholders are state bodies so that they are controlled by the government.

Government control over the private press is exercised above all through advertising by public institutions, by companies mostly owned by the State, and by companies that, although private, are managed by figures from the political elite linked to the power structure. Since Mozambique does not have a law that regulates the distribution of State advertising among the media, each government body makes its own decision as to which media it wishes to advertise in.<sup>124</sup>

Public sector bodies may, and indeed do, place advertisements in other papers without the need to justify the choice of where they advertise. But the insertion or not of State advertising in the media is used as a mechanism for editorial control over the media. An editorial line favourable to the government means the possibility of greater access to State advertising, while an editorial line critical of the government means the paper will not have access to State advertising. This control mechanism is effective particularly given the absence of regulations on the distribution of State advertising, and a situation where the State is the largest client of the economy and still exercises a certain control over private companies.<sup>125</sup>

Thus, the press that took a critical approach to the HD was sanctioned by withholding advertising. This happened not only with the HD, but also for example with the demonstrations against price rises, in which one media group lost more than 70% of its advertising that came from the government, and from companies in which the government owns shares, because it approached the demonstrations in a way critical to the government. History repeated itself in the case of the HD.

Following the HD revelation, with the country going through a financial crisis, the State significantly reduced the amount of advertising it placed in the media, even in the media that it controls. This can be seen through the financial crisis that the company “Sociedade de Noticias SARL”, which controls the papers “Noticias” and “Domingo”, is facing. Probably only the fact that it is a company held by the State has prevented it from declaring bankruptcy. The same is true of the public television station, TVM.

### **The G40 and attacks on the media**

On 26 July 2013, six months after the setting-up of ProIndicus and a week before EMATUM was set up, the newspaper *Savana*, the largest and oldest private weekly in Mozambique, published a front-page article entitled ‘Frelimo increases pressure on the Media’.<sup>126</sup>

The article exposed ‘harassment and purchase of private media companies by companies of the ruling party, Frelimo’, in order to control the editorial line of papers critical of the Government or even to close them down. It denounced the existence of a group of commentators formed with the aim of invading various newsrooms in order to influence their respective editorial lines, to issue and spread opinions favourable to the government, and to take a hostile attitude towards critics of the Government.

This group of commentators instructed to defend the government came to be known as the G40, referring to the number of names on the list of pro-government commentators. There were initially 40 names on the list originally published by *Savana*. The name G40 did not mean merely the group of 40. It had a deeper meaning. It was used for the first time in an article published by the journalist Matias Guente, editor of *Canal de Moçambique*. At the time, there was a group of criminals, supposedly consisting of 20 members, who, in the dead of night, cruised through outlying neighbourhoods of Greater Maputo (Maputo and Matola cities, and Marracuene and Boane), assaulting homes, raping women, and passing a hot iron over their victims. The group became known as G20. The name G40, given to the commentators created by the Government and inserted in the public and private media, was analogous to the G20. The name gained social acceptance and came to be known and used by all, even by those who did not know its origin.

124 Several laws establish that obligatory public announcements must be inserted in the newspaper of greatest national circulation, but there is no reliable way of defining the paper of greatest circulation. The pro-government daily paper “Noticias” has been regarded as the paper of greatest circulation, but without any scientific basis to support this position.

125 In addition to the company “Sociedade de Noticias”, which controls the daily newspaper of the same name and the Sunday paper “Domingo”, there are other companies in Mozambique that are officially considered private but are de facto public. Clear examples are the public enterprises that present themselves as limited liability companies, such as Petromoc, Tmcel, etc.

126 <https://macua.blogs.com/files/savana-1020.pdf>

Later, the number of commentators instructed to defend the government increased. They acted under the direction of the spokesperson of the then President of the Republic, monopolizing public debate in newspapers and on television and radio stations. The group spread out, gaining power in the public and private press. After only a short time, members of the G40 were directing some media and monopolising debates in others. The daily paper *Notícias*, considered by the Government as the paper of greatest circulation in the country, *Miramar* television, the audience leader in Mozambique, and the weekly *Público*, famous for the excessive practice of “yellow” (sensationalist) journalism, all came to be directed by members of the G40. In regard to the sacking of an experienced and well-reputed journalist from the management of *Notícias*, and the appointment of an inexperienced member of the G40 to replace him, *Savana* wrote an article headlined ‘Satunjira decapitates Notícias’.<sup>127</sup>

*Savana* connected the replacement of the experienced director of *Notícias* with an interview with Afonso Dhlakama – at the time living in the Renamo base at Satunjira, in Gorongosa district, during the escalation of the armed conflict between the Government and Renamo.

Public opinion connected the creation and propaganda of the G40 with the moment of armed conflict in Mozambique. But at that time, the existence of the hidden debts was not known, and so one cannot connect the G40 to the debts. Later, after the discovery of the debts and the end of the conflict between the Government and Renamo, the G40 came to devote much of its work to an attempt to protect the debt deal and their authors from public criticism, combatting the critics of the hidden debts.

The murder of Professor Giles Cistac in March 2015 was directly related with the character assassination of which he was a victim, carried out by members of the G40 (Ganho 2016).<sup>128</sup>

The HD were not the only factor responsible for the appearance of the G40 and the effort to control the press. But the HD were in part responsible for, and gained protection from, the propaganda of the G40 that led to the repression and “decapitation”<sup>129</sup> of press freedom. The case of the substitution of an experienced director of the daily newspaper *Notícias* by a member of the G40 without any experience of journalism was the most symbolic “decapitation”, as reported by *Savana*.

At least one private television station, TIM, and three private weeklies – *Magazine Independente*, *Público*, and *Expresso Moz* – were purchased by bodies linked to the ruling party. All changed their editorial management and their editorial line, and some ended up closing. Offers were made to buy holdings in companies that owned other front-line newspapers and television channels, but these were rejected. But even so, they did not escape the influence of the Government’s editorial line. Directors of information critical of the government were replaced by others with less experience and easy for the Government to influence.

Thus, the Government’s strategy towards the media resisting its influence was to restrict advertising and take a hostile attitude towards their editors. “Everybody felt the pressure of the G40, and some paid dearly for upholding their integrity”, says the editor of one weekly that has tried to remain firm in its editorial line, regarded as hostile to the Government.

### **Decree to control the international press**

If the local press was controlled, the international press was continuing to carry stories about the hidden debts in Mozambique. Major international news agencies such as Reuters, AFP, Bloomberg and international newspapers and television stations such as DW, CNN, BBC, Wall Street Journal, New York Times, Le Monde, Washington Post, and Financial Times, among others, sent correspondents to Mozambique to report on the hidden debts. The stories were published internationally and were very soon distributed in Mozambique using the swiftness of social media.

The Government therefore saw a need to impose control over the international press to limit news about the debts. In 2018 it passed Decree 40/2018, of 23 July, which, among other measures, required that any foreign correspondent would have to pay 500,000 meticaís (about USD 8,300) to be able to work in Mozambique, and the same amount to renew accreditation every two years. It also demanded payment of 200,000 meticaís (about USD 3,300) for accreditation of

<sup>127</sup> Idem

<sup>128</sup> <https://pt.globalvoices.org/2015/03/03/constitucionalista-assassinado-em-plena-avenida-da-capital-de-mocambique/> [accessed on 2 September 2019]

<sup>129</sup> The expression was used by the weekly *Savana*.

Mozambican correspondents of foreign media and the same amount to renew their accreditation. Foreign freelancers would have to pay 150,000 meticaís (about USD 2,500) for accreditation and the same amount for renewal.

Foreign journalists viewed these fees as a way of discouraging their work in Mozambique.<sup>130</sup> The main foreign journalists and correspondents organised themselves into an Association of Foreign Correspondents to stop the decree from taking effect. Supported by the Media Institute of Southern Africa (MISA), they won this battle, at least temporarily. The entry into force of the decree was suspended, but the decree was not revoked. The electoral cycle (municipal elections in 2018 and general elections in 2019) may have favoured suspension of the decree's application, which also targeted local media with the payment of registration fees and the renewal of licences. The public criticism that greeted the decree might have had a negative impact on the popularity of a Government that was already corroded by the hidden debts crisis and could have had an effect on the election results.

The HD were likely not the only cause for the introduction of Decree 40/2018. The attacks in Cabo Delgado, which began in 2017 and which are attracting increased interest from the local and particularly the international press, were also an area to be shielded by the decree. But regarding the attacks, the Government had an easier way of preventing the work of the press, and it did so later – it arrested national and foreign journalists who travelled to the areas of conflict and confiscated their equipment. Today the information about the Cabo Delgado attacks for the local and particularly the international press is controlled by the existence of a military cordon and is very difficult to confirm. News circulating about the attacks can be spread by social media and then replicated in some newspapers without, however, being able to present elements that are essential for a credible news story. That is, the Government has managed to control news about the attacks without needing the Decree. So the target of the decree was more the hidden debts than the conflict in Cabo Delgado.

Decree 40/2018, of 23 July met opposition from journalists and civil society. A group of journalists requested that it be declared unconstitutional, and when the Constitutional Council decided that the decree violated the Constitution of the Republic, the Government hurried to withdraw it.

Control over the international media continues to be through refusing accreditation to foreign journalists who want to work in Mozambique, except when the subject to be reported is in the Government's interest, such as natural disasters, or the visit of high-ranking figures (such as the Pope or the UN Secretary-General), matters that would help promote the Government's objectives abroad.

### ***Conclusion: The media and the DO***

The HD had a negative effect on press freedom, in leading the Government to increase its control over both the public and private media. The most common forms of control were through government interference in the editorial line of the public media, self-censorship of journalists on the public media, and cutting, or threatening to cut, advertising in the private media. For the international media, the Government introduced regulations that would make it difficult to accredit foreign journalists.

#### ***4.75 Election management: authoritarian response to the hidden debts***

As we saw above, the Mozambicans interviewed by Afrobarometer and the V-dem experts converge in observing that the quality of the elections has tended to decline over time and, according to V-Dem, the worst elections were those of 2019.

The 2018/19 electoral cycle was the first held after the discovery of the hidden debts. Both in the municipal and general elections, the campaigns were marked by debates over the hidden debts contracted by the Frelimo Government, with the opposition attempting to associate the Frelimo candidates with the debts. To run for mayor of Maputo in the municipal elections, Eneas Comiche suspended his mandate as deputy in the Assembly of the Republic where he chaired the Plan and Budget Commission (CPO). He was one of the main targets of criticism by the opposition because, while he was a deputy, he chaired the Parliamentary Commission of Inquiry (CPI) that investigated the hidden debts and recommended their insertion into the General State Financial Accounts (CGE). President Nyusi, who was Defence Minister when the debts were contracted and signed important documents concerning them, was also a central target of the criticism by the opposition.

<sup>130</sup> <https://www.dw.com/pt-002/novas-taxas-para-disciplinar-comunicac3o-social-mozambicana/a-45033877> [accessed on 2 September 2019]

Thus, the elections of 2018/19 were prepared and held in a context of great criticism of the Government due to the hidden debts. This, together with the economic crisis, was a harbinger of unfavourable results for the Frelimo candidates. The hidden debts were the major factor in the fall in the Government's credibility.

Public interest in holding the elections of 2018/19 was an indication that these elections were not like earlier ones. In the history of elections in Mozambique, these were the most scrutinised. And the only significant changes that occurred between the 2013/14 and 2018/19 election cycles were the hidden debts and the crisis resulting from them.

The response given by the Government to its unpopularity was a resort to authoritarianism in managing the elections. Aware of the difficulties in winning the elections, particularly in urban areas with more access to information about the debts, the Government invested in the machinery of intimidation, repression, harassment of those candidates of the opposition with the potential to mobilise more votes, and even manipulation of the results to minimise likely negative results.

The opposition entered the municipal election of 2018 governing four municipalities, and it greatly increased the number of municipalities under its control to nine. But the results of parallel count by the press and civil society indicated that in reality the opposition won an additional five municipalities. The Government resorted to authoritarianism to change the results and keep Frelimo in power. It resorted to State institutions – the electoral bodies, courts, the police – to change the results in Marromeu, Alto Molócuè, Moatize, Monapo and Matola. In all these cases, the police resorted to violence to intimidate voters and the opposition and to influence the results. At the same time, the district election commissions changed the results achieved at the ballot box in secret sessions without the presence of representatives of the opposition.<sup>131</sup> Finally, the courts refused to consider the merit of appeals lodged by the opposition contesting the change in the results. The 2018 municipal elections were the prelude to the general elections of the following year.

Envisaging negative results, the Government relied still further on the authoritarian machinery, managing to win in all the provinces and to obtain the second most favourable result for Frelimo in the history of multi-party parliamentary elections in Mozambique. One example of the poor quality of the 2019 general elections was the struggle over voter registration in Gaza province, and the clash between President Nyusi and the President of the National Statistics Institute (INE), Rosário Fernandes. INE had drawn attention to the discrepancies between the population census in Gaza, undertaken by INE, and the voter registration under the responsibility of the National Elections Commission. A public speech, in which President Nyusi humiliated the President of INE – and it was understood that the controversy in question was the number of voters in Gaza – led to the resignation of Rosário Fernandes.<sup>132</sup> These elections were considered the worst ever by various observers, including local civil society,<sup>133</sup> the European Union<sup>134</sup> and the Commonwealth.<sup>135</sup> Ever since the first democratic elections, there have been reports of fraud of various kinds. But specialists regarded the manner in which cases of fraud occurred in 2018 and 2019 as a change in the pattern of fraud.<sup>136</sup> Such authoritarian behaviour by the state, and the mobilisation of various state institutions to facilitate it, was something new.

The hidden debts cannot be regarded as the sole cause of fraud in the 2018 and 2019 elections. But the only objective factor, which could have led the Government to feel such pressure to influence the election results, was the HD, the economic consequences of which struck significantly at the popularity of the Government and put at risk the victory of Frelimo and its candidates. In contrast to the military conflicts occurring at the time, the political responsibility for which would be divided with the other protagonists, the HD were a problem that was solely the responsibility of the ruling party. For this reason, it seems likely that Frelimo entered the 2018/2019 elections under great pressure caused by the hidden debts, and it was necessary to resort to any means, including authoritarian ones, to avoid defeat.

131 [https://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk/technology/mozambique/files/files/Eleicoes\\_Autarqicas\\_69-21Outubro2018.pdf](https://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk/technology/mozambique/files/files/Eleicoes_Autarqicas_69-21Outubro2018.pdf)

132 <https://www.dw.com/pt-002/mo%27C3%A7ambique-titular-do-ine-demite-se-ap%27C3%B3s-recenseamento-pol%27C3%A9mico-em-gaza/a-50153003>

133 <https://www.dw.com/pt-002/foram-as-piores-eleicoes-de-sempre-de-mocambique-diz-investigador-britanico/a-50876399> [accessed on 8 July 2020]

134 <https://www.publico.pt/2020/02/12/mundo/noticia/ue-estrategia-centralizada-favor-frelimo-eleicoes-mocambique-1903885> [accessed on 8 July 2020]. See also EU, Relatório final. Eleições gerais e das assembleias provinciais, 15 Outubro 2019.

135 <https://www.cipeleicoes.org/commonwealth-diz/> [accessed on 8 July 2020]

136 'Response to Marromeu will set agenda for October 2019', by Hanlon, J & Nhamire, B (2018) available at [http://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk/technology/mozambique/files/files/Local\\_Elections\\_80-25Nov2018\\_Marromeu\\_tables.pdf](http://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk/technology/mozambique/files/files/Local_Elections_80-25Nov2018_Marromeu_tables.pdf) [accessed on 10 September 2019].

## 4.8 Summary: Theses on the influence of the HD

At the start of this investigation, **setbacks** were noted during the period of the hidden debts, measurable in the indices regarding governance and political institutions that seek to sustain democracy, the rule of law, and the quality of justice, as well as a setback in the fight against corruption in general. A range of tools recognized in international studies on governance and democracy were considered and discussed – as well as relevant results in Afrobarometer, which capture the opinions of Mozambicans. In this way, the risk was reduced that eventual analytical biases and preconceptions regarding particular institutions, or methodologies, would be introduced into the study.

Retrograde trends had already begun, bit by bit, as of 2010-2012, although the deterioration of several trends only began as of 2013. In many indices, the deterioration picked up speed, particularly as of 2016.

**Table 4.5: Trends in Mozambique with respect to various indices**

Institution/Index	Trend in Mozambique
Governance in Africa (Mo Ibrahim)	Among the African countries that witnessed a rapid deterioration in the indicators in the period between 2013 and 2017.
World Governance Indicators (World Bank)	Noteworthy decline in all 6 groups of indicators.
Democracy Index (Economist Intelligence Unit)	Accelerated fall in ranking and score as of 2016, and in 2018 Mozambique was classified as an authoritarian regime
Democracy (V-Dem)	Continuous decline in all ways of measuring “democracy” as of 2016, Mozambique categorized as authoritarian.
Civil liberties (V-Dem and Afrobarometer)	Suffered particularly as of 2016.
Corruption (V-Dem, Transparency International)	Abrupt fall after 2015.
Financial credit rating (Moody’s, Standard & Poor’s, Fitch)	Downgrades as of 2016.

The hidden debts are not the only factor that explains the worse governance and authoritarianism in this period. There were many factors that contributed to the result we now are aware of – international political and ideological influences, the increased “supply” of international corruption, changes in the balance of forces between the great international powers (the rise of China), the continuing conflict between Renamo and Frelimo and their polarisation, the boom in the extractive industries and, more recently, the war in Cabo Delgado. The contribution of these factors to the result versus the contribution of the HD cannot be calculated here, but the conclusion is that the hidden debts contributed significantly, which is sustained by the three following arguments:

1. There is a coincidence in time between, on the one hand, the contracting and discovery of the HD and, on the other, the deterioration of the political and institutional environment.
2. The logic and the type of situation in which the HD arose almost predetermined that they would have damaging impacts on governance and on democracy (cf. the primordial costs).
3. A more detailed analysis of specific events over these years shows causal mechanisms linking the HD to examples of bad governance and authoritarianism.

Below we summarise the arguments in points 2 and 3 in the form of series of theses.

#### 4.8.1 *Costs accepted with the contracting of the hidden debts*

The instigators of the hidden debts accepted inherent, or primordial “costs”, at the moment the debts were contracted. The logic of the situation – an illicit act of great consequence for the country, undertaken by senior political leaders – ensured that these four costs ensued, almost as prerequisites for the instigators, because they had no way of avoiding them. They contributed to the political and institutional entanglement of the regime, complicating governance and generating criticism and opposition (theses 1-4). It was in this context that the regime seems to have taken the option to govern in a more authoritarian manner (thesis 5). Each of these costs contributed toward worsening governance or towards reducing democratic space, moving reality still further away from the ideal.

#### *Political tension, conflict and the struggle for power in the Party-State*

Good governance implies institutional cooperation in support of the public good, but the HD, given their scale and their origin in the politico-economic elite, **sharpened the struggle for power and the level of political tension** in the country. The discoveries of natural gas, on top of a natural resource boom already existing, provided the political elite with an opportunity to make future fortunes, but there was strong pressure to consummate this opportunity and transform it into liquid assets immediately and, furthermore, in an economically irresponsible manner – even before the extraction of the resources (hence the expression “presource curse”). This pressure, or better, this haste, came as the end of the second, and last, term of office of President Guebuza approached. As history was to show, the swindle did not work out well for its instigators, many of whom are now discredited as leaders and/or are awaiting trial for their involvement in the HD. But it is certain that, unless there is an enormous windfall from the gas in record time, which would miraculously eliminate all the problems and debts, the contracting of the HD will provoke a settling of accounts within the political elite.

Since it was not possible to conceal the fraud forever, a huge political struggle was predestined within the party-state system to settle accounts. For a period, the wing of former President Guebuza came out of this struggle weakened, and the wing close to the current president Nyusi was gained power. This analysis argues that the political and institutional confusion that materialised in the country was a direct consequence of the struggle for power. Different wings of the ruling party tried to use the power of the institutions of governance in their struggle against other wings. This in turn worked against the impartiality and independence of the other institutions, weakening them.

#### *Impunity and the weakening of the counter-weights*

One ideal of good governance is *accountability*, but the instigators of the initial fraud had an inevitable interest in guaranteeing **impunity**. If it was not possible to protect all those involved, the political and institutional struggle would decide who would come out on top and who would be blamed and held responsible for the scandal. Political pressure from the Executive was applied to the other two branches of governance, which are normally sovereign.

The analysis of the behaviour of the Assembly of the Republic and of the Judiciary shows that these bodies - which in a democracy should guarantee checks and mechanisms of control over the Executive – did not pass the test of the hidden debts. The formal institutions, as well as informal mechanisms, ensured the effective control of the Executive over the legislative and judicial branches in Mozambique. At the crucial moment, this was used to ensure impunity for the illicit acts committed in the case of the HD by well-positioned individuals. To achieve this, the Executive had to weaken the checks and balances, politically and institutionally, taking away their independence and turning them into instruments. The Constitutional Council was a notable exception (in that it declared the HD as null and void), but the Government marginalized this, too, in that it has so far simply ignored its rulings on the matter.

#### *Concealment: worse management of public finances*

Where good governance applauds *transparency* in the management of public assets, one of the first costs of the HD was the **concealment** necessary to hide the initial crime. The Government, and particularly the authors of the HD, designed and implemented several actions to protect themselves from the public criticism provoked by the hidden debts. In an initial phase, the goal was to conceal the debts from the public, which was only possible by keeping them off the radar

of the press. In successive public declarations, members of the governments of both of Armando Guebuza and Filipe Nyusi, denied the existence of the hidden debts as they are known today. The strategy worked until, in April 2016, the international press revealed that, in addition to the EMATUM bonds, there were more debts with state guarantees.

We noted that during the period after the contracting of the hidden debt, the reforms seeking to improve the quality of public financial management ran out of steam. The cause was partly the HD, because the external funding used in the technocratic reform process declined. Furthermore, it seems evident that the will of the Government itself also declined. Other measures taken in these years to remedy the effects of the fiscal crisis also contributed to setbacks, such as centralization and the trend to implement ad-hoc solutions throughout the administration. There also seem to have been signs of social contagion of rent-seeking, with members of the political elite trying to find ways to take advantage of “our turn to eat”, for example, in the continual proliferation of construction projects of doubtful utility, even more so in times of fiscal crisis. This in turn contributed to more pressure for the conscious concealment of predatory rent-seeking.

### ***Discredit at various levels***

Good rulers should act with integrity and personal and public dignity so as to inspire trust – between the Government and its citizens, and between the State and its international counterparts. In contrast, it was here anticipated that the HD would produce a **crisis of trust and discredit** at various levels. This was seen in the international credit rating indices, which Mozambicans confirmed with a high degree of distrust of corruption in the Executive and in the institutions of governance. Afrobarometer has confirmed that this distrust grew during the period of the HD.

This latter effect is probably a normal reflex of the growing movement in the private press, in civil society, in the political opposition and even within the ruling party, to criticise publicly the HD. This sustained campaign could not but produce a greater level of discredit or distrust since the Executive lurched from revelation to revelation and several times was forced to retreat in the face of an exposure of facts that had previously been hidden.

The main public relations catastrophe was the discovery of the MAM and ProIndicus debts, two years after the Ematum bonds, and after several assurances by members of government that there were no additional hidden debts. This was the clearest attack against the credibility of the Government. There was no way to hide the debts forever, and thus the hidden debts were a time bomb of discredit whose fuse had been lit at the moment the debts were contracted.

### ***More authoritarianism in the relations between the State and society***

The four primordial costs, whose consequences we summarised in the four theses above, were inherent in the logic of the conspiracy, and thus almost inevitable. To these four theses, a fifth can be added, which is different in nature: the repression and authoritarianism that followed were a choice made by the political leadership of the regime in power.

The local private press and civil society, including CIP, began to make the debts the main theme of news and debate – and many journalists, editors and activists who did so took a considerable risk of suffering threats and physical assault. In this way, it was shown that there exists, or existed, in Mozambique a public space sufficiently open to show the limitations of the strategy of concealment. Hence the pressure to limit this space with authoritarian measures. Such actions chose as their main targets the local media, civil society and political opponents. Governance became more authoritarian.

Particularly after the revelations of 2016, the reaction was censorship and harassment expressed through restricting public advertising in the media hostile to the debts; government interference in the editorial line of the media through the appointment of editors loyal to the Government; the appointment of commentators and columnists chosen and trained to produce Government propaganda; attacks on figures critical of the debts; and limiting access to information about the debts, among various other ways of restricting freedom of expression.

## 4.8.2 Summary of the political and institutional costs

We can summarise the following costs that the hidden debts brought the country:

1. The Party-State entered into an entanglement of political conflict.
  - The tensions and contradictions will dominate national politics in the years to come.
  - There was less room for discussing programmes and political solutions, and a trend increased to fight for power in order to achieve benefits and rent-seeking in the logic of “it’s our turn now”.
2. Governance deteriorated
  - The institutions that should have provided checks and balances on the Executive were weakened, thereby reducing the accountability of members of government and increasing the risk of impunity.
  - The quality of the public financial management system declined.
3. The political regime became discredited.
  - Mozambican citizens and cooperation partners lost trust in the Government, and the country fell into disrepute internationally.
4. Mozambique became less democratic and more authoritarian
  - The trend to electoral manipulation continued or worsened.
  - Authoritarian measures increased in order to restrict freedom of expression and other civil liberties, including attacks and threats against known critics of the HD.





**SOCIAL  
CONSEQUENCES**

## 5 SOCIAL CONSEQUENCES

The hidden debts had dramatic consequences for the various strata of Mozambican society. As described in chapters 2 and 3, the public's perception of the hidden debts as of 2016 had economic consequences that made themselves felt almost immediately. Likewise, there were strong political and institutional impacts (chapter 4).

There are countless ways of measuring social well-being over time. Despite the proverb that says “you can't eat democracy”, political rights, individual freedoms and trust in society play a role in calculating the psycho-social well-being of people, although these are much more difficult to quantify than “a long life”, “years of schooling” and “per capita Gross National Income” (the basis of the Human Development Index of the UNDP).

Here we shall concentrate on one of the main quantifiable indices, with two different methods for measuring *poverty*. We shall show that, using the calculation of *consumption poverty*, at least 1.7 million people fell into poverty in 2016, and that number could have reached 1.9 million in 2019. And when *multidimensional poverty*<sup>137</sup> is measured, we reach the conclusion that the HD dragged 800,000 people into this type of poverty.

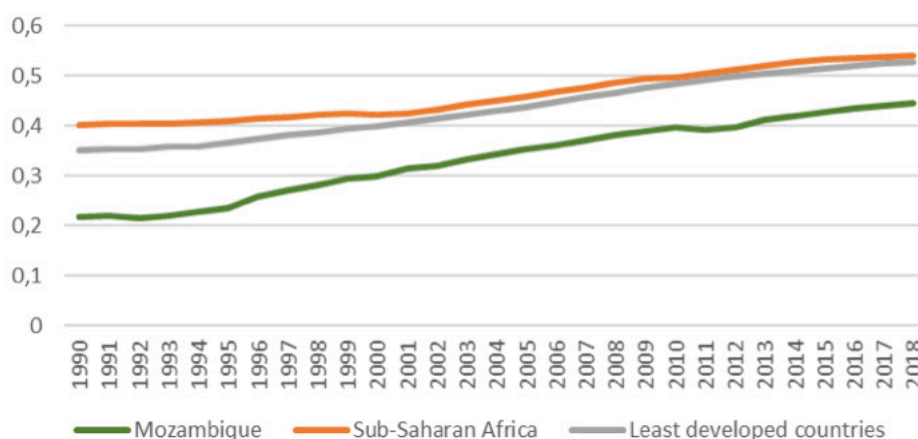
In addition, as a result of the economic and fiscal turbulence caused by the HD, the Government was forced to cut expenditure for the ministries directly charged with social well-being, as analysed in Chapter 3. Poverty increased

The chronic weakness of development has been, is, and will probably still be for some time to come, one of the greatest scourges of Mozambican society. Despite important progress made after independence, and particular during the peace since 1992, Mozambique remains one of the least developed countries in the world. In 2020, the United Nations Development Programme (UNDP) ranked Mozambique at number 181 out of 189 countries in its Human Development Index HDI, containing data up to 2020. Mozambique had advanced more or less at the same pace as other countries, which implies that it remains below the average for sub-Saharan Africa and below the average for the less developed countries on the planet (see graph 5.1).

### 5.1 Poverty increased

The chronic weakness of development has been, is, and will probably still be for some time to come, one of the greatest scourges of Mozambican society. Despite important progress made after independence, and particular during the peace since 1992, Mozambique remains one of the least developed countries in the world. In 2020, the United Nations Development Programme (UNDP) ranked Mozambique at number 181 out of 189 countries in its Human Development Index HDI, containing data up to 2020. Mozambique had advanced more or less at the same pace as other countries, which implies that it remains below the average for sub-Saharan Africa and below the average for the less developed countries on the planet (see graph 5.1).

**Graph 5.1: Scoring in the Human Development Index (UNDP)**



<sup>137</sup> Poverty measured by making reference to the privation of certain goods and services (of a defined quality) in the categories of basic sanitation, water, electricity, dwelling conditions, domestic utensils/technological goods, and cooking fuel.

The main indicators of the HDI – life expectancy, education and per capita income – are such that they react to specific events, such as the hidden debts, with a certain delay. The HD caused problems that will be reflected in future statistics, although these will also be susceptible to other factors that could also impact upon these indicators. But there are indications, and studies, which show us that the hidden debts have already increased the levels of poverty.

Reducing the number of people living in poverty in Mozambique has been an important objective historically. It was the common goal around which the Mozambican government and its partners focused various Poverty Reduction Plans. In this context, the regular publication of data collected during the Household Budget Surveys (IOF) acted as the main reference point.<sup>138</sup> The poverty threshold in the country was defined as the monetary value necessary to acquire a basket of basic goods, varying over time and with the geographical area where the households were located. IOFs were held in 1996/97, 2002/03, 2008/09 and 2014/15. According to these surveys, the percentage of the Mozambican population living below the poverty line fell from 69.7 per cent in 1996/97 to 46.1 per cent in 2014/15 (MEF 2016).

The most recent data produced with the IOF methodology are from 2014/15. There is no similar package of data collected after the hidden debts, and we will only have one when the results of the 2019/20 IOF are published.<sup>139</sup> In their absence, we shall resort to two studies which seek to measure more recent levels of poverty. These studies were undertaken by a group of researchers linked to UNU-WIDER – which has been collaborating for a long time with the Ministry of Economy and Finance in producing and interpreting aggregate data on poverty in Mozambique. We shall give a short presentation of their conclusions.

There are two different principles for measuring poverty in quantitative terms. One quantitative principle is measuring household income and the capacity to acquire a basket of “basic needs” (defined for each country and adjusted by region), and another principle measures poverty through the possession of goods. Each of these methods will be discussed in the context of Mozambique in the following sub-chapter. Note that there exist methodologies with a *qualitative* emphasis (typically based on anthropological studies), which, in another type of study, can and should complete the quantitative tallying typically used by political planners (Jones & Tvedten 2019).

### 5.1.1 Consumption poverty

The first of the two studies mentioned above (Mambo, Paris et al. 2018) is the only study so far that specifically seeks to estimate the effect of the 2016 economic crisis on levels of poverty in the country. Taking the data from the IOF 2014/15 as their starting point, they undertook several simulations to estimate an answer to the following question: with the increase in the price of the basic basket in 2016 – meticulously calculated to be between 55% and 70% more expensive than in the period 2014/15 analysed in the IOF – how many people would have fallen below the poverty line?

The result, according to the researchers, suggested that the national poverty level rose from 46.1% of the population in 2015 to at least 55% – a difference of at least 8.9% percentage points – and perhaps to as much as 60% of the population in 2016. They also made the following observations:

- The impact of the crisis would have been greater in the urban areas than in the countryside; and
- Cabo Delgado, Manica and Tete provinces would have suffered the greatest increases in poverty.

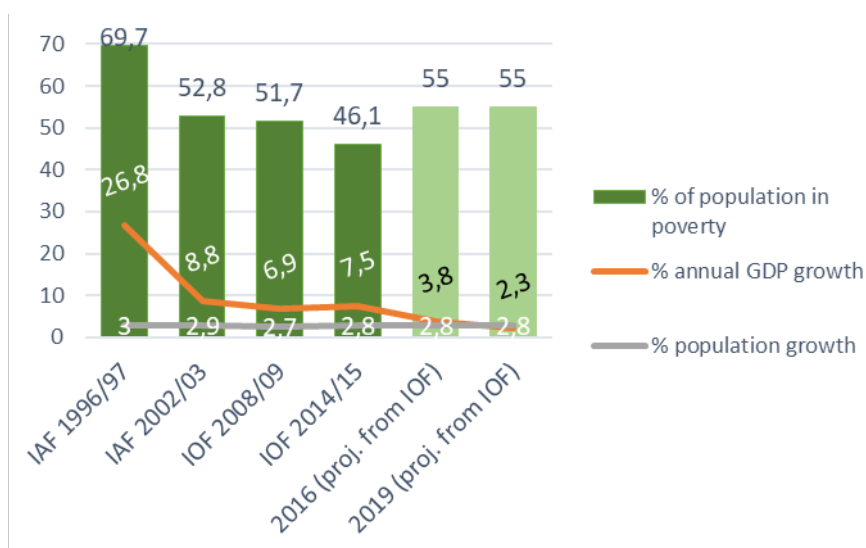
The graph below compares the percentage of the Mozambican population living in poverty up to 2019. Note that the column for 2016 is a projection based on a simulation, using the latest available data (IOF 2014/15). Lacking other data for 2019, it is assumed that the percentage of those in poverty neither rose nor fell in the three years since 2016, the year of the simulation made by Mambo & Paris et al.<sup>140</sup>

<sup>138</sup> According to Jones & Tvedten (2019), poverty in Mozambique, as in other places. Is a prolonged situation of the deprivation of resources to satisfy the material, financial, cultural and psychological welfare of human beings. Hence, the method of measuring poverty through the capacity to acquire a basic basket of goods is very limited, since it does not consider aspects that cannot be quantified in financial terms. The authors recognise, however, that the advantage of this method is that it facilitates the production of statistical data that allow concomitant and diachronic comparisons.

<sup>139</sup> According to the current chronology, the results of the 2019/20 IOF should be published in 2021.

<sup>140</sup> It is argued below that it is highly likely that, due to the economic crisis, the percentage of those in poverty increased between 2016 and 2019, but here we maintain methodological caution to avoid a confirmation bias.

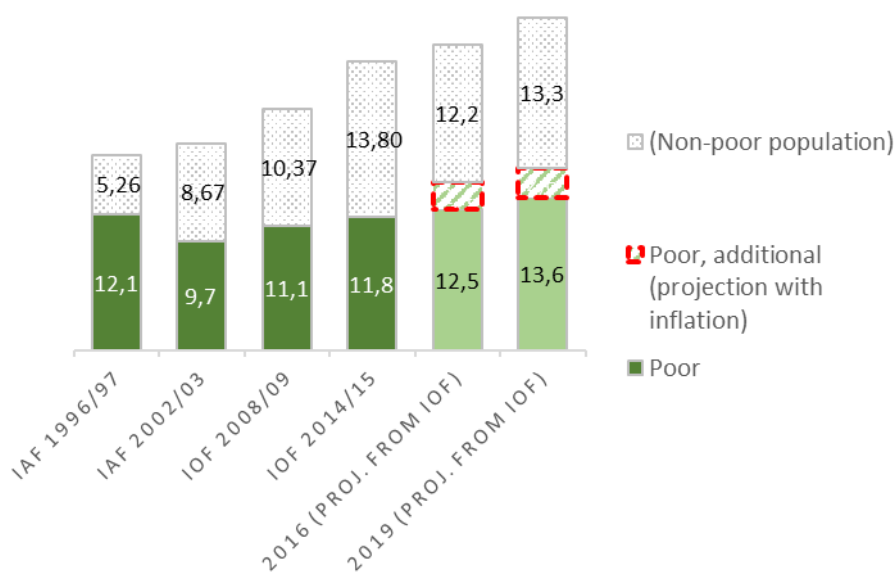
**Graph 5.2: Consumption poverty (in %) and annual growth of the economy and the population**



The graph above also includes two more indicators important for understanding the situation of poverty in the country, namely, the growth of the population and economic growth. These help strengthen the credibility that the simulation undertaken in this study approaches a reality in which the percentage of poor people increased. We saw in Chapter 3 how the growth in GDP, after reaching a maximum of 7-8% during the years 2002-2014, began to fall sharply from 2015 onward until, in 2019, economic growth was much lower than population growth which, since 2015, has been around 2.8% per year. It is very likely that consumption poverty is increasing in times of economic crisis when economic growth falls below population growth. Hence, it is likely that the real situation is as we see in the graph. The percentage of poor people nationally rose until it exceeded the level of 2002/03, that is, prior to the lengthy period of high economic growth.

The central question here is: *How many people became poor because of the hidden debts?* Specifically, how many people fell below the line of consumption poverty because of the HD? It is possible to make a simple arithmetical calculation, taking the projection of the study by Mambo et al. (2018) as the starting point:

**Graph 5.3: People in consumption poverty (in millions)**



The columns in the graph above show the Mozambican population (in millions). The part in dark green represents the number of poor people identified in the IAF and IOF up to 2014/15. The following years are projections and simulations of the number of poor people, taking into account the size of the total population (which, according to calculations based on the latest INE data, was 27.1 million in 2016, and 29.5 million in 2019<sup>141</sup>). Our assumptions are:

- Projection without the inflation of 2016. The columns in light green represent the number of poor, if we project the level of poverty of the last IOF (46.1% of the population) onto the years 2016 and 2019. If inflation had not shot up as it did in 2016, this would be, *ceteris paribus*, the number of poor people in those years.
- Projection with the inflation of 2016 (red boxes on shaded green). If we base ourselves on the simulation in the study of Mambo, et al., which suggests that consumption poverty rose to 55% of the population in 2016, the result of the strong inflation is an addition of at least 2.4 million people into the ranks of the poor. If we keep the percentage of poor at 55% for 2019, the projection suggests an addition of at least 2.6 million people over and above the scenario suggested by the IOF in 2014/15.

We stress that we consider the estimates described above as drawn up on the basis of cautious assumptions – that is, scientific caution tells us to interpret data that contradict instead of confirm the hypotheses that the study seeks to prove. In this case, that means that we underestimate rather than overestimate the increase in poverty. Considering that since then, as we saw above, the economy has continued to slow down, there is no reason to assume there has been any improvement in the percentage of poor people. According to the official INE statistics, economic growth in 2019 was only 2.3%, which was lower than the population growth rate of 2.8%. In other words, if the “cake” of the national income were divided equally among all Mozambicans, everybody would be a little poorer (or less rich).

But, despite this caveat, this methodology does not measure inequality in society. If some rich people became richer during the period, and increased their share of the national “cake”, the poor and the nearly poor (those who barely manage to acquire the basic basket) would be worse off during these years. At the same time, the simulation for the years 2016 and 2019 may err in estimating household income: if income had increased at the same pace as inflation, poverty would not have increased as much as suggested above. However, the opposite is true: in 2016 average inflation was 19.85%, and the minimum wage increased on average by just 8.7%.<sup>142</sup> This implies that the real income of Mozambican waged workers fell by 9.3%. It is worth noting that for the agricultural sector the fall in real income was 13.9% - an important factor in the increase in poverty in Mozambique, since much of the vulnerable population works in this sector.

Another factor bearing on inequality in Mozambique concerns gender. Women constitute 52% of the population in Mozambique, according to the 2017 population census. Women are the majority of the economically active population (50.3%), and they are to be found mostly in the informal sector and in agriculture (GdM 2016). Furthermore, women have been historically among the most vulnerable segment of the population (Tvedten 2011), and are the group most prejudiced by weakened systems of health, access to water, sanitation, education and social protection (GdM, 2016) due to their traditional responsibility of looking after other members of the family.

In general, in a context where there is less allocation of resources to the social sectors, it is women who are most affected. The HD affected the capacity of the Mozambican government to carry out actions that could have contributed to poverty reduction and job creation, which affects women directly and indirectly. Households headed by women and women in vulnerable working situations, such as those in temporary jobs, and in the agricultural, tourism, clothing and commercial sectors, were particularly affected (AfDB 2020:8).

Damaging impacts on food security and nutrition are also expected as a collateral effect of the HD crisis – particularly for vulnerable population groups such as children, women, the elderly and the poor, including those living in the rural areas. The resulting economic slowdown and the interruption in the delivery of public and private goods and services had an impact on poor and vulnerable households in the rural areas due to the reduction in remittances from their families in the urban and peri-urban areas and the increase in the cost of living, particularly of food prices. This aspect seriously affected the rural population with the highest rates of poverty, food insecurity and child malnutrition. This sector of the population was also hit by climate shocks, including seasonal droughts and the cyclones Idai and Kenneth in 2019.

<sup>141</sup> <http://www.ine.gov.mz/estatisticas/estatisticas-demograficas-e-indicadores-sociais/projecoes-da-populacao>

<sup>142</sup> The average wage increase of 8.7% in 2016 covers sector variations ranging from minus 17.9% for the manufacturing industry (a decrease!) to 24.11% for financial services activities, while increasing only 3.2% for the agricultural sector.

Furthermore, it is highly unlikely that the income of the most vulnerable households and individuals, in a context of a significant slowdown in economic growth, would have increased enough to make up for the loss of purchasing power suffered in 2016. For these reasons, we are confident that the risk, that we have exaggerated the increase in poverty, is small. The publication of the 2019/20 IOF could give some answers about the precision of the estimate made by Mambo et.al.

Finally, having noted that household income did not accompany the rise in prices and the cost of living, we are in a position to calculate: **how many people became poor because of the HD.**

The study by Mambo et.al includes the logical assumption that the main cause of the increase in poverty between 2015 and 2016 was the sudden increase in the price of goods in the basic basket.<sup>143</sup>

- Because of this inflation, in 2016 the number of poor people in the country increased by 8.9 percentage points. In numbers (graph 5.3), this is calculated as 14.9 million poor people in 2016 and 16.2 million in 2019, respectively 2.4 and 2.6 million more than in the counter-factual scenario, that is, without the sudden inflation of the basic basket in 2016.

If the exceptional inflation of 19.85% in 2016 caused the increase in poverty, the key question is: what part of this inflation was due to the HD? One “counterfactual” reference is the inflation of 2015, which was 3.55% (see chapter 3), a difference of 16.3 percentage points (pp). Another counter-factual reference point is the IMF forecast. In its report of January 2016, the IMF predicted inflation for 2016 of 5.6%, a difference of 14.25 pp – or an explanatory factor of 71.7% – which supports the calculation for 2016 made in chapter 3, on the contribution of the HD to the economic slowdown. As shown in chapter 3, the hidden debts explained 70.6% of the slowdown in economic growth per capita in nominal terms from 2015 to 2016 (table 3.2, line M)<sup>144</sup>. It can be argued that the greatest difference between the IMF forecast and the inflation that actually occurred was the discovery of the HD just four months later. If we apply this explanatory factor also to the inflation of 2016, it would have been 5.83% instead of 19.85%, that is, a difference of 14.01 pp.<sup>145</sup> Since this factor of 70.6% is the one best justified methodologically, and is more cautious than the explanatory factor of the IMF, this is the one we have used in calculating the consumption poverty caused by the HD.

Projecting the explanatory factor of 70.6% to the poverty estimated by Mambo et.al for 2016, we can deduce the following:

- Without the HD, the increase in poverty would have been 70.6% less – that is “only” 0.7 million people in 2016 and 0.8 million people in 2019, instead of 2.4 million and 2.6 million, respectively, with the HD.
- If 7 out of 10 (or specifically 70.6%) of those who fell below the poverty line would not have done so were it not for the HD, we can conclude that, because of the HD, at least 1.7 million people fell below the poverty line between 2015 and 2016. This number rose to 1.9 million people in 2019 (due to the strong population growth).

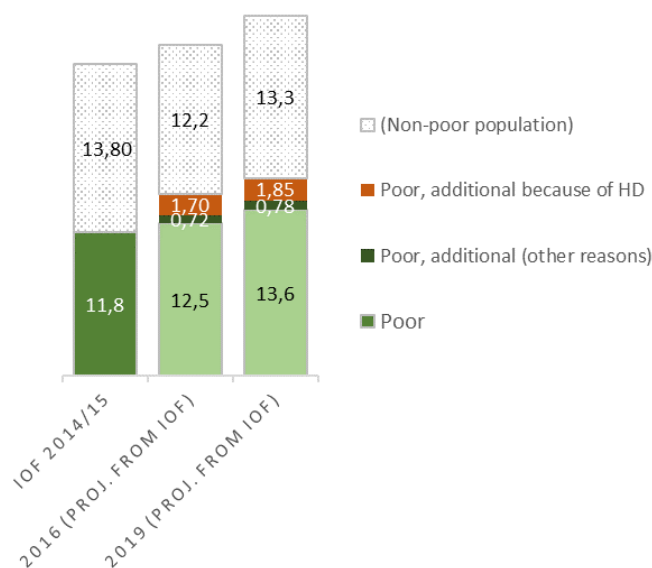
These numbers are a national average. As we argued above, it is likely that the poverty created by the HD was distributed unequally, to the detriment of some groups, such as those living in rural areas and in the north, and to the detriment of women.

<sup>143</sup> In addition to inflation, the fall in production also contributed to poverty which, at the micro level, can be expressed in lower household income, as discussed in the paragraphs above.

<sup>144</sup> In the study by Mambo et al., poverty is related to the impact inflation had on the basic consumption basket. With the nominal cost of that basket increasing, more people fell below the poverty line because they could no longer afford to purchase the same articles that they could before inflation accelerated in 2016. Regarding the impact of the HD, it is therefore appropriate that we use the nominal impact of the HD on GDP, as shown in line M of table 3.2.

<sup>145</sup> Total average inflation in 2016 was 19.85%. 70.6% of this is 14.01 percentage points, which leaves 5.83 percentage points for underlying inflation, in comparison with the average inflation of 3.55% in 2015.

**Graph 5.4: Estimate of consumption poverty caused by the hidden debts**



## 5.1.2 Multidimensional poverty

In 2020, another team from UNU-WIDER published a study on the ‘Evolution of multidimensional poverty in Mozambique’ (Egger, Salvucci et al. 2020). Unlike the study by Mambo et.al (2018), this measures poverty, as the title indicates, in multiple dimensions, not just with respect to income and consumption capacity. The methodology is complex, but essentially it considers that an individual is poor if he/she is deprived of certain goods and services (of a specific quality) in the categories of basic sanitation, water, electricity, dwelling conditions, domestic utensils/technological goods, and cooking fuel. Compared with poverty measured in terms of consumption of goods in the basic basket, poverty measured in this way is more resistant to cyclical economic shocks (Arndt, Castigo et al. 2018:317) – while an increase in the prices of the basic basket (maize flour, charcoal, cooking oil, etc.) rapidly reduces the well-being of anyone on the poverty line – the zinc sheets on the roof of a house remain for some time.

Studies of *multidimensional poverty* make it possible to measure not only the number of people living in poverty, but also the intensity of poverty. Even so, the study on multidimensional poverty reaches the conclusion that is in line with the one reached by studying consumption poverty: “as of the second half of 2015”, there is an interruption in the improvement seen up until then (Egger et.al, 2020:1) and an increase in the number of poor people due to the increase in population. The authors conclude that “the general improvement in access to basic services, ownership of assets and housing conditions seem to have stopped in recent years” (Egger, Salvucci et.al 2020:21-22).

When poverty is measured in this way, the absolute number of poor people is larger than that resulting from the study of consumption poverty. The study reaches the conclusion that:

‘(...) the number of multidimensionally poor people increased by approximately one million people in the period 2015–2018, from about 21.3 to about 22.2 million people. This points to an intensification of poverty, especially because most of the additional poor are located in the already vulnerable rural areas and in the central provinces’ (Egger, Salvucci et.al 2020:22).

They continue:

‘(...) a large share of the population even lost some of their assets increasing their deprivation, which drives the rise in poverty intensity.’ (Egger, Salvucci et.al 2020:22).

The researchers of the two UNU-WIDER teams begin their studies by linking the stagnation identified to the economic crisis, which in turn associates it with the HD since these are one of the factors that explain the crisis – the others being the fall in the prices of export products, and the weak international demand, natural disasters, and the conflict in Cabo Delgado. While they take the precaution not to identify any causal link between the crisis and the HD, the authors seem to draw close to such a link: ‘it is likely that the factor that most contributed to the intensification of the effects of the crisis was the issue of the state-guaranteed hidden debt.’ (Mambo, Paris et.al 2018:3).

Basing ourselves on the analysis of chapter 3, we can go further than the teams of UNU-WIDER in attributing the stagnation in poverty reduction, and the increase in the number of poor, to the HD. The major natural disasters only happened in 2019, after the increase in the number of poor, just as a significant economic impact of the war in the north only began to be felt as of 2018, in addition to being located in only one province. The international economic environment affected the neighbouring countries as well as Mozambique, but the economic decline of Mozambique was much sharper than that of other sub-Saharan African countries – economic growth in Mozambique slowed down by 4.5 percentage points between 2015 and 2018, while the sub-Saharan average slowed by just 1 percentage point.<sup>146</sup> Mozambique stands out from most of the neighbouring countries in those years in one factor: the high inflation of 2016, exactly the phenomenon which hit people in poverty and near poverty in Mozambique. Hence, in our analysis there are no factors that explain the economic crisis and any increase in poverty better than the HD. In chapter 3 we saw how 70.6% of the economic slowdown was due to the HD. There is no exact method for estimating what part of the increase in multidimensional poverty is due to the HD, but if we assume that the economic slowdown is strongly linked to the factors that led to the increase in multidimensional poverty, we can postulate that the number of people newly fallen into multidimensional poverty because of the HD corresponds to the contribution of the HD to the economic slowdown. **In short, it is reasonable to assume that, since about 1 million people joined the ranks of multidimensional poverty between 2015 and 2018, perhaps 706.000 would not have entered this statistics, had it not been for the HD.**

## 5.2 Malaise and fewer opportunities because of public expenditure cuts

### 5.2.1 Cuts in the social sectors

It is assumed that significant cuts to public expenditure in social sectors – those that are responsible for the welfare of the public, such as education and health – will reduce the *de facto* access of the public to these goods and services. It would always be possible that a reform in these sectors, which aspires to efficiency and effectiveness in public expenditure, would produce the same results (or better) with fewer costs. But, as we saw in chapter 4, these years were not years of reforms in the efficiency of using State money. Hence, it is safe to assume that cuts in public expenditure in the social sectors would produce, or result in, less well-being.

The slowdown in economic growth began in 2016 (see chapter 3). But the fiscal crisis erupted almost immediately when the IMF suspended its programme with the Mozambican government and the country’s partners withdrew their direct budget support. On a case by case basis some partners continued certain sector projects, but the budgetary capacity of the government was strongly affected. In mid-2016, the Government revised the annual budget in an attempt to reconcile the budget to the reality in which a significant part of the revenue (the grants) had fallen by half (when measured in USD). Foreign loans had also declined significantly. In the period 2013-2016, external financing for the State Budget fell by approximately USD 1.2 billion, from USD 1.98 billion in 2013 to 821 million in 2016. The government was unable – or did not make enough effort – to ensure that tax revenue would compensate for this loss of external funding. Instead of this, it chose to cut expenditure.

In addition to analysing the budgetary changes, it is necessary to look at the expenditure actually made, since at the end of the day the money spent – as reported in the national income accounts by the INE – is more important than the money promised (the budget).

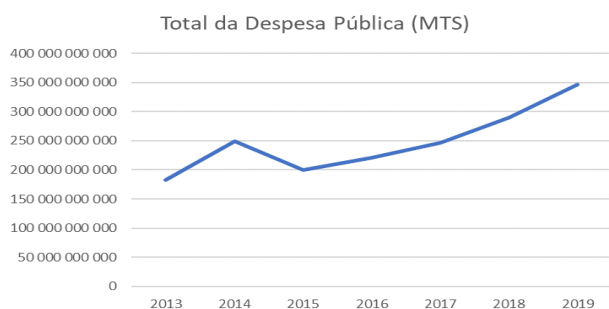
<sup>146</sup> Data from the IMF, see [https://www.imf.org/external/datamapper/NGDP\\_RPCH@WEO/SSO/MOZ](https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/SSO/MOZ).



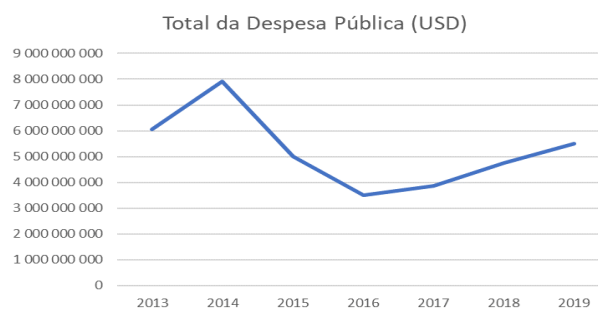
Public expenditure fell drastically in total value. Looking at the State budgets, it would appear that expenditure in meticaís rose greatly during the period under review. But this needs interpretation, taking into account the fall in the value of the metical during the period, which was almost 50 per cent in relation to reference currencies such as the US dollar. In meticaís, the fall in public expenditure between 2014 and 2016 appears to have been “only” 11.4%. But in terms of USD, expenditure fell by 55.6% – to less than half. It needs to be remembered that, to keep the same level of per capita expenditure, public expenditure should ideally have increased at the same pace as the growth in population, of 2.8% per year. Hence, when purchasing medicines or similar products, the costs in meticaís almost doubled. Particularly in health, public works and defence, where much of the expenditure derives from the import of goods and equipment from abroad, each metical was buying less than in the years prior to the HD. Hence, the observed curve of public expenditure, expressed in dollars, gives the correct impression. In fact, when measured in USD, there was a fall in public expenditure per capita.

**Graph 5.5: Public expenditure 2013-2019, in Meticaís and USD**

Total public expenditure (Mts)

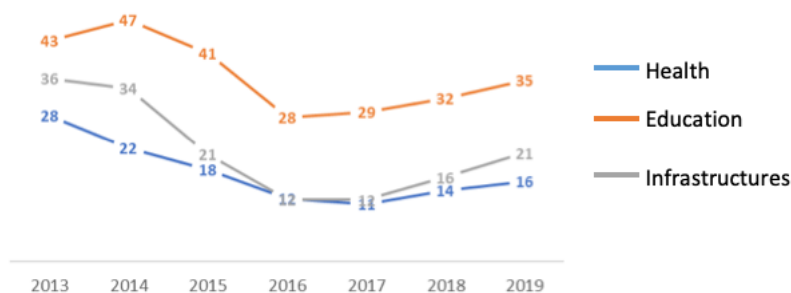


Total public expenditure (USD)



Two social sectors shall serve as an example of the overall trend, as does the expenditure on public infrastructures. In these sectors, one notes that, per capita, public expenditure never recovered the levels of before the crisis, when the HD scandal exploded in 2016. The fall in total public expenditure - in USD *per capita* – was about 39% between 2014 and 2019. The decline in the education and health sectors was about 26% and 28%, respectively. For reference, investment in infrastructure fell by 39% in the same period. In other words, other sectors suffered more or less equally with education and health, although the situation might have improved after a note from CIP in 2017<sup>147</sup> that criticized the government for failing to protect the social sectors and the most vulnerable strata of the population in 2016.

**Graph 5.6: Public expenditure on health, education and infrastructures In USD per capita, 2013-2019.**



Source: INE, National Accounts

147 [https://cipmoz.org/wp-content/uploads/2018/08/REO\\_2016\\_PUBLICACAO\\_FINAL.pdf\\_Maio\\_2017.pdf](https://cipmoz.org/wp-content/uploads/2018/08/REO_2016_PUBLICACAO_FINAL.pdf_Maio_2017.pdf)

If it is true that the government could have protected the social sectors, it is also true that any budgetary cut that subtracts almost half of the State budget would have social consequences. The key point here is this: the economic difficulty that became entrenched in the country after 2013 and that worsened in 2016, becoming a major crisis, was due to the HD.

The following exercise shows the real social impact that the HD are likely to have had on education and health. The average of the three years 2016-2018 can be compared with the previous three years. Using the numbers from the above graph, this gives us the following:

**Expenditure per capita (in USD), before and after the HD**

Sector	2013-2015	2016-2018	difference (USD)
	Annual average	Annual average	
Education	43.6	29.6	14
Health	22.6	12.6	10

We see how per capita expenditure on education and health fell by USD 14 and 10, respectively. In Mozambique, the number of pupils/students from primary school to higher education, that is, between 6 and 24 years old, represents about half the population.<sup>148</sup> In other words, the crisis reduced public expenditure by about USD 28 per year (twice the per capita decrease) for each Mozambican of potential age to be a pupil or student (in fact, it was much more per pupil, because many children and youths are outside the public education system).

Here we maintain the premise that the HD explain 70.6% of the economic crisis in 2016 – and, more specifically, the situation that produced the drastic cuts in public expenditure. That is, in a situation without the HD, the cut in public expenditure on health in 2016 would have been about USD 3 *per capita*, 7 dollars less than the cut of USD 10 which happened in reality (70.6% of 10 ≈ 7).

With this reasoning, it can be estimated that, because of the HD, during each year in the 2016-2018 period:

- Public expenditure on education fell by USD 20, for each pupil and student.
- Expenditure on health fell by USD 7, for each Mozambican citizen.

Adding up the reduction in expenditure on health and education, and comparing the years 2016-2018 with the previous three years, it can be noted that the hidden debts reduced public expenditure in these sectors by USD 1.7 billion.<sup>149</sup>

It is very likely that it was the poorest strata who felt the crisis most intensely: more poor people fell into deeper poverty, while the richer only had to sacrifice a slight percentage of their consumption.

But the HD may also have caused unease among the urban salaried classes. Many companies who sell goods and services ordered by the State received payment late, with all the associated uncertainty and discomfort. Workers who until recently had earned enough for their daily bread were out of a job. People in the public service suffered late payments; retired people and pensioners found their purchasing power reduced; and employees in the public administration found that their medical aid had been withdrawn,<sup>150</sup> particularly those who had special needs and ought to have gone abroad for treatment. Media reports in recent years indicate that the problems worsened in the years following the HD.

The fall in public expenditure for social purposes (welfare) was not only caused by the general economic crisis, but also because part of the public budget had to be destined to debt servicing. They had high opportunity costs.

<sup>148</sup> United Nations demographic statistics, “World Population Prospects 2019”: [https://population.un.org/wpp/Graphs/1\\_Demographic%20Profiles/Mozambique.pdf](https://population.un.org/wpp/Graphs/1_Demographic%20Profiles/Mozambique.pdf)

<sup>149</sup> Total reduction of expenditure on education and health because of the HD = (Reduction per capita)\*(explanatory factor per year)\*(annual population).

<sup>150</sup> Throughout the field work for this report, staff of the public administration were interviewed who said medical assistance had been withdrawn from their dependents who ought to have gone for treatment every quarter to South Africa.

## 5.2.2 Opportunity costs

The HD carried large “opportunity costs” – the expression economists use for what people cease doing when it is necessary to make a choice of some sort. We shall look at some examples:

The hidden debts, of about USD 2.2 billion, have, up until now, cost the Mozambican state more than USD 674.16 million in payment of capital and interest and other associated expenses (see chapter 2). This sum, which is equivalent to 6.04% of the amount of the country’s public debt and to 20.2% of State revenue in 2017, would have been enough to build:

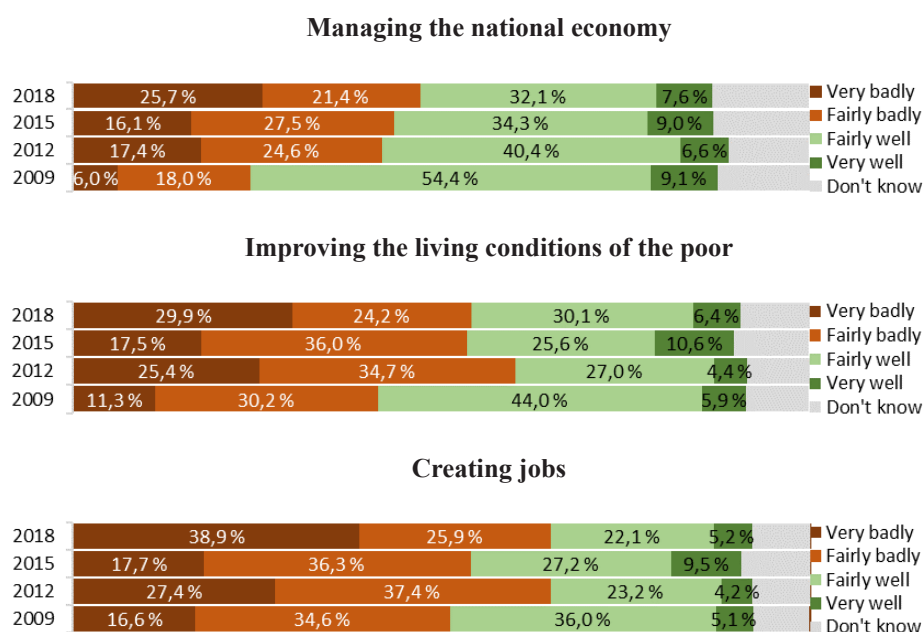
- 56,000 classrooms (for 25 pupils each) or 88 hospitals
- 898 type T2 health centres
- 83,624 houses (for 5 people each, that is, for a total of 418,120 people).

Or, alternatively, the payment of interest and capital could have been better spent on many water supply systems, and millions of basic baskets and assistance for displaced people in Cabo Delgado; or for thousands of kilometres of roads. The budgetary cuts would have consequences of social malaise in many ways. For example, the lack of a budget for the rehabilitation or maintenance of national roads will result in worse roads, which in time will contribute to causing accidents and other distress for the public. Were it not for the HD, it is very likely that at least a few more roads would have been repaired.

## 5.3 What do Mozambicans say about the socio-economic situation?

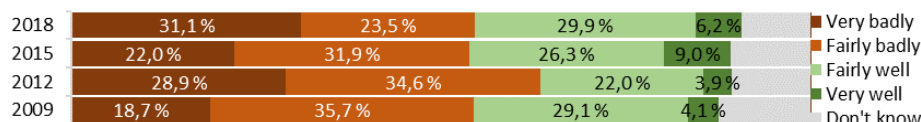
In seven surveys<sup>151</sup> held repeatedly by the Afrobarometer consortium, between 2002 and August 2018, a representative sample of Mozambican men and women gave their assessments about the performance of the government in various social and economic areas. They were asked ‘how well or badly would you say the government is doing in handing the following?’. The issues are shown in the table below. Answers in red represent a negative opinion, with the darker ink the most negative, Green represents positive assessments of the government’s work, while dark green shows the most positive opinions.

**Graph 5.7: How well or badly would you say the government is:**

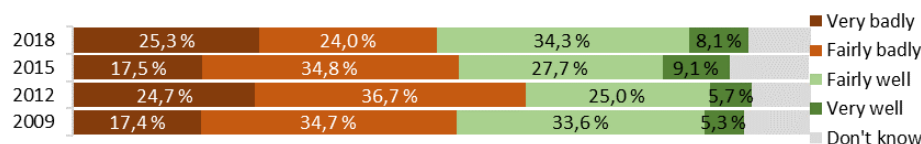


<sup>151</sup> Here, to simplify the graphic and narrative presentation, only the results from the most recent four surveys are shown.

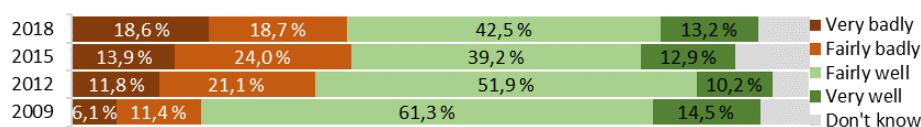
### Reducing the gap between rich and poor



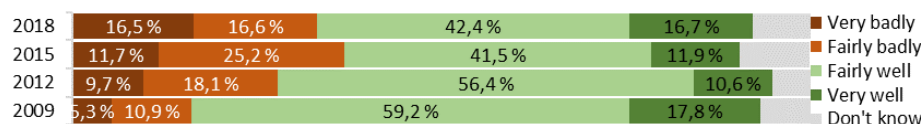
### Ensuring that everyone has enough to eat



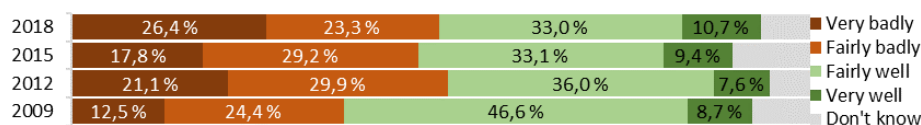
### Improving the health services



### Managing the needs of education



### Providing water and sanitation



One can easily observe a pattern in the answers for almost all areas. Between the surveys that ended in 2015 and the latest survey that ended in August 2018, there was a rise in dissatisfaction among the public, which has become more intense. At the same time, there was a reduction in satisfaction, and, although less clearly, the level of satisfaction is weakening. In addition to the numbers we presented above, these opinions of Mozambicans constitute a strong indication that the socio-economic situation worsened in the years following the revelation of the HD, and that unease entered the daily routine and the opinions of an increasing number of Mozambicans after the HD.

## 5.4 Summary

In chapters 3 and 4 we found that, in the period following public awareness of the HD, particularly after the crisis of 2016, a large number of indicators pointed to a deterioration in the environment. It was also like this in the case of the relevant indicators for social welfare – the problem discussed in this chapter. Furthermore, Mozambicans themselves tend to confirm the deterioration in the Afrobarometer surveys.

The previous chapters show the causal link between economic, political and institutional deterioration and the hidden debts, in line with the causal model of this study (see figure 2). Social malaise is the consequence of this economic, political and institutional deterioration. We can summarise the conclusion into two categories where the HD created a malaise.

1. Social malaise due to less public expenditure – There is the malaise that is presumed to have happened because of the budgetary cuts in the social sectors, as in education, health and social infrastructures. Also in other sectors the cuts in public expenditure could not but create social discomfort. This category includes unemployment, depreciation and delays in paying wages and pensions.
2. Poverty has increased with the economic crisis – The studies of multidimensional poverty confirm that the improvements noted in the country over many years stagnated between 2015 and 2018. Without any progress in these years, the result was an increase in poverty in terms of absolute numbers of poor, due to the rapid growth in the population. As for consumption poverty, we are still waiting for the national results from the first Household Budget Surveys (IOF) since 2015, which will show with some precision the evolution of poverty over the years affected by the HD. A projection of the levels of poverty from the most recent IOF (2014/2015) allows us to make an estimate of the number of people who would have fallen below the official consumption poverty line because of the HD. We conclude that: because of the HD, at least 1.7 million people became poor between 2015 and 2016, and at least 1.9 million by 2019.

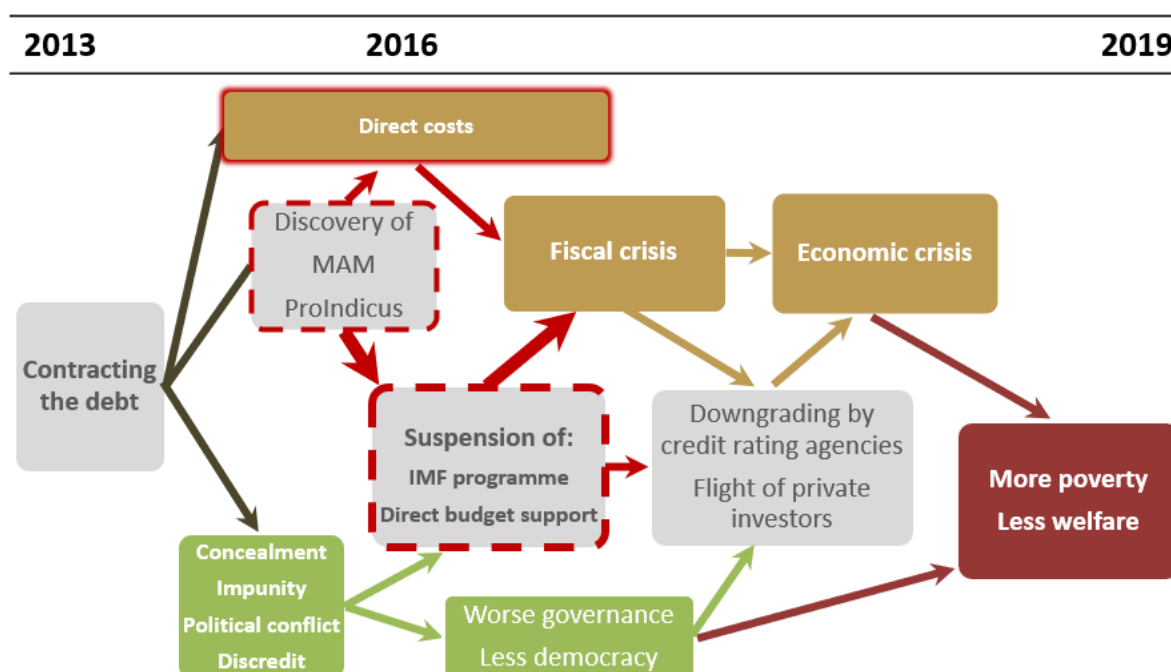


## **SUMÁRIO DAS CONCLUSÕES**

## 6 SUMMARY OF THE CONCLUSIONS

The **objective** of this report<sup>152</sup> was to draw up an inventory of all the costs – economic, political, institutional, and social – of the debacle we know as the hidden debts (HD), and, where possible, to quantify them in monetary terms or other quantitative measures. Where it was not possible to quantify the damage, the report had the goal of showing the mechanisms through which the HD caused damage. Its **purpose** is also urgent: that of promoting an informed debate based on fact and sober analyses about the HD, their extremely high costs and very serious consequences, alerting society to the danger that political corruption represents. There is an ultimate purpose: the question of **reparations for the damage caused** will be raised in domestic and international political forums, and perhaps also in courts. This report is a modest contribution.

The graph illustrates how the evolution of the crisis can be explained – with effects in a chain reaction – from the contracting of the debt to the final consequences: more poverty and less well-being for Mozambicans.



Through direct payments associated with the debt, the management of the debacle, and the devastating effects on the economy, Mozambicans have now paid, between 2016 and 2019, over USD 11 billion, or USD 403 per capita. They will have to pay a further USD 4 billion in debt service – and will forever suffer the consequences of the economic damage in the future. Also, because of the HD, the political institutions worsened, the government became more authoritarian, there was a reduction in social welfare, and poverty increased rapidly. Almost 1.9 million people fell below the consumption poverty line between 2016 and 2019 because of the hidden debts.

### 6.1 Fraud and political corruption

In 2013 and 2014, the banks Credit Suisse and VTB lent 622 million dollars to ProIndicus and 535 million to MAM, and helped place 850 million dollars in bonds on the international market in the name of EMATUM. The attempt to hide the existence of the debt that resulted from this scheme led to the term “hidden debts”.

The hidden debts have been a growing **debacle** ever since the first debt, that of EMATUM, became known in 2013. Instead of celebrating a success in economic modernisation – as was obviously the intention of the exhibition of pomp and

<sup>152</sup> The report is the result of collaboration between the Centre for Public Integrity and the Chr. Michelsen Institute.

circumstance during the visit of the Mozambican and French Presidents to the Privinvest shipyard in Cherbourg, France, in September 2013 – the matter led to surprise, criticism, and many question marks. The reports in the international press at the time insinuated “foul play” with respect to the deal. It didn’t take long before the Mozambican government was trying to calm down the donor community, which, already in 2013, was threatening to withdraw its promised support to the state budget.<sup>153</sup> The real crisis unfolded from 2016, when the ProIndicus and MAM debts were discovered.

**The Mozambican government, as a collective entity, opted to conceal the facts.** By not “putting its cards on the table”, the Government created a climate of suspicion and distrust which, after April 2016, led to economic, political and institutional consequences.

The companies (Ematum, ProIndicus and MAM) **brought no known benefit** to Mozambican citizens – they never became operational, and they were finally dissolved in 2020. So any effect was negative – that is, a cost (see chapter 1).

The HD resulted from **a fraudulent scheme** which sought to enrich a handful of people in three areas. The main protagonist of the scheme was Privinvest. It had counterparts in the European banks: Credit Suisse and VTB. Ordinary Mozambicans were the absolutely innocent victims of schemes drawn up by foreigners with the goal of enriching themselves. But without the corrupt involvement of officials and politicians very close to the top of presidential power in Mozambique, and without the signature of the Minister of Finance on the State loan guarantees, the fraud could not have gone ahead. It is the largest corruption scandal in Mozambique since independence, measured both in monetary terms and in the indirect consequences.

The HD can be summed up as a case of **regressive redistribution** – in simple language, a redistribution from the poor to the rich. The HD increased the wealth of a small group of people involved in the fraud, in Mozambique and abroad. These people left the bill to be paid by ordinary Mozambicans, most of whom are poor (see chapter 5).

## 6.2 The direct financial costs

Chapter 2 presents, in overall terms, the costs or financial losses accepted by the Government on behalf of the Mozambican citizens associated with the (monetary) expenses related with the HD. The current value of financial losses associated with the (monetary) expenses, current and future, come to a total of **4.618 billion US dollars**, equivalent to about **159 USD per Mozambican citizen**.

This value includes costs already paid and those that will come in the future: i) the direct costs (paid) related to the loans accepted by the Government up to the end of 2019, which come to 674.2 million USD, and ii) the present value of the direct costs related with the loans in the future,<sup>154</sup> from 2019 onwards, which amount to USD 3,929.8 million. In the period from 2013 to today, the amount of the remaining debt rose when compared with the initial value, because of defaulting on interest payments (in technical terms, late interest is being “capitalized”).

The table below gives the details<sup>155</sup> of this present value (in USD millions):

	EMATUM	MAM	ProIndicus
Capital subject to restructuring	900.0	644.02	674.0
Total interest 2020-2031	645.8	462.08	483.6
Other restructuring costs	40.0	40.0	40.0
Overall total– 3,929.8	1,585.8	1,146.40	1,197.6

There is a significant risk of ever higher financial costs related with these debts, because of the inability to comply with the repayment deadlines and terms.

<sup>153</sup> ‘Mozambique attempts to placate donors about \$850m bond’, Mail&Guardian, November 13, 2013.

<sup>154</sup> The calculation of the future component is based on the restructuring terms of each loan known so far. It has been assumed that the creditors of the MAM and ProIndicus loans will accept the same terms as the EMATUM creditors.

<sup>155</sup> Amount calculated through the methodology of updating capital, using the EMATUM restructuring terms.



The total amount in loans contracted by the Mozambican government was initially USD 2,007 million. In percentage terms, this value of the HD was equivalent, in 2018, to 21.5% of the foreign debt of USD 9,682 million, and 15% of the country's total public debt.

The Mozambican government has already spent almost USD 700 million on the HD and – unless it manages to free itself from the debt – it will have to pay almost 4 billion dollars more in the coming decade. These amounts could have been much better used for other purposes, which would have contributed to the development of the country and the welfare of its citizens. With the amounts paid up to the end of 2019, in servicing the debt associated with the HD, it would, for example, have been possible to build:

- 898 type 2 health centres, or,
- 56,000 classrooms for 25 pupils each.

The sums that the Government will have to pay up to 2031 could have built:

- A further 5,000 type 2 health centres, or
- 320,000 new classrooms, enough for all children of school age.

### 6.3 The economic losses

The economic damage has risen far beyond the direct financial costs. Chapter 3 presents the **indirect losses** from the HD between 2016 and 2019. The costs of these losses were, on average, **USD 95 per citizen, per year** – hence, much more than the direct costs (USD 6 per year per citizen, over the same period). If the HD had never existed, the slowdown of the Mozambican economy (less real GDP growth) would have been 1.1 pp instead of 2.9 pp from 2015 to 2016 – that is, **the HD explain 62.1% of the slowdown in the real GDP** for that year.

**The reactions to the discovery of the HD unleashed a cascade of damaging effects.** To explain the devastation, this analysis identifies four immediate reactions directly arising from the HD, on the part of various economic stakeholders and international institutions in April 2016 when they became aware of the existence of these debts:

- (1) The IMF suspended its financial programme with Mozambique;
- (2) The cooperation partners suspended all budget and programmatic support;
- (3) Private investors drastically reduced the flow of funds to Mozambique;
- (4) The rating agencies reduced the classification of Mozambique from “CC with negative prospects” to “selective default”.

These reactions were the *direct result* of the HD. Points 1 and 2 – the reduction in donor support – were solely attributable to the discovery of such a large debt, and amounted to **a direct loss of USD 831 million from 2015 to 2016.**

As a whole, these reactions gave the Mozambican economy a shock and led to stagnation – or precisely, a sharp deceleration – that represented **a break in the positive trajectory of economic growth, macro-economic stability and good international relations.**

#### Highlights: The HD caused immediate losses in the public finances

- The international cooperation partners suspended support for the State Budget.
- The fall in state revenue (without capital gains tax) and in total expenditure by 3.2 pp and 10.5 pp of GDP between 2014 and 2019, respectively, led to reprogramming the budgets.
- Cut in capital expenditure of 3.5 pp of GDP in 2016, and 3.3 pp in 2019, compared with 2015, limiting the intervention of the Government in strategic sectors for the development of the country, and with notable negative impacts on health, education, agriculture and infrastructures.
- Significant increase in domestic indebtedness to finance the fiscal deficit. The growing financing of the deficit through domestic debt caused a disproportionate increase in the debt service.

The HD provoked instability in the monetary and foreign exchange sectors. The fall in external resources (foreign currency) caused a depreciation of the metical and an increase in interest rates.

#### Highlights: impact of the HD on the monetary and foreign exchange sectors

- Successive upward adjustments of the central bank's reference interest rates, resulting in increased interest rates in the commercial banks.
- Increase in the Permanent Lending Facility (FPC), Deposit Facility (FPD) and interest on 365 day Treasury Bills (BT) of 13.75 pp, 14.00 pp and 24.88 pp, respectively, between the 1<sup>st</sup> quarter of 2013 and the 1<sup>st</sup> quarter of 2017.
- Reduction in funds that could be lent to the private sector due to the competition imposed by the Government's search for financing.
- Reduction of bank financing for companies due to the high cost of credit: credit to the economy shrank in 2017 and 2018, falling, as a percentage of GDP, from 38.0% in 2016 to 24.8% in 2018 and 24.5% in 2019.
- A 66% increase in the amount of non-performing loans between 2015 and 2016.
- Lack of sustainability of the business sector because of the failure of the state to comply with its financial obligations.
- Sharp depreciation of the Metical, falling by more than 50% against the main currencies traded in the country. This culminated in a higher cost of imports and of the stock of foreign debt.

Without the monetary measures imposed by the Bank of Mozambique, the depreciation (and hence inflation) would have been much higher in 2018 and 2019. Thus, these measures had a positive impact on the monetary and foreign exchange sectors, but negative effects on the real sector.

As a consequence of the HD, inflation accelerated, which resulted in a reduction in the purchasing power of Mozambicans.

#### Highlights: impact of the HD on purchasing power

- Acceleration of the annual average and year-end inflation rates, which rose from 4.21% and 2.96% in 2013, respectively, to a maximum of 19.85% and 25.27% in 2016, respectively.
- Suspension by the government of subsidies for fuel, electricity and water, bread and public transport operators, resulting in the transfer of these costs to the public, and in an increase in the cost of basic goods and services.
- Reduction in citizens' capacity to meet their basic needs (food, health, transport and housing) due to the worsening cost of living.

The public debt increased significantly, leading to the deterioration in the amount and composition of the debt (relatively less foreign debt and more domestic debt), and in the contractual terms, as a whole, increasing the cost and thus the fiscal risk. This took Mozambique into a vicious cycle of debt.

#### Highlights: impact of the HD on public debt management

- Increase in the amount of public sector debt to unsustainable levels, from 43% in 2013 to 79% in 2019.
- Classification of the country as defaulting by the credit rating agencies, resulting in reduced capacity to contract loans on the international market.
- Risk of paralysis of the public administration and collapse of the economy, if the government did not finance the budget through bank credit, resulting in a substantial increase in domestic indebtedness.

As for the external sector, the increase in fiscal risks reduced the level of foreign direct investment (FDI) and of international cooperation, influencing the behaviour of economic agents and of citizens, and contributing to a slowdown of the Mozambican economy.

#### Highlights: impact of the HD on the external sector

- Slowdown in foreign trade. The amount of imports fell by about 55%, between 2013 and 2016, resulting in difficulties in meeting basic consumption and investment needs. The amount of exports declined modestly.
- Deterioration in the capacity to import essential goods (fuel and grain, among others) due to the lack of credit to the economy, both in foreign and in national currency, from the commercial banks.
- Increase in disbursements of foreign currency to service the HD.
- Reduction of FDI, excluding the mega-projects, by 54.9% between 2014 and 2019, with damaging consequences for economic growth.

What part of the slowdown of real economic growth in the period – from 7.0% in 2013 to 2.3% in 2019 – is explained by the HD? The crucial year is 2015-2016, for there was a fall in the growth of real GDP of 2.9 percentage points (pp) between 2015 and 2016 (from 6.7% to 3.8%). To estimate to what extent this difference can be attributed to the HD, the methodology takes into account the fact that the Mozambican economy would have faced the same “extra-HD” challenges (not linked to the HD) in the counterfactual scenario as in the scenario that actually happened.

The main underlying “extra-HD” factors in the Mozambican economy were duly considered: climatic impacts (floods, droughts), the volatility of commodity prices (minerals, coal etc.) and the politico-military tension of 2016-18. The conclusion was reached that only the latter had an impact, of 1.1 pp, in the decline of GDP (at most, and probably less). Subtracting this number from the fall of total real GDP of 2.9 pp between 2015 and 2016, we reach the conclusion that the total impact of the HD in the slowdown of the Mozambican economy in 2016 was at least 1.8 pp. This means that **the HD explain at least 62.1% of the slowdown in real GDP.**

Chapter 3 (table 3.2) also converts these losses of real production into financial amounts, to calculate a (minimum) financial loss. This amount is then converted into GDP per capita, resulting in an average of **USD 95 per year and per citizen as loss of potential purchasing power, or USD 381 for the four-year period 2016-19 (for the entire population, this amounts to USD 10.66 billion).** This reduction in the purchasing power of everyone in Mozambique represents an annual economic loss, which can never be recouped.

#### Summary of costs and losses because of the HD, 2016-2019

	TOTAL					Per capita
	in USD millions					
	2016	2017	2018	2019	Total	
Direct costs, payments made	674				674	22
Costs of the economic slowdown	3,384	3,120	2,339	1,815	<b>10,659</b>	<b>381</b>
Total economic costs	<b>4,058</b>	3,120	2,339	1,815	<b>11,333</b>	<b>403</b>

If Mozambique is forced to pay the hidden debts, it will still have USD 3.93 billion to pay by 2031 in direct costs, and the costs of the economic damage will continue to accumulate.

## 6.4 Political and institutional costs and effects

Chapter 4 discusses the effects of the hidden debts on the national institutions and on the political system, including the way in which they influenced the relations between the Mozambican government and the other national and international stakeholders.

In this area, the methodological priority was to show, **first**, the likely causal link between the HD and an (adverse) political or institutional effect, and **second**, the causal mechanisms that explain how the HD worsened the political and institutional environment. The analyses of this study were also informed by data taken from qualitative studies (stakeholder interviews and consultation of the relevant literature).

Initially a setback was noted during the period of the hidden debts (2013-2019), measurable in recognised indices,<sup>156</sup> of the quality of governance and of the political institutions that seek to sustain democracy, the Rule of Law and the quality of Justice; in addition to a reduction in the quality of public financial management and a retreat in the fight against corruption in general. According to the Mo Ibrahim Index of African Governance, Mozambique is among the countries whose governance deteriorated most rapidly during the 2013-2017 period, the years in which the effects of the HD began to kick in.

In many indicators and indices, the deterioration corresponds with the timing of the discovery of the HD. To establish a causal relation between the HD and these alterations in the political and institutional environment, it was necessary to trace the process from the start and also to look in detail at each sub-sector of the area.

In addition to the financial and economic costs which, sooner or later, would have to be paid by somebody, the instigators accepted other costs at the moment of contracting the debt. Here they have been called **the four “primordial” costs of the HD**, because they inevitably accompanied the act of contracting the debt in an illicit and fraudulent manner.

Just as certainly as the fraud would have economic costs, it would also have consequences damaging to governance and to the democratic institutions envisaged in the Constitution of Mozambique. Since it was of a criminal nature, the instigators had to involve themselves – and since some of them were government members they also involved the institutions of governance – in acts which sought: 1) to **conceal** the reality about the contracting of the debt, as well as trying to influence or manipulate the political and institutional terrain to guarantee 2) **impunity**. The circumstances of arranging the debt, the injection and distribution of large sums of money among the factions within Frelimo and the inevitable struggle over who would be held responsible, would guarantee an increase in; 3) **political tension and the struggle for power**. Finally, in becoming public knowledge, the HD inevitably led to **discrediting**, not only the instigators, but also the country and its institutions of governance.

The table below shows the four primordial costs incurred with the HD, and how each one contradicts the principles of good governance and of a democratic regime.

(Ideal)	(Reality)
Good governance & democratic regime	Cost accepted with the HD
Transparency	Concealment
Accountability	Impunity
Cooperation for the public good	Political tension & struggle for power
Integrity and trust	Lack of credibility

This analysis starts from the assumption that these four “primordial” mechanisms provided the impulse that set into motion a large number of consequences of the HD, which were rapidly unleashed onto the political and institutional environment of the country.

<sup>156</sup> For this report, a range of tools recognised in international studies on governance and democracy were considered and discussed, including the relevant results in Afrobarometer, which capture the opinion of Mozambicans.

To the four primordial costs may be added a fifth: the repression and authoritarianism that was a choice made by the political leadership of the regime in power. The local private media and civil society began to make the debts their main topic of news and debate. In this way, it was proved that there exists, or existed, in Mozambique a public space sufficiently open to show the limitations of the strategy of concealment. These actors suffered the attempts of forces linked to the Party-State apparatus to limit this public space with authoritarian measures. These actions took as their main targets the local media, civil society and political opponents. In this way, governance became more authoritarian.

Summary of the political and institutional costs and consequences of the hidden debts:

General consequence	Specific costs
<p>1. The Party-State entered into an entanglement of political conflict</p> <p>...the contradictions and conflicts of which will dominate national politics in the coming years.</p>	<ul style="list-style-type: none"> <li>— The level and seriousness of conflicts increased within the party that has sustained the government since independence increased, as did the tension between the ruling party and the country’s other political forces and between the institutions of the State.</li> <li>— The HD opened constitutional disorder, with the government ignoring the rulings of the Constitutional Council.</li> <li>— There was less space for decisions about political programmes and solutions, and the trend increased to seek power to achieve benefit and rents in the logic of “it’s our turn now” (alterations of opportunities among elitist factions).</li> </ul>
<p>2. Governance deteriorated</p> <p>The institutions that should provide checks and balances on the Executive were weakened, thus reducing the accountability of government members and increasing the risk of impunity.</p>	<ul style="list-style-type: none"> <li>— With some notable exceptions, both the checks and counterweights against the Executive, the judicial and the legislative powers, have so far failed the test of the HD. Those responsible for the scandal (some of them former members of government) have not yet been brought to trial, and the judicial power shows that it is unable to force the Government to conform to legality and abandon its unconstitutional management of the debt.</li> <li>— The quality of the public financial management system declines. With the probable goal of concealing the HD, public management became more centralised, and the entire process of reform to establish greater transparency in public financial management stagnated.</li> </ul>
<p>3. The political regime became discredited</p> <p>Mozambican citizens and cooperation partners lost trust in the government and the country fell into disrepute internationally.</p>	<ul style="list-style-type: none"> <li>— The Mozambican government’s oldest and most loyal partners reacted with incredulity and anger at the discovery of the HD, in such a way that they withdrew much of their financial support from the country.</li> <li>— All the major credit rating agencies (S&amp;P, Moody’s and Fitch) downgraded the credibility of Mozambique to among the least credible countries in the world immediately after the discovery of the MAM &amp; ProIndicus debts in 2016.</li> </ul>
<p>4. Mozambique became less democratic and more authoritarian</p> <p>The Government became more authoritarian to compensate for the crisis in public legitimacy, internal conflicts, and institutional disorder.</p>	<ul style="list-style-type: none"> <li>— The five variants of democracy measured in the indices of Varieties of Democracy (V-Dem) note a deterioration in Mozambique’s score over the period, worsening after 2016.</li> <li>— In 2018 Mozambique was classified for the first time as an authoritarian country in the Democracy Index drawn up by the EIU.</li> <li>— There are strong indications of a decline in the quality of the elections.</li> <li>— Reporters Without Borders reports a continuous decline in press freedom since 2013. A series of measures implemented by state bodies or some factions within the ruling party were aimed at intimidating or complicating the situation for critics in the national and international media – a trend that grew after the revelations of the HD.</li> </ul>

## 6.5 The social impacts

Chapter 5 concentrates on showing how the HD impacted on poverty levels, how public expenditure on the social sectors declined because of the HD, thus increasing social malaise, and how, in the perception of Mozambicans, the post-HD period is understood as one of increasing the cost of living.

External financing of the State Budget fell by approximately USD 1.2 billion, from USD 1.98 billion in 2013 to 821 million in 2016. Reacting to the reduced international support for the State Budget, particularly after the discovery of the HD in 2016, as well as the abrupt reduction in access to international credit, the Government revised the budget downwards in mid-2016. Public expenditure (in USD) fell by more than half in 2016, compared with 2014.

Real expenditure per capita on the social sectors fell drastically after the HD. Real expenditure per capita fell, from 2015 to 2016 – the year when the HD became public knowledge – from USD 41 to 28 in education (32% less), and from USD 18 to 12 (34% less) in health.

Comparing the averages of the three year periods before and after the revelation of the HD in 2016, and taking into consideration that *at least* 70.6% of the economic crisis after 2016 is due to the HD, it is found that:

- Public expenditure on education fell by USD 20, for each pupil and student, during each year in the period 2016-2018.
- Expenditure on health fell by USD 7, for each Mozambican citizen, every year between 2016 and 2018.

Budgetary cuts affected Mozambicans of all strata – certainly the poor, but also wage earners and others who, directly or indirectly, depend on the capacity of the State to spend.

**Poverty increased because of the HD.** The effects of the HD were analysed with respect to two ways of measuring poverty, *consumption poverty* (household income and consumption capacity) and *multidimensional poverty* (access to goods and services).<sup>157</sup>

For estimating *consumption* poverty, there are no national data later than the last Household Budget Survey, held in 2015. For this reason, this study resorted to projections on the effect of the 2016 inflation on the capacity of households to consume the basic basket – where members of households who could not achieve this are regarded as poor (or below the poverty threshold).

- Taking all reasonable precautions in the estimate, it is found that, because of the HD, at least an additional 1.7 million people fell below the consumption poverty threshold between 2015 and 2016, and at least 1.9 million by 2019.

*Multidimensional* poverty allows us to capture better the intensity of poverty over time. Other studies show that there are more people living in multidimensional poverty than in consumption poverty, and that during the 2015-2018 period there was an absolute increase in people in multidimensional poverty due to the strong population growth. Measured in this way, poverty intensified. In relative terms (percentage of the population) the poverty reduction observed since the start of the century turned to stagnation, but there was no relative increase in the period. Estimating the contribution of the HD to the economic slowdown (70.6%) which increased the number of Mozambicans in multidimensional poverty, we reach the following conclusion:

- Since about one million people joined the ranks of multidimensional poverty between 2015 and 2018, the period after the HD, we propose that 706,000 would not have entered this statistic, had it not been for the HD.

In their answers to the seven surveys held regularly by Afrobarometer between 2002 and August 2018, **Mozambicans bore witness to the socio-economic malaise**. In a representative sample, Mozambican men and women gave their opinions on the performance of the government in various social and economic areas: the economy; poverty and employment; inequality; food security; and health, education and water.

<sup>157</sup> To estimate poverty in Mozambique, we have relied strongly on the work done by UNU-WIDER.

- Comparing those interviewed in 2015 with the last survey, which ended in August 2018, there was a noteworthy and significant rise in dissatisfaction, which had also become more intense in all areas. The opinions of Mozambicans indicate that the socio-economic situation worsened in the years following the revelation of the HD and that the malaise felt in daily life is reflected in the opinions of an ever-larger number of Mozambicans after the HD.
- The dissatisfaction that intensified most between 2015 and 2018 was with the capacity of the government to “create jobs” and “to improve the life of the poor”.



**ANNEXES**



## 7. ANNEXES

### Annex to Chapter 2

This annex presents information that underpins chapter 2 of the report and offers additional information regarding the history of the EMATUM loan (Section A); data on the process of restructuring the EMATUM debt and calculation of the present value (Section B); and information on the other two loans (Section C).

## EMATUM

### A. History of the EMATUM Loan

The Empresa Moçambicana de Atum SA (EMATUM) contracted in March 2013 a loan with a nominal value of USD 850 million. The amortization schedule for that loan was as follows:

**Table A1: EMATUM loan (original)**

Amount of the debt (in millions of dollars)	850
Maturity	2020
Grace period	4 semesters
Starting date for repayments	March 2015
Frequency of payment	Semi-annual
Amount of the semiannual amortization (in millions of dollars) and of interest	76.5+ interest (LIBOR + 6.5%)

Source: DNT

The debt service of EMATUM SA contractually started in March 2015, and comprised semiannual payments of capital of USD 76.5 million, plus the corresponding interest, which was expected to end in September 2020, according to the amortization schedule originally agreed upon.

However, in 2015, the company revealed an inability to honor its commitments, forcing the State, as a guarantor, to make the payments. In March 2015, the first installment was due, but on that date only interest was paid, in the amount of **USD 26.8 million**, of which USD 11 million was borne by the company and USD 15.8 million by the State. In September 2015, the second installment was due, but since the company again had difficulties paying, the State was obliged to assume its debt, having for this purpose disbursed, through the State Budget, the amount of **103.3 million dollars**, of which 76.5 million with respect to amortization of capital and 26.8 million with respect to interest.

In April 2016, and in the context of the assumption of EMATUM's debt by the State, its restructuring was negotiated, with the following characteristics:

**Table A2. EMATUM loan, in millions of USD (first restructuring - April 2016)**

Amount of the debt	726.5
Maturity	2023 (7 years)
Grace period	2 semesters (until January 2017)
Starting date for the repayments of interest/ rate	January 2017 / 10.5%
Frequency of interest payments	7 (annually)
Modality for the repayment of capital	A single payment in 2023 (bullet payment <sup>158</sup> )
Amount of the periodic amortization	n/a

Source: DNT

<sup>158</sup> Bullet Payment: a type of loan in which the borrower, throughout the life of the loan, pays only interest and repays the capital in one installment at the end of the term.

In order to proceed with the payment of the debts assumed, considering the restructuring of April 2016, the Government contracted in 2016 a loan with the Bank of Mozambique, in the amount of USD 199.8 million (14,262 million Meticais), for the payment of the debt coupon of EMATUM S.A. (USD 132.3 million) and for ProIndicus S.A. (USD 67.5 million).

In 2017 and 2018, no additional payments were made regarding the amortization of capital and interest of the hidden debts. However, in 2019, under the terms of the restructuring proposal for the sovereign bonds issued on September 24, 2019 (GdM 2019) and approved in the context of a written decision by the bondholders holding 99.5% of the aggregate capital value of the existing debt securities, once the restructuring was completed, the Government made a payment of USD 40 million, with regard to the consent fees and compensation for the exchange of terms.

**Table A3: Comparison of MOZAM 2023 and 2032 debt service charges and restructuring**

	MOZAM2023	MOZAM 2032
Instrument	\$726,5 million	\$900,0 million (including late interest)
Maturity (Years)	7	12
Amortization of Capital	Bullet. \$765,0 million (2023)	4 years, \$112,5 million per semester (2028-2031)
Interest rate	10.5%	7.52%
Annual Interest (average)	\$76,0 million	5% until 2025 (\$47.0 million); 9% through 2031 (\$81.0 million)
Source: MEF – DPED		

## B. Section 1: Information regarding the restructuring of EMATUM's debt

The following analysis takes into account the last agreement in principle reached by the Government of Mozambique with the holders of the EMATUM debt securities (Table A3) regarding the debt restructuring.

The present value of the cost of the restructuring was calculated, that is, the total costs of amortization, interest, and other costs to be paid until the maturity of the loan in 2031. The estimate was made using the financial calculation methodology for the current value of the capital (Present Value) using the following formula:

Where: 
$$Co = \frac{Cn}{(1 + i)^n}$$

Co - Present Value (amount of the loan to be paid based on the frequency of installments)

Cn - Installment (Capital + Interest)

n - Total Number of Installments

i - Interest Rate (or discount rate).

The Ministry of Economy and Finance (MEF), on May 31, 2019, released a new agreement in principle with the Global Group of Mozambique Bondholders (GGMB), whose final version was published in the Official Gazette on 24 September 2019 (GdM 2019).

This scenario considers a semiannual interest rate of 5% until 2024, and 9% from 2024 to 2031. Under this scenario, the Government would have paid, by the end of 2031, a total of USD 1,545.8 million in nominal terms, of which USD 900.0 million in capital (including capitalized interest from 2015 to 2019) and USD 645.8 million in interest. In addition, as previously mentioned, an additional USD 8 million was paid as a consent fee and USD 32 million as compensation for

the exchange of terms regarding the restructuring negotiated in November 2018 (which was never carried out) with the new, longer terms of the September 2019 restructuring.

**Table A4: Calculation of the costs linked to the restructuring agreement (in millions of USD)**

Capital subject to restructuring	900.0
Total interest 2020-2031	645.8
Other restructuring costs	40.0
Overall Total	1,585.8

This agreement conveys the misleading perception that the Government would not use gas revenues to pay EMATUM’s illegal debt - an element that had been included and strongly criticized in the discarded restructuring proposal of November 2018 that intended to issue “value recovery instruments” associated with gas projects in areas 1 and 4 of the Rovuma basin.

**However, in this restructuring incorporated into the current public finance management (PFM) model, the revenues used to service the debt between 2020 and 2031 would include revenues from gas.**

**Table A5. Restructuring Plan for EMATUM**

Restructuring Plan	24 September 2019
Coupon	5% - counting from (but excluding) July 15, 2019 until September 15, 2023
	9% - March 15, 2024 to September 15, 2031
Interest payment method	Current (and late) half-yearly interest to be paid on 03/15 and 09/15, starting in 2020
Maturity	Sept. 15, 2031
Capital	8 equal half-yearly installments of USD 112.5 million on 03/15 and 09/15 during the four years 2028 to 2031
Consent Fee	Up to USD 8.0 million in total for eligible bondholders who vote in favor of the restructuring.
Compensation for the exchange of terms	USD 32.0 million in total to defray the expenses, fees, and non-reimbursed costs that the GGMB will have borne with the negotiation and implementation of the restructuring. The remaining amount of the compensation for the exchange of terms will be distributed among the bondholders pro rata at the conclusion of the restructuring.

However, the new agreement presents the following risks:

- As it has a relatively short maturity period, it will create pressure for the implementation of productive public policies to be placed in the background;
- As it is subdivided into 4 annual (or 8 semiannual) installments of capital amortization, the annual amount to be paid is USD 225 million, which represents a heavy burden on the budget;
- It reveals a strong relationship with gas revenues, since it incorporates an increase in the interest rate by 4 percentage points from 2024 onward, coincidentally when gas exploration begins;
- In addition to the new obligations, the Government is willing to incur a cost of approximately USD 40 million with regard to the consent fee (USD 8 million) and payment for the exchange of terms (USD 32 million).

Considering the contractual terms of these loans that were taken on without State approval, only for the payment of interest the country would have to disburse approximately USD 81.0 million<sup>159</sup> annually, corresponding to 1.8% of the State’s revenue forecast for 2019.

159 7,659.99 million MT at the exchange rate of 62.15 MT / USD on July 30, 2019 from the Bank of Mozambique. Interest was calculated considering the contractual terms of the loans. The reference interest rates considered for the loans were: (i) EMATUM LIBOR 6 months + spread of 3.2%; (ii) MAM = LIBOR 2 months + 7%; and (iii) ProIndicus = LIBOR + 3.75 (Source: <https://www.global-rates.com/interest-rates/libor/american-dollar/2013.aspx>)

## C. Information regarding the other two loans

### Loan for Mozambique Asset Management, S.A. - MAM

On May 20, 2014, the company Mozambique Asset Management S.A. (MAM) signed a financing agreement with VTB Capital<sup>160</sup> valued at USD 535 million. The loan was taken out with the guarantee of the Mozambican Government issued by the Ministry of Finance and aimed at establishing a company providing multiple services to industries in the oil, mining, navigation, ports, and aluminum sectors, including, among other activities, exploration, marketing and representation.

MAM was authorized by the Government of Mozambique to build a shipyard for the construction of vessels in Pemba and three facilities along the coast to provide maintenance services for government vessels, as well as commercial vessels.

The loan amortization schedule was presented according to the following table:

**Table A6: MAM loan**

Amount of the debt (in USD million)	535
Maturity	2019 (4 years)
Grace period	2 years
Starting date for the repayments	23 May 2016
Modality for the repayment	Annually
Amount of the first payment	USD 178 million (including interest at 12-month Libor +7.739%)

*Source: Annual Public Debt Report 2019*

Bank expenses of **USD 35 million**, associated with the contracting of the loan by MAM, were paid to the VTB. This amount was deducted from the total amount financed, with the loan amount to be received by MAM being valued at USD 500 million.

**According to the 2019 Public Debt Report, the first payment of the referred loan was to be made in May 2016, in the amount of USD 178 million.** The same source mentions that, according to the feasibility study, the amortization would also be over 8 years and would generate an accumulated gross revenue of USD 490 million per year and total operating costs of USD 260 million per year, with net revenue of USD 230 million per year. The maturity of the credit would be 6 years, with a deferral period of 2 years

It should be noted that the report in question mentions that the debt service has not been carried out, and the table below shows the unpaid amount for each loan.

**Table A7: Stock of debt service in dispute or in arrears (USD million)**

Amounts in arrears (cumulative)	2017	2018	2019	% of GDP 2019
ProIndicus	151.90	297.31	436.22	3.0%
MAM	343.06	499.12	644.02	4.3%
<b>Total</b>	<b>494.96</b>	<b>796.43</b>	<b>1,080.22</b>	<b>7.3%</b>

*Source: IMF and World Bank Debt Sustainability Analysis (April 2020).*

Generally speaking, negotiations between MAM and the creditors of its debts have been suspended, awaiting the order for legal action to be brought by the Attorney General's Office against the creditor.

Assuming, within the context of this exercise, that eventually the loan to MAM may undergo the same restructuring as the EMATUM loan, the following financial amounts can be calculated:

<sup>160</sup> VTB Capital is a Russian investment bank based in Moscow, founded in 2008.

**Table A8. Calculation of the costs linked to a possible restructuring agreement (in millions of USD)**

Capital subject to restructuring	644.02
Total of interest payments 2020-2031	462.08
Other restructuring costs	40.0
Overall Total	1,146.40

### *Borrowing by ProIndicus, S. A*

In February 2013, ProIndicus S.A. and Credit Suisse bank<sup>161</sup> signed a financing agreement valued at **USD 372 million**. This agreement underwent two amendments, the first on 14 June 2013 and the second on 17 December 2014, in order to allow the contracted amount to be extended to a maximum limit of **USD 900 million**. Both for the original agreement and for the amendments, guarantees were issued by the Mozambican government.

The amount actually disbursed was USD 622 million, USD 504 million by Credit Suisse and USD 118 million by VTB Capital. The funds were directly transferred to the accounts of the contractor Privinvest Shipbuilding SAL in the United Arab Emirates.

The stated objective of the creation of the company was to ensure the development, financing and implementation of an integrated surveillance and security system for the Exclusive Economic Zone, as well as the provision of security services to infrastructures.

Details regarding the ProIndicus loan amortization schedule and modality can be found in table A9 below:

**Table A9: ProIndicus loan**

Amount of the debt (in USD millions)	622
Maturity	8 years
Grace period	3 years
Starting date for the repayments	21 March 2016
Modality for the repayment	Annual
First tranche	USD 24 million (including 12-month Libor + 3.75%)

Source: Annual Public Debt Report 2019

From the contracted amount, bank charges of **USD 10.1 million** were deducted and **USD 64.4 million** was retained to cover expenses with the contractor, with approximately **USD 547.5 million** remaining as disbursement of the loan.

Additionally, it was agreed, within the scope of the amendment to the agreement signed on December 17, 2014, that operating expenses valued at **USD 57.3 million** would be paid to Credit Suisse, VTB and Palomar during the period of effectiveness of the loan. Of this amount, **USD 14.7 million** has been paid to date.

Until the end of 2016, the sum of principal amortizations and interest paid totaled **USD 96.4 million**, of which **71.5 million** in interest and **24.9 million** in capital. Since then, no additional payments have been made.

Also assuming, within the context of this exercise, that eventually the loan to ProIndicus may undergo the same restructuring as the EMATUM loan, the following financial amounts arise:

<sup>161</sup> The Credit Suisse Group is a Swiss multinational investment bank that also provides financial services. The bank was founded in 1856 and has its headquarters in Zurich, Switzerland.

**Table A10. Calculation of the costs linked to a possible restructuring agreement (in millions of USD)**

Capital subject to restructuration	674.0
Total interest 2020-2031	483.6
Other restructuring costs	40.0
Overall Total	1,197.6

## Annex 1 to Chapter 3

### Deliberations of the Monetary Policy Committee during the economic shock period (2015-2017)

In order to contain inflationary and depreciation pressures in the context of the continuing climate of uncertainty in the domestic and international economic environment, the Bank of Mozambique (BM) had to be guided by a restrictive monetary policy. In this context, several measures were carried out between 2015 and the end of 2016.

With the exception of the meeting of the Monetary Policy Committee (*Comité de Política Monetária*, CPMO) of 14 December 2016, No. 09/2016 of the BM, which maintained the key rates and the Coefficient of Mandatory Reserves (*Reservas Obrigatórias*, RO), changes with an almost monthly frequency occurred since June 2015 (see box A1).

#### Box A1: Resolutions of the Monetary Policy Committees in the shock period (2015-2017)

In June 2015: Marginal Lending Facility (Facilidade Permanente de Cedência, FPC) = 7.5%; Deposit Facility (Facilidade Permanente de Depósito, FPD) = 1.5%; and Mandatory Reserve Requirement (RO) = 8.0%

In October 2015: FPC = 7.75% and FPD = 2.0%;

In November 2015: FPC = 8.25% and FPD = 2.75%;

In December 2015: FPC = 9.75% and FPD = 3.75%;

In February 2016: FPC = 10.75% and FPD = 4.25%;

In April 2016: FPC = 12.75%; FPD = 5.75% and Mandatory Reserves (RO) in foreign currency = 15%;

In June 2016: FPC = 14.25% and FPD = 7.25%;

In July, with effect from 22 August 2016: FPC = 17.25%; FPD = 10.25% and RO national currency = 13.0%;

In October 2016, with immediate effect: FPC = 23.25%; FPD = 16.25%; and, as of November 22, 2016, RO of national and foreign currency = 15.50%;

In May 2017, the BM and the Mozambican Association of Banks signed an Agreement on the standardization of the basis for calculating market interest rates (single index), revoking the MAIBOR agreement and introducing the MIMO rate.

In June 2017, the monthly publication of the prime rate, which derives from the single index and the market risk premia, became mandatory;

And, in June 2017, the principle of a single reference exchange rate was introduced.

In October 2016, in response to the domestic economic situation that had been getting worse and worse and always with a view to containing inflationary pressure and the depreciation of the national currency at the level of the CPMO, it was decided to:

- Introduce, with immediate effect, mandatory reporting, three times throughout the day to the Bank of Mozambique, of the exchange rates practiced by commercial banks in transactions with the public;
- Limit, with immediate effect, to a maximum of twice a week, the access of commercial banks on their own initiative to financing through the use of the FPC window; and
- Ensure compliance with the revised target of the Monetary Base (BaM) established for December of that year (2016), which was 103.249 million Meticaís.

The BM's actions were imposed on it due to the dysfunctional fiscal policy, aggravated by the reduction of FDI and the suspension of Direct Budget Support by development partners. In addition, the prevalence of political-military tensions as well as drought and lack of rain in the southern zone contributed to the deterioration of macroeconomic variables. However, the BM's job of maintaining macroeconomic balance was mainly hampered by a government fiscal policy that did not contemplate protecting that macroeconomic balance. Examples of the challenges caused by a weak and undisciplined (expansive) fiscal policy are found in the fact that, in the last months during 2016-2017, the successive interventions of the BM, aiming to implement a more restrictive monetary policy, took place without a clear coordination with fiscal policies, in an economy based on intermediation and not on production, and with a strong dependence on importing goods (even those of basic necessity).

It should be noted that, despite the efforts of the BM, according to the Monetary Policy Committee meeting of December 2016:

“The fiscal performance during the first nine months of 2016 reveals a worsening of the public deficit and an increase in the use, by the State, of domestic financing, affecting the liquidity of the system, with an impact on the trend in prices. Budgetary execution up to September 2016 was characterized by a slight increase in revenue, offset by a substantial increase in expenditure, which contributed to raising the public deficit, before and after grants. More recent data on the State's financial activity in November show that its net position with the national banking system has deteriorated, as a result of greater recourse to domestic financing, which denotes an increase in the fiscal risk on the economy's liquidity and, ultimately, on inflation.”

In other words, what drove the economy into disrepair was not only the existence and discovery of the hidden debts and the impact on the Government's liquidity, but also the uncoordinated and inconsistent responses to the need for adjustment and stabilization of the economy. These inconsistent and uncoordinated responses to fiscal policies, and the need for the BM to implement a more arduous policy than otherwise necessary, magnified the impacts of hidden debts rather than mitigating them.



## Annex 2 to Chapter 3

As shown in chapter 3 in Table 3.2, the losses in real production can be converted into dollar terms to calculate a financial loss. In this annex we show the calculations for our argument regarding an orthodox counterfactual scenario: that without the discovery of the hidden debts, the real growth rate could have continued near the 6.7% per cent growth in 2015.

**Table A3.1. Constant potential GDP growth rate (In millions of USD)**

	2015	2016	2017	2018	2019
(in real terms with respect to 2015)					
A. Real growth of GDP <sup>1</sup>	6.7%	3.8%	3.7%	3.4%	2.3%
B. Variation in the real growth rate of GDP of year “n” minus GDP growth of 2015, in pp		- 2.9	- 3.0	- 3.3	- 4.4
C. Extra-HD factors applied to declines in real GDP (real growth in year “n” minus the real GDP growth in 2015), in pp:					
— trade		- 1.1	- 1.2	- 0.7	- 0.9
— agriculture		0.3	0.2	0.1	- 0.4
— extractive industries		-0.1	0.9	0.0	-1.1
— others		- 0.2	- 1.1	-0.9	- 0.2
— <b>Total adjustment because of extra-HD factors</b>		<b>- 1.1</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-2.6</b>
D. Explanatory percentage points of the HD in the decline in the growth of real GDP (B - C), in pp		-1.8	-1.8	-1.8	-1.8
E. Explanatory percentage of the HD in the decline in the growth of real GDP (D / B)		62.1%	60.0%	54.5%	40.9%
F. Potential GDP in real terms in USD (2015 = 100)	15,944	17,012	18,152	19,368	20,666
Potential GDP growth rate		6.7%	6.7%	6.7%	6.7%
G. Actual GDP in real terms in USD (2015 = 100)	15,944	16,550	17,162	17,746	18,154
H. Difference between actual and potential real GDP in USD	0	-462	-990	-1,623	-2,512
I. Potential losses in GDP imputed to the HD		-287	-594	-884	-1,027
<b>J. Sum of line I</b>					<b>-2,793</b>

Source: Calculation by the authors

Like in the in-text calculation, the methodology takes into account the fact that the Mozambican economy would have faced “extra-HD” challenges (i.e. not linked to the HD) in the counterfactual scenario as in the actual scenario with the HD. The main “extra-HD” factors identified were climatic impacts, volatility of commodity prices that affect exports, and politico-military tensions.

Under the scenario presented in table A3.1, lines F – J of table 3.2 are replaced by the new parameters, with lines A – E remaining the same.

This alternative counterfactual scenario yields lost production of 2.8 billion during the four years 2016-2019. As already mentioned, this is the minimum impact that the HD had on real GDP.

<sup>1</sup> The real growth rate eliminates the impact of inflation on the annual variation in GDP.

## Economic databases (chapters 2-3)

DATABASES	URL (institutional website, or the one “closest” to the data)
Bank of Mozambique	<a href="http://www.bancomoc.mz/">http://www.bancomoc.mz/</a>
World Bank (WB) — Data, reports and press releases on Mozambique	<a href="https://www.worldbank.org/en/search?q=mozambique">https://www.worldbank.org/en/search?q=mozambique</a>
International Monetary Fund (FMI) — Data, reports and press releases on Mozambique	<a href="https://www.imf.org/en/Countries/MOZ">https://www.imf.org/en/Countries/MOZ</a>
National Employment Institute (INEP) — Various bulletins	<a href="http://www.inep.gov.mz/">http://www.inep.gov.mz/</a>
National Institute of Statistics (INE) — Demographic and economic data	<a href="http://www.ine.gov.mz/estatisticas/">http://www.ine.gov.mz/estatisticas/</a>
Jubilee Debt Campaign — Data on public debt in the world	<a href="https://data.jubileedebt.org.uk/">https://data.jubileedebt.org.uk/</a>
Knoema, 2019 — World economic data	<a href="https://knoema.com/">https://knoema.com/</a>
Ministry of the Economy and Finance  — State budgets, various years — Revised state budget, 2016 — General State Accounts (CGE), various years and volumes. — Budget execution, reports from various years — Public debt, reports from various years — Signed financing agreements for the three companies, EMATUM, MAM e ProIndicus	<a href="http://www.mef.gov.mz/">http://www.mef.gov.mz/</a>
Attorney General of the Republic (PGR)	<a href="https://www.pgr.gov.mz/">https://www.pgr.gov.mz/</a>
Administrative Court  — Reports and reviews of the CGE, various years and volumes	<a href="https://www.ta.gov.mz/Pages/RelatoriosPareceresCGE.aspx">https://www.ta.gov.mz/Pages/RelatoriosPareceresCGE.aspx</a>

## Databases on governance, institutions, and political analysis (chapter 4)

DATABASES	URL (institutional website, or the one “closest” to the data)
Afrobarometro — Various surveys	<a href="https://afrobarometer.org/countries/mozambique-0">https://afrobarometer.org/countries/mozambique-0</a>
Economist Intelligence Unit — Democracy Index	<a href="https://www.economist.com/graphic-detail/2020/01/22/global-democracy-has-another-bad-year">https://www.economist.com/graphic-detail/2020/01/22/global-democracy-has-another-bad-year</a>
IMF — Fiscal Transparency Evaluations — General Mozambique data page	<a href="https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Mozambique-Fiscal-Transparency-Evaluation-42686">https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Mozambique-Fiscal-Transparency-Evaluation-42686</a>  <a href="https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/SSQ/MOZ">https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/SSQ/MOZ</a>
International Budget Partnership — Open Budget Survey	<a href="https://www.internationalbudget.org/open-budget-survey/country-results/2019/mozambique">https://www.internationalbudget.org/open-budget-survey/country-results/2019/mozambique</a>
Mo Ibrahim Index of African Governance	<a href="http://mo.ibrahim.foundation/iiag/">http://mo.ibrahim.foundation/iiag/</a>
PEFA — Public Expenditure and Financial Accountability assessment	<a href="https://www.pefa.org/assessments?&amp;c_ids[]=158">https://www.pefa.org/assessments?&amp;c_ids[]=158</a>
V-Dem (Varieties of Democracy) — Various indicators and indexes	<a href="https://www.v-dem.net/en/online-graphing/">https://www.v-dem.net/en/online-graphing/</a>
World Bank Governance Indicators	<a href="http://info.worldbank.org/governance/wgi/index.aspx#home">http://info.worldbank.org/governance/wgi/index.aspx#home</a>

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