

# Sovereign Wealth Fund proposal for Mozambique must be approved urgently

- Parliament must assume its role as defender of the rights of Mozambicans

Por: Rui Mate

## 1. Introduction

The Bank of Mozambique (BoM) published, in September 2020, a proposal for the creation of a Sovereign Wealth Fund (SWF), with the objective of maximizing gains from natural gas revenues, and from other non-renewable natural resources, and thus minimizing undesirable macroeconomic impacts from an excessive inflow of revenues into the economy. However, since the proposal was presented it has not yet been approved by the Government for subsequent submission for discussion and approval by Parliament. Considering its importance, the Parliament can take the lead for its creation.

The country is expected to collect about USD 96 billion over the lifetime of the natural gas exploration projects, i.e. an average of USD 3.2 billion per year over about 30 years. This average represents about 48% of the total revenues projected in the 2022 budget. In this sense, if the projections come true, there will be a substantial increase in the state's financial resources which, on the one hand, may ease the pressures in the search for resources for public spending and reduce the pressure on the use of credit and, on the other, due to its magnitude, create distortions in the economy and, instead of being a blessing, become a curse.

In the rationale document, the BoM states that “the creation of a Sovereign Fund is a government decision and the best time for its creation is before the start of the massive inflow of revenues from non-renewable natural resources”<sup>1</sup>. This position of the BoM is in line with the need to gradually, before receiving large volumes of revenues, begin to establish the fund to gain management maturity, so that when the country starts to receive large volumes of revenues, the management capacity of the fund is consolidated, minimizing the various risks of an abundance of resources and also of poor management of revenues.

It is expected that the country will receive, in 2022, approximately USD 34 million with the start-up of the FLNG Coral Sul project in the Rovuma Basin, the second project in the gas sector to enter the production phase, after Sasol. In this context, CIP presents a descriptive analysis of the current dynamics surrounding the proposal for the creation of the Sovereign Wealth Fund, proposing the need to revise the proposal and resume discussions in order to approve it as soon as possible.

The analysis recommends, in general, the intervention of the Mozambican Parliament for: (i) the defense of the rights of Mozambicans, approving a Sovereign Fund law that is transparent and inclusive, (ii) the review and periodic publication by the Ministry of Finance, Bank of Mozambique and Ministry of Mineral Resources and Energy of the sector's revenue forecasts and details that allow for public scrutiny of major decisions on the use of extractive resources, and (iii) the need to ensure that the resources being exploited today also benefit future generations.

<sup>1</sup> [https://bancomoc.mz/fm\\_pgLink.aspx?id=352](https://bancomoc.mz/fm_pgLink.aspx?id=352)

## 2. Analysis

The Sovereign Wealth Fund (SWF) model proposed by the Bank of Mozambique (BoM) pursues two objectives, namely the accumulation of savings and the stabilization of the fiscal sector. The first objective is to balance the needs of present and future generations, and the second objective is to insulate the budget and the economy from the adverse impacts of commodity price fluctuations on international markets. In relation to development, the proposal indicates that resources will be directed to investments in infrastructure, to be managed by the Government through the State Budget (SB).

The proposed Sovereign Fund model will be financed, until the 20th year, by 50% of the total gross revenues from the extractive sector (derived from hydrocarbon exploration (gas and oil), minerals and metals) and, from the 21st year on, by 80% of these same revenues. The remainder will be channeled to the State Budget. The BoM warns, in the proposal that “the creation of the fund should be before the beginning of the massive inflow of revenues from non-renewable natural resources and this decision is up to the Government.”

### 2.1 Updates should be made to the revenue projections that underpin the creation of the sovereign wealth fund prior to its approval

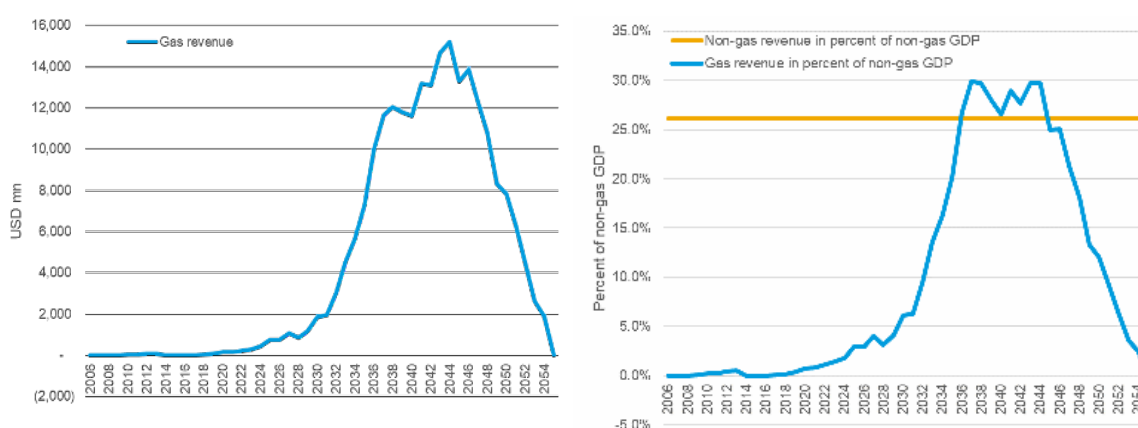
According to IMF projections from 2019, gas projects, could generate over \$200 billion over the life of the projects, which is equivalent to about \$12 billion per year. This is equivalent to about 27% of GDP per year, this at the peak of the project, to occur between the years 2037 and 2045. At this stage, revenues from gas would exceed revenues from the other sectors. After this phase, revenues from this sector would show an accelerated decline. See graph 1 below

Since these are very high volumes of resources, the Sovereign Fund would be an ideal mechanism for managing these revenues to avoid the risks arising from the lack of capacity of the national economy to absorb this volume of revenues, thus avoiding the resources being cursed.

It was expected that the two largest gas projects operating in the Rovuma Basin, respectively the area 1 project led by Total Energies (Mozambique LNG) with an investment estimated at around 20 billion US dollars<sup>2</sup>, and the area 4 project, led by Exxon Mobil (Rovuma LNG) with an estimated investment of about US\$ 30 billion,<sup>3</sup> entry into operation as of 2023.

Considering these projections, and the Medium Term Fiscal Scenario (MTFF) 2022-2024, revenues from the extractive sector would represent about 70% of State revenues, which shows greater availability of its resources, above its absorptive capacity (currently the average contribution of the extractive sector is 8%). This factor justifies the existence of a mechanism such as the Sovereign Fund for the management of this revenue stream. According to IMF projections from 2019, Mozambique would reach, in 2024, a real GDP growth of 11.5%<sup>4</sup>.

Chart 1: Projected total government revenues in the optimal scenario for the Area 1 and Area 4 Rovuma Basin projects (USD million)



Source: taken from the document “Developing Gas Reserves in Mozambique: Revenue Impact”<sup>5</sup>

2 <https://mzlmg.totalenergies.co.mz/>

3 <https://www.voaportugues.com/a/investimento-da-exxon-na-bacia-do-rovuma-poder%C3%A1-ser-abandonado-disse-wall-street-journal/6281716.html>

4 <https://www.imf.org/-/media/Files/Publications/CR/2019/1MOZEA2019002.ashx>

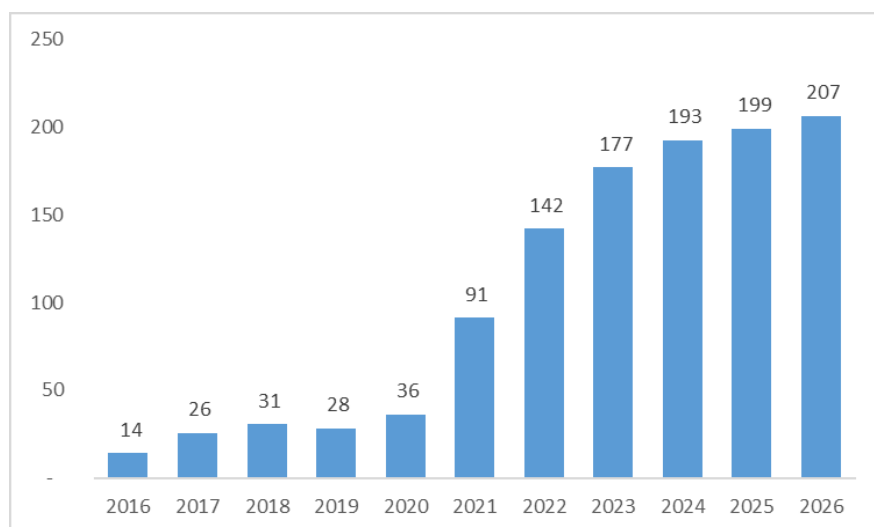
5 [https://bancomoc.mz/fm\\_pgLink.aspx?id=352](https://bancomoc.mz/fm_pgLink.aspx?id=352)

However, in the last 2 years events have negatively affected the sector: i) the Covid-19 pandemic, which negatively affected the extractive sector in its entire value chain (prices, production, distribution and commercialization); ii) the intensification of military attacks in Cabo Delgado, which led to the shutdown of the company Total Energies in 2020, with no concrete forecast of return<sup>6</sup>; iii) the constant postponements by Exxon Mobil in making a final investment decision on its project in area 4<sup>7</sup>; and iv) the climate conference held in 2021, COP26, which presented new agreements in the scope of reducing the use of fossil fuels in order to reduce the emission of greenhouse gases, dictating new contours in investments in this sector all over the world, including Mozambique<sup>8</sup>.

When the Sovereign Fund proposal was designed, it was expected that about \$200 million in revenues would be collected from extractive projects, a figure that should be reached by 2023. However, updated IMF projections as of December 2021, show that this amount of revenue could not be reached until 2026. (See chart 2 below)

Therefore, it is important to revise the proposal because of the scenario that has changed, due to the factors mentioned above, at the risk of approving a proposal that does not consider the current context, and that will possibly harm the management of the fund's revenues because it is based on assumptions that are no longer realistic

Chart 2: Total Government Revenues - 2016-2026 (millions of US dollars)



Source: Built on IMF data, December 2021

In 2022 the FLNG Coral Sul project in the Rovuma Basin, the second project in the gas sector to come on stream after the Temane project, operated by Sasol, comes on stream<sup>9</sup>, about 10% of the 2022 State Budget. However, it is worth remembering that this is one of the smallest projects of the sector in that area compared to the other two whose future is currently uncertain. In this regard, there is a need for the government to publish regularly updated scenarios and also refer to negative scenarios to manage public expectations, given the uncertainty of gas revenues.

6 In early February this year, Total Energies' CEO stated that the company will resume operations in the Rovuma gas exploration projects when peace is established, that is, when safety is guaranteed not only for the company but also for the civilian population, which will not happen in 2022. - [https://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk.technology.mozambique/files/files/Patrick\\_Pouyanne-TotalEnergies-10Feb22.pdf](https://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk.technology.mozambique/files/files/Patrick_Pouyanne-TotalEnergies-10Feb22.pdf)

7 [https://www.rtp.pt/noticias/economia/petrolifera-exxon-volta-a-adiar-decisao-final-de-investimento-no-gas-de-mocambique\\_n1301870](https://www.rtp.pt/noticias/economia/petrolifera-exxon-volta-a-adiar-decisao-final-de-investimento-no-gas-de-mocambique_n1301870)

8 <https://www.bbc.com/portuguese/internacional-59274397>

9 <http://www.inp.gov.mz/pt/Noticias/Presidente-da-Republica-faz-Discurso-Historico-num-Dia-em-que-a-Plataforma-Coral-Sul-FLNG-foi-Baptizada-e-Enviada-a-Mocambique>

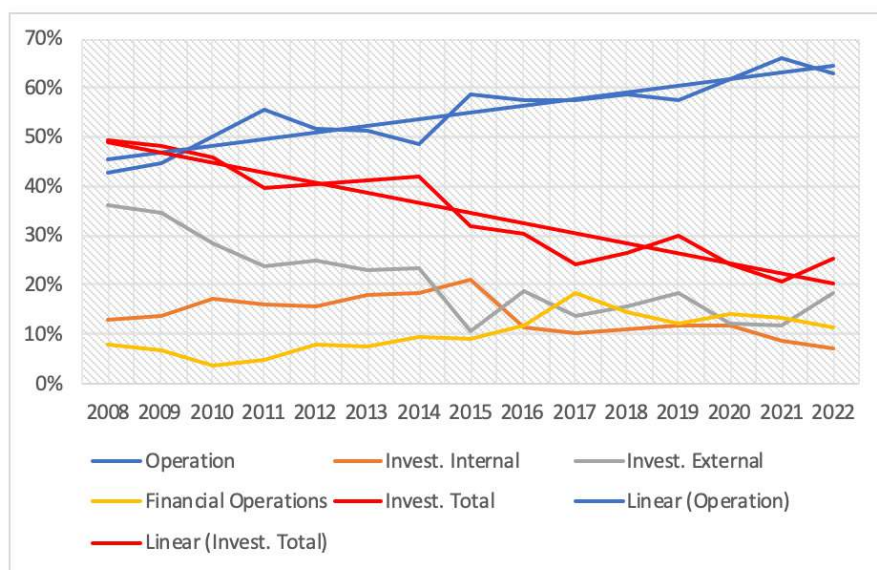
## 2.2 There is need to secure benefits for future generations with the revenues from the extractive sector that the government already receives

Mozambique still lacks infrastructure and basic services that should be prioritized to ensure the well-being of the population, and thus one may question the rationality of saving while there are basic needs to be met immediately. The creation of savings is not the only mechanism to ensure that future generations benefit from the extractive resources that are exhaustible<sup>10</sup>.

The government can guarantee benefits for future generations by investing in health, education, and productive infrastructure. However, if we look at the government's investments over the last 15 years, we can see that in terms of investment there is a downward trend to the detriment of operating expenses which only benefit present generations by guaranteeing the payment of current expenses i.e. consumption.

With the graph below, we can see that in 2008, investment expenditure represented 49% of the State Budget. However, in 2022; the same expenditure represents 26%, a reduction of 23%. In the same period, operating expenses increased by 20%, which shows the preference of the State for consumption and not investment.

Graph 3: Percentage evolution of the main aggregates of State Expenditure (2008-2022)



Source: CGE several years (2008-2019), State Budget (2021 and 2022)

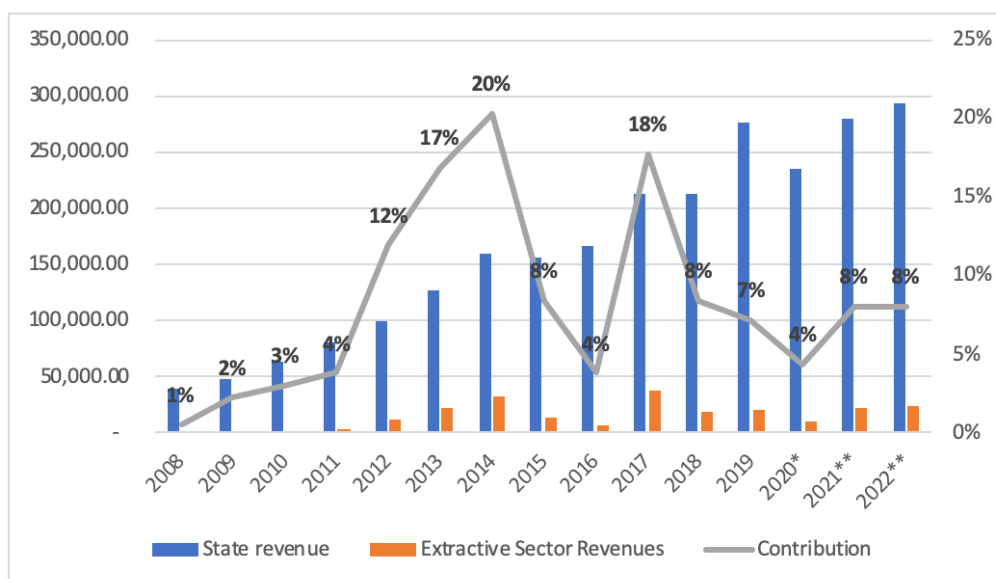
The data presented in graph 4, below, refer to the revenues of the State and the extractive sector between 2008 and 2022. These figures show that in 15 years, the government received<sup>11</sup>, The extractive sector has contributed with an average of 8% per year to State revenues, with hydrocarbons being the largest contributor of the two non-renewable extractive resource sectors<sup>12</sup>.

<sup>10</sup> [https://bancomoc.mz/fm\\_pgLink.aspx?id=352](https://bancomoc.mz/fm_pgLink.aspx?id=352)

<sup>11</sup> It should be considered that the years 2021 to 2022 are forecasts according to the average of the previous years

<sup>12</sup> See EITI reports for more details on each sector's contribution to total state revenues

Chart 4: Total gross revenues of the extractive sector (2008-2022)



Source: EITI Reports (2008-2019), RPCGE (2020) and average-based precision (2021 and 2022)

The failure to create savings for future generations is contrary to the principle generally accepted by several countries, including Mozambique, that the benefits from the exploitation of non-renewable resources should be intergenerational, i.e. should benefit current and future generations through the creation of savings and other mechanisms that can ensure that all generations benefit from the exploitation of these resources.

The President of Mozambique, and head of State, defended at the opening of the conference to launch discussions on the FS for Mozambique, with the theme “Preparing Mozambique for the Natural Gas Era,” that “with a well-structured savings mechanism and modern management and governance standards, we can transform the gains from non-renewable resources into the generation of renewable resources that will benefit our generations and future generations in perpetuity”<sup>13</sup>. Considering that there is an alignment between the Sovereign Fund proposal and the Government’s thinking the question is, what is missing for its creation? This question can be clarified by the entity that gave the BoM legitimacy to present the proposal on the creation of the Sovereign Fund. In the public documents available about the Sovereign Fund it is not clear.

The National Development Strategy 2015-2035 (under review) defines that the resources generated should be channeled to investments in human capital formation, infrastructure construction, research and innovation, and diversification of the productive base<sup>14</sup>. This action would be a mechanism to guarantee benefits for future generations from the exploitation of resources through these development bases that would be created. However, the reality does not seem to be this, as demonstrated by the distribution levels of State spending in Chart 3, presented above, which shows that resources are being spent on current expenses and not looking at future generations.

## 2.3 Key details are missing in the publicly presented Sovereign Fund proposal

According to the Sovereign Fund proposal presented by the BoM, in the first 20 years of the fund, 50% of total gross revenues from the extractive sector should be channeled to savings and stabilization, but without indicating the percentages that will be allocated to each of these two objectives.

The indication of the amounts foreseen for savings may help to understand the rationality of the proportion of revenues that is intended to be earmarked for this objective. It is worth remembering that the decision of the proportion of revenues to be saved or spent should be made considering the short and long term. In the short run, one should consider both the magnitude of the revenues and the short-term effects on the economy if spent immediately. In the long run, one should consider the returns to savings compared to the rate paid on government debt. The idea is that if the returns on the Sovereign Fund are lower than the rate paid on public debt, then it makes sense to reduce debt rather than accumulate reserves<sup>15</sup>.

<sup>13</sup> <https://www.dn.pt/lusa/pr-mocambicano-defende-criacao-de-poupanca-das-receitas-dos-recursos-naturais-10730081.html>

<sup>14</sup> <https://www.mef.gov.mz/index.php/publicacoes/politicas/estrategias-nacionais/397-estrategia-nacional-de-desenvolvimento/file?force-download=1>

<sup>15</sup> [https://www.cabrisbo.org/uploads/files/Documents/postition\\_paper\\_2016\\_fiscal\\_and\\_budget\\_policy\\_revenue\\_management\\_cabri\\_revenue\\_management\\_in\\_the\\_extractives\\_sector\\_in\\_africa\\_portuguese.pdf](https://www.cabrisbo.org/uploads/files/Documents/postition_paper_2016_fiscal_and_budget_policy_revenue_management_cabri_revenue_management_in_the_extractives_sector_in_africa_portuguese.pdf)



Considering this rationale, it would be important that details be publicly presented about the values to be channeled to the Sovereign Fund, namely, of the 50% to be channeled to the fund what is the percentage for savings and what is the percentage for stabilization. Show the details of what are the expected returns of the values to be saved, the operational costs of the fund in order to verify if the size of the fund justifies such costs and how its creation will affect the State Budget.

## **2.4 Parliament should be more proactive in the process of creating the Sovereign Wealth Fund**

The Sovereign Fund proposal presented by the BoM clearly indicates that it is up to the government to approve the creation of a Sovereign Fund and that the best time would be before the start of the massive inflow of revenues from non-renewable natural resources. The government already receives revenues from the non-renewable extractive resource sector which should guarantee benefits for all Mozambicans i.e. the current and future generation. The spending of the revenues from this sector, through the State Budget, is destined for consumption and not for investment (see graph 3 above), contrary to the principle of intergenerational benefits from these resources, either through savings or through investments in structuring sectors that can guarantee the bases for sustainable development. Although the Sovereign Fund proposal presented by the BoM still lacks some improvements, it is a mechanism that can help improve the management of revenues from the extractive sector of exhaustible resources.

Based on the above dynamics, one can conclude that the current government, despite public speeches, has no interest in creating the fund. In this context, it is crucial that Parliament, in its role as legislator and representative of the interests of the people, takes the lead in creating the fund in order to ensure that the benefits of the extractive resources are effectively for all Mozambicans, of this and future generations.

Although the expected revenues from gas exploration in the Rovuma Basin are the largest source of funding for the Sovereign Fund, the government is already collecting revenues from other extractive projects which should form the basis for learning how to manage the resources of this sector transparently. This should happen before the large volumes of resources expected from the Rovuma Basin projects come in. This reinforces the idea of the key role to be played by the Parliament to ensure these benefits.

In its proposed law on the Sovereign Fund, Parliament should include key aspects to ensure transparency and better management of the fund, such as: i) the need for the manager of the FS to be selected through a public tender, which would then be approved by Parliament; ii) defining single terms of office which would be for different periods of time than the political mandate; iii) mandatory publication of independent external audit reports online, and reports by the Administrative Court; and iv) include an independent and multilateral oversight which would report periodically on the management of the fund.

The Sovereign Fund proposal should also safeguard the national interest, i.e. the managers of a future Sovereign Wealth Fund should be accountable to parliament in order to avoid political pressure from the government of the day, which often tends towards short-term and electioneering goals. This might allow the Fund to be managed with some equidistance from politico-electoral struggles and the potential appetites of political elites.

### 3. Conclusion and recommendations

In general, the Bank of Mozambique's proposal of Sovereign Fund presents key elements for a transparent management of the fund and which may make it possible to achieve the defined objectives. However, there are elements that are of great concern, for example, the structural changes that have occurred in the last two years, which have altered the forecasts for the sector. Also of concern are the reasons for the delay in the creation of the Sovereign Fund, the use of the revenues from the resources of the extractive sector, especially considering that the State has already received resources from the exploitation of this sector since 2004, with the start of production by the multinational SASOL, which explores natural gas in Pande and Temane, and that in 2022 another important project, the Coral FLNG project, will come into production with a considerable contribution to the revenues of the sector. In this sense, it is recommended that:

- i.* Parliament:
  - Legislate on the management of revenues from the extractive sector through a document that is solid enough to resist the partisan wars and appetites of political elites; and
  - Greater involvement in the creation of the Sovereign Fund and building the technical-institutional capacity of parliamentarians for this and other matters that require their direct involvement.
  
- ii.* To the Government, Ministry of Economy and Finance and Bank of Mozambique
  - The resumption, with greater speed, of discussions on the Sovereign Funds;
  - The publication of details of the percentages and values to be channeled to savings and economic stabilization, as well as the expected returns on the values to be saved and invested;
  - The presentation of the expected operating costs of the fund, in order to contribute to the verification of the rationality of the creation of the fund, given the operating costs; and
  - The periodic publication of updated scenarios of the fund's forecasts to manage public expectations, given the uncertainty of gas revenues and the need for a more detailed analysis of the fund's performances.

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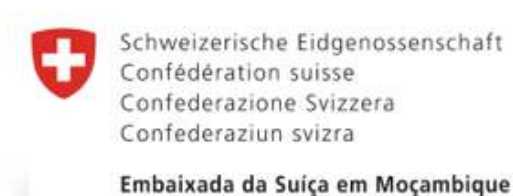
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