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THE DRAFT LAW ON THE SOVEREIGN WEALTH FUND PRESENTED BY THE GOVERNMENT IS DYSFUNCTIONAL TO MEET THE PROPOSED OBJECTIVES

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1. Introduction

After several public debates on the need to establish a mechanism to manage the revenue from the exploration of natural resources in Mozambique, in January 2023, the Government finally submitted for approval by Parliament, the Draft Law that creates the Sovereign Wealth Fund of Mozambique (SFM), a bank account domiciled at the Central Bank of Mozambique.

To be established with the aim of leveraging socio-economic development, budget stabilization and savings for future generations, the aforementioned draft law submitted to Parliament, in CIP's opinion, still has many weaknesses. The weaknesses extend from the definition, the scope, the mechanism for access to the fund to the transparency of its management.

Given the above scenario, there is a need to review the draft law to ensure it can reflect the proposed objectives as well as to make sure that it is aligned with the principles of good governance.

2. Comments about the Draft Law on the Sovereign Wealth Fund of Mozambique

In general, the SFM draft law presents weaknesses that may undermine the fund's intended objectives. The weaknesses can be described in the following aspects:

- i) ***Problems of scope. The SFM that is intended to be created will only capture revenues from the production of liquefied gas from areas 1 and 4, offshore of the Rovuma basin and future oil and natural gas development and production projects. This claim ignores the existence of other projects in the sector which can also contribute significantly to the objectives of the fund. The question that may be raised is why is it intended to capture only part of the revenue from the projects mentioned and leave out not only other projects, but also other revenues such as VAT and IRPS (Individual income tax)?***
- ii) ***Lack of practicality in complying with the revenue distribution quotas between the State Budget (SB) (60%) and the SFM (40%). Given that the aspects invoked in the draft law are recurrent events in the country, it can be said that the distribution quotas between the State Budget and the SFM are unlikely to be observed in practice. Therefore, the proposal presented makes the SFM a mere transitory account to feed the State Budget and not a sector revenue management mechanism to promote long term development or savings.***
- iii) ***Limitation of transparency due to the confidentiality clause in the disclosure of information deriving from the SFM management. Therefore, there is a need to redefine this clause. It should be clarified that confidentiality should be in the sense of limiting or prohibiting the use of privileged information of the SF,***

by its direct or indirect managers, for their own benefit, as established in the Santiago Principles, and not presented as it is in the draft law.

- iv) **The attribution to the Government of the power to regulate structuring aspects, far from public scrutiny, and the remission of the approval of general non-structural aspects to the Parliament, constitutes a weakness in the draft Law that should be reviewed. The Government can approve whatever suits it, even if it may compromise the performance of the FS.**
- v) **The problematic governance structure of the “bank account” referred to as the SFM gives excessive powers to the Government and the Bank of Mozambique. The Government and the Bank of Mozambique are not, at present, credible and transparent institutions. On the one hand, the role which the Government has assigned itself should be better represented by the Parliament, where there is room for public participation. On the other hand, the Bank of Mozambique is a non-transparent institution, as evidenced by the audit reports on its accounts in recent years;**
- vi) **Lack of clarity in the arrangements for the presentation of accounts, as manifested by the absence of criteria for selecting auditors and the role of the Administrative Court.**

Therefore, before the approval of the Law, there is a need to improve the proposal to be submitted to the Parliament in order to safeguard the above mentioned aspects and thus ensure that the SFM, to be created, may contribute to the intended objectives, observing the Principles of Good Governance (transparency and accountability).

3. Proposal of articles to be reviewed

No.	ARTICLE	COMMENTS
1	Article 1(2) Establishment and nature	<ul style="list-style-type: none"> – The Santiago principles consider the SWF (Sovereign Wealth Funds) to be a special purpose investment mechanism. SWFs hold, manage or administer assets to achieve predetermined objectives. In this sense, it is questionable whether a bank account has a legal personality to hold, manage and/or administer assets that a SWF is supposed to have. – The question raised by CIP has to do with the rationality of creating a structure to manage a bank account that will only have incoming and outgoing amounts.
2	Article 5(1) Revenues from SFM	<ul style="list-style-type: none"> – One of the objectives of the fund is to ensure that the exploitation of extractive resources benefits current and future generations, as these resources are exhaustible. – The draft law presents as revenues for the fund, those from the production of liquefied natural gas from Areas 1 and 4, Offshore of Rovuma Basin, and future projects of development and production of oil and natural gas, and the return on investments of the fund itself. – CIP believes that the exclusion of other projects that already operate and contribute significantly to state revenues should be well founded, such as the Sasol project, heavy industry projects in various parts of the country, coal and precious minerals projects.
3	Article 5(2) Revenues from SFM	<ul style="list-style-type: none"> – CIP believes that there is a need to explain the reason behind the exclusion of other taxes paid by companies, such as VAT and IRPS. – There is a need to clarify why it is necessary to submit to government regulation the incidence of revenue from production bonuses and also from production sharing. Why can't it be already defined in law, as happens with the other taxes?
4	Article 6 Transitional Account	<ul style="list-style-type: none"> – The existence of a transitional account is problematic in principle, as it will absorb large amounts of money. – The question is: why do the amounts not flow directly into the SWF account and the CUT, according to the defined distribution criteria? – For how long will the amounts remain in the transitional account until they are transferred to the fund account? – How will the interest that may be generated during the transition time be handled? – Who will manage the transitional account? – Why leaving the regulation of this account to the Government and not defining it in a general and clear way in the law?

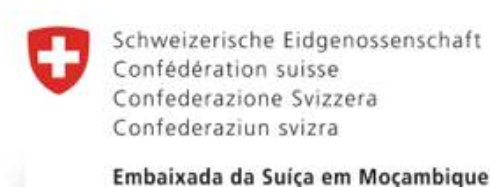
5	Article 7 Single SFM Account	<ul style="list-style-type: none"> - This article seems to contradict article 1, which states that the nature of the SFM is that of a bank account. In this article it is stated that the SFM has a bank account. The question is: is the SWF a bank account or does the SWF have a bank account?
6	Article 8 Projections and deposits of revenue at the CUF	<ul style="list-style-type: none"> - In paragraph 2, it is important to clarify which institution is responsible for determining the average prices of the projections. As paragraphs 4 and 5 point out, the projections affect actual transfers to the fund and to the State Budget. - There is the risk of the projections being overestimated and avoiding channelling to the fund, or underestimated to ensure greater channelling to the fund. In this sense, the institution responsible for the projections will have an important role in whether the budget or the fund receives more, or whether both receive reasonable amounts within projections that are close to reality. - In this case, the institution making the projections can be held responsible for the large deviations that can occur. - Paragraphs 4 and 5 are repeated in Article 9 where they are thought to be better framed than in Article 8.
7	Article 9 Transfers from the CUF to the State Budget	<ul style="list-style-type: none"> - Paragraph 1 is a repetition of paragraphs 4 and 5 of Article 8. - Paragraph 2 is very confusing. It should be clarified what is meant; - In paragraph 3 it is necessary to define a limit for these exits because it puts the continuity of the fund at risk. It speaks of a higher percentage without defining a limit for this percentage, which leaves it to an arbitrary decision by the Government to define what limit it will transfer to the State Budget;
8	Article 11 Investment of SFM resources	<ul style="list-style-type: none"> - Since this is a sovereign fund, CIP believes that the investment policy should be approved by the Regional Parliament, where there is the possibility of hearing other stakeholders in Mozambican society. Approval should be for a period longer than the Government's political mandate. If this decision is delegated to the Government, the risk of responding to party political issues is much higher.
9	Article 12 Domestic investments	<ul style="list-style-type: none"> - Paragraph 1 of this article seems to contradict the objective of the creation of the SFM. Article 8 indicates that the revenue sharing will be 40% to the fund (CUF) and 60% to CUF-OE, for the first 15 years. Number 1 of article 5 establishes that the revenue of the SFM comes from the revenues of Areas 1 and 4, Offshore of the Rovuma Basin and future projects of development and production of oil and natural gas, and from the return of the investments of the fund itself. And number 2 of the same article establishes the tax base. - It is understood that the 60% deposited in the CUT-OE is for the objective of economic and social development of the country, materialized through the State Budget. - However, article 12(1) restricts the use of the 60% of revenues, stating that the revenues earmarked for the investment objectives are those coming only from the production tax, IRPC and capital gains. It excludes, in this case, production bonuses, production sharing and profit oil. - Another aspect that needs to be clarified is domestic investments for macroeconomic stabilisation. What are these investments? - The fact that this article is not clear and that number two refers to government regulation, number 1 of this article, opens space for the government, far from public scrutiny, to make decisions which are detrimental to the transparency of the use of the funds since they will be used through the State Budget, which is not very transparent and does not provide sufficient detail to allow monitoring of the investments referred to in this article.
10	Article 14 Prohibitions on the use of CUF resources	<ul style="list-style-type: none"> - The first comment in this article is about the harmonisation of terms. Is the prohibition on using CUF resources or SFM resources? - The second refers to paragraph b) which states that it is forbidden to use the resources of the fund to pay debt and debt service without going through the State Budget. However, as long as they pass through the State Budget, these funds can pay debt. Considering that in this proposal the Government refers much of the matter to its regulations, using its discretionary power in the regulation, this paragraph may constitute a risk for the use of values of the fund for payment of debts.

11	<p>Chapter IV</p> <p>Governance and management of the SFM</p>	<ul style="list-style-type: none"> - CIP believes that, in this proposal, the Government attributes more power to itself than is really necessary, since this is a sovereign fund whose power should be concentrated in the Parliament, which is the representative of the people. The Government attributes to itself central aspects of regulation and management of the fund that should be regulated by law. The HR is relegated to a secondary role of monitoring and creation of the oversight committee. - The Government, in this proposal, assumes critical roles that should be of the Parliament, such as: i. approval of the SFM's investment policy, ii. establishment of the SFM's Investment Advisory Board, iii. authorization of the signature of the SFM's Management Agreement with the institution that will manage it, and iv. management of the international public tender for the selection of the fund's management institution, whose mandate should be different from that of the Government. - CIP does not agree that the Bank of Mozambique should manage the fund, as established by law. If it wished, the Bank of Mozambique could compete with other institutions through a public tender that would determine the best proposals; - The fact that the Government has the power to decide on the amounts to be paid to the Bank of Mozambique constitutes a risk of lack of transparency. Added to this is the fact that the management of the Bank is in the hands of people appointed by the Executive, and also the problem of the audits of the Bank of Mozambique, which repeatedly show reservations about its accounts. All these elements, which can be summed up as a lack of sufficient independence and respectability, exacerbate the scepticism regarding the management of the Sovereign Fund by the Bank of Mozambique. - The question that can be asked, even within this draft law, is why should the Bank of Mozambique be paid to manage a bank account? CIP believes that only if it were an autonomous entity that administers the mechanism for managing state revenues, and not a bank account, would it make sense for it to be remunerated for such management, on the condition that it returns positive results. It makes no sense for the Bank of Mozambique to receive 0.1% (about 740 thousand dollars annually) to manage a bank account.
12	<p>Article 32</p> <p>Good Governance Transparency, accountability and audit</p>	<ul style="list-style-type: none"> - It would be important in this draft law to have explicitly referred to which Santiago Principles were considered in order to make clear what is meant by Good Governance, Transparency, Accountability and Auditing in the light of these principles. - As it is a sovereign fund, transparency is one of the basic requirements for its operation. Article 32, by prohibiting the disclosure of information about the fund, by natural and legal persons with direct and indirect involvement, violates this right to information and contradicts the other articles and Santiago Principles referred to. - Risk with this article is always to be invoked when fund managers are questioned about information about the fund.



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