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MOZAMBIQUE'S SECRET DEBT: THE IMPACT ON THE STRUCTURE OF THE DEBT AND THE ECONOMIC CONSEQUENCES

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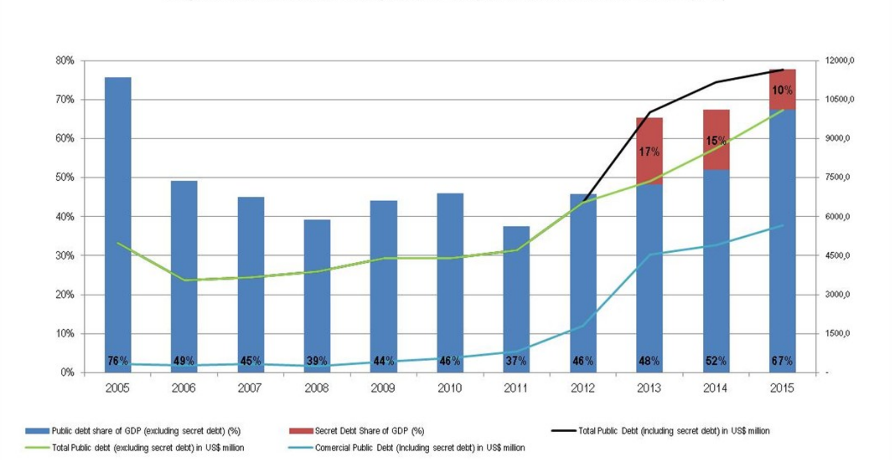
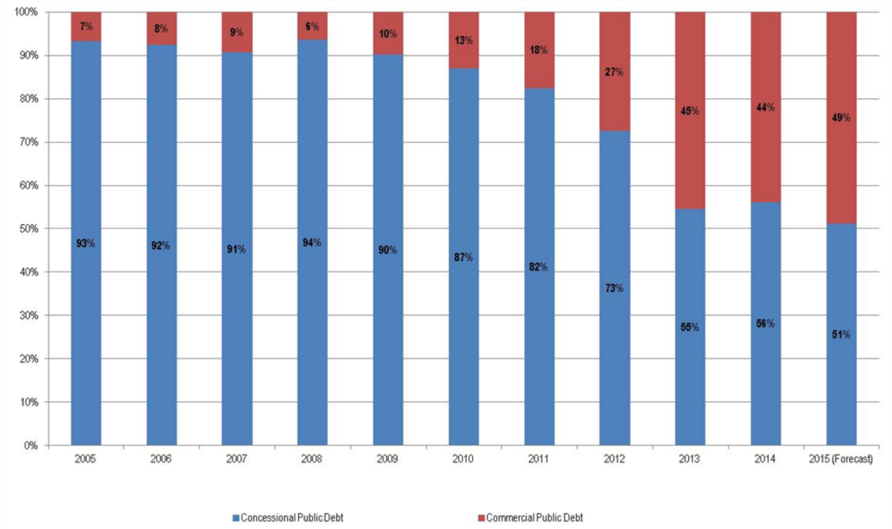
This issue of IDeIAS, part of the series on Mozambique's public debt, discusses the impact of the secret loans on the debt stock, and on the structure and the economic consequences of the Mozambican public debt. Information on the public debt is either not available, or is inconsistent between different official documents. It is excessively aggregated and is vague about the terms and stages of repayment. The data used here are available in the Annual Debt Report, in the *Conta Geral do Estado* (General State Account), and in the *Parecer da Conta Geral do Estado* (the opinion of the Administrative Tribunal - the body that checks the legality of public expenditure - on the General State Account), as well as in official speeches.



Graph 1: Volume of Public Debt (in million US$) and Public Debt Share of GDP (in %)



Graph 2: Concessional and Commercial Share of Total Public Debt (in %)

STOCK AND STRUCTURE OF THE PUBLIC DEBT

Before the recent revelations about the secret debt, the Mozambican public debt had already been growing exponentially. Excluding the secret debt, between 2006 and 2015 the total public debt tripled, from US$ 3.5 billion to more than US$ 10 billion. The commercial debt increased eightfold, from US$ 300 million to US$ 2.4 billion. The engine for the growth of the public debt was the commercial debt (more expensive, shorter term, and more difficult to renegotiate), which grew 13 times more quickly than the GDP and reached 34% of the total public debt, In 2015, the non-secret debt was already 67% of GDP (compared with 39% in 2008), clearly beyond the limits of macro-economic sustainability.

The secret loans amplified a problem that was already worrying. The loans to Proindicus (US$ 622 million), to Mozambique Asset Management (US$ 535 million) and to the Ministry of the Interior, MINT, (US$ 221 million), all on commercial terms, increased the total public debt stock to at least US$ 11.6 billion, or 78% of GDP, the highest level since 2005. The commercial component of the total public debt increased to 49%, 70% of which is foreign debt.

WHY IS THIS SCENARIO WORRYING?

Whether the exponential growth of debt constitutes a problem or not depends on the size and structure of the economy, the structure and the causes of the debt, how it is used, the repayment terms and the macro-economic consequences. There are countries with larger debt stocks than that of Mozambique and who continue to contract debt, because their economies accommodate indebtedness and their productive capacity expands in such a way as to sustain the debt service without running into crises. In the case of Mozambique, the national economy is very vulnerable, particularly when exposed so abruptly to the international financial markets, because of its dependence on imports, for consumption and for investment, and on a small number of primary products for export to volatile markets and with high rates of product substitution. So when the economy expands, imports tend to grow more rapidly than exports. Rapid indebtedness results from this dynamic of dependence and consolidates it. Along with a significant increase in the deficit on the revenue account, over the same period the value of exports has contracted because of the fall in the prices of primary products, and imports have increased in line with the expansion of the economy. The balance of payments crisis is masked by the entry of foreign capital, in an initial phase, but is shown when the economy begins to service the debt. Furthermore, the domestic public debt, financed above all by the sale of debt securities at high interest rates, contributes towards making the domestic financial system more speculative. The fact that the debt is increasingly commercial adds two problems: it is more expensive, with shorter payment periods, and it is more difficult to renegotiate and restructure without additional costs. Finally, the bulk of the debt was used for weaponry or for large scale investment projects, of doubtful return and priority, and which are very long term. Thus they do not generate a capacity to service the debt in the short and medium term. The combination of these factors increases the risks for investors and the costs of capital, as well as the interest rates on the debt, making it more expensive, more difficult to service and hence more capable of reproducing itself, making it difficult to mobilise resources, inside and outside the economy, to service the debt and for development.

The restructuring of the EMATUM debt delayed until 2023 the repayment of the capital, but increased the interest. Between 2015 and 2023, the State will pay US$ 1.4 billion in interest and capital, for the loan of US$ 850 million that EMATUM will be unable to pay (and this excludes the company's operational deficit which, in 2015, was about US$ 20 million). This sum could increase because the interest rate on the EMATUM debt titles has risen by 177 base points, because of the country's financial situation. By 2021, the State will have to mobilise more than US$ 1.4 billion to pay the loans of Proindicus and MAM. There are other loans which fall due by 2023. The capital of these loans, excluding the interest, amounts to US$ 4 billion. We have excluded from these calculations part of the interest on US$ 4 billion (because the terms of this debt are not known), the domestic public debt service (about US$ 300 million, to be paid by 2019) and the concessional debt.

The secret debts annul the momentary relief of the debt service, in the short and medium terms, which resulted from the restructuring of the EMATUM debt. While the delay on amortising the EMATUM capital until 2023 has reduced the annual debt charge for this company from US$ 200 million to US$ 78 million, the secret loans add more than US$ 253 million a year to the foreign debt service (US$ 119 million for Proindicus and US$ 134 million for MAM). The conditions for repaying the debt of US$ 221 million contracted by MINT have not yet been divulged. Hence, if the State assumes these debts, the foreign debt service could be greater in 2016 than it was in 2015, when it was equivalent to about 25% of exports and 10% of public revenue.

In short, between 2006 and 2014, the total public debt service tripled, due to the increase in the domestic debt service (which rose from US$ 62 million to US$ 171 million) and of the foreign debt service (increasing from US$ 63 million to US$ 176 million). From 2014 to 2015, the foreign public debt service almost doubled, rising to about US$ 335 million, due to the inclusion of EMATUM. The inclusion of Proindicus and MAM could make the foreign debt service rise to over US$ 500 million, equivalent to 30% of exports and 17% of public revenue. The amount of domestic debt service in 2015 is not yet available, but it is likely to have increased because of the effect of the increase in the reference rates of the Central Bank.

Furthermore, the officially declared debt stock could be lower than the real debt stock. The debt stock reported by the National Treasury Directorate and in the State accounts is calculated based on the disbursements made and not on the loans contracted by the government in the year in question. For example, the loan for the Maputo Ring Road was contracted in 2012, but the debt was registered in the following years as the disbursements took place. There are major projects under way, such as the Maputo-Katembe bridge, where the loans have not yet been fully disbursed. Hence, the current real public debt stock could reach US$ 14 billion.

Where will the government look for resources to deal with the debt service? In a context where investment in the various social sectors is less than the basic needs, what will be the possibilities, the limits and the impact of cuts in public expenditure to deal with the debt? The European experience shows how the public debt, contracted to rescue private finance capital, ends up weighing on social security, education and health: the Portuguese government cut 40% of the expenses of the national health sector between 2010 and 2014, so that it could finance the debt costs of the financial sector, without entering a debt crisis: for its part, the British government cut 150 billion pounds sterling from health, education and social security over the past five years for the same reasons. In the case of Mozambique, the government has already announced cuts in non-essential expenditure, some privatisations of public assets and other measures. One of the next IDeIAS, in this series, discusses these questions in greater depth.

The public debt has become the second largest source of investment in the economy, which makes it an indicator of the main directions the economy will follow in the future. In Mozambique, more than 60% of the growth in the public debt is linked to financing the large scale infrastructure and service projects, in line with the dynamics of private investment, the purchase of defence and security equipment, and the construction of public buildings. These projects serve large capital which exploits the natural resources, without linkages to the development of a broader productive base: Proindicus, EMATUM and MAM, linked to the gas ad coastal defence, amount to US$ 2.2 billion; Nacala airport, the Nacala Special Economic Zone, the Beira port cargo terminal, the Chimuara-Nacala and Caia-Nacala electricity transmission projects, which together total US$ 1.2 million, are linked to the mining and export of coal, the Maputo-KaTembe bridge and the Maputo ring road, amounting to US$ one billion, are intended to improve vehicle traffic and ease overcrowding on the roads of Maputo City, which does not have a functioning public transport system. Most of these projects do not deal with the main problems of the economy, such as the narrowing of the productive base and the incapacity to substitute imports and to generate decent jobs on a large scale. Instead they feed the extractive character of the economy, concentrated round its extractive core (the mineral-energy complex and other primary commodities for export), and exacerbate its trends towards financial and real estate speculation.

These questions show that the dynamics of the public debt both reproduce and are the result of the vulnerabilities of the economy and tend to generate further indebtedness, as well as revealing the limits that indebtedness imposes on the possibilities of transition to a diversified and articulated productive base, oriented towards improving the living conditions of the majority of Mozambicans. The high and expensive levels of debt limit the possibilities of the State intervening in basic social sectors, put pressure on the economy, and, within the framework of the macro-economic management used, lead to restrictive monetary policies, which make still more difficult and expensive the access to funding of small and medium Mozambican companies. The high debt costs impose domestic indebtedness as a means of financing the State, which increases the costs of capital, limiting financing and making the debt more expensive. Potential future revenue from strategic national resources is already mortgaged with the debt and with investment in these sectors, which limits the possibilities of making use of these resources to build a non-dependent economy, with a broadened, diversified and articulated base, which could substitute imports, create decent jobs and improve the living conditions of Mozambican workers.