



PFM Processes as Key Anti-Corruption Tools

Dr. Adriano Nuvunga
Executive Director
Center for Public Integrity
Maputo, Mozambique

CONTEXT

The effective use of financial resources is one of the biggest challenges for Africa's development.

The Government , as the purveyor of the resources meant to benefit the population of a country, needs to manage these scarce resources efficiently.

Critically, efficiency is dependent on efforts to limit corruption.

Africa could be a creditor to the rest of the world, but its financial structures have given rise to tax avoidance schemes —the main roots of corruption:

- Africa is losing US\$50 billion per year to corruption (HLP on Illicit Financial Flows , 2015).

Commercial corporations have learnt how to “milk” the system and are by far the biggest culprits of implanting corrupt practices.

But also banks have facilitated the movement of capital linked to corrupt activities.

Furthermore, banks are failing to help Africa repatriate illicitly transferred funds and prosecute perpetrators.

The discovery in April 2016 of loans obtained by the Mozambican Government not authorized by Parliament has intensified the focus of civil society on corruption.

CIP has given priority to publications on corruption (an overview is presented in “The Costs of corruption to the Mozambican Economy” May 2016).

A quick overview of CIP

Founded in 2005 as a **watchdog** to “promote integrity in the public domain through the denunciation of corruption and advocacy of good governance in managing the public good”.

Its **guiding principles** are integrity, transparency, prevention of corruption and good governance.

CIP is operating along **four Pillars**: Anti-Corruption, Extractive Industries, Public Finance, and PPP., with investigative journalism as a cross-pillar.

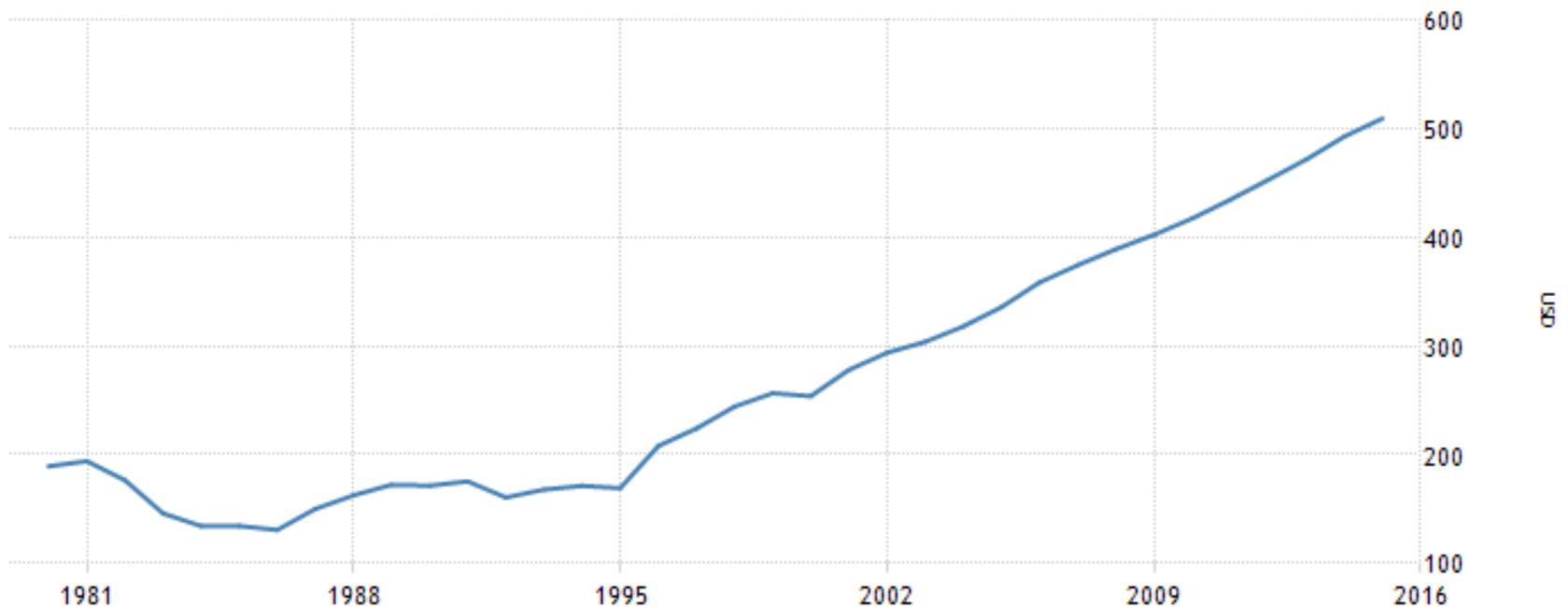
Its **products** include newsletters, studies, articles, workshops, media adverts, and appearances on television and radio.

ECONOMIC CONTEXT

Mozambique's civil conflict (1976-1992) drained the country of resources and know-how. GDP/capita was US\$ 1,182 in 1975, but reached a low of US\$ 150 in 1986.

Good improvement since then, but more progress is needed.

MOZAMBIQUE GDP PER CAPITA



Economic growth was helped by a 2006 Highly Indebted Poor Countries (HIPC) debt rescheduling, reducing the debt-to-GDP ratio from 140% in 2001 to 40%.

During that period, Mozambique's legal and institutional framework was brought into line with good practice.

This boosted Mozambique's international standing, but it also made Mozambique chronically dependent on foreign aid:

- further progress became possible only with the financial aid of DPs
- attracting private sector capital required showing fiscal discipline, hence the need for IMF programs.

During this economic recovery phase, corruption grew, reflecting the fact that only one party (FRELIMO) has been in power since Mozambique's independence in 1975:

- This resulted in domestic resource mobilization not being optimal and many expenditures being unproductive, both of which are signs of corruption:
- the former, because it points to institutional weaknesses of the Mozambican Tax Authority
- the latter, because it implies that funds are being spent without generating income to repay borrowed money (either from DPs or the Central Bank).

However, while donors took notice, corruption levels did not impede the flow of aid—even though it was becoming progressively worse.

Important aspects of Mozambique's PFM tools were left unattended in view of the emerging corruption-enhancing risks, notably:

- (a) off-budget expenditure risks, especially as regards state-owned enterprises;
- b) weak links between investment planning, debt sustainability, and the medium-term fiscal framework; **and**
- (c) lack of enforcement of the Government's legislative anti-corruption package (*Pacote Legislativo Anti-corrupção*, PLAC).

By neglecting these areas, the Government has sown the seeds of a further growth of corruption--particularly worrying in view of the intensifying exploitation of natural resources.

CIP estimates that corruption during 2002 - 2014 cost **US\$ 4.9 billion**, or 30% of GDP in 2014--much higher than the average for many other African countries.

• Performance in the *TI Corruption Perception Index* has highlighted the worsening corruption, with a ranking of **142nd /176** in 2016 (in 2015, Mozambique was ranked **122nd /168**).

• Mozambique's *Ibrahim Index of African Governance* declined during 2012-2015. There was decline in **Safety & Rule of Law**.

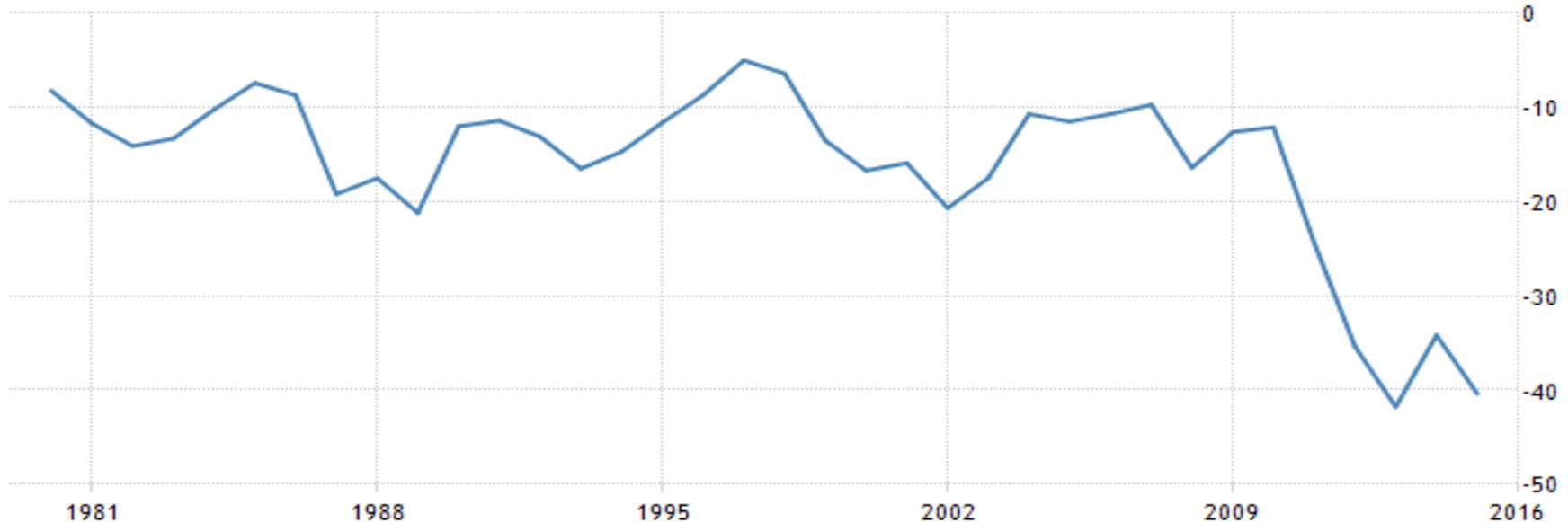
• Mozambican businesses surveyed for the 2015-2016 *Global Competitiveness Report* ranked the country **133rd / 140** (compared to **130th** in 2010-2011). **Corruption** was one of the top 3 problems for doing business in the country.

Challenges facing Mozambique's economy

When commercially viable hydrocarbon deposits were found in the early 2000s, related FDI helped raise real GDP growth above 5% since 2003.

But as the global financial crisis of 2008 depressed RM prices, Mozambique's BOP current account fell from an average deficit of 11% of GDP in 2004-2010 to some 35% of GDP in 2013-2015.

MOZAMBIQUE CURRENT ACCOUNT TO GDP



The weakening of government institutions is at the forefront of Mozambique's corruption:

- The failings of government oversight institutions has affected PFM processes.
- The politization of economic decision-making is leading to costly inefficiency by neglecting the:
 - registration of transactions;
 - formalization of the decision-making process; and
 - monitoring of implementation of government policies.

Bottom line: with the hope of a **major windfall** from future natural resource production, Mozambique has fallen into the “**precourse**” **curse**: spending money from assets that are still in the ground.

ILLICIT FINANCIAL FLOWS

The country was shocked when in April 2016 the Wall Street Journal reported the existence of US\$ 1.1 billion of **secret debts** contracted in 2013 and 2014 with government guarantees to two Mozambican public enterprises:

--Pro-Indicus (US\$ 622 m) and Mozambique Asset Management (MAM) (US\$ 535 m), on top of US\$ 850 m contracted for EMATUM in 2013.

Obtaining the loans had ignored the limits on government guarantees set by Parliament for 2013 and 2014. Also, the National Directorate of the Budget, by not raising red flags, was **hiding the financial transactions** from the Mozambican people.

The Government and the **financial institutions** Credit Suisse and the Russian VneshTorgBank (VTB) were complicit in arranging the secret debts.

The Government has not presented a full explanation of the utilization of the funds, but the involvement of **shadow companies** has been perceived.

The reaction by economic agents was immediate and firm:

--Firstly, **donors** suspended all direct budget support (some US\$ 269 million in 2016).

--Secondly, the **IMF** halted its 3-year Stand-By Credit Facility (only inked in December 2015), and announced that it would require an international forensic audit of the loan transactions before it would resume program discussions.

--Thirdly, **private investors**, scared by the withdrawals of international support in the context of weak raw material prices, quickly curbed their investment activities.

--Fourthly, **civil society** (including CIP, which published many articles on the topic) started a campaign of informing the public and challenging the Government to provide full information to its citizens.

The halting of FX flows, plus the need to service the illegal debt, forced the Government to turn to central bank credit:

--The official exchange rate of the Metical in September 2016 was some 77 per US\$, a depreciation of 37% since end-2015.

--The twelve months August - August 2016 inflation rate rose to 22.0%, compared to 2.3 % for the comparable period in 2015 (the inflation rate for all of 2016 was 23.5%).

--However, the need for FX to service the secret debts proved too large, and the Government incurred debt arrears.

These negative developments caused a significant decline in standard of living for the man in the street, given Mozambique's open economy (importing much of its basic necessities, including foodstuffs).

THE WAY FORWARD

The answer to resolving the current disarray of fiscal policies is multi-faceted:

a) The Government has to publish an **independent forensic audit**, which needs to shed light on the events surrounding the illegal debts

b) **PFM procedures** have to be strengthened by:

--the Government admitting the weaknesses of its PFM checks and balances

--keeping up pressure from civil society to sensitize legislators to force the Government to bring about reforms in PFM processes

c) engage the **private sector to strengthen governance aspects** in their dealings with Government (notably procurement aspects; CIP is leading the Business Integrity Country Agenda in Mozambique).

d) Macroeconomic equilibrium has to be restored

Fiscal policies are still in denial of resource constraints resulting from the cutting of budget support and the drying up of private sector capital.

Economic conditions are also being affected by the climate conditions (drought/hurricane), and the politico-economic effects of the smoldering conflict between the Government and the opposition (RENAMO).

The Government needs a credible program to restore macroeconomic equilibrium. However, with the imbalances already grown, there will be noticeable short-term pain. But doing nothing will only increase that pain and cause a crash landing.

e) **Legal aspects:** The Government needs to implement the recommendations of the Court of Auditors (TA) to legalize the debts contracted by adhering to the provisions of Article 179 of the Constitution.

An increase in government guarantees had not been approved by the National Assembly (NA), so that the debt became illegal.

The NA cannot oblige the Government to comply with those recommendations, but ignoring this legal requirement will incur a loss of confidence (which in other contexts could culminate with the Government's impeachment if approved by the NA).

CONCLUSIONS

Corruption in Mozambique that originated from under-invoicing schemes has evolved into an asset stripping of the Government by contracting illegal debts.

The initial step in remedying the situation is expected to be the publication of the audit report. The publication should lead to a strengthening of PFM processes, and civil society has to keep up the pressure in that regard.

CIP's focus is on sensitizing legislators and citizens to strengthen their understanding of the situation and to try to channel public discontent into constructive action that leads to stronger application of PFM controls.

The experience with the illegal debt has shown that checks and balances exist in principle but are insufficient to prevent the actions of a few officials harming the country as a whole.

The most important step, and the most difficult, is therefore for the Government to accept this fact and engage in internal reforms to strengthen their oversight.

With the economic imbalances grown, there will be noticeable short-term pain.

But half hearted reforms will only increase that pain and cause a crash landing.

THANK YOU!

QUESTIONS ARE ENCOURAGED