



### RECOMMENDATIONS

- The Mozambican government should integrate its hydrocarbon investment strategy with wider development goals to ensure resource extraction generates meaningful benefits for the economy and population. It should strive to attract investors with capital and expertise to develop the gas and mining sectors, and ensure that capital-intensive ‘mega-projects’ result not just in enhanced industrial productivity but also in local job creation and infrastructure development.
- National authorities should revise existing regulations of the gas and mining sectors to enhance accountability and transparency in the collection and management of new revenue streams, and to ensure that these remain in Mozambique. The government should also take demonstrable steps to curb corruption and state interference in extractive industries to enhance investor confidence.
- Foreign donors should define an alternative strategy for their engagement with Mozambique, ideally replacing direct budgetary support with sectoral funding that complements hydrocarbon development. Such a strategy should focus on maximising potential for resource wealth to promote broader development outcomes through programmes building capacity and human capital in resource-rich regions.

# What does Hydrocarbon Wealth mean for Foreign Aid in Mozambique?

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### EXECUTIVE SUMMARY

Recent discoveries of vast gas and mineral resources in Mozambique are attracting unprecedented levels of foreign investment and could transform the country into a major African energy producer. New hydrocarbon-derived revenue streams are likely to supplant Mozambique’s chronic dependence on foreign aid, consequently, reducing donors’ leverage over domestic policymaking and budget processes. Potential resource wealth affords commercial opportunities that could undermine the dominant North–South channel of aid and influence in Mozambique, but it will probably not bring an end to external dependence. Mozambique remains reliant on foreign investment for resource extraction, and many of the attendant risks of hydrocarbon development parallel those associated with aid dependence. It is unclear whether the government will surmount significant obstacles to ensuring that resource wealth spills over, and whether foreign donors will be able to redefine engagement to support the government in aligning hydrocarbon-driven growth with broader development.

### DONORS’ DARLING?

Mozambique gained independence in 1975 as one of the most underdeveloped countries in the world, its economy fractured by liberation warfare and the mass exodus of Portuguese settlers. The brutal 17-year insurgency war that followed devastated the state’s remaining economic basis and infrastructure. Macroeconomic and fiscal reforms, foreign aid, and political stability have facilitated recovery since the end of war in 1992. In the last decade annual growth has averaged over 7%.<sup>2</sup> The World Bank now considers Mozambique one of Africa’s best-performing economies. Donors hail the country

as a success story of post-Washington Consensus development.

However, contrary to such constructions of a model case of post-conflict reconstruction, Mozambique remains an exceptionally poor country. Macroeconomic achievements seem to be disconnected from the population, most of whom live on less than \$1.25 a day, and impressive growth has not translated into job creation or reduced income inequality. Despite receiving about \$2 billion a year in foreign aid, Mozambique was ranked the world's fourth least-developed country in 2011.<sup>3</sup> Since the government abandoned Marxism–Leninism and joined the Bretton Woods Institutions in the mid-1980s, substantial international aid has flowed into Mozambique. With annual aid inflows averaging between one-fifth and one-quarter of gross national income<sup>4</sup> and direct funding to the government's budget accounting for about half of revenues<sup>5</sup> in recent years, Mozambique remains heavily dependent on foreign donors.<sup>6</sup>

External dependence and the pervasive scale of aid inflows raise questions about 'ownership' of Mozambican politics, particularly because they have allowed foreign donors to exercise considerable influence over domestic policymaking. As the most politically influential bloc of donors in Mozambique, the G19 group of Western aid organisations that directly fund the state budget is central in this debate.<sup>7</sup> The G19 is the largest group of its type in sub-Saharan Africa. It dominates policy processes with the Mozambican government, maintains deep control over spending, and constitutes a sort of para-state apparatus.<sup>8</sup> Discord between the government and the G19 came to a head in 2010 with the *crispação* (literally, friction or tension) in relations that resulted in donors cutting off aid owing to concerns about electoral reform, transparency, and inadequate measures to tackle corruption and conflict of interest. The situation worsened when the police killed a dozen people during civil riots over rising food prices and with publication of data indicating a reversal in poverty-reduction trends. Although the G19 resumed budget support later that year, the group's subsequent threats to withhold funding continue to demonstrate the leverage of foreign aid over both Mozambique's domestic decisions and its international relations.

## HYDROCARBON WINDFALL

Recent announcements of vast hydrocarbon resource discoveries in Mozambique suggest that the country's

dependence on international aid could be on the verge of a substantial shift. In October 2011 US and Italian energy giants, Anadarko and Eni, announced discoveries of enormous gas fields off the coast of Cabo Delgado, about 2 000 km north of Maputo. Estimates of gas reserves in the concessions operated by Anadarko and Eni have since doubled and tripled, and, according to the latest appraisals, recoverable natural gas now totals at least 70 trillion cubic feet.<sup>9</sup> These findings represent an approximate value of \$800 billion – 36 times larger than Mozambique's current economy.<sup>10</sup> It is thought that Mozambique could be home to more gas than all the reserves in Norway, which would position the country among the top-20 global natural gas suppliers.

Enormous mineral findings in Mozambique's interior – including coal, iron, tantalum and heavy sands – add to the magnitude of recent gas discoveries. Mozambique's Tete Province hosts one of the largest-known untapped coal reserves in the world. Mining forecasters speculate that annual output will leap to about 40 million tonnes in five years and reach 100 million tonnes in a decade.<sup>11</sup> Mineral investors are descending on Tete from across the globe, and analysts expect the value of the mining industry to reach \$667 million in 2015, up from \$96.5 million in 2010.<sup>12</sup>

The potential windfall from these prodigious discoveries means that Mozambique is becoming a target for global energy investment on an unprecedented scale. Anadarko intends to develop an \$18 billion liquefied natural gas (LNG) plant and export terminal – the largest-ever investment in the country – and Brazilian mining company Vale SA has announced plans to invest \$8 billion in mining and rail services. The scale of Mozambique's resource wealth and the investment it is attracting signal potential for the hydrocarbon sector to become the central driver of the country's future growth. With accelerated investment in mining under way and gas flows expected to come on line in the next two to four years, resource exploitation could provide the government with significant new revenue streams in the near future. Beyond cash flows from state-controlled holdings in extraction projects and exports, Mozambique stands to gain from taxes, royalties and mining rights, and through development of the country's gas and minerals sectors. Because Mozambique has so little heavy industry, hydrocarbon investment also has the potential to fuel broader economic and industrial growth in some of the most underdeveloped areas of the country.

## WHITHER FOREIGN AID?

Natural resource production represents an opportunity for Mozambique to develop new commercial relationships initiating a shift away from the dominant North–South channel of foreign aid and influence. The potential for a reorientation towards the East and South is indicated by the swiftness of multinationals based in countries including India, Malaysia and Brazil to invest in hydrocarbon extraction, as well as multimillion dollar bilateral agreements with China and Japan amid a global race to secure access to natural resources. Additionally, given Mozambique’s strategic location on the Indian Ocean and that demand for natural gas is rising by nearly 20% a year in Asia, recent findings represent a large potential source of supply for Eastern consumers. Compared with Western donors, new ‘unconventional’ commercially minded investors take less interest in Mozambican domestic issues or policymaking. As such, Mozambique should be able to exercise significantly more negotiating power through these new commercial opportunities than its dependent relationships with Western donors have heretofore permitted.

Future large-scale investment and production in the hydrocarbon sector will have a significant impact on Mozambique, as new revenue streams could supplant the government’s dependence on international aid. Consequently, the capacity of foreign donors to influence governance and spending will probably decline and result in the government gaining autonomy in policymaking.<sup>13</sup> New resource wealth will change the terms of the debate over ‘ownership’ of Mozambican politics. This debate has often linked ownership and external dependence, but these resource discoveries are not likely to signal the end of external dependence in Mozambique. Rather, potential resource-derived revenues represent a new sort of external dependence on foreign capital and consumption. Mozambique is acutely reliant on external investment for gas and mineral exploitation, a particularly salient vulnerability in relation to the capital, infrastructure and technology required to deliver its resources to market. The state has enjoyed a ‘free carry’ from multinationals that has insured risk in exploration projects, but in order to maintain a stake in next-phase extraction, the government may need to agree to financing from corporate partners, which will only reinforce dependence.<sup>14</sup>

## PARALLEL RISKS

Many of the attendant risks of natural resource extraction in Mozambique parallel those associated with dependence on foreign aid. First, undiversified exports generate vulnerability to price and demand volatility. In this paradigmatic macroeconomic sense, reliance on market conditions constitutes another type of external dependence with some degree of comparison to *crispação*-prone donor relations. Second, like aid inflows, hydrocarbon resource exploitation can provoke rent-seeking processes that threaten growth, stability and governance. The experiences of African oil producers such as Angola, Sudan and Nigeria, in which resource wealth and commodity price volatility have contributed to chronic reliance on market conditions and socio-economic underdevelopment, attest to these risks. Although oil is monetised more easily, these issues can also apply to gas, given its heightening currency in global energy supply.

Corresponding to challenges of ‘aid effectiveness’, another parallel concern is that the profits from an extractive industry-based growth model will not benefit Mozambique’s economy and population directly. To date large-scale foreign energy investment in Mozambique and the government’s ‘mega-projects’<sup>15</sup> have not resulted in meaningful gains for the economy, state budget or employment.<sup>16</sup> It seems unlikely that new large-scale investments, such as Anadarko’s \$18 billion LNG unit, will deliver more positive results, given that highly capital-intensive projects inherently involve limited links between expenditures and the domestic economy and create few local jobs.

Finally, a reliance on foreign investment (whether donor aid or commercial capital) may orient government accountability towards external actors rather than Mozambican society. Hydrocarbon wealth presents Mozambique with the hazard of the ‘resource curse’, which could be exacerbated by donors’ reduced capacity to pressure governance reform. The extent to which hydrocarbon revenues will benefit the population relies on the government’s creation of systems that promote the role of Mozambicans in exploration and extraction, including links to domestic services and local labour, as well as of a framework to collect and manage new revenue streams that ensures enhanced transparency and accountability. To avoid social unrest, the government should also endeavour to build consensus between

affected communities, energy companies, national institutions and local structures.<sup>17</sup> These measures, in addition to demonstrated reductions in corruption and conflicts of interest, will not only increase the likelihood of socio-economic spillover but will also increase investor confidence. The government's challenge is thus to embed gas and mining investment projects in its poverty-reduction plan and wider development strategy.

## CONCLUSION

Still rebuilding from the destruction wrought by two successive wars, Mozambique lacks critical infrastructure, particularly in its gas- and mineral-rich northern regions, and will require considerable investment and technology to bring its resources to market. This means that the main revenue windfall and meaningful development benefits derived from recent discoveries are a long way off. Nonetheless, hydrocarbon development will have a major impact on Mozambique and its dependence on foreign aid as the government gains access to new revenue streams that do not involve a trade-off with policymaking independence.

The Mozambican government faces a challenging set of tasks to ensure that natural resource profits stay in the country and will deliver socio-economic benefits. This represents an opportunity for foreign donors to redefine their engagement with Mozambique to support the government in aligning hydrocarbon-driven growth with broader development. Strategic reorientation will require replacing budget support with targeted sectoral programmes and considerable coordination between aid missions, donor nations and the G19. If donors are able to recognise their changing role in Mozambique, such a shift from conventional modes of interaction has the potential to benefit Mozambique enormously. But with no exit strategy from their 'success story', it remains uncertain whether foreign donors will be able to let go of their darling.

## ENDNOTES

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