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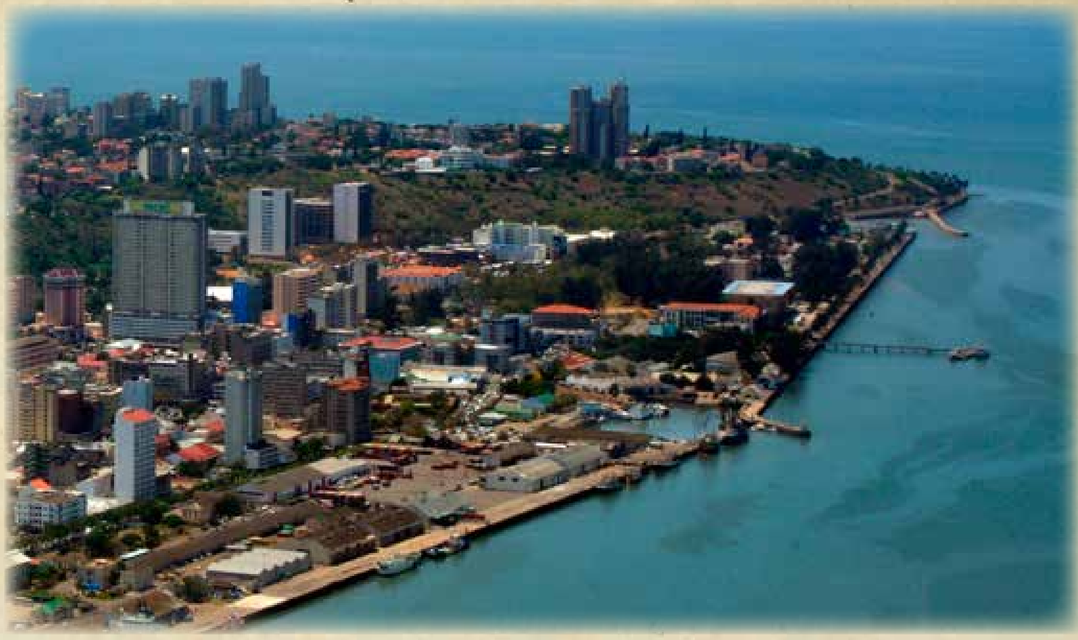

Corruption and state-backed debts in Mozambique
What can external actors do?

Aled Williams
and Jan Isaksen

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Abstract

The average annual cost of corruption to Mozambique was recently estimated to be up to USD 4.9 billion for the period 2004-2014. Although some analysts have entertained the idea that investments in the country's oil and gas sector could reach as high as USD 100 billion over the next decade, Mozambique recently faced a turn for the worse in its balance of payments problems because semi-public entities took out government-backed debts worth over USD 2 billion without fulfilling constitutional and legal requirements. These loans illustrate the mechanisms by which illicit financial flows not only leave developing countries to other locations in the global economy, but also flow back into them, bypassing formal oversight mechanisms and lending rules. We encountered credible allegations that a small group of individuals within the Mozambican state violated laws to secure the loans and initially avoided public control mechanisms. Major financial discrepancies exist in terms of the use of the three loans and international development partners and domestic stakeholders suspect some form of corruption. An international firm will implement an independent audit financed by the Swedish government to look into the loans. The audit findings, and investigations by UK and Swiss financial regulatory bodies, will provide a focus for monitoring and evaluation work, possibly leading to criminal and administrative sanctions.

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Introduction

A 2016 study by the Centro de Integridade Publica and the Chr. Michelsen Institute (CIP-CMI 2016) estimated the average annual cost of corruption to Mozambique, as observed during the period 2004-2014, to be up to USD 4.9 billion. Although this figure is a snapshot and open to contestation, the study provided rare empirical insight into the overall degree to which corruption has an effect on the Mozambican economy. Some have taken the rosy view that investments in the country's oil and gas sector could reach USD 100 billion over the next decade (IMF 2015). Yet corruption concerns recently coalesced when the Mozambican government approached the International Monetary Fund (IMF) for emergency balance of payments assistance (De Renzio and Nuvunga 2016). Shortly after the first disbursements of an IMF loan, it was revealed that semi-public entities linked to the security sector had taken on debts backed by government guarantees without submitting them to the Assembly of the Republic for assessment, approval and monitoring, as required by paragraph 2 of article 179 of the Constitution of the Republic of Mozambique (Fórum de Monitoria do Orçamento 2016a). The state-backed debts were taken on by Mozambique Asset Management (MAM, USD 535 million), ProIndicus (USD 622 million) and *Empresa Moçambicana de Atum* (Ematum, USD 850 millon). The sources of the debts were, in the case of ProIndicus, loans from Credit Suisse and VTB Bank, and in the case of the MAM loans, VTB Bank. The Ematum loan was raised on the European bond market.1 A coalition of 26 Mozambican civil society organizations has called on the government to launch a forensic audit of the country's domestic, foreign, concessional and commercial debts, including the total amount of state guarantees issued to private companies (Fórum de Monitoria do Orçamento 2016a).2 The same civil society coalition has also called on Mozambique's Central Office for Combatting Corruption (GCCC) to conduct an investigation to determine criminal and civil liabilities in relation to the loans. At the time of writing, financial disbursements from the IMF and general budget support (GBS) from the G14 group of foreign donors to Mozambique had been suspended pending an audit. The Mozambican Attorney General's Office has announced that an independent audit will be implemented by the firm Kroll financed by the Swedish government (Hanlon 2016c). The national financial regulatory bodies of the United Kingdom and Switzerland are also investigating the loans (Club of Mozambique 2016c, Reuters 2016b).

This recent Mozambican case illustrates a version of the narrative commonly referred-to in development cooperation discourse as *illicit financial flows* (IFFs).[3] IFFs are widely acknowledged as being bad for development because they reduce the capital available for investment and negatively affect economic growth (see, for example, Fontana and Hearson 2012, Reuter 2012, UNECA 2015). Financial flows can be illicit for different, though overlapping reasons: the funds may come from illegal sources (such as corruption or drug smuggling), or the process of transferring funds may be illegal, even if the funds themselves come from legal sources (Fontana and Hearson 2012). The allegation with regard to the Mozambican case is that the *process* surrounding the state's backing of private debts owed to foreign creditors was domestically *unconstitutional* and that, in addition, the loans broke a domestic budget appropriation bill as well as rules in foreign financial services jurisdictions. Observers also allege that internal due diligence procedures within the banks providing the loans were broken. De Renzio and Nuvunga (2016) suggest that at least

1 One stakeholder interviewed for this study alleged that an additional, earlier, illegal loan of USD 200 million was publicly recognized by the Mozambican government.

2 Mozambican civil society groups have rejected the three loans as illegal and have called for no debt repayments or renegotiation of the debts.

3 Although various definitions exist, the OECD has defined IFFs as being "...generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws (see OECD 2014).

some of the funds raised via the loans were destined for personal enrichment and/or political patronage rather than for their stated purpose, a currently held view in Mozambican news outlets. Some interviewees also alleged the loans bought arms for possible use in repressing popular dissent. The case potentially illustrates how IFFs not only *flow out of* developing countries to other locations in the global economy (e.g. tax havens and secrecy jurisdictions, as has been widely discussed in the literature – for example see Reuter 2012), but also involve illegal flows *back into developing countries*. Pending publication of an independent forensic audit, however, the specific flows of money involved in the case, and what the loan money actually bought, remain unconfirmed.

This U4 Issue explores the main implications for the effectiveness of anti-corruption policies and practices of the recent Mozambican case. We seek to identify the main driving factors that appear to be behind the case, and explore remaining knowledge and evidence gaps. Further, we ask what external actors – including partners in official development cooperation, financial sector regulatory and investigatory authorities, private financial and lending institutions, multilateral financing institutions, both domestic and foreign civil society organizations, and domestic oversight institutions – can do both to alleviate the problems the case appears to create and to try to prevent the recurrence of such cases. Part 1 of our analysis presents the results of a keyword-driven literature review (see Annex I for our keyword terms) focused on corruption and debt. Part 2 presents the Mozambican case in detail, constructed from a desk review of public sources and semi-structured interviews with a cross-section of stakeholders (see Annex II for anonymized categories and numbers of stakeholders interviewed). Part 3 offers a discussion of policy and practice measures from an anti-corruption effectiveness perspective.

Part 1: Corruption and debt: A brief review of the literature

We reviewed the literature on corruption and debt in developing countries focusing particularly on studies aimed at establishing empirical linkages between these two phenomenon, that discuss potential explanations and mechanisms for these linkages, and that present specific case examples containing potential policy and practice lessons. We identified 70 journal articles, book chapters and working papers focused on one or more of the above.

Proposed empirical linkages

Various studies propose and analyse linkages between *corruption*, which we understand broadly as the abuse of entrusted power for private benefit4, and *debt*, which we mean to refer to a sum of money owed or due between at least two parties. Testing the quality of governance, and in particular control of corruption and level of democracy, as a factor influencing the relationship between external debt and economic growth in 72 developing countries in the time period 1970-2005, Jalles (2011) finds that countries with lower corruption seem to be able to use and manage their debt better than more corrupt countries. The same study finds that the level of debt at which the effect of debt on economic growth becomes negative is also higher in countries with lower corruption levels. Grecheyna (2012) explains that the theoretical literature on public debt determination has recently blossomed, from early beginnings that focused almost exclusively on the broad political and economic determinants of debt. Alesina and Tabellini (1990), for example, argued that public debts are higher where politicians disagree about the desired composition of public spending, while Woo (2003) argued that the quality of institutions was an important determinant of public debt. Later, Grecheyna (2012) explains, studies emerged recognizing that the authorities of a country might over-accumulate public debt because of rent-seeking (a form of corruption) by government officials in power. Battaglini and Coate (2008) postulated a political theory of public debt over-accumulation caused by pork-barrel politics, while Yared (2010) and Caballero and Yared (2010) have focused on the effects of rent-seeking on public debt and taxation levels. Ndikumana and Boyce (2011) explain how *odious debt*s have fuelled significant capital flight from sub-Saharan Africa. Coined by the jurist Alexander Sack in 1927, the term odious debt refers to debts contracted and spent against the interests of the population of a state, without its consent, and with full awareness of the lenders (see Sack 1927 and UNCTAD 2007).

Postulated explanations and mechanisms

Jalles (2011) identifies three main explanations and mechanisms linking corruption and debt: (i) corrupt governments are likely to borrow more than governments characterized by lower corruption levels because they have a higher discount rate on the future than the latter; (ii) corruption can influence the borrower's spending decisions, shifting resources away from areas such as health and education towards defence and infrastructure; and (iii) corruption may increase the likelihood of loan defaults. Mauro (1998) concurs that corruption can change the composition of public expenditures such as health and education to areas that involve greater secrecy, such as defence spending. Kaufmann (2010) suggests that, to the extent spending on defence is based on borrowing, the level of public debt and debt-servicing costs are likely to increase. Corruption is also associated with larger shadow economies, with Schneider et al (2010)

4 While recognizing that various definitions of corruption exist, we opt here to use the *Transparency International* working definition.

pointing out that they reduce the ability of governments to raise taxes.[5] Since a government with limited tax revenues will tend to borrow to finance projects, the more corrupt a government, the larger the proportion of tax revenues will go into bribe payments leading to even more borrowing. Coorey and Schneider (2013) suggest this can lead to a vicious cycle of corruption and borrowing. Easterly (2002), examining why successive rounds of past debt forgiveness might not have had substantial positive effects on aid recipient countries, argues that aid recipients reveal behaviour consistent with a preference for high debt and for substituting new borrowing for forgiven debt. Easterly (2002) further suggests that "high discount rates" may be viewed as shorthand for the political economy factors that cause governments to overspend, to prey on the private sector, and to over-extract rents to distribute as patronage. Referring to the literature on the neo-patrimonial and predatory state (e.g. Nafziger 1993 and Van de Walle 2001), the logic of patronage explains why the state must continually mobilize resources by borrowing against the future. Elites that feel they must engage in patronage spending do not feel secure, and thus the future does not have a strong influence on their decisions.

Case examples: Mobutu's Zaire and an earlier Mozambique

Mobutu's Zaire (now the Democratic Republic of the Congo) of the 1970s and 1980s is presented by Wedeman (1997) as one of the most egregious case examples of the relationship between corruption and public debt accumulation. Although a lack of reliable data makes determining the amounts of money stolen by Mobutu and other public officials during this period nearly impossible, it was estimated by Young and Turner (1985) that around USD 5 billion in public funds were diverted by the mid-1980s. Wedeman (1997) argues that around USD 100-200 million was syphoned-off through various forms of corruption each year, with little of this being used in the form of productive investment in the economy. He suggests that the theft of mineral revenues from the state-owned company Gecamines, which accounted for 45-50% of total state revenues, meant that vital export income to finance mounting external debts was reduced, leading to the Bank of Zaire's default on its foreign debts in 1974 and 1975. Total state bankruptcy was averted with new soft loans from the World Bank, the IMF and USAID. Continued state looting, however, necessitated continued rescheduling of Zaire's debt.

A second case example emerges from the Mozambique of the 1990s and early 2000s. Hanlon (2004) recounts how a series of bank scandals brought Mozambican corruption to international attention. The privatization of the *Banco Comercial de Moçambique* (BCM) became, according to Hanlon, a necessary condition for World Bank aid to the country, yet the only candidate to buy the bank was a Portuguese businessman who had had a number of bad debts with local banks. Despite efforts to secure another bidder on the part of the central bank (*Banco de Moçambique*, BdM), the World Bank backed the businessman. Once BCM had been sold, new management was brought in and told to clean up the banks' affairs. Meanwhile the IMF demanded that Mozambique's other state-owned bank, *Banco Popular de Desenvolvimento* (BPD, later to become *Banco Austral*) be privatized by the end of 1996. As with BCM, Hanlon (2004) notes corruption was endemic in the BPD privatization, with loans made to members of the Mozambican elite with no intention of repayment. A Mozambican journalist, Carlos Cardoso, who had been investigating the BPD scandal was murdered in Maputo in a drive-by shooting on 22nd November 2000. Soon afterwards, on the 11th August 2001, the head of the central bank's supervision unit, António Siba-Siba Macuacua, who had been hired by the collapsed *Banco Austral* to recoup its debts,

5 There is no single definition of the term *shadow economy*. However, a commonly employed definition is that the shadow economy comprises all currently unregistered economic activities that would contribute to the officially calculated gross national product if the activities were recorded. See, for example, Schneider and Williams (2013). Stiglitz and Pieth (2016) offer a range of recommendations for overcoming shadow economies.

was killed and thrown down the stairwell from the 11th floor of the bank's headquarters while attempting to collect loans from the Frelimo elite (Hanlon 2004). In mid-2001, Mozambique's development partners were asked to approve the government's poverty reduction strategy paper (PRSP) and, with it, debt relief measures under the Enhanced Heavily Indebted Poor Countries (HIPC) initiative.[6] The PRSP was approved and debt relief granted, despite calls from some Nordic donors to delay approvals until the bank scandals had been investigated.

Our literature review shows that recent allegations with regard to the Mozambican loans case fit well within the frame of reference provided by a large number of academic studies on corruption and debt in developing countries, as well as earlier case evidence from Mozambique. In other words, the allegations are credible.

6 Launched in 1996 by the IMF and the World Bank, the HIPC Initiative is an approach to debt reduction aimed at ensuring that no poor country faces a debt burden it cannot manage. As of September 2016, debt reduction packages under the HIPC Initiative had been approved for 36 countries, 30 of them in Africa, providing USD 76 billion in debt-service relief. See: http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/11/Debt-Relief-Under-the-Heavily-Indebted-Poor-Countries-Initiative

Part 2: Corruption and state-backed debts in Mozambique: Recent case evidence and knowledge gaps

Governance and development conundrums specific to Mozambique have been the focus of many studies and authors (see, for instance, Hanlon 2004 and 2016b, Vines et al 2015, Hodges and Tibana 2004). These studies make it clear that the three recent Mozambican loans are not the sole cause of the country's current governance and fiscal predicament.7 The following section therefore serves to foreground the recent Mozambican case (of state-backed debt to the semi-public entities MAM, Proindicus and Ematum) against a wider backdrop of challenged institutional governance. Our narrative combines analysis of publicly available media, NGO and official reports with anonymized findings from semi-structured interviews conducted during September-October 2016. We approached members of the Frelimo elite in order to inform our account, but were unsuccessful in our attempts to interview them.

Guebuza's presidency in its final years

During the final years of former President Guebuza's term of office and prior to the 2014 general elections, a set of power struggles occurred within the ruling party, Frelimo. The party was highly unlikely to lose the election and a struggle emerged around the *terms of the leadership succession within Frelimo* and on related economic opportunities from future gas revenues from the country's offshore reserves.[8] Three interlinked interpretations of this struggle emerged from our interviews. The first interpretation is that different factions within Frelimo engaged in a period of infighting over the spoils from future gas revenues and who might enjoy them. Second: that a faction within Frelimo aimed to push for cleaner governance in the utilization of gas revenues. Third: that a struggle occurred as to how to deal with the armed political opposition, Renamo.[9] Whatever the motivation for the internal Frelimo struggles, Guebuza faced a narrowing window of opportunity to leverage economic opportunities based on future oil and gas revenues.[10] It is alleged that in order to secure his economic future three semi-public entities - Ematum, Proindicus and MAM – were established in the period 2012-2014 as vehicles for obtaining foreign private loans, to be raised without the knowledge of key government institutions, of parliament, the Mozambican public, or the country's foreign development partners. Although income from future oil and gas revenues did not act as formal collateral for the loans, the lenders viewed such income as increasing the likelihood that the loans would be repaid - although low gas prices eventually induced foreign firms Anadarko (USA) and ENI (Italy) to postpone their investment decisions.

Laws violated, rules broken

The three semi-public entities took out over USD 2 billion in loans from private foreign banks. It is alleged that a small faction within the Mozambican government backed the loans to MAM (USD 535 million), Proindicus (USD 622 million), and Ematum (USD 850 million) illegally and secretly in order

7 In a recent statement, the IMF's resident representative in Mozambique, Ari Aisen, listed four causes of this predicament: odious debt, political-military tension, natural calamities and a drop in commodity prices.

8 Interviewees note Guebuza failed in his attempts to change Mozambique's constitution to be able to run for a third presidential term, and only resigned as head of Frelimo after huge internal pressure. See: http://www.open.ac.uk/technology/mozambique/sites/www.open.ac.uk.technology.mozambique/files/files/Mozambique_242-26Feb2014-Guebuza%26CC.pdf

9 Guebuza was considered by one interviewee to have promoted a military solution, explaining why part of the loans were used to buy military hardware.

10 Dubbed "Mr. Guebusiness", he is the owner of a business empire and is probably the wealthiest person in Mozambique. See: http://mg.co.za/article/2012-01-06-mozambiques-mr-guebusiness

to avoid public, media and donor scrutiny and reactions. It did not submit them to the Assembly of the Republic for assessment, approval and monitoring, as is required by the Mozambican constitution (Fórum de Monitoria de Orçamento 2016b). The loans also overwhelmingly exceeded the top limit placed on government borrowing in the relevant annual budget appropriation bill (which set government borrowing at a low level of USD 6.5 million in 2013, later increased to USD 515 million). The sources of the loans were, in the case of Proindicus, Credit Suisse and VTB Bank, and in the case of MAM, VTB Bank (Jubilee Debt Campaign 2016). These loans were arranged under the laws of England and Wales via these banks' London offices. The Ematum loan was raised on the European bond market, with USD 500 million managed by Credit Suisse and BNP Paribas, and USD 350 million arranged by VTB Capital. It is alleged that these semi-public or hybrid entities were owned and controlled by a very small group of individuals, and that the entities were never meant to pay back the debts. The three entities are allegedly linked to Mozambique's state security and intelligence services (SISE) and shared a common chief executive: a previously little-known director of SISE.[11]

Big loans, few assets

The Proindicus loan (USD 622 million) and part (USD 500 million) of the Ematum loan were, at least superficially, aimed at buying boats for maritime security and tuna fishing purposes, as well as aircraft and radar systems. The idea was that it was necessary for the government to guarantee the security of the assets of oil and gas firms operating in Mozambican waters. The MAM loans (USD 535 million) were closely linked to Proindicus, since they were intended to operate naval installations (including a mobile maintenance dock) to assist the Proindicus maritime security vessels as well as the tuna fishing vessels to be bought via part of the Ematum loan (USD 350 million). A Credit Suisse report from February 2013 (which was leaked to the media) suggested that operators in the Rovuma Basin and elsewhere in the Mozambique Channel would buy services from Proindicus and MAM, thereby enabling them to repay the loans (Club of Mozambique 2016a). Key assumptions were that oil and gas firms would pay an annual fee of USD 3 million per rig, that vessels transiting the Mozambique Channel would be charged a fee for security services, and that the tuna fishing industry would provide revenues for loan repayments. As of September 2016, however, the two main oil and gas firms operating in the Rovuma Basin (Anadarko and ENI) had signed no contracts with Proindicus. Proindicus vessels have, in the meantime, been moored at Pemba, the provincial capital of Cabo Delgado, where some of the smaller boats are being used to train members of the Mozambican navy. The situation with Ematum is similar, with hardly any tuna actually caught and no wages paid to date to workers. One interviewee suggested this might however change now that another (Spanish) firm had taken over its operations. Although a London-based public relations consultant contracted by one of the organizations behind the loans has noted that a large quantity and range of assets exists to show for the loans, such claims have not been independently verified. One interviewee noted that it is possible, given the nature of the security and surveillance equipment claimed as purchased, that this equipment indeed exists and could be accounted for. In retrospect, however, it was noted by several interviewees that the assessment contained within the 2013 Credit Suisse report - launching the idea of nationally-based fisheries, security and asset management entities that could be financed from revenues drawn from international companies operating on the Mozambican continental shelf - was flawed, and that this flawed assessment misled other international investors (including the Norwegian Government Pension Fund Global, "the Oilfund").

11 One interviewee clarified that what we refer to here as three semi-public entities are *private* firms owned by two *public* entities: SISE and the bankrupt state fishing company, EMOPESCA.

Fragility revealed, aid suspended

Barred from seeking a third presidential term, Guebuza resigned as head of Frelimo in March 2015, replaced in this party position by President Nyusi. Warning signs of Mozambique's fiscal fragility emerged when the "new" Mozambican government approached the International Monetary Fund (IMF) for balance of payments emergency support in 2015. During the 2016 restructuring of the remaining USD 700 million on the Ematum loan, the Mozambican government admitted to the IMF the existence of further debt loaned to Proindicus. The Proindicus debt was previously thought to have either been replaced by, or subsumed under, the Ematum debt. In reality, the debt was twice as large as previously thought. Mozambique's Finance Minister, Adriano Maleiane, flew to Washington for talks with the IMF ahead of its spring meetings in April 2016 (Menas Associates 2016), but did not provide detailed information on the dimensions of the debt. The IMF confirmed the hidden debt to be over USD 1 billion and announced the suspension of its programme with Mozambique, including the second instalment of a total USD 283 million loan from its Standby Credit Facility (SCF), the first part of which had already been disbursed (Reuters 2016a). Other development partners followed the IMF's lead, with the World Bank suspending its disbursements and British general budget support to Mozambique also suspended. In May, the G14 group of donors to Mozambique officially suspended all general budget support (GBS), while the United States placed its USD 400 million annual aid allocation under review. The IMF's Christine Lagarde in a May 2016 interview with the BBC stated that: "*When we see a country and a programme with the IMF where international community money is committed, that is not respecting its financial disclosure engagement, which is clearly concealing corruption, we suspend the programme. We did that just recently with Mozambique*" (Club of Mozambique 2016b).

Investigations and calls for an international forensic audit

The United Kingdom's Financial Conduct Authority (FCA) opened an investigation into Credit Suisse and VTB Bank to determine whether they broke British loan rules (Club of Mozambique 2016c). The Swiss Financial Market Regulatory Authority (FINMA) also began investigating Credit Suisse's involvement in the loans (Reuters 2016b). In Maputo, a coalition of 26 Mozambican civil society groups called on the government to launch a forensic audit of the country's domestic, foreign, concessional and commercial debts, including the total amount of state guarantees to private companies. Civil society groups also called on Mozambique's Central Office for Combating Corruption (GCCC) to conduct an investigation to determine criminal and civil liabilities in relation to processes through which companies incur private debt with state guarantees. The main demand from the IMF, echoed by Mozambique's other development partners, has been for an international, independent, forensic audit in order to track exactly what has happened with all the loan money. In April 2016, upon meeting President Nyusi in Berlin, German Chancellor Angela Merkel reportedly asked: "where is the money?" (Africa Confidential 2016). The Mozambican attorney general's office announced an investigation into the alleged illegalities, and an IMF statement on meetings between President Nyusi and Christine Lagarde indicated that an independent audit would be conducted for the three loans. An IMF mission to Maputo at the end of September 2016 reinforced that "*effective initiation of the audit process in the near term would help create the conditions for the possible resumption of programme discussions with the fund*". As of the time of writing, the Mozambican Attorney-General's Office had announced that an independent audit would be implemented by the firm Kroll financed by the Swedish government (Hanlon 2016c).[12] A Commission of Inquiry has also been established by the Assembly of the Republic of Mozambique to look into the loans and state guarantees. Both the Attorney General´s Office and the Commission of Inquiry are currently investigating former Finance Minister Manuel Chang, who allegedly signed the state guarantees. In a meeting with international creditors on 25th October 2016, the Mozambican authorities noted that the country's debt was not sustainable, and that full payments could not be made until gas revenues began flowing after 2021 (Hanlon 2016a).

Box 1: Key dates from the Mozambican cases

December 2012: Proindicus incorporated

August 2013: Ematum incorporated

March 2014: Filipe Nyusi selected as Frelimo presidential candidate

April 2014: MAM incorporated

January 2015: Nyusi inaugurated as president

March 2015: Former president Guebuza resigns as head of Frelimo, replaced by Nyusi

April 2016:

- IMF confirms hidden debts over USD 1 billion
- World Bank suspends aid disbursements
- G14 donors suspend general budget support

May 2016: Initial repayments to Proindicus and MAM investors due

Source: Adapted from Africa Confidential (2016).

12 Kroll is a corporate investigation and risk consulting firm, headquartered in New York City, see: http://www.kroll.com/en-us One interviewee described Kroll as the "foremost forensic auditing company in the world", and noted the audit will be run from its London office, from where its European, African and Middle Eastern operations are directed. The same interviewee noted Kroll had 90 days to complete the audit from the date of contract signature.

Discrepancies and further questions

The total value of Ematum's fishing assets has been noted to be worth no more than USD 100 million, possibly less, implying an unexplained sum of around USD 250 million (from the USD 350 million of the Ematum loan intended for the purchase of tuna fishing boats and equipment). The Mozambican authorities and senior military personnel have given the impression in the media that large amounts of defence and maritime equipment were purchased via the three loans (Wall Street Journal 2016). Reports suggest there is little to show for this on the ground, hence the call for an independent, international, forensic audit to establish precisely how the loans were used. There are media reports of further undisclosed state-backed loans to Mozambique, including from China, and it has been suggested that the sheer level of abuse may have caused Mozambique's Ministry of Finance to lose track of its total debts (Africa Confidential 2016). President Nyusi's reluctance to move against his predecessor over the Ematum loan is explained by some reports as evidence of his involvement when he was Minister of Defence (Africa Confidential 2016). Others disagree with this assessment. A crucial outstanding question is how broad and thorough the remit of the audit will be, and whether it will aim to produce evidence that can result in criminal and administrative sanctions. Although terms of reference for the audit have been agreed, as of the time of writing they had not been published. A further question relates to the options external actors could pursue if the audit were implemented in a less rigorous manner than agreed in the terms of reference or should its results fail to produce effective sanctions and follow-up measures.

Part 3: What can be done? Entry-points for external actors

Despite two decades of experience in attempting to address corruption through development aid policy and practice, the best means of tackling various corruption challenges is still contested, and theoretical debates continue to rage (see, for example, Marquette and Pfeiffer 2015). Recent meta-studies focused on anti-corruption effectiveness (DFID 2015, Johnsøn et al 2012) suggest that solutions must fit specific contextual circumstances, and that answers to developing country corruption problems may be both within and outside developing countries themselves, given corruption's frequently transboundary character. With this broad advice in mind, below we consider possible entry-points for external actors interested in pursuing anti-corruption impacts with regard to Mozambique´s current predicament. We divide these entry-points between actions within Mozambique and actions internationally, or in other jurisdictions. The overall impact of any anti-corruption intervention on Mozambique's overall development – including conflict prevention goals - must be the foremost consideration. Although some of the measures mentioned below might be mutually exclusive, our *overall* advice is that external actors interested in anti-corruption impacts must think in terms of a range of interrelated interventions and responses to the Mozambican case.

Within Mozambique

Understanding and monitoring the audit's implementation and its results

An international, independent audit is agreed and the firm Kroll contracted to implement it following a limited tendering process. Importantly, the use of the word 'forensic' to describe the audit proved a sticking point with the Government of Mozambique given it implied the audit could lead to legal proceedings. One interviewee noted that the agreement between the IMF and Mozambique indicates production of *two* audit reports: the first a public document aimed primarily at tracing the use of the loan money; the second a confidential audit report that will specify individual responsibilities. Several interviewees suggested that, even if the word 'forensic' is not used to describe the audit, the fact that Kroll will implement it implies that the audit will *de facto* be of "forensic quality". At the same time, what is publicly known so far about the audit implies that it will *only* focus on the three semi-public entities (Ematum, Proindicus and MAM), possibly leaving the money-trail *beyond these entities* (and hence individual responsibilities) unmapped and untraced. Most interviewees recommended rapid publication of the audit's terms of reference as a means for external stakeholders to verify the details of the agreement between the IMF, the Swedish government (which is financing the audit), and the Government of Mozambique. The argument for publishing the terms of reference is that, without knowing what the audit *should* achieve, foreign donors and investors, as well as domestic public agencies and civil society groups, will not be in a position to monitor its implementation, or properly evaluate and use its results.

Improving transparency in public financial management with an oil and gas future in mind

If the three loans had been made public before their approval, some interviewees suggested that they may not have been approved at all. Improving transparency for state-backed loans and public financial management are seen by some, therefore, as important components of corrective anti-corruption measures in Mozambique. One interviewee noted time was short for introducing improved public financial management, given the expected influx of oil and gas revenues over the next decade and the further *resource curse-type* challenges this could bring. There is some evidence for the effectiveness of public financial management in tackling corruption (Johnsøn et al 2012 and DFID 2015) and the Mozambican authorities could focus on making the mechanism for procuring state guarantees for public borrowing more transparent towards the Assembly of the Republic, to civil society, to the media and to the public. International donors could further support measures and initiatives that improve budget, borrowing and public financial transparency, in collaboration with organizations such as the International Budget Partnership (IBP) or its local partners in Mozambique. Several interviewees expressed deep scepticism, however, as to the potential for such measures to be effective in the current Mozambican context, stating that no law or regulation could have prevented such blatant use of power and influence to override constitutional and legal requirements as displayed in the recent loans case. This point echoes a broader finding from the anti-corruption effectiveness literature, namely that a fundamental challenge in much anti-corruption work over the past two decades has been the frequent establishment of new laws, regulations, and institutional bodies that have acted as *good governance facades* to please external donors, without actually addressing *underlying political economy challenges* (Moene and Søreide 2015). This realization is one factor behind a recent focus in the anti-corruption effectiveness literature on improved methods for corruption risk identification, assessment and mitigation (for an overview see Johnsøn and Søreide 2013). The main learning point from this literature is that *iterative processes* of corruption risk assessment are required, focusing not only on fiduciary risks to investments, but on risks that arise from political economy dynamics. Another main learning point is the need for flexible and adaptive management within international donor agencies that provides capabilities to respond to findings from detailed corruption risk assessments.

Joint donor assessments and responses to corruption and the audit findings

Joint donor support to iterative processes of corruption risk identification, assessment and management could offer a focus for another strand of interventions from external actors. All of Mozambique's international donors have suspended GBS, with resumption dependent on progress of the audit. Some interviewees suggested international donors should now move out of GBS altogether and finance instead projects with "trusted people". Other interviewees disagreed and pointed to recent public health data as evidence that GBS was at least partially effective in spite of political economy challenges. One interviewee suggested that the frequency and quality of policy dialogue between international donors and the government had deteriorated significantly since the suspension of GBS. Disagreements and a lack of coordination among donors – including over what would constitute a responsible way forwards in responding to audit findings - are likely to be detrimental, whether from a conflict or poverty reduction, public health, or from a corruption risk perspective. One interviewee noted that differences of approach to the loans among foreign donors were being deliberately exploited to reduce external oversight and accountability.[13] One means to reduce the potential for such differences could be to pursue a 'joint response to corruption' approach, as trialled by DFID to some effect in Uganda (for details see De Vibe 2012). A main learning point from this experience is that the *predictability* of responses from donors to corruption cases matter, perhaps even more so than the *actual severity of the response*. International donors could already begin jointly mapping-out various scenarios of the outcome of the audit process and develop proposed responses for each envisaged scenario. This will be difficult to accomplish, however, in the absence of a shared donor understanding of the audit's terms of reference.

13 In particular, through suggestions that the security situation might significantly deteriorate if criminal and administrative sanctions are pursued against members of the Frelimo elite.

Internationally

Sanctioning the banks and reforming domestic financial services rules and regulations in the UK and Switzerland

Several interviewees shared their incredulity that bank loans of the size provided to Mozambique were given without formal establishment of the legality of the Mozambican state's guarantee. The respective national financial regulatory bodies of the United Kingdom and Switzerland have begun investigations into the loans in order to determine whether their domestic rules, regulations and laws were indeed broken, and interviewees expected that sanctioning of the banks involved, and recommendations for the improvement of financial services rules and regulations, could result from these investigations. The investigations are likely to focus on the due diligence procedures implemented by the banks involved. Another focus of the investigations could be the quality of the analytical work conducted by Credit Suisse in assessing the feasibility of the business plan for nationally based fisheries, security and asset management entities. International donors and both international and Mozambican civil society could play roles in publicizing the results of these formal investigations, and creating space for policy dialogue on the sustainable development aspects of reforms to financial services rules and regulations in the UK and Switzerland.[14]

Sanctioning corrupt 'politically exposed persons' responsible for the loans

In the field of anti-corruption policy and practice there is interest in the application of 'non-traditional sanctions' targeted towards particular corrupt individuals or groups of individuals, including travel and visa bans. In November 2015, for example, ten countries (the United States, the United Kingdom, Canada, Finland, Germany, Japan, the Netherlands, Norway, Sweden and Switzerland) imposed travel restrictions on Kenyan public officials implicated in corruption.[15] The reasoning behind such approaches is that traditional sanctions, such as aid suspensions, are blunt tools likely to affect people accessing public services in aid-receiving countries, while formal legal, administrative and criminal sanctions in aid recipient countries may not be feasible given jurisdictional and political barriers, or simple lack of interest. International donors and their domestic law enforcement and ministry of justice counterparts could consider pursuing non-traditional sanctions in the Mozambican case, possibly based on the audit findings.

Pursuing international asset recovery measures based on the Mozambique audit

Considerable policy and practice experience has been built-up in recent years in the area of recovering stolen assets over multiple jurisdictions, including the proceeds of various forms of corruption. Notable cases include the recovery of over USD 1 billion stolen from the Philippines by former President Marcos and over USD 700 million stolen from Nigeria by former President Abacha (STAR 2016). Asset recovery involves tracing, freezing, confiscating, and returning to the country of origin, funds obtained through illegal means, and usually involves lengthy and politically complex processes. The United Nations

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14 The UK House of Commons International Development Committee (IDC) heard evidence in a 2016 parliamentary inquiry that 'enhanced due diligence' procedures are necessary to address the role of London-based financial institutions in overseas corruption, see: https://www.parliament.uk/business/committees/committees-a-z/commons-select/international-development-committee/inquiries/parliament-2015/tackling-corruption-overseas/

15 See: http://www.nation.co.ke/news/US-imposes-travel-bans-on-officials-/-/1056/2978940/-/slykp9z/-/index.html

Convention against Corruption (UNCAC)[16] has enshrined the recovery of stolen assets as a fundamental principle of international public law, and global centres of competence, notably the International Centre for Asset Recovery (ICAR) at the Basel Institute on Governance, have developed expertise in assisting national enforcement authorities in handling complex international corruption cases with an asset recovery angle.[17] The Mozambique audit could be an initial step in the direction of pursuing international asset recovery efforts with support from foreign donors. A frequent, and important, consideration with such efforts, however, is whether there are reasons to believe state looting will not simply reoccur, hence asset recovery tends to form part of a suite of measures, including sanctions.

Introducing a multilateral body for monitoring odious debts and their likelihood

The concept of odious debt introduced by Sack in 1927 highlights the lender's responsibility for considering whether a loan is likely to be used in a responsible manner or not.[18] It has been argued that the Ematum, Proindicus and MAM loans meet the criteria for odious debts (for more on the concept of odious debts, see Howse 2007) since they were (a) incurred without the consent of the people, (b) have not led to tangible public benefits and (c) the lenders were aware of conditions (a) and (b). Apart from the possibility that (a) - (c) can be contested, there is also a possibility that if the debts were not settled this would have a strong effect on future borrowing by Mozambique. Various ways of handling odious debts are proposed in the literature. Ndikumana and Boyce (2011), for example, argue for the creation of a new international organization or watchdog that would act as an impartial arbiter for the status of debts, as well as a body for the adjudication of odious debt disputes. Nehru and Thomas (2008), however, argue that a better approach would be to: (a) renegotiate loans in the conventional way (via the London and Paris clubs), and (b) improve lending and borrowing practices in a more mundane way, using existing organizations, such as the IMF, rather than relying on the elusive concept of odious debt. Whichever approach were taken, our interviews confirmed that systemic issues with regard to the creation and monitoring of odious debts remain despite previous policy initiatives, and that these systemic issues are beyond the power of individual nations to address alone. In other words, a multilateral approach is required. The Mozambique audit along with the ongoing UK and Swiss financial regulatory investigations could establish whether the loans were odious in character and the degree to which the lenders acted responsibly or not. It does appear, however, that the banks should have checked the legality of the state's guarantee before finalizing the loans. Declaring the debts as odious would imply that the current Mozambican government would not be liable to repay them. However, this would not need to detract from other efforts to pursue criminal, legal and administrative sanctions against individuals in Mozambique responsible for violating laws and regulations to secure – illegally – state-guarantees for the loans.

16 See: https://www.unodc.org/unodc/en/treaties/CAC/

17 See: https://www.baselgovernance.org/theme/icar/#casework

18 The term 'illegitimate debt' is sometimes used interchangeably with the term 'odious debt'.

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Appendix I: Literature review key search terms

- Corruption (*anti-corruption, transparency, accountability, good governance*) + debt
- Corruption (*anti-corruption, transparency, accountability, good governance*)+ budget transactions
- Corruption (*anti-corruption, transparency, accountability, good governance*) + off-budget
- Corruption (*anti-corruption, transparency, accountability, good governance*) + hidden debt
- Corruption (*anti-corruption, transparency, accountability, good governance*) + debt burden
- Corruption (*anti-corruption, transparency, accountability, good governance*) + private loans
- Corruption (*anti-corruption, transparency, accountability, good governance*) + fiscal fragility
- Debt + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Budget transactions + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Off-budget + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Hidden debt + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Debt burden + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Private loans + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)
- Fiscal fragility + patronage (*bribery, fraud, fraudulent, extortion, kickbacks, rent-seeking*)

Appendix II: Anonymized categories of stakeholders interviewed

- Civil society representative x 1
- Academic x 4
- Consultant x 2
- Development cooperation agency representative x 4
- Government representative x 1
- Journalist x 2

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INDEXING TERMS
Anti-corruption
Corruption
Aid effectiveness
State-backed debts
Illicit financial flows
Odious debt
Illegitimate debt
Mozambique

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The average annual cost of corruption to Mozambique was recently estimated to be up to USD 4.9 billion for the period 2004-2014. Although some analysts have entertained the idea that investments in the country's oil and gas sector could reach as high as USD 100 billion over the next decade, Mozambique recently faced a turn for the worse in its balance of payments problems because semi-public entities took out government-backed debts worth over USD 2 billion without fulfilling constitutional and legal requirements. These loans illustrate the mechanisms by which illicit financial flows not only leave developing countries to other locations in the global economy, but also flow back into them, bypassing formal oversight mechanisms and lending rules.

We encountered credible allegations that a small group of individuals within the Mozambican state violated laws to secure the loans and initially avoided public control mechanisms. Major financial discrepancies exist in terms of the use of the three loans and international development partners and domestic stakeholders suspect some form of corruption. An international firm will implement an independent audit financed by the Swedish government to look into the loans. The audit findings, and investigations by UK and Swiss financial regulatory bodies, will provide a focus for monitoring and evaluation work, possibly leading to criminal and administrative sanctions.

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