Policy **Note** 06

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Navigating the debt challenges and unloking the paths for sustainable growth.

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ANALYSIS OF THE SUSTAINABILITY OF MOZAMBIQUE'S EXTERNAL PUBLIC DEBT

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ABSTRACT

This analysis delves into the complexities of Mozambique's external public debt, unveiling a dual narrative of challenge and opportunity. Despite significant hurdles, the country stands at a crossroads where strategic reforms and transparent collaboration with international creditors could pave the way for sustainable economic recovery. By prioritizing investments in vital sectors such as health and education, Mozambique can alleviate its debt burden and foster a resilient foundation for future growth. This exploration highlights the potential for transformative change, positioning Mozambique as an inspiring case study in overcoming adversity and steering towards a prosperous, equitable future.

ANALYSIS OF THE SUSTAINABILITY OF MOZAMBIQUE'S EXTERNAL PUBLIC DEBT

Introduction

In recent years, Mozambique's public debt has reached worrying levels, standing at around 971.4 billion Meticais in 2023, equivalent to approximately USD 11.3 billion. This amount contracted both internally and externally from bilateral and multilateral creditors, imposes a heavy burden on public finances, restricting the government's ability to invest adequately in the economy, especially in key social sectors such as health and education. According to 2023 General State Account data, the main multilateral creditors include the International Development Association (IDA) with 55% of the multilateral debt, followed by the International Monetary Fund (IMF) with 18%, the African Development Fund (ADF) with 16% and the Inter-American Development Bank (IDB) with 4%.

Debt sustainability has become a central theme for developing economies. A country is considered insolvent when the cost of rolling over the debt outweighs the benefits of maintaining it. In Mozambique, this imbalance is increasingly evident, with public debt growing rapidly, particularly commercial debt, aggravated by governance challenges and financial scandals, such as the "hidden debts" revealed in 2016. This episode, which involved the contraction of undeclared loans totalling more than two billion dollars, undermined international confidence in the government, significantly increasing the country's financial vulnerability, precipitating the growth of total public debt and limiting access to international financial markets. In addition, the debt resulting from this scandal has increased the pressure on public finances, leading the country to a debt crisis with international creditors and the cutting of financial aid from important partners.

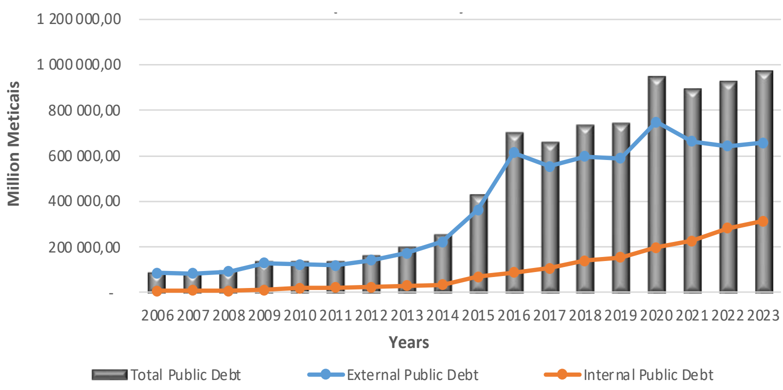
This article analyzes the sustainability of Mozambique's public debt based on empirical data extracted mainly from the General State Account (CGE), as well as other official documents and data from the Government of Mozambique (GM). The central argument of the article is that the growth of public debt not only has pernicious effects on the economy in general but also weakens the capacity to provide fundamental basic services in the short and medium term, favouring economic deterioration in the long term. The article will develop, from this introduction, with a review of the historical evolution of debt, the debt profile of Mozambique and its creditors, payment capacity and sustainability analysis, possible impacts versus debt forgiveness and, finally, the conclusion.

Historical Evolution of Mozambique's Public Debt

Several significant events mark the evolution of Mozambique's public debt since its independence in 1975. Starting from a relatively controlled debt and benefiting from reliefs such as the HIPC initiative in the 2000s, the country's situation has undergone a series of hidden debt contracts since 2010, raising public debt to alarming levels. Indeed, high levels had already been reached before, such as in 1998, when public debt represented about 153% of GDP. However, with the implementation of debt relief initiatives between 1999 and 2006, this amount was reduced to approximately 49% of GDP. During this period, reforms and restructurings were implemented under the supervision of the IMF, resulting in the country's economic recovery.

Between 2006 and 2010, Mozambique maintained a path of economic growth, with the stock of public debt increasing moderately (Graph 1). An important fact to highlight is that, during this period, the external debt grew rapidly again, especially from 2011 onwards, when the volume of debt amounted to about 5 billion dollars. This growth was exacerbated by the revelation of hidden debts in 2016, which were assumed and entered into the public accounts, turning into a financial scandal that conditioned an increase in public debt by 1.4 billion dollars and resulted in a crisis of confidence both domestically and internationally.

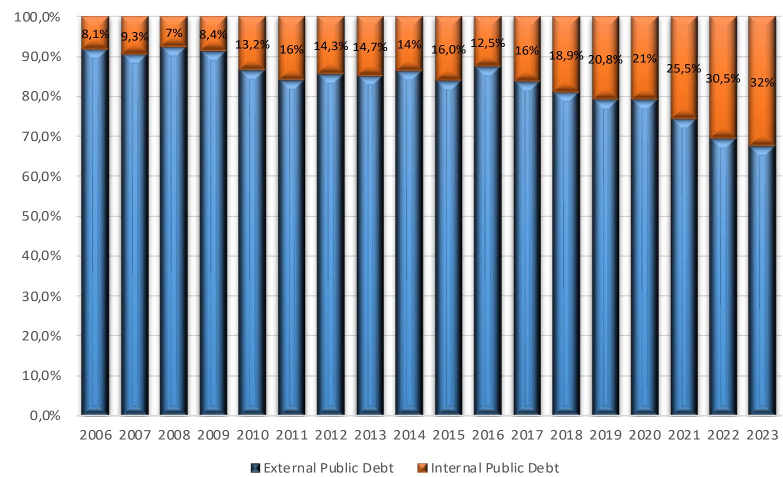
Graph 1: Evolution and Composition of the Public Debt Stock (2006 - 2023)



Source: General State Account (CGE)

The so-called "hidden debts" were the result of irrevocable loans that the Mozambican government guaranteed between 2011 and 2014, without the approval of Parliament, and which totaled about US$2.2 billion. These were contracted through three state-owned companies, namely Ematum, Proindicus and Mozambique Asset Management (MAM), which benefited from guarantees from the Mozambican State to obtain their loans from the banks Credit Suisse and VTB, respectively. The impact of this scandal was not limited to the increase in indebtedness, as shown in Graphs 1 and 2, but also resulted in sanctions such as the suspension of donations from the international community, essential for the survival of the national budget, and a significant increase in fiscal risk that conditioned its access to international financial markets. It is due to this context that from 2016 onwards the external public debt experienced a stationary trend in absolute terms, with a corresponding reduction in its weight in the percentage structure of the debt, leveraged by the continuous debt service on the one hand and the other the government's recourse to internal debt (Graphs 1 and 2).

Graph 2: Evolution of the Percentage Structure of Public Debt (2006-2023)



Source: Adapted from the General State Account (CGE)

Another direct consequence of this scandal was a dramatic increase in the burden of Mozambican public debt. In 2016, public debt rose dramatically, representing about 71.6% of GDP, therefore above the sustainability limit. The public debt crisis combined with the economic recession has led to significant cuts in public services and social programs, disproportionately hitting the country's most vulnerable populations.

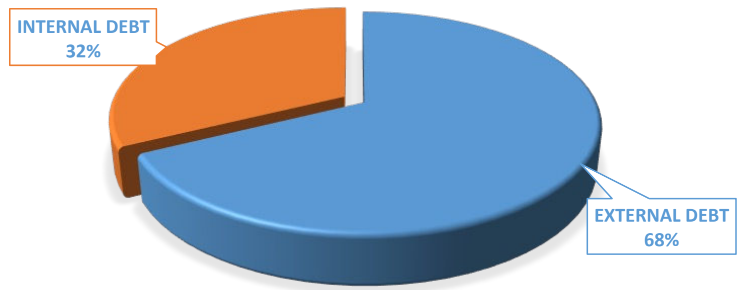
In response to this debt crisis, Mozambique has begun to implement citizen audit processes and discuss possible forms of debt relief. Civil society organizations are pressuring the government for greater transparency in the management of public debt and accountability of the elites involved in the hidden debts, a fact that has forced the public judgment of some entities involved in the process of hiring them. This trial process, in Mozambique, involved 19 defendants and more than 50 different declarants, having started its formal investigation in 2018. Therefore, although Mozambique's total public debt has continued to grow in absolute terms, it is worth noting a significant slowdown in the pace of its almost stationary growth from 2016 onwards, except in 2020 when there was a quantitative jump in it. This particular jump can be explained by the outbreak of COVID-19 and international assistance to disadvantaged countries. However, it is notable that the stationary trend of the DPT prevails after this bounce, although at a higher level. As shown in Graph 1, it should be noted that this trend is supported by the accelerated growth of domestic public debt, in contrast to the trend of external debt, which showed a downward trend.

The future of public debt in Mozambique will depend on the government's ability to implement robust reforms and ensure the continuous improvement of transparency mechanisms in the debt process. However, our analysis of public debt not only considers its amount but also the social and economic implications that result from its inadequate management, ensuring that the resources generated are directed towards sustainable development and to meet the needs of the population[1].

Mozambique's Public Debt Profile

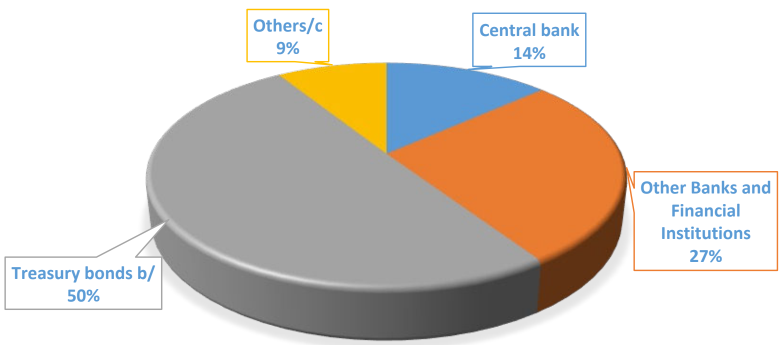
Mozambique's public debt structure tends to change with a clear record of the increase in the proportion of domestic public debt over external debt. Between 2013 and 2023, the proportion of domestic public debt slightly more than doubled, from 14.7% to 32%, respectively (Graph 2). Therefore, until December 31, 2023, Mozambique's public debt stock comprised 32% domestic debt, and 68% external debt, as shown in chart 3. It should be noted that the rapid growth of domestic debt was mainly due to the difficulty of accessing the international financial market due to the significant drop in international financial credibility that the country gained with hidden debts, making international credit more important, and the risk of investing in Mozambique higher for investors. In turn, the domestic debt has a mostly commercial structure, with 50% consisting of Treasury Bonds, 27% referring to Other Banks and Financial Institutions, 14% to the Central Bank and 9% to other creditors (Graph 4).

Graph 3: Composition of the Total Public Debt Stock of Mozambique 2023



Source: Adapted from the General State Account (CGE)

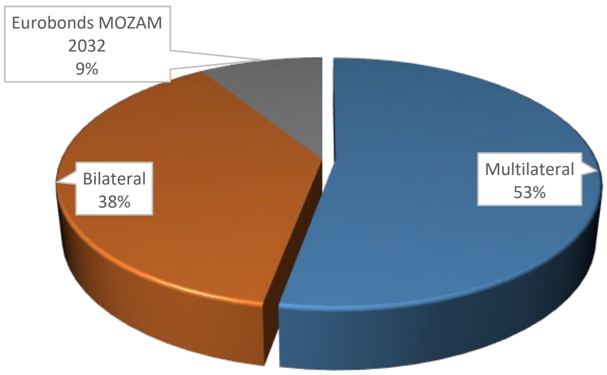
Graph 4: Structure of Domestic Public Debt 2023



Source: Adapted from the General State Account (CGE)

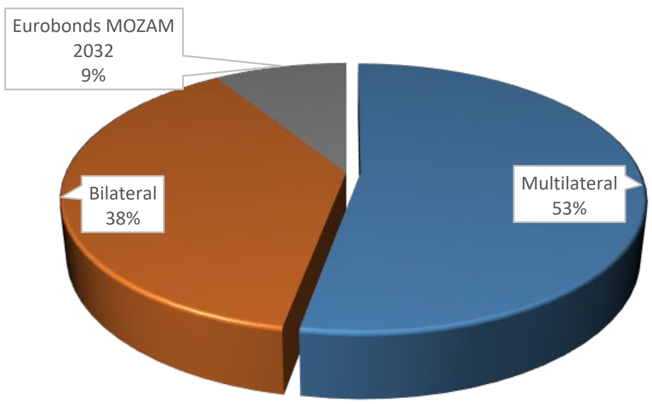
On the other hand, external public debt remains with a greater weight on the DPT, with a weight of 68%, and dominated by multilateral debt. Mozambique's external debt stock has three components, respectively multilateral, bilateral and external bonds. In its composition, 53% is made up of multilateral debt, 38% of bilateral debt and 9% of external securities (Graph 5), whose registration in public accounts has been reflected since 2021. Concerning multilateral creditors that hold 53% of external debt, the largest are namely the International Development Association (IDA) with 55%, the International Monetary Fund (IMF) with 18% and the African Development Fund (ADF) with 16% (Graph 6). These three multilateral institutions alone therefore hold 89.6% of total multilateral credit, which corresponds to 47.5% of the country's total external debt, which gives these entities a major role in debt relief.

Graph 5: External Public Debt Structure by Creditor in 2023



Source: Adapted from the General State Account (CGE)

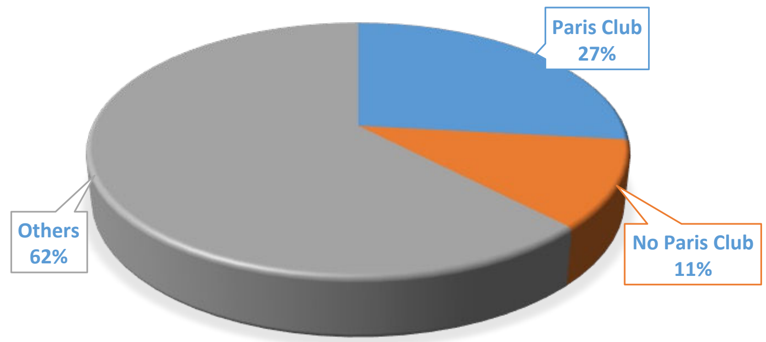
Graph 6: Composition of External Public Debt by Multilateral Creditors 2023



Source: Adapted from the General State Account (CGE)

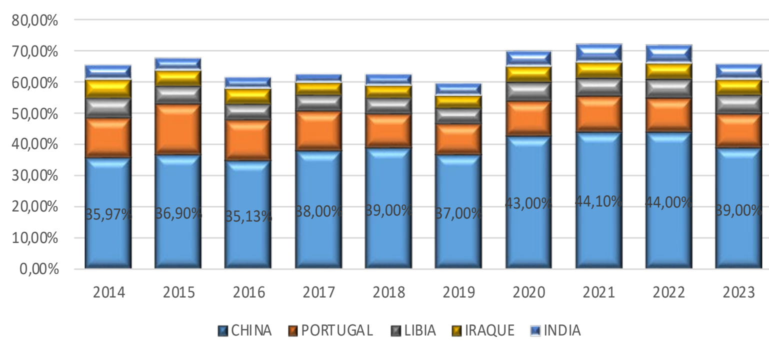
In turn, the bilateral component of the debt, which totals USD 3,935.18 million, is quite diversified, but with great weight falling on the category of other creditors. This component is grouped into three groups, as follows: Paris club (27%), non-Paris club (11%), and other bilateral creditors totalling 62% (Graph 7). It should be noted that part of this category of other bilateral creditors, therefore, with greater weight, is China, which holds 39% of the total stock of bilateral debt in 2023, a weight that has slightly reduced compared to the previous year (44%), thus making it Mozambique's largest bilateral creditor, followed by Portugal (11%), Libya (6%), Iraq (5%) and India (5%) (Graph 8). Of this group of countries, only Portugal belongs to the group of bilateral partners in the non-Paris Club category, while Libya and Iraq belong to OPEC in the category of the others as well as China and India that can be grouped in the so-called BRICS. This diversification of lenders implies different payment terms and associated risks, which makes it crucial to analyze the characteristics of these loans and their implications for the budget.

Graph 7: Proportion of Bilateral Public Debt by Group of Countries (2023)



Source: Annual Report on Public Debt

Graph 8: Proportion of External Public Debt Stock by Main Bilateral Creditors, 2014- 2023



Source: Annual Report on public debt

Analysis of the Sustainability of External Public Debt

To analyze debt sustainability, pre-defined sustainability ratios tend to be used. Every year, the World Bank's (WB) International Development Agency (IDA) and the International Monetary Fund (IMF) conduct an External Debt Sustainability Assessment (DSA) for Mozambique. For the analysis, the Debt Sustainability Analysis Framework for Low-Income Countries (LIC DSF), developed by these same institutions, is used as an instrument. According to Ossemane, R. (2009), "the DSF LIC assesses the risk of the debtor country's economy suffering disturbances resulting from its Public and Publicly Guaranteed (PPG) external debt in the long term (over 20 years) and recommends actions to control this risk."The ratios that this instrument adopts as sustainability indicators are: debt service/exports (or tax revenues); Present Value of Debt (VPD)/exports (or tax revenues) and VPD/Gross Domestic Product (GDP).

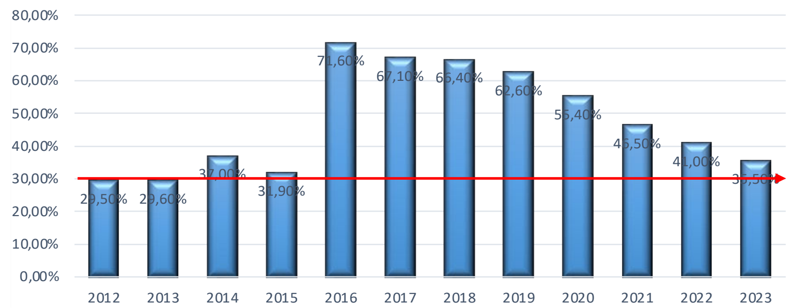
These ratios tend to give sensitivity to the effort required or that the country should make concerning each of the indicators used to meet its obligations arising from indebtedness. In this context, significant variations can be noted in each of the ratios over the period 2012 and 2023, with a particular disproportionate increase in 2016 for all ratios, indicating a jump in debt related to hidden debts with severe impacts on the sustainability of external public debt. However, after 2016, debt containment efforts, the suspension of new loans and continued debt servicing have contributed to an improvement in the indicators, although the country is still in a vulnerable and unsustainable position. As illustrated in the graphs below.

Solvency Indicators:

It should be noted that the limits for the ratios were revised in 2018 with the aim of containing debt growth and aligning with international standards.

VPD/GDP (Present Value of Debt/Gross Domestic Product): This ratio shows the ratio of external public debt to GDP. Its sustainability limit went from 40% in 2012 to 30% in 2018. In 2016, the ratio increased to 71.60%, reflecting the increase in debt due to hidden debts and the country's inability to manage its debt. From 2016 to 2023, a gradual reduction was observed, signalling stabilization efforts. In 2023, the ratio was at 35.5%, still above the new threshold, although in a downward trend (chart 9).

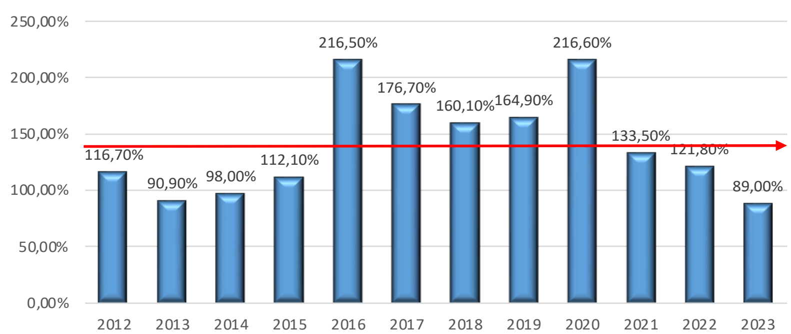
Graph 9: Present Value of Debt to GDP Ratio (VPD/GDP) 2012-2023



Source: Annual Report on public debt

VPD/EXP (Present Value of Debt/Exports): This ratio indicates the country's ability to pay its external debt with export earnings. The limit was adjusted from 150% in 2012 to 140% in 2018. After an increase to 216.50% in 2016, as a result of the drop in exports and the increase in debt, there was a gradual improvement until 2019, having risen again to 216.50% in 2020 (Graph 10). Dende then, by 2023, the ratio tended to reduce until it reached 89%, therefore, below the sustainability limit. This suggests that the economy can generate enough foreign exchange export earnings to meet its debt obligations. It is, therefore, a favourable situation. However, it is important to note that this indicator cannot be reliable in an economy whose exports are dominated by multinational companies of foreign origin, exempt from taxes, and which tend to expatriate their profits, therefore in an economy with a weak capacity to retain the resources generated.

Graph 10: Present Value of Debt to EXP Ratio (VPD/EXP) 2012-2023



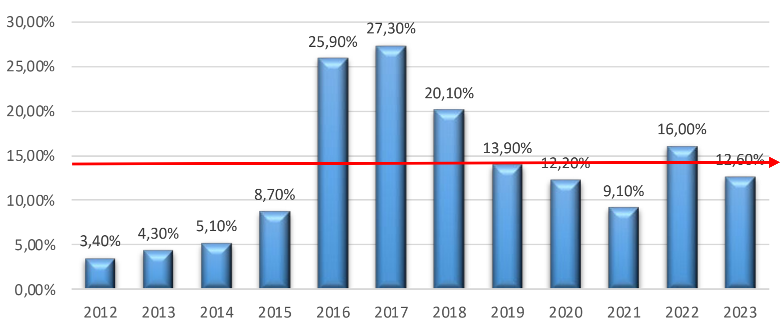
Source: Annual Report on public debt

Liquidity Indicators:

SD/EXP (Debt Service/Exports): Evaluates the portion of export earnings allocated to debt service payments. In 2018, the limit was revised to 14%. While in 2016, it recorded a jump to 18.80%, due to the increase in payment obligations. Despite a downward trend from 2018 onwards, the value remained relatively high until 2023.

SD/REC (Debt Service/Revenue): Measures debt service pressure on government revenues. The limit was revised in 2018 to 14%. In 2016, the ratio reached 25.90% and rose to 27.3% in the following year (Graph 11). From 2017 onwards it had an improvement trend with an oscillation in 2022. In 2023 it was recorded at 12.60%, therefore, below but close to the sustainability limit, a fact that keeps it a concern.

Graph 11: Debt Service/Public Revenue (SD/REC) 2012-2023



Source: Annual Report on public debt

In turn, in 2018 the limit of the SD/REC ratio was also revised to 14%, with the same objectives as the previous revisions. In 2023, the SD/REC ratio remained below this threshold.

Mozambique's ability to repay its debt depends directly on its tax revenue and economic growth. The debt-to-GDP ratio, which currently stands at a high level, is an important indicator for measuring the weight of debt in the economy. In addition, the ratio of debt service to tax revenues illustrates how much of the budget is committed to interest and amortization payments. The analysis of these indicators is essential to predict whether the country will be able to maintain solvency or if it will need interventions, such as debt forgiveness.

Mozambique's public debt sustainability is subject to several risks that could jeopardize the country's ability to meet its obligations in the future. One of the main risks is the exchange rate, given that a significant part of the debt is in foreign currency, making the country vulnerable to exchange rate fluctuations. In addition, variable interest rates can increase debt service costs, and stagnant economic growth can reduce the ability to generate tax revenues. These risks make careful planning and possibly debt restructuring imperative to ensure long-term sustainability.

Arguments in favor of Debt Forgiveness

The forgiveness of Mozambique's public debt has been widely discussed as a necessary measure to restore fiscal sustainability, free up resources for essential sectors such as health and education, as well as to improve the social well-being of citizens by enabling equitable development. Arguments in favor of debt forgiveness include the immediate reduction of fiscal pressure, allowing the government to redirect a significant portion of its revenues to social and infrastructural investments. In addition, based on the debt trap theory, forgiveness could break the vicious cycle of high interest payments through debt service, enabling the country to regain its trajectory of growth and sustainable development.

With the continued growth of debt, the government's ability to allocate resources to essential services such as health and education has been severely limited. In 2023, spending on the health sector was 52,500.10 million Meticais, while education consumed 82,790.20 million Meticais, equivalent to 3.63% and 5.82% of GDP respectively. Although significant, these amounts are insufficient to guarantee the universality and quality of services, especially in the context of rapid population growth and growing demand for public services.

Debt forgiveness appears as a viable solution to free up resources that can be redirected to these critical sectors. According to Reinhart and Rogoff (2010), debt relief has positive effects on the economies of developing countries, allowing a reorientation of investments in social infrastructure and contributing to long-term economic recovery. In addition, a study by the United Nations Conference on Trade and Development (UNCTAD, 2021) argues that debt forgiveness for low-income countries can prevent humanitarian crises, especially in post-pandemic recovery contexts, where the pressure on health and education systems is particularly intense.

In general, it is to be supported that the forgiveness or restructuring of the public debt of countries such as Mozambique can be essential to ensure financial stability and sustainable development. For debt forgiveness increases the government's ability to free up a considerable amount of its revenues, which would otherwise be used to pay interest and repay public debt, to invest in socio-economic development through social programs and development infrastructure.

The "Sustainability Trap" theory, in turn, emphasizes that, in situations of high indebtedness, nations tend to fall into a vicious cycle, in which the payment of high interest rates inhibits the realization of productive investments, with effects on the reduction of medium and long-term economic growth, and an impact on the increase of vulnerability to new debt crises. Looking at Mozambique's current conditions with low levels of investment in education and health, crucial for the formation of human capital that is the main factor responsible for innovation and materialization of development, this argument becomes central to advocacy in favor of debt forgiveness. Therefore, if debt payments are considerably minimized, then the available resources can be applied to key economic and social areas for development, such as the expansion of educational infrastructure and health, which not only have an impact on improving social welfare, but also have the potential to generate multiplier effects on the economy.

Conclusion

The analysis of Mozambique's external public debt reveals a complex scenario, marked by significant challenges, but also by promising opportunities. The undeniable need for debt reforms and restructuring highlights the importance of strategies that ensure long-term financial sustainability. With a focus on transparency, accountability and collaboration with international creditors, Mozambique can transform its debt situation into a catalyst for economic growth and social development.

Investing in essential areas such as health and education will improve the population's quality of life and strengthen the country's ability to generate future revenues, creating a virtuous cycle of growth. Debt forgiveness presents itself as a viable solution, which could free up critical resources to boost investments in infrastructure and public services, essential for sustainable progress.

By walking this path, Mozambique will not only be able to overcome current economic challenges but also create a strong foundation for a more resilient and prosperous future. The potential for social and economic transformation is immense, and the determination to face adversity can position the country as an inspiring example of recovery and development amid adversity. With an eye to the horizon, Mozambique can turn the winds of change into a new era of prosperity and social harmony.

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