Above all, Stability

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Mozambique is currently facing a challenge familiar to many countries blessed with natural resources: how to attract private investment to develop those resources while ensuring public benefit therefrom. There is no single, correct answer to this question, either across countries or across time; rather, specific countries must choose the right mix of policies at any given moment. This article, and those that follow, will argue that, contrary to irresponsible calls for general renegotiation of contracts for large-scale projects, what Mozambique most needs now is legal stability.

Why is stability important? When investors – both foreign and national – feel confident that they can reap the benefits of their long-term investments, they will be willing to take the associated risks. A mine may easily require 10 years from initial prospecting to reach production, requiring hundreds of millions or billions of dollars; a large gas field, along with a liquid natural gas (LNG) plant, over the same period, can easily consume US$10 billion before first production. Investors in such undertakings must project costs and revenues over 25 or 30 years. If they are fearful that, once they have built the mine or the plant, the Government will increase their tax burden, they may well not invest at all. Even if the main investor itself is keen to go ahead, it may not be able to raise remaining finance needed for the purpose. In such cases, the resources stay in the ground and the "resource rich" country remains poor.

We should be clear what we mean – and do not mean – by "legal stability." In Mozambique as elsewhere, the Government commonly enters into a contract with a large investor. Stability means that in such contracts, the Government promises that if it changes the law in such a way as to significantly diminish the benefit the investor projects from its investment – such as by doubling the rate of royalties – the Government will make compensating changes so that the investor is not, on the whole, worse off. Stability does *not* mean that investors are not subject to changes in the law – they are. Indeed, many investment contracts current in Mozambique go even further, providing that companies have no right to compensation when environmental, labor or health and safety legislation changes (in line with international best practice) so as to impose more costs. Thus, stability is mainly about the Government promising not to raise taxes or change other laws in ways that impose big costs. (Note: currently, for petroleum and mining companies wishing to sign new contracts, the corporate income tax rate in the country is 32%, and royalties are between 3% and 10% of the value of production, depending on the mineral.)

Different countries have different strategies when facing the question of stability. Some, like Bolivia and Venezuela, have simply nationalized the operation of oil & gas fields and certain mines in recent years. At first, revenues rise as the proceeds of sales – including the amounts that would have gone to the investors -- flow into Government coffers. But soon enough, arbitration follows, judgment creditors seek to seize the Government's assets abroad, and the new investment required to maintain or further develop production dry up. Why? Simply because "once burned, twice shy." By contrast, other countries have made stability a cornerstone of national policy and enjoyed years of sustained investment. Chile and, more recently, Peru, are in this category.

Which approach should Mozambique follow? Mozambique should offer investors stability, for obvious reasons. The country is only at the very beginning of the development of its natural resources. The nature of those resources, and their location, means that massive amounts of investment will be needed to develop them. The little Sena Line, with its maximum capacity of 5-6 million tons per year, cannot ship the 100 million tons of coal per year that will need to move from Tete to the coast by 2025; various new rail lines and ports, costing billions, will have to be built. Will investors build them if there is a risk that, once they are finished, their tax rates will double? If Mozambique does not offer stability, the industries of the future, together with all the jobs, business opportunities and tax revenues they create, will never develop, or will do so only as feeble shadows of what they could be. Or, to the extent they can, they will take root in neighboring countries that are more investment-friendly.

This is why those foreign advisors, whether Davos-style celebrities or anonymous officials of multilateral financial institutions, who recommend that Mozambique renegotiate its contracts for large-scale investments, are in fact doing development in Mozambique a disservice. This is for at least two reasons.

First, as a matter of principle and of law, if the Government unilaterally elects to renegotiate the investment contracts by which the so-called megaprojects are governed, Mozambique may find itself summoned before international arbitration tribunals. This would be very bad for the country's reputation as a destination for investment.

Second, with the benefit of historical perspective, the name "mega-projects" applied to the project we know will soon become a misnomer. This is because the amount of investment projected to come to Mozambique in the next few years is far greater than the amounts invested in the small handful of projects that enjoy the especially low tax rates granted – let us recall – when investing in Mozambique was riskier than it is today. Based on recent success in petroleum prospecting, it is projected that the development phase in deep water may require more than US$10 billion: that is more than all the large-scale project investment made in Mozambique since the end of the war, combined. In hindsight, those early projects will no longer seem so "mega" and the corresponding tax benefits a mere historical footnote. That is, of course, unless the bigger projects never occur because new investors are scared off by seeing promises made to earlier investors dishonored.

Those advocating renegotiation are, in effect, seeking to collect a few million more dollars of revenue today, at the sacrifice of many billions tomorrow. That may be good politics for some, but it is bad business for Mozambique. Precisely because we are in hurry to develop, we must be slow and objective in our choices. Legal stability is the objective choice for Mozambique.