LARGE AND MEGA-PROJECTS IN MOZAMBIQUE

Negotiations management for creating linkages and jobs in manufacturing

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# ABBREVIATIONS AND ACRONYMS

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<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AIM</td>
<td>Agência Informação Moçambique (Mozambique News Agency)</td>
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<td>APIEX</td>
<td>Agency for Investment and Export Promotion (Agência para a Promoção de Investimento e Exportações)</td>
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<tr>
<td>BATNA</td>
<td>Best Alternative to a Non-Agreement</td>
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<td>CAC</td>
<td>Competition Appeal Court of South Africa</td>
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<tr>
<td>c.i.f.</td>
<td>cost, insurance and freight</td>
</tr>
<tr>
<td>CKD</td>
<td>completely knocked-down</td>
</tr>
<tr>
<td>CNA</td>
<td>Central Negotiations Authority</td>
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<tr>
<td>CPI</td>
<td>Centro de Promoção de Investimento (Investment Promotion Centre)</td>
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<tr>
<td>CREIF</td>
<td>Centro di Ricerca di Economia Industriale e Finanza</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<tr>
<td>EDM</td>
<td>Electricidade de Moçambique</td>
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<tr>
<td>ERP</td>
<td>effective rate of protection</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FAS</td>
<td>Federal Antimonopoly Service of the Russian Federation</td>
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<tr>
<td>f.o.b.</td>
<td>free-on-board</td>
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<td>GAZEDA</td>
<td>Office for Economic Zones for Accelerated Development (Gabinete das Zonas Económicas de Desenvolvimento Acelerado)</td>
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<tr>
<td>IPRC</td>
<td>Imposto sobre o Rendimento das Pessoas Colectivas (Corporate Income Tax)</td>
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<tr>
<td>ISDS</td>
<td>Investor-State Dispute Settlement</td>
</tr>
<tr>
<td>JDC</td>
<td>Jubilee Debt Campaign</td>
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<tr>
<td>KACC</td>
<td>Kaiser Aluminum and Chemical Corporation</td>
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<tr>
<td>LME</td>
<td>London Metal Exchange</td>
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<tr>
<td>MFN</td>
<td>most favoured nation</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>SKD</td>
<td>semi-knocked-down</td>
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<tr>
<td>tpa</td>
<td>tonnes per annum</td>
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<tr>
<td>TRIMs</td>
<td>Trade-Related Investment Measures</td>
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<td>US</td>
<td>United States</td>
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<tr>
<td>Valco</td>
<td>Volta Aluminium Company</td>
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<td>VAT</td>
<td>value added tax</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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EXECUTIVE SUMMARY

Since the Peace Accords of 1992, Mozambique has relied heavily on large and mega-investments by multinational corporations to spur economic transformation in manufacturing. This has entailed negotiations that have often been from an ill-prepared and professionally and competitively disadvantaged position. To understand what has been done well or badly and what can be learnt to improve the country’s negotiation capabilities and the consequent benefits, this study examines six negotiations for large and mega-projects with investors in sectors outside of coal and gas mining—namely aluminium, aluminium rods and cables, steel, petroleum refining, transport vehicles and beverages. Though the document files for these cases are far from complete, their analysis revealed major structural, technical and legal deficiencies affecting the ability of Mozambique’s negotiators to shape agreements for large and mega-projects to best promote jobs, upstream and downstream linkages and economic and social development.

- The government has no overarching authority—namely, trained analysts and negotiators—to evaluate and question the sum total of the commitments and concessions by the diverse ministries, provincial and local authorities and other organs, and, if necessary, to demand modifications before emitting the final global authorisation for a project to start. This fragmentation virtually guarantees the occurrence of major mistakes and significantly suboptimal results for the country. Likewise, no overarching authority exists to oversee and supervise the disparate organs charged with monitoring the agreements’ implementation—for example whether the lands that have been allocated are used effectively and, in fact, needed for the projects. The lack of such an authority also hinders the nation’s ability to design and execute large and mega-projects that require timely and thorough adherence to schedules by diverse organs and parties.

- Apart from learning on the job, negotiating authorities and teams have received little systematic training on how to prepare for and manage and conduct negotiations. Nor do they have resources allocated for and authority to hire consultants skilled in this. This skills gap engenders costly but avoidable errors—for example acceptance of insufficient, suboptimal or obsolete technology; succumbing to bullying on the count of phony time pressures; giving in to demands for excessive concessions; subjection to biased or overly expensive legal procedures and lengthy or termless stability clauses; agreement to vague and unenforceable contract language; failure to analysis plans and the viability of increasing local value added over time; and allowing investment in product assembly using tricky or vague commitments and prices for semi- or completely knocked-down imported kits. The skills required also encompass negotiation tactics—for example how to extract information from your counterpart, especially when they are the only possible source of that information; or how to access relative strengths and weaknesses to determine whether to acquiesce or press an advantage.

- In none of the cases studied did the Mozambican negotiators conduct a thorough due diligence analysis to verify not just the financial and technical capabilities of the potential investor(s) but also whether they might use financial strategies or possess corporate structural interests in partial conflict with Mozambique’s national economic development goals.

- Mozambique has no legislation defining and outlawing monopolistic practices that reduce fiscal revenues, that impede the development of upstream and downstream linkages and that require that large exporters sell their products to local and African regional users at an ex-factory price that is equal to or lower than that to anywhere else. Nor does the law, or the agreements, clearly prohibit base-point pricing in national territory and require that, if local producers want to buy products from the project, the latter must sell it to them at a fair price. For example, the evidence the study unearthed strongly suggests that Mozal uses intermediaries to impose monopolistic base-point pricing and to sell aluminium in Mozambique at prices far above the free-on-board factory price of its exports to Europe. Finally, except for in oil and gas, Mozambique has
• no regulations or laws delimiting the scope and duration of stability clauses to merely fiscal issues.

• In some cases (e.g. transport vehicles), the import tax structure grants excessive effective rates of protection that encourage investments in projects that will create little if any value added (in international terms) and that will, instead, merely transfer income from Mozambicans to mainly foreign investors.

• Finally, big costs and huge difficulties face companies seeking VAT refunds and requesting to hold moderate amounts of inventory in bonded warehouses to permit speed up deliveries and entice customers.

The study of how Mozambique evaluates investment proposals and negotiates agreements for large and mega-projects, except for in coal and gas, concludes that the process is disparate, uncoordinated and largely bureaucratic and legalistic.

Based on these findings, the study recommends:

1. creation of a Central Negotiations Authority with a well-trained, well-paid and stable staff to supervise, analyse and ultimately approve major investment authorisation;
2. regulation of monopoly practices impeding development
3. a proactive design and promotion of interlinked projects by the Agency for Promotion of Investment and Exports;
4. a more rigorous assessment of the technical and financial necessity of vast land and mineral right grants that the proposed projects have no explicit plan to even utilise;
5. central oversight of the monitoring of mega-projects by disparate governmental organs;
6. stability clauses should be restricted to fiscal issues and, then, be limited to 15 years, at most;
7. quick reimbursement by the fiscal authorities of VAT refunds due to companies;
8. elimination of tax exemptions for dividends for foreign shareholders; and
9. a re-evaluation and, sometimes, drastic reduction of the effective rates of protection implied by the tariff structure for assembly projects using semi- and completely knocked-down kits of imported inputs.
1 INTRODUCTION

Since the Peace Accords of 1992, Mozambique has relied heavily on large and mega-investments by multinational corporations to spur economic transformation in manufacturing. This has entailed negotiations that have often been from an ill-prepared and professionally and competitively disadvantaged position. To understand what has been done well or badly and what can be learnt to improve the country’s negotiation capabilities and the consequent benefits, this study examines six negotiations for large and mega-projects with investors in sectors outside of coal and gas mining, which we excluded because of political sensitivities and lack of access to the relevant archives. It considers how Mozambique’s institutional and legal structure affected the negotiations, how its negotiators were selected and trained, whether it used advisors during the negotiations, whether due diligence analysis of the prospective investors was carried out and, if not, what the consequences were. The study also examines the extent to which the Mozambican negotiations conducted preparatory research to verify or challenge the technical and financial assumptions presented in the investors’ proposals and considers the costs to the nation when this research was not done.

The study also identifies seriously questionable decisions and concessions made during the negotiations—problems that were often repeated in the various negotiations under review. Moreover, it looks at the mechanisms used to monitor whether the investors fulfilled their contractual promises during the projects’ implementation and whether and how well the state took measures to remedy such lapses. Finally, the study examines to what extent, if at all, the negotiations focused on guaranteeing that the projects would promote local linkages both upstream and downstream; enhance job creation resulting from the direct and subsequent income-multiplier effects of spending; and spur economic transformation, especially considering how other mega-projects had hampered the creation of local value added.

The case studies show that the creation of linkages and jobs was sometimes far less than optimal, owing to:

1. international conflicts of interests about the desirability of expanding downstream production
2. failure to negotiate for and programme a progressive increase in local content for an assembly plant based on semi- and completely knocked-down (SKD/CKD) component imports
3. failure to negotiate with great specificity the investors’ commitments to train local workers
4. the monopolisation of mineral resources far beyond what a project would reasonably use, which thereby blocks investment by others in the same industry and
5. the absence of laws to prohibit large and mega-projects from using base-point pricing or other monopolistic pricing techniques to charge local buyers more than the free-on-board (f.o.b.) factory price charged for international customers, thereby impeding the development of local production and jobs or, if not, price gouging and increased flows of profits and foreign exchange out of the country and, hence, decreased local tax revenues and income-multiplier effects.

Although this is a preliminary study of only six negotiations in diverse non-coal, non-gas sectors, this report draws conclusions and proffers recommendations to avert the kinds of egregious errors spotted during the research study.
2 RESEARCH OBJECTIVES AND METHODOLOGY

To spot opportunities to earn more fiscal revenue, enhance local content, create jobs and thwart abuses by new monopolies, the present study evaluates the legal and bureaucratic structure and the preparations for and supervision of negotiations for large and mega-projects (except for in coal and gas mining), including the post-contract monitoring of the implementation of the investors’ agreed commitments. We examined the negotiations for:

- Midal Cables (aluminium bars, conductors and wires)
- Mozal Aluminium
- Capitol Iron and Steel (iron ore mining and steel refining and rolling)
- Matchedje Motor (automobile and truck assembly)
- Ayr Petro-Nacala (petroleum refining) and
- International Beverage Company A.¹

To do this, we examined the files graciously availed by the Investment Promotion Centre (Centro de Promoção de Investimento, CPI) and the Cabinet for Economic Zones for Accelerated Development (Gabinete das Zonas Económicas de Desenvolvimento Acelerado, GAZEDA). Coal and gas mining were excluded since the government has spent considerable resources improving its negotiating capabilities for these sectors and because of the difficulties in gaining unfettered access to the files about such politically sensitive negotiations.

The study was handicapped because the files CPI and GAZEDA provided were often incomplete. For example, for 1997 to 2000, GAZEDA’s files about the initial negotiations for Moza’s Phase I investment included only the original agreement, nothing more (e.g. no correspondence, no minutes of meetings, no environmental impact study, no governmental evaluations of diverse aspects of the project). For the Phase II expansions between 2000 and 2002, the Moza files, despite many gaps, were more complete. Curiously, after 2002, very little information was available, even though the government has representatives on Moza’s Board of Directors. Contacts with the Ministry of Commerce and Industry were also unsuccessful in terms of finding additional files. Significant gaps also existed in the files for the other five negotiations studied. Considering the disparate process of approvals, which are given independently by various ministries, it is quite likely that some of the missing information exists even though it is not centrally archived. However, given the scant time available for this study, compounded by the difficulties typically encountered in gaining access to sensitive files, it was not practicable to ferret out the missing correspondence, minutes and other documents. For a better understanding, we interviewed the original participants in some of the negotiations, if available. Nevertheless, the significant gaps in the records are indicative of a lack of institutional capacity to properly document and monitor the negotiations and their outcomes.

These handicaps meant the research could not be comprehensive and, instead, had to be content with identifying and analysing the seriously questionable decisions and procedures referred to in the available documentation.

¹ Identity suppressed because the project has still not been officially approved.
Management of negotiations with large multinational investors should begin way before a potential investor is selected and discussions commence. These early preparations include (i) the selection and training of specialised researchers and frontline negotiators and team leaders; and (ii) legal specification of the structure for and overall supervision of any negotiations, including the mechanism for the final authorisation or correction of the resulting agreement. Due diligence research and analysis of each proposed investor is then required to understand their strengths and weaknesses; to identify how their financial and technical structures, constraints and alternative options may work for or against Mozambique’s advantage; and, specifically, to understand the investor’s Best Alternative to a Non-Agreement (BATNA) (Fisher and Ury, 1979: 50–54; Mulhotra, 2004). Their BATNA reveals whether they have ready and cheap alternatives to making an agreement with Mozambique or whether, for technical or financial reasons, they feel an urgency to cut a deal with it. Similarly, the country’s negotiators need to know their own BATNA and to research for additional alternatives whose existence would give them confidence and strength in the negotiations. If you enter negotiations feeling weak, you will likely act weak. Indeed, Diekmann et al. (2003) ‘found that negotiators who expected a very competitive opponent actually became less competitive, as evidenced by setting lower, less aggressive reservation prices, making less demanding counteroffers, and ultimately agreeing to lower negotiated outcomes’ (p. 672). Thus, due diligence research and an understanding of both sides’ BATNAs yields insights, strengthens confidence and can often improve results.

To illustrate, the negotiations from 1983 to 1985 between the Government of Ghana and the US transnational corporations Kaiser Aluminum and Chemical Corp. (KACC) and Reynolds Metals Co.,2 owners of the local subsidiary the Volta Aluminium Company (Valco), show how research about the opposition can sometimes reveal a successful strategy to overcome an investor’s intransience. When, Valco ‘unaccountably repudiated the earlier progress… and took a hard line,… the government team… had to choose whether to continue the talks with the prospect of only marginally improving a basically unaltered relationship, or to move—even at the risk of a complete breakdown of the negotiations—to compel Valco to accept a major restructuring’ (Sawyerr, 1989: 42–43).

After analysing both Valco’s and Ghana’s political, economic and technical situation, the team decided Valco was unlikely to risk letting the government act unilaterally because (i) the Valco agreement had become such an egregious example of exploitation, which, if intransigent, Valco would ‘probably lose in an arbitration’; (ii) Ghana’s negotiators had ‘tried to present carefully reasoned, principled positions which could be defended before the aluminium industry, international financial institutions, and any arbitration tribunal’; and (iii) KACC’s dependence on Valco’s ‘aluminium ingots had risen from 54% in 1978 to just over 96% in 1982’, thus making it highly vulnerable to a cut of these supplies. As for Ghana, strong popular support existed for any unilateral action taken by the government, especially after its strenuous efforts to reach an accord. Moreover, since Volta Lake reserve was very low, ‘Valco could not continue production’ anyway, at least for another year. Hence, ‘if the talks broke down’, Ghana would lose very little in the short run ‘though action against Valco and its U.S. parent companies could easily jeopardize delicate, ongoing negotiations between Ghana and international financial institutions’ (Sawyerr, 1989: 42–43).

2 Merged with Alcoa Corporation in 2000.
After weighing all this, we felt confident that Valco could not risk a breakdown of the negotiations, and that, in the unlikely event of a breakdown, Ghana could competently justify its action. We, therefore, called off the talks and informed Valco that the government’s last proposals remained ‘on the table’. If Valco wished to restart talks, it could respond within the spirit of those proposals. We would evaluate the response, and if it showed sufficient progress, advise government to resume negotiations.

Halting discussions with Valco after three rounds was neither an emotional outburst nor a blind gamble. The team’s judgement was vindicated almost immediately after the talks collapsed. Valco held a press conference in Accra, acknowledged some problems in the old agreement, and undertook to present proposals within the broad framework established by government (Sawyerr 1989: 42–43).

Even though it was based on the national support for the negotiating team and on a thorough analysis of its counterpart’s position, calling Valco’s bluff took guts. But Ghana won!

Besides the need to conduct due diligence research, proper training should alert a country’s negotiators also to the economic tricks, rotten deals (Gachuki and Coughlin, 1988) and pressure techniques that investors sometimes use.

**Monopolistic prices and sales structure:**

- base-point pricing systems that require local companies to buy the product at a price far above the f.o.b. price applied for international sales
- failure to guarantee that, if demand exists, a significant portion of the production be directly purchasable by local users and
- transfer pricing loopholes through failure to apply arms-length pricing for inputs or sales.

**Suboptimal or obsolete technology:**

- sale of inefficient second-hand factories with sub-optimal or even obsolete technology.3

**Phony time pressures:**

- time deadlines and fake allegations that other countries want to get the project, used to force acceptance of a bad deal.

**Demands for excessive concessions:**

- exaggerated demands for land concessions far beyond real requirements
- requests for tax concessions based on phony allegations that, without such subsidies, the project will not be viable
- exaggerated fees and royalties for technology and
- requests for restrictions on competition against their expensive locally made products.

**Biased or overly expensive legal procedures and excessively long-lasting or broad stability clauses:**

3 For example, in 2016, a proposal was presented to set up a cement factory on the basis of second-hand machinery from a certain country. While visiting there, the Mozambican delegation kept asking in different venues why they wanted to sell this equipment. ‘A factory does not just close. It closes for lack of market or for lack of efficiency. Eventually, they let it slip that this factory was one of more than 300 cement factories that had been closed because they could not meet environmental standards… [But] we had no one able to analyze this technology [and] discover this [deficiency] by themselves… We always use internal persons, specialists, technicians or functionaries for this. And, many times, they… have no adequate budget to conduct such analyses, even if they know how to do them’ (translation of interview with Danilo Nalá, ex-Director, GAZEDA, 23 March 2017).
- exaggeratedly broad and long-lasting stability clauses that go beyond fiscal issues to also cover environmental, labour relations, health and other legal conditions (Cotula, 2008)
- designation of an international arbitration panel that, given its organisational base and history, may well be biased against your country’s claims and
- choice of the country whose laws will apply for the contract and whose courts will render judgements in case of conflicts. (For example, South African courts and law may be much easier and cheaper for Mozambique than if English courts and law were to apply.)

**Vague unenforceable language:**

- the inclusion of vaguely defined, legally unenforceable promises for local training, infrastructure creation and promotion of local industries to supply inputs or stimulate local industries using the project’s outputs (indeed, the legal enforceability of such clauses is questionable, owing to vague and disputable terms and expressions such as ‘take all reasonable steps’, ‘use reasonable efforts’, ‘where appropriate’, ‘the highest standards of the day’, ‘to the greatest extent possible’, ‘take all reasonable precautions necessary’, ‘provide ‘adequate financial resources’, ‘shall give all available traditional knowledge full consideration along with other scientific knowledge as the environmental plans and programmes are developed and revised’, especially if no expenditures commitments are specified (O’Faircheallaigh, 2016: 164–165)
- lack of clear and specific commitments to promote and not impede local upstream and downstream producers and to train local workers, technicians, supervisors and managers.

**Tricky, completely knocked-down assembly manufacturing projects:**

- poorly designed projects for SKD or CKD assembly that cost much and gain little or no true value added and
- SKD and CKD projects that do not specify (i) progressive increases in the percentage of locally produced inputs and (ii) the formula for calculating the cost, insurance and freight (c.i.f.) prices for components in the SKD and CKD kits based on the verifiable cost of production of the vehicle or other product in the supplying country.

CKD assembly projects are especially problematic and often little more than a sales trick that brings no real value added or development. Although if any real gain is to be made, the sum of the c.i.f. prices for the imported CKD components must be less than the c.i.f. price of a completely built-up product (e.g. a car or truck), CKD suppliers often strategise to inhibit local manufacturing by manipulating the deletion allowances.

[A] deletion allowance (also called omit-allowance) is the refund given by the overseas supplier for an item imported in a completely-knocked-down assembly kit e.g., for tape cassettes, telephones, watches, radios, refrigerators, transport vehicles. Thus, if a local assembler prefers to purchase locally the pedals for a bicycle and to omit them from the imported kit, a ‘deletion’ amount is subtracted from the price of the kit. Locally made components often cost more than this deletion allowance and, quite logically, the local assemblers then prefer to continue to import those components. But these allowances are often artificial prices set below the production costs in the mother country. Given such artificially low deletion allowances, even an efficient local

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4 For instance, though the deletion allowance for a rough door for a pickup truck was about $50, in 1984, its price, including freight, as a service replacement part from the manufacturer was $212 when sold to the local assembly plant. The general manger and the plant manager for a large Kenyan vehicle assembly plant figured that the deletion allowance for wire harnesses is about 70% of the production cost in the mother country. Thus the deletion allowance was 30% below their production costs. He thought that this would be common for most vehicle components. A local cooker assembler said that the deletion allowances for cooker parts averaged only 40% to 50% of the mother company’s production costs’ (Coughlin, 1988: 279–280).
manufacturer of components would most likely be unable to compete against components that come in a kit (Coughlin, 1989: 23).

To impede growth in local content and continue to import as much of the kit as possible, CKD suppliers overprice the omit allowances (rebates) for the components that are very difficult for local manufacturers to make and underprice the omit allowances for components that local firms can or might produce efficiently. Though the grand total of all possible omit allowances may look fair, their composition is skewed to inhibit local production and slow down the growth of local content. Therefore, although there is the illusion of creating local value added through investments in CKD manufacturing projects, if a progressive schedule for local or regional content\textsuperscript{5} and a clear formula to determine non-discriminatory omit allowances is not agreed upon, the international investor will almost certainly abuse the recipient country by overpricing the components and permitting tiny omit allowances for locally produced substitute components.

A country’s tariff structure can also misdirect investment by encouraging projects that, though profitable in local terms, create little or even negative real value added in international terms. For example, ‘if, initially, the international value added on a double-cabin pickup were merely 20%—a typical value for a new assembly plant—while the Most-Favoured-Nation (MFN) tariff on complete vehicles coming in from outside the Southern Africa Development Community were also 20% while that on the CKD kit [were] just 7.5%, the effective rate of protection (ERP) equals 70%, that is:

\[
\begin{align*}
\frac{V_A}{V_A - 1} &= \frac{(100\% + 20\% - 107.5\% \times 80\%) / (100\% - 80\%) - 1.0}{(40\% - 6\%) / 20\% - 1.0} \\
&= \frac{70\%}{1.0} \\
\end{align*}
\]

Where:

- \(V_A\) = domestic value added after taxes
- \(V_A\) = international value added calculated by c.i.f. before national taxes’

(Coughlin, 2015b: 3).

A 70% effective rate of protection means that, in international terms, for the value added an investor creates, they will earn 70% more than the true international value of that activity. In short, with such taxes, investing to create very little real value added is highly profitable. As demonstrated, small differences in tariffs can greatly influence the effective rate of protection and skew investors’ incentives towards choices that create income transfers but little real development. Hence, in such situations, policy-makers and negotiators should be wary.

National negotiators should also be taught to analyse the economic and technical proposals and to extract additional information needed to confirm their veracity even when that can be obtained only from the investor. Typically, this is achievable because it is difficult for an investor to simply insist that you must believe their numbers. By querying the assumptions and, perhaps, drilling down with subsequent rounds of queries, one can obtain a more accurate picture, especially if many of the assumptions can be verified independently. Negotiators should also learn how to discern the investor’s genuine concerns and find flexible least-cost win-win solutions that do not sacrifice the basic interests (Sawyerr, 1989: 37).

Finally, negotiators and team leaders should have a protocol for the essential topics to be considered and be trained on how to prepare a negotiations’ brief and identify when additional technical, financial or expertise should be hired, especially for negotiations for large and mega-projects.

\textsuperscript{5} Alternatively, to be in conformance with the World Trade Organization (WTO) Agreement on Trade-Related Investment Measures (TRIMs) (1994), which discourages trade barriers and preferences (including local manufacturing, equity, content and technology transfer requirements), protective tariffs may be structured to favour domestic producers meeting certain quality and local content regulations. Thus, to eliminate content targets, Pakistan adopted a Tariff Based Scheme that ‘ensures compliance to the WTO-TRIMs’ (WTO, 1994; Pasha and Ismail, 2012: 29 and 31).
4 INSTITUTIONAL, LEGAL AND STRATEGIC STRUCTURE FOR NEGOTIATIONS FOR INDUSTRIAL INVESTMENTS, EXCEPT IN COAL AND GAS MINING

Until July 2017, GAZEDA and CIP were the two organs charged with coordinating Mozambique’s disparate approval process and granting the final approval for projects not involving mining, gas and petroleum: GAZEDA for Special Economic Zones and Export Processing Zones and CPI for investment outside those zones. If a project is small and simple, little scope and need for negotiation exists, since the project’s execution will not need to request concessions or special assistance and infrastructure to enable it to function and be profitable. According to the case, GAZEDA or CPI served as a one-stop-shop to assist the investor to obtain all the various ministerial and other legal approvals—company registration, acquisition of land, environmental authorisations, etc. When all these had been obtained, it was to issue the investment authorisation, including a clear statement of the investors’ fiscal rights and obligations under the applicable laws.

The process is highly bureaucratic and legalistic, requiring the issuance of numerous governmental opinions (typically by mid-level analysts with no overall strategic vision and little or no technical knowledge about the industry under consideration) about whether the investor’s proposal and submissions fulfil the laws’ requirements and, if so, whether, a specific aspect of the project should be approved by the relevant ministry or the Central Bank. An exception to this pattern involves the environmental impact evaluations, which, though paid for by the investor, must be done independently by a consultancy company selected from a list approved beforehand by the Ministry of Environmental Coordination, thus reducing—though not eliminating—concerns about the possibility of incomplete evaluations or severe bias. However, even for environmental impact evaluations, the chief negotiator should insist on knowing whether the evaluators were experts thoroughly familiar with the international technological options and standards for the industry under consideration. Only this can help ensure that the nation’s people, air, land, rivers and ground water are not poisoned or eroded.

Large and mega-projects require considerable coordination with diverse ministries and the providers of infrastructural services (e.g. water, electricity, roads, railways and ports) plus coordination with local and provincial governmental organs (e.g. land offices, police) and private interests (e.g. labour unions, occupants of the target land). Often, exceptional requests are made for large amounts of land or special fiscal concessions or protections. When the parties’ interests are not in conflict but rather just need good thought and cooperation to overcome practical problems in a timely fashion (e.g. security arrangements, supply of transport, energy and water, practical modifications or flexibility to define the custom procedures required to import specific materials or export new products), the creation of task-specific committees to agree upon and execute the necessary steps is enough.

This segmented and mechanically bureaucratic approval process is, however, problematic when major and, possibly, unusual commitments or concessions are made with no central supervision, techno-economic analysis and ultimate approval. Moreover, to the extent that

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6 In July 2017, GAZEDA, CIP and the monibund Institute for Export Promotion were all abolished and operationally subsumed under the new Agency for Investment and Export Promotion (Agência para a Promoção de Investimento e Exportações, APIEX).

7 Including the Investment Law (Law 3/93 of 24 June as revised in 2009), the Regulations for the Investment Law (Decree 43/2009 of 21 August), the Code for Fiscal Benefits (Law 4/2009 of 1 January), the Regulations for the Code for Fiscal Benefits (Decree 56/2009 of 7 October) and the Code for Value Added Tax (51/98 of 29 September). The Public–Private Partnership Law (15/2011 of 11 August) and its regulation (Decree 16/2011 of 4 July) also requires, with rare exceptions, that (i) large investment projects worth more than 12.5 billion meticais (as of 1 January 2009), (ii) business concessions ‘to prospect, research, extract and/or exploit natural or other national resources or assets’ and (iii) public–private partnerships in a public domain be adjudicated by public tender albeit the evaluation of the bid should grant a 15% preference for the company or group that proposed the private initiative (Victorino, 2017: 5).
negotiations occur, they are decentralised and largely conducted by correspondence instead of face-to-face by a panel of diverse Mozambican experts led by a chief negotiator who has an integrated and global vision of the size and timing of the commitments for each component and phase of the project. Thus, except for in gas and petroleum, such negotiations have largely occurred with each ministry approving separate aspects of a project in the absence of overall supervision by a well-trained, strategically oriented and consistently led body to guarantee an integrated, development-oriented approach. Such an approach would include a thorough due diligence examination of each investor’s capabilities, structure, motives, prior investments elsewhere and proposed new or second-hand technology, as well as their potential conflicts of interest with Mozambique’s development goals, especially the need to stimulate backward and forward linkages and to create local jobs.

In this milieu, the government has no overarching mechanism, with trained analysts and negotiators, to evaluate and question the sum total of the commitments and concessions by the diverse ministries, provincial and local authorities and other organs and, if necessary, to demand modifications before emitting the final global authorisation for a project to start. This fragmentation virtually guarantees major mistakes and significantly suboptimal results for the country.

The directors of both GAZEDA and CPI confirm, moreover, that they have no funds to hire technical experts and advisors trained and experienced in conducting large international negotiations. Thus, when asked about Mozambique’s capacity to negotiate for large and mega-projects and whether his negotiators were trained to negotiate to enhance upstream and downstream linkages and to conduct due diligence research about the potential investors, Danilo Nalá, ex-Director of GAZEDA, summarised his long experience:

If you want me to give you a very frank answer, our government institutions… don’t have any capacity to negotiate anything though we do negotiate. We always and everyday negotiate projects.... [Consider] a big company like Bao bab. They come here with experts. They contract expert firms locally, internationally, experts on a specific issue, legal experts, experts on industrialisation, experts on this and that. And, when they come to this table, they’ll find [me] and one of my colleagues here and another one that is negotiating [with] everybody. And, of course, we don’t have the capacity to negotiate anything. We just rely on what they are telling us and, sometimes, on looking at the terms that are in the contract and looking at our law, and our law does not cover everything. If there’s something that can excite, we just look at it and say, okay, let’s try. But, in many cases, we don’t have capacity to negotiate with these guys. I believe [this] deeply.

Except for gas-related investments, the country mainly reacts to investors’ proposals rather than identifying the number and location of desired industries and proactively soliciting—by means of direct approaches or through public requests for bids—and enticing firms of renowned capabilities to advance investment proposals. Since, except for infrastructural investments, neither the government’s Industrial Policy and Strategy 2016–2025 nor its National Development Strategy 2015–2035 advances operationally clear plans to initiate investments in specific industries in certain years and provinces, the presently ad hoc, reactive, laissez faire approach to investment creates situations whereby the government has a significantly reduced

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8 Owing to the vast sums involved in gas exploration and production projects, the government’s negotiators have received training and benefited from hired technical and economic consultants. However, the consequent political sensitivity and inadequate transparency of these negotiations mean the present study did not review mega-projects in the gas sector. Nor did it cover coal sector negotiations.

9 The lone exception was the customs experts supplied by Crown Agents, who, among many other responsibilities, helped in designing the procedures and reporting forms required to facilitate Mozal’s imports and exports (interview with Danilo Nalá, ex-Director, GAZEDA, 23 March 2017).

10 Interview with Danilo Nalá, ex-Director, GAZEDA, 24 February 2017.

11 Interview with Danilo Nalá, ex-Director, GAZEDA, 23 March 2017.
scope to plan integrated projects and negotiate to increase local upstream and downstream linkages and other benefits for the country. With few exceptions, this lack of integrated forward planning and proactive investment promotion virtually eliminates its ability to attract multiple potential investors, create competition, receive interrelated proposals and select the most attractive candidate(s) with whom to conduct detailed negotiations.

Sometimes, however, the way to achieve potential linkages from a project is less direct. For example, for the Moatize–Nacala rail line, of the 24 tpa capacity, 4 tpa are reserved for passengers and general cargo. However,

... the contract... has a clause prohibiting price discrimination. Though that clause makes sense for the price applied to different coal producers, it constrains the country’s ability to use the line aggressively to promote agricultural development and exports from the region to other countries or to the south via coastal shipping.

The importance of the non-discrimination clause becomes clear when one realizes that the capacity of a rail line is not rigid: it depends on the maximum safe speed, the capacity of the wagons, the length of the rail sidings, and, consequently, the maximum number of wagons in a train. Thus, rail capacity is a flexible, not a rigid concept (Coughlin et al. 2013: 70).

This implies that the marginal investment cost per tonne of expanded capacity is far less than the average cost. Similarly, the marginal operational cost per tonne of expanded carriage is less than the average. This realisation should have allowed Mozambican negotiators to reject the non-discrimination clause and, instead, insist on far lower charges for passengers and general agricultural cargo and thus more easily use the new railway to spur agricultural and agro-industrial development (Coughlin et al., 2013: 70). The negotiations for the Moatize–Nacala rail line thus illustrate (i) how upstream development linkages might go beyond mere linkages to the mother project, in this case coal mining; and (ii) how flexible, marginal-cost analysis can sometimes reveal surprising opportunities for negotiators.

Finally, the government relies almost entirely on the relevant ministries or other interested local parties (e.g. input and service suppliers, downstream investors, labour unions, affected communities) to insist on the full and timely implementation of the contract. This approach works poorly when these groups are weak and politically disorganised. For example, a review of ‘40 mining agreements negotiated in Australia and Canada’ concluded that,

in general, implementation issues are dealt with poorly or entirely ignored by the agreements... [Moreover] A key finding of almost every study involves the need to allocate adequate and appropriate resources, financial and human, specifically for implementation functions. For example, if agreements provide for payments to native title parties through a trust, specific resources must be allocated to establish that trust and make it operational. Resources also need to be provided to support implementation structures for an agreement as a whole (O’Faircheallaigh, 2002: 14).

The supervision of implementation is also relevant for (i) the training of local workers for more than just the investor’s immediate needs and (ii) the purchase of local foods and other content. For example,

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12 Interview with Elídio Matola, Director of Planning, and João Vieira, Advisor, Caminhos de Ferro de Moçambique, 9 January 2013.
13 Also Woodrooffe et al. (2000:28).
14 Articles 7(b) and 27 of the Regulation for Private–Public Partnerships, Large-Scale Enterprises and Concessionaire Companies, Decree 16/2012, require the Regulatory Authority (i.e., the main sectoral ministry responsible for a large public–private partnership project) to prepare semi-annual monitoring and evaluation reports about how well the project conforms with their contract clauses and indicators and to submit these reports to the government’s financial and sectorial authorities. It is dubious that this will, in fact, be done systematically and, if done, whether the reports will improve the implementation of agreements.
though the mining companies have developed many local producers and suppliers, their efforts
are sometimes inadequate or inconsistent particularly for educational services and certain
agricultural and animal products. For example, in Tete, the largest mining companies persistently
fail to buy local beans, beef (for stew, not steak), goat meat, and freshwater Pende fish. Instead,
they usually import black beans, prime steak, and salt water fish. Only when their imports fail to
come in sufficient quantities do they rush for local supplies. Reportedly, the companies’ food
contractors often insist that local suppliers be able to supply their total demand instead of
allowing them to supply a fraction of the total requirement to give them time to improve their
equipment, systems and managerial skills and increase their reliability, quality and capacity.
Another problem is that local fruits are off the menu, eschewed, though available and tasty. But,
judging by the menus, eating in the local company canteen should be like eating in Toronto or
São Paulo.

This problem has origins in the way the contracts were negotiated. For example, the
government’s negotiators failed to anticipate the mining companies’ resistance to buying local
and typically Mozambican foods. They can be excused. They were new at such negotiations.
Now the lesson should be learnt... In the future, the government’s negotiating team[s] should
comprise knowledgeable representatives from diverse sectors, including agriculture, and demand
strong contractual guarantees that the companies will, in fact, nurture local agricultural suppliers
and respect the nation’s culinary customs (Coughlin et al., 2013: 69).

Indeed, the structure for the promotion of local content is still inadequate. Though the Mining
Law 18/2014, art. 8, para. 2, requires mining contracts to specify the anticipated local content,
the Petroleum Law does not. Nevertheless, the Petroleum Law 21/2014, art. 41(4), and the
Mining Law Regulation 31/2015 both grant preference to local suppliers of inputs and services
so long as their price is no more than 10% more expensive than those of foreign suppliers. With
the continuing failure to pass a more general Local Content Law, no such preferences for local
suppliers apply by law for other sectors.15

15 Reportedly, as of 27 July 2017, the Council of Ministers will soon consider the proposed Local Content Law
5 SIX CASE STUDIES

Though the six case studies analysed here involve diverse industries—aluminium smelting and ingot production, aluminium rods and conductors, iron ore mining and iron and steel refining and rolling, motor vehicle assembly, beer production and crude oil refining—some commonalities become apparent. None of the case files was anywhere near complete. None contained the environmental impact analyses of the projects. Few contained minutes of the meetings of government officials to evaluate the projects. Some did not even include the final authorisation agreement. The project application forms do not ask whether the equipment will be new or second-hand, modern or obsolete. Also, the government side never conducted due diligence research of the investors’ structure, constraints and alternative options—that is, their BATNA.

Moreover, the written opinions by government officials never evaluated or seriously challenged the projects’ technical assumptions about the amount of land needed, the technical processes and machinery chosen and the consequent economic implications, and, except for on Mozal, none discussed in detail the need for and ways to promote the use of local inputs and services for the projects. Furthermore, the government fumbled hugely in not even evaluating how to use Mozal’s aluminium to promote downstream industries and jobs, or considering clauses to require that some fraction of the output be available for sale to promote aluminium processing industries. Nor, except for in the case of Mozal, did the Mozambican evaluators and negotiators ever employ technical advisors or negotiation specialists to analyse better the evolving proposals. Finally, the files contain little or no evidence of how the projects were monitored to ascertain whether the various clauses of the final agreements were duly implemented.

Besides these general observations, the six case studies reveal serious, but avoidable, problems in the way the negotiations were conducted. Nevertheless, because of the severe gaps and inconsistencies in the available files, the case studies only present selected problems, missed opportunities and problematic decisions rather than examining the projects’ proposal, negotiation and authorisation process step by step.

5.1 Midal Cables

In 2002 and 2003, the Midal group of Bahrain entered negotiations with Mozal to set up a highly efficient mill to produce aluminium rods from molten aluminium delivered in ladles from the Mozal smelter to Midal’s proposed factory some 600 m away, similar to the group’s Bahrain mill, which obtains liquid aluminium from the nearby Alba Aluminium smelter (Midal Cables, [2007?]!).

The project’s promoters wanted use, initially, 50,000 tpa, of Mozal’s aluminium to make rods, draw and form steel-reinforced conductor cables for Electricidade de Moçambique (EDM) and other buyers and, eventually, draw aluminium wire.

5.1.1 Mozal’s price and supply offers and the government’s lack of due diligence research about Mozal’s and BHP Billiton’s international linkages

The negotiations between Midal Cables International Ltd and Mozal were hugely protracted, owing to the latter’s prolonged insistence on selling ingots but not molten aluminium to Midal to produce aluminium rods and Mozal’s intransigence about the price.

16 This lack of advisors contrasts sharply with the government’s practice in the petroleum sector, wherein ‘Simonsen Vogt Wiig AS… has since 2003 been the key legal advisor to the petroleum authorities in Mozambique and the national oil company (Empresa National de Hidrocarbonetos)’ (Leerberg and Vareberg, [2013?] : 3).

17 This subsection is, in large part, an update of Box 2, entitled ‘The Delayed and Suboptimal Development of Downstream Aluminium Industries’ in Coughlin (2015b: 35–36).

18 See the discussion of base-point pricing in section 5.2 about Mozal Aluminium.
The first point of friction concerned Mozal’s insistent and perplexing refusal to supply molten aluminium despite appeals for flexibility by Luís Sitoe, then the National Director of Industry and Commerce. Curiously, in 2002, Mozal’s sister plant, 19 BHP Billiton’s Bayside aluminium casthouse, was being upgraded and expanded, and the value-added product strategy for the casthouse was to ‘maximize liquid metal from [the] Hillside [smelter]’ (BHP Billiton, [2003?]). Consequently, the casthouse’s capacity was increased from 200,000 tpa to 310,000 tpa. According to the then General Manager, Marius van Tonder, “the projects will also improve product quality, which will enable us to increase our exports and to sell more value-added products on the local market, using additional liquid metal from our sister smelter, Hillside Aluminium, which is across the road” (in Zhuwakinyu, 2002). In fact, even before the upgrades, the casthouse was receiving ‘liquid metal from the Hillside smelter in ad hoc batch lots to suit Bayside’s requirements’ (Hughes, 2001:14).

By international standards, continuously casting rods from liquid metal direct from the smelter is the most common and efficient technology, owing to ‘productivity, capital cost, operating cost, and yield’ (Whiteley, 2001: 9). If a holding furnace receives liquid aluminium from the smelter, it needs merely to maintain the aluminium’s temperature, thereby saving much of the gas that would otherwise be used to re-melt ingots. This more efficient process uses less gas and reduces environmental pollution since ingots are not re-melted (increasing noxious emissions). The direct reception of molten aluminium also allows Midal to convert its melting furnace and subsequent lines into a continuous process with much the same equipment but approximately 15% to 20% higher capacity. These savings were predicted to reduce total costs by roughly 4% to 5%, thus augmenting the venture’s profitability.

As a result of these potential savings, Midal was keen to receive liquid aluminium directly. Such a highly efficient configuration using liquid aluminium with two rod production lines would make Midal Cables International very profitable, eager to expand and able to compete very strongly in international markets for rods and, eventually, for conductors and wire. However, only in November 2015 did Mozal finally agree, in principal, to supply liquid metal. Accordingly, both Mozal and Midal began to install the required equipment and, in May 2016, they signed a formal agreement to supply and receive molten aluminium. In June 2016, Midal started to receive molten aluminium (Figure 1). The direct reception of molten aluminium has allowed Midal to convert its melting furnace into a holding furnace to feed a whole additional line of production, thus more than doubling capacity and gaining huge economies of scale, since the investment in the additional line was estimated to cost only about 20% of the cost of the original factory.

19 Until May 2015, the shareholders in Mozal Aluminium were BHP Billiton (47.1%), Mitsubishi Corporation Metals Holding GmbH (25%), Industrial Development Corporation of South Africa (24%) and the Government of Mozambique (3.9%). In May 2015, BHP Billiton demerged its non-core operations, creating South32, which is ‘a globally diversified metals and mining company with high-quality and well-maintained operations which mine and produce bauxite, alumina, aluminium, energy and metallurgical coal, manganese, nickel, silver, lead and zinc in Australia, Southern Africa and South America’. In Southern Africa, South32 has investments in four companies, including a 47.1% share in Mozal Aluminium in Matola and 100% ownership of South Africa Aluminium in Richards Bay (www.south32.net/about-us/our-company and www.south32.net/our-operations/south-africa).
Figure 1: Timeline for Midal–Mozal negotiations, 2002–2016

Why, after many years of resistance, did Mozal suddenly decide to cooperate in supplying molten aluminium? BHP Billiton’s international context was changing. In January 2014, ‘Hulamin advised shareholders, on a cautionary announcement, that it had entered into negotiations with BHP Billiton SA over the future of slab supply from the Bayside casthouse’ (Nedbank, 2014). In November 2014, it sold its Bayside aluminium ‘casthouse to Isizinda Aluminium, which is 40% owned by Hulamin and 60% held by [the] black investment group, Bingelela Capital. [As part of the deal,] BHP will supply the casthouse with 96,000 tonnes of liquid metal from its nearby smelter for 10 billion rand (582 million pounds) over the next five years’ (Reuters, 2014). Hulamin had been importing 100,000 tpa from South32 (BHP Billiton’s successor) for its Pietermaritzburg casthouse. With this deal, the Bayside casthouse would send ‘Hulamin rolling slabs for semi-fabrication’ (Erasmus, 2015). Until Midal began production, Billiton’s Bayside casthouse was one of the few producers of aluminium rods and conductors in the region. However, BHP Billiton’s sale of its casthouse ended any possible motives for opposing Mozal’s sale of efficiency-boosting liquid aluminium to Midal, till then a potential regional competitor to Billiton’s Bayside casthouse.20

The second point of friction was that Mozal insisted on selling the ingots at a price equal to the prevailing price for 99.7% high-grade aluminium ingots quoted on the London Metal Exchange (LME), plus a substantial regional premium. The Midal group objected vehemently to such a price, a price far above the f.o.b. Matola (ex-factory) price/tonne at which Mozal was selling ingots to its client in Amsterdam. Reportedly, in response to the Midal group’s objections, Mozal averred that it was only an exporter and could only provide ingots from its factory on behalf of its client in Europe and only for the client’s full price, not Mozal’s f.o.b. ex-factory price for its European buyer—a pretext arising because of Mozambique’s failure to insert a clause into the

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20 In 2016, Midal’s principal markets were Europe, the US, Turkey and South Africa.
investment authorisation to require Mozal to sell to Mozambican aluminium processors. Reportedly, Mozal’s managers argued that the only solution was for Midal to buy and ship ingots from London, although that would incur handling, transportation and insurance costs—a huge increase in costs, especially considering that, in fact, the ingots would be produced by Mozal and transported 600 m to Midal’s factory next door! In effect, Mozal was offering to sell ingots at a price that included phantom freight for a non-existent shipment of ingots to Europe and a second phantom freight for their fictitious return to Mozambique, plus the European intermediary’s additional profit margin. This pricing system is called base-point pricing, a system of monopolistic pricing widely explored in the economic literature. Nevertheless, since Mozal’s project authorisation agreement permits, but does not require, it to sell up to 15% on the local market whenever demand exists, and since Mozambican law does not require a large manufacturing exporter to sell to local clients at an f.o.b. factory price equal to or better than its lowest prevailing f.o.b. export price, there was no easy way to oblige cooperation.

Figure 2: Visualisation of Midal and Mozal factories on 9 August 2017

Source: GoogleEarth

In the end, because of the inability to reach an agreement for liquid aluminium and a more reasonable price, it took another 12 years for Midal Cables International to be set up and to start production next to Mozal in Beluluane Industrial Park—albeit still not with molten aluminium,\(^\text{21}\) by far the most efficient way to produce rods. This delay also postponed the start of further downstream industries for the local production of conductors and wire. For ingots, the agreed price equalled the prevailing LME price plus a large regional premium.

Finally, after the 12-year delay, Mozal acquiesced and serious negotiations began for the supply of molten aluminium! To facilitate the negotiations, Midal agreed to pay for the road between the two factories and to install the weigh bridge. For the molten aluminium, however, Mozal

\(^{21}\) In February 2013, Mozal signed an agreement for Midal to use up to 50,000 tpa of aluminium ingots—that is, nearly 9% of Mozal’s total annual production (AllAfrica, 2013). However, this limit was quickly reached after Midal Cables International began production and started running around the clock, with nearly 100% capacity utilisation. By July 2017, Midal’s capacity stood at 62,000 tpa, or nearly 11% of Mozal’s 560,000 tpa capacity.
continues to charge the LME price for 97.1% pure aluminium ingots plus a lower regional premium and a tiny local charge for transporting the metal between the two factories. Thus, the pricing system continues to enforce the cartel’s base-point price scheme, which charges a premium (phantom freight) as if the metal comes from Europe, thus charging Midal an ex-factory price far above what Mozal charges ex-factory for ingots sold to its European intermediary (FAS, 2014: 8).

Who would gain by insisting that, for a huge exporter like Mozal, the ex-factory sales price to local firms should not exceed the prevailing ex-factory price to foreign customers? First, Midal’s net profits would soar, especially on its non-Mozambican sales. Second, once, in Year 10, Midal started to pay corporate income taxes, the government would collect far more corporate income tax, since Mozal pays none. Offset against this, the government would lose some tax revenue from the reduction in the value of Mozal’s cheaper sales to Midal since the government charges a 1% royalty on Mozal’s sales. Third, the costs for the national electrification programme could be significantly reduced. If EDM could buy the liquid aluminium for the same f.o.b. price at which Mozal sells ingots to Europe plus a tiny fee per tonne for transporting the molten aluminium 600 m over to Midal, this would allow EDM to reduce significantly the cost of high-tension steel-reinforced conductors, which typically represent 35% to 40% of total costs of a high-tension power transmission line.

For the country’s negotiators, the lessons from this experience point to the huge losses that can occur when, as in the Mozal case, they fail to conduct due diligence research about the investors’ financial and physical structures and practices to understand well their motivations, constraints and alternatives. For example, if Mozambique had been alert to why Mozal obdurately insisted on selling—supposedly on behalf of its European buyer—at a price calculated as if the ingots were coming from Europe or why, year after year, it refused to agree to sell molten aluminium to the Midal project, it would likely have been highly offended and, consequently, argued that Mozal was acting in gross violation of its 

contractual commitment to act in good faith. Similarly, it might have challenged Mozal’s justification that, instead of selling ingots directly, it could serve only as the intermediary for ingots owned by others in Europe although, in fact, the aluminium is merely transported from Mozal to Midal’s factory next door. Again, the government might argue that this was evidence of Mozal acting in bad faith, possibly as a cover for transfer pricing that would warrant a tax investigation. These arguments may well suffice to trump and overthrow the stability clause.

5.1.2 Contractual clarity about fiscal and foreign exchange regulations

The Mozambique Tax Authority and the Customs Authority have, in some cases, refused requests by Midal for a flexible interpretation of the law to permit the company to respond agilely to market needs and, thereby, reduce costs and increase sales.

1. Insistence that Midal collect VAT on domestic sales for EDM’s electrification programme: The Tax Authority insists that Midal collect VAT on conductors sold to EDM’s contractors for repair and expansion of the national power grid, though EDM is VAT-exempt. Oddly, according to Midal, EDM has refused requests to cooperate by splitting the donor-funded electrification contracts into two parts, one for conductors and the other for installation, thereby eliminating the requirement for Midal (if it were to win the bid) to charge VAT. Curiously, for repairs and expansions paid for out of EDM’s own funds, the Tax Authority also insists that Midal charge EDM VAT, though, reportedly, EDM is VAT-exempt for such purchases. Since paying VAT would strain EDM’s already

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22 According to the investment authorisation agreement, Midal pays no Corporate Income Tax (Imposto sobre o Rendimento das Pessoas Coletivas, IRPC) for the first 10 years of the project; for Years 11–15, it will receive a 50% reduction in that tax rate; afterwards, it will receive a 25% reduction. Under current law, IRPC is set at 32%.

23 In 2015, Midal wrote to EDM offering to charge just a processing fee if EDM were to buy aluminium from Mozal for Midal to transform into conductors.
tight liquidity, it resists, and Midal does not get the sale. Though the Treasury gains nothing on net, these obtuse rulings have largely blocked the production and sale of aluminium conductors for the local market.

2. VAT refunds: The oft-reported unwillingness of the Tax Authority to refund accumulated VAT credit also hampers Midal. At current exchange rates, the Tax Authority owes Midal nearly $285,000 in VAT refunds accumulated since 2014; to date, there is no sign that this money will be forthcoming. Moreover, since credit is expressed in meticais, the company has already suffered large losses owing to the surging exchange rate deprecation as well as the financial cost of tying up big money as idle capital.

3. Sales of stock held in foreign warehouses: As a result of the need to deliver conductors quickly to their clients, especially in Europe and the US, Midal requested permission from the Bank of Mozambique, in 2016, to use overseas warehouses that would contain about 500 tonnes of Midal’s material (i.e. about 12% of one month’s production by the factory). Since the availability of shipping has reportedly been increasingly unreliable out of Maputo Port and Midal’s clients have been demanding 90 instead of 30 days credit after the material is delivered to their installations, Midal often does not receive payment for roughly 180 days.

To guarantee transparency and security for the Central Bank, Midal offered to provide trimestral stock and sales reconciliations for the warehouse’s activities and, at the end of the year, to furnish KPMG’s auditor’s report about the warehouse. The Bank of Mozambique denied the request to use overseas warehouses and continues to insist that receipts for sales enter Mozambique banks within 90 days after merchandise leaves Mozambique. The bank’s rigidity about the use of overseas warehouses and the period allowed for receiving the foreign exchange has caused the company to lose clients, thereby reducing sales and production and, consequently, significantly lowering the rate of capacity utilisation and raising the cost per tonne of production. The Central Bank has even fined the company’s bank for non-compliance with this regulation, thus pushing the company to turn away yet more clients. Moreover, the problem is general. As the country develops, large exporters will often need external warehouses and, perhaps, a little more time for payments to be effectuated, especially if the terms of sale offer an extended period for repayment. The Bank of Mozambique should anticipate and cooperate with requests of this nature to permit such international business practices. They are normal and should not be deemed illegal.

These three examples of fiscal and foreign exchange regulations and interpretations that, without gain for the country, hamper sales and the efficient operations of Midal suggest wider lessons. Until laws are changed to remove these obstacles and the Tax Authority begins to fulfil its obligation to refund VAT debits to companies, the project authorisation contracts for large and mega investors should include clauses to avert the problems arising from such non-economic, counterproductive rulings. This is especially since projects valuing more than $500 million must be approved by the Council of Ministers, which would legitimate such exceptions to the law or its regulatory interpretations. Such clauses would create a win-win situation for the investors and the country.

5.2 Mozal Aluminium

The government approved its first agreement with Mozal Aluminium on 23 December 1997. Involving a $2 billion investment, Mozal was the country’s first mega-project after the Peace Accord of 1992. The Phase I investment, located in Beluluane Industrial Free Zone, enabled the factory to produce 250 ktpa of 99.7% pure aluminium ingots. The first metal was cast in June.

2000. With this mega-project, the government sought to prove to the international community and other potential investors that Mozambique was a reliable and profitable investment destination and, thereby, spur subsequent investments in other sectors. Later, the Phase II expansion (plus 250 ktpa) costing $1 billion cast its first metal in April 2003. After the Phase II expansion, MozaL consumed 900 mW of electricity, which equalled all of Mozambique’s other consumption of energy and the entirety of the available capacity of Cahora Bassa hydropower station (Mozal Aluminium, 2004). In 2016, aluminium exports comprised 34% of the country’s exports.25

The available information about the negotiations and agreements with Mozal revealed four problems: (i) failure to conduct due diligence research about the physical and financial structure and incentives of the investors, including the likelihood of monopolistic practices harmful to national development; (ii) failure to guarantee that aluminium would be available for sale at a fair ex-factory price to the local market to facilitate the development of a local aluminium-processing industries; (iii) tax concessions, with no expiry date, for MozaL and its investors and shareholders; and (iv) overly broad and non-expiring stability clauses.

5.2.1 Lack of due diligence research and consequent failure to protect potential local downstream aluminium processors against MozaL’s base-point pricing scheme

In the run-up to the negotiations for the MozaL project, the Mozambican negotiators did no due diligence research and analysis of the fiscal and financial structure and motivations of the investors, especially of BHP Billiton Ltd, the biggest owner (47.1%). Not only did they fail to understand the possible financial conflicts of interests arising from BHP Billiton’s ownership of two aluminium smelters in Richard’s Bay, but also they failed to learn that the international aluminium market functions as a cartel that uses base-point pricing, a monopolistic practice that discriminates against local downstream processors that are not financially integrated with an aluminium producer or that are far from the LME regional warehouses in countries that are large net users of aluminium.

The failure to understand that Billiton’s other properties and the worldwide use of base-point pricing by aluminium smelters could create significant conflicts with Mozambique’s need to grow downstream industries and to earn tax revenues led Mozambique’s negotiators to approve an authorisation agreement (para. 14.5) that merely allows—but does not require—MozaL to sell up to 15% of its output to local aluminium processors at non-discriminatory ex-factory prices. This huge mistake seemingly allows MozaL to sell everything to an intermediary in Europe and to insist that Midal buy at a price including all the transportation and other margins from there (see Section 5.1 on Midal). Because of this mistake, the authorisation agreement for the MozaL project has no clause to guarantee that local downstream users would be able to buy aluminium directly from MozaL at a price equal to or less than its best prevailing f.o.b. price to foreign customers or the netback price,26 whichever is lower, so long as local demand absorbs but a fraction, not all, of total aluminium production. This competitive solution occurs at $1,250 (Figure 3 in Box 1). These issues of base-point pricing and local sales plus the conflicts of interests by MozaL’s major owner, BHP Billiton, were neither anticipated nor researched by Mozambique’s negotiators, but the prior section on Midal examining the relationship between Midal and MozaL shows them to be crucial, so crucial that they helped stymy downstream investment for the production of aluminium rods and conductors for 12 years between 2002 and 2014.


26 The netback price is calculated by working backward from the fair competitive price that should be charged in the export-recipient country. The netback price can differ from the ex-factory price if the supplying factory uses transfer pricing to avoid taxes in one of the two countries, perhaps by paying a subsidiary located in a tax haven though, in fact, the goods never go there. In this latter case, the netback price would be significantly higher than the ex-factory price charged for those exports. Under this scenario, Mozambique would need to insist that, for the time period in question, sales to local buyers be set at that low ex-factory price while the tax authorities would use the netback price to calculate the company’s taxes on sales—a double loss for the monopoly!
Box 1: Cartel base-point pricing versus free competition for aluminium

Assume that a region has four aluminium smelters, each able to produce 500,000 tpa and each with different depreciation and operating costs—that is, maximum regional production capacity is 2 million tonnes per year. If, for simplification, transportation costs within the region are zero, Figure 3 illustrates two production scenarios: regional demand is insufficient to absorb all their production versus regional demand can absorb all their production; and two pricing scenarios: intense regional competition versus cartel collusion to impose a price equal to the LME forward price plus the West Europe premium plus fictitious costs of transport and insurance costs from Europe. Freight and insurance Maputo—Amsterdam is conservatively assumed to cost $250/t, and Amsterdam—Maputo $300/t; and the LME price plus the West Europe premium is, for illustration, assumed to equal $1,500, though, in fact, this varies greatly. Moreover, aluminium manufacturers often sign contracts to sell ingots downstream to large aluminium processors rather than to forward buyers or LME warehouses. Even so, the agreed price is normally calculated on the basis of the LME price.

In our hypothetical model (Figure 3), if the region’s aluminium smelters compete and regional demand is low, they would maintain a single ex-factory price ($1,250/t) for all customers regional or international while selling 978,000 tonnes regionally and the rest elsewhere. Competition would impose a uniform price because the LME forward price plus West Europe premium minus transport and insurance charges to Europe would be the best alternative net price obtainable abroad for any excess aluminium (FAS, 2014: 6–13). However, in this competitive milieu, if high regional demand absorbs all regional production (2 million tonnes), the regional smelters would sell their entire production regionally at $1,350/t ex-factory. No aluminium would be imported because the LME warehouses would charge $1,800/t c.i.f.—a price far above what the regional customers would be willing to pay.

If, however, the regional smelters implicitly or explicitly cooperate as a cartel, the smelters would charge regional customers $1,800/t ex-factory—that is, the LME forward price plus West Europe premium plus transport and insurance, thus charging phantom freight, thus hugely inflating their average before-tax profits on regional sales nine-fold, from $69/t to $618/t, assuming high regional demand. With the cartel, the smelters would impose that price ($1,800) under both the high- and low-demand scenarios and export any unsold amounts for $1,250/t ex-factory, the LME forward price plus West Europe premium plus transport and insurance charges to Europe. Thus, under a cartel, regional aluminium processors would pay far more than the smelters’ ex-factory export price to Europe.

Figure 3: Theoretical price under a cartel or competition assuming high or low regional demand and maximum regional capacity of 2 million t/year

* See Annex 4 for the hypothetical data un
The regional warehouses for aluminium use London as the base point for the pricing system whereby their delivered price equals the price at the base point plus a regional premium that considers a region’s temporary supply-demand variations. That premium is hypothetically the average payment needed to deliver the aluminium to the client’s destination even if the real supplier (e.g. Mozal) is literally next door. Thus, for primary aluminium products, the final or full price is the sum of a basic component determined in a highly organized market, namely the London Metal Exchange (LME), and an additional component, called premium [or regional premium]. The full price of aluminium has thus two components: the LME price and the premium. The drivers of the premium are various: duty, cutting, alloying, transportation costs from the warehouse to the plant, aluminium grade, and time of delivery. Regional premiums are fundamentally set by the major primary aluminium producers in their negotiations with purchasers, taking into account the premium they could gain by selling 99.7 ingot to a financial organisation for delivery to warehouse deals. More in detail, premiums are set by major producers based upon the market position of the sellers and buyers. [This] means that premium markets are fundamentally ‘sellers’ markets’ in the sense they can eventually keep markets short by selling overproduction to a finance organisation which puts it on warrant in an LME licensed warehouse (CREIF, 2015: 85, 86 and 89).

With such base-point pricing, if a region has but a few producers, all of whom are willing to collude, implicitly or explicitly, as a cartel to set the price to maximise local profits, they can then insist on selling locally for a price equal to or just slightly lower than what a local client would have to pay, including transport and insurance, to bring aluminium in from a source outside the region (i.e., from an LME warehouse). Under this system, if these producers also sell outside the region, their f.o.b. export price will be far lower than their f.o.b. local price—a flagrantly monopolistic practice benefiting from the compartmentalisation of markets into low- and high-price segments that will stymy local development. Calculating prices from such “phantom bases”, all cartel members charge transportation costs that are not actually made. In this way, the firm that gets the order can reap cartel profits in the form of phantom-freight charges. With a regular stream of more-or-less evenly placed orders, all cartel members gain from this agreement (Bos and Schinkel, 2008: 3). For example, in Europe, ‘the cement cartel included base-point pricing to avoid competition on transportation charges’ even beyond national borders (Levenstein and Suslow, 2008: 1121). In many developed countries, such behaviour is deemed an illegal anti-competitive abuse of monopoly power. In this regard, ‘the United States has historically been the only country where price fixing, domestic or international, was a felony. Recently, however, price fixing has been criminalized in the United Kingdom and Ireland, and similar reforms are underway in other countries, including Australia and Israel’ (Levenstein and Suslow, 2008: 1112–1113). Still short of that, however, the Consolidated version of the Treaty on the Functioning of the European Union, Article 102, confirms that

... any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

27 The LME publishes premiums in four zones that are net consumers of aluminium: West Europe, US, East Asia and Southeast Asia.
28 A “warrant entitles the holder to collect physical aluminium from the network of LME licensed warehouses” (CREIF 2015: 87).
29 For an overview of the history and financial impact of cartels in diverse sectors, including aluminium, see Connor (2014).
30 See also EC (1994: para. 48(3)).
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts (EU, 2008: 89).

Similarly, according to Section 19 of the German Act Against Restraints of Competition, an abuse of a dominant position... exists in particular if a dominant undertaking as a supplier or purchaser of certain kinds of goods or commercial services: (1)... (2) demands payment or other business terms which differ from those which would very likely arise if effective competition existed; in this context, particularly the conduct of undertakings in comparable markets where effective competition prevails shall be taken into account (OECD, 2011: 59, italics added).

To determine whether a price is excessive, three methodologies may be used to estimate the benchmarks against which to compare the prices in question.

Several different sorts of benchmarks have been used to determine whether a price is excessive. These benchmarks can be geographic, historic (in time) or relate to other companies providing identical or similar products or services. Benchmarks can also involve a combination of these elements or relate to a notion of reasonable return. These benchmarks could be based on a direct comparison of prices, a comparison of profitability or a comparison of price-cost mark-ups (OECD, 2011: 62).

For example, by using price comparisons to evaluate base-point pricing, the Federal Antimonopoly Service of the Russian Federation (FAS) (2014: 6–13) shows how, in the Russian Federation, the netback-minus-logistics-costs method determines economically justifiable local prices for a company (like Mozal) that mainly exports. The report exemplifies how this was calculated for the RUSAL Group (the Federation’s only producer of primary aluminium), as replicated here in Annex 2. The South African Competition Tribunal has also interpreted the Competition Act 89 of 1998 to prohibit base-point pricing (Box 2).

5.2.2 Tax concessions, with no expiry date, for Mozal and its investors and shareholders: the problem and the fix

The problem. Eager to entice the investors behind the Mozal project, the government granted some concessions with no expiry date. From a national economic perspective, such termless concessions are unnecessary, since the private discount rates (or marginal opportunity costs) used to calculate the internal rate of return hugely discount the value of such long-off concessions, whereas the social discount rate is typically far lower since a country has intergenerational responsibilities and will, thus, value far-off returns more than impatient private investors (Caplin and Leahy, 2004). For example, the European Better Regulation Toolbox recommends using a social rate of discount of 4% when evaluating the costs and benefits for public projects, whereas private investors will have a significantly higher opportunity cost (EC, 2015). Thus, if a private investor discounts the stream returns at 10% per year, net returns obtained in Year 20 will be worth 15% of those received in the first year, whereas for the nation they will be 46%. This understanding of private corporations’ strong preference for quick, high returns versus a nation’s long-term perspective is key when evaluating the asymmetric cost and utility of making long-term concessions.
The 1997 Investment Project Authorisation requires Mozal to pay a 1% royalty fee (taxa liberatória) on gross sales after a one-year grace period, but exempts it from (i) any other tax on sales or net income, (ii) all import duties on inputs and imported services; (iii) the Industrial Contribution and Complementary Tax on profits and value added, (iv) the tax on circulation and consumption and (v) taxes on interest payments to lenders. Moreover, paragraph 14.1.4 about profits and value added affirms that ‘Mozal and its shareholder and investors are exempt from the Industrial Contribution and Complementary Tax and from any other fiscal taxes.’ The concessions to Mozal were huge and, worse yet, endless. ‘As a share of net profits, the taxa liberatória in 2006… [was], therefore, equivalent to a corporate income tax of 2.9%.’ At that rate, compared with the normal 32% ICPR, the ‘forgone state revenue [was] roughly US$120 million in 2006’, which equalled ‘11.9% of total government revenue’ that year (Kuegler, 2009: 295).

The Jubilee Debt Campaign (JDC) examined Mozal’s finances and questioned Mozambique’s
tiny share in the company’s profits but failed to examine the implications of the project for the development of downstream industries (JDC, 2012).

The shareholders and investors are also exempt from ‘any tax on the distribution and receipt of dividends and the transfer, sale or alienation of shares in Mozal’—throughout the life of the project.31 So, not only is Mozal exempt from profit taxes on its net revenue but also its investors and shareholders will never pay Mozambican taxes on their dividends.

**The fix?** The concerns about base-point pricing, termless fiscal concessions and the overly broad stability clauses can still be brought up, especially considering that the government has been negotiating with Mozal for the Phase III expansion of the factory’s capacity to 750,000 tpa, which creates leverage to open additional questions. If resumed, the temporarily suspended negotiations with Mozal may present an opportunity to remedy or mitigate the overly generous concessions made to Mozal (Scala, 2017).32 Unless Mozal retreated, these arguments and considerations could even lead to a challenge to the validity of the original project authorisation agreement and its huge, permanent tax concessions, perhaps by arguing that its use of base-point pricing and its long and unreasonable opposition to letting Midal use molten aluminium constitute a major violation of the agreement’s clause that the parties must act in good faith. Hence, an economic case can be made for challenging the cartel’s price formula for local sales and its apparently prolonged refusal to sell molten aluminium to Midal as an abuse of Mozal’s dominant position in the local market.

The Mozal–Mozambique investment agreement states, however, that ‘all disputes arising under the [Mozal] investment agreement must be arbitrated according to the rules of the International Centre for Settlement of Investment Disputes’, whose ‘decisions will be definitively and immediately executable in Mozambique’ (Council of Ministers Mozambique, 1997: para. 24.2). This clause seems to mean that, if the arbitrators were to judge in favour of Mozambique, the decision would not immediately be applicable in any other country except Mozambique (Annex 3).33 Moreover, since the agreement is silent about the applicable law, presumably it is Mozambique’s. Given that Mozambique’s competition law is underdeveloped and vague, if arbitration were eventually necessary, this legal context may work to Mozambique’s disadvantage unless the EU’s competition regulations should also apply, since Mozal’s sales go mostly to the EU. Lawyers can assess the legal prospects; politicians will decide whether to proceed.

**5.2.3 Overly broad and non-expiring stability clauses**

These termless concessions are strongly protected by the agreement’s stability clause, which states:

23.1 The benefits and incentives ceded in the present authorization may not be revoked and the acquired rights may not be reduced, except in the case of material lack of compliance with the obligations and undertakings by the beneficiaries of such benefits and incentives;
23.2 Except in cases defined by the present authorization, Mozal will pay the normal rates for administrative requests, licenses, authorizations, that may be necessary for the project;
23.3 In case this authorization does not refer to, consider or include legal dispositions, procedures or administrative practices or similar matters that can have a detrimental impact on the project, then Mozal, its investors, financiers, contractor or subcontractors will be exempt for rates, taxes, emoluments and costs resulting from these determinations so that the project can be

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31 Paragraph 14.1.4 of the 1997 agreement.
32 Before resuming the negotiations, Mozal is trying to guarantee the additional energy needed for the expansion.
33 Borsilov Tsekov, President of the World Jurist Association, presents a succinct table itemising some of the disadvantages of states agreeing to use the ‘supranational tribunals known as Investor-State Dispute Settlement (ISDS)’ as opposed to national tribunals (Tsekov, 2015). See Annex 3 in the present report.
completed and operate according to the terms, conditions and spirit endorsed in the present authorization.

23.4 The terms of the present authorization oblige the government, during the life of the project (and the expansion project), which commits it not to institute unilateral changes or to act in a way that affects the terms and conditions for the implementation and operation of the project. The government also commits that the new legislation, regulations or determinations by the government (including new taxes) that may come to be adopted will not apply to the Mozal Project. The conditions established in this paragraph also apply to Mozal's investors, financiers, contractors and subcontractors for activities exercised for the project.

23.5 All and any alterations to the present authorization will only be emitted by the government after mutual consent between the government and Mozal.

23.6 Partial or total cancelation or revocation of the present authorization will only be decided on the base of a decision by an arbitration tribunal (translation by author).

Besides being never-ending, this stability clause covers everything in the agreement, not just the fiscal provisions. In sharp contrast, a recent evaluation of Mozambique’s efforts to mobilise natural resources recommends that ‘stabilisation clauses should apply only to fiscal regulations and only for a limited period of time’ (Radon, 2013: 165).

Worse yet, with the Phase II expansion of Mozal, the stability clause 23.4 was amended in 2001 to read:

The terms of this Authorisation are binding on the government for the duration of this Project (and the expansion Project) and the government undertakes not to modify the authorisation unilaterally or otherwise to act in such way as to affect the terms and conditions granted for the implementation and operation of the project. The government undertakes that new legislation, regulations or determinations of the government (including new taxes that may be adopted) shall not be applicable to the project, save when such new legislation or regulations, or parts thereof, when applicable to the projects, do not have a detrimental effect on it. Mozal shall, at its sole discretion, assess and determine if such detrimental effect exists [emphasis added].

This last sentence replaces clauses 23.5 and 23.6 of the 1997 agreement. In essence, Mozambique gave away even its right to arbitration about questions covered by the stability clause. Before adopting the revised agreement, the government held a meeting on 23 November 2000, including six ministries plus the Bank of Mozambique, Caminhos de Ferro de Moçambique, EDM and Ara-Sul, to have a final discussion and evaluation of the proposed addenda to the 1997 agreement. Curiously, the minutes for that meeting do not mention any discussion or challenge to this concession. Nor do any documents in the files held by GAZEDA even explain what motivated it and why the government agreed to give away its right to arbitrate any disagreements relevant to the stability clause.

5.3 Capital Iron and Steel

5.3.1 The proposal

With construction to begin in early 2018, the Tete Iron and Steel Project promoted by Baobab Resources Ltd has two components—mining and steel manufacturing—to produce 500,000 tpa of rolled steel (30% for Mozambique, 70% for inland African countries) and employ about 500 workers. For this, Baobab created two wholly owned subsidiaries, Capitol Iron and Steel Ltd, to produce steel, and Capitol Resources Ltd, to do the mining. In total, the project will cost $769 million, of which $80 million will go to construct a line to connect to the national power grid and a 42 km road from Tenga to Moatize. Capitol Resources Ltd has mining concession 7055C,
covering 19,878.23 ha,\textsuperscript{35} of which it ceded 5,650 ha for the industrial zone, 1,616 ha for resettlement of the population, 880 ha for mining and 340 ha as the town for the resettled population. The mining area includes Monte Tenge, which contains 759 megatons of high-quality titanium magnetite containing 37.8% iron with no overburden to remove after the trees are taken out, which, with coking coal nearby, augurs quick, high profits. Moreover, ‘no blasting or crushing is required in the mining process, resulting in a very low mining cost’ (Proactive Investors, 2014). However, of the reserve, the project plans to mine only 2 MT per year, or just 50 MT during the project’s first 25 years—that is, merely 6.6% of the total reserve (Capitol Iron and Steel, 2015).

For the factory, Capitol Iron and Steel Ltd has a two-year provisional DUAT 3909/2016 for 558,3665 ha.\textsuperscript{36} Instead of depending on a highly polluting coke-oven plant, the factory will use direct-reduction rotary kilns fed with coking coal and high-quality iron ore to make molten pig iron to be sent, still hot, directly to a vanadium-separating electric smelter. The smelter’s slag goes to a vanadium refinery; the remaining vanadium-free iron will be hot-charged into a basic oxygen furnace to reduce the carbon content to make steel. If proper pollution controls are installed, the direct reduction rotary kilns will create far less pollution than blast furnaces.\textsuperscript{37} The molten steel will be hot-charged into a continuous casting to make ingots, which, while still hot, will be immediately converted into rebar and other shapes (Annex 1). The transfer of material while still hot from the rotary kiln to the smelter, then to the basic oxygen furnace, and, onward, to continuous casting of ingots for immediate rolling will reduce energy consumption and costs greatly.

The availability of electricity, the high quality of the coal and iron ore, the well-integrated and efficient design of the factory and the clever targeting of inland markets should make the project highly profitable. Moreover,

... the new integrated steel factory will stimulate demand for many upstream ancillary services (training, food preparation, computer services, metal and electrical engineering, and electricity supply) and cause steel prices to fall below the cost of imported steel, thus improving the cost efficiency of downstream industries (e.g., construction and wire drawing). Moreover, with a nearer supply, deliveries should be speedier thus permitting firms to incur lower inventory costs (Coughlin, 2015b: 7).

The success of the downstream industries will, however, depend on whether the government regulates this new steel monopsony and avoids any tendency for price gouging.

5.3.2 Negotiation issues and the final agreement

Despite gaps in the information available in the files availed for this research, two problems were identified in the negotiations leading up to the authorisation agreement:

- **Evaluation of resource requests:** Though the project plans to use only 6.6% of the confirmed deposit in 25 years, Capital Resources was given a mining concession over the entire deposit, thus preventing Mozambique from inviting other investors in order to use this resource more fully. Seemingly, mining concession 7055C, valid until 9 December 2039, was given for the entire 19,878.23 ha in absolute disregard for whether the project had plans to use those deposits fully. An overly broad monopoly was created controlling this entire, huge deposit, thus impeding future competition based on it. The laws, regulations and administrative procedures that can yield such an economically

\textsuperscript{35} The concession is valid for 25 years, plus one 25-year extension.

\textsuperscript{36} Direito do Uso e Aproveitamento de Terra (translation: Right to Use and Benefit from Land)

\textsuperscript{37} ‘The impact on the environment of a direct reduction unit itself is very limited. There is little dust emission, which is easy to collect. The water need is low and water can be recycled to a large extent’ (Remus, 2010: 553).
anti-developmental outcome clearly need scrutiny and radical reform—quickly. Land concessions should be given in accordance with the investors’ proven ability to utilise those resources well. Companies monopolising huge tracts of idle natural resources should be avoided.

- **Facilitation of the local community’s ability to negotiate well to defend their interests**: Baobab Resources is committed to negotiating with the local residents for the Agreement for Local Community Development, whereby Baobab has promised to spend $6.3 million on social projects over 23 years. As agreed, that contract should be signed in the third year of the steel factory’s production. Besides being of dubious legal validity, this agreement to agree implies a big delay that puts the local community at a huge disadvantage in the negotiations. Moreover, neither the investor nor the government allocated any funds to enable the community to hire professional advisors to improve their negotiating posture and the eventual outcome. For example, in a review of many negotiations between native or aboriginal communities and multinational mining companies in Australia and Canada, O’Faircheallaigh (2016: 118) concluded such assistance was often crucial to enable communities to stand firm and improve their agreements’ outcomes. Indeed, for the Tete Iron and Steel project, three parts of the investment authorisation could have been improved.
  
  o As approved, the investor’s proposal states that $2.3 million will be spent on community projects within the first five years after signature of the Agreement for Local Community Development, though that agreement will be negotiated and agreed upon only in the third year of the steel project’s production. The community, however, may well have wanted a larger and quicker investment in training to enable local people to become workers in the mine and factory. Strangely, the money will not begin to be spent till the third year of production by the steel factory. Thus, nothing will be spent on training locals in time for them to be hired for the start-up of the factory!
  
  o The project makes no commitment to give preference to local workers so long as their qualifications are competitive with those of other applicants.
  
  o Though no investment agreement exists, the project authorisation of 28 October 2016 envisages the possibility of a 25-year extension. It does not stipulate that the project has any obligation to provide additional funds to support community projects during any extension of the authorisation.

### 5.4 Matchedje Motor

#### 5.4.1 The proposal

In November 2010, a mission from China Tong Jian Investment Co. Ltd came with, seemingly, an incredibly good offer to set up an assembly plant that would, within five years of start-up, employ 3,000 workers, produce 20,000 vehicles and generate $2.5 billion in sales revenue. The factory (initially called Surmount Ltd and later Matchedje Motor Ltd) would supposedly cost $100 million and eventually be able to make 100,000 vehicles per year on the basis of SKD and CKD component kits. Analysing the project proposal, Abílio Cossa, a mechanical engineer for the National Directorate of Industry in the Ministry of Industry and Commerce, complained about ‘the lack of descriptions for the production processes that will occur in the factory, whereby the company explains clearly the industrial operations that it proposes to do’. Then he observed sceptically that

the production equipment listed in the document is insufficient (insignificant) for the industrial processes referred to in the flowchart. Almost none of the items of equipment have anything to do directly with the operations referred to in the production flowcharts presented in the document...
[Instead] it refers to common equipment used in any mechanical shop that is far short of being specific for the assembly of vehicles.\textsuperscript{38}

Cossa also recommended that the proposal ‘clarify if vehicle components would be produced in the factory or imported’. Indeed, the technical vagueness in the proposal should have, but did not, set off alarm bells in both the Ministry of Industry and Commerce and GAZEDA.

The project’s proponents also requested 100 ha—1 km\(^2\)!—adjacent to Maputo Port, to use for free for 50 years. Though they presented no analytical justification for demanding such a huge tract of prime land, the government’s analysts never insisted on a detailed justification. Nor do the project files mention any analysis having been done to judge the economic and technical validity of this request. Instead, the proponents were merely told to submit their request to the Matola and Maputo City Councils and to the Ministry of Agriculture, bodies not well equipped to judge the economic and technical justifications and the urgency (or not) of the request.

Later, when a Chinese mission came, it objected to having to pay $12.50/m\(^2\) in the Beluluane Free Zone. Caminhos de Ferro de Moçambique was then persuaded to permit the project to use its 50 ha parcel for free for three years. This was accepted in Clause 3 in the implementation agreement, though Matchedje Motor had already been granted 50 ha in the Maluana Science and Technology Park, in Manhiça district. The proponents also requested exclusivity for the production of vehicles in Mozambique and a commitment by the government to buy their vehicles and facilitate purchases by government employees. In its evaluation report, GAZEDA’s Studies and Projects Department argued that ‘exclusivity does not seem recommendable since it runs contrary to the benefits and advantages of a free market and economic competition’.\textsuperscript{39}

Having obtained information that, simultaneously, other Chinese delegations were making similar offers to Tanzania and Zimbabwe, the Mozambican side felt immensely pressured to seize the opportunity despite the lack of due diligence research and essential details in the contract. So, in mid-December 2010, GAZEDA signed the implementation agreement. Instead of a robust grant of an Exclusive Service Provider Regime, the agreement merely contained a vaguely worded Clause 17 granting an Exclusive Service Provider Regime for three years, ‘only applicable to the Chinese companies of the same business area’ and only if China Tong Jian Investment Co. Ltd fulfilled its promises.

The implementation agreement, however, contained no details specifying whether the components would be SKD or CKD kits, how fast imported components would begin to be produced locally or, at least, within the region, or how the company would facilitate that transition for increasingly more local production of the components.\textsuperscript{40} Nor was the pricing formula specified for the components in order to restrain the worst manipulations to bias the omit allowances against local producers. Except for the Ministry of Industry and Commerce’s engineer’s brief criticism of the lack of details about the local versus overseas production of inputs, the files reveal no discussion at all of the need to promote local and regional production of inputs.\textsuperscript{41} Judging from the files, no one on the government’s side knew that these were normal and essential issues in a negotiation for any assembly plant based on imported CKD components, for example for cars, trucks, televisions, computers, refrigerators.

\textsuperscript{38} Evaluation of the industrial project by Matchedje Motor Ltd, prepared by Abílio Ruben Cossa, Mechanical Engineer, National Directorate of Industry, Ministry of Industry and Commerce, 28 August 2012.

\textsuperscript{39} Evaluation of the Automobile Project proposed by China Tong Jiang Investment Co., Ltd., prepared by the Studies and Projects Department, GAZEDA, 1/11/ November 2010.

\textsuperscript{40} Sandra Song, Matchedje Motor’s Director, confirmed that no schedule exists to progressively increase value added over time—interview on 14 August 2017.

\textsuperscript{41} Evaluation of the industrial project by Matchedje Motor Ltd, prepared by Abílio Ruben Cossa, Mechanical Engineer, National Directorate of Industry, Ministry of Industry and Commerce, 28 August 2012.
After some delays in start-up, China Tong Jian Investment Company’s Feasibility Research Report of 2012 also promised to ‘build a flagship exhibition hall,... copy [that] in the 27 major cities of Mozambique after success [is achieved], and then set up a sales network in southeast Africa and all area[s] of Africa’. On 9 July 2012, in the weekly meeting for the implementation of the factory, Matchedje Motor’s director, when requested to explain the project’s plans for training workers, provided no data at all, only vague promises to train ‘those necessary for the factory’. Then, to bolster her case, she promised—vaguely—that the project would also set up a Matchedje Motor university to train workers in relevant skills.42 To date, neither the exhibition halls nor the university exist, and, given its financial straits, Matchedje Motor has no plans to create them.43

5.4.2 The project

Production began on 14 November 2015. As of March 2016, the company—hugely constrained by difficulties in obtaining foreign exchange—had only 80 employees and was assembling just 10–15 vehicles per month.44 By mid-2017, the company had just 40 employees, and the director confirmed that it had produced no vehicles in 2016 and none till then in 2017. Worse yet, it still had unsold stock from the few vehicles it had produced in 2015.45

Despite the project’s announced plans to sell many thousands of vehicles within the region, Matchedje Motor requested, on 18 April 2016, a change of status from an Industrial Free Zone company to a normal Mozambican assembly manufacturing company subject to all the normal import duties on inputs. Very probably, a significant motivation for this request was to eliminate Matchedje Motor’s obligation that, as an Industrial Free Zone company, it could sell no more than 30% of its production within the Mozambican market.

So far, the project has been a fiasco. By September 2017, Matchedje Motor had stopped assembling vehicles and switched to repairing buses (Mahumane, 2017). By mid-2018, it was merely converting bus carcasses into schoolrooms and, according to Rajendra de Sousa, Minister of Industry and Trade, had ‘only left debts for the Mozambican state’ (AIM, 2018). In retrospect, the Mozambican side should have been intensely suspicious of the proponent’s (i) dubiously achievable promises to ramp up production to 20,000 vehicles within just five years, which, in truth, would have required a massive effort to train thousands of local workers for the assembly plant and for input suppliers and to set up reliable quality control systems; (ii) request for an exclusivity regime with the government; (iii) vagueness about required equipment, training and the establishment of Matchedje University; (iv) exaggerated requests for free land; and (v) failure to offer a progressive and detailed schedule to substitute imported CKD components with locally and regionally manufactured ones. Even its promise to focus on the regional market is dubious and, for now, has been completely abandoned.

The project’s allure was too good to be true. So why did the proponents invest their money? Though the evidence is inconclusive, a strong hypothesis can be suggested. It seems that they were betting on three things: (i) the high effective rate of protection (≈70%) that the tariff structure grants a vehicle assembly project with small value added;46 (ii) their ability to persuade the government to buy exclusively their vehicles; and (iii) the seeming willingness of the
Chinese government to support their project, at least, partially. Their excessive requests for land may have been another part of the gambit.

To disprove the hypothesis, Matchedje Motor will need to show the money, provide significant financial guarantees, commit to specific and detailed plans to shift to locally and regionally made components, provide detailed plans about equipment, buildings and training and rely on competition, not the subsidies implicit in an exclusivity regime. That they can or want to do this seems unlikely.

5.4.3 Lessons

- No critical assessment was made of the technical and economic justifications for requesting huge amounts of free land and an exclusivity regime. Negotiators never demanded additional details to verify whether the requests were, indeed, needed technically or financially. Their approach was merely bureaucratic and legalistic.
- The Mozambican side did not demand technical and financial details for Matchedje Motor’s promise to build a technical university.
- No details were required about the production process and how, over time, more and more components would be made locally or regionally. Nor were details demanded about the formula for the omit allowances for locally made components.
- The demand for exclusivity should have been, on principal, flat out refused.
- Succumbing to time pressures, the Mozambican negotiators accepted an extremely vague and bad deal.

5.5 Ayr Petro-Nacala

5.5.1 The proposal

In 2007, Ayr Logistics Ltd Inc. plus two South Africans and a Mozambican proposed an investment of $1.3 billion for a crude oil refinery, Ayr Petro-Nacala, which would hire 450 workers and produce 33,000 barrels/day of gasoline, diesel oil, kerosene, propane, butane, fuel oil, naphtha, oil, grease and other products, two thirds of which would, supposedly, be for export. For this purpose, in 2006, they created a local company, Ayr Logística Limitada, with the minimal capital of 20,000 meticais. The project files contain no evidence that any due diligence research was conducted about the technical and financial capabilities of the proponents. In December 2007, Rafique Jusob, Director of CPI, informed Ayr Logística that the project was approved, though the proponents were requested to provide the government a $10 million bank bond as guarantee for the execution of the project; failing that, the investment agreement would be cancelled. In March 2007, the government announced its approval of the project and the allocation of 838.3 hectares—8 km²—for it, though CPI had not analysed the technical need to request to be granted so much land, for free, in Nacala-à-Velha. Belatedly, on 12 June 2008, Ayr Logistica informed CPI that it had paid $50,000, a mere fraction of the required $10 million bond. Nevertheless, for years, CPI and later GAZEDA took no further action against Ayr Logistica.

Finally, in 2013, GAZEDA—suspicious of the company’s seriousness—requested the government to cancel the investment authorisation. On 14 February 2014, Ayr Logistica submitted its proposal for the construction of an oil refinery and the construction of a deep-water pier. Bizarrely, on 10 October 2014, the principal proponent of the project, Ayr Ltd Inc., filed for voluntary bankruptcy in the Texas Northern Bankruptcy Court. However, as of early July 2017,
GAZEDA’s director had still not been informed if the investment authorisation had ever been cancelled.

5.5.2 Lessons

- Thorough due diligence research about the proponents should have revealed the dubiousness of the proposal.
- The request for 8 km² of land should have undergone a thorough technical and economic evaluation.
- Given that CPI was dealing with Ayr Logistica, a virtually worthless shell company, it should have conditioned the issuance of the investment authorisation upon the prior receipt of the banker’s guarantee or, at least, cancelled the authorisation immediately when the six-month period for the receipt of the guarantee had expired.

5.6 International Beverage Company A

5.6.1 The proposal

In 2016, International Beverage Company A proposed to invest $100 million in a factory that, by the third year, would directly employ 250 workers and, indirectly, another 15,000, to produce and distribute 800,000 hl. Mozambique would be its main market. The company’s proposal was, however, conditioned on receiving

- a complete exemption from taxes on imported inputs and packaging materials\(^49\)
- an extended seven-year period (instead of the normal five years) to recover initial losses and
- a 50% reduction in the specific consumption tax (itself normally 40%) up to 40 million litres and a 25% reduction on up to 60 million litres.

Upon receiving this request, CPI did not press the company to prove its assertions that, without these tax concessions, the project would be unfeasible. Nor did it conduct even a quick two- or three-page economic and financial analysis discussing the unfair competition that acquiescence to these requests would generate and, hence, the decrease in tax revenues hitherto garnered from other producers, whose sales would shift partly to the new company. Such an analysis would have quickly revealed that, in effect, the company was asking the government to finance much of the investment, while simultaneously diverting some of the sales of other producers to the new factory—a proposition that, from the Mozambican perspective, would be bad both economically and politically. Nor was any analysis conducted of the company’s international structure to reveal whether it had serious pressures to open a factory in Mozambique or whether its proposal was merely a gamble to see if huge concessions could be won easily by merely asking the government.

To date, the proponent has not submitted a revised proposal. Nor does CPI’s file indicate any effort by the centre to revive discussions and explore options.

5.6.2 Lesson

- The preference for bureaucratic procedures and legalistic analysis and the routine failure to conduct due diligence research about the investor’s structure, constraints and alternative options and an economic, financial and technical analysis of the proposal hampers the government’s ability to identify innovative win-win counterproposals instead

\(^{49}\) No import duties apply to relevant inputs imported from within the Southern African Development Community, but a 7.5% duty is charged on inputs from most favoured nations, where this company’s inputs come from.
of merely responding to and, perhaps, rejecting an investor’s first proposal. A bureaucratic or legalistic approach cuts off discussion whereas a careful effort to sound out and better understand an investor’s diverse needs may enable both parties to identify alternative ways to meet each other’s fundamental needs.
6 CONCLUSIONS

This first-time study of how Mozambique evaluates investment proposals and negotiates agreements for large and mega-projects, except for in coal and gas, reveals that the process is disparate, uncoordinated and largely bureaucratic and legalistic. For instance, in the six cases studied, the technical and economic justifications of the proponents’ requests for tax and land concessions were never evaluated, which in some cases led to hugely excessive concessions. Nor, in any case, was a due diligence investigation conducted about the proponents’ financial and technical structure, in order to confirm the investors’ capabilities, identify any possible conflicts of interests they may have vis-à-vis Mozambique’s development objectives, and understand their negotiation strengths or weaknesses, especially as regards their alternatives to a non-agreement with Mozambique.

Also, except for in the Mozal negotiations, no detailed discussions ensued about the promotion of upstream or downstream industrial or service linkages to see whether, in this regard, more could be gained than initially proposed by the investor.

The evidence unearthed by the study strongly suggests that Mozal uses intermediaries to impose monopolistic base-point pricing and sell aluminium in Mozambique at prices far above the f.o.b. factory price of its exports to Europe, a practice that has greatly delayed the development of local downstream industries.

Finally, in this study, which excludes coal and gas, the leaders of the key agencies involved in investment promotion (CPI and GAZEDA) emphatically confirm that the complete absence of training of key personnel about the preparation, strategy and tactics of negotiations, and the lack of a central body to supervise negotiations for large and mega-projects, has seriously reduced their effectiveness and the benefits achieved for the country.
7 RECOMMENDATIONS

7.1 Structural reform

- For large and mega-projects, Mozambique needs a Central Negotiations Authority (CNA) with a well-trained, well-paid and stable staff to supervise, analyse and ultimately approve major investment authorisations, including the related ministerial authorisations. For large and mega investments involving interventions by multiple sectors, the CNA should have full authority to designate the lead negotiator, presumably a professional who is well trained and skilled in conducting multifaceted negotiations with multinational corporations. For small investments, the CNA should limit its intervention to approving ministerial decisions or, if big errors have been made, denying final approval and insisting on renegotiation. To ensure its authority over the sectoral ministries, the CNA should be an organ of the Ministry of Economics and Finance, work in close cooperation with the Directorate of Economic and Financial Studies and have strong endorsement from the Office of the President. This placement would also ensure good complementarity between the professional staff in Directorate of Economic and Financial Studies and the CNA and contribute to a unified vision of development needs and strategy.
- When it deems necessary, the CNA should have the necessary budget and authority to employ technical experts to advise it during negotiations. However, such advisors should always be charged with training CNA’s local staff to become competent, long-term advisors for the authority.
- The CNA should maintain a central archive of copies of all proposals, correspondence, communications, authorisations, etc. related to a project under its jurisdiction.

7.2 Regulation of monopoly practices impeding development\(^{50}\)

- ‘Refusal to sell to local companies or consumers should be classified as an illegal restrictive business practice. Moreover, if production is inadequate and supplies are scarce, local businesses should receive priority over international buyers though not in contravention of long-term sales contracts.’
- ‘If the local sale of by-products or intermediate products (e.g., gas, chemicals, metals) would permit the development of new downstream industries or greatly improve their efficiency and/or significantly reduce environmental pollution, producers should, by law, be obliged to sell such products at a fair market price.’
- ‘If a company sells principally to export markets,\(^{51}\) then, without a strong economic justification (e.g., extra real costs incurred for handling small quantities), charging local companies prices higher than the ex-factory price applied for goods sold to export clients should be defined as an illegal restrictive business practice that is commercially unfair, impedes development, and contravenes competition policy and law. If the export clients are part of the same financial group as the exporter, the correct price to local buyers should be the lower of the \textit{ex-factory price} (f.o.b.) to export clients or the \textit{netback price} calculated based on an independent estimate of the competitive landed value of

\(^{50}\) From Coughlin (2015a: 43).

\(^{51}\) ‘This caveat is necessary because, if a company is producing principally for the local market but has significant excess capacity, it may justifiably sell at a discount into export markets in order to utilize more of its capacity and achieve additional marginal profits. Nevertheless, if this were done on a massive scale, it might be classified as dumping by the World Trade Agreement and... legally [punishable] if the government in the target countries could prove that such imports hurt their local companies (WTO 2015). However, small and medium-sized companies that use such compartmentalized marketing with low prices in export markets would almost certainly fly under the radar and not be detected or complained about. But megaprojects have no such cover’ (Coughlin, 2015a: 43).
the product. The latter calculation would be used to test for disloyal intra-group transfer pricing.’

• ‘The Competition Law, especially articles 17, 18 and 19, should be carefully analysed to ascertain whether it requires clarification and strengthening by amendment or interpretive regulations… to prevent the abuses of monopoly power identified above.’

7.3 Operational reforms

• **Investment promotion**: The newly constituted Agency for Promotion of Investment and Exports (APIE X) should not just passively receive, evaluate and process investment proposals but also proactively design and promote interlinked investment programmes and projects and encourage bidding for their components.

• **Due diligence research**: APIEX should conduct thorough due diligence research to analyse the investor’s financial and technical structure and, hence, assess its alternatives and motives (including possible conflicts with Mozambique’s development goals) and maximise the beneficial effects for local development.

• **Land and fiscal concessions**: More than merely conducting bureaucratic or legalistic assessments, APIEX should always include the technical and economic evaluations to confirm genuine need exists for requests for land and fiscal concessions.

• **Processes and equipment**: Whether the equipment to be installed will be new or second-hand and whether the processes to be used will be modern and top of the line or less so should be specified and justified in the investment application form. The eventual agreement should detail this commitment.

• **Monitoring of the implementation of investment agreements**: In cooperation with the line ministries, APIEX should systematically monitor the implementation of the major components of investment agreements, especially the types and quality of equipment and processes, including those for environmental protection, the commitments to invest in labour training and obligations to affected communities.

7.4 Specific contract clauses

• **Stability clauses** should cover only fiscal matters and be valid for, at most, 15 years.

• **Commitments to invest** in training, relocation and social services and promote upstream and downstream linkages should specify the quantitative and financial details. Vague language should be avoided.

• **Land concessions** should be subject to partial revocation for any portions that are not utilised or do not have well justified and specific plans for future use.

• **The choice of which country’s law and courts or which arbitration body** will apply in the event of disputes requires great care to avoid huge disadvantages and costs (Annex 3).

7.5 Tax law and its implementation

• It is urgent for the Ministry of Finance to promptly refund tax credits upon request. The failure to do so ties up capital and creates counterproductive economic reactions, belies the offer of VAT tax exemption for firms in Industrial Free Zones and inevitably discourages investment in these zones.

• No tax exemptions on paid-out dividends or interest payments should be granted to local or overseas investors.

• The government should re-evaluate and, in some cases, drastically reduce the effective rates of protection implied by the tariff structure for assembly projects using SKD and CKD kits of imported components.
ANNEX 1: INTEGRATED STEEL-MAKING PROCESS FLOW FOR TETE STEEL PROJECT

ANNEX 2: NETBACK-MINUS-LOGISTICS-COSTS METHOD TO DETERMINE JUSTIFIABLE BENCHMARK PRICE

According to a determination by the FAS, members of the RUSAL Group (the only producers of primary aluminium in the Russian Federation) should not fix the ex-works price for primary aluminium for consumers (buyers) in the Russian Federation higher than the price (P1), estimated on the basis of EXW [ex-works] or FCA [free carrier] railway station or consignor’s warehouse under the formula:

\[ P1 = LME1 + \Pi A7, \]

where:

- \( LME1 \) = average quotation for a particular aluminium brand on the LME in a particular period;
- \( \Pi A7 \) = \( P_{preg} - Lf - Lt \), where:

  - \( P_{preg} \) = average regional premium for aluminium of a particular brand on the main segment of the world market for particular goods where RUSAL exports the most amount of goods in comparison with other segments of the world market (the main segment of the world markets: Europe, Asia or America) in the period similar to the period selected to determine \( LME1 \). The following premium indices are used in the main segments of the world market: Europe – ‘CIS-origin: index warehouse Europe: A7e premium’ or ‘MB Aluminium Premium Rotterdam Low – High’ (Metal Bulletin Daily - www.metalbulletin.com); Asia – ‘Aluminum CIF Japan premium ($/mt)’ (Platts Metals Daily - www.platts.com); America – ‘Aluminum MW US Transaction premium (eVlb)’ (Platts Metals Daily – www.platts.com);
  - \( Lf \) = the average weighted value of the actual logistic expenses by RUSAL for freight from a port in Russian Federation (the main Russian Federation port through which aluminium is shipped for sale in the main segment of the world market) to the destination port outside the Russian Federation (a port of the main segment of the world market) in the 3rd month preceding the shipment month;
  - \( Lt \) = the average weighted value of the actual logistic expenses by RUSAL to deliver aluminium from producers to the main Russian Federation port in view with port transhipment costs in the 3rd month preceding the shipment month.

Source: FAS (2014: 8).
### ANNEX 3: ADVANTAGES AND DISADVANTAGES OF ISDS TRIBUNALS VS. NATIONAL JUDICIARIES FOR RESOLVING COMMERCIAL DISPUTES BETWEEN STATES AND INTERNATIONAL CORPORATIONS

<table>
<thead>
<tr>
<th>ISDS tribunals*</th>
<th>Judiciary at national level</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transparency of process</strong></td>
<td>Missing completely or severely restricted.</td>
</tr>
<tr>
<td><strong>Guarantees of judicial independence and objectivity</strong></td>
<td>Vague and difficult to apply in practice as they are not backed by a solid mechanism for sanctions. Insufficient guarantees for the professional integrity of the arbitrators and against conflicts of interest and corrupt practices. Cases are handled by private arbitrators selected for the event (usually lawyers associated with large corporations) that receive substantial payment per hour for each proceeding under ISDS and are financially incentivised to have more investors to refer cases to the appropriate tribunal.</td>
</tr>
<tr>
<td><strong>Equality of parties involved in dispute</strong></td>
<td>No – the legal possibility of bringing an action is unilateral and favours the foreign investor. The state cannot hold liable a foreign investor who violates their legal and contractual requirements.</td>
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<tr>
<td><strong>Possibility to appeal</strong></td>
<td>No or very limited and inefficient.</td>
</tr>
<tr>
<td><strong>Guarantees of equal legal conditions for business</strong></td>
<td>No – foreign investors are privileged by the mechanism of ISDS compared with local businesses.</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td>It is a very expensive procedure that disadvantages poorer countries against large corporations.</td>
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</table>


Note: * ISDS are ‘supranational tribunals known as Investor-State Dispute Settlement (ISDS)... such as the international Centre for Settlement of Investment Disputes at the World Bank..., [the] London Court of International Arbitration, [the] International Chamber of Commerce, UNCITRAL and the Hong Kong International Arbitration Center.’
ANNEX 4: ASSUMPTIONS UNDERLYING FIGURE 3

<table>
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<tr>
<th>'000 tons</th>
<th>LME price</th>
<th>LME + T&amp;I</th>
<th>LME + West Europe premium - TI</th>
<th>Marginal cost of production</th>
<th>Average cost for all companies</th>
<th>LowD (price curve with insufficient regional demand)</th>
<th>HighD (price curve with excessive regional demand)</th>
<th>Transport &amp; insurance</th>
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Note: Formula for LowD: \( p = 2000 - 0.8q \); formula for HighD: \( p = 3490 - 1.07q \), where \( p \) = price; and \( q \) = quantity in thousand tonnes.
REFERENCES


