IMF in Mozambique and Mongolia: Exacerbating climate crisis with more tax breaks for coal and gas

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This paper provides a summary of a review of IMF loan operations in Mozambique and Mongolia. The review aimed to identify climate change related economic policies and specific structural benchmarks contained within IMF loan programs. Mozambique and Mongolia were selected because of large-scale coal and gas investments taking place during IMF loan operations since 2015.

Main Findings

Overall, the review found that the IMF's loan programs in both Mozambique and Mongolia have to be considered against the context of the IMF's macroeconomic projections (e.g., GDP and government revenue growth rates) and assessment of the country's ability to service debt, e.g., pay back loans, (including that of the IMF and multilateral development banks). In both countries, the growth rate projections and associated debt servicing assessments are overly dependent on making sure massive investments in coal and gas go forward. This context ultimately makes it difficult to determine the neutrality, climate or otherwise, of economic and financial policies and related structural benchmarks.

However, the review did find several policy reforms with direct links to either increasing or decreasing public assistance for fossil fuels. There were no direct links to renewable energy. Specifically, the review found IMF policy reforms, reinforced by structural benchmarks and/or IMF technical assistance, supported:

- **New producer subsidies for coal and gas –** The IMF program supported the creation of new tax polices providing producer subsidies for coal and gas in Mozambique and for coal in Mongolia. These new policies result in significant tax breaks for coal and gas operations, which incentivizes new investments. Additionally, the IMF provided technical assistance for the development of these tax policies in both countries.
- **New legislation to facilitate public finance for gas –** The IMF loan program supported new legislation in Mozambique that provided substantial benefits to Export Credit Agencies (ECA) instrumental to clenching the public finance of 8 ECA's for a $15 billion financial package for LNG Area 1. The deal is hailed as the largest project financing ever in Africa
- **Public investment for priority mega coal and gas projects –** The IMF loan programs are actively engaged in assessment criteria and selection of priority infrastructure projects that receive public finance. In Mozambique and Mongolia, priority projects involve mega coal and gas projects.
- **Reduction in electricity and/or fuel subsidies –** The IMF loan programs support reforms aimed at reducing subsidies for petroleum and electricity in Mozambique, which could potentially have climate benefits. However, the potential for associated GHG emissions reductions are questionable and undermined by other IMF reforms. First, the majority of electricity in Mozambique is from hydro power and reductions in consumer fuel subsidies are undermined by new producer subsidies. In Mongolia, potential climate benefits could result from the IMF's Structural Benchmark to increase excise tax rates and reform retail fuel prices, which also are undermined by IMF support for tax breaks benefitting coal producers.

Introduction

The scope of this assignment is limited to a review of IMF loan programs to identify policy measures within those programs and structural benchmarks with either positive or negative climate change ramifications. The development of recommendations is not part of this assignment. This assignment also does not provide an analysis of the assumptions surrounding IMF GDP and government revenue growth rates heavily dependent on gas and coal production in these two countries.

Table 1 provides a summary of outstanding IMF loan programs in Mozambique and Mongolia. Until a loan is paid in full, the IMF continues to review and consult the government on progress towards the economic and financial policies associated with the loan program (more details below). It is important to note, IMF loans are provided as general government budget support. Even though the IMF does not provide finance for specific projects, IMF loan programs significantly influence budget priorities and policies, which in turn can be linked to specific projects or sectors.

Table 1. Outstanding IMF Loan Programs in Mozambique and Mongolia

Mozambique			
IMF Loan Type	**Approval Date**	**Amount Approved**	**Amount Drawn**
Rapid Credit Facility	April 29, 2020	$309 million	$309 million
Rapid Credit Facility	April 19, 2019	$119.2 million	$119.2 million
Stand-by Credit Facility*	Dec. 18, 2015	$282.9 million	$117.9 million
		Total	**$546 million**
		Outstanding	**$502 million**
Mongolia			
IMF Loan Type	**Approval Date**	**Amount Approved**	**Amount Drawn**
Rapid Financing Instrument	June 3, 2020	$99 million	$99 million
Extended Fund Facility~	May 24, 2017	$434.3 million	$217.33 million
		Total	**$316 million**
		Outstanding	**$312 million**

*18-month stand-by arrangement from December 2015 to June 2017. During this time, $117.9 million was drawn/borrowed.

~ Three-year extended arrangement from May 2017 to May 2020. During this time, $217.33 million was drawn/borrowed.

Memorandum of Economic and Financial Policies

At the time of approval of an IMF loan program and for each subsequent loan program review, government authorities issue a Letter of Intent. The Letter of Intent includes the Memorandum of Economic and Financial Policies (MEFP), which sets forth the objectives and policy measures/reforms of the program that the government authorities intend to pursue during the duration of the IMF loan. The MEFP is developed in consultation with the IMF. Additionally, several of the MEFP policy measures/reforms are indicated as structural benchmarks with targeted completion dates.

IMF loan program reviews typically take place bi-annually or annually. At which time, the IMF determines progress on the MEFP and whether or not structural benchmarks and indicative targets (typically involve level of government revenue, and other targets on levels of reserve money, priority spending, etc.) have been met. Each IMF review results

in revisions and additions to the MEFP and structural benchmarks.

For this assessment, the Letters of Intent (i.e., MEFPs) and related IMF Staff Reports were reviewed for each of the loan programs listed in Table 1. This paper provides a summary of the relevant findings. Tables 2-6 below provide text taken from the Letters of Intent and Staff Reports.

Role of Mega Coal and Gas Projects in IMF Loan Programs

The IMF's loan programs in both Mozambique and Mongolia are inextricably linked to on-going efforts to attract investments into mega coal and natural gas infrastructure projects. The IMF's macroeconomic projections (e.g., GDP and government revenue growth rates) and assessment of both countries' ability to service debt, e.g., pay back loans, (including that of the IMF and multilateral development banks) are highly dependent on massive growth in coal and gas production and the global prices of both commodities. In fact, the IMF staff reports associated with the loan programs urge both governments to move forward on specific coal and gas mega projects (see Table 2, below). Examples include:

> Mozambique: "In the coal sector, agreements need to be reached to unlock financing for the completion of the Nacala rail corridor, which would triple coal export volumes by 2017… It is crucial that jointly satisfactory agreements are reached soon to ensure that LNG [liquified natural gas] investment can move forward."

> Mongolia: "Mongolia has huge potential in many key commodities...one of the largest coal deposits, at Tavan Tolgoi (the redevelopment of which is expected to begin in 2019)… Keys to leveraging this potential are better infrastructure and a more market-friendly investment environment… The future of the coal sector is intimately connected with developments in China. One scenario is that China downsizes its own coal industry for environmental reasons and either imports coal or coal-powered electricity from Mongolia."

The IMF does list volatility in global commodity prices and demand as risks to the projected growth in revenues from coal and gas production. The recommended policy response is measures to improve management of natural resource wealth and economic diversification. There is no discussion of downside risks associated with the decrease in coal and gas production necessary to meet the goals of the Paris Climate Agreement.

New Coal and Gas Producer Subsidies

In both Mozambique and Mongolia, the MEFPs associated with the IMF's loan program supported new producer subsidies through tax breaks for coal in Mozambique and Mongolia and also for gas in Mozambique (see Table 3, below). In addition, the IMF provided technical assistance to develop new tax regimes in both countries.

In Mozambique, the MEFP listed the adoption of new tax regimes for mining and hydrocarbons (i.e., oil and gas), which benefitted from IMF technical assistance. The IMF Staff Report and government Letter of Intent do not provide any information on what new measures were contained in the new tax regimes. One can only find out by doing additional research. Existing research shows that:

New coal tax breaks: The new Mining Tax Law has a low royalty rate of only 3% for coal. Earlier government drafts of the law had set the royalty for coal at 5%.[1] An IMF tax reform technical assistance mission took place in June 2014 just prior to the law being finalized for submission to the Parliament. In addition, the new regime provides a tax reduction of 50% of the Mining Production Tax when the production of coal is used by local industry, e.g., mine-mouth coal plants used to extract more coal.[2] Lastly, mining operations are exempt from Custom Duties on the importation of capital goods for a period of five years.[3] This is a substantial subsidy as Mozambique's general tax code levies 20% for Customs Duties.[4]

New gas tax breaks: The new Petroleum Tax Law gives a VAT exemption to goods and services rendered for the drilling or construction of infrastructure involved in oil or gas exploration.[5] This is a substantial subsidy as the general VAT rate is 17%. Oil and gas operations are also exempt from Custom Duties and domestic oil and gas consumption has a 50% reduction of the Petroleum Production Tax (i.e., royalty).

In addition, the new Petroleum Tax Law provides a special investment incentive in the form of accelerated rates of depreciation for oil and gas exploration.[6] Accelerated depreciation of new capital investments allows oil companies to quickly write down capital investments that would otherwise depreciate more gradually. In other words, larger tax reductions are taken at the start of the operation, thus making new projects more economic and increasing cash flows that can be put towards more drilling.

In Mongolia, reform of the mining tax regime was on the agenda of the MEFP and listed as a Structural Benchmark for December 2017 (see Table 3). The IMF Staff Report (April 2017) suggests support for tax incentives/ breaks:

> "An appropriate tax regime for mining is also important, with the aim being to continue to incentivize participation by foreign companies, with their specialized expertise, while allowing Mongolia to gain the benefits from its resource endowment."

The new tax law adopted in March 2019 (affective as of January 2020) provided many new tax breaks applicable to coal producers, including: reduction in Corporate Income Tax rate on transfer of land rights and mineral exploration and mining rights from 30% to 10%; and the previous tax regime did not allow refund of VAT on capital expenditures, while the new law provides VAT refund for buildings and construction (equal amount over 10 years) and for equipment/exploration (equal amount over 5 years).[7]

However, the new tax regime also appears to close one mining loophole. The old regime did not have ring-fencing for separate mines – meaning one mine's losses could be applied to other mines. The new law stipulates that income and expenses that are incurred for different mines must be accounted separately for tax purposes.[8]

Legislation to Facilitate Gas Investments

In Mozambique, the IMF program's Memorandum of Economic and Financial Policies lists the approval of the Decree Law as operationalizing the development of natural gas liquefaction plants in the Rovuma Basin (see Table 4). Further research shows that the Decree Law was instrumental to clenching the $15 billion financial package in July 2020 involving the African Development Bank and 8 Export Credit Agencies (ECA) for the Area 1 Liquified Natural Gas (LNG) project.

Among many concessions, the Decree Law includes that no preference needs to be given to Mozambican suppliers for goods and services due to financing from ECAs.[9] This concession was key to securing ECA finance as it greatly increased opportunities for companies from the countries with participating ECAs at the expense of Mozambican firms. For example, the Export Import Bank of the United States (US EXIM) announced its $5 billion loan to Area 1 LNG involves 68 American suppliers and an estimated 16,400 American jobs.[10] It is hard to believe this financing agreement structured under the new IMF supported Decree Law is the optimal outcome for job creation in Mozambique.

Public Investment for Priority Infrastructure Projects

In Mozambique and Mongolia, the IMF loan programs are actively engaged in assessment criteria and selection of priority infrastructure projects that receive public finance (see Table 5). In these two countries, priority infrastructure involves mega coal and gas projects.

In Mozambique, the loan program involved the development of a new Integrated Investment Program that would identify priority infrastructure projects. This program and priority project preparation received technical assistance from the IMF. There were also related structural benchmarks.

In Mozambique, the IMF program included a Structural Benchmark to approve new guidelines for appraisal and selection of public investment projects with technical assistance from the World Bank. Furthermore, the MEFP stipulates that the Public Investment Program will be better aligned with the national development priorities, which are listed as key mining projects, including coal (see Table 2).

Consumer Subsidies for Fuel and Electricity Tariffs

The IMF loan programs support reforms aimed at reducing subsidies for petroleum and electricity in Mozambique, which could potentially have climate benefits (see Table 6). However, the majority of electricity in Mozambique is from hydro power and reductions in consumer fuel subsidies stand to be replaced by new producer subsidies. In Mongolia, potential climate benefits could result from the IMF's Structural Benchmark to increase excise tax rates and reform retail fuel prices (see Table 6).

Other Notable Items

It should be noted that the policy reforms and structural benchmarks only come from the Stand-by Credit Facility program in Mozambique and the Extended Fund Facility program in Mongolia. In addition to these two loan programs, Mozambique also has two Rapid Credit Facility loans and Mongolia has one Rapid Financing Instrument.

In the case of Mozambique, these two loans were provided as emergency finance to address financial needs associated with the two tropical cyclones in 2018 and the current COVID crisis, respectively. In Mongolia, the rapid finance is for the Covid crisis as well. These emergency finance loan programs were reviewed as part of this assessment. The Letters of Intent provided descriptions of items the funding would be used for, including health, food programs, etc. Only one item stood out that may be seen as tied to stimulus for gas. Mozambique is using some of the COVID recovery funds for "VAT losses". The Mozambique Stand-by Credit Facility also had structural benchmarks for government funding prioritized to pay for outstanding VAT refunds. This may be associated to VAT refunds for the massive LNG investments and could be important for cash flows related to these projects. More research needs to be done to better understand the VAT losses issue in Mozambique.

One other item that is curious involves the Mozambique Structural Benchmark for a new Law on Moveable Collateral. This may or may not be linked to new financial vehicles for offshore gas.

Table 2. Coal and Gas Projects Central to IMF Economic Programs in Mozambique and Mongolia

Mozambique	
Stand-by Credit Facility	
Staff Report December 3, 2015	GDP growth expectations
	Over the medium term, growth is projected to recover to 7½-8 percent, supported by massive investment in natural gas projects and higher coal production if key agreements can be reached for coal and gas sector development. In the natural gas sector, such agreements between the government and concessionaries would trigger massive FDI in LNG processing facilities (starting from the second half of 2016) and pave the way for LNG exports by 2021. **In the coal sector, agreements need to be reached to unlock financing for the completion of the Nacala rail corridor, which would triple coal export volumes by 2017**.
	Main sources of the fiscal revenues are (i) the government's share of gas profits, (ii) the corporate income tax on the concessionaires, and (iii) the dividends paid by the state-owned hydrocarbon company (ENH), which owns 10 and 15 percent stakes in the two exploration areas where gas has been found [Areas 1 and 4].
	Ensuring that LNG production materializes remains important to underpin Mozambique's long-run debt sustainability. The same applies for completion of coal investment. The authorities have made significant progress in establishing **legal frameworks** for the sector. Negotiations with private operators on outstanding issues recently regained momentum after some delays. **It is crucial that jointly satisfactory agreements are reached soon to ensure that LNG investment can move forward.**
	Natural Resource Wealth Management
	Negotiations between the authorities and the oil and gas companies should continue to move forward to allow final investment decisions in near future. Even with recent subdued commodity prices, including LNG prices, gas development companies remain confident in the viability of the LNG projects. However, further delays in the negotiations would result in lower FDI inflows in the short run and delay the expected benefits on growth and fiscal revenues.
Letter of Intent December 2, 2015	**Memorandum of Economic and Financial Policies (MEFP) - December 2, 2015**
	Nevertheless, [GDP] growth will accelerate towards the 7-8 percent range during 2016-2020, supported by agriculture, construction and financial services, and **spearheaded by expanding coal production and construction works for LNG projects**.

Mongolia	
Extended Fund Facility	
Letter of Intent, April 13, 2017	Memorandum of Economic and Financial Policies
	We also jumpstarted discussions on key mining projects such as Tavan Tolgoi and began implementing a number of key structural reforms to ensure that, after a difficult phase of adjustment, the economy would be poised for sustainable long-run growth.
Staff Report April 13, 2017	
	Mongolia has huge potential in many key commodities and is one of the lowest-cost producers globally. It has one of the top copper and gold mines in the world (Oyu Tolgoi, whose first phase is already in production and whose second phase will begin production in 2018) and also one of the largest coal deposits, at Tavan Tolgoi (the redevelopment of which is expected to begin in 2019)… Keys to leveraging this potential are better infrastructure and a more market-friendly investment environment. While these are key constraints currently, the new administration has announced a series of measures to accelerate the development of mega-projects, including new railways and power stations, and these should help to drive the commodity sector over the coming years, despite uncertain global conditions. As a consequence, GDP growth will be boosted and exports will more than double.
	The future of the coal sector is intimately connected with developments in China. One scenario is that China downsizes its own coal industry for environmental reasons and either imports coal or coal-powered electricity from Mongolia.

Table 3. Coal and Gas Producer Subsidies – Tax Incentives

Mozambique	
Stand-by Credit Facility	
Letter of Intent December 2, 2015	**Memorandum of Economic and Financial Policies** (MEFP)
	Strengthening the Mining and Hydrocarbon Tax Regime. The regulations of the mining and hydrocarbon fiscal regimes which **benefited from IMF technical assistance** were submitted to the Cabinet and approved in October 2015.
Staff Report December 3, 2015	**IMF Technical Assistance***

	IMF Mission, June 2014: Mining and petroleum fiscal regime reform and tax projections
	IMF Mission, July 2013: Follow-up on mining and petroleum fiscal regime reform
	IMF Mission, May 2013: Public consultation of the revised fiscal regime for mining and petroleum
Mongolia	
Extended Fund Facility	
Letter of Intent, April 13, 2017	**Memorandum of Economic and Financial Policies**
	Working group to review the tax system. By end-August 2017, we will set up an independent working group of experts, aided by technical assistance from the IMF, to review the tax structure (including the VAT, as well as business—and in particular mining—taxation) and make revenue-neutral or revenue-enhancing recommendations to improve equity and efficiency (structural benchmark). The working group will be expected to submit its report by end-December 2017 (structural benchmark).
	Structural Benchmarks 2017
	Establishment of a working group to review the tax structure and make recommendations to improve efficiency and equity including review of the investment, VAT, personal income tax, and economic entity tax laws with a view to enhance revenue, reduce complexity, and introduce progressivity in personal income tax, in consultation with IMF staff.
Staff Report April 13, 2017	
	An appropriate tax regime for mining is also important, with the aim being to continue to incentivize participation by foreign companies, with their specialized expertise, while allowing Mongolia to gain the benefits from its resource endowment. Mining is a relatively capital-intensive sector with limited spillovers, and it will principally be by channeling tax revenues from the sector into the economy that the country will be able to make progress. While existing agreements will be respected, the mining tax regime for future projects will be considered as part of a comprehensive review of the tax system that the authorities are undertaking.

*The IMF provided technical assistance financed by the Topical Trust Fund for Managing Natural Resource Wealth (TTF-MNRW)

Table 4. Legislation to Facilitate Gas Investments

Mozambique	
Stand-by Credit Facility	**Memorandum of Economic and Financial Policies** (MEFP)
Letter of Intent Dec. 2, 2015	**Mining and Hydrocarbon Legislation**. The Regulation of the Mining Law was approved by the cabinet in October 2015 and the Regulation of the Petroleum Law was approved in November 2015.
	Development of natural gas liquefaction. After the Decree-Law was approved to operationalize the development of natural gas liquefaction plants in the Rovuma Basin, negotiations continue to amend the Exploration, Production and Concession Contracts (EPCC), as requested by the Concessionaires of Area 1 and 4. With respect to the Concessionaire for Area 1, negotiations are in the final stage, and preliminary agreement has been reached on modalities for the financing of the participation of ENH, amount of gas to be reserved for domestic purposes and the structure of marketing activities. A unitization agreement for the exploration of the greatest gas field that straddles Areas 1 and 4 (Prosperidade/Mamba) has also been reached. The government expects that recent progress will allow the concessionaires for Areas 1 and 4 to reach a final investment decision in 2016.
	Executive Board of Directors Statement, December 18, 2015
	Directors commended the progress on structural reforms, including on the mining and hydrocarbon legislation which should facilitate further investments in the large natural gas projects.

Table 5. Public Investment: Determining Priority Infrastructure Projects

Mozambique	
Policy Support Instrument	[Note: The Policy Support Instrument (PSI) was the active loan program prior to the 2015 Stand-by Credit Facility. The PSI determined the priority infrastructure projects for 2014 to 2017.]
Letter of Intent, Dec 20, 2013	**Memorandum of Economic and Financial Policies** (MEFP) – Priority Infrastructure Projects for 2014-2017
	Strengthening Investment Planning: in September 2013 the Government approved the Integrated Investment Programme (IIP), which **identifies priority infrastructure projects for 2014-2017**. As a next step by June 2014, the Ministry of Planning and Development will approve, and share with IMF staff, an enhanced IIP by adding financial information for projects for which financing has been secured to inform the DSA, MTFF and the budget. The revised IIP will also include summary project descriptions in line with the project summary table already developed (structural benchmark). **The IMF and the World Bank are providing assistance to build capacity in public project preparation, assessment and selection, and the linkage between IIP financing needs and debt sustainability**.
	Structural Benchmark for 2013

	Submission of Integrated Investment Plan to the Council of Ministers with sufficient specific information to analyze the impact of the related borrowing on debt sustainability.
	Structural Benchmarks for 2014
	The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget.
Mongolia	
Extended Fund Facility	
Letter of Intent, April 13, 2017	**Memorandum of Economic and Financial Policies**
	Public investment program (PIP). Serious questions have been raised about Mongolia's project selection criteria and its implementation of chosen projects. A Public Investment Management Assessment (PIMA) was recently undertaken to provide a detailed diagnosis and offer specific recommendations. **We intend to rationalize the PIP, culling low-value-added projects, and over time we aim, with World Bank assistance, to improve our processes for ensuring that the PIP is fully aligned with national development priorities**.
	Public-private partnerships (PPPs) / concessions. In recent years, concessions have proliferated in Mongolia, undertaken by different units of government without sufficient central oversight. We have already restricted the ability of local governments to initiate such projects, and going forward we intend to assign the MOF a gatekeeper role over all PPPs. We intend to have an audit conducted of all existing concession contracts before making any further payments related to them. Furthermore, with assistance from the Asian Development Bank (ADB), we will work to revise the existing legal framework toward best international practice. Until this legislation is amended, we will contract no new concessions (except possibly some new BOT projects, and we may convert BTs into BOTs). Furthermore, we will attempt to cancel contracted projects that have not yet been launched.
	Structural Benchmarks 2017
	Enact a law on the use of public funds
Letter of Intent Oct. 10, 2018	**Structural Benchmarks 2018-2019**
	The MoF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria.
	Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF.

Table 6. Consumer Subsidies and Electricity Tariffs

Mozambique	
Stand-by Credit Facility	
Letter of Intent Dec. 2, 2015	**Memorandum of Economic and Financial Policies** (MEFP)
	Electricity tariffs. The revised tariff proposal is still under consideration by the Government. It is envisaged that the new tariff has become effective in November.
Policy Support Instrument	
Letter of Intent June 12, 2015	**Memorandum of Economic and Financial Policies** (MEFP)
	Electricity tariffs. Current electricity tariffs from 2010 make EDM financially unsustainable. The discussion on tariff adjustment study is ongoing with a view to restoring the financial position of EDM and protecting low income consumers. It is expected that the revised tariff proposal will be submitted to the cabinet by June 2015.
	Subsidies for petroleum products. The Government continued to subsidize only diesel prices for general consumption (other than megaprojects, construction, public works and other large consumers), but not other fuels. The amount of compensation paid to fuel importers in 2014 was 0.14 percent of GDP related to fuel sales in 2013; the amount due in 2014 was (4.6 billion meticais) to be paid in 2015 through a combination of budget payments and/or cost recovery through the price-setting formula.
Mongolia	
Extended Fund Facility	
Letter of Intent, April 13, 2017	**Memorandum of Economic and Financial Policies**
	Excises and duties. We also intend: to reverse the last two cuts in the petroleum excise (from July 1, 2017 and October 1, 2017, respectively) while rationalizing the rates across different petroleum products; to increase the excises on vehicles and on alcohol and tobacco (from May 1, 2017 and January 1, 2018, respectively); and to raise duties on tobacco (from May 1, 2017).
Letter of Intent Oct. 10, 2018	**Structural Benchmarks 2018-2019**
	Enact a legislation to reform structure of retail fuel prices and increased excise tax rates.

Endnotes

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