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The role of transparent and fair taxation in converting Africa's mineral wealth into development

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Text

Mineral extraction is an 'enclave' economic activity. In African mineral-rich countries, foreign mining companies create very little forward or backward linkages into the local or national economy that would stimulate private sector development and job creation. This is why there is consensus among the United Nations Conference on Trade and Development (UNCTAD), the United Nations Economic Commission for Africa and the IMF that the paramount development benefit of mining in Africa is the potential to generate public revenue through a transparent taxation and budgeting system (UNCTAD, 2007). This is the key instrument through which governments can make mining work for development in the foreseeable future.

Up to now, African governments have failed to collect the additional rents generated by mining companies before and during the price boom (2003-2008), partly because mining companies operating in Africa are granted too many tax subsidies and concessions. This partly explains the high prevalence of low-income indicators in mineral-endowed African countries and communities in mining areas.

Many Africans harbour expectations of economic and social development, based on the continent's rich mineral deposits. They believe that mining activity, if well managed, can transform the continent's economies. To do so, the process of creating tax regimes and mechanisms of tax payment need to become transparent, and African mining-tax regimes need to be reformed to ensure that African governments are able to collect a fair share of mining rents.

Mining revenue, key to development

Foreign mining companies import most of their mining equipment, as well as the technical, financial and managerial services needed to run the mines. Very few African firms, mostly based in South Africa, can provide this equipment and these services. Once extracted, raw ore is exported for further refinement or processing elsewhere. Furthermore, given the capital-intensive nature of industrial mining, these companies create very few jobs relative to the abundant labour supply in mineral-rich African countries. As an illustration, UNCTAD (2007) estimates that the mining sector employed just 0.2% of Tanzania's workforce in 2001.

The World Bank has challenged this view, and maintains that if multinational mining companies can commit to sustainable development as part of their bottom line, then the transfer of skills, technology, and capital from mining can improve the impact of mining on economic and social development. However, this commitment is still lacking, especially among the junior players in the mining industry. Coupled with legal mining frameworks linking mining to local communities and wider economic development – on which governments are intentionally or unintentionally silent – revenue collected through the budget remains the key instrument through which they can make mining work for development in the foreseeable future. Furthermore, a surplus of revenues could counteract the impact of mining on local communities (Box 1).

Box 1: Impacts of mining on local communities

Those who are living around mining areas continue to fall victim to the social and environmental fall-out from large-scale mining, with very little protection from their governments to stem the erosion of their livelihoods, health and natural resource base. The costs of mining to communities and households include the loss of land for farming, soil and water contamination, air pollution, deforestation, forced removals, physical damage to dwellings, and an unsafe living environment. In Zambia, for example, farmers living near Konkola Copper Mines's (KCM) Nchanga plant have suffered crop losses due to sediments and silt that are flooding farmers' fields so that farmers can no longer use them (Christian Aid, 2007). This has prevented farmers from growing basic foodstuffs such as cabbage, tomato and maize for their own consumption or for selling in local markets. This cost local farmers a total of GBP 12 641 in lost income during 2005 alone. Such routine discharges are not the only problem caused by mining operations. On 6 November 2006, one of KCM's pipelines released significant quantities of acidic liquid into several rivers, including the Kafue – one of Zambia's largest rivers.

These community impacts constitute an additional cost to society. So far, African mining tax regimes have failed to encourage mining companies to sufficiently improve their social and environmental practices, and national laws have generally failed to adequately protect communities and the natural resources on which they depend. Compared with the enormous energy devoted to costing and mitigating the commercial risks of mining to companies, very little energy has been devoted to costing and mitigating the social and environmental risks of mining to communities.

Downward drivers of revenue: mining tax subsidies, concessions and avoidance

During the 1980s and 1990s, slower international metals-driven growth, together with oversupply, led to a slump in international prices. Many African mineral-rich countries were suddenly faced with a sovereign debt crisis, as they no longer earned sufficient foreign exchange from their mineral exports to fund the repayments of loans they took during the boom years. The World Bank became a lender of last resort, and used this position to rewrite the mining laws and tax regimes across Africa, resulting in a shift to lower tax rates and other tax concessions offered to foreign mining companies. The justification was that capital for mining was scarce, given low international prices; therefore, African countries had to compete with one another and with other mining economies to attract high-risk capital, by developing 'competitive' tax regimes. Many of these laws allow ministers to negotiate tax deals with individual mining companies at their discretion, often leading to lower royalties, corporate taxes, fuel levies, and windfall or other taxes than those stipulated in the law. At their worst, contracts may completely exempt companies from any taxes or royalties.

These tax reforms, coupled with the tax incentives offered by some of the major mining economies, such as Australia, Canada and the US, to mining multinationals for overseas exploration, have led to an upsurge in 'junior' exploration companies obtaining mining licences and trading their concessions, or attempting to make quick short-term profits. For example, Canadian companies now account for more than 60% of all new investors in African mining exploration (Open Society Institute of Southern Africa – OSISA *et al.*, 2009). Five out of every six of the 1220 companies registered on the Toronto Stock Exchange are juniors (Tougas, 2008). This is significant, as these companies are seen as very risky by institutional investors, and are more likely to ask for special tax deals from governments to help sway potential financial backers. The upsurge in these types of investors has compromised the quality of foreign direct investment in Africa's newly privatised mining sector. 'Junior' companies require huge tax subsidies to help them finance their operations; they need to turn profits faster as they are not in business for the long term, and they are often less sensitive to the need for corporate social responsibility.

In addition, multinational mining companies seeking to invest or expand their investment in Africa often enter into confidential agreements with governments to acquire special tax rates and concessions that are outside statutory frameworks. These agreements are legal commercial contracts, and can override national laws and tax regimes. Mining companies have been able to obtain these exemptions in countries desperate to attract foreign private investment into their mining sectors. In Zambia, the mining development agreements negotiated with private investors who took over the copper mines after the privatisation of Zambia Consolidated Copper Mines in 1998 offer huge tax exemptions to companies. The two largest mining companies, KCM and Mopani Copper Mine, managed to negotiate deals whereby they would pay only one fifth of the royalty stipulated in the mining law. At 0.6%, these royalty rates were the lowest in Africa. While KCM reported increased net earnings, from USD 52 million in 2005 to USD 206.3 million in 2006, Zambia's minister of finance in his 2006 budget speech estimated that the country would earn less than USD 11 million from copper mining royalties in the next financial year (OSISA *et al.*, 2009).

Some mining companies have also been accused of illegally evading taxes – in Tanzania, a government-commissioned auditor alleged that the country's four main gold mining companies over declared their losses by millions of dollars.

Tax subsidies, together with tax avoidance and alleged tax evasion practices by mining companies, have robbed African treasuries of millions of dollars of tax revenue from the mining industry. OSISA *et al.* (2009) have estimated that in Ghana, South Africa, and Tanzania, lower royalty rates have or will cost treasuries up to USD 68 million, USD 359 million, and USD 30 million a year respectively. In Malawi and Sierra Leone, tax breaks granted in mining contracts have cost or will cost treasuries up to USD 16.8 million and USD 8 million a year respectively (OSISA *et al.*, 2009). In the Democratic Republic of Congo, the tax exemptions in a single mining contract have cost the treasury USD 360 000 a year (OSISA *et al.*, 2009).

Increasing mining revenues

Too many African governments are still unwilling to open up their tax deals and tax receipts from mining companies to public and parliamentary scrutiny. And too many mining companies are still pushing for tax exemptions, and fail to report what they earn and what they remit to government in each jurisdiction where they operate. Transnational mining companies have also been pushing for tax exemptions, and fail to report what they earn and what they remit to government in each jurisdiction where they operate. The credit crunch and its impact of a reduction in finance available for mining investment are set to motivate governments to continue such secret deals. The crunch will also give mining companies the moral instrument to demand more exemptions.

In order to reverse the 'paradox of plenty' characteristic of many mineral-rich societies in Africa – whereby countries with the most natural resources are often the poorest and worst governed – two major changes are needed to increase mining revenue and transparency.

First, the process of creating tax regimes and mechanisms of tax payment needs to become transparent. To ensure that the correct amount of revenue is collected from mining activity, and that this is spent equitably according to the country's agreed national development strategy, civil society organisations and parliaments need to be able to monitor and oversee the collection, allocation, and actual spending of budget revenue. To contribute to such transparency, a new international accounting standard that requires all multinational companies to report on their remittances to governments, and their profits and expenditures in each of the countries where they operate needs to be established. The International Accounting Standards Board (IASB)[1] is presently discussing whether to introduce such a standard for the extractives sector. This would be an important systemic reform, which would enable governments and citizens to track where companies pay tax, and how much. This would make it more difficult to shift profits between the subsidiaries of different companies.

Second, African mining tax regimes need to be reformed to ensure that African governments are able to collect a fair share of mining rents to fund their national development plans. In some countries, this would require an increase in the rates of royalties and other taxes; in others, it would require stopping the practice of negotiating tax breaks for individual companies in secret contracts.

African governments also need to revise their company acts to require the subsidiaries of multinational mining companies incorporated in their jurisdictions to publish the financial information required by the Extractive Industry Transparency Initiative[2]. This will ensure that private or state-owned mining companies, such as the growing number of Chinese state-owned or financed mining companies are required by national law to publish their profits and losses, and remittances to government and other structures.

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[1] IASB is an independent, privately-funded accounting standard-setter responsible for developing international financial reporting standards and promoting the use and application of these standards.

[2] The EITI is a coalition of governments, companies, civil society groups, investors and international organisations. It sets a global standard for transparency in oil, gas and mining, making it possible for companies to publish how much they pay and for governments to reveal their incomes.