Publish What You Pay

HOUSE OF COMMONS INTERNATIONAL DEVELOPMENT COMMITTEE

INQUIRY INTO TAX IN DEVELOPING COUNTRIES: INCREASING RESOURCES FOR DEVELOPMENT

Submission from Publish What You Pay, 6 February 2012

EXECUTIVE SUMMARY

Exec.1 Publish What You Pay (www.publishwhatyoupay.org) makes this submission as a global civil society coalition calling for extractive industry revenues to form the basis for development and improve the lives of ordinary citizens in resource-rich countries.

Exec.2 Developing countries have widely failed to mobilise natural resources revenues for development, through both under-collection and poor revenue management. The extractive industries are a key source of developing country income, but weak contractual terms, secrecy, corruption and lack of accountability are common, and there is evidence of corporate tax non-compliance.

Exec.3 Zambia's recent favourable macro-economic performance masks poor human development. Public social spending is inadequate. Government revenue from the dominant mining sector is relatively low.

Exec.4 Revenue transparency and accountability are essential to tackle poor governance, corruption and tax non-compliance in the extractives sector. Civil society has a crucial monitoring role.

Exec.5 Mandatory reporting regimes to complement the EITI, under the US Dodd-Frank Act and the EU Commission's proposed new Accounting and Transparency Directives, can help create a level playing field.

Recommendations

Exec.6 The UK Government should continue to support, and should join, the EITI. DFID should engage with the EITI's 2010–11 evaluation recommendations.

Exec.7 The UK Government should lead in strengthening the proposed new EU directives and be mindful of its duty to protect against human rights harms under the UN Business and Human Rights Framework with respect to social and economic rights.

Exec.8 Regarding Zambia, the UK Government and authorities should investigate serious allegations of fraud on the part of UK companies and where necessary apply penalties. The Government should ensure that extractive companies operating in weak governance zones are transparent and accountable.

Exec.9 DFID should enhance support for revenue administration reforms in Zambia, advise on establishing a revenue account to prepare for long-term mining revenue decline, and support Zambian civil society in its watchdog role.

Publish What You Pay

1. INTRODUCTION

1.1 Publish What You Pay (PWYP) is a global civil society network of over 600 member organisations calling for oil, gas and mining revenues to form the basis for development and improve the lives of ordinary citizens in resource-rich developing countries.

1.2 PWYP has led international civil society advocacy in the development of resource transparency legislation under the US Dodd-Frank Act 2010 and the EU's proposed new Transparency and Accounting Directives. For more information please visit www.publishwhatyoupay.org.

1.3 This submission is made jointly by Publish What You Pay UK (members include CAFOD, Christian Aid, Global Witness, ONE, Revenue Watch Institute, Tearfund) and Publish What You Pay Zambia (members include Caritas Zambia, Churches Council of Zambia, Development Education Community Project, Evangelical Fellowship of Zambia, Mineworkers Union of Zambia, MISA-Zambia, Zambia Congress of Trade Unions).

2. FACTUAL INFORMATION

Developing countries' failure to mobilise natural resources revenues for development

2.1 As the IDC has noted, failure to collect tax in developing countries results in constrained budgets for the provision of basic services and alleviating poverty. Developing country governments' failure to manage tax effectively, once collected, is equally serious.

2.2 Extractive industries are critically important sectors in about 60 developing countries and emerging economies and a key source of revenue for development. Yet among the 3.5 bn people in these countries, 1.5 bn live on less than US$2 a day. Africa's natural resources were worth $246 bn in exports in 2009, six times greater than ODA ($44 bn) and seven times the value of agricultural exports ($39 bn). In 2008 Africa's oil, gas and minerals exports at were worth nine times its ODA.

2.3 In Africa natural resource revenues are likely to increase in proportion to other financial flows for some years, but oil, gas and minerals will not last indefinitely and will become more costly to extract as easier-access sources deplete. It is therefore urgent for poor countries to benefit from the exploitation of their natural resources.

2.4 In the extractive industries in particular, payments to governments are often not disclosed by companies and, as a result of mismanagement and corruption, may not contribute to development or poverty reduction. Extractive companies may not pay fairly for the resources they extract. Lack of reliable public information often makes it impossible for civil society to monitor the money, ensure their governments get a fair deal, and prevent revenues being mismanaged.

2.5 Lack of transparency enables multinational companies to avoid tax compliance and contributes to a drain of capital from developing countries estimated at over US$1 trillion a year.[1] While

[1] Global Financial Integrity, *Illicit financial flows from developing countries: 2000-2009*, iff-update.gfip.org

companies maintain that they pay their taxes fairly,[2] evidence indicates major problems of corporate tax non-compliance.[3]

2.6 Civil society has documented how African governments have failed to collect expected revenue from extractive companies because:

- they have granted over-generous tax subsidies;
- companies have pushed for secret tax breaks;
- companies have manipulated profits (eg through transfer mispricing) to low- and no-tax havens and secrecy jurisdictions, costing developing countries up to $160 bn a year in lost revenue.[4]

Zambia

2.7 Zambia has experienced 5% economic growth, low inflation and a trade surplus in recent years. Mining accounts for more than 70% of its export earnings.

2.8 Despite this macro-economic performance, Zambia ranks 150th out of 169 countries on the 2010 Human Development Index (HDI), and of 135 countries sampled Zambia is one of only three to have a lower HDI in 2010 than in 1970. This reflects retrogression in life expectancy, school enrolment, literacy and income. Zambia faces major challenges in reducing poverty and economic inequality. The extremely poor account for about 42% of the total population (5.4 million of approx. 13 million), and the moderately poor 18.2% (2.4 million). Many Zambians are unable to afford a minimum food basket.[5]

2.9 Zambia's public health sector has approximately 24,000 frontline staff out of the recommended 39,360.[6] The health sector budget has increased to 13% of the total national budget, but resources are still inadequate to meet Zambia's health MDGs. Whereas annual costs of basic care and reaching the health MDGs require about 3% of GDP, Zambia spends only about 2% of GDP on health, with consequent poor provision of services including inadequate equipment and lack of essential drugs.[7]

2.10 A parallel situation exists in Zambia's education sector.

[2] Eg Simon Henry, chief financial officer, Royal Dutch Shell, 'Companies and tax authorities can all benefit if they work together', www.telegraph.co.uk/finance/newsbysector/energy/9026018/Companies-and-tax-authorities-can-all-benefit-if-they-work-together.html, 19 Jan 2012

[3] Eg PWYP Norway, *Lost billions: transfer pricing in the extractive industries*, 2012, www.pwyp.no/lost-billions-transfer-pricing-extractive-industries ; Tearfund, *Unearth the truth: making extractive industries work for all*, 2011, tilz.tearfund.org/webdocs/Tilz/Research/Unearth_the_truth_web_summary.pdf; Open Society Institute, Third World Network, Tax Justice Network, ActionAid, Christian Aid, *Breaking the curse: how transparent taxation and fair taxes can turn Africa's mineral wealth into development*, 2009, www.christianaid.org.uk/Images/breaking-the-curse.pdf; CEE Bankwatch, *The Mopani copper mine, Zambia: how European development money has fed a mining scandal*, 2010, www.counterbalance-eib.org/?p=347; Eurodad, *Exposing the lost billions: how financial transparency by multinationals on a country by country basis can aid development*, 2011, www.eurodad.org/uploadedFiles/Whats_New/Reports/CBC%20report_hi.pdf?n=7530

[4] Christian Aid, *Death and taxes: the true toll of tax dodging*, 2008, www.christianaid.org.uk/images/deathandtaxes.pdf; African Development Bank, *Domestic resource mobilization across Africa: trends, challenges and policy options*, 2010, www.afdb.org/, pp4-5; Savior Mwambwa, Centre for Trade Policy and Development, Zambia, 'We need greater transparency over tax payments', April 2011, www.financialtaskforce.org/2011/04/20/we-need-greater-transparency-over-tax-payments/

[5] Central Statistics Office, *Living conditions monitoring survey 2010*, Lusaka 2011

[6] Zambian Ministry of Finance and National Planning, *Economic Review*, Lusaka, September 2010

[7] IMF, Country Case Study: Zambia, Washington, DC, 2006

2.11 Key factors preventing Zambia from mitigating some of these challenges are: (1) over-generous tax subsidies and concessions to mining companies; (2) companies' tax non-compliance; (3) secretive agreements and incentives between government and companies.

2.12 Zambia's total mining taxes due to be collected in 2011 were only 9% of total budgeted national revenue. Between 2005 and 2009:[8]

- Employee payroll tax was the largest component of mining industry taxes paid, ahead even of corporation tax. Mining taxes averaged 9.75% of total annual taxes, but subtracting employee payroll tax they averaged only 5.94%. So close to 40% of the taxes mining companies pay is what is deducted from employee payroll. Half a million Zambians employed in the formal mining sector carry a tax burden comparable to that of the mining companies.
- Zambia falls below the African average of mining taxes as a percentage of total taxes.
- In 2005-9 Zambia's mining taxes amounted to only 3.4% of gross sales and just 1.85% of GDP; in Latin America mining taxes average a far larger 17.39% of GDP.

2.13 Caritas Zambia and PWYP Zambia estimate that in 2005–6 the Zambian treasury lost about K635 bn[9] (US$127 million) in corporation tax as a result of mining companies not paying at the applicable level, and a further K1,463 bn (US$292 million) in mining royalties paid at a lower rate than the applicable 3%. Such evidence indicates the existence of dual taxation arrangements. If Zambia's tax take from mining were scaled up from the recorded 1.85% of GDP to a more normal 5% or 10% of GDP, mining companies would have paid a further US$7 bn or US$19 bn in taxes between 2005 and 2009, equivalent to 18% or 37% of total mineral sales revenue.[10] This is in addition to the K247 bn (US$49.4 million) unresolved discrepancy found in the 2008 EITI report for Zambia.[11]

2.14 Civil society research indicates that some mining companies provide false documentation to reduce their tax burden.[12] Mopani Copper Mines (73% owned by UK-listed Glencore) is alleged to have defrauded the Zambian Government of taxes.[13] Some sectors of society have accused the mining companies of robbing the nation.

2.15 Extractive industry governance in Zambia is weak.[14] The government does not know the true operational cost of the mines. The companies do not declare their audited financial statements. No analysis is done of mining companies' balance sheets. The country follows obsolete mining policies. Parliament is excluded from negotiation of contracts and development agreements. Concessions and payment holidays are approved for companies without consultation or regard to costs and benefits. Misappropriation of funds and corruption have increased.

2.16 Zambia has pursued ambivalent policies towards the mining sector. While it has instituted a review of the development agreements, supposedly to enable Zambians to benefit from the

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[8] Findings from Caritas Zambia and PWYP Zambia, *Mining contribution to economic development*, Lusaka, 2011
[9] 5,000 Zambian kwacha = approx. US$1.
[10] Caritas Zambia and PWYP Zambia, op cit
[11] Al Jazeera, '"Transparency" hides Zambia's lost billions: mining corporations' tax avoidance schemes cost African nations billions of dollars each year', www.aljazeera.com/indepth/opinion/2011/06/20116188244589715.html, June 2011
[12] Christian Aid, *The missing millions: the cost of tax dodging to developing countries supported by the Scottish Government*, 2009, www.christianaid.org.uk/Images/missing-millions.pdf; Caritas Zambia and PWYP Zambia, op cit
[13] 'European Investment Bank halts loans to Glencore', 31May 2011, www.guardian.co.uk/business/2011/may/31/eib-halts-loans-to-glencore
[14] Caritas Zambia and PWYP Zambia, op cit; Christian Aid, *Missing millions*, op cit

resources extracted, ministers have continued to sign contracts that are over-favourable to the companies.

2.17 Government monitoring and enforcement are also weak due to inadequate funding and lack of skilled personnel. Major discrepancies in statistics provided by mining companies to the Ministry of Mines and Minerals Development, Zambia Revenue Authority and Bank of Zambia illustrate this.

Conclusions

2.18 The starting point for tackling corruption, poor governance and tax non-compliance in the extractives sector is transparency. PWYP calls for companies to “publish what you pay” and for governments to “publish what you earn”. Citizens, civil society, investors and developing country governments (including regional and local governments) need detailed reliable financial information from companies on their payments to governments. This will enable stakeholders to hold their own governments – as well as the companies – to account. The data needs to be comparable between countries and companies and sufficient so that stakeholders can verify that the amount of tax paid is correct.

2.19 In Zambia, good revenue governance can help generate substantial sums from mineral resources for economic growth and poverty reduction. The duration of mining the known copper deposits at current throughput is estimated as less than 50 years. It is therefore essential for Zambia to maximise revenue now, because production costs will rise and profits will decline. Mining taxes in Zambia should be set and applied at significantly higher rates and achieve much higher revenue targets.

2.20 Transparency and accountability reduce corruption, conflict and costs of capital for developing countries, encourage foreign direct investment, favour the best companies and deter less scrupulous competitors. Aid budgets will go much further if developing countries better manage their resource revenues.

2.21 Independent, free and strong civil society organisations have a crucial role in monitoring companies and all levels of government to help translate transparency into accountability.

2.22 The Extractive Industries Transparency Initiative has made progress since 2002 in promoting revenue transparency.[15] It is now implemented in 35 countries, with the US the latest country to join. However, not least because the EITI is voluntary, complementary mandatory reporting for extractive companies is needed worldwide to ensure a level playing field.

2.23 Since 2010 mineral companies have had to disclose country-by-country information on payments to governments when listing on the Hong Kong Stock Exchange. Other examples of companies reporting payments to governments include:

- Newmont Mining (Peru, Bolivia and Ghana).
- Statoil (Algeria, Angola and Iran).
- AngloGold Ashanti (Argentina, Guinea, Namibia, Tanzania).
- Anglo American (including Brazil, Chile, South Africa, Peru, Namibia).
- Rio Tinto (including Indonesia, Mongolia, South Africa, Namibia, Guinea, Zimbabwe, Cameroon).
- ExxonMobil (Chad).

[15] eiti.org/

- The World Bank's IFC requires payment reporting and the publication of related contracts as a lending condition.

2.24 Following ground-breaking revenue transparency legislation under Section 1504 of the US Dodd-Frank Act, currently undergoing rule-making by the US SEC, the European Commission has proposed detailed extractive industry reporting requirements in the revised Accounting and Transparency Directives.[16] Effective rules resulting from these proposals will go far in addressing problems noted above, and genuine leadership is needed from EU member states to ensure this.

2.25 The UK Government has expressed positive support for this EU legislation at the highest levels, as have other governments, European Commissioners, parliamentarians, companies, investors, and civil society around the world.[17]

2.26 However, oppositional corporate lobbying has occurred in the US and EU as rule-making has begun, based on claims about the impact of reporting regimes on competitiveness that PWYP continues to refute.[18] There have also been indications of the UK Government weakening in enthusiasm for strong EU rules. PWYP seeks to avoid a major missed opportunity for some of the world's poorest people and for a fairer and more enlightened form of business to prevail worldwide.

3. RECOMMENDATIONS

General recommendations

3.1 The UK Government should continue to support the EITI, which the new EU proposals will complement. As the EU's largest oil producer and second largest natural gas producer, the UK should follow Norway and the US in joining the EITI.

3.2 DFID should play a more active role within the EITI in implementation of the recommendations of the 2010–11 evaluation.[19] It should work to enhance the EITI's focus on clear attributable results at a societal level and on joining its good governance agenda to development and poverty reduction strategies at country level.

3.3 The UK Government should reinvigorate its European leadership as the EU develops reporting rules under the Accounting and Transparency Directives. It should lead in making the EU regime fit for purpose on such issues as project-level reporting, materiality, exemptions, geographical scope, auditing and publication.[20] To ensure corporate tax compliance, future development of the EU rules should require extractive companies to report production volumes, sales and profits as well as payments to governments.

[16] US SEC, *Disclosure of payments by resource extraction issuer; proposed rule,* sec.gov/rules/proposed/2010/34-63549fr.pdf; European Commission, *Disclosure of payments to governments*, ec.europa.eu/internal_market/accounting/other_en.htm

[17] Eg Task Force on Financial Integrity and Economic Development, 'David Cameron calls for extractive industry transparency', July 20111, www.financialtaskforce.org/2011/07/19/david-cameron-calls-for-extractive-industry-transparency/

[18] Eg PWYP UK, 'The European Commission's proposals on extractive sector transparency: a civil society view', December 2011, www.publishwhatyoupay.org/resources/european-commissions-proposals-extractive-sector-transparency-civil-society-view-uk-brief, included as supplementary material with this submission

[19] EITI, 'Achievements and strategic options: evaluation of the Extractive Industries Transparency Initiative – final report', 2011, eiti.org/files/2011-EITI-evaluation-report.pdf

[20] PWYP UK, 'The European Commission's proposals on extractive sector transparency …' op cit

3.4 While the UK Treasury, Department of Business, and DFID are rightly concerned not to harm the competitiveness of UK, EU and other Western companies, they need to see the bigger picture. Profits built on secrecy are unethical and unsustainable. A more transparent and accountable extractives sector will be a win-win outcome in the long run.

3.5 The UK Government should be mindful of its state duty under the UN Business and Human Rights Framework and Guiding Principles to protect people in resource-rich developing countries from human rights harms.[21] Such harms include developing countries' failure to realise their citizens' social and economic rights due to financial mismanagement, corruption, and extractive companies' non-payment of taxes due.

Recommendations particularly applicable to Zambia and other African countries

3.6 The UK Government and regulatory authorities should keep a closer check on UK-listed mining companies, their subsidiaries and joint ventures operating in Zambia and other resource-rich developing countries. Serious allegations against companies such as Glencore (majority owners of Mopani) should be carefully investigated and penalties applied if they are found guilty of fraud. The Government should commit to ensuring that extractive companies operating in Zambia and other African countries pay fairly, transparently and accountably for the resources they extract.

3.7 The UK Government, through DFID, should enhance funding and technical support for revenue administration reforms in Zambia to enable its government to improve regulation and monitoring of the mining sector, reduce corruption and address problems of non-compliance. It should advise Zambia on establishing a revenue account to prepare for the long-term decline in mining revenue as resources deplete.

3.8 DFID should continue to strongly support civil society in developing countries such as Zambia independently from its support to governments, thus helping strengthen civil society's role in ensuring government and business accountability.

[21] www.ohchr.org/documents/issues/business/A.HRC.17.31.pdf