THE ECONOMICS ASSOCIATION OF ZAMBIA

EAZ/IFE Report on the topic

“Taxation, Institutions and Participation: What is the best Way to tax Natural Resources?”

19th November 2015

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Introduction

The Economics Association of Zambia is a membership-based advocacy platform with the mission to contribute to the Economic Development of Zambia through the promotion and advocacy of sound economic policies. One of its objectives is to enhance awareness of, and interest in, economic and social development issues in Zambia.

The Association, in conjunction with the Institute for Finance and Economics, held a panel discussion on 19th November 2015. The theme of the discussion was: **Taxation, Institutions and Participation: What is the best Way to tax Natural Resources?** The event was held at the Southern Sun Hotel and 120 people were in attendance. This included government officials, EAZ members and stakeholders, and members of the press.

Four panelists were invited to discuss the topic. These included Dr. Caleb Fundanga

Prof. Odd-Helge Fjeldstad, Prof. Oliver Saasa and Mr. Robert Liebenthal.

The discussion begun with a background introduction by Dr. Caleb Fundanga, who stated that the Taxation, Institutions and Participation (TIP) project is an international research project which runs over three years and involves three countries - Zambia, Mozambique and Angola. Dr. Fundanga explained that the project seeks to address issues relating to taxation of natural resources and capital outflows, especially illicit flows to tax havens. The project is managed by the Chr. Michelsen Institute (CMI) of Norway, and has partner institutions in the various countries it is being implemented, with the Institute of Finance and Economics (IFE) being the project partner in Zambia.

Dr. Fundanga also shared on the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI), a Zimbabwean based institution, of which he is Executive Director. The former Bank of Zambia Governor revealed that MEFMI is starting a new capacity-building Programme on natural resources management focusing on three key areas, namely concessioning, share of tax payments and prudent use of the natural resource revenues raised. Dr. Fundanga added that MEFMI is looking at building capacity among governments to help them maximize the collection of resource revenues. He then briefly elaborated on the three key areas the MEFMI training programme is focusing on.

Concessioning

Dr. Fundanga wondered how the concessions are worked out when foreign investors come to invest in the natural resources sectors. He said preliminary studies have shown that negotiations of concessions are shrouded in secrecy, or concluded at state houses, in some cases. Because of this, the deals that come out are not to the best interest of our countries. He further wondered why such concessions can't be done openly. He said MEFMI will be training government officials who are involved in the concession agreements. The objective of the training will be to build capacity in them so that they are able to come up with agreements that are in the best interest of our countries.

Taxation

Apart from concessioning, the MEFMI training will also be looking at taxation. Once the investors have been given the concessions, how much tax are they paying? Sometimes, LDCs are so obsessed with international investors that they almost give them all their resources for free, yet it is an opportunity for them to make some money. Dr. Fundanga said most of the African Countries' taxes on natural resources are quiet low, presenting a sharp contrast with developed countries. The 2008 Central Governor of the Year gave an example of Norway as one of the countries where taxes on natural resources are quiet high. Dr. Fundanga also bemoaned the instability in Zambia's tax regime. He said taxes in most African countries change with change in political regimes, a situation which contributes to a lot of uncertainty in the minds of investors. He stated that one of the negative results of unstable tax regime is the possibility of illicit cash outflows by investors to safeguard their money in tax havens, a situation that robes countries of capital. The MEFIMI training programme will also emphasis on stability in the tax regime.

Sovereign Wealth Fund

The third aspect that the MEFMI research project will focus on is the issue of sovereign wealth fund. Once countries have the money collected from taxes, what do they do with it? Do they spend the whole of it when the going is good, or do they spend a little on immediate priority development issues and put aside a little for stabilization in hard times when there is a deficit, and also keep some of the revenue for future generations.

In his presentation, Prof. Old-Helge Fjeldstad addressed three main issues. Firstly, the natural resource tax regime should be considered as one component of overall tax system. He also looked at the general principals and characteristics behind a good natural resource tax system. And lastly he addressed the choice of revenue sources in extractive industries in Zambia, i.e., whether government chooses to use CIT or mineral royalty.

Building a Holistic Tax System

The main panelist, Prof. Odd-Helge Fjeldstad, who is a Senior Researcher of CMI, Research Director of the International Centre of Tax and Development (ICTD), and Extraordinary Professor of the African Tax Institute (ATI), said the natural resources tax regime should be considered as one component of the whole tax regime. A good natural resource tax regime, he said, is one that does not undermine or strangle the development of the ordinary or entire tax system. Prof. Fjeldstad gave examples of how tax exemptions, tax holidays, tax avoidance and transfer miss-pricing in the mining sector have a negative impact on other tax payers' behavior, and vice versa. If the most resourceful companies are not paying a fair share of tax, it affects the perception of fairness by other tax payers. The end result is that those paying higher taxes will use various means to try and level the playing field, either through tax avoidance or through lobbying for tax exemptions. This kind of scenario is taking place in Tanzania, where the cost of tax exemption is as high as 5 to 6 % of GDP, and there are also indications of similar occurrences in Zambia. These tax exemptions are driven by domestic tax payers who think that resource –rich multinational companies minimize their tax payments through various measures such as profit cheating and transfer miss-pricing, etc.

Prof. Fjeldstad further added that overdependence on one resource makes Zambia very vulnerable to international market forces. Political economy research also finds that a broad based tax system is essential for state –building. Zambia, which is so highly dependent on one natural resource, should diversify its resource base, if it to build good state-citizen relations. The largely untaxed informal sector is not conducive for state-building because it undermines the fairness of the tax system. The tourism sector, agriculture and NGOs are not paying their fair share of tax in Zambia. Tax concessions rank the list on the factors that drive investment decisions among foreign investors.

Characteristics of a Good Tax System.

Prof. Fjeldstad also outlined the general characteristics of a good tax system. He, however, cautioned that there is no such thing as the best tax system in the world. What works in one country may not work in another.

A good natural resource tax system would generally have the following characteristics:

i. Establish clear and ambitious rules with few exemptions and equal treatment of companies. The Mining Development Agreements in Zambia are very damaging in this respect.
ii. Build broad consensus among stakeholders. This is a pre-requisite for a sustainable natural resource tax framework.
iii. Establish long term stability and predictability for investors. In Zambia, the erratic and frequent changes in the tax regime have damaged the credibility of the tax system in the country.
iv. Establish a simple tax system, both for the tax collection department and for the tax payers.
v. Openness and transparency is essential. This implies citizens' access to mining agreements, for example, to avoid suspicions. I Zambia, unlike in Mozambique, Mining Development Agreements are not published. They are kept secret!

vi. Meaningful citizen participation and engagement around taxation is important. The credibility of a tax system depends, among other factors, on how the tax resources are used for the benefit of the citizens.

Choice of Revenue Sources in Extractive Industries in Zambia

On the sources of tax revenues, Prof. Fjeldstad concentrated on the Corporate Income Tax (CIT) and Mineral Royalty. He said research literature by Africa Progress Panel indicates that resource-rich countries in Africa and other LDCs are quiet vulnerable to aggressive tax planning and tax evasion facilitated by extensive use of off-shoe companies and high level of intra-company trade and commercial secrecy surrounding foreign investment activity. He added that African governments lack the technical and human capacity needed to secure tax compliance and the commercial market intelligence needed to assess company tax liabilities. Because of that, LDC governments are losing significant amounts of revenues.

Bob Liebenthal, a board member of the EAZ, reiterated the importance of enough analysis, enough information and participation among the people, government and the mining companies, to enhance transparency and trust among the various stakeholders. He said there is a real task to work on this lack of trust between the people and government on one side, and the mining companies on the other.

Mr. Liebenthal said although Zambia is not highly dependent on the mining industry for tax revenue, but about 70% of the country's foreign exchange comes from the mining sector. He said the current situation where PAYE contributes the largest share in terms of tax revenue is not acceptable. It is everyone's desire that the mining sector should contribute more to the national treasury than it currently does.

Commenting on accountability and public participation, Mr. Liebenthal wondered why Zambia can't consider a system where citizens collect income directly from the mines through shareholding, a situation that would then enable government to tax the citizens and thus collect more revenue from the sector.

Mr. Liebenthal, who is also the Senior Country Advisor for the International Growth Center, bemoaned the appalling data on mining as problem number one. He said there is a serious lack of reconciled data from Ministry of Mines, Bank of Zambia and ZRA. He said the efforts of the EITI to try and produce reconciled data on mining should therefore be supported. Mr. Liebenthal stated the lack of a good system Zambia for managing the mining sector as another big problem. He gave examples of Botswana and Chile who have done a brilliant job in managing their mining sectors. He said it is not acceptable that Zambia can't do better than Botswana. He reminded the audience how Chile and Zambia were on a par in 1970, but now Chile boasts of more than five million tons of copper production per year! This can largely be attributed to better management than anything else. He wondered why the Ministry of Mines in Zambia can't be one of the best in the World.

Another panelist, Prof. Oliver Saasa, commended Prof. Fjeldstad's presentation as a good description of the Zambian situation.

Prof. Saasa touched on three issues in relation to the mining sector in Zambia-institutional capacity, enabling policy regime and fair taxation.

Institutions

Prof. Saasa reiterated the importance of institutional capacity in Zambia to be able to determine production figures, quantities being processed, export figures and cost structures in the mining sector. In the absence of such figures, he said, Zambia can only accuse the mines of stealing but without evidence of how much they are stealing. He said this means Zambia is not ready to do the right thing which the country can use to solicit for support when it accuses the mining investors of stealing what belongs to the Zambian people. He said Zambia should therefore put in place a sound knowledge base in terms of mining statistics.

Policy Consistency

In addition to strong institutions, Prof Saasa said consistency in the policy regime is very important. He said in the absence of predictable policies, including tax levels, attracting quality investors will be a problem. He pointed to the recent changes in the 2015 budget as an example of inconsistent policies, resulting in the mining sector contributed the least, in years, in terms of tax revenue to the government. He expressed sadness that after 50 years of independence, Zambia has not tax regime in palace where other countries can learn from. This, he said, is unacceptable.

Fair Taxation

Lastly, Prof. Saasa said a fair tax system is critical in the mining sector. The former Lecturer at the University of Zambia said investors are not donors. He said investors are here for profit, and that's why Zambia liberalized its economy. As much as government wants to collect more in terms of mining tax revenue, efforts should be made to ensure that there is an enabling environment for growth in the mining sector, which growth will then lead to more tax revenues. The current situation where government is bent on higher taxes at the expense of growth has the potential for encouraging tax evasion, which is currently high already in the country.

Questions and Comments

1. It looks as though the best way to get the best revenues from copper is just to nationalize, in a similar fashion to what Chile did.
2. Is there any way we can separate those institutions that collect tax from those that manage the tax, to make tax administration more effective?
3. Don't you think revenue-based tax would be better than variable profit tax, given Zambia's lack of capacity to audit profits in the mining sector.
4. What really is Zambia's problem? Is it lack of correct statistics in the mining sector or lack of access to correct statistics?
5. In response to Prof Old's presentation that a uniform tax system in the various sectors is beneficial to the entire tax system, how feasible is this proposal in the light of fluctuating copper prices?
6. One way in which Zambia is losing revenue is through secretive Mining Development Agreements (MDA), where mines become profitable prior to the end of concession period. This can be avoided.
7. It is sad that cabinet scrapped off the mineral revenue sharing mechanism from the law, a provision meant to benefit mining communities from the country's mineral wealth.
8. In the light of frequent changes in the political leadership, how is the Political Party System affecting policy process in terms of consistency?

Recommendations

- Government should remove the veil of secrecy on Mining Development Agreements and make them public documents.
- Government should create Sovereign Wealth Fund where part of revenues from the mining sector can be deposited for stabilization in hard times.
- Build capacity among government officials involved in concession agreements.
- Government should collect reasonably high taxes from the mining sector.
- Put in place a fair tax system for all players to avoid the race to the bottom.
- Broaden the tax base to include the informal sector
- Build broad consensus among tax stakeholders
- Establish long term stability and predictability for investors
- Meaningful citizen participation and engagement around taxation is important
- Zambia should put in place a sound knowledge base in terms of mining statistics.