EXECUTIVE SUMMARY

The Extractive Industries Transparency Initiative in Mozambique (MEITI) is largely irrelevant in preventing diversions of public funds. In Mozambique, these diversions occur on a much greater scale at stages where both the companies (and their foreign and national shareholders) and individuals linked to government power can take advantage of a lack of transparency, rather than at the stage monitored by the MEITI, where only the latter can take advantage. The briefing shows that most funds are diverted earlier – during the negotiation of the fiscal regime and declaration of the tax base. These are phases that are shrouded in a high and unjustified level of secrecy. This allows large-scale private appropriation of the rents generated in the sector and the payment of derisory sums to the state. In addition, the fact that these diversions occur so early on leaves little to be gained from diversion at the stage covered by the MEITI.

INTRODUCTION

The Extractive Industries Transparency Initiative (EITI) was conceived internationally in response to the finding that many countries rich in natural resources were proving incapable of transforming this wealth into developmental benefits for the population at large. This poor management of resources for broader development takes a variety of forms, including the diversion from the state coffers of the rents generated by exploitation of the resources; poor management of social, environmental and cultural impacts; and the adoption of a strategy for the allocation and management of public expenditure that is inconsistent with the expansion and diversification of the productive base and with poverty reduction.
The EITI is presented as an instrument to improve the governance of extractive resources by promoting transparency in the state’s collection of extractive industry rents. The EITI attempts to achieve this goal by providing information on the payments made by companies in the extractive sector (mining and hydrocarbons) and the monies received by the government, and having this information verified by an independent body – the reconciliation firm – at the request of a national multi-stakeholder group (MSG). The EITI intends to prevent the diversion of funds deriving from extractive activities, and thus ensure that greater resources are available for addressing government’s priorities, such as implementing development strategies. The briefing discusses the relevance of the EITI in Mozambique for identifying and reducing the possible diversion of funds in the mobilisation of public revenue.

THE EITI AS AN INSTRUMENT TO IDENTIFY AND REDUCE THE DIVERSION OF PUBLIC REVENUE

State coffers stand to benefit at several stages of the extractive process, which also means that revenue can be diverted at different stages. The state may lose revenue in the following instances.

- The state is incapable of establishing a system for taxing relevant economic operations.
- The tax regime offers excessive and redundant benefits on the decision to invest.
- The declaration of the tax base is not transparent and the state’s capacity to verify it is weak, which creates opportunities for mispricing by companies. Mispricing refers to under-invoicing sales or over-invoicing costs, which reduces the amounts declared that are subject to tax.
- The companies do not pay what is due according to the fiscal regime applied and the declared tax base (regardless of whether the latter is correct or not).
- The payments made by the companies are diverted from the state coffers.

In the Mozambican case, it is important to understand the dynamics of private accumulation in the country. Here, public policies facilitate international capital. Moreover, there is a close association between national and international capital. The largest diversions occur at stages where both the companies (and their foreign and national stakeholders) and individuals linked to government power can take advantage of a lack of transparency. This includes the negotiation of the fiscal regime and the declaration of the tax base, phases during which companies can gain from discretionarily added fiscal incentives and underreported amounts subject to taxation. Individuals who wield influence within government may also obtain personal benefits, for instance, by softening the positions imposed on the companies in exchange for shares in the companies or places on their Boards of Directors, or through arrangements for preferential treatment of service companies to which they are linked. Indeed, Machel shows large-scale involvement of senior government figures in business interests in Mozambique’s extractive sector, which may suggest conflicts of interest. Furthermore, strong opposition to transparency in the fiscal regime expressed by government members in the MEITI MSG strengthens the idea that such conflicts exist and that there is an alliance between the executive and some extractive companies. This harms the efforts in favour of transparency, sound management of natural resources and defence of the interests of the state and its citizens, for whom the revenues should ultimately be used.

In the following phases, when the payments already made by the companies are diverted from the state coffers, the companies do not benefit from these illicit acts. In these phases, transparency of host governments (mostly in developing countries) is in the interests of the companies and their home governments. Likewise, when senior government figures are involved directly in private business activities that are directly or indirectly linked to the extractive sector, motivation for the diversion of funds during the phase monitored by the EITI is lessened for several reasons. Firstly the most significant gains have been made earlier. As a result of these earlier gains, payments made to the state are small. By not diverting these payments the alliance with international capital is not ‘betrayed’ and the government displays a commitment to...
anti-corruption measures and good governance in accordance with the priorities of international donors. This is not only a determinant for continuing foreign aid flows, but also helps to attract international capital and thus broadens the prospects of national capital allying with it. As a result, many of the key stakeholders have a strong incentive to implement an EITI that does not address the most relevant issues regarding extractive sector generation of funds to finance development.

**RELEVANT ISSUES REGARDING MOBILISATION OF RESOURCES AND LIMITATIONS OF THE MEITI**

The two MEITI reconciliation reports that have been produced (2008 and 2009) detail payments made by extractive companies reconciled against information on the money received by government. The data from the reports shows that all the sums paid by the companies in 2008 were confirmed by the government, but that in 2009 the government was unable to account for a sum of about $110,651 (approximately 0.25% of total payments).

To illustrate the relevance of the losses resulting from the fiscal regime, the amount of revenues lost as a result of redundant fiscal incentives to a single company, Sasol Petroleum Temane, regarding a single revenue stream, the tax on company profits (Imposto sobre o Rendimento de Pessoas Colectivas), is more than 12 times greater than the discrepancy found in the entire extractive sector (the total sum of payments from companies that the government was unable to corroborate). Although some of the fiscal incentives were standardised in the 2002 code of fiscal benefits, it also provided space for some companies to negotiate softer tax obligations. The revised code of fiscal benefits (2009) has reduced possibilities for individual negotiations. However, the number of taxes (and methods of calculation) that are unspecified in the code and the mining and oil laws still leaves room for individual negotiations. These secret negotiations create conditions for rent seeking from companies and government officials. Moreover, these deviations are hidden by contract confidentiality clauses and are out of the reach of the MEITI. As the government negotiates the contracts on behalf of the people who, according to the national constitution, are the owners of the natural resources, the result of the negotiation process should be publicly accessible in all that is not commercially or technologically sensitive information.

Mispricing practices are more difficult to identify. However, mispricing is one possible explanation in situations where data shows (i) differences between export values reported by the exporter and the respective import values reported by importing country; and (ii) reductions in the royalties’ payments as a share of production values. Both these situations occur in Mozambique and the estimated loss accruing from these differences is more than 15 times higher than the value of payments from the companies that the government was unable to justify. The fact that available data is inconclusive about the causes of these differences is in itself an argument for broadening the scope of data provided by the MEITI.

These practices result in derisory flows of payments from the extractive sector. In 2009 companies declared direct payments accounting for about 1% of total state revenue. Official data available for two companies already exporting their production shows that for each $1,000 of exports, $946 remained with the companies (to pay their capital and operational costs, profits and dividends), and only $54 was paid by these companies to the state. This feeble contribution to state revenues happens even without corrupt individuals or institutions diverting payments made by the companies from the state coffers.

Such revenue losses are not captured by the MEITI because of its limited scope. The information provided by the MEITI report is insufficient and needs to be complemented by a detailed breakdown of the fiscal regime, the volumes and values of production, and capital and operational costs. These costs need to be disaggregated by project, as companies tend to transfer costs within projects to reduce total payments to the state. The secrecy of the fiscal regime does not allow for verification of whether or not the companies have paid what ought to have been paid in accordance with the fiscal regime applied. The secrecy and incapacity to verify the information declared for tax purposes allows companies to underreport the wealth that is
being generated and exported, thus reducing the wealth that is retained by the state. The inability of the MSG to monitor what should have been paid permits deviations of wealth from the state prior to the phase in which government officials can divert payments made by companies from state coffers. This renders monitoring whether government deviated from what was actually paid largely irrelevant.

Each national MSG has the responsibility to discuss the priorities that will make the application of the EITI relevant in each context and to devise strategies on how to implement them. The lack of openness of government actors in the MEITI MSG towards broaching these questions reduces MSG activities to implementing the basic standards of the EITI as defined internationally. These shortcomings render this body irrelevant as a forum for dialogue – which is its main function – and reduces the possibilities of making the EITI relevant for the country.

CONCLUSION

The most significant diversions of public resources from the extractive sector in Mozambique occur as a result of bad agreements and illegal practices, which are the responsibility of both government and the companies involved. Diversion of public resources occur at the contract negotiation stage where payment terms from companies to the state are fixed, and at the stage of contract implementation. Thus, more relevant than monitoring discrepancies in the amounts paid and received, are issues relating to the transparency of the fiscal regime and the system for valuing the resources and capital and operational costs. The secrecy shrouding this information contributes to its irrelevance. Transparency in these procedures and their results is fundamental for ensuring greater involvement of society in informed and useful discussions about how to improve the management of natural resources for development.

ENDNOTES

1 Rogério Ossemane is a researcher at the Instituto de Estudos Sociais e Económicos – a member of the Governance of Africa's Resources Research Network.

2 The MSG is composed by representatives of the government, companies and civil society organisations. Among other things, the MSG produces the terms of reference for the EITI report and helps in monitoring the work of the reconciliation firm.


5 Ossemane R, ‘MEITI – Analysis of the legal obstacles, transparency of the fiscal regime and full accession to EITI’, IDeIAS, 43E, 19 April 2012a; Ossemane R, ‘MEITI – Analysis of the reconciliation exercise in the second report of EITI in Mozambique’, IDeIAS, 42E, 19 April 2012b.


7 The data from the reconciliation report is in meticais. The conversion was done using the average exchange rate of 31 December 2009, which was MZN 27.51 = $1.


9 Ossemane R, 2012c, op. cit.

10 The data is in meticais; with MZN 27.51 = $1 (as of 31 December 2009).