'Transparency' hides Zambia's lost billions

Mining corporations' tax avoidance schemes cost African nations billions of dollars each year.

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Zambian copper being offloaded at Dar es Salaam, Tanzania, in an archived image from 1966. Much of Zambia's copper exports appear to 'disappear' from official paperwork, leading to huge revenue losses for the country [GALLO/GETTY]

African nations such as Zambia are often seen as grossly corrupt. Yet it is corporate tax "avoidance" on the part of mining companies that costs the nation hundreds of millions annually, while lining the pockets of middle-men in countries such as Switzerland. And the much-lauded Extractive Industry Transparency Initiative (EITI) may help - rather than hinder, this reality.

Zambia recently became the 26th country to publish the EITI report, disclosing payments from mining companies for the year 2008. The EITI standard is meant to "facilitate transparency" by assessing net discrepencies between resource rents, for example: royalties and taxes, remitted by multinationals and received by governments.

The primary intention of the EITI report, backed by many of the world's major extractive or resource-seeking multinationals including Shell, Chevron, Vale, BHP Billiton, Anglo-American and others, is to eliminate corruption by shining a light on the flow of revenue. Describing companies as "complicit" in corruption limited to the criminogenic environments in which they are required to operate, the EITI system claims that reduced reputational risk is a tremendous upside for foreign investors and corporate entities.

Elilminating corruption?

Currently, Zambia is one of twenty-four EITI candidate countries, of which more than half are African, including Tanzania, Gabon, Cameroon, the Democratic Republic of the Congo, Chad, Mali, Mauritania, Sierra Leone, and Burkina Faso - among others. Already, five of eleven EITI "compliant" nations are African - many of them surprising choices - think Nigeria, Niger, and Liberia.

According to Clare Short, head of the EITI system and former British secretary of state for international development, a ministry created under then-Prime Minister Tony Blair - who announced the initiative in 2002 as a joint project of the UK and the World Bank - once a country joins EITI, all companies operating within the "host" country must make full disclosures.

The logic goes that, so long as there is disclosure of cash payments within national boundaries, transparency will act as a natural sanction - diminishing the potential for, and realisation of, corruption.

It is a logic that appears to bank on political or "demand-side" corruption, chiefly innate to the developing country's character - with corporations simply "going along" with the system - a kind of "when in Rome" response.

But the EITI theory is vastly different from the reality and has more to do with corporate and "first world" country supply-side corruption. Zambia's first report, for instance, revealed that mining companies remitted $463 million in payments to the government in 2008. The EITI report claims "significant discrepencies" noting a net total of "unresolved discrepencies" of $66 million.

In that same year - 2008, much of Zambia's exported copper, almost half of which was earmarked for Switzerland, never arrived at its destination - disappearing into thin air. Moreover, the pricing structure for Swiss copper - remarkably similar to Zambia's exported copper - was six times higher than the funds Zambia received, facilitating a potential loss of some $11.4bn. This is especially interesting when taking into account that Zambia's entire GDP for 2008 was $14.3bn.

Glencore's lucrative policies

This type of corporate corruption - known as transfer mispricing, made headlines recently when a leaked report authored by Grant Thornton at the request of the Zambia Revenue Agency (ZRA) unpacked how the Glencore-controlled lucrative Mopani Copper Mines (MCM) - a company which declared no profits, was cheating the country's tax base of copper revenue.

The auditors disclosed that MCM tried "resisting the pilot audit at every stage", rendering them unable to access crucial data in many instances. MCM's chief executive, Emmanuel Mutati, claimed that the audit was not accurate, precisely because data was inaccurate. Yet Glencore, the world's largest commodity trader, controlling 50 per cent of the global copper market, is confident that MCM will be "exonerated".

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In all probability, Glencore will be saying that transfer pricing is perfectly legal and central to trade. But the nature of "arms-length transfer pricing" within the current deregulated global financial architecture, enables multinationals (conducting as much as 60 per cent of global trade within - rather than between - corporations) to "self-regulate" pricing.

So, though pricing, in theory, is determined according to "market values", in reality, the "corporate veil" facilitates tremendous mispricing when subsidiaries of the same company trade with one another - the means through which Glencore allegedly purchased grade +1 copper well below market prices, with MCM allegedly preferring - all too often, the lowest price offered by a Glencore subsidiary, described by the audit as an act likely for buyers, not sellers, who would experience diminished profits.

Glencore International AG, based in Switzerland, the world's leading secrecy jurisdiction, handpicked by Glencore founder and notorious commodity trader Marc Rich, further enables the company to take further advantage of little or no taxation.

Tax havens such as Switzerland are essential to resource-seeking corporations operating in Africa: more than 85 per cent of asset portfolios for sub-Saharan Africa passes through tax havens. In Zambia, MCM's structure - like that of Vedanta and others, keenly utilises tax havens as vehicles for shell companies able to access legal and financial opacity tools including banking secrecy, thin capitalisation, little or no taxation, zero disclosure of company accounts, use of nominees, and - best of all - high-level client confidentiality, all of which is entirely legal.

Mining and tax havens

Thus, however illicit, by outsourcing the commercialised sovereignty of tax havens, transfer mispricing, when realised through tax avoidance, is legal within select jurisdictions. The financial geography of MCM is located almost entirely in tax havens: though a Zambian company, it is 73 per cent owned by Carlisa Investments (a British Virgin Islands company, 82 per cent owned by Bermuda-based Glencore Finance, which is 100 per cent owned by Glencore International AG). MCM's mining partner, holding 18 per cent of Carlisa, is another mining entity active globally and in Zambia - First Quantum.

And while the extractive industry is being promoted rather aggressively as the primary vehicle to kickstart Zambia's real economy, mining companies generate just 2.2 per cent of revenue collected by Zambian authorities, with the bigger percentage of tax derived from withheld taxes paid by workers. The result? Just 4.4 per cent of actual taxes remitted from the already minute sum paid by mining houses comprises corporate tax. This is a particularly nifty boutique tax product called Total Tax Contribution, created by auditing firm PricewaterhouseCoopers, which helps corporations avoid taxation.

Zambia's government acknowledged that the country missed cashing in on the 2004-2008 commodity boom, when copper prices more than tripled. But companies like MCM don't have to pay the new royalty rates of three per cent - as 20 year stability clauses from secretive development agreements issued soon after privatisation provided the company with arguably the world's lowest royalty rate at 0.6 per cent. This agreement will remain in force until the year 2020. Worse still, had these agreements not been leaked, it would never have come to light that corporate tax rates were effectively zero, thanks to deferments and royalties.

MCM is the largest copper mining operation in Zambia - and Glencore certainly stands to benefit from locking down the copper market, not simply because copper underwires the modern world, but also because it is fundamental to renewable energy. In fact, shortages are estimated to drive up the price of copper from it current historic high at $9,000 per tonne, to that of about $11,000 by 2013, elevated in large parts by the demands of emerging nations such as China, the world's largest consumer.

Solutions to company operations

Thus, catching revenue leakage through EITI - off the mark by billions - is impossible because it does not focus on what multinationals ought to have paid, only what they have paid, and it never investigates the means through which corporations were able to circumvent taxation.

There are several reasons for this: EITI allows inconsistent standards, limited to national boundaries, despite the international nature of multinational economic activity. And the EITI system, for instance, provides national governments with choices that fragment the legitimacy and accuracy of conclusions - even insofar as they attempt to track cash payments, including whether reporting is mandatory, whether auditing is required, what should be published and the accounting policies used, materiality levels, *et cetera*.

Aggregated templates used by multinationals - and even the EITI system, prevent scrutiny, for example, of where problems are arising, where they are replicated, how they are realised - whether it has been identified, if problems are being sorted out, and how. The EITI system would easily allow another subsidiary of the same mining company, based in another jurisdiction, to make a corrupt payment to a politician in Zambia. It would allow a company within Zambia, created for shell purposes, to be paid for "services rendered", diminishing tax. Thin capitalisaton would allow for one subsidiary of the same parent company to make high interest loans to the host country subsidiary, diminishing taxable profits. The possibilities are endless - and often utilised.

Of course, there are many solutions, namely that of corporate country-by-country reporting (CbC), created by Richard Murphy, a founder of the Tax Justice Network. This would involve real natural sanctions prohibiting companies from artificially using tax havens (by disclosing the lack of substantial economic activities in these jurisdictions) while also limiting the scope of transfer mispricing.

Elements of CbC include the names of each country in which the multinational operates; the names of all companies trading in each country in which the company operates; the financial performance in each country in which it operates; sales between third parties and other group companies; purchases split between third parties and intra-group transactions; labour costs and employee numbers; financing costs; pre-tax profits; deferred taxation liabilities for the country at the start and close of each accounting period; the actual payments to the government; the tax charge for the split between current and deferred tax and so on.

It is a method inspired by a system already in place in the US. Certainly, critics will claim that transfer mispricing is always possible, but the difference between CbC and EITI, is that with the former, it is exceedingly difficult, whereas with the latter, it is highly probable.

World Bank's push

So why does the EITI allow for so many potential faultlines, vacuums and opt-outs? Like Chile, Zambia historically was one of the world's leading copper producers, extracting and exporting some 700,000 tonnes annually during its "golden peak". Currently, Zambia has hit the 800,000 mark, pegged to exploit more than 1 million tonnes per annum in the next year or so.

Way back when Zambia's copper industry was being privatised, the World Bank pushed for the lowest possible tax and royalty rates, providing companies with the type of secretive development agreements mentioned above. The Bank claimed that the limited intervention of the Zambian government rendered the process the most successful in the region.

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Describing Zambia's new system imposed by the "arm-twisting of the World Bank", **a 1996 New York Times piece** stated: "All exchange controls, tariff barriers and food subsidies have been dropped in the shock-treatment switch-over to rampant capitalism … Virtually everything the state owned is for sale."

For African citizens, the World Bank, perceived as the source of devastating structural adjustment programmes created conditions still haunting countries like Zambia. Until mid-1995, the Bank itself refused to acknowledge the "C-word" - corruption, claiming such to be political and beyond the Bank's mandate.

This was despite the reality that 60 per cent of every dollar provided in external loans left the continent through illicit flight.

It has yet to factor illicit flight in accounting models. Had this been done, sub-Saharan Africa would be unpacked as a global net creditor - as the Bank itself disclosed in a report many years back.

As *Treasure Islands* author Nick Shaxson reveals in his book, though looted wealth is transformed to private wealth, the empty hole in the public purse is transformed to a public debt. He cites the example of Africans "bearing" the public debts by describing the case of a pretty Angolan girl, forced to bear an infection rotting a hole the size of a golfball in her cheek, because she could not access public healthcare.

Meanwhile, EITI's other backer, the UK, is host to more than half of the world's tax havens: three as British Crown Dependencies (such as Jersey - the corporate hub from which Glencore recently launched an IPO), seven as British Overseas Territories (including world famous hubs such as the Cayman Islands, British Virgin Islands, and Bermuda - where Zambia's multinationals have incorporated and maintained subsidiary entities), and 21 as members of the Commonwealth.

The City of London, a ring-fenced financial district, is one of the world's leading tax havens, previously described by the UK's Serious Fraud Office (SFO) as "head office" to some of the world's major tax havens.

Put simply, whether or not we choose to acknowledge it, these actors - including the Organisation for Economic Development and Cooperation (OECD) - comprising the world's most powerful nations and its leading donors, may be seen as benefitting from the impoverishment of African regions.

Capital losses

Each year, Africa loses a minimum of $148bn - almost four times the sum of foreign aid it receives, to capital flight - of which 60 per cent is due to corporate mispricing. Clearly, the solution toward enabling African countries to recover their lost revenue and become economically independent, is to block revenue leakages, rather than provide further loans and grants characterised by conditionalities that undermine development.

Yet, even as 60 per cent of non-grant revenue is generated by resource rents, constituting a main source of income for African nations, many of them "rent-seeking" and dependent on resources for their tax base, the OECD has not implemented CbC, preferring the "arms-length system" created by the International Accounting Standards Board (IASB) - itself operating from a tax haven, founded and financed by the world's leading accounting firms - such as PwC - and all of whom compete with another to create the best tax avoidance products for corporations.

Nick Shaxson said this to me in a recent email:

> The role of the OECD is particularly strange in this respect. It jealously guards some of the main mechanisms and models for transparency and information exchange with respect to international financial flows, and with respect to international tax. And yet these models all, in important ways, significantly disadvantage developing countries.

It is a disadvantage, locked into the EITI system, designed to present an illusion of accountability where none exists.

So, while EITI may be good news for the companies involved in Zambia, casting them in a clean light, the same cannot really be said for the country's citizens who are being shortchanged.

Short recently claimed that the EITI model, still evolving, would be complemented by such measures. But intimated along with this statement is the notion that EITI itself will not lead this charge. So much for transparency.

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