Short Guide to Parliamentary Oversight of Mineral Revenues

Tanzania Parliamentary Seminar

REVENUE WATCH INSTITUTE

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Short Guide to Parliamentary Oversight of Mineral Revenues

This short guide provides some basic information for parliamentarians conducting oversight of mineral resources and the revenues they generate. It provides a set of questions that members of parliaments might need to ask in order to ensure that the country receives maximum revenues for the minerals extracted and that these are used in ways that will most benefit the country and its people. This guide is divided into two parts that relate to the potential roles of members of parliament:

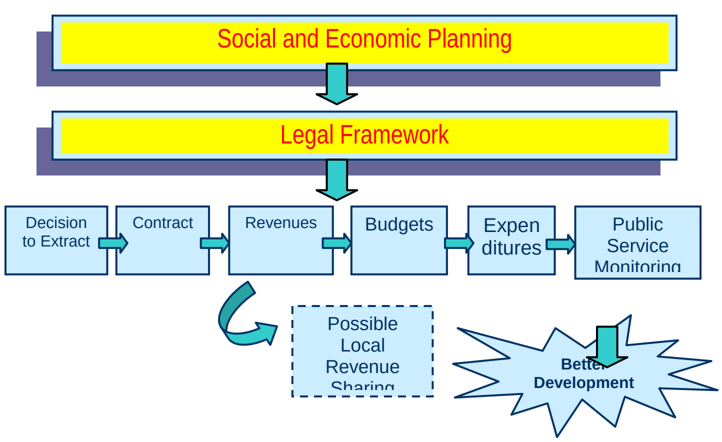
Part A: Setting the strategic framework
This involves setting the development vision for the country, clarifying the role of the minerals sector within this and establishing the legal framework to enact it.

Part B: Over-seeing each key stage in the minerals 'value chain'.
Turning mineral resources in the ground into improved well-being for citizens takes a series of steps that together can be termed the 'value chain'. Maximising benefit requires that different questions are raised at each stage in this 'value chain'. Part B of this guide introduces the issues that need to be addressed at each of the following stages:

1. Decisions to extract
   – Should mining take place? How much? Where? When?
2. Bidding management
   – Does the process select the best operator or service provider?
3. Contracting with companies
   – Are the terms a good balance of risk and return?
4. Revenue management
   – Is what is owed, received? By whom? Are there any losses?
5. Budgeting
   – Are the plans to spend the mineral revenues focussed on development and poverty reduction?
6. Expenditure management and public service monitoring
   – Is the money actually spent according to the plans?
   - Is it benefitting the people?

The following diagram provides an overall 'map' of the way these different key elements fit together. Each section of this guide relates to the element highlighted in the diagram at the start of each.

Part A: Setting the strategic framework – social and economic planning, mining policy and the legal framework



Mining is only a means to an end. Defining that end before mining begins is vital to ensure that it is effectively serving the interests of the country. The overall aim must be to maximise the benefits to the citizens of the country, now and in the future. Parliamentarians have a key role to play in long-term social and economic planning that clarifies the contribution that mining is expected to make to long-term development. They are also key in the development of mining policy and related laws that reflects this long-term vision.

At a very strategic level, to achieve this, mining policy and laws need to clarify:

- What is mining for? What benefits are sought?
  - How will it contribute to the long term plan for the country's development?
  - How will it be used to reduce poverty?
  - What will it contribute to employment, economic development, social welfare, environmental sustainability, political stability, accountable governance and which of these take priority?
- Who should benefit?
  - The population as a whole or those controlling resources?
  - Producing areas or the whole country?
- When should the benefits be generated?
  - For this generation or futures ones?
  - How can finite resources be converted into long-term, sustainable income and benefits for the people?
  - When would extraction maximise benefits, even if this means a delay?

The answers to these questions provides a 'societal test' against which all questions surrounding mining policy and law can be judged.

A key route to effective decision-making is to adopt a cost-benefit frame of analysis. Clearly, as spelled out the constitution, the role of parliament should be to strive for the option that is likely to bring greatest benefit to the all people. All along this process the key questions to ask will be:

1. What are the costs of this decision?
2. What are its benefits?
3. Do benefits outweigh the costs?
4. Are there alternative decisions that could be more beneficial?

In asking this questions, parliaments ought to take into account the real economic cost and benefits (opportunity cost) and not the simple monetary cost and benefits (accounting cost) of any decisions. This will be particularly important when formulating the decision to begin extracting minerals. In this respect it is worth understanding the concept of opportunity cost (see below) which is at the basis or economic costs.

What is an Opportunity Cost?
An opportunity cost is a benefit you could have received by taking an alternative action but which you forgo in pursuing a different choice

For instance, if farmers choose to grow carrots and sell them on the market, their opportunity cost is the amount they would have earned from sales of an alternative crop that could have been grown instead (e.g. potatoes, plantains).

In the extractive sector, for instance, a government decides to extract iron ore deposits from a previously defined forest conservation area. The opportunity cost of the decision to extract would be the value of the benefits forgone of some other thing which might have been done with the conservation area instead. For instance, in granting a permit to exploit iron ore in the reserve to a private industrial operator, the government has forgone the opportunity to encourage sustainable eco-tourism, or to set up a small scale mining project with local communities or to earn revenues from forestry.

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Specifically, if the overall income earned from the mine is estimated at 100m US$, the accounting costs linked to the realization of the project are estimated at 60m US$ and the share of profits accruing to the company as spelled out in the contract is set at 50%, the net benefit will be:

Net income 100-60= 40m US$
Net government income: 40- 20 (50% of 40)= 20m US$

This would suggest that it is in the interest of the country to extract. However, if we introduce opportunity cost into our equation (e.g. lost revenues from eco-tourism) if these are significant, mining may not be the most cost-effective use of the reserve. In addition, there are likely to be a number of external costs that need to be factored into decisions, such as environmental damage, potential waste of mineral revenues through corruption and mismanagement and social conflicts. In this example, if together the opportunity and these other costs are in the range of 30m US$, then our net result is:

Net government income: 20- 30= -10m US$

Under these assumptions, taking into account the opportunity cost, it would be detrimental for the country to invest in extraction in this particular case.

The concept of opportunity cost is crucial to bear in mind when weighing the decision of whether to extract.

Mining policy and law must then be reflected in legal and regulatory frameworks that govern minerals and revenue management. Therefore, again, the legal framework should be anchored to a clear vision for national socio-economic development and regulations governing mineral extraction should be geared towards contributing to the realization of that vision. In the case of Tanzania, where the importance of mineral extraction is on the increase, the Bunge might want to seek advice from national and international experts, specialized NGOs or fellow legislatures in other countries that have an established track record in the mining industry and have managed to reap the benefits of extraction.

It should be noted that mining policy, law and regulatory frameworks will also need to outline key features of each of the following stages in the minerals value chain outlined below in Part B. The same key questions will need to be considered at the policy formulation stage as during each stage of implementation. They are only outlined once to avoid repetition in this guide.

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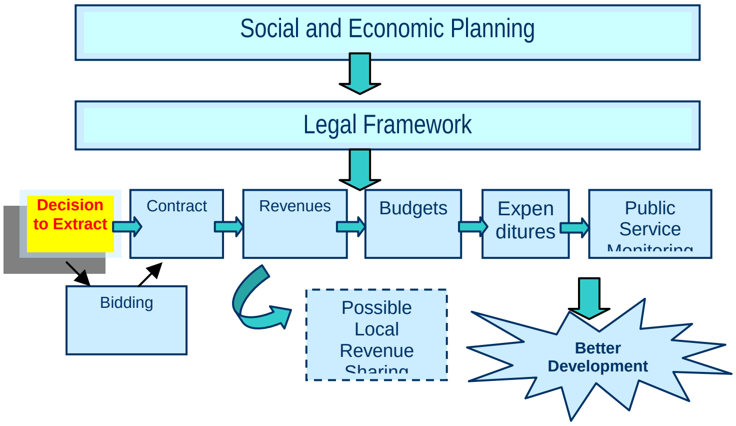
PART B – Role of Parliaments at each stage of the Minerals 'Value Chain'

1) Decisions to Extract



When a government announces that it is considering opening new areas to mining exploration or development or that it is in discussions with one or more mining companies, parliamentarians should question whether it is in the interest of the country to extract at all.

More specifically, in making the decision to extract, some key questions to ask will be:

- Are there alternative economic uses of the land concession, such as tourism, farming, and forestry? Could they bring revenues? How sustainable and important would these revenues be as compared to those of the mine?

- On balance, will the mine generate more employment than it will destroy (for instance substituting small-scale miners, or inducing a brain drain from other sectors)?

- Which type of extraction generates greater employment and welfare for local communities? What are the current uses for land where the mine will go? Will a mine impact local community livelihoods? Have the local community given their consent for the area to be mined?

- Are the country's institutions strong enough to avoid the potential political instability, economic instability, and tendency towards waste often associated with inflows of large revenues from extraction?

- In particular, could extraction generate imbalances in the national economy? For instance, could foreign direct investment linked to the mine provoke a real exchange rate appreciation thus hurting other export-oriented sectors of the economy (such as industry and agriculture)? Can national institutions (government, central bank) ensure economic stability in the face of the traditionally volatile earning from extractives?

- Will the government save a portion of mineral revenue for future generations? Or will it use and invest all revenues now to fuel immediate development? If it does not save mineral revenues today, what strategy will it need to put in place to ensure a fiscal base and economic stability tomorrow?

- Will it redirect a portion of revenues to producing regions for local development? Or will it centralize revenues to promote more even national development?
    - Are local governments capable of adequately managing mineral revenues? Are local oversight mechanisms in place or do they need to be created?

- Does the country want to develop a national industry or rely on international companies? For the technology of extraction? For financing?

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- o Is it better to rely on foreign companies to immediately earn the benefits of extraction or develop a strategy for national extraction that might involve immediate costs, longer lags, but possibly higher benefits to the country in the future?
- o If the country wants to develop a national industry, how is it likely to acquire the needed skills? Will an initial co-ownership and transfer of knowledge from foreign companies be needed?
- o Are national mineral reserves sufficiently high to anticipate that investment in the development of a national industry will pay off tomorrow?
- o Which option will generate more employment? More revenues?

- Does the country need to encourage industrial mining or rely on small-scale artisanal mining?
  - o Is any artisanal mining taking place? Is it bringing benefits ?
  - o What option is likely to bring greatest economic benefit? Can artisanal mining be organized in a legal framework (for instance, cooperative system) that will ensure that the government reaps sufficient fiscal benefits from both extraction and processing?
  - o What are the employment and welfare implications of industrial vs. artisanal mining?
  - o Which option is environmentally more sustainable?
  - o What will be the social and governance implications of either choice?

- If minerals extracted are for exports, does the country possess its own processing capacity for turning rough ore and minerals into refined products to generate additional employment and revenues from the processing of the mineral? If it does not, can the country set up a processing industry? Or should it wait a few more years to acquire processing before extracting? Or should it accept that processing will take place abroad given the economic benefits of exploiting the mine immediately?

- Should the country opt for its minerals to be exported or to be consumed nationally, for instance in the construction of infrastructures? Is national demand currently sufficient to absorb production? If not, should the decision to extract be postponed until the country will indeed need raw materials for national use? If the country opts for exporting now, what will be the costs of importing minerals to satisfy national demand in the future?

- Is the project environmentally risky? Are there potential hidden costs from permanent environmental damage the country might need to bear?

- Can the nature and location of mineral deposits generate social strife or cross-border conflict? Will it generate or heighten separatist claims from producing regions? Can these be successfully mitigated?

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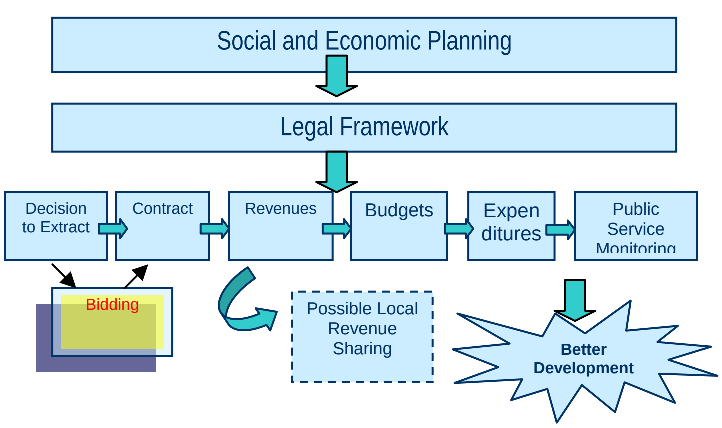
2) Bidding management



Once the decision to extract has been made, governments should launch a competitive bidding process and ask various operators to submit offers. If this is not deemed appropriate, the government should explain why an alternative approach has been chosen. Bidding formats vary across countries, but they usually provide a bidding framework with changing variables for the bidders. For instance, the bidder might be asked to specify its technical and financial qualifications, a work plan (i.e., the amount of money it will spend on exploration), flat fees or the proportion of revenues accruing to the government, and local content requirements. In general, the purpose of open competitive bidding in the award of licenses is to obtain the highest economic value for the nation by awarding blocks to the technically and financially qualified company and/or group offering the largest expected return to the government.

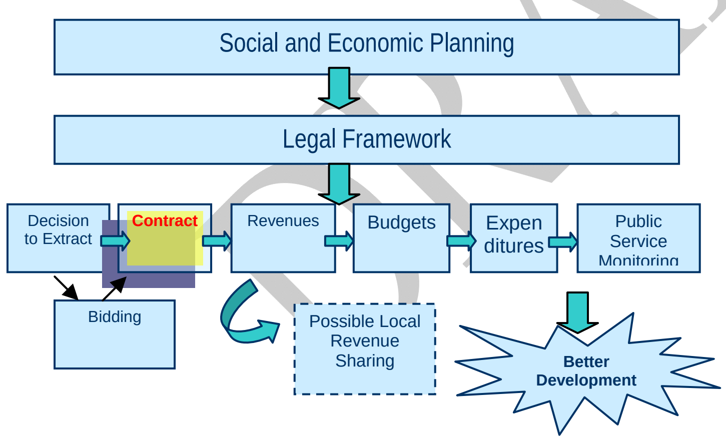
However, governments also engage in direct bilateral negotiations with operators. This practice tends to increase the opacity of the negotiations and might lead to sub-optimal results, especially if the government has not yet acquired sufficient negotiating skills and experience compared to companies.

Parliamentarians, via their specialized standing committees, can request to be included in the bidding processes, as observers of negotiations or, better, as observers in the committees in charge of evaluating bids received and making the final selection. As a member of parliament, the Attorney General could also be included in overseeing the bidding process.

Some key questions to ask at this stage are:

- Were national bidding regulations respected?
- How was bid evaluation and selection conducted? Was the most qualified bidder selected?
- Is any individual in a position of conflict of interest? Are decision makers stakeholders in the bidding company?
- Does the chosen operator have the technical and financial competence to implement the project?
- Was due diligence conducted ahead of determining awards?

3) Contracting companies



Once the bidding process, if any, has been concluded, parties will begin negotiating a contract. A contract is a set of rights and duties binding the two (or more) parties (government and operators) throughout the duration of the concession. A contract will normally specify taxation levels, fees, royalties, import and export duties on minerals, derogations and special exemptions from taxation, stabilization of taxes or other financial burdens, environmental and social obligations, clauses on duration and changes to the agreement, rights of assignment, local content provisions, financial terms including lending policies, currency of operations and repatriation of profits, and disclosure provisions among others. At times, contracts might cover only some of these issues where certain issues are standardized in the legal framework (i.e., non-negotiable).

Contract negotiation is typically a government prerogative and parliaments are generally not involved at the negotiation stage. Yet, contracting represent a key stage in the value chain since it affects the government's ability to extract revenues from the project as well as ensure environmental and social sustainability. Given these fiscal, environmental and social implications, the Bunge, as the direct representatives of the Tanzanian people,

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might want to request involvement as an observer in contract negotiations via its specialized committees, such as Finance & Economic Affairs, Public Accounts, Land, Natural Resources & Environment, Social Welfare & Community or Energy & Minerals. Committee members would probably be bound by confidentiality agreements if they were allowed to observe negotiations.

Even without being granted access to negotiations, parliaments should request copies of negotiated agreements and prompt governments on their provisions during question time sessions or committee sessions.

In some countries, contracts of strategic significance must be ratified by parliament (e.g., if the represent a certain percentage of GDP or FDI).

Key questions to ask on contracts:

- What is the duration of the Contract, its provisions on renewal, and termination? Notably:
  - Can the government terminate the contract on grounds of non payment of taxation or fraud?
  - Are force majeur rules clearly articulated?
  - What law will apply in the case of a dispute? National or foreign? International arbitration or national courts?

- What are the local content provisions?
  - Does the contract lay down ratios for the employment of nationals and their wages? Does is specify ratios for management positions?
  - Does it include training of nationals and transfer of knowledge?
  - Does it cap employment of foreign staff?
  - Does it call for involvement of national sub-contractors or sourcing from local providers?

- What revenues will Tanzania earn from the contract?
  - What is the royalty rate? On what base is any percentage calculated? (e.g. is it based on volumes? Or on any measure of market value? If so, is it based on the reference value at the point of extraction or export? Is this adjusted for any costs?
  - Which taxes are applicable (income tax, VAT, corporate tax, tax on profits)? Are custom duties exempted for any portion, or all, of the project life-span?
  - Are there any exemptions from general legislation or regulations on taxation or custom duties? If so, what are they and what's the rationale?
  - Does the contract include a fiscal stabilization clause? What kind? Does it restrict the ability of the parliament to pass new laws or does it simply provide for economic compensation for changes? Does it apply to key taxes only, or to minor charges and non-fiscal (i.e., environmental or labor) provisions? Is it for the life of the project or just an initial period?

- Is the state a co-owner? Will it receive dividends?
  - If Tanzania wishes to invest in co-ownership, how much will this cost? What will be the interest rate on any borrowing? What else could it do with that money (i.e. what are the opportunity costs of investment)? What risks and obligations come with co-ownership?
- Is the operator required to make Corporate Social Responsibility contributions or build infrastructure for local communities?
  - Are the operators required to build infrastructures (roads, railways) as part of the project? Will they be automatically transferred to the government at the end of exploitation?

- What are the provisions on disclosure of information and data on extraction by the operator to the government (these are key to verify payment levels)?
- What banking and financial rules apply? Notably:
  - Can profits be repatriated? Do they need to be invested in a local bank?
  - Who is bearing the financial risk of exploitation?

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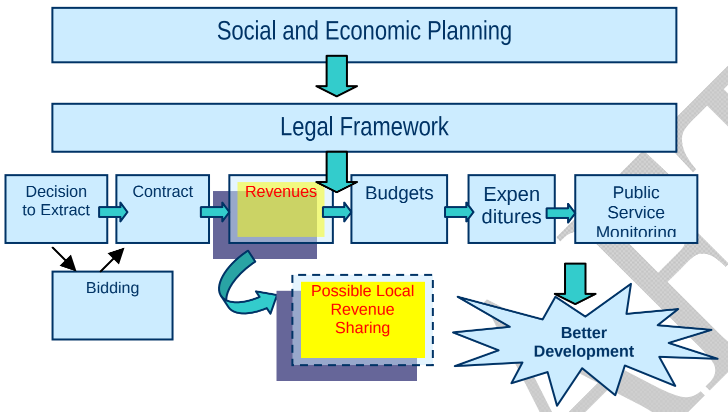
- Are there any loans involved in the project? Could loans imply a shift of financial risk to the state of Tanzania?

- What are the environmental clauses of the contract?
  - Does the contract provide for mine decommissioning, removal and clean up obligations? What standards will be applied to these closure activities?
  - What mechanisms will be used to ensure adequate funding of closure activities? Insurance?Separate accounts? Parent company guarantees?
  - Does the contract provide for reforestation?

- How do contract terms compare with international practice?
- Are contracts in line with national legislation?

4) Revenue management



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Revenues will start to enter government coffers from signatory bonuses and licensing fees if these are part of contracts. Once extraction has begun, depending on the contract a range of other payments may be received including royalties and taxes. Given that most revenue payments are dependent upon the quantity and quality of mineral produced, it is critical for the government to have an effective and independent means to value the mineral produced and therefore the amounts due.

Cost Recovery
A key element to understanding the government's take of revenues is also understanding the amount of the gross revenues that the companies are entitled to claim as costs. Terms for costs are usually clearly defined in the contract and legal framework but may differ for each revenue stream. For example, sometimes royalties allow for cost of transport and smelting to be deducted while a corporate tax may allow for all exploration and development costs to be deducted. When parliament is reviewing the revenues collected by the government, they have the opportunity to ask whether the revenues reflect a proper assessment of cost recovery.

A variety of national institutions will be responsible for collecting different payments made by the operator. Collecting institutions vary from country to country but are in general the central bank, the tax authorities, regulatory authorities, and the national mining company, if any.

In decentralized systems, revenues might flow also to regional and state governments, either in the form of direct payments by the companies or transfers from the central government

Parliamentarians should hold these agencies accountable for the handling of such receipts. This should be done on a regular basis, with periodical reviews of revenue management systems, which could be conducted by the relevant committees, and their specialized services with the help of experts. Such reviews should also be conducted in extraordinary circumstances, when for instance mismanagement or loss of revenues have been alleged by independent reports and audits. Some key questions they might want to ask are:

- Does the state have revenue projection models to shape expectations? Are these made publicly available?

- Are data on production, values and receipts systematically disclosed publically by the agencies involved in revenue collection?
- Is similar data systematically disclosed publically by the mining companies?
- Does the data on payments made by companies match that on revenues received by government
- Do data on cross-agency transfers (say from tax collection department to the treasury, from central treasury to local governments) match?
- Are revenue receipts in line with expectations and international price trends? Is there a widening gap between government revenues and company profits? Should parliaments initiate a contract review to ensure the state is maximizing its stake?
- Is there a good revenue management coordination and division of labour in place at the government level? Are all the agencies delivering on their roles as spelled out by the law?
- What's their standard of book keeping and data management?
- What are the systems in use? Are they up to date? Are government functionaries trained to effectively use these systems?
- Are there any quality control and review mechanisms in place within the different government departments?
- Are internal audits of government departments conducted? Does the Auditor General have access to data and carry out periodic analyses of fiscal receipts?
- Are payments by the operators made on time? Are penalties and interest levied on companies making delayed payments?
- Have sanctions been imposed on companies underpaying, providing false information or manipulating books?
- Are all these measures also effective at the local level if part of the revenues is transferred to local governments?

Parliamentarians might want to consider advocating for the country to join the Extractive Industries Transparency Initiative (EITI), an international transparency initiative that, at its minimum, facilitates the publication of company payments and government receipts. If the EITI is endorsed by the country, parliament should request inclusion of a number of parliamentarians in the EITI multi-stakeholder group, the body that will govern the verification of payments and government receipts. It should be noted that many countries have expanded the EITI to include other key areas that will support improved revenue transparency, e.g. transparency of production, costs; transparency of payments to local governemnt etc.

In addition, in extraordinary circumstances (corruption scandals, liquidation of an operator, non payment of taxation by operators etc.), parliamentarians might also demand an independent audit of government systems and processes as well as financial flows. This audit, which can also be conducted within the EITI, should be widely published and made available to parliament for review and action. It should contain recommendations as to the issues requiring attention and reform.

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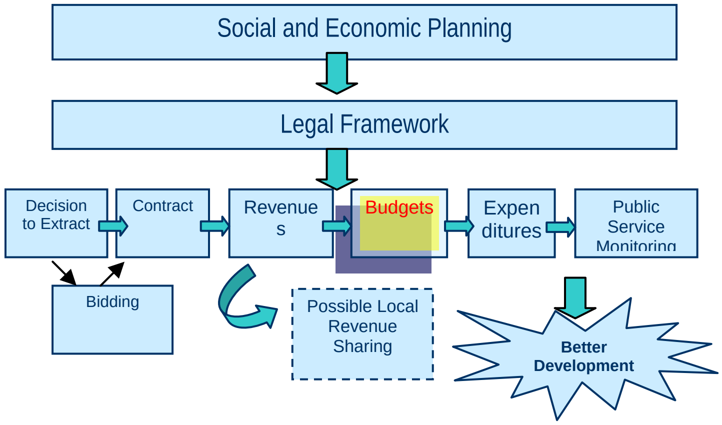
5) Budgeting

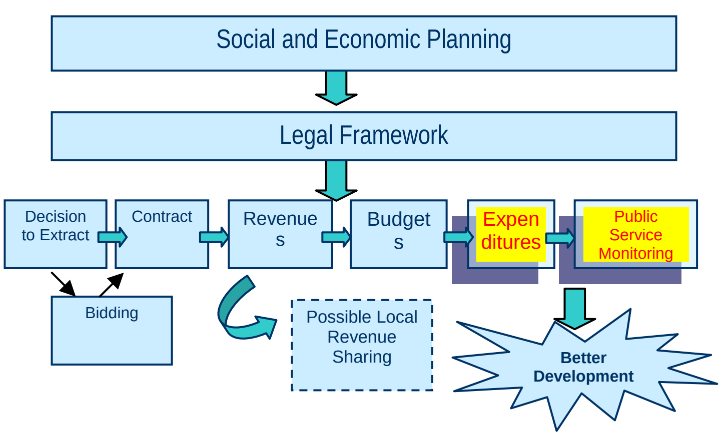


In the exercise of its prerogatives, the Bunge is responsible for discussing, approving and executing the annual budget proposed by the government. Revenue payments would normally be consolidated in the annual budget. These budgetary powers provide an excellent opportunity to review fiscal receipts by the government and for planning how they will be spent.

Some key questions that the parliament might ask:

- Are all revenue payments included in the national budget ? Do some payments bypass the budget? If so, why? Are there oversight mechanisms in place for non-budget revenues?
- Do figures in the proposed budget and those in any other reports produced by the government match?
- Is the budget process participatory?
- What information about the budget is publicly available?
- What are the overall ratios of spending to priority sectors (agriculture, infrastructures, education, health etc.)?
- Are there any items in the budget that are not a priority for national development? Can they be removed? Are there some items missing from the proposed budget that should be introduced?
- Does the proposed budget reflect national development priorities as spelled out in the poverty reduction strategy?
- Is the level of spending greater than income? Is so, is further indebtedness justified? How will it be financed?
- In the event of redistribution of revenue shares to local and regional governments, are effective budget approval mechanisms in place at the sub-national level?

6) Expenditure management and public service monitoring



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Once the budget has been approved and executed, parliamentarians' role is to verify the effectiveness of budget execution. In general, parliaments should establish an impact monitoring system that quantifies the effectiveness of spending (did spending actually achieve its goals and to what extent?). This is a complex endeavor and will likely require assistance from experts.

An important precondition to effecive budget monitoring and execution is access to documents such as budget execution reports. In many low-income countries, these reports are shrouded in secrecy and not as widely published as they should be. Access to information might require changes in the overall legal framework.

Once information on budget execution is available, it is of key importance to track spending and its actual impact all the way down to the end users. In this respect, parliamentarians might want to hold consultations and meetings with their constituents and organize field trips in order to verify the completion of infrastructures and proper delivery of commissioned investments. These meetings and field visits should provide an opportunity to understand many of the causes underlying poor budget execution, and should therefore serve as a basis for parliaments to propose reforms to address any ascertained weaknesses.

In addition, parliamentarians might want to verify how annual spending has contributed to long-term development goals and propose changes that might be made to development trajectories.

Some key questions to ask at this stage are:

- What is the effectiveness of budget execution? Are any changes to legislation needed to increase spending effectiveness?
- Have procurement procedures been respected by all governmental and quasi-governmental agencies?
- Have any breaches to procurement procedures been sanctioned?
- Are the revenues generated from mining (and other non-renewable resources) being spent in ways that will generate sustainable revenues in the future?
- When the minerals are finished, where will replacement incomes come from?

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Contact information

For any further information on issues relating to this guide and the management of revenues from the extraction of minerals, please go to:

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