CDD
CENTRO PARA DEMOCRACIA E DESENVOLVIMENTO

GOVERNAÇÃO ECONÓMICA

GUARDIÃO DA DEMOCRACIA | www.cddmoz.org

Friday, May 12, 2023 | Year V, NO. 19 | **Director:** Prof. Adriano Nuvunga | **English**

A comprehensive look at the draft decree regulating the allocation and management of revenues generated from the mining and petroleum production tax

- After more than a decade, Mozambique will finally have a legal instrument that regulates revenue-sharing with producing regions and those affected by the exploitation of natural resources in the extractive sector. The Government's initial proposal has the merit of representing a legislative advancement by offering a defined framework for revenue sharing with producing regions. However, it falls short in terms of providing comprehensive details.

Credits: Redactormz

Credits: Jornal Evidências

For slightly more than a decade, the allocation and sharing of revenues with regions impacted by resource extraction in the extractive sector have been conducted without a specific regulation to govern their allocation and management. Since 2013, the year in which the first transfers took place within the scope of the revenue-sharing regime, the Government has annually resorted to budgetary laws to define the share of communities in producing regions.

The legal framework for revenue-sharing in the extractive industry for the development of communities that host large investments in the mining and hydrocarbon sector is regulated by Law n.º 11/2007, Mining Law, and Law n.º 12/2007, Petroleum Law, both of June 27th. Although not specified in detail, these laws determine that a percentage of *royalties*[1] is allocated to the development of local communities.

Six years after the enactment of the 2007 laws, containing more general provisions on revenue-sharing, in 2013, through the Budget Law (Law 1/2013, of 7 January), the Government decided to establish a percentage of 2.75% royalties for transfers to be allocated to communities. In the same year, the criteria to be observed in the implementation of projects financed by revenues from mining and oil exploration directed to the communities were defined, through Circular n.º 01/MPD-MEF/2013[2].

The Government determined the percentage of 2.75% at its own discretion, without the public participation of the producing regions and affected communities. As a result, since its establishment, the percentage has been recurrently contested by civil society and other *stakeholders* in the extractive sector, demanding an upward revision to guarantee the right to development of the affected communities.

In 2022, after years of contestation and advocacy work by civil society organizations and other relevant actors, the percentage was finally revised to 10% of *royalties* from natural resources destined for the development of provinces, districts and local communities where extraction takes place. The measure was announced in August last year as one of the reforms under the Economic Acceleration Package (PAC).

In line with the announced measure and the subsequent revision made to the Mining Law, Law n.º 15/2022, of December 19, and the Petroleum Law, Law n.º 16/2022, also of December 19, the proposal for a government decree for the allocation and management of revenues from the extractive industry defines a percentage of 10% of revenues from the tax on mining and oil production for producing regions. Of the 10% of *royalties*, 7.25% are allocated to provinces and districts and 2.75% are allocated to communities where the respective projects are located.

If, on the one hand, the proposal has the merit of representing a step forward in legislative terms, providing a specific framework for the revenue sharing regime with the producing regions, on the other hand, it fails to go into detail about some aspects that emerge as important determinisms to ensure a more sustainable and equitable distribution of the benefits and costs of resource exploitation in the country, through an efficient, fair and stable revenue-sharing mechanism.

The provisions on the reference year and the 10% tax base, the assignment of revenues, the eligibility criteria for local community projects, and the rules that dictate the allocation of revenues are some of the aspects that suffer from deficiencies and important omissions in the Government's initial proposal.

1. Reference year

Article 4 of the proposal establishes that the allocation of resources destined for the development of provinces, districts, and local communities is based on the revenues to be collected from the Tax on Mining Production and the Tax on Petroleum Production in the year object of the programming, that is, has year *n as reference.*

This mechanism has the advantage of allowing transfers to communities to go *hand in hand* with the revenues from the Production Tax collected annually from projects in the extractive sector, providing significant resources in cases of *booms in the commodities* market. However, due to the increasing volatility in the market for *commodities* in the

[1] Tax on Mining and Oil Production

[2] In general terms, this instrument defines as eligible for the application of transfers destined to the communities the projects destined to the construction of socioeconomic infrastructures , such as education, health, agriculture, forests, services, roads and bridges of local interest, as well as systems of water supply and sanitation.

extractive sector, could imply serious challenges in the planning and budgeting process at the level of districts and local communities.

Although desirable, the mechanism that favors *year n* is not effective and efficiently enforceable. If maintained, situations of (over)underestimation of the resources to be channeled to the provinces, districts and local communities in the planning and budgeting process, as well as cases of frustration with the expectations of the communities in the affected regions will be more and more recurrent.

Ideally, the definition of the reference year for calculating the 10% percent should be aimed at providing the greatest possible predictability of the revenues to be transferred, taking into account the ever-increasing volatility of commodity prices on the international *market*. Therefore, the maintenance of the mechanism (n-2) that has been in force since 2017 or the recovery of the mechanism (n-1) emerges as the most correct bets.

2. Tax base

In line with article 20 of Law n.º 20/2014, of August 18, Mining Law, amended by Law n.º 15/2022, of December 19, and article 48 of Law n.º 21/ 2014, of August 18, Petroleum Law, amended by Law n.º 16/2022, also of December 19, the proposal establishes the Tax on Mining Production and the Tax on Petroleum Production as the basis for the incidence of the 10% to be transferred to the development of the province, district and local communities.

Nevertheless, this provision remains ambiguous and insufficiently detailed to align the regulation with the present dynamics of the State's interactions with companies in the extractive sector, particularly regarding the payment methods for the Production Tax.

The regulation does not clarify the procedures to be followed when companies pay the Production Tax in kind. This aspect is particularly important not only because it constitutes a common practice in the hydrocarbon industry (example of the case of Sasol in Inhambane), but above all because it is already provided for in the tax legislation applicable to the sector (article 14 of the Specific Regime of Taxation and Tax Benefits of Operations).

In this context, the regulation must contain additional provisions on the procedures for determining transfers when the Production Tax for a certain period is paid in kind, under penalty of harming and frustrating the expectations of the beneficiary regions. Here, it is suggested to use the valuation methods in the Specific Regime of Taxation and Tax Benefits to determine the amount of the payment in kind that is made to the State, followed by the application of 10%, in the total amount corresponding to the respective payment.

3. Consignment of revenues

Article 5 of the proposal allocates 7.25% of the Tax on Mining Production and the Tax on Petroleum Production to finance structural projects in the provinces and districts and 2.75% for local communities. Although it has the merit of predicting the transfer of resources beyond the communities directly affected by resource exploitation, this article has shortcomings on two levels:

(1) The definition and distinction of "provinces and districts" that will receive the 7.25% and "local communities" that are entitled to the 2.75% are not addressed in due detail in the regulation. The definition of "local communities" in the glossary does not present the dimension of the region "directly affected" by the exploitation of resources.

(2) It is not clear how the 7.25% will be divided between provinces and districts (Provincial Executive Councils and District Governments. Additionally: there are no clear distribution rules for the 7.25% between the aforementioned provinces and districts, which can lead to situations where, for example, transfers are being applied to cover budget deficits at the provincial level instead of

pursuing the objective of development.

Therefore, clear criteria are needed to determine when a region becomes eligible to receive 2.75% or 7.25%. Likewise, it is necessary to specify clear distribution rules and the objectives of the 7.25% (to support the development of the provinces and districts as a whole and/or to compensate the indirectly affected regions).

4. Eligible local community projects

According to Article 8, at the level of local communities, projects in the following areas are eligible for funding: education, health, agriculture, fisheries, infrastructure, water and sanitation, and other projects that boost local development.

If, on the one hand, the proposal establishes and makes binding guidelines for the design and selection process of projects at the level of "local communities", on the other hand, it fails to present unrealistic eligibility criteria for the transfers that are allocated.

Looking at the transfers that are generally made to communities (mainly those that host projects in the mining sector), it becomes very ambitious to expect that the resources are sufficient for their application in the construction of classrooms, health centers, and infrastructure (roads and bridges), as specified in the regulation.

Additionally, it is necessary to consider that the transfers of 2.75% do not replace the obligations that the State has in the provision of public goods and services at the level of the communities directly affected by the exploitation of natural resources.

The eligibility criteria for projects at the level of local communities should be revised to reflect the nature and the "compensatory" and development objectives intended with the 2.75% transfers. Additionally, provisions need to be strengthened so that provincial and district governments are supported in the development of ideas that result in projects aligned with the development perspectives of the communities covered following the challenges they face.

Conclusion

Overall, the proposed mechanism represents an advance compared to the current regime in terms of revenue-sharing with the producing regions. However, there is a perception that there is still room to ensure that the referred regions are effectively "owners" of the transfers that will be made annually.

In addition to the aspects already mentioned, it is understood that the total 10% cannot be fully linked to normal execution operations within the framework of the procedures applied to the State Budget, in which the resources return to the Treasury when they are not executed. This is particularly important as experience points to systematic delays in the disbursement of funds to subnational governments, making the execution process pressured by the rules closing financial execution by December 31st.

Detaching 10% from the normal implementation rules would allow for greater alignment of projects with the broader perspective of integrated development. The producing regions would be free, for example, to decide to move forward with savings mechanisms to invest in larger investments in the long term and articulated with an integrated development perspective.

Because the approval of the instrument will practically end more than a decade of discussions and advocacy efforts for the institution of a legal framework with solid foundations for an efficient, fair, and stable revenue-sharing mechanism in the extractive sector, addressing these issues becomes imperative. Capitalizing on the openness shown by the Government in discussing the proposal with various *stakeholders*, the expectation is that the regulation will conform to the different views/perceptions collected.

EDITORIAL INFORMTION:

Property: CDD – Centro para Democracia e Desenvolvimento
Director: Prof. Adriano Nuvunga
Editor: Emídio Beúla
Author: Gabriel Manguele
Layout: CDD

Address:
Rua Dar-Es-Salaam Nº 279, Bairro da Sommerschield, Cidade de Maputo.
Telefone: +258 21 085 797

CDD_moz
E-mail: info@cddmoz.org
Website: http://www.cddmoz.org

PROGRAMMATIC PARTNERS

FINANCING PARTNERS