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GHANA'S MINING CODE:

IN WHOSE INTEREST?

by

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Summary

When Ghana's first mining-specific legislation, PNDC Law 153, was enacted in 1986, the law was heralded as a shining example of best practice by many. The legislation sought to provide a stable policy environment in addition to significant financial incentives, as a means of encouraging investment. The replacement of the 1986 law with the Minerals and Mining Act in 2006, developed with technical assistance from the World Bank, represented a continued focus on investment promotion. Many of the fiscal incentives in the 1986 law were retained or, in some cases, enhanced. The success of these mining codes in promoting investment is clear, with mining output increasing significantly since 1986. However, the increase in mining levels does not necessarily equate to better development outcomes for Ghana. This paper examines one key change that occurred in the shift to the new mining code - the removal of the additional profits tax. This tax was intended to ensure that Ghana benefits from any windfall profits derived from higher commodity prices. Its removal raises an issue as to whether Ghana has the right fiscal regime to ensure that it derives full benefits from recent and future increases in commodity prices (particularly gold). Drawing on recent tax policy literature on the benefits and practicality of a 'rent' tax, this paper suggests that serious consideration should be given to reintroducing such a windfall profits tax into Ghana's mining legislation.

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INTRODUCTION

On 20 April 2011, the price of gold reached a new world record of $1500 per ounce, a rise of almost 600 percent from its price of $256 a decade earlier (see figure 1 below). In fact recent increases in commodity prices, notably gold, have put into sharp focus rising public concern that Ghana may not be adequately benefitting from the mining of its natural resources. Ghana is endowed with significant natural resources, a source of wealth that has considerable potential to aid the country's economic development. Yet there are many challenges in ensuring that such wealth is maximised and used effectively.

In recent times, much attention has been given to the anticipated revenue flows from Ghana's oil resources and how they will be managed.

Nonetheless, while the management of this new resource remains an important issue, the enactment of the Petroleum Revenue Management law provides an opportunity to reflect on the framework governing Ghana's other natural resources. Indeed, given the recent ad-hoc attempts by Ghana's Government to increase its revenue take from mining, there is the real question as to whether Ghana has the appropriate fiscal settings to ensure that it derives maximum benefit from its resources - now and into the future.

Research suggests that Ghana and other resource rich African states aren't deriving an adequate benefit from mining activities, particularly given the level of tax incentives provided to companies

Figure 1

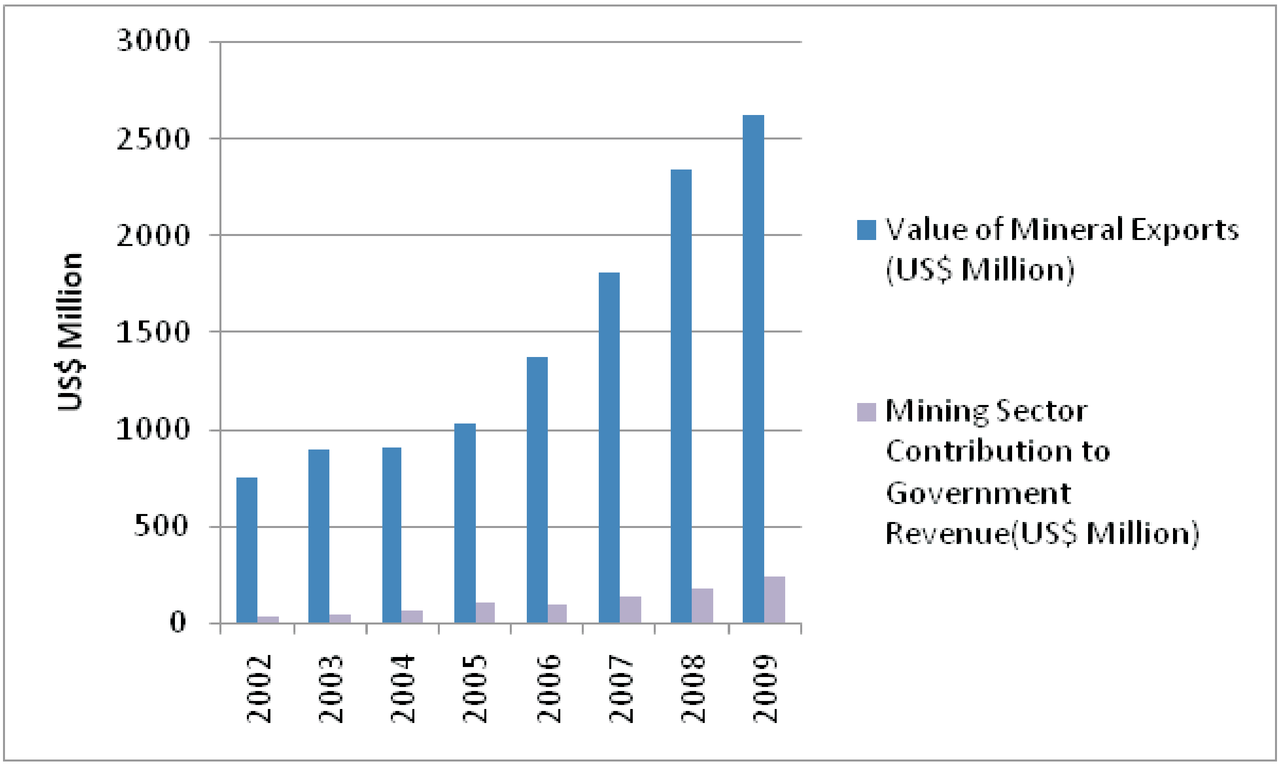
Source: IHS Global Insight (available from www.gold.org)

(Akabzaa, 2009; Third World Network & Ors, 2009; Tutu, 2011). A comparison between the value of exported minerals and the contribution of the mining sector to Government revenue can be found in figure 2 below.

It is worth noting that the numerous fiscal incentives were meant to encourage investment in the mining sector. However, critics have called for the removal of these exemptions - and greater transparency by mining companies. While the Extractive Industries Transparency Initiative (EITI) has improved transparency in the mining sector, the creation of an international accounting standard that would require companies to publish information relating to their profitability on a country by country basis is still lacking. This creates a challenge in relation to verifying reports provided by mining companies. On the other hand, some evidence highlights Ghana as one of the highest taxing states in Africa (UNCTAD, 2003). It is thus not surprising that organizations, notably the World Bank, have called for a reduction in royalty rates arguing that it tends to distort investment.

This paper evaluates the fiscal framework for mining in Ghana with a focus on one key change that occurred in the shift to the new mining code - *the removal of the additional profits tax*. This tax was intended to ensure that the country benefits from any windfall profits derived from higher commodity prices. Its removal in 2006 raises an issue as to whether Ghana has the right fiscal regime to ensure that it derives full benefits from recent and future increases in commodity prices

Figure 2



Source: Government revenue data obtained from the Minerals Commission (2009) and export data computed from the Bank of Ghana Statistical Bulletin Series.

(particularly gold). We begin by briefly tracing the history of Ghana's fiscal regime for mining. Next, the paper considers the existing regime in the light of recent debate on resource taxation in Africa and around the world. Overall, we argue that the current fiscal framework for mining is not in Ghana's interest, both in ensuring an adequate return and in providing a stable policy environment that promotes investment. The paper concludes by proposing policy, legislative and administrative recommendations.

OVERVIEW OF THE MINING CODE: A FISCAL PERSPECTIVE

The first consolidated mining code was introduced by the Provisional National Defence Council (PNDC) regime in 1986. In fact the *Minerals and Mining Law, 1986* (PNDCL 153) was generally hailed as a leading example of a pro-investment mining code; it was introduced as part of Ghana's structural adjustment programme, which was developed with the support of the International Monetary Fund (IMF) and World Bank.

The law provided numerous financial incentives to mining companies to attract investment and kick-start Ghana's fledgling mining industry. This included, amongst other things, generous capital and investment allowances, exemption from customs duties for certain equipment, tax free remittances for expatriate staff and a royalty with a sliding scale from 3 to 12 per cent.[1] Another aspect of the regime was the introduction of an additional profits tax.[2] Effectively, this sought to apply an additional 25 percent tax on profits over a certain level (more generally known as a windfall profit). The mining code also allowed the Government to take up to a 30 percent stake in mining companies, yet government interest was generally kept at around 10 percent. What followed in Africa appeared to be an attempt to follow the Ghanaian example with other resource rich countries adopting similar codes, all with generous incentives to attract investment.

The apparent loss of competitiveness of the Ghanaian code appears to have been one of the reasons given for the move to adopt a new law, the *Minerals and Mining Act, 2006* (Act 703). The new mining regime addresses a number of perceived problems with the old code (unrelated to the fiscal elements) and maintains very generous fiscal terms for the mining companies.[3] It also provided an absolute ceiling on Government interest in mining companies at 10 percent. Significantly, the additional profits tax was removed.[4] Also, the royalty scale was amended to between 3 and 6 percent - the precise amount to be determined by reference to a measure of profitability as was the case under the previous law.

[1] The evidence suggests royalties rarely, if ever, went above the minimum 3 percent.
[2] The additional profits tax was contained in a different piece of legislation, the *Additional Profits Tax Law, 1985* (PNDCL 122)
[3] By the time the new code was introduced, general company tax had been reduced to 25 percent, from the higher rate of 45 percent when the first mining code was introduced.
[4] It is worth pointing out that the additional profits tax element of the previous law was never applied. While the depressed price of minerals over the course of its existence appears to explain why it was not applied, it has also been suggested that the tax authorities lacked the technical capacity to effectively administer the tax.

Amid growing concern that Ghana was not getting enough revenues from its resources, the Government announced in its 2010 Budget Statement that it would be increasing all royalties to 6 percent as well as engaging ‘all mining companies to address the issue of dividend payment, exemptions and [reviewing] the whole mining sector fiscal regime’. The subsequent amendment to the Mining Act, the *Minerals and Mining (Amendment) Act, 2010* (Act 794), provided for a 5 percent royalty rate across the board and abolished the sliding scale. The decision not to proceed to the full 6 percent rate appears to have been a reaction to pressure from the mining industry.

It is worth noting that the increase in the royalty may not actually affect some large mining companies as a result of stability agreements signed with the Government of Ghana. Such agreements can provide for a set fiscal regime for a certain number of years (the mining legislation limits this to 15 years) irrespective of what changes the Government makes to tax laws. Although the finer details of stability agreements are rarely made public, they have been broadly criticized as a limitation on a country's sovereign right to amend its laws - and give effect to those amendments. Conversely, they are seen by many in the mining industry as a means of providing the stable fiscal regime necessary to make a long term financial commitment.

In the 2011 Budget Statement, the Government again noted its reassessment of the mining industry, indicating that it would be conducting a review of the 'mining list' in conjunction with the industry. The rationale behind this move was to 'reflect changes that fairly meet the needs of the industry, tighten exemptions, ensure fairness across industries, while safeguarding revenues'.

It is also worth noting that in 2009 Ghana introduced a National Fiscal Stabilization Levy. This imposes an additional 5 percent levy on profits (before tax) on companies in certain industries, including mining. Originally introduced for 18-months it was extended for an additional year 'in lieu of bringing in an Additional Profit Tax'. It is not entirely clear how the stabilization agreements would have operated with respect to the levy; however, the evidence indicates that some large mining companies have paid the levy (Ghana Chamber of Mines, 2009).

The debate over appropriate mining fiscal regimes has also been raging elsewhere in Africa amidst rising commodity prices. Broadly, the public and civil society's view is that African countries are simply not getting enough for their mineral wealth. In 2008, for instance, Zambia introduced Africa's only windfall profit tax amid strong criticism. This was subsequently scrapped by the Zambian Government, presumably under pressure from the mining industry and in the context of falling copper prices as a result of the global financial crisis.

Another interesting development in the West African sub-region is the commitment, since 2008, for the Economic Community of West Africa States (ECOWAS) to harmonise their mining legislation. This is seen as important to ensure that ECOWAS countries have a stable fiscal regime to attract investment and to ensure that there is no 'race to the bottom' with such regimes in order to attract investment. The first stage of this was the agreement on guiding principles on mining legislation, which Ghana recently gazetted. Amongst other things, these guidelines call on member states to 'optimise and protect revenues'; ensure that staff of mining companies pay tax at the same rate as everyone else (including removing tax free remittances for expatriate staff), and only provide exemptions from customs duties and VAT on condition of the mining company respecting its social and environmental obligations.

TAX REGULATION FRAMEWORK

From a tax theory perspective there is a very real debate over whether or not a country should adopt a profit based fiscal regime. The theoretical argument for such taxes is quite clear: as they are matched to a company's profitability, they are less distortionary than simple volume/value based royalties, which are paid irrespective of whether or not a company is profitable in a particular year.

If effectively implemented, they can also ensure that a country benefits from any windfall profits received by the company, for instance, as a consequence of higher commodity prices. The IMF and the World Bank are generally supportive of these taxes, though many mining companies are reluctant as they see windfall gains as compensation for the risky and expensive nature of exploration. The Australian Government recently moved to replace existing state royalty regimes with a single profit based tax applicable across the country.

The difficulty with implementing a profits based tax in a developing country is that it requires effective tax administrators to carry out implementation. It has been argued that, as mining companies have the information which will determine the rate of tax that will be applied, some companies may engage in transfer pricing activities to reduce their profits. Moreover, relying solely on a profits tax does cause some difficulties. When commodity prices are low, a country may not receive any revenue – something that may not have public appeal. To address this issue, Collier (2010) amongst others have put forward the suggestion for developing countries to consider a mixture of a fixed royalty (at a lower rate, to ensure some return) and some type of profit-based tax.

The introduction of a profit-based tax would not be without its challenges, as additional demands will be placed on the Ghana Revenue Authority (GRA). In fact it is unclear whether the GRA has the capacity to take up this additional task. Calder (2010), however, argues that such a scenario justifies the need to enhance the capacity of tax authorities, as opposed to foregoing a profit based tax.

It is apparent from the discussion above that Ghana has moved away from a profit-based tax and sliding royalty, adopting instead a set royalty rate and relying on ad-hoc levies. This raises questions about whether the country has the long term fiscal framework necessary to maximize its revenues and provide a stable environment to encourage further investment. Inevitably, commodity prices will fluctuate. However, relying on ad-hoc legislative changes and individual contracts with mining companies is not ideal, weakens transparency and ultimately undermines public confidence. On the whole we have argued that the current mining reviews underway in Ghana should give consideration to an appropriately framed profit-based tax as part of the fiscal mix. So too should be the need for greater transparency in company reporting. This is critical because, for the most part, the lack of information on mine profitability makes it difficult to determine how a profit-based tax would impact revenue. Finally, the Government should also consider treating the tax incentives provided to mining companies as tax expenditures, as occurs in many other jurisdictions.[5] This will help to ensure that the true costs of incentives are taken into account when considering these issues.

CONCLUSION

On the whole, the current record price of minerals such as gold draws attention to the view that the removal of the additional profits tax from the statute book may have been short-sighted. This tax was intended to ensure that Ghana benefits from any windfall profits derived from higher commodity prices. Whilst there were undoubtedly issues with its original design and its interaction with generous taxation incentives, the decision to remove it, rather than improve it, raises an issue as to whether Ghana has the right fiscal regime to ensure that it derives full benefits from recent and future increases in commodity prices, particularly gold. This paper suggests that serious consideration should be given to reintroducing such a tax into Ghana's mining legislation. Along this line, the limited ability to verify exemptions also remains a concern, owing to possibility of abuse. Thus reforms which will make it possible to verify country by country profits of international mining companies, as opposed to single global reports, remains necessary if the additional profits tax regime is to provide maximum benefit.

Of course, issues relating to the fiscal regime are only part of the broad challenges confronting Ghana with respect to mining. There are significant societal and environmental impacts associated with mining. The Financial Intelligence (2010), for example, cites one estimate that puts the negative effect of mining on the environment between 4 and 10 percent of Ghana's GDP. Tutu (2011) also argues that while cocoa has higher economic and social benefits than timber and gold, the latter has serious environmental and social costs. Moreover, minerals are overwhelmingly exported in their raw form, with the mining sector only contributing about 2 percent of Ghana's Gross Domestic Product (GDP).

There is, therefore, significant scope for Ghana's natural resources to contribute more through greater integration with the rest of the economy. What is required now is a comprehensive review of the mining regime in Ghana. This must be conducted in an open and transparent manner - allowing civil society, the public and the mining industry to debate and consider key issues at stake so that competing views will be balanced.

[5]Australia, for instance, publishes annually a full list of concessions, benefits and incentives provided through the tax system, along with the estimated cost of those expenditures (see www.treasury.gov.au).

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