The Private Sector, Natural Resources and Inclusive Growth in Africa: Policy Levers and Incentives

Presentation by:
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African mineral sector: Large, unfulfilled potential

Example: The 2 African countries among 20 world top producers of minerals

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
<th>South Africa</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production value ($ bn)</td>
<td>2000</td>
<td>12.7</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>38.5</td>
<td>5.4</td>
</tr>
<tr>
<td>% change</td>
<td></td>
<td>203</td>
<td>800</td>
</tr>
<tr>
<td>Mining contribution to GDP (%)</td>
<td>2000</td>
<td>9.6</td>
<td>19.0</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>10.1</td>
<td>26.4</td>
</tr>
<tr>
<td>% change</td>
<td></td>
<td>5.2</td>
<td>39</td>
</tr>
<tr>
<td>Share of World minerals production</td>
<td>2000</td>
<td>9.9</td>
<td>0.5</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>5.0</td>
<td>0.7</td>
</tr>
<tr>
<td>% change</td>
<td></td>
<td>-50</td>
<td>40</td>
</tr>
</tbody>
</table>

Key potential channels of private sector contribution

- Supporting export-led growth
- Promoting investment: domestic and foreign (FDI)
- Government revenue generation
- Job creation
- Rural sector income generation and poverty reduction
- Financial sector development
- Training and skills development
- Diversification and value addition
Mining life cycle

Exploration
1-10 years
High sunk costs; low revenue

Site design and construction
1-5 years
High costs; low revenue

Operation
2-100 years
Increasing/maximum revenue

Financial closure and decommissioning
1-5 years
Low/declining revenue
“The critical focus is not (should not be) on how mining can be sustainable but on how mining, minerals and metals can contribute to sustainable development” (ICMM 2014, P. 7)

- The full contribution of the mining sector needs to be planned and evaluated on long-time horizons
- Need to consider:
  - Indirect effects through: market creation and expansion; forward and backward linkages
  - Multiplier effects through income creation (especially rural incomes) and consumption expansion
  - Accelerator effects through income creation and investment expansion
Benchmarking overall impact of mining: stylized facts in LICs and MICs

- Share of FDI in mining: 60-90%
- Share of minerals exports: 30-60%
- Government revenue contribution: 3-20%
- GDP contribution: 3-10%
- Employment: 1-2%
### Focus area #1: Exports

Among World top 20 in share of minerals exports in total exports (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Share (%) 2012</th>
<th>% change from 1996 to 2012</th>
<th>% change from 2010 to 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>91.6</td>
<td>10.7</td>
<td>9.6</td>
</tr>
<tr>
<td>DRC</td>
<td>81.5</td>
<td>9.1</td>
<td>3.9</td>
</tr>
<tr>
<td>Zambia</td>
<td>69.2</td>
<td>-6.9</td>
<td>-11.0</td>
</tr>
<tr>
<td>Mauritania</td>
<td>62.9</td>
<td>27.0</td>
<td>-3.3</td>
</tr>
<tr>
<td>Eritrea</td>
<td>60.5</td>
<td>-2.0</td>
<td>57.7</td>
</tr>
<tr>
<td>Guinea</td>
<td>60.1</td>
<td>-16.2</td>
<td>12.5</td>
</tr>
<tr>
<td>Namibia</td>
<td>53.4</td>
<td>15.0</td>
<td>8.2</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>50.6</td>
<td>22.8</td>
<td>-1.6</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>46.3</td>
<td>38.1</td>
<td>3.1</td>
</tr>
<tr>
<td>Sudan</td>
<td>45.8</td>
<td>N.A.</td>
<td>33.4</td>
</tr>
</tbody>
</table>

Source: ICMM 2014; original data from UNCTADstat

Policy concern: Increasing mineral dependence
Focus area #2: Investment

- Policy questions:
  - How to manage privatization to stimulate mining development?
  - How to incentivize foreign investment while keeping level playing field vis-à-vis domestic investment?
  - How to deal with forgone revenues?

![Graph showing Net FDI inflows (million $) from 1980 to 2012 for Tanzania and Zambia.](graph)

What role of privatization in early 1990s?
Focus area #3: Revenue generation

- Overall goal is to maximize revenue from the mining sector while encouraging private investment
- Need to balance between incentivizing private investment and revenue generation
  - Tax exonerations
  - Investment tax credits
- Need to combat tax evasion, especially by multinational corporations
- Key areas of action:
  - Tax structure: 1) Minimizing “nuisance taxation”; 2) Rationalizing tax exonerations
  - Tax administration: 1) Increasing transparency; 2) Addressing multiplicity of tax collection points; 3) Broadening the payee pool (avoid temptation of “going for the big fish”)
“If Tanzania is to attract the investment it still needs in the mining industry, priority will need to be placed on maintaining a competitive fiscal regime”

Underperformance in tax revenue generation (2010-2012 averages)

Minerals-rich countries perform poorly, relative to potential

Source: WDI
Limited contribution of mining to government revenue

Mining revenue as % total revenues

- Botswana: 44.6%
- Congo, DR: 25.3%
- Guinea: 22.9%
- Zambia: 11.1%
- Namibia: 8.1%
- Ghana: 6.4%
- Sierra Leone: 3%
- Lesotho: 1.9%
- Tanzania: 1.4%

Exceptions
One important problem = smuggling and tax evasion

Example: Declared vs. estimated values of precious minerals exports in Tanzania, 1998

<table>
<thead>
<tr>
<th></th>
<th>Estimated actual value (million $)</th>
<th>Declared value (million $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold</td>
<td>93.2</td>
<td>3.3</td>
</tr>
<tr>
<td>Colored gems</td>
<td>29.5</td>
<td>8.1</td>
</tr>
<tr>
<td>Diamonds</td>
<td>18.8</td>
<td>40.5</td>
</tr>
<tr>
<td>Total</td>
<td>141.6</td>
<td>21.9</td>
</tr>
<tr>
<td>Ratio declared / estimated actual</td>
<td></td>
<td>15.4%</td>
</tr>
</tbody>
</table>

Focus area #4: Revenue redistribution

- **Objective:** maximize gains for local communities; use revenue sharing to finance development initiative at local level (e.g., infrastructure)
- **Suggestion:** negotiate and institutionalize a redistribution formula

Example of redistribution formula:

- Central government: 75%
- Province/region: 10%
- Mining district: 10%
- Surrounding districts: 5%

Learn from experiences. E.g., Ghana, Guinea, others?
Focus area #5: Value addition and spillover effects

- **Set up incentives and rules to maximize value addition:**
  - Increase domestic content of minerals exports
  - e.g., “penalize” exports of raw minerals.
  - Successful examples: DRC in the copper/cobalt sector

- **Set up incentives and rules to maximize spillover effects on domestic goods and services markets**
  - e.g., procurement rules favoring domestic providers and contractors

- **Maximize contribution of mining to domestic financial sector development**
  - Incentivize “banking local” by MNCs
  - Can “thin capitalization” rule help (by encouraging domestic capital mobilization by MNCs)?
  - Incentivize contribution by private mining companies to financing of SMEs and capitalization of MFIs
  - Incentivize technology transfer and skills development
  - Incentivize contribution of mining companies to financing of on-the-job training, technical and vocational education and training.
“One dollar of economic activity in the mining sector can generate three dollars or more of economic activity elsewhere.”


Question: How can the private sector help achieve this potential in Africa?
Focus area #6: Ownership and domestication

- Encourage and facilitate participation of indigenous investors in industrial mining operations
  - To stimulate private sector development
  - To foster mining profits recycling into the domestic economy
- Negotiate government shareholding in mining corporations
  - Build government capacity to negotiate mining deals
  - Take advantage of technical assistance from existing institutions in the continent (e.g., at the African Development Bank, the UNECA, the AU).
Focus area #7: Regional strategy

- Develop regional mining processing and marketing hubs (e.g., Nairobi for East Africa)
  - Take advantage of economies of scale
  - Take advantage of larger financial markets
  - Increase regional spillover effects – making mining an engine of regional integration

- Challenges:
  - Addressing (or living with) asymmetric gains in the value chain
  - Quality of regional infrastructure is a constraint
Focus area # 7: Effectively balance large-scale and small-scale mining

- Leverage the potential of small-scale mining
  - Advantages:
    - High potential for employment creation in the rural sector
    - High potential for income generation and poverty reduction
    - Driver of diversification of economic activity in the rural areas
  - Disadvantages:
    - Temporary income and employment
    - Difficult to regulate; limited tax revenue generation
    - High exposure to smuggling

- Harness advantages and mitigate disadvantages of industrial mining
  - Advantages:
    - Economies of scale
    - Opportunities for technology transfer
    - Opportunities for tax revenue generation
  - Disadvantages:
    - Capital intensive; low employment creation
    - Displacement of small-scale mining and domestic entrepreneurs
    - High environmental footprint
Summary: Key policy levers

- Importance of a long-term perspective in designing and evaluating mining sector development strategy
- Using the tax system to incentivize domestic and foreign investment in mining
- Diligent use of privatization to attract private capital and foster market expansion
- Mainstreaming employment creation in mining sector development
  - Need “complementary” policies (beyond mining policies)
  - Leverage small-scale mining for employment creation and poverty reduction
- Using incentives and rule-based strategies to maximize spillover effects of mining in the rest of the economy
- Curbing tax evasion, especially by mining companies, and mining sector-related illicit financial flows.