Mineral Taxation and Resource Nationalism in Zambia

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This article examines the resource nationalism cycle in Zambia. The resource nationalism cycle has episodically plagued investors in resource rich nations. Host states, lacking the financing and technical know-how, invite foreign investors to explore and exploit their vast natural resources. The former offer all sorts of fiscal incentives to appear attractive to the latter. Once operations commence and the resource experiences a sustained upward growth trend, the host state may retract the fiscal incentives previously offered, or simply nationalise assets, in a bid to exercise greater control over their natural resources and maximise the benefits accruing from high prices. The cyclical nature of the resource nationalism cycle can be seen in countries like Zambia.

1. Introduction

The resource nationalism cycle is a phenomenon that has episodically plagued investors in resource rich nations. It describes a situation whereby host states, lacking the financing and technical know-how, invite foreign investors to explore and exploit their vast natural resources (Fatouros, 1962). The former will offer all sorts of fiscal incentives to appear attractive to the latter. Once operations commence and the resource experiences a sustained upward trend, the host state may either retract the fiscal incentives previously offered, or simply nationalise assets belonging to the investor. This is in a bid to exercise greater control over their natural resources and maximise the benefits accruing from high prices (Stevens, 2008).

The cyclical nature of the resource nationalism cycle can be seen in countries like Zambia. It is a mono-economy, relying primarily on its vast copper reserves. By the time Zambia attained its independence in 1964, the copper industry was dominated by the Anglo-American Corporation (AAC) and the Roan Selection Trust (RST). Both were foreign entities. These were nationalised by the government of Zambia in 1969 (Mwambwa, Griffiths and Kahler, 2010). A decline in copper prices, the oil crisis, massive debt and outright mismanagement led to the decline of the mining industry in Zambia. This eventually led to the privatisation of mines and their eventual sale to foreign corporations. Most of the development agreements entered into between the government of Zambia and foreign mining companies were completed between 2002 and 2004. Once this had occurred, the price of copper in Zambia dramatically increased from $2,500 per ton in 2004 to more than
$8,000 per ton in 2008. The Mwanawasa administration was thus compelled to increase mineral taxation in 2008 (Ng’ambi, 2010). Due to capital flight, this was retracted by the Banda administration in 2009. Various new taxes were introduced by the Sata administration between 2011 and 2014. However, by 2015 these were being reconsidered by the Lungu administration.

The aim of this article is to look at the resource nationalism cycle in Zambia. To that end, section two will consist of a general discussion of the resource nationalism cycle and the factors contributing to it. Section three will discuss the resource nationalism cycle in Zambia. Section four will conclude.

2. The Resource Nationalism Cycle

The resource nationalism cycle describes a situation whereby a host state solicits foreign direct investment and then later seeks to maximise the benefits accruing from such an investment, once it has been sunk. This could either mean increasing taxes or nationalising assets belonging to an investor outright. In the beginning the host state essentially solicits foreign direct investment. However, after operations commence and the natural resource experiences a sustained upward growth trend, the host state seeks to exercise greater control over the investment. Another factor contributing to this cycle is the system of governance adopted by the host state. It will be seen that democracies are the least likely of regimes to adopt resource nationalist policies. This also applies to autocratic regimes. The most likely to adopt resource nationalist policies are “hybrid systems”, which hold regular elections, but are also characterised by weak institutions that are typically unable to perform necessary checks and balances on the arbitrary use of power by the executive (Guriev, Kolotilin and Sonin, 2009).

A practical example of the resource nationalism cycle is Venezuela where oil is the “engine of the economy” (Karl, 1997). The oil industry started out in private hands and by the end of the 1920s Venezuela was one of the world’s leading oil exporters. Venezuela’s oil companies were nationalised in the 1970s and put in the hands of the state run Petróleous de Venezuela, S.A. (PDVSA). Due to a fall in oil prices and mismanagement, Venezuela’s oil industry saw a decline. This led to the reprivatisation of Venezuela’s oil industry after the election of President Caldera in 1994. When Hugo Chavez became President in 1998, he introduced various policies which culminated in the nationalisation of Venezuela’s oil industry. Since renationalisation, Venezuela’s oil production has decreased. By 2009, the attitude of the government had changed and the government was beginning to tone down its nationalist rhetoric, in a bid to attract foreign direct investment (Corrales and Penfold, 2011).
2.1 The Need for Foreign Direct Investment

Host states typically lack the finances and technical know-how to explore and exploit their natural resources. They thus solicit foreign direct investment in order to do so. This process is invariably fostered by the granting of concessions to foreign investors. The problems arise once the investment has been sunk and the natural resource experiences a sustained upward growth trend (Duncan, 2006). In such a situation, the host state will seek to exercise greater control over their natural resources. This may be influenced by various factors. To begin with, the host state will wish to gain a greater share of the profits being generated by foreign investors. In addition, there may be public pressure on the host state, especially if the perception exists that the investor is making excessive windfall profits through no real effort of its own and to the detriment of the people of the host state. In such a situation, the host government may feel compelled to either increase taxes or nationalise the investor's assets outright.

2.2 The Role of Government Systems

The type of system also plays a role in whether the host state undertakes resource nationalist policies or not. A democratic government is the least likely to adopt a resource nationalist stance, because it is susceptible to public pressure. This is due to a variety of factors, including regular elections. Thus, if a democratic government adopts unpopular policies it is likely to be reflected in election results. A democratic government, however, is unlikely to adopt resource nationalist policies even in the face of public pressure. This is due to the fact that democracies are characterised by strong, independent institutions. Such institutions perform checks and balances on the arbitrary use of power. Such institutions also make it less likely for the executive to operate in a way that detrimentally affects the interests of foreign investors. For this reason, democratic host states receive a lot of foreign direct investment.

Autocratic regimes are also unlikely to adopt resource nationalist policies. Although autocratic governments are characterised by weak institutions and are therefore not susceptible to the same checks and balances that are typical of their democratic counterparts, they also lack regular free and fair elections. For this reason, they are less predisposed to popular pressure. Therefore, public calls for increased taxes or nationalisation are likely to be ignored. Moreover, autocratic regimes will regularly utilise their state machinery to ruthlessly squash any protests or uprisings. Given this fact, autocratic regimes are not obliged to adopt resource nationalist policies. Policies pertaining to foreign direct investment are more likely to remain stable, as long as that particular government continues to maintain political hegemony. For this reason, autocratic regimes also receive a substantial amount of foreign direct investment.
The most likely regime to adopt resource nationalist policies is a hybrid system. This is a system that holds regular elections but lacks the strong institutions that are found in democratic systems of governance. Instead, they have a highly centralised executive and weak institutions, which are unable to check the arbitrary use of executive power (Petrov, Lipman and Hale, 2010). The fact that there are regular elections means that host governments of hybrid systems are subject to public pressure. This includes calls to raise taxes or nationalise industries. The risk of being ousted in the next election places pressure on the host government to take measures that will appease the masses. The lack of institutional checks and balances makes it easier for host governments of hybrid systems to roll out their resource nationalist agenda.

2.3 An Expression of Nationalism

It could also be argued that resource nationalism is an expression of nationalism and not an expression of socialism (Chua, 1995). That is to say that host states adopting resource nationalism wish to place a national identity on their industries. This is typically in response to a perceived foreign domination of the state’s industries. In so doing, the host state not only eliminates the foreign national, it also eliminates foreign capital. Once the initial euphoria subsides, it oftentimes happens that the host state experiences severe economic problems. A factor contributing to this is the mismanagement of nationalised entities. There may also be a depreciation in the price of the natural resource. The need to eliminate foreign domination from the economic paradigm is suddenly subjugated by the demand for development and modernisation. As such, the host state will once again seek foreign capital, which will be facilitated through the solicitation of foreign direct investment. This effectively brings us back to square one of the resource nationalism cycle.

3. The Resource Nationalism Cycle in Zambia

The aim of this section is to demonstrate how the Zambian copper mining industry fits into the resource nationalism cycle. It will be seen that just like Venezuela, Zambia has gone through various waves of the resource nationalism cycle since independence in 1964. At independence Zambia’s mining industry was in private hands, yet it was subsequently nationalised in the 1970s, before being privatised again in the 1990s. Since then, however, the government has episodically sought to introduce new taxes, so as to maximise on the benefits accruing from high copper prices. Zambia is a hybrid system. Although it is characterised by regular elections, like a democracy, the system still remains highly centralised and institutions are relatively weak. This makes it easier for Zambia as a host state to adopt resource nationalist policies when the price of copper experiences a sustained upward growth trend.
3.1 Zambian Mines in Private Hands

Commercial mining commenced in Zambia in the 1920s (Roan Consolidated Mining Ltd., 1978). This was due to the British South Africa Company (BSAC) granting various concessions, which eventually culminated in the mining industry being dominated by the Anglo American Corporation and the Roan Selection Trust. The BSAC derived their right to grant concessions through the acquisition of various concessions from Paramount Chief Lewanika of Barotseland and various other chiefs in Northern Rhodesia (Ndulo, 1988). The BSAC was then able to use these concessions as a means of asserting ownership over all minerals throughout Zambia and this meant that they could do whatsoever with these minerals including levying royalties ‘on all minerals won by whoever won them’ (Ndulo, 1988).

3.2 Nationalisation of the Zambian Mining Industry

Zambia attained independence in 1964. The administration of President Kenneth Kaunda expressed concerns that the mining industry was dominated by foreign entities. The President, in his Mulungushi Reforms speech (1968), also expressed concerns that despite the exorbitant profits being made by mining companies, no new mines had been opened since independence. Simultaneously, the Kaunda administration also adopted the socialist policy of “humanism” and became a one-party state (Phiri, 2001). Under this policy it was the role of the Zambian government to look after each citizen. This was in line with various African governments who had adopted their own forms of socialism. Tanzania had adopted “ujamaa” (Nyerere, 1968) and Ghana had adopted “consciencism” (Nkrumah, 1964). Zambia thus proceeded to nationalise the mines and amalgamated them into the Zambia Consolidated Copper Mines (ZCCM). This not only helped to eliminate foreign domination over the mining industry, it also did a lot to advance the government policy of humanism (Fraser and Lungu, 2006).

The mines were used as a cash cow to advance this quixotic ideology. However, it was not to last long. A depreciation in copper prices, two oil crises in 1974 and 1979 and mismanagement of the mines led to a decline of the mining industry in Zambia. This meant that the government had to borrow money in order to keep the economy afloat, which in turn led to a debt crisis. Moreover, copper production declined from a staggering 750,000 tonnes in 1973 to just 257,000 tonnes in the year 2000. This decline in the industry necessitated attracting foreign direct investment to refinance the mines.

3.3 Full Circle: Privatisation and the Subsequent Introduction of a Windfall Tax in 2008

Multiparty democracy was reintroduced to Zambia in 1990 and in the following year President Chiluba’s Movement for Multiparty Democracy (MMD) won a landslide election
victory. Despite this fact, Zambia remained a hybrid system under which power weighs heavily in favour of the executive. In order to be a minister in the Zambian government, one has to be a Member of Parliament (Constitution of Zambia). Moreover, since the reintroduction of multiparty democracy the legislature has generally been dominated by the party of the ruling executive, making it easier to roll out its own agenda (Electoral Commission of Zambia). Although the judiciary is completely separate from other arms of government, judges are appointed by the President and the judiciary is funded by the executive. Any questions raised, as to its independence, would therefore be legitimate.

When the MMD came to power in 1991 they promised to privatise the mines. In order to enforce this, the Privatisation Act 1992, Investment Act 1993 and the Mines and Minerals Act 1995, were introduced. The mines were unbundled and sold to various investors (Craig, 2001). This was fostered through development agreements, under which various incentives were offered, including preferential tax rates. To ensure that these incentives would subsist for the duration of the contract, tax stability clauses were also inserted. Under these clauses the government promised not to undertake any administrative or legislative measures that would adversely affect the profits of foreign investors. This was done in order to present Zambia as a favourable investment destination and thus attract foreign direct investment.

When these agreements were signed, the price of copper stood at $2,500 per ton in 2004. This increased dramatically to $8,000 per ton in 2008. This meant that the mining companies were earning profits beyond what they had envisaged. For example, Vedanta in 2005 was able to recoup its initial investment of $25 million rendered the year before, due to a doubling of copper prices. There were thus calls to introduce some sort of a tax, so as to capture a greater share of the revenue that mining companies were making. This essentially sparked another wave of the resource nationalism cycle in Zambia. This was further exacerbated by the fact that there was a general election in 2006, in which the MMD lost all seats in the mining towns, even though President Mwanawasa ultimately won the presidential election. Mwanawasa was able to maintain a majority in parliament because an incumbent President is constitutionally able to appoint eight members of parliament (Gould, 2007).

The lost seats in the 2006 election prompted the Mwanawasa administration to cancel all development agreements through the Mines and Minerals Act of 2008. It then proceeded to raise the corporate tax from 25 percent to 35 percent. The mineral royalty was raised from 0.6 percent to 3 percent. A windfall tax was also introduced and this was triggered by pressure at various levels. It was hoped that these measures would bring in revenue of $415 million in 2008 (Lungu, 2009). However, these changes rendered mining operations more onerous. The effective tax rates for high cost mines ranged between 64 and 96 percent and for low cost mines between 57 and 64 percent. This was clearly above the intended rate of 47 percent (Musokotwane, 2009).

Because these changes rendered operations more onerous, the mining companies resisted these measures. It was noted by the Minister of Finance that the windfall tax had
some major flaws and was very weak in its design. As a result, the effective tax rate was higher than that intended. In 2009, world copper prices fell as a result of the effects of the global financial crisis (Mwambwa, Griffiths and Kahler, 2010). Consequently, the mining companies announced that there would be major job losses. This compelled the Banda administration, which had come to power in a presidential bye-election in 2008, to announce several concessions to the mining sector, including abandoning the windfall tax. This is evidence of Zambia as the host state retreating from its resource nationalist position to ensure that the advantages of foreign direct investment would continue to exist.

This changed, however, when the administration of Michael Sata came into power in 2011. Sata’s administration introduced various taxes to the mining sector. Of note was the increase in mineral royalties to 20 percent. As a result, Barrick Gold, which owned Lumwana Mine, announced that it would suspend its operations. President Edgar Lungu came to power in the 2015 presidential bye-election. In March 2015, he announced that the mineral royalties increase would be revisited and revoked. This was subsequent to mining companies threatening a suspension of projects due to high taxes (Lusaka Times, 2015). Royalties were thus revised to 9 percent and corporate tax to 30 percent (England, 2015).

4. Conclusion and Policy Recommendations

This article has demonstrated the cyclical nature of resource nationalism, manifested in Zambia’s copper industry. The copper mining industry went from being in the hands of private foreign corporations to being nationalised. Subsequently, the industry has been privatised again. However, since privatisation copper prices have appreciated and various attempts have been made by successive governments to maximise the benefits of the high copper prices. This has led to various taxes being introduced and then withdrawn again, once the mining companies would threaten to reduce production, which would mean job cuts.

There appears to be a clash between the government of Zambia’s legitimate public functions, on the one hand, and the investor’s legitimate expectations, on the other. As a means of ensuring cooperation between the host state and the investor there needs to be constant dialogue. One way of ensuring this is by insisting on the insertion of renegotiation clauses in development agreements between the government and foreign mining companies. Such clauses define, inter alia, the events that would trigger renegotiation, the outcome of these renegotiations, an obligation to renegotiate in good faith and the way forward, should renegotiation fail.

Such clauses are more flexible than the tax stability clauses in the development agreements. It has been noted that host states seldom abide by contracts that are too rigid (Asante, 1979). For this reason flexibility is needed and this could be ensured through the insertion of renegotiation clauses. In that way, when natural resource prices increase it would place a legal obligation on both the host state and the investor to come back to the renegotiation table, as and when circumstances would dictate this. They are then able to
create mutually beneficial solutions and through this a long term relationship can be fostered. In this manner both the legitimate public functions of the host state and the legitimate expectations of the investor would be protected.

References


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