The proposition that nations may suffer, rather than prosper, through the exploitation of their material wealth has developed over the past several decades from a notion held by an inquisitive few, to a suspicion of many, to an observation of most -

-MICHAEL STRAUSS-

Discussion Paper

Turning Zimbabwe's Natural Capital into Wealth

1. Introduction

Zimbabwe is one of the many heavily indebted poor countries and yet endowed with enormous natural wealth which includes Marange diamond fields, thought to be the biggest diamond find in over 100 years, and the second largest platinum reserves in the world. Despite this wealth, the 2012 UNDP Human Development Index ranked Zimbabwe 172 out of 187 countries and territories.[1]

In recent years Zimbabwe has witnessed a rapid shrinking of the manufacturing sector[2] and a rise in natural resource extraction. Extractive exports grew from 24% of total exports in 2005 to

1 United Nations Development Program Human Development Report. (2013) http://hdrstats.undp.org/images/explanations/ZWE.pdf

2 Muzulu, P. (2012) Zim industrial sites now ghostly. In *Zimbabwe Independent*, November 16 2012. http://www.theindependent.co.zw/2012/11/16/zim-industrial-sites-now-ghostly/

36% in 2011.[3] However, governance of the extractive sector remains a challenge. According to the recent Revenue Watch's Resource Governance Index (RGI), which assesses transparency and accountability in the oil, gas and mining sector worldwide, Zimbabwe ranked 51st out of 58 countries.[4] As noted by the RGI, 'the political climate surrounding Zimbabwe's extractive sector is characterized by hostility, mistrust, and lack of transparency.'

Centre for Natural Resource Governance has also warned that Zimbabwe's natural wealth is a two edged sword. If managed properly it can be the basis for economic growth and poverty reduction whilst at the same time pausing a serious threat to peace, stability and development, if mismanaged. Further, if the governance deficit, also identified in the RGI, is not addressed urgently, Zimbabwe stands to lose several billions of dollars through illicit financial outflows whilst its citizens sink deeper into poverty. Ultimately, if the country is not equipped to extract profitably, it is better to lock up its natural resources in the soil and concentrate on revamping its archaic legislative, institutional and policy frameworks until such a time when mining decisions are made in a transparent and efficient manner.

This paper aims at offering constructive advice and alternatives on how Zimbabwe can strengthen the governance of its extractive sector for the benefit of its people in the short to medium term. The paper also calls on local, regional and international stakeholders to collaborate efforts in strengthening the capacity of the Zimbabwean government and its people in managing natural resources.

2. Normalizing relations with the international community

One of the biggest challenges afflicting Zimbabwe's extractive sector, and its entire economy, is damaged relations between Zimbabwe and sections of the international community. Normalizing diplomatic relations between Zimbabwe and other countries, in particular the EU bloc, US, Canada and Australia is important for the economy of Zimbabwe. Zimbabwe's look east policy, adopted after the West had slapped the country with sanctions in 2002, has limited investment options in Zimbabwe's extractive sector. Government has had to open up its

3 World Bank indicators http://data.worldbank.org/indicator

4 Revenue Watch Institute (2013), Resource Governance Index, Zimbabwe. http://www.revenuewatch.org/countries/africa/zimbabwe/overview

extractive sector to political allies, in particular China, in return for political support and soft loans. Consequently the extractive sector became highly contentious as mining contracts were negotiated secretly, ostensibly to bust sanctions. China's investment in Zimbabwe, in the absence of competition from the West has done more harm than good as most of the Chinese operations have been riddled with opaqueness and serious allegations of corruption. Zimbabwe needs to depoliticize the extractive sector and unlock the potential of negotiating competitive business deals with reputable companies. Business deals that were hurriedly entered into for the sake of 'sanctions busting' should be reviewed. Western countries also have a responsibility to review their policies on Zimbabwe and ensure a mutually beneficial relationship, based on common interests and mutual respect.

3. Institutional and Legal Setting

According to the RGI, Zimbabwe's institutional and legal framework 'reflects a non-competitive licensing process and the lack of mechanisms to promote public accountability in the mining sector'. Mineral exploitation rights are vested in the president and major companies often negotiate contract terms directly with the government. Industry representatives, including officials of state-owned companies, sit on the Mining Affairs Board, compromising its independence. There are no checks and balances to promote public accountability and protect the national interest. The weak institutional and legal setting has resulted in different interpretations and application of laws and regulations. The Institutional and Legal Setting is probably the most urgent intervention to get Zimbabwe's extractive sector on the right path. The following recommendations are made:

3.1. New Minerals Policy

Zimbabwe has no minerals policy, making the extractive sector extremely difficult to govern. Currently potential investors have to interpret the policy from diverse sources of information such as the Mines and Minerals Act, Indigenization and Empowerment Act, Zimbabwe Investment Authority Act, Precious Stones Trade Act and the Diamond Policy. Countries that already have official stand-alone mineral policy documents include Canada, India, Malaysia, Pakistan, Sierra Leone and Tanzania.

A published, stand-alone policy is a very useful regulatory tool that serves two important functions. First, it provides the mineral industry with a clear statement of the Government’s expectations and intent towards the industry. Secondly, it provides lawmakers and regulators with broad guidance on what legislation to pass. A mineral policy is capable of evolving in response to geological resources, politics, economics and advancements in technology which gives it an edge over legal instruments. A draft mineral policy has been developed by the Ministry of Mines. However, no consultation with stakeholders was conducted during the crafting of this policy. Government only carried out consultative meetings to present the draft to stakeholders. It is essential that an outreach program is rolled out to get stakeholder contributions from the beginning.

The National Minerals Policy should aim to address the following:

- **Policy scope**: Outlining the types of minerals found in Zimbabwe, activities and the relationship between the national mineral policy and the national vision as well as the Africa Mining Vision.

- **Sovereignty:** Emphasizing the role of government in investment decision-making and the role of State enterprises. Explanations of the mineral ownership are provided. Regulations that govern foreign participation in the extractive industry and the State equity requirements, formulation of local joint venture or other equity requirements are clearly laid down. Benefits of mining to the communities are outlined, duties and responsibilities of government and extractive industries to the communities are clarified.

- **Legislative framework:** Outlines the following:

    - Applicable laws
    - Exploration / mining rights regulatory approach
    - Security of tenure

- **Regulatory agencies:** outlines the role of government agencies such as Zimbabwe Mining Development Corporation (ZMDC) and Minerals Marketing Corporation of Zimbabwe (MMCZ) and how these relate with various government ministries such as Ministry of Finance, Industry and Trade, Mines and Mining Development etc. Government agencies also outline how information is availed to the public.

3.2 Development of the Minerals Development Act

The Mines and Minerals Act (Chap 21:05) was passed in 1961 and has become quite irrelevant to the demands of today's Mining industry and the aspirations of the people of Zimbabwe. The law was passed by a colonial government that was not accountable to the majority of the disenfranchised Zimbabwe population. At Independence in 1980 Zimbabwe maintained the 1961 mines and Minerals Act. Consequently Zimbabwe's Mining legislation continues to serve the interests of a minority whilst the majority of the population is excluded. There have been inconclusive government efforts to address this misnomer in the past. A Mines and Minerals Amendment Bill was tabled in 2007 but was never passed into law. In 2013 the Ministry of Mines drafted a Minerals Policy which makes a provision for the development of the Minerals Development Act. The next government should take up the challenge and ensure the country has a new minerals law which addresses the weaknesses in the current legislation. However good laws and policies can only be effective under certain local and international conditions.

4. Mining Fiscal Regime

According to the World Bank Oil, Gas and Mining Unit 'it is important to have systems and processes in place to effectively address oil, gas and mining tax payments administration. The general tax system may not be efficient-enough for the extractives sector'.[5] Zimbabwe's mining taxation system has been criticized for being weak, outdated and riddled with corruption. Revenue Watch observed that although the Zimbabwe Revenue Authority collects taxes 'a significant portion of mineral revenues never reach the treasury'. According to the UNDP 'it is crucial for governments to promote more institutional cooperation and coordination between the ministries of finance and mining', adding that 'there is also a need for more information sharing between these departments to improve the tax collection administration.'

Further, government should ensure that the mining tax regime responds to market volatility so that the country can retain investors when prices fall and maximize revenues when mineral prizes go up. An overhaul of the mining tax regime is required to ensure Zimbabwe's minerals contribute to the economy. There is need for thorough training of government ministries, heads of department and Zimbabwe Revenue Authority on best practices in tax administration. This technical support can be sought from regional and international agencies and institutions.

5 World Bank Oil, Gas and Mining Unit. Better Mining Tax Collection to Maximize Development Impact.

In coming up with a competitive mining fiscal regime government objectives should include:

- **Maximizing Revenue Collection**: This addresses the question "How high can be the total fiscal take before it becomes a serious disincentive for industry to invest in Zimbabwe?"
- **Optimal tax base**: In a globally competitive capital market, a balance must be found at a point where the inflow of necessary exploration and development capital is optimal in supporting a growing pipeline of future mining project developments. This will result not only in acceptable, ideally growing, levels of total mining taxation revenue, but also in a range of broader, desirable socio-economic benefits and multipliers, consistent with the government's role of optimizing social welfare.
- **Economic allocative efficiency**: the objective is to ensure that, as far as possible, the same exploration and production activities would occur whether the rent-collecting tax were in place or not. An efficient fiscal regime will prevent over-exploitation or high-grading.
- **Revenue stability**: As mineral commodity prices are highly volatile and as a consequence so are the revenue flows of a mining project, government should find a balance between fixed taxes and taxes based on accounting profits or economic rents. The latter, while desirable because of their greater economic allocative efficiency, result in unstable government revenue while the former prevent government from sharing in high rents when commodity prices are high, besides being economically inefficient.
- **Equity**: This objective addresses the question as to whether the impact of the tax is spread fairly among various taxpayers. Should the tax system differentiate among different mineral commodities, size and/or profitability of different projects or companies, their location etc.?
- **Transparency and stability**: This principle relates to whether miners are fully informed about the tax liabilities that may follow from any proposed activity. Transparency also refers to the openness of the taxation arrangements and collections to examination by the community.
- **Administrative efficiency**: The compliance burden on both governments and companies is a significant consideration in establishing a mining tax system. Compliance costs increase with the sophistication and complexity of the tax system and is a major reason most mineral royalty regimes currently in place are based on reasonably simple royalty formulations (mainly unit or value-based) in spite of their relative economic inefficiency.

5. Disclosure

The RGI noted that 'the public—and even other government agencies—know very little about licensing processes and contractual arrangements with mining companies'. Lack of disclosure of contracts has also created conflicts between communities and companies. Publishing contracts helps citizens evaluate which benefits and protections their country receives in exchange for access to publicly owned natural resources, and lets them monitor whether companies and government live up to their obligations. For the sake of national interests government should open up the sector to public scrutiny by disclosing information on contract negotiations, licensing and revenues. Zimbabwe is strongly urged to sign up to the Extractive industries Transparency Initiative as well as establish tight legislation which compels companies to publish mining contracts.

6. Strengthening Institutional Capacity

Collier and Gunning (1999) point to institutional weaknesses as the main reason why Africa lacks the key growth drivers. A decade long political crisis has severely weakened the capacity of state institutions. Brain drain due to poor working conditions in government has depleted government's pool of qualified and experienced personnel in the natural resources sector. Long serving professionals have compromised their ethics and practices in response to the changing political environment. Government should come up with a plan to lure back professionals in the natural resources sector and give them space and support to carry out their duties professionally, without undue political pressure. There is also need to train government personnel in best practices in the extractive sector

7. Exploration

By its own admission, government has limited knowledge of the minerals within its domain. Government should fund exploration activities to determine the geology and mineralization of the country. Prior to independence several multinational corporations undertook exploration activities throughout Zimbabwe. In some cases mining corporations have more information about the geology and mineral potential of Zimbabwe more than the government. Consequently government negotiates contracts with investors who have more knowledge and information about the quantity and quality of a mineral in a particular place than the government itself. This information asymmetry results in bad deals which benefit investors at the expense of the people of Zimbabwe. Further, this leads to a myriad of challenges such as tax avoidance, under-invoicing. Information asymmetry is a major reason why contract publication should be enforced in Zimbabwe.

8. Beneficiation

Lack of value addition in diamonds, chrome, platinum and other minerals means Zimbabwe is creating tens of thousands of jobs in countries such as China and India when unemployment in Zimbabwe is estimated at over 70%. Countries importing unprocessed minerals and precious stones from Zimbabwe are benefiting more than Zimbabwe. Zimbabwe needs to maximize the returns it makes from its extraction industry by encouraging downstream processing before exporting. Whilst value addition requires huge technical and infrastructural investment subject to creation of a conducive investment climate, there is need for government to establish the requisite legal, policy and institutional frameworks for value addition The law must stipulate that a certain percentage of minerals and precious stones are processed locally. On a positive note, government draft Minerals Policy and the newly unveiled Diamond Policy all prioritizes beneficiation.

9. Rationalizing the indigenization program

The mining sector involves heavy capital investment and great risks for the investors. The main duty of governments is to create an environment that is conducive for business. However the enactment and implementation of the indigenization law appear to be causing capital flight, alarm and uncertainty in the extractive sector. The panic concerning the indigenization program is also noticeable among Zimbabweans who feel the politicization and radicalization of the program may do more harm than good to the extractive sector and the economy in general. Whilst the idea of indigenizing the economy is good, government should ensure the process is predictable, inclusive and transparent. Citizens across the political divide should know how to participate in the indigenization program. Genuine empowerment should target the less privileged, including the communities affected by mining. There is need for nationwide consultation with citizens and stakeholders on how best to implement the indigenization law without driving the sector into the ground. Government should also learn from countries that have successfully implemented indigenization programs, particularly in the developing world.

10. Conclusion

Zimbabwe's next government has a huge responsibility to reform policies, institutions and legislation governing the extractive sector. However, as has been noted elsewhere, good policies and laws without political will to implement them will result in corruption. Further, challenges in Zimbabwe's extractive sector should not be dealt with in piecemeal fashion. A holistic approach is required to start a chapter in Zimbabwe's extractive sector. Government should adopt zero tolerance to corruption and eliminate impunity. However the problem of corruption is not only limited to government officials. It also involves international corporations who may take advantage of weak policy, legislative and institutional frameworks to corruptly acquire mining licences which they further violate through facilitating illicit financial outflows. It is therefore essential for all stakeholders to collaborate in adopting best practices of integrity, good corporate governance and transparency.

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