Briefing

Creating a Legislative Framework to Govern Mining in Zimbabwe

By Catherine Anderson

July 2011

Summary

Zimbabwe's Parliament may soon be called to debate the draft Mines and Mineral Amendment Bill 2010 or an alternative "Diamond Act." As drafted, the bill offers improvements, but is it enough? Instituting a national mining policy would help define a shared national vision for the mining industry, set benchmarks against which to measure the impact of new mining reforms, and promote coherence in the laws, policies and institutions governing the mining sector.

This paper reviews five sections of the draft bill and identifies issues for further inquiry:

License and contract awards

The bill improves the contract award process by introducing a global positioning grid scheme to demarcate territory; removing arbitrary distinctions in the treatment of base and precious minerals and stones; and expanding public access to the mining register. New work program requirements also offer protection against speculator companies that tie up licenses but do not invest.

To further tighten the bill and prevent the abuse of power, Zimbabwe should consider introducing checks on the Executive's decisions, specifying the minimum technical and financial qualifications required for a prospecting license, and clarifying grounds for license revocation. Capping the number of exploration license renewals would encourage licensees to explore the license area rather than simply squatting on it and retaining exclusive rights. Following the example of other countries in the region, Zimbabwe could also consider creating a single licensing authority and introducing a standard model mining contract to streamline licensing and reduce room for discretionary decision-making.

Managing the fiscal regime

Zimbabwe's fiscal regime is highly competitive in regional terms and therefore highly attractive to investors. The country seems well-placed to increase the government's share of its resources without prejudice to sectoral development, but it requires several fiscal adjustments. The country should consider balancing baseline royalties on gross revenues to ensure a steady stream with progressive taxation to give the government a greater share of revenues as profits rise. Graduating depreciation over time and limiting the period for carrying over losses would also limit firms' ability to defer sizable income tax payments.

National empowerment and foreign ownership

Zimbabwe has the opportunity to increase the benefits from mining for the state and citizens,

Contents

Briefing

but doing so through the proposed indigenization and empowerment regulations could lead to inefficiency and waste or, in more serious cases, abuse and corruption. Proposing firms transfer 51 percent of their equity to indigenous investors may discourage investments unless equity is compensated at market value or fiscal concessions, such as lower corporate taxes and other benefits, are granted to investors. Gains from equity ownership might be more than offset by the operational costs and diminished revenues associated with such endeavors, together with the direct losses that could arise if fiscal concessions are made to compensate investors for reduction in equity. Also, the bill does not clarify criteria to select indigenous investors and the processes by which equity partnerships would be formed.

Local content

Zimbabwe could benefit from local content policies to maximize employment of nationals and the purchasing of goods and services required by mining. However, the bill currently makes no provision and fails to establish any procedures for handling local content programs and monitoring their implementation. These provisions should be clarified either in the bill, related regulations, or in a separate local content policy.

Sector organization and governance

The bill enables public access to the mining lease register, which promotes sound management of multiple land uses. Public disclosure of contracts and implementation of the Extractive Industries Transparency Initiative (EITI) would improve Zimbabwe's standing among investors and generate incentives for effective sector management through increased transparency and oversight. However, overall sector management could still be further improved by storing all licenses in a single consolidated mining register to which the public has regular access. In addition, access to information could be eased by disclosing contracts and implementing EITI as other countries in the region have done.

The bill requires the submission of environmental impact assessments but lacks clarity on the creation of environmental rehabilitation funds. The funds are essential to provide the resources needed to offset or manage any negative environmental spin-offs from mining. The bill would benefit from further clarification as to how such funds are to be managed. It is equally important to harmonize the mining and environmental regimes, and to establish mechanisms for implementation and monitoring of environmental provisions.

ABOUT THE AUTHOR

Catherine Anderson is an independent economic and public sector governance specialist and consultant for RWI. RWI legal advisors Matthew Genasci and Patrick Heller provided comments. Experts consulted during the drafting include Mutuso Dhliwayo and Shamiso Mtisi at the Zimbabwean Lawyers Environmental Association and Robert K. K. Sichinga, an independent legislative and financial consultant and former Zambian legislator.

Briefing

Introduction

Parliament may be called upon to review and debate the draft Mines and Mineral Amendment bill or an alternative, yet to be introduced diamond bill. This review is structured around key issues on mining that could stimulate discussions even if the bill is not introduced in its current form. The review takes into account the Indigenisation and Economic Empowerment (General) Regulations 2010, the Income Tax Act (chapter 23:06) and their amendments, as well as the Finance Act (chapter 23:04) and the Environmental Management Act 2002 (chapter 20:27).

General comments

According to Zimbabwe's 2011 budget, the country's mineral resources contributed 4.9 percent of GDP and 65 percent of its exports in 2010. By some definitions, this makes Zimbabwe resource-rich, although the mineral revenues that actually accrue to the state are minimal and significantly less than one might expect. The 2011 Budget Book reports in paragraph 199 that royalties collected from precious metals amounted to a paltry $20.7 million from sales of $593.8 million between January and September. Nonetheless, the nation's minerals constitute important sources of revenue and are a leading export; and there is a chance that their significance to Zimbabwe's economy could grow. With this in mind, comparative resource-rich country experience may be instructive, and experience suggests that the essential challenge for Zimbabwe is to effectively harness the nation's resources and convert these into profitable, productive investments through stable, transparent, accountable and effective sector management. The two necessary pillars to do this well are sound economic management and strong institutions.

Achieving prudent management of the mining sector is possible but a challenge. External influences that are beyond a country's control (i.e. supply and demand, corporate interests, capital flight, foreign exchange rates) can negatively impact a country's capacity to derive full benefits from its extractive industries. Domestic challenges further compound the risks. Increased foreign currency inflows associated with extraction can drive real exchange rate appreciation and lead to the crowding out of investments in non-resource sectors such as agriculture and other industries (a phenomenon known as Dutch Disease). Volatile commodity prices can also result in large year-on-year fluctuations in resource revenues adding to a country's macroeconomic management challenges. At the same time, the "voracity effect"—a term that describes wasteful spending—often follows resource windfalls. Because of the large sums of money at stake, rent-seeking and corruption in the extractive industries can flourish unless the necessary checks and balances are in place.

As it stands, the proposed amendment bill in Zimbabwe is being prepared before any attempt is made to formulate a national mining policy. Both the Constitution and Mines and Minerals Act 1961 are silent on sectoral priorities, and this ought to be addressed. Zimbabwe would benefit substantially from establishing a shared vision for the development of its extractive industries and then crafting a strategic plan to achieve this. In terms of goals for developing the sector, the Ministry of Mines and Development talks of raising capacity for mineral production; continuous exploration including beneficiation and value addition; and mechanizing small- and medium-scale miners with the potential to generate substantial mineral exports.[1] At the same time, members of Parliament have emphasized revenue sharing and local participation as key sectoral priorities. These could be combined to form a national mining policy, and this, in turn, would provide an important benchmark against which future mining sector reform proposals could be measured. Ultimately, leading with a clearly articulated sectoral vision or policy would promote coherence in the laws, policies and institutions governing sectoral management, and provide a platform around which different sectoral interests can align.

Briefing

Detailed Comments:

I. License and Contract Awards

The current provisions of the draft bill strengthen the administration of prospecting and exploration licenses and mineral titles through the introduction of a global positioning grid scheme to demarcate territory; clearer definition of the rights and privileges that attach to each award; the removal of arbitrary distinctions in the treatment of base minerals and precious minerals and stones; and expanded public access to the mining register. Taken together, and if administered well, these measures promise tangible efficiencies in the administration of license awards, the benefits of which might include expedited approvals, greater consistency and predictability of awards, and a reduction in the incidents of overlapping claims. That said, attaining these goals still depends on the degree of transparency and accountability extant in the process of approvals, and on this, the bill presents some risks.

Overall, while the bill presents clear improvements in the administration of the license and contract regime, there several ways this could be strengthened. De-concentrating executive decision-making, clarifying contractual terms and conditions, and introducing protections against the abuse of discretion could go a long way toward further strengthening the licensing regime. Creating a single licensing authority and introducing a standard model contract might also be considered.

Devolving the responsibility of issuing prospect license awards from the president to the minister (on recommendation by the mining affairs board per section 290), is a good step toward de-concentrating decision-making and is in line with global trends in sound mining sector governance.[2] Overall, however, there are few mechanisms in the bill to ensure that the executive is accountable for the manner in which it grants license awards. Add to this, appointments to the mining affairs board are left to the minister. Experience suggests that creating broad intra- and extra-governmental checks on decision-making is the best first step to take to create objective, transparent results in sector management. In case of board appointments, cross-sectoral representation will help to reduce any real or perceived conflicts of interest. At the same time, having established independent bodies appoint or select board representatives would strengthen these protections even more. In Ghana, for example, a committee established to monitor management of petroleum revenues under recent legislation comprises representatives of civil society, trade unions, the media and academia, each nominated by bodies representing these constituencies.

Second, there are several discretionary elements in the award regime and many vague or ambiguous terms. The mining commissioner may decline to issue a prospecting license if the applicant is not deemed "fit and proper," according to sections 21(3)(b) and 21(4)(c) respectively. The board may refuse to recommend that the minister grant an exploration license for the same reason.[3] The minister may cancel the same license if the prospector's representative has conducted himself in a manner that renders him or her "unfit" to prospect.[4] In each case the meaning of "fit and proper" or "unfit" is undefined, leaving application of these provisions open to abuse. The problem arises again with repeat references to the "national interest." This is seen with respect to the issuance of special grants under section 300(2)(c). It would be important to clarify what "national interest" means; and, again, this could be achieved as part of defining a national mining policy.

As a related point, the absence of clear criteria for contract awards is also problematic. Both the bill and license applicants would benefit from greater clarity on the minimum technical and financial qualifications required to apply for a prospecting license. The grounds for a license to be revoked should also be clearly specified. In this same context, it would be helpful to know what "guarantees a licensee must provide to show that s/he will perform his or her obligations under a special grant" as per the reference in section 299(b). In other cases, detailed information must be submitted as part of an application (as with a special mining lease), but no information is given

Briefing

about the criteria or thresholds to met in the application. In the interests of securing partnerships with the most qualified operators, to improve investor certainty, assure security of tenure, and to reduce the potential for abuse of discretion, these matters should be addressed in the law or attendant regulations.

Finally, the disparate network of license approval bodies contributes to the opportunity for corruption and inefficiency, and fails to capitalize on opportunity to build a critical mass of expertise within the decision-making bodies. The mining commissioner is responsible for approving "Staking Agents";[5] the minister is responsible for awarding exploration licenses, on the board's recommendation; the board awards mining leases; and the president is responsible for awarding special mining leases and special grants. This is a complex and disparate regime for license and contract awards. Taken together with the various instances of discretion in the law, this regime could lead to inconsistent, unpredictable and nontransparent awards and expose Zimbabwe's mining sector to inefficiency and corruption. It also makes license administration more difficult for the agencies responsible, and this can have several implications down the line in terms of operational oversight, regulation and revenue collection. As an alternative, the government might make one agency or office responsible for awarding all types of mining licenses to strengthen efficiency and transparency in license administration. Ensuring consistent, objective and transparent decisions would protect the rights of titleholders (in terms of security of ownership and taxation) and help secure a better deal for the country. The government could further reinforce the process for making license award by introducing competitive bidding for exploration licenses. This would have the benefit of ensuring that Zimbabwe gets the best possible value from its mining blocks. As for how this might work, one option is for the law to make competitive tenders the norm and require the ministry to announce any decision to award a contract by direct negotiation and explain its rationale. Such a process may be necessary, for example, when the mining cadastre does not have adequate geological information to make a site attractive to a variety of potential bidders.

Managing a disparate licensing regime presents an administrative challenge, and so too does the absence of a standard model contract. There is a natural tension between the desire and need for control over operations, as set forth in an individual contract or license, and the dictates of a nation's constitution and law. A country must balance the need for firm policies that promote the national interest with the need to sign workable contracts that reflect variations among different mining areas. Global best practice and proponents of the Natural Resource Charter recommend that governments enshrine as much information as possible about the operational and financial details governing their extractive industries into law or a model contract, leaving relatively little to individual negotiations between the government and extractive companies.[6] Liberia is an example of an African country that has recently put in place a model mining contract in an effort to standardize administration and get the most out of its mineral resources. Togo, Eritrea and Namibia have also developed model mining agreements. The use of model agreements is widespread in the petroleum sector.

There are two reasons behind this recommendation. First, companies have an advantage over national governments during the contract-drafting phase. Companies bring experienced negotiators to the contracting process, and if the nation does not have clear rules in place across the board, there is a risk that the company—not the government—will set the agenda. Second, contract enforcement is substantially easier if key terms are standardized. Many countries have elected to put as many key fiscal and operational provisions into law as possible for these two reasons, while others have instituted model contracts.

Ultimately, the application of consistent, nondiscretionary procedures for license and contract awards, clarity of terms, and the use of a standard model contract better guarantees security of tenure for investors while at the same time promoting the impartial administration of awards.

Briefing

Adoption of both a standard model contract and consolidation of licensing responsibilities into a single licensing authority would signal that the government is serious about mining sector investment and is committed to integrity in business. Streamlined transparent licensing procedures could also improve the government's ability to secure partnerships with the most qualified operators and increase Zimbabwe's chances to make the most of its minerals.

Questions:

Is there scope in the law to eliminate or substitute vague words and phrases, i.e. "fit and proper person" and "national interest" for more concrete terms?

Has the government considered defining the minimum financial and technical qualifications required for all license applications more precisely (including special grants and special mining leases) and specifying the grounds for license revocations?

Has consideration been given to consolidating licensing responsibilities into a single authority to replace the currently disparate system for license awards? Could the Mining Affairs Board be statutorily appointed and tasked with the approval of all license and contract awards?

Has the government considered substituting case-by-case negotiation of mining leases with a standard model contract or a regime of standardized terms and conditions (which may or may not include duration, size, geometry, fees calculated in such a way as to offset price volatility, and conditions for transfer and renewal)?

II. Contract Governance and Review

Contract governance involves monitoring and enforcing the following activities: exploration and production; programs of work; and fulfilling relinquishment requirements. Here the bill introduces several challenges. Monitoring work programs requires more capacity than is currently available.[7] In addition, several ambiguities and instances of discretion leave considerable scope for uneven application of the law.

"Program of work" provisions are designed to ensure that mining companies that possess lease rights are actively investing in exploring and developing the resources, rather than simply sitting on the areas as a sort of speculation that does little to promote development in Zimbabwe. That in mind, the repeal of section 212, which previously allowed companies to pay for certificates of inspection for base mineral blocks without the need to do any work, is a considerable improvement that could serve to counter inefficiencies in exploration and extraction, and guard against that class of companies that tie up licenses but do not invest. In several other instances, however, the criteria for obtaining certificates of inspection are subject to interpretation or still require prescription, leaving many important questions unanswered. For example, what constitutes a program of work that is "satisfactory to the Board"? Who prescribes the criteria for an adequate "amount of work,"[8] and where are these set out; in the contract or by regulation? The current provisions of the bill are unclear, and defining minimum "program of work" requirements in the regulation would be one way to address concerns about security of tenure.

In other instances, wide executive discretions could make transparent, consistent and equitable application of the law difficult. For example, the minister is empowered to award certificates of protection to guard against the forfeiture of mining leases. This, in effect, would override the program of work requirements in the law (see section 221B[1]). The board has a role in making and receiving recommendations about awarding these certificates, and such certificates would be accessible to the public. But, ultimately, this provision renders the minister—not the law—the

Briefing

ultimate arbiter of contract governance. With greater specificity on the contract governance provisions in the law, this section could be limited in its application to ensure that it is used an exception rather than the rule.

A further example of how this can cause problems arises under Part XXIII of the law in which the president, on the board's advice, can order the expropriation of operations "not appropriately worked." No compensation would be awarded in this instance unless the land is sold to others, and the state would retain the land. Again, while this helps guard against unproductive or speculative use, such provision could also be unfairly applied. One safeguard might be to introduce a standard *force majeure* clause in all mining sector contracts to ensure that investors are not arbitrarily penalized by events beyond their control (such as civil strife or natural disasters) that adversely affect operations.

That the government has retained the prohibition against the sale or transfer of an exclusive prospecting order can be applauded. However, the draft bill makes no provision to cap the number of exploration license renewals that a licensee can make, allowing firms to sit on a lease *ad infinitum* even where resources are not found, and therefore risk non-productive or speculative use renewals. A more effective practice would be to allow for one or two renewals, so companies are pressured to invest in exploring the land rather than simply squatting on it and retaining exclusive rights.

The penalty of imprisonment for failing to comply with the certificate of inspection and program of work provisions also seems high, and we wonder whether the civil penalties, i.e. a fine and potential forfeiture, that are already provided for in the law would perhaps be adequate. By graduating the fines so that they rise over time, the law can make continued noncompliance sufficiently costly for mining operators.

Questions:

What are the minimum requirements for a program of work to be deemed "satisfactory" and eligible for a certificate of inspection? Who will be responsible to prescribe the required "amounts of work," and where will these requirements be set out to ensure that they are not inaccessible or arbitrary? Is there scope to establish minimum work requirements by law or regulation?

Has the government considered introducing a standard force majeure clause into mining contracts to account for those instances in which, due to no fault on the part of the firm, adherence to a program of work was unviable? Such clauses could provide for a review of terms when conditions substantially change.

Is the government open to adopting a graduated system of fines as a substitute for the penalty of imprisonment for noncompliance?

III. Fiscal Provisions (Tools, Loopholes and Pitfalls) and Revenue Management

Zimbabwe's dual fiscal goals are to effectively harness the country's sovereign assets and convert them into sustainable socioeconomic benefits, while at the same time seeking to attract and retain investments. The country's ability to do this hinges on three things: its ability to project the value of its resources; its capacity to secure a fair share of its wealth through coherent, progressive fiscal policy models; and its ability to reinvest those resources to produce sustainable, long-term benefits. For a firm, profitability is key to investment, and mining companies will look carefully at the mix of fiscal terms—i.e. royalty levels, surface tax, depreciation rates, windfall and profit taxes, value added and withholding taxes, and remittance controls—to assess how these could impact their rates of return. That said, industry surveys also suggest that tax rates matter less

Briefing

than predictability and efficient administration. Overall, contract enforcement, the coherence of a sector-wide fiscal strategy, and fiscal expansion are enhanced when the discretion to alter the fiscal terms set down in individual contracts is minimal. In such cases, the opportunity for corruption is also much reduced.

Zimbabwe's fiscal regime is highly competitive in regional terms, and the country seems well-placed to make several fiscal adjustments to increase the government's share of its resources, without prejudice to sectoral development. Even so, in calculating fiscal reforms, Zimbabwe needs to ensure that overall increases do not put the country beyond competitive international and regional fiscal models.

In terms of Zimbabwe's capacity to project the value of its resources, we note that the mining commissioner is to provide estimates on the total volume and the size of any strategic mineral present in a mine. But, capacity is weak, and we wonder what measures are in place to ensure that commissioner is qualified to do this. We further note that the current and proposed regimes make limited provision for the submission of geological data and corporate fiscal projections, and yet the government could derive much benefit from an obligation that requires firms to do this. This would enhance its capacity to estimate the value of the country's resources.

In terms of the fiscal model, the current regime is a hybrid: royalties are calculated at 4 percent on gross fair market value for base and precious minerals, while the royalty for precious stones stands at 10 percent. The 2011 budget records the minister's recent increase of gold and platinum royalties to 4.5 and 5 percent respectively, and diamond royalties to15 percent. Firms can claim 100 percent capital depreciation in the year of expenditure rather than amortizing capital expenditures over time and carry losses forward indefinitely, enabling firms to significantly defer sizable income tax payments. Surface taxes are levied at a variable rate, withholding tax on dividends and interest are 5 percent, while corporate tax stands at 15 percent, which are low by international standards. These pro-investor provisions are counterbalanced to a degree by the fact that, contrary to standard international practice, royalties are nondeductible for income tax purposes.[9]

Overall, Zimbabwe's is a highly attractive fiscal regime for investors, even for sub-Saharan Africa where tax and royalties rates are often low. Irrespective then of the urgent need to recapitalize, there is arguably scope to increase the government's take, and the government is reviewing options that will allow it to do so. Some of the fiscal changes currently being explored include reducing the depreciation allowance, limiting the carry-over period for losses, and increasing the corporate tax to 25 percent. The government has introduced taxes designed to stem the trend in stripping and shipping of mineral resources out of the country in crushed raw form, with the aim of improving domestic value and preserving local jobs.[10]

Policy decisions about royalties and taxation are highly strategic in nature. Royalties represent an important element for the country as they compensate for the extraction of a nonrenewable resource, produce fiscal revenues early in the life of a mining project, and represent a comparably low administrative burden for the government. Standard royalties do not, however, enable a country to benefit in a progressive manner from windfalls generated by high prices. So the government may wish to consider retaining a baseline royalty on gross revenues to ensure minimum compensation for the permanent loss of finite resources, while at the same time maintaining or bolstering progressive fiscal elements that can be structured as variable rate supplemental royalties or as some version of Zimbabwe's existing profit tax regime, which includes a standard corporate income tax and an additional profits tax designed to capture a share of windfalls. This would let the government capture a greater source of the wealth in line with rent and profit margin increases, without prejudicing capital investments.

Briefing

Turning to the governance of mining sector revenues, two issues are worth discussing. Under the current regime, royalties "may be fixed by the Minister," giving the minister authority to consider how much has been paid for minerals over the last three years, representations of the Chamber of Mines, and "any other matters as he deems fit." This creates the potential for a highly arbitrary exercise of power, which raises serious concerns about public accountability.

Equally worrying is the practice of case-by-case negotiation of royalties and tax concessions for special mining leases, each of which is executed by the minister in consultation with the president, according to section 167. The original act also says in section 254, "The President may remit in whole or in part the royalty payable on any mineral product to encourage investment, processing or refining within Zimbabwe or the development of any export market." These are commendable objectives. The question is whether safeguards exist to ensure that Zimbabwe gets its due, and to guard against the corruption that can occur where concessions are individually negotiated. In Zimbabwe's particular case, the top five mineral producers operating in the country have benefited considerably from tax concessions granted by their individualized agreements. As a result, the lion's share of the country's mineral revenues does not currently enter the state coffers, but instead is remitted outside Zimbabwe, leaving the country with paltry revenues.[11] The current process of reform presents an opportunity to amend this.

Flexibility in the fiscal regime is necessary to keep pace with fluctuations in the market and to ensure that Zimbabwe is well positioned to secure an adequate share of any windfalls. But, in the end, predictability and consistency in the fiscal regime is key not only to attract investment, guard against capital flight and excessive remittances, but also to stem corruption. These dual objectives for Zimbabwe's fiscal regime could be achieved through legislation that prescribes core fiscal provisions, and accompanying regulations that define royalties and fees. This would have the dual benefit of ensuring consistent application of the fiscal regime, while at the same time enabling royalties to keep pace with market fluctuations and ensuring that these are not constrained by the rigidity inherent in parliamentary law.

Questions:

Has the government considered requiring companies to submit all exploration data and any fiscal projections pertaining Zimbabwean mineral reserves?

In revisiting the fiscal regime and as part of efforts to increase the government's share of resource revenues, what are the government's views on the following:

- *(a) balancing sufficient baseline royalties on gross revenues to ensure a steady revenue stream with progressive fiscal provisions that give the government a greater share of revenues as the profit of a venture rises; and*
- *(b) retaining baseline royalties while at the same time graduating depreciation over several years and limiting the period for carry-over losses?*

What is the benefit to be gained from case-by-case negotiation of special mining lease royalties? Would the government be willing to commit to ending the practice of individualized agreements, ensuring that all key fiscal terms are determined by law, and royalties and fees (including those of special mining leases) by regulation?

IV. Foreign Ownership, Equity Participation and Indigenization

The policy that "no future mining right or title shall be granted unless the controlling interest is held directly or indirectly by the State or indigenous Zimbabweans" is controversial, though its aim of national empowerment makes sense. Experiences in the region have seen few extractive

Briefing

industries benefits accrue to host states or populations over time and, if executed well, national empowerment initiatives have the potential to reverse such a trend for Zimbabwe.

Indigenous economic empowerment is not new to the region. Consider South Africa's Black Economic Empowerment Initiative, which sets state equity participation in mining at 15 percent, or Zambia's nationalization experience from 1967 in which the state took a majority share in its mining industry and subsequently had to bear tremendous losses as a consequence of falling commodity prices and increased costs. There are many examples of nationalization and empowerment regimes, and the results vary. But in most cases governments wound up carrying the burden of externalities, and poor governance resulted in waste and corruption. In today's regional context, Zimbabwe's proposed equity ratio, of 51 percent, would be the highest in the region, and this will have effects on investment.

In the process of equity participation and indigenization, several considerations arise. Zimbabwean policymakers would be advised to carefully consider questions of economic efficiency, competitiveness and governance. Who will own the assets, how will equity participation will be managed, and what are the risks? With few exceptions, developing countries in which state-owned enterprises are the major operators in the sector tend to face the problem of insufficient reinvestment to sustain exploration, as well as a lack of technical capacity. High costs, overemployment and low productivity are also commonly observed when state ownership levels are high.[12]

For investors, their interests center on questions of control and financial impact: ensuring that equity interests are acquired at market value, maintaining profitability, and securing adequate returns on capital and investments. The financial impact depends on whether the shares are acquired at market value (in which case an investor would be indifferent, all other things being equal) or at something less than market value (carried or free interests).

Addressing each of these points in turn hinges on economic efficiency. The indigenization proposal envisages the following: the sale or disposal of existing mining rights and the allocation of future mining rights to the state and/or indigenous Zimbabweans at a rate of 10 percent in two years, 20 percent in five years, and 26 percent within seven years for strategic or precious minerals (see section 414 [3][a]). These provisions allow the state to secure a 25 percent noncontributory or "carry-free" interest.[13] Progressive indigenization of nonstrategic and nonprecious minerals is set at a rate of 20 percent within two years, 40 percent within five years and 51 percent within seven years, according to section 414 (3)(b).

In a low capital, high risk investment environment, the profit margins necessary for a mining company to be willing to invest often increase. It would not be unusual for a company to require a 30 percent return before investing in Zimbabwe and where the proposed state or direct equity shares are high, the government could expect substantial pressure to provide trade-offs down the line in the form of fiscal concessions such as lower corporate taxes and other benefits. In cases like this, Zimbabwean ambitions to secure a higher share of the resource dividend, to inculcate competitive development of the nation's extractive industries, reinvestment and sectoral expansion may not be met by equity participation. It may be worthwhile exploring more competitive, investment-compatible options instead such as increasing corporate taxes or introducing value-added requirements.

Beyond economic efficiency and competitiveness, other challenges arise: high turnover in senior management; maintaining a bank of the technical and management skills needed for effective participation; the potential for politicization of appointments; and the risks of political interfer-

Briefing

ence in management decisions. The indigenization and economic empowerment regulations require the minister to maintain a database of interested indigenous investors wishing to partner with foreign investors, according to section 15 (1). What is less clear, however, are the criteria by which indigenous investors are selected and the processes by which equity partnerships would be formed (by direct negotiation or competitive tender for the 26 percent or 51 percent stake). This leaves the system open to abuse. Ultimately, as currently drafted, indigenization may benefit wealthy, capitalized Zimbabweans with limited trickle-down effects or opportunities for those with average to low incomes.

The Community Trust Regime established under the new regulatory provisions—and designed to enable equity participation for the residents of rural communities affected by resource extraction in their wards—adds further complexity to the regime, and its success depends upon the competence and governance of the trusts and trustees.[14]

Questions:

What objectives is the government trying to achieve with indigenization and equity participation, and do the provisions of the draft bill effectively deliver this?

Has the government run projections of the costs associated with the "carried interest"? For example, how would exploration or "sunk" costs and related upfront capital expenses be accounted for under these equity arrangements? Will the state and indigenous Zimbabweans be able to finance those, or would companies have to assume these costs themselves?

How will indigenous equity partnerships be formed? What are the criteria for indigenous participation and the inclusion of Zimbabweans in the database? Has the government considered adopting competitive bidding processes to allocate the 26 percent equity share of investments for indigenous Zimbabweans?

What measures exist to empower poor, undercapitalized indigenous Zimbabweans to participate under these arrangements?

Do senior members of the ruling coalition see the policy option—which envisages direct equity participation limited to 15 percent with the remainder (to 51 percent) to be made up in empowerment credits, otherwise known as local content credits—as a viable, more equitable and empowering national alternative?

V. Local Content and Benefit Sharing

The existing Mines and Mineral Act requires that local content contributions be stipulated in special mining lease applications, though it is unclear why this applies here and not in the case of standard mining lease applications.[15] As currently drafted, the bill is also unclear about how government aims to ensure that local content obligations—where they exist—are realized. Clear eligibility criteria and detailed procedures for project approval may be needed in regulations if not in the law. An additional challenge is ensuring that local communities are aware that such provisions exist and that they have the opportunity to benefit.

The draft bill makes limited reference to benefit sharing or local community participation, and yet this is reportedly a priority for Zimbabweans and Parliamentarians as their representatives. The current act says the minister can direct miners to make certain payments to local authorities, while site rentals are to be paid directly to the mining commissioner responsible for the mining location in question. These fees are then remitted to the central budget. This could be an opportunity to channel these resources directly to local communities for social and community development. More explicit provisions for benefit sharing could be made within the draft bill or in a

Briefing

Finance Act amendment. The government may wish to explore this. The Ahafo Linkages Program in Ghana could offer some useful lessons on the opportunities and challenges associated with such initiatives; under the program's rules, $1 for every ounce of gold is allocated to communities impacted by the mining operation for socially and environmentally responsible programs, and to improve their economic situations.

Questions:

Is there scope for the law to require a general set of local content provisions that apply to all mining leases? What is the procedure for approving local content programs? What eligibility criteria apply? How are the delivery and quality of local content initiatives monitored?

Are local communities aware that these initiatives or commitments exist? What measures are envisaged to make local communities aware of the local content provisions that might affect them, and what provision is made for affected communities to participate or benefit from the revenues received from mining activities conducted in or around their communities?

How will the government ensure that revenue sharing and local participation opportunities arise? What is the nature of the benefit-sharing scheme that the government envisages? Has the government considered requiring mining companies to pay a share of royalties (or other mining taxes) directly to communities?

VI. Sector Organization and Governance

More steps could be taken to ensure that Zimbabwe's mining sector is well governed and attracts investment. Opportunities open to Zimbabwe include: establishing a clear, simple and nondiscretionary legal and regulatory framework;[16] designating policy, regulatory and operational agencies with clearly defined and complementary functions; minimizing discretion in decision-making; ensuring public access to information; and activating enforcement through a network of complementary checks and balances. Experience shows that the mining sector's efficiency and governance are greatly enhanced when executive powers are deconcentrated and an integrated network of mutual accountabilities exists.[17]

That the Mines and Minerals Amendment Bill simplifies the existing mineral licensing regime and deconcentrates decision-making are important achievements. So too is the strengthened oversight and enforcement in sector administration that is enabled by the new provisions for parliamentary revocation or veto of an exclusive exploration award, and in the administrative court's more consolidated role as the ultimate forum for administrative redress.[18]

Still there are several opportunities for additional improvements, particularly in terms of sector administration. The role of parliament should be carefully checked to guard against excessive politicization of the sector, and there are multiple ways to achieve this. The new law could require the submission of annual reports or mining audits to the parliamentary Committee for Mines and Mineral Development, or an audit committee for review. A threshold could also be imposed on the exercise of Parliament's proposed right of veto; for example, the exercise of parliamentary veto could be limited to the case of strategic minerals or those projects with an investment threshold of more than $50 million.

Comparative experiences on the role of parliament vary. In Ghana, parliament's role has involved ratification of leases, contracts and stabilization agreements, but in reality oversight has been weak due to a lack of mining sector expertise. In the East Asian context, Mongolia's experience has been one of high levels of parliamentary involvement, particularly in legal and regulatory issues

Briefing

governing the sector. Some believe that this has led to Mongolia's mining sector being driven by populism and elections instead of public interest.

With these examples in mind, we would ask:

What measures are envisaged to ensure that board members are qualified to exercise their functions? And again, how will the independence of the board be safeguarded? Has the government considered prescribing statutory appointments to reduce the opportunity for discretion that could board independence and quality?

Has the government considered instituting obligatory income and asset declarations for board members on appointment as a means to guard against conflicts of interest (i.e. cronyism and administrative corruption)? What will be the process to remove nonperforming members?

How will the role of parliament be managed so as to promote supervision but avoid excessive politicization of the sector? For example, has the government considered introducing a requirement that annual reports and mining audits be submitted to the Parliamentary Committee for Mines and Mineral Development or an audit committee for review? Or has the government explored the merits of a minimum threshold for the exercise of Parliament's proposed right of veto, e.g. only for strategic minerals and/or those cases that involve an investment threshold worth more than $50 million?

VII. Transparency and Access to Information

Efforts to address information asymmetries by allowing public access to the mining lease register throughout the system as well as at national and provincial levels are important steps for transparency, and they enable better management of multiple land uses. But again, more could be done. All approved licenses could be stored in a single consolidated mining register to which the public has regular access, contract disclosure could be mandatory, and Zimbabwe could commit to the Extractive Industries Transparency Initiative (EITI).

Contract disclosure has the advantage of enhancing competitiveness, and it introduces consistency in license and contract awards particularly in terms of fiscal provisions. Taken together with EITI implementation, disclosure would reduce the opportunities for corruption in the award of contracts and help avoid leaks in revenue management. Liberia and Nigeria's experiences could prove particularly instructive as these provide tangible regional examples of transparency's merits and its potential economic spin-offs.

In Liberia, the second country in the world deemed EITI compliant, the EITI law requires contract disclosure. As a result of an audit conducted under EITI auspices, $104,288 in lost state revenue was identified and repaid; this discrepancy was the result of fraud on the part of an employee of the operating company.[19] Nigeria's EITI report revealed $500 million worth of discrepancies in petroleum revenues in 2005.

Beyond revenue transparency, and by virtue of its multi-stakeholder arrangements, EITI also provides an excellent opportunity to bring government, civil society and industry representatives together to build policy consensus on measures to improve revenue management and transparency practice. It also enables sharing of lessons learned and any insights on sectoral development.

Questions:

Has the government considered storing all licenses in a single publicly accessible mining register held by the mining board, with duplicate copies held by local authorities to facilitate subnational administration and access?

Briefing

Has the government considered joining the community of regional practice (which includes, but is not limited to Mozambique, Ghana, Liberia, Nigeria, and Tanzania) in Extractive Industries Transparency Initiative (EITI) adherence? If so, would it be supportive of full contract disclosure as is required in Liberia and other African countries?

VIII. Environment Impacts, Community Development and Social Inclusion

The amendment bill introduces important environmental protection measures and galvanizes several provisions of the Environmental Management Act 2002. The requirement that an environmental impact assessment be submitted in tandem with any prospecting, exploration or mining lease is to be applauded; see sections 90(a), 159(3)(iv) and 197(b). The provisions for creating an Environmental Rehabilitation Fund are crucial as well, since such funds could provide the resources necessary to offset or manage any negative environmental spin-offs related to mining. The bill would benefit from further clarification about how such funds are to be managed. For example, it could outline how trustees are to be appointed and how their independence will be guaranteed; a provision requiring income and asset declarations on appointment might be one way to achieve this. It could also explain the specific terms and conditions the minister may or may not include within the trust deed or constitution of Environmental Management Funds, according to section 257C (2). With the key legal provisions in place, the bigger question then is how environmental management would be realized in practice. Harmonizing the mining and environmental regimes is key, but there will also be a need for clear mandates and coordinated implementation.

Questions:

What provision has the government made to ensure that environment obligations under this bill will be appropriately enforced?

What measures does the government intend to introduce to harmonize the mining and environmental regimes and coordinate environmental management?

Briefing

ENDNOTES

1 Ministry of Mines and Mining Development Publication, 'Investing in the Zimbabwean Mining Sector', July 2010, 3.
2 Barma, Naazneen, Kai Kaiser, Tuan Minh Le, and Lorena Viñuela. *Rents to Riches? The Political Economy of Natural Resource Led Development* (Washington, DC: World Bank, 2011).
3 Sect. 89(1)(a).
4 Sect. 23(1)(b).
5 An approved "Staking Agent" is a person registered in the Register of Approved Staking Agents and is entitled to act as an agent on behalf of a prospect licensee.
6 http://www.naturalresourcecharter.org.
7 Tony Hawkins, "The Mining Sector in Zimbabwe and its Potential Contribution to Recovery" (Working Paper 1, United Nations Development Programme, 2009), 9.
8 Sect. 205.
9 Ministry of Mines and Mining Development Publication, 'Investing in the Zimbabwean Mining Sector', July 2010, 17.
10 2011 Budget, para.102.
11 Ibid., para. 199.
12 See Nadeja M. Victor, *On Measuring the Performance of National Oil Companies (NOCs)*, Stanford University Program on Energy and Sustainable Development, September 2007, available at http://pesd.stanford.edu/publications/nocperformance/; Baker Institute Policy Report, *The Changing Role of National Oil Companies in International Energy Markets*, April 2007, available at http://www.rice.edu/energy/publications/PolicyReports/BI_Study_35-1.pdf; and the forthcoming World Bank report *Rents to Riches: NRM in Resource Rich Fragile States*.
13 Carry-free refers to a free equity interest.
14 Sect. 14B(1) of the Indigenisation and Economic Empowerment (General) (Amendment) Regulations 2010 (No. 2).
15 Sect. 158(3)(e)(vii)(E)(xiii) of the Mines and Minerals Act.
16 A number of policy papers produced by the Oil, Gas, and Mining Division of the World Bank outline the criteria for a such a legal and regulatory framework; see, for example, Eleodoro Mayorga Alba, *Extractive Industries Value Chain*, March 2009.
17 World Bank, *Rents to Riches: NRM in Resource Rich Fragile States.*
18 Sect. 92 of the amendment bill says "If within three months after exclusive exploration licence was laid before the House of Assembly in terms of subsection (2), the House resolves that the licence should be revoked or altered, the Minister shall without delay comply with the resolution."
19 http://leiti.org.lr/press.php?news_id=13&related=28, accessed April 4, 2011.

REVENUE WATCH INSTITUTE

The Revenue Watch Institute promotes the effective, transparent and accountable management of oil, gas and mineral resources for the public good. Through capacity building, technical assistance, research, funding and advocacy, we help countries to realize the development benefits of their natural resource wealth.

1700 Broadway
17th Floor
New York, NY 10019
Phone 1.646.929.9750
rwi@revenuewatch.org