POLICY AND LEGAL FACTORS AFFECTING INVESTMENT IN THE MINING INDUSTRY : THE CASE OF ZIMBABWE

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Abstract:

The research study sought to highlight the policy and legal factors affecting investment in the Zimbabwean mining industry in general and the mining of diamonds and gold in particular. Zimbabwe being home to more than 40 economically exploitable minerals has been undergoing changes to the policies and laws around the governance of those minerals. This research was prompted by the current debate and topical issues arising from the resource nationalism which is not only akin to Zimbabwe but to other resource-rich nations both in the developing and developed nations. The problem statement emanates from the numerous policy changes instituted by the Government of Zimbabwe in the mining industry. The overriding objective therefore was to bring to the fore the policy and law changes affecting the foreign direct investment inflows into the mining sector especially gold and diamonds. The study utilised the multiple case study research technique to extract mostly qualitative data. A survey was conducted, on a sample size of 51 respondents picked from a population of 66 elements comprising of Murowa Diamonds, Freda Rebecca, Reserve Bank of Zimbabwe (RBZ), Ministry of Mines and Mining Development (MMMD) and Chamber Of Mines Zimbabwe (COMZ) management employees. Senior management employees were targeted in this research study since policy formulation is highly understood and appreciated at that level of the organisations chosen. The research findings are

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that investments in the diamonds and gold mining are affected by the inconsistency in mining legislative and policy formulation. The research also revealed that Zimbabwe does not necessarily have the highest taxation regime in the region but needs to stabilise policy formulation to offer an environment which allows investors to plan better.

Keywords

Investment, indigenization, empowerment, taxation, foreign direct investment

List of acronyms

COMZ- Chamber Of Mines Zimbabwe

FDI- Foreign Direct Investment

GOZ-Government Of Zimbabwe

KPCS-Kimberly Process Certification Scheme

MMCZ- Minerals Marketing Corporation Of Zimbabwe

MMMD-Ministry Of Mines and Mining Development

RBZ- Reserve Bank Of Zimbabwe

ZIA- Zimbabwe Investment Agency

1. Introduction

The mining industry at its peak earns 40% of the Zimbabwe's foreign exchange earnings, contributes approximately 20% towards Gross Domestic Product (GDP) and employs in excess of 65 000 people directly; thereby creating a livelihood for a quarter of a million Zimbabweans. It is estimated that a million people are also dependent on small scale mining as artisanal miners according to the Chamber of Mines Zimbabwe statistics mining report (2010).

The main mineral and other related exports produced by the Zimbabwe mining industry are gold, ferrochrome alloys, asbestos, nickel, platinum and recently diamonds. To date, over 40 different minerals have been discovered and extracted in the country. Mining has remained an important cog in the wheels of the Zimbabwean economy; creating jobs, earning foreign currency and diversifying the economic base as commented by Matsika (2010). Due to the prevalence of minerals in the country the colonial government established regulations to control the mining activities. Mining regulations in Zimbabwe were established as early as in 1910 but the Mines and Minerals Act was later on developed to its current state in 1961.

The world over, policies introduced by governments for the exploitation of minerals are mainly centred on taxation, royalties, empowerment and environmental in nature.

James Otto (2006) commented that public perceptions of company windfall profits often provoke calls for revisions in taxation legislation, triggering policy shifts detrimental to investments inflows. The Permanent Secretary in the Ministry of Mines and Mining Development announced that Government was in the process of consulting stakeholders to review mining fees as reported in the Newsday (13 January 2012). His argument was that the mining companies were not paying enough for the exploitation and exploration of minerals in the country. Thus Zimbabwe had to revise the mining charges to align them to international standards, noted the government official.

Gold and diamonds have been selected for this research. The two minerals were chosen for study among others due to the fact that gold is the biggest contributor to the country's exports and that gold is a strategic mineral in the country.

The discovery of alluvial diamonds by De Beers in the eastern part of Zimbabwe triggered one of the biggest rushes of the century. It is thus through regulations and policy frameworks that such activities are brought under control.

The laws and statutes on mining are mainly centered on the Mines and Minerals Act Chapter 21:05. Part 1 section 2 of the act states that "all minerals are vested in the President". Thus this is used as justification for the persistent revision of policies on royalties and taxation. Between 1961 and 2001 the Act was amended more than 20 times for a variety of reasons. Proposals were made in 2010 to carry out further amendments. Various statutory instruments were also put in place over the years.

Gold is regarded as a strategic reserve asset by the Government of Zimbabwe. Gold mining is thus the most known activity in the mining sector. The Gold Trade Act chapter 21:03 gave the

Reserve Bank of Zimbabwe the monopoly on purchasing, disposal and exporting all gold produced in Zimbabwe. The RBZ Act (2001) chapter 22:15 section 4 paragraph (h) says that the "RBZ shall buy, sell or deal in precious metals, and hold in safe custody for other persons gold, securities or other articles of value."

There was a gradual decline in the production of gold from 2005 until 2008, which became the worst year for gold production in the country with only 3.5 tons produced. In 2009 the gold sector was liberalised as a way of encouraging investment and thus enhanced productivity that had been declining over the years. Policy shifts on gold have mainly been around the disposal, royalty payments, small scale mining and licensing. The Gold Trade (the gold buying permits for concession areas) regulation was introduced and amended in 2004. In 2005-2008 gold mining companies experienced serious operational difficulties which saw some of them scale down operations while others were put on care and maintenance.

Policies on diamonds by governments were over the years complicated by the requirements from the Kimberley Process Certification Scheme, forthwith referred to as KPCS. The KPCS demands that countries or companies dealing with diamonds do so with high degree of transparency, ethics and accountability. This was necessitated by the need to prevent wars emanating from conflict diamonds. As cited by Meyer (2010), the casual diamond trade fuelled conflicts and wars threatening the ousting of legitimate governments by rebel movements such as the UNITA in Angola. Therefore, for diamonds to trade on the international market they require a certificate of clearance that distinguishes them from conflict or blood diamonds..

2. Literature Review

The mining sector of Zimbabwe is diversified in terms of size and variety. There are approximately one thousand properties, mainly gold, worked by companies, syndicates and individuals classified as operating mines. However, according to Simpson et al (2008), by global standards, Zimbabwe is not a mineral-rich economy, but it does possess resources, especially of platinum, gold, diamonds, methane gas, asbestos, nickel, coal and chromite, sufficient to generate export earnings in the region of US$2 billion annually. With more investments in the sector this can be grown to a figure more than $5billion per year. The Zimbabwe Investment Agency, ZIA (2012) however, believes that endowed with such an array of minerals the country has a policy and legislative deficiency in the mining sector.

The Fraser Institute (2009) which rates countries according to environmental regulations; regulatory duplication and inconsistencies; taxation; uncertainty concerning native land claims and political stability; labour issues; geological data base and security use a composite index measuring overall policy attractiveness called such policy measurement as the Policy Potential Index (PPI). Zimbabwe has been given a very low index percentage based on the measurables above.

In the past large investments in Zimbabwe mining industry were initially made by Anglo-American Corporation, Rio Tinto, Lonrho and other Canadian junior mining companies in the mid 20th century and after the 2nd World War. The investment environment was then perceived as relatively stable with policies meant to promote inflow of FDI (Hawkins 2009). There are policies with indirect impact on mining which may also be cited in this write up. According to Chanda (2000) the Mining Policy, Legal and Regulatory framework prevailing in the SADC member states were on a converging trend. These features included:

2.1.1 Ownership of minerals vested in the state
2.1.2 Stationery guarantee of tenure of mineral rights
2.1.3 State participation on the decrease
2.1.4 Removal of uncertainties: granting, removal and transfer of licences
2.1.5 Investment incentives becoming more competitive
2.1.6 Environmental protection

However, for Zimbabwe problems in the other sectors of the economy spilled over to the mining sector. Agrarian reforms issues also had deleterious effect on the mining investment environment.

In Zimbabwe, the years 2005 to 2011 saw a raft of legislation and statutory instruments put in place not only to control, regularize and curb leakages of minerals but to source income for the fiscus. Shifting policies in the mining industry has not always been unique to Zimbabwe only. These reforms are motivated by a desire to encourage greater mining investment and concerns about the public and private shares of mining revenues. Boocock (2002) cited the case of Zambia, where regulatory effects of FDI were apparently negative, as government had relaxed mining policies in order to attract investment. Mining requires huge capital outlays and has a long gestation period meaning that investors have to wait longer to recoup their investments.

However, Moles *et al* (2006) state that in times of shrinking mineral markets, firms tend to shift their investment to regions that are perceived to have more stable mineral policies. Latin America is said to have drafted the most competitive mining laws dubbed by the World Bank (2006) as the Latin America Mining Law Model. As a result huge mining investments have been realized in countries like Bolivia, Chile, Argentina and Peru in the past 10 years. On the other hand, Daniel Lederman (2003) in a discussion states that there is need for developing countries, eager to attract FDI to balance their mining laws with investors' need for stability of their investment terms and parameters. In this citation the author is emphasizing on stability of the mining laws to attract and retain investment.

The Zimbabwe mining regulations have been amended many times as the government keeps on adjusting and amending the legal framework citing the need to align them to international practice. The recently promulgated law; The Indigenisation and Economic Empowerment Act (2007) is an example where the government cited the Broad Based Black Economic Empowerment (BBBEE) of South Africa as a good of policy for adoption and adaptation. The act was followed by the Minerals Marketing Corporation of Zimbabwe (Diamond Sales to Local Diamond Manufacturers) Regulations, 2010. The SI was introduced to enforce diamond producers to sell 10% of their production to local diamond cutters and polishers as a way of adding value by beneficiation.

Through an extraordinary government gazette SI 32 of 2011 was introduced in March 2011 as amendment number 3 to the Indigenisation and Economic Empowerment Act. This regulation redefined the value of the non-indigenised entity which then qualified to be compliant as $1.00 from the previously gazetted $500 000 value.

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However, Zimbabwe assured legal protection for all its investors through its constitution, which guarantees the right to private property and prohibits expropriation of private property without adequate compensation as enshrined in the Zimbabwe Investment Centre Guideline (2011) citing the constitution of Zimbabwe.

Naito et al (2001) concluded in their findings that long term success in attracting private investment depends on how a mineral-rich country adapts its legal, fiscal and institutional framework to the challenges of competitive global markets for capital and mineral products.

In Latin America as cited by the World Bank Report (2006) the mining sector underwent a massive reform to reduce real and perceived risks by designing legal safeguards and to enable an environment appropriate for investment. As a result Latin America, Chile in particular has been dominating as the destination of choice for investment in mining and exploration. The investment decisions made by corporates assume an elastic supply of investment capital, homogeneity of deposit, consistent extraction costs and other assumptions which give an investment a positive net present value (NPV). By continuously shifting the legal mining policy governments tend to destablise the smooth flow of FDI.

The Indigenisation and Economic Empowerment Act of 2007 had serious impact on the operations of most companies in the country. The law was gazetted in 2007, but government failed to come up with the requisite statutory instruments to guide companies on how to implement it. The act required all foreign owned companies to cede 51% of their shareholding to the local indigenous people. There was generally mixed feelings in the country as some viewed the act as a way of self enrichment by the politicians as history had shown that such programmes normally benefit politicians and those well connected as commented by Chanda (2009). Those views were citing the Land Reform Programme of year 2000 as an example. On the other hand some thought that it was a noble idea but the timing might not be right since the country was broke and there was no cash available on the market to purchase the majority stake in the mining firms. A lot of multinational companies like Unki Platinum, Zimplats, Mimosa and Murowa had to postpone their expansion programmes as a result of the uncertainties surrounding the Act. The researcher having analysed the broad macro environment in which the case under study operates in, it was also important to give some background information to fully understand the challenges and opportunities present.

Otto (2000) says that taxation in the mineral industry is not a new phenomenon but has been there throughout history where rulers and governments taxed mines to share the created wealth. Taxation is however, viewed by mining companies as having the greatest impact on investment decision due to the effect it poses on operating costs and hence on profitability. On the other hand Johnson (2000) identified the right to mine any deposit, and not taxation, as the most important non-negotiable factor before a mining firm will consider investing in a country.

The ultimate goal of any government's mining taxation system is to ensure the greatest possible benefit for the public while simultaneously encouraging investment in the sector. However, higher taxation levels are likely to reduce incentives to invest, and, in marginal cases, even to keep some mines operating.

Contribution of GDP by the mining industry is showing that Zimbabwe's figure is in line with other SADC countries. This is because unlike Botswana and Angola the Zimbabwean economy is diversified with agriculture and tobacco weighing in.

Mining has always been regarded as a risky business whose payback period is over 5 years. Among the top ten company decision making criteria in mining investment is consistency of policy and not taxation according to Paul Mitchel (2009). James Otto (2005) believes that investment in mining will flow to where geology is attractive, regulatory systems are workable, and taxation is stable. However it is not always the case that governments keep the taxation regimes stagnant. On the 23rd of March 2009 GOZ announced that it will review upwards the taxation and royalty structures in mining in order to bring them in line with international standards. On the 27th of January 2012 the GOZ gazetted the statutory instrument 11 of 2012 with more than 100 times increase in mining fees. The Permanent Secretary of the Ministry of Mines and Mine Development announced that registration, rental and license fees for mining activities have been revised upwards. Mining companies meanwhile argued that the new fees would make mining financially unsustainable in the country.

Paul Mitchel (2009) in his research realized that between 1985 and 2005 over hundred countries introduced new mining laws, most involving reforms to their fiscal systems, including taxation. Taxes are one of the key issues when doing business, investing or working in a foreign country as argued by Lauri Elliott (2009).

Taxation is at the centre of the mining policies, since it has a direct effect on return on investment (ROI). Taxation in Zimbabwe comes in the form of royalties, corporate tax, capital gains tax, levies and VAT. It should be noted that higher taxes have a knock on effect on after-tax profits that makes the country less competitive to FDI.

On the other hand, Daniel Lederman et al (2010) in their study argued that SADC's low FDI inflows are caused by economic rather than political or policy inconsistency risk. Citing Zambia where tax incentives were put in place to induce inflows of FDI but the net result was negative, Botswana and a few other African countries bent their backs to relax the taxation regime only to achieve negative results.

3. Methodology

The study utilized the multiple case study approach to extract mostly qualitative data. The study focused on the diamond and gold industries and two leading mines in these mining sectors namely Murowa diamonds and Freda Rebecca Gold Mine were used. However, the findings of the study can be generalised to the rest of the mining sector since the factors affecting the mining sector are generally the same across the industry. A survey was conducted on a sample size of 51 respondents picked from a population of 66 elements comprising of Murowa Diamonds, Freda Rebecca, RBZ, MMMD and COMZ Management employees. The research focused on senior management as they are the ones who are aware of changes in policies and how this impacts on productivity and viability. The research combined random, convenient and stratified sampling methods. The questionnaires were self administered by the researcher and utilized likert scaling, closed questions and open ended questions due to the insightful nature of the research. Observation was also used and the fact that one of the researchers was an experienced miner made observation a useful method.

4. Results

The research sought to assess the effects of law and policy changes in the mining of gold and diamonds in Zimbabwe and the results are presented under this broad theme.

a) Investment in the mining of gold in Zimbabwe has been on the decline during the period under review. This could be due to the ever changing macro political and legislative instruments. For gold, the decline was mainly contributed by the Reserve Bank of Zimbabwe policies on remittance of gold produced and the retention of foreign currency. Diamonds,however, registered growth in production and investment but debate is raging on concerning the accountability of the proceeds.

b) Taxation in Zimbabwe is very high and is greatly affecting the mining business in the country since it has adverse effects on the sector. Taxation is viewed by mining companies as having the greatest impact on investment decisions due to the effect it poses on operating costs and hence on profitability. The chamber of mines is currently lobbying the government to revise the royalties and taxation recently gazetted.

c) Zimbabwe has seen a significant number of policy reforms that have affected operational efficiencies and profitability of the entities in the mining sector. There have been changes in shareholding requirements brought about by the promulgation of the Indigenization and Economic Empowerment Act which stipulates that at least 51% ownership should be reserved for indigenous Zimbabweans. This has had an adverse effect on the mining sector since it has scared off foreign direct investment.

d) Zimbabwe is presently not in a position to attract and retain FDI possibly because of the volatility in policy changes and the prevailing unfriendly investment climate which makes divestment most likely. The current political and investment climate which does not respect existing ownership arrangements makes investors lose confidence in future government decisions and hence shun the country and withhold FDI. The indigenization laws and levies / fees for new and existing entries also deter foreign direct investment in Zimbabwe's mining sector. The policies should be driven by the parent ministries rather than through a ministry with no technical competencies.

e) Zimbabwe is viewed as having exorbitant taxes on mining in general and these have adverse effects on FDI inflow in the country. On the 27^{th} of January Statutory Instrument II of 2012 was passed which increases rental fees on prospective ground and exploitation of mineral resources. Taxation is however viewed wrongly by the respondents. It is based on perception than facts. The recent study by Deloitte (2012) of taxation levels of top mineral rich countries has put Australia as the top taxed nation followed by Chile and within the region Angola, Mozambique and Namibia top the highly taxed nations.

f) The western countries do have worse policies and legislation on mining than Zimbabwe. Countries like Sweden, Australia and Germany do not allow foreign companies to own large stakes in the mining industry. The threshold in Sweden is 7%. They however attract more FDI due to the consistency of their regulatory framework which makes it much easier to plan and factor in Net Present Value (NPV) when making investment decision.

5. Conclusions of the study

The current policy inconsistencies in the Zimbabwean mining sector are militating against any meaningful growth in the sector. Zimbabwe is currently unable to attract the much needed Foreign Direct Investment mostly due to high taxation, the indigenization and economic empowerment Act and the policy making framework which is generally unpredictable. Investors are concerned about the security of their investment and the consistency of the regulatory framework.

6. Recommendations

In view of the findings of the study, the researcher made the following recommendations inter alia;

a) The government of Zimbabwe should stabilize the investment environment with policies meant to promote inflow of foreign direct investment. There is need to have stability of the taxation and mineral policies.
b) The Government of Zimbabwe should consult stakeholders when formulating mining policies. There is need to balance the mining laws with investors need for stability of their investment.
c) Policies should be put in place not on political emotions but on a win-win scenario. The Economic empowerment and Indigenization Act is seen as political rhetoric meant for self enrichment by the politicians as history has shown that such programmes normally benefit politicians and the well connected.
d) The Government of Zimbabwe should speed up the ratification of the diamond policy and declare the diamond a strategic commodity to protect it from the perceived plunder and looting happening in the Marange area.
e) The mining industry through the Chamber of Mines in Zimbabwe should study new policies introduced by government before rushing to criticize without having understood the contents. The taxation regime for Zimbabwe for instance is comparable to some regional countries.

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