WHO BENEFITS FROM MINING?

Over the last few years, the tide of resource nationalism has risen globally with countries from Africa to Australia, Brazil, Canada, Chile and India considering options to increase state interventions in the mining sector. But nowhere was a debate on the desired level of state participation in mining as high-profile, emotionally charged, divisive and potentially damaging as in South Africa. Although ultimately settled against nationalisation, it has cost the country a sharp drop in attractiveness as mining jurisdiction (from 49 in 2008/2009 to 64 in 2012/2013, as measured by Fraser Institute policy potential index) and billions of dollars in deferred and / or abandoned investment. And the negative sentiment still prevails, as illustrated by the words of an exploration company Vice-President: "*Both South Africa and Zimbabwe are driving social experiments not driven by logic and economy, but by ideology. In the absence of reason, primary industries become the cash cows to fund the un-fundable. The rise of oligarchs in both countries evidences decline*" (Fraser Institute Annual Survey of Mining Companies 2012/2013).

However, despite the current macro-economic uncertainty, governments around the world are still taking, or are planning to take, ever larger shares of mining profits. Whilst straightforward nationalisation is no longer on the agenda of governments serious about economic growth, it has been replaced by a raft of interventionist measures in both emerging and well-established mining jurisdictions. These measures include: limiting foreign ownership, mandatory state share in mining projects, reviewing and auditing of mining rights and contracts, transferring of new exploration rights to state-owned companies, removing tax incentives and tax holidays, changing tax basis (on gross revenue rather than profit), introducing new taxes, royalties and licence fees, restricting mineral exports, declaring some metals and mineral commodities as "strategic" and mandating local beneficiation.

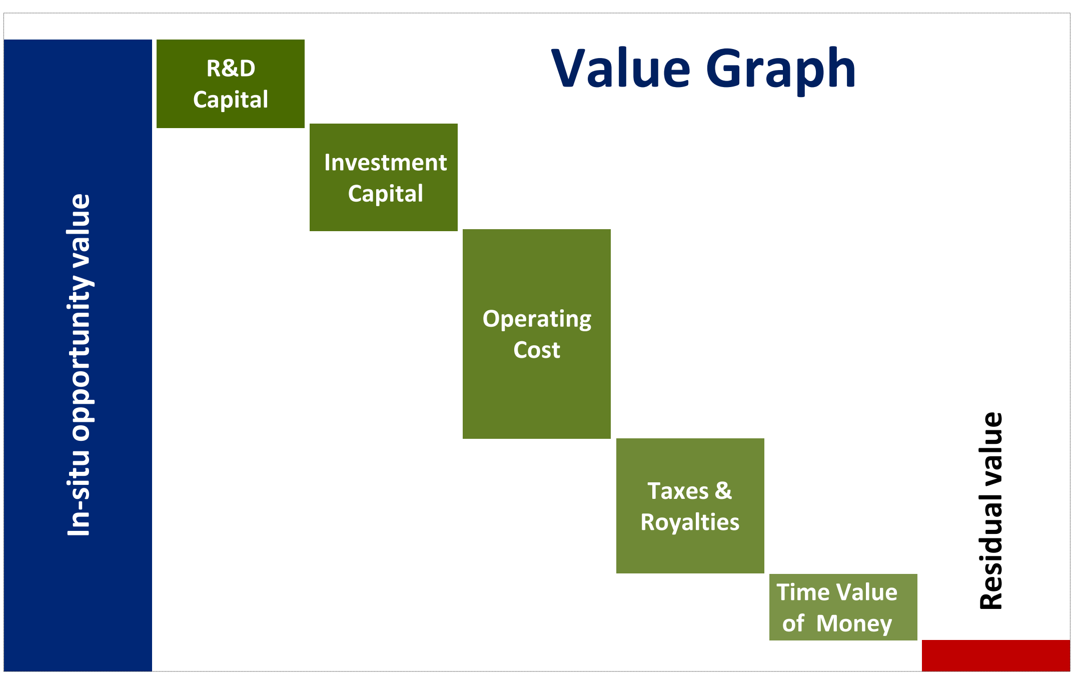
In Africa, 24 out of 54 countries rely on relatively few mineral products to generate more than 75% of their export earnings. Yet mining companies on the continent are pervasively treated with suspicion by their host governments. Mining as an industry is too often seen as closed enclave, foreign owned with few linkages to other sectors of economy, not-aligned to local aspirations, eagerly repatriating dividends and leaving behind damaged environment and scarred communities. Mining companies are also often alleged of exaggerating costs and misrepresenting production to pay less tax than is otherwise due. This results in an on-going state effort to "tighten the net" with new regulations and escalating requirements, which may in turn lead to unintended consequences and shrinking, rather than growing, of the mining pie.

The size of Namibia's mining sector is relatively modest by African and world comparisons, but with the world's fourth largest uranium production, the seventh largest diamond output and a host of smaller mining operations in other commodities, it still directly contributes 8% -10% to country's GDP. The country's historically stable and predictable regulatory and fiscal environment has earned Namibia recognition as the third most attractive mining jurisdiction in Africa, behind Botswana and Morocco. Namibia has actually improved its overall ranking from 45th place in 2011/2012 to 30th spot in 2012/2013, which was the largest jump out of all ranked African jurisdiction. It improved its ratings in uncertainty concerning disputed land claims, availability of labour and skills and uncertainty concerning the administration, interpretation or enforcement of existing regulations. Although the survey recognised that in Namibia "*mineral resources data is provided at relatively low cost to industry participants. This creates a junior-senior company level playing field thus encouraging investment*". It also noted that: "*Black Economic Empowerment (BEE) rules, the uranium moratorium, and moves by the government to change mining law are toxic to new exploration investment*" (Fraser Institute Annual Survey of Mining Companies 2012/2013). Clearly, some mining investors were concerned that sustained attractiveness of Namibia as a mining jurisdiction is being put at risk.

Without much prior communication or consultation with the mining industry, the Namibian Ministry of Finance announced in 2011 that it was considering a number of new tax measures designed to increase government revenues from mining. Although these were eventually deferred (but not all together retracted) until their potential consequences were better assessed, it caused a serious uncertainty among mining investors. The uncertainty was further escalated early this year when the Ministry of Finance issued a draft new revenue-based tax that proposed differentiated rates of tax on exported minerals. Adding to these mining-targeting resource nationalism measures are concerns about limited value from a state-owned mining company, Epangelo, which was launched in 2009. The Minister of Finance asserts that: "*We only want to make sure that we get a fair share from* (mineral) *value*" (Chamber of Mines News, February 2012) – but is the current state-share of mining profit unreasonable?

In context of this, let's examine the question of who benefits from mining simply from the high-level value creation (or destruction) point of view.

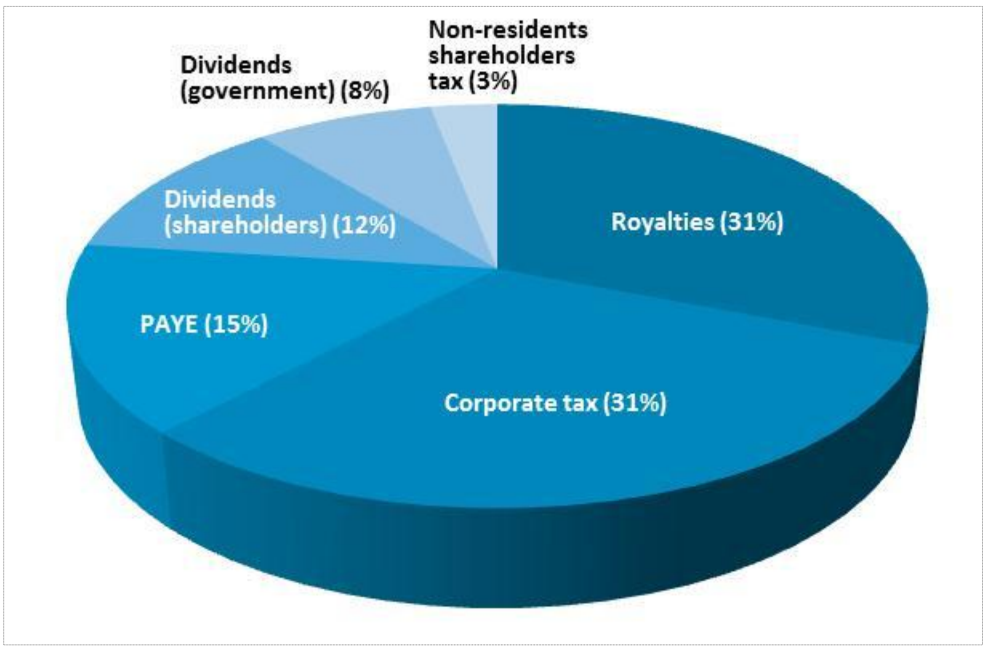
Each, not only mining, opportunity has an inherent, or "in-situ", value; which could eventually end up in the pockets of enterprising investors, if not for various concessions necessary to convert it into a commercial value all along the life-cycle of the project. These concessions, at a very high level, could include: R&D capital, investment capital, operating costs (including salaries of employees and procurement from suppliers), time value of money, royalties and taxes, etc. (refer to value graph below).



In the end, only a small residual portion of the inherent value of an opportunity finds its way to original private shareholders. In our experience, there are many successful mining projects where this residual value is only a lower single-digit percentage of the primary in-situ value. The remainder (and the lion's share of the inherent value of any commercial opportunity), ends up in the economy at large, either through state treasury or through private sector spending, where it benefits all and translates into wealth and jobs.

The Chamber of Mines of Namibia calculations show that the country's government already receives substantially more than 50% of mining profits, and these exclude additional revenues from non-residents shareholders tax (NRST) and pay-as-you-earn (PAYE) tax paid by mining employees (Chamber of Mines News, February 2012). In 2010, the private shareholders in Namibia's largest seven mines earned just 12% of value available for distribution, while the government's share was the remaining 88%, made up of corporate taxes, royalties, PAYE, dividends and NRST (refer to graph below).

The distribution of value from the seven largest mines in Namibia, 2010 (Chamber of Mines News, February 2012).



This is in line with similar figures for South Africa. Citigroup Global Markets ("Nationalisation – killing the goose that lays golden eggs", 29 June 2011) estimates that "only 7% of the value generated by SA miners gets distributed to shareholders i.e. the entrepreneur and risk taker". The biggest beneficiaries are in fact suppliers to the industry, mining sector employees and the government.

To turn an opportunity into value (and many fail along the way), requires substantial upfront investment capital and specialised and scarce skills. The question remains, why would government want to assume bigger risk of a complex entrepreneurial activity for such an incremental value, given the significant investment required?

In spite of some notable exceptions, governments' track record in managing commercial entities the world over is, at best, inconsistent ("The return of state-owned enterprise: should we be afraid?", A. Musacchio and F Flores-Macias, Harvard International Review, 31/07/2009). One can therefore question what value will ultimately accrue to society by replacing the role of the entrepreneur with a government institution. Transferring ownership from private shareholders to the state (to ensure "fair" distribution of generated value), creates a different set of incentives for public sector entities, which may potentially result in consequences contradictory to the primary intentions. While maximising shareholder value drives the management of private companies, the definition of objectives for a state principal is a lot more complex and politically charged. Alternatives such as financial sustainability, job creation, fair distribution, or community development often require trade-offs between efficiency and policy imperatives, and often blur the overall mandate. In addition, performance of managers in public sector companies is not always subject to the same level of scrutiny as is standard in the private sector and public firms do not face take-overs or bankruptcy and their associated threatening but performance-enforcing consequences.

On the other hand, for a relatively small reward or incentive, private investors shoulder the entire burden of risk in developing and managing complex opportunities. They are also usually willing to wait for returns throughout volatile economic and commodity cycles. But any entrepreneur has to be assured that this risk is worth taking, considering the alternatives to deploy their capital in the most productive manner, and the security of tenure is the very basic consideration.

It therefore appears that the intensity and profile of the debate on nationalising, or taking a greater role by the state in the mining industry in Africa, is far out of proportion with regard to the actual value that its resolution is capable of generating or redistributing. Historically, metals and mineral resources seem to have been the favourite nationalisation targets (especially at the peak of commodity cycles when windfall profits have been evident). Only the banking sector can be said to have been targeted for nationalisation with similar resolve. What is conveniently forgotten is that the global mining industry goes through alternating cycles of poor- and super-profitability, and a steady stream of positive free cash flow is not guaranteed.

The Namibian mining industry (whilst not the biggest contributor to domestic product or the largest employer) cannot be underestimated in terms of its importance to national economy. It is only natural that a society with the Namibian level of inequality (Gini coefficient of 70.7 in 2003, according to CIA World Factbook), debates the best use of its resources. However, the focus of such a debate should rather shift from re-distribution of relatively insignificant residual value, to identifying and removing impediments to growth of the mining industry. This has the potential to generate far greater wealth than is presently the case. More so, considering that efficiency, diversity, and the competitiveness of the mining sector are not questionable.

The state should ensure an environment that is conducive for economic growth, and support the private sector by providing enablers and removing obstacles to development. In such an environment, both the state and the private mining sector have at their disposal multiple instruments and tools to optimise components of the industry value graph. This can progress the developmental agenda of the government as well as accommodate fitting rewards for entrepreneurial risk. Exactly who benefits from mining, is as important a question as who would lose on its over-regulation.

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