SASPEN brief

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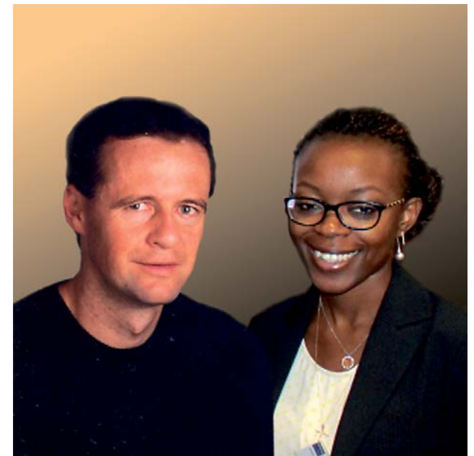
Africa's opportunity to finance social protection: The role of revenues from extractive industries



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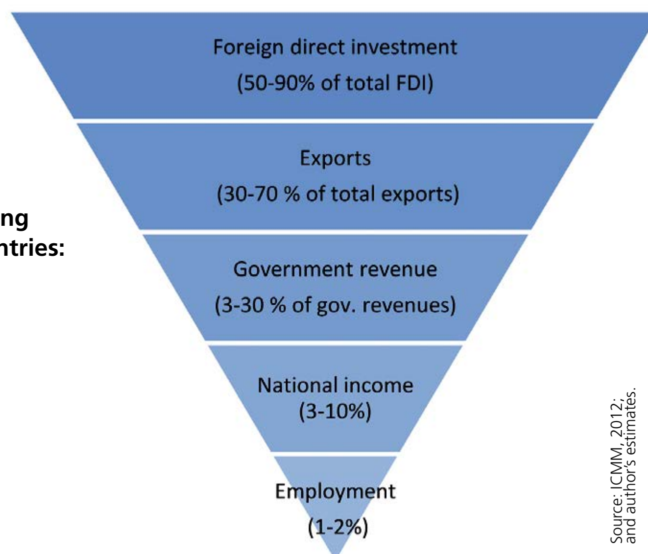
The wealth generated by the natural resources of a country should be translated in the wealth of all parts of the population of a country, but the link is far from automatic, as the past has shown. The challenge of Governments is to strike a balance between macroeconomic considerations and development goals, economic (higher productive investment, diversification strategies to reduce vulnerability) and social goals (to improve income distribution and to increase social protection). Thus extractive industries can be a major source of wealth and income to a number of resource-rich developing countries (also Mining Developing Countries (MDC)) as shown in the following figure.

Macroeconomic benefits to mining developing countries:



Source: ICMM, 2012; and author's estimates.

The mining sector is highly important in attracting foreign direct investment (FDI) in MDCs and producing for exports. It generates currency reserves and government revenues. Its direct contribution to national income is rather limited due to its lack of linkages to the rest of the economy. Moreover, its contribution to direct employment is limited because the sector is rather capital-intensive and dominated by large companies, mainly transnational corporations (TNCs). A recent calculation by the Extractive Industries Transparency Initiative for Zambia (EITI, 2013) found the following actual values for 2013 (2012): exports 68 per cent (71 per cent), FDI 3.4 per cent (62 per cent), government revenue 30 per cent (33 per cent), national income 9 per cent (11 per cent), direct employment 1.7 per cent (1.7 per cent).

However, far too little of this wealth reaches the general population. Often, economists talk about the resource curse of many MDCs due to the following negative effects:

In 2015, SASPEN and Friedrich-Ebert-Stiftung Zambia hosted a high level **international expert conference on Sustainability of Social Protection** in Johannesburg, South Africa, Oct 20-21.

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- It often causes the Dutch disease effect, appreciating the national currency thus making other export goods more expensive and leading to their decline.
- Ineffective revenue collection from extractive industries and inequitable and ineffective distribution of the mining wealth
- Lack of transparency, weak institutions and corruption
- Limited bargaining power with mining transnational companies
- Negative environmental and social externalities

But the "resource curse" is not a fatality for MDCs (see Humphreys, Sachs and Stiglitz, 2007) as it can be overcome. Indeed, the mineral rent, if better shared with the whole population under specific circumstances and national and international strategies, can be an instrument for inclusive growth and development. But the link is far from automatic, as the past has shown.

The challenge for governments is to strike a balance between macroeconomic considerations (mitigation of the business cycle and price volatilities, sterilization of currency inflows) and development goals, meaning both economic goals such as higher productive investment and diversification strategies to reduce vulnerability, and social justice and human rights goals for improved income distribution and increased social protection measures.

The following measures could help to increase revenue from extractive industries for social protection:

1. Direct government ownership: It has often been argued that state-owned enterprises suffer from underinvestment and lack of technology transfer, which is certainly true in some cases but far from automatic. Nevertheless, ample care must be taken to find the right types of contract – including licenses, joint venture and production-sharing arrangements or full nationalization – which correspond to the specific country circumstances.

While the share of Government revenues in rents from mining in Angola (83.3 per cent, oil), Ecuador (76.3 per cent, oil) and Chile (51.9 per cent, copper) is high thanks to a large share of State-owned enterprises, Zambia (17.5 per cent, copper) and Tanzania (17.9 per cent, gold) have a rather low share. More recently, some countries have taken steps to renationalize their extractive industries to improve the distribution of the rent, to expand the production or/and to encourage local transformation of primary commodities.

Table: Share of Government revenues in rents from oil, copper and gold (2004 & 2012)

		2004	2012	Cumulative share
Oil	Angola	63.2	95.1	83.3
	Colombia	32.7	55.1	41.1
	Ecuador	71.8	93.5	76.3
	B.R. Venezuela	58.4	70.9	64.1
Copper	Chile	50.9	55.5	51.9
	Peru	23.5	47.0	32.7
	Zambia	0.8	30.5	17.5
Gold	Ghana	20.1	32.8	27.7
	Mai	21.4	28.3	33.6
	Peru	23.7	29.9	27.7
	U.R. Tanzania	17.3	28.5	17.9

Source: UNCTAD, 2014

2. Raising the tax base: In many countries the private sector takes the lead in the exploitation of natural resources. The State is indirectly included in the mineral rents, as it receives part of the rent in the form of taxes, as follows:

- *Production-based taxation:* per unit or ad valorem royalties, sales taxes, export and import duties, VAT, land rents, property tax, payroll tax, registration fee and stamp duty;
- *Profit-based taxation:* corporate income tax, resource rent taxes, taxes on windfalls, tax holidays, accelerated depreciation periods, tax-free remittances of profits, capital cost allowances, profit tax on dividends, royalty based on profit, taxation on capital gains; and
- *Environmental taxes:* to compensate for negative environmental effects caused by the activities of the mining companies.

These are only options; there is no recommendation made on which taxes are the right choice, as this is country-specific. The advantages and disadvantages of each tax have to be understood (UNCTAD, 2014a and b; Commonwealth Secretariat and ICMM, 2009) as well as the social impact on different household groups assessed.

Current developments worldwide are in favour of reaping more benefits from mineral wealth, even though in the short to medium term, the growth perspective of extractive industries is not very promising. Bargaining power has changed again in favour of MDCs, as new actors have appeared in the sector from emerging countries such as Brazil, China and India (UNCTAD, 2014a). Increased competition has led to a sort of implicit basic tax harmonization without negatively affecting investment flows (Hinojosa et al., 2010). As a result, successful renegotiation or cancellation of existing contracts, mainly in Latin America (Bolivia, Argentina, Venezuela), successful changes in taxation in favour of countries (e.g. Zambia, or even in OECD countries such as the United Kingdom) are common now. Global and national initiatives to increase transparency around contracts with transnational corporations (TNCs)

Box 1. Zambia: Changes in the fiscal regime for mining, 2006 and 2010

Zambia is perhaps the most prominent example of a country having raised various taxes since 2006. In particular, the 2008 Act which established uniform rules and regulations with minimum company-specific exemptions was a milestone in the reform of the tax regime.

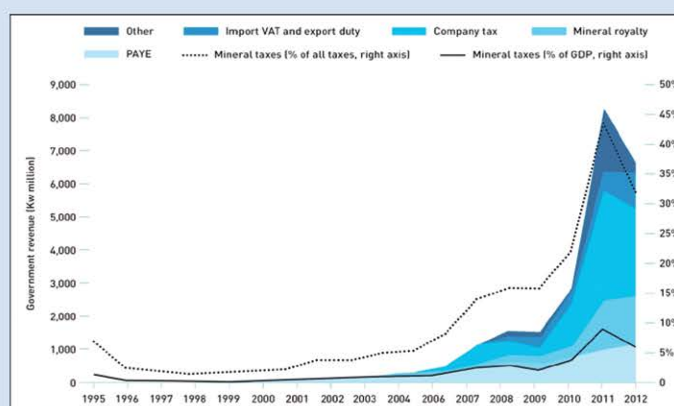
Zambia: Changes in the fiscal regime for mining

Measure/Year	2006	2010
Royalty	0.60%	6%
Corporate Income Tax	25%	30%
Variable Income Tax	No	Yes
Windfall tax	No	No*
Custom duties	Exports = 0	15 % for unprocessed copper
Income of foreign subcontractors & interest	0%	15%

Note: * Introduced in 2008, but then abolished after the global financial crisis.
Source: Simpasa et al., 2013, based on Zambia Revenue Authority and IMF, 2012.

Zambia also introduced institutional reforms such as the creation of a large taxpayers' office and a gradual strengthening of the revenue collection framework. Tax administration is thus relatively effective, with limited tax leakages, compared with other African countries (Chamber of Mines of Zambia and ICMM; 2014). The abolition of the windfall tax is an interesting example of political economy. Introduced in 2008, it was most likely the global financial crisis, combined with threats by TNCs to lower investments, probably to close mines and to take legal action against the measures that brought the Government to give up on this measure.

Zambia: Fiscal revenues from the mining sector, 1995–2012



Source: ICMM, 2014, based on original data from the Zambia Revenue Authority.

In the year after the introduction of the 2008 Act, tax collection was rather disappointing with a rise from KW 1.1 billion in 2007 to KW 1.5 billion. The main reasons for this result were delays in tax payments due to disputes concerning the Act, combined with a fall in copper production due to the worldwide crisis. Since then, government revenues have improved considerably, from less than KW 1,000 million per year before 2008 to Kw 6.619 billion in 2012 (and US$1.5 billion in 2013 according to EITI (2013): over30 per cent of total tax collection. Among mining countries (excluding petroleum) worldwide, Zambia's receipts from mining are the second highest after Botswana, higher than revenues in the Democratic Republic of Congo, Chile or Guinea.

Source: Chamber of Mines of Zambia and ICMM, 2014

and taxation issues are another encouraging sign. There is still potential for further regional and international agreements on taxation to avoid tax competition, and a need for improvements in tax administration to enforce national rules more effectively. But recent trends in the effort to increase and better distribute mineral wealth to the general population in MDCs are encouraging.

3. Creating national resource funds: Government revenue coming from the extraction of non-renewable resources is a particular source of income as it is related to the depletion of national wealth in the long run. Therefore, this common wealth should be shared with the whole population for equity reasons and also in time among generations through saving schemes (Davis et al., 2001). These types of fund represent an opportunity to combine macro-stabilization policies, including counter-cyclical fiscal policies, with the goal of sustainable social protection systems. Given the volatile nature of primary commodity prices, many governments have created "stabilization funds" based on windfall taxes. Instead of spending the revenue on social and other development programmes, governments have accumulated such funds because they allow a smoothing of government income and expenditure, keeping savings in years of bonanza for "rainy days" when prices of commodity exports may be low, and hence ensuring that investments in social and economic development remain constant over time.

Botswana moved up from a least-developed country level to upper-middle, also thanks to the effective handling of mineral rent. Even though mineral revenues have not been earmarked, most of the mineral rent (Pula fund) has been used for human and capital investment (infrastructure, education, health) and not for recurrent spending, according to a recent OECD study (Korinek, 2014). In addition, a recent UNRISD study (Hinojosa et al., 2010), found that an initial good quality of institutions seems to be associated with effective resource management (Botswana, Chile, Norway).

The creation of such a fund is not a miracle solution and should be evaluated with caution, as it is prone also to rent-appropriation behaviour by elites. It could create a type of parallel budget, opaque, without any control (Karl, 2007). Moreover, MDCs are often not capable of effectively absorbing a high increase in resource rents, which leads to investments in low-yielding projects (see Chang, 2007). Governments often change, and with them political direction about the use of the funds. Rules could be introduced to set up quantitative constraints to government's discretionary use of the fund (see Humphrey and Sandbu, 2007). In addition, when setting up a fund it is not just the optimal solution from a fiscal policy point of view that should be considered, but also political (dis-)incentives in the national context.

Concluding remarks

There is certainly a need for technical assistance, including skills development, to MDCs in formulating fiscal strategies which on the one hand invest into "extracting" more revenues from extractive industries, and on the other hand channel these funds into activities promoting not only economic development, but also social development through sustainable social protection systems. For a long time, mineral wealth was rarely used for social protection purposes. Currently, an increasing number of countries are aware of the importance of a proper social protection system and investing more into tax administration. Also, TNCs have recognized the importance for reputational reasons of increasing their social investments, particularly in obtaining "buy-in" for their mining projects on the part of local communities and civil society organizations.

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