SARW
Southern Africa Resource Watch

Resource Insight
Issue No 3 August 2007

Copper Boom in Zambia

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Southern Africa
Resource Watch

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Issue 3   August 2007

Resource Insight is published by the Southern Africa Resource Watch
Sothern Africa Resource Watch (SARW) is a project of the Open Society Initiative for Southern Africa (OSISA).

ISSN: 1994-5604
Key title: Resource Insight

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Contents

Acronyms

BGRIMM	Beijing General Research Institute of Mining and Metallurgy
GDP	Gross domestic product
EITI	Extractive Industry Transparency Initiative
IMF	International Monetary Fund
ZCCM	Zambia Consolidated Copper Mines

Zambia

INTRODUCTION

Zambia was the first country on the African continent to produce copper and its economy has historically been heavily dependent on the mining of copper and cobalt. Once a middle-income country, Zambia began to slide into poverty in the 1970s when copper prices declined on the world market.[1]

The copper industry is a major provider of employment in the country and the current high copper prices on the international market after a three-decade slump have led Zambians to believe that there will be a marked improvement in their conditions too. The country's economic prospects have also been transformed by debt relief.

But the Zambian government has not received an adequate share of the huge profits gained from copper mining. This is evident from the nature of the contracts that the Zambian government has entered into with the new investors in the copper mining industry. It remains to be seen also whether even the small profits will be passed on to the people of Zambia.

According to the statistics presented to parliament in February 2007 by the Minister of Mines and Minerals Development, government revenue from copper as a proportion of the value of copper extracted from the Zambian mines is small. Zambia needs to receive a bigger share if the revenue from copper is to contribute to the development of the country. This view is supported by the studies undertaken by Christian Aid in January 2007.

Zambia received about US$752 million in various taxes from foreign investors holding large-scale mining licences for the period 2002–06. Experts in the industry estimate that the government could in fact have earned about US$70 million from the total sales of approximately US$3 billion from the copper mining industry in 2006 alone. However, the amount received may not be enough to enable the Zambian government to make an immediate and significant impact on poverty (estimated to be over 60 percent) or to provide social services.

The prevailing question, therefore, is whether the Zambian people are being adequately rewarded from this boom in the copper price. The price of copper is as much as US$7.75

per tonne[2] on the London Metal Exchange, up from xxx in 19xxx.

This paper attempts to answer the above question and highlights issues that limit Zambia's ability to fully benefit from the copper boom. It examines the incentives given to the new mine owners, their willingness to comply with domestic laws on pollution control and employment regulations, and the Zambian government's ability (or rather inability) to enforce the provisions of development agreements.

Copper Industry and Privatisation

Copper mining industry in Zambia

Zambia's economic development since the 1920s has been heavily dependent on the copper mining industry. Copper mining is Zambia's largest industry and it is responsible for over 60 percent of the country's foreign exchange earnings. Some 15 percent of Zambia's total workforce is employed in the copper industry and it contributes over 10 percent to gross domestic product (GDP).

Zambia's copper production jumped by 7.1 percent in 2006 as a result of increased investment in the mining sector: output increased from 459 324 tonnes in 2005 to 492 016 in 2006 and the target for 2007 is 600 000 tonnes.

Over the past 30 years, however, the copper mining industry suffered serious setbacks caused by insufficient re-investment, falling production and a world slump in copper prices. The industry went into steep decline, with copper production dropping from an annual output of 700 000 tonnes in the 1970s to about 368 000 in the mid-1990s. The negative impact on the Zambian economy was mitigated to some extent by the government's decision in 1997 to privatise the mines. This created opportunities for new investment in the industry, but it also created challenges in ensuring that gains from the copper resources benefited the majority of Zambians.

Prior to the privatisation process, the copper mining industry was dominated by Zambia Consolidated Copper Mines (ZCCM), which operated ten integrated mines, three smelters, two refineries and a tailings leach plant. ZCCM was owned by the Zambia Industrial and Mining Corporation (60.3 percent), ZCI Holdings (an Anglo-American subsidiary) (27.2 percent), RST International (7.0 percent) and the public (5.5 percent).

The objectives in privatising the ZCCM were to:

- transfer control of and operating responsibility for the ZCCM's operations to private sector mining companies as quickly as possible;

- mobilise substantial amounts of committed new capital for the ZCCM's operations; ensure that the ZCCM realised value for its assets and retained a significant minority interest in its principal operations;
- transfer or settle the ZCCM's liabilities, including third-party debt;
- diversify ownership of Copperbelt assets;
- promote Zambian participation in the ownership and management of the mining assets; and
- conduct the privatisation as quickly and transparently as is consistent with good order, respecting the other objectives and observing the ZCCM's existing contractual obligations.

However, the above objectives (particularly the last two) have not been met in full. In terms of "realising value", the US$25 million, US$28 million, US$35 million, US$17.5 million and the US$20 million purported to have been paid by foreign investors for Konkola Copper Mine, Kansanshi Mine, Luanshya Mine, Chibuluma Mine and Chambishi Metals respectively are regarded as low by local industry experts, even taking into consideration the uncertain world market at that time. They argue that at the time of privatisation the quantity of copper ore already mined and brought to the surface was worth about the same as the amount paid by the investors. There are now misgivings regarding the advice that the World Bank and International Monetary Fund (IMF) gave to the government to expedite the sale of the mines. This advice was based on the fact that the government was losing approximately US$1 million a month by subsidising the mines.

The objective to promote Zambian participation in the ownership and management of the mining assets has also not been met. There has not been significant shareholding interest by Zambians in any of the privatised mining firms. In addition, the fact that many Zambians are not aware of the contents of the various development agreements and the conditions under which the mines were privatised suggests that the level of transparency was inadequate. And this means that the objective to conduct the privatisation as "quickly and transparently as is consistent with good order" has not been fulfilled either.

Privatisation of the copper mines

The government unbundled the ZCCM and sold its assets in business packages on the advice of German-based firm Kienbaum Development Services. The latter was contracted by the World Bank. As a result of the advice, the following asset packages/units were sold in 1998.

- *Chibuluma Mine* was sold to the Metorex Consortium comprising Metorex, Maranda Mines (both South African junior mining companies), Crew Development Corporation (a Canadian development company) and Genbel (formerly Randex) (an Australian finance company).

- *Luanshya Mine* was sold to Binani Industries, an international company registered in both the United Kingdom and India, but it failed to operate the mine profitably. The mine was repossessed and has since been offered to Switzerland-based J&W Holdings.

- *Chambishi Mine* was sold in 1998 to China Non-Ferrous Metals Foreign Engineering and Construction Corporation of the Peoples' Republic of China for about US$20 million after the pull-out of a Canadian firm which had pledged to acquire the mine at US$100 million. Chambishi has not been operating effectively since 1998. Apart from mining activities, the Chambishi Mine has shareholding interests in the Beijing General Research Institute of Mining and Metallurgy (BGRIMM), a firm that was established to manufacture explosives for the mining industry in Zambia and the sub-region. In an extreme case of neglect and irresponsibility the new owners of Chambishi Mine allowed the infrastructure to rot after it was flooded.[3]

- *Kansanshi Mine* was sold to United States–based Cyprus Amax Minerals. The mine is flourishing and has made a significant contribution to the development of the surrounding Solwezi area. For example, there is an increase in the number of small businesses owned and managed by Zambians who provide services such as transportation to support the mining activities.

- *Konkola Copper Mine* was sold to an Anglo-American subsidiary, but the Anglo American Corporation pulled out of Zambia in 2001. Konkola has since been awarded to India-based Vendatta.

- The *Chambishi Cobalt/Acid Plant* was acquired by Avmin following the withdrawal of the Kafue Consortium.

- The *precious metals plant* was awarded to the Binani group. Binani, operating under a company called Minerva, failed to run the company. The company's assets have since been stripped and the company has been liquidated.

The method used by the Zambian government to privatise had both good and bad points. Some of the motivations given for unbundling the assets were that it enabled the government to privatise individual units quickly and encouraged competition in the mining industry. This view is justified in that the choice of a single bad investor would have had catastrophic results for Zambia's economy and probably not even a fraction of the current gains would have been achieved. However, there are those who believe that the move to unbundle the assets robbed the industry of the ability to gain leverage from the strengths and weaknesses of individual units and to thereby prevent the negative social impact of state divestiture, as in the case of Luanshya where workers went without wages for months. This mine was not generating enough revenue then to cover its costs.

Zambia's Development Agreements

Out of the nine foreign firms with development agreements operating in Zambia, seven were sold to foreign investors under the privatisation programme. The nine copper mining firms with development agreements are: Konkola; Mopani; Chambeshi; Luanshya; Kansanshi; Bwana Mkubwa; Chibuluma; Lumwana; and Albidon (Z).

It has been speculated that the development agreements signed by the government and foreign investors contain provisions that are not in the best interests of the Zambian people. For example, these contracts are said to contain provisions that allow the mining firms to outsource some of the mining operations to foreign contractors who can employ Zambians on a casual basis. This "casualisation" practice allows companies to continue re-hiring casual workers with short-term, three-month contracts to fill permanent positions without the obligation to pay gratuities, retirement or health benefits.

As a result of these employment and labour engagement practices, the number of foreigners working in Zambian copper mines has increased rapidly. It is estimated that 850 work permits were issued to mining expatriates between 2004 and 2006.[4] This practice of engaging foreign contractors along with their foreign labourers has been objected to by the local people given the high levels of unemployment in the country.

There are other issues that require close examination. For example, very little mention has been made of gold as a by-product by the investors in the Kansanshi mine. It is a well-known fact that during the ZCCM days, Kansanshi was almost categorised as a gold mine. What is happening to the gold that the ore may be bearing?

A typical development agreement may contain the following clauses.

1. Government undertakes that, during the stability period usually of 20 years, it shall not by general or special legislation or by administrative measures or decree or by any other action or omission whatsoever vary, amend, cancel or terminate this Agreement or the rights and obligations of the Parties …

2. The Tax regime applicable to (name of the company) shall include the following:

Income Tax
Subject to the provisions relating to deferred taxes:

a. The company (name specified) shall pay to GRZ [Government of the Republic of Zambia] income tax of 25 percent in accordance with the provisions of the Income Tax Act on taxable income arising from all mining, concentration, smelting and refining and other related activities.
b. … allowing the deduction of 100 percent of capital expenditure in the year in which the capital expenditure was incurred provided the facilities continue to be owned by a single legal entity.

Mineral Royalty
… the company shall pay to GRZ a mineral royalty on the gross value (as defined in the Income Tax Act) of the mineral produced in the mining area at the rate of 0.6 percent. The mineral royalty paid under the Act shall be deductible against liability for income tax.

Customs and Excise Duties
Subject to the provisions relating to deferred taxes, the company shall:

a. be exempt from payment of customs duty on grinding balls for a period of five years (and GRZ shall reasonably consider any longer period as can be justified by the Company as being necessary …)
b. be exempt from payment of excise duty on electrical energy until the end of the fifth year of the date of commencement of commercial production …
c. be exempt from payment of excise duty of fuel until the end of the fifth year of the date of commencement of commercial production.

It has been said that this type of development agreement has led to the plunder of Zambia's natural resources with little benefit for the majority of Zambians. For example, under such agreements the company's are being allowed to pay income tax at 25 percent when the normal corporate tax rate in Zambia is 35 percent, and mineral royalties are being paid at 0.6 percent when the normal rate is 2.5 percent The "generosity" of the Zambian government in giving mine owners reduced tax rates and exempting them from paying excise duty has meant that Zambia and its people have been deprived of much needed tax revenue.

Impact of the Boom on Zambians

The new investors lack human heart

Undoubtedly, the mining of copper has impacted both positively and negatively on the lives of Zambians. The copper mining industry employs over 40 000 Zambians directly and contributes over 10 percent to the national GDP. The mining industry has contributed approximately US$652 million in corporate taxes to government revenue since 2002 (US$173 million in 2005 and US$303 million in 2006), and in terms of mineral royalties, the mining companies have paid the government of Zambia approximately US$23.2 million since 2002 (US$7 million in 2005 and US$14 million in 2006). But relative to corporate taxes and mineral royalties paid elsewhere in the world, these figures are in fact low. In addition, despite the huge return on their activities, foreign-owned copper mining companies in Zambia are not investing in the local communities or workforce in the areas in which they mine. As such, Zambia's economy has been growing at a rate of 5 per cent a year over the past couple years, but this growth has not been passed on to the Zambian people.

Prior to the privatisation of the mines, the Zambian government used the assets of the ZCCM to diversify the economy. For example, the ZCCM established subsidiary firms that focused on tourism (Kasaba Bay Lodge, Manchichi Bay in Siavonga), agriculture (Mpongwe Farm in Ndola), agro-processing (Mulungushi Milling) and transport (Mulungushi Traveller). The copper mining companies (both in private hands before independence and in public hands after independence) developed and maintained social infrastructure such as hospitals, schools and sports facilities. The investors knew that it was in their best interests to motivate the workers in some measure.

The selling of the mines to foreign investors in a somewhat haphazard fashion had its own advantages and disadvantages; however, the negative effects seem to have outweighed the positives. For example, the production of copper initially took a sharp downward fall and there was massive retrenchment of employees resulting in reduced economic activities.[5]

Furthermore, the new investors in the mining industry are not contributing as much to the local social infrastructure, although Lumwana mine in the North-Western Province currently being developed by Australian-based Equinox Minerals might prove to be the exception. Lumwana is Zambia's newest and largest copper mine and it is said to have the largest undeveloped copper deposits. Supporting infrastructure is being developed by local firms, including the railway line and housing units.

A comparison between copper mining towns before privatisation and now during the boom will show that conditions have not changed for the better. The roads have potholes and are still in poor condition, training programmes for artisans has been abandoned, football fields are unkempt, and the new mine owners no longer operate hospitals and schools.

It is therefore not surprising that Zambians are challenging the entire economic model espoused by the Zambian government. They are aware of the inadequate maintenance of social infrastructure left by investors in the mining townships and argue that as much as the country needs foreign investment it must also ensure that it is self-sustaining. It is not judicious for the Zambian government, with its highly educated economic technocrats, to allow foreign companies to operate without having to pay import or value added taxes indefinitely. When will the finance minister levy taxes on minerals that will eventually result in decent salaries being paid to Zambian civil servants?

In Zambia and in other mineral rich countries, the companies and not the state are keeping the profits from high metal prices. Poor people in mineral-rich developing countries are missing out on the benefits of higher commodity prices while large multinational oil and mining corporations make record profits. A Christian Aid report alleges that "secret" deals in Zambia have tied the government into 20-year contracts, allowing mining companies investing in the newly privatised copper mines to pay virtually no taxes or royalties. The report alleges that Zambia receives only around 0.1 percent of the value of its copper resources.[6]

Environmental and human rights issues

Copper mining and processing is not kind to the environment. There was, for example, spillage of hazardous material from the Konkola Mine into the Kafue River in December 2006. The Environmental Council of Zambia threatened to take the company to court but did not proceed, leaving some Zambians questioning why the council did not take action when it had a legal right to do so.

Pollution from the mining of copper also threatens the health of the residents in the area. For instance, continued use of reverberatory furnaces for smelting produces a large volume of hazardous sulphur dioxide gas. A number of respiratory illnesses have been recorded among inhabitants in Copperbelt Province, with asthma and lung diseases two of the most reported cases. In addition, open-pit mining deforms the surface of the land and creates waste materials containing dangerous substances that pollute the water, soil and atmosphere.[7]

A fatal accident at BGRIMM factory in April 2005 was responsible for the deaths of over 45 Zambians. The cause of the accident has not been made public officially but it has been speculated that the accident was caused by inadequate or poor safety measures, including the use of untrained Chinese personnel. The Chinese government offered US$10 000 compensation to the victims of the accident, although no negotiations were held with the families of the victims. It has not yet been established whether the workers were insured or not.

The African people are beginning to resent the presence of the Chinese despite the large financial investment flowing from Beijing into sub-Saharan Africa.[8] There have been widespread allegations that the Chinese treat their workers badly, paying them poorly and forcing them to work long hours in sometimes dangerous conditions. This has resulted in violent anti-Chinese protests in Zambia.[9] Certainly China is no different to the Western governments with their practice of illegally replacing democratic regimes with dictators and extending open and sustained political and financial support to kleptocratic and dictatorial regimes, which have contributed extensively to Africa's misery. There is no doubt, however, that the money pouring in from China can have potentially dire consequences for the economics and politics of the continent.[10]

The Case of Revising Mining Contracts

Government's tax revenue

As mentioned, the revenue that the Zambian government has been receiving from the new investors in the mining sector is minimal, due to the nature of the 20-year contracts that the government entered into with the copper mining companies in terms of which they pay virtually no taxes.

The new investors are now making significant profits. For example, First Quantum, part owner of Mopani Copper Mine, reported net earnings of US$4.6 million in 2003, rising to a staggering US$152.8 million in 2005. Similarly, Konkola Copper Mines' operating profit rose from US$52.7 million in 2005 to US$206.3 million in 2006. However, government revenue from the mining sector has not kept pace with these huge increases in profit. In 2006 the Zambian government earned US$70 million from about US$3 billion turnover from copper sales. This is not reasonable even if the case for recapitalisation is being advanced.

As mentioned, the review undertaken by Christian Aid pointed out that government revenue from copper is miniscule compared to the value of the copper extracted from Zambia's mines and that a much larger share of the revenue is needed if copper is to contribute to the country's social and economic development. But the Zambian government is unable to enforce certain provisions in the agreements, and the investors are neglecting to fulfil certain obligations. For example, investors committed to promote local business developments but they are not implementing this satisfactorily and there is no mechanism for monitoring or enforcing the progress in this regard.

The issue of windfall gains therefore requires more attention, having been highlighted only this year by ZCCM Investment Holdings, a public institution that holds government interests in the privatised mining companies. If implemented this measure would allow government to share in the huge profits new mine owners are earning as a result of the high copper prices.

Preferential tax concessions (25 percent instead of 35 percent) and low royalties (0.6 percent instead of 3 percent) which were granted to mine owners in the development agreements are responsible for the government's low revenue collection. In addition, new investors are allowed to deduct capital expenditure from profits, further reducing claimable taxes for the government. A World Bank study conducted in 2004 confirmed this. The study revealed that Zambia's mining firms enjoy a marginal tax rate of zero.

Mwanawasa demands a revision of the tax regime

This situation, along with pressure from the Zambian people, has forced the government to consider reviewing the mining tax regime. During his successful 2006 election campaign for a second term, President Mwanawasa promised to consider revising concessions currently enjoyed by the mining companies to ensure a more even balance. Another force urging this change was main opposition figure, Michael Sata's, election pledge to raise taxes paid by the mines.

Reminded of the fact that in the process of privatisation it cheated itself and the country of much needed revenue, the Zambian government is now trying to redeem itself by introducing new clauses to the development agreements. It wants to include, for example, issues of corporate social responsibility in future development agreements. In fact, behind this move is a desire to completely overhaul conditions in the mining sector. The government has already expressed its intention to review certain clauses that have deprived Zambia, one of the poorest countries in the world, from benefiting from its copper resources.

In June 2007 the Zambian government threatened to cancel mining licences that have not been used since they were granted (years ago in some cases) and to reassign them to new investors.[11] Part of this process will also include investigating companies operating outside the allocated areas stipulated by their licences.

Mines and Minerals Development Minister Kalombo Mwansa has warned that licences not being used in accordance with the law will be withdrawn and handed to groups of Zambian investors.[12] In May 2007, President Mwanawasa expressed concern about investors who obtained licences but never started mining operations. Big companies such as Canada's First Quantum Minerals, London-listed Vedanta Resources, Swiss-based Glencore International and Australia's Equinox Mineral could be affected because they own huge tracts of land.[13]

The Zambian government has also announced its intention to renegotiate increases in mineral royalties and corporate taxes with foreign investors, and it is believed that President Mwanawasa himself will lead the negotiations with chief executive officers of key copper and cobalt mining companies. It is proposed that mineral royalties will increase from 0.6 percent to 3 percent and corporate tax from 25 percent to 30 percent.

This is a positive move, but transparency in the use of revenues from mines is also critical. In keeping with this it will be vital for the Zambian government to reflect the intent of the Extractive Industry Transparency Initiative (EITI) by voluntarily publishing details of revenues, and for companies to report their taxes in a form that citizens can understand. There should also be third-party (civil society) verification; without such information it will be impossible for civil society to participate effectively in any consultative process as required by the EITI. However, the complex set of taxes, fees, and duties are impossible for civil society groups to understand without greater industry knowledge. Zambian civil society must therefore acquire in-depth understanding and insight into the workings of the extractive industries to enable them to monitor the behaviour of both the government and the mining companies.

It is encouraging that the mining companies in Zambia seem amenable to such negotiations, unlike companies in other countries such as the Democratic Republic of the Congo where the government is experiencing resistance to the revision of 60 mining contracts. Zambian Finance Minister Ng'andu Magande assured Zambians that "there is a process in place that is diligently observed to ensure that tax audits are conducted to verify the profits declared by mining companies." It is ironic that the IMF which spearheaded Zambia's rush into privatisation announced its support for the Zambian government's mining initiatives in January this year. According to the IMF representative to Zambia, Birgir Amason, the concessions enjoyed by investors were not helping the country to generate resources "to channel into social programmes".[14]

As the Zambian government takes actions to increase taxes and royalties on its minerals, it must take note of the fact that copper is a diminishable resource and that booms are cyclical in nature. Revenue collected from the mining companies should therefore be used to diversify the economy in order to safeguard it against a collapse in the event of falling international copper prices.

Conclusion

There is no escaping the fact that Zambia and its people have not profited from the copper boom to the extent that foreign investors have. The amounts received in taxes from the large-scale copper mining industry has not had a visible socio-economic impact on the majority of Zambians: one percent of the value of copper extracted and sold by the foreign owners of the mines is insufficient for the rapid advancement and development that is necessary if Zambia is to attain the Millennium Development Goals.

The Zambian people have not seen a notable improvement in their living standards since the copper boom and they have begun to question whether the decision to privatise the mines was justified. The government's lack of foresight and its inability to consolidate its agreements have also contributed to its failure to fully benefit from the copper boom.

Notes

1 http://en.wikipedia.org/wiki/Zambia
2 Price on 30 July 2007. See http://africa.reuters.com/business/news/usnBAN038550.html
3 Rose, David 2007, *A rich seam – who really benefits from the commodity price boom, case studies of Bolivia, Zambia and Philippines.* Christian Aid, January, 2007.
4 "Lifting the lid on Kansanshi Mine", *Times of Zambia*, 31 January 2007.
5 *Times of Zambia*, 30 January, 2007.
6 Christian Aid, available at www.christianaid.org.uk.
7 Mekesell et al 1989, *The World Mining Industry*. London: Allen and Unwin,
8 Whatever its economic effects, observers say that the river of Chinese money, even without explic it political intent, could have a malign influence on Africa's political development (see Beattie Alain, "Loans that could cost Africa dear", *Financial Times*, 23 April 2007).
9 Ibid.
10 Ibid.
11 "Zambia says plans to cancel unused mining licences", *Reuters*, 12 June 2007.
12 Ibid.
13 http://www.mningweekly.co.za/article.php?a_id=110798
14 "IMF believes the risk reward scales are skewed in favour of miners". See http://www.mining weekly.co.za/article.php?a_id=100150.