ZAMBIA LURED BY THE SIREN SONG OF RESOURCE NATIONALISM

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Legal Briefings – By **Peter Leon, Partner**

Zambia, the world's seventh-largest copper producer, is the latest leading African mining jurisdiction to succumb to the siren song of resource nationalism. In recent years this trend has seen international miners and their host governments in Tanzania and the Democratic Republic of Congo clash over swingeing tax changes and other regulatory imposts.

The government's current court application, through its state-owned proxy ZCCM Investments Holdings, to liquidate Konkola Copper Mines, a business controlled by Vedanta Resources, has been greeted with alarm and marks the culmination of a three-year clampdown on private, and especially foreign, influence in the mining sector. In 2017, the Zambia Revenue Authority (ZRA) initiated a mining industry tax audit, claiming it was losing $3bn annually through "illicit financial flows", mostly in the mining sector.

In 2018, the ZRA slapped Canada's First Quantum with a $7.9bn tax bill, which remains unresolved. In September, the government announced a series of fiscal reforms: introducing a new 5 per cent import duty on concentrates; increasing royalties by 1.5 per cent and making them no longer tax-deductible; while replacing value added tax with a non-refundable sales tax.

The latter is significant, as mining companies were owed $600m in VAT refunds at the end of 2018. Then in January, the ZRA declared it would not pay, claiming that its (unpublished) audit showed mining companies owing more than this in unpaid taxes, penalties and interest.

So why is the government doing this? And why now?

Typically, resource nationalism manifests in response to certain cycles. Most fundamental is the investment cycle. Countries that are rich in natural resources, but lack the capital, operational and technological resources to extract them profitably, adopt liberal legal frameworks and fiscal incentives to entice foreign investors (who may otherwise invest elsewhere, if it promises a better return on their capital outlay).

Once investments are made (and capital sunk), the government may flex its legislative muscle to claim a greater share of the returns than the original laws or licence terms allowed.

Whether a government does this depends on one or both of the following immediate factors. Commodity cycles drive resource nationalism in countries that are highly dependent on raw mineral exports: during a period of price depression, the state receives less revenue from royalties and export duties, but a subsequent surge in prices presents an opportunity to feed the fiscal deficit by extracting higher rents from mining companies.

Electoral cycles also drive resource nationalism in countries that have regular elections with relatively close margins, as incumbent governments often seek to increase their support by exploiting the populist appeal of resource nationalism.

Zambia is no exception, but is in fact a stark exemplar of both price driven and populist resource nationalism.

The country's finances are extremely sensitive to the price of copper, which accounted for 80 per cent of export earnings in 2016, when copper's price per tonne reached a 10-year low of $4,800 a tonne, down from its 2010 peak of $8,800. That year, Zambia boasted annual GDP growth over 10 per cent and a fiscal deficit of 3.3 per cent.

But by the end of 2018, after four consecutive years of sub-4 per cent economic growth, the deficit had ballooned to 7.5 per cent of GDP, and Zambia had accumulated over $10bn in external debt (73 per cent of GDP), despite having had most of its debts extinguished under the IMF's "heavily indebted poor countries" scheme in 2005.

On top of this acute fiscal strain, the government also faces intense electoral pressure. President Edgar Lungu won the 2016 election with just over 50 per cent of the popular vote, only 2 per cent more than his rival Hakainde Hichilema.

After losing a critical by-election in the Copper belt region in April, and facing another general election in 2021, the Lungu administration now claims that the country's mines were "sold [to foreigners] for a song [in the early 2000s] because Hichilema and his cartel misled then President Mwanawasa".

It is also true that resource nationalism tends to be contagious. First Quantum's hefty ZRA tax adjustment resembles those visited on Glencore in the DRC and Acacia in Tanzania during 2017. Both countries, which share borders with Zambia, overhauled their mining codes over the past two years, claiming that the existing regimes unfairly benefited foreign investors at the state's expense. This created a precedent, as much as popular expectation, for Zambia to follow suit.

While the government's escalating confrontations with mining companies are driven by tangible short-term fiscal and political gain, the long-term consequences of such measures are likely to be dire.

Zambia should know better about the dangers of nationalisation. The country's 1970s nationalisations brought economic ruin and IMF structural adjustment, prompting precisely the mining regime liberalisation the government now resents so intensely. If the country continues on its current path it will place the whole economy at risk.

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