

An industrial strategy might choose to shift the incentives currently offered to copper mines towards processing industries. For example, placing higher export duties on copper concentrate would create a clear economic incentive to do the smelting in Zambia. It could also be possible to offer incentives to companies that could further process the copper, manufacturing wires, electrical plugs, pipes and other light-industrial goods. Suppliers could similarly be encouraged to manufacture their products in Zambia. For example, for the past fifty years, a Swedish company, Alvinus, has provided all of the piping required by Zambian copper mines, shipping in pipes manufactured in Sweden. Since privatisation their product has been imported by the mining companies under no/low tariff arrangements established under the Development Agreements. However, with the opening up of sourcing systems, the company has been considering its response to lower-quality, lower-price competition from South African firms. One strategy that would lower costs for Alvinus and secure its position as the most competitive manufacturer would be to finish semi-manufactured pipes at a new facility that it is considering building on the Copperbelt. However, the current system provides very limited incentives for the building of such facilities – because mining companies can import equipment from overseas without paying duty, there is little incentive to attempt to source locally. If supplying companies did set up locally, it is not clear what incentives they might be given. (147)

Could renegotiating the Development Agreements provide funds for development and to overcome aid dependence?

The relationship between copper revenues and aid dependence

From independence until the first oil crisis, Zambia received relatively little aid. From 1978 there was a steady increase until 1990. The arrival of the new MMD Government in 1991 saw huge increases, reaching a high point in 1995, before dipping in the period to 2001. Aid has again recently picked up, with 2004 seeing the second highest flows in the country's history. Aid as a share of Zambia's GNI has been as high as 63% in 1995, but by 2004 was back to 21% (148).

While Zambia's aid statistics are high, they are not unique amongst low-income countries. What marks the country out, rather, has been its spectacular debt burden. By 2004, debt service was US \$ 424 million a year, 8.1% of GNI. Around 60% of this debt was owed to the IFIs (150). This debt emerged in the late 1970s when the Government (encouraged by the World Bank) believed that the collapse of copper prices would be temporary and borrowed to soften the blow to health and education services and food and industrial subsidies. However, as government spending continued to grow, and copper prices did not recover, the debt ballooned. As early as 1984, Zambia was the most indebted country in the world relative to its GDP (151). Since 1996, a number of debt relief initiatives slowed growth of the debt, making faltering inroads into its overall size and the size of annual debt service until the point in 2006 when a massive new deal was struck. When Zambia finally attained HIPC 'Completion Point' in April 2005, debt stock reduced significantly from US\$7.1 billion to \$4.5 billion. The best news was still to come. Under the Multilateral Debt Relief Initiative (MDRI) arrangement, announced by the Bank and Fund in 2006, those countries that had already reached HIPC Completion Point won a massive additional write off with debt stock reduced to \$500 million, less than 1/10th of its previous level.

Because foreign donors attach policy conditions to new loans and debt relief, Zambia's massive debt weakened the government's ability to set its own policies over the past twenty years. The country has been described as a 'disciplined democracy' (152), in which aid conditions have been used by the International Financial Institutions (IFIs) to such an extent that, no matter who gets elected, liberalisation and privatisation will inevitably follow.

A country's aid dependence is directly influenced by the absence or presence of alternative sources of funding that the country can turn to instead of relying on donors. In Zambia's case, the obvious alternative to aid is copper revenues, whether in the form of profits during the state-owned era, or royalties and corporate taxes once the mines had been privatised. Zambia's need for aid has related closely to shifts in the country's terms of trade, themselves driven by secular declines in the world market price of Zambia's principle export, copper, starting in 1975. External receipts from copper dropped 23% between 1974 and 1988 ⁽¹⁵³⁾, severely restricting access to foreign exchange.

How much more money does Zambia need now?

Given the massive increase in copper prices, and its coincidental timing alongside a huge debt relief package that reduces the need for Zambia to borrow further to cover interest payments, the possibility arises of making a fresh start. Could Zambia again use revenues copper, as it did in the 1960s and 1970s, to drive major investments in the country's economy and people and to break the country's aid dependence?

The Government has recently completed a major five year national development planning exercise, the 'Fifth National Development Plan'. The Government estimates that the cost of implementation will be K65.2 trillion. Most of this funding should be available from normal expenditure and funds previously budgeted for debt servicing but released by the MDRI deal. Secretary to the Treasury Evans Chibiliti announced in July 2006, "The resources available, though not entirely confirmed, have been estimated at 49.9 trillion Kwacha over a five-year period." ⁽¹⁵⁴⁾. This leaves a financing gap equivalent to around US \$1.5 billion between projected costs and projected domestic resources. Ministry of Finance representatives argue that aid would have to contribute to filling this gap, and that, despite debt relief, Zambia would still need to see a 66% hike in aid, from an average of US \$550 million per year in the last three years to an average of at least US \$800 million for the five years of the FNDP ⁽¹⁵⁵⁾. This figure would cover only just over half of the expected gap. The Ministry of Finance accepts that, in order to finance the FNDP, Zambia will have to start borrowing again, from both the domestic and external sources, risking a situation where, having just got rid of the country's debilitating debt burden, it immediately starts to rack up loans again.

Does copper present an alternative to aid dependence and a new debt trap? A recent report by the UNDP argues that in order to fund the programmes necessary to halve poverty and meet the Millennium Development Goals, Zambia should spend an extra 5.5% on health spending, 1.9% on water and sanitation and 2.7% on social safety nets over and above existing budgets ⁽¹⁵⁶⁾. The authors argue that, in order to avoid the unpredictability of aid and debt relief flows and the biting political conditionality attached to them, the country should raise these funds from its own resources, partly by increasing tax revenues equivalent to 3% of GDP.

They argue against increasing 'non-tax' revenues, such as 'user fees' for health and education services or utilities bills because these tend to have the effect of decreasing public access to these services, and thus work against poverty reduction. So how could these taxes be raised?

- Currently Zambian personal income taxes generate an unusually high share of the total tax take. The authors suggest a reduction in income tax rates for the poorest.
- They also propose that the Government should increase tariff rates, although this would be difficult given the WTO restrictions that apply to the country.
- VAT has generated relatively little revenue, and increasing it would adversely affect poor consumers who already pay unusually high prices for food and other basic goods.

Their main conclusion is therefore that, “There could be considerable scope for increasing the corporate tax, which in 1990 brought in over six per cent of total income... the rejuvenation of the copper sector and the growth of agribusiness provide ample scope for expanding this tax base, especially if various forms of tax exemption were removed. Zambia’s earlier legal commitment to an ill-conceived tax-holiday arrangement with the copper companies should not pose and insurmountable obstacle to re-imposing levies on the sector. One can find many international examples of the alteration of tax rules by government when circumstances change significantly. The dramatic increase in the copper price since privatisation and the subsequent questionable behaviour of some of the copper companies combine to justify a change in government policy. Since the world market for copper is experiencing excess demand, a change in policy would be unlikely to deter production or even new investment.” (157).

As shown by figures presented in Appendix 8, these policies would represent something of a rebalancing of the tax structure in Zambia which, since 1991 has seen massive increases in personal taxes and massive cuts in company tax. Extraction royalties brought in just 0.2% of Central Government revenues in 2003 and company tax a further 5.5% while personal income tax contributed just under one third of the total.

How might such a renegotiation occur?

Over the past few years the Zambian Government has started to discuss renegotiating the terms of its relationship with investors. This appears to be a response to:

- increasingly obvious and politicised disenchantment with mine privatisation,
- massive rises in world copper prices, and thus the profitability of the new companies,
- a wave of bad publicity following major fatal accidents on the Copperbelt.

Since mid 2004 the Finance Minister has repeatedly suggested that mineral royalty rates will be raised. Mineral royalties are a tax on the revenue from sales. In comparison to income tax, which is levied on profits and can thus be avoided if a company is re-investing heavily or carrying over losses, royalties can be understood as compensation simply for the fact that a private company has removed from the ground and sold an asset which is recognised to belong ultimately to every Zambian citizen.

The royalty rate, fixed for between 15 and 20 years in most of the existing Development Agreements, is 0.6% of total revenues. The Finance Minister has repeatedly mooted in media interviews raising the rate. In the run up to the 2006 elections, he claimed, “We are seriously working out a programme to urgently review all our development agreements with mining investors and increase the royalty tax to an average of 2.5% for copper.” (158). The rationale is clear, “when we signed these agreements almost four years ago, the copper price was at its lowest at about \$2,000/ton. Five years on the price has risen sharply by 400% to \$8,000/ton. For the national treasury to reap maximum benefits from the higher metal prices, we didn’t have other options but to view the legislation.” (159).

This figure of 2.5% is still at the lower end of international averages, and represents significantly less radical approach than that adopted for example by the Chilean Government in its ‘pro-poor’ mining policy. It is also very low by the standards of Zambia’s neighbours – an IMF survey of tax and royalty rates in developing country found no other African country charging royalties with royalty rates below two per cent, and some with royalties as high as 20 per cent (160).

As the Permanent Secretary of the Ministry of Mines explains, this is because, for Zambia, raising royalties would not reflect a change in the strategy represented by the Mining and Investment Acts, in which investors' concerns come first: "Both local and foreign investors want very attractive incentives in order to come in. So we would wish to see an adjustment of this mineral royalty, but to a level which is at the bottom of the average in the region or the world at large so that we still are competitive, and when we leave other incentives that are there, in place, the overall picture should be of Zambia remaining a highly attractive investment destination." (161).

Whatever rate the Zambian Government wants to set, it is far from clear how they might actually establish it. The Finance Minister's media statements suggest that there will be new legislation, which would represent a unilateral action by Zambia as a sovereign Government. However, the Development Agreements establish a contractual commitment on the part of Government not to change the tax take from companies for between 15 and 20 years, a commitment underpinned by the right for either party to take the other to international arbitration in any dispute over implementation of the Development Agreements. The stability periods thus negate the sovereign right of the democratically elected Government to legislate.

Since the discussion has started in the media, the primary concern of companies and international donors has been to establish the absolute primacy and legal status of the Development Agreements over and above Zambian sovereignty. Their message to the Government is clearly: 'don't try to do anything without getting our agreement first.' In other words, the Government should open a discussion with the companies first. KCM argue, "If they try to change the Development Agreements, it becomes a legal question. It becomes one of arbitration." (162). MCM agree: "There is no way that a Development Agreement renegotiation is going to be bullied, it's going to be negotiated. Because if it's going to take the bully route then we do have courts to resolve the issue." (163).

Although there are examples of Governments around the world overruling contracts in the case of massive privatisation windfalls, the Permanent Secretary of the Ministry of Mines suggests Zambia will constrain itself: "We believe in the rule of Law. We have signed these Agreements and they have the force of law behind them, so Government cannot unilaterally start changing things. If they feel something has to be changed then they have to go back and re-negotiate." (164).

However, this leaves unanswered the question of how any discussion should start. In the absence of a direct initiative from the Government, there will be no change in the rate. As the Chief Executive of Mopani Tim Henderson notes, "We have had no direct communication saying 'this is going to be an issue - we're going to talk about it'. You know we see it in the paper, where the Minister says, 'well we're going to do this and that', and we say, 'well, it's a legal thing, so we'll see you in court.' As far as we're concerned we don't need to arrange a meeting because we're not here saying, 'we'd love to give you some more money.'" However, as with most of the companies, he also accepts that the repeated press announcements represent some sort of softening up of the companies by Government, that an eventual move from the Government move is inevitable, and that the companies will have to engage, "They've got to come to us company by company and say, this is what we'd like to try to do. What's your feeling? Where are you going to go? And once they've done all the companies they'll have a general idea what the feeling is. Then they might have to say, now we'll have a general meeting along these kind of lines... There should be dialogue and discussions and all that and I think there needs to be more of it, and yes, I am sure they'd like a different number than 0.6. And yes, maybe there is one between there and 2.5, but let's talk about it." (165).

What negotiating capital would the Government and companies bring to the talks? The question then is, if the Government does start discussions with the companies, and given the companies hold contracts that the Government is committed to respecting, what negotiating capital can the Government deliver in this situation to ensure that 'the number' is as high as the Government would like?

The answer, initially, appears to be very little. The PS at the Ministry of Mines suggests that the Government will have to rely on its 'good relationship' with the mining companies: "Fortunately, we have a very good rapport with all mining companies in the country. They recognise that Zambia has the best incentives in the region and maybe in the entire world, but we would like to go back to them and appeal to their conscience that at the time of privatisation certain parameters were different from what they are today. Nobody thought the copper price would be at these levels. At that time they were below \$1 and in fact their feasibility studies, when you check all of them, you find that the long-term price that they have assumed to make the mines profitable is about \$1 or slightly above, but not \$2, \$3 and beyond, which we have. So there is a lot of windfall gain that has come. We believe that they should help us to get more benefits from the windfall gains." (166).

However, worrying about the threat of court action, and relying on the good will of the companies may underestimate the strength of the Government's position. The companies' greatest weakness is that any threat that they would pull out their investment if pushed too hard lacks credibility. Although, for example, KCM claim, "KCM is the highest cost producer in the world. So if copper prices fall below a particular price, I'll stop mining," (167), they also recognise, "If you start charging me more right now, it's alright. I am making a profit." (168). This is also true for Bwana Mkubwa and First Quantum. The other major mines, Chambishi Mines and Mopani both recognise that, although they are not yet making huge profits, that is why they are not in any position to pull out. Having only recently made significant investments in the mining sector, they will have to stay put in Zambia until they are able to recoup their financial inputs.

In the current political climate, the Government also clearly has significant political leverage in such a negotiation. With the MMD totally routed on the Copperbelt and in Lusaka in the September 2006 elections, and with everyone understanding that mining was the decisive factor in that process, the social and political situation on the Copperbelt is tense. With strikes already launched at Mopani over pay to contracted workers, and KCM under pressure over their environmental record, the Government would enjoy significant popular support if it put more pressure on the companies through its regulatory arms. One tactic in such a discussion that the companies may adopt would be to question the degree to which the election was directly a protest against them, attempting to put as much focus as possible on the failure of Government services in urban areas, in other words, on the failure of the government to use the mining boom to benefit a broad spread of the population. As KCM's Resident Director argues, "If we raise from 0.6% to 2.5% is the Copperbelt going to vote MMD? No, not unless they bring the money back to the Copperbelt." (169).

For Government, maximising negotiating capital by suggesting to the companies that their social license to operate is under threat might imply raising a wider range of issues (health and safety, wages, terms and conditions, environmental protection for example), that the Government feels are of public concern, and on which they could act - making the companies' lives extremely difficult. Widening the range of issues under discussion could be a tactical move designed to force the hand of the companies in one key area - tax. However, it does not appear to be a tactic under consideration for the Government. The PS of the Ministry of Mines reports that beyond the royalties, "We don't think there are other issues to be revisited. The cry now from the general public... is that they want to benefit more from the copper industry, given the higher prices that are now obtaining. So, we can't bring into the agenda things outside that cry." (170).

The companies, however, could also attempt something similar – accepting a discussion about royalty rates, but only on the basis that the entire content of the Development Agreement is also put on the table. The Chief Executive of Mopani argues that, contrary to common perceptions, investors in Zambia are working in difficult circumstances, don't have a particularly good deal and might like to raise a number of other issues about the Government's implementation of their side of the Development Agreements: "We are a specific case in Zambia. 2.5% might be a global average but you name me copper mines that are 2,000 miles from the nearest port. You name me export companies in other countries that can't get duty off on their imports. You name me copper producing companies that have price participation - they don't exist. So there's already special things that apply to us that don't apply to the 2.5% guys out there. So if you're going to change one thing, you're going to change everything. So it might be a discussion but it's going to be a lengthy one and that's not going to be the only thing we're talking about." (171).

The role of the IMF in the negotiations

There is one further complicating factor in this negotiation. The Government appears to be attempting to use the IMF as an intermediary with the companies. KCM's Resident Director notes, "In this negotiation, the IMF is Big Brother." (172). In 2005, the IMF prepared a report for the Government on the overall Zambian tax policy, including recommendations for reform. The Government claims that this report is the source of their desire to increase mineral royalties. Immediately after the election, an IMF staff mission arrived from Washington to Zambia. Part of their schedule was to call the mining companies in for a discussion. Nervous of the meeting, and in the absence of an agenda, the companies responded tentatively to the proposal, and the IMF withdrew the proposed meeting. However, Mopani senior management claim that, as Chair of the Chamber of Mines, they insisted that an agenda was agreed, and that the meeting went ahead. It did, on October 19 2006, and involved the major mining companies, the Ministry of Finance and the IMF.

The Government's strategy has certainly caused a degree of annoyance amongst the companies, who feel that the press and the IMF are being used by the Government as a part of their 'softening up' strategy, rather than the Government opening direct discussions with the companies. However, the companies also felt that they were able to use the meeting to get their point across. Mopani's CEO claims that companies took a firm line. "telling the IMF very strongly, you were the guys advising the government, now don't come in and change the rules just because things have swung around slightly differently." (173). The companies also feel that they have made some progress. Although it flatly contradicts media statements by the Finance Minister, that clearly refer to the existing development agreements, the investors greatest hope is that increased royalty rates will not apply to them. The Resident Director of KCM wonders, "I think there is a question of whether any re-negotiation will apply only to future investors, not to current ones." (174). Mopani's Financial Officer is also hopeful that the mining companies were able to convince the IMF of this position. "The IMF said they were looking at the tax base in general in Zambia. In a meeting with the Chamber of Mines this week, they specifically said they will not be addressing the mining industry. In particular, they will not be addressing the existing Development Agreements. And they are not stupid enough, to quote their own words, to advise the Government to challenge legally binding documents." (175).

This raises the possibility that the message being given by Government to the media – that they are aiming to renegotiate the existing Development Agreements, is not quite what it appears. It may be that what they will eventually do is to adopt a different figure from the 0.6% percent that applies to existing investors for any future agreements it might make with new investors. Mopani's Financial Officer claims, "The IMF said, 'don't pay much attention to what you're seeing in the papers. We've had an election. People say what they need to say'." (176).

The Zambian election of 2006 is likely to mark some sort of watershed in relations between workers, communities, the Government of Zambia and mining companies on the Copperbelt. For the moment, much of the attention of the media and the mining companies is on the question of the revision of mineral royalty rates. How this renegotiation will work out remains unclear. This report has argued that the Government ought to maximise its income from mining companies, and that the amounts it is able to secure will have an important impact on its future ability to avoid constantly relying on foreign aid donors. This presents Government with a difficult choice. From 1991, a key element of the Zambia's strategy has been to do everything it feels might be necessary to keep international donors and investors sweet. In the process, the Government has strained its relationship with the Zambian people. Negotiating a change of strategy will require not only that the Government is decisive and confident, but that donors and investors understand the importance of Zambia and Zambians being allowed and encouraged to define their own future democratically.