Speech to the Mining Expo

27 May 2010

Honourable ministers

Mr President

Ladies and gentlemen

I remember the first time I visited a mine – it was of course in Namibia – and how impressed I was at the sheer scale and, dare I say it, brutality of what I saw. “not very subtle is it?” My guide remarked. In obtaining the raw materials we need to run an industrial society, no one has yet discovered more subtle alternatives to digging big holes in the ground using explosives and heavy duty machinery. There are, however, more subtle ways of giving economic advice. But I am not going to employ them this evening. I have been accused in the past, not least by several friends from the mining industry, of being far too subtle and not clear enough about how economic policy needs to change. Lots of clever words but what on earth does he really want to say? So in the second part of my presentation this evening, I want to devote myself to what we should be doing in Namibia to maximise the benefits the country derives from its mineral resources. In doing so I make no apology - to both representatives of the mining industry and the government present in the room - for any lack of subtlety. Let me then insert my explosives and warn you to reach for your hard hats.

I want to talk about a number of issues that I think are critical:

- Ownership
- Taxation
- Beneficiation
- Infrastructure
- Speculation
- Environmental standards
- Fiscal policy
- Economic and political stability

Before I do so, however, I would like to briefly remind you of some of the harsh economic realities that I believe should inform our views on how we best move forward in Namibia.

The first is that mining on any scale involves huge amounts of money and equally huge amounts of risk. Mining companies spend hundreds of millions of dollars on exploration and development only to discover the resource is insufficient to justify a viable business plan or that mineral prices have suddenly plunged just at the wrong time. This is why the rewards for success need to be as high as they are. No one would voluntarily risk such money if the prospect of a commensurate reward was not there. And the cyclicality of the business means it is unfair for anyone – including fiscal authorities – to look at one year's profits and deduce that super normal profits are being made which can be taxed without altering incentives.

Second, we all live in the same world and face the same laws of economic gravity. To hear some commentators speak, one would believe governments or Namibian citizens possessed some magical powers which allowed them to defy gravity and succeed where others fail. Partial government ownership of Namdeb could not make up for the fact that the market for its product evaporated almost overnight thanks to economic meltdown in the US and other rich countries. The last year has given us a sharp reminder that being a shareholder doesn't only mean waiting around to coin the profits: shareholders have to be prepared to pay up when the going gets tough (which it invariably does in mining). Just imagine if the Namibian Government had been on the hook for Namibia's entire multi-billion dollar mining industry rather than just the "letter of support" that was required for Namdeb. Have we learnt nothing from the experience of Ongopolo? We are learning once again that public debt – and that includes contingent liabilities – has important implications for any country (regardless of whether it is African or European) and we in Namibia have just raised our debt limit from 25% to 30% of GDP.

Third, the reason we have private companies and governments is because they are designed to do different things. Private companies are designed to exploit commercial opportunities for profit. They take risks to make profits but if they fail their shareholders fail (although the recent crisis has shown that some companies might indeed be "too big to fail"). Governments are designed to deliver a wide range of political and other goods and services that cannot be delivered by private companies. They are not designed to take risks (with taxpayers' money) to make profits and when they have tried they have generally failed. Having said that Professor Magnus Ericsson of the Raw Materials Group gave an interesting talk at this year's Mining Indaba in Cape Town in which he surprised his audience with data showing how many mining companies were actually state-owned. The recent trend towards greater state-ownership is, as I understand him, one way developing countries have of countering being dominated by the global mining giants. In his view state-ownership was not necessarily a recipe for disaster. The key to success seems to be that successful state-owned mining companies must be allowed to look after their own futures and not simply act as cash machines for revenue-hungry governments. They must also be commercially well-managed and avoid being run for political purposes. I remember how surprised I was when our former Minister of Mines, the Honourable Nghimtina, expressed his shock on discovering that Namdeb had not built up a significant cash buffer for the hard times that struck at the end of 2008. Can anyone doubt that Government has treated Namdeb primarily as a source of revenue ever since it was established?

Fourth, adding value to raw materials is a legitimate policy aim, of course it is. But only when it is based on sound economic s. It makes no sense for governments to force private companies to "add value" to something which ends up losing them money and subtracting value or to put pressure on the wrong companies to do the value addition. There are not many countries in the world that have pulled off the trick of being both successful miners and successful manufacturers and there are good reasons why that is so.

Fifth, reading our newspapers and the comments of people who should really know better, one would believe that Namibia's mining companies do little more than rape and pillage the land giving nothing in return. The evidence shows that nothing could be further from the truth. As the Chamber's Annual Review tries to show, Namibia's mining companies play an absolutely vital role in the country's economy – not only generating the lion's share of our exports (and therefore allowing us to import the goods and services we all require), contributing handsomely to Government's coffers, helping to build the country's physical infrastructure as well as creating employment (and bear in mind the multiplier effects I have already mentioned), but also critically (although this is often harder to measure) to skills, experience, exposure to world markets, technology transfer and a host of other intangibles as well as boosting general demand throughout the economy.

Then there is the inevitable trade-off between costs and uncertainty on the one hand and investment on the other. The trick is not to kid oneself that one can raise costs (including taxation) and uncertainty without reducing investment but rather to strike the right balance. There is no guarantee all the new mines we read about in the newspapers will in fact come to fruition. Many deposits are marginal and mineral prices, including uranium prices, are always highly uncertain. Our policies must recognise this reality and address the question of how we can strike the right balance.

But some costs are worth raising because they bring benefits or help avoid even greater costs in future. Namibia's natural environment is one of our country's key assets. It is hard not to believe that ensuring the mining industry behaves in an environmentally responsible way – "meeting the needs of the present generation without jeopardising the needs of future generations" as the Brundtland Report might put it – is not a price worth paying. Yes adhering to environmental standards will raise costs, but those costs outweigh the costs of doing nothing. And an economic cost-benefit approach and use of the precautionary principle rather than an arbitrary bureaucratically determined approach provide a more rational framework within which such standards can be set.

Each individual mine (and mining project) finds itself in very different circumstances. In a country with relatively few mining operations, an optimal approach might involve treating each operation separately and creating tailor-made tax and regulatory packages for each one (imagine doing this for other sectors!). The trouble with this is that it opens the door for endless negotiations, policy discretion and corruption. Few countries have government institutions strong enough to adopt this approach in a way that improves on a non-negotiable "level playing field" for all-comers.

The risky nature of mining means there is an important role for smaller, nimbler more entrepreneurial companies which can raise money on stock exchanges and from other sources and take a punt on riskier projects which can be then sold on to the mining majors at a worthwhile profit. I would say that Namibia has benefited enormously from the existence of the Reunions, the Paladins, the Extracts and the Bannermans to name just a few. The only real shame is that so few of these small exploration and development companies are Namibian grown.

Telling the difference between genuine entrepreneurship and making a quick buck is often not easy. In any market containing huge risks and rewards (and what economists call "information asymmetries") there will be a degree of speculation. Yes there will be people who try to make money with no intention of establishing a mine. Yet we seem to be quick to see the negative side of the "stock exchange miners" without recognising the tremendous benefits that some of them bring. My regret is that we are not seeing any local "stock exchange miners" on the NSX. An element of speculation is bound to creep in. But no one should contemplate throwing the baby out with the bath water.

Finally, we must not delude ourselves on what a healthy mining industry can and cannot achieve. Mining in Namibia will not solve our unemployment problem (the industry is unlikely to generate more than a few thousand jobs however well things go – compare that to the 80,000 jobs which tourism has created). Neither will it deliver the industrialisation of our economy for us. Labour intensive industrialisation will only take place when we have an economy and labour force competitive enough to make it worthwhile to manufacture here (more often than not mining industries work against this aim by pushing up a country's exchange rate and discouraging other export-oriented industries).

So these I believe are the harsh realities. And with these points in mind, let me go on and lay out what I think Namibia can do better to maximise the benefits from mining.

Ownership

On the question of ownership, we have to be realistic. I read Skorpion mine was recently sold to Vedanta for us$698 million – that's over n$5 billion in our currency. A quarter of that would be n$1.25 billion. Now how ask yourselves who in Namibia has that sort of money (or access to that sort of money) to become a shareholder of any significance? And who would want to if they did? The only real candidate is Government. But surely Government has better things to do with taxpayers' money than gamble it on a single zinc mine? Most investors would anyway far rather seek exposure to a diversified mining group than a single operation. The largest amount of money Government has thrown at any single company since Independence is Air Namibia: some n$2.5 billion over 15 years. Surely it is far better to let those who can gamble do so?

On the other hand, Government does have a legitimate interest in understanding and being fully informed about how the country's most important industry is run. Establishing Epangelo to take stakes in key mining companies is not necessarily a bad idea provided Government is prepared to pay for its equity (in one way or the other – it does not have to be cash up front) and provided Epangelo board representatives were sufficiently knowledgeable and active to play a meaningful role. This would allow Government access to more information and help ensure mining companies play by the rules. But we are not talking about majority stakes here – maybe 5-10% shareholdings. Certainly, this makes much more sense than an arbitrary TESEF policy of encouraging companies to seek out individual private shareholders (who would presumably sell themselves on the strength of their special influence with Government and regulators).

Taxation

I have just come back from a week in Zambia where an awful lot of work on mineral taxation is being done after seven years of muddled policy-making. Is it not fair to say that our taxation of the mining sector – which has grown up organically over the years – is also in something of a mess? Different minerals pay very different royalty rates (based on what?). Waivers and deferments are granted on an ad hoc basis. We have a mining profits tax of 37.5 percent (Australia is in uproar over a 40 percent tax). Some operations enjoy open ended EPZ status. We have opened the door to all sorts of special pleading and strange deals which can lead to perverse results (the "law of unintended consequences"). Are we sure, for example, that offering EPZ status to mines does not undermine the local production of inputs for the mining sector? At the same time it is impossible to pick up a newspaper without reading that Namibia's mining sector is not paying its way and that the country is being short-changed. And it has taken us years to get this far (five years just to sort out the royalty tax!). If we are to stay with a "one size fits all" system rather than a tailor-made one, surely it is time for a rethink to ensure not only that the national interest is being served but that it is seen to be served? Surely it is time for a rethink, and a rethink that includes centralising powers of taxation in the Ministry of Finance with a specialised mining taxation unit staffed with top notch professionals who know about mining?

Fiscal policy

Among local economists there is little doubt that the mining sector makes a significant contribution towards Government revenues. Whether it is making enough is harder to judge. Government introduced the royalty tax because it believed mining companies were using "creative accounting" to avoid paying tax. However, it would not be difficult to identify tax payments by mining companies separately in the budget document (to some extent this is already done). This would serve two purposes: it would show how much mining companies were really paying (and how important they were to the fiscus) and it would show how much revenue was derived from a non-renewable resource separately from recurrent revenue. A portion of this revenue could be diverted from the Ministry's big pot to be used by Government to buy its strategic stakes.

But all the policy attention should not just go on squeezing more money out of the mining sector. There is an equal need to ensure that money raised through the tax system is spent more effectively. We spend vast amounts of money every year on education and training with precious little to show for it. This has to change and that means giving far more attention to enhancing the quality of our spending. The mining industry is proving good at helping to develop the nation's skills base. Perhaps it can play an even more active role than it does already with NIMT?

Speculation

I have spoken enthusiastically (perhaps too warmly) about the role "stock exchange miners" can play. But Government is also concerned about multi-billion dollar deals being done with Namibian resources "over its head". While to the economist, there seems little wrong with junior companies making large profits by bringing good projects in Namibia to the attention of the big mining houses (really adding value), it strikes most ordinary people and politicians as wrong that someone can make vast amounts of money from a Namibian resource without Namibia getting something in return too. Of course, Namibia sometimes ends up getting a mine but perhaps Namibia should be cut into deals at an earlier stage too? One way of doing this and discouraging pure speculators (those who never intend to build a mine) would be to impose a windfall tax on trading projects and licences. But it is not just dastardly Australians and other foreigners who get up to these kinds of things. Namibians too are in the business of all kinds of speculation. If a valuable deposit is discovered on someone's land, they should not be able to hold the company (and the country) to ransom. The Minerals Act already lays out quite clearly the procedures that need to be followed to allow a project to move forward swiftly. It is vital that the integrity of our Office of the Mining Commissioner (which did not come out particularly well in the recent Old Mutual Namibia- NSX Executive Opinion Survey) must be preserved for this to happen.

Political and economic stability

Namibia has won two prizes that have eluded many other developing (and developed) economies around the world: it has won a reputation for political and economic stability, and it remains a place where business can be conducted without having to grease palms. Mining is also relatively unpoliticised. This will take on increasing importance as the world places more trust in us to deliver the raw material its nuclear energy industry depends on. We must do our utmost to ensure this reputation remains intact. If not handled correctly, greater discretion in policymaking will lead to our good reputation being eroded.

A mining strategy

Government policy White Papers, like company annual reports, are often as important for what they do not state as for what they do state. I know Veston was a prime mover in developing the Minerals Policy of Namibia published I think in 2003. Yet for all its strengths, the document failed to make any explicit mention of royalty taxes (which were introduced out of the blue a year after publication) or Epangelo, two of the most significant changes in mining policy in recent years. With 20 years of experience behind us (and a new Minister), now might be a good time to revisit, update and improve this potentially valuable document. Do we not all think it would be better to have a properly thought through public mining strategy as we move into the third decade of independence and a possible uranium boom?

To summarise, I believe there is a decent strategy out there consisting of the following seven elements:

1. Be realistic about what is and is not both desirable and achievable. The mining sector should be exempted from TESEF equity targets. There is a real danger Government and industry will spend a lot of energy arguing over equity targets only to discover that they cannot be funded. Government attention would be better rewarded by focussing on maximising the contribution the mining sector makes to skills and local business development. Someone somewhere in Government needs to monitor this carefully. Leaving it to a voluntary arrangement such as the Namibia Preferential Procurement Council is not enough. The mining sector's contribution to the economy needs to be measured and monitored so that where it falls short it can be improved.
2. Instead of TESEF targets, Epangelo, representing the national interest and not the interests of a few well connected individuals, should take minority stakes in companies Government considers strategic using tax revenue (or future tax revenues) from the industry. Epangelo should not be about hogging all the EPLs issued by Government and blocking progress on developing projects.

3. Namibia should stick with a uniform, non-discriminatory tax and regulatory regime for the mining sector and thus avoid doing special deals with special companies. Mining taxation should be centralised in the Ministry of Finance - or better still in a Namibia Revenue Authority - which would have a specialised mining unit with the professionals to make sure the industry is paying what is due. Epangelo could play a role here. Revenues would be supplemented by a windfall tax on trade in mining assets between companies.
4. If it does stick to the uniform regime, Government must come to an informed judgement on what is optimal over the longer term and over the resource cycle. One size will never fit all. Government must deliberately decide on how to strike the right balance so that it does not chop and change between mines and over the lives of mines. Namibia has a particular advantage here because the political cycle is unlikely to disrupt the mining regime.
5. The full contribution made by the mining sector to Namibia's fiscus should be separately identified in the budget so that people are fully aware of its magnitude and that this revenue comes from a non-renewable resource. This could even be assisted by the Chamber. Government should ensure current spending is not financed out of this revenue. Revenue from mining can help finance Namibia's significant infrastructure requirements over the coming years.
6. Mining companies should be obliged to set aside revenues for mine closure and rehabilitation which should be independently audited and based on a cost-benefit approach using the precautionary principle.
7. Beneficiation of mineral products should be encouraged but only where it makes economic sense. If there is something Government can do to help ensure projects get off the ground this should be done but this should not mean a policy of open-ended subsidies for unviable ventures. Rather than giving vague lectures to the industry, Government should spend money (a portion of mineral revenues) on specific studies looking into beneficiation of specific minerals in very concrete terms. This could even be spearheaded by the Development Bank of Namibia. I do not know what the Minerals Development Fund is up to these days but merging it into the DBN might help to create a greater critical mass in public mining finance. Far more should be done to foster Namibian involvement in the early stage development of mining projects where smaller amounts of money can go a long way (although of course they can be more easily lost).

Honourable Minister, ladies and gentlemen, I believe the future looks bright for our mining industry. Ironically, in contrast to what many wanted to see happen, it now looks as if we will become more reliant on our mining sector than ever before. But let us be clear. Success in mining will not solve all our problems. It will not create many jobs and it will not transform the structure of our economy. To make a difference on the ground, policymakers must guard against being distracted by bogus and unrealistic aims, however glamorous or politically attractive they may seem. But success will allow us to develop a sector which is dynamic and healthy and which provides a solid foundation for our economy for many years to come.

I thank you