UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

MULTI-YEAR EXPERT MEETING ON COMMODITIES AND DEVELOPMENT

9-10 April 2014

Utilizing Resource Revenues for Diversification and Structural Change

by

Mr. Degol Hailu
Senior Policy Adviser and Team Leader on Economic Governance and Globalization, UNDP

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Zambian copper sector: Challenges in revenue generation

- Private ownership, then nationalisation and then privatisation
- No significant revenue capture both under private and public ownership
- Under state ownership – collapse of world markets, low investments, political economy
- Under private ownership - a result of tax policies that provided generous terms to companies *plus* transfer pricing schemes

The Zambian copper sector: "Generous" contractual agreements pre-2008

- Mineral royalty rate of 0.6%
- Below the IMF's own estimates of between 5% and 10% for developing countries
- No VAT charged on mine related transactions
- Capital expenditure had a deductible allowance of 100%
- 'Stability periods' of 15-20 years
- The subsidy on the purchase of mining machinery, at 18.3%, is considered large
- The World Bank noted that the marginal effective tax rate was in the neighbourhood of 0%

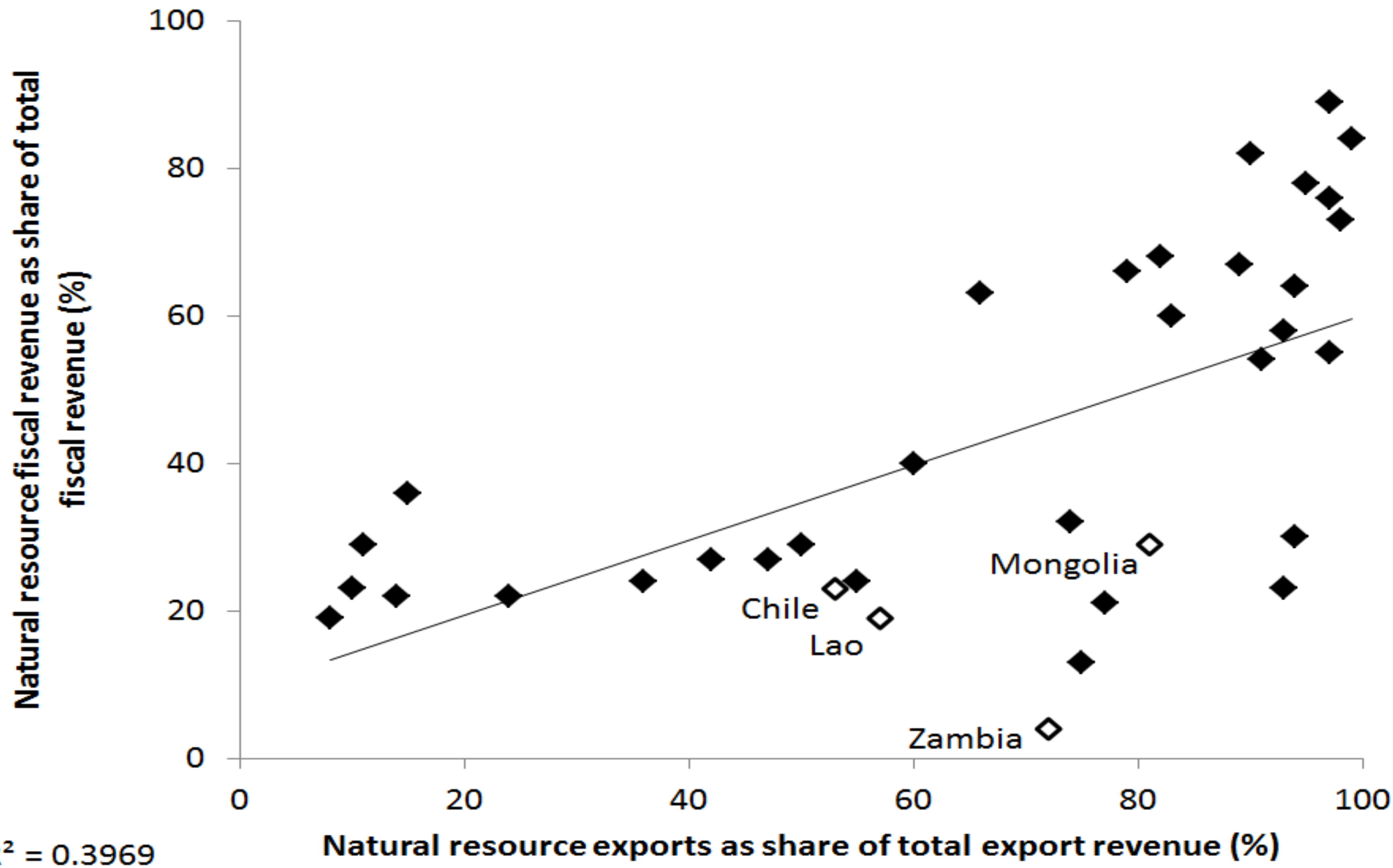
Transfer Pricing

- Switzerland is a "major copper exporter"!!
- Companies registered in Switzerland have copper producing subsidiaries in Zambia
- The Zambian based subsidiary sells copper to its Swiss-based subsidiary at a price well below the market (so profits are not recorded in Zambia)
- The Swiss-based company sells the copper at world prices (netting the price difference as profit)

Zambia: Mineral revenues

(percent of total revenue, **average 2006-2010)**

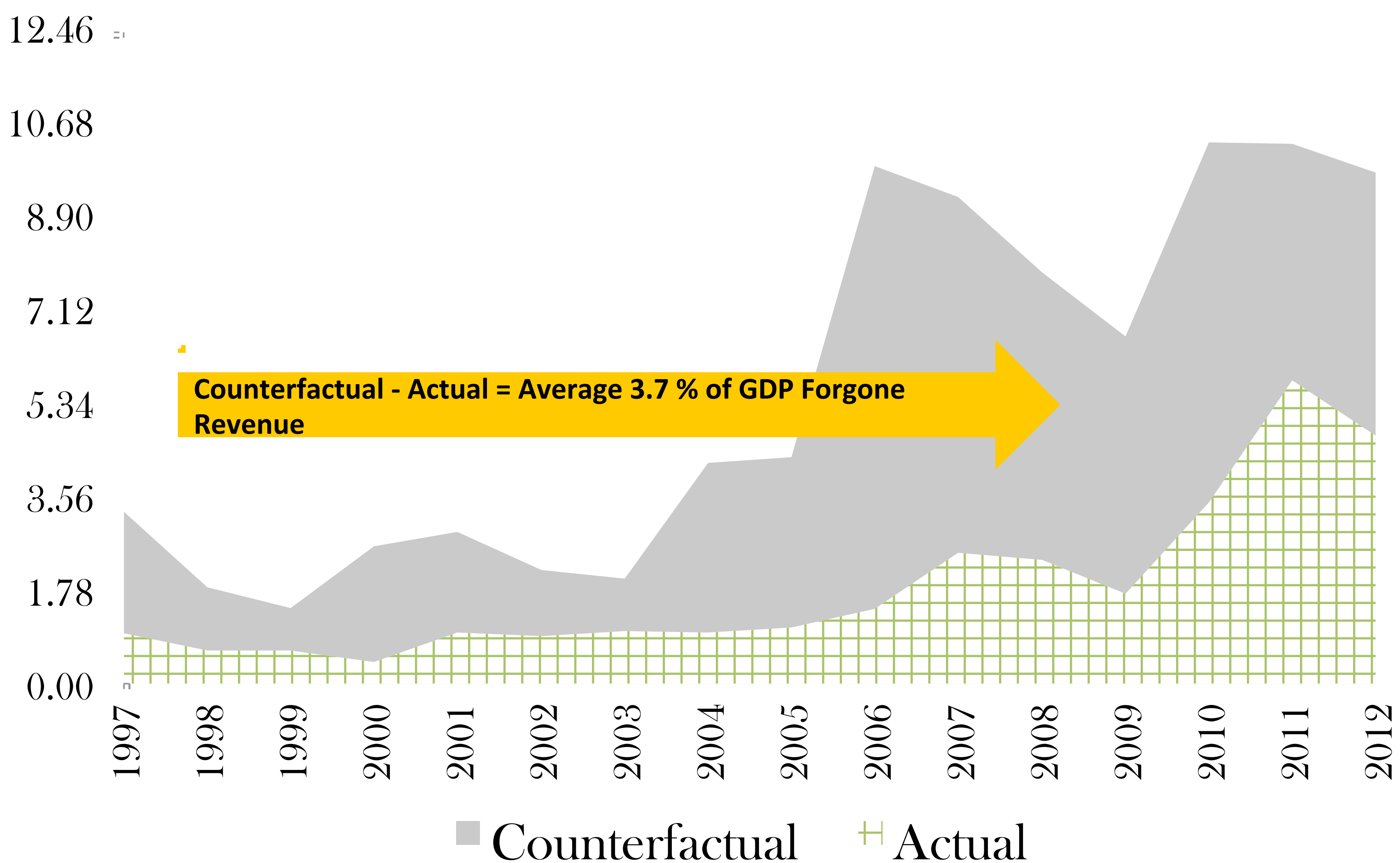
Zambia: Fiscal Revenue and Export Earnings



$R^2 = 0.3969$

Zambia: Actual and counterfactual revenue flows

(% of GDP)



Diamond Exports from Botswana: Revenue Management

- Govt. of Botswana has a 15% share holding in De Beers
- Debswana Diamond Company, a De Beers – GoB joint venture (50/50) and 80/20 revenue share (in favour of GoB)
- Technical and negotiation capacity broke the bargaining asymmetries

Botswana: Lessons from revenue utilization

- High government expenditure on health, education and
- School fees abolished. Adult illiteracy rate fell by half (1980-2001)
- Maternal mortality and under-five mortality rates less than 30% and 50% of the average for sub-Saharan Africa, respectively
- Total roads network increased from 8,134km in 1991 to 25,798km in 2005 (3-fold)

But, limited job creation

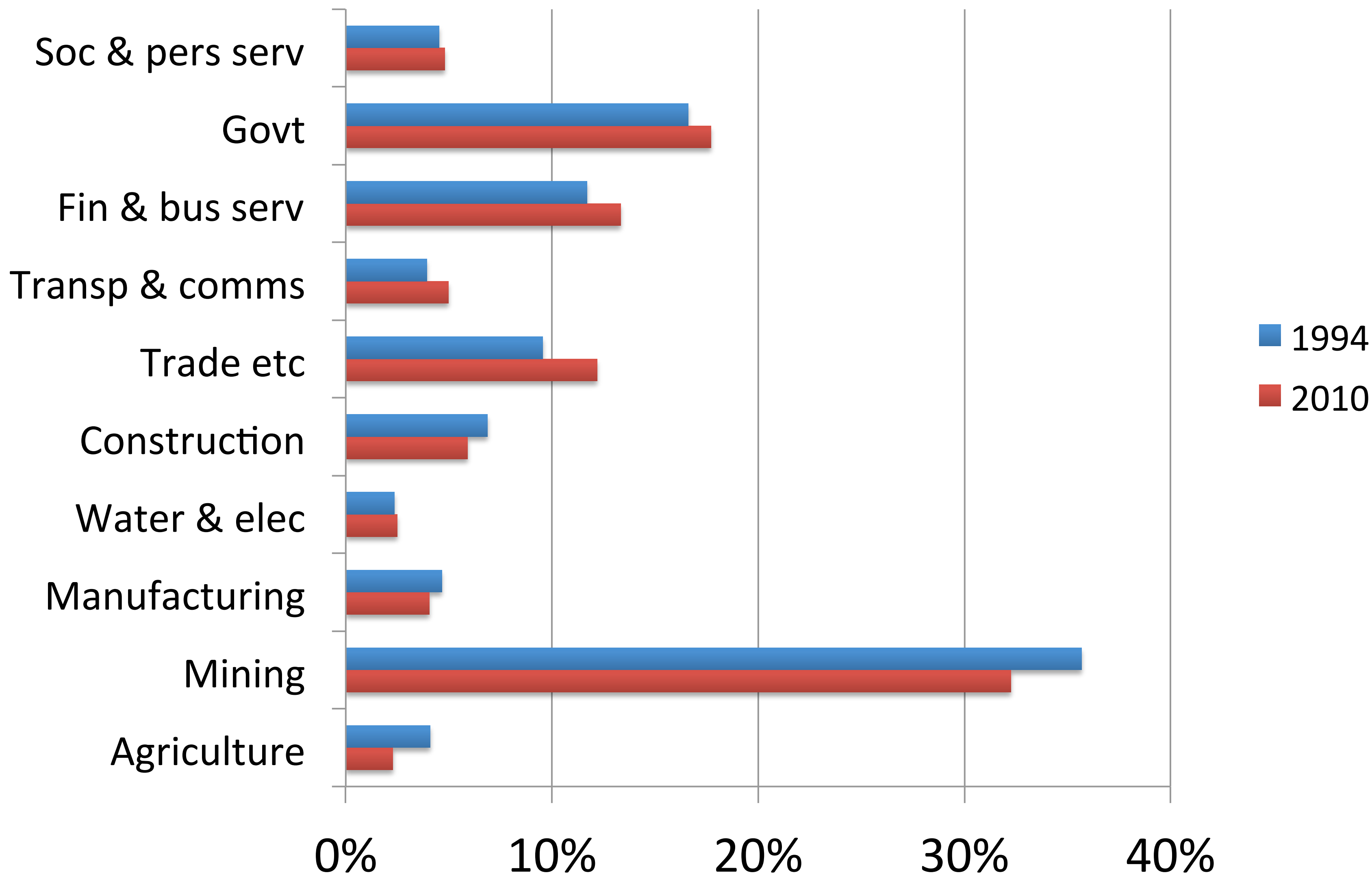
Sectoral share of employment

	1994	2010
Mining	**3.4**	**3.3**
Agriculture (commercial)	2.3	1.9
Manufacturing	**9.4**	**10.9**
Services	36.9	36.5
Government	**35.4**	**39.3**

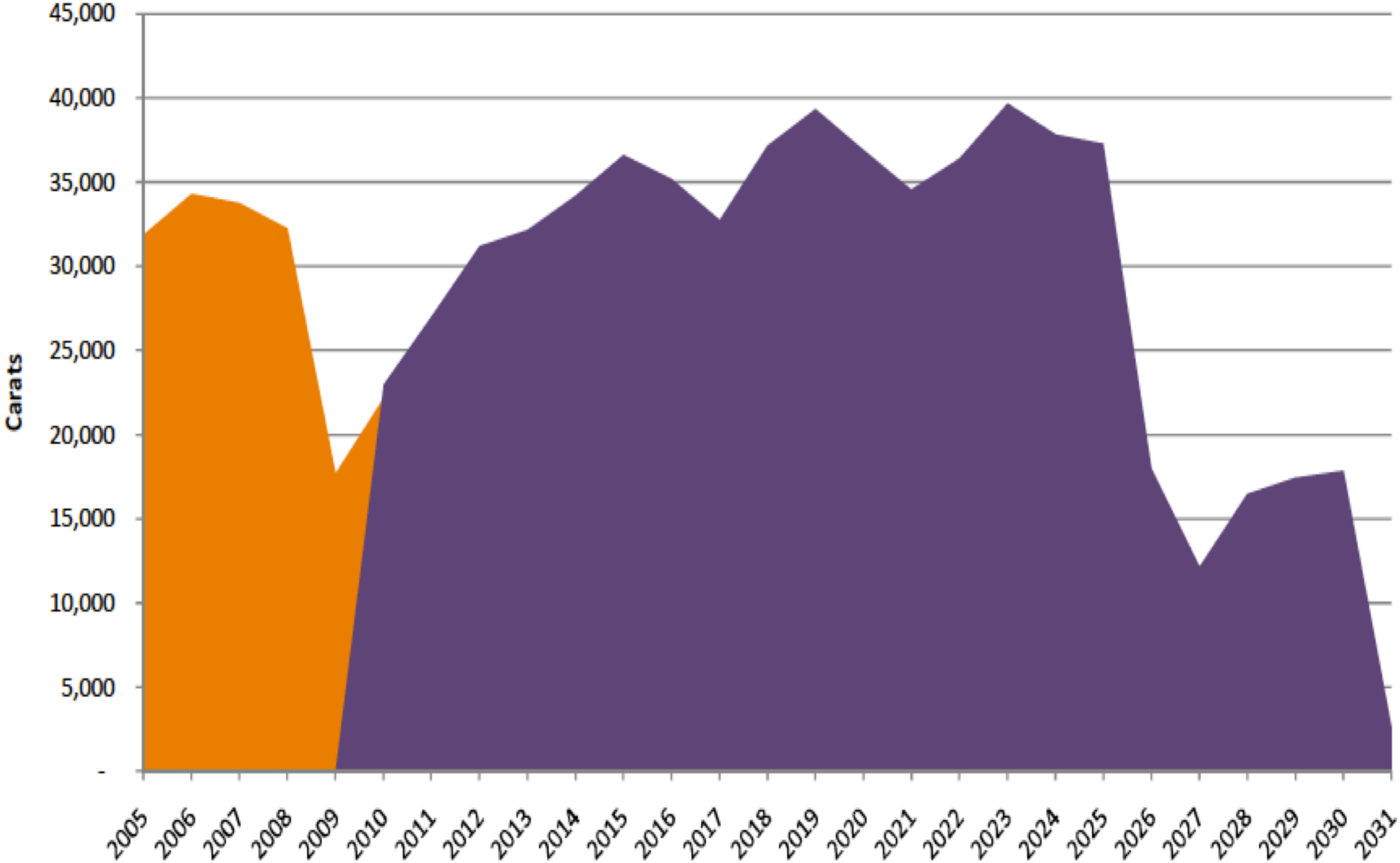
National unemployment rate (%)

	1985	1995	2000	2005	2010
Total	26	22	16	32	18
Youth		38	40	33	39

Limited diversification: Sectoral shares of GDP



Especially because of depletion
Diamond production and projections



Lessons from Zambia and Botswana

- Legislation and enforcement required to capture revenues
- Investing in human capital & infrastructure is not sufficient
- Historical experience globally demonstrates success is a result of:

Investing resource wealth in structural transformation mainly in labour–intensive export oriented manufacturing

Indonesia

- Share of oil and gas in Indonesia's public revenue ***fell*** from 49% in 1982 to 23% in 2005
- Promoted exports of non-oil goods (textiles & footwear) through tax incentives, credit and subsidies
- 12% average annual growth rate of manufacturing (1965-1997)

Malaysia

- Focused on labour intensive manufacturing
- Selected products for exports (electronics, aircraft parts, building materials, furniture, chemicals etc.)
- Incentive measures were drawn up for each of these commodities - tax, credit, subsidy, mainly for SMEs

Thailand

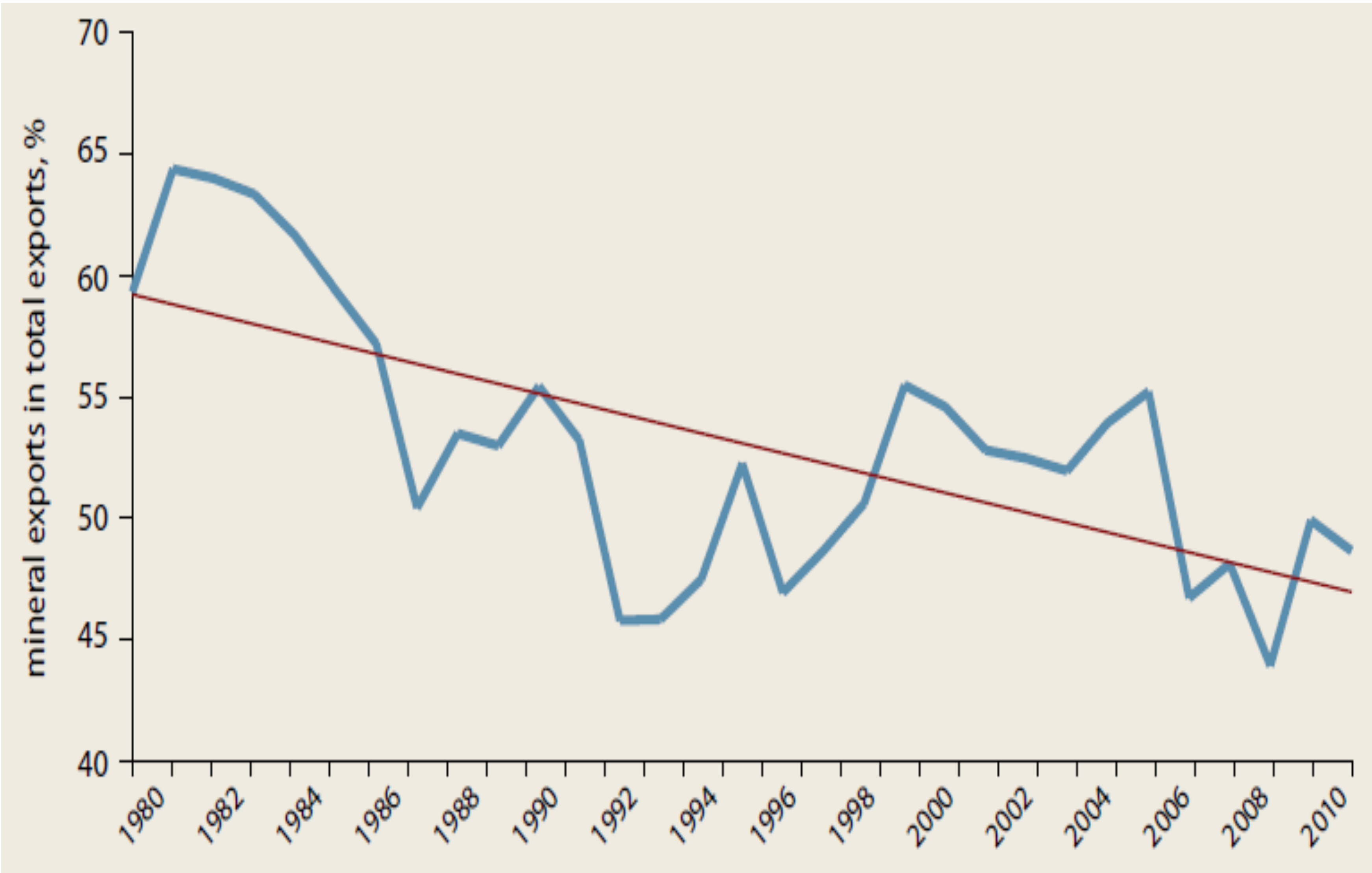
- Focused on value addition (agro-processing)
- Flexible financing from commercial banks
- Exports of raw farm and marine products fell from 63% to 16.5% of total exports (1970-1995)
- Processed farm and marine products increased from 0.6% to 9.4%. (e.g. export tinned tuna, tinned fruit)

Chile, continued….

- Fund for Innovation and Competitiveness (FIC)- royalty payments to fund R&D, vocational education and training,
- Policy incentives were designed to promote the winery, horticulture and salmon fishing sectors
- State-owned Codelco’s local content policy - approximately 90% of engineering services in the Chilean mining industry comes from SMEs

Chile: Mineral exports % total exports

(WDR 2013)



Policy lessons

- **Capacity to select key sectors** to support through tax, credit, subsidy incentives
- Policy lending or **low interest finance**, in an environment of underdeveloped financial sector
- Production and consumption **linkages** between the extractive sector and SMEs
- **Macroeconomic policies** - exchange rate policy for export promotion
- **Caution!** Prolonged intervention can be inefficient, can breed collusive behaviour and rent seeking
- **Know when to exit and phase out industrial policy**

Thanks You

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