POLICY BRIEFING 19

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# Policy effectiveness and China's investment in the Zambian mining sector

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## RECOMMENDATIONS

- African governments that receive inward investment from both Western and Eastern countries need to acknowledge how the difference in business culture (and political relationships) affects practice and consequently regulation.
- Regulation in Zambia's mining sector currently relies on self-reporting and consensus, which are increasingly inappropriate to the growing diversity in investors' business practice and operational standards, and should therefore be reformed.
- The government should leverage existing policy frameworks, including its 'multi-facility economic zones', to develop local industry so as to accommodate the expanding needs of Chinese investors.
- By mandating and enforcing the public reporting requirements of the mines, civil society could assist government to hold firms accountable.

## EXECUTIVE SUMMARY

Despite the financial crisis of 2008–2009, the pace of China's investment into Africa has quickened. This is re-configuring state–firm relations in Africa's resource-rich countries. However, Chinese and Western investors have different approaches to regulatory practices and operating standards. In the case of Zambia, this threatens to undermine policy effectiveness of a fragile regulatory framework that is heavily reliant on self-reporting, consultations and consensus among the mining companies.

The government must recognise that Zambia's regulatory policy has failed to keep pace with the changing needs of its expanding mining sector. Regulators must be empowered to implement (possibly unpopular) regulatory reforms, which should be decoupled from political influence. The challenge is to do both in the context of the growing number of Chinese investors who often enjoy close relations with the presidency, through which they may seek to circumvent the regulatory agencies entirely.

This briefing describes some of the challenges facing the efforts of Zambian policymakers to secure sustainable benefits from the exploitation of the country's mineral resources. At present, while Zambia's copper mines generate about two-thirds of the country's foreign exchange, their contribution to national development remains contested for various reasons. These are explored under the broad headings of the investor-friendly financial terms set by the government when the mining sector was privatised, the entry into the sector of Chinese companies, and the strain their distinctive mode of operation has put on the regulatory regime.

## POST-PRIVATISATION EXPECTATION & DISAPPOINTMENT

Zambia's mining sector was privatised roughly between 1997 and 2002. Shortly thereafter copper prices began rising, prompting rapid expansion by Western as well as emerging-economy investors and raising prospects for a revitalisation of the long-stagnant sector. Yet Zambia's copper mines have failed to live up to their development potential for a number of reasons, including the government's

limited ability to capture fiscal benefits: incoming investors negotiated highly concessional tax and royalty rates at privatisation, when Zambia was a forced seller in a buyer's market.[2] Consequently, in 2007 the government collected just 3% of the $4.7 billion earned by copper and cobalt exports.

Popular pressure on government to secure a larger share of benefits from copper extraction grew throughout the boom, but attempts to revisit the provisions of state–firm contracts through a formal renegotiating process failed. In early 2008, the government announced a new tax regime that would raise taxes on mining companies. Their responses varied. Several Western mining companies, including First Quantum Minerals and Mopani Copper Mines, threatened to go to international arbitration and quietly scaled back their investment plans, while most emerging market firms, including China's Non-Ferrous Metals Corporation Africa (NFCA), were silent on the issue.

Local regulatory capacity has not kept pace with the rapid acceleration in mining sector investment. High-profile examples of regulatory failure include a now-infamous incident in 2005 when the explosives manufacturing facility of BGRIMM (Beijing General Research Institute of Mining & Metallurgy, a subsidiary of NFCA) literally blew up, killing over 50 Zambian workers.[3] When the Indian-owned Konkola Copper Mines polluted the Kafue River in 2007, it caused Zambia's largest environmental disaster, but ministerial intervention prevented the Environmental Council (the regulator) from bringing charges against the company.[4]

These shortfalls in regulation have added impetus to the calls for reform. High on the agenda are proposals for new licensing procedures, increased resources, and limitations on government interference. However, progress has been stalled.

## CHINESE EXPANSION DURING THE FINANCIAL CRISIS

In 2008 foreign direct investment (FDI) to developing countries fell by 30% (to $385 billion) – the first such drop since the East Asian crisis of 1997.[5] The financial crisis limited the ability of many investors to raise the capital required to repay existing debt or finance new projects. The immediate impact on the Zambian mining sector was significant. Forecasts for the production of finished copper in 2009 halved, from 1 200 to 600 kilotonnes, and about a third of directly employed mineworkers were made redundant. The impact of the crisis on Western firms operating in Zambia was exacerbated by the uncertainty caused by the government's u-turns on fiscal matters in 2008. Sudden policy reversals represent a significant risk for firms reliant on highly sophisticated but fickle institutional investors. Thus, when the crisis hit, many were already reconsidering their investments. The mood of mining companies was described as 'very suspicious', because there was 'no guarantee of stability, the government can turn around again any time'.[6]

However, outward FDI from China continued to grow. Investment into non-financial sectors reached $41 billion in 2008, a year-on-year increase of 64%.[7] Chinese companies are far less vulnerable to a global 'credit crunch' because their government can instruct the state-owned banks to continue lending, even when pure market logic might dictate otherwise. Moreover, higher capital reserves and trading restrictions meant that Chinese banks were less exposed to exotic (and toxic) mortgage-backed securities.

Zambia benefited through various high-profile investments from China. In May 2009 NFCA, competing against Vedanta Resources and the Luanshya Mineral Resources consortium, acquired Luanshya Copper Mines, which was being sold as a direct result of the low copper prices. Similarly, the Jinchuan Group company 'saved' Albidon's Munali nickel mine through an injection of equity. In North-Western province Zhonghui Mining was awarded a prospecting licence in February 2010, having undertaken to invest up to $3 billion.[8] The Minister of Commerce said the government was 'grateful' that, despite the global downturn, Zhonghui's investment budget had increased.

## THE NATURE AND IMPLICATIONS OF INVESTOR DIVERSITY

The entry of Chinese actors into the African mining industry represents a tremendous opportunity for the continent's resource-rich countries, yet it poses

certain problems for policymakers. Zambia's influx of Eastern and Western companies from markedly different institutional and cultural backgrounds means that the regulatory framework will have to accommodate widely divergent ways of doing business. These variations cover involvement with home governments, embeddedness in international capital markets, and the business culture developed by each company over time.

For example, Chinese state-owned companies are often both influenced and protected by the state, so their exposure to markets is only partial.[9] NFCA is a subsidiary of the state-owned China Nonferrous Metal Mining (Group) Company, which plays a very specific role in China's foreign policy, operating all the large Chinese mines on the Copperbelt, and pioneering the development of 'special economic zones' in Africa. Chinese investors often enter Zambia through 'closed-shop' negotiations between the presidency and Chinese officials. The government is rewarded by large loans from China.[10] Chinese investors appear to look to cultivating close relationships with members of Zambia's central government rather than fostering community relations and demonstrating corporate social responsibility to ensure the stability of their ongoing operations.[11]

Chinese companies also enjoy an advantage in raising capital. For most firms, raising debt capital on international markets is increasingly associated with regulatory pressures. International banks require compliance with the Equator Principles, which provide for regular audits, by independent consultants, of the applicant's social and environmental management systems. Moreover, firms listed on stock markets must report audited financial accounts prepared to international accounting standards. Chinese state-owned companies that do not raise capital on international markets are not subject to these reporting requirements. NFCA was the only one of the five companies I studied in Zambia that did not produce auditor sign-off on the accounts lodged with the Zambia Revenue Authority, a significant omission given the evidence of transfer pricing in the sector.[12]

Again, the informal norms and practices of Chinese companies are distinct in ways that affect regulatory compliance. For instance, the typical period that NFCA managers spend at the company is three years, an unusually high management turnover that may lead to short-term incentives: managers focus more on near-term production and profit to the detriment of investment in longer-term projects, like improving environmental and safety standards. Moreover, segregated managerial practices and language problems increase the propensity for dangerous mistakes. An NFCA employee reported that poor communication was the reason for his company's having the highest number of fatalities underground.[13]

## HOW DIVERSITY UNDERMINES REFORM

Zambia's regulatory framework for its mining sector relies on co-operation, consultation, self-reporting and mutual accountability. Regulators are viewed as partners who should support and enable, as well as control and constrain, private sector interests, with the aim of creating 'a win–win situation, so that when we regulate, we regulate such that they are more than willing and glad to comply'.[14]

However, where investors follow different standards and practices, regulators cannot rely on consensus. Firms that already have adequate reporting and control systems, like most of the Western mining companies, need not fear that regulatory reform will impose higher compliance costs. However, companies that do not have such systems in place are unlikely to support stricter standards. A mining manager from Chambishi Metals said that his firm fully supported reforms that would sharpen the regulatory 'teeth' of the Mines Safety Department, but described NFCA's mood as 'apprehensive'.[15]

Zambia's 'presidential' political culture, in terms of which large foreign investors are expected to brief the president on their investment plans, also complicates reform efforts because it engenders an interventionist approach. What should be relatively straightforward bureaucratic regulatory policymaking and enforcement becomes politicised. For example, a mines safety department official divulged that the ministry of mines was resisting plans for a more independent regulatory agency because it does not wish to relinquish control.

## CONCLUSION

The recent crisis showed African governments just how sensitive private investment can be to the vagaries of international capital markets and a global downturn. In contrast, Chinese investors, who are often supported by the state through direct ownership or debt financing, have been able to offer long-term commitment, a matter of key importance to African governments that rely heavily on foreign investment to develop their resource sectors.

Differences between Chinese and Western companies in practice and standards can impede their agreement on regulatory reform. Moreover, the tendency among Chinese investors to cultivate relationships with executive-level members of government may entrench personalised and discretionary arrangements that undermine the drive towards regulatory reform. Under the new administration of President Rupiah Banda, Zambia's commitment to the Extractive Industries Transparency Initiative and greater transparency remains ambiguous. For example, the government rejected donor proposals to involve external consultants in assessing bids, and failed to disclose its reasons for awarding the Luanshya Copper Mines to NFCA.

If Zambian copper is to support economic and social development, the government must strengthen and clarify the mandates of the regulatory agencies involved in the mining sector. This can be done only if policymakers become less reliant on collaboration with the mining companies. Although self-regulation and consultation over policy formulation have merits, they can be counter-productive when there are wide divergences in the culture and interests of the companies requiring regulation.

## ENDNOTES

1. Dr Haglund received his PhD from the University of Bath in 2010. This policy briefing draws on research he conducted in 2007–2009.
2. The World Bank had made further lending contingent on successful privatisation, whilst the sale of the mines coincided with the privatisation of the copper sectors in Peru, Kyrgyzstan and Uzbekistan.
3. See *BBC News*, 'Dozens killed in Zambia explosion', 21 April 2005, http://news.bbc.co.uk/1/hi/world/africa/4466321.stm.
4. For an example of such political intervention, see *Times of Zambia*, 'Zambia: parley committee takes ECZ [Environmental Council of Zambia] to task', 15 May 2007, http://allafrica.com/stories/200705150531.html.
5. See World Bank, 'Global development finance 2009', 2009.
6. Interview with First Quantum Minerals manager.
7. *China Daily*, 'Green rules eye Chinese firms abroad', 29 May 2009, www.chinadaily.com.cn/bizchina/2009-05/29/content_7952605.htm.
8. *The Post*, 'Government awards prospecting licence to Chinese company', 23 Feb 2010, http://www.postzambia.com/post-read_article.php?articleId=6259.
9. See *The Economist*, 'Here be dragons', 15 April 2010. I elaborate on this point in Haglund D, 'In it for the long term?', *China Quarterly*, 199, 2010, pp. 627–646.
10. The Minister of Commerce, Felix Mutati, remarked, '[i]t's because of the president going to China that we have been able to secure a loan of US$1 billion'. *LusakaTimes*, 'Chinese visit pays off for Zambia', 11 March 2010, http://www.lusakatimes.com/?p=24649.
11. Haglund D, 'Regulating diversity: China and the changing composition of Zambia's mining sector', *China Monitor*, September 2009. Stellenbosch: Centre for Chinese Studies, Stellenbosch University.
12. Transfer pricing is the practice whereby companies reduce tax payments engaging in intra-company sales and purchases at non-arms-length basis. See Haglund D, 'Regulating FDI in weak African states', *Journal of Modern African Studies*, 46, 2008, pp. 547–75.
13. Interview with NFCA employee.
14. Interview with ECZ official.
15. Interview with Chambishi Metals manager.

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