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in the Minerals Sector
Geneva, 26 October 1995

Report of the Ad Hoc Group of Experts on State Participation and Privatization in the Minerals Sector

Held at the Palais des Nations, Geneva
from 26 to 27 October 1995

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INTRODUCTION

1. The Ad Hoc Group of Experts on State Participation and Privatization in the Minerals Sector held its session at the Palais des Nations, Geneva, from 26 to 27 October 1995. It was attended by 12 experts on different countries[1], invited by the Secretary-General of UNCTAD, by a number of other invited speakers and discussants[2], and by representatives of governments and intergovernmental and non-governmental organizations[3].

Opening statements

2. The Officer-in-Charge of the Commodities Division of UNCTAD welcomed the participants and, referring to the current financial situation of the United Nations, thanked the experts, speakers and discussants for their generous support for the work of the Ad Hoc Group. Addressing the situation in the non-fuel minerals industry, he said that private enterprise had been responsible for much of the rise in world production capacity in recent years and that the private sector continued to increase its share of production at the expense of the State sector. Nevertheless, many instances remained of State participation in this industry. Some State-controlled mineral enterprises seemed reluctant or unable to carry through the privatization process. The wide variety of expertise available in the Group would help with the consideration of problems hindering the privatization of the non-fuel minerals industry.

3. The Chief of the Resource Development Section of the Commodities Division said that the UNCTAD secretariat, in analyzing the contribution of the minerals sector to the process of economic development, had identified one of the problem areas as being the organization and efficiency of mineral production. Political interference in State-controlled production was frequent and often entailed diminished efficiency. On the other hand, privatizing these enterprises could be difficult because of their large size and the existence of debts and environmental liabilities. While an expert approach was needed to address these and other technical issues of mineral resource management properly, it was also necessary to bear in mind the larger and increasingly complex context of sustainable development in which the mineral industry operated. In this context there was a large and continuing role for government, both at the national and local community levels, to ensure that mineral wealth made an effective and lasting contribution to socio-economic development, especially in resource-dependent developing countries and countries in transition to a market economy. The Ad Hoct Group could thus also help to delineate the respective roles of government and the private sector in organizing the exploitation of mineral resources.

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[1] Bolivia, Brazil, Chile, India, Kazakstan, Morocco,Papua New Guinea, Peru, Poland, the Russian Federation, South Africa and Zambia. See annex I for a list of experts.

[2] See annex II for a list of the speakers and discussants.

[3] For the list of participants see document TD/B/CN.1/GE.2/INF.1

Chapter I

COMPARISON OF NATIONAL EXPERIENCES OF STATE PARTICIPATION AND PRIVATIZATION IN THE CONTEXT OF THE EFFICIENT MANAGEMENT OF NON-FUEL MINERAL RESOURCES

(Agenda item 3)

4. For its consideration of this agenda item, the Group of Experts had before it the following report by the UNCTAD secretariat: "State participation and privatization in the minerals sector" (TD/B/CN.1/GE.2/2). Experts made detailed presentations covering various developing countries in Africa, Latin America, and the Asia-Pacific region, and countries in transition to a market economy. For each of these regions the secretariat provided an informal note on recent developments in the minerals sector. Presentations were also made by invited speakers in a general introductory meeting.

Introductory meeting

5. Mr. Magnus Ericsson of the Raw Materials Group (Sweden), noted that State-controlled mining was still more important than generally believed. The share of the value of world non-fuel mineral production controlled by States (excluding countries of Eastern Europe as well as China) had increased from 16 per cent in 1975 to a peak of 21 per cent in 1984; since then, it had fallen back to 18 per cent in 1993. The decline had been slower than might have been expected, largely because privatization programmes had been delayed and because production by some State-controlled enterprises had increased. He cited examples of several State companies that had succeeded in adapting to changed conditions and in improving their position in the market. In his view, formal ownership was not the most important factor determining performance but rather the exercise of control: owners, whether State or private, should not interfere in the day-to-day management of the company, but should confine their interventions to strategic actions. He also examined some recent trends in the behaviour of State-controlled mining companies. There appeared to be a trend towards increased internationalization of operations, either through investment in other countries or through development of joint ventures with foreign corporations in the home country. There were also signs that State-owned companies were becoming more diversified with regard to the range of minerals that they produced. Regarding the effects of privatization on the global industry structure, it was likely that the degree of industry concentration would increase in developing countries since most of the privatized companies had been bought by large, international mining companies ; in developed countries, on the other hand, privatized companies had mainly been purchased by institutional investors. Finally, he noted that the industry was passing through a transition period, and that changes within the private sector segment of the industry were likely to prove more important than changes in the relative shares of State and private sectors.

6. Mr. Norbert Schmitz of Kienbaum Development Services GmbH (Germany), observed that privatization programmes were often triggered by crises. Nevertheless, coordinated action at all levels of the economy was essential to achieve a holistic approach to privatization. At the macro level, privatization should be supported by socio-political reforms and actions that would, for instance, serve to preserve and create employment and promote competition in order to improve the efficiency of the economy. Such actions could be of a long-term nature, for instance, the creation of a social security system; or medium-

term, such as the establishment of retraining programmes or promotion of private initiatives; or they could be short-term, for instance, direct support to affected workers. At the meso level, it was essential to build and strengthen an institutional framework that facilitated implementation of the privatization programme. Possible components of such a framework were privatization agencies, business associations, and Chambers of Commerce. At the micro or enterprise level, a comprehensive approach that took all aspects of the enterprise into account was necessary. The enterprise analysis should include such aspects as production, organization and information technology, management and human resources, accounting and finance, marketing and business, materials management and logistics, and strategy and business planning. One important aspect to be considered was whether enterprises should be privatized as a whole or "unbundled" and sold as separate parts. In conclusion, he emphasized that the main criterion that should be used to evaluate a particular method of privatization should be the effect on international competitiveness.

7. Mr. Claus Hochgrebe of Banque Paribas (France), noted that difficulties were likely to arise at all stages of privatization from initial planning to final implementation and that the process needed the long-term dedication of the government concerned. In his experience, the smoothest privatizations were the ones where the government had used a public relations campaign to explain the objectives of the privatization to all interested parties. He also noted that mines were often located in remote areas where all infrastructure was dependent on the mining operation. Since the employees in such cases depended on the mining company not just for employment but also for social services of all kinds, they tended to feel insecure about privatization and the implicit effects on such services. The question of who should handle the associated services and businesses therefore needed to be addressed in a serious manner. A privatization programme involved a large number of different kinds of expertise in its various phases. Part of the role of the investment bank advising the government was to coordinate these forms of expertise. However, unless the government side was equally well coordinated and prepared to work closely with the investment bank, success could not be assured. As regards the revenue arising from privatization, he emphasized that the prospective purchaser was not just buying a mine, it was investing in a project. There could be a trade-off between the purchase price and the investment commitment, and governments would be well advised to examine closely the long-term implications of different alternatives in this regard.

8. Ms. Kathleen Anderson, Center for Resource Studies, Mining and Environment Institute, Queens University (Canada), referred to a number of environmental problems and challenges that arose from mining operations and which merited consideration in the context of the privatization of mining companies. First, given that funds for environmental remediation were limited, there was a need to assign priorities to the environmental problems that were facing communities. This might necessitate choosing between actions to tackle problems endangering human health and those intended to deal with problems affecting ecosystems, and care should be taken that the privatization process did not distort the evaluation of these problems. Secondly, tremendous effort had gone into identifying and quantifying the environmental degradation from past mining activities. However, the assignment of responsibility for "past sins" might be less important than determining the appropriate level of responsibility which the mining firm should assume for future actions. Thirdly, public participation, in particular the participation of local communities, was a necessary and essential part of future decision-making on privatization and the environmental remedial action associated with it. Finally, to the extent that privatization

resulted in an infusion of capital, both financial and human, which could be directed towards increasing the efficiency of mining, there would most likely be improvement in overall environmental performance. It was important, however, that sufficient mineral rents were captured to build and maintain regulatory capacity. The best environmental outcomes were achieved by good general mining practices on the part of companies and by well -trained, well-funded government regulators.

Developing countries in Latin America

9. Mr. Sergio Hernandez, Under-Secretary for Mining, Ministry of Mines, Chile, speaking on his country, said that during the 1960s and 1970s, the future of the copper sector had been increasingly identified with that of the country, given that copper had then accounted for about 80 per cent of export earnings; the resulting feeling that the country needed to control the development of its resources had led the State to take over copper production activities. The Government had embarked on a path of economic liberalization in the 1980s and since then the central element of development policy in the mining sector had been to encourage private sector development. The role of the State consisted in providing stable institutions and a stable policy framework for private initiative with a view, *inter alia*, to creating confidence for foreign investors. The Government had recently established a science and technology programme in order to train the professionals required by the mining sectors. He emphasized the importance of geological surveys for strategic planning: copper resources in Chile were estimated to last for at least another 60 years, and consequently this resource could be exploited without fearing imminent exhaustion. In these circumstances, the copper sector could be a basis for development and for diversification both out of mining activities as well as within the mineral sector itself. Four factors were crucial in the Government’s current privatization policy: first, the Government should not initiate privatization of a company unless maintaining its stake in the company had a high opportunity cost; secondly, the privatized company should be able to operate in a competitive market; thirdly, the company should be sold at a price that corresponded to its real economic value, rather than any arbitrarily fixed value, in order to ensure credibility of the project in the population; and fourthly, workers should be enabled to acquire part of the privatized company. He said that the State maintained full ownership of CODELCO, which was the world’s biggest copper company, because the company was of strategic importance for the country’s economic development. As CODELCO was operating efficiently and making profits, its privatization was not likely to generate additional benefits to the country. Moreover, it was in the interest of the mining sector to direct investment to new projects rather than to buying a stake in CODELCO. All of CODELCO’s support services, such as power generation or production of mining equipment, as well as the development of new mining activities, were being offered to the private sector. The Chilean mining sector had been open to private investors for 10 years which explained the sector’s high level of development.

10. Mr. Rafael Toledo, consultant to Minero Peru, said that the minerals sector in Peru had come under strong State influence in 1969 when two of the three large mining companies had been nationalized and mining, as well as marketing, processing and numerous other activities in the minerals sector, had come under State control. Given the monopoly position of the State enterprises, they had not invested in advanced technologies with a view to reducing costs, and had thus incurred losses. This situation had been compounded by the general

economic and social crisis in Peru. The main objective of the process of privatization, which had started in 1992, was to attract investment from those able to develop projects, improve technology and raise mining capacities. In the preparatory phase of privatization, a balance needed to be found between the interest of the State and those of potential purchasers. It was important that experts paid on a contractual basis were hired to advise on the privatization process. One difficult problem was to determine the actual level of debt each company had incurred because this debt had been assumed by the central government. The presence of a stable and transparent legal framework was crucial for investors, and it was advantageous to have a company's market value calculated by specialized auditors. Five main factors had contributed to the success of Peru's privatization process: first, broad political support; second, investment had been handled by experienced people; third, as many investors as possible had been contacted in order to ensure competition; fourth, an intensive information campaign had been undertaken which included all aspects of the privatization process; and finally, a legal framework had allowed the process to go forward in a flexible and dynamic manner. In the future, State involvement should be limited to the provision of a transparent, reliable and stable legal framework .

11. Ambassador Jorge Lema-Patino of Bolivia said that structural change in Bolivia's minerals sector had been initiated in 1985 as a result of the State companies' accumulated losses, made worse by the collapse of tin prices the same year. The principle objectives of restructuring were to develop an internationally competitive mining industry with state-of-the-art technology and administrative efficiency, and to increase the production of minerals and metals to levels that would take full advantage of the country's mining potential. In 1993, the Government had opted for the capitalization of State-owned companies rather than for simple privatization. He explained that capitalization, compared to simple privatization, made it easier to capture the market value rather than the book value of an enterprise. Capitalization was a package deal. The private investor seeking to acquire smelter operations made a significant investment of an agreed amount in the operation being acquired. In return, the investor was attributed the mining rights and gained management control of operations and a majority on the board of directors of the new company. The company, once restructured and "capitalized" in this way, was allowed to operate only in the metallurgical-mining sector and only within the country. Temporary private monopolies were tolerated since this allowed more efficient investment opportunities and hence benefited the economy as a whole. Both profitable and unprofitable operations were restructured and capitalized since it had become difficult for State-owned enterprises to obtain finance from international capital markets. Finally, the State's remaining share of the equity in the capitalized company was made over to national pension funds and the income from this equity thus generated additional resources for social security. Each adult Bolivian was allocated an individual share in the pension funds.

12. Mr. Luis Martins of the State University of Campinas, Brazil, said that the strategy of strong State involvement in the mineral sector of Brazil had been put aside in the 1980s in the light of the country's mounting foreign debt. Privatization had been actively pursued since 1990 and the only significant remaining participation of the federal government in the mineral sector was the 51 per cent stake held in the Companhia Vale do Rio Doce (CVRD). The objective of the present government's privatization policy was to raise revenues in order to reduce both external and internal public debt. He argued, however, that privatization policy should not aim simply to raise revenue but should rather

focus on long-term objectives such as increasing the efficiency of the private sector and of tax collection, as well as on the reduction in government expenditure following privatization. Referring to the planned privatization of CVRD, he explained that a privatization council would value CVRD's assets and liabilities in order to establish a minimum share price before starting the sale process through public bidding. Three main factors suggested that CVRD should be sold as a single unit: first, CVRD had many interrelated companies and some of these would probably not be competitive on their own; secondly, given the existing minority private-sector ownership and the fact that the shareholders had a preference for share acquisition in the case of some subsidiaries, it was possible that a low price for the shares would result; and thirdly, the division of CVRD could adversely affect the rights of small shareholders. The Government was intending to allocate around 10-15 per cent of the shares to employees of the privatized company, as well as to attract as many independent investors as possible to prevent the formation of oligopolies. Maintaining a minority State participation for a limited period of time could be justified on the grounds of an expected rise in the company's stock prices after its privatization.

13. In conclusion, he recommended the following actions and policies to promote and sustain privatization in the minerals sector: first, the Government needed to balance its objectives of maintaining a national interest in mining and encouraging foreign private investment; secondly, privatization should be carried through in a transparent manner; thirdly, appropriate mining and investment laws and trade policies needed to be adopted; and finally, the international community could help through the provision of both finance and expertise.

14. In the following discussion, Mr. John Strongman of the World Bank said that the experience in Latin America showed that: (i) privatization and capitalization could bring significant benefits in the form of cash payments and investment commitments; (ii) there were many ways to undertake this process, including direct sales, auctions, capitalization and sale of shares; and (iii) Peru's successful privatization underlined the need for government to take preparatory steps in terms of (a) creating an enabling environment with clear rules for private-sector investors in particular in terms of modern, competitive tax laws, licensing and environmental legislation, and a good registry of mining claims; and (b) for the process to be carried through in a well organized and orderly manner by individuals who were not part of the company to be privatized, assisted by professional advisors who could provide the Government with realistic valuations of the value of the enterprises or assets being sold and assure investors a transparent process. He said that it was probably easier to privatize a company if: (i) it were not the single most important asset of the country; (ii) the country already had a well-functioning private sector; and (iii) there were no minority private-sector ownership in the company.

15. The discussion then concentrated on the issue of whether State ownership of a company was compatible with efficient management. It was noted that a company's efficiency depended on managerial decisions rather than the form of ownership. However, State ownership tended to preclude effective management because politically appointed managers lacked interest, rarely took risks and were not responsible for investing their own capital. The streamlining of activities was also more difficult and State-owned companies were prone to corruption. Business ethics and the moral standards of a government had a large impact on this issue. Some managerial decisions affected not only the short-term efficiency of the company but also the long-term development of the country.

It was questionable whether privatization should be carried out in periods when private investment was anyway buoyant.

16. The discussion also addressed environmental issues. One discussant said that developed countries which purchased raw materials from developing countries were now trying to establish specific environmental standards for raw-material production in developing countries. State enterprises in developing countries often lacked the financial means to undertake the investment required to meet these standards. Developing countries were also questionning whether standards should be as strict as those in place in developed countries; their implementation would be an implicit subsidy for raw-material production in developed countries where these standards were already in place. It was suggested that some environmental liabilities could be abandoned in the process of privatization.

Developing countries in the Asia-Pacific region

17. Mr. I.G. Jhingran, former Secretary, Ministry of Mines of India said that the minerals sector in India had been dominated by the State as part of a deliberate policy during the post-colonial period and there had been minimal private-sector initiatives during this period. Central government had overall responsibility for regulation and development of mines and minerals. Regional State governments, as owners of the minerals under the Indian constitution, exercised power with respect to minor minerals, but major minerals were the responsibility of central government. Until 1993 mineral sector policy had been conducted as part of a broader industrial policy. The new mineral policy initiative of 1993 aimed to encourage an increase in private-sector investment, both local and foreign. The major provisions included the possibility for local private investors to own new mineral enterprises up to 100 per cent (less for foreign investors), and a longer life for mining leases and for prospecting licences, with area restrictions remaining at the discretion of the Government. Some degree of privatization of State-controlled enterprises was also provided for. In the initial stage, this allowed disinvestment by the State of up to 49 per cent of equity, but buying was limited to financial institutions and a small percentage of equity was earmarked for employees. Labour restructuring was also being undertaken before disinvestment; redundancy was dealt with through voluntary retirement schemes. Another form of privatization being tried was joint venture between public and private companies. In general, the major State enterprises in the minerals sector had performed well, establishing important infrastructure, showing due regard for environmental issues and providing a large reservoir of technically trained people who were now being absorbed in the privatization process. However, this performance could have been enhanced had there been greater delegation of power to the enterprise level.

18. Mr. Charles Lepani of the Mineral Resources Development Company Pty Ltd (MRDC), refering to Papua New Guinea, said that in the immediate post-colonial period the aim of government policy had been revenue generation which had been achieved through minority equity participation by the State in major mining and petroleum projects (30 per cent in the former and 22.5 per cent in the latter), held for the most part by MRDC. The original Bougainville Copper Mine Agreement had been renegotiated with this aim but without enough attention to environmental and land-ownership issues; in the latter respect he noted that only 2 to 3 per cent of the land was owned by the State with the rest owned by tribes, private individuals and other entities in the private sector. Papua New Guinea had embarked on a structural adjustment programme and government policy

in the mining sector was evolving towards a mainly regulatory role. The current privatization programme centered on the financial restructuring of MRDC and an initial public offering of 49 per cent of the company was planned. This would allow MRDC to capitalize on some of its assets for investment in future mining and petroleum projects while continuing to provide returns to its stakeholders (including the State). The longer-term objective was a gradual, controlled divestiture by the State consistent with government policy of effective ownership of the economy by the country’s citizens.

19. In the discussion that followed, Mr. James Otto of the Centre for Petroleum and Mineral Law and Policy, University of Dundee (United Kingdom), noted that experiences differed between countries of the region: Papua New Guinea was selling off State minority interests in mineral enterprises, while India’s mineral sector was still largely dominated by the State. The question was whether the State’s intervention should be regulatory, asserting control through licences, taxation etc., or should be participatory, effected through State enterprises or equity participation. He noted that new mining legislation in the region aimed to reduce but not eliminate protectionist policies, seeking investment from home and abroad. Government was taking both a regulatory as well as participatory role. He gave several examples of countries in the region which reserved the right to take up equity interest in mineral enterprises. He noted that among the reasons for this was the need for governments to exercise control through an equity stake under a federal system where provinces had no taxation rights or in situations where indigenous rights must be protected. He noted, moreover, that both risks and rewards were associated with equity participation as governments could be liable for lawsuits served on the enterprise.

Africa

20. Mr. Joseph Phiri, Permanent Secretary, Ministry of Mines and Minerals Development, speaking on Zambia, said that during the post-colonial period a policy of nationalization had been carried out in the expectation that greater benefits would accrue directly to society as a whole. However, during this period the mining industry had failed to attract investment in new exploration ventures or into existing mines, owing to inappropriate fiscal and other policies. The politicization of the industry had eventually led to inefficiency and Zambia’s position in the global mining industry had declined significantly, from a production peak of 700,000 tonnes in 1977 to under 400,000 tonnes in the 1990s. The Zambian copper mining industry, as currently operated, was not economically viable. But even in its present state of decline, mining was a major contributor to the Zambian economy in terms of exports (accounting for 90 per cent), GDP (20 per cent) and employment (15 per cent of the formal sector). Given the importance of copper to the Zambian economy, there was a need to restore economic viability through greater efficiency and productivity. This could be done only through increased private-sector investment and good, accountable management, acting in accordance with business ethics and ideals. There was the political will to do so following the change of government in 1991, and current government policy was to privatize the copper industry with the expectation of obtaining the large capital investment necessary to revitalize the industry. To facilitate the process of privatization in the mining sector, the Government had put in place new measures in mining legislation and the fiscal regime and included environmental considerations in keeping with widespread international practice. In conclusion, he said that the Government recognized the need to deal with

stakeholders, including those who would be opposed to privatization, including labour unions and politicians. It was the Government's intention to educate the general public about the benefits that would accrue from privatization and its value to society as a whole.

21. Mr. Michael Solomon of the Minerals and Energy Policy Centre, South Africa, compared the privatization under the previous Government of the iron and steel company Iscor with that of Alexcor, a State-owned diamond mining company, which the present Government was planning to privatize. The privatization of Iscor under the apartheid regime had been based solely on commercial considerations and had resulted in the transfer of ownership from the State to institutional, white investors. The current Government needed to use the privatization of Alexcor as an instrument for sustainable economic development, with a special regard for mine labour and the local community, while maintaining economic efficiency and productivity. Since mineral resources and the proceeds from privatization were considered to be a national patrimony, the role of foreign investment needed to be limited with an emphasis on technology transfer. Two cardinal rules had to be observed during the privatization process: first, the attractiveness of mineral projects should not be impeded by the imposition of contractual arrangements unacceptable to potential investors; and secondly, sustainable development should not be funded through taxes or levies over and above the normal taxes imposed on mining. The guiding principles of privatization included a coherent policy framework, the attraction of new investment, transparency of the process, and the participation of the community directly affected including the poor and disadvantaged. Finally, the State had a special role to play to ensure that sustainable economic activity would result from the privatization process.

22. Mr.A. Mahzi of the ONA Mines Group, speaking about Morocco, said that the State was active in those areas where private enterprise was unable to meet the challenges of a developing economy; privatization was undertaken as and when the private-sector became mature enough to take over. The privatization law in Morocco aimed mainly at supporting social and economic modernization as well as obtaining additional fiscal revenues. Partnership between the State and the private sector was a guiding principle of privatization. All non-energy minerals were now open for privatization, with the sole exception of phosphates which remained a State monopoly for the time being. The Bureau for Research and Participation in the Mining Industry (BRPM), the State body responsible for geological research and the promotion and development of mineral deposits, already operated mining ventures in partnership with domestic and foreign private enterprises. An appraisal of privatizable mining operations had been completed. Conditions for private enterprise included maintaining the existing level of employment for a minimum period of five years and an emphasis on research and development. Schemes for the transfer of ownership were being studied, such as direct transfer to investors, which could possibly include BRPM, and the sale of shares through the Casablanca stock exchange.

23. Ms. Kamala Bhoolai of the Commonwealth Secretariat, London reviewed the situation of three Southern African countries, namely Botswana, Zimbabwe and Namibia. She noted that Botswana, a stable economy, had been successful in attracting foreign investment in the mining sector where diamond mining was the dominant activity. Diamonds accounted for 70 per cent of foreign-exchange earnings and this was one of the main reasons for government involvement in the sector. The diamond sector was 50 per cent Government-owned, the Government was involved in all major management decisions as well as in marketing, and there

were no immediate plans to dilute the State’s participation under the present Government. In Zimbabwe, the State had been a major participant in the mining sector since independence in the 1980s. In some instances, as for the copper and tin mines, this was an attempt to save ailing industries. Government participation was between 50-55 per cent in some gold mines as well as for copper and zinc. There had been an increase in private investment in recent years and measures had been taken to attract foreign investment through various incentives. The situation in Namibia was similar to that in Botswana, with the State negotiating joint onwership of diamond operations with the DeBeers company in an attempt to ensure local employment and local participation in the decison-making process within such an important sector.

24. In the discussion that followed, it was pointed out that no one method or combination of State/private ownership was suitable for all countries. Moreover, the timing of privatization was important to obtain the maximum benefit for the country. The receipts from privatization were better spent on future economic development rather than to pay for the "sins of the past". The issue of effective and continuing community participation, including appropriate mechanisms to ensure this, was recognized as being important.It was also important for the State to find the appropriate trade-off between revenue earned through dividends from retained equity and revenue obtained through taxation of the privatized enterprise. Finally, with reference to the SYSMIN financing facility, a form of ACP-EEC cooperation under the Lomé Agreement, the view was expressed that the facility was intended to provide support to the minerals sector in the event of loss of earnings due to price fluctuations and should not serve to shore up ailing or badly managed State enterprises.

Meeting on countries in transition to a market economy

25. Mr. Alexander Andreev, State Committee on Property , of the Russian Federation, underlined the unprecedented volume of privatizations which was being undertaken in the Russian Federation - over 100,000 enterprises from all sectors of the economy had been privatized in the space of two years. Largely because of this, a universal approach towards privatization had been adopted, rather than a case-by-case approach. Under the Special State Programme on Privatization, there remained only a few enterprises in the mining sector in which the Government held a controlling share. A private enterprise was allowed to manage State-owned companies in exchange for loans to the Government. In some cases, the State retained a controlling share but the ultimate aim of the Government was to withdraw entirely from ownership. Government bureaucracies had neither enough time nor sufficient direct interest to manage these enterprises efficiently. The State supported the privatization process in four ways, namely: through transfer of part of the assets to employees at symbolic prices; through investment financed by sale of the State share of the assets; by accepting to take over social liabilities (although this was proving to be a very complex issue); and by offering the initial package of assets on very favourable terms, which gave shareholders the possibility to organize a second emission of shares and thereby to increase investment in the enterprise. Finally, he underlinined the necessity of a coherent strategy for managing investment during the privatization process.

26. Mr. Piotr Syryczynski, Ministry of Privatization, Republic of Poland, explained some characteristic features of the privatization process, taking one of the leading national mining enterprises as an example. First, shares were offered at a rather high price by Polish standards (in this case, $80 per

share); second, a commitment to invest in the enterprise was established (at the level of $42 million); third, a social package including an employment commitment was included; and finally, the contract also dealt with the issue of environmental liabilities. In the view of the Government, offering the enterprise as a whole made it easier to obtain a $42 million investment commitment and it was unlikely that such an amount would be forthcoming if the enterprise had been divided and offered for sale in separate but smaller parts. Privatization involved the sale of both assets and liabilities and any liability left with the State implied a partial privatization only; nevertheless, some long-term liabilities were currently taken on by the State. Preparing an offer was the crucial point in the privatization process. Currently Poland practised various types of privatization in the minerals sector such as sale through the international stock market, through joint ventures, and through privatization coupons. The preference of the Government was for privatization through a public offer of capital. Privatization also occurred when a new enterprise was established with private capital. In the mining industry the most common method of establishing new enterprises was through offers by tender; a tender system for gold prospecting was planned for the end of 1995.

27. Mr. John Huhs, of the law firm LeBoeuf, Lamb, Greene and MacRae, highlighted some aspects of the current "case-by-case" process of privatization in Kazakstan, which provided for direct foreign investment and included many important mineral enterprises such as those engaged in the mining and processing of precious metals, other valuable non-ferrrous metals and some interesting ferro-alloys.The two main variants of the process were: (i) direct equity sales, basically similar to those under other privatization regimes; and (ii) management agreements, whereby the foreign investor is granted a power of attorney to control the management of the target company together with a profit-sharing right and a share purchase option. Since early 1995 the latter variant was being heavily promoted as a "fast-track" path to privatization in order to inject urgently needed investment into the minerals sector where the majority of mining companies had enormous debts for electricity and raw material supplies as well as for unpaid wages and taxes. Some 34 mineral enterprises had been identified for case-by-case privatization during 1994-1995 and eight significant management agreements were known to have been awarded since January 1995. Given the rapidly evolving situation, he stressed the need for due diligence on the part of foreign investors with regard to the Kazak legal process.

28. The Representative of the United Nations Economic Comission for Europe, noted that the coal industry, which had many aspects in common with the non-fuel minerals industry in terms of exploration, mining and legislation, faced serious difficulties in Europe at present and was also subject to privatization. Privatization in the coal industry was expected to take place over the next 5-10 years in Central European and CIS countries, particularly in opencast coal mining in the Russian Federation, Kazakstan, Romania, Hungary, Poland, and the Czech Republic. All these countries would phase out coal subsidies before the year 2000 and they were currently preparing the privatization process. Drawing attention to the ECE programme of work on a three-dimensional classification of mineral resources, he said that this classification would help countries in transition and other countries to reassess their coal and mineral deposits under market conditions, and would also help investors, since the feasibility study for a large mining investment often involved calculations for mineral reserves.

29. In the discussion that followed it was noted that the process of privatization in the countries in transition to a market economy was very

complex and not immune from political and economic controversy. The Russian Federation was currently carrying out the largest ever mass privatization programme, during which about 75 per cent of GDP had already undergone a change of ownership from State to private; there was a tremendous pressure to complete this process before the mandate and the political will disappear.

Concluding meeting

30. Mr. Phillip Crowson, Chief Economist of the RTZ Corporation, United Kingdom, pointed out that any mineral project that supplies international markets was largely governed by global forces, no matter who owned or managed it. In these circumstances, competitive cost structures had to be maintained or recurrent losses would occur. All mines had to be actively and agressively managed in order to ensure that the maximum amount of ore was extracted in a sustainable fashion over the long run. Speedy and flexible decision-making was essential. Unsuccessful policies had to be recognized and reversed. This was never easy but was virtually impossible in a bureaucratic State-controlled framework. Paradoxically, the exploration and environmental policies of large international mining companies often operated in the long-term interests of host nations more effectively than the policies pursued by their State-owned counterparts. Large international companies increasingly followed the best available practices in all their mining and processing operations, no matter where they were located, largely because it was cheaper and more effective for them to meet the toughest standards from start-up. Continuing pressures for international competitiveness required mining companies to keep up with economic and technical change, and to reinvest in modern plant and equipment, expansions and new ore deposits in a timely fashion. Managements therefore needed adequate control over a mine’s cash flow. But State-owned enterprises usually had to hand all their cash flow to national treasuries and to compete for investment funds with a plethora of national projects, including for current expenditure. In conclusion, State-owned mining companies were often faced with a range of tasks and objectives that would stretch the imagination and abilities of even the most successful private-sector companies. Governments could exercise adequate control over any company, domestic or foreign, through the legal framework and the tax system, rather than through ownership. Mining projects need not necessarily be 100 per cent privately owned, but the private shareholders would normally need to hold at least 51 per cent of the equity to exert effective control over all operational and commercial decisions. The overriding principle should be for countries and companies alike to maximize the economic value of mineral resources for present and successive generations.

31. In his concluding remarks, the Chairman said it was difficult to reduce all the ideas and experiences presented at the meeting into a short statement. In so doing, some important nuances would be lost, and some important ideas perhaps overlooked altogether. None of the experts had suggested that there was a single formula for privatization, only different approaches that worked best, or had the best potential for success, in different situations. That being said, the following points had emerged, in his view, from the discussions and presentations of the Group of Experts:

(a) State participation in the minerals sector had both a long history and, for some countries, a secure future. Where privatization was envisaged, the major challenge was to resolve the process in an economically efficient and socially equitable manner. In this regard, there was no one path to privatization.

(b) The Group of Experts, drawing on actual experiences, showed that there were compelling but differing reasons for the decisions taken or contemplated. In one case, minority equity participation was most appropriate even though it reduced the immediate financial benefits to the State. In another case, full State ownership was preferred in order not to divert from the private sector the immense amounts of capital required for the purchase of existing State assets; in this case, the decision was to allow the limited capital available to go towards the development of new deposits and the creation of new assets. In a third case, existing State assets were being "capitalized" in such a way as to capture more successfully for the State and society the full market value of State assets as opposed to the book value of the assets.

(c) Regardless of the ownership structure, the transparency of the objectives of the enterprise were of central importance, as were the competence and integrity of the manager or owner. Moreover, whatever the path to privatization or continued State participation, the successful exploitation of the mineral assets would depend very much on the existence of a good legislative, administrative and regulatory framework and clear and enforced labour, legal, and environmental regimes.

(d) Privatization should not be undertaken simply to make up a short-term deficit or to pay off external debt. The rationale for privatization must be based on long-term considerations, to benefit present and future generations; this was particularly important for non-renewable assets such as mineral deposits.

(e) Privatization in the minerals sector is a complex and lengthy process. It must be seen in the context of the whole economy and include both macro- and micro-level considerations. It required a dedicated, sustained commitment on the part of the State, supported and supplemented by professional advisors from different disciplines and sectors of the economy. The process was best carried out openly and with public involvement. But the final decision and the responsibility for the process still rested with the Government.

(f) Local communities that were largely or entirely dependent on minerals activities were stakeholders in the privatization process and they should be involved. A mechanism or process needed to be in place to ensure that local communities benefited from the mineral resource and this mechanism should include planning for the future of the communities after the resource had been exhausted. This was particularly important when the resource made only a minor contribution to the State treasury but lay at the heart of the regional economy.

(g) Environmental liabilities would inevitably be viewed differently from country to country, depending on national priorities. In any privatization process, the emphasis should be placed on expectations for present and future environmental management and standards. Assessing environmental damage caused by past practices could consume time and resources to little or no productive end.

(h) When privatization was undertaken on an economy-wide basis and involved thousands of enterprises of every imaginable size, such as was the case with the economies in transition, the process would inevitably differ from the case where a single entity was being privatized. However, the role of professional advice to support the political decision-making process and administrative implementation remained.

(i) Decisions regarding the role of the State, and the choices made concerning the degree and form of ownership, were ultimately political in nature. Because of this, and because there were economic and social consequences flowing from those decisions, there was almost always criticism and public debate surrounding every privatization or State participation decision. This was particularly true when the mineral asset in question was a central pillar of the national economy, or when it was the leading economic activity of a particular area. The political objective was nevertheless clear: it was to achieve the most economically efficient and most socially responsible exploitation and use of the natural resource base of the nation.

32. The above oral conclusions of the Chairman were adopted by the Group of Experts which authorized the Chairman to present them to the Standing Committee on Commodities.

Chapter II

ORGANIZATIONAL MATTERS

A. Opening of the session

33. The session of the Ad Hoc Group of Experts on State Participation and Privatization in the Minerals Sector was opened on 26 October 1995 by Mr. John Cuddy, Officer-in-Charge of the Commodities Division of UNCTAD.

B. Election of officers
(Agenda item 1)

34. At its 1st plenary meeting, on 26 October 1995, the Group of Experts elected the following officers to serve on its Bureau:

Chairman:
Mr. Bruce McKean, Director, International Division,
Mining Sector, Ministry of Natural Resources of Canada

Vice-Chairman-cum-Rapporteur:
Mr. Armando D. Alvarez, of the Permanent Mission of the
Republic of Argentina.

C. Adoption of the agenda and organization of work
(Agenda item 2)

35. At the same meeting, the Group of Experts adopted the provisional agenda set forth in section I of TD/B/ CN.1/ GE.2/1. Accordingly, the agenda for the session was as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Comparison of national experiences of State participation and privatization the context of the efficient management of non-fuel mineral resources
4. Other business
5. Adoption of the report of the Ad Hoc Group of Experts to the Standing Committee on Commodities.

36. Also at its 1st plenary meeting, the Group of Experts agreed to pursue the discussion of agenda item 3 in private meetings.

37. At its 2nd (closing) plenary meeting, on 27 October 1995, the Group of Experts, in view of the short time available, authorized the Rapporteur to complete the final report as appropriate.

Annex I

EXPERTS

Mr. Alexander P. ANDREEV, Chief, Industrial Department, State Committee on Property, Russian Federation

Mr. Sergio HERNANDEZ, Under Secretary for Mining, Ministry of Mines, Chile

Mr. J.I. HUHS, CIS Group Senior Partner, LeBoeuf, Lamb, Greene and Macrae, Kazakstan

Mr. I.G. JHINGRAN, Former Secretary, Ministry of Mines, India

H.E. Mr. Jorge LEMA PATINO, Ambassador of Bolivia, Permanent Representative, Geneva

Mr. Charles W. LEPANI, Managing Director, Mineral Resources Development Company Pty Ltd (MRDC), Papua New Guinea

Mr. A. MAHZI, Strategy Director, ONA Mines Group, Morocco

Mr. Luis MARTINS, Professor, Department of Mineral Resources Policy and Management, State University of Campinas, Brazil

Mr. J.K. PHIRI, Permanent Secretary, Ministry of Mines and Mineral Development, Zambia

Mr. Michael H. SOLOMON, Coordinator, Minerals Policy Division, Minerals and Energy Policy Centre, South Africa

Mr. Piotr SYRYCZYNSKI, Team Manager, Environmental Unit, Department of Capital Privatization, Ministry of Privatization, Poland

Mr. Rafael TOLEDO, member of the Special Committee and Consultant, Minero Peru, Peru

Annex II

PANELLISTS

Ms. Kathleen ANDERSON, Director, Center for Resource Studies, Mining and Environment Institute, Queens University, Canada

Mr. Jacques ASTIER, Industrial Consultant, France

Ms. Kamala BHOOLAI, Special Adviser, Economic and Legal Advisory Services Division, Commonwealth Secretariat, United Kingdom

Mr. Olivier BOMSEL, Director, Center for Industrial Economics CERNA, France

Mr. Phillip CROWSON, Chief Economist, RTZ Corporation PLC, United Kingdom

Mr. Madani DIALLO, BHP Minerals, United Kingdom

Mr. Magnus ERICSSON, Raw Materials Group, Sweden

Mr. Claus HOCHGREBE, Advisory Department, PARIBAS, France

Mr. James OTTO, Centre for Petroleum and Mineral Law and Policy, University of Dundee, United Kingdom

Mr. Norbert SCHMITZ., Managing Director, Kienbaum Development Services GmbH, Germany

Mr. John STRONGMAN, Industry and Mining Division, World Bank, United States of America

ANNEX III

ATTENDANCE

The following States members of UNCTAD were represented at the session

Algeria
Argentina
Bolivia
Brazil
Canada
Chile
Cuba
France
Germany
Greece
Haiti
Honduras
India
Kazakstan
Madagascar
Malaysia
Morocco
Papua New Guinea
Peru
Poland
Republic of South Africa
Saudi Arabia
Slovakia
Thailand
Turkey
United Kingdom
Zambia

Economic Commission for Europe