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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Multi-year Expert Meeting on Commodities and Development
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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: Actual and counterfactual revenue flows

(% of GDP)

Counterfactual - Actual = Average 3.7 % of GDP Forgone Revenue

Counterfactual  Actual
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**

<table>
<thead>
<tr>
<th>Sector</th>
<th>1994</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>3.4</td>
<td>3.3</td>
</tr>
<tr>
<td>Agriculture (commercial)</td>
<td>2.3</td>
<td>1.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>9.4</td>
<td>10.9</td>
</tr>
<tr>
<td>Services</td>
<td>36.9</td>
<td>36.5</td>
</tr>
<tr>
<td>Government</td>
<td>35.4</td>
<td>39.3</td>
</tr>
</tbody>
</table>

**National unemployment rate (%)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>1985</th>
<th>1995</th>
<th>2000</th>
<th>2005</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td></td>
<td>26</td>
<td>22</td>
<td>16</td>
<td>32</td>
<td>18</td>
</tr>
<tr>
<td>Youth</td>
<td></td>
<td>38</td>
<td>40</td>
<td>33</td>
<td>39</td>
<td></td>
</tr>
</tbody>
</table>
Limited diversification: Sectoral shares of GDP

- Agriculture
- Manufacturing
- Water & elec
- Construction
- Transp & comms
- Trade etc
- Fin & bus serv
- Govt
- Soc & pers serv

1994: 0% 10% 20% 30% 40%
2010: 10% 20% 30%
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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