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MINERAL POLICY: A WORLD BANK PERSPECTIVE

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EXECUTIVE SUMMARY

The goal of a mineral policy is to achieve good governance and transparency in the management of natural resources, in order to enhance their contribution to national and regional economic development.

Although the abundance of mineral resources is a exogenous blessing, sound mineral development and mineral wealth, the basic outcomes of a successful mineral policy, depend on a number of factors such as an attractive legal and regulatory framework, institutional capacity to implement it, overall political and institutional stability, and sound economic management, particularly with regard to the revenues originating from the mining sector.

Just as sound macroeconomic policies have implied in a redefinition of the role of government away from direct involvement in production towards the provision of essential public services, a successful mineral policy entails a shift in the role of the State, from owner and operator of mining ventures to regulator and facilitator of mineral development. This should be accompanied by the establishment of appropriate incentives to foster private-sector development as the main engine for growth.

Forging a partnership with the civil society to build a consensus on reforms is essential for the formulation of a sound mineral policy. Governments need to ensure full transparency and accountability in the management of mineral resources and establish mechanisms that will provide a fair distribution of revenues among private companies, central government and local communities.

This paper discusses the four building blocks of a successful mineral policy: a transparent legal and regulatory framework; a competitive, stable and fair fiscal regime; strong institutions to implement them; and sound environmental management systems. It briefly refers to the role of the World Bank in assisting governments

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in the design and implementation of a sound mineral policy and concludes with a discussion of the significant challenge facing industry and governments: achieving sustainability in mineral development through sound revenue management.

1. INTRODUCTION

The goal of a mineral policy is to achieve good governance and transparency in the management of natural resources, in order to enhance their contribution to national and regional economic development. In formulating a mineral policy, one needs to be aware of the salient features that distinguish mining, and other extractive industries like oil and gas, from sectors like manufacturing or services.

In many countries, mineral resources belong to the State and are they are developed through a system of concessions to mining companies. The world mining industry is evolving in a context of globalisation of economic and information flows. Competition leads to a secular decrease in the prices of mineral commodities and, as a result, profitability of mining companies has tended to be below average: rather than create wealth for its shareholders, the industry often 'destroys' capital for prolonged periods of time.

Mining is an industry requiring huge initial capital outlays and very specialised skills. Because of its cyclical nature, mining companies must have the financial strength to endure prolonged periods of depressed prices, while maintaining their capacity intact to fully benefit from the next recovery. These economic characteristics are at the root of a shift in ownership patterns towards the private sector, making mining a priority area for foreign direct investment.

Mining is no longer a strategic industry but it can play a catalytic role in economic growth. Mining is often an important source of fiscal and foreign exchange revenues for governments. The size of these revenues constitutes a major challenge for governments in terms of putting in place adequate policies for their financial management and redistribution. Significant and volatile resource windfalls encourage self-interested 'rent-seeking' behaviour and misguided investment policies that can quickly reverse into huge fiscal deficits in times of downturn. In extreme cases, revenues from mineral resources can fuel conflicts by providing easily available financing for military expenses.[1]

[1] Collier, 2001.

Mining operations leave a big 'footprint', i.e. they have huge economic, environmental and social impacts in the areas where they are developed; poor management of the impacts of mining can influence negatively the economic and social fabric of a region or even of the entire country; this explains the growing emphasis on local issues when dealing with mining investments.

2. FORMULATING A SOUND MINERAL POLICY

The first question a mining company asks before deciding on any given investment is where in the world is there the greatest probability of finding and exploiting a mineable deposit, and making a profit. The exploitability of any given mineral deposit, as well as its profitability and risk, are determined by such factors as the country's mineral potential, its political stability, and its infrastructure.

Although the abundance of mineral resources is an exogenous blessing, the other factors are not, they are rather the result of carefully designed and well-established policies. Sound mineral development and mineral wealth, the basic outcomes of a successful mineral policy, depend on a number of other factors like an attractive legal and regulatory framework, institutional capacity to implement them, overall political and institutional stability, and sound economic management, particularly with regard to the revenues originating from the mining sector.[2]

The design and set up of a sound mineral policy has to be part of broader economic reform that includes:

1. Sound macroeconomic policies: the policy focus should be on economic security and market-oriented economic reforms, notably the freedom to export production, to import equipment and supplies, and to access foreign exchange at market rates;

2. The establishment of a competitive investment climate for private sector participation, including the liberalisation of investment laws, and deregulation;

3. Commitment from high-level officials, and broad participation from the civil society to build a social consensus for reforms;

[2] Weber-Fahr, 2002, for a discussion of the links between effective mining development and sound macroeconomic management.

4. Fair share of the revenues originating from the mining sector.

Just as sound macroeconomic policies have implied in a redefinition of the role of government away from direct involvement in production towards the provision of essential public services, a successful mineral policy entails a shift in the role of the State, from owner and operator of mining ventures to regulator and facilitator of mineral development. This should be accompanied by the establishment of appropriate incentives to foster private sector development as the main engine for growth. These incentives typically involve elements such as: (i) transparent rule of law; (ii) predictability of government and past track record; (iii) transparent application of rules with minimum levels of governmental discretion; (iv) straightforward transition from exploration to exploitation; (v) security of tenure and unrestricted right to transfer ownership; (vi) transparent fiscal terms and ability to repatriate profits; and (vii) clear dispute resolution mechanisms.

That does not mean that governments no longer have a role in mining development. It is the role of government to design and strengthen policies and institutions for economic management, as well as an attractive framework for the mining sector. Governments should be actively involved in: (i) the formulation of an integrated and participatory minerals policy; (ii) the establishment of a sound macroeconomic and trade environment; (iii) the set-up of an attractive legal and fiscal framework; (iv) the strengthening of public mining institutions, for the enforcement of the legal framework and the transparent administration of mining rights; (v) the promotion of private sector investment, notably through the update of the country's basic geoscientific infrastructure and the restructuring and privatisation of State-owned mining enterprises; and (vi) the design and enforcement of sound environmental and social practices.

More generally, governments need to ensure full transparency and accountability in the management of mineral resources and establish mechanisms that will provide a fair distribution of revenues among private companies, central government and local communities. Human resource and social development are crucial for enhancing the sustainability of the mining sector and reducing poverty.

Forging a partnership with the civil society to build a consensus on reforms is essential for the formulation of a sound mineral policy. Governments need to encourage the participation of all segments of society in economic policy debates on the short-term costs, as well as medium to long term benefits of mining activities. A typical first step is engaging in a 'policy dialogue' to enhance comprehension of the basic trends of the global mining industry.

As the need for reform is usually preceded by a steep decline of the domestic mining industry, the debate should also take stock of the causes of the decline. More often than not, other than the difficulties caused by the international environment mentioned above, this deterioration is compounded by a combination of inappropriate economic policies, poor investment decisions, increasing budgetary deficits, loss-making State-owned enterprises, growing inflationary pressures, and loss of international competitiveness. Often, there is also deterioration in governance, epitomised by a weak legal framework and judiciary system, as well as corruption in the management of mineral resources. In many mining countries in the developing world, these negative factors are aggravated by rapid population growth, neglect of human resource development, deteriorating infrastructure and outbursts of ethnic conflict and political instability.

This means that in many cases governments will also have to move ahead in the restructuring and privatisation of loss-making State-owned enterprises in order to reduce budgetary subsidies, increase the room for private sector activities, and enhance overall economic efficiency. This requires the set-up of well-targeted social safety nets to mitigate the possible adverse effects of adjustment on the poorer and most vulnerable groups.

3. THE FOUR BUILDING BLOCKS OF AN EFFECTIVE POLICY

3.1. Legal and Regulatory Framework

The transparency, predictability and impartiality of the legal and regulatory framework for mining is the first building block of an effective mineral policy. A modern legal framework should:

1. Provide security of tenure, including the absolute right to develop the mineral resources found as a result of exploration activities, and the transferability and mortgageability of mineral rights;

2. Ensure transparent administration, with minimum levels of discretion and discrimination in the implementation of the law, and the right to arbitration and appeal;

3. Guarantee access to mineral resources, often by allowing or expanding private access to resources previously reserved to the State; this involves unfreezing unused mineral reserves, and granting access to mineral titles according to transparent principles, namely the 'first-come, first-served' rule.

Since the mid-1980s, more than 50 countries have engaged in the revision of their mining codes to incorporate to a greater or lesser extent the principles described above. As a result, vast areas of land have been opened to mineral exploration by the private sector.

An innovative feature first developed in Latin America[3] is a set of new conditions for granting and maintaining mineral titles that is not based on the pre-licensing review of the technical and financial capabilities of the applicant, nor in the compliance with an agreed amount of expenditure, but rather on the payment of surface rental fees proportional to the area covered by the mineral permits. Assessing the capability of mining companies and checking the actual amounts spent during their exploration campaigns are difficult tasks and facilitate discretionary behaviour by less-prepared public mining institutions. In order to reduce discretion, there is a tendency in many civil law countries to detail in the regulations all criteria, procedures and even deadlines for most acts of the public administration. The timely payment of the surface rental fees is often the only requirement needed to keep the tenure of the mineral rights. The fees are partially used to fund capacity-building of the minerals administration, and they can provide an immediate flow of funds to affected communities from the early stages of mineral development.

3.2. Competitive, Stable and Fair Fiscal Regime

Designing a fiscal regime that provides for a fair distribution of revenues among mining companies, central governments and local communities is a challenging task. In the past, these fiscal regimes have tended to be custom tailored to each mining project, in the context of specific investment agreements (or '*conventions d'investissement*' in Francophone countries). While often time-consuming and difficult to negotiate, these investment agreements have provided adequate frameworks to attract mining investments into countries with difficult investment climates. However, they have also sometimes failed to generate the expected amount of revenues to the host States and the local communities. In many cases, they have generated conflicts and had to be renegotiated.

There is now a tendency to move from investment agreements to non-negotiable fiscal regimes stated in the law (the keyword being 'no special deals!'). A good fiscal regime should set the overall fiscal burden at competitive levels,

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[3] Naito, Remy and Williams, 2001, for a discussion on the main characteristics of modern legal and regulatory frameworks.

without hindering the country's ability to attract private investment. In order to facilitate tax recovery, especially in countries with weak tax authorities, the fiscal regime for mining should be as close as possible to the tax law, but taking into account the specifics of mining: reasonable royalties, low import duties on capital goods, capitalisation of exploration expenses and accelerated depreciation.

However, standard fiscal regimes tend to be poorly adapted to the competitive nature of the global industries and the requirements of project financing. They tend to rely too much on indirect taxes (royalties, export taxes and import duties) because they are easier to collect and often reflect the country's common practices. Contrary to income-based taxation, high indirect taxes penalise excessively the cash flow of mining companies during downturns. Nevertheless, because mining companies tend to be big tax payers, it is possible to design mineral tax regimes based on profitability, and train a special unit in the country's tax authority to understand the accounts of the companies.

Moreover, a good fiscal regime should not raise unreasonable obstacles to the liquidity of the mineral properties market and should facilitate the ability to raise project financing. Mortgageability and step-in rights should be as automatic as possible, as prior approvals increase substantially the risks for lending institutions.

In order to increase the attractiveness of their fiscal regimes for mining, some countries have decided to include stability clauses in their mining laws, thereby freezing the fiscal conditions of a given investment for a given number of years. Although these clauses limit the ability of governments to raise additional tax revenues in periods of budget deficit, they are extremely popular with mining companies because they substantially reduce the risk associated with the projected profitability of a mining venture. Reducing political and other risks related to discretionary behaviour of governments has proved to be a much stronger incentive than tax breaks or holidays.

Finally, no fiscal regime is complete without providing for a fair share of revenues to the local authorities. Although many countries have adopted provisions to return a part of the tax revenues generated by mining activities to the affected areas, these transfers are often slow and ineffective. Modern fiscal regimes designed in the context of decentralisation now include taxes that should be collected by the local authorities and earmarked to priority expenses, often social investments.

3.3. Institutions Matter More that Texts

Good mineral laws are often difficult to implement. The implementation of sound mineral policies is still hindered in many countries by poor management capacity and weak institutional and administrative structures. Achieving good governance is of paramount importance, and public institutions should be reformed to tackle corruption and inefficiency, and to enhance accountability.

The objectives of public mining institutions reform are manifold: (i) adjustment of the sector institutions to the new role of the government; (ii) higher institutional efficiency to cope with the increased level of activity; (iii) non-discriminatory, efficient and transparent work procedures to create a favourable climate for investment; and (iv) good governance in the management of revenues from the sector, including the allocation of revenues to the population directly affected by mineral development, and protection of vulnerable groups.

The attributes of a modern minerals administration include the clear definition of mandates and functions, adjusted to the new role of the government, with no duplication of functions and efforts, and no conflict of interest among the different functions. Homogeneity in the application of the legal framework at the national level is of paramount importance, especially in countries moving towards decentralisation. Modern minerals administration must have a core staff of highly trained and well-equipped professionals, focused not on control but on service delivery adjusted to demand, and not in competition with the private sector.

Well-defined and managed property rights are an essential element of economic security for mining companies. A well-organised mining cadastre is the key institution to ensure transparency and security of tenure. It grants and cancels mining rights, controls their location and validity, and serves as a one-stop shop for registering and control of compliance with regulations. The cadastre should preferably be an independent institution, benefiting from administrative and financial autonomy, in order to reduce political interference and maximise its ability to collect and distribute surface rental fees.

The main focus of other institutions should be on regulatory functions, enforcing and monitoring implementation of the mining legislation, and promotion of private investments. This requires huge human, material and financial resources. In many countries, however, limited skills, overstaffing and deteriorating remuneration have contributed to low morale, weak incentives to improve performance and illicit practices of civil servants. Overhauling the civil service becomes then a key priority. In countries with weak institutional capabilities, however, some of the functions can be contracted to the private sector.

3.4. Sound Environmental Management

Although mining occupies a relatively small part of the land surface, it creates a big environmental 'footprint', i.e. it has significant and often irreversible impacts that at worst can seriously limit the ability of surrounding communities to make a living, especially in areas where they rely on their natural environment for their livelihood.

Over the past years, the mining industry has increasingly recognised the need and obligation to identify and mitigate the adverse impacts of its operations, and environmental management is now a full part of mineral planning and development. However, mining operations often take place in developing countries where institutions and systems are ill-equipped to regulate, manage and monitor the environmental impacts of mining.[4] Under all circumstances, however, governments need to be actively involved in a process of developing an environmental policy, with clearly defined strategies and goals, and gradually establishing:

1. The legal basis for environmental management and monitoring, and enacting the essential regulatory framework;
2. A National Environmental Action Plan, providing a clear definition of monitoring and enforcement procedures, including public disclosure and consultation;
3. Basic institutional responsibilities for environmental management and enforcement, and adequate resources to address priority issues.

Rising awareness by governments, non-governmental organisations and local populations has led many mining companies to commit to best international environmental and social practices and good corporate behaviour, even in countries where the regulatory framework and the institutional capacity is weak. As these companies usually have more expertise and resources than governments in the countries where they are operating, a trilateral approach involving governments, companies and local communities could set the stage for a sounder environmental management and to the resolution of eventual social conflicts arising from mining activities.

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[4] Weber-Fahr *et al.*, 2002.

4. THE ROLE OF THE WORLD BANK

Since the late 1980s, the World Bank has worked with governments in Latin America, Africa and Asia in the development of guidelines and best practices for the establishment of sound mineral policies. The World Bank has also become increasingly active in addressing the issues of the environmental and social sustainability of mining for individual countries, supporting the establishment of environmental laws and regulations and the strengthening of environmental monitoring and enforcement capabilities. At a more general level, the World Bank has prepared guidelines for environmental management in mining (as well as other sectors) that are today widely accepted by the industry.

In its efforts to assist governments in the formulation of sound mineral policies, the role of the World Bank is to: (i) have reliable, accurate and current country knowledge, and to make available and apply its expertise; (ii) act honestly, and transparently in all its transactions; (iii) build government capacity to contribute to the improvement of the investment climate and to deliver good quality services to the business community and the entire population; (iv) broker carefully chosen strategic initiatives, developments and projects in partnership with local governments and the private sector; and (v) target communities and effectively contribute to reduce poverty and raise living standards of the population.

5. THE CHALLENGE AHEAD: ACHIEVING SUSTAINABILITY

In recent years, the perception of the different stakeholders regarding the social and environmental impacts of mining have experienced substantial changes. The mining companies traditionally adopted the view that their responsibility was limited to generating profits for their shareholders, paying taxes to the central government and complying with any environmental, health and safety regulations existing in the country. This perception now has changed considerably, as companies become aware of community relations. The old enclave model of development is no longer considered a viable model for mining projects, as companies and governments increasingly involve mining communities and NGOs in the formulation of policies and the planning of new projects.

A sound mining project is often the result of work undertaken in processes of consultation, participation and, increasingly, of a strong trilateral dialogue among the mining company, the local community, and government at the local, regional and national levels. A recent research conducted by the World Bank Group's Mining Department showed that the most successful mining projects were those where local communities gradually got involved in providing many of the goods and services needed by the mining companies.[5] In order to make this happen, communities need support from the mining companies in economic, social, cultural and environmental areas, notably in the early stages of operation and in anticipation of mine closure.

Unlike in the past, where the community interactions were largely built on philanthropic actions, the process of enhancing social and economic development at the local level can best be achieved through carefully designed public/private partnerships. It is essential to create a climate of trust and cooperation in dealing with key issues, such as: (i) access to land and water; (ii) resettlement and compensation for lost assets and income; (iii) development programmes centred on asset creation and social capital formation; and (iv) preparation for mine closure. Local communities are expected to assume ownership of these initiatives with a view to achieving long-term stability and sustainability after mine closure has taken place. For communities with lower levels of income, a crucial element for achieving this goal is the integration of mining with the decentralised management of natural resources.

Over time, through a constructive process, mining communities can learn how to organise to take advantage of the opportunities offered by mining, and foster the sustainability of mineral development. In this respect, outsourcing is critical for the sustainability of the economic impact of mining operations. There is a need for companies to be proactive in assisting the development of local sources of supply, and for governments to design policies to encourage supply chain integration and diversification of economic activity to benefit from the ability of mining to stimulate the creation of clusters of contract and service-related activities (earth-moving, transportation, information services, logistics, etc.)

One pitfall to avoid is the trap of excessive specialisation in the resources sector. Not only does it leave a country particularly vulnerable to the wild fluctuations of commodity prices, but it draws capital away from other sectors that would otherwise have contributed to a more sustainable long term economic growth (the well known 'Dutch disease').

[5] McMahon and Remy, 2001.

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