Extractive Sector Regulations and Policy in Africa: Old Practices and New Models for Change

by

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Despite centuries of metallurgy and decades of industrial mining and oil production, most African countries remain nascent players within globalized extractive industry markets and value chains. Strong and sustained economic growth rates across many African economies over the past decade and into the foreseeable future have been and will be driven to a large degree by (mainly foreign) investments in, and exports of, extractives (UNECA 2012; UNDESA 2013). Even so, Africa's geological affluence is still vastly under-explored and under-exploited: African mineral production is perhaps 10 per cent of world output and accounts for 15 per cent of total investment. Sub-Saharan African oil and gas output is set to grow rapidly as Ghana, Mozambique, Tanzania, Uganda and others ramp up production, but overall levels of exploration are still relatively low. Over the past decade, new international players, particularly from China and India but also elsewhere, have challenged traditional Western dominance in investment. And in the past few years many African governments and some homegrown companies have reasserted themselves in both investment and production.

African governments and stakeholders everywhere continue to wrestle with the decades-old conundrum of how extractives best fit into the pursuit of broad-based economic growth, structural transformation, and poverty alleviation, especially as environmental and climate change concerns add costs and constraints to extractive industry development. As a result, over the past 20 years sub-Saharan Africa has experienced myriad regulatory and fiscal changes governing extractive industries. This is problematic given that 20 years is not a long time in the economic lifecycle of extractives.

By 2012, the pendulum had swung back toward greater state involvement, activist industrial policy-making, and resource nationalism, reflecting African governments' growing assertiveness and willingness to challenge economic liberalization orthodoxy in place since the 1980s (Besada and Martin 2013). Some observers argue that mining is "no longer being seen as an extractive industry, but as a development industry" (O'Keefe 2013). The World Bank now uses language such as "extractives for development." But the probable outcome of less foreign investment attuned to market signals and more direct state intervention harkens back to an earlier era where the same expected combination of extensive exploitation of extractives, broad-based socio-economic upliftment, and expanded industrialization did not occur across much of sub-Saharan Africa. A complex mix of domestic and transnational laws and regulations, normative guidelines, incomplete institutional (including constitutional) transformations, political pressures, governance orientations, and global commodity market volatility generates a dense yet uncertain setting in which extractive industry decision-making operates across sub-Saharan Africa today.

With this complex governance and economic environment in mind, what should African governments and other extractive industry stakeholders—including Canada, firms, non-governmental organizations, and local communities—do? There are sometimes competing goals to consider. First, there is a desire to leverage Africa's rich resource endowment in an environmentally and socially sustainable manner. Second, there is a growing expectation that a rich resource endowment should drive structural economic transformation (Morris, Kaplinsky, and Kaplan 2011). And third, there is a concern that wealth derived from extractive industry sectors should be equitably distributed, not just between African governments and global actors, but within African societies. Policy-makers need to be aware of the implications of pursuing these sometimes competing goals. Too often regulatory approaches aimed at specific outcomes misread a complex situation and produce unpredictable, unintended, and unwelcome consequences. Natural resource abundance is neither a panacea nor intrinsically beneficial or harmful to socio-economic development. Rather, "natural resources put the institutional arrangements to a test" (Mehlum, Moene, and Torvik 2006, 3). Getting the institutional and policy mix right is an ongoing and often difficult process.

The Importance of Institutional and Policy Frameworks

Institutional and policy frameworks do not operate in a vacuum—they shape how extractive industries evolve. Regulatory variability in sub-Saharan Africa is based on the push and pull of domestic elite-driven governance orientations, including post-conflict and constitutional transitions, populist and local community political pressures, especially as electoral competition becomes a political reality, transnational influences, networks, and impositions, and competing discourses about the role and objectives of extractives in development. As well, regulatory variability reflects ongoing debates about the efficacy of command and control regulatory approaches versus voluntary private sector self-regulation, or some compromise position (Ayres and Braithwaite 1992). Incremental or responsive regulatory changes are expected since experience and learning induce necessary adjustments. Major shifts signal new governance orientations or regulatory objectives, and can profoundly affect future extractive industry directions. Over the past few years, major shifts in governance orientations and regulatory objectives have occurred in many African countries. The interplay of governance orientations, institutional pillars and competencies, and regulatory objectives and approaches creates a complicated web for policy-makers and stakeholders who aspire to leverage resource riches for socio-economic development.

African countries, as elsewhere, have been caught between the common-sense notion that rich resource endowments can be easily leveraged as a development catalyst and the unfortunate dilemma that extractives can also trigger negative economic, environmental, social, and political effects. From a political economy perspective, the inherent contradictions among extractive industry objectives such as value maximization (through expanded exploration and exploitation), mitigation of negative effects, and catalyzation of structural economic transformation provide the context and indicate potential trade-off considerations for every regulatory measure. These three objectives are evident in any resource-rich country.[1]

Notably, because resources are just one component in a large risk equation that determines if specific resource occurrences are economically feasible to develop, geology or geological prospectivity alone cannot determine the value of resources and thus overall economic potential. James Otto (2006) suggests that geological prospectivity falls within the first of nine risk criteria categories (or modifying factors) used within the extractive industry to gauge potential opportunities: geological, political, marketing, regulatory, fiscal, monetary, environmental and social, operational and infrastructural, and profit. This means that delineating the economic potential of resources or assets is not simply a scientific or technical undertaking. Such delineation is complicated by variable and often uncertain market forces, taxation and royalty frameworks, existing infrastructure, available technology and processes, mitigation expectations, and political stability, among other things.

Assertive Africa

From 2001 until the global economic crisis of 2008–09, a renaissance in African extractive industry development drove economic growth, investment, and trade. Efforts to mitigate negative effects expanded on all fronts across Africa. Corporate social responsibility became a mainstream practice driven by both firms and non-governmental organizations (Dashwood 2012). International financial institutions, extractive industry multinationals and non-governmental organizations mobilized and often clashed as they tried to instill environmental and social best practices into project development cycles. In some countries undergoing political transitions, such as Liberia, newly elected governments reassessed previous extractive industry agreements and were able to get more favourable terms. However, domestic institutional capacities for environmental monitoring and enforcement, tax auditing, and other complex regulatory functions remained weak in many jurisdictions. As commodity prices and extractive industry investments shot up during this commodity “super-cycle” period, African governments and publics were increasingly aware of windfall returns accruing to mostly

[1] See Drohan (2012) for some Canadian soul-searching.

foreign firms with apparently limited upside for state coffers and local economies. The short boom instigated regional reconsideration of the role of extractive industries in development.

Since the global economic crisis, many African leaders, their electorates, civil servants, scholars, non-governmental organizations, and some private sector representatives have found policy space to challenge economic liberalization orthodoxy and the value maximization objective prevalent since the 1980s. Mainly six factors account for this. First, the economic boom prior to the collapse in 2008 drove up commodity prices to the extent that investment in exploration and proposed projects appeared limitless. Second and concurrently, windfall resource rents were not accruing to host governments, a situation noted by elites and voting publics alike. Third, Western countries, along with their economic credentials, were weakened during the crisis. Fourth, the rise of China and other extractive industry actors changed the landscape of investment: strategic agreements, non-market-based calculations of investment thresholds, and ready access to cheap equity and debt financing via government-backed banks and export credit agencies reduced dependence on Western capital markets. Exposure to China's style of development, including its vast state-owned extractive industries tied into rapid industrialization, provided ideological alternatives to Western models. Fifth, resource nationalism policies in Latin America and Asia presented policy alternatives. And sixth, some measure of experience with globalized extractive industry sectors gave African governments, alone and in concert, more confidence in challenging prevailing orthodoxy and external impositions. Expected broad-based economic benefits from extractive industries, particularly industrial linkages, had not materialized by the late 2000s. By responding to public pressure or mobilizing it, democratically elected leaders could make a case for extractive industry regulatory reform to fund Millennium Development Goals and integrated national development "visions." The not so democratically inclined could mobilize public pressure to access a larger chunk of an often shrinking resource pie.

If value maximization and mitigation objectives were the focus of the past 20 years, a swing of the pendulum back to the catalyzation of structural economic transformation objective characterizes the contemporary era of extractive industries in sub-Saharan Africa. In the mining sector, the Africa Mining Vision initiative that was launched in 2009 crystallized a comprehensive approach toward mining and development that promotes the catalyzation and mitigation objectives.[2] Since 2010, several African countries have amended their mining and/or hydrocarbon legislation or regulations in significant ways,

[2] See www.africanminingvision.org and UNECA (2011).

generally moving away from value maximization toward the catalyzation objective. These amendments can comprise any one or some combination of the following measures: increase and speed up the share of revenues accruing to the state through taxes, fees, and royalty adjustments, increase direct government ownership stakes via free carried interest or state-owned enterprise participation, promote increased local private ownership via various mechanisms, increase local contracting opportunities (upstream linkages), mandate greater health, safety, and environment and corporate social responsibility provisions, and—controversially—establish targets for downstream processing and/or beneficiation.

Concurrently, globalized extractive industries have been hit by fast-rising operational costs, lower commodity prices, less investor interest, and huge write-downs on assets purchased at top-of-market prices. The tide of resource nationalism, however defined, [3] and focus on the catalyzation objective come at a time of crisis within always cyclical sectors. But the key question remains whether governance orientations, institutional competencies, and regulatory approaches have been significantly transformed to a point where most African governments can manage such abrupt changes without scaring away investors and suffering economic and political ramifications.

Cultivating Institutions and Visions

There are no "silver bullet" policies that either host governments or external actors can implement to translate mineral and hydrocarbon riches into broad-based and environmentally sustainable economic growth, structural economic transformation, and poverty alleviation. Institutional strengthening is critical, but this is a multifaceted process that takes time. Across sub-Saharan Africa, domestic political uncertainty (and sometimes conflict), institutional and infrastructural fragility, skills shortages, and international interventions can limit host governments' capacities and blur lines of accountability. Quick fixes attempt to but cannot replace long-term visions.

It is thus a unique era for the governance of natural resources, one distinguished in sub-Saharan Africa by the paradox of both too much governance—a resurgence of state-led development orientations and command and control regulatory approaches plus a dense web of overlapping international initiatives specifically around mitigation issues—and too little governance—significant gaps in practical local expertise, resources, infrastructure, and institutions exist. In the past few years, the pendulum has swung too far back toward the catalyzation objective and increased state intervention (in other

[3] See Bello (2013).

words, command and control regulatory approaches) at the precise time when 20 years of difficult liberalization and mitigation efforts were starting to gain traction.

Policy Recommendations

From this perspective, what general issues should governments and other stakeholders take into account to cultivate extractives for structural economic transformation?

- Leaders and policy-makers have to be committed to institutional strengthening within and outside extractive industry sectors. This can help to normalize these sectors through improved regulatory stability and reduce expectations for African risk premiums, which have been again on the upswing.

- Publics need to be consulted on and educated about the potential of extractive industries, their rights in various processes, and benefits to be expected. Leaders who promise more than the benefits that extractive industries can actually provide create false expectations that can lead to political and social instability.

- The mistakes of the past must be avoided, particularly state-owned extractive industries draining government revenues rather than generating them.

- Policy-makers should revise and amend regulatory and policy frameworks based on experience and learning. Incremental experimentation, not wholesale policy shifts, reduces uncertainty and costly missteps.

- Serious recognition of the roles that taxation and royalties play in development can reduce unrealistic expectations. Is the government trying to cultivate a wider range of economic activities or is it committed to a narrow policy of driving up resource rents? There is no guarantee that revenue streams accruing to government easily translate into "development." As the "resource curse" literature warns, increased resource revenues flowing to state coffers may instigate processes that work precisely against broad-based socio-economic development and political stability. To reiterate, extractives are a test of all institutions—economic, political, social, and cultural.

These are general observations, but there are specific things that all stakeholders can promote to address lingering regulatory weaknesses across different areas of extractive industry governance.

Technical, Legal, and Infrastructure Capacities

- Invest in skills development for national and regional economic community regulators and civil society. Skills related to global standards in tax, audit, finance, land, and mineral law, health, safety, and environment, corporate social responsibility, geology, engineering, and economics should be priorities. Build professional regulatory agencies with appropriate incentives and salaries. These initiatives help level the playing field for negotiations, oversight, and revenue collection. The African Minerals Development Centre should initiate such initiatives.

- Invest in skills development for local and foreign operators and service providers. Technical and vocational trades, business management, geology, environmental sciences, and engineering are priority areas.

- Adjust regulations where necessary to cultivate two key enablers of extractive industry value maximization and industrialization—energy and transportation infrastructure. Leverage extractive industries to create transportation corridors and facilitate electricity generation and grid expansion that have significant sidestream linkages to host economies and communities. Recognize that energy and transportation infrastructure can create domestic and regional markets for extractive industry outputs and downstream beneficiation. Such infrastructure can also develop carefully attuned and realistic local content requirements that stimulate local and regional downstream extractive industry investments.

- Leverage regional economic communities in terms of standardization of mitigation measures and statistical data, shared learning and skills development, coordination around regional clusters, spatial development corridors, electrical grids, and lower trade barriers to expand regional markets for both raw materials and finished goods.

Transparency and Accountability Mechanisms

- Limit the amount of discretion in extractive industry production agreements through clear legislation, regulations, and administrative processes. Make contract terms public once finalized and ensure firm and government reports about revenues paid and collected concur.

- No longer offer special or discretionary corporate tax holidays other than normal business expenses, capital cost allowance, and import duty exemptions. Overall taxes, fees, and royalty rates cannot be punitive or be revised too often or investment will dry up.

- Extractive industry firms need to rein in out of control administration and overhead costs, including management salaries. It is difficult to complain about operational cost escalations when senior-level salaries have shot up over the past decade and tax avoidance strategies are commonplace. This irritates labour and government and generates support for punitive corporate tax and royalty increases.

Participatory mechanisms

- Promote sectoral diversity through tailored large, medium, and artisanal as well as local and international regulations along the breadth of the extractives value pyramid.

- Build up local managerial capacities but do it organically without hiring away the most qualified regulators from elsewhere. Create opportunities for employees at all levels to earn and acquire equity stakes via local exchanges.

- Ensure free, prior, and informed consent, corporate social responsibility, and host community-mandated revenue allocations are enforced along the entire exploration, production, and remediation spectrum.

- Extractive industry firms, especially foreign ones, need to approach new jurisdictions and project areas with a partnership attitude. Many resources, guidelines, and frameworks are available to help firms engage with host communities to earn a social license to operate.

Assertive African governments are changing the rules of the game and demanding larger shares of resource rents, as well as greater local economic integration and linkages. These regulatory changes—coming on stream just as the benefits of the difficult liberalization era begin to materialize in terms of a critical mass of exploration, development, production, and linkage projects—will significantly affect the risk calculations of many extractive industry investors. Cost structures for firms continue to escalate while global investment appetite is waning. Both the content of new regulations and the uncertainty generated by substantive changes to the rules of the game will keep the risk averse away and attract only the strategic players and high-risk speculators. An alternative "resource curse" may be taking hold in African capitals that can lead to traditional forms of it. That is, a revived view that extractives are indeed a panacea to development when in fact their positive or negative impacts remain firmly tied to their wider institutional milieu.

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