Update and Analysis of Extractive Sector and Mining Issues in Zimbabwe

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Introduction

The past eight months of 2011 have witnessed a number of legal, policy and administrative developments in Zimbabwe's extractive and mining sector with great implications on mineral trade, investment and economic empowerment. This brief update and analysis seeks to profile some of these developments. The key developments include the outcomes of the 2011 Intersessional Meeting of the Kimberly Process Certification Scheme (KPCS) held in the Democratic Republic of Congo (DRC), the passage of Indigenization and Economic Empowerment Regulations which seeks to compel mining companies to dispose 51% of shares to locals and the suspension of licences issued to local diamond manufacturers by the Ministry of Mines and Mining Development.

Marange Diamonds and the Kimberly Process Certification Scheme (KPCS)

The Kimberly Process Certification Scheme (KPCS) Intersessional meeting was held in the Democratic Republic of Congo from the 20th-23rd of June 2011. The KPCS regulates and controls trade and export of rough diamonds to eliminate conflict diamonds from entering the market.

The DRC Intersessional meeting failed to break the impasse on export of Marange diamonds despite a notice that was issued by the Chair of the KPSC that Zimbabwe should continue exporting diamonds. Other participants such as United States, European Union, Australia and Canada rejected the notice to allow exports from Marange without putting in place credible monitoring mechanisms. During the KP Intersessional meeting civil society walked out of the meeting. The decision of civil society to walk out was based on a number of reasons. Firstly, civil society felt that the Minister of Mines of Zimbabwe was very disrespectful to civil society and other participants of the KP when he attacked civil society representatives who are monitoring events in Marange during his address to the KPCS plenary. Secondly, civil society were protesting against the attempts by the Chair of the KP (DRC) to push for an agreement that did not guarantee monitoring of exports from Marange and failure to ensure the protection of civil society organisations such as the Local Focal Point that report on the situation in Marange. Thirdly, civil society felt that the KP had failed to recognize the connection between human rights violations and diamonds in many parts of Africa. Fourthly, civil society walked out of the meeting as a protest at the failure by the KPSC to respect its own rules and procedures.

For theoretical purposes it is vital to briefly unpack the contents of the notice that was issued by the Chair of the KPSC on the 23rd of June 2011. (**Click here to view notice**) The notice allows Zimbabwe to export diamonds from Mbada and Marange Resources. It also provides for an assessment of compliance of other mining operations in Marange by a KP Monitoring team. In addition, the notice states that Zimbabwe commits to uphold KPCS minimum requirements and guarantees the participation of civil society in KPCS matters.

An analysis of the notice shows a lot of weaknesses. Firstly, the notice is full of statements that are too general and can be interpreted differently. For example it is not clear what civil society participation entails and what KPCS matters civil society will participate in. Secondly, the notice did not recognize the local focal point mechanism that was put in place by the Working Group on Monitoring (WGM) for civil society to support the KP Monitor in assessing the situation on the ground by the St Petersburg Agreement. Further, there is no guarantee that civil society will be involved in the verification of post shipment mine level data together with the KP Monitoring team. Thirdly, the notice failed to recognize the need to ensure that exports are also linked to progress on outstanding issues in Marange such as continuing illegal digging being perpetuate by syndicates that work with some security forces, phased withdrawal of the military from the diamond fields, engagement of small scale miners, development of effective border control measures to curb smuggling of diamond into Mozambique and sporadic incidences of violence in Marange.

However, the notice issued by the KP Chair at the end of the meeting was rejected by other participants such as USA, EU, Canada, Australia and Israel. These countries are calling for further negotiations. However, the government of Zimbabwe is arguing that it will stick by the Chair's notice and will continue exporting diamonds in terms of the notice. The EU has made an attempt to break the impasse by proposing another text. **(Click here to view EU text)**

The conclusion one can draw from the above situation is that there are a number of weaknesses in the KP and these are; the KPSC never envisaged that it will be confronted by a situation as what is obtaining in Zimbabwe. Unfortunately the KP participants are not willing to reform and recognize human rights violations as a factor in conflict diamonds. In addition, the decision making process in the KP has caused problems since in many cases it is difficult to reach decisions by consensus. The KP has also been affected by national politics especially in Zimbabwe where some political elites are benefiting from trading outside the KP and would want no monitoring or supervision.

Indigenisation and Economic Empowerment in the Mining Sector

On the 25th of March 2011, government published General Notice 114 of 2011 which prescribes the minimum requirements for indigenization implementation plans to be

submitted by businesses in the mining sector[1]. The General Notice was issued in terms of the Indigenisation and Economic Empowerment (General) Regulations SI 21 of 2010. The notice set the minimum threshold for which indigenization implementation plans are required in the mining sector. In section 2 of the General Notice, every mining business in which 51% of shares or controlling interest is not held by indigenous Zimbabweans and whose net value is of or above $1 (one United States dollars) is required to submit an indigenization implementation plan within 45 days of the date of publication of the notice. The date for submission of such plans was the 10th of May 2011.

In section 3 the notice also sets the timeframe for achievement of minimum indigenization and empowerment quota in the mining sector. It is provided that every non-indigenous mining business shall achieve the minimum indigenization and empowerment quota by the disposal to designated entities within a period of six months from the date of publication of the notice. However, the implementation plan should be approved by the Minister first. The date for mining companies to dispose of the shares is the 24th of September 2011. However, the deadline for disposal of shares may be extended by the Minister for a further 3 months.

The notice also states in section 3(2) that the value of shares or other interest required to be disposed to a designated entity shall be calculated on a basis of valuation agreed to between the Minister and the non-indigenous mining business and this valuation shall take into account the State's sovereign ownership of the mineral or minerals exploited or proposed to be exploited by the non-indigenous mining business.

From the above there are important issues to note and consider. Firstly, the General Notice states that shares in mining companies will be disposed to designated entities. The term designated entities is defined in section 1 of the notice and it includes the national Indigenisation and Economic Empowerment Fund, the Zimbabwe Mining Development Corporation (ZMDC), any company incorporated by ZMDC or the Fund, a statutory Sovereign Wealth Fund that may be created by law, or an employee share ownership scheme or trust, management share ownership scheme or trust, community share ownership scheme or trust that complies with the requirements of section 14, 14A or 14B of the regulations. The above position provides various options that can be pursued in the disposal of shares in mining businesses.

The first point to note about the notice is that ideally, the concept of community share ownership scheme as an option for disposal of shares is a noble idea that if transparently and properly handled and managed can result in benefits flowing to communities affected by mining operations. One can also interpret the community share ownership scheme as part of corporate social responsibility in the mining sector. This is because in terms of section 14 of the Indigenisation and Economic Empowerment (General) Regulations SI 21 of 2010 the revenue realized from the community share ownership scheme will be used for community projects such as hospitals, schools, irrigation. Given the fact that the revenue

[1] Published in the Government Gazette Extraordinary of 25th of March 2011.

will be used for community project that seeks to uplift the lives of communities, one may then argue that the recognition of community share ownership schemes by the law is what may have been lacking in the legal terrain in making it mandatory for mining companies to carry out corporate social responsibility activities. Therefore, it can be persuasively argued that this provision crystallize corporate social responsibility in the law, although the provision does not specifically mention the phrase corporate social responsibility. What it does is simply to recognize some of the key elements of CSR.

Secondly, the idea of creating a sovereign wealth fund for acquiring shares from mining businesses will be important so long the right economic and political environment exists. The world over many natural resource rich countries have established what are called Sovereign Wealth Funds (SWF) that are meant to support government savings and promote an intergenerational transfer of resources or to build savings for future generations. The sovereign fund is a state owned investment fund. The concept is therefore not new and some lessons should be learnt from different countries such as Botswana and its Pula Fund made up of revenue from diamonds and other minerals, Norway which used oil revenue to create the Norway Government Pension Fund Global. Kuwait has a Reserve Fund for Future Generations from oil revenue, Libya has an Oil Reserve Fund, while Nigeria has an Excess Crude Account from oil revenue. However, what should be noted is that while the idea of creating a Sovereign Wealth Fund from mining revenue and payments is noble, in most cases such funds are created in situations where the government has budgetary surpluses and have little or no international debt. Creating the Fund in the immediate future may not work properly in Zimbabwe, until the macro-economic environment has improved and government has managed to effectively manage the economy with budgetary surplus and having cleared the huge external debt.

The other potential problem with the creation of such a fund is that in many countries where they have been created, there is lack of transparency and accountability on investment decisions and the purpose of investment. The challenge for Zimbabwe is that in the absence of a conducive political and economic environment, proper institutions that are transparent and accountable, the creation of this fund may be a cover for impunity and this may result in creation of a fertile ground for corrupt elements to loot funds from mineral resources.

Thirdly, the valuation of shares in mining businesses for purposes of disposal to the designated entities will also be based on the fact that mineral wealth is owned by the state. The Mines and Minerals Act in section 2 vests the dominium in and the right of searching, mining and disposing of all minerals in the President. One may argue that while the dominium over minerals rests in the state, this should not be used as a means to expropriate property in the valuation of shares and interest in mining businesses. A balance should be struck between the interest of the mining companies and state interests.

However, there are a number of potential and real draw backs in the General Notice. Firstly, there are real fears that the community ownership scheme may be abused by powerful people or the political elite who may end up facilitating the formation of community share ownership trusts or scheme to serve their own economic interests and using them as fronts to gain economic and political capital. The political patronage system in Zimbabwe may end up feeding on these schemes to the exclusion of deserving people in rural communities affected by mining operations. Lack of transparency and accountability in the extractive and mining sector in Zimbabwe can stifle any efforts to make community benefit from such schemes since the system can be abused to benefit political allies and not the general public.

The second criticism against the General Notice is that it further entrenches the position of state intervention and participation in business, especially the mining sector through the Zimbabwe Mining Development Corporation (ZMDC) or its subsidiaries or affiliates that have traditionally failed to resuscitate some of the mining operations it is running. Therefore, giving ZMDC other mining operations to run even if they are joint ventures can result in disastrous consequences due to mismanagement and corruption. Unless if there are institutional and legal reforms that can help transform the ZMDC into a professional state entity, there may be no hope in this organisation effectively operating or managing new mines that may be acquired through the indigenization programme. What will be needed are reforms that promote transparency and accountability as well as ensuring that revenue realized from such a programmes goes to the national fiscus and benefit the nation.

Thirdly, it has been reported that General Notice SI 114 of 2011 is still subject to assessment on its constitutionality by the Parliamentary Legal Committee[2]. The Parliamentary Legal Committee has a constitutional mandate to analyse all Bills or statutory instruments to assess if they do not contravene the Declaration of Rights or the Constitution. If a law is ultra vires the constitution then it can issue an adverse report on it. In the interim, the notice has also been roundly and heavily criticized by leading lawyers as unconstitutional, ultra vires and badly drafted[3].

Cancellation of Local Diamond buyers (Manufacturers) Licences

In June 2011, the Ministry of Mines and Mining Development issued a series of press statements indicating that it had cancelled licences issued to local diamond cutting and polishing entities issued in terms of the Minerals Marketing Corporation of Zimbabwe (Diamond Sales to Local Diamond Manufacturers) Regulations, Statutory Instrument 157 of

[2] Bill Watch 26/2011, 30 June 2011, Parliamentary Legal Committee (PLC) and Indigenisation Regulations

[3] ibid

2010. The regulations allow local diamond manufacturers to buy rough diamonds from the Minerals Marketing Corporation of Zimbabwe (MMCZ). The broader reason for suspension was non-compliance with the requirements of the regulations. However, in the notice issued in the press no specific details were provided on the nature of non-compliance except reference to general provisions of the regulations which sets out the duties of local diamond manufacturers who benefit from the local diamond pool.

The regulations defines a local diamond manufacturer as a person who in Zimbabwe cuts, polishes, crushes or otherwise processes rough diamonds for gain or reward. The Minerals Marketing Corporation of Zimbabwe (MMCZ) is required in terms of section 3(1) of the regulations to set aside, every month, not more than 10% of gem quality diamonds, not more than 10% of near gem quality diamonds and not more than 10% of industrial diamonds for sale to local diamond manufacturers. Accordingly, the regulations in section 3(2) establish a *local diamond pool* from which diamonds are made available for sale to local diamond manufacturers. Local diamond manufacturers are required to make an application to the MMCZ to purchase diamonds from the local diamond pool for purposes of cutting, polishing or crushing. The regulations states that the diamonds should be sold at a competitive prize (Section 5 (1) (b)).

In addition, the regulations also set out the duties of local diamond manufacturers and these include (section 6); duty to cut, polish or crush the diamonds within the time indicated in their application, file a written return at the end of each quarter of the volume of diamonds purchased by him, those cut, polished or crushed by him and volume of those still in their rough form at the end of each quarter as well as furnishing the reasons why the diamonds have not been processed. In section 7 the General Manager of MMCZ has the power to deny or restrict access to local diamond pool in certain cases. Some of the instances in which restrictions may be imposed include failure by local manufacturers to timeously make a return, making a false statement and failure to give adequate reason why allocated diamonds still remain uncut or polished. In this case local diamond manufacturers may be prohibited from making any further application or their allocation may be reduced.

Further, the regulations also place a duty on the General Manager of the MMCZ (section 5(1) (e) at the end of each quarter account to the Minister, the Board and diamond producers for the total sale of the diamonds from the local diamond pool.

The regulations also contain a section on offences and penalties in section 10. The following are offences; to purport to be a local diamond manufacturer when one is not licenced in terms of the Precious Stones Trade Act (Chapter 21:06), to make a false statement that one knows to be false and failure to timeously render a return.

It is clear from the above that the intention of government in this respect was to ensure that local diamond cutters and polishers also benefit from the resource and to promote value addition in the mining sector. It should be pointed out that the regulations were passed after massive lobbying by locals players who felt that diamonds are being exported in their rough form to other countries without any value being added through cutting and polishing. The rationale behind this initiative was good.

However, there are both practical and theoretical problems with the arrangement. Firstly, from a practical perspective the cancellation of licences by the Ministry of Mines and Mining Development in terms of the regulations indicates the practical challenges associated with this initiative. While the real reasons behind the cancellations were not revealed in the press statement by the Ministry of Mines, there is no doubt that there was failure to comply with the law by the local diamond manufacturers. However, media reports indicate that there has been massive looting of diamonds by some locals using this scheme.[4] It was reported that diamonds were being looted from the MMCZ by dealers who were getting diamonds for a song instead of the *competitive prices* as recommended in the regulations. It has also been reported that most of these companies did not have equipment to cut and polish. These diamonds would then be sold at higher prices. The diamonds would then be smuggled to Dubai, India, Lebanon and other countries. According to media reports a total of 28 companies had been issued licences to purchase rough diamonds for cutting and polishing.

The issue of transparency and accountability is another concern on the initiative. Such a scheme would have required a special committee than just giving wide powers to the General Manager of the MMCZ in considering the applications and making decisions related to the purchase of diamonds by local diamond manufacturers. While the regulations contains a provision that requires the General Manager to report to the Minister, the Board and diamond producers for the total sale of the diamonds from the local diamond pool at the end of each quarter , it would have been more plausible to state the specific issues on which the General Manager would report to the Minister or the Board about e.g. the price at which the diamonds were sold, the volume to each local diamond manufacturer and any other terms and conditions of each licence issued. For the sake of promoting transparency and accountability the list of local diamond manufacturers should also have been required to be published for the public to know.

Geophysical Survey of Marange Diamond Mining Area

In May 2011 the Ministry of Mines and Mining Development issued a call for tenders in newspapers requesting interested geophysical survey companies to carry out an aeromagnetic survey and exploration for purposes of quantifying and assessing the diamond and mineral deposits in Marange. However, it is not yet clear if any bids have been

[4] Diamond looting sucks in minister, http://www.dailynews.co.zw, By Reagan Mashavave, 26 June 2011 15:40

received and awarded to any company to survey the area. This development came amid media reports that one of the diamond mining companies operating in Marange, SINO-Zimbabwe had ceased its mining and exploration activities in April 2011 due to non-viability of diamonds to sustain commercially viable mining in the claim area[5].

This position raises questions about the statics that are often cited by different sources about the diamond deposits in Marange. The fact that the government does not have its own statics on the quantities of diamonds in the area, and secondly the fact that one of the mining companies has been issued rights to mine an area where there are not enough diamonds, makes it difficult to state with certainty that Marange has the potential to produce 25% of the world diamond production. Further, this position puts questions on the allocation of a multiplicity of investors and parceling of the fields to different players when adequate information is not available. In addition, the fact that some of the areas are not commercially viable as demonstrated by the SINO-Zimbabwe episode illustrates the importance of bringing in small scale miners especially the villagers who can work on those areas. At the moment government has not developed a scheme for small scale miners to mine diamonds in Marange as well as an incentive to curb illegal digging and smuggling in diamonds that is ongoing in the area. Noteworthy, the Joint Work Plan that was agreed between the Zimbabwean government and the Kimberly Process Certification Scheme (KPCS) states that government shall develop a plan to engage small scale miners in Marange. In addition, the Joint Work Plan states that the government shall identify resource areas in Marange so that these can be given to investors.

[5] The Herald 16 June 2011