Resource Generation and Financial Leakages:
The Case of Africa's Extractive Sector
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'HALTING ILLICIT FINANCIAL FLOWS TO ACCELERATE AFRICA'S STRUCTURAL TRANSFORMATION'

KEY ISSUES & MESSAGES

- Financial Leakages rooted in Neoliberal Restructuring of Mining Sector – at the level of Production, Trade & Finance in favour of and under increased TNCs control
- Technical and Organisational restructuring fragmented national mining sectors and emerging integrated value chains; e.g. outsourced knowledge & technology value added dimensions, marketing, business services, branding etc, repositioning these as the source of value added
- Affected production relations against host country domestic labour engaged in actual physical mining production e.g. deskilling, devaluation & decreasing share of wages, weaker employment rights/downgraded conditions, flexibilisation of labour, productivity enhancement through downward pressure on labour costs

Key Messages Continued

- Host country economy lost out in technology transfer and diffusion, share of revenues
- Thus a radical re-balancing of ‘internal’ terms of trade inimical to African economies and very much compounding adverse external or international terms of trade, division of labour
- Mode of integration also changed from evolving nationally integrated production & trade systems (with corresponding controls over revenue flows, investment strategy, TNC regulation etc) to Global Value Chains, wherein ‘integration’ is controlled by the TNCs, the system integration at the global level. This points to contested/competing ‘value chain integration or systems’.
- Loss of technical & organizational components of production, revenue flow & TNC regulation, and share of benefits by domestic agents and economies also reflected in increased leakages – e.g, Fiscal regime of TNC tariffs and tax subsidies, profit repatriation ands external retention, interest and currency arbitrage etc
- Thus worsening leakages through terms of trade & industrial profits hardwired into new configuration of production, investment and trade structures, and structurally imbalanced against Africa e.g. reversal of stabilization & compensation for losses, for example from changes in exchange & interest rates, in mining investment contracts
- Thus, there’s now added another layer and channel of financial surplus capture and appropriation & their externalization – through the dimension of liberalisation of Finance & Capital movements and Financialisation of Commodities

Key issues & messages continued

- Factors in the Evolution of current role of Finance in Mining: Even the best run of the state owned mining firms had deal from the challenges arising from being outside the global framework of access credit, technical knowhow and marketing that the TNCs possessed within their individually or within oligopolies.

- Nationalized African producers seeking investment funds have had to raise much lower amounts at credit at higher costs that TNCs; part of the financial difficulties were mitigated by the increasing readiness of multilateral and bilateral lending agencies to provide loans. In 1978 the World Bank announced a new policy for lending to mining ventures in developing countries so as to contribute to the rebuilding of confidence between foreign firms and assertive national governments.

- The restoration of export earnings to fund debt repayments (and critical imports) emerged as an early strategic goal and with that the rehabilitation or revival of the mining sector loomed large as countries retreated from seeking control of the commanding heights of their economies and transformation to simply restoring growth looking first at the sectors which offered the quickest response. Hence WB revenue/rent maximization stipulations

- **The Links between Commodity and Financial Markets**
  - The heightened price volatility since the collapse of the International Commodity Agreements has led to a rapid expansion of derivative markets The growing interlinked activities between commodity and financial markets by portfolio investors could manifest itself in important changes in commodity price dynamics and distribution/allocation of returns from mining
  - entry of global institutional and private investors-the accelerated link as a flight from equities and bond markets as well as from volatile currency markets; New actors - investment, pension and hedge funds and sovereign wealth funds (managed funds) and commodity index trading

Key issues & messages continued

- Structures in commodity markets have undergone fundamental changes close links between commodity and financial markets hold important policy implications in managing the global economy as we well as macroeconomic management of both commodity producing countries
- Huge Collateral Damage to commodity dependent developing countries; and even larger damage due to the ensuing financial instability & tendency to financial distress, crises & transmission into economic recessions
- Exacerbated by the poor functioning of the international financial system in performing a vital role of financial intermediation for global development
- Both Market Failure and Governance Failure addressing commodity-related issues such as price stabilisation should be a part of creating a new system of governance over globalisation process Resolution of commodity related issues is fundamental to dealing with the "*Commodity-Dependence Trap*"

Financial Reforms

- Financial Reforms: should not be confined just to narrowly defined issues of bank supervision or regulation.
- Need for fundamental reforms providing alternatives to commodity export regime, GVCs, and interconnection between development of integrated national/regional SET, and to national/regional (and also international) Monetary and Financial Systems
- New thinking over macroeconomic management under financial globalisation (exchange rate management, capital flow management, monetary policy framework)

Commodity Markets

- Functioning of commodity markets has changed related to processes of financialization that involve two major developments – the rise of financial interest on commodity derivative markets through the increasing presence of financial investors and the changing business models of international commodity trading houses and the increasing importance of these markets in price setting and risk management since the liberalization of national commodity sectors

- These global financialization processes affect commodity producers in low income countries via the operational dynamics of global commodity chains and distinct national market structures. The global financialization processes influence how prices are set and transmitted and how risks are distributed and managed in African commodity sectors.

- Uneven exposure to price instability and access to price risk management have important distributional implications. Whilst international traders have the capacity to deal with price risks through hedging in addition to expanding their profit possibilities through financial activities on commodity derivative markets, local actors in producer countries face the challenge of price instability and increased short-termism – albeit to different extents deepening on local market structures – with limited access to risk management.

- Goldman Sachs & Ghana; double listing arbitrage (e.g. AAG 2014), Zambia Copper – Kwacha, double listing

AGC and Goldman Sachs

- In 1998, Ashanti Gold was the 3rd largest Gold Mining company in the world. The first "black" company on the London Stock Exchange, Ashanti had just purchased the Geita mine in Tanzania, positioning Ashanti to become even larger. But in May 1999, the Treasury of the United Kingdom decided to sell off gold reserves, flooding the world market. By August 1999, the price of gold had fallen to its the lowest it had been in 20 years

- Ashanti turned to Goldman Sachs - for advice. Goldman Sachs recommended that Ashanti purchase enormous hedge contracts - "bets" on the price of gold. Goldman recommended that Ashanti enter agreements to sell gold at a 'locked-in' price, and suggested that the price of gold would continue to fall.

- But Goldman was more than just Ashanti's advisors. They were also sellers of these Hedge contracts, and stood to make money simply by selling them. And they were also world-wide sellers of Gold itself. One month later, 15 European Banks with whom Goldman had professional relationships made a unanimous surprise announcement that all 15 would stop selling gold on world markets for 5 years. The announcement immediately drove up gold prices to $307/ounce, and by October 6, it had risen to $362/ounce.

- Ashanti was in trouble. At Goldman's advice, they had bet that gold prices would continue to drop, and had entered into contracts to sell gold at lower prices. These contracts were held by a group of 17 other world banks. Ashanti found themselves being forced to buy gold at high world prices and sell it at the low contract prices to make good on the contracts. The result? In a few weeks time, Ashanti found itself with 100s of million dollars worth of losses. It had to beg the 17 banks not to force the execution of the contracts.

- Who served as the negotiator for the 17 banks and Ashanti? Goldman Sachs. The same company that designed the contracts for Ashanti was making a profit in their sale.

AngloGold and Goldman Sachs

- The basic bankruptcy of Ashanti drove its stock price from an all time high of $25 per share to around $4 per share. Thousands of investors, including miners, local investors and government, lost their investments almost overnight as Ashanti was declared insolvent.
- In the end (2003), Ashanti was purchased by their largest African competitor, AngloGold, a British company headquartered in South Africa, who bought them for a song. The Financial Advisors to AngloGold, Goldman Sachs,
- GS profited form the contracts they designed and marketed for Ashanti; was involved in the manipulation of the gold prices on which the contracts depended; represented Ashanti's creditors when the contracts went bad; and profited as the Financial Advisors to the company that picked up the Ashanti corpse for pennies on the dollar.

Zambia

- Zambia: The 'Resource Curse' literature often links a boom in commodity exports with appreciation of a country's real exchange rate as a result of an influx of foreign exchange. This leads to a loss of international competitiveness and hampers diversifi cation of the economy. So adopting the right exchange-rate regime is extremely important for commodity-exporting countries.
- However, we prioritise exchange-rate management as a more effective tool to combat commodity-induced appreciation. One reason is that the link between the money supply and domestic prices is often weak because of extensive excess capacity in African countries. Since under-used factors, such as labour, will be mobilised to increase production when aggregate demand increases, prices will tend to remain stable.
- Another reason is that food prices account for a large share of the Consumer Price Index. And they are heavily influenced by supply conditions. So an increase in domestic demand for food, because of an increased money supply, might not significantly affect the CPI.

Zambia – Exchange Rate Management

- Exchange rate management of the copper boom The recent copper boom in Zambia provides a concrete basis to evaluate exchange-rate regimes. The Zambia boom elicited an influx of foreign exchange that, together with speculative capital inflows and debt relief, sharply appreciated the Kwacha, first in November 2005 and then during mid-2007 to mid-2008 (see figure).

- However, because the Bank of Zambia was committed to using foreign exchange interventions only to smooth volatility in the exchange rate, it did not undertake any concerted eff orts to counteract the appreciation, especially during the sharp upturn of 2005. As a result, Zambia's non-traditional exporters of tobacco, cotton, coffee and horticulture experienced a 30 per cent decrease in their earnings and thus contracted their production in 2006-2007. This drop in production had dramatic consequences for employment since these sectors accounted for almost 70 per cent of the total workforce while the copper mines accounted for only 10 per cent.

- What could have happened if the Bank of Zambia had managed the exchange rate? What would have been the respective impact on infl ation of the money supply and the exchange rate,? What would have been this impact both in the short run and the long term

- If BoZ intervention had been to finance or stimulate financing of expanded productive employment & utilization of excessive spare capacity, managed exchange rates could have forestalled a real appreciation without having had a major impact on domestic prices. Would also have been an an effective tool for safeguarding international competitiveness without inducing excessive inflationary pressures in the domestic economy.

Implications for Domestic Resource Mobilisation

- Savings important BUT even more Crucial are appropriate intermediation for Productive Investments, Jobs, Livelihood incomes & Development – credit systems, allocation, institutions, multi-sector production linkages via investment, employment and output
- ***Track it, Stop It, Return it*** – doesn't address many fundamentals. In addition to its specific beneficial possibilities it must be seen, even more fundamentally, as a tactical entry point towards resolution of strategic developmental reform of Finance policies, structures & institutions for financing equitable & sustainable SET
- Progressive reform of Finance and the Finance and Development nexus comes back to the question of production structures, systems and processes; and, production relations within and across Extractive Sectors and wider economy.
- As such it also comes back to the position & role of Labour and its Transformation accompanying & underpinning SET
- The issue of Resource Generation and Productive Labour is central & frames the interrelation between integrated expansion of production – ONLY way to create more goods, services i.e. wealth, and its diversification and upgrading.
- One immediate concern for Labour is how its own savings, ESPECIALLY Pensions, becomes a dynamic – either in an anti-developmental growth paradigm reliant on Financialisation, inflation of pricing & returns to predatory Credit (including payday savings & loans, microcredit, mobile payment systems) and/or Financial Assets, as the new 'investment' – e.g. Infrastructure PPPs; or as developmental, productive, transformative Finance

Some Recommendations for DRM

- Build strong institutions, develop systems and structures and a comprehensive policy framework to address tax evasion/avoidance/dodging
- Address informality & the informal sector to ensure dynamic and sustainable productivity growth
- Review Incentives regime to facilitate and prioritize domestic production capacities and domestic business
- Facilitate policy development to direct financial services & Investments through appropriate intermediation & deepening within an Integrated national finance system to key sectors of real economy like agriculture to promote Income, savings and Investment resources.
- Revenue and Expenditure targets are not enough. There must also be savings, Investment, employment and output targets and Indicators In all national economic plans and their Implementation within, between and across all key economic sectors.
- Champion Job creation linked to prioritizing enhancement of SMSE's & appropriate financial system and Investment regime
- Comprehensively review past failures of Development Banks for the re-design and prioritized development of National, Regional, District as well as Sectoral Development Banks as the centre of domestic financial deepening and Intermediation

Other Issues

- Some other issues for Financial Leakages, DRM, SET nexus
  - Reserve Accumulation
  - Interest Rate arbitrage
  - Financial Asset Price inflation and Deflation of Labour share & share of real sector Productive Investment
  - Bank ownership & credit market restructuring (nb: recall corollary of mine ownership, IFF Report)
  - Developmental States and the Control of Finance
  - Contradictions of ‘Financial Inclusion’ – S& Ls, microcredit, inclusion in appropriation by Finance?
  - Finance as upward and regressive redistribution within and between economies
  - Development Banking/ cooperative banking/mutual funds/building societies etc – Important Traditions organically connected with Labour Movement as part of Alternatives role of Finance in Equitable and Sustainable Growth and Development