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# Diamonds Are Not Forever: Implications for Lesotho

**By:**
**Selloane Khoabane**
Principal Economist
**Department of Research**
**Central Bank of Lesotho**

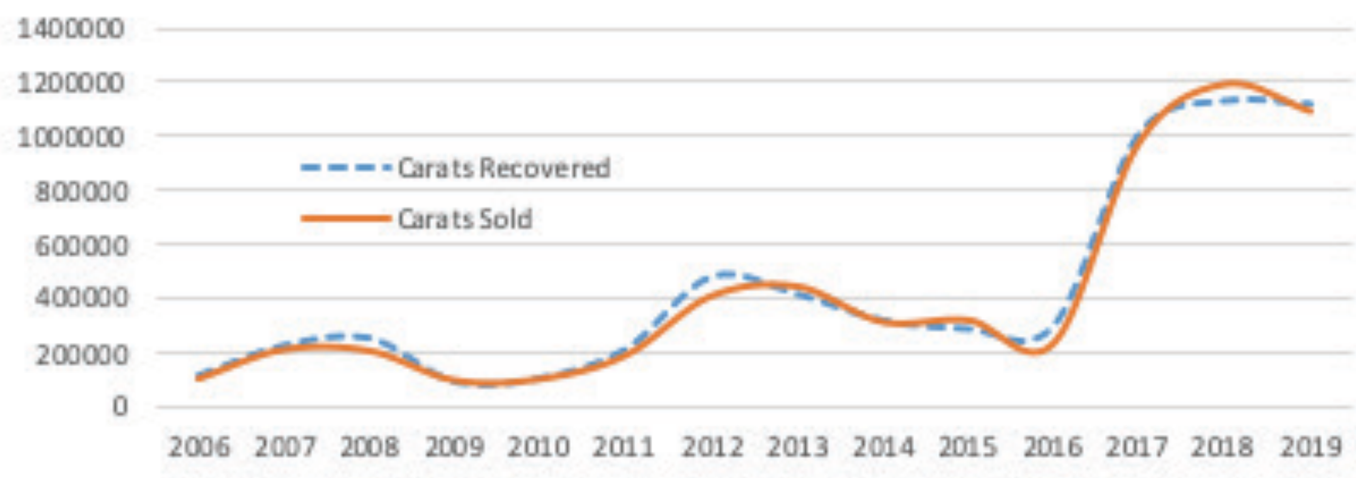
**Outline**

# 1. Introduction and Background

In Lesotho, diamonds were first discovered in the late 1950s. Prospecting rights were granted over some of the mines but large scale operations did not continue due to low global diamond prices, failure to reach amicable agreements on royalties and taxes between the Government and mining companies and in some cases dissatisfactory diamond production results, amongst other reasons. Nonetheless, the diamond mines have in about a decade or so re-opened and up-scaled production. Four mines, namely Lets'eng, Liqhobong, Kao, and Mothae are in operation while Lemphane, Kolo and the Motete kimberlites are in the preparation phases. The mining enterprises operate as foreign direct investment companies with majority shareholding of up to 70.0 per cent by foreign companies. The Government of Lesotho through the Ministry of Natural Resources is responsible for authorizing exploration and extraction, issuing mining leases to companies as well as regulating the industry.

Production of diamonds by Lesotho's mining industry has grown from 114 211 carats in 2006 to more than 1 000 000 carats from 2017. It closed the year 2019 at 1 113 786 carats. This growth resulted from investment initiatives, including construction activities that were intended to unlock additional production value. In addition, expansion related investments were undertaken to reduce waste stripping, minimize diamond breakage, hence loss of value of diamonds during production as well as optimize operations in general. Diamond sales, measured in carats have also increased along with production.

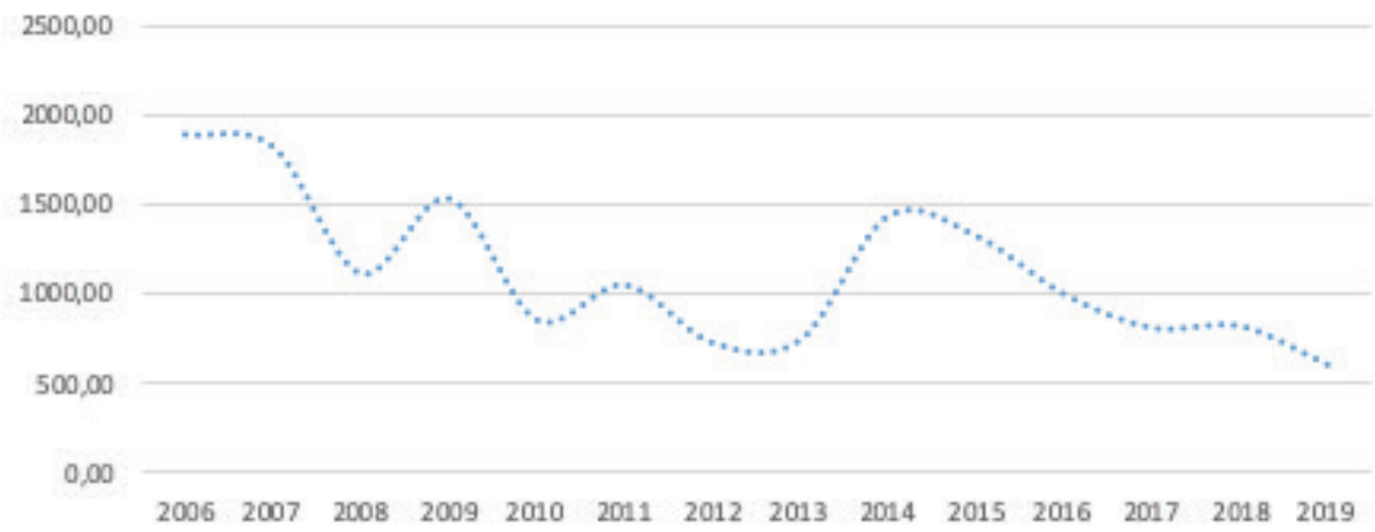
**Figure 1: Lesotho Diamond Production and Sales**




Source: Diamond Mining Companies and Author's calculations

In contrast to the improvement in production and sales, the average price achieved per carat, calculated as a simple average of prices per carat attained by the different mines that sold diamonds during a specific period, has plummeted. It fell from US$1 895.55 per carat in 2006 to US$595.29 in 2019. While Lesotho' diamond mining industry is famous for its production of large, top color and exceptional value diamonds, the bulk of the recent surge in production has been of low value industrial type diamonds. This is the main reason behind the decline in Lesotho's average price per carat, coupled, of course, with market fundamentals such as global demand.

**Figure 2: Average Price of Diamonds Achieved (in US$)**




Source: Diamond Mining Companies and Author's calculations

The main traceable benefits from the diamond mining industry, in Lesotho's case, are in its contribution to government revenue, foreign exchange earnings from exports, and its contribution to economic growth. Contribution to government revenue is mainly in the form of rent, comprising royalties, surface and ground rent. This component has increased from M212.50 million in 2014 to M352.61 million in 2019. The GOL is a shareholder in [some of the] the mining companies and has occasionally received dividends, which have increased from an estimated M33.67 million in 2015 to M270.00 million in 2018. The diamond mining industry's contribution to GDP has averaged 5.0 per cent from 2007 to 2018. As expected, due to its capital intensity, its contribution to employment is very small, estimated at 1 500 employees.

## 2. Diamonds Are Not Forever

Diamonds are forever" is the title of the 1971 007 Bond film and of the theme song (soundtrack) of the same film performed by Shirley Bassey that became a hit throughout the 1970s and early 1980s. The truth is diamonds are not forever. This is so for two reasons. Firstly, they are a finite, non-renewable mineral resource. They are a finite resource that will eventually be depleted and some diamond mines operating today will cease to exist sometime in the future. The timing of their depletion per mine and/ or economy may not be easily predictable but is inevitable. Some of the mines that were discovered over that past 4 decades or more, such as the Marange diamond deposits in Zimbabwe have closed down operations due to diamond resource exhaustion, some such as the De Beers' Victor mine in Canada are expected to close soon. According to the Edahn Golan Diamond Research and Data LTD, Lesotho's Kao and Lets'eng mines are expected to shut down in the next 24 to 31 years on the basis of 2018 data. Global production has remained fairly stable despite the depletions and closures, largely on account of new discoveries. In addition, the lifespan of some mines has extended beyond forecasts as a result of advanced technologies and underground mining techniques. Nonetheless, the threat of exhaustion is inevitable as some countries have already experienced.

Secondly, the threat of substitutes has begun to materialize with the emergence of synthetic and growth of lab grown/engineered/ man-made/ cultured diamonds. These are grown in highly controlled laboratory environments using advanced technological processes that duplicate the conditions under which diamonds naturally develop when they form beneath the Earth's crust. Their physical makeup resembles that of natural diamonds hence consists of actual carbon atoms arranged in the characteristic diamond crystal structure. In addition, because they are made up of the same material as natural diamonds, they exhibit the same optical and chemical properties. The man-made diamonds are readily available in the market in a variety of colorless ranges. Cultured diamonds are also available in fancy colors that are considered very rare in nature, including popular hues of vivid fancy yellow. Fancy colored lab diamonds sell at comparatively reasonable prices compared to their natural colored diamond counterparts.

## 3. Diamond Mining Sector Policies: Botswana and Lesotho in Perspective

The extractive sector in resource rich countries could provide such countries with the opportunity to raise domestic funds to finance public goods and achieve their development goals (Stürmer and Bochholz, 2009). The resources and minerals rights are owned by governments, on behalf of their nations and they should be compensated for their extraction and the opportunity cost associated with their consumption (Manungo, 2013). Hence the resource rent principle that efficient output from minerals includes a producer surplus that should accrue to the owner of the asset, leaving an adequate rate of return to the producer to encourage investment (Commonwealth Secretariat and International Council on Mining and Metals, 2009). Governments derive the resource rents through taxation. The revenue accruing to governments from taxing the extractive sector is a key component of this sector's contribution to development (Commonwealth Secretariat and International Council on Mining and Metals, 2009).

Since diamonds are not forever, it is important that endowed countries ensure that their diamond mining sector makes a substantial and effective contribution to economic development.

Botswana is an African country that is reaping substantial economic benefits and resource rents from its diamonds. Jeffers (2013) explains that Botswana's diamond mining sector was the largest contributor to GDP, exports and government revenues at 25.0 per cent, 86.0 per cent and 41.0 per cent, respectively from 2003 to 2013. This is attributable to high production and a favorable resources rents and taxation regime. Botswana has consistently been the main producer of diamonds in value terms from 2010 to 2013 when it was overtaken by Russia. It has retained the 2nd position at US$3 535 million in 2018 while Lesotho was in 7th position at US$377 million during the same year. As depicted in Table 1 below, the sources of revenue for the Government of Botswana from the diamond mining sector are Government's equity investments through joint ventures and taxes in the form of royalties, corporate tax and withholding tax on dividends. Botswana has utilized its diamond revenues responsibly to build infrastructure such as roads, hospitals, and schools, and to significantly elevate the income of the citizens of Botswana. Diamond income has been used for the betterment of the country, and at $7 961.3 in 2019, Botswana's per capita GDP, as estimated by the World Bank, is among the highest in Africa.

**Table 1: Diamond Sector Tax and Equity Rates by Country**

| | Royalty Rate | Corporate Tax | Government Equity Interest | Taxation on Down-stream Processing |
|---|---|---|---|---|
| Lesotho | 10.0 (6-8) | 25 | 20 - 30 | 0 |
| Botswana | 10 | 22 - 55 | 50 | 15 |

Source: Lesotho – Mines and Minerals Act 2005, Income Tax Act 1993, FIAS, IFC and World Bank (2006), Ministry of Mining and Websites of mining companies or major shareholders. Botswana – Mines and Minerals Act 1999, Ministry of Minerals Water and Energy Resources on www.gov.bw/Global/MMWER, MBendi Information Services on www.mbendi.com.

The Botswana Mines and Minerals Act 1999 Section 40 (1) provides for the Government to acquire up to 15.0 per cent working interest participation in the mines. However, being regarded as a strategic mineral to the economy of Botswana the diamond sector is treated differently in this regard (MMWER, 2008). The Botswana Mines and Minerals Act 1999, Section 51 (1) stipulates that "the issue, renewal, transfer or amendment of a license to mine diamonds shall initiate a negotiating process, in good faith, between government and the applicant, covering all technical, financial and commercial aspects of the proposed project including government participation". This has enabled the Government to acquire a substantial 50.0 per cent stake in the main diamond mining company in Botswana (Debswana) through a joint venture with De Beers and 50.0 per cent or more in other companies. In addition, the Government of Botswana has 15.0 per cent shares in De Beers. According to Jefferis (2013) this was facilitated by engagement of high level technical expertise by the Government to strengthen its negotiating position and using its "leverage points" such as renewal of agreements.

In Lesotho, the Mines and Minerals Act 2005 section 44 (1) provides for the Government of Lesotho (GoL), through the Mining Board, to engage in negotiations with an applicant of the issue, renewal, transfer or amendment of a mineral concession for diamonds. The negotiations cover technical, financial and commercial aspects of the project applied for, including government participation. GoL's shareholding in diamond mining companies ranges from 20.0 per cent to 30.0 per cent.

Regarding the tax regime, in Botswana the diamond mining sector is taxed in terms of an agreement with Government. However, the rate cannot be less than 22.0 per cent and increases with profitability of the mine. FIAS, IFC and World Bank (2006) point out that the corporate tax rate for the diamond mines in Botswana ranges from 25.0 per cent to 55.0 per cent. In Lesotho a standard corporate tax of 25.0 per cent applies to diamond mining companies.

The statutory royalty rate for diamonds is 10.0 per cent in both countries. The royalty rate for Botswana is stipulated in the Mines and Minerals Act 1999 and Jefferis (2013) confirms that the rate is non-negotiable in Botswana. However, in the case of Lesotho, even though the 10.0 per cent royalty rate is stipulated in the Mines and Minerals Act 2005, the mining companies have negotiated lower rates. Consequently, the royalty rates in most of the existing diamond mining contracts in Lesotho range between 7.0 and 8.0 per cent (FIAS, IFC and World Bank, 2006). The withholding tax is higher in Lesotho than in Botswana but does not compensate for the low rates on the other taxes, especially because companies hardly pay out dividends every year.

## 4. Policy Implications for Lesotho

Diamonds are not forever. They are a finite non-renewable resource. As such it is important for countries that have this non-renewable mineral to maximize on its potential to contribute to their economic development. Botswana demonstrates that this is achievable through a resources rents and taxation regime that is generous to the people of Botswana. Lesotho's diamond taxation and rent regime should be reviewed with the objective of maximizing fiscal revenue to finance Lesotho's economic development. The following recommendations could generously compensate the Basotho nation for the extraction of their diamonds and the opportunity cost associated with their consumption;

- The statutory royalty rate of 10.0 per cent should be applied to all mines. This will increase the average royalty rate by 3 percentage points from our estimate of the current average royalty rate of around 7.0 per cent, which would boost revenue from diamond mining royalties.

- An increase in the income tax rate from the current 25.0 per cent to Botswana's level of 50.0 per cent would result in a doubling of corporate income tax revenue from the diamond mining industry.

- The Government of Lesotho's equity interest in diamond mining companies ranges from 20.0 to 30.0 per cent. Increasing it to 50.0 per cent will significantly increase government revenue from dividends.

- The revenue should be directed to specific development objectives including infrastructure development and reforms that facilitate ease of doing business in Lesotho.

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