The Price of Gold Soars - Governments Ask, Whose Gold Is It Anyway?

On July 29, 2020, Paul Monica wrote about the gold price hike on the CNN business page. The metal had continued its year-long rally and reached a record high of US$1950.00 per ounce. According to the same article, the current price represents nearly 30% growth in this year alone. Monica also suggested that the possibility for the price of the precious metal to reach a whopping US$2000 is 'almost at this stage inevitable'. https://edition.cnn.com/2020/07/29/investing/gold-prices-fed-silver/index.html He was proved correct only a week later on August 4, 2020, when the price reached US$2041 per ounce, phenomenal by any stretch of the imagination.

This performance is not surprising, given the state of world markets. The world is experiencing unprecedented levels of unpredictability. As in most times of uncertainty, markets have once again sought comfort in gold as an alternative source of investment. The metal is seen as having comparatively more stable value in the long run. Thanks to several factors, the year 2020 particularly epitomises economic uncertainty. First, the short- and long-term impacts of the COVID-19 pandemic on the global economy promise to be devastating. The second factor is the increasingly unpredictable US political climate. Also on the cards is the negative impact of that country's economic stimulus packages on the value of the US dollar, which has depreciated relative to other major currencies. One of the casualties of these actions by the US government on the US dollar is that investors have shifted from making investments in US-dollar-denominated savings to other less volatile options; at the top of the charts are gold and other precious metals such as silver. Interestingly, this response by investors becomes a self-fulfilling prophecy in that the move props up well-sought-after alternatives like gold—at least in the short term.

Of course this is not the first nor the last time gold outperforms other commodities. https://goldprice.org/gold-price-history.htm The last time gold rallied nearly as much was between 2011-2012. As is the case now, the markets and business journalists went to town and, like Paul Monica, focused on the markets and changing investment trends. But as with most things, the story of the soaring gold prices has different sides, and I was reminded of this as I read the CNN story and other pieces. I was reminded of the mineral and fiscal policy angle and of a conversation I had during the last boom, in which an African politician said to me, 'Whose gold is it anyway, Sheila?'

Source Goldprice.org

The missing link in Monica's informative report is the mineral policy angle, which relates to matters upstream of the investment decisions in Wall Street and other world financial capitals. It is found in countries that produce the gold, and the issue relates to the following question: Between the mining companies and the countries that license them to extract the gold, who should enjoy the benefits of a commodity boom? It also relates to the principle of wealth-sharing between mining companies and developing countries. Practically, it ultimately raises the matter of windfall tax.

Arguments for and Against Windfall Tax

I am reminded of the 2011 argument that ensued between AngloGold Ashanti and the Ghanaian authorities, in which the latter argued that the price of gold had risen way above expectations. Furthermore, the country's taxation threshold had not kept pace. On this basis the Ghanaian tax authorities argued that the country's take was disproportionate to that of the company and that in the spirit of equitable wealth sharing and to maintain parity, an interim tax should be levied.

Ghana was not alone. Other African governments were also seeking higher rents and bigger ownership stakes from foreign miners. In Ghana, Guinea, Zambia and Namibia, as well as a host of other countries, tax authorities raised royalties and tax rates. Following the 2012 national budget statement, in which the Ghanaian government announced plans to raise corporate tax in the mining sector from 25% to 35%, as well as to introduce a windfall tax of 10%, predictably, investors voiced concern about potentially adverse impacts on profits and the capacity to fund new projects.
For instance, Nick Holland, CEO of Goldfields, the South African firm that operates some of the larger gold mines in Ghana, argued against the idea. At the time, the company operations included a $1 billion project pipeline, and Holland described the Ghanaian government's proposed tax changes (10% increase in mining corporate tax and 10% new windfall tax) as a 'big concern' that could threaten the group's expansion plans in Ghana. The companies may have had a point, but advocates of tax hikes, including the IMF, maintained that the increase in taxation was justified and that it would ensure that the countries reap the benefits of that boom without jeopardising investors. These views were aligned with those of some in Ghana, across Africa and in other emerging markets. The governments and their citizens were convinced that they deserved to claim a greater share of revenue during a commodity boom. They were convinced that companies should share the financial gains from the boom with host nations.

Windfall Taxes are Justified and Potentially Good for the Continent, but They Can Be Smarter: Here Is How.

It is possible for such tax provisions to be better designed to balance the interests of nations and mining companies. To achieve balance, governments should consider devising windfall tax based on a pre-determined trigger mechanism. Such a system would be preferable because it is transparent and provides a predictable investment environment. Under these circumstances governments could consider putting in place a similar mechanism to provide investors some relief in case of a sustained and severe drop in commodity prices. The goal here is not to save mining companies but to save mining projects whose economic value and therefore survival is critical to many national economies. Such a mechanism becomes a case of enlightened self-interest, on both sides.

Investors' assertions that projects may be shelved due to the tax increase might be justified, but typical projects are financed through borrowings based on an accepted level of risk and return. Though less common, funding of projects from internal sources is indicative of several factors, for instance, large cash reserves and shareholders' preference for own resources over high cost of capital. The former might indeed be a direct outcome of greater financial gains resulting from the price growth, thus supporting the position of Ghana's tax authorities in seeking a windfall tax. However, lack of internal funds very rarely gets in the way of developing a financially viable mineral project. So, while the two issues are related, it does not follow that the logical end of a windfall tax would be for investors to walk away from new projects.

Of course, one way of addressing the issue of additional revenue from price growth may be for industry to take the lead and initiate ways to share the benefits with governments, rather than to wait until ways of sharing are imposed on them. Otherwise, it may be hard to argue that it is unrealistic for governments to expect to reap the benefits of extreme commodity price gains similar to those prevailing in the gold commodity market now.

Transparency

An introduction of windfall tax that is based on a pre-agreed trigger mechanism would be more preferable than one that is introduced ad hoc because the approach would ensure that the windfall tax levy is tied directly to a known quantum and that market forces prevail. The fiscal regime would provide a more predictable and a more transparent platform for planning. The current proposals stop short of facilitating this mechanism; hence, the policy exposes the authorities to criticism.

Most importantly, as custodians of mineral wealth, it is not enough for governments to simply ask for more tax revenue. Thought must be given to how the revenue from windfall tax provisions should be invested. Using the revenue to fund routine public expenditure, for instance, is missing a golden opportunity to beef up national savings. Using the funds to create future public revenue streams is a better option. Falling short of these long-term goals means that governments undermine the true value of revenue from windfall taxation. Being transparent and disclosing the revenue received and how it is spent avails the governments the necessary moral authority and a value proposition to make a case to the investors at a time, such as now, when ESG issues are of concern.

These decisions and actions of governments downstream of an imposition of a windfall tax are far more important for governance and accountability purposes and should be factored into policy reforms.