Some Thoughts on the South African Mining Industry at a Time of Crisis

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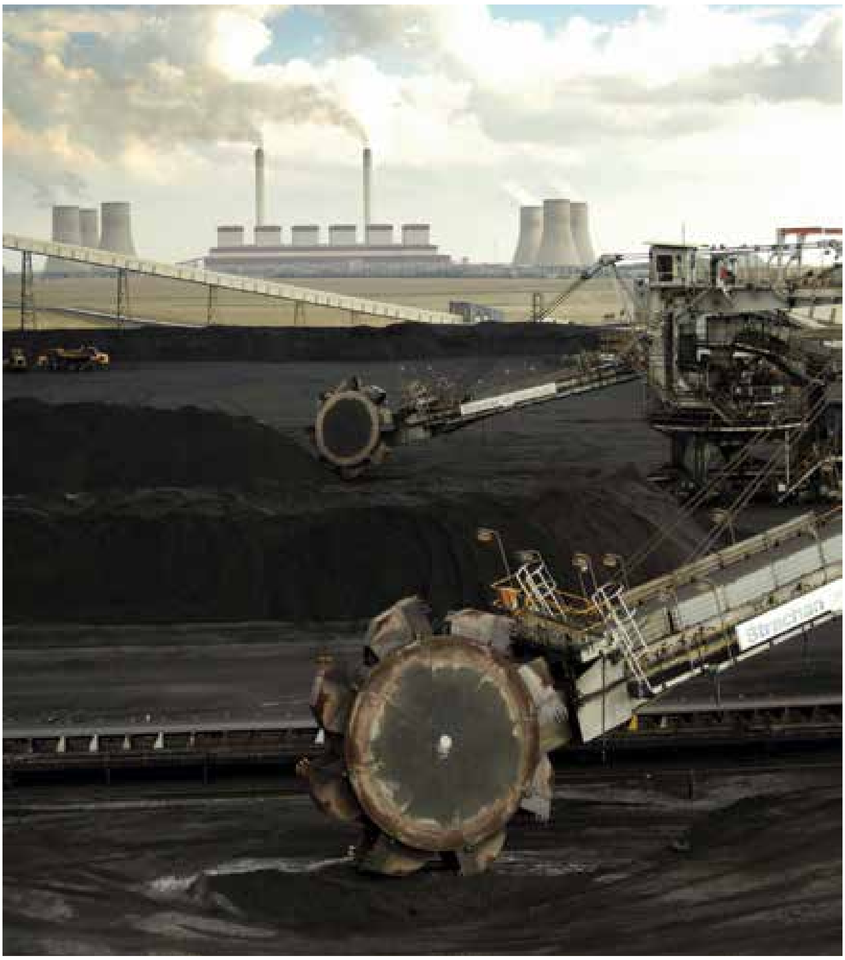

Setting the scene

President John F. Kennedy experienced many crises during his time in office—the Bay of Pigs debacle in Cuba, the Cuban missile crisis, the beginnings of the Vietnam war, and irredentist opposition to civil rights in the South. Perhaps drawing on these experiences, he once observed: 'When written in Chinese, the word "crisis" is composed of two characters: one represents danger and the other represents opportunity.' [1]

South Africa, at the end of 2015, in the fourth year of a commodity bear market and the second of the final Zuma Administration—with a paltry 1.5 per cent growth rate—is in precisely this situation. As mineral exports constitute some 60% of the country's exports (and mining itself some 6% of GDP), there is a direct correlation between evanescent commodity prices and the trade balance of the current account, as much as the exchange rate. As good Keynesians, the government has contra-cyclically boosted expenditure, to drive demand, in the wake of declining government revenues.

South Africa's current account deficit is now -4.3% of GDP while its fiscal deficit is -3.8% of GDP, principally funded by short term capital inflows in the bond and equity markets. These could rapidly reverse in the wake of a decline in economic sentiment. This is illustrated by the fact that while the country is close to the bottom of sovereign investment grade ratings, foreigners own 37% of its domestic bonds compared with 14% six years ago.[2] A further ratings downgrade could see such investors scrambling for the exit.

This is not surprising given that the State now employs some 1.8 million employees, 28% bigger than it was 10 years ago. This 7% public sector wage settlement in 2015 (11.5% with benefits) will cost the country an extra R12.6 billion and a staggering R32.6 billion in 2017.

Government borrowing has ballooned under this Administration. Debt as a percentage of GDP has doubled from 22% at the start of the Zuma Administration to 44% at the end of 2015. It is still climbing. This is largely due to an increase in public sector wages and employment, which is now 28% bigger than it was ten years ago.

According to the Bank of International Settlements, South Africa has accumulated the most debt of the fourteen emerging market economies it monitors.[3] Interest on government debt now represents nearly 11% of South Africa's fiscal revenue, while government spending itself constitutes 1/3 of GDP, which is high by emerging market standards.

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The mining industry

Where does that leave the South African mining industry? Like much of the global industry, but with some significant domestic add-ons, the industry faces an unhappy combination of ever declining commodity prices and increased cost pressures, only slightly mitigated by the 45% depreciation in the Rand Dollar exchange rate over the last three years. The Bloomberg commodity index recognises this, falling 16% in 2015 to its lowest level since 2009. According to Goldman Sachs, a case of too much supply combined with too little demand from China and others means 'lower prices for even longer'. [4]

The cost of transporting commodities, as measured by the Baltic dry index, is now at its lowest for thirty years, reflecting lack of demand from China for iron ore and coal, while prices are at their lowest in six years. Professor Carmen Reinhart of the Harvard Kennedy School observes [5] that declines in commodity prices normally endure for seven years and we are now in year four, with a peak-to-trough fall of 25 per cent and another five per cent to go. She also notes that that during these downturns, banking, currency and sovereign debt crises all tend to proliferate.

In some respects the South African mining industry is testament to this thesis. While the revenue of JSE-listed mining companies improved fractionally in 2015, net profit fell by 75%, leaving the industry 'struggling for survival.' [6] The market capitalisation of JSE-listed mining companies is less than half of what it was in June 2014 (R304 billion compared with R675 billion).

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Increased operating costs and, in some cases, declining ore grades are placing huge pressure on existing operating models. Infrastructure constraints, principally energy and logistics related, combined with ever increasing wage demands, not matched by any improvement in labour productivity, add to the industry's woes. South Africa's mining export value per capita has fallen further than other mineral commodity producers.

This is illustrated by South Africa's ranking in 2015's Fraser Institute survey of the world's major mining jurisdictions, where it was ranked 66th out of 122 countries surveyed in the policy perception index. [7] Botswana ranked first in Africa with a score of 81% and 13th overall. South Africa, with a score of 44%, was the tenth ranked African country, behind Burkina Faso, Ghana, Liberia, Mali, Namibia, Tanzania, Zambia and others. An investor remarked that the country had a 'highly political unionized workforce that perpetually demands more and more in return for less and less productivity'. [8]

Wage increases in the mining industry have averaged 12.3% annually for the last five years, in other words double the inflation rate, without any concomitant increase in productivity (or, indeed, any agreement linking the two). Labour costs now represent over 50% of the industry's fixed costs. An absence of mandatory secret balloting before strike action, coupled with what are effectively 'closed shop' agreements, denying recognition to minority unions, are not conducive to labour stability. At the same time, the migrant labour system, a product of colonialism and apartheid, contributes to workers' sense of anomie and alienation.

Energy costs, monopolised by Eskom, a state-owned service provider, have increased by more than 238% between 2007-2012. Unlike in Australia and Brazil, mining companies are largely dependent on Eskom for power (although this is changing in the light of this year's energy outages) as they are on Transnet, another SOE monopoly, for rail and port facilities. Lack of cost-competitive access to essential infrastructure has a major impact on economic growth. The Chamber of Mines has estimated that if this constraint were removed, it would ensure an annual increase in GDP of between 3-5 per cent. [9]

Opportunities

All is not doom and gloom, for there is opportunity.

First, the National Development Plan ('NDP'), adopted by government and the ANC three years ago, recognised the industry's paradoxically poor performance during the 2004-2011 commodity boom. It recommended that South Africa's Mineral and Petroleum Resources Development Act ('MPRDA') should be amended to 'ensure a predictable, competitive and stable regulatory framework'. [10]

Second, the 2014-2019 Medium Term Strategic Framework, which gives effect to the NDP, requires government to streamline regulatory processes in relation to the grant of mining and water licences, as well as environmental impact assessments. Government has already given effect to this, in part, through the introduction of the One Environmental System for mining on 8 December 2014, following President Zuma's announcement in his 2014 State of the Nation address that a 300 day joined up system for all mining, water and environmental permits would be introduced. [11] Currently, this takes the form of an agreement between the three Ministries pending legislation to give effect to it.

Third, the July 2013 Framework Agreement for a Sustainable Mining Industry, signed by government, labour (with the notable exception of the Association of Mineworkers and Construction Union ('AMCU')) and business in the wake of Marikana, for the first time since the original Mining Charter was adopted in 2002, imposes obligations on all three protagonists.

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The agreement recognises the importance of a sustainable mining sector and that living and working conditions for mineworkers are not optimal (although it is vague about the migrant labour issue). It requires government to ensure 'consistency and certainty' in the application of law and law and policy, while promoting fairness and impartiality in the industry's governance.

Fourth, the President's decision in January 2015 to refer the controversial MPRDA Amendment Bill, 2013, back to Parliament is a blow for the rule of law as much as good governance. It will be recalled that this Bill flew in the face of the NDP by increasing Ministerial discretion in relation to the domestic beneficiation of minerals, long something of a lodestar to this Administration. Bizarrely, the Bill abolished all the MPRDA's already inadequate time limits and replaced these with Ministerial regulation.

More worryingly, it abolished the open access system for the grant of rights, which operates in most mining jurisdictions, and replaced it with an opaque quasi-auction system. Finally, it established a non-WTO compliant export licensing system for 'designated' minerals under which the Minister of Mineral Resources must 'designate' minerals for domestic beneficiation in the quantities, qualities and timelines which he may specify. [12] Mineral producers are obliged to supply such minerals for domestic beneficiation either at a 'mine gate' price or an agreed price. If not so supplied, mining companies may not export them without the Minister's written consent. [13]

In January 2015, President Zuma referred the Bill back to the National Assembly for reconsideration in terms of section 79(1) of the Constitution as he had reservations about its constitutionality. Importantly, he did so on the basis, inter alia, that the Bill's beneficiation provisions, described above, 'appear to be inconsistent with South Africa's obligations under the General Agreement on Tariffs and Trade (GATT) and the [EU-SA] Trade, Development and Cooperation Agreement (TDCA) insofar as they appear to impose quantitative restrictions on exports in contravention of GATT and the TDCA and in so doing render the state vulnerable to challenges in international fora.' [14]

While this is obviously important for the rule of law, Parliament's inaction on the Bill since then either indicates that it is uncertain how to address the substance of the President's referral or that the Department of Mineral Resources ('DMR'), now under new Ministerial management, [15] is having second thoughts about it. Whatever the case, it is positive that the Bill has not progressed any further, given its contents.

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Next, in May 2015, the Chamber of Mines of South Africa ('the Chamber'), responding to an adverse—and disputed—Mining Charter audit by the DMR of their members' compliance with the Charter's 26% historically disadvantaged South African ('HDSA') ownership requirements, launched proceedings against the DMR in the Pretoria High Court for a declaratory order as to the meaning of the Charter's key provisions. [16]

Although this matter will only be heard in March, what is unusual about this case is that not only is it the first time that the Chamber has collectively challenged the DMR's interpretation of the Mining Charter, but that it in effect responded to an invitation by the former Minister, Ngoako Ramatlhodi, to do so.[17]

As Ramatlhodi remarked at the time, 'sensitive issues' required 'legal remedies' rather than the imposition of regulations. [18] Importantly, the Chamber's case challenges the DMR's rejection of the 'once empowered always empowered' principle to HDSA ownership, which effectively requires mining companies to substitute any departing HDSA shareholders on an ongoing basis. It likewise challenges the retrospective application of the revised Mining Charter to transactions which took place prior to the introduction of that Charter in September 2010, and the inability of mining companies to obtain credit for the 'continuing consequences' of HDSA transactions which occurred after the promulgation of the MPRDA in May 2004.

Finally, two events took place in the final quarter of 2015 which may have a positive outcome for the industry. First, in his October medium term budget policy statement, the Minister of Finance announced some important policy decisions by government to support the economy. The most important of these for the long term—no doubt influenced by this year's visa debacle and its detrimental impact on tourism—is Cabinet's decision that with effect from 1 September 2015 'all future legislation and regulations will be subject to a socioeconomic impact to mitigate unintended consequences'. [19]

On this basis alone, the MPRDA Amendment Bill will have to be reconsidered, never mind its Presidential referral to the National Assembly. Spelling this out later in the statement, the Minister observed that this impact assessment would be mandatory and promote 'greater policy coordination, highlight potential implementation risks or unintended consequences'. [20]

Second, a five week mining Phakisa, under the auspices of the Presidency, has just been completed involving government, labour (again with the absence of

AMCU) and business. The purpose of the Phakisa was to 'identify key constraints to investment and growth of the industry as well as develop a shared vision and growth strategy for the long term' in accordance with the NDP. [21] Although it appears that the Mining Charter itself was on the table, little discussion seems to have taken place about the MPRDA Amendment Bill which, if correct, is unfortunate. One participant remarked that that he could not 'hold out too much hope in a five week laboratory coming up with all the solutions to save this delicate industry'. [22]

Conclusion

It has long been true that the absence of an overarching social impact for the mining industry imperils its future. The 2013 mine framework agreement, discussed earlier, is a start, but is rather vague about some of its key commitments and lacks effective enforcement mechanisms. The Mining Phakisa is another step in the right direction provided its outcomes are credible and effective. Government's recent decision, in effect, to impose regulatory impact assessments on any new legislation or subordinate legislation is another positive. Having said that, given the 35,000 and climbing job losses in the industry over the last two years, [23] unless there is such an overarching agreement with clear obligations on all parties and effective enforcement mechanisms, the industry's travails, in the current economic climate, are unfortunately likely to continue.

NOTE

1 John F Kennedy, Speech at the Valley Forge Country Club, Pennsylvania, 29 October 1960
2 Etienne le Roux, "Sacrifices must be made to keep SA out of the junkyard", Business Day, 11 May 2015
3 Lesiba Mothata "New data show our debt is growing at an alarming speed", Business Day, 20 October 2015
4 "Natural resources prices may fall again", Financial Times, 19 November 2015
5 Carmen Reinhart, The Commodity Roller Coaster, Project Syndicate, 19 November 2015
6 PWC, SA Mine, 2015, 3
7 Fraser Institute, Annual Survey of Mining Companies 2014, 24 February 2015, 10
8 Ibid, 54
9 Chamber of Mines of South Africa, Submission to the National Energy Regulator of South Africa, 31 January 2013, 1
10 National Development Plan 2030: Our Future – Make it Work, National Planning Commission, 15 August 2012, 146
11 See joint media release by the Departments of Mineral Resources, Environmental Affairs and Water Affairs, 9 December 2014
12 Clauses 21(b) and (c) of the Mineral and Petroleum Resources Development Amendment Bill, 2013
13 Clause 21(d) of the Mineral and Petroleum Resources Development Amendment Bill, 2013
14 Letter from the President of the Republic of South Africa to the Speaker of the National Assembly, 16 January 2015
15 Mosebenzi Joseph Zwane, a former MEC for Agriculture in the Free State, was appointed Minister of Mineral Resources on 23 September 2015
16 The 2014/2015 Mining Charter audit released by the DMR in May 2015 found that 79 per cent of mining companies had failed to achieve the 26 per cent HDSA ownership requirements of the original and revised Mining Charters. This was challenged by the Chamber.
17 "South Africa's DMR and Chamber of Mines to face off in court", Mineweb 31 March 2015.
18 Ibid.
19 National Treasury, Medium Term Budget Policy Statement 2015, 21 October 2015, 8
20 Ibid, 16
21 Statement by the Minister of Mineral Resources on mining operation Phakisa, 14 May 2015, www.sanews.gov.za/mining-operation-phakisa-start-work-august
22 "More jaw than ore - so far", Financial Mail, 3 December 2015
23 South African miners accelerate job cuts to 35 000 over two years", Financial Times, 25 May 2015