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It's simple: just slap another tax on mining industry

THE African National Congress (ANC) study group report on the mining industry has been covered fairly extensively in the press. These reports were based on a leaked version of an executive summary, but the report as a whole has now been published. Since, as they say, the devil is in the detail, what does the report as a whole tell us that the summary does not?

The summary is about 60 pages, but the report as a whole is just under 400, so there is detail there. In this article I'd like to highlight a few topics that help explain why the specific diagnosis was arrived at in the conclusion — and perhaps also why I think it presents a misdiagnosis that could really hurt the patient.

But first let us recap quickly. The report is not ANC policy, not yet; it constitutes an investigation into the issue that will form part of ANC discussions at its policy conference later this year. It has the character of an opinionated challenge and extended research document rather than the formality you might expect from a policy white paper, for example.

Its main conclusions are to deride the notion of nationalisation, but propose a string of alternatives. The most significant of these are: the implementation of a "resource rent tax", of the same type recently imposed in Australia, but at a much higher rate; the creation of a state-owned mining company; and the fairly extensive revision of the now famous Mineral and Petroleum Resources Development Act.

The report was greatly anticipated for its views on nationalisation, but oddly this highly charged topic was not really meaningfully grappled with in the text. In the final summary, the conclusion was essentially drawn that nationalisation would be cost-prohibitive, coming in at about R1-trillion, and that without compensation it would transgress bilateral trade agreements and would generally be disastrous.

Hooray for that pretty obvious conclusion. But it is disappointing that the discussion of why state ownership had been so disastrous, is lacking in the report itself. It does not actually address that topic in any real way, other than expounding at length on the international trends, which have generally speaking been strongly away from state ownership over the medium term.

It does, however, note the three main trends of recent years: that state ownership currently is between 90% and 40% lower than its peak level; that state ownership has increased recently from 22% in 2000 to 30% now; and that most of that increase is accounted for by the increased influence of Chinese state companies on the mining sector.

But it does formulate an argument implicitly in favour of state-owned mining companies, which prepares the ground for the recommendation that SA should have a state-owned mining national champion in the conclusion.

MONDAY COMMENT

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> **"The report fails to explain why mining companies and oil companies are different, and why oil companies tend to succeed under state ownership and mining companies not**

For example, it heaps praise on Chilean copper miner Codelco and cites the company as one of the "few and important" examples of successful state-owned mining companies. The others are LKAB, the Swedish iron-ore mine, Finnish miner Outokumpu and Botswana's Debswana. It notes that state-controlled national oil companies have become the norm internationally, but that state-owned mining companies have not been able to operate successfully, leading to privatisation.

It then concludes, entirely wrongly in my opinion, that "the energy sector shows, however, that such poor performance is not a corollary of state ownership". It then lists a whole string of requirements for state-owned mining companies to be successful, most of which are absolutely correctly identified — and are consequently extremely unlikely to exist in practice. These include having a knowledgeable and independent board; transparency; the need for constant reinvestment; and the need for politicians to understand the long-term nature of mining, and so on.

But importantly, the report fails to explain why mining companies and oil companies are different, and why oil companies tend to succeed under state ownership and mining companies do not.

This is a complicated topic, but at root I suspect the reason is pretty basic: drilling for oil is fabulously profitable, returns come fast, and (the industry is going to hate me) it is comparatively easy. The oil industry also has the major advantage that it is very outsourced; many national oil companies are national in name only, and the people who do the actual drilling are companies such as Halliburton and General Electric.

The oil industry also has a very effective supplier cartel at its disposal, which tends to support the industry in bad times — not that we have had those in almost a decade.

Oil is also mainly pumped in totalitarian states, or ones that often end up that way — witness Venezuela and Iran. The point is that state ownership of the oil industry is absolutely not a reason to support a state miner; if anything, it is a reason to avoid establishing a state miner.

Perhaps the most important part of the report is not what is explained, but what goes unexplained. The report ultimately suggests the imposition of a super-profits tax. So you might expect a detailed explanation of how it would work, some kind of economic model that supports it.

In some ways, the tax does not seem like a terrible idea, particularly since it includes reducing the new mining royalty tax at the same time. The result, it might seem, would be to reduce the tax on mining turnover, thereby reducing the load on mining companies that are just getting off the start line, and increase it on those elements of the mining industry burning up the tarmac.

Yet, and it is so disappointing, the report does not include a real attempt to grapple with the issue. The report suggests that the super-profits tax, called the "Resource Rents Tax", kicks in when a company earns a certain amount, but will be applied at 50%, and that it will be applied to the whole industry. The Australian tax which brought down the government and ended the career of former prime minister Kevin Rudd, applies only to the iron-ore and coal industry, and it is set at half the rate.

Hence, the proposal is, frankly, for an onerous new tax. Why do the report's drafters think the industry will be able to take that kind of taxation strain, and simultaneously, beneficiate, do empowerment, pay carbon tax and do all the other things? We don't know. They don't say.

WHY would a state-owned mining company succeed where private companies have failed? The ANC's study group uses some interesting, and controversial, examples to argue its point.

Imbedded in the report are serious allegations against South African manganese producers, an implicit criticism of the ANC for allowing Anglo to move its listing to London, and a really vociferous attack on ArcelorMittal. These all have the common thread of justifying the creation of a state miner.

How so? Well, at a fundamental level, the report really works on the basis that the mining industry has not and does not sufficiently beneficiate its product. A whole range of new weapons are therefore designed to bring the industry into line. But is this charge really justified?

> **"These are credible complaints the companies must answer to escape the charge of causing an unfortunate experiment to be unleashed on taxpayers**

The main exhibit for the prosecution is the manganese industry, which the report claims has colluded in order to gain higher export prices, and consequently it not only wasn't interested in beneficiation, it was positively against it.

"One of the beneficiation enigmas is manganese, where two-thirds of this high-grade resource is exported as crude ore, despite the next step (smelting to produce manganese ferro alloys) being electricity intensive and SA having had low electricity prices over the last 30 years," the report says.

The manganese export ore price was controlled by an oligopoly of four companies, which resulted in monopoly ore prices and very high returns for mining.

"Any downstream investments in capital-intensive smelting would consequently have yielded lower returns on capital than selling ore at monopoly prices.

"In this way one distortion (monopoly pricing) led to another (lack of beneficiation) and this would be a good example of the necessity for state intervention to effect a correction, through, for example, applying a correcting export tax on manganese ore exports, a resource rent tax on the excess profits or using infrastructure tariffs."

Personally, I have no idea whether this allegation is justified, but if it is not, the manganese industry could do us all a favour and explain why not.

The next example is Anglo American's divestment from its main platinum group metals downstream beneficiator and technology developer, Johnson Matthey, which the report criticises.

Anglo was a 40% holder of Johnson Matthey in the early 1990s, and invested heavily in it for years, precisely in order to understand the technology behind platinum group metals. It divested from Johnson Matthey because of the pressure to focus on its core competence.

"This appears to indicate that the decision to allow Anglo to relist abroad was possibly ill advised and that a developmental state might take a different view on the 'unfettered' movement abroad of domestic capital," the report says.

The same sort of argument is forwarded with respect to ArcelorMittal SA (AMSA). The report says that "due to the ISI (import substitution industrialisation) strategy of the apartheid era, Iscor/AMSA have always relied on monopoly pricing to maximise profitability and/or subsidise inefficiencies, with devastating impacts on the competitiveness of downstream steel-intensive manufacturing. Post-liberation in 1994, the democratic ANC government has been markedly unsuccessful in curbing this job-destroying abuse, despite concerted efforts to achieve competitive steel pricing by the Competition Commission."

It strikes me that these are all credible complaints that the respective companies need to answer if they are to escape the charge that their own narrow interests have not unleashed an unfortunate experiment on South African taxpayers.