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Nationalisation out, nationalism in

The state plans to take a bigger share of the resources pie through tax and price controls

Sharda Naidoo

Get ready for resource nationalism: the state and ruling ANC are rigorously debating proposals that could force a radical shake-up of the country's $2.5-trillion non-energy mineral wealth.

The broad strokes of the reforms, presented in the ANC's 600-page draft "State Intervention in Minerals Sector" report, call for, among others, supertaxes on the mining industry that could be ring-fenced into various investment vehicles and sovereign funds.

With the world in a state of economic flux and sovereign debt spiralling, countries around the globe are under great pressure to reduce their borrowings. The idea is: Why fund the economy on debt when you can fund it with taxes?

Although the taxes have been flayed by mining executives as intrusive, a disincentive for investment and another regulatory burden, they could be a good method of propping up the fiscus and developing the infrastructure and skills needed to grow the struggling sector. The question is whether the plan can be implemented, considering the many infrastructure and skills constraints, political factionalism and the disconnect between the public and private sectors.

One of the biggest moves is the plan by the state to consolidate, or take, majority control over South Africa's key manufacturing input minerals under a state mining company, a model adopted in many of the 14 countries from which the ANC is drawing lessons.

The plan is for development finance institutions, such the Industrial Development Corporation, Public Investment Corporation and National Empowerment Fund, to join forces with mining trade unions and pool their pension funds in a special-purpose vehicle that can be used to increase stakes in listed companies.

Mineral Resources Minister Susan Shabangu talks to the media at the Mining Indaba in Cape Town this week, at which the ANC released a plan for greater intervention in the minerals sector. Photo: David Harrison

The ANC report lists Sasol in particular for state intervention. It has products that feed into almost every manufacturing sector.

The report calls for trade federation Cosatu to consider using its influence over its fund managers, which invest members' pension funds, and partners to increase the state's 26% stake in Sasol to one of majority control. That way the state and the labour movement could exert more influence on mine management. All this will be managed and governed through a super-ministry merging five departments.

Price penalties will also be attached to licensing conditions: companies such as Sasol and ArcelorMittal South Africa, which continue to charge predatory prices, could have their mining rights revoked.

"The second most important feedstock into manufacturing is polymers, which are sold by Sasol into the local market at monopoly prices," says the report. "Mining licences should obligate local sales at 'cost plus'." Local customers must likewise be obliged to apply export parity pricing to their products."

The bigger picture is about getting competitive input prices in the economy to stimulate job creation, as pronounced in South Africa's various industrial policies. Figures released this week put the country's unemployment rate at 23.9%, whereas the new growth path is targeting five million jobs by 2020. The ANC report estimated that between 400 000 and one million jobs could be created over two to five years through the mooted interventions.

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Although nationalisation of the land-grab style is discouraged in the report, the state will apply a heavy hand to all strategic mineral assets that feed into downstream job-creating sectors such as manufacturing, energy, infrastructure and agriculture. Targeted for intervention are the producers of steel, polymers, base metals, coal, gas, uranium, nitrogen, cement, copper, platinum group metals, chromium, manganese, phosphates, zinc and potassium.

The state is already putting this plan in motion. The third most important mineral feedstock into manufacturing is copper. It is also an important feedstock into infrastructure (construction and power).

The report says copper should also be declared a strategic mineral with competitive pricing mining-licence conditions. The main producer is Phalaborwa, owned by Rio Tinto and Anglo. The Industrial Development Corporation has put in a bid to purchase it and if successful, the ANC says, the economic development ministry should instruct the corporation to sell into the local market at a competitive export parity price.

"However, our main copper reserves are in the PGM reefs (a co-product) of the Bushveld Complex and the platinum group metals mining licences should stipulate sales into the local market at competitive prices," said the ANC report.

The plan, parts of which have been leaked to the media, still needs to be debated and vetted at the ANC's policy and elective conferences, respectively in June and December.

Although the treasury still needs to scrutinise the fiscal interventions, on the table is a windfall tax or resources rent tax of 50% on superprofits (defined as a return on investment of 22%), a 50% tax on the sale of mineral rights, a reduction in royalty tax from 4% to 1% and a rent share of mining rights.

The idea is to warehouse the estimated R40-billion a year earned from the resources rent tax into a sovereign wealth fund that could be used, in part, to develop infrastructure, skills and geo-knowledge.

A resources rent tax, similar to the Australian model, is regarded as progressive because it is a tax on exceptional profit — it kicks in only after the normal average profit is recorded. If managed properly, it could dramatically reduce South Africa's current account deficit.

Trevor Manuel, the minister in the presidency in charge of the National Planning Commission, said at the Mining Indaba in Cape Town this week that it was critical that sensible taxation existed to extract rent from the industry to invest in South Africa's development.

Although some mining executives bemoaned the idea of supertaxes, saying it would discourage investment and thus job creation, others, such as Anglo American and BHP Billiton, were happier to have the taxes on their plate than a policy of nationalisation.

"I believe there is a need for some state intervention that is a constructive partnership between the private sector and government," said an Anglo executive, who did not want to be named. "At least with taxes, there is some policy certainty and we can do our forecasts and modelling for the next 20 years. It does mean, though, that we might not invest as much in capital expansion."

The mining industry has been in a state of structural decline. Its contribution to the economy has shrunk from R103-billion in 1993 to R92-billion in 2009 and from 21% of gross domestic product in the 1970s to about 6% now, despite a synchronised commodities boom.

Employment has also dropped, from more than 400 000 to just more than 100 000. It is the reason why Manuel believes the trend must be reversed through a state interventionist approach of policy and regulatory certainty, the extraction of rents from the sector, investment in infrastructure, beneficiation and the reduction of mining's impact on the environment.

Tax changes reflect measures taken in other countries

Royalties: The royalties rate varies depending on the earnings before interest, taxation and gross sales. For refined minerals the maximum rate is 5%, and for unrefined it is 7%.

Corporate income tax: There is a standard corporate tax rate of 28% and a secondary tax on companies (STC) of 10% is levied on companies.

Withholding taxes (WHT): South Africa does not currently apply a WHT on dividends. However, plans are under way to introduce a WHT at a rate of 10% in 2013, which could replace the STC.

Capex expensing: Mining companies are eligible for an upfront deduction of all capital expenditure incurred. However, the deduction can be claimed only when the company reaches production stage and is subject to sufficient taxable income. Assessed losses may be carried forward indefinitely as long as the company trades.

SOME OF THE NEW PROPOSALS:

Resources rent tax (RRT): The idea is that South Africans should get a fair share of resources rent. This is the surplus value or exceptional profits: it is the difference between the price at which a resource can be sold and its extraction costs, including normal returns. Many countries take a part of the resource rents. In oil and gas extraction, the RRT is generally between 50% and 90% of the excess profits. Australia has an RRT of 21%. The ANC is proposing an RRT of 50% that will kick in only when the investor has made a reasonable return, which the researchers believe would not deter investors or have an impact on marginal or low-grade deposits. A "normal" return should be defined as the treasury long bond rate plus 7% (about 15% currently). The tax of 50% would yield about R40-billion a year at current prices. The RRT proceeds should be housed in a sovereign wealth fund to ameliorate the strengthening of the rand during commodity booms and could be used to invest in long-term projects and instruments. This ties in with the new growth path proposals to create a sovereign wealth fund.

Gold mining tax: The current gold mining formula tax should be combined with corporate income tax plus the RRT. Currently, companies can deduct 100% of much of their capital expenditures against tax. Gold mining companies pay a corporation tax rate calculated according to a formula that keeps remittances to the government low.

Mineral royalties tax: The researchers believe royalties on mineral production (turnover, revenue or sales) add to costs and increase the cut-off grade. Once the RRT is in place, the royalty rate should be cut to 1% of revenue (about R4-billion a year) to enhance optimal resource extraction.

Mineral foreign shareholding withholding tax: This is proposed to encourage direct investment from a company's primary listing country. If the foreign mining company is held in a tax haven (as determined annually by the minister of finance) the rate should be 30%. If not, the normal rate of 10% should apply. Brazil has a similar system to discourage investments from tax havens.

Carbon tax: The report suggests that a carbon tax, as proposed by the treasury, could be "extremely damaging" to the economy and should be put on hold.

"It could also potentially render many energy-intensive beneficiation operations unviable."

It is proposed that a carbon tax, which it is estimated could bring in about R80-billion a year, be reconfigured, possibly by having a higher RRT (above 50%) linked to carbon emissions and should also include a realistic basket of supply-and-demand side measures to reduce national carbon emissions.
— Sharda Naidoo