SAIIA SUBMISSION:

TO PUBLIC HEARINGS ON THE MINERAL AND PETROLEUM RESOURCES DEVELOPMENT AMENDMENT BILL 2013 (PORTFOLIO COMMITTEE ON MINING, PARLIAMENT OF SOUTH AFRICA)

Governance of Africa's Resources Programme (GARP)
at the South African Institute of International Affairs

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SAIIA has been rated the top-ranked think tank in Africa for the past four years. GARP deals specifically with natural resource governance.

EXECUTIVE SUMMARY

The best economic evidence available indicates the importance of high quality institutions for ensuring equitable and sustainable development outcomes. This is especially true in mineral-wealthy countries, where mineral rents can either spur development or be channelled into directly unproductive activities that benefit the elite at the expense of citizens. To ensure the former – our shared hope as South Africans – it is imperative that the rules of the game be clear to all stakeholders and that whatever legislation governs the extractive industries be transparently, accountably and efficiently administered. We submit that the Mineral and Petroleum Resources Development Amendment Bill (hereafter MPRD-AB), which amends the Mineral and Petroleum Resources Development Act (MPRDA) of 2002, needs to be made clearer and the extensive room for ministerial discretion currently embedded therein needs to be reduced. It is our contention that Botswana's success in utilising its vast diamond wealth to spur sustained economic growth provides a comparable, instructive lesson for Parliament's Mineral Resources Portfolio Committee legislators as they prepare to address the MPRD-AB.

KEY RECOMMENDATIONS:

1. The proposal in the MPRD-AB to repeal the 'first-in, first-assessed (fifa) system for processing exploration licenses (Section 9 of the Principal MRPDA), possibly in favour of the submission of a licensing bid from competing stakeholders, should be urgently revisited. At a minimum, the institution of an auction-based system must be accompanied by excellent geoscience information (available to all stakeholders) and informed by established global best practices in this area to guarantee transparency and a level playing field. Viewed against the South African reality of relatively poor geoscience information availability, significant problems arise from the recommendations of the influential SIMS Report,[1] which proposes a shift to an auction bid system for the granting of exploration licences.
2. It is our contention that whatever licensing procedure is to be followed must be explicitly written into law now. Neither government nor industry can afford further oscillation on these matters. SAIIA is in the process of formulating a policy briefing that examines alternative options and conditions under which auction bids, for instance, may be more optimal than 'fifa'. Mechanisms to ensure credible commitment to deliver on promises contained in respective bids are central to the debate.
3. South Africa must enshrine a retention licence in the MPRD-AB. In a context where the state is the 'custodian' of a nation's resources, security of tenure for private operators becomes all the more important. Embedded in Botswana's Mines and Minerals Act is a retention licence. There, the exploration company may retain its exclusive right to mine the resource even if it is not immediately able to bring a mine into production after discovering a mineral deposit. Development can be deferred under the license for two successive three-year periods (subject to certain qualifications in the second period). This innovation avoids the problem of mining companies hoarding assets to deter competitors while simultaneously incentivising production through providing ex-ante security of tenure under clear regulatory guidelines.
4. The state should not act as both player and referee in the mining game, as this presents a conflict of interest. Granting a free carried interest to the state mining company on new explorations, for instance, should thus be avoided.

[1] See State Intervention in the Minerals Sector (SIMS), commissioned by the African National Congress (ANC), 2012.

INTRODUCTION

We contend that, given the continued importance of mining as a primary transmission belt for sustaining both manufacturing and services in South Africa, against its unfortunate history in perpetuating social and economic inequality, mining legislation should seek to:

- Simultaneously address past injustice without compromising investor attractiveness (insofar as these goals are not mutually exclusive). Our natural resource heritage should be used to achieve a legacy of wealth redistribution sustained by high quality, diversified economic growth.
- Ensure that mining truly contributes to social equity and national economic growth. To achieve the former, the industry must be prepared to transform working conditions to build human dignity and capital. The latter will follow. Migrant labour and the structure of the industry specifically require urgent reform.
- Avoid placing economically unsustainably burdens on mining companies, especially in contexts where local government is the constitutionally mandated entity to deliver services to communities.

These principles will only gain traction if legislation is reliably, transparently, accountably and efficiently administered by national and local government.

SAIIA recognises the importance of the principles written into the Mineral and Petroleum Resources Development Act (MPRDA) of 2002, enacted in 2004. These sought to reflect the imperatives of the African National Congress (ANC) 1955 Freedom Charter, which declares the mineral wealth beneath the soil as belonging to all South Africans. It also reflected an ethical imperative to redress the perverse concentration of mineral wealth ownership within a racial minority that had been cemented by the Minerals Act of 1991, which went further than all previous legislative efforts to vest mineral ownership in exclusively private hands, in opposite direction to the preceding trajectory – a final effort of the apartheid regime to protect white interests.[2]

The MPRDA unfortunately contained some untenable definitional ambiguity and excessive ministerial discretion,[3] to which the Minister herself admitted in 2010. Of particular concern was the confusion endemic to the conversion of old to new order mining rights. This was most visibly reflected in the Kumba Iron Ore vs Imperial Crown Trading (ICT) and Department of Mineral Resources (DMR) case.[4] There was also significant concern expressed over the confusion pertaining to the administration of mining 'associated minerals'.

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[2] Cawood F & R Minnitt, 'A historical perspective on the economics of mineral rights ownership', *The Journal of the South African Institute of Mining and Metallurgy*, November/December 1998, pp. 369-376.
[3] See http://www.polity.org.za/article/minister-shabangus-joint-mining-declaration-a-very-important-first-step---leon-2010-06-30-1 - 'There is now an admission by everybody, including the government, of the need to go back to the drawing board and fix the issues in the Act, like Ministerial discretion and lack of compulsory time periods for licensing' (Peter Leon).
[4] See http://mg.co.za/article/2012-02-10-shock-and-ore-dirt-flies-in-sishen-battle

Many of the submissions that will now appear before parliament deal with the specific details of the legislation's perceived shortcomings. For instance, there is likely to be a particular focus around the problems of repealing section 9, which contains the first-in first-assessed (fifa) principle on which exploration rights have historically been granted. Repealing fifa in favour of an auction-bid process, for instance, requires revision. At a minimum, licensing procedures must be made transparent in the MPRD-AB and not be subject to ministerial discretion or codes that are published beyond the reach of inclusive processes.

At the 1995 Chamber of Mines Annual General Meeting, former President Nelson Mandela recognised that 'it is in the best interest of stability and investor confidence that the healthy and necessary debate on such a (minerals) policy should soon find its way to consensus'. Eighteen years on, we are unfortunately further from a consensus. The advice is thus ever more pertinent. As professors Cawood and Minnitt put it in 1998: 'the issue of mineral rights and its impact on the welfare of the mining industry is a matter of grave concern'.[5]

Recognising the above points, this submission aims to provide a more comparative approach, which we hope will prove instructive in the process of parliamentary revision. Notwithstanding the admittedly different historical evolutionary processes in play, we examine the specific insights and good practices from Botswana's experience that can inform the current policy formulation process in South Africa and which can contribute to South Africa's attractiveness as an investment destination while providing the best deal possible for all citizens.

[5] Cawood F & R Minnitt, 'A historical perspective on the economics of mineral rights ownership', *The Journal of the South African Institute of Mining and Metallurgy*, November/December 1998, pp. 369-376.

BOTSWANA: SUMMARY OF LESSONS LEARNED:

- State custodianship of mineral deposits *without* state control over extraction is a demonstrably successful mineral rights model under certain conditions.
- Clarity in minerals legislation regarding security of tenure is critical to incentivise private investment, without which an industry cannot thrive. Mining is an inherently risky business. Any perceived attempt by the state to appropriate rents by jeopardising security of tenure is therefore inherently unwise. The state should, however, receive a fair share of the rents generated by mining for the benefit of the nation.
- Minerals legislation should create a perception, built on truth, that both companies and the state are receiving a fair deal – government for leasing the minerals, and companies for incurring the risk. This is a necessary condition for mining communities and the nation at large to benefit materially in the long run.
- Procedural clarity and administrative efficiency is crucial for conveying credible commitment to investors that their investments will be safeguarded.
- Amalgamating minerals, energy and water under one ministry reflects an understanding that mining does not exist in a vacuum, but necessarily involves cross-cutting issues, especially as far as social and environmental impact are concerned.
- Minerals are a finite resource. While they exist and can be economically extracted (at a sufficiently low opportunity cost to society and the environment), they should serve as a transmission belt for spurring more sustainable, diversified economic activity beyond the life of the mines.

BOTSWANA CONTEXT

Economists Daron Acemoglu, Simon Johnson and James Robinson write in their study of Botswana as an African success story that 'there is almost complete consensus that Botswana achieved rapid growth because it managed to adopt good policies'.[6] A stand-out amongst its peers, the diamond-rich country managed to avoid resource-curse effects endemic to similarly endowed countries. It is too often the case that high levels of mineral wealth produce political infighting for easy rents, resulting in poor economic policy and, consequently, poor development outcomes. How Botswana managed to avoid predatory rent-seeking around mineral riches is therefore at the heart of what South Africa can learn in terms of formulating a good economic policy framework to govern its mineral endowments.

How did Botswana achieve the right balance?

[6] Acemoglu D, Johnson S, & JA Robinson, 'An African Success Story: Botswana', in *In Search of Prosperity: Analytical Narratives on Economic Growth*, edited by Dani Rodrik, 2003.

Some commentators have proffered that development outcomes have been positive because of limited government intervention in the economy – this is the standard neoclassical view in economic theory. In Botswana, however, central planning is prevalent and government expenditure is approximately 40% of GDP. Government intervention is therefore evidently not inherently problematic, provided the conditions under which it intervenes are clearly understood by all stakeholders and the state refrains from placing economically inefficient burdens on private investors. Botswana has avoided the temptation to form state-owned mining entities specifically. State-owned companies tend to be economically inefficient under certain conditions. They also present a serious problem for administrating a mineral rights regime, as the state may inadvertently become player and referee, a conflict of interest.[7] The state can benefit as an administrator without being a player. One recent persuasive analysis of post-Soviet oil-rich states shows that if the state both owns *and* controls a country's minerals, development outcomes are likely to be poor.[8] State ownership of minerals with private control, however, can produce desirable development outcomes.

This micro-institutional observation speaks to the question of institutional quality more generally. The development economics literature has now almost reached consensus that good institutions determine beneficial and sustainable outcomes.[9] Good institutions have two critical components. First, they should provide secure property rights, 'so that those with productive opportunities expect to receive returns from their investments'. Second, a broad cross-section of society should have the opportunity to invest in economic activity. Political, social and economic power should not be concentrated in the hands of a small elite, if it is to safeguard access by the majority of the population to secure property rights. Effective property rights institutions guard against both private sector predation and arbitrary, parochial conduct by political elites.

There is a strong case to be made that Botswana is rich because it has good institutions. Diamonds helped precisely because good institutions were in place prior to the discovery of mineral wealth. Exactly why it has good institutions is a function of some unique historical antecedents interacting with institutional formation. However, the lessons are still highly relevant for South Africa today.

[7] If the state is going to run a state-owned mining company, it should not receive favourable administrative treatment in terms of access to minerals, as this contradicts the principle of a level playing field for all players.
[8] Jones-Luong P & E Weinthal, *Oil is not a curse: Ownership structure and institutions in soviet successor states*. Cambridge University Press, 2010.
[9] Rodrik D, Subramanian A & F Trebbi, 'Institutions rule: the primacy of institutions over geography and integration in economic development', *Journal of economic growth*, 9,2, 2004, pp. 131-165.

GENERAL INSIGHTS

First, since they had no platform from which to fund development at independence in 1966, the Botswana Democratic Party (BDP) encouraged mining companies to explore the country.[10] It was not long before copper, nickel and coal deposits were discovered. Diamonds soon followed. In 1975, 'once it became clear how productive these [diamond] mines were [Orapa and Letlhakane], the government invoked a clause in the original mining agreement with De Beers and renegotiated the diamond mining agreement. As a result the government received a 50% share of diamond profits'.[11] In this specific case, the state did not attempt to own *and* control the extraction of diamonds. It simply negotiated to receive 50% of the rents generated by the private sector. All players knew the rules of the game. Importantly, it was perceived to be a fair deal by both sides.[12] Moreover, 'right from the beginning, the income was managed in an intertemporally efficient manner with the rents being allocated to investment in the government budget… Although diamonds have clearly fuelled Botswana's growth path, these resource rents have been invested rather than squandered'.[13]

Second, the principle of ensuring a fair share of resource rents for a country's citizens is not in dispute. What is emerging from the Botswana story is *the importance of fair legislation and clarity of contract concomitant with institutional mechanisms designed to prevent predation*. Government maximised the benefits from diamonds in its negotiations with De Beers and exploited the resource in a socially efficient way by investing the rents. At the same time, it built credible safeguards into the political institutional fabric which made it unattractive for competing factions to fight for control of resource rents. As is becoming obvious in South Africa, fighting for the control of rents actually erodes the rent pool – evidenced partly by the fact that the mining sector has contracted by 1% per annum for the last decade while competing mining jurisdictions grew at an average rate of 5% per annum.[14]

Whether it is the intention or not, increased ministerial discretion to determine, among other things, the way in which exploration rights applications will be administered, creates the perception of impending predatory rent extraction. This concern is distinctly absent in Botswana.

Before we proceed to draw specific lessons for South Africa's MPRD-AB from Botswana, we acknowledge a number of differences, but also note relevant similarities.

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[10] Certain commentators suggest that is highly likely that both De Beers and Botswana's inaugural president, Seretse Khama, knew about the existence of diamonds prior to independence.
[11] Acemoglu et al, *op. cit.*
[12] A major part of the problem in South Africa's current context is that government feels the country is not getting a fair deal from its mineral wealth (or at least that is the narrative sub-text to the MPRDA amendments). Similarly, mining companies feel that they are not receiving fair and equitable treatment before the law.
[13] Acemoglu et al, *op. cit.*
[14] National Planning Commission, *National Development Plan* 2012.

First, the size of South Africa's population is at least thirty times Botswana's. However, our mineral wealth ($2.5 trillion) is by far the largest in the world, estimated at US $1 trillion more than its nearest competitor, Russia. The ratio of South Africa's potential mineral rents to GDP is, however, comparable to Botswana's.[15]

Second, Botswana did not suffer extended destructive colonial exploitation, nor did it endure anything as debilitating as Apartheid. Even then, evidence exists of minerals legislation in South Africa enacted prior to 1991 – the Mining Rights Act, 20 of 1967, for instance – which took a progressive, forward-looking stance consistent with Botswana's successful approach.[16] Paying attention to this may prove useful for the current context.

Third, factional competition for rents in Botswana is lower than in South Africa. Though inequality is still high across different socio-ethnic groups, broad-based access to power was built into the eight Batswana states' political institutions since the early 1800s. The *kgotla*, for instance, ensured a certain degree of accountability among political elites that carried into the modern state beyond 1966. The resultant separation of politico-administrative functions provides an instructive lesson for South Africa, where this separation seems increasingly blurred.

Finally, Botswana's Mines and Minerals Act of 1967, similar to the MPRDA (and SA's own 1967 Mining Rights Act), vested sub-soil mineral rights in the national government. This particular micro-institution is thus not antithetical to secure property rights, provided the legislation governing state ownership is clear (and that state control is avoided).[17] De Beers, for instance, has never operated under threat of future expropriation. The 50/50 profit-sharing arrangement has anchored as a credible partnership that has inhibited predation and benefited the nation.

[15] The World Bank data for 2011 indicates that mineral rents in both South Africa and Botswana contributed 4% to annual Gross Domestic Product (GDP). http://data.worldbank.org/indicator/NY.GDP.MINR.RT.ZS

[16] See, for instance, the Mining Rights Act, 20 of 1967 which consolidated the plethora of previously disparate acts. Cawood and Minnitt write of the Act that its 'approach demonstrates a sense of equity and cooperation between government and holder of mineral rights that present-day policy makers should try to emulate.' Cawood & Minnitt, *op.cit.* p. 371.

[17] In this respect, the idea that the state should receive a free carried interest share in all new exploration endeavours (as a means of capitalising the state mining company) seems unwise. For the state to be both player and referee does not carry promising international precedent.

SPECIFIC LESSONS FROM BOTSWANA FOR THE MPRD-AB

Though mining exploration had been encouraged since 1966, Botswana's Mines and Minerals Act contained some unclear provisions. In 1999, the government revised the 1977 amendments to the 1967 Act. Experts and global opinion are unanimous in their assessment that the 1999 Act is clear and predictable, especially as it pertains to the process of granting, renewing and transferring licences.[18]

It is also worth noting that Botswana's institutional arrangement governing its resources vests the responsibility for Minerals, Energy and Water Resources in a single ministry. In South Africa, there are three separate ministries and departments dealing with each of these matters. Given the obvious interrelationships between minerals and energy (especially given South Africa's Minerals Energy Complex), it is imperative that the MPRD-AB reflects both the centrality of mining to the rest of the economy and its associated social and environmental cost-benefit trade-offs. While it may not be practical to reintegrate these ministries in the present context, more must be done to ensure that mineral, social, environmental and industrial policies are mutually self-supporting fulcrums in public policy.[19]

Most importantly, the Minister of this cluster in Botswana has little or no administrative discretion. This is opposite to the 34 instances contained in the current MPRD-AB that are open to ministerial discretion. Licensing conditions, for instance, are explicitly stipulated in Botswana's Act. Equality before the law for all actors is a crucial principle on which a government guarantees that investment will be protected. Ministerial discretion undermines this credibility.

[18] See http://www.politicsweb.co.za/politicsweb/view/politicsweb/en/page71619?oid=370269&sn=Detail and the Fraser Institute Survey, 2012/13.

[19] At the last count, for instance, there were at least 53 mines operating in South Africa without a water license, demonstrating the need for greater streamlining. A water license should be a prerequisite for an exploration or mining license, in line with best practice. Moreover, a clear and transparent legal regime, where license application processes do not reside under the minister's discretion, would not call into question the use of political influence. We raise this point because at least five of the mines currently operating without water licenses are reportedly linked to one highly influential politician. See http://mg.co.za/article/2012-11-09-00-edna-molewa-accused-of-meddling

CONCLUDING REMARKS

South Africa has a difficult history that cannot be alienated from current discussions of regulatory reform. There are legacy issues that raise challenging questions for how best to administrate our mineral and petroleum rights regime to produce equitable and sustainable development. Understandably, government feels that mining should make more of a contribution than it is at present. By the same token, mining companies feel that too much is being asked of them, especially under conditions of regulatory uncertainty. This perception mismatch must be resolved through mutual efforts that go beyond mere rules and regulations. However, clear and consistent regulation is a necessary condition for building the trust necessary to produce genuine national gain.

Botswana provides an instructive comparative case example for South African legislators as they seek to refine the MPRD-AB. State custodianship of mineral resources can work, provided the governing legislation is unambiguous, administratively efficient and investment is credibly protected with clear security of tenure. Each side must perceive that they are receiving a fair deal, as is evident from the Debswana 50/50 profit sharing arrangement between De Beers and the Botswana government. It is demonstrably the case that many companies would be willing to pay a higher tax share, or arrive at some kind of profit sharing arrangement *if* the regulatory conditions under which they operated were clear and predictable.

The Fraser Institute Annual Survey of Mining Companies for 2012/13 ranks South Africa 64th out of 96 jurisdictions.[20] Botswana ranks 17th. On every measure, Botswana outperforms South Africa and the rest of the continent. A difficult history alone cannot explain the difference. Institutional quality, reflected predominantly by a predictable, transparent legislative framework is the primary determinant of this result. South Africa cannot wish this metric away. In the preceding 2011/12 Survey, the president of an exploration company is quoted as saying that Botswana is one of a handful of jurisdictions that are proactive about attracting foreign investment, policies are clearly defined and the process of obtaining mining licences is quick and straightforward in comparison with most countries. This is an accolade for which South Africa should be aiming and there are no reasons why this cannot be attained. Expert submissions on the finer details of the MPRD-AB should thus be diligently considered, especially to counter the criticism that industry submissions have thus far not been reflected in the revised MPRD-AB.

Finally, Botswana's Mines and Minerals Act of 1997, combined with how the ministry and departments are run, should serve as a relevant example of mutually beneficial institutional arrangements for managing our shared mineral wealth.

[20] Wilson A, McMahon F, & K Green. 2013. Survey of Mining Companies 2012/ 2013. Fraser Institute, Canada.