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Nationalism with Chinese Characteristics: How Does it Affect the Competitiveness of South Africa's Mining Industry?

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RECOMMENDATIONS

- For the sake of attracting the most transparent sources of foreign direct investment, South Africa must re-amend the MPRD-AB to remove ambiguity and ministerial discretion.
- The state should not be both a player and the referee in the mining game – it should either participate or regulate. The state's support of the IDC as a *de facto* state mining company, in partnership with Chinese state-owned enterprises, undermines its claims that it seeks to provide a level playing ground for all players in the sector.
- Chinese investment in South African mining should be encouraged, but not at the expense of other players. Transparency of revenue flows and ownership structures should become a prerequisite for companies applying for exploration and mining rights. Only 'rule-of-law' players will contribute to productivity enhancement in the long run.
- All companies with obvious political connections to those in political office should be precluded, *a priori*, from applying for exploration or mining rights.

EXECUTIVE SUMMARY

Between 2001 and 2008, the longest sustained commodity boom in recent history, South Africa's mining industry contracted at roughly 1% a year. According to the National Development Plan 2030, its top 20 competitors grew at an average of 5% a year. The country's declining competitiveness is best captured by the results of the 2013 Fraser Institute Survey of mining exploration investment attractiveness. It placed South Africa 64th out of 112 global mining jurisdictions. Botswana ranked 25th, Namibia 34th and Ghana 43rd. South Africa possesses the most valuable *in situ* mineral reserves in the world (valued at $2.5 trillion). Any reasonable forecast would suggest that such wealth should drive rapid economic growth. Instead, the International Monetary Fund has lowered its South African growth forecast to 2.8% for 2014. Meanwhile, new players are entering the market as several major mining houses reduce their exposure to South Africa. This briefing analyses the implications of these dynamics.

INTRODUCTION

On 11 December 2012, the Palabora Mining Company (PMC) announced that a consortium involving South Africa's state-owned Industrial Development Corporation (IDC) and three Chinese companies would buy a 74.5% stake in PMC from Rio Tinto (which owned 57.7%) and Anglo American (which owned 17%). The remainder of the company is publicly owned. The consortium paid ZAR[2] 110 ($10.69) per share for the new acquisition. The deal valued the copper mine at ZAR 5.3 billion ($515 million), including its cash pile of ZAR 2.5 billion ($243 million).[3]

Hebei Iron and Steel Group, a Chinese state-owned entity, led the buying consortium (with a 35% share of the sold 74.5%). 'Privately-owned'[4] Chinese company General Nice Hong Kong Group comprised a further 25% and Chinese government firm Tewoo Group another 20%. The IDC accounts for the final 20% of the sold 74.5% share in PMC;[5] the remaining 25.5% share remains public.

Rio Tinto claimed that Palabora was still a good business but was 'no longer a natural fit within Rio Tinto's portfolio'. However, the world's second largest mining company appears to have been looking to withdraw from Palabora since 2007, with reports[6] suggesting this was exacerbated by a mineral rights dispute with the Department of Mineral Resources (DMR).[7]

The IDC's partnership with China represents a new dynamic in the local mining game, as it signifies the entrance of players that are not constrained by the rules of foreign security-exchange listings.

ENTER CHINA INC.

According to the Chinese Ministry of Commerce, South Africa is one of the top five recipients of Chinese outward foreign direct investment projects in sub-Saharan Africa.

Kaplinsky and Morris note that China's investment in Africa is increasingly concentrated in oil, gas and mining to meet the growing demand for resources to fuel the expansion of China's domestic economy. They also 'show how Chinese State-Owned-Enterprises (SOE) investments are predominantly bundled with Chinese aid in projects designed to meet China's resource needs'.[8]

In 2008, the Industrial and Commercial Bank of China purchased a 20% stake in South Africa's Standard Bank. Only in 2012, however, did China start to invest directly in mineral resources in South Africa. In addition to the aforementioned PMC deal, in January 2013 Wesizwe Platinum announced that it had received a $650 million loan from the China Development Bank for its Bakubang project. This loan funded the purchase of a 45% stake in the company by Chinese mining group Jinchuan.[9]

The total value of Chinese investments in South Africa amounts to $8.74 billion, with 30.5% of that in minerals or metals. China's partnership with the IDC is its most telling move thus far in terms of its mining strategy in South Africa.

WHY IS CHINA PARTNERING WITH THE IDC?

Hebei Iron and Steel Group was established in June 2008 with the merger of Tangshan Iron and Steel and Handan Iron and Steel in Hebei Province, China. Hebei is now the single largest steel producer in China. General Nice Hong Kong Group has two main business streams, one in coal and the other in iron ore. The last of the Chinese players is Tewoo,[10] with a diversified interest in at least nine different fields, including metals, energy and minerals.[11]

IDC CEO Geoffrey Qhena stated that the PMC takeover transaction supported the IDC's steel industry initiative, which seeks further beneficiation of local raw materials. In particular, Palabora's 240 million tonne magnetite resource has long been viewed as a means of building South Africa's iron and steel industry.[12] It also fits the logic of the Mineral and Petroleum Resources Development Amendment Bill of 2013 (MPRD-AB).[13] Section 26 of this amendment proposes a quota restriction on designated 'strategic mineral' exports to spur local beneficiation. This is consistent with the DMR's beneficiation strategy. The deal appears to be a marriage of convenience between China's resource appetite and South Africa's desire for increased local beneficiation.

Internet publication *Mining MX* interpreted it this way: 'In the case of Palamin … there are practical reasons for the IDC consummating the [China] deal as it [seeks] to secure phosphate production for another state-owned company, Foskor, from Palamin.'[14] For a state-owned bank, the IDC's activities in the mining sector during the last quarter of 2012 were notable.

The IDC is envisaged as an important vehicle through which the recommendations of the State Intervention in the Minerals Sector document, commissioned by the ANC in early 2012, can be realised.[15] Some analysts suspect that the state plans to build a steel industry that will challenge ArcelorMittal SA on its domestic pricing policy, which critics regard as exploitative. There appears to be a move by the South African state to emulate China's economic development through the SOE-driven 'strategic' intervention model.

CHINA–IDC: IMPLICATIONS FOR SOUTH AFRICA'S FUTURE COMPETITIVENESS

The South African government has long promoted increased beneficiation, but the IDC's reflection on the matter is puzzling. It recognises that[16]

> infrastructure bottlenecks like the lack of rail and port capacity required to ship volumes to export markets continue to impact negatively on opportunities for

> growth. In addition, a lack of energy capacity, safety stoppages, labour issues and escalating production costs pose serious threats to the profitability of the industry, even prompting the mothballing of some mining projects.

This is one of the most succinct assessments of the difficulties faced by the mining sector in South Africa, although the same analysis ignores the critical dimensions of labour–employer tensions and increasing policy uncertainty (specifically around amendments to the MPRD Act of 2002).

Coupled with the serious obstacles it acknowledges, the IDC is also critical of the industry:[17]

> While government considers mining to be a key driver of growth … the industry needs to play its part in economic empowerment and social transformation … With the highest mineral wealth in the world, South Africa struggles to pass on the potential benefit of this sector to all South Africans.

According to the IDC, this 'slow pace of transformation is best illustrated in renewed calls for resource nationalism'.[18] The state is seen as a more effective transformation driver than the private sector. Presumably SOEs would be free from some of the regulatory inconsistencies often pointed out by private investors in South African mining.

While transformation and improved beneficiation are laudable goals, attempts to provide increased rents for the state and politically connected companies through beneficiation-oriented deals may prove counter-productive. Moreover, it is unclear whether Chinese steel companies would be in favour of promoting local beneficiation once the deals are struck. A more likely scenario would be the export of raw materials for beneficiation in China.

PREDATION VS. PRODUCTION

Ultimately, the competitiveness of South Africa's mining industry will be determined by whether players committed to long-run production prevail over investors focused on short-term rent extraction ('predators'). Analytically, categorising external players into three distinct sets may be helpful. The first set is 'rule-of-law' orientated companies ('producers'), subject to the constraints of security exchange listings and listing-country domestic law, both of which tend to improve transparency and accountability. Many of the traditional players in South Africa's mining game now fall into this category since they have been listed on major Western security exchanges. The second set may be categorised as 'opportunists'; those with political connections and few constraints. The third set is generally 'resource-for-infrastructure' orientated with significant financial muscle and a relatively indiscriminate approach to the types of bargains they are willing to strike.

China's entry into South Africa's minerals game is of the latter dynamic, and as yet its impacts are difficult to ascertain. Presumably the model of partnering with a local SOE such as the IDC liberates Chinese companies from the policy uncertainty under which the 'rule-of-law' majors operate. Moreover, Chinese companies are exempt from the kind of regulatory scrutiny at home to which listed companies are subjected. This combination is likely to undermine the competitiveness of South Africa's mining industry in the long run.

A key reason for this is that transparency avoidance by domestic and external players carries inherent risk for a country's mining sector as it creates opportunity for revenue mismanagement. It also makes companies more willing to strike deals with unscrupulous local players – politically connected domestic opportunists.

There is some evidence of deal making between local 'opportunists' and Chinese companies. One example from a piece by Roger Southall[19] is particularly instructive:

When Pamodzi Gold's Grootvlei and Orkney mines went into liquidation in October 2009, Aurora Empowerment Systems won the bid to take them over. Khulubuse Zuma (President Jacob Zuma's nephew), Zondwa Mandela (grandson of former President Nelson Mandela) and Michael Hulley (the lawyer who defended President Zuma in court against charges of corruption) led the bid. Aurora was a relative newcomer to the mining game but won out against experienced players, including Harmony Gold. Primitive rent accumulation followed. At the time of the takeover, 13 shafts in the two mines were still operational. Aurora proceeded to sell machinery, scrap metal and gold, and misappropriated pension and unemployment funds. Water pumps not sold stopped working, threatening the mines with flooding. A few months later, 5 000 mineworkers were left unpaid. Despite unions' charges of asset stripping, Aurora gained successive stays of execution from government liquidators.[20] 'Amidst the controversy, Khulubuse Zuma … promised that a Chinese company, Shandong Gold, would buy a 65% stake in Aurora for over ZAR 800 million ($7.34 million).'[21] The deal never materialised, and Aurora was only removed from its mines in 2011. The assets were sold to China Africa Precious Metals for a paltry ZAR 150 million ($13.77 million). Khulubuse Zuma has meanwhile amassed significant wealth for himself while Aurora employees have yet to see their money.[22]

In light of such evidence, the ability of producers to trump predators appears increasingly diminished.

CONCLUSION

This briefing has shown that deep-pocketed Chinese companies, hungry for resources, may be willing to strike bargains with politically connected local opportunists such as Aurora or SOEs such as the IDC, whose mandate is stretched at best. If the IDC/PMC deal is an indicator of future modes of engagement, Chinese firms will be partnering with local state-owned entities to escape policy uncertainty and extract the resources required for completing the industrialisation phase of the Chinese Communist Party's current economic plan. While the South African government may present the deals as an opportunity to realise the state's beneficiation strategy, the above analysis suggests it should tread carefully. The long-term competitiveness of the industry is at stake.

ENDNOTES

1 Ross Harvey is a research fellow with SAIIA's Governance of Africa's Resources Programme (GARP) in Cape Town.

2 Three-letter currency code for the South African Rand.

3 Reuters, 'IDC, Chinese firms buy Palabora for R5.3bn', *Moneyweb*, 11 December 2012, http://www.moneyweb.co.za/moneyweb-mining/rio-tinto-anglo-american-sell-stakes-in-palabora.

4 Ownership structures of Chinese firms are notoriously opaque.

5 McKay D, 'Govts of China, SA unite in R5.3bn Palamin bid', *Mining MX*, 11 December 2012, http://www.miningmx.com/page/news/base_metals/1485056-Govts-of-China-SA-unite-in-R53bn-Palamin-bid#.UefmfRYrzww.

6 Ryan B, 'Rio Tinto to sell out of Palabora', *Mining MX*, 5 September 2011, http://www.miningmx.com/page/news/base_metals/1012440-Rio-Tinto-to-sell-out-of-Palabora#.UTdcnKXI12o.

7 See Sergeant B, 'Palamin in mining rights spat', 24 November 2010, *Moneyweb*, http://www.moneyweb.co.za/moneyweb-mining/palamin-in-mining-rights-spat for more details; as well as Palabora Mining Company Annual Report, 2012, p. 94, http://www.palabora.com/documents/annual_report_2012.pdf.

8 Kaplinsky R & M Morris, 'Chinese FDI in Sub-Saharan Africa: Engaging with large dragons', *European Journal of Development Research*, 21, 2009, p. 559.

9 Moody N, 'Nation proves crucial lifeline for African mining sector', 19 March 2013, http://www.frontier-advisory.com/index.php/news-article-library/84-china-s-xi-to-visit-south-africathis-month-nation-proves-crucial-lifeline-for-african-mining-sector2.

10 See http://www.tewoo.com/en/index.asp. The group was previously known as Tianjin Materials and Equipment Group Corporation.

11 See http://money.cnn.com/magazines/fortune/global500/2012/full_list/401_500.html for further details: CNN Money ranked the group 416th out of the 500 largest global corporations, with revenue in 2012 of $26.4 billion.

12 Swanepoel E, 'Palabora sale to China-led consortium seen as part of SA's steel ambitions', *Engineering News*, 11 December 2012, http://m.engineeringnews.co.za/article/palabora-sale-to-china-led-consortium-seen-as-part-of-sas-steel-ambitions-2012-12-11.

13 This Bill amends the MPRD Act. At the time of writing, it was awaiting the president's signature before being enacted as law.

14 McKay D, *op. cit.*

15 McKay D, 'IDC remains flywheel in SA industrialisation', *Mining MX*, 7 February 2013, http://www.miningmx.com/page/news/markets/1514094-IDC-remains-flywheel-in-SA-industrialisation#.UXQD0L_I12o.

16 IDC Annual Report for the year ended March 2012, p. 46.

17 IDC Integrated Annual Report for the year ended March 2012, p. 44, http://idc.co.za/IR2012/downloads/08_investing_in_the_economy.pdf.

18 *Ibid.*, p. 44.

19 Southall R, 'Family and favour at the court of Jacob Zuma', *Review of African Political Economy*, 38, 130, 2011, pp. 617–626.

20 *Ibid.*

21 *Ibid.*

22 *Ibid.*, p. 621.

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