

CURRENT CHALLENGES AND OPPORTUNITIES IN THE SOUTH AFRICAN MINING INDUSTRY

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**1 MARCH 2004
COALTRANS SOUTH AFRICA CONFERENCE
CAPE TOWN SOUTH AFRICA**

Order of protocol

The Honourable Minister of Minerals and Energy, Mrs Phumzile Mlambo-
Ngcuka; Session Chairman Mr Zoli Diliza; members of the organising
committee; international and local delegates; colleagues; ladies and
gentlemen.

Introduction

The challenges and opportunities facing the modern South African mining
industry are today as diverse as they are many. On the eve of celebrating
10 years of constitutional freedom in South Africa, we as South African
citizens, are all working together to become, to quote President Mbeki, a
"winning nation". The mining industry, as a committed corporate citizen, is
contributing just as wholeheartedly. However, there are a number of
challenges that need to be addressed for the industry to play its role
successfully. One of the biggest is to ensure that race is no longer a factor in
sharing in the wealth of our country's mineral resources. The mining industry



has probably gone further than most other undertakings in the private sector to ensure that previously disadvantaged South Africans empower themselves and become very much part of our mining future.

Broad-based black economic empowerment - BEE - is of utmost importance to South Africa as a whole, and is accordingly an overarching target in all current and future developments within the mining sector. Much work on this front took place well before any legislation made it obligatory, the results of which could be seen by the number of deals before and shortly after the passing of legislation. Those deals did not happen overnight, they were clearly the final result of negotiations that had been going on for months, or even years before. Of course, there have been many other deals since then, and some fairly significant ones too, with some mining companies claiming to be close to meeting all laid down empowerment targets, well ahead of schedule.

I would like to focus today on three "environments" in which South Africa's modern mining sector has to operate, namely **the new legislative, the social and the economic environments**, touching on some of the more pertinent issues, challenges and opportunities in each category. You will be able to judge for yourselves what the positive or negative outcomes may be of the various issues.

The New Legislative Environment

Preservation and sustainable growth of the mining industry as an invaluable national asset is what the Chamber of Mines seeks to achieve in its interaction with policymakers. These efforts are aimed at ensuring that legislative and



regulatory enactments do not cause unintended consequences that might prevent South Africa's world-class mining companies from creating wealth that can be distributed to the benefit of all the country's people. As I mentioned earlier, the challenges and opportunities in this arena are significant.

Let me take you on a brief trip through the legislative environment.

The Minerals Act

Parliament passed the Mineral and Petroleum Resources Development Bill during June 2002. During October 2002 the bill was signed by the President and published in the Government Gazette as the Mineral and Petroleum Resources Development Act, 2002, which I will refer to as the "Minerals Act". According to Minister Mlambo-Ngcuka in her statement to the Investing in African Mining conference held at this venue last month, it is expected that the Minerals Act will be promulgated in May this year.

During 2003 the Chamber drew to the attention of the Department of Minerals and Energy - the DME - a number of provisions in the Minerals Act which, on the basis of analysis required urgent improvement for constitutional and other reasons. At the request of the DME, the Chamber submitted to it proposed amendments for the improvement of the Minerals Act. The DME subsequently advised the Chamber that, because there was no prospect of preparing a Minerals Act amendment bill in time for consideration by parliament during 2003, the best course would be for it to defer discussions with the Chamber on the points identified to a time nearer the stage when proper consideration may



be given to drafting an amendment bill. Thus far the matter has been left on the footing that these discussions will be taken up when that time approaches.

Mining Charter & Scorecard

Discussions between the Chamber of Mines and government on transformation issues took place as early as the year 2000. The Chamber had developed its own discussion paper around transformation in the sector, while the DME had been working on its version of a Charter. Unfortunately, on 26 July 2002, a very rough, government-designed draft Charter was somehow leaked to the media. This leaked Charter proposed the transfer of 50 percent of the equity of the mining industry to historically disadvantaged people within a ten-year period. This rocked the financial markets with JSE listed mining companies losing over R50 billion in market capitalization within days.

The social partners in the industry, namely the government, the Chamber, the unions, community representatives and new emerging producers immediately got together to negotiate a Charter that would be acceptable to all parties and would address the negative consequences of the leaked draft government document.

The participants set about plotting a course for unwinding the economic legacy of apartheid, but firmly within the confines of the need for competitiveness. Just as they had done when developing the country's constitution, South Africans again demonstrated their ability to sit around a table and negotiate an outcome – and on 11 October 2002, the Broad-based Socio-economic Empowerment Charter was publicly released. The Charter necessarily



represented a compromise solution but all parties recognised it as a document of significance in the commercial history of our country, which was demanding yet achievable. It succeeded in capturing a number of issues that stakeholders have committed to in terms of human resource development, employment equity, mine community and labour sending community development, procurement, broad-based equity participation and beneficiation.

From the Chamber's perspective, much of the Charter makes generally sound business sense. Over the longer term, the emergence of a more inclusive mining industry will reduce the risk profile of operating in South Africa, to the benefit of all stakeholders. In February 2003, a Scorecard, which in essence acts as a checklist for the commitments in the Charter, was agreed between the Chamber, government and labour. The challenge that now remains is one of implementation. Already we have seen significant progress on many fronts but much remains to be done if the ideals of the Minerals Act are to be achieved.

The draft Royalty Bill

In late March 2003, the National Treasury released a draft Mineral and Petroleum Royalty Bill to give effect to the fiscal ramifications of the Minerals Act.

Notwithstanding assurances from government that the draft bill was not a fund raising exercise and that it would be internationally competitive, the investment and mining community viewed the first draft negatively. The first draft proposed the introduction of an *ad valorem* royalty charge on the gross sales



value of mining commodities ranging between one and eight percent and payable quarterly to the general fiscus. Mining companies would be given no exemption period upon conversion of their old order rights to new order rights and they would be required to pay a 50 percent premium above the royalty rate to 'lock-in' the royalty level, the so-called fiscal stabilisation clause.

The Chamber detailed its concerns about the draft bill in a memorandum submitted to the National Treasury on 29 April 2003. A Chamber delegation met with the Minister of Finance and senior officials of the National Treasury to discuss its concerns.

Let me be clear on one point: The Chamber recognises government's right to impose a royalty for the extraction of a non-renewable resource. What it vigorously challenges, however, is the basis on which a royalty would be charged and the proposed royalty rates. In particular, gross revenue royalties are the exception rather than the rule for the world's successful mining countries (Chile, Peru and Canada for example), however, they are prevalent in countries that have little investment in mining activity. The key point is that a gross revenue royalty takes no account of the ability of a mine to pay, nor does it deal with the cyclical nature of the minerals industry. For existing mining operations the imposition of a gross revenue royalty would raise costs, strain cash flow, raise cut-off grades, sterilise ore in the ground, shorten the lives of mines, undermine rates of return and ultimately prejudice investment, employment and the benefits of the sector to the economy. In essence, a gross revenue royalty would seriously undermine or negate the laudable objectives of the Minerals Act, namely to promote growth, investment and



competitiveness in the sector, something I am sure was not intended by the Treasury.

The Chamber argues that a royalty system must take cognisance of the prevailing taxation regulations of the successful mining countries around the world. What the Chamber seeks is a royalty system that does not undermine the competitiveness and benefits of one of South Africa's truly world-class industries.

During his Budget speech on 18 February 2004 the Minister of Finance announced some changes to the proposed Bill. Although it is still revenue-based, the fiscal stabilisation clause has been removed. He also announced that the royalty payment would commence in 2009.

Beneficiation

Another of government's legislative and regulatory intentions that has attracted the detailed attention of the Chamber is the proposed Promotion of Beneficiation Bill. The Chamber recognises that an increase in the current level of beneficiation would have advantages for South Africa, and that it should be supported. However, beneficiation should not be perceived as a panacea to add considerable value to mineral commodities and to create a large number of new jobs.

Beneficiation is a commonly misunderstood process with extractive mining operations at one end of the value chain and differently skilled manufacturing entities at the other. Although the proposed bill has not yet found its way into



the public domain, the Chamber will find it difficult to support policy enactments that attempt to compel mining companies to diversify radically their primary business focus and add the manufacture of beneficiated mineral products to their corporate portfolios.

Moreover, the real commercial consequences of beneficiating ores for supply to markets accustomed to receiving these products from elsewhere must be clearly understood by all. While the move towards greater domestic beneficiation of ores and their subsequent export makes intuitive sense, it should always progress according to a commercial rather than an ideological objective.

Rather than attempting to force mining companies to move into manufacturing, the Chamber believes that a major focus of the Promotion of Beneficiation Bill should be to create a regulatory environment in which rewarding incentives are offered to manufacturers so that they will be encouraged to invest in downstream activities in South Africa.

However, despite the mining sector's reservations concerning its involvement in downstream beneficiation, it has spent vast amounts of money to find ways to promote beneficiation in a range of minerals.

The Social Environment

As far as the social environment is concerned, this subject on its own could occupy a conference at least as long in duration as this one, so I will address only a few of the issues. The mining industry has met many social challenges



head-on and has grasped opportunities to deliver positive results. I must at this point again borrow some words from our country's President. In his speech made during the opening of parliament recently he emphasised the need for human dignity in all walks of life and as such it should therefore be uppermost in every employer's mindset.

Mining is doing more than most other industries to achieve this goal by improving the lives of its employees and their families by, for example, having given appreciable real wage increases for many years, continually improving accommodation options, expanding health care initiatives to even "off-mine" communities, boosting retirement funding, enhancing skills development and significantly contributing to rural development, amongst others.

The challenge facing South Africa as a whole, and therefore its mining sector in particular, is the fact that while it is generally agreed that more jobs and additional investment are obviously critical criteria for the achievement of a secure future for South Africa and its people, the country faces a potentially more dangerous menace in the form of HIV/AIDS. As with the wider South African population, mining industry employees have inevitably been exposed to HIV/AIDS and the industry identified the virus as a major threat considerably more than a decade ago. Educational campaigns were launched and these have been consistently improved and sustained.

During 2003 two important developments took place in the industry's ongoing efforts to deal with the HIV/AIDS epidemic. First, major mining companies that are members of the Chamber took a decision to provide antiretroviral



treatment to mineworkers with HIV/AIDS. This initiative, we are proud to say, was launched well ahead of most similar initiatives in South Africa. Since then the government has announced that it would be rolling-out antiretrovirals to the South African population at large. Secondly, under the auspices of a Tripartite HIV/AIDS Committee for the Mining Industry, a summit was organised to consolidate and strengthen partnerships in the fight against HIV/AIDS.

The summit was the first of its kind held in South Africa and as a main sponsor and organiser the Chamber believes that a great deal was achieved in bringing together industry stakeholders to adopt a common approach to a debilitating viral infection. The summit ended on a high note with the partners signing a joint declaration dealing with all the important aspects of HIV/AIDS: prevention, treatment, care and support; research, monitoring and evaluation; and socio-economic development.

In the context of the social environment, sustainability is crucial for mining companies, given that they are dependent on finite mineral resources. The general definition of “sustainability” is *‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’*. The essence of this definition is that development should be pursued but in a manner that is tempered by a balancing of the needs of both current and future generations.

There is a growing demand from stakeholders for companies to integrate the sustainability concept into their business activities and report thereon. Here in South Africa, the King II Report on Corporate Governance is a major driver for



sustainability reporting, recommending that every company should report at least annually on its social, transformation, ethical, safety, health and environment management policies and practices.

The trend is that companies around the world are gradually integrating sustainability practices into their operations and although sustainability reporting is still very much in its infancy, a number of South African mining companies are successfully meeting the challenge, and are leaders in this arena, developing best practice as they proceed.

Yes indeed, ladies and gentlemen, we operate in challenging, though interesting, times.

The Economic Environment

The final 'environment' I want to speak on today, is the economic one.

The centrality of mining to the South African economy is evidenced by its consistent domination of national export earnings, its provision of direct employment to well over 400 000 people and the fact that it accounts for more than 40 percent of the market capitalisation of the JSE Securities Exchange South Africa. Additionally, it is a major private-sector supplier of social infrastructure including schools, clinics and other essential facilities in parts of the country where poverty is endemic.



Contribution of mining to the economy

Mining continues to be a key foundation industry for the growth and development of the South African economy. The mining industry's contribution to gross fixed capital formation grew by over 12 percent in real terms in 2002, to nearly R18 billion, which represents some 11 percent of total fixed investment in the economy. The high rates of fixed investments enabled the sector to increase its share of contribution to gross domestic product, GDP, to a bit more than 8 percent in 2002. If one includes the indirect multiplier effects that the mining industry has on the rest of the South African economy - such as the consumptive power of employees - then the contribution of mining to GDP is closer to 12 percent. The 2003 figures are not available as yet but I do believe they will show a similar picture.

Mineral sales and exports

Driven by the 22 percent depreciation in the rand/US dollar exchange rate in 2002, the value of South African mineral sales increased by over 20 percent to almost R140 billion.

The value of total mineral exports increased to R110 billion, which accounted for just over a third of the value of total South African merchandise exports. Gold exports increased to R41 billion, returning the yellow metal to South Africa's top export earner position. Other good performers were nickel, iron ore, manganese, platinum group metals and coal, the latter up 14 percent to some R19 billion.



Consequences of the strong rand

Given the current strength of the rand against the US dollar, I must discuss in brief the consequence of a strong South African currency on the mining industry. However, before examining this issue, let me put it on record that the mining industry considers a stable, more predictable and competitive exchange rate - not a weak currency - to be very much in the national interest.

Although there has been a recent reversal in the fortunes of the rand I think it nevertheless appropriate at this time to discuss what the mining industry, as this country's major exporter, sees as the consequences of a too strong South African currency.

Let's take the platinum group metals, gold and coal, which are South Africa's three largest export earners. Current projections indicate that their foreign exchange earnings were likely to diminish in 2003 by some R14 billion to a total of R77 billion. It was furthermore projected that should the financial ballpark remain the same in 2004 as it was last year, year-on-year export earnings for the entire mining sector could experience a loss as high as R20 billion. While this represents a reduction of 18 percent in Rand revenues, it represents a much greater percentage of the operating profit of mining companies, in many cases, absorbing most of or even all their margin.

Well, it is now 2004 and whilst some encouraging positive trends have emerged - for example, the price of gold having sustained its level above \$400 an ounce and the rand losing some of its firmness - it is still too early to



measure whether the rather gloomy picture painted earlier will begin to show the signs of reversal we sorely need.

In the meantime the industry continues doing much to cut costs and improve efficiencies. This process will serve us very well in the longer term. A persistently over-firm rand will have severe negative long-term consequences for employment at existing mining operations, the generation of employment opportunities at new projects and the pace of successful black economic empowerment. It is only a vigorous and profitable mining industry that can deliver on its accepted transformation obligations and the cost-cutting and efficiency drives underway will help the industry meet these goals. Without this vigour, no amount of legislative coercion will achieve the results so desired by government and the industry.

The negative consequences of sharply diminished rand revenues, accompanied until recently by relatively high levels of producer price inflation, and compounded in particular by sharply increased administered prices such as rail rates for coal producers, is having an impact that extends way beyond the sphere of the mining industry and will make its presence felt in most of the broader national economy. However, since it is obvious that the mining sector is one of the industries most severely affected by the strong currency, it is essential for all concerned that the mining industry does what it can to address the situation. The Chamber is currently engaging with its social partners, in particular the unions and the Government, on the impact of the strong currency.



Conclusion

The modern mining industry operates in a global arena where the economic, social and legislative environments play crucial roles. While we deal with several challenges, we like to believe that the mining industry is on a path of continuous improvement, creating improved value for all stakeholders, and that it sets a positive example for many other industries.

It has been my pleasure to be part of Coaltrans in a small way, in being able to address you today and to give you some insight into the broader situation regarding the challenges facing our mines and what has in many cases been done to meet them, and the opportunities that exist in South Africa's mining sector.

Thank you.