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Keynote Address: Strategic implications for the platinum group metals: privatization vs. nationalization in South Africa

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The issue of privatization versus nationalization of PGM assets is currently under discussion in Russia, South Africa and Zimbabwe. Implications regarding ongoing foreign investment in the sector and uncertainties about supply—with worst case scenarios as consequences—are currently being debated and speculated about by their respective governments.

In his paper, Stephen Forrest addresses and examines this question of public nationalization versus privatization, which is of growing interest to the South African PGM industry. He will examine arguments both for and against the nationalization of mining assets, citing global examples and discussing the effect such a move has had on their economies. Key to the discussion will be the strategic implications on the PGM value chain, and uncertainties surrounding future metal prices.

Introduction

The mining industry is on the cusp of techno-economic change, a change which, for a time, came all too close to having a major negative impact. The global economy, wrought with a recession that had essentially bankrupted capitalism, bore down on miners and investors alike, causing falls in base metal stock prices and slower rates of growth and development than had been enjoyed during more economically equitable times.

In this era of 'boom and bust', good times are invariably matched by bad ones; upturns in the markets are often followed by downward spirals. Such instability is rarely a positive factor on any balance sheet, and mining companies and global governments are now attempting to promote a more sustainable future for us all.

The ANCYL and a nationalized South Africa

The recent call by South Africa's ANCYL for a debate on the nationalization of the country's mines has rocked the confidence of an industry of which much of the lifeblood flows deep beneath South Africa's Bushveld Complex; and an industry which is already facing challenges surrounding issues of liquidity, raising capital, longer lead times and costs to access ore at even deeper horizons.

Social and economic issues have plagued South Africa throughout its dramatic history, and the country's disillusioned people are now calling out for change and a return on the promises made to them in the ANC's Freedom Charter so many years ago.

However, such a move, with all the intertwined political implications, would to say the least, be a little risky for South Africa; not for the ideals which frame the belief in the South African state owning its own mines, but for the likelihood of driving private investment away from a country which is heavily dependent on mining exports (platinum currently represents 15% of total annual export earnings—see Figure 1) to sustain and develop itself.

The birth of mining in South Africa

Ever since the discovery of minerals in South Africa in the 19th century, the country has benefited heavily from huge private funding being pumped in for the extraction, refinement and export of these commodities, acting as a stimulus for the entire South African economy.

Capitalism helped to modernise South Africa's industrial state: the emergence of Johannesburg, as well as the development of the railway and other sophisticated transport infrastructures and the corresponding growth of small-scale towns, is linked to the development of its mining sector, which is currently estimated to be worth ZAR2 000 billion.

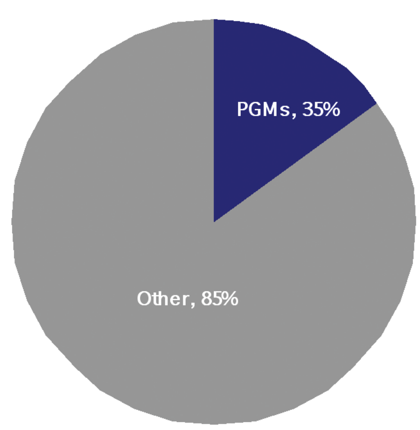

Figure 1. South Africa's foreign export earnings (2008). Source: Chamber of Mines, South Africa

Could state ownership of the mines even hope to match this kind of record of investment and development?

Historical examples of nationalization

History has shown that more often than not the inherent ideals of nationalization do not necessarily transfer into the dividends or benefits to the people that governments believe they will. The sustainability of CAPEX and flow of skilled labour alone are major liabilities that typically mean that these attempts at socialism result in a swift move back to privatization.

Moreover, Africa's recent past is populated with failed mining nationalizations of its own as governments quickly discovered that the processes involved in and surrounding the mining of minerals were too great an undertaking, and the political imperatives that go hand in hand with state ownership, such as maintaining employment, prevented them from making necessary cutbacks when stock prices were low.

After Zambia's government nationalised Anglo American and Selection Trust's copper mines in 1969, copper production peaked at 750 000 tons in 1973 and then went into decline. By the turn of the century annual production was a mere 275 000 tons, a fall of more than three-fifths in less than 30 years.

Similarly, the contribution of copper to Zambia's GDP and government revenue declined rapidly once nationalization had been instated, the overall contribution to the government gradually shrinking to nothing (see Figure 2). Ultimately, the Zambian government ended up hiring back the private companies to manage them.

The liabilities that the South African government would take on in nationalizing the country's mines could overwhelm an already demanding political system and social infrastructure through a redirection of resources.

From where would the government raise new capital for development? Where would the money come from to support the industry were it in trouble? Would the industry remain competitive without the engine of capitalism driving it?

The private sector's expertise in engineering, organisation, marketing and profitable management of assets through wars, depressions and commodity price swings is certainly something to be admired and it's questionable as to whether any government could maintain such a steady hand.

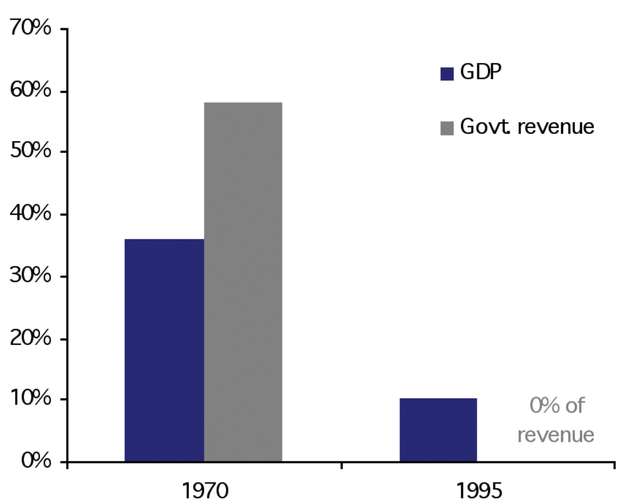

Figure 2. Zambia: Cu contribution to GDP and government revenue. Source: SFA (Oxford) estimate

The impact of South African mine nationalization on the PGM industry

There is much speculation as to the kind of damage such a nationalization in South Africa could do to the global mining industry: the loss of the reserve base, in particular for PGMs, would cripple the market, sending metal prices sharply upwards and ultimately forcing end users to engineer PGMs out of other products.

In its anticipation the stock market's reaction to South Africa's suggested nationalization has thus far been limited; were it to occur, the loss of foreign direct investment to South Africa would be quite serious and the rand would most likely take a hit.

So, what would be the likely outcome of such a mine nationalization in South Africa on the wider market—and more specifically on the platinum and PGM industry of which the country holds 90% of global reserves?

Investment would see a negative impact through fear of tightened production and other associated issues and the government would then have to find new sources of capital. When Anglo PLC and Billiton PLC moved their offices from Johannesburg to London, it caused great concern in the South African government. Nationalization would only increase this financial exodus.

Productivity would invariably suffer too through the lack of a less profit-driven working environment, ultimately rendering South Africa uncompetitive on the world stage.

The UK saw this happen under the nationalization of its network of coal mines in the 1940s—a once thriving industry that has since shrunk in size (see Figure 3).

The growing global demand for PGMs for use in autocatalysis and jewellery would struggle to be catered for by the supply balance and, as such, prices could reach and remain at astronomical levels, reflecting the loss of privately owned mineral resources.

These are the kind of issues that await South Africa if it chooses to go down the route of nationalization such as the ANCYL is suggesting.

Conclusion

The strategic implications for South Africa were it to go down the route of nationalizing its mines could prove devastating. It would be a road that would likely lead swiftly back to a state of privatization through loss in foreign direct investment to the industry, an inevitable

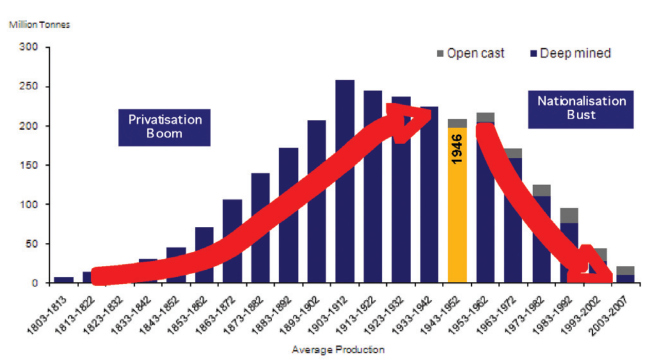

Figure 3. UK coal mine production pre- and post-nationalization. Source: BERR, UK Government, and Stevenson and Cook, *The Longman Handbook of Modern British History*

focus away from the kind of profit margins that keep private companies competitive, and a feeling of governmental remorse against a backdrop of a nationalization that could affect severely the country's economy and leave its people without the benefits that private investment has afforded the country for so many years.

PGM production would also be greatly affected, with the costs of mining the minerals increasing significantly, supply fears would drive investment towards PGM substitution in case of availability shortages, and both the junior sector and foreign exploration would be affected.

Furthermore, mine working conditions could suffer through a shortage of training and skills, particularly at management level.

These are some of the reasons why the global mining industry is anxiously waiting to see whether South Africa is willing to go down the route of nationalization.

Strategic implications of privatization and nationalization

Implications of nationalization in South Africa	Implications of privatization in South Africa
General • Nationalization: no significant incentives to meet demand: uncompetitive. • Privatization: belief in supply-side economics and the power of competition: consumer demand encourages improved services and internal efficiency. • Privately held companies can more easily raise capital than publicly owned ones. • Almost all state-run industries are loss-makers, few proving efficient or profitable. • History has shown re-privatization usually follows.	**General** • The public has little control over private companies. • A centralized enterprise is generally more cost effective than multiple smaller ones. • Nationalized companies are usually guaranteed against bankruptcy by the state, they can therefore borrow money at a lower interest rate to reflect the lower risk of loan default to the lender.
Politics • Political interests of governments can be seen as a primary driver for improving the performance of a company. • Governments may put off improvements due to political sensitivity. • A government may seek to run a company for social goals rather than business ones. • Governments have few incentives to ensure that enterprises run well; private owners can lose money if performance is poor. • The Minerals and Resources Development Act (2002) brought mineral rights under state control, thereby making it unnecessary to nationalize South Africa's mines, as this legislation means that all South African's through state ownership of the mineral rights already share in the wealth of the mining industry. • Where would the vast government capital to buy the mines come from? Anything less than full nationalization would start a panic amongst investors on whom South Africa depends. • There is always a need for new mining investment—the South African government is unlikely to be able to offer that. • Today's mining industry is characterized by volatility in metal and stock prices. Can the South African government afford such a liability on top of mounting social and economic issues? • New challenges for industry around issues of liquidity and raising capital. From whom would the South African government raise capital? • Due to long lead times on projects, time itself can be a risk as governments can change along with policy.	**Politics** • Government ownership should happen through a democratic, transparent legislation of parliament, which will ensure that all mineral wealth is used for the benefit of the people, and the development and growth of South Africa's economic activities. • 'Demanding the nationalization of … mines and the land would strike a fatal blow at the … mining monopolies … that have for centuries plundered the country and condemned the people to servitude'—Nelson Mandela (1956). **Implications for South African people** • South Africans, shall be restored to its people'—ANC charter. Charter was drawn up to promote sustainability and development of local communities, as well as realize the economic and social needs of South Africa as a whole. • 'It is necessary for monopolies which vitally affect the social wellbeing of our people, such as the mines … be transferred to public ownership so that they can be used to uplift the life of all the people'—Oliver Tambo. • State ownership of mines and mineral resources will allow South Africa to attract industrial investors who will contribute to the growth of the economy, transfer skills, education and expertise to locals and give them more sustainable jobs. • Privatization can lead to the seizure of privately owned land; the destruction of economies and culture; damage to the natural environment; consumption and pollution of water sources and destruction of health through mining development.

- South Africa has one of the largest gaps between rich and poor in the world, some of the highest levels of HIV in the world, and huge unemployment—all liabilities that make taking on the burden of a national company a huge strain on government resources.
- Expertise in engineering, organization, marketing and profitable management of assets through wars, depressions and commodity price swings is amazing. Could the South African government do the same?
- Arguments for nationalization/socialization based on convenient ideology of the politically aspirant; arguments against such state ownership are based on solid pragmatism formed from failed examples of past attempts.

Nationalization in other countries

- Africa's recent history is populated with failed mining nationalizations.
- Botswana's part nationalization has not necessarily meant that the people have benefitted from state ownership: unemployment at 25–30% with the highest poverty gap in the world.
- However, Botswana has one of the highest economic growth rates in Africa as a product of foreign investment.

Implications for the South African people

- Two-tiered economy: one developed; other under-developed. The primary sector, of which mining industry is at the head of, has seen high investment from private benefactors. The secondary tier i.e. the unemployed, is underdeveloped due to a lack of government funding.
- Mining companies invest large amounts of money in social future, education, health care, and infrastructure.

The mining industry and market

- Improved environmental and cultural performance of mining companies, thus gaining a 'social licence' to mine in developing countries.
- Demand for new reserves is forcing the industry down to greater depths fraught with greater risks and challenges. If private companies are forced out of South Africa, where would the investment and skills to sustain this seeming necessity come from?
- Mining workers currently enjoy considerably better pay and health care than the average person. Would this remain the case under nationalization?
- South Africa is highly dependent on minerals; since the 19th century its economy has been based on their export. Nationalization could greatly affect this.
- The mining industry acts as stimulus for the development of other branches of economy.
- PGMs—leading South Africa export earner: 35% of exports.
- The move from Johannesburg to London of Anglo PLC and Billiton PLC caused concern in South Africa government. Nationalization would only increase the exodus of capital.
- Mining accounts for over 50% of exports in South Africa. This figure would invariably suffer under the weight of nationalization.
- Private mining has dug the world's deepest and most sophisticated mines in South Africa; investment totals around R2 trillion.
- HIV/aids rates are typically higher in mining towns than national rates.
- The plight of the poor in South Africa is worsening, whilst unemployment is rising—therefore there is scope for social change driven by frustration and disappointment in the youth population: political capital.
- South Africa: 24th largest economy in the world, though much of the country's population do not benefit from the country's wealth.

The mining industry and market

- Privatization can mean poor working conditions in the narrow pursuit of profits at the expense of community and human development.
- Privatization doesn't allow for the building of internal capacity.
- Nationalization can be argued for in part to protect the supply of metals which countries need for economic growth.
- A primary driver for private companies is to maximize profits, sometimes at the detriment of more altruistic goals.
- Often, profits from successful enterprises such as mining end up in private pockets instead of being available for the common good.
- Minerals mined in South Africa are typically disposed of by multinational companies where they are listed; while South Africa is left with the huge costs of mining, the profits go to the First World.

• Sustainability is a key development in the mining industry—managing not only the economic benefits but also the environmental and social dividends. **Implications on PGM market** • Nationalization may greatly affect the supply and thus price of platinum—susceptible to supply shocks. • Loss of foreign direct investment. • There would be a significant increase in the cost of PGM production. • The junior sector in South Africa would completely disappear. • Greater investment in PGM substitution through worries about availability of PGMs and price appreciation. • Reduction in training on mines in South Africa. • Shortages of key mining management skills.	

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Please note: Some tabulated data may not add up due to rounding of individual numbers.

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Stephen Forrest has a track record of successfully leading and conducting analytical investment research, developing both financial and fundamental commodity forecasting models. He has worked as a commodities strategist, fund manager and senior operations manager. In 2001 he founded Steve Forrest Associates, an independent consultancy covering a broad spectrum of mining, minerals and commodity related issues, including macroeconomic analysis, supply and demand scenarios, in-depth cost analysis, derivative research and price forecasting.