Briefing Note

Introduction

Three years ago we were riding a euphoric wave of a commodity boom that everyone debated. ‘Would it continue?’ ‘How would it end?’ and some were oblivious to it even going on. Parts of the commodity boom arrived later in South Africa than it did in other countries and the rising tide did not raise all ships equally. South Africa responded as best as it could and in the end some commodities grew their global market share, but some others lost market share. The new debate around commodity cycles is, will South Africa participate in the next wave...or again be a late joiner.

When mineral rights ownership was due for change and a new legislative regime was on its way, the debate was about ownership vs custodianship. The new debate around ownership is currently wrapped in a debate around nationalisation. The debate, like many sectoral debates before it, have polarised not just the mining sector but anyone that holds a view on the economy, good or bad. This has reached a fever pitch to the extent that there is an unwillingness to understand what is being proposed and inadequate consideration of the case being made by any school of thought. Camps are forming and ramparts being built. It is assumed that ‘the other camp’ (and there are many other camps) have a one-dimensional understanding of what it could mean, and our side (whichever side that is) have a view of what it actually means. The dilemma is then further exacerbated by inadequate information. It seems as if nothing good can be learnt in the debate so the general approach is to dig into trenches on either side, armed with as little information as possible. In this article the author considers various views in order to inform the debate on all sides.

The Reasons to Nationalise

In the case of Norway and Bolivia nationalisation was to regain control of natural resources that would provide the necessary revenue to fund much needed development. The nationalisation in Zambia was to also increase government revenue that was supposed to lead to increased social spending. Once nationalised or re-negotiation was forced the re-negotiated contracts have returned the nationalised assets, largely to the original owners but under different tax regimes (50:50 up to 80:20 in favour of the state), compared to a general 20:80 split before nationalisation. Government revenues can be achieved by a combination of taxes and dividend payments. This is a model similar to that of Botswana’s diamond industry.

Drivers of Nationalisation

Nationalisation is not new in global economic evolution. There are many forms of nationalisation and unlike some views, nationalisation it is not only a feature of despotic developing countries hell bent on punishing the colonialists/imperialists/the rich/foreign investors/take your pick. Nationalisation has occurred in the USA, Canada, the UK and Japan, all leading players in mining investment. It has occurred in producer countries and consumer countries. When discussing the taking back of ownership, the academics would describe expropriation at one end of the spectrum (taking with no compensation) to de-privatisation at the other end (with full compensation at fair market value). What we do know is in between we have any number of permutations and hybrid forms of ownership. The really clever academics would even propose a ternary model of ownership but for now we can leave this to them.

Across the world governments do maintain ownership in some enterprises. These are typically those linked to utilities (electricity and water), providers of public goods (roads and free public broadcasting) and defence companies.

Governments are usually the drivers of nationalisation and the private sector the
purported victims (but on occasion, the beneficiaries of nationalisation). Nationalisation can be encouraged by both economic need and political agendas. There is a common set of justifications for nationalisation and some countries would legitimately cite these and others have been known to hide behind using the same reasons. These are either market failure; national interest; natural monopolies, required for socio-economic development; revenue generation for government or national security.

The pro-poor pro-development agenda being touted in South Africa as the reason for considering nationalisation remains clouded in political machinations and the eventual trickledown effect to the poor is still to be seen.

A fear does arise when a weak, government connected group, lobbies for full or partial nationalisation as a means for them to increase their own stake in the sector. The State Owned Enterprises (SOE’s) become the vehicles through which nationalisation is typically handled.

The Role of SOE’s

In many countries governments have established their own state owned entities (SOE) and state owned businesses’ either controlled by an SOE or directly responsible to a Ministry. China has in excess of 200,000 SOE’s but when these SOE’s performed badly they are propped up or allowed to go into decline, sequentially closed or consolidated but these actions also lead to some SOE’s increasing their profitability. State owned enterprises sometimes do perform poorly (some would say it sometimes performs well). This can be due to market conditions (external drivers) and sometimes poor management (internal drivers). The production of socially desirable goods where these are at either a cost covering or other favourable price level can be a deliberate reason for poor performance.

South Africa’s well known, fully government controlled SOE’s are Transnet and Eskom. In mining, the Department of Public Enterprises manages Alexkor for the state. Government have smaller stakes (though disproportionate control) in partly privatised SOE’s such as Telkom and SAFCOL. Through the IDC we could trace commercial holdings in mines which would ultimately accrue to the state. Loss making though is not the ultimate sin for an SOE. Often they are required to shoulder additional externalities for the benefit of the ruling junta, the state or its citizens.

The Speed of Nationalisation

One of the big concerns is that nationalisation occurs swiftly (e.g. by decree) which makes it akin to expropriation. No one likes uncertainty particularly investors and to protect against this some host countries migrate towards expropriation incrementally. This form of incremental nationalisation or ‘nationalisation by stealth’ is seen in an environment that has increasing legislative compliance, pecuniary taxes and a shutting down of forex movements, increasing interest in windfall taxes, manipulation of exchange rates and forced re-negotiation. We have seen many forms of re-negotiation, particularly during regime changes. When something is viewed as “in the national interest” as with iron ore and steel in South Africa, we see the compelled re-negotiation between government and mining companies. Venezuela achieved this by Decree in 2007 and companies were required to renegotiate. The DRC did this in 2007/8 with gold, copper and cobalt producers. Following the Venezuela expropriation and forced re-negotiations around oil fields (particularly the companies in the Orinoco Belt), the government moved in on the means of production, also confiscating rigs, ships etc. This re-negotiation could typically include a clause that the case will not ever be taken to international arbitration or into a foreign jurisdiction. The Zambian expropriation occurred over a short period but this was quickly reversed in a form of denationalisation – privatisation. This was not a complete capitulation and today the Zambian government still holds in excess of 80% of Zambia Consolidated Copper Mines but this entity holds less than 25% in the subsidiary operations.
What is nationalised

There are numerous examples of what governments have nationalised. Governments have not only nationalised mineral deposits but also the electricity production and distribution, banks, telecommunication networks, universities and motor manufacturers. Airlines are popular and so too are airline routes and on occasion shipping lanes.

So what is a good target for nationalisation? The host country can either seize the right to develop, the facilities to extract or processing or the commodity or intermediate products. This is usually done in the national interest. In South Africa it does happen that the owners of the various stages of the mineral value chain are different entities and so where government decides to nationalise will affect a different stakeholder group directly. Currently the commonly held view is that there is interest in the mineral deposits itself with no one thinking that the processing, refining or financing sectors could be under threat. What we do know so far from history is that any stage can be targeted.

The favoured commodity seems to be oil and natural gases and because we hardly feature in this space, many think it is an OPEC-ish thing to do. But there are many other examples of nationalisation like copper (in Zambia and Chile), coal mines (in the UK and India) and diamond mines (Botswana). Cement is also occasionally nationalised (an important construction sector input built on a largely low value input, limestone). The price of the commodity is not important but the value to end users or stakeholders is therefore a good indicator of targets for nationalisation.

Losses made by nationalised mining operations can be absorbed to a limited extent but when commodities run so far down that they will require government to prop these up it is a double blow. This is part of the problem that Zambia had to deal with a few years after it nationalised the copper miners. A report by the COM that R67-billion would have been needed to be pumped in by the SA government during the last economic crisis, to maintain the mining sector, is of interest only. What the argument misses is that if the sector is correctly segmented, there are probably some commodities on which nationalising can be focussed, and as mentioned above, we should not think that the target could never be another part of the minerals value chain. If government requires increased revenues they will not necessarily target the entire mining sector but cherry pick on some basis to acquire the lucrative operations. Governments have gone as far as to nationalise geographical areas and all who operate within it. The equivalent in South Africa would be the nationalising of certain geological terrains or formations. The precedents for all the above are in place.

Strategic industries tend to be regular enough targets. Different countries identify different strategic industries and even different strategic minerals. South Africa is no different. China has adopted a system whereby they classified their industries as either “strategic”, “key”, “basic”, “pillar” and “other” industries. The strategic industries are where nationalisation is focussed and downstream and side-stream development focussed. The Beneficiation Strategy of South Africa was not informed by this form of classification of sectors but merely by availability of minerals in South Africa.

Oligopolistic industries are good targets for nationalisation. In South Africa there are difficult commodity sectors. The increasing global production across multiple sectors means that oligopolies are being broken down. The areas where Cournot Monopolies still exist will remain important. South Africa may have internal oligopolies (these exist on a national scale) there are few sectors that fit this bill on a national scale.

Nationalisation in favour of

Nationalisation would typically be in favour of a government agency or SOE. In Bolivia its 2006 nationalisation was in favour of the state oil and gas company, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) In the DRC it was in favour of Gécamines. The 1960’s nationalisation in Zambia was in favour of the Industrial Development Corporation (INDECO). The model of ownership is usually in favour of either the State or in favour of the people. A common practice then is to hold the
states share (50-75%) on a non-dilutable basis in strategic industries. Non-strategic industries can be ignored or held at lower levels. If South Africa nationalises it would have to be in favour of one of the SOE’s, or agencies (IDC would possibly fit if it merely at an investment level or AEFMC, CEF, etc at a management level). There is a view that if the South African government does nationalise, that government-connected (not government driven) companies which cannot compete adequately will try and shore up their own mineral reserves which they could not acquire at fair market value.

From the Outside Looking In

Why is it that just South Africans are frothing at the mouth? Foreign investors are less caught up in the fracas and are staying well hidden. The answer may lay with the sometimes science, sometimes art called risk management which suggest that investors have grouped ‘political risk’ into one basket when it comes to South Africa and nationalisation keeps company with currency risk, poor clarity of laws and political violence, corrupt allocation, political connectedness and expropriation. The brouhaha within South Africa is then possibly the political realignment. In an election year, anything can be fair game. Investors would not object to nationalisation at Fair Market Value as widely as they would at compensation a discount (Expropriation goes the shout)

The Penalties of Nationalising

There are not always the same severe penalties as one would typically expect. There are instances where investing countries did not react towards nationalising countries. From the 1930’s nationalisation of oil fields in Mexico, 1980’s nationalisation of some Saudi oil fields or the 2006 nationalisation in Venezuela. The thirstiest oil consumer, the US government, did not intercede. On closer examination this has not been total (100%) nationalisation. The host governments have just identified the threshold to keep the original operators within their countries but increased their own returns.

The Soft Underbelly

The soft underbelly where a hungry government could look to supply a SOE with a new project would be where some oligopolies or monopolies can be identified. Commodities or processes that the government can convincingly classify as “strategic” would also make for easy targets and where market failure is feared they could see opportunity. Where a weak interest group is in control of a step along a value chain, it is easiest to displace them. Can a sharp observer identify geographical areas, focussed on common geology, where stable, high value oligopolies operate? Furthermore if a sector has tried to persuade government that they are strategic (for any number of reasons) this successful lobbying could make the sector a target. Government also has the option to nationalise incrementally in which case we are in for a decadal transitioning process.

Readers can already pick out geographical areas, commodities, processes and installations that match these. What we need to ensure is that the reason to leave in the hands of private capital, is bigger than the need to remove it. This is not a South African dilemma but a global phenomenon that has reached the shores of South Africa. So while some try to sink below the radar and hope that nationalisation refers to their neighbours, the time for our next debate is already upon us.

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