

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing June 2017

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#### South Africa Summary 16 June 2017

*Mines minister Mosebenzi Zwane publishes the revised 2017 Mining Charter, which increases black ownership stakes to 30% and requires 70% of goods to be procured from broad-based black economically empowered (BBBEE) companies. The South African Chamber of Mines (SACM) launches a court case to challenge the new charter. South Africa formally enters a recession, as gross domestic product contracts by 0.7% across first quarter 2017, following a 0.3% contraction in the fourth quarter of 2016. Allies of President Jacob Zuma (2009-present) at state-owned power utility Eskom, Brian Molefe and Ben Ngubane, both leave the company due to their links to the Gupta family.*

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#### Chamber of Mines pushes back against new mining charter

Mines minister **Mosebenzi Zwane** published the **2017 Mining Charter** on 15 June.<sup>1</sup> The long-awaited charter is far more radical than the mining industry expected and includes the provision that mining companies need to increase their percentage of black ownership from 26% to 30% within 12 months.<sup>2</sup> It is a document the latest cabinet of President **Jacob Zuma** (2009-present) is promoting as the first example of its commitment to radical economic transformation. Zwane told the media on 15 June:

*"This Mining Charter we present to you today is a key instrument for radical change, designed to address many of the inequalities in the mining and minerals sector prior to 2002...This is a task that cannot be taken lightly."<sup>3</sup>*

The **Broad-Based Black Economic Empowerment (BBBEE)** charters are government documents that support the **BBBEE Act** (amended 2014), and are agreed standards with which players in the industry are legally required to comply. The government introduced the first mining charter in 2007 and has been attempting to revise it since 2014.<sup>4</sup> The new charter contains a number of new elements with which mining companies will have to comply by June 2018:

- Black ownership requirements will increase to 30% from 26%; they will also have to be divided, or apportioned, according to a new formula: black entrepreneurs 14%, employees 8%, and communities 8%. The division is a new BBBEE regulation that prevents companies from giving stakes only to a single entity or only to employee pension options.
- Boards will need to be 50% black, up from 40% in the old charter.
- Companies applying for prospective mining rights must be 50% plus one person black-owned.
- All mining companies must pay BBBEE shareholders 1% of revenue before paying dividends to other shareholders over and above the dividends they would normally pay.
- Companies will need to procure 70% of goods, up from 40%, and 80% of services, up from 70%, from BBBEE-compliant companies.

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<sup>1</sup> Business Day, 15 Jun 2017.

<sup>2</sup> Business Day, 15 Jun 2017.

<sup>3</sup> Daily Maverick, 16 Jun 2017.

<sup>4</sup> Business Day, 15 Jun 2017.

- There will be a 2% levy on profits to fund a new **Mining Transformation Development Agency** to replace the existing **Mining Qualifications Authority**, to help with professional development for black people within the mining industry.<sup>5</sup>

Importantly, the companies will have to top up their ownership and comply with these regulations regardless of whether they have hit those targets in the past. This ends an ongoing dispute over whether a company can be “*once empowered, always empowered*”.<sup>6</sup>

*“They (the government) promised radical, and radical is what we got...this is BBBEE taken to its logical extreme, and you can bet that Zwane and Zuma are lining up ‘black entrepreneurs’ to take stakes on their behalf in the mining industry.”<sup>7</sup>*

The **South African Chamber of Mines (SACM)** is pushing back against the new regulations. It claims that the mines ministry had not consulted it in two months and gave no prior warning of the press release.<sup>8</sup> The charters technically require the mining industry to agree to their provisions, prior to becoming enforceable. It is also the duty of the mining industry itself, and not the government, to implement and enforce the charter.<sup>9</sup> SACM president **Mxolisi Mgojo** told the media that:

*“This process that the department of mineral resources has embarked on is their own unilateral process. We’re not going to sign a document that we’re not committed to. This charter is bad for the industry...it is one charter that is going to scare investment.”<sup>10</sup>*

The SACM, which represents 90% of **South Africa’s** mining houses by revenue, is preparing a case in the courts to interdict the implementation of the charter and force a review.<sup>11</sup> SACM CEO **Mark Baxter** told the media that the industry opposed numerous provisions: the goods and services provisions will be difficult to achieve due to a lack of suppliers, and the need to retain ownership at 30%, even when company values and shareholding percentages fluctuate, is an unnecessary expense.<sup>12</sup> However, some black business leaders believe the charter could be beneficial:

*“There is a genuine need for transformation in the mining sector, I actually think that the requirement to give some ownership to employees and the local community is a good thing...it is up to both the government and the mining industry to implement this in a way that delivers good returns for business...this is possible.”<sup>13</sup>*

Mining unions have also complained about the lack of consultation from the department. **Gideon du Plessis**, general secretary of **Solidarity**, which represents the majority of higher skilled mining workers, said that he was “*very upset*” about the lack of consultation.<sup>14</sup> However, he was positive about the need to include employees in the benefit. The **National Union of Mineworkers** and the **Association of Mineworkers and Construction Union** have yet to comment on the document.<sup>15</sup> It is likely that the unions will support some of the provisions in the charter, according to one senior union official:

*“I think that the provisions around community ownership of housing, and including employee ownership in companies are a very good thing...I am just worried that the 30% ownership won’t translate into actual benefit for workers.”<sup>16</sup>*

<sup>5</sup> Daily Maverick, 16 Jun 2017.

<sup>6</sup> Daily Maverick, 16 Jun 2017.

<sup>7</sup> Source, financial journalist, Johannesburg

<sup>8</sup> Business Day, 15 Jun 2017.

<sup>9</sup> Daily Maverick, 16 Jun 2017.

<sup>10</sup> Daily Maverick, 16 Jun 2017.

<sup>11</sup> Rand Daily Mail, 16 Jun 2017.

<sup>12</sup> Daily Maverick, 16 Jun 2017.

<sup>13</sup> Source, black business association leader, Johannesburg

<sup>14</sup> Daily Maverick, 16 Jun 2017.

<sup>15</sup> Daily Maverick, 16 Jun 2017.

<sup>16</sup> Source, senior union official, Pretoria

Mining has proved one of the most resistant sectors to transformation. This is partly due to the nature of the industry, where companies are often international and have tight margins due to the low point on the commodities super cycle. However, mining also has a legacy of apartheid with consistently poor conditions for workers and little demonstrable progress in diversifying its ownership. The new mining charter has some positive and innovative aspects – the division of the ownership stake will force many companies to pass some of the benefits on to employees. However, the lack of consultation shows in the unreasonable sub-contracting requirements and the extra 2% levy to fund a new version of a body that already exists. The charter does not necessarily alter corruption risk around BBBEE as politically exposed BBBEE companies will always be able to invest. However, the sharp turnaround time and the rhetorical manner that Zwane announced it will deter investment, at least in the short term. If the SACM is successful in preventing the policy roll-out then the charter may spend months, possibly longer, in further discussions.

### South Africa enters a recession, surprising analysts

South Africa formally entered a recession at the end of the first quarter 2017, government statistics agency **Statistics SA (SSA)** revealed on 6 June.<sup>17</sup> The recession surprised economic analysts who had projected the underlying strength of the economy would prevent consecutive quarters of negative growth. SSA released official government figures showing that South Africa's gross domestic product (GDP) contracted by 0.7% across first quarter 2017, following a 0.3% contraction in December 2016.<sup>18</sup> This is the first time the country has entered a recession since 2008, when the economy had three consecutive quarters of negative growth.<sup>19</sup> Economic analysis had projected GDP growth of between 0.7% and 0.9% for the quarter, based on strong mining figures.<sup>20</sup> The **South African Reserve Bank (SARB)** (central bank) cut its GDP growth forecasts from 1.2% to 1% on 25 May.<sup>21</sup> The **International Monetary Fund (IMF)** increased its forecast for South Africa's growth from 0.8% to 1% of GDP on 19 May.<sup>22</sup> However, SSA revealed that the trade, catering and accommodation industry contracted by 5.9%, and the manufacturing sector contracted by 3.7%, collectively decreasing growth by 1.3%.<sup>23</sup> Driving the contraction was a decline in household consumption of 2.3%, representing a significant drop in consumer spending.<sup>24</sup> The rand fell by 1% against the dollar to 12.87 on the news.<sup>25</sup> SSA director **Joe de Beer** told the media that this had hit the trade, catering and accommodation sector hard:

*"There is a clear link between the fall in household consumption expenditure and the decline in trade."<sup>26</sup>*

Finance minister **Malusi Gigaba** told the media on 6 June that he would meet business leaders as a matter of urgency to find out how the government can reverse the decline. The treasury also issued a formal response to the figures saying:

*"The current state of the economy puts more pressure on us as government, business, labour and broader society to intensify our growth programme and improve confidence as a matter of urgency to arrest the decline and set the economy on a higher growth trajectory."<sup>27</sup>*

However, economic analysts predict that the recession will hit international confidence and trigger further quarters of contraction.<sup>28</sup> **Standard Chartered** chief economist **Razia Khan** told the media

<sup>17</sup> SSA press release, 6 Jun 2017.

<sup>18</sup> SSA press release, 6 Jun 2017.

<sup>19</sup> Business Day, 7 Jun 2017.

<sup>20</sup> Business Day, 7 Jun 2017.

<sup>21</sup> Bloomberg, 25 May 2017.

<sup>22</sup> IMF press release, 19 May 2017.

<sup>23</sup> Business Day, 7 Jun 2017.

<sup>24</sup> Moneyweb, 6 Jun 2017.

<sup>25</sup> XE.com

<sup>26</sup> Moneyweb, 6 Jun 2017.

<sup>27</sup> Moneyweb, 6 Jun 2017.

*“this awful data shows weakness where we did not expect it ... confidence is rattled.”*<sup>29</sup> Other private sector commentators agreed that it was a shock recession from *“usually stable consumer-facing sectors that had been the key drivers of growth in recent years”*.<sup>30</sup> Consumer spending is credited for high South African growth prior to the 2009 global recession, and has remained high throughout the low growth years since.<sup>31</sup> The recession will add weight to warnings from international ratings’ agencies **Standard and Poor’s (S&P)** and **Fitch** that low growth and ongoing political uncertainty within the ruling **African National Congress (ANC)** pose major threats to the economy (see *ARC Briefing South Africa April 2017*).

The shock recession has uncovered an unforeseen weakness in South Africa’s economy. Consumer spending has remained high through difficult economic times, as wages have continued to rise despite low overall economic growth. However, falling wages and increased costs of living have hit consumer spending. The underlying strength of the economy, due to its complex financial infrastructure and well established corporate entities remains. However, it demonstrates the urgent need for the government to encourage growth.

### Pushback on Zuma influence at Eskom as Molefe and Ngubane leave

Allies of President Zuma at state-owned power utility **Eskom**, **Brian Molefe** and **Ben Ngubane**, have both left the state-owned enterprise (SOE) due to their links to the **Gupta** family.<sup>32</sup> The resignations show the pressure on Zuma from his adversaries in the ANC. An inter-ministerial committee, appointed and chaired by Zuma, recommended that Eskom’s board reverse the reappointment of Molefe as CEO on 31 May (see *ARC Briefing South Africa May 2017*).<sup>33</sup> The ANC’s national executive committee (NEC) opted to not vote to recall Zuma as president on 27 May, after a highly acrimonious session in which Zuma accused *“foreign agents”* of undermining him.<sup>34</sup> The NEC reportedly told Zuma that not forcing a vote was conditional on Molefe not being allowed to continue as Eskom CEO.<sup>35</sup> Zuma allies have shifted the blame for the decision to reappoint Molefe, who is implicated in the state capture report into links between the Zuma administration and the Gupta family, onto Eskom’s board.<sup>36</sup> Finance minister Gigaba said that the board made *“a major mistake”*<sup>37</sup> and public enterprises minister **Lynne Brown**, who authorised the re-appointment, has rescinded her permission.<sup>38</sup> Brown has also ordered Eskom to investigate coal deals between Eskom and Gupta-owned coal mining firm **Tegeta**.<sup>39</sup> Eskom made a 600m rand (R) (\$45m) advance payment to Tegeta in 2007, in breach of public sector tendering regulations.<sup>40</sup>

Ngubane resigned as chairman of Eskom on 12 June after local media published emails showing direct links between him and the Gupta family.<sup>41</sup> Brown announced on 12 June that Ngubane would step down with immediate effect.<sup>42</sup> The emails showed that the Gupta family drafted Ngubane’s first speech as chair of Eskom following the dismissal of his predecessor, **Zola Tsotsi**, in 2015.<sup>43</sup> They also show that **Salim Essa**, one of the Gupta’s closest associates, was in business with Ngubane in oil

<sup>28</sup> Rand Daily Mail, 7 Jun 2017.

<sup>29</sup> Rand Daily Mail, 7 Jun 2017.

<sup>30</sup> Moneyweb, 6 Jun 2017

<sup>31</sup> Business Day, 7 Jun 2017.

<sup>32</sup> Business Day, 31 May 2017.

<sup>33</sup> Business Day, 31 May 2017.

<sup>34</sup> Rand Daily Mail, 29 May 2017.

<sup>35</sup> Business Day, 31 May 2017.

<sup>36</sup> Business Day, 31 May 2017.

<sup>37</sup> Business Day, 31 May 2017.

<sup>38</sup> Business Day, 31 May 2017.

<sup>39</sup> Daily Maverick, 30 May 2017.

<sup>40</sup> Daily Maverick, 30 May 2017.

<sup>41</sup> Business Day, 13 Jun 2017.

<sup>42</sup> Rand Daily Mail, 12 Jun 2017.

<sup>43</sup> Rand Daily Mail, 12 Jun 2017.

company **Gade Oil & Gas**.<sup>44</sup> Ngubane invoiced expenses for an oil deal in the **Central African Republic (CAR)** directly to the Gupta family.<sup>45</sup> Brown has appointed non-executive director **Zethembe Khoza** as interim Eskom chair and has hinted that she may replace the entire board at Eskom's AGM in July.<sup>46</sup> Ngubane told the media on 13 June that he resigned for personal reasons.<sup>47</sup> He is a close ally of President Zuma with whom he has worked closely as premier of **KwaZulu Natal (KZN)**, then as minister of arts and culture while Zuma was deputy president from 2001-2004.<sup>48</sup> Zuma then appointed him to the boards of SOEs, including the now highly indebted **South African Broadcasting Company (SABC)**, allegedly to ensure that they served the interests of the president and the Gupta family.<sup>49</sup>

Zuma's attempt to maintain his and the Gupta's grip on Eskom has been set back for now. Molefe was simply too toxic to rehabilitate and Zuma's attempt to do so has resulted in disgruntled government officials leaking emails to the media that have brought down Ngubane as well. There is nothing new in the revelations that both Molefe and Ngubane had close financial ties to the Guptas. However, their resignation will place pressure on other Zuma appointees at SOEs, notably **Dudu Myeni** at **South African Airways**, who is due to have her contract reviewed later this year.

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<sup>44</sup> Business Day, 13 Jun 2017.

<sup>45</sup> Business Day, 13 Jun 2017.

<sup>46</sup> Rand Daily Mail, 12 Jun 2017.

<sup>47</sup> Business Day, 13 Jun 2017.

<sup>48</sup> Rand Daily Mail, 13 Jun 2017.

<sup>49</sup> Rand Daily Mail, 13 Jun 2017.

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