

LUCID AFRICA CONSULTING INC.

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Lucid Africa Consulting Inc.

To the Esteemed Clients of Lucid Africa Consulting Inc.:

Welcome to the second edition of Lucid Africa Consulting Inc.'s (Lucid Africa) quarterly newsletter. Lucid Africa's newsletters have the objective of providing you with succinct analytical reports on relevant economic and political issues.

To coincide with the Prospectors and Developers Association of Canada's (PDAC) annual convention, which takes place in the first week of March, this edition focuses on mining. Three articles are included, two of which are specific to South Africa. The third article focuses on Ghana. Brief summaries of each of these articles are provided below:

Article 1: South Africa's Recent Mining Sector Performance - This article compares South Africa's mining sector performance from 2002-2011 with those of Australia and Canada and concludes that South Africa's mining sector has performed poorly. The article argues that underlying this disappointing sector performance were increased levels of uncertainty and regulatory complexity, a deterioration in the competitiveness of the gold sub-sector, energy constraints and the global financial crisis. Moreover, the article flags employer-labor tensions and increased taxation as two key risks over the medium-term.

Article 2: Robust Improvements in South Africa's Mine Safety - This article highlights the recent robust improvements in mine safety in South Africa and attributes this improvement to the implementation in 1996 of a tripartite system of governance that includes the state, workers, and mine owners to advise the government on advancing mine safety. In addition, the article argues that the increased levels of mine safety inspections and audits that have followed the 2007 incident at Harmony Gold's Elandsrand mine have contributed to sustaining the improvements in mine safety in South Africa.

Article 3: Overview of Changes in Ghana's Fiscal Mining Regimen from 1986 to 2012 - This article focuses on identifying and explaining the mining tax trends in Ghana from 1986 to 2012. The article finds that Ghana instituted more attractive fiscal mining regimen policies when mining investments were low or there was increased fiscal mining competition amongst countries. Ghana, however, instituted less attractive fiscal mining policy changes during periods of substantively increasing mineral prices. In addition, the article highlights the controversy surrounding Ghana's review of mining contracts with stabilization clauses as well as Ghana's re-institution of the windfall tax provision, which have increased the costs and risks of mining in Ghana.

We at Lucid Africa strive to ensure that our clients succeed in Africa by providing cogent analysis on politics, economics, industry, and value chains in Africa.

Thank you.

Sincerely,

David Shiferaw
1 March 2013

South Africa's Recent Mining Sector Performance

Since the discovery of diamonds in Northern Cape and gold in Transvaal in the 19th century, South Africa has emerged as a leading mining and mineral processing country. Today, it is among the top five global producers of platinum group metals (PGMs), gold, manganese, titanium, and zirconium. Moreover, it is the top country by reserves of PGMs, gold, and chrome and manganese ore.¹

In spite of these rich mineral deposits, there remain concerns about the South African mining sector's anemic levels of growth. These stem from its poor performance in real mining sector growth and exploration budget rankings compared with Australia and Canada.

This brief will explain the reasons behind the sector's disappointing performance. It argues that growth has been negatively affected by increased levels of uncertainty and regulatory complexity, deterioration in the competitiveness of the gold sub-sector, energy constraints, and the global financial crisis. Moreover, it underscores the two key risks over the medium term, i.e., employer-labor tensions and increased taxation.

First, an overview of South Africa's recent mining sector performance will be provided. Thereafter, the reasons for this performance will be explored, and an outlook onto the sector's prospects over the next three years will follow. The brief will conclude with a summary of findings.

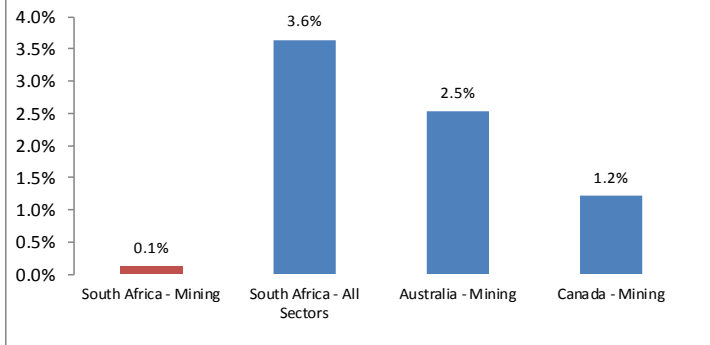
Overview of South Africa's Recent Mining Sector Performance

In spite of a commodity price boom that has seen the real metals and minerals price index increase by 172% over the period 2002 to 2011,² South Africa's

mining sector grew anemically with an annual average growth rate of 0.1%.³ In comparison, Australia and Canada's mining sectors grew at an annual average rate of 2.5%⁴ and 1.2%⁵ respectively (see Figure 1). As a result, some commentators have argued that South Africa has missed out on the recent commodity boom.⁶

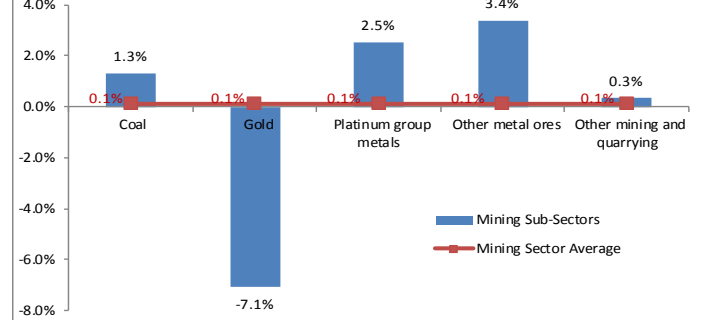
At the sub-sector level, South Africa's gold mining declined by 7.1%. In comparison, the country's PGM and coal mining subsectors grew at annual average rates of 2.5% and 1.3% respectively (see Figure 2).

Figure 1. South Africa Mining Sector - Annual Average Real Growth, 2002 - 2011



Sources: Statistics South Africa, Australia's Bureau of Statistics, and Statistics Canada
Note: Growth series for South Africa was in constant 2005 dollars, for Australia was Gross Value Added chain value measure, and for Canada was chained 2002 dollars.

Figure 2. Ave. Annual Real Growth Rate - Mining Sector and Mining Sub-Sectors, South Africa, 2002 to 2011



Source: Statistics South Africa

¹ See Yager, Thomas. 2012. The Mineral Industry of South Africa.

² World Bank's Global Economic Monitor (GEM) Commodities database, accessed 6 February 2013.

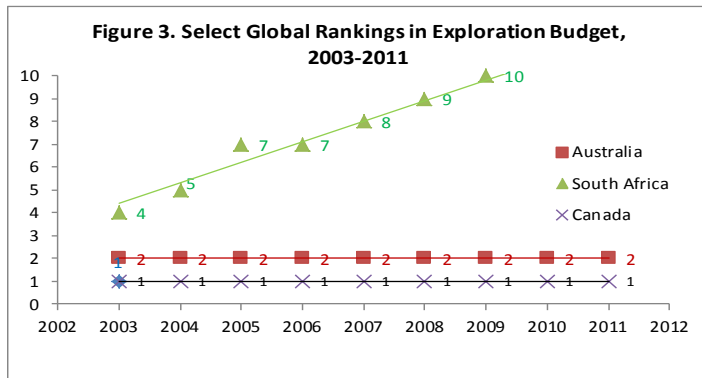
³ South African real growth data sourced from Statistics South Africa's P0441 - GDP, 3rd Quarter 2012 Publication

⁴ Australia Bureau of Statistics. 2012. 5204.0 Australian System of National Accounts, 2011-12, Australia Bureau of Statistics, Australia 02/11/2012.

⁵ Statistics Canada. 2012. Table 379-0027 Gross domestic product (GDP) at basic prices, by North American Industry Classification System (NAICS), Statistics Canada, 2012.

⁶ England, Andrew and Javier Blas. 2011. South Africa: Undermined Potential. Financial Times, London, U.K., 4 September 2011.

Moreover, according to the Metals Economic Group, South Africa's exploration budget's global ranking has steadily dropped from fourth in 2003 to tenth in 2010. In 2011, South Africa was not even in the top ten list.⁷ Over the same period, however, the global ranking of Canada and Australia remained at first and second respectively (see figure 3).⁸



Explaining the Sector's Recent Economic Performance

The South African mining sector's anemic growth, as well as the deterioration in its global exploration ranking, are related to the following factors: increased levels of policy uncertainty and regulatory complexity; deterioration in the global competitiveness of gold production; energy constraints; and the impact of the global financial crisis. These factors are outlined below:

- Increased levels of policy uncertainty and regulatory complexity: The transformative provisions related to the ownership and procurement requirements of the Mineral and Petroleum Resources Development Act (MRDA), as well as the ensuing deliberations on royalty rates, have increased policy uncertainty and regulatory complexity in South Africa's mining sector.⁹ Moreover, the persistent public politicization of a mine nationalization agenda by a vocal minority in the governing coalition has made mining companies skittish.
- Deterioration in the competitiveness of South Africa's gold production: The high extraction costs and lower ore quality of South African gold compared with gold from emerging producers has resulted in production decreasing by 55% from 399 tons in 2002 to 180 tons in 2011.¹⁰ Moreover, given that gold exploration accounted for 46% of global exploration budgets over the period 2002 to 2010, this deterioration in competitiveness has also contributed significantly to the fall of the nation's

global exploration ranking.

- Energy constraints: South Africa's rolling electricity blackouts in 2008 and 2009 significantly affected production levels in the mining sector. Moreover, they underscored the problems in the quality of South Africa's electricity supply, which according to the annual World Economic Forum's Global Competitiveness Reports has shown a marked decline over the period 2002 to 2010.¹¹
- Global financial crisis: The financial crisis of 2007 and 2008 led to global slump in demand for metals and minerals, as well as a decline in their real prices. The real price index of metals and minerals in 2007 and 2008 declined by 10% and 29% respectively.¹² As a result, production levels of South Africa's minerals such as diamonds, PGM, chrome, manganese, and cobalt dropped significantly over the period 2007 to 2009

Outlook

The two-to-three year outlook for South Africa's mining sector is not positive. This is principally a consequence of the sector's volatility, as was evident in the employer-labor issues that erupted in 2012, and vulnerability to the following:

Outlook

The two-to-three year outlook for South Africa's mining sector is not positive. This is principally a consequence of the sector's volatility, as was evident in the employer-labor issues that erupted in 2012, and vulnerability to the following:

- Employer-labor tensions: With the anticipation of a fall in PGM prices, PGM mines – the sector's largest employer – are expected to close plants. As a result, employer-labor tensions are expected to continue.
- Increased taxation: While the South African government has nixed the call by extreme elements for mine nationalization, it does see increased taxation in the most profitable areas of the mining sector as a strategy.

On the positive side, the South African government is expected to begin commercialization of the country's massive shale oil reserves, improve the energy supply, and simplify regulatory oversight.

Conclusion

Over the period 2002 to 2011, the South African

⁷ See the Metals Economic Groups World Exploration Trends.

⁸ *Ibid.*

⁹ Linear regression of South Africa's policy potential index according to the Fraser Institute's Policy Potential Index in the Fraser Institute's Survey of Mining Companies 2002/3 to 2011/12 shows a trend decline in South Africa's Policy Potential Index Scores, which serves as a report card to governments on how attractive their policies are from the point of view of an exploration manager.

¹⁰ See the Department of Mineral Resources for Republic of South Africa, Statistical Tables 2012 dated 2012-03-28 <http://www.dmr.gov.za/publications/viewcategory/149-statistics.html>

¹¹ See the World Economic Forum's Global Competitiveness Report 2002/2003 to 2011/2012.

¹² Data sourced from the World Bank's Global Economic Commodities database on 1st February 2013.

sector's performance has been negatively affected by the following: increased levels of uncertainty and regulatory complexity; deterioration in the competitiveness of South Africa's gold production; energy constraints; and the global financial crisis.

Employer-labor tensions and increased taxation remain prominent risks over the medium term. However, the government remains committed to improving the country's energy supply and regulatory oversight. In addition, there is the possibility in the medium term for concrete action in the development of South Africa's massive shale gas reserves, in spite of environmental concerns.

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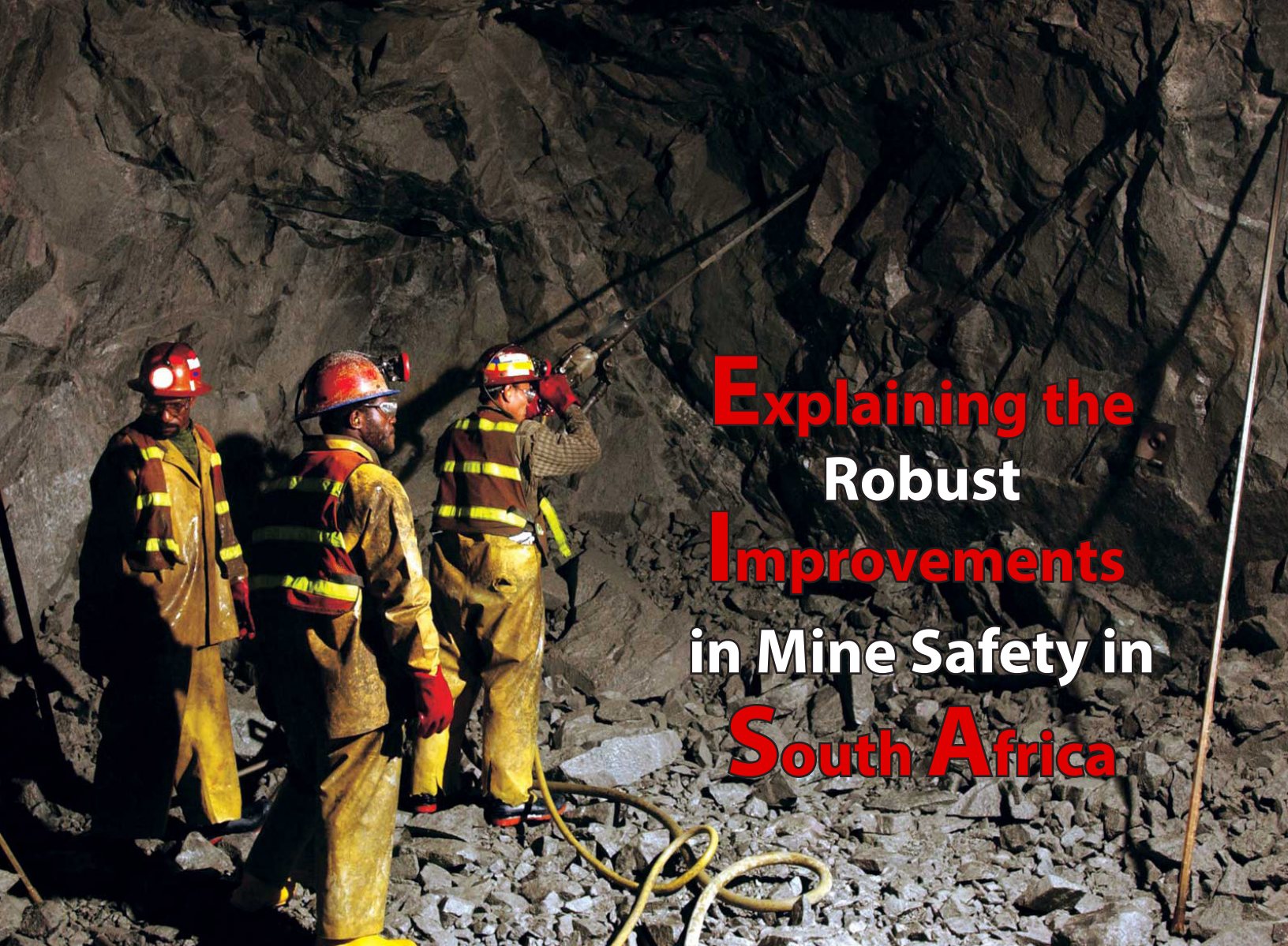
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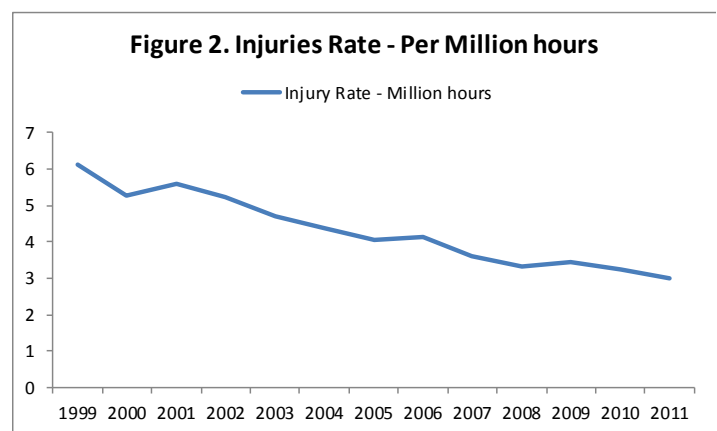
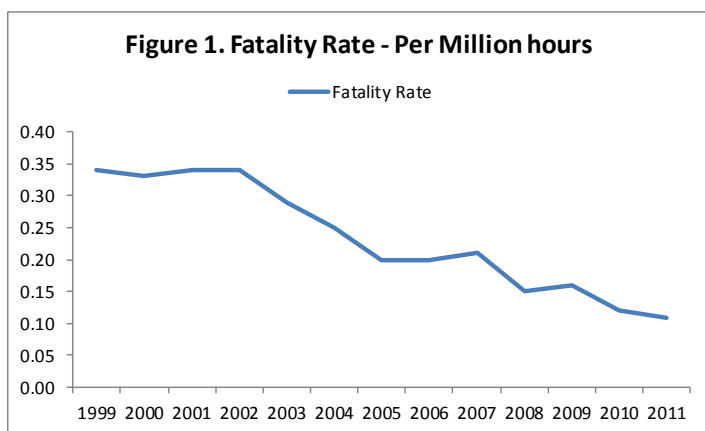
Yager, Thomas. 2012. *The Mineral Industry of South Africa, U.S. Department of the Interior, U.S. Geological Survey, Washington, D.C. August 2012*.





Explaining the Robust Improvements in Mine Safety in South Africa

Mine safety in South Africa has demonstrated tremendous improvements. The country's fatality frequency rate, which measures the number of fatalities per million hours hours worked, declined from 0.34 in 1999 to 0.11 in 2011 (see Figure 1). Moreover, South Africa's injury frequency rate, which measures the rate of injuries per million hours, declined from 6.1 in 1999 to 3.0 in 2011 (see Figure 2).



This robust improvement in mine safety followed the government's adoption in 1996 of the recommendations in the Report of the Leon Commission of Inquiry, which called for the implementation of a tripartite system of governance to advise the minister in charge of the development of health and safety policies, regulations, training requirements and a research program.¹ This system of governance under the Mine Health and Safety Council

¹ See the homepage of the Mine Health and Safety Inspectorate, <http://www.mhsc.org.za/>

(MHSC) fostered commitment and coordination between the state, workers and mine owners in improving mine safety.

More recent trend improvements in South Africa's mine safety are attributable to the robust efforts of the MHSC, as well as to government efforts to increase the levels of inspections and audits. These factors are outlined below:

- Robust Efforts of the Mine Health and Safety Council (MHSC): To date, the MHSC has been very active in the sector, formulating industry health and safety targets, advising the ministry on a revised regulatory framework for the industry, and promoting and disseminating research on occupational best practices. In addition, in 2005, MHSC stakeholders agreed to implement new fatality milestones based on actual fatality rates of Australia, the U.S. and Canada.²
- Increased Levels of Mine-Safety Inspections and Audits: Following the 2007 incident at Harmony Gold's Elandsrand mine, where 3,200 miners were trapped underground after a falling pipe damaged a shaft³, the South African government developed protocols for mine safety audits and audited all South African mines. In addition, the government has boosted the capacity of the Department of Mineral Resources to regulate the sector.

In spite of these improvements, however, South Africa still has a way to go before it reaches the mine safety levels of countries such as Australia, which registered an average of 0.04 fatalities per million hours worked over the period 2002 to 2009.⁴ Toward this end, further cooperation of mining sector stakeholders, improvements in the mining technologies utilized, and a more capable Department of Mineral Resources, will be critical.

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² See page 4 of the Mine Health and Safety Inspectorate's Annual Report 2006/2007.

³ See Matthew Hill's article DME to Launch Safety Audit by Mid-November on Mining Weekly <http://www.miningweekly.com/article/dme-to-launch-safety-audit-by-midnovember-2007-10-23>

⁴ See page 15 Safety Performance Report of the Australian Minerals Industry 2008/2009 of the Minerals Council of Australia.

Overview of Changes in Ghana's Fiscal Mining Regimen from 1986 to 2012

Since the institution of Ghana's first minerals and mining law in 1986, the country's mining sector has witnessed significant levels of investment and growth. Moreover, Ghana's experience has encouraged other African countries to follow suit and institute more liberal mining codes to promote private-sector investment.

Recently, however, the Ghanaian government has sharply revised its mining sector's fiscal regime upwards. This move has politicized the contest between promoting investments and appropriately taxing the returns on them. In addition, it provides valuable insights into the future relationship of private capital and political interest in Africa's mining sector.

This brief aims to identify and explain mining tax trends in Ghana over the period 1986 to 2012. It is structured by first introducing Ghana's 1986 mining

law and outlining its impact. Thereafter, it outlines the factors that resulted in the enactment of new, more investment-friendly legislation in 2006, and the ensuing reversal of course, which resulted in a steep upward revision of mining taxes. The conclusion iterates the brief's main findings.

Ghana's 1986 Minerals and Mining Law

Ghana introduced its first minerals and mining law, PNDC Law 153, in 1986. This had the objective of both promoting and regulating Ghana's mining sector, which had witnessed a significant decline in the production of key minerals since 1960.¹ The law and its associated legislation placed all minerals under state ownership and provided mining companies with investment incentives (see Box 1). As a result, Ghana's mining industry was able to attract more than \$5 billion in foreign investment through to 2002.²

BOX 1. KEY PROVISIONS FOR PRIVATE LARGE-SCALE MINING UNDER 1986 PNDC LAW 153

Government Carry	Government free-carry interest of 10% with option to acquire a further 20% at fair-market value.
Mining Lease	30-year mining lease.
Royalty	3% to 12% of gross value of minerals produced depending on the operating profit margin ratio.
Corporate Mining Tax	Reduction of tax rate to 45% in 1986 from 50%. Further reduction of tax rate in 1994 to 35%.
Additional Profit Tax	Additional profit tax of 25%.
Accelerated Depreciation	75% of capitalized expenditures and fixed capital in first year and 50% of remaining in subsequent years on a declining balance.
Investment Allowance	For mining assets, 5% of cost base in first year added to written down value on second year – implies amortization of 105% of capital costs.
Capital Allowance	Any unutilized accumulated capital allowances can be carried forward indefinitely.
Income Losses	Maximum 5-year income loss carry-forward .

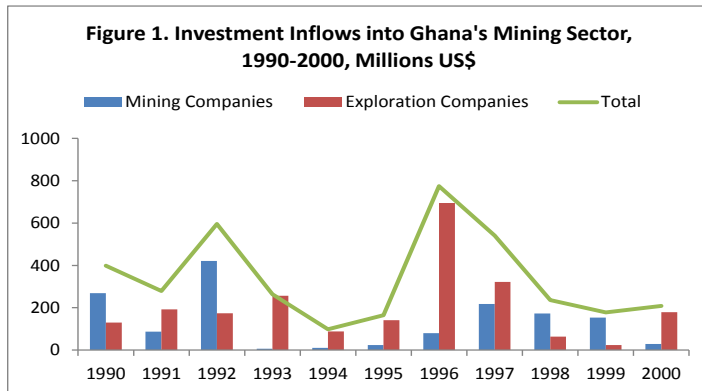
Exemptions: * Payment of customs import duties on plant, machinery, equipment, and accessories for mining;
 * Income taxes on staff for furnished accommodation at mine-site; and
 * Taxes on expatriate staff for transferred monies out of Ghana.

Sources: Akabzaa and Ayamdoo, 2009; Kusi, 1998, pages 15–18.

¹ See page 3 of the Draft National Mining Policy of Ghana.

² Coakley, 2003, page 17.1.

In the late 1990s, however, the levels of investment in Ghana's extractive sector began to drop (see Figure 1).³ This occurred at a time when other African countries had updated their mining codes, offering companies more attractive fiscal incentives than those in Ghana.⁴ Consequently, in 2001 the Ghanaian government commenced a review of the country's mining code.⁵



Source: Akabzaa and Ayamdo, 2009, page 18.

As a result of the review of the 1986 mining code, Ghana's 2006 Mining and Mineral Law was enacted on March 2006. This revised and consolidated Ghana's mining legislation and provided companies with additional fiscal incentives. Table 1 highlights the key changes in fiscal incentives resulting from the adoption of this new law.

Table 1. Highlights of Changes in Key Fiscal Provisions of Legislation Associated with Adoption of 2006 Mining and Minerals Law

	1986 Mining and Minerals Law	2006 Mining and Minerals Law
Government Carry	Free government carry of 10% with option to acquire additional 20% at fair market value.	Free government carry of 10%, with any other or future interest only on agreement with mining holder.
Corporate Mining Tax	45% (1986); 35% (1994).	Reduced to 25% in 2006.
Royalty	Between 3% to 12% of gross value of minerals produced.	Between 3% to 6% of gross value of minerals produced.
Additional Profit Tax	25%	Scrapped
Stabilization Agreements	N/A	Government ability to enter in stabilization agreements for a period not exceeding 15 years from date of agreement.

³ Coakley, 1998 page 21.1

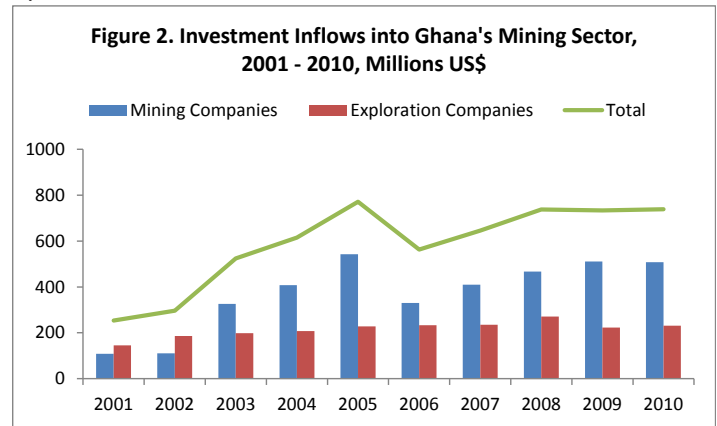
⁴ See Financial Times article 'Ghana Reviews Mining Laws', <http://www.modernghana.com/news/20339/1/ghana-reviews-mining-laws.html>

⁵ Ibid.

⁶ Peer mining countries such as Australia and Tanzania have already upwardly revised their mining taxes. A number of other countries are in the process of so doing.

⁷ See Aubynn, 2012, slide 22.

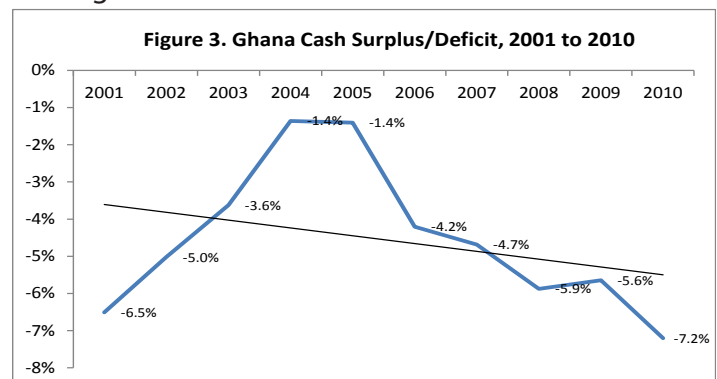
As a result of the Ghanaian government's decision in 2001 to review its mining code in order to stimulate investment, as well as the enactment of the 2006 Minerals and Mining Act, the country witnessed a rebound in extractive sector investments (see Figure 2).



Ghana Chamber of Mines, 2011.

However, a growing fiscal imbalance (see Figure 3), a perception that Ghana was losing out on the dramatic gold price increases (see Figure 4), as well as a growing number of mining code revisions by peer countries,⁶ resulted in the Ghanaian government's subsequent decision to revise its mining taxes upward. These revisions included the following:

- mining royalty set at a fixed 5% rate over the 3% to 6% prevailing band;
- corporate taxes for mining companies increased to 35% from 25%;
- capital cost allowance on assets shifted to a five-year straight-line basis from an accelerated one;
- ring-fencing of mining assets;
- 10% windfall profit tax (not yet implemented); and
- a government review of its stabilization agreements.⁷



Source: Akabzaa and Ayamdo, 2009; Kusi, 1998, pages 15-18.

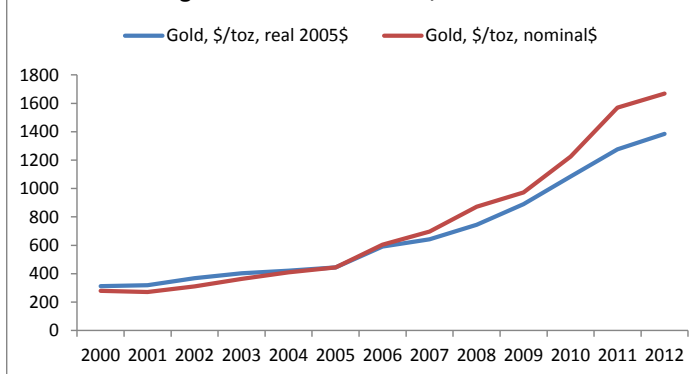


risks of mining in Ghana.

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Figure 4. Gold Price Trend, 2000-2012



These upward revisions in Ghana's mining tax regimen have generated strong criticism from mining companies active in Ghana. The Ghana Chamber of Mines' CEO Dr. Toni Aubynn has argued that such increases have adverse ramifications for mining operations and have resulted in Ghana being no longer a preferred investment territory.⁸

Conclusion

Since the early 1980s, reforms to Ghana's mining laws have been motivated by the competing political imperatives of promoting investment and maximizing the sector's contribution to the nation's development. The operation of these interests in periods of very low mining investment or substantively increasing mineral (particularly gold) prices have resulted in significant adjustments to the Ghanaian mining sector's fiscal regimen.

The recent upward revision of mining taxes, however, is contentious. This is because it includes a review of mining contracts with stabilization clauses, as well as the re-institution of a windfall tax provision – which had been scrapped in 2006. Not surprisingly, therefore, the revisions have become highly politicized and have increased the costs and

⁷ See Aubynn, 2012, slide 24.

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