FREE MARKET FOUNDATION
SUBMISSION ON THE MINERAL DEVELOPMENT BILL

MATTERS DEALT WITH IN THIS SUBMISSION:

A. Basic Concept and Principles
B. Empowerment
C. Discretionary Powers and Specific Provisions
D. Paper by Professor Richard Epstein
E. An enabling environment for a high-growth economy

A. BASIC CONCEPT AND PRINCIPLES

Fatal contradiction in government policies

The government has committed itself repeatedly to liberalisation, most notably and recently in President Mbeki's opening address to Parliament on 9 February 2001 in which he said:

> *The objectives we seek to achieve are moving the economy onto a high-growth path, increasing its competitiveness and efficiency, raising employment levels and reducing poverty and persistent inequalities. To improve our competitiveness, we must lower input costs throughout the economy. Accordingly, we have decided to go over to a managed liberalisation of the energy, transport and telecommunications sectors.*

Government's fundamental policy has been towards liberalisation and privatisation. The Mineral Development Draft Bill (Minerals Bill) therefore strikes an inconsistent and discordant note that cannot fail to alarm local and foreign investors.

Numerous government representatives including former President Mandela and President Mbeki, and ministers such as Minister Trevor Manual and Alec Erwin on numerous international platforms have assured the world and the investment community that there will be no nationalisation in South Africa.

Nationalisation

Regardless of linguistic attempts to disguise the essence of this Bill it amounts to unambiguous nationalisation. There are in fact privately owned mineral rights in South Africa and declaring them to belong to the State is nationalisation as it would be if any other existing private asset is declared by legislation to belong to the State.

There is an international outcry at President Mugabe's nationalisation of private land without compensation in Zimbabwe. What this Bill proposes for mineral rights in South Africa is indistinguishable from what President Mugabe proposes for land in Zimbabwe. This will become plain if "mineral resources" is replaced with "land" in the Bill. It would read, for instance, in the Introduction, that "the fundamental principles which underpin this Bill are –

(a) land is the common heritage of all South Africans and belongs collectively to all the peoples of South Africa;
(b) it is the universally recognised principle of a State to exercise full and permanent sovereignty over all its land;
(c) public trusteeship of South Africa's land."

Replacing the word "minerals" with the word "land" illustrates the true nature of the Bill very clearly. The drafters of the Bill wish to ask Parliament to approve the confiscation of all mineral rights and the vesting of those rights in the state.

Proceeding with this Bill will send a clear message to the world that the South African government is willing to nationalise private assets for ideological purposes in conflict with declared and official government policy.

South Africans frequently repeat that "the fundamentals are in place" and yet there is low growth and virtually no foreign investment. Critics of government's GEAR and liberalisation polices argue that they have "failed". They are wrong, the GEAR policies are sound, they have just not been thoroughly and consistently implemented. To the extent that they have been implemented the GEAR policies have been very successful. As a result, South Africa can pride itself on being one of very few countries to have meaningfully reduced government spending as a proportion of GDP. It has also reduced aggregate tax levels and reduced government employment as a proportion of population. These macroeconomic improvements are not easily achieved.

Sadly, the potential benefits are destroyed and counteracted by measures such as the draft Minerals Bill. This is one of a number of contrarian and contradictory initiatives. Others include the dramatic increase in government control of, and imposition of unproductive costs on financial markets, draconian consumer legislation (already found to be unconstitutional), nationalisation of water, intensified regulation of the taxi industry, widespread curtailment or prohibition of street trading, and substantially intensified government interference with labour markets. These measures are inconsistent with the GEAR philosophy and have a detrimental effect on the economy.

If government wants to succeed it should adopt a consistent economic paradigm. At the moment there is no such philosophy or paradigm in place and policies are seemingly random and ad hoc. The principles that inform the Minerals Bill are in direct contradiction, for instance, with those that inform fiscal and monetary policy.

It should be noted that countless countries that tried nationalisation of mineral and other rights have had to eat humble pie. Nationalisation has been a near universal failure. Our northern neighbour Zambia used all its capital and foreign aid resources to pay for the nationalised mines, mainly on the Copper Belt. After virtually destroying its mining industry it has been selling the mines back to some of their previous owners at huge discounts. The mining houses that had their mines expropriated used the capital to earn billions of dollars to develop mines in more investor-friendly countries. They have needed only a fraction of their earnings to buy back the mines that were once theirs.

The nationalisation of South African minerals is economically unwise. It will have virtually no identifiable benefits and massive disadvantages, especially for the poorest people in the country.

Foreign and Domestic Investment

There is an optimistic view that nationalisation of mineral resources will attract foreign investment. This view is promoted by self-serving foreign mining houses that want access to private mineral resources in South Africa without having to pay for them. This concept of foreign investment in South African mines amounts to a bizarre transfer of capital wealth from South Africans to foreigners at no benefit to the government or the people of South Africa. That they will pay royalties is no amelioration of this irony since existing, mainly South African, owners already pay royalties and taxes on the exploitation of the minerals they hold and own.

Whether or not there will be more direct foreign investment with nationalisation is unknowable. Without nationalisation foreign investors will have to enter into deals with existing mining right owners and the government. In order to mine here they will have to invest more. They support nationalisation precisely because it will enable them to mine in South Africa at less cost. In other words, nationalisation reduces the prospect of direct foreign investment contrary to unwarranted optimistic speculation.

The impact on non-mining foreign investment will be devastating. International investors are already aware of the mineral rights nationalisation process and many have turned their backs on South Africa as being just another country in which private assets are unsafe.

It is universally recognised that the way to attract both foreign and domestic investment is to guarantee secure property rights. It is for this reason that the government has itself been reassuring investors at great cost all over the world that private property is safe in South Africa. This Bill will destroy all their efforts.

Allocation of scarce resources

The Bill is informed by a fundamentally flawed understanding of economic theory and experience. It presupposes that the State *can* allocate scarce resources more efficiently than private owners can. However, economists have reached virtual consensus based on theory and experience that this is not so. It is therefore anomalous and inappropriate for a government department to base policy decisions on such a notion. In most other countries state assets, including minerals, are being privatised because state ownership and control has been found to be inefficient.

There are many reasons why private allocation of resources is more beneficial for a country. The Bill is base on a classic “one-size fits all” fallacy. It assumes that there is some method of determining the perfect way in which to utilise resources, and that this method is universally true throughout the country and in all contexts. Where resources are privately owned, private owners apply diverse strategies and some outperform others. There is absolutely no economic theory according to which a government can improve on this process. In a market of competing ideas and strategies, there is a demonstration effect according to which those who adopt less successful policies can learn from others. Sometimes those who fail sell out to those with a greater propensity to succeed. With nationalisation of minerals the government will necessarily adopt a

single sub-optimal policy and there will be no demonstration effect and no dynamic process whereby resources are transferred from less to more efficient users.

The Bill recognises the problem of market failure in the private sector but is completely oblivious to the greater reality of government failure. With nationalisation failure is not confined to single enterprises. The market provides natural damage control. Nationalisation subjects the entire sector to damage on a scale never produced by private ownership.

The worlds experience

The worlds experience produces unambiguous evidence – to a degree seldom achieved in social science – that market processes and private ownership outperform interventionism and nationalisation. In recent decades numerous studies have been carried out analysing different economic systems and identifying individual variables (such as the proportion of capital in private versus government hands) and all the studies reveal a positive correlation between private ownership and prosperity. (See section E)

Furthermore legal systems that respect private ownership and protect property according to the rule of law also coincide with greater prosperity.

Exploitation versus conservation

The declared policy – although this is not enshrined in the Bill – is "use or lose". The idea is that all minerals have to be exploited, failing which they will be sacrificed to the State, with a view to the State ensuring extraction. Simultaneously the government, especially through the Department of Environmental Affairs, and the international environmental movement, propagate conservation as a virtue. The idea is that immediate and greedy exploitation of scarce non-renewable resources is unwise and there should be active conservation. The Bill ignores the fact that private companies conserve minerals for sound economic reasons. The firms take the view, rightly or wrongly, that certain deposits, even if they can be viably mined immediately, will have greater value if conserved and mined in the future. The market mechanism provides an automatic and spontaneous harmony between the interests of exploitation and conservation.

The Bill, on the other hand, will have the effect of wiping out any conservation process and bringing about premature, often sub-economic, exploitation of minerals. The optimal balance between exploitation in the short term and conservation for the long term cannot be known, simply because the future is unknowable. The best that can be achieved is to allow self-interested owners to exercise their best judgement in the market place. Those who get it wrong will be long-term losers, and those who get it right will be winners. There is a natural economic process that results in assets being transferred from those who make bad judgements to those who make sounder judgements. Nationalisation has the effect of destroying this process and results either in uniformly premature exploitation or, if conservation becomes the dominant orthodoxy at some future date, belated exploitation.

Poor government track record

The Bill assumes that government, as owner of all the nations mineral resources, will utilise them effectively, especially for empowerment purposes. There is overwhelming evidence in South Africa and worldwide to the contrary. The South African experience has been that vast

mineral resources already held by the State, and owned by the State for over a century have been poorly utilised. Even in the years since transition the State has not utilised mineral wealth efficiently. Virtually none of the State's existing minerals have been used to create empowerment opportunities or to attract domestic or foreign investment in mining.

The private sector, on the otherhand, has proved to be a substantially superior utiliser of viable resources, including for the purposes of empowerment through job creation and investment. Most empowerment investment in mining in South Africa is through institutions and blacks already own a substantial part of the mining interests in South Africa through institutional investments.

Empirical flaws in the Bill

On the one hand the Minister said that the government would consider compensating mines "for the loss of their mineral rights". On the other hand the introduction and preamble to the Bill assert as a fact that South Africa's mineral resources "belong to the nation". The incontestable historical and jurisprudential fact is that there is a mixture of ownership in South Africa. Some mineral rights are owned by surface right owners of land, including traditional communities. A small proportion (by area) of mineral rights is owned by mining companies. Many of South Africa's mineral resources are already owned by the State. The statements to the contrary in the preamble and the introduction are therefore simply incorrect.

It would be a different matter were the preamble to say for instance that "mineral resources ***ought*** to belong to the nation" or that "the State ***ought*** to be the custodian of the nations mineral resources". Clause a) of the introduction in the explanatory notes asserts that "mineral resources is (sic) the common heritage of all South Africans and belongs collectively to all the peoples of South Africa". This is simply not so.

Another conceptual flaw in the Bill is the assumption that government ownership is the same as public ownership. The government is not the people. When Minister Vaclav Klaus of the Czech Republic was asked why he gave rather than sold privatised assets to the people after the fall of communism, his response was that the people had been lied to for many years that government ownership was ownership by the people. If the assets did indeed belong to the people, he maintained, the government could not sell them what was already theirs. Therefore the assets had to be given to the people and the government should cease claiming that it was the people.

The Bill envisages, not that the people in general will benefit, but that a select, privileged few *might* do so.

This is possibly delusional. It is well known that some mining companies, both foreign and local, support the Bill. The reason is very simple. Some of South Africa's mining companies do not own mineral rights whereas their competitors do. Once mineral rights are nationalised, the government will have only one option, which will be to allocate the right to mine the newly nationalised mineral rights to existing mining houses, as is the practice wherever mineral rights are nationalised. This means, in effect, that these mining companies will acquire the minerals of their competitors at a reduced or zero cost. The result will be a direct redistribution of wealth

from mining houses that have invested in South Africa and its future to those who have not done so.

Equally, foreign mining houses are delighted. They see the Bill as a transfer of South African wealth from South African companies to foreign companies.

To the extent that there is empowerment, real or fictitious, the beneficiaries will inevitably be a small handful of super-privileged elites. The historically victimised black populace will be worse off by virtue of the fact that the South African mining industry will be less efficient and generate less prosperity. It will, in particular, generate fewer jobs to the obvious disadvantage of the least privileged people.

Negative impact on stock exchange and capital markets
Since private mineral rights currently constitute valuable assets in the mining sectors of the private capital markets, nationalisation without compensation will result in a reduction in the capital wealth held in shares. As a result the South African share market will be downgraded as a participant in international markets.

B. EMPOWERMENT

The original idea in the Green Paper on Minerals was that all mineral rights would be nationalised for the purposes of redistribution. This plan was abandoned and replaced by the "use or lose" notion. At this point the entire logic that informed the original plan disappeared. The reason is that mining houses will retain and mine their valuable minerals and give up only those with little or no value. When it became clear that only low value or valueless mineral rights were to be nationalised the original plan had lost any real meaning and should have been abandoned in toto. To the extent that there are valuable mineral rights not already owned by mines and mining houses the Bill will have the effect of confiscating them without compensation from relatively poor people of all races. Mineral rights attached to tribal and black held land will be taken from them, as will mineral rights still in the hands of surface owners, mainly farmers. The irony therefore is that the Bill, in its new formulation, will not "redress the results of past racial discrimination and ensure the historically disadvantaged persons participate in the minerals and mining industry and benefit from the exploitation of the nation's mineral resources". It will have quite the opposite effect to what is envisaged in the introduction to the Bill.

There is ambiguity regarding the interests of current tribal owners of mineral rights the mining of which has been sub-contracted or outsourced to mining houses, such as those held by the Royal Bafokeng and on such areas as Uitvalgrond and Krokodilkraal. There appears to be the possibility of a hidden implication in sections 17 (1) and 17 (2) that the traditional communities currently benefiting from royalties will lose control of this income. There appears to be a possibility that the funds would have to be paid into a Local Economic Development Fund administered by the Minister of Provincial Affairs and Local Government but the Bill is not clear on the issue. If there is such an intention, it should be spelled out so that the traditional communities know exactly where they will stand in the matter.

It will be a bitter irony if, now that black South Africans are free, their opportunity to become mineral right owners will be denied. Real liberation in South Africa means allowing blacks to enjoy the benefits whites enjoyed historically. This Bill will destroy that prospect.

Not only is this a dangerous misrepresentation to South African blacks of potential benefits from the Bill, but it is a betrayal twice over. To the extent that black South Africans could benefit from mineral rights they will in fact be losing them under the Bill.

If the government is serious about empowerment it has at its disposal extremely attractive options which are consistent with and do not undermine declared policy. The government could, for instance, take the minerals it already owns and allocate them to empowerment companies and, in many cases, small businesses. It is often forgotten that micro enterprises are perfectly capable of undertaking many mining activities. This characterised the privatisation of mining in, for instance, China and is well known as a characteristic of mining in the early "pioneer" days. One way to promote empowerment in mining is to liberalise rather than intensify an already over-regulated industry.

A possibly more ambitious but probably more effective proposal would be to transfer all existing government owned mineral rights to a newly formed public company. The shares in this company could be distributed directly and free of cost to the intended beneficiaries of the Bill "the historically disadvantaged persons" of South Africa. This would be a real and effective way of using South Africa's mineral resources for empowerment of the people – the real victims of apartheid. It would do so without reducing the efficiency of the South African economy by misallocating scarce resources, bringing about premature exploitation of minerals, transferring South African assets abroad, and redistributing assets from investors to those mines that have chosen not to invest.

C. DISCRETIONARY POWER AND SPECIFIC PROVISIONS

Principles of Good Law

A project is underway in the Department of Justice to establish and promote principles of good law in South Africa. These principles include universally recognised criteria including the following:

1. *Laws must be objective rather than subjective.*
   People affected by the law should not be subject to subjective or arbitrary interpretation of what law means and should be able to reliably establish their rights in advance from the letter of the law.

2. *Laws should avoid discretion.*
   Good law is law that is certain and one aspect of certainty is an absence of discretion. If there is discretion, it should exist only under special circumstances and for abnormal reasons, and then, according to Constitutional Court judgements, there must be clear guidelines from the legislature as to the basis on which the discretion must be exercised.

3. *There must be no retroactivity*.
People should know what the law is at any given time, and there should be stability and certainty regarding the future. If laws applicable now can be changed retroactively in the future then people cannot know whether what they do now is lawful or what their rights are.

4. *Separation of powers*.
The South African constitution requires that the legislature alone may legislate, the executive arm of government should execute or implement law, and the judiciary should be solely responsible for adjudication.

5. *Administrative and procedural justice*.
The constitution requires that all laws be implemented in ways that conform to recognised criteria of due process and the rule of law. All procedures should conform to such principles as *audi alteram partem*, the right of access to relevant information, the right to cross-examine, and so on.

These are examples of the twenty-five or so principles of good law.

South Africa's heritage is one where virtually all principles of good law were routinely violated. Indeed, apartheid would not have been possible had the government been required to follow these principles. The new constitution requires that principles of good law be followed in law and in practise, and the democratic values to which the country is committed take the matter further according to recognised jurisprudential criteria.

One of the principle features of the Bill is the vast discretionary power envisaged by it. This is so extreme that the Department has been running advertisements to deny that it is so. The fact is that there are many discretionary powers envisaged by the Bill which are probably unconstitutional in view of recent Constitutional Court decisions. Whether or not the envisaged powers will survive a constitutional challenge is not the issue. Even if they do, there will be a needless and wasteful misallocation of resources towards establishing the constitutionality of these powers.

More fundamentally, discretionary power inevitably and unavoidably creates real or suspected abuse, corruption, nepotism, and misallocation of resources. South Africa is already plagued by widespread problems as a result of the excessive extent of discretionary power inherited from the past. This legacy of conferring limitless power on the executive is inappropriate in a democracy and should not be perpetuated in this Bill.

Apart from their unconstitutionality, it is simply unwise for law to operate in this way. In free societies that which is not prohibited is allowed, in authoritarian societies all that is not specifically allowed is prohibited. This Bill is in the authoritarian, anti-democratic society paradigm. It provides for no rights and freedoms but only for ministerial and arbitrary privileges. This is a classic example of "bad law", which is inappropriate in an emerging democracy.

In the context of litigation, reference should be made to the proposal, not yet in the Bill, to the effect that there should be special courts. This is in violation of the constitutional principle of separation of powers, according to which the legislature should legislate, the executive should execute, and the judiciary should adjudicate. South Africa's legacy of conflating the three basic functions of government into the executive should be reversed not perpetuated.

Examples of discretionary powers contained in the draft Bill

- **Section 9** grants the Minister the power to suspend or cancel a mining or prospecting right if a holder fails to comply with certain provisions of the Act, some of which such as the requirement to "provide the necessary finance for conducting such prospecting or mining operation" are not based on objective criteria.
- **Section 11** confers powers on the Minister "if in his or her opinion it is necessary in the national interest, cause any investigation to be conducted on any land to establish if any mineral or geological formation occurs in or on such land".
- **Section 12** empowers the Minister under certain conditions to direct the holder of a mining right "to take … such steps as may be necessary and practicable to mine any … specified mineral or group of minerals" to mine the minerals within a specified period or to abandon the mining right.
- **Section 13** allows the Minister to issue a directive to anyone intending to use the surface of any land "to take such rectifying steps" as the Minister may direct.
- **Section 14** confers power on the Minister to "prohibit or restrict any prospecting or mining on any land".
- **Section 15** empowers the Minister to "expropriate any property or any right therein for public purposes or in the public interest".
- **Section 17** confers powers on the Minister (to be exercised in consultation with other ministries) without any indication of the criteria according to which these powers must be exercised.
- **Section 26** stipulates that the Minister must approve the granting of a prospecting right on "such terms and conditions as he or she may determine". It further stipulates that an application for a prospecting right shall not be considered if in the opinion of the Chief Inspector "the applicant does not have the ability or cannot make the necessary provision to prospect in a healthy and safe manner."
- **Section 43** empowers the Minister to refuse to grant a mining right if in his/her opinion one or more of a list of requirements have not been met, some of which are not objective, for example, if "the intended mining operation will not be in the national interest". The term "national interest" is impossible to define.

The above list merely provides a sample of the undesirable discretionary powers contained in the Bill. There are many more. All such powers are contrary to the concept of good law and are also in conflict with the rule of law properly defined.

Compensation

The issue of compensation does not appear to have been adequately considered. Quite apart from the fact that the constitution requires compensation for the expropriation of property, there is no provision in the budget for the funds that may be required which could amount to billions of rands.

D. PAPER ON MINERAL RIGHTS BY PROFESSOR RICHARD EPSTEIN

The following paper by an internationally recognised American expert on the protection of property rights is an important contribution to the debate on mineral rights and forms an integral part of this submission.

Professor Epstein is the James Parker Hall Distinguished Service Professor of Law at the University of Chicago, U.S.A. He is the author of many papers and books, the most famous of which has probably been *Takings: Private Property and the Power of Eminent Domain* (1985) The 5th Amendment to the US Constitution contains the phrase "nor shall private property be taken for public use without just compensation". The book *Takings* is a powerful argument for the strict application of this clause and for the proper and consistent identification of takings of private property.

This paper is an abridged version of an address by Professor Richard Epstein on Friday, 28 July 2000, at a meeting held at the Johannesburg Country Club, organised by the Free Market Foundation. Leon Louw introduced him as probably best known for his specialisation on property rights issues – intellectual property, water rights, mineral rights and property law in general. Professor Epstein has been involved with the question of mineral rights as an academic, consultant, author and researcher.

Professor Epstein's address on Mineral Rights (condensed):

Contrast with intellectual property rights

When I spoke recently about intellectual property rights it occurred to me just how oddly similar and how strangely different these two sets of rights are. The key feature of mineral rights, in terms of their political dimension, is that they are fixed *in situ.* The exit option, which is used in many forms of property, is simply not available. That is also true in some respects with respect to land. It is not that you can take land with you; it is rather that relatively cheap close substitutes can be found somewhere else if that is your resource of choice. But with a mineral like chrome, platinum, zinc, diamonds or gold, its scarcity value means that its site-specific nature is extremely important.

With mineral rights, therefore, the huge rent sitting there under the ground leads to a huge controversy over what the proper system of ownership ought to be. So one reason you want a system of secure property rights with respect to minerals is to make sure that effort is expended on the exploitation of these rights rather than on struggles over how to divide the spoils. Mineral rights therefore present, in many ways, a unique kind of political issue.

Mineral rights are also interesting from another point of view, which is that it is easy to find legitimate ways to regulate them. For one thing, you've got to dig minerals out of the ground, so you're always worried about subsidence. You are also worried about dangers, such as contamination and pollution, which means that there is a health and safety concern with respect to neighbours. Mining is generally regarded as a dangerous trade or occupation, so there is the whole question of employment protection. And because the mines are immobile, they are targets for very strong union operations. This has always happened in the United States, and I dare say it

will happen in South Africa. That is, the threat to a union that you are going to go somewhere else with your business is not credible if you have only one mine as your source of supply. So this means, in effect, that you are dealing with a highly contestable resource, and the physical peculiarities of the mineral will dictate large parts of the political economy associated with its operation.

With intellectual property, the opposite difficulty presents the same kinds of political problems. The idea that fixity could be a problem becomes almost laughable. Instead you try desperately to find a way in which you can fix the property right. Take a case where somebody comes up with an invention or composes a new song. There is nothing that says you cannot build it in a country different from its origin, or play it somewhere else. So to get the right balance with respect to intellectual property, you have to find ways to prevent flight from taking place in order to permit the appropriate return on the asset. And that means you have to develop international treaties and arrangements to make sure that the property rights match the sphere of potential use and application of the right in question.

So in the one case you get the political struggles that take place because of the expropriation of a fixed asset. And in the other case you get the political struggles that take place because folks in foreign jurisdictions are always trying to figure out a way to use the property without paying the rent associated with its use. All who are familiar with the current struggle regarding patent application laws in pharmaceuticals in South Africa will understand just how dynamic it is. So we can say about property law in intellectual property on the one hand, and mineral rights on the other, that because of the nature of the asset there is going to be powerful competition over both these resources. So the definition of property rights is of paramount importance to both areas in order to quell that competition and prevent a wasteful redistributive struggle.

Classification of mineral rights

We have a kind of two-by-two classification with respect to mineral rights. One consideration is the kind of land minerals are located on. The relevant qualification is that we have private lands and public lands. This is the case in both South Africa and the United States. It is not as though public land is an anomaly and private land is the rule – there are huge portions of land, which are, in fact, public land. Now, the peculiarities of nature are such that the lands on which you are likely to find heavy concentrations of valuable minerals are also craggy and remote and dry and parched, so there are not going to be many competing uses for them. It also turns out that the government owns lots of this desolate land that is extraordinarily valuable, not for what is on the surface but what is below. What you then have to figure out is how to deal with the government regime of the land.

The second thing about minerals is that they tend to be concealed when you examine the land on the surface, so some deposits are discovered and others are not. A property rights regime must be able to deal with both parts of this problem – those things we know about and those things we do not know about.

We therefore have these four different boxes – public and private, known and unknown – and we have to figure out how everything fits into them.

But this is only the start of the problem. Some of you are in gold, others in diamonds, chrome or manganese. Each mineral probably gives rise to different problems with respect to its distribution, politics and so on. Also the mining companies will not all have the same problems or points of view on all the issues in question. I think one has to be aware that any generalisations that one may make are likely to be tripped up by the distinctive features of a particular resource and the way it operates.

Private ownership

I shall start with the "private" side of the situation. The central rule I want to focus on is a Roman law rule which has been carried over to the English law and is probably pretty powerful everywhere else, which says: "He who owns the surface of the earth owns up to the heavens on the one hand and down to the depths on the other." The "heaven" part of this in Latin is called the *ad coelum* rule, and since minerals do not exist in air we are not going to worry about that, although the law of air rights is an extremely interesting question.

Today we are interested in the *ad inferos* part of the rule and in going down, as it were, instead of up. Now, why is this rule so important? When you are dealing with private systems of law in a primitive society (which of course is what most societies are when they begin), the basic rule with respect to the assignment of ownership is that the person who is the first occupant of the land owns it. The question then is: what is the land that you take, when you take it by occupation?

To some extent this case is distinct with land, and harder to define than it is with chattels. If I found a seashell and was the first person to take possession of it, you know what possession would mean because I can engulf it completely. But when you take possession of land, what is it that you have? How far up and down do you go? You could say that you only operate in two dimensions, so you only own the surface. But since all of us are three-dimensional creatures it would be rather useless to own the surface of the land if you are not allowed to stand upright on it.

So we necessarily move from a rule that says "you own the surface" to a rule that says "you own some kind of volume associated with that particular surface". Next we ask what that volume is going to look like. Going up, we go very high because before there were aeroplanes there was no particular harm in giving somebody private ownership of some space between here and the moon. Later, when you get over-flight, it becomes a rather different question and the property rights regimes will change in response to new technology.

Then the question is, how far down do you go? I think it is probably fair to say by way of analogy that in the initial conception of this subject one of the attitudes was, "We may as well go down to the centre of the earth; after all, what harm is there? If I cannot get there from the surface of the land and nobody else can get there either, what does it mean to say that I have exclusive ownership and possession of a part of the land that I can never reach?" Which, of course, would apply to everything below, say, 10 000 feet underground, or whatever is the maximum feasible depth with respect to mining. So, how far down do you go?

Separate sub-surface rights

You do not necessarily have to go down to include mineral rights far below the surface in order to make the surface useful for farming or for other kinds of occupation. One could say that the fellow who owns the surface has the right to the support of the land in its natural condition and for any improvements that he may erect upon it, but that any minerals that may exist will be subsequently discovered only when somebody takes possession of them directly. Alternatively, one could apply an imputation rule that says, "If you own the surface we want to have a definite structure of property rights so that your rights go all the way down".

Both these solutions, to some extent, have been adopted at various times. To give you an illustration: In some cases, the ore goes in seams that traverse long and far. The fear people then have is that, if you say that the owner of the surface gets the minerals, when somebody finds the minerals, they may follow a seam that eventually goes underneath somebody else's land. The fellow who has put in all the labour to discover what was going on under the surface would then not be able to claim the minerals he has discovered. Other people would be able to free-load off the information. The consequence of a rule that says, "He who owns the surface owns everything that's beneath the soil," is that it will inhibit the discovery of the minerals. An alternative regime would therefore be to say, "Once you take possession of some portion of this seam you are allowed to follow it under everybody else's land to its conclusion" and the result would be a divided-rights regime.

Of course, one of the things you discover when you create regimes of property rights is that for every advantage offered by a given configuration of rights you can discover an equal disadvantage. The disadvantage in the case of the tracing situation is that if you start to go underneath other people's land, you tend to mess it up pretty badly. Also, the whole question of how you co-ordinate uses on the surface that are inconsistent with those beneath the surface becomes much more acute when there is no single common owner who can arrange the division of resources by contract between the parties. The result is that you have a kind of trade-off.

If you allow the ownership to go straight down, you get very definite property rights that can be held in perpetuity like the surface of the land. You also have somebody who can decide exactly how the resource allocation is to take place. This involves several kinds of choices: for example, whether you do this by yourself or contract it out to somebody else. Generally speaking, the talents that are appropriate to the surface are not appropriate to the sub-soil, so there is an extensive network of leasing, royalty interests and all the rest. Following the *ad coelum* rule then makes it easier to adjust the relationships between the surface and the sub-surface estate. To that extent the rule has a very powerful advantage vis-à-vis the tracer rule, which is a first-to-the-post kind of operation. All other things being equal, you would therefore tend to prefer it.

Time limits of rights

The second thing that is important for both of these rules is that generally, if you decide that the property rights go to the soil, those rights will have all the durability characteristics associated with the ownership of the soil. One of the geniuses of the system of ownership of land with respect to the surface is that because the time horizon is indefinite, the individuals who make investments in the land don't have to worry about the timing at which they make the investments or the timing at which the returns are yielded. If I invest $1 000 today and this will give me $110

of income per year, that is a very attractive investment to me and I will do it. However, if we decided that the ownership interest that I got by occupation of the surface lasted only 20 years, I would have to truncate what is going to take place in making the investment knowing that on the expiration of the term I will lose the yield. As the lease gets shorter and the time that I continue to get my yield decreases, my willingness to make capital improvements will diminish.

Virtually every well-negotiated commercial lease takes into account, at the expiration of the term, the residual established value of the fixtures or the investments that have been made. So you do not have an externality. You get a lump-sum payment after you have had the use of the asset during the period of the lease. But if property rights are created in ways that provide short time horizons, you get real distortions in investment. Compare this to the situation where you not only get the depths forever but you also get the depths on an indefinite time-horizon. Such a system allows the efficient matching of investments on the one hand and their returns on the other. This is particularly important with respect to some kinds of minerals, where the front-end capital investments that are required to achieve a high yield are very great. Time limits distort investment patterns because investors know they will not be able to garner all the returns.

"Use it or lose it" and inefficient structures

Now I want to discuss the whole question of "use it or lose it" as a matter of policy. I think that by and large it is very dangerous to have a policy whereby your ability to perfect your property rights depends on your willingness to make expensive investments. An example from America, which is unrelated to mineral rights, established the point; there is a book called *The First Four Years* by a woman named Laura Ingalls Wilder, and any of you who have read *The Little House on the Prairie* series will remember her. She and her daughter, Rose Wilder Lane, and their whole family were libertarians. They had a very strong intuitive appreciation of the logic of property rights, which runs through the books and accounts, I think, in part, for their intuitive appeal.

They describe how, if you went to the American West in the 1870s and 1880s and you wanted to homestead, you had to earn your homestead. The argument was, "We are not going to give the land out to anybody who is completely frivolous", which is of course a mistake. The homesteader was required to stay there for a certain period of time and had to plant trees on the land and make sure that they survived. When you read the account you find that the land was so inhospitable to the trees that 80% of the value of the land was dissipated in this hopeless effort to make the trees grow – planting them, giving them shade and water, tilling the soil so they had nutrients, and so forth. One of the great advantages of a "first possession rule" is that if you have a very simple test that establishes possession, you do not have to spend resources on establishing rights. You only have to spend the resources on things that generate productive economic activity.

In exactly the same way, there should be rules on ownership of mineral rights that are relatively simple to accomplish. You do not want this constant conflict between making huge investments to establish legal title, which is a private gain but a social wealth, and making investments when economically there is no particular reason to do so. When you start to worry about surface interests with respect to mining, it is similar to having forest land and trying to decide whether it is optimal to clear it today or wait five or so years before turning it into farm land. A lot depends

on what you think about the anticipated price of crops or the value of the timber. If the government says "Use it or lose it," you will have premature development of the land, or premature harvesting of the timber, even though from an economic point of view it might well be that deferral is best.

With mineral interests this is an extremely important consideration because the cost of storing minerals *in situ* is zero. It is not as though you have to find special places to keep the diamonds that are in the ground. The situation will take care of itself very comfortably. When a firm makes a decision not to mine at any particular point, what they are telling you is that they think that given all the cost-benefits involved in the equation, the present discounted value of a future decision to mine gives them a greater yield than a current decision. No distortion will take place in the business judgements of the firm by virtue of the operation of the legal rule.

Once you start to give people "use it or lose it"-type options, on the other hand, you introduce a massive set of distortions that will lead to premature excavation. Then when you start mining you have another set of decisions to make. You have to decide whether to store the minerals or sell them immediately given the existing market circumstances. Of course, it is not feasible to stockpile materials that have a relatively low value and are costly to store. But I assume you could store a lot of diamonds relatively cheaply. The problem would then be that you would incur costs in year one for sales that would be made in year ten. It would have been far better to wait until year ten to do both the mining and the sale. So that what you have achieved with the "use it or lose it" principle is a massive waste.

In other words, these changes and permit rules alter property rights from efficient rights structures to inefficient structures. The effort to create things by way of government regulation under these circumstances is actually counter-productive to the interests that they are intended to benefit. This also applies in the tracer situation where you follow the seam here and there under the land. Under those circumstances there is obviously no particular reason why one would want to force the development in question. So I think one of the reasons we like private property rules like the *ad inferos* rule is that these rules ensure that the temporal decisions made by the firm will be efficient. If the firm makes the decision to mine today, it gets 100% of the yield; if it makes the decision to mine tomorrow it still gets 100% of the yield – it is making an apples-with-apples comparison. If, on the other hand, it gets 100% of the yield for mining today and only 40% of the yield for mining five years from now, there is going to be a systematic effort to bring things forward in time.

Clash with environmental regulation

There is another problem with respect to the "use it or lose it" rule. Ironically, it creates great tension with some of the environmental regulations. For example, take somebody who would engage in mining only five or ten years from now: they can postpone for five years the slides, the waste and the run-off. Not only do they get a time benefit out of this, they may also get a technological bonus. That is, if five years from now better techniques are available, so that the yield relative to the waste improves, that means that you're not only going to delay the waste, you're going to get less of it.

By forcing things forward artificially under a rights preservation regime, you create additional and unnecessary tensions with environmental regulation. So again the logic of the surface ought to apply with perfect clarity, I think, to the areas underneath the surface as well. A system of private ownership protects individuals by not forcing development.

Protecting undiscovered mineral rights

The same kind of thing happens with respect to discovery. Ask yourself, "What is the condition with respect to a tribe that may have valuable mineral rights underneath its land?" If you have the *ad inferos* rule in place, ownership of the soil protects the ownership of all the mineral rights beneath it. They need do nothing else whatsoever to ensure that these rights are protected. They don't have to go out today and hire prospecting firms or analysts to explore their holding. They can wait until somebody comes to them with independent information that there might be something there of value. In other words, this rule gives enormous security with respect to mineral interests, and keeps them out of the political province. And since the political province can re-assign the rights from A to B or from B to A or even both ways simultaneously, all that it does is create friction without generating any particular forward energy. The protection that you're getting is so strong that it doesn't force you to acquire information and it doesn't attach any penalty to a lack of information. Also, coherent ownership of the surface allows you to create coherent mechanisms between the surface owner and the sub-surface owner with respect to the allocation of the resource in question. And this is a very nice kind of interaction between the public and the private law.

An American coal-mining example (see Appendix*)*

Goal of the takings (expropriation) law

You should understand the primary goal of takings law regarding issues such as mineral rights. Our objective is to ensure that when the government intervenes, the strong *ad coelum* rules are not distorted. You achieve that as follows: recalling what we said about leases, the way in which a tenant makes extensive investments in property when he knows that the lease has a fixed term is that the landlord pays him the residual value of the improvements at the end of the term, so that his incentives are not distorted.

That is exactly what ought to happen here when there is a coerced transaction. When government decides to interfere with mineral rights, unless it pays full compensation it will distort the patterns of use prior to the confiscation. And it will create gratuitous social inefficiency. Just compensation is a way of having a seamless transfer of resources – well, as seamless as you can make it – from private to public hands.

Public lands

That is how one should think about private resources, or resources that start private and end up reverting to public. Finally I want to talk about public lands and how one works these. The first thing to recognise is that the division of labour that applies to mineral rights on private land also applies to mineral rights on public lands. That is, a government as the surface owner is going to be no better at mining, for the most part, than any private surface owner. In order to effectively exploit the rights to minerals and to oil and gas that are underneath public land, the state is almost always going to have to enter into some kind of voluntary transfer with a private party, in

which the state will retain a royalty interest or receive a front-end fee in exchange for allowing the private company to mine the stuff.

As with all kinds of contracts, the only thing that makes sense is for the mining company, by taking the working interest, to get a return on capital equal to what it could get by investing in private lands or investing overseas, because mineral expertise and know-how is highly mobile, even if the resources are not. From the government's point of view, it must be able to get a return out of the land that is greater than any cost that it suffers from the alteration of the land's surface. In most cases, if those minerals are in desolate locations, it may well be that the surface damage is relatively small, so one would start to see some effort on the part of the state to utilise its minerals. That is the logic.

The difficulty with respect to public issues is how you decide what the pattern of allocation should be. Leon Louw said in his introduction that one of the Free Market Foundation's concerns is street traders. Now the street-trader problem and the mining problem are in many ways identical, for the following reason. With street trading, you have this public space which is now subject to private occupation. It is a partial privatisation. Does that take place under an occupation rule? Under an auction rule? Under a permit rule? Do you have an application system where you have to show that you are a wonderful person in order to receive a space? Are the interests, once they are created, permanent? Are they terminable? If so, at cause, or voluntarily? Are they freely transferable? Are they descendible? Do they survive a change of use on the site in question? What happens if there is a change in the neighbourhood? etc, etc? What happens with the street traders is that you do not have a definite strong contract or property-rights perception associated with them, so that the industry itself is subject to immense conflict and instability.

Well, mining on public land raises a very similar question. Nobody understands the correct principles for disposing of a public resource. This has been a chronic problem.

Disposal by favouritism

One of the things that the government can do, of course, is to simply take applications from people, look them over, decide which of these people it thinks is going to be the appropriate contractor and give them the operation. But the great danger of that is that it opens up the door for an enormous amount of political favouritism, where only the nephew of the Minister is sufficiently qualified to do the mining. The way you know that it is a racket is as follows: the Minister's nephew gets the property and then enters into a sub-contract with a commercial operator. The commercial operator pays him a rent, which is greater than the amount that he had to pay for the stake, and he pockets the difference. Thus an intermediary is introduced who gets a percentage of the take but provides nothing by way of social values, and this is an effective measure of the degree of dissipation of public resources that are put into private hands. One always has to be aware of sweetheart deals, and the sub-lease is in many cases a very easy way to identify them.

In the United States, for example, we have a system with respect to the broadcasting spectrum that gets very farcical. A radio-station band opens up and the administration says that interested parties must apply to it. So one guy says, "You should give the frequency to me because I am a

minority broadcaster," and somebody else says, "I represent a religious sect" and somebody else says, "Well I'm a member of the local community who has been there for you" and somebody else has got some other special virtue. And the government tries to figure out which of these many virtues is the greatest. And in the end they say, "Aha – Jones, you are the one who gets this thing". Well, what does Jones do? He sits on it for a year and then sells it in the open market.

So all you are doing, in effect, is wasting resources to decide who is going to be the vendor. And once you have made that decision, you have managed to take a public asset and transfer the net proceeds of the sale to a private party. One of the things you have to worry about in the allocation of state mineral rights is that sweetheart deals followed by re-sales will have exactly the same pattern as radio frequency spectrum sales followed by resale in the United States. So one is not wildly enamoured of the permit application system because it is subject to abuse.

Disposal by auction

What other system might you use? You could use an auction system, which is much more promising. First you define the mineral rights that are subject to regulation, and then you let people bid for them. You have to figure out how to organise the auction in order to maximise the value of the sale, and that is not easy, but let's put that aspect aside. The difficulty you sometimes get with auctions is this: say one guy bids $1 000 and another guy bids $800, but the guy who bids $1 000 causes $300 worth of damage to the retained interest which the other fellow avoids – the higher bid is not of the right quality.

So when you deal with sales of partial interests, as mineral issues always are, you have to be able to adjust the quality terms. That means not only the specifications of what is going to take place, but also the kind of work that you expect to be done. You have to worry about bond postings and all sorts of other things, so the auction is not nearly as easy a device as you might otherwise believe it to be.

Of course, the other thing you could do is allow the first guy to come to the mining site to just take it. Or you could sell prospecting permits. It will depend a lot on local circumstances which of these various schemes you want to use.

Undesirability of government ownership of minerals

Once one realises how difficult it is to conduct a public auction – and there are many more difficulties of a political nature as to when and how it takes place and so on – the last thing you want to do if you are the government is be the owner of minerals.

Wherever there are proposals to nationalise this, that or the other unused mineral, the thing to remember is that it is problematic how the state should give them up after pulling them in. The appropriate structure for government with respect to mineral rights is to privatise as much as it can and get its take from excise taxes, if that is permissible under your constitution, or income tax of one form or another.

To nationalise minerals may well result in government getting less money overall, because if you do not know what you are doing with respect to sale and leasing arrangements, your revenues

from sales could be smaller than the taxes you would receive from private ownership of the things in question.

Although the *ad inferos* rule sounds kind of crazy and naïve, it turns out to be extremely robust. And since it is robust, it ought to be a guide not only to historical practices but also to modern rules. What you want to do is to keep things private. So start to privatise and to develop intelligent privatisation policies which make sure that the money potentially available from minerals in public places ends up in the public treasury and not in private hands.

Responses to (unrecorded) audience questions

Employment in mining

There are several ways that government can employ people into the mineral business. One way to try is to start new firms and employ them there. But you run the risk that a new firm will be filled with people who have no expertise or knowledge of the business, and who will therefore be inefficient producers. Since South Africa now sells most of its minerals on international markets, there will be no forgiveness in world markets for local inefficiencies. What you may do is to create subsidies without benefits. You have to be very careful about that.

There are three better ways for government to do this. One way is to be very emphatic about the preservation of tribal rights, because when these folks negotiate their contracts or leases they can say, "We'll take a smaller royalty rate but we want you to make sure that some of our people are involved in the operations of these programmes so that we get some control and knowledge and expertise". If you nationalise these rights, you are going to make it much more difficult for these processes to happen.

Secondly you can use government lands that are often under-utilised and attach conditions about who can be in the consortium to bid for the mining lease. It is not something I favour, but it is worth thinking about. This is done all the time in the United States and it means that you have to have some degree of set-aside associated with the program. There are inefficiencies associated with this, but there are also distributional benefits and you can decide when you lease public lands what kinds of conditions you want to impose.

A third approach is actually, I think, the most important. Looking at the shareholders of mining companies, often they are pension funds, mutual funds and other organisations which have expensive flat membership. In time, that flat membership will be felt throughout the corporate structure. So you can rely upon the normal diffusion of power to create the operations, not at the bottom level but at the upper level. The point to stress is that a program which says, "We want to level the playing fields," is going to be destructive for everyone if it produces inefficient outcomes by depriving everybody of the accumulated expertise and capital that the established mining companies have been able to acquire through their operations over the years. That is, there may be an injustice involved, but there is also a heavy cost associated with any kind of very strong action to eliminate the injustice in question.

I think there is a fair degree of freedom for constructive activities without destabilising property and minerals rights regimes. This is a very expensive proposition. I do not know what the total

value of all unclaimed minerals in South Africa is at world market prices. My guess is that it is probably falling as minerals lose value relative to other commodities over time because of improved means of production and efficiency. But even if there is a decline, you are talking about tens of billions of dollars of assets. You have to make sure that when you get them out of the ground you actually get the net profit from them. You cannot make a set of policies and property-rights rules which essentially mean that the value of the minerals will be dissipated in a political struggle over the division of the rest.

The other point I want to make is that there has never been a level playing field. Every time you have any kind of historical past in any country, you always have some people who have advantages over other people. But the advantages that somebody has in 1990 will depreciate over time. As long as one recognises that, the question you have to ask is whether the effort to redress the balance produces more inefficiencies than the natural erosion of those advantages would otherwise do.

Monopoly, hoarding and confiscation

There is a big danger in putting all mineral rights in one house, which is what you do when you create a state monopoly. A state monopoly means that you may charge too much for the prospecting rights, which will diminish the efficiency in the realm, or it may be that you get favouritism and you will give the permits out to one group rather than to another. What I would recommend is as follows: First of all, publish, worldwide, an announcement which says, "Anybody who has mineral rights in South Africa will lose them in five years unless they register and record them in a particular place in which there is a Deeds Office". Once people do come forward, you will have established the rights in question.

In the interim, the state can auction off the prospecting rights with respect to those lands where there is no identifiable owner, but put the monies that it receives in trust. Then when these mineral or surface owners come forward, it can transfer the interest back to them. There is absolutely no reason to have a state take-over to deal with the problem of indefinite or imperfect property rights. You do not want to have confiscation without compensation.

I will go further – you complain that there is an indefinite nature of the property rights systems which makes it impossible for people to enter into voluntary transactions. That is the most valid complaint that anybody could make about any property system. The last thing that you want to do in running property systems is to create new forms of indefinite property rights by making it unclear who owns what. So, going back to this "use it or lose it" principle, how do we know what is being used? You have complicated mines underneath the ground in which the deposits are not uniformly distributed. A guy says, "Well I'm going to use it". And he starts mining on the west. Well, what has he used? Has he used the west wall? Has he used the central wall? Has he used the east wall? Which has he used, which has he lost? The moment you recognise that you do not know what the implications are, how much you keep by using any particular amount, this principle creates massive indefiniteness with respect to the property rights in question. One does not want that. You are shooting yourself in the foot.

The term "hoarding" is very powerful but it is also misapplied under the circumstances of this case. We talk about hoarding in cases when there are artificial shortages in a market. Say, for

example, that there is a siege around a fort, and you happen to have a large amount of grain which you hoard instead of selling at previously competitive prices. When such constraints are imposed by natural circumstances or war, we do not want the fellow who is lucky enough to have purchased property in a competitive situation to enjoy the huge run-up in value that is created by this artificial creation of scarcity. So we socialise the stuff. In fact, this is not new socialism, but old socialism. It goes back to the common-law principles, and the first one is that ordinary property rights are suspended during periods of necessity. That is the rule, and hoarding is a manifestation of that.

But this is not hoarding. The reason it is not hoarding is that you are selling minerals in world markets and there are no artificial constraints or shortages. What you are doing is making judgements as to what you think the present and future price rate will be, and you are conserving. To have a hoarding situation you have to show that there is some kind of distortion from a competitive equilibrium. This mineral market, if anything, has become more competitive worldwide than it has ever been before, so the hoarding argument is completely inappropriate.

What is really going on here is confiscation. The traditional view of property rights was that you held the minerals in perpetuity, whether you utilised them or not. Now the state changes the rules and says 'either you use them or we take them'. Well, what you have done is you have taken the stuff that has not been used and you have not paid for it. And I do not think you can do that under the property clause of your constitution.

But I think it is worse than that. You are going to take interests that are worth $10 000, and by the time you are done, they will be worth $1 000. It is not as though you can preserve value after confiscation. There is a fundamental theory about that – the thief never values the property as highly as the original owners because if he did, he could have purchased it and made a gain. The moment one hears the argument, with respect to a mineral resource, that “we have to have it and we can’t afford to pay,” what you are saying is, either credit markets are bad, which with minerals they are not - they are very good - or alternatively, “we can’t pay it because it is not worth as much to us as it was to you”. You do not make money in a nation that way. You make money by having high levels of production, low rates of taxation, and benefits from the increase in jobs and from the improvement of public goods. So my fear is that by misusing the word hoarding, and by giving the wrong response to the imperfection and titles that you have, what you are doing is to introduce a regime that is not defensible on its own terms. What you should do is to fix the gap in the one case and correct the terminology in the other. And that means, I think, abandoning the expropriation policy.

Investment

Nobody will choose to invest in South Africa tomorrow if you confiscate the property of people who live in South Africa today. I say this as a foreign investor. You were as blunt to me as you possibly could be, but although I may not know everything about South Africa, I suggest that you don’t know about America – maybe you do, but I’m also going to be as blunt as I possibly can. I am going to tell you right now, the guy who is the new investor today is the old investor in five years. And if you say that the government has an obligation to redress today you are not going to change your tune in five years, which means that the guy who comes in today is going to be confiscated in five years.

That means that I am going to do one of two things. Either I am going to say I can't play in this political game because I don't know what's going on, so I'm going to stay out. Or I'm going to say to you, "I don't trust you and therefore I want a 20% rate of return, not a 10% rate of return". Now, why on earth do you think that taking your position is going to help foreign investment? There is no one on the outside so foolish as to have listened to the speech of welcome if they do not hear this other conversation. They hear both conversations. And they know that today you are a welcome investor and tomorrow you are an exploiter to be redressed.

Secondly, you talk about trading sites. But this is not the right analogy. First of all, you made it appear as though the only people who can get the sites from hand to hand are in the "in" group. In fact, if these sites are vendible, any outsider can buy, and it turns out they are vendible! Are you telling me you cannot buy a share in De Beers?

Let me give you the following argument. Whenever a lawyer is faced with a question, there are two ways in which you can deal with it: by way of denial or admission, or by way of demur. The first raises questions of fact; the second raises questions of law. I am not going to try and answer any of the questions of fact about the distribution of mining, title and mineral rights in South Africa – how much is owned by the state, by the tribe, by individuals, by the mining companies, and so forth. What I will say, in effect, is that demur is how you ought to proceed. First of all, with respect to those lands that are held in some lease, in indefinite sense, under tribal kinds of arrangement, I think that the perfection of individual freehold is an appropriate solution as a first approximation.

If the surface rights turn out to be too small to be efficient, I would recommend a pooling arrangement whereby all the mineral rights underneath the land are combined into a single corporation which can do business with respect to them. And then fractional interests will be created in the residual with respect to each surface owner in proportion to surface area over the land in question, so as to obviate the bargaining problem that I talked about. It seems to me that that is perfectly well attainable and there is no problem whatsoever with just compensation because the fractional interest that you get in an efficient operation is worth much more to you than the tag end direct mineral rights that you would get if you just simply kept all of these parts separate. This is a responsible way; it seems to me, within all sorts of local cultural issues, to deal with the question of title. First you engage in a system which makes the title more rather than less definite, then you engage in a system in which you pool the resources so that you become more efficient in dealing with the outside world.

Secondly, in dealing with the property rights that are currently in government hands, it seems to me that if there is any empowerment issue, it should not deal with the legacy of apartheid but with the realities of going forward. The state has the property. It has to decide whether the property is going to be controlled by bureaucrats – many of whom will be black – or by black citizens. My view is that true empowerment leads to decentralisation of government, and I would urge that these rights be sold off, given away, or auctioned off.

The key element is to make sure that privatisation of the rights takes place. How would I do it? In exactly the same way as with the private rights. I would try to make the mineral rights large

enough so that they are economically useable under the circumstances, and I would create various kinds of pooling arrangements that would be able to deal with it.

Thirdly, we have rights which are currently in the hands of the mining companies. I do not know how many they are. The first thing I would say is that if there is any doubt as to whether or not there can be re-alienation and sub-lease of mineral interests to any group, I would want to eliminate those ambiguities and to make sure that subsequent alienation in any form would be freely available. Once you did that, these mining companies would be in a position where they can give out rights arrangements or co-operative arrangements to any black person who is interested in working in each particular situation.

So it seems to me that we do not have to know the distribution at this moment of state lands, private lands and tribal lands. We do not have to know how many tribes there are, or what the values of the minerals are. What you have to agree upon is a stable legal regime. And the question we are dealing with is not whether there will be black control – in South Africa there will be huge amounts of black control in the future because of the distribution of population. The question is whether it is going to be private or public. And the thing that I would urge upon you is that private rights out-perform public rights. So the function of a government ministry ought to be to figure out how to privatise. This, of course, is against nature. The moment a minister privatises rights, a ministry loses power. And that becomes the central question.

We had a similar issue in the United States with the Bureau of Indian Affairs (BIA). The moment it became clear that getting rid of all the tribal lands into individual land would leave the BIA with nothing to do, the policy started to change. Do not repeat the American mistake. There are lots of precedents for going wrong in this particular area. Apartheid makes everything terribly charged. It makes it easy to say to an outsider that he does not understand what is going on. You can't undo the past, but you can mess up the future. So I'm in favour of moving very fast, and the way to move fast is to privatise now and allow voluntary transactions to take place thereafter.

Appendix - An American coal-mining example

Let me explore in some detail an American case that deals with this subject (the allocation of a resource between surface and sub-surface owners), a case called *Pennsylvania Coal Co vs Mahon* (1923). This is in many ways considered to be the single most important takings (or expropriation) case in American jurisprudence, mainly because of the enigmatic response it gives to a terribly difficult question, or at least as they conceived it, of law. But before you can understand the constitutional issue you have to know something about the private law issue that generated the question.

It turns out that when you mine anthracite coal (that's the hard coal) in western Pennsylvania, there is no way to get the coal out without posing a risk to the surface. So when you create, by contract, mineral interests that are separate from surface interests, you create not two estates, but three. It is clear that you have the surface estate and it is also clear that you have the mineral estate. But there is this third thing in between that is sometimes called the support estate. So as you enter into this space, in contract, you have to ask whether the support estate remains with the

surface zone – that is, whether the guy who mines below is under an obligation to make sure that the surface does not fall into the hole – or whether the support estate is transferred with the mineral interest to the mining operative, so that the thing on the surface can topple down and the risk is to the surface owner and not to this level beneath.

When mineral interests are located in the middle of nowhere, the surface estate is not particularly important because the land is barren. But in many cases the surface estate contains the homes of the very miners who are digging out the coal underneath the ground. So you have houses on top of the land. The question then is, "How did you allocate these transactions?" Well, there is a standard economic analysis called "The Coase Theorem" which says that you allocate the risk to the party that is most easily able to bear it. If it turns out that the cost of mining the coal is inordinately expensive in the beginning unless you have the right to take a risk to the surface, it may well be that you will pay the surface owner an advance to take the risk in question, allocate the mineral estate and the support estate to the mining company and continue about your business. And from time to time these houses will fall in underneath you.

But if the surface interest is extremely valuable, you allocate the risk in another way. In this case, there is a time element which probably complicates matters. That is, early on it may well have been difficult to mine in ways that allowed you to preserve the surface, so that given the poor structure of the industry in, say, 1880 when these leases were first negotiated, the efficient solution was one that transferred the support estate to the mineral interest. Then, as 20 or 30 or 40 years go by and your equipment and your knowledge of geology improve, it may be that the cost of protecting the surface is lower, at which point you would want to have a re-allocation. The difficulty is that it is very expensive to resell these interests because there is no ready market for them. Mineral rights in these circumstances create what we call a bilateral monopoly. The only guy who owns the support rights under these circumstances is the mine-owner, and the only fellow to whom he can sell them is the guy who owns the surface above. There is no set price for this particular exchange, and often the difficulties involved in negotiating the deal are so great that the sale never takes place. What makes it even more difficult is that there is sometimes a co-ordination problem as well. That is, there may be a hundred or two hundred or even a thousand houses above the mine.

Now when you originally bought these mineral rights, you bought them from a single owner before the land was subdivided, so it was easy to negotiate the transaction. But when you want to sell them again, you have to sell them to all these people. And it does help a mining company to sell support rights to 800 people if the other 200 people are still going to say, "Hey, we don't want to". So it may be very difficult to rearrange the property rights in question.

Now, how would you approach this matter if you decided that the bargaining problems of the two-party relationship and the co-ordination problem of all the surface arrangements made it no longer efficient for the coal company to own the support estates and it wanted to give them back to the surface owner? The answer is a clear explanation of the use of the takings (expropriation) power. One justification for imposing force is that we cannot arrive at an efficient solution by bargaining because of our inability to co-ordinate the activity amongst the many parties to the arrangement which actually changes the property rights amongst individuals.

Normally we tend to think about common pool issues in terms of mobile resources like fish or oil or gas. But here, because of the differences in scale between what goes on below the surface and what happens on the surface, you have a very nice common pool problem with respect to land. If you go back to the literature on common pools, you find that people are always thinking about coercive solutions to regulate the use of common pools in water, oil and gas. In fact, the history of oil and gas is completely different from the history of mineral rights precisely because of the "fugacious" nature of the stuff - it doesn't stay in one place. And the same point applies – the scale effects on the surface would call for an efficient allocation of small units, whereas an oil field is large. So again you have this fundamental asymmetry which you do not have under public land, which tends to be held in much broader tracts. All these details really start to matter.

Well, in the Pennsylvania case the legislature intervened. We're not quite sure why. But what they said was that all the support rights that were alienated by grant from the surface owners to the sub-surface owners in 1880 now belonged to the surface owners again. They just passed a statute called the Kohler Act which did exactly that. And the question that came before the United States Supreme Court was whether or not this thing was a taking without just compensation. And the argument that, I think, in the end is correct, is really very simple.

You find that you have a bargaining defect that prevents you from reaching an equilibrium price and allocating that price across all the surface owners. But the one price that you're confident would never be the appropriate price at which the sale would take place is, of course, zero. What the state did was to say, "We can't get a voluntary exchange so we need to coerce an exchange," and then mandated one half of the exchange – the support estate going from the mineral owners back to the surface owners – but somehow forgot to complete the deal by saying that something ought to come from the surface owners back to the mineral owners.

If there is no just compensation, then you do have some kind of injustice because at this point, the mineral owners have to adopt more expensive modes of production but they have received nothing in return for the concessions they have made, whereas every contract is normally meant to benefit both sides. By virtue of the zero price the contract has all its benefits moving in one direction. So the case went to the Supreme Court, which had to decide whether or not there had been a taking that required compensation under the American constitution. Let me tell you, since it is short, what our takings clause says and you can then see what the obvious extensions will be to the South African context. It says, "Nor shall private property be taken for public use without just compensation". That is the whole thing. Your property clause, of course, is rather longer and more convoluted.

Well, the first question one wants to ask is whether or not the support estate is a property right. To some extent the question is almost one of self-definition. If you call the thing an "estate", that's a technical, legal term for some kind of an interest in land. So the answer is yes, it has to be a property right. Well then, was the thing taken? Well, I think the answer to that question also has to be yes. This estate started out in the hands of the mineral owners and ended up in the hands of the surface owners, so how could one say that the thing had not been transferred? Then the question is, has just compensation been supplied? The answer is that since nothing has been paid and the right has some value, compensation has not been forthcoming.

That leaves only one other question under the American takings law. This is whether or not the taking was justified under the police power. That is a term of ours that started with the sense that the police are allowed to do things to preserve law and order which, to some extent, violate ordinary property rights. They can enter your home with a warrant, for example, to conduct a search and seizure, even though property normally gives you the right to exclude. In this case, we have to ask whether there is some self-help and safety justification which allows the state to regulate. Justice Holmes did consider it very much, but when the identical issue arose with bituminous coal in 1987, in a case called *Keystone vs Benedictus*, the police power issues were thought to be paramount and the health and safety of the surface owners was regarded as a sufficient justification for transferring the interest back to them without compensation. Now, that is just plain wrong as a matter of legal theory, and it is important that one understands why.

In the Pennsylvania case there was an assumption of risk of harm. But to say that the harm has been visited upon another individual is to ignore the fact that he has been paid for it in advance. So if you look at the transaction as a whole, you have to find out whether there is harm in a transaction when people have decided that it was in their interest to enter into it. Somebody will say, “But you know, it really did turn out very badly for me as I am worse off because this thing fell down than I would have been if I had never entered into the deal at all”. To which the answer is, “Look, what you should have done when you got the consideration from us for the support estate is take some fraction of it to buy insurance. The insurance would have protected you against the adverse contingency and the rest of the payment would be profit. In fact, if you could not afford to buy that insurance, you should not have entered into this transaction to begin with”.

What, then, is the police power about? Suppose the dangers that are posed by the mining of the coal do not come from the people who gave you the grant but rather from people who owned land nearby and that land fell in or was flooded or in some sense inconvenienced you. Under those circumstances, the clear logic of consent no longer applies and what you have is a tortive nuisance which is committed by a sub-surface owner with respect to a neighbour. And there is no reason why that ought not to be actionable under the normal principles which say, “You can’t spill your slag and silt on the property of a neighbour in order to increase the efficiency of your own operation”.

So the police power, rightly understood, provides a means for the government to give protection, in advance, to neighbours who cannot organise to prevent bad things from happening to them. This is extremely important, for example, if you are mining coal and the risk that you are worried about is the escape of pollution into the atmosphere which might cause damage to other people. Anti-pollution mechanisms would fall within the scope of the police power.

So when Justice Holmes got this case, it should have been a relatively easy decision. But what he did was to muddle up American takings law forever. Instead of treating the support interest as a separate estate, saying that it had been taken from one party to another, and putting the state to the test of determining the compensation, what he said was, “This is not a taking because it does not involve the entire interest”. So instead of treating it as the transfer of an estate from one party to another, he treated it as a “mere regulation”. What then became the great question under American constitutional law was, “What regulations count as takings for which compensation is owing and what regulations do not count as takings?” Now, one explanation is that all

regulations count as takings unless they're justified by the police power. But given what I have said about consent, you cannot make that argument here. And Justice Holmes in 1923 did not try. Instead, what he did was to engage himself in the single largest cop-out associated with the takings law. He said, "A regulation is a taking when it has gone too far". Those are the words that he used – "if it goes too far".

Well, if you do not even know where you are starting or ending this journey, you do not know what "too far" is going to be. And again Justice Holmes got it dead wrong since he did not know anything about mineral rights, when he said, "It went too far because the pillars of coal that you had to leave in the ground to support the surface were, in fact, taken by the government because those pillars could not be used for the only purpose for which they were appropriate – for mining". He did not understand the mining business. I think all of you would instantly understand that it is just the wrong way to think about this thing. The right way to think about this is that before the imposition of the regulation in question, you had degrees of freedom which allowed you to wreck the surface if you so chose. Now there are constraints that are imposed upon you. The correct measure of damage is not the value of the coal *in situ* which you are not allowed to take. The correct measure is, "What is the value of the mining enterprise that you had with the freedom and flexibility that were granted to you without support rights, and now, what is the value of the mining enterprise to you when you have to leave some of the coal in place?" And it could easily be that the two measures of damages are completely different. It might be that the coal in place is of relatively trivial value. But having to leave these pillars means that operations are very expensive so that Justice Holmes systematically understated the amount of damage. In other words, he was prepared to grant compensation but mis-stated the nature of the injury and, in effect, did not understand that any regulation that crimps the way in which operations take place on particular land should count as a taking if other people have consented to the risk.

But, in fact, once you do that, there is another American takings case which is exactly parallel to it. This is the "Euclid Case", which says, in effect, "If you restrict the use that a land owner can make of the surface, that is not a taking unless you wipe him out". So now, if you move, as I suggested you do, from the crazy analysis which says that the taking is the coal that remains *in situ*, to the taking being the limitation on the use, it turns out that American law has the following fixation: if there is a particular thing that is taken, that is going to be compensible, but if the *use* of a thing is restricted, it may well be non-compensible. So, when you understand the case correctly as being about not columns but rather utilisation, you may have moved yourself from the compensible to the non-compensible side of the line.

Academically and intellectually there is only one right answer, which is the one that I gave you. Since property is use, its possession, and its disposition, if we know what the bundle of rights was before the regulation and we see its diminution after the regulation, then it is that diminution which constitutes the taking, and just compensation has to be the amount of money which makes you indifferent before and after the taking. And if you think about it, that is exactly the way the private bargain would have taken place between these two parties. What would have happened is that the surface owners, if they had no transactional difficulties, would have come back to the mines and said, "In order for us to make this deal worthwhile to you, we have to compensate you $1 million because that is what it is going to do to your operation. But on the other hand, it is

worth $1 200 000 to us to get the greatest security possible for our ever-more-valuable homes". Now, that is not exactly the way the bargaining would go because there would probably be some division of the surplus. It might be $1 100 000 instead of $1 million. But what the just compensation clause allows the government to do is to give these guys what they lost and to take away from them the opportunity to extract a gain from somebody else in these bilateral negotiations.

But that is still completely different to what Justice Holmes said. Here you have a man who does not understand mining rights particularly well, does not understand property interest, does not understand business and has a little bit of sense about jurisprudence, and he writes a decision which has got some of it right and most of it wrong, and for the next 80 years the Takings Law has had to deal with the following puzzle: If I stick a machine on your land, that is an invasion of your space and I have to pay you something to do it, even if it is a cable box. But if, on the other hand, I regulate the use value of your land and that costs you millions, that is a mere regulation that "has not gone too far" and I therefore do not have to compensate you at all. So there are many people who say, after looking at the subsequent developments of the takings law, that what Justice Holmes said about regulation means that he decided his case wrongly.

E. AN ENABLING ENVIRONMENT FOR A HIGH GROWTH ECONOMY

Mining in a market economy

The government has stated that it favours market-oriented policies as the best means of increasing the economic growth rate, uplifting the poor and dealing effectively with globalisation. Government policy is therefore consistent with the worldwide trend towards more open markets. One of the most valuable contributions this submission can make to the debate on mining is therefore to illustrate how a consistent market economy approach brings about increased economic growth and uplifts the entire population.

South Africa's economic freedom rating

South Africa is placed 47th out of 123 countries in the economic freedom ratings published in the *2001 Economic Freedom Report* published by the Economic Freedom Network. The 2001 Index of Economic Freedom published by The Heritage Foundation and the Wall Street Journal places South Africa 81st out of 155 countries analysed. Different factors and weightings are used in these two rating systems but both show that South Africa has some way to go to become a truly market-oriented country.

Economic freedom is characterised by personal choice, protection of private property, and freedom of exchange. Individuals have economic freedom when: (a) their property, acquired without the use of force, fraud, or theft is protected by physical invasion by others and (b) they are free to use, exchange, or give their property to another as long as their actions do not violate the identical rights of others.

The countries that are rated most economically free, such as Hong Kong, Singapore, New Zealand, United States, United Kingdom, Ireland, Australia, Canada, Luxembourg, Netherlands and Switzerland, show clearly that citizens benefit infinitely more from economic freedom than

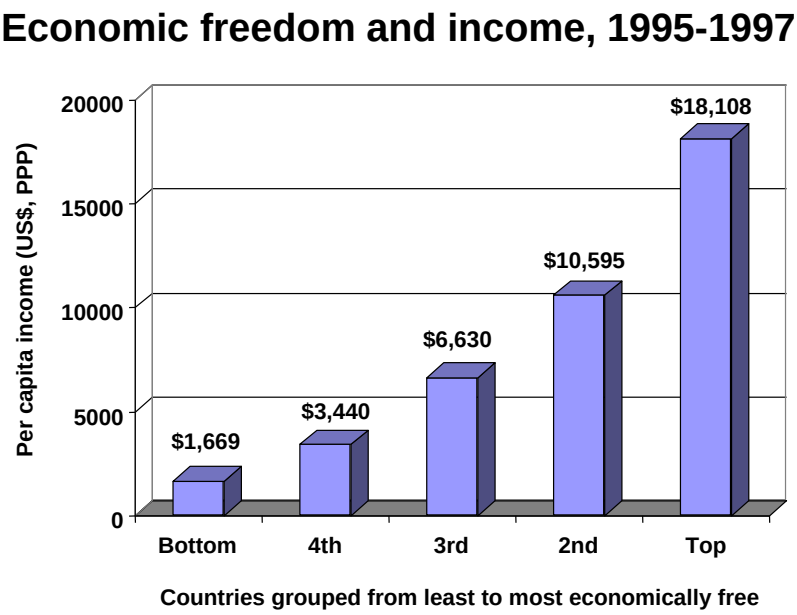
from pervasive government management of their economies. Ireland and New Zealand demonstrated, for example, that liberalisation of their economies very quickly resulted in higher economic growth rates. We provide brief evidence of the advantages of economic freedom to support our view that the global trend towards economic liberalisation should guide policymakers in all decisions affecting the economy – including decisions on policy towards mining and mineral rights.

The countries with most economic freedom have the highest growth rates

We provide evidence that countries that have the greatest economic freedom have the highest growth rates and the highest per capita incomes (see Exhibit 1). In addition, the freest countries perform best on other indicators of human welfare such as food production per hectare, life expectancy and literacy, whilst income inequality is lower in the freest countries than in most other countries.

The annual publication *Economic Freedom of the World* rates countries according to their levels of economic freedom. Exhibit 2 shows that countries with greater economic freedom have higher per capita incomes than less free countries. Economic freedom and economic growth reflect similar patterns.

Exhibit 1



Economic freedom also has a positive relationship with other measures of human well-being. Exhibits 2 and 3 show the direct correlation between economic freedom and greater life expectancy as well as with lower levels of income inequality. These factors are very relevant to government policy decisions on every aspect of South African society.

Exhibit 2

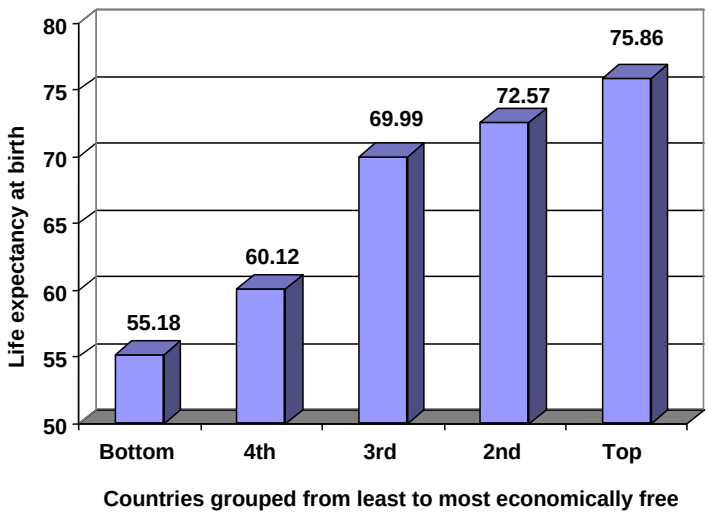
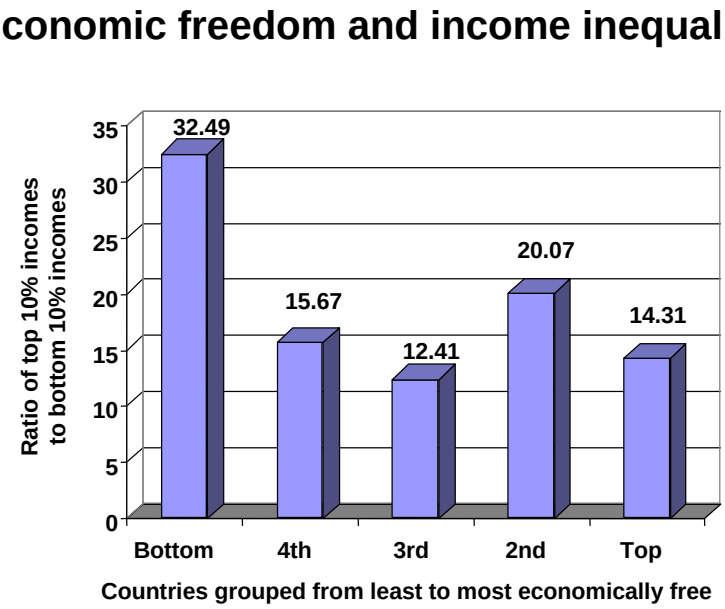


Exhibit 3



Unnecessary legislation increases costs and reduces economic growth

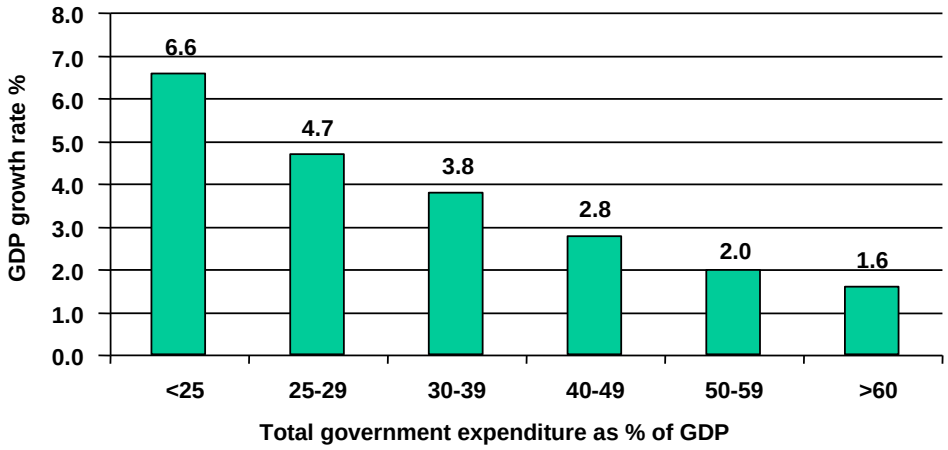
The departure point in this comment is that legislation should be avoided whenever possible due to the costs it imposes on taxpayers. The costs consist of the burden of compliance, losses through reduced efficiency, and the taxes to fund surveillance and policing. We provide evidence that countries that have lower government expenditure (at all levels of government) as a percentage of GDP have higher growth rates. We also show that there is a direct correlation between increases and reductions in government expenditure as a ratio of GDP and increases and declines in growth rates. Every piece of unnecessary legislation weighs down the economy, and the civil service and legislators should consequently take great care to use legislation as a last resort.

Government spending and economic growth

A 1998 study that was done for the Joint Economic Committee of the U.S. Congress showed that increased levels of government expenditure reduced economic growth. An economic analysis of the results of the OECD countries for the period 1960 to 1996 showed that countries with total government outlays (at all levels of government) of less than 25 percent of GDP averaged a GDP growth rate of 6.6 percent. As government expenditure rose, growth rates dropped sharply, so that countries spending between 30 percent and 40 percent of GDP averaged 3.8 percent growth. The inverse correlation between government spending and economic growth is very direct as can be seen from Exhibit 4.

Exhibit 4

A1998 study for USA's Joint Economic Committee of Congress by Gwartney, Lawson and Holcombe grouped 1960-1996 data for the 23 long-standing OECD member countries, which have many similarities. Government size varied between them and across time periods. Government size and growth are obviously related (inversely).



The study confirms our contention that government expenditure must be curtailed if we want higher economic growth in South Africa and one of the most important ways of doing so is to avoid unnecessary legislation and regulation.

Maintaining an entrepreneurial society

Our purpose in providing this information is to show that the less bureaucratic South Africa is, the better the economy will perform. The reason is that economic growth and investment are largely dependent on entrepreneurs who are the true engines of growth in any economy. Every hour that an entrepreneur has to spend on unnecessary legislation, regulation, and taxes, is an hour less spent on generating the increased productive activity that drives the economy. This is particularly true of activities that form the backbone of the economy, such as mining. Respect for property rights and the resultant efficient utilisation of property without hindrance in almost every facet of American life has, without doubt, been one of the most important factors in the rapid and sustained growth of the United States of America since its founding.

Governments do not create wealth but can facilitate or retard its creation

There is a strange and false view that governments "run" countries and are the generators of economic growth. It is true that government action has a major influence on economic growth, and unfortunately that influence is too often negative. Generally, if governments confine themselves mainly to their core functions, the economies of their countries flourish. However, if they impose excessive taxes or interfere unduly in commercial activities, they can bring their economies to a grinding halt. The most unfree countries in the world bear stark testimony to the damage governments, often unwittingly, can do to their people.

Government can very often do most by doing least

Considering a legal framework for the optimum functioning of mining and the economy in general is therefore a critical issue and the manner in which the government deals with it will affect the lives of South Africans for many years to come. Paradoxically, it is often the case that the best decision a government can make is to do nothing except ensure that its peace-keeping and judicial activities are properly performed. Mining appears to be an example of such a sector of the economy and we contend that the government should withdraw the draft Bill and continue to respect the property rights of the owners of minerals.

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