



Comment on the Precious Metals and Diamonds General Amendment Bill

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1. Introduction

- 1.1 This comment is submitted to the Department of Minerals and Energy by the Free Market Foundation of Southern Africa.
- 1.2 The Free Market Foundation of Southern Africa is an independent non-profit public policy research and educational organisation founded in 1975 to promote the principles of limited government, economic freedom, and individual liberty. It is financed by membership subscriptions and sponsorships.
- 1.3 The comment concentrates mainly on the economic implications of the proposed amendments, including the effects on future economic growth as well as the constitutional implications. Apart from commenting on the preamble to the Bill, which describes the purpose of the amendments to the legislation, it therefore concentrates on the proposed amendments to the Diamonds Act 56 of 1986, which will have the most far-reaching economic consequences.

2. Preamble to the Bill

The preamble to the Amendment Bill contains disturbing wording that is reminiscent of the national socialism practised by the apartheid government. The preamble states that the bill is intended to “ promote equitable access to, and local beneficiation of **the nation’s** precious metals and diamonds and to provide for matters connected therewith”. (emphasis added) The reality is that the “nation” does not own the precious metals and diamonds mined by privately owned mining companies – they do, and the government should lay claim to nothing more than income tax on the profits made by the mines.

3. Amendments to the Diamonds Act 56 of 1986:

3.1 Amendments to section 5 – The Constitution of the Board:

Although the original Diamonds Act and the establishment of the South African Diamond Board appeared to the observer to be a mechanism instituted by earlier governments as a means of exercising political control over the De Beers company, and retained in later years because of that company’s opposition to apartheid, an attempt was made to give it a semblance of legitimacy by pretending that the purpose was – section 4(a) to ‘ensure that the diamond resources of the Republic are exploited and developed in the best interests of the country; and 4(b) to promote the sound development of diamond undertakings in the Republic.

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South Africa's diamond producers are world leaders

Earlier governments knew full well that De Beers was not only developing the diamond industry to the great benefit of South Africans in all walks of life but had become the leading manager of worldwide trading in diamonds. It was this great company that had recognised that the owners of diamonds and the producers had a mutual interest in ensuring that diamonds would maintain their relative value. Cheap diamonds were in nobody's interests and the company succeeded brilliantly in ensuring that the price did not collapse through oversupply.

The apartheid government did not have benign intentions

Despite the great benefit to South Africa's people, the apartheid politicians certainly wished to exercise political control over the company's activities because in Mr Harry Oppenheimer and his colleagues they had formidable philosophical and intellectual opponents. They did not take kindly to calls for greater freedoms to be granted to black South Africans, such as the call by Mr Gavin Relly, then Chairman of the Anglo American Corporation, for the abolition of influx control. In a speech to a Free Market Foundation gathering in Cape Town on 30 August 1983 in which he described the detrimental consequences of influx control (the pass laws) for black South Africans and the economy in general, he said:

The crucial point is that the generation of incremental wealth by blacks, if it is to continue, is absolutely and necessarily dependent upon urbanisation. The inextricable link between economic growth and urbanisation can be demonstrated in the history of individual countries or by comparisons between different countries at the same time. It is also clear that agriculture as well as industry benefits from the process of urbanisation.

In the same speech Mr Relly said:

For my part I am quite satisfied that economic imperatives will be the main determinants of South Africa's future and acceptance of that fact represents the best point of departure at this stage in our history.

In other words, 'apartheid is doomed and you had better get used to that idea'. Naturally such statements were not well received by the apartheid government and when the local cutters and polishers complained that they were not getting enough of the better grade diamonds, the government had no hesitation in making the entire diamond mining industry a hostage of the struggling and fundamentally uncompetitive local diamond cutting and polishing industry. However, they also did not wish to do irreparable harm to diamond mining activities as they wished to extract as much as they could from the industry in taxes.

The structure maintained a semblance of respectability

The apartheid government did maintain the representation of diamond producers, dealers, cutters and jewellers on the Diamond Board giving the Board a semblance of industry representivity. The reason would probably have been twofold, first, to intimate that it was not intent on acting in an authoritarian or dictatorial manner, and second, to ensure that the Diamond Board would have access to expert knowledge of the diamond industry at all times. In other words, an attempt was made to give the appearance that the Diamond Act and the Board were created with benign intentions whereas it was clear that they were intended to hamper the activities of the diamond producers. If the real intention of earlier governments had been to assist diamond cutters and polishers it could simply have given them tax exemptions or some other form of direct assistance. There was absolutely no reason to establish an elaborate and costly structure and hold the whole diamond industry to ransom merely to aid the relatively few people engaged in the South African cutting and polishing industry at the time.

The Diamonds Act and Board were not economically justified

In our oral and written evidence to the Commission of Enquiry into the South African diamond industry in October 1997 the Foundation submitted that the Diamonds Act, 1986 (Act No 56 of 1986), should be repealed. We have not changed our view. The Act did not have a benign intent, was not the most efficient way to assist polishers and cutters, and had detrimental economic consequences for the diamond industry and the country.

Removing industry representatives provides reason for concern

The proposed amendment to the Act seeks to remove all industry representatives from the Diamond Board eliminating even the semblance of co-operation between government and the diamond industry. Possibly the Minister will appoint knowledgeable members to the Board in terms of the powers granted in section 5(m), able to speak out on behalf of producers, jewellers, cutters and polishers and their employees but the industry cannot be sure that this will occur. The possibility therefore exists of having a Diamond Board without a single representative of the industry appointed to it, a most unhealthy prospect. To any impartial observer the proposed amendment raises the prospect of the exercise of authoritarian and dictatorial control over the diamond industry by a Board consisting entirely of government officials, some of whom may have no knowledge of the diamond industry. This may not be the intention but it certainly appears to be a possibility.

Why maintain this stranglehold on the SA diamond industry?

There appears to be no good reason to maintain a regulatory stranglehold on one of South Africa's oldest and greatest industries. De Beers, the largest producer, has played a critical role in the worldwide development of the diamond industry. Because of this company, diamonds remain a sought-after commodity and South Africa and its people have benefited greatly from its activities. Past governments, and specifically the apartheid government, chose to impose unnecessary burdens on the industry for political reasons but there appears to be no good reason why our current democratic government should continue with what amounts to a form of persecution.

If the diamond industry is set free to operate in the same way as all other industries, it will function more efficiently than it does now, it will sell more diamonds from South Africa, earn more foreign exchange, be able to employ more workers, earn higher profits, and pay more taxes. In a more conducive environment it will probably also invest more. These predictions can be made with confidence because the industry is now being unduly hampered with no apparent benefit to the industry or the economy.

The Diamond Board should be abolished. It hampers the activities of diamond producers, reduces the functioning, efficiency and growth of the industry, and imposes an unnecessary cost on taxpayers and the industry.

3.2 Constitutional and international treaty considerations

(Amended section 62(2) together with the deletion of sections 63 (a) (i), (ii) and (iii) – Constitutional implications of the legislated obligation upon producers to sell diamonds to local firms or face the proposed tax on exports of diamonds)

The supremacy of the Constitution and the Rule of Law

Chapter 1 of the Constitution of the Republic of South Africa sets out the Founding Provisions, which are its cornerstones. The Founding Statement declares that one of the values upon which the Republic of South Africa is founded is 'Supremacy of the Constitution and the rule of law.'

The rule of law therefore carries a great deal of weight, not only in the functioning of the legal system, but also in the requirement that legislation should conform to its fundamental principles. This view differs from the widespread misconception that compliance with the rule of law merely requires that the laws upon the statute books should be respected and enforced.

Some of the most important attributes of the rule of law are:

- (a) Nobel Laureate Friedrich von Hayek described this requirement: ‘The general, abstract rules, which are laws in the substantive sense, are...essentially long-term measures, referring to yet unknown cases and containing no references to particular persons, places, or objects. Such laws must always be prospective, never retrospective, in their effect.’
- (b) The rule of law is a rule regarding what the law ought to be.
- (c) The rule of law restricts government only in its coercive activities.
- (d) The laws must be known and certain.
- (e) The laws must be equally applicable to all, including those who govern.
- (f) There must be a separation of powers between the legislature, the executive and the judiciary.
- (g) Administrative discretion must be limited.
- (h) The powers of the administration must be circumscribed.

The above is not a thorough discussion of the nature of the rule of law and is merely intended to indicate that there is a great deal more to the concept than is generally recognised. If the rule of law were to be strictly applied to the Diamonds Act and the current proposed amendments to the Act we would find that they do not meet its requirements in the following respects:

- (i) The Diamonds Act and the proposed amendments are too specific, attempt to achieve particular outcomes, do not treat the various interested parties equally, and do not deal with diamond producers in the same way as the law deals with other mineral producers.
- (j) The law creates great uncertainty.
- (k) The legislation is coercive in its nature.
- (l) Provision is made for excessive discretionary power in the hands of officials.

The offending sections of the Diamonds Act should be removed in order to comply with the Rule of Law as required by the Constitution.

The Bill of Rights

Section 7(1) of Chapter 2 of the Constitution, which contains the Bill of Rights, states that it is ‘a cornerstone of democracy in South Africa. It enshrines the rights of all people in our country and affirms the democratic values of human dignity, equality and freedom.’

The following further sections are particularly pertinent to a discussion of the rights of citizens:

Section 9 (1) ‘Everyone is equal before the law and has the right to equal protection and benefit of the law.’

Section 9(2) ‘Equality includes the full and equal enjoyment of all rights and freedoms.’

The above sections of the Bill of Rights repeat and confirm statements contained in the Preamble and Founding Provisions of the Constitution. Government cannot avoid applying the principles described in these sections in reviewing the constitutional rights of all the country’s people to fair treatment under the law.

Section 9(3) ‘The state may not unfairly discriminate directly or indirectly against anyone on one or more grounds, ...’

Unfair discrimination is usually thought of in relation to the issues specifically mentioned in the Constitution, such as race, gender, sex etc but there may be unfair discrimination against a group of people on other grounds, such as treating them differently to others, instructing them in fine detail how they may deal with their products or imposing a special tax on them that is not imposed on anyone else.

It may appear unusual to raise the question of unfair discrimination in relation to the manner in which very large companies are being treated but in this case it is necessary. Previous South African governments could get away with unfairly discriminating against the diamond companies because the country then had Constitutions that placed no real constitutional constraints on government actions, allowing the ruling parties to do exactly as they pleased, with apartheid and its massive web of laws being the consequence. That situation no longer exists. Our Constitution does not allow our democratic government to act in the authoritarian, autocratic and discriminatory manner that characterised the actions of the apartheid government.

Forcing diamond producers to sell their products to a particular category of buyer, a requirement that is not imposed on any other South African producer, and imposing an export tax on diamonds, a tax that is not imposed on any other mineral producer, is discriminatory and therefore unconstitutional. The Bill of Rights stipulates that there shall be no discrimination and the discriminatory aspects of the Diamonds Act should therefore be repealed. The rights of members of the diamond industry cannot justifiably be limited in terms of section 36 of the Constitution and the offending provisions of the Diamonds Act therefore appear to be unconstitutional.

Unconstitutional discriminatory legislation remains in many South African statutes and government should appoint a special task team to remove it and should not wait for such legislation to be challenged in, and struck down by, the Constitutional Court. In preparing legislation such as that contained in the proposed amendments to the Diamonds Act, government officials reveal a disturbing lack of respect for the Bill of Rights and the rule of law, which form crucial aspects of the protection of South Africa’s citizens enshrined in our democratic constitution. All new legislation should be critically examined to ensure that it meets all the requirements of the Constitution. The discriminatory aspects of the amendments to the Act should therefore be reconsidered.

The export duty imposed by section 62(2)

The punitive export duty of 15% that was previously imposed was introduced in order to compel diamond producers to offer all the diamonds they produced to local cutters or polishers, unless exempted. The producers could therefore entirely avoid paying duty by complying with section 63 of the Act. The export duty was therefore discriminatory but avoidable.

In terms of the proposed amendments, deleting sections 63(a)(i), (ii) and (iii), the duty is no longer intended as a mechanism to compel compliance but becomes an outright additional tax on part of the production of the diamond industry. The reason is that local beneficiation cannot possibly absorb all the diamonds produced in South Africa. This proposed tax therefore appears to offend in several respects:

- It is contrary to the Rule of Law in that it is not equally applicable to all South African exporters.
- It is contrary to the Bill of Rights because it discriminates unfairly against diamond producers
- As section 62(2) now becomes an unavoidable outright tax on exports it becomes a money bill, which is the exclusive responsibility of the Ministry of Finance.
- It appears to contravene the rules of the World Trade Organisation.
- It appears to be in conflict with the recently-signed Agreement on Trade Development and Co-operation between the Republic of South Africa and the European Union.

It is not only the proposed amendments to the Diamonds Act that need to be reviewed but the Act itself. Section 59 needs to be reviewed because it is probably unconstitutional and section 62 needs to be reviewed because it is probably both unconstitutional and in contravention of international treaties.

3.3 Economic considerations

3.3.1 South Africa's economic freedom rating

Comparison of the economic results of free and unfree economies shows very clearly that the free economies have higher economic growth, higher per capita incomes, and greater life expectancy than unfree economies. The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of persons and property. Governments promote economic freedom when they provide a legal structure and law-enforcement system that protects property rights of owners and enforces contracts even-handedly. Governments should therefore refrain from actions that interfere with personal choice, voluntary exchange and the freedom to compete in labour and product markets.

If the government of South Africa wishes to improve conditions for the poorest of the poor in our country it must heed the results of the comparative research that has been carried out on 30 years of data for more than 120 countries, including all the major economies of the world. The evidence is incontrovertible and cannot be ignored. South Africa has gained in economic freedom over the last ten years from improved protection of intellectual property, better control over the money supply and inflation, reducing the mean tariff rate, reducing the variability of tariffs, reducing regulatory trade barriers, increasing the size of the trade sector, and increasing access to foreign capital, but has lost economic freedom in the area of regulation of business, especially that relating to labour and increased bureaucracy. Overall South Africa improved its level of economic freedom by approximately 10% since 1994. These are not mere theories, they are backed by hard data and results. Our economy has been growing because South Africans are freer than they were in 1994 but this will continue only if we keep moving in the right direction.

The proposed unavoidable export duty is a move in the wrong direction from an economic freedom perspective. It will have a negative impact on our economic freedom rating, making South Africa a less desirable destination for international investment. However, if the export duty were to be abolished as recommended by the Greeff Commission in 1973, our economic freedom rating in the area of international trade would improve. The implications are consequently far wider than the extraction of additional tax from the diamond industry. South Africa is being watched and measured from an economic freedom point of view and from the point of view of its desirability as an investment destination, as are all other countries, and the policies that are adopted are therefore of crucial importance. Every step backwards has a detrimental effect on South Africa's population, in less economic growth

resulting from the backward step itself but also because of reduced growth due to less foreign investment. This is not merely a matter affecting the diamond mining industry, it can be detrimental to the whole economy.

3.3.2 Effect on the workers in the diamond industry

Workers in a firm, from top to bottom, form a team that competes, firstly, to sell the firm's products to consumers, secondly, to attract capital resources with which to conduct their business, thirdly, to attract workers to their firm that will add the greatest value, and finally, to out-compete all others in their particular industry. So anything damaging to the firm is not detrimental only to the shareholders but to all its workers. The National Union of Mine Workers (NUMSA) is therefore correct to be concerned that the workers in the diamond mining industry will be detrimentally affected by the export duty. They will lose either existing jobs or potential future jobs if this amendment is adopted. Government cannot take resources away from a firm without detrimentally affecting the workers in that firm. The detrimental effects may not be immediately and clearly visible but they occur nonetheless.

3.3.3 Benefiting one group at the expense of another

It is not government's proper function to benefit the 'beneficiation team' at the expense of the 'diamond mining team'. If diamond beneficiation can add value to the South African economy then the 'beneficiation team' must buy its diamonds on the open market and compete with all comers on the world market. It will then add to South Africa's GDP. If it cannot compete in this way, and has to be subsidised by the 'diamond mining team' it is consuming resources, which is detrimental to both the subsidising firm and to economic growth. The 'diamond mining teams' should calculate how much has been lost in potential profit due to the existence of sections 59 and 62 of the Diamonds Act, and the compliance costs imposed by the Act, and determine how much better off the members of the team would be in the absence of the legislation. This may bring home to government the serious consequences of this type of intervention. In many cases the cost far outweighs the benefits to the intended beneficiaries. The Department of Minerals and Energy could determine these costs and benefits to the economy in general by carrying out a detailed cost benefit analysis.

3.3.4 Maintaining an entrepreneurial society

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 life has, without doubt, been one of the most important factors in the rapid and sustained growth and high per capita incomes of countries like Hong Kong, Singapore, the United States of America, New Zealand, UK, Canada, Australia, Ireland and Switzerland, which are currently the most economically free countries. Critics sometimes say that there is no such thing as a totally free economy. That is unfortunately true, but what is also true is that the countries that are freest grow faster, are wealthier, and provide their citizens with the greatest human welfare benefits.

3.3.5 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.

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 a sector of the economy that would function better if there was less intervention in its activities.

4. Conclusion

We propose that the government should withdraw the sections of the draft Bill relating to the Diamonds Act and seriously review the costs and benefits of every aspect of the Diamonds Act (No 56 of 1986) with a view to repealing those measures that are unconstitutional and those that have negative economic consequences for the diamond mining industry and the economy of South Africa.

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