South Africa: The African bull saddled in enigma

South Africa is undergoing rapid economic reform

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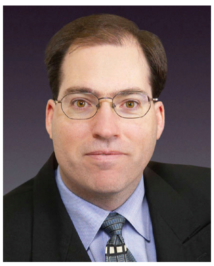

It is difficult to compare South Africa to other countries. Perhaps Russia is the best analogy. Like Russia, South Africa has witnessed the recent rise of a handful of powerful oligarchs resulting from black economic empowerment (BEE) transactions. Like Russia, the state has exercised significant influence in creating such oligarchs. And, like Russia, these oligarchs have played a major role in state decision-making processes, including foreign investments.

The analogy to Russia is also appropriate in light of the importance of natural resources to the local economy and the considerable interest of the country—as the regional military and economic powerhouse—in its neighbouring countries, particularly the SADC region. For example, South Africa accounts for nearly 45 per cent of all mineral production, over half of all electricity production, and nearly 40 per cent of all industrial output within Africa.

Like Moscow, the economic importance of Johannesburg, South Africa's economic capital, has only grown in recent years. Since 1994 and the removal of the former South African government's apartheid policies, Johannesburg has been reasserting itself as the New York of Africa in terms of capital, trade, and skilled labour, a status it lost in the last two decades when London and Paris virtually monopolized the flow of foreign capital coming to rest within the African continent.

The risk and complexity of doing business in South Africa is also analogous to Russia, although the precise risks are somewhat different, except for risks relating to personal security. Principal among the financial and transactional risks are the volatility of the local currency (the rand), the impact of South African Reserve Bank (SARB), and the pace and nature of recent legislative reform.

Legislative reform has been largely aimed at fiscal and anti-discriminatory measures. A new mining law and "mining charter" have been passed, which require mining companies to convert their existing mining rights into "new order" rights and, in the process, table their plans for vesting up to 26 per cent of their interests in BEE hands. For the most part, these legislative initiatives have been met with acceptance within South Africa; outside of South Africa, many foreign investors cringe at the BEE requirements, which complicate and threaten the control over and value of their investments. Further legislative initiatives linger over the horizon, such as the Mineral and Petroleum Royalty Bill, which would impose new royalties on mineral production ranging from 3 per cent for gold to 8 per cent for diamonds.

SARB's policies play a major role in structuring transactions. Of particular note is the general restriction on the holding of foreign (e.g. Canadian company) stock by a South African resident. Thus, a simple share exchange takeover bid of a JSE-listed company by a TSX-listed company is made complicated by the fact that were such a transaction to be completed without special SARB dispensation, the South African shareholders would be forced to sell their stock almost immediately and repatriate the proceeds.

Statistics support the view that South Africa will continue to attract enormous capital from foreign investors. The country's future is built on the knowledge that it hosts nearly half of the world's reserves of gold, PGMs, and vanadium and has the vast majority of the world's chromium and manganese reserves. It is not surprising therefore that many Canadian firms supporting the mining industry have followed their clients, such as SNC-Lavalin, Hatch, and Fasken Martineau DuMoulin LLP, by establishing offices in Johannesburg to better serve the minerals industry. ■