

# Facing an uncertain future: Government intervention threatens the global mining sector

## Mining hot topic report: government intervention

The mining sector faces an uncertain future. Increasing and unpredictable government intervention across the globe is adding further complexity to a sector that is already heavily laden with risk.

The shadow of higher taxes, restrictive regulation and indigenisation looms large over an industry already grappling with the risks normally associated with exploration and extraction.

From a likely windfall levy in Peru, through to potential mine nationalisation in South Africa, a wide variety of government interventions pose a real threat to commodity prices, corporate valuations and, most critically, investment in the global mining sector. For the most part, interventions are motivated by financial and political pressures.

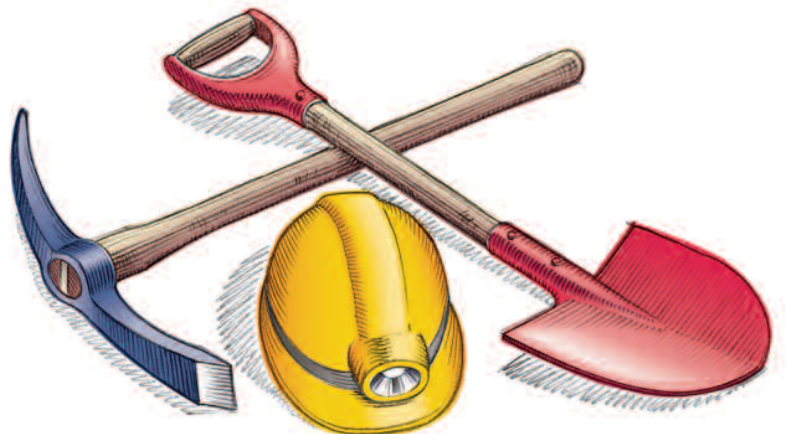
Governments looking to increase revenue – whether to fund developing or indebted economies, recover from the financial crisis or simply to top up the coffers – are targeting what they see as a thriving, profitable income source. With global demand creating high commodity prices<sup>1</sup>, government taxes, royalties and other sector-targeted revenue-boosting measures are on the rise, particularly in Asia.

On the political front, governments are responding to growing pressure from environmental interest groups and the public. In the face of devastating incidents, like the BP oil spill in the Gulf of Mexico and the dramatic miners' rescue at the Copiapo mine in Chile, governments have

Government intervention includes direct and indirect taxes, royalty arrangements, nationalisation and economic empowerment policies, as well as regulatory compliance with environmental and other government standards and business criteria.

increased environmental legislation with numerous regulatory frameworks in development around the world.

Similarly, the growing calls for nationalisation and indigenisation of mining assets and resources threaten the very existence of some mining companies. Organisations that have 'jumped ship' from their home tax jurisdiction looking for a more relaxed set of rules must now contend with an uncertain future, particularly in Africa.



<sup>1</sup> Bloomberg. Accessed at <http://www.bloomberg.com/markets/commodities/futures/> on 16 June 2011.

In short, government interventions are:

- raising sector uncertainty and complexity to acute levels, complicating decision making and heightening risks
- increasing risk for investors, clouding corporate valuations, making it harder to raise capital; and
- affecting project viability by reducing supply, disrupting demand and limiting overall profitability.

Without clarity over the type and extent of government interventions, the development of the sector is in danger of stagnating, ultimately threatening global economic growth.

The three key intervention areas are:

1. taxation
2. nationalisation/indigenisation
3. environment.

Below we describe them in more detail and provide examples of each across the world. We also suggest measures that companies and governments can take to improve these areas.

# Taxation: when the ‘take’ doesn’t have much give

The tremendous profits being made in the commodities markets are attracting significant attention from governments developing their economies or looking to reduce deficits created by the global recession. Even governments that weathered the storm relatively well are seeing mining corporates as a lucrative source of revenue. This is, however, a short-sighted, potentially harmful assumption.

Several factors make the spectre of increased taxation an ominous one. At an operational level, the costs of meeting current booming demand will be further increased by taxation. While taxation demands may raise immediate government revenue, it will also reduce overall mining profitability.

From the investor’s perspective, interest is likely to diminish in proportion to the level of taxation, levies, royalties and other costs. The threat of additional taxation will lower company valuations and increase investor risk, making investment in jurisdictions with onerous tax burdens unappealing. At worst, companies and investors may reach a tipping point, where they see taxes reducing their potential returns to the point that they may simply walk away and search for more competitive jurisdictions.

As a simple measure the **tipping point** can be reasonably estimated as the point where the government’s aggregate ‘take’ – corporate taxes, sales taxes, payroll taxes, royalties and special costs associated with doing business in a particular jurisdiction – exceeds 50% of profits.

## Around the globe

### Australia



Mining companies operating in Australia are experiencing uncertainty due to the introduction of new federal taxes designed to replace existing state-based royalty schemes. BHP and Rio Tinto have already publicly stated their reluctance to pay much more in tax or royalties and would consider moving operations to a nation such as Mozambique where taxation is lower.

The concept of resource rent taxation is being explored in many countries on the basis that it is a more efficient cash flow based tax, compared to royalty regimes which charge royalties on the gross value of extractions.

Taxation can also disrupt demand, with customers stating that they will not tolerate new layers of taxation. China's Iron and Steel Association chief recently said that Chinese steelmakers will not be able to accept rising costs from the Australian iron ore mining tax, as steel prices will reach a ceiling and downstream users, including automakers and producers of home appliances, will not absorb rising costs.

#### Canada



With each province taxing mining companies at different rates, national competition is strong.

Quebec recently announced CA\$10bn of investment in exploration, making it one of the most attractive mining jurisdictions in the world. The Fraser Institute's annual Survey of Mining Companies ranked Alberta, Quebec, Saskatchewan and Manitoba in the world's top 10 most attractive mining regions<sup>2</sup>.

#### Africa

Industry analyst Thomas Wilson predicts more governments in Africa and elsewhere, especially newly-elected ones, will look at raising mining taxes and royalties amid historically high commodity prices<sup>3</sup>. For example, the price of iron ore has risen from US\$80/Metric Tonne in 2009 to US\$178.7/Metric Tonne in Q1 2011. (International Monetary Fund). In some countries, such as Tanzania, the IMF has actually advised governments to tax mining operations to meet their spending commitments. This summer the country's National Assembly will debate proposals for a super-profit tax on mining as part of the country's five-year development plan.

#### Peru



Throughout the campaign for Peru's recent presidential elections, both the main political parties campaigned on promises to tax mining companies. Though President-elect, Ollanta Humala, pledged to levy a windfall tax on mining operations, he now says he will negotiate rather than impose an unilateral levy<sup>4</sup>.

# Nationalisation and indigenisation: changing the state of play

**Nationalisation:** where the state takes control of some or all of a country's mining assets.

**Indigenisation:** where the people or native populations are ceded control.

Nationalisation, the takeover of a private company's assets or operations by the state, and indigenisation, increasing local participation in or ownership of company assets, are forms of government intervention related in scope but with varying implications and perceptions. In extreme cases of nationalisation or indigenisation, third-party investor interest could be wiped out. Even if measures don't ultimately come to pass, interest will be highly limited as long as uncertainty remains.

#### Around the globe

##### South Africa



Nationalisation is arguably the number one issue affecting the mining industry in South Africa, a move which will be causing concern among investors. With the ruling African National Congress party debating state participation, analysts agree that reform of some sort is needed, but most argue that full-blown nationalisation will be detrimental.

<sup>2</sup>Fred McMahon and Miguel Cervantes. Fraser Institute Annual Survey of Mining Companies. P. 10. Accessed at [http://www.fraserinstitute.org/uploaded\\_files/fraser-ca/Content/research-news/research/publications/mining-survey-2010-2011.pdf](http://www.fraserinstitute.org/uploaded_files/fraser-ca/Content/research-news/research/publications/mining-survey-2010-2011.pdf) on 16 June 2011.

<sup>3</sup>Mining Weekly, 10 June 2011. More mining tax, royalty hikes 'inevitable' – Control Risks, by Liezel Hill. Accessed at <http://www.miningweekly.com/article/more-mining-tax-hikes-inevitable-control-risks-2011-06-10> on 16 June 2011.

<sup>4</sup>Reuters. Humala seeks to reassure Peru mining companies on tax. Accessed at <http://www.reuters.com/article/2011/06/08/us-peru-election-idUSTRE75702520110608> on 16 June 2011.

## Namibia and Zimbabwe



Indigenisation is in the spotlight in Namibia and

Zimbabwe. In the latter, proposals include the disposal of 51% of the shares in mining companies to indigenous Zimbabweans, which will apply to all companies with a net asset value of more than US\$1.

## Venezuela



In Venezuela, falling oil prices combined with poor fiscal management and rising gold prices

have switched the government's attention to the gold industry. In recent years, restrictions on exports and foreign exchange controls, as well as increased government participation through its own mining operations and joint ventures, have become more prevalent.

# Environmental legislation: fine tuning the green machine

Recent years have seen a number of environmental disasters involving big business, of which BP's Gulf of Mexico oil spill in 2010 was the most high profile. But while environmental events are an inevitable component of industrialisation, media and social media now put images, opinions and blame in the public arena seconds after the incident. The stream of stories is continuous, providing interest groups with the ammunition they need to mobilise the public. Governments around the world remain acutely aware that the green agenda is increasingly important, and that tightly legislating the mining sector is a political necessity as well as an ethical imperative. Though global governments are working to achieve common regulatory ground, the current global landscape remains diverse.

## Around the globe

### Australia



The Australian Association of Mining and Exploration Companies (AMEC) says that areas recently defined by the Queensland government as Strategic Cropping Land Protection Areas are so vast the policy will potentially cause "major impediments" to the future of regional mining<sup>5</sup>. In addition miners in Australia are grappling with the proposed carbon taxation and how that will affect operations.

### South Africa



In its recently released Diagnostics Overview<sup>6</sup> document, the South African Government commits to

ensuring that "natural wealth is harnessed sustainably, in a way that protects our environment, using science and modern technology to ensure a growing economy that benefits all."

### Germany



Germany's decision to close all nuclear power plants over the next ten years is at least partly driven by

the incumbent government's need of the Green Party's support to stay in power.

### Canada



Canada operates a two-step approval system, where

environmental plans must be given approval at a provincial level and then at a national level. A recent initiative to fall foul of the process was the Prosperity mine, which was denied environmental approval by the government having been granted it by the province. This has renewed complaints that the process is complex, time consuming and too political.

<sup>5</sup>Mining Weekly, 31 May 2011. Qld introduces policies to protect cropping land from mining, by Esmarie Swanepoel. Accessed at <http://www.miningweekly.com/article/qld-introduces-policies-to-protect-cropping-land-from-mining-2011-05-31> on 16 June 2011.

<sup>6</sup>National Planning Commission, Republic of South Africa. Diagnostic Overview. P. 4. Accessed at <http://www.npconline.co.za/MediaLib/Downloads/Home/Tabs/Diagnostic/Diagnostic%20Overview.pdf> on 16 June 2011.

# Corrective measures: keeping the mining sector strong

## **Governments**

- work to end policy and taxation uncertainty; create a stable legislative environment that enables operations, planning and investment within the mining sector
- recognise that short-term, excessive intervention stifles investment and exploration
- resist targeting mining as if it were a limitless taxation/revenue stream
- seek environmental protection without complication
- work to streamline the compliance process
- understand and appreciate the many positive aspects that mining can and does bring to your economy.

## **Mining corporates**

- ensure financial plans and strategies factor government interventions into multiple tax and environmental scenarios
- be willing to work with local, regional and national governments; help them understand your operations and the effect of interventions
- ensure that key risks are understood and articulated to investors. Consider your investors' tipping points carefully; when and where will their cost of doing business outweigh the profit or benefit?

# Interventionist policy mines a perilous vein

Government intervention – unchecked and independent of broader government and sector strategies – poses a real threat to mining. Augmenting revenue, reducing fiscal deficits and protecting the environment are clearly legitimate government endeavours. But the resulting instability and uncertainty of current policy-making endanger the mining sector's future development.

Moreover, though interventionist policies may successfully meet some governments' short-term fiscal requirements, they may ultimately hinder overall global financial recovery. This will distort the cost of commodities and capital and affect the viability of numerous international exploration and extraction projects.

For more information on government intervention in the global mining sector, or to learn what it could mean for your company, please contact:

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