**GOLDEN EGGS AND GEESE: An Industry Perspective on**

**What Constitutes a Rational Fiscal Regime for Mining.**

By

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Any plan by government to create a new fiscal regime for mining must begin with an appreciation of the peculiar characteristics of the extractive industry and the investor’s exposure to risk before and during actual mining operations.

The extractive industry has certain characteristics that distinguish it from other industries and justifymining contractors’ deep concern over recent tax proposals aired by government:

1. **Mining is inherently risky; a high number of investments yield no economic return because exploration is unsuccessful.** –Success rates in the extractive industry are very low, with all the infrastructure cost and financial risk assumed entirely by the investor. Out of 25,000 mining prospects, 500 will see some form of drilling or exploration, and of these 500, only one will go on to become a mine.[[1]](#footnote-2)

Despite government being the owner-in-trust of the minerals and a partner in the mining venture, a mining investor has no recourse to the latter for recovery of costs in case exploration fails to yield a feasible ore deposit. Moreover, even if a feasible deposit is found, it is still no guarantee that the same will be mined, given all thepermits and prior consents required.

1. **As a business, mining is notoriously volatile with regular boom-then-bust price cycles determined by factors beyond the miners’ control**. Investors face huge uncertainty about the economic outcomes of extractive industry investments, especially at the start of an exploration program. *The only factor mining companies can control is their cost of operation, and even then, only to a limited degree.*
2. **Exploration and mining companies operate over long time frames during which minerals are explored, developed, and extracted.** The gestation period for many larger scale investments commonly exceed10-15 years if a full exploration program needs to be undertaken. The *TampakanProject*, for instance, started exploration work in the 1990s; after spending over US$300 Million in exploration and community development, it has yet to reach project development stage. The *Far Southeast Project* exploration started in 1990 and is still in the feasibility study stage. The *Silangan Mindanao Project* started exploration in 2000 and is slated to start production only sometime in 2017. The *Didipio Project* started exploration in the mid-1990s and managed to start production only in January 2013.

The current global mining industry situation is not good. The prices of metals (gold, copper, and nickel) have been on the decline since 2011. Gold’s 20% drop in the last 12 months to a closing price of US$1,250.00/oz.in July brings it closer to the globalaverage production cost of about US$1,200 an ounce. If prices fall to that level, many smaller, non-producing companies will consider a temporary closure and even established miners will pull back on any new projects.

After 12 consecutive years of rising gold prices, the current downtrend has many institutional investors looking elsewhere to place their money—makingit very difficult for contractors to find financing for mining projects, especially those at the exploration stage. If metal prices continue to decline, coupled with the lingering policy uncertainties on tenement rights and taxation created by the Philippine government, international investors will continue to look to other more welcoming countries like Papua New Guinea, Myanmar, and Indonesia—*to the detriment of the hundreds of thousands of people and the communities that depend upon mining for their business and employment*.

The extremely high excise tax proposal *(set at 10% of the international market price x quantity)* is of great concern to the industry. As this tax is set on gross revenues and not profitability, it will penalize lower margin mines. In particular, it will diminish the ability of mining contractors to borrow funds or access financing simply because the chances of incurring financial distress are accelerated by the mechanics of this tax.

The proposed fiscal regime would also net the contractor an internal rate of return (IRR) that may be seen as *uncompetitive* by world standards, considering that mining companies incur huge exploration costs in determining the feasibility of mining projects. *A higher IRR for mining projects encourages mining companies to do more exploration work for the discovery of new minesand, more importantly, helps ensures responsible mining practices*.

To justify an increased tax based on gross output, government regulators have expressed the concern that mining contractors may not be reporting their true costs and contract prices and are thereby depriving government of its fair share in revenues. Whether the concern is real or not, government’s tax base approach is an overly simplistic solution that disregards equity/fair play for the sake of ease in administrative implementation. It also disregards international market practice that gives the smelters and the mining companies the option to choose from various international market prices for commodities.

If government’s objective is to raise its share in mining revenues, the proposed tax scheme may fail as it will discourage mining investors from even considering the country. Like the proverbial farmer with a goose laying golden eggs, government’s new tax plan for mining will kill the goose: there will be no new mining operations to tax.

If we are to develop a new tax regime that gives government a higher take and is competitive so that it attracts quality investments to the minerals sector, there must, first of all, be a realization that the current fiscal structure is not inequitable. A sober analysis of the current fiscal regime shows that large-scale mining companies give government a fair and equitable share in the profits from mining.

A recent study undertaken by the Chamber of Mines indicates that the total tax take of government translated to about 40% of a company’s income after deducting operating expenses but before income tax[[2]](#footnote-3)--a figure which varies and can go to as high as 100% when metals prices are severely depressed and the company reports a net loss.This is validated by the IMF Technical Assistance Report, which indicated that *“the low contribution of the mining sector to government revenue is not due to the Philippine fiscal regime for mining being generous to the contractors by international standards.”*[[3]](#footnote-4)

These facts, based on documented studies, should make policy-makers realize that a 10% tax based on gross revenues will be prohibitive and uncompetitive.

If the premise for the planned 10% excise tax is because this is what is currently being paid by mining companies, the premise is wrong. There are only a few nickel mines operating in mineral reservations and there are currently no copper or gold mines in mineral reservations. For mining operations outside a mineral reservation or ancestral domain, the government proposal would represent an increase of more than 300% the current rate *(2% excise tax plus 1% local business tax)*while for mines operating in ancestral domain areas, the proposal would represent an increase of 250%.

No other mining country in the world imposes such a high tax rate on metallic minerals. It will disadvantage any mine, even those highly profitable under average price scenarios, to pay such a high rate during periods when metal prices are low. Even the IMF has forewarned that, “*by international standards a 10 percent royalty is quite high.”[[4]](#footnote-5)*

While the mining industry believes that the current fiscal regime already gives government a fair and adequate share in the proceeds from mining, it also acknowledgesgovernment’s need for additional revenues to fund its development projects. The mining industry is always ready to work with government in achieving a revenue sharing scheme that will be fair and equitable for all stakeholders, government and investor alike. However, whatever revenue sharing scheme government may ultimately decide on,it must meet the following criteria:

1. *Internationally competitive*—it must encourage investments in the mining industry, and help enhance the country’s economic base;
2. *Achieve an equitable sharing of proceeds* between the government and investors, in particular the provinces or localities that host mining operations;
3. *Provide steady and sustained revenue streams* to government;
4. *Progressive* in nature, and
5. *Ensures an efficient and transparent system for revenue payment and collection,* therebyreducing the cost of business.

Ultimately, the test of the effectiveness of a mining tax structure is: *can the country attract investments in its mining sector?* If not, the fiscal regime may be inappropriate for the country, given its exploration, development, and production costs; the size and quality of mineral deposits; and investor perception of commercial and political risk.

To be attractive, a fiscal regime must provide a return to the investor at par with the average of other developing mining countries like Indonesia, Peru, and Papua New Guinea.

Unchanged, the current fiscal regime will yield government an estimated annual revenue of Php8.6 billion in mineral royalty alone considering several pipeline projects that are currently in various stages of mining operations. By 2020, we project government to receive Php13 billion[[5]](#footnote-6) if and when the eight *(or more)* large mining operations finally come on stream, *i.e.,Tampakan Copper Project, OceanaGold Project, Silangan Copper Project, Far Southeast Project, Kingking Copper Project, Runruno Gold-Copper Project, Colet Mining Project, Mindoro Nickel).*With the current policy uncertainties however, we may not see the growth of the mining industry in the medium term.

There is clearly a need for further consultations and interaction between government policy-makers and the private sector. Given the complexity of the issue, there is also a need to undertake an in-depth review of the current mining regime to help ensure that the country’s benefits from its finite mineral resources translate into sustainable wealth that will benefit future generations.

1. Being an exceptionally well-endowed country, the chances of prospects in the Philippines may be slightly better at 1 mine being developed for every 1000-5000 prospects. [↑](#footnote-ref-2)
2. ArtemioDisini, Getting a Fair Share:The Industry Perspective on Mining Taxation, 2012. [↑](#footnote-ref-3)
3. Emil Sunley, Selcuk Caner, Richard Krever, and Oana Luca, *Reform of the Fiscal Regimes for Mining and Petroleum*, June 2012. [↑](#footnote-ref-4)
4. *Ibid*, p. 21. [↑](#footnote-ref-5)
5. Assuming a conservative average annual increase in gross mineral production value of 10%. [↑](#footnote-ref-6)