Mining investment
local challenges global implications

BAKER & McKENZIE

GLOBAL BUSINESS CHALLENGES

“Mining jurisdictions must consider their competitiveness to mining investment or risk that investment being deployed elsewhere.”

David Ryan, Partner
Baker & McKenzie, Australia
commenting on the global mining market

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“Simplify approval processes. It's a worldwide problem. Getting government approval to start mining operations anywhere is getting more and more complicated.”

Legal Counsel, Australia
commenting on the global mining market

Foreword

David Ryan

Welcome to the fourth report in our Global Business Challenges series. This report considers the impact of regulatory arrangements and other issues on mining investment in a number of the world's key mining jurisdictions.

We surveyed industry leaders from Australia, Brazil, Canada, China, Indonesia and South Africa. While each jurisdiction has its own specific issues, the common theme across all jurisdictions surveyed is that investing in mining is becoming more difficult and less certain. Factors contributing to this include an increase in the complexity of regulation, the rising trend of "resource nationalism", bribery and corruption, and rising costs of doing business.

More and more mining industry participants are being drawn to the "frontier" regions of Africa, Asia and Latin America for their growth opportunities. The development of these regions provides increased competition to the established mining jurisdictions – all the more reason to consider whether their regulatory arrangements and other controllable issues are optimal.

While a country may have the natural benefit of high quality mineral resources, investment decisions and capital flows are significantly influenced by other factors such as foreign investment restrictions, the processes for obtaining consents and approvals, land access, access to infrastructure and fiscal arrangements such as applicable taxation and royalty regimes.

Governments are now charged more than ever with balancing the interests of mining companies with other stakeholders, including landowners and indigenous groups. Governments must also consider broader policy issues such as the protection of the environment and the sharing of the benefits of mining operations.

For the established mining jurisdictions, this research provides a reminder of the need to evaluate their competitiveness in attracting mining investment. This report identifies some areas where the competitiveness of our surveyed jurisdictions could potentially be enhanced.

We hope you enjoy reading our report.

David Ryan
Partner, Head of Global Mining Group
Baker & McKenzie, Australia

“Creating and maintaining new levels of supply annually is both a significant challenge and opportunity for the industry.”

Stanley Jia, Partner
Baker & McKenzie, China
commenting on the Chinese mining market

Executive summary

This report is based on a Baker & McKenzie survey of industry leaders from Australia, Brazil, Canada, China, Indonesia and South Africa, and assesses the impacts of regulatory arrangements and other issues on mining investment decisions.

The countries of focus in our report are at different stages of economic development, but all have one factor in common – they are resource rich and the mining industry is a significant component of their domestic economy.

In 2011, the financial results for the top 40 mining companies hit new heights, with revenues of over US$700 billion, an increase of 26% from 2010's levels.[2] The top 40 mining companies invested US$98 billion in capital projects in 2011 and planned for a further US$140 billion for 2012 in an effort to increase supply.[3]

301 senior executives, C-suite and senior legal counsel from mining companies were interviewed, as well as members of the financial community and mining services companies.

We asked respondents for their views on what encourages and discourages investment in their different markets.

Key themes

The key themes that emerged from our study relate to complexity surrounding the legal and regulatory environment, political stability, the increase in resource nationalism and the need for access to infrastructure and skilled labour.

Legal certainty and complexity

Legal certainty was a major theme emerging from our study, with concern being expressed about the ability to enforce contractual rights and certainty of tenement grants in certain jurisdictions.

Across all the jurisdictions we surveyed, most scored highly on the ability to enforce contractual rights, except for China and Indonesia where the majority of respondents said that it discouraged investment.

Most respondents said they believe mining investment will grow more complex over the next 10 years.

This complexity results largely from the need for greater levels of approvals and compliance obligations, and from a greater focus on issues such as the environment and the impacts of mining on other stakeholders.

In a number of countries, governments are placing increased pressure on mining companies to act in an environmentally-friendly manner. Worldwide investment by the mining industry in renewable energy and energy conservation will reach about US$8.4 billion by 2016 and nearly US$20 billion by 2020, according to a new report from Pike Research.[4]

There were mixed views when asked about the impact of environmental issues in different countries. In Brazil, 56% were discouraged by the impact of environmental issues and approvals whereas in Indonesia, only 22% were discouraged. In other countries, many believed environmental issues neither encouraged nor discouraged investment. The impact of environmental legislation is largely determined by how expensive, complicated and bureaucratic the processes are made.

Political stability

Political stability also featured prominently in our study.

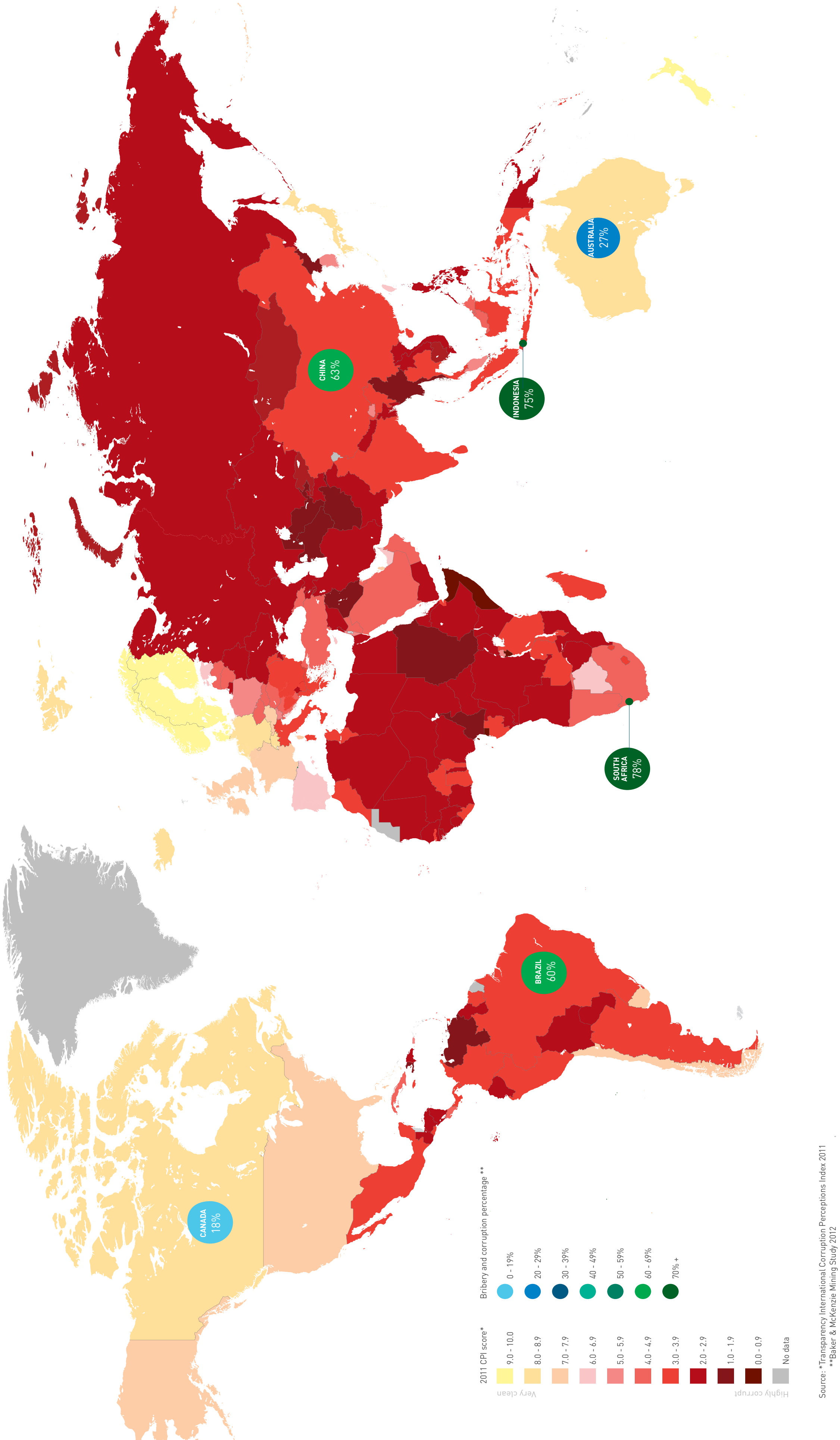
Mining investments are capital intensive, long-term commitments, and companies are understandably wary of material changes to legal systems, taxes and ownership rules. The mining community sees Canada as the most politically stable country of those our research covers, with 88% believing this factor encourages investment. By contrast, 55% of respondents considered political stability a discouraging factor in South Africa, where there are concerns about the policy position of the governing African National Congress (ANC) party.[5]

On government support for the mining industry, 71% considered that Canadian government support and subsidies for exploration or mining operations encourages investment. In China this figure was 53% and in Australia it was 51%. In South Africa, 53% believed the level of government intervention discouraged investment in their mining sector. Indonesia and Brazil fared only marginally better with 43% and 40% respectively.

Corruption and bribery issues are material concerns in several of the jurisdictions we studied. In South Africa, 78% of respondents considered that corruption, bribery and crime issues discourage investment (Fig. A). The figures were also very high in Brazil (60%), China (63%) and Indonesia (75%).

56% were discouraged by environmental issues in Brazil

Fig. A
Transparency International Corruption Perceptions Index 2011 overlaid with jurisdictions in which respondents saw bribery and corruption discouraging investment.



Resource nationalism

Resource nationalism is a key worry for the mining sector. High commodity prices over the last decade have fed high mining profits, and many governments are now looking for ways to extract more revenue from the sector and capture the benefits of the industry on-shore. Examples of such behaviour abound, from bans on exports of unprocessed raw materials, export levies, foreign ownership limits and hikes in royalty and tax rates.

This trend is not confined to the developing world. One of the most notable examples is Australia, where the Minerals Resource Rent Tax (MRRT) was introduced on 1 July 2012. Other jurisdictions used the Australian action as a precedent for their own proposed changes.

Our research shows that globally, 78% of respondents believe that protectionism and resource nationalism for mining will increase over the next 20 years. Taxation and royalty regimes seem to be a discouraging factor in most of the jurisdictions. Only in Canada did a majority of respondents (61%) consider that the taxation and royalty regime encouraged investment. Brazil fared the worst, with 65% believing that the taxation and royalty regime discouraged investment in mining. The taxation and royalty regime in Australia was also a significant concern with 61% of respondents believing that it discouraged investment in mining. (Fig. B)

Access to infrastructure and workforce

In developing economies, the availability of rail, port and other infrastructure can be a major barrier to mining investment. Some developed economies – particularly those dealing with government deficits – have other challenges, such as how to maintain investment in infrastructure without adding to an already strained fiscal position. One thing is common: infrastructure unlocks development and growth potential and all economies have further infrastructure needs.

It is in this context that we asked whether the state of infrastructure in a jurisdiction encouraged investment in the mining industry.

Our results show significant differences by country with regard to quality of infrastructure. 89% of respondents who invest in Canada said they believe its infrastructure encourages investment, 82% in Australia, 73% in China and 60% in South Africa. However 51% in Brazil and in Indonesia said that the state of infrastructure in those jurisdictions discouraged investment in mining. A number of our respondents also note that access to infrastructure will become a global challenge in the future. In order to finance infrastructure needs, some respondents suggested that governments should launch their own sovereign wealth funds to invest the earnings from mining activity.

> "The mining industry is a global opportunity. Our clients will continue to make their development decisions by weighing up the competitive advantages of different jurisdictions."
>
> John Mollard, Partner, Baker & McKenzie, Australia
> commenting on the Australian mining market

63% said investing in China's mining industry will become more complicated

70% of Australian businesses predict some difficulty in hiring skilled staff.[6] Compared to other issues, skills shortages were on the whole not seen so much a dissuading factor in investing in mining. However, many respondents noted the link between the availability of skilled labour and the costs of mining operations. Australian respondents in particular bemoaned how the cost of their workforce was affecting project economics and calling for greater use of migrant labour.

In summary

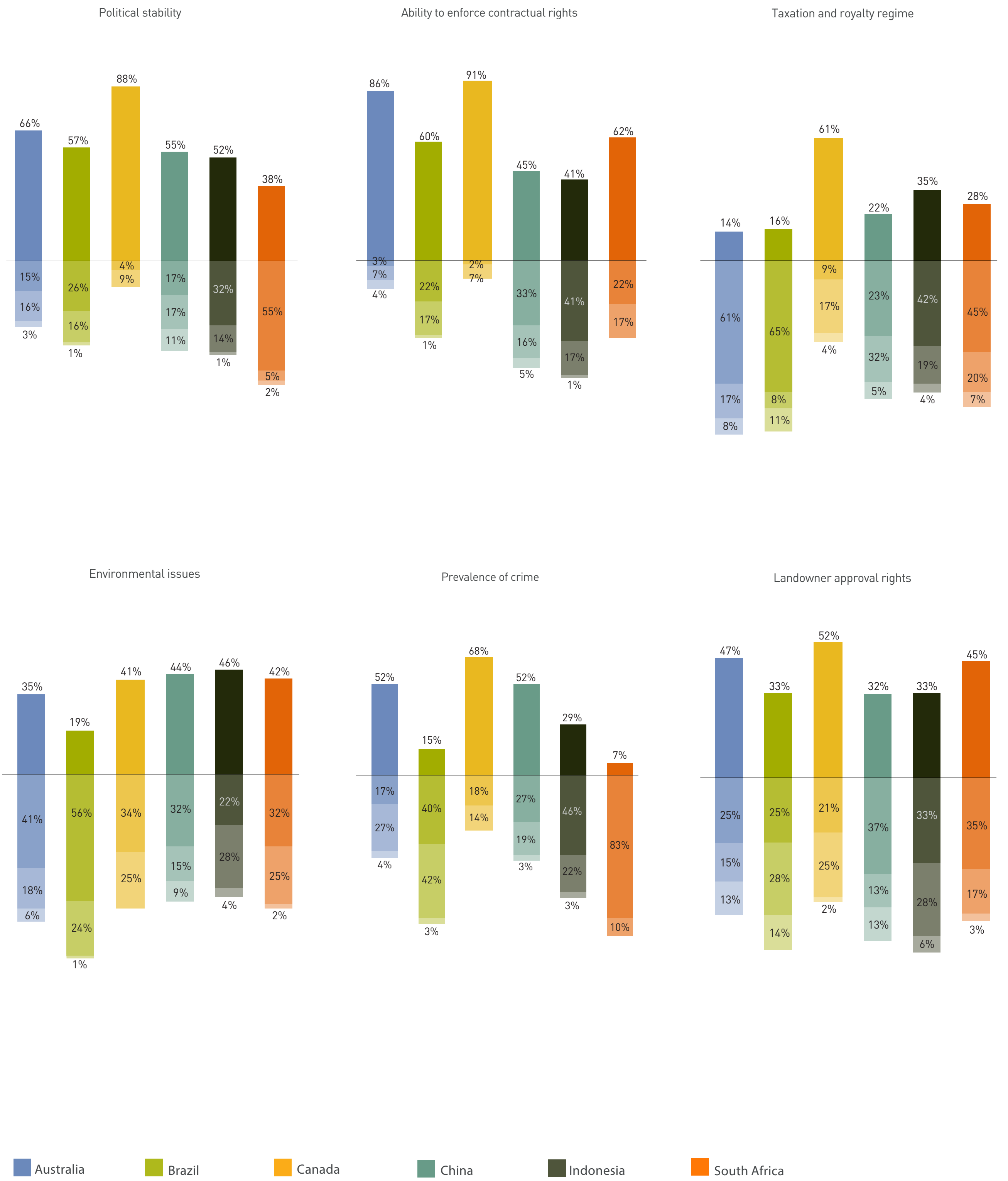
One theme all jurisdictions have in common is that a majority of respondents said they believe that investment in the mining sector will continue to become more complicated in the future.

When we asked about the outlook for the future, respondents commenting on Brazil were the most optimistic. Only 31% thought that the future climate for investing in mining will be slightly or much more complicated. Those commenting on Australia were the least optimistic about the future with 66% agreeing that the investment climate will be more complicated to some degree in the future. China is not far behind with 63% believing investing in China's mining industry will become more complicated in the future. That figure drops to 58% in South Africa, 52% in Indonesia and 54% in Canada.

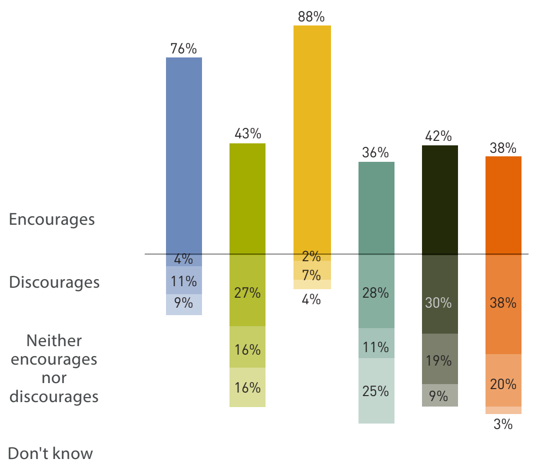
This report examines the above issues in more detail by focusing on the challenges and opportunities for the mining industry in the six countries in which our research was conducted – Australia, Brazil, Canada, China, Indonesia and South Africa.

Fig. B

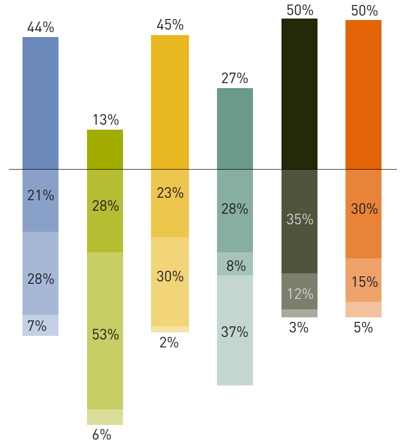
To what extent do you think each of the following factors encourage or discourage investment in mining in this country?



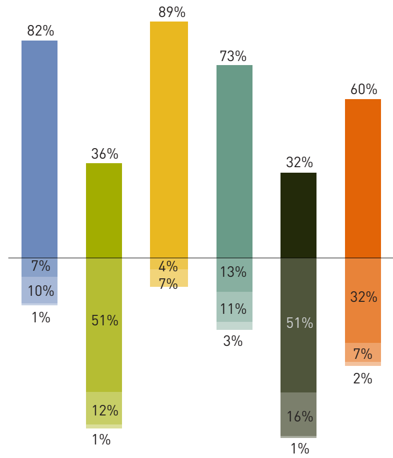
Certainty of tenement rights



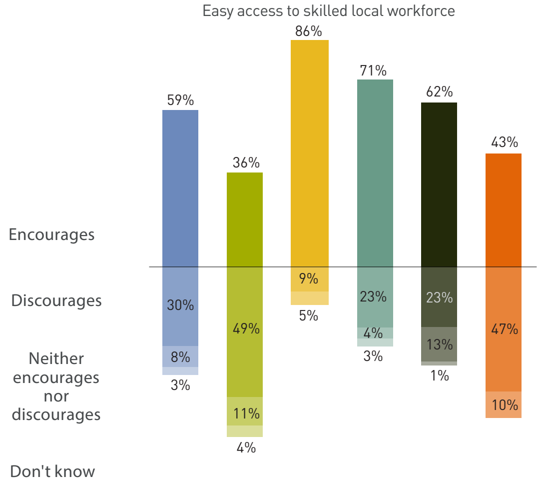
Foreign ownership requirements and investment approvals



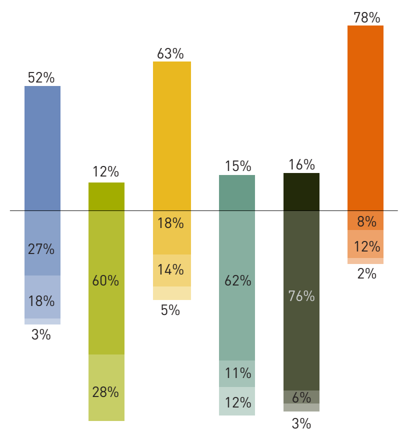
Solid infrastructure



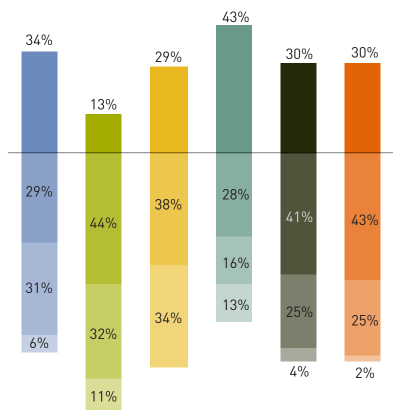
Easy access to skilled local workforce

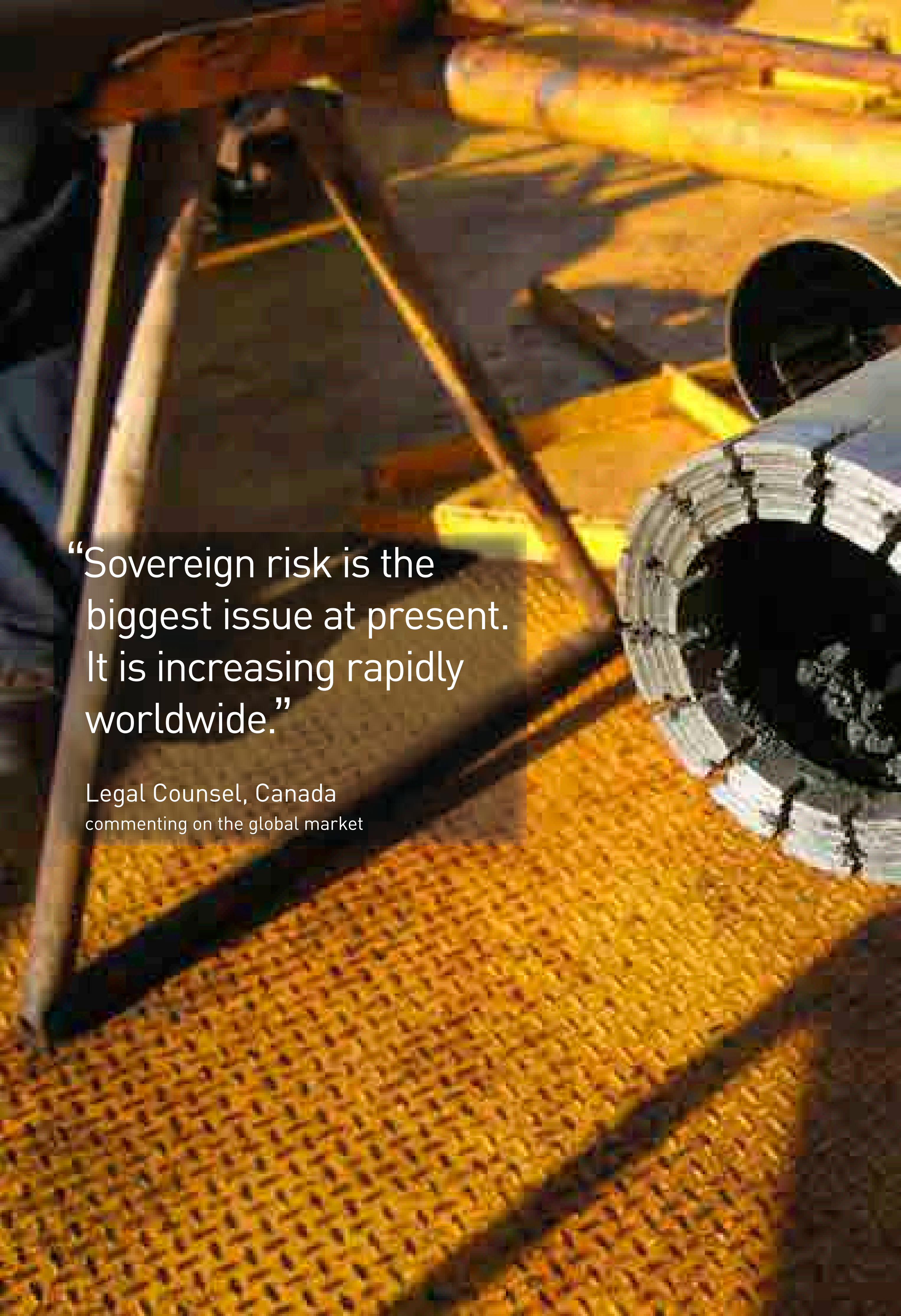


Corruption and bribery issues



Native / indigenous people rights to the land





"Sovereign risk is the biggest issue at present. It is increasing rapidly worldwide."

Legal Counsel, Canada
commenting on the global market

"The development of these frontier regions, and the evolution of the more established regions, provides all the more reason to consider whether the regulation of mining in Australia is optimal."

David Ryan, Partner
Baker & McKenzie, Australia
commenting on the Australian mining market

Australia

KEY ISSUES

Australia's Minerals Resource Rent Tax (76%) and Carbon Pricing Mechanism (70%) are viewed as discouraging investment in Australia

86% believe the ability to enforce contractual rights encourages investment into Australia

79% believe it has grown more expensive, 75% believe it has grown more complicated and 70% believe it has grown more time consuming to invest in Australia

72% see sovereign risk increasing

61% believe there is too much government involvement in the mining industry

Australia enjoyed 17 years of consecutive growth before the 2008 financial crisis.[7] GDP increased from AU$400 billion in 2002 to AU$1.37 trillion in 2011, with the mining sector having a key part to play.[8] During the 2008/09 financial crisis, Australia's strong commodity exports meant the country only experienced one quarter of negative growth and experienced 1.2% of economic growth in 2009, outperforming all other OECD countries. The minerals resource industry accounts for more than 6% of Australia's economy and in terms of export income, mining generates AU$138 billion of export income per annum representing over half of total goods and services.[9]

Australia is the world's largest coal exporter, second largest producer of gold and nickel and the largest exporter of uranium.[10] The industry has a large number of participants, with the Australian Securities Exchange listing more than 600 mining companies, representing around a third of all listed companies.

Australia's strong and successful history in mining is reflected in the positive sentiment of investors towards investing into its mining sector. The country's mining industry accounted for one quarter of foreign direct investment (FDI) in Australia as at the end of 2010, reflecting strong world demand for mineral commodities and the competitiveness of Australia's resource industry.[11] Fig. 1 shows the key factors that have been encouraging and discouraging investment into Australia. 86% of respondents are encouraged to invest in the Australian mining industry because of Australia's strong record in ensuring mining companies can enforce contractual rights. Solid infrastructure in Australia is also seen as a key attraction for investors, with 82% encouraged by it.

Our research suggests that over the past 10 years mining has generally become more difficult. 79% said investing has become more expensive, 75% said it has become more complicated, 70% said it has become more time consuming and 51% believed it has grown riskier (Fig. 2).

Fig. 1
To what extent do each of the following factors encourage investment in mining in Australia?

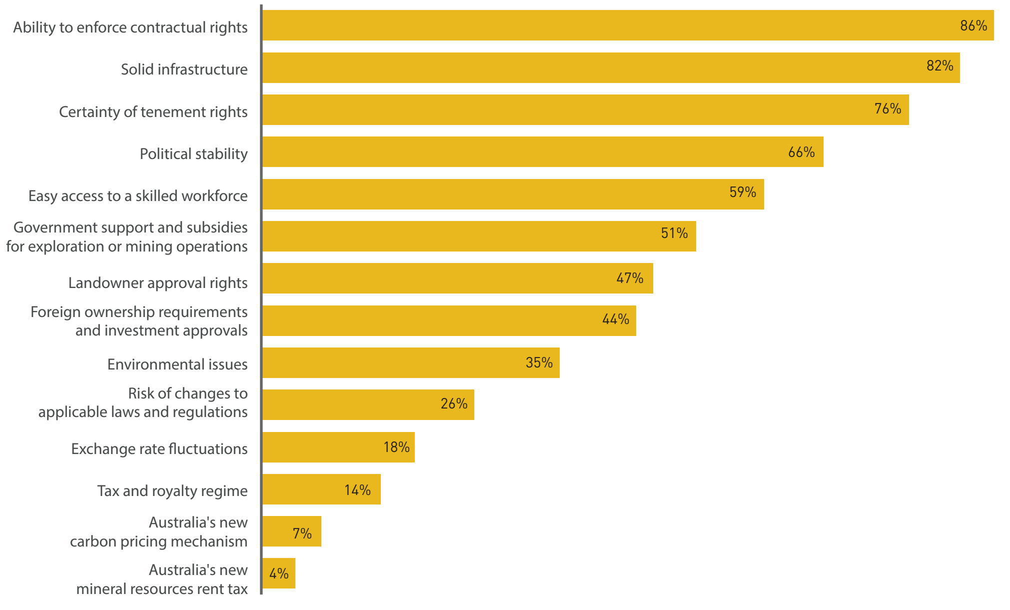


Fig. 2
Over the last 10 years, has investing in mining in Australia generally become...

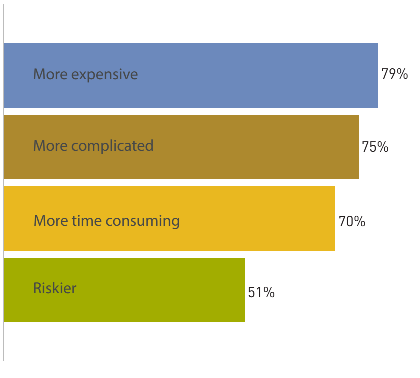
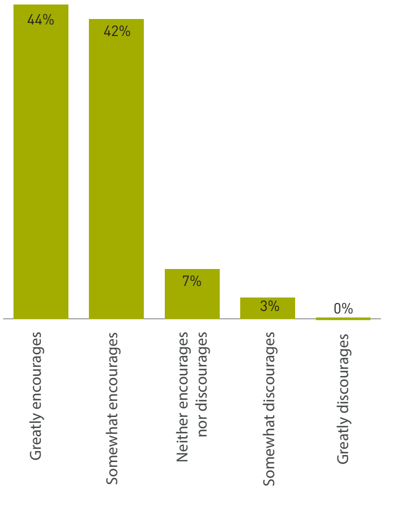


Fig. 3
Does the ability to enforce contractual rights encourage or discourage investment in mining in Australia?



"Reduce sovereign risk by ensuring that broad spectrum legislation which impacts the resources sector, has greater industry involvement prior to implementation."

Legal Counsel, Australia
commenting on the Australian mining market

Legal certainty and complexity

In Australia, the mining industry is regulated primarily by state and territory governments, and Australia is ranked 15th in the World Bank's Ease of Doing Business Index.[12]

Despite the reassurance of Australia's solid legal system, there are concerns surrounding the increased complexity of navigating it for mining projects. There is a growing perception amongst the industry of a complex maze of green regulations and red tape that must be navigated to deliver projects efficiently and effectively.

Unnecessary delays or duplication among government approval offices are seen as a source of frustration by our respondents. In Queensland, the approvals process is regarded as particularly complex, with one respondent noting: "When you look at a mega-project, there are up to 1,800 permits and approvals to go through".[13]

Some of the solutions offered by our respondents are:

- "Streamlining the legislation across the states and territories."
- "Acceleration of the processes to gain access to land. This is because it currently takes a long time and you need to get lots of approvals from different government areas."

The certainty of being able to enforce contractual rights is seen as the most encouraging factor (86%) by respondents in securing investment into mining (Fig. 3). Australian contract law has provided a solid foundation for companies to be able to operate with confidence.

While 52% of respondents do not currently see sovereign risk as a material factor in their organisation's decision to invest in Australia (Fig. 4), 72% said they see Australian sovereign risk increasing as a result of the MRRT and Carbon Pricing Mechanism (CPM)(Fig. 5). Therefore, although investors are not overly concerned about sovereign risk in Australia at present, there are worries about the future.

Political stability

Coupled with its political stability, the ability to enforce contractual rights influence Australia's low risk rating on international indexes that rate location specific corruption risk. In 2011, Australia ranked 8th out of 182 countries in the "Worldwide Corruption Perceptions" ranking of countries by Transparency International.[14]

Conversely, Australian mining companies often operate in highly corruption prone foreign localities. How to tackle corruption risk abroad is an issue Australian mining companies must resolve with increasing frequency.

Resource nationalism

Unlike a number of other resource-rich developing countries, unstable governments and vague mining codes are not material concerns for the mining industry when doing business in Australia. The country does, however, face some key challenges that threaten the competitiveness of the industry. The CPM and the MRRT have unsurprisingly proven unpopular amongst industry participants. It may not simply be the financial impact of levies on the balance sheet. The concerns may emanate from the fear of future government involvement (Fig. 6).

Following the Labour Government's re-election in June 2010, Prime Minister Julia Gillard announced the Government's intention to introduce the MRRT. The MRRT subsequently passed through parliament on 19 March 2012 and came into play on 1 July 2012. It applies to iron ore and coal producers and it is anticipated that these producers will pay AU$11.1 billion in taxes over three years. Unsurprisingly, 76% of our respondents said the MRRT discourages investment, as shown in Fig. 7.

Australia's CPM is perceived by survey respondents to be a discouraging factor in the decision to invest in the Australian mining sector (Fig. 8). The CPM has also proven to be a highly political issue. While the Government has now implemented the scheme, the opposition has stated its intention to repeal the CPM should they come into office. This uncertainty has made it more difficult for the industry and investors to develop long term plans.

The Minerals Council of Australia has estimated that th mining sector would face "a carbon tax liability of AU$25 to AU$30 billion by 2020-21".[15] The council has opposed the CPM claiming that it will reduce growth in employment, harm competitiveness and in fact produce no environmental dividend. However, Treasury's analysis has estimated that the impact of the scheme will be far more limited on the mining sector stating that the mining sector will still grow 77% by 2020 (0.8 – 1.2% less than in the absence of the CPM).[16]

The immediate impact of the CPM on the mining industry has also been reduced through various compensation packages for much of the sector.

Access to infrastructure and workforce

A significant proportion of respondents (82%) are encouraged by Australia's solid infrastructure as shown in Fig. 9. Infrastructure investment in Australia is relatively strong comparatively: the World Economic Forum ranks Australia 37th out of 142 countries surveyed on its quality of infrastructure.[17]

Fig. 4
Is sovereign risk a material factor in your decision to invest in mining in Australia?

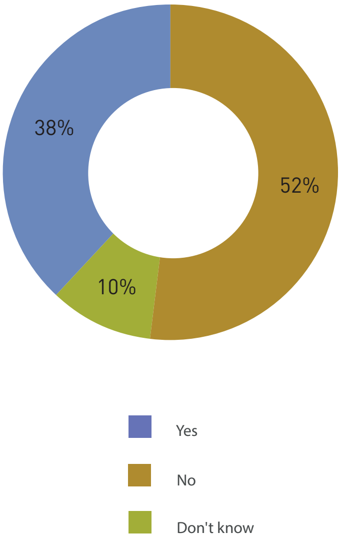


Fig. 5
Do you see sovereign risk increasing as a result of the introduction of a CPM and MRRT?

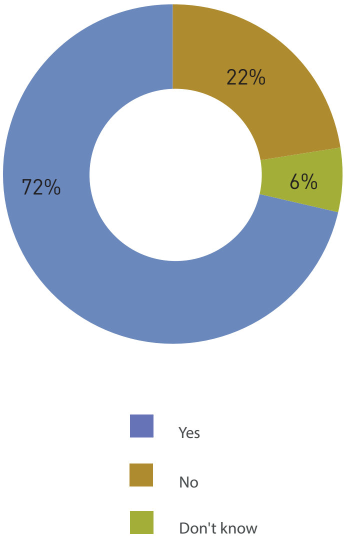


Fig. 6
Do you believe there is too much government involvement in the mining sector in Australia?

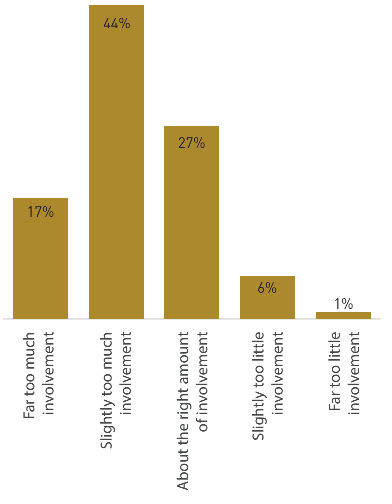
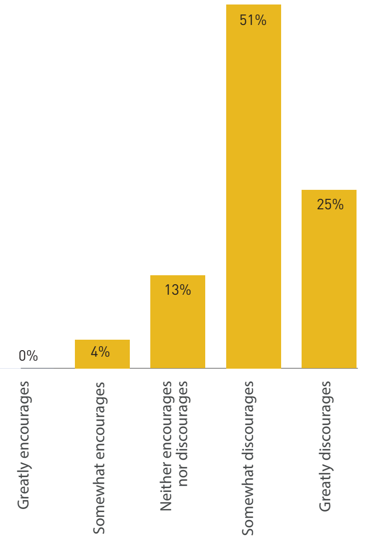


Fig. 7
Does the Minerals Resource Rent Tax impact investment in mining in Australia?



Although bottlenecks in the bulk minerals supply chain (in particular, in coal) have and still cause concerns, there has been significant investment in rail and port and infrastructure in recent years.

Public Private Partnerships (PPPs) have also been encouraged to increase growth in the mining sector. State governments such as Queensland have been seeking private investors to fund major infrastructure projects to serve the mining industry. However, despite Australia's existing infrastructure the future still holds challenges. Resources in remote areas such as the Queensland Galilee Basin will require significant additional infrastructure development.[18]

In Australia at the end of 2011, there were 102 projects at an advanced stage within the mining sector, with a record capital expenditure of AU$231.8 billion. This represented an increase of 34% from April 2011 and a 74% increase from October 2010.[19] This growth within the minerals sector has meant more opportunities for workers, with an 86% increase in employment within the minerals sector from February to November 2011.[20]

The industry directly and indirectly employs approximately 320,000 Australians, many in remote and sparsely populated areas, and is responsible for significant infrastructure development. Since 1967, the industry has built 26 towns, 12 ports and additional port bulk handling infrastructure at many existing ports, 25 airfields and more than 2,000 kilometres of railway line. The industry underpins vitally important supply and demand relationships with the Australian manufacturing, construction, banking and finance, process engineering, property and transport sectors and has contributed more than AU$600 billion directly to Australia's wealth over the past 20 years.[21]

Future outlook

Our analysis of the investment climate in Australia outlines a positive foundation for investment opportunities in the mining industry. Nonetheless, although investment into Australian mining is strong, there are clearly a number of concerns surrounding the complexity and expense of projects, highlighted by the finding that 67% said that the future of investing in Australia will grow more complicated (Fig. 10). Looking to the immediate future, a period believed to be of increasing competition, uncertain economic growth and rising costs, it will become increasingly important that the industry is competitive with other jurisdictions.

Australia relies heavily on China for export revenues. There is concern amongst the mining community of the sustainability of continued growth within China. One respondent claimed that "the biggest issue would be the continuing demand cycle particularly driven from China, and the sustainability of China demand".

Recommendations

Our study highlights that Australia remains an attractive destination for mining investment, not only for its abundant mineral deposits, but due to factors such as political stability, the ability to enforce contractual rights, government support and subsidies for exploration or mining operations, solid infrastructure, easy access to a skilled workforce, lack of crime and/or violence and certainty of tenement rights.

Other factors were seen as being mildly attractive to mining investment: foreign ownership requirements and investment approvals, corruption and bribery issues and landowner approval rights.

Factors such as environmental issues and native/indigenous people's rights to land were considered neutral factors to mining investment: neither positive nor negative factors.

Unsurprisingly, the risks of change to applicable laws and regulations, tax and royalty regimes and the new CPM and MRRT were considered as strongly negative factors to mining investment in Australia. Responses on all these issues are perhaps all inter-related and are seen by respondents as a form of resources nationalism. It is also clear that investors in the mining industry do not like changes in regulatory arrangements. Mining involves large amounts of capital and long life projects and participants in the industry desire certainty of their regulatory treatment, particularly in relation to royalties and taxes.

Generally therefore, respondents are largely positive towards Australia as a destination for mining investment, other than the recent changes regarding the CPM and MRRT.

However, on the responses received, and the comments provided by respondents, it seems clear to us that Australia can also improve its attractiveness as a destination for mining investment by:

- addressing the complexity of approvals and pace of permitting of mining projects;
- addressing the costs of operations, largely through allowing the use of increased levels of skilled foreign labour;
- resolving the balancing of the competing rights of landowners and other stakeholders; and
- streamlining the processes for obtaining environmental approvals.

Fig. 8
Does the Carbon Pricing Mechanism impact investment in mining in Australia?

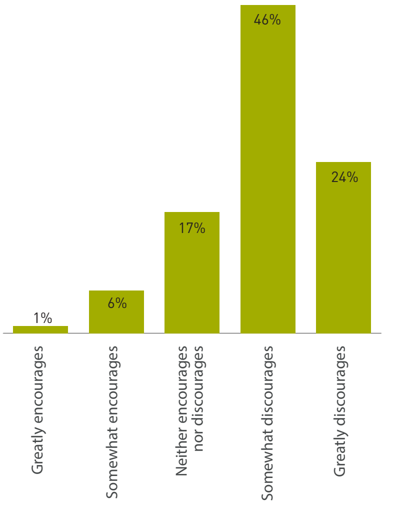
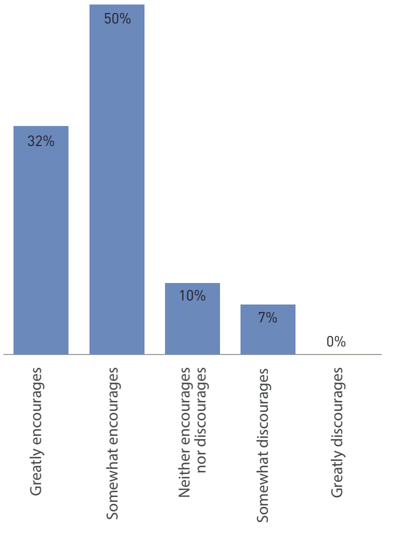
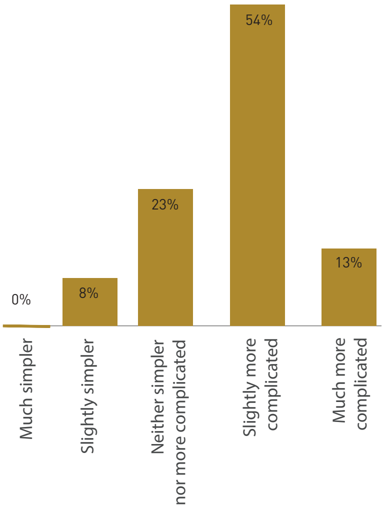


Fig. 9
Does solid infrastructure encourage or discourage investment in mining in Australia?



> "The country is so vast and more infrastructure must be built."
>
> Senior Decision Maker, Indonesia commenting on the Australian mining market

Fig. 10
How will the climate for investing in mining in Australia evolve over the next 10 years?



Our respondents overwhelmingly noted the sense that mining regulation in Australia was overly complex, and likely only to become more complex. Increasing complexity will bring longer timeframes for project approvals and will only harm Australia's competitiveness for mining investment. It may also reduce the ability of mining "juniors" to develop mining projects. We encourage state and territory governments to look at ways of simplifying the regulation of mining projects and streamlining of project approval and environmental approval processes (i.e. reducing the level of "red tape" and "green tape" associated with mining project development).

The regulation of mining investment can give rise to difficult balancing issues for state and territory governments between the competing interests of mining companies and the legitimate interests of other stakeholders such as landowners and holders of non-mining tenements, together with the consideration of broader issues such as the protection of the environment. While these are difficult issues and it is impossible to keep all stakeholders happy, we encourage state and territory governments to develop clear requirements in each case and streamline the relevant approvals processes. In our experience, investors in the mining industry are comfortable with these considerations, provided the relevant requirements are transparent, understood in advance and can be accurately modelled (in terms of what is/is not permitted and the associated costs and timeframes). We also encourage the states and territories to consider the empowerment of super ministries and departments to expedite the approval of mining project development and minimise conflicting and multiple ministerial/departmental objectives.

In Australia, on-shore minerals are the property of the individual states and territories rather than the Commonwealth. The comments provided by respondents noted some frustration with the multiplicity of state and territory-based mining regimes, and the variances between those regimes. One area that should be considered to assist Australia's competitiveness is trying to make the state and territory mining regimes more consistent.

While the states and territories are understandably proprietorial regarding their regulation of mining, we encourage state and territory governments to evaluate the benefits of developing a national mining law, adopting the recognised best practice elements of individual state and territory mining regulation, similar to the existing regulatory arrangements for electricity and natural gas. Similar considerations would apply to the state and territory petroleum regulatory regimes which could potentially be combined with minerals regulatory regimes.

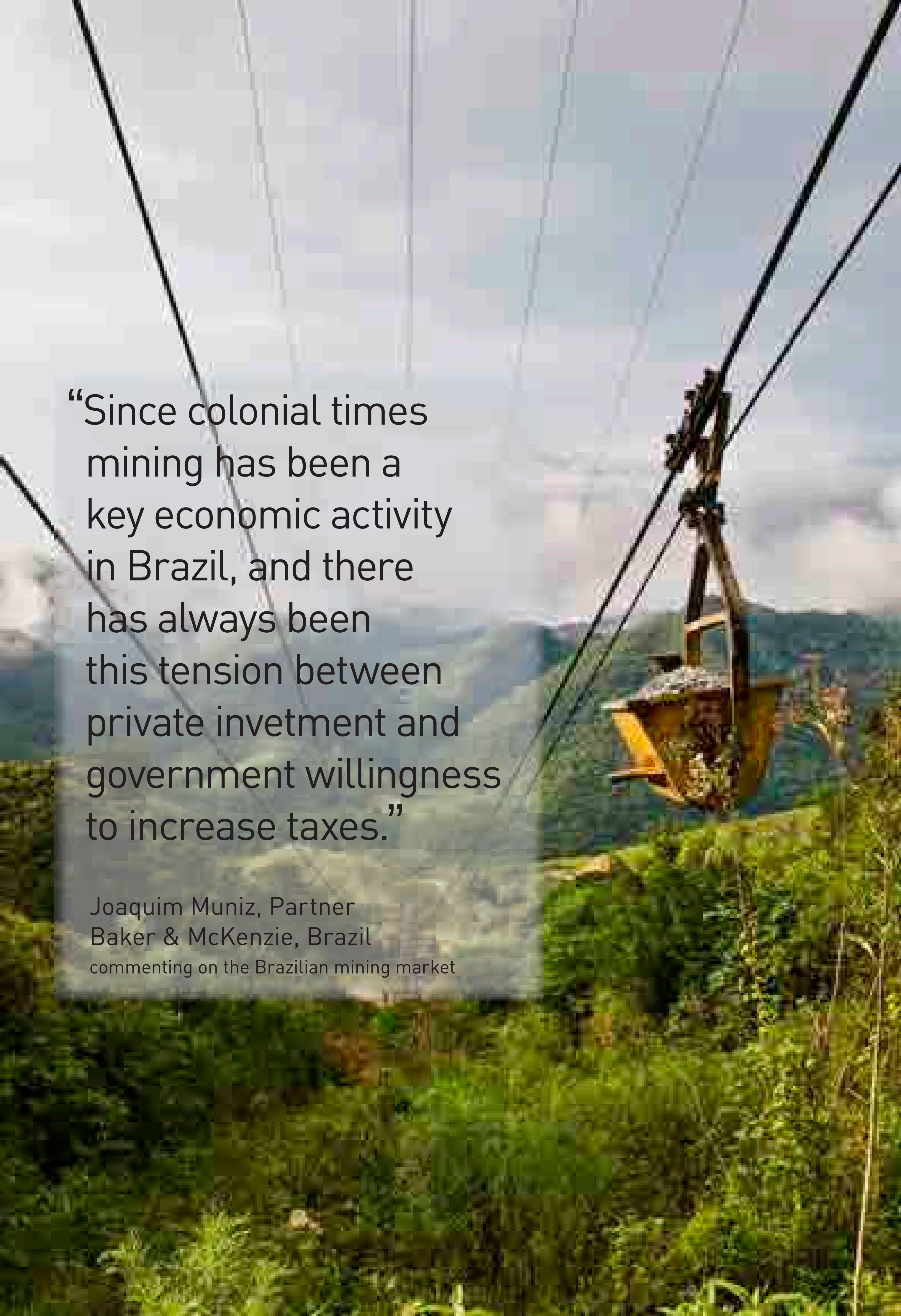
Somewhat surprisingly, Australia's foreign investment regime was viewed by respondents as a mildly positive factor for mining investment in Australia. This may be explained by the averaging of results. Anecdotal evidence and the views expressed by some of our foreign clients (particularly those from China) evidence a perception of unfair treatment of investors from some jurisdictions and wariness of Australia's foreign investment approval process.

"Streamline the legislation across the states and territories. At present there is no harmonisation of the laws which makes investing more complex and difficult."

Legal Counsel, Australia
commenting on the Australian mining market

“The impression is that the Government is trying to push the industry to close down.”

Legal Counsel, Indonesia
commenting on the Australian mining market



"Since colonial times mining has been a key economic activity in Brazil, and there has always been this tension between private invetment and government willingness to increase taxes."

Joaquim Muniz, Partner
Baker & McKenzie, Brazil
commenting on the Brazilian mining market

Brazil

KEY ISSUES

60% believe corruption is the biggest impediment to investment in Brazil

60% feel investment in Brazil is encouraged by the strong enforcement of contractual rights

57% believe Brazil's political stability is a key facet of its attractiveness as an investment destination

76% believe that Brazil has become a more expensive place to do business in the last 10 years

58% believe the Brazilian mining sector has either about the right amount or too little government intervention

Brazil's size, economic power and significant resource base overshadows its Latin American neighbours in terms of mining production, and as a destination for FDI. Even as its economic growth stalled in 2011, the appetite to invest in Brazil expanded voraciously: year-on-year FDI flows in November 2011 were 82% higher than a year before.[22] Mining is one of the main targets for FDI in Brazil.

Mining makes up around 2% of Brazil's GDP, and is growing at a tremendous pace. Between 2000 and 2008 the industry quintupled in size according to the Brazilian Mining Institute.[23] Today it stands as the sixth largest mining sector in the world, and has immense potential to grow even further due to huge potential resources in its hinterlands. Brazil is also a leading and growing producer of gas and oil. It was the world's ninth largest producer of the latter in 2009, and its oil rents were equivalent to 2% of GDP in 2009.[24]

Besides oil, Brazil's most important mineral resource is iron ore, of which it is the second largest producer in the world – accountable for around 19% of global output. This iron ore accounts for 83% of Brazilian metal exports, and is largely exported to China, Japan, Germany, France and Korea. Other core minerals include niobium, tin and gold.

There are a over a dozen major players in the Brazilian mining sector; however mining company Vale is the market leader, representing 80% of Brazilian production of iron ore.[25] Firms such as Anglo American, CSN, MMX, Samarco and CBMM are amongst the largest of the other players. In the oil and gas industry, partly state-owned Petrobas is the dominant player and the third largest energy company in the world by market capitalisation.[26] Other operations are far smaller than Petrobas, but have only been allowed to compete with it since 1997; the main private players include OGX, Shell and Chevron.

The potential for future growth in the Brazilian mining sector is huge with investments in mining expected to reach $75 billion by 2016, driven by a growing demand for raw materials such as iron ore.[27] Meanwhile the Brazilian Mining Institute believes that "Brazil has the potential to double or triple its current mining production"

Fig. 11
To what extent do each of the following factors encourage investment in mining in Brazil?

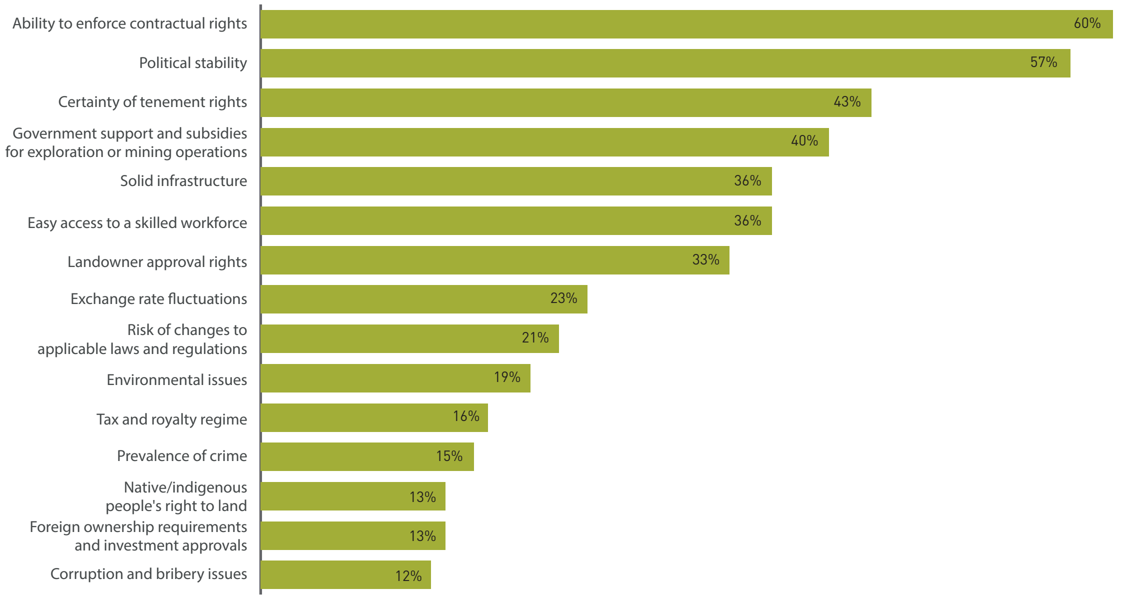


Fig. 13
To what extent do you think the following factors encourage or discourage investment in mining in Brazil?

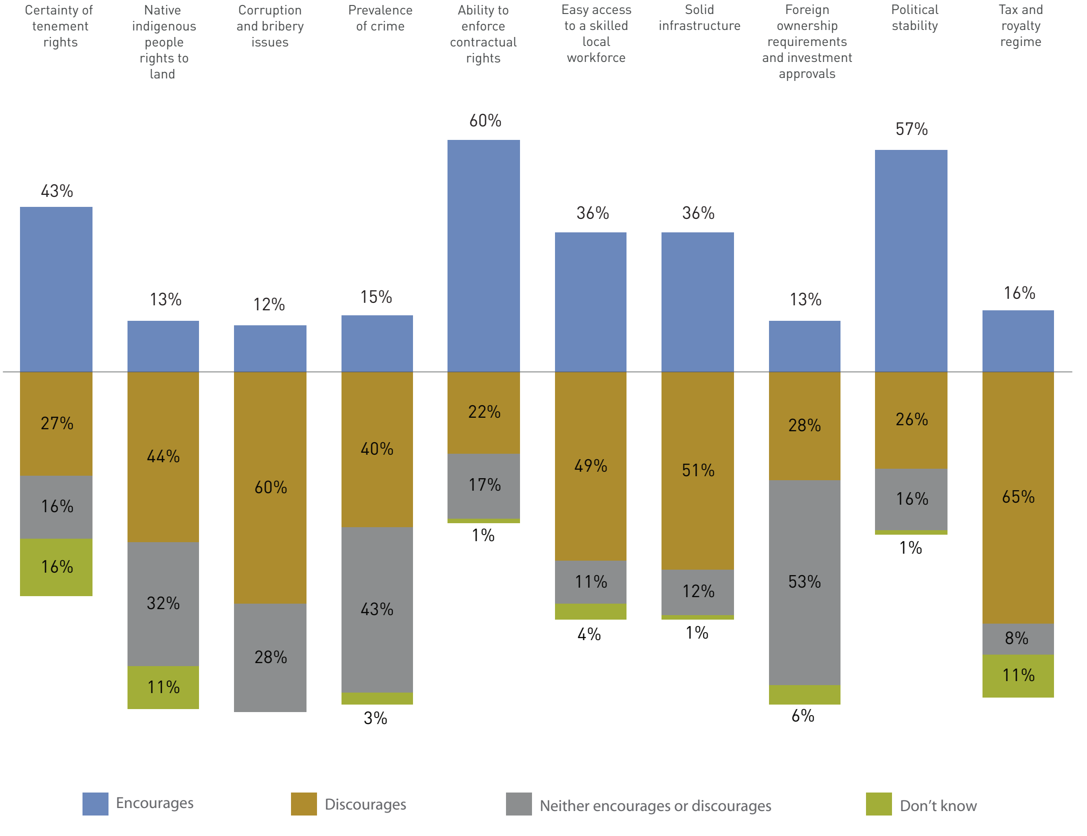
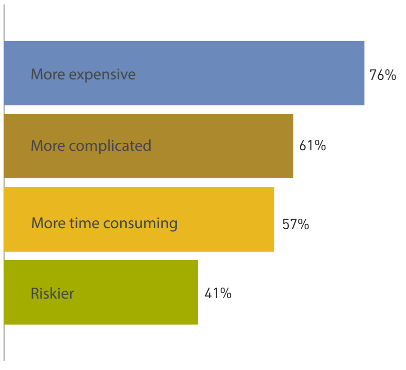


Fig. 12
Over the last 10 years, has investing in mining in Brazil generally become ...



in the coming years, since current exploration has only geologically mapped 30% of its territory.[28]

Despite the size of the economy, its recent high growth rate, and its huge mineral wealth, many potential investors into Brazil remain concerned about its prospects. Economic growth has been sluggish since mid-2011, when the central government – concerned about an overvalued currency and high interest rates – deliberately adopted policies designed to produce a slowdown.

Despite these negative trends, our research shows that investors still see great potential value in Brazil. However, despite several positive findings, we see overall that the mining community believes it has become more expensive, time consuming and complicated to invest in Brazil over the past 10 years (Fig. 12). This is a worrying finding which, if not reversed, could have a serious impact on the country's competitiveness and ability to attract FDI in years to come.

Legal certainty and complexity

Brazil currently sits 127th in the World Bank's Ease of Doing Business index. Our research supports this impression; large majorities believe that Brazil has become not only more expensive to do business in the last 10 years, but also more complicated and more time consuming.[29]

The laws and regulations of Brazil, as well as their enforcement, attract both praise and criticism from those we interviewed for this study. Whilst success in contract enforcement and securing tenement rights are seen as successes for Brazil, elsewhere there is criticism of a failure to do enough about crime, corruption and a poorly performing bureaucracy.

The contract law system of Brazil is seen in a positive light by the mining community, with 60% saying that investment in Brazilian mining is encouraged by the ability to enforce contracts in Brazil as shown in Fig. 13.

The World Bank's 2012 "Doing Business" report states that it takes 13 procedures and 119 days of work to start a business in Brazil, whilst construction permits take 469 days to get authorised.[31] Whilst some businessmen believe small improvements have been made in recent years, and the bureaucracy has certainly shrunk since its inefficient 1980s nadir, the mining community's concerns remain: one respondent noted "If I could I would diminish all forms of bureaucracy."

Environmental regulation is also a pertinent issue in Brazil, where environmental sustainability is written into the 1988 constitution, and protecting the Amazon rainforest is a high level priority. The complexity of environmental licencing was a common complaint amongst respondents in our research, with one mining services executive pleading for the Government to make "environmental approvals faster or more agile". The Government is planning a change of the current regulatory structure, which it is hoped will simplify the application and licensing process and make Brazil a more attractive destination for investment.

Political stability

In the past, Brazil – like its Latin American neighbours – faced a high degree of political instability. The country has been subject to several coups in the last 50 years, and the economy since 1945 was characterised by inefficiency, corruption, industrial relations crises and hyperinflation. The return of democracy in the 1980s also brought with it gradual economic liberalisation by the 1990s.[32]

The last two decades of relatively solid management of the economy and public finances by the Central Government have largely assuaged investor concerns about political risk in Brazil.

Our research shows this level of stability has been recognised. 57% said they are encouraged by it in the mining community (Fig.13). However this does not mean that there are no political risks in Brazil. Whilst there is confidence in the Government itself to remain stable, only 23% are confident that it will keep the exchange rate under control, and such fluctuations can seriously impede the practicality of investment in a jurisdiction. The appreciation of the Brazilian Real until 2010 and its fall since then represents an example of such potentially damaging fluctuation.

Brazil's expansive and inefficient bureaucracy has created a climate in which bribery can thrive. 60% of the mining community said that issues surrounding corruption and bribery discourage investment in the sector and only 15% said Brazil's handle on its crime situation will encourage people to invest, whilst 40% feel it is a discouragement (Fig. 13).

Resource nationalism

More serious than currency fluctuation is the political risk for mining companies involved in Brazil being caught up in a wave of resource nationalism. 2012 has already seen Argentina seize 51% of oil company YPF from Spanish producer Repsol.[33]

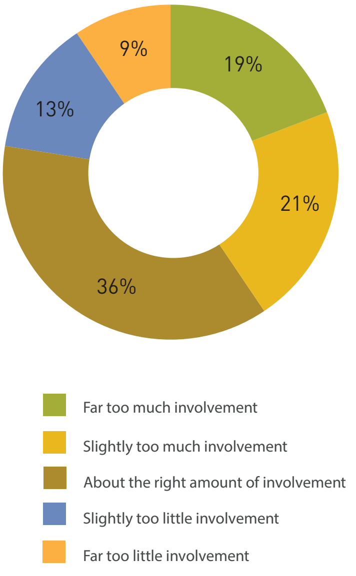
Moreover, the country is seen as at risk of more protectionism in the future, with 76% of respondents in our research believing the Government may be tempted to move in this direction.

29% said bureaucracy would be the one change they would make to the legal system

"The environmental regulations and laws are becoming more restrictive making it more difficult for the mining companies to explore it and grow."

Senior Decision Maker, Brazil
commenting on the Brazilian mining market

Fig. 14
Do you believe there is too much government involvement in the mining sector in Brazil?



It is encouraging that over half of those interviewed about Brazilian mining (58%) said the Government is either involved too little or just about the right amount in the sector as shown in Fig. 14. Complaints seem to reside with the implementation of policies or levels of certain taxes rather than the need for an overbearing state to retreat.

Our survey revealed complaints with the levels of taxation and royalties for mining in Brazil, potentially spurred on by proposals to increase mining royalties. There are also complaints at a local level, where individual states are imposing new taxes on mining production in states such as Para and Minas Gerais – potentially threatening the competitiveness of the industry in these areas.[34] These taxes were fully supported by the Central Government, and the negative impact on investment sentiment can be seen by comments about "excessive taxation", and by the fact that only 16% of respondents said Brazil's tax and royalties regime encourages investment (Fig. 13).

Access to infrastructure and workforce

Brazil is ranked 104th out of 142 countries on its quality of infrastructure by the World Economic Forum.[35] Worryingly, its recent investment pledges appear to be nowhere near large enough, as it wants to spend 1% of GDP a year on infrastructure, which is hurting the appetite for mining investment in Brazil. 51% of respondents said Brazil's infrastructure discourages investment and only 36% said it encourages it as shown in Fig. 13.

It is well known that Brazil has a problem with infrastructure that is economy-wide, not just an issue facing its mining industry. Whilst its economy grew quickly in the early 2000s, its roads, railways, ports and energy investment lagged behind. In 2010 only 12% of Brazil's roads were paved, yet Brazil spends twice what the USA does per year on transport as a percentage of GDP.[36] Its current president Dilma Rousseff has laid out an ambitious US$1 trillion dollar plan to modernise infrastructure, but it is difficult to see how this can be accomplished plausibly and speedily without significant private sector involvement.

The effect of this infrastructure deficit on potential investment is clear: it increases costs. A mining company seeking to invest in Brazil not only has to build a mine, it also has to build the roads, railways, ports and airports necessary to link its project to the rest of the country. Petrobas estimates its costs are boosted by as much as 20% by such effort.[37]

The mining industry is a key supplier of jobs to Brazil. Directly, the sector employed 161,000 people in 2008, and this has since increased. Indirect jobs in the mining supply chain are thought to total around two million people. Given the geological richness of Brazil, there is the potential for this number to dramatically increase in the coming years.[38]

Future outlook

Our analysis of the investment climate in Brazil shows several significant barriers to Brazil being an ideal target for mining investment. However, these issues are not insurmountable, and indeed the huge mineral and fossil fuel wealth of Brazil will mean a material shift in the investment climate would be necessary for it to become an entirely unattractive destination.

Rather, the picture that emerges is of a country with vast amounts of potential which could be doing more to exploit it. Fortunately, Brazil has a stable government that our research shows the mining community has a significant amount of trust in; a government that despite a few nationalist overtures seems more concerned with overhauling Brazil's outdated regulation and tackling its antiquated infrastructure than forcing foreign companies out the door.

Whether they will succeed is another matter. As such, the mining community is unsure whether investing in Brazil will become easier or harder in the next 10 years: 39% said the former, 31% the latter, and 27% are on the fence (Fig. 15).

Recommendations

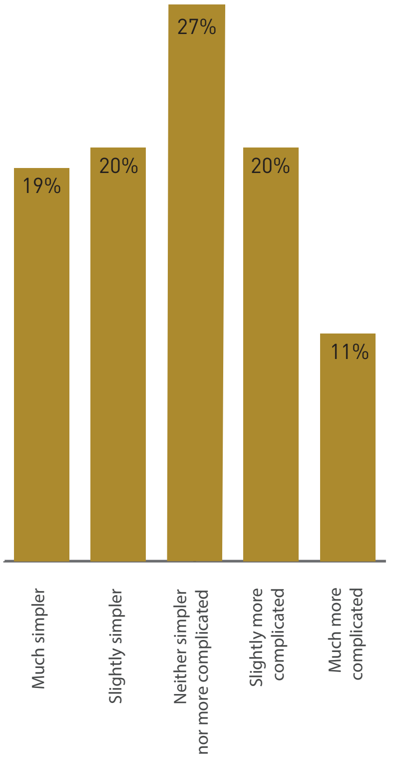
Brazil has huge opportunities for mining investments, considering that most of the country has not been geologically mapped and the mineral production could be doubled or even tripled within a short timeframe. In addition, Brazil offers political stability and respect to the rule of law, as well as a significant local market for several minerals, including iron ore and phosphate.

But investing in mining in Brazil also poses threats. Its complicated and time demanding environmental regulations are just a part of the governmental red tape, which increases costs and triggers delays. Moreover, the lack of infrastructure in certain areas of the country forces investors to fear significant additional costs such as building railroads and ports, or even housing and schools, depending on where the mine is located.

Although Brazil is not in the same nationalist mood as other developing countries, state and local governments still desire a larger piece of mining revenues. States all over the country have been creating new taxes on mining activities and the Federal government is about to present a proposal to increase the mining royalties.

Since colonial times mining has been a key economic activity in Brazil, and there has always been this tension between private investment and government willingness to increase taxes. But, considering the importance of mining for maintaining the country's

Fig. 15
How will the climate for investing in mining in Brazil evolve over the next 10 years?



> “There is too much protection from local government.”
>
> Financial Community, China
> commenting on the Brazilian mining market

foreign trade surplus and to keep the current level of FDI, we believe that the Government will consider, in its proposal of raising royalties, the need to keep economic certainty and balance to attract funds for new projects. The current trend in regulated activities in Brazil is to increase the governmental presence in the economy and, at the same time, to use capital from private parties.

"Identifying compliance risks and consultation with indigenous groups and local stakeholders are critical to getting any new project to start without immediate setbacks."

Greg McNab, Partner
Baker & McKenzie, Canada
commenting on the Canadian mining market

Canada

KEY FACTS

Canada came out on top for its encouraging investment attributes with 91% encouraged by the ability to enforce contractual rights there

88% believe that investing in Canada has become more expensive

73% believe that the Canadian Government has just the right amount of involvement in the mining industry

29% are encouraged by legal issues relating to indigenous people's rights

73% believe investing will grow more complex in Canada

The Canadian Government's belief that "resource development has vast power to change the way a nation lives"[39] underlines the importance of the mining industry to Canada's economic, political and social landscape.

Mining contributed CA$50 billion to the country's GDP in 2011 and accounts for more than one-fifth of Canada's exports. Canadian companies have close to CA$200 billion in assets throughout the world.[40]

Mining and its related industries are vitally important contributors to federal, provincial and territorial reserves. The industry paid an estimated CA$5.5 billion in taxes and royalties to federal and provincial/territorial governments in 2009. Over the past 20 years, the value of minerals and metals to Canada's economy has remained relatively stable at 3.5% to 4.5% of the country's GDP. [41]

Canada is currently the world's number one potash producer, second for uranium and a major global producer of most mineral and energy products.[42] Analysts predict continued strong growth for the Canadian mining sector with one forecasting an average annual industry growth of 8% between 2012 and 2016.[43]

Many in the industry believe that Canada's business environment is one of the world's most favourable for mining, due to its competitive tax structure, stable political landscape, vast natural resources and well-developed capital markets. This has made it an attractive location for mining company headquarters; including gold miners such as Barrick Gold, IAMGOLD and Kinross Gold as well as a number of smaller players. The nation remains home to the most top 100 mining companies in the world with 19 companies followed by China (17), Australia (11), the United States (11) and South Africa (9) according to Natural Resources Canada.[44]

It is little surprise that Canada is seen as having the most encouraging investment environment out of our countries surveyed. The positive environment is highlighted by the fact that companies are due to invest approximately CA$130 billion in Canadian mines over the next five years.[45] China has also been providing significant investment in the Canadian mining industry, surpassing CA$20 billion in 2011, becoming the second largest trade partner of Canada and the seventh largest source country of investment.[46]

Fig. 16
To what extent do each of the following factors encourage investment in mining in Canada?

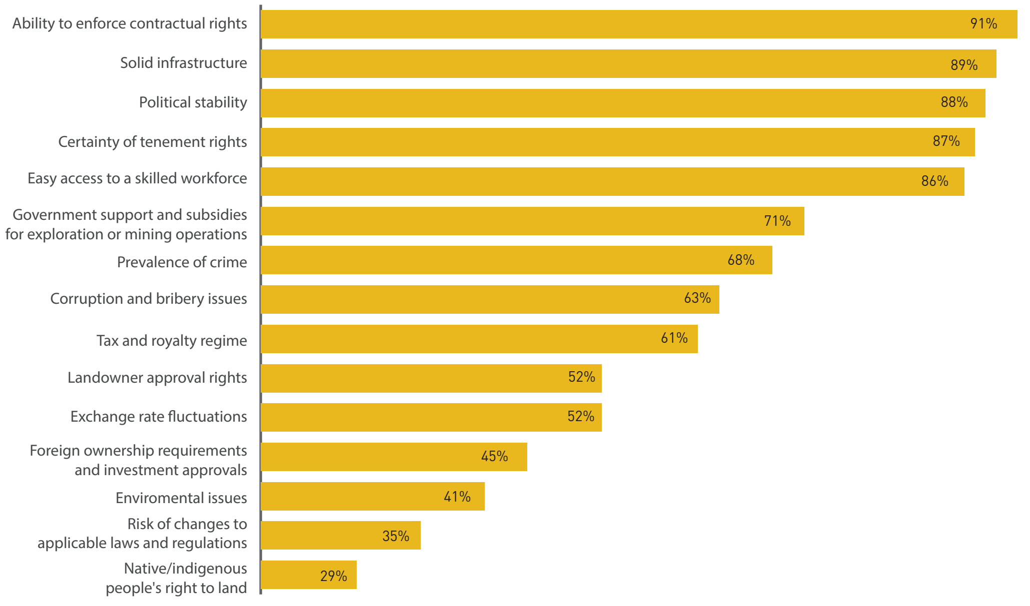


Fig. 17
Over the last 10 years, has investing in mining and extractives in Canada generally become...

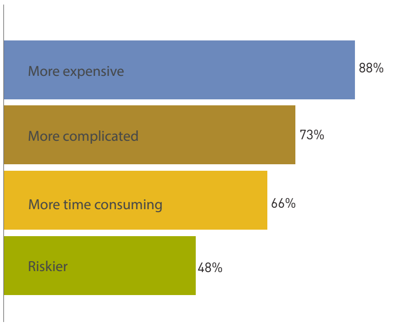


Fig. 18
Does political stability encourage or discourage investment in mining in Canada?

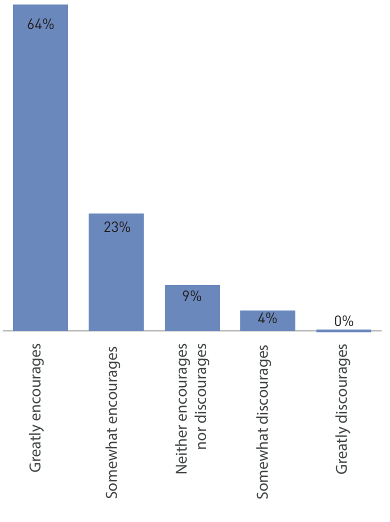
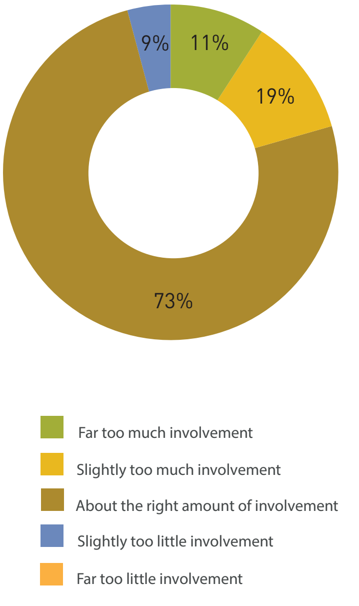
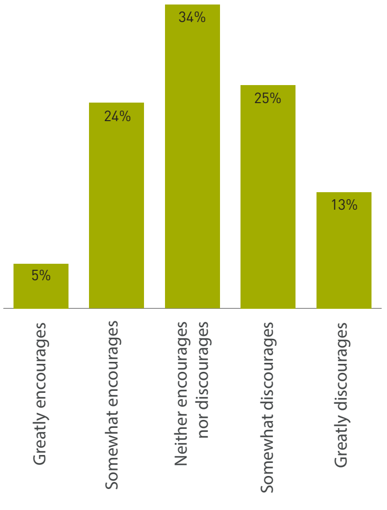


Fig. 19
Do you believe there is too much government involvement in the mining sector in Canada?



73% said there is about the right amount of government involvement in Canadian mining

Fig. 20
Does a commitment to sustainability, in relation to indigenous people, encourage or discourage investment in mining in Canada?



Legal certainty and complexity

Political stability (88%), solid infrastructure (89%) and the ability to enforce contractual rights (91%) are seen as the most encouraging factors for investing in Canada. Notwithstanding these results, our survey also notes that the industry has had to comply with rules and regulations not so favourable to business such as native and indigenous people's right to land (29%) and environmental regulations (41%) (Fig.16).

Our research has identified that over the past 10 years mining has generally become more difficult. 88% believed investing had become more expensive, 73% said it is more complicated, 66% said it has become more time consuming and 48% believed it has grown riskier as shown in Fig. 17.

Political stability

Canada is seen as the most politically stable country out of those surveyed in this study, with 88% believing that political stability in Canada is encouraging investment in the mining industry, with 64% being greatly encouraged (Fig. 18).

Canada has typically fared well on international indexes relating to corruption and ease of doing business. In 2011, Canada ranked 10th out of 182 countries in the "Worldwide Corruption Perceptions" ranking of countries by Transparency International.[47] It also ranks 13th in the World Bank's Ease of Doing Business Index, ranking 3rd on the ability to start a business.[48] This illustrates how stable and transparent governments are able to create a conducive environment for investment.

Despite regulatory hurdles, 73% believe there is about the right amount of government involvement in Canadian mining (Fig.19). This is highly encouraging for the future of the sector, showing that the Government has been able to find the right balance of providing a favourable environment for the industry to do business at the same time as respecting the rights of the indigenous communities in Canada.

Resource nationalism

One of the key legal issues facing the mining sector, at present and in the future, is the rights of indigenous communities to defend their land from mining exploration. Our research found that a significant proportion of the industry (38%) said that the legal issues surrounding indigenous people's rights is discouraging investment (Fig. 20).

Governments in Canada have increasingly considered the rights of indigenous people. In 2010, Ontario introduced changes to a 136 year old law governing mining in the province, including measures aimed at increasing native communities' control over their land, and limits on mineral rights on private property. [49] This followed increasing political pressure from the indigenous communities for changes to the old law. Community activists have become much more effective at challenging big projects with large environmental impacts, having had success winning injunctions to stop projects. Community consultation processes are now essential for companies that hope to win local support, and prevent strong opposition for their projects. The key issue for the Government is being able to balance the rights of those who live in communities affected by mining activities and those who own the rights to do the extracting.

Despite concern over the rights of Aboriginal Canadians, the mining industry has a largely positive relationship with the Aboriginal community. A TD Bank study released in June 2011 noted that the global commodities boom of the past decade has helped double the income of Aboriginal Canadians and their businesses. At the company level, business agreements with Aboriginal groups help facilitate progress on extractive projects, while providing investment in education, training, and jobs.[50]

Since 2004, members of the Mining Association of Canada (MAC) have been required to implement MAC's Towards Sustainable Mining (TSM) initiative. This initiative requires member companies to implement programs to meet requirements under the following performance indicators: Tailings Management, Energy Use and GHG Emissions Management, Crisis Management Planning, External Outreach. For 2012 the governance team has made performance improvement for energy use and greenhouse gas emissions management a top priority.[51]

Canada is trying hard to craft a favourable future for its mining industry. The Government is into its seventh year of comprehensive tax reduction, with federal business tax rates down to 15%, making it the lowest overall tax rate on new business investment in the G7. The Mineral Exploration Tax Credit associated with Canada's flow-through share mechanism, combined with relevant provincial credits, has also helped enhance mineral exploration and discovery in Canada.[52]

Access to infrastructure and workforce

Our research shows that 89% of respondents believe solid infrastructure encourages investment (Fig. 21). Mining and infrastructure investments often work together in a virtuous circle encouraging each other's growth. This is shown by the fact that the mining industry accounts for 21% of total Canadian goods exports – a consequence of this is that over half of the freight revenues of

89% said solid infrastructure encourages investment in Canada's mining industry

Fig. 21
Does solid infrastructure encourage or discourage investment in mining in Canada?

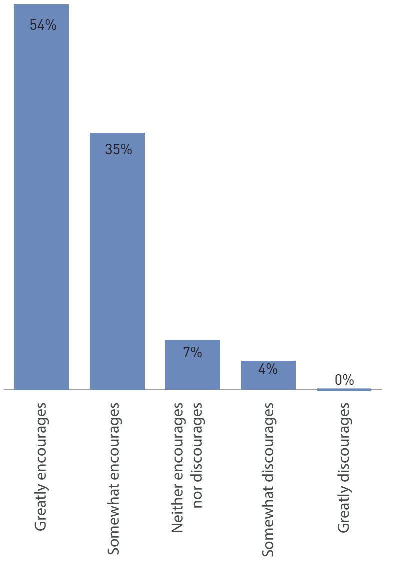
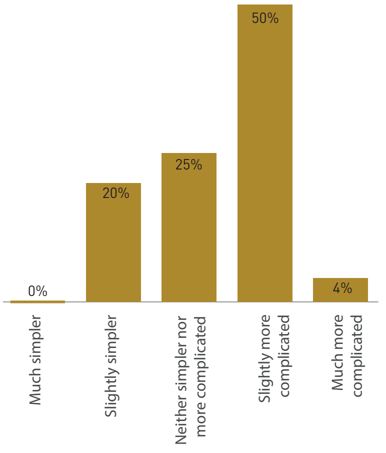


Fig. 22
How will the climate for investing in mining in Canada evolve over the next 10 years?



Canada's railroads are generated by the mining industry. Canada also features world-leading mineral exploration capabilities, with an estimated 1,000 Canadian exploration companies active in over 100 countries.[53]

The mining sector is the largest customer for Canada's transportation sector. Despite this, it is believed that investment is needed in areas such as northern all-weather roads, sea ports, rail and inter-modal links and marine facilities.[54] When interviewed, our respondents revealed that the industry believes that well directed public investments can in fact improve the economics of numerous potential mining projects in remote regions.

The mining industry accounts for approximately one of every 50 Canadian jobs. As defined by Statistics Canada and Natural Resources Canada, the mining and mineral processing industry directly employed 306,000 people in 2009.[55]

Future outlook

We can conclude from responses relating to the countries analysed as part of our research study, that Canada leads the way in attracting investment into its mining industry. The Canadian Government, it seems, has found the right balance between protecting the interests of the mining industry in addition to respecting and upholding the rights of wider stakeholders.

Although the nation is set up to sustain growth in its industry, looking to the future, there are a few key concerns noted by our respondents, outlined in Fig. 22. These concerns are set against the backdrop of economic uncertainty. The fact that the EU accounted for nearly a quarter (23%) of Canada's mineral exports in 2011 does raise concerns around the impact of Europe's economic troubles on the future of this demand.[56]

Fundamental to Canada's record of success in exploration and mining is their ability to explore large tracts of land. The extent to which the land base is available for exploration has a significant influence on the amount of export revenue received. Maintaining ease of access for exploration will remain key challenge for the Canadian Government.

Also important are federal regulatory processes that can operate in an inefficient and duplicative manner. Project review processes for example can sometimes take five years or longer. To reform this process, moving from a double approval to a single approval process is an important step towards ensuring mining and exploration can be conducted effectively. Clarity on the tenure of transborder lines as certain areas require approval to mine can go right up to the border of a neighbouring country where there are different laws and regulations. Prime Minister Stephen Harper has also voiced commitment to end duplication between departments and overlapping federal, provincial and territorial reviews of new mining projects, saying, "One project, one review".[57] Ensuring efficient implementation of this plan will prove important to the future success of the industry.

Recommendations

Canada continues to present a stable and progressive jurisdiction for mining investment due to its lack of political turmoil and consistent regulation. The Canadian Government recognises the value of the industry to the Canadian and global economy and is generally supportive of both domestic and international mining company efforts. Like many nations, Canada does monitor and review significant foreign investments, but a very high percentage of the those investments proceed with little or no intervention. In addition, Canadian mining legislation at both the federal and provincial levels is being refined as part of ongoing efforts to streamline the project approval process. As Canada's regulatory regime is refined however, it does mean that an increased amount of effort will be required to ensure that social issue issues such as indigenous peoples consultation and environmental damage are considered.

In addition to a stable regulatory platform, Canada continues to offer access to significant mining capital resources – the Toronto Stock Exchange and the Canadian capital markets, generally. The Canadian investment community also continues to focus on resources companies, and the Toronto Stock Exchange continues to pursue its goal to be the dominant international platform for resource issuers. Coupled with efforts to streamline securities offering laws in Canada, the Canadian markets continue to develop as a leader in resource company finance.

> "The level of involvement by other parties in aboriginal groups and nature conservation areas will hamper development opportunities and timelines."
>
> Senior Decision Maker, Canada
> commenting on the Canadian mining market

“To be successful in today’s environment, mining companies need to be proactive in their identification of significant risks.”

Greg McNab, Partner
Baker & McKenzie, Canada
commenting on the global mining market

“Mining companies continue to believe in the emerging markets story, and particularly in China, given the strong demand for primary resources as well as the targeted GDP growth in China’s 12th Five Year Plan.”

Stanley Jia, Partner
Baker & McKenzie, China
commenting on the Chinese mining market

China

KEY FACTS

73% saw infrastructure as one of the most important factors in encouraging investment within China

88% agree that investment in China has become more expensive over the last 10 years

52% believe China's low crime rate encourages investment in mining

62% saw corruption and bribery issues as the greatest factor in discouraging investment in mining

55% believe China's political stability encourages investment

China's mining sector is large and diverse. According to the World Bank, natural resource rents accounted for 4% of its total GDP in 2010.[58] It is a world leader in mining and ore processing and has an abundance of natural resources, specifically coal, iron ore, mercury, tin (China is the largest tin producer in the world, exporting 60% of its output), aluminium and other base metals. It also controls much of the world's supply of rare earths – essential metals for the production of many advanced technology products.

Despite the significance of the mining sector to its economy, and the large amount of reserves in its possession, the huge demand for many raw materials in China is outstripping domestic supply leading it to rely heavily on imports, especially of crude oil, gas and copper. Indeed, some analysts suggest that with domestic consumption growing at least 10% each year, China will soon become a net importer of many natural resources, including rare earths over which it currently accounts for 90% of the world's supply.[59]

A current GDP growth rate of approximately 8% and being home to one fifth of the world's population means China's consumption of natural resources is huge, and growing. China consumes one-third of the world's steel and over a quarter of the world's aluminium, and these figures look set to rise. Although home to many natural resources, China relies heavily on imports of a number of raw material types, including crude oil and copper – the International Energy Agency expects China's imports of oil to triple by 2030.[60] One way to reduce reliance on imports is to increase domestic productive capacity, and opening up the investment regime to stimulate greater financial investment and international technology transfer. Wang Min, Vice Minister of Land and Natural Resources, stated in June 2012 that China must do more to encourage mine explorations in order to reduce its dependence on foreign reserves.[61]

This increasing reliance on imported raw materials is having an impact not only in China, but also in the countries and regions around the world which are meeting the demands of China's ever increasing resource requirements.

Fig. 23
To what extent do each of the following factors encourage investment in mining in China?

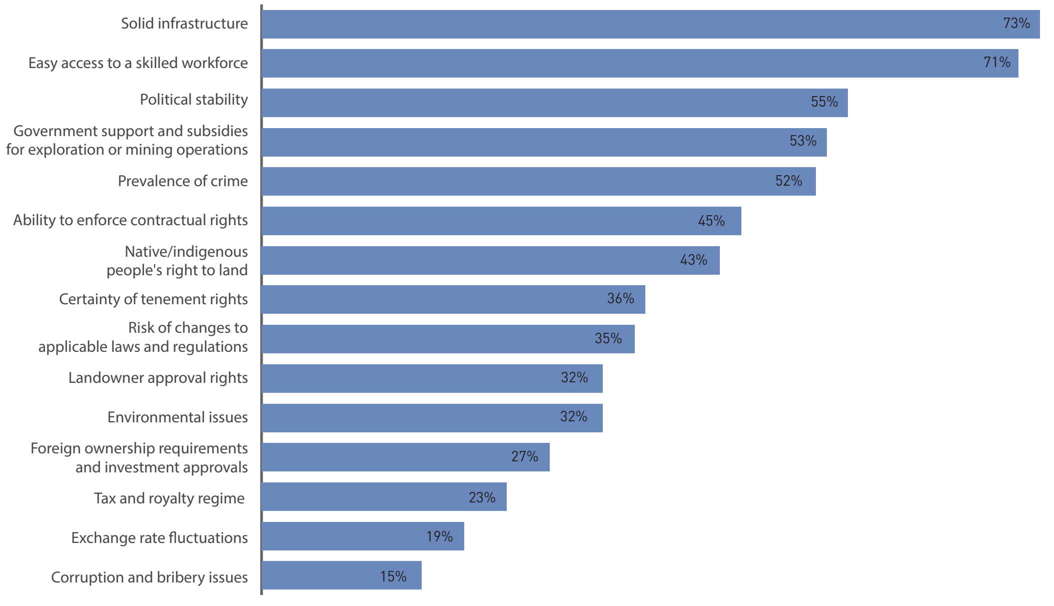
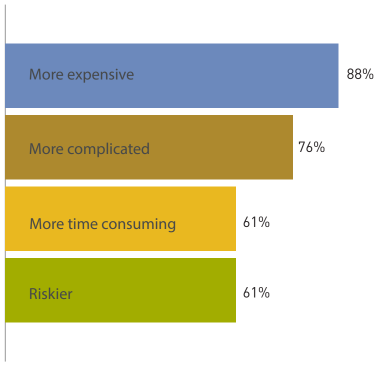


Fig. 24
Over the last 10 years, has investing in mining in China generally become...



"The reduction of resources, vicious market competition, and too many corruption and bribery issues."

Senior Decision Maker, China
commenting on the Chinese mining market

It is with this backdrop that the World Bank has identified four key challenges for China's energy and mining sector: [62]

1. Ensuring supply-side reliability to meet future demand growth.
2. Managing the environmental impact of the industry, especially coal production
3. Increasing the diversity of China's energy sources to include a greater reliance on gas and renewable energy sources.
4. Increasing the efficiency of energy use.

We asked which factors are most likely to encourage investment into China's mining industry. 73% of respondents agreed that solid infrastructure encourages investment and 71% agreed that easy access to a skilled workforce encourages investment. A majority of respondents also agreed that political stability, government support and subsidies for the sector and a favourable crime rate are factors which will encourage investment into the sector as shown in Fig. 23.

When we asked respondents about investment climate trends in China over the last 10 years, most respondents (88%) agreed that investment in China has become more expensive (Fig. 24). A large proportion (76%) also thought that it has become more complicated, and we explore the reasons for this later in the chapter.

"It is getting too risky and I feel that resource nationalism is already in place."

Mining Services Company Decision Maker, Indonesia
commenting on the Chinese mining market

Legal certainty and complexity

Respondents were asked a number of questions concerning the legal matters in China, covering issues such as crime levels, prevalence of corruption and bribery and the enforcement of contractual rights. Respondents commenting on China were split – 45% thought that the ability to enforce contractual rights in China encourages investment, and 33% expressed a concern that the ability to enforce contractual rights in China is insufficient, and is a discouraging factor. Respondents from China and Indonesia were more likely to view the ability to enforce contractual rights in China favourably, whereas respondents from Australia and South Africa were most likely to be concerned.

The World Bank has identified environmental concerns in China specifically around coal mining. Environmental issues in China were a concern to 32% of respondents in our survey who thought that they are discouraging investment (Fig. 23). 44% viewed the situation more favourably, being either greatly or somewhat encouraging factors. One concern about resource waste and pollution relates to the funding of exploration projects. One respondent said "when there is a lack of funding of resource exploration, the resource exploration cannot be implemented efficiently, which causes resource waste and pollution".

Political stability

China is politically stable with changes in the top leadership taking place approximately every 10 years. 2012 (or early 2013) will be a significant year for China's Government as the current leadership steps down and make way for a new generation of leaders. However, although leadership at the top of the spectrum is very stable, political risk can be an issue for foreign companies investing in China. As Ian Bremmer and Fareed Zakaria write in the Harvard Business Review, "foreign firms in China operate in an uncertain, politically influenced investment climate. Local Chinese competitors are often better able to navigate the country's labyrinthine business environment".[63] Our results, however, suggest that political stability in China is a positive force for investment in the country's mining sector. More than a quarter of respondents (27%) thought that China's political stability greatly encourages investment and only 3% thought that it greatly discourages investment. Overall, 55% of respondents thought that political stability in China encourages investment and less than a fifth of respondents (17%) agreed that political stability in China discourages investment.

When we asked the mining industry about government intervention in the mining sector, a majority (55%) of respondents agreed that there is too much intervention. Just under a quarter (24%) thought that there is the right amount of intervention (Fig. 25).

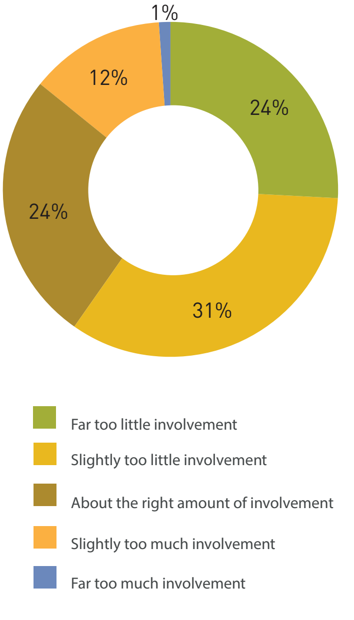
Given China's planned economic and government system, it is unlikely that the Government will reduce its intervention in mining. In fact, intervention is likely to increase as China looks to explore ways to stimulate greater investment and productivity in the sector. China is unlikely to rely on market forces alone.

Intervention is not just on economic grounds. China is taking a keener interest in corporate, social and environmental responsibility issues. Environmental regulations are discussed in more detail later in the chapter, but other areas where the Government has intervened in the mining industry include the recent announcement by China's State Council on 3 August 2012 of a three year plan to improve safety standards in the sector.[64]

We asked respondents what impact they thought the level of crime would have on investment decisions in China's mining industry. The picture is favourable, with 52% of respondents agreeing that China's low crime rate encourages investment in mining. Slightly more than a quarter thought that China's crime rate has a negative impact. Interestingly, respondents from Indonesia and South Africa – commenting on investing in China – were more likely to view China's crime rate situation negatively. Respondents from Australia and Canada were more positive.

55% said political stability in China encourages investment

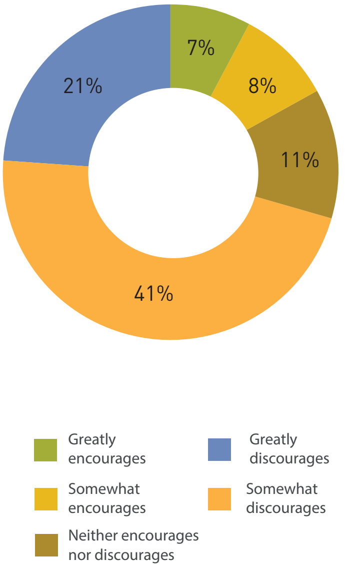
Fig. 25
Do you believe there is too much government involvement in the mining sector in China?



"Too many layers of government."

Senior Decision Maker, Australia commenting on the Chinese mining market

Fig. 26
Do corruption and bribery issues encourage or discourage investment in mining in China?



When we asked about corruption and bribery issues, the picture was a little different. Whilst respondents overall viewed the impact of China's crime rate favourably, when we asked specifically about corruption, the majority of overall respondents (62%) viewed corruption in China as a problem, specifically agreeing that corruption and bribery issues somewhat or greatly discourage investment in the mining industry. 11% of respondents said they "don't know" and only 15% respondents believed that the level of corruption and bribery in China encourages investment as shown in Fig. 26.

Resource nationalism

Resource nationalism in China seems to be underpinned by an increasing reliance on imports of raw materials. As noted above, although China currently controls approximately 90% of the world's supply of rare earth metals, it is expected to become a net importer of rare earths over the next few years. A growth in domestic demand is leading to supply-side pressures that are being addressed in two ways:

1. A search for alternative sources of supply, based overseas
2. Restricting exports of raw materials

The latter has featured prominently in the news over the last couple of years. In June 2012 China's Government published a white paper on the "Situations and Policies of China's Rare Earth Industry". The white paper promises stricter environmental standards and greater regulation of the mining, production and export of the minerals. The white paper was preceded by the creation of a China Rare Earth Industry Association in April 2012.[65]

The factors driving these developments are not just limited to a concern about the environmental impact of rare earth mining – rare earths are a key component in the high technology supply chain and any move towards a dependence on imports – no matter how large the domestic supply – will have national economic security implications.

Another issue concerning nationalism is foreign ownership requirements and investment approvals. As noted, authorities in China are trying to stimulate greater investment in the mining sector but our research results suggest that more needs to be done, as opinion is fairly divided as to whether the current foreign ownership and investment approval regime encourages investment. Only 27% of our respondents thought the regime encouraged investment (Fig. 23).

Our findings suggest that overall, the tax and royalty regime for mining firms operating in China can be improved. As shown in Fig. 27, 22% thought that the current regime encourages investment and 37% thought that is a discouraging factor.

When it comes to views on government support and subsidies, the conclusion is even clearer. 53% of overall respondents thought that the government support and subsidy regime for mining in China encourages investment and only 16% thought that it discourages investment.

Access to infrastructure and workforce

Infrastructure is one of the most important factors when it comes to investing in the mining industry in China. An overwhelming 73% thought that it either greatly or somewhat encourages investment. Only 1% of our respondents thought that China's infrastructure greatly discourages investment and 12% thought that it somewhat discourages investment (Fig. 28).

The recent slowdown in the Chinese economy has prompted the Government to target and accelerate infrastructure investment. In its latest economic outlook report on China published in May 2012, the OECD encouraged China to speed up the implementation of infrastructure projects in an attempt to mitigate the effects of the economic downturn.[66]

With such a large population it is not surprising that 71% of respondents thought that access to a skilled workforce in China was an encouraging factor. While China is currently benefiting from a large working age population, demographic pressures will lead to new public policy challenges in the future.

Future outlook

Despite many encouraging factors in China, respondents expressed a concern that investing in China's mining industry is going to get more complicated over the next 10 years. 29% thought that it would get much more complicated and 33% thought that it would get slightly more complicated over the next 10 years. In contrast, only 3% thought it would get much simpler (Fig. 29).

Recommendations

With the continued momentum of growth, we expect that China will continue to be in strong need for minerals and natural resources, and as a result the mining industry will continue to play an important role in China's economy in the coming years. The Chinese Government encourages direct foreign investments with advanced technology and management skills, and environmentally friendly and energy efficient projects will be highly promoted and encouraged. State-owned and private Chinese companies are open to and exploring mining investments and acquisitions outside China.

29% said investing in China's mining industry will become more complicated

Fig. 27
Does the tax and royalty regime impact investment in mining in China?

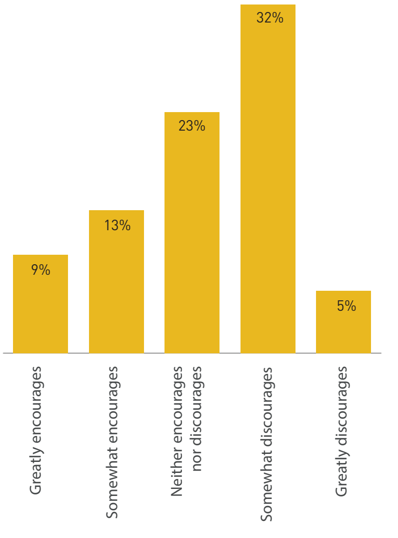
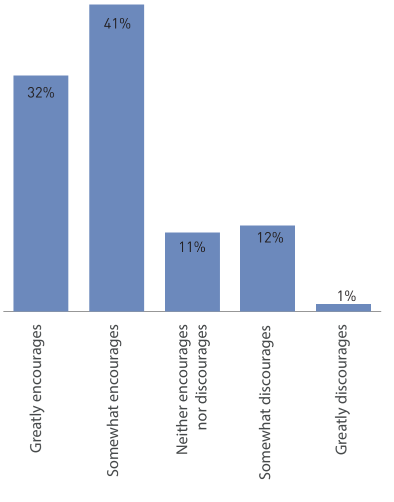


Fig. 28
Does solid infrastructure encourage or discourage investment in mining in China?



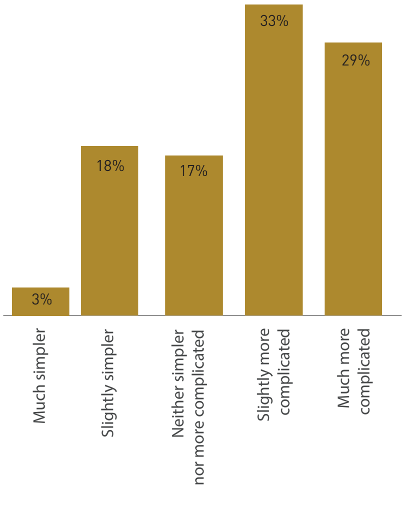
> "The best 10 years in mining industry are already passed, for now products are more than needed in the market."
>
> Mining Company Senior Decision Maker, China
> commenting on the Chinese mining market

Based on our survey results concerning China and comparisons against results for other jurisdictions, it would appear that that in all provinces, sustainable development of resources needs to be carefully monitored and enforced to ensure the balance between mining and environmental conservation is reached.

As with most other mining jurisdictions, China needs to monitor the rising cost of development to ensure its compositeness. It also needs to continue to develop the rule of law and investor confidence in enforcement mechanisms.

Our report also suggests that the central and local governments need to work in a co-ordinated manner to ensure consistency of policy. The new leadership can review how foreign investment and experience may be better utilised within China to assist in developing a sustainable resource industry.

Fig. 29
How will the climate for investing in mining in China evolve over the next 10 years?



"The suite of changes introduced since the 2009 Mining Law has certainly made life more difficult for foreign investors. Restrictions have left them re-considering the size of their investments in Indonesia, and in some instances looking altogether for new destinations for their investment capital."

Luke Devine, Foreign Legal Consultant
Baker & McKenzie, Indonesia
commenting on the Indonesian mining market

Indonesia

KEY FACTS

76% believe that corruption and bribery discourages investment

62% believe that Indonesia's skilled workforce encourages investment

52% believe the Indonesian investment climate will get more complicated in the future

59% believe that there is too much government involvement

51% believe that the current state of infrastructure discourages investment

Indonesia's mining industry is large and diverse and accounts for 17% of the country's GDP.[69] In recent years its mining industry has attracted significant FDI. In 2011, according to the Indonesia Investment Coordinating Board, mining accounted for 19% of all FDI (excluding oil and gas).[67]

Indonesia is the world's largest exporter of thermal coal and its major mineral resources include tin, nickel, bauxite, copper, coal and precious metals (gold and silver). Its gold mining sector is significant and Indonesia is home to the world's largest gold mine (and third largest copper mine – copper and gold are often mined together).

But whilst mining continues to attract foreign investment, recent policy changes have made it more challenging to invest in the sector due to limits on foreign ownership, restrictions on the export of raw materials without value-adding locally and support for local companies.[68]

The mining sector has a reputation for being poorly regulated in Indonesia. The authority for licensing mining activities has been largely decentralised to regional governments.

Legal certainty and complexity

We asked respondents which factors encourage or discourage investment in Indonesia's mining industry. 62% of respondents agreed that easy access to a skilled workforce encourages investment, followed by political stability and foreign ownership requirements and investment approvals as shown in Fig. 30. We refer to political stability and foreign ownership rules in greater detail later in the chapter.

Rule of law issues, such as the prevalence of corruption and bribery, accounted for some of the main factors likely to discourage investment in Indonesia's mining industry.

Looking back over the last 10 years, a majority of respondents feel that investing in mining in Indonesia has become more burdensome. 80% feel it has become more expensive over the course of the last decade, 58% feel it has become both more complicated and more time consuming, and 55% feel it has become riskier (Fig. 31).

Fig. 30
To what extent do you think each of the these factors encourage investment in mining in Indonesia?

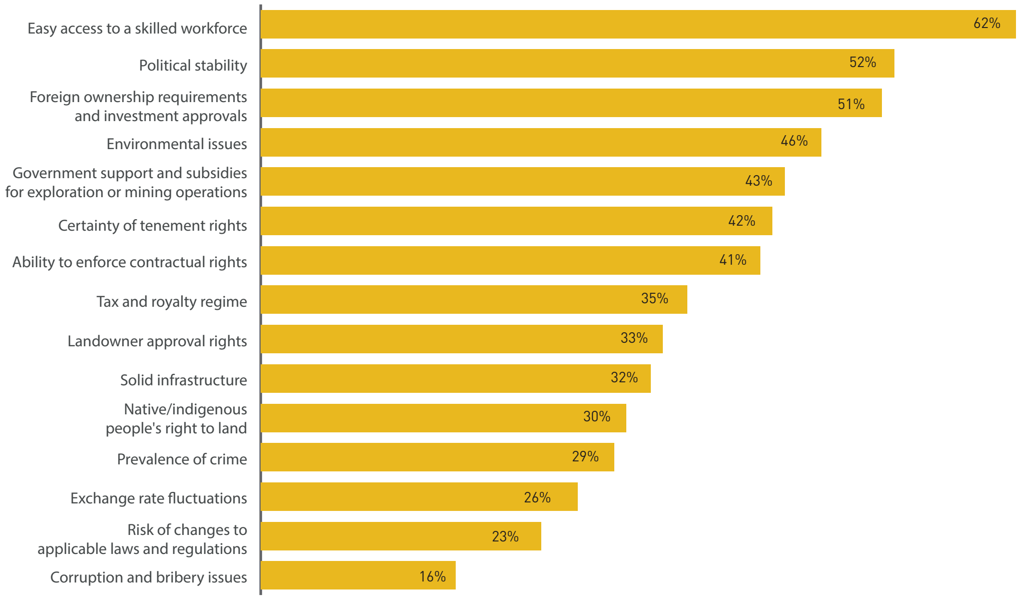


Fig. 31
Over the last 10 years, has investing in mining in Indonesia generally become...

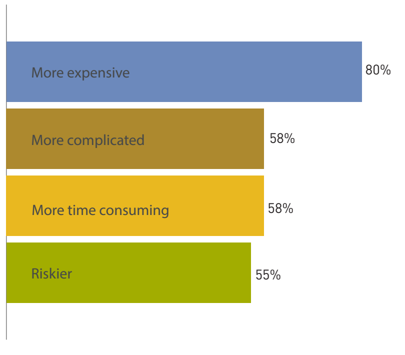
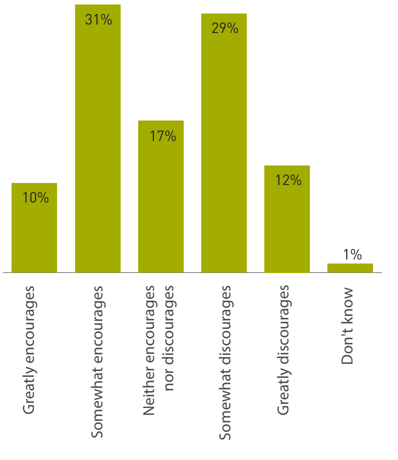


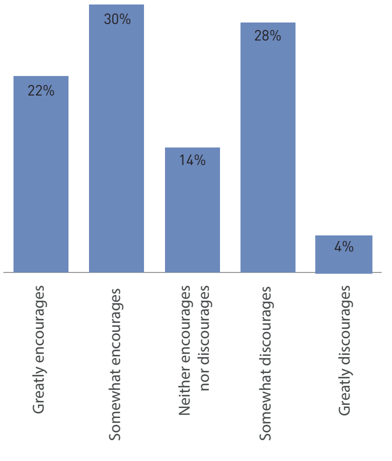
Fig. 32
Does the ability to enforce contractual rights encourage or discourage investment in mining in Indonesia?



“Corporate leadership needs to support strong, consistent implementation of compliance policies – whatever the cost. Ultimately, doing little or nothing may end up costing the business a far higher price.”

Mini vandePol, Partner
Baker & McKenzie, Australia
commenting on the global mining market

Fig. 33
Does political stability encourage or discourage investment in mining in Indonesia?



Views on the impact of the ability to enforce contractual rights in Indonesia on investment decisions in mining are evenly spread. 41% agreed that the ability to enforce contractual rights encourages investment and exactly the same amount (41%) were of the opinion that the ability to enforce contractual rights discourages investment as shown in Fig. 32.

In 2003 the World Bank warned Indonesia that the environmental impact of its mining industry is very costly. In its study, the World Bank accused most medium-scale and local miners of being reckless with the environment.[70] Since then, Indonesia has been striving to reduce the negative environmental impact of its mining industry and more recently, in May 2011, the Government announced it would audit over 8,000 mining permits to ensure the permit holders are abiding by environmental laws.

Despite this uptick in the enforcement of environmental regulations, our study suggests that the environmental regulatory regime in Indonesia is viewed favourably by the mining industry. 46% of respondents thought that the regime encourages investment, as opposed to 22% who think that it discourages investment in the sector.

This is indicative of the fact that, compared to some of its more developed neighbours such as Australia, the processes and timelines to obtain environmental approvals in Indonesia for mining projects are significantly simpler and less time consuming.

Political stability

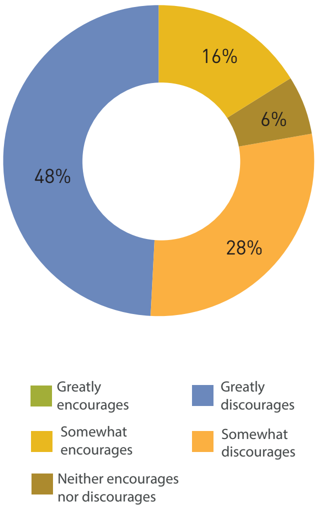
Since the late 1990s Indonesia's political system has gone through quite radical change. Following a period of dictatorship, Indonesia has successfully transformed itself into a multi-party democracy, with term limits on senior members of the executive and a high degree of checks and balances. These reforms seem to be paying off and overall, a majority of respondents thought that political stability in Indonesia is an encouraging factor. 52% said that political stability encourages investment in mining and 32% thought that it discourages investment (Fig. 33). It should be noted, however, that respondents from Indonesia are more optimistic than respondents from other countries in this study.

Corruption remains a large problem in Indonesia. In Transparency International's 2011 Corruption Perceptions Index[71] Indonesia ranks joint 100. In recent years, Indonesia has embarked on a large-scale corruption crackdown and the Corruption Eradication Commission (KPK) has been aggressively pursuing powerful individuals suspected of corruption.

Despite this crackdown, corruption remains a real concern for our respondents with nearly half (48%) agreeing that corruption and bribery in Indonesia greatly discourage investment in mining. This is reflective of the fact that, despite some large and high-profile corruption prosecutions involving central government figures, the regionalised nature of mining sector regulation exposes mining companies to corruption and bribery challenges at a less highlighted regional government level. Overall, 76% of respondents thought that corruption and bribery issues discourage investment (Fig. 34).

When we asked about crime issues more broadly, 46% thought that the prevalence of crime discourages investment, compared to 29% who thought the current situation is positive enough to encourage investment.

Fig. 34
Do corruption and bribery issues encourage or discourage investment in mining in Indonesia?



Resource nationalism

Resource nationalism is a growing concern in Indonesia. In May 2012, the Ministry of Finance introduced a 20% export tax on metallic and non-metallic mineral ores. The export tax is designed to boost investment in onshore minerals upgrading and processing activities. The new tax is on top of further regulations passed earlier in 2012, including a future ban on the export of certain unprocessed minerals, including gold, silver, nickel and copper, from 2014.

Further restrictions were implemented by the Indonesian Government in February 2012 on the foreign ownership of mines and mining companies, essentially limiting foreign ownership in mining companies to 49% after 10 years of production.

However, despite the recent regulatory developments, our survey indicates that Indonesia's current foreign ownership rules and investment approvals regime is favourable with half of our respondents agreeing that the rules encourage investment in the sector (Fig. 35). Only 35% agreed that the rules discourage investment.

Government intervention in the sector is seen as a discouraging factor. This might be, in part, a response to the Government's recent announcement to increase export taxes and prohibit the export of certain raw resources altogether.

42% agreed that there is slightly too much government involvement, and nearly one fifth (17%) thought that there is far too much government involvement in the sector as shown in Fig. 36. Conversely only 9% and 1% thought that there is slightly too little or far too little involvement in the sector respectively.

Fig. 35
Do foreign ownership rules and investment approvals encourage or discourage investment in mining in Indonesia?

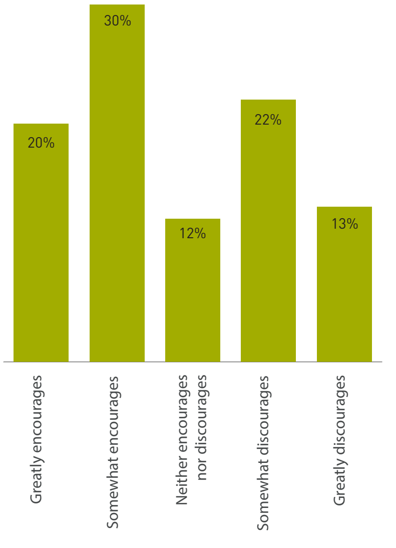


Fig. 36
Do you believe there is too much government involvement in the mining sector in Indonesia?

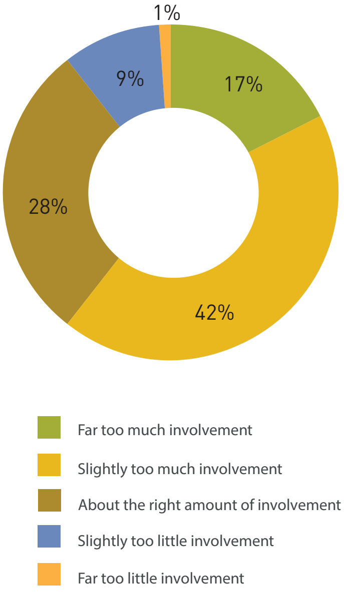
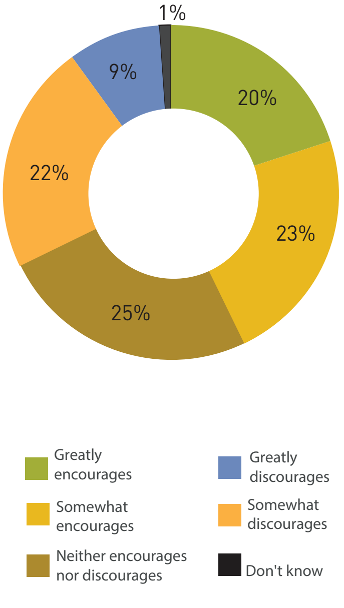


Fig. 37
Do government support and subsidies for exploration or mining operations encourage or discourage investment in mining in Indonesia?



Opinion was more evenly split on the impact of government subsidies on investment (Fig. 37). Overall, 43% thought that government support and subsidies for exploration or mining operations encourages investment in the industry, with 31% disagreeing. Nearly a quarter of respondents thought that government support and subsidies neither encourages or discourages investment indicating the Government could be doing a lot more to promote the benefits and advantages of the government support schemes on offer.

Turning to the taxation and royalty regime, 35% thought that it encourages investment and 42% thought that it discourages investment.

Access to infrastructure and workforce

In the Asian Development Bank's (ADB) report Asian Development Outlook 2012, Indonesia was encouraged to increase its spending on infrastructure projects.[72] Respondents to our survey appear to agree that more should be done to improve Indonesia's infrastructure (Fig. 38). Nearly one fifth of respondents thought that the current state of Indonesia's infrastructure greatly discourages investment in mining and 32% thought that it somewhat discourages investment in mining.

With coal historically being the dominant mining export out of Indonesia, and the coal sector being well serviced by barges and trans-shipment facilities traversing Indonesia's network of rivers and islands, hard infrastructure demands in Indonesia have not been a necessity. However today, as mines with significant reserves are being developed further away from river ports and coastlines, Indonesia is now being forced to look at infrastructure solutions such as coal railways and larger port facilities to move coal.

With almost all of Indonesia's mines being relatively shallow open-cut mines (and predominately truck and shovel operated coal mines), Indonesian mining practices do not involve some of the technical challenges encountered in jurisdictions where underground projects are prevalent. As a result, Indonesia's population of approximately 240 million provides a very large pool of both unskilled and skilled workers to support Indonesian mining projects.

Whilst mining projects in Indonesia, like those anywhere in the world, have their share of employee related disturbances (the most recent examples of which have been at the Freeport mine in Papua and the Newmont Batu Hijau mine), organised trade unions do not play as big a part in mining employee affairs as in other mining jurisdictions. For these reasons, it is not a surprise that respondents have ranked access to a skilled workforce as a significant incentive (62%) to encouraging investment in the Indonesian mining sector.

Future outlook

In terms of the future outlook for Indonesia's mining industry, a majority of respondents were of the opinion that the situation will get more complicated (Fig. 39). The largest group of respondents (32%) think that the regime will get slightly more complicated and 20% think that it will get much more complicated. Some of the reasons given for this were "the recent changes of laws for foreign ownership" and "as a result of the announced reforms … loosely described as nationalist policies in the extraction industries". It therefore appears that recent regulatory changes are having a negative impact on sentiment amongst the mining industry.

Concerns have also been expressed about increasing nationalism, with one respondent from the mining industry commenting on the recent reforms:

"I think they are just trying to get more money out of the foreign mine owners there, it does make life more difficult. They want a lot more of their own people taking over the mining activity to keep the funds internal and probably a lot of the investment has been to take it out, rather than increase skills".

Concerns about the future outlook for the sector have been expressed more broadly with one respondent saying: "I think it is going to be more complicated, especially the changes in government regulations, the political issues in Indonesia, uncertainty in the regime, corruption and higher taxes".

Recommendations

Our study confirms that Indonesia remains a very good mining story. Blessed with an abundance of mineral and coal wealth, and strategically located within short distances to the resource-hungry Asian giants of India and China, Indonesia presents as an attractive investment destination for mining companies and investors in the sector. However, the study results very clearly indicate that the recent regulatory reforms have certainly caused a stir in the mining community, causing some investors to consider whether these compelling geological and geographical qualities are in fact outweighed by the uncertainties in the regulatory and investment framework. If the Indonesian Government can find the balance between protecting its domestic interests and ensuring appropriate benefits from its natural resource wealth are enjoyed by its citizens, and providing sufficient investment certainty and economic incentives for investors, Indonesia can certainly expect continued investment in its mining sector.

Fig. 38
Does solid infrastructure encourage or discourage investment in mining in Indonesia?

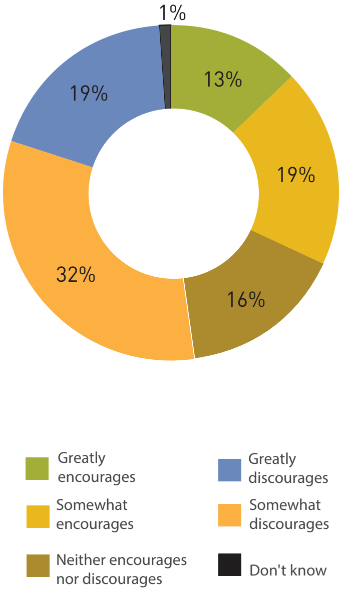
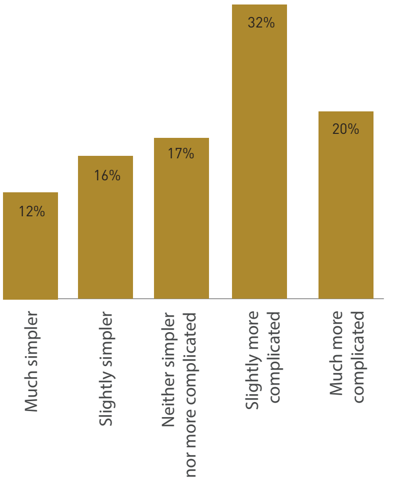


Fig. 39
How will the climate for investing in mining in Indonesia evolve over the next 10 years?



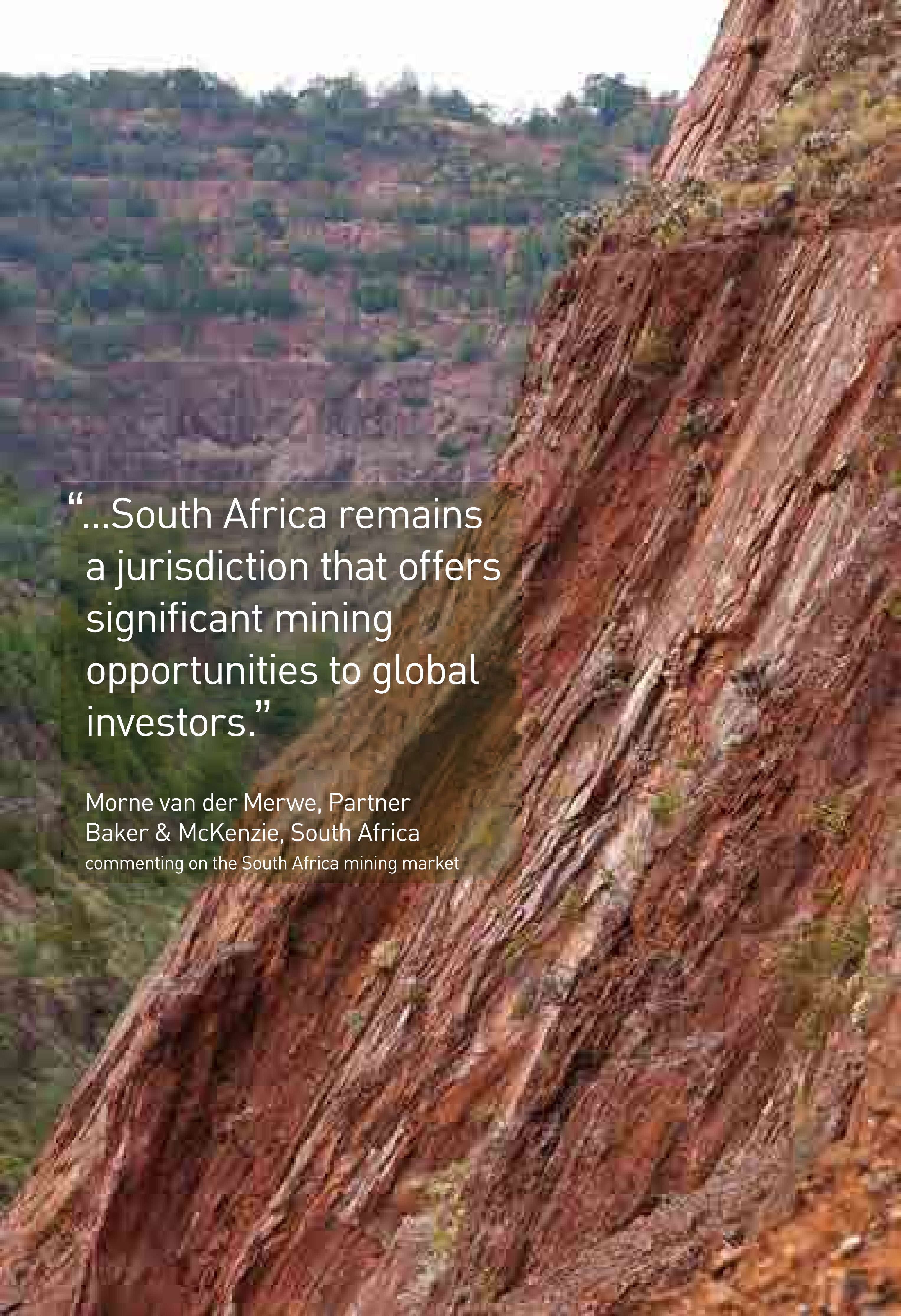
> "Resources are running out – the process for getting mini-licences or field exploration will be difficult and more stringent as the government will control the number of licences issued."
>
> Legal Counsel, Indonesia
> commenting on the Indonesian mining market

Corruption and bribery remains a significant deterrent for investors. Indonesia's largely decentralised system of awarding and regulating mining projects, with Regional Governments finding themselves with broad authority over mining investors, coupled with Indonesia's infancy as a fully functioning democracy, may be seen as contributing factors to our respondents' perception of the prevalence of corruption throughout the mining sector.

The very clear positives for Indonesia are the large human resource pool from which mining companies can draw to staff their projects, and the relative simplicity and efficiency of environmental permitting process for Indonesian mining projects(with Indonesia scoring the highest out of all countries surveyed in respect of environmental issues). Recent industry-wide audits of mining companies, and the addition of new environmental licensing requirements have done little to dampen the good spirits of investors in relation to Indonesia's environmental regulatory regime.

The early warning signals have been raised by respondents in respect of a two key issues: Indonesia's under-investment in mining infrastructure, and the increasing prevalence of crime and violence surrounding mining developments. As the majority of the early large-scale mines developed in Indonesia had easy access to river transhipment facilities or in some cases direct access to export load ports, infrastructure development was not high on the agenda. However, as mines have become further inland, volumes increase, congestion on Indonesia's rivers and new government restrictions on the use of public roads by mining companies - infrastructure is one of the near term challenges that will need to be faced by the industry. The respondents' feedback on the concerns over crime and violence are likely not so much driven by any concerns over an excessively high number of such incidents occurring, but perhaps are a reaction to the very high profile and public attention that these events attract when they do occur. Such events can have disastrous consequences from a public relations or shareholder value perspective for a mining company. More than ever before, mining companies will need to work in close collaboration with local communities, local governments and Indonesian authorities to ensure that such events are minimised both in number and scale.

Indonesia comes out of the survey with somewhat of a mixed report card. In some areas it is very strong, and others it is found lacking. The results however show that Indonesia has its fundamentals in check - relative political stability, Government support of the mining sector and investors having reasonable comfort over certainty of tenement rights. If Indonesia can address the areas of concern identified by our respondents, the focus of investors will certainly be honed back squarely on Indonesia's geological attractiveness - and that should lead to a considerable increase in investment.



"...South Africa remains a jurisdiction that offers significant mining opportunities to global investors."

Morne van der Merwe, Partner
Baker & McKenzie, South Africa
commenting on the South Africa mining market

South Africa

KEY FACTS

Crime (83%) and corruption (78%) are the two largest discouragements to investment in mining in South Africa

South Africa has US$2.5 trillion worth of untapped minerals

South Africa's ability to enforce contractual rights is the number one factor encouraging investment (62%)

58% believe that it will become increasingly complicated to invest in the sector in the next 10 years

The South African mining sector is getting costlier (92%) and risker (75%) to invest in

South Africa's environmental regulations are improving with only 32% discouraged from investment

The South African mining sector is one of the world's most important; it produces some of the largest quantities of minerals in the largest varieties. It possesses the world's largest reserves of chrome, gold, vanadium, manganese and platinum group metals (PGMs); moreover it is the leading producer in Africa of nearly all metals and minerals save diamonds, uranium, copper, cobalt and phosphates.

To give some sense of the importance of minerals to the South African economy, the sector is a direct employer of more than 498,000 people and, including multiplier effects, accounted for about 19% of GDP in 2010.[73] Between 10% and 20% of South Africa's direct corporate tax receipts stem from the mining sector, and 35% of the value of the Johannesburg Stock Exchange derives from mining.[74]

Whilst production of some commodities – notably gold – has fallen in recent years following the exhaustion of the easiest seams, South Africa is still more richly endowed with resources than even Australia, with an estimated US$2.5 trillion worth of minerals in the ground after over 100 years of heavy mining.[75]

In spite of its huge mineral wealth and long history of mining, the country is lagging behind in the level of FDI and overall production levels. Despite its mineral reserves, it is only the world's fifth largest mining economy.

The Fraser Institute, estimates that in spite of its many advantages the country only ranks 66 out of the 79 major mining areas in the world, only four places ahead of the Democratic Republic of Congo.[76]

The mining community shares these concerns about South Africa. Nearly all (92%) of those surveyed said that the country has become more expensive to invest in over the last decade, with nearly as many believing that investing in mining has become riskier, more complicated and more time consuming (Fig. 40). These opinions are borne out by the fact that whilst the South African economy has grown at a respectable 5% per annum in the last decade and joined the prestigious ranks of the BRICS economies, its mining sector has shrunk by 1% per annum.

Fig. 41
To what extent do each of the following factors encourage investment in mining in South Africa?

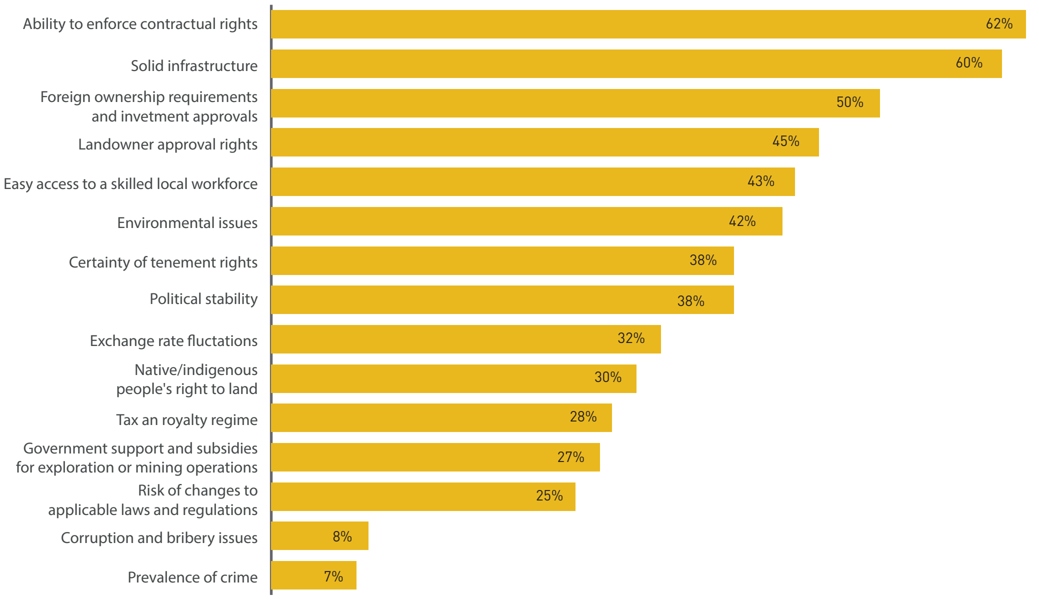


Fig. 42
To what extent do you think the following factors encourage or discourage investment in mining in South Africa?

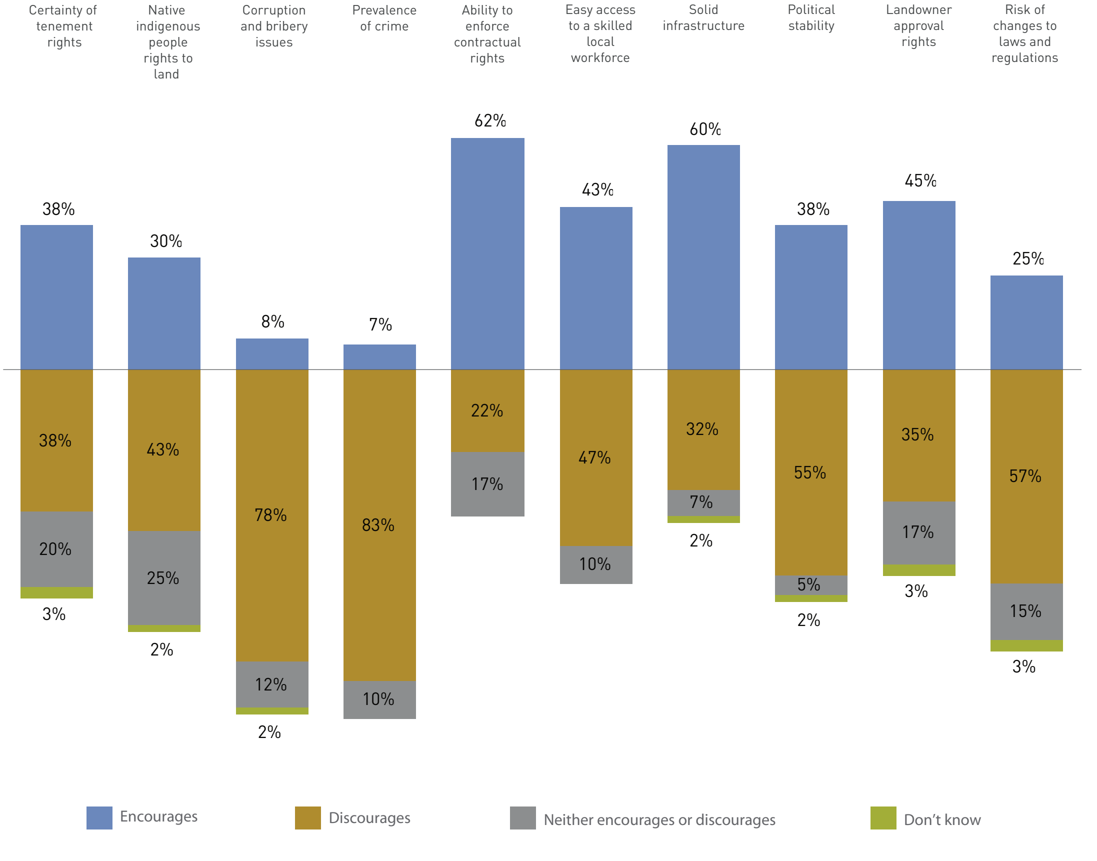
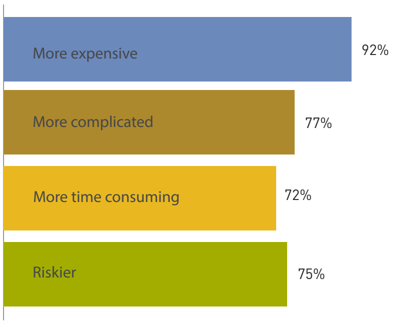


Fig. 40
Over the last 10 years, has investing in mining in South Africa generally become...



Foreign investment has also been low (although it has recently picked up), with FDI averaging less than 1.5% of GDP during 1994-2002 compared with 2-5% in a group of similar countries.[77] More recently, Ernst and Young noted that South Africa was fourth in Africa when it came to FDI inflows in the period 2003-11.[78] This is of particular importance to the long-term health of the South African economy since, unlike many other emerging markets, South Africa has a large current account deficit with the rest of the world, and at present relies largely on short-term portfolio inflows to make up the shortfall; a source of funding far less sustainable than FDI.[79]

Several themes emerging from our research findings, to be discussed in more detail below, help to explain this trend. It should also be noted that our research indicates that South Africa still maintains key strengths that encourage foreign investment. Chief amongst these are its legal system and its infrastructure, which large majorities of the mining community endorsed in our survey (Fig. 41).

On the other hand, problems relating to crime and corruption appear to reduce the appetite for investment. There is a concern in relation to the language of nationalisation despite the fact that the ANC-controlled government has on numerous occasions confirmed that nationalisation does not form part of official government policy. The impact of South African mining legislation introduced almost a decade ago was to bring in the "use it or lose it" principle and effectively place the exploitation of mining assets under the control of government.

Finally, companies are increasingly concerned about changes to taxes and regulations which may make investment a less attractive prospect.

Legal certainty and complexity

One of South Africa's key strengths is its legal system and corporate governance. South Africa is a constitutional democracy where the rule of law and independence of the judiciary prevail.

South Africa is commended by the World Economic Forum in its latest competitiveness report, where it is ranked 30th in the world for its intellectual property protection, 30th for its property rights protection and 3rd for the accountability of its private institutions.[80] These are important building blocks for a well functioning and competitive mining sector where contracts and rights are enforced properly. Our research confirms that these attributes are recognised and rightly praised, especially in the areas of contract enforcement and landowner approval rights as shown in Fig. 42.

Opinion is split over whether the current state of environmental regulation encourages or discourages investment into South Africa. Several damaging legacies from past mining projects have turned environmental impacts into a major issue, particularly the overflowing of acid from the Western Basin into Robinson Lake in 2002. Licences are often long-standing and date from before the age of standard environmental clauses.

However, new participants are compelled to provide far more clarity on the impact of their decisions on the environment, suggesting that the future situation will be far more positive. Only 32% of our respondents disapproved of South Africa's environmental regulations, and many prominent industry figures have praised its regulations as amongst the strongest internationally. In 2011, Lambertvan der Nest from Fraser Alexander stated: "South Africa has some of the best environmental legislation in the world and we are seeing the application of these moving in the right direction".[81]

Political stability

55% of the mining industry participants surveyed showed concern over South Africa's political stability (Fig. 42). The Government of President Zuma, whilst occasionally accused of rhetoric that could rattle investors, has generally attempted to encourage the mining industry.

However, disappointing economic growth, high unemployment (the financial crisis cost South Africa a million jobs) and increasing factionalism within the ruling ANC has raised the prospect of a challenge to Zuma's leadership at the party's December conference.

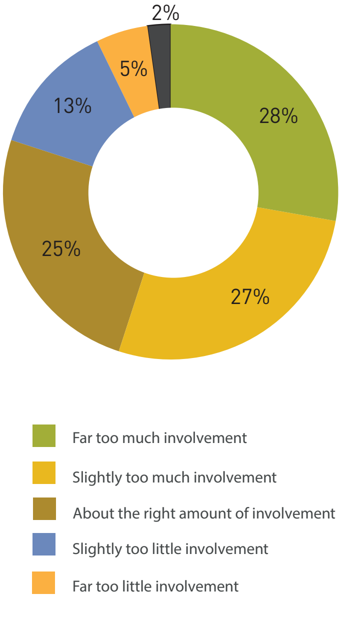
A director of investment bank Macquarie First South was quoted making this point in 2011, noting: "what you are starting to see, especially from a foreign investor's perspective, is that politics in South Africa matters".[82] These political risks are unlikely to dissipate before South Africa's 2014 national elections. This is a potentially disruptive influence on those making mining investment decisions, given the long term prospects involved in mining projects and a fear of future changes to policy (Fig. 43).

Historically, South Africa has faced serious challenges in relation to crime. Recently statistics indicate that crime is on a downward trend with the murder rate in particular falling close to 50% between 1994 and 2010.[83] However, our research demonstrates that South Africa is still considered as a relatively dangerous country, and 83% of the mining community, with an interest in South Africa, view high levels of violent crime as a significant risk that discourages investors.

"The current political situation is moving from warranting to some nationalization."

Legal Counsel, South Africa
commenting on the South African mining market

Fig. 43
Do you believe there is too much government involvement in the mining sector in South Africa?



78% recognised that corruption and bribery discouraged investment

"For Australian companies investing in South Africa, one of the big issues is sovereign risk."

Legal Counsel, Australia
commenting on the South African mining market

The mining community has recognised that corruption and bribery issues discourage investment in South Africa with 78% of our respondents identifying that this issue as the greatest detractor to investment.

The 2011 Transparency International report revealed an increase in corruption. This has a negative impact on investment, as the general integrity of the South African legal system is undermined by bribery and corrupt practices in the granting of mining rights – highlighted by a series of scandals involving the sector in 2010.[84]

These events have forced the Government to undertake a review of how mining and prospecting rights are issued, as well as the concentration of power in the hands of a few mining ministry officials. Whether serious action is taken to overcome these problems will have profound consequences in terms of mining investment.

Resource nationalism

In November 2011, the African National Congress Youth League (ANCYL), the youth wing of South Africa's dominate political party, staged a march for "economic freedom mass action", which saw its members demonstrate outside the Chamber of Mines and its then president Julius Malema call for the nationalisation of mines.[85]

This call for nationalisation claims that according to the Freedom Charter, "all minerals must belong to the people". This statement caused unnecessary panic with investors. Subsequently, the ANC has clearly stated that it is not its intention to change its existing policies in relation to the mining industry as encompassed in existing legislation and regulations.

The Government has further allayed the fears of potential investors, with the national planning minister noting in 2011: "our responsibility must be to remove obstacles to investment. We need investment, jobs and taxes if we are to raise living standards". [86] These assurances seem to have comforted some, if not all, of the mining community.

Half of those surveyed in our research were encouraged by the Government's attitude to foreign ownership requirements and investment approvals. However, when expressing less enthusiasm about the future of mining in South Africa, many mining professionals specifically cite "political and nationalisation of mine issues" as a justification.

At present, the South African mining industry is very much open to foreign investment, and whilst most of the world's leading mining companies operate there, some originated there.

One of the recent controversies over mining in South Africa regards the ANC's recent proposals to introduce windfall taxes, as well as other new levies. Although the proposals were heavily opposed by the Chamber of Mines, they were favoured by the ruling party as a way of generating new revenue for government. However, discussion in relation to these proposals at an ANC meeting in late June 2012, led to the ANC failing to agree on an acceptable method of extracting more revenue from mining companies.

Our survey reveals that 57% of the mining community believes the risk of changes to the laws and regulations (including taxes) affecting the industry discourages investment, more than the current tax and royalty regime (Fig. 42).

Access to infrastructure and workforce

The South African Government understands the importance of infrastructure. President Zuma recently adopted an Infrastructure Plan aimed at strengthening all areas of South Africa's infrastructure, and the plan specifically notes how the mining sector in particular depends on links with the rest of country.[87]

It seems that this dedication has pleased the investment community, 60% of whom see infrastructure as a great encouragement to investment in mining in South Africa as shown in Fig. 44. Where the limits of the country's current system have been exposed, as they were in energy supply in 2008 when demand outstripped supply, government response has been bold. In the case of energy supply, a huge investment in new power stations was announced.

However, the state electricity provider Eskom has been given three years of electricity price rises, and has embarked upon a programme of power plant building, but admits supply will remain tight until at least 2017.[88] Under-investment has sent many sectors of South African infrastructure moving down the World Economic Forum's rankings over the past decade, and its creaking roads, railways, ports and water supply are all threats to a fully functioning mining sector.

The relatively unskilled and heavily unionised labour market of South Africa is also a problem: investment is difficult when hiring and firing is time-consuming and labour relations with employers are sometimes adversarial.

In 2010, the South African mining sector was a direct employer of around 498,000 people, and including multiplier effects accounted for about 19% of GDP.[89] However concerns have been raised about whether the country has a suitably skilled workforce to service the sector. Our research reveals a mixed picture. 43% of respondents

"Appoint people that are honest in the decision making positions."

Senior Decision Maker, South Africa
commenting on the South African mining market

Fig. 44
Does solid infrastructure encourage or discourage investment in mining in South Africa?

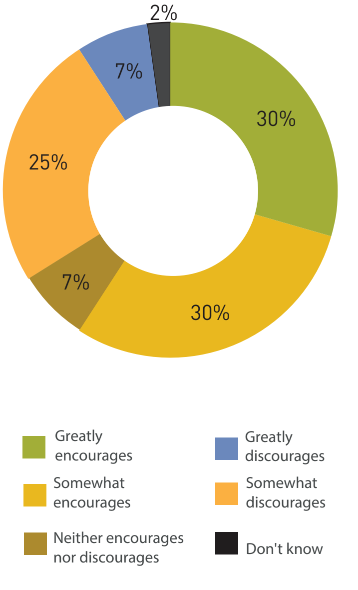
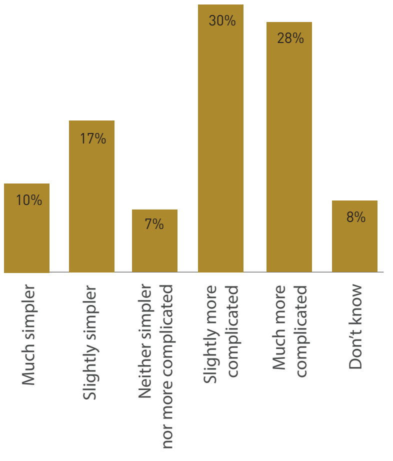


Fig. 45
How will the climate for investing in mining in South Africa evolve over the next 10 years?



said the quality of the workforce encourages investment in South African extractives, whilst 47% said it discourages it (Fig. 42).

The South African mining industry has significantly increased the level of employees entering technical training in recent years, and many of our respondents may believe that in the long term the South African skills gap can be closed.[90]

Future outlook

A majority of the mining community with an interest in South Africa are concerned that investing will become more complicated over the next 10 years as shown in Fig. 45. As we have seen, this opinion is likely informed somewhat by the various issued raised above. These issues are intensely important for South Africa, as they are intrinsically linked to its future success as a mining powerhouse.

It is encouraging, that the industry, government and unions have provided a positive way forward by creating a competitive mining sector which encourages investment through their joint efforts to create a workable and successful compromise on health and safety regulation.[91] Whether this investment-friendly cooperation will attract FDI will determine the future growth of the South African mining industry.

Recommendations

The continent of Africa is regarded as the bread basket of the world's mineral resource wealth, and South Africa remains a jurisdiction that offers significant mining opportunities to global investors. The challenges to unlocking the massive potential and the opportunities available lies in addressing the factors highlighted in this report, including political instability, corruption and proposed amendments to the tax laws.

The fundamental problem is that these challenges stir the rocky cradle of uncertainty for investors. However, populations across the globe are growing, urbanisation is increasing and developing economies continue to grow resulting in a greater demand for commodities, which South Africa can deliver. Moreover, South Africa's official financial and economic alliance with the BRICS group of nations including Brazil, China, India, and Russia confirms that the world's most resource hungry players cannot afford to ignore South Africa and foreign direct investment will continue to flow.

"There needs to be more guarantee to the mining rights."

Financial Community, Canada
commenting on the South African mining market

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"The complexity and stability of mining regulation, and the costs of operations, are significant factors in mining companies deciding where to invest their capital."

David Egan, Partner
Baker & McKenzie, Australia
commenting on the global mining market

Methodology

In total 301 telephone interviews were conducted with senior mining industry stakeholders between 17 July and 3 August 2012. The sample composition quotas were as follows:

	Australia	Brazil	Canada	China	Indonesia	South Africa
Financial community	10	10	10	10	11	10
Mining firms senior in-house legal counsel	20	20	20	0	20	20
Mining firms C-Suite and other senior executives	10	10	10	20	10	10
Mining services firms	10	10	10	20	10	10
Total	50	50	50	50	51	50

Strict screening requirements were employed to ensure that all respondents were expert in the mining sector. By audience:

Financial community

- All respondents to personally take a particular interest in at least one of the following investment areas: mining of coal and ignite, extraction of crude petroleum and natural gas, mining of metal ores, other mining and quarrying
- All respondents to personally take a professional interest in at least one of the six countries listed above
- Typical job titles included: Fund/Investment Managers, Senior Equity Portfolio Managers, and Directors & Chief Investment Officers

Mining /mining firms; senior in-house legal counsel

- Sectors as per the investment areas listed above
- Companies with at least 51 employees worldwide
- Typical job titles included: Chief Corporate Counsel, Chief Legal Counsel, Legal Director/Manager

Mining/mining firm; C-suite and other senior executives

- Sectors as per the investment areas listed above
- Companies with at least 51 employees worldwide
- Main decision makers or strongly involved in decisions regarding investment and business strategy
- Typical job titles included: President, CEO, Chairman, Managing Director, Vice President, Director

Mining services firms; C-suite and other senior executives

- Machinery/ equipment suppliers or transport companies
- Sectors as per the investment areas listed above
- Companies with at least 51 employees worldwide
- Main decision makers or strongly involved in decisions regarding investment and business strategy
- Typical job titles included: President, CEO, Chairman, Managing Director, Vice President, Director

All fieldwork was conducted from a specialist, UK-based telephone interviewing centre, using specialist mother tongue interviewers. All interviews were conducted in accordance with the UK Market Society Code of Conduct.

Further analysis

A number of comparative studies may be of interest to readers:

1. Fraser Institute Annual Survey of Mining Companies 2011/2012 (http://www.fraserinstitute.org/research-news/display.aspx?id=18045)

   Since 1997, the Fraser Institute has been conducting an annual survey of metal mining and exploration companies in order to assess how mineral endowments and public policy factors, including taxation and regulation, affect exploration investment.

2. Behre Dolbear, '2012 Ranking of Countries for Mining Investment Where "Not to Invest"' (http://www.dolbear.com/_literature_125436/2012_Ranking_of_Countries_for_Mining_Investment)

   Since 1999, Behre Dolbear has presented a yearly report based upon an assessment of countries deemed important to the mining industry. The intention of the report is to highlight countries whose policies and business conditions promote investment growth in the mining sector.

3. Transparency International, 'Corruption Perceptions Index 2011' (http://cpi.transparency.org/cpi2011/results)

   Since 1997, Transparency International has published the Corruption Perceptions Index (CPI) annually, ranking counties by their perceived levels of corruption, as determined by expert assessments and public opinion.

4. Fund for Peace and Foreign Policy, 'Failed States Index 2012' (http://www.fundforpeace.org/global/?q=fsi-grid2012)

   Since 2005, the Fund for Peace and Foreign Policy has published the annual Failed States Index. The list assesses sovereign states (determined by membership in the United Nations) and ranking is determined and based on twelve indicators of state vulnerability - four social, two economic and six political. The point of the index is to measure a state's political stability, particularly its vulnerability to collapse and conflict.

5. Economist Intelligence Unit, 'The Democracy Index 2011' (http://www.eiu.com//public/topical_report.aspx?campaignid=DemocracyIndex2011)

   Since 2006, the Democracy Index has measured the state of democracy in 167 countries. The index is based on 60 indicators grouped in five different categories: electoral processes and pluralism, civil liberties, functioning of government, political participation and political culture.

6. PWC, 'Mine 2012: The Growing Disconnect' (http://download.pwc.com/gx/mining/pwc-mine-2012)

   Since 2002, 'Mine' has been providing a comprehensive analysis of the financial performance and position of the global mining industry as represented by the Top 40 mining companies by market capitalisation.

"...it is getting too risky. I feel that resource nationalism is already in place."

Senior decision maker, Indonesia
commenting on the Chinese mining market

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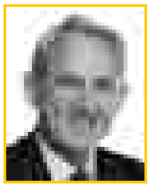

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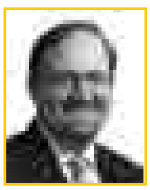

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