Striking a balance between the interests of investors and host nations

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BRUCE SHAPIRO
A formula allowing investors at least a minimum return on investment – sufficient for them to invest in a country – over the life of the investment, could be the answer to mining revenue sharing

The rapid growth of emerging economies in Asia has driven a surge in demand for commodities in recent years, spurring investment in mineral resource projects across the globe. Higher commodity prices have seen governments of many resource-rich jurisdictions stepping up efforts to extract the most revenue from projects in their territories.

Host jurisdictions are re-evaluating the level of economic rent they are receiving through taxes, royalties and other levies, while calls for more local participation in projects have also been made. However, resource nationalism – which is seen as one of the top business risks in the mining sector – is unsettling to investors and is creating uncertainty.

So how can investors and host nations reach an equitable and sustainable revenue sharing arrangement?

Business development and marketing company MineAfrica president **Bruce Shapiro** believes the answer could lie in a formula that allows investors at least a minimum return on investment (ROI) – sufficient for them to invest in a country, given its risk profile – over the life of the investment.

"Clearly both investors and the jurisdiction will want to benefit from the upside, but on a minimum return basis, the investors will likely be happy with a lower share of that upside," he states. Some base income to the jurisdiction could be included as a cost to the venture and thus included in the calculation of the ROI.

Investors should be allowed to recoup for those years in which the agreed ROI was not achieved by receiving more than their agreed returns in those years where excess returns are achieved.

Shapiro is proposing that jurisdictions and the majority of investors agree on a formula that will measure all input costs and output revenues on a regional basis. The calculations should be made by neutral experts in the relevant fields to arrive at the ROI in any particular year.

The jurisdictions should also be required to publish what percentage of quantum of their revenue share is attributed to each branch or department of government on a yearly basis, he says, adding that it should include the benefits to the communities in which the investor operates.

"Apart from creating clarity for the investor and the relevant jurisdictions, such a formula will limit negotiations to what is an acceptable ROI for the investor and resource rent for the jurisdiction, what the split of upside should be between the investor and the jurisdiction above the agreed ROI to the investor and, in a recovery period, how much of the upside should go towards past shortfalls to the investor," Shapiro explains.

He believes that more certainty will allow investors to take a slightly lower ROI, thereby allowing the jurisdiction a proportionately greater share of the revenues. In addition, should the jurisdiction want to renegotiate an agreement, they will be renegotiating a much simpler formula. "Although this will not prevent investors becoming nervous and stock prices falling, it will be far easier and much quicker so the pain will be over sooner."

Shapiro recently participated in the inaugural meeting of the Organisation for Economic Cooperation and Development policy dialogue on natural resource-based development in Paris, France, where he presented his proposed formula.

Mining Risk

Companies are getting better at managing resource nationalism risk.

In 2012, advisory group EY ranked resource nationalism as the number-one business risk in the global mining and metals sector and although it has slipped to the number-three position last year, resource nationalism remains of great concern around the world.

While increasing taxes and royalties, mandated beneficiation, government ownership and the restriction of exports continue to spread across the globe, EY says companies are getting better at managing the risk and that resource nationalism is no longer the surprise it once was.

EY global mining and metals leader **Mike Elliott** said in June last year, that there were signs that the retreat in capital investment by the sector might see governments take a more considered and cautious approach.

Resource nationalism – the umbrella term for exercising greater control over natural resources with the object of deriving a greater share of the economic benefits that accrue from their extraction – places a large cost burden on mining and metals companies and increases risks associated with achieving long-term project profitability.