Controversial new INSTITUTIONAL FRAMEWORK

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Divided opinions — The Ministry of Mines and Energy has been working on three bills that will be sent to Congress in 2011. Together, they constitute a new regulatory framework for the sector. They envisage the creation of the National Mining Agency (ANM) and the National Council of Mineral Policy (CNPM), and would set out a new policy on royalties that promises to be highly controversial.

"The regulatory framework will enable serious, capitalized businesses to thrive," says the CEO of Top Investment Ventures, Tim Chen. "The new rules will help to discourage speculation. Well-structured mining companies will develop projects, and production will bring revenue to the country." The current rules date back to 1967, when the Mining Code was adopted (Decree-law 227).

Miguel Nery, director general of the National Department of Mineral Production (ANP) of the Ministry of Mines and Energy, says the government's intention is to stimulate competition between companies and attract new investment. He believes that the new National Mining Agency will be in a better position to press holders of mineral exploitation rights to follow the law, including investing in mine prospecting and establishing productive enterprises. He says, "Whoever fails to comply could lose its rights, and the agency will re-open bidding for that area so that someone else can invest. Thus, the state will stimulate competition among economic agents operating in the sector, and should reduce the concentration of areas in the hands of a few."

Despite these arguments, raising the tax burden by increasing the Financial Compensation for Exploiting Mineral Resources (CFEM) tax is causing dissatisfaction. Those active in the mining sector fear excessive taxation, and as a result foreign companies may move to other countries.

The vice president of operations at Canadian consortium Forbes & Manhattan in Brazil, Helio Botelho Diniz, believes that "one should not tinker with a winning team." "The government wants to control things better," he says, "but we must understand the reality. Everyone talks about increasing taxes on mining due to the good results, but it is shooting yourself in the foot because more taxes will make investments in mining less attractive."

Chen, on the other hand, says, "I don't see this as an obstacle. If as investors we have the support and partnership of government, with legislation that gives us support to work and to carry out projects, we will grow and have profits consistent with the tax burden."

In fact, the tax on mineral extraction will indeed rise if Congress approves the bills as drafted by the government. There is a rumor that the government's intention is to align the tax burden and royalties policy for mining activities with those for oil activities. Mineral law expert and lawyer Roger Targino thinks this could affect the sector.

Maurilio Monteiro, secretary of development for Pará state, believes that the government proposal should incorporate some positive points of the new regulations for oil exploration now pending in the Senate. He says, "When you purchase rights at auction for oil exploration, dates and deadlines are set for both prospecting and production. In mining, there are no such constraints or guarantees. A company can win the concession and almost indefinitely postpone prospecting and production. This complicates planning, investment, and government actions."

According to Nery, the Ministry of Mines and Energy has not yet finalized the proposal for royalties, and he believes the adoption of a new framework should not increase the tax burden: "It is incorrect to say there will be higher costs, though more fines may occur for mining companies in default. The penalties should be harsher to deter violation of the law and keeping large areas unproductive." Today, out of 160,000 fields for which prospecting and mining rights have been granted, only 8,000 are producing. In an increasingly competitive environment, this translates into lost opportunities for companies that operate here and lost revenues for the country.

The new regulatory framework will insist that granting mining rights take into account the financial viability of the investor. This can be considered an advance; since that is not the case under current rules. In Targino's opinion, in the current concession model, "speculators become 'mining landowners' who have acquired a huge number of permits but are not doing any mineral exploration, bringing great harm to the population and serious mining companies."

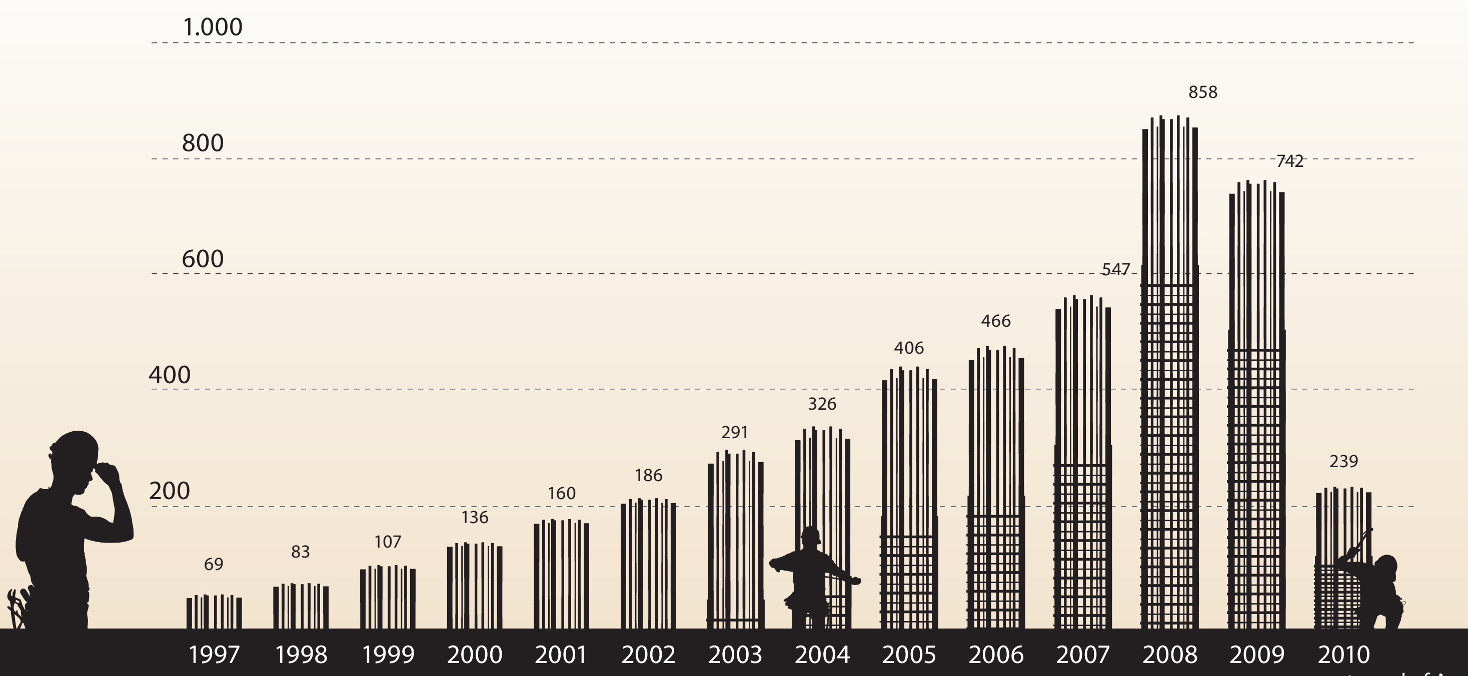
The new legislation will facilitate the sanctioning of those who do not meet deadlines. "The Mining Regulatory Agency and the National Council of Mineral Policy will bring autonomy to the government," Targino emphasizes. "The time for prospecting will be reduced, which will require a greater commitment by companies to both complete prospecting and start production. This will certainly keep away speculators."

This probable change is causing anxiety, though. "The stage of greatest risk is mine prospecting. The new procedures are worrisome because the government takes up to two years to grant a permit," Diniz says. He said each drilling for prospecting costs US$1 million. "I cannot be subject to licenses renewed annually. There is no legal security on which to raise funds," he says. Today's authorization for prospecting lasts three years, without proof of investment. The proposal provides five years, extended for three more, but with annual demonstration of investments in exploration.

CFEM revenues

Financial Compensation for Exploiting Mineral Resources

(Millions of Reais)



Source: National Department of Mineral Production (DNPM).

About CFEM — Municipalities, states, and the federal government gain from mineral exploitation. The Constitution of 1988 established the CFEM to compensate for the economic use of mineral resources in the territories. Over the years CFEM collections have been growing exponentially. In 2010, it is estimated that revenues will exceed R$1 billion (US$550 million).

On average CFEM proceeds are allocated 12% to the federal government, 23% to the states where the mineral is extracted, and 65% to the producing municipality. The rates applied vary according to what is extracted. For aluminum ore, manganese, potassium, and rock salt the tax is 3% of net sales; for iron, fertilizer, coal, and other substances, 2%; for gold, 1%; and for precious stones, colored stones, and carbonaceous and noble metals, 2%. CFEM proceeds are to be invested in projects that directly or indirectly improve the living conditions and services provided to local populations.

The New Agency and Council — The purpose of creating the National Mining Agency is to better regulate the sector. To keep the process transparent, the agency will have a board and normative powers to stimulate competition between businesses operating in the mineral market. Board members must have a mandate to ensure that decision-making is not vulnerable to outside pressure. The National Council on Mineral Policy is an agency linked to the Presidency of Republic to set government policies and activities for the mining sector; several ministers of state will be members.

Brazil: Mining sector institutional framework

	Current	Government's proposal
Policy	MME[1]	National Council of Mineral Policy
Grantor of concessions	MME (Grantor) DNPM[2] (autorização)	MME
Regulation and supervision	DNPM	Regulatory agency
Mining activity	Private companies CPRM[3]	Private companies CPRM
Prospecting	Private companies	Private companies
Prospecting in special areas	None	Public bidding for concession
Development, production and trading	Private companies	Private companies
Collection of CFEM[4]	DNPM	Regulatory agency

[1]Ministry of Mines and Energy; [2]National Department of Mineral Production; [3]State-owned Mineral Resources Prospecting Company; [4]Financial Compensation for Exploiting Mineral Resources. Source: Ministry of Mines and Energy (MME).