

Removing obstacles to investment in Georgia's mining regulation - Summary of findings -

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Georgia's mining regulation

- Scope of mining law: All non-renewable, subsoil natural resources ,
- Not: Oil, gas and water for hydro power

- Georgia's mining regulation is relatively old
 - Key law from 1996
 - Important regulations from 2008 and 2011

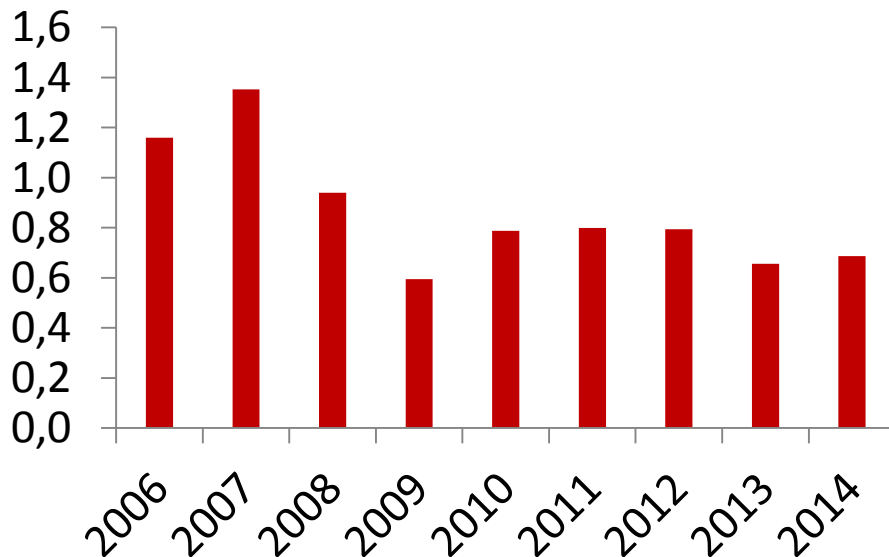
- Main problems:
 - Too little investment in mining, natural resources not leveraged for economic development
 - Little fiscal revenue from mining

- **How can obstacles to good investments in mining be removed and more revenue be raised?**

Mining sector accounts for less than 1% of GDP

Gross value added in mining and quarrying

% of total GVA



Source: Geostat

Two parts of sector regulated by mining law:

- Metallic minerals (e.g. manganese, copper): Export
 - High capital intensity
 - Large sites and companies
- Construction materials: Domestic
 - Smaller companies and sites
 - Less expensive production

➤ **Focus here: Metallic minerals**

But 24% of goods exports are mining-related

Georgian export goods related to mining activity, 2012-2014 average

	USD m	% of Georgian exports	% of world exports
Ferro-alloys	258.71	9.5	1.0
Copper	154.42	5.7	0.3
Fertilisers	135.14	5.0	0.6
Gold	66.87	2.5	0.0
Cement	26.75	1.0	0.3
Manganese oxides	6.69	0.2	2.1
Manganese	2.98	0.1	0.1

Source: UN Comtrade

- Some mining-related exports combine natural resource with energy-intensive production (alloys, fertilisers)
- Partly results from Soviet time decisions on plants
- Availability of resource will be a key factor for continued viability

Mining regulation in Georgia: Key features

- **Scope:** All subsoil resources excluding oil and gas
- **Property rights:** Public ownership of subsoil, extraction requires license
- **License allocation:**
 - Exploration license : GEL 500 / hectare, up to 5 years
 - Extraction license: Usually 20-30 years
 - Allocated by auction with minimum price
 - „Extraction plan“ for annual extraction volumes
- **Fiscal instruments**
 - Royalties: „Regulatory fee“ and „extraction fee“ per tonne of resources
 - Minimum floor of payment determined by extraction plan
 - Auction: Minimum price defined as NPV of extraction fee
 - Taxes: Normal corporate profit tax (15%) and VAT (18%)

Assessment: Licensing

- **License allocation (exploration stage):**
 - Key problem: Existing geological information is not centrally and freely available – raises uncertainty for investors
 - Exploration cost of GEL 500 / ha is very high in international comparison
 - **High costs, little information for investors in risky exploration stage**

- **License allocation (extraction stage):**
 - Auctions for licenses are ineffective: Usually only one bidder
 - Effectively: Only pay the minimum price
 - **Unnecessary frontloading of financial burden**

Comparison of royalties, fees and corporate tax (CIT)

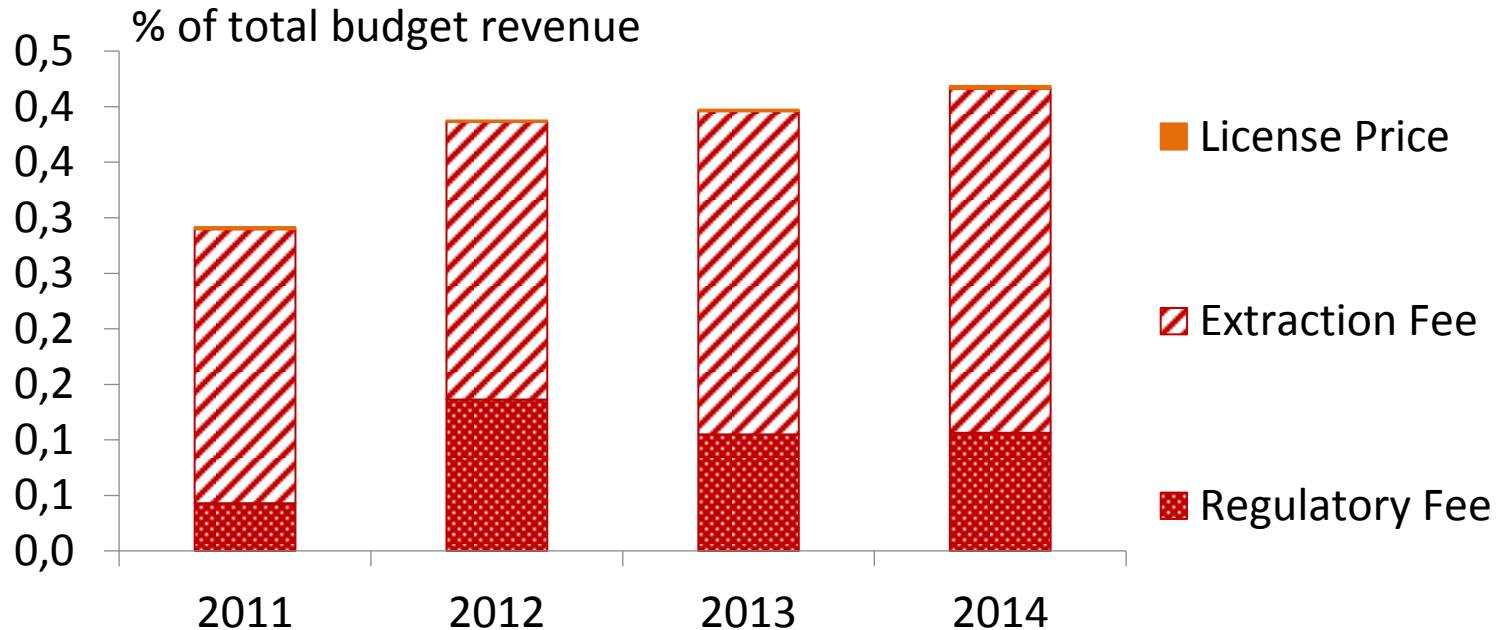
	Royalty rate	Royalty base	Exploration fees	CIT
Georgia	0.003-5%	Planned extraction volume	min. 500 GEL per ha (≈USD 210)	15%
Western Australia	2.5-7.5%	Volume of extracted minerals	min. AUD 30 per ha (≈USD 22)	30%
Quebec (Canada)	16%	Adjusted PBT	Administrative fees only	26.9%
Chile	0-14%	Adjusted PBT	min. MTU 0.005 per ha (≈USD 0.18)	20%
South Africa	0.5-7%	Adjusted revenues	min. ZAR 1 per ha (≈USD 0.07)	28%

Source: National Governments, PWC, own calculations

Assessment: Fiscal instruments

- **Too large scope:**
 - Large and small require different treatment (simple vs. thorough)
- **Limited total fiscal burden**
 - Royalties not high in international comparison (even including minimum price auctions)
- **Market price risks for investor increased through taxation**
 - Royalties inflexible to market price situation
- **Royalty payment on planned volumes creates additional financial risks**
 - Have to pay royalties even when extraction falls short of plan
 - Punishes investors for market risks or production difficulties
- **Current system treats mining like banks, not companies**
- **Aims at controlled liquidity provision rather than tax revenue dependent on companies' revenues**
- **Result: Underinvestment and lower total revenues**

Limited public revenue from mining activity



- Small absolute size of sector (underinvestment)
- Nearly no income from new licenses
- Also relatively low revenues for the size of sector (inadequate rents extraction)
- **Low revenue situation consistent with previous conclusions**

Recommendations (I): Aims and guiding principles

Aims:

- More **economic activity**
- More **fiscal revenue**
- **(Environmental standards should not be compromised!)**

Guiding principles:

- **Appropriate differentiation** of regulation by needs of subsectors
- **Reduce uncertainty and risks** for investors
- **Reduce frontloading** of fiscal burden
- **Increase total rent extraction**

Recommendations (II): Separate regulation

Recommendation 1:

- Separate regulation for metallic minerals and other mining/quarrying
- **Metallic minerals:**
 - High market prices, large resource rents
 - Capital intensive extraction, large companies
 - Export focus
 - **Regulation should be supportive to investors, but at same time ensure thorough tax enforcement, production monitoring**
- **Other minerals/stones:**
 - Largely construction materials, smaller companies
 - Domestic market, lower prices and resource rents
 - **Regulation focus should be on simplicity, low compliance costs for government and companies**

Recommendations (III): Mining strategy

Recommendation 2:

- Develop a **National Strategy for Mining of Metallic Minerals**.
 - Objective: Ensure better use of natural resources.
1. **Public ownership of resources** should continue
 2. **Collect, consolidate, integrate and publish all geological information** for free
 3. **Targeted attraction of investors** for selected sites (Environmental Agency, Invest in Georgia, ministries: Environment, Economy)
 4. **Publish investor interest** in a site to allow others to register interest
 5. **Retain license auctions, abolish minimum price**
 6. **Reduce exploration license costs**
 7. **Include investor pre-qualification screenings** before licenses are allocated, include “use or lose” clauses to ensure license usage
 8. **Formulate clear rules on expropriation and compensation of landowners**
 9. **Ensure sufficient capacity of National Environmental Agency** for above tasks

Recommendations (IV): Royalties

Recommendation 3:

- **Develop a two-stage royalty system** as the principal fiscal instrument
- **First stage:**
 - Fixed GEL/t
 - Regular, transparent updates of royalty e.g. every 5 years
 - Royalty / reference market price should be similar as in other countries
- **Second stage:**
 - Market price-based component
 - Dependent on current annual market price vs. reference price
 - Can be positive or negative
- Based on the **actual annual extraction volumes** of companies
- Extraction volumes must be **closely monitored**
- Different resource **qualities** should be treated differently
- **Reconcile public interest in fair rent share with investor requirement of predictability and limited risks**

Recommendations (V): Compliance and legacy investors

Recommendation 4:

- **Join the Extractive Industries' Transparency Initiative (EITI)**
- International standard for transparency of data on resource extraction
- **Strengthened governance** through transparency of use of tax income
- Better **tax enforcement** due to transparent company data
- No harmful **regulatory competition** between states

Recommendation 5:

- New regulation (royalty levels) should **only apply for new investments**
- Old investments can proceed under old regulation until end of license
- **Reputation for treatment of investors** crucial for attracting new ones

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Annex I: Mining regulation in Georgia

Resource	Legal Document	Content
Mining	Law on Mining	Property rights and obligations
	Law on Licenses and Permits	License allocation
	Decree 136 of 11 th August 2005 on rules and conditions for giving out licenses	License allocation
	Decree #1-1/480 of 4 th April 2008 – methodology of initial price of an auction	Determines initial price for auction
	Decree #1 of 12 th August 2011 – regulatory fees for extraction licenses	Sets regulatory fees (royalties) for resource extraction
Mineral Water	Law on Water	Property rights and obligations, license allocation
	Decree 136 of 11 th August 2005 on rules and conditions for giving out licenses	License allocation
	Decree #1-1/480 of 4 th April 2008 – methodology of initial price of an auction	Determines initial price for auction
	Decree #1 of 12 th August 2011 – regulatory fees for extraction licenses	Sets regulatory fees (royalties) for resource extraction
Oil and gas extraction	Law on Oil and Gas	Property rights and obligations, license allocation

Source: www.matsne.gov.ge

Annex II: Royalties in Georgia

Natural Resource	Unit	GEL amount of regulatory tariff	GEL Amount of Extraction Fee
Coal	1 ton	0.1	1
Manganese	1 ton / with 1 % content	0.1	0.012
Copper	1 ton	127.5	255.31
Lead	1 ton	14.8	37
Zinc	1 ton	36	90
Gold	1 gram	1.5	3
Silver	1 gram	0.02	0.03
Diatomite	1 ton	3	6
Oil	1 ton	24.19	21
Other minerals	1 m ³	0	N/A
Construction materials and stones	1 ton – 1 m ³	N/A	0.14 – 8 (depending on type of material)

Source: National Environmental Agency

Annex III: Comparison of royalties and mining taxes

	Georgia*	Western Australia	Chile	South Africa	Canada
Coal	1.1 GEL/ton (0.8%)	7.5% of gross invoice value	0-14% of gross sales	0.5-7% of gross sales+ 0-22.5% of mining profit	16% of profits (Quebec) 2-13% on “net revenue” (British Columbia) 5-10% on profits (Ontario)
Manganese	1.12 GEL/ton (0.3%)	5%			
Copper	382.8 GEL/ton (3.1%)	2.5-7.5%			
Lead	51.8 GEL/ton (1.3%)	2.5-7.5%			
Zinc	126.0 GEL/ton (3.1%)	2.5-7.5%			
Gold	4.5 GEL/gram (5.0%)	2.5%			

Source: National Governments, PWC, own calculations

* Auction costs not included!

Annex IV: Mining in Western Australia

Exploration

- Application physically or electronically, application and rental fees apply
- Exploration licence term 5 years, can be extended in prescribed circumstances
- After 3rd and 4th year each, have to surrender 50% of the licence
- Can extract or disturb up to 1000 t of material including overburden

Extraction

- Exploration licence holder has the right to mining license
- Require a mining proposal or a statement and a mineralisation report, prepared by independent person, information on start date, mining method and area usage
- License term is 21 years and may be renewed for further terms

Royalties/taxes

- As a percentage of sales value, three ad valorem rates:
- 7.5% for bulk material, 5% for mineral concentrates and 2.5% for minerals in metallic form or equivalent.
- CIT of 30%; a special tax on mining (Federal Minerals Resource Rent Tax (MRRT) of 22.5% on profits) was abolished

Annex V: Sell property rights for resources?

- In almost all developed countries, **subsoil remains public property**
- **Why?**
 - **Extent of deposits** often exceeds limits of private ownership
 - **Public interest:** Efficient, long-term resource use
 - **Distribution issue:** Who is owner before privatisation?
 - Landowners?
 - All citizens?
 - Only the latter makes sense, but implies a voucher system or an agency for privatisation
- **Voucher based privatisation has dismally failed** in transformation countries
 - Concentration of property with oligarchs happened very quickly
 - High corruption risks
- **Preserving public ownership of resources is the only way to ensure public benefit**
- **Benefit from investment alone (without royalties) is too small**