Country Profile: Ecuador

Despite Ecuador's metallic mineral wealth dating to before the Inca Empire (600 B.C. to 400 A.D.), its riches were a mere myth until 2007 when Aurelian Resources discovered 13.7 million oz. of gold and 22.4 million oz. of silver in inferred resources at its Fruta del Norte (FDN) project.

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The "gold dinosaur," as FDN was known in the industry, attracted the most important gold producers in the world, including Barrick and Newmont, and was eventually acquired by Kinross Gold Corp. last September 2008. The deal was the largest private transaction ever completed in Ecuador.

Besides gold and silver, Ecuador also possesses tremendous copper deposits. Corriente Resources' copper-gold Mirador project, for instance, has resources of 11 billion pounds of copper, in a camp located alongside FDN in the southeastern Cordillera del Condor. Both FDN and Mirador are the two most advanced exploration development projects in Ecuador, the latter possessing an approved government feasibility study. As a result, Kinross and Corriente will become pioneers in developing a responsible and sustainable mining industry in the only Latin American country with no large-scale mining operations when the country unveils its new mining law, expected in January 2009.

In spite of Ecuador's recent discoveries and galloping metallic mineral prices, junior mining companies operating there suffered a setback in April when the Constituent Assembly, a temporary legislature, issued a mining mandate halting all mining activities until the new mining law is enacted. The harsh move sought to expel land speculators – including former mining authorities' relatives – who held hundreds of mining concessions for easy profit. The decision also slashed foreign firms' market capitalisations and in some cases threatened their cash flows, forcing them to sell assets or consider friendlier jurisdictions to diversify their portfolios and calm jittery investors. This scenario, however, will change in 2009 when the new mining law is approved and firms operate again.

Dan Carriere, Senior Vice-President of Corriente Resources, sees a bright future for the mining industry in Ecuador beginning 2009. "It will be a win-win-win for everybody: for the government, the environment, and communities." Furthermore, he says, "the country has recently shown some very positive signs, such as the recent import tariff cuts for mining equipment. It's a very important mining incentive for the foreign direct investment, and a great way to start." In fact, Ecuador's Council of External Commerce and Investment (COMEXI) recently approved a resolution to eliminate the import tariffs on a range of mining equipment, such as crushers, mills, screens, and grinding balls.

Another optimistic firm in Ecuador is International Minerals (IMZ), which has been exploring and developing gold and silver projects there for over 15 years. "We are following the approval and implementation of the new mining law in 2009. Our firm hopes to be in Ecuador for at least another 15 years as an important contributor to the country's emerging mining industry for the benefit of all stakeholders, especially the local and regional communities," states IMZ President and CEO Steve Kay. IMZ has two main projects in Ecuador: Río Blanco and Gaby, with a resource estimate of 4.2 million oz. of silver and 5.6 million oz. of gold, respectively.

Conversely, some junior exploration firms could not continue operations in the country because their capital dried up. Atlas Minerals, for instance, recently announced that they are selling their wholly owned Ecuadorian subsidiary Atlas Moly, which will be held for regulatory and shareholder approval on March 2009.

"The company had been placed in a very difficult position due to the April 18 mandate of the Ecuadorian government which effectively shut down all mining activities… The company curtailed all of its active mining activities shortly thereafter and was advised that the previously announced financing could not be completed due to the uncertainty of the actions of the Ecuadorian Government," reads its November 19 press release.

The only major in Ecuador, Kinross, see a promising mining future in Ecuador, and believe their FDN development can become a pioneer project for other companies operating there. "We are confident that working with the government of Ecuador, and with the communities in the area of the deposit, we can develop FDN as a world class project that will showcase the opportunities that Ecuador offers the mining industry; also, the economic and social benefits that responsible mining can create for the people of Ecuador. In that sense, Kinross' investment in FDN has the potential to serve as a pathfinder project for Ecuador," said James Crossland, Senior VP Government Relations & Corporate, in an interview following the Aurelian acquisition.

Ecuador Only Has Small-Scale Mining

To date, Ecuador has only small-scale gold mining projects in the Zaruma, Portovelo, and Bella Rica areas of southwest El Oro province – where 85% of mining workers are concentrated, and in the Zamora Chinchipe, Imbabura, and Loja provinces, according to Ministry of Mines and Petroleum (MMP) data. Nevertheless, these small-scale miners including artisan and informal sector ones are incapable of satisfying local demand and Ecuador has a growing mining trade deficit.

"Ecuador has sufficient mineral resources, but it has a persistent mining trade deficit during the last decade. The gap could reach $1 billion in 2010," forecasts former undersecretary of mines Julián Rosero, now a Riverhills Resources project manager.

Currently there are about 200 foreign exploration mining firms investing in Ecuador, mainly Canadian junior firms listed on the Toronto Stock Exchange, according to MMP records. Investment records on file show that Corriente Resources, for example, would invest $2 billion in their four projects, while IMZ has invested US$70million since exploration began, and plans to invest more than US$100million when the Rio Blanco mine construction begins. For their part, IAMGOLD's Quimsacocha project in Azuay province would invest US$11million to complete their feasibility study and continue exploration activities.

Political Environment

The level of political certainty in Ecuador has plummeted over the period from 2006-07 to 2007-08, according to the Fraser Institute Policy Potential Index (PPI), from 30.1/100 to 4.9/100. In their latest report surveying 372 companies in 68 countries, Fraser noted that Ecuador was positioned among the worst three countries with poor policy attractiveness to perform mining exploration activities.

The main risk which miners operating in Ecuador may have feared is President Rafael Correa's constant campaigning and multiple elections since he took office in January 2007. Correa's first goal when he assumed the presidency was the creation of a 130-member Constituent Assembly to rewrite the constitution. After being elected in a special referendum backed by Correa, the new body replaced the disreputable Congress, and later assumed legislative powers. The government's political party, Alianza Pais (AP), won with an overwhelming majority of 60%, more than the simple majority needed to shape a new constitution and, later, any law or mandate AP pursued including the baneful mining one.

Due to disagreements with AP members, especially over mining, the Constituent Assembly's superpowers were weakened by President Correa's hidden dominance, resulting in the resignation of the Assembly speaker and former MMP minister, Alberto Acosta. Acosta is an anti-mining environmentalist sympathiser who wanted to ban open-pit mining and require communities' project approval through mini-referenda. Both ideas were rejected by Correa himself, causing distress within the AP and splitting the party into "acostistas" and "correistas." This marked the beginning of Correa's war against the extreme left.

Following the Constituent Assembly, Ecuadorians were summoned to the polls again in September, this time to approve the new constitution, which won with 64% of the vote, ratifying Correa's proposal and convening the interim 76-member Congresillo. The new legislative body is currently reviewing the new mining law, approval of which will allow mining companies to recommence operations.

One of the biggest mining detractors is the Confederation of Indigenous Nationalities of Ecuador (CONAIE) – once the president's allies – that has gained Correa's nickname of "childish environmentalists" for being ruled by international green NGOs. CONAIE and their global backers want the Congresillo to table the mining law, and if possible declare Ecuador free of large-scale mining. However, President Correa sees mining industry royalties as essential to government revenue which must be sustained to support his high social spending; 40% of Ecuador's national budget relies on oil income, which is declining due to international prices. After the Congresillo, Ecuadorians will have to vote yet again, this time in regularly held general elections for president and vice-president, members of congress, and mayors, amongst 6,000 other authorities next April or May 2009. The move will grant Correa another 4-year term, with the eligibility to be re-elected for another consecutive term. His ambition to stay in power for a decade, then, may become a reality.

The continuation of Correa power may not be a bad thing for international mining firms, some of which have seen four presidents failing to complete their terms in the last 10 years, having been forced from office. In this context, a Correa victory may bring some needed political stability. Ecuador may want to look into the Fraser's survey and take advantage of the fact that companies see the light at the end of the tunnel.

The Fraser Institute's survey ranked Ecuador fourth in the Room to Improve Index, with an 80% gap out of a maximum 100%. In other words, many respondents answered that Ecuador will be a good place to perform operations if it employs the best regulations available in other jurisdictions.

Although the country is far from approaching Quebec's success in mining, which scored 97/100, Ecuador's new mining law will calm nervous international firms and investors, who are seeking to benefit from the country's riches in a stable political environment.

New Mining Law Content

The proposed mining law under revision by the Congresillo falls short of a panacea. Despite that, it brings some good news for the industry: it permits open pit mining, mandates community referenda but makes them unbinding, and places no limits on the number of concessions held by mining companies. One red flag in the law is that it gives the government authority to cancel mining concessions or contracts if any human right is violated, or if the natural habitat suffers irreversible damage. These articles are to be detailed in the regulations, to be written within 60 days of the new mining law being passed.

An important matter still playing out is the fate of a 70% windfall tax (WFT), which was previously applied only to the oil industry. The latest Tax Law Reform of December 2007 created a WFT for all natural resources extractive industries that have signed contracts with the state. Under the prior 1991 mining law, mining firms were only required to have concessions for exploration and exploitation; therefore, the WFT on profits didn't apply. But the new legislation under review stipulates individual exploitation contracts and sets a base price on which to apply a WFT. Congresillo members now must decide whether to exempt mining firms from such a tax, or join Mongolia and make Ecuador only the second country globally to apply a WFT to the mining industry.

For some mining companies, "it is the overall total tax burden on a project, rather than any one specific tax, that is relevant in assessing and determining the economic viability of any project." That's the view of James Crossland of Kinross, who have had their own exploration team working in Ecuador for about the past three years even prior to the Aurelian acquisition. "Based on our research, we believe that the tax regime under consideration in Ecuador will allow for the development of a viable, responsible mining industry."

Corriente Resources is also positive about the mining law outcome. "Yes, we feel that Ecuador is going to play very fair with international mining companies and accomplish its desire to build a mining future," asserts Vice President Dan Carriere.

The mining law also creates new environmental controls, most of them already applied by international mining companies. Some of these requirements are already included in a company's environmental plans, such as Corriente's, which will plant four trees for each one they have removed for operations to minimise their footprint. And Atlas Moly, unfortunately now selling their assets, had even cleaned up the mess left by informal small-scale miners, removing 22 tons of garbage and disposing of it in a state-of-the-art landfill.

Ecuador's new mining law, new political environment, and Correa assertiveness in backing mining operations will bring more stability in 2009. This is positive, encouraging news for the country's nascent mining industry. Ecuador badly needs the creation of thousands of jobs to alleviate its 40% poverty rate, improve its economic growth, and develop. Correa appears certain that the mining industry would be Ecuador's best ally in this venture.