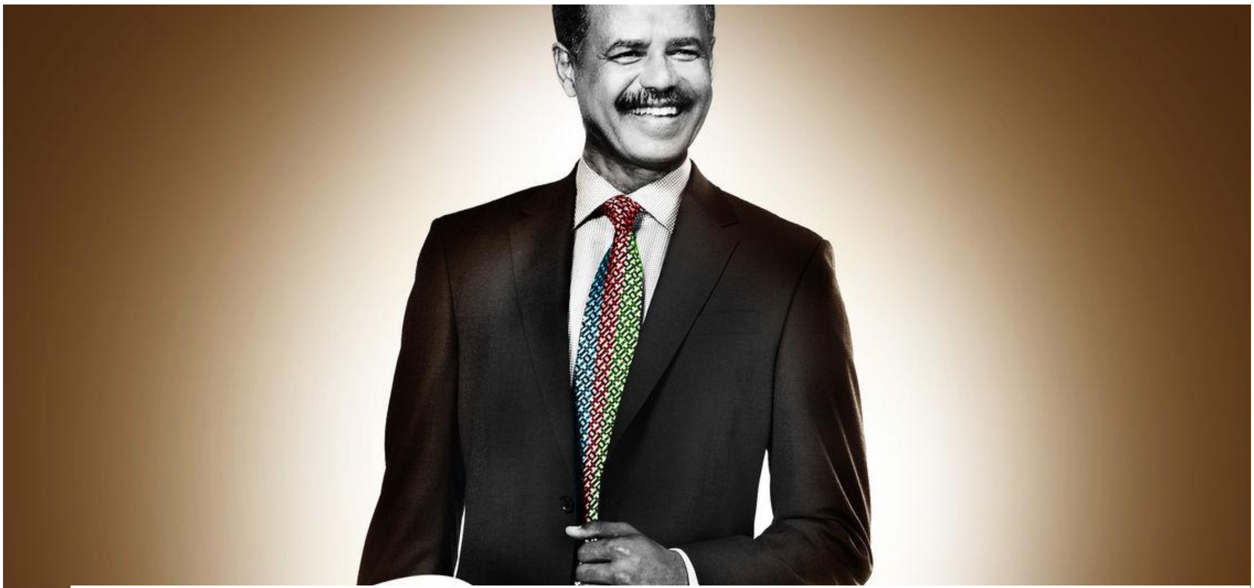
Mining Journal

Danakali tests corruption claims

Danakali directors are at odds with third party rankings of jurisdictional risk, which characterise Eritrea as being among the worst places in the world to do business.

John Robertson*



However poorly Eritrea is governed under president (read: dictator) Isaias Afwerki, a shift in power will deliver unwelcome flux for business

22 FEBRUARY 2018

Danakali's Colluli potash deposit in Eritrea is an explorer's dream. Big, flat, shallow and thick mineralisation make it an ideal development prospect. Proximity to markets and infrastructure are advantageous. Outside the Pilbara, there might not be anything better in mining.

In real life, regrettably, dreams are never realised perfectly. Colluli is located in a country widely seen as being among the most corrupt on the planet.

Eritrea has never had a general election. Along with the likes of Cuba, North Korea and Vietnam, the country belongs in a shrinking club of one party states, led by an aging liberation fighter.

Transparency International ranked Eritrea in the bottom 15 of its 180-country, 2017 Corruption Perceptions Index. The 2016 Worldwide Governance Indicators survey published by the World Bank for 214 countries put Eritrea in the lowest percentile for regulatory quality.

The 2017 Resource Governance Index produced by the Natural Resource Governance Institute (NRGI) had Eritrea last out of the 89 countries covered. Countries with the weakest resource governance, the Institute said, are least likely to implement the rules they set.

The NRGI report describes the role played by well-run state owed enterprises (SOEs) in harnessing minerals for national development as potentially pivotal. On the other hand, it observes, "others squander nations' resources through inefficiency and corruption".

Of the 74 SOEs assessed, the NRGI identified the Eritrean National Mining Corporation, Danakali's compulsory joint venture partner, as the worst of them all.

Mining Journal proved somewhat kinder as it employed the broadest range of criteria to rank Eritrea but it still languished in the bottom dozen of the 85 jurisdictions covered in the Investment Risk Index published in the Mining Journal 2017 World Risk Report (feat. MineHutte ratings).

> **Investors without any on-the-ground experience are confronted with an uncomfortable binary choice between two solidly entrenched opposing opinions**

The available corruption surveys do have some methodological faults as a January 2018 World Bank working paper ('Can We Measure the Power of the Grabbing Hand? A Comparative Analysis of Different Indicators of Corruption') by Alexander Hamilton and Craig Hammer recently confirmed.

Despite the evident shortcomings in the survey approaches, Hamilton and Hammer concluded that the aggregate survey-based indicators of corruption such as those cited above remain the most valid measures of the magnitude of overall corruption.

There is another risk for investors not generally considered explicitly by the surveys. Within the anticipated life of the Colluli project, the current president will be replaced without having bequeathed any history of peacefully transferring power.

A freshly installed Eritrean leader, in currently unknown circumstances, will have the power to renege on commitments made by administrators acting without democratic, constitutional or legal backing. A large decline in the Danakali market value, even if only temporary, cannot be ruled out as investors await reassurances about how business will be treated under a different leader.

In stark contrast to these views, Danakali executives have consistently denied the presence of Eritrean corruption. They have always spoken in glowing terms about the way in which business can be conducted and the behaviour of the officials with whom they have had to deal.

An executive of Nevsun Resources, operating the Bisha copper-zinc mine in Eritrea since 2011, described the company's experience in similar terms in 2015. Vice president Todd Romain, speaking at a Chatham House seminar entitled 'Business and Human Rights in Eritrea: Lessons from the Mining Sector', said he "had never seen any human rights abuses on any of his travels there" citing paved roads, schools and hospitals as evidence of money being spent beneficially, according to the official seminar record.

These views sit together uncomfortably. Companies have been either extraordinarily naïve or skilfully hoodwinked if the Eritrean government has not been grievously maligned.

So, what did the directors of Danakali say about the unusually complex set of jurisdictional circumstances surrounding the Colluli project when they released the results of its front-end engineering design, the most detailed analysis of the project yet, on January 29, 2018? They said absolutely nothing.

In their defence, the latest assessment is primarily targeting customers and financiers capable of drawing their own conclusions about jurisdictional risks. Each will have different attitudes to the country and varying motivations for wanting to participate.

Also, the regulatory regime enshrined in the JORC Code, and designed to protect individual portfolio investors, is less than onerous. Section 4 of Table 1 of the JORC Code, for example, touches only tangentially on these matters asking for comments on "the status of governmental agreements and approvals critical to the viability of the project".

Of course, the Eritrean government appears wholeheartedly onside. It has grabbed a 50% equity stake, is owed a 3.5% revenue royalty and will take a 38% cut of profits in taxes.

But Danakali must do more than satisfy its customers and financiers to comply with the spirit of the regulatory regime in which it operates.

The JORC Code requires compilers of reports to be guided by its intent, "which is to provide a minimum standard for Public Reporting, and to ensure that such reporting contains all information that investors and their professional advisers would reasonably require…".

In their public reporting, Danakali directors are characterising the risks to which so many others have averred as matters to which investors should pay no heed. The subject should not even be broached.

Interested investors without any on-the-ground experience are confronted with an uncomfortable binary choice between two solidly entrenched opposing opinions. There is Eritrea as a business hellhole. Then, there is Eritrea as an inviting commercial locale with misunderstood leaders displaying an unexpectedly acute sense of business needs.

Colluli is a real-time experiment. Its progress will test whether the Danakali directors are giving us a bum steer or whether the corruption and governance surveys are fake analyses compromising development progress.

**John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia*