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Simandou Deal Marks Breakthrough for World's Largest Untapped Iron Ore Deposit

Following eight years of wrangling, British-Australian miner Rio Tinto has announced a US$20 billion deal to develop the Simandou iron ore project. The breakthrough after a series of investment disputes, delays in reviewing the Mining Code and challenges over project-linked infrastructure will provide a major new impetus in Guinea's mining sector.

The scale of the project is also breathtaking. Simandou involves exploiting what is thought to be the world's biggest untapped deposit of iron ore and creating Africa's largest integrated infrastructure project. When fully operational, its annual economic contributions could reach US$7.6 billion, thereby doubling Guinea's current GDP.

Light at the end of the tunnel

The signing of the Simandou Investment Framework on 27 May 2014 formalises the contractual relations between the four stakeholders: Rio Tinto (46.6%), Chinese state-run aluminium company Chinalco (41.3%), Republic of Guinea (7.5%) and the International Finance Corporation (4.6%). The investment framework will now pass to Guinea's National Assembly for ratification, which is expected to go ahead.

Within a year of ratification, project partners will complete a feasibility study to determine costs and timeframes over the mine's 40-year lifespan. In view of the vast project-linked infrastructure required, initial exports will not begin before 2018. Peak output is expected around 2024, when Simandou could produce 95-100 million tonnes of iron ore annually.

Familiar cycle of political instability halts progress

Despite the obvious commercial incentives to develop Simandou, reaching this point has been fraught with difficulties. Rio was awarded the site's four permits in 2006, but two years later was forced to relinquish two of these to the long-standing Lansana Conte government – over spurious claims that the development schedule had fallen behind.

A further blow to developing Simandou was dealt by the 2008 coup, which saw a military junta seize power and threaten the revocation of foreign mining licences. While democratic elections in 2010 marked a turning point, investor confidence was again eroded after the new government, led by Alpha Conde, unveiled a Mining Code in 2011 that involved the potential negotiation of licenses and higher taxes. Growing awareness of the need to attract investors led the government to amend the code in April 2013 – crucially with tax cuts.

New chapter for mining sector

The Simandou deal, a revised Mining Code and recent anti-corruption efforts suggest Guinea is finally coming of age as an investment destination. This is reassuring since companies will now need to cooperate closely with the government as minority partner on all projects.

The country itself may also at long last benefit from its tremendous mineral wealth. Fully operational, Simandou should boost state revenues by US$1.2 billion and create up to 45,000 direct/indirect jobs. The mining-reliant economy is projected to grow by 17.5% in 2018 when Simandou comes online.

With two-thirds of the US$20 billion-injection going to infrastructure, other stakeholders also stand to benefit, not least local businesses. Under the deal, project-linked infrastructure and mining operations will be financed separately, with an external group of investors to develop rail and port infrastructure and target multiple users.

Reaping the benefits is not assured

If managed effectively, the gains could be colossal for one of the world's poorest countries. However, the dismal track record of mining development in Guinea suggests further challenges ahead for Simandou.

Of critical importance will be weakening global iron ore prices, which are currently languishing near a two-year low. However, one mitigating factor is Chinalco's involvement in the project. China is expected to remain the world's top consumer of iron ore as domestic sectors like energy and potash sectors take off, and is already Rio's largest customer.

The risk of resource nationalism is another major consideration for investors, given ongoing lack of clarity in the Mining Code over government stakes in projects and onerous local content requirements.

Another consideration for investors are the significant environmental concerns surrounding the development of an open-pit mine – involving a rail line, 1,000km of roads and multiple construction camps – in the Upper Guinean forests, an internationally recognised region of biodiversity. Scrutiny from NGOs and the media is therefore likely to be high.

Yet, the challenges of Simandou to make a lasting socio-economic impact could prove to be the most contentious aspect of the project. Reflecting the risk of mining revenues failing to filter down to local communities, Guinea is ranked seventh most at-risk globally in Maplecroft's Corruption Risk Index 2014. Should this translate into social unrest over the unequal distribution of natural resource revenues there is a risk that further populist resource nationalist policies could be enacted to offset public dissatisfaction.

The project partners will need to address the same issues that have beset so many other African mining projects, including social unrest, environmental degradation, corruption, transfer pricing, opaque tax arrangements, lack of skills and weak infrastructure. Still in relative infancy and with input from the international donor community, however, Simandou may yet prove to be transformative not only for companies but for Guinean society.