

China's connection

Much of the Philippines' gold production goes to the black market. Tourists and traders take it on to China.

BY ROSEMARIE FRANCISCO

MOUNT DIWATA, PHILIPPINES, AUGUST 23, 2012

Erich Mulato walked out of a dingy workshop in this mountain village and into a gold shop next door, clutching a handful of shiny warm nuggets newly refined from the ore he had brought in.

The 53-year-old father of six had come off a 24-hour shift at one of the hundreds of small-scale mines in this region of southern Philippines. He sold the 5.49 grams of gold in his hand - his share of the day's output - for 8,260 pesos (\$200). That's more than 16 times what a manual laborer earns daily in Manila.

"Here, we can easily make money," Mulato said, blowing smoke from a cigarette as he waited for his money at the gold shop. "Whatever we want to buy, we can buy ... Making a living is better here."

Better for Mulato, but not for the Philippine government.

In all likelihood, Mulato's gold will find its way through middlemen and into the luggage of a tourist or the black market in Manila - not to its only legal destination, the Bangko Sentral ng Pilipinas or the central bank.

BLACK MARKET GOLD: Small miners in the southern Philippines use blow torches to refine ore into nuggets. It then usually finds its way into Manila's black market or is smuggled out in the luggage of tourists.

REUTERS/ERIK DE CASTRO

Up to 90 percent of small-scale Philippine gold production is being smuggled out of the Southeast Asian country, according to estimates from officials and traders, much of it to China.

The potential revenue being lost is considerable: The Philippines, the world's 18th largest gold miner, produced just over 1 million troy ounces of gold in 2011, worth \$1.6 billion at current prices. About 56 percent of that came from small-scale miners, data from the Bureau of Mines showed.

A top central bank official told Reuters new taxes on gold sales imposed last year appear to be a key factor in the alarming rise in gold smuggling. But the head of the revenue agency said in an interview the 7 percent tax on gold sales will not be rolled back and suggested better policing of the borders instead.

The Customs Department, however, told Reuters the problem has become so overwhelming it can do little about the smuggling of gold and other minerals out of the archipelago of more than 7,100 islands.

SMUGGLED TO HONG KONG

"All the production of small-scale mines, almost all, now goes to the black market, because there is no tax in the black market," said Rex Banggawan, an accountant for a small-scale mining cooperative that buys and sells gold in the mountain city of Baguio in northern Philippines. "After that, smuggling is automatic."

Arthur Uy, who looks after Mount Diwata as governor of Compostela Valley province in southern Philippines, the top small-scale gold mining province in the Philippines, said the black market in gold is mainly based in the capital, Manila.

"Most of the gold is being smuggled out to Hong Kong, that's the biggest market," said Uy, a two-term governor whose family of Chinese descent partly owns one of the four most productive small-scale mines on Mount Diwata.

Both Uy and Banggawan estimated 90



RAW GOLD: Small-scale miners in the Compostela Valley carry sacks of mucky ore to shacks where it will be crudely refined before being sold to traders in nearby towns. **REUTERS/ ERIK DE CASTRO**

percent of the gold produced by small-scale miners is going into the black market.

Official data reflects those estimates.

The amount of gold sold by small-scale miners and traders to the Philippine central bank in the second quarter plunged 98 percent from a year earlier, according to the latest government data. By law, all gold produced by miners such as Mulato in the Philippines should be sold to the central bank at around world market prices.

It has been an accelerating trend over the past year. The data shows central bank gold purchases dropped an annual 4 percent, 76 percent and 88 percent in the second, third, and fourth quarters of 2011, respectively. It fell 92 percent in the first quarter.

Small-scale gold mining output, is the main source of the central bank's gold reserves, which hit a record high of \$10.4 billion early this year.

The problem extends beyond gold to

other minerals, which are being smuggled out of the porous and inadequately policed borders of the archipelago.

The Philippines has one of Asia's richest trove of minerals with reserves of gold, copper, nickel, chromite, manganese, silver and iron worth a total of around \$1 trillion.

Foreign investors are circling around one of Asia's hottest emerging markets. The \$225 billion economy grew 6.4 percent in the first quarter, second only to China among Asian economies. But mining investment has been held up for various reasons, including a moratorium on new projects until Congress passes long delayed legislation governing the industry.

That has left the field largely to small-scale miners, who fall under local regulations and are often in collusion with the officials governing them.

The record-breaking bull run in gold prices over the past decade has spurred

small-scale gold mining, much of it illegal, across the developing world.

The Canada-based Artisanal Gold Council estimates it now accounts for 15 percent of global gold supply - a \$20.5 billion industry that employs 10-15 million people.

Like the Philippines, some countries have tried to tax the output, only to find that just diverts it into the black market. Sierra Leone announced last week, for instance, it is cutting taxes nearly in half on gold produced by small miners to reduce smuggling.

An estimated 40-60 percent of Burkina Faso's small-scale mining out is smuggled out of the country, officials there say.

In Mongolia, a spike in black market demand from China has spawned a small army of "ninja miners", so named because of the large green pans carried on their backs that look like turtle shells. As in the Philippines, Mongolian producers are obliged to sell their gold to the central bank and it is subject to a 10 percent tax. The lion's share, however, is being smuggled across the border to China, which overtook India as the world's top gold consumer last year.

Chinese citizens have swelled the ranks of illegal gold miners in Africa and elsewhere. That prompted a warning in May from China's foreign ministry after dozens were arrested in Ghana: "Recently there have been many incidents of Chinese citizens alleged to be involved in illegal gold mining", it said, and urged them to apply for work and residence permits.

The Philippine government is aware that gold from small-scale mines either passes through traders in the black market or is sold directly from mines to foreigners coming in on a tourist visa, Leo Jasareno, head of the Mines and Geosciences Bureau, told Reuters.

"We have heard a lot of rumours about that - that it is being sold in Binondo (Chinatown)," he said.

Traders and officials say it looks like much of the gold is going to Hong Kong, the main conduit for gold flows into China.

Hong Kong's top source of gold im-

ports from 2005 to 2010 was the Philippines, official data from the Chinese territory shows. Philippines gold shipments to Hong Kong hit a peak of 81,471 kilograms in 2010, way above imports of just 11 kilos nine years earlier, and were steady at 81,192 kilos in 2011.

Hong Kong customs regulations require all trade- or business-related gold shipments be registered with authorities, but they do not put restrictions on gold carried by passengers.

Official statistics in the Philippines, reflecting legal exports, show gold exports to Hong Kong in 2010 and 2011 at just around 3 percent of the total volume recorded by Hong Kong authorities.

The Philippines data represents only

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head of Philippines mines bureau

shipments by big mining firms with supply contracts, as exports of gold from small-scale mines are banned. Officials from the statistics office could not explain the discrepancy, saying the data was based on Customs records.

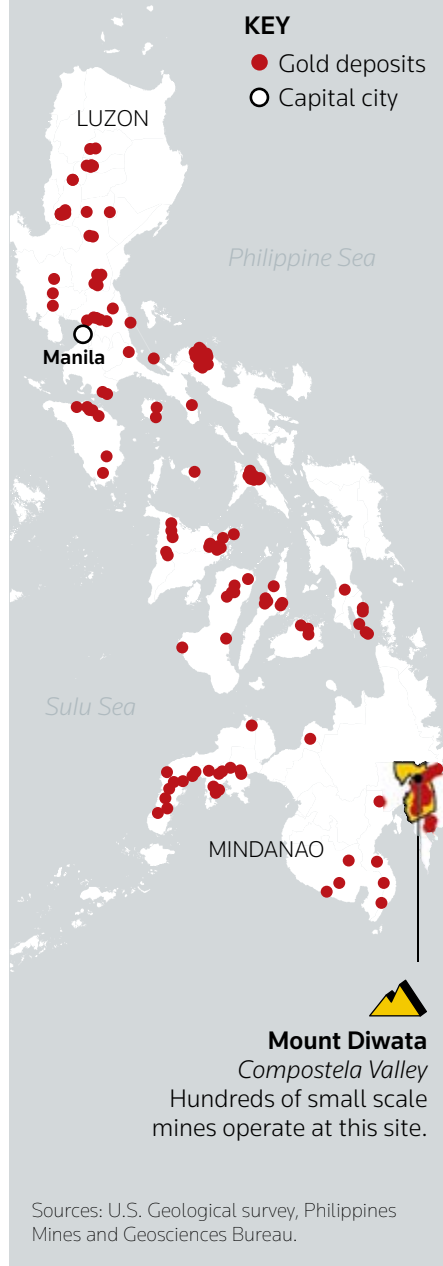
China, which strictly controls gold imports, does not publish trade data for the metal, considering it a state secret. Hong Kong's data, however, is used as a proxy for Chinese demand.

Gold exports in the first half of this year from Hong Kong to China soared six times over the same period a year ago.

China's gold output reached a record 361 metric tonnes last year, but in the first half of 2012 alone, China imported more than 380 tonnes of gold from Hong Kong, the Hong Kong Census and Statistics Department said on its website.(www.censtatd.gov.hk.)

Gold rush

The Philippines is the 18th largest gold miner in the world, producing over a million troy ounces of gold in 2011, worth \$1.6 billion in current prices. However, due to poor policing of its borders, the smuggling of gold and other minerals out of the archipelago of more than 7,100 islands is rampant.





GOLD LIFE: A view of houses in the gold mining town of Diwalwal in Compostela Valley in southern Philippines. **REUTERS/ERIK DE CASTRO**

HAND-CARRIED SMUGGLING

Foreign gold buyers have been coming in droves to the Philippines, where they can buy the metal cheaper in the black market, said a 42-year old jeweler, who asked for anonymity to protect her family business.

“Whether they make it into smaller nuggets or smaller sheets, that’s what they take with them, hand carried,” she said. “They know they can get gold cheaper here.”

Rozzano Rufino Biazon, head of the Philippines’ Bureau of Customs, agreed “hand-carried smuggling” accounts for much of the outflow of gold.

He explained that the Customs agency only has 40 offices to cover all airports and ports in the archipelago, which also sends huge shipments of other minerals - chromite, nickel and copper - to China.

Biazon cited as an example of the difficulties he faces a recent case in which nine cargo vessels shipped 75,000 metric tonnes of smuggled chromite to China from a private port in Zambales province, 50 miles from the nearest Customs office.

Traders and officials say the biggest factor behind the spike in the gold smuggling trend the past year is a 2 percent excise tax and a 5 percent withholding tax approved

in 2008 but which the Bureau of Internal Revenue only started enforcing last year. The tax is imposed on gold sales to the central bank, so is usually borne by the traders.

Tagum city, the provincial capital of Davao del Norte, is the biggest gold-buying centre nearest to Mount Diwata. Known as the “city of palm trees”, Tagum has become one of

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<http://link.reuters.com/ges22t>



CRUDE INDUSTRY - Record gold prices have helped spawn an industry of 10-15 million small-scale miners across the developing world, who use crude tools such as blow torches (L) and stones to process raw ore into nuggets, plates or bars. **REUTERS/ERIK DE CASTRO**

the fastest-growing cities in the Philippines, driven by the small-scale gold-mining boom.

Gold traders in Tagum say if not for the tax, they would rather sell to the central bank than in the black market where prices fluctuate fast.

“Our mark-up cannot even cover (the tax) because of the tight competition and the fast turnover of supply,” said one trader who asked for anonymity. “As far as I know, no one is selling to the central bank anymore,” said the trader, who buys and sells at least 100 kilograms (3,215 troy ounce) of gold monthly.

Diwa Guinigundo, a career central banker and now deputy governor of the central bank, said the drop in gold sales to the central bank is likely to persist if the current tax regime remains.

“The ball is with them,” he said, referring to the Bureau of Internal Revenue.

But like the Customs Department, the Bureau of Internal Revenue has marching orders to prop up state revenues to pay for

an array of public infrastructure projects -- needed to lure private investment and drive growth, perhaps earn the Philippines investment grade status from ratings agencies for the first time.

Internal Revenue head Kim Henares said smuggling was a long-standing problem even before the agency’s July 2011 imposition of taxes on gold sales.

“The revenue regulation stays,” Henares declared, referring to the tax on gold sales. If smuggling was the problem, she said, then it was up to other agencies to tighten controls on the movement of minerals.

HARDER TO MINE

Tax or no tax, sustained demand for gold and firm prices will keep miners on Mount Diwata pounding on the rocky walls of its deep tunnels to extract gold ore, with some using illegal dynamite to blast it out.

The gold is harder to find these days, and the ore not as rich, but the work is far more remunerative than it used to be, miners say.

“In the 1980s, one bag (of ore) could produce 5 to 10 grams of gold, but the price then was just 160 pesos (\$3.82) per gram,” said George Cantilla, a 51-year-old underground mine supervisor who has been working in mines since finishing college.

“Now, you get tiny amounts of about 0.2 gram per bag, but the price now is so much higher.”

(\$1 = 41.77 Philippine pesos)

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