

Mining in Latin America

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RAFAEL VERGARA

Rafael Vergara of Carey takes an in-depth look at mining in Latin America.

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Latin America slips but stays on top

In the last years, the region maintained its leading position in attracting mining investment, with 28 per cent of the total investment pipeline (source: Engineering and Mining Journal 2012), though the mining exploration has declined and new exploitation projects or expansions have been slowed by global economic uncertainty, volatility of markets, softening commodity prices, and higher input costs.

Notwithstanding this, the region is being targeted for inbound investment; this is partly due to the scale of opportunity where much of the region is yet to be subjected to vast exploration and partly a result of the relative attractive regulatory environment of countries such as Chile, Peru, Colombia and Mexico, which are well positioned to supply the global market.

The region has also benefited from these facts and continues being a very important target of many international mining companies. Thus, 25 per cent in 2012 of the world's total investment in nonferrous exploration were spent in our region, keeping its position from 1994, as "the most popular exploration destination" (source: Metals Economics Group). New high-grade deposits are being discovered and new resources and reserves are being identified in the mines under exploitation. Even though most of the projects that were frozen in 2008–09 were back on track in 2010–11, and a quarter of world investment is attracted to this region, it is perceived that the construction and expansions of projects are slower and more difficult, mainly due to the factors mentioned below.

Latin America is still an important base for the world supply of metals and a substantial global mineral reserve. Currently, the region produces 45 per cent of global copper production, 50 per cent silver, 26 per cent molybdenum, 21 per cent zinc and 20 per cent gold.

Mining continues to be significant to the economies in the region, especially in Mexico, Peru and Chile, and is gaining more importance everyday in Brazil, as well as in Argentina. In Chile, for example, the mining sector represented 15.4 per cent of GDP in 2012. Investment in mining continues to come largely from outside of the region – mainly from Canada, USA, UK and Australia – and not only from large companies but some from junior companies as well, particularly in exploration.

Lastly, some investments from China – including purchase of mines and companies -- and, once again being very active, old players from Japan are being seen in the regional scenario. Chinese participate in 34 projects referred to commodities across the region, mainly in Peru (where their major projects are located) and Brazil, but also in Ecuador and Argentina, and their presence is increasing in other countries of mining tradition, such as Chile and Mexico. In addition to the above, regional private mining companies -- such as Grupo Mexico and Peñoles in Mexico, Buenaventura and Southern in Peru, and Luksic in Chile – have also grown and expanded internationally. While production is largely privately held, regional government-owned mining companies, such as CVRD in Brazil and Codelco in Chile, have also become stronger, with expansions not only in the region but also abroad.

With the increase of their revenues, several governments in the region are trying to get a bigger share of such revenues, through creeping increase of windfall taxes or royalties. Additionally, the contribution made by the mining industry to each country, through the creation of work places, infrastructure and payment of general taxes, are sometimes either not recognized or perceived as not enough by the people and, accordingly, some governments have made eco of them. And that, in spite of the efforts made by the companies, especially during the last years, when they have executed direct agreements with the local communities whereby the companies have committed investments in infrastructure, education or health, use local goods or services or to train and employ local workforce. Sometimes, the companies have made additional direct contributions focused in certain specific social areas of such communities, either under a shared administration or trust, with a long-term view to strength their relationship with the local people and environment.

Legal title to a mining deposit and to key supplies (such as water), availability of the required economic resources, or even technological capabilities, are no longer sufficient. Instead, a need for the “social licence” is growing more important every day: an approval by human communities having some geographic, ancestral, cultural or other relationship with the place where the project is located. The social licence is part of the social and environmental issues, sustainable development or corporate social responsibility, of growing importance and necessary for the development of mining projects in Latin America.

In addition to indigenous rights (discussed in an earlier edition of this publication), nowadays special attention should be paid to the following matters: community relationships; increased costs and capital access; skills shortage and relevance of people; and rule changes.

Indigenous rights and community relationships

The approval of the 169 Convention on Tribal and Indigenous Peoples in Independent Countries (the Convention) by the International Labour Organization is the milestone that has given a definitive impulse to the legal recognition of indigenous and tribal people's rights. The Convention contemplates a consultation and participation process whereby indigenous peoples are entitled to decide their own priorities for the process of development as it affects their lives, beliefs, institutions and spiritual well-being and the lands they occupy or otherwise use, and to exercise control, to the extent possible, over their own economic, social and cultural development.

Consistently with the consultation and participation process, the Convention establishes the rights of the peoples to the natural resources and their rights to be consulted before such a project is approved or carried out; it also establishes if and to what extent the peoples may be affected by such project, as well how they may benefit from the projects which exploit the natural resources and how they may participate in the utilisation, administration and conservation of such resources. The hurdles that mining projects may face due to the application of the Convention, which may consequently affect their financing, lay in the ambiguity of their terms and binding force. Questions have arisen as to how the Convention must be applied and what the meaning and extension of the consultation process is. For instance, is it compulsory for governments or investors to follow the recommendations given by the indigenous people? What if the recommendations are not efficient for the investor or even illegal? If we were to assume an extreme position indigenous people would become managers of the projects. By contrast, if we were to disregard their opinions the whole purpose of having a consultation process will be diminished. Anyway, more balanced positions have fostered the reaching of agreements between investors and indigenous people focusing on taking account their views and position toward the development of mining projects.

Additionally, governments are placing pressure on mining companies to take a greater role in supporting the broader community through social and logistical infrastructure, community developments, local hiring and procurement and training practices.

In other hand, the local communities are not just looking for minimal disruption but also to share the economic and social benefit from local mine operations; and for such purposes the local communities sometimes use any sort of tools to push, including judicial claims.

Increased costs and capital access

Although there is a massive pipeline of projects for the coming years, at the same time there has been high increase of costs and heightened macroeconomic uncertainty.

The costs increase in the mining sector is expected to intensify over the next few years owing to a number of reasons, including labour, energy, currencies, supplier constraints and taxes. In the prevailing environment of global economic uncertainty, volatility of markets, softening commodity prices, higher input costs and strengthening local currencies in many mining jurisdictions, the pressure on company margins is increasing.

Companies are revisiting their capital expenditure plans as spiralling capital costs threaten the viability of new projects. Furthermore, high crude oil prices, wage inflation and increasing complexity are driving operating costs.

In response, mining companies are reviewing their portfolios to identify underperforming assets, with plans to shut down or divest high cost and non-core assets. So, industry consolidation, automation technology, owner-operated mines and investment in energy assets are some of the steps that companies are taking to lessen the impact of rising costs.

Additionally, with this macroeconomic outlook, the junior mining companies are facing difficult times to access capital, while for the major mining companies, though they are able to raise low-cost debt the key issue is how, when and on what to allocate it (among the different projects in file).

Skills shortage and relevance of people

The increased investment in mining and metals to quickly develop new projects is in turn driving a demand for skilled workers around the world and drawing on the same global pool of talent. The risk is that this could slow growth and increase costs.

The significant risks related with skills shortage include impact to production, project delays and increasing labour costs. Identifying, attracting and retaining critical operational and construction skills remain a top priority for the mining and metal sector. Companies need to understand what is important to their targeted workforce and be creative in providing not only an attractive compensation but also a range of additional employee benefits.

This issue includes the need of sharing the benefits. As the mining sector continues to flourish while other sectors flounder, a wider range of stakeholders are looking for a greater share in the perceived profits. These stakeholders feel entitled to a portion of the profits and balancing these varied and competing expectations is challenging.

Finally, the employees are seeking higher wages and greater workplace benefits and can incite industrial unrest if they are not achieved.

Rule changes

In the regional context, there is an uneven development in mining industry, which in some ways could explain different problems in each of the countries where this

activity is performed. There are more developed mining countries such as Chile, Peru and Brazil, while others show emerging growth and potential, such as Colombia, despite the efforts and potential for geological mining in regions such as Argentina and Ecuador. Finally, there are countries such as Venezuela where private investment in mining is not observed.

Ecuador is one of the countries in process of developing its mining industry. However, its new mining legislation and amendments, designed with criteria based on the country's oil experience (a very different industry from mining), have imposed high tax rates on the activity, which have driven away the big mining companies that are precisely those which aim to attract the country, for its high standards of production and social and environmental responsibility. In this context, the Canadian company Kinross Gold recently decided to retire its Fruta del Norte gold project, after 30 months of unsuccessful negotiations with the government.

In fact, mining law reforms are repeated in other countries. For example, in Brazil, the government has sent a bill to amend the Mining Code, probably increasing the applicable tax. In Argentina, some provinces have approved laws to levy a fee of 1 per cent of the mineral reserves.

Additionally, these rule changes could consider some national resources, meaning that some governments are seeking to ensure that they retain ownership of their minerals, which is not a new phenomenon. These changes in ownership laws can have a significant impact on the reward miners' expect to receive for the risk they have taken as they have paid for 100 per cent of the investment but will receive only a percentage of the future investment return.

Nonetheless, some countries are taking measures to facilitate the development of mining. For example, in the case of Peru, the government has committed to accelerating the bureaucratic procedures to unlock mining projects and ensure dialogue with communities.

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Water scarcity is another relevant issue for mining projects. Companies are focused in finding access to water sources to supply future mining projects; reducing water consumption in their mining processes; and using seawater for the whole mining operation, even implying the construction of long pipelines to transport water from the coast to the mine.

Infrastructure for mining projects, facing either poor or entirely absent facilities, is another challenge for the mining industry in Latin American countries, especially in Brazil, Colombia and Peru.

Final words

Other important matters that also represent a challenge to Latin American lawyers, particularly regarding their legal implementation, include the reclamation and closure of mining facilities and related environmental costs and liabilities; bilateral mining treaties signed by some Latin American countries; a complex energy situation, which has led to some mining companies to look for alternative sources of energy, including possible investment, such as geothermal opportunities and/or building their own power generation plants (including LNG facilities) mainly to secure their needs but also to supply third parties, as the revenues appear to be interesting; escalation of labour-related burdens and pressures – including rules to rigidify the labour relationship that has been put in place in some countries; exploration options and joint venture agreements, becoming ever more sophisticated as often mining properties owned by different individuals must be brought together to make a project attractive and owners of mining concessions require a greater share in project profits through mechanisms such as net smelter return or net profit interest; and the attempt to implement in some Latin American countries the implementation of a venture capital market to finance exploration, trying to replicate the Toronto Stock Exchange model, including the approval of codes on resources and reserves, regulations on qualified person, etc.

Additionally, illegal mining in Latin America has become more common over the years. Different minerals are targeted by illegal miners but gold has become the most wanted commodity. Peru, Colombia and Bolivia are current hotspots for this activity. In the case of Peru, many farmers have flocked into the Amazon region to become informal miners but this activity has brought destruction and pollution to this precious rainforest. In the case of Colombia many guerillas are now controlling gold mines in order to obtain money to finance criminal activities. Governments have made attempts to stop these activities but the efforts have not shown any results yet.

In connection with the financing of mining production, project finance continues to be used as traditionally structured, through direct or syndicated loans from national or international banks, multilateral agencies or export credit agencies, or a combination of such sources. Lately, mining companies have started to use other vehicles, such as stock or bond issuances in the domestic or foreign markets, or mining infrastructure leases (the latter has been successful particularly in expansions of mining projects currently in production, at conveniently low costs). Additionally, the sale of future production or a royalty over the same, such as the old *avío*, is being used as a way of financing.

Most of the factors and challenges mentioned above are common not only to Latin American countries but also to any other mining country worldwide. Accordingly, they must be assessed in the appropriate way; that is what the mining companies do. It is not for the wrong reasons that they have put hope into our regions and declared investment of \$220 billion dollars within the next seven years, especially in Argentina, Brazil, Chile, Mexico and Peru.