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Resource nationalism sweeps Latin America

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Introduction

With attention focused on the conflict in Europe, Latin America has generally stayed on the periphery of the world media spotlight. However, from a geopolitical perspective, the region is of critical importance to the long-term stability of the Americas and global commodity supply chains.

Politically, the region's big picture is one of volatility and radical change. More specifically, long-standing social problems such as income inequality and limited access to healthcare, exacerbated by COVID-19,have fuelled public anger and led to a political changing of the guard in several Latin American countries.

Chile, Peru and Mexico are among the countries where upstart anti-establishment politicians have pushed aside traditional mainstream parties. Because right-wing parties were in power when the pandemic hit in Chile and Peru, rising discontent benefited political forces well to the left of the political spectrum. As for Mexico, the far left has been in power since 2018 and has surprisingly weathered the pandemic with its approval ratings largely intact.

For a variety of reasons, all three countries are pushing to exert more control over their natural resources. The policy implications range from higher taxes to outright government control of certain sectors. The motivation is largely the need for more government revenue to address the impact of the COVID-19 pandemic, which has increased demand not only for social programs but also for investments to reactivate their national economies.

Commodities such as copper and lithium, which are crucial inputs for IT products and alternative energy, have been especially targeted. Given the difficulty that many developed countries have experienced in trying to garner sufficient public support to open new mines within their own borders, Latin America's commodity output will take on an increasing importance to the global economy and its energy transition.

These countries are facing the difficult balancing act of increasing taxes and government control of the mining and energy sectors while trying to grow production and attract investment. Failure to achieve these dual goals would mean lower revenues for their ambitious social agendas.

On the global front, despite fears of an economic slowdown currently weighing on commodity prices, barriers to production in the near term could translate into tighter global supply conditions and higher prices over the longer term.

Chile tilts left

Even though Chile has been one of Latin America's fastest-growing economies in recent decades, it has not been able to avoid political unrest. In 2019, Chile was hit by the worst protests in a generation. These were sparked by high-school students upset about an increase in subway fares but then quickly expanded to other matters such as the high cost of healthcare and education.

The events led to the election of Gabriel Boric as president last March, and an agreement to hold a referendum whether or not to approve a new constitution to replace the existing one drafted in 1980 by the military dictatorship in power at the time.

A left-leaning former student activist, Boric had campaigned on implementing more stringent environmental regulations, particularly with regard to mining. This included attaining net-zero carbon emissions by 2050 and overhauling management of the country's water reserves.[1]

He also promised to increase mining taxes and create a state lithium company that would compete with the private sector. Last January, the government rescinded approval for lithium mining operations that had been granted to two private sector companies late in the term of the prior government in order to revaluate the approval process.[2]

[1] "Chile's lithium mining dilemma: Reconciling economic opportunity with environmental concerns," Fortune, May 23, 2022
[2] "Chile court freezes multi-million dollar lithium deal," France 24, January 15, 2022

Mining is a huge part of Chile's economy. It accounts for about 10% of GDP and over 50% of exports.[3] Chile is the world's largest producer of copper and second-largest producer of lithium.

Higher mining taxes are likely in Chile because they are seen as the best way to generate revenue. More importantly still, there appears to be sufficient cross-party support in Congress for such a tax hike. Chile recently introduced a tax bill that targets high earners and mining revenues. It includes the following:

- A tax based on the amount of copper produced: 1% to 2% for companies producing between 50,000 and 200,000 tonnes annually, and up to 4% for those that produce more than 200,000 tonnes.
- An additional tax of between 2% and 32% on profits for copper prices between $2 and $5. The higher the price of copper, the higher the marginal rate of tax.[4]

Constitutional reforms

In October 2020, against the backdrop of a COVID-19-induced economic contraction, 79% of those who cast ballots supported drafting a new constitution. Another vote was then organized in May 2021 to choose who would sit on the constituent assembly responsible for drafting the document. To the surprise of many people, about 70% of the assembly's seats went to left-leaning candidates.

The proposed changes to the constitution include requiring miners to pay for environmental damages, granting indigenous groups extensive autonomy over ancestral lands and banning mining near glaciers and other water-sensitive areas.[5] While many Chileans view these proposals as necessary, their inclusion in the constitution would mean higher operational costs for mines.

Chile will be voting on these changes on September 4th. Polls in the first few months of the year showed a majority intended to vote in favor of the new constitution, but recent surveys show those whose oppose the new document narrowly in the lead. **Should the proposed document be rejected, the current constitution would remain in place, and the country would probably have to restart the drafting process.**

The longer the uncertainty regarding regulations and taxation levels in the commodity sector, the longer before new mining projects get underway.

Other challenges facing Chile's mining sector

Against this backdrop, the mining sector also faces growing water-related challenges. Much of the copper and lithium in Chile is mined in water-stressed areas ranked among the driest in the world. This is the case for over 80% of its copper production.[6]

Mining is a particularly water-intensive process. Extracting lithium from South America's Lithium Triangle—a region covering parts of Argentina, Bolivia, and Chile—involves pumping large amounts of water underground and pushing up to the surface a salty mud known as brine, which contains lithium. The brine is left in a large pool until the water evaporates. After 12 to 18 months, the process is complete and lithium carbonate can be extracted and processed.[7]

Copper mining involves crushing copper-rich rocks to dust and mixing it with water to be transported through giant pipes. The liquid is then further mixed with chemicals to separate the copper from other mineral residues. This strong demand for water in the mining sector is further complicated by the fact that Chile is in the midst of a severe multi-year drought that has caused the capital Santiago to prepare for the risk of water supplies being rationed.

Desalination and recycling are two solutions being increasingly adopted by the mining sector to reduce the stress on scarce water reserves. It is important to bear in mind, however, that these necessary measures will add to costs.

In addition to water scarcity, the declining quality of ore bodies is another long-term challenge facing the copper industry. This means that significant additional investment is required just to prevent copper production from shrinking further. For instance, state-owned Codelco needs to spend $35 billion between 2021 and 2030 to maintain current output levels.[8] Lower ore grades also mean higher extraction and processing costs due to, among other things, the greater amount of water required to separate copper from other minerals.

[3] "In Chile's Lithium Sector, the End of Pinera's Privatization Era Nears," Stratfor, January 18, 2022
[4] "Chile sticks to plan for new mining profit tax up to 32% linked to copper price," Reuters, July 1, 2022
[5] "Chile's lithium mining dilemma: Reconciling economic opportunity with environmental concerns," Fortune, May 23, 2022
[6] "Desalination is not the only answer to Chile's water problems," McKinsey & Company, September 2020
[7] "The Lithium Triangle: Where Chile, Argentina, and Bolivia Meet," Harvard International Review, January 15, 2020
[8] "Copper boom: how clean energy is driving a commodities supercycle," Financial Times, June 8, 2021

President Boric's political honeymoon is already over

His party's lack of a majority in congress leading to gridlock on many issues, the slowing economy and mounting concerns over crime have all combined to hurt President Boric's popularity. His administration's disapproval rating shot up to 59% in late June, the highest level since he took office.[9]

As the economy loses steam, it will become increasingly difficult to strike a balance between implementing more stringent regulations and growing the economy to fund the government's ambitious social agenda.

Peru's mining sector faces a wave of protests

Over the past few years, Peru has faced growing geopolitical headwinds. First, political infighting saw the country go through four presidents in five years. Then, in 2020, came the economic and social devastation of COVID-19.

It is in this context that Pedro Castillo, leader of Peru's Marxist Party at the time, was elected president in June 2021 by a mere 72,000 votes over his opponent.

During the campaign, he promised greater state control over the mining sector and increased distribution of the profits to communities living in the mining regions. He also vowed to keep 70% of mining profits. Mining is the lifeblood of the Peruvian economy, accounting for about 10% of GDP and 60% of export revenues.[10] Peru is the world's second-largest producer of copper and zinc.

However, since coming to power President Castillo has run into major problems. For starters, he has been unable to raise mining taxes because of a fragmented Congress. Second, Castillo's time in power has thus far been extremely chaotic. He has already gone through dozens of cabinet ministers and fended off two impeachment attempts.

The mining sector hit by a wave of protests

Although Castillo was elected with massive support in the mining regions, his time in power has been marked by protests against mining companies. Communities in Peru's copper-rich Andes region, whose hopes have perhaps been raised by Castillo's victory, have long complained that the country's mineral wealth did not trickle down to their communities.

So far, two major Peruvian copper mines that account for about one fifth of Chile's copper production have seen their operations disrupted:

- U.S.-based Southern Copper suspended operations at its Cuajone mine for over 50 days ending in late April. The company is preparing for formal talks with community members demanding a greater share of company profits.
- A mine in the Apurimac region owned by China-based MMG recently endured a 51-day shutdown because of protests. The protesters—villagers relocated more than a decade earlier to make way for the mine—accuse the company of not having fulfilled its financial commitments to them. They agreed to stop protesting for a period of 30 days starting June 15 in order to engage in negotiations.[11]

Failed negotiations could lead to renewed protests and further disruptions to operations.

More recently, local communities in the Espinar Province began protesting against expansion of a mine owned by Swiss-based Glencore. In this case, they are demanding that new infrastructure be built and that the company acknowledge that it has caused serious environmental damage. Operations have so far not been disrupted.[12]

Political tensions to persist

Congressional gridlock and broad resistance to Castillo from the political establishment and business elites likely mean that the next few years will continue to be marked by political turbulence. This instability will likely be worsened by the President's recent breaking of ties with Free Peru, the party that took him to the presidency, over ideological differences. Adding to all these tension points is the divide between poorer rural regions that massively voted for Castillo and wealthier urban coastal areas that strongly opposed him.

A May poll from the Peruvian Studies Institute showed that Castillo had a 70% disapproval rating.[13]

[9] "Chile poll shows support for Boric, new Constitution at record low," Reuters, June 27, 2022
[10] "Protests sweeping Peru strand tourists and close copper mines," Financial Times, April 22, 2022
[11] "Peru communities to allow Las Bambas mine restart after 51-day shutdown," Reuters, June 10, 2022
[12] "Protests sweeping Peru strand tourists and close copper mines," Financial Times, April 22, 2022
[13] "Peruvian president faces investigation in corruption case," Associated Press, June 17, 2022

Mexico undoes private-sector reforms

Since taking power in 2018, President López Obrador has taken measures to reassert state control over natural resources. For instance, he halted any further private-sector access to oil and gas exploration, mining concessions, and the electricity sector. He even went so far as to revoke existing contracts. Mexico's energy regulator shut down a fuel-import terminal owned by investment firm KKR last September, and it is currently attempting to revoke Japan-based Mitsubishi Corporation's operating licence for its wind farm, the largest in Latin America.[14]

Given that the President's coalition enjoys a majority in both houses of Congress, President Obrador was able recently to pass legislation to nationalize the lithium industry, declaring the mineral to be of strategic importance. Included in this law is a clause that allows the state to assign the same status to other minerals as well.[15] This potentially opens the door for the government to nationalize other commodity sectors.

While Mexico ranks tenth in global reserves of lithium, its clay-based deposits are far more expensive to exploit than the brine-based deposits found throughout South America. This geology, combined with the uncertain regulatory climate, could dissuade foreign money from investing in this sector.[16] Further, the government takeover of lithium production is likely to trigger a dispute-settlement mechanism under the United States-Mexico-Canada Agreement. Mexico is also a major producer of oil, silver, copper, gold and zinc.

Poll numbers holding up so far

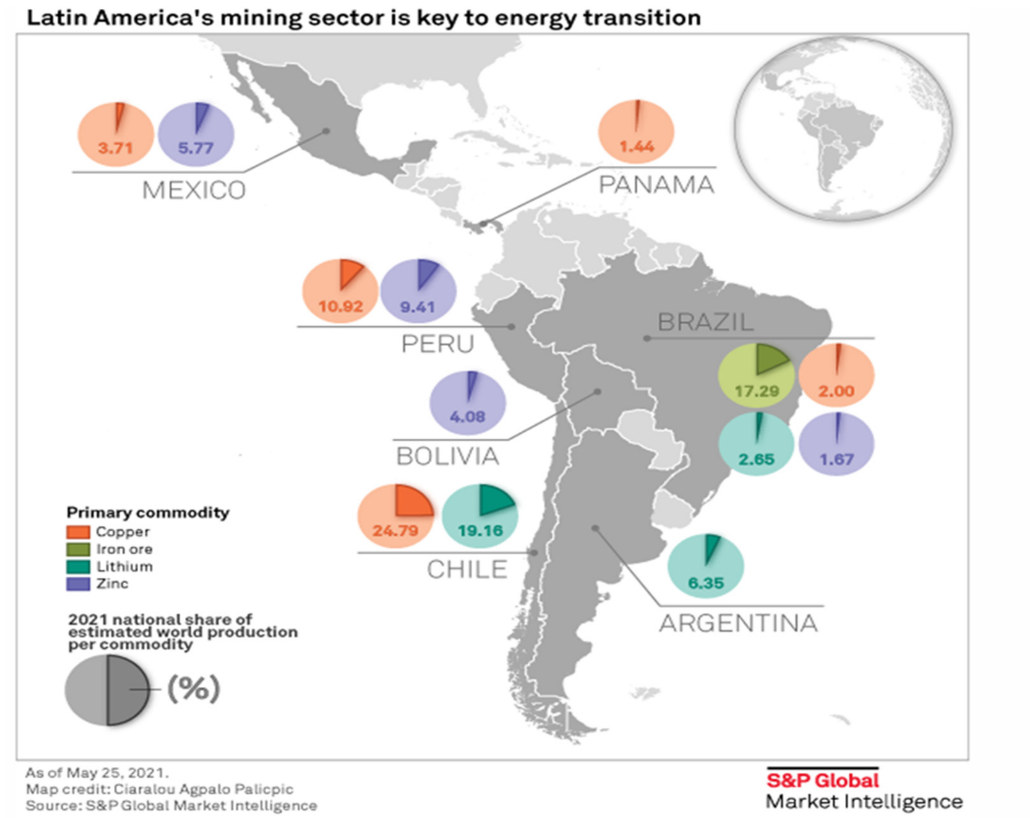
Despite Mexico's high rates of violence, a stagnating economy, and a heavy pandemic death toll, President López Obrador still commands an approval level close to 60%.[17]

Latin America's growing strategic importance

Latin America's geopolitical significance is on the rise because the region is a rich source of critical minerals needed by countries transitioning to green energy. Chile, Peru and Mexico account for nearly 40% of estimated global copper production. Over 25% of the world's estimated lithium production is located in Chile and Argentina, while Peru, Mexico and Bolivia account for an estimated 19% of zinc production (see map below).[18] The importance of these supplies are reinforced by the difficulties many developed countries facing in increasing domestic mineral production because of political resistance.

Latin America's strategic importance could eventually lead to greater competition among the world powers—the United States, China, Japan, and the EU—for access to these minerals. In terms trade, the United States has already lost ground to China in a region considered to be in its backyard. Excluding Mexico, which is tightly integrated with its northern neighbour, total trade flows between Latin America and China hit nearly $247 billion last year, compared to only $174 billion with the United States.[19]

[14] "Mexico Takes Aim at Private Companies, Threatening Decades of Economic Growth," Wall Street Journal, June 12, 2022
[15] "Mexico nationalizes lithium mining," Mining.com, April 21, 2022
[16] "AMLO's Lithium Grab and War on Green Energy Will Hurt North America," Council on Foreign Relations, May 9, 2022
[17] "Approval Tracker: Mexico's President AMLO," Americas Society Council of the Americas, June 15, 2022
[18] "Turmoil casts doubt on Latin America's mining of energy-transition minerals," S&P Global, June 28, 2021
[19] "Under Biden, China has widened trade lead in much of Latin America," Reuters, June 8, 2022



Source: "Turmoil casts doubt on Latin America's mining of energy-transition minerals," S&P Global, June 28, 2021

Conclusion

Political unrest, looming tax hikes and regulatory uncertainty are reasons that could prompt mining companies to delay plans to invest in new production in Chile, Peru and Mexico.

Regardless of the political climate, we project that strong long-term demand trends for commodities such as copper will eventually lead to the opening of new mines. What will differ is that the decision process followed by mining companies to approve new production will likely take much longer more than would have been the case under a different set of political circumstances.

Bloomberg Intelligence estimated that it takes on average 14 years to move a copper mining project from the discovery phase to production. The International Energy Agency (IEA) estimated that it takes over 16 years. (See "The monumental challenge of trying to hit climate targets" for a more detailed analysis of lead times.)

The projected long-term demand for commodities such as copper and lithium draw attention to this risk. Goldman Sachs estimated that an electric vehicle contains five times as much copper (60 to 83 kg) as does a car with an internal combustion engine and that a 3-megawatt wind turbine contains up to 4.7 tonnes of copper.[20] According to the IEA, in order to meet the climate targets set under the Paris Agreement, at least 40 times as much lithium will be needed by 2040 compared with 2021.[21]

On the political front, if the left-leaning leaders of Chile, Peru and Mexico do not fulfill expectations, certain of these countries could tilt back to the right in the next elections. The leaders of Peru and Chile have already seen their approval ratings fall sharply amid the growing public perception that they are failing to deliver on their campaign promises. This means foreign investors, especially those in the mining sector, could be forced to navigate regulatory environments that change radically from one government to the next.

Finally, while fears of an economic slowdown are currently weighing on commodity prices, delays to production could add to the already very long lead time required to get mining operations running. Over the long term, this could mean tighter supply conditions and higher prices.

[20] "Copper boom: how clean energy is driving a commodities supercycle," Financial Times, June 7, 2021
[21] "The Role of Critical Minerals in Clean Energy Transitions," International Energy Agency, May 2021

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