A magnet for investment

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President Piñera plans to offer new tax incentives to mining companies that develop new technologies and expand mining research

As the 33 trapped miners emerged blinking into the glare of the world's media, Chile's mining industry found itself caught in the same spotlight and perhaps offered thanks for the feel-good nature of the story. Few industries anywhere on the globe would welcome such exposure – and mining is a heavy industry that does not easily generate light entertainment.

But make no mistake, mining is the star performer of the Chilean economy. Chile is the world's largest producer of copper, and copper exports account for more than one-third of government revenues, while significant reserves of gold, silver, molybdenum, iron ore and coal make further contributions to the coffers.

The cameras could barely have left the country after covering the February 2010 earthquake. In the immediate aftermath of the 8.8 Richter scale quake there were dire predictions for the mining sector, but the epicentre was well away from the main Norte Grande mining region straddling the Atacama desert, and there was little direct damage to mining operations. As a result analysts are predicting continued strong growth of more than 9 per cent for 2010, with the sector reaching a value of more than US$40 billion (bn).

Almost slipping under the radar amid the disasters both natural and man-made, at the beginning of the year the country elected a new president, with centre-right candidate Sebastián Piñera ending 20 years of power of the centre-left Concertación coalition, a four-party alliance that included the Christian Democratic Party, the Socialist Party, the Party for Democracy and the Radical Party. Piñera's presidential bid was supported by Chile's two right of centre parties – his own moderate-right National Renovation party and the Independent Democratic Union party.

His election has been well-received by many within the international mining community. Tye Burt, President and CEO of Kinross Gold, one of several Canadian mining companies active in Chile which operates two mines and is considering investing US$2 bn more on a pair of development projects, said: "His reputation is to have a favourable stance towards business and taxes, so those are all positives. But even before Piñera stepped in, we thought Chile is absolutely one of the best jurisdictions in the world for what we do." But the earthquake will cost an estimated US$30 bn. With its dominant position in the economy, some might have expected that a considerable burden of the cost of reconstruction would fall on the mining industry.

However, the new President's plan for a voluntary increase in mining royalties to raise over US$1 bn a year were scotched by the opposition in Congress, leaving the industry free of additional costs for the moment (but leaving a large hole in plans for raising the required reconstruction revenue). Compromise plans are still being negotiated.

President Piñera plans to offer new tax incentives to mining companies that develop new technologies and expand mining research. Chile already has an admirably low corporate tax rate of about 17 per cent for foreign mining firms on income that is reinvested back in the country.

Among other campaign promises, Piñera pledged to sell up to 20 per cent of state-owned copper company Codelco, the world's largest copper producer. Shares are likely to be sold to private pension funds in Chile, although Piñera's advisors have also floated the idea of listing Codelco shares on Chile's stock exchange.

The new President has also suggested creating incentives for companies to build desalination plants to provide water to mining operations in dry regions such as the Atacama desert where miners, including Teck, Kinross and BHP Billiton, the world's largest mining company, all have operations.

The latter is already using desalinated water at its operations in the desert. Teck, Canada's largest base-metals mining company, has spent more than US$4 bn acquiring copper assets in Chile in the past three years. "Chile has great copper resources. It has a very stable political and economic system and a stable and well thought-out tax regime. Those factors are all good for encouraging investment," said Greg Waller, Teck's Vice President of Investor Relations.

Piñera's opponent, Eduardo Frei, had pledged to double revenues from Chile's 5 per cent mining royalty to raise an additional US$300 million annually for government coffers, a move which was received with some apprehension in the mining community.

Almost inevitably in the new global economic order, the Chinese are now major players in the Chilean mining sector. "The Chinese government will cover 40-50 per cent of the exploration costs incurred by any Chinese mining companies searching for deposits overseas" said Fernando Reyes, Chilean ambassador to Beijing. "As the world's largest copper producer, Chile is a prime target for this financing." This follows a recommendation made last October by the Chile-China Mineral Commission that Beijing should directly invest in Chilean mining operations in order to boost Chinese industry.

Chinese mining company Shunde Rixin recently announced a US$2.2 billion investment in the Vallenar iron ore mine in Chile's Atacama region. Analysts predict that reserves at the Vallenar facility will satisfy 10 per cent of China's iron ore demand in the coming decade. Chile's trade with China grew by 6.3 per cent in the nine months up to September 2009, with China replacing the US as Chile's largest trading partner in both the past two years. It is perhaps a good indicator of the new global economic order that China can be the biggest player in what was once part of "Uncle Sam's backyard" without it appearing in the slightest way odd.

One industry that will rise on the back of the earthquake is the steel industry. 2011 will see significant growth in domestic consumption of iron ore as the industry ramps up production to rebuild Chile's infrastructure. To date effort has concentrated on running emergency repairs, but as tenders for major rebuilding projects are decided, steel production will rise by the end of the year with an increase on 2009 production rates – despite the quake halting production at one major steel plant for three months. Steel producers are expecting demand to peak in 2011 as projects get underway.

An area of concern as the mining sector grows over the next few years will be increasing wage demands. Recent months have seen some production disruption as a result of strike action and one or two unions are sounding increasingly strident in their demands. Some observers fear the unions may be tempted to make political points aimed at the first conservative government for two decades. With the mining sector accounting for more than 20 per cent of the GDP of the Chilean economy, it is far too important to be used as a political chess piece, those observers argue.

One unwanted side effect of the success of the mining sector is the skills shortages that increasingly confront companies operating in the country. Companies will have to compete aggressively to attract talent, Lumina Copper CEO Nelson Pizarro said recently. "There are several projects that are scheduled to start operating within the next 2-3 years. Companies will be forced to compete to attract professionals to their projects, as the formation [education and training] of these professionals is something that cannot be done in the short term."

The industry expects a total of 23,000 positions to be created in the next 10 years, including professionals, skilled employees and machinery operators, according to Pizarro. "We can only hope that the lack of professionals and technicians for the mining sector will not hurt the development of projects in the near future," he said. It is, he added, a problem facing mining companies not only in Chile but across the developed world.

And finally, one unwanted side effect of the rescue of the 33 trapped miners will be to focus attention on health and safety within the mining sector. Only 24 countries ratified the 1995 ILO Safety and Health in Mines Convention, and Chile (in fairness, it must be said, along with Australia, Canada, the Democratic Republic of Congo, India, Russia and Ukraine) was not among them. The reasons for doing so – or not doing so – are many and varied among the countries and companies involved, but it is unarguable that H&S considerations are not great boosters of operating margins. President Piñera will do well to resist siren calls for a dramatic overhaul of Chile's most important industrial sector.

As mining analyst Orest Wowkodaw of North American banking firm Canaccord Adams observed of Chile's lead on rival countries as South America's mining country of preference: "It is the best. It is that simple. Ask any mining executive where they want to own assets in South America and number one on their list is always Chile." F

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Chilean miner Juan Illanes celebrates with President Sebastián Piñera after he became the third miner to be rescued at the San José mine in Copiapo

REUTERS/Jose Manuel de la Maza-Chilean Presidency