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On "Mineral Rents and Social Development in Chile"¹

Manuel Riesco²

CENDA, Chile

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Social Policy in Mineral-Rich Countries

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<http://sites.google.com/a/cendachile.cl/cenda/Home/unrisd-workshop-on-mineral-rent-and-social-policy-files>

² Vice-president of Centro de Estudios Nacionales de Desarrollo Alternativo, CENDA, Santiago, Chile. mriesco@cendachile.cl, www.cendachile.cl

³ Disclaimer: this is a draft paper. All figures presented have been double-checked. Nevertheless, the serious implications of the conclusions demand greater care in this aspect prior to publication. The author kindly requests all readers who may find any inconsistency in the data presented – or any other mistake – to please consider communicating this to mriesco@cendachile.cl. In addition, the results will be sent to Consejo Minero, Minera Escondida, CODELCO and Cochilco to request their comments prior to official publication.



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UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: (41 22) 9173020
Fax: (41 22) 9170650
E-mail: info@unrisd.org
Web: <http://www.unrisd.org>

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Introduction

UNRISD has continued its research on the decisive issue of mineral rents and development, with a seminar on "Social Policy in Mineral-Rich Countries." Previous UNRISD findings¹ on the subject aroused quite an argument in Chile, as they showed the rather scandalous fact that most private mining companies which since the 1990s have regained control over 70% of Chilean nationalised copper minerals - the rest is exploited by State owned CODELCO - had operated over a decade without paying any taxes at all - even worse, they had accumulated billions in tax credits.

In addition, the UNRISD research showed that the only company that had paid significant taxes - which happens to be the world largest, and a leader in the corporate social responsibility (CSR) as well - had been systematically under-pricing its copper, overpricing refining services paid, and underestimating the value of by-products contained in the concentrates it ships; in all cases ostensibly in the benefit of related companies that buy and process the concentrates (Riesco, Lagos and Lima, The 'Pay Your Taxes' Debate 2005).

Understandably, such conclusions caught the attention of the Chilean government, parliament, and public opinion - as well as the company involved. The latter commissioned a counter-report by experts in a leading university that was published by UNRISD together with its own research. The debate took place in a moment when the facts denounced were matter of wide public concern in Chile, and two of it's main assertions have since been proved true beyond any doubt, while the third remains a matter of serious concern as this paper will show (Riesco, Lagos and Lima, The 'Pay Your Taxes' Debate 2005).

New legislation was enacted in 2005, which established a special 5% surtax² on net profits, for the mining companies. However limited, it has already produced over a billion dollars in tax revenues, in addition to the modest returns of regular income taxation that have started to flow from the mining companies since copper prices boomed in recent years - profit-disguising and complete tax evasion has become quite impossible at current copper and by-product prices. These financial resources, in turn, helped the Chilean state to partially supplement the serious deficiencies of privatised Chilean social policies, which have been reaching a point of crisis as well in recent years.

The above-mentioned UNRISD research may properly be considered as one of the elements that contributed to create the public awareness that led to this reform.

On occasion of this seminar, the paper on the Chilean case³ (Guajardo 2008) presents a singularly positive vision of current Chilean mining industry, and the country's overall economic and social policies as well⁴. This should come as no surprise, because this time its author happens to belong precisely to the centre that maintains the closest relation with the private mining industry, and has provided both the main intellectual support and the cadres that have implemented the mining policy that has been in

¹ See for example The Pay Your Taxes Debate, UNRISD, 2005

² This is the maximum surtax rate, and it is applied over net income calculated before tax, depreciation and interest payments.

³ Which will be referred in what follows as "the paper," and only page number (pg.#) will be used to mention specific citations.

⁴ For example, many of the facts enumerated in the paper are also listed in the website www.consejominero.cl, which represents the private mining companies operating in Chile. The description of social and economic policies is also commonly repeated in government official presentations.

effect since 1990¹.

Most of these facts are correct - an [appendix](#) is included where a few factual objections are raised, in addition to the presentation of the other side of the argument in matters not directly related to mining, such as social policies and others -, but they represent only the bright side of the picture, so to say. This may seem necessary and useful for many purposes, but certainly is not the kind of reasoning that lead to changes in the prevailing state of affairs - which in the case of many current Chilean policies may be in the loom, as current events in the country, the region, and the world, seem to suggest.

On the other hand, UNRISD has at the same time requested this commentary on the above mentioned paper, from a researcher belonging to one of the centres² that has spearheaded the criticism of current policies, which understandably is focused in underlining the main problems. Both centres have earned a widely respected reputation for long-term, serious, commitment to the subject matter. As a result, both the paper and its comments should offer the reader an interesting perspective on the main confronting positions in an ongoing debate that addresses what is by far the main strategic problem facing Chilean public policies in the present day.

The issue at stake is no less than the major part of the overall yearly Chilean social policy budget - roughly the equivalent to public expenditure in education, health, and pensions, put together. That is approximately the bulk of mineral rent that - at current copper prices - is being siphoned offshore every year, mostly to finance the global monopolistic ambitions of one or two transnational mining behemoths.

Will the country be able to define a policy that may both maximise and retain the ground rent of its rich minerals? This is by no means a technical matter, but rather a purely political one - in the sense that a very wide and powerful advocacy coalition must be put together in order to achieve this purpose, *vis a vis* the awesome power of the mining companies who benefit disproportionately from the current situation.

Furthermore, it will require major changes in the *transición a la democracia* (*transition to democracy*) political system that has lasted longer than the dictatorship it replaced in 1990. Precisely, the limited democratic procedures of "transición" confer practical veto power to the actors identified with special interests such as the mining companies - which operate both from within the government and the opposition.

These challenges may seem quite overwhelming. At first glance it looks like David vs. Goliath struggle. However, Chileans have learnt how to overcome such situations. They already achieved it once against much worse odds. When President Allende nationalised mineral resources in July 11, 1971, he received the unanimous support of all political forces represented in parliament at the time, which were otherwise engaged in the worse of confrontations against one another.

Precisely, at the very moment the seminar is taking place in the seemingly perennially calm waters of Geneva, far to the south, in the rough, mineral rich, Chilean deserts and cordilleras, thousands of mining sub-contractor workers are blocking roads and paralysing copper production, with the explicit support of regular employees. Ostensibly, they are demanding equal treatment, equal pay, and equal

¹ Centro de Estudios del Cobre, CESCO, Santiago, Chile. www.cesco.cl. The leading author of the mentioned counter-paper commissioned by a private mining company against the previous UNRISD paper is a member of this centre. Other members of this centre have occupied the key posts in government and CODELCO, the State mining company, where mining policy is in fact decided, since 1990 and up to this day Roberto Farías, *El cobre chileno los nuevos caminos a la usurpación.*, Terram (Santiago: http://cep.cl/CENDA/Cen_Documentos/Cobre/cobreterram.pdf , accessed on 12 July 2004.).

² Centro de Estudios Nacionales de Desarrollo Alternativo, CENDA, Santiago, Chile. www.cendachile.cl The author of the previous UNRISD paper belongs to this centre.

benefits, for equal jobs. However, they have explicitly said that the end goal of their struggle is the re-nationalisation of mineral resources. An overwhelming majority of Chileans support this quite evident demand, whatever the form it may assume.

Sooner or later, this will become unavoidable. Hopefully, all Chileans - including all academics that have so enthusiastically promoted and supported the current scheme for so long - will join such a stance when the time comes.

The recent Chilean struggle for the rent of its mineral resources

The commented paper underlines the extraordinary dynamism of the Chilean mining sector, especially since the mid 1990s, when transnational companies starting pouring investment into this industry. The author presents at length the spectacular production increase and its several positive impacts.

However, is there was a darker side to this boom? A strong case may be presented, suggesting there are negative aspects, indeed! There are three main lines in this argument:

- As a result of ill-conceived taxing policies, most of the ground rent of the millions of tons of minerals extracted, ended up in private hands.
- Mostly, the mineral rent ended up in hands of the main foreign competitors of the one and only world-class Chilean company, with considerable debilitating effects on its position.
- In addition, the hyper favourable conditions offered to investment in mining, generated a serious distortion in resource allocation, which among other problems caused severe rent loss during several years, damaging the economy at large and State revenues in particular.

These seem to be the main reasons why a wide advocacy coalition has been in the making, with the purpose of retaining and maximizing Chilean mineral rent. Significant advances have already been attained. However, the main objective is still pending.

¿Liberals versus nationalists?

The commented paper presents the Chilean mining policy as the result of "a never ending struggle between the opposing trends of thought represented by liberals and nationalists. This curtailed the application of consistent long-term policies (pg.30)." The prefix "ultra" is added to both categories during the Pinochet years.

This hardly appears to be a fair presentation of the argument. Alternatively, why not conceive it as the long-term struggle by Chilean people, to attain the rational goal of appropriating and maximizing the significant ground rent ¹ of the country's rich mineral resources?

¹ As is well known, ground rent is an economic concept that derives from the existence of fixed factors – land is the case studied by the classics, especially Smith, Ricardo and Marx – which constrain production when demand increases past a certain level, making prices to rise above competitive levels. The extra price is transformed into rent paid to the owners of the scarce resource by new entrants attracted by the surplus profits. Additional theoretical developments took into account differential rents (Ricardo), absolute rent (Marx), and inter-temporal rent (Hotelling), as well as the marginal formulation of the concept (Samuelson), among others. All economic schools reserve extensive treatment for the subject, and most of them, including all the mentioned authors, conclude that the optimal economic treatment of ground rent should tax it completely, to avoid distortions in resource allocation. Ricardo, for one, supported nationalization of all farmland, for this purpose. Manuel Riesco, «Chile: Un nuevo esquema de impuestos para la minería,» *Visiones Económicas Universidad ARCIS*, october de 2002,

This struggle has been waged in good part against a school of thought that has consistently pretended the concept of ground rent is irrelevant, at least in the case of copper, and should not influence policy making. Not surprisingly, but certainly contradictory, such an ideology have been followed, supported, and promoted with fervour, and funded with largesse, precisely by those interested in appropriating the huge ground rent at stake, for themselves.

It seems quite clear why it prevailed during the dictatorship, at least in the formulation of public policies. Extremist neoliberal Chicago boys dominated the Pinochet government economic sphere, and they were starved for foreign investment that did not arrive in spite of the ever-improving conditions they offered. However, it is not clear why the same kind of formulations continued to be followed with enthusiasm by democratic governments after 1990 – they were even intensified, and the implementation occurred mainly during this period. After almost two decades of democratic “transition,” it does not seem convincing to continue with “this balancing act” that could even perhaps been sustained during the initial years as “a necessity when confronted by the political uncertainties of the country and the fragility of the transition from dictatorship to democratic rule (pg. 12).”

The basic formulation of this policy is rather simple. All private companies operating in Chile should be treated equal, regardless of the industry where they operate and the nationality of their owners – and all of them should be offered the most favourable conditions possible. There is no consideration at all for mining rent. The same was applied to several other industries based on natural resources – water in particular -, which generate significant ground rent as well.

In practice, such policies resulted in the bulk of mineral resources being privatised for free – mostly to foreign transnational companies¹. CODELCO, the giant State holding formed from the US companies nationalised in 1971, which produced 90% of copper until 1989, was displaced in 2007 as the largest copper producer in the country by BHP Billiton (Anglo Australian, listed in London Stock Exchange, LSE), its main competitor worldwide. This year, each one of them represented 30% of Chilean copper production, while Anglo American (Anglo-South African, listed in LSE) accounted for 13%, and Antofagasta Minerals (Chilean Luksic group, listed in LSE) for 8%. In this way, private companies now account for 70% Chilean copper production, with three of them producing over half of the total (see table 6 in appendix).

Until 2002, private mining companies were allowed to adopt an especial legal structure tailored “to elude the payment of taxes (pd.12),” which resulted a significant tax subsidy (Mouguillansky 1998). The same alternative was not available to companies operating in other industries. Using and abusing such dispositions, as well as all “normal” tax elusion² techniques, mining companies extracted millions of tons of copper and other minerals in Chile, earning billions of dollars, without paying any taxes at all - with one notable exception -, until 2002.

In one notorious case, Exxon Minerals operated *Disputada de las Condes* copper mineral along three decades, ostensibly at a “loss.” Then sold the “money-losing” operation at the beginning of the 2000s for over a billion dollars, part of the price consisting in the tax credits accumulated throughout decades of sustained “losses.” Legislation enacted in 2002 reduced the loopholes that most companies were using for tax elusion, motivated in good part precisely by this case. In addition, as said, the above cited UNRISD paper showed that even the only “well behaved” company incurred in other questionable tax

<http://cep.cl/Arcis/Visiones/Visiones0210/Visiones0210.html>, accessed on 12 July 2004. ed. Eugenio Figueroa, *Economic Rents and Environmental Management and Natural Resource Sectors* (Alberta: Faculty of Business, Universidad de Alberta, Alberta, Canada., 1998).

¹ The constitution forbids the sale of mineral resources, all of which were nationalized in 1971. For this reason, they are handed over to private companies under a “permanent lease” provision introduced 1981. The author was José Piñera, then mining minister of Pinochet, the same person who at the same year privatized the Chilean pension system.

² The concept of “tax elusion” has been generalized in Chile, to distinguish “legal” tax avoidance procedures from outright illegal “tax evasion” practices.

practices (Riesco, Lagos and Lima, The 'Pay Your Taxes' Debate 2005).

However, all along there was a considerable resistance to such policies among wide sectors of Chilean society (Lavandero 2001, Caputo, Fazio and Riesco, Carta al Presidente Lagos 2000). It is not widely known that the Chilean military, which violated most Chilean laws, respected the two main legacies of the developmentalist period – the agrarian reform law¹ and the mineral nationalisation act – almost to the letter. In fact, up to this day, the Chilean constitution preserves the exact terms of the nationalisation act of 1971, stating: “All mineral resources belong to the Chilean State, inalienably” (Congreso Nacional Chileno 2005). CODELCO, the principal instrument of the Chilean state to appropriate mineral rent, has continued to grow and modernise all along over three decades, even as it has been losing share in the total produced, since 1990.

The Chilean parliament – led by senator Jorge Lavandero Illanes² – in 2000 started demanding information and precisions on taxation and the effects of overproduction by private mining companies. In 2003, it named a Special Commission for Investigating Mining Industry Taxing Practices (Chilean Senate 2003) – which held a special audience to listen to the aforementioned UNRISD findings.

In 2004, after declaring once and again that no changes would be introduced in mining legislation, President Lagos presented parliament with a law that established a royalty for Chilean mineral exports. (Chilean government 2004). The importance of this document is that – in addition to nationalisation consigned in the constitution – it formally re-established orthodox ground rent theory as the official policy of the Chilean state³. The first project – known as “royalty 1,” because in effect it proposed a royalty charge on mining sales – was not approved by parliament. It received high majorities in both chambers of parliament – several MP of the opposition parties voted together with the government coalition in support of the law – but fell a few votes short of the 2/3 required to enact a modification of the constitution required for this reform (Riesco, Lagos and Lima, The 'Pay Your Taxes' Debate 2005).

A second law – incorrectly referred to as “royalty 2” because it is in effect a sur-tax on profits – was sent to parliament by the President a few months later, and after a long discussion it was approved by a huge majority. In this case, however, the government had previously agreed the project with the private mining companies⁴. The new law was much worse than the previous project. Firstly, it avoided a

¹ Agrarian reform was enacted by parliament by large majorities in the mid 1960s, and implemented mainly by Allende and the peasant movement in the early 1970s, in a sweeping manner that in two years wiped all the traditional latifundia. After the coup, the old owners, or their sons rather, received back about 30% of the expropriated land, however, only the relatively small “reservas” to which they were legally entitled. Peasants – those considered “loyal” – received 40% of the land in accordance to the law, and even though many sold their parcels soon after, most still have them, and no few have prospered and with the others conform a vibrant capitalist agriculture, responsible for much of the export boom. The rest of the land, mostly “cordilleras,” was

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