



Sizing up the Threat of Nationalization in Bolivia

By Anthony Vaccaro

May 29, 2006

"This is just the start," Bolivian president Evo Morales recently told a crowd regarding the nationalization of the country's hydrocarbons industry.

"Tomorrow, or the day after, it will be mining, then the forestry sector, and eventually all of the natural resources for which our ancestors fought."

While those words don't appear to leave much room for ambiguity, companies with assets in the region insist their talks with Bolivian officials paint a different picture.

"They've talked about some fairly benign policy changes that will not materially affect the way we operate," says John Carlesso, president and chief executive of Apogee Minerals (APE-V, AGEEF-O), a company with all of its silver and zinc assets in Bolivia.

In fact, all seven companies with operations in Bolivia surveyed by The Northern Miner said while higher taxation is anticipated, anything approximating nationalization is not.

Speaking via satellite in Toronto in early February, the Bolivian minister of mines, Walter Villaroel, sought to ease anxieties over nationalization. "I was a miner," Villaroel said at the time. "I've been in the industry for 20 years. I understand that mining needs investment."

The Ministry of Mines has recently issued statements saying its principal goals are to strengthen the national Bolivian mining company, COMIBOL, increase taxes on mineral sales, and revise the mining code.

Carlesso says officials at the Ministry of Mines have told him a draft of the new code will be forwarded to Apogee within weeks, and he anticipates nothing overly burdensome in the draft.

But Ivan Rebolledo, president of the Bolivian-American chamber of commerce, says the threat of nationalization is real.

"It's not going to happen today or tomorrow," Rebolledo says, "but there is a call for it and it is evident it will happen down the road."

Rebolledo notes that after a slight dip, the polls show Morales has been riding another wave of support as nationalization rhetoric and actions in the hydrocarbons sector have been ramped up.

However, Rebolledo thinks the Morales government will be kinder in its dealings with the mining industry than it has with hydrocarbons.

Unlike that industry -- infamous among much of the population for running natural gas lines past towns without consistent sources of heat -- the mining industry has built some goodwill in the country over the last 15 years, Rebolledo says.

"They've been lucky," Rebolledo says of foreign mining companies operating there. "They've been sheltered from the issues that hydrocarbons (companies) have had to deal with."

The market has, thus far, echoed Rebolledo's concerns. After Morales' comments in early May, companies with significant assets in the country saw their share prices hacked.

Apex Silver Mines, (SIL-X) with its massive San Cristobal project, has fallen roughly 43% since May 1. Apogee and Coeur d'Alene Mines (CDM-T, CDE-N) -- which is developing its San Bartolome project in the country -- both lost roughly 57% over the same period.

But John O'Brien, an analyst with Seattle, Wash.-based Ragen Mackenzie, a division of Wells Fargo, says the market overreacted to news from Bolivia.

O'Brien points to similar comments made by Venezuelan president Hugo Chavez in September 2005. Those remarks, which alluded to Venezuela reclaiming its natural resources, sent shares of companies in the region plummeting -- only to regain those losses months later.

"Based on the Venezuela example, it will correct itself if there are not any additional, major, negative developments in the country," O'Brien says. "We're looking at, at least, a two-month timeframe before the stock begins to recover. But it could be longer."

O'Brien holds shares in Denver, Colo.-based Apex, and Wells Fargo holds a greater than 1% interest in the company.

The Bolivian context

Morales won the December 2005 election on a platform that promised the nationalization of the hydrocarbons industry -- a promise he is making good on. But the note of nationalization has struck a chord with voters, pushing Morales to look beyond just oil and gas.

Judith Anne Teichman, a University of Toronto professor of political science specializing in Latin America, describes Bolivia as the "poster child" for the failure of economic structural reforms in the region over the last two decades. These reforms, which saw the privatization of public-sector industry, also sent a wave of foreign investment into the region.

But as poverty persisted, especially among the country's massive indigenous population, while foreign investors took profit, the impetus towards nationalization grew amongst the electorate.

"Bolivians have had a huge upheaval and there's a strong demand for nationalization," Teichman says. "The government will have to make some effort in that direction."

However, Teichman says, moving "in that direction" doesn't necessarily mean full-scale nationalization.

"The government doesn't have the funds, or possibly even the expertise, to take a one-hundred-per-cent controlling interest," she says.

Instead, Teichman speculates that the government could take a 30-40% interest in projects.

"But if levels of tax and redistribution don't improve," she warns, "everyone will be just as mad as they are now, and they'll want further nationalization."

Teichman's analysis touches upon another issue that has investors in Bolivia scratching their heads. Just what counts as nationalization in the eyes of Morales and his supporters?

"The word 'nationalization' in Spanish means something slightly different than it does in English," says General Minerals (GNM-T, GMCJF-O) chief executive Ralph Fitch. "It's more like participation than a take-away, which is how we understand it."

While Fitch anticipates new regulation in the industry, he says General Minerals will live with it.

"Change is never comfortable, but Bolivia is poor and will go through a number of changes," Fitch says. "Provided you can live with it and ride it out, it's a very interesting place to be from a mineral point of view."

But how much change can companies successfully adapt to?

By O'Brien's calculations, the market is already factoring a 65% tax increase into Apex's current share price.

O'Brien says an increase of 60% is more likely. That would bring Apex's current 25% tax rate up to roughly 40%, a rate at which San Cristobal would still be economic, he says.

The power for words

As for the nationalization rhetoric coming out of La Paz, Carlesso says the strong words have more to do with playing politics than setting policy.

"Morales is trying to get the most amount of leverage that he can right now," Carlesso says of the recent speech. Such comments are aimed at getting Bolivia into a better negotiating position with countries that have significant stakes in the country, he adds.

"We're being caught in the middle of it," Carlesso says. "And in the short term, I'm fine with that."

On May 17, Apogee announced that it owned 100% of the La Solucion silver-zinc-lead mine in Bolivia. Beyond the usual economics behind the acquisition, Carlesso says the deal is symbolic in that it underlines the company's confidence in the direction of the government.

More joint ventures?

Pan American Silver's (PAA-T, PAAS-Q) chief executive, Geoffrey Burns, envisages more companies following Pan American's lead in the future: The Vancouver-based silver producer is partnered with EMUSA at its San Vicente mine, in a joint venture giving the Bolivian-based company an option to earn a 50% interest in the project by investing US\$2.5 million.

Burns says Bolivia needs foreign investment -- it is the poorest country in South America -- and that a "draconian" nationalization policy would only drive away foreign investment .

Many believe the country cannot afford that scenario, as it would leave larger projects such as Apex's San Cristobal and Coeur d'Alene's San Bartolome -- which still need capital investment to get to production -- at a complete standstill.

Coeur d'Alene's chairman, president and chief executive, Dennis Wheeler says that Bolivians themselves won't let that happen.

"There is recognition in most quarters that foreign capital is necessary for them to successfully develop their country," Wheeler says. "As long as companies behave responsibly, they are welcome."