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Histories of nationalization and privatization: the cases of the Chilean and Zambian Copper Industries

Abstract

Both Zambia and Chile went through periods of left wing government rule. During those times their copper industries were nationalized and assets owned by foreign companies were taken over by the state, leaving extraction, processing and commercialization of copper in government's hands. The paths followed by both copper industries once there were changes in government differ substantially. This paper will analyze the circumstances under which the privatization of ZCCM happened in Zambia, and the "strategic reasons" why the military government did not privatize CODELCO, the state-owned copper enterprise.

Introduction

Since its early beginnings in the late 1800s, the Zambian and Chilean economies have heavily relied on copper as one of its fundamental growth driving pillars. Large-scale copper extraction was commenced both in Chile and Zambia because of the efforts of foreign companies, mostly American, South African and British; and the interaction between foreign multinationals and the local governments has taken place since those early days.

Zambia gained independence from the British in 1964, and Kenneth Kaunda became the first president of independent Zambia, a position he held for the following 27 years. During his time in power the Zambian government acquired control of the two principal mining firms operating in the country, and later on these were merged forming Zambia Consolidated Copper Mines (ZCCM), a large-scale state-owned copper mining company.

Chile experienced consecutive left wing governments from 1964 to 1973. Same as in Zambia, the copper industry was nationalized and foreign multinationals were forced to hand in their assets, production facilities, and mining rights to the state.

A combination of factors, including the decline in the international copper price, ZCCM's bad financial performance, and the pressure exercised by the World Bank and the IMF pushed the Zambian government to privatize ZCCM. The long and complicated privatization process went from 1996 to 2000, when the last portion of ZCCM was sold to Anglo American Corporation.

In 1973 the military regime led by General Augusto Pinochet overthrew president Salvador Allende and gained control of the Chilean government for the following 17 years. An economic team lead by the "Chicago Boys" – young neoliberal economists trained at the economic faculty of the University of Chicago - designed and implemented the economic framework to take the country out of its serious state of underdevelopment. Even though more than 550 state-owned enterprises were privatized during this period, CODELCO, the state-owned copper mining company was never privatized, and remains until today in government's hands.

Historic Overview of Chilean and Zambian Copper

Due to being the main source of Chilean wealth, copper and Chile's 20th century economic development have a strong relationship (Meller, 2001). Large and rich copper mines were discovered in Chile in the early 1900s, which attracted the interest of large-scale international mining firms. US firms were the pioneers in exploring and exploiting Chilean copper, opening El Teniente and Chuquicamata, two of the largest copper mines in the world in 1904 and 1911 respectively (Meller and Simpasa, 2010).

In 1904, the American company Branden Copper Co. initiated the exploitation of the El Teniente mine, whose administration was later transferred to the also American Kenecott Corporation. The Chile Exploration Company, property of New York's Guggenheim family was the first company to extract copper from the Chuquicamata mine in 1910. Later on in 1923, Chile Exploration Company was sold to Anaconda Copper Company, also in charge of the exploitation of the El Salvador mine (Codelco, 2010).

Chile's level of underdevelopment and lack of local companies qualified to explore and extract the mineral at the time were critical factors for the copper industry to be developed by international companies.

The British South Africa Corporation (BSAC) acquired mineral rights in Zambia in 1889 due to the efforts of Cecil Rhodes. During the first half of the 20th century, two companies monopolized copper extraction: South African Anglo American Corporation (AAC) and Rhodesian Selection Trust (RST), controlled by the American firm American Metal Climax Inc. (Butler, 2007).

These two companies opened several mines in the Copperbelt region, and throughout the 1950s Zambian copper production experienced an astonishing growth. Drivers of this growth included high international copper prices and incremental global demand due to industrialization. By 1956, Zambia was the world's second largest copper producer behind the US, and the Copperbelt accounted for 90% of Zambia's exports and Governments revenues (Butler, 2007).

Nationalization

Chile

In 1964, Eduardo Frei Montalva from the Christian Democratic Party (PDC) became Chile's president. According to the PDC's program*,* Chile was in the midst of an "integral" crisis whose economic manifestations were insufficient growth, structural inflation, unequal distribution of income and wealth, and external dependency (Allende, 1988, p. 59). One of Frei's pillar programs was acquiring control of primary resources and the partial nationalization, also called "*Chilenization*", of the copper industry. The Chilean state acquired 51% percent holdings in the foreign-owned mining companies exploiting El Teniente, Chuquicamata and El Salvador, through what was called "*contratos ley*" (Codelco, 2010) and afterwards in 1969 the “*nacionalizacion pactada*” (agreed nationalization). This was the first step to the complete nationalization that would eventually take place in the following government.

Salvador Allende was democratically elected in 1970. Allende’s Unidad Popular (UP) was the combination of three political parties: the Socialist Party (PS), the Radical Party (PR) and the Communist Party (PC), of which the PS and the PC defined themselves as Marxists (Allende, 1988).

One of the main objectives of this government’s economic program was the nationalization and the so-called “*estatizacion*” of the mining industry. In July 1971 the Chilean congress unanimously approved the nationalization of the copper industry through a reform to the Constitution (law 17.450). As President Allende stated on his July 1971 speech:

“This is maybe the most important act since our independence declaration, because entitles a modification to the political constitution that accentuates and gives strength to the national feeling of our country…to nationalize and preserve for the state our country’s basic richness”.

The infrastructure and mineral rights of the foreign companies became property of the Chilean state, which created collective societies to be in charge of operations, all coordinated by CODELCO (Corporacion del Cobre). CODELCO passed from being a government regulatory agency to become a state holding company in charge of exploration, development, extraction, production and marketing of copper (Allende, 1988).

Zambia

Zambia became independent from British Colonialism in October 1964. Beliefs that foreign copper mining companies took production and investment decisions in favour of their own interests, leaving Zambian’s interests aside pushed forward the idea that the industry should be nationalised. In 1969, the government announced the nationalisation of the mines owned by AAC and RST. Through an amendment of the Constitution, mineral ownership rights and prospective and mining licences were reverted to the state. RST and AAC were forced to give to the Zambian state 51 percent of shares in all of their existing mines (Fraser and Lungu, 2007).

Two state companies were formed. The Nchanga Consolidated Copper Mines (NCCM) became what AAC was, and Roan Copper Mines (RCM) was born after RST. The government increased its equity stake in the companies to 60 percent in 1979, and in 1982 the decision of merging the two companies into a single state-owned mining conglomerate, Zambia Consolidated Copper Mines (ZCCM) was made. ZCCM was in charge of copper production, and a separate company under the name of Metal Marketing Company of Zambia (MEMACO) was responsible for the marketing and sale of Zambian copper (Meller and Simpasa, 2010).

<u>Privatization</u>

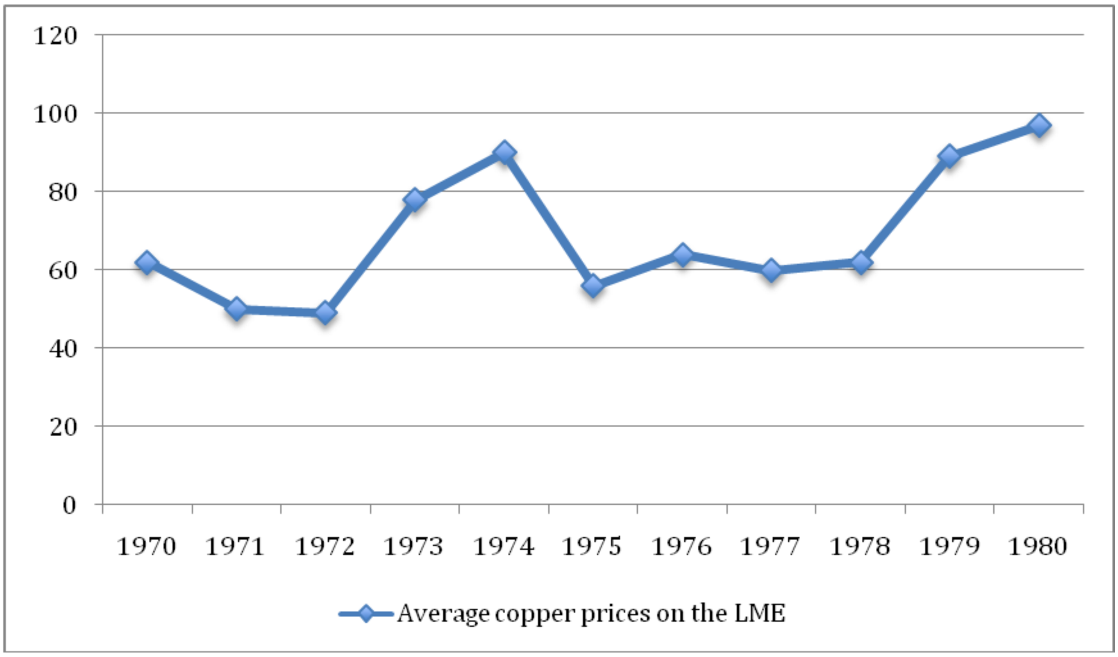
Zambia

"The distribution of mineral rents to other parts of the economy was limited by the economic, institutional and political strength created by the Copperbelt region and the need to sustain this economic powerbase. The Copperbelt province emerged as a prosperous region with a well educated, well paid urbanized labour force, which also enjoyed highly generous welfare support from the mining companies. It was a network of towns with a cluster of heavy industry supporting the needs of the mines and represented the economic heartland of the country" (Meller and Simpasa, 2010, p. 44).

During the first ten years after independence (1964-1974), the Zambian economy experienced sustainable growth, averaging GDP growth levels of 2.3 percent (Rakner, 2003). This stable growth condition has been attributed to the high mineral rents obtained by the government from copper mining.

As showed in Figure 1, in 1974 world copper prices fell fast due to the oil crisis created by the OPEC formation, which brought economic uncertainty to the world. Additionally to the long decline in world copper prices, South Africa's geopolitical environment translated in a disadvantage for land-locked Zambia's engagement with the world economy (Adam and Simpasa, 2009).

Figure 1: Evolution of International Copper Price (US$ cents/pound)



Source: US Geological Survey, 2010

Additionally to the exogenous copper price factor and the transport issues, the Zambian government used ZCCM's foreign exchange generated from copper sales to finance other activities, leaving little remaining for the financing of ZCCM's own operations and various activities.

As explained by Auty (2008), the Zambian government used ZCCM and copper mining as a source of income and sponsorship, which was used to extract rent and enhance employment at the expense of competitiveness.

Zambia's political class was highly influential on the economy and on ZCCM itself. Often, decisions inside ZCCM were politically driven, overruling the technical experts' advice. The involvement of ZCCM in socially and economically unviable activities that went beyond its core-mining expertise is an example of this. For example, the president's luxury holiday resorts were maintained and financed by ZCCM (Meller and Simpasa, 2010).

ZCCM supplied even more facilities and services to the Zambian people than the ones provided during the colonial days. Amenities included free education for miner's children, water and electricity, subsidised housing and food, and transport. The delivery of services was not limited only to the miners and their families, but was extended to the whole community. ZCCM had a big impact on the mine township's environment, maintaining roads and collecting rubbish, providing bars, cafeterias and social clubs for people to relax and socialize. Moreover, the company encouraged economic and social activities such as shops, farms and other industrial activities dependent on miners' incomes (Fraser and Lungu, 2007).

As stated by James Fergusson, the exploitative mining business in Zambia involved a very relevant social project. Its presence was socially *"thick"* (Fergusson, 2006).

At the beginning of the decade of the 90's, ZCCM was in front of severe problems related to its financial stability and long-term development. Levels of reinvestment were not sufficient to maintain copper production, and this fell by a quarter between 1982 and 1990. During the same period of time the company's debt levels also rose from one third of its total asset value to over half of it, and had to rely on debt payment rescheduling and the support of the Zambian government (Craig, 2001). Table 1 shows that by the late 1990s, ZCCM was experiencing sustained losses.

Table 1: ZCCM Consolidated Financial Position (US$ million)

	Sales	Cost of sales	Net Profit/Loss
1990	915.58	711.76	82.06
1991	881.11	663.66	80.53
1992	560.12	532.95	23.83
1993	666.95	554.67	91.72
1994	583.51	851.62	(108.66)
1995	692.20	1,165.61	3.98
1996	1,322.21	1,223.83	(24.91)
1997	1,149.46	1,188.15	(151.80)
1998	699.12	825.61	(251.39)

Source: Meller and Simpasa, 2010

The company was in serious need of investment to finance the rehabilitation of existing plants and the development of new sources of ore (Craig, 2001). ZCCM's decline was the consequence of a combination of external market conditions, political instability affecting southern Africa at the time, and bad management decisions taken by ZCCM's executives and the Zambian government.

During the 90s both the International Monetary Fund and the World Bank put pressure on the Zambian government to adopt economic liberalization policies. The Zambian government had huge levels of debt with both of the institutions at the time, and it was starting to be unable to fund government expenditure through mining rents (Fraser and Lungu, 2007).

By the early 90s the situation was unsustainable, food riots and general public discontent pushed for new elections and a change of government. In 1991, the Movement for Multiparty Democracy (MMD), an opposition party composed of a broad coalition of trade unions, intellectuals and students, headed by the Zambian Congress of Trade Unions' leader Frederick Chiluba won the elections and defeated President Kaunda (Rakner, 1991).

President Chiluba and his Multiparty Democracy believed that for Zambia to get back in shape a couple of fundamental things had to take place. First, the statist development policies taken by the United National Independence Party were in part responsible for Zambia's current fragile economy; and second, any given path to recovery would require the financial support of the World Bank and the IMF (Craig, 2001). The new government's view on the role of the state in economic management and, as a consequence, in the administration of Zambian copper was different from the previous government's one (Adam and Simpasa, 2009).

Financial aid and the overall support of the IMF and World Bank was conditional to a serious of economic reforms, of which many related to privatization of state owned companies. The privatization programme started in 1992, and by June 1996, 137 state-owned companies had already been sold.

Joseph Stiglitz, former chief economist at the World Bank reflects well on his 2002 bestseller about the approach these international financial institutions had to promote, or sometimes impose privatization processes on developing countries' governments.

"Unfortunately, the IMF and the World Bank have approached the issues from a narrow ideological perspective – privatization was to be pursued rapidly. Scorecards were kept for the countries making the transition from communism to the market: those who privatized faster were given the high marks" (Stiglitz, 2002, p. 54).

Fergusson (2006, p. 198) uses the social "thickness" concept and the views international financial organizations had towards it. "When the industry went into decline, starting in the mid 1970's, all of the forms of social "thickness" that older workers remembered as the gains of this period – higher wages, good social services, powerful unions, and strong nation-state control over national wealth – were identified by the advocates of privatization and neoliberal reform as "inefficiencies" responsible for the industry's decline".

ZCCM was considered to be the crown jewel of the privatization process, and the Zambian government analysed a series of options between 1992 and 1996 to come up with an ideal formula that would comply with three principal objectives. The first was to access the investment needed to ensure the future of the local mining industry as a top player in the copper world market. Secondly, it was considered compulsory to maintain a certain degree of control over the industry, as most probably potential bidders for the company would be foreign. The third objective was to secure the best selling price (Craig, 2001).

ZCCM's ownership structure was a combination of private and state ownership. The government of Zambia had 60.3% of the shares and Anglo American controlled 27.3% of them. AAC also had pre-emptive rights over acquiring shares sold by the government once the government's share went below 50%. Additionally, AAC had an effective veto right over any major asset sale (Craig, 2001). These conditions made AAC play a key role on the privatization and overall sale process of ZCCM.

In order to attract investors, in 1996 ZCCM was unbundled into a set of separate packages, denoted A through J. Packages had different size and quality, so some were easier to sell than others. Packages A1, D, E, G, J and I were sold quickly and with little difficulty. The major complexities happened when trying to sell ZCCM's core mining activities (packages A and C), the Nkana, Nchanga, Konkola, Konkola Deep and Mufulira divisions. The sum of these assets accounted for more than two thirds of Zambian copper production (Adam and Simpasa, 2009). The privatization process was originally scheduled to be complete by 1997, but because of several complexities and adverse market conditions it was not until 2000 that the Zambian government was able to sell the last productive assets (Craig, 2001).

Chile

In September 11, 1973 the commanders-in-chief of the Armed Forces overthrew the democratically elected Chilean president, Salvador Allende, in a coup d'état. General Augusto Pinochet became Chile's new president, ruling the country for the following seventeen years (Garreton, 1988).

Chile's economic situation at the time was dramatic. Very low economic growth, high unemployment, high inflation and elevated poverty levels had the country in bad shape overall. Interventionist measures taken by the previous government such as price fixations and subsidies were the main causes of the dreadful economic situation (Delano & Traslaviña, 1989).

The new government had central economic goals, which were to reach full employment, eliminate extreme poverty, and achieve effective economic decentralization. Central policies included tariff reductions, ending price controls, privatizations of state enterprises and services, generous terms and guarantees for foreign investors, reduction of public expenditures, and ending exchange controls (Allende, 1988, p 68)

The whole economic recovery plan for Chile was designed and implemented by the so-called "Chicago boys". During their training in the school of economics at the University of Chicago, these young economists became unconditional followers of professor Milton Friedman. They were convinced that the full introduction of a totally competitive free market economy was the only solution for Chile's development problems. This group of young neoliberal technocrats became the designers and executors of the economic policy applied during the Pinochet period (Silva, 1991).

"This led to favouring individual rights such as private property and the principle of non-discrimination, the market as the principal instrument of economic decisions, the private sector as the fundamental development agent, and the opening toward foreign trade as a means of making use of comparative advantages and as an encouragement to the efficiency of the productive process. Within this context, and in light of the state's importance as an entrepreneur under the Allende government, the privatization process apparently is a consistent action" (Luders, 1991).

Between the years of 1974 and 1989, the Chilean government privatized over 550 state owned companies. The privatization efforts can be divided into two privatization rounds, of which each can be divided in two phases as Table 2 shows.

Table 2: Summary of Privatizations in Chile

	Year	Number of Companies
First Round		
First Phase	1974	Over 325
Second Phase	1975-1978	228
Second Round		
First Phase	1984-1986	About 50
Second Phase	1985-1990	About 30

Source: Allende, 1988

The different rounds of privatization involved the sale of companies diverse in both size and economic sector origin. COPEC, a commercial and industrial conglomerate with participation in the gasoline distribution and forest product businesses; CCU, a beer- producing monopoly and large-scale producer of soft drinks; ENDESA, a generator and distributer of electricity; and ENTEL, one of the largest telecommunication companies are just a few examples amongst many of the state-owned companies that were sold to both local and foreign economic groups (Luders, 1991).

One of the first things the new government did regarding the mining industry was to compensate the foreign corporations which's subsidiary companies had been nationalized during the previous government. In 1974, the government began formal conversations with Cerro Corporation, Anaconda and Kennecott Corporation to compensate and settle agreements with them. The government of Chile reached an agreement in 1974 in New York to pay the sum of US$ 532 million in compensation (Allende, 1988). After this Chile recovered the confidence of the international financial community, support from international financial institutions like the IMF and the World Bank, and was on its way to re attract foreign investment.

The privatization efforts found resistance by the power coalition. By 1981, assets totalling US$ 770 million had been sold by the government, but the three largest state owned companies (CORFO, ENAMI and CODELCO) had a 10 times larger value of US$ 7.7 billion (Allende, 1988).

"The copper policy of the Pinochet regime mirrors the neo-liberal model, especially the stress in comparative advantage, integration in the world capitalist economy, open policies for foreign investment, and a subsidiary role for the state. The fact that the nationalized copper industry remains in state hands is a contradiction and an anomaly" (Allende, 1988). According to Luders (1991), the military regime never agreed to privatize CODELCO for "strategic reasons".

Whenever the technocrats tried to make CODELCO part of the privatization discussion, the nationalist sectors reaction was resolute. The fact that the Army personified the nationalist sectors has to be understood not only in terms of their corporatist interests. Their particular military ideology and middle-class background had also a strong effect on their position towards the privatization of CODELCO (Allende, 1988).

"The military's motives in retaining sovereign ownership of the subsoil and state ownership of CODELCO were not entirely patriotic. Since the 1930s a portion of the military budget had been directly subsidized from copper rents. Under Pinochet a decree law dedicated 10% of income (not profit!) from sales of CODELCO to the military budget" (Hellinger, 2004, p. 12-13).

The military retained state ownership of CODELCO because it was convenient to them. Apart from the straightforward economic reason, having control over the largest Chilean company provided them opportunities for employment creation, and a strong position to negotiate with one of the country's largest and most powerful unions.

Exponential growth in copper production only happened in Chile after democracy was re-established. The main reason for this was that foreign companies did not want to indirectly support Pinochet's regime, and were overall fearful of measures that could be taken against them during the military dictatorship. After democracy was restored, large investments from foreign companies started to flow into the country.

During the last two decades of the 20th century large investments by foreign companies were capitalized in Chilean ground. While in the 1980s the average annual foreign investment totalled around US$ 300 million, in the 1990s this figure was US$ 1.250 million (Meller, 2001). Tables 3 illustrates the historic evolution of Chilean copper's market share as a percentage of total world production, and Table 4 shows the boost in investment by the private sector in Chile's copper industry from the 1980s to 2008.

Table 3: Chile's participation in world copper production in the 20th century

Year	World Market share (%)
1900	5.3
1910	10.2
1929	16.5
1938	17.5
1950	14.4
1960	12.6
1970	10.9
1980	13.8
1990	17.8
2000	36.4

Table 4: Chilean Copper Industry's market distribution

Year	CODELCO	Private Companies
1980	84.7	15.3
1990	75.3	24.7
2000	32.9	67.1
2008	28	72

Source: Meller, 2001

Conclusion

The nationalization and privatization processes experienced by the Chilean and Zambian copper industries have some similarities, but also differ quite substantially in the incentives and drivers behind the respective processes. When comparing the processes of nationalization and privatization experienced in Zambia and Chile, a few key points can be addressed.

The main reason behind nationalization in both countries had to do with the belief that investment and production decisions were undertaken by foreign companies to serve their own interests and not the country's (Meller and Simpasa, 2010). In order to increase growth the state had to have complete control of copper extraction, production and commercialization, securing copper rents for the country's benefit.

ZCCM's privatization process was done in a hurry with strong pressure from the World Bank and the IMF. Privatization meant a clear way of "socially thinning" the mining industry, and transforming it into efficiently run profit making units. There is agreement that ZCCM's sale could have been done better, and the Zambian government could have achieved a better deal.

Under the government of General Pinochet in Chile, more than 550 state-owned companies were privatized as part of the neoliberal economic policies applied by the "Chicago Boys". CODELCO was never privatized and remains state-owned until today. The military's statist frame of mind, and the fact that by law 10% of CODELCO's revenues went to finance military expenses, stands out as the main reasons why this company was never part of the privatization efforts.

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