

Hugo Chavez, Socialism for the 21st Century and Venezuela's Narcissistic Resource Nationalism

By Joseph Kirschke, News Editor-Mining

On a Thursday night in November 2011, a plane carrying an undisclosed consignment of gold bullion previously secreted in overseas bank vaults touched down under cover of darkness at Venezuela's Maiquetia International Airport.

After the first delivery of several shipments totaling more than 200 tons—in 15,000 stock 400-oz gold bars—was loaded, an armored convoy guarded by 500 soldiers, helicopters and members of the central bank's elite security team embarked on a 13-mile journey on a decrepit, potholed highway toward a vault in Caracas, one of the world's most lawless cities.

To many, it was mere stagecraft by Venezuela's fiery President Hugo Chavez less than a year after the diagnosis of cancer to which he succumbed in March. But to die-hard loyalists it signified more: Central Bank President Nelson Merentes termed it "historic," reported the state-run AVN news agency. "We're returning assets that belong to the people."

To particular victims of Chavez's "socialism for the 21st century," on the other hand, it would prove a depressing, if apt, metaphor for the pending death knell of Venezuela's long-decayed mining sector in one of the world's most resource predatory regimes.

Despite abundant mineral wealth with some of the world's greatest reserves of iron ore, aluminum, nickel and gold—and Latin America's second-largest coal deposits—Venezuela has long stagnated behind regional mining powerhouses like Mexico, Colombia and even Bolivia, since Chavez took power in 1999. The damage his erratic, quintessentially one-man rule inflicted on Venezuelan mining, moreover, is all but impossible to know—and equally hard to overstate.

A Grim Post-mortem

Few can doubt the cult-like "Chavista" legacy will endure for decades, if not generations. Less assured is Venezuela's economic prosperity—and its moribund mining industry, according to observers like James Lockhart-Smith, a

senior Latin America analyst at Maplecroft, a U.K.-based risk analysis firm.

In all, nearly 1,000 foreign and domestic private businesses were appropriated over 14 years. Ecoanalitica, a Venezuelan research firm, has reported the losses to the country's private sector at \$23.3 billion. The trend, according to the Venezuelan Confederation of Industries, soared 924% since 2007.

Bitterly contested April elections—wherein Chavez's hand-picked successor Nicholas Maduro won by 1.5%—herald little change. The former bus driver claimed Chavez's cancer was poisoning by "historical enemies," for example. "The outlook is pretty bleak all in all," said Lockhart-Smith.

"The government is highly likely to become more entrenched in its positions," he added, while striving to "maintain the same strategic goal of control over the whole supply chain for the construction industry—including the required hard commodities."

These include what's left of Venezuela's bauxite and iron ore deposits languishing alongside the world's 16th largest gold reserves at 4,600 tons. In total, Venezuelan mining, according to the U.S. Geological Survey's 2011 report, stood at just 1% of GDP; government data similarly reports formal mining at just 4.3 million tons annually.

Regardless of Chavez's legacy—amid continued international praise—few can deny Venezuela's squandered economic potential. The World Bank's 2013 Doing Business report is typical, ranking Venezuela at 180 out of 185. The survey, co-authored by its International Finance Corporation wing, reflects a one-point decrease for the country from 2012.

There are many others. "Venezuela is an example of nationalization being a populist as opposed to an economically strategic program," notes a 2012 report by the South African Institute of Mining and Metallurgy, which concluded that "an economy under nationalization driven purely by a socialist ideological program is not sustainable."

Influences Near and Far

Chavez was never ideologically shy. From the start, he made unusually fast friends with Cuba's Fidel Castro, champion of his own nationalizations. For access to the world's greatest oil reserves, the strongman's 86-year-old mentor gave his protégé an army of doctors, military advisers and intelligence agents; a special terminal at Maiquetia Airport exclusively processes Cuban nationals.

But a failed, U.S.-supported 2002 coup radicalized Chavez's militancy: Championing a leftist "pink revolution" across Latin America, his nationalization binge accelerated as he forged ties with similarly anti-Western—and resource rich leaders worldwide—some with shared appetites for mine appropriation.

These included Zimbabwe's diamond-wealthy Robert Mugabe along with Argentina's Christina Kirchner, Ecuador President Rafael Correa and—to a lesser degree—Brazil's populist Lulu Ignacio da Silva across the Americas. But it was Bolivia's Evo Morales—in one of the hemisphere's most mineral-rich jurisdictions—who most closely emulated Chavez, to the detriment of its mining industry.

Neglect, Avarice and Middle Class Flight

Like other resource nationalists, Chavez's charisma resounded among poor Venezuelans long exempted from the country's oil benefits, noted Jorge Neher, a lead Latin America partner for Norton Rose, an international law firm that advises companies on resource nationalism issues. "After years of being neglected by the state, there's a sentimental relationship," said Neher, a counsel to Venezuela's Congressional Mines Commission in 1994.

Indeed, the subsidized literacy campaigns, free public housing and health initiatives that brought accolades from statesmen to intellectuals to celebrities worldwide, would have been impossible had oil prices not surged beyond \$100 a barrel through the last decade. Mean-

while, Venezuela's vast mining potential—like so much else in its state-run economy—withered in the background; South America's less developed, but second-largest coal reserves were no exception.

Yet the sweeping nationalizations of oil, mining and other businesses themselves precipitated a full-blown exodus from the country itself, with the skills, capital and investment mandatory to keep all extractives afloat. Venezuela's further descent into chaos—fueled by a multibillion dollar cocaine trade and Chavez's deliberate culture of political violence—made a difference, too.

Robert Amsterdam, an attorney representing companies facing state takeovers internationally, equates Venezuela with Vladimir Putin's Russia. In both countries "the state has become the principal instrument by predatory business groups," which employ the authority of the courts, regulatory agencies and police to seize assets and enrich themselves at the people's expense," he wrote in a 2009 *Washington Post* article.

"It is grounded in the insecurity of the populace," he added. "What is not accomplished by faux legalism is carried out through government-backed neighborhood militias or extreme nationalist youth groups."

Empowering the Poor, Disenfranchising Mining

The country's long-profitable metals industry is now in the worst shape in 30 years. A Chinese cash and infrastructure injection pending a 2011 deal now lies in limbo since Chavez's death. "One can drive a car without doing maintenance until it decomposes—ditto with the metals companies of Venezuela," an aluminum trader told *Reuters*. "We have reached the breaking point."

A significant example of pressures on such industries was a 200,000-unit housing program—key to the October victory that allowed Chavez a fourth term of six years—so poorly managed it flattened nationwide demand for metals, according to analysts.

The reason is simple. "The industry has been required to produce without investment in equipment or parts," the trader said.

Similarly damaging was the establishment by the corrupt and mismanaged state-appropriated oil company Petroleos de Venezuela (PDVSA) of non-petroleum

Colombia and Venezuela: Tilting the Scales in Mining Business and Nationalism

Just as Venezuela's economy and its mining sector have plunged into near-total ruin under Hugo Chavez since 1999, another tectonic shift has been under way in next-door Colombia—ahead of one of the potentially largest, most diversified mining booms on earth.

Once a byword for cocaine kingpins, civil war and regional instability, South America's fourth-largest nation is now enjoying a relative peace dividend, an economic renaissance and—thanks in part to its vast mineral wealth—more foreign direct investment (FDI) than anywhere else in the Western hemisphere.

In addition to being on-and-off adversaries—at times militarily—the divergent fates of Colombia's and Venezuela's mining industries are even more closely intertwined than they might seem at first blush—and resource nationalism isn't the only reason.

Colombia, to be sure, endures lingering instability that peaked in the early 1990s: Ongoing bloodshed among paramilitaries, drug traffickers and Venezuela-backed Marxist guerrillas—underwritten in part by some 30,000 wildcat miners—persist alongside government corruption. Latin America's No. 5 economy remains its most unequal, too, with a 12% unemployment rate and 20 million people mired in poverty.

A Study in Contrasts

Yet unlike its eastern neighbor, Colombia is doing plenty right in business terms, according to a broad international consensus. The World Bank, for instance, has ranked Colombia a top-10 performing economy and the safest Latin American nation to do business in. The Fraser Institute, a Canadian think tank, has listed it the region's third-most attractive investment destination—and the third of 79 jurisdictions in mining potential—and Canada's mining companies are accordingly leading the mining charge.

The differences with Venezuela, of course, couldn't be starker: Since assuming power 14 years ago with a sweeping populist mandate, strongman Hugo Chavez nationalized more than 1,000 private sector businesses—often at random. And the country's sizeable gold and

coal deposits—South America's second-biggest—lie in tatters.

But in ways, it's also one of the biggest ironies of Chavez's one-man tenure: Venezuela's tremendous oil riches have both subsidized Chavez's chaotic nationalism—while allowing for sweeping mining expropriation that has left the country's other significant natural resource at 1% of GDP.

International observers have long since taken note. The World Bank's 2013 Doing Business report ranks Venezuela at 180 out of 185. The study, co-authored by the International Finance Corp. (IFC), reflects a one-point decrease for the country from 2012.

Back in Colombia, once known as the Switzerland of Latin America, a more culturally ingrained attitude prevails. With a sophisticated business class and well-educated population, Latin America's oldest democracy is also home to its strongest political institutions and remains the only South American nation never to have defaulted on a major loan; Bogota has yet to expropriate a foreign company.

In recent years, Free Trade Agreements with the U.S. and Canada and regulatory reform have been crucial to luring explorers, miners and investors, according to analysts, priming mining exports to 27%, while employing 300,000 Colombians.

But this creeping switch came at the crosswinds of something perhaps less obvious: a \$7-billion U.S. aid package to Colombia's military that lifted the nation of 46 million to more fertile ground.

Socialism and the Cocaine Equation

In 2002, Colombia was a far different place. With much of the country seemingly poised to unravel, not even the inauguration of hardline conservative President Alvaro Uribe was spared: Artillery rained down from slums occupied by insurgents known as the Revolutionary Armed Forces of Colombia (FARC) with dozens injured.

These days, countryside instability remains—including an apparent March

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industry subsidiaries including shipbuilding, construction and services. By slowing this investment, officials effectively spawned a mining sector meltdown while nationalizing iron ore and bauxite processing facilities.

Unsurprisingly, Caracas has endeavored to avoid compensating foreign

investors. Indeed, the gold repatriation, while not mining-related, underscored a Chavez decree three months on to withdraw from the World Bank's International Center for Settlement of Investment Disputes (ICSID)—representing 140 member nations—where it faced 20 multi-billion-dollar claims. In a

Foreign Ministry statement, the move allows Venezuelans “to decide the strategic orientation of the social and economic life of the nation.” Bolivia and Ecuador had pulled out years before.

Some powerful companies have been seeking redress there, including oil giants like ExxonMobil and

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attack by the FARC on El Cerrejon, Colombia's largest coal mine operated by Anglo American, BHP Billiton and Xstrata. But under Uribe's decisive anti-guerrilla campaign, along with a demobilization of the paramilitaries formed to fight them, have yielded successes.

Indeed in 10 years, some 54,000 paramilitaries have been disbanded, kidnappings are down a reported 90%, guerrilla attacks have declined 71% and homicides are down by half. Former Gen. Oscar Naranjo, who led the cartel crackdown, is now security adviser to a Mexico embroiled in its own drug violence. Colombian military units have also trained local police in opium-heavy, NATO-occupied Afghanistan.

Across the lawless border near Cerrejon, however, things have swung in the opposite direction. From the beginning, Chavez's revolution brought ties with FARC members—Castro allies who picked up drug trafficking where the cartels left off. Given its anti-Americanism, Caracas has ignored or defied U.S. drug interdiction requests—allowing Venezuela, with full government complicity, to become a multibillion dollar transshipment point for European and African-bound cocaine.

A crime pandemic has followed in its wake, consuming Venezuela's 29 million people, leaving them some of the world's very highest homicide rates—often at the mercy of gangs operating with impunity well beyond the prison walls that ostensibly house them.

A Numeric Advantage

More positive numbers have proliferated in Colombia—with FDI between 2002 and 2008 quadrupling and then doubling by 2011 to \$14.4 billion, up from \$6.8 billion in 2010—a rate of 113%. According to the United Nations Conference of Trade and Investments, 2011 was a banner year—one in which its FDI surpassed the rest of South America.

Until recently, minerals have accounted for less than 3% of Colombia's economy, representing \$2.6 billion in investments within the last two years. Claims for lands with reserves of base and precious metals also surged to 21 million acres in 2010—from 2.8 million in 2002. The next year, accordingly, Colombia received \$4.5 billion in resource sales—twice that of 2006.

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ConocoPhillips. The final mining company to leave after an across-the-board mining fiat was Rusoro, a Russian-Canadian Toronto-listed gold junior after a profitable—and harmonious—10 years beginning in 2002. America's Peabody Energy and Anglo American had long since abandoned minority

stakes at Paso Diablo, Venezuela's biggest coal mine.

Other Casualties of the Revolution

Crystallex International Corp. also suffered a particularly unpleasant high-profile divorce from the palace at Miraflores.

Initially, officials at the Canadian company sought to develop one of the world's biggest deposits—Las Cristinas—with its 16.9 million gold oz and 20.8 million oz indicated.

But in February 2011 the relationship was “unilaterally terminated.” Venezuelan authorities accused

Despite a presence at Chavez's funeral, Juan Manuel Santos shared little in common with his fiery neighbor: Indeed, promotion of foreign mining was a centerpiece of his presidential campaign. Bogota has since designated a 7.4-million-acre “strategic zone”—an area the size of Greece—for mining exploration; a further 40% of the countryside may also be available.

The policies are well-warranted. As the world's seventh gold producer, the precious metal is anticipated to draw \$2 billion in FDI by 2015. Mining Ministry officials seek a 30% increase in gold output to 73 metric tons; from the current 47.8, reported by the National Geological Survey. Giants like South Africa's AngloGold Ashanti, Alabama-based Drummond Inc. and Canada's Barrick Gold all have a presence.

The world's No. 5 coal producer, Colombia has large deposits of low sulphur, high Btu coal with a vibrant export market. Bogota currently seeks a 35% increase to a 115-ton annual output by 2014—one estimated to double by the end of the decade. In the past, the U.S. has sourced up to half its foreign coal from Colombia via entities like Alabama's Drummond Company, which has a \$1.3-billion joint investment for production.

Colombia has a wealth of high-value metallurgical coal, too. This has drawn attention from the Chinese government, which has been in talks with Bogota over a \$7.6-billion railroad crossing the country. Colombia has also announced a \$3-billion, 1,000-mile rail project with financing from the Inter-American Development Bank. Coal is a top foreign currency earner, along-

side an advanced hydrocarbons sector—forecast to be well outstripped by mining—and a fast-emerging tourism industry.

Ground zero for Colombia's mining expansion is the commercial hub of Medellin, its second-largest city of 2.7 million—a place long associated with cocaine-related massacres, now beset by throngs of international businessmen. In the foothills of the Andes beyond, it is also surrounded by other foreign opportunity seekers: scores of Canadian junior prospectors and engineers scouring for metals and minerals beneath its mountains.

Their synergy underscores yet another promising scenario: Over the past decade, Colombia's economy has grown four times faster than that of Canada—which is home to half the world's mining companies.

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Rusoro in Venezuela: A Cautionary Tale

As Venezuela's only gold producer, Russian-Canadian junior Rusoro Mining Ltd. became the final casualty of the late President Hugo Chavez's war against foreign-owned miners after a "force of organic decree" expropriated all of the country's gold mines in mid-September 2011.

Though the socialist caudillo had been diagnosed with cancer that summer, Rusoro's fate was sealed, too—just months before Chavez was re-elected a fourth time to a six-year presidential term prior to his death in March.

In July 2012, CEO Andre Agapov sought compensation through the World Bank's International Center for Settlement of Investment Disputes—only weeks before Caracas withdrew from the tribunal altogether. "We spent a lot of money in the last 10 years," said the well-connected Russian businessman. "The value of the company could be very high."

Some could argue that Agapov and his fellow executives at the 11-year-old company should have known better: After all, Chavez had long since nationalized Venezuela's oil wealth to buttress multibillion dollar fuel sub-

sidies and social programs, along with the rest of its mining sector which, coupled with the country as a whole, spiraled into ruin.

But in ways, Rusoro was different. In 2008, the company was riding high—and alone—as a "partner of choice" to operate with a subsidiary of Venezuela's Ministry of Mines and Basic Industries. "The country boasts first-class geology and gold potential within an identical setting to some of the world's largest mining districts including Ashanti in West Africa and Kirkland Lake in Canada," stated a Rusoro news release.

Agapov's nationality, of course, didn't hurt: Venezuela had long been close to a Russia notorious for its own shadowy double-dealing in mining, hydrocarbons and other natural resources—with tight economic and military ties and a high profile, mutually strident anti-U.S. agenda to show for it. In one of his typically high profile state visits to Caracas, Vladimir Putin brought Chavez a puppy.

Previously, Chavez gave Rusoro permission to use up to 30% of liquid export proceeds to cover foreign costs and capital expenditures—up from 10%. This followed

economic reforms, according to a Rusoro release, that included a two-tier currency system to blunt runaway inflation (the Bolivar was devalued five times since 2002 and, having lost 90% of its value in 14 years, left Venezuela with one of the world's highest inflation rates.)

But for Rusoro, the picture was bright. With an output of 80,000 gold oz in 2011 and an output of 150,000 gold oz in 2010, the company owned 85% and 50% stakes in the Choco 10 and Isadora mines, respectively, with 10 more projects in exploration and development pipeline—subject to 2011 feasibility studies that could have helped tripled output.

No matter; vague denouncements of alliances between illegal miners and foreign companies suddenly swirled later that year. "This has to end, without killing anybody, without torturing anybody—just applying the law," Chavez thundered on his weekly television show. "We cannot allow capitalist mafias, both national and international, to keep destroying our homeland."

Chavez railed against the "serious impact of the capitalist mining mode," while Rafael

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Ramirez, his Minister of Energy and Petroleum, told *El Universal* that “multinational companies operate in different ways to perform covert and illegal activities.”

Rusoro’s royalty rates were fixed at 13% soon thereafter, coupled with new rules mandating state ownership of 55% of all joint ventures—up from 30%; exports were then banned shortly thereafter. A further \$130 million was diverted to the state-owned mining holding company Corporacion Venezolana de Guyana to compensate workers for previous strikes and overtime. “It’s clear the mining industry is not producing dividends for the state at the moment,” Chavez concluded.

For a time, Rusoro remained “optimistic.” Following initial talks with Mining Minister Ramirez, according to Agapov, officials pledged compensation by fair market value in the name of Venezuela’s good standing among capital markets.

But not for long; “Then all the people who started to work with us on the settlement were proposing different things and much lower valuations,” an exasperated Agapov later reported. “There was no way we could have accepted their numbers or conditions.”

In the end, “we lost it all,” said Agapov.

Crystallex of neglecting the project, dating back to the 1980s, for over a year for “reasons of opportunity and convenience.”

Crystallex officials countered in a release that they were effectively “shovel ready.”

It was no use. Crystallex was summarily forced into bankruptcy protection and de-listed from the Toronto Stock Exchange. Like Rusoro, company representatives are now seeking \$3.8 billion in damages for a hearing before the World Bank’s ICSID set for November.

Like Rusoro, Chavez initially gave Crystallex a warm welcome: It was even awarded Las Cristinas over Canada’s Infinito Gold Ltd., which claimed rights to the asset after Placer Dome International Corp. abandoned the project during a slowing of global market prices before its acquisition by Barrick Gold Corp.

Chinese state-run investment company CITIC Group (formerly the China International Trust and Investment Corp.) has since stepped into the breach; an ICSID lawsuit by Infinito seeking \$1 billion was later dismissed.

Others are in the ongoing, seemingly uneventful fray. In 2008, for instance, Spokane, Washington-based Gold Reserve Inc. sued for \$2.1 billion over the loss of its Las Brisas copper and gold mine—containing one of Latin America’s biggest gold veins.

Chavez’s appropriations are not without their domestic critics, notably the Venezuelan Confederation of Industries, decrying an atmosphere that “creates legal uncertainty, drives investments away and reduces the possibility of increasing production.” Jorge Botti, president of the Federation of Trade and Industry Chambers, called it a “fear factor.”

The factor continues, but it’s too late for Venezuelan mining.

In January, for the first time in his divisive rule, Hugo Chavez Frias missed his own inauguration amid months of chemotherapy treatment. But even without his presence, legions of the poor Venezuelans he empowered with mixed results cheered wildly.

Less than two months later, he would lie in state—with all the stillness of his beloved country’s mining sector.

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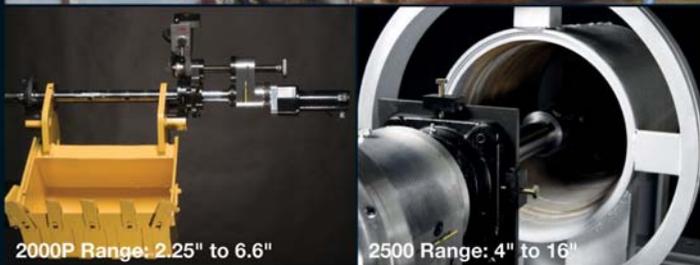
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