RESPONSIBLE SOURCING IN South America

Andrew Britton and Timothy Perkin, Kumi Consulting, UK, explore the South American context and how evolving regulatory and market requirements for responsible sourcing will impact companies sourcing from the region.

South America has historically been an important source of minerals and metals, including: iron ore, gold, zinc, silver, lead, and tin. More recently, a burgeoning demand for minerals – such as lithium, nickel, and copper – to feed the electric vehicle boom has further increased interest in the region. However, the evolving regulatory and market requirements for the responsible sourcing of these minerals brings a focus on the environmental, social, and governance risks in the region.

Today, some countries' economies are heavily dependent on exports of extractives. In 2019, over 50% of Chile's exports were minerals or metals, primarily copper, whilst 14.5% of Peru's, 18.9% of Guyana's, and 23% of Bolivia's were made up of gold. The largest country in the region, Brazil, has a more diversified economy, but still 10% of its exports are comprised of iron ore.[1]

This reliance on extractives is compounded by an increase in demand and subsequent production of minerals in recent years. In Bolivia, for instance, almost 360 000 t of zinc and over 64 000 t of lead were produced in 2020, an increase of over 125% and almost 500% respectively since 2005.[2] Another example is the demand for lithium from countries such as Chile, which the Global Battery Alliance expects to grow by 25% each year.[3]

Although the North American and European companies and investment remain significant in the region, there has been an increase of Asian interest in the past decade. This interest has come notably from countries such as China, South Korea, Japan and India, which have all significantly increased their imports in recent years.[4] For instance, China alone comprised 60% of Chilean copper exports in 2020.[5] Further, China's foreign direct investment (FDI) in the broader Latin American and Caribbean region increased from US$3.8 billion to US$109.5 billion between 2005 and 2014. By 2014, India's FDI in the region had reached US$16 billion.[4]

Regulatory and market requirements

For the past decade, the responsible sourcing agenda has been driven by the US Dodd-Frank Act, which requires companies to report on the inclusion of tin, tungsten, tantalum, and gold (known as 3TG) from the Democratic Republic of Congo (DRC) and adjoining countries in their supply chains. This led to the focus of due diligence efforts being made on central Africa and so-called 'conflict minerals'. For a long time, many purchasers of minerals and metals considered that if they were not sourcing from central Africa, there was little to be concerned about from a responsible sourcing perspective.

This is no longer the case as responsible sourcing expectations and regulations are now global in nature and are encompassing a much wider range of metals and minerals. Further, the uptake of these expectations is becoming a commercial imperative.

For example, the London Metal Exchange's (LME) new Responsible Sourcing requirements, (which, salient to South America, impact on the aluminium, zinc, nickel, tin, lead, and copper industries), require LME-listed brands to demonstrate that producers in their supply chain comply with strict due diligence requirements to trade on the exchange. Brands not implementing conformant due diligence practices will not be listed.[6]

Similarly, requirements are required of smelters or refiners that want to be listed on the London Bullion Market Association's (LBMA) Goods Delivery List (gold or silver) or as conformant by the Responsible Minerals Initiative (3TG). Numerous other standards have also been developed, covering everything from base metals through to gemstones.

At the core of global responsible sourcing expectations is *OECD Due Diligence Guidance for Supply Chains of Minerals Sourced from High-Risk and Conflict-Affected Areas* (the OECD Guidance). This guidance was developed to help companies at all levels of the supply chain to implement actions to strengthen responsible business conduct in mineral supply chains.

Uptake of the guidance has been propelled forward by the integration of many of its expectations of the European Union's (EU) Conflict Minerals Regulation (Regulation (EU) 2017/821). To comply with the regulation, all EU-based importers of 3TG must undertake robust due diligence on their supply chains and be able to show that the minerals they import into the EU are not contributing to issues such as conflict and human rights abuses.

A key requirement of the regulation and standards that align with OECD Guidance is that companies sourcing from identified 'conflict or high-risk areas' (CAHRA) should undertake enhanced due diligence in those areas. Kumi's CAHRA Map currently identifies eight South American countries as CAHRA.[7] The likelihood is, therefore, that all LME brands and companies importing minerals to the EU that are sourcing from South America should be implementing enhanced due diligence in some or all their supply chains.

Finally, proposed future EU legislation is hinting that other metals and minerals, ranging from cobalt to zinc and lithium, may also be required to meet the same expectations. In addition, the EU's proposed Mandatory Due Diligence law would cover all supply chains for all companies with any commercial presence in the EU.

Sourcing risks in South America

Indigenous rights

Although in some jurisdictions indigenous peoples' rights are protected by local law, this is not always the case. Even when there is legal protection, indigenous peoples can continue to suffer discrimination, displacement, or violence.[8]

When it comes to mining specifically, illegitimate land acquisition is a key risk. In March 2021, indigenous people in Northern Brazil were requesting for the Brazilian government to support them in a fight against mining speculators coming onto their land.[9]

For mineral companies producing responsibly, it is essential to engage with the rights of indigenous people and understand a well-established body of international law. In this instance, this includes the core right to free, prior, and informed consent (FPIC) which should be pursued when moving into areas where indigenous people may be present.

Environmental protection

When poorly managed, the extractives industry can create environmental effects that impact on local communities and ecosystems. The 2019 collapse of Vale's Brumadinho tailings dam at an iron ore mining complex in Brazil is perhaps one of the starkest examples.

Another example of an environmental risk is the use of water in the production of lithium. Chile, together with Argentina and Bolivia, comprises South America's 'lithium triangle'. This region holds 54% of the world's lithium resources and is pivotal for one of the key components of lithium-ion batteries, which are central to the global sustainable energy transition.[10]

Much of Chile's lithium production takes places in the fragile ecosystem of the Atacama Desert and is highly water intensive as it requires brine water for extraction. This, in turn, depletes water resources and impacts on the balance of the water composition.[11,12]

Artisanal and small scale mining

Artisanal and small scale mining (ASM) is more widespread in South America than perhaps companies sourcing from the region realise, with major private and public mining companies buying product from ASM sources. According to the ASM Inventory, the largest number of ASM operators in South America can be found in Colombia, Bolivia, and Peru.[13]

ASM outputs have been found to fund conflicts or exacerbate existing abuses. For example, Venezuela's

neighbouring countries can be transit routes for smuggled ASM gold, and paramilitary groups in Colombia have been known to profit from minerals extraction to fund their activities.

There has been a tendency from mining companies to disengage from ASM production sources due to the increased likelihood of operational risks such as child labour, health and safety issues, and forced labour. However, good practice is to engage responsibly with ASM. It is only with a realistic understanding of the scope of ASM in mineral supply chains that risks can be managed.

Corruption and weak governance

Companies operating in South America can often find themselves operating in areas of weak governance, increasing the risk of corruption, bribery, and fraud. This is even though governments, industry initiatives, and civil society organisations have worked to improve extractives governance and reduce corruption within the sector. This has involved establishing stricter anti-corruption laws, creating new transparency and social accountability mechanisms, and improving planning and the predictability of extractives revenue.[14]

However, governance and corruption risks remain, with eight countries in South America ranked as high or very high risk on Transparency International's Corruption Perceptions Index. On-the-ground examples include low mining tax collection in Peru, consequently meaning that local communities do not benefit from the resource wealth,[15] and instances of misinvoicing in Chilean exports of copper.[16]

How can companies address these risks and meet regulatory expectations?

Due diligence is more than a tick-box exercise. Instead, it is about developing robust management systems that help companies to understand their supply chain and identify salient risks early on. This, in turn, helps companies to get ahead of developing appropriate mitigating actions. Although it is the responsibility of upstream companies to mitigate any identified risks, downstream companies are ultimately responsible for the implementation of effective supply chain due diligence. Of course, cooperation and engagement between the two should, where possible, be encouraged.

An essential place to start is by getting to grips with the recommendations detailed in the OECD Guidance:

- Establish strong company management systems: Make commitments at policy level to responsible business conduct and include senior management in this process. Ensure staff are adequately trained in responsible business conduct.
- Identify and assess risks: Develop a process to identify and assess potential or actual risks in the supply chain. This article has presented four common risks in South American mining. However, companies need to understand these may not be the only ones, or indeed the highest risks, relevant to their supply chains.
- Respond to identified risks: Develop a risk management plan and use leverage to make effective changes.
- Verify due diligence: Have operations or supply chain due diligence independently assessed.
- Report annually: As a commitment to transparency, provide timely, accurate, and public reports and disclose information relating to risks, due diligence actions, and financial transactions.

Further, when adapting responsible sourcing programmes to the South American context, companies may require support from local stakeholders such as civil society groups and nearby communities to understand local concerns. This should be integrated into the risk assessment process, as well as in any subsequent steps taken to address risks.

Finally, although proactive responsible sourcing programmes may appear costly at first glance, they will save companies significant costs further down the line as it will reduce the impacts of severe risks and crises or being cut out of global markets altogether. GMR

References

1. *The Observatory of Economic Complexity*, https://oec.world/
2. *Instituto Nacional de Estadística*, https://www.ine.gob.bo/
3. 'A Vision for a Sustainable Batery Value Chain in 2030: Unlocking the Full Potential to Power Sustainable Development and Climate Change Mitigation', *World Economic Forum*, (2019), http://www3.weforum.org/docs/WEF_A_Vision_for_a_Sustainable_Battery_Value_Chain_in_2030_Report.pdf
4. 'Extractives in Latin America and the Caribbean: The Basics', *Inter-American Development Bank*, https://publications.iadb.org/publications/english/document/Extractives-in-Latin-America-and-the-Caribbean-The-Basics.pdf
5. *International Trade Centre*, https://www.trademap.org/
6. 'LME Responsible Sourcing', *The London Metal Exchange*, https://www.lme.com/About/Responsibility/Responsible-sourcing
7. 'CAHRA Map', *Kumi Consulting Ltd*, https://www.cahramap.com/
8. 'Undermining Rights: Indigenous Lands and Mining in the Amazon,' *World Resources Institute*, https://media.business-humanrights.org/media/documents/Report_Indigenous_Lands_and_Mining_in_the_Amazon_web_1.pdf
9. 'Brazil officials warn clash looms between Indigenous, miners', *The Associated Press*, (2021), https://apnews.com/article/brazil-latin-america-29766c5ab49251ade348efe6308c34bb
10. 'The white gold rush: A battle for supremacy in the lithium triangle', *The Economist*, (2017), https://www.economist.com/the-americas/2017/06/15/a-battle-for-supremacy-in-the-lithium-triangle
11. 'Lithium firms depleting vital water supplies in Chile, analysis suggests', *Engineering and Technology*, (2019), https://eandt.theiet.org/content/articles/2019/08/lithium-firms-are-depleting-vital-water-supplies-in-chile-according-to-et-analysis/
12. 'Water rights under scrutiny in Chile's Atacama Desert', *Mining [dot]Com*, (2020), https://www.mining.com/water-rights-under-scrutiny-in-chiles-atacama-desert/
13. 'Global Trends in Artisanal and Smal-Scale Mining (ASM): A Review of Key Numbers and Issues', *Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development*, (2017), https://www.iisd.org/system/files/publications/igf-asm-global-trends.pdf
14. 'Transparent Governance in an Age of Abundance: Experiences from the Extractive Indusries in Latin America and the Caribbean', *Inter-American Development Bank*, (2014), https://publications.iadb.org/publications/english/document/Transparent-Governance-in-an-Age-of-Abundance-Experiences-from-the-Extractive-Industries-in-Latin-America-and-the-Caribbean.pdf
15. OLIVA, N., CONVERTI, L., OGLIETTI, G., and SERRANO, A., 'Reparto de la renta minera en el Perú: Efectos macroeconómicos de una major distribución de la renta para el Estado', *CELAG Análisis Económico*, https://www.celag.org/wp-content/uploads/2019/12/mineria-peru.pdf
16. 'Trade Misinvoiving in Primary Commodities in Developing Countries: The cases of Chile, Côte D'Ivoire, Nigeria, South Africa and Zambia,' *United Nations Conference on Trade and Development*, (2016), https://unctad.org/system/files/official-document/suc2016d2_en.pdf