Sustainability Critical in Extractive Industries

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As a final note in our conversation about metals of the future, the development of the extractive industry is inevitable considering global demand for energy and mobility— but policies must seek to ensure that any potential adverse implications on environmental, social, and governance (ESG) considerations are addressed.

Environmental

As Alexandra Symeonidi and Luis Olguin described in their recent series about the rise of electric vehicles, mining can have adverse environmental consequences. It often requires large surface areas, which can damage biodiversity, and processing can cause high emissions as well as water and soil pollution.

There are legislative, regulatory, and policy tools available to national governments to help address the four main areas of environmental management in mining: water, biodiversity, waste, and emergency preparedness and response. Governments can seek to implement strict policies regarding the disposal of waste and mine tailings, and regulations can give authorities the ability to end operations if environmental protection, pollution mitigation, and waste management systems are not in place. But as with all national development policies, the implementation and enforcement of these measures requires adequate resources and institutional support success.

Social

Host communities of the natural resource sector are vulnerable to potential adverse implications of mining activity through displacement (of indigenous communities) and harm from safety incidents.

More broadly, when the expansion of the natural resource sector is not accompanied by diversified economic growth and employment expansion, it can be associated with increased poverty and inequality. This, in our view, undermines a country's growth potential and in turn its medium- to long-term creditworthiness. And in conjunction with the other adverse implications, it can undermine the social support for mining activity in the short term.

Over the past year, there have been a notable number of public protests against mining operations in Latin America. As societal support for the sector has diminished, the political response has been populist policies that promise to maximize government revenue from the sector in the short term through increased taxes or nationalization of assets.

Governance

Strong governance is, in our view, critical for the prudent exploitation of natural resource wealth. In this vein, we believe that robust public finance management and corporate governance systems assist in bolstering transparency and accountability in the sector.

We believe opportunistic exploitation of natural resource wealth can be limited through enhanced transparency in the way contracts and licenses are awarded; the volume and value of natural resources extracted and exported; and how much revenue is collected by governments on the back of produced and exported resources. This requires disclosures on the part of both governments and mining companies.

Corporate issuers in the mining industry should, in our view, uphold global best standards in their financial reporting. While we acknowledge that mining companies have the right to protect certain licensing and taxation information for competitive reasons, we believe that companies should disclose information by jurisdiction at a granular level to further anticorruption goals.

Equally so, poor or insufficient disclosure by governments and state-owned enterprises serves as a red flag presenting inherent risks to public finances through the potential ineffective or inefficient use of resources. Public frustration and distrust of the natural resource sector is, in our view, fueled by lack of transparency and accountability.

The Future of Metals

In conclusion, we believe the demand for metals of the future could contribute to stronger export revenues, fiscal proceeds, and investment flows in nascent producers—not the least in Sub-Saharan Africa and Latin America.

However, there is a risk that governments seek to opportunistically target the mining sector to temporarily maximize rent (particularly in Latin America), while considerable investments (in infrastructure) will be necessary to develop the sector (particularly in Africa).

Additionally, while the emergence of mining capacity in developing countries is economically an appealing prospect given the potential revenue that can be generated from the exportation of natural resources, policies must seek to ensure that any potential adverse implications on ESG considerations are addressed.

In terms of investment opportunities, many of the established producers of the metals of the future we have discussed in this series (including China, Chile, and Indonesia) are categorized as low-beta countries, which generally have strong macroeconomic fundamentals and present investment-grade opportunities. The contribution of the metals of the future could allow for further diversification over the medium term; however, the developments could prove more transformative in less developed parts of the world.

We believe there is significant scope to generate alpha in frontier markets. In our investment process, we seek to unlock alpha by positioning in markets where the scope for fundamental improvements is inadequately reflected in the pricing of assets.

Metals of the Future Series

Rising Demand Supports Commodity Exporters
Seeking Opportunities in Metals of the Future
Sustainability Critical in Extractive Industries

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