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AQ FEATURE

Resource Nationalism: Beyond Ideology

BY Hal Weitzman

The hemisphere revives an old policy standby.

Latin America's political Left has displayed symptoms of bipolarity for much of the past decade.

An early purveyor of this diagnosis was Jorge Castañeda, former Mexican foreign secretary (2001–2003), who in 2004 identified what he called "two Lefts" in a piece for *Project Syndicate*. One Left had "truly socialist and progressive roots" that was "following pragmatic, sensible and realistic paths." The other stemmed from "a populist, purely nationalist past" that had "proven much less responsive to modernizing influences."[1]

In a 2006 essay for *Foreign Affairs*, Castañeda expanded the argument. He said Latin America's overall leftward shift was driven by two wings: moderate parties and movements led by reformed socialists who had come to embrace "a more or less orthodox market framework" and a more radical set of populists whose main aim was to seize control over sources of revenue and who were "much more interested in policy as an instrument for attaining and conserving power than in power as a tool for making policy."[2] His model was underpinned by the assumption that the latter camp—the far Left—would quickly collapse as its economic policies proved unsustainable, thus paving the way for the free-market reforms gaining traction around the hemisphere in the 1980s and 1990s.

But Latin America's Left has not followed Castañeda's model. At the heart of his analysis was the notion that economic nationalism and extreme government interventionism were confined to the far Left. Empirically, however, the economic policy of more moderate regimes has united them with their more radical ideological cousins.

Strip away the rhetoric about "neoliberalism," and the two Lefts blend into a policymaking continuum. The best example is in the area of natural resources. National leaderships representing both wings have raised taxes on foreign investors, enhanced the roles and budgets of state-owned companies and intervened in the economy. Both pursue policies of "resource nationalism," in which the state asserts its control over natural resources and uses that control for political rather than economic ends. The differences between them are more of degree than conceptual distinction. That such resource nationalism even encompasses right-of-center governments, such as Chile, suggests that the tendency runs far deeper in Latin America than any one particular political ideology.

Emerging Markets Blur the Line

How did the "two Lefts" analysis become undone? In a word: China.

That country's spectacular growth, along with that of other advanced emerging economies such as India, has had a more pronounced impact in Latin America than in other world regions, for four reasons.

First, it caused a boom in commodity prices. That was of obvious benefit in particular to South American economies, which had long been key global suppliers of basic commodities such as oil and gas, precious and base metals, and foodstuffs such as soybeans, cocoa, coffee, and orange juice. These price increases meant a windfall for governments of all political persuasions.

Not only did they make existing extractive facilities more lucrative; they also created strong incentives for more exploration and exploitation. Even though prices have fallen from their peaks, commodity revenues are still high by historical standards. For example, in September 2012, U.S. rating agencies raised Ecuador's credit outlook, citing high international oil prices. This has enabled countries such as Venezuela, Ecuador and Bolivia to shrug off declining production and to defy predictions of their imminent demise for at least the past six years. It has also spurred more moderate regimes to pursue rent-seeking policies, including higher taxes and a bigger role for state-owned enterprises.

Second, trade and diplomatic ties between China and Latin America have grown rapidly. China's share of the region's exports boomed from a paltry 0.8 percent in 1990 to 12 percent in 2008, according to the United Nations Economic Commission for Latin America and the Carribbean (ECLAC). This came as Latin American exports to the U.S. fell during the same period—from 47 percent in 1990 to 42 percent in 2010, according to the Inter-American Development Bank.

Photo: Nicolas Villaume

Beijing has targeted Latin America as its primary focus for foreign direct investment (FDI) outside Asia, pouring 70 percent of its non-Asia FDI there in the first few years of the new millennium. Chinese companies invested $15.3 billion in the region in 2010, more than double the total Chinese investment in Latin America over the previous 20 years, according to ECLAC. Because China's foreign policy toward Latin America is mercantilist, Beijing is agnostic about trade partners' domestic policies. This has further helped governments whose policies of resource nationalism have otherwise frightened off foreign investors or locked them out of international bond markets. It has also helped prevent the chickens from coming home to roost in countries such as Venezuela, Ecuador and Bolivia, and has provided an insurance policy for other countries to implement resource nationalistic policies.

Third, China's "state capitalist" model has offered an alternative to the free-market development path for emerging economies around the world. For decades, multilateral lenders and Western powers told developing countries that there was only one path to development: remove the state from the economy and design policies to make foreign investment as attractive as possible. But in the wake of the 2008 financial crisis, that argument lost some of its luster.[3]

China, in contrast, represented a potent example of a fast-growing economy that was not only competing with the U.S. to become the world's economic superpower, but was doing so successfully with an alternative model—apparently demonstrating to developing countries that free markets were not necessarily more productive than ones with large doses of state economic intervention.

Fourth, China has been an important source of funds for big-spending Latin American energy producers. The China Development Bank has loaned Venezuela $42.5 billion in oil-backed loans since 2007, and China has given Ecuador $7.3 billion in such guarantees since 2009, according to Bloomberg, as well as billions more to Brazil and Argentina. These loans have enabled energy producers to avoid making investment terms more attractive or having to seek further loans from multilateral agencies.

Interestingly, the impact of China seems to have been missed by the original advocates of the "two Lefts" model. Yet it is impossible to explain political and economic currents in Latin America in the past decade without reference to the emergence of China, which is now on track to become the world's biggest economic power before 2030.

Group Intervention

Latin America has a long history of governments flexing power over their natural resources, although today's picture is a marked contrast with the 1980s and 1990s, when almost all governments in the region enthusiastically adopted the policies of the Washington Consensus.

Assumptions from the past decade that macroeconomic orthodoxy—inviting foreign oil companies to drill, pursuing strong relations with the private sector and maintaining hefty budget surpluses—would be the region's main policy narrative are now less persuasive. Under President Hugo Chávez, Venezuela nationalized its oil, telecommunications, electricity, cement, and rice production industries; and it expropriated steel mills, glass factories and supermarkets. Bolivian President Evo Morales has nationalized the country's gas, telecommunications and electricity sectors.

Even before President Rafael Correa's government took power in Ecuador, the country slapped a 50 percent tax on "extraordinary profits"—the difference between the price of oil at the time the contracts were drawn up and the current oil price—being amassed by foreign oil companies. It also expelled Occidental Petroleum Corporation, the U.S. oil company that had been the biggest foreign investor in the country, charging that it had violated the terms of its contract. Ecuador then seized $1 billion in Occidental assets and handed them over to Empresa Pública Petroecuador, the state energy company. Correa's administration further raised the tax on extraordinary profits to 99 percent, a move that led French oil company Perenco to leave the country and the state to seize its assets.

Next, Correa forced foreign oil companies to shift from production-sharing agreements to pure service contracts in which the state owns the oil and gas produced and the multinationals simply receive a fee for their work, which forced out U.S. firm Noble Energy and Brazil's state-owned Petróleo Brasileiro S.A. (Petrobras).

Ecuador revoked most existing mining concessions in 2008 and passed a new mining law in 2009 that included a 70 percent windfall tax on extraordinary profits; a 5 percent royalty on the sale of all primary and secondary minerals; a 25 percent income tax; a 12 percent tax on profits; and a 12 percent value-added tax. Although Correa has said he will soften the law to attract investment, his failure to persuade congress to do so prompted Iamgold of Canada to leave the country in November 2012, while International Minerals Corporation of the U.S. has also announced plans to quit Ecuador.

Meanwhile, Argentine President Cristina Fernández de Kirchner has nationalized pension funds, Aerolíneas Argentinas and Yacimientos Petrolíferos Fiscales (YPF), the oil company formerly owned by Repsol.

The record of the far Left practitioners, then, is clear. But what of the moderates?

Brazil, the economic powerhouse of South America, provides the best example. In the 1990s, Brazil ended Petrobras' monopoly and opened the industry up to foreign investment, but in recent years the country's oil policy has become markedly more nationalistic.

Brazil's government has restricted foreign companies to secondary roles in most new projects. In Brazil's *pré-sal* fields, Petrobras must be the operator with a minimum 30 percent stake. In 2010, when Brazil issued $67 billion worth of stock in Petrobras—the biggest share offering in history—it structured the deal to increase its share in the company from 40 percent to 48 percent. (The state always retained a majority of the voting stock.)

The government is also adopting a more muscular approach to managing Petrobras. Most recently, it has pressured the company to use expensive local equipment suppliers and keep petroleum prices artificially low to help manage inflation. Fitch Ratings observed in February 2012 that its rating of debt issued by the state oil company's finance arm was "tempered by Petrobras' exposure to local political interference."

Political interference is not restricted to the oil industry. Brasilia likely forced out Roger Agnelli, the head of Vale S.A., the world's second biggest mining company, based in Rio de Janeiro, because it did not like his job-cutting plans. The move demonstrated the Brazilian government's willingness to meddle. While Vale is a private company, it is effectively controlled by the government, since its biggest shareholders are public pension funds.

Some saw signs of economic nationalism in Brazil's crackdown on Chevron Corporation after a November 2011 leak at the Frade offshore oil field earned the U.S. company fines and criminal investigations. At the same time, the government was much slower to pursue Petrobras, Chevron's junior partner. In January 2012, the Brazilian state of Minas Gerais created a new mining tax on the exploration of iron ore and other minerals not processed in the state, although it subsequently reduced the level of the tax after companies took legal action. Moreover, Brasilia renegotiated electricity contracts with private operators in September 2012 to slash electricity prices for the industry by as much as 28 percent. The move was condemned as "a form of nationalization of property […] more or less the same as we have seen in Venezuela or Argentina" by Skagen Global Fund, a Norwegian fund that holds 17 percent of the outstanding preferential shares in Eletrobrás, Brazil's state-owned electricity generator.

Despite an increasing default rate and slowing economic growth, Brazil's leading banks are being pressured to reduce their lending rates after the central bank began lowering its benchmark rates. In the telecommunications sector, the government froze new sales by some operators that were accused of providing poor service.

Meanwhile, the moderate governments of Chile and Peru have both increased taxes on foreign resource extraction investors in recent years. Peru slapped a new windfall tax of more than $1 billion on mining companies in 2011—a move that actually came as a relief to the industry, which had braced for much worse. Chile raised royalty taxes on mining companies in 2011 from a flat 5 percent rate to a progressive rate that goes up to 14 percent—and domestic protests have called on the government to raise taxes further. The total tax burden for mining companies is currently almost 50 percent in Peru and 43 percent in Chile, according to industry estimates.

Mexico offers an intriguing example of how even the failure of resource nationalism has limited impact on government policy. Although there is widespread acknowledgement that Mexico is facing serious national problems as the Cantarell wells dry up, exports fall, and government revenues dwindle, newly elected President Enrique Peña Nieto's *Pacto por México* (Pact for Mexico) package of reforms stresses that ownership and control of Petróleos Mexicanos (PEMEX) and the country's hydrocarbons "will remain in the hands of the nation, via the state." While he has pledged to open up refining and the transportation of oil and gas to competitors, PEMEX will be spared any competition.

Indeed, the current resource nationalism in the hemisphere represents the revival of a policy tool that was prevalent in the pre-Washington Consensus era. Its return to popularity over the past decade has coincided with a surge in economic nationalism internationally, from developed countries such as Australia and the United Kingdom to emerging economies such as China and Russia. That's one reason why resource nationalism continues to be the chief concern of the world's biggest mining companies, according to Ernst & Young's (EY) annual "Business risks facing mining and metals 2012-2013" report.[4] "The uncertainty and destruction of value caused by sudden changes in policy by the governments of resource rich nations cannot be understated," the report states.

Reconsidering Investment and Policy

One of the central criticisms leveled at resource nationalistic policies is that they will alienate much-needed foreign investment.

But high commodity prices have meant that while most foreign investors are generally unhappy about the trend in Latin America, some companies are still willing to linger. In some cases, such as Petrobras' decision to maintain its operations in Bolivia, they are apparently betting that they can ride out the trend and make profits in the longer term. In others, those willing to stay have benefited from the departure of rivals.

In Argentina, after the government seized control of YPF from Repsol, Chevron struck a deal with the newly nationalized YPF to develop the Vaca Muerta shale reserves in the west of the country—an arrangement that is now the subject of a lawsuit in U.S. federal court.

Chinese firms have also seemed willing to snap up investment opportunties where others will not. Despite Ecuador's burdensome mining taxes, China's EcuaCorriente agreed in 2012 to pour $1.4 billion into developing the El Mirador copper mine in Zamora Chinchipe province.

While the EY survey reflects concern among multinational energy firms, the problem is that they have to go where the deposits are—though the risk attached to investments has increased. Argentina, for example, happens to be sitting on handsome oil deposits and some of the most promising shale gas resources in the world.

None of this supports the notion that resource nationalism should be welcomed or encouraged. It tends to make economies less sustainable, discourages trade and investment and, ironically, hampers sovereign governments' abilities to exploit their own natural resources. When states look more to extractive industries' revenues to fill their coffers—whether directly or in the form of taxes—they also become more dependent on the notoriously fickle commodity markets. Government efforts to combat poverty, reduce inequality and spur domestic demand become heavily tied to price and demand volatility.

When prices fall, interventionist governments are often the first to feel waning interest from outside investors. Brazil and Cuba, for example, have seen foreign investors shy away from exploration projects. If prices were to plummet, more resource nationalistic regimes might lose the access to capital, investment and technology that energy multinationals provide. But commodity markets have remained robust by historical standards. "Supercycle theory"—the notion that emerging market growth means commodity prices will be permanently higher than historical norms—may have often been overstated in recent years, but underlying demand from developing economies in Asia remains strong.

Another risk on the horizon for interventionist governments in Latin America, however, could be the rapid growth in U.S. energy production, with projections of North American energy independence within a decade.

The effect of that trend on global prices remains unclear, but it may make the U.S. a less reliable customer for Latin American energy and allow Washington to put pressure on regional trading partners.

Prior approaches for Washington merely consisted of "waiting it out" until resource nationalism died, after which it could re-engage with the region and build ties with the friendlier regimes that would inevitably follow the collapse of radicalism. But today's overall regional picture requires a more complex and subtle response.

Leaders of the far Left have certainly behaved more autocratically in office, and have shown little compunction about changing the rules of the game by rewriting existing business contracts. But the defining feature of the "bipolar" characterization has been economic policy, and on this front the two camps are more similar.

The U.S. would do better to drop the attitude that it can only engage with like-minded governments and take a more pragmatic view of bilateral relations, as it has done with countries such as China and Saudi Arabia. When it comes to Latin America, Washington has all too often allowed ideology to determine relations, from the Cuba embargo, to diplomatic ping-pong with Venezuela, Bolivia and Ecuador, to the failed "war on drugs." The outdated idea that the U.S. can only really be trading partners with countries run by "friendly" governments—those that limit state intervention in the economy—is both counter-productive in that it reduces American influence and ineffective, since the rise of China and other new global powers means Latin American countries face unprecedented choices in their trade policies.

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  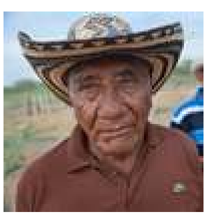

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