The New Political Economy of Natural Resources in Latin America

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Critical Debates

The New Political Economy of Natural Resources in Latin America

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Anthony Bebbington and Jeffrey Bury, eds., *Subterranean Struggles: New Dynamics of Mining, Oil, and Gas in Latin America*. Austin: University of Texas Press, 2013. Photographs, maps, figures, tables, abbreviations, bibliography, index, 361 pp.; hardcover $60, paperback $30.

Noel Maurer, *The Empire Trap: The Rise and Fall of U.S. Intervention to Protect American Property Overseas, 1893–2013*. Princeton: Princeton University Press, 2013. Illustrations, map, tables, figures, notes, bibliography, index, 568 pp.; hardcover $39.50; ebook available.

Michael L. Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations*. Princeton: Princeton University Press, 2012. Illustrations, tables, abbreviations, appendixes, bibliography, index, 312 pp.; paperback $22.95, ebook available.

Elana Shever, *Resources for Reform: Oil and Neoliberalism in Argentina*. Stanford: Stanford University Press, 2012. Map, figures, notes, bibliography, index, 231 pp.; hardcover $70, paperback $22.95, ebook $22.95.

It is widely known that there is a negative correlation between natural resource reliance and political and economic development. Consider, in particular, the Great Arid Zone of Afro-Eurasia, which stretches from North Africa (the Sahara) to Eastern Central Eurasia (the Gobi). While this region contains the lion's share of the world's conventional hydrocarbons, it is also a democratic desert, characterized by countries with low levels of economic and social development (Galal and Selim 2013).

For example, even though it is the world's largest oil producer and exporter and the region's largest country, Saudi Arabia remains quite underdeveloped. The kingdom's problems are numerous. It lacks a modern industrial and service sector (Mazaheri 2011). Its government is unable—or unwilling—to tax the population (Alkhathlan 2013). Instead of the rule of law, there is the rule of a monarch who avers that Islamic jurisprudence inspires his draconian decrees. Saudi Arabia is one of the few places on earth where citizens have no say whatsoever over their political destiny and women are treated as second-class citizens under an apartheidlike system.

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This co-occurrence of natural resources and underdevelopment also characterizes Latin America. Oil-dependent Venezuela is bedeviled by intractable poverty, despite Hugo Chávez's so-called Bolivarian Revolution, as well as political and social unrest. Gas-dependent Bolivia also suffers from these ills; indeed, it is still plagued by a veritable caste system. Oil-dependent Ecuador is afflicted by environmental degradation and corruption.

There is also, it appears, a correlation between natural resources and numerous pathologies in sub-Saharan Africa, including civil war, dictatorship, and poverty. Take oil-dependent Angola and mineral-dependent Congo, for example. Both have had these problems in spades since the end of colonial rule.

What explains the correlation between natural resources and political and economic underdevelopment? The orthodox, and most influential, school of thought on this issue posits that there is a causal relationship that runs from natural resources to numerous pathologies. This is the view put forth, in its most nuanced manner yet, by Michael Ross in *The Oil Curse*. Conversely, a heterodox and emerging alternative to the resource curse view also tries to make sense of the same set of facts outlined above. This latter camp, composed of both skeptics and newfangled political ecologists, does not deny that natural resources and underdevelopment are coeval. They are less willing to concede that the former causes the latter, however. This less cohesive, more inclusive, and quite iconoclastic school of thought is expressed in recent books by Bebbington and Bury, Shever, and Maurer.

Ross's *Oil Curse* is not your grandfather's resource curse theory. The book transcends, if not usurps, the older rentier state view, which evolved from the study of state building and democratization in Western Europe. This paradigm holds that if a ruler wishes to collect revenues by taxing the citizens, the ruler must make concessions in exchange for their compliance: provide public goods and grant them representation (Tilly 1975). This is particularly likely when capital is hard to tax because it is liquid and mobile (Bates 1991). It therefore follows that taxation of modern, formal sectors, composed of investors, salaried white collar workers, and wage laborers, is more likely in the absence of natural resources (Ross 1999). So is democracy (Ross 2001). And because the accumulation of capital hinges on secure property rights (North 1981), oil may be inimical to capitalism, too. When they have vast oil rents at their disposal, rulers not only may fail to provide property registrars and courts but may indulge in opportunistic behavior (Jensen and Johnston 2011).

Latin America is indirectly implicated in this view of how the world works. It has an important, albeit secondary, role to play in one of the premiere examples advanced to defend the thesis that natural resources are anathema to state building, democracy, and capitalism. Many researchers blame Spain's prolonged economic decline, which began in the seventeenth century, as well as its inveterate despotism, on its sequestration of Latin America's precious metals, especially silver, after Columbus (e.g., Drelichman and Voth 2008). Access to Latin America's bountiful natural resources doomed Spain to backward institutions and fostered complacency. Spain's concerted "rentierism" is unfavorably contrasted to England's commercial and industrial development—even though the British Crown continued to earn rents from land and wool well after the Glorious Revolution waged in 1688.

The Oil Curse departs markedly from this old-fashioned view. For Ross, even oil states must negotiate with citizens who care deeply about their country's subsoil riches and their natural patrimony. In other words, the logic of the contractarian approach to state building and democratization does not stop at the water's edge in places where natural resources are abundant, as earlier theories imply. Indeed, Ross shows that even the rulers of very oil rich states have to resort to bargaining with, taxing, and providing services to everyday citizens. The key difference between them and the rulers of poorly endowed lands is that they can successfully hide the lion's share of the state's revenues, granting themselves more latitude and breathing space—but never freeing themselves from the quotidian exigencies of politics.

Ross tenders several novel predictions; only some of them are recounted here. While oil rents should fuel secessionist wars because independence in oil-producing regions is lucrative, they should not make civil war and authoritarianism more likely in general. Increases in oil rents should make democratization less likely after 1980, however, because of the proliferation of national oil companies (NOCs). Also, increases in oil rents should translate into greater social spending.

While *The Oil Curse* offers a sophisticated theory and new findings that depart considerably from previous work, it also builds on the preexisting literature on the politics of oil. It illuminates several patterns that seem endemic to places with oil. This book has moved the debate forward, and should become the definitive take on the resource curse. It certainly deserves to displace all previous versions.

Is There Really a Resource Curse?

A shift away from the naive rentier state view of the world should be made easier by recent research that vitiates the claim that the rulers of oil-rich countries are immune from the law of political gravity—that they sit atop a throne built on oil without worrying about mundane issues, such as negotiating with the opposition, taxing the citizenry, or investing in public goods. What these works share is twofold. First, they either exploit the data's impressive time-series variation or utilize econometric techniques that isolate the exogenous component of the rents produced by natural resources. Second, they reject the view that there is a resource curse after all.

There are several works in this fledgling camp. This author (Menaldo 2014) finds that rather than displacing regular sources of government revenues, oil rents allow governments to invest in tax administration and thus improve their taxation of non–oil-related consumption, imports, and exports. Haber (2014) argues that Latin America's industrialization was catalyzed by resource booms. Other skeptical research finds that oil boosts public goods (Stijns 2006), bolsters economic growth (Alexeev and Conrad 2009; Brunnschweiler and Bulte 2008; Lederman and Maloney 2008), and does not cause civil wars (Brunnschweiler and Bulte 2009; Cotet and Tsui 2013). Furthermore, Bruckner et al. (2012), Haber and Menaldo (2011), Wacziarg (2012), Wright et al. (forthcoming), Liou and Musgrave (2014), and

Menaldo (2014) conclude that oil actually bolsters democracy instead of undermining it.

But what, then, do we make of the cross-national correlation between natural resources and the pathologies recounted above? To start with, we can consider a set of alternative stories for some oil-rich places that are so notoriously exceptional. Take the Middle East and North Africa (MENA). Saudi Arabia and its ilk have always had a tribal social structure (Menaldo 2014); were subject to repeated conquests and occupations over several centuries spearheaded by the Arabs, the Ottomans, and the British (Chaney 2012); and are home to inhospitable deserts where agriculture is unlikely to blossom, let alone foster industrial revolutions or liberal democracies. Because the MENA missed out on the Enlightenment, mosque and state are still joined at the hip (Lewis 2002), and hold modernization at bay.

Elsewhere, I provide a theory (Menaldo 2014) that synthesizes the statistically oriented recent work that uncovers resource blessings and the anecdotes related above. The rulers of weak states that attempt to consolidate power and raise revenues when commitment problems are thorny and fiscal transaction costs high turn to the deliberate construction of an oil sector to accomplish both tasks simultaneously. States are more aggressive at launching discovery efforts and converting oil plays into active wells exploited at high rates when they are strapped for cash or face current account deficits. This is usually the case when governments do not have much else to tax, face high costs to taxing it, and find it difficult to credibly commit to a broad section of the population. Provided that there is an inkling of geological potential, low-capacity states will do their best to conjure an oil sector.

I adduce evidence for several empirical implications generated by this theory. Revenue-starved states with low capacity explore for oil more intensively. They court larger volumes of capital in the oil sector. They produce oil rents at greater rates by goosing the production of extant wells. They also export and tax it at higher rates. These results hold after controlling for geological endowments, oil prices, and production costs, among other factors.

Yet large and constant flows of capital are required to transform fossil fuels into gasoline. It is much more complicated than just drilling a bunch of holes in the ground. Investors are required to deploy intrinsically valuable fixed assets with sunk costs across an exploration and production phase, a petrochemical separation process, and a transportation phase, which hopefully culminates in the safe, uninterrupted departure of oil from export terminals. A relatively long lag separates exploration from profits. Moreover, the oil price is very volatile.

Given these complicated, capital-intensive phases, I have observed that several strategies have evolved to selectively protect foreign investors' property rights in the oil sector. While NOCs have increasingly shouldered more of the heavy lifting to make this happen, private investors also continue to play a prominent role. International oil companies (IOCs) increasingly engage in regulatory arbitrage to sidestep stringent environmental regulations and labor standards in their home countries, as well as higher taxes. Whereas IOCs once protected their property rights in the developing world through colonialism, "gunboat diplomacy," and the oligopolistic structure of the market, they now tend simply to exploit huge advantages in power, money, and information.

Subterranean Struggles, *Resources for Reform*, and *The Empire Trap* help elucidate how exactly this happens. They deserve to become go-to works in the new political economy of natural resources.

Holding a Magnifying Glass to Latin America

In *Subterranean Struggles*, Bebbington and Bury have put together a remarkable edited volume that explores the causes and consequences of the huge inflows of foreign direct investment (FDI) that have poured into Latin America's natural resource sectors over the past few decades. "Between 1996 and 2007, global investments in exploration by transnational private sector corporations accounted for approximately US$2 trillion in the hydrocarbons sector and US$91 billion in the mining sector" (42). A whole lot of that was directed toward Latin America: "between 1990 and 2007, Latin America received US$969 billion in FDI" (41), most of it in the natural resource sector. The growth of FDI in hydrocarbons from 2004 to 2007 amounted to 223 percent in Brazil and 623 percent in Colombia; and in mining it was 458 percent in Brazil, 502 percent in Bolivia, and 550 percent in Mexico. Bebbington and Bury note that these investments have flowed into traditional areas of extraction and new projects (16).

Much of this FDI can be traced to fiscal and economic crises that have plagued Latin American countries since Mexico defaulted on its sovereign debt in 1982. According to Bury and Bebbington, "within Latin America, the extractive sector was seen as a critically important driver of economic growth by policymakers seeking to overcome the economic and political crises spurred by successive oil price shocks and massive national debt burdens" (38). A massive debt overhang was inherited from a statist era, and the response was swift and painful: austerity and the steady retrenchment of the state. While publicly owned companies were privatized at a rapid clip to generate much-needed government revenues and foreign exchange, capital accounts were liberalized and free trade agreements penned. The so-called neoliberal era had arrived.

Latin American governments bent over backward to curry foreign investment in their natural resource sectors. This entailed "reorganizing and clarification of mining and hydrocarbons concessions, removal of local hiring and sourcing requirements, limitations on expropriation rights, ratification of international arbitration accords, and the creation of investment protections" (44–45); "natural resource extraction legislation was either abolished or amended to limit public interest and eminent domain, reform environmental protection, establish minimal taxation regimes, formalize mineral and hydrocarbons concession taxation and leasing, and create investment incentives" (45); and furthermore, Latin American countries "developed infrastructure to provide access to remote areas where new hydrocarbons and mineral deposits were being discovered" (45) and "provided the necessary military and police support to ensure the safety of new extractive operations and their foreign personnel" (45).

Subterranean Struggles also makes clear, however, that this phenomenon is not entirely new. Instead, it reflects some disconcerting facts. Natural resources are often Latin America's default economic sector. Moreover, the region's weak states perennially find themselves negotiating from a very weak position when seeking to raise revenues and foreign exchange from their natural resources. In part, this is precisely because they often lack viable alternatives to mining and hydrocarbons, and are therefore desperate. This means that the rhetoric of oil nationalism and sovereignty that is so ubiquitous in Latin America is often contradicted by the reality of political survival and fiscal exigency.

Consider Bolivia. Chapter 3 of *Subterranean Struggles*, written by Thomas Perrault, recounts a lopsided history in which IOCs have always had the upper hand. Although in the 1950s U.S. president Eisenhower made it clear to Bolivian president Paz Estenssoro that continued financial assistance would be contingent on Bolivia's granting generous concessions to U.S. IOCs (77), decades later, in 2006, outgoing president Sánchez de Lozada "reduced the royalties paid by private firms on newly discovered oil and gas reserves from 50 percent to 18 percent" (79, citing Hindery 2003). Moreover, even Evo Morales's "nationalizing" of the gas industry was a nationalization in name only. Instead, it was "a forced renegotiation of the terms of hydrocarbons development" (81, citing Spronk 2007). While the new royalty structure that was put in place benefits the Bolivian state much more than it did previously, it still represents a regressive and inflexible method of taxing oil rents that reflects its endemic weakness.

Indeed, *Subterranean Struggles* points to the possibility that the myriad problems faced by the citizens of weak states in the Latin American periphery are ultimately due to the state's neglect or incompetence and not to natural resources per se. It argues that "at their core, most struggles over extraction reflect demands for a stronger state—for stronger regulatory presence, for planning, for protection of human rights and environmental assets, and for predictability in the lived environment of rural populations" (24). Alas, however, one of the chief reasons that FDI is attracted to natural resource sectors in developing countries to begin with is that these places are cursed by a deficient fiscal and regulatory infrastructure (Menaldo 2014).

This does not rule out the fact that NOCs have helped to underwrite oil sectors across Latin America. In *Resources for Reform*, Elana Shever reveals that there is more than one way to skin a cat: even weak states may lean on a state-run firm to explore for and produce oil when they have few other options. Arguably, the most prominent example of this phenomenon is PEMEX. Founded in 1938 by Mexican president Lázaro Cárdenas, Latin America's most famous NOC was a response by the Mexican government to truculent IOCs. These companies had, on the one hand, resisted calls by oil workers for higher pay, while on the other, shifted their focus to other countries—in the process foregoing the investments required to sustain Mexico's oil industry.

In her spirited book, Shever deploys innovative ethnographic research that suggests that perhaps Argentina is a more appropriate example, however. She maintains that

> Argentina is unique in the prominent role that the national government has played in the oil industry since its initiation. State institutions were largely responsible for exploration and extraction beginning with the discovery of deposits in Patagonia in 1907. The state oil company, YPF Estatal, was founded in 1922, long before similar companies were established elsewhere in the world.… Policies such as price controls, taxes, and subsidies and programs like advertising campaigns, consumer education, and boycotts have encouraged citizens of all classes to use petroleum in their daily lives. (7)

Furthermore, "although General Jorge Rafael Videla, the de facto president under the military dictatorship from 1976 to 1980, changed YPF's legal status from an autonomous state enterprise into a joint-stock corporation, he did so in order to increase government control over the company" (174, citing Solberg 1979).

Yet despite the state's crucial and historically noteworthy role in fostering hydrocarbons in Argentina, *Resources for Reform* makes clear that a weak state faces nonetheless considerable challenges when attempting to rein in the power and influence of IOCs. Thirteen years after Argentine president Carlos Menem privatized YPF in order to boost investment in hydrocarbon exploration and production, Argentina's government has had difficulty regulating and taxing IOCs in a way that might allow it to benefit politically and fiscally. Despite government-sponsored protests, complaints about rising prices, and changing government policies, IOCs did quite well after privatization: "The transnational corporation Repsol, which in 2011 owned a little more than half of YPF, reported that its profits had more than tripled between 2009 and 2010" (188). The government and its allies, however, were not as fortunate.

After privatization, Repsol was able to extract more generous concessions from management and labor than it would have from unions or a state enterprise. For example, it was able to convert state oil workers into "worker-owned microenterprises," which then subcontracted their expertise and labor to the company (57). This system meant that Repsol did not have to bring in foreign workers and could pay local wages with few benefits. The same was true for other IOCs operating in Argentina, most important Shell and Exxon.

Although President Néstor Kirchner founded a new NOC (ENARSA) in 2004, it is not much more than an empty shell (131–32). Conversely, "Shell's investments in Argentina had not translated into significant employment, but company coffers benefited from Argentina's high unemployment rate and the state's weakening of labor laws and feeble regulatory enforcement" (162). While the Argentine state tried to buy Shell installations and to force Shell and Exxon to abstain from raising fuel prices, it was utterly unsuccessful.

Reacting from a position of rejection and weakness, Kirchner thereafter supported a boycott of Shell and Exxon in 2005 (133). Shever argues that ironically, this boycott was somewhat of a boon for these two companies. The reduced domestic consumption of gasoline that ensued freed them to export more crude and thus to generate greater profits as the global price of oil boomed. And Shell continued astutely to co-opt, if not bribe, the residents of areas adversely affected by its footprint in Argentina through so-called corporate social responsibility programs. In particular,

> its new Creating Bonds program aimed to portray Shell as a caring neighbor and a good citizen, both to the impoverished people living near its refineries and to consumers, investors, and employees living far from them. Individual company employees attempted to form intimate relationships with the leaders of its partner organizations, using affective, educational, and fiscal techniques both to "empower" and to discipline the residents of Dock Sud [a neighborhood in which Shell ran a petrochemical complex]. (190)

IOC Rights Enforcement

Given the examples adduced above, what do we make of the popular view that IOCs are inherently vulnerable and subject to expropriations and renegotiations? Are IOCs really in a weak position relative to host states?

Bohn and Deacon (2000) predict that hydrocarbon firms will underinvest in the capital-intensive operations that characterize the upstream oil industry—extraction, transportation, and the exportation of crude oil—in weak states, due to insecure property rights. These predictions draw on a time inconsistency dilemma coined the "obsolescing bargain" (Vernon 1971). When oil exploration and production contracts are signed and financing is committed, investors have substantial power to extract concessions and promises from host governments; they are, after all, the ones with the technology, capital, and expertise necessary to extract the oil. Over time, however, this power shifts to the hosts. Plants, machinery, and storage facilities associated with oil exploration, drilling, and transportation can be confiscated quite easily. Investors must make expensive investments in these assets several years before the oil starts flowing and several years before they can realize a return on their investment.

Although these costs are sunk at the beginning of a project, it can remain profitable for oil companies to continue to produce oil even if the terms of the initial deal worsen significantly. Host governments can therefore exploit this phenomenon and pounce when the time is right. Especially when the oil price rises, governments face incentives to increase royalties and introduce windfall taxes, if not expropriate foreign oil firms altogether. And the host's commitment problem is exacerbated in that it can renege on a contract, whereas a private oil firm cannot appeal to a higher authority to remedy this violation.

In *The Empire Trap*, Noel Maurer eviscerates the shibboleth that IOCs face highly risky conditions when they invest in weak states. He shows that U.S. government intervention on behalf of U.S. foreign investors in the developing world has been astoundingly successful at extracting compensation, often above market value, after expropriations. Maurer shows that the practices and institutions that the U.S.

government used to protect U.S. property rights overseas changed radically over time. Ultimately, U.S. investors inherited a set of tools that they could use against foreign governments without explicitly calling on the power of the U.S. government to protect them.

Indeed, Maurer's book is brilliant because he shows how, over time and through learning by doing, the U.S. government found innovative and crafty ways to protect investors' property rights abroad. These included bribes, threats, and outright changes in foreign governments. Unlike the explicit pursuit of imperial conquest undertaken by other great powers, however, the United States failed in efforts aimed at outright annexation, and with a few notable exceptions, such as Iran and Chile, largely eschewed covert action. Instead, "by the 1990s, American investors had access to an array of mechanisms to protect their property rights that did *not* depend on executive action" (389).

Make no mistake, however: before this relatively recent phenomenon, the U.S. government used threats and softer forms of coercion to ensure adequate and swift compensation after expropriations of U.S. companies. This was sometimes accomplished under the aegis of the Hickenlooper Amendment, a statute that called on the U.S. government to suspend foreign assistance to countries that expropriated U.S. property without adequate compensation. Similar provisions called on the United States to vote against loans from the World Bank and Inter-American Development Bank to these countries and to suspend tariff preferences.

However, international arbitration gradually allowed for the depoliticization of the enforcement of multinationals' property rights in the developing world. Maurer shows how this freed the U.S. government from having to intervene on behalf of U.S. investors who faced expropriation. While he argues that arbitration clauses that were unenforceable once served to create bright lines that the U.S. government could use to justify foreign interventions to defend FDI that was under threat, he shows that they gradually evolved into arbitration treaties that became self-enforcing.

Maurer identifies several important milestones. The International Center for Settlement of Investment Disputes (ICSID) went into force in 1966 (398) and created a mostly procedural body to arbitrate claims regarding contacts that contained clauses for arbitration over expropriation. The Foreign Sovereign Immunities Act of 1976 empowered U.S. investors to file lawsuits against foreign governments in U.S. courts. Bilateral investment treaties then emerged as the tool of choice for codifying the rights of foreign investors. "A BIT spelled out exactly which investments and classes of investments would have recourse to ICSID or other forms of international arbitration without the need for a specific clause in a concession" (400).

The Empire Trap also highlights the growing role of investor insurance in allowing foreign direct investors to hedge against a variety of risks. Organizations such as the Overseas Private Investment Corporation (OPIC) and the Multilateral Investment Guarantee Agency (MIGA, bankrolled by the World Bank) pay insured companies if they are expropriated and undertake sometimes heroic efforts to recover the money from the host country, with the backing of the U.S. government. Using this tool, IOCs can even securitize themselves against changes in contracts and currency volatility.

Conclusions

Subterranean Struggles, *Resources for Reform*, and *The Empire Trap* are all landmark expositions of the ways that IOCs are able to exploit opportunities to defend their interests in an uneven global playground. This playground is populated by both strong and savvy multinational companies and weak states that cannot really project a credible commitment to any domestic constituency, let alone to foreign investors. This playground is also polarized between the strictures of operating by one set of stringent rules in the U.S. heartland and the ability to invent another set, on the fly, in places such as the Peruvian Amazon and Buenos Aires. But IOCs have not done this via the establishment of a latter-day empire. Instead, they have found clever and subtle ways to maneuver successfully around ever-evolving obstacles. Alas, bringing geological potential to energy reality almost requires this. The more things change in Latin America, the more they stay the same.

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