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Resource Nationalism and Energy Security in Latin America: Implications for Global Oil Supplies

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Introduction[1]

Energy policy is usefully characterized by the degree to which resource nationalism[2] (RN) and energy security[3] (ES) are pursued. The balance achieved between these two key concepts dramatically affects global energy supplies. Over the past century, both of these ideas have played particularly significant roles in Latin America, where the oil industry first developed outside the United States, and an area that continues to draw the attention of the world market. Because Latin America is a growing source of hydrocarbons[4] for the world market, its energy policies are of increasing importance. The United States is particularly affected by Latin American oil policies, as 43 percent of U.S. imports from January to August 2009 came from the region; five of the top 15 source countries were Mexico (#2), Venezuela (#3), Brazil (#8), Colombia (#10), and Ecuador (#12).[5] Although the United States imports very little oil from Argentina, that country exports more oil than Ecuador, a member of the Organization of the Petroleum Exporting Countries (OPEC). In addition to traditional investment from the United States and Europe, Latin America now attracts investment from Chinese, Indian, Russian, and Iranian national oil companies (NOCs).

Whether Latin America will continue to export expected volumes of oil and gas, however, is an open question. Oil exports from Mexico, Venezuela, Ecuador, and Argentina are down, as are natural gas imports from Bolivia. Geology has something to do with the decline, but so do the levels of resource nationalism and energy security philosophies that can be found in these countries' energy policies. Resource nationalism and energy security policies are not inherently at odds with each other, but finding the balance between them means considering domestic and

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[1] I thank Amy Myers Jaffe for her helpful comments. Responsibility for views herein is mine alone.

[2] The core idea behind a resource nationalism perspective is that the natural resources in the ground or under the sea are a "national patrimony" and consequently should be used for the benefit of the nation rather than for private gain. In addition, the commodity itself has an intrinsic value, not one determined by the market, and this value belongs to the nation.

[3] Energy security embodies a claim for government action to protect national economic activity from, or significantly mitigate the impact of, shocks emanating from the international market.

[4] 90 percent of known lithium deposits are in four Latin American countries: Chile, Bolivia, Argentina, and Brazil. Thus efforts to diminish the world's reliance on hydrocarbons by significantly expanding our use of electrovoltaic power will further increase the importance of Latin America.

[5] Energy Information Administration, *Crude Oil and Total Petroleum Imports Top 15 Countries*, January-August 2009.
http://www.eia.doe.gov/pub/oil_gas/petroleum/data_publications/company_level_imports/current/import.html accessed October 31, 2009.

international interests in these hydrocarbons. If resource nationalism and energy security concepts guide national policy, long-term global oil supplies will be maximized when producing countries use their oil rents to generate public goods, such as a minimum level of health, education, and public security, as well as a competent and honest public bureaucracy. Alternatively, if the rents are used mainly for private goods (e.g., employment and government contracts for the politically connected; a transportation infrastructure to serve middle class needs, etc.) energy policy will be unstable and supplies to the global market will suffer.

How did we reach today's balance between RN and ES in the region? At the start of the 1980s, governments controlled the energy sector in all of the major Latin American countries— even in the case of the archetypal neoliberal military dictatorships in Chile and Argentina—and they favored resource nationalism policies vis-à-vis international markets and energy security orientation at home. In the 1980s and 1990s, however, low international oil prices, a lack of state capital to support NOC exploration and production (E&P), as well as increasing concerns over the environmental consequences of an electric power system based on oil and hydro, forced energy policy reforms in every country in the region. As democracy consolidated and won over skeptics of liberal economics, markets were given more play across Latin America, including in Mexico's natural gas sector, and privatization made significant inroads on the Latin American continent. The era of the Washington Consensus, which emphasized political democracy, macroeconomic prudence, outward orientation, and liberalization of domestic markets, was at hand.[6]

The Consensus turned out to be short-lived. Its failure can be attributed to Latin American politicians, the shortage of international and domestic capital, international financial institutions,

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[6] See John Williamson, ed., *Latin American Adjustment: How Much Has Happened?* (Washington, D.C.: International Institute for International Economics, 1990).

and U.S. policymakers.[7] During the Consensus, hydrocarbon rents went overwhelmingly to private firms, while country after country suffered through general economic reforms whose promised benefits turned out to be short-lived, if they materialized at all, and the poor and indigenous suffered even more than prior to liberalization. The resulting political backlash against the market has been understandable, if misplaced and counterproductive. Certainly one cannot understand the rise and success of Hugo Chávez, president of Venezuela, without understanding that the state-owned petroleum company, PDVSA, had previously lived in a privileged reality. Despite its success exploiting the nation's oil for domestic elites and international partners, PDVSA contributed little to the life of the people (70 percent of whom lived in poverty) in whose name it operated. Similarly, in Bolivia the largely indigenous poor violently rejected national gas policy, which they viewed as favoring multinational companies and national elites, despite the potential of significant discovery of natural gas and development of important export markets.

Of course, market reforms were not rejected everywhere. In Brazil, President Fernando Henrique Cardoso's breakup of Petrobras' monopoly, and even his partial privatization of the NOC, was not reversed by his successor, Luíz Inácio Lula da Silva of the Workers' Party. Alberto Fujimori's reforms in Peru have thus far survived his overthrow and subsequent conviction on human rights violations during his stormy decade as president, though popular protest is continually bringing that policy into question. The administration of Alvaro Uribe in Colombia has promoted even greater liberalization in the energy sector, including selling shares in Ecopetrol, the national oil company.

The challenge, therefore, is to understand why a country works with or against market forces in the energy sector. In this paper, I develop an argument about the determinants of energy policies of oil and gas exporters. The remainder of the paper explores the impact of these energy policies

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[7] Nancy Birdsall and Augusto de la Torre, *Washington Contentious: Economic Policies for Social Equity in Latin America* (Washington, D.C.: Carnegie Endowment for International Peace and Inter-American Dialogue, 2001); Joseph Stiglitz, "Challenging the Washington Consensus: An Interview with Lindsay Schoenfelder" Watson Institute, Brown University, May 7, 2002, http://www.watsoninstitute.org/bjwa/archive/9.2/Feature/stiglitz.pdf, accessed September 20, 2009; John Williamson, "A Short History of the Washington Consensus" (paper commissioned by Fundación CIDOB for the conference "From the Washington Consensus Towards a New Global Governance," Barcelona, September 24–25, 2004), http://www.iie.com/publications/papers/williamson0904-2.pdf, accessed November 3, 2009.

on global oil supply by applying the argument to the Latin American oil exporters— Venezuela, Mexico, Brazil, Colombia, Argentina, and Ecuador. The paper concludes by looking for ways to influence the determinants of energy policy to ensure the development of the region's resources for the benefit of people within and beyond the region.

Resource Nationalism and Energy Security

If resource nationalism and energy security are useful concepts for thinking about energy policy, we need to be clear on their definition, how they relate to each other, and how they affect global energy supplies. The answer to the latter two questions can be boiled down to "it depends," so it becomes all the more important to understand the full nature of these two concepts before we can address the issue of their impact on world markets.

Resource Nationalism

Resource nationalism is a concept in which the natural resources in the ground or under the sea are the property of the nation rather than of a firm or individual who owns the surface area. In this view, natural resources are a "national patrimony" and, consequently, should be used for the benefit of the nation rather than for private gain. By historical tradition and political constitutions, all Latin American countries currently own the subsoil resources in their political jurisdiction (this includes offshore oil and gas). Although in the late nineteenth and early twentieth centuries governments generally had Liberal private property perspectives regarding subsoil resources and may even have transferred ownership of these to private companies through oil concessions, the practice has been virtually eliminated in the region. Today, ownership of resources cannot be bartered or sold; instead, joint ventures, production-sharing agreements, service contracts, and other arrangements determined by national legislation dictate the permissible means through which parties other than the owner (the national government acting in the name of the country) might have access to the subsoil resources.[8] Most countries in the world have similar ownership rules though, importantly, the United States and Western Europe permit private ownership of subsoil rights.

[8] For a discussion of the various types of contracts, see the Total corporate Web site, http://www.total.com/en/corporate-social-responsibility/Ethical-Business-Principles/Financial-transparency/contractual_arrangements_13289.htm.

One of the major challenges for energy policy in Latin America, however, is the new claim by indigenous tribes that subsoil rights belong to them, not to the nation. Indigenous movements advocating redress of 500 years of exploitation by colonial and national governments have developed in many Latin American countries. Assisted by nongovernmental organizations (NGOs) from the United States and Europe, and appealing to international norms that recognize the rights of native peoples to control their territories and protect their cultures by remaining isolated if they wish, indigenous groups have complicated the resource nationalism perspective. Until a means is developed to resolve the tension between indigenous and national rights, exploration and production will be negatively impacted.

A resource nationalist assumes that properly used hydrocarbon deposits result in the national good. An underlying tenet is that the commodity itself has an intrinsic value, not one determined by the market, and this value ("rents") belongs to the nation.[9] Since rents are earnings beyond "normal" profit (by whichever of several definitions one chooses), and ownership of the resource lies with the nation, the question of the distribution of rents between the resource owner and the producer of oil arises. This distributional debate does not occur simply between developing country governments and private companies. Now that many NOCs are investing internationally, the distributional question can pit one government's interests against another's. For example, the Brazilian NOC Petrobras has encountered difficulties in Ecuador as the government of Rafael Correa exerts greater control over oil contracts. When Bolivia nationalized its gas fields in 2006, again the company most affected was Petrobras. Even developed countries like Norway, the United Kingdom, and Canada forced private oil companies to renegotiate their production contracts when oil prices boomed.[10] And, of course, rents can be created by government intervention that raises the price of an input (e.g., labor, equipment, and services required to be purchased domestically, etc.) and these domestic actors can be powerful political forces in favor of keeping those rents even at the cost of public goods foregone. Although often overlooked by analysts focusing on international markets, the battle for rents is also fought in the domestic

[9] See the position taken by the Partido de la Revolución Democrática (PRD) on Mexico's energy reform,,"La izquierda mexicana está unida en la defensa del petróleo nacional: Sandoval," Nota N° 3760 Fundar: Centro de Análisis e Investigación, http://www.fundar.org.mx/c_e/notas.htm, September 20, 2009.

[10] Merrie Gilbert Klapp, *The Sovereign Entrepreneur: Oil Policies in Advanced and Less Developed Capitalist Countries* (Ithaca: Cornell University Press, 1987), 76-81 and 92-93; Osmel Manzano and Francisco Monaldi, "The Political Economy of Oil Contract Renegotiation in Venezuela" in *Populism and Natural Resources*, eds. William Hogan and Federico Struzenegger (Cambridge: MIT Press, 2009).

political arena: between elite and poor, rural and urban populations, organized and unorganized labor, large and small businesses, and a variety of other distinctions within the producing country that have political salience.

The distribution of rents is particularly conflicted when contracts have not been designed to deal with upward price volatility.[11] Rents are appropriated by the resource owner of the asset largely in two ways: royalties and taxes. (Other means of appropriating rents include dividends paid by NOCs, increasing a company's cost of business through redundant employment policies, domestic content requirements, and responsibilities for social programs, bonuses, etc.) The distribution of rents also becomes an issue domestically when important sectors of society believe that they have not been receiving revenues commensurate with their development needs. When society questions the representativeness of their public agents, the question of appropriation of rents for private or public benefit can polarize politics and policymaking.

Resource nationalism is not simply a means by which government leaders might enrich themselves and their cronies by selling the resource. The goal of RN is to maximize rent appropriation to benefit national development; the means is by government setting the terms for exploration, production, transportation, and distribution of energy. In addition to the rent distribution issue noted above, two other matters dominate the resource nationalism agenda.

The issue that has gotten the most attention in contemporary times is who should extract the resource, public or private firms. Since rents can be appropriated simply through various forms of taxation of private enterprises or, more directly, by having a state-owned enterprise (SOE) involved in the production and distribution of the resource, resource nationalists could favor either. Each mechanism has its own advantages and disadvantages. Taxes on private enterprises could be set at levels that still provide incentives for efficient upstream and downstream operations, but private companies have information asymmetries that could result in the government appropriating less rent than expected. If the state sets up its own NOC, it can theoretically appropriate all the rents, but the reality is that NOCs are less efficient than private

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[11] Osmel Manzano and Francisco Monaldi, "The Political Economy of Oil Contract Renegotiation in Venezuela," in *Populism and Natural Resources,* eds. William Hogan and Federico Struzenegger (Cambridge: MIT Press, 2009).

firms, so the state loses potential earnings via this route. Resource nationalists who prefer the NOC route to rent appropriation can be usefully characterized as "statists" because they prefer to err on the side of too much government intervention; those who promote more effective government regulation of private actors to capture rents are best identified as "reformers" within a RN perspective. (In Latin America, those who believe that markets should function with minimal government oversight are identified as neoliberals; today none of the major countries in the region is governed by advocates of this position.)

The third issue dominating the RN agenda is to which market (foreign or domestic) the resources should flow. Resource nationalists could seek to export as much as possible and to maximize rent appropriation in order to invest in public goods for the benefit of the nation. In more radicalized versions of resource nationalism, however, a distinction is made between markets for the elites and benefits for the people. Exports can generate rents that elites use to maintain a polarized social structure that permits them to accumulate political and economic power. Hence, radicalized resource nationalists want the resource distributed at home first to meet the needs of the people at the bottom of the social scale.

Energy Security

Turning to the second of our key concepts, energy security embodies a claim for government action to protect national economic activity from shocks emanating from the international market. Adjustment to a price shock from the international market could be market-based (decreased use of this resource via either increased efficiency or reduced activity and a search for alternative sources of energy). The time required for and the difficulty of increasing efficiency and developing alternatives create adjustment costs that are not simply economic, but also include social dislocation where jobs, consumption, and investment are affected; in addition, political realignment, or even upheaval pursuant to a major social and economic adjustment process, is also a source of concern to governments and their constituencies. Therefore, the usual response to the external shock is not to let the market determine adjustment, but to adopt public policies to mitigate at least some of those costs while market adjustments unfold.

The point of attempting to structure an energy policy to promote ES among consuming countries is to minimize the adjustment costs that a reduction in volume or an increase in price has on the national economy. This defense of the domestic economy can be pursued via government regulation of private companies or consumers in national energy markets, or through direct state provision of energy at subsidized prices. In either case, the policy goal of energy security implies subordination of other policy goals (e.g., production of food, environmental protection, or increased competitiveness of the national economy in world trade) to a more aggressive pursuit of domestic supplies, price controls, and trade restrictions. In the United States, for example, in the name of energy security we subsidize the domestic production of corn-based ethanol and have high tariffs on the import of more efficient sugar cane-based ethanol.

While the concept of energy security first came to the fore in the United States and Western Europe after the Arab oil embargo of 1973, it is an old concern in Latin America. Already in the 1920s major countries in the region were concerned about it. As the international market began to shift into surplus in the late 1920s, and major oil companies colluded among themselves to protect market share, their production in high-cost Latin America (Venezuela was the only low-cost producer) declined. Latin American countries had to use scarce foreign exchange to meet domestic demand for crude or petroleum products at high oligopolistic prices. In addition, the U.S. and British governments used access to loans (e.g., Colombia in the 1920s), the potential to let rebels purchase arms (e.g., Mexico and Colombia in the 1920s), and diplomatic sanctions (e.g., the British against Mexico after the 1938 nationalizations) to pressure Latin American governments to accept their countries' role in the global business plans of the major oil companies. Recent debates regarding the future availability of oil and gas reflect both skepticism about whether the Earth is running out of resources and concern for the environmental impact of hydrocarbons. Thus, the search for answers today focuses on alternative sources of energy, as well as on traditional sources. This difference has important ramifications since both consuming and producing countries are now concerned about how unfavorable market forces might impact the national welfare and security.

From the exporter's perspective, the ES issue is whether the demand for oil and gas, and hence national earnings, will be significantly reduced if a deep and global recession occurs or if more environmentally friendly sources of fuel become widely available.[12] The loss in export revenue could produce similar economic, social, and political adjustment issues for exporting countries as described above for importers when the oil and gas markets are tight. In major exporting countries, the specific route through which the impact is felt is often via a reduction in the rents that had permitted the government to subsidize consumption of energy goods or to absorb a great deal of low-skilled labor. In both Venezuela and Iran, riots broke out when governments attempted to raise extremely low gasoline prices because export revenues were no longer sufficient to cover the cost of the subsidies.[13]

The Relationship Between Resource Nationalism and Energy Security

With the definitions of RN and ES clarified, let's examine the complex relationship between the two at both the national and international levels. Under certain circumstances, a producing country pursuing ES via cheap domestic energy can undermine RN by lowering the profitability of the industry to the point that reserves are depleted and no new exploration is undertaken by private firms; this is especially problematic because the NOC is usually too inefficient and unskilled to pursue the requisite E&P. On the other hand, pursuing RN can undermine ES by diminishing private investment and giving more control to a less effective NOC, resulting in decreased productive capacity and, ultimately, supply shortages. At the international level, the pursuit of ES by importing countries can fuel short-term strategies by producing countries to capture more rents now (RN) before alternative sources of energy can be adopted on a large scale. And, of course, large doses of RN in exporting countries can fuel increased efforts at ES in importing countries. Yet, moderate levels of RN and ES can work together by creating a stable level of political support in producing countries to export, and by convincing the public in importing countries that oil and gas are scarce resources with high values whose use should be more efficient.

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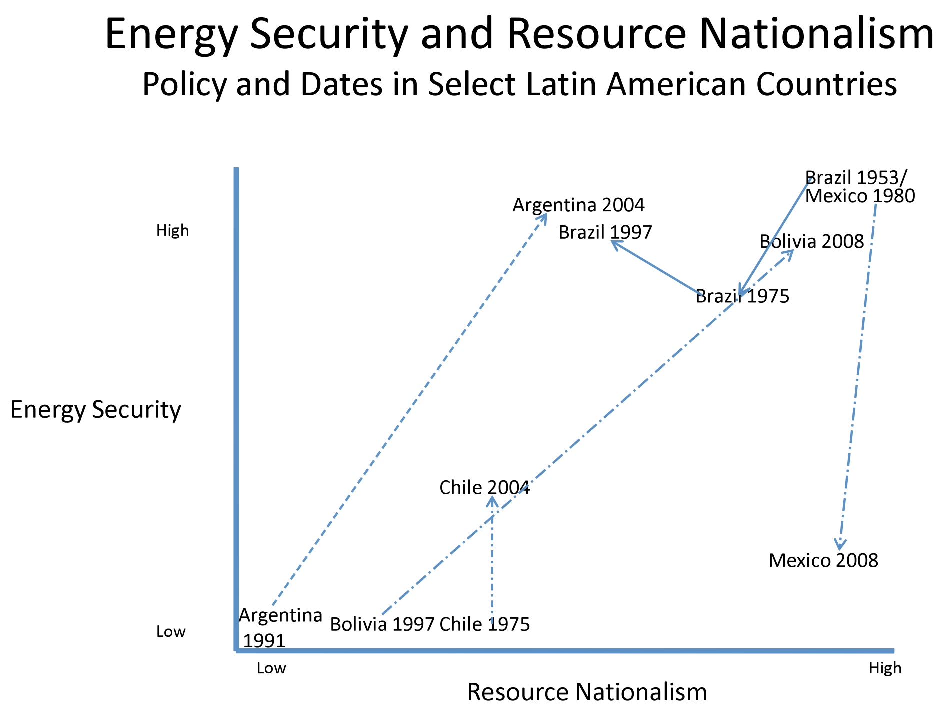
[12] See HRH Faisal Bin Turki, "Perspectives on the Saudi Arabian Energy Industry," Royal Institute of International Affairs in London, U.K. on December 2, 2000, *http://www.saudiembassy.net/archive/2000/speeches/page0.aspx*, accessed September 20, 2009; Jad Mouawad, "Saudi Officials Seek to Temper the Price of Oil," *New York Times*, January 28, 2007, http://www.nytimes.com/2007/01/28/business/28oil.html.

[13] Riots in multipleVenezuelan cities in 1989, known as the Caracazo, killed hundreds and forced the president to declare a state of emergency. Moises Naim, *Paper Tigers & Minotaurs: The Politics of Venezuela's Economic Reforms* (New York: Carnegie Endowment, 1993); Marc Wolfensberger, Bloomberg, "Tehran Revolts, Iran Rations Gasoline, Sparks Protest in Tehran," June 27, 2007, http://www.bloomberg.com/apps/news?pid=20601091&sid=a9HiN8aoQngM&refer=india#, accessed September 20, 2009.

Graph 1 illustrates relationships between RN and ES in Latin America and shows that they can change over time.

Graph 1.



Thus, for example, contemporary Mexico illustrates the case of resource nationalism with little energy security—the country maintains a monopoly for Pemex; permits service contracts in natural gas; and currently imports natural gas and gasoline, with crude perhaps to follow within a decade. However, in 1980 the country's energy policy scored high on both ES and RN—Mexico maintained a monopoly for Pemex and limited exports. Chile in 1975 had an energy policy with moderately low RN (the country allowed foreign participation in everything except oil production, if any resources were discovered) and very low ES (its NOC, ENAP, operated in a competitive market). After Argentina cut natural gas exports in 2004, the Chilean government became more proactive in securing energy supplies, but still left the bulk of the effort to the private sector, hence the country's moderately low RN and moderate ES. In 1975, Brazil reduced a focus on RN, which had dominated policy since the establishment of a monopoly for Petrobras in 1953, to permit risk contracts with private firms as part of its increased drive for ES. In 1997, with the same concerns about ES, Petrobras was partially privatized, joint ventures with other companies were permitted, and the NOC monopoly on imports was terminated, thus representing a further decrease in RN.

Bolivia went from one extreme to the other. In 1997, it privatized its NOC (YPFB) with no stipulations for extending the inadequately small domestic market; but in 2008, with a reconstituted NOC, Brazil dramatically increased taxes and royalties and insisted on the expansion of the domestic market.

The combination of little resource nationalism or energy security was illustrated in 1991, when Argentina's congress passed legislation to begin the privatization process for its NOC (YPF) and the government of Carlos Menem (1989-1999) favored complete market adjustment for exports and the domestic market. RN became a moderate policy goal in 2004 when the new NOC, ENARSA, was created to compete in the market; ES simultaneously became a prime goal when exports were discouraged via taxes and quotas.

The Political Economy of Latin American Energy Policy

Policy is Politics

Any discussion of energy policy should begin with an understanding and appreciation that public policy is politics. Public policy is about making tradeoffs among desirable goals; the priorities that determine those tradeoffs reflect what people in the society want and the costs they are willing to pay.

To put the Latin American experience in perspective, it is useful to begin by looking at some elements of U.S public policy on energy. For instance, the United States has a great deal of oil and natural gas in the Alaskan National Wildlife Refuge (ANWR); Congress has severely limited access to multiple Alaskan sites largely in favor of environmental priorities. California has significant offshore natural gas reserves and a long coastline that could accommodate LNG regasification terminals. But Californians have successfully lobbied Congress and the state legislature to effectively prohibit offshore drilling and construction of LNG facilities; the state therefore pays higher prices for its energy-rich lifestyle to attain both environmental and perceived safety goals. While vested interests influence these policies, none of these tradeoffs are irrational or imposed on the public; they are simply the result of the priorities of U.S. and California citizens.

Latin Americans also have multiple goals and debate priorities. There is agreement across the political spectrum that countries face many challenges in today's energy market and that current policies are not adequate. But in deciding how to effectively respond to these challenges, Latin Americans are finding they have to decide how they will balance issues of control (overproduction rates and the distribution of rents), the domestic distribution of export revenue, and their own energy security. We should not be surprised, therefore, that energy policymaking in the region is slow and contentious.

Explaining Latin American Energy Policy

The context for an energy policy is set by geology, the international market for oil and gas, and the country's macro-history, but the specifics of energy policy, that is, how much resource nationalism and energy security inform the government's policy in the energy sector, is determined by the degree of inclusiveness in the political system, the competitiveness of politics, and the innovative and risk-taking characteristics of the leader. These three variables will interact to make more or less likely the choice of an energy policy that emphasizes RN and ES.

Sustainability of the policy chosen is determined by the capacity of the government to turn oil and gas-generated rents into public benefit. These are not just academic lessons, nor relevant simply to countries that have chosen extreme positions on resource nationalism and energy security. After taking a moderate position for a decade, Brazil is reconsidering its energy policy in light of the immense oil and gas discoveries in the country's pre-salt layers. On the pro-market side, Peru is in great danger of having its successes in exploration, production, and the development of export markets for its natural gas overthrown in the streets by a public unhappy with the distribution of benefits so far. Thus, understanding a nation's standing on the following three variables will shed light on policy choice and sustainability.

Inclusiveness

Inclusion is defined not in terms of who the system claims to represent, but in terms of who has the ability to influence the selection of a government and its policies. Groups that are included are "empowered" [14] within the system. Inclusion, therefore, is determined by the provision of public goods that address those interests, as well the provision of private goods to that group. Voting alone is insufficient to demonstrate inclusiveness[15]—the 1990s saw a number of presidents elected in Latin America on anti-liberal platforms and, once in office, they adopted those policies against which they had campaigned.[16]

In the contemporary era, the poor and the indigenous have been empowered and demand participation as independent actors and not just as symbolic beneficiaries. Riots in the streets can bring down presidents (e.g., Ecuador in 1996, 2001, and 2005; Bolivia in 2003 and 2005; and Argentina in 2001) or save them (e.g., Venezuela in 2003), but the impact of the rioters on what policy is actually adopted depends upon their having access to the institutions where policy is made.

The impact of the "inclusiveness of political system" variable, *ceteris paribus*, on energy policy stability and character is outlined below. Note that while inclusiveness is desirable morally and politically, unless counterbalanced by the "competitive and leadership" variables discussed later in this paper, it will produce poor energy policy.

- Political systems that exclude significant portions of their politically active groups will be unstable (voting is not sufficient to constitute inclusiveness), and thus their energy policy will be unstable.
- Political systems that exclude significant portions of their politically active groups will be more likely to favor rent appropriation for provision of private over public goods.

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[14] See Angelo Bonfiglioli, *Empowering the Poor* (New York: United Nations Capital Development Fund, 2003), especially pages 41-58. http://unpan1.un.org/intradoc/groups/public/documents/un/unpan010168.pdf, accessed September 20, 2009.

[15] Consequently, the concept of a "selectorate," used by Bruce Bueno de Mesquita and his collaborators, is broader than my category of "the included." See Bruce Bueno de Mesquita, James D. Morrow, Randolph M. Siverson, and Alastair Smith, "Policy Failure and Political Survival: The Contribution of Political Institutions," *The Journal of Conflict Resolution* 43, no. 2 (April 1999): 147-161.

[16] Susan C. Stokes, *Mandates and Democracies: Neoliberalism by Surprise in Latin America* (Cambridge: Cambridge University Press, 2001).

– If the exclusionary coalition favors capital, there will be less RN and ES, with a proliferation of unregulated private monopolies and oligopolies.

– If the exclusionary coalition favors labor, there will be more RN and ES, with NOCs under direct control of the government.

- Political systems that are highly inclusive will have governing coalitions that are correspondingly larger, and thus will generate pressures for greater control of rents in order to have resources to reward members.

  – Inclusiveness pulls in the direction of greater resource nationalism.

  – Inclusiveness pulls in the direction of greater energy security.

- Political systems that are highly inclusive will have broad political support, and thus:

  – As long as market conditions generate high rents, their energy policies will be stable.

  – If market conditions soften and rents fall, their energy policies will be unstable as governments seek ways to squeeze more rents out of a smaller pie to support the level of private goods they have been distributing.

Competitiveness

The second key variable in the model addresses competition for control of the deliberative body that makes policy: does it alternate among rivals, or remain under the control of a single constituency, that is, the groups and individuals who support the people in office? A constituency wants the people it supports in government to make public policy in their specific interest—if public goods are produced along the way, fine, but businesspeople and homeowners want tax breaks, unions want benefits for unionized workers, and so forth. Investing the nation's wealth in physical and human infrastructure may be beneficial to society as a whole, but a politician's constituency may very well demand private goods. The natural constituency for public goods is rare and limited; think of a philanthropist.

It shouldn't be a surprise, then, that in Latin America the recently included poor and indigenous groups want private goods to be allocated in the name of justice and national development. After almost 200 years of their country's independence, the poor and indigenous continue to lack decent and stable employment, education, and health care because governments have historically emphasized providing private goods to the elites and middle class, and invested little in public goods.[17] It is hard for these newly empowered groups, therefore, to perceive their demands for private goods as unjust or problematic. When these groups comprise significant numbers of the citizenry in a country with large reserves of natural resources (the percentage of people living below the poverty line ranges from Brazil's 31 percent to Bolivia's 60 percent for all of our cases, except Argentina's 23 percent),[18] it is difficult for leaders who hope to get elected or re-elected to argue that reforming public policy in a manner that is sustainable over the medium to long term is better than simply redistributing today's wealth. Those who wish to lead these newly included groups will find it necessary to emphasize their ability to provide private goods immediately and significantly (e.g., ordering an agency to install a health clinic in a district because of the way it voted rather than its assessed ranking in terms of health care needs).

Despite the fact that constituencies are self-centered, some governments manage to work with markets in ways that promote efficiency and effectiveness, while others largely promote the private gain of their constituencies. Political competition within the deliberative body that designs policy (e.g., the legislature in a democracy) is the key to getting politicians to view the delivery of public goods as furthering their career interests.[19] Competition is determined by whether control over the deliberative body and presidency shifts between rival political forces.

Competition for control of the deliberative body affects the private-public tradeoff in public policy in multiple ways, though it only reduces—rather than eliminates—private goods.[20] Since democratic governing coalitions consist of multiple partners, it is difficult to build one capable of winning at the national level and rewarding each partner solely with private goods; hence, the coalition will seek to generate public goods, as well. In addition, when rival political groups are evenly balanced, they will have equal access to patronage. Distributing patronage in this

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[17] Gustavo Márquez, et al., *Outsiders? The Changing Pattern of Exclusion in Latin America and the Caribbean* (Washington, D.C.: Inter-American Development Bank, 2007).
[18] CIA, *World Factbook,* www.cia.gov/library accessed November 11, 2009. Figures are for 2005 and 2006.
[19] Barry Ames, *Political Survival: Politicians and Public Policy in Latin America* (Berkeley: University of California Press, 1990); Barbara Geddes, *Politician's Dilemma: Building State Capacity in Latin America* (Berkeley: University of California Press, 1994); Pablo T. Spiller, Ernesto Stein and Mariano Tommas, *Political Institutions, Policymaking Processes, and Policy Outcome: An Intertemporal Transactions Framework* (Washington, DC: InterAmerican Development Bank, April 2003).
[20] Agricultural subsidies in the European Union and the United States demonstrate that democracies are not immune to providing private goods at public expense.

situation provides no relative advantage. The development of state capacity and the provision of public goods provide only a short-term advantage with the voters. Competition also diminishes the cost of losing an election. Because no coalition can be sure of winning the next time, chances are that the winning coalition today will not use its position to institutionalize increased patronage to the party in power; without dominating patronage distribution, the winning coalition will find it difficult to break the competitive cycle.

Finally, competitive political systems are more likely to develop independent legal systems to protect what is broadly known as property rights—which include not only physical property, but contractual obligations and civil rights. Since everyone knows that, at some point, their group will not be running the government, they will want protection from the times when others are in office and thus will seek to institutionalize the rule of law.

With reference to energy policy, once politicians decide that satisfying their constituencies requires the use of natural resource rents for the production of public goods, they need to build the state capacity to generate, capture, and use those rents. In the energy sector, the promotion of an effective energy policy includes creating competition in exploration and production, open access to transportation pipelines, and effective regulation at times when natural monopolies form and operate. In the case of countries with a national oil company, the public goods provision is furthered not only by making it compete with other companies, but also keeping it independent of the patronage needs of government and insuring that it has sufficient capital to operate effectively.

The impact of competitiveness on energy policy can be usefully summarized as follows:

- A political system with low levels of competitiveness will develop an energy policy that produces private goods for distribution to the dominant coalition's constituency.
  - – If the dominant coalition favors the private sector, energy policy will score low on RN and ES, but there will be little effective regulation, and monopolies will characterize the energy sector.
  - – If the dominant coalition favors the poor, energy policy will score high on RN and ES, with little effective regulation to prevent the NOC from essentially

serving as a mechanism for the distribution of private goods to the coalition's constituency.

- The more competitive the political system, the less energy policy will be characterized by resource nationalism and energy security.

  – Both RN and ES generate (see earlier discussion), as well as appropriate, rents. In a highly competitive environment, leaders focus on providing public goods and will be concerned about their long-term credibility with investors. Hence, they will not seek to modify contracts retroactively every time prices rise (a characteristic of RN); nor will they introduce supply-focused regulations that generate rents at the expense of increasing supply (a characteristic of ES).

  – Groups and leaders in a competitive system will be less likely to attempt to capture maximum rents in the short-term because their need to reward constituencies renders them more public goods-oriented.

- An independent and effective regulator is more likely to be established if the political system is competitive.

Leadership—Innovation and Risk Acceptance

The third and final key variable relates to whether a country's leader is innovative and willing to accept risks. Political leaders function within varying constraints; they may retain important discretionary capacities and, therefore, have an ability to make a fundamental difference in policy.[21] Leaders are not just a sounding board for their constituencies; they may be able to tap into the demands of those who are, or could become, politically relevant. Whether or not leaders can take advantage of opportunities to innovate within the constraints or push beyond them depends on their personal characteristics for innovation and the acceptance of risk.

Innovation in policy is the development of a new vision or strategy, not just the offering of an alternative idea. It is defined in the national context and thus is determined by whether anyone in leadership positions has pushed these policy positions in the past. Risk acceptance is determined by whether the leader takes proposals against the perspectives of his own party or constituency

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[21] Merilee S. Grindle and John W. Thomas, *Public Choices and Policy Change: The Political Economy of Reform in Developing Countries* (Baltimore: Johns Hopkins University Press, 1991).

(moderate degree of risk), or the leader challenges key government actors (Congress, the Supreme Court, or the military) who could cause his impeachment or overthrow (high degree of risk).

Innovation is an important characteristic that determines whether a leader is seeking to follow or restrain markets. Creating an independent regulatory agency is innovative in the national context because it dramatically alters existing patterns of rent appropriation and distribution. It is also risky because the expected increase in production and rents will be the result not only of the incentives provided by the government (and therefore controllable), but also geology and the state of the international market (circumstances that leaders do not control). If an innovative leader is seeking to restrain the market (private investment or consumption), she will have a plan for either effectively replacing private actors or creating incentives to induce them to adjust their business plans in accordance with the new policy.

Risk acceptance is important for two reasons. If a leader has new ideas but is timid about putting them on the agenda, institutional constraints will determine whether he puts forth the proposals. Only under very loose constraints will a risk-averse leader propose new ideas that do not have the possibility of immediate support. In contrast, a leader who is risk-acceptant and has new ideas will be quite willing to seek to create the political conditions that mitigate the institutional constraints. The combination of risk acceptance and lack of innovation is dangerous; it suggests a leader who is willing to push ahead on poorly conceived new ideas or ideas from a failed past. The leader who is both innovative and risk acceptant fits the category others have labeled a "political entrepreneur." A political entrepreneur characterized by a high degree of risk acceptance is a "radical," and she may be radical in the advocacy of pro-market or statist positions. The moderately risk acceptant leader, in turn, fits Hirschman's classic category of a "reformmonger,"[22] and could advocate pro-market or statist reforms.

These personal characteristics affect energy policymaking in the context of the inclusiveness and competitiveness of the political system. Table 1 illustrates the relationship between leader characteristics and institutional constraints.

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[22] Albert O. Hirschman, *Journeys Toward Progress* (New York: Norton, 1973).

Table 1.
Leader Characteristics and Institutional Constraints

		Risk Acceptant? Yes	Risk Acceptant? No
Innovative?	Yes	Pushes new ideas while seeking to alter institutional constraints	If institutional context is permissive, pushes new ideas
	No	Takes full advantage of institutional permissiveness to put issue on agenda but pushes old ideas	Reacts to events by sticking to traditional policy positions; strong hand of history

An understanding of the independent power of each of the three variables—inclusiveness, competitiveness, and leader characteristics—permits us to detail how their interaction will affect energy policy. Three potential combinations are particularly interesting and relevant to the investigation of Latin America's likely contribution to future global oil supplies:

Combination 1
High Inclusiveness + High Competitiveness + Innovative and Highly Risk Acceptant Leader → Leader will push for ways to get around deliberative body's constraints to provide private goods for constituency (high on RN and ES), but energy policy will be unstable. (Example: Hugo Chávez in Venezuela, 1998-2002.)

Chávez' governing coalition has been built on the poor who had voted in the past, but nonetheless bore the brunt of the austerity programs adopted by governments when oil prices fell in the 1980s and 1990s. Chávez depends significantly upon not only the periodic vote of the poor, but their willingness to take to the streets and engage politically every day in their neighborhoods and workplaces (high inclusiveness). In the early period of Chávez' rule, from 1998 to 2002, the opposition and Chávez both perceived the possibility of electoral defeats (high competitiveness), and Chávez was clearly innovative and highly risk acceptant (e.g., his 1992 coup attempt against what was widely perceived as a stable democratic system was the first in over 30 years and did not include the senior military officers). Chávez made initial moves in the direction of RN with a new petroleum law in 2001, but did not implement it and did not restructure PDVSA despite having difficulties with a succession of the NOC's presidents. Energy policy was stable despite uncertainty raised by the new petroleum law.

<u>*Combination 2*</u>

High Inclusiveness + Low Competitiveness + Innovative and Highly Risk Acceptant Leader → Leader will have free hand to provide private goods for constituency (high on RN and ES); stability of energy policy will depend on market conditions. (Example: Hugo Chávez in Venezuela, 2003 to present.)

In this case, the opposition rallies in the streets, has access to print and online media (though the extent of this has diminished over time), can run in elections (again, with increasing restrictions on specific individuals), and can vote. (This set of characteristics constitutes high inclusiveness since politicians will represent government and opposition voters.) The April 2002 military coup and the petroleum workers' strike that paralyzed PDVSA in December of that year, and that was supported by the civilian opposition, indicate that the opposition no longer saw the possibility of winning elections (low competitiveness). Chávez has since been free to move increasingly into an RN and ES direction by raising taxes, nationalizing the heavy oil projects and some service company operations, and threatening greater nationalization if service contracts are not renegotiated in line with the decline in oil prices.

The determinants of the most efficient and effective energy policy are illustrated in the third combination considered here. The inclusive nature of the political system means that every major group in society believes that they are represented in the political system to the extent that their needs are given serious consideration in all relevant policies. Each group would prefer that policy be made in its own interest, i.e., provided private goods, but will make use of public goods as well. But because politics is competitive and the constituencies of politicians are large (due to the inclusive character of the political system), politicians are pushed in the direction of designing policy that produces more public than private goods. (No political system can ever eliminate the provision of private goods.) The provision of public goods means that society as a whole is receiving benefits, thus consolidating the inclusiveness of the political system. The innovative but cautious leader can discover a focal point to bring competing forces in the legislature together, but will not push his own constituency's agenda in a game of chicken with the legislature.

Combination 3

High Inclusiveness + High Competitiveness + Innovative and Moderate Risk Acceptant Leader → Leader will accept the demands from Congress for the provision of public goods as a way to meet the demands from a highly inclusive constituency (lower levels of RN and ES). President will be a key advocate of innovation in energy policy, especially in regard to an independent regulator. Energy policy will be stable. (Example: Alvaro Uribe in Colombia, 2002 to present.)

The Constitution of 1991 significantly increased the inclusive character of Colombia's democracy. Uribe is innovative (he dramatically altered the government's strategy in fighting the FARC and FLN guerrillas) and he is moderately risk acceptant (his pursuit of a constitutional amendment to permit his reelection to a third term has been slow and cautious). Energy policy has moved significantly away from RN and ES in Uribe's two terms in office. In 2002, royalties were decreased; in 2003, the mandatory 30 percent share for the NOC in all projects was eliminated; in 2004, an independent regulator was created; and in 2007, 10 percent of shares in the NOC were sold to the public. The pro-market orientation of the Uribe government has not been seriously questioned and his public standing remains high at the end of his two terms in office.

Fernando Henrique Cardoso of Brazil (1995–2002) is another innovative but cautious leader. While Minister of Planning he devised the Real Plan to halt hyperinflation; as president, he pursued the privatization of state-owned enterprises (SOE) and the establishment of an independent regulatory agency in the energy sector. But when Congress and society indicated an unwillingness to pursue that path in the energy sector, he settled for breaking the Petrobras monopoly and selling shares in the NOC without surrendering management control.

Latin America's Contemporary Oil Geopolitics

What does this analysis suggest about contemporary energy policy in the region and its impact on global oil supplies? The global supply context was extremely favorable for energy exporters over the past five years, and though prices fell significantly at the end of 2008, they seem to have recovered to a still-high $70 per barrel level. Yet in the past, high petroleum prices contributed to severe economic and political challenges within the exporting countries, with disastrous results for the ruling coalition (e.g., Venezuela's traditional parties had trouble managing the 1973-1980 bonanza, and this failure contributed to their collapse in the 1990s). The needs of the poor are so immense, and the appetites of the military and some political allies are so great, that a leader's policies can easily exceed the parameters created by whatever revenues oil brings to their countries.

Oil exporters who find themselves overstretched financially and under pressure from their political constituency may seek to transfer to international energy markets as much of the cost as possible of confronting a domestic economic and political crisis. If adopted, this strategy will push energy policy to the RN and ES extremes. Included in this category are likely to be the governments of Chávez in Venezuela and Correa in Ecuador. Néstor Kirchner (2003-2007) and Cristina Fernández de Kirchner (2007-present) in Argentina may be pulling away from populism, given their defeat in the 2009 congressional elections. Lula is being tempted to move further along the RN and ES axes, but will be limited by the competitive nature of Brazilian politics. With no chance for reelection to a third term, however, he might try to use his executive powers to push beyond congressional constraints. But without the support of Congress, he won't be able to nationalize existing contracts and may have to exchange Petrobras monopolies in transportation and distribution to secure an effective nationalization of the pre-salt reserves. Colombia seems likely to continue on a path that is low on both RN and ES. The Colombian constitution of 1991 facilitated incorporating the poor and indigenous into the system in a stabilizing fashion. Mexico is also likely to move in a centrist direction on energy policy after the PRI's (Partido Revolucionario Institucional) 2009 congressional victories and the demise of the PRD (Partido de la Revolución Democrática), since Pemex lacks the capital and skills to develop the Chicontepec field in the short-term and the Gulf of Mexico in the medium-term. Since PRI has the potential of regaining the presidency in 2012 after 12 years out of power, one should expect the party to support reforms now so that the new president can enjoy its fruits.

We should consider some scenarios for the short- to medium-term in more detail, highlighting the three variables, as we think about how Latin American energy policy could impact global energy markets, IOCs, and the United States. The challenges posed by countries led by statist leaders and scoring high on RN and ES draw our attention first; then we move on to the energy policies of countries that are led by reformists and characterized by lower levels of RN and ES.

In recent history, democratic neoliberal leaders Menem in Argentina, Sánchez de Lozada in Bolivia, and Alberto Fujimori in Peru (1990-2000) represented the extreme versions of market orientation (not even the neoliberal military dictatorships in Argentine [1976-1982] or Chile [1973-1989] privatized their NOCs, as did Menem and Lozada). But neoliberalism is currently in disrepute in the region (the Argentine is in disgrace, the Bolivian is under indictment for deaths resulting from his order to suppress street demonstrations, and the Peruvian is serving 25 years for corruption and human rights violations), and so it is not relevant to speculate about neoliberal scenarios for the near future. Three scenarios are worth considering within the statist and reformist groupings: leaders consolidate their rule, leaders find their rule likely to be limited, and leaders are forcibly ejected from office by the violent protests of the opposition.

The Statists

<u>Scenario 1: Statists monopolize the government</u>

Among Latin American oil exporters, this scenario is relevant to contemporary Venezuela and Ecuador because statists have won landslide elections and reelections; both Chávez and Correa have high levels of risk acceptance. Scenario 1 requires that international oil prices remain high enough to permit these administrations to extend their inefficient provision of social services to the poor, as well as appease their militaries. It also requires that Chávez and Correa be successful in creating umbrella organizations that subsume all of the political parties that support their governments under their direct control. As a result, support for the statists will continue to soar and their political allies will continue to see the benefits of reinforcing their respective leader's legitimacy and control. In terms of our model, the inclusiveness of the political system is high, the competitiveness of politics is low, and these two leaders are not only innovative but also quite risk-acceptant.

In this situation, oil supplies to international markets will slowly decrease as investment dries up in the face of greater returns to the governments and the poor, with corresponding increases in costs to other consumers, governments, and IOCs, even within Latin America. One should expect the oil geopolitics of these countries to have the following characteristics:

- Leaders will work to strengthen OPEC in accordance with the strategy of maintaining high prices.
- These leaders will work together to strengthen regimes opposed to U.S.-led globalization. Only Chávez can deliver on aid, however, and he is unlikely to be as generous as his rhetoric because of domestic needs (social programs as well as infrastructure investment) and the declining productivity of PDVSA.
- The promotion of Latin American and Caribbean energy integration centered on Venezuela will slow as a result of diminished resources and increased tensions within the region.
- These leaders will seek E&P alliances with NOCs of like-minded governments as a way of pressuring both the U.S. government and the IOCs to negotiate political and economic relationships closer to the resource nationalists' preferred terms.
- Venezuela and Ecuador will continue to export to the U.S. market even as they seek to complement it with new markets because the U.S. market is the most profitable for both countries. But exports to the United States will decrease as a result of the above-mentioned decline in production, and the alliances with NOCs seeking to supply domestic over world markets.

<u>Scenario 2: Statists remain in power, but politics grows more competitive, thereby raising the possibility that they will lose the next election</u>

This scenario has two versions, depending upon whether the statist leaders are moderately or highly risk acceptant. The scenario applies to Argentina after the summer 2009 legislative elections, but could also apply to Venezuela and Ecuador if a decline in oil revenues undermines their populist programs, to Mexico if the nationalist wing of the PRI wins the 2012 presidential election, and to Colombia and Brazil if the next presidents are statist.

2a: Moderately Risk Acceptant

These leaders (Brazil's Lula, Argentina's Cristina Fernández de Kirchner, and potential successors in Brazil, Argentina, Mexico, and Colombia) recognize the limits to promoting resource nationalism and energy security and focus on consolidating the gains already achieved. We can see the impact of the political context on Lula's new proposals for dealing with the oil and gas deposits discovered in the pre-salt layers. The need for congressional approval and capital to finance the extraordinarily costly E&P, as well as the public and private goods Congress will be expected to generate in light of these oil riches, mean that even a president who comes from the Worker's Party on the left isn't using the specter of a bonanza to join the ranks of the statist resource nationalists. His proposal thus requires private investors to associate with Petrobras in parts of the gigantic Tupi field but not elsewhere, and is not retroactive. The private sector is thus expected to continue to be a significant partner.[23] The Kirchners in Argentina, meanwhile, seem to be moderating in the face of growing opposition over the last year, culminating in their recent losses in congressional elections.[24]

The energy policies of these moderately risk-acceptant statists will be stable and will seek to increase the role of the private sector, albeit under continued state supervision. In the Mexican case, private participation in the oil sector will continue to be limited to the provision of services to Pemex, but the terms will have sufficient incentives to bring private firms into the service contract regime. The promotion of the domestic market over exports (ES) will become restrained. As a result, oil supplies to the global market should grow moderately.

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[23] "Brazil's oil policy: Preparing to spend a 'millionaire ticket' from offshore," *The Economist,* September 3, 2009, http://www.economist.com/world/americas/displaystory.cfm?story_id=14370680, accessed September 16, 2009.

[24] "Price liberalisation spurs gas-drilling activity in Argentina," *Petroleum Economist,* September 2009, http://www.petroleum-economist.com/default.asp?page=14&PubID=46&ISS=25466&SID=721904, accessed September 20, 2009.

The oil geopolitics of the moderate statists facing domestic political competition should have the following characteristics:

- If in OPEC (Brazil will join in this scenario), support the organization's efforts to promote higher prices but don't take a leadership role. Cheat on your quota when production increases.
- Offer IOCs a small improvement in contract terms without undercutting the NOC.
- Seek alliances with NOCs of "respectable" countries (e.g., no to Iran or Russia, but yes to China).
- Stay out of the fray between the United States and regional countries seeking to promote anti-American alliances.

2b: Highly Risk-Acceptant

These statist leaders (Chávez and Correa, potential successor in Brazil, but unlikely in Colombia or Mexico) must retain enough control over the military and enough influence among the poor to convince opponents that they cannot be overthrown, even as politics radicalize. But their rule would be unstable because, in this scenario, they cannot capture enough resources to satisfy their constituencies (the deliberative body is competitive), and the opposition retains control over some key assets that enable them to speak and act against the government (the system is inclusive). In this context, the high risk-acceptant leaders will be frustrated and worried that they might be overthrown at some point or that they will lose the next legislative or presidential election (Mexico does not permit reelection). They will increasingly lash out against their "enemies" and seek to squeeze even more out of private investors using executive powers in order to materially and ideologically placate their supporters.

In this situation, the supply to international markets from these countries will be unstable, with a tendency downward as politicization of their NOCs and the transfer of its resources toward social and military programs increase even more. Under these conditions, one should expect the highly risk-acceptant statists' oil geopolitical strategy to have the following characteristics:

- Leaders will work to strengthen OPEC in accordance with the strategy of maintaining high prices. Brazil would join OPEC.

- Countries will see continued instability in contract terms with IOCs because the NOC's inefficiencies will limit its productive capacity at the same time that the statists' demands upon them increase. In the Brazilian case, Petrobras will be unable to contribute its share in the new production associations for the pre-salt projects and partners will be expected to front more of the costs.
- These countries will seek E&P alliances with NOCs of like-minded governments as a way of pressuring both the U.S. government and the IOCs to negotiate political and economic relationships closer to the resource nationalists' preferred terms.
- Countries will continue to promote anti-Americanism and instability both in the Americas and globally in order to encourage speculation that will drive prices higher, and to try to polarize domestic politics in order to increase the likelihood of building a dominant political movement.
- Countries will increase efforts to develop Latin American and the Caribbean energy integration centered on Venezuelan oil and gas, complemented by the promise of Mexican oil in the future. Because of Venezuela's vast resources and Chávez' promotion of "Socialism of the 21st Century," the statists will seek to convince their constituencies that Venezuela is able and willing to bankroll those who emulate him.

<u>Scenario 3: Statists are overthrown, with two sub-scenarios based on how the poor and indigenous respond</u>

This scenario is foreseeable in Venezuela and Ecuador, but relevant to the other oil exporters only if new statist leaders are highly risk-acceptant and promote the polarization of domestic politics in support of their policies. The scenario is likely to develop only in the context of a severe domestic economic collapse and a sustained decline of oil prices into the low $40 per barrel range or less. This would dramatically slow Mexican exploitation of its large Chicontepec field and the development of the Brazilian pre-salt fields because international sources of capital for those expensive and risky projects would dry up. An economic collapse can occur in Venezuela and Ecuador even with oil prices in the $50-$60 per barrel range if inflation accelerates in these countries, and oil output continues to suffer from lack of investment; neither Mexico nor Brazil is sufficiently dependent on oil revenues to suffer a similar fate merely because prices settle in at these levels.

In Venezuela and Ecuador, the poor and indigenous can be expected to take to the streets as the statists' largesse dries up. The military will be called upon by the governments to intervene, but they will be reluctant to use force. The political opposition will be rejuvenated. Radical statists will turn increasingly to violence to regain control of the streets, and the military will be forced to decide whether they are simply supporters of the current government or whether the time has come to declare that the statists have lost the ability to govern.[25] If the rioting is severe enough, the military will be expected to step in to "save" the country, though not to run it.

3a: Poor and indigenous demobilized

In this situation, the affected countries will likely increase their supply to global markets as the new governments will be more market oriented than the statists and will not face immediate demands from the poor and indigenous for benefits. These groups will become demobilized either because a repressive regime engages in massive human rights violations to terrorize them into demobilization, or because they are exhausted after the failure of the statists' experiments with direct democracy.

Policy will be unstable in the medium term, however, unless the new energy policy provides public goods and the poor and indigenous are reincorporated into the political system, Congress becomes competitive, and the new leader is both innovative and cautious.

- While not leaving OPEC, the new governments will push for higher export quotas and cheat on their own quotas.
- The new government will move away from RN and ES.
- The new leaders will draw their countries closer to the United States and seek to undercut regional support for the remaining statists.
- The NOCs will be returned to professional management and new relationships with IOCs will be sought to help the company recover and the country to export. Given the pent-up demand for infrastructure investments and private goods for elites out of power for a decade or more, these countries are likely to adopt export strategies that

[25] The Honduran political crisis of 2008 has nothing to do with energy politics. But the fact that the military stepped in and exiled the constitutional president when he called for a national referendum to permit him to be reelected in order to continue transforming Honduran politics, is a reminder that the Latin American militaries might be tempted to act "in defense of constitutional order" once again.

maximize income via a supply rather than a price-per-barrel strategy. IOCs are likely to earn greater returns as resource nationalism and energy security recede.

3b: Poor and indigenous remain mobilized (power in the streets)

In this situation, political inclusiveness is low as the poor and indigenous remain mobilized and largely leaderless, with the populist leaders and their close associates eliminated as political actors. Congress will rank low on competitiveness because any party advocating public over private goods investment will be banned due to presumed links to poor and indigenous rioting in the streets. The new president will be cautious and unlikely to be an innovator because he will fear for the stability of the new political system. No post-populism government will be able to govern the country, and a succession of coups will likely ensue as the military resents its use by the post-populist governments to attempt to control the streets. Supply instabilities will ensue in the domestic market, and the countries will become unreliable partners in international and regional energy markets.

- The new government will accuse OPEC of being under the control of statists, renounce their membership, and strive to export as much oil and gas as possible.
- The new government will move away from RN and ES.
- Supply to the international market will be disrupted as a consequence of a backlash by the poor against the installations of the IOCs and the NOCs now regarded as under the control of international capital.
- The new leaders will draw their countries closer to the United States and seek to undercut regional support for the remaining statists.
- The NOCs will be returned to professional management and new relationships with IOCs will be sought to help the company recover and the country to export. Given the pent-up demand for infrastructure investments and private goods for elites out of power for a decade or more, these countries are likely to adopt export strategies that maximize income via a supply rather than price per barrel strategy. IOCs are likely to earn greater returns as resource nationalism and energy security recede.

The Reformists

Resource nationalists and energy security statists are not the only leaders who face challenges to their energy policies. Today's reformists operate within a Latin American tradition in which ownership of the subsoil resources belongs to the nation, a framework that limits how far they will move toward a market orientation in the energy sector. Nevertheless, the reformers have been pursuing energy policies characterized by lower levels of resource nationalism and energy security than have been seen in decades. Among Latin America's oil exporters today, the reform group is represented more moderately by Alvaro Uribe in Colombia and Felipe Calderón in Mexico, and the list may be augmented by their own successors, as well as by those in Brazil and Argentina.

Exploration of how this reform group would fare under monopolization of the government, competition, and overthrow yields the following scenarios.

<u>Scenario 4: Reformists monopolize government</u>

In this scenario, the political coalition behind these leaders becomes dominant at least at the national level, even if not at the provincial one. The leader can be expected to win reelection if permitted to run (e.g., there have been discussions about modifying the constitution a second time to permit Uribe to run for a third term), or if the leader is termed out, members of her coalition would win election. The political system remains inclusive but politics are monopolized by the leader's coalition. In terms of our model, the inclusiveness of the political system is high but the competitiveness of politics is low, thus generating pressure for oil and gas rents to be used for private goods. In these circumstances, whether or not the leader is innovative and risk-acceptant, he will support an energy policy that generates rents for private goods because that is what his constituency wants; since his coalition controls Congress, he can provide it as long as the rents keep coming in. Note that in this scenario, the reformer becomes satisfied with his ability to provide private goods and abandons his earlier claims about the importance of reform for the provision of public goods. No current or foreseeable reformists in the oil exporting countries fit into this scenario.

Scenario 5: Reformists in a competitive political environment

Contemporary Latin America provides two sub-scenarios for reformists in a competitive political environment, distinguished by the degree of inclusiveness of the political system.

5a: Political system is highly inclusive

In the first sub-scenario, the political system is inclusive and the Congress is competitive. Competition forces Congress to support an energy policy that provides public goods. Brazil under Cardoso and Uribe in Colombia[26] are in this sub-scenario; their successors, and perhaps Argentina in 2011, may fall into this scenario. Oil supplies to the international market will increase from the countries with reformist administrations.

One should expect reformist leaders in an inclusive and competitive environment to have the following characteristics in their oil geopolitical strategies:

- The countries will seek to maximize exports in the near term, diminishing ES.
- Better terms will be offered to national and foreign investors throughout the energy chain, moderating RN and capturing moderately high levels of rents.
- The leaders will play active roles in pursuing regional energy integration based on market signals.
- The governments will seek closer ties to the United States, both as export markets for energy and as promoters of greater regional energy integration.

5b: Political system is moderately inclusive

The other sub-scenario for reformist leaders facing competitive politics finds Mexico in a unique situation: moderate levels of inclusiveness, high competitiveness, and an innovative and cautious president. The political system is the least inclusive of the countries in the study.

Among the many challenges facing the Mexican political system: many people believe the PRD was deprived of victories in the 1988 and 2006 presidential elections; the FZLN guerrilla

[26] The FARC no longer represents a political movement for change; its persistence as a drug trade and kidnapping-fueled criminal organization poses no challenge to the inclusive nature of the Colombian political system.

movement has widespread legitimacy (unlike the FARC in Colombia);[27] the violent teachers' strikes in Oaxaca had significant citizen support;[28] and the attractiveness of the drug traffickers' way of life (memorialized in the popular ballads heard on radio stations across northern Mexico).

The country's politics are extremely competitive, both within Congress and at the level of the presidency. At worst, the leftist party PRD barely lost the last presidential election, the polymorphous PRI party is expected to win the 2012 presidential election in light of its impressive midterm congressional victories in 2009, and the last two presidents hailed from the pro-market PAN party. Mexico has the most resource nationalist character in the region, yet its energy policy scores low on the energy security criteria, but more because of the weight of resource nationalism than from a conviction that the market can provide the appropriate supply of energy at acceptable prices.

Calderón in Mexico has an important opportunity to make significant changes in energy policy that will decrease resource nationalism slightly (akin to the levels of Venezuela) and increase energy security significantly. But this will only come at the expense of his own party's likely future in the next elections because PRI controls the reform process in Congress and will only approve reforms for which it can take credit. It cannot alienate the nationalists and win in 2012, but it will also want a more effective energy sector if it wins in 2012; hence, PRI should seek further reforms in the energy sector. Calderón has already demonstrated his innovative nature in working with Congress to pass important, though still limited, reforms in the non-energy sectors; now he has to take the risk of putting his historical legacy ahead of his party's chances in the next presidential election. If Calderón succeeds, Mexico's geopolitical oil and gas strategy will move slightly away from RN, but remain outside the range defined by Colombia and Brazil. Oil supplies to the international market will increase, though because of past lags in exploration, it will take some time.

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[27]See Internal Displacement Monitoring Centre (IDMC), *Mexico: Evictions of indigenous communities fuel displacement in Chiapas*, January 22, 2008, available at: http://www.unhcr.org/refworld/docid/4796f48b2.html, accessed September 21, 2009.

[28] See Associated Press, "School's out in Oaxaca: Teacher strike," September 2, 2009, in *Taiwan Times Online, http://www.etaiwannews.com/etn/print.php*, accessed September 20, 2009.

Scenario 6: Reformists overthrown by riots

If the reformists promote energy policies that marginalize the poor and indigenous either in terms of their input on policy or in the provision of private goods, these groups will have become effectively excluded from the political system. When the poor take to the streets, they are demonstrating their continued political relevance, despite their diminished voice in the political system. Fortunately, none of the oil exporters in the region appear headed in this direction, but an example of this failure can be found in the government of Sánchez de Lozada in gas-exporting Bolivia between 2002 and 2003.

An overthrow of a moderate by the poor and indigenous demonstrating violently will favor statists and their RN and ES visions. When such an overthrow occurs, two potential scenarios can develop. Statists may come to power and develop Scenarios 1 or 2, depending upon whether Congress was closed or became uncompetitive (Scenario 1) or remained open and competitive (Scenario 2). If the reformist that was overthrown was replaced with another reformist through the use of force to suppress the demonstrations, we would likely see Scenario 3b play out.

Promoting Pragmatic and Cooperative Energy Policies

The logic of the market pushes and pulls in different directions at different points in time. The increased competitiveness of the oil market in the 1960s and the evolution of financial markets in the 1970s provided countries with new opportunities to reclaim oil rents from IOCs. Yet even as producing nations were appropriating more rents, IOCs found it still in their interests to work with producer governments, as Cowhey[29] noted almost 30 years ago. But with the inclusiveness of Latin American political systems significantly increased today, the public-private partnership must go beyond the producing government-IOC relationship if we are to have stable energy policies and meet the needs of citizens in exporting and importing countries.

Ultimately, of course, the design of an energy policy is an issue for a country to decide. Fortunately, contemporary Latin American politics are not characterized by civil wars and democracy is valued even by the supporters of the leading statists (Chávez and Morales).

[29] Peter Cowhey, *The Problems of Plenty* (Berkeley: University of California Press, 1985).

Domestic politics, however, matter in ways that go beyond whether the country is democratic or the president prefers a statist or market-oriented path. This study has demonstrated that a country with an inclusive political system, competitive politics, and leaders who are innovators but cautious is most likely to adopt energy policies that enable oil and gas to be used effectively to benefit citizens at home and abroad.

From a normative perspective, this finding is good news, but it does raise important challenges. Political systems have become more inclusive across the region. While the competitiveness of politics is under threat in a number of countries, the cause is more related to the current popularity of certain leaders and the interpretation of particular laws than to a part of a process to create a dictatorship; consequently, the possibility of increasing political competition remains. In addition, many leaders in the region are innovative and able to manage risk at appropriate times. Even in the countries currently led by extremely risk-acceptant leaders (especially Venezuela and Bolivia), the potential for cautious leaders to rise still remains; the domestic political context for the success of moderately risk-acceptant leaders, even if they are statists in electoral politics, needs to be nurtured. If those who oppose the statists are to increase their chances of winning future elections, politicians need to offer an inclusive vision to the poor and indigenous; too often, the opposition merely harkens back to the "good old days," which were not, in fact, good for this newly mobilized constituency.

IOCs, international financial institutions (IFIs), and the U.S. government can contribute positively to the development of a competitive political context in which innovative, yet cautious, leaders are respected and sought after, thus making it more likely that energy policy will swing back toward cooperative and pragmatic energy relations. So how can the likelihood of our three key variables lining up this way be positively influenced by foreign actors? It is fundamental to begin this section with a warning about how not to attempt to wield influence. Becoming a player or taking sides among players in the political system would be considered illegitimate behavior and would undermine the very outcomes one is trying to promote. It is, instead, through apolitical behavior that foreigners can best influence politics.

It is important for all actors, whether market reformers or statists, to recognize that democracy and empowerment of the poor and indigenous in Latin America are here for the foreseeable future and are not phases in the region's history. In this context, the private sector, whether domestic or foreign, should recognize that its accountability is no longer vis-à-vis just the leader, but also to his constituency, particularly the poor and indigenous. Regarding the U.S. government and IOCs, it is important to move beyond a focus on the leader's characteristics and consider the concrete issues and demands of the new inclusiveness that have given voice and power to the poor and indigenous for the first time. Yet, it doesn't resolve the practical challenge of creating competitive political forces and stable government institutions to create an environment for the political give-and-take that is the very essence of democracy.

The range for constructive, profitable, and cooperative public-private relations in the oil and gas industry is likely to lie somewhere between the contemporary Colombian and Brazilian experiences. At one end, we find a government-regulated sector in which private investors compete on a level playing field with a reasonably efficient NOC (Colombia). At the outer range toward state control is a sector with the most promising areas limited to private associations with a reasonably efficient NOC, and all other areas falling under a more openly competitive structure (Brazil). Chile and Argentina fall within this range, especially with the reforms weakening ES in the latter.

Relationships that fall outside this range are not likely to be fruitful or sustainable. A major reform of Mexico's energy policy would likely fall short of Brazil's reforms by requiring significant majority control for Pemex in any venture permitting foreign or private investment. As a consequence, the reforms will not likely generate the levels of investment required for the country to meet external and internal demand. The combination of Venezuela's reserves and its domestic politics makes it unique, but even so, the private sector is not welcome enough to generate sufficient investment for the country to produce and export at the levels that would meet both internal and external demand. Bolivia, and even less so Ecuador, does not have the level of reserves or the internal political dominance (high inclusiveness and low competitiveness) that underpin Chávez' energy policy. While Peru is more generous and welcoming to the private sector than Colombia (so it lies outside the range on this end), its energy policy is likely be unsustainable because it is not generating enough environmental protection or return to the newly empowered poor and indigenous.

IOCs and the U.S. government have learned that RN and ES are policies adopted by all Latin American countries to some degree. The more statist leaders must be tolerated, at worst, and worked with, at best. After the failed 2002 coup attempt against Chávez, the administration of George W. Bush didn't respond as the United States did after the failed 1961 Bay of Pigs operation in Cuba and embargo Venezuela, nor did it fund armed rebellion, as with the Contras in Nicaragua during the 1980s. Instead, the U.S. government wisely avoided being provoked by Chávez' insults or pressured by the vocal, and at times quite vehement, opposition to Chávez in Caracas, Miami, and Washington.

We can surmise that IOCs, even ExxonMobil and Conoco, have thought about the explicit and implicit bargaining context since they did not leave the country at the first demand for contract renegotiation. For two of the IOCs, that has meant reaching a point where Venezuela no longer fits within their business plans; for most others it has meant staying, but limiting investments to the minimum acceptable to the government. Those calculations will clearly be affected by a country's resource base and expectations about the future of the energy market; nevertheless, when that minimum investment decreases, both sides will reevaluate. The same process is at work in Bolivia.

The pursuit of less RN and ES in Latin America cannot mean, however, simply turning the country's resources over to the profit-seeking drives of the private sector. Former Bolivian president Gonzalo Sánchez de Lozada's innovative capitalization program for YPFB was not theoretically wrong, and indeed was hailed by the IFIs, U.S. government, and foreign private investors. However, it was untenable to put the reduced rents into long-run development in a society where two-thirds of the population lives in poverty. Providing incentives to investors that would actually reduce the absolute revenue of the government in the medium-term as gas was discovered and exported, could only have been perceived as business-as-usual by a society that has given up its natural resources for 500 years and still lives in poverty. We should not have been surprised when the policy proved to be short-lived.

Because policy is politics, and because the region has a long history of exclusion, what seem like extraneous events in the U.S. government and IOCs' eyes are not for many in Latin America. Sensibilities to the south of the U.S. border are not as sanguine about changes in U.S. or IOC behavior as many in the United States assume. The violent invasion of Panama by 22,000 U.S. Marines to capture Gen. Manuel Noriega was 20 years ago, but remains an active memory in the region. Trade preferences have been terminated for Venezuela and Bolivia over drug policy issues just within the past few years, but the United States continues to refuse to cut all aid to the Honduran government installed after the military exiled the democratically elected president. The administration of Barack Obama insists that it will use its recently-granted access to seven military bases in Colombia only to help the Colombian government fight drugs and terrorism. But the ability to easily use those military assets beyond Colombia's borders raises fears about future U.S. behavior. Thus the burden of history, or what is seen as a constant threat of U.S. exploitation, is likely to underpin all evaluation of U.S. government actions. This same historical context similarly raises suspicions about IOC intentions.

If the demands for RN and ES are to be effectively managed, the link between the oil and gas industry and an improvement in people's lives has to be explicit and direct. The statists are aware of that link and use it. But reformers in Latin American governments, in the United States, and within the industry have to be as aware of that link if they are to convince the statists that their own career interests are better served by using their resources more effectively than by simply extracting more rents and providing private goods.

IOCs are missing an opportunity to address the concerns of the poor and indigenous in ways that avoid taking sides in domestic politics, but nonetheless positively communicate their role. Political credibility can be improved through transparency that stimulates the demand for improved accountability. For example, if IOCs broadly publish the taxes and royalties that they pay, it can stimulate public demand for greater accountability for those revenues from the domestic government. In a climate of broad empowerment, it can only benefit IOCs to contribute to a move toward greater transparency and credibility, which could lead to improved accountability by governmental and nongovernmental players.

Some steps have been taken to improve transparency and accountability. Latin American congresses have punished corrupt cabinet ministers and NOC leaders in Bolivia and Ecuador, and even impeached two presidents—Venezuela's Carlos Andrés Pérez in 1993 and Brazil's Fernando Collor de Mello in 1992 (though the Federal Supreme Court threw out the charges later on a technicality; he had already resigned his office). However, these actions are not typical, and many Latin American governments are still quite opaque in regard to the internal workings of government. The judiciary is also often heavily politicized. By illuminating their transactions with the government, IOCs can contribute to improving the climate of transparency. Public recognition of the "publish what you pay" (PWYP) protocol will also serve to heighten public awareness of IOCs' contribution, thereby serving a strong public relations role for the IOC. It is important in all such communications to maintain a neutral stance that neither supports nor attacks the government. The point here is to increase information flow, changing the climate from one in which nothing is known so the worst is assumed, to one that sets an expectation of disclosure.

IOCs can also improve relations by accepting the priority that countries place on domestic markets and by responding to environmental concerns with investment in alternative energy. IOC public relations should target the poor about the medium term needs for oil and gas, as well as the benefits of alternative energy. The family that has to wait in line for hours to buy LPG, or has limited access to electricity, may think less about supply issues than about class and international conspiracies; so it is important to recognize the fundamental linkage over time between satisfying the domestic market and being able to continue to produce oil and gas in that country.

Many of the model corporate behaviors that companies employ in their regional headquarters will also be effective internationally. For example, companies might engage in domestic philanthropic work and publicize it in the national media, or adopt and promote best practices on environmental issues. There will be a growing debate in many countries between local desires to limit oil and gas development and national demands for the revenue and supplies. Working effectively with the locals will require that the costs of environmental protection be factored into investments based on global, not national, standards. National governments are typically weak in environmental legislation and knowledge, a situation that today produces substantial local opposition. By leapfrogging over national legislation and adopting global standards for environmental mitigation and participating in local social development projects, IOCs can avoid becoming the fall guy for poor provincial programs and inadequate national standards that are often the targets of local anger.

Conclusion

History matters. It is impossible to keep promising "we'll do better next time" when centuries of natural resource exploitation have failed to provide benefits for the majority of a country's citizens. Vested interests in maintaining the status quo and institutional obstacles to change have protected systems that disadvantage newly empowered members of these societies. This cannot help but affect the credibility of contemporary players, whether foreign or domestic, or whether in favor of reform or revolutionary change.

Yet, the past does not always determine the future; the options have not been limited to continued poverty via exclusion of the poor and indigenous from energy market profits or continued poverty for the nation through exclusion of international capital. Reserves have to be monetized, and capital and technology are necessary for accessing the increasingly difficult geology in which the major oil and gas finds are discovered or through which they must be transported. Consequently, foreign capital will remain a major player in the international oil and gas market.

In the 1990s, important reforms were undertaken to consolidate democracy after the collapse of the elite-dominated democracies. Latin American leaders and their international advisers understood that increased participation and a sense of empowerment by previously excluded citizens were fundamental to successful democracies. The challenge was to channel the demands of these groups into existing political institutions (political parties, established unions, etc.) in ways that strengthened, not threatened, the political system. Brazil, Chile, and Colombia have clearly succeeded in this task, and Argentina may be getting back on track after the Kirchners' loss in the 2009 midterm elections; Mexico and Peru are struggling to make the transition. But

Venezuela, Ecuador, and Bolivia are increasingly proving incapable of accommodating the demands of the dispossessed in ways that create the context for expanded political and economic development. The result is political instability and radicalization of policy, both of which have proven detrimental to the development of regional energy sectors.

The end of the 1990s was probably the moment in which Latin America had the best opportunity to move toward an inclusive democratic political system. Many neoliberal economic reforms were on the verge of generating income that could have been invested in employment and social welfare. Those empowered by the democratic reforms were ready to take control of their destiny and demand that government be accountable. One of the ironies of these reforms is that efforts to create transparency and accountability of government to citizens from the top down created a context for political instability, as empowerment of the poor proceeded at a pace that outstripped the reform of the parties and the political systems in many countries.

Fortunately, the political economy of energy policy is a constantly evolving process. If the U.S. government and the IOCs can work with the Cardosos and Uribes of the future to meet the needs of Latin American societies, the oil and gas industries can develop to the profit of all.