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NATURAL RESOURCES, DEVELOPMENT AND DEMOCRACY IN LATIN AMERICA

Propuesta Ciudadana Group

INTRODUCTION

On December 5 and 6, 2007 the *Propuesta Ciudadana* Group, Revenue Watch Institute and Oxfam International organized in the city of Lima an international seminar on Natural Resources, Development and Democracy in Latin America, sponsored by the Economic Commission for Latin America and the Caribbean (ECLAC) and the Peruvian Catholic University (PUCP).

The seminar was proposed as a space for authorities, academicians and technical experts, and representatives of resource extraction companies and civil society from several countries to reflect on and discuss the opportunities, problems and challenges the increase of resource extraction industries poses for the development of Latin American countries. The seminar was organized around seven work groups and 16 speakers. The seminar was attended by over 150 participants from several countries. The debate about the efforts underway is part of an evolving shared agenda about the relationship between extractive industries and development and democracy in Latin American countries. We present below the main conclusions and ideas presented at the seminar.

1. Natural resources, development and democracy in the 21st Century – a global and Latin American perspective

Fernando Sánchez Albavera[1] highlighted the new opportunities for the sustainable development of the natural heritage resulting from technological change, a renewed institutional framework, and regulations that allow to better use natural advantages. He also underscores the lower entry barriers for developing natural resources coupled with more strict environmental regulations. All this happens in a scenario where environmental issues take a more prominent role in the world scene, civil society assumes an increasingly leading role, and new industrialized countries make greater demands, all of which compels us to paying greater care to our cultural heritage.

In oil and gas, a stronger national capitalism seems to be on the rise in Latin America as a response to a past where exploitation rents flowed mostly towards the private sector and little was kept by local economies. In recent years, state-owned companies and national private companies have made the largest exports and sales (74.7% in 2006), with the former making the largest investments, in particular PEMEX, PETROBRAS and PDVSA.. Only in Argentina, Bolivia, Ecuador and Peru did foreign investment exceed local governments' capital spending, reflecting the greater control exerted by domestic companies over development of this resource.

On the other hand, transnational companies predominate in the mining industry, in view of the region's natural advantages. Latin America accounts for 24% of mining exploration

[1] Director, Natural Resources and Infrastructure Division, ECLAC

expenses (2006) and 34% of the worldwide investment project portfolio. The arrival of foreign investment has not reduced the states' constitutional mandate to control natural resources. However, as Latin American countries compete for foreign investment, there is concern that oftentimes greater competitiveness may be accomplished by reducing the state's share of exploitation rents. In turn, this weakens the understanding of the benefits that may be derived from exploiting such resources, and fosters the perception that the governments' use of the natural resource rents can have but little social impact.

Finally, Sánchez holds that for Latin American countries to make the best of natural resources development, it is necessary to specify the sustainability factors in public-private relationships. He stressed the requisite national consensus that must be reached on natural resource development, the importance of governments' effectiveness, and of a stable economic scenario, how to manage economic and social vulnerabilities that calls for a permanent interaction between the various involved actors so the perception of risk may in addition to the legitimacy of the political regime and the State's effectiveness in addressing social issues.

Terry Lynn Karl[2] proposed interpreting the link between natural resources, development and democracy from a global rights and security perspective. Karl explained resource extraction industries are so necessary for development that no modern economy may operate without access to them until alternatives are found. The problem, which has been historically interpreted as a North-South relationship one, must be reconsidered in a context of several developing economies or economies under transition that are highly dependent of their resource exportations, directly facing a double challenge to their development, that is, capturing the resources' value and making the best use of the income they generate as well as ensuring their effective administration and redistribution.

The high concentration of these resources in just a few countries (10 of them have more than 80% of proven oil reserves) and the link established by the United States in its foreign policy between access to oil, governance and security, which even supports the right to military occupation when supplies are jeopardized by the struggle for political control, are a dramatic combination, especially when taking into account that 12 countries holding 68% of oil reserves have very low governance indicators whilst 5 countries with the greater level of governance hold only 5% of reserves.

In this context, where natural resource prices skyrocket because of the fast-growing demand by countries like China and India, it is absolutely necessary to take an in depth look at ore prices beyond historical volatilities, and to the more permanent rise and structural rise of fuel prices. To relate natural resources, development and democracy we must understand the "resource curse" in a different way, i.e. to the presumed reverse relationship between growth and abundance of natural resources. When examining the fact that from 1970 to 1993 resource-poor countries grew four times faster than resource-rich nations, it must be said that the difference was not brought about by the natural resource itself but by the distribution of income, the rich countries' reliance on oil and minerals, and the poor countries' difficulty to invest in agriculture and industry. As a result, a perverse effect was created with negative effects on their economic development and social expenditure (i.e., rent-earning states with high poverty rates).

[2] Professor and researcher, Stanford University, United States.

While natural resources, especially oil, are the main source of income for these countries, and are directly related to their States' spending power, productivity and expenditure are disassociated and the indispensable link between taxation and expenditure is broken. This alters the principles of democratic representativeness, participation and transparency that rest on the relationship between citizenry and taxation. In this way, dependence on resources is politically linked to authoritarianism, concentration of power in the Executive Branch and corruption. Finally, it is undeniable that dependence on oil and ore resources is closely related to war, both civil (16 cases) and international, encouraging useless military expenditure and the creation of repressive machineries.

In view of the many environmental and social problems brought about by this dependence, Lynn Karl pointed out to the need for an international social agreement focusing on the use of resources, institutional building to end rent seeking behaviors (merit-driven civil service and government career), transparency and accountability, fair participation and income distribution, and establishing international standards to protect human rights.

2. Global and regional distribution of income in the resource extraction sector – An international perspective

Humberto Campodónico[3] showed the results of the oil and ore rents' analysis in several countries of the region, provided an overview of these resources, and contributed a methodology for measuring them. Resource rent, defined as the difference between their value at an international price (volume x price) and production cost, requires further specifying.

Beyond each country's particular situation, oil and ore revenue has regained its importance for the region. Countries need a portion of this revenue to finance social and infrastructure spending, promote competitiveness and fight poverty through equitable distribution. The cyclical nature of these activities requires thinking up a tax on excess profits because prices charged are not commensurate with companies' investment and technological progress. Also solving the problem of how to distribute the State's rent is paramount to prevent rent seeking and the "Dutch disease".

In the present scenario of high oil and mineral, prices it is necessary to show good economic results and adequate national capture of income created by developing these resources. Paul Mitchell explained the need for analyzing the historical performance of different natural resources exporting economies in order to identify the causes for their success or failure. The Initiative for Resource Allocation is an effort encouraged by the World Band and ICCM to identify the critical factors contributing to the success of socioeconomic performance of 33 countries from 1983 to 2003.

La buena administración macroeconómica y un marco legal eficaz fueron indispensables; la transparencia en la asignación de los recursos y en el flujo de ingresos, así como un uso eficaz de la actividad económica en los momentos de crecimiento, incluidos los ingresos públicos, también. Los gobiernos que fueron capaces de emprender reformas en esta perspectiva, que tuvieron necesidades de desarrollo bien definidas, prioridades sociales y no de consumo y efectividad y coordinación en el planeamiento e implementación, -Chile y Ghana- obtuvieron mejores resultados.

[3] Senior researcher, DESCO. Professor, Universidad Nacional Mayor de San Marcos.

The Initiative identifies the crucial elements that contribute to the success of countries. It presents four -country case studies (Ghana, Tanzania, Chile and Peru) that exhibit very different results in poverty reduction. In macroeconomic management, it emphasizes competitive exchange rates and taxes, low inflation, a falling fiscal deficit to manageable levels, and free repatriation of profits.

In the legal arena, it underscores respect for property rights, clear and fast court procedures, legal stability and the ability to settle disputes. In these two fields, government's role was paramount.

An effective macroeconomic administration and an efficient legal framework were indispensable, as well as accountability for resource allocation and revenue flows coupled with the effective use of economic prosperity, including public income. Administrations that managed to introduce suitable reforms to meet well defined development needs and social priorities, and not consumption goals, and had effective and coordinated planning and implementation –as in Chile and Ghana– had the best results.

3. The role of the State and private companies in developing natural resources

Roque Benavides[4] said the mining industry has made a triple contribution in Peru: to decentralize the country, create business opportunities and attract foreign direct investment. In few places as in Peru are there opportunities for 20% of the country's population living at 3,500 meters above sea level to benefit from investment which in contrast to most countries in the region has a significant local component. Mining contributes 2,700 million dollars in purchases, 85% of which are made locally.

Despite its importance, the State is oftentimes absent from these communities and shows limited ability to act, leading to an erroneous understanding of the role of business in community development. This misunderstanding gives companies roles and responsibilities that belong to the State. The mining industry instead would like to focus on a plan for sustainable development focusing on implementing sound environmental practices and developing the mining industry, together with communities.

The business sector is committed to enforcing international standards, managing its activities responsibly and including economic, social and environmental dimensions to its decision-making. With regard to the relation with communities in the companies' area of activity, Benavides stressed the importance of introducing good corporate government practices (disclosure and respect for its stakeholders), respecting community culture and traditions), and fostering cooperation with the State and local communities.

Accomplishing sustainable development in this scheme requires States to guarantee better environmental oversight, formalize artisanal mining, consolidate a more realistic legal framework and assure its greater presence. The State has to encourage the growth of mining and attract new investments, and companies must tap new market opportunities and foster national and community development.

William Donaire[5] discussed Bolivia´s hydrocarbon policy to recover such resources and reorganize the State-owned company. The new transparent operation contracts with

[4] Buenaventura Mining Company, Peru.
[5] Bolivia's Vice minister for Hydrocarbons and Energy of Bolivia.

private oil companies were approved Congress under the new laws in force since 2005. The nationalization of Bolivian resources combines an internal policy to guarantee gas, oil and byproducts supply for the nation, and an external policy to strengthen exports and confirm Bolivia as South America's center of the gas sector.

Through the new operation agreements, the State is the sole owner of resources. The state company controls the value chain and owns the assets. Private companies are paid in cash for their services. YPFB acts as a single client and has right to build and operate pipelines to transport its own and third party production. It is the industry's sole vendor, and directly pays royalties, profits and taxes.

As a result of such changes, companies that used to pay 18% royalties, are now contributing though different channels, up to 50%. The State recognizes all of their costs, and split profits. Several oil companies (12) have signed operation contracts, and reserved areas of hydrocarbon interest in traditional and non-traditional zones for future exploration and development activities, through combined-ownership companies or international bidding.

Bolivia has nationalized its oil to recover property of the resource at well mouth, of all related resources, of capitalized and privatized oil companies in Bolivia and takes control of and manages the hydrocarbon value chain through the State company. Since 2005, State income has increased from 250 million of dollars to 1,350 million, thus increasing the income available for distribution in Bolivia.

4. Domestic distribution of resource extraction rent between central and subnational governments – the Latin American situation

Germán Alarco[6] explained the case of Mexican oil income distribution as well as the challenges facing public administration of energy resources. The importance of this case is undeniable in view of its magnitude - Mexico is the world's fifth crude oil producer, accounts for 1.4% of the world's gas production. PEMEX is the tenth international oil company and the main Mexican company. PEMEX's annual sales reach about US$ 97 billion; rent from oil is US$ 54 billion, and profits are US$ 4 billion. The company is the source of 40% of government revenues, and 12% of the country total exports.

The Mexican government's management of its energy resources teaches us important lessons. First, the opportunity to use hydrocarbons as a tool for international negotiations is wasted. Increasing demand and international conflicts are disregarded, and rather follow the US agenda.

Second, there is a general economicist and rent-seeking perspective. The oil industry focuses on crude oil exploration and development, ruling out, for example, petrochemicals and wasting the advantages provided by resource location.

Third, the country's natural resource-based tax policy is fragile. Tax pressure is only 15.2% of GDP and an even lower 8% excluding oil. Fourth, maintaining hydrocarbon reserves and their extraction, the core issue of the hydrocarbons industry, is disregarded, as is the issue of this industry's internal organization and linkages. Finally, the State lacks macroeconomic sector and regional policies to manage hydrocarbons.

[6] Researcher, Instituto para la Integración y el Desarrollo Económico y Social (IPIDES), Mexico.

Vladimiro Huaroc[7], discussed the decentralization underway in Peru (including the distribution of natural resource rent through the mining, gas and oil ground royalties). Peru seem to confirm the ¨curse of resources¨, mostly found in its poorest regions. The central government's expectations focus on economic growth propelled by increased investment in extractive industries. Its policy seeks to subordinate the biodiversity and culture of large areas of Peru to this view of production.

Peru's present resource-based model not only creates frequent conflicts with peasant communities by disregarding their rights, in particular to access and use water, but also affects other industries through the dollar's loss of value. Because of the major challenge posed by decentralization and the location of natural resources in the interior, extractive rent should be directed to decentralize production, institutions and service infrastructure, and seek the harmonious encouraging responsible mining of resources, local transformation of mineral resources, and exploring opportunities for involving local communities in mining projects, said Huaroc.

5. Transparency in the extractive sector. The Global EITI Initiative

Francisco Paris[8] discussed the Extractive Industries Transparency Initiative that sets global standards for disclosing payments to companies resulting from extraction of natural resources (mining, oil and gas), and the revenues of governments from those sources. The driving engine is in the payments and tax collection stages, as is typical of extractive industries. The initiative is governed by a structure comprising multiple participants, including companies, civil society, governments and investors who meet every two years and elect a Steering Council charged with directing the Initiative.

The EITI is implemented locally revolving around four central values: the persuasion that wealth from natural resources should result in economic development and poverty reduction; a commitment to transparency as a tool based on comprehensive disclosure of understandable information; respect for the sovereignty of countries and their laws, and involvement of all significant stakeholders.

[7] Regional President of Junin, Peru.
[8] Member of the EITI Secretariar, Norway.

Paul Mitchell[9] said what matters most to attract investment to natural resources is the national governments' commitment to introduce hended economic, legal and institutional reforms. These reforms should lead to public policies to encourage investment in resources, but also social cohesión and security for investments, together with the effective use of revenues from natural resource development.

Strictly speaking, this view means transparency is not a requisite to start investing in mining so social benefits shall be accomplished. Beyond the initial stage, however, it is important for society as a whole because it enhances competition among companies seeking development rights and increases the efficiency of negotiations among companies and governments. In turn, this enhances the public's opinion about miners and enhances the credibility of their decisions about contracts. Transparency contributes to political stability, countries' access to capital markets and promotes responsible government expenditures and overall accountability.

Governments are key transparency actors because they decide who has access to resources and under what conditions. Multilaterals are important to build capacities, and civil society matters in ensuring control and oversight. Companies must demonstrate their arguments through their field operations.

Javier Aroca[10] said natural resource extraction ranks among the region's most important activities, and is frequently characterized by environmental degradation, displaced local communities, in particular indigenous peoples, weak regulations, lack of oversight mechanisms, and violation of various human rights. The challenge is daunting, most of all as multilaterals have succeeded in accelerating foreign debt repayments, neoliberalism is the reigning policy, a bipolar world strengthens under the rule of transnationals, while poverty and exclusion deepen, and gaps between the rich and the poor, and differences within and among countries widen.

In this scenario, the EITI must encourage socially responsible investment, respectful of the rights of peoples affected by such investments and internationally recognized human rights. It should assist in fighting corruption and thereby contribute to economic growth and social development. In the light of international experience, OXFAM proposes international regulations to link investments to national interests, strengthen capacities and transparency mechanisms in States, and encourage economic and environmental zoning in each country, leading to environmental agreements involving all actors.

[9] International Council on Mining and Metals (ICCM), Chairman. Member of EITI´s Steering Council, United Kingdom.
[10] OXFAM International, Representative in Peru.

6. Transparency in the extractive sector in Latin America. Regulations, instruments and mechanisms

Pedro Gamio[11] said development is not possible without citizen participation, social license and enforcement of international regulations, lile ILO's convention 169, in addition to effective participation in resource distribution. In a country where trust is not a social value, because of its recent history of internal strife, authoritarianism and corruption, creating budget transparency is an imperative that depends more on the political will to act than on regulatory changes, even more so when there is no strong civic culture and institutions were destroyed in the last decade dramatically weakening the state.

The challenge Peru's government faces today is to improve the distribution of income from natural resources using canon royalties as the main tool. As has been proposed, they will be partially (35%) allocated directly to the communities through an effective scheme to ensure sustainable access and benefits. Transparency is paramount in this scenario and to confirm its support to EITI, Peru has announced it will disclose the results of accepting tax paying companies, and will in addition put in place two pilot programs to show how resources are distributed.

Mercedes de Freitas[12] demanded integrity-driven institutional systems should be put in place to define the strengths needed for transparent and equitable management of public affairs. In our region, experimental political processes underway, coupled with weak institutions, may lead to undesirable impacts from extractive industries in places where the State is absent or weak, and receives significant funds that may be used on a discretionary basis to create dependence relations between citizens and the State. Such pattern can open the road to a type of clientelism that may impact sustainable development. As demonstrated by the Venezuelan case, large State revenues result in the concentration of power amidst weak and co-opted control systems. In Venezuela, the state-owned company provides up to 71% of social program funding and 65% of public expenditure but has no accountability system in place, and provides no access to information although 97.3% of its expenses are allocated directly, and reach 47.9% of total allocations.

7. Experience of national civil society networks in monitoring extractive industries in Latin America.

To conclude the International Seminar, three experiences of national civil society extractive industry monitoring networks were presented. Of particular interest was the experience of Vigila Peru (Peru Watches) a watchdog network focusing on extractive industries' rents born in 2004 to oversee decentralization. This work had started a year before within Grupo Propuesta Ciudadana, a consortium gathering 11 NGOs.

Epifanio Baca[13] said their monitoring reports prepared by various regional teams aims at strengthening citizens' oversight capacities throughout Peru's regions, promoting transparency in extractive industries' rent generation, distribution and use, and influencing public policy and debate. Its basic instruments and procedures are i) a matrix of

[11] Vice Minister for Energy, Ministry of Energy and Mines, Peru.
[12] Transparency International, Venezuela. Executive Director.
[13] Propuesta Ciudadana, Peru. Representative.

indicators, ii) a roadmap of activities embracing from data collection to regional report drafting and dissemination of a validated national repor, iii) data registration and report cards, iv) standardized processing and presentations, and v) use of official and corporate data sources.

Its main contributions to public debate in recent years were the analysis of tax and non-tax contributions of extractive industries, canon royalty distribution, inter and intraregional inequalities, regional and sector based investment management, and the use of canon royalties in universities. Its work has significantly impacted national media, is used by various audiences, including community leaders, regional authorities, congress members and pubic officials, and has influenced some decisions at the Ministry of Economy and Finance, all in the way of improving economic transparency. Its involvement in the EITI Peru group gives it high starting marks, if judged by existing reports. In addition, this experience contributes to building oversight capacities through editing and dissemination of training materials and micro radio broadcasts in the regions, and supports local leaders to persist in moving forward various investment projects