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Ian Bremmer; Robert Johnston

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# The Rise and Fall of Resource Nationalism

**Ian Bremmer and Robert Johnston**

Resource nationalism has been a catalyst for the rapid rise of prices for oil and other commodities over the last five years. It encompasses efforts by resource-rich nations to shift political and economic control of their energy and mining sectors from foreign and private interests to domestic and state-controlled companies. High-profile cases such as the quasi-nationalisation of heavy-oil assets in Venezuela and the re-consolidation of the Russian oil sector under giant state-owned energy firms have created upheaval for foreign investors. Moreover, these cases have elevated the importance of energy security in policy discourse in the major energy-consuming states, while embedding in oil markets a deep sense of pessimism about prospects for future supply growth.

With sharply falling prices for oil and other commodities over the second half of 2008, the geostrategic and industrial implications of resource nationalism are rapidly changing. In geostrategic terms, several regimes that have pursued externally oriented resource-nationalistic policies – sometimes described as use of the ‘energy weapon’ – will have to revisit these policies. The most prominent examples are Russia and Venezuela. With the global economy slowing and commodity demand falling, a sustained period of weaker prices will shift the advantage back to international companies and

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**Ian Bremmer** is President of Eurasia Group, the world's leading global political risk advisory and consulting firm. He is author of *The J Curve: A New Way to Understand Why Nations Rise and Fall* and, with coauthor and colleague Preston Keat, of *The Fat Tail: The Power of Political Knowledge for Strategic Investing* (2009). **Robert Johnston** is the Director of Eurasia Group's Global Energy & Natural Resources practice. He specialises in oil, gas, power generation, metals and agriculture research as well as client relations. He received his PhD in international relations from American University in Washington DC.

away from host governments, as international companies can now afford to be more selective about the fiscal terms and regulatory conditions they are willing to accept from host governments. Evidence of this is already clear for producers of base metals and natural gas, and higher-cost oil producers are beginning to feel the effects as well. The rapid shift of leverage from producer states to international companies will likely have destabilising effects on a number of regions, particularly sub-Saharan Africa, Central Asia and the Andes.

### **Beyond the headlines**

Resource nationalism has been a mainstay of commodity-market headlines, but with little nuance. There are, in fact, at least four variants which differ in the factors motivating the policy and impact on industry and investment patterns.

The highest-profile, and most notorious, cases of resource nationalism in the current commodity-market cycle (2002 to the present) are Russia and Venezuela. Both exemplify revolutionary resource nationalism, which is linked to broader political and social upheaval, not merely directed at the natural-resource sector. In Russia, this encompasses the broader reconsolidation of state power under the Putin presidency beginning in 2000 and the larger rollback of privatisation in strategic sectors. In Venezuela, oil-resource nationalism was an important feature of the 'Bolivarian Revolution' in which political and economic power was transferred under the Chávez presidency from the technocratic business class (symbolised by the management of state-run energy giant *Petróleos de Venezuela* (PDVSA) under former CEO Luis Giusti).

A second feature of revolutionary resource nationalism is its dangerous effect on international resource companies. Ownership of prized assets may be wrenched away through forced renegotiation of existing contracts, using perceived historical injustice or alleged environmental or contractual misdeeds by the companies as justification. These actions tend to be top-down, arbitrary and accompanied by little if any compensation or recourse.

Revolutionary resource nationalism is much less frequent than economic resource nationalism, which often takes place in relatively stable political

environments, where turnover in elected governments or unelected power elites is not a necessary precondition. Economic resource nationalism tends to involve rebalancing, a focus on shifting a larger share of commodity revenues from international to domestic hands. Actual political control and ownership of the projects may be less significant than increasing the host government's fiscal take. A good example is Kazakhstan, where the government of President Nursultan Nazarbayev is widely perceived to have used environmental policy and project-development problems as a basis for negotiating a larger share in the super-giant Kashagan project for the state oil company KMG. While the renegotiations led to a larger stake for KMG and a greater fiscal take for the government, control of the Kashagan consortium remains in the hands of international companies. Similarly, in Algeria the Abdelaziz Bouteflika government successfully imposed a new windfall-profits tax on the upstream oil sector in 2005 without demanding control of projects run by Anadarko, Repsol and others. In Mongolia, the government has led a strong push to increase state ownership of the massive Oyu Tolgoi copper project to 34%, but has not insisted on majority control. Like many other frontier-market states – countries that are in the initial stages of new natural-resource exploration and industry development – Mongolia recognises that its rebalancing efforts in rewriting contracts and legislation governing natural resources cannot be so punitive that international companies exit the country. Without the deep pockets and technology of the mining multinationals, the Oyu Tolgoi riches would likely remain in the ground.

A third mode of resource nationalism is legacy resource nationalism, as practiced in Kuwait and Mexico. Nationalisation of oil assets (Mexico in the 1930s, Kuwait in the 1960s) is central to national political and cultural identity in both countries. In Mexico, public opposition to allowing foreign ownership of hydrocarbons runs deep; even the tepid initial steps toward reform under the government of President Felipe Calderón met with massive public protest. In Kuwait, the royal family has been unable to overcome intractable opposition from the

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national parliament to international investment in the 'Project Kuwait' plans to develop the country's geologically complex but vast northern oil fields. Legacy resource nationalism may well be the most ingrained variant, with the most durable impact on industry and oil prices.

Finally, resource nationalism is not exclusive to frontier- and emerging-market countries. It is rampant in OECD countries such as Canada and Britain, and is emerging in the United States and Australia. In general, resource nationalism in the OECD countries (and Brazil) can be characterised as soft resource nationalism. OECD countries have the same motivations as those pursuing economic resource nationalism, but generally avoid tearing up existing contracts and using arbitrary tactics. Rather, these countries have generally imposed royalty increases or tax changes through established regulatory or legislative channels, rather than in arbitrary action. But there are exceptions, particularly in the Canadian cases, where 'forced renegotiation' without independent regulatory or legislative review has taken place. But because there are no state-owned national oil companies in these countries, resource nationalism is narrowly confined to fiscal measures, especially taxes and royalties, which benefit the state as a whole but not a government-owned competitor. This is not always the case; Canada and Australia are clear reminders that resource nationalism can be led by provincial and state, rather than national, governments. The 2007 royalty review in Alberta was an effort to rebalance oil-sands windfalls from the private sector to the province. Newfoundland pursued a similar tack with deepwater oil projects. Both cases involved effectively forcing renegotiations on existing contracts.

### **The other side of the coin**

In its most virulently populist form, resource nationalism can pose political risks for governments that pursue it. It can deprive them of the foreign technology and expertise they need to expand, or even sustain, the output and revenue streams they need for long-term survival. So long as prices remain high, governments can extend international influence and sustain popularity at home. But if and when prices begin to fall and the cash cow begins to lose weight, resource-drunk politicians may face, or produce, serious local and regional instability.

Venezuela, for example, is thought to control some 270 billion barrels in conventional and non-conventional oil reserves, the deepest supply in the world. With prices hovering near or above \$100 per barrel and PDVSA reaping most of the profits, President Hugo Chávez appeared to have all the cash he needed to spend his way toward greater popularity and to extend his influence abroad. Yet, his government and PDVSA have become international symbols of the economic decay wrought by the impact of populist politics on resource management.

In the mid 1990s, before Chávez's climb to power, PDVSA's leadership believed that joint development projects with foreign firms could increase production to 6.5 million barrels per day (b/d). In 1998, Venezuela produced about 2.9m b/d. But output has since fallen to about 2.35m, for two main reasons. First, during a 2003 power struggle with Chávez and his government, PDVSA's workers went on strike. The president responded by sacking some 18,000, including the vast majority of the company's best-trained and most experienced engineers. Five years later, the company has still not recovered from the loss of so much valuable human capital. Secondly, Chávez's government has pocketed much of PDVSA's profits, bleeding the company of the money it needs to maintain deteriorating infrastructure, buy new equipment and invest in bringing new crude supplies on line. In 2007, to buoy his domestic popularity, Chávez spent \$14.1bn on social transfers, more than three times the amount devoted to oil exploration and the servicing of PDVSA's existing assets. Unaudited figures released by Venezuela's energy ministry suggested that the company's profits fell by about 32% in 2007 despite the surge in oil prices.

The rest of Venezuela's economy is already in rough shape. The most optimistic estimates put core inflation at 20%, and the real figure is probably closer to 30%. Foreign investment is severely limited by Chávez's habit of voiding contracts with international firms, creating shortages of a broad range of consumer goods. Venezuela is a net importer of virtually everything except oil and remains deeply dependent on its neighbours, including the United States, for goods and services vital to the country's economy.

Convinced that oil production will rise and that high prices are here to stay, Chávez has aggressively antagonised the United States, his best oil

customer. He has awarded rights to future development deals in the country's oil-rich Orinoco belt to companies owned by friendly governments: CNPC (China), ONGC (India), Gazprom (Russia), Petrobras (Brazil) and NIOC (Iran). He has repeatedly threatened to divert oil exports now destined for the United States toward consumers in Asia.

But Venezuela needs access to US energy markets; crude-oil shipments to America represent more than half the country's total exports. Chávez cannot simply redirect that much oil toward China and India. Venezuela has no direct access to the Pacific Ocean. Its rusting tankers must pay transit fees to use the Panama Canal and take seven weeks to reach East Asia. More to the point, neither China nor India will have the capacity to refine that much of Venezuela's heavy crude oil any time soon.

What happens as oil prices fall? It will not take \$40-per-barrel oil to drain Chávez's government of capital, leaving him at the mercy of a people who have come to expect cheap gasoline and generous federal spending on social projects. The consensus among market analysts is that sustained \$60-per-barrel oil or lower (WTI) would create serious fiscal and currency headaches

in Venezuela. And unless Chávez changes course, the danger point will rise. Meanwhile, PDVSA's inability to expand its output ensures that much of the oil from the world's deepest reserves will remain offline, even as demand for new supply rises across the developed world.

Similar problems can be found in other energy-rich states. Following the chaotic privatisations of the 1990s, private companies owned a clear majority of Russia's energy reserves. Output growth was

strong. Today, after concerted state efforts to reclaim the country's natural wealth, nearly half of Russia's oil and gas reserves are again under state control. Oil and gas revenues now account for more than 60% of Russia's GDP. Oil alone generates nearly 70% of state revenue. Russia's oil production reached a peak of 9.9m b/d in October 2007, but is expected to decline by as much as 4% in 2009. This decline would be the first year-on-year drop since 1998. State dependence on oil profits has not done much damage so

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far, but depleted Soviet-era fields in Western Siberia and a lack of infrastructure investment in new, previously undeveloped areas on the Arctic Shelf and in East Siberia suggest that the Russian fiscal picture will be under greater strain as production falls off.

Despite these worries and surging production costs, Moscow continues to impose punitive taxes on oil production, helping it finance a stabilisation fund and a sovereign wealth fund, but discouraging major oil company investments in new plant and equipment or exploration projects. And as Western firms like Shell, TNK-BP and Exxon find themselves at the mercy of political machinations in Moscow, Russia risks losing access to the foreign technology and expertise it will need to access the hard-to-reach petroleum deposits that could reverse the country's declining output.

### **The end of resource nationalism?**

If most resource nationalism is economic rather than revolutionary, the long-term impact of resource nationalistic policies on commodity prices may be less severe than generally assumed. Economic resource nationalism tends to delay projects rather than force their cancellation. Moreover, most modes of resource nationalism are sensitive to commodity prices. The general rule is that when commodity prices are high, resource-rich nations have greater leverage, yet the moment of leverage can be fleeting. The resource nationalism of the OPEC countries in the 1970s triggered a massive shift in exploration and production to areas such as the North Sea and Alaska. The current wave of resource nationalism is empowered by the relative absence of similar oil prospects available at a comparable cost, but this dynamic is limited to oil. While peak-oil worries are driving growing industry willingness to accept tougher terms from host governments, the same cannot be said for copper, uranium, natural gas or gold.

This dynamic impacts resource-nationalistic governments in two ways. First, efforts to impose resource nationalism in sectors such as natural gas (Bolivia) or copper (Zambia, Democratic Republic of the Congo) will be undermined should the ongoing global financial crisis continue to put downward pressure on commodity prices. Natural-gas developers and mining companies will have greater resistance to resource nationalism because of

the relative abundance of prospects in other markets. Mining companies may even elect to pre-emptively defer or cancel projects to wait for prices to recover. Producers could also elect to substitute aluminium for tin or coal for natural gas if resource security becomes an issue.

Secondly, even with peak-oil worries, the oil-rich states are not entirely immune to demand destruction or substitution. While alternative conventional resources are not as easy to find as they were in the 1970s, industry does have options in terms of unconventional oil (most notably from Canadian oil sands) and of alternative fuels ranging from biofuels to coal-to-liquids. While developing scale is a challenge for all alternative fuels, when confronted with resource nationalism, consumer governments have strong incentives to develop their own resources (for example the US outer continental shelf, Chinese coal) and to lower the energy intensity of their economies through greater efficiency standards for automobiles, power plants and buildings. These energy-security dynamics overlap with efforts to lower greenhouse-gas emissions.

Oil-rich states that have effectively squandered the recent windfalls – most notably Venezuela – may find it difficult to sustain resource-nationalistic policies even in the event of a moderate oil-price correction, where prices stabilise in the still historically high range of \$70–80 a barrel. Venezuela has its 2008 government budget set at \$35 a barrel, but is believed to be spending at a rate of \$75 a barrel. Both Venezuela and Russia have failed to materially reinvest the recent windfall in new upstream projects, though Russia at least has been more fiscally responsible in building up a large foreign-exchange and fiscal surplus.

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Frontier-market governments looking to conduct resource-nationalistic experiments on the back of abundant metals or natural-gas resources will likely see their hopes dashed. Within the oil sector, resource nationalism will be most persistent in states that have maintained strong leverage relative to the international oil companies through investments in the operating capacity of their own national oil companies and broader efforts to diversify

their economies to limit the extent of exposure to lower oil prices. Saudi Arabia probably best fits this category. Along with Libya and Algeria, Saudi Arabia will also benefit from additional leverage gained from low production costs. This means that international oil companies will continue to pursue limited investment opportunities under tough fiscal terms.

In several frontier markets, the sharp reversal of commodity prices and dashed expectations for a natural-resource-led economic boom could add to geopolitical instability. In Bolivia, for example, the Morales government depends on mining and gas revenue to fund politically important electrification programmes. In the Democratic Republic of the Congo, a fall-off in expected mining investment could add an element of economic volatility to a country already beset by a severe humanitarian crisis in its Eastern regions. The copper-rich southern provinces could be less able to prevent similar problems from emerging closer to home. In Kyrgyzstan, a gas-exploration boom and high gold prices have helped sustain the 'Tulip Revolution' of 2005, although the country remains beset by corruption and remains a difficult operating environment for business. In other words, natural resources play an outsized role in the economies and politics of these frontier markets. If failed experiments in resource nationalism result in lost investment as global commodity prices fall and multinational energy and mining firms look elsewhere, the countries themselves could be in for a spike in political turmoil.

A better understanding of the complexities of resource nationalism suggests that its significance may be both more fleeting – or at least cyclical – and narrow than is generally believed. In the context of international politics, worries over security of demand for resource-rich nations may prove no less important than security of supply for the major energy- and commodity-consuming states. As commodity prices spiked between 2003 and mid 2008, countries such as Russia, Iran and Venezuela amassed substantial reserves of hard currency. They then used these reserves to spend lavishly on projects meant to bolster their political popularity. But as a range of factors depress prices for energy and other commodities, these governments face domestic economic and political problems for which they are not prepared. Rich-world states, which have grown to accept these coun-

tries' new strength, may again find themselves managing the fallout that comes with their weakness – and a slowdown in supply growth over the next several years.