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The integration of natural resource markets as a means to peacebuilding in Latin America

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Executive summary

The rising prices of natural resources and generally stronger economies in Latin America have led to deeper economic integration among the countries of the region. Former foes have now become economically interdependent, reducing the risk of serious conflict. However, the potential of exporting natural gas and hydroelectricity from the Andean region to the energy deficient local superpowers of Brazil and Chile is still untapped. Resistance to large-scale projects by indigenous groups and regional politicians empowered by treaties protecting indigenous rights, combined with a commitment to decentralisation in general, implies that central governments lack full control of their territories. The large-scale investments needed for such projects are hence perceived as risky, because expensive infrastructure is needed on both sides of the border. In addition, the cash-abundant consumer nations are expected to fund the necessary investments in producer nations through public-private partnerships. They are hence vulnerable to accusations of "foreigners and multinational companies stealing our resources", which fuel local resistance. Norway could contribute to overcoming the tense conflict level that prevents the realisation of both economic and climate-friendly cross-border energy co-operation by sharing its experience on indigenous rights and the geographical distribution of income from natural resources. Currently, Norway cannot respond to requests for assistance due to a lack of organisational capacity at the Ministry of Foreign Affairs. This report therefore proposes the creation of an independent unit to deal more efficiently with delegations requesting assistance.

Introduction

Latin America has traditionally exported natural resources to the more industrialised countries, previously in the West, and now increasingly in Asia. However, the flow of goods and services between Latin American countries has been minimal. Low intraregional trade volumes reflect similarities in the resource base and rather small industrial sectors in most countries.[1] In addition, even when comparative advantages do exist, distrust and antipathy between close neighbours due to historic conflicts and border disputes often prevent economic exchange. Furthermore, ethnic and political differences obstruct the development of cross-border trade.

Considerable political efforts have been made to boost economic integration. The Union of South American Nations (UNASUR) is the latest venture aimed at creating overarching political and economic integration in Latin America comparable to that in the European Union (EU) (Portales, 2012). UNASUR comprises the two major pre-existing trade blocs, i.e. the Southern Common Market and the Andean Community of Nations, as well as the economically powerful Chile. Most emphasis has been put on political collaboration and continuing the pre-existing Initiative for the Integration of the Regional Infrastructure of South America (IIRSA), which is funded by national governments and the multilateral system. The Bolivarian Alliance of the Americas is a trading bloc among the more radical regimes, which is

1 Mexico and Brazil are exceptions, but even here the extent is small compared to these countries' large populations.

largely supported by Venezuela's exchanging of oil for other local products and services, e.g. doctors from Cuba, at fixed long-term prices. The Latin American countries also act as a bloc in relation to the rest of the world, co-ordinating trade agreements with the U.S. or EU, for example, or taking part in the Asia-Pacific Economic Co-operation.

However, the ability of these organisations to mediate conflicts is weak, and in practice neither countries nor companies tend to see contracts and agreements as absolute and unbreakable. This is of vital importance in the hydroelectricity and gas sectors, which require enormous investments. What happens if one of the partners does not comply with the agreement, e.g. if it fails to pay for supplies or does not deliver the agreed volume? If infrastructure is fixed, alternative sellers and buyers may be non-existent. This combination of monopsonies (single-buyer situations) and monopolies (single-seller situations) means high risks for both sides of the trade.

However, economic growth has encouraged actors to take on more risk. Companies have been buying firms across national borders and governments have been taking unilateral action in order to show themselves as trustworthy partners. This positive spiral of regional economic integration and peacebuilding is threatened by two factors: firstly, the slowdown in economic growth makes actors more risk averse in terms of cross-border investments, and, secondly, weak governments cannot control local resistance to export-oriented projects and their related infrastructure, which makes potential investors see such governments as less reliable partners.

Norway cannot influence the overall economic situation in Latin America, but it can make a small difference when it comes to improving the poor periphery-centre relations that hamper economic development. By sharing its experience in regional distribution and the creation of representative consultative organs for the indigenous population, Norway might inspire Latin American actors to build institutions that can help to prevent social and environmental conflicts.

Trust/peace and trade

The EU was awarded the Nobel Peace Prize for 2012 in the midst of economic and political crises as a reminder to the world of its peacemaking effects. Building trust among the former foes of two world wars has paved the way for economic co-operation. Even more impressive is the level of mutual economic interdependence and trust that has developed. This positive spiral of trade/integration and peace/trust seems to hold true even if the current economic crisis may reveal that some countries have been "cheating". (One example is Greece's deliberately incorrect reporting of its national accounts, which was intended to make its EU partners believe that the country was solvent so that they would continue to lend it money.)

Similar sources of conflict exist between some Latin American countries, although open warfare has been less common and there are fewer casualties in each episode. However, injured national sentiments may endure, obstructing economic collaboration for centuries.

The explicit link in Latin America among economics, trade and environmental resources integration, on the one hand, and peace, on the other, is similar to that in Europe. The populations in nations with cross-border economic interests have more to lose from war and are hence more willing to seek peaceful outcomes when conflict arises for any reason (Hirschman, 1997). Furthermore, increased contact between nations makes it easier to understand each other, thus preventing misunderstandings that might otherwise lead to war. On the other hand, trade can also result in the exploitation by people of one nation of those of another, which might cause a sense of grievance, e.g. the Itaipu dam collaboration.[2]

Latin American trade and foreign direct investment policies

A fundamental reason for trade is the principle of comparative advantage described by David Ricardo two centuries ago. Given a situation where two countries each manufacture those goods and services that they can produce relatively more efficiently, the ensuing trade between the two parties will lead both to consume more of both types of goods and services than if each country produced solely for its own consumption.

Throughout history the countries of Latin America have vacillated between free trade and restrictive state industrial policies. The import substitution policy of the 1960s-80s imposed high import duties to protect local infant industries. The idea was to enable companies in non-traditional sectors to learn their business until they could become competitive on the world market, and then open up these sectors to trade. However, the combination of protection and subsidies provided few incentives for companies to become more productive. The result was low tax revenues compared to the state expenditure involved, and low growth rates. The resultant frenetic printing of money to enable states to meet their financial obligations brought hyperinflation and economic despair.

After the failure of import substitution had become evident, free trade and no state intervention in business (laissez-faire) became the policy of choice during the 1990s. Whether imposed by the debtor nations through the so-called Washington Consensus or actively chosen by the new rightwing governments that came to power at the

2 See footnote 12.

time, this policy also failed to deliver. Simply selling public entities to private companies, whether local or international, did not necessarily increase productivity, because their monopolistic position in the market continued. This period of weak economic growth in Latin America has been called the "lost decade". It paved the way for left-leaning governments that had more active state-led industrial policies to take power.

This "pink" tide coincided with an extraordinary growth in demand for natural resources on the world market, accompanied by rising prices. The increased production and export of minerals, oils and foodstuffs not only brought economic growth, but also filled state coffers with tax revenues. This provided governments with greater financial ability to engage in more active industrial policies by financing investments in certain sectors.

"New trade theory" has emphasised the role of individual companies and intra-industry trade (Grossman & Helpman, 1995; Krugman, 1997). "Love of variety" implies that consumers are interested in buying foreign varieties in addition to nationally produced ones. Different countries/companies will attract consumers, and world champions will drive less efficient companies out of competitive markets. Companies are thus forced to innovate and become more productive by entering world markets, thereby increasing productivity at home as well. By facilitating the growth of companies to become multinationals, governments seek to create an economic structure that can secure future national income.

The Brazilian government has implicitly financed some companies and sectors at the cost of others. The Brazilian Development Bank (BNDES) has given subsidised loans to some companies or bought new stock issued to cover new activities abroad. The aircraft producer Embraer has factories in China, the meat industry has bought parts of the supply chain in importing countries to establish vertical control, and construction companies like Oderbrecht are taking on large-scale infrastructure projects all over Latin America. In addition, the BNDES has funded infrastructure that facilitates intraregional trade, from continent-crossing roads and energy grids at home to large-scale infrastructure programmes in neighbouring countries. The IIRSA, which is part of UNASUR, discusses and sets priorities for cross-border investments in transport, energy and communications. Its portfolio contains 524 projects, of which 9% have already been completed and 47% are under way, with a total investment of $46 billion (UNASUR, 2012).

A large share – 66% of IIRSA investment in the energy sector – is in the form of public-private partnerships with the host-country government. Thus, natural monopolies like trains, pipelines, etc. are de facto private companies subject to heavy price and quality regulations intended to prevent the misuse of their market power. The motivation is twofold: growth will increase the demand for Brazilian goods in neighbouring countries, while increased activity in these countries helps Brazilian companies to enter world markets.

Brazil also protects and nurtures some selected industries at home, irrespective of the nationality of the companies concerned. Because of the local content requirement in the oil sector – set in general terms by the law, with explicit percentages for a government agency – most of any product or service within the sector must be produced with Brazilian labour. By forcing multinational companies (MNCs) to establish production units in the country, Brazil seeks to create a viable national supply industry.

Brazil's current approach follows China's "Go Global" initiative from the early 2000s, which was predicated on a developmental and interventionist state (UNDP, 2013). This active export-oriented policy, based on subsidised investments, can be described as a return to mercantilism from laissez-faire. "Success" is measured by market share rather than current profits, with the underlying expectation that market share will give rise to income streams in the future. However, such an expansionist policy in Latin America is probably fuelled by the currently large inflow of foreign exchange based on the taxation of natural resources, since it is not possible to regulate wage and cost levels in the same way as in dictatorial China.[3]

Increasing trade and foreign direct investment

The countries of Latin America have become more economically interdependent over the last decade, and goods exports to Latin American neighbours rose by 19.4% in 2011 (ECLAC, 2012). The higher growth in total exports to the whole world, about 25% on average, reflects increases in prices rather than volumes of natural resource extraction. Still, the trend over the past four years is for relatively more intraregional trade, with a 6.5% annual increase, compared to a 5.6% increase in imports from and exports to countries outside the region (Melchior, 2012).

Latin American countries have a large share of the total global inflow of foreign direct investment (FDI), which reached $216 billion in 2011. Latin American companies tend to invest in consumer markets, while companies from outside the region mostly invest in natural resource extraction. Latin American companies undertook $8 billion in mergers with and acquisitions of other Latin American companies in 2011, up 70% from the previous year and

3 Large current reserves in China have a different origin. In China, it is possible to restrict wages and hence consumption due to weak labour unions and the absence of political competition. In addition, large companies (partly state owned) with monopolistic high prices dominate the economy. The private savings rate is high due to the country's one-child policy. It is difficult to invest at home, so both retained profits and savings are invested abroad (Song et al., 2011).

currently 39% of total volume. The corresponding figure for greenfield FDI was $14.6 billion, up 22%, but only 10% of total volume.[4] The mix of explicit local content requirements (such as not being allowed to sell a product or service if it is not produced locally), along with increasing import tariffs, induces what is known as "barrier jumping" FDI.

Reduced nationalism

The increase in cross-border ownership of companies has met surprisingly little resistance from host-country consumers and investors. One example is the Chilean acquisition of major retail stores and supermarkets in its historically hostile neighbour, Peru. Consumers do not appear to mind whether the product is marketed under the original Peruvian trade name (Wong) or the Chilean one (Saga Falabella). The dominance of Chilean companies in the export-oriented agricultural and food sector is not merely accepted, but is generally seen as a positive "export service" that allows Peruvian farmers to gain access to world markets.

On the other hand, due to historical grievances and differences in ethnicity, class, and political systems, cross-national investments in otherwise-historically hostile countries always entail the risk of being used as ammunition to stir populist sentiments in political and economic conflicts. For example, in 2012 Chinese demonstrators attacked Japanese stores to stir up nationalism in the conflict over the Senkaku/Diaoyu Islands. Peru's unsettled claim in the International Court of Justice in The Hague over territorial waters currently under Chilean control is a clear parallel that currently obstructs further investment in cross-border infrastructure.

Feelings concerning national ownership differ by industry in Latin America. People generally accept foreign ownership in the services, manufacturing, and construction sectors as long as it serves to create local jobs and development. For instance, the Brazilian government does not discriminate between national and international owners in giving company-level financial support, as long as the local content requirement is fulfilled.[5]

The exception seems to be the exploitation of natural resources. These are perceived as national tangible wealth that belongs to the "people" rather than wealth produced by individuals. With good reason: Latin American constitutions state that all subterranean natural resources are the property of the nation.[6] The government can organise resource exploitation in three main ways, i.e. (1) via a state-owned company with full control of production and marketing; (2) via concessions to private companies, involving a mix of net profits and gross production taxation (royalties); and (3) via auctions of rights to exploit the resource (sell on "the root"). Which approach brings most benefit to the population in general through income, employment and environmental consequences will depend on the institutional, technical and financial strength of the country. Latin American state companies have proven rather inefficient (e.g. PDVSA in Venezuela), however. Few MNCs are willing to pay a one-off sum prior to exploitation, due to the perceived political risk, as newly elected governments in Latin America have often not respected contracts signed by their predecessors.[7]

Most countries end up inviting MNCs to invest, which are the only realistic and viable alternative, since local companies lack capital and technical know-how. These MNCs carry most of the financial burden of investment, while the host countries also expect a transfer of know-how to national companies within and outside the natural resource sector in question.[8]

However, deals with foreign owners often become the targets of popular criticism, facing accusations of "national sellout", "corrupt politicians", "disrespect for the local population", "environmentally irresponsible behaviour", etc. much more readily than would have been the case with national companies. The immediate explanation might be grievances based on historical experiences with similar MNCs and a long history of foreigners looting the nation's riches, first by representatives of the Spanish and Portuguese crown, and more recently by MNCs that paid corrupt dictators for exclusive rights and little regulation of their activities. National governments now have a stronger negotiating position towards MNCs: governments have become more transparent and have developed the institutional capacity to auction exploration and exploitation

4 FDI figures do not necessarily reflect inflows of money, as the term includes retained profits from activity in the given country. Thus, the figures also reflect the degree of foreign ownership in a given country and the willingness of owners to keep investing.

5 This contrasts with the import substitution public discourse of the 1970s, which emphasised national ownership, self-reliance and independence. However, multinationals still dominate the technically more advanced industries, e.g. the automobile industry.

6 The Peruvian constitution even defines some surface resources like running water and trees as the property of the nation independently of formal ownership to the land as such. However, historical rights imply a de facto limited access to some users, normally the landowner, only. The U.S. has a different legal system and surface property rights also extend to subterranean resources. Many actors in Latin America believe that similar rights exist in the region and hence make similar claims.

7 Lack of confidence often becomes a self-fulfilling prophecy. MNCs need exceptionally good terms to secure initial investments if they fear that incoming governments will renege on agreements; the latter will in turn rightfully perceive such terms as unreasonable and demand their renegotiation (Rigobon, 2010). The Chinese have been acting against such conventional wisdom by paying upfront for future deliveries of oil, e.g. $40 billion to the current government in Venezuela. The opposition claims that these funds are used to "buy the elections" and they are considered by many to be an illegitimate debt.

8 Some countries, Brazil in particular, have partly privatised public companies. However, they retain a majority share, and thereby decision-making power as regards the company. Furthermore, the company is often granted a near monopoly in vital parts of the sector: for instance, the state may grant only pre-salt oil rights if Petrobras is part owner of the consortium that owns the field (pre-salt oil is found in reserves in deep-sea areas and under thick layers of salt; its extraction requires large investments). Peru and Colombia are examples of the "small state" approach, in which all production and investment are left to private companies through private-public partnerships. The Peruvian case is especially interesting because the new left-wing president, Ollanta Humala, has continued the neoliberal agenda of the World Bank's wonderboy of the 1990s, former president Alberto Fujimori, that has achieved double-digit annual growth rates over the past decade.

rights to the highest bidder. Most important is the growing competition among MNCs, because new entrants, such as partly state-owned companies – e.g. large Chinese and South Korean companies – are able to take on technically advanced projects and break the cartel tendencies within the oil sector.

Lack of state control

It is easier for indigenous movements and regional interests to get support from the majority against "foreign capital interests" than to appeal for the protection of minority rights. Today such special-interest groups have real power to prevent central governments from exploiting the riches of the nation through MNCs as their preferred instrument.

With the transition from military dictatorships to democracy in Latin America, local populations have dared to raise their concerns and protest against centrally imposed activity on their "territory". The fear of police/military repression and violent retaliation has dwindled, despite the deaths that have occurred in veritable battles – not least during road blockages, which are currently the most efficient method of obtaining wide attention.

Prior to granting an exploitation concession, national constitutions normally require an environmental impact assessment, in which consultations with the local affected population feature strongly. Moreover, the Latin American countries are signatories to International Labour Organisation (ILO) Convention 169 on Indigenous and Tribal Peoples and to the United Nations Declaration on the Rights of Indigenous Peoples, which give indigenous populations a certain right to be "consulted" on development projects on "their territory". However, interpretations of the terms "consultations" and "territory" vary. The state traditionally perceives this as a duty to *inform* the indigenous populations, whereas the indigenous populations often interpret it as a veto right over any proposed project. Non-governmental organisations (NGOs) tend to operate with the latter interpretation in working closely with affected indigenous groups, thereby indirectly encouraging protests (Wiig, 2008). In the end, the courts must make the final decision on how these conventions are to be interpreted. The Inter-American Court of Human Rights has practised a more pro-indigenous activist approach than, for example, its European counterpart, and has actually introduced the principle of a veto right if projects "threaten the cultural survival" of the affected indigenous population in specific cases brought before it (Garavito et al., 2009).

Furthermore, international financial institutions have become more restrictive in issuing loans to MNCs without explicit acceptance of the projects by the local populations. They fear for both their public image and the project's viability if it is met by hostility. The 2012 update by the World Bank's financial arm, the International Finance Corporation (IFC), of required performance standards regarding affected indigenous populations, which moved from the previous "right to consultation" to the current "free, prior and informed consent", represents a paradigm shift. Disregarding state sovereignty, these standards implicitly grant veto rights to the indigenous and local population in certain circumstances (IFC, 2012). Private investment banks follow suit by copying such "best practice". Especially Western MNCs now take into consideration the negative effects on their public image and the opinion of the owners and politicians – especially when the two coincide, as in Norway, where the state has controlling positions in most MNCs. The list of cancelled projects is long: for example, SN Power sold its 80% share in the planned Trayenko dam in Chile due to violent resistance from local Mapuche Indian organisations. Entire regions are considered "no go areas" because they are sensitive with regard to indigenous issues – Norway's Statoil, for instance, will not bid for oil fields in the Peruvian Amazon, leaving the initiative to potentially technically less capable small companies that do not worry about the loss of their international reputations if they spill oil in the jungle.[9]

The other problem is regional resistance to the use of the central government's claims to what the regions consider to be "their" natural resources. In the 1990s multilateral organisations saw decentralisation as the remedy for achieving good governance, because it was assumed that local governments would be more transparent, less corrupt, and more efficient in building functional institutions and carrying out development projects than central governments. The Latin American countries responded by decentralising decision-making power. More importantly, about 50% of the natural resource revenues should go directly to the producing region, mainly at the municipality level in a system known as "*el canon*" (the canon).

The idea of introducing this system was to provide an extra incentive for the local population to support natural resource extraction, but the effect has often been the opposite. Implicitly, it confers property rights on the local people, who hence focus on what they perceive as unreasonable income going to the central government from "their" resources. For example, the $5 billion government investment in the Conga mine in the northern department of Cajamarca, Peru, was halted due to local resistance. The local people protested both against expected water pollution and what was seen as an unsatisfactory share of the revenues.

At first sight, the argument of few economic benefits to the local population may seem unreasonable. However, recent research has indicated a "local natural resource curse". Caselli and Michaels (2011) show that the people living in

9 Personal communication with Statoil. Environmental concerns as such are seen as less problematic than potential resistance from local and indigenous groups. Onshore exploitation is technically less complicated than offshore activity.

Brazilian municipalities with large oil canon incomes do not enjoy better services or higher income than comparable municipalities without such incomes. What this research has shown is that municipal employees have significantly larger houses, indicating the same mismanagement of funds that the decentralisation policy sought to prevent at the central level. A similar study of the mining canon in Peru demonstrates a similar lack of positive impact, when controlling for department fixed effects (Loayza et al., 2013).

The canon system was incorporated into law during the 1990s when prices of natural resources were low. This was followed by steep price increases: oil prices, for example, soared from $10 to $130 barrel and real mineral prices are currently five times higher than they were then (Sinnott et al., 2011). The cost for non-producer regions of allowing the canon system was initially small, but their discontent has increased with rising price levels.

In 2013 the Brazilian Congress, dominated by non-producer states, passed a new law that reduces the share of oil royalties for producer states and municipalities from 62% to 26%. The difference is to be distributed in all states according to population size and developmental needs (Kasahara et al., 2013). The three main producer states, Rio de Janeiro, São Paulo and Espírito Santo, responded by bringing the new law before the Constitutional Court and then by threatening to impose local taxes on the oil companies to compensate for their (i.e. the states') losses. The latter would constitute something tantamount to an "act of war", as it would drastically undermine the federal government's ability to provide stable conditions for MNCs.

The smaller countries tend to copy the policies of "their big brother" Brazil as regards the general move away from the laissez-faire system to an interventionist development state policy. The Brazilian turnaround on the local canon system might set precedents elsewhere in Latin America for the similar suspension of rights to natural resource income by the regions of origin.

De facto separatism is actually a reality in some places. One example is Puno Department in Peru, which is dominated by Aymara Indians. The population and the local government have resisted large investments by MNCs, but hardly lift a finger to prevent "informal" mining, even when it involves thousands of employees and heavy machinery. All income is then local (in fact, many of these entrepreneurs are actually South Asians) and no tax revenues are sent to the central government in Lima.

Bolivian gas

Two examples illustrate the effect of trust and trustworthiness on economic integration. The Bolivians have never forgiven Chile for stealing their access to the sea during the 1879-83 War of the Pacific. They still claim their piece of the Atacama Desert, refusing the offered preferential access to Chilean ports and using a Peruvian alternative instead. Also, Peru brought the related maritime boundary delimitation between it and Chile before for the International Court of Justice in The Hague in 2008.[10] These unresolved territorial issues dating back more than a century have a real impact on current economic co-operation because the strong, but energy-deficient Chilean economy cannot buy natural gas from either of its neighbours with huge unused gas reserves.[11] However, Chile also does not trust its neighbours after Argentina cut contracted deliveries of gas in the cold winter of 2006. It now prefers to import liquefied natural gas from Qatar.

Peruvian hydroelectricity

Fixed, inflexible investments in hydroelectricity grids make both producer and consumer nations vulnerable to extortion by their partners in spite of signed contracts. The consumer might offer a minimal price because investments are sunk cost and there is no alternative buyer (monopsony). Equally, the producer might ask for sky-high prices if the consumer has few alternative energy sources (monopoly). Foreseeing this time-consistency trap, neither partner is prepared to risk investing in expensive hydroelectricity infrastructure.

The availability of and need for hydroelectricity tend to coincide with national borders. Waterfalls in sparsely populated mountainous regions have high fall heights and thus hydroelectric schemes there can produce large amounts of electricity, but the water runs more slowly through the populous lowlands, where the energy demand is located. The hydropower potential of the eastern slopes of the Andes is enormous. The World Bank mapped this potential in Peru in 1979, proposing 543 hydroelectric dams with an installed capacity of 45 GW. However, most plans stalled due to lack of project implementation capacity at the time. Less than 5% of this potential is exploited today (World Bank, 2010).

However, local know-how has improved, and Finer and Jenkins (2012) indicate the potential for 151 large dams on the eastern slopes of the Andes of Peru, Ecuador, Colombia and Bolivia that could supply far more than local needs, which opens up the possibility of exports to Brazil. The environmental impact of these upper valley projects is small compared to dams in the Amazonian lowlands, giving a positive climate effect if hydropower replaces coal- or gas-fired power stations.

10 Peru is constructing the southern gas pipeline in the belief that increased industrial consumption and exports to Chile will induce support for further exploitation in the Amazon jungle, counteracting resistance from indigenous groups and regional separatists.

11 Norway's possible reclaiming of Jemtland and Herjedalen, lost to Sweden in 1645, is a parallel situation. Two Bolivian presidents were ousted by popular sentiments in apparently "win-win" gas deals with Chile, paving the way for the election of Evo Morales.

At a meeting in Manaus in 2008 Presidents García of Peru and Lula of Brazil signed an agreement on their two countries' intent to release this potential of hydroelectric energy co-operation (*The Economist*, 2011). Trust is needed to risk such heavy investments. Brazil has taken several initiatives to create an image for itself as a trustworthy business partner.[12] Firstly, it was willing to pay for much of the infrastructure on the other side of the border. Peru's policy has been to keep state involvement in any production to a minimum by putting the projects out to tender to private companies to build the dams and transmission lines. Brazilian companies were expected to bid, supported by government through subsidies from the BNDES. They were to achieve three integration goals in one go, i.e. those of (1) helping Brazilian business to grow internationally in strategically defined sectors; (2) helping neighbouring countries to grow, with expected feedback in terms of import demand for Brazilian goods and services in general; and (3) securing low-priced energy for Brazil's industry and consumption, both today and not least for the future, if this carbon-free alternative were to become a comparative advantage. But most importantly, by taking the financial risk, Brazil demonstrated its willingness to comply with the contract.

Both Peru and Brazil entered the negotiations hoping to reach an agreement. From an initial list of 52 possible hydroelectric projects, the countries agreed to develop six, with expected annual production of 20 TWH (Dourojeanni et al., 2012). Then problems started in Peru. In an attempt to pre-empt potential protests, President García issued an emergency decree that allowed for the fast-track processing of applications to build the dams. The "emergency" was explained in terms of the risk that Brazil might withdraw if the process dragged on for too long. According to the new arrangement, constructors would not need an environmental permit until *after* construction had been initiated, which of course meant that any consultations with local people would take place too late to make any difference (Balarezo & Wiig, 2012).

This presidential move drew enormous protests from regional authorities, indigenous groups and other locals, as well as national and international NGOs. After a long, hard battle involving violent protests, especially in Puno Department, they were able to convince Congress to force the president to nullify the offending decree.[13] By first provoking opposition and then retreating, President García sent out a signal that it would not be possible to implement the projects.

Little is known about the process that ensued. As the consultancy reports were published, the number of projects to be included was reduced. Ultimately, only the large Inambari project remained, but early in 2013 the Peruvian government indicated in a press release that the project would not start before 2020. This major effort aimed at integrating Latin America's energy markets thus came to nothing, with economic losses not only to both countries, but also to the world, due to the non-realisation of a carbon-free energy resource.

The failure demonstrates the Peruvian government's inability to undertake projects outside Lima: it has generally opted not to become involved in the implementation, operation and ownership of large projects. This implies that companies must somehow negotiate with the locals to gain their consent, as the central government has in practice abdicated its responsibility to enforce decisions locally. The political cost of violence is too high and the probability of success too low, because locals can sabotage the process for extended periods, e.g. through repeated road blockages. The company must pay for public services to the communities affected, as well as provide monetary compensation to individuals. The locals tend to refer to solutions negotiated for other projects and then add more demands of their own. This inflationary practice further fuels the perception that locals are entitled to veto any project.[14]

The government also fears a contagion effect on larger areas. In 2009 indigenous groups blocked traffic in the northern part of the Amazon region for months, protesting against plans to implement large-scale agriculture in virgin rainforests. About 50 people – both protesters and police – were killed when the road blockage was lifted in the infamous "Bagua episode" that has adversely affected Peruvian politics ever since. The government later became very cautious about implementing new laws or projects that might provoke indigenous or regional rebellions, as the very unity of the country was at stake.

Furthermore, oppositional organisations have often accused the government of selling out to foreigners (in this case Brazilians) as their main argument (Franco Moreira, 2012). Both governments have probably lost faith in the viability of the project and are unwilling to risk the massive investments needed – the Inambari dam alone is projected to cost $4 billion (*The Economist*, 2011).

At the same time Brazil discovered large amounts of associated gas on the pre-salt oilfields outside Rio de Janeiro,[15] which represents an alternative source of energy. Furthermore, Brazil's active "conquest" of the Latin

12 Brazil worked hard to improve its credibility as a trustworthy partner by renegotiating perceived unfair contracts that were signed during the times of dictatorial regimes. For example, Paraguay and Brazil share the Itaipu hydroelectricity dam on their border river as equal partners. However, the former can consume only a small part of its share of the enormous 95 TWH/year production and has been forced to sell the remainder to Brazil at a pittance. In 2009 Brazil agreed to almost triple the price it paid for the electricity from $124 to $360 million a year "to calm tensions with its neighbors, asserting Brazil's leadership in the region and promoting regional integration" (Barrionuevo, 2009). It would appear that Brazil wishes to signal that it has become a reasonable and reliable business partner.

13 Local representatives and the government met in the military compound in Juliaca to negotiate a "peaceful" settlement, implying that the Inambari project had been cancelled.

14 Personal communication with PRODIALOGO, a conflict-resolution NGO in Peru.

15 See footnote 8 for an explanation of pre-salt oil.

American economy might be over, as the Brazilian state now faces financial problems. Investments in the oil sector have been heavy and technical problems have delayed the expected revenues from oil exports. As economic growth slows down – projected to be 1.5% in 2014, compared to 3.5% on average for Latin America, according to the International Monetary Fund – the government has become more restrictive about financing risky economic integration projects (Kasahara et al., 2013). Peru also plans to invest in natural gas energy by extending the pipeline system.[16] Thus, relatively carbon-free hydropower is losing priority to carbon-based gas energy. Latin America could attract energy-intensive industries – take, for example, the coal-fired energy industry in China, currently one of the major sources of CO_2 emissions in the world – if in future carbon emissions are priced according to the true negative climate effect.

Norway's possible contribution to Latin American economic integration

Latin America is growing rich and independent. The BRICS – the South-South collaboration involving Brazil, Russia, India, China and South Africa – has demonstrated its ability to find development paths independently of multilateral organisations and political pressure from the West. Norway is a small country with limited influence on local development in the Global South. Even the $1 billion support to the Amazon Rainforest Protection Fund in Brazil is proving to have little impact because the BNDES, which manages the fund, has limited management capacity and does not spend the money.[17]

However, as democracy deepens, the Latin American countries are seeking inspiration to solve their political and institutional challenges outside their own borders. How to consult the population to increase the legitimacy of coherent development strategies is of vital importance, because top-down imposition has become difficult in Latin American democracies.[18] Norwegian-designed consultation processes with both indigenous and regional actors might serve as a source of inspiration for Latin American countries in their efforts to develop their own political systems. The Norwegian Ministry of Foreign Affairs has assisted some countries in developing institutions for consultation and related legislation: in Guatemala, for example, Norway has supported institutional development after serving as a mediator in the peace process since the early 1990s. Other countries, among them Peru, are also interested in drawing on Norway's unique experience in this area.

It is difficult for governments to comply with the requirement for consultations with indigenous populations prescribed by ILO Convention 169. One reason is the lack of co-ordination among the various indigenous groups affected by any given project. Different tribes often oppose each other and different organisations fight among themselves to be recognised as the representative body in such consultations. And here Norway's Sámi parliament stands as a remarkable example of how different regional and political factions within the indigenous population can be co-ordinated to become an accepted counterpart in consultations with the Norwegian government.

Norway's experience with the regional distribution of national income with some regional autonomy could be a valuable lesson for countries concerned about national unity. The panacea of decentralisation introduced by the multilateral system – in the Latin American case, the natural resources canon – has led to considerable co-ordination problems among various levels of government: for instance, the main roads, for which the central government is responsible, may be in disrepair, while regional governments put new asphalt on feeder roads.

By inviting mixed delegations of politicians, NGOs, activists and business to Norway to study the Norwegian system, the country could demonstrate how natural resources can prove to be a blessing to the population at large. It could show that natural resource extraction is possible without disastrous effects for the environment, even in spite of harsh natural conditions, and could demonstrate how the income can be distributed equitably among citizens and regions. The possibility of preventing the natural resource curse is actually a novel idea for many Latin American actors. They should, of course, not automatically copy Norwegian policies, but they could draw inspiration from them to design their own institutions and laws.

Unfortunately, Norway's Ministry of Foreign Affairs does not have the capacity to invite delegations from all the countries that have shown interest in how Norway handles natural resource extraction. The NORAD "oil for development" initiative builds competence directly in developing countries, while PETRAD offers courses to visitors interested in the oil sector. I would propose the establishment of a similar organisation, for example named "SAMTRAD" to deal with indigenous issues and regional distribution, although on a smaller scale, and to support governments in designing institutions and receiving delegations of visitors. The limited capacity of the Ministry of Foreign Affairs, the Sámi parliament and other organisations could be used more efficiently if a programme were designed that could handle more and larger delegations efficiently with less administrative burden. The cost of a secretariat would be minimal compared to the efficiency gains. However, the understanding that visitors take home will

16 The moratorium on new hydroelectric dams to protect the Camisea gas field was lifted only recently (Statkraft, 2011).

17 The Organisation for Economic Co-operation and Development forced Norway to remove parts of this fund from its development aid statistics: the money had not been released since the BNDES had not fulfilled the agreement and could hence still not use the money.

18 The presidential system gives seemingly large discretionary powers to one person. However, it is easy to rally against such central state initiatives by painting the president as personally responsible rather than representing the population at large, as would be the case with decisions made by the Congress.

depend on the choice of informants and presenters in sensitive discussions on indigenous and local rights. By giving a specific interpretation, rather than an objective description, informants might give a biased view of how such rights are exercised in Norway and the country from which a particular delegation comes.[19] It would thus be advisable to present opposing views and experiences from directly involved actors and academics so as to provide a multi-sided view of the process under discussion.

Such opposing views could prove fruitful in nurturing internal discussions within delegations. The most conflict-ridden countries lack spaces for discussions between the government and indigenous groups. Existing channels are too heavily influenced by politics and leave no room for finding common ground. Inviting opposing groups as part of a single delegation can provide good opportunities to discuss conflict-laden issues in a more general form in the less sensitive context of Norway.

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19 Even in Norway, some lawyers accuse human rights experts of actively misleading parliament in the interpretation of ILO Convention 169 in order to give more rights to the Sámi. See, for example, the dispute between law professors Ulstein and Graver vs. Fleischer on Finnmarkseiendom (*Dagbladet*, March 14th 2005).

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Appendix: The proposed South American Gas Ring

Source: *The Economist*, August 18th 2005

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