State ownership in Latin America's Oil and Mining: Politics, Reform, Agency

Jojo Nem Singh| Workshop on Resource politics| Kyoto, 11 Oct 2019

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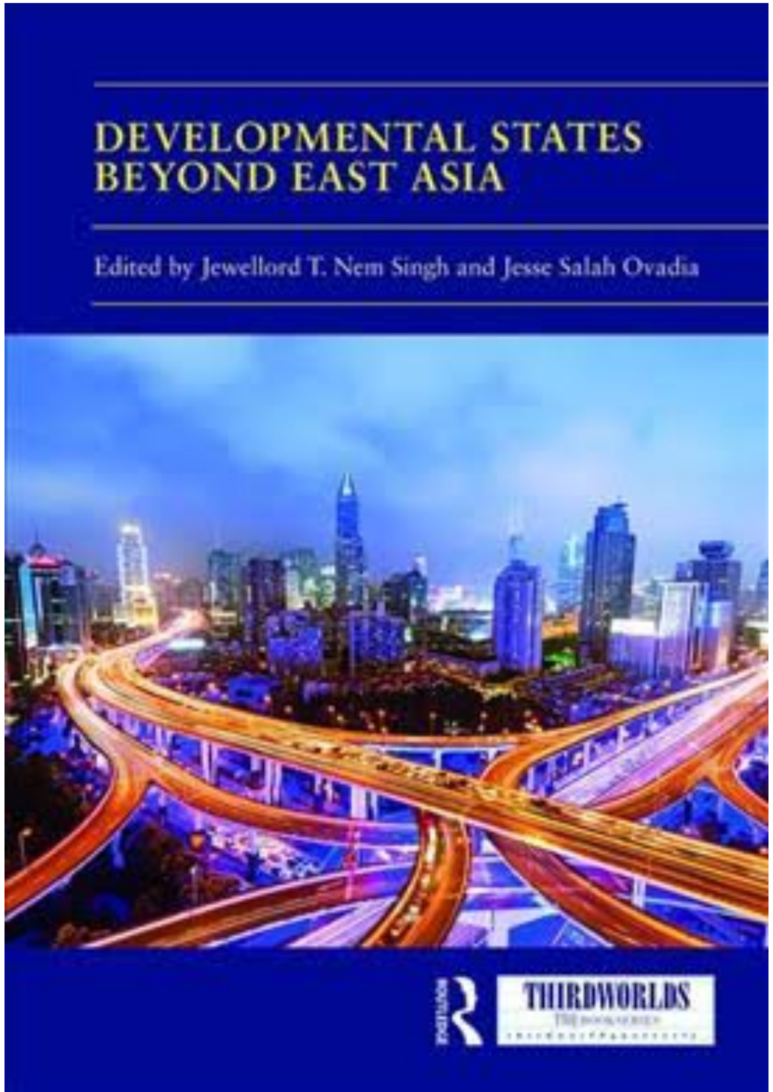
Outline

1. The Puzzle
2. Argument
3. Chile's Codelco (mining)
4. Brazil's Petrobras (oil)
5. Tentative Conclusions



The main puzzle

- Why do SOEs persist despite neoliberal reforms to privatize state assets?

- What developmental roles can SOEs play, but more specifically, how can they facilitate *industrialization*?

Analytical Argument

Why maintain SOEs?

- Path dependence
- Continuing strategic importance of SOEs
- Economic performance of SOEs

→

How do states alter SOEs?

- Corporate governance reforms/restructuring
- Assigning new roles – value creation and sectoral coordination
- Socialization of risks and rewards

→

Reform Outcomes

- Different ownership/management structures
- Multiple roles of SOEs
- Mutual dependence between domestic capital and SOEs
- Foreign capital as part of ‘triple alliance’

Why Brazil and Chile?

- Two cases showing different pathways of state ownership

- Embedded neoliberalism (Private sector-driven)
- Codelco as vehicle for profit revenue maximization
- Control over high quality copper ore as its comparative advantage

SOEs with *direct* state control (Coldeco)

- State developmentalism (Tradition of industrial policy and state control)
- Petrobras as vehicle for industrial policy
- Technological development through Petrobras as its advantage

SOEs with *indirect* state control (Petrobras)

What do we know about SOEs?

Traditional understanding of SOEs

- Soft budget constraints (inherently inefficient?)
- No mechanism for disciplining the agent
- Non-commercial goals → not always efficient

SOEs and national innovation

1. Value creation

- Build sectoral linkages across industries to generate spill over and learning effects
- Fiscal maximization to generate revenues for the state

2. Coordination or direction-giving role

- SOEs as lead users of technology adoption and diffusion in supply chain

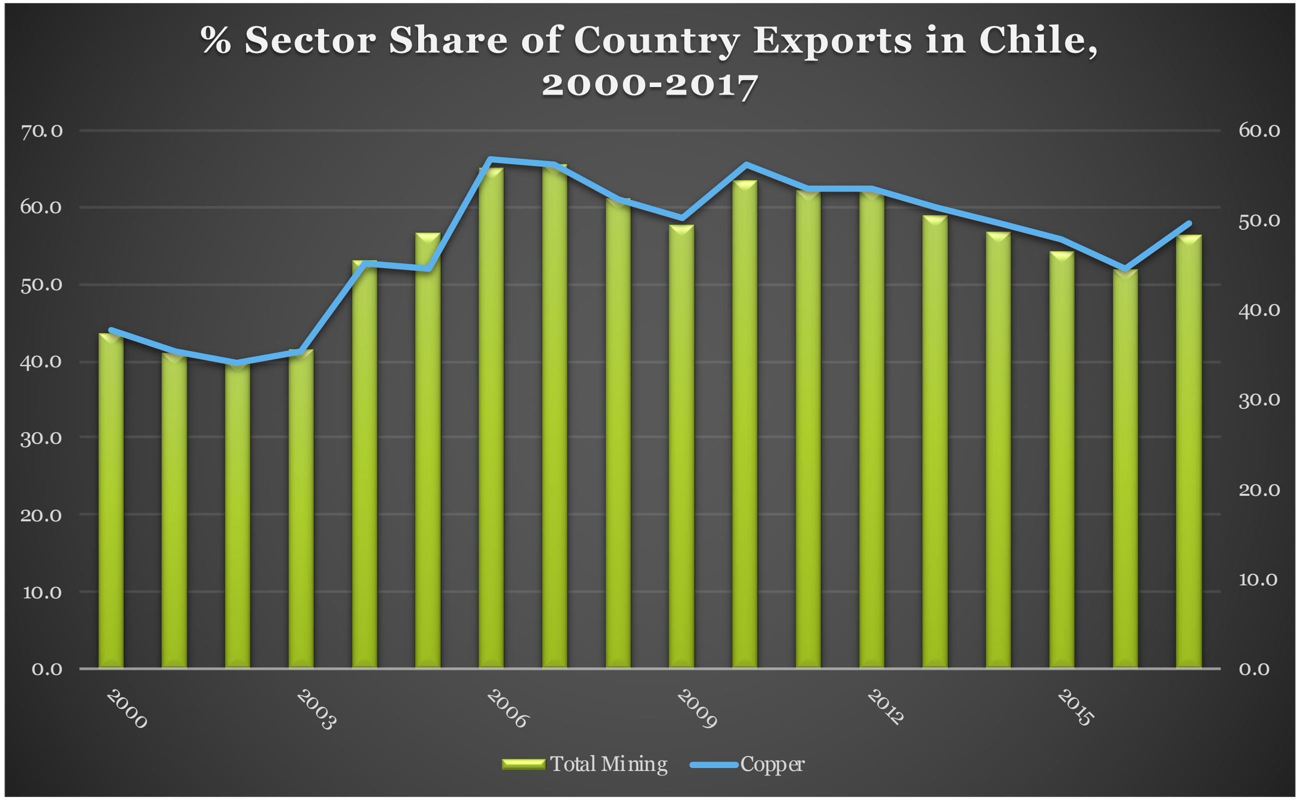
Towards a 'Mission-oriented' state

- States as investors that actively *create* and *shape* markets rather than resolving market failures (Mazzucato 2016)
  - Innovation as inherently disruptive and requires long-term commitment
  - Private firms: risk-averse, short-term orientation

  - Example: Development banks that can socialize *risks* and *rewards* (BNDES in Brazil, KfW in Germany)

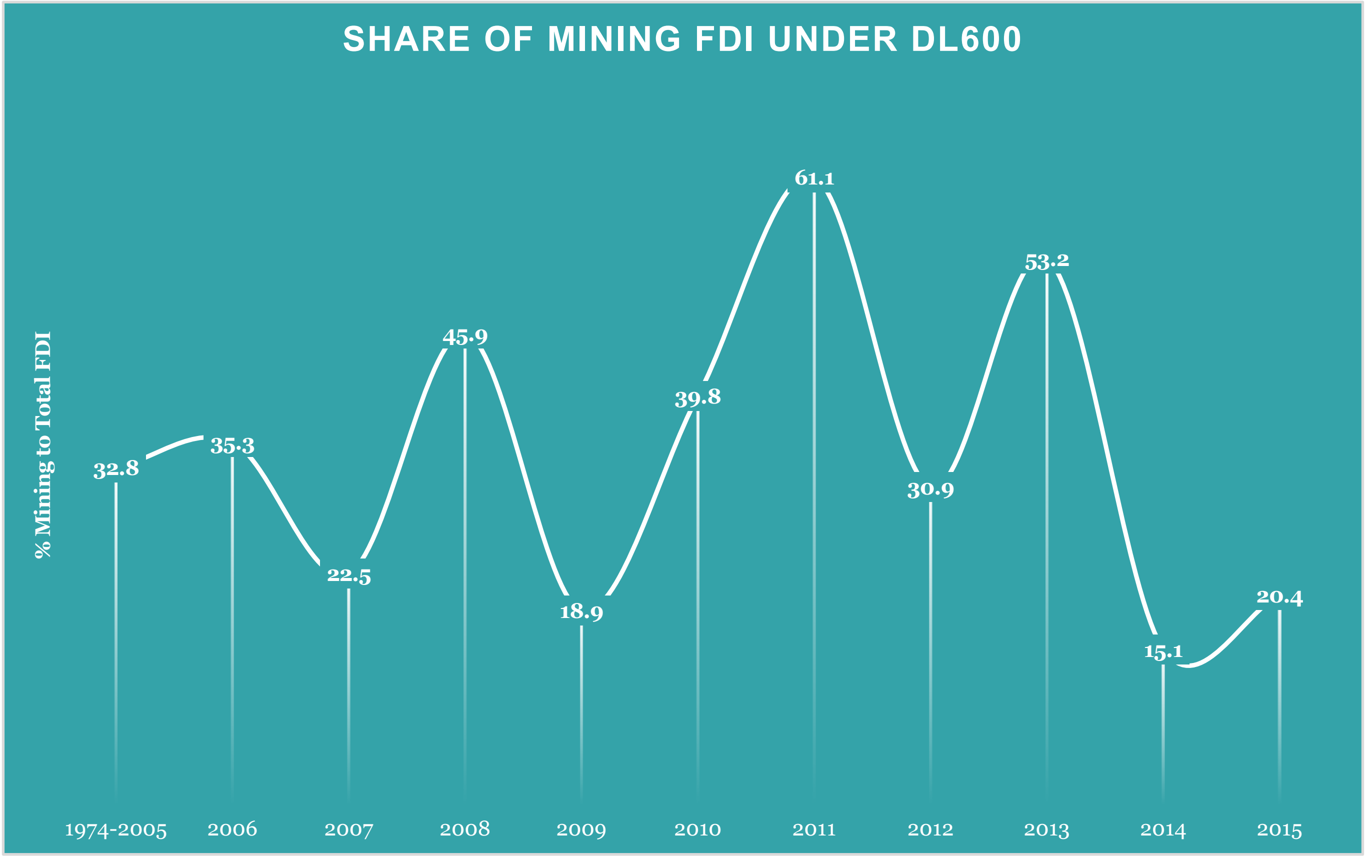
Case Study 1: Chile's Codelco (mining)

- Copper or 'red gold' (nearly 60% export)
- Centre-left government goal was to maintain some form of control over the industry *without* marginalizing private firms.

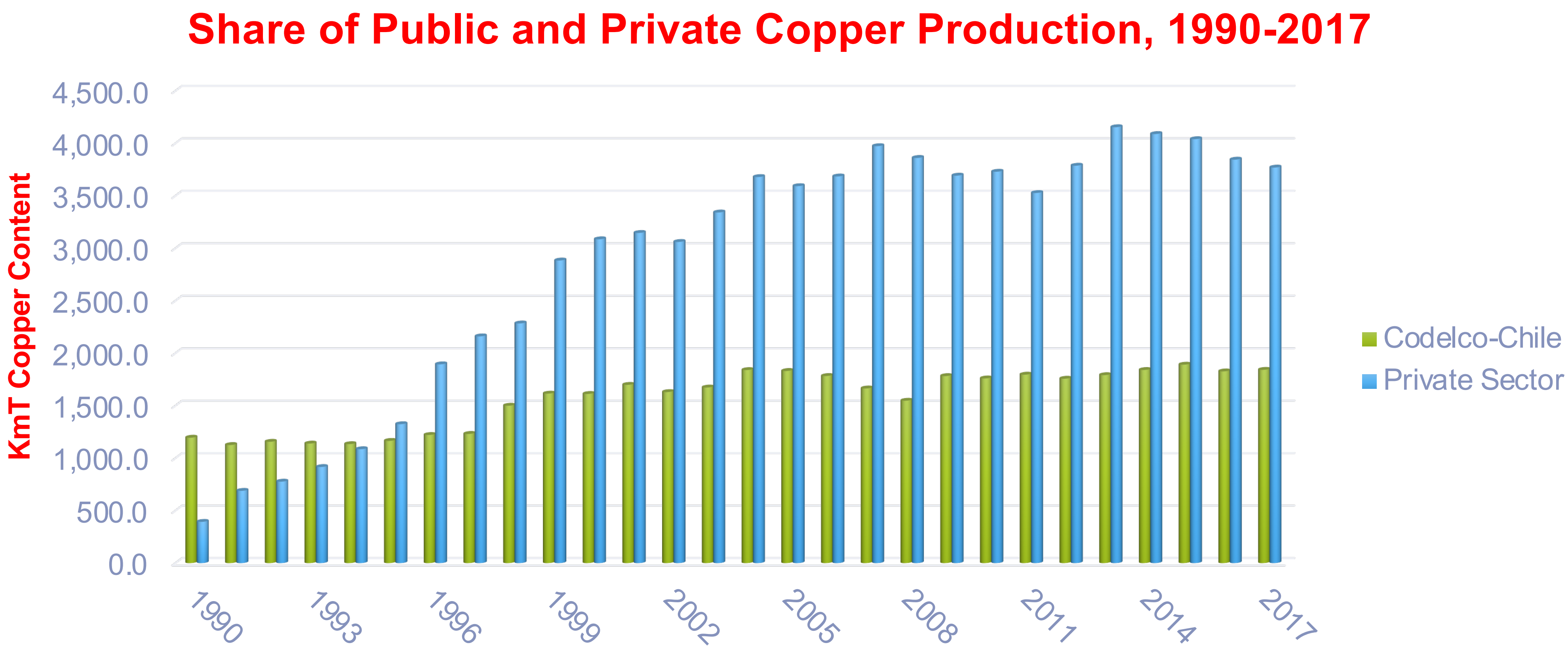


Mining and innovation

- The role of Codelco was *fiscal maximization*, not necessarily *innovation*.
- Innovation as private-sector driven (mostly FDI)



Structure of Mining Industry

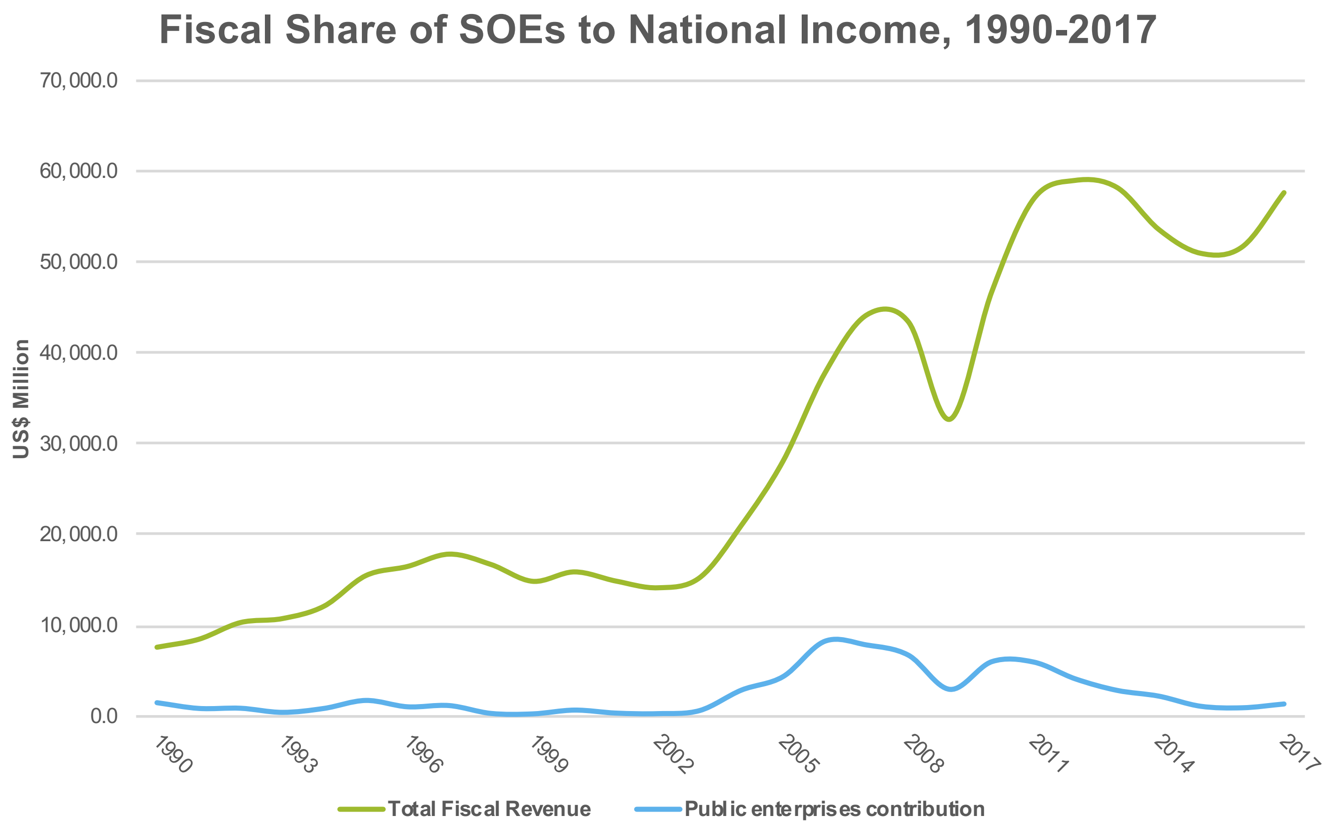


"There is an argument around why the state did not do the mining itself. I think there are two reasons. One, the state simply had no money to do it, to invest. If the government invests in mining, you cannot invest in education, healthcare and other things. On the other hand, the role of the state in Chile is to regulate, promote and take care of the poorest section of society, and not to do the business by themselves. The role in Chile... is *subsidiary*. The state is not going to conduct business where the private sector can do it."

Marco Fluckiger,
Head of Foreign Investment Department,
Comisión Chileno del Cobre (COCHILCO), October 2009

Codelco's role over time…

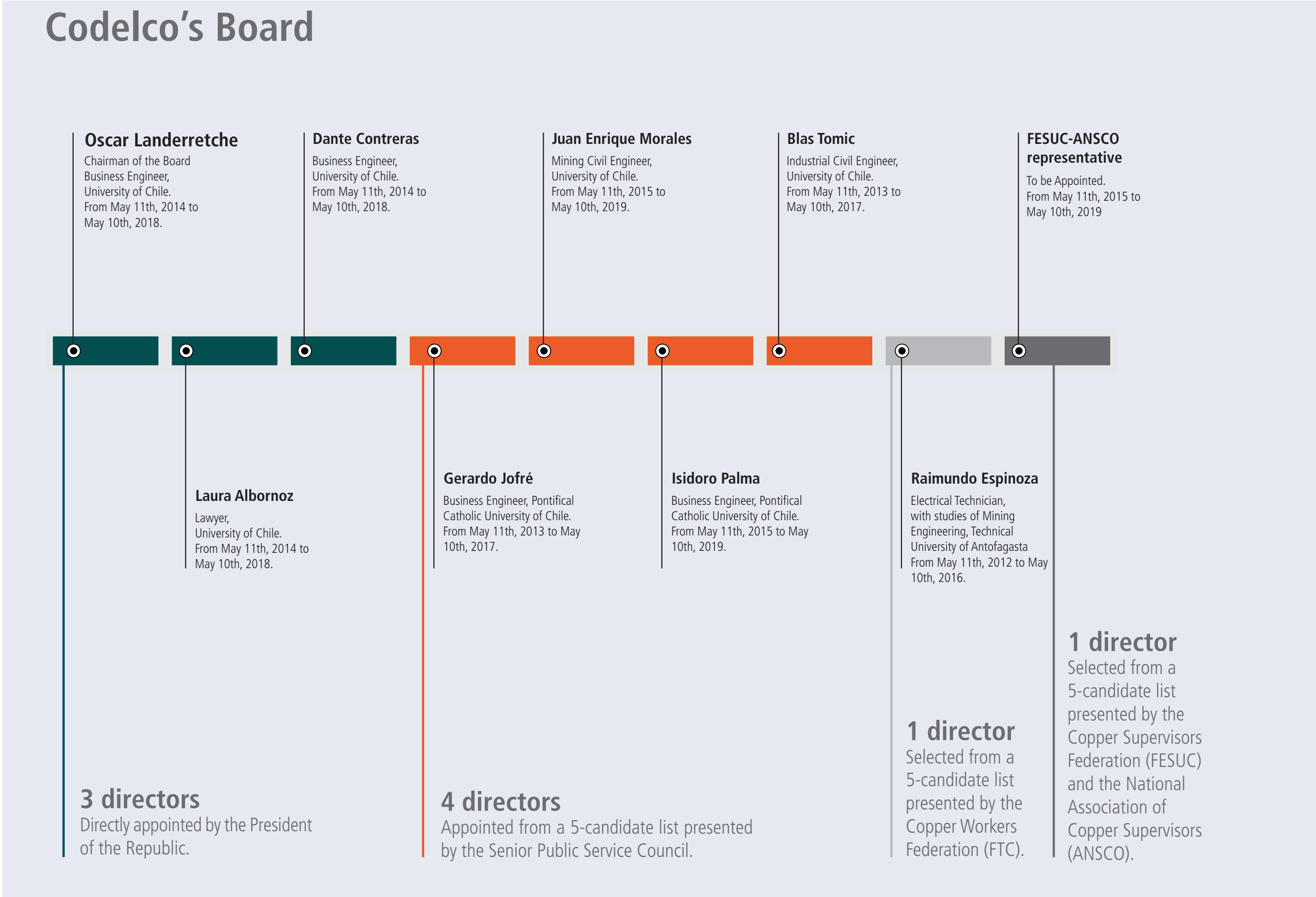
- As a source of rent-seeking for the military;
- Fiscal maximization due to commodity dependence; and
- A political buffer between states and private capital.



Note: Codelco: Income Taxes (corporate, 40% additional for State-owned companies, and specific mining tax), taxes payable under Law 13,196 and dividends reported by Codelco; not included other taxes (Customs and other duties). Codelco's contribution for 2011 was downwardly revised by US$948.6 million in consideration of income taxes paid at year-end, in line with tax revenues reported in 2012 by DIPRES, the Government Budget Office. Excluded from Codelco contributions in 2012 are US$114.7 million in income tax paid by related companies.

Corporate governance structure

- Corporate structure is highly politicized – no change in ownership structure of the company
- **Key functions of the Board**
  - Submit annual budget to the Ministry of Finance
  - Transfer profits to the state
  - Make decisions over joint ventures, divestments and investments
  - Appoint and remove the CEO
  - Approve acquisition of loans (internal and external) with the approval of the Finance Ministry
  - Approve structural projects and long term expansion
  - Discuss and approve mechanisms of capitalization and financing for the corporation
  - Approve the business plan



Implications for Autonomy and Developmental role of Codelco

Chile announces $1 bn for state-owned copper giant Codelco

Ministerio de Hacienda Chile
@Min_Hacienda

Titular del @Min_Hacienda @felipelarrain junto a su par de la cartera de @MinMineria_cl y presidente de @CodelcoChile anuncian capitalización de Codelco por US$1.000 millones. "Esto es solo capitalización extraordinaria", explicó el ministro Larraín.

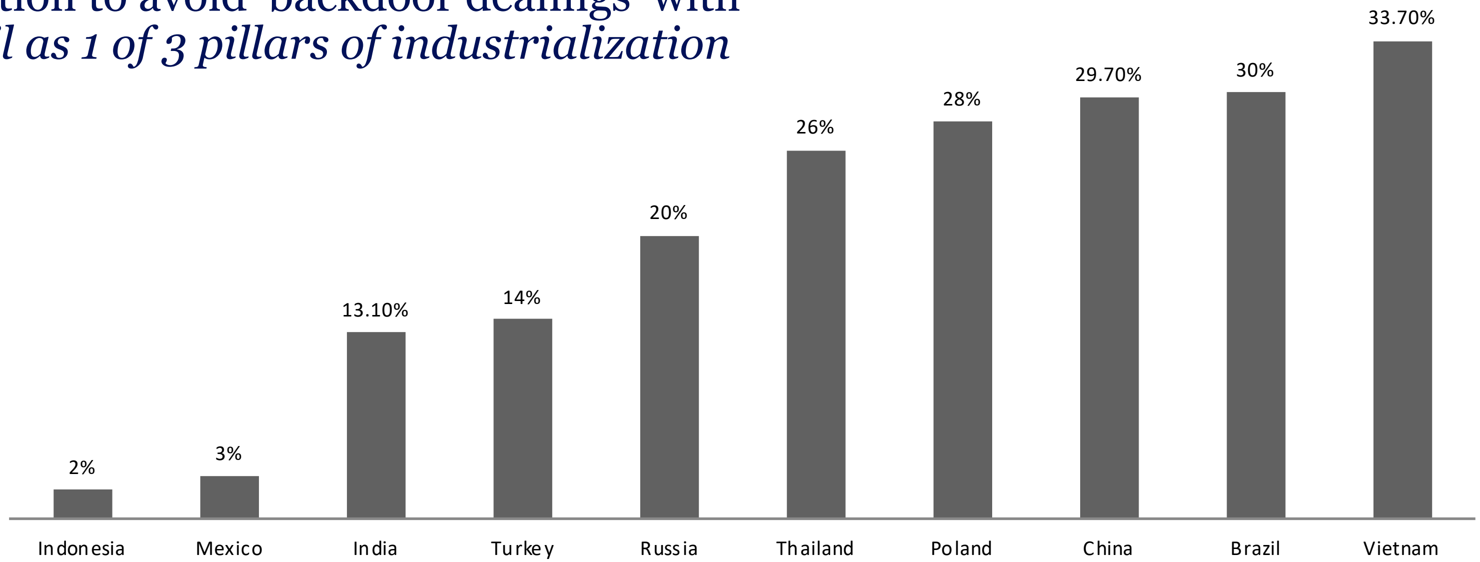
6 4:53 PM - Jun 29, 2018

Codelco remains tied to the hands of the Chilean state

- Investment decisions not just based on commercial pressures
- Inevitable tensions over the *appropriate* role of the state in development
- Codelco's capacity to promote innovation depends on government in power

Case Study 2: Brazils' Petrobras (oil)

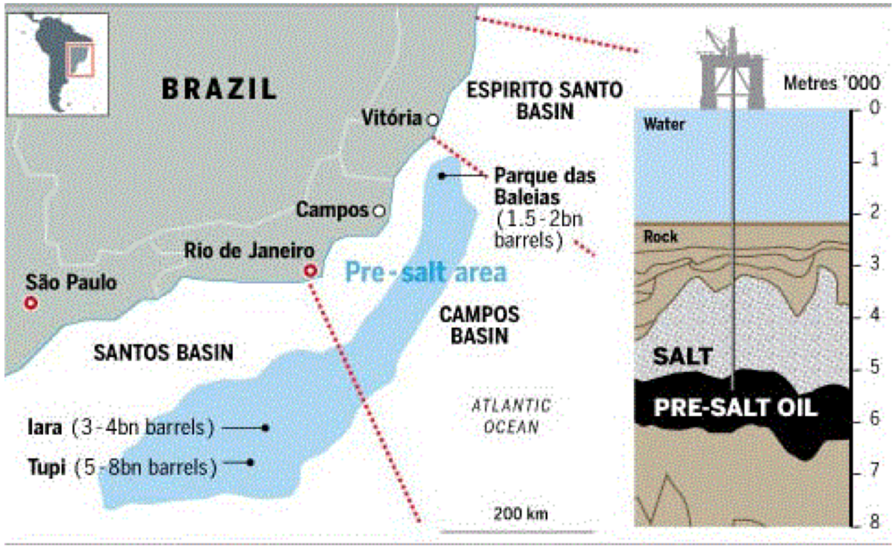
- Brazil has a tradition of *desenvolvimentismo* – state developmentalism – which effectively translates into a history of industrial policy-making.
- SOEs account for around 30% of Brazilian GDP
- Petrobras (1952) as a solution to avoid 'backdoor dealings' with foreign oil companies – *oil as 1 of 3 pillars of industrialization*



Source: Mussachio & Lazzarini (2014), *Leviathan in Business*, p. 7

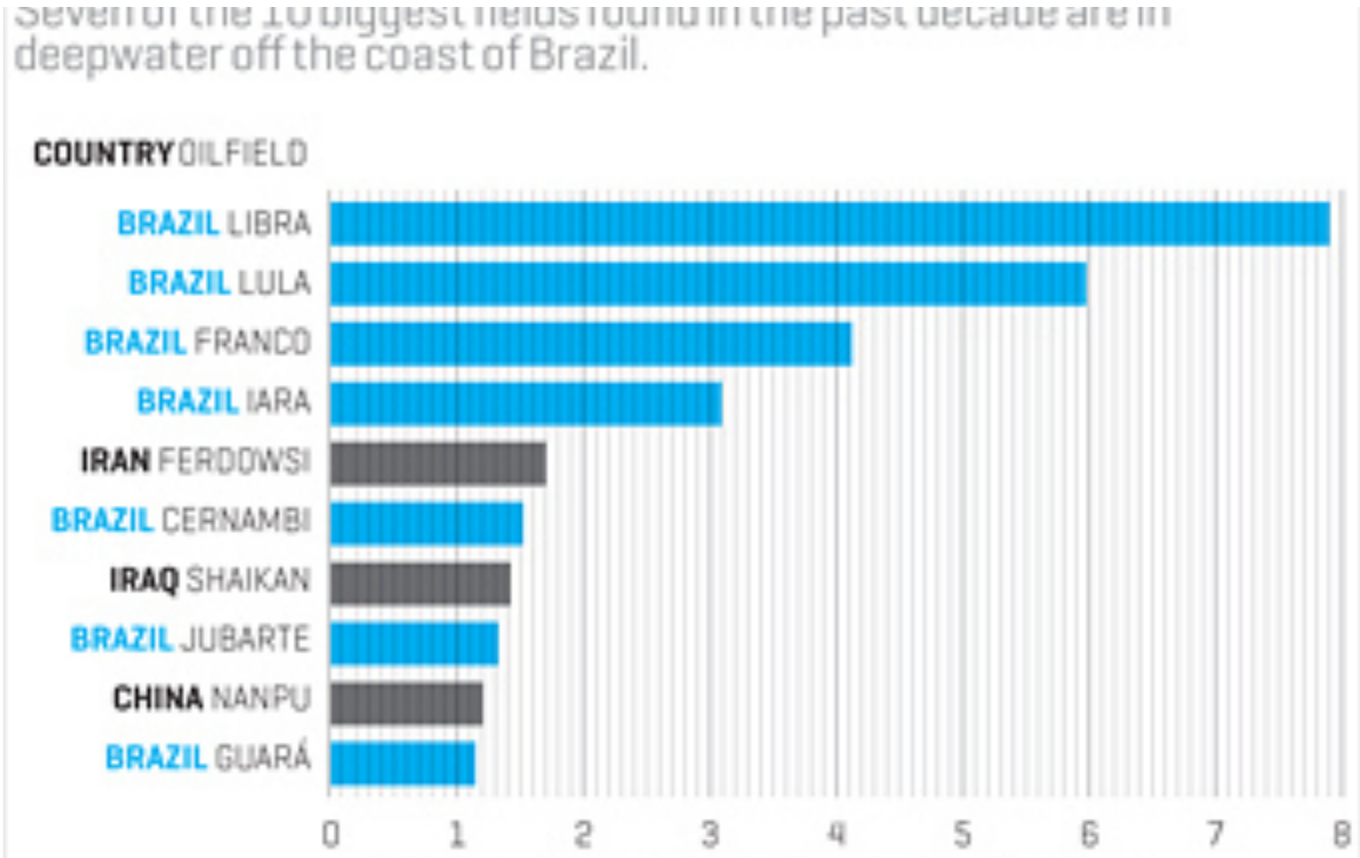
Enter 2007: The ‘Petroleum Cycle’ in Brazil

- Offshore reserves 2,000 metres below sea level – high investment risk
- Lula government introduced “production sharing agreement” in the context of *low risks to strengthen Petrobras role in upstream sector*
- Capitalization Law: Petrobras required to have 30% minimum participation share



10 Largest Oilfields discovery, 2001-2010

- Key to the success of oil and gas development is *Petrobras.*
  - Culture of innovation
  - Autonomy from government and close ties with military
  - Control over the *pace* and *scope* of oil exploration and production



Return of industrial policy in Brazil, 2000-2014

- Two key components
  - Heavy state investment infrastructure in oil and related sectors to generate domestic demand
  - Increase local content requirements to speed up the investment of IOCs into the sector

- Context of industrial policy:

➢ Investments in pre-salt reserves would only be viable as long as oil prices remained HIGH and

➢ Petrobras can maintain the *pace* and *scope* of its large-scale investment (assumption: corporate autonomy)

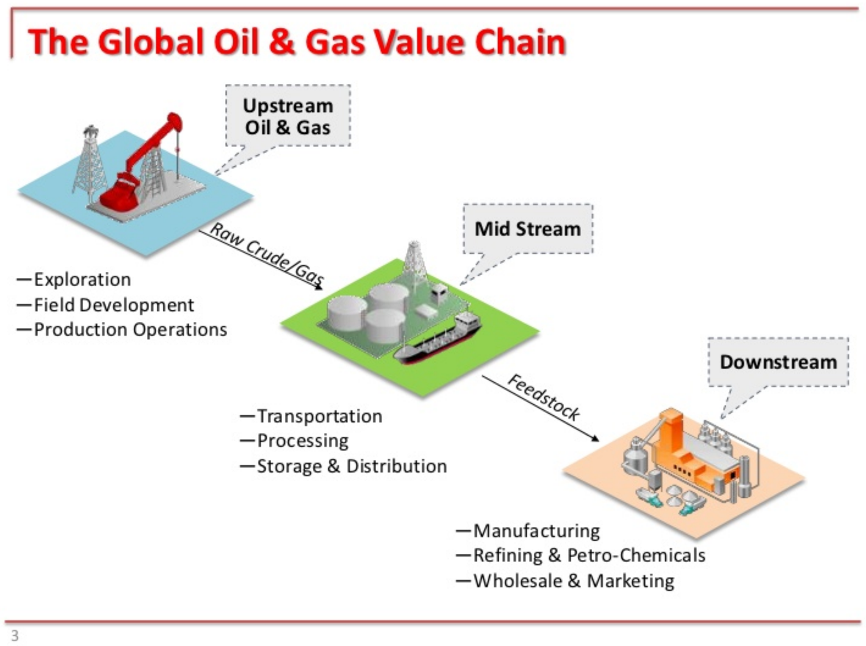
Petrobras as a lead firm for innovation

- Petrobras was a highly adaptable SOE:

➢ Shifted role from seeking oil (1952-1960s) to domestic market creation (1970s-1980s)

➢ Developed technology to address very specific problems to Brazil (e.g. heavy oil in sensor zones with high permeability, deepwater drilling technology, etc)

➢ Developed local supply chain for goods and services



Petrobras as an international energy firm

- Market reforms in oil sector highly contentious
- Make IOCs invest in the sector *without* giving up control over oil
- Petrobras remains the dominant market player
- State objective: To make oil industry *sufficiently* competitive.
- NB: Local content requirement remained, mixed ownership structure

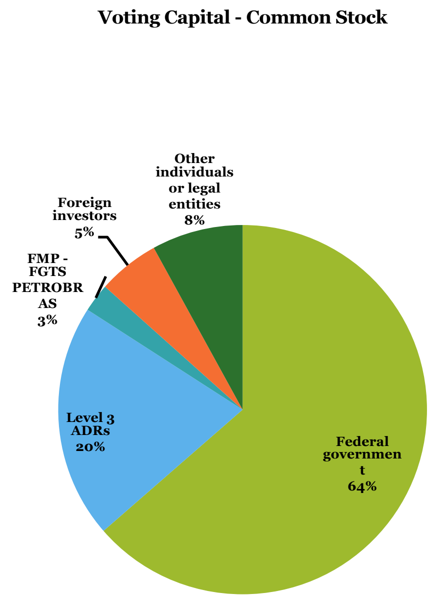
Petroleum and Natural Gas Production in Brazil by Operator, 2015

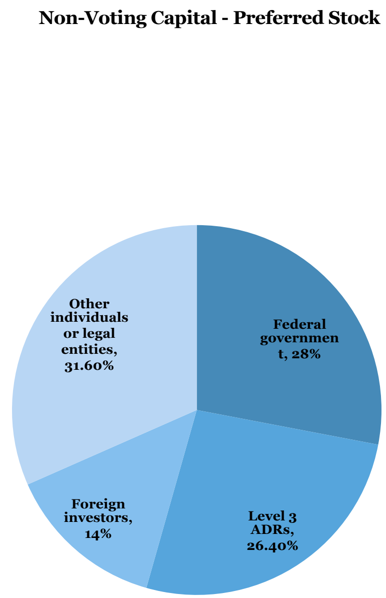
	Petroleum (in Barrels)		Natural Gas (in Cubic millitres)	
TOTAL	889667381		35126447	
Petrobras	822,051,381.5	92%	33115158.6	94%
Statoil Brasil	26,459,293.4	3%	36773.1	0%
Shell Brasil	23,460,667.4	3%	265679.3	1%
Chevron Frade	8,500,306.9	1%	92041.3	0%
OGX	4,900,627.0	1%	15407	0%
Others	4,295,104.8	0%	1601387.7	5%

Source: ANP 2016: 82 (Adapted).

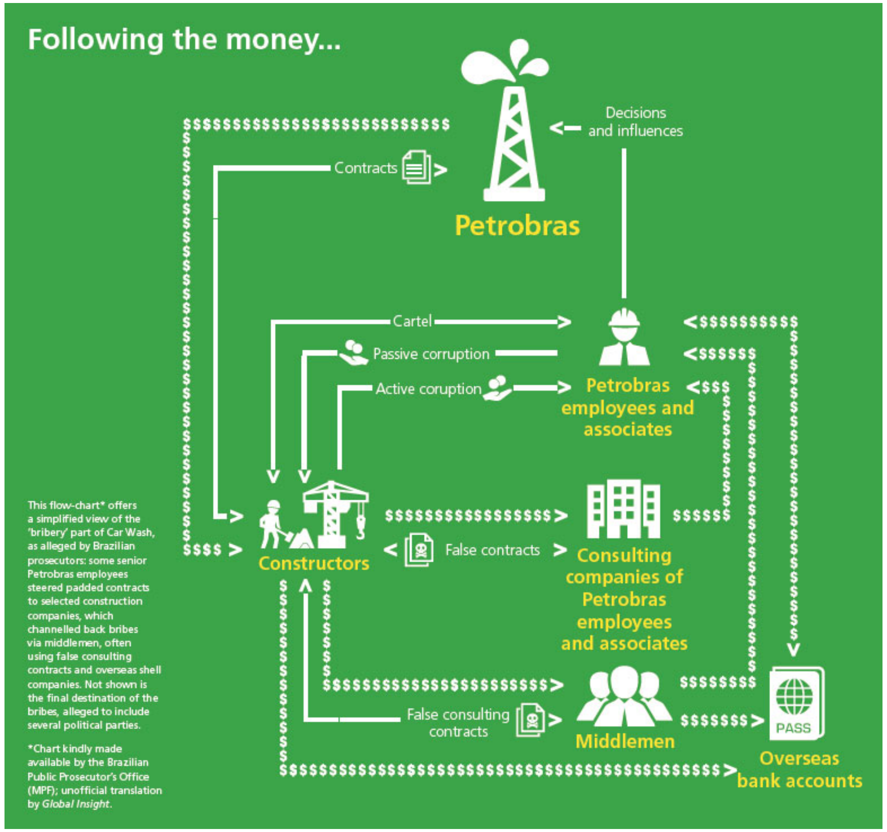
Corporate governance reforms in Petrobras

- Introduction of international shareholders in its non-voting capital shares → internationalization of Petrobras
- Separation of ownership and management (Nem Singh & Chen 2018)
- However, state remains in tight control of Petrobras → appointment of CEO remains a presidential prerogative





Petrobras and the ‘Lava Jato’ Scandal



- *Lava Jato* (Car Wash*)* operation:
  - Extensive corruption involving private and public actors
  - Political corruption financing campaigns

Politicization of Petrobras a constant

fastFT Petroleo Brasileiro SA ✓ Added

Petrobras shares plunge as Bolsonaro halts diesel price rise

Bryan Harris APRIL 12, 2019

Shares in Petrobras plunged more than 7 per cent on Friday after Brazilian President Jair Bolsonaro announced he would halt a previously announced increase in the price of diesel in a decision that raised fears that Brasília could tilt back toward interventionism.

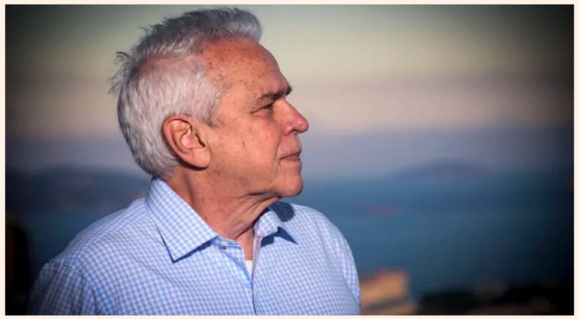
The move was ostensibly aimed at pre-empting another strike by Brazil's legions of truck drivers, who last year brought the country's economy to a halt while protesting the rising cost of fuel.

However, it has spurred fears that the new administration may veer away from its commitment to free markets.

Petroleo Brasileiro SA + Add to myFT

New chief vows to keep Petrobras free from political meddling

Castello Branco knows Brazil oil group needs to show autonomy to regain investor trust



Roberto Castello Branco, chief executive of Petrobras © Ricardo Lisboa/FT

Comparative Insights from the cases

- SOEs function differently depending on their political economy context – especially their historical antecedents.
- At the minimum, SOEs can take a fiscal role for the state to ***maximise rents*** and ***capture windfall profits***, which taxation policy cannot immediately provide. At best, SOEs can become ***vehicles of industrial policy*** and ***structural transformation***.
- A central feature of SOE governance is their autonomy.
- Corporate governance reforms especially aimed at separating *state ownership* and *control* have limitations because of the *intrinsically political* nature of SOEs.

Multiple Pathways in maintaining control

- Embedded neoliberalism (Private sector-driven)
- Codelco as vehicle for profit revenue maximization
- Control over high quality copper ore as its comparative advantage

SOEs with *direct* state control (Coldeco)

- State developmentalism (Tradition of industrial policy and state control)
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SOEs with *indirect* state control (Brazil)

Tentative Conclusions

- SOEs increasingly play a vital role in industrialization - especially in building national innovation systems (though we know more about China and East Asia…).
- SOEs face inherent operational and political problems → corporate reforms central to address them.
- Mixed results – SOEs embedded in domestic politics
- Need to examine historical/long-term role of SOEs rather than *cyclical* nature of politics.

Thank you!

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