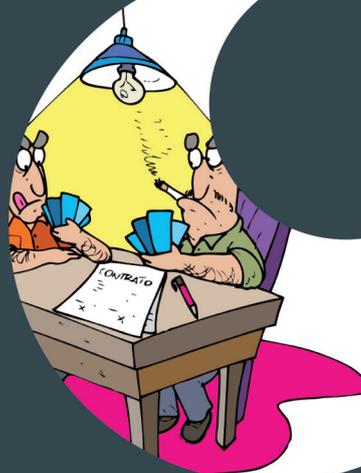
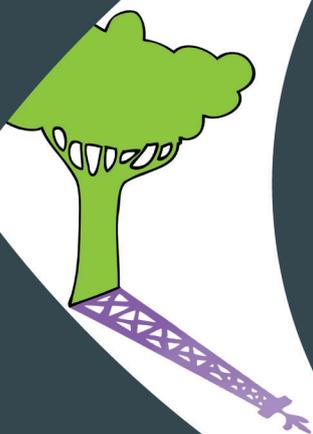


# TRACE BRIEFINGS 2010-2011

Examining oil extraction and transparency  
in Bolivia, Ecuador and Nicaragua



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# INTRODUCTION

Publish What You Pay Norway's TRACE programme is an educational programme that gathers civil society representatives working for transparency and accountability in the extractive industries. The 17 participants in TRACE 2010- 2011 come from civil society organizations, media and workers' unions based in Bolivia, Ecuador and Nicaragua.

In addition to coordinating the TRACE programme, PWYP Norway's main pillar of work is political advocacy, in Norway and internationally, and there is a mutual reinforcement between the TRACE programme and the campaign's advocacy work. On the advocacy side, PWYP Norway works through an international network with a flat structure. The cooperation with the participating organizations in the TRACE programme both strengthens and feeds into this PWYP network.

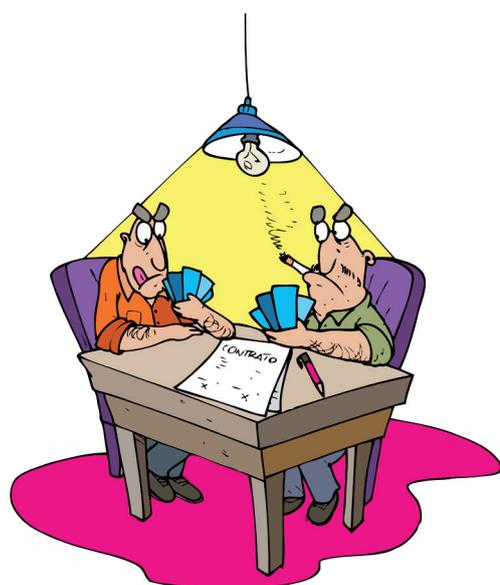
As part of the TRACE programme the participants gain technical knowledge, share experiences and work together in order to strengthen their own approaches to the issues. As for the following briefings, the hope is that they will be useful for those who did not have the chance to join in the programme, but would like insight into the topics.

The four briefings in this publication are written by the participants and edited by external consultants. Examining the impact of oil extraction in the three countries from different angles, the articles span thematically from environment and indigenous people's rights to contract transparency and financial flows. This diversity in the topics that are addressed reflect the complexity of petroleum technical, management and finance related issues that civil society have to address in their work for petroleum sector transparency and accountability. It was the participating organizations themselves that chose to go in-depth on these particular topics, and as the chosen priorities they were covered extensively during Module 1 and Module 2.

For more information about the TRACE programme, please visit [www.publishwhatyoupay.no](http://www.publishwhatyoupay.no) and go to **TRACE**

## The organisations and their representatives in TRACE 2010-2011:

Organisation	Representative	Country
CEADL	Alejandro Landivar, Juan Pablo Flores	Bolivia
Central Obrera Departamental	Galo Andrade	Bolivia
Diario Correo del Sur	Weimar Arandia	Bolivia
Fundacion Jubileo	Célica Hernández	Bolivia
Somos Sur	Marco Escalera	Bolivia
Sonora de Comunicaciones y Publicidad	Pedro Humberto Vacafior	Bolivia
Transparencia Bolivia	Jaime Pérez	Bolivia
Centro Andino de Acción Popular	Marcelo Varela	Ecuador
Diario El Universo	Christian Zurita	Ecuador
Frente de Defensa de la Amazonia	Ermel Chavez	Ecuador
Grupo FARO	Mabel Andrade	Ecuador
Jubileo 2000	Mariela Mendez	Ecuador
Terra Incognita	Juan Freile	Ecuador
Centro de Derechos Humanos, Ciudadanos y Autonómicos	Joel Narvaez	Nicaragua
Centro Humboldt	Iris Soledad Valle Miranda	Nicaragua
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# TRANSPARENCY IN PETROLEUM CONTRACTS

## A Comparative Study of Ecuador and Bolivia: What are the Strengths, the Weaknesses, the Opportunities and the Threats?

### I. Summary & Introduction: What is contract transparency and why does it matter?

Historically, the hydrocarbons industry has been considered very complex. Access especially to information that explains its management, its agreement, and its economic, social and environmental impacts, despite the important role these impacts have played, has been extremely limited. Governments have failed to create clear and viable mechanisms to control the industry and the channels of interaction; the coordination with national and international operators has also been non-existent or nuclear. Thus, promoting transparency mechanisms in the sector can help avoid the misuse of public resources, secrecy, improvisation, inefficiency, and discretionality in terms of resource management and practices. Therefore, generating and accessing truthful, timely and systematic information about the industry becomes indispensable. In addition, transparency can strengthen and promote citizen participation.

Within this context, and if we consider that 'transparency is not one of the qualities of petroleum, there is no other product that generates so much corruption, the producing countries are characterized by highly concentrated power, very weak democracies, and a weak state of law'<sup>1</sup>; this study will reflect upon the main changes and current rules and conditions of **petroleum contracts in Ecuador and Bolivia**. Because the transparency of contracts between governments and the hydrocarbons industry is essential for any effort to trace income and expenses, the focus will be on contract transparency, but other aspects of the industry will also be discussed. Both countries have undertaken numerous changes to the industry in the recent past; they have undergone a process of migration from participation to service lending, or politically speaking, from 'privatization' to 'nationalization' of contracts. The significance of these changes and the role of transparency in these processes and going forward is the subject of this paper.

Several main conclusions come from this study, which assess both historical evolutions and makes suggestions for the future. First, experience demonstrates that an attitude of transparency does not occur spontaneously among public institutions. Many times, State Management is interested in maintaining an asymmetry of information that favors the government over their citizens, given that this facilitates political success and permanency in position. And yet, transparency can emerge, but it might be limited. In Ecuador and Bolivia, contracts are disclosed. In Ecuador, contracts are disclosed once they have been negotiated and awarded. In Bolivia, contracts are to be approved by parliament; yet this has not been fully implemented.

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<sup>1</sup> Comment taken from the Systemization Forum 'Los Contratos Petroleros Y Sus Implicaciones Sociales, Económicas y Ambientales' 'Petroleum Contracts and their Social, Economic and Environmental Implications', Guayaquil, 20-21 January 2011

Nevertheless, it is not only the public sector that must make its information transparent. Private stakeholders involved in the production chain of a specific product or service and who act as allies of a specific government, be it strategic or not, must seek sufficient mechanisms to ensure the transparency of information. And in that regard, contract transparency is not enough. Much more information about operations, environmental concerns, strategy to diversify the economy, domestic use of resources, among many other topics, is needed for full citizen engagement in this important sector. Contract transparency is an important and necessary start, and Bolivia and Ecuador should be applauded for these disclosures; but both countries could do much more. This paper highlights some of these areas and yet acknowledges that consolidating the gains around other disclosures remains a high priority as well.

#### **a. What is meant by 'contracts' in this context?**

One important threshold question is 'which contract'? Experts estimate that a single oil or gas project is built, operated, and financed with around 100 major contracts, i.e. not smaller and repetitive contracts done in the ordinary course of business, like employment agreements. Which of these contracts can and should be publically available?

The question is not a simple one, but there are areas of clarity within it. Freedom of information and public participation principles dictate that government decisions and the deliberative process preceding decisions should have citizen engagement. Access to information is critical for meaningful participation in all aspects of government. For example, oversight of governments and the ability to change government necessitates access to information after decisions have been made.

Of the hundreds of contracts involved in an oil and gas project, the contracts to which a State or a state-owned company is a party should be made publically available under these principles. These are typically a contract to prospect, explore, or exploit hydrocarbons resources. These could be called licenses, permits, agreements, or other names in different countries. In the oil and gas sector, three prevailing types of contracts exist:

- 1) Production Sharing Contracts, in which the field operator is allowed to recover its operating costs (opex) and capital (capex) prior to sharing income and/or a share of oil with the State;
- 2) Service contracts, in which the field operator receives a certain amount of resources, generally a percentage of gross income, to cover its opex, capex and still earn reasonable profits; and
- 3) Concessions, or 'tax/royalty' contracts, in which the field operator has a main (but not single) obligation to the State, which is to pay taxes and royalties. The contractor has rights to all the hydrocarbon resources.

#### **Participation Contracts vs Service Contracts**

In general, the differences between these types of contracts is the manner in which each assumes operating risks, payment for services, and the modality in which adjustments are made when there are variations in international prices. For example, in service contracts, the potential upside for windfall profits is retained by the state instead of the contractor; in a concession system, this upside potential would typically be retained by the contractor. Similarly, the downside risk of price collapse is retained by the state in the

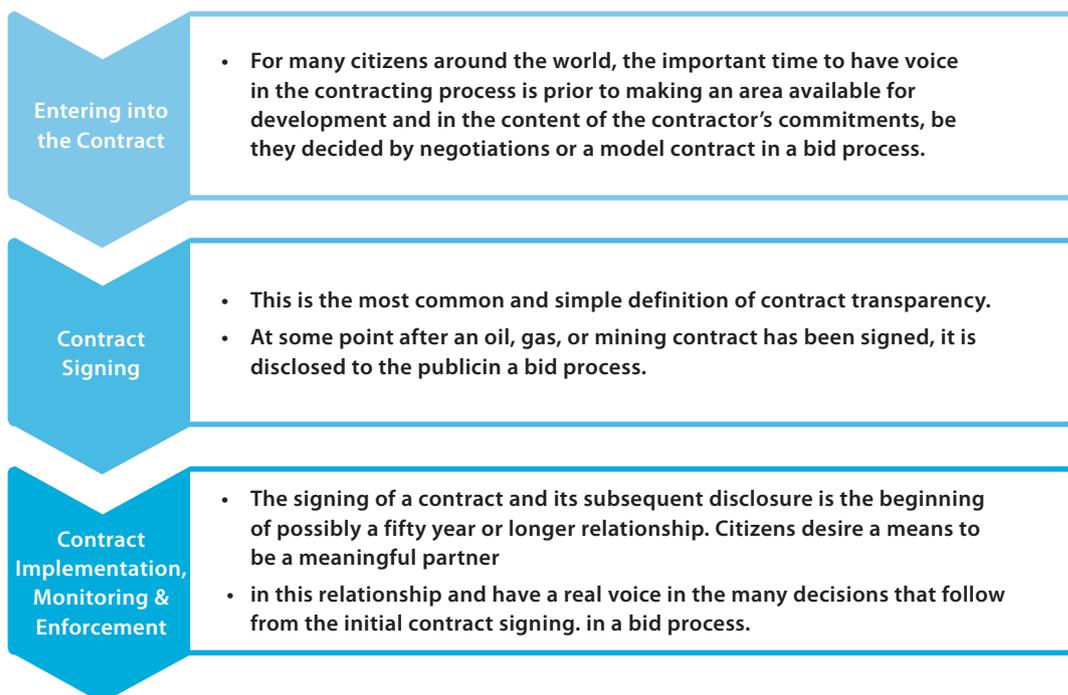
service contract whereas it is borne by the contractor in the Concession, unless particular mechanisms are put into these contracts to mitigate this.

It is common that States use a combination of aspects of all of these contract types to allocate risks and responsibilities or to laud a change of policy or both. Interest in signing one of these contracts will depend on the expectations of the contracting parties (the State and the private companies) to smooth imbalances between the benefits perceived by the parties, consolidating greater participation in oil earnings, and promoting reasonable profit horizons with regard to the various price fluctuation scenarios that could arise in international markets.

**b. What constitutes transparency?**

While transparency might seem far more straightforward, in fact it may also have different meanings for different people and in different contexts. For some authors who talk of governmental transparency, for example, transparency consists of opening up government information to the public, to scrutiny by society. Transparency does not imply an act of accountability to a specific person or the simple disclosure, but the democratic practice of revealing governmental information and creating participatory and public processes for engaged democracy.

Here is one way to conceptualize possible points for ‘contract transparency’ to occur in the life cycle of a hydrocarbons project:



**c. Why does contract transparency matter?**

Contract transparency is a prior and essential condition to ensure all parties benefit from the hydrocarbons industry. Disclosure is a prior necessary requisite for coordinated and

effective management of the extractive sector by governmental organisms. It allows citizens to follow up on contracts in areas which they could be better situated such as fulfillment of environmental norms and social commitments. Contract transparency provides incentives for improving the quality of contracting: it prevents government employees from prioritizing their interests above those of the population, and in time, governments can begin to increase their negotiation power if they learn from contracts signed in other parts of the world.

Secrecy hides incompetency, poor management and corruption, but only from public opinion, not from the industry which generally knows the terms of a transaction and even the text of the supposedly secret contracts. As to 'confidential' contracts, rights of access to information must be instrumentalized as few countries have public transparency policies regarding hydrocarbons exploration and exploitation studies.

Likewise, contracts unknown to the public should be made transparent such as those referring to types of concession, shared production, jobs, project funding, and contract transference. Although treaties, laws, regulations and other legal documents that define relationships between government and private companies are public documents, petroleum, gas and mineral extraction contracts between governments and extractive industries are shrouded in mystery. In general, they are not available to the citizens of the countries rich in resources, in which the extraction takes place, and often they contain confidentiality clauses that explicitly limit access to public opinion. Internationally, there is more and more demand to make contracts with the extractive industries available to the public and to establish new standards to define what information is revealed and what isn't regarding transactions between the government and the industries.

Unfortunately, contract transparency remains a nascent practice, including the most straightforward form described above, disclosing the signed agreement. Bolivia and Ecuador are among a few countries that do this. If the arguments for contract transparency are so compelling, why is it not yet common practice? Responses to common arguments against contract transparency are detailed below.

1) Confidentiality clauses do not allow for contract transparency.

Both governments and companies have consistently argued that confidentiality clauses in their contracts forbid the disclosure of the contract. A global survey of over 150 oil, gas, and mining contracts demonstrated that this assertion is partly a myth and partly a truth. There are many ways in which confidentiality clauses are not an obstacle to contract transparency, which makes this statement a myth. For example: the parties to a contract can always agree to make certain information public that would otherwise be covered by confidentiality clauses. In other words, governments and companies can always agree to publish contracts and can agree to modify confidentiality clauses to allow contract transparency. Even when the parties can't agree on making certain information public, the confidentiality clauses of the extractive industries almost always include an exception for disclosure that is required by law. In this manner, governments can demand contract transparency through legal means.

In sum, this argument is only correct if neither the governments nor the companies desire to approve contract transparency. In this case, the confidentiality clause would impede citizens from having access to the contract, unless some other legal mechanisms are used to annul the government's and company's decision, such as the stipulations of the freedom of information law.

- 2) Contracts contain sensitive commercial information and should, therefore, be confidential.

Governments and companies argue that contracts contain delicate commercial information that, if revealed, would jeopardize their ability to be competitive. The information considered sensitive includes: financial conditions, labor obligation commitments, and environmental mitigation and protection measures to be taken.

One problem with this argument is that much of the information is already known in the industry (for example, financial conditions). In such cases, the information cannot be considered an industrial secret that merits legal protection. Another factor is that frequently the sensitive commercial information is not contained in the main contract, which activists want to see. It can be found in documents such as environmental management plans and documents on costs. Thus, contract transparency doesn't mean that information that was previously secret will now be made available to the competition. Additionally, the highly sensitive information can always be redacted before it is revealed.

For these reasons it is necessary to acknowledge that transparency contributes to modernizing the State and its institutions, along with acknowledging citizens as observers. We should also ask ourselves, once the information is known, are citizens capable of correcting things that seem undue or inadequate? The question leads us to acknowledge another profound deficit of democracy: the lack of instruments to democratically control governments in decision-making processes and in their actions.

## **II. Background: Resource Extraction-based Economies in Ecuador and Bolivia**

Petroleum is the main source of funding for the Ecuadorian economy. According to 2010 official data it represents fully one-fourth of the GNP, 35% of the State's budget, and over 50% of exports. From crude oil exports, according to a sum of official data, between 1972 and December 2009 the government obtained 77.568 billion dollars. The foreign companies earned 20.096 billion dollars from crude oil exports just between 2000 and 2008. Between 2007 and 2010 the government received about US\$ 30 billion.

Hydrocarbons are also one of the main sources of funding for the Bolivian economy. In 2010, the revenues perceived by the Bolivian government from the production of oil and natural gas approximately represented 21.1% of the national budget and 5.20% of the GDP (gross domestic product). Data released by the Instituto Nacional de Estadística (The National Institute of Statistics) indicates that over this period Bolivia exported the equivalent of 2.942 million dollars for hydrocarbons only; this amount represents 42.29% of the 6.956 million dollars generated by the country through exports. Between 2001 and 2010, the Bolivian government approximately received 8.188 million dollars in royalties, shares, and taxes on hydrocarbons.

### **a) Ecuador Hydrocarbons History**

The history of petroleum in Ecuador dates back to 1875 when a field on the peninsula of Santa Elena was given under concession to the transnational company Anglo Ecuadorian Oilfields Ltd. The State received 1% of the benefits of exploitation.

The second stage of the country's petroleum history took place near the end of the 1960's when oil fields were discovered in the Amazon region, even though in the 1950's

companies such as Shell had researched the area and determined that the quality of crude oil was not as interesting as compared to Arab countries with much safer and more trustworthy sources.

Since then, the Ecuadorian state began to intervene in petroleum policy but most of the hydrocarbons activities have been managed by the transnational companies, especially by Texaco and Gulf. Historically there was a break in 1981, which led to the famous lawsuit that is currently covered in international media, the case against Texaco for environmental damage. At the time, the State was not as involved in the hydrocarbons sector. The neoliberal politics of the moment stated that, 'Ecuador does not have the necessary capital to carry out petroleum activities. We need capital for health, education, highways, public housing. We must attract international capital. Ecuador doesn't have the technology and we must attract foreign investments, as foreigners have the necessary technology'...

Many critics of this policy believe that this argument was the basis for planned weakening of the state petroleum company to enable foreign companies to enter. Although in the 80's and 90's attempts were made to improve national operations, the results were given very little importance. At the time, petroleum was extracted but it was not based on the country's energy needs, the aim was to receive monetary compensation from foreign oil companies.

#### **Principal Figures for Petroleum Exploitation**

Today, much of Ecuador's petroleum resources have been depleted. In 1970, when the mini-petroleum boom began, the country had 8.084 billion barrels of proven reserves. Forty years later, the remaining commercially exploitable reserves have been reduced to half of that, including the ITT (Ishpingo, Tambococho, Tiputini) Block. The 43 Block contains the 3 fields Ishpingo, Tambococho, and Tiputini (ITT). According to experts, the total proven reserves from the 43 ITT Block are 856 million barrels of heavy crude (14°API). The proven reserves from North and South Ishpingo total 450 million barrels alone. The reserves at Tambococho and Tiputini are approximately 400 million barrels. 80% of ITT is located inside Yasuní Park, a no-go zone and also the buffer zone where exploitation is prohibited perpetually.

The temptation to exploit the ITT reserves will be great, particularly in the current era of high oil prices. Historically, the government obtained 77.568 billion dollars from crude oil exports from the period between 1972 and December 2009, according to a sum of official data. Foreign companies earned US\$ 20.096 billion dollars from crude oil exports just between 2000 and 2008. Between 2007 and 2010 the government received about US\$ 30 billion.

#### **b) Bolivia's Hydrocarbons History**

Bolivia has recently gone through two very important moments in the oil sector; first, due to a capitalization and privatization process of the main business units of the state company Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) and second, due to a nationalization process whose main objective was the recovery by the State of the ownership of the hydrocarbons and of those companies that were capitalized and privatized.

### ***Period of Capitalization and Privatization***

As a result of bilateral negotiations between Bolivia and the Federative Republic of the Brazil, a sales contract of natural gas for a volume of 30 million cubic meters day (MMcmd) during 20 years, was signed in 1996. For the execution of this contract, a search for foreign investments that would allow the increase of the certified reserves of Bolivia as well as the levels of production of hydrocarbons became necessary, given the low financial capacity of YPFB.

For this reason, Hydrocarbons Law N° 1689 was passed in April of 1996, establishing a regime of Shared Risk Contracts and declaring them free to make decisions regarding the exploration, exploitation, refinement, industrialization and commercialization activities of the hydrocarbons and their by-products. Also, together with the promulgation of this law, began the transfer of the exploration and production unit of Andina SAM, owned by YPFB, for a total of US\$ 264.8 million dollars; the exploration and production unit of Chaco SAM was capitalized, also owned by the state, for \$US. 306.7 million, as well as the Transportadora Boliviana de Hidrocarburos-unit for 263.5 million dollars.

On the other hand, between 1998 and 1999 the main refineries of the country were privatized (Gualberto Villarroel and Guillermo Elder Bell) on a base of US\$ 102 million dollars and the Compañía Logística de Hidrocarburos Bolivia for US\$ 12 million dollars. In total, revenues in the order of approximately US\$ 935 million dollars were obtained. With regards to the newly established contracts regime, the Executive Branch of Government of that time period submitted a model of a shared risk contract for the approval of the national congress. This model was approved and applied and started in 1996, for all the exploration and exploitation activities of hydrocarbons. As a result of this process, more than 70 shared risk contracts were entered into between YPFB and the transnational companies.

Among the main aspects contemplated by this contract model was the transfer of the ownership of the exploited hydrocarbons in favor of the private companies, which were responsible for the direct payment of the petroleum income in favor of the State. In equal manner, these companies could decide the destination of the production they generated as well as the commercial conditions (price, volume, etc.).

Regarding the topic of information and confidentiality, this contract model, in its tenth clause stated the following: 'YPFB, the National Secretary of Energy and any other State body, will maintain the information received as confidential and the information may not be of the knowledge of any person that is not in service of the State who will also maintain the information in confidential manner...'. Therefore, the information generated starting from the signing of these contracts had a confidential character and it was not of easy access for the civil society in order to make an appropriate monitoring of the situation of the hydrocarbons sector in Bolivia.

Another important point that should be mentioned is that according to what is stated in numeral 5 of article 59° of the Political Constitution of the State, effective from the beginning of the year 2009, one of the attributions of the Legislative Power was to 'Authorize and approve the contracting of loans that commit the general income of the State, as well as the contracts related to the exploitation of the national wealth'. However, the national congress did not move forward with the analysis and the approval of each one of the 75 oil contracts, limiting itself to approving the basic contract model for the negotiations. Under this framework, it became more difficult still to access the content of the contracts that were being subscribed by YPFB starting from 1996 until the year 2005;

up to now those contracts have not been published or revealed for the consideration of the population in general.

The regime of the shared risk contracts made it possible to obtain important investments mainly in exploration, production and transport activities of the hydrocarbons; these investments also impacted on larger certified reserves of natural gas and petroleum and in the discovery of mega fields that began to dedicate its production toward the Brazilian market. It is important to mention however, that due to the lack of approval of each one of these share risk contracts on the part of the legislative power, the government of Evo Morales has initiated legal liability actions to four former presidents of the Republic, by considering these contracts as unconstitutional.

### ***Nationalization Period***

In 2002, the Bolivian government of that time began to negotiate the execution of a potential project for the export of liquefied natural gas (LNG) to Mexico and the United States through a Chilean port. This project was a nuisance to the Bolivian population due to political problems between Bolivia and Chile over the loss of the Bolivian coastline in 1879. This reason, along with the low level of the export prices that were being negotiated and the differentiated petroleum income that existed among old and new fields generated a social protest in October 2003 on the part of all the organizations and social movements forcing then President Gonzalo Sánchez de Lozada, to resign and escape from the country.

In July 2004 and as a response to these social demands, Bolivia applied a binding referendum whose main results were the recovery on the part of the State of the ownership of all the hydrocarbons, the non-export of natural gas through Chilean ports and a level of petroleum income for all the fields equivalent to 50% of the value of the production in favor of the State.

In May 2005, the Hydrocarbons Law N° 3058 was enacted, creating the Direct Tax to Hydrocarbons with a tariff of 32% totalling together with the royalties of 18%. Also, this law established three new modalities for the oil contracts: of operation, of shared production and of association.

One year after the approval of this regulation and under the government of Evo Morales, the Supreme Decree N° 28701 was promulgated for the Nationalization of the Hydrocarbons; among the most important aspects that are contemplated in this legal disposition are the following:

- The State recovers the property, ownership and total and absolute control of all the hydrocarbon resources of the country. Likewise, it recovers the property of those companies that were capitalized and privatized during the period 1996-1999.
- YPF, in the name and in representation of the State, in full exercise of the ownership of all the hydrocarbons produced in the country, assumes their commercialization, defining the conditions, volumes and prices for the internal market as well as for the export and industrialization.
- A period no longer than 180 days is established in order for the private companies that carried out exploration and production activities to regularize their activities, by means of operation contracts that comply with the legal constitutional conditions and requirements. At the end of this period, the companies that had not subscribed new contracts cannot continue to operate in the country.

- YPFB will not be able to perform contracts for the exploitation of hydrocarbons that have not been individually authorized and approved by the Legislative Power in the middle of the execution of the mandate from section 5 of article 59 of the Political Constitution of the State, effective then.

This last point settled down in S.D. 28701 was an important landmark in matters of transparency in oil contracts since each one of the 44 operation contracts that were negotiated and undersigned between YPFB and several oil companies, had to be necessarily approved by the Chamber of Deputies, as well as the Chamber of the Senators of the Honorable National Congress. In this sense, they were the national authorities chosen by vote who approved by means of a law of the Republic and in representation of the Bolivian population, the oil contracts that are being applied nowadays in Bolivia. After their approval, YPFB as well as the Ministry of Hydrocarbons published, in their web pages, the summarized content of the 44 contracts. However, to this date and due to the constant changes of authorities and technical teams in this sector, these contracts have not been published by these instances and it is very difficult to find them in the electronic pages.

There is also Law N° 3740 that has to do with the Sustainable Development of the Hydrocarbons Sector, promulgated in August 2007, that in its article 6 on Transparency of the information states that 'YPFB will publish biannually and in an official manner, in its institutional web page and in writing by means of official communications, all the information referred to Recoverable Costs and the calculation carried out for the determination of the participation of YPFB and of the oil companies in the benefits of the hydrocarbons activities'.

Among the minimum contents of information that will be submitted by each producing field of hydrocarbons are the following:

- Personnel costs of the operating companies
- Mobilization and demobilization costs of the personnel
- Transport and relocation costs of the personnel
- Costs of the materials
- Taxes, Royalties and Participations, Direct Tax to Hydrocarbons (IDH), patents, contributions, compensations and indemnifications
- Exchange differences
- Protection of the environment, industrial security and occupational health.
- Legal costs
- Insurance, administration costs and services
- Depreciation of the fixed assets.
- Production volumes, prices and gross income of the hydrocarbons for each component (natural gas, liquids, etc.) for the internal market as well as for the foreign market.

This is a very large amount of information for a country to disclose. Although a large part of this information is published at the moment by YPFB, full compliance with this regulation is still not being observed neither the disaggregation of it at the level of the producing fields, though it is established in the aforementioned law. We believe that one of the main shortcomings of this regulation is the absence of sanctions for cases of non fulfillment on the part of YPFB.

### III. Strengths: leaders in transparency

#### a) High levels of transparency, but on a relative scale

In most societies around the world, the primary contract for the exploration and exploitation of oil, gas, and mining resources is not available to the public. Countries far more dependent on these non-renewable resources do not disclose these vitally important contracts to their citizens. A 2009 study on contract transparency worldwide noted that: 'to date, many countries have not yet committed to full contract transparency.'<sup>2</sup> And very few, if any, have undertaken full contract transparency: disclosure of all past contracts, public voice and participation in contract awarding, disclosure of all signed contracts, and a post-contract award monitoring mechanism. In short, in most countries, the hydrocarbon sector remains beyond the oversight of citizens and of other governmental oversight institutions, like the parliament, the media, and even 'independent' government bodies, which may be too conflicting to perform such functions well.

Globally, the Latin American region does quite well compared to other regions vis-à-vis government transparency in the oil, gas, and mining sector. In the first ever ranking of resource-rich government transparency, The Revenue Watch Index, all Latin American countries in the 30-country ranking scored over 50 out of a total 100. On contracts and legal terms, many countries in the region have disclosed contracts, including Ecuador and Bolivia. A notable feature of Ecuador's contract disclosure is that it has historically been done under the country's LOTAIP – its freedom of information law.<sup>3</sup> The contracts were published by the government without citizens needing to go through long and costly administrative or judicial procedures to gain access to these contracts in Ecuador, which is much more faithful to freedom of information principles and practice. In other countries, contracts are not disclosed as a matter of course, even though there is a freedom of information law. In Mexico, citizens had to file a claim to gain access to contracts. Citizens were successful, which is a great achievement; however, disclosure without such costly and time-consuming process would be far better.

Bolivia's contract disclosure is driven by similar concerns and strong principles of public voice and participation, though disclosure has not been expressly governed by freedom of information law. The levels of transparency regarding the approval of oil contracts in Bolivia has increased significantly, seeing that its approval is an indispensable requirement on the part of the legislative power (deputies and senators) and that the information resulting from the application of these contracts also has a public character when Law N° 3740 is being applied. This is a crucial means for public participation in the contract award process – the first step in the chart above in 'What is Contract Transparency?' As the representatives of the people, parliamentary vote should provide a check and voice for citizens in the contracting process. A number of countries from diverse parts of the globe follow this practice: Azerbaijan, Egypt, Georgia, Liberia, Sierra Leone, Yemen, for example.

Bolivia's new policy is still quite nascent, and its implementation is remains limited. To date, due to constraints in technical teams and changes in leadership, a number of contracts have not been published. But, the law provides strong grounds for the future.

#### b) Groups are engaged in contract issues and policy formation

Citizen groups in both Bolivia and Ecuador are deeply engaged in contract issues despite limited access to these contracts during their negotiation or other awarding process.

<sup>2</sup> See *Contracts Confidential: Ending Secret Deals in the Extractive Industries* available at <http://resources.revenuewatch.org/sites/default/files/RWI-Contracts-Confidential.pdf>.

<sup>3</sup> See <http://www4.petroecuador.com.ec/lotaip/pdfs/acp/contrato16.pdf>

Both countries have seen the reformations of their hydrocarbons sector in recent years, and access to information and principles of public participation have resulted in reforms according to citizen demands. While it is too soon to say what benefits these reforms have brought, there is evidence that renegotiated and new contracts are better contracts and there have been improvements in the sectors in both countries more broadly.

**Early Indications of Better Contracts and Stronger Benefits**

In 2010, Ecuador renegotiated its contracts as a result of the introduction of reforms to the Hydrocarbons Law and the Tax Regimen Law. This generated a transition from participation contracts to service contracts, and a new focus from ‘privatization’ to ‘nationalization’ of this activity (see Table 1).

The context of this change was the Correa government’s ‘2007-2011 energy agenda’ which refers to the Montecristi Constitution regarding state control over natural resources. This changed the logic regarding the use and destination of natural resources in Ecuador.

**Table 1 Key differences between Service Contracts and Participation Contract**

	<b>Service Contracts</b>	<b>Participation Contracts</b>
<b>Risk</b>	The risk associated with the exploration and commercialization phases is assumed by the State	The global risks of the operation are assumed by the contracting company
<b>Payment for Services</b>	The state owns all production and pays a fee which includes operating costs, investments, and a profit margin	The company receives part of the crude oil it produces
<b>Price Fluctuation</b>	No mechanisms for acknowledging extraordinary earnings when there are positive variations in prices	Law 42-2006 and its reforms, as well as Article 170 of the Tax Fairness Law, establish a share of 70% in extraordinary earnings
<b>Companies operating under this figure</b>	Agip operates under a service lending contract with rates set based on costs. Ivanhoe signed a service contract that contemplates payment of a fixed rate (37 USD)	Repsol, Perenco, Andes Petroleum, Petroriental, and Petrobras operate under this contractual formula. Only the Andes Petroleum contract clearly establishes sharing extraordinary earnings (50%) when prices surpass 17USD per barrel

Source: ‘Lupa Fiscal, Nuevos esquemas en política petrolera: Monitoreo de la Industria Petrolera’ (Grupo FARO, 2009)

Tariffs. The fundamental idea in the renegotiation of the oil contracts is given in a tariff that will serve to bolster the operation of currently productive fields and another oriented toward the promotion of new investments that will finance exploration and prospecting plans in fields not yet exploited. In both cases, it was contemplated that the value of the tariff be adjusted according to the inflation that is registered in the costs associated to the production of the resource (infrastructure, inputs, oil services, among others).

**Table 2 Types of tariffs in the contractual model for the rendering of services**

	The Tariff	Other scope
Fields in operation	The tariff is equal to a fixed value per barrel. The operative costs are recognized plus a tariff close to 5%	If the company carries out investments to empower the fields it is already operating, an additional tariff in a range between 15% and 18% is recognized
Fields non exploited	A return rate of 25% is obtained in the measure in which an exploration plan bears a higher risk	This tariff shall also be applied in fields where improved recovery systems are implemented

Source: 'The oil companies will have the model of the contract next week' Interview with Wilson Pastor, published in the El Comercio newspaper on June 24, 2010.

Taxes. The reduction of the percentage of payment of the income tax from 44.4% to 25% was introduced because its contracts now pass to the rendering of services model for the exploration and exploitation of hydrocarbons (article 27 of the Reform Law). Additionally, the deduction of the expenses of the companies is modified. The companies won't be able to report as expenses, the financial costs nor the costs of transport through the pipeline (article 27 of the Reform Law). Likewise, a maximum limit of 5% of the tax charged for the deduction by concept of expenses in technical and administrative services is established (article 26 of the Reform Law).

These changes indicate that the Ecuadorian state should earn more in terms of financial benefit from its oil contracts in the future; but it is too soon to tell, and whether the deal was the best possible deal for the state is also opened to debate. And, despite the regular disclosure of contacts after signing (or renegotiation in this case) citizen groups in Ecuador seek more voice during the negotiation phase. These are areas discussed in greater detail in the next section, 'Weaknesses.'

Like Ecuador, Bolivia has also seen numerous changes in its hydrocarbons sector in the recent past at the demands of the citizens, as detailed in the historical background section, above. Similarly, it is too soon to quantify the benefits of these changes; and, the government is considering further changes in its legal structure, including contracts, at the time this report went to press. Citizen groups are actively involved in working with the government on thinking about these changes. The extent of meaningful citizen participation in these processes will only be known in the future. And, finding long-lasting

legal structures that benefit the society is no easy task. It takes time and may take several tries before finding the structure that will work. On the positive side, both countries are doing more vis-à-vis transparency and participation than many other countries—for example, Nicaragua, another country in the TRACE programme, where contracts are not disclosed at all and avenues for citizen participation are extremely limited.

#### **IV. Weaknesses: the limits of current policy**

Bolivia and Ecuador have disclosed more than many other countries and have principles of public participation that exceeds many countries. But this is in a context of limited disclosure worldwide, where all countries and the companies that operate in them could do much more. Transparency itself is a means for more meaningful participation in a critical sector of many economies.

##### **a. Participation and voice in negotiations/award is very limited in practice**

A common theme of citizens and citizen groups worldwide is the need for greater participation in the contracting award and/or negotiation process. While the disclosure of contracts after their signing can be an incentive for a government to act in the public interest while engaging in this process since the final product of the process will be available for public view, citizens may still see a closed approach as indicative of a process which does not have their interests sufficiently represented.

How to manage a participatory process remains an open question. Parliamentary involvement is one method, through either having legislation dictate the majority of the legal terms that companies are obliged to fulfill and/or contract approval; and, having citizen groups a part of the advisory team in contract negotiations, as has been done in Sierra Leone's contract renegotiation process with success. In a sector that has historically been so closed to any form of public information, much less participation, models and country experiences are limited.

##### **b. Monitoring and enforcement of the contract post-signing is challenging**

Even with strong commitments to disclose much information about the sector's operations from both Bolivia and Ecuador, actual disclosure has not been complete and can be out of date or inaccurate.

In Ecuador, a challenge in terms of monitoring and enforcing the contracts going forward will be whether the new regulatory structure mandated by the Montecristi Constitution and new laws will be fully implemented. Within the reform of the law, when PETROECUADOR was replaced by 'The Secretary of Hydrocarbons', new responsibilities are granted to the Ministry of Natural Resources, such as the awarding, subscribing and expiration of the different contracts through the Secretary of Hydrocarbons, infringing what was established in articles 313, 315, 316 and 317, of the Montecristi Constitution and the opinion is that the Secretariat of Hydrocarbons will become a SUPER ministry, concentrating important powers in just one institution.

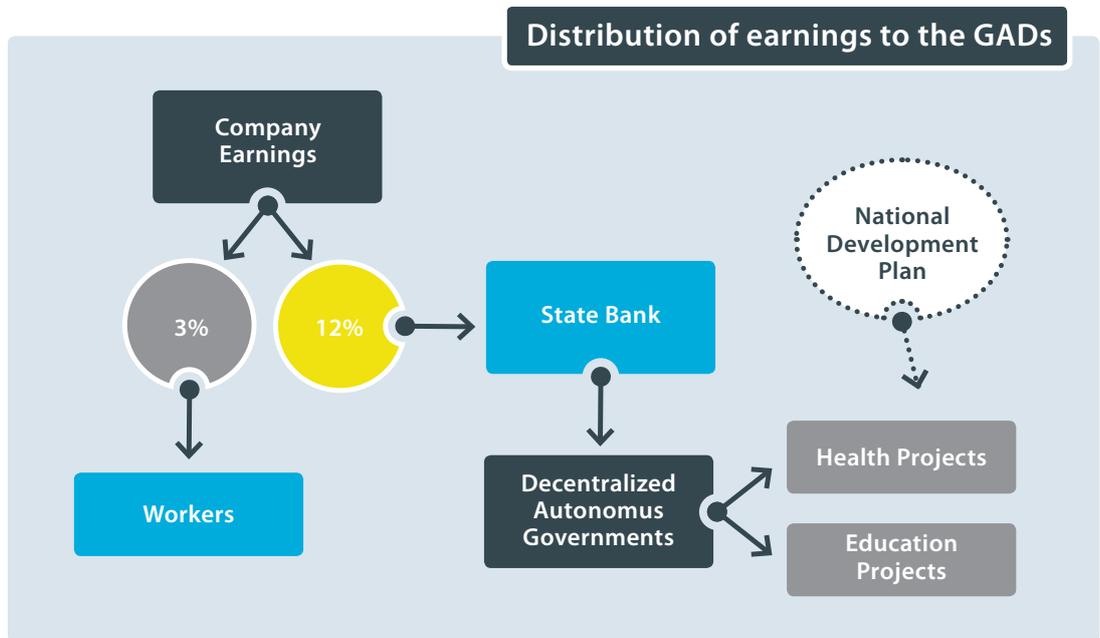
Also, Articles 204 and 213 of the Constitution point out that the activities of control cannot be subordinated to the executive branch, the Ministry of the Sector; instead, the controlling institution should enjoy autonomy, specialization, independence and social participation; and, delegate those activities to the new Agency of Regulation and Control of Hydrocarbons. The new Agency replaces the DNH, which was attached to the Ministry of Natural Resources. If this new independence is not fulfilled, the regulatory structure

of the hydrocarbons sector looks unconstitutional and antidemocratic, perpetuating the impunity of the oil sector.

There are other inconsistencies because the reform ostensibly surrenders strategic sectors: SOTE, secondary pipelines, multiple pipelines, gas pipelines and terminals, refineries. These are all highly profitable business deals for foreign investors, via delegation, something that is not allowed by the new Constitution.

In the Reform Law, a new outline for the distribution of the earnings was also established: 3% of the earnings will be surrendered to the workers linked to the hydrocarbon activities and the remaining 12 % will be paid to the State. The destination of this last amount shall be invested in social projects for health and education (in line with the National Development Plan) and it will be distributed equally from the Decentralized Autonomous Governments (GADs) located in the areas defined by the contracts in which the hydrocarbon activities are being carried out.

**Table 3 Distribution of the earnings from the State to the Decentralized Autonomous Governments (GADs)**



Source: Article 16 from the Hydrocarbons Reformatory Law

As for tariffs, the State introduced the 'margin of sovereignty' approach, by means of which they seek to guarantee a participation of 25% on the gross income generated through the exploitation of any of the fields surrendered for such effect. That is why they considered the possibility that the investment programs (which are part of the development plans) of each company be supported with bank guarantees that are cashed in the measure in which they are fulfilled and the payment of a **unique tariff** that covers costs, investments, earnings and taxes, was proposed. This could be paid in foreign currency or in kind (provided the internal supply from the refineries to the country is not affected).

Additionally, an earning capacity between 15% and 20% will be allowed in fields with a current production and a profit margin that will make the exploration and operation of new fields attractive.

### **c. Historical problems persist**

Despite efforts to fundamentally change the trajectory of resource exploitation, great challenges remain. Current transparency efforts do not make old problems disappear: environmental degradation from historical exploitation is not cured by good policies today; exporting resources while insufficiently providing energy for citizens is not rectified by better resource revenues or increased state participation or control in the sector.

According to environmental experts, the reforms to Ecuador's Hydrocarbons Law unfortunately do not demonstrate any real changes to what happened historically. Despite the fact that the problem of climate change is intimately related to petroleum and the exploitation of fossil fuels, and the country wants to move to a better future less reliant on these fuels, there are not clear signs that the country will, in fact, move away from exploiting petroleum resources that cause climate change.

And, while the Yasuni initiative has sought to protect nature over the exploitation of hydrocarbons, the temptation to exploit the ITT reserves will be great. A feasibility study done by PDVSA-PETROECUADOR (2008) stipulates an investment of 6 billion dollars, and operating costs of 3.5 billion dollars over the course of 20 years. Total reserves, at current value, with an average price of \$US 60.00 per barrel, would total US\$ 50 billion dollars. If only two Tambococho and Tiputini (TT) were exploited, approximately 400 million barrels, the economic reality would change substantially as the value of the reserves would be US\$ 29 billion dollars, at current value.

If investments, costs and operating expenses represent about US\$ 9.5 billion dollars, and the profits made by the operating company that partners with Petroecuador are about 15%, this would be approximately US\$ 3 billion dollars. The company's investments, costs, expenses and profits would be about 12.5 billion dollars. This analysis determines that earnings for the State would be approximately US\$ 16.5 billion dollars over 20 years, equivalent to US\$ 775 million dollars annually. This suggests that exploitation should be redefined.

Finally, hydrocarbon resources up to this point have not been successfully used to diversify the economy, and the reserves are being depleted quickly:

- The economy is anchored in petroleum. Petroleum represents between 20 and 40% of the income of the State budget. Raw materials are exported, derivatives are imported.
- No new reserves of petroleum and gas have been incorporated.
- The reserves are being depleted very quickly from 8.2 billion to half that, including ITT. With daily production of 480 thousand barrels of medium and heavy crude.
- Ecuador is a net importer
- External trade of hydrocarbons and derivatives is controlled by foreign traders.
- There is legal, political, labor and administrative instability in the sector.
- Environmental, collective rights, and prior consultation laws are not complied with.

Bolivia faces many of the same challenges: information is not always timely, though there has been significant progress in making it available. Social divisions are still deeply connected to the hydrocarbons sector. Environmental damage continues to occur, and government officials are slow to respond.

In sum, while the disclosure of contracts has been a significant step in the right direction, there is still much to be done for Bolivia and Ecuador's goals and vision of a better future to be fulfilled.

## **V. Opportunities**

### **a. Greater engagement could lead to less conflict**

A common refrain heard in favor of greater transparency and public participation is that it will lead to greater stability for the investments for at least two reasons: (1) communities will have their true consent and voice taken account in the process of resource extraction (assuming they do consent); (2) the investments will be less subjected to the political process. Natural resource contracts are the most unstable and regularly renegotiated among all investment contracts with foreign governments, and politics plays a key role. Contracts may be signed by one government only to be repudiated by the next. The secrecy of these contracts and negotiations must, the theory says, play a role in political grandstanding about these contracts. A public vetting of these contracts could go a long way towards buffering contracts from this source of instability.

Bolivia and Ecuador's steps towards greater public participation and transparency could blaze this path and test these theories, which, if correct, could provide much-needed trust and stability.

### **b. Revenues from the hydrocarbons sector can be used to promote industries and societal goods that will survive these resources**

Both Bolivia and Ecuador have historically been primarily extraction and resource-based economies. A well-planned strategy for using remaining hydrocarbons resources to diversify the economy away from extraction and into other sectors could result in an inherently non-renewable resource providing a more sustainable and diverse future for both countries.

Ecuador and Bolivia both have considerable mining resources that have not yet been extracted. In Bolivia, large lithium deposits are said to be world-class. Under the 'Buen Vivir' (good living) plan, the Ecuadorean government has introduced a proposal to begin mining metals on a large scale considering that Ecuador's petroleum reserves are now 50% of what they used to be, the remaining amount continues to decrease, and it is found in some sensitive areas.

If not thoroughly planned and designed to promote other sectors, both of these new areas could continue the path of resource extraction as the primary driver of the economy. Lessons must be learned from the past decades of extraction to move to something more environmentally and economically sustainable.

## **VI. Threats**

### **a. Disaffection at the lack of transformative change through transparency**

Even though Ecuador and Bolivia have high levels of transparency compared to other countries world-wide, the commitments of these countries to hold themselves to the high levels of genuine public participation in a new Constitutional order has created an expectation that the political reality will change from past policies. Contract transparency, and transparency more generally, cannot, alone, create a meaningful public participation. It demands innovative mechanisms and testing new means of governance that perhaps no other country has tried before. And while citizens should continue to demand new models of governance and participation, there is the risk that the important gains in transparency could be forgotten or their importance under-estimated. Continued pressure to maintain high levels of transparency will require constant monitoring and a balanced approach of understanding its limits while acknowledging its importance as well.

### **b. Resource extraction always has risks, no matter how transparent it is**

There is no way to extract petroleum without causing environmental and social impacts. They can only be mitigated. And large-scale disasters cannot be avoided, as the cases of Texaco in Ecuador and the Gulf of Mexico spill demonstrate. This activity cannot be nature-friendly nor does it conserve biodiversity. It is an inherently risky business, and some argue that for Ecuador, the damages have outweighed the benefits.

The reforms to the Hydrocarbons Law do not respect the new Constitutional framework as they do not discourage the expansion of the petroleum industry or its negative impacts and the reform seeks to motivate hydrocarbon activities by increasing production levels in oil fields.

What is seen as positive is the inclusion of the following text, 'The Ministry of this Sector may declare the contracts void if the contractor: causes, either by action or omission, damage to the environment, quantified by the Ministry of the Sector; if it does not remedy the damage according to the dispositions of the competent authority.' But this brings up the question: to what extent can this feasibly be fulfilled? If the environmental damage will be quantified by the Ministry of the Sector, meaning the Ministry of Natural and non-Renewable Resources, can the Ministry, whose function it is to promote petroleum exploitation, be expected to quantify environmental damage so as to make voiding the contract possible?

Also positive is the incorporation in the Constitution, of the term 'Integral Reparation' which includes the restoration of nature. This is much more extensive than simple 'remediation', a term which has been used and is not effective. It explains that 'remediation has meant eliminating the black oil slick so it can't be seen and nothing else, and that is what Texaco did after its operations and this caused environmental damage and an international lawsuit with this multinational company.'

In another of the reformed articles, regarding the distance that must be kept between the construction of petroleum infrastructure and nearby population centers, there is discretionality because in practice there is no new prohibition in terms of installation. Previously a distance of 10 kilometers from towns was specified and petroleum infrastructures could not be installed closer. But now, with this reform, the distance is at the discretion of the environmental authority who could easily determine a distance less than 10 kilometers, if a technical report recommends it.

For environmentalists it's time to seriously think about Post-petroleum Ecuador.

## **VII. Conclusion: Charting a Path to Consolidate Gains and Chart New Territory to Ensure Leadership**

The transparency of contracts is fundamental to promote the good handling of the hydrocarbon resources. Ecuador and Bolivia are two countries highly dependent on their non renewable resources. Even so, the efforts of these States to benefit from the related industries are in their primary stage. Within this line, Ecuador as well as Bolivia have migrated their models of participation contracts to service contracts, where the State has the role of proprietor of the resources and the oil companies are the operators. The national company becomes a marketer in this transition. To institutionalize these new administration models, the two countries have reformed their respective hydrocarbons laws.

One particularly salient difference between the countries is in the approval process of the new models of contracts. In Bolivia, contracts should be approved by the legislature, whereas this is not the practice in Ecuador. Whether parliamentary approval of contracts will be a viable mechanism to achieve meaningful public participation in the contracting process of the hydrocarbons sector remains to be seen. If parliamentary approval is successful in this regard, it could be a possible mechanism for many other countries, including Ecuador, where citizens seek greater involvement and oversight over the contracting out of the sovereign, non-renewable resources of the State. With much greater democratization of the hydrocarbons sector, more trust could be built, leading to more stable investments—which would benefit all involved. Furthermore, the revenues, if invested wisely, could create other industries that are not inherently dependent on a non-renewable resource.

And yet, resource extraction, no matter how transparent and participatory it is, comes with great risks, particularly for environmental destruction that cannot be undone. Ecuador has had a bitter history of environmental damages already. Moving away from an extraction economy becomes even more important when this is considered.

The steps towards greater transparency and contract transparency are good and in the right direction. It is the TRACE participants' hope that this is the first step of many more in a direction of greater transparency, public participation, and non-dependence on the hydrocarbon sector for our countries.

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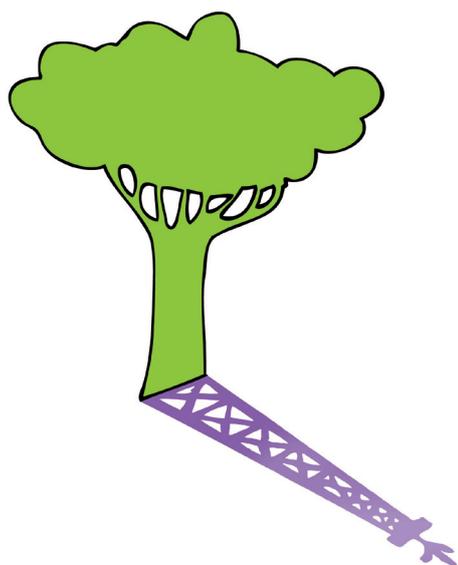
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## SOCIO-ENVIRONMENTAL CONFLICTS LINKED TO THE OIL EXPLOITATION IN THREE LATIN-AMERICAN REGIONS

### INTRODUCTION

Since the beginning of their history as republics, Ecuador and Bolivia have based their economy on the exploitation of natural resources such as oil. This extractive economy has laid its stake again and again on depending on one of the few primary products whose export generates a financial income for the country. The income from the oil yield has not always been reflected in the infrastructure or in social projects for the regions where the exploited resources come from. On the other hand, the oil exploitation has generated serious social and environmental conflicts to which the states or the privately owned oil companies that carry out their activities under concession contracts or service contracts pay little attention.

Over the course of the last decades, a large number of documents have been published that take a critical look at the socio-environmental conflicts derived from the activities of the oil exploitation in Bolivia and Ecuador (e.g. Oilwatch, 2005). The oil extraction has come into the centre of attention in particular due to the scale and scope of its socio-environmental impacts. In Ecuador, the current struggle between the transnational Chevron-Texaco and social organisations and communities affected by the deterioration of the environment, culture and health has brought in a reality the states do not really admit and multi-national companies have rarely accepted.

The model of economic and social development that is applied in Nicaragua has not been based on the exploitation of oil, instead it has had a clear vision of short-term development and environmental degradation, contamination which has been shown in the traditional model of the enclave (banana, African palm trees) and the inadequate development of contaminating industries (Penwatl case), but in any case the oil process has advanced slowly in comparison with Bolivia and Ecuador, more for technical reasons, political factors and instability; remembering the hard path of dictatorships, revolutions, economic blockades, intervention of privatization politics and the implementation of contaminating industries.

At present, the economy in Nicaragua is propitious to giving an impulse to significant changes; however, unfortunately they are for the time being not included in a model of sustainable development. With regard to the exploitation of oil, the economy depends on the energy matrix, on allies with a strong expertise in the matter, such as Libya, Arab countries and member of ALBA (Bolivarian Alliance for the Americas), which due to the instability of the oil industry itself and the technical/legal weaknesses does not guarantee the general well-being for everybody, and much less so with regard to the environment.

Despite all these factors Nicaragua that is still a very young state stands out as one of the legal systems that has recognized more participation and autonomy of indigenous peoples and peoples of African descent (Law 445 and Law 28). Jurisprudence has recognized the right to property and the granting of permissions, which happened in the case of Awas Tingui. The paralysation of oil concessions in two occasions since 2006 shows the effect of the rights of indigenous peoples and peoples of African descent. In this framework, the subject of oil and the handling of its derivatives has not been discussed very widely, which enabled the generation of noticeable legal and technical gaps that violate the principles of prevention and precaution, despite the fact that Nicaragua has signed international conventions for the protection of specific maritime resources in particular on the handling of hydrocarbons in the sea, such as OPRC (International Convention on Oil Pollution Preparedness, Response and Co-operation) and the one of Antigua Guatemala; it still does not have a national plan in case of spillages on the coast bearing in mind that Nicaragua is the largest country with the longest coastline both on the Atlantic and the Pacific.

In the Central American region only San Salvador has currently presented a contingency plan in case of spillages, as the handling of hydrocarbons presents severe problems in Nicaragua starting from its sale (petrol stations) which caused the reforms of the law no. 277 through to the traffic of hydrocarbons and its derivatives, which applies for remote communities and communities on the border where we find up to 15 clandestine supply stations. The river San Juan that connects the Atlantic Ocean with the Pacific and through which different types of sharks enter Lake Nicaragua – making it a unique natural phenomenon – is full of oil waste and contamination.

In this present piece we present a review of two cases, one in Bolivia and one in Ecuador and analyse the application of environmental regulations in order to contribute to the socio-environmental discussion generated by the oil activity. Parallel to that we also analyse what could happen in the case of Nicaragua, a country which is beginning to exploit oil, but whose people still do not know the extent of the impacts this could have. Finally, we evaluate the coincidences and contradictions that arise in the Bolivian and Ecuadorian cases and try to identify the lessons that can be applied for Nicaragua.

## **METHODOLOGY**

We start with a historic, comparative and analytical description of a case in Bolivia and one in Ecuador about the environmental and social impacts and the possible processes to remedy them. Then, after a brief description of the history of oil in Nicaragua we will analyze what could occur in this country, if the oil border opens and the legal practices, as they occurred in the two Andean countries, are repeated.

## **ENVIRONMENTAL IMPUNITY OF OIL COMPANIES IN BOLIVIA**

It is often said in Bolivia that it has the best laws, but that nobody abides by them. This statement corresponds to reality: The drafting and passing of laws that are created in contexts that are alien to national specifications, which has been normal since the beginning of the republic, together with the weakness of the state to exercise the due control of the environmental management. In fact, the con-compliance and/or the negligent compliance with the rules in force tend to damage the poorest sectors of society and environment and benefit the sectors with a lot of capital.

In the area of extractive industries, social and environmental irresponsibility of companies extracting natural resources has been recurrent in the history of the country (Gavaldá, 2005). The consequences of the colonial logic, and later the capitalistic logic

in the mining and oil extraction have caused a series of social and environmental impacts, such as the permanent violation of labour rights and the degradation of the environment.

Below we will address the consequences of the irresponsible environmental management of oil companies in indigenous territories that, due to their historic social and legal marginalization, have frequently been victims of the logic of profitability as an objective as such. The fact that one of the companies that is largely responsible for the contamination of indigenous territories is the state-owned oil company Yacimientos Petrolíferos Fiscales Bolivianos (YFBF) whose environmental impacts accumulated over various decades of work still contaminate the aquifers and soils of indigenous communities in the area of the Bolivian Chaco.

### **Colonial inheritance**

The Bolivian Chaco stretches over three departments: Santa Cruz, Chuquisaca and Tarija; and it is the traditional zone where hydrocarbons are produced. In this region the first oil concessions were granted in 1916. After nearly one century of oil exploitation, there are numerous environmental effects, and they particularly affect indigenous communities, because the areas of concession are in many cases in native community land (Gavaldá, 2003).

Government officials of consecutive governments were the first defenders of oil companies to the detriment of indigenous communities or peasants with respect to disputes about ownership and use of their land where explorations or the exploitation of oil or gas is carried out. This sad reality reflects to a large extent the colonial past that has marked the institutionalized character of the Bolivian state. Below, we will show how the Bolivian government has favoured the irresponsibility of oil companies and damaged the environment, biodiversity and of course the well-being of indigenous peoples and peasants.

### **An audit that never came**

On 18 September 2004, a pipeline transporting hydrocarbons from the former Bolivian oil capital Camiria Sucre broke and spilled about 70,000 litres of diesel in the area called Paso del Tigre, very close to the Azero bridge that separates the provinces of Tomina and Hernando Siles in the Chuquisaca department in the south of the country.

Six years after the accident, the environmental audit is still pending that can determine the responsibility and with that the measures to repair the environment, and the corresponding reimbursement. This spillage affected hundreds of wild and domesticated animals as they drank the water of the contaminated streams and put an end to the cultivations of the peasants in the area.

According to the former director of the Natural Resources and the Environment of the Chuquisaca Prefecture in 2004, Leonor Castro, the diesel spilled for 32 continuous hours through a 15 centimetre large hole in the pipe. The spillage spread along 9 kilometres of the river Azero. 'Five communities were witness to the advance of the large patch of diesel that passed through the river and brought death with it,' confirmed the former environmental official.

In the opinion of engineer Castro, the measures of remediation taken to mitigate the environmental impact of the spillage on the part of the company CLHB, owned by Peruvian and German shareholders that are responsible for the pipeline, were not adequate and turned into another attack on the environment and the health of the inhabitants of the area. The inspection conducted by technicians of the Directorate of

Natural Resources and the Environment, as well as the spokesperson of the Competent Sectorial Organisation proved that the company had committed various transgressions of environmental regulations.

The actions (transgressions) consisted in burying the spilled diesel with a tractor, or in other words making the contamination invisible. Furthermore, children and adults were hired to clean the contaminated waters without any type of industrial protection, only in their underwear. Furthermore, children and adults were hired to clean the contaminated waters without any type of industrial protection, only in their underwear. Lastly, they collected the dead animals to make them disappear, although animals kept dying for days because of the magnitude of the spillage days.

The official said that some affected families were influenced so that they would not make a statement about the facts. When the Public Ministry sent two spokespeople to the site, the local inhabitants did not want to make a statement. However, several months later affected families living downstream reported that the diesel patch was about 10 cm thick, very large and had killed different animals.

In view of the evidently irresponsible handling of the environmental disaster by CLHB, the Directorate of Natural Resources and the Environment of the Chuquisaca Prefecture as well as the Directorate of Natural Resources and the Environment managed the execution of an environmental audit before the Ministry for Sustainable Development. The environmental audit should have been started in August 2005 and would have been carried out by a consultancy in Santa Cruz de la Sierra under the independent supervision of the United Nations Development Programme (UNDP). The company CLHB should have paid the expenses of the process. However, at the end of 2005, the new authorities of the Ministry for Sustainable Development (the minister Martha Bozo and Marianela Curi) decided, to the surprise of the institutions that had requested the study, to suspend all audits because they determined that regulations for their application had to be implemented. Since then nothing has been heard about a regulation to reactivate the audit applied for.

### **The contamination was left unpunished**

#### **A pending case**

Six years after the mentioned environmental disaster it was proven that the environmental regulations had been avoided by those responsible for the spillage. Therefore, no measures of remediation or restoration were taken in the affected area. It has not been possible to prove whether the contingency measures the company CLHB had taken have had an effect; there is evidence that the resources which the company had employed to clean the area were 'handmade' (hoses were covered in cotton to absorb the diesel, while peasants cleaned the diesel with sponges without having been provided the necessary protection).

According to the ex-president of the Asociación Sucreña de Ecología (ASE or the Environmental Association of Sucre), Apolonia Rodríguez, it has been proven that the diesel spilled into the ecosystem is still there 20 years later. The affected communities and families are still waiting for a specific response. Engineer Rodríguez says that the spillage was caused by the old age of the pipeline, which is about 50 years old, and the absence of adequate maintenance. 'The Bolivian government must evaluate the environmental liabilities of the oil exploiting activity, because such old pipes without adequate maintenance can be regarded as obsolete material that has a negative impact on the ecosystem; it is, therefore, necessary to replace or do maintenance work on the pipeline between Camiri and Sucre,' emphasises the environmental activist.

### **THE LARGEST OIL CONTAMINATION IN HISTORY: TEXACO IN THE ECUADORIAN AMAZON**

In 1937, shortly before the end of Federico Páez' dictatorship, a model was created to hire companies with concessions by means of one of the first oil acts passed in Ecuador (Aráuz, 2009). Although later governments modified the hydrocarbon acts, hiring companies with concessions was the preferred norm; currently the law also considers other options such as association contracts, participation contracts, service contracts and other contractual forms of delegation.

In February 1964, the Ecuadorian state granted a concession for a territory of about 1,431,430 hectares to the consortium Texaco-Gulf so that it can explore and extract oil in this region of the Amazon. In the first quarter of 1967, Texaco drilled the first wells in the land of Lago Agrio. After various contractual modifications and modifications of the laws on hydrocarbons of the country, a new contract was signed with Texaco in August 1973 increasing the area of the concession by 491,355 hectares. Since then, the company has drilled more than 200 wells and built a large part of the oil infrastructure existing in the area, including the Trans-Ecuadorian Oil Pipeline System (SOTE) starting in the Amazon and ending in the coastal area.

In the long years of the concession called Río Napo (1964 – 1990), Texaco breached regulations and procedures, which the company itself applied in the operations in its country of origin, the United States of America (Power and Quarles, 2006). After the end of the contract, various independent studies and audits of the state showed irresponsible technical handling that lead to severe environmental, social and cultural consequences. In 1993, PetroEcuador, a state-owned oil company, took on the environmental remediation of the damage Texaco had left and has since uncovered one of the most severe environmental crimes world-wide, which can only be compared with the famous spillage of Exxon Valdez (1989 in Alaska) and the Gulf of Mexico (2010). Prior to that, in 1993, a group of communities, peasants and indigenous people in the Amazon took the company to court in the state of Texas (the place Texaco is based).

#### **The contempt for the environment**

There are many episodes of environmental damage caused in the 25 years Texaco was in the Ecuadorian Amazon, which is shown in the numerous technical studies, audits and surveys carried out since 1994 (Hurtig and San Sebastián, 2002). Next follows a summary.

Even if the injection of formation water underground is a practice that has been regulated for more than sixty years in many oil extracting countries and has been applied by Texaco in its operations in other countries, the reality was different in the Ecuadorian Amazon. These waters, which are loaded with heavy metals and full of chlorine and other contaminants, are present in the subsoils together with the hydrocarbons; to obtain the oil it is necessary to first separate these waters.

The practice of Texaco in Ecuador consisted in not injecting these waters that were deliberately thrown into bodies of water or onto the surface of the land. This has gravely contaminated the land and the water in the region, both on the surface and underground. Heavy metals do not biodegrade; they are very persistent, so that they have prevailed in the soil and the bodies of water until today. In the studies and surveys prepared during the legal proceedings against the current Chevron-Texaco, in a sample of 80,000 chemical analyses toxic contaminants were detected in the ground and the water.

Texaco knew the environmental risks the discharge of superficial formation water entails and had the technological experience to reinject it instead of discharging it. Contrary to the global valid standards Texaco discharged 15,834 million gallons between 1972 and 1990 in small river beds and land close to its stations and drills.

Before discharging the formation water Texaco stored it in earth pools without waterproof lining so that it regularly filtered through and flowed over the edge, thus extending the contaminated areas, which is proven by an audit by Fugro/McClelland West prepared for the company itself. From these pools, where the oil was already separated from the oil, pipes emerged to drain the toxic liquid – with impunity – towards the jungle and its riverbeds. Without any doubt, this open discharge of formation water without any type of analysis or previous treatment was cheaper for Texaco than building and maintaining reinjection wells.

Texaco built and abandoned more than 900 open-air pools without lining and full of toxic mud containing hazardous chemicals, such as chromium, barium, lead, etc., highly cancerous substances (San Sebastián, 2000). These pools were nothing else than not very profound excavations and not at all technical that did not repair any bodies of water or headwaters of streams nearby. Their construction under the open sky lead to their repeated overflowing resulting from the accumulation of rain water. The contaminating substances dispersed by filtering into the ground and underground water, by deliberate discharge through pipes and by overflowing pools.

Nine of the 18 production facilities of Texaco that were audited by Fugro-McClelland (in 1992) had pools that directly discharged the surface water; they also contained a high proportion of hydrocarbons that was not separated from the contaminated water. There was evidence of oil discharged from these pools in the fields of Aguarico, Cononaco, Sacha Central, Sacha Norte and Yuca, while the draining canals in Sacha Central and Yuca were strongly contaminated and contained crude oil.

Equally, the audits carried out by AGRA Earth & Environment (1993) discovered pools with waste containing hydrocarbon in 125 of 162 oil drills that were evaluated; this is to say, in 80 pools of the 22 audited stations. These audits recommended immediate remediation in all production facilities and in the majority of the drilling locations. This remediation did not take place as we will see.

Practices similar to the water formation pools were applied for the handling of the drilling mud, which is a dense liquid that comes out of the first drilling holes. Again, Texaco was far below the international industry standards as the documentation of their own audits shows. The entire mud was abandoned in ditches without lining or in open spaces.

But this was not all. Another severe source of contamination was the oil spillage – accidental or not, which we will not discuss in much details – and the intentional combination of oil with ballast and sand to ‘clean up’ roads and paths. This measure, which seemed to be full of good intentions, turned out to be another source of contamination after frequent rainfalls that carried the oil towards natural riverbeds. Lastly, the quality of the air in the area was also affected due to the bad handling of the petroleum gas that burnt 24 hours every day. A measure Texaco took before oil spillages was the intentional burning according to information by Fugro-McClelland (1992). In 1987, Texaco advised that it had burnt a spillage of 100 barrels of oil, while the National Directorate of Hydrocarbons advised that Texaco burnt approximately 40 barrels of crude oil of the collection drill Sacha 37 in 1976 without any authorization, which caused serious damage to the adjacent facilities.

As a climax, we will show an example of the level of contamination existing around the Aguarico station, in the canton Shushufindi, where Texaco started its operations in 1974. The judicial inspection revealed excess chemicals in the water and ground, and the following substances exceeded the maximum tolerance threshold for contamination of the ground: benzene, benzanthracene, benzopyrene, chromium, ethylbenzene, PAH, naphthalene, pyrene, vanadium and xylene. At the time, the water samples showed intolerable levels of barium, benzopyrene, cadmium, PAH and TPH, exceeding the threshold of barium by more than 1000 times and of TPH, naphthalene and PAH by more than 200 times.

#### **Impacts on the local population**

Just like the environmental impact, the many damages to the local population have been sustained in various technical studies. In 1994, Jochnick and their collaborators showed concentrations of polynuclear aromatic hydrocarbon (PAH) that were several times higher than the levels permitted by EPA, the US Environmental Protection Agency, in 32 samples of drinking water of the zone. So, while the permitted level of benzene in drinking water is 5 micrograms per litre, the international standards do not tolerate even one nanogram in the case of PAHs. Nonetheless, the samples of analysed drinking water had PAH concentrations of between 32.8 and 2,792 nanograms per litre. Due to the high cancerous potential of these PAHs, the risk of cancer due to the consumption of this water is up to one for every one thousand inhabitants.

Nearly 10 years later, San Sebastián (2000) evaluated the incidence of abortions and cancer in a sample of 500 people. It was shown that the numbers were considerably higher in communities that were exposed to oil contamination than in communities that lived far away from this activity. Abortions were 150% more frequent and cancer was 130% more frequent with a mortality risk that was 260% higher than in the city of Quito. The Yana Curi report by the same author shows that there is an elevated health risk for domestic animals and human settlements when they are exposed to toxic substances derived from oil. These severe and irreversible effects, such as for example cancer, spontaneous abortion and reproduction deficiencies translate to a public health problem.

According to this study, the rate of spontaneous abortions in the region oil has an impact on is 2.5 times higher than in similar communities that are not exposed to this contamination. Equally, the rate of leukaemia among children in these zones of the ages between 0 and 4 years of age was three times higher than in other regions of the country. The Cancer in the Ecuadorian Amazon (1896 – 1998) report by Hurtig and San Sebastián (2002) documents that in areas of oil exploitation the risk of suffering from cancer was higher than in those areas without this activity. The National Tumour Register shows a progressive increase of new cases of cancer in the provinces of Napo (today Orellana) and Sucumbios until 1984. The cases with higher incidence were uterine, stomach, blood, skin and lymphatic gland cancer.

On the other hand, a psychosocial study of the activities of Texaco in the Ecuadorian Amazon (Beristain and collaborator, no year) registered a higher rate of sexually abused women. One out of 20 interviewed people said that they knew of such acts, both against adult women and women under age. Equally, one out of every 10 interviewed people had witnessed sexual violence by the company operator in their own family, while at the time nearly half of the interviewed people confirmed that they had fallen victim to hostile behaviour on the part of workers of Texaco.

Indigenous people reported that they had suffered discriminations in the form of deceptive behaviour, abuse, or mocking about their clothing and culture. Three out of every four interviewed people indicated that they had lost land as a consequence of contamination or the exploitation of petroleum, which included land of the community. Lastly, this study showed that the deterioration of the environment, the loss of land, serious illness, accidents and violence caused a higher rate of emigration from areas in which Texaco operated. The indigenous groups were more inclined to relocate.

#### **But was there any remediation?**

For contractual obligations vis-à-vis the state, Texaco had to remedy and restore its socio-environmental damage, which was called liabilities in the language of oil contracts. There is a lot of evidence that proves that its irresponsibility and negligence was deliberate. This evidence comes from independent studies, and audits carried out by the state itself (via the National Comptroller's Office, the Subministry of Environmental Protection of the Ministry for Energy and Mining and the Environmental Protection Unit of Petroeducador, Petroproducción).

Repeatedly Texaco did not comply with valid environmental regulations in many instances of its supposed remediation; from the moment it hired and subcontracted companies to act as remediators that were not qualified by the Ministry for Energy and Mining (now the Ministry of Natural Not Renewable Resources) until it abandoned the formation water in the covered up pools that were not treated in any way. The companies IECONTSA and CANONI for example incinerated recovered solid and crude residue in the open and did not comply with environmental regulations. According to additional technical investigations Texaco hid about 500 pools before 1990. Until 1996, the environmental authorities of the energy sector reported information about approximately 200 hidden pools, the fact that the formation water was not reinjected in the majority of the production stations, shafts that were closed badly and abandoned, spillage without remediation. Thus, Texaco did not comply deliberately with its contract with the Ecuadorian state.

The studies developed by the Comptroller's Office conclude that the damage caused by Texaco is irreversible and leaves a level of contamination that is above the permitted limit in most of the samples of water for human consumption. The judicial inspections during the proceedings against Chevron-Texaco, when thousands of samples were evaluated, brought up similar results. It is interesting that the surveys arranged by Chevron-Texaco had similar results.

The desire to accuse Ecuador of deliberate inaction adds more to the controversy of the actions of Texaco. Texaco puts forward that it fulfilled its commitments of socio-environmental remediation and restoration in its convention of environmental remediation signed with national authorities in 1998<sup>4</sup> that declined to present a later claim against the company once the remediation was implemented and approved and the state is responsible for the damage it was accused of because Petroecuador took on the exploitation of their fields from 1993 onwards. In a concomitant way, the Ecuadorian state turned into a complice of Texaco as it effectively approved the closing down of its operations.

#### **Petroecuador takes over the fields franchised to Texaco**

Once Petroecuador took possession of the fields of Texaco, the big damage had already been made. Although the state-owned oil company claims having tried to improve the conditions of exploitation, little was improved. According to the quoted Comptroller

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<sup>4</sup> In 1998, Texaco signed a convention with the State, four municipalities and two provinces where previously the concession area had been, and they agreed a transaction and liberation from complaints in a series of contracts signed in 1995, 1996 and 1998.

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between 2000 and 2004 Petroecuador used 1% of its budget for the protection of the environment and 2% for the reinjection of formation water. These percentages were in any case not sufficient. Furthermore, it was documented that Petroproducción did not comply with the environmental regulations for the reinjection of this water. While a report of the state-owned oil companies mentions 38 reinjection wells, the information provided by the Subministry for Environmental Protection of the ministry of the industry suggested that 35 of them did not comply with the environmental regulations for the treatment of this water.

According to an inspection by the Comptroller, many production stations (Lago Agrio, Parahuaco, Anaconda, Secoya, Frontera) do not dispose of reinjection equipment, so the formation water is still discharged into the environment without any treatment, a clear reiteration of the disastrous practices of Texaco. Furthermore, the majority of the reinjection wells does not dispose of a retention area around the drill hole and does not have a waterproof base (as stated in the same report of the Comptroller quoted before). According to the report of the National Hydrocarbon Directorate Petroproduccion disposed of more than 61 million barrels of formation water into the environment. Data of the Water Reinjection Unit of Petroproducción informs of discharges of 83 million barrels into the environment. Regardless of the exact amount, the contamination dose of the hydric resources and the ground was enormous.

A similar situation became evident in an analysis of leachates taken from the Conocaco well no. 27, where a concentration of barium was registered that was 2.4 times higher than the limit legally permitted in Ecuador. As it had occurred 10 years earlier with Texaco, the companies subcontracted by Petroecuador, such as Drillfor, S.A., Schlumberger and Sipec, did not apply the appropriate procedures to avoid contamination or to remedy the environmental impact.

#### **A systematic violation of the law**

The environmental legislation in Ecuador goes back to the 1970s, in 1976 under the model of Mexican legislation from 1971<sup>5</sup>, the Prevention and Control of Environmental Contamination Act was passed that created an Inter-Institutional Committee for the Protection of the Environment. The objective of this act was to establish the mechanisms necessary for the prevention of the contamination of the environment in the resources air, water and soil.

Afterwards, the first environmental regulation was included in the Constitution of 1978, which was reformed in 1983; it established the right to live in a healthy environment free of contamination. The Constitution of 1998 widened the regime of the protection of the environment, as well as the scheme of participation incorporating among other topics a previous consultation and indigenous rights derived from the Convention no. 169 of the International Labour Organization (ILO) and among them the consultation when their territory is subjected to extractive activities.

With regard to the hydrocarbon sector, the valid Hydrocarbon Act obligates oil companies to take measures to prevent environmental damage. (Art. 31 paragraphs r,s,t,v). In 2001, a specific environmental regulation was developed for hydrocarbon operation (Environmental Regulation for Hydrocarbon Operations).

Currently, the valid Constitution of 2008 is wider in environmental matters, it recognizes nature as a rights-bearer and grants at the same time the same human right to living in a healthy environment.

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5 Ecología y Derecho. Vladimir Serrano Pérez, 1987. p. 266

Nonetheless, in spite of the validity of a legal framework to prevent environmental damage caused by the activities of oil companies, the application of the environmental rules was not very effective and efficient.

### **NICARAGUA ALSO WANTS TO BE AN OIL EXTRACTING COUNTRY**

The first oil explorations in this country, the largest one in Central America, were made on the Pacific in the 1930s, and in 1965 Chevron and Shell had drilled about 20 wells. Forty years later, Nicaragua's plans to extract oil appeared again with exploration studies prepared by Norwood, a US-American company. Something similar happened on the Atlantic side, where the first studies discovered oil in 1940, but nearly 60 years had to go by until the important oil potential of the region was recognized.

Today, the Nicaraguan state plans to put its trust in the oil industry as a source of income for the impoverished country after years of political conflicts triggered by a long dictatorship, an economic blockade and a counterrevolution; however, the legal instruments to prevent, regulate and in this case to remedy social and environmental impacts are awkward and in some cases even inexistent.

Like in Ecuador and Bolivia, the laws in Nicaragua regulate the previous consultation in the process of approving oil concessions in areas where indigenous peoples and people of African descent live; however, they are very weak with respect to their compliance and the level of experience and expertise of the actors who take the decisions and the debate of this matter; this has now become very important because exploration processes have been started and because of the large number of companies that have approached communities of indigenous people and people of African descent to negotiate on a bilateral level by making a large variety of promises.

The social and environmental conflicts lie in the fact that the people are negotiating their resources without any type of advice, they sign conventions that do not include any measures of prevention and precaution, which is made worse in view of the fact that the country does not have technical rules in force to measure and quantify the limits of contamination emitted by the industries. Proof of this is the workshops related to oil extracting activities that have brought together a large number of people in the surrounding communities; but unfortunately, it has not resulted in the review of public policies and environmental rules.

We will merely quote some means of public and legal management that prove this statement.

Decree 76-2006 demands the creation of an Inter-Institutional Committee (art. 10) to discuss and prepare proposals, which the competent body, MARENA (the Ministry for Natural Resources and the Environment) hardly ever organizes, and the appropriate guidelines are not in place to be able to identify the criteria of this committee or the levels of advice. As a result, the communities are advised by the companies themselves. Oil concessions are granted and the creation of a large refinery called Supremo Sueño de Bolívar is planned, but there are not any rules in place for the evaluation of the environmental impact or any technical rules for the companies carrying out the remediation. Nicaragua is governed by NOM-052-052-SAMRNAT 2005, so there are resources for large projects, but not to establish an adequate environmental regulatory framework. .

According to the provision of art. 7 para.8 of the Municipality Act and art. 21 of the Oil Exploration and Exploitation Act 286 the Regional Councils of the Atlantic have the

ability to approve or reject oil concessions; however, as we have been able to see, there is no basis of analytical information or any criteria with regard to environmental matters; yet, there is an enormous economic need and a strong dependence on oil derivatives for the generation of electricity, and about 70% to 80% of the country generates energy on the basis of oil. .

Currently, the Fishing and Agricultural Act 489 in its article 79 designates interior waters and a three-nautical-mile-wide strip measured from the shoreline along the Pacific coast and the Caribbean Sea for the exclusive use of private fishing. In the same article the autonomous regions are granted the exclusive right for community and small-scale fishing in the three-nautical-mile-wide strip next to the shore and 25 miles around the adjacent cays and islands.

The zones that may be affected by the exploitation of oil on the Caribbean side of Nicaragua are more than three nautical miles away from the coast, but the consequences of a possible spillage would directly affect the communities on the coast due to the natural conditions of the region where the currents tend to move northward at a speed of two nautical miles per hour, which would directly affect the communities of RAAN and the border with Honduras and Columbia, both of which are covered by a large variety of reefs.

In the territory of Nicaragua many corals and other protected areas would be affected, some of which are: the cays of Miskitos, Edimburgo and Perla covering a total of about 454 km<sup>2</sup> and providing a habitat for 38 species of aquatic diversity and an immense variety of sea grass that reaches up to the coast and is home to 6 of the 7 turtle species known in the world, and above all the leatherback sea turtle.

On average every hectare of the coral reef provides:

- food, raw material for ornamental resources: 1,100 U\$D (up to 6.000)
- Climate regulation, water purification, limitation of hurricanes: 26,000 U\$D (up to 35,000)
- Cultural and touristic services: 88,700 U\$D (up to 1.1 million)
- Maintaining biodiversity: 13,500 U\$D (up to 57,000)
- Total average value of one hectare of the coral reef: 129,300 U\$D (up to 1.2 million U\$D)

According to preliminary data of INPESCA (Institute of Fishing) 67 % of the fishermen are Misquitos and about 20% are of African descent, and in the south more than 50% of the fishing is small-scale fishery done by the Ramas and with a marked migration towards industrial ships in times of shortage, which is worrying because the granted areas are in banks of fish or very close to them.

Until today the companies have started to make social investments at an accelerated speed, and in particular Infinity Energy Resources in the region of Atlántico Norte, with about USD 35,328.60 invested into the construction of a bridge and about USD 297,999.41 in one year and a portfolio of social projects exceeding one million US dollars of investments; this obeys the large interest the zone that was granted as a franchise represents, which according to studies of Fugro Group is about 3 billion barrils of light oil; thus, the social investment made until now evquals about one day's salary of its current president and at least 0.00000042% of his estimated income.

Nicaragua is tying itself to the oil industry via exploration, and it also does it by means of its high energy dependence and international treaties that diversify its economy; it has a lot of difficulty in controlling the enormous amounts of derived oil that are transported,

due to which between 2003 and today about 80 hydrocarbon spillages have been discovered. This does not include illegal and non-registered traffic, as until today there are only three companies acting as remediators that have been inspected by the state on the basis of foreign rules and without appropriate equipment for this inspection.

There are emblematic cases, such as the spillage of the Texaco unit Propósito-Managua where a spillage of at least 4,544 gallons of gasoline was measured, but it was 'plagued' by irregularities and the interest to put petrol stations in the area next to Lake Managua, one of the richest drinking water sources in the country, which put the human right to clean water and a healthy environment at risk, because a group of businessmen wanted to increase their earnings in a strategic geographic point as it is one of the main entrance roads to the city and the international airport.

The main cause of the spillage was a broken hose that made the product return to the drains (blind shafts) of the tank pit through secondary pipes so that the drains overflowed and the product spilled onto the bottom of the tank pit. The pipes of the station were outdated pipes of the second and third generation by Enviroflex; the one that had been damaged most was of the second generation, and the pipe of the third generation had a broken section and small inflations that looked like creases, as well as darkened parts on the interior engraving. When the pressure test was carried out on all lines of the product, they showed totally damaged stretches and two that did not pass the test.

When the tank pit was dug out two large fractures were found, but they were not taken into account despite the technical implications that this can have for the mobility and the propagation of contaminants.

Although the case was reported one week later and in view of the irregularities the state signed an act of mediation in 2006, the results of which are not yet evaluated.

Contrary to the expected ideal, instead of promoting the participation of all bodies of civil society and the people as a whole, the Supreme Court of Justice demanded the payment of 20 thousand Córdobas for the intervention as a third party in favour of the Alexander Von Humboldt Centre and has not been able to respond to the petition to incorporate an ad hoc committee to analyse the case for about two years, so that this case has become a too bureaucratic, difficult and uncompleted case for the time being.

On the Pacific side there is Norwood, a noteworthy oil company that after years of exploration still has not presented a full and published environmental audit report to the MEM (Ministry of Energy and Mining) and to the MARENA (Ministry of the Environment and Natural Resources). The questions that interested most were: Was there formation water? What happened to the drilling mud? Where are the complete reports? These and other questions sleep the sleep of the innocent, because there are very few organizations that monitor environmental questions; until today there are only two: the Humboldt Centre and the Fundación del Río, as the topic environment is complicated and there is a lack of control.

Like in Bolivia and Ecuador, Nicaragua has ratified international conventions for the protection of indigenous peoples and people of African descent, as well as environmental prevention and control (like the ILO convention no. 169). However, its legal structure and inter-institutional coordination seems to be weak bearing in mind the social and environmental impacts of an oil industry that is growing. In view of this, the coordinated participation of government institutions in processes of oil exploration has been incipient until now weakening any opportunity to monitor these processes, environmental evaluations and the participation of civil society in them.

The legal framework of Nicaragua is full of instruments protecting indigenous peoples and people of African descent, but the government lacks the means to watch and control these industries. To prove this statement the Law no. 286 in its article 32 limits the access to information about oil contracts until two years afterwards and only on the will of the companies; furthermore, the access to information act no. 621 in its article 15 limits the access of the public to information about contracts; contrary to Bolivia, where contracts pass through the congress which makes them public one way or other, and contrary to Ecuador where transparency is talked about; in Nicaragua this is a pending subject, due to which the principles of prevention and environmental precaution are not applicable.

In Ecuador, where legal instruments related to the exploitation of oil date back several decades (Aránz, 2009), and are not only a few, Chevron-Exxon could systematically not comply with valid rules and regulations. What can be expected in the case of Nicaragua, if its environmental legislation with respect to hydrocarbons proves to be weak? What would the panorama be like, for example regarding the environmental remediation of possible spillages of crude oil, if the regulations for remediation are the same as established in Mexico, where the specifications for the exploitation of oil are different? Is it not time that Nicaragua established a series of strong legal instruments that standardize and regulate the exploitation of oil, that control the processes for the evaluation of impacts or the remediation of damages? It is necessary to prevent what has happened in other latitudes where companies could act like judges and a part of the 'resolution' of socio-environmental conflicts.

## CONCLUSION

From this analysis we can draw the following conclusions:

- a) The trend of companies to continue postponing the internalization of the cost of externalities in environmental matters<sup>6</sup> and the slowness of the state to exceed compliance with rules and policies that obligate companies in this matter. For this reason, companies avoid this principle that the one who contaminates pays, and continue using the ecosystems as drains for hazardous waste, which leads to severe consequences with responsibilities for the environment.
- b) The lack of transparency of some companies and of the states to enable broad and fluid access to environmental information.
- c) The institutional weakness of tutelage models and the environmental management of the states, as well as of the existence of weak models of sustainable development that displace the political will towards implicit economic short-term interests at the expense of environmental sustainability and the valid legislation under the pretext of current poverty and the economic crisis in these countries.
- d) The relativization of the public interest to protect and conserve the environment according to the short-term economic interests of the companies.
- e) The weak public participation in environmental matters as well as the absence of special legal systems for environmental responsibility and access to environmental justice.

In view of these conclusions we can comment as follows:

The Ecuadorian and Bolivian cases we have quoted are paradigmatic in the history of oil exploitation, as they have all the features of what tends to occur when an oil company or an oil service company operates with all the freedom the state grants, or in other words a relativization of the interests of the companies becomes noticeable that puts the public interest to protect the environment into second place. In this relativized relation

<sup>6</sup> Principle 16 of the Rio Declaration from 1992 says: 'National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.'

between the state and the companies, oil companies repeatedly empowered themselves directly or indirectly with the technology of remedying environmental damage, and consequently when the results of the processes of remediation occur, they are not refuted by environmental authorities, which take them as the last word from those who 'know most about the subject'. Complaints come from environmental organization and in particular from directly affected peasant and indigenous communities. However, their word is disregarded in the majority of cases as they allegedly do not have the authority to discuss technical questions related to oil.

What is most paradoxical is that the environmental remediation has never taken place or – which is worse – was carried out in a deliberately negligent way knowing the weak environmental legislation or unfavourable institutional framework very well. The indemnification as well as repair and restoration were not at all or only partly carried out or they were turned into relationship programs with communities separated from real community needs or into programs of 'conflict resolution' (Fontaine, 2004).

Although it could be said that the Bolivian, Ecuadorian and also the Nicaraguan environmental sectors suffer from an institutional weakness compared to the extracting sectors, the non-compliance with environmental regulations goes further. It responds, as Andrade suggests (2008), to the disequilibrium between financial and environmental interests of these countries, in urgent need of exploiting their natural resources to sustain their public purse.

As these countries depend on the exploitation of primary resources the thought that they give priority to environmental regulations over the extraction of hydrocarbons, is, at the most, ingenious. The recent history of the Yasuni National Park in Ecuador (Andrade, 2008) is a good example; it shows how fragile legislation and the environmental institutions are compared to the urgent need of oil companies. Firstly, they signed contracts of oil concession in the national park, which fully contradicts the objectives of conserving this category of protected area. Secondly, in view of the international critique the government would receive it introduced modified limits (in 1990) that reduced the extension of the park to be able to award land to the Waorani tribe. Although this measure was beneficial for this tribe, it also favoured the oil industry, because it freed it from environmental regulations applicable to areas protected by the state.

Due to the relativization of environmental laws depending on the interests of oil companies, and the inoperability of environmental institutions with their cross-sectoral approach and their concurrent competences different environmental institutions have roles that are not very clear in these countries; and due to the absence of state-controlled entities for the defence and control of nature (defender and supervisors of the environment) the application of environmental regulations is ineffective vis-à-vis the exploitation of hydrocarbons – and equally the mining industry.

The short-term vision that exceeds an extraction-friendly economy (Acosta, 2009) dissuades prolonged discussions and processes of analyzing the population directly affected by a certain extractive activity. On the contrary, it motivates client relations of companies with local communities or even of the state itself with its inhabitants. The application of blunt contractual clauses with respect to the environment that dissuades an arbitrary handling of the environment is put behind the need for resources. This need is converted into an argument to justify any violations of the national constitutions and describe the exploitation of hydrocarbons (and other natural resources) as a national priority. Is it possible that the environment is turned into a priority?

The interest and participation of the civil society is key, which shows the prolonged proceedings one sector of the Ecuadorian society that is directly affected by the extractive activities of Chevron-Texaco continues against this gigantic corporation. Therefore, thanks to the pressure of certain sectors of the civil Ecuadorian society, it was possible to achieve at least that certain environmental regulations are respected with regard, for example, to the exploitation of the Yasuní National Park. In recent years, the public interest in environmental matters related to the oil industry has grown; certain pressure is exercised on the Ecuadorian government and its concessionaries. On the contrary, the general perception is that the society in Nicaragua shows little interest in this matter, apart from certain exceptional episodes that have made the news.

Ecuador and Bolivia have constructed an oil history with more obstacles than good decisions in contractual, financial, social and environmental matters. Although they have a most robust legal framework than Nicaragua, there has been an abundance of mistakes in socio-environmental matters. If Nicaragua has to open its borders to the oil industry, it will have to study the processes of these two countries (and various other impoverished countries) that strongly depend on the exploitation of hydrocarbons.

As long as the responsibility for and social participation in the management of the environment as well as the tutelage of the environment on the part of the states that have enough political will are not strengthened, the risk of perpetuating environmental disasters will remain. Nicaragua has an important advantage over the abused oil history of Ecuador and Bolivia (in environmental matters): it is only starting its oil adventure.

This gives it the opportunity to strengthen the principles of prevention and precaution from the start. After all, the best form to remedy severe socio-environmental damage caused by bad oil exploitation is to avoid that they happen in the first place.

Unfortunately, in Nicaragua the subjects of democracy, human rights, starvation and poverty did not allow that the subject of the environment was given the same priority, and our home and our land were relegated to second place, although it is our mother that offers us what is necessary to live, unlike our brothers and sisters in Bolivia and Ecuador who have created spaces to discuss this subject on their way that is full of irregularities and environmental disasters and are at least aware of this problem.

Finally, we have to point out that the defence of the environment is a fundamental right of the people and as such inalienable and inviolable. The social organisation and political will to achieve a true model of sustainable development is still a priority.

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# THE RIGHTS OF INDIGENOUS PEOPLE AND EXTRACTIVE INDUSTRIES IN PROGRESSIVE GOVERNMENTS: A LECTURE ABOUT BOLIVIA, ECUADOR AND NICARAGUA

## I. INTRODUCTION: INDIGENOUS PEOPLES AND THEIR RIGHTS IN THE CURRENT CONTEXT OF BOLIVIA, ECUADOR AND NICARAGUA

The present article on extractive industries and indigenous peoples is limited to the context of Bolivia, Ecuador and Nicaragua, countries with a high percentage of indigenous peoples that are in the process of implementing the rights of these internationally and nationally recognized people, and are ruled by governments that are at the left of the political spectre, or are so-called progressive government lead by their presidents: in Nicaragua, Daniel Ortega, historic leader of the Sandinista National Liberation Front (FSLN), who won the presidency again in 2007; Evo Morales, leader of the social organizations of the cocaleros, the coca leaf growers, and the first president of indigenous origin, re-elected in 2009 for the Bolivian government; and Rafael Correa, economist, who defines himself as a left-wing humanist, and president of Ecuador since 2007.

Therefore, we try to approach the subject of the most important rights of indigenous peoples recognized in international treaties these three countries have ratified, and the way how they are applied in the national legal system, above all in relation to the processes of previous consultation for the cases of exploration and exploitation of natural resources by extractive industries in indigenous territories.

### The indigenous peoples in Nicaragua

The seven indigenous peoples in Nicaragua are distributed in two main regions, the Pacific coast and the central northerly part of the country (or simply the Pacific); here are the chorotega (221,000), the cacaopera or Matagalpa (97,500), the ocanxiu or sutiaba (49,000) and the nahoa or náhuatl (20,000). On the Caribbean coast (or the Atlantic) live the miskitu (150,000), the sumu-mayangna (27,000) and the rama (20,001). Other peoples that have collective rights according to the Political Constitution of Nicaragua (1987) are those of African descent, called 'ethnic communities' in the national legislation, which include the creoles or kriol (43,000) and the garífuna (2,500).

As a result of their historic fights the indigenous peoples and the people of African descent on the Atlantic coast were admitted a form of self-government and self-determination, called autonomy, a right that was incorporated in the Political Constitution of 1987, and normative and sectorial bodies which grants them the faculty to elect their own regional authorities, define the functioning of the regional public bodies, control the natural resources inside the indigenous territories, collect taxes and administer education, health and justice in accordance with their culture and traditions, have their own forms of social organization and administer their own local affairs, as well as maintain the communal forms of property of their land and the possession, use and enjoyment of their land.

However, the gap between rhetoric and reality is still big provoking that the autonomous ideals are still seen as pure aspirations and what really practically exists is the exclusion from politics and little or no decision-making power of indigenous peoples and peoples of African descent over their territory and their natural resources.

### **The indigenous peoples and nationalities in Ecuador**

In Ecuador, there are 17 indigenous peoples and nationalities that live in their ancestral territories in the Amazon, on the coast and in the Andes; they are represented by the Confederation of Indigenous Nationalities of Ecuador (CONAIE).

The CONAIE with a long trajectory of claiming the rights of its peoples unites the following peoples and nationalities: Shuar, Achuar, Siona, Secoya, Cofàn, Waorani, Zapara, Shiwiar, Andoa and Kichuas in the Amazon region. Tsachila, Epera, Chachi, Awa, Manta and Wankavilka on the coast. Peoples of the Kichua nationality: Palta, Sarakuru, Kañari, Puruwà, Chibuleo, Tomabela, Salasaca, Kisapincha, Waranka, Kitukara, Kayampi, Otavalo, Karanki, Natabuela and Pasto in the Interandean Ecuadorian sierra. These peoples are reconstituted by their self-definition, and organizational autonomy.

The political constitutions of both the Ecuadorian state and of Bolivia that had a constituent congress in the last year introduce innovative and advanced principles in relation to indigenous rights, such as the Plurinational Concept of the state, the Good Living as a general orientation for the development processes, and the Rights of Nature and Mother Earth.

In Ecuador, the right to previous consultation, indigenous territorial districts, the right to territory and self-determination of indigenous peoples in voluntary isolation, the right to recover rituals and sacred places were included among other things in the constitution.

### **The indigenous people in Bolivia**

Over the course of the last 40 years a number of rights of indigenous peoples, which they had demanded in their historic fights over many centuries, was progressively recognized. In the 1970s, different ideological movements appeared, such as indianism or indigenism, which created the foundations for the formation of political groups and parties that would years later participate in democratic elections; this incorporation into the democratic life of the country is very important for future fights and the recognition of rights by of the Bolivian state.

Thus, at the beginning of the 1980s, organizations appeared that brought together and represented indigenous peoples, such as for example the Confederation of Indigenous Peoples of Bolivia (CIDOB) or the CONAMAC, the National Council of Ayllus and Markas of Qullasuyu of the highlands.

One of the most important contemporary historical facts was the large-scale mobilization of the people in 1990 called the 'March for Territory and Dignity'. Thanks to these movements Bolivia was one of the first American countries to ratify the Convention no. 169 in the following year (1991), and to start incorporating indigenous rights in the reform of the constitution of 1993, which proclaimed the multi-ethnic and pluricultural nature of the Republic and confirmed in its article 171 the collective rights of indigenous peoples; it recognized the legal status of indigenous communities, granted jurisdictional faculties to its authorities, considered the need for special legislation and recognized the right to the 'native land of the communities'.

In 2001, the national census established that just over 62% of the population over the age of 15 confirmed that they were part of an 'indigenous or native people'; this implied the acceptance and recognition of individuals to be part of a community or an indigenous people; this identification enabled indigenous peoples to implement and legitimize a national movement in which the rights of indigenous peoples were constitutionalized.

Precisely this constituting process made it possible to establish that there are 37 indigenous people in Bolivia, of which 34 are represented by the Confederation of Indigenous Peoples of Bolivia (CIDOB) and others such as the CONAMAQ of the highlands. This aspect determined that the political constitution of the state recognizes the languages of indigenous native peoples as official languages, such as Aymara, Araona, Baure, Bésiro, Canichana, Cavineño, Cayubaba, Chácobo, Chimán, Ese Ejja, Guaraní, Guarasu'we, Guarayu, Itonama, Leco, Machajuyai-kallawaya, Machineri, Maropa, Mojeño-trinitario, Mojeño-ignaciano, Moré, Mosestén, Movima, Pacawara, Puquina, Quechua, Sirionó, Tacana, Tapiete, Toromona, Uru-chipaya, Weenhayek, Yaminawa, Yuki, Yuracaré and Zamuco.

The incorporation of indigenous peoples in the constitution is one of the most relevant aspects for the conformation of the plurinational Bolivian state together with citizens in urban areas of different social classes and intercultural and Afro-Bolivian communities.

#### **Recognition of the main indigenous rights**

The three countries have ratified the ILO Convention no. 169, which is the most important and advanced body of rights for indigenous peoples and has a constitutional status in many countries, as it is an International Treaty referring to human rights; its legislative development and applicability must lie with the governments by incorporating these rights into their national set of regulations.

#### **The United Nations Declaration on the Rights of Indigenous Peoples**

In 2007, after 20 years of deliberations a historic and significant step forward was achieved, when the United Nations Declaration on the Rights of Indigenous Peoples was signed that recognizes important rights for these peoples, including the right to free determination, handling and collective control of their own traditional territories and their resources, the right to participate in decisions that affect them including the rights to free, prior and informed consent, and the right to determine their own priorities of development.

#### **The Right to Territory**

The main collective right of the indigenous peoples is the right to territory. The territory has been one of the first demands and the motor of the conformation of organizations representing indigenous people. The territory is the physical and spiritual basis that ensures the means of reproducing and the existence as peoples; it is an important reference for the individual and collective identity. For indigenous people in different continents it is the so-called Mother Earth, and it is regarded as the source of life itself; it includes the entire habitat they occupy, use, love and care about, and not only the superficial area of the land that is necessary for life and food.

The Inter-American Commission on Human Rights (CIDH) said that for many indigenous cultures, the continuous use of traditional collective systems for the control and use of the territory is essential for their survival and individual and collective well-being. The control over the land is connected to their ability to obtain resources to sustain life, and for the geographical space required for the cultural reproduction.

The most modern works related to the development of Economic, Social and Cultural Rights (ESCR) express that in the case of indigenous peoples the territory is a fundamental human right and a prerequisite to exercise other human rights. In the case of the ILO Convention no. 169, the territory has an integral, collective, transgenerational, inalienable, unlimited, indivisible, inalienable and original character. In relation to the existing natural resources in indigenous territories, the Convention no. 169 extends this right to the use, enjoyment administration and conservation of the existing natural resources, and when there are underground resources over which the states exercise their jurisdiction, the plans for their disposition must be implemented in agreement with the right to previous, free and informed consultation on everything that can affect the free exercise of the right to territory, and the right to participate in the benefits of any kind of exploration or exploitation of these resources.

#### **The Right to Free, Prior and Informed Consultation**

It is necessary to specify that according to the provisions of the ILO Convention no. 169, the exercise of the right to prior, free and informed consultation has the purpose of reaching an agreement or achieve a consent, which is understood as the declaration of a clear convincing agreement following the procedures of transparency and good will, as well as the traditional system of deliberation and decision-making of the indigenous peoples the consultation is given to. The right to Consultation and Prior Free and Informed Consent is also recognized in the United Nations Declaration on the Rights of Indigenous Peoples in its article 19.

The term Prior Consultation refers to what must be carried out before the project is started, the term Free Consent means that there must not be any pressure to take a hasty decision or in a limited period of time, and there must not be any coercion or exterior pressure, including monetary incentives.

The consultation must guarantee that all relevant information, enough time to collect information and to fully discuss the potential risks and benefits of the project, a translation into traditional languages and the opportunity that all sectors of the indigenous society participate are given.

Although it is a constitutional controlled and regulated mandate that has foundations in international law, the Prior Consultation cannot stop the exploitation or an extractive activity in indigenous territories, because the decision adopted by the people as a result of the consultation does not have a binding character and the possibility of a veto or prohibition to implement the project.

Exercising the right to Free, Prior and Informed Consultation for projects or exploration and exploitation of natural resources also includes the opportunity to prevent or mitigate potential environmental and social damage and a form of social control and transparency in the development of these operations in indigenous territories. A mechanism of dialogue between the state and indigenous peoples that exists on the basis of respect for the forms and ways in which indigenous communities take decisions about the use of their territories that is part of the foundations of the construction of any plurinational state.

#### **The right to decide about their own development**

The convention also recognizes the right to decide about their forms of development and how to actively intervene in the application of this right; this includes the participation in the formulation, application and evaluation of development plans by the State.

The Special Speaker for Indigenous Peoples of the UN observes that: '... In all sectors of the world, indigenous people feel unable, in any possible way, to proceed with their forms of development that are consistent with their own values, perspectives and interest... Generally, the economic development has been imposed by the outside, leaving out the right of indigenous peoples to participate in the control, implementation and benefits of this development.'

## **II. HYDROCARBON LEGISLATION AND THE RIGHTS OF INDIGENOUS PEOPLE**

Ecuador promulgated a new Hydrocarbon Act; its analysis that was done by Alberto Acosta (2010) specifies that certain adjustments were introduced to adjust the law to the demands to renegotiate oil contracts in order to obtain higher extraction rates and to ensure the stability and trust of private companies.

However, while things are made easier for investors, the law does not pay attention to environmental and social rights that are established in the Constitution. Thus, the regulation to remedy severe environmental and social liabilities of operations that have been active in the Ecuadorian Amazon for more than four decades are not included, neither is given priority to monitoring, investigation and environmental control systems or procedures to abandon operations, and punitive measures against those that are responsible for the damage. It also does not prescribe mechanisms to establish full or partial, permanent or temporary restrictions for interventions in ecologically and socially vulnerable zones, and it does not include prior consultation for indigenous peoples and nationalities, in whose territories oil concessions shall be granted.

In the case of Bolivia, there was a development process starting with the ratification of the ILO Convention no. 169 (1991), which established different laws and rules, such as no. 1615 and no. 1777 for the recognition of social, economic and cultural rights; however, the full exercise and earlier regulations did not admit exercising and putting means into practice for the right to previous consultation.

The Hydrocarbon Act no. 3058 of 2005 indicates in its article 114 the compliance with act no. 1257 that ratifies the ILO Convention no. 169 that peasant communities and people of indigenous origin will have to be mandatorily and appropriately consulted, before it is attempted to carry out any hydrocarbon activity. The Hydrocarbon Act no. 115 art. 115 requires that the consultation is given in good faith with the principles of veracity, transparency, information and opportunity.

The requirement that the consultation process works and is operative was established in the supreme decree no. 29033 (2007), which was promulgated by President Evo Morales; it is a consultation rule that establishes the participation of native indigenous peoples and peasant communities (PIOCs) in hydrocarbon activities. The main idea of Morales' government was to respect the peoples when they define whether the activities that are attempted to be carried out in their territories are detrimental or beneficial to them, and that they can take a decision on this matter by means of a transparent information process and adequate consultation.

Under the Environment Act, no. 1333 (1992), the general regulation of environmental management, the regulation of prevention and environmental control and the Hydrocarbon Act no. 3058, the supreme decree no. 29103 on socio-environmental regulation of Hydrocarbon activities on the territory of native indigenous peoples and peasant communities is passed with the objective to defend and/or preserve the environment.

The political constitution of the state passed in 2009 in a national referendum ratifies, incorporates and constitutionalizes in its article 352 the right to consultation, and indicates that the exploitation of natural resources in certain territories will be subject to a process of free, previous and information consultation of the people affected by it and called by the state. It also establishes and guarantees the participation of the citizens in the process of the environmental management, and promotes the preservation of the ecosystems. The same article indicates that in Indigenous Native Nations and Peoples the consultation will take place respecting their own rules and procedures.

In the case of Nicaragua, with its constitutional reforms in 1995 and the adoption of the Autonomy Statute for the Autonomous Region on the Caribbean coast, it was clearly established that concession and contracts for the exploitation of natural resources the state grants in autonomous regions on the Caribbean coast must have been approved by the respective Regional Autonomous Councils. It will also be necessary to offer the inhabitants of these communities a prior and information consultation detailing the benefits and problems these may have for their traditional form of life.

In this sense, the General Environment Act in Nicaragua (law no. 217) adopted on 2 May 1996 entails this constitutional principle and establishes clearly in its article 3 para. 7, which stipulates that indigenous people and peoples of African descent have the right to decide about the natural resources that are in their territories. Equally, the law no. 286, the Special Exploration and Exploitation of Hydrocarbons Act reconfirms this constitutional principle and makes it clear in its article 21 that for the case of Autonomous Regions contracts for the exploration and exploitation of hydrocarbons must first be approved by the Regional Autonomous Council.

In 2010, the government adopted the Act on the Legal Status of its Borders that created a new legal status for the area of up to 15 kilometres from the actual border towards the interior of the national territory affecting all people living in these territories including indigenous peoples and ethnic communities who had just achieved territorial recognition with their own autonomous administration in these areas thanks to law no. 445.

The new Border Act assigns the role of conservation, protection, renewal and sustainable use of natural resources and the environment, the development of zones of touristic interest, and other strategic plans that the president of the Republic may order to the Army of Nicaragua; and it declares that in these areas natural resources are the property and direct, indivisible, inalienable and unlimited possession of the state.

This act is considered unconstitutional and will affect indigenous territories in coastal regions on the Caribbean and the Pacific as well as along the Coco river and the San Juan river.

### **III. INDIGENOUS TERRITORIES AFFECTED BY EXTRACTIVE INDUSTRIES AND THE NON-COMPLIANCE WITH THE PRIOR CONSULTATION**

#### **Ecuador**

The oil companies in Ecuador have operated intensely in the Amazon in six protected areas and in the territory of nine indigenous Amazonian nationalities for more than 40 years: Siona, Secoya, Cofán, Huaorani, Kichwa, Shuar, Achuar, Shiwiar and the indigenous peoples of Tetetes and Sansahuari, who lived in voluntary isolation and have currently disappeared.

This year, in 2011, the government started a tender to award extractive projects in indigenous areas. It is not clear to what extent the indigenous communities were consulted with regard to this matter.

The activities of oil companies have meant a radical change in the life of indigenous peoples and the people settled in the northern Amazon of Ecuador who have suffered endless violations of their basic rights. Some of these peoples have lost a part of their ancestral territories, they have suffered from the disintegration of their communities, they have been obligated to retire to small areas where they now live surrounded by the infrastructure of the oil industry; water, air and the ground have been contaminated, which has a severe effect on their health; food resources have been reduced drastically, which limits their physical and cultural ability to sustain themselves; and they live in a state of alert and under constant tension to be able to defend themselves. Apart from generating other social problems that ruin the structure of their societies like the dependence on food, migration, divisiveness, asymmetrical negotiations of resources and even territorial spaces followed by a progressive passive and marginal integration in processes of external development and the loss of territories, resources and decisions, accompanied by a progressive loss of identification with the territory on the part of new generations.

The current Ecuadorian government has also granted new opportunities for the mining industry in indigenous territories, which is the case in the controversial project of the gold mining industry in the mountain ranges of Cónдор, Intag or Quimsacocha, habitat of the Shuar, an indigenous people in the southern Amazon. The form, in which mining operations are carried out, also causes serious damage to the environment due to the degradation and erosion of the ground, contamination due to tailings or the use of toxic chemical products that affect the ground and superficial and underground water bodies; this is worsened by the fact that these concessions are in territories of indigenous people that use these resources for their subsistence; and in many cases the affect on the people can be multiplied by the exploitation of the mountains where rivers have their source.

The Constitution of Ecuador recognizes the right of *'communes, communities, indigenous peoples and nationalities'* to *'prior, free and informed consultation'* about the *'plans and programs of prospecting, exploitation and sale of non-renewable resources that are in their land and can affect their environment and culture'*, and three months after the Constitution was adopted, this precept was not complied with, when the Mining Act was promulgated, the provisions of which refer to activities that are carried out in indigenous territories, and for which the CONAIE reported its unconstitutionality before the Constitutional Court of Ecuador.

This is to say that for indigenous organizations, the processes of Prior Consultation suffer from many vices, or are not carried out. Since 2002, the Kichwa de Sarayaku, a native people of Ecuador, has been fighting for its right to be consulted with respect to extractive projects that are undertaken on their ancestral territory. In 1996, the state authorized an oil company to carry out three oil prospecting tasks in its ancestral territory without their consent. On 6 and 7 July 2011, members of the community and its legal representatives presented their case before the Inter-American Court of Human Rights. 'If they want to carry out such a damaging activity, we want to be consulted and if we tell them, no, then we want to be respected.'<sup>7</sup>

In the context of a new constitution that proclaims the Sumak Kawsay<sup>8</sup> (good living) as a principle of life and orientation, the search for an alternative to indiscriminate extractive activity, such as on the Yasuní-ITT initiative that considers leaving hydrocarbons underground in exchange for obtaining a percentage of the potential earnings via international cooperation; this is an example that there are possible ways Ecuador is exploring to revert decades of extraction that did not do the people any good.

<sup>7</sup> Patricia Gualinga, member of the Sarayaku community, in declarations to the Inter-American Court of Human Rights:

<sup>8</sup> The 'good living', the 'sumak kawsay' 'penker pujustim' o 'waa quiriri', as it is expressed in some languages spoken in Ecuador, is a symbolic category denoting in the view of the world of many ancestral peoples a collection of values that give meaning to existence at the individual and collective level. *Life in harmony that combines the relation with the natural environment, the 'world without evil' and with culture or the 'ancestors' wisdom'. It is a complex concept, alien to ethnic-religious traditions western civilization is nurtured from, which is obsessed not by 'good living', but by 'living better'.* Mario Melo, 'Good living, nature and nationalities in the new Ecuadorian Constitution: a hopeful lecture'

### **Nicaragua**

The government recently granted contracts for the exploration and exploitation of oil and gas to the American company MKJ Exploraciones Internacionales, S.A., a member of Noble Energy Ltd., with concession of 45,000 km<sup>2</sup> in the maritime platform of the Nicaraguan Caribbean Sea that has a great biodiversity and a fragile ecosystem. The average depth of the water is less than 30 metres, and it is also the habitat of indigenous communities and communities of African descent that mainly live of fishing and tourism. Equally, the exclusive right of indigenous and ethnic communities of the Caribbean coastline, islands and cays is recognized so that they can use maritime resources for community and private fishing within the three miles next to the coastline and 25 miles around the adjacent cays and islands.

Both the Convention no. 169 and the Demarcation and Titling of Communal Property Act, no. 445, – the latter promulgated as a result of the sentence of the Inter-American Court of Human rights for the Awas Tingni case – grant strong legal mechanisms to indigenous people to demand prior and information consultation, as well as the distribution of resources that come from the concessions to the extracting industry that were granted in the territories of indigenous peoples and peoples of African descent.

With the intention to advance the fulfilment of the Convention, the Territorial Assembly of the Rama-Kriol Territorial Government informed about the proposed regulation presented to the national government on procedures for the free, informed and prior consultation. At present, there is no knowledge about processes of consultation carried out by the state in the framework of Convention no. 169 the country has recently ratified.

### **Bolivia**

In four of the nine Bolivian departments there are operations of hydrocarbon exploitation:

Santa Cruz, Tarija, Chuquisaca and Cochabamba, and it is planned to add other departments, such as La Paz, Potosí and Beni as areas of exploration. Precisely, in the middle of 2011 information became public that the state-owned YPFB-Corporación has applied to increase the new areas of hydrocarbon exploration from 56 to 98<sup>9</sup>, which includes regions in which there is no tradition of hydrocarbon activities, for example in the Lake Titicaca and in the Bolivian Amazon, area of high biodiversity and with a fragile ecosystem, and where indigenous people and peasant communities live.

The hydrocarbon and mining deposits in Bolivia are mainly in Native Community Lands (TCO). The state-owned Bolivian company YPFB has oil operations in 56 reserved areas with an approximate surface of 14,982,589.27 hectares in which are 18 TCOs of which 12 are affected by the exploitation of hydrocarbons and mining<sup>10</sup> and 9 are located in national parks and protected areas: Madidi, Pailón Lajas, Carrasco, Isiboro Sécuré, Tariquia, San Matías, Kaa Iya, Iñaño and Aguaragüe, to which Manuripi can be added, where hydrocarbon exploration is expected.

With regard to environmental and social liabilities, the peasant communities and indigenous Bolivian peoples that live in the departments of Santa Cruz, Tarija, Chuquisaca and Cochabamba are affected by oil companies that carry out hydrocarbon activities in their territories, and abandoned about 400 wells without closing them properly and now causing permanent environmental contamination. According to oil audits<sup>11</sup> the economic damage caused amounts to USD 61 million and none of the operating companies took care of the liabilities so that the government decided to take on the expenses through the state-owned company Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).

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<sup>9</sup> <http://www.cambio.bo/noticia.php?fecha=2011-06-06&idn=46945>

<sup>10</sup> An article in the press: It points out that of the 18 protected areas three areas are also affected by mining activities. Apolobamba, Eduardo Avaroa and San Matías. In total, 12 indigenous territories suffer from the effects of the exploitation of natural non-renewable resources.

<sup>11</sup> Mariaca Bilbao Enrique, Complete Report on Oil Audits, 2010.

Regarding the consultations carried out between 2007 and 2010, 21 completed processes of previous consultation were carried out in 20 Native Community Lands (TCOs) in different phases or activities, such as for example the exploration of activities, the exploitation of wells, or the hanging or extension of gas pipelines. The native community land of Alto Parapeti had four consultation processes, just like the native community land of Itika Guasu in phases of digging a well, seismic exploration or the construction of roads. For this year, 15 processes of previous consultation are planned in 13 native community lands, many of which are in the departments of Santa Cruz and Tarija; six processes have been announced for the native community lands of Itika, Guasu, Takovo Mora, Charagua Norte and other peasant communities<sup>12</sup>.

The data provided by the Hydrocarbon Ministry shows successfully the processes of Prior Consultation carried out as well as the harmonic and horizontal relation to the organizations; however, there is serious doubt about the appropriate compliance, mainly with regard to true and opportune information and the real participation of the people involved in the area of the project.

The systemization carried out by indigenous and peasant organizations in Bolivia in 2009 and 2010 gives information about the feeling of the people in relation to the consultation processes carried out by the state; serious contradictions can be found regarding the compliance with this right and above all with matters linked to environmental conflicts derived from the exploration and exploitation of hydrocarbons in territories of indigenous peoples, be it because of the way the consultation was carried out, the participation of the indigenous peoples in the processes of monitoring and socio-environmental investigation of these operations, or the remediation of the environmental liabilities left by the industry<sup>13</sup>.

They declare that they feel affected by the negative, economic, social, cultural and environmental impacts that are produced by the extraction<sup>14</sup> of hydrocarbon resources and the mining in their territories; and that the executive organs establish rules without the participation of the peoples involved; they observe that public officials intervene trying to divide their organizations in order to favour the acceptance of the extractive projects; they explain that all impacts on the vital resources of subsistence that are affected – and including cultural impact – must be included in the processes of evaluation and valuation of the total of compensation and indemnification.

Therefore, in July of this year the National Council of Ayllus and Markas of Qullasuyu (CONAMAQ), the organization representing indigenous peoples, presented the 'Draft of the Law on the Framework of Prior, Free and Information Consultation and Consent of Indigenous Native Nations and Peoples mandatorily to be complied with by the Plurinational State' establishing two objectives of the law: 1) To eliminate any action of the state or of companies and private institutions that may try to carry out activities in lands, territories and resources owned ancestrally by Indigenous Nations and Peoples and Afrobolivian Communities while omitting their prior consultation, affecting constitutional rights, as well as the environment in the place and impeding that they can exercise their self-determination. 2) To avoid that violations and omissions of the legal order are consolidated that affect the rights of these Peoples emphasising that all actions against their decision will be declared null and void and without legal effect.

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12 More detailed information about Native Community Land and peasant communities on: [http://www.hidrocarburos.gob.bo/sitio/index.php?option=com\\_content&view=article&id=938](http://www.hidrocarburos.gob.bo/sitio/index.php?option=com_content&view=article&id=938)

13 'It is the environmental damage as a whole, in terms of the contamination of the water, ground, air, the deterioration of the resources and ecosystems caused by a company during its ordinary operation or by unforeseen accidents... ' Colectivo de difusión de la deuda ecológica; deuda ecológica ¿Quién debe a quién?; Barcelona, 2003.

14 Extraction is activities that move large volumes of natural resources that are not processed (or are limited), and are going to be exported. Eduardo Gudynas.

#### **IV. NEOEXTRACTIVISM AND THE RIGHTS OF INDIGENOUS PEOPLES**

In the last decades left-wing and progressive parties took office in Latin America, they had ideas to promote big changes in the societies that incorporate the claims of the majority of the people that had been put behind and including those of indigenous peoples with alternatives that would contribute to the fair redistribution of wealth. They claimed to undo neoliberal reforms, break with the dependence on the international

market, diversify production, be self-sufficient, industrialize raw materials, change the production and energy matrix, and suggested to replace the economic extraction-friendly model where the exporter comes first to become an industrialized country. This is the case of the current progressive governments in Ecuador, Bolivia and Nicaragua.

To this end, new Constitutions and laws were adopted where the changes were expressed, contracts with the extractive industries were renegotiated to raise taxes and licence fees for the exchequer, and in Bolivia nationalization processes were promoted to put an end to the 'plundering of natural resources', as president Evo Morales put it. With higher income from the oil and mining industry, the governments have substantially increased their ability for public spending and started to depend on this income to finance the national budget. And in this way, like before in past times, the state becomes an economic agent with a more active role in favour of extractive sectors, the main promoter of foreign investments for the export of raw materials, and depends more on the world market.

The next step is the legitimization of extractive industries, although it has been acknowledged that these activities can have negative environmental and social impacts; the subject is relativized by talking about an alleged contradiction between the right of indigenous peoples and the interests of the entire nation.

So, after they have been in office for several years in the three countries of this study, extraction-friendly practices are maintained, and more so, this model is deepened and widened in areas that used to be outside the extraction border in the past, such as for example socially vulnerable areas and protected areas.

In Bolivia under the two governments of Evo Morales, the policy of massive extraction of natural resources like gas or minerals is continued, and there the still experimental and not very efficient industrialization process has only started; yet at the same time, the fiscal income generated by extractive activities does not allow the government to comply with the social agenda of the National Development Plan (NDP).

In the last six years, the gross domestic product (GDP) of Bolivia went up by 4.8%, mainly due to the growth of extractive activities of the hydrocarbon and mining industry and the increase of taxes for hydrocarbon exploitation, and additionally due to the favourable context of international prices for these minerals so that the import of extractive industries into the Bolivian and Ecuadorian economies could be increased; today, they are the pillars of their respective development strategies.

In Ecuador, the dependence on oil in the national economy is elevated bearing in mind that the oil reserves show clear signs of exhaustion. This is clearly reflected in the following table showing the participation of oil in the GDP, the exports and the fiscal income.

**TABLE 1. A petroleum dependent economy**

Petroleum GDP as a percentage of total GDP, petroleum exports as a percentage of total exports and petroleum revenue as a percentage of the general State budget (USD in millions and percentage).

Year	GDP (total)	GDP of oil companies	% GDP	Total export	Export of oil companies	% of total export	State budget	Income oil companies	% State budget
1970	1,509	20	1.3	258	1	0.4	230	-18	-7.8
1972	1,874	57	3.1	395	60	15.2	391	37	9.4
1975	4,310	486	11.3	1,242	587	47.3	1,301	574	44.1
1980	10,784	1,279	11.9	2,990	1,587	53.1	2,959	1,563	52.8
1985	11,502	1,906	16.6	3,374	1,927	57.1	3,378	1,728	51.2
1990	10,579	1,486	14	3,386	1,418	41.9	2,727	1,339	49.1
1995	20,288	1,792	8.8	5,196	1,530	29.4	3,791	1,330	35.1
2000	16,283	2,820	17.3	5,906	2,442	41.4	3,828	2,186	53.0
2005	36,942	6,088	16.5	11,480	5,870	51.1	7,431	4,155	45.4
2010	56,998	8,713	15.3	17,369	9,649	55.6	17,718	5,917	27.9

Source: The Central Bank of Ecuador

In the case of the oil contract with MKJ in the Caribbean sea of Nicaragua, it was agreed that 48% of the revenue was given to the Nicaraguan state, of which 15% would be reserved to the central government and the authorities of the autonomous regions, and 3% to projects of the communities of the autonomous region of Atlántico Norte and the autonomous region of Atlántico Sur.

One part of the revenue given to the exchequer is going to finance social plans oriented at the poorest, some of which include aid programs where cash is handed out. This distribution establishes a link between poor people and the extractive industries that provide the funds, which does not only legitimize the economic extraction activity, but also the social policy of the government; and as it depends on this economic model, it is forced to continue obtaining new and more financial resources; therefore, the development model is not questions any more, or it does not matter how this wealth is extracted; instead the debate is centred around how the income of the extractive companies is divided, and the validity of the extraction-friendly model is not queried, the environmental and social impacts continue mainly in territories of indigenous people and peasants, and the sector remains to be one the most controversial.

Under these conditions it is to be expected that the situation of managing natural resources is not going to change in the next four years, but that on the contrary the areas of exploration and exploitation of hydrocarbons and minerals destined to obtain higher financial income are going to be widened at the cost of maintaining a profitable economy in the country based on the extraction and exportation of raw materials, which will affect national parks and indigenous territories with the consequential potential social conflicts this may lead to.

In this line, projects that have been started in Bolivia are the construction of the hydroelectric power station between the departments of Beni and Pando affecting

biodiversity and local indigenous communities or the Mutún for the exploitation of iron and manganese causing problems in the land of local peasant communities and the road of the second stretch between Villa Tunari and San Ignacio de Moxos (Beni and Cochabamba) cross indigenous peoples and the TIPNIS national park.

At the end of June, the president stepped forward to defend this last project against the opposition that was expressed by the march of hundreds of indigenous people and their sympathizers, and said that the road will pass through the Tipnís, no matter what.

In Ecuador, the president of Ecuador declared in a similar way in January 2009 in connection with protests and legal actions presented by indigenous people affected by the mining concessions in their territories that he was not going to reverse the Mining Act, because it was fundamental for the progress of the country, and that they would otherwise be like beggars sitting on a sack of gold.

### **A clash of visions**

The indigenous concept of Good Living, of Sumak Kawsay, Suma Qamaña (living well), Ñandereko (harmonious life) that was recognized in the Constitutions of Ecuador and Bolivia is reflected in the plans of life of many indigenous peoples. It expresses a project of life that profoundly contradicts the project of unsustainable and depending development based on non-renewable resources, which the governments favour. The clash of visions, which the left-wing governments in Latin America still do not comprehend, is expressed in the vision of plural balanced good living, in harmony with the surrounding and a healthy environment indigenous peoples aspire to against the vision of modernity development is looking for, which is understood as accumulation, consumption and growth, and where thinking and sometimes persistent resistance of indigenous peoples and peasant communities against the loss or the discreditation of their vision of the world and their vital sustenance are regarded as obstacles of this modern form of development.

Indigenous people emphasize that they do not have the intention to inhibit the development of the country, they assert their right to live according to their own models of life and demand that their rights are taken into account when decisions are made on their territory, because there in this territory they themselves, the possibilities for their future generations of the natural resources that are regarded as gift of Mother Earth that is one unit only coexist. But exactly these natural resources are the centre of the conflict, which has not been resolved yet, and where this clash of vision and the disputes are expressed most strongly. In view of this, the progressive government and their liberal preceding governments are responding in the same way to the protests and demands. Leaders and members of the communities are often victims of threats, imprisonment, intimidation and occasionally homicide in conflicts relating to their territories.

We believe that great regulatory progress has been made and indigenous peoples as right-bearer have legally become more visible in recent years in Latin America; however, there is still a lot to do to advance in the understanding of visions, the compliance with rights and in the institutionalization of the processes that are oriented towards structural changes in the relations between indigenous people and other members of society, and to achieve that the principles, values and norms are embodied in our everyday sentiment and reflected in our public policies. The challenge is there, and now it is time to sit down in an open and genuinely intercultural dialogue, to think together of the most harmoniously way of living in the future; and the future is defined by the way how we decide to live in the present, which sends us messages talking about sustainability, cultural potential and biological diversity. And the presence and the future are the responsibility of all of us.

### CONCLUSIONS:

1. Despite the optimistic panorama of advances in the recognition of the rights of indigenous people in the new constitutions and the secondary legislation of Bolivia and Ecuador, as well as in the constitution and in special laws for the autonomous regions in Nicaragua, there are still conflicts between indigenous people and progressive governments because these peoples still feel that their recognized rights are not respected, such as for example the rights of mother earth; that the rights of their peoples are not guaranteed; that the processes of prior consultation are not carried out or when they are complied with the results do not reflect their interests; and that they do not see the political will of the government to avoid the impunity of companies and exceed remediation and indemnifications for the severe damage caused for the people and their territories.
2. The progressive governments of the three countries that are the object of this report maintain, like their preceding more liberal governments, contradictory policies in relation to the tutelage of constitutional, environmental and human rights and on the other hand their promotion of economic extractive activities; there is no appropriate balance, which shows a prevalence in favour of these activities that damage indigenous peoples and local people socially, culturally, economically and with respect to the environment in the areas where the resources are extracted.
3. Despite initial declarations postulating a change of the model of living of the income from investments for the export of raw material, the progressive governments are deepening this model that has been called neoextractivism, they are increasing tributes and royalties to this sector, and generate a national economy based primarily on mining and hydrocarbons, and with this a stronger dependence on the resources of the exchequer coming from the exploitation of non-renewable natural resources.
4. Programs of public services in the most deprived sectors are implemented with funds of the income from extractive industries, which at the same time legitimize the current economic model, and bring about an attitude of implicit acceptance by the people; it avoids the critical analysis of the model and makes the relation with a sustainable model impossible based on communities as the indigenous people proposed and has also been inserted in the new constitutions.
5. The needs for more production of gas and oil for the increased public spending show us the clash of visions of the indigenous peoples on the one hand who value the good living and the healthy co-existence with the Pachamana, the goddess of indigenous people, as a fundamental part of the project to change society, and on the other hand the vision of earnings for the development based on more consumption and economic growth, for which it is indispensable to continue opening new areas of exploitation, even in the most fragile environments, such as protected zones as they are environmentally vulnerable, territories of isolated indigenous people and in places that are sacred to the peoples.

### **RECOMMENDATIONS:**

1. The promulgation of laws requires the development of real mechanisms to make the right to consultation and free, prior and informed consultation effective, in accordance with international regulations and the Inter-American system of human rights.
2. To abstain from granting concessions, authorising activities of prospecting and exploitation and carrying out any development project that may affect indigenous peoples without adequate consultation or by not fully carrying out the consultation in harmony with international and Inter-American regulations.
3. To take urgent measures to resolve existing disputes about the land and abstain from evicting indigenous peoples when these have not been resolved.
4. To create and maintain the necessary conditions so that indigenous leaders and the members of the communities can peacefully defend their rights without fear of reprisals; for this it is among other measures indispensable to avoid the use of the criminal justice system in order to dissuade them from carrying out their work as defenders of their human rights.
5. To recognize the contribution and experience of indigenous and peasant organizations in the processes of previous consultation carried out according to the characteristics of the community itself and the processes of the activity that is to be carried out by identifying the real dimensions of the effects of the extractive exploitation in their territories, which will allow strengthening the control, monitoring and vigilance of the process of previous consultation, but also of the extractive industry in their territories.
6. To promote the creation of processes and participatory applications of analysis and proposals of economic alternatives to replace the non-sustainable economy based on industries extracting non-renewable natural resources.
7. To develop regulations and procedures for the implementation of a participatory system that includes monitoring of the social and environmental responsibility of the extractive industry, its financial income, the fiscal yield derived and their use, as well as monitoring the transparency of tenders and contracts of extractive industries.

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# TRANSFER PRICING IN THE BOLIVIAN, ECUADORIAN AND NICARAGUAN OIL INDUSTRY

## INTRODUCTION

*Why are the countries in Latin America, which are the richest in natural resources, condemned to be the poorest and most unequal in the world?*

This question opens the debate on the paradoxical disadvantage of possessing territories that are abundant in minerals, hydrocarbons, soils, wood, biodiversity, water and other natural resources of strategic importance for the insatiable economic development of the developed countries, combined with the misfortune into which our countries fall in the insatiable ambition for power of only a few. The topic on the under-development of nations, whose economies are based on the extraction of their natural resources, is always current. We refer to the legal gaps in the tax system, the discrepancy between national and international tax laws and the universal declarations on human rights claimed in our constitutions.

We already have declarations that protect levying by foreign laws that undermine our national tax systems, such as the American Declaration of Man's Rights and Duties established in 1948 at the IX International American Conference held in Bogota.

### Article XXXV

Everyone has the right to cooperate with the State and the community in social assistance and security in accordance with their possibilities and the circumstances.

### Article XXXVI

Everyone has the duty to pay the taxes established by Law to sustain the public services.<sup>15</sup>

However, it was only when the process of Financing for Development (FpD)<sup>16</sup> was begun in Monterrey that the protection of these duties was assured on the international level – as well as the support of the foreign states in compliance with the duties of their citizens found in other countries. This declaration has resulted in placing more emphasis on **international tax cooperation** as a method for cooperation in development, technical assistance, and state cooperation in research and public policies.

'Strengthen international cooperation in tax matters, improving the dialogue among national tax authorities and increasing the coordination in the work of the competent multilateral agencies and the pertinent regional organizations, paying special attention to the needs of the developing countries with economies that are in transition' – *Declaration of Monterrey 2002 Art 64*

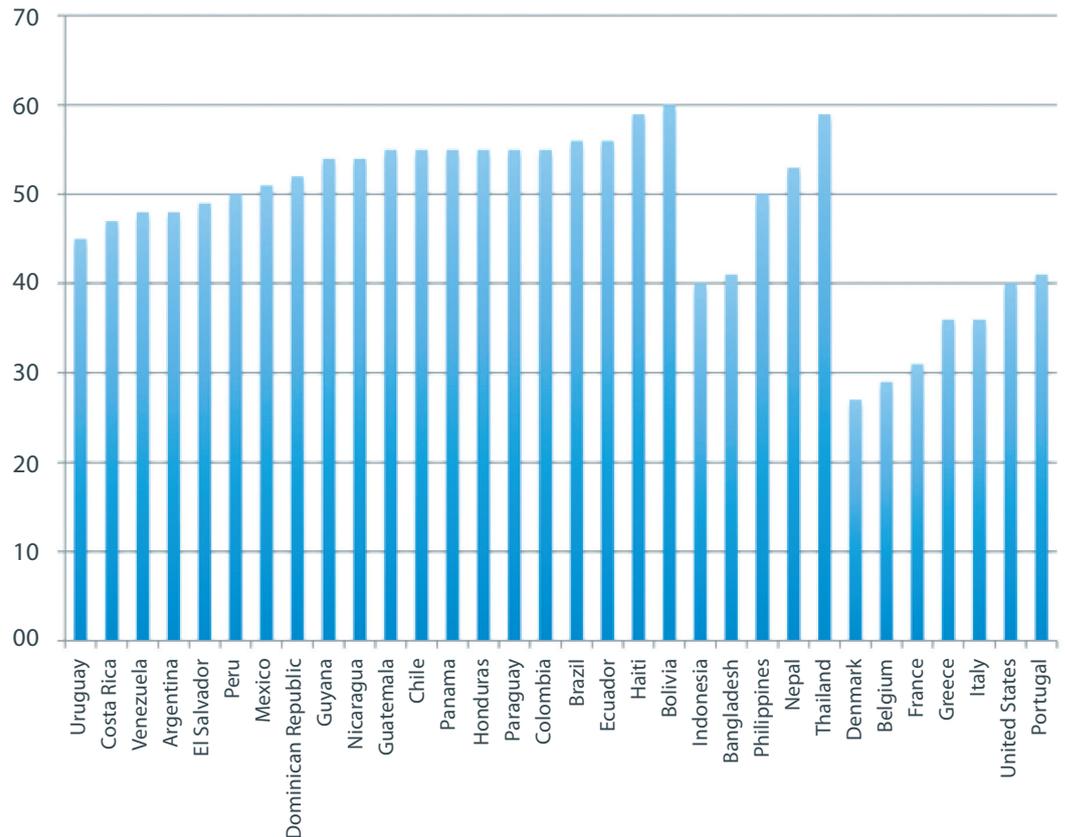
Rights cost money, and this cannot be achieved without a strong focus on paying taxes at all levels: national, regional, and international. Just like fulfilling rights, this is a budgetary cost to which individuals and companies must contribute with their fair share,

<sup>15</sup> OEA Res. XXX 1948 referred to in Kohonen, 2011

<sup>16</sup> ONU, 2002

while States have to use these resources in a transparent, responsible manner. In none of the poor regions of the world has the economy taken off based on the exploitation of their natural resources. What is worse, the inhabitants have become poorer. With very few exceptions, those regions with abundant natural resources are under-developed today.

**Graph 1: Gini Index on the per capita income in the home**



*Note: The Gini Index considered in each case corresponds to the last year for which there is available data during the period between 1995-2005.*

*Source: UNDP 2010 using Gasparini et al. (2009) based on SEDLAC (CEDLAS a the World Bank, 2010), quoted in Kohonen, 2011*

But for some economies, this happens not despite their natural riches, but rather due to them, thus we find that in many Latin American countries, characterized by their low governance, institutional instability, the absence of democracy, a lack of transparency in government management and access to public information, the benefits generated by the exploitation of natural resources are to be found in an elite group with airs of a monopoly that limit social development without generating any social capital and economic development.

It is usually understood that a progressive tax system is the best way to reduce this inequality by means of a **redistribution of the income**.

The lack of this redistribution, transparency and good governance are amplified by the lack of an efficient, transparent tax system. This process of an unequal accumulation of resources introduces an illicit financial flow, defined as the use, transfer or illicit destination of the financial flow, including commercial flows and capital flows.

The regions that are affected by the curse of [having] natural resources are apparently condemned to depend more and more on the production of our main raw materials, even the Asian economies of today. This strengthens the oil income for those governments who benefit from the exploitation of these resources and grow as large economic groups, but the concentration of these resources leads to their political empowerment and a control that excludes more and more basic policies for the full development of the society to which the owe themselves.

Because they have exclusive control over transfers and taxes, which helps them to retain their political power, they give themselves the satisfaction of not listening to the real demands of their citizens, while they are co-opted by means of a clientele system that distributes handouts and help, useful mechanisms to discourage the citizen's control over the public administration. Thus a vicious circle of mutual dependence is created, whose end result is corruption in every area of social and political life. A more transparent tax system, one that represents the citizens and their interests through stakeholders in non-government organizations, unions and professional associations, can break this vicious circle.

Considering the paradox presented above, this document refers to one of the mechanisms through which one of the most predominant areas of world economies, such as the case of oil and the riches that it generates, is transferred outside of the continent where it produces<sup>17</sup> through the manipulation of the '*transfer prices*'. It defines a commercial transfer that takes place between the subsidiaries of the multinational itself, causing illicit flows that translate into a tax loss.

**Graph 2: Tax Losses caused by the Manipulation of Trade Prices**

	In Millions of U.S. Dollars
<b>Bolivia</b>	
Average tax losses	27.8
Tax Income	1,919.8
Total (%)	1.4
<b>Ecuador /a</b>	
Average tax losses	137.5
Tax Income	3,300.0
Total (%)	4.2
<b>Nicaragua</b>	
Average tax losses	217.0
Tax Income	783.3
Total (%)	27.7

Source GFI 2010, prepared by Kohonen, 2011.

17 Latin American Tax Justice Network 2011, Kohonen 2011

As we can see in the graph, the oil producing countries are the most affected in the region. Trade Prices include the 'transfer prices' between the subsidiaries of multinational companies, as well as the market prices between unrelated parties that connive to misprice commercial transactions.

Thus we find ourselves with a document that, besides having an ambition to reveal great truths on Latin America's economy, deficits and social injustice, proposes case studies of three countries in the region – whose common denominator is the preponderance of oil in their economies, either as an exploited natural resource (Ecuador and Bolivia), in the exploration phase (Nicaragua), or as a private Agreement-Business between governments (PDVSA-Nicaragua).

#### **BASIC UNDERSTANDING ON THE MEANING OF THE TERM 'TRANSFER PRICING'**

To understand how **transfer pricing**<sup>18</sup> *'the value charged by a company for the sale or transfer of goods, services or intangible property to another related company'*<sup>19</sup> function, it is necessary to briefly determine the existing correlation between the functioning of the **multinational corporations or companies** and, of course, that of **international taxation**<sup>20</sup>. **Transfer Pricing** comprise an instrument developed and widely used by the MNCs to avoid and evade tax charges.

In the current economy, it is recognized that transnational companies or corporations play an ever more prevalent role in world economy. To untangle the complex web that hides the opaque actions of the MNCs requires characterizing, defining, and conceptualizing certain aspects. We start from the concrete fact that *'a disproportionate percentage of world trade is carried out'*<sup>21</sup> inside the MNCs, equivalent to over 55 % of the world's GDP<sup>22</sup>. This implies that enormous amounts of capital that escape the control of national states are in transit. This phenomenon can be characterized as *capital flight*, in other words, *'the expatriation of hidden money, voluntarily and illicitly, by physical companies or persons subject to taxes in the country of origin'*<sup>23</sup>, as a result of the harmful *'tax planning'* practiced by the MNCs that allow them to avoid<sup>24</sup> and evade<sup>25</sup> their tax responsibilities, thus considerably increasing their benefits.

A foreign subsidiary is an incorporated or unincorporated company in which an investor, who resides in another economy, has a participation that permits a lasting interest in the management of that company. What constitutes a related entity is a matter of national legislation. It is conceptualized as a company that can be an affiliate and/or a subsidiary of a parent [company]. The prices of these transactions usually differ substantially from those that would be agreed upon between unrelated companies<sup>26</sup>. According to the OECD, trans-border transactions of goods, services and intangible assets that are carried out between the different units of Transnational Corporations represent up to 60% of world trade<sup>27</sup>.

The value of the transactions that are done inside the networks that form the transnational corporations (intra-firm relationships) comprise a large part of the trans-border transactions of goods, services and intangible assets between economic entities that are located in different countries that are done at prices that do not necessarily correspond to the prices that would prevail if said transactions should occur between independent companies in an open, competitive market.

18 Acevedo 2011

19 Acevedo 2011

20 Avi-Yonah 2007, referred to in Kohonen, 2011

21 Acevedo 2011

22 Kapoor 2006

23 SOMO 2008

24 From an international tax perspective, tax evasion is that kind of tax planning that complies with the law, in other words, it uses practices to minimize or evade tax obligations taking advantage of the cracks and opportunities that the law permits.

25 Tax evasion is a taxpayer's total or partial noncompliance in declaring and paying his legal tax obligations to the Treasury and, as such, it is susceptible of receiving the sanctions foreseen in the law if detected.

26 **CHRISTIAN AID**, calculated that the loss of income suffered by developing countries deriving from company taxes due to practices of manipulating transfer prices and fake invoicing currently amounts to the sum of USD 160 billion a year. See Christian Aid 2008.

27 Neighbour, 2002

We thus understand that an ever increasing amount of international transactions are no longer completely governed by the market forces, but rather they are driven by the common interests of entities in the group under which the transaction is structured. These comprise the cases of operations between companies that are formally composed of independent legal persons, but that directly or indirectly respond to the same owner(s), so their objective is to cooperate amongst themselves in seeking to maximize the group's global profitability.

Here it should be noted that the *Arm's length Principle* is that which is agreed upon between companies that do not have common interests; that do not have any relationship of dependence.<sup>28</sup> The 'status of the situation' that permits the huge bleeding of economic resources from poor countries by rich countries is explained using different reasons, perhaps two of the most noticeable are the creation and functioning of the so-called '*tax havens*'<sup>29</sup> and the existence of a body of lawyers, consultants, auditors and bankers who become facilitators, builders and defenders of a system of '*tax injustice*' of worldwide scope.

In many senses, tax havens are fictitious places. Of course, there is a physical reality that bears the country or territory's name, but in most cases the operations promoted by that tax haven are carried out or have recipients who are not residents, private parties or entities; moreover, they have an unusual characteristic in common which is that, although a bank or merchant society has been registered in the tax haven, they are not allowed to trade in that territory in accordance with the legal requirements that they need for their incorporation because it is expected that their commercial activity will take place outside of that environment. A British tax advisor told the press in 2003 that 'it does not matter what the current legislation is; advisors and lawyers will always turn it around. Norms are norms, but they are there to jump over them'<sup>30</sup>.

#### **Methods for Calculating Transfer Prices according to the OCDE, U.S., and Brazil**

The **uncontrolled comparable price** compares the price of goods or services for operations between related people or parties with the same goods or services that have been identified with similar characteristics, and the circumstances in a transaction between unrelated parties. Any corrections in the price can be made if the characteristics or the circumstances are different, using the comparable price as the baseline. The method has some variations, specifically, an uncontrolled comparable transaction (TCC) and, in the case of immaterial intangible services, or the term uncontrolled comparable price for services (CCC) that is used.

The **resale price method** can be used when a product has been bought from a related party and then re-sold to an independent company in the medium. The resale price is reduced by an appropriate gross margin that represents the amount from which the re-seller can expect to cover his sales costs and other operational expenses, and corrections are made to the concrete operations that are carried out. What is left after subtracting the gross margin can be considered the market price after making adjustments for other costs associated to the purchase of the product.

The **increased cost method**, a cost that is incurred by the supplier of the goods or services in a transaction between related parties provided by the purchaser with related parties. An adequate margin of profit is added to this cost for a margin of profit in the light of the functions that he carries out, the market conditions, circumstances, etc. After these costs are added, the price can be considered the market price. In each case the margin is determined taking into

<sup>28</sup> See OCDE 2006 and OECD 2011

<sup>29</sup> Tax Justice Network 2005

<sup>30</sup> Ibid.

account the company per se, the sale of the goods or services in a comparable uncontrolled situation.

In the **net transactional margin method**, in the first phase a net margin is determined based on the net margin that the taxpayer himself gets in comparable transactions with the unrelated third party. A functional analysis is done based on the contributions of each party in the transaction, and the comparable transaction tries to establish the price that would be charged in a transaction between unrelated parties. In the second phase, a statistical cut above 25% and below 25% is made from the average price (depending upon the application of the norm), and if the transfer prices fall within this range of the upper and lower quartile, they are corrected to the average price (in the U.S. the variations of the rule of existing).

In the **distribution of profits method**, the benefits are assigned to the different parts of the company using as a reference comparable companies in similar situations that carry out similar tasks. In the first case, the global benefits of a company are determined by calculating the amount of benefits of all the related parts. In the second case, the benefits are distributed among the related companies based on the approximate validity of comparable companies. The **remaining profits distribution method (RUR)** is a variation of the above method, but with a different formula for dividing the remaining profits, which are savings in the costs of the economies of scale or other means.

Brazil applies **fixed margins**, which means that during the first three methods a fixed margin of 20% is calculated on the price of imports for non-manufactured products, and 60% on manufactured products (added value), the merchandise. Other margins also exist. For exports, different margins are applied, 15% for wholesalers and 30% for retail sales operations.

*Source, Kohonen, 2011*

This act will have important implications for the **tax systems** of the different countries in which the entities that form part of transnational corporations operate. This derives from the fact that by these deviations earnings can be transferred to one or another company in the connected group [that are] situated in different tax jurisdictions.

However, the predominance of transactions within the networks formed by Transnational Corporations in international swaps, and the use of transfer prices to assess said transactions, is only one condition to be able to use them for tax avoidance and/or evasion.

The flow of resources that will affect profits in one way or another can be grouped as follows:

- Payment of interest for inter-company loans.
- Purchase of raw materials, materials and components,
- Purchase of services,
- Payments of rights or royalties,
- Quotas for licenses on patents, software, brands and other similar concepts,
- Administrative quotas for counseling, technical assistance,
- General compensation for expenses incurred by the parent company in operations related to its subsidiaries and affiliates.

Transfer prices become one more mechanism that generates the possibility for transnational corporations to 'direct' or deviate tax bases from one tax jurisdiction to another.

In order for transfer prices to be able to be used to affect tax collection, differential tax rates must exist in the different geographic zones in which the companies that form part of a business group operate. This fact would create the incentive for the parent company to want to transfer funds and income from those units in the group that are located in countries with high tax rates to countries with low rates in order to minimize the flow destined to paying taxes on benefits and income.

Thus, through manipulating transfer prices, Transnational Corporations can reduce their global tax charges and obtain greater tax earnings than two or more unrelated companies.

## **I. TRANSFER PRICING IN NICARAGUA<sup>31</sup>**

### **2004:**

As early as 2004 the Republic of Nicaragua's General Income Department (DGI – acronym in Spanish) requested help from the U.S. Department of Treasury to study the effect transfer price practices had on Nicaragua and thus determine the tax gap that is caused by the application of these practices – understood as the difference between the actual tax collection over the effective income and what would be obtained if said practices did not exist – and to contribute towards developing regulations that would allow the authorities to face them.

Comparing the ruling legislation in other countries, the most used characteristics and criteria for comparisons, a synoptic chart was prepared of the proposed Tax System Law. The law considers capital participation (without any limitation of fixed percentages), management control and strategic alliances, family members and permanent establishments. The methods that are used to determine a transfer price would be based on the profits, similar to OCDE's last two methods. To determine the best method, six criteria were established based on the economic circumstances and relative homogeneity of the products on the market. There are no simplified 'safe port' or 'advanced price agreement' methods in the 2004 law. The Executive Branch presented this proposal to the National Assembly as a bill for its discussion and approval, but for reasons unknown to the people, it was shelved.

### **2007:**

The topic returned to the public arena in 2007 when on the Central American regional level (Salvador, Guatemala, Honduras, and Panama) and the Dominican Republic, the respective Treasury Ministers jointly approved a transfer price model. Economists considered that this was a good regional effort to advance towards a regional tax framework using OCDE's model on transfer prices.

Regarding the transfer methods, as the main methods the model considered price setting methods, 'comparable, not controlled by the price', 'total cost', and 'resale price'. The document also considers 'advance price agreements' as a possible simplified method based on an independent unrelated to the price, which the taxpayer must demonstrate.

Moreover, a technical group that was formed with the objective of preparing a regulatory model for the member countries of the group that considers the simplified 'safe port' method and which mentions anti-abuse rules that, nevertheless, should not 'be used prudently'. So far, in Central America only El Salvador and Panama have laws on transfer prices, in Honduras, Guatemala and Nicaragua they exist as bills that have not been approved.

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<sup>31</sup> Reference on 'Transfer Prices in Nicaragua and its Development' Adolfo Acevedo-Strategic Studies Institute for Public Policies (IEEPP) Managua Nicaragua. (out soon)

### THE 2009 BILL ON TAX COORDINATION AND TRANSFER PRICES

In October 2009 the Nicaraguan Government presented the Bill on the *Tax Coordination Law*, which was prepared with technical assistance from the Inter-American Development Bank (IDB), to the National Assembly. This represented a complete modification of the current legislation. However, this bill would shortly be abandoned by the Executive Branch itself and, in December 2009, reforms to the existing legislation were approved based on an agreement with the most important business groups in the country.

This bill proposes 5 methods for calculating transfer prices according to the OCDE's guide. The arm's length principle is reaffirmed, but it does not clearly define what would be considered as a related party, which leaves an ambiguous law regarding those cases in which it would be applicable. With respect to tax havens, the law says that taxpayers must present additional proof of the underlying reasons for the transactions, but it does not make any effort to establish a list of tax havens or preferential tax systems. The bill does not have any option of a 'better method'. It does not foresee any sanctions for bad conduct.

Afterwards, the Executive Branch abandoned driving this project, with Nicaragua now finding itself without a legal tax framework to regulate transfer prices.

## II. THE CASE OF ECUADOR: THE WORST PARADOX

Ecuador has been intensively exploiting oil for 39 years. Throughout this period it is ironic that civil society, the media, and the State entities that govern the extraction and tax policies have not asked about a fundamental fact of the extraction process: What conflicts of interests exist in the process of setting the price for a barrel of crude?

Society has not understood this fact and has made it invisible, the result is the lack of capacity to determine whether the price per barrel of extracted oil or whether the values at which they acquire oil by-products on the international market, are fair. The 'fair price' principle that was studied in the United States since 1918, was only considered in Latin America as a way for tax justice since the decade of the nineties.

The fair price is directly related to the concept of 'transfer prices'. It is related to studies that were carried out in all the production areas to determine how affiliates of related companies are located in different countries that belong to the same international corporation transfer goods and services amongst themselves and how they determine the end price of the product. An oil company taxes itself a certain amount on profits and royalties and, if the company manipulates any aspect of its products or trade services, it can result in fewer benefits declared in the tea producing country.

The study of the transfer prices seeks to set mechanisms that will permit controlling commercial transactions between related parties. The way in which the transfer price rules were introduced in Ecuador was through regulatory provisions and the general norms issued by the Internal Revenue Service (SRI – acronym in Spanish) by Executive Decree No. 2430<sup>32</sup>, and not by law<sup>33</sup>. This was agreed in 2007 in the *Reform Law for Tax Equity*, which went into effect in 2008. There was a legal provision so that the **arm's length principle** established in the Ecuadorian legislation established what a related party is<sup>34</sup> The *Internal Tax System Law* (RTI – acronym in Spanish), was published in the Official Bulletin on December 23, 2009 together with the Reform Law for Tax Equity, which establish the legal framework by criteria, such as 50% of the volume of transactions with the same company.

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<sup>32</sup> Executive Decree No. 2430

<sup>33</sup> Tong and Velalcázar 2007

<sup>34</sup> Art. 4, Regulations to be Applied to the Organic Tax system Law, SRO 337

In the following example on the sale of LPG I want to remind you of the principle of 'connected companies' or 'related parties'. These are those entities (companies, trustees, or any natural or legal person) who have a business relationship either in the capital, the administration or Government control over a company<sup>35</sup>. Clause 4.3.14 of the contract details the concept of related companies:

'Parent company: This is the company or entity that directly controls the affiliate or subsidiary; Affiliate: A company or entity that is directly controlled by its Parent Company; and Subsidiary is a company or entity that is directly controlled by the affiliate and indirectly by the Parent Company. This definition does not limit in any way the application of the tax legislation with respect to related parties and transfer prices.'<sup>36</sup>

Point 4.3.26 of the contract on 'Contractor costs and expenses' establishes:

'of the non-capitalized, reasonable and necessary costs directly incurred by the contractor or indirectly through its related companies, inside or outside of Ecuador, during the production phase, including those indicated in his annual programs and budgets, and accounted in accordance to the accounting regulations, and it will include the operational transportation costs through secondary pipelines and those made for the training and technical administrative programs that the contractor carries out during the production phase.'

But in Ecuador these oil price studies do not exist in the extraction sector despite the fact that oil production is of great importance: the current crude oil reserves are 3,407 million barrels and, of that volume, private companies will be responsible for extracting 1,203 million according to information from the Ministry of Non-renewable Natural Resources. Within this context society does not know how the internal production costs were established in the previous oil concession contracts.

Nor do we know the actual production, investment and sale conditions and values. For the government to efficiently regulate the oil sector, and for civil society and the media to be able to play an independent role, it is absolutely necessary to know how oil prices are formed, and the prices that are charged within the companies for the transfer prices within the same multi-national group. The big problem in applying the price transfer legislation in Ecuador is precisely this lack of something to compare it with. The government needs this information to be able to make comparisons with other producers to determine whether a transfer price was actually a market price.

How can this objective be achieved when most of the oil companies have affiliates incorporated in tax havens<sup>37</sup>, where they can easily hide or manage their costs to their convenience? As examples, the company Canada Grande Limited, operator of Block 1, one of the smallest in the country, has its residence in the British Virgin Islands; the company CNPC International (Amazon) Ltd., affiliate of the Chinese corporation CNPC, currently the most powerful and influential in charge of oil blocks – is also incorporated in the Islands.

In the Virgin Islands there is no need to declare who the real owners are of a company that is incorporated there; no company taxes are paid on the benefits it records, and no effective tax information shared with other countries and jurisdictions. Therefore, it is a secret jurisdiction<sup>38</sup>.

The government entity that must drive these studies is the Internal Revenue Service (IRS) that carried out the first transfer price study in 2010 and [which] is related to the banana

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<sup>35</sup> Esrobross External Auditors, Transfer Price Practice, Ecuador

<sup>36</sup> The underlining is ours

<sup>37</sup> See Romero and Ruiz 2010 and Richard Murphy 2011

<sup>38</sup> Tax Justice Network 2011

sector. It is preparing a new study in the pharmaceutical area, but it has no plan, date, clarity and political intention to start this kind of process in the non-renewable resources area.

But not everything starts from zero; in Ecuador the new oil contracts signed towards the end of 2010 already establish responsibilities. These have made important advances because for the first time they talk about submitting them to the Ecuadorian legislation regarding transfer prices.

We can explain this through the following example. On November 23, 2010 the Ecuadorian State, through the Secretariat of Hydrocarbons, signed a modification contract to the service provision contract to explore and exploit hydrocarbons in Block 16 in the Amazon region with Repsol YPF Ecuador, Overseas Petroleum and Investment Corporation; Amodaimi Oil Company Ltd and CRS Resources (Ecuador) LCD.

In the contract it also clearly indicates that Repsol YPF Ecuador S.A is a company that is organized and incorporated in accordance with the laws of the Kingdom of Spain, with its main headquarters in Spain; Overseas Petroleum and Investment Corporation, incorporated in Panama, has its main headquarters in Panama; Amodaimi Oil Company Ltd., incorporated with the laws of Bermuda, has its main headquarters in Bermuda; and, CRS Resources (Ecuador) LCD, a company that is organized and incorporated in accordance with the Great Cayman Islands, with its main headquarters in the Great Cayman Islands.

On January 16, 2006, in Official Register 188, the SRI incorporated the first framework of the transfer price study<sup>39</sup> applicable to trans-national companies into its tax regulations, called the 'Annex to the Complete Report on Transfer Prices'. Taxpayers whose overseas related [companies] have operations as parties above 3,000,000 U.S. dollars must present a 'Transfer Price Report' or those that have over 50% of its taxpayers with total incomes deriving from said transactions. The Complete Report must contain the following information<sup>40</sup>:

- analysis of the industry;
- analysis of the activities and functions carried out;
- risks assumed by and assets the taxpayer uses in carrying out these functions;
- identification of the related parties, which indicates an economic situation of slavery and the shareholders' structure;
- detail and amount of the operations carried out with connected parties;
- method used, indicating the reasons why the method was chosen;
- details on the selected comparables;
- elements, quantification and methodology used to apply any adjustments to the comparables;

The norms require that a report and its annexes be presented independently. Moreover, the company must indicate the method that the taxpayer used to in order to apply the transfer prices in accordance with the arm's length principle.

In accordance to the Regulations for the application of the Tax system Law, as of the 2006 tax period the taxpayer must present the annex with the Transfer Prices within 5 days after the date of the presentation of his Tax Return.

It is requested that he detail the country of his tax residence, the company's residence with which the commercial relationship is established in his tax residence country. The tax

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<sup>39</sup> Colombia also has this annual transfer price annex for large companies, see Barbosa Mariño 2006

<sup>40</sup> Gonzalez-Bendixsen and Toro 2009

registration or identification number that is used in his tax residence country is requested. The Difference from previous tax periods, which is the total of the difference to be adjusted in the operations with related companies accumulated in previous tax periods.

Companies are also required to explain the business relationship, the reasons why the informing taxpayer considers an overseas subject as a related party; the operations that were carried out and whether these were declared as transactions of goods or services<sup>41</sup>. They must also explain the Arm's Length Principle, understood to be a fair price, which was applied by the corporation<sup>42</sup>.

However, none of this information – which is a legal obligation for companies – has been analyzed by the IRS. In turn, the companies understand that this is internal information that no one has the right to have access to. One of the objectives of this essay was to ask the IRS Director for an explanation of how this legislation will be applied to the oil sector in the future. The request for an interview was never answered.

It is not a simple topic. In the current foreign crude oil, gas, and oil by-products trade system (approximately 10 billion dollars a year) they have sought to anchor the prices to those that are established in the international market, but they put aside precisely those related values that are known as differentials or penalties and about which it is unknown whether they represent the market's reality. The only thing that the State does in the internal and external LPG (Liquid Petroleum Gas) commercialization chain is to pay costs. The rest of the activities, from the imports to dispatching it in cylinders, are done by powerful multinational companies like Trafigura, Agip, Duragas, Repsol.

In 2007 the state-owned oil company, Petroecuador, signed an agreement with the Ecuadorian military company Flopec for the latter to provide it with Gas through the Multinational, Trafigura. Between November 2009 and April 2011 the Ecuadorian public company, Flopec, signed a gas supply contract with Trafigura for the sum of USD 1.540 billion, according to reports from Petroecuador<sup>43</sup>.

How does the business work? Each ton of gas has a penalty or differential that is added to the established international price. According to the information from the contracts between Flopec and Trafigura (i.e., the related parties), in June 2009 the differential was USD 73 for each metric ton of gas. Currently, (2011) that differential surpasses USD 200 per metric ton.<sup>44</sup>

Trafigura delivered 70% propane and 30% butane in a gas ship anchored in the Gulf of Guayaquil. This Storage system on high seas is administered by a company called Depogas (with special powers from Trafigura, therefore, it is related to it) which is classified as private commercial storage. There the two products are mixed and then transported by small unloading boats to a terminal on firm land to be sent to the provinces through multi-purpose pipelines or in bulk.

The operational cost for storage is 12.90 for every metric ton (MT); the operational costs of the unloading boats is 12,15 MT; the financial costs add up to 9.85 MT; the profit is 4.54 MT. The total is 39.44 MT. This means that there is a cost of USD 39.44 per MT which, multiplied by 1,560,000 MT from the last direct contract with Trafigura, meant a total cost of an additional 61.5 million dollars.

Under what parameters do they establish that the agreed upon values compare to international values?

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41 Attached Technical Sheet on Transfer Prices

42 *ibidem*

43 Villavicencio 2011

44 Villavicencio Fernando 'Trafigura's Robberies 2011'

In April 2011 Petroecuador, once again in charge of the business, called an international bid only for state companies to provide gas in which the winners are two companies that do not produce gas for export: ANCAP of Uruguay and PMI of Mexico, with a differential that has never been seen over the past decades, USD 220 MT to the floating boat, and an additional USD 40 MT for storage and transportation costs on unloading boats, this item is in Flopec's favor. Now it is known that Trafigura operates through Ancap.<sup>45</sup>

### **III. BOLIVIA AND THE LEGAL WEAKNESSES TO CONTROL ILLICIT CAPITAL FLOWS**

Bolivia has been going through a process of change on the social and economic levels since 2006. It is well known in the industry that one of the first changes that was felt in the hydrocarbons sector, and more specifically in the natural gas sector, was the nationalization of the oil companies that operated in the country. This change, which some analysts consider more as a repurchase than nationalization, was done very theatrically and, with the army's help, facilities and fields of various companies that operated in the country were taken over.

The repurchasing process of the hydrocarbon operations in Bolivia was accompanied by a legal structure provided by the new Constitution, which transformed the Republic into a Multi-national State, but which also changed the oil companies into service providers. Aside from the theatrical conditions with which this symbolic takeover was carried out, a new hydrocarbons law was also promised, as well as a strategy for gas extraction and hydrocarbons operations in Bolivia. Therefore, they now operate under the guidelines granted according to their contracts with state-owned Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).

Meanwhile, new laws have been promised to govern and set the norms for the sector. Each year the government promises to finish the new Hydrocarbons Law. However, the legal gap continues. Several drafts have been prepared and presented before commissions of private companies and they have even used the counseling [services] of the Norwegian cooperation. The most recent draft is being reviewed by teams of lawyers from the oil companies that operate in the country, which creates political problems and causes a risk of conflicts of interests.

So much so, that Ministers of Hydrocarbons and Presidents of YPFB come and go in interim positions because they do not meet the selection requirements for the position. The legislation that is still in force has the requirement of several years of experience in the area, as well as having specialized academic diplomas. This situation is added to the restrictions on minimum permissible salaries in state institutions, which must not surpass the salary of the President of the Multi-national State. The restriction on the salaries of YPFB employees was recently lifted and almost 50 employees have been hired at salaries greater than that of the President, which is approximately 2,000 U.S. dollars a month.

Jurisdictional problems have emerged within the existing regulating structures. This has taken the power from the regulating agency, which does not define whether it is an autonomous institution or whether it responds to the Ministry of Hydrocarbons or if it responds to YPFB. Moreover, it presents a special problem for the Bolivian authorities to find the ways by which unscrupulous companies could, if they want to, evade taxes or defraud the State with the transfer price system.

The topic of transfer prices is currently treated by a commission of lawyers from YPFB who check the expenditures of the companies, now service providers, to

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<sup>45</sup> Ibidem.

authorize investments or not. Here a balance must be maintained between the strict controls and the political requirements and pressures generated by an energy crisis that occurred during 2010. There is political pressure to increase the levels of investment of the private companies, so they tend to relax the controls over these companies' expenditures.

#### **IV. TRANSFER PRICES IN BOLIVIA**

The general balance of the actions of the extractive industry (EI) in Bolivia is enormously negative. Although most of the weight is on the mining side, the oil sector carries a heavy historical load, not only from its exploitation of Bolivian hydrocarbons resources, but also from the loss of thousands of lives blinded in the Chaco War, a fratricide battle that was caused and encouraged by foreign oil interests.

The exploitation of hydrocarbons in charge of foreign capitals was and continues to be enormously beneficial for them as: risks in investments, having adequate technology and personnel for the business, and other arguments, such as having the necessary capital, cynically and corruptly imposing unfair conditions on the current government, thus taking the biggest piece of the cake.

This deceitful practice not only corrupts the public administrative and political apparatus, but it also – and above all – destroys the possibility of creating better opportunities of life for the large traditional populations. In Bolivia, this situation is unsustainable. Far into the 21st century, it is inadmissible that a country so rich in strategic natural resources should – paradoxically – have immensely poor inhabitants.

So, the question arising from this situation is: how do the multinational companies manage to keep the exploitation of strategic natural resources unscathed in Bolivia?

The main objective of this article is to make a theoretical and legal approach on the problem related to the extractive industries, providing civil society with the instruments that will allow it to understand the practices of the Multinational Companies (MNC) that are in the country.

#### **BOLIVIAN NORMS REGARDING TRANSFER PRICES**

Reviewing Bolivia's legal economy regarding the topic in question, it can be affirmed that it is too weak to be able to – effectively – control the MNC's activity. Let us look at what this weakens in the norms consists of.

#### **State Constitution (CPE – acronym in Spanish)**

In February 2009, Bolivia approved a new constitutional text which incorporates an entire chapter regarding hydrocarbons. Although the CPE does not specifically mention the norms and regulations for transfer prices, the following provisions are observed:

#### **Article 362.**

I. YPFB is authorized to sign contracts under a service provider system with Bolivian or foreign public, mixed or private companies for said companies, in its name and representation, to carry out certain activities in the productive chain in exchange for a salary or payment for their services. In no case can signing these contracts mean any loss for YPFB or the State (Bolivian National Congress: 2009, page 87) *The underlining is ours.*

Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) is the operational institution that must carry out what is enunciated in the CPE. To date it is not known whether YPFB has developed the necessary institutional capacity to allow it to fulfill this constitutional mandate.

Further down it reads:

**Article 366.**

All foreign companies that carry out activities in the hydrocarbons productive chain in the name and representation of the State will be submitted to the sovereignty of the State and they will depend upon the State's laws and authorities. In no case will any foreign court or tribunal be recognized nor can they invoke any exceptional situation of international arbitration, nor resort to diplomatic claims. (Bolivian National Congress: 2009, page 88)

YPFB's characteristic rachitis definitely makes the purpose of the preceding text unviable.

**Law No. 843 (Tax Reform)**

In a still incipient and even timid manner, in this law we can find the first progress of the State in trying to regulate the MNC's activities through the Transfer Prices. Two articles stand out:

**Article 37**

All companies, both public and private, are subject taxes, including: stock companies, mixed stock companies, limited partnerships with shares and simple partnerships, corporate societies, limited liability companies, collective societies, companies irregular or de facto, individual companies, subject to regulations, branches, agencies or the permanent establishment of companies that are incorporated or reside overseas, and any other kind of companies. This list is expository and not limiting. (Bolivian National Congress: 2004)

The article refers to the scope of the tax on company profits as the State's faculty and capacity to tax the benefits from economic activities. The MNC's tax planning will seek – at all costs – to maximize their benefits; this implies that YPFB must develop and strengthen its supervisory capacities.

Further down it states:

**BRANCHES AND ESTABLISHMENTS OF FOREIGN COMPANIES  
OPERATIONS BETWEEN CONNECTED COMPANIES**

**Article 45**

Branches and other establishments of foreign companies, people or entities must keep their accounting records separate from their parent companies and other overseas branches or establishments, so that the financial statements of their management permit determining the tax results from Bolivian sources.

Legal acts that are celebrated between a local company with foreign capital and a physical or legal person residing overseas who directly or indirectly controls it will be considered, to all effects, as having been celebrated between independent parties when the agreed-upon conditions adapt to the normal market practices between independent entities.

When the requirements foreseen in the previous paragraph are not met to consider that the respective operations were celebrated between independent parties, any amounts surpassing the normal market values between independent entities will not be admitted as deductibles to the ends of this tax. To the effects of this article, a local company with foreign capital will be understood as one in which more than 50% (fifty per cent) of the capital and/or the decision-making power directly or indirectly corresponds to natural or legal persons residing or incorporated overseas.

In this article the MNC's are obligated to keep differentiated, separate accounting, as well as imposing the **arm's length principal** as the guiding [principle] for transactions between related companies. Finally, it defines and differentiates local, from foreign, companies, whether they are affiliates, subsidiaries or parent. In sum, the Bolivian norm must be much more specific and must be accompanied by the development of strong, effective capacities in YPFB.

Bolivia's ex-Superintendent of Hydrocarbons (Victor Hugo Sainz) presented a document entitled: '**BOLIVIAN REQUEST FOR A COOPERATION PROGRAM IN THE NORWEGIAN – BOLIVIAN OIL SECTOR**' to the Norwegian cooperation that contemplated a two-phase cooperation program that included six areas: I. Evaluation of the Legal Regulatory Framework and the Hydrocarbons Law, II. Inventory of the Hydrocarbon Resources, III. Administration Program for the Hydrocarbon Resources, IV. Oil Income Taxes and Administration, V. Environmental Protection Program, VI. Transparency and Anti-corruption Program.

According to the 'Energy Platform' website, on Monday, July 25, 2011 'the Minister of Hydrocarbons and Energy, Jose Luis Gutierrez, signed an 'Inter-institutional Framework Agreement of Cooperation in the Energy Sector' with Trond Heyerdahl, Counselor and Mission Head of the Norwegian Diplomatic Section' that includes 'three scopes of technical assistance, on hydrocarbon and energy matters, another scope is technical assistance, but from the institutional point of view, technical assistance to strengthen the different institutions. Two things stand out in this agreement: that Bolivia is the only country in the American Hemisphere that is receiving this kind of cooperation and the document has not been made public to date.

#### **THE MNCs CONTROL THE OIL BUSINESS IN BOLIVIA**

On May 1, 2006, with the promulgation of Supreme Decree No. 28701, the rules of the oil business game were apparently modified in favor of the Bolivian State, forcing the MNCs to pay more taxes and strengthening YPFB's share participation in different foreign companies. However, 'when YPFB was ordered to return to hydrocarbon activities in precarious conditions and submitted to the open competition with transnational companies – this allowed for the reserves and extraction – which is what gives them an economic value – to continue in their hands, and it was their income that was supposed to be affected'<sup>46</sup>.

Despite the 'nationalization' measures taken by Evo Morales' Government, it can be said that in the case of the hydrocarbons reserves 'the presence of the transnational companies is prevalent'<sup>47</sup>, contravening the spirit and what is established in the 2009 CPE and Hydrocarbons Law No. 3058. It can objectively be observed that 'in 2005 companies such as Petrobras, Repsol, and Total E&P controlled 83.4% of the natural gas and oil reserves, expressed in energy terms; in 2009 this participation increased, reaching 85.2% of the total reserves. On the other hand, in 2005 YPFB's control over the reserves, through its subsidiaries Andina and Chaco, was only 12% and in 2009 it went down to 11 %'<sup>48</sup>.

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46 Carlos, Espada et al 2011

47 Ibidem, page 52.

48 Ibidem, page 53. Laws 075 and 079 dated December 2010, transferred Don Wong's rights in the Palmer field to the company GTLI and the rights of Total E&P in the Itau field to Petrobras Bolivia. Ibidem. Page 54.

The situation is much more beneficial for the MNCs when you consider that in the official statistics for the 2010 hydrocarbons production, for example, you see that Petrobras Bolivia controls 60.48 % and Petrobras Energia 2.63%. Both add up to almost two-thirds of the total, a reality that gives them a monopoly in hydrocarbons production in Bolivia. In any case, the MNCs control 80 % of the hydrocarbons production.

To crown this, the out-and-out defense –by President Evo Morales himself – of the provisions in Supreme Decree No. 748 dated December 2010 is still present<sup>49</sup>, which sought – above all – to favor Direct Foreign Investments<sup>50</sup> (DFI).

In order to attract investments to develop the oil and natural gas riches and increase the search for reserves, the new hydrocarbons law must establish mechanisms that encourage the interest of foreign capital. The adaptation of the tax system is one of the approaches in which the President of the Bolivian Chamber of Hydrocarbons and Energy (CBHE – acronym in Spanish), Carlos Delius, and the ex-Minister of the area, Fernando Vincenti, coincide:

‘Tax flexibility is for future contracts, because those that are in force are already functioning with the conditions that were imposed in May 2006’.

This deteriorates the popular economy, an enormously significant act that contradicts the political project to recover the natural resources [and] which was literally stated in Supreme Decree No. 28701<sup>51</sup>. In accordance with news from the Energy Platform:

‘For the (ex) Minister of the nationalization, Andres Soliz Rada, the supreme decree set the bases for the nationalization, but it was abandoned by the Government, who did not fulfill the stipulations of the norm when it signed oil contracts with these same transnational companies without first waiting for the results of the oil audits his office carried out and which revealed accounting frauds and noncompliance with investment commitments, among other irregularities’.

#### **The Contract to Reduce the Unpredictability of Prices (CRVP – acronym in Spanish) that was celebrated between Repsol (Andina) and Petrobras as one case of the application of the Transfer Prices**

The oil business in Bolivia is a ‘State secret’. To gain access to the oil contracts is a ‘mission impossible’ because there is no culture of transparency in this IE. To objectify tax avoidance and evasion, we resort to the Article on ‘**Oil Delinquency**’ written by Andres Soliz Rada, ex-Minister of Hydrocarbons of Evo Morales’ government. In the same we read:

‘Camacho Cuellar also made the accusation that Repsol and Petrobras swindled YPFB out of 300 million dollars when they agreed upon the purchase-sale price for gas to Brazil, at lower prices than the ones agreed upon between Bolivia and its neighbor

by means of a hedging contract (to prevent an alleged unpredictability of prices). The country’s defender himself revealed the contraband of crude oil, as well as the tax evasions of the Spanish company, crimes for which its manager in Bolivia, Julio Gabito, was arrested in Santa Cruz. The Public Ministry was pressured by the government to file all the lawsuits against the companies, instead of using the results to get better contracts than those that were signed last May. Andina’s Board of Directors, formed by five delegates from Repsol and two from YPFB, forbade Camacho Cuellar to record their official meetings, to then order him to sign distorted Minutes’.

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49 Popularly known as the ‘**gasoline price hike**’. The paradox of this ‘price leveling’ is that ‘if the gas price hike had occurred, the population would have ‘subsidized’ an increase in the profits of the private oil companies that operate in Bolivia because, besides having other benefits, their income would increase up to 400%’. See [Plateformaenergetica.org](http://Plateformaenergetica.org), 01-09-2011

50 See: Energy Platform, August 29, 2011

51 See Energy Platform, May 4, 2011

To September 1, 2011 none of the public institutions of the Bolivian State have taken any concrete actions against this larceny, much less sanctioned the authors.

The same ex official, in another article entitled '**The struggle over gas prices**'<sup>52</sup>, provides us with more details on the 'tax conduct' of the MNCs in Bolivia, which has gone astray. The companies seem to export gas at a price that is much lower than the one that was agreed upon in the GSA.

'Pluspetrol was sending gas to Argentina at 0.67; Repsol (Andina) was selling gas to Petrobras, behind YPF's back, at one dollar (a 'hedging' contract). On its part, British Gas exports gas to its affiliate, COMGAS, in San Pablo, also on the fringes of the GSA [...] These contracts were 'incestuous' because the gas producing companies in Bolivia bought [gas] on the other side of the border, converted the country into a gas sieve, which began to be sold, through legal and illegal branches, like what happened in Corumba'.

These examples give us a clear idea of what the presence of the MNCs represents in Bolivia. Apparently their marginal 'tax conduct' will not be straightened out by their own will. So, the challenge to put the house in order goes back to civil society because the current government has granted many tax advantages to the IED in the hydrocarbons sector and apparently a package of greater 'incentives' is coming.

## CONCLUSIONS

In the facts it can be verified that the official discourses of 'recovering our natural resources' is completely opposite to the reality: the prevalence of the hydrocarbons activity's monopoly by the MNC's in Bolivia. Although the Bolivian Government's tax income has increased considerably since Hydrocarbons Law No. 3058 and Supreme Decree No. 28701, it is observed that YPF has not developed the institutional capacity to allow it to control the oil business. This means that the MNCs continue to use the corporate strategies defined in their 'tax planning' that allows them to continue avoiding and evading their tax responsibilities, a situation that implies the elimination of better opportunities and living conditions for Bolivian society as a whole.

The status of the situation in the hydrocarbons sector repeats itself with the same or greater magnitude in the mining sector, i.e., the current norms are permissive and they even promote the exploitation of the existing 'strategic resources' in the Bolivian sub-soil. There is no need to state that the State and civil society do not have the capacity to control and much less know what is extracted, where [the resources] are exploited and where they go, how much is exploited and exported and, above all, how much it is worth. Therefore, it is impossible – objectively – to determine how much the MNC's must pay to the State and the Bolivian people in concept of what corresponds to them by rights.

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52 Rebananas de Rebalidad

## RECOMMENDATIONS

The exploitation must end. For this, it is necessary to take concrete actions.

- Generate a current of opinions in the bosom of civil society to design a new judicial economy that takes precautions, protects, and guarantees Bolivians' rights, favoring them over the MNCs.
- To establish, country by country, the accounts established by the transnational companies in the oil sector in all their operations in each country where they operate to increase the companies' transparency and facilitate tax inspections. The reports on transfer prices in Ecuador are a step in that direction.
- For an effective, efficient demand to exchange tax information between tax havens and Latin American states, the lists of tax havens, as in the case of Ecuador, form part of this process.
- The above requires permanently training investigators, professionals in different areas, social activists, and people identified with the Bolivian people's common good so as to learn in depth the MNC's mechanisms and strategies oriented towards tax avoidance and evasion. This will permit the design and application of sustainable strategies over time that will finish the larceny to which we are subject.

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