Resource Nationalism – Managing the Risks

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One of the least expected turns in the Global Economy today is undoubtedly the return to centre stage of Resource Nationalism. The assertion of state ownership and control over the natural resources within their territories was believed to have had its heyday in the 1960s and 1970s when, spurred by a spike in the prices of commodities and particularly in the value of oil, many developing nations then engaged in a wave of nationalisations and expropriation.

The unprecedented spike in the price of oil from 2005, has seen economic policies shifting again. This time, however, the move towards Resource Nationalism was not the reserve of developing nations. Surprisingly, perhaps, the UK was at the forefront when it introduced a windfall tax on North Sea oil and gas profits in early 2006. Other countries including, states as geographically and economically diverse as Russia, the Democratic Republic of Congo, Venezuela and Bolivia, soon followed suit by imposing various forms of direct or indirect expropriation.

As global economic uncertainty increased toward the end of the decade and while commodity prices remained high the pressure to adopt Resource Nationalistic policies was amplified by concerns over budgetary deficits and security of supply issues. Thus Russia banned the export in wheat in 2010, and most recently Southern European states such as the Czech Republic, Italy and Spain have reversed subsidies promised to foreign investors in the solar energy industry.

The commercial uncertainty created by such policies has been compounded in recent weeks by the events in the Middle East as well as by regime changes in sub-Saharan Africa. Significant political and constitutional change has long been associated with Resource Nationalism as new governments seek to distance themselves from the policies and perceived corruption of their predecessors. As evidenced by recent events in North Africa, the process of regime change can cause serious business uncertainty and disruption, as well as commercial losses and damage to property.

Resource Nationalism and its consequences appears to be a feature of the global economy for years to come. However, business entities investing and doing business in foreign states can reduce their exposure to such risks as explained below.

Insuring against political risk

A large amount of political risk cover is already taken out by entities who trade across borders in order to mitigate the risks associated with participating in international projects, investments and contracts. Political risk insurance is commonly available to cover the following risks:

- Political violence, such as civil unrest, insurrection, revolution, war and terrorism.
- Governmental expropriation or confiscation of rights and assets.
- Governmental frustration or repudiation of contracts.
- Wrongful calling of Letters of Credit or similar on demand guarantees,
- Inconvertibility of foreign currency or the inability to repatriate funds,
- Frustration and cancellation of sales contracts, and
- Unpaid arbitration awards.

It is always important to be certain that the insurance taken covers the risks against which protection is sought. It is clear that just as Insureds need to make an effort to understand the cover they have purchased, they also need to carefully assess the foreign markets in which they operate.

When political unrest breaks out such as that seen in Thailand, Egypt and Libya, losses can affect a wide range of companies for example those who deal in oil and gas, real estate, infrastructure projects, hospitality, financial institutions. These losses can range from business interruption, theft, devaluation of currency, the cost of evacuating or protecting employees, property damage or seizure of assets.

In this regard organisations such as the World Bank sponsored Multi Investment Guarantee Agency (MIGA) and the African Trade Insurance Agency (ATI) provide innovative forms of cover, including for example, cover for so called "Brownfield investments", the injection new capital into existing projects.

Although cover has been available in the market, many policyholders with investments in the Middle East and North Africa have found that they are not adequately protected against recent events. Political risk cover is one way of making sure losses do not fall between the cracks. For others, who failed to insure their operations in time the horse may have truly bolted, as commercially viable cover in these fragile regions may no longer be available.

It is important for investors and traders to be clear that there is no geographical boundary which is immune. Even regions which are now classified as low risk (as many parts of the Middle East were considered to be) where premiums will consequently be more reasonable, are prone to political upheaval and unexpected politically motivated government intervention.

It is inevitable that the insurance market will keep a close eye on matters unfolding in this potentially volatile region. The potential for the spread of socio-economic unrest to other areas, and the ripple effect it could have on the insurance market remains a concern. Market commentators consider that the recent spate of unrest could lead to a reassessment of the market. It is not just the issues arising out of the present violence which have to be considered but also whether if and when new governments are in power there will be a significantly increased risk of policies hostile to foreign investments such as restriction of movement through the Suez Canal and other forms of Resource Nationalism. Multi-national corporations should continue to monitor events but also take this opportunity to think hard about their potential exposure not only in potential hot spots, but also in other regions where coverage is more easily available and premiums more reasonable.

International treaty protection and corporate structures

Further protection from Resource Nationalism might be available to foreign investors under applicable international treaties between states for the promotion and protection of foreign investment. These treaties, commonly known as Bilateral Investment Treaties (BITs) or Multilateral Investment Treaties (MITs), offer foreign investors directly enforceable guarantees against government expropriation and other forms of unfair government taking and intervention, such as unfair taxation and discriminatory administrative treatment.

These guarantees are backed up by a sophisticated and well established system of international arbitration, predominantly under the auspices of the World Bank sponsored ICSID System. The vast majority of successful claims brought against national states have been satisfied. Further, an increasing number of claims are being resolved amicably before formal arbitration proceedings.

The availability of investor treaty protection depends on the terms of the relevant treaty. Fundamentally, protection applies when an investor based in one treaty state makes a qualifying investment in the territory of another treaty state.

What constitutes a "qualifying investment" differs from one treaty to the next and does not always follow pure commercial logic. The contribution that an investment makes to the development of the host state is one important factor. Thus, while a string of commodity purchase contracts would probably not constitute a qualifying investment, establishing an in-state marketing and export company to undertake the same underlying transactions probably would. Similarly, providing advance debt or other finance to the seller in order to enable the transaction, is also likely to constitute an investment. On the other hand large infrastructure projects and long term concessions over natural resources almost always qualify as "investments" for these purposes. Parties who do business with or make investments in foreign countries should always consider whether the transaction can be structured in a manner that attracts the protections afforded by applicable investment treaties.

Some practical "due diligence" for business

Advance strategic planning is a key factor in mitigating political risks. International businesses should consider taking the following steps:

1. Review your insurance policies and in particular check whether information that has been provided is up to date and that you are compliant with continuing obligations. The continuing obligations are important and vary from one policy to the next.

2. Familiarise yourself with the warranties contained in the insurance policies and ensure that your business implements internal procedures to minimise the risk of breach.

3. Review the extent of your existing cover with your broker. Consider your exposures worldwide to decide whether further cover should be obtained. Maintain regular valuations of assets to ensure adequate cover.

4. Find out from your broker what cover is available in the market and the costs of that cover.

5. Consider whether it is worth buying insurance in those countries considered low risk (for the time being) in the light of the low premium at present.

6. Consider how best to structure investments and business transactions so as to seek to attract the protections afforded by international investment treaties.

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