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SPECIAL REPORT

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Bolivia: Negative Business Outlook

Bolivia's nationalization of its gas sector will deter foreign investors and further impoverish the country, South America's poorest, business leaders and experts say.

BY JOACHIM BAMRUD

When President Evo Morales last week signed a decree nationalizing the gas sector in Bolivia, the move was expected. After all, it had been a cornerstone of his campaign to remove two presidents and win the December elections. What wasn't expected were the terms of the nationalization nor the way they were announced, with military troops sent to guard key gas installations.



NEW BOSS: Bolivian gas fields like this one controlled by Spanish gas giant Repsol YPF may soon be completely in the hands of the Bolivian government.

Photo: REPSOL YPF.

"Bolivia's recent action sends a chilling signal to international investors," says Eric Farnsworth, vice president of the Council of the Americas, a New York-based organization that includes the leading U.S. multinationals in Latin America. "Many investors took a wait-and-see attitude. At this point, they've waited, and they've seen, and they don't like it, and other sectors could be next."

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Jerry Haar, a professor of management and international business at Florida International University, agrees. "Evo Morales and Company are sending a very clear message: "Foreign Investors Need Not Apply." With rates of FDI to Latin America declining in tandem with rates increasing to Asia, it is both ill-timed and idiotic for one of the region's poorest countries to have taken this anti-neoliberal, self-destructive action," he says.

The move can be seen as a confirmation of the growing nationalist mood in Latin America, says Roger Tissot, a director at Washington, DC-based consultancy PFC Energy. Other countries may be tempted to follow a similar path, while others will likely think twice before repeating the Bolivian example, he says.

The nationalization and the way it was handled led to condemnation and criticism from Brazilian oil giant Petrobras, Spanish gas company Repsol YPF (both affected) as well as the Spanish government and the European Union.

Antonio Brufau, CEO of Repsol YPF, said the decree was "outside the norms and business logic that should guide relations between companies and states."

The latest attacks against foreign gas companies follows previous actions that raised eyebrows locally and abroad. In March, a Bolivian judge issued arrest orders against Repsol's top two executives in the country. And last month, Morales expelled Brazilian steelmaker EBX.

FOREIGN INVESTMENT

Foreign investors have pumped \$3.5 billion into Bolivia's gas sector since 1997, enabling it to boost its proven reserves from 6 trillion cubic feet to 48.7 trillion cubic feet. Venezuela is the only Latin American country that has larger gas reserves.

Petrobras is by far the top investor having invested more than \$1.5 billion in Bolivia. The Brazilian company accounts for 24 percent of the country's tax collection, 18 percent of its GDP, and 20 percent of all direct investments in the country, according to a statement from Petrobras.

It operates nearly half of Bolivia's gas reserves and nearly all of its refining. And it produces 100 percent of the gasoline and 60 percent of the diesel fuel the Bolivia consumes. For Petrobras, Bolivia represents a fifth of its total gas reserves, according to Bloomberg.

Repsol is the top gas producer in Bolivia and has invested more than \$1 billion since 1995. Additionally France-based Total SA and UK-based BG Group Plc operate in Bolivia.

Even before the gas nationalization, both Petrobras and Repsol had stated that they were cancelling new investments in Bolivia as a result of the unfavorable investment climate. In the case of Repsol the amount came to 400 million euro, Brufau stated in January.

However, Bolivia needs additional investments to boost future production so that it can meet the demands in Argentina and Brazil, US-based consultancy Global Insight says. "The decree threatens to undermine existing investments in the country and means that companies will remain unwilling to invest in new export projects," it said in a commentary last week.

NOTICE OF EVACUATION

Morales decreed that foreign companies have six months to sign new contracts or be forced to leave Bolivia. He also decreed that the state share of production from the San Alberto and San Antonio gas fields will rise to 82 percent. At the same time, the government plans to acquire a controlling stake in the refineries currently controlled by Petrobras. If Petrobras refuses to sell, the government may expropriate them, Vice President Alvaro Garcia said last week, according to the Associated Press.

"The impact is almost immediate, and will double revenues," Tissot says. "As long as those two fields keep operating, that will obviously benefit Bolivia."

The move to raise state ownership of the gas production will likely generate additional revenues of \$780 million, according to Global Insight.

The new decree also enables the Bolivian government to retake control of Bolivia's partially privatized companies Chaco, Andina and Transredes. Previously, private investors held a 50 percent stake in the companies, with the remaining shares held by a state entity (FCC) managed by pension funds. As stipulated by the new hydrocarbons law, the state can transfer the stake from FCC to YPFB and the government will likely also acquire an additional one percent ownership, so it can control at least 51 percent of YPFB, according to signals from key officials.

NEGATIVE EFFECTS

While the government will succeed in boosting revenues in the short term, it will lose out in the long term, experts warn.

"Clearly, greater rent, or more crudely put, a much, much larger slice of the pie is what the government is after," says Jeremy Martin, director of the energy program at the Institute of the Americas, a non-profit institution based at the University of California San Diego. "The terms of last Monday's decree - building upon last year's increased taxes and royalties under the new hydrocarbons law - could certainly provide a boost in the short-term, but Bolivia is not Venezuela and the commodity in question is not oil that is already being produced at the rate of the fifth largest in the world so I am dubious as to the long-term boost and overall viability of the terms announced last week."

Both Farnsworth and Martin point to the statements by Brazilian oil giant Petrobras that it plans to stop new investments in Bolivia. "This is particularly important as Petrobras has been the investment bellwether in the Bolivian energy sector over the last several years with a staggering \$1.5 billion invested to date," Martin says.

And although the new decree does give companies six months to comply, the government does not appear interested in negotiating new terms, but rather forcing the new terms on the companies. "It seems hard to believe, at this stage, that companies will fully accept the new terms," Martin says. "It could be a rather acrimonious period of renegotiation for Bolivia."

GROWING ATTACKS

The decree is only the latest chapter in an increasingly hostile environment for foreign gas companies. Nearly two years ago - in July 2004 - a majority of Bolivians voted through a referendum to repeal the investor-friendly hydrocarbons law implemented by former president Gonzalo Sanchez de Lozada, permit the renationalization of Bolivian state gas company YPFB (which had been partly privatized in 1996) and boost state ownership of hydrocarbons. The referendum was held by then-president Carlos Mesa amidst violent protests from groups led by Morales. However, it did not pledge an outright nationalization of the gas sector and thus did not weaken the protests. Then, last year, the legislature approved a new hydrocarbons law, which raised taxes from 18 to 50 percent, forced migration of existing contracts and mandated consultations with indigenous groups on new contracts and exploration. Mesa refused to sign the new law, but it was passed into law by the Bolivian congress anyway.

The new hydrocarbons law, coupled with political instability, led to

a fall in investments. According to preliminary data from Bolivia's Hydrocarbons Chamber quoted by Global Insight, exploration and production investment in Bolivia's natural gas sector reached \$175 million last year - its lowest level since the sector was privatized in 1997.

The original privatization of YPF and other companies, called capitalization, was an innovative scheme implemented by Sanchez de Lozada that enabled state companies to gain fresh investment while creating a new pension systems for Bolivians and adding fresh capital to the country's stock market. Sanchez de Lozada won widespread international praise for the concept, but met resistance at home.

Sanchez de Lozada was forced out of office in October 2003 amidst the growing violence led by Morales. His successor, Carlos Mesa, was also forced out of office in March 2005 by the same protests. Mesa was succeeded by Supreme Court president Eduardo Rodriguez until Morales assumed office in January.

The political unrest was one of the key factors behind Bolivia's low rank in the [2006 Latin Business Index](#) published by *Latin Business Chronicle*. Bolivia ended in second-to-last place, just barely better than Haiti.

ARMED TROOPS

Apart from the actual nationalization, many foreign investors reacted negatively to the fact that Morales sent troops to seize the gas fields and guard foreign gas companies' offices.

"The symbolic value is important both domestically and internationally," says Farnsworth, who is based in Washington, DC. "Domestically, it means that President Morales is in charge of both the military and the police, which had feuded during the previous government, and is now the undisputed leader of Bolivia. It shores up his base and sends the signal that he is in control. Internationally, of course, it means that the government is both willing and likely to exercise a heavy, clumsy hand in the marketplace. In a global economy, that means investors will look elsewhere for markets and Bolivia, quite possibly, has set itself back a generation or more in terms of the economic development the government says it seeks."

The European Union sent out a statement particularly condemning the use of military in the action.

"This played well to the masses - it made for great theater," Haar says. "However, one has to realize that there are even more radical indigenous-based parties than that of Morales; and he is under pressure to move further to the left at times to keep these groups at bay."

OUTLOOK

In a forecast released before the gas nationalization, the International Monetary Fund said Bolivia's economy likely would expand by 4.1 percent this year and another 3.9 percent next year. That is more or less the same growth rate the country experienced the past two years. But the fall-out from the nationalization and likelihood of reduced foreign and local, private investment in Bolivia may result in lower growth than originally expected.

"In general, the economic outlook for Bolivia is worrisome," says Farnsworth. "Without a rational and effective means to develop the massive natural gas resources in the country, Bolivia's future is

uncertain at best. Both domestic and foreign investors will remain on the sidelines, and there isn't enough international aid to keep the economy afloat even if donor nations were inclined to do so. Expect uncertain and difficult days ahead."

With foreign gas companies on their way out, speculation is growing that Venezuela will play a larger role. Morales is seen as a close ally of Venezuelan president Hugo Chavez.

"The economic outlook for Bolivia will be determined less by the price of gas and more by the size of Hugo Chavez's checkbook and willingness to cover Morales's bets," Haar predicts. "Other than gas shipments and foreign aid-cum-welfare checks from Hugo Chavez, Bolivia has very little going for it."

Bolivia may also see speculative, short term investments that won't benefit the country, Farnsworth warns. "Such investment as does come into Bolivia in the near term will be speculative and short term, or tied to other foreign governments, exactly the kind of attention an emerging economy like Bolivia doesn't want in terms of its long term development prospects," he says.

The productive part of the country - Santa Cruz - will see a slowdown in domestic economic activity as well, as local private capital seeks alternatives to investment/reinvestment in the country, Haar adds.

"The social, ethnic, and economic divides within the Bolivia are longstanding and expectations for change are high," he says. "If Morales fails to deliver, he'll wind up in the dust heap of Bolivian politics. Winning an election is one thing; governing is quite another."



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