Nationalizations in Latin America: Dog Bites Man Story?

That a couple of Latin American countries have recently announced the expropriation of foreign investors in the energy sector seems hardly like new news. After all, cycles of nationalization and privatization have unfolded for more than half a century. Moreover, the expropriation simply marked the latest illiberal measures by Argentina and Bolivia, the two protagonists here.

There is significant risk that others will follow Argentina and Bolivia. Ecuador comes to mind quickly, for example. Yet even if there is not a new wave of energy nationalizations, as some more doom-and gloom prognostications suggest, other developing countries are dealing with many of the same forces that led to the recent nationalizations.

The combination of high price commodities and the internationalization of ownership are important, if not necessary conditions. Weakness in global aggregate demand and the disruption of global trade and financing flows is the kind of exogenous shock that has produced changes in the developmental model of Latin American economies in the past. Indeed, some scholars point to those conditions caused by the Great War that compelled large countries in Latin America to adopt import-substitution strategies in the first place.

It has been over a decade since Argentina defaulted on around $95 bln in sovereign obligation, and the policies it has pursued have continued to undermine investor confidence. It has levied surcharges on agriculture exports. It has nationalized pension funds. It has seized foreign reserves from the central bank. Argentina is also one of the leading target cases brought before the World Trade Organization.

The expropriation of YPF, the largest corporation in Argentina, from its Spanish parent Repsol needs to be placed in this context. Yet there is another dimension that is less considered, but is just as important. President Christina Fernandez de Kirchner was also responding to what is best understood as a capital strike.

We are all familiar with labor strikes. Labor withdraws from the production process. What happens when capital, one of the factors of production, is withdrawn from the process? Capital goes on strike. Kirchner was clear. Even before the nationalization, her government was critical of YPF’s lack of investment.

Argentina spent almost $9.5 bln on fuel imports last year to ostensibly replace the decline in YPF’s oil and gas output. Repsol is concerned about its global operations and managing to maximize its risk adjusted profits. Surely, reasonable people will agree that Kirchner’s interest and the national interest of Argentina are different.

Argentina had already forced YPF-Repsol to sell its oil in Argentina at a price of $42 a barrel and required that domestic demand be met before oil could be exported. While these conditions may sound onerous, YPF reported cash flow from operating income of $3.2 bln in the 2008-2010 period, even at $42 a barrel. Before the recent decline in the price of its shares, the market cap of YPF was about $5.5 bln.

On top of this, reports indicate that in the same 2008-2010 period YPF paid dividends of about $5.1 bln of which some Repsol received almost $3 bln. While doing business in Argentina is difficult and the conditions placed on Repsol-YPF made it even more difficult, Repsol was not only limiting its investment and output in Argentina, but was also withdrawing its capital via dividends. While perfectly reasonable and rational for a multinational company, it runs counter to the interests of the country.

In response to a labor strike, courts can and have issued injunctions, ruling that labor must return to the production process or face fine and/or incarceration. A capital strike is more difficult to resist. Expropriation through nationalization is a more common response than it may seem. In the US, recall that Wilson nationalized the railroads during WWI. In 1952, Truman nationalized the US steel industry (to prevent a labor strike). More recently, the state powers of eminent domain (taking, with compensation, private property for public use) have been explored to varying degrees in the US.

Yet Argentina has a weak hand. It is clumsy and will succeed in increasing its international isolation. Its actions will also heighten the risk of a new financial crisis. The gap, for example, between the tightly controlled official exchange rate and the parallel rate used by businesses (called the blue chip swap rate) has widened considerably. Interpolating from it warns of the risk of as much as a 20% devaluation by Argentina if the official exchange rate were to be liberalized.

Bolivia's recent move was somewhat less of a surprise. Since being elected in 2006, President Morales has used the Labor Day (May Day, for those less class conscious) celebration to pursue his nationalistic goals. On the sixth anniversary of nationalizing the gas fields, Morales ordered the army to take control of Spain's Red Electrica Corp, which generates 85% of Bolivia's electricity.

Spain's Red Electrica Corp purchased a 99.9% stake in Bolivia's electric utility in 2002. Ironically, Red Electrica itself is not simply a private company. The Spanish government has a 20% stake. Contrary to what it may appear then, Morales' move is in part, one state capitalism going against another.

Morales too complained about the lack of investment in the Bolivian unit, but he also had long identified the energy industry as one of the "commanding heights" that ought to be controlled by the government. Under his government, gas fields, oil refineries, pension funds, telecommunications and, even a tin smelter, have been nationalized.

It is not clear where it ends. Brazil's Finance Minister has complained about currency wars. Many observers have expressed concern about trade wars. Weak global aggregate demand, the internationalization of ownership, and ideologically pre-disposition to resisting the demands of global capital makes for a dangerous environment.

Argentina and Bolivia's expropriations are likely to be neither the start of a new trend nor the end of such moves, especially in Latin America. The best way to avoid what some game theorists may call regime defection is for the major countries to provide the conditions for stronger, more sustainable growth. It will not prevent nationalism and nationalizations, but it will provide strong disincentives.

Marc Chandler

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Global Currency Strategy Team

Marc Chandler | Global Head of Currency Strategy | 1.212.493.8800 | marc.chandler@bbh.com

Win Thin | Global Head of Emerging Market Currency Strategy | 1.212.493.8867 | win.thin@bbh.com

Mark McCormick | Currency Strategist | 1.212.493.8744 | mark.mccormick@bbh.com

Ilan Solot | Currency Strategist | 44.20.7614.8747 | ilan.solot@bbh.com

Masashi Murata | Currency Strategist | 011.813.6361.6328 | masashi.murata@bbh.com

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