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Bolivia "Clarifies the Deal"

by Stephen V. Arbogast

News coverage of Bolivia's re-seizure of its oil and natural gas industry has emphasized the extent to which President Evo Morales is following a path charted by Venezuela's Hugo Chávez. A closer look reveals something else: The "Chávez path" has fatal flaws and is coming up against its natural limits. Increasingly, the opposition to Chávez-Morales will not have to come from the United States; it will come instead from within Latin America. As for the international oil and gas industry, Bolivia's actions have made it very clear, to both private firms and state companies, that there is no new investment deal to be done with this government – and that "no deal" ultimately will be the case with Chávez and Venezuela as well.

If one wanted to write a script outlining how best to drive foreign investment to zero, one could hardly do better than the story of Bolivia since Morales assumed the presidency in January this year. Upon returning in May from Havana, where he signed a Free Trade Agreement of the People with Cuba and Venezuela, Morales promptly sent the Bolivian army to occupy a Petrobras gas facility. Upon his arrival at the site he announced the "state recovers title, possession and total and absolute control over these recourses." Petrobras and other foreign companies (Repsol, Total and BP) had invested $5 billion to develop Bolivia's natural gas industry from scratch. Morales gave the companies 180 days to accept new contract terms to be dictated by state company YPFB, the restored owner of the gas produced at the facility. There was no mention of compensation for the foreign companies. In the interim, the government's fiscal take from the country's two largest gas fields will rise to 82 percent. It was 18 percent as recently as 2004.

Lest this treatment of the oil and gas industry be seen as an exception, Morales' government has taken a similar approach to other major industries. A case in point is the El Mutun iron-ore project: Foreign steel companies were advised that a draft agreement would have to be renegotiated, with the contract's planned duration cut in half. India's Jindal Steel & Power Ltd. reported it faced Venezuelan advisers posted alongside their Bolivian counterparts when they sat down to negotiate on April 25. Forestry and mining interests have also been advised to expect unilateral increases in their taxes.

Completing the program for scaring off investment capital, Morales' government is in the midst of attempting yet another rewrite of Bolivia's constitution. At issue is whether the president will be able to follow the Chávez playbook, combining constitutional means and popular referenda to dismantle checks and balances on presidential authority.

Strategic Flaws

If it weren't so obvious that Morales and team are being coached every step of the way by Chávez, Bolivia's tale would be just another spasm of self-inflicted damage in a history replete with such incidents. What gives the Bolivia case more international weight is what it reveals about the flaws in Chávez' strategy. What will be visible clearly and soon in La Paz will eventually happen in Caracas as well.

Unlike Venezuela, Bolivia does not have a large existing oil and gas export industry from which to cream off rents. The gas fields seized by YPFB are material, but not huge by international standards. Even after the tax hike, the government's take from the fields will be less than $1 billion. For impoverished Bolivia, this is serious money, but it is nowhere near enough for a go-it-alone investment strategy – especially when most of the increased take is likely to disappear down other funnels. Bolivia will not develop its large gas reserves without someone else putting up the money.

The chance of this happening on any large scale during Morales' tenure is now zero. Bolivia is counting on the fact that Brazil, which uses Bolivian gas for 5 percent of its energy consumption, will have to deal on Bolivia's terms. This thinking fails on multiple grounds. Brazil's government has been embarrassed by Bolivia's actions and the image of seeming to be helpless in the face of a dictator. Its elected government is highly unlikely to sign up for more potential embarrassments at the hands of the very unpredictable Morales-Chávez team. Brazil also has resources, funding and other options, so the Bolivian "they must come to us" thinking is not shared by Brazilians. Petrobras is a professional state company, listed on national and international stock markets. It will defend its commercial interests and not throw good money after bad.

Most important, Petrobras knows that Bolivian gas can be commercialized only by construction of large pipelines. Having been held hostage once, Petrobras understands that pipelines are the quintessential asset if one wishes to hold a customer hostage. New pipelines can only be commercialized on the backs of sound contracts, a reliable legal framework and trustworthy partners. All of this the Morales government has clearly undermined. As a final nail in the pipeline coffin, large, long-distance pipelines are almost always funded with ample amounts of project financing. Even if Petrobras wanted to progress a project, the company would have no chance of convincing international bankers that any contract signed with YPFB or the Morales government could be counted on as a deal framework. Smaller pipeline projects touted for the Argentine market will face the same problem.

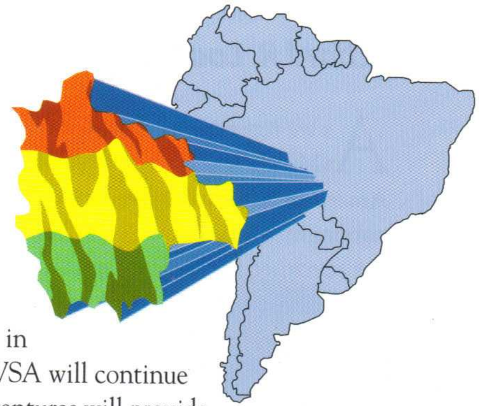
All this should start to become obvious within the next 12 months, whereupon Bolivia will experience what Venezuela has quietly been experiencing since 2001: the sound of silence as far as new project development is concerned. All of Chávez' bombastic antics have served principally to distract attention from what is actually happening in his oil and gas industry. The last major Venezuelan project to go forward was ChevronTexaco's Hamaca heavy oil. Since then, an impressive list of projects, heavy oil expansions, the Jose Olefins project and a major liquefied natural gas project have been announced, only to then stall and disappear into the shadows. Meanwhile, PDVSA production of conventional crude oil is down as much as 1 million barrels per day. Its future decline curve is unknown; PDVSA is not talking about the damage done to its aging fields from neglect, the exodus of expert personnel, underinvestment and overproduction. However, Chávez' recent stance in relation to the Organization for the Petroleum Exporting Countries – in favor of reducing production quotas – was widely perceived as rooted in Venezuela's increasingly obvious inability to meet its current quota.

A Precarious Balancing Act

To succeed, Chávez' strategy required a delicate balancing act. He needed to focus his authoritarian interventions on "severable enemies" – that is, opponents who would be widely regarded as either exceptions or deserving of harsh treatment. For leftists in Latin America, the United States and private oil companies qualify on both counts. Keeping this distinction clear would have enabled Chávez (and Morales) to turn to state companies from moderately socialist countries as alternative partners and capital providers. Instead of ExxonMobil and ConocoPhillips, PDVSA would be partnering with Petrobras and Sinopec. The Chinese companies, desperate to find secure alternative sources of hydrocarbons, were especially good prospects. With Venezuela doing the coaching, Bolivia's harsh treatment of Petrobras and Repsol has made it clear to all that it is no protection to be non-American and/or a state company.

The other mistake Chávez has made involves his increasingly overt efforts to overthrow political establishments in neighboring countries. Latin American nations dislike foreign intervention in their politics, whether the meddling comes from Washington or Caracas. It is striking to see two presidential campaigns, Peru and Mexico, where the apparent winners accuse their opponents of fronting for Chávez. These events have made it clear in capitals from Mexico City to Buenos Aires that Chávez and allies are not just untrustworthy commercial partners – they are dangerous rogue governments with designs to promote regime changes throughout the region.

Thus, despite common perception, Chávez has painted himself into a corner and the paint is already drying. How long he may hang on in Caracas is anybody's guess; high oil prices have given him the means to buy loyalty for now. But the direction of future events is already visible. Few, if any, major new projects will progress. Conditions on the ground in Venezuela and within PDVSA will continue to deteriorate. Foreign adventures will provide distractions but eventually will be seen as not doing anything to improve conditions at home. Attitudes will swing, and Chávez will be seen for what he is: a populist autocrat who destroyed Venezuela's democratic institutions in the name of the popular good and then failed to deliver the goods.



The U.S. Role

By and large, the posture of the U.S. government toward Venezuela and Bolivia has been correct. Not taking Chávez' bait, the Bush administration has allowed conditions to evolve to where Colombia, Peru, Mexico and eventually Brazil will take most of the responsibility for containing the "Bolivarian revolution." As for a hole card, the United States has an interesting one to play: the status of PDVSA-owned Citgo within the U.S. market. How to play this card will be the subject of a future article.

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There is one area, however, where the United States should be more proactive. Support should be given to secure due process and compensation for contracts violated by the Venezuelan and Bolivian interventions. The U.S. press has distinguished itself by a lack of appreciation for the damage extra-legality has done to the future of these countries and ultimately the welfare of their people. In editorials, even the *Houston Chronicle* has found it impossible to talk favorably about investor rights, contracts or compensation in Venezuela or Bolivia.

Someday, when Chávez and Morales are gone, the reserves they left sitting in the ground will still await development. The damage they did to the contractual framework around those resources will hover; both Venezuela and Bolivia will have "rap sheets" as repeat offenders, several times opening their resources to foreign development and then confiscating the assets once steel is in the ground. It will take additional, enforceable legal structures of an international nature to overcome this ultimate legacy of Chávez to his people. ◆

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