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Dealing With Latin Populists

Populist rhetoric and policies will continue as long as natural resources prices remain high. But what happens after they fall?

BY JOACHIM BAMRUD

Last week's Ibero-American Summit in Chile was supposed to be a good opportunity for private-sector leaders in Spain, Portugal and Latin America to influence policy-makers to boost investor-friendly policies.

Instead, the summit turned out to be only the latest platform for populist, anti-business rhetoric, with presidents like Hugo Chavez of Venezuela and Daniel Ortega of Nicaragua attacking Spanish companies.

Ortega compared Spanish electricity company Union Fenosa to the mafia and accused it of using "gangster methods" and corruption. He also criticized a previous government of Nicaragua which sold state electricity companies to Union Fenosa. "We wouldn't have let them in," he said, while the Spanish king and prime minister were looking on. "They bought, amidst corruption, the generating companies which were in good shape."

Ortega blames Union Fenosa for Nicaragua's electricity problems and has repeatedly threatened to expel the company. Union Fenosa, however, blames the problems on users who are not paying their bills. Ortega's speech in Chile earned him a rebuke from the American Chamber of Commerce in Nicaragua.

CONTRACT RENEGOTIATIONS

The latest rhetoric comes after a series of populist policies implemented this year in Latin America. In January, Chavez nationalized Venezuela's largest telecom and electricity companies CANTV and EDC. He later renegotiated the terms of existing oil contracts – leading ExxonMobil and ConocoPhillips to leave rather than accept the less profitable terms. Meanwhile, Ecuador's populist president Rafael Correa this month announced he will renegotiate the contracts of foreign mining firms and revoke those who aren't being used. He also threatens to expel U.S.-based City Oriente and Mexico-based America Movil for alleged tax problems. That comes on top of his recent decision to hike oil royalties from 50 to 99 percent.

"Risks remain high while Correa is in office and beyond given Ecuador's long history of political instability and inconsistent policymaking," U.S.-based consultancy Global Insight warned in an analysis today.

City Oriente has taken its case to the World Bank's International Center for Settlement of Investment Disputes (ICSID). But it may face some problems. Correa says he won't recognize any verdicts from the ICSID. Ecuador already faces a suit from U.S.-based Occidental petroleum, which was Ecuador's largest foreign investor until it had its operations expropriated from the government last year.

And Bolivia – led by populist president Evo Morales – has decided to leave the ICSID altogether. It also faces a possible ICSID case brought by Swiss-based Glencore, which had its tin smelter seized without compensation in February.

LESS PRIVATE INVESTMENT

The result? More litigation and less investment, experts say. "Obviously there will be protracted litigation at certain levels," says Michael Diaz, managing partner at U.S.-based law firm Diaz, Reus, Rolff & Targ. "It will affect their trade policies with the U.S. and other developing countries."

Both Ecuador and Bolivia are seeking an extension of the Andean Trade Preferences and Drug Eradication Act (ATPDEA), which provides duty-free access for around 5,600 products. The two are also – along with Colombia and Peru – set to negotiate a free trade agreement with the European Union.

Meanwhile, investment will decline. "Who wants to invest in those countries if they won't respect the rule of law?," asks Diaz.

Venezuela is likely the best example of what populist policies can do to deter investors. The country last year posted a net FDI outflow of \$543 million after seeing FDI inflows of \$2.5 billion (mostly oil-related) the previous year, according to the United Nations Economic Commission for Latin America and the Caribbean (ECLAC). Spanish investment alone has fallen from 1.7 billion euro (approximately US\$1.5 billion) in 2001 to 106.7 million euro last year, according to data from Spain's Council of Chambers of Commerce quoted by *El Pais*. During the first half of this year, Spanish investment had fallen to a mere 6.6 million euro, the paper reports.

PDVSA: LESS OIL, MORE SPENDING

"The economic injury at this point is most severe in Venezuela," says James Roberts, a research fellow at the Heritage Foundation. "Chavez has repeatedly raided PDVSA's piggybank to pay for grandiose social spending, military weaponry, and foreign adventurism. Inflation is up and the value of the Bolivar is down. The *Chavistas* have mismanaged PDVSA...Although Chavez is inviting oil companies from other authoritarian countries such as China and Iran to take the place of the Western oil companies, they do not have sufficient technical capacity to turn around PDVSA's decline."

PDVSA was once considered one of the most efficient state oil companies in the world. Under Chavez it has become one of the least efficient ones, with falling production and profits. Instead of using profits to invest in the company itself - to assure long-term oil production - PDVSA is now using its windfalls on social and political programs. It has also replaced its well-regarded professionals with unqualified political loyalists.

"Radical policies brush aside the fact that extractive industries demand high capital investments that need to be executed over a fixed time period," Beatrice Rangel, managing director and president, AMLA Consulting. "For these investments to create wealth they demand human capital formation through training programs which are essential for the host country to acquire the operational know-how that will eventually transform itself into a competitive advantage."

