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FEATURED Q&A

What Does a State-Run Energy Company Need to Succeed?

Q Argentina earlier this year seized the 51 percent of YPF owned by Repsol, arguing that the company had not invested enough in the country's energy sector development. Meanwhile, the frontrunner in the race for Mexico's presidency has suggested that state-run Pemex should be opened up to private investment, following examples in Brazil and Colombia, to improve productivity. What does it take to make a state energy company succeed? What policies should governments seek to emulate and which should they avoid? Does history stand on the Argentine government's side in YPF's nationalization?

A Francisco Monaldi, director of the Center on Energy at Instituto de Estudios Superiores de Administración, IESA, in Caracas: "Governments tend to nationalize oil companies (or expropriate their revenues) when the price of oil is high, significant resources have been found or large investments have been sunk. In the case of Argentina, the first two conditions are met, but not the last one. The country needs massive investment to develop its resources. State-owned companies tend to prevail when investment risks are low and oil is easily extractable, as in developed oil basins. However, when risks are significant, in frontier developments (e.g., deep offshore or unconventional) or in the exploration of new basins, state-owned companies are usually not able, or willing, to assume the high risks involved by themselves. In Mexico, production has been declining and significant investments with high risks are needed, while Pemex has been over-milked for decades. As a result, there is a need to attract private capital to make Pemex financially sound, share the investment risks and obtain know-how. All these objectives would be advanced by having some private investment in Pemex. Likewise, Mexico requires an institutional framework that gives financial autonomy to Pemex, improves accountability and

Continued on page 3

Spain's Economic Woes Cast Cloud Over G-20 Meeting

Spain's worsening economic troubles sent a dour mood through the G-20 summit, which began Monday in Mexico. Mexican President Felipe Calderón also praised U.S. President Barack Obama for announcing the halt of some deportations. See story on page 2.

Photo: Mexican Government.

Inside This Issue

FEATURED Q&A: What Does a State-Run Energy Company Need to Succeed? 1

Uribe's Former Security Chief Vows to Fight Drug Charges 2

Jump in Spain's Borrowing Costs Casts Pall Over G-20 Meeting 2

Grupo Bimbo Not Planning Major Acquisitions Until 2014: CEO 2

Chile Cuts 2012 Inflation Forecast 2

Yamana Gold Buying Miner With Argentina Gold-Silver Project.....3

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NEWS BRIEFS

Grupo Bimbo Not Planning Major Acquisitions Until 2014: CEO

Mexico's **Grupo Bimbo** is not planning to make any major acquisitions until 2014 as it works to realize cost savings following a string of acquisitions, Bloomberg News reported Monday, citing the company's CEO. "This year is going to be a year particularly focused within the company on processing the integrations of the acquisitions we did last year," Daniel Servitje said in an interview. The world's largest bread producer recently struck deals to acquire Argentina's **Alimentos Fargo** and the North American, Spanish and Portuguese bakeries of **Sara Lee**.

Chile Cuts 2012 Inflation Forecast

The Chilean central bank on Monday cut its inflation forecast to 2.7 percent from 3.5 percent and held its outlook for GDP growth steady at between 4 and 5 percent, Reuters reported Monday. GDP expanded 5.6 percent in the first quarter year-on-year but growth is slowing as the European debt crisis and slowing Chinese demand continue. The bank is expected to hold its key interest rate steady at 5 percent.

Air Products to Take 67 Percent Stake in Chile's Indura

Industrial gas supplier **Air Products and Chemicals** will buy a 67 percent stake in Chile's **Indura**, the largest independent gas company in Latin America, MarketWatch reported. According to Air Products, the $884 million deal will make it the second largest industrial gas producer in Latin America. Indura has annual revenue of $478 million with retail outlets in Argentina, Chile, Colombia, Ecuador and Peru. The deal is expected to close by early July.

Political News

Uribe's Former Security Chief Vows to Fight Drug Charges

Retired Colombian police Gen. Mauricio Santoyo, who served as the head of security for then-Colombian President Álvaro Uribe, on Monday denied that he colluded with drug traffickers and vowed to fight charges against him in the United States, BBC News reported. According to an indictment from the U.S. District Court for the Eastern District of Virginia, Santoyo is alleged to have participated in a conspiracy to distribute cocaine "knowing and intending that it would be unlawfully imported to the United States." Santoyo is accused of committing drug-related crimes between about 2000 and November 2008. He was head of security for Uribe from 2002 to 2006, and for two years before that, he was commander of Colombia's elite counterterrorism task force.

Santoyo

File Photo: Colombian Government.

His previous positions included chief of Medellín's anti-kidnapping police, the Associated Press reported. Santoyo denied the allegations in an interview with Colombian newspaper *El Tiempo*, which first reported the charges on Saturday. "I served Colombia for more than 30 years in the National Police and I'm sure I can dispel any doubts about my actions," he said. "I always have been and will continue to be at the disposal of the relevant authorities to dispel any accusations made against me." Uribe, who was president from 2002 to 2010, said in a statement posted on his Web site that he "rejects, with pain and indignation, whatever illegal activity" Santoyo might have been involved in, the AP reported. In a posting on Twitter, Uribe added that he hoped "Santoyo and the police institution would explain the case," BBC News reported. The indictment alleges that Santoyo helped a drug gang known as Office of Envigado and right-wing paramilitaries of the United Self Defense Forces of Colombia smuggle cocaine from the South American country overland to the United States. He is accused of passing intelligence information from Colombian security forces to traffickers, including warnings to drug gangs about planned operations by Colombian forces, the U.S. Drug Enforcement Administration and British anti-drug agents. In exchange for the information, Santoyo allegedly received large bribes.

Economic News

Jump in Spain's Borrowing Costs Casts Pall Over G-20 Meeting

Relief over Greek voters' rejection Sunday of a government that could have forced the country to drop the euro quickly turned to angst Monday as the interest rate Spain must pay on its debt climbed past 7 percent, the level that previously forced Greece, Ireland and Portugal to seek bailouts, the Associated Press reported. The possibility that Spain, whose economy is larger than those of the three other countries combined, cast a dark cloud over the two-day G-20 meeting which began Monday in Los Cabos, Mexico. The surge in the interest rate overshadowed earlier expressions of optimism from the meeting's host, Mexican President Felipe Calderón, that the world's largest economies would make record commitments to the International Monetary Fund to protect economies in the event of future bailouts. Such payouts are not certain, however, as the BRICS nations have been seeking greater control of the IMF. Also, Calderón said the United States would not contribute to such a fund as it would be viewed as a U.S. bailout of Europe. Spanish leaders at the G-20 meeting said the market's reaction to Spain's economic woes did not take into account the country's strength. "We in the government are convinced that the current situation of punishment in the markets, what we're suffering from today, doesn't correspond with the efforts, or the potential, of the Spanish economy," said Spanish Economy Minister Luis de Guindos, the AP reported. "This is something that will have to be recognized in

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the coming days and weeks." In a report released Monday, the IMF said that Europe needs more policies that boost growth. The continent's governments need to make it easier to hire and fire employees, streamline government economic regulations and make it easier for workers to move between European countries in search of jobs. "Fostering growth is always important; in the euro area it has become urgent," said the report. On the sidelines of the G-20 meeting, Calderón met with U.S. President Barack Obama and praised him for limiting the deportation of some young undocumented immigrants, the AP reported. On Friday, Obama announced that undocumented immigrants brought to the United States before they turned 16 would be able to avoid being deported if they are younger than 30, have been in the United States for at least five consecutive years, have no criminal record and graduated from high school, earned a GED or served in the military. Calderón called Obama's announcement a "valuable decision" and a "humanitarian action."

In a report released Monday, the IMF said that Europe needs more policies that boost growth.

Company News

Yamana Gold Buying Miner With Argentina Gold-Silver Project

Canada's **Yamana Gold** announced Monday that it will buy **Extorre Gold Mines**, which has a gold and silver project in Argentina, for $400 million in cash and stock, The Canadian Press reported. Yamana's chairman and chief executive officer, Peter Marrone, said the Cerro Moro project is "one of the best underdeveloped, high-grade opportunities in the Americas." Yamana will pay 3.50 Canadian dollars in cash and 0.467 of a share for each share in Extorre.

Featured Q&A

Continued from page 1

allows it to partner with IOCs. The way nationalization is being implemented in Argentina will not help to generate credibility. However, in the future, having the advantage of high oil prices, a more credible institutional framework, the presence of private shareholders in YPF and new joint-ventures with IOCs could help Argentina develop its significant resources. State-private alliances can be an effective way to develop the energy sector."

A Jeremy Martin, director of the energy program at the Institute of the Americas: "Depart our hemisphere and head to the North Sea for a helpful case study: Norway. The 'Norwegian Model,' far from perfect, does offer insights for hydrocarbon policy administration and fiscal management. Most useful are the guideposts established by clear delineations of state control, a well-defined role for the national oil company in economic and natural resource development and the importance of competition and private participation. Norway's ability to separate commercial, regulatory and policy functions across its oil sector—and to tweak those areas when necessary, including the partial privatization of national oil company Statoil in 2001—is highly touted. A framework for fiscal management and control of its natural resource development balanced against government's normal desire to maximize revenue is also quite relevant. In sum, Norway controls its own oil destiny but with a successful state-owned firm open to private investment, partnership and competition. Per a Stanford University analysis: among its state-owned peers, Statoil is perhaps the most similar to an international oil company in governance, business strategy and performance. Turning to Argentina, the energy story is far greater than merely the Repsol gambit. The lack of a national energy strategy and distorted market combined with a confrontational stance toward private firms does not bode well for the nation's energy future. But a unique ingredient and wrinkle for the Argentine energy equation is the nation's apparent unconventional resource bonanza. An Energy Information Administration report placed Argentina first in Latin America in terms of possible unconventional hydrocarbon resources. None other than Repsol underscored the potential with the huge Vaca Muerta discovery. As last seen in Venezuela, vast resources can make for interesting dances on the heads of nationalism pins."

A Francisco Ebeling Barros, member of the board of Economics and Energy Policy of the Brazilian Institute of Oil, Gas and Biofuels in Rio de Janeiro: "The discussion about the pertinence of the recently approved nationalization of YPF assumed very ideological tones. In this debate, names as important as the writer Mario Vargas Llosa and Brazilian economist Luiz Carlos Bresser-Pereira delivered their opinions; the latter against and the former supporting Argentina's claim. One party argues that this is an unacceptable return to an archaic statist model; the other one claims that, in the context of a return to state-led development strategies, it is the best answer. In this sense, an important question to be answered is whether the excuse for nationalization—low E&P investments made by Repsol—was the result of a low fuel price policy imposed by the Argentine government or of the excessive profit remittances practiced by the company. Looking beyond those ideological quarrels, two important issues are at stake. On the one hand, the act of nationalizing a company of strategic interest such as YPF is the state's indisputable right. Further, Argentina's claim of expropriation without compensation can be acceptable if Repsol, in the years that it had control of YPF, was able to earn sufficient profits to offset the initial capital invested. The other issue is whether Argentina, after nationalizing

Continued on page 4

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Featured Q&A

Continued from page 3

the company, has the necessary resources to augment its oil production. Given that the hidden motive for nationalizing the company could have been Repsol's plans of selling YPF to the Chinese, one might consider that there is a new BRICs investments circuit which neoliberal wisdom has not yet grasped."

Jed Bailey, managing partner at Energy Narrative: "In order to succeed, any company—regardless of ownership or industry—must invest its resources to produce goods or services that can be sold for a profit that is greater than the company's cost of capital. Competition, in turn, puts a cap on profitability and forces companies to continually innovate to improve productivity. For oil producers, critical skills include the ability to successfully find oil, manage the cost and logistics of producing it and negotiate the terms of its sale to refiners or the final consumer. There is no inherent reason that a state-owned company would be less able to do these tasks than a privately-held company. In practice, however, state-owned companies tend to face greater pressure to invest or operate in ways that sacrifice profit maximization in favor of other objectives, such as supporting greater employment or providing energy at subsidized rates. State-owned companies also often operate as a monopoly, reducing the external pressure to continually improve or reduce costs. State-owned oil companies that can avoid these traps—that is, those that are insulated from political interference and that operate in a competitive environment—tend to be the most successful."

> "State-owned companies tend to face greater pressure to invest or operate in ways that sacrifice profit maximization."
>
> *— Jed Bailey*

The Advisor *welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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